



# The political economy of project preparation: An empirical analysis of World Bank projects<sup>☆</sup>

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## ABSTRACT

Using a novel application of stochastic frontier analysis to overcome data limitations, this paper finds substantially shorter project preparation periods for World Bank loans to countries that are geopolitically important (especially to the U.S.). Accelerated preparation is one explanation for how the World Bank might increase the number of loans to a recipient member country within a fixed time frame, for example in response to that country siding with powerful donor countries on important UN votes or while that country occupies an elected seat on the UN Security Council or the World Bank Executive Board. This channel of donor influence has important implications for institutional reform and provides a new angle to examine the cost of favoritism and the impact of project preparation.

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## 1. Introduction

Over the past decade, the political economy of international financial institutions (IFIs) has emerged as an important area both for policy and for empirical research. A growing number of empirical studies have reinforced anecdotal reports of the powerful donor countries (notably, the U.S.) intervening to overturn the technocratic decisions of these international organizations. This has been particularly well documented for the IMF where links have been found between access to Fund resources, on the one hand, and UN voting patterns and United Nations Security Council (UNSC) temporary membership, on the other hand (Andersen et al., 2006a; Barro and Lee, 2005; Dreher and Jensen, 2007; Dreher et al., 2009b; Stone, 2002, 2004, 2011; Thacker, 1999). Similar patterns, including links with trade and bilateral aid flows, have also been found for the World Bank (Andersen et al., 2006b; Dreher et al., 2009a; Fleck and Kilby, 2006; Frey and Schneider, 1986;

Kilby, 2009b, 2013; Weck-Hannemann and Schneider, 1991) and the Asian Development Bank (Kilby, 2006, 2011a; Lim and Vreeland, 2013).

This paper is part of a project that builds on this literature to examine donor influence in IFIs at different stages in the resource transfer process. A better understanding of donor influence at each stage is critical to develop a complete picture of how donors impact the efficacy of IFIs. It is also essential for the design of appropriate policy reforms. The present paper focuses on the “upstream” process at the World Bank, the length of time between project identification by World Bank staff and project approval by the World Bank Executive Directors (EDs). This topic is important for a number of reasons. It may elucidate the mechanism by which politics influence the number of projects (Dreher et al., 2009a) or the volume of lending (Andersen et al., 2006a; Kaja and Werker, 2010). “Quality at entry” (the quality of preparation) has been identified repeatedly as an important determinant of project success (e.g., Kilby, 1994; Limodio, 2011; Smets et al., in press). Rushing a project to the World Bank’s board for approval could undermine quality by limiting consideration of alternatives and local needs during the identification process, leaving insufficient time to develop a full project plan, and creating a disincentive for a critical appraisal. If we can identify which projects were rushed, a more precise measure of the “cost of favoritism” (in terms of reduce aid effectiveness) is possible (Dreher et al., in press).

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To date, no one has tackled this issue because project identification dates (at the World Bank and elsewhere) are not publicly available. I side-step this problem by using a stochastic frontier model (SFM) to estimate the identification date from sequentially issued project identification numbers. This methodology, developed for studying productive efficiency at the firm level and since adapted to analyze total factor productivity at the national level, allows me to use project identification numbers, loan approval dates, and project/country characteristics to explore what determines the duration of project preparation. Duration in this context is akin to cost where the most “efficient” projects – those with the shortest duration – define the frontier. The methodology is analogous to duration analysis (in this case modeled with an exponential distribution) which simultaneously estimates the starting date from a variable that is a noisy measure of that date. The advantage of this approach is that, because it explicitly models the data generating process, the marginal effects of explanatory variables have a clear interpretation in terms of their impact on preparation duration, a feature not shared by a linear regression.

The analysis finds that several political factors have a significant impact on the length of World Bank project preparation. When recipient countries vote with the U.S. in the UN General Assembly (UNGA) on measures the U.S. considers important, occupy one of the non-permanent seats in UNSC, or have their own national representative on the World Bank Executive Board, the length of project preparation is reduced. This fits with Dreher et al.'s (2009a) finding that the number of World Bank projects approved per year is higher while a country holds a non-permanent seat on the UNSC. It is also consistent with Kaja and Werker's (2010) result that loan amounts from the World Bank's less concessional window, the International Bank for Reconstruction and Development (IBRD), are higher when a country's national is serving as a World Bank Executive Director.

The next section (Section 2) presents a brief survey of the relevant portions of the literature on the political economy of IFI lending. Section 3 describes data on project identification numbers and explains how to incorporate them in a stochastic frontier analysis (SFA). Section 4 describes the remaining data and presents estimation results. Section 5 explores the robustness of these results. Section 6 concludes.

