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The Development Challenge

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The Development Challenge

Jeffrey D. Sachs

PROMISES, PROMISES

AS A MATTER of stated policy, there is no doubt that Washington is committed to supporting economic development in impoverished countries. In September 2000, it joined the UN in issuing the Millennium Declaration, in which the world pledged to cut extreme poverty in half and reduce child mortality by two-thirds within the next 15 years (aims later formalized as part of the Millennium Development Goals). In March 2002, the United States and the international community adopted the Monterrey Consensus, which laid out a multifaceted strategy to achieve these objectives by promoting the private sector in developing countries, opening trade with them, and increasing official development assistance (ODA). That year, the U.S. National Security Strategy promised to “secure public health,” “emphasize education,” and “continue to aid agricultural development” in low-income countries. “The United States and other developed countries,” the document asserted, “should set an ambitious and specific target: to double the size of the world’s poorest economies within a decade.”

Most Americans, and perhaps most senior U.S. government officials, believe that the United States has been following through on such commitments. The U.S. response, public and private, to December’s Indian Ocean tsunami has seemed to confirm the nation’s generous engagement with those in need. Ironically, though, this outpouring of concern may obscure rather than clarify a deeper truth. Other than

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in response to disasters—famines, floods, and earthquakes—U.S. assistance for the world's poorest countries is utterly inadequate. It falls far short of meeting the needs of recipient countries, fails to tap into the vast U.S. capacity for providing aid, does not fulfill Washington's many promises to fund development adequately, and is a small fraction of what Americans believe the U.S. actually provides.

Without a new approach, Washington risks undermining the most important international development goals that the world has accepted—and plunging the international community into a maelstrom of recrimination. Without dramatic reform, the United States will increasingly be tarred as a country ready to invest in war, and perhaps in emergency relief, but not in peaceful development. The number of failed states will increase, spreading disorder and threatening global and national security.

Only a new U.S. international development strategy can avoid this outcome by achieving the objectives set forth in the Millennium Declaration, the Monterrey Consensus, and the National Security Strategy. Embarking on a new, practical course of assistance will have short-term costs, but the long-term benefits will far outweigh them. Continued failure, on the other hand, will be far too expensive to bear.

THE DEVELOPMENT MIRAGE

THE DEVELOPMENT ASSISTANCE COMMITTEE (DAC) of the Organization for Economic Cooperation and Development defines official development assistance as the sum of grants and sub-market-rate loans made to developing countries to promote economic development and welfare. Military aid is not counted, nor is aid to high-income countries such as Israel. Even with these parameters, the DAC definition is too expansive to measure real assistance for economic development, but it nonetheless gives a systematic measure of U.S. foreign assistance.

By the DAC's definition, in 2003 (the most recent year for which comprehensive international data are available), the United States gave \$16.3 billion in net ODA. Of that amount, \$1.7 billion went to multi-lateral organizations such as the World Bank, which in turn grant or lend the money to developing countries. Washington distributed the remaining \$14.6 billion bilaterally, directly targeting recipient nations.

Together, the multilateral and bilateral aid represented 0.15 percent of the \$11 trillion gross national income (GNI) of the United States in 2003. In the 2004 U.S. budget—which totaled \$2.3 trillion—development assistance represented just 0.7 percent of budgetary expenditures.

These sums are vastly smaller than the American people think they are. In a 2001 survey, the Program on International Policy Attitudes (PIPA) at the University of Maryland found that Americans, on average, believe that foreign aid accounts for 20 percent of the federal budget, around 30 times the actual figure. PIPA surveys in the mid-1990s came up with essentially the same result.

Many Americans and senior government officials also mistakenly believe that private giving represents a substantial amount of U.S. aid to developing countries. *The Wall Street Journal* and others, citing an earlier study by the U.S. Agency for International Development (USAID), have even reported that private giving significantly exceeds official giving, but their estimates erroneously include \$18 billion in private remittances, which are not development aid but income transfers between family members in the United States and abroad. The

U.S. assistance for the world's poorest countries is utterly inadequate.

