

NBER WORKING PAPER SERIES

WHY IS THERE MULTILATERAL
LENDING?

Dani Rodrik

Working Paper No. 5160

NATIONAL BUREAU OF ECONOMIC RESEARCH
1050 Massachusetts Avenue
Cambridge, MA 02138
June 1995

This paper was prepared for (and funded by) the World Bank and will appear in the forthcoming volume Proceedings of the World Bank Annual Conference on Development Economics 1995. Some of the ideas in this paper have their origin in an earlier paper co-authored with Michael Gavin, whose important contribution I would like to acknowledge. I thank Michael Bruno and Ishac Diwan for helpful conversations, Guillermo Calvo, Stijn Claessens, Bill Easterly, Olga Jonas, Nathaniel Leff, Boris Pleskovic, Jeffrey Sachs and several anonymous Bank staff members for very useful comments on an earlier draft, Sudarshan Gooptu for help with data, Peter Boone for providing his political variables, and Euysung Kim and Maggie McMillan for excellent research assistance as well as comments. This paper is part of NBER's research programs in International Finance and Macroeconomics, and International Trade and Investment. Any opinions expressed are those of the author and not those of the National Bureau of Economic Research.

© 1995 by The World Bank. All rights reserved. Short sections of text, not to exceed two paragraphs, may be quoted without explicit permission provided that full credit, including © notice, is given to the source.

**WHY IS THERE MULTILATERAL
LENDING?**

Dani Rodrik

Working Paper No. 5160

WHY IS THERE MULTILATERAL
LENDING?

ABSTRACT

Why should multilateral lending exist in a world where private capital markets are well developed and governments have their own bilateral aid programs? If lending by the World Bank, IMF, and regional development banks has an independent rationale, it must rest on advantages generated by the multilateral nature of these institutions. There are in principle two such advantages. First, since information on the quality of investment environments in different countries is in many ways a collective good, multilateral agencies are in a better position to internalize the externalities that may arise. This creates a rationale for multilateral lending in terms of information provision, particularly in terms of monitoring of government policies in recipient countries. Second, as long as multilateral agencies retain some degree of autonomy from the governments that own them, their interaction with recipient countries, while official in nature, can remain less politicized than inter-governmental links. This in turn endows multilateral agencies with an advantage in the exercise of conditionality, (that is, in lending that is conditional on changes in government policies). Neither of these two potential advantages of multilateral lending has much to do with lending per se. However, multilateral lending may be required to make these agencies' tasks incentive compatible. The empirical analysis reveals little evidence that multilateral lending has acted as a catalyst for private capital flows.

Dani Rodrik
Department of Economics
Columbia University
420 West 118th Street, Room 1312
New York, NY 10027
and NBER

Introduction

The World Bank and the IMF are such an ubiquitous part of the international economic landscape that it is surprising to discover that there has been little systematic analysis of the question in this paper's title. The question turns out to be a tough one to answer. It is difficult to generate a rationale for multilateral lending in a world where, on the one hand, well-developed private capital markets exist, and, on the other, governments have their own bilateral aid programs.

Prior to Bretton Woods, multilateral lending had taken place on occasion, but it had never become institutionalized.¹ "Permanent, organized, intergovernmental economic co-operation was so revolutionary an idea in 1919 that it was not even considered by the statesmen who drafted the Treaty of Versailles," writes Oliver (1975, xiii). "By 1945, however, it was an idea acceptable to most of the people of the world, and its acceptance has become institutionalized through special agencies of the United Nations...." These specialized agencies of the United Nations were founded on the idea that private capital markets could not be relied on to provide the resources needed for postwar reconstruction. One of the perceived lessons of the inter-war period was that international capital flows tended to exacerbate, rather than stabilize, global business cycles and that private external financing was often lacking for projects that were otherwise sound and profitable. But since 1945, private capital markets have developed to an extent that would have been hard to foresee by those at Bretton Woods.² In addition, economists' faith in the capacity of governments--and much less intergovernmental bureaucracies--to make superior investment decisions compared to private capitalists has largely dissipated.

¹See Gavin and Rodrik (1995) for a short discussion of what made an institution like the World Bank special in terms of historical experience with international lending.

²As Bulow, Rogoff, and Bevilacqua put it: "Generally speaking, the extensive evolution of private capital markets over the past twenty years makes the missing market rationale for IFI lending considerably more dubious than in the years immediately following the Bretton Woods." (1992, 221)

It is of course true that private creditors are not motivated by humanitarian considerations, and that the flow of resources to poor countries may be inadequate from a broader perspective. But if such humanitarian--as well as political or strategic--considerations are of concern to donor governments, they can be taken into account in the bilateral assistance programs of these governments. It is not clear that the presence of multilateral institutions would necessarily increase the aggregate flow of humanitarian assistance, as concessional flows from multilateral sources is financed by the same donor governments. Once again, we have to ask what additional role there is for multilateral agencies to perform.

If lending by the World Bank, IMF, and regional development banks has an independent rationale, it must rest on advantages generated by the multilateral nature of these institutions. I will argue in this paper that there are in principle two such advantages. First, since information on the quality of investment environments in different countries is in many ways a collective good, multilateral agencies are in a better position to internalize the externalities that may arise. This creates a rationale for multilateral lending in terms of information provision, and particularly in terms of monitoring of government policies in recipient countries. Second, as long as multilateral agencies retain some degree of autonomy from the governments that own them, their interaction with recipient countries, while official in nature, can remain less politicized than inter-governmental links. This in turn endows multilateral agencies with an advantage in the exercise of conditionality, that is in lending that is conditional on changes in government policies.

Neither of these two potential advantages of multilateral lending has much to do with lending per se. One can envisage multilateral agencies monitoring government policies and exercising conditionality on behalf of bilateral and private lenders, without engaging in any of their own lending activities. There is nothing in these functions that inherently requires lending. However, there may be severe incentive problems in the provision of these functions in the absence of lending. In particular, private creditors may well question the quality of the monitoring

and conditionality exercised by multilateral agencies if these agencies did not back up their recommendations with their own resources. Put differently, multilateral lending may be required to make these agencies' tasks incentive compatible.

Where concessional lending is concerned, there exists possibly a third role for multilateral lending, related to humanitarian considerations. As I will document later, bilateral flows tend to be determined to an important extent by political and military considerations. Consequently, while governments could in principle take humanitarian considerations into account in their bilateral lending, such considerations in practice get swamped by other considerations—at least where the major donors like the U.S., EU, and Japan are concerned. By delegating authority over some of their lending to multilateral agencies, these governments could be viewed as pre-committing themselves to levels of humanitarian lending *ex ante* which they know they would otherwise be unable to fulfill *ex post*.

Whatever the merits of such an argument, I will not be concerned with it in this paper. My principal focus will be on the efficiency and economic implications of multilateral lending, rather than on humanitarian consequences. I note in passing, however, that humanitarian considerations would provide at best a weak justification for multilateral lending, at least as it is carried out presently. The reason is that the bulk of such lending takes place at non-concessional terms: during the early 1990s, less than a quarter of gross disbursements from multilateral sources was concessional.

The first half of this paper elaborates on the informational and conditionality rationales for multilateral lending, and discusses their relevance and plausibility. The second half of the paper turns to empirical evidence. In this part of the paper, I report on a number of exercises trying to uncover whether multilateral lending has actually performed the tasks discussed earlier. In particular, I focus on two questions: (a) has multilateral lending acted as a catalyst for private flows? (b) has multilateral lending been a signal of future development potential? These tests

should be of independent interest, even if one disagrees with the argument that multilateral lending plays--or should play--a primarily informational role. While the tests are crude and some of the results mixed, on balance there is very little evidence that multilateral lending has been able to catalyze private capital flows. A final section discusses some of the implications of the analysis.

Background

We begin by surveying briefly some of the quantitative characteristics of multilateral lending compared to other types of flows. Unless otherwise specified, I use the following classification of flows in this paper: Private flows refer to direct foreign investment (DFI), portfolio equity flows, bond issues, commercial bank lending, and other private lending. Bilateral flows are loans and credits from governments as well as grants (but excluding technical cooperation grants). Multilateral flows refer to loans and credits from the IMF, World Bank, regional development banks and other intergovernmental agencies.³ Net transfers refer to disbursements minus repayments and interest charges.⁴

Figure 1 shows the trends since 1970 in net transfers to developing countries by three types of flow: private, bilateral, and multilateral. Several things are noteworthy in the figure. First, private resource transfers are highly cyclical. There were large private transfers until 1982, which disappeared thereafter as the developing world succumbed to the debt crisis. Between 1984 and 1989, private net transfers were negative. After 1989, private flows took off again and very rapidly. In 1993, the combined net resource transfer to developing countries from private

³The source for all the flow data is the World Bank's World Debt Tables, on diskette. While I have formed my own groupings of flows as discussed in the text, the reader is referred to this source for more information on each of the sub-categories.

⁴In the cases of DFI and portfolio equity flows, data on profits or earnings accruing to the foreign investor--analogous to the interest on bank loans or bonds--are not available.

sources (as a percent of recipient GNP) was much larger than any experienced to date.⁵ The consequences of the recent Mexican crisis will surely be reflected in a substantial drop in these flows. These cycles are only the latest in a series of boom-and-bust cycles in international lending that have taken place since at least the beginning of the 19th century (see Eichengreen 1991 for a review).

Second, net transfers from multilateral sources are not negligible compared to the other kinds of flows. Together with bilateral flows, multilateral lending played an important stabilizing role especially in the 1980s when private flows disappeared. The view that multilateral lending is small compared to private flows is correct only for certain periods, such as the late 1970s or 1993-94. Third, net transfers from multilateral agencies have never turned negative in aggregate.

Table 1 lists the ten most significant recipients of gross flows during 1990-93, by type of flow. Three countries--China, Mexico, and Indonesia--make the top-ten list in all three categories of flows, and two additional countries--Brazil and Argentina--are in the top ten for both private and multilateral flows. Indeed, the three types of flows are heavily correlated with each other in terms of recipients (Table 2). The cumulative shares of the largest recipients reflect the greater concentration of private flows in a smaller number of countries: the top ten recipients account for 70 percent of gross private flows to developing countries, but less than 50 percent of multilateral and bilateral flows. Private flows have generally become less concentrated since the 1970s, and the gap in this respect between private and multilateral flows has shrunk considerably since then (see Table 3). Note also that private flows tend to concentrate on the larger economies, as reflected by the greater share of the top ten recipients of such flows in the aggregate GNP of developing countries (Table 1).

