

# LIMITS OF INFORMAL GOVERNANCE?

## THE SCOPE OF CONDITIONALITY IN

### THE WORLD BANK

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#### **Abstract**

This paper analyzes the political economy of conditionality in World Bank aid projects. We argue that the scope of conditionality reflects the outcome of bargaining between the development assistance agency and recipient countries. Whereas major shareholders have the ability to influence these negotiations informally to favor strategically important recipient governments, we suggest that the major shareholders in fact do not have incentives to intervene early in the conditionality process because they can prevent conditionality from being enforced, if necessary. We use a new data set that includes information on conditionality in the World Bank's aid projects to test the economic and political determinants of the scope of conditionality. We find that the World Bank indeed seeks to implement conditionality as an instrument to increase aid effectiveness, and recipients seek to mitigate the stringency of imposed conditionality; major shareholders, on the other hand, appear to avoid using their informal influence to bias conditionality negotiations.

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## INTRODUCTION

Foreign aid is politicized. Decades of research has demonstrated that donor governments<sup>1</sup> allocate their bilateral foreign aid in favor of recipient countries that are of economic, military, or geo-political interest to the donor government.<sup>2</sup> Whereas multilateral aid institutions (MAIs), such as the World Bank, have been regarded as less politically biased, recent work points to opportunities for powerful members to bias the allocation of multilateral aid as well. This bias exists not only for the decisions about which recipients receive foreign aid, and how much aid they receive, but also how aid resources are distributed among different sectors. These findings imply that the staff in MAIs face trade-offs between pursuing the official goal of the organization and accommodating powerful members' strategic interests. Donor countries' long-term goal is to promote sustainable economic development in the poorest countries in the world, but donors' short-term strategic objectives can create pressures on the MAI to implement policies that limit the agency's effectiveness in reaching the long-term goal.

Whereas there is extensive research on the politicization of foreign aid flows, much less research effort has been spent on analyzing the politicization of foreign aid conditionality. Existing aid studies that examine powerful member governments' interventions in conditionality associated with World Bank aid flows focus on interventions at the enforcement stage. In particular, the World Bank appears less likely to punish non-compliance with aid conditionality by suspending aid flows when recipients have strategic relations with donor governments (Mosley et al. 1995; Collier 1997; Dreher 2004; Kilby 2009). From studies of the World Bank's sister institution, the International Monetary Fund (IMF), there is some evidence that conditionality is also influenced by the strategic interests of its most important shareholders at the decision-making and implementation stage (Dreher and Jensen 2007; Stone 2002, 2004, 2008, 2011).<sup>3</sup> While it may seem reasonable to assume that World Bank conditionality is subject to the same constraints as a result of informal influence exerted by powerful member countries, we argue that effective influence at the enforcement stage may create incentives for such countries *not* to intervene at the initial stage of conditionality negotiations between the World Bank and its recipients.

This paper draws on newly available data to analyze the political economy of World Bank conditionality and, more specifically, to search for any evidence of informal influence on the scope of imposed conditionality. We start by drawing on existing work about IMF conditionality to develop a political economy model of World Bank conditionality (Dreher 2004, 2009; Dreher and Vaubel 2004; Stone 2004). At the same time, we show how important differences between the sister institutions create different expectations about informal influence in conditionality negotiations. In particular, we analyze the interactions between the World Bank agency, the recipient government, and important shareholder countries to derive empirical implications for the scope of World Bank conditionality.<sup>4</sup> We argue that the Bank's expectations regarding a given recipient's willingness to implement required reforms serve as key determinants of its desired

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<sup>1</sup> We refer to shareholder governments and donor governments interchangeably.

<sup>2</sup> Maizels and Nissanke 1984; Meernik et al. 1998; Thacker 1999; Alesina and Dollar 2000; Burnside and Dollar 2000; Alesina and Weder 2002; Stone 2002; Neumayer 2003; Vreeland 2005; Berthélemy 2006; Dreher et al. 2006, 2009; Dreher and Jensen 2007.

<sup>3</sup> Other authors find no effect at the implementation stage (Dreher 2004; Copelovitch 2010).

<sup>4</sup> We primarily focus on the number of conditions as scope and thereby follow most of the IMF literature. Another dimension is the substantive scope of World Bank conditionality, which we explore in robustness checks.

scope of conditionality. We consider two potential constraints on the agency's ability to impose its desired level of conditionality: the first is a given recipient's bargaining power, and the second is the short-term strategic interests of the World Bank's major shareholder countries. Given the particular features of World Bank development work, we argue that major shareholders may have fewer incentives to intervene into the conditionality negotiations than they would at the IMF. In particular, major shareholders generally favor implementation of conditionality as a driver of development, and they only intervene against conditionality to assist strategically important recipient governments. Since major shareholders can effectively intervene in favor of strategically important recipient countries at the enforcement stage, they may shy away from more frequent and potentially unnecessary interventions in the early stages. Intervention at the enforcement stage allows them to target their interventions to those instances where strategically important recipient governments in fact do not want or are unable to implement conditionality. This diminishes the likelihood that the shareholder uses political capital to reduce conditions that would have been implemented by the recipient country. Intervention at the enforcement instead of the negotiation phase therefore increases the likelihood that even strategically important countries implement some conditionality, thereby advancing the shareholder countries' long-term interest in promoting development (Dreher 2006). In addition, recipients of World Bank assistance receive more projects than countries that enter into agreements with the IMF. Transaction costs of interventions in conditionality negotiations are, as a consequence, much higher in the case of the World Bank. Intervention at the enforcement stage instead of the negotiation phase therefore also allows governments to minimize costs of (potentially unnecessarily) intervening in a large number of conditionality negotiations.

We use a negative binomial regression model to analyze the World Bank's decisions over the scope of conditionality in recipient countries in the period between 1980 and 2011. We find moderate empirical support for the conceptualization of conditionality negotiations as a bargaining process between recipient countries and the World Bank. The World Bank indeed imposes less extensive conditionality on recipients that are more successful in reaching development objectives – when past performance success is operationalized as high rates of economic growth. Our results also indicate that recipients with more bargaining power receive somewhat better conditionality terms – e.g., a recipient's vote share in the Executive Board appears to reduce the scope of conditionality – but few other factors matter for the scope of conditionality. Importantly, we find only weak evidence that the agency is constrained in its conditionality negotiations by major shareholders' strategic interests in the recipient country. For most operationalization of such strategic interests and regardless of whether or not we account for the economic vulnerability of the recipient country, major shareholders do not exert any systematic influence on the scope of conditionality.

Our findings provide interesting insights to the literature. First, whereas previous research on aid conditionality has relied on indirect measures of World Bank conditionality, such as macroeconomic performance, or focused on analyzing IMF conditionality, we exploit newly available data on World Bank conditionality. We therefore are able to provide a first empirical test of the outcomes of the negotiations over conditionality in World Bank adjustment lending. Second, our analysis is informative for comparing conditionality practices of the World Bank with those of its Bretton Woods sister institution, the IMF, which has been the focus of most empirical conditionality studies.<sup>5</sup> Our findings suggest that the use of conditionality by the World Bank and the IMF is oftentimes similar, but differs in important ways: while the IMF has imposed more conditions

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<sup>5</sup> Dreher (2004) offers a theory of World Bank conditionality.

over time, the World Bank conditionality indicates a downward trend during the period under study. Another difference is that poor governance does not appear to affect the scope of conditionality in the case of the World Bank, whereas research on the IMF suggests that this organization may be more sensitive to the quality of recipients' institutions and policies. Third, our findings identify limits of informal governance: World Bank conditionality does not reflect strategic interests of powerful shareholder countries, no matter how they are operationalized or whether we account for any conditional effects of economic vulnerability.<sup>6</sup> We offer a rationale for these findings, which is based on the peculiarities of World Bank development work as well as the rational behavior of major shareholder governments who aim to minimize the financial, political and economic costs of frequent interventions.

#### OVERVIEW OF WORLD BANK CONDITIONALITY

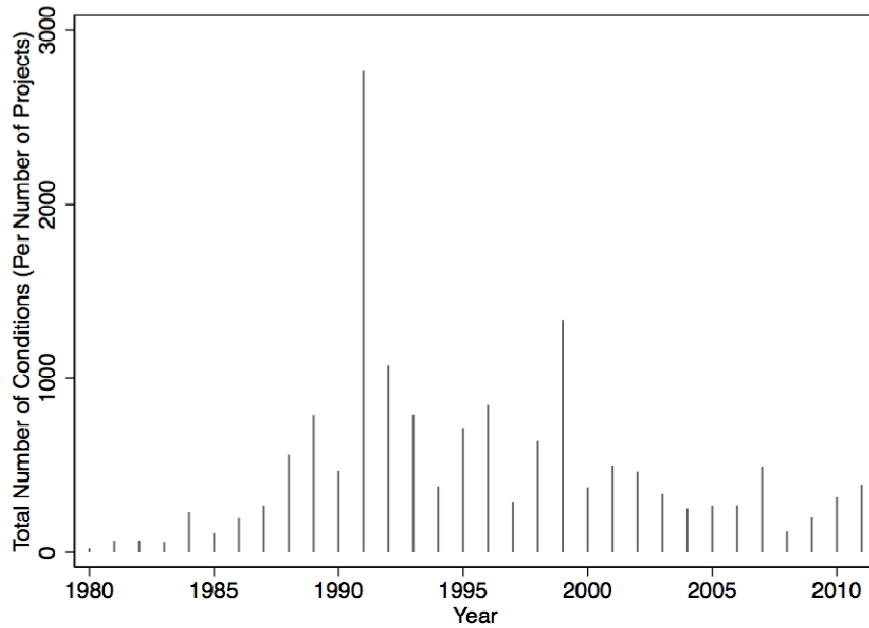
The World Bank started to apply *ex ante* conditionality to its aid projects in the early 1980s as a consequence of the introduction of structural adjustment loans.<sup>7</sup> Since then, World Bank conditionality has evolved in many different ways. There exists no formal definition of “conditionality” in the World Bank’s legal framework. However, the provisions of Operational Policy (OP) 8.60, *Development Policy Lending* state that “(...) the Bank makes its resources available if the borrower (a) maintains an adequate macroeconomic framework, (b) implements its overall program in a manner satisfactory to the Bank, and (c) complies with the policy and institutional actions that are deemed critical for the implementation and expected results of the supported program” (WB 2005, i). The term “conditionality” has been used to describe any policy actions that a recipient country has to implement before the World Bank disburses any aid for a structural adjustment project (so-called prior actions).<sup>8</sup> In general, policy and institutional conditions in a program vary in number, scope, and content depending on the operation. They may include institutional actions, modifications in policies, sustained implementation of policies, maintenance of satisfactory macroeconomic framework, as well as analytical work.

