

AMERICA'S FOREIGN AID PROGRAM

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INTRODUCTION

An evaluation of foreign aid can usefully begin with an emphasis upon three significant political and economic developments in the postwar world. First, the security of the United States has been threatened seriously since World War II by the rise of a powerful group of Communist nations that are hostile to capitalistic countries such as our own. Moreover, it is increasingly apparent that the resultant political struggle between the western capitalistic countries and this Communist bloc may continue for many years.

At the same time the United States was trying to turn back the challenge of international communism, it was confronted with another fundamental change in international relations. This is the attainment of political independence by a number of nations that formerly were alined closely to certain western countries. A major way in which these nations exercise their newly gained independence is by attempting to raise their living standards. In this effort, they are also joined by other relatively poor countries that previously had attained a large measure of political autonomy. The conviction that their long-endured poverty can be eliminated deeply influences the actions of the political leaders of these regions. However, in their attempts to carry out the objective of accelerated economic growth, many of these nations are not as yet firmly committed to the methods either of democratic capitalism or of totalitarian socialism. Consequently, the programs and policies followed by these countries are necessarily of vital interest to both the West and the Communist group.

A third point to keep in mind while analyzing the American foreign aid program is that international financial difficulties have plagued many of the western capitalistic countries since the end of the war. Although much progress has been made toward solving this problem, the rebuilding of a stable, relatively free pattern of international trade with these nations is still not completed.

Within the framework of these postwar developments, two major sets of questions must be answered in considering the foreign aid policy of the United States. They are: (1) Is the current volume and regional distribution of foreign aid by this country adequate; and (2) Is the economic and financial form of this aid satisfactory.

THE VOLUME AND REGIONAL DISTRIBUTION OF FOREIGN AID

The adequacy of the magnitude of America's foreign aid program is a question that must be decided in terms of the relative importance of our various competing national policy objectives and the limited

volume of resource available to achieve these goals. In particular, it must always be remembered that satisfactory international political and economic relations are only one of many objectives of national policy. Furthermore, expenditures by the Federal Government are only one method of attempting to achieve this specific goal.

Within recent years, the threat of Communist aggression caused this country to allocate most of its foreign aid for the purpose of providing direct military assistance to our close allies. To meet the immediate danger of war there can be little question about the wisdom of this decision. Such foreign assistance clearly can indirectly strengthen our military capabilities more than would be the case if these funds were employed directly for increasing the potential of our own military services. We must, however, make certain that these funds are received by nations who would make effective fighting partners in case of a general conflagration.

The appropriate volume of direct military aid would seem to depend upon the maintenance of a balance of military power between the free and Communist worlds. Shifts in foreign policy—apparent or real—on the part of the Communist nations should not be allowed to cloud their basic hostility to the West. The only adequate guide for defense expenditures in the West is an appraisal of the military strength of the potential adversary. An appraisal of this type is a difficult task, but the risks involved are so great that we must be sure not to underestimate the military power of the Communist bloc.

Although a policy of military strength may prevent a general conflict and also retard Communist expansion by means of small-scale wars, it does not adequately meet the problem of thwarting the spread of communism by peaceful methods. One means of partially dealing with this matter is by attempting to increase the economic power of those nations in which there are democratic leanings but in which communism is still a real threat. The more fully these countries can satisfy the economic desires of their people through democratic methods, the more secure will be the international position of the United States. However, to view the problem of raising the level of economic well-being throughout the free world solely in terms of the struggle between the West and the Communist bloc is to adopt a much too narrow view of our foreign policy problems. In many countries communism is not an immediate danger, yet there are beginnings of a profound revolution in traditional social, political, and economic ways of life. To minimize the significance of this upheaval for the United States would be to take a dangerously shortsighted view of our interests. Our interests clearly are to help these nations achieve their political, economic, and social goals within the framework of a stable, democratic, and capitalistic system. For with this type of government the chances of gaining the type of world peace we seek are greatest.

In addition to shifts that are occurring in the poorer parts of the free world, our foreign policy must also take into account the problems faced by some of the older capitalistic nations. In these nations our interests are less social or political and more economic. We are especially concerned with their economic ills that appear in the form of periodic balance of payments difficulties. Such difficulties tend to lead to the imposition of additional quantitative restric-

tions on trade by these countries and sometimes to curtailment of the volume of resources devoted to military preparedness in order to cope better with their international economic problems. Since these policies are not in the interests of the United States, the question of possible economic aid to these countries is also relevant.

