

# International Institutional Change and Multilateral Development Finance Institutions

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## Abstract

States with credible institutional threats still create new international organizations (IOs). This is puzzling, as their credibility suggests that they will not need to create new IOs; they can reform existing ones. I argue that states create or join new multilateral development finance institutions (MDFIs) when they cannot credibly press for reform within an existing institution. I develop arguments about when states should get reform, create new institutions, or join alternative institutions. I test these arguments using large- $N$  quantitative analysis of state decisions to create or join MDFIs, using Pevehouse, Nordstrom and Warnke (2004) data on International Governmental Organizations. I find some evidence in support of my theory: states that can make larger threats but are unlikely to cooperate internationally join (or select into) alternative institutions. On the other hand, states that cannot make threats but that can cooperate create new institutions.

Regional patterns in the proliferation of international organizations suggest that neither transaction costs (Keohane 1984) nor credible alternatives (Lipsky 2009) satisfactorily explain why different states have different propensities to create international organizations (IOs). On one hand, transaction costs need to vary cross-nationally (or at least cross-regionally), in ways that the IO literature has not yet explored. On the other hand, if states' efforts to reform institutions become more credible when they can threaten to create a new institution, bargaining models suggest that reform will be successful. Why, then, do states with credible institutional threats end up creating new institutions?

I examine the question through the lens of multilateral development finance institutions (MDFIs). These institutions should be most prone to reform because of the wide range of credible alternatives to any current institution (Lipsky 2009). Yet in spite of these alternatives, states continue to create MDFIs. I argue that states create or join new multilateral development finance institutions when they cannot credibly press for reform within an existing institution. Even when states agree to create an institution, the status quo represents some bargain over which actors with different preferences manage to come to agreement. As preferences change and continue to diverge, however, some states prefer a new status quo and push for reform. Factors that increase the credibility of this push for reform will increase the probability of reform, decreasing the probability of institutional creation.

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## The Puzzle of IO Proliferation

The number of international organizations in the world has increased more or less continually since the end of World War II. Poor data prior to 1965 prevents assessing patterns during this period. Since then there have only been two significant periods during which IOs have died faster than states have created them. Even accounting for data issues, however, the trend has been markedly upward since World War II and before (see figure 1). For whatever reason, IOs tend not to die, so a portion of the increase takes the form of “zombie” organizations, still lurching about even after their creators have abandoned them. Still, zombie IOs cannot account for the fact that states create IOs that serve similar purposes as those that both preceded them but have not died or been reanimated. States should be biased toward the maintenance of IOs rather than their creation (Keohane 1984, 100). Although high transaction costs of IOs stands as the classic explanation of this expected bias, it should also occur as a result of bargaining processes among states. Where states have credible alternatives to existing IOs, the bias toward institutional maintenance and reform should hold (Lipsky 2009). Yet even when credible alternatives exist institutional proliferation occurs. The proliferation of IOs and multilateral development finance institutions over time, the variation in their regional distribution, as well as variation in the sectoral allocations across development finance institutions generate a puzzle. Why do states vary in their propensities to create IOs, specifically multilateral development finance institutions?

For example, shortly after the Asian Financial Crisis, Japan proposed the creation of an Asian Monetary Fund (AMF)<sup>1</sup>, which would provide Asian states with liquidity that the IMF would not. The Japanese proposal quickly fell apart, however, as the US government lobbied against the plan and even offered increased IMF quotas to dissuade states from supporting the Japanese scheme (Lipsky 2003, 96). A slightly reformed IMF emerged, alongside an informal framework (the New Miyazawa Initiative) that became the foundation for the Chiang Mai Initiative (102), which has recently multilateralized (The Star [Petaling Jaya] 2009; Bernama [Kuala Lumpur] 2009). On one hand, Japan and its supporters managed to generate reform at the IMF. On the other, they pushed ahead with plans to create alternatives to the IMF. The AMF proposal generated a credible threat to the IMF, resulting in institutional reform (Lipsky 2009, 36), yet Japan moved forward with alternative arrangements. If the AMF proposal was, in fact, a cred-

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<sup>1</sup>The AMF would not be an MDFI. However, the example is apt since it demonstrates that the existence of credible institutional alternatives can effectively generate both reform and institutional creation.

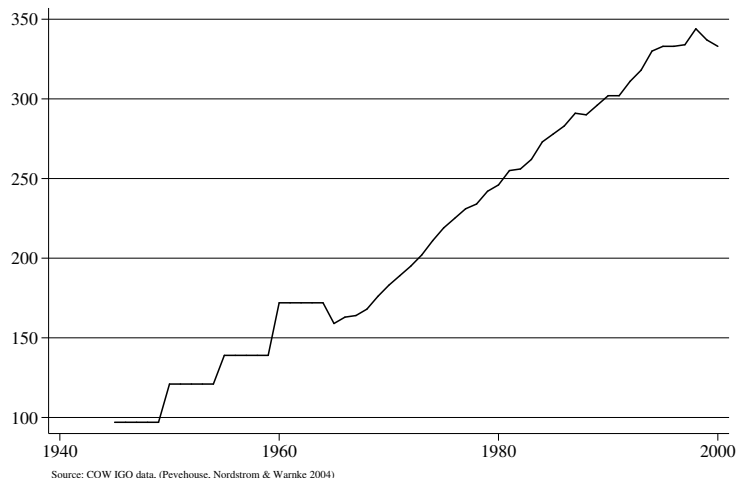


Figure 1: IO Proliferation over Time.

ible alternative to the IMF and generated gains for Japan at the IMF, why follow through with the threat? More generally, institutional reform correlates with credible policy options, but if outside options increase the probability of favorable institutional reforms, why do states continue to create international institutions precisely in those areas in which reform should be more feasible? In the case of development finance institutions, credible alternatives abound, yet institutional proliferation occurs here as well (see figure 3). In fact, like regional variation in IO creation (Pevehouse, Nordstrom and Warnke 2004) (see figure 2, below), regional variations in the creation of development finance institutions suggests that the factors that determine whether a state can credibly threaten and create a new institution also vary regionally. Neither the transaction costs argument nor the credibility argument predicts such variation.

