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Center for Comparative and International Studies (CIS)

Working Paper No 62, 2010

Published by the Center for Comparative and International Studies (ETH Zurich and University of Zurich)

# The Impact of World Bank and IMF Programs on Democratization in Developing Countries

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ISSN 1662-7504

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# The Impact of World Bank and IMF Programs on Democratization in Developing Countries[1]

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September 2010

This paper proposes a theory on the interference of World Bank and IMF programs with domestic politics by changing the prevailing power balance between pro-democratic and anti-democratic forces. However, World Bank and IMF programs differ in design and impact. Thus, the question arises whether the participation in different types of World Bank and IMF programs also has a different impact on democratization in recipient countries. Therefore, this paper analyzes empirically the separate and joint effects of World Bank and IMF programs on democratization in 76 developing countries in Africa and Asia from 1974 to 2007. Our results show that aid modalities matter. In general, while World Bank and IMF programs do not change electoral accountability mechanisms in recipient countries, they induce changes in civil liberties and domestic oversight of the borrower government. Traditional lending types have significant negative short-term effects on the extent of horizontal accountability and civil liberties in recipient countries, while more flexible policy lending types significantly increase the extent of checks and balances at the domestic level in the long term. Moreover, civil society's participation in the formulation and implementation of national poverty reduction strategies potentially increases a country's civil liberties record.

**Key words**: Democratization, international financial institutions, aid, conditionality, power balances, poverty reduction, PRS

[1] The authors are very grateful to André Bächtiger, Axel Dreher, James Vreeland and Eric Werker for sharing their data with us. We thank Rodwan Abouharb, Eugenia Baroncelli, David S. Brown, Florens Flues, Jeffry Frieden, Desha M. Girod, Simon Hug, Kathryn Lavelle, Amanda Licht, Trude M. Midtgård, Stephen Nelson and Anke Weber for offering helpful advice. Special thanks go to David Schönholzer, who has provided valuable research assistance. Earlier versions were presented at the 2009 Americal Political Science Association Meeting, the 2009 General Conference of the European Consortium for Political Research, the 2009 International Political Economy Society Meeting, the 2010 Swiss Political Science Association Meeting, and the 2010 Political Economy of International Organizations Meeting. Financial support by a special research grant of the University of Zurich ("Forschungskredit") is gratefully acknowledged.

## 1. Introduction

In the 1990s, the World Bank and IMF's structural adjustment programs came under rising criticism from civil society for having, in general, negative social and economic impacts on marginalized people and for undermining democracy in recipient countries (for a comprehensive assessment of these negative consequences, see the Structural Adjustment Participatory Review International Network Report 2004, which was born of an unique five-year collaboration among citizen's groups, developing country governments, and the World Bank). The policy conditions attached to these programs seemed unable to lever critical political and economic reforms. At the same time, there was an increasing awareness on the part of the donor community that broadened participation and political competition were crucial ingredients for aid effectiveness and economic progress. As a result, both bilateral and multilateral donors began to look for new development strategies, redefining their role not only in the transfer of financial resources, but also in contributing to good governance which, at least implicitly, also includes democratization – the issue on which we will focus here.

In this context, a closer analysis of the instrument of poverty reduction strategies (PRS) is particularly warranted. Tied to a set of governance conditions, PRS have placed issues of poverty reduction and good governance at the center stage of the official agenda in a number of developing countries. Introduced in 1999, PRS related lending is currently the World Bank and IMF's main program type for regulating access to debt relief and concessional financing. By replacing the former structural adjustment programs (SAPs), the PRS approach seeks to increase the participation of civil society in the design and implementation of national development strategies. As a result, the international financial organizations (IFIs) expect to see the voices of formerly excluded social groups help to formulate more effective development strategies leading to welfare-improving outcomes. Along with that the PRS approach induces political processes on which we will focus here. We argue that PRS can contribute to a democratic transition in recipient countries by empowering civil society and strengthening democratic accountability of governments towards their citizens and vis-à-vis other domestic political institutions.

Whereas bilateral donors have shown fewer problems in autonomously redefining their role, the official mandate of the World Bank and the IMF does not allow them any political interference with recipient countries. In practice, however, their lending modalities do have political consequences for recipient nations (independently of whether this effect is intended by the international financial institutions or not). The design of loan conditionality is intrinsically highly political because it involves policies and processes which affect the welfare of most people (Killick 1995: 170) and thus changes the power balances between the political actors involved in the domestic democratization process. Adapting Rueschemeyer et al.'s (1992) theoretical concept of political power balances to the context of development cooperation, we distinguish three categories of political actors: the multilateral donors, the borrower government, and the domestic civil society, who all shape democratization processes through complex and dynamic interaction. In our theoretical framework, democratization is perceived as an outcome of a conflictual decision-making process between these domestic and international actors, whereby the whole process is conditioned by formal and informal institutions (see also the PRS case studies by Booth 2003; Bierschenk et al. 2003). All in all, whether certain types of IFI program lending have a positive or negative impact on democratization in developing countries depends on the incentives or constraints created for the borrower government and the domestic civil society through multilateral program lending. The question thus arises, *whether IMF and World Bank programs encourage or inhibit democratization, and how their traditional and more recent forms of lending arrangements and accompanying conditions have fared in this respect*.

Previous research on the political economy of international organizations has rarely analyzed the domestic political consequences of their lending within recipient countries. If they received scholarly attention, their political impact was mainly conceptualized in terms of regime stability (cf. Bienen and Gersovitz 1985; Sidell 1988; Killick 1995; Franklin 1997; Dreher and Gassebner 2008). Three exceptions with a focus much closer to ours, are Nelson and Wallace (2005), Barro and Lee (2005), and Abouharb and Cingranelli (2007). Most of these papers have a primarily empirical orientation.

In this paper, we would like to contribute to the growing research on the political effects of the World Bank and the IMF in developing countries by complementing the existing empirical findings with the theoretical insights of other strands of the literature. Our paper builds upon redistributive theories of democratization, neo-patrimonial politics, and class formation in developing countries. We combine Rueschemeyer et al.'s (1992) theoretical model of relative class power with the landmark analysis of neo-patrimonial politics in Sub-Saharan Africa (cf. Bayart 1993; Bratton and van de Walle 1997; Chabal and Daloz 1999) and strategic group theory as developed in the Southeast-Asian context (cf. Evers and Schiel 1988; Schubert et al. 1994; Evers and Gerke 2009). As the latter convincingly argue, the working class and the bourgeoisie are weakly developed in African and Asian countries. Instead, the state has taken a leading role in the capitalist development of the developing world which is highly influenced by international factors. In a context where resources are scarce, the domestic struggle for political power is particularly accentuated among different fractions of the society. The appropriation of state resources through informal means is the focal point of neo-patrimonial politics. It is often seen as a more effective strategy by the ruling elites in developing countries for cementing their place in power than building formal democratic institutions that submit government behavior to public scrutiny (cf. Herbst 1990; Collier 2006). Because the informal institutions of neo-patrimonial politics are embedded in state structures, they are socially very powerful. To a large extent, they determine the distribution of power within society and between the state and society.

World Bank and IMF programs are negotiated between the IFIs and the borrower goverments, thus interfering directly with the internal power balances of recipient countries. In analyzing the causal mechanisms of the IFIs' influence on domestic politics, we draw on the aid effectiveness literature. Research indicates that foreign aid is a highly fungible resource and acts similarly to other forms of non-tax revenues (Moore 1998; Bräutigam and Knack 2004; Knack 2004). Malevolent governments can distribute the extra resources to their key constituencies and thus cement their place in power (Morrison 2009; Licht 2010). As many developing countries show strong democratic deficits, foreign aid is seen to exhibit mainly negative influences on democratization in recipient countries. By constrast, some scholars argue that donor intent and aid modalities can counteract this negative baseline effect for democratization (Goldsmith 2001; Collier 2006; Morrison 2007; Bermeo 2009). As opposed to bilateral donors, ever since the 1970s, the IMF and the World Bank have made their financial assistance conditional on certain policy and institutional reforms in recipient countries. Conditionality plays a central role in their programmatic lending approaches. As far as it is related not only to economic policy, but also to political governance, we may expect a positive effect of multilateral aid on democratization in developing countries or at least some compensation of the otherwise possibly negative effect of aid.

With this paper, we also attempt to make an empirical contribution to the existing literature. In fact, this is the first large-scale study comparing the impact of different types of World Bank and IMF programs on democratic transitions in recipient countries. It is based on a panel of 76 developing countries in Africa and Asia from 1974 to 2007. We explore a longer time series than previous studies, which allows us to include the most recent World Bank and IMF program lending based on PRS.

We assume that apart from the funding itself the aid modalities are particularly relevant. They have changed over time and across different program types. The various lending approaches by the World Bank and the IMF differ in terms of eligibility, development objective, donor conditions, and program duration. We thereby distinguish firstly, between the traditional lending types of the World Bank and the IMF available to all member countries and their concessional lending types for which only low-income countries are eligible; secondly, within the later, between those which are conditioned on specific policies and those which have process conditions attached. Eventually, the aim of this paper is to explore, whether the *participation in different types of World Bank and IMF programs has a different impact on the quality of democracy in recipient countries.*

Methodologically, we build upon the few pioneering studies having analyzed the impact of IMF and World Bank program lending on human rights, rule of law, and democratization in recipient countries. Based on the discussion in Abouharb and Cingranelli (2007: 81), we analyze the effects of World Bank and IMF concessional programs jointly. Moreover, following Barro and Lee (2005), we correct for potential endogeneity of program participation using an instrumental variables approach. And finally, in keeping with Nelson and Wallace (2005), we examine the relevance of time-delayed effects by analyzing the effect of IFI program lending on the level of democracy over different time horizons (using different lags of the IFI program variable).

The rest of this paper is organized as follows: In section 2 we will first review important contributions of various strands of the literature. In section 3 we will clarify our democracy concept and move on from there to build our theoretical framework for analyzing the underlying causal mechanisms between the various types of IFI program lending and different dimensions of democracy. Section 4 discusses the data and operationalization of our hypotheses. Section 5 provides an overview of our econometric estimation strategy the results of which are presented in section 6. Finally, section 7 presents a discussion of the major findings, followed by a conclusion in section 8.

## 2. Previous research

### 2.1. Democracy diffusion and promotion

The international dimension has rarely been examined in the comparative political research on democratic transition and consolidation in developing countries. In explaining the so-called "third wave", democratization studies have either largely concentrated on micro-explanations relating to political processes, contingent events, and the choices of domestic principal leaders in democratic transitions (e.g., O'Donnell et al. 1986; Di Palma 1990; Przeworski 1991; Higley and Gunther 1992) or focused on contextual variables at the macro level, such as pre-existing economic conditions, cultural heritage, class interests, or the existence of a vibrant civil society for explaining democratic consolidation (e.g., Diamond 1999; Clague et al. 2001; Linder and Bächtiger 2005).

Recent empirical work, however, started to explicitly take international factors into account and to integrate them into more complete democratization models. Following Levitsky and Way (2005: 21), international influences on democratization come in two forms: linkage (the density of a country's external ties) and leverage (governments' vulnerability to external pressure). Globalization and democratic diffusion studies have found an overall positive impact of external linkages. On the one hand, economic globalization reflected in a country's trade and capital market integration is perceived as significantly affecting national democracy levels (e.g., Doorenspleet 2004; Rudra 2005). On the other hand, political influences from abroad are considered as having an impact on domestic politics through diffusion processes or demonstration effects, whereby democratizing countries "infect" their more authoritarian neighbors (e.g., Starr and Lindborg 2003; Wejnert 2005; Brinks and Coppedge 2006).

Democratization is not only shaped by diffusion processes, but also promoted by international actors through external leverage. Theoretically spoken, foreign assistance has the potential, on the one hand, to create the structural prerequisites necessary for democratic transition and survival, and on the other hand, to directly empower domestic actors that struggle for democratization (Finkel et al. 2007: 410). Even though most studies within the aid effectiveness literature focus on economic outcomes, some studies have empirically examined the impact of foreign aid on political outcomes. Yet, the empirical experience regarding the effects of aid on democratization is controversial. Some scholars find a positive relationship between bilateral aid and democratization, particularly for aid given with "intent" (cf. Goldsmith 2001; Dunning 2004; Finkel et al. 2007; Bermeo 2009), while others find that external assistance has no effect or rather inhibits democatic transition and good governance (cf. Svensson 2000; Bräutigam and Knack 2004; Knack 2004; Busse and Gröning 2009; Morrison 2009; Licht 2010). The aid and democratization literature usually does not distinguish between bi- and multilateral aid. The specific role of international organizations is widely neglected.

## 2.2. Political economy of international organizations

Democratization processes work not only through neighboring countries and bilateral donors, but also through regional or, more broadly, international organizations. Pevehouse (2002) shows that membership in democratic regional organizations can encourage the process of democratization in member states. Another study in the European context concludes that not only the membership status, but even the offering of a membership perspective in combination with EU political conditionality on democracy, shows a robust and strong effect on political reforms in EU neighboring countries (Schimmelfennig and Scholtz 2008). Similar studies related to the influence of IFIs on democratization in developing countries are rare.

More generally, the effect of IFIs' lending on developing countries is widely examined in the literature on the political economy of international organizations. However, the outcomes considered are generally limited to economic variables such as growth and income inequality (for an overview, see Mosley et al. 1991; Killick 1995; Killick et al. 1998; Khan and Sharma 2001; Vreeland 2003; Dreher 2006). In most studies, the IFIs' economic impact in recipient countries has been found to be negative. For example, Abouharb and Cingranelli (2007: 7) conclude that "structural adjustment did the most damage to the least well off in society. It usually reduced the size of the 'economic pie' to be distributed, and resulted in a more unequal distribution of the pie itself".

A handful of empirical studies with a more political orientation further analyzed the consequences of these economic effects, such as social protests and political demonstrations. Some older studies on IMF-supported financial stabilization either do not finad any significant effect on political stability, or if they find a correlation, the causal relationship remains unclear (cf. Bienen and Gersovitz 1985;

Remmer 1986; Sidell 1988). They suggest that the observed political instability is probably due to the common causal factor of economic difficulties. More recent studies control for this common factor and find a negative effect on political stability in recipient countries (cf. Franklin 1997; Dreher and Gassebner 2008).

The fact that the World Bank and the IMF officially constrain their activities to purely economic interventions may explain why previous research on the IFIs' development assistance has focused on its economic payoff (or lack thereof) rather than on its social and political effects. Nevertheless, there are three global, comparative empirical studies that have taken up the issue of the IFIs' impact on democratization in a systematic way.[2] The econometric analyses carried out by Barro and Lee (2003, 2005) suggest that IMF financial stabilization programs have a marginally negative effect, directly on democracy and indirectly on economic growth over the contemporaneous and the lagged five-year period.

By contrast, the study by Nelson and Wallace (2005) reveals that countries being under any kind of IMF program show significantly higher democratization levels, and concludes that the conditions attached to the loans disbursed by the IMF have a positive effect on the quality of democratic institutions in participating countries. These positive effects grow over time. For a one-year time lag, no apparent relationship between the participation in an IMF program and the level of democracy is detected. However, in the three-year and five-year lagged models, the coefficients for participating in an IMF program become stronger and statistically significant (ibid.: 22-23).

Similarly, the path-breaking study by Abouharb and Cingranelli (2007) on the IFIs' human rights impact looks at the length of time a country has been under a structural adjustment program by either the World Bank or the IMF in the 1980 to 2003 period. The authors find that longer exposure to structural conditionality is positively correlated with procedural democracy. At the same time, their finding that long-term structural adjustment has a negative impact on a wide range of civil, worker and human rights points to the paradox that structural adjustment "may have led, simultaneously, to advances in procedural democracy and a decline in substantive democracy" (ibid.: 207).

These three studies all provide important ground for our analysis which will build on a combination of their methods and add a theoretical framework of the possible democratization processes at work.

[2] There is an additional early study by Moore and Scarrit (1990) on the impact of IMF conditionality agreement on African polity structures. However, given their limited data and geographical focus we do not include this study in this review of global comparative analyses.

### 2.3. PRS case studies

As opposed to the cross-country analyses reviewed above, PRS case studies have always been more attentive to the political processes implied by the IFIs' interventions. More specifically, the discrepancy between procedural and substantive democracy fostered through external democracy promotion received a lot of attention in a multitude of PRS case studies. The democratizing potential of the participatory processes leading to the formulation of the national development strategies has been studied by scholars and development practitioners alike. Yet, results in terms of country ownership and political democratization are mixed.

