Effect of Conditionality of Loans: The Comparative Analysis of the Kreditanstalt für Wiederaufbau and the Chinese Development Bank

By

Cooper Hendrix

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Supervisor: Professor Björn Bremer

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Abstract

Developmental Finance is an essential tool to help bring developing countries into the modern world, with liberal markets being built and public services being provided by advanced economies. The Kreditanstalt für Wiederaufbau of Germany and the Chinese Development Bank of China are both Developmental Financial Institutions that aim towards this goal. With both institutions being from different varieties of capitalism, their goals would vary, as would the conditions of the loans they provide. This thesis investigates to what extent that plays out in the recipient countries and how these loans can impact the human and democratic development of recipient countries. Based on the academic literature, the main focus is on the correlation between the amount of money given and how the Human Development Index, as well as a variety of democracy scoring systems, are impacted. These findings highlight the key differences of these two developmental financial institutions with statistically significant findings.

Author's Declaration

I, the undersigned, Cooper Hendrix, candidate for the MA degree in Political Science, declare herewith that the present thesis is exclusively my own work, based on my research and only such external information as properly credited in notes and bibliography. I declare that no unidentified and illegitimate use was made of the work of others, and no part of the thesis infringes on any person's or institution's copyright. I also declare that no part of the thesis has been submitted in this form to any other institution of higher education for an academic degree. However early draft portions of this work were previously submitted for the International Political Economy Fall 2023 class.

Vienna, 31 May 2024

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Cooper Hendrix

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Introduction

With the "End of History" after the fall of the Soviet Union, the liberal capitalist agenda has been without competitors on a large scale (Fukuyama 1992). Polanyi would claim that without the double movement, capitalism would become similar to Icarus and burn itself down (Polanyi 1944). State capitalism in China is one of the varieties of capitalism; however, it is in stark contrast to the liberal capitalism of the United States and the social market economy of Germany. The Chinese state holds a majority interest in the country's economic production, granting it a more remarkable ability to spread soft power to the periphery countries (Sanderson and Forsythe 2013). This is not to say that spreading soft power was, and is not attempted by Western powers, but to a different extent, reigniting the capitalist competition. For the study, we have a unique focus on developmental finance institutions in China and Germany, excluding the United States and international development finance institutions such as the World Bank or the International Monetary Fund. The institutions excluded are due to the ample literature already existing in the field. This tailored approach allows us to delve deeper into the roles of national actors and their respective banks. The liberal market regimes, such as the United States, will also be avoided in this study as extensive research has already been done on the relationship between the Chinese and the United States.

This paper aims to analyze a different relationship between a sizable Western democracy, that is, Germany, and of China's up-and-coming, if not already arrived, country as a player in the international economic sphere. With most Western Banks having the mandate to help improve democratic institutions in the recipient countries, many of the loans have conditions attached to them that would improve democratic institutions or required to have pre-existing democratic institutions in the recipient country. This study would like to examine the success of the Chinese Developmental Bank (CDB) and the Kreditanstalt für Wiederaufbau (KfW) (in English, “Credit Institute for Reconstruction”).

With developmental finance ever-evolving, there is no one right way to be the most effective Development Financial Institution (DFI). China and Germany are held to different standards and use various approaches to developmental finance. By viewing the results of these two countries through the success of their respective banks, CDB and KfW, we will see how these strategies affect the end solution. With this knowledge, we can provide evidence for further research into the failures and successes of developmental finance projects. This analysis will shed light on the achievements and failings of these two institutions, aiming to understand the effectiveness of these two banks better.

Western-backed DFIs have been studied intensively. The World Bank and the IMF have numerous studies looking at how they operate. It makes sense, as they are some of the largest DFIs in the world (Weaver 2008). Liberal market capitalism has also been studied significantly, with many of the DFIs following these ideals (Weaver 2008). It would be interesting to see with the varieties of capitalism if there is a difference in the outcome of the loans for countries’ main DFI if those countries have a different form of capitalism.

With Germany being a social market economy and the Chinese being state capitalist, their ideas of a successful loan would vary. They might target different types of countries, would loan out different amounts, and we would see different results. The development should both go up, with the democracy ratings only going up for the KfW due to the fact they would have conditionality attached to their loans.

Also, with these varieties of capitalism, they would have different conditionalities attached to their loans, allowing for the analysis. The social market economy has a main characteristic of attempting to have social equity, where state capitalism will try to control the economy to gain an economic advantage without the worry of democracy. With the KfW and the CDB coming from different forms of capitalism and neither coming from an over-studied location, it will be a novel approach to see how these two affect the democratic process in their borrowing countries.

The structure of the thesis will go as follows: First, we will have a literature review that will provide a comprehensive review of the existing research on this topic, such as developmental financial institutions and state-owned banks, and then a brief history of both the CDB and the KfW. After the literature review, a theoretical framework will be explained that helped guide the research. The Washington Consensus, varieties of capitalism, social market economy, state capitalism, democratic conditionality of loans, and the differences between social market economies and state capitalist economies in developmental finance will be spoken about. In this section, we will also explain the key concepts and variables chosen, such as the human development index, to show the success of developmental aid. Following this will be the methodology section, where the research design will be explained, as well as the justification for the chosen methodology. This will also include information on the data collection and processing process, and the justification for using the specific data sets. Then, the findings will be presented with figures and tables, as well as a fundamental analysis of the findings. A discussion section will immediately follow, where a more in-depth analysis will take place, with the limitations and biases that could have occurred during the study. Finally, the paper will provide the conclusion with a summary of the paper will be conducted as well as suggestions for further research. Overall, this paper aims to answer the research question: To what extent do divergent conditionality of loans affect democracy ratings and the Human Development Index within loan-recipient countries?

Literature Review

The world of developmental finance institutions has ample pre-existing literature that delves into the processes and the success of DFIs. There are many types of DFIs, some being multilateral banks, national banks, import and export banks, and traditional developmental banks (Gutierrez et al. 2011). DFIs help promote and finance private investment to create economic growth and sustained development while remaining financially viable for long-term success (Massa 2011). Their goals do slightly change when it comes to specific types of DFIs. An import-export bank's goal is to promote internationalization, investment state-owned developmental financial institutions could be focused on private sector promotion of emerging economies, and traditional developmental banks would generally focus on the economic cooperation of developing and emerging economies (Griffith-Jones 2016).

All of these have their own goals and success matrices. Therefore, it is possible to compare a multilateral development bank with an import-export bank or a multinational bank. The sheer amount of money transitioning hands is too large to be comparable. The International Bank for Reconstruction and Development had $420 billion in the fiscal year of 2006 alone, whereas the KfW peaked at just over $7 billion in 2020 (Weaver 2008; “Transparency | KfW Development Bank,” n.d.). When calculated for inflation, it is over $650 billion in 2024 for the International Bank for Reconstruction and Development. This would limit our ability to compare a national bank with a multinational developmental financial institution.

A gap in the literature exists when it comes to the comparison of the KfW and the CDB. There is, however, ample literature on the CDB and the KfW. This paper will use existing literature to bridge the gap and compare these two large DFIs. Chin and Gallagher speak on how the CDB is on track to become an essential and permanent part of the Chinese economy, and due to the lack of competitive bidding, Chinese soft power is spread to recipient countries

(Chin and Gallagher 2019). Naqvi and Henow believe the KfW changes the orthodoxy of the international economic order and suits the needs of their home countries for developmental goals (Naqvi, Henow, and Chang 2018). Mazzucato and Penna believe modern KfW finance derives from “mission-driven banks" focusing on smart growth in recipient countries (Mazzucato and Penna 2015). Groce and Köstem argue that there are minuscule differences between western and eastern DFIs (Skalamera Groce and Köstem 2023). With the connection of these two different literature themes, the literature gap in state-level development financial institutions will start to be filled.

Developmental Finance Institutions

Developmental financial institutions were derived from multinational organizations around the end of World War 2 (Weaver 2008). They were ruled by development, and then they turned to a more profit-driven model with the Washington Consensus (Williamson 2009). Laissez-faire decentralized banking systems studied in the 1990s called for long-term industrial finance with co-financing, targeted intervention, and government support, which has led to the desire to decentralize financial institutions into a more profit-driven model (de Aghion 1999). During the Global Financial Crisis 2008, Development Banks scaled up lending operations to help subsidize the private financial sector's difficulties in lending to risky businesses (de Luna-Martinez and Vicente 2012). The new strategy includes borrowing from households, small and medium enterprises, and even large corporations (de Luna-Martinez and Vicente 2012). “From Billions to Trillions” is the new idea behind international developmental finance, with state-sponsored private capital moving to developed countries as the primary source for developmental finance (Alami, Dixon, and Mawdsley 2019). The World Bank issued a “Maximizing Finance for Development” (MFfD) agenda in 2019, which has increased the need for private market actors entering the developing world to help developmental finance (Alami, Dixon, and Mawdsley 2019). The MFfD agenda has also brought along the ideas of state capitalism, liberal ideals, and a "New Cold War" (Alami, Dixon, and Mawdsley 2019).

State-Owned Banks

In the '60s and '70s, development economists supported the idea of government intervention in banking with direct ownership of banks and suggested that DFIs run a profit (Levy-Yeyati, Micco, and Panizza 2004). With these large profits, economists claim that the banks should create a large endowment and let the DFIs decide what to do with it; however, more recent ideas that state ownership of banks slow the private financial sector growth, leading to overall stunted growth (Levy-Yeyati, Micco, and Panizza 2004). With evidence showing that state-owned banks have nonoptimal credit allocation, others would argue that the slowing of the financial growth of a country is less accurate than previously thought and that banks should be viewed through a lens of the development goals as well as their stabilizing effects (Levy-Yeyati, Micco, and Panizza 2004). Public financial institutions have helped bring society through the COVID-19 pandemic through financial capacity and institutional structures, and it has been claimed that it could also help with the global climate crisis (Marois 2024). Conventional thinking holds that public finance should use private finance to socialize risks to help find cures to market failings (Marois 2024). With little applied research on the power that public development banks host on sustainable and healthy development, with private financial markets being the most profitable, research suggests that public DFIs can help alleviate this pressure by funding public goods that are not profitable and that need to be developed (Marois 2024). With most emerging and advanced economies holding onto state ownership, developing and transitional economies had a high influx of foreign-controlled banks and did not significantly weaken host states, with a variance of protectionism and openness to nationalized banks, worsening financial instability (Epstein 2014).

