Policy Analysis

# Cato Institute Policy Analysis No. 65: The Continuing Failure of Foreign Aid

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## Executive Summary

For 40 years, U.S. foreign aid has been judged by its intentions, not its results. Foreign aid programs have been perpetuated and expanded not because they have succeeded, but because giving foreign aid still seems like a good idea. But foreign aid has rarely done anything that countries could not have done for themselves. And it has often encouraged the recipient governments' worst tendencies--helping to underwrite programs and policies that have starved thousands of people and derailed struggling economies.

In agriculture, in economic planning, in food assistance, U.S. foreign aid has routinely failed to benefit the foreign poor. In Africa, Asia, and Latin America, the U.S. Agency for International Development (AID) has dotted the countryside with "white elephants": idle cement plants, near-empty convention centers, abandoned roads, and--perhaps the biggest white elephant of them all--a growing phalanx of corrupt, meddling, and overpaid bureaucrats.

Since 1946, the United States has given over $146 billion in humanitarian assistance to foreign countries. In 1985, the United States provided over $10 billion in non-military aid abroad, ranging from free food to balance-of-payments support to project-assistance and population-planning programs. AID employs over 4,500 employees to administer these programs, many of which have expanded rapidly under the Reagan administration.

Americans have a long tradition of generously aiding the victims of foreign earthquakes, famines, and wars. Before World War II, private citizens provided almost all of America's foreign assistance. After World War II, the Truman administration decided that a larger, more centralized effort was necessary to revitalize the war-torn economies of Europe. Economic planning was the rage in Washington in the late 1940s, and Marshall Plan administrators exported their new-found panacea. The Marshall Plan poured over $13 billion into Europe and coincided with an economic revival across the continent. The best analysis indicates that Europe would have recovered regardless of U.S. aid, and that the clearest effect of the Marshall Plan was to increase the recipient governments' control of their economies.[1]

The apparent success of the Marshall Plan led Truman in 1949 to propose his Point Four Program to provide a smaller version of the Marshall Plan for poor countries in Africa, Asia, and Central and South America. Truman declared that Point Four would be "a bold new program for making the benefits of our scientific advances and industrial progress available for the improvement and growth of undeveloped areas."[2]

In the 1950s, the Eisenhower administration downplayed humanitarian aid, concentrating on security assistance to strategic allies. In 1954, Sen. Hubert H. Humphrey pushed the Food For Peace program through Congress, but that was the largest innovation in economic assistance during the decade. When John F. Kennedy took the helm in 1961, the stage was set for a huge expansion of foreign aid. In a special message to Congress, Kennedy called for "a dramatic turning point in the troubled history of foreign aid" and proclaimed that the sixties would be the "decade of development"--"the period when many less- developed nations make the transition into self-sustaining growth." Kennedy placed heavy stress on the willingness of recipient governments "to undertake necessary internal reform and self-help."[3] In 1961, AID was created, and the U.S. foreign aid bureaucracy came into its own.

Despite Kennedy's stress on requiring reforms from recipient governments, foreign aid routinely went to countries pursuing policies destined to turn them into permanent economic cripples. Partly as a result of a widespread perception that such aid was usually wasted, it consistently ranked as one of the least popular government programs with the American public.[4]

From the mid-sixties to the early seventies, South Vietnam received the bulk of U.S. economic aid. In 1973, Congress, concerned about the ineffectiveness of U.S. aid, heavily revised aid-program goals to focus more on social services and less on economic development.

When Ronald Reagan took office in 1981, many observers expected a thorough reform of U.S. foreign aid. Reagan declared in a major speech before the annual meeting of the World Bank and International Monetary Fund, "Unless a nation puts its own financial and economic house in order, no amount of aid will produce progress."[5] Since then, despite Reagan's tough rhetoric on requiring reform from recipient governments, little has changed. American foreign aid still suffers the same problems it did when Kennedy took office in 1961. Despite countless reforms, foreign aid is still a failure.

Instead of breaking the "endless cycle of poverty," foreign aid has become the opiate of the Third World. AID and other donors have encouraged Third World governments to rely on handouts instead of on themselves for development. No matter how irresponsible, corrupt, or oppressive a Third World government may be, there is always some Western government or international agency anxious to supply it with a few more million dollars. By subsidizing political irresponsibility and pernicious policies, foreign aid ill serves the world's poor.

American foreign aid has often harmed the Third World poor. In Indonesia, the government confiscated subsistence farmers' meager plots for AID-financed irrigation canals. In Mali, farmers were forced to sell their crops at giveaway prices to a joint project of AID and the Mali government. In Egypt, Haiti, and elsewhere, farmers have seen the prices for their own crops nose-dive when U.S. free food has been given to their countries.

AID cannot be blamed for all the mistakes made in the projects it bankrolls. However, by providing a seemingly endless credit line to governments regardless of their policies, AID effectively discourages governments from learning from and correcting their mistakes. Giving some Third World governments perpetual assistance is about as humanitarian as giving an alcoholic the key to a brewery. Good intentions are no excuse for helping to underwrite an individual's--or a country's-- self-destruction.

