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Mirages of External Finance in Social Protection: the Politics of Aid Viewed Through the Monetary Transfer Dilemma

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Abstract

Official development assistance (or aid for short) that is intended for financing social protection is, for the most part, not actually spent on social protection given that social protection expenditures—especially cash transfer programmes—are almost entirely in domestic currency, whereas aid is in foreign currency. This article elaborates a theoretical and conceptual framing of this counterintuitive understanding that has been ignored in the scholarship on the financing and/or politics of social protection in developing countries. The framing is based on what can be called a monetary transfer dilemma facing most developing countries that confront strong external constraints with subordinated (or "soft") currencies. Combined with illustrations from a research project on the external financing of social protection, it clarifies how external funding that is notionally associated with social protection programmes tends to exacerbate underlying tensions between donors and recipient governments given the balancing act that the latter must perform between addressing foreign currency needs versus compliance with donor expectations. These tensions are synthesised along three themes: the predominance of budget support in so called social protection financing, which relies on conditions rather than direct funding; how this has tended to associate the social protection agenda to the broader policy mandates of international financial institutions, especially the International Monetary Fund, with its focus on fiscal consolidation, austerity, and macroeconomic reforms; and the gulf of understanding between governments and donors regarding the fundamental role of aid in such contexts. Rather than simply accepting that the supply of their hard currency is the primary function of their aid, the insistence of donors to influence domestic policy and spending through the power of their hard currencies potentially paves the road to structural adjustment with good intentions.

Keywords

aid; cash transfers; developing countries; external finance; fiscal policy; macroeconomics; monetary policy; political economy; social protection

1. Introduction

The idea that official development assistance (aid for short) funds social protection programmes in low- and middle-income countries, and that other sources of external funding could and should as well, is generally treated as self-evident, to an extent that it is almost never questioned. However, it runs against what can be called a monetary transfer dilemma in these countries. This is the inverse of Keynes' famous "German transfer problem," whereby Germany could not use savings in domestic currency to pay for reparations in foreign currency (Keynes, 1929). Similarly, most developing countries today cannot pay their external debits and liabilities in their domestic currency, as an expression of what Eichengreen and Hausmann (1999) refer to as "original sin," or a core feature of what some current heterodox scholars refer to as "international financial subordination" (e.g., Alami et al., 2023) or "currency hierarchy" (e.g., de Paula et al., 2017; Kaltenbrunner, 2015). Inversely, foreign currency also cannot be used to pay for expenditures in domestic currency (unless the economy is dollarized) but must instead go through a conversion or transfer process. This might appear unproblematic but involves a range of complex and contentious politicised dynamics in countries that face hard external constraints with "soft" (or subordinated) currencies. In such contexts, we need to ask why aid would be conceived as funding domestic currency expenditures when recipient governments desperately need foreign currency and use the foreign currency supplied by aid to meet their external payments.

If we specify this dilemma to social protection, aid (grants or concessional finance) that is notionally associated with social protection is, for the most part, not actually spent on social protection given that social protection expenditures—especially cash transfer (CT) programmes—are almost entirely in domestic currency (except for items such as payments to foreign consultants). Instead, the foreign currency that aid provides is necessarily spent on expenditures that require foreign currency. As a corollary, expenditures in domestic currency, epitomised by social protection, do not actually need aid given that they can be financed through domestic fiscal and monetary operations, to the extent that this is permitted by international financial institutions (IFIs) if countries are under their tutelage. In other words, such expenditures do not face an external constraint, unlike many other aspects of government spending in developing countries that do.

This counterintuitive understanding has been ignored in the scholarship on the financing or politics of social protection in developing countries. It is even overlooked in most of the finance for development scholarship more generally, except for a specialised subset of work affiliated with the International Monetary Fund (IMF) on the macroeconomic management of aid following the Multilateral Debt Relief Initiative in the mid-2000s. However, that work has been ignored by social protection scholars, and mostly ignored by finance for development scholars. Rather, a direct channel from aid to the funding of programmes such as CTs is generally taken for granted, to the extent that aid or other sources of foreign currency such as international taxation are regularly referred to as potential sources of funding for social protection and this is almost never perceived as problematic (e.g., see the book edited by Hujo & McClanahan, 2009, and a recent special issue edited by Idris et al., 2025, as well as Holmqvist, 2012; Ortiz et al., 2019).

As a theoretical and conceptual contribution drawing from the above-mentioned IMF-affiliated work and from classic structuralist and post-Keynesian insights on external constraints, this article clarifies how the monetary transfer dilemma is in fact problematic and lies at the core of politicised encounters in donor-driven agendas of social protection. In other words, the link between aid and social protection does not necessarily pass through direct funding, but instead operates through obscure processes of negotiation, conditionalities (or their equivalents), and monitoring, which in turn exacerbate underlying tensions between donors and recipient governments. That this might also lead to diverse outcomes—as is often asserted as evidence that external pressure is neither homogeneous nor sufficient to explain variations in CT programmes across similarly aid-dependent countries (e.g., see Hickey et al., 2019; Lavers & Hickey, 2016, 2021)—is not surprising given the convoluted, contested, and often contradictory nature of these processes.

To illustrate this framing, examples are drawn from a larger research project that I led from 2015 to 2021 on the political economy of externally financing social policy in developing countries (AIDSOCPRO, ERC grant number 638647). The project examined seven countries (Cambodia, Ecuador, Ethiopia, Ghana, Paraguay, the Philippines, and Zambia), which were selected as crucial cases, in the sense that they involved substantial involvement from donors in the inception and/or extension of CT programmes. They were also selected as contrasting cases along several dimensions, such as external trade balance, sovereign debt situation, monetary characteristics, degree of aid dependence, extent of state capacity to manage donors and implement national development strategies, ideological propensity to resist donors, and the extent to which social protection programmes had already been implemented. The primary research methodologies involved documentary analysis of loan, grant, and policy documents, applied balance of payments analysis from the late 1970s onwards (e.g., Fischer, 2020), and extensive elite interviews concentrated in 2017–2018 (over 60 per country). While other members of the research team (three PhD and one post-doctoral researchers) focused on the political economy of social protection more generally, I focused on the more technical financing dimensions, as discussed in this article. This included elite interviews with senior staff in finance ministries and central banks, and other elite policy actors with specialist knowledge on the technicalities of financing social protection programmes.