⁵See Claessens and Gooptu (1993) for a compendium of essays on the recent experience with portfolio investment in developing countries.

Rationales for Multilateral Lending

The fact that private capital flows are highly cyclical and geographically concentrated is often read as evidence that private capital markets are inefficient. There are indeed good reasons to believe that private capital markets are given to bandwagon effects. The magnitude of private flows notwithstanding, this should make us wary about the optimality of the operation of these markets. However, the possibility of market failures in private capital markets does not directly provide a rationale for multilateral lending. One first needs to be clear about the nature of the market failures, so as to ensure that the distortions are tackled with the appropriate instruments. Second, one has to supply an argument as to why the same purposes could not be equally well served by bilateral, as opposed to multilateral, flows. As suggested in the introduction, my answer to these questions has to do with informational and enforceability problems in international finance. These problems, and how multilateral agencies can help solve them, is discussed in this section.⁶

Multilateral Aid As Information Gathering And Monitoring

The level of private capital flows to individual developing countries is determined by a number of factors. The availability of high-yielding investment opportunities is obviously a chief consideration. But equally important is the nature of government policies that shape the economic environment in which projects are undertaken. The relevance of government policies is obvious when private flows take the form of bank loans to or international bond issues by public agencies. The repayability of such borrowing depends directly on sound government policies. But there is an important connection even in the case of direct foreign investment: as entrepreneurs in the developing countries know all too well, government policies in the macro

⁶Some of these ideas were previewed in Gavin and Rodrik (1995). I am grateful to Michael Gavin for discussion on these topics.

and micro spheres impinge significantly on the profitability of specific projects. A project that is profitable under one set of trade and exchange-rate policies, for example, may easily go bankrupt under a different set. Policy risk of this kind is one of the chief impediments to capital inflows in economies where the rate of return to capital is otherwise high.⁷

Multilateral lending agencies collectively employ thousands of analysts who follow closely economic developments and policies in developing countries. They prepare detailed country reports, sectoral reports, and cross-country analyses. Their evaluations of the quality of policy-making in member countries, as revealed most clearly in the level of multilateral lending to these countries, are an important input in the decisions made in private capital markets. How important are such monitoring and information gathering activities, and could they not be performed as well by private institutions?

Consider the following thought experiment. Suppose the government of a country which was hitherto closed to the outside world decides to open up the economy and to invite foreign investors. It announces that it is doing away with trade and investment restrictions, and that it is committed to fiscal and monetary restraint. To entice foreign investors, the government further points out that the economy has adequate infrastructure and is rich in natural resources as well as in human resources. Assume that all of this is indeed correct and that the government is indeed deeply committed to reform. How are foreign investors likely to respond?

From the perspective of individual investors, information about the availability of profitable

⁷Reviewing the literature on international capital mobility, for example, Feldstein (1994, 683-684) points to the "importance of two aspects of the risk of international investing: political and currency risk. Although there may be little political risk associated with portfolio investment within the OECD countries, there are more substantial risks when investments are made in the emerging markets. Even within the OECD there is always the risk of some kind of capital controls or convertibility restrictions. These risks, which are not reflected in the covariance matrices that analysts use to calculate risk-return trade-offs of internationally diversified portfolios, tend to make portfolio investors more reluctant to invest abroad.

The risks of changes in government policies are even more important for direct foreign investments than for portfolio investments since direct investments are much more difficult to reverse. Even OECD governments can change tax rules, government procurement rules and other regulations in ways that are particularly disadvantageous to foreign investors."

projects can be treated for the most part as a purely private good. For example, a multinational mining firm can retain for itself most of the benefits of a discovery of mineral deposits by contracting with the government beforehand for extraction rights. A foreign manufacturing firm which is contemplating establishing a subsidiary in the country will be by and large the sole beneficiary of the market research it undertakes. Therefore, in general there will be adequate incentive for private investors to undertake the information-collection activities where specific projects are concerned.

On the other hand, information about the broader investment environment and the quality of government policy-making is a public good: such information benefits all potential investors, regardless of their specific projects. Were such information to become available through the activities of any of the private investors, it would be socially efficient to share it with other potential investors. But of course, in view of the public nature of the benefit, individual investors have inadequate incentives to devote resources to information gathering of this particular kind, and certainly little incentive to share with others the information they do gather. One way of overcoming this problem is for the government to invite the World Bank and the IMF to provide the informational public goods. As multilateral institutions, these organizations are not--or should not be--subject to the incentive problems that confront individual investors.⁸ In practice, what happens is that these institutions carry out intensive consultations with the government to determine the state of the economy and its future, as well as cataloguing in detail prevailing government policies. From this perspective, then, when these institutions "certify" the quality of government policies or place their "stamp of approval" on a country, what they are effectively doing is to provide a collective good to investors at large.⁹

⁸In a memorandum, Demirgüç-Kunt and Squire (1994) have made similar informational arguments to justify World Bank lending.

⁹This assumes of course that the job is well done. If it is not, what we get are collective "bads".

I have used here the example of a country waiting to be discovered by foreign investors to motivate the informational/monitoring role of multilateral agencies. But clearly this role exists in other situations as well. Think of a country which has been successful in attracting a lot of private capital inflows due to market-oriented policy reforms. Especially if the inflows are of the liquid and short-term kind, investors will need reassurance that the governments macroeconomic policies remain sound and sustainable. Multilateral institutions like the World Bank and the IMF are well placed to undertake the requisite monitoring, both because they can once again internalize informational externalities and because they have good access to government data and analytical talent of the right kind. Or think of a country that comes under pressure in international capital markets for reasons that its government feels is not justified by economic fundamentals. (To take a topical case, suppose investors have turned sour on this country because another favorite of financial markets has suddenly taken a nose dive.) This government may benefit from inviting the IMF and the World Bank to provide close monitoring of its monetary and fiscal policies.¹⁰

In all of these instances, the role played by multilateral institutions is a purely informational role. There is in principle no reason why this role could not be played without attendant lending. However, close monitoring of a government's policies is in practice almost always undertaken in the context of a lending program, even when the government has access to private flows and no demonstrable need for borrowing from multilateral sources. The World Bank's or the IMF's stamp of approval takes the form of a loan, not of a pronouncement. Are there any good reasons for this linkage? Two explanations come to mind. First, governments may be less willing to open up their books for inspection to outsiders if this does not directly lead

¹⁰The example is of course more than hypothetical. This is the strategy followed by Argentina in the wake of the recent Mexican crisis: "The International Monetary Fund is to lend Argentina \$420m ... and monitor its fiscal accounts every quarter as part of a campaign to restore credibility to the country's economy." See "IMF Loan Deal to Boost Argentina," Financial Times, March 6, 1995, p. 6.

to financial flows. While this explanation may carry some weight in some instances, it is difficult to accept it as a strong argument for linking monitoring with lending: if governments themselves do not attach sufficient value to the monitoring role of multilateral agencies, then we have prima facie evidence that this role cannot be such a big deal.

The second argument is more likely to be important: in the absence of direct lending by multilateral agencies, there is very little to ensure that these agencies will exercise their informational function⁴ as competently as possible. For example, if their own money is not at stake, they may be more easily swayed by political demands—from either their major shareholders or developing countries—in their certification of creditworthiness (or lack thereof). The fact that, in colloquial terms, they put their money where their mouth is acts as an incentive mechanism for “truthful reporting.” On the other hand, the insistence of multilateral lenders that their claims be senior to private claims undercuts the signalling value of their exposure.¹¹ If these lenders really want to signal confidence, shouldn't they make their claims subordinate instead? In addition, lending may also make multilateral agencies reticent to acknowledge problems in countries to which they have large exposure.

We note that the private market for information of the type provided by multilateral agencies is not entirely undeveloped. Major bond-rating agencies rate the bonds issued by sovereign creditors, including a number of developing countries. In addition there are a number of private services that evaluate the creditworthiness or the investment climate of countries around the world. Moreover, none of these private agencies combine their informational function with financial transactions. The breadth and scope of country coverage by these private-sector entities, however, tends to be limited compared to the work undertaken by the World Bank and the IMF. The skeptic might still point out that, on his first visit to an unknown country, he would rather take the Economist Intelligence Unit's most recent quarterly report on that country than

¹¹Whether multilateral claims are effectively senior in practice is another matter. Bulow, Rogoff, and Bevilaqua (1992) argue that they are not.

one of the World Bank's documents.

In addition, even if there exists a potential role for multilateral lending along the lines sketched above, this does not mean that multilateral institutions have actually strived to perform that role. The World Bank and regional development banks have traditionally seen their role to be primarily one of lending, with information provision relegated to second place. For example, it is important to note much of the information generated by the World Bank and the IMF in the course of their country work is actually not made public. These institutions defend secrecy by arguing that governments would otherwise not share their data with them. From the current perspective, there is very little to be said for caving in to governments on this score. Such secrecy simply makes it more difficult for multilateral agencies to play their informational roles to the fullest.

Finally, where multilateral agencies have played an informational role through their lending activities, it is not clear that they have always done so with success. In the recent Mexican crisis, for example, the World Bank and the IMF were arguably at fault for not having emphasized the danger signals early on and with a loud and clear voice.¹² Had the unsustainability of Mexico's exchange-rate policy, which was evident to many independent academic observers, been made equally evident to money managers in the United States, Mexico would not have been allowed to get so deep into the crisis and perhaps some of the spillovers to other countries could also have been avoided. Of course, by advertising the danger signals the World Bank and the IMF could have precipitated the crisis and end up being blamed for it. In such instances, these institutions have to walk a fine line between withholding criticism of inadequate policies and sounding alarm bells that may lead to over-reaction on the part of private investors. But their long-term credibility and effectiveness vis-a-vis borrowing

¹²As Karin Lissakers, the U.S. executive director of the IMF, put it: "The whole surveillance process [in Mexico] did not work the way it should have.... We were too tolerant..." quoted in New York Times, March 19, 1995, p. E3.

governments require that they play it straight with market participants. So it is ultimately an empirical question whether multilateral lending performs a useful monitoring and signalling role that facilitates international capital flows.

