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# REPORT OF THE STAFF SURVEY TEAM

OF THE

## SUBCOMMITTEE FOR REVIEW OF THE MUTUAL SECURITY PROGRAMS

ON

# ECONOMIC ASSISTANCE TO KOREA, THAILAND, AND IRAN

WITH

## SUBCOMMITTEE RECOMMENDATIONS



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# ECONOMIC ASSISTANCE TO KOREA, THAILAND, AND IRAN

## NATURE AND PURPOSE OF SURVEY

This is a report of the observations of a staff survey team of the Committee on Foreign Affairs in three Asian countries during the period October 7 to December 9, 1959. The three members of the team were: Roy J. Bullock, senior staff consultant; Harry C. Cromer, detailed from General Accounting Office; Henry E. Billingsley, consultant.

The group spent 24 days in Korea, 9 days in Thailand, and 16 days in Iran. On the way to Korea, the team had an opportunity to discuss Japanese-Korean economic and political relations with U.S. officials in Tokyo and, on the way home, to visit the headquarters of the U.S. European Command at Paris, which has responsibility for the military assistance program for Iran, where certain aspects of the military assistance program in Iran were discussed with EUCOM officers.

The purpose of the survey was to observe in detail the functioning of the mutual security program at the operating level. In order to make this possible, it was decided to have the survey team limit its work to three countries rather than to make shorter visits to more places. Priority was given to surveying military assistance operations, although there was opportunity in all three countries to examine various aspects of the economic assistance program.

The Subcommittee for Review of the Mutual Security Programs, after holding four executive sessions during which a comprehensive oral report was presented by the survey team and documentary material submitted, directed the survey team to draft separate reports on its observations of the economic assistance programs and of the military assistance programs in the three countries visited.

The reports are admittedly incomplete because material and observations classified by the Executive as involving national security have been left out. The Departments of State and Defense made classified information freely available to the survey team and were fully cooperative in facilitating its work. Although U.S. officials in the countries visited did not lead the survey team to closets in which skeletons were located, they apparently imposed no obstacles and unlocked the necessary closet doors when requested to do so.

Had the subcommittee not been willing to respect the classification of material imposed by the Executive, the observations would have been drastically limited and its ability to report on the status of mutual security operations greatly diminished.

The subcommittee has also withheld material when in its judgment reporting of facts or incidents would reveal the source of information obtained by the survey team from individuals on the condition that they be protected. A conscientious effort has been made by the subcommittee to assure that the published report conveys an accurate impression of the complete observation of the survey team and that observations omitted were neither predominantly favorable nor unfavorable to the mutual security program.

A number of the shortcomings of the economic assistance program noted by the survey team are, in the judgment of the subcommittee, attributable to defects in the organization and procedures of the mutual security administration rather than to errors in judgment or to local considerations. The following findings and recommendations of the subcommittee are of general application and are submitted for the consideration of those responsible for the administration of the mutual security program.

## SUBCOMMITTEE FINDINGS AND RECOMMENDATIONS

1. The observations of the staff survey team add to evidence developed by the subcommittee in its hearings and investigations (hearings held December 2, 3, 4, 9, and 10, 1958, on Examination of Selected Projects in Formosa and Pakistan; hearings held January 21 and 22, 1959, on Pakistan; and Interim Report of the Subcommittee for Review of the Mutual Security Programs dated February 15, 1959) that the administrators of the mutual security program have been giving a higher priority to the development of programs and to getting the funds from the Congress to finance them than to carrying the programs out promptly and efficiently after the money has been provided. There are indications that in the International Cooperation Administration preferment goes to the official demonstrating ability to formulate programs of assistance and to secure the agreement of foreign officials to such programs rather than to the official demonstrating that he has made effective use of the money allocated to him.

We recommend that the administration of economic assistance be modified so as to assure that the execution and administration of programs receive no less emphasis than program development, intergovernmental negotiation, and congressional presentation.

2. The United States provides economic assistance to help solve the problems and to meet the deficiencies of the recipient country. The administrators of the mutual security program apparently do not always distinguish problems and deficiencies which exist primarily because of the action or the failure to act of the recipient government from problems and deficiencies which cannot be taken care of by local executive decree or legislative action. In some situations it appears that the United States is attempting to overcome lack of cooperation from the beneficiaries of our assistance by augmenting the assistance provided.

We recommend that the allocation of funds and the administration of programs be so directed that we are more generous to governments which cooperate effectively in carrying out economic programs and that lack of cooperation on the part of a government receiving U.S. assistance is not reflected in increasing the cost of economic assistance to the United States.

3. The report of the survey team presents additional cases in which mutual security funds have been obligated for several years for projects which either have never gotten underway or which show little evidence of being completed. The Committee on Foreign Affairs took the initiative in trying to prevent such situations when in 1958 it obtained the approval of the Congress of an amendment to the Mutual Security Act (sec. 517), requiring the completion of detailed plans and cost estimates before funds can be obligated. This provision became effective after June 30, 1958, and has applied to fiscal year 1959 funds and later. It appears that section 517 is being complied with and that funds are no longer being obligated unless the details of the project have been worked out and the obstacles to it have been overcome. The International Cooperation Administration reports that it has recently inaugurated quarterly reviews of all "old" obligations in order to transfer funds to higher priority uses when possible.

We recommend that the administrators of the mutual security program inventory and evaluate all prefiscal year 1959 obligations so that the Congress can be assured that no obligations are carried on the books for projects which have bogged down.

4. It is U.S. policy not to interfere in the internal affairs of other nations, and it has been stated that U.S. assistance to any nation was not dependent on whether the recipient accepted the doctrine of socialism or whether it favored government ownership of industry rather than a private enterprise system. The record of U.S. economic assistance, however, provides numerous cases illustrating that it is essential for industrial-commercial-type enterprise (as distinct from public utility-type) to be directed by businessmen motivated by the desire for profit, possessing know-how together with sufficient capital so that they are penalized for errors in judgment. The less developed countries invariably overestimate the business capability of their own people in the modern industrial fields and believe that an abundant supply of capital will inevitably and automatically produce rapid and widespread economic development.

We recommend that U.S. funds not be made available to finance industrial-commercial-type projects, except for experimental pilot projects, unless enterpreneurs, either indigenous or foreign, with both know-how and capital are available. Economic assistance to nations insisting on government ownership or operation of such enterprises should be restricted to other types of development.

5. U.S. economic assistance is being provided to foreign nations by Government agencies which are independent, except for coordination at the top and for being subject to the foreign policy guidance of the Secretary of State. The International Cooperation Administration is only one of several agencies making available economic assistance to the less developed countries. Others include the Development Loan Fund, the Export-Import Bank, and the International Bank for Reconstruction and Development. Frequently more than one of these agencies participates in financing a single program—such as, highway construction in Iran discussed in detail below. These agencies are coordinated as to what they are trying to do; for instance, consideration is given to what is already being done by each before any new project is undertaken.

There apparently is no U.S. official or agency, however, maintaining continuous supervision, either in the field or in Washington, over the phasing of the various segments of the program or the progress toward overall objectives. Doing this job involves more than coordination at the heads-of-agency level. Competent technicians must be available who are sufficiently well-informed to observe or anticipate shortcomings. Adequate procedures must be established to assure that corrective action is taken and compensating adjustments made.

