The Heritage Foundation Committee Brief

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A Special Report to the Appropriations Committees

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FOCUS ON FREE MARKETS: HOW TO CUT FOREIGN AID

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Mr. Chairman, it has been recognized for years now by nearly everyone—from the right, left, and center of the political spectrum—that the U.S. foreign aid program is critically flawed. In addition to having too many goals and too little focus, U.S. development assistance programs have done little to advance economic growth in the developing world. Far more important than economic aid in determining whether a developing country emerges from poverty is that country's own economic policies—in short, how free its economy is. This fundamental fact has been overlooked by the designers of America's foreign aid program. It is time to begin looking at it. Without question, this Congress has a unique opportunity to reform foreign aid. This opportunity must be seized. The American people will support a foreign aid program, but only one that serves American interests and promotes international economic growth.

We at The Heritage Foundation have examined the issue of foreign aid closely. We have published *The Index of Economic Freedom*, a study that measures the comparative economic freedom of 101 countries.[2] The Index scores countries on ten factors, including taxation levels, trade barriers, regulations, and openness to foreign investment. The purpose of this study is to introduce a new understanding of economic development. Hitherto, most development economists and the U.S. foreign aid bureaucracy believed that a laundry list of factors ranging from health, education, and even population controls must be manipulated by governments for economic development to occur. The Index takes a different approach. It is based on the premise that economic freedom is the most important factor in economic development—or, as we prefer to call it, economic growth. As we discovered in the Index, how free an economy was, and not the amount of economic assistance it had received, was the most important and consistent determining factor in a country's level of economic development and its rate of economic growth. This being the case, we concluded that the purpose of economic aid should be to promote economic freedom and to create the economic growth that will someday make this aid unnecessary.

1 Substantial portions of this were delivered as testimony before the House Appropriations Subcommittee on Foreign Operations, January 31, 1995.

2 Bryan T. Johnson and Thomas P. Sheehy, *The Index of Economic Freedom* (Washington, D.C.: The Heritage Foundation, 1995).

But The Index of Economic Freedom is more than a study of the factors contributing to economic development. It also can be instrumental in evaluating America's development assistance programs. The Index can be a useful tool with which to decide whether particular countries deserve development assistance and, if so, what kind of aid is best for them.

The assumption behind the Index and indeed our entire approach to reforming foreign aid is that U.S. foreign assistance programs should serve three fundamental purposes:

❶ **To enhance** U.S. national security.

❷ **To advance** American national interests.

❸ **To promote** economic growth around the world, which creates markets for American goods and contributes to democratization and international stability.

While we believe that U.S. foreign assistance should be used under certain circumstances for humanitarian purposes and to help friendly foreign countries in an emergency, we also believe that U.S. foreign aid programs should be understood primarily as an extension of U.S. foreign policy and designed to advance its goals.

Thus, some forms of assistance to advance the process of democratization, if they are effective and given to deserving countries, would be compatible with the U.S. goal of promoting international stability. But economic development assistance, which by and large has failed, should be carefully scrutinized and curtailed. To the extent that current military and security assistance programs serve the national interest, they, too, should be continued. Economic support for Israel, Egypt, Russia, and the Newly Independent States (NIS) of the former Soviet Union by and large should be retained, although in the cases of Russia and the NIS, some cuts can be made safely. However, so-called economic support funds for Israel and Egypt should not be understood as a means to promote economic development, for they surely do not serve this goal, but rather as a form of security support assistance and as a political demonstration of U.S. support for the Middle East peace process.

With these assumptions in mind, we have prepared a list of recommendations for your committee to consider as it reviews the foreign aid program. I need not remind the members of the committee that the balanced budget amendment, if it passes the whole Congress, will bring every federal spending program under close scrutiny. Foreign assistance programs should be no exception. With that reality in mind, I have combined the total savings from all the recommendations made in this testimony into two budgetary options which I hope you will consider.

OPTION A ($2.58 billion savings). This option represents the minimum amount which should be cut from this year's foreign aid budget. It includes:

- ✓ **Reducing** bilateral economic development assistance programs by 50 percent for a total fiscal 1996 savings of $1.8 billion.
- ✓ **Trimming** aid to Russia and the NIS by $200 million.
- ✓ **Shrinking** funding for multilateral development banks by 25 percent for a total savings of $481 million.
- ✓ **Abolishing** the Agency for International Development for a savings of $100 million in administrative costs.