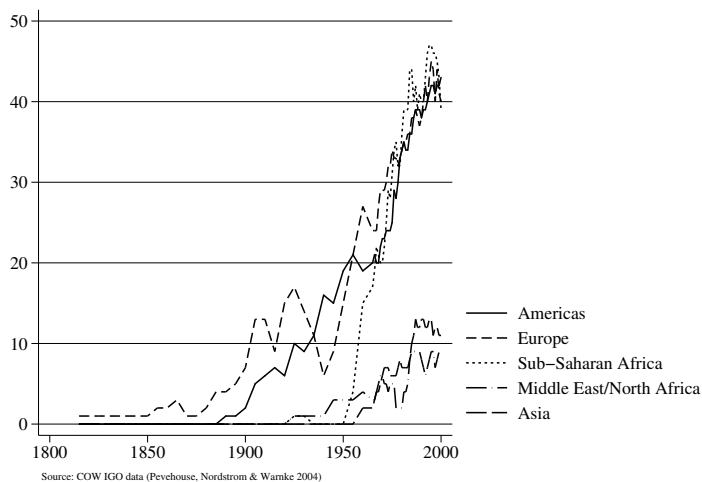


Figure 2: IO Proliferation by Region

## Temporal Trends, Regional & Sectoral Patterns

Figure 3 indicates that the number of MDFIs has continually grown since the World Bank's creation in 1944. This trend includes institutions at all levels: global, regional and subregional.<sup>2</sup> It took twelve years before donors created the European Development Fund (EDF) and fourteen before they created the Inter-American Development Bank, which was the first of the regional development banks. After the EDF's creation, the increase in multilateral development institutions only reached a plateau in 1980, followed by a slower increase as the Cold War ended and through the post-Cold War period.

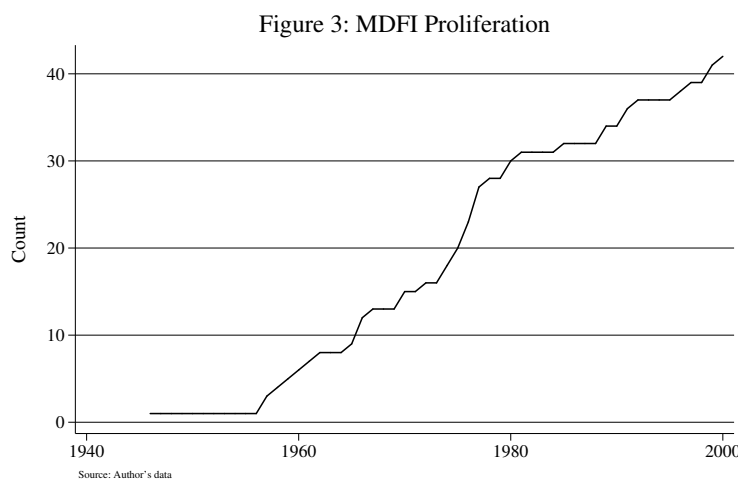


Figure 3: MDFI Proliferation

Table 1 presents information on the regional distribution of MDFIs in terms of the regions served by a particular institution.<sup>3</sup> That is, in most cases, donors (and recipients, where applicable) create new multilateral aid institutions to serve a particular geographic region. In a few cases, these institutions have universal scope, or, in the case of the Islamic Development Bank, a scope that is so broad and multiregional as to defy any other effort to categorize it. Most MDFIs have global, African, or European scope, with the fewest targeting Asia and the Middle East. Certainly the number of global or African institutions seems justified, although four of the seven African institutions are sub-regional institutions primarily controlled and financed by subregional states. The number of European-focused

<sup>2</sup>I code an international organization as a "multilateral development institution" as such if it has at least three state members, gives loans or grants to other states (which may or may not be members of the institution themselves) primarily for the purpose of development, economic growth or poverty reduction. This includes some institutions that may be considered emanations of other IOs (and are thus not included in the COW IGO data (Pevehouse, Nordstrom and Warnke 2004)) or are classified by the Yearbook of International Organizations as for-profit enterprises. This number may still be subject to some revision as I re-evaluate my coding. I use an institution's beginning of operations as the date of its "creation" instead of the year that formal agreements were signed. I intend to replace this with the date of ratification, but have not yet collected the data.

<sup>3</sup>I have not developed a clear rule for coding either "region served" nor "ownership." Currently, both tables are somewhat impressionistic, although region served tends to be a much clearer concept than ownership. Additionally, this list excludes several organizations that may be development institutions, although it is not clear if development constitutes their main purpose or if they pursue this primarily via project lending. These organizations include the African Fund for Guarantee and Economic Cooperation, ASEAN Foundation, Asia Cooperation Dialogue, Development Bank of the Great Lake States, Financial Fund for the Plat River Basin, Fonds de Solidarite Africain, G-15, Mutual Aid and Loan Guaranty Fund of the Entente Council, Nordic Investment Bank, UN Trust Fund for African Development.

institutions seems unusually high, both because the European states should have fewer barriers to coordination—focusing on a single institution rather than proliferating them and because of the relative wealth of the region. Latin America, the region with the largest income inequalities in the world, only has four institutions—five including the yet-to-begin-operations Bank of the South. Asia and the Middle East, finally, only have two institutions providing each region with development funds. Of Asia’s institutions, one is subregional. Of the Middle East’s both are: definitions of the Middle East as a region tend to include several non-Arab states, but the institution closest to being “regional” only admits Arab members. The other fits the “subregional” type much better, and includes three states. Although it seems straightforward that donors would want to use global institutions or target the poorest parts of the world, it seems that in both of these cases they have failed to coordinate on a single institution. As for other regions, which do not lack poverty, donors have either ignored them—as in the Middle Eastern case—or perhaps have managed to coordinate—as in Asia and the Asian Development Bank.

Table 1: Regional Distribution of MDFIs

Region	Region Served	Region of Ownership	Difference
Global	8	NA	-8
Africa	7	5	-2
Latin American & Caribbean	4	2	-2
Europe	7	9	2
Asia	2	1	-1
Middle East/North Africa	2	6	4
Western	NA	7	7
Total	30	30	NA

In terms of ownership, different patterns emerge. Europe owns—that is, European countries hold a controlling share in—the largest number of development institutions. More broadly Western donors—including the European donors, the US, Canada, Japan, Australia and New Zealand—own the next largest group of seven institutions. The Middle Eastern donors own six institutions, followed by African states. Asian and Latin American and Caribbean states only own one and three, respectively. Western, European and Middle Eastern donors tend to own institutions with larger scopes than those of the other regions. African, Asian and Latin American and Caribbean-owned institutions tend to be subregional. States within subregional institutions appear to prefer control over higher levels of finance. That is, where external states contribute funds, these funds tend to be limited to levels less than those contributed by regional members, and institutional control is distributed similarly. Again, issues of coordinate come up. On one hand, one might expect wealthier states to create more institutions. But institutional proliferation has costs, aside from the bite that administrative costs take when managing institutions performing similar missions in both overlapping and non-overlapping parts of the world. What, for example, were the gains to additional development finance for Asia via the Asian Development Bank that could not be coordinated or managed within the World Bank? Finally, poor or middle income countries own fifteen of the thirty institutions in table 1.

These institutions vary significantly with respect to specialization as well. Figures 4 and 5 present data on the mean share of aid commitments across two broad categories: Energy, industry, and mining in figure 4 and social, education, health, and water in figure 5. Average sectoral shares by sector all demonstrate significant variation. In both cases, at most only a few institutions lie within a 95% confidence interval. Although I do not present additional figures here energy, industry and mining share has the highest mean level, while public sector lending has the lowest mean share. The most variation occurs in social, education, health, and water, while the least lies in the banking, finance, business and trade category. Variation in both mean levels and variation itself across sectors suggests that donors create additional institutions to specialize. Nevertheless, although “mission creep” may be a concern, creating new institutions for the express purpose of focusing on a particular type of lending would need to provide significant gains to compensate for the additional costs of creating such institutions.

