The costs of favoritism: Do international politics affect World Bank project quality?

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Abstract: We examine whether politically motivated projects of the World Bank have lower quality than other World Bank projects. Specifically, we consider the World Bank's own evaluations of projects granted to countries that are temporary members of the United Nations Security Council (UNSC) versus the evaluation of countries that are not members. Previous work suggests that countries serving on the UNSC receive higher numbers of Word Bank projects, are more likely to receive International Monetary Fund (IMF) loans with reduced conditionality, receive more United Nations Development Project support, and more direct foreign aid from the United States (see, respectively, Dreher et al. 2009, Dreher et al. 2006, Kuziemko and Werker 2006). If foreign aid is extended to temporary members of the UNSC for international political reasons rather than for purely economic reasons, at the margin, is such aid less effective in generating the ostensible goals of development? We find evidence suggesting that it is. Analyzing a panel dataset of 2,605 projects from 116 countries over the period from 1958 to 1988, we find that the probability of a negative evaluation is higher if the country participated in projects as a member of the UNSC.

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1. Introduction

Is development aid extended for political reasons less effective than aid provided on more economic grounds? We examine this question by considering the project quality of World Bank projects provided to countries temporarily serving on the United Nations Security Council (UNSC) versus countries that are not.

In support of our hypothesis, we find the probability that a country receives an unsatisfactory evaluation is higher for countries serving on the UNSC than for countries not. This conclusion is based on the analysis of a dataset including 1,033 observations of 88 countries from 1958 to 1988.

The rest of the paper is organized as follows. After providing background and developing our argument (section 2), we turn to empirical evidence (section 3). Section 4 concludes.

2. Background and argument

There is growing evidence that sometimes the World Bank provides aid to countries because they are favored by the Bank's major shareholders for political reasons. This is no secret. The World Bank itself freely admits on its web page:

> It is true that during the Cold War years aid was politically motivated. Now however aid is being delivered to countries most in need, and to those who show they are determined to use it well (World Bank, FAQ, www.worldbank.org).

Scholars have confirmed this claim, providing evidence that political favoritism has influenced World Bank decisions both during and since the Cold War (see, for example, Frey and Schneider 1986; Andersen, Hansen and Markussen 2006; Fleck and Kilby 2006).

Importantly, it has also been shown that countries favored by the United States – the largest shareholder at the World Bank with the most influence over its governance – face less strict enforcement of economic conditions attached to lending from the World Bank (Kilby 2008). Kilby (2008) suggests that an important implication of such favoritism is that it undermines the credibility of conditionality, rendering it ineffective.

To test this claim, we consider World Bank project evaluations of countries serving as temporary members of the UNSC versus countries not serving.

There is good reason to believe that the major shareholders of the World Bank – the United States, Japan, Germany, France, and the United Kingdom – agree on the importance of winning favor with some elected members of the UNSC.

The Security Council is the most important organ of the United Nations (UN); its actions are highly visible, sometimes receiving considerable press, and its duties include taking military action. While five members of the UNSC – China, France, Russia, the United

Kingdom, and the United States – serve on a permanent basis, ten others are elected. These elected members serve two-year terms and face strict term limits. They are nominated by their regional caucus and must be approved by at least two thirds of the votes in the General Assembly.

UNSC decisions on substantive matters require a majority of nine votes. Each member has one vote, but the five permanent members have veto power. With less than half of the votes of the elected members required for measures to pass, elected members are rarely pivotal. O'Neill (1996) shows that the cumulative voting power of all ten elected members is less than two percent of the total voting power (according to the Shapley-Shubik index). Yet, even if few votes are required for a minimum winning coalition, the United States may seek out the support of elected UNSC members to secure insurance votes. It is well established in the vote-buying literature that oversized coalitions tend to be established (see, e.g., Volden and Carrubba, 2004). This is especially true if votes can be bought at low cost.

There may also be reasons beyond the formal voting rules that concern powerful countries. The United States and other important countries may seek the support of the UNSC for reasons of legitimacy (Voeten 2005, Hurd 2007). Legitimacy may be both moral and informational. Members of the UNSC have access to sensitive documents and private discussions regarding the importance of taking international action. To the extent that the UNSC is a legitimizing force, every single vote matters. This view is consistent with the observation that there is a premium for getting (nearly) unanimous votes (see, e.g., Doyle 2001: 223). In the absence of UNSC legitimacy, domestic public support might be more difficult to achieve and the US Congress might be recalcitrant (Voeten 2001, Hurd 2007, Hurd and Cronin 2008). Chapman and Reiter (2004) indeed find that "Security Council support significantly increases the rally behind the president (by as many as 9 points in presidential approval)… This [robust] effect is unique among international institutions because other actions by the UN or regional security organizations do not significantly affect rallies."

Often, the major shareholders may agree that temporary members of the UNSC are potentially important. Should a significant issue come up during the tenure of such a temporary UNSC member, it behooves the major shareholders to have the country in their debt.

