

## RETHINKING FOREIGN AID

*Evan Osborne*

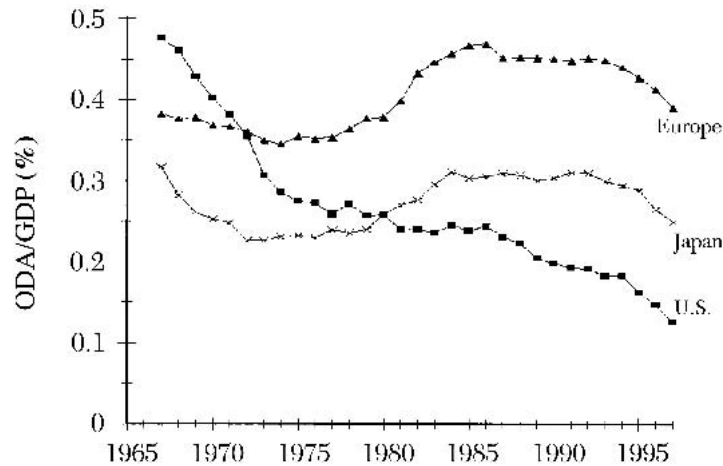
Recent years have witnessed escalating criticism of the industrialized world for declining levels of foreign aid, especially the official development assistance (ODA) that is expressly supposed to facilitate prosperity in the developing world. Criticism of the alleged foreign-aid shortfall is striking because critics fail to ask a more profound question: Do ODA and other forms of transfers to poor nations actually help them prosper? The increasingly loud controversy over inadequate “foreign aid,” in turn, hinges on whether it is effective in reducing poverty compared to other things rich and poor countries might do to achieve that aim.

This paper details the substantial changes that have occurred during the past 30 years in trade and aid patterns between the developed and developing worlds. It then provides a statistical analysis of the effects of foreign aid on growth compared to the effects of foreign trade, market-friendly policies, and other considerations. It also augments the findings of the body of economic literature known as “new growth theory” by testing whether its results are robust when developing countries are examined alone. Finally, in light of the findings, it reassesses the relative contribution to development of the Western European nations, the United States, and Japan.

### Trends in Aid and Trade

While there is an old controversy over the ability of foreign aid and international trade to help countries develop, in recent years the patterns of the developing world’s trade with and aid from developed nations have changed dramatically. This section briefly summarizes those changes.

FIGURE 1  
NET ODA AS A PERCENTAGE OF GDP IN EUROPE, JAPAN, AND  
THE UNITED STATES (FIVE-YEAR MOVING AVERAGE)



NOTE: Europe is defined as the 18 nations (other than Liechtenstein) that have been members of the European Union or European Free Trade Association during the 1967–97 period.

SOURCE: United Nations, *Statistical Yearbook* (various years).

### *Official Development Assistance*

Official development assistance by wealthy countries, as a percentage of gross domestic product, has declined sharply in recent years and provoked much critical commentary.<sup>1</sup> Figure 1 depicts the ratio of ODA to GDP from 1967 to 1997. The ODA data are collected from OECD governments as well as the European Commission, and include capital projects (e.g., dams and roads), monetary transfers to provide general budgetary support, lending to support nations with balance of payments problems, food and other commodity aid, technical cooperation, and emergency relief. Although they do not allow differentiation among those types of assistance, the potential confounding factor of military assistance is avoided.

<sup>1</sup>For example, consider Krugman (2001): “Right now, the United States is the Scrooge of the Western world—the least generous rich nation on the planet. One of the tables in [a recent World Health Organization] report shows the share of GNP given in foreign aid by advanced countries; the United States ranks dead last, well behind far poorer countries such as Portugal and Greece. The sums proposed by the WHO would double our foreign aid budget, not because those sums are large, but because we start from so low a base—about a dime a day for each U.S. citizen.”

Figure 1 indicates that measured ODA from the United States has declined relentlessly throughout. In 1967, the United States gave almost 0.5 percent of GDP in foreign aid, while by 1997 it gave less than 0.15 percent. In contrast, Europe gave a progressively larger share of GDP in ODA until the mid-1980s before that share began to continuously decline in the early 1990s, although not as much as that of the United States. Finally, Japan's transfers have been relatively stable throughout the entire period.