Positive impacts of PRS processes are seen in three key areas, namely (i) that the PRS consultation process created new space for domestic policy dialogue and resulted in an unprecedented engagement of civil society organizations in poverty policy debates; (ii) that the PRS process contributed to a much stronger focus on poverty inside government; and (iii) that the PRS approach focused attention on donor coordination internationally and at the recipient country level (e.g., Booth 2003; Molenaers and Renard 2003; World Bank and IMF 2005; Driscoll and Evans 2005). However, a lot of challenges for achieving national ownership and democratic control of the PRS process are still remaining. They are mainly seen in the areas of institutionalizing sustainable participation and taking the domestic political context into account. Even though the ownership principle suggests participation of a variety of actors, in practice the PRS process was often characterized by "government ownership" rather than broader "country ownership" (Dürr et al. 2008). Moreover, governments often limited participation by depoliticizing the topics open for discussion and by politicizing the selection of participants (cf. Eberlei 2001; Molenaers and Renard 2003; IEO 2004; World Bank and IMF 2005; Driscoll and Evans 2005). Another challenge that has not attracted enough attention so far is that many PRS processes have unfolded in semi-democratized states in which domestic politics tend to be patronage-based, with fragmented party systems, politicization of administration, as well as weak state regulatory and implementation capacities. Some case studies indicate that there is a risk that PRS will become identified with the political party in power and be discarded when there is a change of government (e.g., Bierschenk et al. 2003; Booth 2003; World Bank 2003; Dijkstra 2005).

All of these are important aspects of policy processes in developing countries which appear relevant when trying to construct a theoretical framework for the impact of different types of IFI lending on democratization. In this paper, we will thus attempt to connect the insights from case study analysis with the aforementioned literature on the international determinants of democratization, and the literature on the political economy of international organization. In doing so, we seek to advance the research frontier by closing two research gaps that have been identified in the previous literature:

Firstly, we would like to *contribute to theory-building on the impact of international organizations on democratization* by combining ideas from different academic disciplines. Until now, we have found few studies trying to combine the various strands of the literature. Democratization studies have rarely taken actors outside the nation-state into account. On the other hand, with the possible exception of a few PRS studies (e.g., Stewart and Wang 2003; Brown 2004; Dürr et al. 2008), the impact of the IFI on democratic outcomes has rarely been included within the existing political economy and development policy literature. Two likely reasons for the lack of studies on external influences in democratization research are that core theories are missing (Pevehouse 2002; Grugel 2003) and that the understanding of the specific causal mechanisms linking international organizations to the quality of democracy in recipient countries is quite limited (Levitsky and Way 2005; Nelson and Wallace 2005).

Secondly, we will *differentiate between both, various types of IFI programs and various time horizons*, i.e. periods during which they may become effective. Most empirical studies on bilateral and multilateral aid have either distinguished between its short-, medium- and long-term impact (cf. Clemens et al. 2004; Nelson and Wallace 2005; Atoyan and Conway 2006), or they have analyzed its impact in terms of different program types (cf. Boockmann and Dreher 2003; Dreher and Sturm 2006; Biglaiser and DeRouen 2009; Bermeo 2009). Given that both aspects, different program types and time horizons, may well be relevant jointly, it is surprising to see that, apart from two studies on the IMF (cf. Evrensel 2002; Figura 2007) the different combinations have never been examined by other scholars. Today, the available data on World Bank and IMF lending also include about a decade's experience with the PRS approach, i.e. the approach supposed to mark the most important structural change in comparison to other lending types. Being able to include the PRS programs into our analysis offers a unique opportunity to examine potential differences in the impact of different types of financial support to developing countries over time.

## 3. Theoretical framework

### 3.1. Democratic dimensions and deficits in hybrid regimes

Democracy in this paper is defined as a political regime "that presents a stable institutional structure that realizes the liberty and equality of citizens through the legitimate and correct functioning of its institutions and mechanisms" (Morlino 2004: 12). Following Morlino, we consider different dimensions of democracy. At the center of his concept of democracy stands the notion of accountability, which is defined as "…the obligation of elected political leaders to answer for their political decisions when asked by citizen-electors or other constitutional bodies" (ibid.: 17). A government in a democratic polity is accountable in two ways: vertically and horizontally. *Vertical* accountability exists between the governor and the governed, when the former can be removed from power by the latter, usually through elections. This first type of accountability has a periodic nature and is dependent on election dates. The actors involved in vertical accountability are politically unequal. *Horizontal* accountability, on the other hand, is the responsibility governors have to answer to other institutions or collective actors that have the expertise and power to control the behavior of those in power. Horizontal accountability is mainly constitutional and/or law-bound. In contrast to vertical accountability, the actors are, for the most part, politically equal (ibid.: 17-18). Besides these two accountability dimensions of democracy which represent the essence of procedural democracy, we consider a third, more *substantive* dimension of democracy delineating the limitations of state power, namely civil liberties. This third dimension of civil liberties does not constitute in itself the exercise of democratic power; rather, it guarantees the individual freedom from arbitrary state power and secures the political equality between citizens as a necessary pre-condition for the formal routines of a democratic system (for an interesting discussion, see Rueschemeyer et al. 1992: 44). In summary, democracy including both procedural and substantive dimensions is conceptualized in this paper as a matter of degree or quality and varies between and within different dimensions of democracy.

Today, many developing countries are moving back and forth along these three dimensions of democracy. They seem to be stuck in a "gray zone" (Carothers 2002: 9) which appears to be the most common political background for the recipients of IFI program lending. In the theoretical realm, this has led scholars to speak of *hybrid regimes* that feature both democracy and autocracy (Karl 1995). Hybrid regimes have at least formal democratic institutions, but in practice, access to power is often ensured by non-democratic means. They face serious democratic deficits within all three democratic dimensions: Deficits in *vertical* accountability are due to shortcomings in the voting or administrative system, also due to very little effective choice between alternative political programs, or to a weak and divided civil society, controlled by dominant partial interests. The *horizontal* accountability deficit is embodied primarily in an overly powerful and potentially tyrannical executive vis-à-vis the legislative, in widespread corruption, or in an intimidated judiciary and media (Luckham et al. 2001: 23). Finally, *citizenship rights* in the developing world are often hollow. Equal rights and entitlements as citizens can be denied either formally, due to constitutional and legal arrangements, or effectively as a result of gender, social inequalities, lack of organization, cultures of intolerance and violence (ibid.). These democratic deficits are often very long-lasting due to the political leadership's unwillingness to change the prevailing power constellation. According to Carothers (2002), "dominant power politics" appears to be the most widespread political syndrome in Africa and Asia. Its central feature is that one political grouping dominates the system in such a way that it ensures its power and leadership, thus leaving "little prospect for an alternation of power in the foreseeable future" (ibid.: 11-12). As the majority of the countries in our sample are hybrid regimes, the question thus arises whether and how external actors can intervene to change the existing power balances, thereby mitigating the widespread democratic deficits in the developing world.

## 3.2. Power balances in developing countries

In order to analyze these possible outside-in linkages and their impact on domestic democratization processes, we will adapt the political economy approach of power balances, originally developed by Rueschemeyer et al. (1992). In their view, democratization is first and foremost a matter of power. They identify three “balances of power” favoring or inhibiting democratization: (i) the balance of power among different classes and class coalitions in society; (ii) the structure, strength, and autonomy of the state apparatus and its interrelations with civil society; and (iii), the impact of transnational power relations on both the balance of class power and on state-society relations. These power balances depend on structural conditions decisive for democratization of which capitalist development appears as the main driving force. The development of a modern market economy, according to the authors, “affects the chances of democracy primarily because it transforms the class structure and changes the balance of power between classes. It is the growth of a counter-hegemony of subordinate classes and especially the working class that is critical for the promotion of democracy” (ibid.: 45-47). Democratization in their theoretical framework thus is a bottom-up process, which gives the many an effective share of power in the institutionally differentiated political sphere (ibid.: 75).

Applying their relative class model of democratization to the recipient countries of IFI program lending, we will modify it in the following way:

*Firstly*, the concept of class is not very useful in analyzing social groups in African or Asian countries. The working class, which is perceived by Rueschemeyer et al. (1992) as the main proponent of democratization in advanced industrialized countries, is weakly developed. This is due to a lack of industrialization in the new democracies where the Western gap between capital and labor has never been accentuated. Because of the weakness of the bourgeoisie and the working class, the state has assumed a leading role in the national capitalist development. As a consequence, the societies in many developing countries are not so much differentiated between social classes as defined by their relation to the organization of production than structured along different social groups with strategic importance for the political development within these countries. We thereby refer to the “strategic group theory” as developed by the Bielefelder school of development sociology (cf. Evers and Schiel 1988; Schubert et al. 1994). A good introduction is provided by Evers and Gerke (2009). Depending on the national context, strategic groups may be based on social, ethnic, or religious characteristics, but also on professional affiliations (e.g., the military, the civil service etc.). They share one common goal: “to secure present and future chances to gain access to resources; to share chances of appropriation of resources and their distribution” (ibid.: 3). As resources by definition, and in particular in the developing world, are scarce, strategic groups try to shape the economic and political system in a way that offers them the best chances for appropriating additional surplus (ibid.: 8). In contrast to class theory, strategic group formation is a constant process of conflict and coalition, which may (or may not) result in the establishment of social classes in Marxian terms. Moreover, the state is not perceived as an objective superstructure set above the class base, but rather as a sphere of activity where the subjective motivations and strategies of strategic groups are central. The legitimation of their strategies, e.g. through the politization of ethnicity, through reference to religious movements, or through a demonstrated nationalist value orientation, is of particular importance in this theoretical framework. It can even shape the group's public appearance. In the rapidly developing societies of the Third World, we consider the concept of strategic groups as a more adequate analytical category than rigid class structures. Hence, unlike Rueschemeyer et al. (1992) we will not focus on the balances between classes but on the societal balance among previously excluded groups and dominant strategic groups.

*Secondly*, the interactions between the state as a partially autonomous block of power and a highly heterogeneous civil society have received considerable attention in earlier studies on the relationship between civil society and the state in developing countries. We will follow Rueschemeyer et al. (1992) regarding their concept of state autonomy that can be both pro- and anti-democratic. Autonomy from a dominant strategic group is considered as *pro-democratic*, whereas autonomy from the population as a whole is conceptualized as anti-democratic. The pro-democratic autonomy refers to the situation where the state is autonomous as to any specific social group, and strives for public welfare. By contrast, *anti-democratic* autonomy refers to the situation where the state is autonomous from the general public, a situation where the state is domesticated by the dominant strategic group using public resources to pursue its own private ends at the cost of civil society and the general public. The state thus has a mainly instrumental character in that the the dominant strategic group uses its main assets – money, jobs, information and monopoly on force – as a resource base. The state apparatus serves as rent distribution agency in order to maintain clientelistic relationships with particular segments of society. In the African and Asian context, this pattern of anti-democratic state autonomy has been described as "neo-patrimonial politics"[3], which highlights the informal and cultural aspects of politics in developing countries as well as the blurring of boundaries between the private and the public (cf. Bayart 1993; Bratton and van de Walle 1997; Chabal and Daloz 1999). As these informal or cultural aspects of politics are embedded in formal state structures, they are socially powerful (cf. Rueschemeyer et al. 1992: 51) and should thus become part of our analysis. We will look at the extent of pro- or anti-democratic autonomy of the state with a special focus on neo-patrimonial politics in developing countries.

[3] The origins of the neo-patrimonial approach are found in the socio-anthropological theories of patron-client relations in the developing world. These vertical networks of dyadic alliances are characterized by unequal status, face-to-face contact, and reciprocal exchange (for an overview of the anthropological literature on patronage see Gellner and Waterbury 1977). In political science, the term "neo-patrimonialism" was first used by Eisenstadt (1973) to characterize patrimonial practices in modern contexts. In this regard, he made reference to Max Weber who distinguished ideally between patrimonial rule in traditional societies and rational-legal forms of authority in modern state bureaucracies.

*Thirdly*, concerning the impact of transnational power relations, we agree with Rueschemeyer et al. (1992) that political and economic international relations (or dependencies) are vitally important for the domestic power balance and thus for the prospects of democracy. However, we complement their perspective of focusing on the system of states and economic dependencies by adding the IFIs to their theoretical framework. We will concentrate primarily on the impact of World Bank and IMF programs and accompanying policies on power balances in recipient countries. As their program lending offers large revenues for established and competing strategic groups, they could, in practice either reinforce the power of the dominant strategic group or encourage the growth of alternative centers of power in developing countries. Moreover, because their loans, credits and grants are given to the government in borrowing countries, they might have a direct impact on the domestic power balance between the state and civil society. Finally, they constitute a powerful actor themselves able to tip the balance between domestic and international regime in order to increase the chances for democratization.

To sum up, we agree with Rueschemeyer et al. (1992) that democratization is a matter of power balances. The chances for democratization are conditional on various formal and informal institutions influencing the power balances within society, between the state and society, and between the domestic and international regimes. However, we differ from Rueschemeyer et al. (1992) in that we perceive democratization processes as actively driven by both domestic and external actors, and not merely shaped by diffuse political and economic forces. Democratization in our theoretical framework is not only a bottom-up process, but might also be influenced from the top down. But how does this influence of the World Bank and IMF on democratization look like? What are the causal mechanisms between the IFIs and democratization in developing countries? In the next sub-chapter, we will argue that their influence might work either in the direction towards, or against democratization in recipient countries in Africa and Asia depending on the specific type of IFI program lending and their respective influence on the power balances discussed above.

### 3.3. Causal mechanisms

Hybrid regimes appear to be locked into political balances which are undesirable from a development and democratization perspective. Power is unevenly distributed within society, between the state and society, and between the borrower government and the IFIs. Within society, a dominant strategic group often controls the means of production due to their affiliations with the the ruling elite, while the poor constituting the vast majority of the population lack access to political and economic power. State-society relations in developing countries are often characterized by a powerful state and a weak civil society. This common pattern can be attributed at least partially to the colonial inheritance in these countries. The colonial state typically enjoyed high autonomy from the indigenous society (Rueschemeyer et al. 1992: 64). In many cases, the anti-democratic character of state autonomy often persisted in the newly independent countries. As Herbst (1990: 949) convincingly argues, most post-colonial leaders institutionalized their regimes not through electoral votes but by establishing patron-client relationships and direct state interventions. Through the distribution of resources to clients they gained the necessary political support for remaining in power. Regarding the balance between society and the state, there is thus a lack of popular control of the state in many African and Asian societies. Finally, with respect to the power balance between the domestic and international regime, most of the time, power is concentrated on the side of the IFI as they have the money their clients, i.e. the borrower governments, usually need (Gros and Prokopovych 2005: 15).

In our theoretical framework, a transition to democracy occurs when the pro-democratic forces within these three power balances are strengthened. For two out of the three dimensions of democratic quality defined above (chapter 3.1), the proposed theoretical relationships between the IFIs' impact on power balances and democratization are relatively clear-cut. A transition to democracy occurs, when the society as a whole can exercise more control over the state apparatus (*vertical accountability*), and when the socio-economic and political equality within society increases, i.e. when previously excluded social groups are strengthened vis-à-vis the dominant strategic group (*civil liberties*).

Regarding the transnational power balance, the expected theoretical impact of strengthening the borrower in relation to the donor is rather ambiguous. There should be a positive effect on horizontal accountability of the borrower government, given that the recipient country already exhibits a substantial degree of democratic quality. However, as the majority of the countries in our sample are hybrid regimes with overly powerful executives, the IFIs are often the sole institutional actors in developing countries who have the power and the expertise to hold the government accountable. If the power of the donor is strengthened at the cost of the borrower, it then depends on the incentives created by the specific type of program lending whether this increased power of the IFIs has a positive or negative impact on horizontal accountability. A positive effect on horizontal accountability in recipient countries thus can be expected when the IFIs encourages the growth of alternative centers of power which are capable to hold the borrower government accountable, while a negative effect results if no alternative executive constraints are promoted (*horizontal accountability*).

In delineating the specific causal mechanisms of external leverage and linkages, this paper builds on the aid effectiveness literature, where an interesting debate on the effects of aid on political regimes is taking place.

As mentioned in section 2, some scholars argue that, in general, foreign aid has a *negative* effect on democracy, because it makes a government less accountable to its citizens as it has alternative revenues at its disposal. In doing so, aid parallels other "unearned" income sources, particularly oil and other rents from mineral extraction (cf. Moore 1998; Bräutigam and Knack 2004; Knack 2004). Foreign aid reduces (or even replaces) a government's need for taxation, an "earned" income source which normally exhibits greater levels of public scrutinity and cannot easily be appropriated by the ruling elite. Hence, the principal problem with foreign aid is its discretionary use by non-democratic recipients. Given to the government, it directly influences the power balance between the state and the society, as it strengthens the anti-democratic autonomy of the state from the wider society. As a result, the vertical accountability in recipient countries decreases. This argument draws heavily on the literature on the rentier state and the political resource curse (cf. Mahdavy 1970; Beblawi and Luciani 1987; Karl 1997; Ross 2001; Wantchekon 2002; Jensen and Wantchekon 2004).

At the same time, a *positive* effect of aid on political regime is attributed to donor intent and specific modalities of aid delivery, which make them less fungible than the rents generated from natural resources. According to this perspective, foreign aid is given for a specific purpose and not allocated randomly. In addition, it comes with various donor-imposed mechanisms of scrutiny which may substitute for lessened pressure from society in developing countries (cf. Goldsmith 2001; Collier 2006; Morrison 2007; Bermeo 2009). While these scholars generally acknowledge the negative baseline effect of non-tax revenues on democratization, they argue that aid agencies have added value to the resource transfer. The program objectives and donor conditions have the potential to mitigate the negative effect of aid on democratization. In particular, foreign aid could increase horizontal accountability in recipient countries through making financial flows transparent and through installing appropriate checks and balances on government behavior. Moreover, it aims at creating the necessary conditions for greater socio-economic equality among citizens. As a result, political equality within society and thus the extent of civil liberties might increase.

