

The Money-Moving Syndrome and the Effectiveness of Foreign Aid

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Dissertation Abstract

Aid ineffectiveness, defined as the low performance of aid in promoting economic growth and reducing global poverty, is a problem utterly complex, prevalent and unfortunately still unresolved. For decades now, it has generated a huge literature reaching conflicting conclusions as to the justifications of aid, the impact of aid on growth and institutional reforms, and the role of economic and political institutions in aid effectiveness. Western countries, international donor agencies, recipient countries, and other agents in the aid delivery chain have been pondering why, after \$2.2 trillion of official development assistance transferred to developing countries since 1960 and in spite of countless reform approaches, many aspects of the performance of international development assistance yet appear dismal. In the discourse of foreign aid, the potential causes of the shortcomings of development assistance to promote economic growth and self-sustainability in poor countries appear to be manifold, ranging from weak policies and institutions in recipient countries to problems within the donor agencies themselves.

The goal of this dissertation is to examine in depth one of the potential causes of the low performance of foreign aid; in particular, the role incentive structures within international donor agencies could play in leading to “a push” to disburse money. This pressure to disburse money is termed as the “Money-Moving Syndrome”. In this dissertation, the “Money Moving Syndrome” exists when the quantity of foreign aid committed or disbursed becomes, in itself, an important objective side by side or above the effectiveness of aid. A fundamental reason to limit the scope of this dissertation to institutional framework within donor agencies is that without this transfer of funds to developing countries, there would be not much “foreign aid”. If the objective is to maximize the effectiveness of aid, it would appear essential to enhance the design and objectives of aid resources *at the source*, i.e. at the stage where the funds originate with donors, before considering the causes tainting aid in recipient countries.

The overall motivation for this dissertation is to uncover to what extent the Money-Moving Syndrome (thereafter MMS) may be one major handicap of foreign aid effectiveness and to what extent this syndrome may shape other incentives at the macro and micro levels of the aid delivery chain. In short, donors’ incentives to “move the money” may potentially hinder their genuine intentions to help poor countries, rendering these efforts ineffective and possibly in some cases, making an already deplorable situation in developing countries worse.

The theoretical analysis relies on the principal-agent theory to explore how donor agencies’ institutional incentive systems affect the characteristics of an optimal incentive contract and thus give rise to the MMS. Additionally, the model derives conditions required to reach an efficient outcome in terms of the impact of aid on poverty reduction and sustainable economic growth. We adapted the basic framework developed in Baker (1992) to fit the organizational settings of international development agencies. Due to data unavailability regarding other bilateral and multilateral aid agencies, the empirical framework tests the predictions of the theoretical model by mainly examining whether money moving incentives affect the World Bank’s decisions over loan amounts of development projects or programs in aid-receiving countries and how these incentives may directly or indirectly affect the effectiveness of aid resources in those countries.

The intent of this study is not to identify whom to blame for the ineffectiveness of foreign aid; the objective is rather to help demystify an undermining problem. No doubt, behind the ineffectiveness of international aid lie the many problems of the recipient countries. However, examining the poor performance of the bureaucracies of developing countries is beyond the scope of this study. Thus, the contribution of this dissertation will not necessarily solve the problem of aid ineffectiveness. The scope of this dissertation is also limited to official aid as opposed to private contributions; i.e. we focus on money specifically coming from donor countries’ governments and channeled through bilateral and multilateral development agencies, as well as money mobilized by multilateral organizations on international capital market.