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by

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I. General

Since World War II the United States has instituted and maintained a variety of foreign assistance programs. Table 1 divides these programs among three general categories--military assistance, economic assistance, and export-promotion loans--and indicates how these programs have evolved from 1946 to 1978. As these categories suggest, U.S. foreign assistance serves several distinct objectives. In the immediate postwar period, refugee relief and economic reconstruction in Europe were the main priorities. Military and strategic objectives predominated during the 1950s, but the objectives of promoting economic development in low-income countries and expanding U.S. exports gained greatly in importance in the early 1960s.

After the postwar reconstruction period, U.S. foreign assistance programs tended to decline--from almost 2 per cent of U.S. gross national product to only about one half of one per cent of GNP in the late 1970s. This was largely due to the general decline of U.S. military assistance programs, except during the period of major U.S. involvement in the Vietnam conflict. The decline of foreign aid activities of the United States was most dramatic in Western Europe--the main recipient of such assistance during the decade following World War II. After the recovery of European productive capacity and incomes to high levels in the 1950s, most European

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countries were no longer recipients under the U.S. economic assistance programs. (See Table 2.) Economic aid to other regions rose to high levels during the early 1960s but declined in real terms during the latter part of that decade before resuming a normal rate of growth in the 1970s.

The concept of "foreign assistance" presented in Tables 1 and 2 encompasses official sales, grants, or loans to foreign governments or foreign residents by the United States government that are provided on concessional terms. Some of the transactions involve a relatively small concessional element--particularly, in certain periods, loans provided by the U.S. Export-Import Bank and by the Commodity Credit Corporation. Non-concessional government sales of goods and services are not included. Defense services provided by U.S. military personnel stationed abroad are also not counted as foreign assistance; but non-military technical assistance services provided by U.S. civilian or contract personnel are included. Assistance is provided by the U.S. government to exporters in developing countries through preferential waivers of tariffs under the Generalized System of Preferences (GSP), but the benefits of these waivers accrue partly to U.S. consumers and are not included in the federal budget. Similarly the benefits of tax preferences to U.S. exporters provided through Domestic International Sales Corporations (DISC) are presumably shared between the exporters and their foreign customers. Neither the GSP nor the DISC are defined here as a form of "foreign assistance."

Tables 1 and 2 also exlcude private foreign assistance and all types of private capital outflows from the United States, including those guaranteed by the U.S. government. For many developing countries, however, private capi-

Table 1. **Foreign Assistance Programs of the United States by Type of Program**
($ million, disbursements, calendar years)

Year	Economic Assistance: Bilateral (except food aid)	Economic Assistance: Multilateral	Economic Assistance: Food Aid	Export Promotion: Eximbank	Export Promotion: CCC1/	Military Assistance	Total	% of GNP
1946	3020	1470	--	1037	137	15	5679	2.7
1947	4372	868	--	824	86	74	6224	2.6
1948	4231	625	--	429	7	420	5712	2.2
1949	5695	1	--	185	27	214	6122	2.4
1950	3809	--	--	200	27	531	4567	1.6
1951	3347	--	--	204	--	1494	5045	1.5
1952	2405	--	--	478	--	2730	5613	1.6
1953	1907	--	--	647	--	4332	6886	1.9
1954	1732	--	--	276	--	3196	5204	1.4
1955	1923	--	710	207	--	2387	5227	1.3
1956	1746	--	1481	229	--	2649	6105	1.5
1957	1708	--	1788	667	--	2500	6663	1.5
1958	1814	--	1654	646	--	2372	6486	1.5
1959	1974	--	1128	493	--	2086	5681	1.2
1960	2070	153	1438	406	--	1841	5908	1.2
1961	2425	172	1534	821	--	1545	6497	1.2
1962	2867	122	1522	621	--	1777	6909	1.2
1963	3132	62	1672	509	--	1742	7117	1.2
1964	3410	112	1766	337	--	1412	7037	1.1
1965	3317	--	1484	533	--	1695	7029	1.0
1966	3134	-101 3/	1396	908	--	1969	7306	1.0
1967	3451	194	1317	1260	52	2515	8789	1.1
1968	3099	127	1259	1517	67	2978	9047	1.0
1969	2790	184	1156	1259	76	3108	8573	0.9
1970	2686	234	1165	1092	176	2693	8046	0.8
1971	2904	246	1148	1426	339	3668	9731	0.8
1972	2829	271	1205	1298	459	4901	10963	0.9
1973	2797	373	905	1680	799	3341	9895	0.8
1974	4931 2/	537	985	2578	147	3400	12578 2/	0.9
1975	2716	654	1383	2490	318	3718	11279	0.7
1976	2976	1102	1135	2004	678	2790	10685	0.6
1977	2992	870	1141	1482	702	2449	9636	0.5
1978	3827	867	1127	1237	1357	2580	11095	0.5

1/ Includes preceding programs.
2/ Includes debt cancellations for India ($2,035 million) related to earlier food aid loans.
3/ Negative entry due to procedural change in which U.S. Treasury collected public debt instruments previously issued to multilateral institutions and exchanged them for letters of credit.
Sources: National Advisory Council on International Monetary and Financial Policies (NAC), Annual Reports; Department of Agriculture, Food For Peace.

Table 2. Bilateral U.S. Foreign Assistance Programs, Geographical Distribution
($ millions, disbursements net of repayments, calendar year)

	W. Europe		Other Europe	Africa		W. Hemisphere		Asia	
	military	economic	economic	military	economic	military	economic	military	economic
1951	1083	2303	-15	--	5	64	97	291	707
1952	2184	1566	-4	--	56	60	72	383	620
1953	3434	965	4	2	40	34	369	769	642
1954	2329	771	7	2	50	47	77	791	585
1955	1758	629	-1	3	85	30	73	568	981
1956	1907	296	-3	2	68	56	56	643	1196
1957	1573	455	15	9	50	66	273	814	1055
1958	1368	301	24	9	57	71	504	885	1225
1959	1267	-291	61	7	197	59	338	669	1453
1960	955	115	123	12	288	77	194	743	1751
1961	655	-404	53	18	405	124	710	689	1629
1962	709	-157	54	30	550	74	587	789	1826
1963	893	-46	43	32	491	63	576	706	2089
1964	598	281	46	25	481	59	447	677	1955
1965	574	67	-12	24	473	59	644	1012	1999
1966	392	-113	-13	34	473	72	739	1429	2131
1967	493	399	-13	29	343	64	624	1915	2148
1968	416	245	2	34	284	64	833	2405	1908
1969	328	233	-29	26	283	36	599	2561	2021
1970	266	-187	5	19	275	25	531	2235	1799
1971	304	-42	-2	25	454	21	379	2824	2258
1972	281	-4	70	12	253	26	433	4203	2041
1973	323	88	369	11	278	25	464	2491	1849
1974	278	318	-102	19	492	24	713	2515	1717
1975	102	470	-58	21	496	25	780	2738	2694
1976	96	381	166	28	740	16	505	1192	2971
1977	74	251	214	10	994	14	452	664	2580
1978	129	696	424	6	1238	17	299	687	2779

Source: NAC Annual Reports.

tal inflows have gradually substituted for foreign assistance as the main vehicle for transfers of real resources. Commercial banks have played an increasing role as providers of financial flows to developing countries. Net lending from U.S. chartered banks to developing country borrowers appears to have averaged over one per cent of U.S. GNP during the 1970s. However, these are not concessional loans and therefore do not fit under the general heading of "foreign assistance."

Because of the diversity of objectives promoted by various U.S. foreign assistance programs and because of their disparate administrative arrangements, the following programs are analyzed separately--

(1) economic development assistance (except food aid);

(2) food aid and the disposal of surplus commodities;

(3) export promotion loan programs; and

(4) military security assistance and training.