Multilateral Lending As Conditionality

This second role subsumes the first, and goes much further. With conditionality, what is at issue is a much more active and intrusive role for multilateral lending, involving policy advocacy, leverage, and bargaining. Of course, in practice monitoring and information gathering activities can have some elements of these as well. But as conditionality is specifically directed at changing government policies, rather than simply reporting and evaluating them, the two roles are conceptually different and are best kept apart.

The need for conditionality in international lending arises from the time inconsistency problem inherent in many creditor-debtor relationships. A simple example helps illustrate the issues. Consider a liquidity-constrained government and let its two possible courses of actions be: cutting public consumption or cutting public investment. Foreign creditors in turn can choose to either lend or not lend. The situation is shown schematically in Figure 2.¹³ We assume that creditors can get paid back in full only if the government chooses to cut consumption rather than investment. The government prefers cutting investment to cutting consumption everything else being the same, but would rather cut consumption if that is the only way it can borrow. However, under the payoffs shown in Figure 2, if the government cannot credibly commit itself to cutting consumption, creditors would refuse to lend knowing that the government will choose to cut investment instead. The inability of the government to commit itself thus leads to a sub-optimal situation for all concerned.

That conditional lending—lending contingent on certain actions by the government, here a

¹³The argument is laid out in more careful detail in Diwan and Rodrik (1992).

cut in public consumption--has a useful role in such cases is clear. Conditionality can be a commitment technology allowing borrowing governments to undertake decisions that are desirable ex ante, in circumstances where the rational strategies ex post differ.¹⁴

Whether conditionality can be made effective in practice is a difficult question. Obviously, sovereign entities can and do revoke commitments that they undertake. From the current perspective, however, the more relevant question is whether there are reasons to believe that multilateral institutions are inherently better at exercising conditionality. Despite the existence of a vast literature on conditionality (see for example Guitian 1982, Mosley 1987, Polak 1991), there has been practically no discussion of why policy conditionality has become nowadays an almost exclusively multilateral affair. Could conditionality not be as well applied by ad-hoc groupings of private and/or governmental creditors, depending on the particulars of each case? In fact, prior to 1945, that is precisely the form that conditionality took. It was sometimes gunboat diplomacy, sometimes organized bondholders' committees, and sometimes a combination that brought recalcitrant debtors into line. And conditionality was often more direct and intrusive: it was not uncommon, for example, for part of government tax revenue on, say, imports, to be earmarked for foreign debt service.

What has now irrevocably altered is the political acceptability of these old forms of persuasion. And therein lies the main argument in favor of multilateral conditionality: in an era where national sovereignty is highly prized and zealously guarded, this type of conditionality is politically more palatable to all involved. This is due partly to the fact that debtor governments are shareholders of the multilateral institutions. But since effective power in these fora is exercised not by developing countries but by the advanced industrial countries, the political

¹⁴One reason too often is that governments find it politically expedient to cave in to supplicants once the money is borrowed. In the words of The Economist, "The [International Monetary] Fund enables the people pursuing sensible policies to defend them against lobbyists and populists by saying, 'We cannot give you more money because that would put the IMF loan at risk' " (March 11, 1995, p. 18).

acceptability of multilateral conditionality derives more from the perception that the World Bank and the IMF operate somewhat autonomously from Western capitals and in a relatively non-political manner. While the U.S., in particular, exercises considerable leverage over both institutions, the relationship is still an arms' length one. Consequently, negotiations with borrowing governments can be maintained at the technical and economic level.

Something along these lines has been implicit in much of the thinking on multilateral conditionality, but has rarely been articulated in full. The Pearson report of 1969 provides an early statement of the idea:

The aid dialogue involves sensitive questions of performance monitoring and advice and persuasion in matters of policy and planning. By playing a leading role as intermediaries in this ongoing debate between the suppliers and users of aid, international organizations do much to endow development assistance with the character of a truly international effort, reducing any overtones of charity or interventionism which have at times embittered the aid process in the past. (Pearson 1969, 213-4)

The World Bank and the IMF, as well as many of the regional development banks, are prohibited by their charters from taking political considerations into account. In addition, they have some in-built mechanisms to ensure relatively non-political operation. The high caliber and professionalism of their staff is one important factor. Both the World Bank's and the IMF's chief executives have traditionally been rather independent from their respective boards. Finally, since the World Bank's non-concessional lending is financed by borrowing from international capital markets, it is difficult for that institution to deviate from market and creditworthiness criteria in its lending decisions. None of this, of course, is to deny that these institutions often act under political constraints or that they get embroiled in controversy in developing countries.¹⁵ They are

¹⁵As Jacques Polak puts it: "Clear cases of political decisionmaking occur [in the IMF] when decisions on access or potential access are not supported by a staff judgement on the adequacy of a country's program. The deviation may be in either direction. Some countries may be barred from access for political reasons even if they have technically adequate programs.

frequently viewed by groups on the left as the tools of Washington, D.C., or of "international capital." But the fact that they are none too popular in Western capitals or with the U.S. Congress belies such simplistic characterizations.

I offer two bits of evidence in favor of the proposition that multilateral flows are less governed by political considerations than bilateral flows. The first consists of the regional distribution of official development assistance (ODA) by type of provider. As Table 4 shows, the distribution of bilateral aid tends to be heavily biased towards regions of political or strategic interest to the donor government. U.S. aid is concentrated on the Middle East, Japanese aid on east and southeast Asia, and EC aid on sub-Saharan Africa. Multilateral aid flows, on the other hand, are generally free of such regional biases. As the table shows, the regional distribution of multilateral aid is closest to that for the Nordic countries. Since the Nordic countries tend to be the donors most responsive to humanitarian needs and least motivated by strategic considerations, this similarity is meaningful.

The second bit of evidence is more formal. Following the recent work of Boone (1994a), I present panel regressions on the determinants of net resource transfers from bilateral and multilateral sources (Table 5). The panel consists of country data averaged over four five-year sub-periods: 1970-74, 1975-79, 1980-84, and 1985-89. In each regression, the dependent variable is the net resource transfer from bilateral or multilateral sources as a share of recipient GNP. The independent variables are a set of economic indicators, region and period dummies, and three additional dummy variables meant to capture the presence of political motives in

Some other countries may be granted access for political reasons...

The list of countries denied access on political grounds is very short, and each case would be difficult to document. It seems to me beyond question, however, that, from the mid-1980s, South Africa was unable to use the Fund as long as it maintained apartheid and that China would have been unable to draw during the first year after Tiananmen Square. An arrangement with Vietnam that would have been technically possible has likewise been blocked by political considerations..." (1991, 30-31).

bilateral flows.¹⁶ The last three dummies, denoted as “Friends of the US,” “Friends of France,” and Friends of OPEC,” are taken from Boone (1994a) and are meant to identify recipient countries that are politically important to each of these donors. “Friends of US” and “Friends of OPEC” are countries that receive more than 1 percent of U.S. and OPEC aid budgets, respectively, while “Friends of France” are members of the French Franc zone in Africa. The results confirm that these “political variables” are important for bilateral lending, but not for multilateral lending. Put differently, the main bilateral donors’ political preferences do not carry over to the lending pattern of multilateral institutions. Hence the statistical analysis supports the more casual evidence gleaned from the data on the regional distribution of ODA.

If multilaterals have any advantage in the exercise of conditionality, then, this veneer of autonomy and political neutrality would have to be an important component of it. It allows sovereign governments to swallow a bitter pill without appearing to cave in to either another sovereign government or private entity. Note once again, however, that the exercise of conditionality does not necessarily require lending activities to go with it. One could imagine multilateral institutions simply negotiating the conditions to be followed by governments, with lending provided by private and bilateral creditors only. The argument for lending in this context must again rely on incentive reasons: putting their own resources at risk helps keep the World Bank and the IMF honest about what policy changes will work and what will not. In addition, the ability of these multilaterals to lend their own resources in principle bolsters their independence and autonomy from governments and private creditors. That in turn helps them maintain their non-political image.

¹⁶These regressions differ from those in Boone in two respects: (a) I use net transfers on all flows, rather than gross ODA flows, as my dependent variable; and (b) I distinguish between bilateral and multilateral sources.

Why Private Creditors Are Not Very Good At Monitoring and At Exercising Conditionality

As mentioned previously, since the second world war it has become rare for creditor governments to exercise conditionality. The task has been increasingly left to multilateral institutions. The exceptions have occurred when there exists a close security relationship between governments, as with the U.S. in South Korea during the 1950s and early 1960s or France in several African cases. Conditionality exercised by private creditors has been even rarer still. However, there has been one well-publicized case of private conditionality involving Peru in 1976. In that year, facing a growing balance-of-payments problem, the Peruvian government allowed a consortium of six U.S. banks to impose conditions on it and to monitor their implementation. In return, the banks extended the government a \$240 million loan. The experiment did not last very long. Amidst all-around discontent, the IMF was called in the following year. I will briefly discuss this case, relying on the account provided by Stallings (1979) as well as the financial press at the time, as it provides a nice illustration of the difficulties encountered by private entities in monitoring government policies and in exercising conditionality.

In October 1968, the civilian government of Fernando Belaunde Terry was overthrown by General Juan Velasco Alvarado. The military government proceeded to follow expansionary fiscal and industrial policies. In addition, it alienated the United States government by nationalizing Standard Oil's subsidiary (the International Petroleum Company), defending the 200-mile fishing limit, and establishing close relations with socialist countries (Stallings, 233-34). As a consequence the Velasco government was practically cut off from lending by official sources. According to Stallings, Peru received almost no loans from the U.S. AID or the Export-Import Bank between 1969 and March 1974, and received only one loan from the World Bank between 1968 and late 1973. However, private international banks continued to pour vast sums into the country, because of Peru's apparent mineral wealth (copper and oil). As one local banker put it, "foreign bankers wanted to give us money before we asked for it. The Italians had

lira for a dam. The French had francs for our steel mill" (Wall Street Journal, September 1, 1977, p. 1). In 1974, the dispute between Peru and the U.S. over the nationalization of the Standard Oil subsidiary was resolved, allowing large sums to come in from U.S. sources as well.

