

Political Aid: Is Multilateral Lending Strategic?

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* Comments welcome!

Abstract

International Financial Institutions have been at the center of policy debates in the past decade. As multilateral development agencies, they represent an important arm of international aid and their activities are highly consequential to donors and borrowers, North-South relations, and the stability of the international economy. They have been accused by politicians, activists, and academics of: (1) operating as foreign policy extensions of powerful donors; (2) not directing their efforts to the neediest countries that borrow from them; and (3) competing with private sector resources in developing countries. This paper tests these various claims of “strategic-lending” using the example of regional development banks (RDBs). It explores whether strategic lending occurs and under what circumstances we are more likely to see lending that is strategic. A comparison of the four major RDBs highlights the possible reasons for employing certain strategies in lending under varying institutional designs. Findings suggest that lending policies across the institutions are not identical, and that strategic lending occurs in varying degrees under and varying circumstances. No conclusive “pattern” of strategic lending has been found, suggesting either that other motivations might be driving RDBs’ decision making, or that the economic and political forces influencing the institutions’ decision-making are pulling the banks in different directions, causing inconsistent lending policies.

Introduction

There are four major regional development banks (RDBs): The Inter-American Development Bank (IDB), the African Development Bank (AfDB), the Asian Development Bank (AsDB), and the European Bank for Reconstruction and Development (EBRD). The first three were created in the 1960s and were modeled after the World Bank. The EBRD was created in 1991, with the fall of the USSR, under very different circumstances and with a different mandate to serve a different purpose. They all share the goal of development in the developing region they make loans to. They are also all primarily lending institutions – disbursing loans to projects (“project lending”). While they are not profit-making institutions, they do operate like banks in that they assess the merits of projects not only on the basis of needs, but also on the prospects for success, maximizing the likelihood of their loans being repaid. Moreover, the RDBs charge interests on their loans. Although the interest charged by the banks is often below market rate, variable, and with long maturities, it is an essential component of the RDBs budget plan.

The RDBs provide an excellent platform for investigating the merits of international financial institutions (IFIs), development strategies employed by Western countries, and the effects of globalization on developed and developing countries. Because of their similar scope (each make loans to a developing region), exclusive lending targets (there is hardly any overlap in the countries they each lend to),¹ and comparable reasons for creation (apart from the EBRD) the RDBs present a unique

¹ The only overlap is between the AsDB and the EBRD – they both make loans to the eastern former Soviet caucuses. However, this has little impact on this study as: (a) it is only a handful of countries; and (b) the EBRD becomes relevant only in the 1990s and its different mission and mandate set it apart from the AsDB.

opportunity for research on IFIs with a comparative aspect that is added to the study (most academic studies of IFIs focus on either the World Bank or the IMF). RDBs are also an important contributor to the debt problem of the developing world and thus the subject of much scrutiny in the past decade with the emergence of developing countries' debt crisis. At a time when activists, policy makers, and politicians all advocate debt relief studying the roots of the debt problem is indispensable for the achievement of a viable solution.

The International Financial Institutions Advisory Committee (IFIAC), appointed by the US Congress in 2000 to study and make recommendations on the work of IFIs (including the RDBs), found that the IFIs suffer major shortcomings and made suggestions for the improvement of their work. The IFIAC Report is important not only for its contents, but also as a signal that major donors to the IFIs are engaging in the debates on development strategies and see themselves as stake holders in the institutions. Although major donors could retain more control on aid and development initiative by focusing on bilateral lending and aid, donors are apt to sustain the IFIs because they perceive certain advantages in administering loans and aid through multilateral institutions.

This paper examines how decisions about loans are made in IFIs. Using the example of RDBs, I compare the institutional structures (decision-making apparatus) of the four institutions and analyze their loans over time. Since the primary activity undertaken by the banks is making loans, a comprehensive analysis of their loan activities provides insight into their decision-making process. With the various political and financial pressures these institutions face, this paper analyzes whether lending is strategic

and what implications this might have on the prospects for a successful development policy.

Puzzle and hypotheses

This analysis is intended to provide some answers to a central puzzle underlying the work of IFIs in general and RDBs in particular: Since these institutions embody both banking and political features, does strategic lending occur? And, if it does occur, under what circumstances are we more likely to see certain strategies being employed? I use the term “strategic lending” to indicate lending that is driven by motivations that are not primarily poverty alleviation or development.²

[Insert table 1 here]

The organizational structure of RDBs resembles that of a corporation: They are governed by a board of directors that represent the shareholders (states), while their daily operations are managed by a president, managers, and permanent staff. Additionally, the banks are rated by rating agencies such as Standard and Poor’s and Moody’s. In order to maintain their shareholder support, the RDBs must sustain prudent financial policies, a solid financial portfolio, and a balanced budget. Shareholders provide the bulk of the

² Although the loans can still contribute to both poverty alleviation and development, when the institutions lend strategically they put other considerations above those of development. This can cause suboptimal efficiency and results.

capital available to the banks and the banks' ratings depend on the financial standing of its central supporters (hence the need for support by countries with strong economies). However, of the money committed by shareholders, only 10-20% is actually "paid-in" and available for use in the regular budget. The remaining committed capital, "callable capital", is not expected to be used, or called upon. These reserves of committed capital help provide the RDBs with the reputation, rating, and safety net they need. If they make use of the callable capital their ratings would drop and donors would likely reassess their support. Thus, the total sources available to the RDBs in each budget year are the paid-in capital of the members, returns on investments, and returns on loans and interest. Since the RDBs are non-profit institutions, they must use their budgets every fiscal year and are sometimes caught in what observers call 'the need to get the loans out'.

All member countries are shareholders of the RDBs. Both donor and borrowing members own shares in the banks based on the amount of capital they commit. Their voting power corresponds (although not linearly) to the amount of shares they hold. However, unlike the World Bank, the RDBs' charters guarantee a more central role to the borrowing members of the banks and limits the powers of the donors (as we shall see, these limitations vary from bank to bank). But ultimately, it is the board of governors/directors that approves each loan, and important members on the board, even if they are not majority shareholders, must be appeased. Thus, politically, the RDBs are a forum in which states – rich and poor – interact. The member states have certain preferences and interests that guide them in their decision-making. Nevertheless, they are bound by the RDBs' Articles of Agreement and their power is limited by their need to delegate responsibilities to the agency.

Finally, the purported *raison d'être* for the RDBs existence is to fill a gap in development. Three of the RDBs stress their goal of poverty alleviation and development (IDB, AfDB, and AsDB). They also vow to make loans only to projects that would not otherwise get funded, making a sound contribution to development in poor countries.³ However, it is not entirely clear how the RDBs assess the merits of projects proposals – there is much room for financial and political maneuvers to enter the set of considerations that are otherwise supposed to primarily focus on poverty alleviation and development.⁴

The dilemma is partly based on the question of what constitutes a successful project. If success means getting the loans repaid and being able to use these funds to make new loans (thus maintaining good credit rating and donor support), then the guiding considerations when approving the loans are financial. How likely is the project to be completed in a timely manner? How likely is it that the government receiving the loan will be in a position to repay the loan at the designated maturity time? These considerations indicate lending that is financially strategic. There is more of a chance in this case that the project in question could garner financial support from the private sector.⁵ Lending that is politically motivated occurs when major shareholders (hegemons) make interest-based decisions and prefer making loans to allies or countries that are strategically important to them. Finally, development driven loans are those that

³ The EBRD's agenda is more openly political: To promote market economies and democratization. However, it also stresses its commitment to "additionality" – making sure that their loans are not competing with the private sector. This has been an important aspect of the bank's public relations campaign particularly after it came under heavy critique in the mid 1990s for competing with private sources available to Eastern European countries and wasting public money.

