

# WebMemo



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## David Cameron and Barack Obama Must Advance Economic Freedom—Not More Foreign Aid

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British Prime Minister David Cameron and U.S. President Obama are scheduled to meet on July 20 at the White House. The issue of how the two leaders can take joint steps to spark greater global economic growth will be a major topic of discussion.

**Reevaluating Foreign Assistance Agendas.** As revealed during the G-20 meeting in June, the two countries have adopted profoundly different strategies for turning their domestic economies around. While Obama, with his short-term vision of an economic recovery, urged other members of the G-20 to maintain or even further increase deficit spending, Cameron has proposed a dramatic series of domestic spending cuts in order to arrest record deficits and secure a more sustainable economic future.

However, there is at least one area where both Cameron and Obama see eye to eye on spending: foreign aid. Despite the fact that nearly every area of British government expenditure will face serious cuts under Cameron's budget, his coalition government remains committed to increasing the foreign aid budget, stating that "even in these difficult times we will meet our commitment to increase spending on aid to 0.7% of gross national income from 2013."<sup>1</sup>

During his election campaign, Barack Obama pledged to double all U.S. foreign assistance to \$50 billion by 2012.<sup>2</sup> As illustrated in the President's FY 2011 budget request, he has followed through by requesting significant increases in foreign aid funding.<sup>3</sup>

Both leaders no doubt believe that foreign assistance will help bolster economic growth and

much-delayed economic advancement in the less developed world and thereby contribute to the overall global economic recovery. However, there is no clear evidence that there is a correlation between the two. In fact, the record demonstrates that recipients of large amounts of aid are more likely to founder economically than they are to prosper.

Instead of backing flawed aid theories, donor nations like the U.S. and the U.K., as well as recipient nations, would benefit from a reevaluation of their foreign assistance agendas, which should be focused on advancing economic freedom.

**The 0.7 Percent Myth.** Numerous studies indicate that policy changes that create a more conducive environment for economic transactions, which in turn bolster a free and fair legal system while strengthening government accountability and responsiveness, are far more important to development than the amount of aid a country receives. Unfortunately, the idea that development requires greater aid flows is still omnipresent. Indeed, the notion that developed countries must provide 0.7 percent of gross national product (GNP) in development assistance if developing countries are to

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escape poverty has attained iconic status in the United Nations and in the aid community.<sup>4</sup>

The idea of linking development assistance to the gross national product of donor countries rather than to any demonstrated need by developing countries or evidence that such aid could be used effectively is illogical. Even staunchly pro-aid groups have questioned this idea's relevance, including the Center for Global Development:

However ubiquitous and durable, the target of 0.7% was never meant to represent the "right" level of aid needed by poor countries. A look at its history shows that it was calculated using methods with little relevance to today's understanding of the development process. ... The specific figure of 0.7% was a compromise between educated guesses based on economic conditions in the early 1960s and on a crude and deeply flawed model of growth. ...

[O]ver time 0.7% has gained prominence well beyond its initial intention and gained credibility as the correct aid goal that it does not deserve. ... We find that if we apply the same assumptions that went into the original formulation to conditions present today, that the updated target would be 0.01% of rich country income—well below current aid levels for all major donors.<sup>5</sup>

The emphasis on levels of aid endures despite numerous economic studies that have concluded that economic assistance is not a key component of economic development.<sup>6</sup>

**Economic Freedom Works.** During the upcoming summit, rather than continuing to discuss the failed approach of development assistance, Cameron and Obama should focus on initiating a more effective and innovative way of providing real development assistance that encourages recipients to adopt and pursue sound economic policies that advance economic freedom.

While there may be a role for assistance by donor nations, the bulk of economic evidence has repeatedly proven that the key to development lies in the hands of the governments of developing countries. They must first remove obstacles to development by adopting policies that bolster free markets and entrepreneurship, good governance, and the rule of law.