Meanwhile the government's economic mismanagement led in 1975 to another coup within the junta, with General Francisco Morales Bermudez, the prime minister, taking over as president. There were some half-hearted adjustment measures which led nowhere. In the words of Stallings,

By early 1976, then, the Peruvian economy faced a serious crunch, owing to a combination of bad luck, bad planning, and the inevitable dilemmas of dependent capitalist development. The bad luck had to do with the failure of the expected oil bonanza, the disappearance of the anchovy schools that had provided a major Peruvian export, and the fall in copper prices. Bad planning reinforced these problems through over-fishing and borrowing money to build a billion-dollar pipeline before the extent of oil reserves was known. (237)

At this point, the Peruvian government seems to have decided that the obvious next step, an IMF standby loan, would be too drastic, and that the commercial banks themselves might prove more flexible. The Peruvians consequently asked the major U.S. banks in March 1976 for a large balance-of-payments loan without an agreement with the IMF. The bankers were initially reluctant but eventually accepted (see Belliveau 1976). According to Stallings, their reasoning was that

if the crunch were to come [from an IMF standby arrangement], General Jorge Fernandez Maldonado and the left-wing faction of the government might come out on top and lead Peru back toward a radical nationalist position.... One New York banker involved in the negotiation put the point very clearly. He said the "main reason" for the loan was "to perpetuate Morales Bermudez in power," since the banks considered this the best bet for

getting their money back. (Stallings, 238)

The U.S. banks then drew up an agreement with the Peruvian government which had three components: (1) an orthodox stabilization program, "though of a milder sort than the IMF would have imposed"¹⁷ (Stallings, 239) involving a 44 percent devaluation, price increases, credit controls, and minor budget cuts; (2) more favorable treatment of foreign investment, including the reopening of the jungle and coastline to private oil companies and the promise of an agreement with Marcona on a price to be paid for its nationalized iron mine; and (3) partial withdrawal of the state in favor of local private enterprise. The loan was divided into two equal tranches, with the first released immediately. It was a clear provision of the agreement that the banks would monitor the Peruvian government's management of the economy to ensure that the conditions on the budget, among others, were met. However, no specific numerical targets appear to have been set, unlike in an IMF program (Belliveau 1976, 34). The second tranche would be released only if 75 percent of the lenders (in dollar-weighted terms) were satisfied with Peru's economic progress. In the words of Stallings, "[n]ot since the 1920's had private banks become so involved in the domestic affairs of a Latin American government" (239).

The problems were evident from the very beginning. The package had been put together by Citibank together with Bank of America, Chase Manhattan, Manufacturers Hanover, Morgan Guaranty and Wells Fargo, which collectively formed the steering committee. Two other American banks, Bankers Trust and Continental Illinois, had also been invited but refused to join in because they did not think it proper for the banks to be involved in close supervision and monitoring of government policies. In addition, the steering committee banks found it difficult to get the European and Japanese banks to go along. The European and Japanese shares were not arranged until the first half of 1977, even though the original announcement had been made in July 1976.

¹⁷Thorpe (1979, 122), however, claims that the program "was generally assessed afterwards as having been almost as stringent as the Fund's would have been."

The stabilization plan turned out to be a failure. Government expenditure continued to rise in real terms, and inflation was higher than ever by early 1977 (Thorpe 1979). When the Peruvian government approached the banks again for additional financing, the banks referred it this time to the IMF. Stallings lists several reasons why the banks were not keen on repeating the experience. First, there was heavy opposition among the banks to the monitoring role being played. As Stallings points out, opposition from the left had been expected, but the opposition that the steering committee encountered from within the banking community was more surprising. As a representative of Continental Illinois (who along with Bankers Trust refused to join the steering committee) put it:

For a private bank to police the actions of sovereign governments puts it into a difficult position. International agencies have a more neutral role and are better suited for this (cited by Stallings, 243).

Bankers were worried that their role would be perceived as "Wall Street imperialism" (Shapiro 1976). European bankers were also highly skeptical and complained about politicization. A Citicorp vice-chairman concluded: "The reaction to this loan was a signal to me that I want no part in deals with this kind of discipline in the future" (cited by Stallings, 243). In the judgement of Stallings,

The criticism that arose--especially inside the financial world--was decisive. The banks do not want the publicity and controversy that comes with setting macroeconomic conditions for loans and monitoring their implementation. (249)

Bringing in the IMF was now seen as a way of allowing the banks to close their ranks and present a "more neutral facade for imposing conditions". Finally, the banks realized that the IMF would demand tougher conditions than they had. They felt that the Peruvian situation had sufficiently deteriorated to warrant more serious treatment.

An IMF mission began work in Lima in March 1977. The IMF's relationship with the

Peruvian government proved to be rocky as well, but the banks were content this time to watch from the sidelines.

From our perspective, what is particularly interesting in this episode is how unworkable private monitoring and conditionality can be even when the host government has a preference for it. In this case, Peru's military government was unconstrained by public opinion and did not worry about appearances as it opened its books to private bankers.¹⁸ It was the bankers, mindful of their reputation in other countries and their "non-political" function in international finance, who found themselves in a role that made them uncomfortable. In the end, it was the bankers--and not the Peruvian junta--who appeared to have more completely internalized the norms of the post-war era.

Recapitulation

The discussion in this section sheds light on the informational roles that multilateral lending can play, but it also clarifies that these roles are highly contingent ones. The arguments I have made do not roll off the tongue very easily. A range of conditions have to be satisfied before we can convince ourselves that these arguments are likely to be empirically relevant and quantitatively significant. Since the a priori case for multilateral lending is weak, it is all the more important to develop empirical evidence on how well multilateral agencies have performed their informational roles. That is the task of the next section.

¹⁸Even so, the authorities were reluctant to acknowledge the fact that the banks were essentially imposing conditionality on Peru. See the interview with Peru's Central Bank president in Institutional Investor, October 1976, pp. 32-33.

Empirical Evidence

Ultimately, whether multilateral institutions have been able to use their lending to good purpose is an empirical question. But in line with the arguments so far, the empirical issue is not simply whether this lending has been productive in and of itself, but whether it has played the informational roles that justify the existence of multilateral lending institutions. In this part of the paper, I will present some empirical results, necessarily crude, aimed at providing an answer to this question. Two specific issues will be analyzed: (a) has multilateral lending acted as a catalyst for private capital flows? (b) has multilateral lending been a leading indicator of future economic growth in borrowing countries?

Is Multilateral Lending A Catalyst For Private Capital Flows?

One way of gauging the success of multilateral lending as a provider of information on the quality of government policies is to enquire whether countries that have received substantial inflows from multilateral sources have subsequently been large recipients of private capital flows as well. For simple monitoring or conditionality reasons, we might expect governments whose policies have been "ratified" by significant multilateral lending to have been perceived by private investors as desirable ones with which to do business. Everything else being the same, then, multilateral flows should have acted as a catalyst for private flows.

The basic procedure followed here is to test across countries whether net transfers from multilateral sources are a predictor of subsequent net private capital flows, controlling for past private flows. For this purpose, we divide the 1970-1993 period into four sub-periods of 6 years each, and calculate for each sub-period (and country) the averages of bilateral, multilateral, and private net transfers (as a share of GNP). Six years would seem a reasonable length of time for discerning regularities in the data in view of the inevitable lags in the formation of country "reputations". It is a compromise between using even shorter sub-periods, which may exhibit

great volatility in flows, and longer sub-periods, which may lead to averaging out a series of years during which net multilateral transfers were highly positive. The selection of six-year intervals also has the advantage that it coincides fairly well with the aggregate cycles in private capital flows: Private flows during the 1970-75 sub-period were relatively stable, but increased rapidly during the 1976-81 sub-period, only to collapse during 1982-87. The 1988-93 sub-period is one in which private flows rapidly increased once again.

The basic regression takes the following form:

$$\text{PRIV}_{i,t} = \alpha + \beta \text{PRIV}_{i,t-1} + \gamma \text{MULT}_{i,t-1} + \delta \text{BILA}_{i,t-1} + \sum \zeta D_t + \sum \eta_j D_j + \epsilon$$

where PRIV, MULT, and BILA stand for private, multilateral, and bilateral net transfers, respectively, as a percentage of recipient GNP¹⁹, D_t and D_j are dummy variable for sub-periods and country groupings based on income and indebtedness levels, ϵ is the error term, i is the country index, and t is the sub-period index. I will also present results where each type of flow is further disaggregated (e.g., distinguishing between concessional and non-concessional lending), as well as results from each sub-period separately. Note that while we have four sub-periods in all, only the last three can be used in the regression because of the presence of a one-period lag in the specification. The question this regression can help us answer is: do countries that receive large net transfers from multilateral organizations subsequently experience an increase in private capital flows, controlling for past levels of private and bilateral flows?²⁰ Since past private

¹⁹Multilateral flows include the IMF, World Bank, and regional development banks. Bilateral flows include grants.

²⁰While net transfers are naturally a better measure than gross flows in the current context, there is a problem with their use. Since repayments on past multilateral loans enter negatively in this measure, they may play a confounding role in distinguishing cases where multilaterals make a big commitment. Hence, suppose that the World Bank makes a big loan to two countries. If one of these two countries has no past loans coming due while the other one does, it will appear as if the Bank has made a bigger commitment to the former. If this is a serious issue, it will tend to bias estimated coefficients on multilateral lending towards zero. One way to eliminate this problem would be to use an event-study methodology, rather than relying on net multilateral transfers.

flows are explicitly entered in the regression, we can expect that factors that make some countries attractive to foreign investors other than past multilateral lending will be controlled for.

The results for the basic regression are presented in Table 6. There are two sets of results in the table, one for the full sample and one for a restricted sample with countries receiving net transfers of more than 10 percent of GNP (in any of the sub-categories of flows) removed in the relevant sub-periods. The restricted sample essentially eliminates some very small countries that in certain time periods have received aid flows that amount to a substantial part of their GNP. In either case, we find that the coefficient on past multilateral lending is negative, but not statistically significant. The coefficient on past private flows is positive as expected, but much smaller than unity, reflecting the volatility of private capital flows. Interestingly, the coefficient on past bilateral transfers is positive and significant at the 5 percent level in both regressions. Hence, it appears that it is bilateral transfers, and not multilateral transfers, that act as a catalyst for private flows.

