

"The Strategy of Foreign Aid, 1961," by W. W. Rostow, 1960

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THE STRATEGY OF FOREIGN AID, 1961

THE PROBLEM

1. It is crucial to the Free World position that the first days of the Kennedy Administration be used for a breakthrough on the question of aid to the under-developed nations. Decision on this matter is now about five years overdue. If the immediate and maximum impact of the new President is not applied to this issue, the odds are that we can not reverse the dangerous course of our relations with the under-developed areas in the foreseeable future.

2. But an effort by the new President to expand economic aid is likely to fail on the American scene unless the public and the Congress can be assured on two points very soon after the new effort is launched:

- First, that the Kennedy Administration has a sufficiently effective program for protecting our foreign balance by other means to justify an expansion, not a contraction in economic aid.
- Second, that foreign governments will contribute on an equitable basis to the new effort.

PROTECTING THE DOLLAR

3. It follows that the new Administration must be prepared before the Inaugural Address with a multi-faceted program that promises to deal effectively with the dollar problem on a scale which would permit an enlargement in economic aid. One major figure in the new Administration should be promptly given personal responsibility for formulating and overseeing the execution of such a program. This memorandum is not designed to elaborate such

a program; but it has, evidently, these dimensions:

- measures which promise to reduce U.S. military outlays abroad, where reductions are compatible with our own and the Free World's security;
- measures to remove artificial incentives for private capital flows to Western Europe and Japan;
- measures to increase U.S. foreign exchange earnings, including tourism;
- measures to halt and reverse the outward flow of short-term capital;
- measures to increase U.S. productivity and our basic competitive position;
- measures to hold wages and reduce prices;
- measures to economize and co-ordinate the use of the Free World's gold reserves.

I shall comment briefly only on the last two lines of approach.

4. No action would be more effective in re-establishing confidence in the dollar than an agreement in steel and automobiles to hold money wages for some fixed period and to pass along productivity increases in lower prices. Given the role of prices and wages in these industries in setting the nation's pattern, widespread results can be expected. This measure is also required if we are to reflate the economy in confidence that expansion in income and employment will not promptly result in further inflation. These steps will be easier or more difficult to negotiate to the extent that the new President challenges the country as a whole to make good on new tasks. One such challenge should be the building of new relations with the under-developed areas despite the current

dollar problem. The challenge could be made electrifying. It needs vivid and blunt statement in the Inaugural.

5. In addition, we must link negotiations on expanded economic assistance by the Free World to negotiations which would economize the Free World's gold reserves and ensure their co-operative use to counter dangerous short-term capital and gold movements. There are various ways to do this: an informal agreement among Central Banks; and expanded IMF; or a more elaborate scheme along Triffin lines. Whatever method (or sequence of methods) is chosen, action on this dimension of the reserves problem is as urgent as an expansion of economic aid. Such action should be taken concurrently with the March DAC negotiation referred to in paragraph 8, below.

6. A Free World reserves agreement is urgent for another reason. We are now moving towards tied loans in foreign aid. Other nations have had and still have important elements of tying. So long as they are not confident about their reserve position -- and we are not confident -- this regressive trend will continue. Such beggar-thy-neighbor tactics will not work any better than they did in the 1930s. But they will be followed unless we assume leadership and organize an international alternative. We should be prepared in 1961 to bargain our tied loan provisions against those of other nations. But we and they can only move with confidence if the underlying common problem of reserve shortage is under control.

7. The possibility of untying aid loans and grants makes particularly important the American price reduction envisaged in

paragraph 5, above; although the evidence is that the lack of American competitiveness has been, in part, a result of a lack of competitive bidding in aid project contracts rather than of excessive American relative costs.

8. Before the Inaugural, a high official of the new Administration should quietly journey to Western Europe and Canada -- and consult the Japanese -- to gain acceptance in principle that:

- any increase in U.S. development aid would be roughly matched by our partners on some version of per capita income formula;
- that the March meeting of DAC be used as an occasion for working out such an agreement in detail.

