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THE INDEX OF ECONOMIC FREEDOM: A TOOL FOR REAL REFORM OF FOREIGN AID

INTRODUCTION

The U.S. foreign aid program badly needs a major overhaul. Its guiding legislation, the Foreign Assistance Act of 1961 (FAA), is burdened with 33 objectives. The need to consider goals as diverse as promoting urban development and improving a recipient country's human rights practices leaves the U.S. foreign aid program unfocused. The FAA also restricts the President's flexibility in dispensing foreign aid. An important tool of foreign policy, foreign aid is best allocated by the President, and not by Congress, which doles out funds to its favorite countries and programs. Moreover, the U.S. Agency for International Development (AID), the lead agency for coordinating and implementing U.S. bilateral economic assistance, is inefficient and wasteful. In fact, before taking charge of AID, incoming Administrator Brian Atwood called the agency a "disaster."[1] Representative John Kasich of Ohio expressed a common congressional sentiment last June when he called AID "broken."[2]

Foreign aid is supposed to be a tool for advancing American interests abroad. But it is a tool worn down by repeated misuse. Most of the countries receiving U.S. development aid have made little economic progress. This has been the case with Zaire, for example, which has received some $1.2 billion in development aid from the U.S. since 1964. Zaire today is in chaos, experiencing decline instead of economic growth. Rather than helping poor countries, U.S. aid has often discouraged economic development by propping up governments pursuing ruinous statist economic policies. This certainly has been the case with Brazil, Peru, and Sudan, which have received collectively $5.5 billion in development aid since 1946.

The Clinton Administration recognizes the need to reform U.S. foreign aid. It has unveiled a foreign aid reform proposal which it claims will advance American interests in today's world. Unfortunately, the centerpiece of this effort, the Peace, Prosperity, and Democracy Act of 1994 (PPDA), fails to address the fundamental problems facing U.S. foreign aid. In fact, the changes proposed by the PPDA are merely cosmetic, promising much but delivering little, disguising an attachment to the status quo behind the seductive rhetoric of reform.

1 Doug J. Swanson, "Foreign aid agency has a long history of waste. New administrator pledges to battle bureaucracy," *The Dallas Morning News*, August 8, 1993, p. 1A.

2 *Congressional Record*, June 16, 1993, p. H3629.

The Administration's proposal indeed perpetuates many of the same policies that have been so ineffective over the past 33 years. For example, it will guarantee that development aid continues to flow to countries with economic policies that preclude any chance of development. The Clinton plan institutionalizes the concept of "sustainable development," or state-controlled economic management undertaken in the name of objectives such as protecting the environment. While doing little to encourage economic development, this concept will foster a destructive mindset of entitlement and dependency among developing countries, as sustainable development put into practice in the developing world would work against economic growth.

Rooted in the Cold War, the current foreign aid framework is rotting. A dramatic new approach to U.S. foreign aid could promote economic development abroad and serve the interests of American taxpayers and foreign aid recipients alike. To do this, foreign aid must advance clearly identifiable national interests, and when intended to promote economic development, be conditioned on free market reforms and progress toward establishing a market economy.

Thus a U.S. foreign aid reform package should:

✓ **Establish the Index of Economic Freedom as the prime determinant in allocating development aid among recipient countries.** Using the Index, a quantitative measure of economic freedom, to allocate development assistance would ensure that U.S. aid helps countries that want to make the transition to free markets. Otherwise, aid will only prop up non-reforming economies that refuse to grow and prosper despite the influx of billions of dollars of aid.

✓ **Reduce foreign aid.** Clinton Administration foreign aid spending, a planned $14.6 billion in 1995, would throw taxpayers' dollars at problems over which the U.S. has little or no influence. In Kenya, for example, the U.S. plans on spending some $15 million in 1995 to promote economic growth, despite the fact that the Kenyan government for years has been dragging its feet in implementing desperately needed economic reforms. It makes no sense to spend money on these kinds of programs. With a budget deficit of some $223 billion this year, the Clinton foreign aid spending proposal should be cut by at least $1 billion this year.

✓ **Eliminate the Agency for International Development.** The Clinton Administration wants to "reinvent" this agency, which is renowned for its inefficiency and mismanagement. But several credible and bipartisan studies have recommended doing away with it altogether.[3] The Administration's proposal appears to be driven by the bureaucratic survival instinct. In reforming America's foreign aid program, AID's responsibilities should be reassigned to the State Department, eliminating this unnecessary government agency.

3 These include the Hamilton-Gilman Task Force Report (1989) and the President's Commission on the Management of AID Programs (1992).

✓ **Grant the President more flexibility in using aid as an instrument of foreign policy.** Aid can be used to promote economic development and serve American political and security interests abroad. However, this is not being done. Congressional micromanagement has hamstrung the U.S. foreign aid program, rendering it largely incapable of responding to opportunities where it might make a difference.

✓ **Reject the concept of "sustainable development."** AID Administrator Brian Atwood has stated what sustainable development "signifies": "broad-based, economic growth which protects the environment, enhances human capabilities, upholds democratic values and improves the quality of life for the current generation while preserving that opportunity for future generations."[4] While proposed as a new guiding philosophy of the revamped American foreign aid program, the concept of sustainable development promises nothing but increased government control of economic activity. This outcome will be the exact opposite of the free market development the Clinton Administration claims to champion. Real sustainable development is occurring in places like Taiwan and Hong Kong, where economic growth depends on neither foreign aid nor the environmental watchdogs at AID and the World Bank.

