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Introduction

In his renowned novel *Great Expectations*, Charles Dickens explores class differences and struggles in nineteenth-century England through the story of a young boy named Pip. Living in a poor fishing town, Pip one day receives a huge sum of money from an anonymous source. The money is kept in a trust, intended to support Pip's transformation into a gentleman. Accepting the generous offer and the conditions that come along with it, Pip moves to London. He quickly becomes well-versed in the ways of the aristocracy, and more educated and sophisticated than he would ever have otherwise been. One day, the generous donor appears. To Pip's surprise, it is not the wealthy old lady whose niece he used to play with (whom he always suspected was responsible for his fortune), but a convicted runaway criminal whom he helped to hide when he was very young. This revelation poses some serious moral dilemmas: Is there an importance to the nature of the source of the money that meant to benefit Pip? Did it *really* benefit him, though it uprooted him from his home under the assumption that a privileged life among the nobility is superior? What power does the source of his finances have over his life, and what kind of demands can his benefactor make of him? Finally, given these circumstances and dilemmas, would Pip have been better off not accepting the offer?

The moral questions that are raised by Dickens' novel on an individual level with respect to Pip, his personal destiny, and the choices he is given may also capture the complex relationship between donor and borrowing states within the arenas of international financial institutions and their policies.[1]

[1] These can obviously also be posed with regard to bilateral aid, but that is not the central matter of this study.

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Ultimately, the concerns preoccupying the critics and supporters of these institutions are very similar to those presented by Dickens: In what way can or should donors impose their policies on those receiving aid? Are these institutions doing more harm than good? Would developing countries be better off integrating into the world economy at their own pace, with no outside influence? And, finally, would it be realistic to expect donor countries to provide aid but forgo imposing conditions on the developing countries receiving the aid?

While this research cannot begin to answer all of these complicated questions, it provides a first and important step in the study of regional development banks, which belong to the family of international financial institutions (IFIs). It explores the internal dynamics of these institutions, analyzes how they approve loans, and places the disbursed loans in the context of the socioeconomic and financial status of the recipient countries. The donor countries that support these institutions, although not anonymous, have certain agendas that they wish to advance. If it were not for their own self-interest, these wealthy nations might not engage in development efforts in the first place. Yet while the borrowing members of the institutions are eager for the assistance, critics of these institutions often claim that IFIs contribute to developing countries' debt in a way that exacerbates these countries' problems rather than constructively advancing their development. Naturally, donors wish to retain control wherever possible, while borrowers strive for more independence and power over their own destinies.

RDBs have been a central vehicle for multilateral assistance since the 1960s. While the Inter-American, Asian, and African Development Banks (IDB, AsDB, and AfDB) were created as a result of Cold War geopolitics – in an effort to expand American influence – the official justification for their creation was to provide poor countries with a bigger say in multilateral banks that affect their development. It would follow, then, that the RDBs should be spared the harsh criticism generally directed at IFIs, particularly with regard to donor control. But whether RDBs serve developing countries better than global IFIs by virtue of their membership composition and the voting shares that are allocated to borrowing (developing) members is a question that still lingers. To operate properly, it may prove advantageous (or even imperative) that multilateral banks have a nonregional, nonborrowing hegemon; however, this would then undermine the stated rationale for the RDBs existence, that is, that aid institutions managed and run by the recipients of the aid are in a better position to contribute to the goals of poverty alleviation and development.

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Moreover, the fact that RDBs, despite greater stakeholder involvement, fall into the same policy related "traps" that the World Bank and IMF are so heavily criticized for might indicate that institutional mechanisms have a greater impact than the preferences of the institutions' member states.

The research presented here has implications for numerous theoretical and policy debates associated with multilateral financial institutions and development aid. These include whether and how cooperation works, and the power politics and policy agendas engendered in multilateral organizations. Furthermore, it considers questions about the merits of aid and multilateralism, including the way multilateral aid/lending institutions work; the effect aid may have on developing countries; and the fundamental question of whether developed countries use multilateral institutions to advance their own interests.

The theoretical foundations for this book, rooted in the ongoing realism-liberalism (neoliberal institutionalism) debate, as well as more recent constructivist approaches to cooperation, provide a useful focal point for the study of RDBs. The comparison of four institutions allows for an assessment that goes beyond interests, preferences, and outcomes. It provides a platform from which differences in norms, ideas, and culture, as well as hegemonic configuration, can be analyzed. The synthesis of these issues requires careful analysis. Although these underlying themes may be theoretical in nature, the ideological positions that they generate have a strong bearing on the "real world." An understanding of the theoretical premise of development can shed light on the approaches, critiques, and possibilities of development assistance and poverty alleviation policies.

