

# ESG Series

## Social Part 4:

### Foreign Aid

Research & Insights

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MONOCHROME ASSET MANAGEMENT

## Learning Outcomes

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This piece will discuss the legacy global foreign aid system and the challenges faced in traditional foreign aid. We then demonstrate how Bitcoin has dramatically reduced friction in foreign aid with a case study on The Ukrainian Government's "Aid for Ukraine" initiative, to use bitcoin and other crypto-assets to raise funds in a friction-free way. The key topics of this piece include:

- What is foreign aid and how does it work
- Limitations in the current foreign aid system
- How Bitcoin can remove intermediaries and provide a secure alternative

## Introduction

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The need to reduce poverty and support economic development in less developed countries is typically addressed by wealthier nations and global organisations such as The United Nations, World Bank and The International Monetary Fund, in part through the instrument of foreign aid. However, aid effectiveness has long been a topic of scrutiny as its impact is often undermined by systemic issues faced by recipient countries. At the core of foreign aid's problems is its centralised system which is subject to political pressure on the donor and recipient sides, leading to criticisms such as a lack of transparency, corruption and waste. In this article, we aim to provide a new perspective on foreign aid that employs Bitcoin, and utilises its decentralised, peer-to-peer characteristics to potentially reinvent what aid might look like altogether.

## What is Foreign Aid?

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Simply defined, foreign aid is an international transfer of capital, goods, or services from a country or international organisation in order to benefit the recipient country or its population.<sup>1</sup> It manifests in many forms, often economic (i.e. monetary), military or emergency humanitarian relief, especially following a natural disaster. In this article, we narrow our discussion to monetary aid, focusing on its hurdles as a tool for economic development.

## How Does it Work?

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Monetary forms of aid, which is classified as **Official Development Assistance (ODA)** under the broader umbrella of economic aid, can be distributed bilaterally (i.e. from one country to another), or multilaterally (i.e. a consortium of countries providing aid to a single or multiple recipients) typically channelled through the United Nations or World Bank.<sup>2</sup> This aid may also be provided to Non-Government Organisations (NGOs) in lieu of governments. These transfers may be distributed in the form of grants, loans, or through other conditional deals. The process and factors considered to determine allocation of funds are sometimes complex, and typically NGOs and countries will use different allocation models that often incorporate economic indicators such as Gross National Income (GNI) per capita or population size.<sup>3</sup>

However, whilst foreign aid is used to improve human welfare and development, several other factors may influence donor governments' decisions such as diplomatic ties or the pursuit of foreign

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<sup>1</sup> V Williams, 'Foreign Aid (<https://www.britannica.com/topic/foreign-aid>)', Britannica, n.d., accessed 25 January 2022.

<sup>2</sup> OECD, 'Net ODA (<https://data.oecd.org/oda/net-oda.htm>)', OECD, n.d., accessed 25 January 2022.

<sup>3</sup> United Nations, 'Allocating aid – practices and implications ([https://www.un.org/en/ecosoc/docs/pdfs/aid\\_allocation\\_1.pdf](https://www.un.org/en/ecosoc/docs/pdfs/aid_allocation_1.pdf))', United Nations, May 2008, accessed 2 February 2022.

policy objectives.<sup>4</sup> This can lead to countries providing aid as a politically strategic tool, using it as both a carrot and stick in order to influence the recipient country's behaviour. An example of this type of aid would be a donor country providing aid to develop, say, oil and gas or other energy infrastructure in a donor country, and directly benefiting from these new developments once they are established.

## Aid Effectiveness

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Foreign aid effectiveness is a widely researched and debated topic that has saturated academic discourse, news and politics. Research in particular has produced mixed evidence. From a macro-economic perspective, researchers tend to agree that as a whole, there is a link between aid and positive outcomes over time in less developed countries such as economic growth and reduced poverty, particularly in the Sub-Saharan African region.<sup>5</sup> However, the extent of its empirical effect has been difficult to prove or disprove, and whilst analysing the macroeconomic effects is useful, there are many other factors to consider. One of these factors is the conditionality of aid, and how closely its efficacy is tied to political stability and dimensions of governance in recipient countries. Evidence reveals that **the quality of institutions receiving aid plays a significant role in aid effectiveness**, particularly for low-income countries, where laws, government effectiveness and accountability have the greatest impact.<sup>6</sup>

The discussion surrounding foreign aid therefore tends to be a socio-political one, centred on governance and the presence of corruption. As a mechanism, foreign aid is reliant on the actions of those in power to deliver outcomes. Therefore, it is perhaps useful to think of foreign aid as not just a transfer from one country to another, but rather a transfer from one *government* to another. That is, a deal made between leaders, and not the country's citizens. Whilst there have been efforts to mitigate corruption and misuse of foreign aid, particularly through conditional aid deals and increased oversight, concerns over its fungibility and lack of financial transparency are likely to persist.