But is economic aid a sufficiently effective means of implementing our foreign policy of combating communism and of promoting a world in which we can prosper in peace? The experience of economic aid under the Marshall plan must certainly be judged as encouraging. By 1950 most of industrial Europe regained its prewar level of production and the great dollar shortage of the immediate postwar years was significantly reduced. Financial crises have occurred since then but the fear that an economically weak Europe would be an easy prey to communism has long since passed. As a result, economic aid to industrial Europe was greatly reduced. There still remains, however, the need to develop a stronger international organization to help these nations—as well as the rest of the world—to meet short-run balance of payments strains.

Although the Marshall plan was highly successful, one must be cautious about generalizing from this experience in discussing methods of furthering our interests in the poorer parts of the free world. The problem in postwar Europe was to rebuild a war-disrupted industrial structure. These countries already possessed the economic and social requisites for successful economic growth. Moreover, their governments were of the type with which the United States could maintain harmonious relations. The main task for us was to help restore their economic strength as quickly as possible in order to turn back the threat of Communist aggression and to renew mutually profitable economic relations.

The situation in the undeveloped areas is quite different. In these regions it is not mainly a matter of restoring economic strength within a framework of established social, political, and economic institutions but of creating an environment in which sustained and faster development can occur. To accomplish this goal significant changes in the social, economic, and political milieu of these nations are required. Many of these countries have long been caught in a vicious circle of poverty. Being poor they do not possess the means to save nor the purchasing power to encourage a large volume of investment in manufacturing. In addition, the efficiency of the people as productive agents is low, and their natural resources are poorly utilized. To break out of the circle of poverty necessitates more than the provision of capital funds; it also requires a modification in their cultural patterns that will be conducive to growth.

When the problem of accelerating development in the poor countries is viewed in this manner, arguments for economic aid claiming that the recipient nations will become friendlier toward the United States or that they will turn away from communism as their living standards rise appear rather superficial. Establishing a creditor-debtor relationship or a donor-donee one certainly does not breed friendship in any deep sense. Nor is democratic capitalism necessarily correlated with a rising standard of living. Indeed one must be careful about assuming that economic aid will make a significant contribution toward permanently raising living standards in the poor regions. A case for

general foreign aid based upon the development of sources of raw material supplies and of markets for our manufactures also should not be pushed too strongly. It is not at all obvious that these objectives are best satisfied by a large-scale Government-sponsored aid program.

Does it follow that the benefits to the United States of an economic aid program to the poor countries are so problematical that such aid is not justified? I think not. It should be recognized, first, that fundamental economic, social, and political changes are already occurring in these regions. Whether we step in and assist these nations develop is not going to affect the underlying forces making for change. We may be able to influence the forms of expression of these forces but not their basic nature. In short, the United States is confronted with changing political, economic, and social forces in these countries to which we must adapt.

Although most poor countries in the non-Communist world are not undertaking development programs within the framework of minimal direct government sponsorship that existed in such nations as Great Britain and the United States during the 19th century, they are following policies closer to capitalism than to the type of detailed planning practiced by a completely socialistic state. Their poverty and backwardness may necessitate more state activity than under American capitalism, but these characteristics at the same time tend to discourage the use of all-embracing planning techniques. For the very lack of administrative and entrepreneurial skill makes the communistic technique of deliberate industrialization highly risky.

Thus, the United States faces the problem of adapting to deep-seated revolutionary forces that in most of the poor nations at the present time are being channeled into forms of political and economic activity that are reasonably acceptable in terms of our foreign policy interests. Our chances of living in a peaceful and prosperous world would seem to be greater if the development programs of these regions are successful than if they are not. If they succeed the chances of strengthening democracy and free enterprise in the poor countries would seem to be increased. Failure in their development efforts will strengthen the positions of those advocating complete planning and the kind of undemocratic political methods usually associated with this policy. However, even with successful development programs in the poor countries, it should be stressed that what we should seek is a strengthening of political independence, democratic forces, and capitalistic traditions in these countries rather than the creation of carbon copies of American political or economic institutions and of governments that are prepared to follow blindly our political leadership.