Kreditanstalt für Wiederaufbau

The Kreditanstalt für Wiederaufbau (KfW) was founded on November 5th, 1948, just after currency reforms had taken place in Western Europe (Grünbacher 2017). It was used as a crucial tool in the reconstruction of Germany after World War II. With US and British interests being aligned with the destruction of ultra-conservative Nazi-era German Banks being completed, the break from the Military Government installed by the Allied powers that was used was the creation of a German bank, that being the KfW (Grünbacher 2017). With the board of directors, chairman, deputy chairman, and board of managers being picked by Germans, this allowed for some autonomy in the country (Grünbacher 2017).

However, during the globalization of the 1980s, the goals shifted from the reconstruction of buildings to building up industrial sectors that could be used to help build the German economy, with the promotion of high technology and high value-add manufacturing (Naqvi, Henow, and Chang 2018). KfW was looking towards the capital goods sector for industrialization and new markets that were too risky for the private sector to finance (Naqvi, Henow, and Chang 2018). They also targeted exporting of German companies to new markets, such as Siemens and AEG, with foreign direct investment (FDI) being used to help promote German companies breaking into new markets, with 60% of lent Aid being returned to German firms (Naqvi, Henow, and Chang 2018). However, with the Maastricht Criteria, with debt needing to be controlled to join the Euro, along with pressure from the OECD (Organization of Economic Co-operation and Development) and the WTO (World Trade Organization), private markets were now the location from which the significant funding was coming from, therefore creating a need to limit spending, thus targeting what is now tradition markets for Western DFIs (Naqvi, Henow, and Chang 2018).

The KfW has 17 main sustainable development goals in which they want to get more involved ("More Commitment Needed | KfW Development Bank," n.d.). Those being the following: No poverty, zero hunger, health and well-being, quality education, gender equality, clean water and sanitation, affordable and clean energy, decent work and economic growth, industry innovation and infrastructure, reduced inequalities, sustainable cities, and communities, ensure sustainable consumption and production patterns, climate action, life below water, life on land, peach Justice and strong institutions, and partnerships for the goals ("More Commitment Needed | KfW Development Bank," n.d.). The paper will talk about the top five goals promoted by the KfW in a little more depth. For goal number one, no poverty, they aim to provide social protection, financial inclusion, and sustainable economic development, as well as women and poverty, and strengthen the capacities of local markets. With a total financial volume of above 4.3 billion euros, this is the main goal, with emergency aid going to the poorest countries ("SDG 1 – No Poverty | KfW Development Bank," n.d.). For no hunger, they plan on fighting climate change and hunger by creating sustainable agriculture and food supply, with commitments of 474 million euros, targeted towards India ("SDG 2 – Zero Hunger | KfW Development Bank," n.d., 2). With 582 million euros being funded, they aim to fight health and well-being by integrating healthcare systems, preventing diseases, both communicable and non, and creating proper access to healthcare, especially in Iraq, Cambodia, and Pakistan ("SDG 3 – Good Health and Well-Being | KfW Development Bank," n.d.). In 2022, 435 million euros were committed by the KfW to help promote primary and higher education, as well as vocational training, in countries such as Yemen, the West Balkans, and Palestinian refugee camps ("SDG 4 – Quality Education | KfW Development Bank," n.d., 4). In African countries and Lebanon, plus others, more than 205 million euros have been contributed in 2022 to help fight gender inequality by promoting financial inclusion, participation, and gender mainstreaming, as well as pushing for the abolition of forced marriages ("SDG 5 – Gender Equality | KfW Development Bank," n.d., 5). An essential thing that follows this thesis is sustainable development goal 16: peace, Justice, and strong institutions. this goal is Free independent elections, systems of ownership, a solid financial system, and permanent and legal oversight, inadvertently creating democracies ("SDG 16 – Peace, Justice and Strong Institutions | KfW Development Bank," n.d.).

The KfW also actively funds green investments, part of the UN's SDGs, in Europe and emerging economies worldwide (Griffith-Jones 2016). The bank has offices in over 60 locations worldwide but operates mainly commercial banks housed domestically in Germany. It refinances USD and Euros in international and capital markets (Griffith-Jones 2016). With its ties to the German Government, in the form of a guarantee, the AAA ratings allow for issuing bonds in terms that favor the KfW (Griffith-Jones 2016). KfW has also entered FinTech with software with feature modeling that will improve its retail loan portfolio based on mandatory and optional loan aspects, creating a faster approach to bringing loans to the market (Fritsch, Abt, and Renz 2020).

Chinese Development Bank

The China Development Bank (CDB) was established in 1994, with 157.7 billion US Dollars (USD) in Capital while loaning out 1.28 trillion USD (Wang 2016). That is a loan-to-capital rate of 8.2, meaning they have eight times as much loaned out as they do have of capital. They also have 1.66 trillion USD of assets, equating to about 16% of China's GDP (Wang 2016). This is much larger than the similar banks in Asia, with the Development Bank of Japan loaning 0.112 trillion USD, and the two banks in Korea, Korea Development Bank, and the Korea Finance Corporation, even after their merger loaning only 0.246 trillion USD (Wang 2016). The largest loan receivers of CDB money are concentrated around the Asia-Pacific, being over 50% of all loans, and China is the largest receiver at 39.78 (Wang 2016). This shows that the main target of the CDB is to keep the money in or around their economy so that they could have the potential to control the vast amount of resources in their country and the surrounding area. With the most significant shareholders being the State Administration of Foreign Exchange, the Ministry of Finance of China, and the Central Huijin Company, most of the primary stake comes from the state (Wang 2016). Being controlled heavily by the state is just a way for the state and the communist party in China to gain further soft power outside of their borders (Wang 2016). Also, with the gap in infrastructure creation not being filled by the private sector, the state needed to take control and help build the industrial sector in China (Sanderson and Forsythe 2013). With the China “Go Global” Strategy, the CDB wants to control and have the stability of external resources and energy supply with the implementation of loans (Wang 2016). The “One Belt and One Road” initiative has drastically increased CDB’s assets in overseas locations, with a multitude of significant projects for resources, infrastructure, and other vital industries, all in countries that this project will expand into (Wang 2016). The main sectors in which the Chinese Development Bank operates are energy, transport, water resources, agriculture, logistics, and underground utility tunnels. In 2022, they issued RMB 1.4 trillion in loans (“China Development Bank_Strategic Priorities,” n.d.). The exchange rate of 7.08RMB to 1 EURO is over 195 billion euros (“ECB Reference Rates,” n.d.). Their goals include water conservation projects that are vital to the people's livelihood, which is essential to welfare as water can be viewed as a human right. They also provided RMB 49.6 billion of interest-free student loans that helped over 5.15 million students, along with RMB 130.2 billion that benefited over 278,000 households with affordable rental housing, along with 26 million households allowing them to move from slums to brand new apartments (“China Development Bank_Strategic Priorities” n.d.). They also deal with elder care and healthcare but to a lesser extent.

There are a few main differences between the CDB and the KfW, as well as other Western DFIs. One difference is that they do not use callable capital for loans, as well as being on large-scale loaning compared to the Asian Infrastructure Investment Bank (AIIB), New Development Bank (NDB), and other Western DFIs (Chin and Gallagher 2019). The AIIB aims at a medium scale, and the NDB and Western DFIs aim for small to medium scale (Chin and Gallagher 2019). There is also a difference in lending currency; with Western DFIs lending in USD and local currency, the CDB lends in USD and RMB, the local currency in China, along with a target of energy and infrastructure rather than poverty alleviation, as compared to Western DFIs (Chin and Gallagher 2019). The main difference, however, is that there is no policy set for the conditionality of loans, which, compared to Western DFIs, has micro- and macro-level conditionality of these loans (Chin and Gallagher 2019). The CDB, however, generally loans to countries and sectors not targeted historically or currently by Western DFIs, especially the KfW (Chin and Gallagher 2019). More recently, as a country, China joined the BRICS (Brazil, Russia, India, China, and South Africa) Development Bank project in 2013. With political interests, China can influence the norms of DFIs and development in general (Abdenur 2014). This allows them to change the global DFI market and turn it into what they want to use to succeed.

Theoretical Framework

The theoretical backing for this paper is the idea behind state capitalism versus the ideal of the Wall Street Consensus (Schindler, Alami, and Jepson 2023). This is to compare the concept behind the state capitalism of China and the CDB and the Wall Street Consensus-esq ideal of the KfW in Germany. The theory would suggest that Western-backed DFIs, such as the KfW, would follow the Wall Street Consensus (Schindler, Alami, and Jepson 2023).

Washington Consensus

To understand why the Wall Street Consensus is essential, we must first understand the orthodoxical thinking that preceded it, the Washington Consensus. It was initially conceptualized by John Williams, who made a list of 10 policy reforms to help development in Latin America (Williamson 2004; 1993). These reforms boil down to three principal ideals: privatization of state companies, liberalization of trade and capital, and macroeconomic goals (Gabor 2021). Basically, in countries backed by loans from Western DFIs, primarily the World Bank, the economies should lean towards more of a liberal economy. Fiscal discipline, liberalization, and privatization are all hallmarks of a liberal market economy.

This form of developmental finance has raised criticism, as there have been arguments that this is just neoliberalism orthodoxy, having a stranglehold on developmental finance (Deeming 2013). This causes a trade-off between efficiency and equity, with the goal of equity. However, efficiency would be needed (Williamson 2004).

With the Washington Consensus having the lowest common denominator of policy, it created a one-size-fits-all approach to development, causing the policies provided to be unable to combat poverty (Williamson 2000). The main idea of the Washington Consensus that has stayed with us today is the idea of conditionality. Both private lenders and official organizations use policy instruments to achieve certain types of goals. Still, they have come to be exclusively applied to governments of developing countries that receive aid (Babb and Carruthers 2008).

Varieties of Capitalism

The idea behind the varieties of capitalism is how different forms of political economy and institutional structures affect economic performance, equity in society, and policy-making (Hall and Soskice 2001). This would lead to a strong correlation between an institution's organization and its financial activities, in which the country would have a comparative advantage (Amable 2003; Chin and Gallagher 2019). This idea focuses on the foundations of political economies shaped by private actors pursuing self-interested behaviors, leading to the solving of collective action problems (Hall and Thelen 2009).

This framework is used as a reference for studying national political economies, with political institutions as the main focal point (Bruff and Horn 2012). Behind political economy institutions, there are limitations and propositions of new ideas, with critics discussing the failings of the concept (Wilkins et al. 2010). This approach can be applied to various contexts, such as differences in the internationalization of domestic universities, inequities in national models, and the unique way each country creates capitalism (Graf 2009; Rafiqui 2010). It can also be used to explain corporate governance and what is used to determine how each company runs, as well as the unique differences in European political economies, even though they share a similar history and goal with the EU (Rapacki and Czerniak 2018; Aguilera and Jackson 2003).

