

## Strategies of Assistance

### Geopolitical Alignment and American Aid Policy in the Cold War

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#### Abstract

There is a prevalent assumption in the literature on aid policy that geopolitical goals are distinct from developmental goals, with some studies arguing that the presence of strategic interests undermines the developmental effectiveness of economic aid. However, some of the most successful aid programs in history, such as the Marshall Plan, were fundamentally political in nature. This paper argues that geopolitical alignment conditions the developmental effectiveness of foreign aid. Allies are vulnerable to attack or coercion from the donor's geopolitical adversary, leading the donor to have a strategic interest in using aid to promote their economic development. Non-aligned states, on the other hand, do not fall within the donor's sphere of influence, leading the donor to have an interest in using aid to influence their foreign policy. Therefore, the donor's aid to allies will have a greater emphasis on development than its aid to non-aligned countries. I substantiate this claim using historical case studies of American aid to Taiwan and Egypt in the early Cold War and statistical analysis of an original dataset on U.S. aid programs in that period. Using a novel measure of geopolitical alignment and a disaggregated measure of aid, I find that compared to American allies, non-aligned countries received a higher proportion of aid in the form of soft loans that were economically unproductive. These findings shed light on the relationship between economic development and geopolitical motives in aid policy, and more generally on the role of economic development in international strategy.

## Introduction

Scholars of international relations have long recognized that differential rates of economic growth lead to structural shifts in the balance of power.<sup>1</sup> It naturally follows that the great powers should seek to alter global patterns of economic growth to serve their strategic interests. And yet there is a prevalent assumption in the literature on foreign aid that strategic interests are distinct from and may even undermine efforts to support economic development.<sup>2</sup> For example, Headey (2007) argues that multilateral aid is more effective at promoting economic growth because “bilateral donors’ desire to purchase concessions from the recipient...need not necessarily also purchase development.”<sup>3</sup> Similarly, Berthélemy and Tichit (2004) argue that “if aid responds only to strategic and political considerations, there is indeed no reason for aid to be effective in promoting growth or reducing poverty.”<sup>4</sup> This distinction between developmental and political goals reflects the assumption that political outcomes are non-economic, an example of which would be the use of aid to produce a change in the recipient’s foreign policy.

While it is beyond question that these kinds of aid relationships exist, there have been many aid programs in which economic development has played a vital role in advancing the donor’s strategic interests. The Marshall Plan supported the economic reconstruction of Western Europe, and American aid underwrote the economic recovery of Japan and the rapid industrialization of South Korea and Taiwan. In all of these cases, the United States’ pursuit of economic development was driven by American strategic interests, which belies the notion that geopolitical objectives are

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<sup>1</sup> Gilpin (1981); Kennedy (1989)

<sup>2</sup> Alesina and Dollar (2000), 33-34; Bearce and Tirone (2010); Deaton (2013), 274-289; Headey (2007), 162; Berthélemy and Tichit (2004), 253-254; McKinlay and Little (1977)

<sup>3</sup> Headey (2007), 162

<sup>4</sup> Berthélemy and Tichit (2004), 253-254

inherently inimical to economic progress. To account for this variation, I argue that the geopolitical alignment of the aid recipient is critical for understanding when economic development is supported by strategic interests and when it is undermined. Whereas much of the existing literature has focused on the impact of aid or the domestic determinants of aid policy,<sup>5</sup> I focus on the geopolitical factors that influence aid policy. The thesis of this paper is that the donor has a greater strategic interest in supporting economic development among allies than among non-aligned countries.

Geopolitical rivalry involves the efforts of a great power to maintain spheres of influence so that the actions of foreign governments do not threaten its security. Under this broad mandate fall two types of policies: defending and expanding a sphere of influence. Defending a sphere of influence entails strengthening client states that are at risk of being coerced or attacked by the donor's geopolitical rival. Economic development serves the donor's strategic interests because it entails a greater ability to finance a military burden, and the expansion of industry contributes directly to the military power of the aid recipient.<sup>6</sup> On the other hand, using aid to expand a sphere of influence entails offering non-aligned countries an incentive to align with the donor in their foreign policy. The presence of these motives affects the composition of the aid program. Although the donor may also seek to support economic development among non-aligned countries, one generally expects that development will assume a less prominent role in the donor's aid program to non-aligned countries compared to allies.

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<sup>5</sup> For the impact of aid, see Boone (1996); Dunning (2004); Burnside and Dollar (2000) and Easterly (2003). For the domestic politics of aid, see Milner and Tingley (2010); Milner and Tingley (2013); Tingley (2010); and Chong and Gradstein (2008). See also Christensen (1996), 58-69 for a detailed discussion of the domestic politics of the China Aid Bill in 1948.

<sup>6</sup> Gowa (1994)

This paper substantiates this claim through an analysis of U.S. aid policy in the early Cold War. After accounting for the strategic setting for American foreign assistance programs, I present statistical analysis of an original dataset on American aid programs that uses a disaggregated measure of economic aid and an original measure of geopolitical alignment based on declassified State Department records. I substantiate this claim further through historical case studies of American aid to Taiwan and Egypt. I argue that because Taiwan was anti-Communist and Egypt was non-aligned, the United States placed a higher emphasis on development in its aid to the former than in its aid to the latter.

