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Commentary
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The Perversion of Foreign Aid

Nick Eberstadt

THE ATTITUDE of the American people toward the world's poor, and toward our government's effort to attend to their distress, is seldom examined by those who frame our policies toward the international economy and the less developed regions of the earth. It is instructive, however, to listen to what the American people have to say.

Surveys of public opinion consistently show a deep concern about the plight of needy people in other countries—a concern higher among the public at large than among those groups pollsters designate as "public-opinion leaders." While attitudes about most other aspects of foreign policy tend to vary with the times, the public's interest in aiding the desperately poor has remained remarkably constant. In 1982, as in previous years, nearly 60 percent of the respondents polled by the Chicago Council on Foreign Relations said they viewed "combating world hunger" as a "very important" objective for the United States; only 5 percent felt it to be "not important." As in previous surveys, combating world hunger ranked far ahead of "protecting American business abroad," and even ahead of "defending our allies' security" or "matching Soviet military strength," as an international concern. Though these results may surprise some who consider themselves experts on foreign policy, they are not a fluke; to the contrary, they are in keeping with a wide range of findings from other polls.

combat hunger

Paradoxically, while the public's commitment to aiding the wretched of the earth gives all the signs of an unwavering consensus, its attitude toward foreign-aid *programs* appears to be thoroughly hostile. Since 1974 the Chicago Council on Foreign Relations has asked respondents to volunteer their views of "the 2 or 3 biggest foreign-policy problems facing the nation today." "Reducing foreign aid" is always one of the two top concerns. In these surveys neither the arms race, nor the threat of nuclear war, nor even relations with the Soviet Union has yet evoked the sort of response elicited by the idea of cutting foreign aid, which is by far the most unpopular program in the federal budget. In 1978—foreign aid's "best" year in the Chicago Council surveys—over four times as many interviewees favored cutbacks as approved of increases, leaving the program with a net rating of minus 39 percent. Even at the height of the disillusionment with the Vietnam war or on the eve of the "Reagan revolution," neither defense nor domestic welfare was held in such low esteem.

vs. reducing foreign aid

−39% lowest year

What can explain these strong—and yet apparently contradictory—feelings about helping the world's poor? One possibility is that they are only a specific example of a more general proposition: that the public's opinions about international problems are ill-considered, volatile, and vaguely irrational. But there is also a perfectly logical explanation for this ostensible paradox. The American public may think its government's programs for aiding the world's poor defective, or positively injurious. On this view, the stronger the public's commitment to the world's poor, the more forcefully it would reject programs that seem untrue to that commitment.

Interestingly enough, America's elites do not appear to share the deep misgivings of the public about U.S. foreign-aid programs. According to a number of surveys, the overseas-relief, development, and security policies which our people find so objectionable are considered utterly unexceptionable by our "public-opinion leaders." Such surveys typically indicate that leaders view foreign aid as a "non-issue."

This cleavage between the public and the opinion-makers is highly significant. At different times in American history the general public has come to an understanding about the world before its leaders. We are now at such a point. The American people seem to recognize an important fact about world affairs that continues to elude their leaders—namely, that the American government's efforts to bring relief, prosperity, and security to impoverished peoples in other countries have gone seriously wrong.

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II

The descent of our foreign-aid policies from their original purposes is a poignant story. Its outlines must be recounted, if only to recall how far we have strayed from our initial objectives and principles.

America's policies toward the international economy and the "backward areas" (as the "South" was then called) were fashioned, in the early days after World War II, by idealists whose vision had been tempered by hard times. America had suffered through more than a decade of economic depression, and had then spent four years embroiled in a war of total mobilization against anti-democratic regimes that had gained control over several of the world's major industrial societies. America's leaders were determined that such events not be repeated.

Their ideas for rebuilding the world economy were shaped not only by their understanding of the causes behind the Depression, but by their memory and understanding of the international economic order which had existed before World War I.

As they knew, and as economic historians have since confirmed, the late 19th- and early 20th century was an era of widespread economic growth —not only in sovereign or imperial nations, but in many colonies as well. This growth had been made possible by technical advances, but it was propelled by a dramatic increase in trade and international flows of private capital, which served as conduits for the transfer of information, productive knowledge, and skills.

Though the architects of the postwar order wished to rebuild this framework, there was to be a crucial difference. Before World War I a system of empires and colonies had provided the political underpinnings for the financial and monetary arrangements of the world. America's leaders, however, were anti-imperialist; before World War II and after it, they were proponents of decolonization and national self-determination. Thus, toward the end of the second war, American statesmen began to create a "liberal international order" in which it would be possible to have, in effect, both bread and freedom: to capture the most beneficial economic workings of the trade and finance arrangements associated with the "Age of Imperialism" and at the same time to protect the weaker peoples of the world against imperial subjugation and anti-democratic oppression.

The instruments devised to meet these objectives were, respectively, the Bretton Woods institutions —the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (the World Bank)—and the United Nations. In laying a base for international material progress, perhaps the more important of the economic agencies was the IMF. In theory, it provided a mechanism for the international convertibility of all members' currencies; in practice, it established the American dollar as the world currency, the new medium of international trade. This guarantee removed an enormous risk in international trade, one which had proved so dangerous between the wars for rich and poor regions alike.

Investment as well as trade had been a vehicle of international progress in the earlier era. The World Bank was to attend to some of the risks of putting private capital to work in poor or devastated areas. The Bank's Articles of Agreement outlined its mission succinctly: "to facilitate investment for productive purposes . . . to promote private foreign investment by means of guarantees . . . and when private capital [is] not available on reasonable terms, to supplement private investment." The U.S. Treasury Department, which would underwrite much of the World Bank's operations, had a similar understanding of its purposes. In the words of one analyst: "The Bank would encourage private investors to undertake international lending by guaranteeing international loans *through the usual investment channels* and by participating with private investors in such loans. ***In exceptional cases,*** where private capital is not available, the Bank would make loans out of its own resources" (emphasis added).

The key to improving a nation's access to international capital, the early statements of the Bank explained, was its "investment climate." This phrase is no longer in common usage, but its meaning remains fairly clear. It referred, if obliquely, to the economic and social policies promoted by the state—including its tax policies, its budget policies, its monetary and credit policies, its foreign-exchange policies, its trade policies, its public-investment policies, its legal system, and the extent to which formal and informal restrictions were placed upon people engaging in economic activity. The World Bank was, in these early days, extremely serious about the question of "investment climate." It went so far as to sanction a practice known as "strategic non-lending" —abstaining from participation in loans to certain nations, even if they appeared credit-worthy in the technical sense, because their economic policies were leading them, and the world community, in the wrong direction.

III

What was the right direction? In his last address to Congress, President Roosevelt warned that "we cannot succeed in building a peaceful world unless we build an economically healthy world." "Economic health," in Roosevelt's vision, depended upon both the international environment *and* the actions of individual countries. Even in regions of severe wartime devastation or acute mass poverty, recovery

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and growth were to be stimulated primarily by domestic effort. Roosevelt was firm on this point:

> The main job of restoration is not one of relief. It is one of reconstruction which must be largely done by local people and their governments. They will provide the labor, the local money, and most of the materials. The same is true for all of the many plans for the improvement of transportation, agriculture, industry, and housing that are essential to the development of the economically backward areas of the world.

Roosevelt and the men around him were not hostile to the idea of foreign aid. They had, after all, devised the Lend-Lease program, by far the greatest foreign-aid program the world had ever seen (over $200 billion by today's prices). It was their unshakable conviction, however, that foreign aid should meet exacting standards. Its purposes were expected to be clear, and morally legitimate; the programs that it fashioned should prosecute these objectives directly and effectively.

1st Effort

American relief efforts during and immediately after World War II were conditioned by this understanding, and proved eminently successful. Protracted war had destroyed the local economic base throughout Europe and Asia. In many areas, mass starvation seemed a real possibility; in the months after defeat, for example, Germany's infant-mortality rate was higher than Sahelian Africa's is thought to be today. To prevent a widespread loss of life, the United States had prevailed upon the United Nations to organize a Relief and Rehabilitation Agency (UNRRA). UNRRA was charged with providing "only those immediate relief needs which cannot be met out of the resources of the countries involved." Since it was understood that the danger of postwar famines was a temporary problem, and would resolve itself as civil order and economic activity resumed in stricken regions, UNRRA's mandate was explicitly limited. UNRRA made clear its intentions to pull out after the first adequate harvest in an afflicted country—and kept its word. By 1947 the threat of mass famine in non-Communist nations had been averted; for the first (and possibly last) time in the UN's history, an agency was disbanded after successfully meeting the problem it was created to solve.

UNRRA
Food
when hungry
disbanded

2nd
Marshall
Plan

The next great application of American public resources in foreign lands, the Marshall Plan, was likewise considered a resounding success. The "European Recovery Act" brought together a variety of heretofore disparate American concerns. In contributing to the restoration of the Western European economies, it created a natural bulwark against the imperialistic ambitions of our erstwhile allies, the Soviets; it strengthened the foundations of the postwar economic order, which would require larger markets and greater supplies of private capital than America itself could offer if the rest of the world was to be drawn rapidly out of poverty; and it satisfied the American urge to assist endangered peoples overseas who shared our ideals and values.

In retrospect it can be seen that the accomplishments attributed to the Marshall Plan—a venture originally undertaken as a gamble—may have inspired a certain confusion about the potentialities of foreign aid under less extraordinary circumstances. Its unique marriage of strategic, economic, and humanitarian objectives would later give rise to the notion that foreign aid *naturally* wedded these distinct, and often contradictory, concerns.

Strategic
Econ.
humanitarian

In addition, the rapid Western European recovery was to mislead proponents of aid about the pace of progress that might be expected in underdeveloped areas, since it was widely forgotten that Western Europe *was restoring* itself to prewar levels of production activity. And with the restoration of Western Europe's economic health, the actual role of specific Marshall Plan policies in advancing or retarding recovery and economic progress was quickly submerged. Today only a handful of economic historians seem to remember that some of the policies advocated by Marshall Plan administrators, and tied to Marshall Plan aid, seemed to lead to inflation, a diminution of local savings, and economic stagnation—or that West Germany's economic boom did not begin until after Konrad Adenauer and his finance minister, Ludwig Erhard, had repudiated and reversed the policies which Marshall Plan aid was financing in other Western European nations.

