

## FOREIGN AID—SOME ISSUES AND PROBLEMS IN ASSESSMENT

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In public discussion, foreign aid is in a class with the Yankees—blisteringly hated or ardently loved. Yet unreserved convictions are unwarranted on whether or not foreign assistance is an efficient allocation of American resources. Aid involves intractable uncertainties and inherent difficulties of assessment. This paper deals largely with some basic obstacles to firm conclusions on whether or not the benefits from foreign aid exceed the costs.

### THE PEACE EFFECTS

The main thrust of foreign assistance is to maintain peace, or at least to avoid a major nuclear war, and to preserve and expand the number of countries which are friendly, or at least not hostile, to the United States. That is the way one State Department-International Cooperation Administration staff memorandum put it.

The means by which aid serves these ends are roughly as follows. Foreign aid appropriations equip and train Allied forces. In 1956, over 60 percent of net United States grants and credits took this form, though, for the postwar period, military aid constitutes about one-third of the total. Some allies (now primarily Turkey, Pakistan, Taiwan, Korea, and Vietnam) receive economic aid for it is felt that they cannot support their own defense efforts without nonmilitary help from us.

Government grants and credits, partly out of foreign aid appropriations but also from the Export-Import Bank and from the proceeds of the sale of agriculture surpluses overseas, provide capital and finance the transfer of technical know-how to assist the long-term economic growth of certain underdeveloped countries. The Secretary of State recently stated that, unless the aspirations of the people of underdeveloped countries for greater growth are met, they may install governments which are unfriendly if not violently opposed to the United States.

Foreign aid appropriations also provide emergency assistance to shaky governments to sustain them during imminent internal threats. Examples include recent assistance to Jordan during an internal crisis, to Guatemala after the overthrow of its pro-Communist government, to Iran after the ouster of Mossadegh, and to Bolivia. In these instances, the likely alternative government was thought to be less favorable to the United States.

Economic assistance has also been used in an attempt to prevent countries (Afghanistan for example) from becoming entirely dependent on Soviet aid. And both economic and military aid were used to support Tito's withdrawal from the Soviet camp.

*Some general problems in assessment*

One major difficulty in determining whether aid constitutes an efficient allocation of resources is that, as between individual Americans, peace is indivisible. Unlike peas and carrots, it cannot be divided and sold to individual consumers by the pound. Consequently it cannot be produced in response to individual consumer demand as in a market place. Therefore, one cannot say that more or less resources are used in gaining security than individual consumers in total would want.

Another major problem is the difficulty of knowing what the policies of other countries would be in the absence of aid, which involves a difficult estimate of the behavior of other governments. Three examples show the relevance of this.

(1) An assessment of aid requires knowledge of the effect of aid on Sino-Soviet policies. Military strength is purely a relative matter. Few benefits would be gained from an increase in the military posture of the free world if this induced the Red bloc to raise its defense expenditures to maintain the previous ratio of strength.<sup>1</sup> Hence, any assessment of increased aid must involve some assumption about the Communist response. Obviously, the appropriate assumption is difficult to determine.

(2) An assessment of aid requires a judgment of the effect of aid on the balance of power within aided countries and the consequences of any shift in that balance. For example, in one Latin American country, United States assistance supports a government which, in its ideological outlook, is probably not predisposed to the United States. The withdrawal of aid probably would bring down that government, for aid provides half of its revenues. Among the possible alternative governments are ones which are more and less favorable to the United States. But which would come to the top in a revolution set off by the weakening of the present government?

(3) An assessment of aid requires an estimate of what the government in power in fact does with the aid. A given type of assistance may produce an unrelated type of benefit. Yet, discussions of aid often assume that the benefits are directly related to the type of assistance provided. The transfer of military items to allies, for example, increases their military strength and consequently we are supposed to gain certain defense benefits. But, at least in principle, all military aid could in fact result in economic assistance and all economic aid could provide military assistance. The nature and complexity of this problem was developed in a recent colloquy between Congressman Otto Passman, chairman of the subcommittee in charge of foreign-aid appropriations, and Mr. John Hollister, then director of the agency which administers part of United States foreign assistance:

Mr. PASSMAN. \* \* \* In the past, practically all nations have budgeted a certain amount of their national income for national defense, and when we go in and pick up mili-

<sup>1</sup> This must be qualified for the possibility that increased Communist defense expenditures could sap the economic strength of the Sino-Soviet bloc more than additional aid would weaken our strength. This would restrain the growth of the bloc's productive capacity and thereby affect its ability to increase its military strength in the future or reduce its willingness to offer grants and credits to underdeveloped countries as an instrument of political penetration.

tary checks, it releases the money that country normally would spend for national defense for economic purposes or other purposes. In effect it is helping the economy of the country.