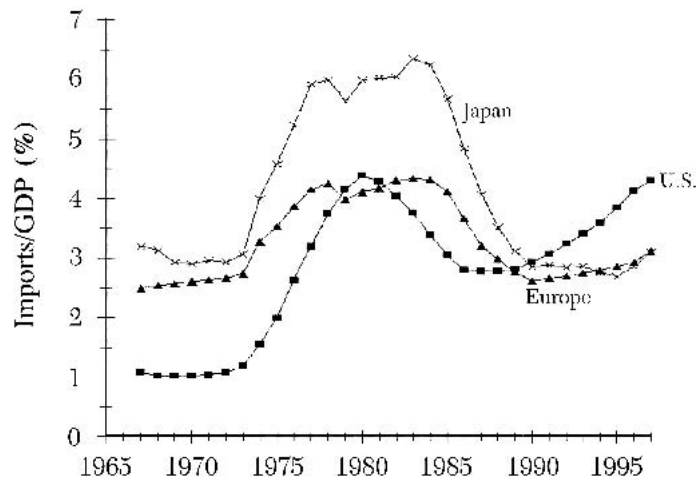
During this period the United States has thus changed from being the largest provider of ODA to the smallest. U.S. ODA is now barely a third as much as that of the European nations collectively and, despite Japan's economic malaise of recent years, barely half as much as that of the Japanese. The decline in foreign aid, particularly from the United States, is undoubtedly the major evidence for the claim that the developed world in general and the United States in particular are shirking their duty to assist poorer countries. Hence, the recent UN Monterrey Declaration and President Bush's decision to increase U.S. aid to developing countries, on the condition that they pursue sound policies.

#### *Trade between the First and Third Worlds*

Long-term economic growth in developing countries is assumed to be the primary goal of ODA, and therefore the basis for its comparison to openness and sound economic policy in the developing world. In analyzing why foreign trade might also positively affect growth, there are several (nonexclusive) theories to choose from. The most elementary one is comparative advantage: when there is free trade between industrial and developing countries efficient specialization is encouraged. In addition, there are dynamic effects—for example, the economies of scale that result when firms in a small, poor economy begin exporting to much larger, more prosperous global markets, as well as the ability of trade to promote learning of modern industrial techniques and other important knowledge (Kemp and Schweinberger 1991, Ethier 1982, Krugman 1979).

For most of those concerns one measure of the assistance that industrial countries can provide is their imports of products from the developing world. Figure 2 depicts five-year moving averages for imports from developing countries as a percentage of GDP for the United States, Japan, and Europe during the 1967–1997 period. The European pattern is quite similar to its ODA timeline: rising imports throughout the 1970s, followed by a substantial decline beginning in the second half of the 1980s. Unlike the ODA case, Japan's imports from developing countries have not been stable but have instead

FIGURE 2  
IMPORTS FROM DEVELOPING COUNTRIES AS A PERCENTAGE OF  
GDP IN EUROPE, JAPAN, AND THE UNITED STATES (FIVE-YEAR  
MOVING AVERAGE)

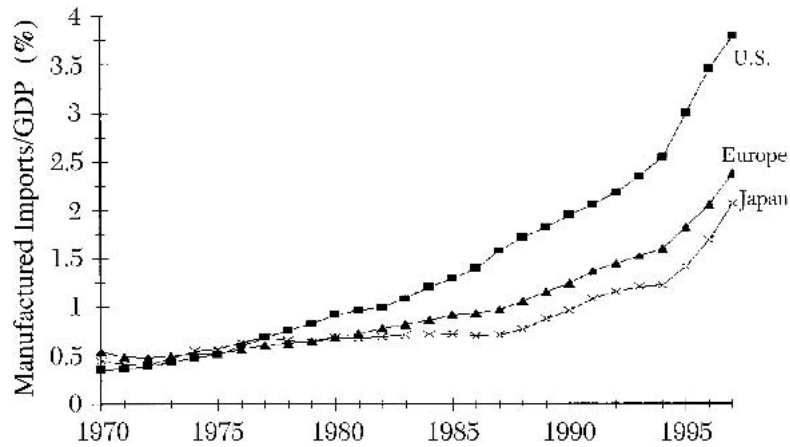


SOURCES: United Nations, *International Trade Statistics Yearbook* (various years); United Nations, *Statistical Yearbook* (various years).

followed the European pattern, only more dramatically. In contrast, the United States in 1967 imported the smallest proportion of GDP from the developing world, less than half of Europe's share and less than a third of Japan's. By 1997 that pattern had completely reversed, with the United States absorbing the most, by a significant margin, and Japan the least.

