Available online at www.sciencedirect.com
ScienceDirect
Journal of Macroeconomics 30 (2008) 1269–1284
Journal of MACROECONOMICS
www.elsevier.com/locate/jmacro

Foreign aid, domestic capital accumulation, and foreign borrowing

Cui Xiaoyong, Liutang Gong *

Guanghua School of Management, Peking University, Beijing 100871, China

Received 25 April 2006; accepted 8 August 2007
Available online 19 August 2007

Abstract

In an infinite-horizon model with Marshallian time preferences, foreign aid, foreign borrowing, and domestic capital accumulation, this paper reexamines the effects of foreign aid on domestic capital accumulation and foreign borrowing. Comparative static analysis shows that a permanent increase in foreign aid leads to an increase in both long-run capital accumulation and domestic consumption, but a decrease in foreign borrowing. Short-run analysis shows that both a permanent and a temporary increase in foreign aid makes people more patient, which leads to a rise in investment and a reduction in foreign borrowing initially.
© 2007 Elsevier Inc. All rights reserved.

JEL classification: E2; F34; F35; F43; O1; O4

Keywords: Foreign aid; Foreign borrowing; Capital accumulation

1. Introduction

Ever since the pathbreaking analysis of the "two-gap" model of development, which predicts that foreign aid and foreign capital inflows can accelerate investment and speed the transition to a targeted self-sustained growth path (Chenery and Strout, 1966), the effects of foreign aid and external borrowing on investment and growth in developing countries have received considerable attention in both academic studies and policy discussions.

* Corresponding author. Tel.: +86 10 6275 7768; fax: +86 10 6275 1463.
E-mail address: ltgong@gsm.pku.edu.cn (L. Gong).

0164-0704/$ - see front matter © 2007 Elsevier Inc. All rights reserved.
doi:10.1016/j.jmacro.2007.08.002

However, both empirical and theoretical studies have produced rather inconclusive, often contradictory findings: see Griffin (1970), Griffin and Enos (1970), Boone (1994a,b), Claessens et al. (1995), Calvo (1996), Feyzioglu et al. (1998), Taylor and Sarno (1997), Barro and Lee (2003) and Gong and Zou (2000, 2001). The implication of these earlier studies naturally suggests that foreign aid has very little positive impact on capital formation and output growth in developing countries.

The story changes with an academic study by Burnside and Dollar (1997, 2000). Using a new database on foreign aid that had been developed by the World Bank, they find the interaction term between foreign aid and good policy to be significantly positive, and that "(foreign) aid has a positive impact on growth in developing countries with good fiscal, monetary, and trade policies but has little effect in the presence of poor policies" (Burnside and Dollar, 2000). Following this line of thought, recent studies, including Burnside and Dollar (2004), Collier and Dollar (2001, 2002), Collier and Dehn (2001) and Svensson (2003), employ better empirical methods and better data and show that aid works in all countries, but its impact on growth is contingent on the policies of recipient countries so that it works better in countries with better policy regimes. Though these studies emphasize the role of the policy environment in aid effectiveness, most recently empirical research has suggested that aid works in countries irrespective of the quality of the policy regime, see Dalgaard et al. (2004), Gounder (2001, 2002), Ram (2004), Economides et al. (2004), Feeny (2005), Clemens et al. (2004), Heady et al. (2004) and Ouattara and Strobl (2004). Regardless of whether policy is important for aid effectiveness, almost all empirical studies conducted over the last seven or eight years have shown that foreign aid and capital inflows appear to work in the sense that per capita economic growth would have been lower in its absence.[1]

Although several studies focus on aid effectiveness and the controversy continues, it is mainly on empirical side. The theoretical attempts have not been able to fully rationalize these empirical findings. Obstfeld (1999) adds foreign aid to Cass–Koopmans–Ramsey optimal growth model and predicts some positive impacts of foreign aid on domestic investment and growth in the sense that foreign aid stimulates short-run investment and speeds up the transition to the long-run steady state of the economy. In the long run, however, foreign aid has no effect on capital accumulation, and it only increases long-run consumption dollar for dollar. In contrast, Gong and Zou (2000, 2001) show the negative effects of foreign aid on domestic investment and growth. Turnovsky (2008) discusses the effects of different foreign aid programs on economic growth and shows that the consequences of tied and untied programs for economic growth and welfare depends crucially upon the elasticity of labor supply and possible production externalities of public capital in the production process.

Among these theoretical studies, Gong and Zou (2000) consider the relationship between foreign aid and economic growth in an infinitely lived, representative agent model that implements Uzawa (1968) endogenous time preference, and foreign aid increases the agent's income. They assume that the representative agent's subjective discount rate depends negatively on the level of current utility, which itself is an increasing function of consumption. Foreign aid raises the agent's income and increases his/her initial consumption. This decreases the agent's subjective discount rate, and makes him/her less

[1] One exception is a recent paper by Kourtellos et al. (2007). They use model averaging methods such as Bayesian Additive Regression Trees (BART) and find that the relationship between aid and growth is negative.

متن کامل مقاله

دریافت فوری

ISIArticles
مرجع مقالات تخصصی ایران

- ✓ امکان دانلود نسخه تمام متن مقالات انگلیسی
- ✓ امکان دانلود نسخه ترجمه شده مقالات
- ✓ پذیرش سفارش ترجمه تخصصی
- ✓ امکان جستجو در آرشیو جامعی از صدها موضوع و هزاران مقاله
- ✓ امکان دانلود رایگان ۲ صفحه اول هر مقاله
- ✓ امکان پرداخت اینترنتی با کلیه کارت های عضو شتاب
- ✓ دانلود فوری مقاله پس از پرداخت آنلاین
- ✓ پشتیبانی کامل خرید با بهره مندی از سیستم هوشمند رهگیری سفارشات