Mr. HOLLISTER. Perhaps I do not follow you. You mean in a country where we help them militarily we assist the economy by our military expenditures?

Mr. PASSMAN. Yes. If we are paying for their tanks and planes and ships for national defense, that releases the amount of money which before that time they had spent for national defense for such things as flood control, irrigation, and so forth, to strengthen their economy.

Mr. HOLLISTER. In some cases. In other cases the whole point of our military expenditures is for the military defense of the United States.

Mr. PASSMAN. That is the claim, but it certainly helps the economy of a country to be relieved of the responsibility of spending its own money for armament and military purposes; it releases that money to strengthen its economy.

Mr. HOLLISTER. That must be counterbalanced in that everything you put into one of those countries in the way of a military establishment increases the cost of keeping that military establishment going. The people in the military services must be fed and clothed; they are taken out of economic pursuits, et cetera. So it is one of those complicated questions you cannot give a direct answer to.

Mr. PASSMAN. That is right. It is like the old saying you can take figures and do anything you want to with them.

Mr. HOLLISTER. Yes. Here is a country that has a certain appropriation on the military side and a certain appropriation on the economic side. If we say, "Raise your military budget, and we will increase your economic aid," it looks like we are raising the economic aid. If we say, "Put more money in your economic budget, and we will give you more military aid," it might look the other way.<sup>2</sup>

The disparity between the kind of aid and the type of benefit appears in another way. For its mutual-security program for fiscal year 1958, the administration had to divide nonmilitary aid into that which supported United States military objectives and that which aided economic development. Officials were frank to say that the distinction was exceedingly difficult to make. Estimates of the economic-development content of previous nonmilitary aid to countries with whom we had mutual-security treaties ranged from 20 percent to 60 percent. Two examples will suffice to show the problem. Assistance to build a road serves military objectives since the road facilitates troop movements; but it also provides economic benefits since the road permits more internal and external trade. Aid for the modernization of the Turkish Army, while increasing military strength, also released surplus soldiers for civilian uses.

Unless one assumes that an equivalent amount of military aid and nonmilitary aid bring exactly equal benefits to the United States, the

<sup>2</sup> Hearings, Mutual Security Appropriations for 1958, Subcommittee of the Committee on Appropriations, House of Representatives, pp. 7-8.

disparity between the mixture of aid provided and the type of resulting benefits makes assessment of the aid program difficult.

Without attempting a balanced presentation of pros and cons, let us consider some basic uncertainties regarding military and developmental assistance.

#### *Problems in determining the benefits from military assistance*

It is tempting to assert that the United States must obtain net benefits from military aid because the Department of Defense plans and administers the program. Presumably DOD would allocate funds between foreign and domestic expenditures in a way designed to maximize United States national security. However, the Special Senate Committee To Study the Foreign Aid Programs contends that it has not:

Expenditures on military aid must be weighed primarily against the return which could be expected if these funds were spent directly on the National Defense Establishment. The committee is not satisfied that this principle is now being followed under present procedures. Military aid appears to be considered as an end in itself, insufficiently related to the total problem of national defense and its cost.

The committee also expressed some doubt about the relationship between military aid and the strategic concepts of United States defense.

#### THE TYPE OF WAR

The benefits gained from military assistance depend on the type of war we may have to fight. Obviously this is difficult to predict. For all-out nuclear war, military aid is perhaps largely wasted since it consists to date entirely of conventional weapons. Yet, some persons see a need for some conventional forces in a nuclear war, if for nothing else than mopup and occupation.

In any event, under present circumstances, our ability to threaten massive retaliation depends significantly on access to overseas bases. Sufficient intercontinental bombers and guided missiles are lacking. The fact that we can disperse our retaliatory forces instead of concentrating them in the United States is itself an advantage. Military assistance arms and trains forces which provide some protection for overseas bases. And our rights to those bases may depend on aid. This was the case in Spain, where we bought the base rights with aid, having little intent of using Spain's troops in the integrated defense of Western Europe.

In Western Europe, United States assistance is a relatively small part of the recipients' gross national product—probably no more than 2 percent in any country and less than one-half of 1 percent in several. Hence, it is difficult to argue that these allies could not possibly provide their own defense now, assuming, of course, that they put their dollar balance in order so that they might purchase equipment from us. But it is also difficult to know what their reaction with respect to base rights would be if we withdrew our assistance. Some might hope to avoid national demolition if the Russians move by evicting American forces; others might conclude that their ultimate defense depends upon the ability of the United States to threaten massive retaliation and would therefore not take such drastic action. Their

response would also be affected by their interpretation of United States policy: Does the withdrawal of United States aid indicate that we would not assist in their defense? Clearly, the effect of a cessation of military assistance would depend on what other commitments we would undertake and how it is done.

