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MUTUAL SECURITY PROGRAM

REPORT ON GRANT ECONOMIC ASSISTANCE RELATING TO DEFENSE SUPPORT AND SPECIAL ASSISTANCE PROGRAMS

*(Submitted to the Congress pursuant to Section 503 (c)
of the Mutual Security Act of 1954, as amended)*

A. I. D.
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DEPARTMENT OF STATE
March 4, 1960

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Report on Grant Economic Assistance Relating to
Defense Support and Special Assistance Programs
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Identical letters from the Acting Secretary of State to the President of the Senate and the Speaker of the House of Representatives

DEPARTMENT OF STATE
WASHINGTON

February 29, 1960

The President has directed me to transmit to the Congress, pursuant to Section 503(c) of the Mutual Security Act of 1954, as amended, a report of the plans of the Executive Branch for progressively reducing and terminating, wherever practicable, bilateral grants of economic assistance in the Defense Support and Special Assistance categories. There is attached a full report together with an annex projecting the future of these programs country by country, which of necessity, because of the sensitive nature of the contents, is being furnished on a classified basis. A general summary report which is unclassified is being prepared and will be provided to the Congress in a few days.*

For a number of years, programs of grant economic assistance have been proposed by the Executive Branch and approved by the Congress as the most effective means of promoting the attainment of United States objectives. Such programs have been annually reviewed by both branches of the government. These programs have served our national interests over a wide range of special and emergency situations and have contributed measurably to our security. They have been an indispensable instrument of foreign policy over a period of rapid and sometimes violent change. Thus, in formulating plans for progressively reducing and eventually terminating such programs we have had to review the objectives of these programs and to determine whether there were alternative and equally satisfactory methods of securing these objectives.

An intensive review of the goals of our economic assistance programs has been made by the executive agencies concerned. This review has confirmed the main conclusions of studies of our foreign aid methods undertaken by the Congress and the Executive Branch in 1956 and 1957. During the past few years, there has been a reduction in the amount of grant

*The classified report is not included in this release.

aid, particularly for countries receiving Defense Support assistance. For FY 1961 the requirement for Defense Support is \$111 million less than was requested last year. There has been a gradual but continuous shift from grant to loan programs.

The principal means of reduction in grant aid is in courses of action which will accelerate the process of economic growth in less developed nations and hasten their economic independence. This argues for increased emphasis on economic development loans and a larger role for the Development Loan Fund. It also indicates a need for reform of these economic policies and administrative weaknesses in the major aid-recipient nations which stifle initiative and impede economic expansion. Our future plans take account of these requirements. Economic growth, however, is not susceptible to precise scheduling. Conditions under which progress is possible can be described, and our energies and resources can be concentrated to these ends, but no timetable of achievement can be advanced. The accompanying report indicates the numerous conditional factors which may affect our future courses of action.

More generally, however, we must allow for ourselves a range of flexibility in the instruments and techniques of our foreign policy for the uncertain years ahead. The accomplishment of our mutual security objectives, upon which everything depends, will require not only the devotion and energies of the men and women responsible for the day to day conduct of our activities abroad but also the availability of resources in the forms most suitable to the tasks to be performed.

We have now, under the Mutual Security Act, methods of assistance designed for our several military, political, and economic purposes abroad. In the past, we have found grants of economic assistance indispensable to some of these purposes. Our review of goals, and our assessment of the prospective world environment within which these goals will be sought after, argues very strongly that this will continue to be the case for some years to come.

Economic progress in the poorer nations remains an abiding problem of our times. The great gulf between living standards of the people of the industrial countries and those of the developing countries must be narrowed. As the accompanying report indicates, we look forward to the possibility of gradually diminishing needs for grants of economic assistance abroad and for an increase in emphasis on loans for the direct objective of economic development.

The continuation of or the termination or reduction of grant assistance proposed in this report represents the best judgment based on the current situation in each of the countries concerned and in the world as a whole. However, we all realize that this is a time of fluid political conditions in which political change is frequent and sometimes drastic and unexpected. It is entirely possible that conditions may change so rapidly and so greatly that it would be possible to speed up the timetable in some countries, or it may be necessary to slow it down in others. As the proposals in this report are being implemented, it will be necessary to keep each country situation under constant review in order to ensure that our actions are consonant with conditions at the time.

