What are the positive and negative impacts of aid?

Introduction

Trade can be the most important source of Gross Domestic Production (GDP) and a powerful engine for economic growth. Based on the World Trade Organization (WTO) investigation, trade has been ‘ identified as a key priority in the national development strategies of partner countries’ (WTO, 2009). However, this description might be more realistic for developed countries. For most of the developing countries, especially the Least Developed Countries (LDCs), the picture might be totally different. The statistics from Food and Agriculture Organization (FAO) showed that the number of hungry people all over the world in 2010 has reached 925 million, nearly 14% of the world’s total population of 6. 8 billion’. As a lack of resources, infrastructure, educated labour, information, well-organized institutions, the people’s basic living demands cannot be satisfied, let alone to develop economy or construct a stabilized society. Such as a country, which is called Sao Tome and Principe, 75. 2% of its GDP come from international aid. All of these facts made international aid extremely necessary and significant. As aid has been playing an increasingly important role in international affairs, the topic about whether aid is performed as a substitute for trade of a complement to trade has aroused a huge debate. A programme called ‘ Aid-for-Trade’ jointly launched by the World Trade Organization and the Organization for Economic Co-operation and Development (OECD) might have suggested that aid can help enhance a country’s trade capability. At the same time, aid is also being criticized as a block in smoothing trade due to its potential side effects, such as ‘ Dutch Disease’, ‘ rent-seeking’ or corruption problems. Based on all these arguments, this essay is aimed to offer a comparatively comprehensive and objective view of international aid’s effects on trade. After a general analysis of all these views and facts, this essay’s viewpoint is that aid, from some aspects, can help facilitate trade, but it can also trigger some problems for trade. However, the side effects can be mitigated as long as we take some effective measures. Undeniably, there is a long way to go, still, we have hopes.

Aid’s positive effects on trade.

The first positive effect on trade is that aid can ‘ overcome internal trade-barriers’ and serve as a complement to market access, this is also an important motive for the ‘ Aid-for-Trade’ (AFT) project (Stiglitz, 2010). Market barriers include tariff barriers and non-tariff barriers. For the Least Developed Countries, the tariff barriers are not the primary constrains for the low exports, rather, the ‘ weak infrastructure, high product standards, poor access to credit and unfavourable business environment’ are the fundamental restrictions for them to enhance exports (Stiglitz, 2010). Infrastructure, also called ‘ internal trade barrier’, is the priority for all the countries to conduct international businesses. Under the AFT project, the low income countries have attached a greater importance on infrastructure. Based on the AFT research, the amount of money they invested in infrastructure was USD 8 billion, accounting for 60% of the total money they received (WTO, 2009). Another typical example is the AFT’s ‘ The Phnom Penh-Ho Chi Minh City Highway’ project, which aims to enhance the economic connections among Cambodia, China, Lao PDR, Myanmar, Thailand and Viet Nam by improving the physical links, which focus on transport corridors, power interconnection systems and telecommunications networks.

The outcome was fruitful: the transportation cost was estimated to have dropped at least 10% for passenger cars and 15% for buses and trucks. Moreover, the total value of trade passing through the Cambodia-Viet Nam border increased by about 41% per year between 2003 and 2006 (WTO, 2009).

The second reason for aid is a complement for trade is that aid can ‘ redistribute the gains from trade’, promoting fairness among the world (Stiglitz, 2010). This would help establish a more favourable environment for trade in the world. Obviously, the status between two countries when conducting trade is not equal, the comparatively powerful country or the ‘ big country’ would take a more beneficial stance in which they can greatly influence the final trade prices or terms. If this continues, the small countries’ terms of trade would be deteriorated. Under such circumstances, aid could perform as a complement of trade to remedy this problem through an artificial and well-purposed redistribution of resources or profits. Furthermore, once the recipient countries’ economic situation gets repaired, they would enhance their economic ties with the original donor countries. That would be beneficial for both of the countries’ development in the long run.