However, to clarify, due to lack of space this article does not offer any detailed systematic analysis of the primary data generated by the project. An initial overview of the project findings can be found in Fischer (2019), and specific case analyses in Badillo Salgado (in press), Dadap-Cantal (2025, in press), Dadap-Cantal et al. (2021), Ramos (2020, 2021), and Yiyugsah (2023). Instead, this article focuses on providing a framework for understanding the centrality of the monetary transfer dilemma in donor-driven social protection agendas and uses the illustrations from the research project to demonstrate the utility and importance of this perspective, although without going into any detailed case analysis.

As a further qualification, the illustrations reflect certain commonalities observed across all our cases. This is not to suggest that the processes and outcomes were the same across these cases or across developing countries more generally. Rather, the point is to illustrate how, despite the diversity of settings, similar types of politicised dynamics were evident that have been overlooked in the politics of social protection scholarship. These suggest deeper underlying tensions generated by mainstream development agendas that insist on using aid to influence domestic social expenditures, under conditions of strong external constraints and often austerity. Indeed, during our research or soon after, five of our seven country cases entered IMF programmes and two defaulted, which speaks to the overriding balance of payments constraints they were facing.

The politicised dynamics in these contexts broadly relate to the balancing act between foreign currency needs versus compliance with donor expectations about domestic government spending, which can be synthesised along three themes. First, the predominance of budget support in so-called social protection financing (grants or loans) disassociates the use of the foreign currency from the promotion of social protection programmes. Accordingly, while social protection is effectively financed through domestic government budgets, donor influence mostly occurs through conditionalities (or variously renamed equivalents) rather than through actual direct funding. Second, this in turn clarifies many of the tensions around CT programmes, not because of the nature of the programmes *per se* (although these tensions also exist in many contexts) but because the notional funding of these programmes has been closely associated with broader IFI mandates, such as fiscal consolidation, austerity, retrenchment of other government programmes, and various orthodox policy reforms. Third, within these tensions, governments generally have fundamentally different understandings of the role of external funding given that their primary motivation is to mobilise foreign currency, in contrast to the focus of most donors on government adoption (or "ownership") of donor-promoted programmes.

These arguments are presented in the following three sections. Section 2 provides background on aid absorption in the context of external constraints to clarify the complexities that the monetary transfer introduces into the political economy of most developing countries. Section 3 discusses the macroeconomic management of aid from this perspective. Section 4 offers a synthesis of insights from the research project to demonstrate the relevance of this perspective in political economy analysis. The conclusion returns to the fundamental tensions implicit within aid-driven agendas of social protection.

2. Aid Absorption and External Constraints

The classic understanding of the role of aid in financing development relates to the idea of foreign exchange constraints ("exchange" in this sense used synonymously with currency). Economic development is constrained by chronic shortages of foreign currency, which aid is intended to supplement, rather than supply the bulk of financial resources needed for development, most of which could be supplied domestically. However, as discussed in Fischer (2009, 2016), this principle has been mostly overlooked in recent aid debates, including by most economists.

External constraints are also related to the subordinated or "soft" character of most developing country currencies, which have very limited external demand or use outside their economies. As a result, external constraints cannot be managed with these domestic currencies—there is effectively a partition between the domestic and external monetary circulations. As noted in the introduction, this has been discussed through the concept of "original sin" (Eichengreen & Hausmann, 1999), or in some recent heterodox scholarship as a core part of "international financial subordination" (e.g., Alami et al., 2023), "currency hierarchy" (e.g., de Paula et al., 2017; Kaltenbrunner, 2015), or (lack of) "monetary sovereignty" (e.g., Gadha et al., 2021). However, the ideas have a long pedigree dating much earlier than this, as the key difference between central and peripheral monetary systems in the international economic order. Indeed, it was the central contention in "The German Transfer Problem" by Keynes (1929), who clarified that Germany could not use its domestic currency to pay war reparations. Instead, as with developing countries today, external payments needed to be paid in foreign currency, which needed to be earned through trade surpluses (or today through income surpluses such as remittances), or else externally borrowed or supplied through foreign investment or aid. The key distinction between central and peripheral economies in this sense is that central economies such as the US can pay for their trade deficits with their own currencies, whereas most peripheral countries cannot.

The German transfer problem, however, was the inverse of contemporary aid flows, in that resources were flowing out of Germany, not in, and this net transfer of resources abroad required trade surpluses. In contrast, aid flowing into a developing country (or any net financial inflow) requires trade deficits to be absorbed (ideally goods, but also services). This is not a theoretical proposition but derives from the balance of payments accounting identity, in which net flows of external finance are the inverse of current account balances (or more specifically, trade balances are the inverse of financial plus income account balances). The simplest way to think about this is that aid (or external debt) allows a country to consume and/or invest more than it produces or earns, which is the implication of a trade deficit. It is also the principle of redistribution—a transfer that allows the recipient to consume more than they earn. If they do not consume the transfer, they save it, which means it is not absorbed, but instead held in foreign exchange reserves.

This point—that aid absorption requires trade deficits—was an accepted premise in early development economics, as discussed by Fischer (2009, 2016). It is also well recognised in a specialised tangent of scholarship on the macroeconomics of aid, largely associated with the IMF (e.g., Adam et al., 2009; Berg et al., 2007, 2015; Buffie et al., 2008, 2010; Hussain et al., 2009; IMF, 2005; Martins, 2011). With respect to net financial flows, it has been a foundational point for a range of post-Keynesian and structuralist macroeconomists, such as Thirlwall (1979, 2011), Taylor (1983), or Kregel (2008), although these latter contributions rarely address the question of aid and are possibly overlooked in the aid-related literature for this reason.