For each, the common approach will be (a) to summarize the objectives and methods of administration of the program, (b) to describe the changes in program characteristics and terms of assistance over time, (c) to identify the major issues regarding the effectiveness of the programs and their consistency with secondary policy objectives.

In examining the effectiveness of foreign assistance programs, attention is focussed on the major criticisms that can be applied to the individual programs. Such criticisms by no means necessarily lead to a conclusion that individual U.S. foreign assistance programs should be reduced. Any judgment that individual foreign-assistance programs should be reduced or, on the contrary, increased in size must be related to certain global purposes of foreign assistance. These global purposes include, in addition to the narrower objectives discussed in each program, reduction of the risks of military hostilities or of economic conflicts in a world where disparities of wealth between nations are wide and where future disruption of international trade relationships could be very costly to the United States as well as to other countries.

In addition to providing transfers of resources to other countries, almost all foreign assistance programs of the United States have been designed to influence the pattern of resource allocation and distribution in the recipient countries. However, since the foreign assistance provided by the United States is normally a small fraction of the overall resources available to the recipient government, the effects of foreign aid are elusive. Foreign aid funds sometimes may be used to finance expenditures that, in the absence of foreign aid, would have been fully financed by the recipient government with alternative resources. To this degree, foreign assistance becomes a fungible addition to the general spending capabilities of the government, and the pattern of marginal spending by the recipient may or may not be consistent with the purposes intended by the donor.

The potential fungibility of foreign assistance presents problems of program design, administration, and evaluation that are common to all of the major assistance programs. To control the fungibility of foreign assistance, most of the U.S. programs have required "self-help" actions by the recipient in the area that is being promoted by the program.

Within the U.S. government, the Administration faces constraints on the fungibility of foreign assistance resources between programs. Each of the programs listed in Table 1 is funded separately by the U.S. Congress[1/], after which the Administration cannot readily substitute increased expenditures or financial commitments under one program for reduced expenditures under another. The funds for the U.S. economic and military assistance programs are appropriated by Congress on an annual basis--including U.S. contributions to multilateral development banks that, in principle, have already been negotiated for multiple-year replenishments of the banks' resources.

Budget targets for foreign assistance programs are submitted to the Congress by the President in January of each year as part of the overall federal budget for the fiscal year which will begin on October 1.[2/] This budget document contains both proposals for financial commitments to be made for individual programs and a set of projections of the budget outlays which will result partly from commitments made in previous years.[3/] Table 3 presents the President's proposed program of budget outlays on international affairs for Fiscal Year 1981, estimated levels of expenditure during Fiscal Years 1979 and 1980, and anticipated levels of budget outlays for Fiscal Years 1982 and 1983.

1/ In addition, many of the functional and geographic sub-components of the U.S. foreign aid programs are subject to separate expenditure limits.
2/ The Budget of the United States Government, Fiscal Year 1981. January 1980.
3/ The lag between commitments and outlays of funds is especially long in the case of economic development assistance projects financed by the Agency for International Development and by the multilateral development banks.

Table 3. Budget Presentation to the U.S. Congress for Conducting International Relations, FY1981[1/]
(outlays or disbursements, net, millions of dollars)

Major missions and programs	1979 actual	1980 estimate	1981 estimate	1982 estimate	1983 estimate
OUTLAYS					
Foreign economic and financial assistance:					
AID development assistance	1,374	1,575	1,737	1,928	2,158
Multilateral development banks	683	926	966	1,193	1,297
Public Law 480—Food aid	976	1,169	1,153	1,190	1,275
Peace Corps	94	104	116	126	138
Economic support fund/Peacekeeping operations	1,755	2,040	2,056	2,200	2,200
Refugee assistance	166	468	534	598	514
Offsetting receipts and other	−304	−309	−349	−397	−405
Subtotal, foreign economic and financial assistance	4,743	5,974	6,212	6,839	7,178
Military assistance:					
Grant military assistance	140	195	150	150	95
Foreign military training	28	26	28	29	29
Foreign military sales credit	640	540	515	510	510
Relocation of facilities (Israel)	31	411	318	175	100
Offsetting receipts and other	−276	−275	−260	−260	−254
Subtotal, military assistance	563	897	751	604	479
Total, foreign aid	(5,306)	(6,871)	(6,963)	(7,443)	(7,657)
Conduct of foreign affairs:					
Administration of foreign affairs	785	867	927	1,042	1,166
International organizations and conferences	495	487	535	543	573
Other	30	35	39	40	41
Subtotal, conduct of foreign affairs	1,310	1,389	1,501	1,625	1,780
Foreign information and exchange activities	465	544	569	600	643
International financial programs:					
Export-Import Bank	200	1,054	1,230	1,193	1,822
Foreign military sales trust fund (net)	−1,434	1,200	....	....	....
International commodity agreements	....	....	5	....	....
Other	354	−568	−566	−573	−580
Subtotal, international financial programs	−879	1,687	669	620	1,241
Deductions for offsetting receipts	−110	−90	−89	−88	−88
Total, outlays	6,091	10,401	9,612	10,199	11,234

1/ CCC outlays for export credits are excluded from this table as program funding comes under the budget function of agriculture.

Source: *The Budget of the United States Government, Fiscal Year 1981*, January 1980.

II. Economic Development Assistance Programs

Objectives and Administration

Foreign economic development assistance programs of the United States, other than food aid and export-promotion loans, are authorized by the Foreign Assistance Act (FAA).[1] The objectives of the foreign economic development assistance programs have shown a varying emphasis over time among the promotion of economic growth in developing countries, alleviation of economic hardship and deprivation, and the advancement of diplomatic and strategic goals. In recent years under the Foreign Assistance Act the U.S. development assistance programs are intended to emphasize four principal policy goals:

(1) the alleviation of the worst physical manifestations of poverty among the world's poor majority;
(2) the promotion of conditions enabling developing countries to achieve self-sustaining economic growth with equitable distribution of benefits;
(3) the encouragement of development processes in which individual civil and economic rights are respected and enhanced; and
(4) the integration of the developing countries into an open and equitable international economic system. (Section 101.)

In 1979, the International Development Cooporation Agency (IDCA) was established and given responsibility for overall coordination of U.S. foreign economic assistance policy. However, detailed planning and administration of FAA economic assistance are executed by the Agency for International Development (AID) and by the Departments of State and Treasury. AID is subordinate to IDCA and administers the bilateral program of loans and grants for economic development projects. The Treasury Department has responsibility for the financial aspects of U.S. participation in

1/ The text of the U.S. Foreign Assistance Act is available in Legislation on Foreign Relations.

the World Bank and in other multilateral development banks. The Department of State has responsibility for allocating Economic Support Fund resources among designated countries or regions that have strategic or military significance to the United States. The Secretary of State also has responsibility for disaster relief assistance[1/] and for other assistance delivered through agencies of the United Nations.

The Overseas Private Investment Corporation (OPIC) and the U.S. Peace Corps operate smaller, specialized aid programs. Subject to the general oversight of IDCA, OPIC offers insurance to U.S. foreign direct investors in developing countries to cover losses due to war, expropriation, or inconvertibility of foreign currency holdings and administers a program of loans to small foreign direct investors.[2/] The Peace Corps was established in 1961 and is subject to the general oversight of the federal voluntary service agency, ACTION. The Peace Corps sends volunteers to poor countries to meet local needs for trained manpower and to promote understanding between the American people and the people of the host countries.[3/]

As indicated in Table 3, three of the largest channels for U.S. economic development assistance in recent years have been the functional development assistance program of AID, the Economic Support Fund, and the multilateral development banks.

