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FIRST PRINCIPLES OF DEVELOPMENT

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Three times in the past 55 years an American President has gone to the nation in times of peril and delivered a major address on foreign assistance. The first was Harry Truman on March 12, 1947, with the Cold War looming. Truman appeared before a joint session of Congress and warned of the grave dangers facing Greece and Turkey.

Three months later, Secretary George Marshall in his famous speech at Harvard announced this country's intention to restore normal economic health to the European states.

The Marshall Plan was more than a transfer of U.S. funds to fight hunger, poverty, and desperation and chaos, as he put it. Equally important was the demand that the Europeans come together to determine their needs and design a program for their own recovery. Thus, the process of European integration was started, and the economic and political foundations were laid for the stable, prosperous, and democratic Europe we know today.

The second President with an important international development initiative was John F. Kennedy. On March 13, 1961, with the Cold War at its height, he announced the creation of the Alliance for Progress, a 10-year plan to address basic needs of the Latin American people. Nine days later, Kennedy sent a message to Congress that would lead to the creation of the United States Agency for International Development (USAID).

A third President has now made a major statement on foreign assistance and its importance to the national security and foreign policy interests of the United States. On March 14, 2002, with the events of September 11 fresh in the nation's mind in the midst of the war on terrorism, President Bush addressed the Inter-American Development Bank and announced the creation of a $5 billion Millennium Challenge Account.

To quote from the President's speech, "The growing divide between wealth and poverty, between opportunity and misery, is both a challenge to our compassion and a source of instability. Even as we fight to defeat terror, we must also fight for the values that make life worth living; for education and health and economic opportunity." The President was clear, however, that the new funds would

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be used for countries "that root out corruption, respect human rights and adhere to the rule of law, as well as encourage open markets and sustainable budget policies."

In emphasizing these points, the President laid out a course for foreign assistance that is based on sound theory and solid practice and promises a more productive future in the area of foreign assistance.

DISPOSING OF MYTHS

Before we go to some other comments about the Millennium Challenge Account, I want to talk about some of the wrong-headed presumptions that have plagued development assistance for the past four decades. I'd like to emphasize that ideas count. If people think that the theories of people in think tanks or in universities don't count, all they need to do is look at the fact that people in the developing world and in the Northern countries as well use these theories to defend or attack ideas that they do or do not like.

The first myth I'd like to deal with is a popular view among some developing world intellectuals (fortunately for us, a declining number of them) called dependency theory. Dependency theory argues that poor countries are poor because they are victims of the craven greed of wealthy countries which prey on their economic and political weakness to extract wealth.

For too long now, dependency theory has been used by some leaders in some countries as a convenient if dishonest escape from responsibility for bad economic policy and bad governance; if one is a victim, one need not accept responsibility for one's own failures. If there were a careful analysis of statements of leaders in the developing world making the most progress, dependency theory would not be found in their rhetoric. The converse is equally true.

A second myth that follows from the first is that income redistribution from wealthy Northern countries to impoverished Southern countries will solve the problem of poverty in the world. The presumption of this school of thought is that there is a fixed amount of wealth in the world, and if the South has too little it is because the North has too much. This was an implicit axiom of some of those who were in the debate before President Bush's attendance at the International Conference on Financing for Development in late March in Monterrey, Mexico.

Wealth, however, is not fixed. The total amount of it can be increased or reduced depending on the economic incentives and system of governance chosen by a country, rich or poor, North or South.

The third myth is that the engine of development is capital. That is not so. The reality, as the Heritage Foundation's Brett Schaefer has pointed out, is that economic freedom is far more important. Until recently there has not been wide enough discussion of the values of societies that reward risk-taking and business enterprise, that bring about an empowered entrepreneurial class and a favorable business climate. These are aspects of economic freedom that deserve more attention.

The perception has been that official development assistance—that is, government foreign assistance—whether it be from the United States or other Northern governments, can in and of itself allow progress in the developing world. I would argue that prudent economic policies and wise and just governing systems are more important. Capital will flow to nations with open economies and transparent legal systems.

The fourth myth is that donor nations put money into development to assuage their guilt for their colonial past. This may be true for certain countries. But it hardly applies to the United States. There are moral reasons why foreign assistance is important, just as there are reasons of national interest. But to let guilt drive policy is an invitation to poor decision-making. Our goal is to help developing countries make the right decisions—and for the right reasons.

