Exporting Capitalism
EXPORTING CAPITALISM

Private Enterprise and US Foreign Policy

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Preface

The way of economic life which goes by the name of private enterprise is the sound and true gospel.
—US ambassador Merwin Bohan, 1954

The United States has long believed that private enterprise is crucial for economic growth. So deep is this belief that the United States has sought to spread it around the world, including to developing countries. Yet in many settings the private sector has failed to flourish. Why is that the case, and what can the United States and the international community do to help it take root? These are among the questions I address in this book.

For me, that topic goes beyond academic or theoretical interest. Prior to the COVID-19 pandemic, I spent much of my time visiting projects backed by multinational corporations and foreign aid agencies that had as their objective private sector development; and by the time this book is published, I hope to be back in the field! A seemingly new objective of donors and investors, “private sector development,” is meant to supplement or even supplant foreign aid as a driver of economic growth and poverty reduction. Some of the relevant projects that have I studied over the years include SABMiller’s brewing of a novel type of beer in Uganda (Eagle Lager) that made intensive use of local cassava and thus local farmers, instead of imported hops; Newmont Mining’s encouragement of local entrepreneurs surrounding its Ahafo iron ore mine in Ghana; and Coca-Cola’s long-standing efforts in many countries to create “inclusive” domestic value chains running from agriculture to final distribution. I have also worked in the former Soviet Union on the conversion of defense plants to commercial activity and in
conflict-affected countries including Afghanistan, where US policy makers hoped that spurring private enterprise would lead to economic growth and job creation, contributing to peace. Prior to becoming an academic, I worked as an international banker, supporting private sector development directly in such countries as Brazil.

As I examined the economics of these and many other programs, I realized that some were more successful than others in catalyzing the private sector; similar interventions in two different places generated two very different results. Why was that the case? To what extent did the economic structure of a country shape the attitudes of its elites toward private investment? And that led to an even larger, “so what” question: under what conditions did private enterprise programs within a country lead to systemic or political-economic transformation of the country? What is the relationship between micro, firm-level interventions and macro political-economic change?

In contemplating these issues, I also discovered that private sector development wasn’t such a new policy objective after all. In fact, it’s probably fair to say that no line of effort in US foreign aid policy is of longer-standing than private enterprise promotion. US government efforts to address private sector development went back at least to the postwar Marshall Plan, while the multilateral International Finance Corporation (IFC) was founded in 1956 with that very purpose. Now that the international community was rediscovering private enterprise as a key component of development policy, I wondered what previous experiences might teach us, in the hope of making contemporary policies and programs most effective. That motivation was given further impetus by the creation in 2018 of the new US International Development Finance Corporation (DFC), whose objective is to support private sector–led investment in developing countries, in contrast to China’s state-led model of economic growth.

This book tells the story of Washington’s persistent efforts to encourage private enterprise in the developing world and so-called transition economies of Central and Eastern Europe (note that I do not emphasize short-term capital flows via portfolio investments or bank loans in this study). It has done so both by motivating foreign direct investment (FDI) and the creation of local firms, and more generally by encouraging the creation of an amenable “investment climate.” The US government, of course, has also sought to export capitalism through a variety of other policies, including international trade agreements and foreign aid programs aimed at building institutions like judiciaries and enforceable property rights (and many scholars would argue that the United States has used its military power and intelligence services for this purpose as well). Not surprisingly, the outcomes of these efforts have varied across time and space; after all, the beliefs and
aspirations of policy makers may not necessarily map neatly onto the reality they confront in a given place.

For one thing, leaders in the developing world have not always shared Washington’s enthusiasm regarding private enterprise; alternative economic ideologies, often coupled with political efforts to concentrate industrial power in the hands of government officials and state-owned enterprises, meant that fostering private sector growth has not always and everywhere been a policy priority. For another, American business leaders have often proved unwilling to follow Washington’s lead when it came to investing in the developing world. Instead, these executives worked to further their own interests and corporate strategies, which usually emphasized the wealthier industrial world, or a handful of the larger developing economies or those with specific resources like petroleum. As a consequence, the US government’s ability to export capitalism through private enterprise has been repeatedly constrained by the preferences of leaders in the developing world on one hand and those of executives of US multinational corporations on the other.

The structural conditions found in developing countries also play a major role in shaping the environment for private enterprise. Private sector development, for example, has proved much more difficult in countries that rely heavily on natural resources and that are mired in violent conflict. Conversely, in countries where the local elites are invested in a wide range of economic activities—and where at least some are committed to long-term investment schemes as opposed to short-term rent-seeking—the chances of promoting private sector–led growth are much greater. Indeed, the economic structure of these elites will play a decisive role in determining the success of private enterprise. Donor nations that seek to promote private enterprise would do well to consider these structural and related political economy issues as they devise their policies and programs. To put this starkly, if the preferences of local elites are not closely aligned with those of foreign donors, the chances of programmatic success are severely limited.

