



# Benefits over the Long Term

**USAID's economic growth programs strive for transformational impacts to benefit current and future generations. With highly successful projects, the benefits spread and grow over time. These impacts are best viewed from a long-term perspective.**

Two hallmarks of successful development assistance are sustainability and broad impact. The eradication of smallpox, for example, ranks among USAID's most famous successes because it ended a deadly disease that affected millions of people across generations. Other well-known cases of long-term success involved imparting to beneficiaries new technology or behavior—the proverbial goal of teaching people to fish (or teaching people to teach others to fish). Examples include the introduction of high-yielding wheat and rice varieties and tube wells that spread the Green Revolution (see Briefing Note 6, Linking People and Food), and family planning and child survival programs in many countries that permanently reduced mortality rates and improved child welfare.

USAID's economic growth (EG) programs are less well known than the examples cited above, but many EG interventions have similarly fostered huge and sustained benefits for current and future generations. By facilitating economic reforms, strengthening economic institutions, promoting markets, and supporting private sector development, successful EG programs have helped to alter incentives, behaviors, and capabilities to help people escape poverty and attain higher standards of living. The full benefits from such interventions can often be appreciated only in the long run as households, businesses and governments adjust to innovations and respond to new opportunities spawned with USAID support.

This note presents a series of retrospective cases to illustrate the long-term catalytic power of economic growth programs in cases where USAID has worked with willing and dedicated partners to alter traditional practices and overcome constraints to growth (USAID 2008a). The examples include programs for building policy analysis capacity, promoting trade and investment, modernizing the financial sector, improving revenue mobilization, and supporting enterprise development.

## BUILDING POLICY ANALYSIS CAPACITY

After the collapse of the former Soviet Union, and again in postconflict settings such as Afghanistan, Iraq, Liberia, Kosovo, and Bosnia (see Briefing Note 7), USAID has faced the need to help emerging or recovering states with fundamental policy reform and institution building. To fully appreciate the long-term potential of capacity building assistance in this domain, it is helpful to look back to the most prominent example from an earlier era: South Korea (hereafter, Korea).

Fifty years ago Korea was one of the poorest countries in the world, with GDP per capita of only \$100 (equivalent to \$1,100 at 2000 prices). The economy depended heavily on foreign assistance, mainly from the United States. U.S. bilateral aid averaged 8 percent of GDP from 1953 to 1962 and financed more than two-thirds of the nation's imports

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This briefing note is part of a series produced for the EGAT Bureau at USAID as a contribution to the recurrent debate on development priorities. Each note in the Programming for Growth series examines a topic relating to the value and effectiveness of USAID's economic growth programs. All the titles in the series are listed on the last page of this note.

(Fox 2000). Over that period evidence of progress was scant. Some experts warned of donor dependency and doubted that Korea would pursue the fundamental reforms advocated by American technical advisers. After a change in government in 1964, however, Korea began to encourage export-led private-sector development. By 2008, with an annual GDP per capita of US\$15,447 (in constant 2000 dollars), Korea had become the 12th-largest economy in the world, an export powerhouse, and a source of investment and foreign aid for other developing countries.

The people and leaders of Korea merit the preponderance of credit for the country's remarkable economic transformation. Be that as it may, USAID (and its predecessor, the International Cooperation Agency) played an instrumental and perhaps catalytic role in helping the Koreans get their economy on track for rapid growth. U.S. technical advisers provided sound advice on economic development policies while building the capacity of local policymakers and technocrats to understand and then implement reforms. Notably, U.S. support strongly encouraged new thinking about private sector and export-led development. After 1964 the seeds of progress began to sprout, and Korea pursued reforms with more vigor, dexterity, and success than anyone would have imagined (Fox 2000, Pillsbury 1999). USAID continued for another decade to provide technical support and training for policy analysts and helped to create influential policy think tanks, especially the Korean Development Institute. This experience also created spillover benefits to countries eager to imitate Korea's success.

Korea is just one of many cases where USAID has supported capacity building for policy analysis and policy management to create a foundation for long-term growth and poverty reduction. Other highly successful examples include Taiwan, Indonesia, and Thailand. Elsewhere, as in Bolivia, El Salvador, and even much of Africa (through support for the highly influential African Economic Research Consortium), USAID also helped to create similar capacity, though with less impressive outcomes. USAID continued in this tradition more recently by supporting dozens of young disadvantaged South Africans to earn advanced degrees in economics through the Mandela Economic Scholar-

ship Program while also providing training in economic policy analysis to members of the postapartheid Parliament.

## PROMOTING TRADE AND INVESTMENT

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As in the case of South Korea, Vietnam's success in achieving high rates of growth and rapid declines in poverty is a tribute to the commitment of the leadership and energies of the people. Here, too, technical support from the United States played an instrumental role, this time in helping the country implement fundamental changes in the legal system to stimulate trade and attract foreign investment.