THE U.S. FOREIGN AID PROGRAM: A RECORD OF FAILURE

The U.S. will spend approximately $13.4 billion in total foreign aid in 1994. Spending for bilateral economic development aid to specific countries is $2.4 billion. Aid given through such multilateral institutions as the World Bank and the Inter-American Development Bank totals $1.9 billion. Bilateral U.S. aid for the former Soviet Union is approximately $900 million. Economic Support Funds (ESF), a form of economic aid given to advance U.S. political and security interests (as opposed to promoting economic development), amounts to $2.4 billion. Direct military aid will be $3.2 billion this year.

Israel and Egypt are by far the largest recipients of U.S. foreign aid. This year, Israel will receive $3 billion and Egypt $2.1 billion in ESF and military aid. The U.S. has given Israel about $21 billion in economic aid and $34 billion in military aid since 1946. Over this time, Washington has given Egypt about $22 billion in economic aid and $17 billion in military aid.

Such high levels of spending would not have come about had it not been for the rise of economic development theory in the 1960s. At that time, many Western governments and their academic advisers came to believe that the state had to take the lead in mobilizing resources and directing economic development in the Third World. Thus their foreign aid programs often supported the nationalization of industries, high levels of individual taxation, the establishment of state monopolies, high trade barriers to protect home industries, and heavy restrictions on the private sector of the economy.

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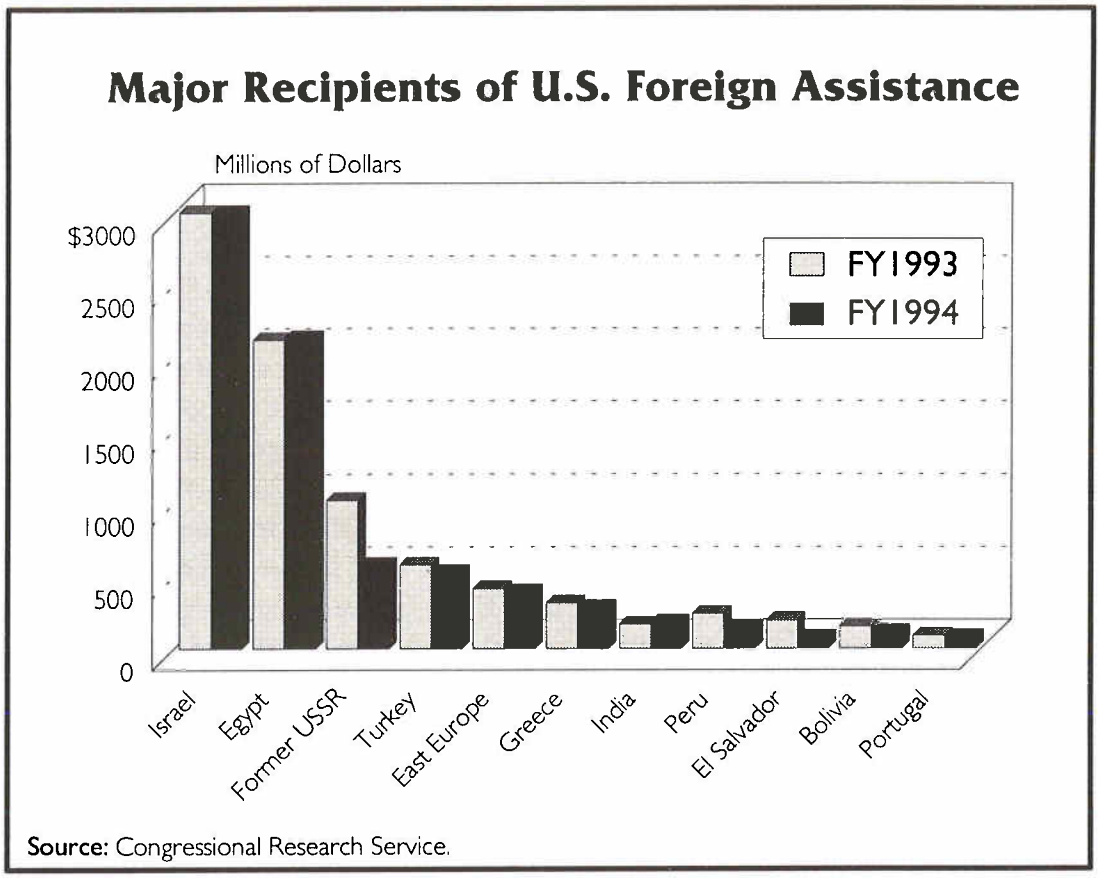
4 Statement of the Honorable J. Brian Atwood, Administrator, Agency for International Development, Before the Senate Committee on Foreign Relations, Subcommittee on International Economic Policy, Oceans and Environment, February 9, 1994, p. 11.



In Tanzania, for example, AID provided financial support and technical assistance to forced rural collectivization efforts.[5] A *cause célèbre* of Western donors, Tanzania became one of the most heavily aided countries in the developing world, having received some $13 billion in development aid since 1961. Today Tanzania is the world's second poorest country.[6] Tanzania's per capita GNP is approximately $120.

India is another country that has pursued a disastrous and largely Western-sponsored statist development strategy. Despite some recent attempts at economic liberalization, India still has one of the world's most heavily state-controlled economies. After nearly 45 years of state-planned economic development, India's per capita GNP remains around $330. This ranks India behind Haiti, with its $370 per capita GNP. India has received an estimated $55 billion in foreign aid since 1951, more than any other developing nation since the end of World War II.