⁴ Poverty alleviation and development are broad and contested concepts. There is no agreement as to what constitutes the best strategy to achieve them, and therefore it is hard to determine which project should or should not be pursued and whether these factors are calculated into the RDBs' motivations (and to what extent). So this analysis centers on observable phenomenon from which conclusions are deduced.

⁵ With more FDI making its way to developing countries, projects that carry with them possible profits (e.g. where there is very high likelihood the government will not default and there is business interest in the project itself) are more likely to get approved for funding by private sources.

are approved and disbursed because of the project's contribution to development, the assessment that no other (private) institution would finance the project, and a determination that the recipient needs aid.

To sum, strategic lending can be manifested as political and financial:

- 1) Financial strategic lending: considerations of the prospects of loan repayment trump need/development priorities.
- 2) Political strategic lending: powerful shareholders advance their own interests by supporting loans to countries with strategic ties.

It should be stressed that both of these types of strategic lending do not preclude the possibility that the loans disbursed do in fact contribute to development. This analysis is a step toward unraveling whether there is merit in the argument made by critics that the IFIs strategic lending practices are an impediment to their true role as development institutions. It does not attempt to measure the success of the loans and the extent to which they contribute to or hinder development. Also, strategic lending, according to the propositions above, can be either a result of the shareholders' influence or the agency's policy initiative. Both the shareholders and the agents (the institutions) have financial and political concerns that can influence their decision-making. This paper tests for possible political motivations employed by shareholders (or hegemons), and for financial considerations that are advanced by the shareholders, the institutions, or both.⁶

⁶ It is almost impossible to attribute the financial motivations, at any given time, to either the shareholders or the institutions. The comparison between the banks helps highlight differences between institutional structures and how they might affect strategic lending (including the level of involvement of the

Theory

Multilateral lending has numerous advantages for both donor and recipient states. First, IFIs are highly specialized, collect information and are able to process and provide the information to members in a cost-effective way. They provide the kind of expertise and analysis needed for the assessment of project-based loans and are intermediaries between donors and recipients, overcoming the Collective Action Problem. Second, they act as a “buffer” between the donors and the actual development activities being conducted, so that these activities seem less political than bilateral lending (Rodrik 1995; Milner 2003). This also enables donors to avoid being criticized directly for project failures since the institution bears the responsibility for its loan decisions. On the other hand, for powerful donors (hegemons), control and influence can be disguised within the actions of the institution; the hegemon can use the institution to advance its interest without seeming “political”.⁷ Third, for recipients, the setting of a multilateral institution can be more conducive for negotiating. This is especially true for the RDBs, where borrowing members hold a bulk of the shares and voting power and are influential in the decision-making process. Fourth, and related to the previous point, delegation of power to the institution can benefit recipients since the institution is more closely connected (through representatives, country offices, etc.) to the recipient country, and recipients might find it easier to deal with the experts and officials of the institution rather than with political figures who represent member countries.

shareholders and the resources available to the institution). This in turn enables some conclusions as to whether it is the principal or agent or both that is the driving force behind strategic lending.

⁷ See Thacker 1999 for an argument that the US is the chief influential decision-maker at the IMF. Also, see Stiglitz 2002, Easterly 2001, and Rodrik 1995 for a discussion of the “Washington Consensus”.

Hegemonic Stability Theory (HST) posits that hegemons are needed not only to create institutions, but also to maintain and sustain them. A strand of realism, HST argues that institutions merely reflect the interests of their members, particularly those of the hegemon (Krasner 1981, 1983; Gilpin 1987; Gowa 1984). The RDBs were created only because hegemons supported their formation. Although Latin American countries have been pressing for a regional development bank since the turn of the century, it was only in 1959 that the US finally changed its approach and agreed to create the IDB. Without American support the IDB would not have been created. And it was Cold War politics, and specifically the Communist Revolution in Cuba, that was the catalyst for this change of policy.⁸ But the idea for the institution itself originated in Latin America. The borrowing countries began the initiative, and kept pushing for it even after the Bretton Woods Institutions (BWI) were created, claiming that these institutions were primarily focused on the reconstruction of Europe and that developing countries were not benefiting from their development assistance.

Shortly after the foundation of the IDB, the AfDB and the AsDB were created (1964 and 1966 respectively).⁹ Like Latin American countries, African countries had been pushing for the creation of their own development institution for years. The US and Western European countries supported this initiative in the mid-1960s for similar reasons that led to the creation of the IDB: Cold War politics. The success of the IDB signaled that via multilateral aid institutions, the American sphere of influence could be sustained. The history of the AsDB is slightly different. Its creation was the initiative of the US and

⁸ And it should be noted that to this day Cuba is not a member of the IDB and thus is not eligible for its loans.

⁹ Officials at the IDB actively supported the creation of these other two development banks, believing that similar regional institutions would raise the importance of the RDBs, especially with respect to the World Bank and IMF.

Japan, rather than of developing Asian countries. However, it is not surprising that the timing of its establishment coincided with US involvement in Vietnam. At this time, the US was worried about the spread of Communism in Asia, and wanted to strengthen its bastions in the region. A financial institution seemed to be a useful, positive, and indirect way for the US to attain more dominance in Asia.

The EBRD was created at the twilight days of the Cold War. It was a Western European vision to establish a development bank that would assist in the development of market economies and democracies in the former Soviet strongholds of Eastern Europe. It was only possible to establish the EBRD, though, when the US agreed to support it. And although Western European countries are the most dominant donors and shareholders of the institution, American support is essential – and European donors coordinate their decisions with US representatives.¹⁰

HST is then clearly a useful tool of analysis for the early stages of the establishment of the RDBs. In his discussion of the power structures of RDBs, Krasner (1981) argues that “The disparate experiences of the regional development banks suggest that the best structure for weak developing countries is one in which there is a hegemon.” (p. 305) But to what extent are hegemons influential in the daily activities and decisions of the RDBs years after their creation? The first two hypotheses to be tested are therefore those that address the political strategy behind the lending policies of the RDBs:

(H1) If hegemon(s) determine the policies of the RDBs, then we expect the bulk of the loans made by the RDBs to be strategically aligned with hegemon(s)' interests (e.g. more loans to allies).

¹⁰ See Weber 1994 for more on the EBRD.

(H2) If hegemon(s) are influential on the Boards of the RDBs, then we expect the general policies of the banks to match the preferences of the hegemon(s).

The first hypothesis tests the possibility of political strategic lending based on the outcome of the work of the RDBs. An analysis of loan recipients tests whether a relationship exists between alliances and loan amounts. The second hypothesis deals with the decision-making process of the RDBs. Specifically, it asks what kind of role hegemon(s) play on the Boards of Directors of the institutions and in the daily process of approving loans. It tests whether hegemon(s) have special privileges or power that steer the policies of the RDBs in a direction that corresponds to vital interests of the hegemon(s).

Financial strategic lending offers a different explanation for the policy that drives decisions about loans. It suggests that the institutions and/or their shareholders are primarily concerned with the financial returns on the loans they make and above all would want to avoid countries defaulting on their loans. Thus, the third hypothesis this paper tests is that of financial strategic lending:

(H3) If RDBs are primarily concerned about their financial resources and balance sheets, then they are likely to make more loans available to countries that have better economic and social indicators (e.g. countries that are recipients of higher amounts of FDI, with higher GDP per capita, and that have lower mortality rates and higher levels of primary education).