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<sup>6</sup> The findings for the IMF are mixed. Some find no systematic influence of powerful countries' interests on the scale of IMF conditionality (Dreher 2004; Copelovitch 2010). Other studies suggest that major shareholders' strategic interests have an effect on whether and to what extent IMF conditionality is applied, at least when the recipient is vulnerable economically (Dreher and Jensen 2007; Stone 2008).

<sup>7</sup> Dreher (2004) provides an excellent overview of the development of World Bank conditionality.

<sup>8</sup> In addition to prior actions, the World Bank uses benchmarks. In contrast to prior actions, benchmarks describe the contents and results of the reform program. They have frequently been used to describe small steps in a reform process, which allow the World Bank and the recipient to assess progress in the implementation of the program. They are, however, not legal conditions for disbursements of Bank loans or grants.



*Figure 1: Average Number of World Bank Conditions per Number of Projects, 1980-2010*

As the historical developments show, conditionality has become an important instrument of World Bank financial support since the early 1980s. Figure 1 shows the total number of conditions that the World Bank imposed each year since it started using conditionality, divided by the total number of World Bank structural adjustment projects in each year. Most importantly, the figure shows that the average number of conditions per project has fluctuated over time. Figure 2 graphs the average number of conditions imposed on each recipient country each year since 1980. Each dot in the graph represents the number of conditions for a particular recipient country in a given year. The figure immediately illustrates the variation in the number of conditions imposed on each recipient country per year. Whereas many recipient governments received World Bank projects without having to accept conditionality, some countries had to accept an average of over 50 conditions per project in a given year. The maximum number of conditions a country has accepted until now is Panama with an average of 81 conditions per project in 1992. If we do not control for the number of projects, then the country that accepted the largest number of conditions is Peru (208 conditions in 1992).

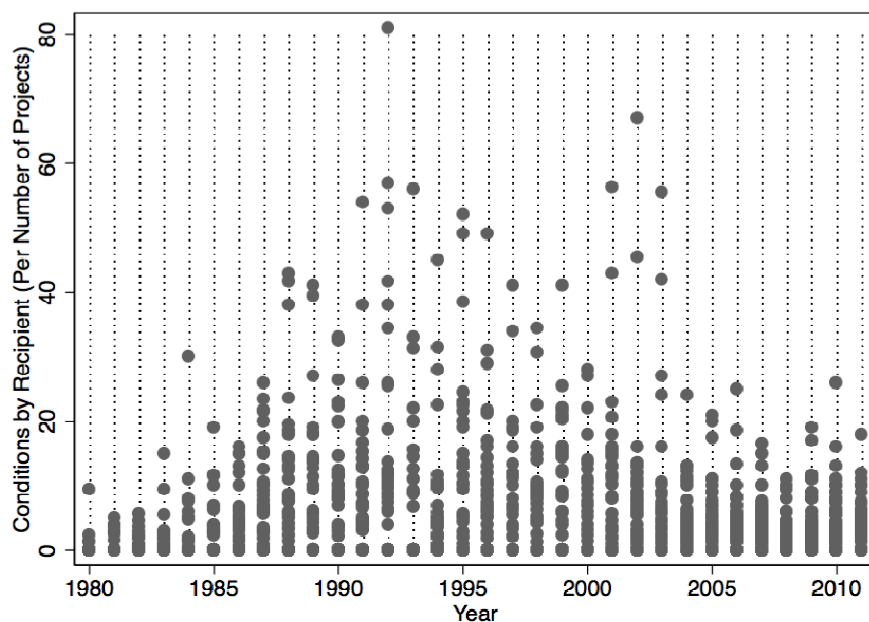


Figure 2: Variation in World Bank Conditionality, 1980-2010

What explains the spatial and time variation in the number of conditions applied to recipient countries? Previous research has focused on the tension between the interests of member governments and World Bank staff, and its influence on World Bank allocation policies. On the one hand, multilateral aid agencies seek to increase their influence and autonomy, and reduce their member states' control over MAIs' decision-making (Vaubel 1986, 1991; Mosley et al. 1991; Dreher and Vaubel 2004; Przeworski and Vreeland 2000; Vreeland 2003a). On the other hand, influential members can use their formal and informal power to align MAI allocation decisions with these members' preferred policies. In particular, the literature on multilateral aid allocation has demonstrated that major donors of multilateral aid institutions have successfully biased the allocation of multilateral aid in favor of their foreign policy interests (Dreher et al. 2009; Kuziemko and Werker 2006; Lyne et al. 2009; Milner and Tingley 2010; McLean 2012; Schneider and Tobin 2013a,b).

While there is increasing evidence that multilateral aid allocation is biased when major donors' strategic political and economic interests are at stake, much less is known about the ability of major donors to bias the World Bank's imposition of conditionality. Most previous work has focused on the likelihood that the World Bank enforces conditions (Mosley et al. 1995; Collier 1997; Dreher 2004; Kilby 2009).<sup>9</sup> That is, if a recipient country fails to implement conditionality,

<sup>9</sup> The literature on the enforcement of conditionality is larger when including analyses of the International Monetary Fund (IMF). IMF scholars have previously demonstrated that the scope of conditionality is more limited in the IMF's programs assisting countries that are favored by the most influential members of the IO (Dreher and Jensen 2007; Stone 2008; Copelovitch 2010). The research on the effect of U.S. influence on multilateral assistance, for instance, suggests that countries that vote with the U.S. in the UN General Assembly or receive substantial amounts of U.S. economic or military aid, tend to receive more favorable treatment from IOs, in which the U.S. is the most powerful stakeholder (Vreeland 2005; Stone 2002, 2004; Barro and Lee 2002; Thacker 1999). Enforcement of conditionality also tends to be weaker in the case of such recipients (Stone 2002, 2004). However, as Morrow (2005: 220) argues, the Bank's policy-based conditionality is different from the IMF's conditionality be-

does the World Bank punish the recipient by, for example, delaying the provision of the next tranche of project aid or future project aid? Kilby (2009) analyzes the effect of macroeconomic performance on the World Bank's decision to disburse loans under structural adjustment loans when recipients are important to the U.S., and shows that strategic interests of the U.S. decrease the likelihood of enforcing conditionality. In other words, disbursements take place regardless of whether the recipient implemented conditions or not. If major donors can intervene when it comes to the enforcement of conditionality, what does this imply for their incentives to intervene in the initial decisions regarding the scope of conditionality? Our theoretical argument investigates whether powerful countries are motivated to use their informal influence in conditionality negotiations between the World Bank and recipient countries.

## POLITICAL ECONOMY OF WORLD BANK CONDITIONALITY

In this section, we analyze the strategic interactions of the three relevant actors in multilateral aid programs – the World Bank agency, influential shareholder countries (such as the U.S.), and recipient countries – and the result of these interactions in the form of conditionality attached to development aid projects funded by the World Bank. Our theory rests on the assumption that the actors involved in the negotiations over aid programs are rational actors with distinct preferences over the imposition of conditionality. We first discuss the preferences that these players have over the imposition of conditionality in World Bank projects. Subsequently, we analyze how these preferences affect the decision-making process and implementation of conditions by the World Bank. It is important to note that we treat the foreign aid amount for a given assistance package as fixed or pre-determined, and hence not part of the conditionality negotiations. Ceilings on aid allocations are generally set five years in advance; hence, the Bank cannot purchase additional reforms with more aid. Instead, it seeks to impose as many conditions as it can, given the available aid amount.<sup>10</sup>

### DEVELOPMENT, FOREIGN AID, AND PREFERENCES OVER CONDITIONALITY

All actors that have a stake in the decisions made about the imposition of conditionality in World Bank projects – the powerful shareholder governments, the World Bank agency, as well as the recipient governments – share an interest in alleviating poverty and promoting economic growth in the recipient countries. Conditionality can be instrumental in pursuing such developmental goals because it gives the Bank the authority to intervene when recipients do not comply with the terms of the assistance agreement. In particular, World Bank conditionality can solve the time inconsistency problem that many recipient governments face in implementing reforms that are critical to the sustainability of aid projects. Whereas recipient governments have long-term interests in implementing such reforms because of their positive long-term effect on economic growth, in the short run they often have incentives to shirk reforms due to significant political costs. The incentives to shirk are particularly high if aid resources are provided independent of reform progress. When aid is conditional, however, the donor has at least one opportunity to withhold some share of the promised aid by disbursing only some part of the total commitment at

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cause “The IMF normally provides financing under different circumstances and deals with a different set of policy and institutional issues than the Bank.”