We recommend that the International Cooperation Administration retain responsibility for determining the needs of recipient nations, recommending the nature of the economic assistance to be rendered, keeping them on schedule and seeing that they attain their intended objectives. For example, additional loans by the Development Loan Fund or the other lending agencies for projects in a given country should be adjusted to the current rate of progress in the projects already underway in that country.

## SCOPE OF WORK OF SURVEY TEAM

The survey team was directed to report to the subcommittee on the use being made of funds already provided for economic assistance to the countries visited and to throw whatever light possible on the magnitude of essential expenditures to be required in the future.

In evaluating the use of the funds already provided, the survey team focused its attention in three general directions:

First, discernible accomplishments of the program, both direct (roads and factories built, improved living standards) and indirect (trends, institutions, procedures—cooperation with the United States);

Second, indications of misapplication of funds (projects that failed to get into operation, diversion of money and effort from intended purpose); and

Third, evidence of inability to cope with significant problems or situations.

Considering the time available and the circumstances confronting it, the survey team gave first priority to finding instances of misapplication of funds and of the inability of the administrators of the program (both United States and the recipient government) to handle specific situations. We did not spend much effort to search out or measure the accomplishments of the program. We took the position that many of the results of a successful program should be apparent even to a casual visitor and that its less obvious achievements would be pointed out to us by those in charge.

In formulating judgments as to whether future expenditures should continue at about the current rate, be curtailed or increased, the survey team relied on its observations of the nature of the obstacles to be overcome in the attainment of U.S. objectives, as well as the effectiveness of present and past operations, rather than upon an examination of the recommendations of U.S. officials as to the future. We recognized that any comprehensive evaluation of future requirements was not our function.

## KOREA

That U.S. economic aid to Korea has been a substantial success was apparent on every hand. The ruins of war have been very largely repaired. Commercial and public buildings have been rebuilt. Railways have been reconstructed and improved. Public utilities are restored and expanded.

The economic situation gave evidence of vitality, and the commercial community appeared to regard the future with some optimism. While the masses of the people still live in extreme poverty, many of them in makeshift huts which have housed them since the wartime shifts of civilian population, there were indications that the standard of living was rising.

Korea should be regarded as responding to treatment rather than as on the road to recovery. The international balance of trade of Korea is more unfavorable than that of any other country in the world, and it continues to be necessary for the United States to augment the revenue of the Korean Government to the extent of some 30 percent of the annual Korean budget.

### *Bogged-down projects*

The survey team examined a number of projects for which U.S. funds have been obligated for 2 or more years which have not gotten into operation and appeared to be seriously bogged down.

*Pusan Iron Works (Dae Han Shipbuilding Corp.).*—The biggest white elephant observed by the survey team was the Pusan Iron Works (the Chung Ju fertilizer plant was not visited since it was included in the itinerary of the Foreign Affairs Committee study mission headed by Hon. J. L. Pilcher), a large shipyard with drydocks and machine shops. The United States, following recommendations of U.S. consulting engineers employed for the purpose, purchased $2 million of machine tools, heavy cranes, and other equipment, including an electric furnace, more than 5 years ago. Much of this equipment has never been used.

This corporation has been controlled by the Government of Korea since being taken over from its Japanese owners. Until the end of 1958 the management was in the hands of people reported to have no experience or qualifications for managing such an enterprise. At U.S. insistance a new management was installed but the ultimate authority still rests with Government ministries.

The company is in virtual bankruptcy and needs to be completely reorganized. The present management regards some of the heavy cranes which were purchased as unnecessary, and they were being offered for sale. The management was also critical of the layout of the new machine tools. There will not be sufficient power available to operate all the equipment at the plant until an expansion of power distribution facilities is completed, which was also bogged down, in part because of the Korean embargo on trade with Japan to be discussed below.

The United States is now confronted with the choice of making a further contribution to financing the Pusan Iron Works as part of a general corporate reorganization or of writing off its past investment and permitting the liquidation of the enterprise.

*Medium industry development.*—Some $13 million of 1957 funds have been obligated to finance the development of medium industries. There were 50 projects included. At the time of the survey team's visit only 24 of these projects had matured to the point where invitations to bid for equipment had been issued. The survey team visited three medium industry development projects which appeared to be stalled.

*Textile parts plant.*—This is a small plant in Pusan to manufacture parts for textile machinery. New buildings were completed but the machinery financed by the United States was still in customs because the management hadn't enough money left to pay the customs duties. Some $214,000 of U.S. funds are involved.

*Fluorescent dyestuffs—near Pusan.*—The buildings had been erected and some machinery was in place. The principal delay was attributed to the fact that ICA/Washington had not approved the purchase of additional necessary equipment, although $50,000 had already been provided. Raw materials were being held in customs.

*Agar-agar plant No. 1—near Pusan.*—This plant is regarded as having important export potential. Rather impressive buildings had been erected, including what appeared to be more office space than necessary. Some equipment was installed and $300,000 worth had been purchased by the United States; an additional $100,000 worth was said to be necessary to complete the manufacturing process. An unofficial source reported to the survey team that a substantial water supply was essential to the production of agar-agar and that none had yet been developed. The firm had run out of money, and the ICA had not decided whether to put more money into the enterprise.

*Nature of problem.*—These stalled projects cannot be gotten back on the track merely by putting up more money. Korea suffers from an acute shortage of capital, but there are indications of an even more acute shortage of entrepreneurs—that is, men able and willing to assume top management responsibility and at the same time risk a substantial amount of their own money in backing up their judgment.

In the United States, as in the other nations of the world where industry and commerce are highly developed, the choice of a factory site, the determination of the type of equipment to be used, and the scale of operations and the prices to be paid for machinery and materials are left to the management of the enterprise. If the judgment of the management proves to be wrong on these matters, the management loses its investment.

In Korea, where many industries are Government-owned and where many others are financed almost entirely by Government loans, the normal profit and loss incentives and penalties cannot be accepted as adequate controls of management, and the elaborate and time-consuming machinery of bureaucratic review has to be relied on.

There are undoubtedly a considerable number of entrepreneurs with management ability and with capital, and the survey team visited a number of factories equipped by the United States which are in successful operation. These successes appear to reflect the adequacy of the entrepreneurs rather than the effectiveness of the procedures for granting U.S. assistance.

Recognizing that its observations were limited, the survey team, nevertheless, invites consideration of the possibility that U.S. assistance to the industrial-commercial segments of the economy (as distinguished from public utility segments—such as railways and powerplants) should be limited to enterprises where there is a qualified manager with adequate equity capital available and then most of the surveying, screening, and reviewing procedures now in effect eliminated.

A corollary of this would be that to the extent that local entrepreneurs are not available to carry forward industrial-commercial development on an adequate scale, encouragement should be given to foreign firms to come in and fill the deficiency. If the Korean Government is unwilling to use the services of foreign entrepreneurs, it should accept the fact that certain areas of economic development must await the indigenous production of management ability and risk capital.