### **U.S. Aid Policy in the Cold War**

After the Korean War, the United States and the Soviet Union were engaged in a competition for influence in the developing world. The Soviets had learned that Mao's revolution on the Chinese mainland was not a model that could easily be exported elsewhere, and there was a limit to the ability of the Soviets to use military force to expand their sphere of influence. Foreign aid consequently became one of the main instruments of Soviet strategy. Moscow provided economic and military assistance in the hope that aid would strengthen its diplomatic influence among countries that had not chosen a side in the Cold War.<sup>7</sup> In contrast to their aid program to their ally Communist China, in which they were so tight-fisted that they secured as much Chinese resentment as Chinese gratitude,<sup>8</sup> the Soviets provided aid to non-aligned countries like Egypt and

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<sup>7</sup> Rostow (1985), 14-16

<sup>8</sup> Barnett (1977), 28-31

India on exceedingly generous terms. Schedules of repayment extended for as long as thirty years and interest rates were low or non-existent.<sup>9</sup>

The United States responded in kind. Failure to provide assistance would give the Soviets a monopoly of influence over countries in strategically vital regions of the world. Whereas the U.S. had previously given economic aid under the rubric of contributing to mutual security, Soviet economic initiatives in the developing world created pressures on Washington to provide aid even when economic growth in the recipient would not directly contribute to American national security. While there was some substance to the claim that economic growth had a universal tendency to limit the appeal of Communism,<sup>10</sup> strategic considerations impinged on how earnestly the United States used its assistance to promote economic growth, especially when that growth required political sacrifices.

When economic growth directly contributed to American national security by enhancing the military strength of U.S. allies, it was in the self-interest of the United States to use its aid for productive ends. Given the fact that these countries were aligned with the U.S. in their foreign policy, Washington had a sufficiently strong assurance of mutual self-interest that it could exert pressure on the recipient government to adopt economic reforms without bearing the risk of alienating its ally. In other words, when the recipient was an ally, the U.S. had a greater national security interest in promoting growth and bore less of a political risk in attempting to do so.

The use of aid to cement political support featured more prominently in American assistance programs to non-aligned countries. In those cases, the United States was motivated by a desire to influence the recipient's foreign policy. Moreover, when the recipient was a non-aligned country, attempting to exercise oversight over the use of aid carried two forms of political risk.

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<sup>9</sup> Rostow (1985), 14-16

<sup>10</sup> See Rostow (1985) for further elaboration on this claim

First, the attainment of economic growth would lead to the strengthening of a country whose political allegiance in the Cold War was undetermined and hence could lean toward the Soviets in the future. Second, using aid as a lever to promote economic reform would potentially provoke resistance from the aid recipient. To the extent that the United States offered aid to non-aligned countries as a putative gesture of friendship, using aid as a lever for promoting politically contentious reforms would have been at odds with the tenor of its diplomacy. For non-aligned countries, there was a primary need to bring the recipient closer to the United States in its foreign policy, which was often at odds with the secondary goal of promoting economic growth.

From the perspective of American national security policy, there was a fundamental distinction between aid recipients on the basis of their geopolitical alignment: for allies, the United States could not achieve its strategic interests unless economic aid had the desired economic effect, but for non-aligned countries, the simple act of providing aid could secure American interests irrespective of whether or not the aid was developmentally effective. Therefore, one would expect the United States to place a greater emphasis on development in aid to allies than in aid to non-aligned countries.

In this paper, I measure the degree of emphasis that the United States places on development using the proportion of economic aid that consists of soft lending, with a higher degree of soft lending meaning a weaker degree of emphasis on economic development. By soft lending, I mean aid that is not allocated for any statutory purpose, but consists of general budget support. It is “soft” because it is not given for any specific economic purpose and entails a minimal degree of oversight on the part of the donor.<sup>11</sup> In contrast, if economic aid falls under a program with a statutory purpose, the donor can appraise the recipient’s use of that aid. Even if those

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<sup>11</sup> This definition both differs from and builds on the definition of soft loans in Baldwin (1966), 5-7.

statutory purposes are sometimes defined at an abstract level, and even if the stated purpose of aid does not always correspond precisely to how it is used,<sup>12</sup> there is still a difference between funds that the donor gives under a broad designation and funds that the donor gives with no designation at all and allows the recipient to spend as it pleases.

In the early Cold War, the statutory purposes of aid were restricted to a limited set of programmatic functions aimed at supporting the recipient's economy: offsetting the economic burden of maintaining military forces; financing development projects; extending loans to private industry; emergency relief, supporting non-governmental organizations; and technical assistance. The fact that these programs had a legally-defined purpose, as well as the fact that the appropriations process rendered them subject to Congressional scrutiny, meant that the aid agencies had considerably less freedom to use aid under statutory programs to advance goals that were not prescribed by law, such as influencing the recipient's foreign policy.

