strategy+business

The Forgotten Lessons of the Marshall Plan

by R. Glenn Hubbard and William Duggan

from **strategy+business** issue 51, Summer 2008

reprint number 08203

booz&co.

Reprint

The Forgotten Lessons of the Marshall Plan

To combat poverty in Africa, government should redirect aid to foster local business.

by R. Glenn Hubbard and William Duggan

More than 60 years ago, on June 5, 1947, U.S. Secretary of State George Marshall announced the European Recovery Program (later known as the Marshall Plan) in a famous commencement address at Harvard University. He said that it was "logical" for the United States to do whatever it could to restore the region to economic growth, "without which there can be no political stability and no assured peace." The plan, funded by the U.S. government and administered by a Europe-wide commission, spent US$13 billion over four years and engendered the highest rate of economic growth (about 35 percent per year) in European history. When the work of the plan was finished, the economies of every western European country had not just returned to prewar levels of growth and economic development, but surpassed them.

Ever since, the Marshall Plan has been widely hailed as a triumph, an example of foreign aid as an enabler of economic revitalization on a grand scale. During the past few years, some leaders have proposed it as a model for helping an entirely different region. A call has gone out for a Marshall Plan for Africa. Extreme poverty, civil wars, and disease have ravaged much of the continent, leaving it poorer today than it was 20 years ago. Sub-Saharan Africa in particular, home to two-thirds of the world's least developed countries, is the focus of greatest concern.

Jeffrey Sachs, the director of Columbia University's Earth Institute, included the idea of a Marshall Plan for Africa in his book *The End of Poverty: Economic Possibilities for Our Time* (Penguin, 2005). The United Nations Millennium Project, which Sachs helped conceive and design, evoked the Marshall Plan in its reports, as did the George W. Bush administration's Millennium Challenge Account (MCA), which was launched in 2006. And, in 2005, the U.K.'s Chancellor of the Exchequer (now Prime Minister) Gordon Brown made "a modern Marshall Plan" for Africa part of his grand vision for international aid, arguing that Africa's situation calls for concerted action by the world community.

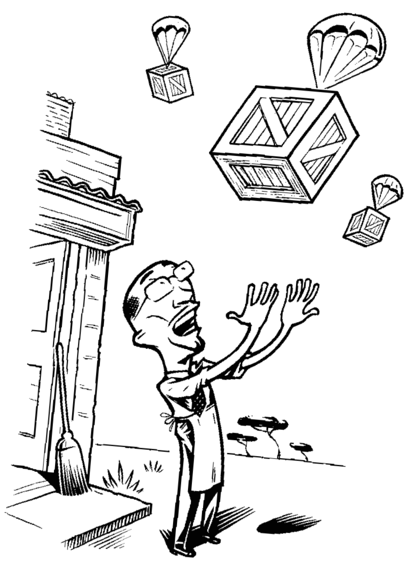

Illustration by Lars Leetaru

Brown's proposal, which has influenced many subsequent proposals and projects, contained four main elements. First, rich countries and multilateral institutions (such as the World Bank and International Monetary Fund) would forgive all their existing loans to the governments of African nations. Second, rich countries would double the amount of their direct development aid to Africa, establishing an "international finance facility" to support early phases of activity by borrowing against future promises of aid. Third, African governments would commit to anticorruption measures and more spending on health, education, and welfare. Fourth, rich countries would end trade barriers that hinder the import of African agricultural products.

There is much reason to agree with the objectives of a Marshall Plan for Africa. Raising the economic growth rates and standards of living in Africa, especially in sub-Saharan Africa, would have many beneficial effects. But most of the existing proposals, including Brown's, represent a great misunderstanding of the intention of the original Marshall Plan and the way it worked. It was less a sweeping program of foreign aid to governments and agencies than a large-scale effort to restore the power of business as a growth engine. A true Marshall Plan for Africa could ignite growth and reduce poverty, but only through a set of institutions that are different from those the current aid system is using. A broader understanding of the history of the Marshall Plan in Europe could lead to much more effective international investments and political initiatives, not just in Africa but throughout the world.

Marshalling Resources

In 1960, the average output per worker of African countries was about the same as that of Asian economies. But the latter have since experienced a boom, whereas most African economies have stagnated or deteriorated. This lack of growth has reinforced war and dictatorship throughout the continent, just as it threatened to do in Europe after World War II.

Indeed, the immediate impetus for the original Marshall Plan was the United Kingdom's announcement that it had run out of money to support the Greek government, which was fighting a Communist insurgency. Communism had already taken over half of Europe at the end of the war, and insurgencies and Communist parties were gaining ground throughout the rest of the continent.