*Awarding of import contracts*

Most Korean imports are financed by the United States because Korea derives from its own exports and other sources only a small part of its foreign exchange requirements. Much of the Korean economic structure is owned and operated by the Government of Korea, partly because of the confiscation of Japanese-owned property at the end of World War II. Certain imports of a commercial nature are financed by the United States for the Korean Government. Others are U.S.-financed for commercial firms. In both cases payment of the proceeds of the sale of such imports is made in Korean currency (hwan). Such payments are deposited in an account (commonly called counterpart) subject to joint United States-Korean control.

The survey team had received, before leaving the United States, a number of complaints from U.S. exporting firms of unfairness and inefficiency in the placing of orders for imports into Korea. All orders must be approved first by the Korean Government and then by the United States. It was alleged that frequently the low bidder or the supplier of the best quality was not awarded the contract, frequently as a result of rigging the specifications to favor a particular supplier.

The nature and difficulty of the problems involved are indicated by the following case which the survey team encountered during its investigations. A Korean manufacturer refused to accept the machinery for a metal printing plant (to print on metal sheets which would subsequently be made into tin cans), which was offered by the lowest bidder, insisting that he wanted only the machinery supplied by the highest bidder. In an ordinary commercial transaction free from Government control, it would be left entirely to the judgment of the purchaser to decide whether to buy expensive or cheap machinery and to select whatever make best suited his needs.

Under conditions prevailing in Korea, it cannot be assumed that the judgment of the purchaser of the machinery will be influenced primarily by considerations of long-range manufacturing advantage. Korean currency is not freely convertible and all foreign exchange transactions require Government approval. Koreans are not allowed to transfer funds out of the country except for a few authorized purposes. As a consequence, there is always a danger that an importer will be glad to pay a high price in hwan for the commodity he buys if he receives a hidden compensation of some kind, such as a deposit to his credit in a European bank by the seller of a "commission" in a convertible currency.

Under the circumstances it is necessary for U.S. officials to scrutinize the price and specifications in every transaction in an effort to determine that the United States gets its money's worth and that U.S. expenditures contribute their full value to the Korean economy.

In the case of the metal printing plant, inquiries by the survey team led to an investigation by U.S. authorities which, in turn, resulted in having the transaction rebid.

Another case examined by the survey team involved the procurement of explosionproof gear motors for use in Korean coal mines. After the bids were received, all bids from U.S. firms were in the range of $100,000 up, while bids from European suppliers ranged from $40,000 to $50,000.

Investigation developed information that the specifications required that the equipment meet U.S. National Electrical Code (NEC) standards, including the definition of explosionproof. The bids from non-U.S. manufacturers did not conform to the NEC standards, although none of the U.S. officials were aware that this was the case. As a result of the survey team's inquiry, the transaction received further study and the award was made to the lowest U.S. bidder.

These cases indicate problems imposed on United States and Korean bureaucracy in supervising U.S. expenditures for the increasing number and variety of imports required as Korean industry and commerce develop. The technical skill and commercial background necessary for the evaluation of specifications and bids for the wide range of imports, including X-ray equipment, explosionproof gear motors, and metal printing machines, inevitably exceeds the capacity of any staff which the United States might expect to maintain in Korea.

Furthermore, the cumbersome and time-consuming preparation of documents and justifications, together with the inevitable approvals, reviews, and appeals, have become a significant factor retarding economic development. It is said that the Korean businessman is required to spend more time dealing with Government agencies than in running his business and that greater opportunity for profit arises from outwitting the bureaucrats than from carrying on commercial and industrial operations.

In the judgment of the survey team, the charges of kickbacks and other irregularities insofar as they relate to American personnel are exaggerated. U.S. technicians were observed to base specifications on which invitations to bid were sent out on information contained in a manufacturer's catalog, not because of any desire or incentive to favor that manufacturer but merely because they were not experts in the particular item and had no other source of technical information. We had contact with most U.S. exporting firms represented in Korea and, on the basis of information supplied by them, made inquiries concerning a number of transactions. In each such instance the apparent irregularity seemed to be due to the lack of knowledge on the part of an official or to a procedural failure rather than to bribery or influence.

The survey team cannot state that after thorough investigation the awarding of contracts for Korean imports was found to be free from kickbacks. We can say, however, that we gave attention to the matter, found no such cases ourselves, and after discussing the situation with representatives of U.S. business firms in Korea, we were convinced that a number of charges reflected the emotional reaction of unsuccessful bidders rather than information known to the complainant.

The U.S. effort to underwrite and accelerate the economic development of Korea appeared to the survey team to be beginning to move. The basic procedures utilized by the United States and by the Government of Korea for providing economic assistance make elaborate bureaucratic control necessary. The controls and procedures now in effect do not prevent misapplication of U.S. assistance and do retard the program because of the delays involved in obtaining approval of the various governmental units involved. The answer does not appear to be in the direction of tighter controls and more expert reviews.

If it is possible for the United States with the cooperation of the Korean Government to redirect its policies and procedures so that the prudence and self-interest of the entrepreneur can replace the alertness and skill of the government official in policing the economic aid program, the United States may reasonably expect better results at the current rate of expenditure.

Unless a basic revision of U.S. operations can be brought about, a reduction in the rate of U.S. obligation of funds might put less strain on the bureaucratic machinery and consequently do as much good as is attained at the present rate.

*Policies of Korean Government retarding economic development*

The survey team noted two major instances in which the policies of the Korean Government appeared to retard economic development and to add to the cost of the mutual security effort as well as to diminish its effectiveness.

*Unrealistic exchange rate.*—The official rate of exchange is 500 Korean hwan per U.S. dollar.[1] Estimates received by the survey team from informed sources as to what the rate should be in terms of purchasing power ranged from 1,200 hwan per $1 to 1,600 hwan per $1. More dollars are obtained by Korea at the official rate (500:1) than any other, although there are at least five other legal rates at which more hwan are exchanged per $1.

On October 29, 1959, the following legal rates were quoted unofficially in Seoul:

| | *Hwan per $* |
|---|---|
| Export dollars for Japan | 1,250 |
| Export dollars for other areas | 1,200 |
| Military supply dollars | 1,105 |
| Service dollars | 1,005 |
| Missionary dollars | 900 |

These rates are for dollars derived from various sources (exports of rice, supply of bus service and waiters to U.S. forces, and from U.S. contributions for missionaries in Korea) which are sold by the Bank of Korea to importers. The right to import designated items is auctioned by the Bank of Korea. The bidder willing to pay the highest price in hwan for a commodity gets the right to import it. Commercial imports are also subject to a tax of a minimum of 150 hwan per dollar, plus whatever additional premium in hwan above

[1] Since the visit of the survey team, the following change has occurred in the situation: A currency stabilization agreement between the United States and Korea provides that whenever the price index in Korea rises by a certain amount, the rate at which hwan will be exchanged for dollars will be adjusted according to an agreed scale. Such an adjustment became necessary in late January 1960. As a result, the rate is now 650 hwan to $1. The new rate still does not reflect the purchasing power of the hwan, and the evils of the multiple rate system persist. The criticism of the 500 to $1 rate contained in the report appear to retain its validity even though this minor improvement has taken place.

the official rate, plus tax, the importer pays. The price reflects the type of import for which each category can be used as well as its status with respect to the import tax, among other considerations.