The functional development assistance program of AID has been narrowed since 1973 to emphasize activities that serve "basic human needs"[4/] and

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1/ In most cases U.S. disaster relief assistance is delivered partly or wholly through international organizations and private voluntary relief organizations.
2/ The purposes and authority for OPIC are described in the Foreign Assistance Act, Chapter 2, Title IV in Legislation on Foreign Relations.
3/ The purposes and authority for the Peace Corps are described in the Peace Corps Act, in Legislation on Foreign Relations.
4/ Three elements of the basic human needs objective are to increase the incomes of the poor, their employment opportunities, and their access to basic public services. A general interpretation of the basic-human-needs strategy in historical perspective is presented by Streeten, "From Growth to Basic Needs." See also Development Assistance Committee, Development Cooperation, 1978 Review, pp. 27-36.

that directly assist the low income strata of the population. The types of projects specified by the Foreign Assistance Act (sections 103-106) include those dealing with agriculture, rural development, and nutrition; population planning and birth control; health; education; and technical assistance. A budgetary ceiling for each of these functions is established annually, and the ceilings place close constraints on the reallocation of loan funds for other types of projects. About three-fourths of AID's functional development assistance funds are allocated to countries having per capita national incomes below $500.

Projects financed by AID are normally executed by an agency of the government in the recipient country. Often AID-supported projects will include technical assistance to the executing agency to assist it in the management of the project. Imported goods and services financed by project loans (as in most bilateral U.S. foreign assistance programs) are ordinarily procured from the United States. (Since 1971, however, AID has also authorized the use of its development loan funds for procurement of imports from developing countries.)

Assistance from the Economic Support Fund, which was known until 1978 as Security Supporting Assistance, is made available to a small number of developing countries where "special economic, political, or security conditions" affecting the interests of the United States require larger amounts of funds than would otherwise be justified.[1/] The principal beneficiaries of the Economic Support Fund in recent years have been Israel and Egypt. Most ESF support for Israel has been provided as general budgetary support.

1/ Foreign Assistance Act, Sections 531-34.

In Egypt, however, most ESF funds have been provided in support of specific economic development projects, many of which would also meet the criteria for funding under the AID functional assistance program.

The United States provides financial support for five multilateral development lending institutions--the World Bank, the Inter-American Development Bank, the Asian Development Bank, the African Development Fund, and the International Fund for Agricultural Development. These institutions seek to promote economic growth in low-income countries principally through development projects that are similar to those supported by the AID program. In addition, the World Bank and the regional development banks assist in projects for the electric power and telecommunications sectors, industry, transportation, and other areas in which AID abruptly reduced its activity after 1973. The United States Government does not directly determine the lending policies of the multilateral development lending institutions but, as a major shareholder, has an important influence upon these institutions. As indicated in Table 1, multilateral institutions have tended to account for an increasing share of the U.S. development assistance program since 1970.

Evolution of Economic Assistance Programs

In the years following World War II the United States supported three major economic assistance programs in Europe--the welfare and relief programs administered by the U.S. Armed Forces and by the United Nations Relief and Rehabilitation Administration (UNRRA) and the Economic Cooperation Administration.1/ The purposes of UNRRA--70 per cent of which was financed by the United States--and of the U.S. Armed Forces

1/ For a description and analysis of these programs see Library of Congress, U.S. Foreign Aid, pp. 21-45.

program were primarily to assist refugees and to support the standard of living in the countries where economies had been most severely damaged during World War II. The United States withdrew its support of UNRRA in 1948, because the UNRRA was unable to maintain a degree of control over the allocation of its resources in Eastern Europe and in China that was satisfactory to the United States. The Marshall Plan, administered by the Economic Cooperation Administration (ECA), was introduced in 1948 and was restricted to the assistance of U.S. allies in Western Europe and in Asia. The primary objective of the ECA was to promote investment and the redevelopment of productive capabilities of the recipient countries. Under both the UNRRA and the ECA programs, the administration of individual projects was primarily the responsibility of the recipient countries.

A limited economic assistance program for the developing countries of Asia, Africa, and Latin America was proposed by President Truman in his inaugural address of 1949. This proposal did not receive strong support in Congress, although a small Technical Cooperation Administration was funded for the purpose of promoting economic development through technical assistance grants. During the early 1950s, other forms of economic assistance (often in the form of general budget support) were associated with military and strategic objectives and were allocated mainly to Korea, Indochina, and other Asian countries.

After a dramatic round of Soviet promises of economic assistance to a number of Asian countries in December 1955, including a credit of $100 million to Afghanistan, the U.S. Congress introduced greater emphasis on economic development objectives in its foreign assistance legislation for 1956.[1/] In response, the Eisenhower administration proposed in 1957 the establishment of the Development Loan Fund, which provided for capital assistance to development projects as well as technical assistance. In 1958, the Administration supported the creation of regional multilateral development banks, including a bank for Latin America which had been advocated for some time by a number of Latin American leaders. Thus, the Inter-American Development Bank was established--with the United States serving as its principal financial supporter.

At the annual meeting of the Governors of the International Bank for Reconstruction and Development in September 1958, the United States proposed the creation of the International Development Association (IDA) as an affiliate of the Bank. The purpose of IDA was to supply low-interest loans to countries on projects that did not meet the creditworthiness expectations or strict financial standards that the IBRD had required in its previous

1/ See Westwood, Foreign Aid in a Foreign Policy Framework, p.65.

operations. Proposals to establish a similar Special United Nations Fund for Economic Development had been advocated by other countries for some years. U.S. government officials had had some sympathy for the objective--since hard loan terms associated with the financing of U.S. allies during World War I and the debt service of obligations imposed on Germany thereafter had been perceived as a cause of deteriorating international political relations during the 1920s and 1930s.[1/] However, the United States preferred to channel such concessional resources through the World Bank and the Inter-American Development Bank Fund for Special Operations--where the United States and other donor countries would have weighted voting power based on the size of their financial contributions. Under the alternative proposal for channeling resources through the United Nations, aid-recipient countries would have had greater power, collectively, to determine the terms of assistance and its allocation among countries.

By the early 1960s, after the Soviet Union and China began to expand their economic and military assistance operations to new regions of the world, both the bilateral and multilateral components of U.S. economic assistance had shifted increasingly to Latin America and Africa. In the case of Latin America, U.S. economic assistance was administered within the framework of the "Alliance for Progress"--a program announced by the Kennedy Administration in 1961 to promote land reform, democracy, and other social and political reforms that might forestall the development of pro-Soviet revolutionary movements similar to that which had emerged in Cuba in 1960. Economic assistance for Latin America rose sharply in 1961 and 1962.

1/ See for example U.S. Foreign Aid, p. 86.

During the mid-1960s, the bilateral foreign economic assistance program of the United States grew especially rapidly in South Vietnam, where the United States had become involved in a major military campaign. While the cost of the U.S. economic assistance program in Vietnam was small in relation to the direct and indirect military costs, commitments of economic assistance for Vietnam reached nearly $600 million or 23 per cent of the budget for AID in fiscal year 1966.

As the Vietnam war and the South Vietnamese government became increasingly unpopular in the United States, the overall foreign economic assistance program met mounting resistance from the U.S. Congress. During its last year in 1968 the Johnson Administration proposed $2.5 billion for economic assistance other than food aid and export promotion loans, but Congress agreed to appropriate only $1.6 billion.

In 1971, a presidentially appointed Task Force on International Development presented several recommendations for change to the Administration and to Congress.1/ One broad proposal of the Task Force was that international lending institutions become the major channel for development assistance, with particular emphasis on institutions such as local development banks and the World Bank's International Finance Corporation that would promote the growth of indigenous private enterprise. The bilateral development assistance program would then be concentrated in selected countries which were of special strategic interest to the United States or in selected sectors, especially agriculture and education.

1/ U.S. Foreign Assistance in the 1970s: A New Approach, Report to the President From the Task Force on International Development.