The lack of economic progress in Tanzania and India is not unique. Many developing countries find themselves worse off today economically than 30 years ago, despite billions of dollars of foreign aid. This is particularly true throughout Africa, a continent where economic growth has been crushed under the heavy boot of the state. Tragically, despite massive infu-

5 See Thomas P. Sheehy, "Tanzania's Travails: Lessons in Improving American Aid to the Third World," Heritage Foundation *Backgrounder* No. 866, November 14, 1991, for an overview of the destructive role AID played in Tanzania.

6 See Thomas P. Sheehy, "Too Much to Hope For? An African Success Story," *The Wall Street Journal Europe*, February 23, 1994, p. 8, for a recent assessment of the Tanzanian reform effort.

sions of foreign aid, many countries in Africa are poorer today than they were at the beginning of the continent's independence era in the late 1950s and early 1960s.[7]

Factors other than misguided economic policies have contributed to economic stagnation in the developing world. Widespread corruption also is responsible. Leaders intent on enriching themselves at their countries' expense is a common occurrence in countries receiving vast amounts of foreign aid. Adding to the misery have been widespread civil war and ethnic unrest, which have retarded economic development in Africa in particular.

This dismal legacy of aid-dependent economic stagnation should be contrasted with the record of countries that have pursued largely open and market-oriented development strategies. The two best examples are the Republic of China on Taiwan and the Republic of Korea. Their tremendous economic success came about only when they adopted free market-oriented development strategies.

The economic development of Chile also demonstrates the perverse effect of foreign aid. Over the last several years Chile has had one of the fastest growing economies in the world. Its GDP growth has averaged 7.3 percent per year since 1988. This growth has dramatically improved the lives of the Chilean people, reducing the infant mortality rate from 78 to 17 per 1,000 births between 1970 and 1991 and raising life expectancy from 64 years to 72 years between 1970 and 1990.[8] All of these improvements, however, came only after the Chilean government of General Augusto Pinochet was almost completely cut off from foreign aid after his 1973 *coup d'etat.*

In 1970, Chile was the world's second largest recipient of foreign aid per capita. It was also stagnating economically. In 1973, Salvador Allende's last as president, GDP shrank 5.6 percent. As with many Latin American countries, the government controlled a large part of Chile's economy, an estimated 75 percent of the GDP. By 1990, this had changed dramatically. The Chilean government controlled about 25 percent of the economy after Pinochet's privatization program was largely complete. It is almost certain that Pinochet would not have taken the political risk of his free market reforms had he been able to depend on foreign aid.[9]

Chile, however, is not the only example of economic growth taking off after a cutoff of foreign aid. The impressive economic performance of Taiwan began only after large-scale economic aid from the U.S. was discontinued. Taiwan moved away from protectionist trade policies—thus beginning its economic miracle—only when it was clear that U.S. aid would be cut in the mid-1960s.[10] Hong Kong and Singapore, other Asian success stories, received only negligible amounts of aid.

Even the World Bank has tacitly admitted the true relationship between foreign aid and economic development. A long-time, consistent champion of increased development aid spend-

7 See Thomas P. Sheehy, "Beyond Dependence and Poverty: Rethinking U.S. Aid to Africa," Heritage Foundation *Backgrounder* No. 947, June 25, 1993, for an account of how foreign aid has contributed to Africa's economic decline.

8 *World Development Report 1993: Investing in Health* Published for the World Bank (Oxford: Oxford University Press, 1993), p. 293.

9 For an excellent overview of Pinochet's reform odyssey, see Angelo Codevilla, "Is Pinochet the Model?" *Foreign Affairs*, November/December 1993.

10 Melvyn B. Krauss, *Development Without Aid: Growth, Poverty and Government* (New York: McGraw-Hill, 1983), p. 160.

ing, the World Bank nevertheless fails even to mention the role of foreign aid in East Asia's economic take-off in a recently released study of the "Asian Tigers."[11]

Clearly, foreign aid is not required for development; more often than not it is a hindrance. Free market economic policies are the prerequisite to development success.

In a 1993 report on development aid to Africa, AID itself acknowledges that "much of the investment financed by USAID and other donors between 1960 and 1980 has disappeared without a trace...."[12] This realization has led many Western donors to drop their strong support for statist economic development policies. By the early to mid-1980s, the U.S. and other donors began to encourage and sometimes even demand that recipient countries undertake economic policy changes as a condition for receiving continued aid. Besides economic liberalization, the U.S. and other donors have begun to demand the establishment of democracy as a condition for aid.

Attaching strings to foreign aid has not been welcomed by many recipients, particularly developing countries that view conditionality as an infringement on their sovereignty. Conditionality also challenges the so-called right to aid, as expressed in the Report of the World Commission on the Environment and Development's 1987 report "Our Common Future" (also known as the "Brundtland Report").[13] Opposition to conditionality also stems from the fact that governments throughout the developing world have a stake in the status quo; the economic and democratic liberalization reforms being pushed by donors threaten the power of the entrenched elites who control the government and economy of many developing world countries.

During the presidencies of Ronald Reagan and George Bush, the U.S. emphasized conditionality, attempting to use aid as a lever to press for economic liberalization. This trend intensified with the end of the Cold War. For example, Zaire today has been almost completely shut off from U.S. development and military aid because its autocratic President Mobuto Sese Seko refuses to sanction a democratic transition and economic liberalization.

