AN INVESTMENT IN GLOBAL GROWTH

Agency for International Development
Washington, D.C. 20523

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The Administrator's Statement
for the Fiscal Year 1989
Congressional Presentation

A reprint

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FOREWORD

Many developing nations are failing economically. Without growth, there is no hope for lasting improvements in the lives of their people. Developing countries and donor organizations must focus on this fundamental problem.

This is the central message that Alan Woods, the Administrator of the Agency for International Development, expressed in his introductory statement in the Agency's Fiscal Year 1989 Congressional Presentation.

On solutions, Administrator Woods points to the record of nations that are winning the battle for economic growth. The success of these countries demonstrates that market-oriented economies and an openness to trade are the keys to prosperity.

The text of his Congressional Presentation statement is reprinted here in full.

Facing the Future

Forty years ago, America made an investment in the future that broke all the conventional rules of the day. In the wake of the Second World War, we reached out and provided economic assistance to the war-torn nations of Europe and to Japan, to those who had been our adversaries as well as to our allies.

Through programs of economic assistance, the Marshall Plan and Point Four, and through the international organizations that we and our allies created, we expressed our conviction that America's security and its future prosperity depend on the fortunes of many nations—on global peace and prosperity.

We believed then, and we believe now, that the economic development of other nations is as much in our national interest as it is in the national interest of the nations to which we provide economic assistance.

The returns we have realized on our investments in Western Europe and Japan more than demonstrate the validity of that view. Today these nations are economically sound. They are our strongest allies. They are also leading consumers of U.S. exports. Equally dramatic is the progress made by some of the nations that were early recipients of U.S. economic assistance: Korea, Taiwan, Brazil.

Yet, for most people in developing countries, life is not much different than it was 20 or 30 years ago. In many of the least developed nations, poverty remains a nearly universal condition. In some middle-income countries, life has been improving in relative terms. The progress made in the majority of these countries is not what people in the developing

countries had thought it might be—or what we had hoped it would be. The gap between virtually all less developed countries is widening, not closing.

We believe that it is time to take stock of where we and the developing nations are headed:

- It is time to look at why some countries have succeeded;
- It is time to look at why other countries have not and to examine, with them, the fundamental causes of their continued poverty; and
- It is time to ask ourselves how economic assistance can better contribute to the process of fostering prosperity.

As the nation with the largest and most dynamic economy in the world, the United States has long exercised a leadership role in international economic development. Our contribution has always extended far beyond the dollars we provide. It is our ideas that have inspired and motivated both donor nations and developing countries. We have always been willing to ask the hard questions that must be asked, and answered. If there is to be progress, that is what we must do again.

In this introduction to the Congressional Presentation, the Agency for International Development is taking a first step in a process of reassessment. It is a process we must complete together. There is much we will need to consider with Congress and the American people as we reassess developing country prospects and examine the ways in which U.S. economic assistance—ideas, talent and money—can best be brought to bear in the future.

Learning from Success

In a world where the need for economic assistance remains strong, it is important to recognize that success is possible. No example is ever a perfect model, yet there are threads that tie together the economic recovery and development experiences of places as diverse as post-war Europe, post-war Japan, Korea, Taiwan, Hong Kong and Singapore. The thread that most clearly ties these examples together—and underlies their economic growth—is the extent to which they relied on market forces and open trading systems to ensure the efficient production, distribution, and pricing of goods and services.

Economic growth, by which we mean increases in the production of goods and services and the gains in real income associated with those increases, is not an end in itself. It is, however, the fundamental means by which individuals improve the condition of their lives.

Where economic growth has been rapid and where participation in that growth has been broadly based, family income, food availability, life expectancy and other measures of development have registered impressive gains:

- Before World War II, Japan's death rate among children was as high as India's is today. But with economic growth came a decline in the birth rate, better prenatal care, and better care for newborns. Today, Tokyo's infant mortality rate is 75% lower than Washington, D.C.'s; and
- While slow-growing countries struggle to ensure that their children are enrolled in primary schools, Korea now enrolls over

90% of its children in high school and sends 26% of its high school graduates on to college.

The changes that yield these results are systemic changes that affect whole economies, whole societies, not simply one or two narrow economic sectors or life in one part of a country. As the experiences of countries that are making significant progress demonstrate, growth and improvements in the human condition evolve together and are mutually reinforcing:

- Greater productivity and rising incomes provide individuals—as well as governments—with the resources they need to invest in more comprehensive health services, better education and more adequate housing; and
- As the health of a population and its level of education improve, still higher levels of productivity and further growth are possible.