Foreign aid programs appear to be incorrigible. For 35 years, American foreign aid policymakers seem to have learned nothing and forgotten nothing. U.S. foreign aid projects routinely repeat the same mistakes today that were committed decades ago. One telltale ironic report title from the General Accounting Office says it all: "Experience--A Potential Tool for Improving U.S. Assistance Abroad."[6]

This study focuses on the failure of U.S. humanitarian aid to achieve its goals. It begins with a close examination of one of the most popular foreign aid programs, Food for Peace. Then comes a review of AID's record in resurrecting the economies of Central America, followed by an analysis of AID's role in African agricultural development. AID's achievements in Egypt and Indonesia are then reviewed, followed by an analysis of AID's role in spurring the development of private business and capitalism in poor countries. The study concludes with an analysis of why U.S. foreign aid has failed in the past and why it will most likely fail in the future. Military aid and security assistance is a different issue and is not examined here.

**U.S. Free Food Bankrupts Foreign Farmers**

Food for Peace is probably our most harmful foreign aid program. The United States is dumping over $2 billion worth of surplus agricultural commodities a year on Third World Countries. Although sometimes alleviating hunger in the short run, the program often disrupts local agricultural markets and makes it harder for poor countries to feed themselves in the long run.

Food for Peace was created in 1954 to help the Eisenhower administration get rid of embarrassingly large farm surpluses. The program aimed to benefit American farmers and the U.S. merchant marine and at the same time help hungry foreigners. In reality, it removes the evidence of the failure of our agricultural policies, often with little concern for the food recipients.

In the 1950s and 1960s, massive U.S. wheat dumping in India disrupted that country's agricultural market and helped bankrupt thousands of Indian farmers. George Dunlop, chief of staff of the Senate Agriculture Committee, speculated that food aid may have been responsible for millions of Indians starving.[7] U.S. officials have conceded that massive food aid to Indonesia, Pakistan, and India in the 1960s "restricted agricultural growth . . . by allowing the governments to (1) postpone essential agricultural reforms, (2) fail to give agricultural investment sufficient priority, and (3) maintain a pricing system which gave farmers an inadequate incentive to increase production."[8]

U.S. food aid is still having devastating effects. A report by the AID inspector general found that food aid "supported Government of Egypt policies . . . which have had a direct negative impact on domestic wheat production in Egypt."[9] AID administrator Peter McPherson has admitted his concern that U.S. food donations are still having an adverse effect on Egyptian agriculture.[10] In Haiti, U.S. free food is widely sold illegally in the country's markets next to the Haitian farmers' own crops. Governments often accept U.S. free food at the same time that they are repressing their own farmers, refusing to pay them what their crops are worth.

Roughly a quarter of Food for Peace giveaways go to the Food for Work program. FFW recipients receive food in return for working on labor-intensive development projects. These projects are intended to increase agricultural productivity but are often only make-work schemes.

FFW workers often labor to improve the private property of government officials or large landowners. An AID analysis of FFW in Bangladesh, which has the largest FFW program in the world, concluded that FFW "results in increased inequity" and "strengthens the semi-feudal system which now controls most aspects of the village life."[11] The workers were paid less than the program promised to pay, and the government used U.S. wheat for other purposes, paying the workers with inferior, infested wheat. A 1975 UN Food and Agriculture Organization report concluded that FFW projects in Haiti "have extremely deleterious effects on the peasant communities and cause great erosion of the reservoir of mutual service relationships of the traditional peasantry."[12] In the Dominican Republic, shoddy AID FFW program management "led to giveaway programs, a road project that proved to be a footpath leading nowhere, agricultural projects for which FFW incentives were not needed," and the usual horde of ineligible recipients.[13] In many places, rural residents neglect their own farms to collect generous amounts of food for doing little or no work on FFW projects. FFW has contributed to a shortage of agricultural labor at harvest time.

Much of the food donated by Food for Peace is targeted for school-food or health programs for mothers and children. AID claims that these programs prevent displacement of local production and reduce malnutrition. However, an AID audit of targeted food assistance in India, which has the largest such program, concluded, "The maternal/child health program has not improved nutrition and the school feeding program has had no impact on increasing school enrollment or reducing the drop-out rate." Even though targeted food assistance has been ineffective, CARE (the private voluntary organization that administers it for AID) and AID's India mission have resisted efforts to arrange an orderly transfer of program responsibilities to the Government of India." r 14]

AID has done little to discipline the private voluntary organizations that distribute the free food and often blatantly disregard official U.S. policy. A report by the AID inspector general found that free food in Tanzania and elsewhere in Africa had created permanent doles, whereby people who could feed themselves did not bother growing enough food to do so. A priest in Tanzania reported that "residents of this area could grow all the food they wanted, but had chosen to not produce all they needed" because of the availability of U.S. free food.[15]

The Catholic Relief Services official policy manual for Food for Peace programs states, "Any child under the age of 5 years is eligible to be registered in the program. All children should be encouraged to stay in the program until the age of five."[16] AID auditors found that over half the children receiving free food were not nutritionally substandard. AID operations have been passing out free food in some villages for over a decade, and several feeding centers have reported that they would have to give out free food for at least another decade.