Sincerely,

/s/

Douglas Dillon
Acting Secretary

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Preface

Section 503(c) of the Mutual Security Act provides as follows:

The President shall include in his recommendations to the Congress for the fiscal year 1961 programs under this act, a specific plan for each country receiving bilateral grant assistance in the categories of Defense Support or Special Assistance whereby, wherever practicable, such grant assistance shall be progressively reduced and terminated.

A detailed report in response to this statutory requirement is being submitted to the Congressional Committees considering the proposed Mutual Security Program for FY 1961. That report deals with general issues of foreign economic assistance policy raised by the amendment. It contains planned courses of action with respect to future Defense Support and Special Assistance bilateral grant aid, projected country by country. The report is of necessity classified because of the sensitive material upon which it touches.

However, the subject of the report is of such general interest and importance that it was deemed appropriate to provide, on an unclassified basis, as much of its general content and conclusions as could be done without injury to the security interests of ourselves and of other nations which are involved. This unclassified version of the report has therefore been prepared.

Introduction

Objectives. The reexamination of our forward planning under Section 503(c) required a review of the objectives of foreign economic aid programs and of the methods and instruments available for prosecuting these objectives.

Our grant economic assistance programs to a very large extent trace to military and political emergencies: the war in Korea, the military struggles in the Indochina peninsula, the political upheavals in the Near East, and the abrupt emergence of new countries out of the breakup of colonial systems. Aid programs had to be designed to strengthen weak and divided states, to help support military deterrents to aggression, and to cope with urgent political problems in the new countries and around the periphery of the Sino-Soviet bloc.

Grants of economic assistance were and are appropriate to these circumstances and to our objectives in them.

We have in the Development Loan Fund an agency and economic resources for the specific and direct purpose of promoting economic development in the less developed countries. It provides aid for sound development projects and programs on a case by case basis. As a general rule, loan assistance is suited to the economic development purpose and under present policies is used for it.

This distinction of purpose is important to the planning of reductions in grants of economic aid. Given our different immediate objectives, grants and loans are not in a strict sense interchangeable. For many situations, the grant method is essential to the successful achievement of our aims. Plans for reducing grants of aid must seek progress toward our objectives rather than changes in the method of aid.

Means to reductions of grant aid. The varied objectives of our grant economic assistance programs make it impossible to establish a uniform pattern of planning. In a number of the smaller programs, a more or less clear path to our primary objectives can be marked out. In others, however, the attainment of our objectives depends on the success of a broad program of action, of which grant assistance is one part.

Special emphasis has been given to the problems presented by the major Defense Support programs in five countries: Korea, China, Vietnam, Pakistan, and Turkey. These five programs, it is presently estimated, will account in FY 1960 for over 73 per cent of Mutual Security Act obligations for defense support assistance.

For this group of countries in particular, the only practicable means through which a reduction of grant economic assistance can be envisaged is to be found mainly in expansion of their own economic capabilities. This in turn depends upon our Mutual Security aid policies as a whole, upon the availability of other sources of economic assistance, upon the domestic policies and attitudes of the countries concerned and upon the extent and nature of internal and external pressures upon them. Our objectives probably will call for more development loan assistance as a part of the process; as a result the resources of the Development Loan Fund will be of key importance.

Taken as a whole, our plans do not project the termination of all present grant aid needs in a defined period of time. This seems neither possible nor desirable in the light of the known factors and our own objectives. Moreover, new needs for grant aid are likely to arise. The grant method of economic assistance is peculiarly well adapted to the purposes and situations to which it has been devoted. It has been an essential instrument of foreign policy and, in an uncertain world, promises to remain so.

After these necessary qualifications, however, it seems clear that the foreign economic aid program is moving, as rapidly as is compatible with our own interests, in the direction pointed to in Section 503(c). If the plans and programs discussed prove possible of realization, there will be gradual reductions in present grant economic aid requirements. If needs for grants for military and political objectives do decline, the emphasis of our economic assistance policy as a whole can be placed more and more on the longer run purpose of helping to foster economic growth. Our institutional and policy structure has already been partially redesigned for this objective. The opportunity to direct resources and energies to it in greater measure will be a welcome challenge.

