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The Reports on U. S. Foreign Aid Policy 10 pages

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The recently published reports on the appropriate role for U.S. foreign aid in promoting economic development 1/ include recommendations ranging from the complete elimination of all U.S. economic assistance (aside from Export-Import Bank loans at approximately current levels) to an annual increase in U.S. economic aid of $2 billion or more. In only a few instances do the reports present useful discussions of the factors to be evaluated in reaching a decision on a given problem, although in other cases one is able to get a reasonably clear idea of the nature of the problem by reading several reports together. In certain important areas, however, including the quantitative estimates of foreign aid requirements, the reports provide little in the way of clues as to the appropriate basis for a decision.

A part of the differences in the recommendations can be explained by reference to the different policy objectives of the development programs envisioned in the various reports. However, even among reports with apparently similar objectives, there exist substantial variations in the nature of the governmental programs proposed.

1/ See: American Private Enterprise, Foreign Economic Development, and the Aid Programs. A study prepared at the request of the Special Committee to Study the Foreign Aid Program, United States Senate, by the American Enterprise Association, February 1957. (Hereafter designated as the A.E.A. study.) Economic Development Assistance. A statement on National Policy by the Research and Policy Committee of the Committee for Economic Development, April 1957. (Hereafter referred to as the C.E.D. study.) New Emphasis on Economic Development Abroad. A report to the President of the United States on ways and means and reasons for U.S. assistance to International Economic Development, International Development Advisory Board, 1957. (Hereafter referred to as the I.D.A.B. study.) The Objectives of United States Economic Assistance. A study prepared at the request of the Special Committee to Study the Foreign Aid Program, United States Senate, by the Center for International Studies Massachusetts Institute of Technology, January 1957. (Hereafter designated as the M.I.T. study.) Report to the President by the President's Citizen Advisers on the Mutual Security Program, March 1, 1957. (Hereafter designated as the Fairless Committee report.) The Role of Foreign Aid in the Development of Other Countries. A study prepared at the request of the Special Committee to Study the Foreign Aid Program, United States Senate, by the Research Center in Economic Development and Cultural Change of the University of Chicago, March 1957. (Hereafter referred to as the University of Chicago study.)

Policy objectives

It is not surprising that the ultimate policy objectives are largely political. These objectives appear to be of two basic types--those that stem from the process of development itself and those that stem from the higher levels of income and output resulting from development. The main objective of a development program set forth in the M.I.T. and I.D.A.B. reports, and one of several important objectives cited in the University of Chicago study, is associated with the process of development. On the other hand, the main political objective of such a program cited in the Fairless report, and several other objectives noted in the Chicago study, stems from the achievement of higher levels of income in the underdeveloped countries.

Process of development -- The hypothesis that U.S. assistance will lead to economic growth and that this growth in turn can be made to lead to politically mature and stable democratic societies is stated most completely in the M.I.T. study (pages 21-23); and while this argument might not be indorsed in its entirety by the authors of the I.D.A.B. and Chicago studies, as outlined below, it is not inconsistent with either of these reports (see page 6 of the I.D.A.B. report and pages 74-75 of the Chicago report).

1. The existence of an aid program may affect the objectives of a country's leaders; even before substantial growth is achieved, such a program "can sharply alter" the leaders' "conception and evaluation of the choices they confront. Specifically, it can reduce the relative attraction of aggressive foreign policies."

2. Once a development program is in effect, it can alter both the structure of the society and the goals of many members of that society in a manner tending to promote the establishment of mature democratic institutions. It can, by channeling energies toward projects benefiting most groups in society, "provide a sense of community in which seeds of class struggle and violence tend to die;" it can provide "new and constructive options for advancement for the ambitious young who are not of the old ruling groups;" by increasing social and economic mobility it can reduce "the unilateral dependence on particular employers or on the approval of particular communities," and thus dilute "the monopoly position of traditional wielders of power and provide the basis for those 'checks and balances' at all levels of society which mark a mature democracy."

The M.I.T. study (page 23) observes that "none of the above effects is an automatic consequence of aid or of growth in the level of output" and recognizes that "political and social change inevitably involve turbulence." However, "since change is already inevitably underway in most of the countries at issue, the United States has a unique capability to steer such change in constructive directions."