To the extent that we simply have exchanged aid for bases, the transaction is a bilateral bargain. The price is indeterminate and could fall anywhere within a significant range. We may have paid more than we need have to gain the bases; i. e., some of our aid brings us no benefits. But without knowing the minimum price of our landlords, one could not tell for certain.

Any assessment of military aid in respect to a limited war—conventional or tactical nuclear—is uncertain because there is no certainty that such wars will remain at the subhydrogen level. One bomb leads to another, bigger each time, and the war, almost unwittingly, is dragged into the superhydrogen era. This would suggest reliance on a trip wire—not extensive force buildups—to unleash massive retaliation. Against this, some argue that neither side would dare use the ultimate weapon in fear of the consequences of retaliation.

But suppose this uncertainty is settled in favor of a limited war. The value of military aid remains subject to doubt. The defense efforts of our allies in Western Europe have fallen far short of their commitments and their plans. The NATO commander stated that an irreducible minimum of 30 divisions is necessary for the defense of Western Europe; at present he has only 15, of which probably only the American divisions are ready for immediate combat. The Defense Committee of Western European Union recently excoriated NATO members for their failure to achieve essential force goals, to cooperate adequately in planning, logistics, and supply; it suggested that failure to attain higher force levels might require a fundamental shift in military strategy in Western Europe.

Outside of Europe the ability of aided countries to stop an allout attack is also in doubt. But the key issue is not, however, what is necessary to beat back aggression but what is needed to prevent it. Forces insufficient to win may nonetheless deter aggression by making it just slightly too expensive for the Communist bloc. The point at which this line is crossed is a neat judgment, especially since it must be an estimate of the judgment of a potential aggressor of the benefits and costs of aggression. Furthermore, even if local forces cannot prevent aggression and if United States national security requires the defense of every country on the Soviet-Sino rimland, local troops can slow the Communist drive until American help arrives and any quantity of local forces would assist United States troops.

### THE SAVINGS

Proponents of military assistance assert that it would cost us many times more than present aid expenditures to achieve the same military strength through our own efforts as is now provided from a combination of aid and allied forces. Admiral Radford guessed it would cost 4 or 5 times as much to replace the 21 Korean divisions with American troops, and one estimate suggested an overall saving of \$25 billion per annum. The cost of maintaining a foreign soldier falls far below

the cost for an American soldier, and the cost to the United States in aid of arming a foreign soldier is much less than that of an American soldier because foreign governments bear part of the burden. Hence, we save resources through military assistance.

Despite the frequent implication that the saving measures the benefits we derive from foreign aid, such figures do not faithfully serve that purpose. If we compare the cost of obtaining a given level of military strength through a combination of aid and United States and allied forces with the cost of obtaining the same strength through our own efforts, the difference measures the benefits of aid to us only if United States national security remains constant. But this cannot be assumed with certitude. The training levels of foreign troops are, with some exceptions, lower than ours, and in some instances the foreign forces are structured for internal security missions rather than combat in the common defense. The United States Government has complete control over its own forces whereas its control over foreign troops is much less firm. The obvious, and extreme, example where our aid may have low productivity for United States security is Yugoslavia. Assistance to Tito may have preserved him and thereby helped to create dissension in the Communist bloc. But it may also have helped to arm a potential enemy.

Despite the foregoing, the saving figures are not necessarily an overestimate. The United States Government does not obtain all of its military personnel in the free market so that the real cost of United States defense expenditures is somewhat higher than suggested by monetary data.

Proponents of military assistance frequently note that for every dollar of aid since the Korean war, our allies have spent \$5.50 on defense and that they have increased their ground forces by 1.3 million men. United States aid stimulated this or made it possible, according to some proponents. Assuming that we must have, to maintain our security, forces equivalent to those now financed by our allies, such figures would seem to suggest the benefits we derive from military assistance. But they fail because, as a few administration witnesses admit, we do not know what level of expenditures or forces would be undertaken by our allies in the absence of aid. There is even the possibility, suggested by the colloquy between Passman and Hollister, that our aid substitutes in part for military expenditures which our allies would otherwise undertake. Unless one knows what would have been done in the absence of aid, one cannot calculate the payoff from aid.