The World Bank and the International Monetary Fund (IMF) have taken the lead in setting the criteria for economic conditionality, functioning together as the coordinating body for national donors, including the U.S. Indeed, a "seal of approval" from these two international financial institutions has become virtually a prerequisite for receiving significant amounts of development aid. The World Bank provides "structural adjustment" loans to assist countries undergoing economic reform. These loans, many times at concessional interest rates, often are directed at liberalizing key sectors of an economy, such as agriculture or manufacturing. A country failing to abide by the terms of its structural adjustment agreement runs the risk of having its access to World Bank and IMF funds cut off. At least in theory, though not often in practice, national donors who pledge support for an economic restructuring program will stop or significantly reduce aid to "non-performing" countries.

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11 *The East Asian Miracle: Economic Growth and Public Policy* A World Bank Policy Research Report, Published for the World Bank (Oxford: Oxford University Press, 1993).

12 *Africa: Growth Renewed, Hope Rekindled: A Report on the Performance of the Development Fund for Africa 1988-1992*, U.S. Agency for International Development, 1993, p. 17.

13 Oxford University Press, 1987.

The World Bank and IMF record of promoting economic growth is modest at best. In Africa, where virtually every country has an World Bank or IMF program in place, the World Bank claims that countries pursuing "fair or adequate" macroeconomic policies have done better than those with "poor or very poor" policies. But the economic growth in those countries has been low; the average annual GDP per capita growth rate has been only 0.4 percent between 1987 and 1991.[14]

Moreover, these countries routinely ignore the World Bank's advice. In fact, over half of all economic reform programs worldwide concluded between the multilateral financial institutions and restructuring countries break down.[15] This does not stop the World Bank and the IMF from returning to do business as usual, however. For example, the governments of Kenya and Nigeria each have broken their economic agreements with the IMF and World Bank several times over the last few years. Nevertheless, there is always a second chance. The Kenyan and Nigerian governments have merely once again agreed to abide by the economic conditionality of the IMF and the World Bank. Thus the aid is flowing back to these countries.

However, it is doubtful that a country would generate sustained economic growth even if it adhered rigorously to the demands of the IMF or World Bank. These institutions have long track records of subsidizing failed statist economic policies. Therefore, they are not in a good position to promote free market reforms. Czech Prime Minister Vaclav Klaus, moreover, has complained publicly that the IMF and World Bank are staffed with people with a statist outlook.[16] Klaus also has noted that IMF and World Bank aid "is wrong and counterproductive." This aid, states Klaus, "is not taken seriously, neither by the donors nor recipients. They are misused, misdirected. They simply disappear. They are very often counterproductive. They prolong the moment when the necessary domestic changes have to be implemented."[17]

The Chileans undertook major economic reforms without any input from the IMF and the World Bank. Their success was mainly the result of a single-minded focus on shrinking the size of the state's role in the economy—something which is lacking in the multinational financial institutions.[18]

Besides economic reform considerations made in tandem with the IMF and World Bank, the U.S. looks at other factors in allocating development aid. Criteria include a country's progress toward democracy and lawful governance, "need" as determined by social indicators, environmental policies, and respect for human rights. Political and security calculations are also made, particularly with military aid and economic support funds. In fact, the State Department, and not AID, takes the lead on decisions concerning the allocation of ESF, the bulk of which is given to Israel and Egypt.

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14 *Adjustment in Africa: Reforms, Results, and the Road Ahead*, A World Bank Policy Research Report (Oxford: Oxford University Press, 1994), p. 6.

15 Joan M. Nelson and Stephanie J. Eglington, *Global Goals, Contentious Means: Issues of Multiple Aid Conditionality*, Policy Essay No. 10 (Washington: Overseas Development Council, 1993), p. 42.

16 Melanie S. Tammen, "Time to Retire the World Bank and the International Monetary Fund," in *Market Liberalism* (Washington, D.C.: The Cato Institute, 1993), p. 311.

17 Vaclav Klaus, "Interplay of Political and Economic Reform Measures in the Transformation of Postcommunist Countries," *Heritage Lecture* No. 470, October 15, 1993.

18 Angelo Codevilla, "Is Pinochet the Model?" *Foreign Affairs* November/December 1993

Sustainable Development

Title I of the Clinton Administration's PPDA is entitled "Sustainable Development." This term is not defined in the act, but aims at "broad-based, economic growth that reduces hunger and poverty, protects the environment, enhances human capabilities, upholds democratic values, and improves the quality of life for current generations while preserving that opportunity for future generations."[27] Close to $5 billion in sustainable development funds has been requested for 1995.

Although sustainable development is only one of the five major titles of the PPDA, AID Administrator Brian Atwood has called it the philosophical basis of the Administration's entire foreign aid reform effort. Hence its designation as Title I. Promoting sustainable development also has been incorporated by AID as its single overarching goal.