Further disaggregation of flows reveals some interesting details (see Table 7).²¹ The catalytic effect of bilateral transfers seems to come from their effect on DFI and on commercial bank loans. And with respect to multilateral lending, there seems to be a sharp dichotomy between IMF and other multilateral organizations. Non-concessional flows from multilateral sources other than the IMF have a negative effect on subsequent private flows, significant at the 10 percent level. This effect seems to operate mainly through commercial bank loans. As Table 8 reveals, the deterrent effect of (non-IMF) multilateral lending is particularly strong in the two sub-periods after 1982. Countries that received larger amounts of net transfers from the World Bank and regional development banks during 1976-81 and 1982-87 appear to have done worse in terms of private capital flows in the two subsequent sub-periods. Regionally, the effect is confined to sub-saharan Africa, where the negative coefficient is statistically significant at the 5

²¹The discussion in this paragraph refers to results with the restricted sample.

percent level (Table 8).²² Figures 3 and 4 present a visual perspective on these results in the form of partial scatterplots between net private transfers and lagged net multilateral transfers. (These scatterplots control for the other independent variables in the regression). The pictures confirm that the estimated negative relationship is not due to outliers.

These are puzzling findings. There does not seem to be a simple explanation for the empirical regularities revealed by the regressions, namely that bilateral lending acts as a catalyst for private flows while multilateral lending (excluding the IMF) either acts as a deterrent or has no impact. With respect to bilateral lending, perhaps the results are reflecting the perception on the part of private investors that the presence of significant official governmental flows acts as a political guarantee of better treatment by host governments. As regards multilateral lending, the results certainly run against the expectation articulated earlier in this paper.

Could these results be due to a bias arising from the tendency of multilateral lending to focus on countries that are already "sick"? Suppose, to make the best possible case for multilateral lending, that the level of private capital flows to sick countries would have been even lower in the absence of multilateral lending. Could our estimated negative coefficient then just reflect the fact that these countries are still getting fewer private inflows than healthier countries? There are three reasons to doubt that a bias like this is operating. First, since the regressions include indebtedness dummies and lagged private inflows on the right-hand side, we have already largely controlled for the effects of an economy's state of health on subsequent private flows. Second, note that the statistically significant effects come from non-IMF lending. This is important because IMF lending tends to be more heavily correlated with economic crisis than other types of multilateral lending. Hence, the bias, if it exists, should have been most evident in the case of IMF lending. Third, even if the bias in question is operative, as long as multilateral

²²A distinction possibly worth making in this context would be between project and policy-based lending. Policy-based lending is presumably more closely linked with conditionality, but both types of lending can be expected to play an informational, and possibly catalytic, role. However, the World Debt Tables do not provide data on this break-down.

lending has focussed on not all sick countries, but those among them which eventually did comparatively better--that is, as long as multilateral lending was effective--the coefficients would be biased towards zero, but not towards a negative number.²³

As a final exercise, we also check to see whether multilateral lending has actually followed rather than led private flows. So we now use net transfers from multilateral sources as the dependent variable. As Table 9 shows, there is actually some evidence for multilateral lending having played the role of follower. In particular, countries that have received large flows from commercial banks appear to have subsequently received larger net transfers from the IMF. In all likelihood, this reflects the fact that most countries which borrowed heavily from commercial banks until 1982 found themselves in economic trouble subsequently, in need of IMF medicine. It also seems to be the case, however, that non-IMF multilateral lending has followed bilateral transfers. It is harder to see why this should have been so.

To the extent that multilateral lending follows private flows, we have to worry about the possibility that multilateral institutions end up bailing out private creditors. Since external resources are fungible, any multilateral lending that helps governments service their private debt is a form of subsidy to private capitalists, the seniority of multilateral aid notwithstanding. For example, Dooley has argued that commercial bank lending during the 1970s was conditioned on the expectation of official bailouts if things were to go wrong: "banks were rational in the sense that they realized a bad outcome was possible but also realized that losses generated by bad outcomes could be shifted to their own governments" (Dooley 1994, 5-6). Eventually, according to Dooley, that is indeed how the debt crisis worked out. Commercial banks stopped lending in

²³To see this point, suppose the sample contains three groups of countries: (a) healthy countries; (b) sick countries that are following the right policies; and (c) sick countries that are not following the right policies. Subsequent levels of private capital flows would be highest in group (a), next highest in group (b), and lowest in group (c). Assume that the regressions do not control for these country groups. Assume further that multilateral lending focusses on countries of type (b) only. The level of multilateral inflows would now be correlated with country status of type (b). But since countries in group (b) still receive higher flows than countries in group (c), the bias is downwards, but not necessarily towards a negative number.

the 1980s, and multilateral creditors stepped in, with the consequence that interest payments to banks came at least in part from multilateral loans.²⁴ If this story of anticipated (and realized) bailouts is correct, we should see multilateral lending following (and not leading) private lending. At least with respect to the IMF, this indeed seems to be the picture revealed by the results in Table 9.

Is Multilateral Lending A Leading Indicator of Country Growth?

The second hypothesis we investigate is that multilateral institutions have had an informational advantage, because of their close monitoring of government policies, in determining which countries have superior growth potential. From this perspective, countries that receive considerable lending from multilateral institutions are presumably the ones whose government policies these institutions have judged to be most worth supporting. The question then is whether, controlling for observable economic characteristics, countries that have received large net transfers from multilateral sources have subsequently grown faster. Note that the association, if any, between multilateral lending and subsequent growth is not expected to arise from the direct economic effects of lending.²⁵ Rather, it is the role of multilateral lending as a possible signal of future growth that is the focus here.

The setup for the empirical analysis is similar to that used previously. The basic regression takes the following form:

$$\text{GROWTH}_{i,t} = \alpha + \beta \text{PRIV}_{i,t-1} + \gamma \text{MULT}_{i,t-1} + \delta \text{BILA}_{i,t-1} + \sum \eta_k X_{i,t-1}^k + \sum \zeta_{jt} D_{jt} + \epsilon$$

where X^k stands for a number of economic variables that are commonly included in growth

²⁴See also Bulow, Rogoff, and Bevilaqua (1992) for argumentation and evidence in favor of the proposition that multilateral debt is in practice not senior; any debt that goes into problem countries is shared with existing private creditors.

²⁵See Boone (1994b) for a sobering analysis of the effects of aid on growth.

regressions, D_i are dummy variables for sub-periods, i is the country index, and t is the sub-period index. All the economic variables except for the data on net transfers (which are the same ones used before), are taken from the Barro-Lee (1994) data set on a panel of countries. Since a different periodization is used in this data set, we change our sub-periods to conform to the Barro-Lee one. Our four sub-periods now become 1970-75, 1975-80, 1980-85, and 1985-90.

The results are displayed in Table 10. The estimated coefficient on lagged multilateral lending is uniformly negative, and becomes statistically significant in some versions of the regression. The coefficient on bilateral transfers, on the other hand, is positive and borderline significant in one of the regressions. Table 11 repeats the exercise, disaggregating further each category of flows and adding dummies for country groups by levels of indebtedness. This set of regressions is more favorable to multilateral flows. In particular, the coefficient on net lending by the IBRD is consistently positive, and significant at the 5 percent level in one case.

One way to read this evidence is as follows: Multilateral lending has tended to go, on average, to heavily indebted countries with poor future growth potential. But once the level of indebtedness is controlled for, some of that lending (e.g. IBRD lending) appears to have focussed on those highly-indebted countries that subsequently did better than others. This can be viewed as partial evidence in favor of the proposition that multilateral lenders have been able to act on better information than is generally available to private markets regarding countries' growth potential .

Concluding Remarks

The experience with multilateral lending since 1945 represents a historically unique experiment. The role played by multilateral institutions--or the role that they ought to play--has always been controversial, with no consensus in sight. As early as 1943, an editorial in the New York Times expressed skepticism about the utility of the World Bank, then under discussion by

the Americans and the British, in strikingly contemporary terms:

If a loan seems really sound--so sound that private investors would voluntarily risk their own money in it--why should it not be left to such investors? People are far more likely to be careful in lending their own money than in lending other people's money. It is no reply to say that many bad private foreign loans were made after the last war [World War I]; the record of repayment is at least incomparably better for these than for Government loans, most of which should probably have been gifts! The defaults on private loans, moreover, did not cause any international bitterness remotely approaching that caused by default on the Government loans.

Under the proposed plan for a World Bank American tax-payers would make foreign loans to Governments whether or not these taxpayers individually considered the loans to be sound. If the creditor Governments had no control over the internal economic and fiscal policies of the debtor Governments to which they made loans, they might be pouring their taxpayers' money down a bottomless pit. If, on the other hand, the creditor Governments did insist on control over the internal policies of the debtor Governments, there would be more sources of international friction and bitterness.

The chief economic need of the postwar world is not new governmental super-machinery. It is the return by individual governments to policies under which a restoration of international confidence and international lending will be possible. (December 4, 1943, cited by Oliver 1975, 160-61)

Private flows have indeed increased tremendously since 1945, undermining the belief that multilateral lending is needed to make up for missing international capital markets.²⁶ And in any case, it was never quite clear what specific advantages a multilateral machinery was to possess

²⁶According to Oliver (1975, 239), John J. McCloy, the World Bank's second president, believed that the Bank "would go out of business in due course because the long-term capital needed for development would eventually be provided directly by private investors."

over bilateral aid programs.

I have argued here that the *raison d'être* of multilateral lending resides in certain informational functions which, if carried out successfully, would improve the workings of international capital markets. These informational roles are: (a) monitoring of government policies, and (b) exercising policy conditionality. The first of these helps direct private investors to countries where the policy environment is sound; the second helps ensure that governments are not tempted to change the rules of the game against foreign investors once investments have been made. I have discussed at some length why multilateral institutions may have an absolute advantage relative to governments or private creditors in performing these roles. The arguments rely on the ability of multilateral institutions to internalize informational externalities and to combine official status with relatively non-political operation.

None of this is to deny that many poor countries deserve concessional lending for humanitarian or other non-economic reasons. The evidence presented in this paper suggests that multilateral institutions may well have an advantage in such concessional flows insofar as political considerations generally figure less prominently in the decision-making machinery of these institutions. But while humanitarian goals may help justify some of multilateral lending, they cannot account for the bulk of such lending, which takes place at non-concessional terms.