<sup>10</sup> See Mosley et al. (1991) for a more detailed description of this process.

a time. Now the recipient is forced to take the donor's future actions into account when choosing the compliance level. With some probability, the donor can decide not to disburse aid if the donor is not satisfied with the recipient's performance. Given that, the recipient will choose its compliance level by taking into account not only the costs and benefits of implementing the project, but also the donor's possible disbursement decisions. By increasing the likelihood that a recipient government implements the reforms that are deemed critical for the success and sustainability of the aid project, the World Bank can "(...) ensure that the assistance it provides contributes to the country's development objectives (development effectiveness rationale), and (...) that the resources are used for the purposes intended (fiduciary rationale)" (World Bank 2005: 1).

Whereas the World Bank's shareholder governments support the World Bank's main goal of economic development in the long run, oftentimes they have short-term strategic interests that are inconsistent with the promotion of economic development. An influential shareholder may seek to address foreign policy concerns that are viewed as more urgent than a recipient nation's long-term economic prospects. If the World Bank suspends aid, the shareholder may have to face a number of negative consequences. For instance, suspended aid could destabilize the recipient government and bring antagonistic groups to power, increase the likelihood of protests and civil conflict, or weaken an important ally. A promise to intervene and prevent aid suspension by the aid agency, on the other hand, could provide the influential country with additional leverage for extracting specific concessions from the recipient country, such as favorable votes in international fora (UNGA, UNSC), or support in other areas of international politics. Second, governments that turn to the World Bank for financial assistance, i.e. recipient governments, seek to achieve two goals: to remain in office, and to implement a set of preferred policies while in office. Whereas recipients share the long-term goal of economic development with the World Bank and the shareholder governments, and hence may have an interest in implementing at least some of the proposed reforms, they may regard conditionality as an interference with a recipient country's sovereignty. In addition, countries may not agree with the set of required policies in the first place. Finally, recipient governments may be unable or unwilling to implement required reforms, due to electoral concerns, or the opposition of domestic groups that benefit from the status quo. If the political costs are expected to be substantial, they would have short-term interests to press for more lenient terms when they enter into assistance programs with the World Bank.<sup>11</sup>

#### THE SCOPE OF WORLD BANK CONDITIONALITY

The discussion above indicates that the three actors (the World Bank staff, influential shareholders, and recipients) have a common long-term goal – they seek to foster economic development in the recipient countries – but that the agency's and governments' interests may diverge in the short term, potentially leading to powerful members' interventions in the negotiation process between the World Bank and aid recipients. We view the process of determining the scale of conditionality as a bargaining process between representatives of the World Bank and recipient governments, while influential members may exercise their informal control over the World Bank's activities by intervening in the bargaining process. If donor countries intervene, they do

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<sup>11</sup> It is important to note that some politicians may be concerned about the policies of their countries' future leaders, and therefore use conditionality strategically as an international commitment device to facilitate and entrench domestic policy changes (Dhonte 1997). Once these politicians' desired policy changes become World Bank conditions, it is more costly for opponents or future governments to reverse these changes (Vreeland 2003b; Vaubel 1991). In this case, the recipient government may share the World Bank's conditionality preferences.



so to support recipients that are important to them, and force the World Bank to adopt the level of conditionality proposed by the recipients. If donors choose not to intervene, the World Bank imposes its preferred level of conditionality if it has sufficient bargaining power vis-à-vis a given recipient. The recipient always has the ability to walk away from the aid agreement if the terms of the agreement are such that the no-agreement outcome gives the recipient a higher utility. Therefore, conditionality can be viewed as a result of a compromise between what the World Bank believes is necessary in order to ensure long-term sustainability of the project and what it is able to implement given the ability of recipient countries to assert themselves in the negotiation process and powerful members' intervention in order to protect their strategic interests.

As we argued above, the World Bank should have a fundamental interest to use conditionality as an instrument to ensure the effectiveness of its projects. While the World Bank agency can determine which policies need to be implemented in order to maximize the chances for project success, it does not know with certainty whether the recipient government will actually implement these policies. Since the World Bank generally has some degree of uncertainty about recipients' reform intentions, the Bank has incentives to make these reforms a condition for the disbursement of any foreign aid project. In doing so, however, it has to also consider the costs of implementing conditionality. First, imposing conditionality comes with an administrative cost. Conditionality requires not only careful analysis of reforms that are conducive for project implementation, but also monitoring of recipients' performance and suspending aid disbursements when performance falls short of the standards captured in the terms of the agreement. Aid suspensions generate additional costs for the World Bank staff due to the agency's strong disbursement culture (Mosley et al. 1991). Second, imposing conditionality can strain relations with recipient governments because it can be perceived as impinging on states' sovereign decision-making, which can reduce the recipients' willingness to carry out reforms, especially if they impose economic costs on domestic interest groups or citizens. The World Bank staff, therefore, has incentives to actively involve recipient governments into the decision-making process at the initial stage, even though the agency may have enough bargaining power to impose its preferred conditionality on recipients. In fact, in 2005 the World Bank introduced "Good Practice Principles" for the application of conditionality.<sup>12</sup> First, projects and prior actions have to reinforce country ownership of the project. Second, World Bank staff has to agree up front with the recipient government and other financial partners about a coordinated accountability framework, as to minimize the appearance of a breach in a recipient country's sovereignty. Third, the World Bank only chooses actions that are deemed critical for achieving results as conditions for disbursement. Finally, the World Bank conducts transparent progress reviews conducive to predictable and performance-based financial support (World Bank 2005). Accordingly, World Bank conditionality has to be interpreted as the result of balancing the agency's preferences and recipient interests.

Consequently, the World Bank faces constraints that limit the use of conditionality to situations when conditions are deemed critical for achieving sustainable project outcomes. From a sustainability standpoint, conditionality appears particularly important when the World Bank either expects that recipient country will not perform – that is, implement the policies necessary to ensure sustainability – or when it is uncertain about whether the recipient country will perform.

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<sup>12</sup> Furthermore, in 2005 governments endorsed the Paris Declaration on Aid Effectiveness in an effort to increase recipient countries' ownership of development aid programs and strengthen the ideal of partnership as the basis of development cooperation between donors and recipients. In 2008, the Accra Agenda for Action was adopted to reaffirm the commitment to changes in the donor-recipient relations, as stated in the Paris Declaration.

While the Bank is never fully certain about the performance of the recipient country, it is able to use several factors in order to improve its estimates of the likelihood that the recipient country performs.

First, a recipient's past performance should lower the Bank's uncertainty about the recipient's willingness and ability to conduct necessary reforms. Past performance can be evaluated based on the record of compliance with previous aid agreements: if the recipient failed to comply with the terms of previous agreements, the Bank is likely to anticipate worse performance in the case of new agreements with this recipient. In addition, the Bank's key objective is to foster development, and recipients that are successful in creating conditions conducive to economic development should reduce uncertainty and lead the Bank to anticipate better performance in the future. Second, the World Bank can gauge the likelihood of success by observing domestic conditions in the recipient country that are suitable for reforms. For example, countries with sound social and economic policies tend to be more likely to achieve development objectives (Burnside and Dollar 2000; Collier and Dollar 2002). The World Bank emphasizes the importance of good governance in its assistance programs.<sup>13</sup> If recipient countries with good governance are more likely to perform well in development assistance projects, then the World Bank should be less likely to impose conditionality in these countries. Similarly, we expect democratic governments to be more motivated to implement reforms conducive to economic development and growth because voters hold them accountable for economic performance through regular elections. Democracies, therefore, should receive more lenient conditionality terms.<sup>14</sup> This leads to our first two testable hypotheses:

*Hypothesis 1: Positive performance of a recipient country in previous World Bank projects should reduce the scope of World Bank conditionality, ceteris paribus.*

*Hypothesis 2: Sound economic and political conditions in a recipient country should reduce the scope of World Bank conditionality, ceteris paribus.*

Although the World Bank is mainly interested in using conditionality as a tool to ensure sustainability and success of aid projects, recipients may seek to minimize the scope of conditions. This is particularly true if they do not gain anything domestically from having conditions imposed by the World Bank, and when implementing conditions is costly. It is, thus, reasonable to conclude that recipients, on average, prefer less conditionality than the World Bank's ideal level and will seek to reduce the number of conditions during negotiations. Consequently, the ability of the World Bank to implement its preferred scope of conditionality depends on its bargaining power vis-à-vis the recipient country. In particular, recipient countries with more attractive outside options (i.e. those that are not in great need of aid, or can get aid from other sources) may be less willing to accept World Bank aid with stringent conditionality. The need for assistance is likely to be greater for countries that are not doing well economically, and are therefore in dire need of economic assistance, and countries that are considered as high-risk for investments (i.e.

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<sup>13</sup> The main elements of good governance are: (1) voice and accountability, which includes civil liberties and political stability; (2) government effectiveness, which includes the quality of policy making and public service delivery; (3) the lack of regulatory burden; (4) the rule of law, which includes protection of property rights; (5) independence of the judiciary; and (6) control of corruption (Kaufmann et al. 1999).