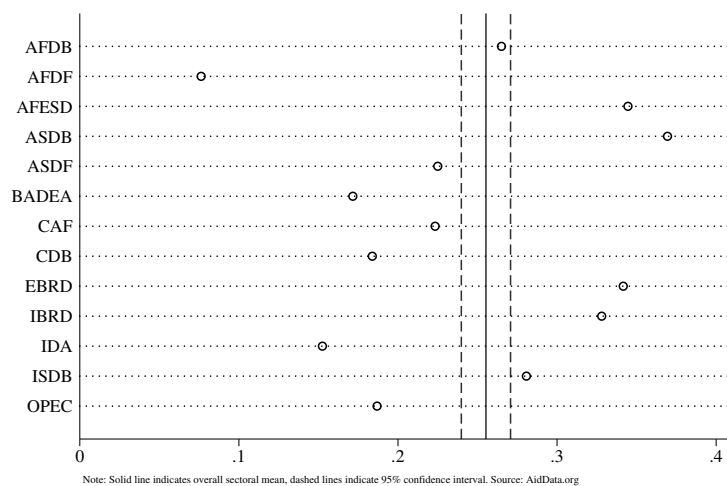


Figure 4: Mean Institutional Share of Funds Committed for Energy, Industry and Mining Projects.

Several patterns emerge here. First, excepting a few pauses, states have continually created additional multilateral development finance institutions<sup>4</sup>. Second, donors failed to coordinate their efforts according to regional focus or ownership. Some regions get more institutions than others. At the same time, clusters of donors appear. Western and European states and Middle Eastern states dominate processes of institution building. This data suggests that there are three major clusters of development organizations by ownership, which evokes questions about other regions. Why don't Latin America, Africa, and especially Asia likewise own multiple and overlapping aid organizations targeting aid in both their own region as well as in other parts of the world? Why do poor and middle income countries create multilateral aid institutions? Finally, donors appear to create new institutions to specialize their lending.

<sup>4</sup>My data does not account for institutional “deaths,” so it may slightly overestimate rates of creation.

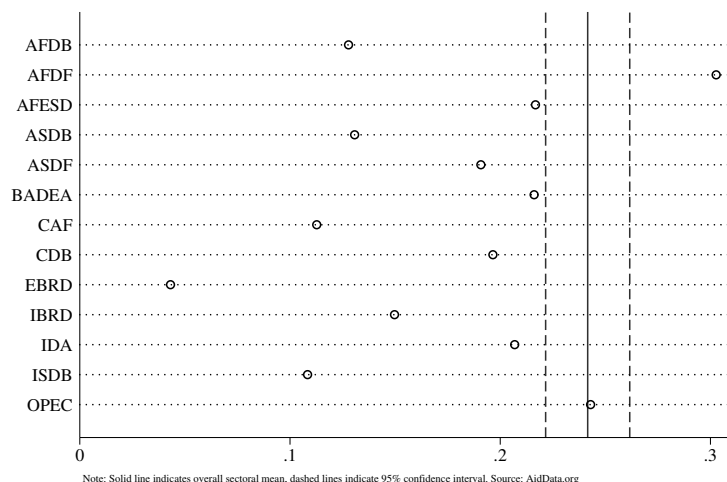


Figure 5: Mean Institutional Share of Funds Committed for Social, Education, Health and Water Projects.

## Research Question

These patterns of MDFI proliferation and regional and sectoral variation suggest that neither transaction costs nor credible alternatives satisfactorily explain why different states have different propensities to create MDFIs. On one hand, transaction costs need to vary cross-nationally (or at least cross-regionally), in ways that the IO literature has not yet explored. On the other hand, if states' efforts to reform institutions become more credible when they can threaten to create a new institution, bargaining models suggest that reform will be successful. Why, then, do states with credible institutional threats end up creating new institutions? Where the literature on international organizations fails to answer these questions, I argue that credibility is not a function of institutional alternatives, but states' abilities to harm an institution by their withdrawal and the probability that states can cooperate to create a new institution.

## Creating Overlapping IOs

In general, functional theories of IOs focus on why states create particular institutions or types of institutions, rather than explaining why they might create multiple, overlapping sets of institutions. Another literature attempts to explain state membership in IOs. Unfortunately, analyses of membership neglect that states pay costs to create new organizations and that the costs of creation differ from the costs of joining once an institution exists. With a few exceptions, these theories fail to suggest why states might create sets of overlapping IOs. Constructivist theories focus on IO behavior, rather than IO creation. Theories that focus on multilateralism in aid fail for similar reasons. Fortunately, the regime complexity literature suggests fruitful directions for theory-building but has weaknesses as well.

## Theories of IO Creation

Rationalist, functionalist models start with Keohane (1984). States create IOs to reduce transaction costs, uncertainty, and property rights problems. As a result, states have little reason to create new IOs unless prior IOs fail. Even so, high costs of institutional creation bias toward reform rather than proliferation. Gruber (2000) argues that “enacting coalitions” of states create IOs that benefit them. Unlike functionalist arguments, what benefits this coalition may not benefit other states, but that failure to join makes them worse off than joining does. The rational design (Koremenos, Lipson and Snidal 2001) and legalization (Goldstein et al. 2003) projects build on this institutionalist foundation. The rational design project argues that states create IOs to further goals (2). Other than this claim, however, the project focuses on institutional design rather than creation. The legalization project suffers from the same weakness. At some level design and creation intertwine inseparably, but these projects and my own have different emphases.

Arguments about the role of delegation (Hawkins et al. 2006*b*) in the creation of IOs avoid the problems of the rational design and legalization literatures because delegation implies the creation of an IO. So states delegate to IOs (that is, create IOs) when they want to specialize production of a particular good, manage policy externalities, facilitate collective decision-making, resolve disputes, enhance credibility, or create policy bias (13). In terms of creating multilateral development finance institutions, some states cannot manage their own aid programs or simply cannot give enough to influence international affairs. By pooling their funds with others’, they can “punch above their weight” (see also Hicks et al. 2008, 221). Delegation might provide donors with access better trained and larger staffs, greater technical expertise, lower administration costs, and other benefits (214).

Externalities can induce cooperation (Milner 1997), which can lead to delegation (Hawkins et al. 2006*b*, 15–17). For example, if one donor’s aid contributes to stability in one country, all donors with an interest in that country gain. An international organization for aid allows donors to avoid free-riding and produce levels of aid they prefer (Olson 1971). Thompson and Verdier Thompson and Verdier (2008) build on this framework to suggest that states will choose between multilateralism or bilateralism in the presence of externalities. Transaction costs help mediate between the two. Unfortunately, as I mention above, such an approach needs to explore how transaction costs vary across states rather than within issue areas.