The plan had four components. The first involved the way aid money was gathered and spent. The United States was the source; it channeled all grants through an independent funding and monitoring mechanism with its own global and local institutions. These included the Economic Cooperation Administration (ECA), which ran the entire program, with headquarters in Washington and small missions in every western European country. Each country had a special ECA account. The receiving countries formed their own regional coordinating body, the Organisation for European Economic Co-operation; this was a forerunner of both the Organisation for Economic Co-operation and Development and the European Union.

The second component was the intensive involvement of the private sector. The original initiative

R. Glenn Hubbard
(rgh1@columbia.edu), a former chairman of the Council of Economic Advisers under President George W. Bush, is the dean and Russell L. Carson Professor of Finance and Economics at Columbia Business School.

William Duggan
(wrd3@columbia.edu), a former Ford Foundation representative for West Africa, is an associate professor at Columbia Business School.

was run by business leaders, including the top administrator, Paul Hoffman of Studebaker Motor Company, then a major carmaker based in Indiana. The ultimate recipient of each loan — in effect, the unit of economic development — was an individual entrepreneur or business, not a government agency or nongovernmental organization (NGO). Money went directly to European governments, but they were required to use it to make loans to local businesses. The borrowers later repaid the loans to these governments, which could then lend them out again. This virtuous circle meant that all money spent on public projects would come from loans, most of which were repaid. It also helped ensure a focus on restoring the commercial infrastructure — such as ports and railroads, supply chains, banks and other financial institutions, and telecommunications networks — that would further boost economic activity.

Third, each European government made economic policy reforms to support its domestic private sector. They made it easier for all businesses, from upstart entrepreneurs to midsized manufacturing and larger enterprises, to thrive. The closest that Brown's proposal for Africa came to enabling business-sector development was the provision to cut trade barriers in donor countries. The original Marshall Plan did the opposite: It cut trade barriers in recipient countries, thereby increasing the markets and prospects for the entire region through increased trade.

The fourth component was a regional coordinating body that handled the distribution of funds among countries. This ensured that countries (and their resident businesses) would compete for funds. If one country did not cooperate, another was happy to take its funds.

It was a fortunate circumstance that these four components, and the pro-global-business sentiment underlying them, could be put into place. Although some isolationists in the U.S. Congress focused on the cost of the enterprise and opposed intervening outside U.S. borders, most U.S. politicians understood that domestic fortunes would rise with those of a prosperous, peaceful Europe. There was also a political consensus that business was the primary source of prosperity and stability; American industry had just won the war. And no competing system of economic development existed; the current, prevailing approach to foreign aid, with its reliance on government agencies and NGOs, would not emerge until the 1960s.

The recipient of each Marshall Plan loan was a business, not a government agency or an NGO.

Current Economics

Most of today's Marshall Plan for Africa proposals have little in common with the original Marshall Plan. But there are some important similarities between Europe then and Africa now. One is the sense of urgency. Africa is in danger of economic and social collapse, whereas Europe was under threat of Soviet advance. The second similarity is the recognition that the speed of implementation is critical. The original plan lasted only four years, and most of the present-day plans aspire to offer help in a similar time frame. Third, the financial scale of the original Marshall Plan was similar to today's proposals; both involved spending about $20 billion per year in today's dollars.

But the original plan's focus on the private sector is missing from today's African aid visions. Brown's plan, for example, fosters government-led development with an emphasis on grants to social service agencies and NGOs: the same old aid-to-Africa idea in a bigger package. The MCA, as designed by the Bush administration, offers major aid packages to governments of poor countries that put in place economic reforms and that improve human rights and democratic institutions. This, too, fails to completely capture the spirit of the original Marshall Plan. The only element the MCA's mission has completely in common with the original Marshall Plan is economic reform. But the MCA provides its primary aid to government-led development, not to business-sector support.

A real Marshall Plan for Africa would represent something that this continent has never seen on a major scale — a private-sector support project. This historical lack of business support in the region is poorly understood. For example, in a June 26, 2006, appearance on the *Charlie Rose* show with Bill and Melinda Gates (announcing his multibillion-dollar gift to the Gates Foundation), Warren Buffett said that "a market system has not worked in terms of poor people." In reality, it was never given a chance.

Of course, the new Marshall Plan would not look exactly like the original. Africa today is not the same as Europe in 1947. Despite the ravages of World War II, Europe then was in better shape than Africa is now. The Marshall Plan aimed to restore the European economy to its prewar prosperity. But most of Africa has never had such prosperity to restore. It has always been poor. Yet the essential elements of the original Marshall Plan offer a way forward that any program of development aid must follow.

An effective Marshall Plan for Africa should concentrate exclusively on business development. It should have its own institutions designed to match those of the original plan. Last time, the U.S. Congress created a commission to oversee the plan. The new plan should require an international commission to provide oversight. And a structure should be put in place, equivalent to the original plan's ECA, to collect and manage the funds on the donor side. Under such a plan, an African country would become eligible by putting policies in place to foster business development; each member government would then have its own revolving fund in a special account. In the original Marshall Plan, governments spent the repaid loans on economic infrastructure projects approved by the ECA. A Marshall Plan for Africa should establish a similar structure. Given Africa's size and diversity, there might be regional ECAs rather than a single one for the whole continent.