<sup>14</sup> Note that governments of such countries should also be more responsive to their populations' demands for economic development and hence more willing to implement growth-promoting reforms, so they are less likely to resist the imposition of conditionality.

they are unstable economically or politically) and therefore are not likely to get resources from other sources.

*Hypothesis 3: A lower level of a recipient country's aid dependency should reduce the scope of conditionality, ceteris paribus.*

It is important to note that Hypothesis 3 assumes that recipients prefer fewer conditions on average. As discussed above, recipients may prefer more stringent conditionality. If this is the case on average, then we would expect that bargaining leverage has no influence or even a positive influence on the scope of World Bank conditionality. We will test this alternative argument directly in our empirical analysis.

Instead of relying on their own bargaining power during conditionality negotiations, some recipients could take advantage of their strategic importance to powerful donor countries. Powerful members can intervene to exert informal pressure on the aid agency on behalf of strategically important recipients to extract better terms in their aid agreements with the agency. Such interventions can be justified when political costs of the reforms are expected to be high, and powerful countries view the destabilization of these recipients as undesirable. Donor countries' intervention at the early stage of conditionality negotiations may be desirable if donor governments seek to avoid intervening later, at the enforcement stage, if the recipient does not comply and the World Bank suspends aid disbursements. However, there are important considerations that indicate the opposite, that interventions at the enforcement stage are in fact preferable to interventions during the conditionality negotiations. Donor countries may seek to build good will on the part of important recipients, or reward recipients for concessions or support in other issue areas. If conditionality is used by donors in linkage politics, the donors' leverage over recipients is likely to be greater at the enforcement stage, when the recipients' aid flows could be suspended and performance record could be tainted due to non-compliance unless a donor uses its informal influence. These considerations may lead donors to view World Bank conditionality as a source of influence over recipients, and hence increase the likelihood of support for higher levels of conditionality, as preferred by the World Bank. Most importantly, donors may have strong incentives to limit their informal influence in the initial negotiations because it allows them to minimize the potential political, financial, and economic costs of intervention. In particular, it may be more beneficial to the shareholder to wait until the enforcement stage because at this point it is clear which conditions are too costly for the recipient country to implement. This reduces the financial and political costs of the shareholder government that might intervene in more situations in the initial negotiations due to limited information about whether the recipient's actual capacity to implement conditions. This is particularly true for conditionality in the World Bank, where the number of projects and recipients is significantly larger than in the IMF. In addition, the failure to intervene at the initial stage may also increase pressure on the recipient country to implement more conditions, thereby increasing the potential for economic development – an outcome that is also favored by the shareholder government. In other words, since shareholder governments generally want foreign aid to foster economic development, and only have incentives to intervene when they need to assist strategically important countries, they may be better off intervening in the enforcement stage rather than the initial bargaining stage. Consequently:

*Hypothesis 4: Recipients' importance to influential shareholders should have no effect on the scope of conditionality, ceteris paribus.*

## RESEARCH DESIGN

To test our theoretical hypotheses, we analyze the World Bank's decision to impose conditionality on recipient countries. The unit of analysis is the recipient country-year. The sample of recipient countries includes all developing countries that received World Bank structural adjustment assistance between 1980 and 2011. Since we are interested in the extent to which World Bank imposes conditionality for recipient countries that receive aid, we exclude recipient-year observations where no aid was provided by the World Bank in that year.<sup>15</sup> Our data set is an unbalanced sample including 152 recipients of World Bank aid between 1980 and 2011.

### DEPENDENT VARIABLE

The theory generates predictions about the World Bank's decision to impose conditionality on recipient countries in a given year. To analyze World Bank conditionality, we make use of a newly available data set on prior actions and benchmarks used in World Bank projects since the MAI started using conditionality systematically in 1980s. Prior actions are policy and institutional actions that are deemed critical to achieving the objectives of the program supported by a development policy operation and that a country agrees to undertake before the Board approves a loan (credit or grant). Prior actions are the legal terms that have to be met for each operation before disbursement. Benchmarks represent progress markers of implementation of the government's program in areas monitored by the Bank. They are not part of the legal agreement between the World Bank and the borrower. Prior actions consequently represent what the literature refers to as conditionality in aid agreements.

Our dependent variable is the number of prior actions that the World Bank imposed on a recipient country in a given year (*Number of Conditions*).<sup>16</sup> It is important to note that virtually all prior actions are applied to adjustment projects.<sup>17</sup> Conditionality is not imposed in projects funded through investment loans. Adjustment lending constituted about 49% of the World Bank's lending portfolio in the period of study, but only about 14% of the World Bank's number of projects. The number of adjustment projects that a country receives may therefore be an important indicator for the number of prior actions negotiated. To account for this, we control for the number of adjustment projects that a country received from the World Bank in a given year.<sup>18</sup> In addition, we show that the results are robust to using a dependent variable that is constructed as the average number of prior actions per adjustment project (*Average Number of Conditions*). Both strategies ensure that we do not bias the stringency of conditionality for recipient countries that, for example, received more conditions but also more adjustment projects than comparable recipient countries. In addition, we created count measures of the sectors and themes included in World Bank conditionality packages to gauge different dimensions of conditionality.

The variation of conditionality across recipient countries and time is large. In 33% of cases, developing countries that receive adjustment projects from the World Bank did not have to accept any type of conditionality. The average number of conditions per recipient year is 7.4. The

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<sup>15</sup> Accounting for whether a country received a project or not does not change our main findings. Results are available upon request.

<sup>16</sup> However, we show that the results are very similar if we use benchmarks instead of prior actions.

<sup>17</sup> This type of lending is also referred to as development policy lending.

<sup>18</sup> The results are robust to using the total number of projects, the project size in terms of dollar amounts, and the overall amount of aid that the recipient receives from the World Bank. Results are available upon request.

average number of conditions per adjustment project is 13.6. The number of conditions per recipient and year varies dramatically between 0 and 208 (the average number of conditions per adjustment project varies between 0 and 125). The government that accepted the largest number of conditions was Peru in 1992. Four World Bank adjustment projects were active during that year. Morocco is the country with the largest average number of conditions per adjustment project: it accepted 125 conditions for one project in 1988. The number of conditions also varies across time: for example, the annual number of conditions that Argentina agreed upon between 1980 and 2011 ranges between 0 and 169.

## EXPLANATORY VARIABLES

To test whether positive past performance reduces the scope of conditionality (Hypothesis 1) we rely on two variables. First, *Compliance (t-2)* measures the number of projects, for which the World Bank's Independent Evaluation Group (IEG) rated the recipient as compliant with World Bank conditionality, as percentage of the total number of projects that were evaluated for that recipient in a given year. The IEG evaluates World Bank projects independently and provides, among other indicators, an indicator of whether the borrower complied with the aid project by, for example, implementing conditionality, or working along the benchmarks written down in the legal agreement between the World Bank and the recipient. We lag this measure by two years, as evaluations are usually not published until two years after the project comes to an end. Thus, when evaluating past compliance, World Bank staff uses data about projects from about two years before. Data are from IEG. Of course, the World Bank's assessment of a recipient's past performance could be biased due to major shareholders' interventions in conditionality enforcement and project evaluation.<sup>19</sup> We therefore use a variable that measures actual improvements in the economic wellbeing of the recipient country. *GDP Growth [t-1]* is measured as the lag of GDP growth in the recipient country, and *P.C. GDP [t-1]* is measured as the lag of per capita GDP in the recipient country. Data are from the World Bank Development indicators.

To test whether good economic and political conditions reduce the scope of World Bank conditionality (Hypotheses 2 and 3), we use several indicators. First, we measure the extent of good governance in a recipient country. *Democracy (t-1)* is the level of democracy in a recipient country, ranging from -10 (autocratic) to 10 (fully democratic). Data are from the Polity IV dataset. We use the Polity data in our main model because it provides a proxy for good governance that is available across recipient countries and time. Most direct measures of good governance suffer from data limitations – they are only available for a few years – and the correlations between the better measures and Democracy (t-1) ranges between 0.4 and 0.8. Nevertheless, in our robustness checks, we also use more direct measures of good governance (see operationalization below). Second, we use various measures for economic conditions in the recipient country. Besides the measures for economic growth and per capita GDP, we use the log of population of the recipient country, *Population (t-1)*, as indicators of the recipient's potential need for international assistance and, hence, strength of its bargaining position vis-à-vis the World Bank. Data are from the World Bank Development Indicators. Similarly, we account for recipients' economic vulnerability and, hence, the weakness of the bargaining position, by including measures of debt service as percentage of GDP (*Debt Service (% of GDP)*), trade openness as the sum of imports and exports as percentage of GDP (*Trade Openness*), and government consumption as percentage of GDP (*Government Consumption (% of GDP)*). Data for these economic variables are from

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<sup>19</sup> See Schneider et al. (2013).

World Development Indicators and International Debt Statistics. While economic indicators can be key determinants of a recipient government's bargaining power (Hypothesis 3), political factors can matter as well. We therefore include a variable that measures the recipient government's votes on the World Bank Executive Board as percentage of total votes (*Board Votes [%]*). We expect that the greater a recipient countries' vote share in the Executive Board, the greater its leverage in the negotiations over conditionality. Data are from Kilby (2009).