This hypothesis has very important implications for development. If the institutions really follow a set of considerations that determine their preference to approve loans for projects that are less risky or where the return payments are certain (to the extent that they could be), then there is a much higher chance that they are competing with private lenders who are becoming more prominent in developing countries. Moreover, it puts in doubt the RDBs' commitment to fund projects that could otherwise not get funded.

The underlying assumptions of the hypotheses is that change – internal and external – has an effect on the work (and outcome) of the RDBs. H1 and H2 examine whether there is change from hegemonic control to institutional independence, while H3 is based not only on the notion that IFIs are interested in making sure their financial resources are intact, but also on the endogenous effects of the international financial environment. Globalization has created many new opportunities and possibilities for some developing countries. For IFIs (and RDBs) to be effective, their work must take into account this changing global economy. Otherwise, for example, a loan (to a country and project) that fit with the RDBs' policy at time T1 (of making loans that do not compete with the private sector), might not correspond with the banks' development commitments at time T2.

In analyzing whether the RDBs engage in strategic lending, we take into account their institutional structure. In doing that, principal-agent theory offers an alternative to the predictions generated by HST. Under this premise, we would expect that the principals (shareholders) would find it too costly to closely monitor and control the

operations of the RDBs and would therefore delegate responsibilities to the agent (institution).¹¹

This is a form of new institutionalism in rational choice theory that combines intergovernmentalism with a supranational approach: “The primary virtue of the new institutionalism in rational choice theory.... is that it allows us to transcend the intergovernmentalist-neofunctionalist debate by acknowledging the initial primacy of the member states and, proceeding from this point, to generate a series of hypotheses about supranational autonomy and influence more precise[ly].” (Pollack 1997, p. 101). Within this framework RDBs present an interesting case where the level of specialization and amount of information needed to assess the merits of loan proposals enables the agent to exert power. We expect that the RDBs’ shareholders delegate responsibilities, under a certain set of conditions. We also expect that there would be differences from bank to bank as the principal-agent relationship is not identical. Furthermore, the extent of delegation is likely to change over time.¹²

Testing these hypotheses and generating findings helps clarify the policy choices of RDBs and how they make decisions. It also places these multilateral financial institutions within the theoretical debate concerning the merits of HST and the extent to which principals delegate authority to agents (and whether principals can really control the extent of delegation). Knowing the preferences, considerations, and interests of the actors involved in multilateral development – determining whether they lend strategically, what strategies they employ, and under what circumstances they employ

¹¹ Principal-agent theory analyzes the degree to which principals delegate authority to their agents.

¹² For more on delegation see Pollack 1997; Epstein and O’Halloran 1999.

them – is essential for drawing conclusions on whether strategic lending undermines development.

Description of the variables and data

The hypotheses are tested in two stages. First, a large N data set for each one of the RDBs is used for the analysis of hegemonic influence on lending and lending that is financially strategic. The dependent variable in this first stage is the loans the RDBs made over the years (unit of analysis: country-year, loans).¹³ The independent variables consist of a political variable that tests political strategic lending by hegemon(s) of each one of the institutions, and socio-economic variables that test (1) the geographic distribution of loans relative to the size of the economies; (2) availability of private financing; and (3) levels of health and education. Time series panel corrected analysis is then used to analyze the data.¹⁴ The results then reflect changes over the years, for each country, and each bank.

For the hegemons, a dyadic data set that includes all pairings of UN General Assembly voting was transformed into the pairings of the hegemon(s) of each region and

¹³ For each one of the banks a separate data set is generated based on the years the banks have been operating. Because the years of operation of the banks are not identical the data was not pooled (IDB 1961-2000; AfDB 1966-2000; AsDB 1997-2000; EBRD 1991-2000). Also, this study includes only the non-concessional (ordinary capital resources – OCR) loans made by the banks since those are the ones that are mostly targeted by critics, whose parameters most resemble those of private institutions (the concessional lending windows of the RDBs resembles grants and is under a somewhat different mandate), and they constitute the bulk of the RDBs financial resources (for example, by the end of 1992, 68% of the AsDB's lending was done by the non-concessional lending window). For the IDB, AsDB, and EBRD the data was collected from the banks own records. Since the EBRD had only aggregate figures for 1991-4, estimation was done to separate those years. Data for the AfDB was obtained from OECD data sources.

¹⁴ The data collected is in time-series form, and the statistical analysis is done using Ordinary Least Square (OLS) or Prais-Winsten models with panel corrected standard error regressions that produce panel corrected standard errors (PCSE) estimates for linear cross-sectional time-series models (for more on OLS estimator, its advantages and shortcomings, see Kennedy 2001).

each recipient country, for all the years the banks have been operating.¹⁵ Each pair (of hegemon and loan recipient in this case) receives a value between 0 and 1 that indicates the level of alliance as measured by UN voting; 0 indicates the countries never cast a similar vote, while 1 indicates a strong alliance in which the two countries always vote alike.

Thus, the US, which is the central hegemon of the IDB was paired with each of the bank's borrowing Latin American countries; the US and Japan, both hegemons (and often competing) at the AsDB, were each paired with all AsDB borrowing countries for every year of the bank's operations; since the AfDB is somewhat different – there is no clear hegemon – the US and France were paired with each of the recipient countries. The US played an important role in the AfDB's foundation and France has maintained a substantial presence (and interest) in post-colonial Africa, thus these two countries are tested for possible effects of hegemonic influence. Finally, major European powers and the US are most influential at the EBRD (“multiple hegemony”) and therefore Germany, France, the UK, and the US were all tested as possible hegemons in pairings with all borrowing members of the bank. This variable tests political strategic lending.

Correlation between similarity in voting over the years (elevated alliance) and loans is an indication that hegemon(s) are influential and have a preference in rewarding allies.

The socio-economic independent variables include GDP per capita, Foreign Direct Investment (FDI), infant mortality rates, and primary school education.¹⁶ These variables were chosen because they represent the size of a county's economy (GDP, GDP

¹⁵ This data set was compiled by Eric Gartzke. See: <http://www.columbia.edu/~eg589/datasets.htm>.

¹⁶ FDI was collected from the United Nations Conference on Trade and Development in Geneva. GDP figures were taken from the World Bank, World Development Indicators. Population data is from the UN. Data on infant mortality comes from the US Bureau of Census, International Programs Center, Population Division. And primary school enrollment data is from the Arthur Banks data set.

per capita), its ability to attract private financial sources (FDI),¹⁷ and its social advancement based on basic health and education indicators (infant mortality rates and primary school enrollment). Together, these indicators point to levels of development: Higher GDP per capita, more FDI, lower infant mortality rates, and higher levels of primary school enrollment indicate that a country is relatively more developed. This is particularly important for testing the economic strategic lending proposition. Borrowing countries that are doing better on all these indicators are less likely to default on loans. They are also more likely to receive more private sources of financing.

The second stage of testing the hypotheses consists of a qualitative analysis. In particular, it tests whether hegemons are influential on the RDBs' boards (H2). Information for this analysis was mostly collected through interviews, and primary and secondary research. Since much of the negotiating about policies and loans happens behind-the-scenes and is off the record, it was impossible to quantify these findings. However, this analysis lays out a more detailed, descriptive picture of the decision-making process in each of the banks and the subtleties of the relationships between shareholders as well as between the shareholders and the institutions (managers and staff).

