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Shopping for Development: Multilateral Lending, Shareholder Composition and Borrower Preferences

CHRIS HUMPHREY and KATHARINA MICHAELOWA *
London School of Economics and University of Zurich, Switzerland

Summary. — This paper proposes two theoretical considerations regarding Multilateral development banks (MDBs). The first is that MDB activities are increasingly driven by the growing economic strength of many developing countries. The second is that categorizing MDBs according to the balance of power among shareholders helps explain why countries might prefer one or another MDB. We compare three different MDBs operating in Latin America—one dominated by nonborrowers (World Bank), another controlled by borrowing countries (Andean Development Corporation, CAF), and a third more evenly split between borrowers and nonborrowers (Inter-American Development Bank, IADB). Qualitative and statistical analysis suggests that demand factors play an important role in MDB lending.

Key words — World Bank, Inter-American Development Bank, Latin America, multilateral, development, International Organization

1. INTRODUCTION

In academic literature as well as general public perception, the World Bank and other Multilateral development banks (MDBs) have long been viewed as domineering organizations able to impose themselves upon developing countries. Since the mid-1990s, however, a number of emerging market governments have found themselves in strong financial positions, due to, among other factors, the huge rise in global private capital flows, high foreign exchange income from rising commodity prices and growing export industries, and much stronger fiscal accounts. Whether these trends represent short-term developments or a more fundamental shift in the world economy remains to be seen. But there is little doubt that the demand for multilateral lending from many major developing countries is undergoing a change. Economies such as China, India, Indonesia, Brazil, Mexico, and Peru—which together accounted for 44% of the World Bank's loan portfolio in 2009—now have stable fiscal accounts, low public debt levels, high international reserves, and well-established access to international capital markets.

Little attention has been paid in the academic literature to how this sea change in economic conditions for many developing countries might impact MDB lending. Is lending on the decline for some MDBs, and if so, which MDBs are facing the most serious drop in lending? What factors might lead a country to prefer borrowing from one MDB vs. another, when it has a choice? Academic research is largely silent on these issues, despite their far-reaching implications for the activities of MDBs and on international development more broadly. The literature instead has focused on how MDB lending decisions are influenced by geopolitical considerations of powerful shareholders, by bureaucratic pathologies within MDBs, or by changing ideologies on development. All of these approaches implicitly assume that lending fluctuates only due to decisions taken by the MDBs or their principal shareholders, while the preferences of borrowing countries are not relevant. This may have been justifiable in the 1980s, but is unlikely to be realistic in the current global context.

In addition, existing research on MDBs focuses mainly on the World Bank, with only an incipient (though fast-growing) body of research on other MDBs such as the Inter-American Development Bank and the Asian Development Bank (see, e.g., Babb, 2009; Kilby and Bland, 2012; Gutner, 2002; Kilby, 2006, 2011; Neumayer, 2003, among others). More than 20 MDBs exist, and some are larger lenders to their particular market than the World Bank. Do different MDBs mediate the interests of their country shareholders in different ways? How might the various shareholding arrangements among different MDBs impact their operations? Do borrowing countries prefer working with some MDBs over others in different situations, and if so, why?

This paper utilizes a new theoretical framework suggesting that differences in lending volumes by various MDBs may be partly explained by the balance of power between borrowing and nonborrowing shareholders. Qualitative research indicates that this balance of power directly shapes the terms of the loans—i.e., financial cost, bureaucratic procedures, and safeguard requirements. Depending on economic conditions, borrowing countries will put different weights on these factors. We thus hypothesize that lending varies systematically as a function of both: prevailing economic conditions among borrowers, and the type of shareholding arrangement in each MDB. The three types of MDB shareholder arrangements considered are: (1) domination by wealthy nonborrowing countries (at the World Bank); (2) stronger but still subordinate influence of borrowing countries (at the Inter-American Development Bank, IADB); and (3) control by borrowing countries (at the Andean Development Corporation, CAF). The operational characteristics of each MDB derived from these shareholder arrangements, we suggest, strongly condition the preferences of countries to borrow from them in different economic circumstances.

The statistical part of the paper examines lending by each of the three MDBs for a common set of borrowing countries in

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Latin America during the period 1991–2010. We make use of a multivariate, large N analysis in a panel framework with observations across the different borrowers and over time. Based on Seemingly Unrelated Regression Estimation (SURE), we compare the coefficient estimates of the different MDB regressions to test our hypotheses on systematic differences between the three cases. The comparison of only three cases cannot prove a causal relationship between MDB governance structures, borrower preferences, and lending, nor can it fully disentangle supply from demand side factors. However, it allows us to test whether the lending patterns observed are consistent with what our theoretical discussion leads us to expect. The aim is to demonstrate that a demand-oriented interpretation of MDB lending is at least as plausible as the supply-side analysis prevalent in the current literature, an interpretation that is further substantiated by qualitative evidence. This points the way to further research to build a more comprehensive and realistic model of MDB activities for the current global economic context.

