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INTERNATIONAL ECONOMIC INSTITUTIONS

Dr. Wilson E. Schmidt

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Reviewed by: Colonel Tom W. Sills, USA

Date: 27 October 1960

INDUSTRIAL COLLEGE OF THE ARMED FORCES
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22 September 1960

CONTENTS

	<u>Page</u>
INTRODUCTION--Colonel John M. Burnside, USAF, Member of the Faculty, Industrial College of the Armed Forces.....	1
SPEAKER--Dr. Wilson E. Schmidt, Professor of Economics, George Washington University.....	2
GENERAL DISCUSSION.....	24

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Reporter: Ralph W. Bennett

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COL. BURNSIDE: Admiral Patrick, Gentlemen: This morning we come to the end of our lecture program in the economic series. International economic institutions, the title of this talk, can play a vital role in the cold war, the economic war, the war we're in now. Therefore our interest.

You probably have with you a list of 13 international economic institutions which will help not only in the short range but in the long range. This list was prepared by our speaker for your perusal during this lecture and later. We are going to hear something about some of these organizations and their programs and something about the nature of the policy problems involved.

Our speaker has had a broad background in international economics and has written a great deal in the field. Dr. Wilson Emerson Schmidt, Professor of Economics at George Washington University, is Traveling Professor of Economic Development, School of Advanced International Studies at Johns Hopkins University. Dr. Schmidt has participated in the economics section discussion group as a visiting instructor on four separate occasions. Although he is a young man, he is, in the words of Andy Kress, an old friend of the Industrial College.

I have enjoyed my association with him in arranging for some of the administrative details of this lecture, and it gives me a great deal of pleasure to be able to present him to you for his second lecture before

the student body as a whole.

DR. SCHMIDT: Thank you, Colonel Burnside.

Admiral Patrick: Coming at the end of your economic orientation sessions, I don't know whether I feel like dessert or the brandy or perhaps merely the finger bowl on this program. I'm here, and it's a real pleasure to be here.

I must congratulate all of you on this magnificent building. For, I guess, five years I perspired in that temporary building, listening to those airplanes buzzing along. We all were looking forward to this day, and I had no idea it would come out so beautifully. You are to be congratulated, all of you. You are very fortunate. And I congratulate anybody who had anything to do with it.

Well, the topic of my assignment is the international economic institutions. I think probably the outstanding feature of the international economic institutions is one thing, namely, their proliferation. The committee that the President appointed about a year ago concluded that the situation had gotten so far out of hand that these things were true: "It has become increasingly difficult to integrate the several forms of assistance into a harmonious whole. Too many uncoordinated voices are permitted to speak for the United States in the economic assistance field. Uncoordinated policy and program guidelines are issued by individual agencies separately and at different times. Important issues may remain unresolved for considerable periods of time or be glossed over in a series of compromises made by the lower-level interagency working groups.

As a consequence, clear-cut courses of action are not defined. Costly delays occur. An excessive amount of staff time is spent on interagency coordination, reduction of the program planning, analysis, and control. Often delays occur because of the necessity of reconciling the views of many agencies now participating in overseas activities." And so on, on the next page.

The situation has gotten so extreme that one of the Presidential candidates commented on it in his acceptance speech. He said: "There's another step we must take. Our Government activities must be reorganized to take the initiative from the Congress and develop and carry out a world-wide strategy, an offensive for peace and freedom. The complex of agencies which have grown up through the years for the exchange of persons, for technical assistance, for information, for loans and grants--all of these must be welded together into one powerful economic and ideological striking force." It's a rather remarkable fact that a candidate would comment in this sort of intimate subject.

In a recent study by an agency here in town they had a paragraph which came awfully close to saying this; namely, that countries would have to have foreign aid in order to be able to get foreign aid, so complicated were the processes by which countries would get ultimately funds from these various institutions.

So the key point that I want to leave with you at the start is the proliferation and the complexity of these international economic institutions.

Now, I suppose that the best thing for me to do is to go through these

institutions and try to give you a general idea about each of the leading ones, or the ones that have the most publicity. So Colonel Burnside was good enough to have this thing mimeographed, or whatever you call this process; and I thought we might just go through it, and I would add a few comments on each of these institutions.

The items on the first page, those first four institutions, are US-owned and -operated. The remainder are the so-called multilateral or international organizations.

The first one is Export-Import Bank. It was actually established, rather paradoxically, back in the early 30's to finance trade with the Soviet Union. But that didn't come off, for obvious reasons. Ever since that time its primary purpose has been to stimulate American exports. Don't misunderstand that word "Import" in the title "Export-Import Bank." It means nothing. Ex-Im, as it is called, got into the economic assistance business really during World War II, when it undertook a number of projects in Latin America. And this kind of activity has been a fairly important part of its total program ever since World War II.

You notice from item 4 that it makes not only project loans, which are economic development assistance loans, but also it makes balance of payment loans in exporters' currency. These balance of payments loans arise, for instance, like this. A country gets into a position where it has a serious shortage of foreign exchange. Its export earnings are not enough to pay for all the imports. They will stop paying the people they owe, including the American exporters. Then Ex-Im will come in with a

loan to pay off those arrears of debts. And when Ex-Im does that, it will often put on conditions, saying they have got to do something in the monetary and fiscal policy to straighten out this mess.

