Aid, growth, and welfare in an interdependent world economy

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December 19, 2006

Abstract
We examine growth and welfare effects of foreign aid in a two-country, two-good endogenous growth model with learning by doing and intersectoral knowledge spillovers. We obtain two main results. First, a permanent increase in untied aid raises the common growth rate if and only if the propensity to consume the capital-intensive good in the recipient country is larger than in the donor country. Second, the growth-enhancing aid is also Pareto-improving if and only if the propensities to consume are sufficiently different between countries, with the required difference being smaller for the lower subjective discount rate.
JEL classification: F35; F43; O41
Keywords: Aid and growth; Intersectoral knowledge spillovers; Factor price equalization theorem; Stolper-Samuelson theorem; Pareto-improving untied aid

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