AID's mission in Tanzania and the private voluntary organizations have repeatedly refused to make any distinction between needy and self-sufficient families. The result is a program that discourages people from feeding themselves and that has a crippling effect on the development it seeks to encourage. Food for Peace is a handout program designed more to make the donor feel good than to benefit the recipient. Although this problem has been obvious almost since Food for Peace began, the program still suffers from the same fundamental defects that afflicted it in 1954.

Food for Peace is also an administrative nightmare. Recipient governments for years neglect to file reports on how food aid has been used, but AID keeps shipping them millions of dollars worth of free food every year. The Congo, instead of using FFP donations to feed its people, sold free food to buy a small arms factory from Italy.[17] In March 1984, the New York Times reported that AID officials believed Ethiopia was selling its donated food to buy more Soviet weaponry.[18] Mauritius insisted on receiving only the highest quality rice and then used it in hotels catering to foreign tourists.[19] Cape Verde begged for more emergency relief aid at the same time that it was busy exporting wheat donated by other countries.[20] Nothing was done about these incidents, however, and the free-food gravy train kept on running.

Despite all these problems, Food for Peace still has the loyal support of the U.S. merchant marine. The program requires that at least half of all donated commodities be shipped in U.S.- owned carrier vessels. An AID study found that it cost four to five times more to ship raw materials by U.S. carriers than by foreign carriers.[21] In some cases, shipping charges cost almost as much as the food donated. However, even this income has not made the U.S. merchant marine prosperous. A recent Senate Agriculture Committee report concluded, "Rather than encouraging the development of improved U.S. vessels, the program encourages the continued use of semi-obsolete and even unsafe vessels which are of little use for commercial or defense purposes."[22]

**Foreign Aid and the Salvation of Latin America**

AID is playing a key role in the Reagan administration's efforts to revive Latin America. U.S. aid has poured into El Salvador, Honduras, and other countries in a desperate attempt to buy prosperity for strategic U.S. allies. This great flow of assistance provides a good test of the benevolence of foreign aid.

El Salvador is AID's showcase in the Western Hemisphere, and the biggest game in El Salvador is land reform. In early 1980 the government seized the property of hundreds of the largest farmers, began setting up cooperatives, and promised to eventually turn the land over to small farmers. From the beginning, AID has been fully supportive of Salvadoran land reform, pouring more than $250 million into the cause. In a 1983 Washington Post article on land reform, AID administrator Peter McPherson claimed that "real progress is being made," that 500,000 campesinos (small farmers) already benefit, that previously poor peasants "now own their land," and that "agricultural production in the reform sector compares well with pre-reform production."[23]

McPherson's claims are based on wishful thinking. Since the Salvadoran government expropriated large private farms in 1980, production of coffee, the largest export, has plummeted 30 percent. Sugar and cotton production have also declined.[24] The government has provided no real compensation to the expropriated landowners--they were given only worthless government land bonds, which cannot be redeemed now and whose value is rapidly depreciating as a result of inflation. The small tenant farmers who now plow much of the land are required by the government to wait 30 years before selling any of it, which essentially ties them to the land as though they were medieval serfs. Hence, they lack any real title to their land, contrary to McPherson's claim. The government forces farmers to sell their crops to the state for prices far below the crops' true worth, and often it does not pay farmers for as long as two years after they turn in their harvest.

The government of El Salvador has done an abysmal job of administering economic overhaul. The 1983 harvest was disrupted because the government's central bank failed to make sufficient credit available to farmers during planting season.[25] After expropriating large farms, the government set up hundreds of cooperatives to manage those farms. But neither the government nor AID knew exactly how many cooperatives existed; 317 was the best available estimate.

As of September 1983, three and a half years after the property had been expropriated and the cooperatives created, the Salvadoran government still had not surveyed the expropriated properties, established the amount and class of lands involved, determined the number of properties expropriated, or established the amounts owed to the previous owners.

The new cooperatives are very poorly managed. The typical cooperative uses twice as many workers as the previous farmland owners did to work the same land. As a result, many cooperative members work only two or three days a week. Much of the land in El Salvador is mountainous and unfit for farming, but the new cooperatives are futilely trying to squeeze harvests out of the worst-quality land--land on which the previous private owners never considered wasting seed and fertilizer. The AID inspector general estimated that three-quarters of the new cooperatives are located on predominantly poor farmland.[26]

AID personnel have apparently made only a minimal effort to investigate how the cooperatives are actually working. The inspector general found that AID officials had visited only 1 of 41 cooperatives randomly selected for audit. Even though land reform is AID's principal project in El Salvador, AID's post for director of agrarian reform was vacant for 18 months.[27]

Throughout Central America, foreign aid has vastly expanded the size and power of central governments. As Manuel F. Ayau, president of the Universidad Francisco Marroquin in Guatemala City, observed, foreign aid

has been spent putting governments in the business of power generation and distribution, tele- communications, railroads, shipping or other ventures that invariably end up charging monopoly prices and losing money to boot. These ventures not only produce no wealth for their countries, but they also tax economically productive enterprises to cover their losses.[28]

