

WHAT AMERICA SHOULD NOT LEARN FROM JAPAN

(Updating *Backgrounder* 748, "Japanese Foreign Aid: Defining America's Interests," January 30, 1990.)

The Bush Administration correctly has been quick to denounce as unfair the Japanese government's practice of subsidizing Japanese businesses. Special criticism is leveled at Japan's use of its foreign aid funds to promote Japanese exports and investments in less developed countries. This is known as tying foreign aid to specific purchases — or "tied aid." The United States, however, may be flirting with hypocrisy in its criticism of Tokyo. On May 15, the Bush Administration announced its own intention to adopt the Japanese policy. Ostensibly to counter Japan's use of export subsidies and foreign assistance funds to benefit Japanese industry, the Administration will be forcing the American taxpayer to ante up an initial \$500 million to \$600 million to subsidize American enterprises operating overseas. Further, the U.S. Senate's Aid for Trade Act of 1990 (S. 2703), sponsored by Democrats Lloyd Bensten of Texas and David Boren of Oklahoma, would increase funding for the United States Export-Import Bank and the Agency for International Development and would make the tied-aid program permanent.

While the Administration is right to be concerned about Tokyo's tied-aid practices, there is little chance that by adopting the same practices the U.S. will force the Japanese to abandon theirs. Like most government subsidy programs for American businesses, moreover, this one is unlikely to be temporary. Subsidized American businesses will lobby for permanent handouts. The Bush Administration, therefore, should reverse its intention to adopt a tied-aid program and should oppose the Senate bill. A tied-aid policy not only would compromise the integrity of the U.S. foreign aid program and add to the federal budget deficit, it would diminish American competitiveness by addicting American businesses further to government subsidies.

Compromising Foreign Aid. Tied-aid policy would require U.S. foreign assistance projects in less developed countries to use mainly, if not solely, American-made products. U.S. businesses operating overseas would receive federal funds so that they could offer goods and services at prices that compete with foreign enterprises that receive subsidies from their governments. Such subsidies interfere with the principal goal of foreign aid: to promote economic growth through free market reforms. Japan's program proves this point well. While Tokyo's foreign aid has helped a few Japanese firms, it has done little to promote economic growth in less developed countries. The U.S. foreign aid program has been remarkably ineffective in assisting Third World countries. Adopting a tied-aid program only will make it worse.

As part of the Bush Administration's plan, the U.S. Export-Import Bank, which is responsible for financing American exports, will provide \$100 million each in credits to U.S. businesses operating in Indonesia, Pakistan, the Philippines, and Thailand. In addition, the Agency for International Development (AID) in conjunction with the Export-Import Bank would design foreign aid projects that use more American products such as power plants, telecommunications, and construction

equipment in their projects. The trouble is, AID has had a spotty record in designing foreign aid projects. The Inspector General (IG) for AID, for example, has found that AID has been irresponsible in designing projects for:

Indonesia. AID spent \$18 million to assist local governments in Indonesia to plan their own development programs. Ten years after the project began in 1978, the IG determined that the project may have no lasting impact. In a family planning project, AID spent \$36.4 million to purchase equipment for local hospitals including 195 clothes cabinets that could not fit through the doors of the hospital patient rooms.

Pakistan. In a \$35 million Food Security Management Project, the IG found that \$3.8 million has not been spent appropriately. Example: The project bought five motorcycles that sat in warehouses because there was not enough staff to ride them. Further, the IG found that much of the equipment purchased as part of a \$31 million AID project to help the Pakistani agricultural sector remained in warehouses and were not being used. What is more, the project had orders in for more equipment.

These examples, and many more like them, demonstrate the ineffectiveness of AID in carrying out its current mission of promoting economic growth. Projects that further require AID to promote U.S. business interest will reduce AID's effectiveness yet more.

Economic Narcotic. An additional problem with the Bush Administration's strategy of fighting subsidies and tied-aid with more subsidies and tied-aid is that it probably will not work. The U.S. Export-Import Bank is supposed to provide American firms with special credit to help them compete against foreign firms that receive subsidies. Decades of American subsidies, however, have not caused foreign governments to stop their practices. Meantime, the American taxpayer continues to foot the bill for an ineffective policy. In addition, these new subsidies will simply spawn yet new special interest groups of American businesses that desire the subsidies. Such subsidies are an economic narcotic; businesses become dependent on them and find it difficult to end their addiction. Further, both foreign and American businesses will point to each other's subsidies as an excuse to keep government money flowing into their pockets.

The Bush Administration's plan to "tie" foreign aid funds to the purchase of American goods is likely to turn into a corporate welfare system, where American businesses become addicted to government handouts. What is worse, the U.S. taxpayer will be asked again to ante up tax dollars for a federal program that benefits a small group of special interests. The policy will decrease the effectiveness of the already troubled U.S. foreign aid program and will make the poor in recipient countries victims of U.S. commercial interests. If the Bush Administration is serious about pressuring Japan to end tied-aid programs, promoting economic growth in less developed countries, and cutting the federal budget deficit without raising taxes, it must reject this discredited strategy.

Bryan T. Johnson
Research Associate