OPTION B ($5.67 billion savings). The new budget environment may require that you consider more drastic reductions than outlined in Option A. If this turns out to be the case, you can look to our Option B menu of cuts. This option includes:

- ✓ **Eliminating** nearly all economic development assistance for a total fiscal 1996 savings of $3.6 billion.

- ✓ **Ending** all aid to Russia and the NIS for a savings of $839 million.
- ✓ **Cutting** 50 percent of U.S. funding for the World Bank, the International Monetary Fund, and other multilateral development banks for a savings of $963 million.
- ✓ **Cutting** economic support funds for all countries except Israel and Egypt by 50 percent for a savings of $167 million.
- ✓ **Abolishing** the Agency for International Development for a savings of $100 million in administrative costs.

GIVING AID A FREE-MARKET FOCUS: PROPOSALS FOR REFORMING FOREIGN AID

The U.S. foreign aid program must be fundamentally overhauled. In this new political environment of fiscal restraint, foreign aid must not only take its fair share of budget reductions, but also be reshaped to give its remaining programs new life, new meaning, and a new mission. With these goals in mind, we recommend that:

✓ **Economic Development aid be made contingent upon a recipient country's commitment to free markets as determined by The Index of Economic Freedom.**

There is a stark contrast between the tremendous economic progress made by such countries as Hong Kong and Singapore that have pursued free-market development strategies and other poorer countries like Tanzania and Ethiopia that have pursued a statist approach to economic development. Indeed, it should come as no surprise that two of the greatest development success stories of the last few decades, Hong Kong and Singapore, share the highest Index of Economic Freedom score of 1.25. These are two outstanding examples of countries that have elected to unleash the entrepreneurial energies of their peoples by pursuing free-market economic policies. The results have been spectacular. The per capita GDPs of Hong Kong and Singapore have grown nearly eightfold since the mid-1960s. Over the same period the per capita GDPs of Ethiopia, Chad, and Angola grew hardly at all, primarily because their economies were unfree.

No one can argue seriously that economic assistance from the advanced industrial democracies is the principal reason for the economic growth rates of Hong Kong, Singapore, or even other "Asian Tigers" like Taiwan or South Korea. To be sure, some of these countries (like South Korea) have received massive amounts of military aid, but no reputable economist would contend that spending money on tanks and guns is an economic development strategy. No, the reason the economies of these countries have grown is that they have chosen market economies.

Economic development aid not only does little to advance economic development, but even can be detrimental to the welfare of the countries receiving it. Tanzania is a case in point. Once a *cause célèbre* of Western donors, by the early 1970s Tanzania had become one of the most heavily aided countries in the developing world. The U.S. Agency for International Development (AID) was heavily involved in Tanzania, providing financial support and technical assistance for forced rural collectivization, one of Tanzania's many disastrous socialist schemes. Today, Tanzania is the world's second poorest country, worse off than it was at the time of its independence. Foreign aid unquestionably contributed to the destruction of Tanzania's economy. It encouraged and enabled governments to pursue harmful statist economic policies that made economic growth next to impossible to achieve.

Another case in point is Chile, only the outcome has been markedly different. Over the last several years, Chile has had one of the fastest growing economies in the world. It is now the leading "Latin Jaguar." Yet foreign aid had nothing to do with Chile's development success. Indeed, the seeds of this success were laid only after the government of General Augusto Pinochet was cut off from virtually all foreign aid following its 1973 *coup d'etat.*

Here is how this success story happened. In 1970, Chile was the world's second largest per capita recipient of foreign aid. It was also stagnating economically. In 1973, Salvador Allende's last year as president, Chile's GDP shrank by 5.6 percent. Around 75 percent of Chile's GDP at this time was controlled by the government. However, after Pinochet came to power, most of Chile's foreign aid was cut off. Unable to rely on the crutch of foreign aid, Pinochet embarked on a privatization and market reform program that transformed Chile's economy. By 1990 government control of the economy had dropped to 25 percent. Moreover, Chile's infant mortality rate was reduced from 78 to 17 per 1,000 births between 1970 and 1991, and its life expectancy rate rose from 64 to 72 years between 1970 and 1990. These improvements occurred because of economic growth, not because of foreign aid programs.