Results

¹⁷ FDI was selected since it indicates private sector's long-term policies. Portfolio investment (bonds and equity) are added in subsequent research, but are not imperative for this study since they represent short term financial activities, and the lending undertaken by the RDBs is intended as a long term investment, making FDI a better private sector indicator. It should also be noted that the lag of the loans and the FDI was tested in the regressions to see if one might lead to the other (it is the claim of some officials at the RDBs that their lending aids in increasing FDI by creating confidence for the private sector -- in this case we would, though, expect to see loan amounts decreasing as FDI increased).

Various models were used to test the hypothesis. In the quantitative part of the study, the regressions test both political and economic strategic lending.¹⁸ The analysis was carried out using a time series panel-correlated standard error. No heteroskedasticity or multi-collinearity was found in the data (this is according to Breusch-Pagen, White tests, and VIFs).¹⁹ The regressions show the relation between the amount and destination of the loans to indicators of the recipient country. Since the data set used is time-series panel, the lag variable of the previous year's loans will be used to try to establish the possible influence of a previous year's loan disbursements on a current year.

[Insert tables 2-5]

The first model analyzes the impact of FDI on loans made by the RDBs. From the four tables (2-5) we can deduce that the AfDB is the only RDB where FDI correlates with loans (coefficient 2.93e-08, standard error 1.46e-08). In model I, when FDI is isolated, it is only current FDI and not the lag that is significant. In subsequent models, FDI continues to still be significant (when other variables are added to the model, it also becomes significant for the EBRD, but not for the other RDBs). Significant statistical

¹⁸ Most variables in the data set are logged due to their size (and resulting very low coefficients). FDI was not logged since it includes negative values. The results for this variable are therefore interpreted taking into account the large numbers that naturally produce very small coefficients (thus, even though some coefficients are very small, it does not mean changes are not significant – taking into account the very large number that are being analyzed, small coefficients can still indicate important changes). Lags are included because the nature of the variables is such that previous year's loans or FDI might affect the following year.

¹⁹ The Stata command used for this regression, *xtpcse*, is the OLS regression used for a panel time series analysis. For more on cross-sectional time series with panel-correlated standard error see Beck and Katz 1995.

results indicating a relationship between FDI and loans gives strong support to the financial strategic lending hypothesis (that banks tend to make more loans to countries that also receive more FDI). However, the only bank where this holds true, at least when FDI is isolated, is the AfDB, and even in this case, the result is not significant with relation to the lag of FDI (thus making it questionable whether the bank makes more loans available to countries that have a record of receiving more FDI). On the other hand, the fact that FDI is not significant in most cases when the lag of loans is also included in the model, (except for models V and VIII for the AfDB, and models IX, X, and XI for the EBRD), indicates that arguments made by RDB officials and advocates of the RDBs, that the banks' loans and development projects foster the foundation for subsequent increases in FDI (and private sector interest), may be flawed.

Model II includes all the economic variables. For all of the banks, except for the EBRD, the lag variable of loans is significant. This is not surprising and indicates that countries that received loans the previous year are more likely to receive them in the current year. In addition, for both the IDB and the AsDB the GDP and GDP per capita are significant in this model (IDB GDP coefficient 1.21, standard error .16; AsDB coefficient .63, standard error .15). Thus, for example, a US\$1,000 increase in GDP is associated with a loan increase of US\$12,100. This finding supports the hypothesis of "strategic lending" – that the IDB and the AsDB, in this case, tend to make more loans available to countries with higher GDP and GDP per capita, where default is probably less likely; this finding also raises doubts over the banks' claim of lending only when no alternative, private financial sources are available.

Model IV regresses all the social variables with the lag of loans. The lag of loans is again significant for the IDB and AsDB, but not for the AfDB and EBRD. This model introduces the social variables, without any of the economic or political variables. The social variables are important in determining a country's level of poverty. These are the indicators usually used in various development measurements, including the Human Development Report. In general, for a policy that focuses on development and poverty alleviation, we would expect to see; (1) a positive relation between loans and population – as population grows, loans should increase; (2) a positive relation between infant mortality rate and loans – as infant mortality rates increase, more loans should be made available; and (3) a negative relation between primary school education and loans – as primary school education increases, loans made by the bank should decrease.

For the IDB, population is the only social variable that tests significantly (coefficient 1.26, standard error .25). Thus, Latin American countries that are more populated are more likely to receive loans, but since the other social variables did not test significant we can not deduce any connection between loans and infant mortality and primary education. If the bank is concerned about poverty, we would expect more loans where infant mortality rates are higher and less loans as primary education increases. But, the fact that the effect of these variables on loans is insignificant indicates that loan disbursements are not systematically associated with these two variables and thus they can not explain loan availability or lack thereof.

As for the other banks, in the AsDB none of the social variables have a significant effect in this regression, suggesting the loans made by this bank have little relation with

these variables.²⁰ For the AfDB, of the social variables, only primary education had a significant affect on loans (coefficient .005, standard error .002). Thus, as a higher percentage of the population is educated (primary), loans are more likely to increase (however, no significance was found with regard to population and infant mortality rates).²¹ This finding suggests that loans might not be directed at the poorest or neediest because countries with higher primary education rates are likely to be ranked higher by the HDI. Finally, for the EBRD, results were significant for population (coefficient .72, standard error .31). Primary education was not used in this regression because there was not enough data for this variable in this region. To sum, the AsDB and the AfDB seem to have a bias towards less populous countries and none of the RDBs seem to lend more to countries with higher infant mortality rates (usually poorer).

Model V includes all the independent variables except for political affinity. For all but the EBRD, where primary education was not used for the analysis, it is clear that the inclusion of primary education in the model along with all the economic variables greatly reduces the number of observations (for example, in the IDB, from 701 in model II to 218 in model V). In this model, apart from the lag of loans for the AsDB, we observe significant findings only for the AfDB: Both FDI and the lag of FDI are significant. But while FDI positively affects loans (coefficient 4.03e-09, standard error 1.65e-09), its lag has a negative affect on loans (coefficient -6.78e-09, standard error 1.46e-09). FDI is found to have a significant affect on loans for the AfDB in three of the

²⁰ It should be noted that the results for the AsDB are probably skewed because China and India, the two most populous countries in the region, have not received loans from the bank on a consistent level (in China's case for political reasons, and in India's case for economic reasons).

²¹ The finding with regard to population is interesting and contradicts the findings presented by Neumayer (2003) that the AfDB gives more aid to more populous countries. This contradiction could be a result of the difference in years tested (Neumayer's study covers 1983-1997, in three-year interval aggregates) and of the differences between aid and the non-concessional loans that are analyzed in this study.

models (I, V, VIII) – all positive, and the lag of FDI was found significant in five of the models (V, VI, VIII, XI, X) – all negatively related. Therefore, of the three older RDBs, the AfDB is the only one where we find a clear relation between loans and financial indicators.²²

However, with respect to claims made critics of the AfDB, we observe that although in a given year countries that receive loans are also likely to be the recipients of higher amounts of FDI, they are less likely to receive loans if the amounts of FDI they received the previous year are higher (and vice versa). This finding indicates that the AfDB, instead of looking for ‘safe’ financial policies where FDI already is higher, might be the precursor of FDI. For the rest of the banks model V did not yield any significant results indicating, interestingly, that the social and economic variables tested in this regression do not seem to be criteria used for loan allocation.