In Honduras, AID is propping up the major cause of the people's misery--the government. A recent GAO report noted, 'The government's centralized procurement process averages over 100 steps requiring about six months to complete."[29] The economy is dominated by heavily subsidized, inefficient stateowned enterprises. Much U.S. aid is labeled "balance-of-payments support" and is intended to cover the country's trade deficit, which is caused by Honduras's overvalued exchange rate. As Ayau noted, overvalued currency means "the foreign exchange spenders--the exporters--subsidize the foreign exchange spenders--the importers--thus promptly exhausting foreign exchange reserves. Typically, more debt is then acquired to postpone the eventual day of reckoning."[30]

Honduras's overvalued exchange rate is encouraging capital flight because Hondurans recognize that the official exchange rate amounts to a de facto expropriation of their foreign-exchange earnings. The Honduran government refuses to adjust the rate because 'exchange rate policy actions might imply government mismanagement of the economy," according to GAO.[31] Instead of encouraging the government to reform its exchange rate and stop hindering its own export trade, AID is paying to set up a price-checking unit in the government's central bank to better regulate Hondurans involved in import or export transactions. With AID's support, the Honduran government is repressing the symptoms while continuing to cause the disease.

**Africa--Foreign Aid Wasteland**

In the 1960s, AID and other donors began a concerted effort to help the newly independent nations of Africa develop their economies. Since 1960, per capita food production in Africa has fallen 20 percent, roads and bridges have been collapsing across the continent, and Africans' faith in the future has shriveled. As a recent Foreign Policy article concluded, "Average per capita income in the continent at the end of the 1980s may be lower than it was at the beginning of the 1960s."[32] Despite huge influxes of development aid, export volumes for most African countries actually fell during the 1970s.[33] AID, the World Bank, and other donors helped set up many of the state-owned enterprises and state farms that disrupted African agriculture and contributed to the starvation of thousands of people.

AID's record in Africa is dismal. AID agricultural projects routinely provide little or no benefit to African farmers. An AID inspector general report on AID agricultural programs in the Sahel (a belt of eight poor countries just south of the Sahara) concluded that "no one with a modicum of business sense" could have avoided seeing many of the problems associated with AID projects.[34] According to the report, "Food production projects in the Sahel have accomplished little, if any, desired results."[35] A 1981 AID report concluded, "The Sahelian states cannot effectively use this magnitude of assistance."[36] Yet AID continues to pour money into the region.

The Operation Mils Mopti project in Mali is typical of AID African agricultural assistance. In 1976, AID launched a project to boost food production and marketing in the Mils Mopti area of Mali. AID plowed over $10 million into this project, which included the usual development array of applied research, more tools and fertilizer for farmers, better roads, and better grain marketing.

Almost everything went wrong, but AID kept financing the program long after its failure was evident. AID paid for the building of eighteen warehouses, but five were not built, three were not finished, three collapsed, two had their roofs blown off, and three more quickly crumbled owing to "serious structural deficiencies."[37] Fifty-four open wells with contaminated water were to be sanitized, but only nine were actually improved. A hundred mills for grinding grain were to be constructed; the project managers built and tested one mill, then gave up. The road-improvement project repaired less than one-quarter of the roads scheduled for upgrading.

Operation Mils Mopti sought to increase grain marketing, but the government marketing board paid farmers only the official price for their crops, which was far below free-market prices. To fulfill the marketing goals, the government forced farmers to sell their crops, thereby effectively expropriating their harvest. Instead of increasing sales, Mils Mopti resulted in a fall in total procurement by the government marketing board of over 80 percent by the time the project ended in 1979.

Although the government refused to pay farmers a fair price for their crops, it did spend $4,900 on a mural to promote the project. AID auditors found the same kind of mural for sale in a nearby gift shop for less than $700. At last report, the $4,900 mural was inspiring the farmers while hanging in the project headquarters' lavatory.

Livestock-production projects in Senegal were equally unsuccessful. In the mid-1970s, AID committed itself to improving the livelihood of Senegal's livestock producers. AID aimed to increase the number of cattle in the Bakel region from 11,200 to 25,000. However, after almost $4 million in U.S. aid had been spent, only 882 more cattle were on the range. A $7 million project in the Sodespt region also sought to boost livestock production and marketing but managed to sell only 263 cattle. The project was also designed to sell 4,950 goats and sheep, but it failed to sell any.

Both livestock projects sought to stem the deterioration of Senegal's rangeland, which threatens to subvert the entire Senegalese livestock business. They were launched to respond to the devastating droughts that had struck Senegal in the early 1970s, but they assumed that normal climatic conditions would prevail. The projects made no provision for livestock forage in case of renewed drought. In addition, the project was so poorly planned that although it tried to encourage increased production, it did nothing to alter the grazing use of the public commons area. In 1982, Senegal was again hit by drought, and the country's livestock business suffered greatly.

