

41. Foreign Aid

HANDOUTS of U.S. taxpayers' money to Third World countries in the form of traditional foreign aid have failed because they remove essential incentives for the governments of developing countries to open markets, promote a stable economic environment, and thereby let their people build wealth and prosper. Since the end of World War II, the United States has provided more foreign aid to the world than any other country, yet recipients are just as poor now as they were then. Even worse, foreign aid has fostered corruption and irresponsible policymaking.

by *Ana Isabel Eiras*

Recommendations

1. Proceed with the Millennium Challenge Account (MCA). Foreign aid removes the pressure to open markets because it lowers dependence on revenues such as taxes from the private sector. The MCA program establishes market-oriented preconditions for loan disbursement. In this way, it creates incentives for countries to implement pro-market policies in order to get a loan. These policies allow the poor to do business, grow, and prosper. The MCA is a partnership, not a handout.

2. Establish strong oversight over the use of taxpayers' dollars to finance foreign aid. Most aid recipients suffer economic repression, weak rule of law, and widespread corruption that usually lead to misuse of funds, waste, and (in some cases) personal enrichment of political elites. As a result, aid money too often props up corrupt governments. The U.S. Congress should establish a strong monitoring procedure for aid programs, including aid channeled through international organizations such as the World Bank, to prevent (or at least minimize) the misuse of Americans' hard-earned tax dollars.

3. Promote free trade and investment accords as an alternative to aid. Free trade is effective in promoting long-term prosperity. By holding out the carrot of increased access to American markets, a free trade accord creates incentives for other countries to negotiate reforms. As a result, living standards rise, both at home and abroad. Helping others to open their markets is far more effective in eradicating poverty than

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pouring money into corrupt and institutionally weak regimes could ever be. The United States should continue to expand free trade around the world, bilaterally, regionally, and through the WTO, as a strategy to open markets and promote prosperity.

Facts and Figures

■ Over the past four decades, the United States has given about \$480 billion (in constant dollars) in development assistance to less-developed countries. Yet the people in many of these countries are no better off today in terms of per capita gross domestic product (GDP) than they were decades ago; some, in fact, are actually poorer. Zambia, for example, has received \$1.3 billion (in constant dollars) in U.S. development assistance for four decades, but its real GDP per capita has fallen from \$528 in 1960 to \$366 in 2004. Haiti's lot is even worse. Despite U.S. development assistance of more than \$3.5 billion (in constant dollars) over the past 40 years, Haiti's real GDP per capita has dropped by almost half, from \$788 to \$437.

Both Zambia and Haiti have failed to establish essential institutions such as rule of law and free trade, as shown by their status as "mostly unfree" or "repressed," respectively, in the *2006 Index of Economic Freedom*, published annually by the Heritage Foundation and *The Wall Street Journal*. Many of these aid-receiving countries have low levels of transparency. In other words, the aid has been squandered by corruption that obstructs economic freedom, and therefore opportunities for people.

■ The table below shows that most recipients have low levels of transparency. In other words, corruption clouds or obstructs opportunities. (South Korea and Israel have mostly free economies and, therefore, higher levels of transparency as well. The other eight countries have failed to establish these essential institutions, as shown by their status as only "mostly unfree" in the *Index of Economic Freedom*.)

■ According to the Trade Openness Index—a measure not just of tariffs, but also of non-tariff barriers, such as regulations for doing business, restrictions on capital flows, and protection of property rights, taken from the *Index of Economic Freedom*—societies that support the free movement of goods, services, and investment also achieve higher levels of income per capita than societies that do not. Free trade and investment, not aid, is the remedy for poverty.