The concept of sustainable development came out of the World Commission on the Environment and Development's 1987 Brundtland Report.[28] The Brundtland Report also speaks of all people's "right" to development. Sustainable development since 1987 has gained currency, and was an important theme of the 1992 United Nations-sponsored "Earth Summit" held in Rio. Some of the proposals accepted in Rio envision expanded official transfers of wealth from the West to the developing world for a variety of purposes, including protection of the environment and more effective population control, two main pillars of sustainable development.[29]

Growth Under Fire

It was once generally assumed that economic growth was the best way to assure improvements in environmental quality. But this assumption is being challenged by advocates of the concept of sustainable development. One development study explains: "Formerly, we felt that concern with the global environment could be addressed by successful economic development. Now, we are beginning to understand we can attain development only by protecting the global environment and by balancing population and resources."[30]

This "balancing" of resources, however, is a euphemism for heavy state intervention in the economy, which leads to economic stagnation. In pursuit of environmental quality, the inefficient state sector would be reinforced by the "official" transfer of resources from developed to developing nations. In short, sustainable development implicitly rejects economic growth produced by the private sector as the main goal of Western foreign aid. Instead it is based on the premise of government economic control. This premise exists in spite of the fact that free market economies are far better than governments at fostering both economic development and environmental protection.

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27 H.R. 3765, 103d Congress, 2d Session, p. 11.

28 World Commission on Environment and Development, Oxford University Press, 1987.

29 Peter Bauer, "Development Aid: End It or Mend It," Occasional Paper Number 43, International Center for Economic Growth, San Francisco, CA, p. 2.

30 Ralph H. Smuckler and Robert J. Berg with David F. Gordon, "New Challenges, New Opportunities: U.S. Cooperation for International Growth and Development in the 1990s," Michigan State University, Center for Advanced Study of International Development, August 1988, p. 3.

STARTING OVER: A NEW APPROACH TO U.S. FOREIGN AID

While the Clinton Administration's Peace, Prosperity, and Development Act of 1994 purports to "reinvent" foreign aid, it amounts to little more than tinkering with a failed program. Worse, by embodying the concept of sustainable development as its principal philosophy, it guarantees that U.S. foreign aid will continue to be little more than an international welfare program, doling out taxpayer dollars with little to show in return.

The fact is that there is little the U.S. government can do to create economic growth in foreign countries. The key to worldwide economic development is furthering an open international economic system that fosters trade. Some countries will participate, others will not. At best, foreign aid can be used to encourage the types of free-market economic reforms that are needed to enter the world economic system. What has worked for such diverse success stories as Taiwan, Chile, and democratic Poland can work for the entire developing world.

To avoid wasting the American taxpayer's money, the U.S. foreign aid program should be revamped to ensure that its marginal contribution supports economic reform, growth, and prosperity. To reform foreign aid, the Clinton Administration should:

✓ Establish the Index of Economic Freedom as the prime determinant in allocating development aid among recipient countries.

There is a stark contrast between the tremendous economic progress made by those countries that have pursued free market-oriented development strategies and the economic stagnation of those that have established statist economies. The lesson for the U.S. is clear: development aid should be given only to those countries that are making progress toward establishing free market economies. These countries are the only real candidates for sustained economic growth. Yet while the U.S. has made some progress in this area, it has not come far enough. The U.S. foreign aid program needs to establish the Index of Economic Freedom —a quantitative measure of economic freedom—as the prime determinant in allocating development aid among countries.

It was a concern over economic progress that led the President's Commission on the Management of AID Programs (1992) to recommend that AID concentrate its development aid on nations which promote private sector economic growth. In its final report, the Commission's Chairman, George M. Ferris, Jr., urged AID to establish an Index of Economic Freedom for the purpose of allocating development aid among countries.[31]

The Index of Economic Freedom is a means of gauging a country's commitment to free market economic growth. The Index takes into account numerous factors, including:

1) **Private Property Rights.** Does a government expropriate property? Are there restrictions on what citizens can own? Is there an independent judiciary to protect a citizen's property against both other citizens and the government?

2) **The Size of the State Sector.** What percentage of the gross domestic product is controlled by the state?

3) **Taxation.** How high are the top rates and at what income levels do they become effective?

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31 p. 20.

4) **Private Banking and Financial Institutions.** Is private banking allowed? Does the government control banking and give preferential access to funds to privileged elites? Do government policies prevent small, private cooperative banks from being established?

5) **Regulation.** How difficult is it to secure a business license? What sort of red tape do entrepreneurs face? What regulations favor established businesses at the expense of newcomers?

6) **Wages and Prices.** Are wages and prices set by the voluntary mutual transactions of individuals in the market or by government bureaucrats?

7) **Trade.** How high are tariff levels? What value of imports are controlled by quotas or other trade restrictions?

8) **Capital Flows and Investments.** Does the government restrict foreign investment? Are there limits on repatriating capital or profits?

The Index of Economic Freedom should weigh government consumption as a percentage of gross domestic product (GDP). The correlation between government consumption and economic growth is dramatic. For example, in 1975 sub-Sahara Africa, government consumption as a ratio of GDP was 14 percent while in the countries of East Asia and the Pacific it was slightly over 8 percent.[32] Today, the East Asia and Pacific region is undergoing an economic boom.

The Index of Economic Freedom is not an untested idea. *Development and the National Interest: U.S. Economic Assistance into the 21st Century*, released in 1989 by then-AID Administrator Alan Woods, proposed such an index to evaluate AID programs; it was called then an Economic Opportunity Index. The Woods Report noted that AID economists had made a preliminary effort at developing a policy matrix that permitted comparisons of overall economic policy in specific developing countries over time. Their 42-country survey was based on country specific rankings of several factors, including property rights, official corruption, effectiveness of legal remedies to enforce contracts, the extent of directed credit, the incentive effect of marginal taxation, foreign exchange controls, and the size of the black market. Not surprisingly, the Economic Opportunity Index found that countries with more free market-oriented policies have had, on average, better rates of economic growth than more statist-oriented economies.[33]

A recently released World Bank study of Africa also presents a variation of the Index, and demonstrates once again that government intervention hinders economic growth.[34] The World Bank determined the level of market intervention by gauging the degree to which various governments allowed for competition in the pricing, purchasing, and exporting of major agricultural export commodities. Its analysis shows a strong correlation between positive economic growth and limited government intervention into the examined African economies.

