

**Reducing or Fueling: The Effect of EU International Aid
Allocation on the Level of Corruption in Recipient Countries**

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Declaration of Authorship

I, the undersignedYusuke Ishikawa..... hereby declare that I am the sole author of this thesis. To the best of my knowledge this thesis contains no material previously published by any other person except where due acknowledgement has been made. This thesis contains no material which has been accepted as part of the requirements of any other academic degree or non-degree program, in English or in any other language.

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Abstract

The existing literature on the effect of foreign aid on corruption in recipient countries has been controversial and contains methodological issues regarding the use of instrumental variables. In this thesis, based on the work of Carnegie and Marinov (2017), I utilize the EU Council presidency as the instrument to analyze the effects of EU aid on corruption in recipient former colonies until 2006. The results from the instrument variable approach show that while EU aid allocation reduced most types of corruption, the magnitudes of these effects were quite small. The different effects depending on the measurements of corruption were also revealed in the analysis. These results were confirmed by the following quantitative analyses of the contemporary history of EU sanctions against violations of human rights, democracy, the rule of law, and good governance, as well as the case of DRC in which the 2001 Belgian presidency had a concrete influence on aid allocation. The findings suggest EU aid conditionality does not have substantial effects to reduce corruption in recipient countries in comparison to the effects on other development issues such as democracy promotion and human rights improvement when donor countries have little interest to impose sanctions against corruption.

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List of Abbreviations

ACP: Africa, the Caribbean and the Pacific

CC: Control of Corruption (World Governance Indicators)

CPI: Corruption Perception Index

DID: Difference-in-differences method

DRC: Democratic Republic of Congo

EU: European Union

GMM: Generalized Method of Moments

ICRG: International Country Risk Guide

IMF: International Monetary Fund

IV: Instrumental variable

MCC: Millennium Challenge Corporation

NIP: National Indicative Program

ODA: Official Development Assistance

V-Dem Institute: Variety of democracy Institute

WGI: World Governance Indicators

Chapter 1: Introduction

Scholars of political economy have debated the relationship between foreign aid and corruption in recipient countries particularly since the late 1990s when international organizations started to pay attention to fighting against corruption in recipient countries. While some scholastic literature supports that foreign aid can reduce corruption in recipient countries, other literature denies the positive effects by pointing out null significance or effect of foreign aid on increasing the level of corruption. For example, Okada and Samreth (2012) find that foreign aid can reduce corruption, but the extent of the effects depends on donor countries. Asongu (2012), in turn, argues aid can increase the level of corruption when the cases are limited to African countries.

However, the existing studies do not assign foreign aid randomly, and consequently, these studies fail to consider bias caused by a variety of donor motivations (Carnegie and Marinov, 2017). Although many researchers attempt to overcome such endogenous problems, they only provide limited or no justification in their studies. Many of the instrumental variables in the existing studies are selected just based on previous applications without justifying requirements for their use. Reflecting such limitations, this thesis will extend “a novel approach” developed by Carnegie and Marinov (2017, p.671) – European Union (EU) Council Presidency as the instrumental variable – who examine the effects of foreign aid allocation on the level of democracy and human rights in recipient countries.

Not only does this thesis develop an approach to analyze the relationship between aid and corruption in recipient countries based on Carnegie and Marinov (2017), it uses up-to-date innovative indicators from the V-Dem (Varieties of Democracy) Institute. V-Dem successfully develops indicators which can measure specific aspects of political institutions such as *executive, public sector, judicial, and legislative* corruption (V-Dem Institute, 2019), yet only a limited amount of extant scholarly quantitative literature in corruption studies is based on

these indicators. With theoretical justification, this thesis will utilize these newly-developed indicators 2OLS analyses of the relationship between foreign aid and corruption.

The ensuing chapters will discuss *to what extent EU international aid allocation has an effect on the level of corruption* in recipient countries which were former European colonies (Appendix 1 for the list of countries), which contributes to the corruption studies in terms of specific findings about effects of EU foreign aid allocation. Due to the use of the instrumental variable, EU council presidency, this study limits the scope of analysis to former European (UK, France, Spain, Italy, Netherland, Belgium, Portugal) colonies. To the best of my knowledge this is the first study to analyze the effects of EU foreign aid on corruption in former colonies. Studies of the effects of EU foreign aid on corruption in recipient countries are limited to corruption in EU member states or candidate countries (e.g., Vachudova, 2009; Fazekas and King, 2019). Also, while there are some attempts to study the effect of multilateral aid on corruption in recipient countries, few scholars attempt to examine the effect of each multilateral institution (e.g., World Bank, International Monetary Fund, European Union). The thesis will contribute to the anti-corruption literature by identifying the specific effects of EU foreign aid on corruption in recipient countries of former European colonies.