But led
to
inflation
low saving
stagnation

IV

3rd
Development
1949

"DEVELOPMENT ASSISTANCE" to low-income countries began in 1949, on the heels of the Marshall Plan. It was a new and radical idea in international relations. Unlike emergency relief, it was not framed in response to disaster. Unlike reparations, it was a state-to-state resource transfer prompted by volition, not indemnity. Unlike military aid or security assistance, it was not meant, in any immediate sense, to apply American will to distant regions of the earth.

Development assistance, as outlined in President Truman's Point Four program in his 1949 State of the Union address, reflected the American preference that other peoples avail themselves of the good things the 20th century had to offer, including the skills and knowledge which made mass affluence possible. It was consistent with our vision of the postwar world. The United States had already created an international monetary and financial system which could contribute to a nation's economic advancement. We were now stating our willingness to help interested governments move their countries into the international economic updraft that the new order had made possible.

The idea of such assistance—of fostering the competence of new governments to deal with their nations' economic problems—received an enthusi-

4 point prop-

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astic reception from the world community. By the end of 1949 the United Nations had unanimously endorsed an international plan of action modelled directly on America's Point Four programs, though more modest in resources and scope.

The leitmotif of development assistance in its first few years was the connection between the policies and actions of governments in poor nations and their economic consequences. This connection was taken to be inescapable and obvious. Alluding to the "shortage" of Western capital in the less developed countries—a problem that agitated many leaders in Latin America, Asia, and Africa at the time—Truman's Assistant Secretary of State for Economic Affairs observed that "the real decision must be made by these countries themselves, since only they can decide whether they want our capital to participate in their development. If they want it, they must, in turn, create the 'climate' to attract it."

climate

Nor was this perspective a matter of partisan dispute. Early in 1953, President Eisenhower's Assistant Secretary of State for Economic Affairs warned Congress that the limits on the effectiveness of our technical-assistance programs came from the attitude of recipient governments: "There is a strong tendency to build steel mills when the best economic interest of that particular country would be served by growing a little more food.... But the attraction of being self-sufficient, of having these monuments of industry . . . seems to be so great that we have difficulties in getting them to understand wherein their own economic salvation lies."

Development assistance as America envisioned it, unfortunately, was not quite what the new, nationalist elites in less developed countries were looking for. Regardless of their professed political ideologies, these new regimes were almost uniformly preoccupied with augmenting the power of the state apparatus under their control. To many stewards of new states in the 1950's, the goal of building state power seemed, indeed, to be threatened by the liberal international economic order the United States was promoting. An orientation toward international markets and free flows of foreign capital might remove vital decisions about national destiny from their hands. What seemed more in keeping with their desire to focus the national will through the medium of government was some system of central economic planning.

This approach to "nation building," later dignified by the title "development planning," was in fact an application and perfection of the techniques the combatant powers had used to marshall and apply resources against one another in World War II. Around the globe, poor societies in the 1950's were, in effect, putting themselves on a wartime footing. They were going long on steel and short on food; relying on trade where they must, but on autarky where they might.

Development planning by LDCs turned into national setting on a wartime basis - steel production autarky

The extent to which this emphasis on command planning clashed with the American conception of the function of development assistance was not immediately appreciated in the United States—where, after all, the popular preoccupation was with demilitarizing the economy as quickly as possible, and with disassembling wartime economic controls so that the tempo of civilian life might resume. If this conflict in time helped bring about a very large shift in American ideas, in the early 1950's such changes were still far off. The United States had not only firm principles, but clear operational rules by which to guide its foreign-aid policies. It attempted to separate overseas humanitarian aid from the economic interests of lobby groups at home. It made scrupulous distinctions between grants (which were charitable) and loans (which were to be commercial). Perhaps most importantly, it let it be known that there was a difference between military aid and development assistance, and that the demarcation was essential to the purposes and prospects of both programs.

Demarcation (1) Grant / loan-commerce (2) human ... (3) mil aid / ...

One by one, these precepts about foreign aid were to fall.

The first abrupt departure occurred in 1954, when Congress authorized the Food For Peace program. On the East coast, Food For Peace was justified as a humanitarian gesture by which American bounty could be put to the service of a hungry world; in the Midwest its workings were perhaps more honestly discussed. The champion of Food For Peace, Senator Hubert Humphrey, represented Minnesota, a state then beset by agricultural "overproduction." So long as the farmers' ability to produce outstripped the market's demand for their produce, competitive restructuring of the farming industry would be inevitable, and, just as inevitably, it would be small farmers who would be "restructured" off the land. These were Senator Humphrey's constituents, and the Food For Peace program, PL 480, addressed their problems. PL 480 would authorize the purchase of massive quantities of grain and other foodstuffs, subsidizing their sale in the markets of poor nations or giving food outright to governments.

Food for Peace PL 480

For American farmers, the immediate impact of PL 480 legislation was incontestably beneficial. For the poor nations, the consequences were more ambiguous. Heavily subsidized American imports very often drove down local food prices; while this might not have raised qualms in capitals intent upon forced-pace industrialization, it nevertheless caused problems in rural hinterlands, where standards of living were, typically, significantly lower than in the cities.

What is more, recipient governments often resold the food America gave them for cash, so that they could pursue projects that foreign lenders

Food turned into cash
loans repaid in local currencies
no need to value currency

6

had denied them as economically unwise. A concessionary device permitting recipient governments to repay "food loans" in their own local currencies relieved them of the pressure to value their foreign exchange realistically, with predictable consequences for both budget discipline and export incentives. (This also paved the way for several international economic panics, as when the Indian government suddenly discovered it owed the United States more rupees than it had in central reserves—and nationalized the entire private banking system to compensate.)

Perhaps most tellingly, only a tiny fraction of PL 480's allocations was earmarked for regions hit by famine or disaster. This fact was not lost on overseas observers, who had been warned by Marxists and other anti-Americans that the U.S. would export its own domestic economic problems and call the result charity.

II
Soft loans
1946
Brits.

The next radical deviation from principle came over the issue of "soft," or subsidized, loans. In 1946, American authorities had resolved that concessionary loans to foreign governments would have no place among the techniques of American statecraft; such loans, it was felt, would create a dangerous and needless confusion between charity and commerce. After our first soft loan, a large one to the United Kingdom to stabilize the sterling-based currencies, our National Advisory Council on Monetary and Financial Problems, which had sanctioned the offering, stated: "It is the view of the Council that the British case is unique, and will not be a precedent for loans to any other country."

Within ten years, soft loans were becoming a preferred vehicle for U.S. foreign aid. Soft loans seemed to vitiate the need for hard choices. Skeptical inquiries from taxpayers over specific projects could be deflected by assurances that the U.S. expected in time to be fully repaid on its principal. Foreign governments would hear that soft loans gave them great financial leverage, since along with the concessionary bequest the arrangement provided a large pool of working capital. Soft loans thus seemed to offer protection to those aid initiatives whose usefulness was most open to question; yet this naturally made the loans a magnet for precisely those proposals which were least justifiable and most likely to waste resources. If soft loans at this time seemed like a "cheap" way of paying for foreign aid, it was only because one of their major costs had been forgotten: their impact on beneficiary governments' conception of, and attitude toward, capital transfer from abroad.

Problem not taken seriously as loans

In 1948 the president of the World Bank had urged member nations not to fall into the trap of soft lending; by 1959, the idea of a soft-loan facility *at the Bank* was gaining acceptance; by 1961, this facility, the International Development Authority (IDA), was established under World Bank auspices, and with American blessings. Two decades earlier, a principal American proponent of a World Bank, Secretary of the Treasury Henry Morgenthau, had said that the institution he was proposing would "scrupulously avoid undertaking loans that private investors are willing to make on reasonable terms." IDA was true to the late Secretary's wish only in the sense that the sorts of projects it encouraged, and the terms that it financed, were generally unlikely to be attractive to private investors.

World Bank 1959
IDA

VI

The 1949-53 mil grants 1/6th
1953-61 1/2

THE MOST fateful departure from previously enunciated principles of foreign aid, however, concerned the separation of military and development assistance. The Eisenhower years saw a profound shift in American foreign-aid patterns. Between 1949 and 1953, military grants and political aid for beleaguered but friendly regimes had accounted for scarcely a sixth of our foreign aid; between 1953 and 1961 they made up over half our bequests.

Security assistance was a calculated response to a pressing problem. Shortly after the victory of the Communist armies on the Chinese mainland, Communist forces from North Korea attacked our allies in the South, and drew us into war. Strengthening the defensive capability of the states in our alliance system seemed the surest way to deter further outside attacks. There was also a widespread threat, in relatively open societies, of internal subversion by armed, and generally antidemocratic, domestic groups. Security assistance was to address this problem as well: it included not only military aid but police training, political advice, covert activities, and unrestricted financial bequests just to buy time (and thereby, with luck, political stability).

mil aid
police training
covert activities

Military/security assistance proved to be a highly effective program. With American aid, South Korea and Taiwan were able to secure themselves against potential enemies. Greece and Turkey were stabilized and strengthened, both militarily and politically. Insurgencies were suppressed in, among other places, the Philippines and Thailand. In Iran, a demagogue who was deemed anti-American was turned out of office, and the Shah (whom we took to be pro-American) was returned to the throne from which he had been deposed. There were many other, less heralded, achievements as well.

S. Korea
Taiwan
Shah

In the late 1950's and early 1960's, security assistance had widespread public support, while development aid was not nearly so well regarded. Hence, to win acceptance for their overall foreign-aid programs, American statesmen began to draw on the legitimacy of security assistance to protect, and even conceal, development aid.

The process began with a change in legislation: the 1953 Mutual Security Act, which for the purposes of congressional appropriations linked development aid to security assistance. Even so, the

1953 Mutual Security Act

not Bust U

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two programs were kept operationally—and conceptually—distinct. Eric Johnston, at the time Eisenhower's Point Four adviser, spoke for the administration when he said, "I think the Point Four program . . . should not in any way be confused with military aid to countries."

That distinction was lost during the Kennedy administration. President Kennedy went so far as to argue that development aid *was* security assistance, and therefore that advocates of a strong American security posture should support development bequests. As he put it: "I urge those who want to do something for the United States, for this cause, to channel their energies behind the new foreign-aid program to help prevent the social injustice and economic chaos upon which subversion and revolt feeds." The "new foreign-aid program" to which he referred was the Agency for International Development (USAID), the organization which supervises and administers America's development programs in less developed countries to this very day.