The major category of aid that did not have a statutory purpose, and which granted the United States the greatest degree of latitude in attempting to purchase the recipient's political support, was a category of lending under American food assistance with the designation "Loans to Governments." Under Title I of the PL 480 program, the United States disposed of surplus commodities by selling them abroad. The U.S. would then loan the proceeds back to the recipient country, with some loans being repayable in dollars and others being repayable in local currency. For loans repayable in local currency, there were prior agreements on the allocation of those funds. The recipient could use them to finance development projects, support private industry, support common defense, or simply accept them as a direct loan to the government.<sup>13</sup>

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<sup>12</sup> Deaton (2013), 275

<sup>13</sup> "Progress Report on the Agricultural Trade Development and Assistance Act," 476-483

Under this final category of “loans to governments,” the U.S. would not tie the loans to a specific purpose, but would rather leave the use of the funds to the discretion of the recipient. A State Department bulletin from 1958 stated that “foreign governments are also being *encouraged* to reloan some of the funds available under section 104 (g) [loans to governments] for projects involving private enterprise and investment” (emphasis added) but that “express agreements to reserve specific portions of 104 (g) loan funds for this purpose are no longer being sought in connection with current sales negotiations.”<sup>14</sup> In other words, loans to governments were a form of general budget support over which the United States did not exercise oversight. Moreover, they had generous terms of repayment; as of 1970, loans to governments constituted more than half of all of the development assistance that the United States gave to Egypt, and the sum of repayments on the principal and interest collected amounted to only about 18% of the value of the original loan.<sup>15</sup>

I argue that the preponderance of loans to governments in U.S. aid to Egypt reflected the fact that Egypt under Nasser, like India under Nehru and Yugoslavia under Tito, was a non-aligned country in the Cold War. In the absence of common strategic interests, the United States relied on loans to governments to influence these countries’ foreign policy to prevent them from aligning with the Soviet Union. Although they were categorized as development assistance, these loans are best understood as attempts to purchase the recipient’s political support rather than an attempt to promote economic growth. Evidence in support of this interpretation can be found in the fact that these loans had no statutory purpose; hence, there was no provision within U.S. aid legislation for monitoring how the recipients used these loans. Moreover, the United States provided funds to

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<sup>14</sup> *Ibid.*, 484-485

<sup>15</sup> *U.S. Overseas Loans and Grants and Assistance from International Organizations (Obligations and Loan Authorizations, July 1, 1945 – June 30, 1970)*; hereafter the 1971 Greenbook.

governments instead of private firms, which is consistent with the interpretation that the U.S. used these loans to gain political influence.

Simone Dietrich has argued that donors directly give aid to the recipient government when the recipient has a higher quality of governance, reflecting the donor's belief that the government will use aid effectively.<sup>16</sup> This would appear to suggest an alternative interpretation in which the U.S. gave PL 480 government loans to Egypt because of U.S. confidence in the Egyptian state. However, there is an important distinction between the argument in Dietrich (2013) and the argument in this paper. Dietrich focuses on delivery *tactics* – how the donor will provide aid conditional on a desire to promote development – rather than delivery *purposes*, which are the focus of this paper. The subcategories of PL 480 did not indicate how the U.S. would provide aid, but rather what that aid would be used for. The alternatives to extending loans to governments included supporting common defense, supporting development projects, and supporting private industry. What the designation “PL 480 Loans to Governments” indicated was that aid had no other purpose than to provide budget support.

For the most part, U.S. officials did not explicitly refer to “Loans to Governments” as a lever of influence. From their statements, however, one can infer that U.S. officials did think of these loans as an instrument for affecting the recipient's foreign policy. W.W. Rostow, a senior advisor to Kennedy and Johnson, later reflected that “P.L. 480 loans were evidently attractive to many political leaders in developing countries and to their finance ministers as well because they provided a prompt increase in government revenues.”<sup>17</sup> Although there were certainly limits to the ability of the United States to exert meaningful influence using the aid lever, U.S. officials conceived of PL 480 as a political device.

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<sup>16</sup> Dietrich (2013)

<sup>17</sup> Rostow (1985), 329, n. 111

It may appear counterintuitive that the United States was more generous toward countries that did not share its interests than toward countries that did. One might posit an alternate theory in which the U.S. would attach more conditions on aid to non-aligned countries because of an underlying fear that in the absence of shared interests, those recipients would use aid for a different purpose from what the United States intended. This alternate theory might accurately characterize a unipolar or a multipolar international system, but it would not apply to the bipolar system during the Cold War because of the phenomenon of competitive bidding.

If the United States had attempted to attach stronger conditions to its aid to Egypt, the Soviets would have outbid the United States by offering aid on even more generous terms. Attaching conditions to that aid would have implied a lack of trust in the recipient and would have undercut the paramount goal of gaining influence. Instead, by directly lending to governments without stipulating any other purpose, the United States was able to express confidence in the good intentions of the recipient and forestall accusations of meddling in the internal affairs of states that were imbued with post-colonial nationalism. This was not an effective way to promote development, but that had not been the primary intention of the United States in the first place.

In this paper, I identify PL 480 Loans to Governments as a form of soft lending that the United States used to influence the recipient's foreign policy. Using a novel measure of geopolitical alignment, I show that the greater the political distance between the United States and the aid recipient (short of the recipient being a Soviet ally), the more the U.S. provided in the form of soft loans. Allies tended to receive more aid that fell under a statutory economic purpose, whereas non-aligned countries tended to receive more in the form of budget support.