One can think of additional rationales for multilateral institutions, such as coordinating official flows from multiple sources, taking advantage of economies of scale and scope, and acting as a lender of last resort. Where large-scale flows to individual countries have taken place (or have been contemplated) as in Russia or Mexico recently, multilateral institutions have certainly played a role. But the coordinating role in such instances can also be played by ad-hoc groupings of official creditors. Such groupings have formed frequently in the past and have worked well, examples being the OECD Consortium for Turkey and the Inter-Governmental Group on Indonesia (IGGI).

Jeffrey Sachs, who has made a forceful case for the importance of strong external support in stabilizing high-inflation economies, has recently discussed a number of historical cases (1995, 65-66): the Bank of England loan to the Reichsbank in 1923; the League of Nations loans to Central Europe in the interwar period; the Marshall Plan in Europe; the U.S. bridge loan to Mexico in 1988; the U.S. loan to Israel in 1985; the Polish stabilization fund provided by the G-7; Britain's and Sweden's return of prewar gold to Estonia in 1992. With the exception of the League of Nations, all of these successful cases involved lending (or support) from governmental sources. A multilateral machinery can nonetheless be useful as a coordinating device, particularly in cases of smaller countries lacking powerful patrons. The success with which this coordinating role can be played, however, would still depend on the ability of the multilateral agencies to perform the basic functions discussed in this paper: providing information and monitoring, and exercising conditionality.

As noted before, this line of reasoning has an important implication. From the present perspective, there is no independent economic rationale for multilateral lending *per se*. Multilateral lending is needed only insofar as the policy monitoring and conditionality roles cannot be adequately performed when not backed by credits from multilateral sources. In other words, lending plays a subsidiary role to the informational functions.

The results of the empirical analysis are quite mixed when it comes to ascertaining whether multilateral lending has played the informational functions I have ascribed to it. There is no evidence that multilateral lending has acted as a catalyst for private flows. If anything, the evidence can be read to suggest the opposite on this score. At the same time, there is some evidence that IBRD lending has focussed on countries with brighter economic futures (once levels of indebtedness are controlled for). These empirical results should be treated with caution, however. Alternative specifications may well result in different findings, and in any case cross-country exercises of this sort need to be validated by case studies.

It is perhaps not too surprising that the empirical results--preliminary as they are--are not more favorable to multilateral lending. The World Bank and other multilateral agencies have seen their role primarily as one of lending. Their informational activities have been in practice subservient to their lending activities, rather than vice versa. Consequently, the empirical analysis has evaluated multilateral institutions from a perspective that is not entirely consonant with their own self-image. It should then be clear that re-examining this self-image, so as to place information, monitoring, and conditionality at the top of the multilateral institutions' agendas, would have important implications for what these institutions do and how they do it.

References

- Barro, Robert J., and Jong-Wha Lee. 1994. "Data Set for a Panel of 138 Countries." Cambridge, MA: National Bureau of Economic Research, unpublished paper.
- Belliveau, Nancy. 1976. "What the Peru Experiment Means," Institutional Investor. October, 31-35.
- Boone, Peter, 1994 a. "Politics and the Effectiveness of Foreign Aid." London School of Economics, unpublished paper.
- Boone, Peter, 1994b. "The Impact of Foreign Aid on Savings and Growth." London School of Economics, unpublished paper.
- Bulow, Jeremy, Kenneth Rogoff, and Afonso S. Bevilaqua. 1992. "Official Creditor Seniority and Burden-Sharing in the Former Soviet Bloc." Brookings Papers on Economic Activity. 1992:1, 195-234.
- Claessens, Stijn, and Sudarshan Gooptu. 1993. Portfolio Investment in Developing Countries. Washington, DC: World Bank Discussion Papers 228.
- Demirgüç-Kunt, Asli, and Lyn Squire. 1994. "Maximizing the Development Impact of the World Bank." June 8th. Washington, DC: The World Bank.
- Diwan, Ishac, and Dani Rodrik. 1992. External Debt, Adjustment, and Burden Sharing: A Unified Framework. Princeton, NJ: Princeton Studies in International Finance, No. 73.
- Dooley, Michael P. 1994. "A Retrospective on the Debt Crisis." NBER Working Paper No. 4963, December.
- Eichengreen, Barry. 1991. "Trends and Cycles in Foreign Lending," in Horst Siebert, ed., Capital Flows in the World Economy. J.C.B. Mohr (Paul Siebeck), Tübingen.
- Feldstein, Martin. 1994. "Tax Policy and International Capital Flows," Weltwirtschaftliches Archiv vol. 130, no. 4, 675-697.
- Gavin, Michael, and Dani Rodrik. 1995. "The World Bank in Historical Perspective," American Economic Review, Papers & Proceedings, May.
- Guitian, Manuel. 1982. "Economic Management and International Monetary Fund Conditionality," in Tony Killick, ed., Adjustment and Financing in the Developing World. Washington, D.C: International Monetary Fund.
- Mosley, Paul. 1987. Conditionality as Bargaining Process: Structural Adjustment Lending, 1980-86. Princeton, NJ: Princeton Essays in International Finance No. 168.
- Oliver, Robert W. 1975. International Economic Cooperation and the World Bank. London: Macmillan.

Pearson, Lester B. and others. 1969. Partners in Development: Report of the Commission on International Development. New York: Praeger.

Polak, Jacques J. 1991. The Changing Nature of IMF Conditionality. Princeton, NJ: Princeton Essays in International Finance No. 184.

Sachs, Jeffrey. 1995. "Russia's Struggle with Stabilization: Conceptual Issues and Evidence," Proceedings of the World Bank Annual Conference on Development Economics. 57-80.

Shapiro, Harvey D. 1976. "Monitoring: Are the Banks Biting Off More Than They Can Chew?" Institutional Investor. October, 26-28.

Stallings, Barbara. 1979. "Peru and the U.S. Banks: Privatization of Financial Relations," in Richard R. Fagen, ed., Capitalism and the State in U.S.-Latin American Relations. Stanford, CA: Stanford University Press.

Thorp, Rosemary. 1979. "The Stabilization Crisis in Peru 1975-8," in R. Thorp and Laurence Whitehead, eds., Inflation and Stabilization in Latin America. London: Macmillan.

Net Flows to Developing Countries

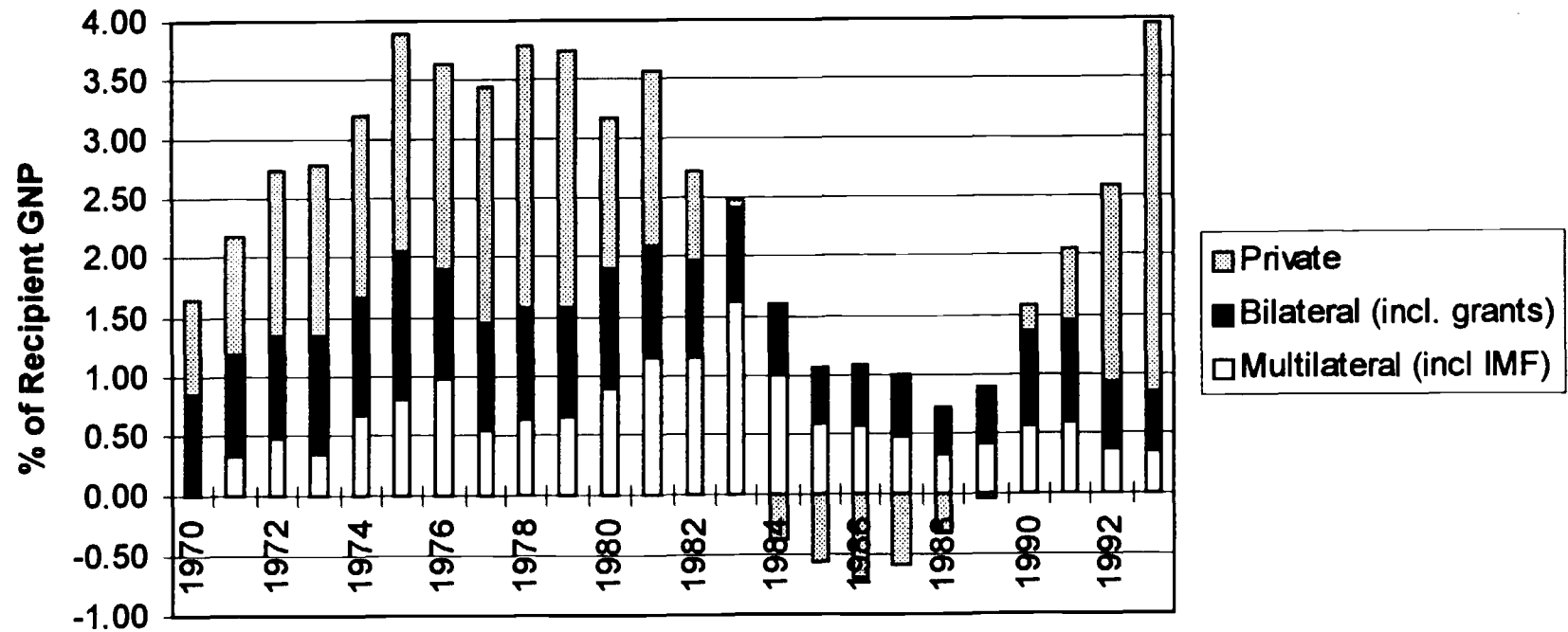
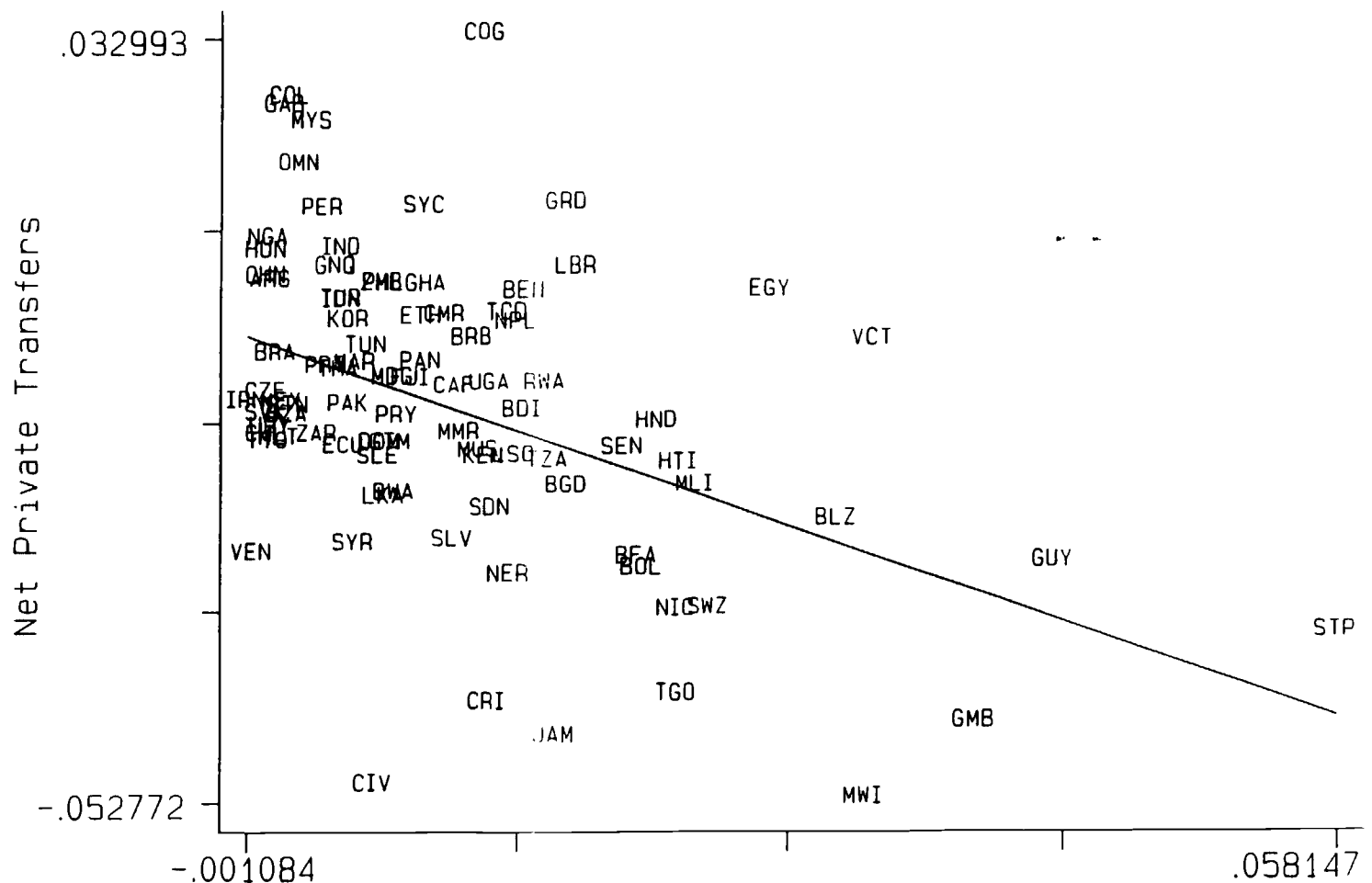