An argument can be made that total imports are an incomplete measure of the development assistance provided by trade with developing countries. Although it does not follow from the traditional theory of comparative advantage, it is nonetheless true that for many development scholars and political leaders in the Third World "development" is synonymous with the creation of a sizable, modern manufacturing sector, as opposed to reliance on exports of primary products. The product-lifecycle theory suggests that as countries industrialize they hand off more labor-intensive industries to countries in earlier stages of industrialization. That theory provides some support for the notion that the development of manufacturing industries frequently accompanies increasing prosperity in the developing world. It is illustrative to examine the absorption of manufactured

FIGURE 3  
 MANUFACTURING IMPORTS FROM DEVELOPING COUNTRIES AS A  
 PERCENTAGE OF GDP IN EUROPE, JAPAN, AND THE  
 UNITED STATES (FIVE-YEAR MOVING AVERAGE)



SOURCE: United Nations, *International Trade Statistics Yearbook* (various years).

imports from developing countries by the United States, Europe, and Japan.

Figure 3 depicts the trend lines for manufactured imports. While there were no significant differences in the absorption of manufactured goods in 1970, there has been an increase in all three destinations but a much more dramatic rise in the United States. By 1997 the United States absorbed nearly 40 percent more manufactured imports as a proportion of GDP than either Japan or Europe.

The pattern for importation generally, and manufactured importation in particular, is thus dramatically different from that for ODA. If we assume that, as a policy matter, importing more from developing nations is preferred to importing less (especially if a major reason for the lack of imports is protection or subsidy of domestic industries in rich countries), then the United States is a comparatively generous provider of trade “assistance” and Japan the least generous, with both Europe and Japan significantly trailing the United States in the absorption of manufactured imports in particular.<sup>2</sup> This suggests that evaluation of development assistance may be incomplete at best when

<sup>2</sup>The word “assistance” is used advisedly, since trade is by definition based on explicit, voluntary, mutually beneficial exchange.

aid but not trade is measured. The contribution of each to economic growth is considered in the next section.

## Trade, Aid, and Growth

### *Theoretical Considerations*

Both trade and aid might in principle contribute to economic growth and development, but they need not do so in the same way or to the same extent. Previous theoretical literature has established a clear default hypothesis that trade can never help a developing country as much as the same amount of aid, while the empirical literature has failed to confirm that belief.

Johnson (1967) originally claimed that aid is unambiguously preferable to import absorption as a way to increase national income in a developing country. He viewed exports as an indirect way of providing assistance. The only gain from exporting widgets is the ability to fund lower-cost importation of other consumption goods. Aid, in contrast, can be used much more flexibly and so in theory can be applied in a manner that will yield the greatest benefit at the margin. Johnson's theory was expanded by Thirlwall (1976), who suggested that even after accounting for the fact that a unit of ODA translates into a smaller amount of actual "aid" because donor countries often require that some (even most) of it be spent on purchases from the donor country, the conditions for exports to augment GDP more than the equivalent amount of ODA are quite stringent.

There has been significant empirical research on these claims. The most direct test was Yeats (1982). He analyzed the relation between growth, foreign aid, and exports, and found that both aid and exports had a significant and positive impact on economic growth in developing countries, although exports were somewhat more effective than aid. His results indicated that one unit of exports was equivalent to approximately 2.13 units of pure aid. But ODA's aid equivalent is smaller because donor countries often tie aid to purchases of donor-country products. Employing a different method and taking account of these considerations, Yassin (1982) claimed that data for Sudan from 1958 through 1979 suggested that ODA on balance had a *negative* effect on recipient countries. More recently, Burnside and Dollar (2000) have suggested that ODA can spur economic growth, but only when accompanied by economic reform.