Finally, the fifth myth is that the United States and Western democracies have become wealthy because they are somehow better than others. That is simply not true. As the Puritans knew well in old Massachusetts, human nature is fundamentally fallen. Political arrangements which ignore this weakness will fail. Democratic capitalism adjusted for the variations of local culture and tradition remains the preferred model for development. Democratic capitalism recognizes both the great strengths and the weaknesses of human nature, and it creates political arrangements which restrain the weaknesses and encourage the strengths.

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LESSONS FROM OUR OWN HISTORY

Now some comments about the United States. It's very interesting, when I go to the developing world I typically will talk about American history and our own development because people in the developing world frequently think the United States was always rich.

If you read the biography of John Adams by David McCullough, it's very clear that in 1800 the United States was a weak, unstable, and very poor country. The great European monarchies at the time believed that it would soon collapse into oblivion, something they actually were hoping for because they didn't like this business of democracy and freedom. I would like to suggest several lessons from our own economic and political development which I think can inform the current debate about international development.

There are reasons why industrialized, free-market democracies of the West have achieved unprecedented levels of prosperity and stability. The elements of success include: a free and democratic system of governance; a heavy investment in public education; policies which created a rising middle class; visionary national political leadership; and economic policies which encouraged private investment, entrepreneurs, the rule of law, and the sanctity of contracts.

The creation of an astonishingly rich and complex set of private voluntary organizations we now call civil society has protected liberty and restrained the power of the state and allowed our citizens to learn to work together voluntarily for the common good. One of my great heroes is Alexis de Tocqueville. I am a Tocquevillian. In his seminal work, *Democracy in America,* de Tocqueville wrote:

> The political associations which exist in the United States are only a single feature in the midst of an immense assemblage of associations in that country. Americans of all ages and all conditions and all dispositions constantly form associations. If it be proposed to advance some truth or to foster some feeling by the encouragement of a great example, they form a society.

We now call these associations "civil society." The nurturing of civil society is in fact a restraint on the power of the state.

The qualities that de Tocqueville describes in such detail and with what he called "religious awe"—democracy, equality of condition, and the freedom that gave rise to a flourishing civil society—are absolutely fundamental to development. There is not a single developed country that has not eventually embraced them at some point in its development.

De Tocqueville also observed another powerful force in American civil life which is not discussed enough in democracy and governance programs. I come from a small New England town. I was brought up by my father and mother in the tradition of the New England town meeting. After 350 years and many, many proposals that we do away with it, the town meeting remains a powerful institution in training people in democratic governance.

De Tocqueville said this in the 1830s:

> Local assemblies of citizens constitute the strength of free nations. Town meetings are to liberty what primary schools are to science. They bring it within people's reach, they teach men how to use it and how to enjoy it. A nation may establish a free system of government, but without the spirit of municipal institutions it cannot have the spirit of liberty.

I would argue that local government has been one of the most powerful impediments in the United States to the abuse of national government power. Some research has been done on which aspects of democratic governance are the most important to economic development and economic freedom. There has been a direct correlation linked between accountability in government and control over the authority of the state which has a tendency to abuse if the control is not there.

As we built our country we established those controls at every level of government. In Massachusetts we invested heavily in education. The Puritans used to argue that an idle mind was the devil's workshop. That is a principle we should reestablish now, because in most failed states that is, idle hands and idle minds are good places for the development

of terrorists, warlords, and of people attracted to warlord armies.

The purpose of education is not just to educate people for the purposes of a job. It is also to educate them in terms of civil pursuits. One of the very first institutions established in Massachusetts was Boston Latin School, which Franklin, Hancock, and Sam Adams attended and where the President signed the "No Child Left Behind" education reform bill last fall.

A year after Boston Latin School began, Harvard was formed, and 11 years later a law was passed in the colony that required every town with 50 families or more to establish an elementary school. Another hero of mine, Horace Mann, built what is now the Massachusetts education system. A mind properly trained, so Socrates once observed, will turn to virtue. That is certainly true now as it was 200 years ago.

Perhaps no one epitomized the virtue of the common man more than Abraham Lincoln. Lincoln is known of course for his leadership during the Civil War. He is not appreciated enough for his role as our greatest development President.

Lincoln did three things of astonishing power to develop the United States. The first was passage of the Homestead Act, which opened up vast tracts of Western territory. He also signed the first of two laws creating the continental railroad, which allowed the agricultural surpluses from the Midwest, made possible by the Homestead Act and the settlement of the West, to be shipped to Europe.