The Index of Economic Freedom is designed to help identify instances in which development aid is playing the type of destructive role that it once played in Chile. By helping to determine which countries are economically free, the Index can help policymakers decide which countries deserve economic aid—i.e., those that are making progress toward a free market—and which countries do not deserve it—i.e., those that are unfree and are not making progress toward a free market. Governments with unfree economic policies—those possessing very high taxes, protectionist trade policies, hostile foreign investment climates, and burdensome economic regulations, for example—will only waste economic aid. In fact, economic aid too frequently is a crutch upon which the governments become dependent and which prevents them from making the economic reforms necessary to create economic growth.

The Index of Economic Freedom has been recognized by many concerned with the future of the U.S. foreign aid program as the best means of identifying those countries with a commitment to free-market-generated economic growth. 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. Last year, minority members of this committee, including a few of you here today, encouraged AID to develop and use an Index of Economic Freedom as a tool for its development aid allocation decisions. Unfortunately, AID has resisted doing so, despite the fact that it has the requisite data readily available.

Instead of putting the Index at the heart of America's development assistance program, AID allocates aid according to a hodgepodge of criteria that are not nearly as important as economic freedom. Take, for example, AID's criterion of democracy and lawful governance. To be sure, democracy is important to economic growth and stability in the long run, but democracy alone is no guarantee of economic development. Singapore is no democracy, yet its free economy generates very high rates of economic growth. By the same token, Russia is slowly developing democratic institutions, yet its economy is mostly unfree and stagnating.

Economic freedom is far more important to economic development than democracy. In fact, in most cases, economic freedom is the best foundation upon which to build democracy. In the long run free economies produce growth and a middle class that come to demand civil rights, political representation, and protection for their property. In short, as has been seen in Taiwan, South Korea, Chile, and many other countries, economic liberalization creates pressures for political liberalization. Some countries like Singapore lag behind, but not all countries march in lock-step toward democracy. While the pace of change may differ, most countries that are economically free tend over time to become politically free as well. It is probably only a matter of time before Singapore follows the path of Chile.

Fortunately, Singapore and other authoritarian regimes that pursue free-market policies do not need or receive U.S. economic aid. Thus, the moral question of whether we should be aiding an undemocratic free-market country does not often arise. However, this question could arise if an undemocratic government making progress toward economic reform were to ask for aid. They could ask us for assistance to help them in their transition toward a free-market economy even though they are undemocratic. We may be facing such a question with respect to Russia sooner than we think.

Should we give economic aid to a government that is abusing the human rights of its people? The short answer is "No, unless it serves some higher national interest." This has been a long-standing tradition in U.S. foreign aid policy. It was practiced widely during the Cold War and, if national security considerations warrant, should continue in the post-Cold War era as well. However, there should be fewer instances in which national security considerations call for dispensing economic assistance. While we can justify giving economic aid to less-than-savory governments for national security reasons, our development assistance strategy should not include aiding countries that are egregiously abusing their citizens. While a case could be made that supporting economic freedom would lead to political freedom in the long run, in extreme cases we cannot wait until that day comes. Unlike private trade, government aid is too direct a symbol of official and moral support. Discretion will have to be exercised if a recipient government becomes abusive of its people.

Another flawed AID criterion is "need" as determined by social indicators. If this criterion is applied, all poor countries are more or less deserving of economic aid. In fact, the poorest countries would be the most deserving. But what if the recipient country's own economic policies are mainly responsible for its poverty? If all we are doing is putting a Band-Aid on misery that it is self-inflicted, how can we say that we are making a substantial difference? And if our aid is being used by corrupt governments to perpetuate the very economic policies that are causing the poverty, how can we continue in good conscience to dispense aid that amounts to little more than a subsidy of economic misery? Looked at this way, we are not satisfying the needs of poor people, but acting as accomplices to governments that are keeping them poor.

To be sure, one can find a U.S.-supported health or education program abroad that has "done some good" for some people in the developing world. Just as first aid relieves the pain and suffering of a sick patient, economic aid can relieve in a limited way the pain and suffering of people who are economically victimized by their own governments. But economic first aid is not a development strategy. It is does not produce economic growth. Free economies not only produce economic growth, but also produce the wealth needed to improve health and education standards for the greatest number of people. A free economy does far more to educate people and raise health standards than U.S. economic assistance. In short, it does more to meet the "needs" of the people.

Far from being too "narrow" a criterion for dispensing economic aid, as AID Administrator Brian Atwood charges, the Index of Economic Freedom encompasses the broadest possible number of factors that determine economic development. The best way to address social "needs," clean up the environment, raise health standards, stabilize population growth, and promote democratization is to produce economic growth. And the best way to produce economic growth is to advance economic freedom. This is a development strategy that is no less sophisticated for its simplicity of purpose. In fact, it is far more sophisticated than the ahistorical analysis that passes for economic development theory.

