

Is Aid from the Inter-American Development Bank Politically Motivated?

Diego Hernandez*

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Abstract

International Financial Institutions have been alleged to be largely influenced by political and economic interests in the developing world of their major stake holders. Particularly, it has been recognized that temporary members of the United Nations Security Council (UNSC) receive a favorable treatment by these institutions in exchange of voting support. Organizations like the International Monetary Fund, the World Bank, and the Asian Development Bank have been reported to follow this pattern. This paper evaluates if the Inter-American Development Bank (IDB), largest Multilateral Development Bank and most important source of development finance in the Latin American and Caribbean region, serves as a vehicle to channel rewards from political support at the UNSC. Empirical results from analyzing loan commitments granted by the IDB for the period 1970-2007 reveals that temporary members in the USNC do not receive significant greater loan shares, indicating that US control over the bank is limited. This singular outcome responds to considerable influence of borrowing members in the governance of the IDB, given their distinct advantageous representation in the bank in terms of voting shares and senior managerial positions.

Keywords: Inter-American Development Bank, United Nations Security Council, Voting, Aid

JEL classification: F33, F35, O19.

* Heidelberg University, Department of Economics, Bergheimer Str. 58, D-69115 Heidelberg, Germany; Telephone: +49 (0)6221 54-3853; Email: diego.hernandez@awi.uni-heidelberg.de

1. Introduction

Lending allocation decisions taken by International Financial Institutions (IFIs) have been subjected to notorious criticism. Contrary to their fundamentals, it has been documented that interests of major stake holders of this institutions shape the direction of loan granting. A wave of studies point that developing countries politically aligned to the G7, especially to the US, and with significant commercial and investment potential are preferred by IFIs when choosing where to dispense development aid. These studies have shown that in institutions such as the International Monetary Fund (IMF), the World Bank and the Asian Development Bank (ADB), donor influence is substantial (Thacker 1999; Stone 2004; Dreher and Jensen 2007; Dreher et al. 2009a; Dreher et al. 2009b; Dreher et al. 2010; Kilby 2010a; Lim and Vreeland 2010).

In particular, it has been suggested that the United Nations Security Council (UNSC) is a major platform to direct global political decisions, in which temporary elected members might receive a favorable treatment from IFIs if they are willing to align politically to permanent members and other influential countries (Malone 2000; Kuziemko and Werker 2006; Dreher et al. 2010; Lim and Vreeland 2010). Arguably, temporary members are willing to swap aid for votes because developing countries value loans more than voting independently, and permanent members of the UNSC value voting support more than efficient aid allocation. If this is true, developing countries serving temporarily in the UNSC should therefore receive extra attention from IFIs in terms of loans allocated. Such behavior has been identified in several studies. For example, Dreher et al. (2010) find that serving in the UNSC increases the likelihood of participating in IMF programs and reduces the number of conditions imposed. These same authors identify a positive relationship between UNSC membership and World Bank lending (Dreher et al. 2009b). Moreover, Kuziemko and Werker (2006) point that US foreign aid increases on average 54 percent when a country is a temporary member of the UNSC, while Frankel and Gibbons (2010) suggest a comparable pattern of Japanese Official Development Assistance. And lastly, Lim and Vreeland (2010) conclude that UNSC membership increases a typical country's share of ADB loans by approximately 25 percent.

In line with this argumentation, the Inter-American Development Bank (IDB), where the US alone possesses 30 percent and by far the largest voting share, might be utilized as a vehicle to compensate countries supporting US interests.¹ In other words, the US might make use of its influence at the IDB to facilitate project loans for the UNSC members in exchange of votes. The IDB is the largest Multilateral Development Bank (MDB) in terms of non-concessional loan granting and the largest source of development finance for the Latin America and the Caribbean (LAC) region.² Influence of

¹ Bank members with the following largest voting shares are Argentina and Brazil with 11%.