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Table 2 41. Foreign Aid

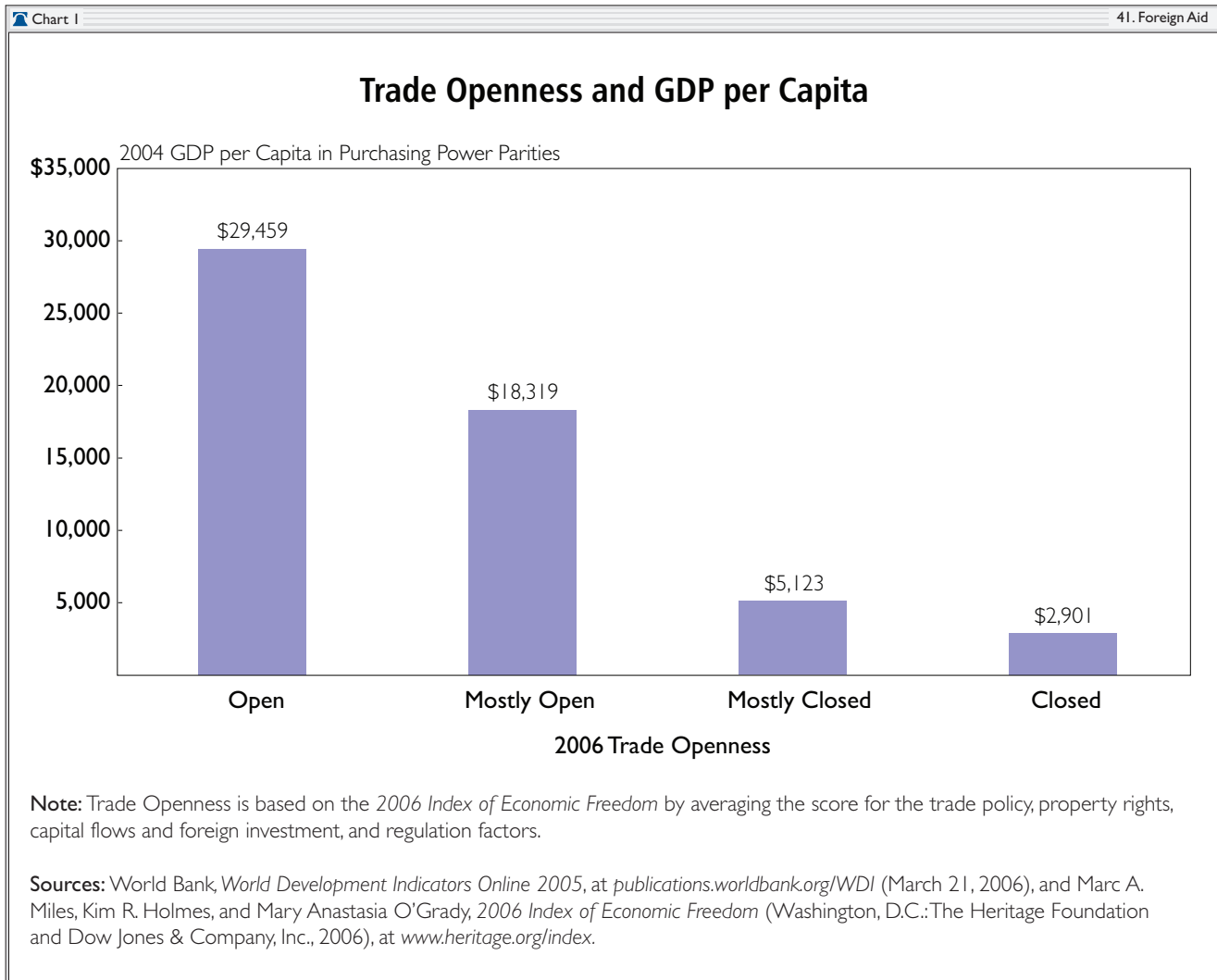
Levels of Corruption Among Top 10 Recipients of Official U.S. Development Assistance, 1960–2004

Country	Cumulative U.S. Development Assistance and Aid, 1960–2004 (\$Billions)	Level of Transparency (1 = worst, 10 = best)
Israel	\$48.7	6.3
Egypt	\$42.9	3.4
India	\$37.5	2.9
Vietnam	\$22.8	2.6
Pakistan	\$20.7	2.1
South Korea	\$12.1	5.0
Indonesia	\$9.3	2.2
Turkey	\$9.1	3.5
Brazil	\$8.4	3.7
Russia	\$8.1	2.4

* Earliest year for which GDP per capita data are available.

Sources: World Bank, *World Development Indicators Online 2005*, at publications.worldbank.org/WDI (March 21, 2006); Marc A. Miles, Kim R. Holmes, and Mary Anastasia O'Grady, *2006 Index of Economic Freedom* (Washington, D.C.: The Heritage Foundation and Dow Jones & Company, Inc., 2006), at www.heritage.org/index; and Transparency International, *Corruption Perceptions Index 2005*, at www.transparency.org/cpi/2005/dnld/media_pack_en.pdf (March 21, 2006).

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This chapter can be read online at issues2006.org/foreignaid.

Additional Reading

Brett D. Schaefer, "How Economic Freedom Is Central to Development in Sub-Saharan Africa," *Heritage Foundation Lecture No. 922*, February 3, 2006, at www.heritage.org/Research/TradeandForeignAid/hl922.cfm.

Adam Lerrick, "Forgive the World Bank But Don't Forget: Debt Relief Should Fund a Turnaround in Development Aid," *American Enterprise Institute Development Policy Outlook No. 1*, February 6, 2006, at www.aei.org/publications/pubID.23836,filter.all/pub_detail.asp.