All hwan purchased by U.S. GI's and civilian personnel are at the 500 to $1 rate as are all deposits of counterpart (payments into the joint U.S.-Korean account after U.S. commodities are sold to Korean businessmen).

This unrealistic exchange rate is bad for several reasons:

First, it adds to U.S. costs in Korea. Our soldiers and other personnel pay too much for what they buy. The counterpart account is used to finance part of the budget of the Korean Government and also to finance economic development. In both instances our dollars provide a smaller number of hwan than they should.

Second, and of greater overall significance, this artificial rate isolates the Korean economy from the forces of world competition. As a result, there is no economic pressure directing U.S. investment in Korean economic development into industries which make the best use of Korean resources and are most likely to pay their own way whenever it becomes possible to reduce or terminate the present subsidies and protection on which the Korean economy depends.

Under present conditions the ability of a Korean exporter to sell in world markets at a profit does not depend on his costs as compared to competing firms in other countries, but only on the rate of exchange at which the foreign currency he receives is converted into hwan. He can afford to sell at a very low dollar price abroad if he gets enough hwan for the dollars received.

The situation is also unfavorable with respect to domestic manufacturing. Korea, as is the case in any country, should expect ultimately to produce for itself those items for which its resources and skills are best adapted and should import those items which can be produced most advantageously in other countries. Under the present exchange rate situation, these economic tests are lacking. Any manufacturer in Korea can make a profit if the exchange rate for the materials and the machinery he imports is favorable. If he can buy raw material at 650 hwan per $1 and sell his finished product at hwan prices reflecting a 1,200 hwan per $1 rate, he is completely insulated against the forces of world competition.

The result of the exchange rate situation is that industrial and commercial development in Korea is directed by judgments of Government officials and by Government policies rather than by considerations of competition. The result could be an industrial development dependent entirely on protection against foreign competition and an agriculture requiring subsidy payments to farmers while surpluses are exported at prices below the domestic level.

A further evil of the current situation is that it makes even more cumbersome and time consuming the bureaucratic procedures which handicap commercial enterprise and industrial development. A single, realistic exchange rate would simplify procedures and would tend to direct the attention of businessmen toward the profits to be made from commercial operations rather than from outsmarting the bureaucrats.

*Objections to exchange reform.*—U.S. officials recognized the defects of the present situation although they were tolerant of it and did not approve of immediate or comprehensive action to correct it. They reported that the Government of Korea opposed changing the exchange rate primarily because of considerations of national pride. The Government does not want to admit officially that its money has declined substantially in value during recent years. A consideration not emphasized was the likelihood that the Koreans believed that more dollars of U.S. aid would be made available to Korea at the 500 to $1 rate than at a 1,200 hwan to $1 rate.

U.S. officials pointed out that a national election was to be held in Korea in April (changed to March since the visit of the survey team) and it was politically impossible to undertake a major reform of this nature until after the election.

*Korean embargo on trade with Japan.*—During June 1959 the Government of Korea placed an embargo on all trade with Japan. This action was taken in retaliation for the agreement between Japan and North Korean authorities to repatriate Koreans living in Japan to North Korea. The embargo has added to the cost of U.S. aid to Korea and has retarded Korean economic development.

During fiscal year 1958 the International Cooperation Administration paid for $32,405,000 worth of commodities bought for Korea in Japan. The most important was fertilizer ($12 million) of which sulfate of ammonia constitutes the largest amount. This represented about 20 percent of the total ICA-financed fertilizer for Korea. ICA regulations require that procurement be made at the lowest price available. For many items, including substantial quantities of fertilizer, Japan has been the cheapest source of supply. After considerable delay, the Koreans relaxed the embargo on fertilizer and permitted the purchase of some sulfate of ammonia in Japan. Otherwise the embargo is still in effect.

The survey team found that a key project being financed by ICA is the rehabilitation and construction of the overall power transmission system. Much of the equipment for this project was being procured in Japan, and one U.S. official estimated that deliveries of about $4 million were held up by the embargo. The direct cost to the United States of having deliveries of shipments for which U.S. funds have been obligated is less important than the indirect cost of the delay in rebuilding power transmission facilities. Many industries in Korea have inadequate power, and the generating plants built since the war cannot be used to best advantage.

The embargo does not have a significant impact on the economy of Japan since Korea is a small market. It hurts Korea and it hurts the United States.

U.S. officials took the position that about all that can be done is to negotiate and wait.

It is U.S. policy in Korea not only to provide sufficient economic assistance so that Korea can maintain a military force, together with a small U.S. force, adequate to defend the armistice line but also to push the development of the Korean economy so that Korea may become increasingly able to support itself.

Korea can never maintain a decent standard of living for its people if it isolates itself from the world and lives off its limited natural resources. The future welfare of Korea depends on making a place for itself in the world in which the abilities and energies of its people can be utilized in agriculture, industry, and commerce.

Japan complements the economy of Korea to a greater extent than any nation and long association has made the language barrier less difficult than in the case of other nations. It would be too much to expect Korea to forget the past and to integrate itself into the economy of Japan. At the same time it should not be too much for the United States to expect that the Government of Korea not aggravate or exploit the anti-Japanese sentiment of its people, or that the Korean Government do all it can to facilitate its own economic development and to lighten the cost of its rehabilitation to the United States, its principal benefactor.

*Future economic aid requirements*

Economic aid to Korea has been related to a number of specific objectives. About 50 percent of it has produced local currency which has been used to underwrite part of the budget of the Korean Government. About 35 percent of the Korean budget is spent on the Korean armed forces. Unless the United States is willing that the expenditures of the Korean Government for its military forces be reduced, economic assistance to underwrite the Korean budget presumably should be maintained at a level sufficient to produce the necessary hwan.

The balance of payments of Korea is more unbalanced than that of any other country in the world. The United States has to underwrite the deficit if the Korean economy is to operate; otherwise imports of fuel, raw materials, and foodstuffs would stop.

In this area, the intransigence of the Korean Government on the exchange rate, the embargo with Japan, together with the continuation of procedures which substitute government controls for commercial incentives, result in a situation in which it takes more U.S. dollars to meet the balance of payments deficit than would be necessary if the Korean Government were more cooperative and if the procedures for administering U.S. assistance could be revised.

The portion of economic assistance devoted to projects—that is, to financing specific factories, public utilities, or other activities involving capital investment—has been reduced in recent years, the 1960 level being about half the 1958 level. The observation of the survey team indicates that existing procedures for using project funds are not as effective as they should be and that money made available for economic development projects is less likely to produce the desired results than money provided for budgetary support or to pay for commodity imports.

U.S. economic aid money would accomplish more in Korea if a realistic rate of exchange were established and if economic relations with Japan were encouraged.

The United States should not attempt to offset, by putting up more money, the handicap imposed on economic development by the Korean Government. It is unlikely that a healthy economy capable of paying its own way can be developed while these handicaps persist. The United States might well limit its economic aid to the level necessary to maintain the present rate of production and standard of living, eliminating capital investment for future production until the Government of Korea is ready to remove these obstacles to long-range economic development.

## THAILAND

The economic situation in Thailand is markedly different from that in Korea, and the U.S. economic assistance program for Thailand differs substantially in nature and magnitude.

