economic considerations. And the political process is pathologically shortsighted. As the former prime minister of Great Britain, Harold Wilson, once said, "A week is a long time in politics." It is this myopic view that made Keynesian economics so politically acceptable and presents supply-side economics with its greatest challenge.

Stimulating the economy before the next election with demand-side policies is relatively easy. Real improvement in the economy's productive capacity, however, takes sacrifice, hard work, and patience—attributes that hold little appeal for the free-lunch crowd in Washington. As much as one may fault the more extreme supply-siders who argued that tax cuts would immediately generate greater productivity and more tax revenue, such free-lunch claims may have been the only way for supply-siders to get their policy program on the political agenda. The success of supply-side economic policy, however, will ultimately depend as much on constraining shortsighted political proclivities as on reestablishing productive economic incentives.

In the meantime, it is important that supply-side economics be correctly perceived as grounded in serious economic analysis and as capable of improving the long-term productive capacity of the economy. *The Supply-Side Solution* is an important contribution in this regard. It provides us with a series of articles by serious scholars who make a compelling case that supply-side economics is a viable long-run solution to our current economic problems.

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Development Without Aid
Melvin B. Krauss
New York: McGraw-Hill, 1983. 208 pp.

Melvyn Krauss has written a book that explores not only the policies that promote Third World development—primarily sensible domestic economic policies—but also those that do not, particularly foreign aid. Krauss' message is all the more important since Congress voted to give the International Monetary Fund (IMF) an additional $8.4 billion in an attempt to bail out insolvent Third World debtors and their Western banking creditors. Unfortunately, *Development Without Aid* suggests that this short-term palliative may ultimately hinder Third World development.

By almost any measure, the problems besetting most of the developing world are severe: dismal economic growth rates, millions in abject poverty and near starvation, and multibillion dollar international debts. For a solution, Third World leaders have turned to international politics and wealth redistribution, devoting their energies to building an active transnational redistributionist movement—a phenomenon left unexamined by Krauss. In doing so, they have wasted valuable intellectual and economic resources that would have been better devoted to private developmental efforts.

The nonaligned movement originally focused on political neutrality in the Cold War, but soon turned to economics. In 1964 the Group of 77, or G-77, as the developing-country political lobby is called, was formed; it pressured the West for trade preferences and increased loans and aid. A decade later the G-77 used its bloc voting power in the United Nations General Assembly to approve the "Declaration on the Establishment of a New International Economic Order" and the "Charter of Economic Rights and Duties of States." The charter endorsed the right of countries to nationalize businesses and form mineral-producing cartels; the declaration demanded additional foreign aid, majority control of international financial institutions such as the IMF, and cancellation of previously incurred debts.

In succeeding years, the G-77 has used every available international forum, including UNCTAD, the Third United Nations Conference on the Law of the Sea, UNIDO, the Commission on Transnational Corporations, and UNESCO, to press for massive wealth and technology transfers from the industrialized nations. Tanzania's president, Julius Nyerere, a prime proponent of the redistributionist ideology, has told Western audiences that "In one world, as in one state, when I am rich because you are poor, and I am poor because you are rich, the transfer of wealth from the rich to the poor is a matter of right; it is not an appropriate matter for charity."[1]

As morally and intellectually offensive as such sentiments are, the greater pity is that as long as people believe them—that underdevelopment is the fault of the industrialized nations—the problem will get worse. Developing country politicians will continue to promulgate faulty domestic economic policies and promote destructive foreign aid programs.

Krauss challenges the conventional wisdom about Third World development in a number of ways. For example, he implicitly questions the use of aggregate statistics to describe all developing countries, showing that the neighboring African nations of Ghana and the Ivory Coast, for instance, have highly divergent economic growth rates. Moreover, he details the tremendous economic success of what he calls the "Gang of Four"—Hong Kong, Singapore, South Korea, and Taiwan—despite the depression throughout much of the underdeveloped world.

Krauss also shows that, despite the interdependence of the global economy, "intelligent *domestic* economic policy is the essential ingredient for economic prosperity in Third World nations" (p. 8). Among the national policies that he finds particularly destructive are those in the "social-democratic tradition of development finance": a large and activist government, high taxes, state development projects, and vigorous income redistribution.

