
Fostering Development

WILLIAM R. CLINE
and JOHN WILLIAMSON

Throughout the postwar period, a combination of humanitarian concern and enlightened self-interest has made global economic development a persistent goal in US foreign policy, even if at times this goal has seemed to command only a low priority. The Cold War spurred US assistance to South Korea in the 1950s and Latin America in the 1960s. The United States' financial self-interest was evident during the Latin American debt crisis of the 1980s, which threatened the US banking system, and again after the Russian default in 1998, which shook financial markets. The positive side of self-interest is increasingly evident in trade and investment. Developing-country markets today account for 45 percent of US exports, up from 37 percent in 1985. Developing countries also account for 37 percent of US direct investment abroad.

Today the most immediate threat facing the United States is international terrorism. This reality should sharpen the United States' recognition that the security self-interest in global development remains vital. It would be naïve to postulate any simple link between poverty and terrorism, but it is equally implausible to maintain that the rich countries can thrive indefinitely in a world where many people are trapped in degrading and permanent poverty. Rising resentment would be inevitable, and in a globalized world this resentment could easily take a destructive form that harms Americans. In other words, the United States increasingly has a strong security interest in seeing the peoples of other countries make the

William R. Cline is a senior fellow jointly at the Institute for International Economics and the Center for Global Development. John Williamson is a senior fellow at the Institute for International Economics.

transition to prosperity that the postwar world has already witnessed in western Europe, Japan, southern Europe, Israel, and the new industrial economies of East Asia. The United States' economic and humanitarian interests in this outcome are also arguably greater than ever before.

The self-styled critics of globalization (who often seem to be objecting to capitalism rather than to globalization *per se*) often give the impression that poverty is not only endemic but worsening. This is simply wrong: By historical standards, the era since World War II has witnessed unparalleled progress, both economic and social. According to the World Bank, "dollar-a-day" poverty (the standard measure of what some of us would consider destitution) has been cut almost in half in little more than 20 years (from 40 percent in the early 1980s to under 21 percent now). Some analysts, such as Surjit Bhalla (2002), have argued that poverty has fallen even faster than indicated by the World Bank's figures. Moreover, the increase in world inequality that had been taking place for almost two centuries finally reversed around 1970 and certainly by the 1980s, as a result of the success of China, India, Indonesia, and other large Asian countries in getting development moving. And economic progress pales in comparison with the progress in the social indicators: Many developing countries have reached levels of infant mortality, longevity, and literacy that were achieved only at far higher income levels in the developed countries. Progress in these fields has been largely maintained even in times of economic crisis.

But this progress still leaves massive poverty in the world, especially if one measures poverty by anything better than the destitution-level figure of a dollar a day. At the \$2 per day level, half of the world's population remains in poverty. The developing world to the west of Pakistan actually has done worse, not better, since 1980. Latin America, and for that matter the Middle East, experienced a Lost Decade in the 1980s, and their growth in the past dozen years has remained below the pace of the 1970s. One of the major regions, namely Africa, really is mired in the desperate sort of situation that the pessimists picture as characterizing the whole of the developing world. The spread of HIV/AIDS has brutally reversed progress in improving the social indicators in much of Africa. Most of the Millennium Development Goals to which the world's leaders solemnly committed in 2000 seem all too likely to be missed in many, maybe most, countries.

While we welcome the decision taken in 2000 to adopt the Millennium Development Goals, we also recognize that to make this more than an empty gesture will require more than has yet been done. Doubtless, many developing countries need to do more for themselves, but this chapter is about what the developed countries—and specifically the largest of them, the United States—need to do to support their efforts.

In this chapter we focus on two central issues: trade and aid. Trade is relevant to all three groups of developing countries distinguished in box

13.1. It is key in both the most rapidly growing countries and the most desperate cases of failed states, where the chance to sell on the world market what they are capable of producing offers one of the few avenues of escape from the prevailing misery. In contrast, aid is of marginal importance in the first group of countries but is key in the other two groups. However, even here there is a major difference. The second group is in a position to absorb relatively large sums of money, whereas large sums given to countries in the third group are all too likely to be wasted or diverted to the bank account of the dictator or some warlord. The report of the CGD commission advises that the donors should be ready to spend money rapidly when a promising opportunity arises, but it would be a mistake to think that throwing large sums of money at these countries will help them.