The implication of this perspective is that aid is supplied primarily to overcome foreign exchange constraints. This is distinct from domestic financial resources denominated in domestic currency. Various poor countries have often been quite successful in mobilising domestic resources, especially prior to the neoliberal era when countries could mobilise domestic savings behind relatively closed capital accounts and with financial tools that are typically absent today outside of China, such as state-owned banks or even fully nationalised banking sectors (as in South Korea and Taiwan in the 1960s and 1970s). The key condition that renders aid developmental (in economic terms) is that its absorption occurs in synergy with productionist policies and investments, which themselves have tended to be import- and hence foreign exchange-intensive. The effects of aid therefore need to be understood relative to these considerations.

Accordingly, a primary concern of governments facing such external constraints is to mobilise and maintain inflows of foreign currency to bolster their economic development efforts. This was confirmed, for instance, in our interviews with several senior finance ministry officials in Ethiopia in 2018. The intensive developmentalist efforts of the government had resulted in increasingly deep trade deficits, and these officials explained that their policy priority was to mobilise foreign currency by all means available to continue these efforts. This became especially urgent after 2015, when the Ethiopian government had effectively stopped external borrowing, based on advice from its Article IV consultations with the IMF in 2016 and 2017 as its external debt distress levels were rising (see IMF, 2017). As a result, the government became reliant on donor grants as its principal source of foreign currency and sought to leverage these as much as possible.

2.1. Sectoral Distinctions

Absorption in this macroeconomic sense refers to the aggregate balance of payments. However, at a disaggregated level, governments generally sustain a strong demand for foreign currency even in the context of overall trade surpluses given that governments themselves usually run external deficits, whereas surpluses are mostly earned by the private sector (with some exceptions such as state-owned oil companies, etc). Governments have limited ability to raise revenue in foreign currency (e.g., even mining royalties and taxes are usually paid partially or fully in domestic currency), whereas they have substantial foreign currency expenditures given that much public sector spending and investment is import intensive, e.g., in the health sector or on infrastructure. This also explains the focus on public sector austerity in IMF stabilisation programmes, as this quickly frees up foreign exchange.

Conversely, the foreign currency surpluses earned by the private sector are not directly accessible to the government, except under external account controls whereby the central bank controls foreign exchange transactions (such as in China). Under liberalised financial regimes where foreign currency is mostly exchanged in regulated private markets (as in most of Africa and Latin America), governments (via central banks) effectively need to purchase foreign currency from these domestic foreign exchange markets, or else they borrow from abroad. Local currency bond markets, when these are liberalised to foreign investors (e.g., see Dafe et al., 2018, 2023), do not provide foreign currency to the government, although they do inject foreign currency into local foreign exchange markets, hence helping to ease overall external constraints, although not necessarily those of the government. Hence, even if aid is technically not absorbed in an aggregate macroeconomic sense, it is usually essential for government expenditure at a disaggregated sectoral level. Indeed, much discombobulation in such settings can be attributed to these types of disaggregated sectoral imbalances.

Zambia provides a good example, as a commodity exporter dependent on transnational mining firms for most of its exports, similar in this respect to many Latin American economies albeit more exacerbated. In 2019, prior to its default in 2020, the country ran a small current account surplus of 141 million USD, composed of a larger goods trade surplus of 744 million USD, offset by a services trade deficit of 522 million USD (International Monetary Fund, 2025). The primary income account, mostly composed of investment income (i.e., profit repatriation), reported a deficit of 404 million USD, whereas the secondary income account, where grants and remittances are recorded, reported a surplus of 322 million USD—in other words, aid grants were more than cancelled out by reported net profit remittances. On the financial side, increasing public indebtedness was partially offsetting what appears to have been relatively massive outflows of wealth hidden within obscure parts of the financial account (see Fischer, 2020). Hence, in a macroeconomic sense, the meagre aid flows to the country were simply contributing to the circulation of foreign currency that, on balance, was leaving the economy.

Yet despite the current account surplus, the government itself was running a significant external deficit in 2019, thereby requiring the aid or else external borrowing. About 30 percent of Zambia's primary government expenditure (i.e., not including amortisation) was in foreign currency in 2019 ("foreign-financed"), equivalent to just over 26 billion kwachas (Zambia Ministry of Finance, 2019, pp. 33–34). Almost all of this (25 billion) was spent on non-financial assets such as roads, electrification, or other infrastructure, illustrating that such developmental investments are very import- and foreign currency-intensive. Amortisation added another 10 billion kwachas to this expenditure, about two-thirds of which was external (Zambia Ministry of

Finance, 2019, p. 35), for a total of about 33 billion kwachas of government expenditure in foreign currency (roughly 2.5 billion USD using a period average for 2019 of 12.9 kwacha/USD). The foreign currency composition of the government's revenue was not reported, although considering that taxes on mining companies, mining royalties, and import VAT or customs and excise duties were largely paid in domestic currency, and together these amounted to around 18 billion kwacha (Zambia Ministry of Finance, 2019, p. 31), it is clear that the government was facing a huge shortfall of foreign currency, hence the necessity for external refinancing. (The government notably introduced a new measure in 2021 requiring mining tax obligations to be paid in dollars, which would have helped, although still clearly resulting in an external deficit.) This helps to understand why the government defaulted on its external loans in 2020, despite the current account surplus increasing to over 2.4 billion USD in the same year.