#### THE SIDE EFFECTS

Military assistance has numerous side effects, all of which must be considered in assessing its value to the United States. For example, aid to ex-mother countries has adversely affected our political relations with ex-colonial territories. The use of American equipment by the British and French in their African actions dramatized this issue, and brought formal complaint from Arabs. Also military assistance to Pakistan incensed India, and, according to the American Ambassador, the difficulties between India and the United States "grew chiefly" out of our aid to Parkistan. Another alleged effect has been to slow the economic growth of underdeveloped countries receiv-

ing military assistance. They have been obliged to provide complementary resources to make use of aid items in order to achieve established force goals. Without additional growth their political stability is allegedly threatened to the detriment of United States interest. Thus, an assessment of military aid requires an estimate of the significance of the adverse political consequences of military aid and it requires a judgment of the relative importance of various countries to the United States.<sup>3</sup> None of these are easy.

*Problems in determining the benefits from developmental assistance*

The uncertainties surrounding aid for development involve three separate issues.

*Will development, per se, bring political benefits?*—An early rationale for foreign aid was that poverty breeds communism. But the facts began to deny this generalization. The frustrated intellectual was seen as the germ carrier of communism. Paradoxes were noted where the richer part of a nation would show the greatest Communist strength while the most conservative influences were found in the poorest, backward areas.

Now, a new rationale prevails. Without adequate rates of economic growth, the newly restless people of the underdeveloped world may install governments unfavorable to the United States. Unemployed intellectuals can find satisfying work in connection with development programs and projects. The very fact of getting on with development breeds hope for the future. Yet, while development may satisfy the discontented, it may also create new sources of discontent and, therefore, induce political instability. Development restructures peoples' wants and needs. It rips them out of their traditional ways and cuts their previous ties, creating insecurity. Development is change, and change creates dissatisfaction which can be exploited by unfriendly parties to propel themselves to power.

Forced economic growth is occurring in many of the aided nations. Does aid in its present amounts or forms raise the tempo of progress beyond the discontent-creating level or is that level not yet reached? The tools of social science are not now sharp enough to provide a firm answer.

*How much development will aid induce?*—It is not certain that a given amount of aid always constitutes an equivalent net increment in the amount of resources used for development in the recipient country. For example, to what extent does aid allow the recipient governments to divert their tax moneys away from development purposes? And to what extent does aid allow them to relax their efforts to obtain resources through other means—higher taxes, removal of restrictions on private foreign investment, and increased reliance on indigenous private initiative? It is a rare underdeveloped country that could not make some additional gains in these ways.

Furthermore, because aid is largely channeled through governments, less meaning may attach to economic growth made possible by United States aid than to development which results from voluntary,

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<sup>3</sup> An interesting benefit alleged by proponents of military assistance is that the military-assistance appropriations, which financed the purchase of military equipment from the armed services, helped to modernize United States forces because the funds received were used to buy new equipment. If this is valid, it implies that Congress was more willing to vote funds for foreign aid than for domestic defense, for why else use the circuitous means of modernizing United States forces?

market-determined decisions. A rise in national income resulting from state-induced expenditures must be adjusted in some degree for the fact that individual consumers have not passed judgment on the increment in output. This is of some importance to the earlier question of the political benefits resulting from development because, if those benefits derive from the increased well-being of individuals, the favorable effects of aid-induced growth would be less than they might first seem.<sup>4</sup>

Finally, population growth permitted by the economic growth which may be caused by aid inhibits a rise in per capita income. We know relatively little about the response of population to increased real income. Total income may outrace population growth if a massive initial increase in income occurs. But the kind of data necessary to determine accurately the required initial rise in income or the amount of aid necessary to bring it forth simply do not exist. Aid short of the required amount is wasted. This does not suggest that more aid is necessary, because any proposed increment may also fall short of the required amount and, therefore, also be wasted.

*Will aid, per se, bring political benefits?*—It is contended that aid, independently of its effect on economic growth, gains cooperation, or at least a favorable attitude toward the United States, from key groups within the governments of the recipient countries. (This also applies to military assistance where political leadership or strength rests with local military personnel.) Aid strengthens the government in power—against internal subversive forces and, in some degree, against other political parties. While we need not be reluctant to gain the enmity of the subversive groups—we have already got that—our support for the present government may backfire when other political parties or persons finally ascend to power, believing that United States aid helped keep them out before or supported corrupt and inefficient governments. While gaining cooperation now, is United States aid creating political troubles for the future?

It is not really certain that we only gain cooperation or favorable attitudes. Aid must be divided. But there are no purely technical, objective formulas for the allocation of aid among countries.<sup>5</sup> It must be a political decision. Those who get less than they think they deserve are miffed. The Arabs complained of the amounts received by Israel. The Latin Americans were embittered by the sums provided to Europe. We must say "No" to some requests. The Lebanese in 1953 wanted more aid than our Government thought advisable.