The idea of the differences in capitalism allows researchers to view the effects of political institutions on the national economies and economic activities of domestic individuals.

This approach provides for explaining and categorizing the varying forms of capitalism in the modern political economy.

Social Market Economy

The idea behind the social market economy (SME) is a model that combines the elements of capitalism with social welfare, characterized by a strong market economy with a social security net to create economic stability and equitable livelihood (Strat and Ștefan 2017). It is also known as Rhine capitalism because one of the major economies that follows this model is Germany, and it plays a significant role in the modern world as a political economy model (Strat and Ștefan 2017).

The social market economy stresses the importance of sustainable growth and development with the idea of prosperity for all society members, not just citizens (Strat and Ștefan 2017). So, economic efficiency with the promotion of collective well-being can be a framework in which political economic activities can be viewed.

The goal of the social market economy is to create an interaction with social, democratic, and political institutions to create a thriving economy that also achieves social goals with the creation of strong institutional frameworks, with their role being in supporting the social market economy (Schneider 2021).

State Capitalism

State Capitalism (SC) is an economic system where the state is the majority stakeholder in financial activities, as well as controlling and owning key sectors and industries, with their involvement being used through their influence over private actors and the allegation of capital to corporations (Wright et al. 2020; Musacchio and Lazzarini 2012). The state is an individual player in the economic sphere it controls. There are two forms of State capitalism, one being state capital, where the state has ownership in capitalist enterprises, and the other, where it has control over private economic activities, also known as statism (Wright et al. 2020). From the idea of Marxists, it has evolved into surplus production in the value chain and an international division of labor (Alami and Dixon 2023). China is a prime example of a country that follows the ideal of state capitalism, as they control large parts of the private market and partake in an international division of labor (Wang 2016).

Democratic Conditionality of Loans

Democratic conditionality for the loans provided by developmental financial institutions is the use of conditions attached to financial institutions that promote democratization and accountability in the recipient country (Pevehouse 2002; Donno 2013). With the Washington consensus, loans are economically driven; however, democratic ideals are growing and playing a role in foreign aid, investment, and loans, allowing them to point at stability for reasoning (Donno 2013; Williamson 1993).

These conditions encourage recipient countries to follow a democratic set of ideals. With ties to financial goods, transparency, and accountability are the goals for the lending countries to apply to the borrowing countries (Mayer and Mourmouras 2007). This also assures the recipient country that financial support will be continued if the conditions are met (Mayer and Mourmouras 2007).

The loan conditions apply to the recipient country, going as far as having requirements on liberalization of labor markets, which will affect employment, earnings, social benefits, and more inside the countries, with other aspects such as increased spending on education (Caraway, Rickard, and Anner 2012; Cormier and Manger 2022). Within democratizing regimes, loan growth positively and significantly impacts political rights and civil liberties

(Asutay and Mohd Sidek 2021). The KfW follows the standards of conditionality set by the World Bank and the International Finance Corporation (Klagge et al. 2020).

SME vs. SC in Developmental Finance

With the social market economy and state capitalism being two drastically different economic models, their developmental finance works in two distinct ways. The social market economy, being both aimed at economic growth and social welfare, will try for economic growth while keeping in line with equity and stability in the country (Beck and Levine 2002; Langley 2020). State capitalism, however, would drive for state ownership or control of the economy, including central sectors and or industries, making the only goal whatever the state prioritizes (Dowling 2017).

The social market economy is driven by the importance of a democratic government, transparency, and accountability. It tries to realize these factors in recipient countries by creating a nurturing environment for equity and social cohesion while maintaining successful development (Beck and Levine 2002; Langley 2020). The social market economy developmental finance model tries to create a hotbed for entrepreneurship while not specializing too deeply but growing all sectors alongside one another (Beck and Levine 2002).

This is in contrast to state capitalism, which uses interventionist tactics to control the economic markets, destabilize the allocation of capital and regulations, prioritize domestic state interests, and only finance projects that directly benefit the state (Dowling 2017). These models have unorthodox financial instruments that will impact the social and economic situations in the recipient countries (Dowling 2017).

The social market economy model focuses on sustainable development while privatizing the market along with the focus on social equity; the state capitalist model focuses on state guidance of integral sectors and markets (Dowling 2017; Langley 2020)

Theoretical Backing

The Kreitanstalt für Wiederaufbau is the premier development bank in Germany ("Our Tasks and Goals | KfW Development Bank," n.d.). Since 2015, it has followed the United Nations (UN) Sustainable Development Goals (SDG). Realizing that these will not be achieved by public funding alone, it has pivoted to allowing for the mobilization of private capital in recipient countries ("More Commitment Needed | KfW Development Bank," n.d.). The fact that they have followed the UN SDGs shows they are a Western ideal-inclined bank. Also, the fact that they are pushing for the mobilization of private capital shows that they also follow Western-backed liberal market ideals, including the Washington Consensus. With their shift to the mobilization of private capital in recipient countries, they follow the same ideal as the Washington Consensus, which aims for market liberalization, financial deregulation, privatization, and fiscal discipline (Schindler, Alami, and Jepson 2023; Volberding 2018).

Our research questions are of significant importance: To what extent do divergent conditionality of loans affect democracy ratings and the Human Development Index within loan-recipient countries?

Here are the following for the hypothesis:

Hypothesis 1: There will be no statistically significant increase in democratic scores within Chinese Loans recipient countries.

Hypothesis 2: The Human Development Index should increase inside Chinese Loan recipient countries.

Hypothesis 3: There will be a statistically significant increase in democratic scoring within countries receiving KfW loans.

Hypothesis 4: The Human Development Index should increase within countries receiving KfW loans.

These hypotheses were chosen because the German KfW has conditionalities attached; therefore, it is safe to hypothesize that there will be an increase in Democratic scoring within the countries receiving KfW loans. The CDB, however, does not have these conditionalities attached to their loans; therefore, there should be less of an impact on the democratic score in the recipient countries. The human developmental index is used as a proxy for development; this will be explained in greater detail in the methodology section. However, one cannot believe that as the primary goal of a developmental Finance institution would be to increase the development of a country, both banks would share in the success of expanding the proxy variable of the human developmental index inside the recipient countries.

The study's objectives are to see how successful the Chinese Developmental Bank and the Kreditanstalt für Wiederaufbau are at delivering developmental aid that increases the country's development. We would also like to examine how democratic institutions have increased or decreased. This is important to study as we will be able to reliably conclude whether or not developmental finance is successful at improving overall development inside the recipient countries, as well as seeing if the conditionality of loans that Western banks create are necessary for increasing democratic institutions, or if they do their job at all.

Methodology

The paper's methodology employed a novel statistical approach. Data from over five locations was collected, and the analysis used a linear model. This form of statistical approach allows for a comprehensive view of the effectiveness of DFIs from both development and democracy perspectives, as well as robust findings.

The research methodology collects historical data based on the year, and the loan amounts to the recipient country from the KfW and the CDB. This data will be complemented with data from the human development index and multiple democracy scoring indexes, which can be used to assess the effectiveness of loans. The human development index will be used as a proxy variable for development. As there are flaws in development scoring systems, the human development index is an excellent alternative variable, showing the overall likelihood of the country's development. With the overall livelihood of individuals in a recipient country going up based on loans, one can see a correlation between the loan amount and the development of the recipient countries. This is not to claim causality between the two, as there are multiple reasons why a developmental index would show an increase in developmental aspects. Still, if there is statistical significance in the correlation between the loan amount given out by the KfW and the CDB, a conclusion could be drawn as this money would affect the recipient countries, and the effect this money brings could affect the country's development. A similar analysis would be used for democracy scores as well. Political rights and civil liberties will be used as the variables for the success of democracy and the combination of the two. Similar conclusions can be drawn from the political rights and civil liberties as from the human development index, as it should be reiterated that correlation does not mean causation; however, if there is a strong statistical significance, then the correlation can be used as a conclusion that whatever this money affects could have a dominant relationship with the democratic scoring of the countries. With a linear model being run, we will be able to find all of these relationships and have a discussion about the consequences of developmental finance in developing countries.

Data Collection

Data collection is of utmost importance for this type of study. If the data is faulty, then the findings would be inconsequential. The Chinese Developmental Bank is not known for its transparency; therefore, outside sources must be used. Luckily, many academic institutions are tracking the development of Chinese finance around the world. AidData is one of them. It is located at the Global Research Institute at William & Mary, a university in Virginia (Custer et al. 2021). They try to collect data for decision-making purposes from traditionally data-poor environments. They are an excellent source to use as they would be impartial as an academic institution and constant data collection. Data from the Global Policy Center of Boston University was also used in the study of the case of the Chinese Developmental Bank ("Global China Databases | Global Development Policy Center" 2023). This Center researches financial stability, human well-being, and environmental stability, providing a convenient place for scholars to engage in the data. Once again, this is an outside source; therefore, the motives are less tied to making the bank and country look successful and more to creating the best world possible. The Kreditanstalt für Wiederaufbau has a drive toward transparency as they have a portal dedicated solely to transparency on a website. Data for this bank was collected from them individually; however, it was exclusively in German. A translation software was needed to compare countries with countries from the CDB data and other data sources to match data to each other; the country variable was used, therefore needing exact copies of the names of the countries for the code to find a match. The Human Development Index, operated by the United Nations, is used as a proxy for development in the recipient countries. This is because they take into account the health, education, and standard of living in each country (Nations, n.d.). This is good as it can work to show quantifiable results for development, and be used as the dependent variable in the linear models that were run. Also, an international organization dedicated to “peace, dignity, and equality on a healthy planet” has less dependency on profit margins; therefore, they can be more independent in their assessment, and consequently, they can be collected without having to go through with a third party (“United Nations | Peace, Dignity and Equality on a Healthy Planet,” n.d.). Also, the Integrity of the data can be upheld as it is an international organization respected in the global financial market. Our World in Data, a non-profit by the University of Oxford, was used for the Democratic scoring (Herre et al. 2024). They also include V-Dem data to help with their analysis, therefore helping legitimize their data. They had a scoring system going back to 1990 for the Political rights and civil liberties of over 200 countries. Some of these countries, such as North and South Vietnam, do not exist anymore; however, the data for modern countries is in there as well. The Economics Intelligence EIU report has a quantitative scoring method for the democracy of countries going back to 2006, which is far enough for our study (“Democracy Index 2023” 2023). The reason the EIU was used rather than any alternative is due to the fact that they use broader aspects to calculate democracy, with a more weighted index, allowing for more verifiable results.