## Data and Analysis

This section of the paper will present the analysis of data on U.S. aid, which USAID has published annually as the Greenbook since the Foreign Assistance Act of 1961. The sample is limited to U.S. aid recipients, meaning that the analysis does not focus on the decision to give aid, but on how the U.S. determines the composition of aid after that prior decision has been made. Because the spreadsheet version of the Greenbook is not sufficiently detailed, I combine data from three printed editions of the Greenbook – 1962, 1966, and 1971 – to collect information on American economic assistance programs on a country-year level for the period 1955-1970. The analysis is limited to this 16-year period because of the temporal constraints of the data; the legislation for PL 480 was not passed until the summer of 1954, and USAID stopped reporting the detailed breakdowns of Title I food assistance after 1971.

I exclude from the analysis countries that were in the Soviet sphere of influence (such as Czechoslovakia) because those countries did not have an autonomous ability to decide their geopolitical alignment. As their response to the Prague Spring in 1968 demonstrated, the Soviets did not allow their allies to decide even their domestic policies, much less their foreign policies. Moreover, the legislation for PL 480 limited the provision of food aid to countries that were considered “friendly nations,” which it defined as those countries that were not “dominated” or “controlled” by the Soviet Union.<sup>18</sup> The data are therefore limited to countries that are non-aligned, neutral, or allied with the U.S.

The independent variable in my analysis is an original measure of U.S. perceptions of the aid recipient’s geopolitical alignment. The variable measures the aid recipient’s distance from the

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<sup>18</sup> Burns (1985), 116

United States, which I operationalize as the recipient's susceptibility to Soviet influence. I assign the aid recipient's alignment a value of 1 if the recipient is an ally of the United States; a value of 2 if the recipient is not a U.S. ally but American officials consider it to be pro-western; and a value of 3 if the recipient is not a U.S. ally and is subject to Soviet influence. I determine whether or not the recipient is an ally by simply determining whether or not there is a formal treaty of alliance. The other categories of geopolitical alignment require a close reading of primary documents in order to measure U.S. perceptions because there was considerable variation in how the United States interpreted neutrality or non-alignment.

For example, even though Ghana was a member of the Non-Aligned Movement, U.S. officials believed that Ghana was pro-western in its geopolitical alignment. The following excerpt is from a telegram sent by the Embassy in Ghana to the Department of State in 1960:

The West has always had a dominant position in Ghana and in my opinion this will continue...in my opinion Ghana is not communist and I detect no desire here that it become so. It is trying to develop a type of socialism that has its roots in tribal life determined not to be exploited by East or West. I feel we should endorse Ghana's policy of positive neutralism and as far as possible show Ghana by our deeds that we are truer friends than USSR.<sup>19</sup>

On the other hand, the United States believed that India and Egypt had considerable potential to align with the Soviet Union. In terms of U.S. decision-making, formal membership in the Non-Aligned Movement was not a clear signal of a whether a country was truly non-aligned. I therefore rely on primary documents to directly measure U.S. perceptions.

I assign values to this original measure of geopolitical alignment by analyzing State Department records in the *Foreign Relations of the United States* series, generally favoring National Security Council statements on U.S. policy and National Intelligence Estimates of

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<sup>19</sup> "Telegram From the Embassy in Ghana to the Department of State." 25 August 1960. *Foreign Relations of the United States 1958-1960, Volume XIV: Ghana*. 659.

individual countries' foreign policies as more comprehensive statements of the perceptions of the United States government than cables or memoranda from individual American officials. However, there were instances in which I based the coding on the latter rather than the former. Not only were NSC reviews and NIEs not conducted every year for every country, they also did not always clearly state the perceived geopolitical alignment of the country in question. These kinds of assessments were sometimes more prevalent in telegrams and memoranda.

The control variables in the regressions are logged population, logged real GDP per capita, and trade openness from the Penn World Tables Version 5.6;<sup>20</sup> the POLITY2 measure of democracy; and indicator variables for U.S. presidential administrations, geographic region, and whether or not the recipient was a European colony. For the indicator variables, I exclude the Nixon administration and Africa to prevent perfect multicollinearity. The results of an OLS regression with standard errors clustered at the country level are reported in Table 1 below. The models specify government loans as a proportion of total aid and as an absolute figure.

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<sup>20</sup> Feenstra et al. (2015)

|                    | Soft Loans<br>(proportion)<br>(1) | Soft Loans<br>(absolute)<br>(2) |
|--------------------|-----------------------------------|---------------------------------|
| Political Distance | 0.079<br>(6.27)***                | 16.385<br>(2.45)**              |
| European Colony    | -0.036<br>(1.87)*                 | -1.234<br>(0.35)                |
| Europe             | 0.066<br>(2.21)**                 | 7.996<br>(1.22)                 |
| Asia               | 0.056<br>(2.07)**                 | 6.435<br>(0.84)                 |
| Near East          | 0.093<br>(2.95)***                | 15.896<br>(2.49)**              |
| Latin America      | 0.051<br>(2.48)**                 | 13.250<br>(2.15)**              |
| Democracy          | 0.003<br>(2.34)**                 | 0.752<br>(1.56)                 |
| Eisenhower         | 0.068<br>(1.70)*                  | -1.202<br>(0.25)                |
| Kennedy            | 0.067<br>(2.93)***                | 4.417<br>(1.51)                 |
| Johnson            | 0.007<br>(1.08)                   | 2.500<br>(1.26)                 |
| GDP p.c. (log)     | -0.004<br>(0.34)                  | -5.175<br>(1.31)                |
| Population (log)   | -0.008<br>(0.59)                  | 6.474*<br>(1.73)                |
| GDP p.c. growth    | -0.116<br>(1.47)                  | -42.644<br>(1.05)               |
| Trade Openness     | -0.000<br>(1.03)                  | 0.060<br>(0.66)                 |
| Constant           | -0.024<br>(0.17)                  | -49.171<br>(1.58)               |
| Year Fixed Effects | Yes                               | Yes                             |
| $R^2$              | 0.21                              | 0.28                            |
| $N$                | 872                               | 897                             |