Similarly, the C.E.D. study (page 10) recognizes the dangers of promoting development as a lesser risk:

> "Where development takes hold, success itself will often create problems, as long accustomed social and economic patterns are broken, and new societies emerge with the new economies. Serious as such disturbances may become in some places, we must take the risk, since the alternative holds greater risk--widespread unrest, aimless adventuring and violence, and the possibility of communist subversion or other regimentation arising from frustration."

It is not quite clear from these remarks, however, or from the rest of the study, whether the C.E.D. expects stability to come primarily from the process of development or from the higher levels of income.

On the other hand, the A.E.A. study emphasizes the costs of development to the exclusion of the possible gains in social and political stability. After noting that disturbance is associated with social change, the report concludes (page 41) that "there is a strong presumption that the processes of private investment are less likely to cause extreme social stress and upheaval than government programs for development." Private investment depends on the availability of factors complementary to capital, and "the presence of these sets up a presumption that people will have made some progress along the road to development, that social institutions and psychological attitudes are not wholly unrelated to the new developments.

Higher income -- Certain of the reports definitely envision the attainment of stability through the achievement of higher levels of income. This argument occurs both in a general form and specifically related to military strength. The Fairless Committee (page 2) advocates a development program as a means of "demonstrating that a free system is far superior to an authoritarian one in providing better living conditions and the individual opportunities which people so deeply desire." It maintains that economic strength makes it difficult for communist psychology or subversive programs to gain strength, and states that where communist successes have occurred they have come via military operations and occupation.

The I.D.A.B. report (page 6) frames the argument negatively: "the failure of the underdeveloped countries to achieve satisfactory economic progress is likely to produce serious repercussions in the free world." (These are identified principally as increased political instability and an increased possibility of extremist or totalitarian governments.) The University of Chicago study notes essentially the same point.

The Chicago study also argues (page 73) that "if the economies of the other countries of the free world are sound, they are stronger militarily and better able to defend themselves against aggression," and the Fairless Committee pushes this argument one step further and observes (page 2) that increased economic strength "should enable these nations to support their military budgets locally, with a consequent decline in the aid which the United States is called upon to provide."

Since even the most ambitious of the reports expect rather modest annual increases in per capita income, it would appear that the arguments relating to the attainment of high levels of income are of an extremely long-run character, insofar as they are applicable at all to programs designed to promote economic development. (However, in the context of a defense program--and the Fairless Committee is concerned with the Mutual Security Program as a whole--they may be of immediate relevance.) Moreover, the hypothesis which relates stability to the level of income rests solely on the assertion that such a relationship exists. In view of the frequently expressed skepticism that income and political and social stability are closely related (in the present group of studies these doubts are found in the A.E.A. study), such assertions are hardly adequate by themselves.

Other objectives -- In only a few reports do purely economic objectives appear, and in general they are quite subordinate. The University of Chicago report contains an explicit statement of such an objective (page 73), though this objective does not have an important position in the argument set forth there: "If other countries within the orbit of the free world are better off, they form better markets for American exports, and they are better able to supply the United States with the commodities we need to maintain a high level of economic activity." Similarly, the C.E.D. report (page 8) notes the favorable effect a development program may have in increasing markets for U.S. exports, and in assuring sources of raw material imports by encouraging the countries to refrain from establishing political ties with the communist nations.

The objective of the program advocated by the A.E.A. may be viewed as exclusively economic, since the assumptions of the report establish in effect a one-to-one correspondence between economic and political objectives. Development is to come about through private investment, which is allocated according to the criteria of the price system. Maximum efficiency in allocation of resources (achieved through a successfully functioning price mechanism) therefore defines the appropriate rate of development.

Financing of development

The variation in the types of programs recommended in the studies is greater than can be explained by reference to the objectives. Differences emerge at almost every point, beginning with the nature of the problem and the extent to which development can be achieved through indigenous investment. While the M.I.T. and Chicago reports stress the inertia in underdeveloped countries and consequent need for a substantial initial impulse in the form of externally supplied investment, the A.E.A. study (pages 21-24) questions the thesis and argues that much investment in underdeveloped countries is unrecognized and that "in recent years there has been appreciable growth both in total and in per capita output in most countries for which reasonable information is available."