This kind of loan has been criticized, the argument being that when Ex-Im stands ready to give this kind of short-term arrears loan, that encourages countries to get into the difficulty which causes the problem; and then Ex-Im comes along and provides the funds. It's a good way to get a loan.

On the export side, Ex-Im is especially important in terms of recent policy because Ex-Im is part of this governmental program to stimulate our exports, like metal, because of the balance of payments problem. As you know, in '58 we had a deficit of 3.1 billion. In '59 the deficit ^{if counted correctly,} was 5 billion. This year it's only about 3 billion. We have tried to stimulate our exports of copper. So what Ex-Im is doing now is to finance up to 55 percent of the value of medium-term exports without investigating the credit of the foreign borrower. This stimulates our exports. The only catch is that the American bank that handles the loan here has got to take 10 percent of the risk without recourse. This is a method by which they hope to force more credit into the exports.

Another thing that Ex-Im is doing is that it is providing an insurance for exporters against so-called political risks. These are essentially inconvertib^{ility of} currencies, and also expropriation of the goods when they are on the dock. This is all designed to insure American exporters that life won't be so terrible.

There are two things to be remembered about Ex-Im that distinguish it from other agencies. First, the repayment of the loan is in dollars. They lend dollars and they are repaid in dollars. Secondly, virtually all--not quite all--of the money loaned by Ex-Im has to be spent on American goods, so-called US-procurement. Thus you have this stimulation of American exports.

The next is ICA. If my numbers are correct--and they're fairly recent--ICA has missions in 66 countries. It's got something like 16,000 employees, very few of whom are in Washington. As you can see from item 4, it makes grants primarily for transport, special assistance, and technical cooperation.

Defense support is basically economic assistance, economic commodities, given to countries where we have a military assistance program. The purpose is really twofold: one, to alleviate the burden that the military effort of this country suffers. Secondly, there is some motive of trying to assist economic growth in these countries, in order to get a little more stability.

Special assistance--that also is economic aid. The only difference between this and defense support is that the special assistance goes to countries where we do not have military assistance programs--that's the basic difference--like in India.

Technical cooperation, which is the third major form of aid--this is a program under which we transfer American know-how and skills. There is hardly an area of human knowledge, where we have some know-

ledge, where the ICA has not been providing some kind of technicians to teach them to do something better--agriculture, education, public administration, industry--almost everything.

Next is the Development Loan Fund. Until the Development Loan Fund, or DLF, as it is called, was organized, virtually all of our economic aid for development of poor countries went through ICA and Ex-Im. One of the problems was that economic development aid and economic development itself was substantially a long-term process, a very slow process; but the ICA's appropriation was an annual appropriation. And so you had this tendency for ICA people to try to speed up the expenditure of the money before the end of the fiscal year, and then allegedly call it waste, and ICA apparently was quite happy to figure out some way out of this problem. The result was the formation of an independent corporation, called the Development Loan Fund, which really now is the chief agency by which the United States assists foreign economic development.

It makes what are known as soft currency loans. A soft currency loan is one in which, for example, DLF will lend dollars, and then the country can repay, not in dollars, but in its own currency. This distinguishes DLF in that sense.

Now, why are soft currency loans desirable? Well, the argument is, first of all, that the countries in which we deal are in such bad shape in terms of the balance of payments situation that they cannot be expected to repay in hard currency, in dollars or sterling or marks or francs. So it's essential to lend them dollars, so they can buy our goods, and then

repay in their own currency.

Secondly--and this is a more technical point--some of the institutions that I'm going to discuss base their lending to a particular country on the debt service of that particular country, in particular the hard currency debt service. That would mean that if the United States gave a hard loan to a country, that would increase the debt service ^{which} that country had to pay off. That would automatically cause another institution to say: "Well, we can lend only less to this country, not more." So all we would be doing is substituting our aid for loans from another institution. So it would be very silly. We would be shifting the burden to ourselves. So for technical reasons we had to have some kind of device to help out these countries that have tough balance of payments problems.

Some of the more difficult problems of administration, that the Vice President referred to in that quotation, that surround DLF-Ex-Im relationships, are obviously that a country prefers to have a soft loan than a hard loan. A soft loan can be repaid with local currency, and you can turn the printing presses and manufacture your own local currency. It's another thing to get dollars to repay a loan. So, naturally, all countries would prefer soft currency loans, all other things being equal.

The problem, then, is, How do we get a country that has sufficient foreign exchange reserves and has a fairly good balance of payments-- how do we get that country to go to Ex-Im and borrow there, when it would prefer to borrow from DLF? This, then, has created the administrative problem. Countries wanted to borrow from DLF, where they could repay

in their own currency. We wanted some of these countries anyway to borrow from Ex-Im, because they were able to repay. This situation got very tight just about a year ago, when a remarkable statement was made by the president of the Export-Import Bank indicating that he was definitely afraid of the consequences of these soft currency loans made by DLF, in terms of the business of Ex-Im and in terms of the general credit problem.

You notice in item 4 that the interest rate on the overhead projects is 3 1/2 percent. Overhead projects are such things as highways, dams-- non-profit-earning projects. The reason for that 3 1/2 percent rate of interest, so much lower than the one on profit-earning activities, is basically, I believe, the fact that the Russians grant theirs for 2 percent; and we felt that we had to get our rate down, in order to make it competitive with that of the Soviets.