² In 2008 the IDB granted \$11 billion in non-concessional loan commitments, compared with \$8.4 billion by the ADB, \$7.2 billion by the Islamic Development Bank, and \$2.8 billion by the African Development Bank (AfDB).

US political interests on IDB allocation decisions have been alleged; for instance, the Washington Post documented that in 1988 President Reagan's administration attempted to block a vote on a \$58 billion loan to Nicaragua, held then by a leftist government.³ However, empirical research on the role of the IDB as an instrument to channel US political interests is limited.⁴

This paper analyzes panel data of loan commitments granted by the IDB to borrower member countries during the period 1970-2008, and observe if countries selected to serve in the UNSC have been favored than those that were not. Following the literature, the econometric analysis controls for loan supply and demand factors, as well as for economic and political characteristics of recipient countries to isolate and identify precisely the size of this effect.

2. Hypothesis

Developing countries elected as temporary members of the UNSC looking to finance their development projects will care more about aid than voting independently in the council, while rich countries seeking for support to carry out their political agenda will care more about votes than allocating aid efficiently. For this reason, a swap of votes for aid is a plausible scenario and consequently candidate members willing to accept such trade should be more likely to obtain a temporary seat in the UNSC (Dreher et al. 2010; Mao Lim and Vreeland 2010).

On the other hand, rich countries, usually major stake holders of IFIs, have alternative mechanisms to channel compensations to temporary members, such as bilateral aid, through which they can exert complete control. However, there are number of reasons why rich countries would prefer to make use of MDBs instead of bilateral instruments to accomplish this compensation. First, the influence of rich countries over the trade of loans for votes is more obvious if aid is allocated bilaterally, than if a multilateral institution is utilized instead (Vaubel 2006). Second, MDBs can reduce the cost of issuing loans, as rich countries can use their infrastructure to access international capital markets more efficiently and better manage the disbursement and repayment of these loans (Lim and Vreeland 2010). And third, specifically in this case, the US possesses 30% of the voting share in the IDB, a proportion by far larger than in any other IFIs.⁵ This outstanding position to influence aid allocation

Amounts allocated by other IFIs serving the LAC region for that same year include \$10 billion by the World Bank and \$4 billion by the Comunidad Andina de Fomento.

³ Article can be found at

<http://www.washingtonpost.com/wp-dyn/content/article/2007/03/21/AR2007032102174.html>

⁴ Another study analyzing US political influence on MDBs in Latin America is implemented by Humphrey and Michaelowa (2010).

⁵ For example, US voting shares correspond to 12% in the ADB, 6% in the AfDB, and less than 20% in all institutes of the World Bank Group.

decisions makes the IDB an attractive institution for the US to compensate favored temporary members of the UNSC.

Given this argument, the main hypothesis to be tested in this study is that LAC countries serving temporarily in the UNSC receive significant larger amounts of aid from the IDB than those that do not. In this way, it is observed to what extent is the IDB a vehicle of the US to compensate political favors.

3. Data and model

The data set contains all loan commitments granted by the IDB to every borrowing member between the period 1970 to 2007. Given different membership entrance dates of bank members, the panel is unbalanced, containing 934 country-year observations for 26 countries. There are not missing values in the full sample. As seen in Figure 1, total commitments have increased considerably during the period analyzed, as in 1970 less than \$3 million were granted to bank members, while the same figure was more than triple in 2007.⁶ However there is also great fluctuation, having the series a historical minimum in 1988 and a maximum in 1998.

