

Diffusing Risk: Bureaucratic Agency, UN Security Council Horse-Trading, and the Role of Co-Financing

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Abstract

Political lending is problematic for the operations of multilateral development banks (MDBs) since politically motivated aid has a greater default risk than other aid projects. Bureaucrats at MDBs, therefore, face a dilemma. On the one hand, they want to please major shareholders by engaging in political lending. On the other hand, they want to mitigate their MDB's exposure to excessive risk. One way to solve this dilemma is to share the risk of loans with other lenders through co-financing. I expect that as countries' share of politically motivated aid increases, these countries' portfolios will include more co-financed loans. Using newly collected loan-level data from the European Bank for Reconstruction and Development, I find that the proportion of co-financing in countries' loan portfolios increases by 19 percentage points when countries join the UN Security Council (UNSC). I attribute this effect to an increase in risky loans given to UNSC members.

Key words: Co-Financing, UN Security Council, Political Lending, European Bank for Reconstruction and Development, International Bureaucrats

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1 Introduction

Powerful states use international organizations as vessels for their “dirty work” (Vreeland 2019). This hijacking of international institutions is well-documented in the realm of foreign aid. Multiple studies show that countries that are politically important to powerful states receive more loans with fewer conditions and face less stringent enforcement from multilateral development banks (MDBs) than less politically salient countries (e.g. Thacker 1999; Stone 2008; Dreher, Sturm, and Vreeland 2009a; Clark and Dolan 2021). Powerful states use their informal influence within MDBs to pressure these institutions into treating certain countries more favorably to extract policy concessions from recipient states (Stone 2011; Bueno de Mesquita and Smith 2009). One of the most prominent examples of this dynamic is horse-trading in the United Nations Security Council (UNSC). There is strong empirical evidence that major powers, such as the US, exploit their influence in MDBs to provide aid to temporary UNSC members in return for their votes in the UNSC (Vreeland and Dreher 2014; Lim and Vreeland 2013; Alexander and Rooney 2019).

While channeling politically motivated aid through MDBs has many advantages for donors, it creates a dilemma for bureaucrats in MDBs. On the one hand, their careers depend on the support from donors. Thus, pleasing their major shareholders by implementing the donors’ preferred policies and resource allocations will secure their position within the MDB (Clark and Dolan 2021; Clark 2021). On the other hand, MDBs rely on international capital markets to raise new capital which means that they need to have sound business practices (Delikanli, Dimitrov, and Agolli 2018). Projects that are solely approved because of political reasons have worse outcomes than projects selected based on their merits (Kilby and Dreher 2010; Dreher et al. 2013; Dreher, Eichenauer, and Gehring 2018). This can increase the risk of default of these projects. Thus, by pleasing donors, bureaucrats increase the MDBs’ exposure to riskier loans, which could undermine an MDB’s credit rating and its reputation as an effective lender. This could potentially also derail the careers of bureaucrats. How do MDB bureaucrats deal with this dilemma?

I argue that MDB bureaucrats use loan design features to alleviate the risks of politically motivated loans for an MDB’s operations. Most of the existing work describes loan design features,

such as loan conditionality, as instruments to reward recipients (Clark and Dolan 2021; Hernandez 2017; Stone 2008). However, there are design features that are in the control of bureaucrats and are more likely to reflect bureaucrats' preferences (Winters and Streitfeld 2018; Iannantuoni, Waeiss, and Winters 2021). One of these features is co-financing, which is the inclusion of third-party financiers into an aid package. Co-financing is a ubiquitous feature in the operations of MDBs (see Winters 2019; Kotchen and Negi 2019). For instance, 40% of all loans by the Asian Development Bank in 2018 included co-financing (Asian Development Bank 2019). Existing work emphasizes that co-financing is an instrument to mobilize private capital (Buntaine and Pizer 2015) and to mitigate political risk for companies (Hainz and Kleimeier 2012). I propose a third function of co-financing. It is an instrument for bureaucrats to deal with the political lending dilemma. It allows bureaucrats to share the burden of risky loans across several lenders. This means that a bureaucrat's MDB will not be liable for the whole aid package if the borrower defaults.

An implication of this argument is that a country's share of co-financed loans in its loan portfolio should increase after joining the UNSC. UNSC members are politically important countries and thus likely to receive more politically motivated loans.¹ To compensate for this increase in risk exposure, bureaucrats will try to seek co-financing for these risky loans given to UNSC members. It is important to note that I expect that MDB bureaucrats will only use co-financing to spread the risks of loans in situations where their MDB is exposed to high-risk projects. The reason is that co-financing comes with significant costs that are only acceptable when dealing with risky projects. There is a collective action problem that can minimize the effectiveness of aid projects (Winters 2019) and impose more coordination costs on bureaucrats. In addition, co-financiers may introduce loan conditions that MDBs and borrowers are not willing to accept (Gould 2003).

I test the argument in the context of the European Bank for Reconstruction and Development (EBRD). The EBRD is a ideal case since the bank commonly uses co-financing in its loans and its major shareholders consist of three permanent UNSC members (the US, the UK, and France),

1. I am agnostic about the mechanism that causes an increase in politically motivated loans. It can be top-down political pressure, higher bargaining power of UNSC members, implicit biases of bureaucrats to treat UNSC members differently, or combination of them. Each of these mechanisms should lead to disbursement of loans that are not picked based on merits but based on political preferences.

which could further incentivize bureaucrats to treat UNSC members preferentially. Since there is no existing data set on EBRD loans, I scraped all EBRD loans from 1996 to 2018 from the EBRD website and identified whether these loans are co-financed. For the empirical test, I aggregated the loan-level information into country-year panel data and calculated a country's share of loans that are co-financed in a given year.²

The main findings support the co-financing hypothesis. I find that UNSC membership increases the share of co-financed loans by approximately 19 percentage points. This is approximately a 50% increase in the share of co-financing compared to the sample mean. These results are robust to alternative estimation methods. I further show that increased risk exposure is the main causal mechanism by which UNSC membership leads to a higher share of co-financing. I measure risk exposure with three different measures: 1) risky assets in the EBRD's balance sheets, 2) share of energy projects, and 3) share of private loans. I found that UNSC membership is positively correlated with each of these variables, which implies that UNSC members receive riskier projects than non-UNSC members. Furthermore, the increase in co-financing is only observable among these risky loans. This supports the idea that co-financing is an instrument for bureaucrats to reduce the risks of political lending for their MDBs.

This paper sheds light on the link between great power politics (Stone 2011) and bureaucratic agency (Barnett and Finnemore 2004; Johnson 2014) to explain the operations of international organizations. Existing work perceives great power politics and bureaucratic agency as two distinct theories. Recent work has softened the distinction between these two approaches by suggesting that bureaucrats in international organizations have implicit biases that cause them to follow the positions of their major shareholders (Clark and Dolan 2021; Clark 2021). I advance this line of reasoning by underscoring that bureaucrats in international organizations implement policies to compensate for the negative effects of great power interests on an international organization's operations. This implies that we cannot understand the actions of international bureaucrats without also considering the power politics within an international organization.

2. To calculate this ratio, I used the number of loans as well as the value of the loans.

In addition, I provide a new perspective on political lending. It is usually assumed that political lending materializes through loan volumes, conditionality, and enforcement (Vreeland and Dreher 2014; Stone 2008; Copelovitch 2010). I show that another form of political lending is to alter the loan portfolio of recipient states. In the context of the EBRD, UNSC members receive on average riskier projects that are likely not approved if the country was not holding a temporary seat in the UNSC. This suggests that we need to pay greater attention to the types of loans when studying political lending.

The findings in this paper further advance the study on co-financing. Co-financing has been a largely understudied phenomenon in political science. The literature discusses co-financing mostly as a mechanism to mobilize additional private investment (e.g. Gurara, Presbitero, and Sarmiento 2020) and as a way for companies to minimize their political risk in a host country (Hainz and Kleimeier 2012). I present an alternative function of co-financing, which is to disburse risk for lenders. In that sense, MDBs' use of co-financing can unlock new profit opportunities for lenders since it allows MDBs to promote projects that have big potential but also come with more risks.

Lastly, I contribute the study of international organizations other than the World Bank and the International Monetary Fund (IMF). This study is one of only a few that evaluates political lending in the EBRD. Furthermore, my newly collected loan-level data of all EBRD loans from 1996 to 2018 will open up new research that tests existing and new hypotheses in the context of the EBRD.

2 Political Lending and Bureaucrats' Dilemma

International organizations should foster cooperation among states. However, in many cases, powerful states “hijack” international organizations to advance their own political goals (Vreeland 2019). This means that a powerful state can take advantage of its control over an organization by pressuring an international organization to implement policies that only benefit this state and not the other members. International organizations possess several features that make them appealing objects for this. International organizations are autonomous institutions that provide states with op-

opportunities to deflect blame for policies that the public perceives as undesirable (Abbott and Snidal 1998). The activities of international organizations are also not that visible to domestic audiences of member states (Dreher et al. 2022). Politics at international organizations are further removed from the domestic arena and often happen behind closed doors. This makes it harder for domestic audiences to detect any suspicious activities. Furthermore, by using the resources of international organizations, states can share the costs with other states (Vreeland and Dreher 2014).

One issue area where the hijacking of international organizations by powerful states is very common is foreign aid. Among other functions, foreign aid is a policy instrument for states to extract policy concessions from recipient states that advance the geo-strategic interests of donor states (Bueno de Mesquita and Smith 2009). Several studies have shown that MDBs treat recipients that are politically relevant to their major shareholders more favorably. These recipient states receive more money from MDBs (Kilby 2013a; Thacker 1999), enjoy fewer conditions on their loans (Clark and Dolan 2021; Copelovitch 2010; Dreher and Jensen 2007; Stone 2008), and face less stringent enforcement of these loan conditions (Stone 2004). The main explanation for these results is that powerful states yield their power in an MDB to shape lending decisions (Stone 2011).

There is also evidence that powerful states exploit MDBs to buy votes in the UNSC (e.g. Dreher, Sturm, and Vreeland 2009a; Kuziemko and Werker 2006; Vreeland and Dreher 2014). Given the political salience of issues discussed in the UNSC and the need of a majority to pass a UNSC resolution, scholars have argued that major powers engage in horse-trading with temporary members³, where they offer aid in return for a temporary member's vote. In their seminal book, Vreeland and Dreher (2014) show that temporary UNSC membership causes higher inflows of multilateral aid. Multiple studies report results consistent with the horse-trading idea (e.g. Alexander and Rooney 2019; Dreher et al. 2022; Lim and Vreeland 2013).

