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America's Total Economic Engagement with the Developing World: Rethinking the Uses and Nature of Foreign Aid

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Introduction

Foreign aid is back on the front burner of U.S. foreign policy. After World War II U.S. government dollars helped rebuild Europe and Asia and contain Soviet influence. Next, after the collapse of communism, aid helped newly democratic states recover from the miseries of central planning. In his first term, President Bush increased the U.S. Government aid budget by 50 percent, the largest increase since the Marshall Plan in 1948. Moreover, the way aid is distributed has been reinvented by the Bush administration to promote effective giving through the new Millennium Challenge Corporation (MCC).[1] U.S. aid, at $16.3 billion per year in 2003, now dwarfs other developed countries, with Japan coming in a distant second at $8.8 billion.

Despite this U.S. Government generosity and creative thinking about foreign aid, claims that America is "stingy" still abound. Economist Jeffrey Sachs, joined by a chorus that includes the *New York Times* editorial page, European governments and the UN, all believe that U.S. Government aid is inadequate. By doubling foreign aid to Africa in particular, as Sachs and the report on Africa commissioned by British Prime Minister Tony Blair recommend, donor countries, it is claimed, will finally be able to lift Africa out of its downward economic spiral.

The criticism of American generosity comes from the much-quoted statistic that U.S. Government foreign aid ranks last among developed countries as a percentage of gross national income (GNI). This annoys Americans as we tend to think of ourselves as a generous people. We invest the most overseas, provide the most militarily for global disasters and security, produce the bulk of the world's research and development for better food and medicines, and provide preferential trade agreements that support imports from developing countries.

So, why should America, the richest nation in the world, not be more caring with its government foreign aid? The simple answer is: We are. The standard measure of foreign aid used to compare us to other donors, produced by the Paris-based Organization for Economic Development and Cooperation (OECD), is incomplete and misleading. It excludes America's private international assistance.

Conservative estimates indicate private international assistance, which is growing significantly every year, is over three and one-half times greater than U.S. government aid. Americans help people abroad the same way they help people at home — through private foundations, corporate giving, voluntary organizations, universities, religious organizations, and money sent back home to needy relatives. In 2003 this private philanthropy came to at least $62.1 billion compared to $16.3 billion of U.S. Government aid, or what is called Official Development Assistance (ODA).

This White Paper updates the private international giving numbers that were produced by the Hudson Institute for the U.S. Agency for International Development report, *Foreign Aid in the National Interest*, for 2000.[2] The new numbers for 2003, the last year for which data are available, are significantly higher than 2000 and reflect a continued growth in private giving as well as increased interest and attention to better measurement of U.S. global philanthropy. For its part, the Hudson Institute is developing a new Index of Global Philanthropy that will document U.S. private giving and begin collecting these numbers from European and other donor countries.

U.S. Government and Private International Assistance to Developing Countries

Based on new research and new data sources, the Hudson Institute has developed a considerably higher figure for 2003 U.S. private international assistance than the year 2000. The following table, using the latest official government figures as well, shows total U.S. economic engagement with developing countries. This engagement includes our government foreign aid or ODA, our private assistance or philanthropy, and our private capital flows or private investment overseas. The table illustrates the small role that ODA plays in America's economic engagement with the developing world. Over 85 percent of that engagement is through the private sector, in either philanthropy or private investment.

Presenting this full picture, not just a limited government foreign aid number, is a more accurate way of measuring American generosity and impact in the world than the current system developed under the OECD.