The data that could be collected reliably for the Chinese Developmental Bank starts in 2008 and ends in 2021. The KfW, on the other hand, began in 2007 and runs to 2024. Due to data constraints, the study will use data from 2008 to 2021 to compare these two banks. So, you first look at some descriptive statistics of locations of loans, the quantity of loans, and the timeline of said loans. This is to get an overview of the data so that the following findings can be perceived to the greatest extent. This can even be used to see if the theory holds that for prolonged involvement of the KfW in the recipient country’s developmental aid, they must continue to meet democracy standards. After that, we can combine all the data sets, making sure to keep the KfW and the CDB data separate so that we have two different data sets to work with. Combining all the data sets would include the EIU rating, the PL and the CR ratings, and an individual bank loan to the country. Some data cleaning will be necessary as the data frames do not come with the same ID systems or in the same formats. Are will be the program used to help shape the data frames into usable data frames for our purposes. The one data frame that would not be possible to do in our was the KfW data set, as it was in German. The countries had to be translated from German to English by hand using software such as Google Translate. Also, the regions, when comparing the CDB data as well as the KfW data, had a less than 100% lineup with the CDB as the KfW data joined both Oceania and Southeast Asia. In contrast, the CDB data frame had Oceania and Asia separately. To clean the data setup, the researchers had to go in by hand and double-check all the countries labeled as Oceania - Southeast Asia and code them properly. One thing that needed to be done was merging all the data sets together to create one that had the recipient country, the year, the loan amounts, and all other dependent variables. If a linear model were run just on that, we would not be testing how the loan affects the dependent variables based on the time; instead, we would be testing which countries the bank lends to. So, what was done, to help test the loan amounts on the country's future, was to test that on the next four years of the dependent variables. Therefore, the loans given in 2017, for example, would also look at the EUI score as well as the developmental index scores of the year 2021 for any particular country. This would allow for creating a relationship between the loan amounts and the dependent variables. With this, if statistical significance was found, we can see the relationship between the independent variable and how it affects future dependent variables. Once the data frames are comparable, linear models can be run. Then cases, the Our World in Data Variables of political rights and Civil liberties, will be used to judge if democracies received more or less money, as well as the same year EIU scores.

We look at HDI's effect on the time of the loan to be able to view, on a more generalizable scale, the types of countries that the banks loan to. Other types of variables include EUI scores and PR and CL scores. With this, we can see where the money goes too. If the coefficients of the independent variables are negative, then that means that the country will lend primarily to countries with lower independent variables, and if the coefficient is positive, then the opposite occurs.

With the linear models being run, we can compare and contrast these two banks on whether the money they lend affects the democratic institutions of the recipient countries by seeing how it affects the EIU scores, and as well if it even works in bringing development to the government, by looking at the HDI scores. A linear model is the best method for this type of research as it allows us to see how closely these relationships are tied and how certain they are. This study would have to be a quantitative analysis because the data for specific variables were collected from centralized sources, not localized ones. This will help the integrity of the research because it will increase the validity of the data, therefore increasing the validity of the findings. In the next section, we will discuss the findings, and we'll start to speak on the implications of these findings.

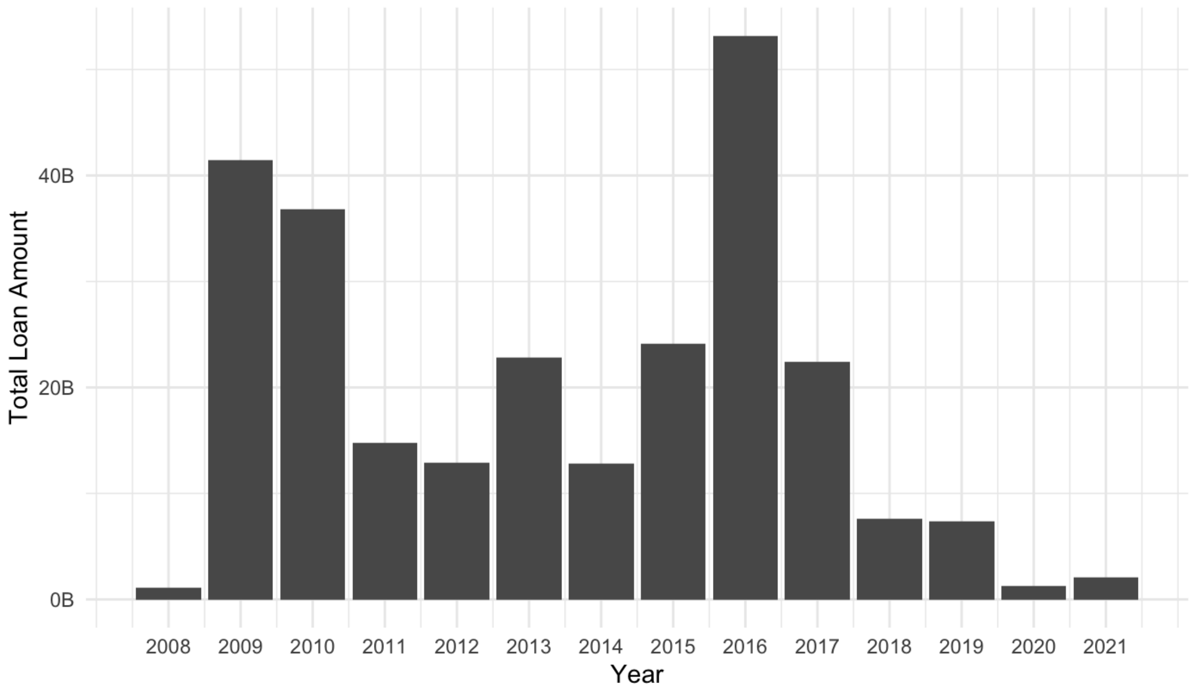
The size of the units for the study is "Year," which will be in a year and have a monetary value of 1 million United States Dollars. The data for the CDB came in that unit, with the data from KfW coming in dollars. Converting the unit by just dividing it by one million was easy; the study could get the units for all data sets to be the same.

The data collected and analyzed will only be from countries that have received a loan from the Chinese Developmental Bank of the Kreditanstalt für Wiederaufbau. So, this study will not include countries that have not been sent loans from either of these banks from 2008 to 2021. This will impact our analysis based on selection bias, as we will only look at the countries that have received loans. This is not to worry as we only focus on whether developmental finance works for recipient countries. It would not be fair to compare countries that have received the loans to countries that have not received any loans. Firstly, the countries that did not receive the loans are more likely to be developed nationals already with advanced economies; therefore, limiting their ability to climb the development ranking is more complex and more challenging. This means that going from 1.5 to 2 is more feasible than going from 9.0 to 9.5. It would be an interesting study to be conducted, but for the purpose of this paper, there is no need to include countries that have not received any loans in the datasets.

Findings

The findings and results section will review the study's conclusion. The first part of the study will be some descriptive statistics, which are graphs from both the CDB and the KfW.

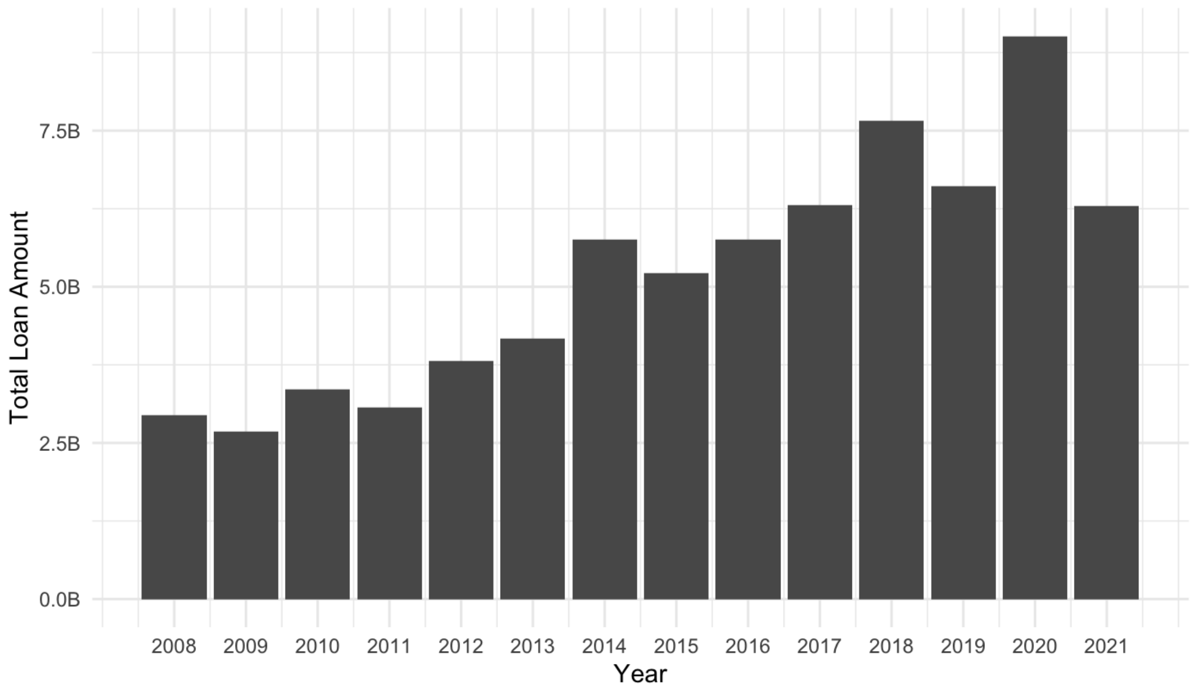
Figure 1: Total Loan Amount Over Time CDB



(Custer et al. 2021; "Global China Databases | Global Development Policy Center" 2023)

Figure 1 shows the breakdown of the CDB loans by year. The year that stands out is 2016, with just under 87 billion US dollars contributing significantly to their total loan amount of 496.4 billion USD. This is in contrast to Figure 2, where the German KfW bank only had 72.7 billion USD loaned out in the same time frame, with their biggest year being 2020. As we can see between the two banks, the KfW bank has steadily increased its loan amounts over the years, and the Chinese developmental bank has varied widely in its loan amounts per year. This could be due to a myriad of reasons, one being that the Chinese still