Delegation may help states create (or avoid) credible commitments (Hawkins et al. 2006*b*, 18–19). Development finance institutions may require costly conditionality as part of their transfers. These institutions may have been designed for this purpose<sup>5</sup> and new institutions may specifically counter it. Middle Eastern development finance institutions eschew conditionality while performing some of the same basic functions as institutions like the World Bank.

Constructivist explanations fail to explain how and why states create IOs in favor of explanations of how IOs behave and how they influence states. For example, Barnett and Finnemore (2004) question the functionalism of IO

<sup>5</sup>Gavin and Rodrik (1995) make this point about the World Bank, arguing that conditionality has always been part of its activities.



creation theories. States might create IOs for functional reasons, but then IOs, for various reasons, become uncontrollable Frankensteins.

The logic of these arguments suggests that states might create new IOs when their previous ones fail to serve them well. Since IOs can be hard to kill (Shanks, Jacobson and Kaplan 2001), multiple, overlapping IOs result. Unfortunately, many of these arguments imply that either IOs or interests change, providing little theoretical leverage for generating predictions about institutional creation.

## **Theories of Multilateral Aid & International Financial Institutions**

Usually, research on multilateral aid focuses on why states continue to give multilateral aid, rather than focusing on institutional creation. Although several historically- or policy-oriented studies of various multilateral finance institutions exist, analyses usually ignore questions about institutional proliferation. Lipsky's (2003; 2009) research does this in a way that few studies within the field of IFIs do. If multilateral aid agencies solve a domestic principal-agent dilemma, states might in turn pursue institutional proliferation to decrease voters' ability to monitor multilateral allocation while simultaneously appearing to focus on development (Milner 2006). Unfortunately, the bulk of the evidence suggests that developmental concerns do drive multilateral aid.

## **Regime Complexity**

More recently, studies in IR have begun focusing on "regime complexity." Regime complexity describes "the presence of nested, partially overlapping, and parallel international regimes that are not hierarchically ordered" (Alter and Meunier 2009). A development finance regime might arise if some states prefer different levels of cooperation (Mansfield and Reinhardt 2003; Young 1996)—in the case of aid, perhaps more or less conditionality. Additional institutions might also allow recipients to "forum shop," by seeking financing from the institutions with the least conditionality (Alter and Meunier 2009, 16). However, there appears to be little reason why donors would prefer this, although they might create similar institutions to generate bureaucratic competition. Creating multiple institutions that compete for donors' funds could allow donors more control over what institutions do. However, it also suggests a "race to the bottom" in terms of MDFI conditionality—increased competition should drive loan conditions, or "prices," down. Additional institutions might ensure that cooperation on development finance continue, should any one institution fail (Alter and Meunier 2009, 16). This explanation fails to satisfy given what we know about the low death rate of IOs (Shanks, Jacobson and Kaplan 2001). Another, more promising approach argues that states make decisions about whether to alter the institutional environment or not based on the costs and risks of creating new institutions, the institutional status quo, the role of IOs, and the nature of the cooperation problem, including distributional issues and capability distributions among the states involved in the process of creating new institutions

(Jupille, Snidal and Mattli 2010). Unfortunately, much of the promise of the approach erodes under the weight of a multivariable framework and a bounded rationality approach to problem-solving by states that neglects strategic interaction in the process of decision-making. These explanations are insufficient to account for the proliferation of MDFIs and the resulting development finance complex.

Existing explanations for international organizations, multilateral aid and international financial institutions, and even regime complexes fail to offer reasonable explanations for state decisions to create a multilateral aid regime complex.

## **Bargaining, Reform and Development Finance Institutions**

States bargain within existing institutions in order to increase the benefit they get from those institutions. States can offer to increase the resources available to an institution or threaten to remove resources. If they threaten to remove resources, states' credibilities hinge on the size of the threat they can make—how badly can they hurt the existing institution—and on their ability to create alternative institutions. Variation in both these factors determines whether states can reform current institutions, create new ones, or select into alternative institutions.

### **The Institutional Environment and Policy Alternatives**

I take a state's decision to create a new multilateral aid institution as my dependent variable. That said, a state make this decision in the face of alternative approaches: they might reform their current institution, join another, pre-existing institution, or simply remain with the status quo. I discuss these options further below. For the time being, I assume that potential multilateral donor states are members of an existing multilateral institution. I also assume that donors give multilateral aid in addition to bilateral aid to generate (and monitor contributions to) public goods (Olson 1971). I plan on relaxing and exploring these assumptions later.

I begin by assuming that states have already cooperated to create a multilateral institution. They do this because institutions allow states to create public goods for domestic consumption (see Bueno de Mesquita et al.2003, for example). States (and their leaders) have a portfolio of goods they prefer to purchase via foreign aid. Some of these can be consumed domestically as private goods—when foreign aid supports domestic industry, for example. In general, states will purchase these via bilateral foreign aid. Other goods have public goods characteristics—such as using aid to supplement domestic political stability in a developing country. As other states may have an interest in political stability they prefer to manage aid jointly, but need an institution to ensure that each donor avoids free-riding on other's contributions (Olson 1971). Multilateral aid agencies allow states to do this by providing information regarding donors' contributions.

Potential donors face several potential outcomes when they pursue institutional reform. Indeed, rather than use the creation of a new international organization as my dependent variable (which may not, in fact, be the outcome states prefer, but the result of strategic interactions), I compare outcomes over several categorical outcomes. In one framework, states have already chosen to cooperate and delegate to an international institution (see Hawkins et al. 2006a), and, upon finding the existing institution unsatisfactory, can choose another institution doing similar tasks, attempt to reform the current institution, or, finally, create a new institution (Jupille, Snidal and Mattli 2010, 14). Figure 6 illustrates the choices states might make.

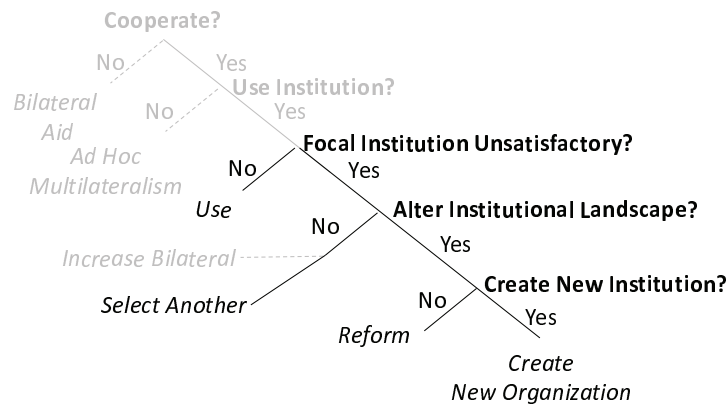


Figure 6: MDFI Decision Tree & Dependent Variable. The grayed portions represent outcomes which my analysis ignores.