DAC estimates that U.S. assistance from private voluntary agencies in 2003 amounted to about \$6.3 billion. Even if one added to this figure a high-end estimate of \$4 billion in other giving from private foundations, corporate philanthropy, and other organizations, the sum of U.S. public and private financial contributions to international development would amount to around \$26.6 billion, or just 0.25 percent of GNI.

Not only are the figures for official development assistance themselves not nearly as large as most Americans believe, but the DAC's estimate of \$16 billion also overstates U.S. official aid for economic development by including a considerable amount of assistance that contributes little or nothing to long-term development. In a recent white paper, USAID makes the point by distinguishing between five operational goals for foreign aid: promoting transformational development, supporting strategic states, strengthening fragile states, providing humanitarian relief, and addressing global challenges such as the HIV/AIDS epidemic and climate change.

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All five operational goals make sense from a foreign policy standpoint, but only the first directly targets economic development. Aid intended for transformational development aims to support long-term economic change by helping a country achieve structural transformations that should allow it ultimately to escape dependence on outside aid. Assistance to strategic countries focuses on nations that have geopolitical importance, such as Colombia, Egypt, Iraq, and Afghanistan, and helps fight terrorism, strengthen alliances, or reduce narcotics trafficking. Aid to fragile states is designed to head off conflict or help countries recover from it. Lastly, humanitarian assistance is earmarked for relief following natural disasters and often takes the form of U.S. grain deliveries. A surprisingly small proportion of U.S. bilateral assistance is directed at transformational development, and only a small part of that actually transforms the economies of developing countries.

Washington's own aid accounting (as opposed to the DAC's) makes a key distinction between developmental assistance and geopolitical aid, which is distributed to strategic countries mostly as Economic Support Funds (ESF). In 2004, the ESF program provided \$3.3 billion to 42 countries. Economic development is a side effect, not a basic objective, of such aid. Strategic states—defined here as developing countries receiving more than half of their U.S. assistance from the ESF or similar funding (such as the Iraqi Relief and Reconstruction Fund, the Andean Counterdrug Initiative, and the Emergency Response Fund for Afghanistan)—include several countries in the Middle East, Asia, Europe, and Latin America.¹ These 16 countries, plus the West Bank and Gaza Strip, received about 45 percent of total U.S. bilateral assistance to developing countries in 2003, even though they accounted for only 11 percent of the population of developing countries receiving U.S. aid. Many of the strategic states are in fact middle-income countries that are not high development priorities. In many cases, ESF supports corruption or allows a government to reduce its own development spending to free up funds for its military.

¹ The states or territories classified as "strategic" by this definition are, by region, Egypt, Iraq, Jordan, Lebanon, West Bank/Gaza, and Yemen; Afghanistan, East Timor, Mongolia, Myanmar, Pakistan, and Sri Lanka; Turkey; Bolivia, Colombia, Ecuador, and Peru.

Meanwhile, according to the DAC database, very little of the \$6.1 billion the United States spent on bilateral assistance to “nonstrategic” developing countries in 2003 actually reached the ground as long-term investment in transformational development. For one thing, \$2 billion was distributed as emergency assistance or as non-emergency food aid. Emergency assistance, although salutary, merely addresses immediate crises. Food aid for non-emergency purposes, moreover, has enormously high transaction costs and distorts the local economy by depressing the prices local farmers receive for their goods. Amazingly, nearly half of the money spent on U.S. food aid in 2004 went to cover transport costs rather than the food itself.

In 2003, only \$4.1 billion in U.S. bilateral aid was not spent on strategic countries, food aid, or other emergency aid. Of that total, moreover, \$1.3 billion took the form of “debt forgiveness grants”—the cancellation of old debts, not the granting of new money. Furthermore, recipient countries saved even less than that amount in actual debt payments in 2003, because the cash-flow savings that year were only a small fraction of the debt that was erased from the books. In some countries, debt payments have actually risen thanks to debt cancellation. (After reaching agreements with creditor nations, countries that had previously been servicing none of their debt burden have had to resume payments on a smaller base.)