Using the Index of Economic Freedom to determine where the U.S. should supply development aid will enable Washington to distance itself from the destructive games being played between the IMF and the World Bank and their aid recipients. Currently, most of the IMF/World

32 *Adjustment in Africa: Reforms, Results, and the Road Ahead*, p. 24.

33 *Development and the National Interest*, p. 52.

34 *Adjustment in Africa*, p. 6.

Bank economic restructuring programs break down. They are consequently renegotiated on terms more favorable to recipients. This hardly engenders the respectful "partnership" between donors and recipients, much-touted within the international development community. Applying the Index would give the U.S. a criterion other than a recipient country's standing with the IMF and World Bank by which to judge its commitment to free market economic reform.

A truly respectful partnership between foreign aid donors and developing countries will exist only when donors get serious about economic reform and are prepared to invest their resources elsewhere if necessary. Under these circumstances, countries would be encouraged to compete for aid by making market reforms, and not by making promises that get broken. Such a climate would better approximate the type of market relationships in the world economy. The status quo of loose to non-existent conditionality only breeds contempt for Western donors and creates a misguided and ultimately self-destructive sense of entitlement. The Index of Economic Freedom would reduce U.S. complicity in this wasteful and damaging charade.

The World Bank itself all but admits the irrelevance of its structural adjustment lending games. Its 1993 *World Development Report* noted: "Some of the most dramatic 'adjustment' reforms took place without adjustment lending (as in Chile and Viet Nam), and some countries that received adjustment loans did little or nothing to pursue reforms (for example, Tanzania and Zambia)."[35] Chile and Vietnam are increasingly granting their citizens economic freedom and, as expected, they are seeing rapid economic growth. Vietnam had GDP growth of 8 percent last year and Chile's is expected to be 5 percent this year. The U.S. would lose little by avoiding this deceptive structural adjustment game and by using the Index as a guide for allocating development aid.

While the measure of economic freedom a country grants to its citizens should be the prime determinant in allocating U.S. development aid, this consideration should also play a part in the allocation of Economic Support Funds (ESF). ESF are provided to countries for reasons that go beyond economic development or humanitarian assistance. Israel and Egypt are the major recipients of ESF.

Support for the statist and inefficient economies of Israel and Egypt may be necessary for political reasons, but it makes little economic sense and only prolongs long overdue economic reform and fosters long-term instability.[36] An Index of Economic Freedom score should at least be calculated for recipients of ESF aid. The rationale for military and emergency humanitarian aid should be determined apart from the Index.

In countries burdened by a non-reforming statist government, continued foreign aid generally focuses on "basic human needs." Nutrition, basic education, and health programs have actually been the major priority of U.S. development aid since the passage of the 1973 Mutual Development and Cooperation Act in 1973. Yet, this is humanitarian aid, not development aid. While the U.S. should continue providing humanitarian aid in emergencies, it should be recognized as such, with no pretenses that it is contributing to economic development. As shown in Chile, the best basic human needs program is market-driven economic growth.

35 *World Development Report 1993: Investing in Health*, p. 45.

36 See Oded Shenkar, "From Beijing to Jerusalem: Pitfalls of a Hybrid Economy," Jerusalem, Institute for Advanced Strategic and Political Studies, April 1994, for an excellent overview of needed reforms of the Israeli economy.

Instituting the Index of Economic Freedom would bring the additional benefit of re-establishing the original premise of foreign aid: that it should be transitional. President John F. Kennedy spoke of seeing U.S. development aid recipients "take off" into self-sufficiency.[37] Yet despite billions spent on overseas aid, the U.S. is no closer to Kennedy's ideal. The Index of Economic Freedom would communicate to other countries that the U.S. will help them establish the sole known means of generating prosperity—the free market.

✓ Reduce foreign aid.

The foreign aid budget should not escape federal budget cuts. Indeed, it is difficult to justify the Clinton Administration spending some $14.6 billion on foreign aid in 1995 when the federal deficit will be some $223 billion this year. Because of this deficit, taxes will be raised by $260 billion over five years. The high level of foreign aid spending is all the more indefensible given that the Administration plans nearly $150 billion in cuts from the defense budget over the next five years.[38]

To find cuts, the Administration need look no further than the Congressional Budget Office (CBO). The CBO, as part of its fifteenth annual report on possible deficit reduction plans, has looked at the Administration's spending plans and cites possible cuts in development aid that would save $330 million in 1995 and $1.9 billion over a five-year period. The CBO notes that this option would allow AID to focus on more attainable goals in those countries most likely to benefit from U.S. development aid. The CBO also cites $120 million in possible cuts in security assistance for 1995 and $2.1 billion in total security aid cuts through 1999. And the CBO identifies a $510 million cut in the 1995 budget of the Export-Import Bank, which subsidizes credit for foreign buyers of U.S. goods.[39]

Proponents of increased development aid often criticize proposals to cut foreign aid. They are quick to point out that the U.S. spends a low percentage of its GDP on foreign aid, some 0.23 percent, when compared to other developed countries.[40] These figures disregard the estimated $12 billion a year given to overseas development efforts by the American private sector.[41] Moreover, while the governments of Sweden and the Netherlands may spend more per capita in foreign aid, these countries have led the international campaign for the kinds of statist economic policies that have devastated Tanzania and other developing countries. The U.S. should take the lead in rejecting their failed approach. Reducing overall levels of assistance would be one way of doing so.