Figure 2: Total Loan Amount Over Time KfW

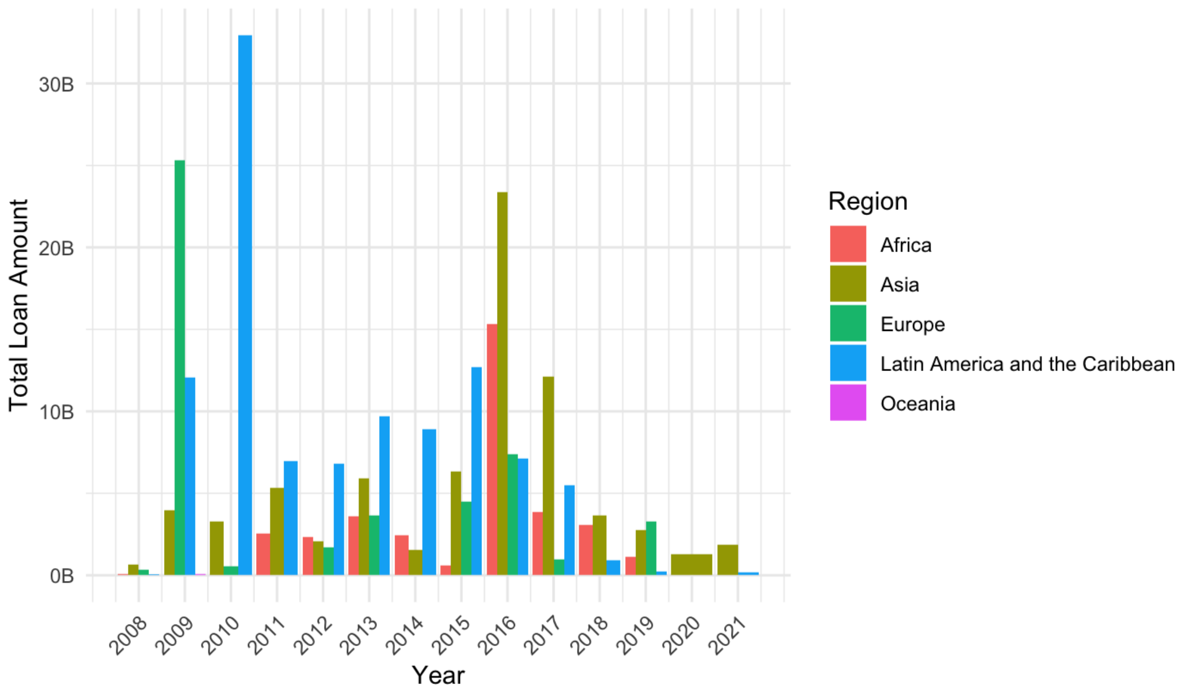


("Transparency | KfW Development Bank," n.d.)

needs a stable way of acquiring designated countries, or the KfW systematically pushes to increase its loan amounts. This means that the Chinese are still looking for recipient countries that are willing to take on Chinese loans, creating a varied amount of money per year depending on when the loans are guaranteed. KFW, on the other hand, most likely has a sustained clientele that is willing to borrow money from this reputable bank, allowing for a more stable lending pattern. Another possible reason for the variance of loan amounts per year is that the CDB can loan out one-shot loans, whereas the KfW will have a systematic loan going to the same countries year after year. This means that these countries that are receiving the loans are only willing or able to borrow a low amount of times, whereas the KfW clientele would be able to have a sustained ability to borrow. This also follows the theoretical idea that the assurance of the KfW is to continue to lend to countries that have continually met democratic conditions built inside of the loans.

If we look at the regions the banks are active in, the Chinese Developmental Bank bounces from region to region, changing their loan amounts per year. This could be due to the same reasons as before or other reasons. If we look at the European region, they received around 25 billion USD from the CDB in 2009 but never surpassed 10 billion after that. A similar situation happened in Latin America and the Caribbean, with over 30 billion USD in 2010 and only 10 billion more in 2015. Africa and Asia peaked at over 20 billion and 15 billion USD, respectively, in 2016.

Figure 3: Total Loan Amount by Region Over Time for the CDB

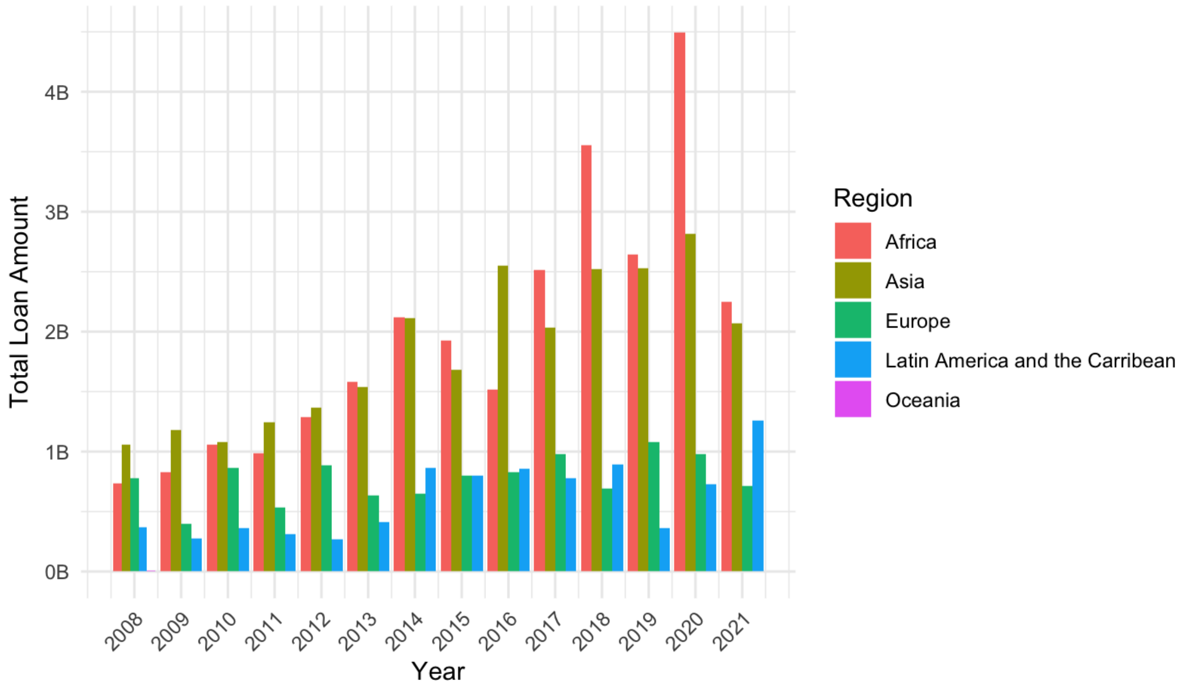


(Custer et al. 2021; "Global China Databases | Global Development Policy Center" 2023)

The KfW, however, does not and has steadily increased throughout the years, just like in Figure 2, where there was a steady increase. The central regions targeted for the KfW would be Africa and Asia, both at the top of the targeted regions year after year. The sheer monetary amount is not the same as the CDB; however, it is essential to note that the increase is steady, with the only dropoff in 2021. This also follows the theoretical idea that the assurance of the

KfW is to continue to lend to countries that have continually met democratic conditions built inside of the loans.

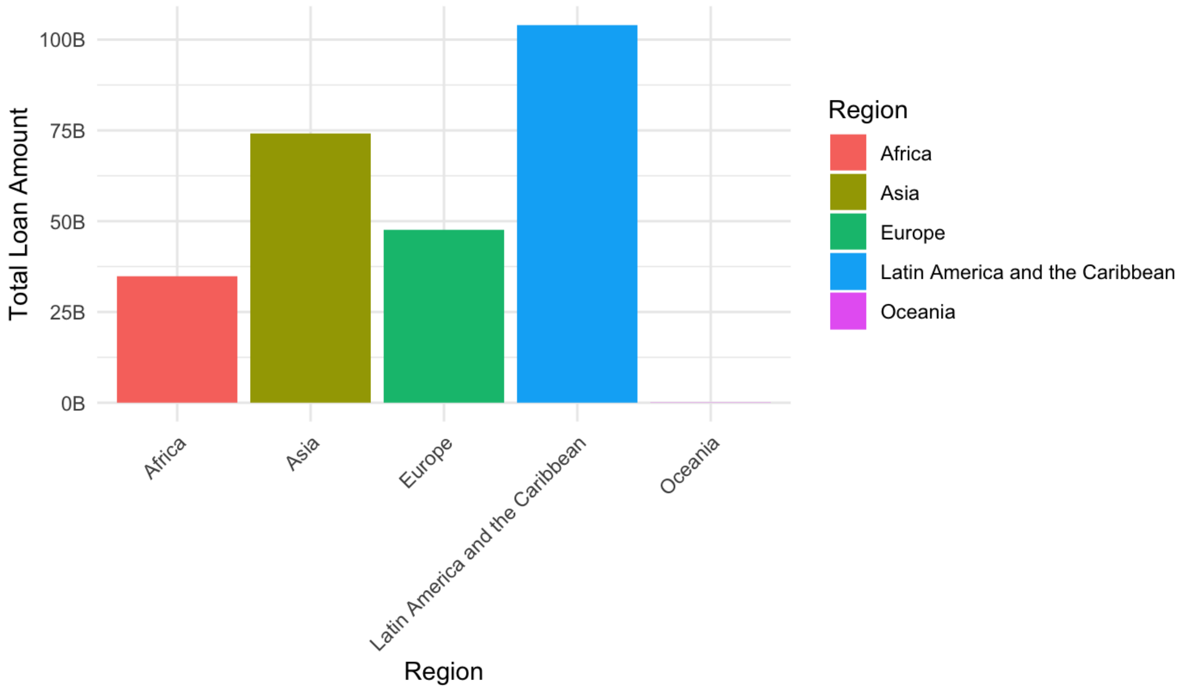
Figure 4: Total Loan Amount by Region Over Time for the KfW



("Transparency | KfW Development Bank," n.d.)