In terms of defining corruption, although there is no universally agreed definition, this thesis will use the following: *The abuse of public power for private gain*. This definition is used not only because it is close to other common academic definitions of corruption (e.g., “Abuse of public office for private gain”: Kaufmann, 1997, p.141), but also because it can exclude broader definitions. The definition in this thesis is narrower than another famous definition of corruption by Transparency International, “the abuse of entrusted power for private gain” (Lovitt, 2004, p.1), as this definition also includes corruption in the private sector. In short, this thesis will exclusively focus on the effects of corruption such as bribery, extortion, and

embezzlement in the public sector (Rose-Ackerman and Palifka, 2016), as other broader concepts regarding corruption such as money laundering (Bullough, 2018) will not be covered .

In terms of structure, this paper starts with a literature review on major theories of corruption – principal-agent theory and collective action theory – and applies the theories to the relationship between foreign aid allocation and corruption in recipient countries (Chapter 2). This section provides theoretical foundation of the discussion of the effects of foreign aid on corruption, which many relevant quantitative articles fail to provide. Then, this paper deliberates on the results of existing quantitative articles on the relationship between foreign aid and corruption in terms of methodologies, the scope of their analyses, and their findings (Chapter 2). Next, the thesis discusses the use of instrumental variables in the analyses of foreign aid including the instrumental variable in the thesis (EU Council presidency; Chapter 3). I will show that EU Council presidency rotation from 1965 to 2006 will work as the instrumental variable better than other instrumental variables in the study of EU foreign aid and corruption. EU Council Presidency until 2006 had been randomly assigned based on alphabetical order and this perfectly satisfies the requirements as an ideal instrumental variable. Subsequent to 2006, the new rotation principle of the EU Council Presidency was introduced at the beginning of 2007, which is no longer regarded as an as-if randomization (Angrist and Pischke, 2014; Carnegie and Marinov, 2017).

As a main theme, this thesis will conduct 2OLS analyses using the instrumental variable (Chapter 4). It further qualitatively assesses the effects of EU aid allocation on corruption not only from the analysis of previous EU sanctions over years but also from the case of aid programs to DRC which is a rare typical case which had a concrete influence over EU aid policies using the Council presidency position – council conclusions of 12330/01, 13802/01, and 15078/01 (European Commission, 2001a; 2001b; 2001c), as well as resumed EU aid distribution (starting from 2001 and boosted from 2003: Arnould and Vlassenroot, 2016;

Bobineau and Gieg, 2016) after the 2001 Belgian EU Council presidency (Chapter 4). I will show while EU aid allocation until 2006 reduced most types of corruption, the magnitudes of these effects were quite small. The results will provide strong policy evidence for EU citizens and policy makers about foreign aid allocation in the sense that they should reconsider how to provide foreign aid in order to ensure corruption control in recipient countries and not allow public officials in the countries to behave in a corrupt way.

Chapter 2: Foreign Aid and Corruption

This chapter will review the existing literature of both theories and quantitative findings of the effects of foreign aid on corruption. I will first discuss theories of corruption and these applications to the relationship between aid and corruption. Then I will review the quantitative evidence of the effects of aid on corruption, which examines the effects using a number of different methodologies, such as the instrumental variable approach.

2.1 Theories of Anti-Corruption and Applications to the Effects of Foreign Aid

Although corruption has been analyzed by many scholars across time (e.g., McGovern, 1908; Leff, 1964; Huntington, 1969), it was not until the late 1970s that scholars started to find theoretical explanations of corrupt behaviors as well as theoretical suggestions to reduce corruption. The first pioneering work on political economy of corruption was *Corruption: A Study in Political Economy*, written by Rose-Ackerman (1978). This book was innovative in the study of corruption because it spread one of the most important ideas in corruption studies that corruption is less likely to occur under some particular institutional settings. In other words, Rose-Ackerman (1978) overcomes the limitations of previous studies in economics and political science which had focused on only either individual benefit maximization without consideration of institutions (economics) or politicians' likelihood of winning elections (political science). Using the principal-agent theory, she (1978) succeeds in explaining that institutions are prone to corruption when principals cannot monitor agents due to information asymmetry between principals and agents (see also, Pratt and Zeckhause, 1985).

In the 1980s, another pioneering work on political economy of corruption using principal-agent theory, *Controlling Corruption*, was published by Klitgaard (1988). Based on the principal-agent theory in corruption studies by Rose-Ackerman (1978), Klitgaard skillfully

formulates an equation of corruption control as $Corruption = Monopoly + Discretion - Accountability$ (p.75). According to him, corruption can be tackled when the amount of agents' monopoly (e.g., privatization and deregulation) and discretion (e.g., merit-based selection and rotation of agents) and when improve agents' accountability (e.g., legal enforcement and civil society empowerment) (2018). This book served later scholars and practitioners as a primary reference book, particularly the part on policy measures which posits the illustrative equation.

A significant number of later approaches to corruption were based on the principal-agent theory, particularly since the late 1990s when the World Bank and IMF changed their policies and decided to fight against corruption in developing countries (World Bank, n.d.; World Bank, 1997; IMF, 2005). The later scholarly study of corruption has provided examples of applications of the principal-agency theory to specific institutions which are related to anti-corruption. Anti-corruption scholars have studied, for example, the effects of electoral institutions (plurality or proportional representation; e.g., Kunicova and Rose-Ackerman, 2005), type of executive branch (presidentialism or parliamentarism; e.g., Gerring and Thacker, 2004), and decentralization and federalism (e.g., Peters, 2010), on the level of corruption.