This book is broken into nine chapters, each of which is meant to elicit key “lessons” for contemporary policy makers. In the Introduction, I discuss the concept of private sector development and why it has held such a persistent attraction for American officials. Chapter 1 focuses on the ideas that shaped US foreign economic policy toward private enterprise during the Cold War, reminding us that many of the policies that are today touted as “new” have a long lineage. Chapter 2 examines private investment in the context of the “developmental” or “dirigiste” states of Taiwan and South Korea, where central governments sought to maintain a heavy hand on their economies as they dealt with both internal and external threats. Chapter 3
examines the long-standing Latin American ambivalence toward foreign direct investment (at least in some sectors) while Chapter 4 focuses on how Presidents Nixon, Carter, and Reagan dealt with the problem of “economic nationalism” and the related threats of expropriation of American property. In Chapter 5, I analyze the post-communist transition, when capitalism finally seemed to triumph—and with it, democracy, highlighting the American belief in the linkage between the two. Chapter 6 picks up the thread of this story in conflict-affected states like Afghanistan and Iraq, where American officials hoped that private enterprise would similarly act as a force for peace and the creation and maintenance of democratic institutions. Chapter 7 examines private sector development with a focus on the DFC and the China challenge. The final chapter provides conclusions and policy recommendations.

As this summary hopefully makes clear, my purpose here is not to write a history of the multinational corporation or of government efforts to regulate that form of business organization. I also give relatively short shrift to “corporate social responsibility” and the role of firms in providing support for community needs. Instead, I focus squarely on the problem of how US officials sought to motivate the spread of private enterprise in a number of different settings, and how effective these policies have been.

I decided to write this book following a brief stint with the US government. Prior to entering government, I was engaged in a project with several collaborators on private enterprise in Afghanistan, and as a follow-up I codirected a project for the United Kingdom’s Department for International Development on private sector development in Afghanistan, Iraq, and Pakistan. Once I arrived in Washington, I became aware of discussions (although I took no part in them) regarding the new International Development Finance Corporation, which replaced the Overseas Private Investment Corporation founded under President Nixon. Upon returning to academic life in late 2018, I felt compelled to write up a proposal to the Smith Richardson Foundation to help fund the work of researching and writing this book, and I am once again grateful to Marin Strmecki and his colleagues for their support. Further support has been provided by Princeton University, including funding from the Princeton Institute for International and Regional Studies for work on fragile states and the Undergraduate Dean’s Office at the Princeton School of Public and International Affairs and the Department of Politics for research assistance. My research in Afghanistan has been supported by the World Bank and by the Department of Defense through its Minerva Research Initiative.

Many people have provided crucial assistance along this road, including my fellow directors of the Empirical Studies of Conflict program: Jacob Shapiro, Eli Berman, and Col. (Ret.) Joseph Felter, and my Princeton colleagues.
David Baldwin, Miguel Centeno, Amaney Jamal, Steve Kotkin, and Cecilia Rouse. Baldwin’s intellectual imprint, in particular, is all over this book, and I am grateful for the time we’ve shared together over the years discussing economic statecraft (and working on a new edition of his classic work). He also provided a detailed reading of an earlier draft of the manuscript, which led to numerous corrections and improvements. Similarly, historian David Painter of Georgetown University, a great student of the issues raised in this book, provided penetrating comments on an earlier draft of the manuscript. At Arizona State, I wish to thank President Michael Crow, along with Ann Florini, Mark Green, Sanjiv Khagram, Jonathan Koppell, and Don Siegel, who are all sources of inspiration and support; I am proud to be associated with an institution that combines the excitement of a Silicon Valley start-up with the foundational principles of academic excellence and student inclusivity. I am also grateful to the many librarians and archivists who so quickly responded to my information requests, especially during the COVID-19 pandemic!

Outside the academy, Neil Gregory of the IFC and Beata Javorcik of the European Bank for Research and Development (on leave from Oxford) have been extremely helpful to me, not just to this project but over many years. I have learned volumes about private sector development through my collaboration with Rene Kim and his colleagues at the firm of Steward Redqueen, and I am grateful to the many firms and development agencies that have sought our assistance.