In a paper released by the World Bank, evidence ties the disbursement of foreign aid to aid-dependent countries with the increased stock of foreign-owned bank deposits in tax havens.<sup>7</sup> The paper suggests that **there are significant leakages and diversions of aid by those in power**. However, coming up with an exact figure on the amount of aid that is intentionally wasted or misused by corrupt entities or governments, is essentially impossible to produce or verify. The paper also recognises this, noting that though their findings are robust, they may underestimate or overestimate the level in which aid is diverted as it does not account for money spent on other forms of wealth such as real estate. Furthermore, macro-level data provides a limited view as we cannot observe who is actually storing wealth in tax havens. Despite this, the evidence implies that its beneficiaries are almost certainly not the citizens which the aid was intended for.

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<sup>4</sup> C Apodaca, 'Foreign Aid as Foreign Policy Tool (<https://oxfordre.com/politics/politics/view/10.1093/acrefore/9780190228637.001.0001/acrefore-9780190228637-e-332>)', Oxford Research, 26 April 2017, accessed 27 January 2022.

<sup>5</sup> E Mahambe and N M Odhiambo, 'Foreign aid, poverty and economic growth in developing countries: A dynamic panel data causality analysis', *Cogent Economics & Finance*, 2019, 7:1, doi: 10.1080/23322039.2019.1626321.

<sup>6</sup> Y Ismahene and N Bouchoucha, 'Foreign Aid-Growth Nexus in Africa: Do Institutions Matter?', *Journal of The Knowledge Economy*, 2020, 1:1663-1689, doi:10.1007/s13132-020-00638-0.

<sup>7</sup> J Anderson et al., 'Elite Capture of Foreign Aid : Evidence from Offshore Bank Accounts (<http://hdl.handle.net/10986/33355>)', World Bank, 18 February 2020, accessed 2 February 2022.

# Reinventing Foreign Aid with Bitcoin: Removing the Intermediaries

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Bitcoin's decentralised network comes almost as a direct contrast to the current system of foreign aid which is largely centralised. This makes it counterintuitive to insert Bitcoin into foreign aid as we know it. That is, whilst foreign aid is traditionally a transfer from government to government, whether channelled bilaterally or through an NGO, Bitcoin can instead facilitate transfers directly from peer to peer. We explore why the removal of intermediaries is useful, particularly in the case where foreign aid cannot be effectively delivered, for it provides a transparent, cost-effective and censorship resistant form of aid.

## Transparent

Whilst privacy and transparency appear to be opposing concepts, they are both features of Bitcoin. This is possible because the blockchain's ever-growing ledger is made entirely public; all address balances and past transactions are permanent and accessible online.<sup>8</sup> In saying this, without third party oversight, participants in the Bitcoin network can remain private, as they do not have to divulge sensitive information and can instead operate pseudonymously whilst transacting.

## Cost-Effective

This degree of transparency means that unlike foreign aid, where there is no single, agreed-upon global set of requirements for financial disclosure, the sender can guarantee that funds are directed to their chosen recipient. Consequently, the costs associated with the channelling of funds between middle-men is significantly reduced, as is the potential for the funds to be stolen or misused in the process. Indeed, research supports that giving directly can be a highly effective means in assisting the poor.<sup>9</sup> This was traditionally done in cash, due to barriers to banking faced by the poor. As highlighted in earlier parts of this series, Bitcoin eliminates most of these barriers so long as the recipient has basic smartphone and internet access. This is not to say that one can control how the funds are used however, as once the funds are sent, the recipient is free to use it at their discretion. Ultimately, Bitcoin's network is simply providing a new, transparent payment channel in which foreign aid can take the form of a direct transfer, from peer-to-peer.

## Unreliant on Third Party Control

Bitcoin's ability to be transacted securely all over the world lies in its Proof-of-Work consensus mechanism, where large amounts of real-world resources are dedicated to mine and secure Bitcoin. In our past piece, *The Origins and Evolutions of Bitcoin*, we explain what would be required to attack the network in what is called a '51% attack'.<sup>10</sup> Such an attack, which requires a malicious actor

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<sup>8</sup> Monochrome Asset Management, 'The Origins and Evolutions of Bitcoin (<https://monochrome.co/research-article/the-origins-and-evolution-of-bitcoin/>)'; Monochrome Research, 8 October 2021, accessed 8 February.

<sup>9</sup> GiveDirectly, 'Evidence - Research on Cash Transfers ([www.givedirectly.org/research-on-cash-transfers/](http://www.givedirectly.org/research-on-cash-transfers/))'; GiveDirectly.org, 22 December 2020, accessed 15 July 2022.