Estimated U.S. Total Economic Engagement with Developing Countries in 2003

	$US Billions	% of Total
U.S. Official Development Assistance	**16.3**	13
U.S. Other Country Assistance	**1.5**	1
U.S. Private Assistance	**62.1**	47
Foundations	3.3	
Corporations	2.7	
Non Profits and Volunteerism	6.2	
Universities & Colleges	2.3	
Religious Organizations	7.5	
Individual Remittances	40.1	
U.S. Private Capital Flows	**51.0**	39
U.S. Total Economic Engagement	**130.9**	100

U.S. Official Development Assistance

This number of $16.3 billion represents what the OECD allows the U.S. Government to count as Official Development Assistance (ODA). This is the so called "donor performance" number that is compared to other countries. It includes the budget of the U.S. Agency for International Development, the Peace Corps, contributions to the World Bank and other multilateral agencies, some State Department refugee and humanitarian programs and some Department of Defense humanitarian functions. Not allowed, and thus not counted in this number, are significant DOD peacekeeping and security efforts.

Other Country Assistance

This category of $1.5 billion includes U.S. Government aid to Israel, the former Soviet Union, and central and eastern European nations. Aid to these countries is not counted in America's tally because, according to OECD guidelines, these countries and regions are more economically developed than others.

Foundations

Private foundations gave $3.3 billion in 2003. This figure is based on the Foundation Center International Grantmaking Report.[3] We took corporate foundation giving of $115 million out of this number and added it to the corporate giving category. We also included some additional foundations since they were not surveyed in the Foundation Center report. These give significant amounts to developing countries, and they include the UN Foundation, the US Fund for UNICEF, and the

Better World Foundation, totaling $413 million in 2003.

Corporations

We found references for corporate giving for a total of at least $2.7 billion. The corporate giving number is vastly underestimated since there is no comprehensive survey of global corporate philanthropy. Many companies do not even keep complete records of their cash and in-kind giving, nor are cause-related and overseas affiliate giving well-documented.

This number is comprised of a separate large-scale study of the pharmaceutical industry which included data for in-kind contributions from a survey conducted by the Center for Pharmaceutical Health Services Research at the Temple University School of Pharmacy, sponsored by the Partnership for Quality Medical Donations (PQMD). This number is only a sample of nine pharmaceutical companies out of 33 members of the Pharmaceutical Manufacturers Association. Also included are data for cash contributions from various company annual reports and the International Federation of Pharmaceutical Associations which has surveyed the major companies.[4]

We added additional corporate numbers from other industries, obtained by researching annual reports and making direct phone or e-mail communications with individuals responsible for corporate philanthropy. USAID also provided a number for corporate contributions to its Global Development Alliance (GDA) program. As Hudson proceeds with developing the new Index of Global Philanthropy, we hope to capture corporate giving more fully.

Non-Profits and Volunteerism

The total number of $6.2 billion for non-profits and volunteerism comes from two sources. The first, $2.9 billion, is from a methodology developed by the U.S. Agency for International Development (USAID).[5] Because USAID keeps full records on its registered non-profits, the data are considered robust, even if some U.S. non-profits may not be registered with them. To this number we added an estimate of volunteer time, reported by the Independent Sector.[6] Since the data for the value of 2003 volunteer time have not been updated, we used the original number calculated for 2000 of $3.3 billion.

Universities and Colleges

The $2.3 billion number for universities and colleges is reported by USAID from data calculated by the Department of Commerce Bureau of Economic Analysis.[7] It reflects the dollar amount of scholarships and other support provided by U.S. academic institutions to students from developing countries.

Religious Organizations

Religious organizations are the most under-reported in international private giving. This is because most do not keep comprehensive records on global giving, and there is no systematic survey of all U.S. religious organizations. The number of $7.5 billion used here is one reported by various organizations that have kept records on their international giving. It does not capture, however, the individual donations and projects of thousands of local churches, synagogues and mosques throughout America that give on a continual basis to overseas people and projects.

Worker Remittances

Hudson used USAID-generated data on worker remittances to developing countries in its compilation of private giving for 2000. The number used in this Hudson White Paper update, however, includes a combination of USAID data and new data from the Multilateral Investment Fund and the Pew Hispanic Trust. [8,9] These remittance numbers cover the amounts that all U.S. states are sending back to Latin America. The number of $30.1 billion is larger than that of the USAID sample survey for Latin America. Since similar independent data sources are not available for other regions of the developing world, we used the regional numbers developed by USAID for the rest of developing countries. These totaled $10 billion, for a total of $40.1 billion that is being sent to relatives and villages in poor countries for such things as food, medicines, and shelter.

