



Development & Security Initiative

March 3, 2005

Transatlantic Cooperation on Development Towards a New Consensus on Growth and Poverty Reduction

On December 6-7, 2004, more than 75 policymakers and international development experts from the American and European policy communities converged in Washington D.C. to debate key principles of an emerging consensus on approaches to reducing poverty and promoting economic growth in developing countries. The two-day conference, *Transatlantic Cooperation on Development: Towards a New Consensus on Growth and Poverty Reduction*, featured remarks by Paul Applegarth, CEO of the Millennium Challenge Corporation (MCC), and Peter McPherson, former Administrator of the U.S. Agency for International Development (USAID). Private sector development, selectivity in aid, managing for results, and good governance were among the themes highlighted at the conference, which was co-sponsored by the Friedrich Naumann Foundation and the Center for Strategic and International Studies (CSIS).

In opening remarks, Patrick Cronin, Senior Vice President and Director of Studies at CSIS, said “development should be a pillar of a renewed transatlantic partnership.” Peter Gottwald, Deputy Chief of Mission of the Embassy of Germany, cited the inauguration of Afghan President Hamid Karzai as a vindication for transatlantic cooperation in developing countries. “It is important to instill a sense of movement and momentum. We can’t do it for them, neither the Americans nor Europeans, but we can of course try to develop that sense of necessity.”

At the conference launch dinner, M. Peter McPherson, former administrator of the USAID, relayed core lessons from the last fifty years of international development. Sound economic policy, political stability and security are fundamental conditions for growth, and should be pillars of a long-term strategy for development, he argued. McPherson stressed the value the spirit of entrepreneurialism in developing societies. “The primary resource [for development] is *that* man or woman who will do wonderful things for themselves and their children,” he said.

Calling Africa “the development frontier,” McPherson cited the need for an American partnership with Africa to accelerate growth. He put forth the Alliance for Progress as a model for American involvement in Africa. “If we are prepared to take a long term view, over a generation we can do huge things in Africa. It would be a historical exception if we were not able to,” McPherson argued. Key investments in technology, infrastructure and public and private institutions require patience on the part of donors and implementers. Development is a “generational kind of effort. Reducing poverty is not accomplished by short-term transmission of goods and services. It is a matter of long-term growth and commitment strategies,” McPherson said.

He went on to note that there exists a general consensus on economic conditions that promote growth. There must be an effort to curb inflation and to increase foreign investment in developing countries. Markets drive the world economy, and developing countries must be able to operate within market frameworks. These fundamental economic conditions can produce dramatic results even without large foreign aid infusions, as the examples of growth in China and India have demonstrated.

Center for Strategic and International Studies
1800 K Street, NW
Washington, DC 20006

Friedrich Naumann Foundation
1730 Rhode Island Avenue, NW
Washington, DC 20036

Agricultural development is a major catalyst for growth. Rural income growth has a significant multiplier effect on overall national income and economic growth. Two-thirds of sub-Saharan Africa lives in rural areas, and new roads and infrastructure are needed to facilitate agricultural development. Africa has relatively few rivers to support water transportation, and railroads were built to service mines and extraction areas but not agricultural transport.

Political stability and democratic institutions encourage long-term investment. “Not necessarily U.S. or English or German-style democracy, but some kind of democratic process is an important component of sustained political stability and security,” he said. The spread of mass communication and information technologies has meant that citizens are better informed, which offers opportunities to garner public support for economic development. Democratic representation helps generate political will for growth projects.

“Reducing poverty is not accomplished by short-term transmission of goods and services.”

- Peter McPherson

Development assistance should be approached as a way to help enable individuals in developing countries to harness skills and realize dreams. Human resource development, for example, creates skilled people and builds in-

stitutional capacity for the future. We must “give people the opportunity to do what they have the power to do,” he said. “If we go back to these touchstones of what has worked, trust in the individual to have initiative, then all of these things that don’t pay off so quickly” will pay off in developing countries.

Panel I: Private Sector Development

P rivate sector development is instrumental to long-term development strategies because it creates institutional capacity for economic growth and builds momentum in civil society. Donald Pressley, principal at Booz Allen Hamilton and panel moderator, cited three key players in private sector development: governments, both recipient countries and international donors, which must work to improve conditions for economic development; the business sector, which must provide assistance in addition to receiving it; and the autochthonous workforce, which is essential to getting over the threshold in development.