## 2. Literature review

This section covers past research on the political economy of World Bank lending directly linked to this paper and other work relating project preparation to project performance. I do not review the stochastic frontier analysis literature because of its size and because I have found no previous studies with similar applications (i.e., where the model is used for duration analysis with measurement error). For an excellent review of the empirical SFA literature, see Greene (2008).

Quantitative research into the role of donor interests in the allocation of World Bank funds began with Akins (1981), Frey and Schneider (1986), and Weck-Hannemann and Schneider (1991). Following in this tradition, Fleck and Kilby (2006) develop a model in which donor threats to withhold funding motivate the aid agency to increase the share of aid going to the donor's preferred recipient. This model motivates a panel analysis of World Bank lending shares from 1968 to 2002 which finds links between U.S. trade interests and World Bank disbursement shares.

Andersen et al. (2006a) narrow the focus to the 1990s and the more concessional window of the World Bank, the International Development Association (IDA). Looking at commitment data, these researchers find a link between UN voting alignment with the U.S. on measures the U.S. considers important and IDA loan volume. Their focus on only those votes considered important by the U.S. follows earlier work on the IMF (Thacker, 1999); in most settings, these votes have proven far more predictive (and robust) than measures that do not distinguish between important and other votes (e.g., Kilby, 2009b).

Some controversy remains over the use of UNGA voting alignment to measure donor interests in this setting. Andersen et al. (2006b) develop a vote buying model to argue for separately including alignment on other votes or country fixed effects to avoid omitted variable bias. Kuziemko and Werker (2006) introduce non-permanent membership on the UNSC as a measure of geopolitical importance to the U.S. in their analysis of the geopolitics of U.S. bilateral aid.

Dreher et al. (2009a) utilize UNSC non-permanent member status in an analysis of the determinants of the number of World Bank projects a country receives per year. The authors find a statistically significant and sizeable jump in the number of projects for countries in the second year of their term as non-permanent members of the UNSC. This pattern is consistent with rushed preparation of projects when a country joins the UNSC, with the bulk of these “rush orders” only reaching the World Bank's Board of Executive Directors by the second year.<sup>1</sup>

Kaja and Werker (2010) introduce a corporate governance angle into the analysis. Many day-to-day decisions at the World Bank (e.g., loan approvals) are made by a group of 25 EDs, a number of them representing several borrowing countries at once. Kaja and Werker's basic question is whether EDs fulfill their fiduciary obligation to provide a level playing field for all borrowing countries or rather favor their own countries of origin. The analysis finds that both ED and ED-alternate status substantially increases IBRD loan commitments to a country while the country holds the position. Kaja and Werker do not find a similar link for IDA credits.

Dreher et al. (in press) use the case of the World Bank to tackle a long debated issue in the aid literature: is politically motivated aid less effective? Measuring performance via World Bank ratings, Dreher et al. find that economically vulnerable countries have worse outcomes for projects approved while the country was a non-permanent member of the UNSC.

There is a largely separate literature examining whether World Bank inputs (such as preparation) influence project performance. Looking after the preparation period, Kilby (2000) finds that World Bank project supervision (which consists of monitoring and advice during project implementation) has a sizeable impact on project performance. Kilby (1994) examines the impact of “quality at entry” on project outcomes; the data available suggest that the quality of preparation has a strong impact on final outcomes, both in terms of average results and in terms of “insulating” a project from a difficult macroeconomic environment. More recently, Smets et al. (in press) find strong direct and indirect effects of “quality at entry” on the outcome of development policy loans.

It is important to note that both Kilby (1994) and Smets et al. (in press) use subjective ratings of “quality at entry” assigned by the same World Bank project evaluators who assess the project's overall performance. While these are the only evaluations available, this design creates obvious potential for endogeneity due to a halo effect. Deininger et al. (1998) take an alternative approach, looking directly at the number of staff weeks of preparation. They find that World Bank project-specific inputs (preparation plus supervision) do not have a significant impact on a country's average performance though weak instruments are an issue.<sup>2</sup> Dollar and Svensson (2000) find that staff weeks of preparation do not influence the success rate of structural adjustment programs although, again, the strategy used to select instruments is likely to generate weak instruments. In sum, the literature investigating the impact of World Bank project preparation on project performance is inconclusive. While it is intuitively appealing that poor or rushed preparation may lead to poor project selection or subsequent implementation problems, attempts to measure this have been plagued by endogeneity concerns.

<sup>1</sup> It is also consistent with the initiation of types of projects that require little preparation, for example supplemental loans for existing projects.

<sup>2</sup> See footnote 3 in Deininger et al. (1998).

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