Private investment -- There is marked variation in the analyses with respect to the extent to which private investment is capable of contributing to general development, as distinct from the development of a particular resource in a given country.

The A.E.A. and the Fairless Committee appear to be most sanguine about the results to be expected from the increase in private investment in underdeveloped countries, though each report takes pains to recognize some of the limitations of this flow as an instrument of development. The Fairless Committee, for example, concedes (page 8) that "general encouragement of private investment and trade will not suffice in certain crucial areas such as Korea, Taiwan, Vietnam, Pakistan and Turkey, which have been heavy claimants on our financial assistance." Since the report is based primarily on the existing aid program, it is probably unfair to infer from this statement that private investment and trade might be expected to contribute substantially to development in nearly all other underdeveloped countries, but the implication that such investment would be an important--though not the only--factor in at least a good many countries is unmistakable.

On the other hand, the A.E.A. study, which is committed by its objectives to the proposition that private foreign investment (plus the not insignificant amount of indigenous investment) should provide the capital for growth, struggles manfully to demonstrate that private investment is able to provide sufficient capital for substantial growth.

On the question of whether or not private investment is capable of supplying the capital required for social overhead projects--and it is the negative answer to this question that leads the I.D.A.B. and Chicago reports to reject the idea that private investment can play any substantial part in promoting needed development in the near future--the A.E.A. report (page 34) contains no doubts: during the 19th century "a vast amount of social overhead capital was provided to developing countries by private investors . . . [suggesting] . . . that there is no inherent reason why social overhead capital cannot come from private sources under appropriate conditions. . . If necessary, governments may make use of subsidies to induce private capital to undertake the types of capital formation involved--a policy for which there is ample historical precedent." This policy, even when supported by historical precedents, contrasts rather markedly with the clear logic of the price mechanism which provides the backbone of the analysis in the report and is rather at odds with the role prescribed for government (page 44).

Again, in considering the benefits to the underdeveloped country of foreign investment in extractive industries, the A.E.A. report lays heavy stress on the advantages such investment provides the government of the country. (The nature of the contribution provided by investment in extractive industries is a matter of considerable importance for the argument of the report, since in 1955 70 per cent of the value of U.S. investment in all underdeveloped countries outside Latin America consisted of investment in mining, smelting, and petroleum.) The two major advantages claimed for such investment are that it provides substantial governmental revenues in the form of taxes and royalties, and that it makes available foreign exchange which can be used for the import of capital equipment. (This use is contingent upon the existence of complementary domestic capital--a point the report fails to mention in this connection.)

The A.E.A. study makes rather modest, and in fact slightly defensive claims (page 26) as to the direct impact of such investment on the economy as a whole. "To the charge that investments in extractive industries provide additional capital to only a relatively small part of the local labor force, it may be noted that this is better than none at all; even a small increase in employment in extractive industries assists in local economic development for it raises the productivity and real income of those employed in conjunction with it." However, despite the rather lukewarm claims made on behalf of this most important portion of private investment, the report contains no real doubts that private investment could, if properly encouraged, lead to a considerable increase in the already not inconsiderable rate of development.

The other reports adopt rather less optimistic attitudes toward the effectiveness of private investment in achieving the objectives set forth, although none goes so far as to reject such investment as of no significance. The M.I.T. study argues that private investment "can play a significant role although it cannot be expected to carry a major share of the burden of an assistance program" (page 42). The major obstacles cited in this study are the absence of self-sustaining growth and the consequent reluctance of investors to take risks where such growth is not present, the difficulties of transferring profits, and the unattractiveness to private investors of the needed social overhead investment.

Although the C.E.D. "assigns great value to an increase in the flow of private capital to the underdeveloped countries," it does not expect private capital to be able to "provide all, or even provide most, of the funds that can be effectively used" (page 19). The reason lies in the large requirements of underdeveloped countries for social overhead capital. For the same reason, the I.D.A.B. study does not expect private capital to "play a major role in the development of either Asia or Africa."