Research support for this project has been ably provided by Princeton doctoral student Zenobia Chan, MPA student Michelle Nedashkovskaya, research assistant Adityamohan Tantravahi, and undergraduates Judy Koo and Cai Markham. My daughter Nina Kapstein did great work in helping compile sources for the endnotes. In Jess McCann I found a terrific editor who helped structure and improve the text. Ian Malcolm of Harvard University Press was an early advocate of this project, and I am grateful to him for all his support; it’s great to be back with the Press after a long absence! Thanks are also due to Olivia Woods at the Press for all her help in moving the book toward production. A special shout-out is due to the anonymous reviewers of the manuscript, who went way beyond any reasonable call of duty in providing incredibly detailed, insightful, and truly helpful critiques of earlier drafts; the Syndics of Harvard University Press added many productive comments as well. Portions of Chapter 1 were first published as “Private Enterprise, International Development, and the Cold War,” *Journal of Cold War Studies*, Volume 22, Number 4, Fall 2020, pp. 113–145. I thank the anonymous reviewers who provided many useful comments on that text and the MIT Press for publishing the article.
One of the most joyful aspects of writing this book was that it led me to reread much of the work of my great mentor Raymond Vernon and recall our many conversations on related topics. I am forever blessed by the memories of the relationship I forged with him over our years working together on Harvard’s Economics and National Security Program. I also recall with gratitude my opportunity to study with Alfred Chandler, whose brilliance was only matched by his kindness. Samuel Huntington, who served as the director of Harvard’s Olin Institute and recruited me when he learned of my interest in bringing together research in economics and national security, has also written powerfully on many of the issues addressed here. I still miss my regular discussions with Sam; working with him was one of the greatest honors and opportunities of my life.

Deep thanks are due to Benedicte Callan, who has suffered through too many discussions on topics related to this book. But I dedicate this book to my four daughters—Anne, Laura, Nina, and Felicity—as partial thanks for all the cherished moments we’ve shared and for being so forgiving of their dad when he was at work. I know they will bring as much happiness to their loved ones as they have to me.
In October 2018, the US Congress passed the BUILD Act, establishing the new International Development Finance Corporation (DFC). Capitalized at some $60 billion, the DFC’s stated economic purpose is to promote “development by supporting foreign direct investment [FDI] in underserved types of projects, regions, and countries.” Its larger geopolitical purpose, however, is to challenge China’s Belt and Road Initiative (BRI), which is a $1 trillion global infrastructure program. As then-Vice President Mike Pence said of DFC, “we’ll be giving foreign nations a just and transparent alternative to China’s debt-trap diplomacy.”

Washington insiders in both government and business have characterized DFC as a sea change in American foreign assistance policy. Ray Washburne, former head of the Overseas Private Investment Corporation (OPIC, which DFC replaces), said that its creation “launches a new era in development finance,” while USAID administrator Mark Green held out its promise to “catalyze market-based, private-sector development, spur economic growth in less-developed countries, and advance the foreign-policy interests of the United States.” Senator Bob Corker (R-Tenn.), who cosponsored the bipartisan BUILD Act, claimed that the founding of DFC heralds the end of traditional, government-to-government foreign aid programs. These programs, he proclaimed, could now “set the goal of putting themselves out of business.” For its part, the US Chamber of Commerce, representing the views of its corporate members, wrote in support of the BUILD Act that it “would leverage the U.S. private sector’s expertise and investment capital
to generate economic growth in the developing world and provide tangible benefits for American companies selling their goods and services there.” In so doing, it would “advance U.S. national security and economic interests.”

The purpose of this book is to examine these claims about the promise of private enterprise as an instrument for international development. The ideas animating the DFC are hardly revolutionary, but instead represent the continuation of a persistent effort to catalyze private sector development on behalf of Washington’s geopolitical and geoeconomic objectives—an effort that was at the focal point of foreign assistance policy during the early years of the Cold War and that, with some ebbs and flows, has remained a policy objective ever since. For at least a decade beginning in the late 1940s, the US government believed that foreign investment could fuel economic growth in the developing world, and in so doing counter the existential threat posed by international communism. As President Dwight D. Eisenhower said in a 1955 address to Congress, “An increased flow of United States private investment funds abroad . . . would do much to offset the false but alluring promises of the Communists.”

In promoting FDI, Washington’s “theory of change” was that American firms would catalyze economic growth through FDI, in turn motivating local entrepreneurs to invest in the supply chains and support functions that these corporations required. Jobs, incomes, exports, and tax revenues would be generated as a result. Economists would later refer to this process as one of creating “linkages” between foreign and domestic firms. By promoting linkages, countries would enjoy faster rates of development. More recently, the United States has sought to grow private firms organically, without depending so much on the catalyzing power of multinational firms.

Generating growth in the developing world through private enterprise was not solely of material or economic interest to Washington; it did not arise solely out of a desire for the developing world’s commodities or market potential. Equally if not more important, it promised a number of political and national security spin-offs, including a pro-American foreign policy orientation, and perhaps eventually democracy (and, more recently, policy makers have held out its potential for promoting peace and more gender equality in such countries as Afghanistan). This causal chain reflected key tenets of modernization theory, one of whose advocates, W. W. Rostow of the Massachusetts Institute of Technology, was an influential academic who would help shape US foreign aid policy before going on to become a national security adviser to Presidents Kennedy and Johnson. As Richard N. Cooper has written of American statecraft in the early Cold War, “the principal instruments for preventing the spread of Communism by nonmilitary means involved building an international economic system...
conducive to economic prosperity,” which required the spread of trade and private enterprise.  