Figure 1

Figure 2: Why Conditionality is Necessary

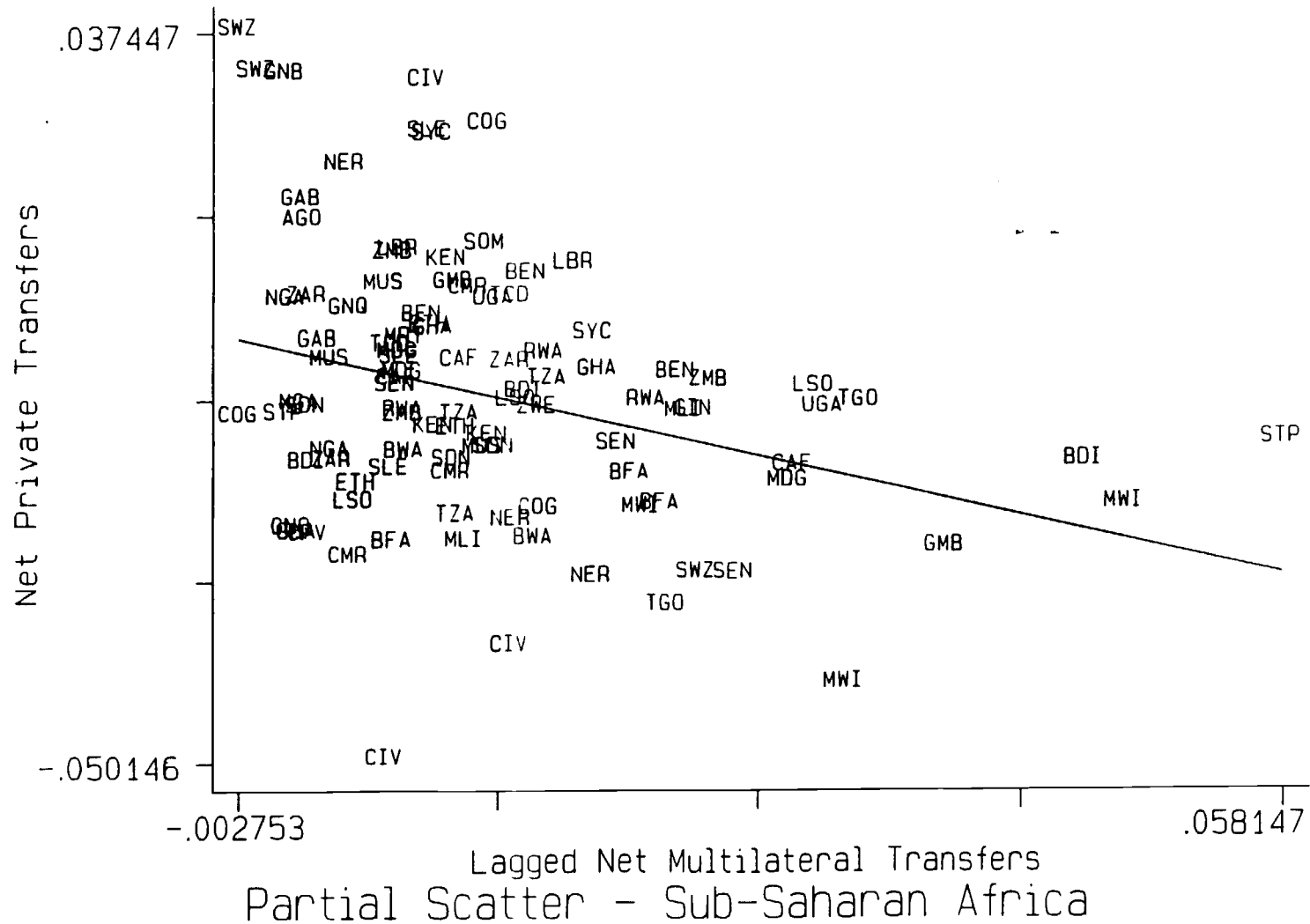
		Government	
		cut investment	cut consumption
Creditors	don't lend	0,20	0,0
	lend	-20,70	50,50

Figure 3 -



Lagged Net Multilateral Transfers
Partial Scatter - All Countries 1982-1987

Figure 4 -



Multilateral				Private				Bilateral			
Country	percent of total	cumul. percent	cumul. percent in LDC GNP	Country	percent of total	cumul. percent	cumul. percent in LDC GNP	Country	percent of total	cumul. percent	cumul. percent in LDC GNP
India	10	10	6	China	15	15	9	Russia	10	10	11
Mexico	9	18	13	Mexico	12	27	16	Egypt	7	17	12
Argentina	5	23	18	Korea	6	33	23	Indonesia	6	24	15
Indonesia	5	28	21	Brazil	6	39	34	China	4	28	24
China	4	33	30	Russia	6	45	45	India	4	32	30
Pakistan	3	36	31	Indonesia	5	51	48	Turkey	3	35	33
Venezuela	3	39	32	Thailand	5	56	50	Mexico	3	38	40
Philipp.	3	42	33	Portugal	5	61	52	Philipp.	3	40	41
Turkey	3	45	36	Argentina	5	65	57	Algeria	2	43	42
Brazil	3	47	47	Malaysia	4	70	58	Pakistan	2	45	43

Source: Calculated from World Bank, World Debt Tables.

	Multilateral	Private	Bilateral
Multilateral	1.00	0.68	0.56
Private		1.00	0.52
Bilateral			1.00

Source: Calculated from World Bank, World Debt Tables.

Table 3: Herfindahl Indices of Concentration of Gross Capital Flows, by Type			
Period	Multilateral	Private	Bilateral
1970-1975	0.05	0.10	0.08
1976-1981	0.04	0.09	0.04
1982-1987	0.04	0.05	0.03
1988-1993	0.04	0.06	0.03

Source: Calculated from World Bank, World Debt Tables.

Table 4: Regional Distribution of Official Development Assistance, 1990-91 (percent)					
	Sub-Saharan Africa	South Asia	Other Asia and Oceania	Middle East and North Africa	Latin America and Caribbean
United States	11.8	6.7	3.6	58.1	19.8
Japan	11.5	15.3	53.2	11.7	8.3
EC	58.2	7.2	4.9	19.7	10.1
Nordic countries	59.6	15.4	8.0	6.9	10.1
International Financial Institutions	43.6	34.9	11.7	1.1	8.6

Source: OECD, Development Cooperation, various issues.