Basic economic choices—as between relying on market forces to set prices or having governments set them—have a direct bearing on whether a country will grow. These fundamental choices also go a long way toward determining who can participate in an economy and benefit from its growth.

Where governments exercise tight economic controls and own many of a nation's productive assets, the opportunities and incentives for individual farmers and entrepreneurs are limited. The economic rewards in such societies are most often retained by a small fraction of the people.

In contrast, market economies naturally encourage broad participation in growth. Their vitality comes from the steady stream of new entrants into the economy—new businesses and new agricultural ventures, and the jobs they create directly and through their demands for inputs, product handling, and other services.

In countries that are experiencing rapid and broad-based economic growth, life is getting better—for the poor, as well as for those who are somewhat better off. When that happens, we in America benefit as well. As countries move up the economic ladder, their imports tend to rise. They want products from abroad—consumer goods and products that can be used by their industries. Many of those products come from America.

Taken together, the developing and newly industrialized countries purchase more than 35% of all U.S. exports. In the first ten months of 1987, exports to these nations were worth $65.5 billion to the United States. Every billion dollars in new exports generates 26,000 American jobs.

When countries prosper, our economic assistance more than pays for itself:

- Of the 50 largest buyers of U.S. farm goods, 34 have received PL-480 food aid from the United States;
- Korea now buys as much from U.S. farmers in one year as it received in its 25 years as a PL-480 recipient; and
- Our sales of manufactured goods to developing nations are equally impressive. In 1985, 30% of our earnings on America's top export line—machinery and transport equipment—came from sales to developing countries.

The developing countries—particularly the fast-growing ones—are the markets on which our future depends. It is in these fast-growing markets, not in the more mature markets of Europe and Japan, that we will see the demand for U.S. products rise at spectacular rates.

Economic returns on our development assistance investments are not the only important benefits we reap when other countries succeed. The more economically successful countries are, the more stable they tend to

become. What is more, there is a tendency for such countries to become more democratic. Where broad participation in the economy is possible, people acquire a stake in what happens and make their voices heard. Countries once run by virtual dictators have moved toward democracy and a greater respect for human rights as their economic circumstances improved.

A Sobering Look at the Developing Countries

In contrast to the successes achieved by nations that have relied heavily on market economies, other countries continue to have difficulties. The economies of many developing countries are stagnating. In some countries the economic base is actually deteriorating, and individual incomes are declining, as a result of negative growth rates over the past 5 to 10 years. Such situations are inherently unstable. They are a breeding ground for political unrest.

Targeted development assistance has helped in many of these situations; it has not been wasted. Economic assistance has prevented a worsening of conditions, often serving as the only stabilizing force in such economies. Even in some of the worst situations, development programs have helped to improve life expectancy. Overall, great strides have been made in protecting children against major diseases and ensuring that they receive at least a minimal education.

These gains are significant, but they are not adequate. What is worse, in economies that are stagnating, they cannot be sustained. No one, for example, has been able to halt the decline in food availability that is a hallmark of economies that are growing too slowly or

not growing at all. One thing is certain: Without sufficient growth, the quality of life in developing countries is not really going to improve.

Neither educated guesses nor straight-line projections of past trends actually tell us what will happen in the future. Nevertheless, projections can suggest quite vividly what could occur if existing trends persist.

If the least developed countries continue to grow at the rates at which they grew during the past 20 years, i.e., at 0.4% GDP per capita on average, little will change.* At this near-zero rate of growth, average income in the least developed countries would rise by only $66 per person by the year 2050. The gap between these economies and the economies of the developed nations would widen significantly (Figure 1).

In the middle income countries, individual incomes would improve dramatically if these countries continue to grow at the compound annual rate of 2.8% in GDP per capita terms. But, even at this growth rate, these nations would not narrow the gap that separates them from the developed countries, which have been growing at the compound annual rate of 2.6% per capita. Paralled lines never meet—nor do countries that start at different economic bases and grow at similar rates. The gap between such countries grows rapidly in absolute terms, since 2.6% of $10,000 is a good deal more than 2.8% of $1,000 (Figure 2).

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* GDP and population trend data for 1965-85 were taken from the *World Development Report 1987* (IBRD). Agency for International Development projections carry those trends into the future on a per capita basis.

