Assessing US Economic Assistance: Context, Impact, and Implications

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Chairman Corker, Ranking Member Cardin, and Members of the Committee, thank you for the opportunity to appear before you this morning to speak about something as critical as the shape and impact of the US Government's foreign economic assistance programs.

I serve as Vice President for Global Development at InterAction, an alliance of nongovernmental organizations (NGOs). Our 180-plus members work around the world and in every country that receives economic assistance from the United States. What unites us is a commitment to working with the world's poor and vulnerable, and a belief that we can make the world a more peaceful, just, and prosperous place – together. InterAction's members range in size from 4 employees to 40,000 employees and – through a combination of private fundraising and official donor financing – they are collectively responsible for the delivery of billions of dollars in development and relief programs around the world.

InterAction's membership is as diverse as it is strong, and the views of our membership organizations are equally extensive. Consequently, my remarks today are informed by the experiences and lessons of InterAction's members, but they should not be taken to represent the specific view of any individual member organization.

Because the specific key drivers and constraints to inclusive economic growth vary by country, the US can maximize support for positive economic outcomes with a diverse portfolio approach to economic assistance. In essence, this is the same approach taken by any investor who diversifies his or her assets to ensure some level of return. To be effective, this requires more purposeful application of analysis, transparent evaluation and reporting, and a willingness to add legislative authorities that would allow existing assistance mechanisms to be responsive to global economic changes. Finally, given the ever deepening relationships among global economic, political, and societal changes, it remains in the US national interest to provide both economic development assistance, as well as other types of support.

In order to inform your assessment of US economic assistance, I have organized my remarks around responding to three broad questions:

I. What drives and constrains economic growth in developing countries?

II. What does a diverse portfolio approach for US economic assistance entail?

III. How can US assistance respond to today's reality that economic and non-economic issues are deeply intertwined?

I. We know that drivers and constraints to inclusive economic growth vary by country

Questions about what drives or constrains national, *inclusive*, economic growth are the fundamental basis of an ever growing collection of economic research. While others on the panel are better positioned to provide details on the breadth and depth of current research, it is worth noting here two key research findings that continue to have significant implications for how the US constructs its economic assistance programs, both in policy and in practice.

The first is a tangible shift in recognizing the variety of policy combinations that other countries can adopt to effectively drive sustained and inclusive economic growth. While macroeconomic research in the 1980s and 1990s often focused on a specific combination of policies that correlated with growth and stability, research in the 2000s began to recognize more diverse paths to growth. The World Bank Growth Commission, for example, concluded in 2008 that, "…no generic formula exists. Each country has specific characteristics and historical experiences that must be reflected in its growth strategy."[1] This recognition of countries' unique drivers and constraints to growth is significant because it opened a new door to how growth diagnostics can shape assistance programming outside of multilateral economic institutions.

The second key development was a growing body of research on the effect of foreign assistance itself on economic growth. A seminal *American Economic Review* article in 2000 by Burnside and Dollar found that assistance leads to more growth in countries with good policies, but is ineffective elsewhere.[2] The article was so influential that many credit it with inspiring the establishment of the Millennium Challenge Corporation, which is explicitly focused on promoting economic growth as a model of foreign assistance, and uses a data driven approach to make large investments in "the most well governed poor countries." Since then, the field has seen a proliferation of econometrically rigorous studies, ably summarized by my fellow panelist's colleagues from the Center for Global Development in 2014 as, "the majority of studies on aid are positive—but the impact of aid is often modest."[3]

[1] *The Growth Report: Strategies for Sustained Growth and Inclusive Development*. The Commission on Growth and Development. The World Bank. 2008. Overview: p 2

[2] Burnside, Craig and David Dollar, "Aid, Policies, and Growth," *American Economic Review* 90(4) (September 2000): pp. 847–68.