The Objectives of Foreign Aid

Grant Assistance Programs

Defense Support assistance, provided to 12 countries, is presently estimated to require \$765 million in FY 1960 and may have to be increased before the year ends. Among these countries, Korea, Vietnam, China, Pakistan, and Turkey are presently expected to receive about \$575 million. The programs range from assistance for the construction of military facilities in the Philippines to general economic support for these major recipients.

The Defense Support programs are designed to provide, through grant economic aid, the margin of resources necessary to assure the capability of the recipient government to provide the military forces and strength mutually agreed to be required for the common defense. In the broadest sense, they are intended to prevent the economic retrogression and political instability that would follow if the country were to attempt to rely on its own resources to provide this degree of military strength. Our aid is thus provided for mutual objectives where the defense interest is paramount. It is for this reason that we consider these as objectives properly to be sought through grants of aid.

Special Assistance is a flexible category of economic aid which has as its broadly stated purposes the maintenance or promotion of political or economic stability abroad.

Programs in this category are being used to support friendly governments that have come under heavy external political pressure; to cope with political and economic emergencies; to maintain an American presence and interest in situations where Soviet or Chinese Communist efforts at penetration have been on a substantial scale; to provide economic aid for defense purposes where it has been found infeasible to enter into the usual mutual security relationship; to assist with small scale projects or programs supplementary to technical cooperation activities; and to provide assistance to projects, for example in the fields of health and education, which are of a non-loanable character.

Most of the bilateral Special Assistance programs are grant programs. Our objectives in these programs usually do not meet the criteria for loans or fit the procedures of established lending institutions. Special Assistance grants are provided mainly for projects or purposes in themselves economically constructive but not on their own merits reimbursable. A special case here is the support of activities directly related to technical assistance. In such cases, the loan method clearly could not serve our objectives. Each Special Assistance program, however, involves a separate judgment about the most effective means to the achievement of our specific aims, and in some cases Mutual Security loans, rather than grants, are used.

Validity of grant aid objectives. Do the general security and political objectives of the grant aid programs remain valid? The answer to this depends basically on judgments about the kind of world in which our foreign policy will have to be conducted in the years immediately ahead.

These give no present basis for expecting that the underlying conditions which created needs for grant aid in the past will now disappear. In Asia, the divided countries and the newly independent states continue under the ominous shadow of the Communist Chinese regime. The Near East is still politically unstable. The process of rapid political change in the less developed areas as a whole seems certain to continue. The Communist subversive effort, world wide, is not diminishing. The realities of the military balance between East and West give no satisfactory basis for looking forward to a declining level of defense requirements and particularly not to a declining requirement for defense against local aggression.

Against this background, the overall purposes of the Defense Support and Special Assistance programs are sound. It is in our interest to share the burdens of mutual defense, to support or assist countries exposed to unusual political or military hazards, and to help new countries to get off to a favorable start as independent states. We need economic assistance methods suited for these objectives. To reduce or end the requirements for grant aid by altering or abandoning the goals of such aid is a conceivable but not an acceptable approach.

Loan Assistance

Under our current policies economic development assistance is provided, as a general rule, as a loan, and under the Mutual Security Act by the Development Loan Fund which for the current fiscal year has received appropriations of \$550 million for lending.

Our national interest in the economic development of the less developed countries is well recognized. The wide, and in some cases growing, disparities in standards of life as between people in the industrial countries and those in the less developed nations make for a profoundly unstabilizing force in the world. Expectations of a better future have been aroused and persist. Unless there is economic expansion, population growth alone will frustrate them. We can ill afford to have whole societies increasingly embittered and despairing. Even on the narrower ground of sustaining our material prosperity, we need in the underdeveloped areas more productive countries which can also be better customers and trading partners. Economic development is one of the prerequisites to an evolution of the world which will enhance our national safety and well-being.

Obviously, economic development is not set aside as the objective of only one instrument or method of policy. Our technical assistance programs always have been directed specifically to helping develop the basic skills and institutions necessary to economic growth. Our grant economic programs help to set a floor of economic activity from which economic expansion is possible; or, in assisting toward other objectives, they provide some of the resources needed for development. Our sales of agricultural surpluses for local currencies are related to the economic development objective.