USAID set up to give development aid as "DA is security Asst" Kennedy

In attempting to broaden and strengthen the domestic constituency behind development spending, President Kennedy had, perhaps accidentally, fundamentally altered the understanding of what development assistance was supposed to be. No longer was it a transfer of skills and a building of basic infrastructure so that governments of poor societies might better take advantage of the economic opportunities afforded them by growing international markets. It was now a program to quell domestic discontent in low-income regions—linking aid to stability through a series of complex syllogisms which ultimately equated rising living standards with diminishing political opposition. This attitude, at once cynical and naive, suggested that counterinsurgency and the diffusion of agricultural research were part and parcel of a single process, differing only in degree. Given this view of the world, Vietnam was in one sense an accident only waiting to happen.

no longer changes in infrastructure SLDC but to quell domestic discontent

VII

EVEN twenty years after the start of rapid escalation, America's prosecution of the war in Vietnam remains a sensitive issue. Though we may still await a balanced and comprehensive account of America's strategies and actions in the Vietnam war, it is not too soon to point out some of the ways in which that war affected our development-assistance policies.

In the first place, development assistance came to be dominated by Vietnam itself. By 1966, that one country was receiving over 43 percent of AID's worldwide development grants, and a similar proportion of AID's talent, energy, and personnel was being applied to problems in Vietnam. The war, moreover, prompted a drastic change in the understanding of what development aid was all about. A violence-rent agrarian society, in which broad stretches of terrain were under the shifting control of contesting armies, was hardly suitable ground for the sort of technical assistance and private investments that the Point Four program had sought to encourage. Development policies had to be adapted, and on the spot; the mutations which evolved had little to do with self-sustaining growth or any of the other desiderata of an earlier generation of technical-assistance policies.

Vietnam 43% of AID

As the war proceeded, AID was drawn into such efforts as the "strategic hamlet" and the "civilian relocation" programs. While these may have served a justifiable military purpose, their economic results were almost the exact opposite of development—at least as that word had previously been understood. By feeding, clothing, and housing villagers who had been dispossessed from areas turned into "free-fire zones," the United States maintained, and often improved, their material living standards, but the economic base which might sustain these people was simultaneously being destroyed.

In subordinating economic objectives to military ones, AID exposed itself to the charge of "waste." In a technical sense, such allegations were valid—and indeed, had to be. The criteria for running a war and running a business are fundamentally at odds. Military effort is judged by its effectiveness in securing objectives; the economic efficiency of subsidiary operations is at most a secondary consideration, and the concept of productivity is, strictly speaking, irrelevant.

There was a greater, more overarching problem in Vietnam, which affected aid and everything else the American government was attempting. This was the notorious "credibility gap" separating our actual intentions, policies, and actions in Vietnam from the official descriptions of them. In allowing this gap to develop, the government encouraged the perception that our policies were considered illegitimate by the very men who were framing them. This could only have painful and continuing reverberations in a nation where domestic support for the international application of American power has so typically hinged on the moral purpose implicit in the initiative.

As distrust between the executive and legislative branches deepened over the conduct of the war, foreign aid became a battleground for a most unfortunate sort of guerrilla warfare. Frustrated by the direction of foreign policy in general, Congress resolved to restrict the government's ability to move economic policy in any direction whatsoever. Within Congress a tactical coalition arose between the "Left" (against the war) and the "Right" (against waste); separated by most issues, these two forces united in their hostility to foreign aid. They did not kill AID, but in retrospect, what they did do might have been worse.

By denying AID "obligational carryover authority," or the right to keep the use of money it had not committed by the end of the fiscal year; by

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subjecting AID to a process known as "Congressional Notification," which required the agency to produce two detailed budgets a year for congressional inspection, and in effect gave Congress a line-item veto over even comparatively small projects; and by requiring legalistic impact statements—often as many as 75—for even modest projects within programs, Congress severely restricted the ability of the agency to engage in "development," and forced AID administrators and project officers to shift their attention from the success of their efforts in the field to the success of their entreaties on the Hill. Sparing AID its institutional life, Congress guaranteed that the organization would be severely and permanently crippled.

VIII

THE efforts to paralyze AID were symptoms of a broader problem of the Vietnam and post-Vietnam era: American foreign policies had come to lack legitimacy in the eyes of a substantial portion of Congress and the public. A period of groping and confusion had begun, during which America's foreign economic policies in general, and foreign-aid policies in particular, broke away from the bipartisan principles which had been established in the early postwar years, and at a speed which sometimes suggested free fall. The events which derailed our foreign-aid policies were specific and discrete, yet in retrospect they seem to form a single, continuing chain of practical and moral errors.

In 1971 and 1972 President Nixon's foreign-aid proposals were defeated in Congress; funding for them was arranged only through a catch-all "continuing resolution" at the end of each session. To restore congressional confidence in the foreign-aid program, and in the presidential purposes behind it, a new code for American development programs was worked out. These were written into law in the Foreign Assistance Act of 1973 and the Mutual Development and Cooperation Act of the same year. At the time, these acts were described as a compromise. They read today as something very different.

The Foreign Assistance Act of 1973 states as directly as such legislation can that our postwar policies toward poorer nations had been a failure: "The conditions which shaped the United States foreign-assistance program in the past have changed. . . . [O]ur relations with the less developed countries must be revised to reflect these realities." The problem, it was suggested, was that the strategy of export-oriented, self-sustaining growth which we had advocated since the 1940's did not actually benefit the common people of the countries it transformed: in the words of the Mutual Development and Cooperation Act, "economic growth does not necessarily lead to social advancement by the poor."

The Foreign Assistance Act implied that American power abroad had been secured through alliances with local leaders who had little interest in the welfare of their own public. Hence, the new American approach to foreign aid "should be . . . targeted on the basics"—meaning that it should be judged by its direct and immediate impact on the living standards of the poorest strata of the recipient nations. "Through the restructured program the United States would be telling the developing countries . . . 'Do not forget the immediate needs of your poorest people.' . . ."

The "reforms of 1973" had sweeping consequences for American development efforts. In establishing "basic human needs" as the ultimate arbiter by which development would be judged, they shifted the purpose of AID from assisting self-sustaining growth to affecting living standards through emergency-style distribution of outside food, medicine, clothing, and materials for shelter. These "basic human needs" stipulations came on top of the operational restrictions which had already been imposed on AID, with their implicit bias against development proposals with deferred benefits or with consequences principally measured in efficiency or productivity.

Thus, American bequests increasingly came to be seen as a means of facilitating a steady flow of funds to the governments of less developed countries for use in whatever purposes they might choose. Though AID administrators could argue that their grants were "tied" to various purposes or conditions, local leaders generally understood the simple truth that, once received, government revenues were fungible—transferable from one objective to the next—and that aid bequests would become all the more fungible when meant to be applied to an operating budget.

There was a final notable aspect of the legislation of 1973: the explicit purpose of development-assistance programs was rewritten in a seemingly slight but nonetheless significant way. Provision 102(a) of the Foreign Assistance Act of 1967 had read: "Development is primarily the responsibility of the people of the less developed countries themselves." In the 1973 legislation, the equivalent passage read, "Development planning must be the responsibility of each sovereign nation." With this semantic change, America was retreating from the concepts of economic health and self-sustaining growth and implicitly repudiating the notion that international markets and free flows of private capital should serve as the instruments by which people might raise themselves to mass affluence. Instead, we had come to endorse, ~~and seemingly~~ to require of recipients of our aid, adherence to the very system of comprehensive planning which our leaders had decried as ~~inimical to the interests~~ of poor peoples scarcely twenty years earlier.

The "reforms of 1973" (also known as the "New Directions" legislation) may yet be hard fully to evaluate, but it is clear that they have had at

Transfer without control: Private, U.S., Multilat,

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least one effect. Before Vietnam, the United States could point to a number of self-reliant and prospering economies—Greece, Taiwan, and South Korea among them—which had "graduated" out of American development aid. Since the "reforms of 1973," there have been no new graduates.

IX

THE decoupling of American development assistance from the policies which had previously been regarded as the best means for improving the economic health of poor nations also bespoke a loss of faith in the United States. It was no longer naturally assumed that American interests and preferences, pursued in practical fashion, would benefit the peoples of the world. To serve the weak and helpless of the earth, Americans were now advised to restrain themselves and their impulse to international action. The United States was urged instead to assist with the one thing it had which poor governments manifestly lacked: money.

As American-administered development programs took on the trappings of relief work, and as the terms "development aid" and "reparations" came to be used interchangeably (in 1973 Nixon administration officials had secretly discussed post-war "development aid" proposals with Hanoi), there arose simultaneously a tendency to give aid through international institutions rather than channeling it directly from our government to the beneficiary capital. Through "multilateralization," it was argued, donor "pressure" on recipient governments might be made to diminish, even as aid outlays were made to rise.

The multilateralization of aid was made easier by the impressive growth of the World Bank under Robert McNamara, the former U.S. Secretary of Defense who had left the Defense Department around the time of the Tet offensive to assume the Bank's presidency. As admirers testified at his retirement in 1981, he oversaw a tenfold increase in the Bank's annual commitments. McNamara accomplished this remarkable feat by reinterpreting the Bank's mission, and its operating rules.

The Bank's Articles of Agreement specify that bank funds must be used for "productive investment"; they neglect, however, to qualify the sorts of spending which may be *labeled* productive investment. McNamara took command of the definition of the term. A growing body of economic research was detailing the connection among education, productive knowledge, and economic growth; the results suggested that augmenting "human capital" was as integral to economic development as was deepening the base of "physical capital." McNamara used this research to argue that health, nutrition, education, family planning, and other social services were in fact investments, and thus legitimate avenues for the application of Bank funds.

While the prerogative for lending was being expanded, the standards for evaluating loans were simultaneously being relaxed. McNamara outlined the Bank's new view of lending in 1970: "What contributes the most to the development of the borrowing country should be the decisive factor in both Bank and IDA operations. . . . Any policy which can be justified for IDA as consistent with its development function can, I believe, be equally justified for the Bank, and the Bank itself should adopt it." Since IDA was in the business of dispensing "soft" loans—"of doubtful validity," as David Baldwin pointed out nearly twenty years ago, "by any measured banking standard"—a large pool of capital was being declared exempt from the scrutiny which private loans must customarily withstand.

