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Trade Versus Aid

Introduction

Since the 1950s we have been familiar with the concept of the 'third world' or 'developing world', a recognition of the gross inequalities that exist between the world's nations. This difference between countries is sometimes referred to as the '**Development Gap**'. Today's LEDCs actually make up over two-thirds of the world, in terms of both area and population, consisting of the majority of Africa, Latin America and much of Asia. These countries are almost all former colonies of the European powers, and are characteristically very poor in economic terms when compared to the West. A typical LEDC has little in the way of industry or technological advances, with the majority of production being low-level agriculture. Many of these countries also suffer from chronic poverty and related issues of famine, disease and violence.

For the last 60 years efforts towards the development of the impoverished world have been characterised by two key approaches, with highly debateable results in each case. The first is the concept of using trade to promote economic growth. The second is the provision of aid by the wealthy West to the poor South. This **Geofile** will look at both approaches, how they have been applied and what effect they have had upon the third world.

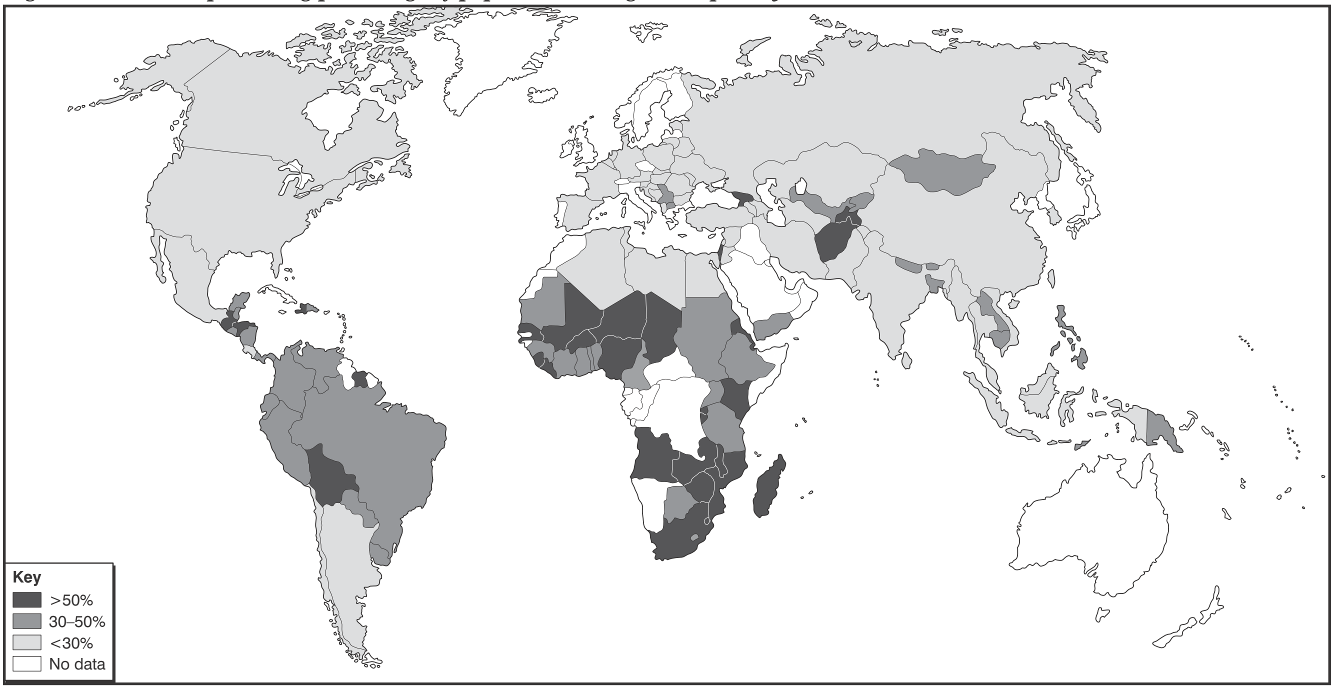
Trade and economic growth

When the concept of the developing world gained recognition in the 1950s and 1960s, the principal approach to improving conditions was to find ways for those countries to generate high levels of economic growth. Economic growth can be defined as the increase in output of goods and services that a country produces over a period of time, which can be seen by an increase in GDP. Economic growth is considered essential to the development of a country, increasing the amount of wealth being generated in the country, and in theory that extra wealth allows for the living conditions of the country's population to improve.