Politically motivated lending, however, comes at a cost for MDBs. Loans disbursed for political reasons expose MDBs to greater credit risk compared to loans that are not subject to political considerations. The reason for this is that these politically motivated loans tend to perform worse

3. I will use temporary and non-permanent interchangeably throughout this article.

than regular loans.⁴ Aid packages designated for political lending may not undergo a stringent review process, which can lead to the selection of poorly designed projects (Dreher et al. 2013). Recipients and MDBs may also not put the same amount of care into the design and implementation of politically motivated aid projects since they know it is only for rent-seeking purposes (Kilby 2015). Furthermore, political lending contributes to aid business cycles (Faye and Niehaus 2012), which could help incompetent politicians to stay in power. Foreign aid disbursed to a country during its time at the UNSC has also been found to reduce economic growth (Bueno de Mesquita and Smith 2010; Dreher, Eichenauer, and Gehring 2018). This performance mechanism suggests that the risk of default is higher for politically motivated projects since these projects will likely not generate the income needed to pay back the loans.

A good example of this dynamic is Sri Lanka. As part of the Belt and Road Initiative (BRI), China financed the construction of a new business hub in Hambantota, Sri Lanka's president Mahinda Rajapaksa's rural home region in the south of the country.⁵ This involved the construction of a new deep sea port, international airport, and highway. Even though the project has some economic rationale, there was a clear political motive behind the location of the loan since it was placed in the president's home region. Furthermore, China's BRI projects often have a political rationale to strengthen China's position in the world (Clarke 2018). The results of the Hambantota development enterprise were disastrous for the country. Due to the poor geographic location, the port and the airport are white elephants. Furthermore, Sri Lanka had to hand over the operations of the port to Chinese companies because they were no longer able to pay the interests on the loans. This highlights how politically motivated aid can derail the ability of recipients to pay back their loans and increase the risk for MDBs.

This aspect of political lending is potentially problematic for MDBs since it could undermine their operations. Political lending poses a threat to an MDB's financing of new aid projects. To

4. Another reason for an increase in credit risk could be that politically motivated aid is more likely to be granted to borrowers with high credit-risk. There is less evidence for this, but Landry and Portelance (2021) find that Chinese aid is more likely to be allocated to countries with lower creditworthiness.

5. <https://www.forbes.com/sites/wadeshepard/2016/05/28/the-story-behind-the-worlds-emptiest-international-air-port-sri-lankas-mattala-rajapaksa/?sh=7051a9d97cea> (last accessed July 21, 2022).

finance their operations, MDBs rely on their earnings from the interests of loans and the international capital market (Delikanli, Dimitrov, and Agolli 2018). An increase in political lending reduces the capital MDBs can raise from these two sources. It decreases the earning potential of loans since politically motivated loans are less likely to be enforced (Stone 2004) and may be more likely to default. In addition, it makes it harder to collect money from the international capital market since political lending increases the share of risky loans in the MDB's loan portfolio, which could worsen an MDB's credit rating. Furthermore, political lending could also taint an MDB's reputation and credibility. If recipient states observe that many projects do not perform well because they were disbursed for political reasons, then they may prefer other funding sources that provide more effective aid projects (Humphrey and Michaelowa 2013).

This effect of political lending on the operations of MDBs creates a dilemma for MDB bureaucrats. On the one hand, they want to appease their powerful shareholders. On the other hand, they need to assure that the loan portfolio they manage does not include too many risky loans. Recent work demonstrates that career concerns of MDB bureaucrats and implicit bias can explain the presence of political lending (Clark and Dolan 2021). By providing more loans to states that are valuable to powerful donors, bureaucrats can signal their preference alignment and thus increase their chances of rising up in the ranks. However, acting in the interests of major donors is not the only way bureaucrats can advance their careers. Job performance matters as well (Bertrand et al. 2020). If bureaucrats oversee a portfolio of projects that does not perform well and leads to financial losses for the MDB, they are likely not considered candidates for higher managing positions.

For bureaucrats in MDBs, political lending is therefore a delicate balance act between showing allegiance to donors and maintaining a balanced loan portfolio that does not include too many risky loans. If bureaucrats decide to support as many politically motivated loans as possible, they can put themselves in the good graces of political appointees of major powers in an MDB. At same time, they will likely suffer internal repercussions from approving too many questionable projects. Bureaucrats who play it by the book and only select projects based on their merits will face the

opposite problem. Internally, they may be respected as high-quality employees. However, they will face political opposition since major powers want to have bureaucrats in high-level positions that they know will represent their interests. This highlights that bureaucrats need to find a middle ground in their approach to political lending. In the following sections, I discuss one approach to how bureaucrats can overcome this dilemma: co-financing.

3 Aid Design, Political Lending, and UNSC Membership

Bureaucrats have significant discretion in shaping policies at MDBs (e.g. Barnett and Finnemore 2004; Johnson 2014). This also holds for the design of aid packages. While some scholars argue that the design of aid packages is the result of a bargaining outcome between recipient and donor states (Buono de Mesquita and Smith 2009; Bayer, Marcoux, and Urpelainen 2015; Vreeland and Dreher 2014), there is evidence that bureaucrats have a major role in designing aid packages. Sharma (2013) documents that structural adjustment loans at the World Bank were an internal innovation driven by bureaucrats' dissatisfaction with the World Bank's operations. Similarly, studies show that the financing structures of aid packages closely align with the preferences of bureaucrats and not with the preferences of major donors (Winters and Streitfeld 2018; Iannantuoni, Waeiss, and Winters 2021).

Due to bureaucrats' control over certain aid design features, I argue that aid design is one way bureaucrats at MDBs can reign in the risks associated with political lending. A specific aid design instrument that can deal with this risk is co-financing. *Co-financing* is "the joint or parallel financing of programs or projects through loans or grants to developing economies provided by commercial banks, export credit agencies, other official institutions in association with other agencies or banks, or the World Bank and other multilateral financial institutions" (International Monetary Fund 2014, p. 225). It is important to distinguish co-financing from counter-part financing (Winters and Streitfeld 2018). Counter-part financing refers to the share of a loan that a borrower needs to finance by itself. Counter-part financing is usually included to reduce the com-

mitment problem by the borrower (Winters and Streitfeld 2018). In contrast, co-financing is a loan or aid package that includes a contribution by a third party. This third party can be a private or public financier.⁶

Co-financing is a common type of loan design in development finance. In 2018, approximately 40% (or \$14 billion) of the total volume of the Asian Development Bank's operations of \$35.82 billion was co-financed (Asian Development Bank 2019). Co-financing is also an important source of funding in the field of climate finance. Based on a joint report by six major MDBs, \$68 billion of the \$111.2 billion that these MDBs spent on climate related projects came from co-lenders (European Bank for Reconstruction and Development et al. 2019). There are also no issue area restrictions with co-financing. A 2018 report by the World Bank (2018) illustrates that more than half of the resources from co-financing are invested in non-infrastructure related projects in low- and middle-income countries.

Existing work assigns co-financing two main roles. First, it is an instrument to raise more private capital to fight important problems, such as climate change (Buntaine and Pizer 2015). This is reflected in the pledge by nine MDBs expressed in the "High Level MDB Statement" from 2019 to commit to more co-financing to mobilize \$40 billion in private investment for projects that aim to mitigate climate change.⁷ Second, companies seek co-financing from MDBs because it reduces the risks for their projects (Hainz and Kleimeier 2012). The involvement of MDBs assures companies that operate in risky environments that their projects are safe due to the political umbrella of MDBs.

I propose that co-financing serves a third function. For MDB bureaucrats, co-financing is an instrument to deal with the political lending dilemma since it spreads the risk of an aid package across multiple lenders. This implies that if a borrower defaults, the loss is shared by multiple actors and not only by the MDB. There are two modes through which co-financing is implemented: joint

6. There are no comprehensive data that describes the most active co-financiers with MDBs. It varies by MDBs. In the case of the EBRD, it is often commercial banks that finance a part of a project. This is because the EBRD provides many loans to private firms. In the World Bank, the relevance of commercial banks is smaller as all projects are managed by governments (Winters 2019).

7. see <https://www.adb.org/sites/default/files/page/41117/climate-change-finance-joint-mdb-statement-2019-09-23.pdf> (last accessed November 2, 2022).

and parallel financing (Sissoko, Toschi, and Martin 2019). Joint financing involves the pooling of financial resources provided by all lenders. A special type of joint financing is loan syndication in which a lead lender brings together a group of lenders to negotiate a loan agreement with a single borrower. The lead lender is the lender of record and handles loan disbursements and debt service on behalf of the group lenders. This type of loan is often referred to as “A/B Loan”. In contrast to joint financing, a parallel financed development project consists of separate agreements between each lender and the borrower. In other words, a project is divided into different components that are individually financed by the co-lenders. Since both of these financing schemes disburse the financing burden across multiple lenders, co-financing opens up the possibility for bureaucrats to engage in political lending without exposing their MDB to excessive operational risk.

To use co-financing, bureaucrats need to find third-party lenders and convince the borrowers to accept this loan design scheme. Why would these actors agree to participate in a co-financed aid package? For third-party lenders, co-financing with an MDB has several advantages. First, MDBs have a *preferred creditor status* which means that MDB debt will be served first in case a borrower declares bankruptcy. Second, the involvement of MDBs in loan packages can serve as an incentive for recipients to honor their agreement as they do not want to lose out on future streams of subsidized loans (Wezel 2004). Both of these factors reduce the risk for third-party lenders to incur losses. In addition, co-financing can open new profit possibilities for commercial co-financiers as they can participate in projects that they would not otherwise finance. Thus, when dealing with politically motivated projects, co-financiers can minimize the risk of default while simultaneously expanding their earning potential.

For borrowers, MDB co-financing can help to secure loans that they would not otherwise receive in the free market. Gurara, Presbitero, and Sarmiento (2020) show that the involvement of MDBs in loan packages helps finance risky infrastructure investment projects that would not receive funding in the private market. Furthermore, Hainz and Kleimeier (2012) argue that MDB involvement helps to manage political risks for projects since MDBs can leverage their close ties with governments. Thus, borrowers will accept co-financing since it is likely the only way they

can raise funding for projects that are politically motivated.