The dependent variable is the commitments granted to a country for a given year as a proportion of the total commitments granted by the bank for the same given year. Unlike the level of commitments, commitments per capita or commitments as a share of GDP, this variable captures directly the relative importance of one recipient versus another (Kilby 2010b). Figure 2 summarizes the behavior of the dependent variable for the 3 largest receivers of loan commitments, namely Brazil, Argentina and Mexico, which also hold the highest voting shares among borrowing members. These countries combined catch on average 45 percent of all loan commitments granted during the whole period, reaching up to 66 percent in 1999. The key explanatory variable is a dummy indicating temporary membership in the UNSC or not. Argentina is the country that has served the most during the period of analysis, with 5 times in total, followed by Brazil and Panama with 4 times. Eight countries never served in the UNSC for the same period: Bahamas, Barbados, Belize, Dominican Republic, El Salvador, Guatemala, Paraguay and Uruguay. On average, non-members of the UNSC received a loan commitments share of 3,7 percent, while members 7,5 percent. Interestingly, among those countries serving in the council, this share increases to 8,5 percent during the second year of the membership, and drops below the 7,5 average in the years immediately before and after the service period. Apparently UNSC temporary membership might matter in the amount of loan commitments granted to a country. The model to be estimated takes the following form:

⁶ Figures in 2000 constant dollars.

$$\text{CommShare}_{it} = \alpha + \beta_1 \text{UNSC}_{it} + \beta_I I + \beta_C C + \beta_F F + \mu_i + \gamma_t + \varepsilon_{it} \quad (1)$$

Where CommShare and UNSC are the dependent and key explanatory variable respectively. Matrix I contains two variables accounting US interests in the region. The first is the share of US bilateral aid commitments a country received in a specific year out of all US bilateral aid commitments allocated in the LAC region for that same year. And the second one is a proportion built in the same way with bilateral exports from the US to every country. C is a matrix of control variables including elections, democracy level, population and GDP per capita. Election is a dummy variable indicating if main elections (presidential or parliamentary according to the political system) have been held in a country during that year, accounting for political cycles which have been shown to influence aid allocation (Dreher et al. 2009). Democracy level captures the preference over certain forms of government, population controls for the size of the country and GDP per capita for economic needs. Following Sturm et al. (2005), F contains variables controlling for loan demand and supply factors. These are government expenditures, debt service, current account and investments, all expressed in terms of GDP, plus GDP growth, inflation rate and international reserves to debt ratio. Variables μ and γ control for country and year fixed effects respectively, and ε is the error term.

The data for the objective variable presents over dispersion, however, variance among temporary and non-temporary members is not statistically different. For this reason a poisson distribution is preferred than a negative binomial.⁷ All regressions include standard errors clustered at the country level to avoid spuriously small p-values.

4. Results

Preliminary result in Table 2 show a positive relationship between UNSC membership and IDB commitments share, however the coefficient is insignificant at conventional levels in all model specifications. As seen in the first column, the effect of serving in the council disappears even when only country and time fixed effects are included. Therefore if temporary members of the UNSC receive on average larger shares of loan commitments, as pointed out in previous section, it must be due to other country characteristics rather than the membership itself. These results imply that the IDB does not serve as vehicle of the US to compensate politically aligned countries in the LAC region during UNSC decisions. Possibly, borrowing members with large voting shares, as it is the case of Argentina, Brazil and Mexico exert great influence in the governance of the IDB, pushing to finance

⁷ All regression were also implemented assuming a negative binomial distribution, however the dispersion parameter alpha obtained suggests a poisson distribution is a better specification in every regression.

projects of their own interest and reducing the space for US control. Unlike the ADB, for instance, borrowing members hold the majority of the voting share, and after the US they hold the next largest voting shares in the top 5.⁸ Moreover, the majority of the senior positions in the IDB are occupied by borrowing country nationals, in contrast to the ADB where these are held usually by American and Japanese nationals. For example, all five presidents of the IDB since its creation have been nationals from borrowing members, while in the case of the ADB every president have been appointed by the Japanese government.⁹

Continuing with results for the other variables, the coefficient for US bilateral aid fails to be significant at conventional levels, indicating that the IDB does not allocate loans along strategically preferred countries by the US. However, the coefficient for the US bilateral exports is positive and significant at a 1 percent level, showing that development projects are more likely to be financed by the IDB if these are to be carried out in a country that is a great US regional trade partner. These results suggest that developing assistance from the IDB is shaped by US economic rather than political interests.