Progress toward establishing free markets should be the sole determinant in allocating development aid among countries. This is the approach of Senator Mitch McConnell's foreign aid reform proposal unveiled this past December. 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 of the Index of Economic Freedom. Vice President Al Gore's 1993 "Reinventing Government" report notes that "AID does not have a single, clearly defined and articulated strategic mission." A free-market focus is what the U.S. development aid program desperately needs.

✓ Cut development aid spending.

The conclusions of the Index of Economic Freedom suggest that U.S. economic development assistance programs should be cut. Even if a case could be made that all economic assistance were needed to promote economic development around the world—a case that cannot be made seriously—the new budget environment would argue in favor of reductions in U.S. development assistance programs. I recommend to you the two following budgetary options. Our analysis is based on the figures from last year's foreign operations budget.

OPTION A ($1.8 billion savings). We assume that development aid should be given under the right conditions—i.e., directed at countries moving toward free markets and used by them to assist them in the transition. Under these conditions, development aid can make a difference, although not a very large one. If used wisely, primarily to promote private enterprise, it can encourage an environment in which a free market can grow. With this assumption in mind, we have prepared a recommendation that cuts most bilateral assistance programs by 50 percent. We anticipate from these reductions a savings of $1.8 billion in fiscal 1996. In our range of options, we consider Option A to be the absolute minimum which should be reduced from this year's development assistance budget. Under no circumstances should the Clinton Administration's development assistance programs be fully funded.

To assist you in deciding which countries' aid should be cut in Option A, we have supplied you with a list of development aid recipients scoring poorly on the Index of Economic Freedom. These are countries that received either a "mostly unfree" or "repressed" score on the Index. Our judgment is that you should scrutinize these countries very closely and consider them prime candidates for reductions in—or outright elimination of—economic development funds. They should be at the top of the list in your efforts to meet the 50 percent reduction target.

OPTION B ($3.6 billion savings). The new budget environment may require that you consider more drastic reductions in the development assistance accounts. If this turns out to be the case, you can look to our Option B menu of cuts in these accounts. In this option nearly all development assistance aid is eliminated. Thus, all funding would be cut for the African Development Foundation, the Development Assistance Fund, the Development Fund for Africa, Eastern Europe and Baltic assistance, population control, and other development programs. Savings from this option would amount to $3.6 billion for fiscal 1996.

As you move to reduce development aid spending, you certainly will hear examples of development aid programs that "have made a difference" in the lives of people throughout the developing world. Without question, there have been "successful" development aid programs. Yet what is the measure of success? Have these programs really made a difference to national development, or have they been an oasis of achievement in an otherwise barren environment? The best designed and executed agricultural project will mean little in a country that is destroying itself through foolish economic policies.

Whether you choose Option A or Option B, you should be aware that critics of cuts in development aid will try to portray you as lacking compassion. They will use the same arguments that some people marshaled to justify America's failed welfare system—that "you don't care about people" or that "some people" have been helped by the aid. You should not be deterred by such arguments. Economic aid that does not encourage economic growth or that serves no discernible strategic interest of the United States is not only a waste; it is downright harmful to the people we are pretending to help. Like our own welfare recipients, foreign governments develop a kind of corrupting dependence on U.S. government funding. Although the programs are different, the results are the same: We encourage behavior that is self-destructive.

Major cuts in development assistance do not amount to neo-isolationism. Neither Option A or Option B touches military or security assistance programs. Nor do they affect aid to Egypt and Israel. They affect only aid that purports to spur economic development. Since it turns out that most of this aid has been a failure, eliminating it would have no discernible impact on international stability or international economic development. America's overseas commitments would be reaffirmed not only by the continuation of military and security aid, but by the far more important military alliance and security commitments that the United States has made to friends and allies overseas.

In the end, it must be realized that the only reliable development strategy is one that recognizes the true power of the market and the private sector. In his excellent report, *Development and the National Interest* (1989), former AID Administrator Alan Woods estimated that the American private sector invested $12 billion a year in overseas development efforts. However, the best "aid" any country can give another is free trade. The some $4 billion of bilateral development aid the U.S. provides to the developing world is a drop in the bucket compared to the trillions of dollars that change hands every year in private trade. No wonder that one of the most desired prizes from the U.S. these days is not economic aid, but a free-trade agreement. Most developing countries have come to realize that their future rests not with AID or the World Bank, but with NAFTA and other free-trade agreements.