This quest for private sector development was, of course, securely nested within American ideology as well—by a persistent belief in the superiority of political-economic systems based on liberal, democratic-capitalist institutions. In fact, one of the most striking things about US development policy is its continually expressed belief in private sector–led growth. What David Baldwin wrote in 1966 remains equally relevant today: “To representatives of the less developed nations it must seem that the United States never tires of citing the advantages—real and imagined—of an economic system based on private enterprise.”

This market-oriented ideology did not just help shape foreign economic policy during the Cold War, when the United States allegedly faced an existential threat from “international communism,” but it has also remained prominent during the subsequent eras of globalization and neoliberalism, and today is a key instrument in challenging China’s “Belt and Road” model of economic development. Indeed, while American officials were not usually blinded by economic ideology—at the end of the day, they generally recognized the art of the possible in a given setting—in some cases the ideologues among them had the scope to advance policies that made little sense given the facts on the ground. In Iraq, for example, US officials believed that they could replicate the “shock therapy” models imported from post–Cold War Eastern Europe in the hope of creating a private sector–led market economy.

What lessons can foreign policy officials today, including those running the DFC, draw from this history, in particular as they seek to confront China in the developing world? What core interests and ideas motivated Washington’s underlying philosophy of international development? And what does this history tell us about the relationship between the American government, the developing world, and US-based multinational corporations, which has been a contentious topic among scholars over many decades? These are among the questions this book will address.

To preview the general argument, Washington’s long-standing private enterprise project has had only mixed success, providing today’s international development community (which encompasses bilateral and multilateral development agencies along with foreign aid implementers and private foundations) many lessons regarding effective vs. ineffective policy interventions. That track record reflects in part the clash between the policy preferences of the Executive Branch on the one hand and the interests of private sector firms and of many local elites in developing countries on the other, not to overlook the foreign economic policy preferences of the US Congress as well, which I will show sometimes conflicted with those of the President. Whereas the US government believed that foreign investment could drive the economic
growth of developing countries, multinational firms have generally been interested in only a handful of those countries as investment destinations. Investing in developing economies has simply not been a priority for most of them, no matter a particular country’s geostrategic importance to the White House and Foggy Bottom. As a result, FDI flows have often lagged behind the amounts that Washington had hoped for, with major consequences for the government’s philosophy of foreign assistance.

Further, structural conditions within recipient nations have often shaped the opportunities for private enterprise. Countries that rely heavily on natural resources, and those in the midst of violent conflict, for example, have proved to be particularly challenging settings for growing the private sector. No less problematic, the kleptocratic rulers of all-too-many countries have exploited national economies as a source of private gains rather than as a seedbed for inclusive growth, dampening the prospects for entrepreneurship. Conversely, in countries in which the elites have a diverse set of economic interests, and where incentives exist to pursue long-term investment schemes rather than engage in short-term rent-seeking, the promise of private sector development is much greater. In sum, certain places have proved more hostile, and some more welcoming, to private sector development than others, largely reflecting underlying structural conditions and the related political economy of elite interests.

At the same time, we will also see that Washington has sometimes exaggerated a recipient government’s hostility to private enterprise. A policy of blocking foreign investment in some “strategic” sectors like petroleum, for example, did not necessarily mean that multinational corporations and local firms weren’t welcome by host governments in others. In that context, it should be recalled that the US government also actively screens, and sometimes prevents, foreign investment, especially when it “threatens” national security.

The story presented here demonstrates, contrary to Robert Gilpin’s famous assertion, that American firms have not served as reliable “instruments of American global hegemony.” In fact, the evidence presented in this book casts doubt upon the ability of the United States to impose its policies, even on supposedly “weak” states (or even those that it has occupied militarily), when preferences and priorities differ. And for their part, developing countries have varied enormously over time and space in their demand for private capital and ability to attract it. In several cases, notably among countries within the former Soviet orbit in Central and Eastern Europe, former hostility toward the private sector turned into a more welcoming embrace as the political economy of their regimes changed.

Despite the crucial differences in the economic policies and trajectories of the world’s developing regions (and even within Latin America, East
Asia, and Sub-Saharan Africa, there has been of course great diversity in both policies and outcomes), it is also important to be cognizant of the commonalities among the world’s poorest countries that played a major role in shaping the contours of US policy. In fact, some generalizations about the postwar developing world, no matter the region, are fairly robust, such as the need of the poorest countries to import foreign capital in some form (i.e., either as grants, loans, or investments) given the “gap” between domestic savings and investment requirements. After all, by definition, developing countries lacked savings, and thus savings had to be mobilized through some combination of domestic and international effort.