Hence, while aid flows (grants and concessional financing) and other official financing were very limited relative to overall needs, they would have been crucial for plugging at least the most essential parts of the foreign currency expenditures of government, even though there were net outflows of foreign currency from the economy given the current account surplus. The aid would have been technically absorbed if it allowed for an increase in imports and hence a lower trade surplus, but instead, imports collapsed by 24 percent in 2019, and continued to fall by another 26 percent in 2020 even as exports started to rebound. The foreign currency that aid was providing was therefore not absorbed and would have been used by the government to pay its external obligations in its attempts to stave off default.

3. The Macroeconomic Management of Aid for Domestic Expenditures

As the example of Zambia illustrates, we need to ask why aid would be conceived as financing domestic currency expenditures when governments desperately need foreign currency and use the foreign currency supplied by aid to meet their external payments. It is useful to lay out several different stylised processes of monetary transfer in the macroeconomic management of aid to clarify this question (examples elaborated by the author).

If aid is spent by a government on imports, the macroeconomic management of the aid is relatively simple. Aid is absorbed by using these imports in the domestic economy, not through a financial transfer into the domestic economy. Hence:

(1) Donor ($) → Recipient ($) → Import → Domestic Economy

Indeed, this was the common approach to aid prior to the neoliberal era, and it would still be prevalent in project loans or grants where funding is directly associated with the purchase of imports (e.g., see Wuyts et al., 2016).

Aid in this case technically has no domestic monetary and fiscal impact, except by way of easing the foreign exchange constraints of the government. The foreign currency in question (that is, claims on dollars, not the actual physical dollars) would be simply held in government dollar accounts at the central bank and used to directly pay for the external purchases of the government. The aid is therefore not coordinated through foreign exchange markets or domestic monetary operations. This point is briefly made by Hussain et al. (2009, p. 493) with respect to the exchange rate, price level, and interest rate impacts of such direct uses of aid.

However, they then assert without justification that the more indirect exchange between governments and central banks is the more relevant case (see below) and deal no further with direct use, which is the position that is maintained in most of the related IMF-associated literature.

A variant of this would include situations where loans or grants are explicitly understood to be used for government foreign currency payments, even if not directly tied to the purchase of an import, such as in past and present balance of payments support lending. This could be represented as:

(2) Donor($) → Recipient ($) → $ used for external payment

In this case, there is again no direct absorption or domestic macroeconomic effects given that the monetary circuit remains entirely external. However, indirect secondary effects could occur, again by freeing up foreign exchange for other purposes such as imports.

Both scenarios clearly demonstrate how the classical understanding of aid involves the least complicated macroeconomic management. Even when the supply and use of aid is indirect, this would also have a limited domestic monetary impact if the use is closely coordinated with the foreign currency expenditure needs of the economy, to the extent that it is fully matched (and thereby absorbed) by increased imports within a short time lag. Such coordination would be facilitated by relatively closed capital accounts and nationalised state-owned banking (as in South Korea and Taiwan in the 1960s and 1970s), which allow the government and monetary authorities to mediate between scarce supplies of foreign currency and the needs and demands for foreign currency (e.g., see Bangura, 2015). Examples are thus largely confined to the early post-war period, prior to widespread capital account liberalisations, when the control and rationing of foreign exchange by developing countries was viewed as the norm and even desirable (despite problems such as parallel foreign exchange markets). This also probably explains why these cases are ignored in the contemporary IMF-associated literature. Aid was still politicised, although this concerned access (such as with rationing) or else use (such as with tied aid), but not necessarily macroeconomic management.

3.1. Indirect Management

More indirect transactions between governments and central banks have become the contemporary norm, especially with the rise of independent central banking and capital account openness. Advocates of both strongly discourage governments from intervening in the allocation of foreign exchange, leaving this to regulated private markets. Indirect macroeconomic management of aid is the exclusive focus of Hussain et al. (2009) and the related IMF-associated literature, and it is also necessarily the approach used with aid intended for domestic currency expenditures given that this requires a disassociation between the foreign currency provided and the targeted domestic expenditures.

As the IMF-associated authors elaborate, the indirect approach adds a degree of complexity to the macroeconomic management of aid. Hussain et al. (2009) frame this as a balance between absorption and spending, conceived implicitly in terms of intergovernmental transfers. Absorption refers to the degree to which an increase in aid is associated with an increase in the non-aid current account deficit, according to the classic logic discussed above (non-aid because aid grants are registered on the current account). The use of the current account instead of the trade account in this conception is problematic given that it implies that absorption can happen through profit remittances, as discussed in Fischer (2017; cf. Serieux, 2011 on related concerns). Spending is the degree to which recipient governments match the aid received through increases in the fiscal deficit.

The monetary transfer dilemma, as coined in this article, extends this framing by clarifying that the two monetary circulations—foreign and domestic—are effectively partitioned in the process of balancing between absorption and spending if the spending is meant to be purely domestic. The foreign currency provided by aid is necessarily used for other foreign exchange transactions, by the government or by private actors if the currency is sold on the market, or else it is saved (i.e., held in reserves). Aid intended for domestic expenditures, in this strict monetary sense, is perfectly fungible—a point noted by Hussain et al. (2009, p. 494), although they do not elaborate further.

In practice, there have been two variants to dealing with the balancing and the transfer dilemma, as implied by Hussain et al. (2009) and elaborated here. In one, a receiving government (the finance ministry) spends the foreign currency directly on external expenditures (imports, external debt payments, etc.) and then matches the funds spent with domestic spending commitments. If this results in an increased government deficit (as it should), it would in turn need to be supported by domestic monetary operations, i.e., the finance ministry sells securities, generally organised by the central bank. This then raises orthodox concerns about increasing public debt, rising interest rates, and "crowding out" other investment, as well as exchange rate appreciation if local bond markets have been liberalised to foreign investors. Alternatively, government securities can be purchased by the central bank, which amounts to deficit or debt monetisation (aka "printing money"), although this is discouraged by orthodoxy even whilst it formed the essence of quantitative easing in rich countries. This can be stylised as follows:

(3) Donor ($) → Finance Ministry (FM) ($) → $ spend (imports, etc.) or save ($ reserves)
⇓
FM commitment to match funds in domestic currency (₱)
⇓
FM sells securities (₱) ↔ FM (₱) → spend or save

Notably, in this first indirect variant, the domestic spending by the finance ministry takes place as any other domestic fiscal-monetary operation, and the domestic effect is expansionary, whereas the foreign currency remains insulated on the external accounts.