<sup>4</sup> This is not conclusive. Aid may substitute for higher taxes and increased reliance on private enterprisers. Therefore, aid may indirectly affect the distribution of income, which may itself affect the political benefits derived from development as well as the rate of development.

<sup>5</sup> The use of absorptive capacity to allocate aid, as suggested in recent proposals, is deficient because it takes the form of aid as given. If a country cannot absorb a given item, this may reflect a failure to provide, through aid, sufficient quantities of complementary resources or services. A nation's ability to absorb trucks without wheels is probably zero, but why provide trucks without wheels? Any limit on the amount of technical service and advice which we will provide in the construction and operation of aid projects could not be founded on technical or engineering criteria. And, if such limits were imposed, any consequent limitation on amounts of other assistance provided would merely indicate that the advice content of the projects selected was too high. Different projects could be undertaken to permit greater amounts of aid unless the recipient country literally could do nothing with any aid items without foreign supervision. Clearly, there is no limit to the amount of aid a nation could absorb if it were given in the form of free dollars which could be disposed of as the Government sees fit; consequently, limitations on absorptive capacity must stem from the specification of the types of goods to be provided or the end use of aid. Unfortunately, such limitations are nontechnical.



American technicians were, in opposition quarters, charged as spies, and frequent demands were made that the Americans go home.

The presence of American technicians, some of them not too well equipped for representation of the United States and most of them living at higher standards than the bulk of the local population, has created difficulties, though there also have been some outstanding successes.

With the Soviet Union extensively in the aid field, we run the risk that the beneficiaries of United States aid may thank the Russians for it rather than us, on the argument that our fear of Russian penetration induced our gifts.

One could go on with additional adverse effects, but little purpose is served. The point is that foreign aid does have unfavorable side effects and, until one can estimate the extent and importance of these and cast them in balance with the favorable results, no firm assessment of aid is possible. Even if one were reasonably certain that the program produces net benefits, it does not necessarily follow that those benefits would be sufficient to cover the cost.

#### DOES AMERICAN HUMANITARIANISM JUSTIFY AID?

Do the United States aid programs constitute an efficient allocation of resources in respect to our humanitarian desires? The Secretary of State, in defending the aid programs, once said that the United States could not live happily as an island of prosperity in an ocean of poverty. But, even if true, this does not necessarily justify aid.

If one thinks of charity as an act which provides satisfaction to the giver, we do ourselves a favor by relieving overseas poverty and helping others protect themselves from communism. In principle, to create an efficient allocation of resources, the United States Government should give just that amount of money which American citizens want to give to satisfy their desire to be charitable. But why won't the American people give that sum individually? Why it is necessary to tax them to do so? There is an element of compulsion over the individual in every tax bill. How, then, can one contend that tax-financed aid simply reflects the humanitarianism of the American people? Doesn't taxation indicate that people are being forced to give more than they actually want to give?

Two possible answers exist, neither of them very helpful. One is that the Government may collect and administer money for charity more efficiently than private charities can. Obviously, it is cheaper for an American citizen to give charity when he pays his tax bill, since he has to pay some taxes anyway. The alternative is to write (requiring additional effort) a separate check (wasting paper), with additional ink (wasting ink), and mail it (at an additional cost of 3 cents) to his favorite charity or the embassy of his favorite country. The saving in stamps alone could run to \$2 million. Against these savings, one must allow for the administrative expenses of United States Government aid—about \$32 million for ICA alone in fiscal 1938—which would not be required under individual charity if Americans would send freely disposable funds to their favorite embassies. (Private charity would not compare as well, however, if Americans insist, as does the Congress, on American supervision of aid.)

Even if there is a saving through Government, is it worth the risk that the Government may be overtaking the individual in terms of his desire to help others? And, if it is cheaper to use the Government, why not establish a separate Government fund to receive voluntary additions to one's tax bill?

A second possible answer is that a gift to an underdeveloped country from one American would bring satisfaction, by relieving overseas poverty, to other Americans who are distressed by foreign squalor, i. e., an act of charity by one American benefits other Americans as well as the benefactor. No individual benefactor would necessarily allow for these "neighborhood" or "external" effects in determining the level of his charity. There is no evidence that such effects exist. But if this interdependence held among all taxpayers, it might be sensible to tax all of them in order to subsidize their individual expenditures for charity or in order to carry out more charity through government aid than they would undertake individually. But, in view of the numerous complaints against foreign aid, it is doubtful that such a strong interdependence assumption can be made.