In December 2001 the government of Vietnam signed a bilateral trade agreement with the United States. It asked the U.S. Trade Representative to arrange for help in designing and implementing legal and institutional changes necessary to ensure compliance with terms of the agreement and promote accession to the World Trade Organization. USAID quickly responded by fielding a team of technical experts under the Support for Trade Acceleration (STAR) project. STAR operated from 2001 to 2007 at a total cost of \$13.6 million, supplemented by another \$600,000 from other U.S. agencies.

To direct the reforms, the Vietnamese government created a high-level steering committee under the supervision of the prime minister's office. The steering committee included officials from major ministries and state agencies. Working with the benefit of this strongly supportive leadership group, the STAR project helped the government rewrite 93 laws and regulations governing business, property rights, investment, and trade. The project held hundreds of seminars for more than 20,000 government and business leaders to explain the trade agreement and WTO requirements and the benefits of adopting and enforcing the new laws (USAID 2007a). Parallel involvement by the U.S. Securities and Exchange Commission, funded by USAID, helped the Vietnamese establish the framework for a vibrant capital market.

These reforms enabled Vietnam to join the WTO by January 2007. They also created the legal and institutional environment that the private sector was looking for. As a result, foreign

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direct investment more than quadrupled—from an average of \$1.5 billion per year from 1999 to 2001 to \$6.5 billion in 2007 (World Development Indicators on line). Vietnam's exports to the United States similarly rose, from \$1 billion in 2001 to \$12 billion by 2009. The surge in investment and exports created hundreds of thousands of jobs for the 1.5 million young people entering the workforce each year (USAID 2008b). In addition to direct benefits in increasing trade and investment, the legal and institutional reforms supported by STAR will have longer-term benefits through fostering understanding of and respect for the laws and institutions that make it possible for innovation, enterprise, and competition to thrive.

Vietnam's success in attracting investment, stimulating exports, and creating jobs required other favorable conditions, including large investments in infrastructure and education. But the support provided by USAID enabled essential reforms at the right time to help national officials achieve their vision of transforming the economy through trade and investment.

## MOBILIZING CAPITAL THROUGH FINANCIAL SECTOR MODERNIZATION

When USAID mobilized to help the republics of the former Soviet Union and former Soviet satellite states in Eastern Europe to establish market-based economies in the 1990s, one major area of intervention was the introduction of modern financial institutions. Most of these countries inherited financial systems consisting of a few state-owned banks that were charged with allocating state resources to state enterprises. They lacked the laws, institutions, training, and experience needed to create or operate financial institutions that could effectively mobilize savings and efficiently allocate financial resources to productive investments.

In Kazakhstan, USAID's Financial Sector Initiative (FSI) from 1996 to 2005 partnered with leaders of the National Bank, the government, and the private sector not only to create basic systems and institutions, but also to establish a thriving capital market. By 2009, this market supported \$26 billion in corporate finance—up from zero a decade earlier. The FSI also helped

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to create from scratch a mortgage finance sector and develop the market infrastructure for real estate transactions, including professional property valuation. By 2009 this market had channeled US\$7 billion into mortgage securities. In addition to helping

investors obtain essential financing for growth, the new financial institutions and markets also helped to rescue Kazakhstan's pension program from certain bankruptcy by providing new channels for long-term investment of funds. By the same token, the emergence of capital markets also helped to stimulate rapid growth of private sector pension schemes to complement the state-run plans (USAID 2007b)

As with legal and regulatory reforms in Vietnam, USAID's support for modernization of the financial sector in Kazakhstan

proved to be a catalyst for transformational changes that will continue to deliver long-term gains in social welfare for the people of the country. Moreover, USAID's intervention has been extraordinarily cost-effective, fostering economic benefits measured in billions of dollars at a cost a thousand times lower. The success of USAID's assistance in modernizing the financial sector hinged, of course, on the commitment and competence of leaders in the National Bank, the government, and the private sector—further confirming the critical importance of local ownership and effective partnership for successful development outcomes.

## LONG-TERM BENEFITS OF FISCAL REFORM

An efficient tax system and prudent expenditure management are fundamental requirements for macroeconomic stability and effective economic governance, which in turn are cornerstones for sustainable growth. USAID has helped many countries modernize their fiscal systems and build capacity for fiscal management, often providing the technical support needed to implement reforms recommended by the IMF or the World Bank. In some cases, such as in Kosovo and Iraq, USAID helped to establish what are essentially new fiscal institutions (see Briefing Note 7 on postconflict programming). In other cases, such as in El Salvador, USAID support improved fiscal institutions that were not functioning well (see Briefing Note 9 on intermediate results). There are also cases where USAID support has not

taken hold because of a lack of capacity or commitment on the part of the host governments, as in Zambia under the Kaunda government in the late 1980s (see the evaluation by Nathan Associates, 1989), and efforts in Southern Sudan over the past few years.