In the second indirect variant, the finance ministry sells the foreign currency to the central bank in exchange for domestic currency, which can then be spent on domestic expenditures or else saved or used to reduce domestic debt. The central bank in turn either sells the foreign currency, which can then be used to purchase imports by private actors (or simply remitted abroad), or the central bank saves the foreign currency, which results in foreign exchange reserves. This approach can be stylised as:

(4) Donor ($) → FM ($) → Central Bank ($) → sell $ or save (Central Bank $ reserves)
⇓
Central Bank exchange $ with domestic currency (₱)
⇓
FM (₱) → spend or save

This last variant appears to be the preferred approach in the IMF-affiliated work, such as Hussain et al. (2009), for several reasons. First, the sale of foreign currency to the central bank allows the government to finance the deficit without incurring debt to investors or to the central bank (to the extent that the latter is a problem—modern monetary theory would argue it is not, but the IMF argues it is). The foreign currency also provides a buffer for the balance of payments effects of a domestic fiscal expansion, and selling it allows the central bank to soak up domestic money supply, thereby acting as the equivalent of sterilisation. However, one drawback of this approach, which Hussain et al. (2009) do not discuss, is that the government no longer has access to the foreign currency. Indeed, this is probably the reason why the first variant remains common in practice.

In the ideal case, when aid is fully absorbed through the trade account and completely spent in the corresponding government budget, the macroeconomic effects of this second indirect variant would be theoretically limited to a range of short-run adjustments, similar to the first two direct cases (domestic monetary and fiscal effects obviously do not occur when aid is neither absorbed nor spent). However, no cases in the study of Hussain et al. (2009) fit this ideal, so their theory was never put to the test.

The management of aid is more complex when absorption and spending do not match. When the government increases spending in the absence of absorption—meaning that the central bank holds the foreign currency in reserves—this has an expansionary domestic effect (similar to the first indirect variant). Indeed, Hussain et al. (2009, p. 492) note that this is equivalent to a deficit monetisation. According to orthodox theory, this could lead to domestic price inflation and some exchange rate depreciation, and the orthodox position therefore advocates fiscal restraint, meaning that spending increases should also be restricted and the domestic currency used for retiring domestic government debt (e.g., see Buffie et al., 2010).

Notably, this latter imbalance (spending exceeding absorption) characterises most of the cases studied in this literature, such as by Hussain et al. (2009) and Martins (2011). This means that the dominant trend in this earlier period, when aid was the main non-trade source of foreign currency in Africa, was that at least part of the foreign currency received from aid flows was directed into reserves (or other financial account uses) and was not absorbed in the short term, even while the aid was used to negotiate government spending increases in domestic currency, including the "policy merchandising" of CTs (to quote Adesina, 2020).

By the time we conducted our fieldwork in 2017–2018, however, aid flows in most of our cases had become dwarfed by commercial financial flows and had also shrunk in nominal and relative terms. This helps to explain why this specialised focus on macroeconomic aid management appears to have faded away and has been replaced by other issues such as sovereign debt management. Nonetheless, these considerations of absorption and spending also apply to sovereign debt—commercial or official—especially considering that such debt flows are usually much larger and lumpier than aid flows. However, commercial debt is also usually more clearly conceived in terms of foreign exchange needs, hence simplifying these issues of macroeconomic management, as with the first two stylised processes above.

3.2. The Politics of Macroeconomic Aid Management

Insofar as the latter two indirect processes involve coordination between monetary and fiscal policies, they implicate various international actors with mandates to oversee macroeconomic management. The IMF and the World Bank in particular weigh in at multiple points, from expectations regarding monetary and fiscal policy, and current and financial account management, to the negotiation of domestic spending commitments associated with aid. This is especially the case for countries that are already in IMF programmes, negotiating them, or else under scrutiny during annual IMF Article IV consultations.

The opacity of these processes also has a strong propensity to exacerbate donor concerns regarding fungibility, transparency, and accountability, that is, assurances that matching earmarked funds are actually spent as promised by the government. These concerns shed light on donor impulses to seek ways of strengthening their control over the end uses of aid and/or intervening in domestic policymaking as means of dealing with the opacity and complexity of the intermediating financial processes. This includes regular negotiation, surveillance, and monitoring of the sectors that donors think their aid is funding, including weekly and even daily monitoring by donors in the African cases of Ethiopia or Zambia. Stipulations about (upward) accountability on these matters was also a regular occurrence in most of the grant or loan documents we assessed. Arguably, this is because donors can only guarantee that governments honour their domestic spending agreements through these micro-administrative methods of control, not through "following the money," which would only lead to the external accounts.

Impulses to control recipient governments obviously do not originate from these tensions but have long roots in colonial and post-colonial histories, especially since the neoliberal phase of structural adjustment programmes (e.g., see Whitfield, 2008). The earmarking of various domestic expenditures, social or otherwise, has also been a common feature of aid since the rise of general budget support (GBS) in the 1990s, which is often justified in terms of easing the macroeconomic complexities of managing aid flows towards domestic uses (e.g., see Hussain et al., 2009). Nonetheless, the complexities associated with managing aid flows have been accentuated by the increased emphasis of domestic expenditures under the Millennium and then Sustainable Development Goals (MDGs and SDGs), which have had a strong focus on social sectors. Some of these social sectors clearly have a strong need for foreign currency, such as health or tertiary education, whereas there is very little need for foreign currency in social protection.

