Regional favoritism is widespread in the subnational allocation of development finance
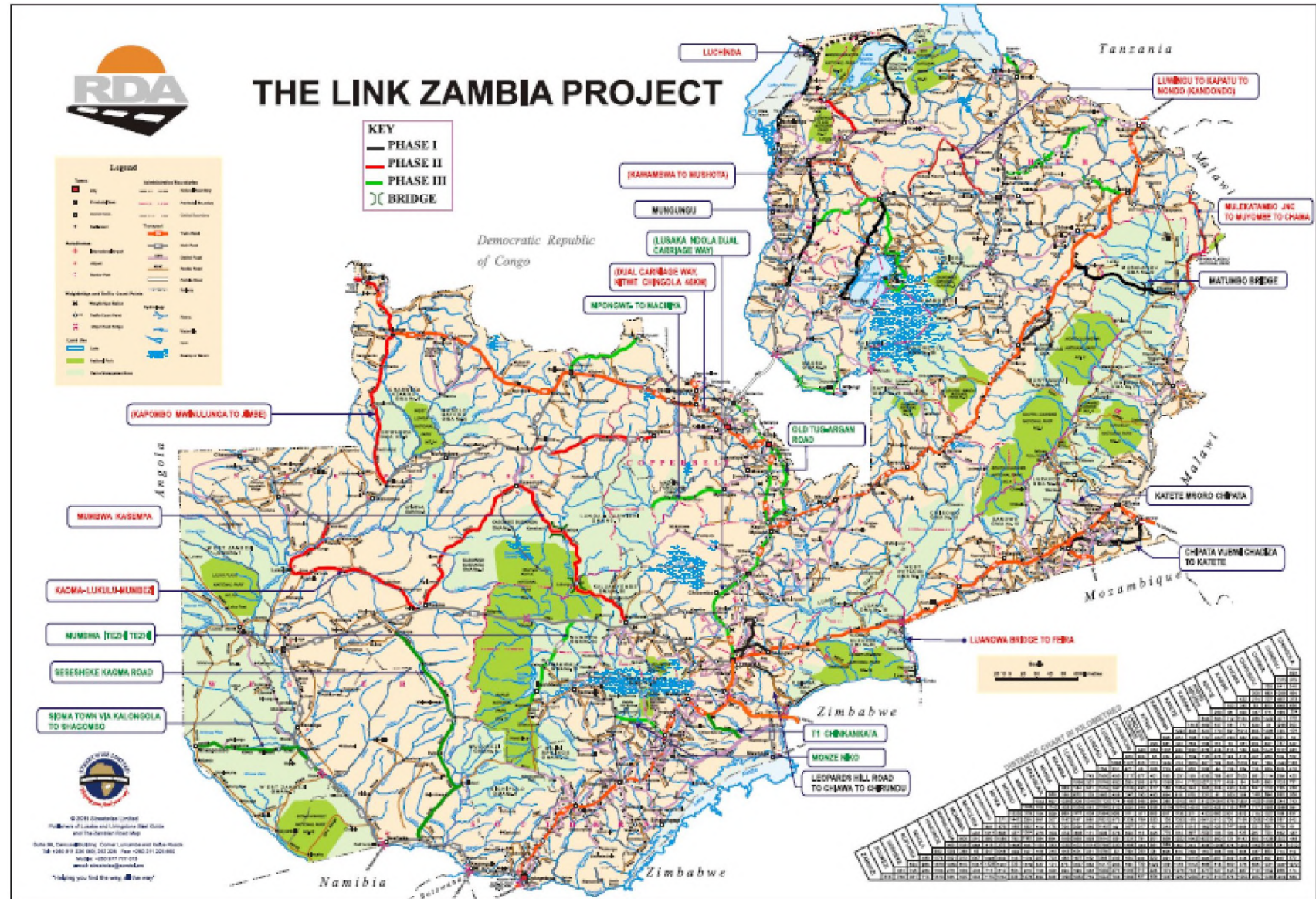
Research Question

What factors influence the allocation of development finance projects based on regional preferences of political leaders?