This literature does not consider many of the factors deemed to be important in the new growth literature. Much of that literature is descended from the original neoclassical growth model of Solow

(1956), with its depiction of economic growth as a convergence toward a globally uniform level of prosperity through the accumulation of state-of-the-art production technology. The new growth literature has augmented the Solow approach by arguing that the population's skills (human capital) affect the ability to absorb modern technology, while the security of property rights and an absence of government distortions facilitate capital accumulation. Wittman (1989) also argues that democracy and political liberty allow populations to more easily decrease the cost of whatever distortions the government does erect. His argument is that democracy is political competition, and should control inefficient government behavior as effectively as economic competition controls inefficient economic behavior.

The new growth literature makes no mention of the benefits of export-led development or the effects of foreign aid. And while trade has the benefits outlined above, aid too in principle can augment factor productivity. Physical capital can be enhanced when aid is used to construct, for example, roads and electric and communication infrastructure, while human capital can be increased when aid is used for public health or educational purposes. The real issue is not whether trade and aid have growth effects by themselves, as seen in previous work, but whether those effects are independent of the factors the new growth literature has found to be important.

### *Results*

The contribution of the various potential determinants of growth is tested via an ordinary-least-squares regression of real per capita GDP growth in the period 1987–95 on trade and aid variables, as well as on proxies for the factors emphasized in the new growth theory. AIDPER and TRADEPER are ODA received and total imports and exports combined, respectively, from 1988 through 1995 as a proportion of GDP. Greater trade may lead to faster growth, other things equal. Aid, trade, and per capita GDP growth are all real variables, using 1990 base-year prices. LOGGDP is the natural logarithm of 1985 GDP, which measures the level of development at the onset of the data period. Both the new growth theory and the Solow growth model suggest that, because the introduction of modern technology has the greatest effect on the least-advanced economies, poorer countries should grow more rapidly than those countries already approaching a modern standard of living, other things equal.<sup>3</sup> This suggests a negative sign for LOGGDP.

<sup>3</sup>This is known as the “convergence” hypothesis.

POLFREE is the commonly used Gastil (1986) measure of political freedom for 1985. It measures freedom of speech and the press as well as electoral competitiveness. It can take a value between 2 and 14, with 2 being the freest and 14 the least free. ECFREE85 is the measure of economic freedom compiled by the Fraser Institute. It takes a value between 0 and 10, with 10 representing the most freedom—that is, the least government intervention in economic activity.<sup>4</sup> FREEDIFF is the difference in the Fraser ranking between 1985 and 1995, and is included to measure whether the rate of change of economic freedom matters, as opposed to the level of economic freedom at the beginning of the period. PFREDIFF is the analogous change in political freedom. HUMCAP is the country's secondary school enrollment in 1985 (UNESCO 1997) multiplied by the country's 1985 life expectancy (Central Intelligence Agency 1986), and measures the country's human capital.

The sample consists of 69 developing countries (as classified by the United Nations) for which data on all the independent variables exist. Because the Soviet Union had not yet fallen in 1987, data on its former constituent republics for the earlier period of the estimation do not exist, and they are thus excluded. Other than that omission, the countries come from all regions of the world. They are listed in Table 1.

Table 2 contains the results. The variables that are important in the new growth theory are statistically significant in the expected direction. Convergence is suggested by the sign and significance of the coefficient of LOGGDP85. Human capital is positively associated with growth. More-skilled populations, other things equal, live in societies that grow faster. Economic freedom and its change during the period under study are both highly significant and positively associated with growth. Finally, as is common in other tests of the determinants of economic growth (e.g., Barro 1996), neither political freedom nor its change over the study period is statistically significant.

As for the primary variables of interest in this study, trade is positively and significantly associated with growth.<sup>5</sup> Aid, in contrast, has a negative and significant coefficient. In absolute-value terms, the coefficient for aid is actually significantly larger than that for trade.

<sup>4</sup>The ratings are constructed from measures of the size of government, the extent of reliance on markets, monetary policy and price stability, the freedom to use other currencies, legal structure and property rights, the size of and restrictions on international trade, and freedom of exchange in financial markets.

<sup>5</sup>In fact, both exports and imports are significantly related on their own to growth when used instead of total trade (details available upon request).