In this particular case, this suggests that potential donors can transfer their resources to a similar aid institution, attempt to reform the current institution, or create a new institution. Additionally, potential donors might choose to reevaluate their overall portfolio of aid cooperation by moving more resources toward bilateral aid. Finally, potential donors may take no action at all, leaving the institutional environment (as well as their bilateral aid allocations) relatively unchanged. I “trim” the tree, focusing only on decisions that occur once at least one multilateral institution exists. This decision tree suggests that the dependent variable ranges from no change, increased bilateral aid, shifting resources to another institution (or institutional selection), institutional reform, or institutional creation.

One outcome is that states remain at the status quo. This suggests that actors either failed change policies at either the multilateral or bilateral level or that they simply made no effort. Both could be the result of strategic interaction, where actors attempted to increase bilateral aid, shift resources to another institution, reform the current institution, or create another one, but failed, or where they made no effort as a result of working through the game tree that both actors faced.

Rather than pursue other alternatives, potential donors might increase their bilateral aid. In some cases, this may mean becoming bilateral donors, while in others, it means allocating more resources toward existing bilateral mech-

anisms. A shift toward bilateral aid should necessarily target the public goods produced by the multilateral institution. However, this shift toward bilateral aid would be unlikely, as it would require that donors have an encompassing interest in a particular good, suggesting that they would forgo the multilateral institution in the first place. For this reason, I trim this outcome from the decision tree.

## Bargaining for Reform and Institutional Creation

My analysis begins with a pair of states, A and B, having already established an aid organization designed to distribute a pair of goods,  $x_1$  and  $x_2$  (see Figure 7). P represents their Pareto frontier. Along this line, neither party can create a distribution of  $x_1$  and  $x_2$  that makes either party better off without making the other worse off. Both states have indifference curves representing their utility from particular distributions of the goods. Their ideal points, identified by  $a$  and  $b$ , lie at the tangencies between their indifference curves and this Pareto frontier. An institution can only produce a single distribution of goods, however, so A and B must bargain along  $[a,b]$  to determine this distribution, the result of which lies at  $q$ . In creating this institution, A and B have agreed to produce  $(x_1, x_2)$  at  $q$ . That said, in spite of the implied indifference between  $q$  and  $a'$  and  $q$  and  $b'$ , A and B prefer  $q$  to these points because it lies on the Pareto frontier while the others do not.  $q$  represents the equilibrium state as long as dissatisfied states<sup>6</sup> lack the capability to change the Pareto frontier. Until their capabilities change, state A (the dissatisfied state) must accept  $q$  or attempt to produce  $x_1$  and  $x_2$  on its own. If the institution produces at  $q$ , then neither A nor B produces these goods at their most efficient level, given the institutional Pareto frontier. Thus, in order to maximize their utility, the two states' indifference curves intersect at  $q$ .

As A's capabilities increase, it gains two options. First, A can attempt to reform the institution by increasing its contributions to the institution. Second, A can threaten to withdraw its resources from the institution in an attempt to reduce the Pareto frontier available for the production of  $x_1$  and  $x_2$ . In the first case (see figure 8), B will always block A's efforts to shift the Pareto frontier outward unless  $q'$  is an unambiguous improvement over  $q$ . This only occurs when A and B cannot agree to a bargain along  $[q', q'']$ . This is hardly a restrictive condition.<sup>7</sup> Figure N illustrates this case and the range of acceptable bargains. A significant shift toward  $b'$  can require a relatively large addition of resources. This suggests my first hypothesis: *H1: Large increases in state resources will increase the probability of reform.*

In the second case, A attempts to revise the agreement by withdrawing resources. By withdrawing resources, A can create an institution with a new Pareto frontier, between P' and P'' or beyond P''. A new frontier between P' and P'' makes A better off but makes B worse off. If A's threat is credible, B concedes and the states reach a new bargain

<sup>6</sup>For parsimony, I assume that states are always dissatisfied, but incapable of reforming the institution because of their lack of capabilities. Similar to Gruber (2000), A may be worse off with the institution than without it, but is better off inside the institution given that it exists, at least until its capabilities shift.

<sup>7</sup>Suggesting, clearly, that I need to spend more time on this point. As it is so unrestrictive, there is little reason for A to attempt anything else, as in the next section.

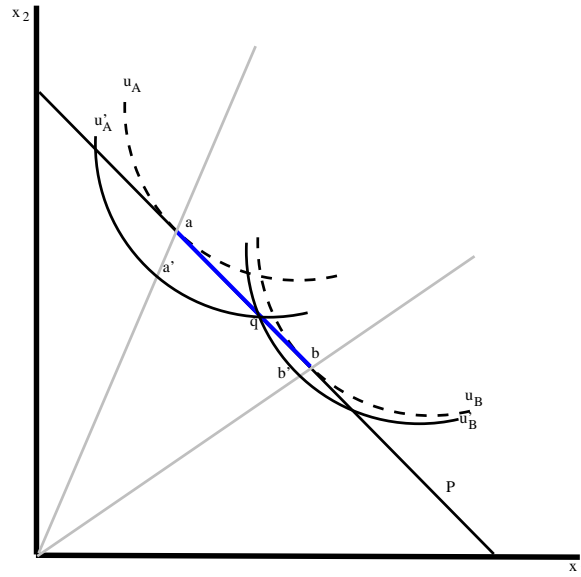


Figure 7: Bargaining for Institutional Reform: Setting up the Model

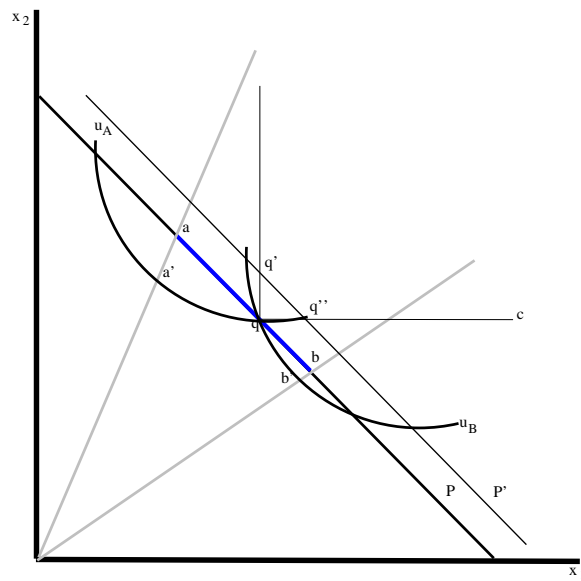


Figure 8: Bargaining for Institutional Reform: Increasing Resources

closer to  $a$  along  $[a,b]$ . A might also threaten a new frontier beyond  $P'$ , which makes both states worse off. Again, if the threat is credible—and I suggest below the conditions under which it may be—B concedes and the states reach a new bargain closer to  $a$  along  $[a,b]$ , as in the prior case.