The exports of Thailand (rice and rubber are the two largest) are nearly sufficient to pay for Thailand's imports so that the balance of payments problem is not of major importance. The domestic revenues of the Thailand Government are almost adequate to meet its budget even when the costs in its own currency of its expanded military program are included.

Eighty to ninety percent of the people own their own land, the average holding being about 10 acres. The country has never been a colony, and there is reported to be none of the anticolonial resentment which is characteristic of some other countries in southeast Asia. The Government of Thailand has continued a long tradition of seeking to improve the lot of the people. Reforms and improvements for the benefit of the masses have been initiated at the top. There is apparently no significant expressed or pent-up sentiment demanding that the Government do something for the people.

The economic assistance program for Thailand is roughly one-tenth that of Korea, although the countries are of about the same population. The program involves supplying of technicians (agriculture, education, highways, etc.) by the United States, as well as the underwriting by the United States of the local currency costs of a variety of projects regarded as of key importance to the economic development of the country. In addition, loans aggregating $150 million have been provided by the World Bank, the Export-Import Bank, and the Development Loan Fund, the largest portion being for power development.

Thailand is stongly oriented toward the West, outlaws the Communist Party, and realizes the threat to its security which would result if the Communists succeeded in taking over any of its neighboring countries, particularly Laos which borders it on the north.

U.S. defense support assistance to Thailand arises as a direct consequence of the requirements which underlie our military assistance program. Thailand occupies a position of strategic importance, particularly since the only supply route to Laos is through Thailand, and requires U.S. assistance to build up military forces capable of defending itself. The Government and the people of Thailand are aware of and share in the desire of the peoples of the less developed areas for a significant improvement in their economic situation as soon as possible. The Thais believe that since they are committed to our side (the headquarters of the Southeast Asia Treaty Organization is at Bangkok) and since the United States has been generous in its economic assistance to nations which follow a policy of neutralism, there can be no hesitancy on the part of the United States to assist with the economic development of Thailand.

*Accomplishments*

Since Thailand is (by Asian standards) a prosperous country, much of the evident development which is going forward is not attributable to U.S. economic aid. Nevertheless, the accomplishments of the mutual security program are impressive. The death rate from malaria has been reduced 85 percent. There are 5,000 students at the Bangkok Technical Institute, from which 1,200 skilled craftsman and technicians will graduate in March 1960. This school has been built from scratch since 1952, mostly at Thai expense but with U.S. technical assistance.

The United States has financed the construction of 550 reinforced concrete bridges throughout the country. The Friendship Highway, approximately 100 miles long, has been completed at a U.S. cost of about $14 million and an East-West Highway of about the same length for which about $12 million has been obligated is in process of construction.

*Bogged-down projects*

The survey team regarded two major projects for which funds had been obligated for some time without being utilized as being significant.

*Aviation overhaul and maintenance base.*—An obligation of $3,580,000 of fiscal 1957 defense support funds (made available on a loan basis) were obligated to finance the construction and equipment of an aviation overhaul and maintenance base at Bangkok Airport. At the time of the survey team's visit $3,451,614.47 of the funds were as yet unsubobligated; that is, no contracts have been let to be paid from these funds or other direct commitments made for their use.

Bangkok is so located that the major airlines across southeast Asia stop there. It was believed that a large, well-equipped overhaul and maintenance facility at Bangkok would contribute to the development of Thailand's commerce as well as serve local and regional airlines. After the funds were obligated, the attitude of the Government of Thailand toward the project changed, in part at least, because there was a shift in the control of the Thai Government. Nothing has been done since toward building or equipping the facility, and during much of the time the Government of Thailand apparently has indicated no interest in going ahead with the project along lines acceptable to the United States.

The U.S. authorities say they are still convinced that the project is a good idea and that negotiations are in progress to carry it forward.

The responsible U.S. officials should not be criticized for failure to further commit U.S. funds until the plans for the project were fully worked out and the interest and backing of the Government of Thailand were assured. The willingness of the International Cooperation Administration to hold a sum of $3.5 million for this purpose rather than divert it to other more immediate and presumably more urgent uses, either in Thailand or elsewhere, appears to support the belief that certain aspects of the mutual security program have been more liberally financed than necessary.

It seems clear in this case that during the fiscal years 1958 and 1959, at least, the International Cooperation Administration was not so short of funds to meet priority demands that it reviewed progress in projects all over the world to see whether or not the funds committed to some might not be reclaimed to meet new and pressing requirements. This is a case of what the General Accounting Office has called stockpiling obligations.[2]

[2] Since the return of the survey team, the International Cooperation Administration reports that funds for this project are being deobligated.

*Southeast Asia regional telecommunications project.*—An obligation of $27,600,000 of fiscal 1958 funds has been established to finance a regional telecommunications project for Thailand, Viet Nam, and Laos. Of this total, $17 million was to be spent in Thailand. At the time of the survey team's visit, the unliquidated obligation for Thailand was $12,855,564 and, more important, $6,835,000 was unsubobligated (that is, contracts have not been let or other direct commitments made for its use).

Of the total obligation, $21,900,000 was from the President's Special Fund for Asian Economic Development, which was intended to finance regional projects and which the International Cooperation Administration has found it difficult to find uses for.

Early in 1957, the International Cooperation Administration entered into a contract with an engineering firm at an estimated cost of $1,852,050 to develop a plan for this regional project. The performance of the contractor was unsatisfactory, and, although a complete plan for the project had not been developed, $21,900,000 of the President's Asian Fund was obligated in June 1958. It appears that a requirement in the authorizing legislation that the Asian Fund would be available only until June 30, 1958, may have been a reason for an obligation of this amount at that time.

A new contract has been let and there are indications that the project is getting underway.

*Major administrative difficulties avoided in program for Thailand*

The relatively small size of the economic aid program for Thailand, together with its nature, permits it to be carried on without getting into many of the problems confronted by those administering the Korean program. There is no financing of industrial or commercial projects, or of general commodity imports.

Aside from loans from the World Bank and the U.S. lending agencies, referred to above, and the supplying of U.S. technicians, U.S. aid consists primarily of generating for the Government of Thailand additional Thai currency (bahts) to meet the local costs of the individual projects being carried on (approximately 50) in the following fields: agriculture, industry and mining, transportation, health and sanitation, education, public administration, community development and housing, plus a half-dozen miscellaneous projects.

The United States generates the local currency for these projects by paying for a portion of the Thai imports of petroleum products (there is no domestic production). These bahts paid by the importers for the kerosene, gasoline, etc., brought in are deposited to a counterpart account owned by the Government of Thailand. The baht are released for purposes agreed to by the two Governments. In Thailand, the practice has been to release currencies to meet the needs of projects which it was agreed in advance would get the benefit of the baht generated by the import program. The principal basis for determining the amount of U.S. financing of imports is the estimated baht requirements of such projects. We pay for enough petroleum imports to produce the required number of baht. As a consequence there is no screening of applications for imports and no determination of the desirability of building manufacturing plants.

*Highway projects*

The Friendship and East-West Highway projects and the highway bridge project have been criticized as being too costly, in part, because they are built to U.S. standards while cheaper construction would meet local traffic demands. In addition, it has been charged that the East-West Highway begins nowhere and ends nowhere, even though it runs between a main rail line and a large, fertile valley.