American policy makers also discovered that developing country leaders, as a general rule, did not believe that FDI was a substitute for government-to-government assistance; instead, different sources of capital were needed for the production of public vs. private goods. These leaders urged Washington to accept the proposition that foreign aid and private enterprise were complementary rather than competitive; aid-funded infrastructure, for example, would attract more investment. At the United Nations, where developing world leaders often expressed similar views on foreign assistance, they called for “external grant aid to finance ‘low-yielding . . . social and economic overhead projects’ basic to economic development.” It would take many years for American policy makers to accept that official aid represented something beyond a failure of recipient nations to harness private capital. As President Eisenhower liked to say, foreign assistance was the equivalent of putting money in a “tin cup.”

The purpose of this Introduction is to lay the groundwork for the case study chapters that follow, which analyze private sector development across a wide range of settings in the hope of generating some overarching findings. In so doing, I define key terms, and present some of the arguments that have been made over the years by scholars on behalf of a growth model based on private enterprise. I then lay out the fundamental principles and ideas that have guided American policy makers in their approach to international economic development.

What Is Private Sector Development?

Private sector development has become a big business in its own right. According to Daniel Runde and Aaron Milner at the Center for Strategic and International Studies, the development finance institutions (DFIs), which include such organizations as the International Finance Corporation, the European Bank for Reconstruction and Development, the Asian
Development Bank, and the Inter-American Development Bank, now commit something close to $90 billion per annum on private sector projects, including equity investments, loans, and guarantees. Much of this funding flows to local banks, which in turn are expected to lend to local private sector firms, including small and medium-sized enterprises (SMEs).21

But what is meant by the “private sector” and “private sector development”? Even if precise definitions remain elusive, we must begin by providing some parameters around these and other key terms which will be used throughout the book. For as we will see in a moment, terms like these, which seem relatively straightforward to define, are perhaps less clear than imagined. USAID, for example, provides the following definition of “private sector”:

- For profit, commercial entities and their affiliated foundations;
- Financial institutions, investors and intermediaries;
- Business associations and cooperatives;
- Micro, small, medium, and large enterprises that operate in the formal and informal sectors;
- American, local, regional, and multinational businesses; and
- For profit approaches that generate sustainable income.

According to this definition, a state-owned enterprise (SOE) that operates at a profit could be construed as operating in the private sector. That, in turn, has implications for both policy and data collection. American policy makers, for example, have generally been uncomfortable providing financial support to SOEs (e.g., through Export-Import Bank financing of their imports); but as we will see, they have nonetheless swallowed their reservations and done so at various times when it was politically expedient. From a data-gathering perspective, a commonly used proxy measure for private sector activity among researchers is “credit to the private sector,” or loans provided by banks to local firms. But the World Bank warns that “for some countries, these claims include credit to public enterprises.”22 While I generally define the private sector and private enterprise as firms that are owned by private actors rather than by the government (and to further confuse things, it must be admitted that private ownership does not necessarily equate to private control), I want to be upfront about some of these definitional complexities (also note that I focus on firms that produce or serve consumers as opposed to governments; thus, I do not discuss US defense industries in this book, although they have certainly played a role in industrialization through co-production and technology transfer arrangements, particularly among military allies).23

Private sector development (PSD), in turn, is “defined” in that wonderfully bureaucratic fashion as “a discipline and area of programmatic work
focused on strengthening the business-enabling environment for the private sector to drive inclusive economic growth . . . PSD often focuses on supporting regulatory reforms that improve business and investment climates, providing public goods that help strengthen the broader private sector, and/or facilitating investment from companies.”

In fact, in the foreign assistance community, private sector development has taken on a multitude of meanings, many of which—it should be emphasized—ironically imply an active role for the state. It should also be recalled that the “foreign assistance community” goes well beyond official bilateral donors and multilateral development finance institutions to include foundations (e.g., the Gates Foundation, which holds approximately $37 billion in assets); foreign aid “implementers,” or those responsible for executing agency programs in the field, some of which, like Mercy Corps, now have venture capital arms that invest directly in developing countries; multinational corporations and banks that promote local industry and develop supply chains through their activities; and an array of social entrepreneurs who are engaged in “impact investing.” Taken together, a short list of what constitutes PSD in the contemporary world would include the following items:

- Improving the investment climate
- Direct financing by development agencies to local companies, especially SMEs
- Providing indirect financing to companies by capitalizing local banks
- Development-related activities by multinational enterprises (sometimes called “inclusive,” “bottom-of-the-pyramid,” or “value chain” strategies)
- Building financial and equity markets
- Promoting development finance for infrastructure, especially through public-private partnerships (PPPs)
- Blended finance (i.e., finance that combines public and private funds)
- Social entrepreneurship and impact investment
- Some activities of export-import banks (e.g., lending to local enterprises in the developing world)
- Microfinance