Principal-agent theory can also contribute to understanding the relationship between foreign aid and corruption. Although existing anti-corruption studies do not offer theoretical reviews of the relationship between the two from a principal-agent theory perspective, theoretical consideration in relevant areas – EU membership conditionality¹ – demonstrates principal-agent theory is applicable to the relationship between foreign aid and corruption in recipient countries. Studies of the effect of EU membership conditionality on corruption show

¹ Throughout this thesis, the term conditionality refers to *negative* conditionality (as opposed to *positive* aid conditionality). According to Mungiu-Pippidi (2019), negative conditionality means conditionality due to “violations of association or trade agreements”(p.74), while positive conditionality refers to conditionality which offers “rewards for partner countries for their reform gestures” (p.75). This is because the idea of negative conditionality dominated more than positive conditionality in EU aid allocation decision-making processes over the period of interest in the thesis.

imposing conditionality, through increasing accountability, led EU candidate countries to establish necessary institutions to fight against corruption in the pre-accession stage. For example, EU member states required Romania during its accession process to set up anti-corruption agencies and increase transparency in judicial process (Szarek-Mason, 2010, ch.4).² Applying this conditionality arguments to foreign aid, principal-agent theory indicates that foreign aid help recipient countries to reduce the level of corruption through imposing anti-corruption conditionalities which are similar to conditionalities for joining the EU.

However, against principal-agent theory's expectations, many developing countries have struggled to fight against corruption since the 1990s. As Figure 1 shows, corruption in the public sector from 1960 to 2019, the levels of corruption across the world have not significantly improved regardless of anti-corruption reforms since the 1990s. These realities of anti-corruption reforms led a growing body of anti-corruption scholars to reconsider traditional theory critically. The movement dates to around 2010 and an increasing number of scholars propose different alternative theoretical frameworks to analyze corruption control.

Within these alternative theoretical frameworks, the most prominent theory proposed as an alternative to principal-agent theory is collective action theory.³ Anti-corruption scholars from the collective action perspective argue mainly two limitations of principal-agent theory in the study of corruption: principals' interests and collective action dilemma for principals. First,

² These EU membership requirements on corruption control originate with the Copenhagen Criteria. It was formulated in 1993 and was developed through the discussion in 1997 and 2000 by describing more detailed criteria of corruption control and other policies (Janse, 2019).

³ Although this thesis will focus only on principal-agent and collective action theories, it should be noted here that there are some other alternative perspectives in addition to these theories. The first is the sociological approach which sees corruption and corruption control in developing countries from the "logic of appropriateness" (March and Olsen, 2004). Lambsdorff, Taube, and Schramm (2004, ch.1) provide more detailed theoretical discussion on corrupt transactions, and Onyango (2017) and David-Barrett et al., (2020) are useful references for applications of a sociological approach to several cases regarding anti-corruption reforms in developing countries. The other approach is the historical approach. This approach focuses on path dependency and informal institutions of anti-corruption institutions. Libman and Obydenkova (2013) conduct quantitative analysis in post-communist countries from a path-dependency perspective, and Hellmann (2017) offers a qualitative investigation of East Asian countries using the concept of path dependency and informal institutions.

