

The Programming for Growth Series—Overview

“We want a better future for our children and grandchildren, and we believe that their lives will be better if other peoples’ children and grandchildren can live in freedom and prosperity.”—*National Security Strategy, May 2010.*

The underlying purpose of development assistance is to help partner countries develop. This means creating conditions in which the people can prosper; the poor can rise above their grim struggle for survival, and the governments can stand on their own in providing essential services, including education and health care, to all citizens without further reliance on foreign aid. All of which requires economic growth.

But does growth always benefit the poor and the disadvantaged? What do we know about how to foster sustainable and inclusive growth? What evidence do we have about the effectiveness of USAID’s economic growth (EG) programs, in the context of U.S. foreign assistance objectives? The Programming for Growth series addresses these questions based on a review of the literature and dozens of EG program documents, taking into account related controversies and weaknesses in the empirical evidence. The main conclusions are as follows:

- **EG programs are vitally important.** Sustained growth is the most powerful engine for reducing poverty and advancing human development—especially when public policies and investments promote a pattern of growth that is broadly based and inclusive. Economic growth also plays a major role in improving food security, reducing conflict risk, and enhancing economic and personal freedom. EG programs that are tailored to local conditions and priorities can be highly effective in fostering growth and enhancing living standards.

- **USAID’s EG programs have been highly successful.** There is compelling evidence showing that USAID’s EG programs have improved key policies and institutions, stimulated private sector development, and spurred broad-based development in many countries—benefiting millions of people, and yielding high returns on the aid dollar.
- **USAID needs to strongly support programs that promote inclusive growth.** A strategy that balances strong support for EG programs along with programs that aid the poor directly can have the greatest impact on poverty and well being.
- **USAID needs to adopt more systematic and rigorous approaches to data collection and program evaluation.** Although program documents provide valuable evidence on program effectiveness, USAID needs better mechanisms for data collection and knowledge management to strengthen institutional learning to improve program design.

WHAT’S AT STAKE?

Rapid economic growth can transform living standards within a single lifetime. Even moderate growth has enormous cumulative effects on social well-being over time. And without growth, the disadvantaged people in poor countries will continue to languish in poverty.

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.

The difference between being richer and poorer was tragically demonstrated in January 2010 when a major earthquake devastated Haiti and killed hundreds of thousands of people, while a far more powerful quake in Chile caused much less damage and loss of life. One reason for the stark disparity in outcomes was that Chile had the wealth and capability to enforce construction standards; Haiti did not. Even before the earthquakes, every indicator of well-being reflected the enormous disparity in their respective levels of income.

But what accounts for the huge difference in living standards? The simple answer is different long-term rates of growth. Over the past 60 years per capita income in Chile nearly quadrupled, while in Haiti it fell. The power of compound growth—and the consequence of its absence—can be seen all over the world.

- In 1960 incomes in South Korea were only marginally higher than in Haiti, and lower than in Ghana. By 2003, incomes in South Korea had increased 12-fold, transforming a poor and rural society into an advanced economy with outstanding performance in education, health, and technology. USAID played an important role in this process, through training, technical assistance, and support for institutional capacity building.
- In 1970, average income in Zambia was higher than in Indonesia. Indonesia then pursued pro-growth policies—with substantial USAID support—while Zambia took a path that deterred investment, lowered productivity, and bred macro-economic instability. By the mid-2000s the income gap was decisively reversed (Figure 1). Along the way, the poverty rate in Indonesia fell to 17 percent, compared to 68 percent in Zambia.

More generally, gains in per capita income (PCI) are strongly associated with declines in extreme poverty (Figure 2). Poverty rates are also affected by country-specific conditions and policies that affect inequality or provide support for disadvantaged citizens. But even a large redistribution of income in a poor country would just leave everyone with low income. Hence, economic growth is the primary route for achieving a deep and lasting reduction in poverty.