A plan like this would not be redundant; it would complement the existing private-sector efforts in Africa — such as those sponsored by the Africa Development Bank (ADB), the International Finance Corporation (IFC, the private-investment arm of the World Bank), the Grameen Bank and other microlending institutions, and the emerging networks of Chinese investors. These private-sector efforts are all beneficial, but they are tiny compared to the public-sector aid going into Africa today. And the existing business-related efforts are limited in their effectiveness. The ADB, for example, makes more loans to government agencies and NGOs than it does to private companies, and neither it nor the World Bank insists on pro-business policies, as the Marshall Plan did. A country like Mozambique, which ranks 140th out of 175 countries analyzed by the World Bank in its "Doing Business" reports for pro-business policy (www.doingbusiness.org), still qualifies for multilateral loans. The IFC does good work, but it cannot meet every business development need on the continent. The Grameen Bank — the microlending institution founded by Nobel Peace Prize winner Muhammad Yunus — is also excellent. But it fosters unregistered, tiny businesses, not the mid-sized, more formal businesses that can move an economy forward more quickly, and that often need more help, because government agencies sometimes see them as competition. China still invests primarily in those companies that work closely with Chinese companies, or in African branches of Chinese enterprise; this is better than a system that funds only governments without private enterprise involvement, but it hardly represents an open business environment.

In the new Marshall Plan, the funds themselves should be dedicated to a variety of purposes. Above all, they should *not* go for government-designed economic development plans, whose track record has not been successful. Competitive regional funds would support activities based on best practices accumulated over the history of aid, from the original Marshall Plan to today. Almost every multinational, national, and NGO aid agency, for example, has some unit or program in place that does, indeed, help the private sector. For example, the U.S. government's Overseas Private Investment Corporation maintains 37 equity funds that provide financing and technical assistance to small and midsized enterprises in emerging markets; aid agencies in France, the United Kingdom, and the Netherlands have similar programs; and the European Bank for Reconstruction and Development and the Inter-American Development Bank have supported a variety of business-focused funds in Eastern Europe and Latin America, respectively.

The Software of Business

This leads to the last key element of a Marshall Plan for Africa: As with the original, the business sector must lead it. Administrators and decision makers should, once again, be drawn from that sector, present in flesh as well as spirit. Like the original, the plan should focus on business infrastructure. In Africa, that would mean not just hardware — upgrades in electricity distribution, telecommunications, and transportation — but also a sort of software. This software would include financial institutions, business schools and associations, anticorruption units, and courts, all of which must be improved or created in most African countries to enable their business communities to expand.

Projects with a business core tend to be less popular than government- or NGO-based plans — after all, charity touches the heart, and business does not. The original Marshall Plan started out with the support of only 14 percent of the U.S. public. But an aggressive information campaign by the Committee for Economic Development, a group of American business leaders, won over the public. Something similar might be needed for this new plan, but business leaders have been conspicuously absent from the growing debate on African poverty. There is a historical reason for this; in the 1960s, when their nations were formed, most African political leaders decided specifically to develop through government, not private, investment. Because the businesses in their nations were largely owned by non-Africans (Indians, Lebanese, Syrians, French, British, and Portuguese), the political leaders felt that supporting businesses would not help governments deliver services to their own people. In addition, in those years just after Sputnik, it was not clear whether state-centered economic development patterned after Soviet and Maoist Communism would succeed or fail. Now we know.

Business leaders have been conspicuously absent from the debate on African poverty.

Despite its scale and speed, the original Marshall Plan was an incremental program. It built on what came before — it made existing European businesses stronger. A Marshall Plan for Africa would do the same: It would take different kinds of African businesses a step further in their development. The overall effect would represent the sum of many small actions. That's how a market system works. It could also be a template for other distressed parts of the world — parts of Latin America and of the Middle East, for example.

In his speech, George Marshall was very clear that the "breakdown of the business structure of Europe during the war" was the problem that aid most needed to solve: "Our policy is directed not against any country or doctrine but against hunger, poverty, desperation, and chaos. Its purpose should be the revival of a working economy in the world so as to permit the emergence of political and social conditions in which free institutions can exist. Such assistance, I am convinced, must not be on a piecemeal basis as various crises develop."

Marshall's logic applies just as well to Africa today: A thriving business sector is the key to improving political and social conditions. And Africa today needs that sort of help. The first Marshall Plan accomplished even more than its creators had hoped; if its successor is designed with the same conceptual base, then history could repeat itself in another part of the world. +

Reprint No. 08203

strategy+business magazine
is published by Booz & Company Inc.
To subscribe, visit www.strategy-business.com
or call 1-877-829-9108.

For more information about Booz & Company,
visit www.booz.com