Our decision to limit this chapter to these two issues does not mean that we are blind to the fact that a wide array of other policies affect development. In fact, the CGD produces a Commitment to Development Index (CDI) that grades the performance of the donor countries in supporting development in seven dimensions (Roodman 2004). Two of these are, of course, trade and aid. The others are investment, migration, the environment, security, and technology. Investment policy is actually of far greater importance than aid to most middle-income countries. Some analysts believe that the potential gains from unrestricted movement of people exceed those from the unrestricted movement of goods, but until recently there was an almost complete absence of studies on the liberalization of migration, and there is still no consensus on what policies in the developed countries would most benefit developing countries. (The topic is discussed in Gordon Hanson's chapter in this book.)

Environmental degradation poses a threat to both developed and developing countries. Many of the latter are probably more vulnerable to degradation than most of the former. For example, global warming is likely to impose greater relative damage on developing countries than industrial countries, because typically initial temperatures are higher, agriculture constitutes a larger share of GDP, and adaptive capacity is more limited. Ironically, given that environmental sensitivity is a superior good, developed countries tend to be more concerned about environmental degradation.

The security component of the CDI reflects the fact that both internal security and freedom from external attack are indispensable to development and that rich-country policies can influence both elements.

Finally, development has taken place over substantial parts of the globe in the last quarter-millennium essentially because people learned how to produce goods better than they used to, and it will take place where it has not yet occurred to the extent that people in the rest of the globe gain access to the new technology that is so much more efficient than the old ways of producing goods and services. Hence the extent to which developed countries facilitate the access of developing countries to technology

Box 13.1 Grouping developing countries

“Developing countries” include both low- and middle-income countries. Many of them are indeed developing and can expect within a historically short time span to make the transition to developed-country income levels. But unfortunately this is not true for all the countries where living standards are still distinctly lower than those in the industrial (or developed) countries. It is necessary to distinguish at least three groups of countries and to tailor policies differently for the three groups.

The first group consists of those countries that really are on the road to development: most middle-income countries (although one worries about a few of them, like Argentina and Venezuela) plus a few low-income countries like China, India, and perhaps Indonesia. The United States has traditionally supported the development of countries in this group mainly through its backing of international financial institutions (IFIs) like the International Monetary Fund (IMF), World Bank, and regional development banks. These institutions are important to this group of countries for several reasons. They provide financial support in times of crisis. They provide loans on favorable financial terms. They give policy advice, most of which is sensible however much one may squawk in protest at their mistakes. Their traditional advice in favor of disciplined macroeconomic policies, market liberalization, and opening up to trade and foreign direct investment has in recent years been complemented by help in supervising the financial sector¹ and assistance in tackling corruption. The United States should continue to give robust support to these institutions, not surrender to the siren songs that periodically call for dismantling them. Of course, the needed policy advice changes with the times: Right now the main extra emphasis needs to be on strengthening crisis prevention (meaning anticyclical policies) and reinforcing the focus on building the human capital of the poor to ensure that growth has a propoor bias.

The second group consists of countries, primarily in Africa, that are mostly rather small and still have low incomes but are doing a reasonable job of governing themselves. These countries also have an ongoing need for IFI support: They are less likely to encounter financial crises but have even more need for the policy expertise of the IFIs. In addition, they get concessional financial support from both the IFIs and the US government (and other bilateral donors), and this is extremely important to them.

The third group consists of failed and failing states. A commission sponsored by the Center for Global Development (CGD 2004) defines these as “states that fail to ensure security, fail to meet the basic needs of citizens, and fail to maintain political legitimacy.” Most of these countries are in Africa, though such countries can also be found in the Middle East (Iraq), Asia (Afghanistan and North Korea, and periodically one worries that Nepal or Pakistan may join them), Latin America (Haiti), and even Europe (parts of the former Yugoslavia). These countries not only give their own citizens a miserable life but also seem particularly likely to breed terrorists.

1. We are thinking of the Financial Sector Assessment Programs and Financial System Stability Assessments of the IMF and the Reports on the Observance of Standards and Codes now conducted for many member countries by joint IMF/World Bank teams.

is clearly important. We nevertheless limit our attention to trade and aid, because they are the two issue areas with perhaps the largest development impact (barring a radical change in migration policies) and most influenced by the policies of the United States and other industrial countries.