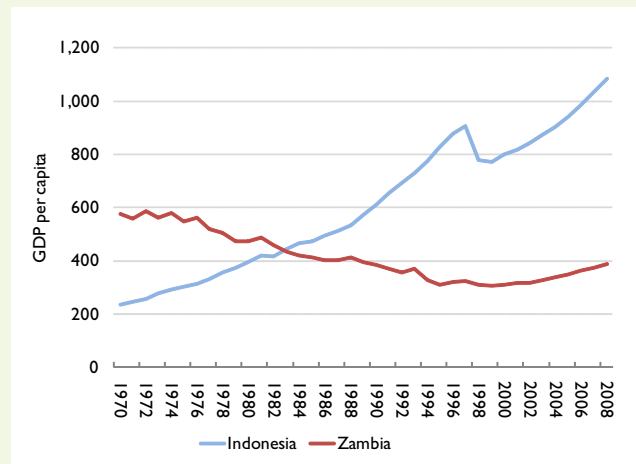
Per capita income is also strongly associated with other indicators of human development, including health, education, and

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gender equity. This is no surprise: a country with a stronger economy has the means to provide more and better education, health care, and infrastructure, and the scope to offer better opportunities for individual advancement, especially for women, who bear the greatest burden of severe poverty. Beyond the statistics, economic growth also brings “the dignity that comes with the opportunity to pursue a better life” (White House 2010, 35).

FIGURE 1

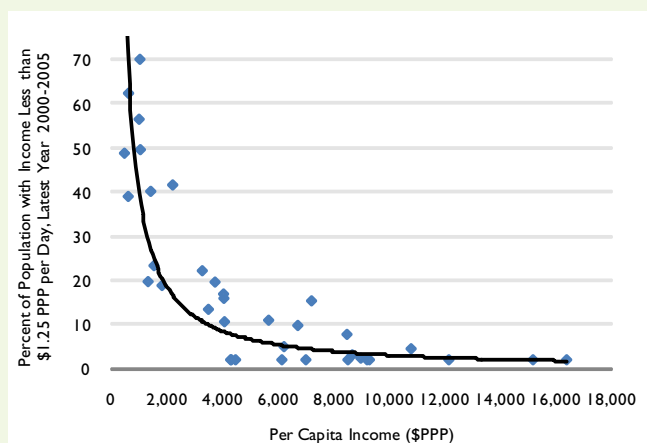
Income Growth Trends in Zambia and Indonesia, 1970–2008 (constant 2000 US\$)



Source: World Development Indicators. Income is measured in terms of GDP.

FIGURE 2

Poverty and Per Capita Income in Developing Countries, 2005



Source: World Development Indicators, 2010 and author's calculations. Income is measured in terms of GDP.

As Amartya Sen (1999) observed, growth is a precondition for full human freedom, expanding individual choice and opportunity for self-realization. Growth also promotes political freedom and tolerance, while economic stagnation breeds dictatorship and violence (Friedman 2005).

In sum, economic growth is central to improving the lives of hundreds of millions of people and offering better opportunities for their children and grandchildren. The many cases of success show that this can happen. And if it can happen, it should be made to happen.

HOW DO ECONOMIC GROWTH PROGRAMS SERVE U.S. INTERESTS?

Programs to foster growth have been a central feature of U.S. foreign assistance policy since the Marshall Plan in 1948 for postwar recovery in Europe. The Foreign Assistance Act of 1961 formalized this emphasis, as two of its goals—“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. EG programs are also vital instruments for achieving the goal of “alleviating the worst material symptoms of poverty.”

President Obama’s National Security Strategy (NSS) cites the need to address economic deficits in fragile states and promote prosperity throughout the world as a matter of national security. The NSS also recognizes the links between development and political progress, as well as links between world prosperity and our own quality of life. Finally, the NSS identifies economic opportunity as a human right. For these reasons, development is a “strategic, economic and moral imperative for the United States” (White House 2010, 3).

IS THERE A RECIPE FOR GROWTH?

Given that economic growth is the source of prosperity and opportunity, we are left with the operational question: How do countries achieve rapid, broad-based and sustainable growth? How has China succeeded in lifting hundreds of millions of its citizens out of poverty in just a quarter century? How did Chile become the most prosperous nation in Latin America? How did

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Indonesia reduce the incidence of severe poverty to 17 percent by 2004?