U.S. Private Capital Flows

This number includes foreign direct investment and net capital markets in developing and emerging economies, and is an important measure of U.S. total economic engagement with developing nations.[10] This category is most indicative of the U.S. contribution to long-lasting economic growth and prosperity in these countries. The number includes direct investment by American companies in agriculture, manufacturing and service industries that creates jobs and income for poor people. It represents the involvement of U.S. companies and institutions in foreign capital markets as well, investment that helps develop permanent economic and social infrastructure in the developing world.

The Privatization of Foreign Aid

Measuring national generosity only by government spending ignores new economic realities. Until the early 1990s most international resources flowing into developing countries came from governments through bilateral or multilateral aid programs. But, in 1992, foreign direct investment and financial markets took off in developing countries. For the first time, these private flows exceeded official financial flows. Developing countries were attracting the kind of private capital that creates and sustains economic growth.

As financial flows went private, so did foreign assistance. International private giving has skyrocketed over the last twenty-five years. While Europeans and the Japanese continue to give primarily through their governments, Americans give primarily through private institutions. Nevertheless, private giving is growing in Europe as well, although it is not well-documented.

Inaccurate Assumptions about Official Development Assistance (ODA)

Effectiveness of ODA in Reducing Poverty

Those enthusiasts for doubling government aid to Africa cling to the notion that official development aid helps countries grow economically and thereby reduce poverty. They ignore the vast body of evidence over the last two decades showing that there are few if any economic growth effects from foreign aid. Citing a few new studies, proponents of massive foreign aid transfers ignore the majority of long-standing studies on aid effectiveness.

It is important to briefly review the actual data on aid effectiveness because the current arguments for doubling foreign aid focus only on inputs, not outputs. Africa has received an estimated total of $520 billion in ODA over the last 26 years. Even this figure excludes all the private investment and philanthropy going into Africa and the continents' own oil revenue. Since 1978, Nigeria alone has earned $300 billion from oil exports.[11] This, along with other extractive industries in other African countries, would double the ODA figure to over 1 trillion dollars.

Where did this money go? Why is Africa in such abject poverty? What worked and what didn't work in foreign investment and assistance? These are the questions that need to be answered before the developed world pours more money into Africa.

Only one study, by World Bank economists in 2000, has shown a possibility of development aid effectiveness. The authors concluded that, "Development assistance can contribute to poverty reduction in countries pursuing sound policies."[12]

William Easterly, former senior economist with the World Bank and professor of economics at New York University, however, is now questioning even these findings.[13] When the data sets are expanded beyond the four years used by Dollar, Burnside and Collier, he found that over the period 1970-1997, aid as a proportion of GDP growth declined relative to growth per capita. He concludes that the governments of poor countries often have little incentive to raise the productive potential of the poor, especially when doing so might engender political activism that threatens the current political elite.

Aid agencies themselves in this difficult environment do not have much incentive to achieve results, since the results are mostly unobservable. Easterly writes: "One can hardly monitor growth itself for a given country for a given year, since growth in any given year or even over a few years reflects too many other factors besides aid. In these circumstances, it is understandable the aid agencies prefer to emphasize an observable indicator of effort — namely aid disbursements."[14]

Using the exact specifications as Dollar, Burnside and Collier, and adding more data than had become available since their study was performed, Easterly, Levine and Roodman (2003) found that the coefficient on the crucial interaction term between aid and policy was insignificant in the expanded sample including new data, indicating no support for the conclusion that "aid works in a good policy environment."[15]

Other studies (Dalgaard and Hansen, 2001; and Lensink and White, 2001) have found that when particular variables are added, the coefficient on "the interaction between aid and policy becomes near-zero and/or statistically insignificant."[16]

