Increasing Trade & Investment

Policies, Institutions, and Development Assistance

Summary

Globalization offers an unprecedented opportunity for developing countries to achieve faster economic growth through trade and investment. But these resource flows remain concentrated among relatively few, largely middle-income developing countries. Can low-income developing countries benefit from the global economy? This paper argues that through greater openness and sound governance—reforms that raise the level of economic freedom—low-income developing countries can gain access to global product and capital markets, and many have already done so. The same measures encourage local investment and enterprise as well. Elements of successful reform programs include achieving macroeconomic stability, liberalizing the trade regime, strengthening the role of the private sector in the economy, and establishing the rule of law. The key is to sustain the pace of reforms, and this is where development assistance can play a major role: nurturing support for reform, building market infrastructure to support private transactions, and assisting vulnerable segments of society through the transition.

United States Agency for International Development

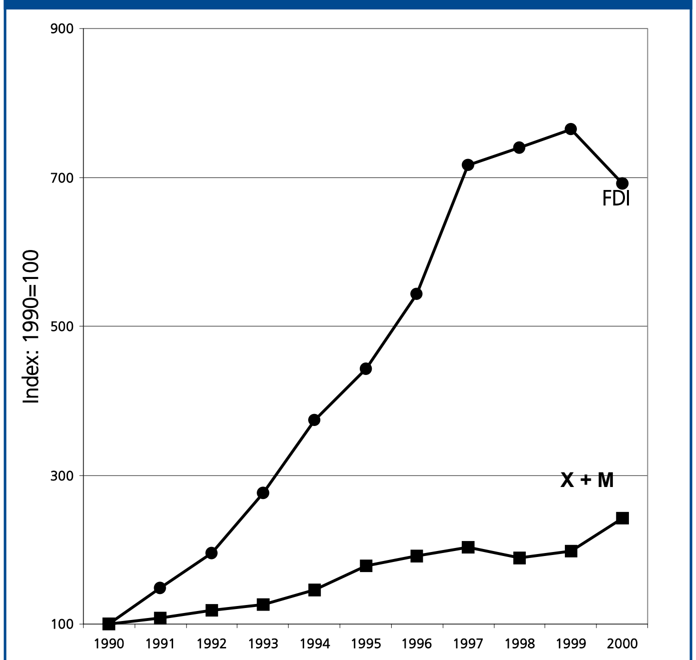
Introduction

The global economy offers an unprecedented opportunity to direct resources toward development. Over the past 10 years, developing countries' total trade—exports and imports—has grown from less than $1.9 trillion to nearly $4.6 trillion. Growth in private capital flows has been even more dramatic: net foreign direct investment, or FDI, to developing countries rose from $24 billion in 1990 to $184 billion in 1999. Countries that have experienced growth in trade and investment have achieved correspondingly faster economic growth.

The key to unlocking the power of trade and investment is expanding the circle of countries actively participating in the global economy. Recent work at the World Bank shows that growth in trade volume has been closely related to subsequent GDP growth in a large sample of developing countries. For a select group of countries that are rapidly integrating into the global economy, trade growth has played a critical role in supporting rapid growth in incomes and making progress in reducing poverty.[1] These findings add weight to previous research showing that developing countries that adopted more open economic policies have achieved substantially faster income growth than have countries that kept their economies closed.[2]

Yet why is it that some countries get this bounty and others do not? Some have argued that trade and investment are only available to a select few countries, such as those on the borders of the developed world or those with natural resources. In fact, trade and investment have the potential to reach every corner of the globe. While several factors influence the ability of developing countries to attract trade and investment, growth in these flows largely depends on the internal process of opening up economies—both internationally through lower trade barriers and domestically through strong private markets, macroeconomic stability, and the rule of law.

Figure 1. Developing Countries: Growth in Total Trade and Net FDI Inflows



Note: X = exports; M = imports.

Foreign Direct Investment and Economic Freedom

FDI is among the most important capital flows an open economy can attract. FDI has drawn increased attention in recent years as a valuable form of capital, because transfer of production, marketing, and organizational technology may accompany such funds. Just as important, FDI has proved less vulnerable to investor runs and cross-border contagion than either portfolio capital or bank lending, thus providing a valuable source of financial stability.

