Jeffrey D. Sachs

The Strategic Significance of Global Inequality

While the United States enjoyed rapid economic growth during the past 20 years, many poor countries, including some of the world's poorest in sub-Saharan Africa, had a generation experiencing an outright decline in living standards. Private consumption spending per capita rose by 1.9 percent per year during 1980–1998 in the United States while declining on average by 1.2 percent per year in sub-Saharan Africa.[1] Is there a "strategic significance" to global inequalities in income levels and economic growth, and, if so, which policies might the United States pursue to address those strategic concerns? Focusing on the scope and limitations of U.S. foreign assistance as a policy instrument to address global income inequalities is illuminating.

The economic success of developing countries enhances the well-being of the United States, which has and should more actively deploy policy instruments to help support economic success abroad. National interests in successful economic growth abroad are multifaceted. Some of these interests are basically economic: the economic success or failure of developing countries determines the gains from trade and investment that the United States reaps in its economic relations with those countries. The ramifications for the United States, however, of good or bad economic performance among the poor countries go beyond direct economic returns. As a general proposition, economic failure abroad raises the risk of state failure as well. When foreign states malfunction, in the sense that they fail to provide basic public goods for their populations, their societies are likely to experience steeply escalating problems that spill over to the rest of the world, including the United States. Failed states are seedbeds of violence, terrorism, international criminality, mass migration and refugee movements, drug trafficking, and disease.

Jeffrey D. Sachs is director of the Center for International Development and Galen L. Stone Professor of International Trade in the Department of Economics at Harvard.

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The Washington Quarterly • 24:3 pp. 187–198.

If poor countries had reliably stable and functional state institutions, global poverty would remain a powerful humanitarian concern but would probably not be a strategic priority of the United States. Alas, poor economic performance abroad has the potential to translate into state failure that, in turn, jeopardizes significant U.S. interests. If the United States wants to spend less time responding to failed states, as the Bush administration has stated, it will have to spend more time helping them achieve economic success to avert state failure. The United States has certain, albeit limited, economic policy instruments at its disposal to help prevent state failure abroad. Foreign assistance can play an important role, in certain contexts, but the United States has not used it well for decades.

Foreign Economic Performance and U.S. Strategic Interests

Americans would dearly love to believe that the United States can be an island of stability and prosperity in a global sea of poverty and unrest. History, however, continues to prove otherwise. One common occurrence has been an economic crisis abroad that leads to a collapse of state authority abroad, which in turn has adverse consequences for the United States. The examples are legion. The rise of the Bolsheviks to power in 1917 took place in the wake of an economic collapse of wartime czarist Russia. The rise of Hitler in 1933 occurred in the midst of the Great Depression that affected Germany especially hard because of its large foreign debt. More recently, Yugoslavia disintegrated into regional war not only because of interethnic conflicts, but also because of an economic collapse and the descent of the former federal state into hyperinflation in the late 1980s. Political adventurers such as Slobodan Milosevic in turn used the economic collapse to grab power. Iraq's declining economic fortunes and rising debt burdens following the Iran–Iraq War of the 1980s prompted, at least in part, Saddam Hussein's invasion of Kuwait in 1990. In the 1990s, most of the world's violent conflicts, which have been related in one form or another to deep economic crises and their attendant state failures, have occurred in Africa.[2]

I do not want to commit the elementary fallacy of attributing all political failures to economic crises. The shah of Iran was knocked from power in 1979 in the midst of an oil boom. Tracing the rise of Lenin or Hitler to power on the basis of economics alone would be fatuous. Yet, in practice, economic failure abroad undoubtedly matters greatly and can translate into very large costs for the United States in many spheres.