The Easterly findings themselves are consistent with perhaps the most exhaustive longitudinal study ever conducted on foreign aid. In January 2000, the Oxford Policy Institute published a retrospective study of aid, covering 50 years.[17] Some of its findings include:

- The effects of aid on poverty are complex and, on average, neutral;
- Aid has had no effect on public spending allocations: governments simply transfer tax money away from sectors favored by donors;
- The benefits of public income transfers are prone to capture by better-off groups;

- 50 years of aid have done little for the world's poorest people or for improving income distribution;
- Even if governments wish to ensure that the poor benefit most, officials are constrained by political considerations to act more on behalf of better organized more vocal, urban groups;
- Aid managers tend to be judged on their implementation rates rather than on programme outcomes;
- Much of the investment [foreign aid] failed to take into account the recurrent costs of maintenance and service delivery, leaving a legacy in many poorer countries of unaffordable social services and of decaying and under-utilized economic infrastructure.

The above macro-analyses on lack of aid effectiveness refer primarily to what is called development aid, or assistance that is supposed to improve economic growth and create lasting institutions in poor countries.

Other types of foreign aid have had a greater degree of success. Disaster relief and humanitarian aid have been more effective and have drawn the strongest support from the American public. The United States has been a leader in delivering goods, coordinating disaster relief, and leveraging vast resources from private contributors. USAID has helped countries implement immunization campaigns, feeding programs and public health emergency programs that have saved countless lives around the world.

Foreign aid has also been used for security assistance in countries where the United States has had strategic interests in combating communism, promoting peacekeeping, maintaining military bases, and controlling nuclear weapons and narcotics. This aid has had a mixed record in achieving strategic objectives. It is not correct to say, however, as Sachs does in *Foreign Affairs*, that U.S. Government security assistance is not "development aid."[18] In fact, most of the assistance to strategically important countries has been delivered in the form of economic development or humanitarian aid. Unfortunately, though, this aid has had the same poor track record as development assistance in other countries.

There are many reasons for lack of aid effectiveness — it isn't delivered properly, corrupt governments siphon it off, donors don't address the real problems, it goes into the pockets of aid consultants and so forth. All of these contribute to aid failures. But, instead of addressing aid effectiveness and looking at projects, country policies, governance and economic freedom in African countries, the enthusiasts for doubling foreign aid focus only on inputs, not the poor track record on outputs.

In fact, more inputs in the form of ODA has had an inverse relationship to economic growth in Africa. In his review of aid effectiveness, "Can Foreign Aid Buy Growth*?,"* William Easterly provides a full review of the theories, data, assumptions and fallacies of foreign aid.[19] Most notably, he tracks ODA as a percent of GDP in African countries against their economic growth over 30 years. The results are plain to see. Since the late 1970s, as economic performance in African countries deteriorated, ODA increased.

Ability of Governments to Use More Foreign Aid

Jeffrey Sachs claims that: "The idea that African failure is due to African poor governance is one of the great myths of our time."[20] He then points to past corrupt leaders like Idi Amin and Mobutu, who are no longer around. With their passing, he seems to believe that corruption and poor governance in Africa is no longer around. What is missing from this analysis, however, is a hard look at many current African leaders. Robert Mugabe has caused famine in his country and is now bulldozing shanty towns leaving his citizens in despair. The British High Commissioner and American Ambassador have openly accused Kenyan officials of stealing from aid projects intended to help the poor. Poor governance by non-democratic regimes has been widely documented by public watch groups and aid agencies alike, including the World Bank.

Even if Africa were free of corruption and most of the countries allowed a free press and their citizens to vote, the issue of the continent's absorptive capacity to spend aid dollars is a real and growing problem. A spokesman for Botswana president Festus Mogae warned, "If people think they can throw $100 million at a problem and expect everything to work perfectly and quickly, well, it won't happen with AIDS….There are all kinds of organizational bottlenecks, training people and retraining them… It takes time. People can learn from our mistakes and our successes."[21] Disbursements by The Global Fund for HIV/AIDS, Malaria and Tuberculosis (GFAMT) fell from $400 million in 2002 to less than $100 million by the end of 2004.