The Chicago study is the most pessimistic concerning the contribution of private investment and, in addition to the point just mentioned, notes that private investment is proportionately much smaller than it was prior to 1914, and "considerably below the capital needs of the developing countries," and that is is "distributed most unequally, both in terms of industrial fields, as well as from a geographical standpoint" (page 54). This unequal distribution is traced primarily to political factors--nationalistic antipathies to private investment and dangers of political change--which increase the risks of certain types of investment, and apparently tend to concentrate investment in the extractive industries. The report argues that such investment "may [provide] little stimulus to the rest of the economy, normally, because these export commodities are produced in plantations or mines which technologically are completely different from traditional forms of production" (page 54). However, this reference to technology is insufficient to meet the argument of the A.E.A. on the impact of any investment on real income.

Measures to promote private investment -- The I.D.A.B. and Chicago reports contain no recommendations for special government programs to promote private investment. In the case of the first report this omission may reflect a desire to concentrate its limited space (18 pages) on the main objective--the Development Fund (which is to participate with private capital in making loans).

The A.E.A., C.E.D., M.I.T., and Fairless Committee reports all point to government guarantees against inconvertibility and confiscation as means of stimulating private investment, and some of these studies advocate additional government programs as well as the expansion of existing ones. The Fairless and C.E.D. reports recommend that joint investment of public and private capital be tried in at least certain areas; the A.E.A. and the C.E.D. advocate certain tax changes; and the A.E.A. recommends an expanded information program calling attention to investment opportunities abroad.

Public programs -- The relative importance of government aid in the recommendations of the various reports has already been implied in our discussion of private investment. The A.E.A. argues that "to the extent that financing in addition to that available from local resources and private foreign investment is needed it can be and is being provided on a loan basis by the Export-Import Bank and the International Bank for Reconstruction and Development" (page 55). Then, roughly in order of increasing reliance on government programs, come the Fairless, C.E.D., M.I.T., I.D.A.B., and Chicago reports.

The Fairless Committee concludes that "grants to provide capital for development should be severely limited, though there may be unusual cases in which they are warranted" (page 11). As two examples of such cases the Committee notes the educational exchange and technical assistance programs. Dollar loans might be made on terms more liberal than those of the established public banks, but loans repayable in local currencies are viewed as undesirable (page 10) because "our relations with other countries will suffer from U.S. control of large amounts of their currencies" and "the validity of international contracts should not be undermined by the granting of loans in circumstances in which there is grave doubt as to the ability of the borrower to repay."

The International Development Fund, proposed by the I.D.A.B., is likewise to concentrate primarily on loans (including loans permitting repayment in local currency and on terms more liberal than those available from the I.B.R.D.), although for such purposes as technical assistance, grants are considered appropriate. The C.E.D. report also emphasizes the role of loans, arguing (page 29) that the use of grants "as the major element of our assistance would tend to erode those very qualities that development assistance aims to build up." In some instances, it recommends making loans repayable in local currency, however.

The M.I.T. report sets forth no general principle, stating "the composition of aid as between loans, 'local currency loans' and grants should be determined by the country's creditworthiness" (page 63). The Chicago study argues against local currency loans on the grounds that they are ambiguous, and urges that funds be made available on a grant basis or as a straight loan, depending on the prospects for repayment.

Thus, the verdict is mixed. Three reports maintain that primary reliance should be placed on loans, while the other two leave the role of loans and grants to be decided on a case-by-case basis. Likewise, two reports urge that loans repayable in local currencies be discontinued, while the other three approve their use as intermediate between dollar loans and grants.

Extent of development aid

The estimates of the aid required are quite varied and almost without exception are unsupported except by the reputations of the authors of the reports.

The American Enterprise Association stands alone in urging a reductio in the scale of U.S. Government aid; the report recommends that all U.S. Government economic aid (except for loans by the Export-Import Bank) be eliminated, on the grounds that "development aid and private foreign investment are more often competitive rather than complementary" (page 9).

Of the remaining studies, that of the Fairless Committee appears to contain the most modest governmental program. The Committee concludes (page 18) that "funds available for economic assistance should be continued . . . over a period of years," and that at the level of fiscal 1956 "the total costs of collective security do not outweigh the results being achieved." The report does not argue, however, that economic aid (which it estimated to be about $1.7 billion on a gross basis--the equivalent of about $1.1 billion net of reverse grants and repayments on loans) should be increased.