To test whether strategic interests of the agency's major shareholders matter (Hypothesis 4), we employ a number of variables that have been used in the literature. In our main model, we include a variable that measures the United States' bilateral aid flows to the recipient country as percentage of the recipient's gross domestic product (GDP). Data are from the AidData group. In robustness checks, we compare the results of this operationalization with other variables for U.S. (and other major shareholders') interests, which are commonly used in the literature. First, we use the logged total amount of U.S. bilateral aid disbursed to a recipient country. Second, following Stone (2008) we use a dummy for U.S. aid recipients. Third, we use the similarity of voting patterns in the United Nations General Assembly. *Affinity with U.S. (s2un, t-1)* and *Affinity with U.S. (s3un, t-1)* are constructed using information on s-scores between the United States and the recipient country in a given year. Data are from Strezhnev and Voeten (2013). Fourth, we recode the affinity variable following Kilby (2009) as a dichotomous measure: *U.S. Friend* takes the value of 1 if the recipient's UN voting record in a given year was more closely aligned with that of the U.S. on votes, designated as 'important' by the U.S., than on all UN votes; and 0 otherwise. Fifth, we include a dummy variable that takes the value of one if the recipient has a formal alliance with the United States (*Alliance*). Sixth, we include a dummy variable that takes the value of one if the recipient has a defense pact with the United States (*Defense Pact*). Data for both variables are from Gibler (2009).<sup>20</sup> Finally, we include two variables that measure (i) the logged total amount of U.S. military aid to a recipient country (*U.S. Military Aid (log)*) and (ii) the amount of U.S. military aid as a percentage of the recipient's GDP (*U.S. Military Aid (% of GDP)*). Data are from U.S. Agency for International Development (2011). To test whether other major World Bank shareholders exert any influence, we also estimate models for the amount of bilateral aid from France, Japan, Germany, and the United Kingdom, respectively, as percentage of GDP. The results are similar to using interest measures based on UN affinity scores, so we only report the aid results here. The results for affinity scores with these donors are available upon request.

We include several additional explanatory variables in the estimations based on the insights provided by the empirical literature on IMF conditionality and on considerations specific to World Bank conditionality. First, we include a set of political variables into the estimations. We use the log of distance in miles between Washington, D.C. and the recipient's capital (*Distance*). We also include a dummy variable for the Cold War. *Cold War (Dummy)* takes the value of 1 for years prior to 1990, and 0 otherwise.<sup>21</sup> During the Cold War, the U.S. and the Soviet Union competed for recipient countries' support and loyalty. It is therefore very likely that the constraints of the bipolar international system created incentives for the U.S. to pressure the World Bank to reduce any conditionality during this period. The results also do not change if we instead analyze a model that excludes any recipient-year information before 1990 (results available upon request).

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<sup>20</sup> We obtained the data using EUGene, version 3.204.

<sup>21</sup> Using 1989 as alternative end for the Cold War does not change the findings.

Second, our main analysis takes into account important trends in World Bank project allocation and importance of conditionality. In our main models, we account for the total number of adjustment projects and for a time trend. In robustness checks, we also account for important events that might have caused structural shifts in the scope of conditionality, such as the Paris Declaration in 2005, or the Accra Agenda for Action in 2008. Since the time variable itself may not capture annual changes in the pressure and willingness to impose conditionality, we also estimate models that account for the total number of prior actions that the World Bank imposed on all recipients in a given year.

Whereas we try to keep our main model as parsimonious as possible, we conduct further robustness checks in order to test for the sensitivity of the main results. First, we control for whether the recipient government had a seat on the World Bank's Executive Board in the current year or past three years (*Seat on Executive Board*). Data are from Kilby (2009). Second, we include a dummy variable that takes the value of 1 if the recipient country had an IMF program, and 0 otherwise (*IMF Program [t-1]*). Third, we account for civil or interstate conflicts that take place on the recipient's territory. *Conflict (t-1)* takes the value of 1 if the recipient country experienced a conflict on its territory, and 0 otherwise.<sup>22</sup> Data are from PRIO. Fourth, we include the logged number of disaster deaths in a recipient country in order to control for changes in conditionality for countries that experience natural disasters (*Disaster Deaths [t-1]*). Fifth, we replace *Democracy*, a proxy measure of good governance, with indicators that gauge the quality of recipients' domestic institutions and policies more directly. We use data from the Governance Matters group that measures good governance on six dimensions (voice and accountability, political stability and absence of violence, government effectiveness, regulatory quality, rule of law, and control of corruption). We use the average score of these six dimensions to provide an alternative measure of good governance. Note, however, that the data are only available from 1996, and only every other year prior to 2001. Data are from the Governance Matters group. In addition, we replaced *Democracy* with a simple dummy for whether a recipient country is a democracy, using the value of 7 of the polity score as a cut-off point. Finally, as mentioned above, we provide estimation results that include the variables of theoretical interest (i.e., donors' strategic interests measured as bilateral aid flows and affinity scores) constructed for major shareholders, other than the U.S.: the United Kingdom, France, Japan, and Germany.

Table 1 presents descriptive statistics for all variables included in the main model specification.

Table 1: Descriptive Statistics

	Mean	SD	Minimum	Maximum
Number of Conditions	19.252	23.272	0	169
Democracy (t-1)	1.678	6.391	-9	10
Compliance (t-2)	65.408	36.649	0	100
U.S. Aid (% of GDP, t-1)	12.491	12.901	0	99.130
Log of Distance	8.532	0.447	7.262	9.229
Cold War (Dummy)	0.202	0.402	0	1
Board Voting Share	0.334	0.992	0	5.350
Current Account Balance (% of GDP, t-1)	-0.061	0.081	-0.513	0.181

<sup>22</sup> We also used variables for the intensity of the conflict without changing the findings.

Debt Service (% of GDP, t-1)	0.060	0.041	0.003	0.295
Trade Openness (t-1)	61.584	32.534	6.320	254.66
Government Consumption (% of GDP, t-1)	13.514	4.873	2.976	35.692
GDP Growth (t-1)	4.103	4.254	-20.085	27.462
P.C. GDP (t-1)	1340.079	1641.768	124.299	8211.662
Log of Population (t-1)	16.546	1.438	12.910	20.912
Adjustment Projects (#)	1.401	0.717	1	6
Executive Board	0.217	0.412	0	1
IMF Program (t-1)	9.72e+08	2.85e+09	0	2.83e+10
Conflict (t-1)	0.231	0.422	0	1
Disaster Deaths (log, t-1)	2.628	2.691	0	12.023
Total Prior Actions	765.425	274.286	152	1451
N	614			

## MODEL SPECIFICATION

We are interested in modeling the number of conditions that are imposed on recipient countries. Our main dependent variable is a count variable, ranging from 0 to 208. We use a negative binomial event count regression model to analyze the variation in the scope of World Bank conditionality. As discussed above, we include a time trend to control for structural changes in conditionality over time. We also assume that the errors are not independent within recipient countries, and therefore cluster the standard errors by recipient country in order to control for heteroscedasticity. The model that uses the average number of conditions per adjustment project uses ordinary least squares (OLS) regression as estimation model. In our sensitivity analysis, we provide the results of alternative model specifications. First, we provide results of models in which we assume the errors to be independent within recipient countries. Second, we estimate the main model including recipient fixed effects. Third, we include a lagged dependent variable to ensure that path dependency in conditionality does not drive the results. We also estimated a Cragg Double Hurdle model which estimates a logit regression in the first stage (whether conditionality was imposed or not), and a zero-truncated regression model to predict the stringency of conditions (greater than 0) in the second stage, and do not find that the results are significantly different. Results for the Cragg Double Hurdle model are available upon request.

## EMPIRICAL RESULTS

Tables 2 and 3 report the main results of our empirical analyses.<sup>23</sup> Table 2 presents estimation results with the dependent variable that counts the total number of conditions, as well as the total number of conditionality sectors and themes; a count of adjustment projects is included as a control. Table 3 presents estimation results with the dependent variable that is constructed as the average number of conditions per adjustment project; two additional specifications rely on dependent variables that are counts of conditionality sectors and themes, divided by the total number of

<sup>23</sup> All models are estimated with Stata 12.1. A replication package is available from the authors.



adjustment projects. Overall, the findings indicate that the scope of World Bank conditionality indeed seems to be the result of a bargaining process that takes into account World Bank and recipient state interests. In addition, there is only little evidence that the World Bank's ability to impose conditionality is compromised when major donors' interests are at stake.