The Role of Remittances

Many proponents of increasing government foreign aid are highly critical of counting worker remittances to poor countries as private international philanthropy — despite the fact that these remittances are playing significant roles in developing countries' economies. In six Latin American countries, remittances constitute 10 percent of GDP. The study by the Multilateral Investment Fund and Pew Hispanic Trust found that remittances…. "are keeping large numbers of working-class families from slipping into poverty."[22]

Remittances are being increasingly studied for their impact on people and economies and are fast becoming an integral part of global private philanthropy. For example, the World Bank states: "Workers' remittances provide valuable financial resources to developing countries, particularly the poorest."[23] The Blair Commission report was also high on these newly recognized financial flows to poor countries: "Remittances are a key source of financing for developing countries," the report stated, "and globally have risen from US $20 billion to nearly US $100 billion between 1983 and 2003, long overtaking official capital flows. They are now the second largest source of development finance, after FDI."[24] This $100 billion figure refers to remittances from all countries to the developing world.

The Real Problem

Proponents of doubling foreign aid continue to squabble over the right side of the decimal point as they try to push the U.S. from .15 to .7 percent of GNI devoted to ODA. The .7 percent target is a totally arbitrary milestone with no economic significance. Yet First World pundits and Third World bureaucrats have managed to give it meaning. The idea originated in the 1950s when the World Council of Churches urged countries to devote one percent of GDP to foreign aid.[25] Over the years this morphed into .7 percent, a goal only a handful of donors have ever reached. Even the OECD, in one of its reports, admitted that the goal was unreasonable and countries were likely not able to absorb that much aid anyway.[26]

The real problem with the UN Millennium Development Goals approach and the Blair Commission report is that they propose statist models for development, with the bulk of funding going into public budgets so that government bureaucrats can engineer solutions for people. These approaches hold that the problems of global poverty are solved through massive foreign aid transfers, grand pronouncements, dramatic events, and top-down silver bullet solutions.

There is little recognition that aid projects have to be conducted in real countries with customs officials who want bribes, leaders who favor their own tribes or withhold food from rival tribes or religious groups, doctors who aren't paid enough by the government so they sell what should be free medicines and services, and lack of free press and elections that provide the important checks and balances on both private and government officials.

Celebrities are in the aid game more than ever now, with Sharon Stone raising $1 million at Davos for bed nets and Bob Geldof imploring people to join his Live 8 concerts and G8 protests in Gleneagles, Scotland. Impractical solutions for reducing poverty, regardless of how well-meaning, are all around. Representative Spencer Bachus has stated in the past that, "to be able to save lives in another country by forgoing a Big Mac sandwich or a Sunday newspaper… is a clear example of something we ought to do out of the goodness of our hearts."

Global poverty and government giving has become an emotional, popularized and trendy issue, lending only increased support for outdated and simplistic approaches.

What Creates Prosperity

Private investment and capital flows create prosperity. Societies that allow their citizens the freedom to use their talents without government interference create prosperity. In this way, wealth spreads quickly among many, not just among a reigning few.

Government foreign aid can provide crucial help in disasters and humanitarian assistance and help leverage projects through public/private partnerships, but its role is limited in increasing growth. Now that Official Development Assistance makes up a much smaller part of the developing world economy and private flows of both philanthropy and investment prevail, the way we measure and think about foreign aid must change.

In short, ODA is the handout of the last century. It is America's total economic engagement with the developing world that creates prosperity.

The Role of Foreign Assistance — Both Private and Public

Donors must embrace the full spectrum of international assistance, including the much larger private philanthropy from foundations and churches to corporations, universities and worker remittances sent back home. Private aid passes the crucial "market test" by raising private dollars and volunteer time. Government aid programs should work more closely with the private sector, partnering with successful private aid programs.