FDI has also been a harbinger of globalization. Direct foreign investment inflows to developing countries were essentially flat from 1970 to 1986, fluctuating around $11 billion in 2000 dollars. These figures were small relative to development assistance and other official flows. Then, from 1986 to the late 1990s, the trend shifted sharply upward: net FDI to developing countries rose more than sevenfold in the 1990s.

Middle-income developing countries receive the vast majority of all FDI flowing to the developing world. Since 1997, middle-income developing countries (those with per capita incomes above $750) have garnered some 93 percent of all such FDI. Even within middle-income countries, FDI flows are concentrated—the top

[1]David Dollar and Aart Kraay, "Trade, Growth, and Poverty," Development Research Group, (Washington, DC: World Bank, 2001). These results are examined in broader context in Paul Collier, David Dollar, et al., Globalization, Growth, and Poverty: Building an Inclusive World Economy (Washington, DC: World Bank, 2001).

[2]Jeffrey D. Sachs and Andrew Warner, "Economic Reform and the Process of Global Integration," Brookings Papers on Economic Activity (1: 1995: 1–118).

10 recipients of FDI consistently account for over 70 percent of the developing world's total. FDI is focused on a few countries that are large, relatively advanced, or both. These include China, Mexico, Brazil, Korea, Thailand, Malaysia, Indonesia, Poland, Hungary, Colombia, the Czech Republic, Peru, India, Chile, Argentina, and Hungary.

However, these figures obscure a more important fact. While most FDI does flow to middle-income countries, the ratio of FDI to GNP has been relatively high in a number of poor countries, including Bolivia, Cambodia, Ghana, Mozambique, Tanzania, and Vietnam. The amount of FDI going to poor countries may be low relative to total FDI, but it can be high relative to the size of these economies. Furthermore, this phenomenon is not simply a function of investment associated with natural resources such as oil or diamonds.

FDI to the poorest countries can increase very rapidly even if initial levels are low. The ratio of FDI inflows to GDP among low-income countries rose from 0.5 percent in 1991 to 1.8 percent in 1997, before falling back to 1.1 percent in 2000. FDI inflows for Bangladesh increased from $14 million in 1996 to $180 million in 1999. In Mozambique, Tanzania, and Uganda, annual net FDI inflows increased roughly sixfold between the early 1990s and the late 1990s, from around $30 million to around $160 million in each country.

A wealth of recent research supports the conclusion that poorer countries can succeed in attracting FDI if they introduce liberal trade and investment policies, support free markets internally, and strengthen the rule of law. For example, Saskia Wilhelms finds that liberalizing trade and investment policies has a strong impact on FDI inflows after controlling for structural variables such as market size; she finds that high rates of taxation discourage FDI.[3] Margaret McMillan, Selina Pandolfi, and Lynn Salinger endorse Wilhelms' conclusions, while also pointing to corruption as a universally acknowledged barrier to FDI. McMillan, et al. also emphasize the importance of good infrastructure and a workforce with appropriate skills.[4] Finally, using the Sachs-Warner "openness" classification to measure the relevant policy environment and the rule of law measure reported by Political Risk Services, Inc. to gauge the quality of the institutional environment, Alberto Alesina and David Dollar find that each factor has a strong and significant impact on FDI inflows.[5]

Additional analysis based on a modification to the Alesina-Dollar model indicates that policies that enhance economic freedom are the principal means for poor countries to attract foreign investment. Replacing the openness and rule of law variables used by Alesina and Dollar with the "Index of Economic Freedom" reported by the Fraser Institute and Cato Institute produces coefficients with similar or better levels of statistical significance.[6] As shown in Table 1, estimates of the impact of economic freedom on subsequent net inflows of FDI remain quite stable in the face of changes in other variables included in the estimates, including measures of infrastructure development, educational participation, and the role of fuels and minerals in export earnings. This pattern suggests a significant contribution of economic freedom to countries' access to FDI inflows.