Jamaica is an interesting case where USAID support for tax reform in the 1980s paid large long-term dividends. For a decade following independence in 1962 the Jamaican economy enjoyed rising prosperity, as per capita GDP grew by nearly 4 percent per year. This growth rested on strong earnings from bauxite and alumina exports, which accounted for 70 percent of total merchandise exports. After 1973, however, a global expansion in the supply of bauxite depressed world prices for these exports, and between 1973 and 1983 per capita GDP fell by 22 percent (Maddison 2007). The drop in export earnings also reduced government revenue. In an attempt to stabilize revenue, the government increased export taxes, but this proved counterproductive (Pillsbury 1999). By 1982, Jamaica's foreign exchange reserves were exhausted, and foreign exchange earnings from exports were insufficient to cover required imports and debt service costs. Standards of living were deteriorating, and the economy was on the brink of collapse.

After the 1980 election of the Jamaica Labor Party, USAID initiated a technical assistance program (the Tax Structure Examination Project) that led to reductions in import duties, price controls, and food subsidies and to the privatization of some state-owned corporations. These measures were followed by a major effort to reform the tax system. The prime minister signaled the high priority of this effort by creating a politically independent Tax Reform Commission to work with USAID's advisers and take responsibility for the decisions. Between 1983 and 1987 USAID helped to craft a politically acceptable and economically efficient tax system. The government simplified the personal and corporate income tax codes, eliminated a host of special tax breaks, and lowered tax rates from a maximum of 80 percent to a flat 33.3 percent—at the time a very low rate by global standards. The government also replaced a multitude of other duties and taxes with a value-added tax, called the general consumption tax, at a uniform rate of 10 percent (Edmiston and Bird 2006).

These measures increased revenue from 25 percent of GDP in the three years prior to reform to 27 percent in the three years ending in 1991. Equally important, the reduction in tax breaks and simplification of the tax code lowered administrative costs and enhanced incentives for private investment. Jamaica's finance minister cited the tax reform project as "one of the best foreign aid projects ever carried out in Jamaica" (Pillsbury 1999, 129). These reforms helped to return the economy to growth as the world economy recovered from the recession of the early 1980s; between 1983 and 1990 per capita GDP in Jamaica rose by 18 percent (Maddison 2010).

Since 1991, Jamaica's economic record has been mixed at best. Even with the reforms outlined above, it took it two decades to restore per capita GDP to the level reached in the early

1970s. But without the USAID-supported reforms, Jamaica was on a fast track to becoming a failed state, which would have plunged the island's population deeper into poverty. By helping Jamaica avert an economic collapse and return to moderate growth, the reforms yielded billions of dollars in income gains and many thousands of jobs for Jamaican workers—at a cost of approximately \$8 million to the United States.

This is an important example of an EG program that produces highly consequential long-term benefits in the form

of preventing economic or financial crises. Another leading example was the potential currency collapse that did **not** occur in Afghanistan in 2002 because of timely USAID assistance for monetary reform immediately after the Taliban was toppled. A less obvious example was the resilience of Indonesia's economy during the recent global economic crisis, due to having strong macroeconomic policies in place before the shock—at least in part a result of years of USAID-supported training, capacity building, and advising for Indonesia's economic technocrats.

## INNOVATION FOR PRIVATE SECTOR DEVELOPMENT

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tunities. The innovations can take a variety of forms, including new products, improved quality standards, new market linkages for inputs or outputs, cluster initiatives to develop business-support services or training facilities, and improved access to financial services.

A USAID project in Peru is an excellent example of the catalyst effect in action, with enough time having passed to see that the cumulative long-term effects have been enormous. In the mid-1980s USAID began working with Peruvian agro-extension agencies and a group of farmers near the southern coastal town of Ica. The Ica Farmers' Association was keen to supplement traditional crops with a viable export crop. After studying various options, the association agreed to test-plant 500 hectares of green asparagus. A USAID-funded specialist confirmed the viability of the crop and gave technical advice on cultivation.

Other regions of Peru were already growing and exporting white asparagus, but green asparagus was a new product. The crop targeted a valuable market niche because farmers could schedule plantings to harvest between September and December when there was virtually no competition from U.S. or Mexican growers. The cultivation of green asparagus turned out to be a technical and commercial success in the early years. After the Andean Trade Preference Act took effect in 1993, exempting Peruvian asparagus from U.S. tariffs, exports surged. By 2001, the Ica Asparagus Producers Association cultivated 9,000 hectares of fresh asparagus, and today Peru is the world's leading exporter of asparagus, having overtaken China and the United States (Robles 1997, O'Brien et al. 2004).