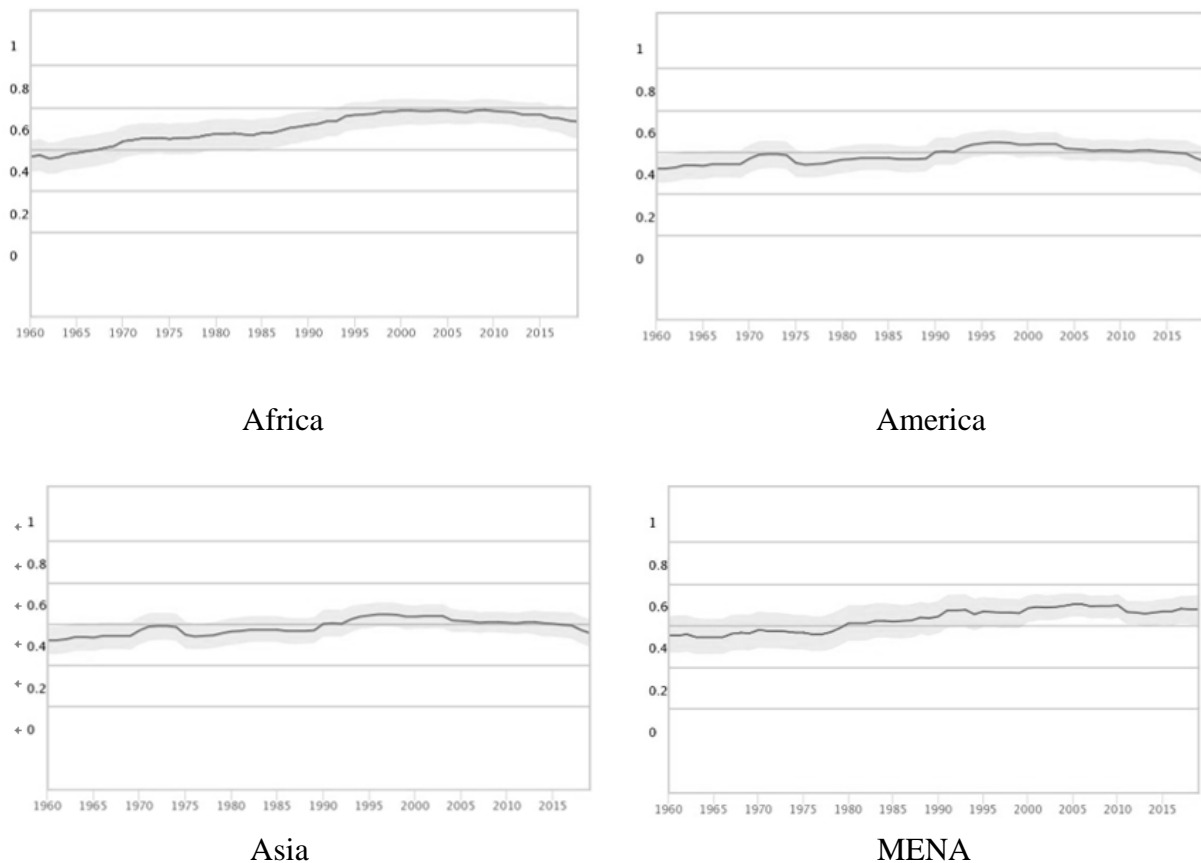


Figure 1: Public Sector Corruption, shown at the original scale: 0 (low) - 1 (high)
 Source: Variable Graph – Public Sector Corruption Index (V-Dem, n.d)

according to Persson, Rothstein, and Teorell (2013), principals’ pursuits of public interests are assumed in most (anti-) corruption studies from a principal-agent perspective.⁴ They assert this assumption does not match the real-world situation regarding anti-corruption reforms by calling principals *principled principal(s)* as follows:

[S]ince the supposed “principled principal(s)” are ... not acting in the interest of the society but instead pursuing their own narrow self-interests, anticorruption reforms based on the principal–agent framework will invariably fail (2013, p.451).

⁴ Although this is a well-known view of principal-agent theory in the study of corruption, it is debatable whether principal-agent theory in the corruption study assumes principals’ pursuits of public interests. While Persson, Rothstein, and Teorell (2019) reassert the view as a comment to Marquette and Peiffer (2018), Marquette and Peiffer (2019) disagree. They point out that relevant literature in political economy does not entail this assumption and it is just misuse of principal-agent theory by later anti-corruption scholars.

In the case of foreign aid and corruption, this implies principals – donor countries or institutions – can impose foreign aid conditionality for their strategic reasons rather than aiming at recipient countries to combat corruption and downgrade conditionalities regarding anti-corruption reforms.

As the name indicates, collective action theory in corruption study offers another important lens to analyze anti-corruption attempts: collective action dilemma. Based on Ostrom's idea of second-order collective action problem (free-rider problems; Ostrom, 1998), Persson, Rothstein, and Teorell (2013) argue that people, especially in countries where corruption is widespread, face challenges to act against corruption, because it entails a huge cost to fight against corruption and benefits to keeping corrupt behavior. Referring to this study, Marquette and Peiffer (2015) successfully provide extensive lists of potential causes for the failures of anti-corruption reforms and actions such as *group size, group heterogeneity, trust/good reputations, heuristics / norms* (p.5). This implies two points in the analyses of the effects of foreign aid on the level of corruption in recipient countries – collective action dilemma among donor countries and population in developing countries.

Theoretically, donors can face collective action dilemma when some or many donors are not willing to seek to combat corruption in recipient countries, which affects the quality and volume of aid conditionalities. In addition, if aid is not effectively enforced among donor countries and institutions due to collective action dilemma, people in recipient countries are also likely to face collective action dilemma, because they cannot rely on external pressure to change the institutions.⁵ These collective action dilemmas may allow corrupt politicians and

⁵ In this section, I introduced two most famous literature of collective action in the corruption study. However, it is worth mentioning that, although it is certain that these studies had a great influence to the study of corruption, there are similar studies which approach anti-corruption from collective action theory even before Persson, Rothstein, and Teorell (2013) and Marquette and Peiffer (2015). For example, Hopkin (2002) critically reviews anti-corruption literature at that time, pointing Rose-Ackerman (1999) ignores the collective action problems in her analysis of anti-corruption policies.

public officers to continue their corrupt practices or even extend them by wasting aid budget. As Marquette and Peiffer (2015) point out, this problem will be exacerbated when countries have larger populations and greater heterogeneity.

2.2 Quantitative Evidence of the Effect of Foreign Aid on Corruption

There are both positive and negative effects of foreign aid on corruption. In this section, I will firstly review effects of aid on *reducing* corruption and then the effects of aid on *fueling* corruption.