One report by the AID inspector general observed that AID's Senegal mission felt "considerable pressure existed [from Washington] to program and spend project funds, with a lesser concern for effective use of the monies," and "overstated project objectives were required to gain AID/Washington approval." In asking for a renewal of the project, AID's Senegal mission "disregarded key evaluation findings," insisting that the "project was sound in goal and purpose."[38] As usual in politics, spending money was more important than getting results. The same pressures that led to failure in Senegal are at work in almost all AID projects.

The Sahel agricultural projects relied on credit sales to poor farmers. As the AID inspector general noted, "The farmers, who were primarily subsistence farmers, were asked to put themselves in debt for a technical package which offered few short-term benefits for them. Although AID officials recognized this problem, no research was performed to correct it."[39] The credit programs were designed so haphazardly that interest rates were set largely by guesswork, with rates ranging anywhere from zero to 12 percent. Farmer demand for loans was less than anticipated, and of those farmers who did borrow, over half de- faulted. It was surprising that the default rate was not much higher, in that the farmers often received the impression that the loans were gifts that did not have to be repaid.

Most of the Sahel agricultural projects relied on extension services to spread the good news. But according to an AID report, "Almost no effort was made in any of the audited projects to determine whether the technical package was economically viable for the small farmers" who were intended to adopt it. The extension agents themselves were "totally ineffective." The report also noted, "In virtually every project we audited, these agents were found to be unqualified to undertake those responsibilities. Though every project paper emphasized the need for training, little or no substantive training was provided. Further, little or no guidance was provided to the agents."[40]

In many African countries, it has been clear that the success or failure of AID agricultural projects could be a life-or-death issue for the citizens. Yet, as is obvious from the AID inspector general's summary on the eight countries of the Sahel and from other reports, AID has bungled its relief efforts. African governments--with state marketing monopolies and policies that force farmers to sell their crops to the government at a loss--bear most the responsibility. (In some African countries, farmers are routinely shot for trying to sell their crops on the black market). Nevertheless, AID has continued to bankroll these governments, regardless of their pernicious policies.

The more foreign aid African governments have received, the worse they have tended to perform. As GAO noted, "The large number of donors and their administrative requirements place a considerable burden on recipient governments and strain their already weak administrative capacity."[41] A recent AID analysis noted:

Many African institutions officially responsible for planning and implementing development are saturated with development assistance, paralyzed by administrative inefficiency, staggering beneath a burden of complex and differing donor requirements, and are themselves in danger of becoming obstacles to development.[42]

Some African countries receive their entire investment budget from foreign aid. As GAO noted, "Governments, because of the importance of donor financing, are often more preoccupied with fund raising than structuring effective development plans."[43] As long as the foreign aid keeps pouring in, life will continue to be prosperous for the government employees who administer development programs.

Ample aid effectively allows governments to neglect reality. The World Bank observed, "African governments and donors continue to prefer new projects, especially new schools and hospitals, when the greatest urgency is to provide more resources to operate and maintain (and, increasingly, rehabilitate) existing projects."[44] Furthermore, "trucks no longer run because there are no spare parts and roads have become impassable; airplanes no longer land at night in some places because there is no electricity to light the runway."[45] Sixty-two percent of the farm tractors in Zambia are broken down owing to lack of maintenance or spare parts.[46] Government health clinics lack medicine, and schools lack textbooks and other supplies.

Despite all these failures, African civil servants continue to prosper. No matter how mismanaged the economy, the government can almost always find funds to provide raises for its employees. As one International Monetary Fund official assessed the effect of foreign aid on Zambia, "It is fair to say that what we have done is to allow Zambia to maintain a standard of living for its civil servants [whose payroll amounts to 20 percent of the country's gross domestic product] which is totally out of synch with the rest of the economy."[47] And no matter how far government extends its clumsy grasp over the economy, foreign aid donors keep pouring in the funds. In Zimbabwe, government spending has increased from 35 percent to 60 percent of the gross domestic product since 1980. Nevertheless, Reagan administration officials continue to boast that U.S. aid is encouraging positive economic reforms. In Zimbabwe, the Wall Street Journal recently noted, the media has been nationalized and the government now bans some foreign publications from entering the country.[48]

**Israel, Egypt, and Indonesia**

As part of the Camp David peace accords of 1978, the United States promised to give Egypt and Israel billions of dollars of aid to compensate them for forgoing the privilege of fighting each other. Total AID assistance to Egypt and Israel since 1978 exceeds $20 billion, with $5 billion in 1985 alone.

Aid to Israel helped finance the 1982 Israeli invasion of Lebanon, wage and price controls, subsidies for scores of inefficient government companies, and a make-work full-employment program custom-made to reduce productivity. The end result of these economic policies is a 400 percent inflation rate.

U.S. aid to Israel has consisted largely of general budget support, while aid to Egypt has more often been earmarked for specific projects. AID projects in Egypt are failing partly because the United States is simply giving too much assistance. GAO recently reported that AID project officers "believe that they do not have enough time with their heavy workloads to participate in project evaluations."[49] Like many U.S. domestic government agencies, AID is too busy spending its money to bother checking how the money is being used.