Of the remaining \$2.8 billion in 2003 U.S. bilateral aid, very little actually funded investments in transformational development. According to the DAC, the entire sum went toward technical cooperation: payments made primarily to U.S. entities—consultants from government agencies or nongovernmental organizations (NGOs)—for assignments in recipient nations. These missions may be useful, but the expenditures are not long-term investments in local clinics, schools, power plants, sanitation, or other infrastructure.

Washington gave very little money directly to nonstrategic developing countries to support specific investments in transformational development. Poor countries have proposed sound plans to build schools and clinics and pay the salaries of teachers and doctors, but the United States virtually never funds such programs directly, sending its own consultants instead. In doing so, Washington contributes to an unworkable proliferation of donor-country pet projects, rather than

to an integrated strategy adopted by the recipient country and supported by the donors. A balanced and judicious aid program would provide both technical cooperation and budgetary support to countries that could use the money effectively.

The case of sub-Saharan Africa—the poorest region of the world—shows how dangerously skewed U.S. aid priorities are. The prevailing image in the United States is that Washington gives Africa vast sums of money, which corrupt officials there then fritter away or stash in offshore accounts. But this image, fueled by inaccurate stereotypes, badly misconstrues the truth.

In fact, in 2003, the United States gave \$4.7 billion to sub-Saharan Africa in net bilateral ODA. Of that sum, \$0.2 billion went to a handful of middle-income countries, especially South Africa. Of the remaining \$4.5 billion, \$1.5 billion was apportioned for emergency aid and \$0.3 billion for non-emergency food aid. Another \$1.3 billion was designated for debt forgiveness grants, and \$1.4 billion went to technical assistance. This distribution left only \$118 million for U.S. in-country operations and direct support for programs run by African governments and communities—just 18 cents for each of the nearly 650 million people in low-income sub-Saharan Africa. This figure represents the total U.S. bilateral support, beyond aid in the form of technical cooperation, for investments in health, education, roads, power, water and sanitation, and democratic institutions in the region that year. The next time U.S. officials visit Africa and wonder aloud where the “trillions and trillions” of dollars went, they should be reminded of how small those trillions actually are.

Two recent U.S. initiatives will modestly improve the picture, but so far their impact remains very limited. Announced in 2002, the new Millennium Challenge Account (MCA) is designed to give grants to low-income countries that demonstrate good governance. For the current fiscal year, \$1.5 billion has been appropriated for the MCA, and in 2002 the Bush administration promised to request \$5 billion per year in 2006 and beyond. The MCA is a highly meritorious new approach. No funds, however, have yet been disbursed. The President’s Emergency

Washington’s aid to developing countries is vastly smaller than Americans think.

Plan for AIDS Relief (PEPFAR) is also budgeted to give an average of \$3 billion per year to certain African and Caribbean countries. In 2004, roughly \$2.4 billion was disbursed. This important initiative should be increased in scale significantly, with more of the funding disbursed with other donors through the Global Fund to Fight AIDS, Tuberculosis, and Malaria. Such an approach would better leverage U.S. funding and allow recipient countries to pursue a more integrated approach to fighting AIDS.

FLUNKING

TO EVALUATE AND IMPROVE the current U.S. foreign aid system, a three-prong test should be used: How much foreign assistance is needed and can be used effectively to achieve transformational development? What is the U.S. capacity to give? And—most important for the United States' international image—how does U.S. aid stack up against Washington's promises to poor countries?

The answer to the first question can be derived from careful studies conducted to determine the amount of worldwide ODA needed to achieve the goals of the Millennium Declaration. Most recently, the UN Millennium Project undertook the most extensive analysis of this question ever performed and determined that the developing world will require an additional \$70 billion in aid over current levels by 2006, rising to \$130 billion over current levels by 2015 (in constant U.S. dollars at 2003 prices). With these added funds, total projected aid in 2006 would represent 0.44 percent of total projected donor GNI that year, increasing to 0.54 percent in 2015. Assuming that all 22 DAC donor countries contribute an equal percentage of their national income and that the U.S. economy grows at an average of three percent a year, the \$16 billion contributed by Washington in 2003 would have to increase to \$51 billion in 2006 and to \$74 billion in 2015. Thus, even the full funding currently promised for the MCA and PEPFAR (\$5 billion and \$3 billion per year, respectively) would leave the United States far short of doing its part to help poor countries meet the Millennium Development Goals.