The developing world offers many corroborating examples of countries that have succeeded in attracting increased FDI by implementing policies and strengthening institutions that enhance economic freedom. Recent examples include Uganda, Tanzania, and Bangladesh—all least-developed countries and ranked in 1990 as among the poorest of the low-income developing countries.[7] None of the three enjoys any special advantage in terms of natural resources or geography.

In **Uganda,** a landlocked country wracked by crisis during the 1970s and early 1980s, the government launched a broad economic reform program in 1992. Elements included tighter management of fiscal and monetary policies, more market-oriented approaches to exchange rate management, and liberalized policies toward coffee production and export. These and other

[3]Saskia K.S. Wilhelms, "Foreign Direct Investment and its Determinants in Emerging Economies" (1998).

[4]Margaret McMillan, Selina Pandolfi, and B. Lynn Salinger, "Promoting Foreign Direct Investment in Labor-Intensive, Manufacturing Exports in Developing Countries" (1999).

[5]Alberto Alesina and David Dollar, "Who Gives Foreign Aid and Why?" *Journal of Economic Growth* March 2000.

[6]Measures of economic freedom represent a proxy for an array of underlying factors. The Fraser-Cato Index of Economic Freedom covers seven areas of policies and institutions: the size of government, legal structure and security of property rights, access to sound money, freedom to trade with foreigners, regulation of capital and financial markets, regulation of labor markets, and freedom to operate and compete in business. The Index of Economic Freedom runs from zero to 10.

[7]In a ranking of countries by per capita income in the 1990 *World Development Report,* Tanzania was fourth from the bottom, Bangladesh was fifth from the bottom, and Uganda was sixteenth from the bottom. Uganda was ninth from the bottom in 1985.

Table 1. Impact of Economic Freedom on Foreign Direct Investment Inflows

	(1)	(2)	(3)	(4)
Constant	-15.430**	-12.982	-38.204***	-22.207**
	(2.059)	(1.540)	(-4.227)	(2.482)
Log of population	-0.104*	-0.057	-0.066	-0.076
	(1.661)	(0.783)	(0.912)	(1.040)
Log of PPP income per capita	3.994**	3.182	10.042***	5.791**
	(2.033)	(1.420)	(4.172)	(2.463)
(Log of PPP income per capita) squared	-0.240*	-0.193	-0.650***	-0.376**
	(1.893)	(1.325)	(4.114)	(2.450)
Economic freedom	0.294***	—	0.279***	0.349***
	(3.366)		(2.938)	(3.618)
Economic freedom excluding rule of law	—	0.290***	—	—
		(2.925)		
Rule of Law	—	0.070**	—	—
		(1.978)		
Telephones per 1,000 people	—	—	0.0077**	0.0062**
			(2.472)	(2.094)
Share of population (25 years+) with "some" secondary schooling	—	—	0.0090	
			(1.230)	
Fuel and mineral share in merchandise exports	—	—	—	0.0094**
				(2.369)
Period dummy 1986–90	0.107	0.097	0.048	0.062
	(0.065)	(0.624)	(0.241)	(0.380)
Period dummy 1991–95	0.643***	0.640***	0.397	0.611***
	(3.174)	(3.176)	(1.639)	(2.760)
Period dummy 1996–99	1.743***	1.688***	1.565***	1.558***
	(6.385)	(5.665)	(4.561)	(5.013)
Adjusted R^2	0.270	0.262	0.318	0.315

Notes: Pooled regression, with 91 countries and four periods. Dependent variable is (net FDI inflow)/GDP, averaged over three five-year periods beginning 1981–85, and a final four-year period 1996–99. To minimize reverse causation, independent variables are initial values in the year before: 1980, 1985, etc. Missing values reduce included observations to between 244 and 307, depending on the specification.
*, **, and *** indicate statistical significance at the 10-percent, 5-percent, and 1-percent levels, respectively, based on White-corrected standard errors. *t*-statistics are shown in parentheses.
Data: Economic Freedom from Fraser Institute, *Economic Freedom of the World 2001.* All other data from World Bank, *World Development Indicators 2001* (CD-ROM).