In the 1950s and 1960s the approach taken was that developing countries needed to increase economic growth via a process of **modernisation**. Essentially this consisted of two key elements, the first being an increase in international trade and the second being a process of intensive industrialisation to help provide goods for export. In effect, developing countries were being encouraged to use the same kind of model that Western countries had adopted in the past, a capitalist system of trading coupled with a powerful industrial sector. The theory was that since it had worked for the West, it should work for the rest of the world too.

Even though it was clear by the end of the 1960s that this model was not having the desired impact upon economic growth, the basic concept of using trade to promote economic growth to improve a country's conditions has remained at the core of much of development thinking to this day. This is partly because the attitude that 'the West did it, so can they' has remained strong with certain international groups, but also because economic growth is still seen as highly desirable. This is true even for development thinkers who are less concerned with simply economic results. As the majority of any population is seen to be involved with the local market in one way or another, the generation of economic growth is seen to have a 'trickle-down' effect, providing extra money and resources. This extra wealth should ideally allow for new industry to begin and for more goods to be produced, allowing for more trade and further economic growth. The

Figure 1: World map showing percentage of population living below poverty line



Source: *CIA World Factbook*, 2008

adoption of Western-style capitalism is also seen to be beneficial politically, as capitalism tends to foster democratic institutions, allowing for the population to be better represented and for fairer conditions to be established.

These ideas about trade and economic growth have become closely associated with a concept known as **neoliberalism**. Neoliberalism is an idea which became popular during the 1970s as an answer to problems with the global market at that time, and since then has dominated ideas about international development, right up to the present day. Neoliberalism is basically the idea that free trade is essential for economic growth, so markets should be allowed to be as open as possible, with no restrictions. The fewer restrictions there are, the more trade can take place, the more growth and benefits there will be. Neoliberalists tend to dislike governments and the state, and believe that their ability to make rules should be kept to a minimum, so that they do not interfere with markets and trading. Key international organisations such as the World Bank and the International Monetary Fund (IMF), as well as powerful Western countries like the USA and the UK, have been strong supporters of neoliberal ideas. As a result of this strong international support for neoliberalism, many developing countries have been encouraged to reduce the power of their governments and to allow for as much free international trade as possible. This was especially the case in Latin America during the 1980s. However neoliberalism and trade-led growth models have also received a high degree of criticism, and their effectiveness is increasingly challenged.

Criticisms of trade-led growth

Despite the vehement support of various institutions like the World Bank, IMF and the World Trade Organisation for systems of trade-led growth, this approach is subject to numerous criticisms. There have, after all, been efforts towards trade-led growth for the last 60 years, and yet the majority of developing countries still remain very poor in comparison to the West. The development gap has in some cases widened, as rich countries have become richer and

Figure 2: The World Trade Centre in Seoul, South Korea.

poorer countries have declined under the weight of increasing socioeconomic problems. So the approach is seen to be flawed.

In their defence, neoliberalists often point to a small group of countries which have experienced significant economic success as a result of trade, the so-called 'Asian Tigers': Taiwan, South Korea, Hong Kong and Singapore. These countries were all very poor in the 1960s, but have since experienced incredible rates of economic growth and industrialisation thanks to the opening up of their markets and free international trade. As such, neoliberalists claim that their theory works, but only if properly applied, suggesting that developing countries remain poor because they are not implementing the trade model correctly. However this view is often challenged; the economic miracle of the Asian Tigers is attributed to factors other than simply trade, such as protectionist methods by their governments, a distinctly anti-neoliberalist approach.

One strong criticism of using free trade is that LEDCs cannot be truly competitive in the global market because of the disparity between the wealth of the super-rich Western countries and the majority of developing countries. Developing countries lack the ability to invest in the same level of industrial production and technological skill as Western countries, and so struggle to compete. A related issue is that the majority of developing counties rely on agricultural exports, and indeed have been encouraged to do so in the past. The problem is that the price of agricultural goods has been steadily decreasing for the last few decades and has only recently begun to level out, so there is little profit to be made in this sector. This problem is further exacerbated by Western countries seeking to protect the interests of their own farmers. A good example of this is the EU Common Agricultural Policy. Countries also leave themselves open to exploitation by allowing totally free trade and restricting the strength of their governments, as countries with high levels of natural resources such as oil or diamonds frequently become targeted by wealthy countries or transnational corporations.

