Aid or Trade?

How to Best Help Developing Nations

Aid is better than trade

Many people throughout the world are concerned about improving living standards in developing countries. Some of this concern is prompted by humanitarian reasons, a desire to enrich the lives of poorer people. Some is based on a security rationale: Improving living standards in poorer countries makes them less likely to threaten the lives and property of their neighbours. Some is based on economics: Raising the income levels of these countries broadens the markets available to firms based in richer countries. Regardless of the motivation, what is the best means of accomplishing this task: aid or trade? That is, should the developed countries give developing countries resources (aid) or provide markets for their goods instead (trade)?

Many experts believe that the development of the less developed countries is dependent on aid. Richer nations annually provide some $60 billion in aid to poorer countries. Much of this aid is destined for infrastructure projects such as electrical generation, new roads, and telecommunications systems. A strong correlation exists between per capita income and infrastructure. Adequate infrastructure is often a requirement for a multinational corporation in deciding where to locate a factory or distribution facility. But private investors may be unwilling to lend funds for such public projects because of the financial weakness of a country's government. Therefore, aid may be the only way in which necessary improvements to the infrastructure can be financed. For example, $63 million of U.S. aid went to build roads in the southern Philippine island of Mindanao. This infrastructure improvement was a critical element in the development of the area's fishing industry.

Other aid may be used to alleviate human suffering directly. Gifts of food, medicines, and building materials help feed, heal, and house millions of people. Such aid is particularly beneficial when civil strife, such as the civil wars that have plagued Rwanda, Somalia, and Sudan, causes farmers to flee their homes, leaving crops rotting in the fields.

Aid also may be preferable to trade because it creates fewer political problems in the donor's country. Developing nations that successfully export often discover that importing countries raise barriers to their goods. For example, the developed nations willingly contribute $1 billion in aid to Bangladesh annually but slap tariffs and import quotas on 80 percent of its exports.

Trade is preferable to aid.

An old Chinese proverb notes: "Give a man a fish and you feed him for a day. Teach a man to fish and you feed him for a lifetime:' In line with this ancient wisdom many development experts believe that it is better to base economic development on trade than on aid. Trade provides jobs for residents of less developed countries. The wages provided by these jobs get spent in the local economy, generating demand for local businesses and employment opportunities for local residents.

More important, as domestic firms expand their exports, their managers and employees learn new skills and techniques for producing and marketing these goods. They make contacts with foreign distributors, earn goodwill with foreign customers, develop credible reputations with foreign lenders, and learn the ins-and-outs of dealing with the customs services of foreign countries. This improvement in a country's stock of human capital inevitably gets transferred to other firms and industries as employees leave to start their own companies or get lured away by domestic competitors. The aggregate effect is to raise the competitiveness, productivity, and efficiency of the economy as a whole. The post-war economic successes of countries such as

R. W. Griffin, *International Business: A Managerial Perspective*. Prentice Hall 2002

Singapore, Hong Kong, and Taiwan are based on this pattern of export- driven economic development. Other experts support trade-based economic development because of the failures of aid programs. Long-term food aid, for example, often depresses local crop prices so that farmers cannot make a living, forcing them to abandon their fields and seek work in urban areas. When U.S. and UN troops entered Somalia in 1992, for example, they brought so much food to feed the local population that Somalian farmers were unable to raise crops profitably In the next growing season fields remained unplanted, thereby making the country more dependent on outsiders. And far too often aid takes the form of large, ill- planned projects that do little to improve a country's living standard. For example, international donors, including the World Bank and Denmark, Norway, and Sweden, donated over $16 billion to Tanzania between 1961 and 1987. Much of this money was used to finance nationalization of the country's industries and relocation of 14 million peasants and their families to newly collectivized farms. Because of inefficiencies of the state-owned industrial sector and reductions in agricultural productivity at the collective farms, the net result of the aid was a halving of Tanzania's per capita income between 1980 and 1993.

Analysis

1. *In your judgment which is better, trade or aid? Why?*

2. *What alternatives, other than aid, are available to improve the infrastructures of developing countries?*

3. *Which should determine how foreign aid is spent, the donor countries or the recipient countries?*

R. W. Griffin, *International Business: A Managerial Perspective*. Prentice Hall 2002