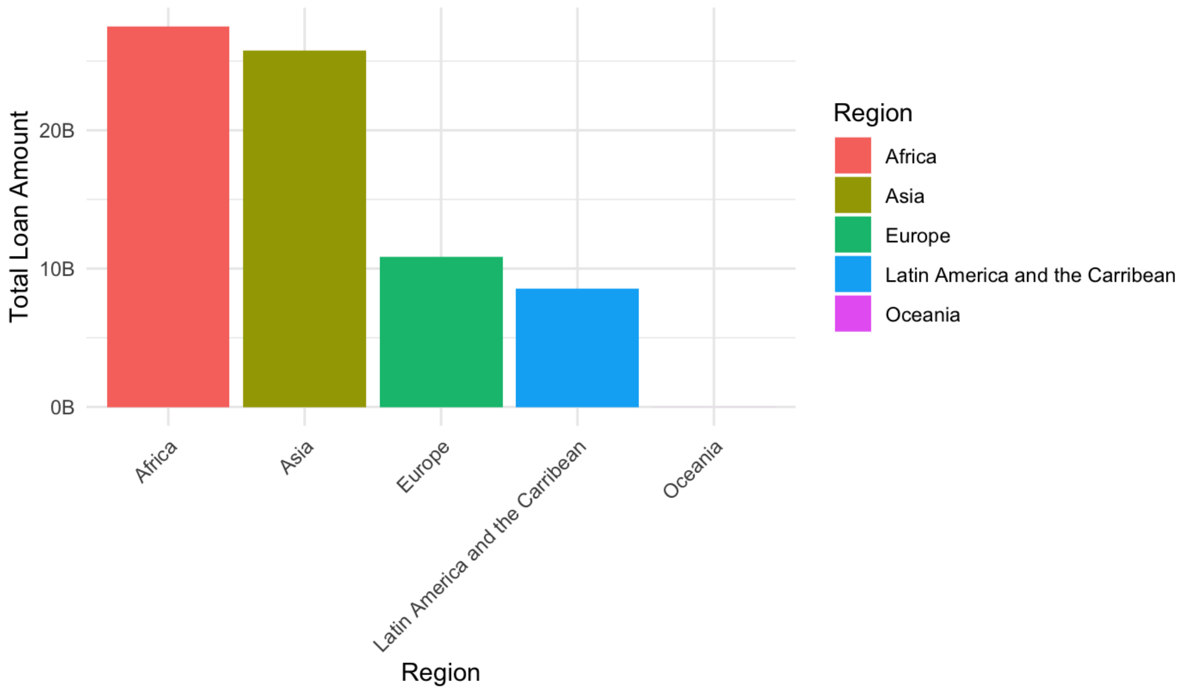
In Figures 5 and 6, we see the regions that both banks loaned to in total sum from the study dates; it is interesting to note that in Africa, both banks loaned the same quantity of money. However, the lending proportion of money going to Africa is more significant in the KfW than in the CDB, as the KfW sends more proportionality to Africa than the CDB does. The CDP has the most considerable size of loans in dollars in Latin America and the Caribbean. The second largest region for both banks is Asia. This could be due to the need for little finance in those areas or the CDB and the KfW trying to control the region through developmental means, allowing domestic firms to produce inside these countries. Also, with the increase in production happening in Asia, people's livelihood needs to increase (Camba, Lim, and Gallagher 2022).

Figure 5: Total Loan Amount by Region for the CDB



(Custer et al. 2021; "Global China Databases | Global Development Policy Center" 2023)

Figure 6: Total Loan Amount by Region for the KfW



("Transparency | KfW Development Bank," n.d.)

We can dive into the actual study with the descriptive statistics out of the way. For a reminder, here are the hypotheses:

Hypothesis 1: There will be no statistically significant increase in democratic scores within Chinese Loans recipient countries.

Hypothesis 2: The Human Development Index should increase inside Chinese Loan recipient countries.

Hypothesis 3: There will be a statistically significant increase in democratic scoring within countries receiving KfW loans.

Hypothesis 4: The Human Development Index should increase within countries receiving KfW loans.

Table 1: Comparison of HDI at the Time of the Loan

	Human Development Index	
	CDB	KfW
	(1)	(2)
‘Loan Amount (USD M)‘	0.001***	0.0002***
	(0.0002)	(0.00003)
Year	0.449***	0.0002
	(0.155)	(0.001)
Constant	−842.189***	0.273
	(312.824)	(2.128)
Note:	*p<0.1; **p<0.05; ***p<0.01	

(Custer et al. 2021; “Global China Databases | Global Development Policy Center” 2023; Nations, n.d.; “Transparency | KfW Development Bank,” n.d.)

Table 1 shows the human developmental index at the time of the loan as a dependent variable of a linear model, with the independent variables being the year and the loan amount, with the units being US dollars in millions. Both banks' loan coefficients are statistically significant, with slightly different values. With the CDB being 0.001, whereas the KfW is 0.0002, this shows that the CDB is much more willing to lend more money to countries with already a higher developmental index relative to other countries than the KfW, which is, therefore, a more developed country. If we look at the independent variable “Year,” it will also show that the Chinese have been more and more willing to loan to countries that have been becoming developed, as the coefficients are 0.449, with statistical significance for the CDB and 0.002 for the KfW—showing that countries that are on the trend of going up are more likely to receive money from the CDB than the KfW. However, it is essential to note the observation amounts in these tables. The CDB has just under 500, whereas the KfW has over 800. If we look back to the descriptive statistics, we will see that where the Chinese have much fewer loans, they loan out nominally more money; therefore, the loans that the countries will receive from the CDB will be, on average, significantly higher than the KfW. That being, on average, $75.36 million for the KfW and $994.8 million for the CDB.

Moving on to Table 2, we look at the human developmental index from one to four years after the initial loan. The observations do decline as the loans that were initiated in 2021 have yet to have the fourth-year data available as it is yet to occur. However, for all loans before 2021, we have the data. It is interesting to know that the loan amount coefficient for the CDB is negative, meaning that the countries that receive loans from the Chinese Developmental Bank will get worse, and that is the case for all four years. It does, however, stay the same with the same statistical significance throughout the four years. The “Year” independent variable is negative as well, hovering around -0.4, showing that the countries are on a downward trend after the loan. This is interesting as, at the time of the loan, the recipient countries were on an upward trend. This can be due to a number of factors, but the solid statistical significance points to the loans having something to do with the inverse trend.

Table 2: HDI from 1-4 years after Loan for the CDB

	Human Development Index			
	One Year	Two Years	Three Years	Four Years
	(1)	(2)	(3)	(4)
‘Loan Amount (USD M)‘	−0.001***	−0.001***	−0.001***	−0.001***
	(0.0002)	(0.0002)	(0.0002)	(0.0002)
Year	−0.445***	−0.405**	−0.446***	−0.470**
	(0.154)	(0.158)	(0.169)	(0.182)
Constant	834.718***	755.063**	836.637**	884.919**
	(309.721)	(318.295)	(340.088)	(366.643)
Note:				*p<0.1; **p<0.05; ***p<0.01

(Custer et al. 2021; “Global China Databases | Global Development Policy Center” 2023; Nations, n.d.)

Table 3: HDI from 1-4 years after Loan for the KfW

	Human Development Index			
	One Year	Two Years	Three Years	Four Years
	(1)	(2)	(3)	(4)
‘Loan Amount (USD M)‘	0.00000*	0.00001**	0.00001***	0.00001***
	(0.00000)	(0.00000)	(0.00000)	(0.00000)
Year	−0.001***	−0.001***	−0.002***	−0.002***
	(0.0001)	(0.0001)	(0.0001)	(0.0002)
Constant	1.080***	2.661***	4.109***	5.031***
	(0.108)	(0.163)	(0.237)	(0.340)
Note:				*p<0.1; **p<0.05; ***p<0.01

(“Transparency | KfW Development Bank,” n.d.; Nations, n.d.)

The KfW has quite a small coefficient for the loan amounts, just above 0; however, it is positive, therefore showing that every year after the loan is received, the development of a country is increased. Once again, all these findings are statistically significant. If we look at the year-independent variable in this table, the KfW has a statistically significant coefficient;

however, it is less negative than the CDB counterpart. This means that the countries that are borrowing from the CDB will progressively be worse off, in terms of the Human Development Index, countries throughout time, whereas the KfW is loaning to countries with very similar decreases in their human developmental indexes.

Little change happens between the four years. The only observable differences for both countries are in the Year row from -0.445 to -0.405 to -.466, then finally to -.47 for the CDB and -0.001 to -0.002 for the KfW. If we look at human development in the following years after the initial loan, we discover that more or less the same situation occurs with minor differences within the coefficients; it is interesting to note that the statistical significance of the KfW with the independent variable of year bounces back between 0.05 and 0.01. The HDI 1 year after the loan in Table 3 shows no drastic changes in nominal value. It is interesting to know that the coefficient for the loan amount independent variable does not change for the CDB throughout these four years; however, there is an increase with the KfW. It is minuscule, going from 0.0 to 0.00001; however, that increase shows that the loan amounts of the KfW do increase the human developmental index, even if it is by a small margin.

Hypothesis 2 is disproven, as the amount that the Chinese loaned has a negative effect on the human developmental index of the recipient countries. Therefore, the loans do not have a positive impact on the HDI of a country that receives loans from the CDB. This is a reminder that the human development index is used as a proxy to test the success of a country's development based on the loan amount given by these developmental Finance institutions.

Hypothesis 4: The KfW would, in fact, have a positive relationship with the increased loan amount to increase the livelihood of the citizens in the recipient country. The relationship is small, being very close to 0 for one year after the loan; however, the relationship is positive, therefore proving the hypothesis to be correct.

Table 4: Comparison of EIU Ranking at the Time of the Loan

	EIU Democracy Rating	
	CDB	KfW
	(1)	(2)
'Loan Amount (USD M)'	0.00004	0.002***
	(0.00004)	(0.0004)
Year	0.042*	−0.064***
	(0.025)	(0.014)
Constant	−79.730	134.404***
	(49.609)	(28.755)
Note:	*p<0.1; **p<0.05; ***p<0.01	

("Democracy Index 2023" 2023; Custer et al. 2021; "Global China Databases | Global Development Policy Center" 2023; "Transparency | KfW Development Bank," n.d.)