Model VII brings in the political variable while taking out most of the economic variables. Significant results are observed only for the US and Germany in the EBRD. Model VIII that includes all of the variables except primary education (for the EBRD, model VII) shows significance for the political affinity measure for the IDB – Latin American countries that vote alongside the US in UN votes are more likely to receive loans from the IDB.²³ For the EBRD, the hegemon bias is with the US and Germany. Subsequent models for the AsDB, AfDB, and EBRD left the regression as it was in model VIII, but tested each hegemon separately. These different models generally did not generate results that are notably different from those in model VIII that included all the major donors.

²² In models VIII-XI for the EBRD, FDI is also a significant variable influencing loans.

²³ For the EBRD, models VIII to XI examine each of the hegemons independently, as do models IX and X for the AsDB and the AfDB.

In conclusion, based on this statistical analysis, both critics and advocates of the RDBs are mistaken in their characterization of these institutions. There are some correlations between loans and FDI and GDP in some of the models in some regions, but as variables are added or removed, the significance is not consistent. Similarly with respect to the social variables – although some correlations are significant, there does not seem to be much uniformity. We can therefore deduce that the RDBs do not follow an explicit policy of financial strategic lending, making more loans to countries that receive more FDI or where the GDP and GDP per capita are higher. On the other hand, they also seem not to follow a purely need-based policy, where increase in loans correlates with higher rates of poverty (based on the health, education, and population variables used in this study). Finally, this analysis found some significant results for the UN affinity measure – for the IDB and EBRD – indicating political strategic lending. Interestingly, for the AsDB, where there is a dual hegemonic structure (US and Japan) no significance was found, as well as for the AfDB where there is no clear hegemon. Further qualitative analysis on the question of hegemonic influence helps clarify the involvement of the central shareholders.

Investigation into the mechanism used by the RDBs to make decisions reveals distinct roles played by the hegemon(s).²⁴ First, the location of the institutions may impact the extent to which hegemon(s) influence decision-making. The IDB's and the EBRD's headquarters are located in donor countries (the IDB in Washington, D.C. and the EBRD in London). However, while the IDB's headquarters are close to top US

²⁴ This analysis is based on research and interviews conducted at the headquarters of the IDB and EBRD, as well as the IDB's regional European Office, in 1999-2002. Also, AsDB and AfDB officials and former employees were interviewed as well as US Treasury representatives for multilateral financial institutions. I am also grateful for the help of researchers at the OECD Development Center in Paris.

policy makers and subject to their political influence, the EBRD's central location, in the heart of London's financial district (the City of London), reflects its bank-like attitude: Although its mandate is overtly political, the EBRD looks and operates much more like an investment bank (many of its staff, even those admitted under the member countries' quota rules, are former bankers). And although the presidents of both banks are usually seasoned politicians, the EBRD is more concerned with financial returns and the "bankability" of the projects it approves. This concern is a reflection of the preferences of the hegemon and the managers and staff of the bank. As in the other RDBs, each loan disbursed by the bank must first be approved by the Board. And it is evident that the Board, like the staff, is interested in projects that will yield positive returns. It is for this reason that the EBRD came under heavy criticism in the mid-1990s (especially by the Financial Times) due to its perceived wasteful spending of public financing (critics claimed that the bank was competing with the private sector).²⁵

As Krasner notes in his 1981 article on power structures in the RDBs, the IDB manages to retain strong donor support (and American hegemony) while allowing developing countries to play a more active role in the bank's decision-making apparatus. For starters, the president of the IDB is always a Latin American national.²⁶ Additionally, the close proximity of the IDB to US political institutions enables an ongoing dialogue and further cooperation between the regional members and the donors. The IDB thus differs from the AsDB, where although the headquarters are located in one

²⁵ This critique is not surprising. The EBRD's mandate puts it in a peculiar position vis-à-vis the private sector because supporting "transformation to market economies" often includes projects that are lucrative for private lenders.

²⁶ Some IDB officials claim that the relative success of the IDB in its regional independence is attributed to Enrique Iglesias, its president since 1988. Although close relations with the US existed before (see Krasner 1981), Iglesias presided successfully over the toughest replenishment negotiations with the US in 1989, showing great diplomatic skills. He seems to have a good rapport with US officials who deal with the RDBs and is thus successful in forwarding the bank's agenda (as opposed to the hegemon's agenda).

of its borrowing members (Manila, Philippines), the top management is always Japanese and American (Japanese president; American vice president). It is also an institution that was created in a “top-bottom” fashion – the donors, not the borrowers being its initiators. Moreover, while borrowing members of the IDB retain a (charter-based) majority of the votes (50.1%),²⁷ the voting shares of the AsDB can be misleading: Japan, Australia and New Zealand are listed as “regional members” even though they do not borrow from the bank. The real voting power of donors (with these three countries included) is 55%, leaving developing countries in the minority. Although the US does have a veto power in IDB decision-making (it is not a blocking veto power for the OCR, only for the concessional funds),²⁸ it appears to delegate much of the responsibilities of daily operations to the IDB as long as major interests are not compromised.²⁹ On the other hand, Japan and the US control the policy decisions of the AsDB much more closely. This can be attributed to the dual hegemonic nature of the governance of the bank. Officials reported frequent discord and constant competition between the two hegemons. Shareholders are thus more reluctant to delegate much of the day to day operations to the staff, and they employ a “hands-on” style of control. This also may be the reason why the AsDB is assessed as following a tighter fiscal discipline agenda (praised by credit rating agencies)³⁰ – when both hegemons must agree on every decision prior to the voting stage, it is easier to advance project proposals that make good financial sense since there are less reasons for disagreement on their financing.

²⁷ The US holds 30% of the voting shares.

²⁸ American “veto” in the IDB primarily consists of its ability to withhold funds that are crucial for the institution’s operations.

²⁹ This was especially important during the Cold War, when the American interest was primarily to prevent Communist spread into Latin America. For this reason Cuba is not a member of the IDB (although some officials at the IDB expressed dismay about this).

³⁰ See Standard 7 Poor’s 1999, 2002.

Finally, the AfDB lacks the kind of donor support available to the other RDBs. This can be traced to its founding stages, when African countries were adamant about having a truly African institution.³¹ Until the 1970s the bank was entirely controlled by Africans. Its headquarters in Abidjan (Ivory Coast), the president is always an African national, almost all the staff is African, and the majority of the votes held by African borrowing members. However, the bank paid a price for its independence from donors and has been struggling financially since its creation.³² Even though it admitted more non-borrowing members in the 1970s (and additional shares of the votes to donors, although not the majority), it continues to encounter financial problems and its endowment is substantially smaller than that of the other RDBs (see table 1).³³

[Insert table 6 here]

Conclusion

This paper examined whether RDBs lend strategically and if it is political or financial considerations (or both) that guide their decision-making. Findings suggest that hegemons play an important role in these institutions, and the differences between the four RDBs highlighted the various ways in which hegemons influence policy. The statistical analysis yielded mixed results. Most importantly, it confirmed that RDBs do not lend mostly to the poorest countries in their regions. But they also do not appear to be clearly competing with the private sector, as some critics claim. A closer look at the

³¹ For more on the AfDB and its history see Mingst 1990.

³² It is the only RDB whose credit rating has been at times less than AAA.

³³ Dire conditions in many African countries and poor infrastructure contribute to these problems, but as far as the institution is concerned it seems that donor interest is linked to the possibility of hegemonic influence, at least to some extent.