So far as DLF is concerned, probably the most interesting recent development is the fact that last fall, just eleven months ago, we shifted our procurement policy. Unlike Ex-Im, until last fall any loan made by DLF could be used to buy goods anywhere in the world. Last fall they changed that, for two reasons. One, the balance of payments of the United States was in bad shape, and they figured that this was a means of stimulating our exports. Whether that is true or not is another point. The second reason was that we wanted to get these increasingly wealthy European countries into the aid business on a larger scale. I'm exaggerating this slightly, but it narrows the point down fairly neatly.

When DLF made a loan that would finance, for example, the capital

equipment exports of a German exporter, we figured that if we cut out making such loans that financed German capital equipment exports, then the German equipment manufacturer would go to his government and say: "Look, I'm losing my business. Won't you set up an aid program?" In this way we would suck the Germans along in as partners, along with the French and English and so on. Whether it works or not is another question.

Now, for PL 480. Public Law 480 is not an institution, but it is one of the most important of the outfits that we could discuss. Basically what is involved here is that we sell surplus farm products, agricultural products, to foreigners for their own currency. Then we lend or grant that currency back to the countries to which we sold the agricultural products.

This looks like a sale, and a lot of Congressmen think it's a sale, and they fool a lot of their constituents that it is a sale. But what it really amounts to is a loan or a grant of agricultural products, when you get right down to it. That's a funny experience with agricultural people on this elementary / point that this is a loan program or a grant program. I called up a guy in AG about five years ago, and it so happened I got hold of a PR man, and I said, "Will you please send me everything you've got of public information on the foreign aid program as it relates to agriculture?" He said: "Oh, you must mean our ^{farm} sales program." He believes his own stuff. Well, people should believe in their own words. In this case we're kidding ourselves.

It may come as a surprise to you, or maybe even as a shock, that

on the order of 40 percent of our agricultural exports in 1959 were sold under some form of subsidy abroad. The PL 480's were the biggest part.

Now, this program has produced certain problems. First of all, it has caused some agricultural exporters elsewhere to complain that we're dumping goods on the market. I'll give you an example.

In one particular country we started up a feed grain program, especially grains for chickens. Chickens, I understand, lay eggs. These eggs, which had never been sold or produced in significant sale in this country, soon got so large in production that they began to export substantially. The exports of eggs took over a big hunk of the Western European market of, it must have been, Denmark. Denmark then complained to the United States, the Ambassador, and there had to be some kind of compromise. But this kind of complaint arises every once in a while. It's not too bad now. Things are easing up.

The second problem on the PL 480 is the danger that we could unbalance a country's economic development. You see, we're going to be pouring tremendous sums of agricultural products into these countries, and it's sensible for them to hold down the development of their agriculture and put more of their own resources into industry and public service. It makes reasonable sense so long as they are getting their food free. But when the day comes, when that millenium comes, that we run out of our agricultural surpluses, and we stop this program, there's a country without any food supply and no development and no foreign exchange, and she goes down the drain. As a matter of fact, that happened on dried milk.

The third fear on this program is a political point. If we didn't sell this stuff abroad, if we just let it pile up in the United States, then the pile would be a lot bigger, the pile would be a lot more obnoxious; and then maybe we would get rid of this agricultural support program, which is such a wasteful thing from the economic standpoint. The argument is that this really louses up our own domestic economy to sustain a program which doesn't make sense.

So, enough of the US institutions. Let's talk about the international ones.

The International Monetary Fund makes loans for short periods for balance of payments reasons. When a country has a balance of payments deficit, it has three choices. It can deflate its internal price levels by cutting imports and expanding exports and making it cheaper to foreigners. It can devalue its currency. Or it can tighten its existing exchange control. This is the way it meets its problems.

Now, the Fund is set up to prevent these kinds of things. The way in which it does it is, it makes these short-term loans to countries to give them time to search out the situation that is causing the problem.

The Fund very often, when it makes a loan, puts certain conditions on it--that the monetary policy of the country shall be such-and-such, no credit shall exceed a certain level, the budget shall be fixed. There may be something about exchange rates too.

The Fund has had some interesting experiences in laying down conditions. For example, in one country they went in with a program which

was very tough, in terms of being anti-inflationary, to try to pick up the situation. On the second anniversary of the signing of the agreement between the Fund and that country's government, the business community had a birthday party for the agreement. They welcomed it so much. It had worked so well.

In a neighboring country, a little bit later, they had an agreement. They signed it. The labor unions went on strike, not against their employers, not against the government, but against the Fund. They were so unhappy with the anti-inflationary measures that the government had to impose because of the Fund demanding ^{them} that they just didn't like the Fund.

So you get different reactions. The Fund has done a lot of interesting things in the way of education. One of the more interesting of the things, I think, is in cases where the Fund sends a representative into the country, and that representative achieves a very high place in the formulation of economic policy in that country.

For instance, I'll give you an example. In one country the representative sits in all cabinet meetings; and, when an economic issue comes up, he talks. This particular cabinet understood very clearly that if they expanded the money supply, that would be inflationary. So they knew that to have a deficit and expand the supply supply would cause inflation. But some bright guy in the cabinet saw that there was some idle money owned by the government in a bank. So he said: "Well, look. Can't we use this and finance this development project that we all want?"