Trade

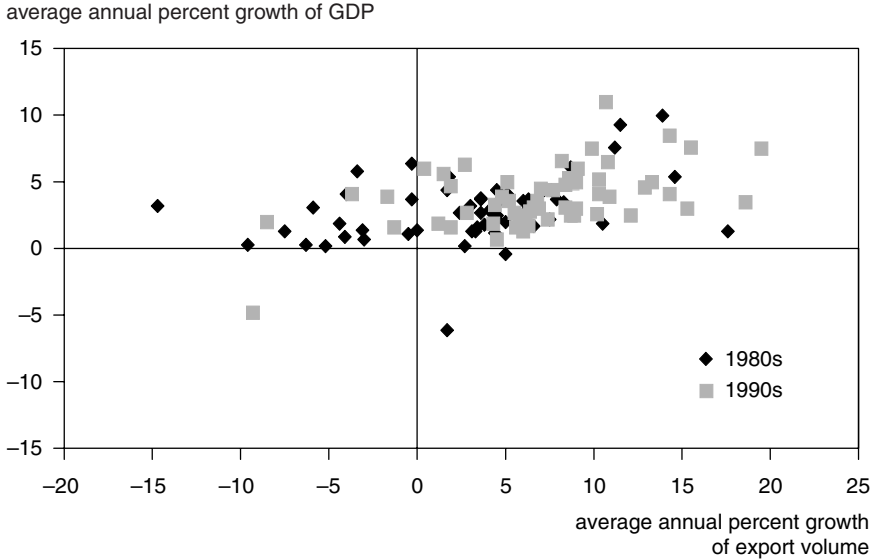
The tradition that international trade enhances domestic growth goes back at least to Adam Smith more than two centuries ago. Trade permits increased specialization. Specialization allows increased attainment of economies of scale, especially for countries with relatively small domestic markets. It also permits more effective utilization of a country's abundant factors of production. Imports provide competitive pressure that keeps domestic firms on their toes and may prompt them to improve their technology. Increased economic integration with the outside world also stimulates technological change through the diffusion of new technologies, especially from the more advanced countries at the technological frontier to the developing countries.¹ Imports also curb domestic monopoly power that would hold production below and prices above socially optimal levels.

Few would doubt that the traditional static specialization gains remain valid, including for developing countries. They will be able to obtain wide-bodied aircraft more cheaply by importing them from Boeing or Airbus with earnings from exports of agricultural goods or labor-intensive manufactures than by attempting to build them domestically. Most developing countries, moreover, are even more acutely dependent on the world market for economies of scale than are the larger industrial countries. Costa Rica has large export earnings from computer chips produced by its Intel plant, but it would not have the scale to produce chips efficiently if it did not have access to the external market.

Similarly, the impact of open trade in countering monopoly is likely to be even more important for developing countries than for industrial countries, again because the domestic market will tend to be smaller and

1. Grossman and Helpman (1994, 40) emphasize that integration with the world economy can help boost productivity growth: "residents of a country that is integrated into world markets are likely to enjoy access to a larger technical knowledge base than those living in relative isolation. Trade itself may help the process of technological dissemination, if foreign exporters suggest ways that their wares can be used more productively or foreign importers indicate how local products can be made more attractive to consumers in their country. . . . Whereas a firm that develops a product for a protected domestic market need only make use of technologies that are new to the local economy, one that hopes to compete in the international market-place will be forced to generate ideas that are truly innovative on a global scale."

Figure 13.1 Average annual GDP and export value growth



Source: Cline (2004).

hence more susceptible to monopolization. An old concern is of developing countries' being locked into monoculture-excessive dependence on a handful of traditional tropical or mineral exports. But it is worth recalling the experience of Chile, which moved from high protection in the 1950s and 1960s to open trade by the late 1970s, yet broke out of monoculture after this change. Copper as a share of Chilean exports fell from 52 percent in 1980 to 44 percent by 1990 and 30 percent in 2000 (UNCTAD 2003, 116), while new product lines such as grapes and other fruits and vegetables became major sources of export growth.

How can contact with the world market enhance total factor productivity (TFP) in an agricultural product such as cotton (West Africa) or soybeans (Brazil)? It should be kept in mind that agriculture is a sector in which technological change has been extremely important, as shown by the Green Revolution in Asia based on new seed varieties and improved practices. It is far more likely that such advances will be made by countries in close contact with global markets than by countries isolated from them.

Open trade policies in developing countries, and open markets for their exports in industrial countries, help promote export growth, which in turn helps stimulate overall growth. Figure 13.1 provides informal evidence of the positive relationship between export growth and GDP growth. For 64 countries with populations of over 10 million in 1999, export and GDP growth are shown for 1980–90 (diamonds) and 1990–99

(squares). A simple regression shows that each additional percentage point in export growth has been associated with an additional 0.15 percentage point in GDP growth. Exports contribute to growth *inter alia* by allowing imports of key intermediate inputs, capital goods, and technologies not available domestically and by reducing the likelihood of a foreign debt crisis.

High domestic protection is an obstacle to export growth. It tends to act as a tax on exports by creating a distorted incentive to produce for the domestic rather than the export market. In fact a formal proposition (the Lerner symmetry theorem) maintains that a uniform import tariff has an effect equivalent to a uniform export tax (Lerner 1936).