A third perspective claims that foreign aid revenues have neither positive nor negative effects on political regimes, but a *stabilizing* property. They enable a regime to stay in power (Morrison 2009; Licht 2010). However, because the majority of the African and Asian countries in our sample are hybrid regimes, we expect this stabilizing property of foreign aid to cause negative long-term effects on the quality of democracy in developing countries.

Previous research has been confronted with two challenges: Firstly, the results may be sensitive to the *time period* under review. Most studies evaluating the macroeconomic effects of IFI programs have analyzed rather short time periods as they expect policy measures to positively affect growth within 1 to 3 years after program initiation, if they do so at all (cf. Conway 1994; Vreeland 2003; Dreher 2006; Atoyan and Conway 2006). By contrast, political effects of foreign aid have often been considered within a 4 to 5 year period to take the electoral rhythm into account (cf. Nelson and Wallace 2005; Finkel et al. 2007; Schimmelfennig and Scholtz 2008). Similarly, the effect of aid on growth is assumed to take some time as the use of 5-year lagged growth periods is quite common in the aid effectiveness literature (cf. Clemens et al. 2004; Barro and Lee 2005; Rajan and Subramanian 2008). We expect that at least parts of the conflicting results of previous research can be explained by the use of different time lags. To see this, we will analyze the political effects of different IFI programs over various time horizons reaching from 1 to 5 years.

Secondly, the causal mechanisms through which the IFIs may influence domestic power balances in recipient countries can be either direct or indirect. Democratization in borrowing countries may be affected *directly* through the money disbursed and the existence and form of conditions attached to loans, credits and grants, or through policy advice. However, democratization may also be influenced *indirectly*, through the IFI programs' impact on economic growth and income distribution. The idea is that World Bank and IMF programs should generate economic growth, and that, in turn, as predicted by modernization theory, economic development furthers democratization in developing countries. Taking this finding into account, and assuming that the their programs achieve their proclaimed goal of promoting economic growth and poverty reduction, one would expect an indirect positive effect of IFI lending on democratic quality in recipient countries. However, given the combined time required for the macroeconomic effect and the following effect on democratization, the overall time horizon may easily exceed our maximum observation period of 5 years. Given the relatively recent introduction of certain lending programs a consideration of effects over an even longer time period does not seem to be appropriate here. Therefore, we will develop our hypotheses only with regard to the direct effects of IFI programs on democratization in recipient countries (for a good discussion of direct and indirect mechanisms of international influence, see Stallings 1992).

### 3.4. Program types and hypotheses

We consider four general types of IFI program lending which have subsequently been introduced in their international development cooperation (see Table 1):

*Table 1: Types of IFI program lending*

| Introduced | Program | Eligibility | Objective | Conditions | Duration |
|---|---|---|---|---|---|
| 1946 | Sector investment (WB-INV) | All WB members (non-concessional) | Infrastructure & production | None (project aid) | Long-term (5-10 years) |
| 1952 | Financial stabilization (IMF-STB) | All IMF members (non-concessional) | Balance of payments | Policy (fiscal reforms) | Short-term (1-3 years) |
| 1980 | Structural adjustment (IFI-SAP) | Only low-income countries (concessional) | Economic growth | Policy (structural reforms) | Medium-term (3-4 years) |
| 1999 | Poverty reduction (IFI-PRS) | Only low-income countries (concessional) | Poverty reduction | Process (governance reforms) | Medium-term (3-4 years) |

The four lending types are: World Bank sector investment projects (WB-INV), IMF financial stabilization programs (IMF-STB), IFI structural adjustment programs (IFI-SAP), and IFI poverty reduction programs (IFI-PRS). These broad types or categories of IFI lending differ in terms of eligibility. *Concessional* lending by the IFIs includes long-term loans that are only given to the poorest of the developing countries at terms that are below market rates, while *non-concessional* lending is available to all member countries.

Although the IMF and World Bank have the same origins (Bretton Woods Agreements of 1944), the same members, and largely similar charters, the division of labor was initially clear-cut: The IMF's non-concessional programs promoted international trade and exchange stability in the global economy through balance of payments support of its member countries, while the World Bank's non-concessional projects aimed at reconstructing the physical and social infrastructure of its member countries, particularly in the less developed countries.

After the 1970s debt crises, however, the Bretton Woods Institutions started to collaborate explicitly regarding their concessional program types, e.g. defining common eligibility criteria for very poor countries or sending members of their staff to each others mission teams. Today, both IFIs work closely together in supporting sustainable economic growth and poverty reduction in developing countries and transitions economies (cf. Butkiewicz and Yanikkaya 2004; Dreher and Vaubel 2004; Faini and Grilli 2004; Abouharb and Cingranelli 2007).

Existing studies seldom examine the joint impact of World Bank and IMF programs. Even though the missions of the two IFIs have become more similar during the last decades and there is increasing cooperation between them, they have largely been analyzed separately (Abouharb and Cingranelli 2009: 49) – with the majority of the studies focusing on the IMF. This may lead to a wrong interpretation of the impact of these specific programs. We thus separate the effects of the World Bank and IMF non-concessional programs, but we analyze their concessional programs jointly.

Depending on program eligibility, lending objective, donor conditions and program duration, we argue that different types of IFI program lending exhibit either a positive or negative impact on existing power balances in borrower countries and as a result, on different dimensions of democracy. The theoretical reasoning behind this argument is lined out in the following for each individual lending type.

### *3.4.1. World Bank sector investment projects (WB-INV)*

First introduced in 1946, investment lending has been the World Bank's main instrument for delivering development assistance to low- and middle-income countries.

- *Eligibility*: The World Bank's investment projects are available to all International Bank for Reconstruction and Development (IBRD) and International Development Association (IDA) borrowers who are not in arrears with payments to the Bank Group.
- *Objective*: The World Bank's sector investment operations provide funding (in the form of IBRD loans or IDA credits and grants) to borrower governments for physical investments, rehabilitation and maintenance, and technical assistance. Typically, these big capital-intensive projects finance either real sector investments in infrastructure or utilities that directly support production, such as roads, ports and water treatment plants ("hard projects"), and social sector investments, such as technology transfer in agriculture, public health campaigns, population growth control and mass education ("soft projects") (Gros and Prokopovych 2005: 10).
- *Conditions*: Development assistance by the World Bank is tied to projects; there are no political conditions attached. Funds are disbursed against projected or actual expenditures related to the purchase of works, goods, and services in support of specific economic and social development objectives in the overall context of the Country Assistance Strategy.
- *Duration*: World Bank financing of these large-scale investment projects is usually spread over 5 to 10 years (for more information, see the World Bank's (2009a) project database as well as the World Bank's (2009b) products and services).

**Short-term effects on vertical accountability (state-society power balance)**

The specific form of non-conditional project aid makes WB-INV lending very similar to bilateral aid funds and natural resource rents. According to the aid effectiveness literature, project funds are generally disbursed without any consideration of domestic accountability relationships. The financial resources provided by the World Bank reduce the government's dependence on its citizenry for tax revenue. The government is strengthened as the most powerful actor in the domestic political arena. Besides the extra resources, it obtains the informational advantage of the level of foreign aid rents, and the discretionary power over the distribution of these rents (cf. Jensen and Wantchekon 2004: 821). As a result, the power balance between the state and society moves further towards the government. We thus expect a negative effect of WB-INV programs on government's accountability towards its citizens in our sample of hybrid regimes.

### Short-term effects on horizontal accountability (borrower-donor power balance)

WB-INV projects are negotiated between the executive branch of the government of the recipient country and the representatives of the World Bank, while “the legislature, the heart of any democracy, is not formally part of the negotiation process” (Alexander 2006, cited in Abouharb and Cingranelli 2007: 204). As a result, these projects are often funded outside the budget without being subject to parliamentary review or any other domestic control mechanisms. This strengthens the power of the borrower government vis-à-vis the World Bank who should be interested in transparent and regular domestic oversight of governments’ financial transactions. Moreover, since there are no policy conditions attached to WB-INV projects, they do not provide any incentives for the government to allow the growth of alternative centers of domestic power which may then be capable to hold it accountable. The effect on horizontal accountability is thus expected to be negative.

### Short-term effects on civil liberties (within-society power balance)

Finally, the question arises if WB-INV projects have the potential to change the prevailing power balance among the previously excluded social groups and the dominant strategic group. According to our theoretical framework, greater socio-economic equality would result in higher equality on the political level as well and can be operationalized through the civil liberties record of a country. Theoretically, one could expect WB-INV projects to have either a positive or a negative impact on civil liberties in recipient countries. It might be positive, when previously excluded social groups are strengthened through investment projects. For instance, one could imagine that these groups benefit from improved infrastructure in remote areas, which would subsequently increase socio-economic equality within society regarding access to markets, schools, hospitals, etc. However, as Stallings (1992: 51) convincingly argues, many of these large-scale investment projects from infrastructure to industrial production facilities went directly to state-owned firms controlled by the dominant social group within society. Because there is no conditionality attached to WB-INV projects, the dominant social group having domesticated the state is not constrained in using and distributing WB-INV projects to its own clientele at the cost of other social groups. We would therefore rather expect a negative impact of WB-INV projects on civil liberties in recipient countries.

### Long-term effects on democratic quality (stabilizing negative trend)

In the long term, the stabilizing character of WB-INV projects matters most for all three power balances. The duration of these large-scale investment projects extends over several election cycles (if any). Following the initial agreement between the Bank and the chief executive, over the whole duration of the project, the steady flow of foreign aid thus strengthens the incumbent’s position. As there is no policy conditionality, WB-INV projects do not provide any countervailing impulse for a change the prevailing power balance between the state and society and within society in recipient countries. Nor are there any incentives that might change the international balance of power between the domestic political regime and the World Bank. Seen from a rather critical perspective, their patronage relationship on the international level fits well with the widespread pattern of neo-patrimonial politics in developing countries.

We thus expect a negative impact of WB-INV projects on vertical and horizontal accountability and on civil liberties in recipient countries, and we do not expect this effect to vary over time, i.e., between the short and the long term. The corresponding hypotheses are:

**Hypothesis (1a)***: In the short term, World Bank sector investment projects have a negative effect on changes in vertical and horizontal accountability as well as civil liberties in the hybrid regimes of the developing world.*

**Hypothesis (1b)***: In the long term, due to their stabilizing properties World Bank sector investment projects continue to have a negative effect on all three dimensions of democratic quality in developing countries.*

### *3.4.2. IMF financial stabilization programs (IMF-STB)*

The two main types of IMF-STB programs are the Stand-by Agreements (SBAs) designed to address temporary payments deficits (since 1952) and the Extended Fund Facility (EFFs). The latter was introduced in 1974 to support countries with protracted balance of payments difficulties as the recognition grew that payments imbalances could no longer be expected to be corrected within a single year (Sidell 1988: 6; IMF 2005: 5).

- *Eligibility*: The IMF's non-concessional facilities are available to all IMF member countries. However, they typically support high- and middle-income countries and do not cover countries with low incomes. Correspondingly, these facilities' are subject to repayments and interest rates based on rates in the major industrial countries (cf. Bordo and Schwartz 2000: 118; Evrensel 2002: 577; Hutchinson 2003: 327; Barro and Lee 2005: 1248; IMF 2005: 5).
- *Objective*: Originally, the IMF's mission as stated in its 1944 *Articles of Agreement* was to facilitate the growth of international trade, to guarantee exchange stability in the world system, and to provide capital infusions to member countries dealing with temporary balance of payments difficulties. With the breakdown of the system of fixed exchange rates in 1973, the IMF lost its role as "guarantor of fixed exchange rates'' and evolved more into a role of "crisis manager" or "development financier". Correspondingly, the IMF's focus shifted from the

management of the fixed exchange rates system to deficit lending and surveillance of its member countries' monetary and fiscal policies (James 1996: 592; Jensen 2004: 196; Barro and Lee 2005: 1247).

- *Conditions*: IMF-STB programs come in the form of general budget support with strict policy conditionality attached, i.e. the IMF requires that the borrower government initiates reforms of monetary and fiscal policy prior to receiving loans (Bordo and Schwartz 2000: 118). Policy conditions include currency devaluation, reduction in the budget deficit, initiation of privatization, tax, and trade liberalization among other policy measures.
- *Duration*: In line with the IMF's core mission of responding to economic crisis (Collier 2006: 1487), program duration is usually restricted to 1 to 3 years (and may be extended for a fourth year in the case of EFFs).

**Short-term effects on vertical accountability (state-society power balance)**

The IMF-STB programs differ from the World Bank's investment projects in their mode of aid delivery and program duration. Unlike project aid, they come in the more fungible form of general budget support, which should increase the anti-democratic autonomy of the state from the general public even more than project lending by the World Bank. This argument is in line with Bermeo's (2009) empirical findings. She looks at regime change and finds that there is no significant effect of bilateral investment projects on the likelihood of regime change, but a significant negative effect of more fungible forms of aid, such as general budget support (ibid.: 14). As the the rent-seeking mechanisms regarding these "unearned" non-tax revenues is accentuated by IMF-STB programs, we thus expect a strongly negative impact of IMF-STB programs on vertical accountability in the short term.

**Short-term effects on horizontal accountability (borrower-donor power balance)**

In contrast to investment lending by the World Bank, financial stabilization programs by the IMF have a relatively short duration. Because the IMF-STB programs are designed for managing crisis situations, they tend to strengthen the chief executive and weaken possible oversight by the legislative and other domestic accountability groups. At the same time, IMF-induced market-friendly reforms set clear limits for the borrower government and provide the Fund with significant leverage (Biglaiser and DeRouen 2009: 81). However, the increased power of the IMF does not result in creating sustainable checks and balances and political control mechanisms on the domestic level. This can be attributed to the perceived crisis situation in the recipient country, in which even otherwise relatively democratic governments often rule per emergency law without regular domestic oversight. Due to their interventionist character, we thus expect IMF-STB programs to fundamentally reduce horizontal accountability in recipient countries.

**Short-term effects on civil liberties (within-society power balance)**

Previous research on IMF program lending demonstrates quite convincingly that its non-concessional lending facilities have significant negative effects on income distribution (cf. Pastor 1987; Garuda 2000; Vreeland 2003; Nooruddin and Simmons 2006). They argue that the Fund's "financial austerity" programs, also including cuts in government spending in social sectors, often cause a significant deterioration in the income distribution and particular hardship for the poorest segments of the population. As social discontent is high among a large part of the population, countries under IMF stabilization programs are more likely to experience collective protest. The government in turn, may react by increasing the level of repression (Franklin 1997: 576). Following this argumentation, we propose that IMF stabilization programs have a negative impact on the within-society power balance, and thus on civil liberties in recipient countries.

**Long-term effects on democratic quality (decreasing negative trend)**

With respect to the expected effects over time, we should recall that the IMF-STB programs are designed only for short-term interventions.[4] They are exceptional measures in the face of a severe crisis situation and are not supposed to be extended over a longer time period. As a result, we should expect that their negative effects on democratic quality decrease over time. In general, we thus expect no significant long-term effects of IMF-STB programs on all three dimensions of democracy.

Therefore, we posit that IMF-STB programs have a strong negative impact on the likelihood of a democratic transition in program countries. They reduce both democratic accountability and civil liberties in the short term. However, as they are explicit short-term facilities we expect their negative impact on democratic quality to decrease over time. This is reflected in the following hypotheses:

**Hypothesis (2a)***: In the short term, IMF financial stabilization programs have strongly negative effects on changes in vertical and horizontal accountability and significantly reduce the degree of civil liberties in program countries.*

**Hypothesis (2b)***: In the long term, the negative effects of IMF financial stabilization programs on all three dimensions of democratic quality decrease over time.*

[4] Nevertheless, some countries are frequent users of IMF-STB programs (cf. Bird et al. 2004). In this case, prolonged participation could accentuate their negative effects for democracy on all three dimensions of democratic quality over time. However, because other types of IFI lending (i.e., concessional programs) are more often used to address specifically the underlying structural problems of frequent users, which cannot be resolved in the short term, we expect the negative effects of IMF-STB programs to fade out in the long term.

### 3.4.3. IFI structural adjustment programs (IFI-SAP)

In the 1980s, the IFIs started concessional financing by introducing structural adjustment programs. Structural adjustment lending by the World Bank began with an early forerunner in the mid-1960s (India) and was revived in the mid-1970s after the first great oil price shock in 1973. Following the second oil shock in 1979, structural adjustment programs were definitively introduced in 1980. However, due to hesitations and uncertainties within the Bank towards this type of program lending, it lasted until the mid-1980s before conditional, non-project lending was internally established. The IMF in turn, introduced its Structural Adjustment Facility (SAF) in 1986, which was later on replaced by the Enhanced Structural Adjustment Facility (ESAF) in 1987 (Barro and Lee 2005: 1248).