The survey team observed part of the Friendship Highway and a number of highway bridges. We did not get to see the East-West Highway. We did not have time to make a detailed study of the highway projects. U.S. officials state that both of the above projects are links in a contemplated countrywide road system to be financed by the Government of Thailand. They served demonstration and training purposes. They were carried out by U.S. contractors, whose costs were high because they were pioneering in a new country where local services, facilities, and skilled personnel were not available. The East-West Highway crosses mountainous country. The United States undertook to build this most difficult and expensive segment of a major east-west road in the belief that it might overtax the resources of the Government of Thailand to do this part of the job.

The way in which economic aid is supplied to Thailand raises a question as to the adequacy in its present form of section 517 of the Mutual Security Act. This section requires, among other things, that mutual security funds to finance assistance which requires technical or financial planning be obligated only after plans and cost estimates for the projects for which they are to be expended have been completed. The purpose of this provision is to prevent obligation of funds to finance an entire project by agreement with a recipient government to do something and then undertake the surveys, planning, and negotiation necessary before final design and construction can begin. Before the enactment of section 517, mutual security funds were frequently tied up for periods of 3 to 5 years before a project got started because of the time required for planning, negotiation, and preliminary legislative action by the recipient government.

Future highway construction is to be carried on by the Thai Government which will handle all of the operations. The United States will contribute to the cost of the program by supplying bahts. These bahts will be obtained as a result of supplying petroleum products to Thailand. Section 517 clearly does not apply to commodity procurement such as is involved in paying for gasoline. On the other hand, the highway projects for which the bahts are to be spent are clearly susceptible to the kind of advance planning and cost estimates contemplated by section 517. If, as U.S. officials in Thailand stated to be the case, the controlling purpose of financing dollar imports is to generate local currency for specific projects, it would be just as wasteful of U.S. dollars to have them spent for such imports (gasoline) and then have the expenditures delayed for several years while engineering surveys and land condemnation proceedings were undertaken.

United States officials in Thailand said that—as a precondition to approving use of baht counterpart for projects—they have required and intend to continue to require advance planning and cost estimates. This would not prevent, however, the expenditure of U.S. dollars before the completion of the plans and cost estimates for the various projects to be financed with the foreign currency generated by the

U.S. dollars. The Foreign Affairs Committee should give consideration to the desirability of revising the language of section 517 to make clear its application in situations of this kind.

The observations of mutual security construction not only in Thailand but in other countries of Asia by the survey team indicate that the United States has not yet found the answer with regard to proper standards for construction not only of highways but also for military installations. It is clear that in countries which to a considerable extent are making a transition from the oxcart to the jet age, traditional architectural and engineering standards are not adequate. At the same time, U.S. traffic loads and U.S. designs which reflect U.S. cost factors and government regulations are almost sure to be more costly than necessary. There are instances where U.S. standards have been followed unnecessarily. On the other hand, it is probably better to err in the direction of building too well than too cheaply. The future prestige of the United States would suffer if our highways and bridges fail to stand up.

*Future requirement for economic aid*

There is no economic or military gage against which the requirements for economic aid to Thailand can be measured. It cannot be said that a drastic cut in economic assistance would cause the economy of the country to collapse. Neither can the size of the Thai military forces be regarded as expanding or contracting in accordance with the magnitude of our contribution to the support of the economy of Thailand.

The scale of U.S. economic assistance to Thailand is determined by political considerations. If U.S. economic aid were terminated, it would be interpreted as indicating an end of friendship for and confidence in Thailand on the part of the United States. The consequences to our military program would be disastrous. The survey team saw no reason why U.S. economic assistance should be increased. Neither did we see any basis for recommending that it be curtailed.

## IRAN

The scope and nature of the U.S. economic assistance program for Iran have been adjusted substantially over the years to meet changing conditions. Although Iran is one of the less developed countries in many respects, it is a major producer of petroleum and its oil revenues should be sufficient in a world at peace to provide the basis for a better way of life for its people and for political stability.

The program started in 1951 as a point 4 technical assistance operation. U.S. economic aid was rapidly and substantially increased following the overthrow of the Mosadegh regime, reaching an annual peak of $85 million in fiscal year 1954. U.S. assistance was progressively reduced in the years following fiscal year 1954.

When the revolution in Iraq occurred in July 1958, the Government of Iran felt considerable apprehension not only as to a possible Communist-instigated attack from Iraq but also of a renewal of aggression across its 1,500-mile border with the U.S.S.R.

The United States gave assurances to Iran at this time of a substantial expansion of our military assistance, together with support for the military budget of the Government of Iran, in view of the inability of Iran to increase its Government revenues rapidly enough to meet its accelerated military expenditures.

At the present time, about half of Iran's substantial oil revenue finances the Government and the National Iranian Oil Co., and the other half is utilized to finance the 7-year development plan. The use of the oil revenue to improve the lot of the Iranian people has been a national issue and is an established national policy of such significance that the United States concurs in the judgment of the Government of Iran that a diversion of petroleum revenues from development to military purposes would be undesirable, even considering the current danger.

As a result of these factors the present mutual security economic program for Iran consists primarily of budgetary support (United States-financed Iranian imports which are sold for Iranian currency—rials—which are then turned over to the Government of Iran to help finance its military budget) and a small technical cooperation program, which provides technical guidance in such fields as agricultural extension, a mineral survey, civil aviation, nursing training, and public administration. In addition, Iran has in recent years been granted loans from the World Bank, the Export-Import Bank, and the Development Loan Fund of some $335 million.

Iran, particularly Tehran, the capital, gives evidence of prosperity and rapid economic expansion. Tehran is enjoying a building boom and the streets are filled with new automobiles, including many U.S. makes and a liberal sprinkling of Cadillacs. A number of large U.S. manufacturers have recently opened factories in Iran. There are no import controls and anyone can bring in anything he can afford.

It is difficult to evaluate the accomplishments of past U.S. economic aid to Iran. There are a considerable number and variety of U.S.-financed projects which have been completed and are in operation. There is also evidence on every hand of the accomplishments of Iran's own development program carried on by its Plan Organization (a separate government agency) and financed with oil revenue. There are, on the other hand, a significant number of U.S.-financed projects which have not turned out well, a few of which will be discussed below.

In connection with the Mosadegh crisis, the United States undertook a large economic aid program for Iran on a crash basis. Iran did not go Communist, and it can be argued that this establishes the success of the program. That the program was badly administered and that U.S. money was wasted have already been well documented by the Subcommittee on Foreign Operations and Monetary affairs of the Committee on Government Operations and by the General Accounting Office. The extent to which the present vigor of the Iranian economy is attributable to past U.S. economic assistance would require a precise analysis which the staff survey team could not undertake.

*U.S.-financed projects that have not turned out well*

The staff survey team did not attempt to develop a score sheet on which all projects for which U.S. funds had been obligated were listed and the completion, success, or failure of each recorded. As far as we could learn, no one has ever made such a tabulation, although it would appear to be worthwhile. The projects cited here came to the attention of the survey team in various ways while the survey team was giving its primary attention to the military assistance program.

