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DEBUNKING THE MYTH OF DEVELOPMENT ASSISTANCE

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This appears to be the year in which the U.S. foreign aid program will undergo its long-awaited and much-needed overhaul. The Heritage Foundation long has held an interest in the U.S. foreign aid program. Our most recent contribution to the foreign aid debate is the *Index of Economic Freedom*, a quantitative analysis of economic freedom in 101 countries. The *Index* should be made the centerpiece of the U.S. development aid program.

The U.S. certainly should not retreat from the world stage. It is essential that we actively seek to advance our nation's global interests. Advancing these interests requires, among other efforts, maintaining a strong defense establishment and strong relationships with strategic allies, developing more effective anti-terrorism capabilities, and working assiduously to promote a free trade regime.

Without a doubt, foreign aid should be part of an administration's foreign policy arsenal. Under the right circumstances, Economic Support Funds (ESF) are an appropriate and effective means of aiding allies. I certainly support its continued availability, though ESF should be renamed "Security Supporting Assistance," its designation prior to 1978. This label better conveys the intent of ESF while avoiding the suggestion that these funds promote economic development.

While ESF may "bolster" allies in the short run, it often creates dependence and distorts the economies of recipient countries, as does development aid in most instances. Indeed, ESF should be used guardedly, for what may seem to be beneficial aid given by the U.S. may instead be self-defeating for both parties in the long run. For example, it is indisputable that the $815 million in ESF that the U.S. provides Egypt each year is prolonging that strategically important country's day of reckoning: the time when it undertakes desperately needed economic liberalization to strengthen the Egyptian economy. So while ESF may be "bolstering" the Mubarak government today against Islamic fundamentalism, this money is increasingly counterproductive from the all-important economic standpoint. I was encouraged to see that on his recent visit to Egypt, Agency for International Development (AID) Administrator

1 Substantial portions of this were delivered in testimony before the House Committee on International Relations on April 4, 1995.

Brian Atwood signaled to Cairo that it ought to begin planning for decreased American financial support in the future.

Like ESF, development aid often works against economic growth. Faced with organizational extinction, AID has been making all sorts of exaggerated claims lately about the efficacy of development aid. In doing so, AID plays a tricky game. At some point, virtually every country in the world has received some amount of American foreign aid. So AID merely ascribes any "development" that has occurred over the last 30 years to its efforts. But I challenge AID to make the case in a rigorous manner that development aid has been *instrumental* in promoting economic growth in any single country.

Indeed, it is revealing that AID points to the Marshall Plan as a paragon of development aid. The Marshall Plan was an effort to jump-start damaged yet developed European economies. This effort bears no resemblance to development efforts in the Third World. The circumstances could not be more different. Moreover, many believe that the Marshall Plan had an economic downside. While it provided a psychological defense against communism, it solidified the welfare state which is frustrating European economic growth so badly today. Regardless of its virtues, the Marshall Plan stands wholly apart from AID's actions over the last 30 years.

Rather, AID's legacy is rooted in such countries as Tanzania. A *cause celebre* of Western donors, Tanzania for many years was one of the most heavily aided countries in the developing world. Tragically, this money was subsidizing the socialist fantasies of its former president, Julius Nyerere, which included the nationalization of property and the persecution of economically productive Tanzanians of the improper race. Tanzania today is the world's second poorest country, with a per capita GNP of approximately $120. By any standard, Tanzanians were considerably better off 30 years ago.

Fortunately, Tanzania has changed. I visited Tanzania a little over a year ago and saw a country implementing some free market reforms. It is moving, however haltingly, away from its socialist past. AID has changed too. It is no longer championing and financing forced rural collectivization efforts in Tanzania. However, the question remains: is the U.S. development aid currently being spent in Tanzania really making a contribution to economic growth? What is certain is that this aid is not needed for development in Tanzania and elsewhere, and that it will be as disastrous as when it subsidized Nyerere's socialist war against his people if Tanzania does not continue to move forward with free market reforms. The case of Chile, like that of Tanzania, illustrates the potential damage of development aid—it also demonstrates that aid is superfluous to economic development.