Existing debate: Determinants of Development Finance Allocation

- **Supply side: foreign financiers**
  - How constraining financiers' conditionality is (Dreher et al., 2019)

- **Demand side: recipient countries**
  - Recipient country's regime type (Burgess et al., 2015; Mesquita et al., 2003; Montinola, 2010)

- **My findings:**
  - Financier conditionality (only weakly) constrains regional favoritism in development finance allocation.
  - Political competition intensifies regional favoritism.

IV: Financiers' Conditionality

- Traditional financiers (like the World Bank) have stricter conditionality/review on projects

- But principal-agent problem in their project delivery could undermine the effectiveness of conditionality in constraining regional favoritism

Chinese finance has even fewer constraints, intensifies regional favoritism

Due to:

- **"Fragmented authoritarianism":** little constraint on state-owned enterprises' moral hazard (Zhang, 2019; Ye, 2020)

- **Non-interference foreign policy** (Dreher et al., 2019)

- **Lack of capacity**
  - 400 staff (China) vs. 15,000 staff (World Bank)

H1: External conditionality constrains but cannot prevent regional favoritism in development finance distribution

IV: Domestic political competition

- **"Value of democracy"** (Bueno de Mesquita et al., 2009; Montinola, 2010; Hodler and Raschky, 2014 ; Burgess et al., 2015)

  - Political competition **reduces** regional favoritism

- Rise of **competitive clientelism** in emerging democracies
  (Lust, 2009; Whitfield et al., 2015; Franck and Rainer, 2012; De Luca et al., 2018)

  - Political competition **exacerbates** regional favoritism

H2. Higher level of political competition leads to **more** political targeting in regional allocation, due to preferences to:

- Sway swing voters
- Reward co-ethnic/partisan strongholds

Overview

- Geocoded World Bank and Chinese development projects in 49 African countries, 1995-2017

  - District-year level:
    - Collapsed all raw project data to (adm1) district level (Dreher et al., 2019)
    - Which districts received more finance and which received less (or none)?

  - Project-district-year level:
    - Among funded projects, what were the political affiliations of recipient districts?

- Case studies on Zambia, Ethiopia, and Ghana
  - Administrative data from Ministry of Finance
  - 170 elite interviews

Unit of analysis: district-year

Dependent variable: (continuous)

- Annual flow of Chinese and World Bank finance to 48 African countries at the AMD1 level between 1995-2017 (AidData)

Independent variables:

- Coethnicity (Berman, 1998; Lindberg 2003; Posner, 2005; Bangura, 2006; Eifert et al., 2010)

- Financier (China / World Bank)

- Political competition: V-Dem's "regime of the world"

Control variables:

- District-level socioeconomic indicators, country-year FE

Identification strategy

$$Development\_Finance_{ict} = \partial_c + \delta_t + \beta_1 Coethnic_{ict} + \sum \gamma X_{ic} + \epsilon_{ict} \qquad (1)$$

$$Development\_Finance_{ict} = \partial_c + \delta_t + \beta_2 Coethnic_{ict} * Regime_{ct} + \delta Coethnic_{ict} + \theta Regime_{ct} + \sum \gamma X_{ic} + \epsilon_{ict} \qquad (2)$$

i: first-level subnational district
c: country
t: year

∂_c : country fixed effects
δ_t : year fixed effects
X_{ic} : sets of time-invariant control variables

Clustered standard errors at country-year level

Does conditionality matter?

Financiers' conditionatliy affects **the degree, not the occurrence** of regional favoritism

```
--------------------------------------------------------
                              Baseline Estimates
                          World Bank          China
--------------------------------------------------------
Coethnic                      0.657**        1.087***
                             (0.218)         (0.200)

Control variables              YES             YES

Country-Year FX                YES             YES

Constant                    -4.182***        -0.721
                             (0.604)         (0.399)
--------------------------------------------------------
Observations                   8310            8193
Adjusted R-squared            0.212           0.204
--------------------------------------------------------
Standard errors in parentheses
* p<0.05, ** p<0.01, *** p<0.001
```

13

Does political competition improve equity in development finance allocation?

