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## Turn off foreign aid?

By Richard W. Rahn

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Why do we give foreign aid? We give aid for humanitarian reasons: that is, we wish to relieve human suffering because of famines or natural disasters, such as earthquakes, floods, etc.; and we give aid for economic development. The crisis in Iraq has again raised the issue of how much aid and in what forms is appropriate for the U.S. and other countries to provide.

Humanitarian aid at reasonable levels has a strong political constituency in the U.S. and is not going to be abolished.

Development aid, on the other hand, has never been popular, and for good reason. Most of it has been a waste of money. The late great British economist, Peter Bauer, was the single most important individual in discrediting the socialist orthodoxy that Third World countries were trapped in a vicious cycle of poverty that could only be broken by massive foreign aid. Bauer explained in his many articles and books, most notably, in his "Dissent on Development" (1972), that all countries were once poor, and that the rich countries did not become rich through foreign aid, but by having the rule of law and the proper incentives.

Bauer noted that all too often foreign aid simply turned out to be "transferring money from poor people in rich countries to rich people in poor countries."

A country that establishes the rule of law and largely eliminates corruption, allows free markets to operate, establishes free trade, maintains low taxation and government spending, does not excessively regulate, and establishes a stable currency will attract sufficient domestic and foreign investment to grow rapidly, without foreign aid. Countries that do not provide the rule of law and sound economic policies will not grow no matter how much "foreign aid" and development assistance they receive.

The great economic success stories of the last several decades, such as Hong Kong, Singapore, Taiwan, South Korea, etc., received little or any aid, but they did put in the right policies to attract capital and provide economic growth. The post-World War II Marshall Plan in Europe is often cited as the great success of foreign aid. But, in fact, the German and other economic miracles in Europe only began after the Germans and others,

despite opposition from the Allied Control Commission, removed their extensive price controls and other restrictions on trade, production and distribution.

Most development economists now realize Bauer and his disciples are correct, and as a result there has been a big shift in the nature of most foreign aid coming from the U.S. government.

However, the World Bank and many foreign governments continue to provide large government-to-government loans, which are rarely used in cost-effective ways but often are stolen by the recipient countries' corrupt rulers, which saddle the citizens of those poor countries with massive debts they repay to the lenders.

The U.S. government provided \$12.9 billion in official development assistance last year, most of it through the U.S. Agency for International Development (USAID), and has spent hundreds of billions in aid since World War II. Sadly, many of the recipients of U.S. development aid are poorer now than they were before receiving assistance.

To break this dismal record, the Bush administration proposed the Millennium Challenge Account (MCA), which would reward countries for putting in proper economic policies and establishing the rule of law. Unfortunately, Congress is diluting the program so it may not operate any more effectively than existing programs when finally put into operation.

Having spent part of my time working in economic development and transition economies over the last several decades, I have seen close up many failures and some successes in aid programs. USAID now has far fewer clearly counterproductive projects than it had in decades past. However, the agency is still a bureaucratic nightmare of excessive paperwork and slow decisionmaking; it relies all too heavily on a few large contractors; and it does a terrible job of sound cost-benefit analysis.

One low-cost success USAID has had in the last decade is the assistance it provided to establish training for economic public policy organizations, known as the Balkan Network, several of which have already become totally self-supporting. These independent think tanks are providing sound economic training and good policy advice, and are having a very constructive influence. Yet, it appears that complaints from the EU statist political establishment about, for example, a think tank in Montenegro being too free market are resulting in resources being diverted from it to the old types of aid programs. Such action sends all the wrong signals.

A major part of America's economic and political success was the formation of voluntary associations to take care of humanitarian, social, educational, infrastructure and public policy problems that are only done by governments in many other countries. Our tax code correctly encourages private support for such organizations by making them tax deductible. In most European and many other countries, support for such organizations is not only not tax-deductible, but donations are taxed.

At the minimum, the Bush administration should demand that no country can receive U.S. aid unless it allows tax deductibility for contributions to private aid, educational and public policy organizations, because such groups will be needed to fill the vacuum when the U.S. and other donors eventually leave (as they should).

The administration should also immediately reduce U.S. support for international organizations, such as the Organization for Economic Cooperation and Development, the United Nations and the World Bank, which have programs that discourage economic growth.

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