Despite receiving over $10 billion in U.S. aid, Egypt is still desperately poor. Egypt remains committed to government dominance of the economy, and the United States has made little effort to dissuade it from following wasteful economic policies. AID officials have not even documented the adverse effects of those policies--and thus have been unpersuasive when lobbying for reform. The Reagan administration's much-heralded emphasis on promoting economic-policy reform in Africa notwithstanding, AID is actually doing less policy analysis with respect to Egypt now than it was in 1983.[50]

AID has provided almost $200 million to help Egypt establish a domestic cement industry to enable the country to produce at home what it previously purchased from abroad.[51] The idea was that a domestic cement industry would save Egypt valuable foreign exchange. AID funds were channeled into a "public/ private" cement company, with cement production scheduled to begin in 1980. Hundreds of millions of dollars later, the fac- tories are still not producing, owing to construction delays, faulty machinery, inept labor, and dismal contracting practices. The company that was hired to construct one cement plant was so incompetent that its employees could not even read blueprints. Plant construction was slowed on account of a persistent shortage of hand tools for workers. The Egyptian construction company refused to sign contracts that would obligate it to complete tasks within a specified time frame, in order to avoid being fined for delays.

AID spent $24 million in Egypt over five years trying to construct 29 government-run and 10 private bakeries.[52] Egypt decided to decrease bread-production costs by centralizing bread baking, but the project was badly mismanaged: rather than hustling to build the bakeries, the contractor placed the original grant money in interest-bearing accounts. The first loaf of bread has yet to be baked in the AID bakeries. But even if the project had succeeded, the results would have been undesirable because the government would have driven scores of small private bakers out of business.

Over half of all U.S.-supplied vehicles at seven AID projects in Egypt have been stolen, or appropriated by Egyptian government officials or others for their own personal use, or have broken down and been left unrepaired.[53] AID auditors found nine fork-lifts (costing $132,000) in mint condition; the Egyptians claimed they could not afford the gasoline necessary to run the machines.[54]

AID projects in Asia suffer from the same problems as those elsewhere. Indonesia has received tens of millions of dollars in aid to build irrigation systems, with little or no permanent benefit. An AID inspector general's report concluded, "The Indonesian propensity [is] to view rehabilitation as delayed maintenance; why spend scarce budget funds to maintain irrigation works when a future donor will rehabilitate them with loan or grant funds?"[55]

In Central Java in Indonesia, the Citanduy project was barely finished before levees were cracking and overgrown with vegetation, flood-control structures were blocked with industrial waste, and farmers were making little or no effort to maintain the on-farm canal system. The project has been so bungled that over half a million dollars worth of AID-donated trucks and construction equipment has never even been used.

The Indonesian irrigation system ultimately failed because the farmers refused to support it. Farmers received no compensation for land seized by the government for canal construction.. There were supposed to be 224 water-user associations established to uphold the system and keep it functioning, but only 9 of these are active. The new associations, according to AID, were "resisted by farmers who have their own, long-established groups and who distrust government intervention."[56] Farmers objected to paying maintenance costs for canals badly built by government public works bureaucracies.

**AID--The Champion of Third World Business?**

Since the 1950s, American foreign aid rhetoric has stressed the need to develop business and private enterprise in the Third World. After 30 years of preaching the virtues of the private sector, however, the United States still directs most foreign aid to foreign governments, not private businesses. Furthermore, the aid that does go to businesses has done little to encourage free markets; foreign aid has yet to buy a single country a free market.

AID has a very liberal definition of "private sector" aid. In El Salvador, AID's Private Sector Support Program is paying for a price-checking unit in the government's central bank designed to regulate trade. The program also provides money to "support or maintain the institutional capacities of selected public . . . entities."[57]

AID has obligated over $179 million since 1976 to support the private sector in Egypt. However, a cursory examination of project descriptions shows that AID has some novel ideas about what that means. Part of its private-sector aid package provides money to the Egyptian government "to take equity positions in private-sector industrial projects."[58] Thus, AID is helping the private sector by giving money to the government to buy it out. Over one-third of the $32 million given to the Development Industrial Bank for private-sector support was reserved for aid to state-owned enterprises. AID also gave Egypt $33 million to set up a "Private Investment Encouragement Fund."[59] After five years, the program's only achievement was the hiring of a part-time executive director, a chauffeur, and two part-time employees. Not a single loan to private business had been made. Despite this dismal record, AID has not terminated the project.

Almost all AID private-sector funds are channeled directly or indirectly through the recipient country's government. The 1979 Chrysler bailout is the domestic equivalent of AID's Third World private-sector development. Some private-sector aid may eventually end up in private coffers, but only after political strings have been attached, and the money usually goes only to businesses with political clout. The result is not free markets but "crony capitalism"--money distributed to the friends and relatives of politicians.

Even at its best, AID private-sector assistance simply buys an industrial policy for the recipient government. AID helps decide which industries are to be developed, where factories will be built, and what prices will be charged for the final products. U.S. assistance thus promotes the kind of government direction of economic development that has been criticized in the United States by prominent economists of all political persuasions and that the Reagan administration claims to abhor. As development expert Melvyn Krauss notes, "There is only one way to privatize the economy, and that is to reduce the role the government plays. Foreign economic aid, because it represents government-to-government transfers, socializes recipient economies."[60] Even when it is ultimately ladled out to private businesses, foreign aid weakens the comparative position of the private sector by increasing the government's revenue and power.