More formal empirical tests have been carried out at two levels: the relationship of growth to the “openness” of the economy and the relationship of growth to trade policy more explicitly. On the first, Cline (2004) synthesizes numerous studies on the trade-growth relationship as follows: Each 1 percent rise in the ratio of trade (imports plus exports) to GDP has been associated with a 0.5 percent rise in long-term output per capita.² The evidence tends to indicate that most of this addition is from an increase in TFP, but some portion is also the result of increased investment (including foreign direct investment attracted by more open economies).

Perhaps the two leading empirical studies more specifically on the relationship of growth to trade policy are by Sachs and Warner (1995) and Edwards (1998). Sachs and Warner examine growth performance for 79 countries over 1970–89. Their binary variable for trade policy is set at “closed” (zero) if *any* of the following is true: the average tariff on capital and intermediate goods is over 40 percent, nontariff barriers cover more than 40 percent of imports of capital goods and intermediates, the country has a socialist economic system, there is a state monopoly on the principal exports, or the black market premium on the official exchange rate exceeded 20 percent in the 1970s or 1980s. Their statistical regressions relating growth in real per capita income during 1970–89 to the trade policy variable and other influences (initial per capita income, investment rate, relative price of investment goods, government consumption spending relative to GDP, and variables for political stability) find that annual per capita growth was 2.2 percentage points faster in “open” economies than in “closed” economies.

Edwards uses estimates of capital and labor stocks for 93 developing and industrial countries over 1960–90 to estimate TFP growth. He then tests the relationship between TFP growth and nine alternative measures

2. The studies that lie behind this summary are Levine and Renelt (1992), Frankel and Rose (2000), Alcalá and Ciccone (2001), Dollar and Kraay (2004), Easterly (2003a), Choudhri and Hakura (2000), World Bank (2002), and OECD (2003). These studies carefully take account of the two directions of causality (from trade to growth and vice versa).

of trade policy openness.³ In 17 of 18 regressions, the trade policy openness variable has the right sign, and in 13 of these 17 it is statistically significant. He considers the results as “quite remarkable” evidence of a “tremendous consistency of a significant positive relationship between openness and productivity growth” (p. 391).

Rodriguez and Rodrik (2000) have criticized the Sachs-Warner and Edwards studies, either by challenging the variables used or by showing that the results are sensitive to inclusion of other variables.⁴ Reviewing the debate, Berg and Krueger (2003) judge that the Sachs-Warner index “represents a fairly successful effort to measure the overall importance of trade policy restrictions.” Cline (2004) similarly suggests that the Rodriguez-Rodrik critique may be overdone.⁵

In sum, there is considerable evidence that more open economies achieve faster growth, and there is a strong basis in theory for expecting this result.⁶ As Paul Krugman (2003, 368) has summarized:

The raw fact is that every successful example of economic development this past century—every case of a poor nation that worked its way up to a more or less decent, or at least dramatically better, standard of living—has taken place via globalization; that is, by producing for the world market rather than trying for self-sufficiency.

The most important way that the policies of the industrial countries enhance the ability of developing countries to work their way out of poverty is by a willingness to buy the goods that they are able to make efficiently. Successive rounds of postwar multilateral trade negotiations sharply reduced protection in industrial countries for most manufactures but have

3. These nine measures include the Sachs-Warner variable, the World Bank’s “outward orientation index,” Edward Leamer’s residual from trade flow regressions, the average black market premium, the average tariff in 1982, the average coverage of nontariff barriers, the Heritage Foundation Index of Distortions in International Trade, the Collected Trade Taxes ratio for 1980–85, and a regression-based index of import distortions in 1985.

4. For example, they argue that the black market premium is the dominant influence in the Sachs-Warner results and that it reflects macroeconomic disarray rather than protection. However, Warner (2003) provides an impressive rebuttal.

5. In particular, as shown by Sala-i-Martin (1997), the technique of decomposing some variables and adding others to remove the statistical significance of the original tests is an exercise that can bias the findings against robustness.

6. The principal contrary theory is that of “infant industry” protection. Although this may help industrial development during a “first easy stage” (Balassa and associates 1982, 40), there is widespread agreement that import-substituting industrialization behind high tariff walls becomes increasingly inefficient, as countries expand output into goods further and further removed from domestic comparative advantage. Even in the case of Korea, where intervention through “industrial policy” may have been less inefficient, it is doubtful whether it made a net contribution to industrial development (Noland and Pack 2003).