In the second case, the crux of the issue then becomes one of credibility. Assuming that states are dissatisfied with the status quo, when can states make credible threats to withdraw resources and force reform? If they cannot make credible threats, what determines whether they choose [bilateral aid,<sup>8</sup>] institutional selection, and institutional cre-

<sup>8</sup>I plan to further develop my analysis to account for the choice of bilateral vs. multilateral as well.

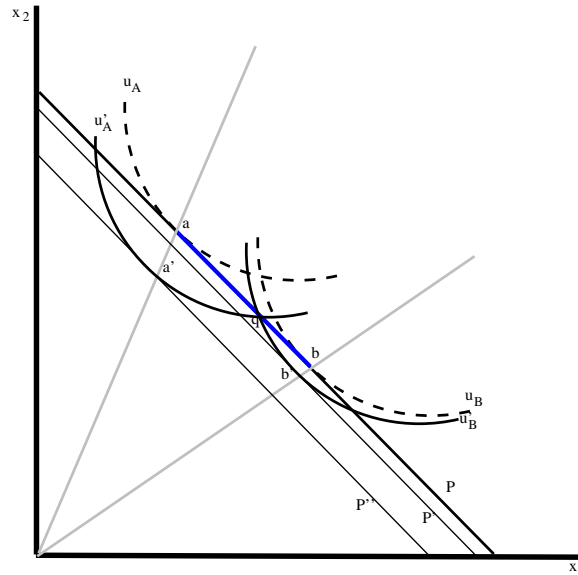


Figure 9: Bargaining for Institutional Reform: Threatening to Withdraw Resources

ation? The above model suggests that as state's abilities to make credible threats increases, the probability of institutional reform increases. On the other hand, as abilities to make credible threats decreases, the probability of other options increases. I argue that credibility will primarily be a function of two variables. First, credibility will increase with the size of the threat a state can make. Second, credibility will increase with the probability of successful outside cooperation. Incredible threats will both lack size and have low probability of success, while credible threats will be large and likely to result in success. Different levels of credibility will correlate with particular outcomes.

### Size of Threat

I use, and interact, two concepts of credibility. The first flows directly from the above model and relates to a state's investments in an institution. Small threats—including threats made by states with relatively few resources committed to an institution—lack credibility simply because they cannot alter states' bargaining position in any meaningful way. As the size of a threat increases, the outcome generated by a state following through on that threat becomes more harmful to other states. Alternatively, one might consider a state's importance to an institution in broader terms. Gruber (2000), for instance, considers that states in an institution's "implementing coalition" have a special place with respect to institutional maintenance. These were the states that were most heavily involved in institutional planning and creation. When these states turn away from an institution, it may destroy the resource base it needs to continue functioning or it may destroy the institution's legitimacy. Consider, for example, the case of the United States or the United Kingdom (but especially the former) withdrawing from the Bretton Woods institutions. Although these institutions could likely survive the U.K.'s departure in financial terms, its departure would indicate that the U.K. no

longer sees the need for institutions it helped create, which could signal to other states that such institutions have little role.

**Probability of Cooperation**

The second concept of credibility suggests that even if a state or group of states can muster a large threat, they may not be able to create a new institution to replace it. Inability to follow through weakens a threat considerably. Research in international relations, particularly Leeds (1999), suggests that credibility can be relational. Authoritarian dyads cooperate as frequently as democratic dyads, but mixed dyads cannot. The burgeoning literature on the autocratic peace (Peceny, Beer and Sanchez-Terry 2002; Werner 2000) suggests a similar result with respect to conflict. Different dyads cannot make credible commitments to each other. I extend this: not only are different dyads unlikely to cooperate easily, but mixed groups of states should likewise have a more difficult time cooperating than groups composed mostly of democratic or authoritarian states. States that deviate from the mean level of democracy in a group are unlikely to cooperate with a particular group. Also, groups of states with large standard errors on their means are unlikely to cooperate.

This, of course, raises the question: which group or groups will be relevant for cooperation? Groups of states will use various focal points to generate organizations based on a (constrained) maximization of regime similarity within groups. These groups can be regional, linguistic, cultural, economic (trade-based), or based on prior successful efforts to create IOs (see Lee and Strang 2006).

**Putting it Together**

Table 2: Credibility and Institutional Outcomes

		Probability of Cooperation	
		Low	High
Size of Threat	Low	Status Quo	Creation
	High	Selection	Reform

As table 2 illustrates, when threat and probability of cooperation are low, the status quo remains. When they are both high, states can reform the existing institution. When threat is high and probability of cooperation is low, states select into another institution. Finally, when threat is low and the probability of cooperation is high, states must create new institutions. Table 2 provides a foundation for additional hypotheses:

*Hypothesis 2: Joint increases in both the size of a state’s threat and in the probability of cooperation with other states increase the probability of institutional reform.*

*Hypothesis 3: Increases in the size of a state’s threat and decreases in the probability of cooperation with other states increase the probability that states will select into a new institution.*

*Hypothesis 4: Decreases in the size of a state's threat and increases in the probability of cooperation with other states increase the probability of institutional creation.*

In the current paper, I test hypotheses 3, and 4. I describe the data I use to undertake these tests in the next section.

## Research Design & Analysis

I test these arguments using large- $N$  quantitative analysis of state decisions to create or join multilateral development finance institutions, using Pevehouse, Nordstrom and Warnke (2004) data on International Governmental Organizations. I use OLS to analyze relationships between my dependent variables—the number of MDFIs states create or join in a given year—and my independent variables. I find some evidence for my arguments.

### Data

I test my hypotheses using Pevehouse, Nordstrom and Warnke's (2004) data on international organizations. I use this data to create a pair of dependent variables. First, I create a "creation" variable to indicate if a state was a member of an multilateral development finance institution at the institution's founding for the first year that the institution is present in the dataset. I sum these values for all countries in the dataset, creating a count of the institutions created by a state in a given year. Second, I create a "joining" variable to indicate if a state joined an MDFI in any year after it was founded. I follow the same procedure, summing these variables over country-years. I intend the joining variable to act as rough proxy for institutional selection. It captures the notion that states might select an institution by joining ones they do not currently belong to. It does not, of course, capture cases in which states shift resources across institutions they already belong to. The resulting dataset covers the period from 1950 to 2000. This dataset only uses institutions that match institutions that I coded as MDFIs from my analysis of the *Yearbook of International Organizations* and are in the Pevehouse, Nordstrom and Warnke (2004) dataset<sup>9</sup>. As a result, it is incomplete and my estimators may be biased as a result of missing data (King et al. 2002).