RDBs paints a picture of varying degrees of delegation from the shareholders (principals) to the institutions (agent), and different methods of hegemonic control that carry differences in policy outcomes. Further research should explore the impact of the various institutional forms and strategic lending on development. While strategic lending does not preclude the possibility that lending policies may still have a positive impact on development, the mechanism used by IFIs to approve project loans and the relationship among the actors that are part of the institution is highly consequential for the results of the institutions' activities as well as for their public perception.

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Table 1: The MDBs in comparison (2002 figures)

Bank	Year of Foundation	Number of Shareholders		Gross disbursed loans and equity investment (US \$ million)	Paid-in portion of subscription ^a	2002 loan approvals (US \$ billion)	Rating (Standard & Poor's)
		donor	borrowing				
IDB	1960	18	28	47,958	10%	4.5	AAA
AfDB	1964	24	53	8,360	28%	1.2	AA+ ^b
AsDB	1966	16	41	29,429	16%	3.9	AAA
EBRD	1991	34	26	9,848	21%	6.3 (bill Euro)	AAA
WB (IBRD)	1944	91	80	116,240	20%	11.5	AAA

Source: Standard and Poor's 2002, Moody's 2002, RDBs Annual Reports (various).

^aPaid-in capital adjusted as a proportion of 'AAA' callable capital and paid-in capital adjusted.

^bThe AfDB's credit-rating was raised to AAA in 2003 by Standard and Poor's.

Table 6

Bank	Hegemony	AAA rating	Overt political agenda	Collaboration with private sector
IDB	Single	√	X	Some
AsDB	Bipolar	√	X	Some
AfDB	None	X	X	None
EBRD	Multiple	√	√	Yes

Table 2

IDB loans (log)								
Variables	I	II	III	IV	V	VI	VII	VIII
Economic								
Loans (lag)	-	.37 (.06)*	.50 (.05)	.37 (.08)*	.37 (.13)	.37 (.12)*	.34 (.05)	.32 (.06)*
FDI (adjusted)	2.13e-07 (2.09e-07)	-1.84e-07 (2.91e-07)	-	-	-3.94e-07 (3.11e-06)	-2.68e-07 (3.52e-06)	-	-1.34e-07 (4.04e-07)
FDI (lag)	3.41e-07 (2.45e-07)	2.01e-07 (3.45e-07)	5.23e-07 (1.20e-07)	-	1.59e-06 (3.43e-06)	3.55e-06 (5.06e-06)	-	2.61e-07 (4.35e-07)
GDP (log)	-	1.21 (.16)*	-	-	-.74 (1.4)	-1.05 (1.50)	-	-.57 (1.06)
GDP per capita	-	-.00 (.00)*	-.00 (.00)	-	-.00 (.00)	-.00 (.00)	-.00 (.00)	-.00 (.00)
Social								
Infant mortality	-	-	-	.006 (.011)	-.20 (.02)	-0.01 (.02)	-.02 (.11)	-.03 (.02)*
Primary education	-	-	-	5.31 (12.04)	-11.59 (16.98)	-6.93 (19.07)	-	-
Population (log)	-	-	-	1.26 (.25)*	1.85 (1.55)	2.13 (1.61)	1.47 (.23)	1.81 (1.12)
Political								
US	-	-	-	-	-	2.48 (1.98)	1.88 (.90)	2.66 (1.14)**
Constant	13.39	-17.99	7.38	-12.19	1.46	2.64	-10.71	-2.80
R-squared	0.03	0.33	0.29	0.26	0.24	0.22	.21	0.12
N	751	701	707	415	218	208	731	538
Durbin-Watson	2.01	1.97	2.01	2.03	1.86	1.87	2.00	1.94

*p ≥ .001 **p ≥ .05

Table 3

AsDB loans (log)										
Variables	I	II	III	IV	V	VI	VII	VIII	IX	X
Economic										
Loans (lag)	-	.58 (.06)*	.65 (.06)*	.64 (.07)*	.68 (.11)*	.69 (.11)*	.66 (.05)*	.67 (.05)*	.67 (.06)*	.67 (.06)*
FDI (adjusted)	-2.55e-07 (2.37e-07)	2.70e-07 (2.29e-07)	-	-	6.72e-08 (4.27e-06)	7.54e-07 (4.32e-06)	-	6.82e-11 (2.42e-07)	-1.21e-09 (2.44e-07)	8.62e-10 (2.43e-07)
FDI (lag)	3.42e-07 (2.79e-07)	-3.93e-07 (2.66e-07)	3.41e-08 (5.81e-08)	-	1.33e-06 (5.12e-06)	1.15e-06 (5.42e-06)	-	-4.09e-08 (2.87e-07)	-3.90e-08 (2.89e-07)	-4.17e-08 (2.88e-07)
GDP (log)	-	.63 (.15)*	-	-	.33 (.99)	-.42 (1.26)	-	-1.09 (.42)*	-1.08 (.41)*	-1.10 (.41)*
GDP per capita	-	-7.82e-07 (3.26e-07)**	-2.00e-07 (2.92e-07)	-	2.44e-06 (2.09e-06)	.000 (5.65e-06)	-3.99 (3.60e-07)	-3.01e-07 (3.55e-07)	-2.27e-07 (3.30e-07)	-2.50e-07 (3.43e-07)
Social										
Infant mortality	-	-	-	-.025 (.02)	.015 (.017)	-.01 (.02)	-.00 (.00)	-.03 (.01)**	-.03 (.01)**	-.03 (.01)*
Primary education	-	-	-	-10.17 (12.73)	-6.28 (19.38)	-7.01 (21.09)	-	-	-	-
Population (log)	-	-	-	.28 (.32)	-.47 (1.02)	.33 (1.17)	.42 (.15)*	1.56 (.44)*	1.52 (.44)*	1.57 (.44)*
Political										
US	-	-	-	-	-	.73 (5.07)	-.43 (1.70)	-.86 (1.78)	-.07 (1.23)	-
Japan	-	-	-	-	-	2.30 (5.63)	2.14 (3.05)	2.34 (3.44)	-	.99 (2.37)
Constant	11.44	-8.71	4.56	4.05	4.31	9.05	-3.15	5.05	6.55	5.95
R-squared	0.035	0.43	.42	0.5	0.52	0.52	0.50	0.56	0.56	.56
N	645	434	472	202	114	94	395	300	300	300
Durbin-Watson	2.2	1.85	1.82	1.94	1.74	1.87	2.03	1.88	1.88	1.88