There is mounting evidence that powerful countries favor UNSC members in various ways:

(1) They receive increased bilateral aid from the United States (Kuziemko and Werker 2006).
(2) They receive increased aid from UNICEF, an aid organization over which the United States has historically exerted much control (Kuziemko and Werker 2006).
(3) They are more likely to receive a loan from the International Monetary Fund (IMF) (Dreher et al. 2006).

(4) They receive fewer economic conditions attached to IMF loans (Dreher et al. 2006).
(5) They receive more World Bank projects.

We therefore suspect that when countries serve on the UNSC, the World Bank may be more likely to grant a project grounded on more political than economic grounds. Furthermore, the level and enforcement of economic conditions required for continued disbursements of loans may be lower. Note – importantly – that while we expect temporary UNSC members to receive favorable treatment while serving, we do not expect them to receive favorable treatment years later when they no longer hold an UNSC and their World Bank projects are evaluated. Evidence shows that the perks of being a UNSC member disappear quickly after a term of service ends.

For all of these reasons, we hypothesize that the quality of World Bank projects is lower for temporary UNSC members, at the margin, than for non-UNSC members. We now turn to testing this hypothesis.

3. Empirics

In this section, we present very preliminary analysis of data supporting our principal hypothesis that World Bank project quality is lower for temporary members of the UNSC than for non-members.

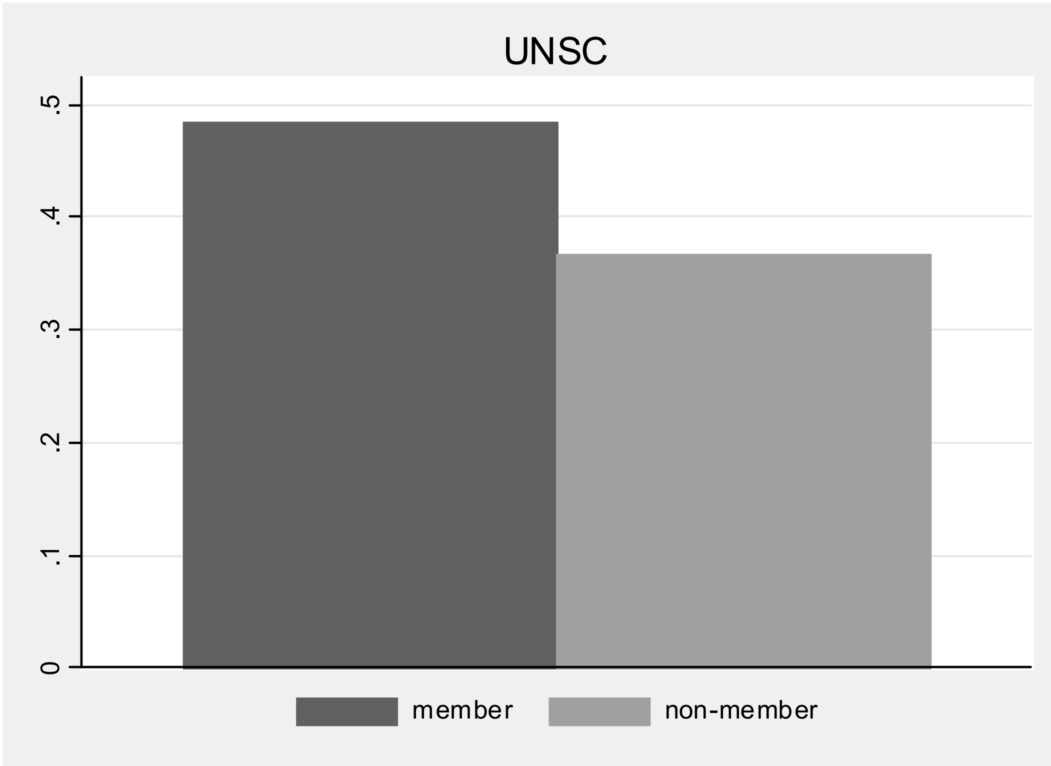
First, consider what we observe. We have data from the World Bank's Operations Evaluation Department, as used in Kilby (2000). The data are discrete performance measures generated by the World Bank project managers and evaluators.[1] There are data on 2,605 projects from 116 countries over the period from 1958 to 1988. Projects are in effect for an average of six years with the longest project lasting 22 years. The first project in our sample ends in 1963, and the last ends in 1991. We had some difficulty obtaining more recent data from the World Bank, despite claims of increased transparency. We were eventually able to obtain data up to 2007, but we have not yet had a chance to analyze the additional data.

Most projects are rated as satisfactory – 77 percent – with the remaining 23 percent rated as unsatisfactory. In 38 percent of our country-year observations, at least one project (many countries have more than one project simultaneously) is rated as unsatisfactory. In the remaining country-years (62 percent), all projects are rated as satisfactory.