Chile over the last several years has had one of the fastest growing economies in the world. It is the premiere "Latin Jaguar." This dynamic economic growth has dramatically improved the lives of the Chilean people, reducing the infant mortality rate and increasing life expectancy. These economic and social improvements, however, came only *after* the Chilean government of General Augusto Pinochet was almost completely cut off from foreign aid after its 1973 *coup d'etat.*

In 1970, Chile was he world's second largest per capita recipient of foreign aid, on a par with Tanzania. Chile was also stagnating economically. In 1973, Salvador Allende's last year as president, Chile's 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 its GDP. This had changed dramatically by 1990 when the Chilean government, after nearly completing Pinochet's privatization program, controlled only about 25 percent of the economy. It is a near certainty that Pinochet would not have taken the political risk his free market reforms represented had he been able to depend upon the crutch of foreign aid. Chile's foreign aid cutoff was a great blessing in disguise.

Likewise, South Korea and Taiwan began their economic growth spurts only after they saw the writing on the wall: that their development aid was ending. It was only then, in the mid-1960s, that these countries began to undertake the free market economic reforms that have allowed them and others to vault into the developed world.

Free market economic policies are the key to development. That is the conclusion of The Heritage Foundation's recently released *Index of Economic Freedom*, a quantitative analysis of economic freedom in 101 countries authored by Bryan Johnson and myself. The results are conclusive: Those countries with the highest levels of economic freedom enjoy the highest levels of development. Conversely, those countries with the lowest levels of economic freedom suffer the lowest development levels. Roughly translated, this means that countries which protect private property and the value of their currency, impose a low tax burden, embrace international trade, welcome foreign investment, and minimize government intervention into their economies enjoy prosperity. Chile (20th), South Korea (13th) and Taiwan (6th) all ranked among the top 20 most free economies in the world.

The findings of the *Index* confirm that it is essential to ensure that development aid be used only in those countries progressing with free market reforms. This progress should be the sole determinant in allocating *all* types of development aid among countries. Otherwise, development aid is guaranteed to be destructive, subsidizing a status quo of ruinous, market-hostile economic policies. There have been too many Tanzanias.

This is the approach of Senator Mitch McConnell's foreign aid reform. The McConnell proposal would condition development aid on the adoption of free-market policies by recipient governments as determined, in fact, by many of the factors used by the *Index of Economic Freedom*. Senator McConnell is not alone. George M. Ferris, Jr., Chairman of the 1992 President's Commission on the Management of AID Programs, urged AID to establish an index of economic freedom for the purpose of allocating development aid among countries.

AID certainly has the technical ability to identify those countries moving forward with free market reforms. It should be given the mandate by Congress to focus its development aid dollars upon such countries. For, recommendations by Chairman Ferris and others notwithstanding, AID will not do so on its own. Nor does the International Development Foundation (IDF), proposed by Senator Jesse Helms in his recently announced refashioning of the U.S. foreign aid program, appear particularly keyed to free markets.

In describing the IDF, which would dispense a considerable portion of development aid in lieu of an abolished AID, Senator Helms's outline of his plan notes: "Emphasis should be placed on the areas of micro and small enterprise development; education; health, including child and maternal care; agriculture; and other economic needs of people in developing nations." This is the so-called Basic Human Needs approach to development which was instituted in the U.S. foreign aid program in the early 1970s.

The Basic Human Needs approach puts the cart before the horse, dealing with the symptoms of poverty, not its causes. What development hinges upon mostly is unfettered markets which allow people to begin providing for their own needs—needs foreign aid can never satisfy. The key question is whether IDF-type aid will be focused on promoting free market reform. I am eagerly awaiting the details of Senator Helms's plan, as well as the foreign aid reform plan this Committee is developing.