\*  $p < 0.10$ ; \*\*  $p < 0.05$ ; \*\*\*  $p < 0.01$

(t statistics reported in parentheses)

**Table 1**

**Geopolitical Alignment and Government Loans**

The results show that there is a significant and positive correlation between a recipient's geopolitical distance and U.S. soft lending, both as a proportion of total aid and in absolute terms. It is not likely that these results suggest reverse causation because if they did, the correlation would have precisely the opposite sign; if loans to governments were successful at bringing aid recipients closer to the U.S. in geopolitics, the relationship between those loans and political distance would have a negative correlation. The small sample size reflects the fact that there were missing data for some of the economic control variables and some of the POLITY scores. This led to some countries being dropped from the data set entirely, the most important of which was South Vietnam. However, it is worth noting that the South Vietnamese case conforms with my argument insofar as it was a U.S. ally from 1955-1970, and none of U.S. aid was in the form of PL 480 loans to the South Vietnamese government.

These statistical findings lend weight to the hypothesis that geopolitical alignment affected the type of aid that the United States provided, with aid to allies characterized by a weaker degree of soft lending (and hence greater emphasis on development) than aid to non-aligned countries. To examine how this distinction operated in practice, I examine the cases of Taiwan and Egypt as major recipients of U.S. aid in the early Cold War. I argue that because Taiwan was aligned with the U.S. in the Cold War, the United States used its assistance to strengthen Taiwan against Communist coercion by supporting economic development. In contrast, because Egypt under Nasser adopted a policy of non-alignment, the United States competed with the Soviet Union for influence by engaging in soft lending to the Egyptian government.

## Taiwan as Nationalist China

Taiwan is an ideal case for this argument because it was a major recipient of U.S. aid during the Cold War that was unlikely to succeed. Soaring inflation and the influx of millions of military and civilian refugees after the Chinese Civil War rendered the economy of Taiwan highly unstable when the United States resumed aid after the Korean War in 1950. Moreover, the ruling Chinese Nationalist (KMT) government did not have a prior record of overseeing significant development on the Chinese mainland. In spite of these inauspicious circumstances, the United States was able to use its foreign aid program to transform Taiwan's political economy because it had a compelling strategic interest in preventing Taiwan from being coerced by Communist China.

Soft lending under PL 480 constituted a small proportion of American aid to the Chinese Nationalists – around 1.5% of total economic assistance.<sup>21</sup> Instead, more than two-thirds of U.S. aid was categorized under the statutory purpose of “defense support,” which had the mandate of enabling Taiwan to maintain its military forces “without lowering living standards or destabilizing the economy.”<sup>22</sup> Under this broad provision, USAID and its predecessor agencies lent support to economic development.

Although Neil Jacoby's classic study *U.S. Aid to Taiwan* considers this to be “a material overuse of Defense Support, with reference to its basic statutory purpose,”<sup>23</sup> I would consider development to be entirely consistent with the intended purpose of defense support. While developmental measures may not have been necessary for maintaining living standards or preventing economic instability while the U.S. was providing aid, they were certainly necessary

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<sup>21</sup> *U.S. Overseas Loans and Grants and Assistance from International Organizations*, 1966

<sup>22</sup> Jacoby (1966), 206

<sup>23</sup> Jacoby (1966), 207

for enabling Taiwan to maintain those same economic conditions after the end of the American aid program. Indeed, the aid agencies gave increasing weight to development as it became clearer that the United States would need to wean Taiwan off of assistance without jeopardizing Taipei's ability to resist coercion from Beijing. Underlying these policies was a growing understanding of the persistent nature of the challenge from Communist China that threatened to detach Taiwan from the American sphere of influence.

The Chinese Civil War ended in a stalemate in 1949 with the establishment of two regimes in Taipei and Beijing that both claimed to be the sole legitimate government of China. However, without even an armistice agreement to bring an end to hostilities (as had been signed at Panmunjom to end the Korean War), the peace between the Chinese Nationalists and the Chinese Communists was fragile for most of the 1950s. Chiang Kai-shek's government continually threatened to use military force to recover the mainland, while Mao Zedong's government continually threatened to use military force to "liberate" Taiwan.