I operationalize my independent variables, threat and probability of successful cooperation using GDP and GDP per capita for the former variable and various measures of democratic similarity for the former. For a measure of

<sup>9</sup>The current dataset includes the the African Development Bank, Arab Bank for Economic Development in Africa, the Arab Fund for Economic and Social Development, the Arab Gulf Programme for United Nations Development Organizations, the Asian Development Bank, the Caribbean Development Bank, the Development Bank of the Great Lake States, the East African Development Bank, the European Bank for Reconstruction and Development, the European Investment Bank, the International Bank for Reconstruction and Development, the Islamic Development Bank, and the Special Arab Aid Fund for Africa. Because it excludes emanations, the African Development Fund; the Black Sea Trade and Development Bank; the Council of Europe Development Bank; the Economic Cooperation Organization Trade and Development Bank; the European Community's Structural Funds; the EU's Cohesion Fund, European Development Fund, PHARE programme, and TACIS programme; the International Development Bank; the OPEC Fund for International Development; the South Asian Development Fund; and the United Nations Development Fund. Other MDFIs not included in this data are the Andean Development Corporation, the Central American Bank for Economic Integration, the Development Bank of Central African States, the Eastern and Southern African Trade and Development Bank, and the West African Development Bank. The Pevehouse, Nordstrom and Warnke (2004) dataset suggests several other institutions that need to be checked against my coding rules.



threat, I use GDP as GDP tends to correlate with voteshare within the multilateral development banks and thus may proxy for the resources that countries can threaten to withdraw within an institution. Still, I expect GDP to proxy weakly for threat, especially because the resources states commit to MDFIs vary across institutions. In future iterations of this project, I plan to collect capital payment and contribution data for a subsample of the countries in my current analysis. This data will also allow me to create a measure of institutional reform, similar to Lipsky (2009).

My initial measure of democratic similarity measures a country's distance from the mean democracy score for its region. I recognize that region codings may not accurately reflect how states approach construction of viable international organizations. I only use a single measure for this version, but in the future I plan to use multiple codings for region, and, following Lee and Strang (2006), I will use multiple possible reference groups. At this point, I have no theory that specifies which reference groups states will use. In future iterations I plan to create several measures of regime similarity within these various reference groups. Table 3 presents descriptive statistics for these variables.

Table 3: Descriptive Statistics

Variable	Mean	Median	Std. Dev.	Min.	Max.
Create	0.0279	0	0.211	0	3
Join	0.043	0	0.221	0	2
Absolute Regime Deviation	5.21	4.57	3.51	0	15.9
GDP (Millions of \$US)	173.0	22.7	575.0	276.0	9,170.0
N = 5343					

All values rounded to three significant digits.

Finally, there are almost certainly omitted variables in such a basic specification. I plan to identify variables that correlate with my IVs and the error term to improve my models in the future.

## Methods

Although my data has a clear count structure, I use ordinary least squares regression as a statistical first cut. I do this because of OLS' general robustness. Count data methods—including Poisson and negative binomial models—will probably be the best approach for such data, but I prefer to research time-series–cross-sectional (TSCS) approaches to these models before using them. I cluster standard errors by country, analyze both pooled and fixed-effects models, as well as account for serial correlation temporal dynamics by using various lag structures.

Both my hypotheses make predictions about relationships between variables. Hypothesis 3—on institutional selection or joining—implies that the coefficient on threat should be positive, the coefficient on probability of cooperation should be negative, and the interaction term should be positive. On the other hand, hypothesis 4—on institutional creation—implies that the coefficient on threat should be negative, the coefficient on probability of cooperation should be positive, and the interaction term should be positive.

## Results

Table 4 presents the results for my initial analysis of hypothesis 3, on joining. In broad terms, I find some (inconsistent) support for this hypothesis. The coefficient on *GDP* (threat) in most models is negative and significant, with an effect ranging from an insignificant 0.0004 decrease in the number of institutions joined to a significant 0.19 decrease. The coefficient on *Absolute Regime Deviation* (probability of cooperation) is inconsistently negative and insignificant. The effect ranges from a 0.0037 decrease to a 0.011 increase in the number of institutions joined. Finally, the interaction term for these variables is inconsistently positive but also insignificant, with an effect ranging from a 0.00015 decrease to a 0.00071 increase.

Table 5 presents the results for hypothesis 4, on institutional creation. On this count, the evidence is inconsistent, but somewhat encouraging. The coefficient on *GDP* is inconsistently negative, and significant when it is. The effect ranges from a 0.078 decrease in the number of institutions joined to a 0.039 increase. *Absolute Regime Deviation* is likewise positive except in one case and occasionally significant. Its effect ranges from a 0.00025 decrease in the number of institutions joined to a 0.067 increase. Finally, the interaction is never positive and only occasionally significant. Its effect ranges from a decrease of 0.0002 to one of 0.0045.

These preliminary results suggest (weakly) that states may join MDFIs as their GDPs increase and they become less like the other states in their region in terms of regime type. On the other hand, states appear to create more institutions as their GDPs decrease and they become more like the other states in their region. Neither result appears obvious: wealthier states join new MDFIs while poorer ones create MDFIs. At the same time, the similarity result appears suggestive as well. At the very least, the results justify additional research.

## Limitations and Future Plans

Like any empirical project, this one has weaknesses rooted in the quality of the data. I have already mentioned my intent to supplement the Pevehouse, Nordstrom and Warnke (2004) dataset, to analyze other possible reference groups for international cooperation, and to collect new contribution and capital subscription payment data. To facilitate the final task, I plan to focus this data collection on Middle Eastern MDFIs. Finally, I address a potential concern about endogeneity.

## Research Strategies

To create a new dataset of capital subscription and contribution payment data requires a significant undertaking. Although many institutions publish such data in their annual reports, many do not. Fortunately, a research design ap-

Table 4: Determinants of Institutional Selection (Joining)

Model	1	2	3	4	5	6	7	8
Lagged DV								
Absolute Regime Deviation	0.0029	0.011	-0.013	-0.016	0.002	0.013	-0.0057	-0.064***
	0.0072	0.013	0.056	0.056	0.0079	-0.0037	0.01	0.013
GDP*	-0.0035	-0.046***	-0.19**	-0.17**	-0.0004	0.015	-0.013	-0.017
	0.003	0.0075	0.066	0.062	0.0033	-0.024**	0.056	0.055
GDP*Abs.Pol.Dev	-0.00015	-0.00072	0.00054	0.00067	-0.00012	0.00053	-0.19**	-0.17**
	0.00042	0.00076	0.0033	0.0033	0.00046	0.0086	0.066	0.063
Absolute Regime Deviation (Lagged)			0.015	0.014		0.00088	0.00055	0.00071
			0.055	0.057			0.015	0.015
GDP* (Lagged)			0.19**	0.14*			0.055	0.056
			0.066	0.062			0.19**	0.15*
GDP*Abs.Pol.Dev (Lagged)			-0.0007	-0.00067			0.066	0.064
			0.0032	0.0033			-0.00071	-0.00072
Constant	0.10*	0.79***	0.039	0.36*	0.042	0.42**	0.0032	0.0033
	0.05	0.13	0.049	0.14	0.057	0.15	0.04	0.40**
Fixed Effects	No	Yes	No	Yes	No	Yes	No	Yes
R-squared	0.0013	0.052	0.0044	0.068	0.00015	0.07	0.0044	0.073
F-test	0.024	1.10E-09	0.022	0.032	0.83	0.028	0.022	0.031
N	5343	5343	4916	4916	4920	4920	4916	4916