If co-financing is such a useful instrument, then why do MDB bureaucrats not use it for all kinds of loan packages? While co-financing has some advantages in mitigating the risk of political lending, it also has two significant drawbacks compared to aid without co-financing. First, co-financed aid packages are more difficult to implement than single lender loans due to collective action problems. This can negatively affect the effectiveness of aid packages (Winters 2019; Kotchen and Negi 2019) and create more work for bureaucrats since they have to recruit co-financiers and coordinate more actors. Second, the addition of co-financiers to an aid package can cause the inclusion of new aid conditions that may be contrary to the recipient's interests. For example, Gould (2003) shows that IMF loans with supplementary financing include conditions that are in line with the interests of third-party financiers. Given these limitations, co-financing is more likely to be net-beneficial for all parties involved in situations where there is a high risk that a project may default, such as in the case of politically motivated aid.

If co-financing is a solution to the risks of political lending, then an implication of this argument is that co-financing should be more prevalent when a borrower receives more politically motivated loans. One situation where this is the case is when a country joins the UNSC as a temporary member.⁸ Many studies have connected UNSC membership to an inflow in politically motivated aid from MDBs, such as the World Bank and the Asian Development Bank (Vreeland and Dreher 2014; Dreher et al. 2022; Lim and Vreeland 2013; Alexander and Rooney 2019). This aid given to UNSC members does not appear to be very effective as several studies have found that UNSC membership causes a decline in GDP growth (Bueno de Mesquita and Smith 2010; Vreeland and Dreher 2014; Dreher, Eichenauer, and Gehring 2018). This means that when MDBs borrow money to UNSC members, they potentially accumulate high risk loans in their portfolio that can pose a problem for their operations. This is the context in which I expect MDB bureaucrats to increase their co-financing activities. In other words, since MDB loans given to UNSC members are more

8. There are other conditions of politically motivated aid. For example, aid to allies may be more susceptible to political motivations. Similarly, aid given to the home regions of leaders is more likely to be driven by political motives than merit (Dreher et al. 2019). My argument should apply to these situations as well but they exceed the scope of this paper.

likely associated with political lending, bureaucrats are more likely to deliver projects with co-financing schemes to UNSC than non-UNSC members. This means that UNSC members should receive a larger share of their loans as co-financed projects.

Hypothesis 1. *The loan portfolio of non-permanent UNSC members contains a larger share of co-financed MDB loans than the portfolio of non-UNSC members.*

4 Research Design

4.1 Case Selection

I conduct a quantitative case study of the European Bank for Reconstruction and Development (EBRD) to test this hypothesis. The EBRD is a regional MDB founded in 1991 to support the reconstruction of Eastern European states after the collapse of the Soviet Union (Babb 2009). Since its foundation, the EBRD has expanded its operations and is also funding projects in certain Middle Eastern and North African states.⁹ The EBRD is smaller than the World Bank but still larger than many other MDBs (Engen and Prizzon 2018). In 2016, the EBRD disbursed \$8.63 billion in loans. Formally, the US is the largest shareholder in the EBRD, with approximately 10% of the voting rights followed by France, Germany, the UK, Japan, and Italy, which each hold approximately 9% of all shares. However, compared to the World Bank context, it is generally recognized that the US' influence within the EBRD is limited (Babb 2009; Dreher et al. 2022). The location of the EBRD's headquarters in London as well as the presence of other powerful donor states undermines the ability of the US to influence day-to-day operations in the EBRD.

The EBRD possesses many characteristics that make it likely that we can observe the theorized relationship. First, co-financing is an often-used financial instrument for the EBRD. Co-financing aligns with the EBRD's official mandate to "mobilise domestic and foreign capital" (European Bank for Reconstruction and Development 2020). This is reflected in the EBRD's practice of co-financing. I find that approximately 35% of all loans issued by the EBRD are co-financed. As

9. These states are Egypt, Jordan, Lebanon, Morocco, Tunisia, and West Bank & Gaza.

a comparison, only 24.2% of loans approved by the International Bank for Reconstruction and Development, the non-concessional lending branch of the World Bank, are co-financed (Winters and Streitfeld 2018).

Second, a majority of EBRD loans are granted to private borrowers. This exposes them to riskier projects because private borrowers do not have the same ability as governments to raise money from capital markets to finance their activities. This exposes private borrowers to greater default risks compared to public borrowers. Thus, if political lending occurs through loans to private entities, then we can expect that the EBRD faces a significantly higher risk than other MDBs that only deal with public borrowers, such as the World Bank. This should encourage bureaucrats' utilization of co-financing.

Third, three major EBRD shareholders are permanent members of the UNSC (the US, the UK, and France), which can incentivize bureaucrats to consider the UNSC status of a borrower's home country. Even though political lending in the EBRD is not well-documented and Dreher et al. (2022) even use the EBRD as a placebo test, this does not exclude the possibility that the EBRD disburses politically motivated aid. As Clark and Dolan (2021) show, political lending is often an implicit bias by bureaucrats to appease major shareholders and has nothing to do with direct influence. Furthermore, political lending is usually measured as an expansion in the volume of loans. This is, however, not the only interpretation of political lending. Portfolio shifts toward loans that benefit governments more directly can also be interpreted as political lending. The main condition for my argument to hold is that UNSC membership causes an increase in the share of risky loans because bureaucrats want to reward politically salient countries.

4.2 Dependent Variable

To construct the dependent variable, I require loan-level data that measure whether an aid package is co-financed. There is no publicly available loan-level data set on EBRD loans and their design. This is why I assembled a new data set by web-scraping the project summary documents (PSDs)

that are published on the EBRD website from 1996 to 2018.¹⁰ PSDs are prepared for all types of projects that need approval by the Board of Directors and include detailed information about the project, including how the project is financed. According to the Public Information Policy of the EBRD, PSDs need to be published at least 30 days before a project is considered for approval by the Board (European Bank for Reconstruction and Development 2014).¹¹ This means that I collect data on projects that have already passed two stages of the project assessment cycle. Before being forwarded to the EBRD Board for approval, projects pass a concept review and final review stage (Gamtkitsulashvili, Plekhanov, and Stepanov 2021). Within these stages, the EBRD assesses whether a project meets its economic and environmental benchmark.

I classify whether a loan is co-financed by using a keyword based approach. Based on the information in the PSDs, I coded projects as co-financed if the PSD included words, such as *syndicate*, *co-finance*, *parallel*, and *B loan*.¹² The final data set includes 1,927 projects in 37 countries. To validate whether this approach is sufficiently accurate, I hand coded a random sample of 400 loans. With a Cronbach's alpha value of 0.83, the key word approach shows an acceptable level of consistency with the hand-coded variable.

According to the newly collected data, 35.3% of EBRD loans are co-financed. Every member receives approximately 2.6 loans per year which means that countries receive 0.9 co-financed loans per year. The EBRD commits \$52.4 million per loan on average. The average commitment in co-financed loans is \$54.2 million. While I was not able to collect information on the duration of the loans as well as the co-financiers, publicly available information provides some background on these variables. The EBRD provides loans with maturities from one to 15 years.¹³ The 15-year maturity loans, however, are mostly reserved for large infrastructure investments. The most frequent co-financiers are commercial banks. For instance, Dutch ING and Italian UniCredit have

10. I scraped the data on December 31, 2018, from this website: <https://www.ebrd.com/work-with-us/project-finance/project-summary-documents.html>.

11. For public projects, there are stricter guidelines. The PSD of a public project has to be published at least 60 days before the Board is discussing it and as soon as possible after the EBRD management approves the project to pass the Concept Review stage.

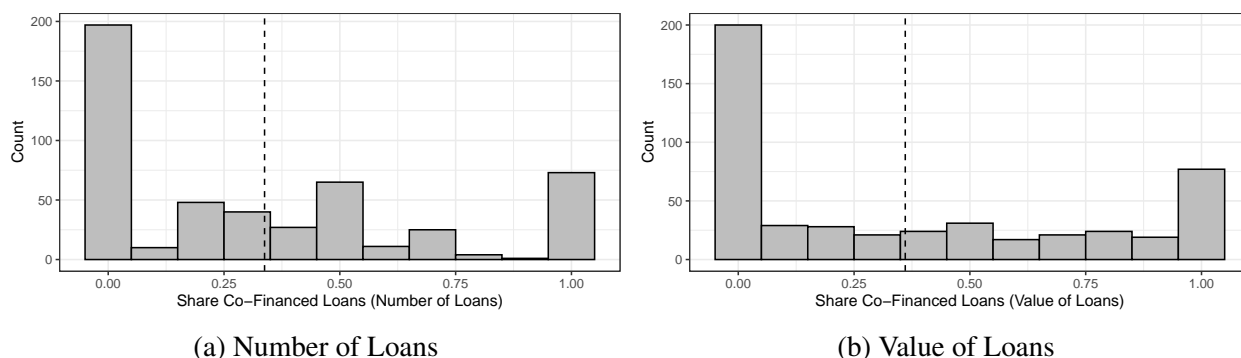
12. See appendix A for more details on how I assembled the EBRD loan level data.

13. See here for more information <https://www.ebrd.com/downloads/research/factsheets/guidetofinancing.pdf>

been the most active co-lenders of EBRD loans over time.¹⁴ More information on the temporal development of co-financed loans and their issue area composition is provided in the supplementary material section B.

For the analysis, I aggregate this loan-level data set to a panel data set with country-years as units of analysis. Since I expect a portfolio shift toward co-financed loans when a country joins the UNSC, the dependent variable is the share of co-financed loans in a country’s EBRD loan portfolio per year. I denote this variable as the *share of co-financing*. I measure the dependent variable in two ways: 1) the number of co-financed loans divided by the total number loans a country receives and 2) the value of co-financed loans over a country’s total value of loans. This results in a ratio that ranges between 0 and 1. The exact distribution of both measures is displayed in figure 1. The distributions of both co-financing ratios are relatively similar with pile-ups at 0 and 1 and a relatively uniform distribution in between.

Figure 1: Distribution of Share of Co-financing Variable



Note: The share of co-financed loans in figure (a) is based on the number of loans and in figure (b) on the value of loans. The black dashed line represents the sample mean. In figure (a), this is 0.338, and in figure (b), it is 0.36.

