USAID IN 2006: BAND-AIDS, NOT DEVELOPMENT

Phil Bliss

ECONOMIC GROWTH IS TOO IMPORTANT TO CONSIGN TO A RESIDUAL CATEGORY OF THE BUDGET, BELOW EARMARKS AND UNFUNDED MANDATES.

BY JAMES W. FOX

The U.S. Agency for International Development has become largely a dispenser of Band-Aids for poor countries, rather than a tool for reducing poverty. It addresses immediate hurts, not underlying problems. Conspiracy theorists and antigovernment extremists might agree on an explanation: government bureaucrats don't solve the problem of world poverty because that would put them out of a job. But this is too simplistic. There is still so much poverty in the world — close to one billion people (one-sixth of the world's population) live on less than $1 per day —

that any "poverty bureaucrat" can look forward to decades of steady work.

A better, more precise, explanation is that people (including members of Congress) respond more to pictures than to theories. Any American who watches the local news knows this implicitly. Fires, murders and other disasters, followed by caught-in-the-act corruption and a couple of heartwarming human-interest stories, dominate. This is not a conspiracy by journalists. It is a response to what the American people want to see and hear.

At the same time, there is ample evidence in the recent history of Japan, South Korea and Taiwan, among other countries, that economic growth — as opposed to the many humanitarian and aid initiatives — is the key to poverty reduction. There is, furthermore, a unique and vital role for USAID to play in helping to improve the environment for business in developing countries. For that to happen, however, economic growth must be reclaimed from its place as a residual category of USAID's budget and made a priority.

The Idea of Foreign Aid for Development

When President Kennedy proposed the creation of the U.S. Agency for International Development in 1961, he offered a clear statement of its purpose: to lift countries out of poverty through sustained economic growth. Some of the original concepts were simplistic or naïve — notably Kennedy adviser Walt Rostow's concept of "takeoff," whereby countries would soar into the wild blue yonder of development once specific preconditions were met. In the ensuing years, some takeoffs were short helicopter rides; others were crash landings, sometimes with economies going up in flames.

But the idea that poverty could be cured by rapid economic growth has been amply demonstrated. This has happened most clearly in Asia, where first Japan, then South Korea, Taiwan, Singapore and Hong Kong leaped from poverty to abundance in little more than a generation. They were followed by Thailand, Malaysia, Indonesia and, more recently, China, Vietnam and India. Nobel Prize-winning economist Robert Lucas, after examining such successes and the possibility of repeating them in other poor countries, observed that once you have thought about this, it is "hard to think about anything else."

Yet sadly, USAID does spend most of its time thinking about other things: child survival, basic education, family planning, microfinance, environmental protection, women's rights and HIV/AIDS. These are all worthy causes, but none are likely to be transformative. Much ink has been spilled by the proponents of these various programs in justifying their role in sustained economic growth, but the data do not support a causal connection.

For instance, basic education is claimed to speed economic growth. But the continent with the most massive increase in years of schooling between 1950 and 2000 — Africa — also had the most dismal growth record. HIV/AIDS is argued to be a major cause of slower economic growth in countries with a high incidence of the disease. But Botswana, the country with perhaps the highest incidence of HIV/AIDS on the continent, continued its record as the only country in continental sub-Saharan Africa to experience rapid and sustained economic growth. Similarly, decades of effort to reduce fertility in Niger have produced almost nothing — the country's women have an average of nearly eight children, just as they did in 1950. Meanwhile, Niger's economy has alternated between stagnation and decline. Indeed, in the case of family planning generally, it is easier to argue that the causality is the opposite of what is claimed: faster economic growth leads to lower fertility, not the other way around.

All of the activities mentioned in the previous paragraph are important, worthy of U.S. support and important contributors to the well-being of people in poor countries. But as far as the problem of poverty is concerned, they are not solutions. Only economic growth — as rapid as in the Asian countries discussed earlier if possible, but slower and more steady if necessary — can lead to an end to dependence on the largess of the United States and other rich countries. The United States itself has been a "slow and steady" country. Since 1820, it has grown in per capita terms at only about 1.7 percent per year. But that rate, maintained over 181 years, produced a 22-fold increase in average incomes and turned the United States into the most economically powerful nation on earth.