2.2.1 Positive Effect of Foreign Aid

A series of quantitative studies have been conducted and found foreign aid can reduce the level of corruption in recipient countries. For example, Charron (2011) examines the effects of foreign aid on corruption, in comparison of pre-1997 and post-1997 when the World Bank boosted anti-corruption reforms in developing countries (World Bank, 1997). Through analyses of around 70 developing countries, Charron (2011) finds the level of corruption will decrease when countries rely more on foreign aid and this positive effect occurs only allocation of foreign aid after 1997. In addition, to capture different effects depending on the level of corruption in recipient countries, Okada and Samreth (2012) develop the quantile regression methodology and find foreign aid has greater effect to reduce corruption in less corrupt countries than more corrupt countries. They also try to identify the different effects on corruption depending on donor countries/institutions and show multilateral aid has effects on reducing corruption, while most bilateral aid (France, the UK, and the US) does not have significant effects. This is an interesting result in relation to similar previous studies. For example, Alesina and Weder (2002) study the effects of corruption on donors' decision over aid allocation. Through regression analysis with a limited number of cases, they (2002) suggest the level of corruption does not

have significant impacts on aid allocation from both multilateral and bilateral aid. Okada and Samreth's (2012) finding implies more nuanced effects of foreign aid depending on donor countries and institutions.

Several recent studies use econometric methods to find positive effects of foreign aid in specific times and places. For example, Öhler, Nunnenkamp, and Dreher (2012) examine the effect of a specific US aid conditionality scheme (Millennium Challenge Corporation - MCC; from 2004) on the level of corruption in 62 recipient countries. Investigating the effects through a difference-in-differences (DID) method, they find (i) the US aid scheme had effects to reduce corruption in recipient countries and (ii) the effects have weakened over time. The results of the study show that US aid conditionality initially worked well because it demanded recipient countries satisfy requirements for receiving US aid, yet limited additional evaluation processes *after* they passed the criteria weakened the continuous efforts for recipient countries to fight against corruption (Öhler, Nunnenkamp, and Dreher, 2012).

2.2.2 Negative Effect of Foreign Aid

However, other quantitative analyses have also been conducted and have revealed foreign aid can fuel corruption in recipient countries. As a pioneering study of the relationship between the two, Knack (1999) finds the slightly negative effect of aid dependence on corruption in 80 recipient countries. Kangoye (2013), who uses the same corruption indicator (International Country Risk Guide; ICRG), also conducts cross-section and panel regression analyses. Focusing on unpredictability of foreign aid, he finds aid unpredictability can fuel corruption in recipient countries (2013).

A number of scholars find similar results in region-specific investigations of the effects on African countries. Asongu (2012) focuses on the effects of aid on corruption in 52 African countries using World Governance Indicators (Control of Corruption) and finds Okada and

Samreth's (2012) policy implication – aid can reduce corruption through conditionality – is not applicable to African countries.⁶ Asongu and Nwachukwu (2016) also analyze the effects of foreign aid on different components of good governance – political: voice and accountability, political stability; economic: regulation quality, government effectiveness; institutional: rule of law, and control of corruption. They (2016) find foreign aid has negative impacts on economic and institutional governance including corruption, whereas it has no impacts on political governance.

In sum, the effects of foreign aid on corruption in terms of variables used, methods, cases and time coverage, and results are illustrated in Table 1. As shown in the table, there are a lot of studies which use instrumental variables (IVs), yet many of them do not justify partially or do not justify the methodology. In addition, their uses of IV do not succeed in finding any causal relations in specific donor countries or institutions. It is to these this thesis will now turn.

⁶ Although this is Asongu's (2012) argument, it should be noted this is an overstated argument. His model is not the replication of Okada and Samreth (2012). In fact, Mohamed et al. (2015) analysed African countries through similar models and the same method and find foreign aid can reduce corruption in African countries as well.

Table 1: Summary of the Foreign Aid Literature

Author(s)	Year	Independent Variable	Dependent Variable	Control Variables	Method	Instruments	Time (Case)	Results ⁷
Asongu	2012	Aid dependence	WGI (CC), CPI	<ul style="list-style-type: none"> • Political regime • Trade 	IV, GMM	<ul style="list-style-type: none"> • Legal-origins • Income-levels • Religious-dominations 	1996-2010 (52)	—
Asongu and Nwachukwu	2016	Aid dependence	WGI (all), CPI	<ul style="list-style-type: none"> • Political regime • Trade 	IV	<ul style="list-style-type: none"> • Legal-origins • Income-levels • Religious-dominations 	1996-2010 (52)	—
Charron	2011	Aid dependence (bilateral, multilateral)	ICRG (corruption) CPI	<ul style="list-style-type: none"> • Political regime • GDP per capita 	GMM	(n/a)	1986-2006 (68-75)	+ ⁸
Ear	2007	Aid dependence (non-lagged and lagged)	WGI (CC)	n/a	IV	<ul style="list-style-type: none"> • Infant mortality 	1996-2004 (155)	-/+
Kangoye	2013	Aid unpredictability	ICRG (corruption)	<ul style="list-style-type: none"> • Income • Population • Rents • Fractionalization 	IV	“instruments constructed from the information set” (p.132; original idea from Pagan and Ullah, 1988)	1984–2004 (80)	—

⁷ Here, negative sign means aid increases corruption and positive sign means aid reduce corruption.