The report of the I.D.A.B. urges (page 16) that Congressional appropriation for an International Development Fund "should be sufficient for a substantial increase in capital investment and technical assistance programs," although there is no indication given of the increase necessary to afford a reasonable chance of attaining the objectives. The report estimates that between $650 and $1,150 million from the mutual security appropriations for fiscal 1956 "contributed to long-term economic growth abroad." It recommends that the Fund be established "for a period of years" and that the appropriation be sufficient to last for at least three years.

The C.E.D. study concludes (page 20) that "if definite proposals should be formulated, involving the outlay of, say, $5 billion in five years in addition to our present economic assistance programs, and holding out reasonable promise of significant contribution to the economic development of the Free World, we would regard this as a desirable and necessary investment in our national security, economic and humanitarian interests." The report finds it unlikely that during the first five years sufficient "programs meeting the tests of feasibility and value" would be found to warrant total expenditures exceeding this amount.

The M.I.T. study finds (page 61) "absorptive capacity . . . so limited in many underdeveloped countries that relatively small amounts of capital ($2.5 to $3.5 billion more per year from all sources) would amply suffice even if every underdeveloped country of the Free World were to avail itself fully of this opportunity. In practice it is unlikely that more than 50 to 60 per cent of this amount would be taken up." No estimate was provided of the proportion of the $1.25 to $2.1 billion of additional capital which the United States might be expected to provide. In another passage in the report, however, it is noted that "an aid program of roughly $1.5 billion per year would raise per capita incomes in underdeveloped countries by 1 to 2 per cent per year." While no basis for this calculation is given in the report, the estimates coincide with those found in the Millikan-Rostow study, 1/ which includes an explanation of the final estimate.

The Chicago report aims for a rise in per capita incomes in the underdeveloped countries of about 3 to 4 per cent per year. Assuming annual increase in population of about 1.5 per cent, national income would have to rise at 4.5 to 5.5 per cent per year, and on the basis of a calculation not shown the report estimates that the necessary investment would have to amount to 14 per cent of income as a minimum. Since the report believes that the underdeveloped countries probably cannot save more than about 10 per cent of income without coercion, and since it estimates total income of the underdeveloped countries in the Free World at about $110 billion in 1955, it puts total required foreign investment at a minimum of about $4 billion per year.

The Chicago study estimates that perhaps as much as $1 billion could come from private investment "of the type most useful for development," leaving $3 billion to be met by public programs of the United States and other more highly developed countries. In the initial years of development, it is estimated that required expenditures would be close to the minimum level cited above; however within 10 to 15 years needed development assistance might reach $5 billion, and the report apparently envisions development assistance extending over two or three decades (page 74). The contribution of the United States to economic aid is put at a minimum of $2 billion annually during the early years of the program (page xiii), but presumably it might have to be increased up to around $3 billion if government aid from other countries were not forthcoming.

The estimates provided in the University of Chicago report are not supported in detail; nevertheless the inclusion of the estimates noted above makes it possible for the reader to evaluate to some extent the recommendations of the report, and the failure of the other reports (except the M.I.T. study which is based on the Millikan-Rostow analysis) to provide even such rough estimates renders them rather useless for purposes of analysis.

1/ Millikan, Max F. and Rostow, W. W., A Proposal Key to an Effective Foreign Policy, New York, Harper and Brothers, 1956.

The A.E.A. study, which is immune from this particular criticism and which must stand or fall on the validity of the qualitative assumptions underlying its analysis, attempts (page 32) to dismiss all quantitative estimates of requirements on the grounds that marked discrepancies in the results make projections of this sort "of questionable value." However, what is required is not uniformity in projections, but a basis for selecting from among the different estimates.

Conclusions

The reports which place greatest emphasis on the benefits stemming from the process of development are those which recommend the largest aid programs. Moreover, the relative role assigned to private investment is apparently dependent on the size of the projected program. Aside from these few points, no general pattern seems to emerge from the recommendations.