- *Eligibility*: The eligibility criteria for the IMF's structural adjustment facilities are based on a country's per capita income and are linked to the World Bank's concessional lending (IMF 2005: 5). The World Bank assesses eligibility for concessional lending on the basis of a country's performance in implementing policies that promote economic growth and poverty reduction (IDA 2010). Structural adjustment lending is only available to low-income countries. The interest rate charged is below market rates at 0.5 percent.
- *Objective*: Structural adjustment programs generally aim at "adjustment with growth" (Killick 1995: 83), i.e., they foster structural and macro-economic reforms in a sector or the economy as a whole.
- *Conditions*: Structural adjustment lending by both IFIs provides direct budget financing to borrower governments. Funds are disbursed quickly, usually conditional on the completion of mutually agreed structural and institutional reforms (World Bank 2009c: 4). The policy conditions attached to IFI-SAP lending generally foresee three means in order to realize these reforms; namely increasing the role of the market relative to the public sector, improving the efficiency of the public sector, and mobilizing additional domestic resources (Jensen 2004: 197).
- *Duration*: Structural adjustment programs are frequently part of a programmatic series of operations, in which the IFIs support a medium-term program (3 to 4 years) of policy reform (Polak 1991: 19; Gros and Prokopovych 2005: 6; World Bank 2009b).

**Short-term effects on vertical accountability (state-society power balance)**

Due to their specific aid modalities, IFI-SAP lending lies between the Bank's investment projects and the Fund's stabilization programs regarding the rigour of conditionality and the length of program duration. In terms of accountability relationships, we therefore expect mixed effects of IFI-SAPs regarding their impact on vertical vis-à-vis horizontal accountability. Similar to IMF-STB programs, the *negative* effect of quick-disbursing budget support on vertical accountability should also hold for IFI-SAP lending. Even though the economic policy conditions attached to structural adjustment programs tend to weaken the role of the government sector in all economic activities, the government or ruling elite still exhibits enough anti-democratic autonomy from society to stay in power through the distribution of patronage and resources.

**Short-term effects on horizontal accountability (borrower-donor power balance)**

Regarding horizontal accountability, however, we expect a *positive* effect of structural adjustment lending. Unlike IMF-STB programs, IFI-SAP lending is only extended to governments of poor countries with limited financial room for maneuver. Recipient countries of IFI-SAP lending are not in an acute economic crisis; rather, they are in prolonged financial distress, a situation which cannot be managed by emergency law. Because recipients of IFI-SAPs are among the least capital abundant countries in the world (Biglaiser and deRouen 2009: 80), the relevance of IFI funding is usually very high. Thus, the IFIs possess significant leverage if they can credibly commit to withhold their funds in case of non-compliance of the borrower government with the attached policy conditions.

Moreover, the longer duration of program participation and the broadened set of policy conditions provide the IFIs with rather flexible political leverage within the international power balance between the domestic and international regime. While in severe crisis situations a reduction in political rights and civil liberties might have often been deemed necessary in order to find the way back to economic prosperity[5], this should not be the case for IFI-SAPs. The IFIs should not turn a blind eye to borrower governments that avoid regular oversight by other domestic accountability groups. Quite to the contrary, they should have an interest to support transparent and democratic control of their funds in the medium term. All in all, a positive impact on horizontal accountability is expected.

**Short-term effects on civil liberties (within-society power balance)**

Finally, the within-society power balance is expected to be negatively affected through a country's participation in IFI-SAP lending. In an environment where resources are constrained and politics is characterized by a winner-takes-it-all mentality, one might expect fierce interest-group politics (Nooruddins and Simmons 2006: 1009). Consequently, the choice of policy instruments and spending patterns will be dependent on the power of various social groups. In a neo-patrimonal or hybrid regime, the "best-organized" or dominant strategic groups will be those with personal links to the ruling elite, or those who control the state apparatus in order to appropriate state resources for personal use. Since poor people do not usually form organized interest groups and lack political voice, their relative power within society will decrease. The discontent thus caused among the affected social groups might

[5] See also the heated debate on the relationship between authoritarianism and IMF-STB programs in Latin America. According to Remmer (1986: 1) authoritarianism was seen as a prerequisite for successful implementation of IMF programs in Latin America – as a "fact", almost reaching the status of conventional wisdom.

prompt oppressive actions on the part of the borrower government implementing the unpopular policies at hand (Abouharb and Cingranelli 2007: 204). Similar to the IMF-STB programs, we therefore expect that the IFI-SAPs lead simultaneously to a polarization at the societal level and a weakening of civil liberties – at least in the short term.

**Long-term effects on democratic quality (increasing positive trend)**

In the long term, however, strict implementation of IFI-SAPs might undermine the patron-clients bonds on which the leaders of many developing countries rely to safeguard their power (Herbst 1990: 955). The lessening state involvement associated with the policy conditions attached creates a vacuum that is filled by private or non-governmental organizations providing goods and services the state is unable or unwilling to deliver to its citizens.[6] Consequently, the number of non-governmental organizations increases significantly, and forms the basis of an emerging civil society in many hybrid regimes (cf. Chazan 1994; Lister and Nyamugasira 2003).

In the light of this, IFI-SAPs might have positive consequences for vertical accountability and civil liberties in the long term, because they change the domestic power balances in favor of previously excluded social groups (within-society power balance) and in favor of domestic civil society relative to the semi-authoritarian government (state-society power balance) in hybrid regimes.

Regarding the international power balance between the borrower and the donor, the borrower government must comply for tranche release in the medium term, which enables the IFIs to react in line with electoral cycles in recipient countries. The government thus cannot bypass other domestic checks and balances in the long term, if it wants to give itself at least the appearance of a minimal democratic regime in order to receive external funding, and if the IFIs want to promote (at least implicitly) democratic control over their funds. Thus the external leverage might create the incentives for the government to allow domestic oversight by other domestic actors. Since recurrent lending allows for learning processes on both sides, we expect this positive effect on horizontal accountability to grow over time.

Accordingly, we expect mixed effects of structural adjustment lending on different dimensions of democracy in the short term. In the long term, however, we posit an overall positive impact of structural adjustment lending on democratization in developing countries. Our hypotheses for concessional IFI program lending via SAPs are:

[6] The private sector in African and Asian countries is normally weakly developed. By contrast, in the last two decades there has been an increase in civil society organizations.

**Hypothesis (3a)**: *In the short term, IFI structural adjustment programs induce negative effects for civil liberties and vertical accountability, while their greater flexibility in program design leads to positive effects on horizontal accountability in recipient countries.*

**Hypothesis (3b)**: *In the long term, IFI structural adjustment programs increases the likelihood of a positive change along all three dimensions of democratic quality in recipient countries.*

### *3.4.4. IFI poverty reduction programs (IFI-PRS)*

With the launch of PRS program lending in 1999, the World Bank and the IMF focused increasingly on institutional and governance reforms that would support a country's medium-term development strategy (World Bank 2009c: 2).

- *Eligibility*: Apart from their specific form of conditionality, PRS funding is quite similar to the earlier IFI-SAP lending. Only low-income countries are eligible for IFI-PRS programs with interest rates charged below market rates at 0.5 percent.
- *Objective*: IFI-PRS programs aim at supporting the macroeconomic, structural and social policies and programs that a country will pursue over several years to promote broad-based growth and reduce poverty.
- *Conditions*: The PRS approach of the IFIs differs from earlier IFI-SAP lending in that IFI-PRS programs are conditional on the foregone formulation of a national Poverty Reduction Strategy Paper (PRSP). The IMF (2009) describes the corresponding process as follows: "Poverty Reduction Strategy Papers (PRSPs) are prepared by governments in low-income countries through a participatory process involving domestic stakeholders and external development partners, including the IMF and the World Bank." Conditionality in IFI-PRS lending thus mainly works through the general process of designing, implementing, and monitoring the national development strategy. Whereas traditional IFI conditionality focused on specific policies, the "process conditionality" (Foster et al. 1999) included in IFI-PRS lending brings to the fore the political processes and actions leading to these policies.
- *Duration*: A typical poverty reduction program usually consists of 3 to 4 annual, single-tranche operations, although many countries consecutively participate in PRS over an extended time period (Dreher and Sturm 2006: 17; Biglaiser and DeRouen 2009: 80; World Bank 2009c: 64).

**Short-term effects on vertical accountability (state-society power balance)**

Country ownership, as perceived in the PRS approach is not only about government commitment to reform but also depends on broad-based participation of all relevant stakeholders in the PRS process. This specific form of process conditionality is concerned with strengthening the accountability of governments to their own citizens. In particular, the condition of including civil society representatives in the political process of formulating and implementing a country's development strategy should have positive effects for vertical accountability by strengthening the society vis-à-vis the state, thus weakening the widespread anti-democratic autonomy of the state from the general public. In theory, organized citizens can act as pressure groups for democratization (Eriksen 2001: 292). They can limit the power of the assumingly strong central state and hold powerful actors accountable. Hence, the power of the state is a direct function of the relative autonomy of civil society (Chazan 1994: 258). With respect to the PRS in practice, a recent study has found that civil society organizations increasingly fulfill the role of "providers of the service of accountability" (Lister and Nyamugasira 2003: 96). They can expose the government's role in formulating and implementing the national PRS to public scrutiny, and consequently oppose the arbitrary exercise of power. As far as civil society can actually fulfill this role in the PRS process, one should expect that vertical accountability is strengthened in recipient countries.

#### Short-term effects on horizontal accountability (borrower-donor power balance)

Earlier types of IFI programs have been criticized as missing their development goals due to a lack of government commitment. The principle of country ownership inherent in the PRS approach tries to take this critique into account. The declared objective of this principle is that the borrower countries should be in charge of their own development goals and strategies. According to the logic of the IFIs, when countries have a greater say in shaping political and economic reforms, governments and citizens will be more committed to them, thereby enhancing aid effectiveness (cf. Booth 2003). Regarding their political effects, we expect that IFI-PRS programs increase the chances for a democratic regime change. Even though the parliament and other domestic accountability groups were often bypassed in the early consultation and implementation processes, the context sensitivity of the PRS approach and the IFIs' pressure for more transparency in the the political decision-making process through integrating the IFI-PRS programs with other domestic planning and budgeting mechanisms is expected to lead to an increase of horizontal accountability in recipient countries.

#### Short-term effects on civil liberties (within-society power balance)

Regarding civil liberties, there is a long tradition in political thought focusing on civil society's essential functions for democracy, which is surveyed by Merkel (2004). Originally formulated by Jürgen Habermas, one of its main functions is to foster critical discourse in an institutionalized public sphere (cf. ibid.: 47). This function has both defensive and offensive aspects in relation to the behavior of civil society organizations, with the *defensive* aspect enabling traditionally excluded social groups to find a voice. People who are marginalized or disadvantaged can join up in voluntary organizations to improve their lives through mutual aid and the articulation of the group consciousness. The *offensive* aspect consists in gaining influence over policy and thus challenging the dominant strategic group. A strong civil society can facilitate democratic debate on what should be done by the state, the economic actors, and groups in civil society itself by raising political issues and promoting specific policies (see also the elaborate book chapters by Diamond 1999 and Young 2000 on civil society's function for democracy). Since the goal of IFI-PRS programs is sustainable poverty reduction, the poor are explicitly invited to participate in the design of "their" programs. Through strengthening the voice and representation of the poor in fostering public discussions of the PRS, the IFIs empower them and mitigate the democratic deficit of hollow citizenship. We therefore posit a positive effect on civil liberties in countries under IFI-PRS programs.

**Long-term effects on democratic quality (increasing positive trend)**

Over time, as far as the principle of country ownership is adequately implemented in practice, we expect that there is an increasingly positive effect of IFIs poverty reduction programs on all three dimensions of democracy due to learning effects at the domestic and international level. At the domestic level, the broad-based participation processes of the PRS approach can function as "schools of democracy" in stimulating participation and democratic practice beyond elections (following the argumentation of Alexis de Tocqueville, see Merkel 2004: 46). More precisely, a rich and pluralistic civil society serves to educate citizens for democracy, articulates and aggregates political interests, recruits and trains political personnel, and strengthens civil society by itself through providing many goods and services outside the state or profit-oriented market sector (cf. Hadenius and Uggla 1996; Diamond 1999; Young 2000). As a result, equality in the power balances within society and between the state and society should increase. On the international level, the transparency and flexible nature of conditionality as well as the context sensitivity of the PRS approach should provide both the IFIs and the borrower government with incentives to listen and to learn from each other, thus leading increased equality between them.

Summing up, due to its specific form of "process conditionality" we posit short-term democratizing effects of IFI-PRS lending in program countries which might increase over time. Our last hypotheses concerning the IFI-PRS programs' impact on democratization in developing countries are as follows:

**Hypothesis (4a)***: In the short term, IFI poverty reduction programs have a positive influence on the vertical and horizontal accountability of governments and increase the civil liberties of societies in developing countries.*

**Hypothesis (4b)***: In the long term, IFI poverty reduction programs increase the positive changes along all three dimensions of democratic quality over time.*

In a nutshell, these four types of IFI program lending, by tipping the balance between pro-democratic and anti-democratic forces, either accentuate or mitigate the widespread democratic deficits in developing countries. Table 1 summarizes the expected theoretical relationship between the different types of IFI program lending and their impact on different dimensions of democracy in recipient countries.

*Table 1: Expected theoretical relationships between program type and democratization*

| | | **Democracy dimension** | | |
|---|---|---|---|---|
| **Program type** | **Time horizon** | **Civil liberties** | **Vertical accountability** | **Horizontal accountability** |
| Sector investment | Short-term | - | - | - |
| (WB-INV) | Long-term | - | - | - |
| Financial stabilization | Short-term | -- | -- | -- |
| (IMF-STB) | Long-term | - | - | - |
| Structural adjustment | Short-term | - | - | + |
| (IFI-SAP) | Long-term | + | + | ++ |
| Poverty reduction | Short-term | + | + | + |
| (IFI-PRS) | Long-term | ++ | ++ | ++ |

Notes: + = pro-democratic; ++ = strongly pro-democratic- = anti-democratic; -- = strongly anti-democratic effect

## 4. Data and operationalization

### 4.1. The sample

On this theoretical basis, we will empirically analyze whether and how the different IMF and World Bank programs can be expected to have an impact on democratization in recipient countries. For exploring the variations of IFI program lending, we will undertake a panel data analysis. We have compiled annual data from 1974 to 2007 for 76 African and Asian countries since they gained independence from Western colonial powers. We exclude industrialized Western countries as they do not benefit from development lending, which is central to our comparison of program types. Moreover, they do not share the difficult legacies bequeathed by colonialism and imperialism, such as weak governance institutions and administrative capacities, export-oriented economic structures, as well as cultural, linguistic and religious tensions fueled by foreign dominions.

We also exclude Latin American and Eastern European countries as they differ significantly from African and Asian countries with respect to their political history and dominance of Western cultural heritage. Eastern Europe countries have not gained independence from their colonial powers prior to the end of the Cold War, while in Latin America the creolization of the cultural heritage of Latin American countries is already well advanced. This is particularly relevant for our analysis regarding the literature on neo-patrimonial politics and strategic group theory, which have not coincidentally been developed in the African and Asian contexts.[7] Finally, some data are not available for all African and Asian countries or years, the panel thus is unbalanced and the number of observations depends on the choice of variables (cf. Annex 3).

### 4.2. The dependent variables

In our sample of semi-authoritarian or hybrid regimes democratization is best understood as an incremental process from non-democracy to some degree of democracy. Therefore, we rely rather on continuous than dichotomous measures of democracy. Democratization is captured by three different indicators, each of which stands for a different dimension of democracy. Freedom House and Polity IV data will be used to operationalize the vertical and horizontal accountability of government as well as the extent of civil liberties in a society. Disentangling the sub-components of these two well-known democracy indices allows us to find relatively adequate indicators for all three dimensions of democratic quality.

**Vertical accountability** as our first dimension of procedural democracy is captured by the Freedom House political rights index. This annual index rates the degree of freedom as experienced by individuals themselves in the political process. Regarding content, the political rights index comes very close to our vertical accountability concept. It is grouped into three subcategories: (i) freedom and fairness of the electoral process; (ii) degree of political pluralism and participation; and (iii) accountability of the elected representatives towards the electorate between elections (Freedom House 2009). Together, these three categories provide reliable information on the state of vertical accountability in a country. For better comparability with our indicator of horizontal accountability (discussed below), the original 7-point-scale is reversed so that in our paper, a rating of 1 indicates the lowest and 7 the highest degree of individual freedom from government control and other potential domination.

**Horizontal accountability** is measured by one component of Polity IV's regime index, namely the independence of executive authority. This variable reflects the institutional constraints which limit the discretionary power of the chief executive. In particular, it measures the degree to which the chief executive is accountable to any other "accountability group" in the polity, be it the legislature, the judicative, the ruling party, a council of nobles, the military, or any other institutional actor (Marshall and Jaggers 2009: 63). Unlike Freedom House, Polity IV country ratings focus on the institutional aspects of democracy rather than the real-world rights and social freedoms enjoyed by individuals. The executive constraints index measures the degree of institutional checks and balances between the various parts of the decision-making process. The 7-category-scale ranges from "no regular limitations on

[7] With the exception of South Korea that became an OECD member only in 1996, the OECD members among our sample of African and Asian countries are excluded too, because, since 1974 they have been IFI lending recipients only under very specific circumstances (cf. Annex 1 for a list of country-years included in the sample).

the executive's actions" (1) to "other accountability groups' equal to or greater authority than the executive in most areas of activity" (7).