*Excess U.S.-financed farm machinery.*—There are substantial quantities of U.S. farm implements brought into Iran during the Mosadegh period for demonstration purposes, which have never been used and much of which probably never can be used. The ICA Mission Controller has end-use checked $1,834,799 of this equipment and found that $800,000 of this had not been used as intended. A total of $7 million of this equipment was brought in. If the same percentage holds, the total of unused equipment would be $3 million or more.

An unimpeachable non-Government observer reported that he visited an agricultural experiment station in the Gorgan area and found a lot of U.S. farm machinery still in crates and unassembled. This was confirmed by the ICA Mission Controller.

Much of this surplus has been collected in warehouses in Iran, and a program is underway for disposing of it. It included hay rakes and hay bailers—no hay; manure spreaders—manure is and has been for centuries burned for fuel; plows and scrapers which require heavy horses to pull them—no such draft animals in Iran.

*Isfahan workers housing and workers recreation center.*—During its visit to Isfahan, one of Iran's major cities, the survey team inspected a workers' housing project and saw a workers' recreation center, both of which have been United States sponsored and partially financed with U.S. funds and neither of which has turned out as hoped for.

The housing project consists of 204 brick houses virtually completed—window glass was the major job yet to be done—with indoor plumbing and electricity. The project agreement for this housing was signed in 1953 and presumably funds were obligated at that time, although the agreement was in general terms and did not specify the number or location of the houses to be built or the funds to be spent at each location. The signing of the agreement probably had some beneficial impact at the time, but the houses have not yet contributed to the well-being of the people of Iran.

Construction of the houses did not begin until 1957. The construction of the project is in the hands of the Ministry of Labor of Iran, although the United States has always been responsible for approving everything done and for seeing that it moved forward. There is an impressive water tower, but the well to supply water went dry while being tested. Another well was being put down during our visit and U.S. officials are sure it will be adequate.

More serious is the sewage problem. The houses are connected with a completed sewage disposal system which includes small individual cesspool-type tanks about the size of a barrel which drain into open ditches running between the houses. Although such an arrangement is not entirely contrary to Iranian traditions, nothing exactly like it apparently has been tried before. Last August, after the present system was completed, the U.S. Director of the ICA Mission had a survey made by sanitary engineers and decided that the whole thing must be done over. No evidence of sewer reconstruction was visible during our visit.

The impact of seeing these fine houses, to outward appearances virtually ready for occupancy, standing idle over a protracted period might be balanced against the initial impact of the signing of the project agreement.

The workers' recreation center, appearing to be ½ to 1 mile away, is finished and in operation. It is a large and attractive brick building.

In response to inquiries as to what it was used for, the survey team was informed that it was not used as much as it should be and that U.S. personnel were working hard to find ways to increase its usefulness.

*Deficiencies in U.S. administration*

*Lack of overall responsibility for highway program.*—Iran is a large country and its major agricultural areas and industrial centers are frequently separated by distances of 300 to 500 miles. Iran has a good railway system but highways are a major deficiency. The United States is financing the development of Iranian highways in a number of ways.

A small amount of U.S. grant aid has been provided annually for a highway maintenance project under which maintenance shops and equipment have been provided.

The Export-Import Bank has made loans aggregating $11 million to supply highway maintenance equipment and to finance a contract under which the U.S. Bureau of Public Roads engineers render advisory assistance on highway maintenance to the Ministry of Roads and Communications of Iran.

The Development Loan Fund has made loans for highway construction in Iran to a total of $33.5 million and the World Bank has made a loan of $72 million for highway construction.

Additional loans are being sought by Iran for its highway program from all three of these lending agencies.

Responsibility for highways is divided between two agencies of the Iranian Government—the Ministry of Roads and Communications and the Plan Organization which spends the portion of the oil revenues allocated for development.

The Plan Organization pays better salaries and apparently has a better staff. The Ministry of Roads and Communications is supposed to be primarily responsible for highway maintenance and to be expanding so as ultimately to take over road construction.

U.S. officials in Iran associated with the highway program emphasized that the highway maintenance program was of key significance and this view was confirmed by Washington officials since the return of the survey team. The argument is that there is little point in building highways unless they can be maintained. The validity of this position has been demonstrated in Iran where a hard surface road built during World War II between the Persian Gulf and the U.S.S.R. to carry war supplies to Russia has disintegrated to the point that people now prefer to drive over the desert rather than the old road.

In recognition of the importance of highway maintenance, the Export-Import Bank made its first loan in 1956 for this purpose and arranged for the U.S. Bureau of Public Roads to provide advisory and training service.

The observations of the survey team indicated that the status of the highway maintenance program was not satisfactory. A visit to the Tehran central maintenance shop showed that substantial quantities of U.S.-financed (mostly Export-Import Bank loans) machinery and tools were on hand which were not in use. Some had been installed but without adequate power to operate them; others—including the machinery for a tire recapping plant—were still in crates because there were not enough buildings to house them.

The reason given for not providing buildings was that the whole establishment was going to move to a new site which, at the time this is written, has not yet been purchased. Nevertheless, construction of a diesel powerplant to make additional power available at the existing site was going forward. There was evidence that the Ministry of Roads and Communications did not keep adequate control of the use and maintenance of U.S.-financed equipment and that the services of U.S. advisers were not being utilized.

We heard the opinion expressed that additional loans were being sought to buy new equipment to replace equipment financed by the United States which had been lost or had become unserviceable through neglect and improper maintenance. There appeared to be a general opinion that until the relationship between the Ministry of Roads and Communications and the Plan Organization could be straightened out, particularly until the salary scale in the Ministry could be increased to the Plan Organization level, the highway program would never be successful.

Our inquiries concerning the Iranian highway program brought out what appears to be a significant deficiency in the administration of U.S. economic assistance. No one in the U.S. mission in Tehran had in mind the story of the overall program for highway development or felt responsibility for whether the whole operation, including the activities financed by the various loans, produced the desired result. At a meeting of U.S. officials in Tehran, called at our request to give us a comprehensive picture of the highway program, we were told that the only one in Iran who could answer our questions was a U.S. economist working for the Plan Organization under a contract with Harvard University. This individual proved to be capable and well-informed, but he was serving the Government of Iran, not the United States.

A followup with U.S. agencies in Washington has indicated that there is no agency or individual here who accepts authority over or responsibility for the highway program as a whole. Bureau of Public Roads officials accept responsibility for the maintenance program and express concern as to its current status. Export-Import Bank people say they have a broader interest than merely whether or not their loan is repaid on time (it is guaranteed by the Government of Iran and thus indirectly has the backing of the oil revenue) but that they have nothing to do with other lending agencies and no direct responsibility for the success of the mutual security effort in Iran.

The Development Loan Fund indicated that it recognized the importance of the highway maintenance program and cited the fact that the Development Loan Fund has not only insisted that part of its loans be used for maintenance equipment but also is utilizing the Bureau of Public Roads personnel to certify the technical adequacy of roads being constructed. The officials of the Development Loan Fund reported that they use the ICA personnel in Iran in evaluating a loan application and that they felt that the highway maintenance was going as well as could be expected. The Development Loan Fund is a lending agency and is not responsible for diagnosing the basic ills of a country or prescribing a course of treatment.