✓ Trim and rename Economic Support Funds.

The rationale for Economic Support Funds (ESF) differs from that for development aid. ESF is given to advance U.S. political and security interests. While ESF, like development aid, does little or nothing to advance economic development—in fact, an argument can be made that it actually retards economic growth—we recommend continuing ESF for Egypt and Israel. However, we believe that ESF funds should be renamed to reflect their purpose more accurately. Since they are intended primarily to support our security interests, we believe they should be renamed "Security Supporting Assistance," which is what they were called before the name was changed to Economic Support Funds in 1978. Israel and Egypt are by far the biggest recipients of U.S. foreign aid. This year, Israel and Egypt will receive $1.2 billion and $815 million, respectively, in Economic Support Funds (ESF). These two countries command the bulk of ESF funding.

OPTION A (no savings). No cuts in ESF are recommended in Option A.

OPTION B ($167 million savings). In this option we recommend a 50 percent reduction of economic support funds for all countries except Israel and Egypt. In 1995, $334 million of ESF was appropriated for such countries as Cyprus, Turkey, Morocco, Cambodia, and Ecuador. A 50 percent cut would damage our relations with these countries, but it would not irreparably harm our fundamental national security interests. Such a reduction would realize a savings of $167 million.

✓ Revamp and cut aid to Russia and the Newly Independent States (NIS).

It is axiomatic that the U.S. has a vital stake in Russia's future. Russia faces momentous challenges. Whether or not foreign aid can improve Russia's chances of succeeding in developing free-market and democratic systems is uncertain. I am inclined at this time to give the benefit of the doubt to continuing a foreign aid program for Russia. I am sufficiently convinced that, on balance, Western engagement in terms of foreign aid helps keep the reforming spirit—however it may flicker—alive. But this is a close call. Moreover, the point at which aid to Russia should be ended, including a drastic reversal on reform, could come overnight.

What is crystal clear is that the case for continued Russian aid has been weakened by the poor performance of AID. Without taking local conditions into account, AID applied its Third World experience to Russia, allocating the bulk of contracts to its "traditional" contractors, as opposed to organizations and professionals with appropriate regional, industry, and language experience. These multi-million-dollar nongovernmental organizations—including CARE, Save the Children, the Academy for Educational Development, Experiment in International Living/World Vision, and the

Urban Institute—had little or no experience in the former Soviet Union. Unfortunately, their organizational culture, shaped by years of working in the developing world, has hindered their work in the region. Meanwhile, Russian nongovernmental organizations, even the most pro-reform ones, are often excluded from the AID bidding process.

Indeed, the AID contracting process is arcane and often understood only by those with long-term relationships with the Agency. This effectively screens out worthwhile organizations which lack an inside track. Tom Dine, AID's Assistant Coordinator for the NIS, has publicly stated that if he could have one wish fulfilled, it would be the abolition of AID's contracting office, which has been primarily responsible for perpetuating the cozy relationship with traditional contractors.

OPTION A ($200 million savings). Two recommendations are made in Option A. The Congress should:

❶ **Reduce aid to Russia and the NIS from $839 million to $639 million.** The pace of aid delivered to this region so far has been slow, in part because these countries are incapable of digesting the aid that already has been appropriated. This region should not escape budget cuts. A good place to look is the Officer Resettlement Program (ORP) which helps to build housing for Russian army officers returning from abroad. The idea was to prevent a restive and angry Russian army from challenging Yeltsin's democratic regime. However, the Russian military has been mainly responsible for the debacle in Chechnya. It stands to reason that if aid should be cut, they should be at the top of the list. Thus, a $100 million rescission should be imposed on funds already appropriated but not spent on the Officer Resettlement Program, and another $100 million should be cut from fiscal 1996's budget, not only for next year's appropriation for the ORP, but also for other aid programs, such as the Eurasian Foundation, which have not performed as well as expected.

❷ **Reprogram $75 million from health and environmental programs to other programs.** Health and environmental programs have a relatively low impact on the development of a free market in Russia. There are difficulties in identifying worthy projects in Russia and NIS. As a result, these funds are disbursed at an even slower rate than in other areas. At the same time, democratic reform, rule of law, and other crucial tasks are underfunded. Thus, the money could be used better in building democratic institutions in Russia. This proposal results in no net change in the overall Russian and NIS assistance budget.