USAID went on to leverage the Ica experience through subsequent projects that have helped poor farmers in other regions of Peru benefit from the introduction of nontraditional export crops. The Microenterprise and Small Producer Support program from 1993 to 2000 and the Poverty Alleviation and Reduction program from 2001 to 2008 helped spread cultivation for export of yellow sweet onions, artichokes, and avocados, which today account for more than \$150 million of annual export earnings. Onion exports alone, at \$25 million per year, have been especially helpful in improving the incomes of small farmers in upland areas.

Anyone trained in the workings of the free market would be inclined—by the sheer scale of this success—to believe that these developments would have happened sooner or later even without USAID's intervention. The Ica Farmers Association was

a capable, entrepreneurial partner, and Peru had been investing for years in agriculture research, extension, and postharvest handling. In addition, many other factors contributed to the outsized success of these efforts, including private investments in cold chain handling and transport and assistance from Peru's export promotion agency. But the Ica farmers recognized that support from USAID was there when they were first searching for a way to improve their incomes, providing an ideal opportunity for USAID to play a catalytic role in stimulating an innovation that has continued to grow by virtue of its own success.

## PRIVATE SECTOR DEVELOPMENT AT THE MICRO LEVEL

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Although this review has focused on examples where USAID's economic growth programs have had transformational effects benefiting large numbers of people or even entire economies, the review would be incomplete without one example of a transformational benefit at the microeconomic level. In many countries, USAID works directly with groups of private firms or private sector associations to improve competitiveness or create new business opportunities. These projects are like venture capital operations in that some interventions have a huge long-term payoff while others have only modest effects or no lasting effect.

In 2006, as part of a celebration of 50 years of partnership with Sri Lanka, USAID commissioned a retrospective look at selected small and medium enterprises that had received USAID assistance in the past. The goal of the study was to feature a few outstanding successes with roots in smaller towns outside the main urban centers of Colombo and Kandy. One interviewee was Violet Pinto, a mother of two living in the village of Chilaw who supported her family by raising chicks for sale to a local poultry processing operation, Maxie's & Company (Pvt) Ltd. Ms. Pinto was one of more than 2,000 small farmers whose livelihoods in 2006 were linked to assistance that USAID provided to Maxie's more than a decade earlier (Van Steenwyk 2006).

In 1994, when Maxie's had fewer than 100 workers, the owner, Maxie Perera, got in touch with USAID's Agro-Enterprise Development project (AgEnt), which was designed to encourage agricultural-based entrepreneurs. AgEnt provided Mr. Perera with technical advice and grants totaling \$58,000, which he partially matched to fund a study trip to the United States to visit poultry processing plants and purchase new machin-

ery. The training and investment launched a growth spurt. By 2006 Maxie's had 550 full-time employees, a fleet of 89 trucks, \$7.5 million in annual revenue, and a network of more than 500 families—including Ms. Pinto's—who raised chicks and broilers for Maxie's.

AgEnt primarily provided technical assistance to firms like Maxie's but also helped groups of firms and business associations advocate for business environment reforms. The project's cost-share grant component totaled \$1 million, with a selection process favoring proposals with a strong potential for a catalytic development impact. Many of the grants were successful and generated second-round benefits. In the long term, the grant to Maxie's, by itself, generated income gains to the entrepreneur, his workers, and the small farmers who raise his chickens that greatly exceeded the total cost of USAID-funded grants over the eight-year period from 1992 to 2000. And these benefits will continue to grow into the foreseeable future.

Could Maxie's have realized the same success without USAID support? Possibly. But according to Mr. Perera and other Sri Lankans who know his story, the advice and grants that he received from USAID played a cardinal role in his success after 1994. They also recognize a more subtle benefit: Mr. Parera's visible success, starting from a humble background, helps to change the traditional mindset in Sri Lanka, which regards business success as some-

thing that can be achieved only by the wealthy and privileged, and a government job as the aspiration path for everyone else. Even a small contribution to changing attitudes about entrepreneurship and private sector development can be a valuable (though unmeasurable) benefit of an economic growth project.

## CONCLUDING REMARKS

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The examples presented here were selected to show that economic growth programs can deliver enormous long-term benefits, particularly when USAID is working with effective and committed local champions in the government or the private sector. These cases also show that the full benefits of USAID support may be fully apparent only from a long-term perspective.

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Not every initiative succeeds, of course. The example from Zambia is a particularly well-documented case where USAID offered technical support for policy reform to a regime that was not serious about implementing reforms and that backed down in the face of political resistance. Even problematic programs, however, offer valuable lessons. To maximize the development effectiveness of successes and failures alike, USAID needs to strengthen program evaluations—including longer-term retrospective studies—and develop more effective institutional learning systems that feed back into future program designs.

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