The **civil liberties** index of Freedom House captures most of the essence of our substantive democracy concept. Country ratings are based on a checklist that is grouped into four subcategories: (i) freedom of expression and belief; (ii) associational and organizational rights; (iii) rule of law; (iv) personal autonomy and individual rights (Freedom House 2009). In sum, these four categories give an estimate of the extent to which citizens are equal before the law and fundamental human rights are realized within the country under consideration. Applying the same procedure as for the political rights index, country ratings are based on a scale ranging from the lowest (1) to highest (7) level of civil liberties.

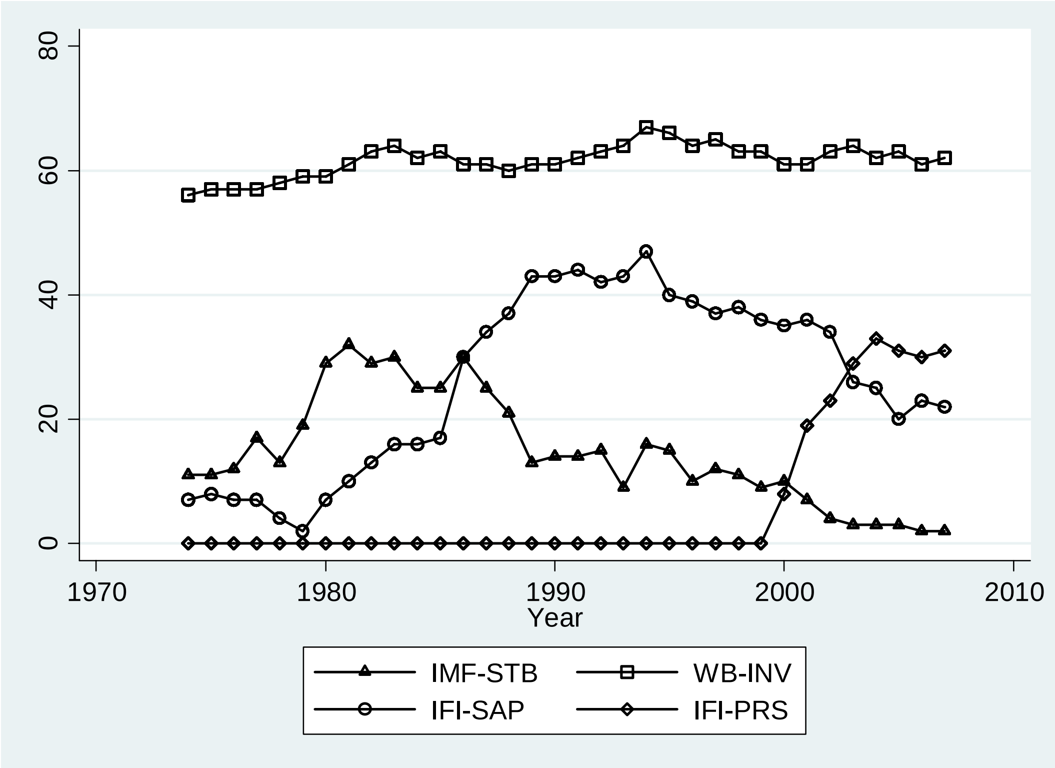
Finally, in order to measure the overall impact of IFI program lending on democratization in developing countries, we created a **composite democracy index** based on these three individual 7-points-scale indices. Because we perceive each dimension of democratic quality as necessary for a fully developed democracy, we take the total of the corresponding democracy indices. By adding the scores of all three sub-components, the scale of this additive democracy index ranges between 3 and 21, so that highest values correspond to the most democratic cases.

Since democratization implies *change* in democracy levels over different time periods, we calculate the differences (Δt) between the current democracy score and a lagged democracy score. By choosing different lags reaching from t-1 ("short-term") to t-5 ("long-term") we capture the different effects of IFI programs over different time horizons. This procedure is applied to all three democracy sub-component indices and to the overall composite democracy index.

### 4.3. Explanatory variables

Our main explanatory variables relate to the various types of IFI program lending. On the one hand, we use data on World Bank projects that is available online. The World Bank's (2009a) Project Database provides information on different financial lending instruments, the amounts committed, and the implementation period of all projects from 1947 to the present. On the other hand, we use data on IMF lending activities from 1974 to 2000 that were generously provided by Vreeland (2003). We updated his data up to 2007 by consulting the IMF Annual Reports (2010). Figure 1 presents an overview of the development of these different IFI programs over time.

*Figure 1: Number of countries under the four types of IFI program lending*




Sources: World Bank (2009a), Vreeland (2003), IMF (various years).

Following Vreeland (2003), a country's participation in different types of IFI programs is measured by a dichotomous variable for each type of IFI program lending in a specific year. The variable equals 1 if a country is currently under a World Bank or an IMF program, 0 otherwise. We depart from this standard coding procedure only with respect to the World Bank sector investment projects. As opposed to the other three program types, there is only little variation in the dummy variable for the Bank's investment projects (WB-INV), with an average of 61 countries participating per year. This particuliarity of World Bank sector investment projects can be attributed to the combination of long duration with high frequency of occurrence. We deal with this problem by creating a categorical variable which counts the number of financial instruments summarized under the Bank's investment lending (cf. World Bank 2010a). This new variable captures the extent of investment lending and ranges from 0 to 4 (see Annex 2 for the detailed description of the dependent and independent variables).

### 4.3. The control variables

In selecting our controls, we use prior theory and research on structural conditions for democratic transitions (cf. Gasiorowski 1995; Doorenspleet 2004; Epstein et al. 2006), on democratic diffusion (cf. Starr 1991; Starr and Lindborg 2003; Rudra 2005; Wejnert 2005; Brinks and Coppedge 2006;), and on democracy promotion by foreign actors (cf. Pevehouse 2002; Bräutigam and Knack 2004; Knack

2004; Finkel et al. 2007; Schimmelfennig and Scholtz 2008) as a guide. This empirical literature provides three alternative explanations of democratization:

A first explanation originating in **modernization theory** focuses on different levels of domestic socio-economic development and their impact on democracy. Countries with higher levels of wealth, industrialization, urbanization, and education are expected to be more prone to democratization (Lipset 1959). The strong correlation between economic development and political democracy is one of the most robust empirical findings of the democratization literature (for a good overview, see Doorenspleet 2004, and for a recent application, see Epstein et al. 2006). To take the level of socio-economic development into account, we will include a country's real GDP per capita and the corresponding growth rate into our empirical analysis. Both measures are taken from the Penn World Tables (PWT) 6.3 dataset, as described in Heston et al. (2009), while the data on our third modernization proxy, the percentage of total population who lives in cities, is taken from the World Bank's (2008) World Development Indicators (WDI) database.

A second explanation relates to **diffusion processes** at the global and regional level. According to the democratic diffusion literature, integration into the global economy promotes the dissemination of democratic ideals and values (cf. Starr 1991; Rudra 2005; Brinks and Coppedge 2006). Among the causal mechanisms that have been proposed are bilateral trade, media exposure through different communication channels, and membership in international networks. Among these, we will focus on a country's trade openness by measuring it with the the sum of imports and exports as percentage of GDP. Trade data is readily available in the PWT 6.3 dataset. Other studies have found that diffusion of democratic ideals and values is more a regional than a global phenomenon (cf. Starr and Lindborg 2003; Doorenspleet 2004; Wejnert 2005) and should thus be operationalized with an indicator of democratic changes in neighboring countries than with the level of a country's world market integration (cf. Brinks and Coppedge 2006; Houle et al. 2009). To control for these alternative aspects of diffusion, we construct an index of regional democratic diffusion by calculating the average value of our three-dimensional democracy index in each of the following four regions: Sub-Saharan Africa, North Africa and Middle East, South Asia, as well as East Asia and Pacific. We then compute the change of these regional averages over time.

A third explanantion for democratic transitions relates to **instable conditions** in the developing world. Diffusion processes may also have a negative connotation. Cross-border and regional diffusion occurs as the "disease" of violent conflict is spread through contagious contact (cf. Starr 1991). Since independence, many developing countries have experienced political instability and war, including civil war and internal strife (cf. Bräutigam and Knack 2004). In particular, partial democracies and hybrid regimes seem to be more prone to political conflict (cf. Mansfield and Snyder 1995; Goldstone et al.

2000; Epstein et al. 2006). Similarly, many scholars argue that economic downturn involving slow or negative growth or high inflation may be most threatening to countries in the "dangerous middle stages" of development and in new democracies, where commitment to democracy is weak (cf. Chirot 1977; Gasiorowski 1995; Gasiorowski and Power 1998). Following these arguments and bearing in mind that the majority of countries in our sample are hybrid regimes, we control for both economic and political instability. Failing to control for these instabilities could produce a spurious correlation between a country's participation in various types of IFI programs and a decline in either procedural or substantive democracy (cf. Haggard and Kaufman 1992; Pevehouse 2002; Bräutigam and Knack 2004). We operationalize political conflict with an index measuring a change in the level of conflict intensity over a given period of years, including both domestic and foreign conflicts. Conflict data is provided by Gleditsch et al. (2002). Following Gasiorowski (1995), a negative growth rate of real GDP per capita is used as an indicator for economic downturn. Additionally, considering its large impact on the poor sections of the population, we also include the price level of consumption taken from PWT 6.3 dataset (Heston et al. 2009) in our set of controls.

Together with our IFI variables, these three sets of controls will be used to explore the effects of internal and external factors on democratization. Considering that our dependent variables reflect the change in democratic quality over time, we transform all our controls in a way to cover the relevant time period. Except for our two diffusion variables of regional democratization and political conflict, we use moving averages; for regional diffusion and conflict intensity we calculate the differences over time, in just the same way as for our dependent variables. Natural logarithms are used for GDP per capita, inflation, and trade openness so that they approximate a more normal distribution.

There are a number of other standard controls in cross-country analysis of democratization, e.g., dummies for particular regions and former British colonies, indices of ethnic heterogeneity, and percentages of Protestants (cf. Clague et al. 2001). As long as these variables are time-invariant, their influence will be captured by our individual country fixed effects (see section 5). However, we separately consider one additional historical factor, namely the lagged level of democracy, or the lagged level of the particular democracy dimension, i.e. the level at the beginning of the time period under consideration. We thereby rely on existing empirical research having shown that previous experience with democratization is one of the most robust predictors of current democratization in developing countries (cf. Gasiorowski and Power 1998; Epstein et al. 2006).

## 5. Research Design

Our data contains 34 annual observations for 76 countries. In order to take into account the nested structure of our data, we use panel estimation models with fixed effects. They have the virtue of addressing the problem of omitted variable bias of cross-section data by controlling for unobservable country-specific variables that are correlated with one or more of the explanatory variables. A Hausman test strongly rejects random effects for all types of IFI program lending and democracy dimensions, thus confirming the need for fixed effects. Alternative estimation strategies based on panel corrected standard errors (PCSE) are discarded, as the cross-country dimension of our sample clearly dominates.

In order to assess the impact of IFI program lending on democratization, we first run separate regressions for each type of IFI program lending on our composite index of democracy. In a second round, we estimate the effects of IFI programs on different dimensions of democracy and over various time horizons (t+1, t+2, t+3, t+4, t+5). The impact of IFI program lending is captured in terms of change from the year when a country was under a specific program type to the current year. For our baseline model, we consider a change in democracy over an intermediate period of three years. This reduces noise as compared to the assessment of year-to-year changes, but the period is not too long to render comparisons with more recent programs impossible. This is the case for changes over five years or more, where only a very limited number of observations would remain for the estimation of the impact of PRS based lending.

The greatest methodological challenge is the appropriate handling of endogeneity. Participation in IFI lending cannot be expected to be randomly assigned. Different estimation strategies in dealing with endogeneity issues of IMF program participation have been proposed and applied (for a selection of recent papers, see Vreeland 2003; Jensen 2004; Edwards 2005; Dreher 2006). Methodically, three avenues permitting the evaluation of the participation effect have been exploited; Heckman, instrumental variable approaches, and matching strategies (see Atoyan and Conway 2006 for comparison and discussion of these three techniques in the IFI lending context). In our paper, we follow Barro and Lee (2005) who use an instrumental variable approach drawing on the literature on the political economy of aid to define their instruments. More specifically, we use panel GMM (cf. Cameron and Trivedi 2005: 744-753) based on the two-step estimator implemented by Schaffer (2007). As our dependent variables are different from those in Barro and Lee, we cannot recur to identical instruments. However, we can use the literature on the political economy of international organizations as a helpful basis to to select appropriate alternatives.

It should be noted that our only objective here is to find appropriate instrumental variables, not to comprehensively model the process of selection into IFI programs. Therefore, we try to select variables that are correlated with IFI program participation, but uncorrelated with democratization processes in recipient countries. We disregard any domestic political variables, because they are most likely to be correlated with democratization processes in recipient countries. By contrast, we include *recipients' developmental needs* which are captured by a broad set of economic key measures. However, based on theoretical considerations we exclude income per capita, growth, inflation, and international trade, which have been shown to influence democratization in previous research on democratization in developing countries. From the remaining set of variables we select those which have been repeatedly identified as significant determinants of IFI lending decisions, namely external indebtedness (as a percentage of total debt), current debt service (as a percentage of GNI), foreign reserves (in months of imports), real gross domestic investment (as a percentage of GDP), and log of population size (e.g., Conway 1994; Knight and Santaella 1997; Bird 1995; Bird and Rowlands 2001; Bird et al. 2004; Ratha 2005; Sturm et al. 2005; Cull and Effron 2008).

Moreover, we consider *political influence within the IFIs*. A country is more likely to receive a credit if it has some influence at the IMF or the World Bank (cf. Barro and Lee 2005; Dreher and Vreeland 2009; Kaja and Werker 2009; Kilby 2010). This influence can be measured in terms of the country's representation on the IFIs' excecutive boards. We only consider temporary membership here because this is the only case, for which we observe some variation over time. Previous analyses suggest that reward from board membership or also from staff representation may stem from some sort of "insider culture" (Kaja and Werker 2009: 35). Due to the "vagueness of guidelines" (Polak 1991: 40) and their links to "interlocutors" with similar ideological and professional background in recipient countries (Kahler 1992: 127; Chwieroth 2008: 1), IFI officials enjoy considerable discretionary power when it comes to decision-making. This suggests that additional information on general IFI staff could also represent a useful instrumental variable. However, unfortunately, such data is not publicly available.

In contrast, another variable we can rather easily take into account are the *geo-political interests of the IFIs' major western shareholders*. The influence of these major shareholders, especially the United States, has been widely examined in the literature on the political economy of international organizations (cf. Frey and Schneider 1986; Thacker 1999; Faini and Grilli 2004; Stone 2004; Fleck and Kilby 2006; Harrigan et al. 2006; Dreher and Jensen 2007). We follow the well-established practice to capture their influence by looking at voting patterns in the UN General Assembly. More precisely, we include variables measuring the similarities in voting patterns between recipient countries and the IFI's major western shareholders, namely the United States, the United Kingdom, France and Germany for votes being highly controversial in the UN General Assembly (for a discussion of UN voting scores and their operationalization in the context of IFI program lending, see Barro and Lee 2005; Andersen et al. 2006; Dreher and Sturm 2006; and Kilby 2009).

We test the appropriateness of our theoretically derived instrumental variables based on test statistics for over- and under-identification, i.e., on the instruments' correlation with the error term in the outcome equation, and on the relevance of the instruments in explaining the endogenous variable (Biglaiser and DeRouen 2009: 84). Considering first the correlation with the error term, the Sargan statistics (or Hansen in the case of cluster-robust statistics) tests for potential over-identification of the instruments, i.e. the test statistics assesses the null hypothesis that the instruments are uncorrelated with the error term. A rejection of the null hypothesis would cast serious doubts on the validity of the instruments. Secondly, potential under-identification of the instruments is assessed through Anderson canonical correlation statistics (or Kleibergen-Paap statistics in the cluster-robust case). If the instruments show a sufficiently strong correlation with the endogenous regressor, the null hypothesis that the instruments under-identify the model should be rejected (for detailed discussion, see Hayashi 2000; Baum et al. 2003; Kleibergen and Paap 2006).

In addition to the selection problem, we face a problem of serial correlation. This problem is confirmed when running the test for first order auto-correlation in panel models suggested by Wooldrige (2002: 274f.). Therefore, in our final specification, we use a variance-covariance estimator which is robust against any kind of serial correlation or heteroskedasticity (cf. Arrelano 1987). Clustered standard errors are thus used throughout the analysis.

## 6. Empirical Results

### 6.1. The effect of IFI program participation on the joint measure of democracy

To examine the impact of IFI program lending on democratization, we first take the differences in our composite democracy index as our dependent variable. Because our democracy index incorporates all three dimensions of democratic quality, it provides us with a general idea of the overall impact of different IFI programs on the quality of democracy. As explained before, we select a medium-term time horizon (3-year period) following program participation as our baseline. Table 3 presents the regression results for all four types of IFI programs. We estimate all models both with and without taking the potential endogeneity of program participation into account. Columns 1 to 4 report our results for ordinary least squares regressions with fixed effects (OLS/FE), while columns 5 to 8 give estimation results for our two-stage instrumental variables approach employing the general method of moments (GMM/IV). The different models explain between 23 and 27 percent of the variance of our democratization index.