These issues can be avoided by assuming that humanitarianism toward foreigners is a duty which the American people will not completely fulfill individually. At one extreme, ancient Christian principles are invoked to support the view that aid is a duty; at the other extreme, modern gimmicks of welfare economics and the international demonstration effect are called in support. This approach leaves some key questions unsolved: How much money does Christian duty (or welfare economics) require? Whose conception of duty shall we use—the foreigner's or that of certain Americans? And this approach does not explain why individual Americans must be forced to do their "duty" through taxation instead of being persuaded to do so voluntarily by the proponents of this view. Again, it may be cheaper to have them convince some key Congressman and Government officials rather than millions of individual Americans, but is the saving worth the risk implicit in the use of compulsion? And does an apparent act of charity have any ethical content when the burden is largely borne by persons other than those who decide to provide charity? And in what sense has a taxpayer fulfilled a moral obligation if he is compelled to do so by law?

#### THE COST OF AID

Do aid figures provide an accurate measure of the money cost of assistance provided by the United States Government? And do they faithfully show the real loss of goods and services by the United States? No detailed analysis is possible in this brief space, but the following comments will show some of the problems and uncertainties involved.

##### *The money cost of aid*

The public and the Congress generally hear two figures. One is the President's request for the mutual security program, and the other is the sum of net utilized grants and credits reported by the Department of Commerce.

Whether or not these figures accurately show the money cost of aid depends on how one defines aid. For example, if one regards military

grants as aid, then the cost of the Korean war might properly be included since it too involved the transfer of United States resources overseas to serve the cause of peace and freedom. In addition, because United States law permits American firms operating overseas to offset certain foreign taxes against their United States tax liability, the burden of increased foreign taxes is sometimes borne by the United States Treasury; in a sense, this drain could be regarded as foreign aid. Finally, loans are included in figures popularly regarded as aid. Yet the aid element in loans, in the sense of resources given up, is less than that in grants since some of the loans will be repaid, i. e., the resources are not given up forever. On this argument, perhaps the only aid in loans is the difference between the interest rate that the borrower would have had to pay to private lenders and the amount charged by the government plus defaults. The correct determination of items to be included is obviously of significance since the size of foreign aid is a politically sensitive issue. Unfortunately, no clear-cut criteria exist which admit of straightforward application.

Without attempting to define aid, several exclusions from the popular figures should be noted. The Department of Commerce net grants and credits figure is deficient with respect to assistance related to the surplus agricultural disposal programs. Under the Agricultural Trade and Development Act of 1954, and section 402 of the Mutual Security Act of 1954, the United States sells surplus stocks of agricultural commodities overseas for foreign currencies and claims and then grants and/or lends part of the proceeds to foreign countries. The disbursement of the proceeds has lagged far behind the sale so the United States has accumulated foreign currencies and claims. By failing to use those proceeds, we have provided over \$1 billion of short-term aid to foreign countries. While it is not suggested that this lag will create a permanent revolving fund of aid, it is not unlikely that this assistance will grow for some time. The necessary adjustment for this aid can be readily made because the Department of Commerce, having recognized this deficiency, provides the data in the same source from which the net grants-and-credits figure is drawn.

Another large understatement of the money cost of United States aid stems from the pricing policies on agricultural surplus. The surplus products are sold overseas for less than their cost of acquisition and shipment. If one is interested primarily in determining the money cost of aid to the taxpayer, then the money value of the loans and grants made out of the proceeds of the sale of agricultural products should be increased by the pro rata "loss" suffered by the Commodity Credit Corporation. The CCC is reimbursed for this loss but the amount is not included in the foreign assistance figures. Under agreements signed through mid-1957, the loss will equal about \$900 million.

The President's mutual security request does not include the foregoing items. Nor does it include such important items as loans by the Export-Import Bank (\$233 million gross in 1956) and loans and grants out of the proceeds of agricultural surplus sales (\$74 million in 1956). The growing importance of the latter (\$1.8 billion is planned for this purpose under sales agreements signed by mid-1957) will make the President's request a less and less accurate measure of United States Government aid.

*The real cost of aid*

The true cost of the aid program is the amount of real goods and services which the United States would have had in the absence of the aid program. A thorough analysis of whether or not the money cost accurately reflects the true cost would require a detailed analysis of the American economy in relation to the aid program. For example, one would need to consider the possibility that the aid purchases from certain industries brought greater economies of large-scale production than those lost through the contraction of demand suffered by other industries because of the additional taxes or reduced nonaid government expenditures necessary to finance the aid. No such detailed effort is attempted here. Rather, two matters of recent discussion and one long-held complaint will be considered.

## MILITARY ASSISTANCE

According to several proponents of military assistance, a serious overstatement of the cost of military items shipped overseas has occurred in the past because of incorrect pricing. This raises doubt about aid figures.