OPTION B ($839 million savings). The best circumstance for choosing this option would be a determination by you that Russia no longer deserves our aid or that the aid is not effectively assisting the transition to democracy and a free market. Indeed, while in our estimation Russia still deserves aid for now, it is not difficult to imagine circumstances in the near future when it would not. The war in Chechnya has raised serious doubts about President Yeltsin's commitment to democracy and reform. It is not even clear that he is in charge of the country. Moreover, Russian foreign policy has become less friendly in the past year. Yeltsin is opposing the expansion of NATO and interfering in his neighbors' affairs.

If, based on these facts, you were to decide that aid to Russia should be eliminated entirely, you would realize a savings of $839 million for fiscal 1996. However, at this time we do not recommend this option. I fear that cutting off all aid at this point would only drive Russia further into isolation from the world community. Moreover, our democratic friends inside Russia tell us that aid is still an important symbol of our commitment to them. However, I cannot predict where I will stand on the issue of Russian aid next year. If current trends inside Russia continue, I fear that I would be hard pressed to recommend a continuation of aid next year.

✓ Reduce funding to all multilateral development banks (MDBs).

The fiscal 1995 House Republican budget would have ended U.S. support for the International Development Association (IDA), the concessional loan window of the World Bank. This proposal would have realized savings in the billions over a five-year period. The Republican budget alternative also proposed that the U.S. withhold all new capital contributions to the International Bank for Reconstruction and Development, Asian Development Bank, International Finance Corporation, European Bank for Reconstruction and Development, Inter-American Development Bank, and African Development Fund. This proposal also would have realized savings in the billions over five years. Whether the U.S. chooses to zero-out some of these activities or make across-the-board funding cuts, it should begin stepping away from the MDBs.

The MDBs duplicate many private sector activities, particularly lending. Many of the MDB loans could be secured from private financial institutions. Indeed, over the last decade, there has been a flood of investment to the developing world. The fact that many World Bank loans could easily be privatized makes the point that its lending activities are redundant.

It is argued that there are troubled countries that would not be able to attract capital without the MDBs. To the extent that this is true, it can be attributed largely to the economic policies of such countries—policies for which the World Bank, the International Monetary Fund, and other MDBs bear considerable responsibility. Consider the words of Czech Prime Minister Vaclav Klaus, who has complained about the statist orientation of the IMF and World Bank. Klaus has noted that IMF and World Bank aid "is wrong and counterproductive." This aid, Klaus maintains, "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." Klaus's insight can explain the deterioration of the World Bank's project performance, as documented even in the Bank's own 1992 "Wapenhans Report." It also highlights the importance of aiding only those countries moving rapidly toward the establishment of a free-market economy, as is the Czech Republic. This imperative has been unappreciated by the MDBs, and the U.S., frankly, has little chance of changing this.

Another problem for the World Bank is the corruption of its conditionality. The World Bank's structural adjustment programs, which are foreign aid packages designed to liberalize the economies of developing countries, have not been effective. It has been estimated that some half of all economic reform programs endorsed by the IMF and the World Bank break down. Yet the donors almost always soon return. In other instances, development aid recipients pretend to comply with economic adjustment program conditions while donors simply pretend to believe them. This hypocrisy and lack of responsibility is a fallow field in which to plant the seeds of economic growth.

This game of pretend is not necessary. Even the World Bank concedes this to be true when it notes in its 1993 *World Development Report* that "Some of the most dramatic 'adjustment' reforms took place without adjustment lending (as in Chile and Vietnam), and some countries that received adjustment loans did little or nothing to pursue reforms (for example, Tanzania and Zambia)." The key to developing vibrant free-market economic growth is not to be found in the MDBs.

This committee's report of last year quoted a 1982 Reagan Administration review of the multilateral development banks and their contribution to American security: "To the extent that the MDBs encourage the participation of developing countries in that international system on a permanent and self-sustaining basis, they are one of the major vehicles available for pursuing these U.S. economic and political/strategic interests." In the succeeding 13 years, I have not seen the MDBs achieve these goals to much of an extent. Rather than make a ritualistic annual appropriation to these institutions, I encourage the committee to make 1995, the fiftieth anniversary of the creation of the International Monetary Fund and the World Bank, a time of fundamental reassessment. This would be done best with a funding cut.

OPTION A ($481 million savings). In this option funding for all MDBs would be reduced by 25 percent. This would result in a savings of $481 million for fiscal 1996. Reducing the MDBs in this way would send a signal to the world community that unless the MDBs undertake major reform, the United States will begin to step away from them and the approach to multilateral development assistance which they represent.