In two crises in 1954-1955 and 1958, the People's Liberation Army shelled the Nationalist-held islets of Quemoy and Matsu off the coast of Fujian Province. For psychological, political, and military reasons, the Eisenhower administration believed that failure to defend Quemoy and Matsu would lead to the loss of Taiwan.<sup>24</sup> The United States had to perform a delicate balancing act in order to defend the Republic of China without allowing the conflict to escalate into a general war with the Communist bloc. Although there were ominous signs of potential escalation to the nuclear level, it appeared that U.S. policies had succeeded after the second crisis ended in 1958: there would not be another military confrontation between the rival Chinese states for the rest of the

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<sup>24</sup> Taylor (2011), 477-478, 495

Cold War. The Nationalist military (especially the air force) performed exceptionally well during the confrontations over Quemoy and Matsu, demonstrating that the initial U.S. goal of stabilization had been achieved.<sup>25</sup>

However, there remained a fundamental problem for the United States government: although the Chinese Nationalists had been able to defend their offshore territories, the internal stability of Taiwan that had enabled successful military action had been dependent in large part on American economic aid. This was unsustainable for the United States given that economic aid deliveries had averaged almost \$600 million a year from 1951-1965<sup>26</sup> and constituted the largest per capita aid program in the world during that period;<sup>27</sup> yet neither could the U.S. afford to immediately withdraw its assistance. To have done so would have severely weakened the Nationalist state and likely would have tempted Beijing to launch another offensive.

In order to enable Taiwan to provide for its own economic security, the U.S. used its aid program to effect Taiwan's transition to a capitalist export economy. This policy reflected the generally high priority that the United States placed on Taiwan's economic progress and the fear that aid would not be utilized effectively toward this end. Underlying these fears was a long and troubled history of corruption within the Nationalist government during its tenure on the Chinese mainland. Chiang Kai-shek had made continual requests for American economic aid only to stand by helplessly as that aid was siphoned off by his subordinates, creating the image of a profligate regime.<sup>28</sup>

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<sup>25</sup> Jacoby (1966), 32

<sup>26</sup> *Ibid.*, 38. Jacoby reports an average figure of approximately \$80 million a year. Using the CPI Inflation Calculator from the Bureau of Labor Statistics and assuming that Jacoby is reporting figures in 1966 dollars, I calculate this to be equivalent to about \$595 million in 2016 dollars.

<sup>27</sup> Tucker (1994), 54

<sup>28</sup> Fenby (2003), 412

There is considerable evidence that through their collaboration on the aid program, U.S. officials were able to persuade technocrats in the Nationalist economic bureaucracy of the need for more liberal economic policies. U.S. officials regularly attended meetings of the Economic Stabilization Board as “observers,” though in practice they had much greater influence than is implied by their nominal role.<sup>29</sup> The United States was involved in meetings of the Council on U.S. Aid and assisted Nationalist officials in planning industrial projects. Based on their interviews with former officials who had served in the economic bureaucracy, Kuo and Myers (2012) conclude that the U.S. emphasis on capitalism made a lasting impact on the Nationalist government.<sup>30</sup> The associates of K.Y. Yin, one of the leading technocrats on Taiwan, later recalled that he had been “the most sympathetic to American ideas” and that many other officials who had been engaged with U.S. aid agencies had been similarly persuaded of the virtues of capitalism.<sup>31</sup>

The U.S. aid program played a critical role in the formation of a capitalist economic system on Taiwan through a range of measures that included an ambitious and highly successful land reform program (as it also did in Japan and South Korea). The institution that oversaw this program was the Joint Sino-American Commission on Rural Reconstruction, the JCRR, which was staffed by two American and three Nationalist commissioners.<sup>32</sup> Land reform facilitated the emergence of both a consumer class and a domestic capitalist class. It accomplished both the easy task of distributing land previously held by the Japanese – which represented as much as two-thirds of all land on Taiwan – as well as the more difficult task of redistributing land held by large Taiwanese landholders. In an abstract sense, this strengthened the institution of private property by giving farmers title to the land they tilled. In a more concrete sense, this stimulated the growth of industry.

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<sup>29</sup> Wade (2004), 388

<sup>30</sup> Kuo and Myers (2012), 115-117

<sup>31</sup> *Ibid.*, 116

<sup>32</sup> Wade (2004), 196-17

To compensate large landowners for expropriated land, the Nationalists allocated shares in state-owned enterprises, many of which were later privatized. These former large landowners became Taiwan's first business magnates and played an important role in the development of light industry in the 1950s.<sup>33</sup>

In addition to supporting the emergence of the private sector through land reform, the United States used aid to finance the establishment of new enterprises through the Small Industry Loan Fund and the Model Factory Program.<sup>34</sup> U.S. advisors were often directly engaged in efforts to recruit private investors. For instance, Formosa Plastics, one of Taiwan's most successful conglomerates, was established with American assistance.<sup>35</sup> Major recipients of U.S. aid included firms in the fertilizer, shipping, cement, aluminum, paper, glass, sugar, chemical, synthetic fiber, and pharmaceutical industries. Another form of aid was technical assistance to the Nationalists to improve the government's ability to generate private investment. This led to the liberalization of investment regulations, the cutting of bureaucratic red tape, and the establishment of export-processing zones,<sup>36</sup> which began as an American proposal.<sup>37</sup>

At times the aid agencies took a more confrontational approach. They blocked state-run projects by the Nationalist government, including a nuclear reactor, a steel mill, and an airline, and they actively resisted attempts by socialists in the Kuomintang to establish new firms as public enterprises. The turning point in the battle between American aid agencies and Nationalist hard-liners occurred in 1957, when the Taiwan's first plastics plant was established as a private enterprise. This was regarded as a watershed moment insofar as it marked an acceptance by the

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<sup>33</sup> Taylor (2011), 413-414, 484-485; Gold (1986), 71