4.3 Independent and Control Variables

The main independent variable of interest is whether a country is a member of the UNSC. I code the UNSC membership as a binary variable with data collected and updated by Dreher, Sturm,

14. See <https://www.ebrd.com/work-with-us/loan-syndications/top-20-participating-banks.html> (last accessed November 3, 2022).

and Vreeland (2009b).¹⁵ Due to the institutional structure of the UNSC, we can treat UNSC membership as as-if random conditional on observables. The UNSC consists of 15 members. Ten of these 15 countries are non-permanent members who are elected for a two-year term. To be elected, a country needs at least two-thirds of the votes of the UNGA. The ten temporary seats are split among five geographic regions, and a retiring member cannot be reelected for another two years. The empirical evidence suggests that these features create a strong norm of turn-taking that alleviates the concern that political and economic factors affect the assignment to the treatment (Bueno de Mesquita and Smith 2010; Vreeland and Dreher 2014).

Even though this turn-taking norm exists, Vreeland and Dreher (2014) argue that UNSC membership is only conditionally exogenous. They suggest that UNSC membership can be treated as exogenous when controlling for population, GDP, and war. In addition, since many members of the EBRD belong to the Eastern European country group, Vreeland and Dreher recommend also controlling for US military aid. Following this advice, I will include the natural log of GDP, population size, and US military aid as well as a dummy variable indicating whether there is an active conflict within the territory of a state.¹⁶ I denote these variables as Vreeland and Dreher control variables (VD variables hereafter).

In addition to the VD variables, I add control variables to the main model specification that are either commonly used in research or related to co-financing to improve the precision of the independent variable's estimate. I include a dummy variable capturing whether a state is a democracy (Marshall, Gurr, and Jaggers 2019). I also control for a set of variables that take into account the fact that access to international capital markets is an often-cited motivation of co-financing. For this purpose, I incorporate the financial market access variable¹⁷ provided by the IMF's Financial

15. While the World Bank sample has a global sample, there might be concern that the EBRD sample includes only very few cases of UNSC members. Within the period of the study, 15 countries that are eligible EBRD loan recipients have held a temporary seat in the UNSC, most of them as representatives of the Eastern European region. More details on the UNSC members are provided in table C.1.

16. Data on GDP/Capita and population are from the World Bank World Development Indicators (World Bank 2020) and conflict data are from the UCDP/PRIO Armed Conflict data set (Pettersson, Högladh, and Öberg 2019; Gleditsch et al. 2002). The data on US military aid come from the US "Greenbook" published by USAID

17. Financial market access is composed of two variables: market capitalization outside the ten 10 largest companies and total number of issuers of debt (Svirydzenka 2016).

Development Index Database (Svirydzenka 2016) as well as the level of foreign direct investment (FDI) and external debt (World Bank 2020). Another set of control variables focuses on political risk. I will take three variables from the PRS Group’s International Country Risk Guide (ICRG): Investment profile, law and order, and corruption. Investment profile refers to the risk of investing. Law and order assesses the quality of the legal system and how often the law is violated. Corruption indicates to what extent public authorities use their power for their personal gain. All three variables are ordered categorical variables, where higher values indicate better scores. Lastly, I will also include a country’s political proximity to the US using UNGA voting data (Bailey, Strezhnev, and Voeten 2017).

I lag all independent and control variables by one year. The reason for this is that I assume that there is a bureaucratic lag until we can observe the effects of UNSC membership. Bureaucrats have to go through a set of applications and find co-financiers. I expect that this process will take up to a year. According to Kilby (2013b), it takes 1.5 years for a World Bank loan to be approved. I assume that this process should be quicker in the EBRD due to its smaller size compared to the World Bank. As a result, I expect that we should pick up the effects of UNSC on loan approval one year after the start of a country’s term at the UNSC.

4.4 Estimation

The main model that I estimate is an OLS model with country and year fixed effects. The standard errors are clustered at the country level. The full model is summarized in the following equation:

$$y_{it} = \alpha_i + \lambda_t + \beta_1 \text{UNSC}_{i,t-1} + \mathbf{X}'_{i,t-1} \delta + \epsilon_{it} \quad (1)$$

Subscript i refers to an individual country, and t defines the year. Country fixed effects are denoted by α_i and year fixed effects by λ_t . The matrix $\mathbf{X}_{i,t-1}$ contains the described control variables. The variable y describes the dependent variable. The coefficient of interest is β_1 . I expect that β_1 is positive and statistically significant.

Because some of the control variables have a relatively high rate of missingness and the number of country clusters within the EBRD sample is relatively small (37 countries), I decided to fill the missing values using multiple imputations. I follow the procedure outlined by Lall (2016). I use the *Amelia II*¹⁸ package (Honaker, King, and Blackwell 2011) and impute the data set five times. I will estimate the model described in equation 1 with each data set and then aggregate the estimates and standard errors using *Rubin's combination rules* (Rubin 1987).

5 The Effect of UNSC Membership on Co-financing

Table 1 shows the effect of UNSC membership on the share of co-financing. In line with the main hypothesis, the share of co-financed loans significantly increased during a country's UNSC membership. The number of co-financed EBRD loans in the portfolio of UNSC members rises by 19 percentage points when a country joins the UNSC. Similarly, UNSC membership increases the value of co-financed loans expressed as the share of the total value of a country's EBRD portfolio by approximately 14 percentage points. Considering that a country's average share of co-financed loans is 33.8% (resp. 36% for the share based on the value), these are large effect sizes. This means that UNSC membership results in an EBRD loan portfolio that contains approximately 50% more co-financed loans. This provides strong support for the main hypothesis that there is a shift toward co-financed MDB loans during a country's UNSC membership.

One possible concern for the robustness of the estimates is that a linear regression model might not be the right functional form given that the data are censored at 0 and 1. This is also evident by the nature of pile-ups at 0 and 1 in figure 1. To account for this problem, I reran the main model specification with a Tobit model. The results of the Tobit model displayed in the supplementary material E support the main findings and are even stronger in magnitude than the OLS results.

Another problem is that ratio variables are not defined if the denominator is zero. Thus, if a country does not receive any EBRD loans in a given year, it will not be included in the regres-

18. I chose the *Amelia II* software because it has the advantage of accommodating the structure of time-series cross-section data.

Table 1: Effect of UNSC Membership on the Share of Co-Financing at EBRD

	Number	Number	Number	Value	Value	Value
UNSC _{t-1}	0.196*** (0.050)	0.180*** (0.049)	0.186*** (0.052)	0.144** (0.066)	0.129** (0.065)	0.136* (0.069)
Country FE	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes
VD Controls	No	Yes	Yes	No	Yes	Yes
Other Controls	No	No	Yes	No	No	Yes
Observations	487	487	487	478	478	478
R Squared	0.156	0.180	0.202	0.138	0.153	0.177

*** $p < 0.01$; ** $p < 0.05$; * $p < 0.1$

Note: The dependent variable in the first three columns is the share of co-financed loans using the number of loans. In the last three columns, the dependent variable is based on the value of loans. All standard errors are clustered at the country level. Full results are reported in appendix D.

sion.¹⁹ This is problematic if receiving any loans is correlated with UNSC membership, as it would introduce post-treatment bias. In the supplementary appendix E, I show that UNSC membership does not increase the likelihood of receiving any EBRD loan. Even though the coefficient of UNSC membership is positive, it is not statistically significant. This helps to alleviate some of the concerns regarding post-treatment bias.

A related issue is that dropping observations that receive no loans can introduce selection bias, as it could increase the likelihood that the sample contains cases that are generally more likely to receive co-financing when they serve on the UNSC. To mitigate this issue, I implemented a linear regression with stabilized inverse probability weights (see Hernan and Robins 2020).²⁰ The results of the weighted linear regression confirm the previous findings that UNSC members receive more co-financed loans from the EBRD.

Lastly, the main model is similar to a difference-in-differences design, which usually assumes that the treatment status does not reverse. This assumption is clearly violated in the setting of the UNSC. To address this issue, I implemented the panel match estimator proposed by Imai, Kim,

19. A total of 209 observations are dropped because of this problem.

20. More details on how the weights are calculated and what model specification I used are described in the supplementary material E. Table E.3 shows the full results.

and Wang (Forthcoming), which applies matching methods to time-series cross-section data to estimate the average treatment effect on the treated and allows for treatment reversal across time. The results of the panel match estimator are largely consistent with the main findings.²¹ While the results for the share based on the value of loans are only significant at the 90% level, the panel match estimator estimated a positive and significant effect at the 95% level in the second year of a country's UNSC membership for the share based on the number of loans. Overall, these findings provide strong evidence in support of the idea that there is a portfolio shift toward co-financing when the EBRD deals with UNSC members.

6 Exploring the Risk Mechanism

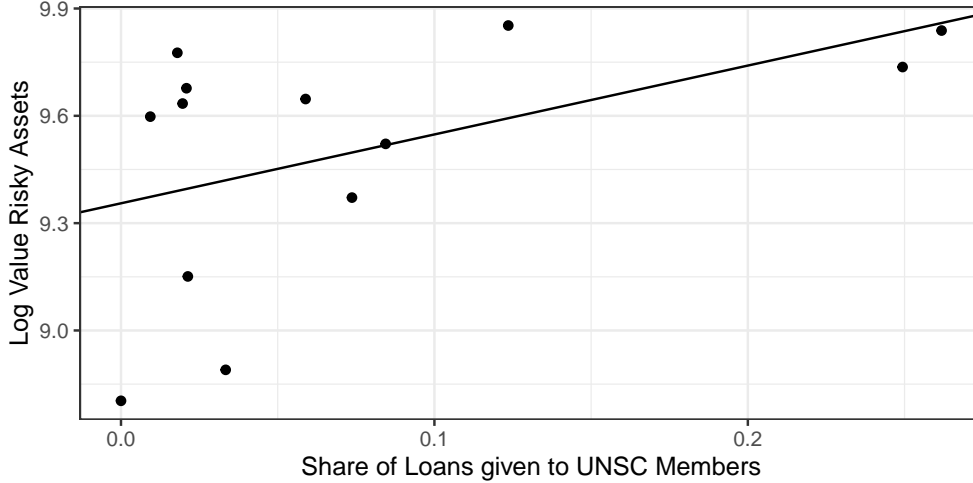
According to my argument, the reason why we observe a shift toward co-financing for UNSC members is that MDB bureaucrats want to protect themselves from the risks of politically motivated loans. This mechanism implies that we should observe that 1) UNSC membership increases the disbursement of risky loans and 2) co-financing is concentrated among these risky loans. Since it is difficult to find an appropriate measure of "riskiness", I will explore these two implications through various pieces of evidence that in their totality should provide compelling evidence in favor of the theorized mechanism.