The most comprehensive study of state failure, carried out by the State Failure Task Force established by the Central Intelligence Agency in 1994, confirms the importance of economic underpinnings to state failure.[3] The

task force gave formal definition to state failure (as a case of revolutionary war, ethnic war, genocides or politicides, and adverse or disruptive regime changes) and counted all cases during 1957–1994 in countries of 500,000 people or more. The Task Force identified 113 cases of state failure. Of all the explanatory variables examined, three were most significant: infant mortality rates, suggesting that overall low levels of material well-being are a significant contributor to state failure; openness of the economy, in that more economic linkages with the rest of the world diminish the chances of state failure; and democracy, with democratic countries showing less propensity to state failure than authoritarian regimes. The linkage to democracy has another strong economic aspect, however, because other research has shown strongly that the probability of a country being democratic rises significantly with its per capita income level.[4] In refinements of the basic study, the task force found that in sub-Saharan Africa, where many societies live on the edge of subsistence, temporary economic setbacks (measured as a decline in gross domestic product per capita) were significant predictors of state failure. They also found that "partial" democracies, usually in transition from authoritarian to fully democratic institutions, were particularly vulnerable to collapse. Similar conclusions have been reached in studies on African conflict, which find that poverty and slow economic growth raise the probability of conflict.[5]

Types of Economic Failure

Distinguishing several kinds of economic failure abroad and then tracing their various strategic implications for the United States is useful and will assist later discussion about whether the United States has policy instruments to address the root causes of foreign state collapse or whether we must satisfy ourselves with treating the outcomes instead. Four types of economic failure that lead to widening income inequalities between rich and poor and to serious strategic concerns for the United States are described below.

Poverty Trap

A poverty trap is a condition, seemingly paradoxical, in which a poor country is simply too poor to achieve sustained economic growth. Many countries in Africa are in this situation. Economic growth depends on minimum standards of health, education, and infrastructure in order to attract the new investments and technology that in turn are needed to raise income levels. Some impoverished countries are too poor to provide the basic public goods of minimally acceptable health and education, much less physical infrastructure. In these settings, the state cannot fulfill its basic tasks of help-

ing to keep the population safe, healthy, and educated. Why do some poor countries succumb to such a trap and others do not? Physical ecology probably plays a role. Africa is uniquely hampered by extreme conditions of disease and low food productivity that in turn prevent those societies from managing to achieve the minimum necessary conditions for growth.[6]

State Bankruptcy

State bankruptcy is the condition in which the state cannot service its current debts. Bankruptcy almost always results from indebtedness to foreign rather than domestic creditors of the state, because domestic debts denominated in the national currency can generally be serviced through printing money. In this case, high inflation rather than a debt-servicing interruption is the consequence. State bankruptcy has powerful destabilizing effects on society, more destabilizing than almost any other peacetime economic malady. Bankrupt states cannot provide basic public goods (health, education, courts, police), maintain troop loyalties, use state revenues to buy off political opposition figures, or make budget transfers to keep allied parties or regions within a governing coalition. The biggest problem from the point of view of the state is the lack of an international equivalent to Chapter 9 of the U.S. Bankruptcy Code, in which a municipality can win a time-out on debt servicing, followed later by a write-down of debts, with the U.S. Bankruptcy Court protecting the municipality during this time against a disruption of public services. State bankruptcy has repeatedly contributed to revolutions (France in 1789); loss of sovereignty (Egypt in 1882); collapse of empires (Ottoman Empire in 1875 onward, the Soviet Union in 1991); innumerable coups (Ecuador in 1999); and internal violence.

> Foreign assistance has been poorly targeted and poorly timed for decades.

Liquidity Crisis

A liquidity crisis is a sudden reversal of capital flows—usually short-term private-sector loans—that leads to an intense contraction of the economy despite long-term solvency and generally adequate fundamental economic conditions. The so-called emerging markets experienced repeated liquidity crises in the 1990s (Mexico in 1995; Indonesia, Korea, and Thailand in 1997), causing extremely abrupt and deep declines of gross national product (GNP) and, at least in the case of Indonesia, provoking a dramatic regime change and internal violence. These crises were difficult to predict in part

because they did not have obvious roots in state-sector weakness, although they contributed to state instability after the fact.