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TABLE 1  
COUNTRIES USED IN ANALYSIS

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Algeria	Mexico
Argentina	Morocco
The Bahamas	Myanmar
Bahrain	Nepal
Bangladesh	Nicaragua
Barbados	Niger
Belize	Nigeria
Benin	Oman
Bolivia	Pakistan
Brazil	Panama
Burundi	Papua New Guinea
Cameroon	Paraguay
Central African Republic	Peru
Chad	The Philippines
Chile	Rwanda
China	Senegal
Colombia	Sierra Leone
Costa Rica	Singapore
Cote D'Ivoire	Sri Lanka
Dominican Republic	Syria
Ecuador	Tanzania
Egypt	Thailand
El Salvador	Togo
Guatemala	Trinidad & Tobago
Guinea-Bissau	Tunisia
Guyana	Uruguay
Haiti	Venezuela
Honduras	Zambia
India	Zimbabwe
Indonesia	
Jamaica	
Jordan	
Kenya	
South Korea	
Kuwait	
Madagascar	
Malawi	
Malaysia	
Mali	
Mauritius	

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TABLE 2  
REGRESSION RESULTS  
DEPENDENT VARIABLE: PER CAPITA REAL ECONOMIC  
GROWTH, 1987–95

Independent Variable	Coefficient	<i>t</i> -statistic	<i>p</i> -value
Intercept	1.04206	1.89	0.0635
AIDPER	-0.18768	-2.32	0.0240
TRADEPER	0.02068	2.29	0.0257
LOGGDP85	-0.20149	-2.97	0.0042
ECFREE85	0.07331	2.29	0.0256
FREEDIFF	0.10492	2.94	0.0047
HUMCAP	0.00512	1.70	0.0937
POLFREE	0.01177	0.98	0.3324
PFREDIFF	0.00099	0.09	0.9302
R <sup>2</sup> = 0.5081			
F = 7.75 ( <i>p</i> < 0.0001)			
n = 69			

Because TRADEPER and AIDPER are measured in the same units, this suggests that the magnitude by which aid deters growth is even stronger than that by which trade promotes it. At a minimum, trade yields benefits independently of the factors that are analyzed in the new growth literature, and is a far more effective way to promote prosperity than aid.

### Explaining the Ineffectiveness of Foreign Aid

Why does ODA seem systematically unable to spur economic growth and even to contribute negatively to it? The incentives the aid system provides to donors and recipients alike are obvious candidates.

#### *Donor Incentives*

ODA is often designed to achieve objectives other than increasing prosperity in recipient countries. Some goals, such as building open societies, are in principle laudable, while others are morally ambiguous at best. In the United States, national security considerations often influence foreign-aid decisions, whether the aid is provided as cash, food, or in-kind contributions. Concern over Middle East instability has made Israel, Egypt, and Jordan the largest recipients of U.S. foreign aid. During the 1980s, cold war considerations caused a

sharp escalation in U.S. aid to Central America and the Caribbean even as aid to Africa declined. The Clinton administration chose to emphasize what it characterized as environmental, population, and democracy-building concerns rather than growth (Ruttan 1996). Some empirical literature has recently documented the extent to which geopolitical considerations determine the overall level of aid by donor countries (Alesina and Dollar 1998) as well as food aid in particular (Zahariadis, Travis, and Ward 2000; Ball and Johnson 1996).

Other donors have their own objectives. For many years Sweden targeted aid toward “progressive” societies. In France, governments since De Gaulle have sought to promote the maintenance and spread of French culture and the French language as well as the preservation of French influence, particularly in West Africa. French aid has also often been disproportionately concentrated among nations with which France has extensive commercial ties. In Japan, aid has historically flowed disproportionately to neighboring Asian nations in which Japan has the greatest commercial interests, and Japan has in the past often tied aid to purchases of Japanese products. In general, pressure groups such as trade associations and, in the United States, ethnic political blocs have also proven quite adept at steering aid to their favored recipients (Hook 1995). If aid is not particularly given with the intention to foster economic growth, it is perhaps not surprising that it does not achieve it.

The same problems afflict multilateral lending agencies such as the World Bank and the International Monetary Fund. Such quasi-state agencies, like national governments, have their own incentives that influence the loans that donors request and that these agencies agree to make. Burnham (1994) finds that increased lending, rather than growth or development, is the operational objective of the World Bank, and that the member nations take the promotion of their own nationals among the professional staff as a primary objective in trying to influence policy. Presumably, if member governments pursue the latter objective as vigorously as they do, there is some payoff in the form of increased lending to the government in question. In addition, the fact that member governments must approve loans increases the risk that the World Bank will prefer to cultivate those governments by facilitating increased state control over the economies over which they preside, with negative effects on the ability of markets to do the heavy lifting of creating prosperity. In light of this, it is not surprising that a 1992 self-evaluation (known as the Wapenhans Report) criticized the World Bank’s “approval culture,” and found that 37.5 percent of projects completed in 1991 were failures by the Bank’s own

criteria. More recently Meltzer (2000) claims that the World Bank itself admits that half its projects, and more in the poorest countries, are failures.