The aid policy proposals of the Presidential Task Force and of the Administration did not fully satisfy Congressional critics who demanded a stronger separation between development policy and foreign policy. There was a popular belief that the benefits of U.S. economic assistance accrued primarily to the ruling class in developing countries.[1/] With growing support for that view, Senators Hubert Humphrey, George Aiken, Gale McGee, and others introduced and passed an alternative to the Nixon Administration's foreign aid bill in 1973.[2/] Their alternative bill changed the statement of U.S. foreign assistance policy objectives to substantially their present form and established the basic human needs objectives for the foreign development assistance programs. Two results of this "New Directions" policy over subsequent years were to redirect U.S. aid toward low-income countries and, within all recipient countries, toward projects that directly benefit the poorest segments of the population.

Issues Regarding the Effectiveness of U.S. Economic Assistance

Economic growth versus basic human needs. While the promotion of economic growth in the developing countries has been a long-standing objective of all U.S. economic assistance programs, the promotion of an equitable distribution of income within developing countries has received increased emphasis since the "New Directions" legislation was introduced in 1973. Growth and equity are not necessarily inconsistent objectives. For example, some investigators have concluded that Taiwan and South Korea

1/ See, for example, Senate Foreign Relations Committee Chairman J. William Fulbright "International Development Cooperation Act," Congressional Record, U.S. Senate, June 25, 1973.
2/ Mutual Development and Cooperation Act of 1973, House Report no. 388.

in recent decades have been able to achieve both an extremely rapid rate of economic growth and a more equitable distribution of income.[1/] Nevertheless, within any country's economic development program--and within the U.S.-assisted component of that program--there may be tradeoffs between projects that promote a higher degree of equality in income distribution and those that promote a more rapid rate of economic growth.

There can be little doubt that administrative guidelines for project funding by AID have been successful since 1973 in shifting a larger share of the direct benefits of those projects to low-income beneficiaries. However, the measurement of the effects on income distribution is generally handicapped by the limited availability of pre- and post-project data on incomes of the population. Meanwhile, there may be substantial foregone economic growth implied for some countries by the choice of equity-promoting projects. Projects which yield high economic rates of return produce not only high direct benefits for the participating individuals, they also tend to generate large indirect benefits through higher government revenues from user fees and income taxes that can be used to finance public services or to reduce tax rates elsewhere. In addition, high returns to the direct beneficiaries of a project may create increased demands for labor throughout the economy and help to raise real wages more broadly. The ultimate incidence of the indirect benefits on the low-income population at large is of course more difficult to identify than the direct benefits of a project, but the indirect benefits, in many cases, may be of greater significance.

1/ See Chenery and Ahluwalia, Redistribution with Growth, pp. 41-2, and Hassan, "Growth and Equity in East Asia."

Unfortunately, little is known about the degree to which equity-promoting development projects require a sacrifice of the average economic rate of return. A study by the Brookings Institution in 1977 noted that the project-preparation process at AID since the 1973 reforms had become extremely cumbersome and that, perhaps because of greater administrative complexity at the field level, the average project size was quite small: "These projects, whose size clusters in the $2-3 million range, compare to an average project size of $30 million for the World Bank . . . [and are] highly inefficient in the use of manpower."1/ Because the World Bank has continued since 1973 to sponsor more traditional development projects as well as to introduce newer-style equity-promoting projects, its experience may shed more light on the relative limitations of the two approaches than can the experience of AID. In this connection, project audit reports by the World Bank for 1978 and 1979 suggest that a relatively high proportion of certain equity-promoting projects (integrated rural development projects and livestock improvement projects) have failed to achieve the rates of return initially expected.2/ These results suggest that there may be a practical, as well as a theoretical, tradeoff between economic growth and equity in the selection of development projects in many low-income countries.3/

1/ Gordon and others, An Assessment of Development Assistance Strategies, p.19.
2/ See IBRD Fourth Annual Review of Project Performance Audit Results, Report No. 2185, 1978, p. 22; Fifth Annual Review of Project Performance Audit Results, Report No. 2637, 1979, pp. 30-31.
3/ One way of eventually integrating the objectives of high economic growth and improvement in the distribution of income is to modify on all projects the weights given to the project's benefits depending upon whether increased incomes accrue to the rich or to the poor and whether a high proportion of the increased incomes will be saved and invested to promote further economic growth. This approach has been advocated by Anandarup Ray and Herman G. van der Tak in "A New Approach to the Economic Analysis of Projects," Finance and Development, vol. 16 (March 1979), pp. 28-32.

Self-help effort of recipient countries. A traditional precept of U.S. economic assistance policy is that governments of the recipient countries must agree on the goals of the assistance program and take complementary action to achieve them.[1/] Such complementary "self-help" actions have been recognized to include both measures to increase the supply of scarce factors of production and measures to improve the efficiency of resource use in the country. In addition, social and political reforms by recipient governments (such as a land-reform program) have often been included among self-help efforts helping to justify U.S. economic assistance.

During the 1960s AID sought to develop objective criteria of self-help performance and to relate that performance to the level of U.S. assistance.[2/] One early and enduring objective indicator has been the level of domestic savings in relation to national income. Since economic growth in the developing countries was felt to be constrained in most cases by the availability of capital,[3/] growth would be enhanced by high savings rates in developing countries and by efforts to mobilize greater savings through higher government tax collections, through reallocation of government spending toward investment, or through reduced government deficits. The relevance of this emphasis on domestic resource mobilization in assessing self-help performance was heightened by a number of criticisms from academic economists who presented evidence that foreign capital inflows to developing countries tended to

1/ A frank and detailed discussion of both the principle and indicators of self-help is presented in U.S. Agency for International Development, "Policy Guidance for Foreign Assistance," pp. 28-32.
2/ Ibid, pp. 5, 28.
3/ See Chenery and Strout, Foreign Assistance and Economic Development.

cause offsetting declines in domestic savings rates.[1/] As Papanek pointed out, the data supporting these claims was subject to serious measurement errors, and tests of the causal relationship between foreign and domestic savings rates did not allow for the jointly determining influence of third factors.[2/] However, for theoretical reasons that Papanek and others have outlined, there are good grounds to suspect that foreign inflows of aid or other external capital will tend to reduce domestic savings performance.

The application by AID of specific standards of self-help performance takes place at three stages of the aid-giving process. First, past and prospective self-help accomplishments of a country are considered by AID when it determines country allocations of the global budget. Secondly, past accomplishments and future targets are discussed by officials of AID and of the host country at the time of the annual review of the U.S. assistance program within each recipient country. It is at this stage, if at all, that the overall resource mobilization effort of the country might lead to a modification in the amount of planned economic assistance from AID and other U.S. assistance programs for that country. Finally, in the planning and negotiation of specific development loan projects, self-help effort

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1/ See A. Rahman, "Foreign Capital and Domestic Savings: A Test of Haavelmo's Hypothesis with Cross-Country Data," Review of Economics and Statistics, 1968, pp. 137-8; H. B. Griffin, "Foreign Capital, Domestic Savings and Economic Development," Oxford University Bulletin of Economics and Statistics, 1970, pp. 99-112; T. E. Weisskopf, "The Impact of Foreign Capital Inflow on Domestic Savings in Underdeveloped Countries," Journal of International Economics, 1972, pp. 25-38.
2/ Papanek, "The Effect of Aid and Othe Resource Transfers on Savings and Growth in Less Developed Countries."

must usually be demonstrated by the borrower through matching budgetary commitments and, in some cases, through changes in host-country policies that will help to ensure the success of the project.