9. These soundings should permit the new President to project his program with confidence, from the beginning, as a co-operative Free World program: and, given the role of our partners, he should with some delicacy project the Kennedy Plan in somewhat less national terms than the Marshall Plan was launched. For example, he might pay tribute to those who have been building towards this climactic effort; e.g., Monnet, Franks, Abs, B.K. Nehru, Prebisch. For example, the relevant portions of the Inaugural and State of Union Message should be revealed before the event to our incipient partners.

10. It is my impression that our major Free World partners are ready -- even anxious -- to move on this basis, if the United States commits itself to an expansion in economic aid. They have done their homework well on this issue and are ripe for negotiating with the new Administration.

THE SCALE OF EXPANSION

11. Some expansion of American economic development assistance can probably be achieved cheaply: by squeezing military aid and military support; by shifting funds from emergency use to the DLF; by exploiting the forthcoming flow of surplus civilian supplies the military are about to declare obsolescent; by expanding the flows of surplus food and fibers. But it is clear that no one is going to take the effort seriously -- here or abroad -- unless it involves a substantial net increase in development resources, with something like a five year forward commitment. The underlying reason is that total investment levels in the under-developed areas are below the critical minimum level needed to yield a regular and substantial increase in output per head.

12. Estimates of how much expansion on present levels is required to surpass this critical minimum vary. The latest Rosenstein-Rodan calculations call for a Free World increment of about \$2 billion per annum for the next five years, of which the United States would supply an annual increase of \$700 million, the rest of the Free World (including international institutions) \$1.3 billion. His proportions are based on the application of U.S. income tax rules to GNP per capita of each nation, taking account of present aid levels. The level of investment that would result is designed to yield a 2% per capita annual increase in real income in the under-developed areas. Other proposals call for a commitment \$1-2 billion per annum higher, for the whole Free World. Taking account of present levels of economic assistance in the Free World (about \$4 billion per annum) such proposals would

yield total Free World development programs including private investment for a five year period, of between \$30 and \$40 billion. That should be enough to ensure a sense of communal barn-raising in the Free World.

13. Although actual absorptive capacity on serious development criteria might justify the lower Rodan figure, there is a strong case for shooting high to maximize the psychological and political effect in the under-developed areas as well as to hedge against Congressional trimming. Moreover, since absorptive capacity depends substantially on how serious the local governments are about their development efforts, the higher figure -- if accompanied by tough criteria for disbursement -- might result in higher absorptive capacity than we would now estimate. And this would be all to the good.

14. On the whole, bearing in mind that the Kennedy First Inaugural is a once-for-all political event, coming at a moment when we must sharply reverse our fortunes in the under-developed areas, I think we should shoot for the high side. But this will require a particularly tough and effective balance of payments policy, carrying immediate conviction, at home and abroad -- not because increased aid need weaken our balance of payments position, but because many people will think it will. In any case, a Free World increase of about \$2 billion per annum, with the U.S.A. bearing up to half the increase, is a minimum.

CRITERIA, MEN, AND ORGANIZATION.

16. The most important single condition for the success of the effort is that we -- and our partners -- dramatize that these funds are for economic development assistance and that they

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will be released only as the developing nations reveal a capacity to absorb such funds productively. This means they must concentrate more than they now are on developing their local resources, human and material. This means also that we must deflate as rapidly as possible the granting of aid on loose political or other terms via defense support, emergency funds, etc.

17. To make this approach effective -- at home and abroad -- will obviously require the highest level of leadership, skill, energy, and dedication in the American foreign aid establishment. The appointments in this field will thus take on a peculiar importance if the new President decided to make a major mark in this direction. It may take some time to find the right pattern of organization and to bring it to life. Despite this ambiguity we must get the best possible man to head the operation, with the understanding that he would have a major voice in its re-organization as well as responsibility for its subsequent operation.

18. There are many ways to re-organize and unify the American economic aid effort; and a considerable and impressive literature on the subject is now developing. I shall not comment here on the alternatives that are emerging; but the best of organizations will fail unless a strategy is worked out by the President and his Cabinet which exploits to the hilt the initial momentum of the Administration while protecting the two exposed flanks: the dollar problem and the problem of equitable sharing.

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