reforms raised Uganda's Index of Economic Freedom from 2.7 in 1990 to 7.1 by 1999. The reform program enabled Uganda to achieve rapid and sustained growth, sharply reduced inflation, a reduced current account deficit, and increased foreign exchange reserves. At the beginning of the 1990s, net FDI to Uganda was essentially zero, but by the end of the decade it averaged $221 million per year.[8]

Following a long, unsuccessful experiment with socialism, **Tanzania** began taking tentative steps toward economic liberalization in 1986. The reform process stalled in the early 1990s, then regained momentum in 1996 when a new government came to power. By the end of the 1990s, Tanzania had taken steps to improve macroeconomic management, liberalizing the exchange rate, reducing trade barriers,

[8]Figures for the beginning and end of the 1990s refer to averages for 1989–90 and 1999–2000, respectively.

instituting agricultural reforms, and improving tax and revenue policies. The Index of Economic Freedom for Tanzania increased from 3.6 in 1990 to 5.8 in 1999, and FDI increased from around $3 million annually at the beginning of the 1990s to over $188 million by the end of the decade.

Bangladesh is not generally considered a reform success story over the 1990s, but it should get credit for prudent macroeconomic policies, reforms in trade, exchange rate management, liberalization of prices for agricultural inputs and outputs, and relaxation of restrictions on FDI. While the Index of Economic Freedom did not rise as quickly as it had in Uganda or Tanzania, it improved from 3.1 in 1990 to 4.8 in 1999. Net FDI increased from around $1.6 million annually at the beginning of the 1990s to $229 million annually by decade's end.

Trade and Economic Freedom

Economic freedom not only helps poor countries attract FDI, but also encourages international trade (Table 2). Some, like Dani Rodrik, have argued there is a limited relationship between trade liberalization and subsequent trade and economic growth.[9] This analysis indicates, however, that trade liberalization coupled with structural economic reform has a strong, positive correlation with growth, both in trade and in the economy overall.

Igniting trade growth in developing countries, and especially in low-income countries, requires companion polices geared toward macroeconomic stability, a sound investment climate, regulatory reform, and the rule of law. Ataman Aksoy and Uri Dadush have pointed to these factors, along with public education, social safety nets, and especially institution building and effective governance.[10] Without such internal policies in place, domestic producers will not achieve the competitiveness necessary to export effectively, financial markets will fail to shift funds toward promising new industries, and higher quality, lower cost imports may remain shut out of domestic markets.

Given the interaction between international and domestic markets, international trade can play a key role in boosting overall economic growth, even when trade is initially a small component of the total economy. For instance, trade reform can reduce bottlenecks and rent-seeking behavior associated with importing capital goods. One of the most compelling mechanisms linking trade with growth in developing countries is that imported capital goods are likely to be significantly cheaper (and of higher quality) than those manufactured at home.[11] With successful companion policies, trade reform can boost the long-term growth rate of the economy, both through its incentive effects on domestic investment and by spurring innovation.[12] In addition, trade reform is often associated with increased inflows of FDI, attendant spillovers of technology, new business practices, and rising productivity.

Table 2 highlights the strong correlations between economic growth and growth in imports, exports, and total trade. This is not at all surprising, since export growth is positively related to GDP growth as a matter of accounting; and income growth clearly influences growth in overall demand, including demand for imports. When per capita income growth is included, the explanatory significance of *initial levels* of economic freedom fades. Changes in economic freedom remain significant in explaining growth in trade, but with significantly reduced coefficients.

Further regressions shed light on these results. Both levels and changes in economic freedom are important in explaining growth in per capita income. Including both per capita income growth and economic freedom in an equation explaining trade growth introduces multicollinearity among the independent variables, which causes the statistical significance of the correlated variables to be underestimated. The impact of increased economic freedom on trade can be seen as working through two channels. The first channel is an *openness effect*: at any given level of income, more open policies will lead to increased trade. The second channel is a *growth effect*: the improvements in policies and institutions embodied in increased economic freedom contribute to growing incomes, which—for any given level of openness—will result in greater trade,

[9]Dani Rodrik, "Globalization, Growth and Poverty: Is the World Bank Beginning to Get It?" (2001).