<sup>34</sup> Gold (1986), 71-72

<sup>35</sup> Tucker (1994), 56

<sup>36</sup> Jacoby (1966), 190-191

<sup>37</sup> Tucker (1994), 57

Kuomintang of the American view that the state did not have to dominate all aspects of the economy.<sup>38</sup> Industrial production rose from a baseline metric of 100 in 1952 to 422 by 1964, of which the composition was increasingly weighted toward private enterprise.<sup>39</sup>

The final stage in the American effort to set Nationalist China on a capitalist development strategy occurred in the economic reforms of the late 1950s and early 1960s. In keeping with the theory that I have presented, the decline in the threat against Taiwan following the Second Taiwan Straits Crisis was attended by a flurry of economic reforms initiated by the United States. The aim of the reforms was to establish the necessary conditions for Taiwan to be economically viable after the withdrawal of direct American assistance. In 1959, the director of the American aid mission proposed an 8-point program of economic reform that included, among other things, unification of the exchange rate, liberalization of controls on foreign exchange, and privatization of government enterprises. This proposal served as the basis of the Nationalist government's Nineteen-Point Program of Reform in early 1960, which marked a decisive shift toward export-oriented industrialization. The United States also used aid funds to incentivize implementation of the Program, offering a loan of \$20-30 million upon realization of the reforms.<sup>40</sup> Subsequent reforms created tax incentives for exporters.<sup>41</sup> By the official end of the aid program in 1965, Taiwan had adopted an outward-oriented model characterized by a strong private sector.

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<sup>38</sup> Wade (2004), 83

<sup>39</sup> Jacoby (1966), 282

<sup>40</sup> Jacoby (1966), 134-135; Gold (1986), 77

<sup>41</sup> Kuo and Myers (2012), 99

## U.S. Aid and Nasser's Egypt

Unlike Taiwan, which was an avowedly anti-Communist state, Egypt under Gamal Abdel Nasser adopted a posture of non-alignment in the Cold War. With the Free Officers' overthrow of the Egyptian monarchy in 1952, the United States had initially hoped that Nasser's government would be sympathetic to American interests in the Middle East. It was not long before tensions emerged; the Egyptian government's decision to purchase arms from Czechoslovakia in 1955 raised the possibility for Communist influence in a strategically vital region of the world. Although relations seemed to improve after American intervention in the Suez Crisis, rapprochement proved to be transitory as the Egyptian government courted Soviet aid and advisors and adopted a posture of hostility toward American allies and security partners in the Middle East.<sup>42</sup>

Faced with the potential for Soviet influence over Egyptian foreign policy, and yet unwilling to consider Egypt to be a client of Moscow, the United States attempted to use aid to bargain with Nasser. Even if it was not realistic to bid for Egyptian friendship, aid might at least forestall Egyptian hostility to American strategic interests. One of the principal elements in this strategy was food aid under Title I of PL 480, especially in the form of loans to the Egyptian government. USAID reports that from 1946-1965, as much as 53.8% of American assistance to Egypt was in the form of PL 480 Loans to Governments, which is all the more striking when considering that the legislation to authorize PL 480 was not even passed until the summer of 1954.<sup>43</sup>

Although PL 480 was initially conceived as a means of disposing of agricultural surpluses, U.S. officials increasingly came to view it as an instrument for achieving American foreign policy

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<sup>42</sup> Burns (1985), 9-13, 32-35, 109-114, 154-155

<sup>43</sup> *U.S. Overseas Loans and Grants and Assistance from International Organizations*, 1966

objectives.<sup>44</sup> The following memorandum from 1961 demonstrates that the U.S. attempted to use the attractiveness of PL 480 loans to advance its strategic interests.

Faced with the foregoing realities, we have concluded that, while it is not now feasible to expect significant help from Nasser in solving major international problems, much can be done to push the pendulum of U.S.-U.A.R. relations more in our direction...pursuant to this general posture, the following specific steps have been initiated since March 1...on May 27, we concluded a PL-480 supplemental agreement with the U.A.R. covering additional shipments of 200,000 tons of wheat and flour...Ambassador Reinhardt, before his departure, and more recently our Chargé d’Affaires, have made clear to President Nasser and his senior advisors that there is a relationship between continued U.S. aid and U.A.R. attitudes and policies towards the U.S.<sup>45</sup>

This statement is all the more striking when considering that the Kennedy administration took a more generous view of non-alignment than the Eisenhower administration. Kennedy came into office believing that Eisenhower’s tendency to think of Cold War allegiances in black-and-white terms had in fact augmented Soviet influence in the developing world. Instead, the new administration would attempt to build a constructive relationship with the Egyptian government while maintaining respect for its non-alignment. The Kennedy administration also believed that economic development was inherently desirable as a means of preventing the spread of Communism irrespective of the geopolitical alignment of the recipient country.<sup>46</sup>

What this demonstrates is that the argument of this paper is not limited to the idiosyncrasies of an individual leader or a specific administration. Rather, as a result of the competitive pressures of the international system, the phenomenon I have documented became a feature of American foreign policy even when it contravened the personal views of the President of the United States. Kennedy did not think it would be fruitful to attempt to bring Egypt over to the U.S. side, and

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<sup>44</sup> Burns (1985), 117