Budgetary self-help efforts on AID-financed projects have often required that the host country finance all "local-currency costs" connected with the project, while foreign assistance would be used to finance "foreign-exchange costs." Moreover, a host country is normally expected to finance all of the recurrent costs associated with the project after the project has become fully operational. This simple division of financial responsibilities may have been helpful in promoting resource mobilization by governments and state enterprises, but it may also have tended to create an undue bias in some borrowing countries toward projects that had a high proportion of capital costs (relative to recurrent costs) and toward the use of imported capital goods rather than capital produced by local factors of production. Such biases would not be rational for a country that was seeking to maximize the potential benefits from a fixed amount of foreign assistance but might rise from a belief that the choice of capital-intensive, import-using projects would induce foreign official donors to provide larger amounts of assistance. In any event, AID became more receptive during the 1970s to the financing of local-currency costs as well as foreign exchange costs of development projects. This shift was perhaps mainly attributable to two features of the "New Directions" programs:

(i) a larger proportion of AID resources was directed toward very poor countries (e.g., Bangladesh, countries of the Sahel) where existing levels of government resource mobilization were so low that a substantial local budgetary contribution did not appear feasible; and

(ii) some newer-style projects (e.g., integrated rural development projects utilizing local-factor technology) had a very high proportion of local-currency costs, that would have imposed heavy budgetary burdens on the recipient government.

Changes in host-country policies are important self-help elements in projects or sectors where government controls or financial practices have been inhibiting growth and development. For example, in connection with an irrigation project, the burden of government taxation or price controls on a principal export crop or an urban food staple may need to be reduced in order to persuade farmers to plant that crop rather than some less valuable crop which the government has not previously chosen to tax or control. In the area of public works and utilities, user fees and tariffs may need to be increased to strengthen the finances of the executing agency and to permit it to develop an independent financial base to finance future maintenance and the construction of new facilities.

For development of self-help criteria and the negotiation of self-help efforts with aid-recipients, the United States tended to rely increasingly upon the World Bank, the IMF, and the regional multilateral development banks during the 1970s. In most countries the World Bank had come to provide a larger amount of financial resources than did AID. Moreover, in the largest aid-receiving countries, the World Bank normally helps to coordinate the plans and policies of all donors through annual meetings of consultative groups under the chairmanship of Bank officials. The World Bank has responded to its more important financial and advisory roles by developing approaches and standards for self-help efforts, at the sectoral and project level, that are more far-reaching and consistent than those that are now applied by AID.1/

1/ A brief summary of self-help objectives developed by the World Bank during the 1970s is presented in the World Bank Annual Report, 1977, p. 9.

III. The Food Aid Program

Objectives and Administration

Since 1954 the United States has maintained a continuous program for food aid for developing countries. This program has been intended to serve three principal objectives:

(1) development of future markets for U.S. agricultural exports;

(2) budgetary support for and economic development of low income developing countries; and

(3) emergency relief for disaster victims and other groups of people that may have nutritional problems.

The food aid program is primarily administered by the U.S. Department of Agriculture and is funded by the Agricultural Trade Development and Assistance Act, also known as Public Law 480.[1/] Under the same statute the U.S. Agency for International Development administers donations of food for disaster relief.

Since commodities provided through the PL 480 program are normally resold to consumers in the recipient countries, the program quickly generates local-currency revenues for the budget of the recipient government. Thus food aid is potentially more flexible than development project assistance[2/] as a source of fungible economic assistance. For this reason PL 480 food aid is often useful in assisting governments with serious near-term weaknesses in their fiscal policies. Nevertheless, PL 480 resources are allocated to most recipients on a recurring longer term basis. In addition, most PL 480 assistance agreements are designed to promote one or both of the following longer-term objectives--

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1/ A detailed discussion of the U.S. food aid program is presented in U.S. Department of Agriculture, Food for Peace: 1978 Annual Report on Public Law 480. The "Agricultural Trade Development and Assistance Act" is presented in Legislation on Foreign Relations.

2/ Disbursements of U.S. project assistance are normally tied to specific capital improvements which are executed with a considerable lag and which normally require matching local government expenditures before generating, with an additional lag, new government revenues from the completed project.

(1) improvement of nutrition and incomes for the lowest-income groups within the recipient countries;

(2) adoption by recipient countries of measures in their agricultural sectors to develop food production capabilities.

Budgetary and policy planning for the overall food aid program is shared among AID and the Departments of Agriculture and State, AID and Agriculture officials participate in negotiations with recipient countries, while AID also implements development projects or programs that are financed by or related to PL 480 food aid.

Most PL 480 food aid is provided in the form of long-term loans to foreign governments. The loans normally finance 90 per cent or more of the total cost of the food, have a maturity of 40 years with a 10-year grace period, and carry interest rates of only 2 to 3 per cent per annum. In fiscal year 1979 PL480 loans accounted for approximately 60 percent of total U.S. commitments of food aid. In recent years, three-fourths of the total loans have been prescribed by law to go to countries with per capita incomes below the poverty criterion ($680 in 1979) established by the World Bank for access to financing by the International Development Association.1/ The specific purposes of PL 480 loans are negotiated on a case-by-case basis and vary widely among recipient countries.

For the purposes of disaster relief, emergency feeding, and on-going nutrition, PL 480 also donates substantial amounts of food for distribution through the United Nations World Food Program and through U.S. private voluntary agencies.

1/ "Agricultural Trade Development and Assistance Act," Section III.

Origins and Evolution of the Food Aid Program

The PL 480 program originated partly as a byproduct of U.S. government intervention in the markets for foodgrains, of which the United States has been a major world supplier since the middle of the 19th century. Since 1933, the U.S. government has intervened in markets for many agricultural commodities with a combination of production controls, government price supports or both--in order to stabilize and to support farmers' incomes.

Prior to the establishment of a separate food aid program in 1954, the United States had provided food aid through several channels--through the Lend-Lease aid program for U.S. allies during World War II, through the UNRRA program in 1945-48, through the Marshall Plan, and through Export-Import Bank loans. Beginning in 1953, U.S. agricultural exports declined, largely because of the recovery of production in Europe. That decline in demand contributed to a weakening of prices for many U.S. agricultural commodities and led to the accumulation of large surplus stocks of several commodities by the Department of Agriculture.1/

While the U.S. Congress of the early 1950s had not been receptive to the principle of general development assistance to low-income countries, food aid was more acceptable--because it could be justified as a low-cost device of disposing of government surpluses.

1/ U.S. Department of Agriculture, A Century of Service: First 100 Years of USDA, pp. 281-82.

The linkage betwen PL 480 food aid and disposal of so-called surplus production was explicit in the original Agricultural Trade Development and Assistance Act which required that farm products used for PL 480 programs be certified as surplus commodities. Under later legislation, however, the Secretary of Agriculture may determine that "non-surplus" U.S. commodities be used for humanitarian purposes.

From 1954 to 1972, most PL 480 food aid was sold for foreign currencies or provided through loans repayable in local currencies. As the U.S. government normally accumulated non-convertible foreign currencies under such agreements, the funds were used mainly to finance the budgets of U.S. embassies in the recipient countries and the development assistance projects and programs of USAID. However, for some countries, the amount of local-currency resources generated by PL 480 sales far exceeded subsequent needs for local-currency expenditures by the U.S. Government. In the case of India, these balances were largely cancelled.1/ After 1972, all new PL 480 loan agreements required repayment in dollars.

Issues Regarding the Effectiveness of Food Aid

While the PL 480 food aid program has enjoyed strong continuing political support in the United States because it serves diverse interests, doubts have been expressed about whether it serves any one of those interests effectively. Two long-standing issues connected with the PL 480 program are

1/ In 1974, the United States government converted $1.8 billion of PL 480 rupee claims on India from loans to grants and returned an additional $200 million of U.S. Government holdings of rupee balances to the Indian Government. Large amounts of local-currency claims on other countries have continued since to accrue under credit agreements concluded before 1972. The variety of uses for such funds is detailed in Food for Peace (annual.)

(1) the extent to which it promotes increased U.S. exports of agricultural products, rather than merely displacing commercial exports; and

(2) the extent to which it depresses food prices and displaces local food production in the recipient countries.

If considered together, these issues reveal an inherent conflict between two objectives of the U.S. food-aid program: the more the program succeeds in generating additional U.S. exports of food, the more it is likely to be creating conditions of excess supply and disruption of food production in the rest of the world.