OPTION B ($963 million savings). In this option funding for all MDBs would be reduced by 50 percent. This would result in a savings of $963 million for fiscal 1996. This option would be chosen to demonstrate that the U.S. has chosen to disengage from multilateral development assistance altogether.

✓ **Eliminate the Agency for International Development.**

AID has failed at its mission of promoting economic development overseas. Since its creation in 1961, AID has spent over $144 billion in development aid. Yet most of the countries that have received U.S. development aid remain mired in poverty, repression, and dependence. Of course, a large part of this failure can be attributed to the fact that development aid has been used to prop up socialist economies; hence, the urgency of utilizing the Index of Economic Freedom.

Before taking charge of AID two years ago, incoming Administrator Brian Atwood labeled the agency a "disaster." Soon after this, Atwood volunteered AID as a "reinvention lab" for Vice President Al Gore's task force to reinvent the federal government. Of course, AID had undergone four major management reorganizations and had been the subject of fourteen management studies within the previous eight years.

While Vice President Gore's September 1993 *Creating a Government That Works Better and Costs Less: Agency for International Development* found that "Reinvention is not simply an option or a challenge for AID; it is an imperative," this report rejected "reasonable arguments" for AID's absorption into the State Department or for its abolition. The President's Commission on the Management of AID Programs (1992) and numerous other studies had recommended absorption into State; the Hamilton-Gilman Task Force Report (1989) had recommended abolition. The Vice President's report instead concluded that, with reform and strong leadership, AID "could reclaim its potential to be an effective provider of U.S. development assistance."

I would assume that AID has been implementing the reforms recommended in the Vice President's report. Yet press reports over the last few weeks suggest that AID came within a few threads of extinction at the hands of the "Super State Department" proposal rejected two weeks ago. What is troubling is what this says about AID's reform progress. It appears either that the Vice President's report was not the right prescription for shaping AID into an effective provider of development assistance or that AID has been rejecting its medicine. Neither answer is encouraging, and the situation begs the question of where AID goes from here. It should go away. We have heard too many promises of reform, from both Republican and Democratic Administrations, to give AID any more chances.

Defenders of AID make the point that another chance is due because AID has been laboring under hopelessly burdensome and conflicting foreign aid legislation. Indeed, the Vice President's report concluded that "AID does not have a single, clearly defined and articulated strategic mission." The report notes that AID's reinvention can succeed only if the Foreign Assistance Act of 1961 (as amended) is replaced with comprehensive new authorizing legislation.

Yet AID struck out with its legislative reform effort. The Clinton's Administration's Peace, Prosperity, and Democracy Act of 1994 was a bureaucratic catch-all which did nothing to give AID a strong focus, never mind a free-market development vision. Not surprisingly, it went nowhere in the last Congress. So AID continues to operate without the reform foundation everyone, including

AID, realizes is desperately needed. Stated bluntly, how can this committee in good faith continue to fund such an operation?

A trimmed down development aid program aimed at fostering free markets around the world could be run out of the State Department, utilizing its worldwide presence and achieving economies of scale. Any ESF could be administered by such offices as the Under Secretary of State for Arms Control and International Security Affairs and the State Department's Bureau of Political and Military Affairs.

OPTION A AND B ($100 million savings). It has been estimated that if AID were eliminated and its remaining functions folded into the State Department, $100 million could be saved in overhead and administrative costs.

CONCLUSION

There should be no doubt that the foreign aid budget will be cut this year. The only question is by how much. With that reality in mind, I have combined the total savings from all the recommendations made in this testimony into two budgetary options which I hope you will consider. They are:

OPTION A ($2.58 billion savings). This option represents the minimum amount which should be cut from this year's foreign aid budget. Thus, we recommend reducing most bilateral development assistance programs by 50 percent (for a total of $1.8 billion in savings for fiscal 1996) while trimming aid to Russia and the NIS by $200 million. The bilateral development assistance reduction should be made in the following programs: African Development Foundation; Development Assistance Fund; Development Fund for Africa; Eastern Europe and Baltic programs; the Inter-American Foundation; International Organizations; population control, migration, and refugee programs. Moreover, we envision in this option shrinking funding for multilateral development banks by 25 percent for a total savings of $481 million. Finally, we propose a savings of $100 million in administrative costs from abolishing AID.