[10]Ataman Aksoy and Uri Dadush, "Tackling the Trade Agenda in the Poorest Countries" (Washington, DC: The World Bank, Draft Paper, 2001).

[11]Dani Rodrik, "The Global Governance of Trade As If Development Really Mattered" (Cambridge, MA: Harvard University, paper prepared for the UNDP, July 2001, revised).

[12]Compare with Paul Romer, "What Determines the Rate of Growth and Technical Change?" World Bank Policy, Planning and Research Working Paper, WPS # 279 (Washington, DC: The World Bank, 1989). See also Tamim Bayoumi et al. "R&D Spillovers and Global Growth" (IMF Working Paper WP/96/47, 1996).

Table 2. Impact of Economic Freedom on Trade and GDP Growth

	Total Trade (X+M)			Imports		Exports		Growth in GDP (%)		
Initial trade	0.57**	0.18	-0.12	-0.16	-0.46	0.16	-0.11	—	—	0.32**
	(2.48)	(0.66)	(0.49)	(0.49)	(1.57)	(0.61)	(0.46)			(2.41)
Initial economic freedom	1.18***	1.13***	0.49	1.22***	0.53	0.87**	0.25	0.63***	0.40**	0.44**
	(3.37)	(2.94)	(1.42)	(2.73)	(1.29)	(2.08)	(0.66)	(2.89)	(2.08)	(2.32)
Change in economic freedom	0.05***	0.05***	0.03**	0.05***	0.03**	0.04***	0.02	0.02***	0.01**	0.01**
	(3.93)	(4.00)	(2.28)	(3.72)	(2.09)	(3.12)	(1.46)	(3.73)	(2.02)	(2.08)
Growth in GDP per capita	—	—	1.04***		1.08***	—	1.04***	—	—	—
			(6.62)		(5.77)		(5.99)			
Initial GDP per capita	—	—	—	—	—	—	—	0.15	0.00	-0.27
								(0.68)	(0.01)	(1.21)
Growth in trade	—	—	—	—	—	—	—	—	0.25***	0.25***
									(6.59)	(6.72)
Asia	—	4.55**	0.90	4.35**	0.54	4.90**	1.23	3.74***	2.33***	1.91**
		(2.47)	(0.53)	(2.03)	(0.27)	(2.46)	(0.66)	(3.73)	(2.60)	(2.13)
Latin America/Caribbean	—	0.95	0.40	0.86	0.29	0.79	0.27	0.26	-0.05	0.16
		(0.51)	(0.25)	(0.40)	(0.15)	(0.40)	(0.15)	(0.28)	(0.06)	(0.20)
Middle East/N. Africa	—	1.26	-0.60	0.38	-1.54	2.94	1.04	1.85*	1.44*	1.30
		(0.66)	(0.35)	(0.17)	(0.76)	(1.42)	(0.56)	(1.91)	(1.71)	(1.58)
Sub-Saharan Africa	—	0.45	-0.22	-0.34	-1.02	0.76	0.12	0.29	0.02	0.24
		(0.24)	(0.14)	(0.16)	(0.53)	(0.38)	(0.07)	(0.30)	(0.02)	(0.29)
Adjusted R^2	0.25	0.32	0.49	0.32	0.46	0.20	0.37	0.40	0.55	0.57

Notes: Pooled regression, with 78 countries and two periods. Dependent variable is average growth over 1980–89 and 1990–99. "Initial" economic freedom, trade, and GDP refer to first year of each 10-year period.
*, **, and *** indicate statistical significance at the 10-percent, 5-percent, and 1-percent levels, respectively. *t*-statistics are shown in parentheses.
Data: IMF, *Direction of Trade Statistics Quarterly,* 2001.

particularly imports. When growth in per capita income is included as an independent variable, the growth effect is captured directly and separately, while the measured impact of economic freedom reflects only the openness effect.