⁸ This is the effect of multilateral aid. The effect of Bilateral aid after 1997 was weaker but still negative.

Table 1 (cont.)

Author(s)	Year	Independent Variable	Dependent Variable	Control Variables	Method	Instruments	Time (Case)	Results ⁹
Kangoye (cont.)				<ul style="list-style-type: none"> • Legal origin • Accountability • Landlock • Africa 				
Knack	1999	Aid dependence ¹⁰	ICRG (all)	<ul style="list-style-type: none"> • GDP • Population 	IV	<ul style="list-style-type: none"> • Infant mortality rate in 1980s • Initial GDP per capita • Initial population, • French zone dummy • A Central America dummy 	1982-1995 (80)	—
Mohamed, Kaliappan, Ismail, and Azman-Saini	2015	Aid dependence	CPI	<ul style="list-style-type: none"> • GDP per capita • Democracy • Rule of law • Political stability 	QR	(n/a)	2002-2010 (42)	+

⁹ Here, negative sign means aid increases corruption and positive sign means aid reduces corruption.

¹⁰ Aid dependence is measured by the ratio of aid/gdp. Other papers which measure aid dependence also use the same measurement.

Table 1 (cont.)

Okada and Samreth	2012	Aid dependence ¹¹	WGI (CC)	<ul style="list-style-type: none"> • GDP per capita • Democracy • Legal origin 	QR	(n/a)	1996-2008 (120)	+ ¹²
Öhler, Nunnenkamp, and Dreher	2012	MCC	WGI (CC)	n/a	DID	(n/a)	before /after 2002 (62)	+ (short-term)
Tavares	2003	Aid dependence	ICRG	<ul style="list-style-type: none"> • GDP per capita • Political rights • Fractionalization • Oil export • Population • Expenditure 	IV	“geographical and cultural distance to donor countries” (p.99)	5-year avg. (182)	+

¹¹ They create separate independent aid variables depending on donor countries. They create multilateral aid variables as well.

¹² The effects of aid (general) and multilateral aid. Most bilateral countries (except for Japan) do not have significant impacts.

2.3 Summary

This chapter reviewed theoretical and quantitative literature on the effects of foreign aid on the level of corruption in recipient countries. First, this chapter presented principal-agent theory and collective action theory in the study of corruption as well as the applications of these theories in the case of the effects of foreign aid on corruption. The former theory argues foreign aid helps recipient countries to reduce corruption through conditionalities. Against this, the latter theory reveals both donors and recipient countries face collective action problems and argues this allows political executives and public servants to keep or extend their corrupt practices. Second, this chapter reviewed quantitative studies of the relationship between foreign aid and the level of corruption through different measurements, methods, and number of cases and year coverage. While a certain number of studies reveal foreign aid can increase corruption control in recipient countries, other studies find aid can deteriorate the level of corruption. The methodological challenges in many of these articles will be discussed in the next chapter.

Chapter3: Methodologies of Corruption Studies: Instrumental Variables

In this chapter, I will offer the instrumental variable approach in this thesis with a critical review of previous usages. The present chapter will first critically review the existing instrumental variable approaches in the study of foreign aid and corruption. Following this review, this thesis will justify the use of the EU Council presidency as the instrument of analysis.

3.1 Existing Instrumental Variable Approaches

Examining the relationship between foreign aid and corruption in recipient countries involves many challenges, such as endogeneity and reverse causality. Reflecting such challenges, many scholars in this field have attempted to examine the effects through instrumental variables (IV). Many existing relevant literatures recognize “an important issue of endogeneity owing to reverse causality and omitted variables” (Asongu and Nwachukwu, 2016, p.2176). Instrumental variables are used in some foreign aid and corruption articles to solve “the problem of endogeneity of one or more explanatory variables” (Wooldridge, 2016, p.461).

Despite some attempts to examine the effects of foreign aid on corruption using instrumental variable method (Table 1), most of these existing studies more or less contain methodological problems: (i) many weak instruments, (ii) unobservable heterogeneity of instruments, and (iii) limited justifications of the exclusion requirement. As Angrist and Pischke (2014) review, there are three main requirements for the use of instrumental variables:

- (i) The instrument has a causal effect on the variable whose effects we’re trying to capture [...]
- (ii) The instrument is randomly assigned or “as good as randomly assigned” in the sense of being unrelated to the omitted variables we might like to control for [...]. This is known as the *independence assumption*.
- (iii) Finally, IV logic requires an *exclusion restriction*. [...] [It] describes a single channel through which the instrument affects outcomes (p.116; italic original).

Most existing studies do not convincingly succeed to pass one or more of these requirements. First, there are some studies which do not show significant effects of the instrument, which is against Angrist and Pischke's (2014) first requirement. For example, Knack (1999) uses many instruments to estimate the effect of foreign aid on corruption.¹³ The instruments include infant mortality rate in the 1980s, initial GDP per capita, initial population, French zone dummy, and A Central America dummy. According to Angrist and Pischke (2014), this way of instrumental variable analysis is problematic because using many weak instruments “to generate precise estimates of a single causal effect” (p.150) cannot detect effectively the causal relationship between foreign aid and corruption. Since this problem can be solved by using a single instrument which has significant effects on the independent variable, using many instruments are considered a risk in instrumental variable analysis.