The term Least Developed Countries refers to 35 of the 37 countries included in the IBRD's lowest income group. China and India are not included in AID's Least Developed Country cluster. The term Middle Income Countries refers to 59 countries the IBRD clusters into a middle income group. Industrial Market Economies refers to 19 countries the IBRD clusters into its industrial market economy group. The term Newly Industrialized Countries refers to: Korea, Brazil, Hong Kong and Singapore. Taiwan was not included in this cluster as data on Taiwan are no longer reported in the publications of U.N. agencies.

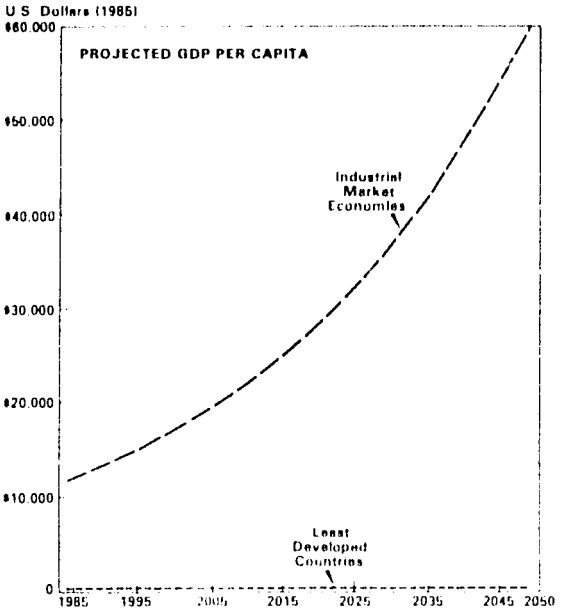

Figure 1. The Gap Between the Least Developed Countries and the Industrial Market Economies Is Widening.

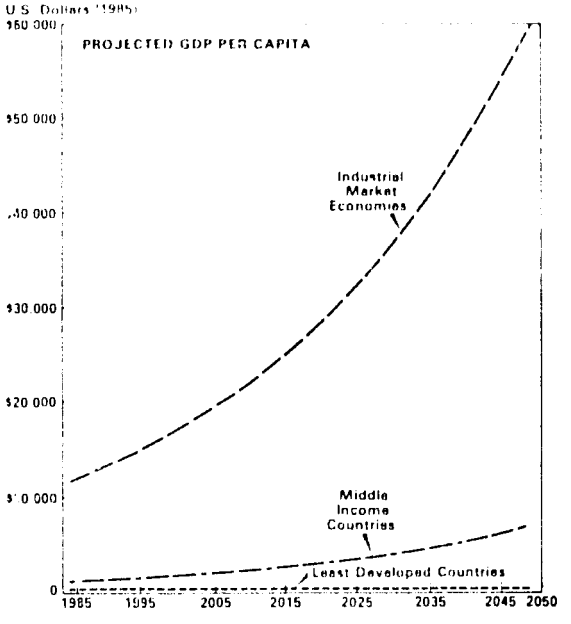

Figure 2. Moderate Growth in Middle Income Countries Yields Rising Per Capita Incomes but Does Not Close the Gap.

Only when countries make the economic choices that result in growth rates that are higher than those of the developed countries do they begin to catch up, as have a cluster of newly industrialized nations, with a compound annual growth rate of 5.4% per capita (Figure 3).

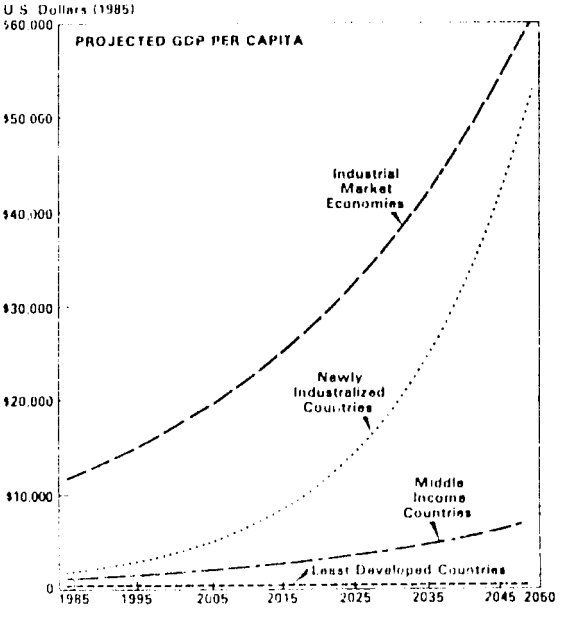

Figure 3. Fast Growth in the Newly Industrialized Countries May Result in Per Capita Income Levels Similar to Those in Industrial Market Economies.