These calculations are based on a transparent and rigorous economic analysis (albeit one subject to uncertainty). The basic idea is straight-

forward. To achieve the Millennium Development Goals, each impoverished country must make specific, identifiable investments in health, education, and basic infrastructure such as roads, electricity, water, and sanitation. Of course, since these countries are impoverished, their own financial means are limited; most of their current income must be used simply to stay alive rather than to invest in the future. Thus, the poorest nations are caught in a poverty trap. They are poor because they lack the basic necessities of health, education, and infrastructure, and because they are poor, they cannot invest in these basic necessities on the scale necessary to achieve the Millennium Development Goals.

Development assistance can close this financing gap. In the typical African country, total investment needs are about \$110 per person per year. Assuming a substantial increase in domestic resource mobilization, around \$10 per person can be financed by local households, and another \$35 by governments in the low-income countries. The balance of \$65 per person is the financing gap that should be covered by donors. Global estimates of necessary ODA are reached by projecting this level of aid for all low-income countries in need, with some further adjustments.

Such an approach is built on the principles of private-sector-led, market-based economic growth. After all, private-sector-led growth depends on adequate infrastructure (roads, power, ports, water, and sanitation) and human capital (a healthy population with adequate levels of literacy, education, and job skills). Domestic and foreign investors will shun a developing country without those prerequisites.

The second standard—U.S. capacity to provide foreign assistance—is far from being fully realized. The small sums that Washington gives in ODA are driven by political considerations, not by economic need. To ensure that the Millennium Development Goals are met, the UN Millennium Project calls for ODA from each donor country to rise to at least 0.44 percent of GNI in 2006, and then to continue to increase to 0.54 percent of GNI by 2015. To meet needs beyond these goals—geopolitical and humanitarian needs, for example—the project recommends that each donor country actually reach 0.7 percent of GNI in development assistance by 2015.

These sums are small not only relative to GNI, but also relative to recent changes in the U.S. budget. Since 2001, defense spending has expanded by about 1.7 percent of GNI, and tax revenues have declined by 3.3 percent of GNI, due mainly to tax cuts. In the same period, U.S. official development aid rose by only 0.04 percent of GNI. The United States has, in short, chosen to spend its money on priorities other than development assistance, yet such assistance is just as fundamental to national security as the military. When ODA is measured as a share

Development aid is just as fundamental as military spending to U.S. national security.

of GNI, each of the other 21 donor countries contributes more than the United States, and most by a wide margin. The United States ranks second from last (slightly ahead of Italy) when NGO development assistance is added to ODA.

U.S. political leaders could mobilize public support for increased ODA. President George W. Bush's emergency AIDS program is enormously popular, and he is rightly proud of having launched the effort. Moreover, the public repeatedly supports the purposes of development assistance, especially when convinced that the money can be effectively used. Indeed, as mentioned earlier, Americans also believe that U.S. assistance is more than one order of magnitude greater than is really the case.

As for the final test of measuring U.S. development assistance against U.S. commitments, the enormous gap between promise and performance has been weighing heavily on Washington's foreign policy for many years. The U.S. political leadership repeatedly emphasizes that it is party to the Monterrey Consensus, and Bush traveled personally to Monterrey to make that case. Yet the administration has failed to follow through.