*Table 3: Medium-term impact of different types of IFI programs on democratization* [a)]

| | (1) | (2) | (3) | (4) | (5) | (6) | (7) | (8) |
|---|---|---|---|---|---|---|---|---|
| Democracy | -.346*** | -.347*** | -.363*** | -.356*** | -.419*** | -.415*** | -.404*** | -.434*** |
| index (t-3) [b)] | (.033) | (.033) | (.031) | (.034) | (.041) | (.040) | (.037) | (.044) |
| WB-INV (t-3) | -.072 | | | | -.726* | | | |
| | (.099) | | | | (.386) | | | |
| IMF-STB (t-3) | | -.337 | | | | -1.948** | | |
| | | (.229) | | | | (.961) | | |
| IFI-SAP (t-3) | | | .657*** | | | | -.011 | |
| | | | (.221) | | | | (.496) | |
| IFI-PRS (t-3) | | | | .918*** | | | | 2.305** |
| | | | | (.321) | | | | (.926) |
| GDP per capita, | .031 | .043 | .160 | .047 | -1.035 | -.545 | -.467 | -.479 |
| log (m-3) [c)] | (.295) | (.291) | (.307) | (.297) | (.683) | (.593) | (.619) | (.542) |
| GDP per capita | .002 | .001 | .002 | .0004 | .002 | -.007 | .002 | -.004 |
| change (m-3) | (.010) | (.010) | (.010) | (.010) | (.021) | (.022) | (.020) | (.020) |
| Urbanization | .043*** | .044*** | .037** | .042*** | .007 | .032 | .037 | .027 |
| rate (m-3) | (.016) | (.016) | (.016) | (.016) | (.025) | (.028) | (.024) | (.024) |
| Inflation rate, | -.330 | -.330 | -.193 | -.273 | -.775 | -.916* | -.885 | -.710 |
| log (m-3) | (.247) | (.248) | (.244) | (.250) | (.608) | (.520) | (.628) | (.565) |
| Trade openess, | .393 | .325 | .281 | .287 | .785 | .345 | .690 | .487 |
| log (m-3) | (.317) | (.312) | (.326) | (.312) | (.726) | (.722) | (.652) | (.689) |
| Conflict | -.240* | -.235* | -.257* | -.246* | -.252* | -.254 | -.344** | -.313** |
| intensity (d-3) | (.128) | (.128) | (.131) | (.127) | (.149) | (.155) | (.152) | (.143) |
| Regional | .679*** | .655*** | .611*** | .670*** | .772*** | .563*** | .717*** | .707*** |
| diffusion (d-3) | (.141) | (.138) | (.134) | (.139) | (.178) | (.183) | (.177) | (.174) |
| Method | OLS/FE | OLS/FE | OLS/FE | OLS/FE | GMM/IV | GMM/IV | GMM/IV | GMM/IV |
| R2 | 0.225 | 0.227 | 0.234 | 0.230 | 0.249 | 0.232 | 0.269 | 0.261 |
| F-test | 17.25*** | 17.28*** | 21.66*** | 17.71*** | 19.03*** | 19.56*** | 23.32*** | 21.17*** |
| | (.000) | (.000) | (.000) | (.000) | (.000) | (.000) | (.000) | (.000) |
| Observations | 2345 | 2345 | 2345 | 2345 | 1404 | 1404 | 1404 | 1404 |
| Countries | 76 | 76 | 76 | 76 | 65 | 65 | 65 | 65 |
| Hansen test | | | | | 9.353 | 10.041 | 13.233 | 5.515 |
| statistics | | | | | (.499) | (.437) | (.211) | (.854) |
| Kleibergen- | | | | | 26.09*** | 21.87** | 25.21*** | 25.13*** |
| Paap test | | | | | (.006) | (.025) | (.008) | (.008) |

[a)] Constant term not reported; robust standard errors in parentheses; *** p<.01, ** p<.05, * p<.10

[b)] Dependent variable in the second stage is the 3-year change in the composite democracy index. The dependent variables in the first stage of column 5 is a categorical variable representing the intensity of a country's participation in a given year in World Bank sector investment projects (WB-INV), whereas in columns 6 to 8 the dependent variable in the first stage is a binary variable representing whether a country participated in a given year in an IMF financial stabilization program (IMF-STB), in a World Bank and/or IMF structural adjustment program (IFI-SAP), or in a World Bank and/or IMF poverty reduction program (IFI-PRS). Lagged instruments in GMM/IV models include external debt (% of total debt), total debt service (% of GNI), foreign reserves (in months of imports), real gross domestic investment (% of GDP), and population size (log); as well as a binary variable for board membership in the IMF or the World Bank, and similarity scores for UN key voting patterns with the United States, Germany, France or Great Britain.

[c)] Denotations for variable transformations are t-3 (lagged values), m-3 (moving averages), d-3 (period differences); all transformations relate to the 3-year period.

However, our estimation results confirm that IFI program participation cannot be considered exogeneous to democratization. When we compare the OLS results in columns 1 to 4 with those of the GMM estimation in columns 5 to 8, we note a remarkable change in size and significance of the coefficients for all four program types. Instrumental variables in columns 5 to 8 include the 1-year lagged values of external debt, current debt service, foreign reserves, domestic investment, and population size, as well as board membership of the IMF or the World Bank and similarity in the UN key voting patterns with major western shareholders of the IMF and the World Bank. We use the same set of exogenous instruments to predict participation in all four types of IFI program lending, and test statistics assessing potential over- or under-identification are generally satisfying. For further details on first-stage results, see Annex 4).

Unfortunately, the GMM/IV approach leads to a significant drop in the number of observations, from 2345 to only 1404. This loss of observations can be attributed mainly to authoritarian countries lacking data for the instruments used. As a consequence of these additional variables, country coverage decreases (from 76 to 65 countries) and the average democracy level in our partial sample increases (from 8.87 to 9.22 on our 3-21 categorical scale). To assess whether this change does in itself lead to differences in the estimation results, we replicate the OLS regressions in columns 1 to 4 with the same set of countries as in the two-stage estimations in columns 5 to 8. Results indicate that the main findings are unaffected (results not shown, but available from the authors upon request). This increases our confidence in the GMM/IV results based on the reduced set of observations.

We can now turn to our primary interest, which is to see if democratization in borrower countries has been differently affected by various types of IFI programs. As expected, different types of IFI programs show significant differences regarding their impact on democratization processes in recipient countries. Columns 5 and 6 show that traditional lending by the World Bank and the IMF exhibits a negative and significant impact on medium-term changes in the democracy score. While the coefficient for IMF-STB programs (-1.948) is estimated to be three times higher than the estimated coefficient for the WB-INV projects (-.726), both reach conventional levels of statistical significance. By contrast, the IFIs' concessional program types do not show such negative effects. Column 7 indicates that the estimated coefficient for IFI-SAP lending is close to zero (-.011), and statistically insignificant. Moreover, as shown in column 8, participation in IFI-PRS programs is even positively and significantly related to democratization in recipient countries (2.305).

These results are generally consistent with our expectations regarding the political effects on the overall change in democratic quality over an intermediate time horizon. For WB-INV projects and IMF-STB programs the summary of our hypotheses in Table 1 (section 3) showed only negative coefficients, for IFI-SAP lending the expected effects were mixed depending on time lags and democracy dimensions. These expectations find their reflection in negatively significant coefficients for the Bank‘s and the Fund's non-concessional lending types (WB-INV projects and IMF-STB programs), and an insignificant coefficient for the concessional IFI-SAPs. For IFI-PRS programs, across all time lags and democracy dimensions, the expected effects were positive which is equally supported by our results.

Let us now check the model with respect to the plausibility of the estimated coefficients for the control variables. As expected, the level of democracy at the beginning of the observation period has a significant impact on the likelihood of democratic transition during the following three years. Since its impact is negative, a positive change in the democracy index is likely to be stronger for countries starting on a low level of democracy. This confirms that "being a peripheral country can be a 'benefit' – the rate of those countries' democratization accelerates faster than in other countries" (Wallerstein 2002, cited in Wejnert 2005: 67).

Turning to our three alternative theoretical explanations of democratization, namely modernization, diffusion, and instability, several other results of Table 3 are noteworthy: Among our controls, the regional diffusion of democratization shows the strongest impact on a country's change in democratic quality. Regional democratization processes exert a positive and highly significant influence in all estimation models. Conversely, the hypothesis of a democratic diffusion effect at the global level (as far as it can be measured by the level of a country's trade openness) could not be confirmed. Our results thus provide a confirmation of dynamic diffusion theories at the regional level (cf. Starr and Lindborg 2003; Doorenspleet 2004; Wejnert 2005; Brinks and Coppedge 2006; Houle et al. 2009). Moreover, at the exception of column 6 where this effect remains slightly below the 10%-significance level, we find statistically significant effects for changes in the conflict intensity on democratization: An increase in the level of conflict intensity leads to a concurrent reduction in our overall democracy score in developing countries. Our results thus confirm previous studies having shown that it will be rare for democracy to arise in a context of social and economic upheaval accompanying civil and cross-border conflicts (cf. Pevehouse 2002; Bräutigam and Knack 2004). Economic instability as proxied by high inflation also shows the expected negative sign, although it remains largely insignificant (except for column 6 where it is significant at the 10%-level).

Surprisingly, we do not find any significant effects for modernization theory in our models, at least once we correct for potential endogeneity. Neither the percentage of urban population, nor income per capita, nor its corresponding growth rate is significant. Our findings thus are fairly consistent with recent studies suggesting that there is no relationship between economic development and democratic transition. Rather, democracies can emerge at any level of development (cf. Przeworski and Limongi 1997; Przeworski et al. 2000; Doorenspleet 2004; Wejnert 2005).

### 6.2. The effect of IFI program participation on individual dimensions of democracy

In a next step, we examine the IFIs programs' impact on different dimensions of democracy and how this impact develops over time. We differentiate between changes in vertical and horizontal accountability measuring improvement or deterioration in the formal routines of a political regime, and changes in degree of civil liberties capturing the more substantive dimension of democratic quality.

Estimation results are reported in Table 4. For ease of presentation, we do not report results for all coefficients but focus instead on our primary variable of interest, namely the participation in different types of IFI programs. The full models are available on request.

*Table 4: Participation effects on different democracy dimensions over time* [a)]

| Program type | Democracy dimension [b)] | Time horizon T + 1 | T + 2 | T + 3 | T + 4 | T + 5 |
|---|---|---|---|---|---|---|
| **WB-INV** | Index (all 3) | -.226 | -.512* | -.726* | -.739 | -.738 |
| | Vertical accountability | -.066 | -.113 | -.144 | -.113 | -.061 |
| | Horizontal accountability | -.115 | -.289** | -.365* | -.338 | -.365 |
| | Civil liberties | -.099** | -.161** | -.228** [c)] | -.250** [c)] | -.278* |
| **IMF-STB** | Index (all 3) | -.667 | -1.600** | -1.948** | -1.736 | -1.205 |
| | Vertical accountability | -.178 | -.362 | -.378 | -.317 | -.175 |
| | Horizontal accountability | -.391* | -.979*** | -1.101** | -.955* | -.727 [c)] |
| | Civil liberties | -.248** | -.390* | -.443 [c)] | -.385 [c)] | -.343 [c)] |
| **IFI-SAP** | Index (all 3) | .078 | -.082 | -.011 | .303 | .752 |
| | Vertical accountability | -.024 | -.167 | -.210 | -.047 | .149 |
| | Horizontal accountability | .095 | .054 | .240 | .525 | .815** |
| | Civil liberties | .046 | .119 [c)] | .150 [c)] | .125 [c)] | .136 [c)] |
| **IFI-PRS** | Index (all 3) | .493 | 1.348** | 2.305** | 2.833** | 4.497* |
| | Vertical accountability | .043 | .201 | .359 | .260 | .403 |
| | Horizontal accountability | .342** | .852*** | 1.284*** | 1.672*** | 2.904** |
| | Civil liberties | .223** | .478** | .818*** | 1.132*** | 1.574** [c)] |

a) *** p<.01, ** p<.05, * p<.10

b) Dependent variables are the differences in our composite democracy index and its three subcomponents, namely in FH's political rights index (vertical accountability), in Polity's executive constraint index (horizontal accountability), and in FH's civil liberties index (civil liberties) over various time horizons. All models are estimated with the two-step estimator for panel GMM. Each cell reports the coefficient for lagged participation in a World Bank sector investment project (WB-INV), in an IMF financial stabilization program (IMF-STB), in a World Bank and/or IMF structural adjustment program (IFI-SAP), or in a World Bank and/or IMF poverty reduction program (IFI-PRS) at the beginning of the respective time period.

c) Hansen test of exogeneity of all instruments rejected at the p<.10 significance level.

The effects of IFI programs exhibit considerable variation across democracy dimensions and various time horizons. Three general observations can be made: First, none of the different types of World Bank and IMF program lending has significant effects for our dimension of *vertical accountability*, in that they would promote changes in the degree of political freedom and electoral competition in recipient nations. Second, if IFI lending has an impact, the biggest changes occur in relation to the degree of *horizontal accountability*, meaning that all program types affect the political constraints on the executive branch of the borrower government most strongly. Third, the Hansen test assessing potential over-identification of our instruments with changes in the extent of *civil liberties* does not reject in half of the models. In particular, results for civil liberties over the long term should thus be interpreted with caution.

The results for **World Bank sector investment projects** show negative coefficients for all democracy dimensions and over all time horizons. However, the results differ in significance with respect to the different dimensions of democracy. As already noted there are no significant results for vertical accountability. By contrast, sector investment lending by the Bank significantly reduces horizontal accountability in recipient countries in the short to medium term, but not in the long term. With respect to civil liberties, we find a very small, but significant negative effect in the short term which grows in size in the medium term, but loses its significance in the long term. Apart from the insignificant result for vertical accountability, the empirical findings thus support Hypothesis 1a proposing a reduced likelihood of democratic transitions along all three dimensions of democratic quality in the short term. In the long term, the empirical results also support Hypothesis 1b suggesting that WB-INV projects have negative effects on changes in the quality of democracy in recipient countries due to their stabilizing properties. The size of the coefficients first increases from the short to the medium term, but then stays constant in the long term. Moreover, the significance (if any) of the coefficients is reduced in the long term.

As expected, we also find strongly negative coefficients for the effect of **IMF's financial stabilization programs.** In terms of the size of the coefficient, this impact is stronger as for the WB-INV projects. Except for vertical accountability, all effects are significant in the short-run, but lose significance over time. Negative short- and medium effects are particularly strong on horizontal accountability. The estimated coefficients imply that program participation lowers the potential change on the 7-point executive constraints scale by 0.4 points within one year. Three years after program participation its negative impact is even worsened by 1.1 points. Following our theoretical model, this remarkable reduction in the government's accountability towards other actors in the political arena can mainly be attributed to the government's higher discretionary power through the general budget support provided and to the IMF's low incentives to support domestic oversight and control in crisis situations.

In line with what we expected, there is a decreasing negative trend over time. We first observe a quick increase, and then a slow decrease regarding the negative political consequences of IMF-induced financial stabilization. Moreover, we find no significant effects on any democratic dimension five years after program participation. It seems that after the end of the program duration (which, as stated earlier, is only 1 to 3 years), the negative effects on democratization, and especially on the checks and balances on the chief executive (horizontal accountability) become blurred through other factors which we cannot take into account here so that standard errors rise and significance gets lost. The results thus support Hypothesis 2a in that IMF-STB programs reduce horizontal accountability and lower the extent of civil liberties in the short term, and Hypothesis 2b proposing a reduction of these negative effects over time.

The results for concessional lending by the World and the IMF in low-income countries appear more encouraging in terms of their political impact. The signs of the estimated coefficients in Table 4 are generally positive for both structural adjustment and poverty reduction programs. Short-term effects of the **IFI structural adjustment programs** on vertical accountability constitute the only exception in this regard. However, in the long run, even their signs turn slightly positive – although they remain insignificant. Comparing the development over time to what we observe for our other accountability dimensions, we observe a similar trend: The participation effect on horizontal accountability is positive, growing and becomes finally significant. A five-year long exposure to structural conditionality increases the growth of executive constraints by 0.8 points of the corresponding index. Regarding civil liberties, the empirical results show that the estimated coefficients are again positive, but remain statistically insignificant. Generally, the results on IFI-SAP lending and civil liberties need to be interpreted with caution because in almost all cases the Hansen test indicates that some of our instruments might not be exogenous in these regressions.