These results confirm the importance of economic freedom—trade liberalization, macroeconomic stability, a strong private sector, and the rule of law—in promoting growth in income and output, trade, and investment, including direct foreign investment. The proposition that market-friendly policies and institutions matter for growth in trade, investment, and the economy overall is hardly controversial among economists, though some mistakenly question the applicability of these universal principles to much of the developing world.

Development Assistance and Economic Freedom

Given the evidence that increased economic freedom and greater openness spur trade, investment, and ultimately growth, why have more developing countries not taken this path to development? The answer is that for closed economies, opening presents political, social, and managerial challenges that can test the most courageous politicians. For instance, in Mali, freeing agricultural prices while ultimately allowing the country to raise production to the point where it could export food, initially resulted in drastic swings in domestic grain prices. Furthermore, in many developing countries, fear of competition from cheaper, higher quality imported goods and services causes protected industries and their workers to lobby against the removal of barriers to imports, despite the costs those trade barriers impose on the broader economy.

In facing these difficulties, development assistance can play a unique and important role, by helping encourage, support, and sustain the self-help efforts behind development progress. FDI and trade respond to and reinforce development progress, creating a virtuous cycle. Development assistance acts through several channels: It can support governments in their reform efforts, it can help develop the market infrastructure necessary for smooth private transactions, it can cultivate the skills necessary to participate in the global economy, and it can provide a cushion for adverse exogenous shocks that might otherwise erode support for reform.

To complement **Mali's** agricultural sector reform, USAID invested in critical market infrastructure aimed at helping private markets work more efficiently. Prior to that effort, farmers, traders, and consumers found it difficult to obtain timely information on agricultural prices prevailing in different parts of the country. Market news moved at a camel's pace, creating an internal trade barrier between regions of surplus and regions of shortage. The situation has been transformed by the introduction of a twice-weekly radio show on farm prices, supported by USAID and implemented by Michigan State University. The show reports in local languages on current prices for grains, crops, and livestock at 64 markets around Mali. About 70 percent of Mali's population tunes in to the market report with the loyalty of a soap opera audience. With this information in hand, the private sector now shifts supplies from surplus to deficit areas. Mali's trade capacity has been enhanced through the deepening of market institutions. The program has helped Mali solve its internal grain distribution problems and has contributed to its ability to export rice to nearby countries.

For **Uganda**, development assistance stiffened the resolve of the government to pursue reform. After suffering 16 years of political instability, civil strife, repression, and severe economic and government mismanagement, the government ended its heavy-handed economic command approach and adopted a market-oriented set of economic reforms. Successful economic reforms beginning in the late 1980s generated remarkably strong economic performance throughout the 1990s. USAID technical assistance and conditionality concentrated on private-sector development, nontraditional exports, abolishing government export monopolies, reducing other trade controls, and streamlining the trade bureaucracy. Backed by support from USAID, the World Bank, and the IMF, government spending was sharply curtailed, runaway inflation stopped, the overvalued foreign exchange system replaced with a free-market rate, and import and foreign exchange controls eliminated. Government marketing arrangements for coffee, tea, and cotton were dismantled, and controls on foreign exchange and investment were eliminated. Foreign investment, which had been minimal before 1990, increased. New, nontraditional exports grew rapidly.

In **Peru**, development assistance helped stimulate a shift in the terms of the internal debate over economic policies, leading in turn to the adoption of important reforms. In the early 1980s, most intellectuals, academic economists, and government policymakers were strongly opposed to economic reform and market liberalization. They distrusted outsiders, but USAID found an innovative way to reform the regulatory framework by changing the intellectual climate. USAID provided half of the funding of Hernando de Soto's Institute for Liberty and Democracy. The Institute, employing 50 to 75 researchers, carried out field-based research, held conferences to spread awareness of its findings, and prepared legislative proposals. The research analysis and presentations by a respected local institution carried considerable weight in Peru. The policy reform payoff came when Peru decided to improve its regulatory treatment of low-income, informal-sector entrepreneurs.