Projections are an imperfect device for looking into the future. The newly industrialized countries, for example, are not expected to maintain their current growth rates indefinitely. As their economies mature, their growth paths will likely mirror those of other developed economies.

Further, projections of the prospects for groups of countries tend to mask what individual countries are doing. Of particular importance in that regard are those nations that—often with the help of the United States—have begun to reform their economic policies, rely on market forces and trade, and

grow at better-than-average rates. Those that continue to pursue this path have a good chance of becoming the second wave of newly industrialized countries.

That is why we are beginning to explore options for transforming our relationship with the advanced developing countries into a productive and more mature partnership. Through partnership programs with the advanced developing countries, we can continue to nourish the investments we have made and the institutions we helped to build. The linkages that we should continue to build with these countries include:

- Strong and open bilateral trade relations;
- Scientific and technical exchanges;
- Educational and work exchange programs that bring our young people together and help them to learn about and from each other; and
- Strengthened relations between our business, scientific and professional communities—through investments and through personal ties.

Moving from a relationship dominated by an economic assistance program to one that is more mature is not easy, but it is important. We, and the advanced developing countries, have much to gain by strengthening further the ties that bind us.

Fostering Development

We are convinced that the most important assistance we can provide to people in developing countries is assistance that helps them to stimulate economic growth—raising their national income, and their individual family incomes. Wherever family incomes are

rising, standards of living are also rising. Growing incomes give people a chance to invest in themselves and in the institutions that serve them—a chance to invest in their future, and in the future of their children.

Improvements in the quality of life are a natural—and necessary—complement to economic growth. Good health, a sound education and a balanced diet are basic building blocks of development. Putting these building blocks in place requires many things: food, schools and teachers, access to modern medicines and to other new and affordable technologies.

To be truly effective, economic assistance programs should address an entire economic system. They must help countries identify and address impediments to growth, and they should be able to assist them in developing their private as well as their public sector capacity to address other basic human requirements.

Countries, even on the same continent, differ dramatically from each other in terms of their capacity or desire to provide services and to absorb new products and techniques—just as their economic policies and their growth rates differ. Programs of assistance must be tailored to fit these differing circumstances.

In order to respond with the appropriate assistance program for each country, we need to be flexible. We need to be able to examine a situation and decide how best to address it—through policy discussions, through projects, and through other assistance modes.

The kind of flexibility that is going to be needed to properly address the problems developing countries are facing is already embodied in our new Development Fund for Africa. The Fund is, in a very important sense, a laboratory for testing ideas about how the U.S. economic assistance program might be most effective in the years to come.

In that laboratory, and throughout the developing world, we must keep a steady eye on economic growth rates—for they are a central measure of whether our efforts and those of the developing nations are succeeding. If they are not positive and growing stronger, something is wrong.

Getting Back to Basics

In his address to the leaders of 22 developing countries at the 1981 Cancun Summit, President Reagan drew attention to the importance of basic economic growth and to the fact that, historically, "economic growth and human progress have made their greatest strides in countries that encourage economic freedom." Since then, the United States and a number of the developing countries have become more concerned with slow economic growth, and with the impediments that stand in the way of higher growth rates.

Within this context, the Agency for International Development singled out economic policy impediments for particular attention. Other donor organizations are also moving in this direction. This focus is not only appropriate, it is necessary, given the future many developing countries will face if they fail to act to improve their prospects for economic prosperity.

The work of the Agency for International Development has already led to the identification of many macroeconomic and sectoral policy choices that are holding back growth in the developing countries:

- Many of the economic problems developing countries face can be traced to the propensity of governments to control economies,

rather than give market forces and individual enterprise a chance to generate growth;

- Price control policies, protectionist trade regimes, and regulations that limit broad participation in the economy and shield government-owned enterprises from private sector competition all work against the nations that apply them—while offering them the illusion of being in control of their economic destinies; and
- Instead of unleashing the entrepreneurial energies of their people, many developing nations are driving their entrepreneurs underground, as attested to by a recent study of the "informal sector" in Peru and anecdotal information from many other countries.