Coupled with the challenge of adapting to the new forces in the poor countries as well as the tendency of these nations presently to follow political and economic methods that satisfy our foreign policy objectives is the belief by most investigators of the development problem in poor areas that well-conceived economic measures on the part of the rich countries can significantly help the underdeveloped nations. Many of these countries do not seem to be too far away from a threshold of sustained growth. Efforts by the poor regions alone, however, may not be sufficient to break out of the vicious circle or at least may delay the breakthrough for a long time. A certain amount of help from the rich nations may provide the push needed to reach a self-

generating growth position. It is emphasized, however, that merely making large sums available under very loose controls or adopting other measures to encourage foreign investment is by no means sufficient to guarantee success. This is a very different case from that of postwar Europe where the problem of utilizing available funds productively was not so serious. There is a much greater possibility in the poor countries that economic aid may not be used in the most productive manner. The reason for this rests on the very characteristics that make these countries poor. As a result, if economic aid is to be successful in raising standards of living, it must be channeled through organizations which carefully appraise the development plans and potentials of these countries. The program should be designed to further the establishment of conditions of self-sustained growth rather than to raise living standards by relief benefits. This implies the application of rather rigid economic criteria in determining the amount of aid a particular country might profitably utilize.

If it is concluded that economic aid to the poor countries is a worthwhile policy for the United States to pursue, then what should be the volume of this aid? One way to approach this question is to ask what are the needs of the poor countries in order to raise per capita income a certain percentage. A United Nations study in 1949 concludes that an annual capital import of well over \$10 billion is required to raise per capita income 2 percent per year in the poor countries as a whole. Since the current flow of foreign investment funds into the poor countries is probably about \$2 billion, the volume of additional aid necessary to accomplish this objective would be very substantial. A more recent study by Professors Millikan and Rostow, however, presents a much lower figure. These authors estimate the additional volume of capital assistance that the poor countries can absorb productively to be between \$2.5 billion and \$3.5 billion annually for the next 5 years. They maintain that this volume of assistance together with existing sources of investment funds should produce "rates of growth of per capita income of at least 1 or 2 percent per year."¹

Although estimates of this sort necessarily are very rough, the Millikan-Rostow figure seems more reliable than the United Nations' figure. It is computed in a less mechanistic manner and takes into account the important concept of capital-absorptive capacity. It cannot be stressed too strongly that the problem of development is much more than one of capital accumulation. Labor skills must be improved, entrepreneurship developed, natural resources more fully utilized, market imperfections reduced, attitudes changed, etc. Without these development requirements the productivity of capital decreases very rapidly. However, even given strenuous efforts to meet these needs, the time involved in fulfilling them implies that the ability of the poor countries to absorb capital productively within the next 5 years is strictly limited.

Another method of gaining a better perspective on the volume of capital assistance to poor countries that might be appropriate on the part of the rich nations is to consider past experience in this area.

¹ Max F. Millikan and W. W. Rostow, *A Proposal, Key to an Effective Foreign Policy*, Harper & Bros., New York, 1957, p. 100.

The conclusion from this approach is that there has been a sharp decline, especially since World War I, in the relative significance of international investment. During the 50 years prior to World War I Britain was easily the most important international investor. By 1913 about 40 percent of total long-term foreign investments were British investments. France and Germany were the second and third largest foreign investors, respectively. Britain's overseas investments averaged 4 percent of her national income during the entire period 1870-1913 and equaled 7 percent of her national income in the years between 1905 and 1913. One-quarter of British capital was exported to regions that today are considered to be underdeveloped.

Private long-term foreign investment by the United States in the record year of 1956 was \$3.4 billion, or about 1 percent of national income. A 4-percent level for this country in 1956 would have raised this figure to \$13.7 billion. If this volume of private investment were undertaken by the United States today and one-quarter of it was made in the poor countries, most of the additional capital needs estimated by Millikan and Rostow for the poor regions could be met from private American sources alone.

After World War I, the international investment position of the rich nations changed drastically. During the war Britain liquidated nearly one-quarter of her overseas investments, and throughout the 1920's her annual net capital exports averaged only about a third of the amount just before the war. France and Germany suffered even greater relative foreign investment losses than the United Kingdom. The United States, on the other hand, emerged from the war as a creditor nation and became the chief source of international loans during the 1920's. American private exports of long-term capital averaged over 1 percent of national income during this period. About 30 percent of portfolio investments and 50 percent of direct investments by this country between 1920 and 1931 were directed toward the underdeveloped areas. Most of this investment was undertaken in Latin America.