Another issue with trade is that it is often very difficult to ensure that the growth that is generated has the desired 'trickle-down effect' and benefits the majority of the people who live in the country. Programmes of free trade and industrialisation often fail to generate the 'pro-poor growth' that is desired, and instead end up benefiting only a certain few elite groups of a society. For example, in countries such as Brazil and Mexico, there is a continuing problem that people with formal employment in the big corporations do very well financially and have good social security, but only make up a fraction of the number of people living in the country. Instead of helping the poor, the gap between the poor and the rich within the country seems to widen.

Given these limitations, one might ask why so many developing countries still pursue policies of free trade and reduced state intervention. The answer in some cases is that they do have little choice. Many of the world's poorest countries suffer from a high level of debt that they owe the World Bank, which puts them in a difficult position. In exchange for further financial help, the World Bank and the IMF often enter agreements with indebted countries where the country must implement recommended changes. These are often referred to as **structural adjustment programmes** (SAPs), although there are variations on this kind of policy. These programmes are strongly based on the neoliberal attitudes of the World Bank and IMF, encouraging reduced state control and increased exports and trade. Developing countries have little choice in the matter if they are to continue to borrow money.

One final thing to consider is the question of whether trade and economic growth can really be enough to develop a country? Whilst neoliberalists and others argue that it is, others challenge this theory.

They question whether trade and wealth alone are enough to deal with problems like famine, war, corruption and health epidemics such as HIV/AIDS, and whether significant economic growth will ever take place with these kinds of problems holding a country back.

Aid

Like the concept of trade, the approach of using aid to help LEDCs develop has been around since the 1950s. In many ways it can be seen to have started with the United States' Marshall Plan (1948–51), a programme designed to provide money to help western European countries which had been economically devastated by the Second World War. The concept was broadened to create a means by which developing countries could be helped to improve their economic situation.

There are three main systems by which aid is distributed:

1. **Bilateral aid** is where aid is given directly by the government of a donor country to a recipient country.
2. **Multilateral aid** is given by a donor country to an international organisation, such as the World Bank or the European Development Fund, who then use the money in programmes to assist developing countries.
3. **NGOs** (non-governmental organisations) also provide and distribute aid in a variety of different ways. Some NGOs are charities, which raise money to use for aid programmes, others are more involved with the management of aid projects, ensuring that aid is effectively used and distributed. The number of NGOs has increased rapidly since the 1990s.

Aid can involve transfers of finance, goods or technical assistance (which makes up around half of all bilateral aid). Even though initially aid was mostly focused on economic concerns, aimed at building up infrastructure and industry, over time it has diversified as a concept to include many different forms. For example, the Cold War led to high levels of military aid being used by the superpowers to keep certain countries on their side and to expand their spheres of influence. Another common use of aid is as a source of debt relief.

Figure 3: ActionAid project: women in this Indian village now market their own produce.

Courtesy of ActionAid

Given that aid is such a wide-ranging concept, it is useful to try and divide it into different categories:

- Short-term initiatives, such as disaster relief aid, which has a specific objective to help a country recover from a particular event and to save lives. For example the World Food Programme provided food aid to more than 1.3 million people in the wake of the Indian Ocean tsunami of December 2004.
- Alternatively aid is often used as part of long-term development projects, with particular goals being worked toward over time. These can take many different forms, from investing in industry or agriculture, to building schools and hospitals, to supporting the country's budget.
- Some aid is seen as being **'top-down'**, meaning that it is coordinated by a senior body like a government or international organisation, who are 'at the top'. These are typically capital-intensive schemes aimed at improving the country as a whole. For example, the Akosombo Dam in Ghana was constructed by the government with the help of foreign aid as part of a plan to improve electricity production and industry.
- Other forms of aid are described as **'bottom-up'**, referring to NGOs and other organisations who work with communities and local groups to improve their conditions. For example, Actionaid is a charity NGO which invests in individual villages. These are sometimes called 'grassroots' initiatives. They often involve a lot more dialogue with people receiving the aid than 'top-down' methods.

One of the most important ways that aid differs from trade is in its diversity. As you can see there are many different kinds of aid and they all have different objectives. Like trade, aid can be to help with economic development, but it can also be targeted at many other concerns such as basic human needs, social development, or environmental conservation. This can be seen as one of the greatest strengths of using aid within a development framework.