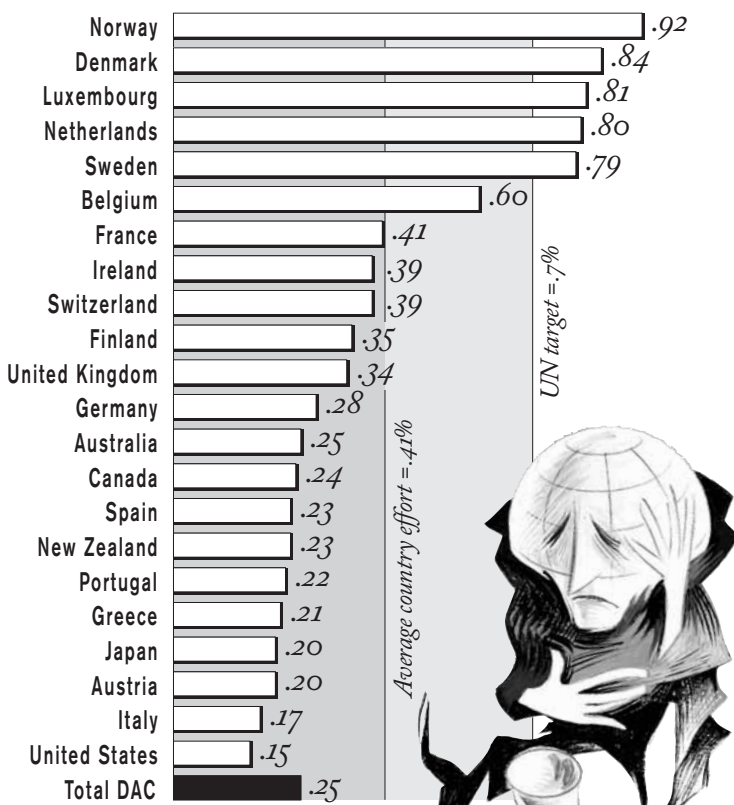
In paragraph 42 of the Monterrey Consensus, the signatories commit themselves to making "concrete efforts towards the target of 0.7 percent of gross national product" in official development aid, a commitment that dates back to a vote of the UN General Assembly in 1970. Although some U.S. government officials have long expressed resistance to that international target, the U.S. government has in fact repeatedly signed onto it, not only in Monterrey but on other occasions as well. Meanwhile, five countries—Denmark, Luxembourg, the Netherlands,

Norway, and Sweden—have already met the goal (and in fact did so many years ago). Six more countries have recently set a timetable to reach it before 2015: Belgium, Finland, France, Ireland, Spain, and the United Kingdom. This year, other countries are likely to join the pledge with specific schedules of their own. The gap between Washington and the other donors is growing.

Washington's palpable shortfall has become a pervasive source of friction in U.S. relations with low-income countries. The United States regularly asks these nations for help in the war on terrorism, only to plead its own "poverty" when asked for more development aid—even for areas such as health, education, and agriculture, which are focal points of Washington's national security doctrine. In one striking example, the United States contributed a meager \$4 million to Ethiopia in 2002 to raise its agricultural output—and then gave \$500 million in emergency food aid when famine predictably hit the country a year later. Low-income nations are painfully aware of the truth: the United States can be counted on to respond to emergencies, but not to help them break free of poverty.

Uncle Sam or Uncle Scrooge?

Net official development assistance to developing countries from donor countries as a percentage of gross national income in 2003*



* The 22 countries of the Development Assistance Committee (DAC) of the Organization for Economic Cooperation and Development.
SOURCE: OECD-DAC. "Final ODA Data for 2003," December 8-9, 2004.

MAKE OR BREAK

THE MILLENNIUM DEVELOPMENT GOALS were announced in 2000. Five years later, and with just a decade until the target date of 2015, dozens of the world's poorest and most desperate countries remain tragically off course—often well governed but too impoverished to make the investments in infrastructure and human capital necessary to meet the goals. And despite repeated commitments to help such nations free themselves from this poverty trap, the amounts of U.S. aid contributed continue to fall woefully short of what is needed. Privately, many U.S. officials around the world are wringing their hands.

Most of the world has recognized that 2005 is a make-or-break year. The United Kingdom has already charted a path to success, albeit one that the United States has still not embraced. The United Kingdom will chair both the EU and the G-8 group of highly industrialized nations plus Russia this year, and in its capacity as host of the G-8's July summit has promised to put development assistance at the center of the agenda. U.K. Chancellor of the Exchequer Gordon Brown has put on the table an important proposal for an International Finance Facility (IFF), backed by donor countries, to double development aid during the next decade. There is widespread European and developing-country support for the IFF. Yet, unwisely, the United States has not only given the proposal a cold shoulder but also failed to explain how the donor nations should otherwise meet the needs of the poorest countries.