Decades of empirical studies have not identified specific reforms that explain differences in growth performance across countries. Some observers conclude that we do not know enough to devise effective policies to promote rapid growth (Easterly 2009). Yet everyone knows of cases where reforms triggered strong growth, including in Korea, China, Mauritius, Chile, and Indonesia, as well as cases where policy reversals led to economic collapse, most notably in Zimbabwe. This suggests that the absence of clear empirical results is simply telling us that no single recipe can be applied to different contexts. Each country’s economic structure, political currents, culture, and history matter in determining the appropriate approaches.

There is broad agreement, though, that private initiative is the primary engine of growth and that major obstacles to growth include policies and institutions that hobble transactions, discourage investments that generate productive employment, and impede private sector development. The decisions by entrepreneurs and families to accumulate skills and wealth and increase productivity are heavily influenced by prevailing policies and institutions. Hence, strategic policy reforms and institutional innovations are essential for improving growth performance. These principles are the core of USAID’s *Securing the Future: A Strategy for Economic Growth* (2008).

According to an international Commission on Growth and Development, all of the economies that managed to sustain rapid growth for at least 25 years since 1950 shared five “striking points of resemblance” (Spence 2008, 21), most notably a credible, capable government committed to development. High-growth economies also exploited global opportunities, maintained macroeconomic stability, achieved high rates of saving and investment, and largely let markets allocate resources. The commission also found that successful growth programs are context specific and that the “art of policymaking” requires a process for determining priorities and approaches that are most appropriate for a given country and a particular time frame.

HOW DO ECONOMIC GROWTH PROGRAMS IMPROVE FOOD SECURITY?

Food security in poor countries became a leading concern for governments around the world following the spike in staple food prices in 2008, when formerly plentiful supplies seemed to evaporate relative to global consumption. In response, a major focus of the president's global hunger and food security initiative, Feed the Future, is to expand food supplies through support to agriculture and food value chains via country-led strategies. But food insecurity also occurs when people are simply too poor to afford food. For this reason, the accepted definition of food security includes not only physical access but also economic access to essential food supplies. Within this framework, EG programs have an important role to play on both the demand and supply sides of the market.

EG programs have contributed greatly to food security by helping countries reform food sector governance. Bangladesh, Indonesia, and Egypt, for example, were once highly food insecure; in all three cases USAID was instrumental in promoting food sector reforms that improved food security for millions of poor families. This was achieved through capacity building for agriculture policy analysis, market liberalization to expand the role of the private sector, the removal of subsidies that created market inefficiencies and inequities, and the introduction of a cost-effective food-for-education safety net program targeting the poor.

Other USAID programs contribute to household food security indirectly by helping partner countries improve macroeconomic management, facilitate trade, reform the business environment, and enhance competitiveness, as well as expand employment, develop workforce skills, and provide more opportunities for micro, small, and medium-sized enterprises. In Cambodia, USAID has worked with the garment industry to raise productivity in an intensely competitive global industry in order to retain jobs that are the source of food security for more than a million people. In Guatemala and Rwanda, after the resolution of destructive conflicts, USAID programs stimulated agribusiness and new markets for agricultural products, generating income gains that improved food security for tens of thousands of small farmers and agricultural workers and their families. And in

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West Africa, USAID is helping to develop regional approaches to market access, agricultural policy, and transportation logistics; similar approaches in East Africa, Southern Africa, and Southeast Asia are also contributing to food security. In short, USAID programs to foster inclusive economic growth can have enormous benefits in linking people and food, for present and future generations.

HOW DO ECONOMIC GROWTH PROGRAMS REDUCE CONFLICT RISK?

One-third of all nations have experienced civil wars over the past half-century, and poor economic conditions have been a major contributing factor (Blattman and Miguel 2010). Hence, programs to spur economic progress can be an essential instrument for postconflict stabilization and the avoidance of conflict in fragile states. As the president's 2010 National Security Strategy says,

To advance our common security, we must address the underlying political and economic deficits that foster instability, enable radicalization and extremism, and ultimately undermine the ability of governments to manage threats within their borders and to be our partners in addressing common challenges. (White House 2010, 26).