The problems with aid

Aid is not without its drawbacks and difficulties. By the 1990s some observers began to claim that an 'aid crisis' had emerged. The achievements of aid programmes were increasingly questioned, as the conditions of the majority of LEDCs did not seem to be improving. Popular support for aid was dwindling as a result and many countries were cutting back on their aid expenditure. Since the end of the Cold War, not only has military aid to developing countries been reduced, but a substantial amount of bilateral

Figure 4: Net overseas development aid in 2005, as a percentage of GNI

Country	ODA, as % of GNI
Sweden	0.94
Norway	0.94
Netherlands	0.82
Austria	0.52
France	0.47
UK	0.47
Germany	0.36
Spain	0.27
United States	0.22

financial aid has been cut too. Many donor countries lost the political will to maintain aid programmes. The current figures on aid expenditure for members of the OECD (a group of the 30 highest income countries in the world) remain far below the amount of aid that is regarded as minimum by the UN. The UN suggests that high income countries should give 0.7% of their gross national income in aid; however, as Figure 4 shows, only a handful of countries actually commit to this. It is estimated that aid figures for 2006 would have been $280 billion higher if countries had committed to the 0.7% figure.

Perceived problems with aid as a concept are many. One of the concerns is that aid money frequently does not get to where it is needed or that it is used ineffectively. This can be due to corruption in the governments and institutions of developing countries, who use the money for themselves. It can just as easily be an unintended outcome, as sometimes it is simply too difficult to use aid money effectively, due to a lack of resources or infrastructure. For example it is not easy to invest money in schools or hospitals when those places have no roads or power, as is the case in many parts of rural Africa.

Perhaps the most significant issue with aid is that it is often subject to **conditionality**. Aid is not actually free, but comes at a price, as a developing country must agree to certain conditions in order to receive aid. These conditions often undermine the effectiveness of aid programmes, or even lead to more problems for the country receiving aid. One of the most common forms of conditionality is what is called **tied aid**. Tied aid is when bilateral aid is given to a developing country, on the condition that this money must be spent on goods or services that come from the donor country. A famous example of this occurred in 1991 when the UK gave £234 million in aid to Malaysia towards the construction of a hydroelectric dam. This was later revealed to be tied to an arms deal that Malaysia made with the UK to buy a substantial number of weapons. Another significant occurrence of conditional aid involves the structural adjustment programmes forced onto developing countries by the World Bank and IMF, which we discussed earlier. Developing countries must agree to the conditions of structural adjustment if they are to receive much-needed financial aid from these institutions.

Despite these problems and criticisms, some people argue that there is a new movement with regard to aid. Since the end of the Cold War there has been a dramatic rise in the number of conflicts in the third world, and aid is seen as necessary to help deal with the increase in refugees and economic problems that have been caused. Some also claim that there is a new shift towards ‘development partnership’, where recipient countries will have much more of a say in the aid they receive and how it is used. The IMF has introduced what it calls ‘Poverty Strategy Reduction Papers’ (PRSPs), which are meant to replace SAPs and involve a much greater dialogue with the countries involved. However, these have been criticised as being just as bad as SAPs, as PRSPs still focus on a neoliberal agenda. Also developing countries have little choice in whether they agree, as adopting a PRSP is required in order to qualify for the IMF and World Bank’s HIPC programme, which provides debt relief. So the future of aid and how it will be carried out remains an uncertain prospect.

Conclusion

It can be seen that aid and trade policies both come with their problems and historically have been limited in what they have accomplished. This is not to say that use of either approach has been an outright failure, as there are numerous success stories, but both can be seen to have failed in many other cases as well. Both could be said to require careful changes and monitoring if they are going to have a chance of creating success stories. It can also be said that neither aid nor trade by themselves are enough to make a significant difference to the developing world, but must be used as part of a much greater framework of international development.

Websites

http://www.worldbank.org – World Bank website.
http://www.actionaid.org.uk – website of a UK Aid NGO.
http://www.mdgmonitor.org – an interactive website allows you to explore the progress of the UN’s Millennium Development Goals worldwide.
http://real-lives.en.softonic.com – allows you to download Real Lives, a free educational game that simulates the conditions people experience around the world.

Focus Questions

1. Choose *either* trade *or* aid. Analyse the strengths and weaknesses of this development concept.

2. Examine the different ways aid is distributed and decide which methods you think work best, explaining your reasons.

3. What is neoliberalism? What have been the positive and negative effects of using neoliberal policies?

4. What is poverty? Is it purely to do with income or are other factors important?