Third, Lincoln signed the Morrill Act, fostering the creation of the state land grant college system, which provided education in agricultural science and engineering for average people who did not have the income to afford private schools, thus helping to accelerate the creation of a robust middle class in America.

These three initiatives of Lincoln's—the state land grant college system, the continental railroad, and the Homestead Act—were the foundation of what many historians would argue led to the development of the United States as the economic superpower it is today.

LESSONS FROM THE DEVELOPING WORLD

Now let us turn from our own history to where this leads us in terms of the current debate. Development as I see it, as we see it at USAID, is an attempt to compress what took a century for the United States and other countries to accomplish into a much shorter period of time.

Ann Krueger's and Vernon Ruttan's study of South Korea in *Aid and Development* highlights the importance of that country's export strategy in raising the national standard of living dramatically in South Korea. It was one of the poorest countries in the world in the 1950s. It is today one of the most prosperous in Asia and, indeed, in the world.

Looking at South Korea during the 22 years following the Korean War, the authors found that foreign aid was an important factor in the first decade or so of the creation of the South Korean republic. In the late 1950s the Koreans undertook, however, their own very important series of steps to encourage economic growth. They reduced inflation, they decreased budget deficits, they liberalized the economy, and they supported exports.

By the mid 1960s, interest rates had driven domestic savings to an extraordinary level, 21.7 percent by 1969, an unheard of figure in the United States. By that year, led by the country's determined export policies, GNP rose by 15 percent in one year, averaging 8 percent over an entire decade.

Another very important book, *The East Asian Miracle,* published in 1993 by the World Bank, points out that the four Asian "Tigers" along with Japan grew more rapidly than others in the world between 1965 and 1990, with real incomes increasing more than fourfold, 400 percent.

The World Bank study reported:

> Private domestic investment and rapidly growing human capital were the principal engines of growth. High levels of domestic financial savings sustained high levels of investment. Agriculture, while declining in relative importance, experienced rapid growth in productivity improvements. Population growth rates then declined more rapidly in high-performing Asian economies than in other parts of the developing world.

The report goes on to note two other factors: sound macroeconomic management which provided a solid framework for investment, and advances in primary and secondary education which generated rapid increases in labor force skills.

Bill Easterly's recent book, *The Elusive Quest for Growth*, makes many of the same points and delivers a particularly scathing attack on those who persist in taking a capital requirements approach to growth and development. While he offers "no magic elixirs" that lead inexorably to growth, Easterly puts his focus on incentives. "If we do the hard work of ensuring that the trinity of First World aid donors, Third World governments, and ordinary Third World citizens have the right incentives, development will happen," he writes. "If they don't, it won't."

Easterly goes on to say,

> Broad and deep development happens when a government that is held accountable for its actions energetically takes up the task of investing in collective goods like health, education, and the rule of law… It happens when the poor get good opportunities and incentives, which requires government welfare programs that reward rather than penalize earning income. It happens when politics is not polarized between antagonistic interest groups, but there is a common consensus to invest in the future.

THE MILLENNIUM CHALLENGE ACCOUNT

President Bush, in his March 14 speech, set a new direction for development assistance by insisting on performance, not mere promises, to determine which countries would qualify for assistance under the new Millennium Challenge Account. The President proposed three standards to judge this performance.

The first is the central importance of policies that encourage economic freedom, private investment, and entrepreneurship. It is an indisputable fact that the only way any country is ever moved from Third World to middle-income or First World status is by sustained rates of high economic growth over a long period of time. That is something we need to repeat over and over again because we get lost in the morass of detail and debate over many other things. Without sustained rates of high economic growth, poor countries will not become prosperous.

Economic growth, in all cases with the exception of city-states such as Hong Kong, Singapore, and the Mauritius Islands, has been driven first by high rates of increase in agricultural production. Three-quarters of the poor people in the world, in Africa and Central Asia in particular, live in rural areas.

Following the Marshall Plan's success in Europe, the greatest international development success was the Green Revolution in Asia during the 1960s. This was the revolution led by the transfer of technology developed through the CGIAR (Consultative Group on International Agricultural Research) network of agricultural research stations to the peasants and commercial farmers in Asia.

Unfortunately, in the mid to late 1980s, funds for agricultural development dried up. First the United States cut funds for agricultural development, then the Europeans unfortunately followed us, and finally the mulitnational banks followed us too. The investment in agricultural development has dramatically declined during the past 15 years, in my view to disastrous consequences.