Table 2: Determinants of World Bank Conditionality (Negative Binomial Models)

	Model 1: Conditions	Model 2: Sectors	Model 3: Themes
Democracy (t-1)	-0.01 (0.01)	-0.01 (0.01)	-0.01 (0.01)
Compliance (t-2)	0.00** (0.00)	0.00 (0.00)	0.00 (0.00)
US Aid (% of GDP, t-1)	0.00 (0.00)	0.01 (0.00)	0.01 (0.00)
Log of Distance	0.18* (0.11)	0.11 (0.10)	0.13 (0.08)
Cold War (Dummy)	-0.07 (0.18)	0.15 (0.15)	0.24 (0.16)
Board Voting Share	-0.10* (0.05)	-0.09* (0.05)	-0.05 (0.04)
Current Account Balance (% of GDP, t-1)	0.63 (0.54)	0.65 (0.50)	0.42 (0.44)
Debt Service (% of GDP, t-1)	-1.31 (1.20)	-1.30 (1.12)	-1.52 (1.08)
Trade Openness (t-1)	-0.00 (0.00)	-0.00 (0.00)	-0.00 (0.00)
Government Consumption (% of GDP, t-1)	0.00 (0.01)	0.01 (0.01)	0.01 (0.01)
GDP Growth (t-1)	-0.03** (0.01)	-0.02** (0.01)	-0.02** (0.01)
P.C. GDP (t-1)	0.00** (0.00)	0.00** (0.00)	0.00** (0.00)
Log of Population (t-1)	0.09** (0.04)	0.03 (0.04)	0.05 (0.04)
Time Trend	-0.04** (0.01)	0.00 (0.01)	0.01 (0.01)
Adjustment projects (#)	0.37** (0.07)	0.33** (0.06)	0.36** (0.06)
Constant	74.19** (18.53)	-4.48 (17.65)	-18.05 (19.10)
Observations	614	614	614
Log Likelihood	-2274.75	-1629.01	-1739.57
Wald Test	254.55	134.38	141.78

\* p<0.10, \*\* p<0.05

Standard errors in parentheses

Table 3: Determinants of World Bank Conditionality (OLS Models)

	Model 1: Conditions (avg)	Model 2: Sectors (avg)	Model 3: Themes (avg)
Democracy (t-1)	-0.15 (0.13)	-0.03 (0.03)	-0.05* (0.03)
Compliance (t-2)	0.05** (0.02)	0.00 (0.01)	0.01* (0.01)
US Aid (% of GDP, t-1)	0.07 (0.06)	0.02 (0.01)	0.03* (0.02)
Log of Distance	3.31** (1.55)	0.57* (0.33)	0.73** (0.34)
Cold War (Dummy)	0.95 (3.27)	0.78 (0.67)	1.42* (0.83)
Board Voting Share	-0.98 (0.82)	-0.27* (0.16)	-0.22 (0.19)
Current Account Balance (% of GDP, t-1)	6.78 (6.63)	2.38 (1.70)	1.95 (1.80)
Debt Service (% of GDP, t-1)	-17.60 (14.65)	-5.64 (3.97)	-8.15* (4.43)
Trade Openness (t-1)	-0.01 (0.02)	-0.01 (0.01)	-0.01 (0.01)
Government Consumption (% of GDP, t-1)	0.07 (0.11)	0.04 (0.03)	0.04 (0.04)
GDP Growth (t-1)	-0.46** (0.19)	-0.06 (0.04)	-0.07 (0.05)
P.C. GDP (t-1)	0.00** (0.00)	0.00** (0.00)	0.00** (0.00)
Log of Population (t-1)	1.10* (0.58)	-0.02 (0.14)	0.14 (0.17)
Time Trend	-0.41** (0.14)	0.01 (0.03)	0.04 (0.04)
Constant	784.13** (283.63)	-18.43 (64.24)	-80.98 (85.79)
Observations	614	614	614
Log Likelihood	-2586.77	-1696.74	-1789.88

\* p<0.10, \*\* p<0.05

Standard errors in parentheses

First, we find mixed evidence for the importance of past performance (Hypothesis 1). On one hand, GDP growth has the expected negative relationship with the number of conditions. In particular, a one percent increase in GDP growth decreases the expected number of conditions by 4.1. On the other hand, more affluent recipients, in terms of their per capita GDP, surprisingly, receive more conditions. This may indicate that these countries are simply more committed to

the implementation of reforms conducive to economic development. At the same time, good compliance with the conditions of previous aid agreements significantly *increases* the scope of conditionality. Looking at marginal effects (holding all other variables at their means), we find that a one percent rise in the share of compliant-rated projects increases the expected number of conditions by 65. This finding is counterintuitive since we would have expected that past compliance reduces the number of conditions in future projects. This result is likely due to the previously mentioned reliability issues: the World Bank experiences pressures not to punish non-compliant recipients when powerful members' interests are at stake, and the IEG has been shown to produce biased evaluations of recipients' project performance when powerful member countries exert informal influence (Schneider et al. 2013).

Second, other political and economic conditions at the domestic level are not significantly related to the scope of World Bank conditionality (Hypotheses 2 and 3). No measures of good governance produce statistically significant results in the expected direction, indicating that the World Bank does not take into account the quality of recipients' institutions or policies in its conditionality decisions. To test whether the insignificant effect of our main good governance variable is due to the operationalization, we re-estimated the main model using different measures of good governance, as described in the research design section. The findings are presented in Appendix A: neither of the alternative measures for good governance have a significant impact on the scope of World Bank conditionality. A recipient's vote share in the Executive Board reduces the scope of conditionality, but not to a large extent. A one percent increase in a recipient's vote share decreases the expected number of conditions by 0.3. Consistently with our expectation, more populous countries have to accept more conditions because they tend to have a greater need for assistance. None of the other economic indicators has a significant impact on the scope of World Bank conditionality.

Third, our main model indicates that U.S. strategic considerations do not matter for the scope of conditionality, which provides support for Hypothesis 4. The size of bilateral U.S. aid flows does not have any influence on the scope of World Bank conditionality. Given the existing findings about U.S. influence on IMF conditionality, this result is rather interesting and merits further analysis. In particular, we re-estimated the main model (Model 1) using a variety of alternative measures for U.S. influence that are commonly used in the literature. Table 4 presents the results for the alternative interest variables, omitting all other variables (full results are available upon request). The results show no robust relationship between U.S. interests and World Bank conditionality. Most operationalizations of U.S. interests lead to insignificant results. If we measure U.S. interests in terms of total bilateral U.S. aid (or whether the country is a U.S. aid recipient following Stone [2008]), we even find that U.S. aid recipients receive significantly more conditions than other countries. The only variables that indicate the expected relationship are *U.S. Alliance* and *U.S. Defense Pact*. That is, the existence of a formal alliance or defense pact with the U.S. significantly reduces the number of conditions that a country receives. These findings are particularly important as scholars have used different operationalizations for U.S. interests, oftentimes not taking into account that these may represent different dimensions of U.S. interests. In fact, the correlations between these variables are not very high. With the exception of U.S. affinity measures and U.S. alliance and defense pact measures, we find that correlations range from -0.075 to only 0.405. This raises an interesting question for future research: whereas scholars have often used different measures of strategic importance interchangeably, it seems that they may measure different dimensions of the concept.

Table 4: The Effect of U.S. Strategic Interests on World Bank Conditionality

U.S. Bilateral Aid (log, t-1)	0.01 (0.01)**
U.S. Aid Recipient (dummy, t-1)	0.25 (0.14)*
UN Affinity (s2un, t-1)	-0.03 (0.17)
UN Affinity (s3un, t-1)	-0.03 (0.21)
U.S. Friend (t-1)	0.01 (0.13)
U.S. Alliance (t-1)	-0.32 (0.18)*
U.S. Military Aid (log, t-1)	0.02 (0.03)
U.S. Military Aid (% of GDP, t-1)	0.05 (0.16)
U.S. Defense Pact	-0.32 (0.18)*
UK Bilateral Aid (% of GDP, t-1)	0.00 (0.00)
German Bilateral Aid (% of GDP, t-1)	0.00 (0.00)
Japanese Bilateral Aid (% of GDP, t-1)	0.00 (0.00)
French Bilateral Aid (% of GDP, t-1)	0.00 (0.00)

Note: Each row presents the coefficient for the interest variable from an independent estimation based on Model 1 in Table 2. All other variables are omitted.

Standard errors in parentheses

\*  $p < 0.10$ , \*\*  $p < 0.05$

The effect of major shareholders' strategic interests could also be conditional on recipients' assistance needs. Stone (2008) argues that the U.S. should only exert influence when strategically important recipient countries are economically vulnerable. We follow Stone (2008) and estimate models to analyze the effect of U.S. interests on the scope of World Bank conditionality for different levels of economic vulnerability. Economic vulnerability is measured using (i) trade openness, (ii) a recipient's debt service as percent of GDP, and (iii) a recipient's short-term debt as percent of total external debt. Figure 3 graphs the marginal effect of *U.S. Interest* with 90% confidence intervals for different levels of a recipient's debt service as percent of GDP. Importantly, the graph shows that the U.S. is not more likely to influence the scope of World Bank conditionality if strategically important recipient countries are economically vulnerable. The interactions models for the two alternative variables of economic vulnerability similarly yield insignificant effects, so we do not report them here (the results are available upon request). Importantly, this indicates that at least for the World Bank, the U.S. has no incentive to use its informal power to influence the scope of conditionality.