Besides, AID is inherently incapable of efficiently aiding Third World businesses, possessing neither the capability nor the incentive to be a competent venture-capitalist banker. AID employees rarely have any training in banking, and they are unqualified to judge which firms might be creditworthy. Each AID country mission suffers from the usual government-bureau incentive to lend as much money as possible, for otherwise its budget for the following year will be reduced, and the staff's chances for promotion will diminish. AID employees are often promoted according to how many loans they make, not according to how many loans are paid back five years down the road. Thus, AID employees have no incentive to adequately investigate loan applicants.

AID assistance to Third World firms inevitably suffers from all the defects of Small Business Administration assistance to American firms. The SBA is infamous for its waste, fraud, and abuse; the Washington Post once scorned it as "a petty cash drawer" for members of Congress. The agency is a dumping ground for political hacks, and political pull determines much of the loan portfolio. Routinely, a business owner will make a large donation to a politician's reelection campaign, and the politician will repay the favor by pushing the SBA to give the donor a subsidized loan.[61]

AID's cheap loans and grants to businesses allow U.S. and Third World bureaucrats to pick winners and losers in village markets. This may be gratifying to the bureaucrats, but it breeds inefficiency in the Third World. When subsidized loans determine which businesses succeed or fail, businessmen spend less time on business and more time on politics.

**The Failure of Foreign Aid**

Foreign aid consists largely of one government "helping" another government by beefing up its budget, increasing its power over the private sector, and multiplying its leverage over its citizens. As economist P. T. Bauer observed, there is an "inherent bias of government-to-government aid towards state control and politicization."[62]

The marvel of foreign aid is that many of the same people who oppose government intervention in the United States somehow think we are doing foreigners a favor by paying for it abroad. Many of the people who recognize that Amtrak has been an expensive mistake have no objection to subsidizing state railroads in Africa. The same people who would fight any Department of Agriculture effort to impose ceilings on prices received by American farmers are silent about U.S. financing of African bureaucracies that burden African farmers with exploitative price controls. Some of the same congressmen who realize that federal irrigation policies squander billions of dollars worth of water are still enthusiastic about constructing government irrigation projects in Indonesia.

Foreign aid is based on the premise that foreign governments are devoted to their citizens' welfare--an assumption that is even less true of foreign politicians than of the members of Congress. AID projects in Guatemala have failed partly because some Guatemalan government officials oppose improving the plight of the rural poor.[63] A million people may have starved in the Sudan in 1985 because the government-owned railroad refused to transport American-donated food.[64] In Africa, where tribal rivalries often still prevail, AID money is used to prop up the reigning factions in the same way that local American political machines use federal grants as slush funds. Foreign aid greatly increases the patronage power of recipient governments. As Bauer notes, "The great increase in the prizes of political power has been a major factor in the frequency and intensity of political conflict in contemporary Africa and in the rest of the less developed world."[65]

AID officials often justify the agency's handouts by claiming that they persuade recipient governments to abandon pernicious economic policies. The idea seems to be that the United States must bribe foreign governments not to commit economic suicide. But few recipient governments have modified their economic policies in response to AID assistance. Poverty-stricken Burkina Faso imposed a 66 percent tariff on importation of animal-drawn plows and a 58 percent tariff on engines used for irrigation pumps.[66] In Zambia, the 1985 crop harvest was endangered because the "Zambian state corporation that collects agricultural produce can't afford to buy the bags it needs."[67] As the World Bank recently admitted, preaching about the virtues of free markets has so far had little effect on African socialism.[68]

Making U.S. aid conditional on policy reform also cannot work simply because AID is probably more anxious to give than Third World governments are to receive. Consider the case of Mozambique. In the last 10 years, Mozambique's Marxist government has thoroughly destroyed that nation's economy. The New York Times recently noted that Maputo, the capital of Mozambique, "lacks virtually everything."[69] Mozambican farm policies pay farmers only a tiny fraction of what their crops are worth, and they are largely responsible for a famine that killed 100,000 citizens in 1984. On the verge of being overthrown by pro-Western guerillas, the Mozambican government decided to make some modest economic reforms and see what the United States would pay. AID has rushed in with a $33 million bailout package, even though the country is still full of Cuban troops and Soviet advisers and is still socialist. The New York Times commented, "The American change of heart is apparently a result of Mozambique's readiness to accept American aid in its time of despair."[70] For AID, willingness to accept a handout is sufficient proof of a government's good intentions.

There is little that foreign aid can do that private credit cannot do equally well or better. As Bauer notes, "The maximum contribution of aid (to development) is the cost of borrowing that is avoided."[71] But the cost of avoiding interest payments on loans is the transformation of imported capital into a pork barrel for recipient politicians. The costs of politicizing aid are greater than the costs of interest payments on private credit. Going on international welfare is frequently as pernicious to Third World governments as going on Aid to Families with Dependent Children is for struggling American families .