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37 *Development and the National Interest*, p. 18.

38 For a full discussion of the Clinton Administration's defense policy, see Lawrence T. Di Rita *et al.*, "Thumbs Down to the Bottom-Up Review," Heritage Foundation *Backgrounder* No. 957, September 24, 1993; Baker Spring, "Clinton's Defense Budget Falls Far Short," Heritage Foundation *Backgrounder Update* No. 217, March 15, 1994; John Luddy, "A National Security Agenda for the New Secretary of Defense," Heritage Foundation *Backgrounder Update* No. 214, February 10, 1994.

39 *Reducing the Deficit: Spending and Revenue Options*, A Report to the Senate and House Committees on the Budget, Congressional Budget Office, March 1994, pp. 97-104.

40 Larry Q. Nowels, "Foreign Aid: Clinton Administration Policy and Budget Reform Proposals," Congressional Research Service Issue Brief, Updated January 28, 1994, p. 6.

41 *Development and the National Interest*, p. 61.

✓ Eliminate the Agency for International Development.

AID is the lead agency for coordinating and implementing U.S. bilateral economic aid. It is also, in the word of its Administrator, Brian Atwood, a "disaster," a dispirited and poorly managed agency suffering low-morale, despite having spent $114 billion in development aid since its creation in 1961. Indeed, AID has become a much-publicized "reinvention lab" for the Clinton Administration's federal government overhaul.

Yet AID has undergone four major management reorganizations, and has been the subject of fourteen separate management studies within the last eight years. In short, AID has been under continuous reinvention and study with no appreciable results.

The 1989 Hamilton-Gilman Task Force Report noted that "the most effective way to remove bureaucratic cobwebs and take up a new mandate is to create a new entity to administer and allocate economic assistance." The report recommended that AID be replaced with a new institutional entity.[42] The President's Commission on the Management of AID Programs and numerous other studies have recommended that AID be fully integrated into the State Department.[43]

Merging AID into the State Department would not be a difficult organizational task. Doing so would offer improved economies of scale. Desk officers and administrative functions and overseas activities, for example, could be consolidated.[44] Why, for example, should there be an expert on Zambia at both the State Department and AID, when both spend most of their time considering the U.S. assistance program? The same is true of having both AID and State Department economic officers on the ground in the same countries. If foreign aid is to be "reinvented," AID cannot be the agency to do so. AID is part of the problem, not the solution.

✓ Grant the President more flexibility in using aid as an instrument of foreign policy.

The President is charged in the constitution with conducting U.S. foreign policy. Aid is a tool of foreign policy, but current U.S. foreign aid legislation makes it all but impossible for the President to use that tool with any flexibility. Moreover, too much U.S. foreign aid is earmarked by Congress for specific sectors and countries. For example, Congress's 1994 foreign aid appropriation bill requires that $1 million be spent for the Micro and Small Enterprise Development Program.[45] Such congressional micro-management results in rigid and ineffective budgets and programs. New foreign assistance legislation aimed at promoting economic freedom and allowing the President the flexibility to achieve this goal is long overdue.

Strict legislative control over foreign aid is unique to the U.S. The appropriations legislation of other donor countries largely avoids earmarking specific amounts for countries and programs. In Japan, an extreme example, the Diet does not even pass foreign aid legislation, even though the Japanese government spent $11 billion in official development aid in 1991.[46]

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42 p. vii.

43 p. 12.

44 *The President's Commission on the Management of A.I.D. Programs: Critical Underlying Issues - Further Analysis*, December 22, 1994, p. 36.

45 Many "gray" or "shadow" earmarks are written into the report accompanying congressional appropriation bills for foreign aid. While not technically law, these "recommendations" and "suggestions" are *de facto* earmarks.

Congressional power over U.S. foreign aid is the result of disillusionment with the Vietnam War. By 1966, Vietnam alone was receiving over 43 percent of AID's development grants. After the recognition that the $7 billion U.S. economic aid effort in Vietnam had been wasteful and largely irrelevant to bettering Vietnamese lives, significant congressional restrictions were added to the U.S. foreign aid program.[47] It is time to move beyond the lessons of this era. This congressional stranglehold has doomed the U.S. foreign aid effort to failure.

The Clinton Administration's Peace, Prosperity, and Democracy Act of 1994 would increase executive flexibility in managing the U.S. foreign aid program. The PPDA eliminates country specific earmarks and restrictions. But it retains several prohibitions against aiding countries that are communist or human rights violators. The PPDA grants the President broad authority to waive these prohibitions when the national interest requires it.

Congress should not issue the President a foreign aid carte blanche. But neither should it continue its current micromanagement. A more constructive approach would be for Congress to hold the President responsible for achieving tangible results in the countries it aids and cutting overall aid levels if those results are not satisfactory.

One area of foreign aid in which the President's flexibility is particularly important is security assistance. Consistent with his role as the commander in chief, the President can use limited amounts of foreign aid to further post-Cold War objectives such as the counter-proliferation of chemical, biological, and nuclear weapons. Foreign aid can also be used to retrain the military forces in the newly emerging democracies in Central and Eastern Europe.