Transition Crisis

The fourth major cause of economic failure that can lead to state failure is a crisis of transition, when political and economic regimes are making a fundamental institutional change. Examples include the transition from communism in Eastern Europe and the former Soviet Union, recovery from war (especially from defeat), transition from colonial rule to state sovereignty, transition from authoritarian rule to democratic rule, and succession struggles after the collapse of a long-standing regime (such as the fall of Suharto after 32 years in power). These transitions destabilize societies directly in myriad ways, but also indirectly by sundering usual paths of economic exchange. Almost all transitions are characterized by extreme uncertainty about the future and therefore an absence of consolidation of any particular set of institutional arrangements. When the future is "up for grabs," moreover, self-fulfilling expectations can play a dominant role in determining the future path of developments. A regime expected to succeed can thereby succeed, as supporters flock to the "winner." A regime expected to fall can fall because of the reticence of potential supporters to rally to the cause of a "loser." The State Failure Task Force found that, in Africa, the most dangerous political condition leading to future state failure was indeed a state of transition. "Partial" democracies were more likely to fail than authoritarian or fully democratic regimes.

Ramifications of State Failure for U.S. Strategic Interests

Economic failure abroad, leading to state failure, significantly affects U.S. interests in military, economic, health-related, and environmental areas. Although a thorough accounting of these ramifications would fill volumes, mentioning some examples is worthwhile.

National Security

If we compare the dates of U.S. military engagement with the timing of state failures according to the State Failure Task Force, we find that virtually every case of U.S. military intervention abroad since 1960 has taken place in a developing country that had previously experienced a case of state failure.[7] (For these purposes, military intervention includes any use of U.S. troops abroad, whether for direct combat, peacekeeping, evacuation of civilians, or

protection of U.S. property, and so forth.) In many cases, the linkages from economic collapse to state failure to U.S. military engagements could not be clearer. Yugoslavia collapsed in part because of dire macroeconomic instability at the end of the 1980s, a point noted recently by the U.S. ambassador at the time, Warren Zimmermann.[8] Of course, security considerations now include much more than the engagement of military forces to encompass terrorist threats and arms proliferation.

Economic Losses

Adam Smith noted more than two centuries ago in *Wealth of Nations* that a country's prosperity benefits directly from the prosperity of other nations. Just as "private people who want to make a fortune never think of retiring to the remote and poor provinces of the country," so too "[a] nation that would enrich itself by foreign trade is certainly most likely to do so when its neighbors are all rich, industrious, and commercial nations."[9] The United States has huge economic stakes in the developing world that are jeopardized by state failure abroad. The U.S. Commerce Department estimates the market value of U.S. foreign direct investments to be $2.1 trillion, of which $500 billion is in developing countries. Around 41 percent of U.S. exports in 1999 went to developing countries, up from 35 percent in 1990. Exports to developing countries grew by 8.5 percent during 1990–1999, compared with 5.9 percent to industrialized countries.

Business operations abroad are heavily affected by host-country instability, poverty, and even disease. A *Business Week* profile of Exxon–Mobil on April 9, 2001, gives several examples of that company's projects facing significant local complexities, and decades-long delays, in Russia, China, Indonesia, Angola, and Chad, among other places. A risk assessment consultancy firm recently argued that "sufferers from AIDS may not scruple to commit violent crimes because they have little reason to fear the consequences. In some cases ... travelers from the developed world are attacked not only because they are potentially lucrative targets but because they are seen as the cause of the poor economic circumstances."[10]

International Crime and Drug Trafficking

State failure is both a cause and consequence of international criminality, including money laundering and international drug trafficking. Failed states are easy prey for criminal groups that seize widespread control of drug smuggling operations, and some states such as Colombia have lost control over internal territories to insurgencies supported in part by proceeds of the drug trade.