[1]In P. T. Bauer and B. S. Yamey, "Against the New Economic Order," *Commentary* (April 1977), p. 27.

The problem with this development philosophy, which holds sway over so many Third World politicians and Western developmental economists, is that high taxes and large government projects discourage private investment by reducing both the private capital available and the incentive to invest in private projects. As a result, Krauss concludes, the very business activity necessary for job creation and economic growth is choked off, causing even a highly advanced and functioning public infrastructure to be of little value. Krauss argues that building an economic framework is part of, not a prerequisite for, development; "the absence of infrastructure is more a sign of economic stagnation than a reason for it" (p. 20).

Income redistribution also hinders development. The high taxes necessary to level incomes reduce the reward for entrepreneurial activity, discouraging individuals from taking risks, exploiting job-creating opportunities, and accumulating human capital. Krauss finds that Costa Rica, Uruguay, El Salvador, and Ghana all have pursued economic equality and extensive social welfare systems at the expense of wealth creation. The poor would have been better off in rich, nonegalitarian countries—ones that consciously promoted economic growth—than these poor, redistributionist ones.

Krauss also examines three other counterproductive domestic policies regularly carried out by activist governments. The first is protectionism, which raises consumer costs and inefficiently wastes valuable resources. Protecting domestic industries also effectively taxes export businesses by increasing competition for limited economic resources, raising their cost. (Some countries also tax their export industries directly.) Such a policy is foolish, for, as Krauss points out, "a healthy export sector is essential to sustained economic growth" (p. 12). Notably, the Gang of Four nations are all major exporters.

Second, many developing nations suffer from what Krauss terms "the error of imitation." In an attempt to emulate the "industrialized model," Third World governments invest in heavy industries like steel and petrochemicals and prestige companies like national airlines, even though such projects will never be cost-effective. Even worse, they drain away scarce capital resources from more productive private investments and keep the countries heavily indebted.

Lastly, Third World regulation of multinational corporations (MNC's) by, for example, taxing capital inflows, reduces economic activity and the influx of badly needed technology and capital. Krauss calls MNC's "the key institution in the world economy facilitating the transfer of prosperity from the industrialized countries to the developing ones" (p. 126).

Krauss ties these points together in a fine discussion of the economic policies of the late Shah of Iran. To recreate the Persian empire, the Shah expanded the role of government, levied high taxes, nationalized companies, built domestic heavy industries, closely regulated business, created a burdensome social welfare state, and adopted extensive protectionist measures. Though commentators have given the mullahs the most credit for bringing down the Shah, Krauss concludes "it is doubtful whether they could have succeeded without the help of other less-religious groups like the traditional bourgeoisie, small businessmen, [and] new technical elites" (p. 102) who were harmed by the failure of the Shah's economic policies.

Though domestic policies are the most important determinant of the economic success of a nation, *Development Without Aid* explores some international policies that can help the Third World. The most important is free international trade. Another is international monetary reform. Krauss says the United States needs to make the dollar more attractive as a reserve asset for other nations, but warns against allowing an expanded IMF—one demand of the G-77—to serve "as a world central bank." Our experience with a politicized United Nations demonstrates the danger of subordinating the international economy to similar pressures.

Lastly, Western domestic policies that promote Western economic growth also benefit the developing world. Krauss demonstrates that increases in industrial production in the West will directly lead to increases in Third World primary product exports, and indirectly to increases in their industrial production as well, because they will become comparatively cheaper and more cost competitive as locations for manufacturing enterprises. Therefore, the industrialized nations, by subsidizing uneconomic special interests, creating extensive social welfare programs, and imposing high taxes, not only directly slow their own economic growth; they also indirectly hinder Third World progress.

But the most important contribution of *Development Without Aid* is detailing which international policies do not help lesser-developed nations—particularly foreign aid. Krauss builds on the pioneering work of economist P. T. Bauer to demonstrate that foreign aid often harms, rather than helps, Third World peoples.[2]

For example, foreign aid causes the recipient nation's currency to appreciate, reducing the competitiveness of its export industries. Yet earnings from a growing export industry will do far more to promote long-term development than politically unstable aid programs.