McNamara's efforts to expand the Bank's financial involvement in less developed countries, while relinquishing some of the rights (and obligations) traditionally assumed to be incumbent on portfolio managers, was consistent, in some ways, with his view of the problems facing the poor nations, and the world. Like many of his contemporaries in Congress, McNamara felt that international development efforts had largely failed the poor. As he told the delegates of UNCTAD III in Santiago, Chile in 1972: "Development programs have been directed largely at gross economic goals, and have failed to insure that all nations, and all groups within nations, have shared equitably in economic advance." The Bank's new "basic human needs" (or "social investment") programs were informed by that opinion.

McNamara had decided that an ongoing "global transfer" of public funds would be necessary to meet the problem of world poverty. In his words, "the rich countries have a responsibility to assist the less developed nations. It is not a sentimental question of philanthropy. It is a straightforward issue of social justice." The idea of unconditional concessionary transfers from Western people to low-income governments was echoed and amplified by a number of officials who rose to prominence in the Bank during the McNamara years; they gave form to McNamara's more vaguely stated notion through their support of "global negotiations" for the expanded and unrestricted transfer of money from the governments of the "North" to the governments of the "South."

Like many other large institutions, the World Bank has never spoken with a single voice or acted as if by a single hand. Nevertheless, the change in direction during the McNamara years was unmistakable: the felt obligation to provide money to poor nations was growing; the right to monitor its disbursement was more and more open to question. The World Bank had come a long way from the Bretton Woods conference, when Secretary Morgenthau introduced it to the world with these words: "The chief purpose of the International Bank for Reconstruction and Development is to

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guarantee private loans through normal investment channels."

Some observers have seen in McNamara's initiatives at the World Bank a sort of expiation for presumed pangs of conscience over his prosecution of the war in Vietnam as Secretary of Defense. A less sentimental and more straightforward interpretation might be that the McNamara initiatives simply formalized, and globalized, the new development policies that the United States had experimented with in Vietnam. In any event, the two were characterized by the same effort at divorcing the living standards of national populations from the productive base which would ordinarily be expected to sustain them.

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THE multilateral institution which most effectively divorced development funding from the "pressures" of donors, however, was not the World Bank but the United Nations. The story of what happened in, and to, the United Nations over the past two decades is by now a familiar tale. During the 1960's, a voting bloc began to form which defined itself by opposition to American policies in Vietnam. It soon became clear that this bloc was opposed not simply to America's war in Vietnam but to American purposes in the world generally, and to the very idea that America should be a country wielding international power. A psychological barrier was crossed in 1970, when this bloc—self-described as "non-aligned"—succeeded in outvoting the U.S. and its allies on an Albanian resolution to recognize Beijing rather than Taipei as the legitimate seat of Chinese government. Thereafter the bloc grew, both in numbers and boldness, until it became the decisive force in framing UN policy.

The apparatus of development organizations which had been erected beneath the UN flag was inevitably influenced by the new thinking in the General Assembly. It had often been said that the International Labor Organization (ILO), the UN Educational, Scientific, and Cultural Organization (UNESCO), and the host of other UN agencies became "politicized" in the 1970's; it would be more accurate, however, to say that they simply became suffused with a *new* political ethos—one which, as it happened, was hostile to the meanings of the UN Charter, to the previous purposes of the organization, and to the principles of the Western peoples who provided most of the UN's monies.

The UN's new agenda followed largely from the same line of thought that led to the accusation —enunciated by President Salvador Allende of Chile before the same UNCTAD audience where McNamara professed the failure of Western-sponsored development efforts—that the industrial nations had created a world where "the toil and resources of the poorer nations pay for the prosperity of the affluent peoples." In logical fashion, and in strikingly consistent measure, the new development initiatives emanating from the UN were aimed at disassembling the liberal international economic order and in augmenting instead the capacity of states and the authority of their leaders to plan their local economies and to direct their people's societies—and to pay for these therapies with renewed "global transfers" of tax revenues from the Western nations which had supposedly made the cures necessary in the first place.

Although there was little intellectual or (in the strict sense of the word) economic merit in most of the new thoughts circulating through the UN during the 1970's, it must be remembered that Western nations put very little pressure on advocates of the New International Economic Order to think more clearly or act more decently. The acquiescence of the United States was especially striking. For seven years—from 1970 to 1977—America made virtually no concerted effort to come to the defense of either its national interests or its principles in any of the UN's many forums. (The attempts of Daniel P. Moynihan, in his brief eight-month tenure as Ambassador, to force a government response to the anti-American invective by then commonplace at the UN, stood in contrast to the accepted policy of the day but did not alter it.)

America did not lack a foreign policy during the early 1970's. On the contrary, from 1970 to 1977 American foreign policy was more fully controlled, and more intricately directed, than it had ever been before, or has been since. Though Secretary of State Henry Kissinger privately—and occasionally publicly—disagreed with the UN's new development thrusts, he seemed to have felt that they were best parried through accommodation. His major speech on development issues, an address to the General Assembly in 1975, highlighted his general attitude. In the course of his exposition he made many references to the need to strengthen free and competitive international markets, but he also proposed a new concessionary window at the International Monetary Fund from which only Third World nations might draw loans and which would allow for the conversion of these IMF loans into "grants under prescribed conditions." Such plans could only diminish considerably the IMF's ability to lobby credibly for economic responsibility with those nations which applied to it for loans; they were also bound to stimulate international inflation at a time when global inflation was already punishing rich countries and poor alike.

Kissinger also proposed new "bilateral support for training and technical assistance to help developing countries find and exploit new sources of fossil fuel"—a striking suggestion from a U.S. Secretary of State, considering that the greatest technical capacities for oil exploration and develop-

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ment resided in the American energy companies then being nationalized throughout the Third World. He further recommended—less than two years after the politicization of oil prices by the OPEC cartel—that "a producer-consumer forum be established for every big commodity," the inevitable result of which would be to sanction the setting of commodity prices by political contrivance rather than economic demand.

For the poor nations, in the meantime, there were no special offers to aid them in learning the ways of the world's markets; there was, however, plenty of help should they experience the usual side-effects of "development planning": a guaranteed disbursement of 10 million tons of food aid a year; a new IMF facility for "emergency" balance-of-payments problems; and "population assistance" to "help curb demographic growth" and thereby, presumably, take pressure off the economic structure to produce efficiently.

In the United Nations, as in so many other arenas, Kissinger presumably hoped to throw his opponents off guard by agreeing to their demands in principle, and then to win the day by rear-guard negotiating tactics. This ploy, however, is considerably less effective when the issue at stake is the principles themselves.

XI

THE period of drift and decline in American policies toward the world's poor continued under President Jimmy Carter. Elected in 1976 on a campaign promise to restore moral purpose to American politics, Carter seemed to find it extremely difficult in practice to determine whether any use at all of American power overseas was in fact moral. The administration's sensitivity to criticism on this score, and its ambivalence about American purpose, were highlighted in its foreign-aid policies.

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The administration enthusiastically embraced the 1973 "reforms," with their seeming evidence that America was interested in directly aiding the world's poor. It created the International Development Cooperation Agency (IDCA)—an umbrella organization above USAID—to remove development-assistance programs from the direct chain of command within the State Department, and thus to shield the United States from charges that it was using foreign aid to further America's purposes of state. It agreed to a continuing cutback in military and security assistance, since (it was argued) these monies might be used for questionable or even inhumane purposes by our chosen allies.

The Carter administration also commissioned two major studies of world poverty. The first, the Presidential Commission on World Hunger, warned of "the continuing deterioration of the world food situation." It stated that "corporations sometimes badly undercut efforts to alleviate hunger and malnutrition," and equivocated about the extent to which international trade might help reduce hunger. Rather, the report explained, "redirecting income from the rich to the poor" would be a principal vehicle for reducing hunger in poor nations, and foreign aid could figure importantly in this process. Among the recommendations of the commission were a "total" debt forgiveness for the "poorest" developing countries; an easing of IMF lending conditions; an immediate doubling of U.S. development outlays; an increase in "Food For Peace" authorizations and a relaxation of the conditions for disbursing such produce; the promotion of a United Nations code to regulate international businesses operating in less developed countries; and the establishment of a public organization in the United States to lobby for these goals.

The second study, the "Global 2000" report, warned of an impending and generalized series of environmental problems born of overly rapid population growth in the less developed countries and excessive economic growth in the affluent nations. One implication of this computer-model study was that the sort of sustained economic advancement which would be necessary to draw the world's poor countries out of mass poverty might seriously destabilize the fragile global eco-system, possibly causing ruin for all. By seeming to question the feasibility of continuing economic growth, "Global 2000" led some observers to conclude that the only viable way to assist poor nations was through the transfer of existing wealth from the Western states.

Without fully realizing it, the Carter administration had thus ended up accepting as counsel in dealing with the less developed countries many of the basic tenets of the United Nation's proposed New International Economic Order. What did not seem to be entirely understood was that the New International Economic Order was a call for the liquidation of the liberal international economic order which America had helped to create, and continued to lead.

XII

RONALD REAGAN's decisive victory over President Carter in 1980 seemed to presage more than just a shift in attitudes toward the use of American power on the international scene. The Reagan administration came into office with an articulated, and internally consistent, vision of America's political and economic role in the world. This vision had implications not only for the international political struggle between the United States and the Soviet Union, but also for American policies toward the world economy and toward development.

President Reagan's critics were quick to brand him a reactionary; there was some accuracy in this characterization, albeit inadvertent. More than

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any President in a generation. Ronald Reagan explicitly embraced the precepts which had guided the foreign economic policies of Presidents Roosevelt and Truman. He emphasized this return to earlier principles in a major speech on international economic development in Philadelphia in October 1981.

"Economic health" was the theme underlying the President's prescriptions for promoting international advancement. There was, he said, a "need to revitalize the U.S. and the world economy as a basis for the social and economic progress of our own and other nations." At the same time, there was "a need for a clearer focus on the real meaning of development and our development record." "The postwar economic system," he asserted, "was created on the belief that the key to national development and human progress is individual freedom—both political and economic."

