

Economic Growth as a Goal of U.S. Foreign Assistance

The basic purpose of development assistance is to help partner countries prosper and ultimately exit from reliance on donor support. This requires growth. Programs to foster growth also contribute to improving food security, empowering women, reducing conflict risk, supporting postconflict recovery, and enhancing individual freedom and dignity.

This note introduces the Programming for Growth series by reviewing the long-established role of economic growth (EG) as a goal of U.S. foreign assistance policy, and the reasons for this emphasis on growth. The note then explains the purpose of the series, and closes with a summary of recent foreign assistance funding trends.

Other notes in the series discuss the benefits of growth and the determinants of growth and demonstrate that well-designed EG interventions yield high returns and strong development outcomes in support of U.S. national interests. Indeed, even relatively low-cost EG interventions can be “game changers” that advance economic and human development by broadening opportunities for private initiative to flourish, while enhancing the capacity of partner governments to self-finance essential public services, including health care and education.

The series focuses on USAID programs that are designed to improve the business environment, strengthen economic governance, reform fiscal systems, strengthen trade capacity, develop

financial systems, support private sector development, and build workforce skills.

ECONOMIC GROWTH IN U.S. FOREIGN ASSISTANCE POLICY

Programs to spur economic growth have been a central feature of U.S. foreign assistance policy since the Marshall Plan in 1948 for postwar recovery in Europe, and President Truman’s Point Four program in 1949, which broadened the vision for U.S. foreign assistance to include alleviation of the suffering of the world’s poor.

These early initiatives were formalized in the Foreign Assistance Act of 1961, which established five goals for U.S. development cooperation. Two of them—“promotion of conditions enabling developing countries to achieve self-sustaining economic growth with equitable distribution of benefits,” and “integration of the developing countries into an open and equitable international economic system”—are direct calls for EG programming. In addition, EG programs are vital instruments for achieving a

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.

third Foreign Assistance Act goal of “alleviating the worst material symptoms of poverty.” (Today the aid community pursues a more ambitious goal of reducing or ending extreme poverty rather than just alleviating its symptoms—a shift reflecting the success of many countries in reducing poverty through economic growth over the past 50 years.)

In 2006, the State Department and USAID adopted the current Foreign Assistance (“F”) Framework, which designates economic growth as one of five priorities. In 2007, a Congressional Commission on Helping to Enhance the Livelihood of People around the Globe (the HELP Commission) reported the results of a thorough evaluation of U.S. foreign assistance programs. One consensus conclusion was that “U. S. assistance programs must help countries create the economic foundation for growth.” And in 2008, USAID produced its *Economic Growth Strategy: Securing the Future*, explaining how improved economic policies and institutions advance not just economic development goals but also the vital U.S. security interests and American values of liberty and democracy.

Most recently, the 2010 National Security Strategy addresses global challenges of the 21st century in the context of enduring American interests and values. According to the strategy, “development is a strategic, economic, and moral imperative” (15), because of the vital links between prosperity, security, political progress, and human rights around the world. The strategy also points out that our own children and grandchildren will lead better lives “if other peoples’ children and grandchildren can live in freedom and prosperity” (3).

WHY IS ECONOMIC GROWTH A STRATEGIC GOAL?

When USAID pursues programs that are designed to improve economic indicators such as income, exports, tax revenue, access to credit, or the business environment, the underlying purpose is always to enhance social welfare, expand opportunities, and improve living standards *for the people*—especially the poor. The vision is that economic reforms *do* matter for human welfare, often hugely, even though the effects may operate indirectly and with a lag. In essence, economic policies and institutions are the instruments, not ends.

To explain the importance of economic growth as a goal of U.S. foreign assistance policy, and the value of EG programming as a pillar for USAID, the Programming for Growth series will

examine a variety of evidence relating to the following chain of premises:

- Sustained economic growth is the main engine for reducing poverty and advancing human development, and an essential condition for expanding government capacity to provide better public services to more people.
- Economic growth contributes simultaneously to other goals of U.S. foreign policy, such as improving food security, empowering women, reducing conflict risk, supporting postconflict recovery, and enhancing economic and individual freedom.
- Sound economic policies and institutions are the foundation for rapid and sustainable growth. Economic growth is a cumulative result of innumerable decisions by entrepreneurs and families, involving investment, schooling, health, innovation, productivity gains, and resource allocation. These decisions are heavily influenced by the quality of policies and institutions.
- EG interventions that are tailored to local conditions and priorities can be highly effective in improving economic policies and institutions; such reforms can have catalytic effects and produce strong outcomes, often at a relatively low cost.
- USAID’s EG programs in many countries have improved economic policies and institutions, stimulated private sector development, and yielded high returns on the aid dollar.

This chain of premises leads to the conclusion that economic growth must remain a fundamental goal of U.S. foreign assistance and that EG programs merit high priority in the balance of aid activities.

