

Lecture at Duke: "Re-targeting Foreign Assistance to Promote Private Enterprise Development"

Robert Myers, Sanford Institute of Public Policy, Duke University, 3/20/03, 5:30 PM

I. About Me

A. My father and Mother spent their first 25 years (1900-1925) in small towns in Oklahoma and Kansas. **My father** got his Ph.D. in Economics from the U of Chicago focussing on unemployment problems and came to DC with the New Deal in 1932. I was born in DC just before Pearl Harbor. My father influenced me to become a Ph.D. economist. I adopted his focus on employment (the magic elixir) and unemployment (societal disaster). My quote stemming from this is:

"A country can't identify its poverty problem until it has achieved full employment."

B. My mother strongly believed three things about successful people: 1) They have detailed knowledge of and often quote the Bible; 2) They've served in the military; and 3) they're lawyers. For me this represents three strikes, with a slight exception. I often use two quotes from the Bible. One, about indecision, concerns the dilemma of Burden's Ass. The other is, "falling like Manna from heaven."

C. This talk is about who gets Aid or Manna from heaven.

1. It is a talk about GRANTS not about loans or the (implicit) subsidy element of loans. Donors like the World Bank and IMF who give loans to Developing Country Governments (DCGs) are not giving aid.¹ Unfortunately the World Bank and IMF set the aid agenda.
2. The KEY difference between my view and that of Donors is that they think giving aid to Developing Country Governments (DCGs) improves governance (public sector administration) and through this, private enterprise development. I think the reverse: **that aid going to private entrepreneurs promotes BOTH faster growth and better governance.** Aid to DCGs, particularly if it is loans, finances increased government administrative interventions, thus stifling private enterprise growth.

II. What is Development?

A. In my view, development doesn't occur until and unless there are simultaneous increases in employment and Total Factor Productivity (TFP). If both of these are occurring together, then GDP and domestic income are

¹ See <http://users.erols.com/rmyers1/MeltzrRpt2.PDF> for my note, "Comments on the Meltzer Report: Can Public-Sector Foreign Debt Alleviate Poverty?"

increasing because of, 1) increases in employment and 2) increases in productive efficiency (TFP). Furthermore, the distribution of income is probably also improving.

1. Employment increases with increases in **private sector investment**.
2. TFP increases with greater **competition**. Increased TFP (greater productive efficiency) **reduces** the strain of GDP growth on the environment.
3. Simultaneous increases in private sector investment and competition **REQUIRES freedom of entry and exit and freedom of calling (competition amongst laborers)**.
 - a. Freedom of entry means that starting up new businesses is easy and inexpensive. Freedom of calling means individuals can pursue that calling that they feel best qualified for (a craft union concept-Florence Italy).
 - b. Freedom of exit requires asset markets. It means that investors can sell their business and move on.

III. Why Doesn't Development Happen?

- A. Traditional View: Developing countries have many high-yielding, growth inducing investment possibilities, but **poor country governance** and **shortages of** savings, credit, government revenue, foreign exchange, entrepreneurs, etc.² Hence the need for aid to correct for these problems. The focus of aid-giving is the **country** or the government, not private enterprise.
- B. The Myers View: Aid-supported governance is excessive (predatory) and the shortages do not, or need not exist. **Witness informal economic activity**.³ The major problem is a lack of private sector competitive investment, caused primarily by **suppression** of freedom of entry and exit and freedom of calling. Most DCGs intervene excessively favoring the protected few, thus sanctioning corruption and tremendously raising the costs (and risks) of new, competitive investment. This prevents fragmented domestic investment, forces household savings to go abroad and stifles growth in the domestic tax/borrowing base. This forces DCGs to seek aid and loans from abroad rather than from their own citizens.

IV. The Myers (Free Initiative) Solution-Detail

- A. Developing Country Governments should be made to be completely **dependent on domestic resource mobilization** (local taxation and domestic currency borrowing) for financing public sector expenditures. There should be no public sector foreign borrowing. This makes governments dependent on private enterprise development, not the other way around.