Well, the Fund representative hopped up and said: "No. MV. PT.

Money supply times velocity." What would have happened in this case was that the idle money would start turning over, the velocity would go up, and that would be inflationary.

That's a very simple lesson, but one that many cabinet ministers don't know. And, again, it's an example of how the Fund, with very simple ideas, can affect the course of economic affairs.

Next is the International Bank. The International Bank by policy is a tough one, the toughest of all the large multilateral agencies making large-scale assistance.

The reason why they are tough is this: By and large, they get their funds, which they lend on long-term projects, mostly by borrowing in the advanced countries' capital markets. And there they have to pay a market rate of interest. Then they turn those funds over to whomever it may be in Africa or Latin America and they add a little commission. But the interest rates the countries have to pay when they borrow from the Bank is basically only moderately subsidized by the fact that the United States Government stands behind the bonds of the International Bank.

The second reason why they are tough is that the loans are repaid in dollars, or at least in the currency loaned. And the third thing is that the International Bank scrutinizes these loan projects very, very carefully. There is a lot of follow-up and watching of the project. It's strictly a banking operation in that particular respect.

The Bank has a very bad reputation among under-developed countries, at least locally. To give you an example of the misunderstandings involved,

at the beginning of the operations of the International Bank, the representative of a particular country, which shall remain nameless forever, I hope, walked in to the president of the Bank and said, "I'd like to borrow 250 million dollars." The president said: "Why would you like to borrow it? What for?" He said: "Oh, I don't know. I just wanted to get it before it was all gone." This is not the way you approach a banker, is it?

Even today, the misunderstanding and animus involved in the Bank's dealings is pretty strong. Not too long ago--I guess about a year and a half or two years ago--one representative of a country stood up in the United Nations and complained about the Bank and said: "They hold us like prisoners in the dock." This is how mad he was at the International Bank's conditions on the loans and the way in which they behave.

Well, I must say that the International Bank and all these agencies have a very tough time getting the potential borrowers to bring up useful and well-designed projects. It's necessary for a real possibility for the request getting/support of a loan /in satisfactory shape, with all the engineering studies in, the market studies, the cost analysis. This is one of the most difficult parts of the problem.

This outfit has ranged well beyond the normal banking functions in two or three respects. One involved the expropriation of the Suez Canal. The Bank did a very nice job in arbitrating between the British shareholders and the United Arab Republic.

Just this week the Indus River Treaty has been signed. You probably saw it. In large measure this was the result of the efforts of the

International Bank to bring these two countries, Pakistan and India, which hadn't liked each other, together. They have done it with cajolery, and they have done it with money. I guess close to a billion bucks is what is involved in the Indus development river system.

In fact, the International Bank has done so well in terms of aid and economic development and these sort of quasi-political things that it is noteworthy that no less a magazine than Life Magazine just two weeks ago nominated the president, Eugene Black, for the Nobel Peace Prize. I think it's the first time in history that a banker has been nominated for that sort of thing. ^{U. N.} The / Expanded Program really finances the activities carried out through the agencies that I've listed in item 4, plus a few others.

You notice in item 3 that it says "voluntary contributions." The point here is that the regular U. N. budget is financed by assessment on all the member countries. This kind of program has a special fund. There is no assessment. The countries come up with what they want to.

In our case we make a pledge, subject to a constraint of 40 percent. We do not want our contribution to exceed 40 percent of the total contribution, for obvious reasons. Since this is a multilateral international organization, we shouldn't be contributing all the money.

This kind of thing can cause problems. For instance, last year we pledged 40 million dollars to expand the program and also the special fund. We ended up giving the two agencies only 22 million, I guess it was, because the other countries didn't come in with their full 60 percent. The result was that the two agencies lost out. This has been going on for some

time.

Next is the International Finance Corporation. This outfit, incidentally, is perhaps distinguished by the fact that it is the brain child of the present Governor of New York, Governor Rockefeller. What it does is, it makes investments in private enterprises abroad in under-developed countries; not loans.

Now, the reason for this is a technical reason. It goes back to the International Bank. The International Bank could make loans to private enterprises in these foreign countries, but there was a gimmick. The private enterprise had to get the guarantee of its own government that the loan would be repaid. No private enterprise wanted to go to its government and ask for a guarantee, because that was an invitation to supervision of that enterprise by the government. So the International Bank did no business in loans to private enterprise, and there are a lot of people who believe that private enterprise is a very effective way to stimulate economic development. So up came the idea of the IFC, the International Finance Corporation. That's the technical reason.

The real reason for the IFC is altogether different. The real reason for IFC is that about two years before it came into being, the under-developed countries were screaming for what is known as SUNFED --Special U. N. Fund for Economic Development, which would make very low-interest loans or no interest at all, very long-term in years, grants for all sorts of social welfare projects and so on. It was to be a U.N. organization with one country, one vote.

The advanced countries didn't at that time like this idea, because it involved such low power and so much money. So in order to ease the pressure that was coming from the under-developed countries for SUNFED, we decided to agree to the IFC as a small thing to keep them reasonably happy. That's why IFC came into operation.