As this list suggests, it is important to be clear regarding what we mean by PSD in our discussion, as all of the above activities have fallen under that umbrella term at one time or another. We will also see how the concept of PSD has expanded over time. During the early Cold War years, for example, US policy makers focused their attention on the role of FDI in international
development, for reasons I describe in the following section and country case studies. More recently, the development community has placed greater emphasis on organically promoting private enterprise, perhaps in recognition of the limits of FDI flows to the world’s poorest and most fragile countries. Still, even in places like Afghanistan and Iraq, US officials have expressed great hopes for the role that foreign investors can play in local economies. More recently, President Joe Biden has urged American-based multinationals like Microsoft to invest in Central America in the hope of promoting economic activity there, in turn reducing the northward flood of immigrants.25

As an additional note, I should flag for readers that I do not emphasize the role of microfinance in this book, despite its prominence as a vehicle for PSD in such countries as Iraq. This is because I consider microfinance to be primarily focused on poverty reduction rather than growing private enterprise. Alex Counts of the Grameen Foundation has written, “The most straightforward measure of microfinance’s social impact is clients’ economic status,” as opposed, say, to the number of firms created.26 Few micro-financed businesses ever evolve into formal companies. Several studies have even concluded that it does little to lift people out of poverty, as the funds are primarily used for immediate consumption needs rather than productive investment.27 Again, my emphasis is on growing private enterprise rather than on social policies, though of course development officials have hoped and believed that private sector development would lead to poverty reduction via job creation and economic growth.

Whereas traditionally the international community relied heavily on FDI to promote development (the fourth point on the preceding list), and while multinational firms continue to provide important developmental “services” through their “linkages” to local economies—as described in more detail below—the development finance institutions (DFIs) and bilateral aid agencies have really emphasized the first three items. First, improving the investment climate, which, as we will see, has been a prominent concept throughout the period studied here; second, directly providing capital injections to local firms, particularly SMEs; and third, injecting funds into local banks or investment companies (which also implies that the government has put into place the kinds of regulations required to supervise such institutions). These three activities are interrelated, and there is an underlying logic to them. After all, if the investment climate is hostile to private enterprise, then providing credit is a futile exercise. Nonetheless, an important point that I will make throughout the book is that interventions of this type are based on some heroic assumptions about the role of local governments in
promoting entrepreneurship and private enterprise; one of our main tasks is gaining a better understanding of the political-economic conditions that favor private sector development.

**Why Private Sector Development?**

One question that might be reasonably asked is, why has Washington been so insistent about promoting private enterprise in the first place? Why did American officials have any preferences at all over a foreign government’s domestic economic policies, so long as those countries maintained a pro-US foreign policy orientation and had sufficient growth to quell domestic instability? As President Eisenhower himself said, the United States “did not need to fear a socialized state as something inimical to us in itself.” What did it matter if countries emphasized SOEs over the private sector, or the building up of social infrastructure (e.g., education, health care, housing, public utilities and transportation) over FDI? Why were Americans so convinced of the benefits of their private sector prescription?

A number of answers present themselves, both pragmatic and ideological in nature. From a practical standpoint, American officials did, and the DFC suggests that they still do, possess what students of international development would now call a “theory of change” when it comes to encouraging private enterprise in general and FDI in particular. It’s a theory that has proved remarkably resilient since its elaboration during the early Cold War era, carrying over from one administration to the next. And unlike some theories dreamed up in Washington, this one also generated a distinguished academic pedigree to back it up—launching a research program on the role of FDI in spurring economic growth that continues to the present day.

In brief, this theory posits that FDI by multinational firms provides the catalyst for local private enterprise in recipient nations, creating a substantial multiplier effect in terms of employment, incomes, productivity gains, tax revenues, and, in many cases, export earnings. In creating these benefits, foreign investors brought with them technology and organizational skills that were otherwise difficult for developing countries to obtain. Already in the “Grey Report” of 1950 on US foreign economic policy, these were highlighted among other arguments on behalf of foreign investment.

Why did officials believe that private investment would catalyze growth in host markets, particularly when coupled with foreign trade—and
promotion of international trade was, of course, the other crucial pillar of US foreign economic policy? Underlying this belief in the power of FDI was the theory of “linkages,” meaning that this type of investment created “backward linkages” or induced demand for “inputs” (e.g., agricultural commodities) while also creating “forward linkages” or “outputs” (e.g., the creation of distribution networks). As one of the great proponents of linkage theory, Albert Hirschman, wrote in 1958, “Development policy must attempt to enlist these well-known backward and forward effects.” The promotion of FDI as the key element in US development assistance seemed to fit that bill for several reasons.

First, foreign capital was deemed essential to development because, by definition, the world’s poorest countries lacked adequate savings to fuel their investment needs. Recall the Keynesian identity that savings = investment. If a country had little by way of savings (since in poor countries people use their small incomes to meet immediate consumption needs, with little left over for savings), it would have hardly any investment. This meant that developing countries had to find ways to “import” foreign savings—in the form of foreign aid, bank loans, private investment, or some combination thereof. With the US government insistent on limiting foreign aid allocations for both budgetary and ideological reasons, countries had little choice but to rely on private sources of funding—a seeming fact of life that many developing world leaders resented and would fight against.