First, I measure risk at the EBRD level. In its financial reports from 2006 to 2018, the EBRD self-classified its loan portfolio into various risk categories. These categories range from highly secure loans to loans that require special attention. I expect that if UNSC membership causes the disbursement of riskier loans, we should see that the EBRD will hold more risky assets in their books when they disburse a higher share of their loans to UNSC members. Figure 2 demonstrates suggestive evidence in support of this idea. It shows that there is a positive correlation between the value of risky assets held by the EBRD and the share of loans given to UNSC members in a given year.²²

21. These results are displayed in figure E.1.

22. This correlation is statistically significant at the 95% level.

Figure 2: Correlation Share of Loans to UNSC Members and EBRD Risky Assets

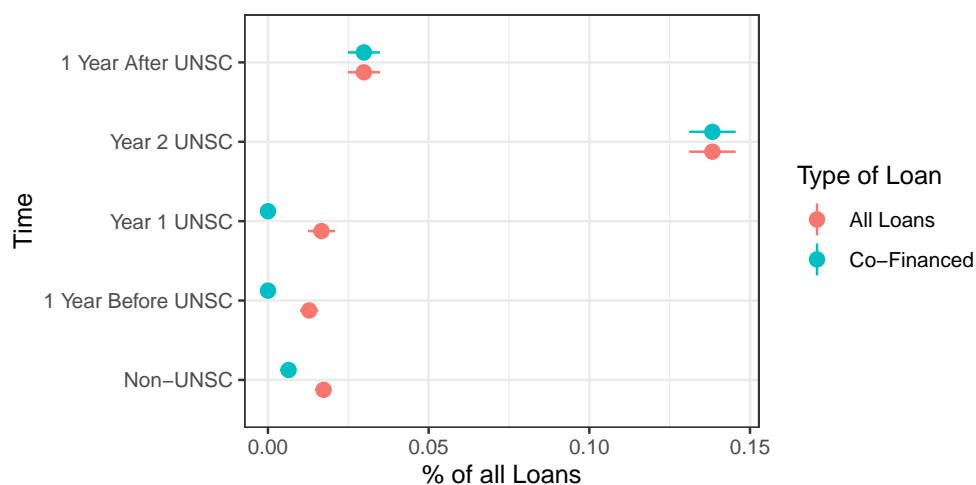


Second, risk varies by issue area. I assume that energy projects are on average one of the riskiest categories of projects, as they involve significant planning and can be derailed by politics or local protests. Furthermore, there is evidence that MDBs finance riskier infrastructure projects on average than the private sector (Gurara, Presbitero, and Sarmiento 2020). Thus, if we see that UNSC members are more likely to receive energy projects during their time of the UNSC, it is further evidence that the EBRD disburses riskier loans to their UNSC members. Figure 3 shows the average percentage of loans that finance energy projects across different treatment conditions. The plot highlights that EBRD members in their second year at the UNSC receive significantly more energy projects. Approximately 13% of the loans that UNSC members receive in their second year at the UNSC are energy projects. In comparison, for non-UNSC members, energy projects only make up approximately 2% of their loan portfolio.

In addition, we can observe that all of these energy loans in the second year of UNSC membership and one year after leaving the UNSC are co-financed. In comparison, only approximately 35% of energy project loans receive co-financing when given to non-UNSC members. This is in line with the mechanism by which EBRD bureaucrats try to account for the riskier nature of the loans granted to UNSC members by searching for co-financing opportunities.

Lastly, I took advantage of the fact that the EBRD issues loans to both private and public

Figure 3: UNSC Membership and EBRD Loans Supporting Energy Projects



Note: Figure illustrates the mean share of energy projects in the portfolio of recipient countries for different treatment conditions. The *all loans* group looks at all energy projects, whereas the *co-financed* group only considers co-financed energy projects. If the values of both groups are the same, then all energy projects are co-financed.

borrowers.²³ I expect that on average, it is riskier for the EBRD to lend to private borrowers since these borrowers have a higher chance of defaulting on their loans than public entities that have a larger set of policies to prevent default at their disposal (e.g. IMF bailout). In particular, if loans are politically motivated, the EBRD may give more loans to companies that do not have sound business practices. This means that as EBRD borrowers join the UNSC, we should observe an increase in the share of private loans. Furthermore, the expansion of co-financing should only occur among private loans.

Table 2 displays this pattern. The share of private loans increases by 8.2 percentage points (based on the number of loans) during a country's tenure at the UNSC. This significant shift toward private loans is surprising given that the EBRD disburses on average 73% of all loans to private borrowers. Furthermore, UNSC membership positively affects the share of co-financing only among private loans. The share of co-financed private loans rises by 18.7 percentage points, whereas the share of co-financed public loans remains stable.²⁴ Substantively, this means that compared to a

23. Private borrowers include commercial banks, small and medium enterprises, and other companies. Public borrowers are municipalities and ministries located in member countries.

24. It is unlikely that this change is due to the fact that private loans are more likely to be co-financed. While not statistically significant, private loans have a smaller likelihood of receiving co-financing than public loans. The details are described in table F.3 in appendix F.

country's mean share of co-financed private loans, UNSC members' share of private co-financing is 100% larger.²⁵ I perceive this as further indicative evidence that recipient countries that serve on the UNSC receive a larger amount of risky loans and that EBRD bureaucrats balance the risks by looking for co-financing.

Table 2: Effect of UNSC on the Share of Private Loans and the Share of Co-Financing

	Share of Private Loans		Share of Co-Financing			
	Num Loans	Value Loans	Priv Num	Priv Value	Pub Num	Pub Value
UNSC _{t-1}	0.082* (0.043)	0.130** (0.059)	0.187*** (0.053)	0.194*** (0.074)	-0.008 (0.035)	-0.064 (0.042)
Country FE	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Control Variables	Yes	Yes	Yes	Yes	Yes	Yes
Observations	487	478	487	478	487	478
R Squared	0.369	0.311	0.214	0.201	0.300	0.256

*** $p < 0.01$; ** $p < 0.05$; * $p < 0.1$

Note: The dependent variable in the first two columns is the share of private loans using both the number and value of loans. In the last four columns, the dependent variable is the share of co-financing in the EBRD. Columns 3 and 4 look at the share of co-financed private loans and columns 5 and 6 look at the share of co-financed public loans. All standard errors are clustered at the country level. Full results are reported in appendix F.

If the risk of loans is strongly associated with the borrower type being private, then we should expect that MDBs that only lend to public entities do not possess the same need to co-finance. The World Bank Group's main lending arms, the International Bank for Reconstruction and Development and the International Development Association, both only give money to governments. Thus, the World Bank is an ideal placebo for this mechanism. I use data from Winters and Streitfeld (2018) on co-financing in the World Bank and estimate the same model specifications as in the EBRD case. I find no statistically significant effect of UNSC membership on co-financing in the World Bank.²⁶ While there are many potential other reasons tied to organizational differences between the EBRD and World Bank that could explain this null result, I see this as additional evidence that co-financing is a tool for bureaucrats to accommodate an expansion of risky loans.

In sum, I displayed across three measures of riskiness that UNSC membership causes a shift

25. On average, a country's share of co-financed private loans in its loan portfolio is 18.3%. This is based on the number of loans.

26. The results are displayed in table F.4 in appendix F.

in a recipient's loan portfolio toward riskier projects. This is strong evidence for the mechanism outlined in theory. Bureaucrats want to demonstrate their allegiance to important shareholders while simultaneously, protecting the EBRD from excessive risk exposure. It is important to note that I am agnostic about why the EBRD disburses riskier loans to UNSC members. This could be because of political meddling by powerful states at the EBRD (Stone 2011), implicit political bias by EBRD bureaucrats, or because companies in UNSC member countries realize that they have better chances to get risky projects approved due to their home country's special political status. Either way, bureaucrats have to balance political interests with operational considerations.

7 Alternative Explanations

There are several alternative mechanisms that could predict the same pattern. First, it could be that co-financing is a way to reward countries for their political support of major EBRD shareholders. To test this mechanism, I use data from Dreher et al. (2022) on UNSC voting patterns. I create two new variables measuring whether a UNSC member has always voted with the US in the UNSC and whether a UNSC member has voted against the US at least once in a given year.²⁷ These two variables are dummy variables that are mutually exclusive.

Table 3 shows that political motives do not drive the use of co-financing. Even though we can observe a significant increase in the share of co-financed loans to UNSC members that have always voted with the US in the Security Council, the coefficient for countries that voted against the US is still positive and marginally significant in one case. If co-financing is a reward, we would furthermore expect that the two coefficients are statistically distinguishable from each other. However, this is also not the case.²⁸ This highlights that co-financing is unlikely to be a design feature that MDBs use to treat certain countries more favorably. It is more likely an instrument that

27. Since most of the Western powers represented in the EBRD have voting patterns in the UNSC similar to those of the US, this is a good proxy for measuring a country's political alignment with the interests of the EBRD's major shareholders.

28. I used the following formula to calculate the p-value of the difference between the coefficients: $Z = \frac{\beta_1 - \beta_2}{\sqrt{\sigma_1^2 + \sigma_2^2 - 2\text{COV}_{1,2}}}$

is in the discretion of bureaucrats, as suggested by Winters and Streitfeld (2018) and Iannantuoni, Waeiss, and Winters (2021), to deal with risk.