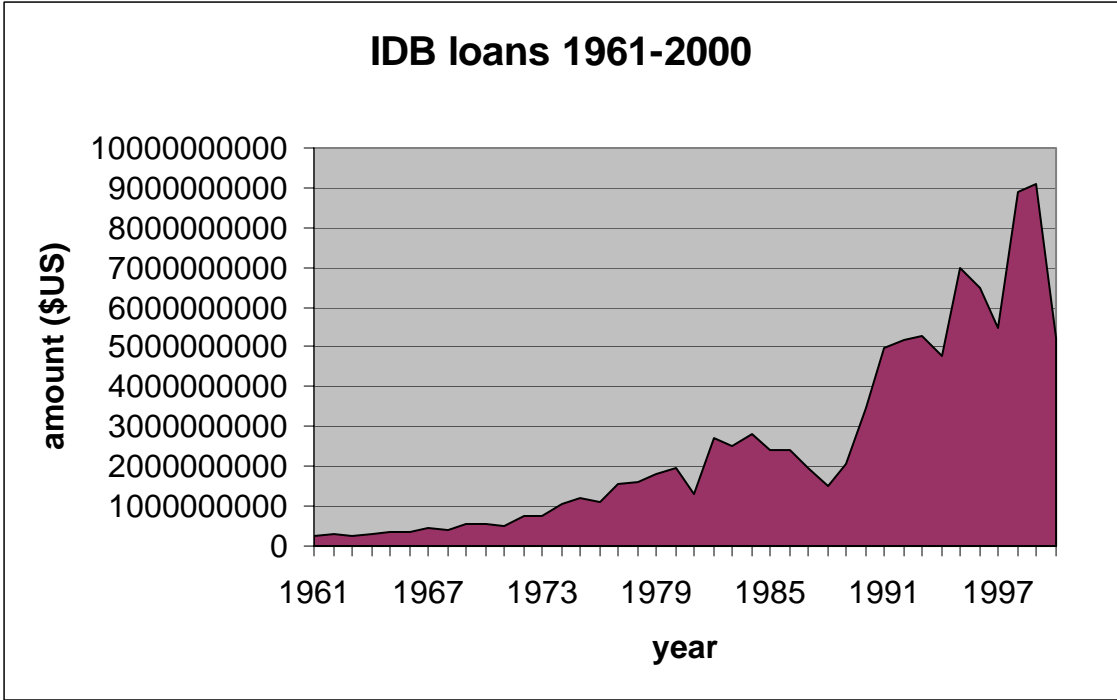
*p ≥ .001 **p ≥ .05

Table 4

AfDB loans (log)										
Variables	I	II	III	IV	V	VI	VII	VIII	IX	X
Economic										
Loans (lag)	-	.74 (.07)*	.77 (.07)*	.35 (.20)	.36 (.18)*	.36 (.17)**	.84 (.06)*	.83 (.06)*	.37 (.17)**	.37 (.17)**
FDI (adjusted)	2.93e-08 (1.46e-08)**	2.00e-09 (1.20e-08)	-	-	4.03e-09 (1.65e-09)*	6.10e-10 (1.19e-09)	-	2.91e-08 (1.09e-08)*	6.08e-10 (1.19e-09)	6.13e-10 (1.22e-09)
FDI (lag)	3.88e-09 (1.02e-08)	-5.87e-09 (1.22e-08)	1.62e-09 (9.05e-09)	-	-6.78e-09 (1.46e-09)*	-6.51e-09 (1.93e-09)*	-	-2.75e-08 (1.17e-08)**	-6.51e-09 (1.93e-09)*	-6.58e-09 (1.92e-09)*
GDP (log)	-	2.89e-03 (1.09e-03)**	-	-	2.77e-05 (3.89e-04)	8.52e-05 (4.26e-04)	-	4.06e-03 (2.74e-03)	8.92e-05 (4.3e-04)	6.92e-05 (4.21e-04)
GDP per capita	-	5.31e-07 (3.09e-07)	5.96e-07 (3.12e-07)	-	1.92e-07 (2.77e-07)	2.07e-07 (2.73e-07)	1.74e-06 (9.82e-07)	-1.32e-06 (2.06e-06)	2.02e-07 (2.80e-07)	2.16e-07 (2.72e-07)
Social										
Infant mortality	-	-	-	-5.19e-06 (3.93e-06)	-3.86e-06 (4.47e-06)	-4.96e-06 (4.29e-06)	-1.83e-05 (1.92e-05)	3.58e-06 (2.28e-05)	-4.96e-06 (4.21e-06)	-4.76e-06 (4.04e-06)
Primary education	-	-	-	.005 (.002)**	4.49e-03 (2.28e-03)**	4.79e-03 (2.65e-03)	-	-	4.69e-03 (2.66e-3)	4.62e-03 (2.69e-03)
Population (log)	-	-	-	-2.16e-05 (1.09e-04)	1.89e-04 (3.39e-04)	2.03e-04 (3.95e-04)	1.49e-03 (1.04e-03)	-2.43e-03 (2.21e-03)	2.05e-04 (3.93e-04)	2.3e-04 (3.88e-04)
Political										
US	-	-	-	-	-	1.92e-03 (1.83e-03)	-5.27e-03 (3.86e-03)	-6.29e-03 (3.85e-03)	1.36e-03 (9.48e-04)	-
France	-	-	-	-	-	-9.36e-04 (2.56e-03)	-3.09e-03 (6.48e-03)	-1.4e-03 (6.76e-03)	-	1.37e-03 (1.35e-03)
Constant	.005	-.06	.002	.002	-.002	-.003	-.021	-.049	-.004	-.004
R-squared	.05	.06	.59	.16	.22	.22	.75	.77	.22	.22
N	1050	790	792	230	180	177	715	698	177	177
Durbin-Watson	2.04	1.81	1.82	1.74	1.72	1.72	1.93	1.92	1.72	1.74