The paper is organized as follows. Section 2 formulates the empirical puzzle to be addressed, and reviews relevant scholarship on MDBs. Section 3 presents qualitative research on MDB governance structures and loan characteristics, which Section 4 then builds on to derive testable hypotheses. Section 5 provides the econometric analysis of lending commitments by the World Bank, IADB, and CAF in five Latin American countries. Section 6 concludes.

2. EMPIRICAL PUZZLE AND THEORETICAL FRAMEWORK

Before moving on to analyze what might be driving variation in lending patterns by different MDBs over time, it is useful to first consider whether this is something worth explaining at all. It could be that lending remains relatively constant or that it moves in ways that are relatively predictable and easily explained. As can be seen in Figure 1, this is clearly not the case, at least for lending by the three MDBs discussed here in five Latin American countries. Annual lending commitments fluctuate widely year by year for each of the MDBs.

How is one to explain these patterns? Why since the early 1990s has the regional IADB lent consistently more than the global World Bank? Why has lending by the relatively little-known CAF grown so dramatically, to the point where it lent

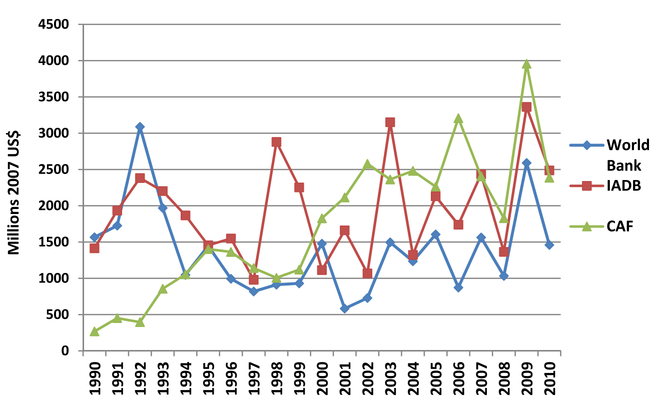

Figure 1. *Annual lending commitments by World Bank, IADB, and CAF to Five Latin American Countries, 1990–2010. Source: Annual Reports of World Bank, IADB and CAF, 1980–2009. Note: Five countries are Bolivia, Colombia, Ecuador, Peru and Venezuela.*

more than either the World Bank or IADB in the last decade? The existing academic literature posits a wide range of explanations for MDB lending patterns, including realist considerations of power politics and donor interest (Babb, 2009; Dreher, Klasen, Vreeland, & Werker, 2010; Dreher, Sturm, & Vreeland, 2009a, 2009b; Harrigan, Wang, & El-Said, 2006; Kilby, 2006, 2011; Thacker, 1999, among many others), a rationalist focus on incentives among main actors in MDB activities (Gutner, 2005; Mosley, Harrigan, & Toye, 1995; Vaubel, 2006), or more sociology-based constructivist interpretations of norms and staff self-image (Babb, 2003; Barnett & Finnemore, 1999, 2004; Weaver, 2008; Woods, 2006).

However, it is notable how little existing research considers the point of view of the borrower when attempting to understand MDB lending. The majority of research on MDBs presupposes that all countries eligible to borrow from an MDB will always want to do so, and the important question to be asked is what factors might lead an MDB to award a loan to a country or not. That is, they focus almost entirely on the "supply side" of MDB activities. The analytical approach of the studies cited above is to focus on the decision-making process of the MDB in granting a loan—either among its shareholders, within its staff, or between the two—with the implicit assumption that countries will always want the loans.

In light of the spectacular growth of many large developing countries in recent years as well as the explosion of international capital flows, explanations of MDB lending that ignore demand seems unlikely to be realistic now. Countries that have been major borrowers from MDBs in the past, like China, Brazil, India, Mexico, Indonesia, Peru, Turkey, and others, have in recent years found themselves in much stronger fiscal positions and also with a great many options for sovereign borrowing, often at very low interest rates and in domestic currencies. MDBs still offer these countries resources generally at better financial terms than they can get from the markets, but the loans also come with a variety of strings attached that these countries may object to. Hence, a more realistic and complete picture of how MDBs function in the current global economic context requires understanding the role played by borrower demand.

The impact of these broad economic shifts on development lending is no news to the MDBs themselves, as evidenced for example by numerous World Bank strategy papers and lending procedure reforms designed to maintain its attractiveness as a development lender for middle-income country "clients" (the term itself is revealing), as will be discussed further below. Policymakers and journalists who follow development issues have also noted these changes, and this is reflected in some of the applied policy literature (see, e.g., Einhorn, 2006; Mallaby, 2005). However, academic research has as yet not reacted in a significant way to the increasing importance of borrower demand. The only studies we have found to explicitly consider the role of demand are Ratha (2005) and Knack, Rogers, and Heckelman (2012), both in relation to the World Bank.[1]

A second step when considering how demand impacts MDB activities is to ask why countries might prefer to borrow from one MDB vs. another, when they have a choice. Although the World Bank has been the object of the overwhelming majority of scholarly research on MDBs, some 20-odd MDBs exist in the world,[2] and many of them lend more to their client countries than the World Bank. While academia has begun branching out beyond the World Bank, only a few studies have compared governance structures of different MDBs and attempted to systematically test the impact of those differences on operations (e.g., Gutner's, 2002, book on environmental