President Reagan identified five principles by which development might be encouraged:

> First, stimulating international trade by opening up markets, both within and between countries; . . .
>
> Second, tailoring particular development strategies to the specific needs and potential of individual countries. . . .
>
> Third, guiding assistance toward the development of self-sustaining productive capacities. . . .
>
> Fourth, improving in many countries the climate for private investment. . . .
>
> Fifth, creating a political atmosphere in which practical solutions can be moved forward—rather than founder on a reef of misguided policies that restrain and interfere with the international marketplace or foster inflation.

Development assistance, in the President's vision, was to be put to the service of these principles. He promised to "work to strengthen the World Bank and other international institutions," and pledged to make available American technical know-how, food, and money "toward the development of self-sustaining productive activities" in poor nations. The President's words suggested that a dramatic change—or more properly, a historic restoration—of American policies was under way.

The Reagan's administration's actions, however, suggested something quite different. Instead of bringing America's foreign-aid policies back into alignment with the goals and ideals that had originally animated them under Roosevelt and Truman, the Reagan administration allowed American programs to continue down the path which had been charted in the 1970's. So smooth, in fact, was the trajectory that it would be difficult to tell which administration was in power from the statements and actions of its development apparatus. No less than during the Carter years, American development programs under Reagan seemed to be at systematic variance with the objectives of the international order we nominally supported. The administrators of these programs, moreover, appeared increasingly intent upon concealing the discrepancy from the American public.

XIII

THE principal spokesman for the Reagan administration's development programs has been its acting director of IDCA and administrator of AID, M. Peter McPherson. Mr. McPherson made clear his perspective in his first presentation before the House Foreign Affairs Committee in 1981. "We have learned," he said, "that continued progress in Third World development is of growing importance to our own domestic and international well-being. In the past year, public awareness of our interdependence has been highlighted by the Presidential Commission on World Hunger, the Brandt Commission [a panel of inquiry, created by Robert McNamara and headed by former Chancellor Willy Brandt of West Germany, that advocated "massive" and "automatic" transfers of revenue from Western governments to "Southern" states] and the 'Global 2000' study." Embracing the findings of these reports, he instructed the congressional committee on their significance: "Failure to make acceptable progress in ameliorating conditions of poverty can only lead to domestic instability and increasing frustration on the part of Third World governments over the workings of the international system and the distribution of economic and institutional power in that system as it is now constituted." To observers of the North-South "dialogue," the device of wrapping a request for aid in a veiled threat may have been familiar, but in the deliberations between appointed representatives of the executive branch and elected representatives of the American people this procedure was something quite new. It had not been seen under President Carter.

To move American development programs back to the stimulation of "self-sustaining productive capacities," as the President had pledged, it would have been necessary to challenge the "New Directions" legislation of the 1970's. AID made no effort to do so. Two years into his appointment, and again before the House Foreign Affairs Committee, McPherson may have suggested why. Reflecting on the early 1970's, he remarked:

> The political, social, and economic structure which had evolved in many less developed countries had produced little improvement in economic well-being for the poor of those countries. To help correct this situation, a new concern with the effects of our assistance on the poor majority emerged a decade ago, in the form of the current New Directions legislation [of 1973].

This was an implicit endorsement, not only of the legislation but of the analysis which had prompted it. That analysis, of course, held that the postwar order America had created could not be relied upon to advance the interests of the world's poor.

In 1983, in an aid request, McPherson told Congress that "trade and debt pressure is particularly serious for stability and longer-run economic progress in the low-income countries. . . . Our foreign-assistance program can play an important role in their recovery." It was a revealing analysis. The problems to which he referred were both financial (relating to balance-of-payments shortfalls) and short-term (being exacerbated by a presumably cyclical drop in international economic activity). But development programs, as generally imagined, involve technical transfers and long-term horizons. A "development program" could play an important role in a short-term economic recovery only if it were intended to infuse monies directly into a pool of current spending.

AID's presentations left little doubt about the Agency's view of the propriety of direct budgetary transfers. An AID policy paper on health assistance, for example, noted that "by 1982, one half of the Agency's development assistance budget for health supported the delivery of basic health services in LDCs." Such "development-assistance" is, necessarily, a direct bequest from the U.S. Treasury, applied to the operating revenues of recipient states. Whatever may be said of such charitable donations, they are in no sense "self-sustaining."

CONFUSION over the distinction between recurrent expense and productive investment likewise marked AID's agricultural program. The agency's Fiscal Year 1983 presentation to Congress proposed to increase agricultural productivity in the less developed countries through the following activities:

> supporting land tenure arrangements and agrarian reform policies; encouraging small farmer organizations and local participation; disseminating and developing new technologies; protecting the environmental and natural resource base through better land management; halting and reversing deforestation by developing renewable energy alternatives to firewood, testing fast-growing tree species, and supporting woodlots for fuel; increasing the availability of water, improved seed, credit, and other agricultural inputs at reasonable prices; reducing post-harvest food losses; and facilitating small-farmer access to markets.

In this conspectus of agricultural productivity, only one item seemed to be missing: any mention of the prices paid to producers. Yet it is prices, unfortunately, which often prove decisive in the success or failure of agricultural development, determining as they do the returns which may be derived from increasing production or adopting innovations.

The President had suggested that misguided policies played an important role in perpetuating poverty in the less developed regions; his AID administrator expressed a very different view. In 1983, McPherson told Congress that "the critical problem of excessive population growth in the Third World . . . constitutes the primary obstacle to increasing per-capita food production, reducing malnutrition and chronic disease, and conserving dwindling non-renewable resources." This formulation, with its implication that parents in less developed nations irrationally choose "excessive" numbers of children, could be understood as excusing governments in those nations from responsibility for agricultural difficulties, hunger problems, or the management of natural resources. It also appeared to lend legitimacy to governmental efforts to control population growth.

AID had maintained that it would only condone voluntary family planning. But even as a position paper to this effect was being circulated publicly, the agency was participating in a $50-million grant to China from the UN Fund for Population Activities. China was pursuing a population campaign known as the "one child norm," requiring parents to agree to have only a single offspring. The campaign appears to have been horribly unpopular with the overwhelming majority of the Chinese people, and the Chinese government found it necessary to use pressure, threats, and far-reaching punishments against married couples to enforce the decree. (Many infant girls and ablebodied women are thought to have died as a result of this program.) Since most of the funding in which AID participated was earmarked for Chinese "population education activities" and for health clinics (at which quotas of sterilizations and abortions were being fulfilled in accordance with the population plan), it would have required extreme mental agility to dissociate the Reagan administration's development money from the practice of involuntary population control.

Still another area in which AID seemed to disagree with received American policy was on the issue of private enterprise. AID is committed by law to refrain from using its funds to displace private investment or private commercial activity. Despite this, AID's 1983 budget presentation before Congress stated that, since energy "has become a field of major concern to AID," the agency had "increasingly broadened its assistance to encompass technical assistance to expand indigenous supplies of coal, oil, and gas. . . ." The projects involved were not described, but it would seem difficult to reconcile these activities with AID's legal mandate.

The question of private enterprise, and its legitimate scope within development, seems to have troubled AID administrators deeply during the Reagan years. One attempt to resolve the issue was the creation of a Bureau of Private Enterprise. In a sense, however, this only compounded

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the problem: for the first time in its history, AID was formally and explicitly separating the job of encouraging private commerce from its overall responsibilities in promoting "development." Moreover, the private-enterprise initiative did not have enthusiastic AID backing. In its heyday it was allocated $27 million; since then, its funding has declined. Although no other program receives such extensive coverage in AID's annual budget presentation before Congress, the private-enterprise initiative now accounts for something less than one-half of one percent of AID's expenditures.

Recently, it is true, AID statements and publications have begun to express formal support for the liberal international economic order. But if the tone has changed, AID's priorities have not. In 1984, a top-level internal document on strategy and objectives for a second Reagan term proposed that AID's mission be redefined to include the following goals: the raising of life expectancy in all developing countries to over 60 years; the reduction of infant-mortality rates in all developing countries to 75 per thousand, or below; and the increase to 70 percent of literacy rates in all developing countries. As the draft noted, this change in mandate would require a "renewal" in America's commitment to development funding; indeed, to follow through on such a program in a world where recipient governments maintain sovereign authority over their economic and social policies, this renewed commitment would have to be not only major but virtually open-ended.

This internal AID document contained a number of formal concessions to the notions of "self-sustaining growth" and "policy reform." Yet as it was outlined, AID's plan for promoting development would not emphasize policies to create self-sustaining growth or to encourage conditions by which living standards might undergo an internally generated transformation; it would, rather, concentrate on the direct and restitutive redress of poverty through social spending. If the rhetoric of the Carter commissions and the Brandt commission had been carefully airbrushed out of AID's public statements in the 1984 election year, such thinking was still clearly acceptable in the inner recesses of the Reagan administration's development apparatus.

XIV

It may be useful to conclude with a look at the effect of recent American foreign-aid policies on a single nation: El Salvador.

To be sure, even by the variegated standards of the developing nations, El Salvador's problems are not "typical." Among other things, the country is caught in a bloody war between government forces and Communist-supported troops, a war which has resulted in both severe destruction and massive emigration from this little land. But it is precisely the exceptional quality of El Salvador's circumstances as a small country which needs American help badly, is receptive to American advice, and is the object of a major strategic and financial commitment, that makes it an illuminating case for the study of American foreign-aid efforts in general.

El Salvador is, first and foremost, a country at war. Economic development is unlikely to proceed there unless civil order is restored, so that a climate free of undue physical risk to investment and commerce may assert itself. Such problems would seem to be best addressed by "security assistance." The Reagan administration, however, has been extremely cautious in extending military aid to El Salvador, preferring to restrict it to a plausible minimum while increasing quite freely the funding for "development assistance" and "economic support." As late as 1983, two years into the Reagan administration's escalated commitment to El Salvador, the ratio of "development" to military aid for that nation was on the order of 3:1—this, at a time when American military advisers in El Salvador were explicitly asserting that the security-assistance bequests were inadequate for the tasks at hand.

That is a highly problematic approach. In the midst of war, investments in infrastructure or American-sponsored local projects are unlikely to promise high rates of return, especially since the projects themselves may well become targets for destruction or disruption by guerrilla forces. By the same token, "economic support" to cover balance-of-payments problems would seem ill-suited to the difficulties stemming from such symptoms of wartime deterioration as capital flight and the destruction of export industries.

