# What does the Negative Aid-Savings Relationship Really Mean?

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**Abstract**

This paper examines the relationship between aid and domestic savings at the global and regional levels. However, it departs from the previous literature on aid and savings in developing countries by abandoning the pervasive, but untenable, assumption that all aid is used to expand the trade deficit and thus applied wholly to consumption or investment. In fact, our results, from a panel of sixty-two countries, indicate that for the period 1968-2006, 29% of any increase in aid relative to output was used to finance reverse flows (some combination of interest payments, debt amortization, capital flight and reserve increases), 64% was used to increase consumption relative to output (meaning a reduction in the domestic savings rates) and only 7% was used to increase the rate of investment.

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