In the wake of a destructive conflict, the restoration of opportunities for income generation is a paramount concern. USAID's *Guide to Economic Growth in Post-Conflict Countries* (2009) explains that the top priorities are first, to prevent a return to violence, and second, to establish a functioning government and other requirements for stimulating private sector development as the main engine for income generation and job creation.

Because it can take time for the private sector to recover from war, USAID has pursued interim employment programs as an urgent need in many postconflict settings. In Nepal, a cash-for-work program created income for poor communities and sup-

ported rural road construction; in Liberia, USAID-assisted community development programs supported local road and bridge work, school renovations, agriculture and agribusiness developments, health center rehabilitation, and sanitation and drainage improvements; in the Mindanao region of the Philippines, USAID supported the 1996 peace agreement by helping ex-combatants return to farming.

Concerted efforts are also needed to strengthen and modernize basic institutions for economic governance, particularly in areas of macroeconomic stabilization and revenue generation. The challenge can be huge because of a lack of skilled cadres and dysfunctional organizations in a postconflict situation. In Iraq, USAID not only supported the transformation of public financial management, it also helped to reform one of the most important and costly social welfare programs—the pension system. In Afghanistan, USAID and the U.S. Treasury were instrumental in introducing a new national currency and building capacity at the central bank. In Liberia, international advisers helped to boost state revenue, control expenditure, and streamline customs procedures to facilitate trade. In Sierra Leone, USAID helped to convert “blood” diamonds into development diamonds by establishing a program to channel a portion of diamond revenue to community projects. And in Kosovo, USAID worked with other agencies to build the revenue system from scratch.

Private sector development is a core element of EG programming in any context, but it is especially important in postconflict settings. In Iraq, for example, USAID has established a network of small business development centers to provide local entrepreneurs with training, information services, consulting services, and trade fairs. USAID has also worked with local institutions to expand access to finance for micro, small, and medium enterprises. And in East Timor, assistance to the Timor Coffee Cooperative helped to jump-start the expansion of the coffee industry, improving the well-being of thousands of poor families.

HOW DO WE KNOW THAT EG PROGRAMS ARE EFFECTIVE?

USAID project documents and evaluation reports provide compelling evidence that EG programs in many countries have produced impressive development outcomes. Even low-cost interventions have been catalytic game changers that improve economic governance, broaden opportunities for private initiative to flourish, increase incomes for large numbers of families, and enhance the capacity of partner governments to mobilize sustainable resources for essential public services, including health and education, particularly for women and girls.

To be sure, not all EG programs are successful. This is to be expected given the complexity of the development process and the influence of factors beyond USAID control. The overall effectiveness of the EG portfolio is hard to assess because of limitations on data quality, consistency, and availability, and inherent problems in quantifying the impact of programs with benefits that are indirect and spread across many sectors, especially interventions involving policy reform or institutional development. But the absence of full evidence does not imply the absence of effectiveness. On the contrary, there is an abundance of information showing that EG programs can be highly effective—and the stakes are too high not to pursue these programs vigorously.

Impact Evaluation

Some EG projects have compiled sufficient data to support economic impact evaluation for at least a subset of activities—most often for private sector development projects with readily measurable outcomes and well-defined beneficiaries. In Peru, for example, an agribusiness project attracted new investment along corridors to impoverished regions and created new markets for farm products. By a conservative estimate, this project component produced \$1.14 in net income gain for poor farmers and farm workers for every \$1 of total project cost. (Any benefit-cost ratio above 1.0 shows that an investment is worthwhile.)

This estimate clearly understates the full benefit because the analysis covered just one component of the program and excluded spill-over benefits for other farmers and businesses. Another private sector development project in Pakistan worked with the dairy sector to establish a strategic plan that increased farm productivity by 50 percent and expanded fresh milk supply by 500,000 liters per day. An impact assessment found that businesses, workers, and farm families gained \$19 for each \$1 of total project costs. Here, too, the analysis was based on conservative assumptions, and the benefit estimate covered only one of several project components.