In 1987 USAID had an investment of $1.3 billion in agriculture; last year it was $250 million. We went from 250 agricultural scientists and agricultural economists in AID in those days to 42 when I arrived a year ago. Given that it was our greatest success, it is odd that we withdrew from that area.

The gross disparities of wealth in Latin America versus the much more equitable distribution of wealth in Asia has been driven largely by different approaches to agriculture and rural development. In Latin America, the infrastructure investment in electricity, roads, schools, and water systems has been heavily concentrated in urban areas, ignoring rural areas. The Asian giants took exactly the opposite approach. They allocated investments evenly between urban infrastructure and rural infrastructure, and since most poor live in rural areas, it meant that the rural areas grew at similar levels. That is why Taiwan, for example, now has the best distribution of wealth of any of the industrialized countries.

As USAID administrator, one of my goals is to revitalize our agricultural program not just for subsistence agriculture for domestic consumption, but also for export. That is why we created a new bureau called the Bureau of Economic Growth, Agriculture and Trade. We are focussing our experts in agriculture to bring about a renewal of this discipline within USAID and in our worldwide missions.

Trade and investment are critical to economic growth. Many developing countries simply do not know how to take advantage of the opportunity the new global economy presents. The 49 least-developed countries in the world account for less than one-half of 1 percent of world trade. That is not a recipe for economic growth.

USAID accounts for more than 70 percent of the U.S. government's trade and development training programs. We have already had success in Eastern Europe and the former Soviet bloc countries in training in marketing, in developing export niches for their particular products. We want to emphasize this now in Africa and Central Asia.

Our current trade capacity building programs help countries prepare to join the World Trade Organization; understand WTO regulations so they can participate in rules-based trading more effectively; and identify exports that can compete more effectively in world markets.

We're also looking increasingly at programs that boost economic performance at the microeconomic level. In the last 20 years, our focus has been heavily in all of the international institutions and agencies on macroeconomic reform, which is an essential but not sufficient for rapid economic growth.

Microeconomic reform focuses on tax policies that encourage local savings and investment, encourage the creation of new enterprises, focus on questions like training an entrepreneurial class. Many countries—Bolivia is a good example—have done what the international community said they should do in terms of macroeconomic reforms. Bolivia has had elections and a parliamentary democracy for 15 years now. It has implemented macroeconomic reforms producing low inflation rates and a stable currency. Still, it has not enjoyed economic growth.

What has been missing is microeconomic reform to create a class of entrepreneurs who can build businesses. Not all investment is international investment. Not all businesses are run by people from other countries entering the developing world. Many of the Asian giants developed because they had an entrepreneurial class, even if it was small, to begin to build their own businesses, to run their own businesses in their own culture and their own society. Increases in production and productivity are required before a country can fully participate in free trade. One must produce something worth trading or trade will not occur.

President Bush's second criterion for the Millennium Challenge Account is the central importance of good governance to economic growth and development. The President described it as "ruling justly."

President Reagan said in the course of his famous speech to the British Parliament in June 1982: "Democracy is not a fragile flower—still, it needs cultivating." That is as absolutely true today as it was when President Reagan launched our country on a new course of fostering democracy.

In this area, USAID has changed a great deal during the last 10 to 15 years. Now we do a significant amount to promote development of democratic institutions. We cooperate with the National Endowment for Democracy, the International Republican Institute, the National Democratic Institute—new institutions formed as a result of President Reagan's initiatives in the early 1980s.

Initially, our efforts focused heavily on ensuring free and fair elections. That is important, but it is not sufficient. Beyond promoting free and fair elections, we must help democracies to be effective at constraining the power of the state toward abuse. Corruption is one of the most serious problems we face in the developing world. A new focus at USAID is in programs to promote accountability and the rule of law, and to root out corruption. For example, we want to provide more assistance such as training a country's supreme audit institution in how to do audits.

We have been training investigative reporters in Eastern Europe. A group of them formed a consortium in Bulgaria very recently to do an investigation of how Bulgaria had been a base of support to international terrorism. The series of articles they pro-

duced has reached 1.5 million Bulgarian readers, and it has caused a real stir.

We hear a lot of complaints in the United States about the news media, but the fact of the matter is the free press has been for a very long time a constraint on the power of political figures in our democracy and in other democracies.

In addition to freedom of the press, other critical accountability functions for effective democracies include a meritocracy in the civil service and a separation between economic and political power. In many developing countries, the economic and political power are so entwined that oligarchies take control of the government, impose mercantilist economic policies, and use political power to ensure themselves markets and suppress competition.

