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Politics of religiously motivated lending: An empirical analysis of aid allocation by the Islamic Development Bank☆

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ABSTRACT

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We investigate whether lending by the Islamic Development Bank mirrors Saudi Arabia's political interests based on religious affinity using panel data for its 56 member countries over the 1970–2007 period. Our results indicate that Sunni regime countries receive favorable treatment in terms of loan allocation, as well as Shia majority populated countries in exceptional occasions of conflict with other religious minority groups, while non-Muslim countries are the least favored. There is also evidence that lending by the World Bank to the same group of countries and over the same time frame does not respond to the political stance of Saudi Arabia founded on religion. These findings reveal the advantage that Saudi Arabia gains by assuming the leadership of a Regional Development Bank in contrast to coordinating common strategies in a global International Financial Institution with other large shareholders for whom religion might not be essential for political alliances. *Journal of Comparative Economics* **000** (2016) 1–20. University of Heidelberg, Heidelberg, Germany; School of Politics and International Relations (SPIRe), University College Dublin (UCD), Dublin, Ireland.

1. Introduction

The establishment of International Financial Institutions (IFIs) is often perceived as an instrument for some countries to achieve influence over others (e.g., Buira, 2005; Bird and Rowlands, 2006). The control pursued may be political, commercial, or over the strategies to attain development. Furthermore, some authors claim that the influence over IFIs' lending decisions is essential to guarantee the engagement of powerful countries in international cooperation and therefore the survival of these institutions (Dreher et al., 2009b; Copelovitch, 2010). Not surprisingly, the development aid literature recognizes that major stakeholders' particular interests in borrowing countries are a key driver of resources allocated by IFIs (e.g., Thacker, 1999; Dreher et al., 2009a; Kilby, 2011).

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In a similar way, regional powers may approach Regional Development Banks (RDBs) to exert influence over their geographical proximity, as these might be advantageous in terms of participation, scope and coverage (Kilby, 2006; Lim and Vreeland, 2013). Saudi Arabia is not an exception and has taken the initiative to found and assume the chief sponsorship of several RDBs most likely to gain leadership in the Arab region and its periphery without the interference of the G7 countries.[1] Unlike the G7, religious affiliation is particularly important for Saudi Arabia to draw political alliances in the Islamic world, making the building of common strategies for this region between both sides a difficult task (Neumayer, 2004; Andersen et al., 2006; Clark, 2012). For this reason, it is rather challenging for Saudi Arabia to position its interest through the Bretton Woods Institutions, despite its important participation in them (Blanchard and Prados, 2007; Copelovitch, 2010; Bremmer, 2013).[2] In this paper we analyze the lending decisions of the Islamic Development Bank (IsDB), by far the largest Saudi-led RDB and Arab development agency, and observe to what extent they are driven by Saudi Arabia's political interests based on religious affiliation.[3] We further perform a similar assessment of the World Bank for the same group of countries and over the same time frame, and observe the relative advantage Saudi Arabia might gain by taking on the directorship of an RDB to pursue its own interests.

The limited number of studies on aid allocation by Arab donors agree that predominantly Muslim countries are their main beneficiaries (Simmons, 1981; Hunter, 1984; Neumayer, 2003, 2004). This finding can also be extended to the IsDB, as it was set up in 1975 with the very purpose of providing development assistance only to countries affiliated to the Organization of Islamic Cooperation (OIC) and to facilitate their access to Sharia compliant monetary resources (Warde, 2000; Villanger, 2007). Though Islamic solidarity is expected to play a dominant role in IsDB lending decisions, Muslim communities are not homogeneous and recognizing a grasp of countries' affiliation to specific Islamic denominations is crucial to understanding politics in the region. Saudi Arabia, as largest donor of the Bank, pays special attention to the different Islamic denominations in forging political alliances in the Islamic world and therefore we expect this to be reflected in IsDB lending patterns (Clark, 2012; Abdo, 2013).

Of particular relevance to comprehending Saudi Arabian interests is the relationship between Sunnis and Shias, which are the first and second largest Islamic denominations and constitute around 95% of the total Muslim population (PEW Research Center, 2009a, b). Sunni-Shia relations have been marked by violent conflict and tensions between them are a common phenomenon across the Arab region and its periphery (Luomi, 2008; Blanchard and Prados, 2007). This has resulted in the polarization of Islamic societies based on affiliations to these two denominations, and international political support among equal Islamic denominations is the norm (Clark, 2012; Keath, 2013). As for communities affiliated with smaller Islamic branches, cooperation is usually sustained on the acceptance of one or the other's religious fundamentals (Luomi, 2008; Clark, 2012). The Sunni-Shia divide, however, seems to play a less relevant role in the presence of strong social frictions with non-Islamic communities. Sunnis and Shias tend to collaborate with one another during periods of conflict with populations of other faiths in multi-religious countries, arguably to join together against a common enemy (Abdo, 2013; Hunter, 2013).

Using panel data on IsDB loan commitments allocated across its 56 member countries during the 1976–2007 period, we find that Sunni affiliated member countries receive significantly more resources from the Bank relative to non-Muslim affiliated members. In addition, members with large Shia populations witness significantly larger loans relative to those with large non-Muslim populations, but this is conditional on the presence of conflicts with other religious groups (Christians or Hindus, for example). These lending patterns closely mirror the political stance of Saudi Arabia in the Islamic world. A comparable analysis employing World Bank loan commitments suggests that Saudi interests do not influence lending from this institution to the Arab region and its periphery. These findings confirm the advantage for Saudi Arabia to positions its interests by assuming the leadership of a RDB.

The rest of the paper is organized as follows: Section 2 introduces the IsDB, Section 3 presents our argument with anecdotal evidence on the polarization of the Islamic world and how it might affect lending decisions at the IsDB. Section 4 introduces our data and estimation strategy, while Section 5 presents the discussion of our main results, and Section 6 concludes the study.

2. The Islamic Development Bank

The founding of the IsDB was in response to the interest of the Organization of Islamic Cooperation (OIC) in providing its member states with access to Sharia compliant financial resources. The idea was encouraged by King Faisal Bin Abdulaziz of Saudi Arabia and first discussed during the Second Islamic Finance Ministers' Conference held in Jeddah in 1974

[1] Saudi Arabia is the largest shareholder of the Arab Authority for Agricultural Investment and Development, the Arab Bank for Economic Development in Africa, the Arab Fund for Economic and Social Development, the Arab Gulf Program for the United Nations Development Organizations, the Arab Monetary Fund, the Islamic Development Bank, and the OPEC Fund for International Development (AAAID, 2012; BADEA, 2012; AFESD, 1968; AGFUND, 2011; AMF, 2012; IsDB, 2010; OFID, 2012). None of the G7 countries is a member of any of these RDBs listed.

[2] Saudia Arabia is the eighth, tenth and sixth largest capital subscriber in the IMF, IBRD and IDA respectively (IMF, 2013, World Bank, 2013a, World Bank, 2013b).

[3] Statistics in OFID (2004) suggest that the IsDB is the largest Saudi led and Arab development agency with cumulative loan commitments until 2003 of US$ 34,224 million. Same figures for the following major Arab development agencies are US$ 15,492 million for the Arab Fund for Economic and Social Development, US$ 12,400 for the Kuwait Fund for Arab Economic Development, US$ 6896 million for the OPEC Fund for International Development, US$ 6474 million for the Saudi Fund for Economic Development, US$ 3384 million for the Abu Dhabi Fund for Development, US$ 2196 million for the Arab Bank for Economic Development in Africa, and US$ 238 million for the Arab Gulf Program for United Nations Development Organizations.

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