One implicit consequence of notionally directing aid towards social protection is that this effectively separates the supply and use of the foreign currency provided by aid from the notional targets of aid, making it easier to divert the foreign currency towards other uses, such as debt-servicing or profit remittances. Such implications were more explicit in the 1980s, driven by concerns of rationing scarce foreign currency amidst debt crises and then structural adjustment programmes. However, these implications have become more obscured since the 1990s, even while the logic is similar. Indeed, the substitutive approach explicitly pushed by the IMF and the World Bank in social protection—that CT schemes be funded from the savings made by retrenching other programmes such as subsidies—would work against the full spending of aid given that aggregate government spending would not increase as a result. It would probably reduce aid absorption as well, given the higher import content of subsidy programmes (such as fertilisers). This speaks to the orthodox bias towards fiscal restraint mentioned above and aligns with the austerity mandates of IMF programmes.

Considering these implications, the complex and politicised negotiations among networks of actors operating within starkly asymmetrical power relations becomes clear. However, outside of the narrow, specialised literature on the macroeconomics of aid, consideration of these dimensions is simply non-existent within the burgeoning economics or political economy scholarship on aid or social protection.

4. Illustrations From Research Findings

The illustrations drawn from this research project can be synthesised into three themes that demonstrate the interpretative value of the above framing, as a neglected lens on the political economy dynamics surrounding social protection agendas in aid-recipient countries where donors have played a strong role in promoting these agendas. The first is the predominance of budget support in so-called social protection financing. The second is how this has tended to associate the social protection agenda with broader IFI policy mandates. The third is the gulf of understanding between governments and donors regarding the fundamental role of aid in such contexts. As noted in the introduction, while the focus here is on commonalities observed across all our cases, this is not to suggest that the processes and outcomes were the same across all our cases. Rather, the point is to illustrate how, despite the diversity of situations, similar types of politicised dynamics were evident.

4.1. Budget Support and Social Protection: Shall the Twain Meet?

Across all our cases, the predominant modality of so-called social protection funding was through budget support, general or with a sectoral focus. This point was also noted by Winther-Schmidt (2011), that much of the aid for social protection is subsumed under GBS, often as unearmarked core contributions, "making it difficult to extract the specific amounts that have been allocated to social protection" (Winther-Schmidt, 2011, p. 4). In other words, the aid in question is used in the general budget, contrary to the popular conception (even among many of the policy experts we interviewed) that it is directly funding a CT programme, as if a classic project loan. Some social protection financing also occurs through what the World Bank calls Investment Project Financing loans, although in the social protection sector these appear to similarly function through the earmarking of matching funds, as discussed below, except for their elements of technical assistance (technical assistance also has a clear foreign currency requirement, given that technical assistance is mostly contracted externally).

As with the third and fourth stylised processes of the previous section, by virtue of being indirect, these lending modalities allow the use of the foreign currency provided by aid to be disassociated from social protection programmes. However, this then implicates various actors—the finance ministry, central bank, the IMF and various other IFIs—in the resulting macroeconomic management (i.e., absorption and spending, as discussed above). The involvement of the IMF in particular follows from the fact that these concerns are typically conditioned by IMF policy mandates—as noted previously, only two of our seven cases (Cambodia and the Philippines) did not enter an IMF programme during our research project or soon afterwards.

With the disassociation of the foreign currency, the influence of aid on social protection mostly occurs through negotiated conditionalities rather than through direct funding. For instance, GBS might come with conditions to implement a CT programme, although given the negative association of "conditionalities" with structural adjustment programmes, the IMF and other IFIs now refer to these as "commitments," "prior actions," "triggers," and "milestones," also aligning these with principles of results-based budgeting or financing. Or else in more specific sectoral loans, the government might match the foreign currency received with the equivalent in domestic currency, with the promise to spend this money in the name of donors, again supported by conditions. Or, in some cases, the government will transfer the domestic currency back to the donor, such as when a CT programme is contracted out to a programme management unit (typically a foreign consultancy firm with domestic staff), although such cases usually only happen with small pilots and small budgets, and are often off-budget.

Regarding the conditions, we also found that in many GBS agreements a demonstration of government commitment to increase spending in a CT programme was generally treated as sufficient verification, without necessarily requiring more specification. The increase could be by the amount of aid received from the donor, or possibly not even by a specified amount. To give an example in Paraguay, an EU grant of 24 million euros operated as budget support with 24 triggers, each trigger releasing a tranche of one million euros. A demonstrated commitment to a social protection programme was sufficient to trigger one of these tranches. The amounts involved were clearly very small relative to the onerous bureaucratic and political processes of negotiation and monitoring involved. However, the EU staff we interviewed were clear that the purpose was not necessarily to fill funding gaps in any significant way but to influence policy.

Despite these highly negotiated processes, the idea that aid was funding these domestic expenditures was the conventional understanding of most of the people we interviewed, except in the two Latin American cases—Ecuador and Paraguay. In these two cases, borrowing or using aid to pay for social expenditures (or any current expenditure) was in fact constitutionally prohibited, which is the norm across the region. It was also not practised in the Philippines, despite the popular perception that various World Bank or Asian Development Bank loans had financed the main CT programme there (the Pantawid). Direct project funding was involved in the CTs of the African cases and Cambodia, although only by bilateral donors, which tended to prefer such modalities as it gave them a tighter control over the design and implementation of CTs. In the case of Cambodia, one international NGO was running the largest CT programme at the time of our fieldwork there, as a subcontracted arrangement with USAID (USAID policy prohibited the financing of foreign governments). Nonetheless, these cases of direct project financing—often off-budget in the case of pilots and non-governmental funding—generally accounted for only a small proportion of total aid notionally associated with earmarked social protection spending. Instead, the dominance of programme lending or grants contradicted the conventional idea that aid was directly funding CTs. Confusions were especially evident in relation to the matching of funds. It was evident in our interviews, especially with donors, that the opacity of these processes often exacerbated their concerns about transparency and accountability.