The success of the food aid program in promoting exports depends upon the impacts of the program on the level of world consumption and on the level of production of the same or similar commodities outside of the United States. The PL 480 loan agreements try to ensure additionality to overall U.S. exports through a set of "usual marketing requirements" for the recipient country. These requirements are intended to fulfill the injunctions of the Agricultural Trade Development and Assistance Act "to avoid displacing any sales of the United States agricultural commodities which . . . would otherwise be made for cash dollars" and "to ensure that sales under this title will not unduly disrupt world prices of agricultural commodities or normal patterns of commercial trade with friendly countries."[1/] To comply with these conditions, each country receiving PL 480 loans must normally agree to buy on commercial terms an amount of the commodity that equals or exceeds the average volume of commercial imports by the country over several preceding years.

1/ "Agricultural Trade Development and Assistance Act," Sections 107(b) and 103 (c).

While the U.S. food aid program has consistently sought to protect U.S. farmers against the displacement of commercial exports by concessional PL 480 assistance, the program did not in its early years safeguard the interests of farmers in the recipient countries. Focussing on India, which produced a large share of its domestic food consumption requirements, T. W. Schultz argued that PL 480 imports lowered the relative price of farm products in the recipient country and undermined incentives to maintain or expand local agricultural production.[1/] Schultz concluded that "not a few countries presently receiving substantial amounts of PL 480 farm products are in danger of impairing their agriculture.[2/]"

One response by the U.S. Government to criticism of the disincentive effects of PL 480 food aid was the introduction of stronger self-help requirements for the recipient's agricultural sector. Since 1967 all loan agreements under the PL 480 program have contained self-help commitments by the recipient that, directly or indirectly are designed to improve conditions in the agricultural sector. In addition, in 1977 a new Food for Development Program was added to the U.S. food aid program to benefit countries that were undertaking or would agree to undertake strong self-help measures to improve production, storage, transportation, and distribution of food commodities.[3/] Countries agreeing to such programs have been eligible for larger levels of assistance, multiyear commitments on the level of U.S. food aid, and relief from repayment obligations on PL 480 loans to the extent that offsetting funds are used for purposes of agricultural development.

1/ Schultz, "Value of U.S. Farm Surpluses to Underdeveloped Countries," Journa of Farm Economics, vol. 42, 1960, pp. 1019-30.

2/ Ibid, p. 1028.

3/ See Title III of the "Agricultural Trade Development and Assistance Act," Sections 301-7.

Another means for insulating farmers in the recipient country from the adverse effects of food aid on local food-market conditions is to reinforce or to develop non-market channels for delivery of food aid to low-income consumers that would otherwise have very low levels of food consumption. This approach is stressed in the food grant program, Title II of PL 480, which delivers food through school lunch and preschool feeding programs and through other non-market channels. However, we cannot assume that food aid provided through non-market channels or in cases of disaster relief is unlikely to have negative repercussions on food production. Additional supplies through non-market channels tend to reduce food demand in market channels.[1/] And national disasters may require different forms of relief than additional food supplies.[2/]

1/ For example, Donald F. McHenry and Kai Bird have estimated that 90 per cent of the food aid sent to Bangladesh in 1976 was sold to the urban middle class through the ration system that was then in effect. This surely caused a great reduction in the demand for food through market channels. See "Food Bungle in Bangladesh," Foreign Policy, no. 21, 1977, p. 74.

2/ For example, U.S. provision of additional food aid may have been excessive in the international disaster-relief operations for Guatemala after the earthquake of February 1976. Because of extensive free distribution of PL 480 grain products, corn prices fell substantially and caused widespread distress among local farmers. See "U.S. Food Aid Seen Hurting Guatemala," New York Times, Nov. 6, 1977, p. 51.

IV. Export Promotion Credit Programs

Objectives and Administration

Two U.S. government agencies provide foreign loans for the primary purpose of promoting U.S. exports--the U.S. Export-Import Bank (Eximbank) and the Commodity Credit Corporation (CCC). Eximbank is authorized by law to finance a wide range of exports but, as a policy matter, restricts its financing principally to exports of capital goods and of related contract services.[1/] The CCC Export Credit Sales Program is restricted to financing exports of "surplus or near-surplus" agricultural commodities and to financing the construction of facilites for marketing, storage, and transport of agricultural commodities.[2/] In addition, in the sectors where they provide direct credits, both Eximbank and CCC offer guarantees and insurance on the financing of exports by private U.S. exporters and/or financial institutions.

Eximbank is administered as an independent federal agency whose Directors are appointed by the President. On the basis of a capital stock of $1 billion provided by the federal government and accumulated retained earnings, about $2 billion in 1979, the Bank is in principle financially self-sustaining. However, within an overall loan ceiling ($40 billion since 1978) the Bank may acquire its loan funds from the U.S. Treasury at a rate of interest determined by current market costs of funds to the Treasury.

1/See "The Export-Import Bank Act of 1945," as amended, Sections 1 and 2. The Act is presented in Legislation on Foreign Relations.

2/ Authorization for the CCC program is provided by the "Food for Peace Act of 1966," Section 4, in Legislation on Foreign Relations. In fiscal year 1981 the Administration plans to replace the CCC export credit program with a progra of guarantees for private export credits, but with the same purposes.

The primary objective of Eximbank is "to foster expansion of exports of goods and services," in the belief that this will contribute to "the promotion and maintenance of high levels of employment and real income and to the increased development of productive resources of the United States."[1] In addition, since 1977, Eximbank has been assigned the more specific objective of providing financial support to prospective purchasers of U.S. exports on terms and conditions which are competitive with the government-supported terms and conditions available on exports from major competing countries. At the same time, however, Eximbank is charged by law to "seek to reach international agreements to reduce government subsidized export financing."[2] By early 1980, however, little progress had been made in that direction despite a long series of negotiations. As a consequence, most of Eximbank's credits were being extended at interest rates several percentage points below the cost of government borrowing for comparable (8 to 10 year) maturities.

The CCC Export Credit Sales Program is administered by the U.S. Department of Agriculture. Financial resources for the program are obtained under the general borrowing authority for credit operations by the Commodity Credit Corporation which provides other forms of credit to U.S. farmers and which, unlike Eximbank, does not have a statutory limit on its credit commitments. However, the export credit programs of both CCC and Eximbank are subject to annual administrative budget ceilings which are set by the President with the advice of the Office of Management and Budget.

1/"Export Import Bank Act,"Section 2(b)(1)(A).
2/ Ibid.

The objectives of the CCC export credit sales program are established by policy guidelines within the Department of Agriculture rather than by statute. The general purposes include promotion of expanded consumption and new uses for U.S. agricultural commodities in the importing countries and the meeting of credit terms by competitors from other countries. A more specific objective has been to accommodate countries that have become ineligible for concessional long-term PL 480 credits. Most types of CCC export credits are limited by statute to a maximum maturity of three years and carry interest rates which, since 1979, have been adjusted at 1/2 percent above the cost of private bank credit to prime borrowers in the United States. Another connection of CCC export credit sales with concessional food aid is that the CCC credit sales may be used by the borrowing country to satisfy the "usual marketing requirement" for commercial purchases of food imports that must be fulfilled by each recipient of PL 480 food-aid credits.

Origins and Evolution of the Export Promotion Programs

The U.S. Export-Import Bank was established in 1934--in a period when widespread foreign bankruptcies and defaults had reduced the availability of private credit to finance exports. During World War II, Eximbank lending was channeled to Latin America to help develop supplies of raw materials. After Congress increased its overall lending authority from $700 million to $3.5 billion in 1945, Eximbank provided large post-war reconstruction credit facilities for the United Kingdom and France. However, Eximbank withdrew from this type of lending when the Marshall Plan came into being. Subsequently, Eximbank began to provide the majority of its loans to countries in Latin America, Asia, and Africa.