Special Fund is run by Paul Hoffman. Their basic purpose is to have so called pre-investment surveys. They go out into a country and they see what that country has got in terms of natural resources, bankable projects. The hope is that on the basis of these surveys, various international institutions or maybe private investors will be able to come in and loan or make an investment. It does not itself provide any loans or grants capital.

IDA, the International Development Association, probably will come into operation this week or next. Like I suspect that IDA is here because of a misunderstanding. Somebody got the idea that all of the local currency that we were getting through the sale of agricultural surpluses would make a wonderful source of financing economic development. And so several people thought it would be a nice idea to have an international agency collecting all this local currency and then lending it.

There is one problem there and that is that local currency is not a real resource. When a country receives its own currency, it is not gaining any additional real goods. You have to give them additional things in order to expand their economic potential.

Well, anyway, the organization has gotten started. It's apparently

has all the things we didn't like in SUNFED--the low-interest-rate loans, or the no-interest-rate loans, the long terms for loans, the grants, the social welfare programs. And so in effect it would appear, since we are now putting in hard currency, that we have lost the SUNFED battle, if you will. Or, to put it the other way, circumstances have changed and we have decided that we want one or the other.

The next three agencies are truly original. The Inter-American Development Bank is the first. We opposed it for 60 years, or 59. The Latinos were always asking us to have an international bank for the region. We said: "No, no, no, no." Then all of a sudden we approved of it. Why? Because there was a crisis in the Middle East, and President Eisenhower and Mr. Dulles felt that the way to solve this crisis in part was to have a Middle Eastern regional bank, into which we would put money. The President and Mr. Dulles realized full well that if we approved of a regional bank for the Middle East and didn't do it for Latin America, the Latinos would be sore as the dickens. And that's why the Inter-American Development Bank got started. It was purely a political measure.

It's so new that it's really impossible to say anything much about it. It's very much like the Bank, in that it's going to borrow most of the money that it lends. It's like IDA, the International Development Association, because it has a soft currency window, this so-called special operations organization. But it's so new that you really can't say a whole lot about it. In fact, I was over there just a week ago and in talking with an economist, I was taking down some numbers with a pencil and it broke. So I said:

"I've got to sharpen this pencil." He said: "I'm sorry. We have one pencil in the whole building." They are just starting out. So you really can't say a whole lot about this outfit.

On the Overseas Development Fund, it's a by-product of the Common Market, which I'm sure Howard Piquet talked to you about yesterday. It has operated so far rather slowly. It's got to pick up. The big problem on this one is that it's a five-year agreement. At the end of five years-- that will be about two years--they are going to have to renegotiate the whole thing. It's very uncertain what will happen to this one.

Special

Next to the European Fund. This is a residue of the now-famous and now-dead European Payments Union. The European Payments Union was a rather technical and rather complicated device by which we cleared debts in Western Europe without the use of dollars. The dollar was in scarce supply. Then, when the dollar shortage ended, and technically when the convertibility of Western European currency was gained in December of 1958, There was no longer any reason for EPU. They took in effect the money that was left over and put it into this Special European Fund. And what it does is to make short-term loans to solve balance of payments problems in Western Europe.

Well, that's a very quick review of the institutions. Let me now talk for the remaining few minutes about some common problems.

The first problem, in terms of time anyway, is this matter of administration and coordination and proliferation. I think that, no matter which candidate makes the Presidency, It is fair to say that you will see within

a year a fairly major reorganization of the foreign assistance activities at least of the United States. It is conceivable that there may be increasing pressure in the years to come to also reorganize the international institutions, because they are proliferated. But the big upcoming change is a centralization of the foreign assistance program, conceivably all of it coming under the Department of State, or conceivably an entirely separate agency. Nobody seems to know clearly what's in progress.

The second big problem, the current problem, is how in the world we're going to entice these increasingly wealthy European countries to get into the aid business. If you look at what's coming up in Africa, if you listen to the screams and the complaints in Latin America, and the problems in Asia, you get overwhelmed by the task that lies ahead of you. And we obviously cannot do it alone. We will have to pull in Western Europe if we're going to do it at all. The problem is how we get the Western Europeans to come in.

We have formed the thing called DAG, the Development Assistance Group, consisting of Western Europe, Japan, and ourselves. This is a consultative committee, to try to figure out means of coordinating and stimulating economic aid to Western Europe. I regret to say that I do not yet see any effect of this committee, or of the rather subtle but nonetheless firm pressure that Mr. Dillon has put on a number of countries to get them to put in more money.

The first question, which has always been with us, is the question of, Shall we give our aid bilaterally or multilaterally? That is, shall we give

it directly, or shall we give it through international institutions?

The arguments for multilateral aid are pretty clear cut. It is less demeaning for a country to come to an international organization and ask for money than it is to come to us. Secondly, there are certain sensitive areas in each countries where it is easier for an international organization to work than ⁱⁿ one country, like the United States. For instance, mineral resources development. In most of these under-developed countries there are mineral resources or special kinds resources tied up with sovereignty. If the United States went in and tried to develop them, that would be an imperialist act. If the U.N. goes in and tries to help, that's a different matter.

Then there's a feeling that the international organizations can impose tougher conditions on the use of these funds and the policies of the borrower. And, of course, the experience of the International Bank sort of reflects this and proves it out. Although I must confess that I really think the reason why the International Bank has succeeded is because it borrows most of its money and it has to make sure that it can pay the interest that it owes and assure that the people that borrow the money pay their interest.