### *Recipient Incentives*

Government officials in recipient countries also have compelling incentives that may render foreign aid ineffective. To some extent, recipients are affected by the same incentives as donors. ODA benefits both donor and recipient governments. Presumably the incentives to seek aid work in tandem with the incentives to offer it, and so the distortions referred to above play out at both ends of the ODA pipeline.

Foreign aid from both individual donor governments and multilateral lending organizations is almost entirely funneled through governments of recipient countries. In some cases it has constituted the majority of government budgets of developing societies. The expansion of the state that foreign aid enables thus makes government a comparatively important focus for entrepreneurial energy. When the state is the most important source of wages, employment opportunities, and many goods and services, as well as other things of value, skilled people find it profitable to work for the state, curry favor from it, or otherwise engage in activities that redistribute rather than create wealth. This perverse incentive structure will cause the state to expand further. The dispensing of foreign aid through the state, in other words, makes it easier for recipient societies to fall into a rent-seeking trap (Krueger 1974).

ODA itself can also be hobbled by corruption due to bureaucratic skimming or related inefficiencies. Corruption may also affect the projects that are chosen to be financed. If ODA is used to build a state-of-the-art hospital in the district of the capital city in which most ministers and their families live rather than to finance vaccination programs nationwide, the waste can be greater than if officials in recipient or donor countries were to embezzle some proportion of the vaccination funding. ODA is also wealth that, because it does not require increased taxation or less government spending, comes to the recipient government at low opportunity cost. It may thus be used to finance comparatively low-value projects that could not obtain funding competitively from private sources.

Evidence on “white elephants” financed by foreign aid is both old and vast (Ayittey 1994; Hancock 1989; Lappe, Collins, and Kinley 1981; Fleming 1966). Such projects are a predictable consequence of the incentives intrinsic to ODA. Leaders in recipient countries, like

leaders everywhere, are frequently interested in maximizing short-term political support, which is often a function of the aggregate level of employment and income provided to citizens, officials, and businessmen. Projects that generate large numbers of jobs while providing few long-term benefits are thus nonetheless beneficial in the short run for the government even as they are unlikely to attract private support. Hence, such projects may be the most likely outlet for foreign aid. But even while the projects are funded from abroad, their creation and maintenance draw scarce local resources and entrepreneurial initiative from other uses. There is thus a particularly sharp divergence between private cost to the government—close to zero—and social cost.

Empirical research on the effects of corruption includes both country-specific analysis and more general investigations. Individual countries in which corruption is found to substantially handicap foreign aid include India (Kamath 1994) and Haiti (Dewind and McKinley 1988). Although it might be hoped that less ODA would flow to states in which corruption most harms its effectiveness, Alesina and Weder (1999) have found that, in fact, there is a slight positive association between the level of corruption and the amount of foreign aid. Even the World Bank (1998) has begun to concede the significant problems that corruption presents for effective development assistance.<sup>6</sup>

### Trade Liberalization as a Form of Development Assistance: The Relative Performance of the United States, Japan, and Europe

If connection to the global economy is a more effective way of promoting growth than aid, the question of the performance of rich countries in helping poor ones achieve prosperity should be rephrased to emphasize the openness of developed countries to the exports of underdeveloped countries. The relative performance of the United States, Japan, and Europe with respect to trade liberalization thus becomes an important policy question.

#### *Regional Integration*

Europe and the United States have gone through increasing formal regional integration in the past 30 years. This pattern is most dramatic

<sup>6</sup>Development economist Peter Bauer long ago recognized the corrupting influence of foreign aid and how it politicizes economic life and breeds instability (Bauer 1981: chap. 5).