THE PURPOSE OF THE PROGRAMMING FOR GROWTH SERIES

The main purpose of the Programming for Growth series is to explain the value and effectiveness of USAID’s economic growth programs. This requires treading carefully around a number of pitfalls inherent in the development process, including

- Country heterogeneity, which defies generalization or uniform prescriptions for stimulating broad-based growth;
- Data deficiency in many low-income countries, including the poor quality of basic statistics such as gross domestic product (GDP) and inadequate data on important indicators such as poverty and employment;
- Technical weakness in the statistical methods used to explore the determinants of growth, and uncertainty about

which policies or interventions will work in a particular context;

- Benefits that are indirect, diffuse or difficult to quantify, especially for programs involving policy reforms and institutional capacity building;
- Outcomes that cannot be measured within the project cycle because they involve market responses or institutional changes that may take more than a few years to play out;
- Difficulty in attributing outcomes to USAID interventions, given the shared contribution of host-country governments and other agents, as well as the effect of factors beyond USAID's control;
- A history in most donor agencies (including USAID) of relying on "soft" evaluation methods that do not provide a meaningful gauge of development impact.

The Programming for Growth series acknowledges these problems and the uncertainties involved in developing successful EG programs. The focus, however, is on the importance and effectiveness of these programs. For example, Briefing Note 8 explains the difficulties involved in quantifying the economic impact of EG activities, while highlighting examples in which the impact *can* be identified, quantified, and attributed to USAID intervention.

A second purpose of the series is to draw operational implications for improving the effectiveness of USAID's EG programs in spurring rapid and broad-based growth.¹ A key point here is that USAID's support for EG programs in virtually every partner country is minuscule relative to the size of the local economy. Hence, the effectiveness of these programs hinges on identifying and supporting transformative interventions to spur growth by strengthening economic governance, stimulating private investment, increasing productivity, expanding linkages to the global economy, and demonstrating the value of various reforms and innovations. Even small gains in growth from such programs produce large cumulative benefits over time (Harberger 2005).

EG PROGRAMS IN THE FOREIGN AID BUDGET

Despite the long-standing mandate for economic growth as a goal of foreign assistance, there has been a lack of consen-

sus for many years on the value of EG programs, and funding in this area has been "largely a residual after other demands have been met" through earmarks for certain sectors and countries (USAID 2008, 21). In 2004, Congress took an important step to increase the resources for EG programs and rectify the lack of programming flexibility by establishing the Millennium Challenge Corporation (MCC) with the mandate to fight global poverty through economic growth. The MCC also created an innovative approach to supporting client-driven "compacts" in relatively well-governed developing countries. In addition, the MCC funds smaller programs in countries on the threshold of qualifying for compacts; these programs are implemented through USAID.

Most USAID partner countries, however, do not qualify for MCC compacts. Furthermore, the MCC compact process has favored particular types of investment, mainly in infrastructure. Hence, there remains a strong need for USAID's approach to economic growth programs that concentrate on improving the policy environment, strengthening institutions to support efficient markets, and facilitating trade and private sector development—especially in countries without MCC compacts. USAID's long-term presence and local expertise in each country are indispensable resources for working with local partners to identify, design, and implement programs to overcome key constraints on growth.

Recent trends in the budget for foreign assistance show that funding for the Development Assistance account fell from 11 percent of (nonmilitary) overseas loans and grants in 2000 to just over 5 percent in 2008, before rising to 8 percent in 2009. Because of earmarks, less than 4 percent of the funding for overseas loans and grants in 2009 was available to USAID for flexible programming for development assistance. The MCC

budget for 2009 amounted to less than 4 percent of the overseas loans and grants, down from 12.5 percent in 2008. Box 1 summarizes these trends.

Viewing budget allocations through the "F" Framework lens, the strategic goal of Promoting Economic Growth and Prosperity attracted 26 percent of the total funding in 2006 (the first year for this breakdown), before falling to 18 percent in 2009. The decline has been especially sharp for private sector development, including trade

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BOX 1

EG Budget Trends, 2000–2009

Figure 1 shows trends in foreign assistance funding since 2000. Funding for the Development Assistance (DA) and Economic Support Fund (ESF) accounts amounted to 35 percent of nonmilitary overseas loans and grants in 2000 and fell to 23 percent in 2005. The funding then rose to 37 percent in 2009, mainly because of strategic earmarks for aid to Iraq, Pakistan, and Afghanistan. The proportion of funding going to the DA account declined for most of the period, falling to just over 5 percent by 2008, before rising to 8 percent in 2009.