The Institute studied street vendors, squatters, taxi owners, and small farmers, all of whose land and operations were outside the law, as it was nearly impossible for informal businesses to register and become legal. In 1990, the economic reform issues were debated among presidential candidates, and as a result many of the reforms were approved. By improving the performance and flexibility of the small-scale and informal sector, these legal and regulatory reforms have complemented and facilitated the far-reaching reforms Peru has undertaken since the early 1990s, including elimination of the fiscal deficit and liberalization of the exchange rate, interest rates, and the trade and payments system.

Hernando de Soto's analysis was published in his book *The Other Path,* and highlighted in the World Bank's 1987 *World Development Report.* His approach has been adopted by many other developing countries and by bilateral donors and multilateral lenders.

Political Will Is Indispensable

Unfortunately, development assistance cannot substitute for political will. In the 1980s, most developing countries had economic controls that deterred investment, trade, and economic growth. USAID, the World Bank, and other donors worked with a number of countries as they introduced major economic policy reforms. One fundamental lesson learned from that period is that pressure from aid donors alone cannot generate reform. If a country has the political will and mounts a strong self-help effort, success is possible, and donor technical assistance and funding can improve the pace of reform. If the country lacks commitment, progress is not possible.

A study by Malcolm McPherson, funded by USAID's Africa Bureau, analyzes donor-supported policy reform in Africa. Over the 1980s and 1990s, most African countries launched macroeconomic, trade, and exchange rate policy reforms. McPherson finds that many countries failed to sustain reform efforts when those efforts threatened to upset entrenched interests. The cases of Zambia and Ghana illustrate this point.

Following its democratic reforms in 1991, **Zambia** received large amounts of foreign assistance—more than $7.9 billion between 1991 and 1998. Zambia introduced several macroeconomic reforms in the early 1990s, but by 1996 had reached a crossroads. Large-scale foreign investment was needed to rehabilitate and expand the mining sector, requiring more serious economic reforms, privatization of the copper mines, and a clampdown on corruption. Zambia's leaders showed no interest in halting corruption or in selling the mines. They stalled the reforms and tried to muddle through, at the cost of forsaking some donor support. As a result, by the late 1990s Zambia was again caught in a spiral of rising debt, declining savings, stagnant investment, increasing poverty, and declining per capita GDP—down nearly 1.7 percent a year.

Ghana began a comprehensive reform program in 1983, backed by strong financial and technical support from donors. The early reforms were straightforward, though economically essential and politically challenging: devaluation, removal of price controls, interest rate liberalization, and tax reform. The institutional reforms that came later were more complicated: removal of subsidies, financial sector reforms, investment promotion, privatization of state-owned enterprises, civil service reform, and government capacity building. After nearly a decade of progress, the reform process came to a halt in 1992, when election-related wage increases of over 80 percent, along with a broader loss of fiscal discipline, generated macroeconomic instability and surging inflation. FDI peaked in 1994 at more than $200 million and then began a steady decline to a mere $17 million in 1999.

Despite these failures—or because of them—many developing countries have learned the importance of political will. After an election in 2000 brought a new government to power, Ghana has again begun to implement economic reforms, including fiscal stabilization and reduced intervention in foreign exchange allocation, along with plans to divest public enterprises to the private sector. FDI has increased dramatically, to $100 million in 2000. In Zambia, privatization of the mines began in 2000. The cases of Ghana and Zambia demonstrate that aid cannot buy reform—it can only reinforce the resolve of a forward-looking government and its constituents.

Broadening Participation in the Global Economy

As the world focuses on development, the need to encourage more countries to participate fully in the global economy through domestic reforms—including trade liberalization, macroeconomic stability, a strong private sector, and the rule of law—has never been greater. Such participation holds greater rewards than ever, and the cost of failure is correspondingly higher. As countries move to take advantage of these opportunities, the United States is prepared to support their efforts, broadening the circle of participation in the global economy, one country at a time.

This policy brief is the first in a series that USAID will produce regularly to explore solutions to the challenges of international development. Kenneth Borghese, Michael Crosswell, Brian Frantz, Elaine Grigsby, Joseph Lieberson, Donald Sillers, and John Simon contributed to this work.