The subject of assisting developing countries has become central to academic and policy debates since the end of the Cold War. Bilateral assistance has always been considered a useful foreign policy tool. But even the bilateral avenue is scrutinized, to a certain extent, by the international community: in 1970 the UN General Assembly passed a resolution that the world's rich countries contribute 0.7 percent of their gross national product (GNP) to aid. Over the years, this pledged target has been affirmed in many international commitments.[2] Furthermore, the Organization for Economic Cooperation and Development (OECD) publicizes the actual amount allocated to aid by OECD countries and

[2] Examples include the 2002 International Conference on Financing for Development in Monterey (Mexico), the World Summit on Sustainable Development in Johannesburg held the same year and more recently, the Paris Declaration on Aid Effectiveness in 2005, and the forums on Aid Effectiveness in Accra (2008) and Busan (2011).

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examines the actions of individual members through the Development Assistance Committee (DAC) in an effort to hold rich countries accountable. Multilateral assistance, one would think, should be less prone to political influences because members must compromise. However, in recent years there has been a surge of activists from nongovernmental organizations (NGOs) and various grassroots movements who are waging a "war" against multilateral financial institutions (namely the World Bank, IMF, and WTO) and other international financial entities that are perceived to be dominated by wealthy countries or large corporations (such as the G7 and the annual International Economic Forum at Davos). For example, the "Fifty Years Is Enough" NGO, one of the leading organizers of the campaign against multilateral financial institutions, describes the World Bank and the IMF in the following way:

> The IMF and World Bank have been empowered by the governments which control it (led by the US, the UK, Japan, Germany, France, Canada, and Italy – the "Group of 7," which holds over 40% of the votes on their boards) with imposing economic austerity policies in the countries of the so-called "Third World" or "global South." Once Southern countries build up large external debts, as most have, they cannot get credit or cash anywhere else and are forced to go to these international institutions and accept whatever conditions are demanded of them. None of the countries has emerged from their debt problems; indeed most countries now have much higher levels of debt than when they first accepted IMF/World Bank "assistance." (www.50years.org)

Sights of protesters waving banners, chanting, and at times clashing with police forces, whose ranks are heavily reinforced at locations of meetings and conferences of the international financial institutions, have become all too familiar. These events warrant careful investigation and analysis. This book and its conclusions provide a platform for understanding the complex decision-making processes and internal political makeups of multilateral financial institutions. By analyzing the history of loans these institutions made in the context of the socioeconomic status of the countries that borrow from them, this study lays out unique and systematic insights into RDB activity patterns over time. Comparing the four development banks yields important conclusions about the role of principal-agent relations and institutional culture in generating aid policies. This, in turn, provides a better understanding of their impact and effectiveness.

Initially, I thought this project would provide clear-cut answers: The strong and vocal ideological stance of all sides of the debate concerning multilateral financial institutions could easily lead one to believe that one must be either "for or against." However, as I accumulated more

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data, interviewed more RDB officials, and visited the headquarters of two of the four RDBs in this study, I realized that just as the problems faced by poor countries and their relations with wealthy countries are complex, so are the strategies undertaken by RDBs (and, by extension, other multilateral financial institutions). Although a central characteristic of the RDBs is that they are different in membership from their international counterparts (the World Bank and the IMF), they are related in that they are lenders to developing countries. The people who work in these institutions are not all cold-hearted bankers or calculating economists. Apart from some obvious misguided policies, some of the traps they fall into are bureaucratic, some are political, and some are simply based on lack of knowledge and processes of trial-and-error. Since these institutions are not likely to be eliminated in the foreseeable future, we should strive to understand how they really work.

Fortunately, an emphasis on reforming IFIs has been a major concern of government officials, scholars and think tanks, and even IFI's own leadership and staff. For example, the RDBs have been studying (and to a varied and limited extent, implementing) productive avenues for reform; the World Bank has conducted numerous internal studies on its own reform needs; and in 2000, the US government commissioned a bipartisan assessment on the merit and future of these institutions (the International Financial Institution Advisory Commission). Those who advocate that we reconsider how wealthy countries assist poor ones serve us well when they present alternatives and critique the current policies of these institutions.

At the outset of the twenty-first century, and with the changed nature of global politics and finance since the end of the Cold War, understanding the creation and endurance of IFIs is crucial if we want to engage in useful debates concerning their policies, effectiveness, and necessity. The interaction between developed and developing countries has become the focus of global political and economic agendas, and development banks are key players in these relationships. They are central to the study of international political economy and security studies alike. As developed and developing countries are encountering more security-related friction, some of which can be traced to poverty in the developing world, it becomes apparent that securing cooperation through multilateral institutions can serve both the international economy as well as global security. But these institutions must work well for this task to succeed. If they generate angry protests and cynicism then their mere existence may be counterproductive to the desired pacifying impact of cooperation.