Retired former FSO James W. Fox served with USAID in Costa Rica, Uruguay and Colombia, and was later the agency's chief economist for Latin America. He also served two stints at State and worked on developing country issues at Treasury and for the Senate Foreign Relations Committee. Before joining State, he was a Peace Corps Volunteer in El Salvador. He is currently a consultant to the World Bank's Independent Evaluation Group.

Sources of Economic Growth

So what generates economic growth? The short answer is that business enterprises do it by finding ways to be more productive — whether through better technology, better management practices, or investment in people and equipment. Government policies do not cause economic growth, but they do set the environment that either encourages or discourages it. The macroeconomic and microeconomic environments enterprises face can, with mild overstatement, be called the *drivers* of economic growth, because by addressing them the efforts of governments and donors are most likely to enjoy success. Other things that donors help governments do — education, HIV/AIDS treatments, family planning or any of a variety of other activities — should be thought of as *enablers* of economic growth. Where the drivers are in place, improvements in the enablers will speed growth. If the drivers are absent, improvement in the enablers will improve human welfare, but will not end dependence on continued donor funding.

There has been great progress on the macroeconomics of development over the past two decades. Nearly all countries accept the general principles that central banks ought to have the goal of low inflation, that government fiscal deficits ought to be modest, that exchange rates ought to be competitive, and that barriers to international trade ought to be modest. These four are all features of the "Washington Consensus," and no alternative policy set has gained much traction. Nearly all countries agree with them in principle, if not in practice. But practice has also improved. For 2003, the World Bank's World Development Indicators database shows that 119 countries had single-digit inflation in that year, and only 30 countries had higher rates — with the highest at 95 percent. The median inflation rate was 3 percent. In 1990, by contrast, only 70 had single-digit inflation, while 65 countries had double-digit inflation or higher. There were five with triple-digit inflation, and four more with quadruple-digit inflation. The median inflation rate for the 135 countries reporting data for 1990 was 17 percent.

On the microeconomic side, however, no simple performance measurements or recipes for success have been devised. Microeconomics addresses the role of incentives and markets at a level that tends to be specific to individual countries, markets and productive sectors. Consequently, the importance of any problem area (e.g., price controls on agricultural products or taxes on exports) will vary widely from one country to another.

In crude terms, macroeconomic policy recommendations can be fashioned in Washington; but microeconomic policy needs to be made in-country, with an understanding of local institutions and the political economy of reform. The lack of easy measurement and generalization from first principles has led successive generations of economists to largely ignore microeconomic problems and concentrate on the easily modeled and easily measured macroeconomic issues. Following the dictum of their quantitative-minded professors in graduate school that "if you can't count it, it doesn't count," they have concentrated on the countable macroeconomic features.

Only recently has the microeconomics of development begun to yield to quantitative analysis, with pioneering efforts by groups like the Heritage Foundation and the World Economic Forum. Still, these early efforts provided only extremely crude estimates of the quality of the microeconomic environment for economic growth.

Spotlight on Microeconomics

In 2003, the World Bank made a breakthrough with its Doing Business database (http://www.doingbusiness.org). It offers annual data for 150 countries on 39 variables that seem most linked to economic growth at the level of the individual enterprise, including information on such matters as: How difficult is it to start a business? How much will it cost? How hard is it to enforce a contract if the other partner simply refuses to pay? How difficult is it to hire a new worker? To dismiss a worker? Is there a credit bureau that keeps track of the willingness of borrowers to repay loans? If a borrower defaults, what recourse, if any, does the lender have? Dozens of other questions that impinge directly on the ability of firms to create value, to employ workers productively and, generally, to increase productivity in a poor country are covered.

Perhaps the most notable fact demonstrated by this new information resource is that government regulation of business is dramatically more extensive, more expensive and more time-consuming in poor countries than in rich ones. On most issues, the United States and Sweden are both far more permissive about virtually any aspect of business than the average poor country.

The table on p. 39 is extracted from the Doing Business database. It presents a sampling of the 39 indicators comparing the United States and Sweden with large developing countries in Asia, Africa and Latin America. The

United States ranks third overall in the ease of doing business, after New Zealand and Singapore. Swedish requirements are often simpler or involve fewer delays but, like most of Europe, Sweden makes dismissing workers more costly than in the United States (but less costly than in most poor countries). For most developing countries, these microeconomic regulations constitute a major impediment to business productivity and efficiency.

