Notes 1’. Why foreign aid can be counterproductive (and usually is)—A note on the influence of Peter Bauer

Why did I become an economist? Well, there are several reasons, of course. But one early influence on me was the work of Peter Bauer. Through most of my undergraduate years, I had never heard of Bauer or his work, largely because he was then (the 1970s) regarded as a nut, a pariah, a peddler of dangerous ideas. One evening, I was watching an episode of “The Age of Uncertainty,” a TV series done by John Kenneth Galbraith, then a famous, well-respected, and influential economist. (Unfortunately, he turned out to be wrong about almost everything. Smart, but wrong.) The show concerned the growth, or lack of it, in poor countries, and of course lamented the pitifully low levels of foreign development aid being disbursed by the US and other developed countries. At the end of each segment, Galbraith had someone present the opposing view to his own. For this one, the presenter was Peter Bauer.

Dressed in a formal suit, and speaking in his Hungarian-accented English, Professor Bauer argued that foreign aid was actually destructive, because it weakened the economies of the recipient countries and made them incapable of further development. I was stunned. What a crazy man! I thought. But his arguments remained in my thoughts, and I tussled with them for months afterward.

Eventually, his arguments won, in my mind. And in those of many others, too, especially as the sorry evidence of the effects of foreign development aid programs mounted. Bauer was fortunate that he lived to see himself, and his ideas, not only accepted but honored. A generation ago, his arguments were considered loony, indeed wicked; today, they are accepted almost as commonplace.

“Against Foreign Aid,” the article assigned for Chapter 1, lays out his thesis. Here is a further explication, in Q&A format.

Q: What is the intended purpose of foreign development aid?
A: Here’s the idea: People living in poor countries suffer from poor infrastructure, such as bad or nonexistent roads, water and sewage systems, electrical and communications systems, and the like, as well as sporadic or chronic food shortages. These conditions hold them back from becoming more productive and hence wealthier. Using money donated by the governments of rich Western nations, the governments of these countries can build the infrastructure needed to solve these problems and clear away the obstacles to economic growth.

Q: Sounds like a good idea. How can anybody argue with that?
A: Glad you asked. The arguments against foreign aid fall into two categories.

1. Aid destroys the incentive to produce and grow.

   Food aid is particularly harmful. A country that is suffering from food shortages needs to find a way either to become self-sufficient in food production, or to produce other goods for export that it can trade for food. Who produces food? Farmers. Why do farmers produce food? First, to eat, and second, to trade for other goods. If we want farmers to produce food for non-farmers, they have to have an incentive to do so. And to increase their food production, they’ll have to invest in new equipment, fertilizers, pesticides and herbicides, irrigation systems, and so on. But before they will invest, they will need an incentive, of course, in the form of a rate of return on investment high enough to justify spending some of their limited resources.

   What kind of incentive? Simple: income earned from the food they produce. So here’s what’s necessary. Let farmers have an expectation of a good income if they invest in capital necessary to produce more food, and they will make those investments and produce more food. But . . . now say that a rich Western government gives several million bushels of corn to the government of that country for distribution to hungry city dwellers. We’re getting a couple of chapters ahead of ourselves, but what effect will this have on the market price of corn in that country? It will fall, of course. And as it falls, farmers’ incomes will fall. Two bad things happen because of lower corn prices: One, they discourage farmers from making investments in their farms, and so the hoped-for increase in domestic farm productivity and food production doesn’t happen, and two, some farmers, who were barely surviving before, now have their incomes fall so low that they can’t make a living as farmers, and either die, or more likely, give up farming and move to a city, where, of course, they now produce no food and are dependent upon . . . food aid to be disbursed by the government.

2. Government to government aid entrenches corrupt and despotic governments who use the aid to cement themselves in power.

   Remember that rarely do poor country governments allow rich Westerners to give aid directly to the people of their country, but require it to be funneled through them. Imagine a poor country ruled by a typically dysfunctional dictatorial government. Now say that the US government proposes to send in engineers and construction crews to build roads and bridges and dams and whatnot where and when its own advisors think best. And also, the US proposes to distribute money to various local groups to spend as they see fit, including groups that are politically hostile to the ruling party. Oh, and we also propose to give money to pro-democracy groups. Do you think the dictator will go along with this?