U.S. Government foreign aid should also foster philanthropy in recipient nations. Official aid programs have moved away from this model by working with large consulting firms, many of which rely on U.S. Government contracts and are not interested in working themselves out of a job. Herein, however, lies a unique niche for foreign aid — helping countries set up the tax structures, non-profit governance models, and other systems for private giving.

Foundations, churches, universities, hospitals, corporations, business associations, volunteer groups, and hard-working immigrants are delivering more than just money to developing countries. They are delivering the values of freedom, democracy, entrepreneurship, and volunteerism. In this diverse yet connected world, the U.S. government must shed its "donor" mentality and become a true partner, enabling others to reduce human suffering and create lasting institutions to carry on that work.

Endnotes

[1] Under the MCC, countries receive foreign aid dollars when they demonstrate good governance and sound economic policies that support the private sector and economic growth. While the MCC has taken several years to get projects funded, this start-up time is no different than any other government or multilateral aid program. In fact, the Global Fund for HIV/AIDS, Malaria and Tuberculosis, from the time it was announced, took over a year and one half to make its first disbursement. According to the World Bank, the Global Fund had $2.4 billion at the end of 2004, but had disbursed less than $700 million, or less than 30 percent of its cash on hand.

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[4] Carol Adelman et al. *A Review of Pharmaceutical Company Contributions: HIV/AIDS, Tuberculosis, Malaria, and Other Infectious Diseases*, Hudson Institute, Washington DC, November 2004. p. 5.
[5] Office of the Global Development Alliance, United States Agency of International Development, January 2005.
[6] Independent Sector, *New Nonprofit Almanac in Brief.*, Waldorf Maryland, 2001. p. 15.
[7] Bureau of Economic Analysis, Department of Commerce, January 2005.
[8] Roberto Suro, "Remittance Senders and Receivers: Tracking the Transnational Channels," Multilateral Investment Fund, Pew Hispanic Center, and Bendixen & Associates, Washington DC, November 24, 2003.
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[10] Office of the Global Development Alliance, United States Agency of International Development, January 2005.
[11] Ian Gary and Terry Lynn Karl, "Bottom of the Barrel: Africa's Oil Boom and the Poor," Catholic Relief Services, June 2003. p. 5.
[12] David Dollar, Craig Burnside and Paul Collier, "Aid Effectiveness: Help in the Right Places" the *Economist*, March 16, 2002. pp. 73-74.
[13]William Easterly, "Can Foreign Aid Buy Growth?" *Journal of Economic Perspectives,* Volume 17, Number 9, Summer 2003. p. 27.
[14] Ibid. p. 35.
[15] Ibid. p. 27.
[16] Ibid. p. 26.
[17] R. Hay, *International Aid: Economics and Charity*. Oxford Policy Institute Brief 1. Oxford 2000.
[18] Jeffrey Sachs, "The Development Challenge" *Foreign Affairs*, March/April 2005.
[19] Easterly, "Can Foreign Aid Buy Growth?" pp. 23-48.
[20] Daphne Eviatar, "Spend $150 Billion Per Year To Cure World Poverty" the *New York Times,* November 7, 2004.
[21] John Donnelly, "Botswana's efforts offer cautionary tale on HIV funding," the *Boston Globe*, June 12, 2005.
[22] Suro, "Remittance Senders and Receivers: Tracking the Transnational Channels," p. 5.
[23] Douglas Hostland et al. *Global Development Finance: Mobilizing Finance and Managing Vulerability: I Analysis and Statistical Appendix 2005*, World Bank, Washington DC, 2005. p. 28.
[24] Commission for Africa Our, *Common Interest: Report of the Commission for Africa*, March 2005. p. 304.
[25] OECD, "Development Assistance Committee in Dates." Development Assistance Group, Paris, 1999.
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