The military items transferred overseas come from new United States production and from the armed services' stocks. Part of that obtained from stocks is called excess by the Department of Defense and is defined by law as stocks exceeding DOD's mobilization reserve requirement. Prima facie, it would seem that in giving away excess items we, in fact, give up nothing of value to us. But the Department of Commerce figures include excess items at their original cost. Consequently, the real cost of foreign aid is overstated by \$787 million.<sup>6</sup>

The validity of this assertion depends on the accuracy and nature of the mobilization reserve requirement. First, it takes account of the time required to procure goods after M-day. Therefore, any item which is "excess" need not be useless but only easily procured. Second, its size shifts with political and military estimates so that it involves a forecast. It is evident that some of the excess items could be used in a conventional war. Therefore, one cannot contend unequivocally that the cost of the aid program is overstated in respect to excess items.

Entirely apart from excess items, the real cost of some of the material obtained from the mobilization reserve may have been lower than the money cost reported to the Department of Commerce by DOD. The armed services, in effect, sell mobilization-reserve items to the military-assistance program and use the receipts to replace their stocks. Until 1956, the law required the armed services to charge the military-assistance appropriation for such items at their replacement cost. But the replacement items were sometimes significant improvements over the material shipped overseas. Therefore, some of the items provided to our allies were in some degree obsolete in terms of United States needs.<sup>7</sup> They should, therefore, have been priced below replacement cost. A small flurry was created in 1956 when the Comptroller General testified that much of the military assistance had con-

<sup>6</sup> This is the difference between original cost and the cost of repair and rehabilitation from the beginning of the program through March 1957. There is also an overstatement for military-equipment loans. Overstatement does not occur in the mutual security appropriation for only funds for repair and rehabilitation are requested.

<sup>7</sup> This does not mean they were obsolete in respect to the allies' needs and capacities to use equipment.

sisted of World War II items, many of which were not being issued to United States forces. He estimated an overcharge in excess of \$1 billion. Recent reports have made much of this point in supporting military-aid appropriations.

If the Comptroller General's estimate were accurate, the combined overcharge on excess items and mobilization-reserve material would exceed 10 percent of the total military-assistance program—a not insignificant overstatement. However, the Comptroller General's estimate cannot be used because the overcharge was estimated against original cost. Suppose there had been no qualitative improvement in the replacement items but replacement costs doubled because of general inflation. Charges against the military-assistance appropriations which equaled original cost would provide the armed services with funds only sufficient to replace half of the items delivered abroad. Since the armed services would need to replace the other half (because they came from the mobilization reserve), additional appropriations directly to them would be required. These should, however, be considered as part of the cost of the military-assistance program. Therefore, while the substitution of improved equipment for military-aid items at replacement cost has caused an overstatement of the true cost of the aid program, the precise amount cannot be indicated.

Still another source of overstatement relates to overseas procurement of items given to Allied Nations. The United States Government has paid over \$2 billion for such goods and, to the extent that those dollars have been used by foreign nations to purchase United States goods and services, this type of assistance constitutes a draft on our resources. Because, however, of the growth in the value of international trade since the beginning of offshore procurement, trading nations find it necessary to hold larger dollar reserves than they otherwise would. Therefore, and for other reasons, it is not impossible that some of the dollars spent for overseas procurement lie unused, in which case such aid has not cost us real goods and services. Two of the major recipients of such dollars, Belgium and Italy, increased their reserves significantly since the start of the program. It is impossible, however, to estimate the amount of offshore procurement which has not resulted in a demand for United States goods.

Against these possible overcharges, one major understatement must be put. The salaries of military personnel in the program are not charged against the military-assistance appropriation. And no allowance is made for the time spent by individuals who work on various aspects of the program but who are not employed directly in it. Since virtually everyone in the Pentagon, from the janitor to the Chairman of the Joint Chiefs of Staff, spends part of his time on the program, the understatement of the cost could be significant.

#### AGRICULTURAL SURPLUS DISPOSAL

While the money cost of foreign assistance through surplus disposal is greatly understated, on one line of argument the money cost seriously overstates the true cost of foreign aid. Given the price-support programs, the surplus stocks dispatched to foreigners could not be used by the American people. Therefore, these aid programs do not reduce the amount of real goods and services otherwise available to the United States.

At minimum, this is misleading. The disposal programs restrain the growth of surplus stocks. All other things equal, present CCC investment would have been more than \$4.2 billion higher, or 57 percent higher, in the absence of the special, foreign-aid related programs.<sup>8</sup> If the continued accumulation of surplus would bring a taxpayers' revolt against the agriculture support programs, then the aid-disposal programs cost the American people something because they help to preserve, for some indeterminate period, the uneconomic allocation of resources inherent in the domestic farm-subsidy program.