There was often a lot of ambiguity in this regard as well. In the Philippines, we spent a considerable amount of time trying to clarify whether a certain social protection-associated loan from an IFI was a project loan or a programme loan. The loan documents were ambiguous, with wording in one paragraph implying that it was directly financing the CT programme, whereas elsewhere in the document it was clearly stated that it was a GBS loan, with social protection as one commitment. A technical staff person in the IFI we interviewed understood that it was a project loan, as he thought they were directly supporting the CT programme (the Pantawid), whereas most government staff we interviewed, in both the Department for Social Welfare and Development, which runs the CT, and the Finance Ministry, were adamant that the loan was a programme loan. Only one senior staff person in the Finance Ministry who was involved in the original loan negotiations was able to clarify that, in these negotiations, the IFI and the government had agreed to keep the wording purposely ambiguous, in part to satisfy political sensitivities on both sides, but that the loan was effectively a programme loan.

The political sensitivities in question relate to the fact that budget support loans and grants are associated with the legacy of structural adjustment programmes (SAPs), particularly in our two Latin American cases, where GBS was unpopular with the government officials we interviewed. This is ironic given that, in donor circles, GBS is generally presented as a progressive improvement over the structural adjustment period or to practices of tied aid, giving governments more "ownership" over aid. In principle, programme or policy loans can be used more freely, although because they come laden with the functional equivalents of conditionalities, they are perceived by governments as a continuity with erstwhile SAPs. The fact that social protection was associated with such loans was therefore a sensitive political issue.

4.2. IFI Policy Mandates

In this sense, much of the politicised sensitivity around CT programmes was not necessarily because of the nature of the programmes *per se* (although these tensions were also apparent in many contexts), but because of their association with broader IFI policy mandates. These include fiscal consolidations and requirements to run primary budget surpluses, which usually imply austerity and retrenchment of other government programmes such as subsidies, alongside other macroeconomic policies such as financial or exchange rate liberalisation, privatisation, etc. Notably, in all the cases we researched, commitments to increase spending in social protection only concerned the specific earmarked programme of donor interest (e.g., poverty-targeted CTs), not general social protection spending, which also includes social security—long a target of orthodox reform agendas—or other programmes not necessarily favoured by donors, such as universal pensions, which the World Bank consistently opposes. As long as spending increased within the CT programme, there did not appear to be any concern among major donors, including IFIs such as the World Bank or various regional development banks, whether the increase represented a net addition to overall social expenditures, or whether it was simply substituting other programmes. This was even in cases with relatively strong government capacity such as the Philippines, where neither the IFI representatives nor the government staff in the Finance Ministry or the Department for Social Welfare and Development who we interviewed were concerned with net aggregate changes in social protection sector spending in their assessment of commitments.

This is important because it means that commitments to increase spending in CTs can be achieved while still adhering to general caps in overall government spending, as required by austerity programmes, which most of the country cases had undergone in recent years or were undergoing at the time of our fieldwork. Increased spending in one programme could simply be achieved by reallocating expenditures from one budget line to another and shuffling money between various programmes, leading to no net effect in spending. Indeed, IFIs and other donors had been lobbying in all our cases to fund CTs with domestic resources freed up by phasing out subsidy programmes—such as in food, fertilisers, fuel, and energy—or even social security reforms, which the governments in most of our cases had been resisting at the time of our fieldwork.

Moreover, the fact that such conditionalities were in many cases implicit rather than explicit is a point that is mostly overlooked in the scholarship on external influence, which tends to measure conditionalities by their explicit mention in individual loan agreements. For instance, in the case of the EU grant in Paraguay mentioned above, one of the triggers was a commitment to macroeconomic stability. The EU representative we interviewed explained that this was verified by the government committing to IMF Article IV consultations and monitoring. In this manner, various macroeconomic conditionalities might not be explicitly mentioned in grant or loan agreements but are implicit by requiring IMF approbation, similar to the way that accessing commercial debt markets requires the same.

4.3. Different Perspectives on the Role of Aid

Returning to the issue of external constraints, one striking feature that came out of our interviews was a fundamental dissonance of perspectives on the role of aid. This was especially revealed by our research in Ethiopia. The donors we interviewed there viewed aid primarily as an instrument of influencing recipient government policy through technical assistance, while the redistributive role of aid was taken for granted (which was probably a fair assumption given that Ethiopia was running very large trade deficits). The main concern of the donors was sustainability, understood as the government gradually taking over the financing of the Productive Safety Nets Programme as the donors were scaling down and withdrawing their funding. In other words, sustainability was framed entirely in terms of government spending commitments in domestic currency.

An interview with a senior director at the Finance Ministry, however, revealed a very different understanding of sustainability. Their concern was primarily aimed at sustaining foreign currency inflows to support much broader development efforts, which had been contributing to the very deep trade deficits. These efforts included projects such as the Grand Ethiopian Renaissance Dam, which the director specifically highlighted. He pointed out that this project was being funded by the government's own resources, through whatever foreign currency it had managed to mobilise from a variety of sources. Aid flows were one important source, especially since the government had agreed with the IMF in 2017 to cease all foreign borrowing. Sustainability from his perspective was framed in terms of being able to mobilise the foreign currency required to sustain such development efforts. Maintaining domestic spending commitments in domestic currency was much less of a concern given that the government was not facing a binding constraint on that front. Even the potential inflationary impacts of an expansionary domestic fiscal and monetary policy did not concern the director. He explained that price inflation in the country up until recently had been largely determined by food prices, which themselves had been largely determined by supply constraints in agriculture rather than money supply. Addressing supply constraints required foreign currency, taking us back to his primary concern.