Environmental Degradation

Economic collapse and state failure are major contributors to environmental degradation of strategic concern to the United States. For example, tropical deforestation—with serious consequences resulting in loss of biodiversity and long-term climate change—is caused in part by population pressures in poor agrarian regions that lead to clear-cutting of forests to make way for peasant agricultural sites. Most of the clear-cut land, alas, is unsuitable for intensive agriculture and is quickly abandoned, with devastating long-term ecological consequences. Because of state failure, and the lack of viable economic alternatives in these economies, environmental regulations are generally not enforceable or are easily corrupted. Some of the earth's most important zones of high biodiversity are at extreme risk because they lie precisely within failed states. In 1988, ecologist Norman Myers identified 25 regions in the world with exceptionally high species endemism. Many of these regions are within states, such as Brazil, Bolivia, Colombia, China, Ecuador, India, Indonesia, Mexico, Panama, Peru, South Africa, Turkey, and Venezuela, suffering under severe economic stres, if not outright failure.[11]

> Economic collapse leads to state failure which leads to U.S. military engagements.

Infectious Disease

Many of the poorest countries in the world, and especially societies with state failure, are subject to horrific conditions of disease. Like international crime, the disease burden is both a cause and consequence of economic and political failures. A heavy infectious-disease burden, such as year-round transmission of malaria, causes a sustained reduction in economic growth for many reasons: individual workers are less productive, children are much less likely to finish school and to reach their cognitive potential, sectors such as tourism and agriculture are directly affected, and foreign investors are deterred. State collapse feeds these problems because failed states lack the financial and institutional means to deliver vital public health services. The AIDS pandemic has ravaged sub-Saharan Africa in part because no African government has the means to fight this scourge with its own resources, and donors have generally not provided sufficient resources.

As a recent National Intelligence Estimate on the global infectious-disease threat clearly indicates, the United States stands at risk as a result of the uncontrolled spread of infectious disease in the poorest countries and

failed states.[12] Risks to the United States include direct financial costs as it responds to the epidemic crises abroad; destabilization of foreign societies as a result of the crippling disease burden; and the spread of deadly pathogens, including multi–drug-resistant strains, across international borders. Notably, Europe has already spent billions of dollars combating "mad cow" disease and will now spend vast sums fighting foot-and-mouth disease in European cattle and sheep. AIDS, of course, illustrates a newly emergent pathogen that arrived from Africa and has caused immense suffering and economic loss in the United States (although only a small fraction of the human devastation that has occurred in Africa itself). One can only wonder whether better public health surveillance and medical treatment, along with a healthier general population in Africa, might have controlled the epidemic much earlier, and either slowed or stopped its introduction to other parts of the world.

The United States has become, by far, the stingiest of all rich countries in donor aid.

Addressing Foreign Economic Failure

Surprising as it may seem, the United States lacks a policy framework for translating its strategic interests in foreign economic performance into foreign policy actions. Because foreign economic failure leads to state failure that in turn has adverse implications for national security, trade and investment, international crime, drug trafficking, and infectious disease, one might suppose that the United States would have developed policy instruments to address preventable or remediable cases of foreign economic failure. One would hope that economic, security, and foreign policy considerations would also be well integrated in national foreign policy making. In fact, economic policymaking vis-à-vis the developing world has largely operated outside any long-term foreign policy framework.

A proper policy framework must start with a hard-nosed assessment of what the United States can and cannot accomplish in support of economic development abroad. For example, as rich as the United States is, direct income transfers from the United States to poor countries can make relatively little difference to their per capita income levels. To illustrate this statement, if the United States decides to spend another $20 billion per year on aid for the 2.4 billion people in low-income countries, that act would amount to less than $10 per person in the recipient countries. Because GNP per person is around $37,000 per year in the United States and only $400

per year in low-income countries, sizeable income transfers would just be a drop in the bucket of the income gap.

Nonetheless, foreign assistance can be decisively significant if it helps to unleash long-term economic growth, for example, by helping a country escape from a poverty trap or by helping a country in institutional transition to consolidate its economic and political reforms. Such uses of foreign assistance depend on a strategic view of the use of such transfers; that strategic sense has been largely missing in practice during the past 20 years. Foreign assistance has been poorly targeted (mostly to countries not in a poverty trap, so that added assistance makes little difference to long-term growth prospects) and poorly timed (often arriving too late to help fragile economies in transition).