For example, Congress has authorized nearly $1 billion to assist in the dismantling of the nuclear arsenal of the former Soviet Union. At the same time, the Pentagon is expected to assist the armed forces of the former Warsaw Pact prepare their military forces for participation in NATO's "Partnership for Peace" (PFP) plan. The PFP is the first step toward expanded NATO membership for important Central European countries such as Poland and the Czech Republic. Joint training exercises with NATO and headquarters staff officer assignments are two important elements of this program, which is expected to cost as much as $30 million a year for the next several years.[48]

Funds for these high priority national security programs come directly out of the Pentagon budget, which has been reduced disproportionately to the rest of government spending. The Clinton Administration intends to reduce defense spending by nearly $150 billion over five years. Given their current rate of growth, domestic entitlement programs will increase by nearly 40 percent during the same period. Under these conditions, it is no longer acceptable to place the burden of post-Cold War security assistance objectives on the Pentagon, which must use every dollar available to modernize weapons and equipment and to sustain the force structure.

46 *The President's Commission on the Management of A.I.D. Programs: Critical Underlying Issues - Further Analysis*, p. 9.

47 See Nick Eberstadt, "The Perversion of Foreign Aid," *Commentary*, June 1985, pp. 19-33.

48 For a full discussion of the Partnership for Peace, see Lawrence T. Di Rita, "Beyond the Partnership for Peace," Heritage Foundation *Backgrounder* No. 957, January 7, 1994.

Countries receiving security assistance would score higher on the Index of Economic Freedom than many recipients of traditional development assistance. Many of the new democracies in Central and Eastern Europe have embarked on aggressive free market reform programs as they emerge from decades of statist centrally planned economies. Providing additional assistance to these countries in the form of military education and training, for example, would be consistent with the overall objectives of a revamped foreign aid program focused on rewarding the transition to free markets. The President should be given the authority to do that, free of congressional over-management, without having to sacrifice America's own military readiness in the process.

✓ Reject the concept of "sustainable development."

AID Administrator Brian Atwood has called "sustainable development," which is Title I of the Peace, Prosperity, and Democracy Act, the guiding philosophy of the Clinton Administration's foreign aid reform effort. Yet this concept is vague. Promoting free market-generated economic growth should be the primary goal of the U.S. foreign aid program.

Sustainable development, while vaguely defined by the Clinton Administration, implies more government control and regulation of resources. It is thus hostile to the free market.[49] Advocates of sustainable development prescribe the same type of statist policies that the development community claims it is encouraging developing countries to abandon. Private property rights (and the liability laws that assign individual responsibility for pollution) are the best protector of the environment, not socialism. Those countries with the highest levels of state control of the economy consistently have produced the most damaging environment problems, whether they be air pollution in Eastern Europe or the devastation of agricultural lands in Zimbabwe.

Another disturbing premise of sustainable development is the notion that developing countries have special rights or entitlements from the developing world. The World Commission on the Environment and Development's "Our Common Future" report, a chief source for the sustainable development doctrine, speaks of all peoples' "right to development." This development, of course, should come through foreign aid. The U.N.'s International Covenant on Economic, Social and Cultural Rights outlines the rights to "adequate food, clothing and housing."[50] AID Administrator Brian Atwood himself has declared that free and uncontested access to a range of family planning methods and services is a "fundamental human right."[51]

This philosophy of rights is dubious at best. Developing countries have no special claim on industrialized ones. They deserve to be treated equally and with respect, but the industrialized world has neither the money nor the obligation to fulfill the rights cited by Atwood and others.

The concept of sustainable development is unsound in theory and practice. There should be one goal of the U.S. foreign aid effort: promoting transitions to free markets. The Index of Economic Freedom is the best philosophical and practical basis for achieving this goal.

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49 See Thomas J. DiLorenzo, "The Mirage of Sustainable Development," Contemporary Issue Series 56, Center for the Study of American Business, January 1993.

50 *The International Bill of Rights* (New York: United Nations, 1993), p. 10.

51 John M. Goshko, "Planned Parenthood Gets AID Grant," *The Washington Post*, November 23, 1993, p. A12.

CONCLUSION

The U.S. foreign aid program needs a major overhaul. Unfortunately, the Clinton Administration's reform plans make cosmetic changes while furthering the philosophy of "sustainable development," which has little to do with promoting economic growth, which is the prerequisite to development.

The Clinton foreign aid reform plan also lacks a commitment to the idea that foreign aid should be temporary. It is also overreaching, promising to remake the world with admittedly limited resources. The limits of such utopian visions of remaking the world were demonstrated in the debacle of Somalia. Millions of dollars of aid were poured into Somalia, and still the country descended into anarchy. In fact, foreign aid set the stage for the chaos in Somalia by enticing a power grab by rival leaders to wrest control of the government and foreign aid pot. The Clinton Administration appears to have little understanding of this foreign aid dynamic.

Foreign aid weakens thrift, industry, and self-reliance—the values that are essential for economic growth and development. Instead of dependence, foreign aid should be premised on the idea of freedom. The Clinton Administration should recognize the dangers of foreign aid and use the Index of Economic Freedom to identify which countries are making the transition to a free market. Applying the Index in this way will help produce the economic growth that is necessary to promote democracy, clean up the environment, and increase American exports —all goals of Clinton's foreign aid plan.

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