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The four RDBs analyzed in this book are representative of the multitude of multilateral financial arrangements that exist today, and this study therefore brings us a step closer to an improved theoretical analysis of this phenomenon, as well as a basis for better policies for sustainable development.

By examining the four RDBs – comparing their structures and policies – this book offers a novel analysis of IFIs. First, it demonstrates the tension between the development mission of these institutions and their bank-like features. Second, it shows that the way in which the institution is governed impacts its ability to operate more like a development agency. Overall, despite the difference in configurations of hegemons, all the RDBs struggle to generate more "financially risky," albeit mission-focused, policies.

Further, while it may be expected that an institution with an active and influential hegemon would advance financially prudent policies, the AfDB, an institution governed mostly by borrowers, without an external, active hegemon, also appears to prefer financially cautious policies. Understandably, Multilateral Development Banks (MDBs) are concerned with their financing, which provides their borrowers the support they seek. However, the way in which the institutions are structured and governed determines their ability to truly be development institutions. Finally, the more recently created European Bank for Reconstruction and Development (EBRD) experimented with an entirely different mission – one that does not shy away from political goals (democratization and privatization), and does not try to hide the interests and status of its non-borrowing members. In that sense, it is more like a bank with political goals rather than a political institution with financial goals.

The rest of this book carefully lays out the histories of the RDBs, maps their lending over the years, and places the data analysis in the context of the stories of each of these institutions. Following a detailed introduction to multilateral development banks (Chapter 1), Chapter 2 presents the analytical and theoretical issues at stake when it comes to regional cooperation and economic development. Chapter 3 presents the history and the background of each of the four major RDBs. The data employed in this study are presented in Chapter 4, along with examples of specific countries, while Chapter 5 applies rigorous statistical analysis. The conclusions of this analysis are supplemented in Chapter 6 with qualitative data, primarily from numerous interviews and secondary sources. A brief conclusion summarizes the book, suggests new avenues of research, and provides policy advice along with speculation as to the role of RDBs in the future.

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International Financial Institutions, Development, and Regional Development Banks

> This association of poverty with progress is the great enigma of our times. It is the central fact from which springs industrial, social, and political difficulties that perplex the world, and with which statesmanship and philanthropy and education grapple in vain. From it come the clouds that overhang the future of the most progressive and self-reliant nations. It is the riddle which the Sphinx of Fate puts to our civilization, and which not to answer is to be destroyed. So long as all the increased wealth which modern progress brings goes but to build up great fortunes, to increase luxury and make sharper the contrast between the House of Have and the House of Want, progress is not real and cannot be permanent.
>
> – *Henry George,* Progress and Poverty, *1879*

In this era of globalization – where international financial markets affect developed and developing countries alike, and where financial flows as well as economic crises spread across borders and oceans with remarkable ease – the role of multilateral financial institutions in the international financial scheme is crucial. These public institutions, designed by politicians and economists to navigate the labyrinth of economic, social, and political development, possess the potential to be central players in the long-term planning involved in healing poverty-plagued regions and advancing their economies. This formidable task offers the invaluable payoff of furthering global economic and financial stability and improving human welfare.

Consequently, the issues of aid and development that are related to globalization have been at the center of academic debates. Multilateral financial institutions, designed to implement global financial policies, have been an integral part of these debates and have come under

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increasing scrutiny. Critics vary from those who believe that these institutions do more harm than good by contributing to the "moral hazard" problem[1] and should therefore not exist, to those who believe that they can play an important role in development, but need to be reformed (Stiglitz, 2002, and Sachs, 2005). But even if one begins in the second, more positive, camp, there is still substantial disagreement as to how these institutions should function so that they can be both constructive and efficient. Much of this controversy stems from limited knowledge about how multilateral financial institutions work and what they are designed to do. Additionally, the financial crises of recent decades (the Mexican Peso Crisis in 1995, the Asian Financial Crisis in 1997, the Russian crisis in 1998, the crisis in Argentina in 2001, and the 2008 US credit crisis) have not only highlighted the potential of international financial institutions to be central actors in efforts to correct market failure, but also signified the fluid changes in the international economic system and the importance of institutional flexibility in addressing new challenges effectively.

Since the late 1980s, RDB lending actually exceeded that of the World Bank. Still, RDBs have received little academic attention compared to other multilateral financial institutions.[2] Evidently, with loan commitments ranging from US $4 billion to over US $12 billion in 2011 for each of the four banks compared to the World Bank's (IBRD) US $26.7 billion loan commitments that same year, the RDBs are certainly central actors in the regions that borrow from them.