TABLE 3  
INTRAREGIONAL TRADE (PERCENT OF TOTAL TRADE)

	1948	1973	1993
Western Europe	41.8	67.7	69.9
North America	27.1	35.1	33.0
Latin America	20.0	27.9	19.4
Asia	38.9	41.6	49.7
World	32.9	49.3	50.4

NOTE: North America is the United States and Canada; Mexico is included in Latin America.

SOURCE: Carlisle (1996).

in Europe, where the completion of the economic union in the European Union (EU) has meant that most goods and productive factors (including labor) move easily across national borders. Table 3 indicates that the proportion of intraregional trade has expanded in the postwar period in North America, Europe, and East Asia, but most dramatically in Europe. As European integration has proceeded, more and more trade has occurred entirely within the EU. This can represent trade creation, in which high-cost domestic production in one EU nation is replaced, after the lowering of trade barriers, by imports from other countries inside or outside the EU. It may also represent trade diversion, in which the common EU tariff (or other Europe-wide protection) against nonmembers causes imports to be diverted from outside the union to within.<sup>7</sup> The former enhances efficiency and so is not a particular source of criticism, but the latter would, if it is a substantial phenomenon, suggest protectionism affecting imports from nonmember nations as the explanation for declining imports from developing countries.

Does the pattern in Table 3 represent trade creation or trade diversion? Several authors (Bayoumi and Eichengreen 1997, Glejser and Moro 1996) have reported significant trade diversion resulting from the expansion of the EU. Between 1970 and 1997, the United States and Japan saw a significant increase in their shares of imports in general and manufactured imports in particular from developing countries, as shown in Tables 4 and 5. The EU and the European

<sup>7</sup>In a customs union, such as the EU, there are in principle no barriers to trade among member nations, but all members must adopt a uniform "common external tariff" with respect to nonmembers. The EU itself now collectively negotiates more and more of its members' trade policies, which are now implemented at the transnational rather than national level.

TABLE 4  
IMPORTS FROM DEVELOPING COUNTRIES AS A PERCENTAGE OF  
ALL IMPORTS

	1970	1980	1990	1994
United States	25.91	48.41	36.55	40.52
Japan	38.65	62.73	53.29	47.75
European Union	16.84	21.26	12.60	14.31
European Free Trade Area	6.83	10.87	5.78	7.00
Total (Europe)	15.04	19.52	12.18	13.88

SOURCES: United Nations, *Statistical Yearbook* (various years), United Nations, *International Trade Statistics* (various years).

Free Trade Area, in contrast, have seen their already small shares decrease slightly for imports in general. For manufactured imports, the trend is even more striking. A substantial increase in developing countries' share of the U.S. and Japanese markets for manufactured imports has been accompanied by only modest increases in Europe.

Of course, as argued earlier, another useful measure of trade assistance to developing nations is the percentage of GDP that imports from developing nations comprise, as indicated in Figures 2 and 3. In tandem, the evidence suggests that Europe is distinct. Standard international trade theory suggests that European integration should not cause European, U.S., and Japanese patterns to be dramatically different with respect to imports from developing countries. The United States, Japan, and each member of the EU are all economically similar. They are highly industrialized nations with well-educated populations relative to the developing world. The theory of comparative advantage, however, suggests that the greatest gains to trade between nations occur when the nations are the most different.

TABLE 5  
IMPORTS FROM LDCs AS A PERCENTAGE OF ALL IMPORTS,  
MANUFACTURED GOODS

	1970	1980	1990	1994
United States	12.65	20.88	30.34	38.29
Japan	18.74	29.25	36.48	47.66
European Union	5.46	6.20	8.84	11.32
European Free Trade Area	2.36	2.98	4.91	6.01
Total (Europe)	4.80	5.56	8.58	10.99

SOURCES: Same as Table 4.

When similar nations merge with others in a single trade bloc, the resulting increase in trade should be comparatively small. European integration, therefore, should not cause imports from developing countries to fall unless integration is accompanied by increased protectionism.

Japan, whose import absorption has varied far less than Europe's, is not a member of any substantial regional trade blocs but has increased its commerce significantly with its East Asian neighbors. Carlisle (1996) suggests that the increase in Asian intraregional trade portrayed in Table 3 is largely a function of investment by Japanese firms in neighboring nations. This increased intraregional trade is not due to the creation of a formal trade bloc, although that does not rule out its relation to government policy. The substantial increase in Mexican exports to the United States, even before the launch of the North American Free Trade Agreement, cannot alone explain the sizable increase in U.S. manufactured imports from developing countries. The European case is thus distinct, and regional integration by itself suffers as an explanation for the differing performance of Europe, Japan, and the United States with respect to trade with the developing world. Protectionism is left as a suspect.