² A complete recent statement of the traditional view can be seen in USAID's 2002 policy document entitled, "Foreign Aid in the National Interest: Promoting Freedom, Security and Opportunity." Online at http://www.dec.org/pdf_docs/PDABW901.pdf

³ On formal versus informal economies go to <http://users.erols.com/rmyers1/SubstantNotes.html> and click on my note entitled, "Should the Government of Egypt Try to Bring Informal Firms into the Formal Economy?"

- B. Domestic borrowing (local currency bond issues) by governments helps establish domestic asset markets.⁴ These are crucial for freedom of entry and exit **and** for keeping household savings at home (i.e., reducing pressures to devalue).
- C. From the above it follows that aid should promote enterprise development (build the domestic tax base). There should be no distinctions between foreign and local resident investors with respect to taxes and commercial law/regulations.
 - 1. The **only** requirement for starting a business would be **registration with tax authorities**. Other regulation may follow the establishment of businesses, however.
 - 2. In-kind subsidies should be targeted to nascent (mostly initially informal) private goods **and service** enterprises. (Note: services are very important. For instance, "the financial system" is a collection of service providing enterprises.)
 - a) Subsidies should "collateralize" emerging businesses making them creditworthy for commercial bank borrowing.
 - b) Subsidies should ease entry by reducing commercial start-up costs and risks.
 - c) Subsidies should be transferable amongst private investors. This means that there must be easy sale and purchase of productive assets through asset markets and bankruptcy procedures.
 - 3. At present the public sector administrative apparatus in most developing countries is "too large" compared to their private sectors. The aim of aid should be **to expand private enterprise relative to the public sector administrative apparatus**.

V. The Traditional View (Administered Development) Revisited and Critiqued

- A. Aid goes to DCGs to:
 - 1) Improve governance or public sector administration
 - 2) Encourage the adoption of "correct" policy reforms
 - 3) Fund any and all public sector expenditures (money is fungible)
- B. Critique
 - 1) The most important critique of the traditional aid approach is that it **doesn't work**, even by the weak and contrived measures established, (frequently *ex post*) by Donors. Most importantly, incredible amounts of traditional aid have not increased either employment or TFP.
 - 2) The essence of "good governance" and "correct policy reforms" ("best practices") is **unknown and unknowable**. Furthermore, Donors **don't know how to cause improvements in governance and policies**. In fact,

⁴ The benefits of domestic debt markets are considered in my note entitled, "The Need for Domestic Currency Denominated Debt (Bond) Markets in Developing Countries." Copy and paste the following URL into your browser and then open the MS Word file to read the 4 pp. note.
<http://users.erols.com/rmyers1/domdbt3.doc>

Donors aren't able to induce improvements in governance and policies
Because these improvements are **endogenous** and dependent on
rapid growth in competitive (fragmented) private enterprise.

- 3) David Dollar (DD) versus Dani Rodrik on causality and trade liberalization.
 - a) David Dollar says "successful" external trade reforms will cause increases in external trade but his measures of successful reforms are not independent of increases in trade. In the OED data base he uses evaluators (I among them) labeled external trade reforms structural as "successful" if trade increased. Of course David Dollar will find a high correlation between (OED identified) "successful" trade reform and increased trade.
 - b) Dani Rodrik says external trade increases with increased domestic GDP growth and trade, **regardless** of the trade regime.

VI. Comments on Development Buzz-Phrases

Here are some buzz-phrases that I have opinions about:

- 1) Stakeholders/Ownership (Agreeing with the US)
- 2) Governance (= Administration; i.e., non-market, non-incentive based approach)
- 3) Sustainability (a complete obfuscation)
- 4) Picking winners and losers (i.e., what commercial banks do)
- 5) Social costs of adjustment (i.e., unemployment, opportunities foregone)
- 6) Buying a place at the policy-making table (there is no such table -- policy-making is an endogenous process)

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