To assist you in deciding which countries should be cut in Option A, we have supplied you with a list of aid recipients scoring poorly on the Index of Economic Freedom. These are countries that received either a "mostly unfree" or "repressed" score on the Index. Our judgment is that you should scrutinize these countries very closely and consider them prime candidates for reduction or outright elimination of funds. They should be at the top of the list in your efforts to meet the 50 percent reduction target.

OPTION B ($5.67 billion savings). The new budget environment may require that you consider more drastic reductions than outlined in Option A. If this turns out to be the case, you can look to our Option B menu of cuts. In this option nearly all development assistance aid is eliminated ($3.6 billion in savings), including that for Russia and the NIS ($839 million in savings). The bilateral assistance programs affected would be the African Development Foundation, the Development Assistance Fund, the Development Fund for Africa, Eastern European and Baltic assistance, population control, and other development programs. Also in this option is a 50 percent drop in funding for the World Bank, the International Monetary Fund, and other multilateral development banks for a total savings of $963 million. Moreover, this option includes a 50 percent reduction of economic support funds for all countries except for Egypt and Israel ($167 million in savings). Finally, $100 million would be saved by abolishing AID. Total savings from this option would amount to $5.4 billion for fiscal 1996.

Whether you choose Option A or Option B, one thing is certain: the budget for foreign aid should be reduced. At a time when America's national security could be endangered because of shortfalls in defense spending, it makes no sense to spend $2 billion to $3 billion a year on development programs that do not produce economic growth and do not serve the national interest. This money would be invested far more wisely in reversing the decline of defense readiness or in funding the estimated $100 billion shortfall in the Clinton Administration's five-year defense plan. Why, because of falling pay, should America's servicemen and women have to live on food stamps while AID funds population control programs in the Third World? We need to reorder our priorities. We need a foreign aid program that serves the national interest and promotes economic freedom and economic growth.

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APPENDIX

The following countries receive U.S. development assistance and are graded in the *The Index of Economic Freedom*.[3] Countries ranked by the *Index* were categorized into one of the four following groups.

Countries whose scores fell between 1.00 and 1.99:	**FREE**
Countries whose scores fell between 2.00 and 2.99:	**MOSTLY FREE**
Countries whose scores fell between 3.00 and 3.99:	**MOSTLY NOT FREE**
Countries whose scores fell between 4.00 and 5.00:	**REPRESSED**

COUNTRY	IEF SCORE
CZECH REPUBLIC	2.10
IRELAND	2.20
ESTONIA	2.25
THAILAND	2.30
CHILE	2.50
EL SALVADOR	2.65
OMAN	2.65
BELIZE	2.70
PANAMA	2.70
PARAGUAY	2.75
SLOVAKIA	2.75
HUNGARY	2.80
JAMAICA	2.80
SRI LANKA	2.80
ARGENTINA	2.85
TUNISIA	2.90
COLOMBIA	2.90
COSTA RICA	2.90
JORDAN	2.90
MOROCCO	2.90
SWAZILAND	2.90
URUGUAY	2.90
UGANDA	2.94

3 Congressional Presentation: Summary Tables, Fiscal Year 1995, Agency for International Development, Washington, D.C., 1994.

SOUTH AFRICA	3.00
BOTSWANA	3.05
GABON	3.05
GUATEMALA	3.05
KENYA	3.05
MEXICO	3.05
ZAMBIA	3.05
ISRAEL	3.10
HONDURAS	3.25
NIGERIA	3.15
BOLIVIA	3.20
ECUADOR	3.25
IVORY COAST	3.25
POLAND	3.25
BRAZIL	3.30
GHANA	3.30
PHILIPPINES	3.30
MONGOLIA	3.33
GUINEA	3.35
DOMINICAN REPUBLIC	3.40
MALAWI	3.40
PERU	3.40
RUSSIA	3.40
BULGARIA	3.50
CAMEROON	3.50
EGYPT	3.50
MADAGASCAR	3.50
MALI	3.50
TANZANIA	3.50
ZIMBABWE	3.50
ALBANIA	3.55
ROMANIA	3.55
BELARUS	3.65
GUYANA	3.70
INDIA	3.70
YEMEN	3.75

ETHIOPIA	3.80
BANGLADESH	3.90
CONGO	3.90
NICARAGUA	3.90
UKRAINE	3.90
SIERRA LEONE	3.95
MOLDOVA	4.10
HAITI	4.20
ANGOLA	4.35
MOZAMBIQUE	4.40