The concentration of Eximbank lending upon exports to developing countries has been encouraged by the injunction that the Bank "should supplement and encourage, and not compete with, private capital.[1/]" During the 1950s and 1960s borrowers in developing countries faced substantially greater difficulties than other borrowers in gaining access to medium- and long-term loans from U.S. financial institutions. Eximbank therefore had wide scope for lending in the developing countries without displacing or competing with the commercial operations of private lenders.

Throughout the 1950s and 1960s Eximbank restricted its export credit activities primarily to capital goods and agricultural commodities. After the introduction of the CCC export credit program in 1966, Eximbank slowly reduced the amount of its short-term agricultural export credits and, in practice, had ceased offering agricultural export credits by 1979.

1/ Ibid, Section 2(b)(1)(B). During the 1970s the avoidance of competition with private capital by Eximbank has been subordinated somewhat to the objective of competing with foreign export credit agencies which, through government intervention, have been able to offer much more attractive credit terms than would be available from the private sector.

Issues Regarding the Effectiveness of Export Credit Programs

When the interest rates charged by Eximbank fall below the cost of borrowing by the federal government, Eximbank is in the position of giving indirect government subsidies to U.S. exports.[1/] The U.S. government has justified these subsidies on two grounds. First, it has long been argued that Eximbank's export credits promote higher levels of employment and a stronger balance-of-payments position for the United States than would otherwise occur. Secondly, it has been argued since 1974 that subsidized rates may be required as part of an overall negotiating effort to persuade certain other industrial countries to withdraw their trade-distorting export subsidies. Between 1976 and 1980, the U.S. government increasingly relied upon that negotiating effort as the justification for concessional Eximbank interest rates. The shift in emphasis was attributable partly to a declining belief in the effectiveness of Eximbank in promoting its traditional objectives and partly to the rising magnitude of export-credit subsidies by other industrial countries.

Theoretical validity of traditional Eximbank objectives. The popularity of the balance-of-payments and employment arguments for export subsidies declined steadily in the United States after the introduction in 1973 of floating exchange rates between the dollar and other major currencies.[2/] In an environment of floating exchange rates, Eximbank financing may generate additional U.S. exports of particular products, but the resulting improvement in the U.S. balance of trade will tend to put

1/ Many economists would consider that interest rates on export promotion cred could be described as "subsidized" whenever they fall below the cost of alternative financing from the private market.

2/ One skeptical analysis of the balance-of-payments and employment arguments for export subsidies is presented by the Congressional Budget Office in U.S. Government Involvement in Commercial Exports: Program Goals and Budgetary Costs, pp. 19-20.

upward pressure on the exchange value of the dollar. The higher exchange rate, in turn, will have a negative impact on export incentives for U.S. firms and industries that do not benefit from export subsidies. In addition, the higher exchange rate will cause a reduction in the relative price of U.S. imports and induce somewhat higher levels of imports. For these reasons, any positive, direct effects of export subsidies upon the U.S. balance of trade may be largely or entirely offset by induced exchange-rate effects.

The employment-promoting effects of export subsidies are similarly questionable in any general-equilibrium analysis of the national economy. In the federal budget process, increased outlays for Eximbank would normally result in reduced levels of government expenditure in other programs. Alternatively, in the absence of reduced government expenditures in other programs, promotion of increased exports by certain firms and industries will increase employment in those enterprises and will place upward pressure on wages in the general labor market. In either case, the longer run effect of increased employment in certain enterprises will be to displace potential employment of those workers in other enterprises or other economic activities. To some extent one can even predict where much of the displacement of employment will occur--namely, the export industries and import-competing industries where product demand has fallen because of the relative rise, as explained above, in the exchange value of the dollar.

If export subsidies are ineffective in providing any permanent improvement in the balance of payments or in the level of employment, can they nevertheless be justified as a temporary or selective economic stabilizer? While such use is conceivable, Eximbank credits and other export subsidy programs have not been designed or administered for use as stabilizers of aggregate income and employment.[1/] In the field of <u>international</u> economic policy as well, Eximbank lending conceivably could be used as an instrument for counteracting undesirable fluctuations in the

1/ Ibid, p. 21.

exchange rate. Indeed, the announcement by the President on September 26, 1978 to expand Eximbank's budget and to undertake other export promotion measures was well-timed to mitigate the sharp decline in the dollar's exchange value that had occurred in preceding months. However, it may not be practical ordinarily for Eximbank to take timely action1/ or to make symmetrical reductions in its lending program at times of undue upward pressure on the dollar's value in international exchange markets.

Reduction of export-credit subsidies by negotiation. The average subsidy element on Eximbank credits increased substantially between the early 1970s and 1980, as Eximbank emphasized the principle of matching the terms (especially the interest rates) offered by export-credit agencies in other industrial countries. The U.S. strategy of matching terms offered by other countries2/ was based on two premises. One premise was that export-credit subsidies by other countries caused substantial distortions to the pattern of international trade and to the development of industrial specialization on the basis of comparative advantage. A second premise was that the United States would benefit substantially from the eventual elimination of those distortions--if a general suspension of export credit subsidies could be agreed among all industrial countries.3/

1/ The assessment of export credit programs as a countercyclical device must take account of the lags that occur (a) between the time of credit commitments to foreign purchasers and the time the exports will be shipped and (b) between the time of shipment and the time of repayment. These imply delays in receipts affecting the U.S. "trade balance" and the "overall balance of payments," respectively, which may or may not cause a delayed impact on the exchange value of the dollar.

2/ The U.S. negotiating strategy also included the retention of a system of indirect export subsidies through the corporate income-tax concessions offered to Domestic International Sales Corporations since 1971.

3/ The existence of great distortions in trade patterns would not necessarily imply that the United States would gain substantial benefits from elimination of those distortions. For example, in the field of agriculture, Cline has estimated that the large welfare losses associated with the European Community's Common Agricultural Policy have been borne almost entirely by consumers within the Community. See William R. Cline and others, "Agricultural Non-tariff Barriers in Europe," in Trade Negotiations in the Tokyo Round, A Quantitative Assessment. Washington: The Brookings Institution, 1978.

The existence of severe distortions of trade owing to export-credit subsidies is suggested by the high level of such subsidies and by the fact that in most countries the subsidies are applied selectively to a more or less narrow class of exports. For Eximbank the average lending rate during 1979, 8.2 per cent, compared to an average borrowing rate for the U.S. Government of 9.4 per cent for bonds with a ten-year maturity and interest rates of 10 to 11 per cent on middle-grade corporate bonds.

In most industries which produce capital goods, export-credit subsidies may have considerable potential to shift the preferences of foreign buyers from suppliers in one country to those in another. For example, on the export sales for which Eximbank provided credits in fiscal year 1978, the U.S. Treasury staff has estimated tentatively that as much as 70 per cent of the sales would not have occurred without support by Eximbank.[1/] From a traditional perspective, this outcome may seem favorable; it sugggests that export-credit subsidies of Eximbank are affecting trade performance, rather than simply transferring public funds to foreign users and domestic suppliers of U.S. exports. From another perspective, it also tends to support the premise that government export-credit programs of other countries, as well as that of the United States, may be quite effective in altering the pattern of trade that would be determined by the private market on the basis of international comparative

1/ United States Treasury, Report on the Additionality of U.S. Export-Import Bank Programs in Fiscal Year 1978, p. 1.

advantage. Under most approaches to measuring overall welfare losses 1/, the greater alteration of trade patterns because of subsidies implies a larger aggregate welfare loss for the world as a whole.