Donors, however, were generally dismissive of this government concern. For instance, a leading (white male) donor staff person who had been responsible for the donor coordination on social protection asked me for my own understanding of sustainability during an interview. He disparaged my suggestion that the guiding concern for the government was sustaining such foreign currency inflows and that financing social protection through domestic resources was secondary. I heard afterwards from my local contact, a professor at Addis Ababa University who arranged the interview for me, that the person in question had been disappointed with my line of questioning and decided to stonewall any further contacts with me, effectively derailing my snowball sampling strategy through this inroad with the donor community. His derision contrasted with the earnestness of the various government officials I interviewed and was especially instructive given that my suggestion was reporting what these officials had shared with me. This speaks to the gulf of understanding between the donor community and the government on these fundamental issues of financing.

We observed a similar dissonance in Cambodia. One director responsible for external relations at the Ministry of Finance explained that the government had remained reliant on grants as their main source of external funding given that they had opted to not rely on external borrowing. Hence the finance ministry's guiding motive for going along with various donor-lobbied social protection programmes was to mobilise foreign exchange through grants. This motive was accentuated by the dollarisation of the Cambodian economy, which meant that sustaining inflows was not only crucial for dealing with balance of payments constraints but also for maintaining money supply and aggregate demand in the economy.

A similar situation faced Ecuador given its full dollarisation. As explained to us by one senior director of the Ecuadorian Central Bank, the only real influence they had over the money supply was through controlling the current account. At the time (in 2017), aid flows were very marginal in Ecuador, although in times of mounting constraints, such as in 2019 when Ecuador entered another IMF programme, the importance of aid flows in terms of this primary function of supplying foreign currency would have quickly regained prominence.

5. Conclusion: Monetary Dilemmas in the Political Economy of Social Protection

As a theoretical and conceptual contribution drawing from classic structuralist and post-Keynesian insights on external constraints and IMF-affiliated work on the macroeconomic management of aid flows, this article clarifies how a monetary transfer dilemma lies at the core of politicised encounters in donor-driven agendas of social protection. The dilemma relates to the effective partition between circulations of foreign and domestic currencies in most developing countries, while also facing stringent external constraints. That their domestic currencies have very limited offshore uses is moderately well recognised in macroeconomics literature (often referred to as "original sin"). However, the counterpart implication—that foreign currencies cannot be directly used for expenditures in domestic currency—receives almost no attention, despite its centrality to the idea that external sources of funding, such as aid or international taxation, can and should finance social protection.

In other words, aid that is notionally associated with social protection programmes for the most part does not actually fund these programmes given that social protection expenditures are in domestic currency. Rather, the foreign currency provided by aid is effectively used for other foreign currency expenditures, especially in the ubiquitous situation of most developing countries where governments face gaping foreign currency deficits in their fiscal balances. This leaves governments holding the bag for whatever domestic spending commitments have been coaxed or coerced out of them in the process of negotiating aid commitments, which they then finance through their regular fiscal and monetary operations. Donor influence in this sense is not through the direct funding of social protection, but through obscure processes of negotiation, conditioning, and monitoring of domestic programmes and policies, which donors are able to assert through their structurally dominant position as providers of foreign currency. That this might also lead to diverse outcomes in social protection is not surprising given the convoluted, contested, and often contradictory nature of these processes.

This framing needs to be taken seriously in the various fields of scholarship overlapping on the theme of social protection, such as the politics or the financing of social protection or policy diffusion. However, it remains virtually ignored in these fields, resulting in important blind spots. This article has attempted to shed light on these blind spots, drawing illustrations from a research project on the political economy of externally financing social protection to highlight several implications.

First, while some authors have recognised that the notional external funding of social protection for the most part occurs through budget support (grants or loans), the framing of this article helps to understand how this allows the use of the foreign currency provided by aid to be disassociated from the promotion of social protection programmes. Indeed, this applies more generally to the rise of policy or programme financing under SAPs since the 1980s. Accordingly, social protection programmes are effectively promoted in such budget support through conditions (variously named as commitments, prior actions, triggers, or milestones) rather than through actual direct funding. This in turn clarifies many of the politicised tensions around the donor promotion of social protection programmes, not because of the nature of the programmes *per se* (although these tensions also exist in many contexts), but because the notional funding of these programmes has been closely associated with broader orthodox policy mandates of IFIs. Depending on the context, these include fiscal consolidations, requirements to generate primary surpluses, austerity, retrenchment in other government programmes, and broader macroeconomic policy conditions such as financial or exchange rate liberalisation. Indeed, this point supports the work of Kentikelenis and Stubbs (2023), who argue that despite the changed rhetoric around "structural adjustment" and "conditionalities," IMF practices of mandating austerity in developing countries have changed very little since the 1980s. The fact that CT programmes are associated with these mandates has therefore implicated them into this politics of austerity.

The framing also highlights that the primary motive for many recipient governments to go along with these programmes is related to their need to mobilise foreign exchange for broader development efforts or for balance of payments support, rather than a lack of domestic resources to finance CTs. However, the dissonance between this perspective and donor beliefs that they are financing domestic expenditures, and the complex and obscure processes that they undertake to simulate such domestic financing, tends to exacerbate donor concerns of transparency and accountability if governments are perceived as disingenuous in these simulations. Yet, in the pervasiveness of external constraints facing most developing countries, domestic expenditures are a secondary concern for governments, especially if latitude is given for expansionary government spending, and the adverse balance of payments consequences of such spending are fended off through increased concessionary supplies of foreign currency or else capital account controls. Indeed, this was the classic understanding of aid in the early post-war period, and it remains the understanding of many governments struggling with external constraints today. In this light, the insistence of donors to influence domestic policy and spending through the power of their hard currencies, rather than simply accepting that the supply of their currency is the primary function of their aid, potentially paves the road to structural adjustment with good intentions.

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