Overall, we find only partial evidence for our hypotheses concerning IFI-SAP lending. While we could not find any significant effects on all three dimensions of democracy in the short term (Hypothesis 3a), the results show that, at least in the long term, the likelihood of a democratic regime change is confirmed (Hypothesis 3b). With respect to vertical accountability, the signs of the coefficients show the expected direction of a negative short-term and a positive long-term impact, but remain insignificant throughout. The time trend involved suggest that probably a time horizon of more than five years is needed to find empirical evidence. Regarding horizontal accountability, there seems to be partial evidence for an improvement through IFI-SAP programs in recipient countries (Hypothesis 3b). Structural adjustment programs induce higher levels of horizontal accountability, but the effect becomes significant, both statistically and in terms of its substantive impact, only in the long term. Finally, there is no evidence for, the negative change in the civil liberties' record suggested by Hypothesis 3a, but this may be related to a problem of finding appropriate instrumental variables for this particular regression specification.

Since **poverty reduction programs** of the World Bank and the IMF are conditional on civil society's participation in the formulation and implementation of the national development strategy, their democratic record is particularly interesting to examine. Turning to procedural democracy first, we observe considerable differences with respect to the size and significance of the coefficients of our two accountability dimensions. On the one hand, we find that the IFI-PRS programs increase the constraints on the executive's power, hence strengthening horizontal accountability significantly. Like for IFI-SAPs, we observe a remarkable increase in the size of the coefficient which, however, in the case of IFI-PRS lending stays significant independently of whether we look at short- or at long-run effects. In fact, a one-year lagged participation in an IFI-PRS program is already significant, but the effect on horizontal accountability rises from 0.2 index points after one year to 1.6 index points after five years. On the other hand, we do not find any significant effect on vertical accountability, although the coefficient of Freedom House's political rights index is positive and growing in all models. Hypothesis 4a suggesting a positive impact on procedural democracy is thus consistent only with our empirical evidence for horizontal accountability, but not for vertical accountability.

Regarding changes in substantive democracy, our results show that there is a positive and highly significant relationship between IFI-PRS programs and changes in the extent of civil liberties in the short term, which is increasing over longer time horizons. In general, the evidence is thus in line with our hypotheses. Except for vertical accountability, our results confirm Hypothesis 4a which states that the PRS approach leads to an overall positive effect on the quality of democracy in recipient countries, an effect which should even improve over time (Hypothesis 4b).

### 6.3. Robustnes checks

In order to validate the findings explained above we subject our empirical model to various robustness checks. In this context, we will consider:

- Controls for time trends or the effect of the end of the Cold War ("time effects"),
- differences in sample size due to different program eligibility criteria ("sample selection"),
- a variation in the choice of instrumental variables ("set of instruments"), and
- alternative operationalizations of our three dimensions of democracy ("democracy measures").

Table 5 presents the coefficients for IFI program participation under the baseline specification, i.e. for a change in democratic quality within a period of three years (see Tables 3 and 4), and under the alternative specifications mentioned above (and further described below). All other coefficients are dropped from the table for the sake of clarity. Apart from the last part of the table which focuses on the sub-components of our democracy index and possible alternative operationalizations, the dependent variable is always the differences in our composite, three-dimensional democracy index. All models are estimated based on panel GMM as before.

Let us first examine **time effects or trending** in the democracy variable that might generate spurious correlations: A first problem could be that the introduction of the PRS in the late 1990s happens to coincide with a new era of international development cooperation which might drive the difference in the results we find for IFI-PRS and other IFI lending types. Recent empirical research on the political effects of foreign assistance has found differing patterns for the pre- and post-Cold War periods. With the fall of the Soviet Union, bilateral aid was found to become either positive and significant when it had no impact on democratization in the Cold War period (cf. Dunning 2004) or to turn insignificant after the fall of the Berlin wall when its impact had been negative and significant before (cf. Bräutigam and Knack 2004; Bermeo 2009; Licht 2010). Recent studies on the political impact of IMF lending came to similar conclusions (cf. Abouharb and Cingranelli 2009; Nooruddin and Simmons 2006). There might thus be a risk to confound the PRS effect with the more general effect of the end of the Cold War.

In a similar way, if there is a general time trend towards democratization, this positive effect may be wrongly attributed to the more recent IFI lending types. Indeed, the democratic diffusion literature argues that since the mid-1970s, there has been a steady temporal trend toward greater democracy in the world (cf. Starr 1991; Starr and Lindberg 2003; Knack 2004; Wejnert 2005).

To take the arguments of an altered geopolitical context and a global democratization trend into account, we include both a post Cold War dummy and a year variable into our controls. Following standard practice, we also include annual dummies to test for any time-specific exogenous developments not yet captured in our controls. This more conservative specification for controlling potential time effects makes no assumption about trends or growth in democracy.

*Table 5: Robustness checks of the medium-term impact of IFI programs on democratization* [a)]

| | **WB sector investment** | **IMF financial stabilization** | **IFI structural adjustment** | **IFI poverty reduction** | **N** |
|---|---|---|---|---|---|
| **Baseline model** | | | | | |
| WB-INV (t-3) | -.726* | | | | 1404 |
| IMF-STB (t-3) | | -1.948** | | | 1404 |
| IFI-SAP (t-3) | | | -.011 | | 1404 |
| IFI-PRS (t-3) | | | | 2.305** | 1404 |
| **Time effects** | | | | | |
| post Cold War dummy | -.537 | -1.789* | -.666 | 1.770** | 1404 |
| year trend | -.315 | -1.519 | -.399 | 1.563** | 1404 |
| time fixed effects | -.329 | -1.973 [c)] | -.538 [c)] | 3.890*** | 1404 |
| **Sample selection** | | | | | |
| only IDA-eligible countries | -.709* | -2.303** [c)] | .386 | 2.775*** | 969 |
| only low-income countries | -.818 | -3.108*** | 1.207 | 2.441** | 717 |
| no small island developing states | -.777* | -1.912** | -.025 | 2.192** | 1319 |
| **Set of instruments** | | | | | |
| reduced IV set | -.960* | -2.056** | .047 | 3.004** | 1421 |
| alternative IV set | -.964** | -1.486* | -.161 | 3.010** | 1404 |
| **Democracy measures** | | | | | |
| *Baseline:* | | | | | |
| Horizontal accountability | -.365* | -1.101** | .240 | 1.284*** | 1404 |
| Vertical accountability | -.144 | -.378 | -.210 | .359 | 1404 |
| Civil liberties | -.228** [b)] | -.443 [b)] | .150 [b)] | .818*** | 1404 |
| *Substitutes:* | | | | | |
| Vanhanen's competition index | -7.970*** | -19.615*** | 4.289 [b)] | 23.531*** [b)] | 1393 |
| Vanhanen's participation index | -2.463 | -6.528 | 2.055 | 5.457 | 1393 |
| CIRI's empowerment index | -.289 | -.406 [b)] | .021 | .351 | 1145 |

[a)] *** p<.01, ** p<.05, * p<.10
[b)] Hansen test of exogeneity of all instruments rejected at the p<.10 significance level.
[c)] Kleibergen-Paap test of under-identification of all instruments not rejected at the p<.10 significance level.
If not otherwise stated, the dependent variable is the difference in our three-dimensional democracy index. All models are estimated over a 3-year period employing the two-step estimator for panel GMM. Each cell reports the coefficient for participation in a World Bank sector investment project (WB-INV), in an IMF financial stabilization program (IMF-STB), in a World Bank and/or IMF structural adjustment program (IFI-SAP), or in a World Bank and/or IMF poverty reduction program (IFI-PRS) at the beginning of the 3-year period.

As can be seen from Table 5, the time effect plays a major role regarding the IFIs' traditional lending facilities. In particular, the relationship between the WB-INV projects and democratization in recipient countries loses its significance. Even though it remains negative, no significant effects on democratic quality could be found in any of the three alternative specifications. The picture is less clear for IMF-STB programs. When a post Cold War dummy is included into the controls, the negative significant effect on democratization still holds. However, when a year variable is included, the negative effect for IMF-STB programs on democratization cannot be detected at conventional level of significance, even though it comes close (i.e., p-value of the coefficient is 0.155). Finally, the regression with time fixed effects is difficult to interprete as the Kleinbergen-Paap test indicates the instruments' under-identification of the program type. We thus do not completely discard the significant negative effect of IMF-STB programs as compared to WB-INV projects. With regard to the IFI's concessional lending, our results seem robust to any kind of time effects, i.e., the effects of structural adjustment and poverty reduction programs are similar to the baseline findings in all time specifications.

In a second set of robustness checks we address the potential limitations for our analysis caused through predetermined **sample selection**. The eligibility criteria for the IFIs concessional programs are explicit: only low-income member countries with lack of access to private capital markets and adherence to a certain policy and institutional standards set by the World Bank can participate in concessional IFI programs (Andersen et al. 2006: 775). Yet, the World Banks grants similarly explicit exceptions to these criteria for small island developing states and so called "blend" countries that do have access to capital markets but are very poor (or at least used to be), such as India or Indonesia. Based on the World Bank's (2010b) own information, we run our baseline model using both a low-income country sub-sample (economic threshold) and an IDA-eligible sub-sample of country-years (political threshold). In addition, we excluded all small island developing states (SIDS, see United Nations 2010). The use of different sub-samples, however, does not significantly change the main results with regard to the IFIs' concessional lending programs for which these sample restrictions hold. Even though the coefficients increase in size, the significance for both structural adjustment and poverty reduction programs is unchanged.[8]

To test the validity of our **instrumentation strategy**, we run separate models with alternative sets of instruments in the first stage of our two-step approach. First, we run our baseline model with a reduced set of instruments by excluding all external political-economy variables from our instruments, because of the concern that they might be endogenous with respect to democratization in recipient countries. Next, we employ an alternative set of instruments for controlling potential interests of the IFI's major shareholders in recipient countries. We substitute their geo-political interests, as measured through voting similarity on controversial issues in the UN General Assembly, with their commercial interests

[8] Similar results were obtained when all countries with a total population of less than 1 million (or 1.5 million) in 2007 were dropped from our sample. Results are not reported, but available upon request.

in the form of their total exports to developing countries.[9] In general, our results are robust to changes in the set of instrumental variables, as Table 5 reports.[10] The main findings for all four program types are not affected by the exclusion or the replacement of the political-economy variables from our instruments, indicating a reasonable robustness of the results.

A final series of tests replaces our outcome variables with **alternative democracy measures**. Whereas we rely on Freedom House's and Polity IV's democracy indices for measuring our three dimensions of democratic dimensions, we use two other sources with sufficient data coverage for our sample of 76 developing countries over the last 34 years. These are Vanhanen's (2009) Polyarchy dataset and the Cingranelli-Richards (CIRI) Human Rights dataset (2010). Together, they provide alternative measures for democratic quality. We use Vanhanen's two democracy dimensions "competition" and "participation" as a substitute for our horizontal and vertical accountability dimensions. Likewise, the CIRI empowerment index summarizes governments' respect for individual freedoms, thus replacing the Freedom House's civil liberties index. Table 5 supplements the results for every dimension of our baseline model with the alternative measurements taken from these two datasets. Regarding procedural democracy, the main results for both vertical and horizontal accountability were unchanged when replaced with alternative democracy measures. By contrast, the results for substantive democracy are quite sensitive to variations in the measurement. While Freedom House's civil liberties index (baseline) shows significant, yet in the majority of cases, not robust results, CIRI's empowerment index exhibits mostly robust, but insignificant results for the different types of World Bank and IMF programs. Even though the CIRI data do not cover the full time period of our analysis, they do at least, question the validity of our results for civil liberties in recipient countries.

In sum, our battery of robustness checks addressed problems that could arise due to time effects, sample selection, instruments choice, and democracy measures. With the exception of the WB-INV projects, there is considerable support given by our twelve alternative specifications for the causal hypotheses advanced above. While the robustness checks indicate that WB-INV projects may be driven by time effects, the results for the other three program types seem more or less robust. Neither time effects, sample selection, different instruments in the first stage or alternative democracy measures in the second stage affect our empirical findings.

[9] Likewise, we ran alternative specifications in which we standardized our instruments on a per capita basis instead of on economic size, and we substituted population size with land area. Both specifications with an alternative set of instruments performed similarly to the robustness checks on time effects, i.e., main results hold for concessional IFI lending programs, but the Bank's and Fund's traditional lending programs lose their significance.

[10] In addition, the simultaneous inclusion of the political and commercial interests of the IFI's key shareholders does not change the main results. Moreover, our second stage results are not affected when the political and/or commercial interests of the major European powers (i.e. Germany, France and Great Britain) are combined in a single index. However, because there are some interesting differences between the European powers with regard to their "clients" program selection, we prefer to show them individually in the first stage (see Annex 4).

## 7. Discussion

This paper presents evidence that participation in different types of IMF and World Bank programs has different impacts on the quality of democracy in recipient countries. Our empirical findings vary both with respect to the the type of IFI program and the time period under observation. Moreover, we find different results for various dimensions of democratic quality. In general, all program types are alike in not having any significant effects on vertical accountability – either in the short or long term. Hence, the subsequent discussion will comment only on the other two dimensions.

Firstly, due to their similar aid modalities the political effects of the *Bank's sector investment projects* resemble the ones of bilateral funds in recipient nations. Their political consequences are very much debated in the scholarly literature. Our empirical findings support the view that external development assistance has negative effects on horizontal accountability, but only in the short and medium term. In the long term, sector investment funds passing through governments' hands seem to stabilize the domestic regime, independent of its political nature. As the majority of all countries in our sample were more authoritarian than democratic during the last three decades, the effect on democracy in terms of horizontal accountability is negative throughout all analyses. By focusing on various time horizons, we combine and confirm both the skeptical view in the aid effectiveness literature (cf. Svensson 2000; Bräutigam and Knack 2004; Knack 2004) and the alternative view that foreign aid has stabilizing properties (cf. Morrison 2009; Licht 2010). Likewise, negative and significant short-term, as well as insignificant long-term, impacts were found for the extent of civil liberties in recipient countries. However, over-identification tests of our instruments were not rejected for changes in the degree of civil liberties, and the coefficients of World Bank investment lending proved to be quite sensitive to our robustness checks, thus leading us to interpret these results with caution.

Secondly, during economic crises, general budget support in the form of *IMF financial stabilization programs* seem to aggravate the tense situation in recipient nations by having significant negative consequences for horizontal accountability, and to a lesser extent, changes in the degree of civil liberties. This empirical finding confirms previous political-economy research on the political impact of IMF-induced financial stabilization. A growing number of studies, which control for selection effects into these programs as a result of economic difficulties, show that these programs have significant negative effects on procedural democracy (cf. Barro and Lee 2003), income distribution (cf. Pastor 1987; Garuda 2000; Vreeland 2003; Nooruddin and Simmons 2006) and political stability (cf. Franklin 1997; Dreher and Gassebner 2008). It appears that hybrid regimes, with few financial resources at their disposal, are more likely to use political repression as a response to threats from society. However, IMF-STB programs do not exhibit any significant long-term effects on democratic quality because they are designed for crisis intervention in the short-to medium term.

Thirdly, contrary to their critics, we find that *IFI structural adjustment programs* do not imply negative changes on the level of both procedural and substantive democracy. Instead, we find a remarkable positive trend over time on the likelihood of regime change for all three dimensions of democratic quality, although this trend remains insignificant in most instances. The only exception is the coefficient for changes in horizontal accountability, which becomes significant over the 5-year period. By contrast, no significant changes in the extent of civil liberties could be detected. Following our theoretical framework, we expected an overall negative impact of structural adjustment lending on democratization in developing countries in the short term, which might turn positive in the long run. The empirical evidence of an incremental trend towards democratic transitions appears to confirm our expectations, even though our analysis probably shows only its initial stages. We conclude that IFI structural adjustment programs have no significant political impact in the short and medium term, but this impact grows and may become significant in the very long term. This conclusion is supported by recent studies measuring the Bretton Woods institutions' joint and cumulative impact of structural adjustment programs (Abouharb and Cingranelli 2007), or alternatively, measuring the IMF's influence on procedural democracy in general, without making any differentiation between concessional and non-concessional program types (Nelson and Wallace 2005). Both studies have found a significant and positive relationship between IFI programs and the level of democracy in recipient countries that increases over time. In other words, the political dynamic in structural adjustments seem to parallel similar economic arguments which hold that IFI programs start out badly and end well.

Finally, regarding *IFI poverty reduction programs*, our empirical evidence suggests that they strengthen horizontal accountability. Furthermore, they show a positive impact on substantive democracy by increasing the extent of civil liberties in recipient countries. These results confirm previous findings of PRS case studies having shown that the PRS consultation process created new space for domestic policy dialogue and resulted in an unprecedented engagement by civil society organizations in poverty policy debates (cf. Lister and Nyamugasira 2003; Molenaers and Renard 2003; Driscoll and Evans 2005). Civil society organizations expose the government's role to public scrutiny, and consequently increase horizontal accountability. Moreover, through strengthening the voice of formerly excluded social groups in fostering public discussions of the PRS, the IFIs empower them and increase the degree of civil liberties in recipient countries. However, we also find evidence that broad-based participation of civil society organizations in the PRS process does not automatically result in higher levels of citizens' engagement with the state on the national level. Contrary to our expectations, vertical accountability in recipient countries has not been strengthened through the introduction of the PRS initiative (or it requires more than five years for this effect to become statistically significant). This may be caused by a lack of institutionalized participation following the initial PRS consultation process, as several case studies have shown (e.g., Eberlei 2001; Molenaers and Renard 2003; Driscoll and Evans 2005).