If we look at Table 4, we will understand the EIU democracy ratings and how they relate to the loan amounts of the CDB and the KfW. The EIU rating at the time of the loan shows us whether the banks tend to lend to democratic countries or not. At the time, the EIU rating of the time of the loan had a negative relationship; the recipient countries were more likely not to be a democracy. The coefficients here for the loan amount, the independent variable, are only statistically significant when it comes to the KfW, and the relationship is positive. That shows that the KFW is more willing to lend larger amounts of money the higher the recipient country is on the democratic ranking rather than those that fall farther down on the ranking scale. The CDB does have a positive relationship; however, it is not statistically significant; therefore, no major conclusions can be made from this, as there was no statistical significance. If we look at the year independent variable, both have statistical significance; however, the coefficient for the KfW does have a higher significance. It is interesting as the coefficient for the KfW for the “Year” variable is negative, meaning that the countries that the bank lends to are backsliding. The CDB has a slightly lower significance; however, it is positive, showing that the countries the CDB lends to are on an upward trend of democracy. This indicates that as the country progresses Through Time, the CDB is more willing to lend to democratic countries, whereas this KfW is working its way down from democratic countries to non-democratic countries. Both Banks have a very similar average EIU rating for recipient countries, with the CDB being 4.7 and the KfW being 4.9. This shows that the KfW is more willing to lend to higher democracies, whereas the CDB tends to lend to less democratic countries, following along with what the theory would suggest.

Table 5: EIU Ranking from 1-4 years after Loan for the CDB

	EIU Democracy Rating			
	One Year	Two Years	Three Years	Four Years
	(1)	(2)	(3)	(4)
‘Loan Amount (USD M)‘	−0.00000	−0.00000	−0.00000	−0.00001
	(0.00001)	(0.00001)	(0.00001)	(0.00001)
Year	−0.004	−0.015***	−0.031***	−0.046***
	(0.004)	(0.005)	(0.007)	(0.010)
Constant	8.921	30.155***	62.697***	92.391***
	(7.774)	(11.014)	(14.756)	(19.270)
Note:				*p<0.1; **p<0.05; ***p<0.01

(“Democracy Index 2023” 2023; “Global China Databases | Global Development Policy Center” 2023; Custer et al. 2021)

Moving to Table 5, we can see the EIU rating from 1 to 4 years after the initial loan for the CDB. The independent variable of the loan amount is not statistically significant for the CDB so no firm conclusions can be drawn, and the year variable has a negative relationship that is quite significant, showing that each country is on a trend of less democratic ways, slowly increasing with time. This means that one year after the loan, the relationship was not significantly significant, with -0.004, moving to -0.015, with statistical significance, after two years, then in the third year -0.031 and in the fourth -0.046, both with statistical significance. It is interesting to know that the relationship between the increased size of the loan amount and the EIU rating is harmful to the countries that receive a loan from the CDB; even with no significance, the relationship is still negative, meaning with each year passing recipient countries should back-slide no matter how much they received.

Table 6: EIU Ranking from 1-4 years after Loan for the KfW

	EIU Democracy Rating			
	One Year	Two Years	Three Years	Four Years
	(1)	(2)	(3)	(4)
‘Loan Amount (USD M)‘	0.00000	0.00005	−0.00001	−0.0001
	(0.0001)	(0.0001)	(0.0001)	(0.0002)
Year	−0.017***	−0.024***	−0.038***	−0.050***
	(0.003)	(0.004)	(0.006)	(0.008)
Constant	34.116***	48.551***	75.899***	100.413***
	(6.360)	(8.560)	(11.654)	(15.584)
Note:				*p<0.1; **p<0.05; ***p<0.01

(“Transparency | KfW Development Bank,” n.d.; “Democracy Index 2023” 2023)

In Table 6, we can see the EIU rating from 1 to 4 years after the initial loan for the KfW. The independent variable of the loan amount is not statistically significant for the KfW, as it is identical to the CDB, so that no firm conclusions can be drawn. It is interesting to note that after two years, the relationship switched from a positive to a negative relationship, going from 0.00005 in year two to -0.0001 in years three and four. The year variable has a negative relationship that is quite significant, showing that each country is on a trend of less democratic ways, slowly accelerating with time, the same as the CDB. The difference is slight between the KfW and the CDB. However, the KfW has a more negative relationship as one year after the loan, the relationship was significantly significant with -0.017, moving to -0.024, with statistical significance, after two years, then in the third year -0.038 and in the fourth -0.050, both with statistical significance. It is interesting to know that the relationship between the increased size of the loan amount and the relationship is still negative, meaning with each year passing, after year two, recipient countries should back-slide no matter how much they received, the inverse of what the theory would suggest.

Table 7: Comparison of Political Rights at the Time of the Loan

	Political Rights	
	CDB	KfW
	(1)	(2)
‘Loan Amount (USD M)‘	0.0001	−0.001***
	(0.00003)	(0.0004)
Year	−0.018	0.059***
	(0.024)	(0.015)
Constant	41.118	−113.979***
	(49.123)	(29.886)
Note:	*p<0.1; **p<0.05; ***p<0.01	

(Herre et al. 2024; “Transparency | KfW Development Bank,” n.d.; “Global China Databases | Global Development Policy Center” 2023; Custer et al. 2021)

Tables 7 and 8 look at the political rights and civil liberties of the countries at the time of the loan. This is to determine whether or not the banks aim to have a recipient country that is more or less democratically inclined. This is where it gets interesting, as the KfW has a negative and significant relationship with the political rights and civil liberties dependent variable when it comes to the independent variable of the loan amount. The CDB has a positive relationship and is only a significant one when it comes to civil liberties. The political rights and the civil liberties variables have a decreasing scale, meaning that the best score a country can get would be a 1, meaning completely free, with a 10, meaning completely not free. So with this, the KfW has a negative

Table 8: Comparison of Civil Liberties at the Time of the Loan

	Civil Liberties	
	CDB	KfW
	(1)	(2)
‘Loan Amount (USD M)‘	0.0001*	−0.0004
	(0.00003)	(0.0003)
Year	0.003	0.064***
	(0.020)	(0.012)
Constant	−1.609	−124.236***
	(39.296)	(23.598)
Note:	*p<0.1; **p<0.05; ***p<0.01	

(Herre et al. 2024; “Transparency | KfW Development Bank,” n.d.; “Global China Databases | Global Development Policy Center” 2023; Custer et al. 2021)

Relationship with both the civil liberties and the political rights variable compared to the loan amount; therefore, it proves that there is a relationship that trend towards the KfW lending to more democratic countries, whereas the CDP only has statistical relevance for civil liberties and that is positive, therefore tends to lend to non-democratic countries. Political rights have no relevance; however, it is also positive; this would show that the CDB tends to lend more money to countries with less political rights than the KfW. This upholds the theory that Western-backed banks are going to lend more to democratic countries than Eastern-baked banks. This rating system is also different from the EIU, so it is another way to view the relationship from the start of the loan.

Table 9 is a combination of the political rights and civil liberties at the time of the loan, and not too much has changed from tables 8 and 9, which is the negative relationship with this political rights and civil liberties variable for the KfW on the loan amount as well as the

Table 9: Comparison of Political Rights + Civil Liberties at the Time of the Loan

	Political Rights + Civil Liberties	
	CDB	KfW
	(1)	(2)
'Loan Amount (USD M)'	0.0001*	−0.002**
	(0.0001)	(0.001)
Year	−0.015	0.122***
	(0.043)	(0.026)
Constant	39.510	−238.215***
	(86.361)	(51.977)
Note:		*p<0.1; **p<0.05; ***p<0.01

(Herre et al. 2024; "Transparency | KfW Development Bank," n.d.; "Global China Databases | Global Development Policy Center" 2023; Custer et al. 2021)

Positive relationship for the year variable. We come to the same conclusion that they tend to loan to more democratic countries; however, they tend to loan more significant amounts of money to democratic nations where the CDB has no statistical significance. With the year variable, these countries have a negative relationship with PR and CL with the CDB and a positive one with the KfW, meaning that countries that receive loans from the KfW are trending backward, whereas the CDB recipient loans are trending upwards toward democratic principles.

Without diving too much into the findings, it is interesting to note that 3 of the 4 hypotheses failed. Hypothesis 1-3 failed, and the only hypothesis that passed was number 4. This is interesting as the theory would suggest otherwise, but with the relatively new introduction of the CDB to the global market for developmental financial institutions, they could show a flaw in the theory, causing a need to reevaluate.

Discussion

Following the comprehensive study, a multitude of findings have emerged, some of which align with the theory and hypothesis, while one stands in contrast. These findings bear significant implications for the academic and research community, shedding light on the complex dynamics of international development and economics.

Hypothesis 1: There will be no statistically significant increase in democratic scores within Chinese Loans recipient countries.

This hypothesis is grounded in the belief that the lack of conditionality of democratic institutions in loans would deter any desire or need to enhance such institutions in recipient countries.

The findings support this hypothesis and theory with no statistical significance. With all years studied having no statistical significance, and with all years after the loan is a negative relationship, for every 1 million dollars being loaned, the EIU democracy score goes down. This is not surprising as the lack of conditionality of the loans does not prioritize democracy building, as profit and domestic growth are the only thing that the CDB is focused on with its developmental finance (Sanderson and Forsythe 2013; Chin and Gallagher 2019).

Hypothesis 2: The Human Development Index should increase inside Chinese Loan recipient countries.

This hypothesis is based on the belief that any money going to a country will, in fact, increase the Human Development Index, a proxy for development, if it is spent on public goods or even the private sector.

Hypothesis 2, however, was disproven. There was a negative relationship between every million dollars spent in development for every year in the study and all with high statistical significance. Granted, the relationship was just slightly below zero, but any below zero would mean that if a country were to receive money from the Chinese Development Bank, its HDI would decrease, so citizens of a recipient country might be better off without receiving any developmental aid from the CDB.

Hypothesis 3: There will be a statistically significant increase in democratic scoring within countries receiving KfW loans.

This hypothesis is the inverse of hypothesis 1, grounded in the belief that the conditionality of democratic institutions in loans would require the desire and need to enhance such institutions in recipient countries.

This hypothesis is not confirmed or denied, as there are no statistically significant findings; however, the first two years had a positive relationship with the unit of loan amount in million United States Dollars. Years three and four have an inverse relationship, causing the hypothesis to be in this stalemate area, and with the hypothesis in the gray area, this causes it to fail, as there is no statistically significant increase in democratic scoring.

Hypothesis 4: The Human Development Index should increase within countries receiving KfW loans.

This hypothesis has been proven positive, as the HDI has a positive relationship with the loan-independent variable at statistically significant values for all four years after the initial loan. This is also important, as the year-independent variable has a negative relationship with the HDI of a recipient country. Therefore, every year that passes, the HDI will decrease, whereas monetary increases will increase the HDI.