Table 5: Determinants of Bilateral and Multilateral Net Transfers

	Bilateral net transfers		Multilateral net transfers	
Friends of the US	0.92 (2.78)	0.76 (2.41)	-0.28 (-1.37)	-0.12 (-0.60)
Friends of OPEC	1.90 (4.15)	1.61 (4.12)	0.75 (2.64)	0.37 (1.49)
Friends of France	1.09 (3.07)	1.00 (2.88)	-0.03 (-0.13)	-0.08 (-0.36)
log of GDP per capita at beginning of sub-period	-2.19 (-9.36)	-1.96 (-8.23)	-0.84 (-5.75)	-0.79 (-5.27)
log of population	-0.64 (-7.74)	-0.58 (-7.64)	-0.22 (-4.35)	-0.23 (-4.98)
lagged growth of GDP per capita	0.18 (0.05)		-1.15 (-0.51)	
lagged change in terms of trade	-0.65 (-0.41)		-0.65 (-0.66)	
infant mortality		1.68 (0.22)		1.27 (0.27)
life expectancy		-0.37 (-0.17)		0.25 (0.18)
sub-saharan Africa	0.06 (0.12)		0.45 (1.41)	
Asia	0.60 (1.23)		0.51 (1.69)	
Latin America and Caribbean	0.05 (0.12)		0.72 (2.52)	
1975-79	0.78 (2.51)	0.89 (2.94)	1.00 (5.12)	1.00 (5.29)
1980-84	1.28 (3.98)	1.40 (4.44)	1.64 (8.19)	1.65 (8.38)
1985-89	1.00 (2.85)	1.25 (3.84)	0.40 (1.82)	0.43 (2.09)
constant	23.19 (10.51)	22.34 (2.56)	7.91 (5.74)	6.98 (1.28)
N	269	277	269	277
Adj. R ²	0.58	0.55	0.37	0.35

Notes: Data are from World Debt Tables, Barro and Lee (1994), and Boone (1994). See text for description of political dummy variables. The dependent variable is the average for each of four five-year sub-periods (1970-74, 1975-79, 1980-84, 1985-89) of net transfers from bilateral or multilateral sources as a percent of recipient GNP. T-statistics are in parentheses.

Table 6: Dependent Variable: $PRIV_{i,t}$		
Independent variables	(1)	(2)
$PRIV_{i,t-1}$	0.42 (7.76)	0.22 (4.27)
$MULT_{i,t-1}$	-0.14 (-1.10)	-0.11 (-0.93)
$BILA_{i,t-1}$	0.06 (2.01)	0.17 (3.61)
1982-1987	-0.02 (-3.78)	-0.02 (-5.59)
1988-1993	-0.01 (-1.52)	-0.01 (-3.32)
SILIC	-0.01 (-2.87)	-0.01 (-3.74)
SIMIC	-0.02 (-3.12)	-0.01 (-2.95)
MILIC	0.00 (0.06)	-0.01 (-1.79)
MIMIC	-0.01 (-2.56)	-0.01 (-2.34)
constant	0.02 (5.22)	0.02 (6.20)
N	300	261
adj R^2	0.26	0.25

Notes: Regression (1) is run using the full sample, while regression (2) excludes observations where net transfers (under any sub-category of flows) exceed 0.10. T-statistics are in parentheses. SILIC: severely indebted low-income countries; SIMIC: severely-indebted middle-income countries; MILIC: moderately-indebted middle income countries; MIMIC: moderately-indebted middle income countries. See World Debt Tables for country categorizations.

Table 7: Dependent Variable: Net Transfers from Private Sources, by Type					
	All Private	DFI	Portfolio	Bonds	Commercial bank loans
Private					
DFI ₋₁	0.49 (6.16)	0.40 (8.52)	0.00 (0.71)	0.01 (0.42)	0.09 (1.36)
Portfolio ₋₁	13.22 (0.74)	12.14 (1.17)	13.13 (12.37)	-12.82 (-2.93)	0.76 (0.05)
Bonds ₋₁	0.83 (3.31)	0.13 (0.87)	0.00 (0.15)	0.84 (13.71)	-0.13 (-0.67)
Commercial bank loans ₋₁	-0.06 (-0.77)	-0.05 (-1.20)	-0.01 (-2.25)	-0.01 (-0.36)	0.01 (0.18)
Multilateral					
IMF ₋₁	0.09 (0.52)	-0.03 (-0.29)	0.01 (0.96)	0.04 (0.88)	0.07 (0.53)
Other multilateral ₋₁ (concessional)	-0.20 (-1.16)	-0.18 (-1.77)	-0.01 (-1.26)	0.02 (0.51)	-0.03 (-0.24)
Other multilateral ₋₁ (non-concessional)	-0.63 (-1.67)	0.19 (0.88)	0.01 (0.37)	-0.02 (-0.18)	-0.81 (-2.71)
Bilateral					
Grants ₋₁	0.11 (1.78)	0.08 (2.14)	-0.00 (-0.39)	-0.02 (-1.54)	0.06 (1.18)
Other bilateral ₋₁	0.37 (3.40)	0.17 (2.62)	-0.00 (-0.05)	-0.00 (-0.16)	0.21 (2.42)
N	261	261	261	261	261
Adj. R ²	0.32	0.40	0.45	0.43	0.25

Notes: Period dummies, country-group dummies, and constant term were included in the regressions but are not shown in the table. Restricted sample is used.

Table 8: Dependent Variable: Net Transfers from Private Sources, by Sub-Period and Region					
	1976-1981	1982-1987	1988-1993	Sub-Saharan Africa	Rest of the world (excl. SSA)
Private					
DFI ₋₁	0.31 (2.02)	0.49 (3.71)	0.81 (4.98)	0.53 (5.52)	0.33 (2.44)
Portfolio ₋₁	--	-133.04 (-1.28)	24.33 (1.43)	--	27.04 (1.33)
Bonds ₋₁	1.15 (3.01)	-0.85 (-1.11)	-0.17 (-0.27)	0.97 (3.83)	-0.09 (-0.16)
Commercial bank loans ₋₁	0.11 (0.49)	-0.13 (-1.34)	0.04 (0.40)	-0.22 (-2.11)	0.05 (0.51)
Multilateral					
IMF ₋₁	-0.72 (-0.59)	0.05 (0.24)	-0.24 (-0.70)	0.02 (-0.11)	0.27 (0.83)
Other multilateral ₋₁ (concessional)	-0.12 (-0.12)	-0.58 (-1.96)	-0.14 (-0.63)	-0.34 (-1.52)	0.02 (0.06)
Other multilateral ₋₁ (non-concessional)	0.71 (0.59)	-1.33 (-1.91)	-1.08 (-2.45)	-1.29 (-2.54)	0.01 (0.03)
Bilateral					
Grants ₋₁	0.09 (0.64)	0.14 (1.48)	0.06 (0.60)	-0.01 (-0.16)	0.19 (1.81)
Other bilateral ₋₁	0.19 (0.74)	0.66 (3.55)	0.20 (1.01)	0.42 (3.22)	0.24 (1.23)
N	83	88	90	101	160
Adj. R ²	0.1	0.5	0.4	0.53	0.30

Notes: Country-group dummies, and constant term were included in the regressions but are not shown in the table. Restricted sample is used.

Table 9: Dependent Variable: Net Transfers from Multilateral Sources						
	All Multilateral	All Multilateral	All Multilateral	IMF	IMF	Other Multilateral
<u>Private</u> _{,1}	0.12 (2.28)	-0.00 (-0.08)		0.04 (2.10)		-0.04 (-1.23)
DFI _{,1}			-0.14 (-2.39)		-0.02 (-0.57)	
Portfolio _{,1}			1.80 (0.14)		2.23 (0.36)	
Bonds _{,1}			-0.22 (-1.23)		-0.07 (-0.75)	
Commercial bank loans _{,1}			0.12 (2.27)		0.09 (3.43)	
<u>Multilateral</u> _{,1}	0.40 (3.22)	0.36 (4.28)		-0.08 (-1.94)		0.43 (6.23)
IMF _{,1}			0.08 (0.66)		-0.10 (-1.80)	
Other multilateral _{,1}			0.64 (5.55)		-0.05 (-0.94)	
<u>Bilateral</u> _{,1}	0.16 (5.45)	0.11 (3.20)		-0.00 (-0.19)		0.10 (3.74)
Grants _{,1}			0.11 (2.50)		0.01 (0.29)	
Other bilateral _{,1}			-0.03 (-0.32)		-0.01 (-0.28)	
N	300	261	261	261	261	261
Adj. R ²	0.34	0.36	0.41	0.19	0.20	0.43

Notes: Period dummies, country-group dummies, and constant term were included in the regressions but are not shown in the table. Restricted sample is used in all but the first column.

Table 10: Dependent Variable: $GROWTH_{i,t}$				
Independent variables	(1)	(2)	(3)	(4)
	Full Sample		Restricted Sample	
$PRIV_{i,t-1}$	0.02 (0.22)	-0.02 (-0.24)	0.11 (1.07)	0.06 (0.63)
$MULT_{i,t-1}$	-0.09 (-0.39)	-0.18 (-0.82)	-0.47 (-1.76)	-0.57 (-2.13)
$BILA_{i,t-1}$	0.11 (1.51)	0.08 (1.14)	0.17 (1.40)	0.22 (1.78)
N	178	178	161	161
Ad. R^2	0.30	0.30	0.36	0.34

Notes: Each regression includes the following additional variables: initial per capita GDP at the beginning of the sub-period, average years of secondary schooling in over-25 population at the beginning of sub-period (male and female are entered separately), initial life expectancy, investment share in GDP (contemporaneous in regressions (2) and (4), and lagged in regressions (1) and (3)), lagged government consumption expenditure net of defense and education as a share of GDP, sub-period dummies, and a constant term. See Barro and Lee (1994) for more detail on these variables. In the restricted sample observations where net transfers exceed 10 percent of GDP are removed.

Table 11: Dependent Variable: $GROWTH_{i,t}$				
Independent variables	(1)	(2)	(3)	(4)
	Full Sample		Restricted Sample	
$IMF_{i,t-1}$	-0.05 (-0.09)	-0.11 (-0.21)	0.17 (0.30)	0.06 (0.10)
Other multilateral $_{i,t-1}$ (concessional)				
IDA	0.52 (0.74)	0.49 (0.69)	-0.49 (-0.65)	-0.64 (-0.83)
Other	-0.20 (-0.38)	-0.39 (-0.74)	-1.10 (-1.61)	-1.03 (-1.45)
Other multilateral $_{i,t-1}$ (non-concessional)				
IBRD	0.99 (1.45)	0.32 (0.49)	1.96 (1.94)	1.20 (1.17)
Other	-0.77 (-0.67)	-0.40 (-0.33)	-0.14 (-0.10)	-0.26 (-0.19)
N	178	178	161	161
Ad. R ²	0.38	0.34	0.44	0.39

Notes: Same as Table 10, but includes dummies for following country groups: SILIC, SIMIC, MIMIC, and MILIC. Parameter estimates shown only for multilateral flows.