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The Americas

U.S. Forces Wrong Medicine Down Latin American Throats

By Manuel F. Ayau

GUATEMALA CITY—The subject of foreign aid for economic development is not easy to discuss. A new Agency for International Development report, remarkable for its self-criticism of AID programs, will likely be condemned as insensitive to the interests of the Third World. Aid proponents are shielded from criticism by the innocent belief that if intentions are good, the results sought are automatic, unless some evil spirits conspire to pre-empt achievement of the worthy goals. However, the truth is that only a small fraction of foreign aid given to Latin America in the past 30 years has actually been of help. Some has been wasted (to put it charitably). But most has actually aggravated the malaise it was intended to cure.

Latin Americans don't stay poor because we want to. It is because we are bribed into accepting interventionist economic policies by so-called developmental economists who view the free market as disorderly, inefficient and unethical. This perception is the result of ignorance of how the market coordinates people's actions, how it allocate resources, why bankruptcy plays an important role, why private property is essential, etc.

There are three broad areas in which bad advice has been proffered as freely as greenbacks. All other bad policies—involving land reform, import substitution and the like—are generally variants of these:

• *Tax policy*. Since its inception, foreign aid has been contingent on the adoption of tax policies that are prompted more by a redistributive than a productive philosophy. Redistribution of land and incomes disguised as "reform" and a more equitable distribution of wealth have been a precondition of aid.

In 1962, I drafted an income-tax bill at the request of the president of Guatemala. Funds providing technical assistance for implementation of the tax came from the U.S. When I attempted to correct the translation of a State Department draft that incorrectly used the Spanish word for "rent" instead of "income," the president became furious. Banging his fist on the table, he exclaimed that he didn't care what the bill said, but the tax must be called exactly what the gringos called it. Otherwise, he explained, no money would be forthcoming.

Curiously enough, many U.S. advisers maintain that the per-person income tax in our countries is too low. This is the result of a simplistic dependence on macroeconomic analysis. Very few people in Latin countries come under the tax systems, given the large informal and subsistence economies. Statistics, however, are calculated by dividing what very few pay into the total population, most of whom don't pay anything at all. Those who do pay look as if they are not paying their share. In Guatemala, of an adult population over age 25 of 3.2 million, only 32,000 are registered income-tax payers, and only 50,000 retailers collect the value-added tax on sales. AID officials' suggestions of strictly enforced, progressive tax rates for such a system work only to hasten capital flight.

From the point of view of eliminating poverty, the last thing underdeveloped countries need is a tax on capital accumulation. As Ludwig von Mises pointed out, the difference between rich and poor countries is mainly in the capital investment per capita. But U.S. "economic experts" prefer equitable distribution of poverty to the creation of wealth.

• *Monetary mismanagement*. All Latin American central banks have as their primary function the totally unnecessary task of expropriating all the foreign exchange earned by their citizens. They pay producers who earn the foreign exchange less than it is worth in the market and then proceed to sell it at different prices depending on what it is going to be used for. By enforcing multiple exchange prices many Latin speculators (or those with inside information) are able to obtain dollars at one rate to sell at a higher one. In effect, monetary policies of Latin America force the producer of dollars to subsidize the spender of dollars and the flight of capital. Central banks become the arbiters of all activities, including how often and for what purposes their citizens should travel (as if they knew).

These monetary demand-side policies are the tragic inheritance of Keynesians and followers of Argentine economist Raul Prebisch. They were the mentors of U.S. aid advisers, and they still haunt the central banks and some of the international entities that dispense money and advice. These destructive practices persist only because legal tender laws have allowed central banks to destroy their currencies through overvaluation (causing capital flight) or undervaluation (causing inflation). No Latin American would use his central bank's money if it wasn't a crime to use something else.

• *Labor legislation*. U.S. labor organizations, funded overtly and covertly by the U.S. government, have dispensed a lot of money in Latin America trying to reform Latin labor laws. Often the help does more harm than good—for the economy and for the workers.

A severance pay provision was initiated in Guatemala that gives the worker the right to one month's wage for every year of employment according to the last wage, but only if he is fired. If he quits, he gets nothing. Therefore the price of leaving voluntarily to take a better job is very high, equivalent to losing all his savings. So the worker is likely to pass up better opportunities. Should the worker quit, the employer is relieved of a contingent liability. Thus, the employer has a strong incentive not to raise wages to induce workers to stay. In effect, workers become captive labor without bargaining power: Should they tell their employer that they would leave if their salary is not increased, the employer will smile inwardly. The end result is that most people end up earning less than they could, and they are stuck in the wrong job to boot. The productivity of the country is lower, diminishing the purchasing power of all earnings.

Of course now that the free-enterprise lexicon is chic (even among communists), aid officials must change their tune. But even in the name of capitalism, aid officials continue to make critical misallocations—currently by pouring money into *private*-enterprise projects (as distinct from *free* enterprises). Private entrepreneurs can be as opposed to the competitive forces of the free-enterprise system as the most stubborn interventionists. Most are by necessity so entangled and dependent on the webs of government intervention that they don't believe the world can operate without it. Since to free the economy means undoing the environment in which they have succeeded, they might not be enthusiastic about destroying their privileged positions.

It is only in the achievement of understanding the functioning and ethics of the free society that foreign aid can contribute to economic development—not in solving actual problems, but in helping to understand the problems. And this can be done with a fraction of the resources that are wasted in the attempt to solve problems themselves. The U.S. Congress has the rare opportunity to do good by spending *less* money. Considering its own huge budget deficit, that should come as good news to the U.S. taxpayer.

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