It is not easy for governments to change their economic policies. We know this from our own experience. Yet, that is exactly what many developing countries need to do, if they want to move forward, if they want to catch up.

Many developing countries are experiencing economic difficulties; yet, each of these situations is unique. The array of factors that inhibit broad-based economic growth differs from country to country. Sound recommendations for change can only emerge from an examination of country circumstances. The consequences of making recommendations without understanding what is impeding growth in a particular country could well be counterproductive. For instance:

- In countries in which there is an active private sector, the transfer of industries that are owned and operated by government to private hands makes economic sense, and it gives a larger number of people a real stake in the economy and in growth; and
- Yet, in other countries, where businesses are heavily regulated and where government policies discourage private sector development, focusing on privatization

could prove futile. Under such conditions, newly privatized industries would be likely to fail. Unlike government-owned industries, they must earn all of the money they need to keep going.

The Agency for International Development is committed to helping countries make needed changes. Throughout the developing world our missions are engaging governments in a "policy dialogue." They are working with these governments to identify, on a national and sectoral basis, where changes are needed, what new policies might be put in place, and how to deal with their impact.

In this work, as in the development projects the Agency for International Development supports, there will be successes as well as failures. Even though we approach the "policy dialogue" knowing that market-oriented economies have the best track record, we know that neither we nor the developing countries can see into the future and understand all of the secondary effects an apparently straightforward policy change may cause. Like it or not, risk and uncertainty are inherent elements of development, just as they are in scientific research.

We do not believe, however, that the people of any nation should suffer inordinately from actions that will ultimately improve their economic circumstances. We believe that it is important to assess the effects that particular economic policy changes may have, and try to moderate their impact on particularly vulnerable groups. While most of the difficulties such groups face predate policy reform efforts, such efforts can exacerbate their plight. That is why much of the economic assistance we provide in support of policy reforms is designed to cushion the short-term effects of such changes.

There are no textbook answers that tell us exactly how to stimulate economic growth in a developing country—even if we know that a market orientation is to be preferred. There is

much uncharted territory, and questions about how to proceed loom large. While we are a long way from pat solutions, we and a growing number of developing countries are at least beginning to take seriously the problems of mismanaged economies and slow growth.

The Importance of Investing in People

The emphasis we place on stimulating economic growth in no way diminishes the importance of actions we take to help people in developing countries improve the circumstances of their lives in a direct way. Improvements in health care, water and sanitation services, voluntary family planning services, education systems, and other social services need to go hand in hand with growth. Developing country capacity to provide these services needs to be nurtured, in the private sector as well as in government.

The development projects and programs that the Agency for International Development supports make an important difference in the way of life in developing countries. That difference is particularly dramatic in countries that are taking steps in the economic arena that will enable them to sustain these improvements over the long term.

Significant improvements have already been made in most developing countries:

- Smallpox has been eliminated from the world;
- In the aggregate, child mortality rates have been cut in half;
- Life expectancy in the developing countries has increased by 10% to 20%; and

- In most developing countries, the majority of children now enter primary school.

Through other projects:

- Farmers have gained access to improved inputs and learned new techniques for increasing their yields.
- Small businesses have found the capital they need and learned new management skills.

Ensuring that such gains are permanent, rather than transitory, is of the greatest importance. Programs and projects that develop institutions and provide goods and services in the developing countries must incorporate the mechanisms that will ensure their continuation over time.

That is why so many of our programs have institutional development and training components. We believe, for example, that if we want to ensure the survival of children who suffer from dehydration, it is not enough simply to provide oral rehydration salts to developing countries. The capacity to produce this remedy, train health workers, and deliver the salts to those in need must be transferred as well. Use of oral rehydration must be incorporated into the practices of private health care providers and organizations, national health systems and, finally, families.

Our concern for permanent improvements in developing countries also underlies our focus on the recurrent costs of projects and programs. Such costs must be manageable within the context of a developing economy's ability to generate resources. If they are not, the activities we support will eventually disappear—no matter how useful they may be.

Changes become permanent only when a broad segment of society values them and benefits from them. That is why we work so hard to ensure that the people who need to be involved in creating change are actually

participating. We know that in many situations it is the women of a country who play a critical role in institutionalizing new behavior—on the farm and in businesses, as well as in the home. Our programs must reach them and engage their energies.