   So, instead, our government gives aid directly to their government for them to distribute. The money and goods are supposed to be distributed to improve the lives of the people of those countries, and their government gives us their word on it. But they’re dictators, and they routinely use every available means to reward people for being loyal to them and punish disloyalty, and giving them a bunch of loot means that now they have more ways to reward and punish. Usually, they’re crooks, too, and line their pockets whenever they can. Recalling the basic assumption of public choice economics, that everyone acts foremost in his own interest, including government officials, it’s not hard to understand what happens next. Foreign aid intended to help a poor country develop ends up either in the pockets and Swiss bank accounts of the rulers, or they use it to oppress the poor even further. Give a dictator a million dollars and you are an accessory to oppression. As well as a fool. Bauer denied having ever said it, but it’s clear that he inspired the dictum that “foreign aid is the means by which poor people in rich countries give money to rich people in poor countries.”
As an extreme case, note that beginning in 1995, under the terms of the agreement negotiated by that noted statesman Bill Clinton, we supplied the government of North Korea considerable amounts of aid—food and oil—as a *quid pro quo* in exchange for them putting a halt to their nuclear weapons program. Since then, North Koreans have continued to starve, and of course, last summer they conducted a test of a nuclear weapon. And their leader, Kim Jong Il, seems as well-fed as ever, and appears still to be indulging his taste for imported whiskey and European prostitutes.

There’s a fairly exhaustive report on the sad history of the North Korean aid program here if you’re interested: [http://www.nautilus.org/DPRKBriefingBook/uspolicy/CRSUSAidtoDPRK.pdf](http://www.nautilus.org/DPRKBriefingBook/uspolicy/CRSUSAidtoDPRK.pdf)

**Conclusions**

How did Europeans and Americans (and Japanese, Australians, and Argentines, and so on) go from poverty to relative riches? By saving, investing in capital and technology, and hence becoming more productive and wealthier. What holds back people in poor countries? Well, in some cases, obviously, disease and drought and the like. But also, and most importantly in most poor countries, it’s rapacious, corrupt, or simply incompetent governments that create obstacles to individuals responding to the incentives to save and invest that always exist.

So, if foreign aid doesn’t work, what other alternative is there, for rich Westerners who wish to help world’s poor, other than despair? The answer is simple: Trade.

We’ll see in Chapter 3, in our study of comparative advantage, how countries can best grow if they can produce and trade those goods and services which they can produce relatively most efficiently. Preventing countries from trading in these goods can keep them stalled in poverty indefinitely. Here’s and example.

The US government has heavily subsidized cotton farmers, to the tune of $4 billion per year. That works out to over $200 per acre planted, although of course it’s not evenly distributed. Why? Because of pressure from farm groups to shovel more of taxpayers’ money into the pockets of farmers. The effect? US cotton production is higher than it would otherwise be, since acreage that would not be profitable to grow cotton without the subsidy wouldn’t be planted. Higher US cotton production drives down the world market price of cotton. And farmers in countries that have a comparative advantage in cotton but little else—which describes several countries in West and Central Africa—find that one of their few good chances to produce a profitable crop are closed off. Note that this isn’t malicious behavior by the US; it’s just politics. US cotton farmers vote in our elections, and African ones don’t. But it nonetheless closes the door on their economic growth prospects.

Pressured by the World Trade Organization (WTO), one of the few international bodies that has done more good than harm, Congress has set about reducing cotton subsidies. How far this goes depends on domestic politics, of course.

The European Union does the same thing with its heavy subsidies to sugar beet farmers. We do, too, although in our case we set quotas that severely limit the amount of sugar that can be imported. That’s why we grow sugar beets in South Dakota, even though it’s much more efficient to grow sugar cane in tropical countries.

Eliminating these trade distortions can allow market incentives to work in poor countries. But that means that politically powerful domestic lobbies have to be shoved aside, and they’ve proven resilient in the past.

A paper by the British charity Oxfam—admittedly not an unbiased source—on this can be found at [http://www.oxfam.org.uk/what_we_do/issues/trade/bp30_cotton.htm](http://www.oxfam.org.uk/what_we_do/issues/trade/bp30_cotton.htm)

In essence, Bauer argued that government aid is destructive because destruction is what governments do best. Removing the obstacles to development faced by individuals in poor countries is the most important thing.

A note on Bauer’s professional background: You can read more about him on the websites I’ve cited below, but it’s important to realize that, unlike most of the academics and international bureaucrats who cooked up the foreign aid policies popular in the late 20th century, Bauer spent much of the 1940s and 1950s actually living in and studying poor country conditions. He did field research on the rubber industry in what is now Malaysia and on trade within West Africa during this time. His understanding of actual conditions in those countries was derived by applying a first-rate and well-trained intellect to his own careful observation.

By the way, Bauer was appointed to the House of Lords by Margaret Thatcher in 1983 and received the first Milton Friedman Prize for Advancing Liberty by the Cato Institute just prior to his death in 2002.

Brief retrospective on Bauer: [http://www.vdare.com/pb/bauer_memoriam.htm](http://www.vdare.com/pb/bauer_memoriam.htm)

Wikipedia entry, with all the usual caveats about Wiki: [http://en.wikipedia.org/wiki/Peter_Thomas_Bauer](http://en.wikipedia.org/wiki/Peter_Thomas_Bauer)

Different and interesting; a commentary on Bauer and his influence by an Indian writer: [http://jeevika.ccsindia.org/policy/glob/articles/people_sc_friendofpoor.asp](http://jeevika.ccsindia.org/policy/glob/articles/people_sc_friendofpoor.asp)