Table 13.1 Protection in agriculture (percent tariff-equivalent)

Protection	United States	Canada	European Union	Japan
Tariffs	8.8	30.4	32.6	76.4
Subsidies	10.2	16.8	10.4	3.2
Total	19.9	52.3	46.4	82.1

Source: Cline (2004).

left protection high in the politically sensitive sectors of agriculture, textiles, and apparel, which happen to be goods in which many developing countries have comparative advantage. The Uruguay Round left tariffs largely unchanged in these sectors (although it converted agricultural quotas to tariffs and promised the removal of textile and apparel quotas by 2005). The effective postponement of liberalization in these areas, together with adverse spillover from new intellectual property rules in pharmaceuticals, created a widespread impression that developing countries had not benefited much from the Uruguay Round. The current Doha Round was designated the “Development Round” to show international commitment to using the new round to permit developing countries to gain larger potential benefits. The implication is that the Doha Round should go beyond the traditional commercial deal making, whereby countries place import liberalization offers on the table solely to obtain reciprocal offers from trading partners. To live up to its title, the round will have to open new opportunities for developing countries.

Industrial-country protection against imports from developing countries is highest in agriculture. Tariffs, including the ad valorem equivalent of specific duties and taking into account the high tariffs above “tariff-rate quota” thresholds, are as high as 400 percent for rice in Japan and 250 percent for sugar in the European Union (Dimaranan and McDougall 2002). Production and export subsidies in agriculture further increase protection. Table 13.1 shows aggregate protection in agriculture for the “Quad” countries.

Protection is also relatively high in textiles and apparel, where many of the “peak tariffs” (15 percent and higher) are concentrated. In the past, under the Multi-Fiber Arrangement, quotas added further protection, but these are to be fully eliminated at the beginning of 2005. Table 13.2 shows an Aggregate Measure of Protection (AMP) against developing countries by the Quad countries after taking account of protection levels of all trade divided into four broad product categories (and including only tariff protection in textiles and apparel). As the table shows, although protection is low in manufactures outside textiles and apparel, and especially in oil and other nonagricultural raw materials, the high protection in agriculture and textiles and apparel means that trade barriers remain substantial.

Table 13.2 Aggregate Measure of Protection against developing countries (percent tariff-equivalent)

Sector	United States	Canada	European Union	Japan
Agriculture	19.9	52.3	46.4	82.1
Textiles and apparel	10.9	16.5	11.6	9.2
Other manufactures	2.1	3.5	3.2	1.5
Oil, other nonagricultural raw materials	0.9	0.9	0.6	0.3
Aggregate Measure of Protection	4.0	10.7	9.5	15.6

Source: Cline (2004).

It is often argued that protection, especially in the European Union, is lower than these “most favored nation” rates would suggest, because of preferential entry for poor countries. However, the countries eligible for the European Union’s “Everything but Arms” duty-free entry account for only a small portion of imports. Even a broader group of “at-risk” countries including the heavily indebted poor countries (HIPC)s, the least developed countries (LDCs), and sub-Saharan Africa (SSA) account for only 8 percent of imports from developing countries by the European Union (and 6 percent for the United States and 4 percent for Japan). So the estimates in table 13.2 accurately reflect the protection facing the great bulk of developing-country exports to these markets.

On the basis of model estimates, Cline (2004) examines how much impact the removal of protection would have on the income of developing countries and the incidence of poverty.⁷ He estimates that global free trade would convey long-term economic benefits of about \$200 billion annually to the developing countries. Half or more of these gains would be attributable to the removal of industrial-country protection against developing-country exports. By removing their trade barriers, the industrial countries could convey economic benefits to developing countries worth about twice the amount of annual development assistance. Helping developing countries grow through trade, moreover, would be accompanied by economic benefits for the industrial countries themselves, in the form of lower consumer costs for imports and increased economic efficiency from open trade.

Cline’s study further estimates that free trade could reduce the number in poverty globally (at the \$2 per day threshold) by about 500 million over 15 years, or by about one-fourth below the level that will otherwise be reached. Agricultural liberalization alone contributes about half of these gains. This suggests that the developing countries were right to risk collapse of the Doha Round at the Cancún ministerial meeting in September

7. He uses an adaptation of the computable general equilibrium model of Harrison, Rutherford, and Tarr (1996).

2003 by insisting on much deeper liberalization of agriculture than the industrial countries were then willing to offer.

The study calls for a two-track strategy. The first track is deep multilateral liberalization involving phased but complete elimination of protection by industrial countries and deep reduction of protection by at least the middle-income developing countries albeit on a more gradual schedule. The second track is immediate free entry for imports from "high-risk" low-income countries (HIPCs, LDCs, and SSA), coupled with a 10-year holiday from taxes imposed by developed countries for direct investment in the high-risk low-income countries. The head start from immediate free entry would provide an important boost to the pace of global poverty reduction.