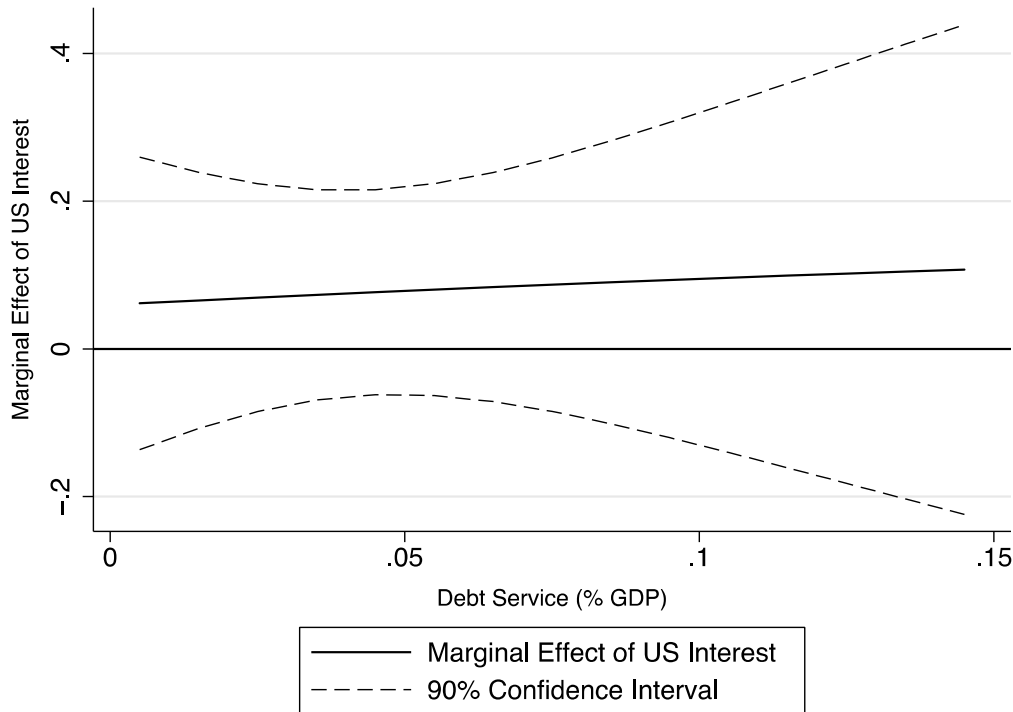


Figure 3: Marginal Effect of U.S. Interests For Different Levels of Economic Vulnerability

We also analyzed whether other major shareholders, particularly France, Germany, the United Kingdom, and Japan, exert any influence on the scope of World Bank conditionality. We use their lagged bilateral aid as percent of recipients' GDP to measure interests in the models of conditionality; the results are the same if we use UN affinity measures instead. Table 4 presents the coefficient for each of the four models, respectively, omitting all other regressors (full results upon request). Again, we do not find any significant influence of major shareholders' strategic interests on the scope of World Bank conditionality.

Whereas there is no robust relationship between major shareholder interests and World Bank conditionality, we do find a significant influence of distance from Washington, D.C., as shown in Table 3 and Model 1 of Table 2. A one unit increase in the distance to Washington D.C. expectedly increases the number of conditions by 8.5. The Cold War, however, had no influence on the number of conditions that recipient countries accepted. Finally, and as expected, countries receive more conditions the more adjustment projects they receive in the first place. In addition, conditionality has become less stringent over time. More recent projects have been attached with significantly fewer conditions than past projects. Descriptively, there is a clear trend toward less conditionality over time: in 1990, on average an adjustment project received 21 conditions; in 2000, 17; and in 2010, just 10. All other economic and political variables do not have any significant effect on the scope of World Bank conditionality. These results are very similar to what Dreher (2004) finds for the IMF.

Since empirical results are oftentimes fragile to different model specifications, we estimated a number of models with additional independent variables and alternative model specifications. The findings are presented in Appendix B. Model 1 unpacks the time dimension a little by replacing the time trend variable with two dummy variables indicating the time from (i) the Paris

Declaration on Aid Effectiveness in 2005, and (ii) the Accra Agenda for Action in 2008. These international agreements reflect donor governments' efforts to increase aid effectiveness through greater recipient country ownership. One specific target of these agreements was conditionality; hence, we expect the use of conditionality to decline after the adoption of the Paris Declaration and the Accra Agenda for Action. The findings indicate that, as expected, the adoption of each agreement is associated with significant reductions in the scope of World Bank conditionality. Model 2 adds a lagged dependent variable (LDV) to the model, which does not significantly affect current conditionality. Model 3 adds more control variables. The only variables that are significant are *IMF Program* and *Number of Prior Actions*. Both have a positive effect on the scope of conditionality. Finally, the results do not change substantially if we include recipient fixed effects (Model 4) or if we use the number of benchmarks as our dependent variable measuring conditionality (Model 5).

## CONCLUSION

What are the determinants of World Bank conditionality? We argue that the World Bank uses conditionality as an instrument to increase aid effectiveness and sets the extent of conditionality through bargaining with recipient countries. Importantly, the World Bank is largely autonomous from major shareholders at this stage of the aid delivery process. We find moderate empirical support for the conceptualization of conditionality imposition as a bargaining process. Also, most operationalizations of important shareholders' strategic interests fail to produce any robust evidence of informal pressures on the agency to reduce the number of conditions. Whereas our paper builds on valuable theoretical insights of the existing literature on World Bank conditionality, we provide the first direct empirical analysis of World Bank conditionality. In doing so, we identify the limits of informal governance: despite their ability to exert informal influence, powerful shareholders choose not to bias World Bank conditionality in favor of strategically important recipients.

Our argument and empirical findings have interesting implications for the study of aid conditionality and interactions of the World Bank, on the one hand, and donor and recipient countries, on the other. While the previous research has centered primarily on the issue of weak enforcement of World Bank conditionality and, as a result, the organization's underwhelming performance in promoting economic development in recipient countries, our study is the first to offer an empirical examination of conditionality imposition. More broadly, our findings have important implications for the delegation relationship between donor countries and MAIs: delegation levels can vary within the same MAI across different decision-making areas. MAIs may enjoy various levels of autonomy and face different levels of informal pressure throughout the aid delivery cycle. Also, major shareholders' non-intervention in conditionality negotiations clearly leaves the possibility of powerful members' enforcement-stage interventions on behalf of important recipients open. This possibility, in turn, generates bargaining leverage for powerful members over recipient countries; such bargaining leverage can then be utilized in linkage politics to get desired outcomes in other issue areas.

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## APPENDIX

Table A1: Governance and World Bank Conditionality

	Model 1: Governance	Model 2: Polity Dummy	Model 3: ICRG
Compliance (t-2)	0.00 (0.00)	0.00* (0.00)	0.00 (0.00)
US Aid (% of GDP, t-1)	-0.00 (0.01)	0.00 (0.00)	0.01 (0.01)
Log of Distance	0.25** (0.12)	0.18* (0.11)	0.14 (0.11)
Cold War (Dummy)		-0.09 (0.17)	-0.05 (0.20)
Board Voting Share	-0.13** (0.06)	-0.10* (0.05)	-0.10* (0.05)
Current Account Balance (% of GDP, t-1)	0.32 (0.64)	0.51 (0.56)	0.77 (0.73)
Debt Service (% of GDP, t-1)	-1.34 (1.41)	-1.41 (1.21)	-2.42 (1.64)
Trade Openness (t-1)	-0.00 (0.00)	-0.00 (0.00)	-0.00 (0.00)
Government Consumption (% of GDP, t-1)	0.01 (0.01)	0.01 (0.01)	0.02* (0.01)
GDP Growth (t-1)	-0.03** (0.01)	-0.03** (0.01)	-0.03** (0.01)
P.C. GDP (t-1)	0.00** (0.00)	0.00** (0.00)	0.00** (0.00)
Log of Population (t-1)	0.05 (0.06)	0.09** (0.04)	0.11** (0.05)
Time Trend	-0.04** (0.02)	-0.04** (0.01)	-0.04** (0.01)
Adjustment projects (#)	0.43** (0.08)	0.38** (0.07)	0.38** (0.07)
Avg. Governance (t-1)	0.03 (0.17)		
Democracy (dummy, t-1)		-0.05 (0.10)	
Good Governance (t-1)			-0.01 (0.01)
Constant	88.78** (30.05)	80.38** (17.53)	85.76** (22.15)
Observations	386	624	507
Log Likelihood	-1379.03	-2312.92	-1899.98
Wald Test	191.62	239.15	254.42

\* p&lt;0.10, \*\* p&lt;0.05

Standard errors in parentheses

Table A2: Determinants of World Bank Conditions

	Model 1: Reforms	Model 2: LDV	Model 3: Controls	Model 4: Recipient FE	Model 5: Benchmarks
Democracy (t-1)	-0.01* (0.01)	-0.00 (0.01)	-0.01 (0.01)	-0.01 (0.01)	-0.03** (0.01)
Compliance (t-2)	0.00* (0.00)	0.00* (0.00)	0.00 (0.00)	0.00* (0.00)	-0.00 (0.00)
US Aid (% of GDP, t-1)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.01** (0.01)
Log of Distance	0.14 (0.11)	0.16 (0.11)	0.08 (0.11)	0.11 (0.10)	0.23 (0.24)
Cold War (Dummy)	0.25* (0.15)	-0.08 (0.19)	0.32 (0.22)	3.64 (6.65)	1.12** (0.24)
Board Voting Share	-0.09 (0.06)	-0.09 (0.05)	-0.11* (0.07)	-0.12** (0.05)	-0.07 (0.08)
Current Account Balance (% of GDP, t-1)	0.39 (0.52)	0.56 (0.59)	0.76 (0.54)	0.33 (0.55)	0.88 (0.94)
Debt Service (% of GDP, t-1)	-1.13 (1.19)	-1.38 (1.15)	-2.79** (1.29)	-2.63** (1.25)	-2.45 (2.04)
Trade Openness (t-1)	-0.00 (0.00)	-0.00 (0.00)	-0.00 (0.00)	-0.00 (0.00)	-0.00 (0.00)
Government Consumption (% of GDP, t-1)	0.00 (0.01)	0.00 (0.01)	0.00 (0.01)	0.01 (0.01)	0.02 (0.02)
GDP Growth (t-1)	-0.03** (0.01)	-0.03** (0.01)	-0.02** (0.01)	-0.03** (0.01)	-0.05** (0.01)
P.C. GDP (t-1)	0.00** (0.00)	0.00** (0.00)	0.00** (0.00)	0.00** (0.00)	0.00 (0.00)
Log of Population (t-1)	0.09** (0.04)	0.08* (0.04)	0.10** (0.05)	0.08* (0.04)	0.02 (0.07)
Adjustment projects (#)	0.38** (0.07)	0.36** (0.07)	0.37** (0.07)	0.43** (0.07)	0.34** (0.13)
Paris Declaration (2005)	-0.32** (0.12)				
Accra Agenda for Action (2008)	-0.23* (0.14)				
LDV		0.00 (0.00)			
Time Trend		-0.04** (0.01)	-0.01 (0.01)	0.14 (0.25)	0.08** (0.02)
Executive Board (Dummy)			0.12 (0.14)		
IMF Program (t-1)			0.00** (0.00)		
Conflict (t-1)			-0.17 (0.12)		
Log of Disaster Deaths (t-1)			-0.02 (0.02)		
Number of Prior Actions			0.00** (0.00)		
Constant	-0.33 (1.16)	78.21** (18.45)	26.24 (21.01)	-290.36 (498.89)	-154.36** (36.90)
Observations	614	585	614	614	614
Log Likelihood	-2275.21	-2177.16	-2265.21	-2261.06	-1794.08