<sup>10</sup> Monochrome Asset Management, 'The Origins and Evolutions of Bitcoin (<https://monochrome.co/research-article/the-origins-and-evolution-of-bitcoin/>)'; Monochrome Research, 8 October 2021, accessed 8 February.

to commandeer 51% of the mining network, can lead to the censorship of transactions. In late 2022 however, even multiple large state actors working in concert would find this task nearly impossible due to the amount of hardware and energy involved and stealth required. Essentially, **the implication is that whilst governments or banks can block foreign aid or impose sanctions and capital controls, no central power can control the movement of bitcoin.**

This is an obstacle that has impeded the distribution of aid in the past, and more recently in Afghanistan in 2021. Prior to the takeover of the Taliban, 70% to 80% of Afghanistan’s government budget was funded by international donors including the US.<sup>11</sup> Unsurprisingly, after the Taliban took over, Afghanistan fell into economic despair as access to assets held at the U.S Federal Reserve worth approximately US\$7 billion and resources from the International Monetary Fund (IMF) - including non-monetary resources of over US\$370million set to arrive late August - were cut off.<sup>12</sup> This only aggravated the humanitarian crisis, with citizens unable to access the banking system for cash withdrawals or lending, and international money providers such as Western Union which use the global financial system, SWIFT, suspending their operations.<sup>13</sup>

These events highlight the limitations that exist in the current foreign aid system, particularly for countries in crisis, due to the reliance on intermediaries such as banks and government bodies.

## Bitcoin In Action

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The recent war between Russia and Ukraine sparked a recent surge in foreign aid donations, but not all of it was in fiat currency - Bitcoin comprised a significant portion of the funds that were sent. When the conflict started in late February 2022, the Ukrainian Government authorised “Aid for Ukraine”, a fund initiated by the Ministry of Digital Transformation with the aim to raise funds for aid directed to the armed forces.<sup>15</sup> The fund is also co-powered by two Ukrainian companies - the staking platform, Everstake, and digital exchange, Kuna. Importantly, it allows a donor to donate bitcoin and other crypto-assets seamlessly and without intermediaries. According to their official website, the fund has raised over US\$60 million as of August 2022, including approximately 595 bitcoin since the beginning of the war. The fund has successfully been used to purchase military equipment and supplies.

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<sup>11</sup> D Lawder, ‘Taliban rule presents aid agencies with moral, fiscal dilemma (<https://www.reuters.com/world/taliban-rule-presents-aid-agencies-with-moral-fiscal-dilemma-2021-08-24/>); Reuters, 25 August 2021, accessed 9 February 2022.

<sup>12</sup> B Timmins, ‘IMF suspends Afghanistan’s access to funds (<https://www.bbc.com/news/business-58263525>); BBC, 19 August 2021, accessed 9 February 2022.

<sup>13</sup> L Fang, ‘Starving Afghans Use Crypto To Sidestep U.S. Sanctions, Failing Banks, And The Taliban (<https://theintercept.com/2022/01/19/crypto-afghanistan-sanctions-taliban/>); The Intercept, 19 January 2022, accessed 9 February 2022.

<sup>14</sup> Ministry of Digital Transformation, ‘Help Ukraine with crypto, don’t leave us alone with the enemy ([donate.thedigital.gov.ua/](https://donate.thedigital.gov.ua/)), n.d. Accessed 5 August 2022.

<sup>15</sup> A Baydakova, ‘Where the Coins Go: Inside Ukraine’s \$135M Wartime Fundraise (<https://www.coindesk.com/layer2/2022/06/10/where-the-coins-go-inside-ukraines-125m-wartime-fundraise/>); CoinDesk, 11 June 2022, accessed 27 July 2022.

Whilst donations to Ukraine in traditional fiat currency remain far larger than those in Bitcoin, the millions raised by individuals abroad nevertheless highlight its capability as an instant, secure and direct method of foreign aid, both unreliant on third parties such as banks to facilitate the transfer. Particularly for individuals in areas within Eastern Europe who may have found it difficult or not possible to send donations via their local bank, Bitcoin provided a secure alternative to send funds directly to an individual, charity or a government-run initiative.

## Conclusion

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Bitcoin's ability to operate without the use of intermediaries makes it a powerful tool for aid to be administered peer-to-peer, particularly in instances where the distribution of foreign aid is restricted. Currently, the mechanism used to channel Official Development Assistance (ODA) is not always as effective as it seeks to be, with exposure to risks such as poor governance and corruption made difficult to control due to the lack of financial transparency. Through the use of Bitcoin, these risks can be mitigated, and direct transfers of aid can be delivered in a cost-effective, timely and transparent manner.

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### Monochrome Asset Management

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