Business development is one key to sustaining economic growth, argued Stephen Brent, director of the Millennium Challenge Secretariat at USAID. Though health and education indicators have improved markedly over the last thirty years, many poor countries have not experienced comparable economic gains, especially across Africa and Latin America. Macroeconomic reforms focusing on privatization and inflation-control are commonplace, but microeconomic restructuring has rarely followed. As a result, business environments have not improved.

Programs for private sector development are needed to complement social development programs, not to compete against them for funding. “We need a second track of reform that is about private sector development, to complement what has already been a somewhat successful social development track,” Brent emphasized. “The second stage of reform has not taken hold, which undercuts the impact of macro reforms.”

New business starts are the best measure of the overall quality of business environments. China has had an enormous number of new business starts while Russia has had very few. In China, a limited series of sequential changes led to incremental reform. Interventions that began in the agricultural sector and at the township and village level established a reform dynamic that led to dramatic growth. Export-led growth reached China only later.

Microeconomic reforms are not likely to take place through conditionality; they must be led by domestic actors

with vested interests in reform. Business environments are too complex and requirements are too easily evaded for conditionality to be effective. Though self-led strategies may not come off as the ideal approach to economic liberalization, they promise to address needs. Economic growth should be nationally—not regionally—driven, as individual business environments differ widely.

Strong outside incentives can help spur reform when internal forces are stalemating. In poorer countries, the concentration of political power at the top tiers of society often leads to ruthless competition for political dominance and limits the independence of the business sector. Entrenched cronyism and corruption reinforces the status quo, so that “elites have little self-interest in making changes,” Brent said.

Democratic development programs must complement economic and social development strategies, argued Peter DeShazo, director of the Americas Program at CSIS. Much as a second stage of business development is needed to build upon macroeconomic reforms, a second stage of governance reform and civil institution-building is needed to promote democratic growth. Developing countries in the Western Hemisphere have undergone a revolution in the formal structures of democracy with the widespread advent of elections. But there has not been a second stage of democratic development. Public safety and security, rule of law, and transparency in government enhance civil society and can help enable economic and social growth.

Under what circumstances is foreign aid effective as a harbinger of economic growth? Obstacles to growth must be eliminated by developing countries in order for assistance to work, according to Ana Eiras, a senior policy analyst at the Heritage Foundation. Eiras presented a development equation in which achievable goals are equal to a country's desires plus abilities minus obstacles. An author of the Index of Economic Freedom, Eiras focuses on key economic benchmarks, including trade policy, government intervention in the economy, capital flows and foreign investment, property rights, and informal market activity. The more obstacles that countries are able to correct, the higher the likelihood foreign aid will promote development and growth will take hold, as in the case of Chile. When too many obstacles remain, foreign assistance is squandered.

Josef Sima, professor at the Prague University of Economics, narrated the economic history of the Czech Republic in the twentieth century, from socialism to free market capitalism to membership in the European Union. Following the fall of the Berlin Wall, there was a revival of entrepreneurial spirit and an abrupt transformation of work. “People started to ask questions that people in developed countries do not ask very often,” he said. A “revolutionary period of dramatic changes” led to economic reforms such as the relaxation of price controls and tariffs as well as the jettisoning of mandatory closing hours in shops.

Accession to the European Union has ended the Czech Republic's experimental growth programs, Sima cited. In contrast to the free market days, the Czech Republic is implementing EU tariff schedules. Sima argued that the current economic environment creates disincentives for entrepreneurialism. Subsidy and rent seekers have displaced entrepreneurs. “Suddenly the spirit of the 1990s is over and we got sort of harmonized. We became a welfare state without wealth.” Although resource-transfer is appealing in the short term, it will not solve the long-term problem of income disparities.

Panel II: Sharing Responsibility with Developing Countries

Growth and poverty reduction require sound leadership. Developing countries must take ownership of growth programs and also be accountable for good results. Donor countries in turn must invest trust and decision-making powers with country leaders and citizens. This can be a difficult balancing act because donors and recipients may hold conflicting short and long-term interests, noted Dieter Kattermann, senior political adviser at the German Development Cooperation Corporation (GTZ), during his discussion of how to build institutional capacity in developing countries. Capacity development should be voluntary and accomplished by the commitment of indigenous players. Outside players can encourage and support capacity development, but it must be driven and owned by local champions.

Today, focus has shifted from input to output, or results-oriented, management. The transition has been a difficult one. Results management will firm up donor ownership of projects if reporting fails to reach domestic constituencies. "Reporting goes to the donors, so ownership is donorship in a sense," Kattermann said. Without country ownership of results-based management, we risk locking in a new type of dependency relationship. Local constituencies and national governments must seek out results-oriented management. "Reporting to Washington must occur per CC and not in the addressee line," Kattermann added.