The reason that the study looked at the PR, CL, EUI, and HDI ratings in the year the loan happened is to see what type of countries each bank lends to. If we look at the HDI at the time of the loan for both banks, we find that both banks have, in fact, a positive statistically significant relationship with the amount of money lent and the HDI. This means that the banks tend to lend more money to countries that are already more developed than countries that are not developed. This is interesting as this is different from what theory would suggest that countries would get what they need. However, it does follow the theory of privatization of capital. For a market to advance sufficiently, there needs to be an influx of cash (Bhambra 2020). This is where the DFIs, as well as banks, will step in and help socialize risks in the market (Marois 2024). If their goals are to create a market in the recipient countries that can create development, then they would need to have a higher starting place to start the market. It would be inopportune to develop a liberal market in a failed state that desperately needs finance but is no longer profitable (Chin and Gallagher 2019; Deeming 2013).

The EIU ratings and the PR and CL ratings at the time of the loan are to see what type of countries each country lends to. The theory would suggest that the KfW would lend to democracies, and that upholds this study. The EIU rating at the time of the loan for the KfW is statistically significant, with a positive relationship. The Political Rights rating at the time of the loan is statistically relevant and has a negative relationship. It is important to note that the lower numbers in this rating system mean more freedom; therefore, a negative relationship would mean that each unit of money loaned by the KfW would lean towards countries with more Political Rights. There is also a negative relationship with Civil Liberties. Therefore, the same relationship exists for political rights; however, it is not statistically significant.

It is interesting to note that the theory would suggest that Western-backed banks, once set up with a recipient country, would continuously loan to them, and this is, in fact, the case with the KfW. If we look at the CDB's lending practices, we see that the amount and location that then loan money to varies drastically by year and location, whereas the KfW's location and loan amount stay relatively stable from the beginning of the study until the end, with only a drop off in 2021. It is unclear what caused this drastic decline in lending, but the hypothesis would be that it was due to the COVID-19 pandemic, causing a shortening of foreign loans going out as the bank group needed money for domestic projects. This would still hold true as theory would suggest a social market economy would want to balance social equity at the time of the global crisis, primarily focusing on the domestic market (Schneider 2021).

If the study was looking at a larger time frame for the EIU ratings, then we might find that developmental finance works better on a longer scale. That would be needed for further research; however, for this study, we would assume that four years would be ample time to see at least the beginning of a trend towards democracy or development, as the conditionality of the loans and the goals of the KfW are tied to democracy building ("SDG 16 – Peace, Justice and Strong Institutions | KfW Development Bank," n.d.; Klagge et al. 2020). If this were to be the case, then there should be the start of a trend towards democracy, and we would not find that. Now, this could be because they are driven to financial markets or the democratic rating systems of the EIU take into account the Political Culture towards their rating system, which might have an effect as there is a positive selection bias towards loans, as in that countries that would accept loans are already canceled out by the political culture category in the EIU ratings. If other rating systems were to be used, similar findings should be assumed, but further research would be needed to see to what extent the differences would be in the conclusions if other democracy ratings were used in these models.

Potential implications of this study help disprove the theory that the democratic conditionality of loans is not the only way of improving people's lives in the developing world. If the goal of a country or a DFI is to improve the livelihood of people in the developing world, then this can help prove that there is no need to increase democracy. Now, this is not to claim that it would not work better inside a democracy, as that most definitely could be the case, but that the raw functionality of the loans is possible inside countries that are not democracies. Another implication is that even if the democratization of the conditionality of loans is upheld, it does not mean that democracy will increase. Therefore, the framing of success would be important for the future of DFIs as if the creation and enlargement of democracy standards is the key to claiming a successful loan, or if the people of the recipient countries benefit and increase their standard of living, if that would be what a successful loan is.

A limitation of this study is that data was collected by an outside source. To be as unbiased as possible, it would be necessary to collect the data from the sources first hand directly from the banks themselves, and it is unlikely that would happen. The KfW data was collected from the bank itself. However, there could be biases as even though they are obligated to be transparent, that does not mean they are 100% transparent. They could be hiding a loan or two, not severely affecting the study, but would have the possibility of doing so. Another limitation is that some countries that receive loans do not give data to democracy-scoring institutions; therefore, not all countries that have been recipients of these loans could be studied, as missing data prevented that.

Another limitation of this study is that it was a broad overview and not a case-specific research. The goal of this study was to see if, in general, all of these theories hold up within these two banks. If a more specific view of these loans would want to be viewed and see if these banks work within a particular country, then further research would be needed. This is a single method that is driving for generalizability; therefore, the findings can only be so specific. The study is able to view if the loans worked in the context of theory, but not why they succeeded or not, or the exact impact these loans had on the people, as a more in-depth mixed methods study would be needed to find the answers to these types of questions.

There are two more limitations that could have had an impact on the study, those being the amount of observations between the two banks and the nominal size of said loans. With the CDB having around 400 loans and the KfW having around 800, this can change the strength of the relationship as the KfW could potentially be having a more long-term relationship with the countries that are recipients of the loans, rather than the CDB, which has a shorter relationship. Another would be the size of the loans, with the Chinese Development Bank spending a much larger sum than their German counterpart. This would need further research to see how these differences affect the outcomes of the EIU democracy ratings and the HDI ratings for recipient countries of loans from national DFIs.

A key finding in this study is that there are different relationships between the HDI and each bank. It would be non-academic to claim that this is due to the conditionality of loans towards democratic institutions. Claiming that CDB does not work in the means of improving the lives of the people in the recipient countries is factual; however, the reasoning behind it needs to be studied. The theory would suggest that it is due to the fact that a successful loan in the eyes of the CDB would help promote Chinese power on an international level (Chin and Gallagher 2019; Sanderson and Forsythe 2013). This is due to the case of state capitalism only wanting to grow the lending country's domestic market and foregoing the borrowers' market (Wright et al. 2020). If that is the case, we did not study this; therefore, nothing can be claimed, and further research would be needed to find out why this is the case.

Additionally, the impact of the CDB's loans on recipient countries could be explored to see the sovereignty more in-depth, allowing us to see the true intentions of the CDB and China as a whole. This can be used to pull back the curtain to see if the true intentions of the CDB are to help people truly or to build up their domestic power and international weight.

Conclusion

With a literature review about both the KfW and the CDB, along with state-owned banks and developmental financial institutions, the groundwork was laid out for the theoretical framework for this study. For the theoretical framework, the study discussed the Washington Consensus, varieties of capitalism, social market economies, state capitalism, democratic conditionality of loans, and social market economies versus state capitalism in the context of developmental aid. The paper then moved on to methodology and justified the data collection process during that time. The findings of the study followed, with tables and figures used to drive home the findings. An in-depth break discussion of the study was then concluded. Finally, the conclusion, where the paper will be wrapped up and the main findings summarized.

The research question for this paper is as follows: To what extent do divergent conditionality of loans affect democratic institutions and the Human Development Index within loan-recipient countries?

Here are the following for the hypothesis:

Hypothesis 1: There will be no statistically significant increase in democratic scores within Chinese Loans recipient countries.

Hypothesis 2: The Human Development Index should increase inside Chinese Loan recipient countries.

Hypothesis 3: There will be a statistically significant increase in democratic scoring within countries receiving KfW loans.

Hypothesis 4: The Human Development Index should increase within countries receiving KfW loans.

Hypothesis 1 was proven correct through the study as there was no statistically significant increase in the democratic scores within the Chinese recipient countries. This follows the theory that state capitalism should not be following the Washington Consensus of democratic conditionality of loans. Hypothesis 2, on the other hand, was disproven as the human index did not increase with statistical significance. This is under the idea that developmental financial institutions should succeed in developing the recipient countries. This could be due to the idea of the proxy variable not being a sufficient way of viewing development all the time. Hypothesis 3 was disproved as there was no statistically significant increase in a democratic score within countries receiving KfW loans. This goes against the theory of democratic conditionality of loans, as the KfW has conditions attached to their lending patterns and tends to follow other patterns, which the theory would suggest. Hypothesis 4, however, was proven correct as the human index did increase in countries receiving KfW loans. This follows the theory that the KfW is a successful developmental financial institution. Therefore, only hypotheses 1 and 4 were proven correct in this study.

To answer the research question, there are minimal effects on the diverging conditionality of loans on democratic institutions and the human development index in recipient countries. This is particularly intriguing as the banks have drastically different goals and conditionalities regarding the types of lending each bank does in developmental finance, as well as the variety of capitalism of the country that each bank resides in; therefore, the findings are unexpected. Now, the success or failure of the bank with these variables might vary from country to country, but as a whole, the findings of this research hold. Another particularly intriguing aspect is that the KfW tries to follow the sustainable development goals of the United Nations, whereas the Chinese Developmental Bank has yet to claim to follow these goals. Yet, even with these differences, there still is the need for more research to conclude definitively why this is the case and to what extent these factors of differences in input create a similar finding on the output for democracy.

The contribution to the field of study of developmental finance institutions is a positive one, as it definitively compares the KfW and the CDB and shows how the conditionality of loans, which supports the idea that the KfW will lend to democratic countries and try to build democratic institutions, does not affect the outcome as much as initially thought. Also, with this form of study, we, the political science world, can be confident that these relationships are genuine, as statistical significance was found in most of the relationships. This study uses reliable sources and takes a positivist and quantitative approach to the subject of Western and Eastern-backed DFIs.

Further research will be needed to determine whether this is the case for other developmental finance institutions and whether these findings are upheld in different regions throughout the world. Some further research that would also be interesting to look into would be on a large scale and acquire all loans from all western-backed national DFIs as well as all loans from the other Chinese-backed national DFIs in comparison of these two, as well as including multinational DFIs, such as the European Bank for Reconstruction and Development and the Asian Infrastructure and Investment Bank. The study misses out on other large-scale data, such as that with large multinational banks, by just comparing one bank to the other. Plenty of research has been completed on these two Banks and multinational banks in general; however, a large-scale project, to the knowledge of the researchers, has not been completed to compare the success of these DFIs when accounting for both aid and democracy building.

The study underscores the urgent need for a comprehensive and nuanced approach when evaluating the effectiveness of developmental finance institutions. It emphasizes that factors such as political stability, economic development, and cultural differences can significantly influence their success in different countries. Therefore, a holistic evaluation is necessary and crucial to fully understanding the impact of these institutions on aid and democracy-building efforts.

In conclusion, there are significant findings for democratic conditions for loans at the time of the loan; however, that fails to be the case for both the KfW and the CDB anytime after the initial loan. For the success in loans through actual development, only the KfW had a positive and statistically significant relationship, whereas the CDB had a negative and significant relationship. The KfW tended to loan to countries that were more democratic, but the CDB did not. With only two hypotheses passing, there is more research needed to see why theory is beginning to fail in developmental finance.

Thank you.

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