International aid also allows developing nations to adopt damaging domestic economic policies for political reasons. Krauss observes that "if governments can escape the burdens of their foolish economic policies, and foreign aid neutralizes such costs, governments have no incentive to discontinue them" (p. 158).

Another problem, which Krauss does not explore, is the concentration of additional power in the hands of Third World governments. In many developing nations, the government already controls what few resources

[2]See, for example, P. T. Bauer, *Dissent on Development* (Cambridge, Mass.: Harvard University Press, 1971); and idem, *Equality, the Third World, and Economic Delusion* (Cambridge, Mass.: Harvard University Press, 1981).

exist in the society; the state is the only arena in which people can gain power, influence, and wealth. Foreign aid, by increasing the money available to the government, increases still further the comparative advantage of entering politics rather than private business. This further drains the private sector of talented people and reduces private developmental efforts.

Krauss reserves his sharpest criticism for the multilateral aid organizations, particularly the World Bank. He points to its pattern of financing government energy and industrial projects, "crowding out private capital in areas in which private capital has a comparative advantage" (pp. 167–68). Even worse, the bank has underwritten such barbarous practices as the forced relocation of a half million families in Indonesia and the collectivization of farmers in Tanzania.

Krauss' critique of foreign aid is supported by two other recent books. In *The Destruction of a Continent,* Karl Borgin and Kathleen Corbett argue that foreign aid has been a "catastrophe" that has disrupted "the natural development of Africa."[3] And Thomas Sowell, in his powerful work *The Economics and Politics of Race,* singles out Tanzania, the recipient of the most foreign aid per capita in the world, "as a striking example of the effects of international wealth transfers."[4] Over the past decade output per worker has dropped by half and half the industries nationalized by the government have gone bankrupt.

Development Without Aid is not without its flaws, however. Krauss' fascination with supply-side economics leads him to proclaim that "economic growth helps the poor not only because of its effect on private incomes but also because economic growth allows public consumption—public housing, public health, education—to increase rapidly" (pp. 40–41). But why does he assume "public consumption" is in the public's interest? Public housing in America has had horrible consequences, including for the poor. The fundamental point is simply that only a growing economy provides the resources necessary to take care of the disadvantaged in society. If no wealth is created, there is none for anyone.

Krauss also endorses political involvement by MNC's, arguing "that the multinationals were able to use their legal influence to rid Chile of a government that had brought untold economic misery to the country is to their credit" (p. 134). The problem, of course, is that what actually replaced the Marxist Allende was the far more brutal and misery-creating Pinochet junta. MNC's are as likely as any indigenous special-interest group to use political influence to enrich themselves at the expense of others.

Additionally, the adverse impact of political repression on economic development is ignored by Krauss. Police states, many underwritten by the United States, stifle initiative and ingenuity, necessarily discourag-

[3](New York: Harcourt Brace Jovanovich, 1982), p. 188.

[4](New York: William Morrow and Co., 1983), p. 240.

ing economic endeavor. Restrictions on the free flow of information and travel also hinder business communication and operations. Just as economic freedom is necessary to preserve political freedom, political freedom underlies economic freedom.

Nevertheless, *Development Without Aid* is extremely valuable. Krauss has convincingly shown that the West should not fall for the guilt syndrome propagated by the G-77 and its intellectual camp followers. That does not mean we should be indifferent to the plight of the Third World. As Boston University sociologist Peter Berger has put it, "immense anguish and pain, physical as well as moral, have been associated with the entry of these people into the common history of our age."[5] We can help ease that pain by undertaking policies that promote international development and by reducing our support for politically brutal and economically backward regimes.

But the fundamental answer to widespread poverty and economic stagnation in the Third World is to change the disastrous domestic economic policies of the developing nations themselves. By stifling economic incentives and ingenuity, wasting domestic resources, and discouraging foreign investment, they have guaranteed economic disaster. And no amount of money from taxpayers in other lands can bail them out. Instead, if these countries give economic freedom a chance, they will find that, in Krauss' words, "the international marketplace prove[s] a much more potent antidote to poverty . . . than the international transfer of income" (p. 190).

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[5]Peter Berger, "Speaking to the Third World," *Commentary* (October 1981), p. 30.