The results orientation risks obscuring the formation of political will in the host country. Governments will agree to the results focus as a price to obtain funds, but governments generally do not want scrutiny from donors. Donors should attempt to extricate themselves from the micromanagement of projects without risking losing sight of key outcomes. Kattermann stressed the need for an "alignment of preferences or mediation of interests" between donors and countries through policy planning and coordination.

Corruption has a corrosive effect on development. It negates aid, retards economic growth, and sours relationships between partner governments. Nii Osah Mills, a lawyer based in Ghana, stressed the importance of civil society in ongoing efforts to curb corruption in Ghana. Civil society can bridge the gap between constitutional provisions and the prevailing system of cronyism and patronage. The Ghana press, in particular, has become an efficient watchdog by publicizing corruption, and media coverage of parliamentary and presidential debates has aired different political viewpoints. Mills argued that the elites in civil society must play a major role in development by setting the example for strong leadership. One of the most interesting developments in Ghana, Mills said, involves the way that traditional rulers have begun taking a more prominent role in the economic activities of the country.

Fighting corruption is not inherently popular initiative undertaken by governments because it requires a sort of internal house cleaning.

"Corruption is the virus that saps the good intentions of development efforts."

- Paul Applegarth

But increasing transparency and accountability is an important step for building popular legitimacy, argued Stephen Morrison, director of the Africa Program at CSIS. One way to mainstream anti-corruption efforts is for governments and leaders to protect citizens who speak out against corruption. Resources are essential for fighting corruption—"you need guns and lawyers and money," he said. In Kenya, for example, the judiciary has struggled to match the power and resources of those brought for prosecution.

Luncheon Address: Paul Applegarth, CEO, Millennium Challenge Corporation

Paul Applegarth, CEO of the Millennium Challenge Corporation (MCC), presented early lessons in the first year of the MCC's existence, and outlined challenges that lie ahead. The MCC and Congress are currently negotiating contracts with Madagascar, Honduras, Nicaragua and Georgia. The first 16 MCC countries eligible for funding were selected in May 2004, and the first threshold countries were named in September 2004. Congress authorized the MCC in January 2004.

Applegarth indicated his desire for the MCC to have signed its first contract in 2004, but noted that it would more likely occur in the spring of 2005. He compared the MCC to a start-up company and noted that "the MCC and the MCA countries are going through this process for the first time; that is a major difference between the MCC and private sector companies, which already have routine operating units." Still, the speed and efficiency of MCC operations is closer to that of the private sector than to that of the multilateral development institutions.

The specific practices of donors such as the MCC are an important determinant of the ability of foreign aid to positively impact economic growth. Financial auditing and fiduciary responsibility on the part of donors play an important role in the promotion of transparency and results. MCC funding should be viewed as an invest-

ment, not in terms of profits, but in terms of economic growth and poverty-reduction as returns on that investment. “We need to make sure that countries are taking our investment and spending it wisely,” Applegarth said. “Americans are a generous people, but they want to know how their money is spent.”

The economic and governance environment in recipient countries is the other key determinant of the effectiveness of foreign aid. Accountability and country ownership are needed to curb corruption. “Corruption is the virus that saps the good intentions of development efforts,” Applegarth emphasized.

Coordination and strong partnerships are a vital aspect of the MCC approach. It is crucial for countries and donors work together to identify country priorities and craft projects that meet those needs. Some countries will want to upgrade access to specific markets, while others will aim to remake their financial sectors. Applegarth encouraged countries to take time to rework and improve proposals. While this can delay contract negotiations, the MCC proposal process serves to spur policy reform and increase the long-term impact of aid. For example, one country has passed four anti-corruption bills in order to better compete for MCC funding.

Panel III: Managing for Results: Monitoring and Evaluation of Aid Programs

While health and social interventions have enjoyed tremendous success over the last fifty years, economic development efforts have not been nearly as transformative. The basic human needs agenda has not resulted in broad economic growth. Only a small few countries have moved up and out of “least developed” status. The final panel of the conference, moderated by John Simon, Director of Development at the National Security Council, asked how the results and accountability framework could be applied successfully to economic growth.

Development efforts must first and foremost focus on sustaining the momentum of the last half-century, which has been the most successful period for poverty reduction in the history of the world, said Steve Radelet, senior fellow at the Center for Global Development. Nearly half the world population has tripled its income in real terms since 1960. The major challenge in development is how to transplant this record of progress to countries that have struggled with growth.