\* Indicates logged variable; standard errors clustered by country  
+ p<0.10, \* p<0.05, \*\* p<0.01, \*\*\* p<0.001

Table 5: Determinants of Institutional Creation

Model:	9	10	11	12	13	14	15	16
Lagged DV					-0.021***	-0.068***	-0.019***	-0.067***
Absolute Regime Deviation	0.0016	-0.00025	0.067**	0.067*	0.0012	0.0038	0.002	0.0039
GDP*	0.0056	0.0085	0.025	0.027	0.0061	0.0016	0.066**	0.065*
	0.0048+	-0.036***	0.039	-0.065	0.0046	-0.078***	0.025	0.027
	0.0027	0.0075	0.041	0.047	0.0029	0.012	0.039	-0.07
GDP*Abs.Pol.Dev	-0.00024	-0.0002	-0.0044**	-0.0045*	-0.00021	-0.00036	-0.0044**	-0.0044*
	0.00034	0.0005	0.0016	0.0017	0.00036	0.00064	0.0016	0.0017
Absolute Regime Deviation (Lagged)			-0.069**	-0.074**			-0.069**	-0.072**
			0.025	0.025			0.024	0.024
GDP* (Lagged)			-0.036	-0.01			-0.037	-0.0095
			0.041	0.043			0.041	0.042
GDP*Abs.Pol.Dev (Lagged)			0.0045**	0.0047**			0.0044**	0.0046**
			0.0016	0.0016			0.0015	0.0015
Constant	-0.041	0.67***	-0.0031	1.32***	-0.035	1.38***	-0.0037	1.40***
	0.046	0.13	0.048	0.2	0.049	0.21	0.049	0.21
Fixed Effects	No	Yes	No	Yes	No	Yes	No	Yes
R-squared	0.0022	0.037	0.0053	0.051	0.0023	0.052	0.0057	0.055
F-test	0.00038	7.6E-07	0.0094	0.0029	0.0018	9.20E-09	0.0089	0.0022
N	5343	5343	4916	4916	4920	4920	4916	4916

\* Indicates logged variable; standard errors clustered by country

+ p&lt;0.10, \* p&lt;0.05, \*\* p&lt;0.01, \*\*\* p&lt;0.001

proach helps constrain this undertaking<sup>10</sup>. My initial analyses suggest that sufficient variation across my independent variables within the Middle East. Figure 10 demonstrates this for one year<sup>11</sup>. Again, while these are based on rough proxies for my variables, they are suggestive. Instead of collecting the entire dataset—multiple years for all countries, I can focus on solely on institutio which Middle Eastern states might plausibly belong to.

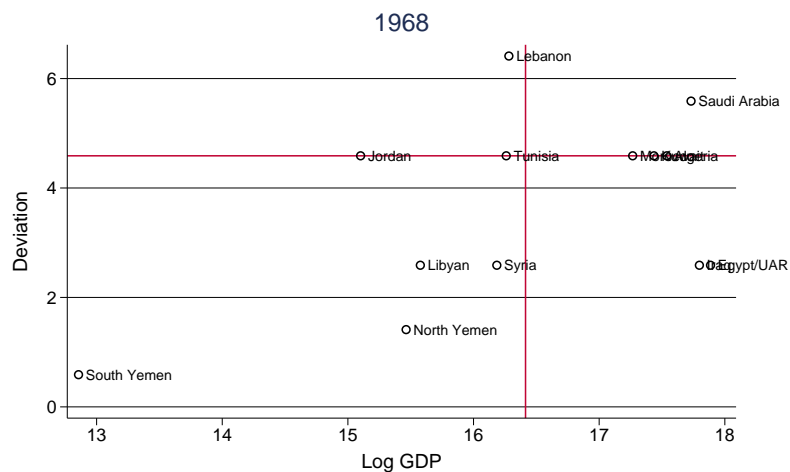


Figure 10: Variation in Independent Variables in the Middle East, 1968

## Endogeneity

I argue that international organizations might act as reference groups within which states assess their ability to create new IOs. This measure may create bias as a result of endogeneity, as the creation of new IOs create new reference groups. That is, creating a new IO can increase a state's ability to create new IOs in the future. Fortunately, this endogeneity is temporally specific. That is, new IOs add to the pool of reference groups, but the effect is contained as long as the new (or joined) IOs are not part of the list of reference group IOs. This makes sense both logically—a brand new institution cannot act as a reference group justifying its own creation—and empirically.

Clearly, I have much work to do. Fortunately, while my initial results are inconsistent, they are encouraging.

## Conclusions

I find evidence to support my hypotheses, which may (subject to measurement concerns) support my arguments that states create MDFIs when they lack the ability to threaten an institution through their withdrawal but they have

<sup>10</sup>Clarke (2005) suggests that a research design approach mitigates the problem of identifying control variables; similarly, it mitigates the necessity of collecting a global dataset to test my hypotheses.

<sup>11</sup>I select the Middle East both because of my own background studying the region (including Arabic language skill) and because of the variation in my independent variables.

strong prospects for new institutional cooperation. Additionally, states join (select into) other MDFIs under the opposite conditions. Although MDFIs share many characteristics of IOs, in many ways these organizations function differently than other IOs. It is not clear that the bargaining framework I have identified here applies to IOs more generally. That said, I have created a model and found evidence that helps explain the puzzle I identified. In spite of credible alternatives generally, states may fail to reform institutions because they lack the resources to threaten those institutions and do so credibly. Instead, states create new institutions or select into others.

In addition to beginning to explain this puzzle, I have identified a regime complex in foreign aid: countries give multilateral development aid through multiple overlapping institutions. My research also has implications for understanding international relations in the Middle East and how authoritarian states make foreign policy. Future iterations of this project will explore these more fully. Finally, institutional proliferation has important policy implications. Collier (2007) illustrates the difficulties that multilateral proliferation produces in aid. Three donors chose to cooperate to build a hospital, but could not coordinate their respective aid policies. After two years, the donors chose to divide the project by floors, each using its own rules on its respective floor. Collier implies that the resulting hospital was a mess (101). He fails to mention whether the donors were multilateral or bilateral, but donor proliferation of either type will contribute to such development disasters. Aid conferences assert a negative link between donor proliferation and effectiveness (OECD-DAC Working Party on Aid Effectiveness 2005, 11) and recipient government bureaucrats report feeling burdened by donors' failure to coordinate policies (OECD 2003). Research suggests similar outcomes. Understanding not only the effects of donor proliferation but also its causes will help aid agencies and governments construct better aid policy.

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