The most notable accomplishment of the multilateral negotiations to reduce levels of export-credit subsidy occurred in July 1976. Export agencies of the major industrial countries adopted a "consensus agreement" on maximum term to maturity and minimum interest rates that they would offer on credits for various types of export transactions. The key element of the agreement was a set of minimum interest rates in the range of 7 to 8 per cent, which at that time was close to the level of government bond rates in most of the participating countries. In principle, the minimum interest rate placed an upper limit on the possible degree of subsidization to exports through officially supported credits.

In practice, the permitted degree of subsidization rose dramatically during 1978-80 because of the upsurge of market interest rates in most participating countries. Moreover, many participants, including Eximbank, began to offer wider coverage and more concessional interest rates than they had previously. 2/ Thus, the overall outcome between 1976 and early 1980 had been an increased level of subsidization of capital-goods exports by the industrial countries rather than a reduction.

1/ For example, see the approaches discussed by Harry G. Johnson, Aspects of the Theory of Tariffs. London: Allen and Unwin, 1971, chapters 8 and 9.

2/ See Organization for Economic Cooperation and Development, The Export Credit Financing System in OECD Member Countries, 1976. (Revised edition forthcoming.)

V. Military Security Assistance Programs

Objectives and Administration

Two continuing objectives for U.S. foreign military assistance have been

(a) to provide support for joint regional defense efforts (involving reciprocal treaty obligations); and

(b) to strengthen foreign governments against external attacks or internal insurrections that would damage important strategic objectives of the United States.

During the 1940s and 1950s, and to some extent subsequently, foreign military assistance policy has been designed to support the broad purpose of maintaining strategic military balance between the United States and the Soviet Union. As a result two areas perceived as having great strategic importance for the United States--Western Europe and the Middle East--have accounted for the bulk of U.S. military grants and loans over the period since World War II.

In some regions--the Far East and especially South Asia, Africa, and Latin America--U.S. military assistance policies have not necessarily been determined by direct strategic defense objectives of the United States. Often assistance to these regions has been for the purposes of securing U.S. military base rights or of advancing general U.S. diplomatic goals. However, these regions--with the exception of the Far East--have accounted for a relatively small proportion of total U.S. foreign military assistance.

The foreign military assistance program[1/] primarily consists of loans and credit guarantees for the purchase of military equipment and supplies and, particularly in earlier years, grants of military equipment. These activities are administered by the Department of Defense under the general supervision and direction of the State Department. In addition, the Department of Defense conducts the International Military Education and Training programs to train foreign military service personnel in the United States.

Eligibility of a country for military equipment and supplies and ceilings on the amount of such assistance are determined by the Secretary of State. However, overall annual limits for grants and credits are established by the Foreign Assistance Act ($133.5 million for FY1979) and by the Arms Export Control Act ($674.3 million for FY1979.) Funds provided by the latter act are available only in the form of credits which are normally restricted to 12 years maturity, with an interest rate equivalent to the average cost of borrowing by the U.S. government. However, the same act also provides for U.S. government guarantees for additional private credits ($1.5 billion in FY1979, of which $.5 billion was reserved for Israel.)[2/]

1/ See Legislation on Foreign Relations.

2/ Under the Middle East Peace Package of 1979 Israel received $2.2 billion in further U.S. government loan guarantees, and Egypt received $1.5 billion in U.S. government guarantees. In addition, Israel received a further $.5 billion in forgiveness of previous loans.

Evolution of the Military Assistance Program

Following World War II, the first major foreign military assistance program of the United States was for the purpose of restoring the military capability of Western Europe.[1/] That program was begun simultaneously with the creation of the North Atlantic Treaty Organization in 1949. The need for rearmament of Western Europe was based on the perceived increase in the external military threat of the Soviet Union. The justification for providing U.S. military aid in the form of grants was to avoid disruption of the European economic recovery which, at that point, had not yet proceeded far enough to restore living standards to their prewar levels. When income levels rose rapidly during the late 1950s, the program of U.S. grants of military equipment and supplies was gradually replaced by a program of cash sales.

Apart from Western Europe, the U.S. military assistance programs of the 1950s and early 1960s was concentrated in countries bordering the Soviet Union in the Middle East (Greece, Turkey, Iran) and those bordering Mainland China in the Far East (Korea, Taiwan.) By 1960, these lower-income countries accounted for the bulk of the U.S. program of military assistance.

The third major episode of concentrated U.S. military assistance was related to the U.S. intervention in Vietnam during 1965-74. While Vietnam was never perceived to have as much strategic significance as earlier recipients of concentrated U.S. military assistance, U.S. authorities believed that resistance of Communist insurgents in Vietnam could

1/ The role of U.S. military assistance in European rearmament is summarized in Library of Congress, U.S. Foreign Aid, pp. 45-56.

reduce the risk of war in other parts of the world. This concept of an "exemplary war" was widely challenged as an inadequate basis for the great extent of U.S. assistance to South Vietnam.1/ In that case, of course, the costs to the United States included not only large amounts of military and economic assistance for South Vietnam2/ and U.S. foreign assistance to other countries in relation to their assistance in that conflict, but also the greater human casualties and financial costs incurred through the direct commitment of U.S. troops and military supplies in Vietnam.

Effectiveness of Military Assistance Programs

The foreign military assistance programs of the United States are intended to prevent an event--namely, a major regional or global military conflict--that in most cases has a relatively low probability of occurrence. As a result, estimation of any (small) reduction of that probability owing to a military assistance activity is fraught with difficulty. The inability to make precise judgments about the expected reduction in the probability of emergence of a major war would not necessarily invalidate the use of formal cost-benefit analysis to assess U.S. military assistance programs. Indeed, a Presidential Task Force in 1970 proposed the systematic use of a cost-benefit basis for determining military grants.3/ However, quantitative analysis of the costs and benefits of military assistance operations is not normally attempted.4/

1/ See especially Fulbright, The Crippled Giant, pp. 83-102.

2/ See section II, preceding.

3/ See U.S. Foreign Assistance in the 1970s: A New Approach, p. 13. This report also recommended as an ultimate goal that all military grant programs be phased out.

4/ The 1979 Middle East aid package for Israel and Egypt was a partial exception. At the request of Congressional committees, Administration witnesses presented estimates of the cumulative costs to the United States of past Middle East wars and the 1973-74 oil embargo ($55-$70 billion) to indicate the order of magnitude of savings that might result from a reduced likelihood of a future Middle East war. See Middle East Peace Package, Hearings before the U.S. Senate Committee on Foreign Relations, 1979, pp. 12-14.

In some instances military assistance programs have been justified on the grounds that they would permit the withdrawal of U.S. troops stationed in the recipient country. If a better-trained and better-equipped local armed force provided an equally effective deterrent to the emergence of a major war, one could compare directly the benefits of reduced global expenses for U.S. military personnel and supplies with the costs to the United States of supplying training and equipment to the recipient country. The Nixon administration used this approach to support a supplemental appropriation for a military assistance grant of $150 million for South Korea in 1970.[1/] This type of analysis, however, cannot rest alone upon a comparison of the relative military capabilities of U.S. forces and alternative local forces, because the presence of U.S. forces as potential victims of an enemy attack may establish a greater probability that the United States would undertake a massive counterattack. Thus, U.S. forces still stationed in Germany or South Korea in 1980 may be seen to provide a stronger deterrent to military attack than would an equally capable body of local military forces. This increased deterrent might be of particular value to the host country even if the United States felt that it would be cost-effective to substitute local forces for U.S. armed forces.

1/ Secretary of Defense Melvin R. Laird argued that the program to finance modernization of the South Korean forces would be "more than offset by the savings which will result from the withdrawal of U.S. forces. Total net savings--that is, U.S. withdrawal and deactivation savings minus incremental Korean modernization costs--will run about $450 million over a five-year period." See To Amend the Foreign Assistance Act of 1961 (Supplemental Authorization for Assistance to Cambodia and Other Countries), Hearings before the U.S. House of Representatives Committee on Foreign Affairs, 1970, pp. 46-47.

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