ICA/Washington officials said that they felt no overall responsibility for the highway program in Iran and were not well-informed about it. They knew nothing about the current difficulties in the central maintenance shop in Tehran. The opinion was expressed that ICA lacked both justification and personnel to keep track of operations not financed with ICA funds.

Representatives of all the agencies agreed that the development of a capability to maintain highways was of vital importance. There appeared to be no procedure for keeping track of the highway program as a whole, and no one who felt it to be his job to see that the situation in Iran was straightened out before further loan applications were considered.

*Possibility of adjustment to existence of Harvard contract.*—Harvard University has entered into a contract with the Plan Organization (the agency of the Iranian Government which carries on development programs financed from oil revenue) to provide a planning staff for that agency. The Ford Foundation finances the contract. Under this arrangement, 27 Iranian economists and other experts who had been educated in the United States and elsewhere and were living outside of Iran have returned to Iran together with 8 U.S. and European economists. The survey team was favorably impressed with the capacity of and the work done by this group.

The availability to the Government of Iran of a staff of this caliber presumably could make a difference in the organization and operation of the U.S. mutual security mission in Iran. In other countries it is frequently necessary for the U.S. staff to provide planning guidance and perform technical services in connection with the formulation of development programs. Since in Iran the Plan Organization provides this service, it should be possible to adjust the functions and operations of the U.S. mission to reviewing and evaluating programs prepared by the Plan Organization for which U.S. assistance is desired.

The survey team, after discussing this matter with U.S. officials, came away with the impression that neither the functions nor the procedures of the U.S. mission had been adapted to take full advantage of the presence in Iran of a planning staff of the size and competence provided under the Harvard contract.

*Failure to enforce section 142(b) of the Mutual Security Act relating to deposit of local currency.*—Section 142(b) of the Mutual Security Act provides that when defense support is provided on a commodity basis in a manner such that sales proceeds result, the recipient nation must agree to deposit in a special account an amount of its own currency equal to such proceeds. It requires further that the country shall make available such portion of this account as may be determined by the President to be necessary for the requirements of the United States.

In most countries receiving defense support it has been International Cooperation Administration practice to have the recipient nation enter into a comprehensive agreement covering all of the conditions of eligibility for assistance required in sections 141 and 142 of the Mutual Security Act, including the provisions relating to local currency. In Iran this has never been done. The eligibility of Iran for military assistance and for defense support has been established to the satisfaction of U.S. officials by exchanges of correspondence dealing with specific aspects of the program.

Upon learning that there was no basic agreement with the Government of Iran requiring the deposit of local currency, the survey team asked the Mission Controller for the mutual security program to submit documents showing that the requirements of section 142(b) were being complied with. As a result of such documents as were submitted and of discussions with U.S. officials, the survey team left Iran convinced that the terms of section 142(b) were not being met.

During the period when this subject was being discussed by the survey team with the Chief of the ICA mission and the ICA Controller in Iran, the United States submitted to the Minister of Finance of Iran (November 28, 1959) a letter outlining the terms under which defense support would be made available to Iran for the fiscal year 1960, which apparently conformed to the requirements of section 142(b). Since returning to Washington, the survey team has been informed that an exchange of letters has taken place with the Government of Iran which constitutes an agreement for the fiscal year 1960 defense support program fully in accordance with section 142(b). This agreement is subject to action by the Iranian Legislature in March 1960; pending this action a provision satisfying the requirements of section 142(b) has been included, by agreement with the Iranian Government, in each procurement authorization financed from fiscal year 1960 defense support funds.

After getting back to Washington, the survey team continued its inquiries concerning past compliance with section 142(b) in Iran. The situation is complicated by the fact that there have been separate exchanges of communications relating to the matter each year. The International Cooperation Administration in response to our inquiries has stated that deposits of counterpart in connection with fiscal year 1956 and 1957 defense support grant aid were made on the basis of "commensurate value" rather than "sales proceeds," a smaller amount than required by law. At the same time, a substantial amount of defense support in these years was provided on a loan basis and deposits of local currency on a "commensurate value" basis were made against the loans although such deposits were not required by law. The end result was that more local currency was deposited by the Government of Iran than the law requires even though the counterpart attributable to the grant portion of aid in those years was deposited at a lower rate than was required by section 142(b).

The International Cooperation Administration acknowledges that for fiscal years 1956 and 1957 no deposits of local currency for U.S. use were made as required by section 142(b).

It may be argued that since the basic purpose of the defense support to Iran is budgetary support—that is, to supply local currency to pay part of the cost of maintaining the Iranian armed forces—it does not make sense to require the Government of Iran to agree to make a certain percentage of such currency available for U.S. operating expenses in Iran. In effect, such an agreement merely requires Iran to give back to us a predetermined portion of what we gave them.

Nevertheless, the language of the law is clear and there is no authority in section 142(b) for those administering the program to use their judgment as to what is reasonable. The failure of the International Cooperation Administration to comply with the legal requirements for the deposit of local currency is not significant because of its direct cost to the United States (whether or not we would have made more aid available if deposits had been made to meet U.S. operating expenses is uncertain). It is significant, however, as an indication of the lax administration which has been characteristic of economic assistance operations in Iran.

*Future requirements for economic assistance*

Iran is a country which has already made significant progress in economic development, which fact, together with its substantial petroleum resources, should indicate that grant economic aid should be required only on a temporary basis. The survey team noted two factors affecting the need for such assistance in the immediate future.

*U.S. share of military budget of Iran.*—Most of the U.S. economic assistance currently going to Iran is for budgetary support justified on the basis that it was mutually desired that Iranian military forces should be expanded more rapidly than the revenues of the Government of Iran could be increased. The United States has every right to expect that its share of the military budget of Iran should be rapidly reduced. This is particularly true since it appears that a significant increase in Government revenues could be obtained if recommended tax reform measures were enacted.

*Threatened balance of payments deficit resulting from inflation.*—The survey team found inflation well underway in Iran. Inflation was reported to have begun in May 1957, when the gold reserves of Iran were revalued with a substantial profit resulting. This was followed by a rapid expansion of credit and a marked rise in the price level. As a result of inflation, Iran is an attractive market in which to sell and a dear market in which to buy. Consequently, exports are down, imports are up, and the foreign exchange reserves of the country are rapidly dwindling.

The opinion was expressed to the survey team that the time had passed when moderate restraints (such as adjustment of the interest rate) could be effective and that drastic measures (including control of imports) were now necessary.

Such drastic measures for dealing with the situation had not been invoked during the visit of the survey team. If inflation is permitted to continue its course, there is every indication that Iran's balance-of-payments position will deteriorate to the point that the United States will be under pressure to provide economic assistance to finance imports essential to the economy of Iran.

The experience with the current inflation in Iran raises a basic question as to U.S. foreign aid policy. It is apparently generally accepted that assistance to foreign countries should be on a no-strings-attached basis and that the donor nation should not interfere in the internal affairs of the recipient. In this instance there is every reason to believe that responsible U.S. officials were aware of what was happening, including its consequences to Iran and the likelihood that the United States would ultimately be called on to repair the damage. Nevertheless, advice, exhortation, and admonition appear to have been ineffective. What are the obligations before the situation gets out of hand? What are the obligations of the United States after it gets out of hand in spite of our warnings?

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