What about the difference between UNSC and non-UNSC members? Figure 1 presents descriptive data. As can be seen, the percentage of country-year observations with at least one unsatisfactory rating is higher for UNSC members than non-members. For UNSC members about 48 percent have unsatisfactory ratings, while for non-members only about 35 percent have unsatisfactory ratings. A t-test for difference in means indicates that the difference is statistically significant at the one percent level.

[1] For some observations, the World Bank provides the expected economic rate of return from the project. This is an alternative variable we intend to evaluate in the next draft of this paper.

Figure 1



While supporting of our hypothesis, the results from the descriptive data may be spurious. Thus we turn to more rigorous analysis of data.

We begin with a probit model, where our dependent variable an indicator variable coded 1 if there is at least one unsatisfactory project in a country-year and 0 if all projects are satisfactory. In this stage of the analysis, we ignore observations of countries with no project. We intend to analyze other models to account for possible problems of non-random selection and endogeneity for the next draft of this paper, where we will analyze data from country-years without World Bank projects.

With out probit analysis, we introduce a number of control variables. We begin by introducing the control variables employed by Dollar and Svensson (2000) in their analysis of what determines the success of World Bank projects: time in office and time in office squared, ethnic fractionalization and ethnic fractionalization squared, instability, and democracy. We also include additional control variables suggested in the literature as potentially important: GDP per capita, population, inequality, terms of trade shocks, inflation, budget surplus, project size, number of projects in a particular country and year.

Table 1 presents some preliminary results with only statistically significant coefficients presented. As can be seen, ethnic fractionalization has a non-linear effect, with highly homogenous and highly diverse countries being the least likely to have unsatisfactory projects. As Dollar and Svensson (2000: 901) point out "the political economy literature suggests that ethnic fractionalisation and length of tenure affect the probability of successful reform, but does not exactly identify the functional form of this relationship. The quadratic form chosen yields the best results." What they find is that high degrees of fractionalization are bad for success. The same is true here.

Turning to our main variable of interest, UNSC membership has a positive effect that is statistically significant at the five percent level. *Countries that receive World Bank projects as UNSC members are more likely to receive negative project evaluations than non-members*.

Table 1

	(1)	(2)		
Ethnic fractionalization	-0.017	-0.016		
	(2.16)**	(2.12)**		
Ethnic fractionalization, squared	0.000	0.000		
	(3.02)***	(2.94)***		
UNSC membership		0.249		
		(1.97)**		
(log) US grants				
UNGA voting				
Observations	1033	1033		
Number of countries	88	88		
log likelihood	-675.12	-673.01		
Pseudo R2	0.02	0.02		

4. Conclusion

The analysis presented in this first draft of a paper is highly tentative. We intend to address a number of serious econometric issues to evaluate the robustness of our findings. Notably, we are concerned about non-random selection and endogeneity as well as possible influences correlated with country and year, and we have not exhausted the list of control variables we intend to consider. We are, nevertheless, impressed that the descriptive data and our preliminary analysis is consistent with what we expected when we began this project.

Thus, with the above caveats in mind, we suggest that when development aid is extended in the name of international political imperatives, it is less effective than when it is extended on more economic grounds. In support of this argument, we have preliminary evidence that World Bank project quality is lower for countries temporarily serving on the UNSC than for countries not. When countries rise to the international stage of the UN Security Council, they have increased leverage and importance for the major shareholders of the World Bank, and thus appear to receive softer conditionality attached to projects funded through the Bank, and the projects appear to be of lower quality as a result.

If World Bank projects for temporary UNSC members are of inferior quality, why do governments pursue them? Why do powerful countries "reward" UNSC members with inferior aid? The answer to these questions has to do with time-inconsistent preferences.

The evaluations of World Bank projects we consider take place some years after the projects have been completed and certainly after the two-year term of a UNSC member has ended. At the inception of the project, both the lenders and the borrowers of World Bank funds are pressed by short-run considerations. While some governments may be better than others, even the most secure dictatorships may maintain power by paying off a small group key constituencies rather than pursuing the public good (Bueno de Mesquita et al. 2003), and even the best elected leaders in democracies may have pressing re-election concerns. If World Bank conditionality requires short-run sacrifices, governments may wish to avoid it. And if these governments are serving on the UNSC, the Bank's major shareholders just might be willing to provide weaker conditionality in return for good behavior when important votes come before them. Powerful countries might be better off in the long-run with more prosperous allies, but the short-run security concerns they pursue through the UNSC may often outweigh the long-run development concerns they are supposed to pursue through institutions like the World Bank.

This line of argument may lead to the conclusion that a solution is to insulate the World Bank from the vagaries of day to day politics. Yet we are cautious about making such a suggestion, as we recognize that the alternative to a world with politically manipulated international organizations may be one with no international organizations at all, where major powers pursue foreign policy unilaterally. Future research should therefore focus on what does more harm – politically motivated aid provided by organizations like the World Bank or politically motivated aid provided unilaterally. If it is the latter, then it may just be that even when faced with political pressure from powerful countries, the international public servants at the Bank have some positive impact.

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