And then there's the feeling that the international organization approach is a way of spreading the burden among a lot of countries. That was the reason in part for IDA.

On the other side, it is pretty clear that Congress loses control of the expenditure of the funds, and in principle this is not a desirable thing.

Secondly, the more money we put through the U.N. operation, the less money we have left over for bilateral aid. And when a crisis

should arise in a particular country--in Laos, Cambodia--where we have special political interests, and where the U.N. would not be expected to find much significance, and where it might be opposed by the Russians, let us say, then we will perhaps not have enough money to do the job in the political areas that we want the job to be done. This issue is being constantly debated, both in the academic field and in the Executive Branch.

Another big issue comes out of this soft currency problem. This is a matter of education. It's remarkable that the United States Government, through DLF, makes loans at a rate of interest of 3 1/2 percent, which are in fact grants, because they are repaid in local currency and we will never use this local currency. It's no good to us. These are grant programs.

The Russians come along with a loan program of 2 percent where it's a real loan. They have to repay in goods. They get all the political benefits because they have this low rate of interest. We've got 3 1/2 percent on our loans, which are practically ^{grants} but we don't get any credit for it. That's an exaggeration, but you see the point I am trying to make.

A lot of people think that the DLF loans are in fact loans and that we will get repaid. This is probably not true in any meaningful sense. So we shouldn't really kid ourselves.

Also, with DLF lending on soft terms, and the PL 480 agricultural surplus disposal program, we are accumulating increasingly large amounts of local currency. The political problem involved here is perfectly obvious. Somebody recently calculated how much local currency

in India we would own in three or four years. I can't remember the exact numbers, but to illustrate his point he said: "We will own as much of India's currency in relation to India's national income as if foreigners owned 35 billion dollars of our currency." In three or four years, mind you. Now, you can imagine the political consequences if we owned this kind of money all over the world.

The final problem, general problem, is the U.S. balance of payments. If this thing doesn't clear up pretty rapidly, or doesn't show clear-cut signs of improving quite rapidly, rest assured that ⁱⁿ the next session of Congress there will be tremendous pressure to cut the foreign aid program, both the military assistance and the economic assistance and the military expenditures overseas, in order to try and relieve this serious, perhaps unrelated, economic problem for the United States.

This has been an altogether too brief review of the institutions. I haven't even begun really to cover ^{them,} both in numbers--I've told you about some of them--and in terms of depth. I do hope that you have a little better understanding of what's going on in this somewhat complex field of foreign assistance. Thank you very much.

COL. BURNSIDE: Dr. Schmidt is ready for your questions.

QUESTION: Doctor, I get the impression, on this question of foreign aid, and on these international programs that we have, ^{that} there is an attitude of feeling that they are temporary measures--something that is going to stop sooner or later, when our surpluses run out; that we won't have foreign aid when our surpluses run out. Do you feel that this is the

case, or do you feel that this is going to be a part of our lives from now on?

DR. SCHMIDT: I think there is increasing recognition that this will be part of our lives, our children's lives, and their children's lives. There will always be poor people, and they will always be clamoring for more from the rich. The world is always moving in that direction.

I think that foreign aid is a part of the fabric of our society. I don't think that people recognize it, but I think it's true. A piece of objective evidence is that in the last year, for the first time, the International Cooperation Administration has been carrying out a really true in-service training program for its personnel; and they have stopped talking about "Well, we can have a few people in and then close down the agency." This is nonsense. We're going on and on and on. I don't think it will ever end.

QUESTION: You made a brief statement about the deficit in the balance of payments in the past year. I think you said that in 1959 it was 5 billion if counted correctly. Would you explain what you mean by that?

DR. SCHMIDT: Yes. The usual statement is that the deficit is 3.6 or 4--I can't remember--billion. This does not include our payment to the International Monetary Fund, which is an out-take. If you pulled this in, our total deficit for 1959 is 5 billion. And I think that in any accounting system you ought to pull this in. Otherwise you are just forgetting about one thing that you should consider.

QUESTION: Dr. Schmidt, in all these international funds we are

putting up 40 percent, which seems like a hell of a lot to me. How would you arrive at the reason why we should put up 40 percent and the rest of them only 60 percent? And, furthermore, with the growing wealth of the other nations, is there any evidence of cutting down our share?

DR. SCHMIDT: I see no evidence of any cutting down on our share through the U.N. program. The big change in that respect is our pressure on Western Europe to start up its own bilateral programs of aid, especially in Africa. There is some outlook there.

QUESTION: Dr. Schmidt, you talked of international trade and balance of payments. Do we have in our own country a ratio of where we should stand in exports relative to imports? And the same thing holds true of the other countries. I know that in England, Argentine, and some of the other countries, they probably export more than they import. In talking about expanding our exports, do we have on the basis of all our international financing, a ratio of where we should be and where the other countries should be?

DR. SCHMIDT: That's a good question. It's a tough one.

I think the seasonally adjusted trade surplus of the United States this year may turn out to be 6 billion dollars, which is unparalleled--an incredibly large surplus of exports over imports. But even with that surplus, mind you, we will probably run a deficit of 2 to 3 billion.