One feature of the Uruguay Round that many developing countries have criticized was the introduction into the World Trade Organization (WTO) of disciplines on intellectual property. While the LDCs were granted a delay in implementing the agreement, all member countries of the WTO are required in principle to allow citizens from other member countries to protect their intellectual property. The general argument for protecting intellectual property is that without such rights, potential inventors will not have the incentive to take the investment risks involved. The wider the area within which such rights are protected, the greater the incentive. However, this incentive comes at the cost of ease and cheapness of diffusion. Some developing countries argue that the additional incentive to innovate coming from protection of intellectual property in developing countries, especially the poorer ones, is small and not commensurate with the increased obstacles to diffusion created by the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs).

The international community has accepted this argument in the specific context of developing countries' access to low-cost generic pharmaceuticals. The Doha declaration at end-2001 recognized the right to grant compulsory licenses to manufacture generic drugs to deal with HIV/AIDS, tuberculosis, malaria, and other epidemics (WTO 2001). An agreement shortly before the September 2003 Cancún ministerial meeting dealt further with the problem of poor countries without domestic capacity to manufacture generics, by permitting them to import generics from other developing countries (such as Brazil and India). The new administration needs to reaffirm this flexibility and stand ready to push it a stage further by allowing the LDCs to renew their exemption from the TRIPs agreement after their first 10-year exemption expires.

Development Assistance

While we regard import liberalization as the most important way that the industrial countries can support development, aid remains of critical im-

portance to many of the really poor countries. Although the United States is still the largest donor in absolute terms, the country has for some years been regarded as a laggard. In recent years the United States has actually given a lower proportion of its GDP as foreign aid than any of the other members of the Organization for Economic Cooperation and Development (OECD) Development Assistance Committee (DAC), which includes all the rich industrial donor countries.⁸ President George W. Bush promised a \$5 billion (roughly 50 percent) increase at the Monterrey Summit in 2002, but even this may leave the United States as the least generous of the donor countries. And not only is the quantity of US aid modest in relation to the size of the US economy but also its quality has been deficient, in particular because a large proportion is tied to the purchase of US goods and services and a small proportion is given as program aid rather than to finance particular projects (and, even then, projects that are largely chosen by the donor). Fortunately the aid increase that is in the pipeline is to be distributed according to state-of-the-art principles via the new Millennium Challenge Account: untied, given to countries that are pursuing enlightened policies and have relatively good institutions for their income level, and to finance projects that the countries themselves have chosen to propose. One could not have asked for more enlightenment in choosing the underlying principles (Radelet 2003), though naturally it will not be possible to make an evaluation of how things are working out in practice for some time yet.

US politicians have customarily appealed to public opposition to increased foreign aid to explain their reluctance to sanction increased spending. Certainly it seems to be true that in the United States (in sharp contrast to Europe), the public believes that the country is giving away too much in foreign aid. But polls undertaken by the Program on International Policy Attitudes of the School of Public Affairs at the University of Maryland suggest that this is because the public is misinformed about the size of the aid program, not because Americans are less generous than Europeans. The poll evidence suggests that on average Americans believe that the government spends over 20 percent of its budget on foreign aid, whereas the true figure is about 1 percent. The average American says that he or she believes that the government ought to be spending about 10 percent of its budget on aid, which would make the United States the most, rather than the least, generous donor. Perhaps the question was framed in a way that failed to emphasize the opportunity cost of an increase in the aid program, but nevertheless there seems to be political

8. US official development assistance was 0.16 percent of GDP in 2000, compared with the DAC median of 0.38 percent. If aid through private charity is included, the US total amounted to 0.21 percent of GDP, leaving the United States still ranked last and well below the DAC median of 0.40 percent. See Roodman (2004).

space for politicians who recognize the importance of foreign aid to mobilize public support for a big increase in the aid program.

The case for a large increase in foreign aid should not blind one to the fact that aid can have perverse effects if it is given badly. Aid can permit a government to perpetuate antigrowth policies that it would otherwise be forced to abandon. It can channel resources to corrupt bureaucrats who are enabled to bid resources away from the very entrepreneurs who are the key to unlocking growth. For some years, many analysts have argued that the empirical evidence did not show any robust impact of aid on development (e.g., Boone 1994, Easterly 2003b), implying that these perverse effects are about as common as positive effects. Burnside and Dollar (2000) concluded that the evidence showed that aid could work in the presence of good policies but was ineffective otherwise, but even this conclusion was attacked as not being robust to an expanded dataset (Roodman 2003).