Each of the sources of economic failure—poverty trap, state bankruptcy, illiquidity, and transition crisis—requires a distinctive policy response from the United States. Consider the problem of a poverty trap, for example, as it afflicts much of sub-Saharan Africa. Economic growth does not occur because these countries do not achieve the minimal standards of health, education, and infrastructure. A valid policy instrument, in that case, is a set of large-scale and sustained income transfers from the United States and other rich countries targeted on the interlocking crises in health, education, and basic infrastructure. Amazingly, the United States gives only a pittance to the poorest countries for the support of basic health and education. In 1999, for example, the United States gave the sub-Saharan African countries (49 countries with a combined population of 643 million in 1999) around $78 million for health and $63 million for education in official development assistance, according to the data of the Organization for Economic Cooperation and Development. Total donor aid (from all donors) to sub-Saharan Africa was $836 million for health and $999 million for education, or little more than $1 per person in each case. In short, the rich countries did nothing significant to help the poorest of the poor in Africa break out of the poverty trap. The results were expected: continued economic failure, massive state failure, collapsing public health, and pervasive adverse consequences for the United States.

The consequences of this miserliness are undermining vital U.S. interests.

State bankruptcy, on the other hand, must be handled in a completely different way. Giving short-term transfers to an already bankrupt state is fairly useless, as one failed International Monetary Fund (IMF) program after another has sadly demonstrated. When a state is buried by external debt, the debt must be reduced for the state to function properly. Both the reality and expectations of continued weakness of a failed state make it impossible

to achieve political stability when debt overwhelms a government. The outright cancellation of debt becomes imperative. Of course, the United States might resist debt relief in the case of a hostile debtor state, but if the United States is truly attempting to foster economic recovery abroad, it should regard debt cancellation as a necessary part of its foreign policy arsenal, similar to the situation of a bankrupt municipality under the U.S. bankruptcy code.

Sizable income transfers would just be a drop in the bucket of the income gap.

In the case of illiquidity, the key step is not debt cancellation but a postponement or "time-out" on debt servicing. The continued hemorrhaging of debt service payments during a liquidity crisis can cause an extremely sharp collapse of economic output. For example, the East Asian emerging markets experienced GNP declines of 6 percent or greater during 1998, not because the economies had suffered a collapse of fundamentals, but because the economies were subject to a brutal squeeze on access to short-term working capital. The IMF did little to relieve the short-term credit squeeze because it was reluctant to insist on a time-out on debt servicing. When that happened as a force majeure, as in Korea in late 1997, economic recovery began sooner.

The main lesson about transitions is that small amounts of help at crucial moments can tip the balance toward successful outcomes. A new government may consolidate its democratic gains, or it may collapse into a new authoritarian regime. If the transition gains momentum in one of these directions, political forces often rush to the seemingly victorious side, and a self-reinforcing process takes over. Because expectations of the direction of change also cause political forces to align themselves one way or another, the paths of transition regimes are subject to self-fulfilling prophecies of success or failure. All of this analysis underscores one essential point. When the United States is dealing with a transition government—in Nigeria currently, for example—time is of the essence. A key use of aid should be to support the consolidation of the new regime, and that goal requires timeliness. Foreign assistance should be used to bolster the political authority of the new government, to remove impediments (such as an overhang of foreign debt), and generally to build signals of the long-term durability of the new government.

Toward a Strategic Use of Foreign Assistance

The United States has rarely wielded foreign assistance as an effective instrument of U.S. foreign policy. During the Cold War, a considerable propor-

tion of foreign assistance was simply a transfer to U.S. allies as a kind of "thank you" for their continued political support that often was not forthcoming. The aid was not well directed toward solving development challenges, and in any event the "thank yous" were often followed by state collapse. Since the early 1980s, and especially since the end of the Cold War, the levels of U.S. donor assistance have in fact plummeted. The United States now spends only 0.1 percent of GNP in foreign assistance, and only 0.02 percent of GNP in assistance for the poorest countries. The United States has become, by far, the stingiest of all rich countries in donor aid. The consequences of this miserliness are undermining the long-term vital interests of the United States.