At the same time, there is a need for a method of economic assistance having development as its primary objective, with its procedures and techniques created for this main purpose. This was a basic conclusion of the intensive studies of foreign economic aid carried on in 1956 and 1957 by the Executive Branch and by the House of Representatives and the Senate. These studies uniformly agreed that our foreign economic aid program had to be devoted to a variety of purposes and that each of these purposes should be pursued by methods specifically suited to it. In the case of economic development, it was concluded that the proper instrument would be an agency to make loans on flexible terms for the financing of development programs and projects. To give effectiveness to this judgment, the Congress and the Executive Branch established the Development Loan Fund.

The choice of the loan method of providing assistance for the purpose of economic development derives from two principal considerations.

First, the economic development of another country, while clearly in our general and long term interest, does not normally represent a requirement of such urgency from our point of view as to necessitate the provision of grant assistance. The growth of an economy depends on more than the provision of additional resources. If the determination and capability to achieve growth exists, the loan technique for financing development is suitable to the interests of both the lender and the borrower.

Secondly, there is the question of repayment. Financing of the creation or expansion of economic capabilities and facilities which help create the means for repayment, is logically to be provided through lending.

Aid in the form of either grants or loans can and should be so administered as to encourage sensible and sound economic and fiscal policies. The use of the loan technique is not incompatible with this objective. The process of preparing and justifying loan requests can itself be a part of the broad process of economic growth. The lending agency can require that loan applications reflect an examination of relative economic needs and priorities, expressed in terms of costs. It can also require the would-be borrower to view possible expenditures in the light of basic economic considerations. These actions help to impose a desirable economic discipline on the borrower.

Prospects for Achievement of Short Run Objectives

The foregoing discussion argues that, while the grant and loan programs under the Mutual Security Act are closely related, loans are not in a significant degree substitutable for grants. This follows because our objectives fix the pattern of aid as between loans and grants. Reductions in grant economic aid depend on progress toward the particular objectives of the Mutual Security Act rather than on a shift among the economic aid methods of the Act.

The variety of the grant aid programs makes it impossible to project uniform courses of action for expediting the achievement of their objectives. In a number of cases, our objectives are limited and it is feasible to schedule more or less firmly future reductions in grant aid. In others, we have set target dates for the termination of present programs. In a few instances, on the other hand, the context within which our grant economic aid is provided gives no basis for expecting or planning reductions in that aid.

Finally our major Defense Support programs present a unique set of issues and problems. Among these, the programs for Korea, China, Vietnam, Pakistan, and Turkey are expected to account in FY 1960 for an estimated 73 per cent of all Defense Support economic assistance. Because of their magnitude, these programs and the planning for them have been considered in more detail.

The Problem of Reducing Defense Support Grant Aid

Magnitude of deficits. In each of the major Defense Support countries there is a very large gap between, on the one hand, total requirements for goods and services and, on the other, the capabilities of the local economies to produce goods and services to match these demands. This gap, or deficit, is especially large in Korea, in Pakistan, in Vietnam, in China and in Turkey. In each case, it is attributable in whole or in large part to the costs of military forces maintained in the mutual defense. Grants of Defense Support aid are intended to make possible the continued maintenance of those forces by filling a portion of the deficits.

In considering the problem of dealing with deficits of this magnitude, two initial assumptions are made. One relates to the defense budgets which directly underlie the deficits, the other to the continuing availability of agricultural surpluses as a partial means of meeting the deficits.

Defense budgets. In the Defense Support program countries, however, the Communist threat is a highly immediate one. If the free world is to have a flexible capacity for meeting that threat, effective local forces are required in the most directly exposed areas. This is a requirement that does not now appear to be susceptible of being diminished significantly.

If, however, developments make it feasible to hold defense budgets more or less stable, increased economic capabilities can then be devoted to productive investment and to meeting the consumption needs of growing populations.

Agricultural surpluses. An important contribution of resources has been made to grant aid countries through local currency sales of surplus agricultural commodities under the provisions of the Agricultural Trade Development and Assistance Act, usually known as Public Law 480. Among the countries having large Defense Support programs, Pakistan in 1959 received \$86 million of agricultural commodities, Turkey \$35 million, Korea \$34 million, and China \$13 million.

The utility of surplus agricultural commodities in specific country situations is strictly dependent, of course, on our availabilities in relation to the ability of countries concerned to absorb amounts in excess of normal requirements. Where all requirements for the particular commodities that we have in surplus are satisfied, through local output or normal imports, there is no possibility of Public Law 480 commodities supplementing Mutual Security Act assistance. Also, especially in the case of food grains, fairly small increases in domestic production will often make the difference between shortage and sufficiency. Wide shifts in requirements from year to year are thus quite possible.