From the control variables in matrix C, all of them except the elections variables turn out to be significant, however, the GDP per capita and population variables take unexpected signs. This behavior is not surprising, as the wealthiest countries in the region (Argentina, Brazil, Chile, Mexico and Venezuela) hold the largest voting shares in the bank and capture the majority of commitments, as seen previously in Figure 2. The sign of the population coefficient reflects overrepresentation of small countries in aid allocation. Loan demand and supply factors in matrix F take the expected signs, but only the international reserves to ratio is significant. This result is straight forward, as naturally endowed countries and consequently abundant in international reserves are less probably to approach the IDB to cover their financial needs.

Columns 3 show results for different timings of the key explanatory variable to check possible effects of UNSC membership over time. Regression in the third column analyzes membership effects a year before serving in the council, during the first and second year of membership, and a year right after completing the membership cycle. Coefficients for all four variables fail to be significant at conventional levels. Consequently a country's share of IDB commitments is neither affected by UNSC membership over time.

⁸ Non-borrowing members hold 51% of the voting share in the IDB, the same figure is 36% for the ADB. The top 5 countries in terms of voting shares are US, Brazil, Argentina, Mexico and Venezuela in the IDB, while for the ADB are US, Japan, China, India and Australia.

⁹ For an overview of the IDB structure please refer to <http://www.iadb.org/en/about-us/>, and for the ADB please refer to <http://beta.adb.org/about/main> and Mao Lim and Vreeland (2010).

5. Conclusions

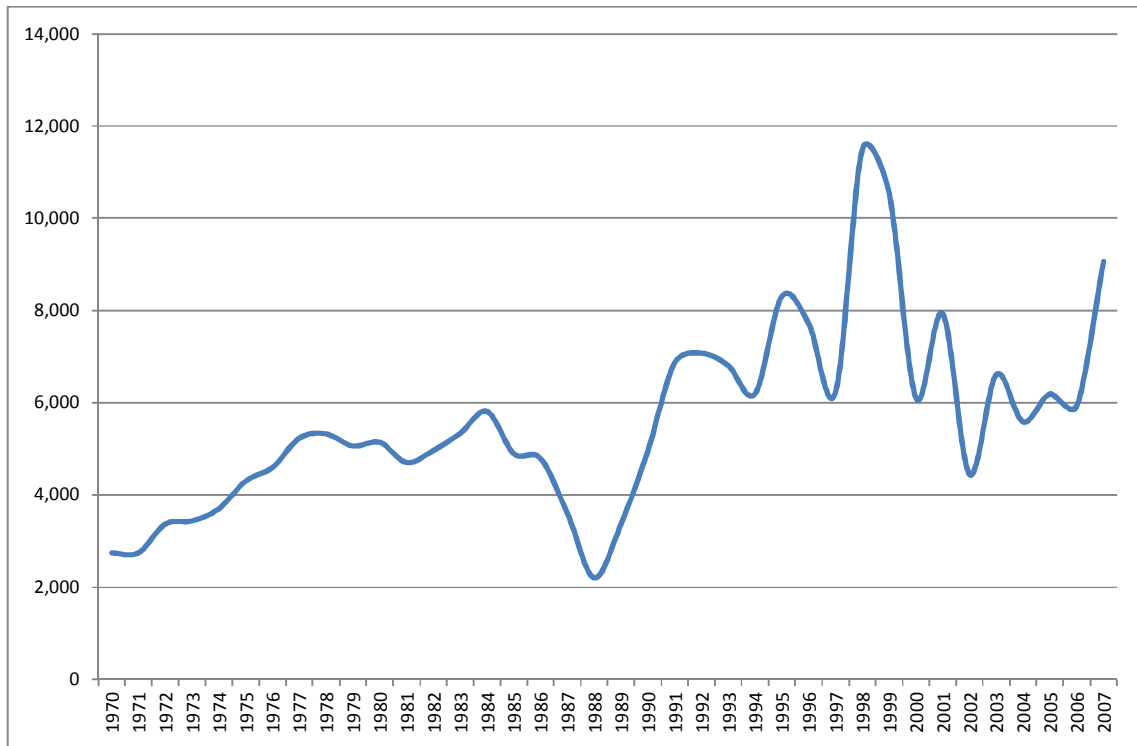
This paper analyzes loan commitments granted by the IDB during the period between 1970 and 2007, and investigate if the US uses its influence over the bank to finance development projects of temporary UNSC members in exchange of votes. Empirical results suggest that countries serving in the council do not receive a significant special treatment by the bank. This effect is persistent not only during the two year period serving at the council, but also in the years before and after the membership. These results diverge from parallel research to other IFIs, such as the IMF, World Bank and ADB, in which temporary UNSC members receive significant larger share of loans, most probably as a reward for alignment in council voting decisions. The reason for this limited influence of the US in the IDB must be related to how the bank is structured. Unlike the above mentioned institutions, borrowing members in the IDB hold the majority of the voting share, and nationals of non-borrowing members do not occupy a substantial share of the senior positions. For this reason, borrowing members can exert greater influence in the governance of the bank, especially those with large voting shares which have historically capture a notorious proportion of IDB's flows.