A more direct cost stems from the relationship between the aid-disposal programs and the level of support prices. Under the law, within limits, the support price rises as surplus stocks fall. When the disposal program reduces surpluses to the point of raising the support level, as it has in cotton and rice, an additional incentive is given to farmers to invest more capital, better seed, more effective pesticides, and fertilizers in agriculture. Resources are, therefore, diverted from more economic uses, increasing the real cost of foreign aid.

Against the foregoing, the disposal-aid programs may save real goods and services by reducing regular foreign-aid appropriations. This is just another way of saying that it is better to give away goods one cannot use than goods one can use. By generating local currency to finance projects which might otherwise be financed with regular aid moneys, we oblige the recipient to accept goods less useful to us than he might otherwise get. ICA guessed that their request for fiscal year 1957 would have been \$50 million greater in the absence of the Agricultural Trade and Development Act of 1954. It was not stated, however, that a substitute aid appropriation would have been spent for nonsurplus commodities.

#### *The real cost of loans*

A frequent charge against the aid program is "We'll never get the money back." To the extent that loans become grants through defaults, the real cost of foreign assistance is increased.

In the literal sense, this charge is undoubtedly exaggerated unless war, a serious depression, or a strongly unfavorable shift in political relations with our debtors ensues. In comparison with \$18.2 billion loans since 1940, only \$8 million of loans have been charged off and \$107 million of principal and interest due remains unpaid for 90 days or more—less than 1-percent loss assuming the worst for those loans not charged off but due.

But in the sense of never getting goods and services back, the charge has real foundation. Continued world inflation will further convert United States loans into grants.

A million-dollar loan allows foreigners to buy an equivalent amount of real goods and services from the United States.<sup>9</sup> We eventually regain goods and services with interest because, to accumulate the dollars with which to repay us, the foreigners who borrowed the money must export more to the United States (providing us with additional

<sup>8</sup>This statement assumes that all of Public Law 480, title I, exports were attributable to the aid portion of the transactions. With some exceptions this is not an unreasonable assumption, because the aid element apparently constitutes the major attraction to foreign "buyers." The data include secs. 550 and 402 transactions under the Mutual Security Act.

<sup>9</sup>Assuming that the loan has a negligible effect on United States import and export prices.

foreign goods) or must import less from us (leaving us with more of our own goods). But if inflation intervenes between the date on which the proceeds of the loan are spent by the borrower and the date of repayment, we regain, aside from interest payments, fewer real goods and services than we initially give up. For example, if the prices of United States imports double, foreigners need export only half as many additional real goods to us to obtain the required dollars to repay the loan. If the prices of United States exports double, a dollar reduction in foreigner's purchases from us leaves us with only half as many additional goods as would have been the case if prices had not risen.

Inflation hurts the creditor. But within nations, the creditor's loss is the debtor's gain so that the total supply of goods and services in the country remains the same, save for the effect of inflation on production. But between nations, a whole nation loses.

From the date that England drew out the last of the British loan of \$3.75 billion (March 1948) to the time that repayments first began (December 1951), we had lost over one-quarter of the real value of the loan in terms of United States import prices. With respect to United States export prices, the loss was "only" 21½ percent. Since 1948, United States import and export prices have risen about 25 percent and 10 percent.

In a world of forced-draft development and high employment policies, secular inflation is quite conceivable. We must therefore remember, in judging foreign aid, that inflation adds to the burdens of foreign assistance and the uncertainty over future price levels further adds to the difficulty of assessing aid. Many of our recent loans have maturities of 30 or more years so that inflation can take a very heavy toll.

Finally, a special problem in repayment may arise as a result of the surplus agricultural disposal program. Under that program the borrowing nation is given the option of repaying in dollars or, at a higher interest rate, in foreign currency. In principle, the economic problem of repayment is exactly the same. The borrower must increase its exports and/or reduce its imports. Hence, there will be no more economic difficulty in regaining goods and services from local currency loans than from dollar loans. But there may be more political difficulty. Since the United States Government will receive local currency it will have to begin the process of transferring goods to the United States by spending the money itself or selling it to American importers. Therefore, the onus of any ensuing increase in the dollar balance-of-payments problem of the country will fall on the United States. To preserve good political relations, the result may simply be relending (a euphemism for default) of the local currency. In sum, the real cost of these loans is also uncertain.

#### CONCLUSION

Aristotle summarized the theme of this paper when he wrote:

to give money away is an easy matter, but to decide to whom to give it, and how large a sum, and when, and for what purposes, and how, is neither in every man's power, nor an easy matter. Hence, it is that such excellence is rare and praise-worthy and noble.