For similar reasons, we must carefully consider the environmental impact of all of our activities. It does a nation no good to thrive in one generation if its prosperity is built on patterns that destroy the nation's resources. Practices that destroy the natural environment can easily undermine the progress developing countries need to nurture. That is why our agricultural projects take into consideration the impact of farming practices on the environment, and why we are working with developing countries to create national plans that will safeguard their natural resources and preserve their biological diversity.

In development, as in most human endeavors, we must be prepared to learn—and to change. Time does not stand still, nor are the challenges facing the developing countries constant. New problems arise as do new opportunities. For that reason, we will be taking a hard look this year at the way we do business. We need to determine whether we are poised to deal with the issues of the future.

Some of the challenges are already apparent:

- The AIDS epidemic—with all of its potential for destruction;
- Rapid urbanization, even in the poorest countries;
- Rising levels of drug addiction, violence and chaos in countries where narcotics production and trafficking have not been brought under control;
- The global communications explosion—with its potential for linking all nations in an interactive network and altering the way people are educated; and

- The development of disease-resistant and stress-tolerant seed varieties.

Technological breakthroughs are being made rapidly, in every field and all over the world. This steady stream will create challenges that we cannot yet imagine.

We, and the developing countries, must be prepared to take new developments into account as we plan for the future. We need to understand the ways in which problems, and opportunities will affect people and we need to explore the ways in which they will impede or facilitate economic growth. We will do that best if we are actively looking ahead.

While we can foresee some of what the future will hold, we can rarely anticipate disasters. Yet, we must always be ready to deal with them.

Our commitment to provide humanitarian assistance to countries ravaged by famine, earthquakes, plagues and other disasters remains absolute:

- Last summer, when floods destroyed 50% of the food grain crop in Bangladesh and uprooted nearly 30 million people, we were there with seeds for a new crop and funds to aid with the rebuilding effort;
- When 60,000 people were left homeless last March in the wake of an earthquake in northern Ecuador, we were there with tents, wool blankets, and funds for reconstruction;
- Had we not been able to act quickly to provide food aid to Africa in 1984, 20 million people might have died as a result of one of the worst droughts in history; and
- Today, in Ethiopia alone, 5 to 7 million people are again at risk. Drought and poor economic policies have combined to recreate a disaster. Once again, we are there—providing lifesaving food aid directly to a starving people.

When America responds to emergencies overseas and when we work with developing countries to foster rapid and broad-based economic growth, we are truly investing in the future. We are helping to preserve and build nations that will one day be able to move forward without our economic aid--not because it wouldn't be there if they needed it, but because they have succeeded by learning to grow, and need it no more.

Conclusion

The process of economic development is difficult. Even when it succeeds, the path to success will be dotted with failed activities that might have worked--but did not. The environment in which development occurs and our own lack of knowledge make this inevitable. What we do know is that every developing country is different--personalities, culture, geography and economic circumstances distinguish each country from every other.

If our economic assistance programs are to have the maximum impact on economic growth and the quality of life, they must be fashioned to fit the unique circumstances and characteristics of these countries. When economic assistance resources are scarce, as they are today, flexibility in the programming of those resources becomes critically important. We need to be able to make every penny count. Without the flexibility to tailor our assistance to meet specific country requirements, our help will not be as effective as we should expect it to be.

As we construct economic assistance programs for developing countries, we need to begin drawing all of the available modes of

assistance together into a coherent framework. America's capacity to assist developing countries is multifaceted. That capacity ranges from our ability to provide economic policy advice, development assistance projects, emergency and food aid to tariff relief under the generalized system of preferences (GSP) and special programs such as the Caribbean Basin Initiative, investment guarantees, and other bilateral programs. Beyond that, we put significant resources into the development programs of multilateral organizations. There is more we can and should be doing to coordinate the way in which these resources are focused in specific countries.

In the face of near-zero growth rates in many of the poorest developing countries, we must determine anew what the balance in our economic assistance programs should be. We certainly should not assume that we have the balance right today. With middle-income countries that are at least growing, and with the more advanced developing countries, the same questions must be asked – but the answers may be quite different.

The challenge, for the developing countries and for us, is a great one. Their futures depend on the choices they make, but so does ours – for the interdependence among nations grows each year. We must ask the hard questions – and face the challenge head-on. If we do not, who will?

Alan Woods
A.I.D. Administrator

March, 1988