However, countries in the LAC region should not be an exception when it comes to the exchange of development aid for voting support in the UNSC. This study shows that the IDB has its limitations to serve as a vehicle to channel compensations. The stage and mechanisms in which this phenomenon occurs in the region still need to be recognized.

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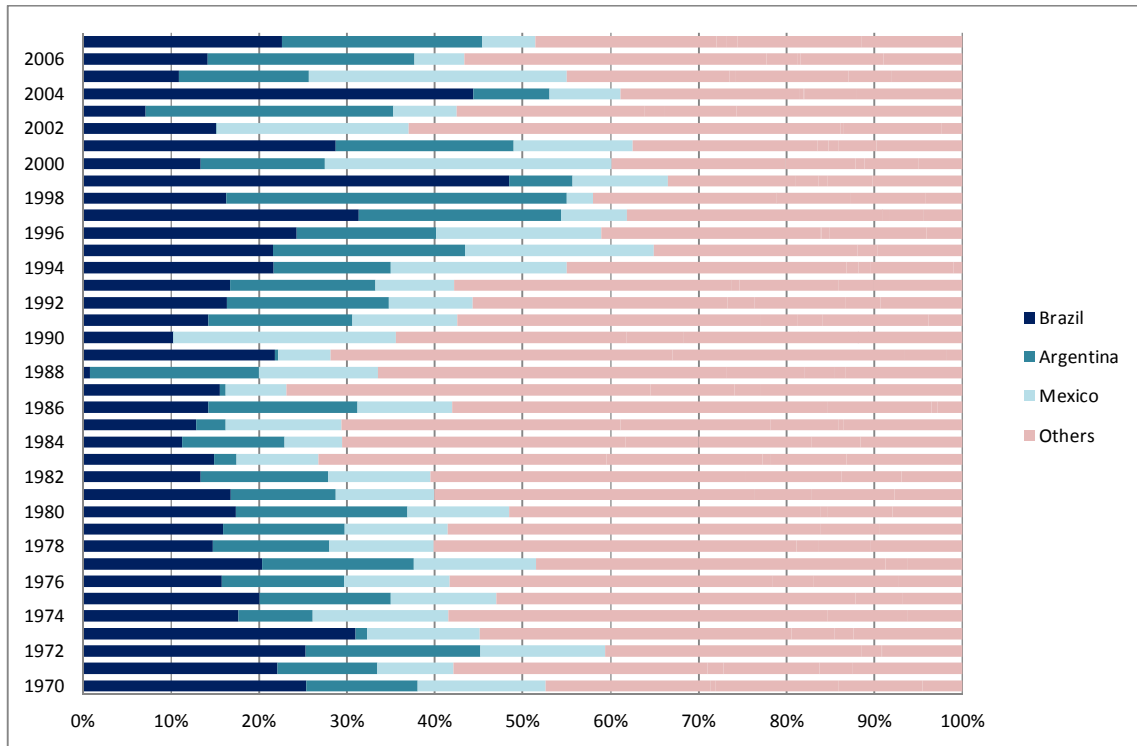
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Figure 1. Total commitments granted by the IDB between 1970 and 2007 (millions of 2000 constant dollars)