In the 1930's long-term foreign investment again dropped sharply. Political instability, the effects of the world-wide depression, and governmental controls caused this period to become one of negligible long-term private foreign investment. The United States in particular ceased to continue its lending role of the 1920's. Total American foreign investments actually fell from \$17 billion in 1930 to \$11 billion in 1939. After World War II private foreign investment by this country increased again but the average volume in constant prices between 1946 and 1952 was only one-half of the 1919-29 average. The flow of private funds since 1953, however, is somewhat more encouraging. But British capital exports in real terms from 1953 to 1956 averaged only 7.5 percent of her capital exports in 1913.

As noted, private long-term investment by the United States in 1956 was \$3.4 billion. Canada and Western Europe absorbed about 60 percent of this sum, while Latin America received 25 percent of the investment funds. The remaining 15 percent was divided between the poor nations of Africa and Asia, and such countries as Australia, New Zealand, and Japan. Direct private investment in 1956 was \$2.8 billion. About 44 percent of this type of investment was made in the underdeveloped countries (mainly in Latin America).

In addition to private investment the United States, of course, has provided substantial governmental assistance to other countries since the end of the war. Between July 1, 1955, and June 30, 1956, for example, Government expenditures for foreign assistance were \$5 billion. The underdeveloped countries (mainly 7 defense support countries) received \$1.5 billion of this aid. If foreign assistance by the Government is added to private long-term foreign investment in 1956, the ratio of these two items to national income is 21½ percent.

A consideration of the current needs of the poor countries and of the past experience of private foreign investment by the rich countries in these areas leads to the conclusion that, if anything like the pre-World War I international investment pattern could be restored, the capital problems of the poor countries would be solved. Fortunately, the United States at least does seem to be approaching again her role in the 1920's of a major source of capital funds. But this will still leave many of the capital needs of the poor nations unfulfilled. Therefore, in view of the opportunities for strengthening our national security, for reducing our long-run defense expenditures, and for opening-up both new raw material sources and markets for manufactured products that are linked with an increased flow of capital funds to the underdeveloped parts of the world, it would seem to be clearly in our national interests to attempt to increase the stream of our capital exports.

FORMS OF CAPITAL ASSISTANCE

If a larger volume of capital assistance to poor countries is an important policy goal for this country, what financial and economic forms should this assistance take?

One of the most important issues in this connection is the extent to which aid should take the form of private versus public investment. There are several important advantages of private investment. Since it is made within the framework of business profit calculations, private investment funds are likely to be employed productively. Furthermore, to the extent that this type of investment consists of direct rather than portfolio investment, it is likely to be accompanied by an inflow of managerial and entrepreneurial talent. This can be an effective method of helping to train the labor force in poor countries. Direct private investment also has the advantage of freeing a country from fixed charges that must be annually transferred abroad. Finally, a larger part of the earnings from direct investment as compared with portfolio investment are likely to be reinvested within the recipient country.

Because of these important benefits from private investment, vigorous efforts should be taken to increase the flow of this type of funds. Most writers contend that this flow can be expanded through such measures as investment treaties, tax incentives, investment guaranties, and the provision of better information concerning investment opportunities abroad. But the majority of investigators in this field do not believe that the kind of additional capital needs estimated by Millikan and Rostow for the poor countries can be satisfied mainly by private investment, particularly within the next few years. The risks and impediments involved in private foreign investment can be minimized only over a fairly long period of time.

There are also some drawbacks to an exclusive reliance on private investment. By far the largest part of British and American foreign investment has been devoted to the development of food and raw material exports and tertiary industries closely associated with the marketing of these exports. In short, there understandably has been an export bias to private foreign investment. The great international flow of capital in the 19th and early 20th centuries also was directed to regions of recent settlement such as the United States, Argentina, and Australia and was accompanied by a large movement of trained labor. The relatively skilled type of labor that emigrated to these sparsely populated regions and the nature of the commodities produced for export were important factors in causing the large-scale investment in industries closely related to exports to create a mechanism of sustained growth. In most of the poor countries the flow of capital and labor was either insignificant or the type of labor emigrating to these nations and the nature of the export industry were such that foreign investment did little to produce a cumulative growth process.