Constraining military aid during a state of war—providing some, but not enough to win—can only be considered a false economy. Providing economic aid *instead of* military aid in wartime makes still less sense. Such bequests may cushion the decline in living standards that fighting, disruption, and uncertainty inevitably bring, but they are unlikely either to bring fighting to an end or to restore the political stability upon which self-sustaining growth must ultimately rest.

American economic aid to El Salvador has necessarily addressed the problem of feeding and providing for refugees, as it did in Vietnam. Under emergency conditions such bequests serve both political and humanitarian ends, though they make little contribution to "development" as such. But AID was also involved in programs to bring long-term economic change to El Salvador, foremost among them land reform.

After the coup against the old oligarchy in 1979, El Salvador's new junta determined upon a major redistribution of the nation's heretofore highly concentrated land holdings. This program

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was to be a sort of "land to the tiller" reform. The large plantations would be broken into small parcels, to be owned by the *hacienderos* who had worked them; in smaller estates ownership would eventually devolve on those who had farmed the fields. In this way, it was thought, El Salvador's farmers might be converted from landless tenants and day-laborers into a class of landowners—possibly even into a middle class.

AID involved itself in these reforms at the Salvadoran government's request under President Carter, and seemed to take an even more prominent role under the Reagan administration. The plan for "Phase III" of El Salvador's land reform (which was to give title to some 60,000 families from the smaller estates) was drawn up by American consultants, and paid for by the Reagan administration. True, legislation sponsored by Senator Jesse Helms prevented the administration from paying directly for El Salvador's land reform by prohibiting the use of aid monies for compensation of confiscated agricultural or banking enterprises. In practice, however, such strictures had little effect on the land-reform program, given the realities of fungibility at a time when American aid was rapidly increasing.

To Americans, the phrase "land reform" often evokes images from our own agrarian past. But the policies America supported and promoted in El Salvador bore little correspondence to the Homestead Act. El Salvador's first step to land reform was the creation of the Salvadoran Institute for Agrarian Transformation. This institute expropriated the nation's large plantations, compensating former owners with government bonds which could not be redeemed until the end of the century, and then only at their nominal face value, unadjusted for intervening inflation. The deeds from these estates, moreover, were not turned over to individual peasants or their families; instead, the land was deeded directly to newly formed "cooperatives," certified by the Institute. With no title of their own, peasants could not sell their holdings, or transfer their interest to a different cooperative. Voluntary association was thus impossible; a peasant's only options under the new system were to remain with his cooperative or to move and forfeit everything.

With no title of his own, the new "landowner" could also not raise credit against his holdings. Credit was only to be raised by the cooperative's management committee, and was to be allocated as the management committee determined. A peasant's chances of receiving credit thus depended largely on his role in fulfilling the plan which the management committee drew up. Since each committee had a representative of the government on its board, and since credit was now allocated to the cooperative by the central government, the new arrangements made *hacienderos* more sensitive to agricultural directives from the capital than they had ever been in the past.

The title program for the smaller estates, the so-called Phase III of land reform, was also managed by the Salvadoran Institute for Agrarian Transformation. As with the hacienda reforms, title to land did not devolve clearly and directly to the peasants. Once arrangements were settled (and this itself often proved a long and difficult matter) peasants would obtain an eventual title to their parcel—so long as the head of the household continued to live and farm on it for the next thirty years. In the meantime they would not be able to raise credit from it through secondary mortgages; if the head of the household were to move or die in the intervening thirty years, "his" land would go not to his family but back to the Institute.

The perverse effects of the new land reforms were soon apparent. On cooperatives, peasants petitioned for the right to grow vegetables in "private plots," and to rent the land they nominally owned so that they might farm it according to their own practices rather than the directives of the management committee. On the smaller holdings, peasants were in effect frozen to their land. Both land reforms had forgotten to take into account the fact that El Salvador was a society with an active rural labor market, in which peasants had moved through their small nation in pursuit of seasonal employment. The new arrangements and their attendant uncertainties virtually precluded "landowners" from pursuing what had previously been an important source of family income. The new arrangements also tended to restrict the healthy growth of towns and rural industries, whose markets and products had typically proved important in countries which had undergone successful rural development.

One perverse effect led to another. The new land policies could not be enforced or financed without controlling the availability of credit. The Salvadoran government thus found it necessary early on to nationalize the country's private banks. Since the private banks were, by one estimate, custodians of some 40 percent of the nation's credit portfolio, the government also nationalized much of the nation's industry in the process. AID did not protest.

When El Salvador's Central Reserve Bank was established in the 1930's, David Raynolds has noted, "the basic law regulating its functions carefully provided that the national government could not hold stock in the bank, since it was feared that otherwise the credit function would become subject to political manipulation." Under the new arrangement, all formal credit was controlled by the government. Interest rates were set considerably below the rate of inflation. This made loans a gift; not surprisingly, loans were increasingly dispensed in the way that gifts tend to be. The Reagan administration did not object to this. Questioned before Congress on the administra-

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tion's support of an IMF loan to El Salvador in 1982, Richard Erb, U.S. representative to the IMF, argued that "it was not an absolute [IMF] requirement to have a positive interest rate." Legally, he was correct; yet it is difficult to overlook the consequences of such a posture, either for the Salvadoran economy or on the bargaining positions of the many poorer nations that were to attempt to negotiate IMF loans in the early and mid-1980's.

Each control required another. To check inflation, price controls were enforced; to compensate for the loss in international competition, foreign-exchange controls were imposed; to make up for the loss in governmental export revenues, mechanisms were created to purchase cash crops at unusually low prices from the "cooperatives." All these controls had the inevitable effect of eroding business confidence; domestic capital continued its flight abroad; the economy listed further into decline.

A strange new form of poverty seemed to be settling over El Salvador, not entirely related to the destruction of war. The destruction now becoming evident was one underwritten by government policies. These policies were not only supported by Washington; in some cases they were recommended by Washington. And in all cases, ultimately, they were funded by Washington.

XV

The record of the last decades shows, in sum, that America's foreign-aid policies are in trouble—not because the American people lack compassion for the suffering of others overseas, and not because Americans are unwilling to devote their nation's resources to helping other peoples~~, but because the~~ policies themselves are formulated and implemented in such a way as to suggest that the United States no longer understands the nature of the problems facing poor people and poor countries. Far from contributing to the goal of self-sustained economic progress in the low-income regions, our funds are instead being directed to a tragic extent into the construction of barriers against such progress and in some cases may actually be paying for the creation of poverty, albeit in new and pernicious variants. This state of affairs can continue only at great human cost to those whom we mean to help—and at great moral cost to our nation.

The cost, indeed, may be more consequential than is commonly appreciated by cool-headed advocates of a "pragmatic" American foreign policy. The experience of the United States in the world arena since the end of World War I suggests that, for our nation more than any other, power and principle are inseparable. When the legitimacy and moral purpose of American initiatives overseas have been commonly understood and accepted, our government has proved able to mobilize awesome resources in the pursuit of its objectives. When, by contrast, the legitimacy and moral purpose of American efforts have become open to question, the domestic base of support has dramatically diminished, and with it the possibility of pursuing those efforts with any hope of success.

The premises of the liberal international economic order the United States labored to create from the wreckage of World War II remain valid, and the instruments of this order remain capable of creating extraordinary opportunities for general material advance throughout all regions of the world. The failures of American aid policies in recent decades are a reflection not on the soundness of the conceptions that originally brought these policies to life but rather on the degree to which current practice has become divorced from original purpose. America's foreign-aid policies today stand in contradistinction to the thrust and purpose of America's overall foreign policy, and to the values and ideals of the American people. How we deal with this contradiction will affect not only the poor and the unprotected of the earth, whose champions we should rightly be, but our own conception of ourselves and our ability to function in the world of nations.

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ROUTING REQUEST

THE CONTINUING FAILURE OF FOREIGN AID

by James Bovard

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]

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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."[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, telecommunications, 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 tc 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 state-owned 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 offi-

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cial 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 defaulted. 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 factories 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.

<u>AID--The Champion of Third World Business?</u>

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 architec-

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

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

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PRIVATIZING FEDERAL SERVICES: A PRIMER

INTRODUCTION

A new word--privatization--has entered the lexicon of federal budget making. Put simply, privatization means the transference of federal assets or activities to the private sector. That can take many forms. Facilities owned by the federal government can be sold to the private sector; these same facilities can be kept in federal hands but managed by private firms or groups; federal services can be provided, under contract, by private firms; or low-income Americans can be given the means to obtain services in the private sector. These forms of privatization enable the deficit to be reduced without cutting necessary services. The reason: by turning over functions to the private sector, bureaucratic decision-making is replaced by competitive private management incentives. So resources are used more efficiently, to the benefit of both the taxpayer and service recipients.

Ronald Reagan's FY 1987 budget draws heavily on privatization to meet the deficit reduction targets required under the Gramm-Rudman legislation. This makes good political and economic sense. Privatization offers politicians the attractive alternative of cutting spending without necessarily eliminating programs; all that is changed is the mechanism by which programs are delivered. And privatization revenues obtained from the sale of federal assets, such as power generating facilities or the student and farm loan portfolios, provides a substantial inflow of immediate revenue. This gives Congress breathing space to find sensible ways to reform and restructure programs to meet the deficit reduction targets, rather than resorting to disruptive across-the-board cuts.

While privatization may be new to many Washington policy makers, it is practiced extensively at the state and local level, and by many foreign governments. Their experience proves that privatization can bring relief to budget heart burn, and that it can be very popular with voters. As Congress explores ways to cut the deficit within the Washington political climate, privatization should become increasingly attractive to lawmakers.

WHAT IS PRIVATIZATION?

Privatization can take many forms. Each has different economic and political effects.

The Sale of Assets

The most complete form of privatization, obviously, is to sell government-owned assets to private buyers. This removes government entirely from any involvement in the activity and the sale provides revenue to the Treasury. Example: The Reagan Administration's budget proposal to sell the federal Power Marketing Administrations, which generate and distribute electricity. Britain has done this by selling several government-owned firms and nearly 1 million public housing units to the public, earning $20 billion for the Exchequer.

Asset sales are particularly attractive because they can provide a considerable amount of revenue to the government in a very short time. Other forms of privatization, where the private sector involvement enhances the efficiency of performance, often take time to yield substantial savings.