\* p<0.10, \*\* p<0.05

Standard errors in parentheses

Table A3: Determinants of World Bank Conditions (Sectors and Themes)

	Model 1 Reforms	Model 2 LDV	Model 3 Controls	Model 4 Recipient FE	Model 5 Reforms	Model 6 LDV	Model 7 Controls	Model 8 Recipient FE
	<i>Conditionality sectors</i>				<i>Conditionality themes</i>			
Democracy (t-1)	-0.01 (0.01)	-0.00 (0.01)	-0.00 (0.01)	-0.00 (0.01)	-0.01 (0.01)	-0.01 (0.01)	-0.01 (0.01)	-0.01 (0.01)
Compliance (t-2)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00* (0.00)	0.00 (0.00)	0.00 (0.00)	0.00** (0.00)
US Aid (% of GDP, t-1)	0.01 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.01* (0.00)	0.01 (0.00)	0.00 (0.00)	0.00 (0.00)
Log of Distance	0.13 (0.10)	0.11 (0.10)	0.04 (0.10)	0.09 (0.10)	0.15* (0.08)	0.11 (0.08)	0.06 (0.09)	0.13 (0.08)
Cold War (Dummy)	0.15 (0.12)	0.15 (0.16)	0.43** (0.17)	6.90 (6.12)	0.19 (0.12)	0.24 (0.17)	0.48** (0.18)	-1.87 (5.99)
Board Voting Share	-0.09* (0.05)	-0.08 (0.05)	-0.11** (0.06)	-0.11** (0.04)	-0.05 (0.04)	-0.04 (0.04)	-0.08 (0.05)	-0.07 (0.04)
Current Account Balance (% of GDP, t-1)	0.52 (0.49)	0.53 (0.55)	0.69 (0.48)	0.40 (0.47)	0.32 (0.42)	0.26 (0.49)	0.42 (0.43)	0.14 (0.46)
Debt Service (% of GDP, t-1)	-1.20 (1.12)	-1.25 (1.10)	-2.23* (1.20)	-2.41** (1.21)	-1.47 (1.06)	-1.52 (1.05)	-2.31** (1.17)	-2.47** (1.14)
Trade Openness (t-1)	-0.00 (0.00)	-0.00 (0.00)	-0.00 (0.00)	-0.00 (0.00)	-0.00 (0.00)	-0.00 (0.00)	-0.00 (0.00)	-0.00 (0.00)
Govt Consumption (% of GDP, t-1)	0.01 (0.01)	0.01 (0.01)	0.01 (0.01)	0.01 (0.01)	0.01 (0.01)	0.01 (0.01)	0.01 (0.01)	0.01 (0.01)
GDP Growth (t-1)	-0.02** (0.01)	-0.02** (0.01)	-0.02* (0.01)	-0.02** (0.01)	-0.02** (0.01)	-0.02** (0.01)	-0.01 (0.01)	-0.02** (0.01)
P.C. GDP (t-1)	0.00** (0.00)	0.00** (0.00)	0.00 (0.00)	0.00** (0.00)	0.00** (0.00)	0.00** (0.00)	0.00 (0.00)	0.00** (0.00)
Log of Population (t-1)	0.03 (0.04)	0.01 (0.04)	0.05 (0.05)	0.02 (0.04)	0.05 (0.04)	0.04 (0.04)	0.07 (0.04)	0.04 (0.04)
Adjustment projects (#)	0.33** (0.06)	0.31** (0.06)	0.33** (0.06)	0.38** (0.06)	0.36** (0.06)	0.35** (0.06)	0.35** (0.06)	0.40** (0.06)
Paris Declaration (2005)	0.18* (0.10)				0.27** (0.11)			
Accra Agenda (2008)	-0.27* (0.15)				-0.26* (0.14)			
LDV		0.00 (0.01)				-0.00 (0.01)		
Time Trend		0.00 (0.01)	0.02* (0.01)	0.26 (0.23)		0.01 (0.01)	0.02** (0.01)	-0.06 (0.22)
Executive Board (Dummy)			0.09 (0.11)				0.14 (0.11)	
IMF Program (t-1)			0.00** (0.00)				0.00** (0.00)	
Conflict (t-1)			-0.17* (0.10)				-0.18** (0.09)	
Log of Disaster Deaths (t-1)			-0.03 (0.02)				-0.02 (0.02)	
Number of Prior Actions			0.00** (0.00)				0.00** (0.00)	
Constant	-0.55 (1.21)	-5.49 (17.81)	-32.51* (19.11)	-532.37 (459.89)	-1.00 (1.07)	-19.93 (19.49)	-42.86** (20.50)	123.73 (447.82)
Observations	614	585	614	614	614	585	614	614
Log Likelihood	-1628.06	-1558.24	-1621.55	-1613.49	-1738.28	-1667.45	-1733.78	-1725.24

\* p&lt;0.10, \*\* p&lt;0.05

Standard errors in parentheses

Table A4: Determinants of World Bank Conditions (Heckman Selection Models)

	Model 1: Prior Actions (avg)	Model 2: Sectors (avg)	Model 3: Themes (avg)
<i>Outcome (conditionality) stage</i>			
Democracy (t-1)	-0.16 (0.13)	-0.03 (0.03)	-0.05* (0.03)
Compliance (t-2)	0.05** (0.02)	0.00 (0.00)	0.01* (0.01)
US Aid (% of GDP, t-1)	0.06 (0.06)	0.02 (0.01)	0.03 (0.02)
Log of Distance	3.50** (1.58)	0.63* (0.35)	0.78** (0.36)
Cold War (Dummy)	0.94 (3.19)	0.77 (0.65)	1.42* (0.81)
Board Voting Share	-1.06 (0.83)	-0.30* (0.16)	-0.24 (0.20)
Current Account Balance (% of GDP, t-1)	8.45 (6.67)	2.97 (1.81)	2.42 (1.93)
Debt Service (% of GDP, t-1)	-18.86 (14.62)	-6.06 (3.95)	-8.57* (4.42)
Trade Openness (t-1)	-0.01 (0.02)	-0.01 (0.01)	-0.01 (0.01)
Government Consumption (% of GDP, t-1)	0.07 (0.11)	0.04 (0.03)	0.05 (0.03)
GDP Growth (t-1)	-0.47** (0.19)	-0.07* (0.04)	-0.08 (0.05)
P.C. GDP (t-1)	0.00** (0.00)	0.00** (0.00)	0.00** (0.00)
Log of Population (t-1)	0.98* (0.57)	-0.07 (0.14)	0.10 (0.17)
Time Trend	-0.42** (0.14)	0.01 (0.03)	0.04 (0.04)
Constant	801.92** (283.35)	-12.34 (64.53)	-76.46 (86.02)
<i>Selection stage (entering into an adjustment project)</i>			
Democracy (t-1)	-0.00 (0.01)	-0.00 (0.01)	-0.00 (0.01)
Log of US Aid (t-1)	0.04** (0.01)	0.04** (0.01)	0.04** (0.01)
UN Affinity (s2un, t-1)	0.35* (0.19)	0.33* (0.19)	0.33* (0.20)
Log of Distance	-0.08 (0.14)	-0.08 (0.14)	-0.08 (0.14)
Cold War (Dummy)	0.07 (0.13)	0.06 (0.14)	0.06 (0.14)
Board Voting Share	0.08* (0.04)	0.08* (0.04)	0.08* (0.04)
Current Account Balance (% of GDP, t-1)	-1.38** (0.39)	-1.39** (0.39)	-1.39** (0.39)
Debt Service (% of GDP, t-1)	0.69 (0.91)	0.69 (0.91)	0.69 (0.91)
GDP Growth (t-1)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)
P.C. GDP (t-1)	-0.00 (0.00)	-0.00 (0.00)	-0.00 (0.00)
Time Trend	0.01 (0.01)	0.01 (0.01)	0.01 (0.01)
Constant	-17.54	-16.94	-17.05

	(15.74)	(15.84)	(15.81)
athrho	-0.13*	-0.19**	-0.14
	(0.08)	(0.09)	(0.12)
Observations	2,209	2,209	2,209
Log Likelihood	-3819.97	-2933.50	-3026.23
Wald Test	141.98	63.36	89.41

\* p<0.10, \*\* p<0.05

Standard errors in parentheses