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Business Cycle Fluctuations, Large Macroeconomic Shocks, and Development Aid

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Abstract: We examine the cyclical properties of development aid using bilateral data for 22 donors and 113 recipients during 1970–2005. We find that bilateral aid flows are on average procyclical with respect to the business cycle in both donor and recipient countries. While aid outlays contract sharply during severe downturns in donor countries, they rise steeply when aid-receiving countries are hit by large adverse shocks. Our findings suggest that development aid plays an important cushioning role in developing countries—regardless of their income level—but only during times of severe macroeconomic stress. Our results are robust to alternate definitions of aid flows, across specifications and estimation techniques.

Keywords: Foreign aid, Bilateral donors, Business cycle, Macroeconomic shocks.

JEL classification codes: E22, E32, O11, O19.

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Avec le concours des Economètres Tunisiens pour l’organisation logistique