If somebody had told me a year ago that the current surplus would be 6 billion dollars, I would have said: "Gee, the problem is gone." But it isn't gone. Why? Because other kinds of payments, investments,

foreign aid, military expenditures, and in particular short-term capital movements--funds moving from low-interest places to high-interest places, from New York to London--are moving out of this country quite rapidly. And so, despite this wonderful trade surplus, we still have this balance of payments deficit.

Now, I just can't answer your question. There is no proper ratio, except to say that no country over the long pull can stand a balance of payments deficit, and we had better figure out how to get rid of it.

QUESTION: Can't we get some kind of use out of these so-called soft currencies in the Western Hemisphere? Can't American industry use them for local payments of labor? Or can't we convert them into some sort of Western Hemisphere currency which would be convertible into dollars?

DR. SCHMIDT: The prospect of the latter is very unlikely. The Latinos are going to have incontrovertible currency for a long time because of their development effort. We do lend up to 25 percent of the PL 480 that we get, under the so-called Cooley Amendment, funds to private enterprise. The basic problem with this kind of activity, however, is that it doesn't really add to the resources of the country, because it's just lending a country its own currency. The Cooley Amendment states, however, that if you can use this as a subsidy to get some American currency to come in, fine and dandy. Whether or not that in fact is possible, whether they are coming in because of that, is another question. But basically this is probably a good idea.

QUESTION: My question is directed to basic matters in foreign aid.

What has happened to the pre-World War II international loans and the World War II loans and the lend-lease loans and things of that kind? It seems that in the process of all these loans we have completely lost track of prior deficits.

DR. SCHMIDT: Not completely. It is worthy of note that the International Bank refuses to lend money to a country unless it will make an effort to come to some kind of an agreement to clean up its defaulted prewar previous debts. It simply refused in a couple of cases because the governments would do nothing to try to straighten out their past debt record. So, while there is plenty of debt lying around unpaid, the fact of the matter is that something is being done about it, and rather effectively. It's really amazing how much good the International Bank has been doing.

QUESTION: In your lecture you discussed the problem of foreign the aid among a large number of agencies. I wonder if you would be a little more specific on the degree of coordination among these and among other institutions that have to do with foreign aid.

DR. SCHMIDT: The problem is very serious. If you take a look at a memorandum coming from ICA and check to see where the thing is going, you will see that it may go to five or ten different agencies, and then the within agency to two or three divisions. Now, there is clear-cut coordination in form. Everything gets fed around and sometimes the files get lost for a while. You know these things yourselves. So there's coordination in form; but there's such a press of paper on this operation, there are so many decisions to be made, that the coordination is in form only

in many cases. Hence mistakes are made.

DLF and Ex-Im have on Tuesday mornings representatives of the two outfits sit down together and work over all the loan applications. This is working pretty nicely. But even there mistakes are made. Ex-Im doesn't DLF to go into a country where Ex-Im thinks it can make a hard loan. So disputes arise. Nobody is resolving them.

I don't know whether that answers your question, but the coordination is there in form, but because of the press of material, it is in form only.

QUESTION: Who makes the final decisions?

DR. SCHMIDT: In principle, Mr. Dillon is the top man on most of these things. But Mr. Dillon is a human being, with only one head, fortunately. It's the agency that has the information to make the decisions that makes them.

QUESTION: To what extent, if any, has the Cuban seizure business been cured by the Export-Import Bank?

DR. SCHMIDT: Not a single investment guarantee contract was signed by any American enterprise in Cuba. And you should have seen the day after the thing blew up. The businessmen across America crying, and the taxpayers on the whole laughing. But not a single American businessman was willing to pay that small price of an investment guarantee contract against expropriation. They paid for it.

QUESTION: You said in your talk that within a year there would probably be a reorganization of all these agencies. Would you care to comment as to whether it will all be given to a separate agency, or whether

it will all be given to the State Department?

DR. SCHMIDT: I'd rather not comment, because I honestly don't know. This is a Republican Administration and it's a very specialized field.

QUESTION: Are these accumulations of soft currency treated as counterpart funds to the extent that officials of our government can spend them for their expenses? Are they in fact counterpart funds?

DR. SCHMIDT: They are not called counterpart, because that name is left for the Marshall Plan period. They are now called local currency.

When we sign an agreement with a country to sell them agricultural surpluses, we agree at that time, roughly, as to what percentage of the local currency will be used for this purpose or that purpose. And a relatively small percentage gets used for our purposes. When you go abroad, if you are in a Military Assistance group, part of your expenditures will be financed out of local currency.

QUESTION: Doctor, I am confused on one point. You stated that a deficit in balance of payments is a dangerous thing. Yet this deficit in payments is occasioned by our own grants in aid to foreign countries. Now, if you grant aid, you have to get it back in some sort of imports or else in currency, don't you?

DR. SCHMIDT: I see what you are driving at. We have two alternatives. We can give them the money and let them spend it where they see fit. Or

we can give them the money and oblige them to spend it here. And what they then get by the gift is official goods either way. So it is a net acquisition to their total resources. It still is aid, at least when you give them the money. When they repay, if they ever do, then you get it back.

The big problem on this choice, quite frankly, is that on some items our costs of production are higher than in Western Europe. So if we give them a hundred million bucks, it goes a heck of a lot less far in terms of buying things here than there. So automatically--and this has happened--we have to increase the size of the aid program, because we are in effect insisting that they spend the money over here.