Why do poor countries have so much more regulation? In some cases, it is the legacy of beliefs learned decades ago at Western universities, when suspicion of the private sector and belief in the benevolence of government were the conventional wisdom. In others, the benefits that accrue to government officials for their help in getting around such regulations are surely a factor. Regulatory complexity is a major feature in the pervasive corruption, favoritism and crony capitalism of many developing countries. One Latin American wag has characterized the situation for government officials in the region: "For my enemies, the law. For my friends, I can do better."

Reforms of such microeconomic policies need to be identified and addressed on the ground, through the various tools of political economy — doing studies that identify the costs of excessive regulation, making common cause with reformers, building coalitions of adversely-affected groups (often nontraditional exporters), responding to opportunities presented when a particularly dynamic minister takes over an important ministry, or a variety of other approaches that creative donor-agency officials might use to help open up a country to creative entrepreneurship. In sum, addressing such problems requires in-country staff, connected to the local economy and polity.

Funding Drivers of Economic Growth

The level of funding provided by congressional appropriations for promotion of economic growth is modest. Only about 4 percent of the USAID budget is available for unencumbered use to promote the largely microeconomic reforms that can speed economic growth in poor countries. Another 20 percent or so of the USAID budget is

The Microeconomics of Running a Business
Comparative Indicators for Five Countries

Procedure	United States	Sweden	Brazil	Nigeria	India
Time to start a business (days)	5	16	152	43	71
Cost of start-up (% of per capita income)	0.5	0.7	10	74	62
Time needed to acquire construction licenses	70	116	460	465	270
Time needed to import a cargo container (days)	9	6	43	53	43
Time needed to export a cargo container (days)	9	6	39	41	36
Hiring Costs (% of salary)	8	33	27	8	12
Firing cost (weeks of salary)	0	24	165	4	79
Time needed to enforce a contract (days)	250	208	546	730	425
Cost of enforcing a contract (% of debt)	8	6	16	37	43
Time needed to register commercial property (days)	12	2	47	274	67
Recovery from a business closure (cents on the dollar)	76	75	54	31	13
Overall Rank	**3**	**14**	**119**	**94**	**116**

available for promoting economic growth in a particular sector (e.g., microfinance, education), for a particular country or region (e.g., Egypt, Jordan, the former Soviet bloc) or for a particular purpose in a particular country (e.g., antinarcotics in the Andes and Afghanistan). The principal reason for this modest support is that funding for economic growth lacks the easily-explainable human dimension offered by HIV/AIDS, basic education, child survival, microfinance or family planning. All these worthy purposes have funding levels earmarked by Congress. Economic growth has no earmark, and is therefore a residual category. Worse, Congress typically adds an unfunded mandate or two each year. Since none of the earmarked categories can be cut to carry out the mandate, the economic growth residual is reduced further.

The Bush administration tried to rectify the imbalance between immediate alleviation of suffering and an eventual end to dependence on foreign aid through faster economic growth by establishing the Millennium Challenge Account. The MCA was intended to reward progress by developing countries that had demonstrated the strongest commitment to three goals: promoting economic freedom, investing in people and ruling justly. To gauge the worthiness of countries on these three dimensions, its executive agency, the Millennium Challenge Corporation, adopted a set of 16 indicators, all calibrated by other institutions. Many of these indicators address the macro- and microeconomic drivers of economic growth. The indicators have been generally approved by outside observers, but the sluggishness in moving from idea to action has caused consternation. The largest problem — the two-year gap between the initial proposal by President Bush and the establishment of a functioning MCC — was caused by the White House and the Congress.

In recent months the MCC has picked up speed. It now has signed agreements ("compacts" in MCC jargon) with eight countries, totaling more than $1.7 billion. The compacts approved so far have been heavy on infrastructure (notably roads and ports, with additional smaller amounts allocated for potential users of the infrastructure — farmers, agribusiness firms and others producing for export markets). As a program to mobilize interest in better policies, and as a vehicle for rewarding countries that offer economic freedom, the MCC has every promise of success. At the same time, it has, and is likely to continue to have, very limited country coverage: its staff is largely based in Washington, with in-country offices focused on implementing the specific terms of the compact.