The use of DA and ESF funds has been tightly constrained by earmarks. Of \$1.7 billion appropriated in fiscal 2009 for the DA account, more than \$1 billion—or 59 percent—was subject to legislative restriction (U.S. Congress 2008). The ESF

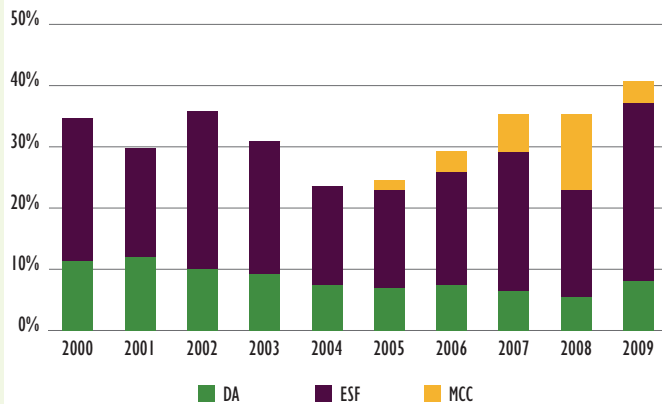
constraints involved earmarks for strategic partner countries. Their purpose is to align foreign assistance funding with security and diplomatic concerns or political priorities, but they also diminish the development impact of U.S. foreign aid by limiting the scope for allocating funds to the most effective uses.

Fiscal 2005 was the first year of funding for the MCC. By 2008, the MCC appropriation accounted for one-eighth of overseas loans and grants funding (excluding military and peacekeeping). This fell to 3.6 percent in 2009. Unlike most accounts, MCC funds are available “until expended.” Actual outlays, however, have been slow to materialize because of the nature of the compact process.

Figure 2 provides a more detailed look at funding for EG activities, in relation to total foreign operations covered by the “F” Framework, excluding activities under the Peace and Security objective. In 2006, EG funding amounted to 26 percent of this adjusted total. By 2008 the EG share was down by more than one-third, to 17 percent of the total. The decline was especially steep in program areas related to the business environment—precisely the areas cited as most productive in USAID’s Economic Growth Strategy. The combined funding for macroeconomic foundations, trade and investment, the financial sector, private sector competitiveness, and economic opportunity fell from more than 14 percent of the foreign operations budget in 2006 to just over 8 percent in 2009.

FIGURE 1

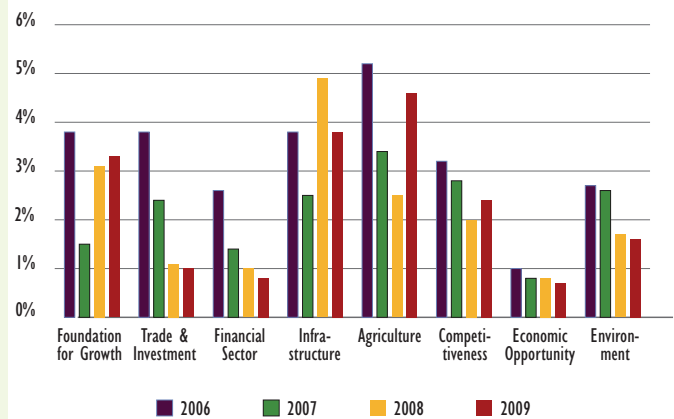
Allocation of Foreign Operations Budget to DA, ESF, and MCC Accounts, Excluding Peace and Security, 2000–2009



Green book 2008, Executive Budget Summary 2011

FIGURE 2

Economic Growth Funding: % Total Foreign Assistance by “F” Program Area, Excluding Peace and Security, 2006–2009



and investment, financial sector development, and competitiveness.

The decline in the share of funding going to USAID for EG programs reflects the high value given to competing aid priorities in areas like health, education, food security, democracy and human rights, empowerment of women and girls, and humanitarian assistance, as well as funding for the MCC. Programs that

deliver direct benefits for the poor have several advantages in the competition for resources. First, they have more political appeal than EG activities that generate welfare gains broadly and indirectly—even if these indirect benefits may ultimately be larger and more sustainable. Second, donors need to show results, and for many economic reforms the major benefits are not easy to measure within the project cycle. Third, the number of economists within USAID has declined sharply since the

1980s, which has eroded institutional knowledge about the role of EG interventions. And fourth, there is an ongoing debate among development specialists about the design and effectiveness of EG programs. (This issue is discussed more fully in Briefing Note 4.)

These considerations suggest that the foreign assistance program in recent years has not adequately taken into account the importance of economic growth programs in strengthening incentives for income and wealth creation, creating broad opportunities for improving living standards, and enhancing the capacity of partner governments to deliver essential public services from their own resources.

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NOTE

1. USAID (2007) provides a more detailed review of lessons for improving the design of EG programs. In addition, USAID (2008) sets out principles and approaches for promoting rapid, sustained, and broad-based growth.

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The Programming for Growth briefing note series was produced by Nathan Associates Inc. for review by USAID under the Country Analytic Support Project (CAS II).