Secondly, the objection is that it is a basic deviation from the principles of free trade multilaterally. America has fought many a battle, and won them, in the economic sphere for non-discrimination multilaterally. Let people buy where they want. Don't force expenditures in a particular channel.

This is the kind of thing which, for instance, the Soviets do--tie their aid to the Soviet Union. We have always been strong on the contrary policy. Then comes along the DLF decision, and, while it's small things in terms of money, it's a big thing in terms of principle.

QUESTION: I'd like to know to what extent the USSR participates in these multilateral international institutions.

DR. SCHMIDT: The Soviet Union and Bulgaria, Czechoslovakia, Albania, Hungary, and one or two more participate in the U. N. expanded program for technical assistance; and also in the U. S. Special Fund.

The Soviet contribution to the Expanded Program didn't start until, I think it was, 1953. The Program started in 1949. So we were well ahead of them. Their contribution is 8 million dollars, I think. It's pretty small. That's the combined bloc contribution, and I think most of the money has been used for technical experts, and a certain amount of capital equipment, for demonstration purposes. It's a pretty small operation on the part of the Soviets.

QUESTION: Doctor, during your discussion of Public Law 480 I sensed a dissatisfaction with the agricultural program. What is your solution to this problem?

DR. SCHMIDT: Don't have it. Let the price fall where it may or rise where it may. That's cruel, but I don't have to get elected, do I?

My point is that you do more harm by these subsidy programs in the long run than you do good. You are just attracting people into this program, or keeping them there, when over the long pull they would be better off somewhere else. This is the horror, the immorality, besides the economic loss.

QUESTION: An article in the editorial section of the Sunday papers spoke of the Aswan Dam and the Russians' failure to move or to perform after they had tied up the agreement between Russia and Egypt, and then they were using it as a club. How does this demonstrate itself, and how is it publicized that this tie of Egypt to Russia is not a practical way of obtaining a loan or assistance?

DR. SCHMIDT: The Department of State has produced a little pamphlet on that. If you're not familiar with it and if you're worried about the Soviet aid program, you should read that pamphlet on Communist aid

and trade policies. It's less than a year old. And in that some of the horror stories are told, though, interestingly enough, not in the full detail and with all the possible points that would make the Soviet aid program look pretty sick in some areas. There are cases after cases where the Soviets have goofed--Burma, /Indonesia, sugar mill; Aswan Dam--the whole Egyptian military assistance. One after another, you can pick them up.

Like us, the Soviets have trouble getting money to lend. They get into problems. This one was kept quiet.

There's a bit of a paradox--if I can speak very bluntly for a moment. I have a feeling that there is a growing attitude within the Executive Branch--and I won't say where--that a certain amount of Soviet assistance is a good thing, to the extent that it assists economic development. That's particularly possible in India. It's essentially a feeling that we should forget about the political standpoint, because economic development is the big thing. It's a paradox. I sense it. I don't know whether that is true in reality. So probably you should forget about it.

QUESTION: My question has to do with financial support of the United Nations. If I understood you correctly, you said that the United States paid in only 22 million dollars last year when its quota was 40 million dollars, and that this was caused by other nations not putting in their whole quota amount. Does this, in your opinion, indicate that the United Nations is headed for a very rough fiscal situation in the future? And, if so, what do you think will happen?

DR. SCHMIDT: There is no question that the United Nations will run into a rough fiscal position in the next five or ten years, because we

are going to put more and more burden on the United Nations, particularly in Africa; and obviously it's the last remaining institution to be a central bank of foreign policy. It's the last place you can go to get something done. And I see very little evidence that we are prepared to meet the tremendous expenses that the Congo affairs need. You can't even get a solid estimate of what it's going to cost a month to keep that country going; and I see no really satisfactory evidence that we are going ahead with a financial program.

I think that within the next year you are going to have to see a major shift of emphasis in Congress about how much we're going to put in, because of this Congo type of affairs.

The U.N. has a program, which I didn't mention, called OPAC, which would literally pay the salaries of people to go in and run the country, run the public utilities, run this division of the government or that division. This kind of thing is going to have to be expensive. I don't know where the solution is except higher taxes.

QUESTION: Along the line of the last question, we apparently have made a fairly solid decision that aid to Africa and these under-developed countries should be multilateral. Would you comment a bit on the economic or political reason for this particular decision?

DR. SCHMIDT: I think the basic political reason is that we feel that, with the competition of the Soviet Union, we cannot behave in a bilateral fashion, because if we behave in a bilateral fashion, then they will and they might beat us at our own game. If it's going to be a multilateral program, then maybe the Soviets will come in and work with us.

Now, on this Congo business, just last week I was talking to a man who had just come back from there. He didn't talk to any Congolese people at all. He would talk to U.N. people and they would go and talk to the Congolese. That was carrying it to the extremes.

Whether or not this will work, whether the Soviets can be sucked into this multilateral program and effort, remains to be seen.

As far as the economics are concerned, I don't think this is too important. The economic concerns are completely overwhelmed by whatever political advantage we might conceivably get.

COL. BURNSIDE: Dr. Schmidt, you have given us a much-needed insight into some of these organizations. On behalf of the faculty and students, thank you very much.

DR. SCHMIDT: Thank you very much.

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