It is anticipated, nevertheless, that sizeable demands for surplus foods and fibres over and above normal needs will continue in the countries receiving grant economic aid. The assumption is made, therefore, that it will be possible, as in the past, to serve important economic purposes with surplus agricultural commodities on terms similar to those of Public Law 480.

Economic Development. The most promising means of reducing Defense Support needs is through the more rapid economic development of the countries concerned. We intend to take vigorous and specific actions looking to an expansion of the domestic economic capabilities of the countries now requiring heavy grants of Defense Support aid. To the extent that such measures expedite economic development, the economic deficits of the aid receiving countries will diminish, and with them the needs for grant economic aid.

This approach, it should be stated frankly, does not lend itself to a timetable of scheduled aid reductions. Economic development is a highly complex matter. We can identify the main elements in it but there are many uncertainties about the forces that affect them. Present techniques and information allow forecasts about trends and directions of change, but we do not have the tools for predicting specific magnitudes.

Furthermore, United States policies and actions have limits of effectiveness. Our aid programs, even the very large ones, make up small fractions, rarely as much as one-tenth, of the total resources involved. As for the policies and attitudes of other governments and peoples, which are critically important variables, we could not and indeed would not take responsibility for deciding them on a unilateral basis.

These limitations on our ability to foresee or manage events in detail make it clear that we cannot set some stated level of economic activity in another country as an objective of American policy. The issue cannot be that much under our control.

The possibilities for expediting economic development are broadly favorable, however. Economic growth has occurred in the grant aid countries and, in many countries, has outrun population growth by varying margins. For example, the Republic of China since 1956 has had an estimated 1.5 per cent rate of increase annually in per capita output.

For some of these countries, the recent past has been devoted to building basic political institutions or, as in Korea, to rebuilding from a devastating war. The next phase, in the absence of new military threats and tensions, can be one of emphasis on progress toward economic viability. This is also the view of political leaders in power in these countries.

Our planning problem is to identify — and our intention is to act vigorously in — the areas where our actions can be most effective in providing the means, or removing the hindrances, to economic development.

In a broad sense, these are, first, capital assistance for expanded investment and, second, actions that will help to make existing and future investment more productive.

Investment assistance. This is a matter for development lending on our part, and on the part of other industrial countries and the international agencies. As time goes on, private foreign investment should make up an increasing element in it.

Our forward planning is based heavily on the proposition that lending agencies will increasingly be able to finance sound development projects and programs outside the probable range of private investment in the countries receiving grant aid.

The Development Loan Fund, which can meet a range of developmental needs, without putting unmanageable immediate burdens on the international accounts of the less developed countries, is particularly important in this respect. Its continued functioning, with substantial resources and flexible techniques, will be an essential feature of the approach outlined here.

An aggressive and effective program of development financing will require in some countries that our technical assistance personnel and our field missions provide help and guidance in planning development projects and programs. It may also involve experiments with new lending techniques by the Development Loan Fund, especially in relation to the provision of limited credits on which countries could draw if increased imports resulting from an accelerated development effort created unusual temporary strains on their balance of payments.

A substantial amount of foreign economic assistance already is provided by other nations or comes from international financial institutions. The United States is currently seeking to encourage larger contributions from Western Europe and Japan to the general task of economic development in the less developed countries. The outlook on this score is favorable. Further, the capital of the International Bank for Reconstruction and Development has been increased and agreement has been reached on the creation of the International Development Association. The trend is toward an expansion of public and private capital flows to the developing countries.

This process will have an indirect effect on future grant aid requirements. It is not possible, obviously, to forecast the amounts of increased economic assistance that will go to individual countries. Moreover, the needs of the developing nations as a whole for investment capital will for a long time be larger than available supplies. Nevertheless, some of the Defense Support countries probably will be able to obtain added assistance for the economic development needed to reduce the huge resource deficits that now exist.

Possible flows of private capital to the countries under consideration cannot be estimated even roughly. We believe, however, that there is room, in these countries as in many other less developed nations, for meaningful improvements in policies and attitudes bearing on private foreign investment. This is a critical point for economic development prospects. It bears not only on supplies of capital but also upon the likelihood that such capital will be fully productive.