The potential for the sale of federal assets is enormous. The federal government, for instance, has a portfolio of outstanding loans in excess of $200 billion. This includes loans to students, small businessmen, and farmers. The federal government also owns over 700 million acres of land--the majority of which long has been in commercial use for timber or grazing land--valued at hundreds of billions of dollars. Uncle Sam owns many other assets of significant value, including two of Washington's airports, over one million public housing units, and many valuable lots in the nation's cities.

By selling assets, the federal government "cashes out" the future income they generate--just as an investor will sell a stock certificate for a price based on its anticipated income. Predictably, this has led critics of this form of privatization to claim that the strategy is a shortsighted and inefficient response to the deficit problem--like selling the furniture to pay the rent.

But every successful businessman knows that it is often prudent to liquidate assets during a crisis to provide a cushion to permit essential restructuring of the firm. The federal government is in a financial crisis. It must meet strict deficit reduction targets required by the Gramm-Rudman law. The up-front revenue from asset

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sales would make it easier for Congress to meet the Gramm-Rudman ceilings for the next couple of years. It could use this breathing space to make sensible, structural reforms in federal programs. This would avoid the meat ax of across-the-board cuts mandated by Gramm-Rudman if the ceilings otherwise are not met.

Privatization, moreover, does far more than merely allow the government to cash out its future income. Such sales are likely to yield a better price than the present value of the government's probable income from the asset. The reason is that managers of publicly owned assets are subject to constant political and budget constraints. They also lack the positive incentives influencing private sector managers. This is why the Forest Service manages to lose money in managing millions of acres of valuable timberland, and why the Postal Service is constantly outgunned in those areas where it faces competition, such as overnight package delivery.

The price a private buyer of a federal asset is willing to pay reflects the income the buyer estimates he can make--not the lower expectations of the public managers. Selling federal assets, therefore, means the full value of the asset is realized. As important to the economy, the resources would be used more wisely. In private hands, the rangeland would not be overgrazed, delinquent student loans would tend to be collected, and Washington's airports run more smoothly because private owners would have the incentive to manage these valuable assets more carefully and efficiently.

<u>Deregulation</u>

A second form of privatization involves simply allowing the private sector to provide a service now monopolized by the government. Take the Postal Service. Private carriers compete with the Postal Service for the delivery of parcels; the result is that 70 percent of that business is now in the hands of the United Parcel Service. It is a different story when it comes to the letters sent by American individuals and businesses. A federal law, the Private Express Statutes, makes it illegal for anyone to compete with the Postal Service in the handling of first class mail. Deregulation would allow private carriers to compete for first class mail business. These new entrants would succeed or fail solely on their ability to serve the public. The federal Treasury would gain both from the contract fees paid by the new private mail delivery services, and from corporate taxes the private firms would pay. And the consumer would gain enormously if first class mail were handled as efficiently as UPS and Federal Express deliver packages.

The Social Security System also could be improved by privatization. American workers and employers are forced to save for their retirement through the government-run pension system. Benefits under the program are a political football, while studies indicate that few younger workers can expect a return on their Social Security contributions comparable with the yield on private pension plans.[1] Giving workers the option to put their Social Security contributions into a private plan would privatize the system by allowing private firms to offer better pension plans.[2]

In this form of privatization, deregulation breaks a government-sponsored monopoly. This leads to more competition and choice, to the benefit of the consumer, and it cuts the budget by reducing the need for government provision of a service.

Contracting Out

In this form of privatization, the government still funds the service, but invites private firms to bid for the right to provide the service under contract. The cost of the service is reduced because the successful contractor must outbid his rivals.

Hundreds of American cities routinely use private contractors to supply basic municipal services, such as garbage collection, maintenance work and even, in some instances, fire protection. At the federal level, the so-called A-76 program enacted in 1955 requires agencies to compare the in-house cost of routine commercial services with those obtainable from private suppliers. In theory, each agency is supposed to use the least expensive supplier of the appropriate quality of service.

In practice, there is little contracting out at the federal level.[3] One reason is that Congress buckles to pressure from the public employee unions, and places obstacles in the path of privatization. Spurious national security considerations, for instance, have been used to rule privatization out of bounds in many programs. Example: Congress has blocked cost-saving contracting out of much supply, maintenance and repair work despite requests from the Pentagon. Agencies have also been instructed not to even consider a private bidder unless the saving is at least 10 percent of the in-house cost.

Another factor inhibiting federal contracting out is the mechanism used to compare costs. Instead of an independent commission

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1. Peter Ferrara, "Rebuilding Social Security, Part 1: The Crisis Continues," Heritage Foundation Backgrounder No. 345, April 25, 1984.

2. Peter Ferrara, "Rebuilding Social Security, Part 2: Toward Lasting Reform," Heritage Foundation Backgrounder No. 346, April 25, 1984.

3. See Stuart M. Butler, Privatizing Federal Spending (New York: Universe Books, 1985), pp. 53-56.

making these comparisons, each agency determines whether it or a private bidder is more economical. Needless to say, employees of the agency have the incentive to use every possible accounting trick to minimize their own stated costs. Until a truly independent method of cost comparison is used in the A-76 program, the deck will be stacked against the private contractor--and hence the taxpayer.

The savings from contracting out are likely to be greatest when the degree of competition within the private sector is most intense. Tough competition means the government knows that the contractor will keep on his toes, for fear of losing the contract.

<u>Vouchers</u>

In this form of privatization, the government also continues to fund the service. But instead of a federal agency giving a contract to a specific firm to provide a service, the agency gives the users of the service the means--probably a voucher--to purchase a specific service in the open market. In this way the government provides individuals with the power to become consumers. This approach is most appropriate in cases where a healthy market for a service exists, but where households have insufficient income to obtain an adequate supply.

The first widespread use of vouchers has been the Food Stamp program. Low-income families were provided with stamps of a certain value, which they could use only to purchase food. Recipients had the incentive to shop around to obtain the best value for their stamps--and supermarkets had to compete for their business, ensuring efficient provision of food to the poor.

Vouchers could provide low-income Americans with other basic requirements as service providers compete for the consumer's dollar. Rather than continuing a system of expensive public housing and subsidies for landlords, for instance, a housing voucher could be given to the poor. It would empower them as consumers and thus open the competitive private rental market to low-income families. The Administration's FY 1987 budget requests Congress to create 50,000 such housing vouchers, to replace part of the spending on other housing programs.

Similarly, a medical voucher for low-income and elderly Americans would provide them with the incentive to seek the most efficient health insurance available, or the lowest cost subscription to an adequate health maintenance organization.

As with contracting out, vouchers do not reduce the federal government's commitment to provide the service involved. But by encouraging voucher holders to seek the most efficient provider, privatization enables the government to keep the cost of the service as low as possible.

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THE RECORD

Privatization is underway in over 50 countries.[4] Canada is looking into the sale of several "crown corporations," and Mexico has earmarked over 200 state firms for sale to the private sector. Even Cuba is busily transferring the ownership of public housing stock to the tenants.

Several Asian countries are turning to privatization to help state finances and resuscitate stagnant government corporations. In South Korea, for instance, the government has divested itself of several major banks, an oil company, and several other enterprises. Malaysia intends to privatize the telephone system, its national airline, and various government facilities. Other Asian countries are taking similar steps. Perhaps most important of all, Japan will soon be selling stock in the state-owned Nippon Telegraph and Telephone, the country's telephone company, and is planning to restructure and partly privatize its heavily money-losing government railroad system.

Privatization is also becoming a trend in Europe. Turkey has already sold stock in the Bosphorus Bridge and the Keban Dam, and is drawing up plans to sell two dozen other government concerns. In West Germany, many municipalities contract out such services as public housing management and health clinics. Even in socialist-ruled France, the government of Francois Mitterrand is taking steps toward returning to the private sector many of the corporations it hastily nationalized during the past four years.

By far the most extensive privatization is occurring in Britain. Since Margaret Thatcher became prime minister in 1979, there has been widespread contracting out at all levels of government, approximately $20 billion worth of government assets has been sold to private buyers, and over 400,000 government workers have been moved to private payrolls. Over 800,000 public housing units have been sold to tenants, while various commercial firms and the entire telephone system have been sold to the public.[5]

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4. See "Privatization--Everybody's Doing It Differently," The Economist, December 21, 1985; Privatization Around the Globe, Policy Report #120 (Dallas, Texas: National Center for Policy Analysis, January 1986).

5. See Butler, op. cit.; Madsen Pirie, Dismantling the State (Dallas, Texas: National Center for Policy Analysis, 1985).

The American Experience

Privatization is not new to the U.S., even though the term itself has only recently become familiar to most Americans. At the state and local level, governments are increasingly turning to privatization to reduce the cost of services. A recent survey by the National Center for Policy Analysis found that approximately 35 percent of local governments now have private firms to collect residential garbage, 42 percent use private firms to operate and maintain their bus systems, and 80 percent contract out vehicle towing and parking.

Other functions routinely undertaken by the private sector in U.S. towns and cities include street repair work, traffic signal maintenance, tree trimming, utility billing, ambulance services, health and welfare programs, park landscaping and maintenance, and legal services.[6] Even fire departments and prison facilities are operated by private firms in many cities. A study by the International City Management Association found a 50 percent rise in the number of cities privatizing one or more of the services during the past ten years.[7] The use of private firms to collect garbage has more than doubled during the decade, private street repair operations have risen 600 percent, and the use of private firms to manage parks has skyrocketed 2,700 percent.[8]

The overriding factor leading local officials to privatization is cost: the competitive private market generally provides routine services much cheaper than a government department. Study after study confirms the significant cost savings when private contractors are used.[9] A recent study of the Los Angeles area, for instance, reveals that street cleaning by city employees typically costs 43 percent more than the equivalent service provided by a private firm; janitorial services cost 73 percent more than the private alternative; and road resurfacing 96 percent more. Of the eight services analyzed, only in

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6. Privatization in the U.S., Policy Report #116 (Dallas, Texas: National Center for Policy Analysis, June 1985).

7. E. S. Savas, "The Efficiency of the Private Sector," in Stuart M. Butler, ed., "The Privatization Option, Heritage Foundation Lecture Series No. 42, 1985.

8. Privatization in the U.S., op. cit. See also Robert Benenson, "Privatizing Public Services," Editorial Research Report, Vol. II, No. 4, Congressional Quarterly, 1985.