[3] http://www.cgdev.org/blog/1385-billion-question-when-does-foreign-aid-work

Based on this, we cannot say that a single type of foreign assistance intervention is the one silver bullet for all countries that produces sustainable, inclusive economic growth. However, in policy terms, over the last 10 years there has been a clear recognition that inclusive growth fundamentally underpins a variety of foreign assistance, and therefore foreign policy, goals. Whether looking at the 2010 Presidential Policy Directive on Global Development,[4] or either of State and USAID's first two Quadrennial Diplomacy and Development Reviews (QDDR),[5] advancing inclusive economic growth is stated as a clear US foreign policy priority.[6]

Practically speaking, this sentiment also informs the way providers of economic development funds consider the structure of their programs. Specifically, the last ten years brought greater application of preliminary economic assessment as a means of designing assistance programs that better contribute to sustainable, inclusive economic growth.

While economic analysis in general is certainly not new to US foreign assistance agencies, the MCC's "growth diagnostics," first implemented in 2007,[7] put research about a country's binding constraints to growth at the center of decision making about how to allocate assistance dollars. By transparently basing the entirety of its (often half billion dollar) investments on economic research into what specifically constrained inclusive economic growth in a country, MCC provided a proof of concept that US bilateral assistance programming could be based on publicly available evidence.[8] Similar diagnostics were subsequently adopted by a variety of presidential initiatives (PFG,[9] SGI[10]), and now play a key role at USAID as well.[11]

Over this same time frame, the notion of inclusive growth as a precursor to nearly all human development outcomes has also been increasingly recognized by non-profits, foundations, and advocates. While individual organizations may disagree on the best way to promote inclusive growth, or how to manage the gains from economic growth, there is clear recognition that inclusive growth itself is a fundamental element of global development and poverty reduction.

II. As an investor, the US needs a purposeful, diverse, economic assistance portfolio

Because the specific drivers and constraints to inclusive economic growth vary by country, the US can maximize support for positive economic outcomes with a diverse portfolio approach to

4 Presidential Policy Directive #6. http://fas.org/irp/offdocs/ppd/ppd-6.pdf
5 2010 Quadrennial Diplomacy and Development Review http://www.state.gov/documents/organization/153139.pdf
6 2015 Quadrennial Diplomacy and Development Review http://www.state.gov/documents/organization/241430.pdf
7 https://www.mcc.gov/our-impact/constraints-analysis
8 The results of these analysis further supported the notion that individual countries have distinct binding constraints to growth by ranging from a lack of electricity, to poor population health outcomes, to over-regulated labor markets.
9 http://www.state.gov/r/pa/prs/ps/2011/11/177887.htm
10 http://www.state.gov/p/af/rls/2016/253906.htm
11 "USAID increasingly looks to inclusive growth diagnostics (IGD) to sharpen its strategy development process." https://www.usaid.gov/who-we-are/organization/bureaus/bureau-economic-growth-education-and-environment/office-economic

economic assistance. In essence, this is the same approach taken by any investor who diversifies his or her assets to ensure some level of return.

This does not imply that we want a haphazard proliferation of overlapping programs. Capacity constraints in partner countries are real at the human resource, organizational, and system levels, and disorganized US efforts to simultaneously support economic activity with all available tools are likely to lead to both haste and waste. Maintaining a diverse economic assistance portfolio means recognizing the primary value of different tools and deploying them in the country contexts in which they can have maximum impact. Key to this is the continued recognition of the different roles for public and private investments in stimulating economic activity, such as:

- **Non-profit initiatives to identify and expand financial tools for traditionally under-banked populations**. Although sometimes not directly supported by USG assistance, non-profit implementers of economic development programs are increasingly experimenting with new financial services. For example, Mercy Corps launched an early stage impact investment fund focused on East Africa in 2015,[12] while Habitat for Humanity used its own seed money and expertise to partner with OPIC and the Omidyar Foundation to create MicroBuild, a mortgage fund for low income families in the developing world.[13]
- **Funding for public goods:** MCC provides public capital for large scale, multi-year investments in public goods such as infrastructure, sustainable public services, or institutional and market reform. Such funds support investment in large, often multi-faceted public works that are unlikely to be independently supported by private sector actors because the gains cannot be captured, or even realized in the absence of government led policy reform. These investments are prioritized for the greatest growth potential through a politically-insulated cost-benefit analysis tool that estimates the return for each dollar investment
- **Integrated approaches:** USAID, present in nearly every country and capable of supporting year on year programming and sustaining long term relationships is perhaps the most flexible. In recent years USAID has not only provided both public funds and technical capacity building, but has also prioritized efforts to bring private sector actors to the table for joint investment. Whether looking at the agency's big push to build public-private-partnerships for investment in Power Africa, the way USAID moved ahead with USAID forward reforms to better align its operating styles with the private sector, or new momentum at the Global Development Lab to bring break through innovations to bear in development, the agency has taken significant steps over the last several years to maximize the economic growth impact it can have within its current mandate and earmarks.
- **Facilitation of US private investment**: OPIC leverages funding to stimulate US-based private sector activity in a country by providing US companies with debt financing, loan guarantees, political risk insurance, and support for private-equity investment funds. Such

[12] https://www.mercycorps.org/sites/default/files/Mercy_Corps_Social_Venture_Fund_Overview_May_2016.pdf
[13] http://www.habitat.org/sites/default/files/2015-microbuild-fund-annual-report.pdf

funds not only crowd in US investors, but support expansion of US businesses, and generate income for the US treasury.

- **Focus Areas:** Though they are not always economic growth focused, some recent sectoral initiatives explicitly recognize the need to address binding constraints to growth in multiple countries. This includes Power Africa as codified through the Electrify Africa legislation, or Feed the Future and the (pending) the Food Security Bill, which explicitly calls out the importance of functional markets in ensuring food security for populations and livelihoods for small holder farmers.

To be effective without feeling chaotic, this approach requires more purposeful application of analysis and coordination, transparent evaluation and reporting, and a willingness to add authorities that would allow existing assistance mechanisms to respond to global economic changes.

Prioritizing the results of economic analysis over politically popular solutions can feel counter intuitive, but may serve as a tangible way to push greater coordination and impact. For example, over a particular transport corridor in West Africa, a visual inspection would suggest that the primary driver of high shipping costs was the road's condition (too narrow to bear the largest modern trucks, pot holes that required serious reduction in speed, and lack of shoulders for accident bypass). But deeper analysis shows that the greater constraint for the first stretch of transit was the sheer number of police check points at which bribes were solicited, and the greater constraint for the second stretch was the grip of a national trucking monopoly. Simply trusting the visual inspection would have led to a heavy dollar investment that feels satisfying to donors and is politically easy for recipient countries – but would have missed maximum impact by overlooking the effects of corruption or monopolistic behavior. Identifying the totality of the constraint also makes it possible to coordinate across actors who provide infrastructure funding, technical assistance, and support for regulatory reform.

Once programs start, transparent, rigorous monitoring and evaluation is the most significant tool available to determine whether economic assistance is achieving intended outcomes. Impact evaluations and rigorous monitoring are more common at MCC and USAID, but are still mostly underfunded and therefore mostly un-adopted by other agencies responsible for funding or implementing economic assistance. This information, on whether programs achieved the specific impacts they set out to accomplish, is fundamentally necessary if the US is to first understand the effectiveness of different interventions intended to support inclusive growth, and eventually make cost benefit decisions about subsequent investments. To this end, the passage of the Foreign Assistance Transparency Act is a positive step and has been broadly supported by InterAction and its members.

Finally, keeping the portfolio up to date will also require more creative thinking about the authorities required for the US to support national level financial instruments as tools, and to respond to evolving global trends. This may include new authorities for OPIC to self-fund expanded administrative services, regional or sub-national investment authorities for MCC, and greater flexibility for operational and program budgets for USAID so that it can begin a shift to the kind of systematic evaluation which would eventually allow the agency can to make evidence-based decisions about continuing and adjusting programming.