## 8. Conclusion

Official rhetoric at the IMF and the World Bank maintains that their programs meet the economic needs of borrowing countries and that their internal decision-making procedures follow technocratic criteria. In short, the Bretton Woods Institutions see themselves as multilateral, independent, professional and, above all, *non-political* organizations of the world economic system (Frey and Schneider 1986: 228; Kahler 1992: 101). But reality may not always confirm rhetoric. This paper presents theoretical arguments that these external actors exert significant leverage on political power balances in recipient countries and empirical results that back this up. Yet, the overall evidence regarding the impact of different types of IFI programs on various dimensions of democracy is mixed. In a narrow sense, democratization cannot be imposed from the outside. We do not find significant effects of any type of IFI program on vertical accountability as measured by the degree of political participation and competitive elections in a country. In a wider sense, however, IMF and World Bank programs do have political implications for changes in the extent of executive constraints and in the level of civil liberties in developing countries. Our main results show that the IFIs' tradional lending programs have negative short-term impacts on horizontal accountability in recipient countries, while their development policy lending to low-income countries increases horizontal accountability over the long term. In addition, this study shows that the IFI's PRS initiative strengthens civil liberties by promoting broad-based participation of civil society and, in particular the poor in the domestic political decision-making process.

Our conceptual framework of power balances has proven to be a useful theoretical device in predicting the effects of IFI program lending on the quality of democracy in hybrid regimes. By simultaneously differentiating between various types of IFI programs and their respective time horizons, we were able to explain the contradictory results of previous studies on the IFIs' impact on democratization in recipient countries. Moreover, this is the first large-N study to compare the democratic outcomes of the latest PRS initiative with those of earlier types of World Bank and IMF lending. However, there are also limitations to our study. The average recipient of an IFI program in our country sample is a hybrid regime, slightly closer to the authoritarian end of the regime spectrum. Our focus on hybrid regimes masks important differences between the effects of IFI programs in democratic and authoritarian regimes. Different types of IFI programs might interact with domestic politics in various ways, also changing over time. Consequently, promising directions for future research point to the analysis of political dynamics of the democratic deficit in developing countries. The joint review of the PRS approach by the IFIs (World Bank and IMF 2005) suggests that there is a general interest in more detailed information on how the PRS process can be tailored to specific country contexts in order to make its implementation more efficient. By incorporating the dynamics between the international dimension and the domestic context in their research, the academic community could make a significant contribution towards this aim (see the path-breaking analyses by Nooruddins and Simmons 2006 and Licht 2010 as a starting point for possible future research in this regard).

Data availability under short time horizons presents another limit to our study. The PRS approach has been in place since 1999, a fact that constrains our comparative analyses to rather short time periods. Yet, IFI-PRS programs carry big democratizing potential in the long term. Distributional consequences, as foreseen by their strong poverty focus, lie at the heart of domestic politics. However, greater economic and political equality within society can be realized only in the long term. The IFIs' double strategy of empowering marginalized social actors and changing the underlying social structures shows great promise for future research from a developmental and democratization perspective. Meanwhile, scholars could analyze the PRS process and its interactions with different dimensions of democracy in depth, especially in countries which have entered the second generation under the IFI's PRS approach. In addition, more detailed data on IFI conditionality have the potential to shed some light on the actual working of different forms of conditionality attached and their consequences for democratization in developing countries.

Finally, the interplay of different domestic and foreign development partners in encouraging democracy is still an underdeveloped research field. In practice, the Paris Declaration on Aid Effectiveness and the Accra Agenda for Action (OECD 2010) set the stage for increased partnership and mutual accountability between development partners. Yet, it takes two to tango. While we have shown that external financial assistance has a significant impact on the accountability of the borrower government, the accountability of the international donors towards domestic actors, particularly towards other branches of the government and towards the civil society at large, has not been at the center of scholarly attention. We thus see the analysis of mutual accountability relationship as another promising direction for future research, which could share more light on political power balances and democratic transitions in the developmental context.

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## Annex 1: Country-years included in the sample

| Country | Years in Sample | Country | Years in Sample |
|---|---|---|---|
| Afghanistan | 1974-2007 | Liberia | 1974-2007 |
| Algeria | 1974-2007 | Libya | 1974-2007 |
| Angola | 1975-2007 | Madagascar | 1974-2007 |
| Bahrain | 1974-2007 | Malawi | 1974-2007 |
| Bangladesh | 1974-2007 | Malaysia | 1974-2007 |
| Benin | 1974-2007 | Mali | 1974-2007 |
| Bhutan | 1974-2007 | Mauritania | 1974-2007 |
| Botswana | 1974-2007 | Mongolia | 1974-2007 |
| Burkina Faso | 1974-2007 | Morocco | 1974-2007 |
| Burundi | 1974-2007 | Mozambique | 1975-2007 |
| Cambodia | 1974-2007 | Nepal | 1974-2007 |
| Cameroon | 1974-2007 | Niger | 1974-2007 |
| Central African Republic | 1974-2007 | Nigeria | 1974-2007 |
| Chad | 1974-2007 | Oman | 1974-2007 |
| China | 1974-2007 | Pakistan | 1974-2007 |
| Congo, Democratic Republic | 1974-2007 | Papua New Guinea | 1975-2007 |
| Congo, Republic | 1974-2007 | Philippines | 1974-2007 |
| Côte d'Ivoire | 1974-2007 | Qatar | 1974-2007 |
| Djibouti | 1977-2007 | Rwanda | 1974-2007 |
| Egypt | 1974-2007 | Saudi Arabia | 1974-2007 |
| Equatorial Guinea | 1974-2007 | Senegal | 1974-2007 |
| Ethiopia | 1974-2007 | Sierra Leone | 1974-2007 |
| Fiji | 1974-2007 | Solomon Islands | 1978-2007 |
| Gabon | 1974-2007 | Somalia | 1974-2007 |
| Gambia | 1974-2007 | South Africa | 1974-2007 |
| Ghana | 1974-2007 | Sri Lanka | 1974-2007 |
| Guinea | 1974-2007 | Sudan | 1974-2007 |
| Guinea-Bissau | 1974-2007 | Swaziland | 1974-2007 |
| India | 1974-2007 | Syria | 1974-2007 |
| Indonesia | 1974-2007 | Tanzania | 1974-2007 |
| Iran | 1974-2007 | Thailand | 1974-2007 |
| Iraq | 1974-2007 | Togo | 1974-2007 |
| Jordan | 1974-2007 | Tunisia | 1974-2007 |
| Kenya | 1974-2007 | Uganda | 1974-2007 |
| Korea, South | 1974-2007 | United Arab Emirates | 1974-2007 |
| Kuwait | 1974-2007 | Vietnam | 1976-2007 |
| Laos | 1974-2007 | Zambia | 1974-2007 |
| Lesotho | 1974-2007 | Zimbabwe | 1974-2007 |

## Annex 2: List of variables, indicators and sources

| Variable | Indicator | Source |
|---|---|---|
| Horizontal accountability | Executive constraints index; scale ranging from "unlimited authority" (1) to "executive parity or subordination" (7); cases of "foreign interruption" (-66) and "interregnum" (-77) were coded as missing, while cases of "regime transition" (-88) were interpolated | Polity IV (2009) |
| Vertical accountability | Political rights index; inversed and transformed scale ranging from lowest (1) to highest (7) level of political rights | Freedom House (2009) |
| Civil liberties | Civil liberties index; inversed and transformed scale ranging from lowest (1) to highest level (7) of civil liberties | Freedom House (2009) |
| Democracy index | Additive democracy index of "horizontal accountability", "vertical accountability", and "civil liberties"; scale ranging from "most authoritarian regime" (3) to "most democratic regime" (21) | own construction |
| WB sector investment project | Intensity of participation in World Bank sector investment projects in a given country-year; 5-point categorical scale including the following instruments: Specific Investment Loan (SIL), Sector Investment and Maintenance Loan (SIM), Financial Intermediary Loan (FIL), and Technical Assistance Loan (TAL) | World Bank (2009a) |
| IMF financial stabilization program | Dummy variable coded 1 for the country-years when there was an IMF financial stabilization program in force, 0 otherwise; including Stand-by Arrangement (SBA) and Extended Fund Facility (EFF) | Vreeland (2003); IMF Annual Reports (various issues) |
| Structural Adjustment Program | Dummy variable coded 1 for the country-years when there was a SAP in force, 0 otherwise; including following instruments: WB: Structural Adjustment Loan (SAL), Sector Adjustment Loan (SAD), Rehabilitation Loan (RIL), Debt and Debt Reduction Service Loan (DRL); IMF: Structural Adjustment Facility (SAF) and Enhanced Structural Adjustment Facility (ESAF) | World Bank (2009a); Vreeland (2003); IMF Annual Reports (various issues) |
| Poverty reduction program | Dummy variable coded 1 for the country-years when there was a PRS in force, 0 otherwise; including following instruments: WB: Poverty Reduction Support Credit (PRSC); IMF: Poverty Reduction and Growth Facility (PRGF) | World Bank (2009a); IMF Annual Reports (various issues) |
| GDP per capita | Log of real GDP per capita measured in constant 2005 US dollars; moving average | Heston et al. (2009) |
| GDP per capita change | Growth rate of real GDP per capita measured in constant 2005 US dollars; moving average | Heston et al. (2009) |
| Urbanization rate | Urban population as percentage of total population; moving average | World Bank (2008) |
| Inflation rate | Log of price index of a country's consumption basket in international prices (variable "pc"); moving average | Heston et al. (2009) |
| Trade openess | Log of sum of exports and imports as % of GDP; moving average | Heston et al. (2009) |
| Conflict intensity | Intensity of internal conflict; 3-point ordinal scale with the categories "no conflict" (0), "minor conflict: between 25 and 999 battle-related deaths in a given year" (1), and "war: at least 1,000 battle-related deaths in a given year" (2); period differences | Gleditsch et al. (2002) |
| Regional diffusion | Democratic diffusion measured as average changes in our additive democracy index within the following four regions: Sub-Saharan Africa, North Africa and Middle East, South Asia, East Asia and Pacific region; period differences | own construction |
| External debt | Total external debt as percentage of GNI; lagged | World Bank (2008) |
| Debt services | Total debt services as percentage of GNI; lagged | World Bank (2008) |
| Foreign reserves | Total foreign currency reserves in months of imports; lagged | World Bank (2008) |
| Investment | Real gross domestic investment as percentage of GDP; lagged | Heston et al. (2009) |
| Population size | Log of total population in thousands; lagged | Heston et al. (2009) |
| IFI board membership | Dummy variable coded 1 for the country-years when a country was a member of the board at the IMF or the World Bank, 0 otherwise | Dreher & Vreeland (2009); Werker & Kaja (2009) |
| UN key votes | UN voting on key issues in line with the Unites States, Germany, France, and Great Britain; leaving votes on which more than 80 percent of all countries agreed aside | Voeten & Merdzanovic (2009) |

## Annex 3: Descriptive statistics for dependent and independent variables

| Variable | Obs | Mean | Std. Dev. | Min | Max |
|---|---|---|---|---|---|
| Horizontal accountability | 2472 | 2.993123 | 1.936349 | 1 | 7 |
| Vertical accountability | 2572 | 2.824261 | 1.677008 | 1 | 7 |
| Civil liberties | 2572 | 2.967341 | 1.382962 | 1 | 7 |
| Democracy index | 2472 | 8.876618 | 4.602419 | 3 | 21 |
| WB sector investment projects | 2572 | 2.208009 | 1.418568 | 0 | 4 |
| IMF financial stabilization programs | 2572 | .19479 | .396116 | 0 | 1 |
| IFI structural adjustment programs | 2572 | .3452566 | .4755443 | 0 | 1 |
| IFI poverty reduction programs | 2572 | .0793157 | .2702834 | 0 | 1 |
| GDP per capita, log | 2571 | 7.88634 | 1.097928 | 5.031514 | 11.38841 |
| GDP per capita change | 2571 | 1.472672 | 9.29169 | -64.36023 | 131.2425 |
| Urbanization rate | 2496 | 37.0597 | 22.49761 | 3.04 | 98.32 |
| Inflation rate, log | 2571 | 3.690258 | .5620575 | -1.306572 | 6.137897 |
| Trade openess, log | 2571 | 4.077237 | .6614034 | .6845449 | 5.869615 |
| Conflict intensity | 2572 | .3981337 | .6694742 | 0 | 2 |
| Regional diffusion | 2572 | 8.926187 | 2.269659 | 5.933333 | 13.61539 |
| External debt | 2006 | 78.85361 | 78.14358 | 0 | 765.7712 |
| Debt services | 2006 | 4.673335 | 4.504142 | 0 | 80.75671 |
| Foreign reserves | 1807 | 3.537719 | 3.526643 | 0 | 40.23842 |
| Domestic investment | 2571 | 15.62711 | 11.27466 | 0 | 73.16051 |
| Population size, log | 2572 | 9.027418 | 1.72019 | 5.054199 | 14.09454 |
| IMF board member | 2572 | .100311 | .3004727 | 0 | 1 |
| WB board member | 2507 | .1005185 | .3007501 | 0 | 1 |
| UN key votes with USA | 2572 | .1342108 | .090206 | 0 | .4444444 |
| UN key votes with GER | 2572 | .3162493 | .1501866 | 0 | .9602649 |
| UN key votes with FRA | 2572 | .2773475 | .1082334 | 0 | .6219512 |
| UN key votes with GBR | 2572 | .264487 | .1118858 | 0 | .6219512 |

## Annex 4: Participation in World Bank and IMF programs, 3-year period (first stage) [a)]

| | WB-INV | IMF-STB | IFI-SAP | IFI-PRS |
|---|---|---|---|---|
| **Included instruments** [b)] | | | | |
| Democracy index (t-3) | .004 | .004 | .016** | .006* |
| | (.014) | (.006) | (.008) | (.004) |
| GDP p.c., log (m-3) | -.795*** | -.021 | -.259** | -.047 |
| | (.230) | (.140) | (.112) | (.087) |
| GDP p.c. growth (m-3) | .003 | -.002 | .003 | .001 |
| | (.008) | (.004) | (.004) | (.002) |
| Urbanization rate (m-3) | -.006 | .014** | -.0009 | -.012*** |
| | (.015) | (.006) | (.006) | (.004) |
| Inflation rate, log (m-3) | -.077 | -.186** | -.266** | .041 |
| | (.241) | (.091) | (.106) | (.052) |
| Trade openess, log (m-3) | .247 | -.194** | -.104 | .115* |
| | (.241) | (.087) | (.097) | (.062) |
| Conflict intensity (d-3) | .077 | .027 | .015 | -.001 |
| | (.061) | (.027) | (.038) | (.014) |
| Regional diffusion (d-3) | .077* | -.065*** | .054** | .008 |
| | (.039) | (.022) | (.022) | (.007) |
| **Excluded instruments** | | | | |
| External debt (t-4) | .0003 | -.0005 | .002*** | -.0005* |
| | (.002) | (.0006) | (.0006) | (.0003) |
| Debt services (t-4) | .029** | .027*** | .016*** | .0009 |
| | (.011) | (.007) | (.006) | (.003) |
| Foreign reserves (t-4) | -.006 | -.011 | -.005 | .014** |
| | (.018) | (.010) | (.009) | (.006) |
| Domestic investment (t-4) | -.00003 | -.003 | -.007* | .0003 |
| | (.007) | (.004) | (.004) | (.001) |
| Population size, log (t-4) | -1.808*** | -.709*** | .109 | .640*** |
| | (.430) | (.240) | (.151) | (.122) |
| IMF board member (t-4) | .245* | .004 | -.086 | -.096*** |
| | (.134) | (.094) | (.081) | (.031) |
| WB board member (t-4) | .009 | .068 | .003 | -.007 |
| | (.127) | (.063) | (.062) | (.024) |
| UN key votes with USA (t-4) | -1.366** | .179 | -.805*** | .454** |
| | (.645) | (.267) | (.299) | (.176) |
| UN key votes with GER (t-4) | -.100 | .025 | -.357*** | .095*** |
| | (.179) | (.108) | (.095) | (.028) |
| UN key votes with FRA (t-4) | 3.124*** | .533 | .609 | -.642*** |
| | (.825) | (.362) | (.409) | (.198) |
| UN key votes with GBR (t-4) | -1.747** | -.624 | .484 | -.289 |
| | (.839) | (.446) | (.452) | (.216) |
| Observations | 1404 | 1404 | 1404 | 1404 |
| Countries | 65 | 65 | 65 | 65 |
| Partial R2 | .131 | .096 | .104 | .178 |
| F-test | 7.14*** | 5.35*** | 6.01*** | 5.35*** |
| | (.000) | (.000) | (.000) | (.000) |

a) Constant term not reported; robust standard errors in parentheses; *** p<.01, ** p<.05, * p<.10

b) Dependent variable in first stage is 3-year lagged participation in a World Bank sector investment program (WB-INV), in an IMF financial stabilization program (IMF-STB), in a World Bank and/or IMF structural adjustment program (IFI-SAP), or in a World Bank and/or IMF poverty reduction program (IFI-PRS).