Table 3: Effect UNSC Conditional on Voting Pattern on Share of Co-Financing

	Number Loans	Value Loans
UNSC, Vote Against US _{t-1}	0.112* (0.067)	0.042 (0.095)
UNSC, Vote all with US _{t-1}	0.288*** (0.087)	0.267** (0.107)
Country FE	Yes	Yes
Year FE	Yes	Yes
VD Controls	Yes	Yes
Other Controls	Yes	Yes
Observations	487	478
R Squared	0.201	0.177

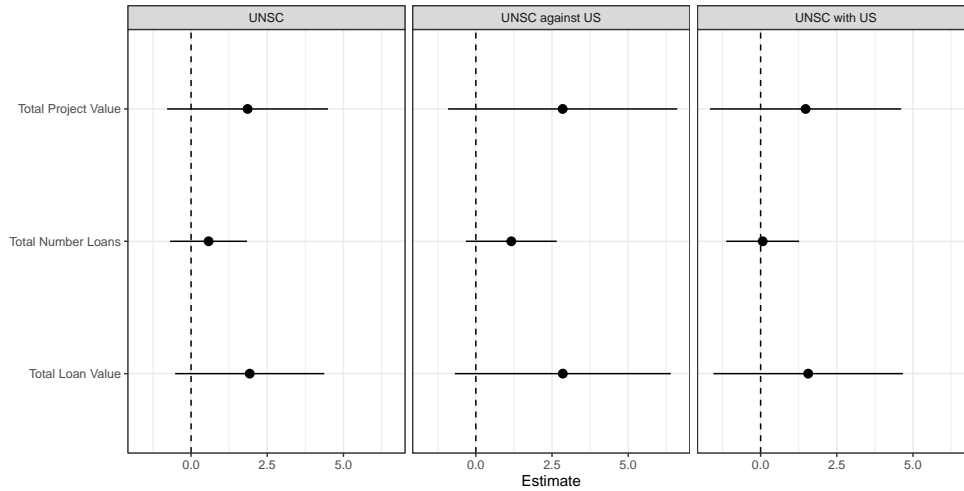
*** $p < 0.01$; ** $p < 0.05$; * $p < 0.1$

Note: The dependent variable is the share of co-financing. In the first column, the share is based on the number of loans, and in the second column, it is based on the value of loans. All standard errors are clustered at the country level.

Another possible explanation is that the EBRD uses co-financing to overcome budget constraints. UNSC members may receive overall more loans from the EBRD. From this perspective, co-financing is a way to mobilize additional resources to finance the EBRD's political lending activities. To rule out this mechanism, I estimated whether UNSC membership affects the total value of loans, total number of loans, and the total value of projects supported by EBRD loans. The results in figure 4 suggest that UNSC membership and voting with or against the US have no effect on the total loan volume. This means that the changes in co-financing that we observe after a country becomes a UNSC member are portfolio changes and not the result from an overall decline or increase in loans. This result is in line with findings by Dreher et al. (2022), who do not find evidence that UNSC membership increases the inflow of aid from the EBRD.

The fact that there are no overall changes in loan volume also excludes a forum-shopping explanation (see Humphrey and Michaelowa 2013). It could be that states have preferences for co-financed loans. When they have a seat in the UNSC, they have more bargaining power and could therefore shop around MDBs and demand more co-financing. However, the forum-shopping argument implies that total loan volumes should increase, i.e., UNSC members obtain their loans from

Figure 4: Effect of UNSC Membership on Total Loan Volume at EBRD



Note: All standard errors are clustered at the country level. The figure includes 95% confidence interval for each coefficient.

the MDB with the best conditions and will take fewer loans from other MDBs. The insignificant effect of UNSC membership on the total volume of EBRD loans does not support the predictions from forum-shopping.

A final alternative explanation is that UNSC membership worsens a country's investment environment and MDBs need to step in to compensate for the lack of private investment (Gurara, Presbitero, and Sarmiento 2020; Hainz and Kleimeier 2012). UNSC membership and the resulting inflow of aid could embolden certain leaders to take actions that strengthen their power position at the expense of the general investment environment (Bashir and Lim 2013). To explore this relationship, I regress the three political risk variables included in the main specification on the lagged UNSC variable. If a country's investment risk is the cause of co-financing, then we should observe that UNSC worsens a country's status as a safe host country. The findings reveal that UNSC membership has no effect on the rule of law and corruption and significantly improves a country's investment environment. It is therefore unlikely that a deterioration in a country's investment climate causes an increase in co-financing.

8 Conclusion

Powerful states hijack MDBs to channel aid to politically important countries, such as UNSC members. This, however, overlooks the fact that this type of politically motivated aid can potentially hurt the operations of MDBs since these loans have higher default risks. This puts MDB bureaucrats in a dilemma, as they have to choose between pleasing powerful shareholders or picking prudent projects. I argue that they can overcome this dilemma by co-financing these politically motivated loans, as it disburses the risk of default among multiple lenders. I test this proposition in the context of the EBRD. I find that countries that join the UNSC experience an increase in the share of co-financed loans in their EBRD loan portfolio. Through multiple measures of riskiness, I attribute this portfolio shift to the fact that UNSC members receive riskier projects.

The findings of this paper shed new light on the workings of international organizations. It suggests that bureaucratic agency and great power politics are connected. In realist frameworks, it is assumed that international institutions will yield to the demands of powerful states. However, there is also extensive work that shows that bureaucracies at international organizations have their own agendas and want to secure the survival of their organizations. These realist and constructivist views are usually described as distinct theories with little overlap. I present evidence that these two theories relate to each other. Great power politics can force bureaucrats to innovate and adapt new policies that protect their institutions. I explored this dynamic with a focus on co-financing. There are likely other possible reactions to political pressure that ask for future inquiry, such as portfolio shifts and the diversification of financing sources.

This paper further highlights the need to rethink how to study political lending. It raises questions about the process of political lending and the measures we use to estimate political lending. Most previous studies assume that political lending is a top-down process and therefore requires major powers to influence the bureaucratic process of MDBs. However, this paper raises the possibility that political lending is a bottom-up process. The political status of a country can motivate companies to seek loans from MDBs for projects that do not qualify for private market loans since they know there is a higher chance that their project will be approved. Bureaucrats then select

these projects to demonstrate their willingness to approve loans for political motives. This also underscores that political lending does not necessarily mean the expansion of the loan volume or a lack of conditionality. It can also mean the approval of riskier loans that are valuable to borrowers.

Given the limitations of the institutional scope of this paper, future work should also investigate other types of MDBs and other kinds of politically motivated aid. This study only looks at the EBRD and a country's UNSC status. I predict that we can observe similar dynamics in other MDBs that lend to private entities, such as the International Finance Corporation, IDB Invest²⁹, and the European Investment Bank. Furthermore, the type of dilemma described in this paper is not only applicable to the status of UNSC membership but should also hold for lending motivated by a country's alliance or other security relationships with a major shareholder. Bureaucrats want to make sure that the "friends" of their MDB's major shareholders receive a preferred treatment as well. This could justify the use of co-financing as an instrument to protect the MDB from too much risk exposure.

29. This is the Inter-American Development Bank's private investment wing.

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Appendix

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A Coding Procedure for EBRD Loan Level Data

Excluded PSD Documents:

Based on the universe of PSDs, I exclude projects if they do not meet three conditions. First, projects had to be past the signature status. This assures that the PSDs are updated and represent the final outcome. Second, it has to be clear in which country the project is implemented. Regional projects do not satisfy this criterion because it is impossible to accurately assess what portion of a project had been implemented in a given country. Lastly, a project is not implemented in Russia or West Bank and Gaza. Projects to Russia are excluded because Russia, as a member of the P-5, has zero probability of being treated as a temporary member, and projects given to the West Bank and Gaza are not considered because they are not countries according to Correlates of War.

Key Word Coding Approach:

To code whether a loan of the EBRD was co-financed, I searched in the Project Summary Documents for the following key words:

- cofin
- parallel
- syndicat
- a / b OR a/b OR a /b OR a/ b OR b loan OR 'a' loan OR 'b' loan
- colender
- international donor

If the document contained any of these key words, I coded it as co-financed.