If IDF aid is not tied to free market progress, then the work of the IDF will be wholly irrelevant to combating poverty, for there will be no chance that its projects, however "successful" on a micro level, will contribute to economic growth in recipient countries. Rather, they are likely to be harmful, though probably not as harmful as the government-to-government development aid the State Department would administer under the Helms reform plan. Nothing has the potential of bolstering the status quo like aid given to bureaucracies setting economic policy. Moreover, if IDF aid is given to countries making no free market progress, then its work is better understood as being charity. Such work is more appropriately done by the American private sector, however, not by quasi-private organizations that receive the bulk of their support from the federal government, whether it be AID or an IDF in the future.

As Chile demonstrates, there is no better basic human needs program than free market reforms, which even the world's poorest nations are capable of implementing. Consider the economic progress of Uganda, featured in a recent front-page story in *The Washington Post*. This once war-ravaged country saw its economy grow by some 8 percent last year; foreign investment is flowing into Uganda; the inflation rate has fallen from 250 percent in 1987 to 5 percent today. Uganda is experiencing a building boom. Sugar and soap factories, a brewery, a packing operation, and a steel enterprise have recently been reopened. This is no miracle.

The secret of Uganda's success is plain for all to see. Uganda is moving to a market economy: Previously banished Indian businessmen have been permitted to return to Uganda; government-run coffee and cotton marketing boards have been disbanded; foreign investment has been encouraged; and the process for acquiring a business license has been streamlined. Not surprisingly, Uganda scored a 2.94 on the *Index's* scale of 1 to 5, placing it behind only Swaziland among sub-Saharan African countries. (A score of 1 indicates the highest level of economic freedom; 5 is the lowest.) This success only further validates the *Index*.

The approach to development aid embodied in *The Index of Economic Freedom* is not about "buying" reform. Years of failed structural adjustment programs engineered by the World Bank and the International Monetary Fund demonstrate that countries are not easily bribed into adopting sound economic policies. The *Index* is about the U.S. taxpayer investing in those countries that are willing to help themselves economically. This hard-headed approach better approximates how the real world works. It also sends a message that foreign aid is not an entitlement—the perception that our foreign aid program has been giving for years with devastating consequences for the developing world. The Administration talks about fundamentally reforming foreign aid—*The Index of Economic Freedom* is the prescription.

Despite the abysmal performance of development aid, those who wish to reform and trim back the U.S. foreign aid program are sometimes called "isolationists." Only government bureaucrats and others with a vested interest in foreign aid spending could view international relations through the prism of foreign aid. The U.S. is engaged in the world in so many ways that dwarf the significance of the U.S. foreign aid program. How does criticizing a foreign aid program that has spent hundreds of billions of dollars, with so few positive results qualify one as an isolationist? Defenders of development aid need to account for the destruction their efforts have brought to Tanzania and elsewhere.

Brian Atwood has defended his development aid program by arguing that "you can pay me now or pay me later." He has suggested that unless we "invest" in countries with development aid we will see more Rwandas and Somalias. But these two countries were major recipients of development aid prior to imploding. In fact, Rwanda was treated as a test case for development aid due to its relatively small and presumably "manageable" size. The results of that test are in. As we all know, Rwanda is a disaster. And interestingly enough, Somalia, after the end of its U.N. operation and after the end of the massive aid that destroyed its agricultural system, is doing better than it has in years. Somalia is experiencing relative tranquillity, and its economy is recovering. If this is the result of the end of development aid, we need more of it.

The Heritage Foundation will soon release a comprehensive review of federal spending which focuses upon where budget cuts can be made toward achieving the goal of a balanced budget.[2] The Heritage study examines all federal programs, asking whether we would start such programs today. I ask the Committee whether we should still be funding many of our development aid programs. Without the adoption of progress toward free markets as the sole criterion for allocating development aid—real foreign aid reform—the answer to this question must be a resounding "No."

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2 For recommended foreign aid cuts, see Kim R. Holmes, "Focus on Free Markets: How to Cut Foreign Aid," Heritage Foundation *Committee Brief* No. 3, February 15, 1995.