Similar methods can sometimes be applied to EG programs supporting business environment reform. An analysis of a trade and investment program in Mozambique examined five activities that led to measurable impacts, including reduced time to register a business, lower scanning fees for shipping containers, and suspension of a costly banking regulation affecting trade

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transactions. This subset of program activities generated \$6 in income gains to Mozambican businesses for every \$1 of total project costs. A program in Georgia produced even more impressive results by helping a reformist government introduce sweeping changes in the business environment. Impact estimates for just three project elements, including a sharp reduction in the time and cost of clearing goods through customs, showed that the Georgian economy gained more than \$18 of net benefits per \$1 of total project cost.

Programs involving policy reform and institutional capacity building may have the greatest impact of all because the benefits accrue to businesses, workers, and families throughout the country. By the same token, the impact of these programs is most difficult to measure. In some cases, though, an impact estimate can be obtained for particular project components. For example, USAID support for tax reform in Bosnia and Herzegovina led to a rapid increase in government revenue and lowered the cost of tax collection. The latter element alone generated \$7 in net benefits to the economy for every \$1 of total program cost.

Few EG projects at USAID have been subjected to a serious impact evaluation, and hardly any have used rigorous evaluation methods. Hence, the examples cited here may not be representative of the overall EG portfolio. In the interest of accountability, impact evaluations should be conducted more widely and more rigorously, and more USAID officers should be trained to understand this analytical tool. Clearly though, well-designed EG programs, aligned with host-country ownership, can yield enormous benefits.

Intermediate Results

In the absence of an impact evaluation, intermediate results (IR) indicators are the main source of information on project performance. When IR indicators are clearly linked to expected impacts, they provide meaningful evidence of effectiveness. For a wide variety of EG programs, IR data demonstrate strong and sustainable development effects benefitting large numbers of people.

- In Ghana, an independent survey estimated that 260,000 small farmers benefited from a project that developed markets for improved seeds, fertilizers, and other inputs.
- In Pakistan, a private sector development project helped the dairy industry install more than 1,000 cooling tanks, benefiting more than 30,000 farmers and increasing fresh milk supplies by 500,000 liters per day.

- In Georgia, a business environment project reduced the time to register a business from 21 days to 3 days, facilitating the registration of 150,000 new businesses in four years.
- In the Philippines, an economic policy reform project was instrumental in supporting new regulations for voice-over-Internet-protocol services, resulting in an immediate 80 percent decline in the price of fixed-line international calls.
- In Colombia, a financial sector reform program supported ambitious regulatory reforms that led to the expansion of banking services to 362 urban areas and expanded the availability of microfinance to hundreds of thousands of clients.
- In Jordan, a program to develop the capital market enabled listed companies to raise more than \$6 billion in long-term financing for business expansion and job creation, also benefiting over 1 million Jordanian savers and investors.
- In El Salvador, a tax reform program increased revenue from 11 percent of GDP to 14 percent, with no increase in tax rates; one measure alone—automating calls to delinquent taxpayers—brought in 10,000 returns and saved \$2.5 million per year for the authorities.
- In Egypt, a program to strengthen policy management was instrumental in transforming trade policies; the average tariff rate fell from 30 percent to 7 percent, and the time required for imports to clear customs fell by nearly half.

There are also cases where the value of certain outputs is self evident, even when there is no measure of the IRs, outcomes, or impacts. Examples include USAID's involvement in creating Investor Roadmaps to help investors deal with bureaucratic requirements (while also casting a harsh light on regulatory constraints to investment), providing dozens of young black South Africans with graduate training in economics after the end of apartheid, and developing policy models to help central banks maintain macroeconomic stability, as in Indonesia.

Long-Term Benefits

Two hallmarks of successful development assistance are sustainability and broad impact. Famous examples include USAID support for the eradication of smallpox, the introduction of high-yielding wheat and rice varieties for the Green Revolution in Asia, and family planning and child survival programs that permanently reduced mortality rates and improved child welfare.

Successful EG programs, too, have had profound benefits that spread and grow over time. The most prominent example, noted above, was capacity building for economic management in Korea from the 1950s to the early 1970s; the ensuing reforms fueled a half-century of transformational growth. USAID assisted with similar capacity building efforts in many countries, including Taiwan, Indonesia, and Thailand, as well as Bolivia, El Salvador, and much of Africa (through support for the African Economic Research Consortium and bilateral programs).