a negotiating side payment- rich countries offer aid as a sweetener to keep developing countries at the bargaining table

negative aspects

The first one is that it may encourage ‘ rent seeking’ behaviour or government corruption. Bribes, taxes, cuts, appropriations, all of these would impose a negative impact on resources distribution, which is essential in promoting a country's comparative advantage, a decisive factor in formulating trade policies. The World Bank reported that the chances for malfeasances have been greatly increased due to the rapid growth of foreign currencies, which were mainly through concessional flows (World Bank, 1989). Also as Klitgaard described, foreign aid in Africa has constituted even more than 50% of government revenue in the 30 most aid-dependent countries in 1970-1990. However, the study by Griffin demonstrated that the macroeconomic effects of aid during that period were so ambiguous (Svensson, 1998).

The second common effect of foreign aid that may undermine trade is ' Dutch Disease', which originally means the negative effects come along with the increasing exports of natural resources, such as oil or natural gas. Broadly speaking, this terminology also refers to other forms of obtains similar to the discovery of natural resources, such as remittance or foreign aid. Basically, mo matter what kind of aid it is, more foreign aid means more foreign currency inflows. This would make the domestic products more expensive, suggesting higher real exchange rate and overall decrease of export sector. In other words, the ' terms of trade' of this country get deteriorated. Another symptom of ' Dutch Disease' is that the industries which get assisted would attract more labour or capital from other industries. This would directly increase other industries' production cost and squeeze their profits, making the whole country's trade environment get worse. One example of this would be El Salvador (Drabek and Laird, 2001), which received a huge amount US aid between 1982 and 1987. During this period, El Salvador experienced high inflation and high interest rate accompany with the US economic aid, which was more than twice of the military aid (Richard A. H., 1988).

The third side effect of aid on trade is that it may be utilized as a channel for the donor countries to get a better control of the recipient countries' markets, which would weaken the recipient countries' independence on trade. One typical type aid of this is ' tied aid', including aid tied with source and aid tied with project. The source tied aid requires that the loans or grants received can only be used to purchase the goods or services from the donor country. One consequence is that this would make the purchase prices even higher as the money is requested to be used in a specific way. More importantly, this tied aid would help donor countries open up recipient countries' markets, which would highly reduce recipient countries' trade independence (Cho, 1995). For instance, in 1994, the Britain's government promised to offer a project aid which amounted to USD 627 million to help Malaysia build the Pergau 600 mW hydroelectric dam in the northern state of Kelantan. This amount of money accounted for more than half of the costs of the project and also was the biggest aid in a single scheme under Britain's Overseas Development Administration's (ODA) Aid and Trade Provision programme. And also, Malaysia was permitted to repay this money at an interest rate of 0. 809 per cent over a period of 14years. Such generous sparked a huge argument and an investigation report, from which we learned about more about this ' tied aid'. The report showed that the Conservative government profited USD 350 million in 1991 to finance this Pergau project, and it also disclosed the efforts from Britain's Government to win contracts from Malaysia in the form of aid. That just explained why Britain had become one of the chief recipients of Malaysia contracts since 1998. From this example, we can conclude that aid sometime is more than what it looks like.

Another aid’s effect that might hurt trade is ‘ expenditure switching’, which basically means that the resources would flow out from the productive activities to the aid-based activities. Firstly, for governments, they would put the money on the areas which are more easily to get donor countries’ aid, or which are more comply with the donor countries’ benefits. By doing this, the rare and valuable resources, like capital, materials, labour would be invested in those less critical projects. Also, the private businesses would adjust their development strategies following the governments’ policy changes and the international economic outlook. Finally, for valuable labours-talents, highly-skilled workers, entrepreneurs would highly likely to change their career plans, flowing into those lucrative areas (Shleifer and Wishny, 2002). All in all, every layer of the society might just tend to chase the short-term profits coming along with aid, sacrificing opportunities in enhancing their trade leverage in long run.