Whether aid works will depend on the strength of country institutions and on the practices of donors. Currently there is a special focus on country institutions and policies, which influenced the selection criteria of the Millennium Challenge Corporation and still exerts influence over development policy at multilateral development institutions.

Selectivity in aid increases effectiveness. Donors must think about “significantly differentiating the way that we deliver aid to different kinds of countries in order to make it more successful,” Radelet argued. Countries have unique needs and institutions that must be addressed on an individual basis. Countries with strong governance structures should benefit from flexibility and more control over aid. Conversely, countries with weaker institutions and policies should be granted less trust and flexibility with funding. In these cases, more aid should go through non-governmental organizations rather than directly through governments, and donor commitment should be shorter. Countries that fall between the good actors and bad actors should be given a mixture of opportunities, depending on the nature of the program. “We have to get away from this one-size-fits-all approach and recognize that we’re dealing with different kinds of customers,” Radelet said.

Corruption and the lack of transparency and accountability cripple growth in developing countries. Steven Albrecht, associate dean at the Marriott School of Management at Brigham Young University, compared the effect of corruption to “spinning wheels to get back to where you would have been, so you are not progressing.” Corruption cuts back consumption, since the wealth or assistance fails to reach the intended recipient, and discourages investment.

Albrecht laid out some key elements in the effort to curb corruption. Foremost is the tone at the top of an organization, since corruption tends to filter down to the other levels of an organization. Training and education can help people understand the expectations for accountability and sound business practice. There must be controls for integrity, such as public and independent audits, or a government accountability office. There must be a way to enable whistle blowing, reporting, and monitoring free of fear of reprisal.

Forensic accounting combines proactive auditing with investigation in order to detect fraud. Albrecht believes that forensics possesses the tools and technology to root out fraud and analyze the logistics of corruption practices, which can help companies better understand how to protect against future abuse. But forensics alone cannot deter fraud, Albrecht said. Even the best governments or companies will experience some amount of corruption.

Larry Cooley, founder and president of Management Systems International, put forward some lessons on how to manage for results. He argued that results-based management systems can undermine candor and straightforwardness in reporting, which skews evaluation. Information should not be used for punitive purposes, but for learning. In the early years especially, the primary emphasis must be on the productive use of information to improve performance. Cooley suggested that periodicity for management information should be reconsidered. Systems are too frequently set up on the basis of annual reporting in order to match budget cycles, but annual reporting rarely matches management systems.

“We have to get away from this one-size-fits-all approach and realize we’re dealing with different kinds of customers.”

- Steve Radelet

Good systems are inherently conservative. Indicators are changed very reluctantly because doing so causes tremendous disruption for the reporter. Monitoring and evaluation in performance management should be a very public activity and should resonate in the media, the legislative process, and the general public.

Good systems are inherently conservative. Indicators are changed very reluctantly because doing so causes tremendous disruption for the reporter. Monitoring and evaluation in performance management should be a very public activity and should resonate in the media, the legislative process, and the general public.

David Williams, principal in dispute consulting and forensics at Deloitte & Touche LLP, distinguished between results-based management systems and traditional management. Management is problem-centric and strives for the most effective solution, while results systems tend to be donor-centric and serve to justify the donor’s investment and activity. “Neither one is bad. They are bad strictly when they are out of proportion and unfortunately I think in many instances they do get out of proportion,” Williams said. Forensic accounting is an important tool for management because it guards against repeat mistakes, he added.

Ruediger Lentz of Deutsche Welle Radio and TV commented on the shift in the development discourse over the last 40 years, from a sense of a “huge obligation of good-doers from the north trying to save the south” to a “more rational discussion. Accountability was not even a word used in the whole discussion about aid” back then, Lentz said.

The last fifty years have produced tremendous results in international development. But there remains much work to be done, especially in achieving widespread economic growth and poverty reduction. Private sector development and microeconomic reform must be implemented on the heels of macroeconomic reforms. Leadership in developing countries, both in government and civil society, must assume ownership of development goals and build constituencies for reform. Corruption sets back growth, and foreign aid must create incentives for transparency and accountability in developing countries. Donors should become more selective in their approach aid in order to better account for individual country needs and operating environments. Good governance should be rewarded with long-term commitments. The emerging consensus on economic growth and poverty reduction seeks to maximize the effect of aid in developing countries, and offers opportunities for new partnerships and progress.