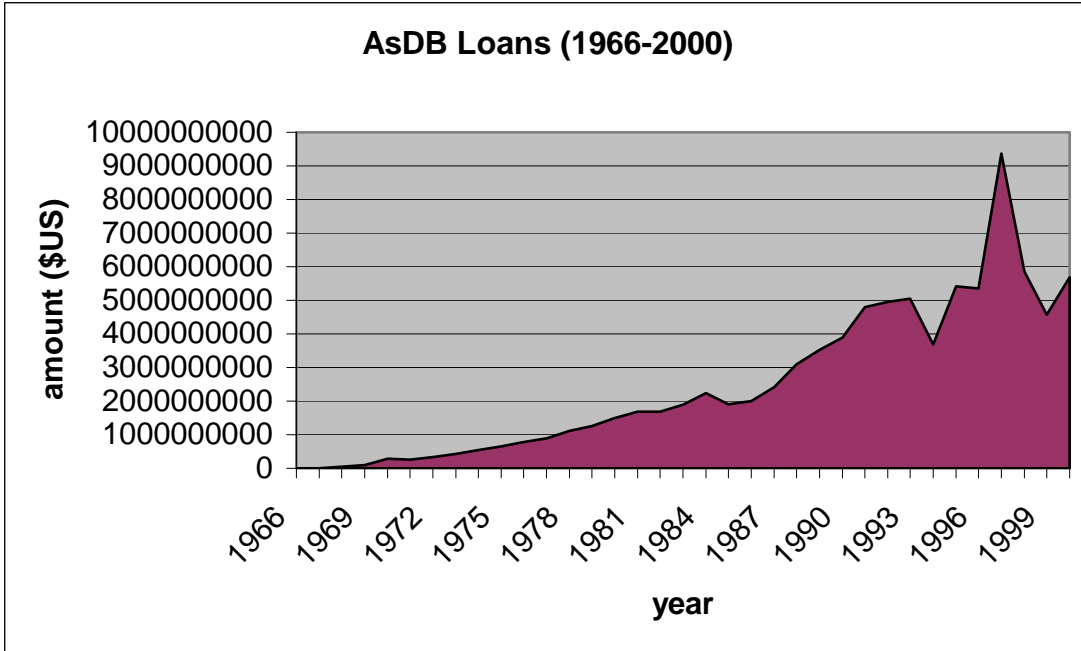
*p ≥ .001 **p ≥ .05

EBRD loans (log)											
Variables	I	II	III	IV	V	VI	VII	VIII	IX	X	XI
Economic											
Loans (lag)	-	.27 (.27)	.30 (.27)	.3 (.25)	.26 (.27)	.69 (.44)	.65 (.51)	.75 (.48)	.84 (.50)	.65 (.50)	.83 (.51)
FDI (adjusted)	6.01e-07 (3.68e-07)	4.22e-07 (3.47e-07)	-	-	4.02e-07 (3.44e-07)	-	-9.38e-07 (5.36e-07)	8.19e-07 (4.44e-07)	9.72e-07 (4.40e-07)**	1.13e-06 (4.53e-07)**	9.50e-07 (4.39e-07)**
FDI (lag)	2.45e-07 (4.48e-07)	-2.81e-07 (3.78e-07)	5.34e-07 (2.87e-07)	-	-2.82e-07 (3.70e-07)	-	-1.05e-06 (6.32e-07)	-1.48e-06 (5.95e-07)*	-1.38e-06 (5.36e-07)*	-1.46e-06 (6.20e-07)**	-1.38e-06 (5.03e-07)*
GDP (log)	-	.70 (.48)	-	-	1.25 (.93)	-	-.67 (1.53)	1.10 (1.37)	1.75 (1.19)	-.12 (1.38)	1.79 (1.29)
GDP per capita	-	5.75e-05 (9.01e-05)	1.54e-04 (1.38e-04)	-	6.78e-05 (1.16e-04)	1.03e-04 (1.13e-04)	2.80e-04 (3.83e-04)	-8.87e-05 (2.96e-04)	-2.45e-04 (2.29e-04)	1.36e-04 (3.67e-04)	-2.55e-04 (2.50e-04)
Social											
Infant mortality	-	-	-	-.01 (.02)	.03 (.04)	4.86e-03 (.03)	-8.99e-04 (.02)	.02 (.03)	.01 (.03)	-2.67e-03 (.03)	.01 (.03)
Primary education	-	-	-	-	-	-	-	-	-	-	-
Population (log)	-	-	-	.72 (.31)**	-.48 (.54)	.54 (.45)	1.23 (1.52)	-.52 (1.24)	-1.46 (.91)	.76 (1.31)	-1.48 (1.13)
Political											
US	-	-	-	-	-	9.15 (4.59)*	10.61 (5.27)**	4.34 (3.79)	-	-	-
UK	-	-	-	-	-	-28.71 (18.23)	-27.59 (21.24)	-	-	-	-2.04 (5.23)
France	-	-	-	-	-	20.07 (15.14)	17.91 (17.71)	-	-2.81 (5.16)	-	-
Germany	-	-	-	-	-	11.83 (3.31)*	13.06 (4.09)*	-	-	10.71 (5.43)**	-
Constant	15.14	-5.25	10.21	.04	-11.24	-12.33	-8.09	-15.15	-13.69	-14.41	-14.81
R-squared	.05	.14	.11	.13	.15	.27	.30	.22	.22	.26	.22
N	195	116	116	131	116	92	81	82	82	81	82
Durbin-Watson	1.82	1.87	1.89	1.88	1.87	1.33	1.30	1.33	1.33	1.29	1.33



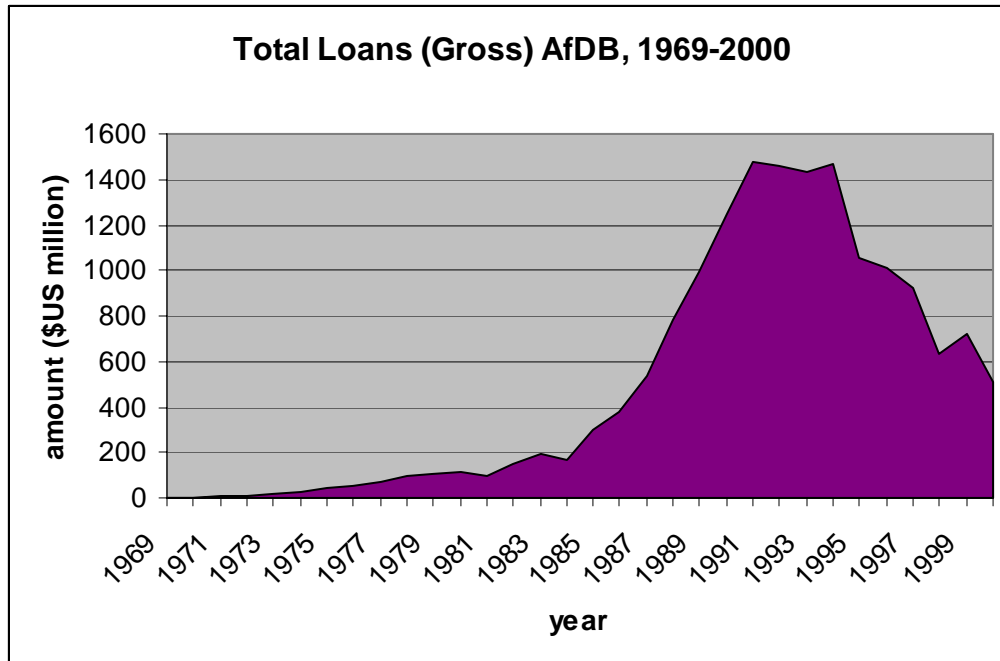
^aGross amounts in constant 1999 \$US million.

^bSource: IDB Database, 2001.



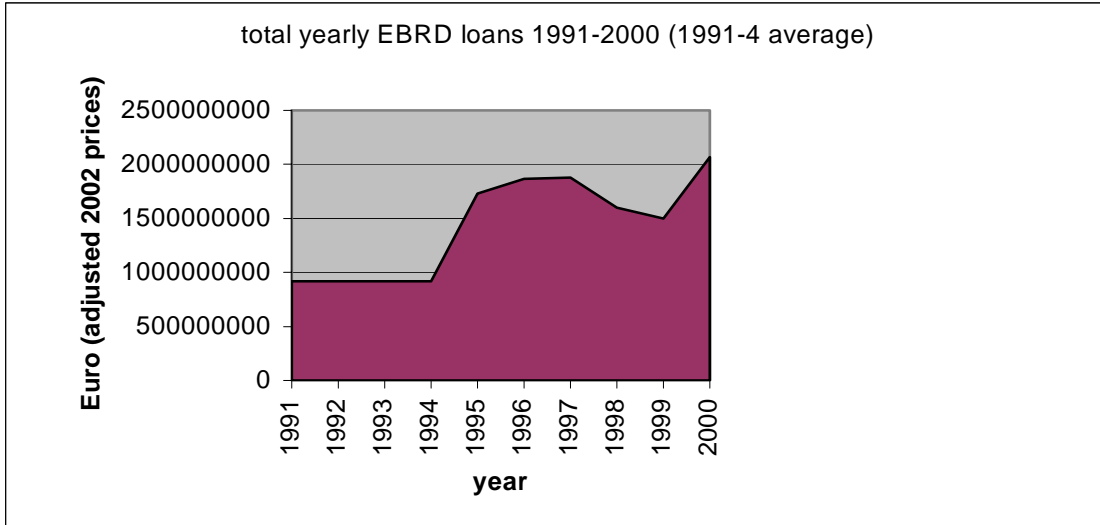
^aGross amounts in constant 1999 \$US million.

^bSource: Asian Development Bank internal documents, December 2001.



^aGross amounts in constant 1999 \$US million.

^bSource: OECD data base, 2002.



^bGross amounts, in adjusted 2002 Euro.

^aSource: EBRD accounting department, December 2001.