Economic research has shown that the entrepreneurship encouraged by greater economic freedom leads to innovation, economic expansion, and overall human development. A fresh case in point is Rwanda's development experience, which can be described as an entrepreneurial revolution. According to The Heritage Foundation/*Wall Street Journal's* 2010 *Index of Economic Freedom*, the Rwandan economy shone, with a notable improvement in half of the 10 indicators of economic freedom, achieving

1. David Cameron, "Our Aid Will Hit the Spot," *The Guardian*, June 3, 2010, at <http://www.guardian.co.uk/commentisfree/2010/jun/03/aid-developing-world-targeted-money> (July 19, 2010).
2. Obama for America, "Strengthening Our Common Security by Investing in Our Common Humanity," at [http://www.barackobama.com/pdf/issues/Fact\\_Sheet\\_Foreign\\_Policy\\_Democratization\\_and\\_Development\\_FINAL.pdf](http://www.barackobama.com/pdf/issues/Fact_Sheet_Foreign_Policy_Democratization_and_Development_FINAL.pdf) (July 19, 2010).
3. Office of Management and Budget, "Department of State and Other International Programs," Budget of the United States Government, Fiscal Year 2011, p. 108, at <http://www.whitehouse.gov/omb/budget/fy2011/assets/state.pdf> (July 19, 2010).
4. For instance, the United Nations Development Program asserts, "First pledged 35 years ago in a 1970 General Assembly Resolution, the 0.7 target has been affirmed in many international agreements over the years, including the March 2002 International Conference on Financing for Development in Monterrey, Mexico and at the World Summit on Sustainable Development held in Johannesburg later that year." United Nations Development Program, "The 0.7% Target: An In-Depth Look," U.N. Millennium Project, at <http://www.unmillenniumproject.org/press/07.htm> (July 19, 2010).
5. Michael A. Clemens and Todd J. Moss, "Ghost of 0.7%: Origins and Relevance of the International Aid Target," Center for Global Development, September 6, 2005, at [www.cgdev.org/content/publications/detail/3822](http://www.cgdev.org/content/publications/detail/3822) (July 19, 2010).
6. Terry Miller and Kim R. Holmes, *Index of Economic Freedom* (Washington, D.C.: The Heritage Foundation and Dow Jones and Company, Inc., 2010), at <http://www.heritage.org/index>. For a paper discussing and citing other economic studies, see Brett D. Schaefer, "The U.N.'s World Summit is Wrong on Development Assistance," September 26, 2005, Heritage Foundation *Backgrounder* No. 1881, at <http://www.heritage.org/Research/Reports/2005/09/The-UNs-World-Summit-is-Wrong-on-Development-Assistance>.

the fourth-largest score gain among 179 economies in the *Index*.

It is not coincidental that Rwanda's gross domestic product per capita increased to over \$1,000 in 2008 from less than \$350 in 1994. Along with solid economic growth backed by sound economic policies, social indicators are rising fast, too. Life expectancy in Rwanda has increased by 23 years, and the country's primary school enrolment has risen by 50 percent.<sup>7</sup>

The *Index* finds that "in pursuing sustainable prosperity, both the direction of policy and commitment to economic freedom are important." Indeed, over the last decade, the countries with greater improvements in economic freedom achieved much higher reductions in poverty, as shown in the *Index*. These principles of economic freedom should be reflected at the core of efforts to revamp foreign aid programs in order for the donor nations to provide real and effective development assistance.

**Increase Prosperity, Not Aid Dependency.** The goal of reducing poverty is admirable and should be supported by the U.S. and the U.K., but focusing on

arbitrary aid targets that are only indirectly related to reducing poverty does little to advance that objective. The folly of adhering to outdated, arbitrary aid targets is compounded when it leads a government to increase aid budgets in the midst of historic debt and deficit challenges.

Cameron and Obama should not make such a policy misstep. Instead, the two leaders should use the summit as a critical first step toward bringing real changes to the less developed world by shifting their commitment to the principles of economic freedom rather than the false promise of foreign aid.

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7. World Bank, World Development Indicator, at <http://www.worldbank.org/data> (July 19, 2010).