Further, in a volatile global economy, lenders of last resort could conceivably be essential for economic recovery. For example, the recent credit crisis and its spread to the developing world, makes the presence of IFIs even more crucial: as private banks scale back their lending to poor countries, these public institutions will surely bear the brunt of the burden of assisting developing countries – not only to continue the efforts already made, but also to prevent a large scale credit crisis, given these countries' accrued debt.

The central puzzle of this study stems from the conflict between the development function of RDBs and their bank function.[3] As this research

[1] That is to say, developing countries follow inefficient and, sometimes destructive, financial policies knowing that if a crisis occurs they will be bailed out (see Milton Friedman, 1992; also, for the debate on the need for aid in general, see Moyo, 2008 and Easterly, 2001).

[2] See Culpeper (1997), Krasner (1981), Neumayer (2003), Babb (2009), and Strand (2010) for the few comparative academic discussion of the regional development banks.

[3] By "conflict" I mean that these two functions often pull the banks in contradictory directions, forcing them to prioritize one over the other.

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shows, these institutions embody structures and operational policies that are similar to those of private banks and corporations. This means that considerations of loan repayment by borrowers (developing countries) are central to the RDBs' decision-making. And by making financial considerations a priority, development needs can be marginalized. Moreover, as their membership is comprised of states, decisions can often be the result of foreign policy preferences and, therefore, RDBs' policies can potentially become extensions of member states' policies, compromising their central role of agents of development. Nevertheless, RDBs' mission is to fill a certain development gap and (multilaterally) assist developing countries in the process of poverty alleviation and development. This task frequently requires formulating and following policy that is financially risky or that does not pay off in the short run.

These conflicting identities are set against the backdrop of the changing paradigms dominating the field of development finance. Specifically, since the central operation of these institutions is loan-making, the line between aid (to developing countries) and financial and political motives (of developed countries) can sometimes be blurred.[4]

Further, the bank financing, that is, the credit, that is available in developed countries is not available to the same extent in developing countries. Development-focused assistance should therefore be designed to supplement financial markets, overcome market failure, and provide credit to support projects that developing countries' governments cannot afford, thereby aiding in processes of development that are often not lucrative for private sector investors.[5] Multilateral channels of development assistance permit many different potential donors to coordinate their efforts, and yet allow developing countries to avoid direct dependence on one single donor. However, this institutionalization of development is problematic because financial markets and private financial flows are dynamic in nature, making development lending a moving target. Thus, the environment in which RDBs operate is continuously changing. It is at these junctions of change that development banks need to continually reinvent themselves in order to remain on the path to fulfill the goals they were set up to achieve.[6]

[4] This also contributes to multilateral development banks' problematic positioning in the court of public opinion.

[5] The recent banking crisis in the US has demonstrated that private credit institutions often operate with a preference for short-term profits and little, if any, long-term planning.

[6] In this study, I mostly refer to "poverty alleviation" and "development" collectively. However, it should be emphasized that by no means do I regard them as synonymous. In

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Thus, the research question guiding this study is: *How do the RDBs balance their bank features with their development mission?* To explore this puzzle this book first analyzes the history and foundation of the RDBs, and then explores the way they operate and how – and whether – they have changed over time.

1.1 THE RESEARCH QUESTION IN THE LARGER CONTEXT

Recently, with accelerated changes in the global financial markets, the role of multilateral financial institutions has been scrutinized and reconsidered. Many of these institutions were established by Western states in the aftermath of WWII and during the Cold War, with the goal of helping advance less developed economies. These institutions, such as the World Bank (WB) and the International Monetary Fund (IMF), were fundamentally a political initiative and are still a political enterprise. However, since the loan mechanism, policies, and the financial assistance they provide are frequently the targets of controversy, IFIs often try to elude their political makeup and portray themselves as economic-driven organizations, characterized by professionalism and immunity to the "political game."[7]

The goals of these institutions are noble: help developing countries overcome the vicious cycle of poverty and eventually become part of the "club" of developed nations. However, it is impossible to imagine that such efforts can be carried out in a nonpolitical way. First, setting up a financial institution in which states are members and shareholders[8], and monetary contributions are reviewed and decided upon by legislators, is political in nature. Second, the threshold as to who is categorized as developing and to what degree, and who can become a member, is prone to political influences. Third, since resources are limited while demand is immense, setting priorities among so many deserving requests for loans embodies, in part, a political preference.

fact, many students of development stress that they are not: poverty alleviation does not necessarily mean that development has occurred, and successful development does not imply the alleviation of poverty.

7 The idea of overcoming market failures embodies both political and economic attributes: It is pursued by states and is thus a political decision by nature, while it involves financial and economic means, resources, and strategy.

8 According to Barry Metzger, former General Counsel to the Asian Development Bank (interview May 2001), shareholders (states) play a very intrusive role in the activities of the RDBs.

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