Second, beyond its role in augmenting domestic savings, foreign investors could bring a number of additional benefits to developing countries—including cutting-edge technology and new modes of economic organization. They often paid higher salaries than local firms, and they also paid taxes, though of course they might use “transfer pricing” techniques to limit their overall tax burden. To the extent that these firms engaged in exports, they helped generate foreign exchange as well. Some of these firms, particularly in Latin America, would also engage in “import-substituting industrialization” (ISI), whereby they manufactured products locally for domestic consumption—reducing imports and the demand for foreign exchange—which was often in short supply.

Third, Hirschman also pointed to certain political economy benefits of foreign investment. Public investment, he noted, was inevitably subject to “pork barrel” distribution, as it was used to generate political benefits for local politicians and elites rather than to serve broader economic objectives. It gave elites prestigious jobs with access to resources that were all too often used for personal enrichment rather than corporate profitability. In turn, these elites would reward the politicians who helped them gain their posi-
tions, creating a cycle that was virtuous for themselves but vicious for development. At times donors have sought to break these cycles, while at others they have thrown up their hands in despair.

Foreign investors, in contrast, had to choose projects that would be profitable, and in so doing they invested in sectors and regions that promised to maximize earnings. As these firms expanded, they in turn uplifted their local suppliers of goods and services. In that way, FDI served the cause of economic development—as if by an “invisible hand,” the selfish interests of foreign investors created widespread social benefits! Note that Hirschman believed that foreign investors were most useful in the early stages of development; he feared that over time, monopolistic foreign investment could actually place a chokehold on local firms, preventing them from upgrading to higher value-added activities. FDI thus had, in his view, an expiration date, and he even proposed an organization that would be responsible for the orderly transfer of multinational assets to local entrepreneurs.34

The emphasis of private enterprise, then, responded to many of Washington’s most pressing concerns regarding how best to promote economic progress in the developing world, which was of strategic concern to the extent that anti-American forces could take advantage of poverty and unrest in these countries. It required only limited taxpayer funds (in the form of various subsidies to encourage such investment), and it was expected to promote local entrepreneurship and, in turn, economic growth, which was viewed by officials as an important contributor to political stability and a long-run driver of democratization. However, the United States would discover that all these attractions would not necessarily convince developing world leaders to prioritize it over official, government-to-government economic assistance.

The US insistence on the importance of private enterprise arose within a broader ideational and ideological context that shaped, and continues to shape, American foreign assistance policy. In fact, one of the most remarkable observations about these developmental ideas, as first identified by David Baldwin in 1966, is how resilient they have proved to be: we will see similar themes repeated over and over by policy makers from the late 1940s to the present day.35 In particular, Baldwin emphasized three interrelated ideas that American have consistently advocated: first, that developing countries “themselves are primarily responsible for their own economic development,” or the principle of “self-help” (or what USAID now calls “self-reliance”);36 second, that growth depends on private rather than state capital; and third, that the “main obstacle retarding the flow of private capital . . . was the absence of a ‘favorable climate of investment.’”37
The American ideology that I focus on in this book concerns the superiority of the private enterprise system over all contenders. Legal scholar Scott Bowman writes of the United States: “Throughout the history of the republic, the corporation has served as the primary agent for economic development and expansion, at home and abroad.” Historian Lawrence Glickman calls free enterprise “an essential American ideal.” In his memoirs, Dwight Eisenhower wrote that his philosophy on how to promote economic growth was powerfully shaped by the American experience, as if this could be readily transferred abroad: “Our economic strength had developed,” he wrote, “historically, freely and without artificial and arbitrary government controls.” As a USAID policy document put it, “a private enterprise economy is . . . the most efficient means of achieving broad-based economic development.”

In Louis Hartz’s view, Washington’s insistence on exporting free enterprise reflected its “totalitarian” mind-set, its righteousness about possessing the one and only model of political economy. This set of “Lockean” beliefs had been deeply rooted since the country’s founding, but they were undoubtedly amplified and strengthened during the Cold War, when the American system confronted an alternative global ideological challenge in the form of communism. Even worse, communism was seemingly attractive to many developing nations—especially given the apparent success of the Soviet Union and then Mao’s China in rapidly industrializing their economies and dragging them out of poverty. The United States had no choice but to export capitalism, lest the world fall prey to this contending worldview.

As Hartz stressed, free enterprise (or what he also called “Algerism,” after the nineteenth-century writer Horatio Alger, who mythologized the American bootstrap economy) was not just another way of organizing production: It was, for Americans, the only way. And that stance was not based on its material fruits alone, as bountiful as these were, but rather because it was the only form of economic organization that simultaneously motivated and safeguarded individual liberty. Americans had no doubt about the singular greatness of their political economy.