Second, relating to the independence assumption, most of the instruments in existing studies have a risk of unobserved heterogeneity, which can weaken the results of foreign aid measured through the instrumental variable method. Many of the instruments were used in previous studies, such as “geographical and cultural distance to donor countries” (Tavares, 2003, p.99). Yet, these “instruments may suffer from unobserved heterogeneity” because scholars cannot provide how exactly assignments proceed (Carnegie and Marinov 2017, p.671; see also Sekhon and Titiunik, 2012).

Third, some scholars poorly justify the exclusion restriction in their investigation of the effect of aid on corruption. For instance, while Ear (2007) uses infant mortality similar to Knack (1999), he provides only limited and intuitive justifications to the exclusion restriction:

Of course, infant mortality is unlikely to be purely exogenous: *it is likely affected by poor governance, though in the long term it is unlikely infant mortality would affect governance.* Infant mortality rates would need to be massive to have a serious impact on a country's governance capacity, and save for adult HIV=AIDS prevalence in Africa, this is unlikely to be the case (Ear, 2007, p.265; emphasis added).

¹³ The same criticism is also applicable to Asongu, 2012; Asongu and Nwachukwu, 2016.

This limited justification weakens the validity of the findings, as it does not explain how long infant mortality would no longer have an impact on governance including corruption.

In addition to the limited justifications to three requirements, it should also be noted that the existing research has another shortcoming, namely lack of consideration over time lag of the effects of foreign aid on corruption. Except for Ear (2007), none of the articles¹⁴ lagged aid to examine the effects on corruption in recipient countries. According to statistic literature, the results of these studies can be less convincing than studies using lagged foreign aid because the latter can effectively prevent post-treatment bias (Rosenbaum, 1984; Carnegie and Marinov, 2017).

3.2 EU Council Presidency as the Instrument Variable

Reflecting problems in the use of IVs in the previous literature of foreign aid, this thesis will use EU Council presidency as the instrument to overcome the existing problems. As Carnegie and Marinov assert, EU Council presidency until 2006 perfectly satisfies the requirements as the IV: EU Council presidency has a causal effect on EU aid allocation; EU Council presidency had been rotated based on alphabetical order in their native language (i.e., it is randomly assigned and the assignment mechanism is quite clear); and EU Council presidency is unlikely to influence the level of corruption directly and can influence only through foreign EU aid allocation (2017).¹⁵ In particular, the second point – random assignment knowing the mechanism – is quite unique. “[N]atural experiments seldom have a known random assignment

¹⁴ Knack (1999), Tavares (2003), Asongu (2012), and Asongu and Nwachukwu (2016)

¹⁵ At the beginning of 2007, “the rotation principle changed such that three countries hold the presidency at a time” (Carnegie and Marinov, 2017), based on “the demographic and geographical range of all the Member States” (Treaty of Lisbon, 2007, Article 9D-5). EU Council Presidency from 2007 will not be considered as the ideal instrument because this principle limited the presidency’s power for initiating discussion in the council (Vaznonytè, 2020) and was not regarded as an as-if randomization in the use of the instrument variable (Carnegie and Marinov, 2017).

mechanism” (Sekhon and Titiunik, 2012, p.53), yet this is not the case in EU Council presidency as the instrument. This thesis will utilize this finding by Carnegie and Marinov (2017) and apply it to the study of corruption, although this instrument limits the scope of the analysis in this thesis to former European colonies. This is because “former colonizers tend to have political, cultural, and economic ties to these states” (Carnegie and Marinov, 2017, p.674) and thus former colonizers are likely to seek to distribute aid more to former colonies. Nevertheless, considering the huge advantages of the instrument and its potential for implications (as this thesis noted in the introduction), this paper regards EU Council presidency as the most suitable instrument.

How can EU Council presidency affect foreign aid allocation? Applying theories in International Relations and American Politics, Tallberg (2004) theoretically argues the presidency can influence EU policy-making processes through agenda setting. He additionally provides several case studies in Belgium, France, Finland, Germany, Portugal, and Sweden from 1999 to 2001. Moreover, as an investigation of specific policies, Warntjen (2007) examines the effects of EU Council presidency on EU environmental policies for wider periods (1984-2001) and finds influences using the position of EU Council presidency.

Based on these general findings, some scholars investigate further in which process EU Council presidency has power to influence EU policies. The most academically agreed argument is the presidency has an effect at the final stage of policymaking processes, namely the final revisions and the voting stage. Schalk et al. (2007) find EU Council presidency has influence most in the final stage from quantitative analysis using *Decision making in the European Union* dataset, which include 162 policy issues and 66 proposals. This result is robust in other studies such as Warntjen (2008). He recognizes the study of Schalk et al. (2007) in terms of lack of consideration of different policy issues and controls effects caused by different

policy issues, yet Warntjen (2008) still finds the effects of EU Council presidency in EU policies at the last stage.