Average Marginal Effects of Coethnicity with 95% CIs
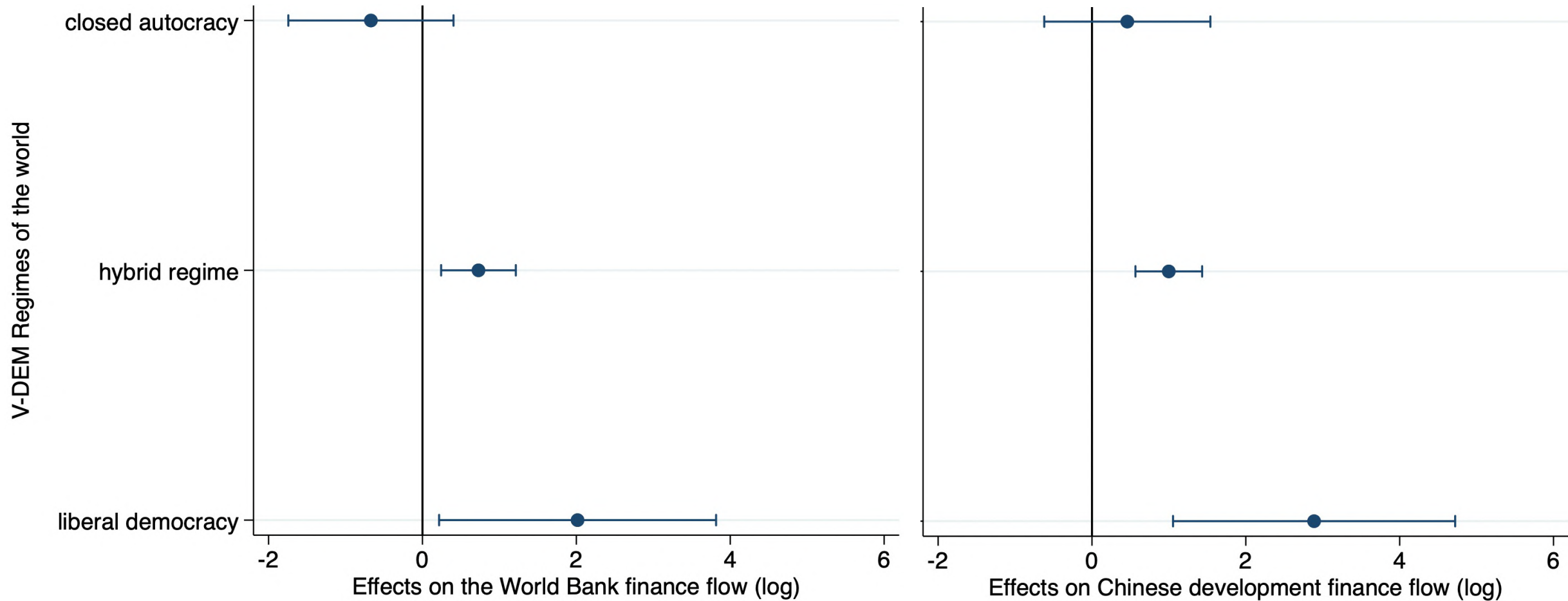
Unit of analysis: project-district-year

$$\text{Prob}\ (Region_{ict} = j) = \frac{\exp\ (\beta_j X_{ict})}{1 + \sum_{k=1}^{m} \exp\ (\beta_k X_{ict})} \quad for\ j = 1, 2, \text{ or } 3$$

$$\text{where } Region_{ict} = \begin{cases} 1, & if\ stronghold\ (incumbent\ vote \geq 60\%) \\ 2, & if\ swing\ region\ (incumbent\ vote: 40 - 59\%) \\ 3, & if\ opposition\ (main\ opposition\ party\ vote \geq 60\%) \end{cases}$$

Dependent variable: District political affiliation
- Categorized based on multiparty election results
- In countries without elections:
 - Classified using Afroborometer, EPR Atlas, literature review

Predictive margins of financier and regime types (95% CIs)

- **Democracy**: sway swing regions

- **Hybrid regimes**: reward strongholds

- **Autocracy**:
  - Higher probability of opposition district funding than democracy/ hybrid regimes