At the same time that Third World leaders claim they are entitled to international welfare to overcome their countries' poverty, they often close their borders to foreign investors, thus greatly diminishing the amount of capital entering their countries. In 1960, foreign investment accounted for roughly 30 percent of the net flow of capital to developing countries. Now, despite a huge increase in foreign investment between industrial countries, it accounts for barely 10 percent of the net capital flow to the Third World. Foreign investment in the Third World in real dollars was lower in 1983 than in 1970.[72]

Many less-developed countries have effectively decided that they would rather stay poor than allow foreigners to share the profits of national development. Governments have expropriated foreign companies, prohibited them from remitting their profits, and cheated them with "official" foreign exchange rates that are simply a disguised form of expropriation. The Mexican government recently rejected a proposed $300 million joint truck-building venture with the Chrysler Corporation because the deal might have endangered the government's control over the Mexican automotive industry.[73]

A Wall Street Journal article recently noted, "In most developing countries, would-be foreign investors face a web of restrictions and conditions that would sour almost anyone." In Venezuela, for instance, "Stringent labor laws make it costly to fire inefficient workers. Corruption, red tape and delays abound; and the government frequently changes the rules of the game."[74]

Yet foreign investment under beneficial conditions would, in contrast to foreign aid, avoid saddling the recipient countries with hordes of inefficient government corporations or getting them mired in debt from government borrowing abroad. Foreign investment played a significant role in the early economic development of the United States, Australia, and other industrial countries. By bankrolling supermodern factories in Tennessee, Ohio, and elsewhere, foreign investment is helping reindustrialize the present-day United States.

Foreign aid is extremely fungible: every increase in outside donations frees up an equivalent amount of a recipient government's own revenue to be spent for other purposes. Many less- developed countries routinely squander their own money. Mobutu Sese Seko, president of Zaire, has amassed a multi-billion- dollar personal fortune and has built 11 presidential palaces. Ghana, Brazil, Kenya, and the Ivory Coast have spent billions building new capital cities. Mercedes-Benz automobiles are so popular among African government officials that a new word has come into use in Swahili to describe them: wabenzi--"men of the Mercedes-Benz."

Of course, not all types of foreign aid are automatically harmful. Private voluntary aid that bypasses a recipient country's political structures can help people in the Third World. The Peace Corps had good intentions, but it is now largely providing bureaucrats and technicians for foreign governments, thereby reinforcing political control over development. Rushing in medical supplies after a major earthquake or tidal wave can help the victims as long as it does not permanently increase the government's power or the people's dependence on politicians.

The question of whether foreign aid is generally beneficial or not ultimately comes down to the question of whether economic development should be undertaken by government or by the private sector. Perhaps the best answer was given in 1830 by British historian Thomas Babington Macaulay:

There are two or three principles respecting public works, which, as an experience of vast extent proves, may be trusted in almost every case. It scarcely ever happens, that any private man, or body of men, will invest property in a canal, a tunnel, or a bridge, but from an expectation that the outlay will be profitable to them. No work of this sort can be profitable to private speculators, unless the public be willing to pay for the use of it. The public will not pay of their own accord for what yields no profit or convenience to them. There is thus a direct and obvious connection between the motive which induces individuals to undertake such a work and the utility of the work.

Can we find any such connection in the case of a public work, executed by a government? If it is useful, are the individuals who rule the country richer? If it is useless, are they poorer? A public man may be solicitous for his credit: but is not he likely to gain more credit by an useless display of ostentatious architecture in a great town, than by the best road or the best canal in some remote province? The fame of public works is a much less certain test of their utility, than the amount of toll collected at them. In a corrupt age, there will be direct embezzlement. In the purest age, there will be abundance of jobbing. . . . In a bad age, the fate of the public is to be robbed. In a good age, it is much milder--merely to have the dearest and the worst of everything. . . . We firmly believe, that five hundred thousand pounds subscribed by individuals for railroads or canals, would produce more advantage to the public than five millions voted by Parliament for the same purpose.[75]

Our foreign aid has made life more pleasant and entertaining for government bureaucrats in poor countries. However, it has done little to promote the production of wealth, or to breed political responsibility, or to encourage people to help themselves. American foreign aid usually only strengthens oppressive regimes, allows governments to avoid correcting their mistakes, and bails out bankrupt state-owned enterprises around the world.

Regardless of our future good intentions, American foreign aid programs will still be controlled by politicians anxious to buy goodwill and administered by bureaucrats anxious to meet their quota of loans, and they will still be received by foreign governments careless of the use of free gifts. As long as the same political, bureaucratic, and economic incentives govern international welfare, the same mistakes will be repeated.

**FOOTNOTES**

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[28] Wall Street Journal, November 18, 1983.

[29] Providing Effective Economic Assistance, p. 18.

[30] Wall Street Journal, November 18, 1983.

[31] Providing Effective Economic Assistance, p. 37.

[32] Carol Lancaster, "Africa's Economic Policy," Foreign Policy (Fall 1983): 15.

[33] Ibid.

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