The difficulties in obtaining congressional approval for a goal as abstract as economic growth are evident in comparing the appropriations for the MCC and for President Bush's Emergency Plan for AIDS Relief. Each initiative was announced as providing $15 billion during its first four or five years. PEPFAR is ahead of schedule to reach this goal, but the MCC will fall far short.

A Key Niche for USAID

In the early 1990s, there was a famous meeting (at least in the world of USAID economists) where Deputy Administrator Carol Lancaster announced that economic growth promotion was a task better left to the World Bank. USAID would concentrate its efforts elsewhere, she said. Thereafter, the staff of USAID economists and private-sector officers quickly declined.

At the macroeconomic level, there cannot be any doubt that the World Bank has the best economics professionals in the development business. Unfortunately, most World Bank staff members live near Washington, D.C., and only make short "economist tourist" visits (though traveling in first or business class) to the countries they assist, so their capacity to address microeconomic issues is far weaker. World Bank President James Wolfensohn made some progress in decentralizing the institution, but in an environment where any overseas posting had to be entirely voluntary the change was not far-reaching. Most World Bank employees prefer the comfortable life in Washington to the often-difficult conditions for them, and their families, in poor countries.

An even bigger obstacle to World Bank assistance for microeconomic reform is the fact that the Bank only lends to governments (or to others with a governmental guarantee). Such agreements usually need to be ratified by the national legislature, sometimes causing long delays and leading to the intrusion of politics into project implementation. In general, World Bank programs to promote the private sector do so by funding government agencies, and they do it with long delays between design and implementation. This is a recipe for ineffectiveness.

Here USAID has a strong comparative advantage, vis-à-vis both the World Bank and most other donors — who either lend only to governments or are suspicious of the private sector, or both. For, despite its numerous limitations, USAID has some distinctive assets. In the first place, it has substantial in-country knowledge, both from high-quality national employees and from experienced economists and private-sector officers. Second, the agency tends to benefit from a long-demonstrated commitment to partnership with the host country. Finally, it makes grants, thereby eliminating the need for (and the often long delays associated with) legislative approval. So USAID can, for instance, fund business associations or NGOs that lobby for simplified regulation, or that help mobilize the business community to demand pro-growth policies.

Numerous anecdotes could be related in support of the claim that USAID can play a uniquely effective role in helping to bring about constructive microeconomic reforms. But the strongest support for it comes from Simeon Djankov, the director of the World Bank's Doing Business project. He reported in a recent e-mail to USAID that "among the countries identified in each of the past two annual Doing Business reports as the top 10 business climate reformers over the previous year, an average of six of those 10 reform efforts were supported by USAID projects." As suggested earlier, the reforms USAID promotes tend to be specific to the particular country's circumstances. In Vietnam it was wholesale reform of the legal environment for business; in Central America, simplification of customs procedures and unification of customs documentation; and in Georgia, simplification of procedures for starting businesses.

In sum, USAID has the tools — in-country staff, a proven commitment to a partnership with the host country, grant funding and (limited) financial resources — to address the key constraint to faster growth in poor countries: the poor environment for business.

What Needs to Be Done

Economic growth in poor countries is too important to consign to a residual category of the USAID budget, after humanitarian and photogenic earmarks and unfunded mandates take their shares. Only strong action by the executive branch, to make clear the foreign policy importance of adequate funding for economic growth, will make USAID an important actor in ending dependence on hand-outs from the United States and other donors.

But a larger budget for economic-growth-promoting activities will not do the job alone. Two other reforms are needed. First, USAID needs to hire more economists and private-sector officers, mostly mid-career people with extensive experience in developing countries. Second, the onerous procedural and contracting requirements that USAID (unlike the MCC) must follow need to be simplified, so that funding can flow to where it is needed when it is needed.

The naming of a new head for USAID — who also carries the rank of Deputy Secretary of State and is empowered, at least in theory, to coordinate the numerous foreign aid programs of the U.S. government — is cause for some optimism. For the first time in decades, a senior official may be able to look at U.S. foreign aid in its entirety and make judgments about whether the numerous allocations, earmarks and narrowly-focused aid spigots add up to a sensible program. This author believes that it does not now do so, and that only a larger focus on economic growth will move countries from permanent dependence on U.S. help to eventual self-sufficiency. ■