### *Protectionism*

The evidence is inferential rather than direct. The most easily measured form of protection, the tariff, is a negligible factor (on average) in most industrialized countries. The EU's common external tariff vis-à-vis nonmembers averages less than 10 percent. Tariffs in the United States and Japan are similarly low. However, tariffs are not uniform against all developing countries. "Affiliated" former colonies in Africa, the Caribbean, and the Pacific often receive advantageous treatment in the EU, meaning that nations in Latin America and the Far East are relatively disadvantaged.<sup>8</sup> EU tariffs have historically tended to disproportionately affect manufactured exports from these nonaffiliated nations, although there is some evidence that this discrimination has declined since the most recent Uruguay Round negotiations (Grilli 1997).

Nontariff barriers (NTBs) are another matter. A large body of literature documents the increasing use of NTBs since the mid-1960s, particularly in declining as well as "strategic" industries and against newly industrializing economies (e.g., Grilli 1997; McAleese 1994;

<sup>8</sup>This provision was the source of the long-running banana dispute at the World Trade Organization between the United States and the EU.



Scott 1993; Laird and Yeats 1990; Pelkmans 1987). Deardorff and Stern (1998) document that in 1993 NTBs were widely used and covered the largest fraction of imports in the United States, with the lowest coverage in Japan and the EU in the middle. However, the authors looked at mostly border measures rather than subtle administrative NTBs.

There is reason to believe that administrative measures have had sizable effects in Europe. In a case study of the Italian automobile industry, Turrini (1996) found large levels of protection despite low tariffs. One prominently studied NTB is the “Voluntary Export Restraint (VER),” in which a nation concerned about import penetration avoids the World Trade Organization’s prohibitions on import quotas by negotiating outside the WTO framework with an exporting nation to restrict its manufactured exports. Grilli (1997) documents that the most frequent targets of European VERs are Japan, South Korea, and Taiwan. Latin American nations are most frequently disadvantaged in steel, and former Warsaw Pact nations (some of which are supposed to eventually assume EU membership) are the most frequent victims in food, steel, and electronics. Other NTBs include antidumping measures and the use of regulations and administrative measures to deter imports.<sup>9</sup> Grilli also finds that the proportion of EU imports subject to NTBs rose steadily throughout the 1970s and 1980s before declining slightly, and it is surely suggestive that it was during this period that manufactured import absorption from developing countries by the EU stagnated while it was rising in the United States and Japan. More ominously, Sarfati (1998) suggests that the expanding power of EU regulatory authorities in Brussels presages an increased use of ecological labeling requirements and taxes, as well as antitrust measures, to restrict trade. If domestic pressure groups in developed countries are able to keep out low-cost imports from developing countries because of alleged violations of environmental standards or worker rights, this could severely limit the growth of developing-country exports.<sup>10</sup>

<sup>9</sup>For a description of an unusually clever NTB, in which the French government attempted to retaliate against what it saw as Japanese protectionism by shunting Japanese videocassette recorders through an out-of-the-way customs station, see Mikic (1998: 356).

<sup>10</sup>Of course, the United States and Japan are hardly blameless when it comes to NTBs. Historical examples include VERs imposed by the United States on automobiles in the early 1980s and onerous inspection requirements at Japanese customs facilities. Clark (1998) finds that U.S. NTBs disproportionately affect the poorest countries. Although trend information is hard to come by, Harrigan (1993) employs 1983 data and finds that NTBs are common in both the United States and Japan, although Japan had the highest levels of any of the studied countries and the United States the lowest.

## Conclusion

Given the negative relation between aid and growth, the performance of industrial nations in development burden sharing must be redefined. The most important thing rich countries can do to aid poor ones is to keep their markets open. Cash and project assistance is at best a distraction and quite possibly harmful in terms of promoting prosperity. The best thing governments of poor countries can do is to become part of the global economy by removing barriers to trade and eliminating government-imposed distortions in the economy. Without those steps, increasing foreign aid will not bring modern standards of living to the world's poor.

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