III. US assistance as a whole must recognize that economic and non-economic issues are ever more intertwined

Economic development assistance represents only one part of the broader US foreign assistance tool box, which also includes humanitarian relief, security assistance, and support for democracy and good-governance. These other tools not only alleviate human suffering, but they remain critical pieces of maintaining US leadership abroad. Interventions in traditional human development sectors have also had tremendous impact –scholars document the eradication of small pox, a near doubling of the proportion of children enrolled in school in Sub-Saharan Africa, and planet wide improvements in life expectancy.[14]

There are compelling and credible cases to be made for a each these of investments, from maternal health, to water and sanitation, to post-conflict community development. What may be less immediately intuitive is that there are also economic rationales for supporting the broader range of US foreign assistance. Economic growth doesn't happen in a social or political vacuum. Consequently, when considering the efficacy of US economic assistance, it is worth bearing in mind the following inter-relationships, and the implications they have for how to ensure economic assistance funds generate positive economic outcomes.

Reform, political will, and democratic societies

When it comes to economic reform – even at the micro- regulatory level – no amount of US economic assistance can compensate for a lack of political will. Because it is ultimately the other-country government that reforms and enforces new laws, decisions about which economic assistance tool to deploy should take incentive structures into account. Critical reforms – like subsidy reduction or tariff structure reform – are domestically controversial. In some places, a government's desire to secure public funding for infrastructure or to attract international investors serves as sufficient incentive. In other places, domestic politics may mean that governments can only take difficult reforms if they are accompanied by popular traditional development programs that support health, education, or agricultural services. In this same vein, no amount of economic assistance to a government will fundamentally alter the degree of space for civil society actors, or respect for the rights of citizens. Democracy support remains a critical, and separate, way for the US to support our values abroad.

Exclusion, inequality, and economic opportunity

Because there are fewer economic opportunities for traditionally excluded populations (women, youth, minorities, the elderly) many development programs designed to support these groups have an economic dimension to them. Consequently, a variety of development programs that appear non-economic at first glance may in fact directly support economic goals. For example,

[14] *Getting Better: Why Global Development is Succeeding and How we can Improve the World Even More.* Charles Kenny. Basic Books. 2012.

an agricultural program in the Sahel that focuses on small holder women farmers adopting more efficient irrigation practices may directly increase community incomes.

Pandemics and economic loss

While the health of a labor force has known implications for economic productivity, we have recently seen how the state of a country's health system has deeper implications in the face of a pandemic. For example, the economic consequences of the Ebola outbreak in West Africa were staggering, with Sierra Leone, Liberia, and Guinea estimated to have lost some $2.2 billion in forgone economic growth in 2015. While traditional economic assistance before the outbreak would not have reduced the negative economic consequences later, health interventions might have (either long term support for health infrastructure systems or faster response to the initial outbreak).

Our own national security goals

In 2015, three countries received roughly 40 percent of US economic development funding: Jordan, Afghanistan, and Pakistan.[15] From a national security perspective, the US has multiple goals for providing all types of assistance in these three countries, which not only affects the level of funding, but also the choice of aid vehicles through which the assistance is provided. When US goals around economic growth converge with goals around stability and national security, many of the best practices implemented in other purely economic development programs cannot be replicated.

This list goes on – urbanization, climate change, social accountability, demographic shifts – these are all intertwined with macroeconomic forces to affect the way US economic assistance programs function. In that context, the US must maintain a diverse portfolio of economic assistance tools while preserving other types of assistance which complement and deepen their impact.

Conclusion

I wish to thank the committee for this opportunity to provide testimony. InterAction's diverse membership strenuously and unanimously supports the United States' continued engagement in the world. To a person, our members recognize that that US global leadership must include assistance designed to lift people out of poverty – and the $15 billion in charitable donations that citizens direct abroad every year suggests the American people do too. In that context, we believe both in the economic necessity of growth, and the human imperative of ensuring that growth is inclusive.

[15] Based on data from the Foreign Assistance Dashboard at http://beta.foreignassistance.gov/