Also essential for accountability is an impartial judicial system enforcing the rule of law and the sanctity of contracts. Businesses require predictability in their relationship to the state in order to invest. Colin Powell likes to say capital is a coward. Business does not invest unless it has some guarantees.

President Bush's third criterion for the Millennium Challenge Account is a demonstrable commitment by Third World countries to invest in health and education and to ensure effective delivery of services. Countries with high rates of sustained economic growth have consistently invested in health and education services for their people, helping create a work force for a growing economy. It is in these last two social services where development assistance has made its greatest progress in the last several decades as literacy rates have risen and child mortality rates have dropped.

Jared Diamond, the author of *Guns, Germs and Steel: The Fates of Human Societies*, rightly pointed out in the *Washington Post* earlier this year that

> high infant mortality rates and short adult lifespans resulting from preventable diseases such as malaria, AIDS, cholera and parasitic infections are a major cause of poverty—and paralyze whole economies in multiple ways. First, they sap the productivity of workers, who are often sick and die young; second, they stimulate high birth rates, because parents expect many of their children to die. The result is that much of the population is too young to work and women can't join the workforce because they are busy raising children. All those things make countries unattractive to investors. The biggest economic success stories of recent decades have been Hong Kong, Mauritius, Malaysia, Singapore and Taiwan, all of which invested heavily in public health and saw their GNPs rocket as child mortality and family size plunged and as worker lifespans lengthened.

USAID's health and child survival programs are the part of foreign assistance that the America public understands the best and consistently supports. Because of this we have been able to retain our leadership and expertise in this area. The magnitude of the HIV/AIDS pandemic and the speed at which it is spreading, threatens to overwhelm us all, however. Twenty-five million people have died from this terrible disease, and estimates suggest that another 20 million may die by the end of this decade. A third of the adult population in the countries of southern Africa are infected, causing untold difficulties. Because HIV/AIDS is primarily a disease of young adults, it is having a dramatic impact on the most productive sectors of society—doctors, teachers, and business leaders. Already we are getting reports of famine-like conditions in certain regions of Africa—not because of drought, but because there are so few adults healthy enough to manage the fields and livestock. Fortunately, after several years of flat budgets, our HIV/AIDS program have begun to grow significantly in the past three years. President Bush has asked for another big increase for FY '03.

We know that advances in primary education have major payoffs in other sectors. Studies in Africa indicate that, without any other changes, agricultural production increases when women, who dominate farming, have primary school education. Children are fed better and their health improves when their mothers have a basic education. We know that an educated citizenry increases the chances for nascent democracies to succeed.

We have created in USAID what's called the Global Development Alliance, which is an attempt to marry private sector capital flows to the developing world with those from the public sector. Thirty or 40 years ago, 70 percent of the capital flows from

the United States to the Third World were ODA—official development assistance—and 30 percent was private. It's the opposite now; 80 percent of the capital flows to the developing world are private, and only 20 percent is ODA.

That is not because ODA has declined in absolute terms; it is because the private sector has been dramatically increasing capital flows to the developing world. This is not just private capital from businesses, although that's the bulk of it. Thirty billion dollars in remittances go from this country to the developing world every year as the ethnic diasporas in this country send their money home. Twelve percent of the gross national product of El Salvador is remittances from the Salvadoran community in the United States.

I was just with the Prime Minister of Lebanon at a lunch and he told me that 25 percent of Lebanon's gross national product comes from remittances from abroad. A study done by UCLA recently said that half of the microfinance lending that's going on in Mexico right now is from the Mexican-American diaspora in California sending remittances back to their villages. So there is a lot of microfinancing that has nothing to do with ODA.

An important question is, how do we link into that in a way that can accelerate many of those capital flows in the private sector? Foundations send a huge amount of money to the developing world each year. Bill Gates, for example, sent $750 million to GAVI, the Global Alliance for Vaccines and Immunizations; USAID sent $49 million. So he hugely outstripped us in terms of being a donor. We know that our private sector allies make a huge difference in development, and we need to give them the recognition that is due them.

Our challenge in promoting international development was summed up well by Ronald Reagan in his same 1982 speech to the British Parliament. He said,

> I have often wondered about the shyness of some of us in the West about standing high for these ideals about democracy that have done so much to ease the plight of man and hardships of our imperfect world. Let us be shy no longer. Let us go to our strength. Let us offer hope. Let us tell the world that a new age is not only possible, but probable.

—Andrew S. Natsios is Administrator of the U.S. Agency for International Development.