But a Hartz powerfully put it, “The question is not whether our history has given us something to ‘export,’ but whether it has given us the right thing. And this question has to be answered in the negative.” For Hartz, the paradox—or even tragedy—of the American creed of democratic capitalism was that it extolled the unique circumstances under which it had emerged while also being convinced of its universal applicability. The novelist Robert Stone (perhaps cribbing from Hartz?) put it this way: “I think what’s best about my country is not exportable.” Focusing more narrowly on democracy promotion, Nancy Bermeo has concluded that “democracy
is not exportable,” adding to doubts about the ability of the United States—despite all its military and economic power—to translate these resources into preferred foreign policy outcomes.45

This book urges us to reconsider such sweeping conclusions by analyzing the conditions under which efforts to export capitalist institutions succeeded and when they failed. In particular, we will examine the underlying economic conditions, including commodity dependence (the infamous “natural resources curse”), violent conflict, and the economic structure of local elites, that seem to shape the environment for private enterprise. Investors who put capital at risk must have some confidence that their property rights will be respected, but sadly that is not the case everywhere. Along these lines, a recent econometric study of political risk insurance unsurprisingly shows that firms are more likely to file claims for losses in countries which suffer violent conflict or depend heavily on resource rents.46 These are the places where companies most often lose their assets either through destruction or expropriation. The analysis presented here supports these hypotheses, while going further to argue that in such places private sector development is less likely to take root in the first place.

While American officials usually recognized the challenges associated with encouraging investment in certain political-economic environments, their faith in the gospel of free enterprise would often overcome any such reservations. For alongside its contributions to material well-being, Americans have often expressed the belief that the free-market economy, with its ability to deliver sustainable growth, was a system capable of overcoming political divisions within societies and bringing harmony to them by creating an ever-expanding pie. To American officials, most social grievances were ultimately rooted in unresolved economic problems. As Franklin Roosevelt said in a January 1941 address to Congress, “economic problems . . . are the root cause of the social revolution which is today a supreme factor in the world.”47 Solving those economic problems through growth-generating policies became a core mission of post–World War II US foreign policy. Charles Maier has written in his brilliant essay, “The Politics of Productivity,” that the stress on “economic growth arose out of the very terms in which Americans resolved their own organization of economic power . . . agreement on production and efficiency had helped bridge deep divisions at home.”48

More generally, Americans have linked together economic and political freedom. Milton Friedman wrote in a famous 1961 essay “that economic arrangements play a dual role in the promotion of a free society. On the one hand, ‘freedom’ in economic arrangements is itself a component of freedom broadly understood, so ‘economic freedom’ is an end in itself
to a believer in freedom. In the second place, economic freedom is also an indispensable means toward the achievement of political freedom.”

A generation later, USAID echoed Friedman by stating: “A society in which individuals have freedom of economic choice, freedom to own the means of production, freedom to compete in the market place, freedom to take economic risk for profit and freedom to receive and retain the rewards of economic decisions is a fundamental objective of the AID, program in less developed countries.” Moreover, USAID stressed the political implications of this policy: “A society in which economic power is widely dispersed is more likely to be one in which transfer of political power by election is permitted than in a society where exclusion from political power carries with it exclusion from economic power.”

We will see that this view of the interlinkage between economic and political freedom reappears time and again throughout the history recounted here. That view has been severely challenged with the rise of China, whose economic liberalization has, at least for now, failed to generate the political freedom that was once widely expected by policy makers and pundits.

The ideology of private and free enterprise has thus provided a roadmap for American policy makers, setting the feasible routes that they can take to promote international development and growth. And while American officials were not, for the most part, ideologues, we will discover some notable exceptions to that rule, cases where economic ideology blinded officials to the facts on the ground. This seems to have occurred, for example, in Iraq, where dismantling SOEs (in part by refusing to finance them) was high on the American policy agenda, despite the fact that these firms were important sources of local employment. One of the tensions explored throughout this study is that between pragmatic policy making and America’s political-economic ideology.

How successful has private sector development been around the world? Figure I.1 provides some tantalizing evidence to consider. Using “credit to the private sector” as a proxy measure for private sector activity, we can see that East Asia and the Pacific is by far the most dynamic of the world’s regions in this respect (and obviously this vast region, like the others listed here, is made up of a great diversity of countries, so any sweeping generalizations must keep that in mind). Further analysis also suggests that East Asia is the region in which FDI has had the strongest association with the rise in credit, suggesting that this may be where linkages were the strongest; and note that in the conclusion we will revisit the structural conditions which seem to influence the prospects for private sector development. Is it a coincidence that this area has also become the epicenter of global economic growth? If so, why did it ultimately provide a hospitable environment for
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