The latest evidence as presented in Clemens, Radelet, and Bhavnani (2004) concludes, however, that these negative views are unjustified. These authors argue that the empirical results are a consequence of jumbling together quite different forms of aid. Humanitarian aid tends to rise when a country faces a disaster that is also likely to disrupt growth, and so it produces an *inverse* association of aid and growth—but not because aid harms growth! Long-term aid (for objectives such as education) cannot reasonably be expected to promote growth over a short-run period like four years, which most of the empirical literature has focused on. When they separate out aid that could plausibly promote short-run growth (like infrastructure and budget support), they find a strong and robust positive effect of this more narrowly defined aid on growth over a four-year horizon. This positive effect implies that the unfavorable possibilities alluded to at the start of this paragraph are the exception and not the rule. Clemens, Radelet, and Bhavnani also find some evidence that the positive effects are still stronger in the presence of good policies and institutions.

The latter finding suggests, as Burnside and Dollar argued, that aid should be given with attention to the recipient's policy stance, rather than thrown at any government that declares itself willing to support a foreign policy goal (as used to happen in the days of the Cold War). It is therefore important to have a vision of the policies that are indeed likely to stimulate development. The care that was put into the design of the Millennium Challenge Account suggests that the US government has absorbed this lesson, but it will be important to make sure that it is not forgotten if and when there is a new increase in spending on aid. And one can argue for going one step beyond the Millennium Challenge Account and giving the countries that qualify for it the chance to win access to a pool of resources supplied by all the donors to finance those countries' development pro-

gram as chosen by them, rather than making them jump through hoops to qualify for support for a series of projects.⁹

One prominent recent suggestion is the proposal of the British Chancellor Gordon Brown to use future aid flows as collateral to raise bonds that would permit a large increase in the aid flow in the next few years, when the world is supposed to be making a special effort to achieve the Millennium Development Goals (HM Treasury 2003). The downside of this proposal for creation of an international financing facility (IFF) is of course the reduction in the flow of aid in the longer-term future, when the bonds have to be serviced. If the mechanism could be based strictly on frontloading only the incremental portion of future aid above current ratios to donor GDP as part of a firm commitment to ramp up aid toward the long-standing (and long-unmet) target of 0.7 percent of GDP, this would not be so much of a concern. Because there is no clear way to ensure that industrial countries will raise their aid flow levels relative to GDP, the problem of taking aid from the future to boost flows today cannot safely be ignored. And if the IFF is essentially an attempt to use financial engineering to force countries to raise aid levels in the future (after their demonstrated inability to do so in the past), the proposal would seem a potential source of trouble when and if donors do not deliver.

Because in practice IFF frontloading significantly risks reducing future aid to levels below those today rather than merely moderating a hoped-for rapid buildup, it is important to think about the time profile of aid needs. It seems unlikely that the magnitudes of aid needed in 2015–25 will be sharply smaller than those needed in 2005–15. The potential time path of the AIDS pandemic alone is sufficient reason for caution in assuming that a major reduction in assistance will be appropriate after a big push in the coming years. Moreover, countries that might be strong candidates for assistance later but do not qualify now (imagine a Sudan with forceful governance reform) would be penalized by “frontloading” a quarter-century’s development assistance. There are also contractual and legislative obstacles, such as the inability of legislatures (certainly the US Congress) to commit to aid flow levels for decades in advance. For these reasons, the proposal could be at best difficult to implement and at worst counterproductive.¹⁰ In contrast, we believe that the United States should follow Britain in committing itself in principle to increase its aid progres-

9. See Kanbur and Sandler (1999) for presentation of their “Common Pool Proposal.”

10. Features of the idea, however, warrant pursuit. The notion of pooling bilateral aid and eliminating the tying to donor contractors is attractive. The IFF would also allow individual donor countries to earmark funds for their favorite recipient countries, which they cannot do for their support through IDA. But pooling, untying, and earmarking could be done without frontloading.

sively in the coming years, which would permit the desired increase in aid in the short term without risking longer-term flows if they continue to be necessary. The Zedillo Report (2001) estimated that something like an extra \$50 billion of aid per year would be needed to offer a reasonable chance of meeting the Millennium Development Goals, provided also that all developing countries adopted the policies that would make such an increase in aid worthwhile.

One aid area in which the Bush administration took an important initiative was in pressing for grants in place of loans for some of the operations of the World Bank's International Development Association (IDA). Many of the European countries strongly resisted this initiative on the grounds that it would reduce the return flow of money to IDA, which was intended to finance many of the future operations of IDA. This argument did not make a lot of sense, because in many cases, IDA is almost forced to make new loans to provide countries with the dollars to make their repayments. Stopping this merry-go-round can alleviate the threat of new debt problems in the poorest countries and relieve them of the need to negotiate new projects to keep the money flowing in. Up to now, only about 20 percent of IDA operations has been converted to grants, in a compromise with the Europeans.