Productivity of investment. The second part of a program for economic development must stress improvements in those factors that restrict the productiveness of investment.

Our technical assistance already has made major contributions to creating or expanding the basic skills and institutions that are necessary. This is clearly, however, a long term process. We shall need to continue training programs and advisory services on a substantial scale as an essential complement to our foreign economic assistance.

The productivity of capital, and the supply of capital as well, is dependent on government policies and attitudes.

This is a matter of key importance. Capital assistance from public sources can break investment bottlenecks and provide resources that would not otherwise be available. But such investment must have an environment generally favorable to economic activity if its productivity is to be maximized. The creation of such an environment is a part of the economic development problem.

There is no specific formula for this. In fact, the policy issues are seldom clear cut. Usually they are combined with sensitivities that, as a practical matter, affect the exercise of our influence. Nevertheless, where it is plain that potentially remediable policies of another government perpetuate the needs for extraordinary assistance, we can properly look for ways to cooperate in amending those policies. Or, on the other side, where opportunities appear for collaboration in positive programs to foster economic development, it will be in our interest to view them sympathetically.

Specifically, we have a legitimate interest in consulting with aid receiving governments on such matters as:

Policies and attitudes toward the private business sector, including private foreign investment.

Fiscal and tax policies, as they relate to investment and to price stability.

Proposed increases in military expenditures.

Exchange rates and foreign trade regulations and controls.

Economic development plans and programs.

Specific applications. Plans embodying the dual approach outlined above are spelled out in the classified report submitted to the Congress. Although these plans list specific possibilities for future reductions in grant Defense Support, they point to economic growth as the chief means to progressive cuts in grant aid requirements.

In the case of China, we have received from that Government a proposal for the hastening of progress toward independence from extraordinary grant economic aid. The Government of China has put forth a series of measures it would take to accelerate the rate of economic expansion in Taiwan. These are designed, in the main, to give private enterprise greater scope and incentive. We consider that the momentum already achieved by the Taiwan economy holds out relatively unique possibilities for the success of this kind of effort.

We propose, subject to Congressional appropriations, to provide within Defense Support grant assistance for FY 1961 an incentive component to be used for additional imports required in connection with an accelerated rate of domestic investment and to encourage the Chinese government in taking the measures necessary to induce the acceleration. It is anticipated that the result of these actions will be additional needs for imported machinery, equipment, structural steel, spare parts, and industrial raw materials. If such demands were to go unmet, strong inflationary pressures would be created and the economic growth process retarded or distorted. The assurance of a sufficient volume of imports is thus essential to the success of the program.

This is frankly an experimental approach. While we regard this grant economic assistance as essential to launching the new program, we believe the principal support for development should be the Development Loan Fund. Thus we will review, in the light of the year's experience, the roles of grant and loan aid in meeting future requirements.

Additionally, we expect from the Government of China a much increased volume of requests for loan assistance for development projects in the public sector. There appear to be good opportunities, also, for Development Loan Fund credits and guarantees for Chinese and foreign private investors on a sizeable scale.

This program for Taiwan, it is to be stressed, emphasizes both elements of an economic development program. We propose, on the one hand, to increase the flow of investment capital to Taiwan, while on the other we expect from the Chinese side that a range of governmental policies bearing on the productivity of capital, particularly in the private sector, will be rapidly liberalized.

Conclusions

This report has discussed the special roles assigned to grant economic assistance under our present foreign aid policies. Grants of economic aid have served the national interests over a wide range of special and emergency situations and have contributed measurably to our security. They have been an indispensable instrument of foreign policy during a period of rapid and sometimes violent change. Every indication is that we shall continue to need the grant method of providing aid if we are effectively to prosecute our objective of a peaceful and stable world. //

There are some prospects, however, for a declining level of grant aid requirements. This follows, in part, from progress toward the specific objectives of many of our grant programs and in another part from the expectation that the economic capacity of the countries receiving large grant aid sums can be progressively enhanced. There is an evident opportunity to place increasing emphasis on economic development as an objective and it is this opportunity that we expect to seize upon. It offers the way to a progressive reduction of the grant aid part of our total foreign economic aid program and, more importantly, to the growth of increasingly self-reliant and prospering allies and friends.

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