In many of the poor countries the current prospects for the creation of the type of balanced economy necessary for sustained development by means of investment in industries closely associated with exports are not very favorable. First, productive opportunities for a significant expansion in the type of export industries that attract foreign capital do not exist in a number of these countries. Moreover, in those nations in which opportunities are present the high proportion of the investment in extractive industries does not directly contribute to an increase in the levels of skill and industrial training of very many people nor does it induce much complementary investment in tertiary industries. The taxation of profits from this investment, however, can serve as an important source of revenue. Although private investment by foreigners in export industries should be encouraged for this reason, it does not follow that the existence of this tax revenue will lead to balanced self-sustained growth in any automatic manner. Total resources available from taxes and royalties paid by foreigners are not now nor likely to be in the near future sufficiently large to meet the capital requirements necessary for this goal. Furthermore, as the experience of certain countries in the Middle East indicates, the availability of capital funds does not ensure rapid development. A well-conceived program is needed, administrative and managerial skills in government and business must be improved, levels of general education and vocational training of the labor force must be raised, natural resources must be more fully exploited, reforms in the system of land tenure are often needed, etc. In short, accelerated development requires the removal of the characteristics of backwardness and underdevelopment as well as of capital deficiency.

Public foreign assistance must be relied upon to aid in the development of those sectors in which private foreign investment is not likely to be undertaken and in which government revenues as well as the non-financial resources of the poor areas are insufficient to initiate a cumulative growth process. The size of the type of aid that would seem desirable in terms of our development goal is difficult to estimate. On the one hand the internal needs of the rich countries are so pressing that massive assistance to poor areas that turns out to be mostly a form of relief because of its unproductive uses must be ruled out. On the

other hand, if the aid is too small, it may not be sufficient to start a cumulative upward growth movement and therefore also may be but a form of subsidy. In terms of the estimated needs of the poor areas and the outlook for alternative sources of assistance it would appear that an additional appropriation by the United States Government of perhaps \$1.5 billion annually for a 5-year period would be a prudent step. But a much more careful survey of the opportunities to absorb capital assistance productively in the poor regions is necessary before any firm opinion can be given on this matter.

An important part of such a program should consist of greater technical assistance to the poor countries. Sums such as the \$116 million appropriated for this purpose by the United States in 1954 and the \$70 million budgeted by the United Nations in the same year are entirely too modest in view of the opportunities in this area. Technical assistance essentially is a form of investment in the people of these countries. It must be remembered that nations such as the United States, Canada, and Australia developed under the impetus of a simultaneous flow of capital and labor. The people who emigrated from Europe brought with them the know-how and production experience that had been slowly acquired in the European nations. We cannot expect any similar migration to the poor countries of today. The problem therefore is to provide an alternative method of transferring technical knowledge to these areas. For with this knowledge the poor countries not only will be able to utilize more productively the investment funds provided by the rich countries but will be able to use their existing resources better. A United Nations study estimates, for example, that if poor countries devoted 1 percent of their national income to agricultural services, they would be able to reap a 50 percent increase in output within 20 years or less without any substantial increase in capital or widespread reorganization of the agricultural system.

Technical assistance should take the form of grants rather than loans. Although its effects on raising the incomes and foreign exchange earning capacity of the poor countries are likely to prove considerable, these repercussions will be indirect and occur only gradually. To insist upon the repayment of these sums plus interest charges may place the poor countries in a very difficult balance-of-payments position and generally discourage the use of technical aid. Efforts also are needed to integrate the several technical assistance programs by means of some central international organization.

In addition to our direct military assistance, the principle of grants is also appropriate for the economic aid that we believe is necessary in order to help those countries receiving direct military assistance to utilize this military aid effectively. Since the purpose of economic aid of this sort is not directly related to the goal of establishing a self-sustaining growth process, it should not be judged on the grounds of economic productivity.

The remaining part of our foreign-aid program, including most of the additional aid recommended here, should be in the form of loans. Although it may well be even in our national interests to give to the poor countries the entire amount of the additional aid suggested here, the loan principle is necessary to help insure the most productive uses of these funds and to encourage the creation of a framework of self-

sustained development. Interest rates, however, should be low and should vary among countries depending upon their level of development. Provision for long-run, flexible repayment terms are also necessary.

In summary, there seem to be convincing reasons for the United States to increase its volume of foreign assistance to the poor countries. Basically, they follow from the attachment of a high priority to the long-range goal of destroying Communist imperialism and of creating a peaceful and prosperous world. In economic matters, as in all forms of human endeavor, a situation must be judged in terms of alternatives. There is no question but that an expanded aid program will place additional burdens on the American people. But these burdens are inconsequential compared to the kind they might have to carry if communism continues to spread throughout the world and if the poor countries fail to achieve a reasonable measure of success in pursuing their peaceful national aspirations. Increased economic assistance is no automatic guaranty that the goal of a peaceful and prosperous world will be established, but the potential dangers of the future in relation to the possibilities for reaching this objective partly by means of economic aid appear to indicate that this aid is well worth the risks involved.