In Vietnam, USAID programs led to enormous long-term benefits by helping highly committed leaders reform the legal system, in conjunction with entry into the World Trade Organization. Foreign direct investment more than quadrupled from an average of \$1.5 billion per year in the 1999–2001 period to \$6.5 billion in 2007, and exports rose from \$1 billion in 2001 to \$12 billion in 2009. The surge in investment and exports created hundreds of thousands of jobs. In Kazakhstan, USAID provided vital assistance for modernization of the financial sector. By 2009, capital market institutions supported \$26 billion in corporate finance for business expansion and job creation, up from zero a decade earlier. Emergence of the capital market also stimulated the rapid growth of private pension schemes, benefiting millions of families. As in Vietnam, these reforms fostered benefits measured in billions of dollars, a thousand times the project cost.

In some cases, the long-term benefits take the form of preventing crisis. Examples include support for fiscal reform in Jamaica in the 1980s, which helped to avert an economic collapse when the country was on track to becoming a failed state; monetary reforms in Afghanistan in 2002 that prevented a possible currency collapse and hyperinflation; and Indonesia's economic resilience during the recent global crisis, at least in part a result of years of USAID-supported training, capacity building, and advisory services.

USAID funding for EG programs is minuscule relative to needs. Hence programming has to be highly strategic and catalytic to have maximum impact. An ideal private sector development program is one that introduces a change that spreads spontaneously as entrepreneurs step in to take advantage of better policies and price incentives, new products, improved quality standards, new market linkages, new training or business-support services, or improved access

to financial services. For example, a project in Peru in the 1980s had enormous long-term effects by helping farmers break into the market for green asparagus. Peru is now the world's leading exporter of asparagus.

Profound long-term changes can also be seen through a microeconomic lens. In Sri Lanka, for example, technical advice and a matching grant helped a medium-size poultry business adopt new machinery in the mid-1990s. By 2006, the company had 550 employees and \$7.5 million in sales, with a network of more than 500 families supplying chicks and broilers.

These examples show that impacts are best viewed from a long-term perspective—and (again) that the benefits are often very large compared to project costs.

HOW DO ECONOMIC GROWTH OFFICERS GET RESULTS?

The examples cited above focused on results and outcomes from program implementation. But effective outcomes happen only when programs are carefully designed. Successful interventions have to be country-owned and country-tailored. USAID's economic growth officers and private sector development officers play a critical role behind the scenes, through collaboration with government officials and local stakeholders to diagnose constraints and design interventions that are responsive to local needs and priorities. They also work with project implementing teams to oversee and shape the delivery of services.

In many instances, USAID officers leverage their technical expertise and intimate knowledge of host-country conditions directly to influence the path of economic reforms through their ongoing discussions with local leaders. In South Africa, for example, the EG office conferred regularly with partners in government, academia, think tanks, and NGOs to discuss issues and analytical requirements; this dialogue fed into the selection of activities for USAID's policy support program, with major effects on important policy decisions. Similarly, in Bosnia's Republika Srpska, USAID dialogue with a new government in 2006 led to the identification of reform priorities and a shift in project activities to take advantage of emerging opportunities.

Impacts are best viewed from a long-term perspective—and the benefits are often very large compared to project costs.

In all respects, USAID's long-term presence in each country—combining the skills of foreign service nationals and expatriate foreign service officers, in collaboration with specialists from Washington—is a powerful asset for achieving effective development outcomes. The value of these assets could be greatly enhanced by more systematic data collection and program evaluation and better mechanisms for institutional learning to provide feedback on what works and what doesn't to improve program design. Nevertheless, the available evidence shows that USAID is well positioned to help partner countries achieve robust, inclusive and sustained growth.

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The Programming for Growth Series

Overview

Briefing Notes on Basic Issues

1. Economic growth as a goal of U.S. Foreign Assistance
2. The critical role of economic growth
3. Growth, poverty, and well-being
4. Reforming policies and institutions to foster economic growth
5. Measuring effectiveness to improve effectiveness

Briefing Notes on USAID's Economic Growth Programs, with Case Studies

6. Linking people and food: The role of economic growth programs in achieving food security
7. Postconflict programming for growth
8. Economic impact
9. Intermediate results
10. Benefits over the long term

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