In September, international leaders will convene on the millennium summit's fifth anniversary to take stock of the world's progress—or lack thereof—in meeting the Millennium Development Goals. They will also consider reforming the UN to support greater global security. The summit's participants must realize that the two agendas—development assistance and global security—are inexorably linked, not only in substance but in process. Countries such as Germany and Japan that aspire to permanent seats on an expanded Security Council will find that low-income states have aspirations of their own. The poorest nations will hold their wealthy counterparts accountable for what they have and have not done to enable the indigent to overcome early death, mass hunger, disease, and extreme poverty.

The United States itself faces a widely unappreciated risk: the risk of business as usual, with the world wanting to discuss development while Washington focuses on the war on terrorism. The emotional, geopolitical, and operational divide between the United States and the rest of the international community could very well widen markedly, and dangerously. If their life-and-death needs are not met, impoverished countries may be much more reluctant to support Washington and its many security concerns. The United States should not be complacent about the growing perception of this country as one that cares solely about itself, even to the neglect of its own pronouncements.

It is not too late to rectify this situation, but it is growing more critical by the day. By taking four fundamental steps, Washington can turn this crisis in international development into an opportunity for the United States to reassert its moral and political authority as a world leader.

First, President Bush and congressional leaders should explain to the American people that U.S. development assistance is far less than what they believe it to be—and far less than what is needed, affordable, and already promised by Washington. The government must explain that aid delivered to well-governed countries for well-targeted purposes—health care, schools, roads, power, sanitation—would not only save millions of lives each year but also help countries break free of the poverty trap that binds them. And Washington must explain that expanded aid is a bipartisan, indeed nonpartisan, cause that is crucial to U.S. national security because impoverished countries are vulnerable to becoming failed states and even havens for terrorists.

Next, the president and Congress should commit to fulfilling the financing needs that have been identified and internationally agreed on: U.S. development assistance should be increased to an average of 0.5 percent of the nation's GNI during the coming decade, reaching 0.7 percent of GNI by 2015. By 2006, U.S. support for the Millennium Development Goals should rise by another \$40 billion per year above the current \$16 billion already designated for development aid. An increase on this scale is affordable; in fact, it equals approximately half

The giant gap between the United States and other donors threatens to keep growing.

of Washington's annual spending on Iraq and Afghanistan, yet it would help more than a billion people in low-income countries, in addition to saving millions of lives each year.

Third, Washington should spend the new total of \$56 billion in aid through a number of reliable channels. Plausibly, the government could distribute \$3 billion to the Global Fund to Fight AIDS, Tuberculosis, and Malaria (partly for AIDS in countries not covered by PEPFAR); \$5 billion to PEPFAR programs; \$10 billion to the Millennium Challenge Account; \$8 billion to the International Development Agency of the World Bank, as well as to regional development banks; \$20 billion to USAID in non-MCA countries for transformational development; and \$10 billion to strategic states (up from the current \$5 billion). Washington's agencies and programs should continue to engage with and support the work of U.S. NGOs, while also funneling a large part of their new funding directly to the budgets of the recipient countries.

Finally, the president and Congress should overhaul the structure of U.S. development assistance programs to enable development to play the strategic role required for national security. USAID should be raised to the rank of a cabinet department, with MCA and other agencies housed under the same roof, similar to the United Kingdom's Department for International Development. The new department must be invested with the analytical capacity and political clout to ensure that the United States becomes a true leader of the global effort to fight poverty and achieve transformational development.

By reassessing its priorities and implementing these sweeping reforms, the United States can seize the initiative in international development. Last year at the UN, President Bush declared, "Our wider goal is to promote hope and progress as the alternatives to hatred and violence. Our great purpose is to build a better world beyond the war on terror." The safety of the nation requires nothing less. 🌍