A good initiative for the new administration would be to press for this figure to be raised. One can, admittedly, make a powerful case against converting all IDA loans into grants, because a number of the IDA countries are likely to graduate in the next few years, and it will be useful if IDA is able to draw on their repayments to finance additional operations in those countries that continue to need its support. On the other hand, it is ridiculous for the poorest countries to be receiving loans when we know perfectly well that they will need to receive yet more loans in a few years' time if they are to service the loans they are getting now! Far better that such countries receive grants until such time as they show clear evidence that their income has started to rise so that from then on they will be in a position to service loans. Hence what the World Bank needs is a third (grant-issuing) window that enables it to provide finance to the poorest countries on terms that they can responsibly accept. We suggest that the Bank reform its IDA operations based on per capita income, perhaps by placing the countries that receive money in three groups: those with per capita income below \$300, those in the range of \$300 to \$500, and those above \$500. The first group would receive all grants, the middle group might continue to receive a mix of grants and loans as at present, and the third group of less poor countries would receive all loans. If IDA continued to disburse an annual total of just over \$7 billion as in 2003, and the pattern of disbursements remained the same, this would result in grants roughly doubling from \$1.2 billion to \$2.5 billion, of which almost \$2.2 billion would go to the below-\$300 countries.

Concluding Remarks

Nurturing development may not be the criterion by which commentators judge the new administration a success or failure, but in terms of its impact on the future of humanity, its achievements in this dimension may be as critical as any. The performance of the United States in this dimension in recent decades leaves much to be desired, even though for many years, when market economics was under a cloud in the rest of the world, it was the United States that kept alive the idea that a liberal economy is the road to growth. Unfortunately, the widespread acceptance of the market economy in recent years has sometimes been clouded by triumphalist advocacy of market fundamentalism instead of leading to a sober resolve to make a market economy work for the general benefit. The new administration will need to stand by the traditional US conviction that the right formula is an outward-looking market economy subject to macroeconomic discipline. But this need not prevent it from supporting initiatives to strengthen the automatic fiscal stabilizers, or improve income distribution, or encourage market-friendly interventions (e.g., to curb excessive swings in capital markets), or increase aid.

The new administration needs to make success easier for countries with governments committed to development. The most important area is trade. Developing countries need access to export markets for the goods that they are able to make efficiently. Our principal recommendations in the area of trade are the following:

- The United States should push hard for deep liberalization of trade in the current Doha Round. The United States and other industrial countries should sharply cut agricultural tariffs and tariff-rate quota protection. They should set an aggressive timetable to eliminate agricultural subsidies or strictly decouple them from production. They should sharply reduce any remaining high tariffs (e.g., 10 percent or above) in manufactures, including in textiles and apparel.
- The United States should press the middle-income countries to make relatively deep reductions in their protection as well, while acknowledging the appropriateness of longer liberalization timetables for these countries.
- The United States, other industrial countries, and middle-income countries should grant complete free entry to imports from LDCs (and perhaps HIPC and SSA countries) as part of the Doha bargain.
- The United States and other industrial countries should ensure that the liberalization of trade in textiles and apparel through the termination in 2005 of remaining quotas under the Multi-Fiber Arrangement, agreed

in the Uruguay Round, is not thwarted by new barriers, such as unwarranted or unduly protracted “safeguards” protection.

Aid is also critically important to the poorer countries. Our principal recommendations in the area of development assistance are the following:

- The United States should build on the recent initiative of the Bush administration to substantially increase the level of its development assistance, in light of the United States’ ranking as last among industrial countries in aid relative to GDP.
- The new administration should forcefully implement the new Millennium Challenge Account with its linkage of aid to policy performance by recipient countries.
- The new administration should continue strong support for the IMF and World Bank in their roles of giving policy advice, emergency financial assistance, and long-term development support to poor and emerging-market economies.
- The new administration should develop more streamlined vehicles for providing aid promptly when political conditions in “failing states” show promise of favorable change.
- The United States should continue the efforts of the Bush administration to increase the portion of IDA financing that is provided on a grant basis and should seek 100 percent grant terms for countries with incomes below \$300 per capita at market exchange rates. Additional funds should also be directed to IDA, so that the grant element in its operations can be doubled without forcing a cutback in disbursements in the longer term.

With strong efforts along these lines, the new administration could make a major contribution to fostering development and reducing global poverty. Stronger prospects for international development, in turn, would contribute to a more equitable and safer world.

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