It is time to reconstruct a strategy of foreign assistance that is commensurate with U.S. strategic interests. The United States should urgently lead an international effort to help sub-Saharan Africa escape from a poverty trap that has led to a downward spiral of disease, falling living standards, and increased conflict, during the past 20 years. More generally, the United States should harmonize the decisionmaking of different parts of the U.S. government, including the Departments of Treasury and State, as well as the Office of the U.S. Trade Representative, to rebuild our national capacity to support economic development abroad as a vital component of U.S. foreign policy.

Notes

1. World Bank, *World Development Report 2000/2001* (New York: Oxford University Press, 2000), table 2.
2. See *Journal of African Economies* 9, no. 3 (October 2000) (series of articles on conflicts in Africa).
3. See State Failure Task Force, "State Failure Task Force Report: Phase II Findings," *Environmental Change and Security Project Report*, no. 5 (Woodrow Wilson Center: Summer 1999), 49–72.
4. Robert Barro, "Determinants of Democracy," *Journal of Political Economy* 107, no. 6, pt. 2 (December 1999): S158–S183 (Symposium on the Economic Analysis of Social Behavior in Honor of Gary S. Becker).
5. See Paul Collier and Anke Hoeffler, "On the Incidence of Civil War in Africa," August 2000, located at <http://www.worldbank.org/research/conflict/papers/incidence1.pdf>.
6. See David Bloom and Jeffrey Sachs, "Geography, Demography, and Economic Growth in Africa," *Brookings Papers on Economic Activity* (1998), 2:207–289; Jeffrey Sachs, Andrew Mellinger, and John Gallup, "Geography of Wealth and Poverty," *Scientific American* (March 2001).
7. In chronological order, cases of military intervention following state failures are (the first date in each case refers to the military intervention, and subsequent dates refer to state failure) Cuba (1962, 1956–1961), Thailand (1962, 1957), Laos (1962–1975, 1960–1979), Congo (1964, 1960–1965), Vietnam (1964–1973, 1958–

1975), Dominican Republic (1965, 1961–1966), Congo (1967, 1960–1965), Cambodia (1970, 1970–1979), Cyprus (1974, 1963–1968, 1974), Vietnam (1975, 1958–1975), Lebanon (1976, 1965–1992), Korea (1976, not applicable), Zaire (1978, 1977–1979), Iran (1980, 1977), El Salvador (1981, 1977–1992), Libya (1981, not applicable), Lebanon (1982, 1965–1992), Honduras (1983–1989, 1978–1990 state failure in Nicaragua), Chad (1983, 1965–1996), Liberia (1990, 1989–1997), Zaire (1991, 1991), Sierra Leone (1992, 1991 onward), Somalia (1992, 1988 onward), Bosnia–Herzegovina (1993, 1992–1996), and Somalia (1993, 1988 onward). The dates for state failure are taken from the State Failure Task Force data set; the dates of U.S. military intervention are taken from Ellen C. Collier, "Instances of Use of United States Forces Abroad, 1798–1993" (U.S. Congressional Research Service, October 7, 1993), located at <http://www.history.navy.mil/wars/forabroad.htm>.

8. *Origins of a Catastrophe: Yugoslavia and its Destroyers* (New York: Random House, 1999).
9. Adam Smith, *Wealth of Nations* (1776), 520.
10. Amon Cohen, "Unhealthy Rise in Danger," *Financial Times*, November 21, 2000, 16.
11. R. P. Cicotta et al., "Human Population in the Biodiversity Hotspots," *Nature* 404 (April 27, 2000).
12. National Intelligence Council, "The Global Infectious Disease Threat and Its Implications for the United States" (Washington, D.C., January 2000), located at <http://www.cia/gov/NIC_Publications/Other_Products/infectious_diseases_paper.html>.