- Financiers' conditions most effective in democracy
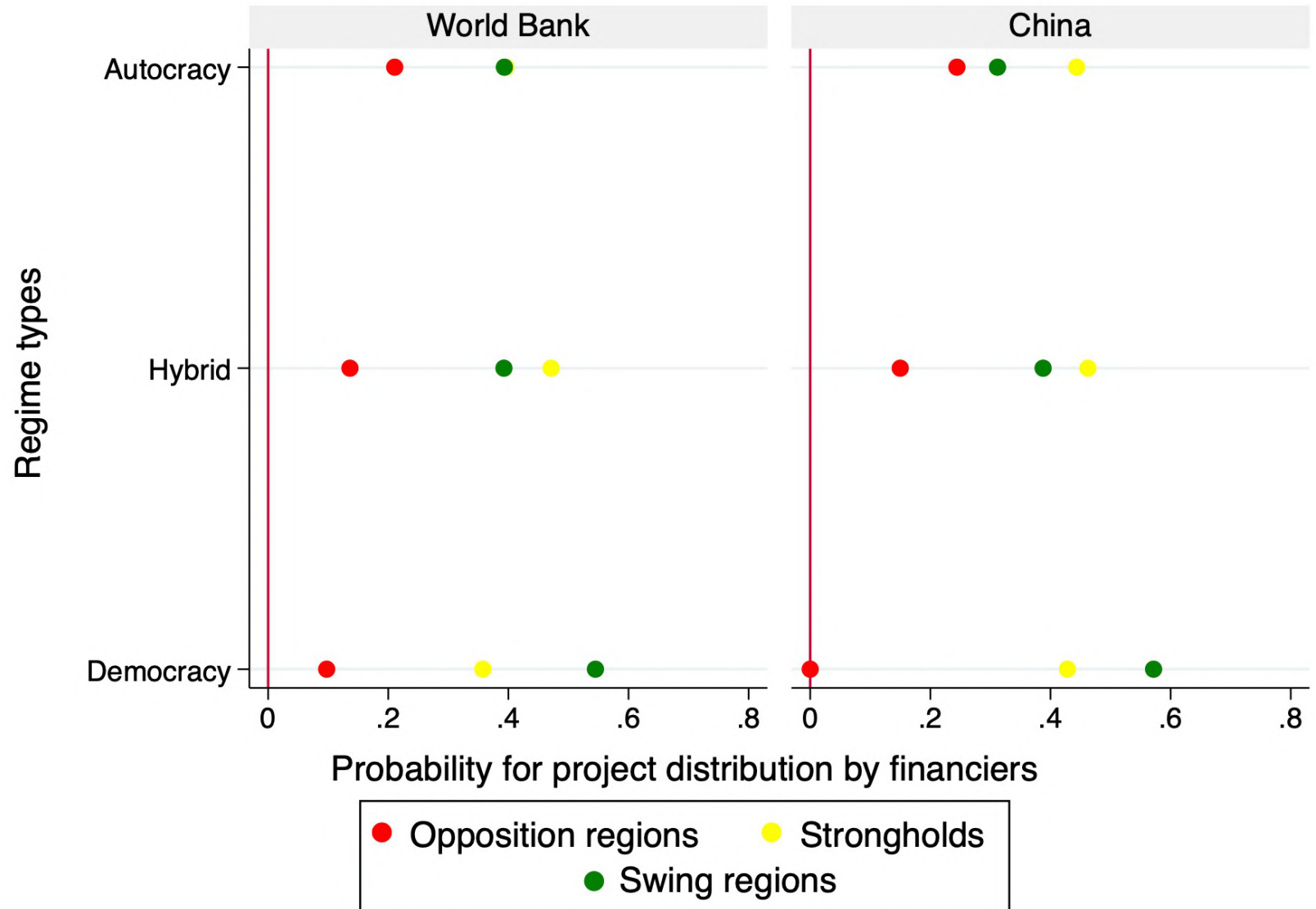
Does project sector matter?

- Project sector matter less for World Bank's project distribution than Chinese project.

- Leaders use hard infrastructure to reward strongholds and soft infrastructure for swing regions.