B Additional Descriptives on Co-Financing Data

Figure B.1: EBRD Loans over Time and by Financing Type

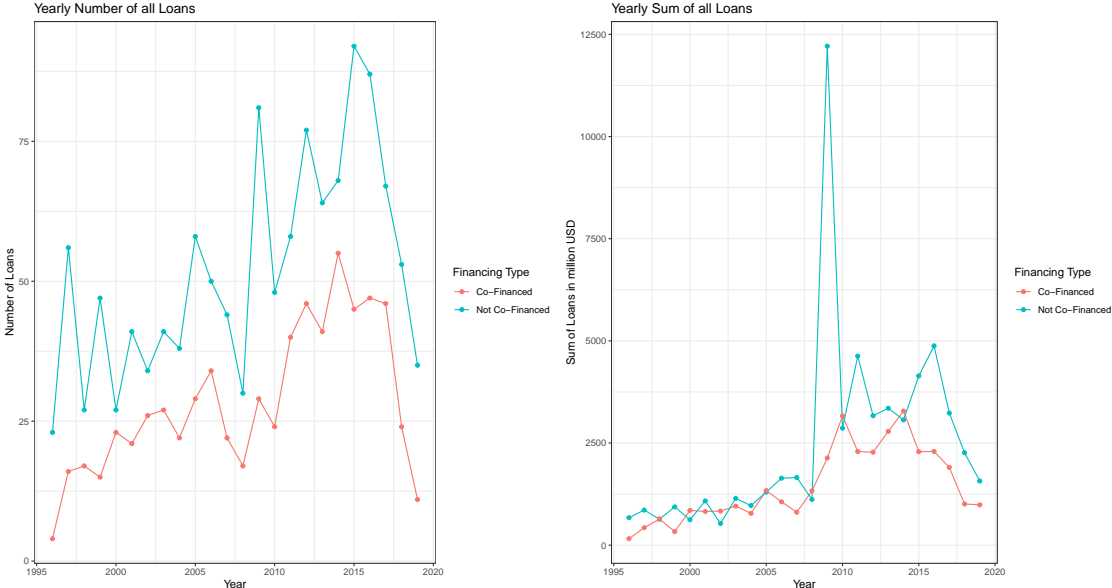


Figure B.2: Issue Areas of EBRD Loans: Total Number

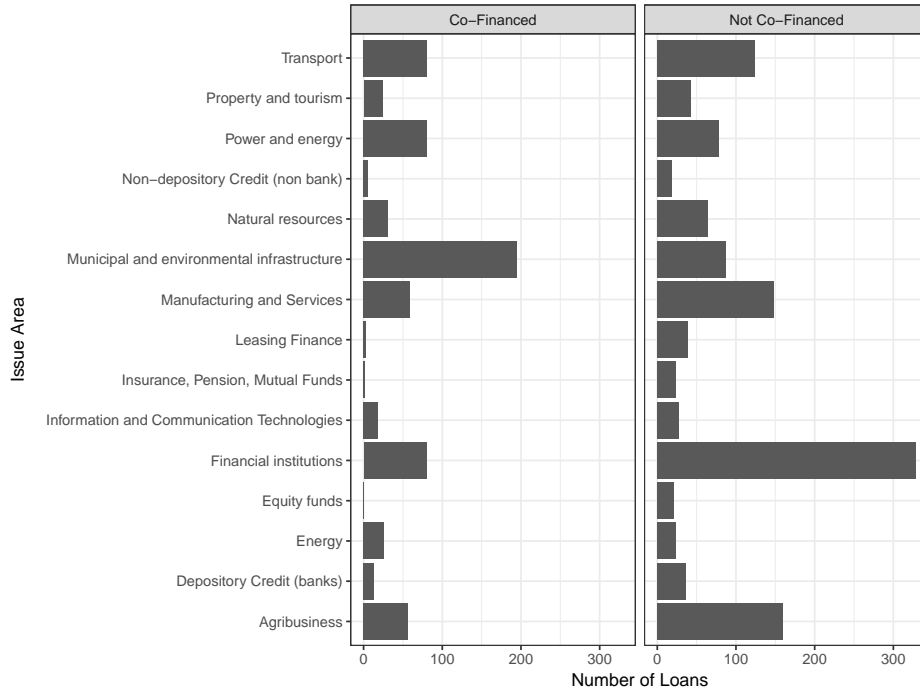
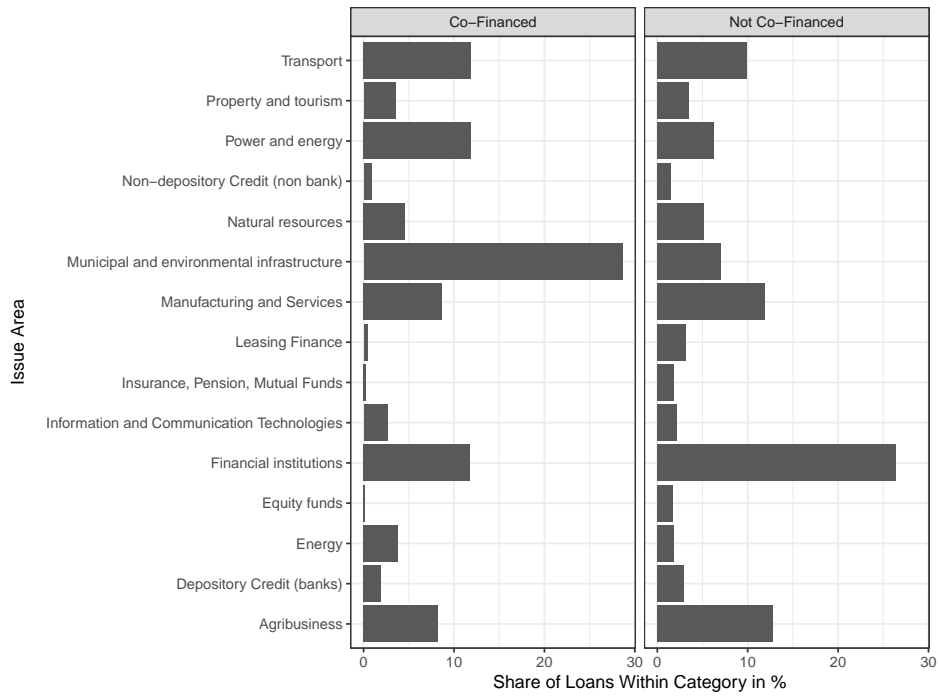


Figure B.3: Issue Areas of EBRD Loans: Relative Distribution



C List of UNSC Members in EBRD

Table C.1 describes all countries that have held a seat in the UNSC between 1996 and 2019 and that were eligible to receive funding from the EBRD.

Table C.1: UNSC Members in EBRD Sample

Country	Years	Region
Azerbaijan	2012-2013	Eastern Europe
Bosnia and Herzegovina	2010-2011	Eastern Europe
Bulgaria	2002-2003	Eastern Europe
Croatia	2008-2009	Eastern Europe
Lithuania	2014-2015	Eastern Europe
Poland	1996-1997 & 2018-2019	Eastern Europe Eastern Europe
Romania	2004-2005	Eastern Europe
Slovakia	2006-2007	Eastern Europe
Slovenia	1998-1999	Eastern Europe
Ukraine	2000-2001 & 2016-2017	Eastern Europe Eastern Europe
Jordan	2014-2015	Asia
Kazakhstan	2017-2018	Asia
Egypt	2016-2017	Africa
Morocco	2012-2013	Africa
Turkey	2009-2010	Western Europe and Others

D Full Regression Results

I present the full regression results in this part of the appendix. The main text only shows the results of the main specification.

Table D.1: Full Results Effect UNSC on Share of Co-Financed EBRD Loans (Value of Loans)

	Model 1	Model 2	Model 3
UNSC _{t-1}	0.144** (0.066)	0.129** (0.065)	0.136* (0.069)
Log GDP _{t-1}		0.067 (0.179)	0.133 (0.189)
Log Population _{t-1}		0.381 (0.545)	0.610 (0.573)
Log US Military Aid _{t-1}		0.012 (0.007)	0.011 (0.007)
War _{t-1}		0.043 (0.056)	0.081 (0.071)
Corruption _{t-1}			0.057 (0.056)
Political Proximity _{t-1}			-0.200** (0.096)
External Debt/GDP _{t-1}			-0.001 (0.001)
FDI/GDP _{t-1}			0.004 (0.004)
Financial Market Access _{t-1}			0.305 (0.319)
Investment Risk _{t-1}			-0.009 (0.037)
Democracy _{t-1}			0.043 (0.099)
Rule of Law _{t-1}			-0.051 (0.073)
Country FE	Yes	Yes	Yes
Year FE	Yes	Yes	Yes
Observations	478	478	478
R Squared	0.138	0.153	0.177

*** $p < 0.01$; ** $p < 0.05$; * $p < 0.1$

Table D.2: Full Results Effect UNSC on Share of Co-Financed EBRD Loans (Number of Loans)

	Model 1	Model 2	Model 3
UNSC _{t-1}	0.196*** (0.050)	0.180*** (0.049)	0.186*** (0.052)
Log GDP _{t-1}		0.156 (0.178)	0.195 (0.180)
Log Population _{t-1}		0.360 (0.539)	0.480 (0.528)
Log US Military Aid _{t-1}		0.013** (0.006)	0.012* (0.006)
War _{t-1}		0.032 (0.048)	0.070 (0.059)
Corruption _{t-1}			0.050 (0.049)
Political Proximity _{t-1}			-0.123 (0.097)
External Debt/GDP _{t-1}			-0.000 (0.001)
FDI/GDP _{t-1}			0.002 (0.003)
Financial Market Access _{t-1}			0.229 (0.327)
Investment Risk _{t-1}			-0.007 (0.027)
Democracy _{t-1}			0.062 (0.081)
Rule of Law _{t-1}			-0.065 (0.062)
Country FE	Yes	Yes	Yes
Year FE	Yes	Yes	Yes
Observations	487	487	487
R Squared	0.156	0.180	0.202

*** $p < 0.01$; ** $p < 0.05$; * $p < 0.1$

E Robustness Tests

Table E.1: Effect UNSC on Share of Co-Financing using Tobit Model

	Number of Loans	Value of Loans
Intercept	1.867** (0.888)	2.294** (0.892)
UNSC _{t-1}	0.371*** (0.115)	0.373*** (0.142)
Log GDP _{t-1}	-0.043 (0.067)	-0.069 (0.067)
Log Population _{t-1}	0.043 (0.075)	0.083 (0.079)
War _{t-1}	-0.016 (0.087)	0.006 (0.087)
Log US Military Aid _{t-1}	0.007 (0.012)	0.009 (0.013)
Financial Market Access _{t-1}	0.181 (0.202)	0.285 (0.224)
FDI/GDP _{t-1}	0.007 (0.005)	0.009 (0.006)
External Debt/GDP _{t-1}	-0.000 (0.001)	-0.001 (0.001)
Democracy _{t-1}	0.121 (0.092)	0.094 (0.112)
Political Proximity _{t-1}	-0.137* (0.080)	-0.253*** (0.080)
Corruption _{t-1}	0.000 (0.046)	0.004 (0.054)
Investment Risk _{t-1}	-0.051** (0.024)	-0.076*** (0.028)
Rule of Law _{t-1}	-0.209*** (0.065)	-0.212*** (0.078)
Log Scale	-0.408*** (0.135)	-0.307** (0.130)
AIC	941.183	955.872
BIC	1004.007	1018.417
Log Likelihood	-455.592	-462.936
Deviance	679.300	660.153
Total	487	478
Left-censored	187	186
Uncensored	227	217
Right-censored	73	75
Wald Test	33.901	37.224

*** $p < 0.01$; ** $p < 0.05$; * $p < 0.1$

Table E.2: Factors Influencing the Likelihood of Receiving EBRD Loans

	Num Loans	Value Loans
UNSC _{t-1}	0.077 (0.057)	0.082 (0.058)
Log GDP _{t-1}	-0.024 (0.216)	-0.016 (0.210)
Log Population _{t-1}	0.946* (0.556)	0.852 (0.574)
War _{t-1}	0.037 (0.114)	0.029 (0.111)
Log US Military Aid _{t-1}	0.004 (0.008)	0.003 (0.008)
Political Proximity _{t-1}	-0.284*** (0.098)	-0.245** (0.105)
Democracy _{t-1}	-0.008 (0.086)	0.000 (0.085)
Financial Market Access _{t-1}	-0.203 (0.263)	-0.201 (0.237)
FDI/GDP _{t-1}	0.000 (0.002)	0.002 (0.002)
External Debt/GDP _{t-1}	0.002*** (0.001)	0.002*** (0.001)
Investment Risk _{t-1}	-0.041* (0.023)	-0.034 (0.023)
Rule of Law _{t-1}	0.024 (0.050)	0.017 (0.051)
Corruption _{t-1}	0.005 (0.054)	0.007 (0.051)
Country FE	Yes	Yes
Year FE	Yes	Yes
Observations	696	696
R Squared	0.357	0.365

*** $p < 0.01$; ** $p < 0.05$; * $p < 0.1$

Estimating Stabilized Inverse Probability Weights:

To estimate weights, I created a new variable D_i that is coded as 1 if a country has received a loan in a given year and 0 if it did not. The weights for an individual observation are then calculated using the following formula:

$$SIPW_i = D_i \frac{\Pr[D_i = 1]}{\Pr[D_i = 1 | \mathbf{X}_i]} + (1 - D_i) \frac{1 - \Pr[D_i = 1]}{1 - \Pr[D_i = 1 | \mathbf{X}_i]}$$

For $\Pr[D_i = 1 | \mathbf{X}_i]$, I ran a logistic regression with the following variables:

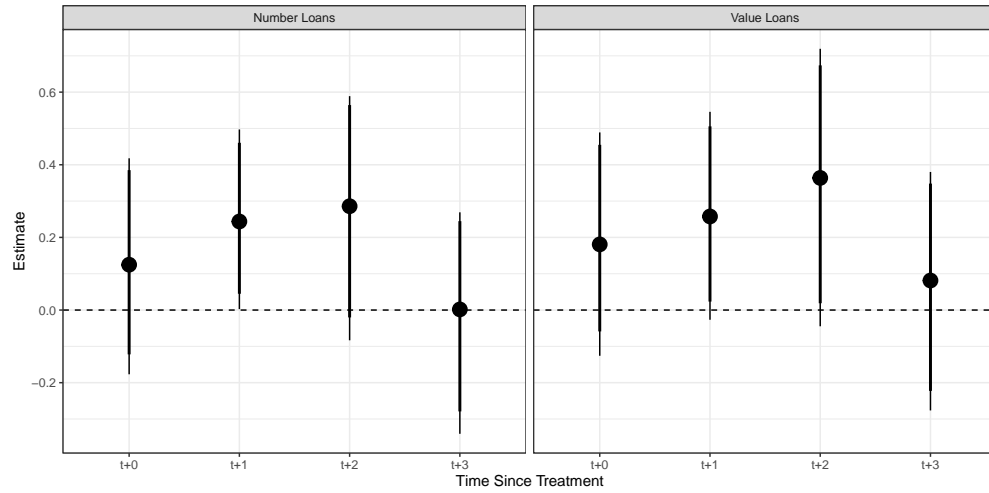
- UNSC
- Log GDP
- Log Population
- Difference in US Ideal Point
- Financial Market Access
- External Debt as % GDP
- FDI as % GDP
- Democracy
- Conflict
- Number of Loans in the past year
- Country and and Year Fixed Effects

Table E.3: Main Results using Inverse Probability Weights

	Share Num Loans	Share Sum Loans
UNSC _{t-1}	0.184*** (0.056)	0.135* (0.072)
Log GDP _{t-1}	0.166 (0.194)	0.088 (0.205)
Log Population _{t-1}	0.234 (0.555)	0.391 (0.591)
Log US Military Aid _{t-1}	0.071 (0.071)	0.081 (0.075)
War _{t-1}	0.014** (0.007)	0.014* (0.008)
Corruption _{t-1}	0.153 (0.374)	0.270 (0.375)
Political Proximity _{t-1}	0.001 (0.003)	0.002 (0.004)
External Debt/GDP _{t-1}	-0.000 (0.001)	-0.000 (0.001)
FDI/GDP _{t-1}	0.077 (0.100)	0.062 (0.114)
Financial Market Access _{t-1}	-0.111 (0.099)	-0.181* (0.098)
Investment Risk _{t-1}	0.057 (0.052)	0.062 (0.058)
Democracy _{t-1}	-0.006 (0.031)	-0.010 (0.040)
Rule of Law _{t-1}	-0.068 (0.072)	-0.054 (0.078)
Country FE	Yes	Yes
Year FE	Yes	Yes
Observations	487	478

*** $p < 0.01$; ** $p < 0.05$; * $p < 0.1$

Figure E.1: Panel Match: Effect UNSC Membership on Share of Co-Financing



Note: Figure shows average treatment effects on the treated (ATT) with 95% confidence interval for each year since joining the UNSC. Standard errors are clustered at the country level. For understanding, $t + 0$ is the first year of UNSC membership. Consequently, $t + 2$ is the first year after leaving the UNSC.

F Mechanism Tests

Table F.1: Full Results Effect UNSC on Share of Private Loans

	Share Num Loans	Share Value Loans
UNSC _{t-1}	0.082* (0.043)	0.130** (0.059)
Log GDP _{t-1}	0.151 (0.199)	0.034 (0.183)
Log Population _{t-1}	-0.587 (0.532)	-0.715 (0.481)
War _{t-1}	0.045 (0.048)	0.053 (0.060)
Log US Military Aid _{t-1}	0.009 (0.007)	0.011** (0.005)
Political Proximity _{t-1}	-0.102 (0.126)	-0.074 (0.137)
Democracy _{t-1}	-0.158** (0.063)	-0.107 (0.066)
Financial Market Access _{t-1}	-0.271 (0.205)	-0.237 (0.247)
FDI/GDP _{t-1}	-0.001 (0.003)	-0.001 (0.003)
External Debt/GDP _{t-1}	0.001 (0.001)	0.001 (0.001)
Investment Risk _{t-1}	-0.029 (0.027)	-0.024 (0.030)
Rule of Law _{t-1}	0.052 (0.047)	0.045 (0.048)
Corruption _{t-1}	-0.018 (0.044)	-0.036 (0.049)
Country FE	Yes	Yes
Year FE	Yes	Yes
Observations	487	478
R Squared	0.369	0.311

*** $p < 0.01$; ** $p < 0.05$; * $p < 0.1$

Table F.2: Effect UNSC on Share of Co-Financing: Private vs. Public Loans

	Priv. Num Loans	Priv. Value Loans	Pub. Num Loans	Pub. Value Loans
UNSC _{t-1}	0.187*** (0.053)	0.194*** (0.074)	-0.008 (0.035)	-0.064 (0.042)
Log GDP _{t-1}	0.249** (0.124)	0.157 (0.135)	-0.068 (0.168)	-0.044 (0.177)
Log Population _{t-1}	-0.388 (0.311)	-0.498* (0.286)	0.920* (0.557)	1.146** (0.538)
War _{t-1}	0.080 (0.049)	0.088* (0.052)	-0.013 (0.039)	-0.013 (0.060)
Log US Military Aid _{t-1}	0.012*** (0.004)	0.015*** (0.004)	0.001 (0.004)	-0.004 (0.005)
Political Proximity _{t-1}	-0.071 (0.066)	-0.063 (0.065)	-0.036 (0.107)	-0.107 (0.103)
Democracy _{t-1}	0.006 (0.048)	0.025 (0.067)	0.044 (0.059)	0.010 (0.066)
Financial Market Access _{t-1}	0.028 (0.130)	0.054 (0.141)	0.147 (0.246)	0.188 (0.263)
FDI/GDP _{t-1}	0.001 (0.003)	0.001 (0.004)	0.001 (0.002)	0.002 (0.003)
External Debt/GDP _{t-1}	0.000 (0.001)	0.000 (0.001)	-0.000 (0.001)	-0.000 (0.001)
Investment Risk _{t-1}	-0.012 (0.014)	-0.013 (0.016)	0.007 (0.020)	0.008 (0.023)
Rule of Law _{t-1}	-0.024 (0.038)	-0.018 (0.045)	-0.033 (0.043)	-0.031 (0.054)
Corruption _{t-1}	0.029 (0.035)	0.007 (0.036)	0.041 (0.053)	0.061 (0.058)
Country FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Observations	487	478	487	478
R Squared	0.214	0.201	0.300	0.256

*** $p < 0.01$; ** $p < 0.05$; * $p < 0.1$

Table F.3: Likelihood of Co-Financing and Private Loans

	Co-Financed			
	(1)	(2)	(3)	(4)
Private Loan	-0.311*** (0.045)	-0.076 (0.078)	-0.079 (0.080)	-0.064 (0.084)
Log Investment Amount	0.016** (0.008)	0.022*** (0.008)	0.030*** (0.008)	0.043*** (0.010)
Constant	0.314** (0.146)			
Year FE	No	No	Yes	Yes
Country FE	No	No	No	Yes
Issue Area FE	No	Yes	Yes	Yes
Observations	1,779	1,751	1,751	1,751
R ²	0.082	0.141	0.157	0.183

Note:

*p<0.1; **p<0.05; ***p<0.01

Table F.4: Full Results Effect UNSC on Share of Co-Financing in World Bank

	Number	Number	Number	Value	Value	Value
UNSC _{t-1}	-0.011 (0.059)	-0.011 (0.059)	-0.009 (0.059)	0.002 (0.060)	0.001 (0.060)	0.004 (0.061)
Log GDP _{t-1}		-0.093 (0.121)	-0.092 (0.129)		-0.119 (0.117)	-0.119 (0.124)
Log Population _{t-1}		-0.340 (0.438)	-0.211 (0.469)		-0.450 (0.458)	-0.339 (0.491)
Log US Military Aid _{t-1}		0.005 (0.003)	0.004 (0.003)		0.004 (0.004)	0.003 (0.004)
War _{t-1}		0.009 (0.071)	0.012 (0.069)		-0.011 (0.071)	-0.006 (0.070)
Corruption _{t-1}			0.001 (0.041)			0.010 (0.040)
Political Proximity _{t-1}			0.071 (0.081)			0.072 (0.082)
External Debt/GDP _{t-1}			0.000 (0.001)			0.000 (0.001)
FDI/GDP _{t-1}			0.002 (0.002)			0.001 (0.002)
Financial Market Access _{t-1}			-0.095 (0.160)			-0.161 (0.185)
Investment Risk _{t-1}			0.011 (0.015)			0.007 (0.016)
Democracy _{t-1}			-0.081 (0.076)			-0.065 (0.082)
Rule of Law _{t-1}			0.010 (0.046)			0.007 (0.047)
Country FE	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	836	834	834	836	834	834
R Squared	0.273	0.278	0.285	0.277	0.281	0.287

*** $p < 0.01$; ** $p < 0.05$; * $p < 0.1$

Table F.5: Effect UNSC on Investment Risk

	Investment Risk	Rule of Law	Corruption
UNSC _{t-1}	0.252*** (0.084)	0.024 (0.051)	0.056 (0.045)
Log GDP _{t-1}	0.495** (0.211)	-0.046 (0.093)	0.009 (0.089)
Log Population _{t-1}	-1.863*** (0.547)	-0.120 (0.229)	-0.160 (0.197)
War _{t-1}	-0.002 (0.178)	0.024 (0.055)	-0.043 (0.088)
Log US Military Aid _{t-1}	-0.009 (0.011)	0.001 (0.004)	-0.002 (0.004)
Investment Risk _{t-1}	0.758*** (0.042)		
Rule of Law _{t-1}		0.864*** (0.032)	
Corruption _{t-1}			0.810*** (0.026)
Country FE	Yes	Yes	Yes
Year FE	Yes	Yes	Yes
Observations	696	696	696
R Squared	0.886	0.928	0.921

*** $p < 0.01$; ** $p < 0.05$; * $p < 0.1$