Source: IDB

Figure 2. Share of total commitments granted by the IDB between 1970 and 2007



Source: IDB

Table1. Data sources and definitions

Variable	Description	Source
IDB loan commitments share	IDB loan commitments received by a borrowing member as a proportion of total IDB loan commitments allocated in a year.	IDB Annual Report (various years)
UNSC membership	Dummy coded 1 if a country is a non-permanent member of the UNSC, and 0 otherwise.	Dreher et al. (2009b)
US bilateral aid share	US bilateral aid received by a borrowing member as a proportion of total US bilateral aid allocated within borrowing members in a year.	OECD data base
US exports share	US exports to a borrowing member as a proportion of total US exports to borrowing members in a year.	OECD data base
Polity	Democracy level scale, from 10 (strongly democratic) to -10 (strongly autocratic)	Marshall and Jaggers (2000)
Elections	Dummy coded 1 if elections were held in the year, and 0 otherwise.	World Bank, Data Base of Political Institutions (DPI)
Population share	A borrowing member population as a proportion of total borrowing members' population.	World Bank, World Development Indicators (WDI)
GDP per capita (log)	Log of GDP per capita in current dollars.	World Bank, WDI
GDP growth	Growth rate of GDP.	World Bank, WDI
Debt service to GDP	Total debt service outstanding in percent of GDP.	World Bank, WDI
International reserves to debt	International reserves in percentage of total debt service outstanding.	World Bank, WDI
Inflation rate	Inflation as measured by the consumer price index.	World Bank, WDI
Government expenditures to GDP	Government expenditures in percentage of GDP.	World Bank, WDI
Current account to GDP	Sum of net exports of goods, services, net income, and net current transfers in percentage of GDP.	World Bank, WDI
Investment rate	Gross fixed capital formation as a percentage of GDP.	World Bank, WDI

Table 2. The effect of UNSC membership on IDB lending

	(1)	(2)	(3)
	Poisson	Poisson	Poisson
UNSC	0.002 [0.488]	0.003 [0.579]	
UNSC 1 year before			-0.002 [0.615]
UNSC 1st year			-0.003 [0.569]
UNSC 2nd year			0.005 [0.636]
UNSC 1 year after			-0.014 [0.255]
US aid (share)		0.039 [0.281]	0.038 [0.348]
US exports (share)		0.113*** [0.001]	0.105*** [0.004]
Polity		0.001** [0.042]	0.001** [0.026]
Elections		-0.006 [0.144]	-0.007 [0.119]
Population (share)		-5.840*** [0.000]	-5.813*** [0.000]
GDP per capita (log)		0.018* [0.053]	0.019** [0.022]
GDP growth		0.002*** [0.007]	0.002*** [0.009]
Debt service to GDP		0.000 [0.989]	0.000 [0.833]
Int. reserves to Debt		-0.000*** [0.007]	-0.000*** [0.009]
Inflation rate + 1		-0.000 [0.909]	-0.000 [0.672]
Gov. expenditures to GDP		0.001 [0.183]	0.001 [0.150]
Current account to GDP		0.000 [0.511]	0.000 [0.629]
Investment rate		-0.000 [0.363]	-0.001 [0.322]
Observations	970	476	476
Country fixed effects	Yes	Yes	Yes
Time fixed effects	Yes	Yes	Yes
Clustered errors	Yes	Yes	Yes

p-values in brackets

*** p<0.01, ** p<0.05, * p<0.1