Average Marginal Effects of hard (vs. soft) infrastructure on the probaility of project distribution by financiers

17
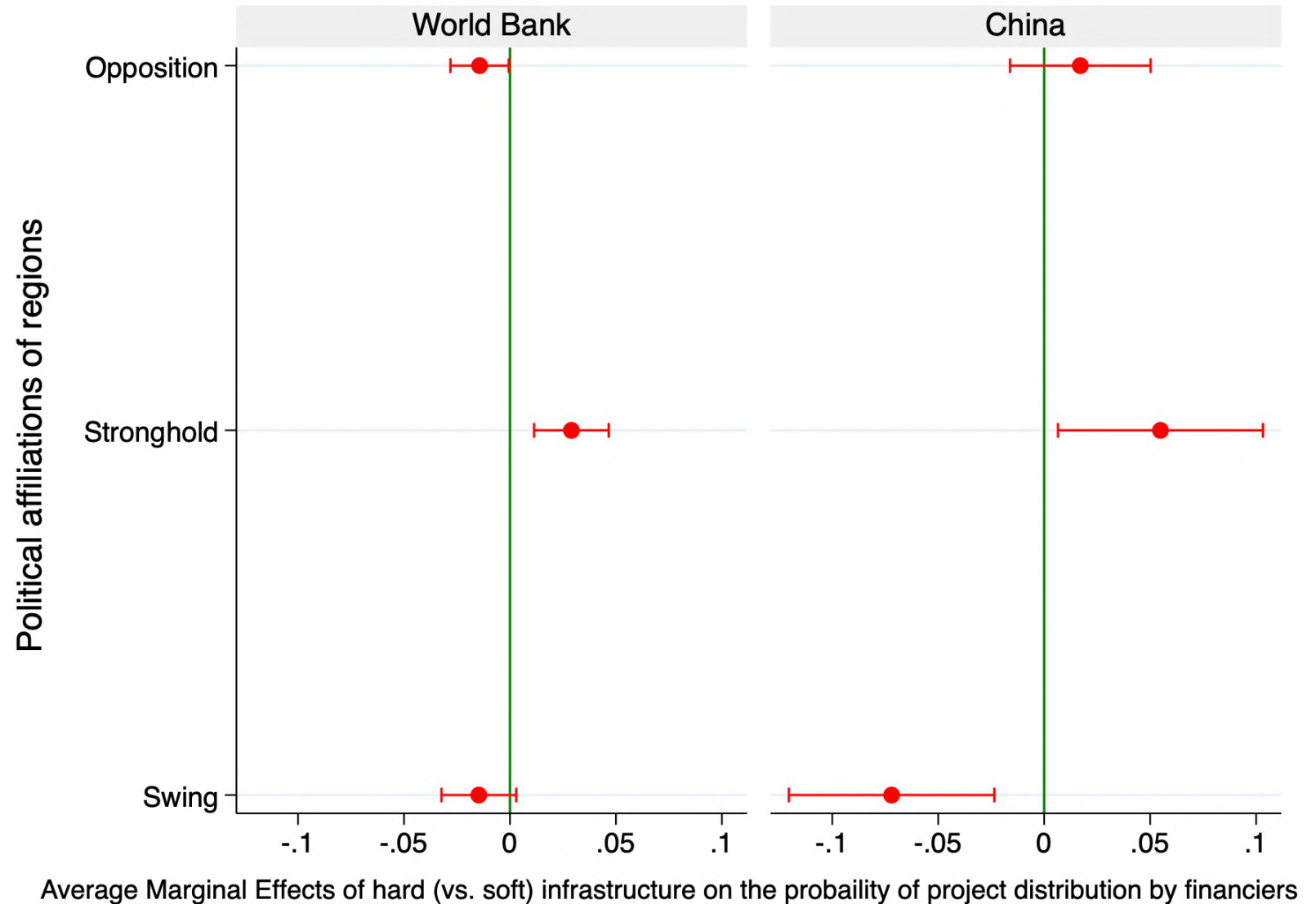
Summary of findings

- Financiers' conditions influence the degree, not occurrence, of regional favoritism.

- High political competition leads to more distribution in swing/stronghold regions.

- Provides granular explanation of distributive politics combining demand and supply factors.