9. Savas, op. cit.; see also E. S. Savas Privatizing The Public Sector (Chatham, New Jersey: Chatham House, 1982).

payroll preparation were public sector costs comparable with those in the private sector.[10]

As a sizeable bonus, of course, the private firms that win contracts to perform public services pay local taxes. The municipal bureaucracy pays nothing to the town treasurer.

At the federal level, there have been relatively few privatization initiatives, even under Ronald Reagan. One reason is that many government activities in other countries are already delivered by the private sector in America. Another reason is that the Reagan Administration's political experiences with privatization have not been pleasant--mainly because it has failed to profit from the tactical lessons learned the hard way by foreign governments. Margaret Thatcher, for instance, carefully builds coalitions of those who have or will have a vested interest in privatization. The Reagan Administration has not. It thus ran into a political buzz saw when it attempted to sell the weather satellite system and a small portion of federal land holdings to the private sector.[11]

Even contracting out routine services to the private sector has not been expanded to the degree that might be expected of a conservative administration. The Administration has done almost nothing to remove the obstacles to the fulfillment of the A-76 program by which federal agencies are required to compare the in-house cost of providing commercial services with bids from private firms, and to choose the lowest cost option.

THE POLITICS OF PRIVATIZATION

The Reagan Administration has set bold privatization goals for the FY 1987 budget. It has proposed selling such assets as the Power Marketing Administrations, the Naval Petroleum Reserve, and a part of the federal loan portfolio. In addition, it is pressing for a full voucher program for low income housing and compensatory education. These and other privatization initiatives, says the Administration, could cut the deficit by $7 billion in FY 1987, and many billions more in later years.

The outlook for these initiatives has been improving dramatically. The passage of balanced budget legislation, and the mounting wealth of tactical experience from abroad, suggests that

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10. Barbara Stephens, "Company Public and Private Sector Efficiency," National Productivity Review, Autumn 1984.

11. Butler, op. cit., pp. 82-91.

privatization could be the key to bringing federal spending under control.

The Impact of Gramm-Rudman

The Gramm-Rudman-Hollings deficit reduction timetable marks a turning point in the debate over federal spending. Even if the Supreme Court upholds the lower court ruling invalidating part of Gramm-Rudman, Congress is committed to reducing the deficit. Reagan's determination to veto any tax increases leaves lawmakers with only one deficit reducing option--cut spending. This could be stingingly painful for Congressmen. What could spare them this pain, while meeting deficit reduction guidelines, is privatization.

As a model, Congressmen need only examine recent state and local experiences. Trapped between the rock of voter resistance to tax increases and the hard place of reduced assistance from Washington, the country's mayors have found that through privatization they can maintain the quality of services at lower cost. This already makes for good politics at the local level.

It would make good politics at the national level. Instead of slashing services to meet spending targets, as traditional budget cutting requires, privatization allows lawmakers to continue supplying the services. The only difference is that a new sign will hang over the programs proclaiming: "Under New Management."

It should not take long for Congressmen, like their local counterparts, to recognize privatization's attractiveness.

Privatization Coalitions

A major reason why even the most wasteful or redundant federal program can be impervious to budget cutting efforts is that a tight coalition forms around it. This coalition consists of program beneficiaries, those who serve these beneficiaries, and the political and bureaucratic constituencies whose careers depend on the program's existence. When the program's budget is challenged, this coalition has a strong vested interest to wage a ferocious campaign to preserve it. As the Reagan Administration has discovered, it may be possible to dent programs supported by these coalitions, but it is usually impossible to eliminate them.

These coalitions win because it is difficult to find congressional and grassroots allies who will support budget cutting with tenacity. The average taxpayers will denounce spending in principle, but in practice will rarely join in an all-out effort to trim or eliminate a particular program.

Privatization changes these dynamics. The creation of a private mechanism spawns groups of beneficiaries and supporters which create a

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"mirror image" coalition to that defending the existing programs. Like the coalitions supporting government programs, the mirror image coalitions consist of individuals who will receive services and the providers of those services--in this case private firms and groups. And these private coalitions have the incentive to campaign hard for stepped-up privatization.

Privatization at the local level has produced a multitude of private sector organizations that have lobbied intensively and successfully against "public sector coalitions." These coalitions can often draw strength from the groups that once supported the government provision. In Britain, for instance, giving public housing tenants the right to buy their units at a discount turned one-time advocates of public housing subsidies into cost-conscious homeowners. Similarly, giving British public sector workers free stock in the privatized companies that replaced their public agency converted privatization's fiercest opponents into some of its strongest supporters.

While these privatization coalitions quickly and almost automatically form when privatization takes place, they need to be mobilized in advance if privatization proposals are to gain the support they need to become law. Thatcher's government has taken careful steps to build a constituency for privatization, primarily by giving key groups, such as employees, management, and customers, an ownership stake in the designated privatized firm.[12] So far the Reagan Administration has ignored this lesson. It is this that has caused its privatization initiatives to be delayed or abandoned.

CREATING THE POLITICAL CLIMATE FOR AMERICAN PRIVATIZATION

The Reagan Administration must create a political environment conducive to privatization and design initiatives to win the support of key constituencies. To accomplish this, several steps should be taken. Among them:

1) Organize Coalitions

Even before announcing a privatization initiative, officials should identify and mobilize those constituencies likely to gain directly or indirectly. In some cases this may involve helping organize such constituencies into an effective political force to counter the established constituencies favoring government delivery of services. Example: the greatest beneficiaries of an education voucher

12. Butler, op. cit., Chapter 2.

program would be low-income parents and the small neighborhood private schools that cater to lower income parents. Helping these groups form national networks and recognizing leaders of these networks as legitimate spokesmen on education issues would strengthen the voucher movement.

2) Attempt to erode anti-privatization coalitions

Public employees understandably are concerned that privatization may endanger their jobs. This concern, and the opposition to privatization that it produces, may be reduced in a number of ways. The pace of contracting out, for instance, can be limited such that the number of jobs lost in the private sector corresponds to the usual rate of attrition. In that way the existing workforce is not threatened--there is simply a freeze on new hiring. Or the employees may be given an ownership stake, even outright ownership, of a privatized asset. When the British government privatized the government-owned National Freight Corporation in 1982, the employees were allowed to purchase 85 percent of the trucking company. With the incentive of ownership, the workers became advocates rather than opponents of the privatization. Private ownership, meanwhile, has turned the money-losing drain on the taxpayer into a highly profitable, taxpaying company.

Steps may be needed to quell the public's fear about private ownership of government assets. It is a fear often fanned by the opponents of privatization. For instance, when the Reagan Administration sought in 1982 to sell five million acres of commercial range and timberland--a tiny fraction of the 750 million acre federal inventory--it faced a crippling barrage of criticism. The argument in effect was that it was selling the national parks to developers, desecrating the memory of Smokey the Bear. Public outcry stymied the sale.

Such a reaction could be averted in the future. The management of parks and wilderness areas, for example, could be given, under contract, to environmental organizations. This should reassure the public that these lands will not be part of any sale policy.[13] Similarly, any proposal to introduce an element of privatization into the Social Security system should be preceded with an iron-clad guarantee that existing retirees and those nearing retirement would not be affected.

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13. John Baden, "Let Environmentalists Manage Wilderness Lands," Heritage Foundation Backgrounder No. 461, October 8, 1985.

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3) Spread ownership widely

A key lesson of the British experience with asset sales is that spreading the private ownership widely, especially among groups that might otherwise be hostile to the sale, helps win political support for privatization. It is now almost routine for Britain to structure sales of government enterprises as stock offerings to the public. But preference is given to purchasers who are employees, users of the asset, and small investors. Sometimes even free stock is given to these groups. When Britain's telephone system was privatized in 1984, 96 percent of the employees and two million Britons bought stock in a tidal wave of enthusiasm for the sale.

The Reagan Administration should heed this lesson. Its sale of the federally owned freight railroad, Conrail, to the Norfolk-Southern Railroad, for instance, would be an excellent deal for the taxpayer. But the sale has been slowed, perhaps fatally, by opposition from key beneficiaries of federal ownership of the freight railway system. Yet these key constituencies might have been converted to supporters of Conrail's privatization if attractively priced blocks of stock had been reserved for employees, shippers and other groups. When the Administration attempts to win congressional support of its plan to sell the five huge Power Marketing Administrations, it will have a better chance of success if it adopts a stock sale strategy favoring employees and customers.[14]

4) Recognize the importance of tax incentives

A tax incentive can provide the focus around which a privatization coalition can develop. Favorable tax treatment of sale-leasebacks, for instance, encouraged construction firms to press municipalities to explore innovative, lower cost wastewater treatment plants. The deduction for Individual Retirement Accounts has stimulated the growth of a powerful new constituency for private pensions.

The powerful stimulus to privatization provided by tax incentives should be part of the effort to simplify the tax code. The purpose of raising taxes is to pay for government spending. Privatization reduces the need for government spending. But eliminating certain tax incentives would reduce the level of privatization, because deductions stimulate charitable contributions, private pension plans, and other alternatives to government programs. Ending such tax incentives would discourage these private options, and that may result simply in more demands for spending--and ultimately higher taxes.

14. Milton R. Copulos, "Cutting the Deficit by Selling Federal Power Marketing Administrations," Heritage Foundation Backgrounder No. 485, February 13, 1986.

5) <u>Adopt an independent method of comparing costs</u>

The current method of comparing the bid of a private contractor with an in-house cost estimate is heavily biased against the contractor. This could be rectified, leading to more privatization, if the role of comparing costs and deciding when to contract out were transferred to an independent commission staffed by government and private sector accountants.

CONCLUSION

Privatization allows federal spending to be reduced without denying services that Congress agreed to provide. And by using vouchers, private contractors, or asset sales, services can be provided more efficiently. Replacing direct government spending on low-income housing with a system of housing vouchers does not cut the housing budget by providing less shelter--it does so by giving tenants the incentive to seeking better housing for fewer voucher dollars. And selling the Bonneville Power Administration to the private sector does not mean that generators will fall silent--it means that the utility's management will have to pay closer attention to the needs of their customers.

Privatization recognizes that it is possible to reduce the cost of government by changing the role of government. Government is not very good at running railroads, or building housing, or picking up garbage. By recognizing this simple fact, and drawing on the competitive private sector to perform such functions, Congress can cut the deficit by ensuring that more efficient services, not fewer services, are provided to the American people.

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