<sup>45</sup> “Memorandum from the Assistant Secretary of State for Near Eastern and Asian Affairs to the Chairman of the Policy Planning Council.” 30 May 1961. *Foreign Relations of the United States, 1961-1963, Volume XVII, Near East, 1961-1962*. 142-145

<sup>46</sup> Burns (1985), 122-126

Kennedy believed that support for development should not be governed by whether the recipient was an ally or non-aligned. Nevertheless, strategic pressures led the United States to observe this distinction in practice. It was under the Kennedy administration that the United States pressured both Taiwan and South Korea to adopt developmental measures in anticipation of the end of U.S. aid and when soft lending continued to feature prominently in American aid to Egypt.<sup>47</sup> The quote above demonstrates that the administration viewed PL 480 as a measure for influencing Egyptian foreign policy, and the data demonstrate that PL 480 continued to be the dominant feature of the overall American aid package to Egypt. During Kennedy's presidency, PL 480 Loans to Governments constituted 49.3% of all American economic aid to Egypt.<sup>48</sup>

This tactic of using soft lending to purchase political support had a mixed record. John Badeau, the Ambassador to Egypt, later remarked that the Kennedy administration had been surprised by the conciliatory tone toward the West that Egypt had adopted during the Nonaligned Nations Economic Conference in 1962. According to Badeau, the Egyptian representative at the Conference remarked that "I presume you noticed, as I did, while we were having this conference, that the Congress of the United States was debating the foreign aid bill."<sup>49</sup> The early 1960s were also a time when tensions between the United States and Egypt seemed to subside and when Egypt seemed to assert its independence from the Soviet Union.<sup>50</sup>

But there were other episodes that demonstrated the limitations of using economic aid to influence Egyptian foreign policy. During an appropriations hearing in the House of Representatives on May 10<sup>th</sup>, 1967, Lucius D. Battle, the Assistant Secretary of State for Near Eastern and South Asian Affairs, was asked to deliver testimony on the American aid program to

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<sup>47</sup> Haggard (1990)

<sup>48</sup> *U.S. Overseas Loans and Grants and Assistance from International Organizations*, 1966

<sup>49</sup> Quoted in Burns (1985), 127

<sup>50</sup> *Ibid.*, 128-129

Egypt. Otto Passman, a Representative from Louisiana, began with a pointed question: “President Nasser recently delivered one of his most blistering attacks on the United States and also said he would not pay the \$200 million debt he owes the United States unless the United States extends to him further credit. Is that right?”<sup>51</sup> The Representative also noted that the U.S. had given Nasser \$800 million dollars “as an outright gift” in addition to the \$200 million loan, but this act of generosity had not secured Nasser’s sympathy, still less his friendship. When attempting to explain the United States’ strategy toward Egypt, Battle could think of no better answer than to say, “I think we simply have to try our best.”<sup>52</sup>

The United States had to try its best because there were no clear alternatives for influencing the Egyptian government so long as it maintained a non-aligned foreign policy. If the United States had cut off aid, then Egypt would have become economically dependent on the Soviet Union, which could well have led to political dependence. In the absence of substantial common interests with its recipient and in the presence of a rival donor, the United States was compelled to use soft loans as a part of coercive diplomacy. Although the U.S. claimed that this aid was being used for development, the composition of its aid program demonstrates that Washington was providing the kind of aid that was least likely to produce economic growth – aid that had no other stated purpose than to provide budget support.

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<sup>51</sup> *Foreign Assistance and Related Agencies Appropriations for 1968*, 644

<sup>52</sup> *Foreign Assistance and Related Agencies Appropriations for 1968*, 643

## Conclusion

This paper has examined the impact of geopolitical rivalries on aid policy. I have questioned the prevalent assumption in the literature that there is a necessary tradeoff, or at least a fundamental distinction, between geopolitical and developmental motives behind the provision of economic assistance. I have argued that the presumption of this tradeoff reflects a narrow conception of geopolitics as the use of aid to purchase political support. This conception is an accurate description of aid to countries that are geopolitically distant from the donor, requiring the donor to provide incentives to secure cooperation. By contrast, for countries that are geopolitically proximate to the donor, the donor and the recipient have enough shared interests that the donor does not need to provide a “carrot” to secure cooperation. As a result, the donor can weight the composition of its aid more heavily toward securing economic objectives. I have operationalized this argument by examining the proportion of aid that consists of soft lending – that is, aid that is not allocated under a specific statutory mandate for supporting the recipient’s economy. Using archived reports on U.S. aid programs in the early Cold War, I have argued that Washington gave more soft loans to countries that were more politically distant from the United States.

Although the data and the historical evidence in this paper are from the early Cold War, the theoretical claims apply more broadly. In principle, one should observe the mechanisms that I have identified in any zero-sum relationship between two countries in which those two countries use aid to persuade third countries to favor one side or another. I would expect to see similar kinds of aid policies in the competition between East and West Germany and the competition between Communist China and Nationalist China for diplomatic recognition during the Cold War. This argument applies best to periods of competition between the two sides, and there would be less

competitive lending during the relaxation of tensions, such as détente between the United States and the Soviet Union, the *Ostpolitik* of Willy Brandt, and the thaw in relations between China and Taiwan after the death of Mao. External competitive pressures are an important factor in the formulation of aid policy, and this paper has shown how one can detect the influence of international strategy in the composition of economic aid.

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