3.3 Summary

This chapter reviewed the use of instrumental variables in existing studies and proposed the instrument this thesis will use. Regarding the literature review on instrumental variables in studies of foreign aid, this paper points out three limitations of their use of IV: many IVs, unclear assignment mechanism, and limited justification to exclusion restriction. Reflecting on such limitations, this paper justified its use of EU Council presidency to analyze the effects of EU aid on corruption in recipient former colonies as a replication of Carnegie and Marinov (2017). EU Council presidency is a perfect instrument as it has a causal effect on foreign aid allocation, the assignment mechanism is known, and it is not likely to affect directly the level of corruption.

Chapter 4: Analysis

This chapter presents the results of quantitative and qualitative analyses. After outlining the variables and the model, I will report the effects of aid allocation on four-year average corruption scores as well as these year-by-year effects. In the following section, this thesis will critically present qualitative evidence to support quantitative analyses: overall EU attitude against corruption and case study of DRC.

4.1 Variables and Model

4.1.1 Variables

The present study uses country panel data from the late 1980s to 2006. Due to the methodological nature of the study, EU aid recipient countries are limited to former European colonies. Data for the dependent variable, corruption in recipient countries, come from two indicators: ICRG and v-dem. First, as a measurement of corruption in recipient countries, I use corruption scores from political risk components of *International Country Risk Guide* (ICRG) index, which is available from 1982. Political components of ICRG index is 100-point scale indicator and measures countries' political risk for corporate foreign investment by adding the specific component which can be political risks (The PRS Group, n.d.). Corruption is also measured (6-point scale) as a component of the indicator. According to The PRS Group (n.d.), it measures political risks which can be caused by corruption including bribes, patronage, and nepotism through inefficient economic activities and dark market and is used as one of the sources of the *Corruption Perception Index* (CPI). While original scores of ICRG range from 0 (high corruption risk) to 6 (low corruption risk), I inverted and rescale the index from 0 (low

corruption risk) to 10 (high corruption risk) in order to make it comparable to other dependent variables.

Second, in order to measure specific aspects of corruption, I also use relevant indicators from the v-dem institute: political corruption, executive corruption, and public corruption. V-dem is a rich dataset aimed at measuring different components of democracy and provides three major indicators to measure corruption. *Political Corruption* score is an aggregated indicator which covers corruption in executive, judicial, legislative, public sector, judicial, and legislature corruption. *Executive Corruption*, *Public Sector Corruption*, *Judicial corruption decision* and *Legislature corrupt activities* scores measure corruption in the executive, public officers, judicial branch, and legislative branch respectively. Compared with other corruption indicators such as *World Governance Indicators* (WGI) and *Corruption Perception Index* (CPI), these five v-dem corruption indicators have a significant advantage in corruption analysis in the sense that they cover much longer periods than existing corruption indicators. While WGI and CPI cover only after the late 1990s, v-dem corruption indicators cover from 1789 to the present (V-Dem Institute, 2019). They are distinguishing indicators because they provide both average corruption score and each component score for such a long period, which previous corruption indices – except for proxy indicators including ICRG – fail to achieve. While original scores of v-dem corruption indicators range from 0 (low corruption) to 1 (high corruption), I rescaled it to a 10-point scale (0-10; from low to high).

In terms of independent variable and instrumental variable, as justified in the previous chapter, the present study will follow Carnegie and Marinov (2017). This thesis will use EU foreign aid allocation (Carnegie and Marinov, 2017), which originates from the OECD, as the independent variable. I will also follow the usage of the instrumental variable of EU foreign aid council until 2006, as Carnegie and Marinov (2017) skilfully find it a useful and effective instrumental variable. Table 2 presents a first look at descriptive statistics of the data used in

Table 2 Descriptive Statistics

Variable	Obs.	Mean	SD	Minimum	Maximum
Former colony status	4,027	.0902657	.2858383	0	1
EU aid allocation	4,250	2.154306	1.507431	0	5.784837
ICRG	1,788	5.681581	1.689272	0	10
V-dem					
Political corruption	4,762	5.698935	2.544215	.1	9.7
Executive corruption	4,804	5.608364	2.631571	.14	9.75
Public corruption	4,804	5.448416	2.578767	.06	9.74
Judicial corruption	4,754	4.807352	1.425333	1.3525	8.645
Legislature corruption	4,249	5.385051	1.497371	1.61125	9.3

the analysis and Appendix B presents the variables and sources.

4.1.2 Model

Following the models generated by Carnegie and Marinov (2017), the regression model (second-stage regression) in the present study is the following:

$$CORit' = \beta_0 + \beta_1 \log(ODA)_{i(t-1)} + \sum_{k \in K} \beta_k I(i = k) + \sum_{j \in J} \beta_j I(t = j) + u_{it},$$

where $CORit'$ indexes country i 's corruption risk for forging investment (ICRG) or political, executive, public sector, judicial, and legislative corruption (v-dem) in period $t' \geq t$, $\log(ODA)_{i(t-1)}$ is the logged net EU aid allocation (ODA) in period $t - 1$ which I replicated from Carnegie and Marinov (2017; originally from OECD data), I reflects country/year fix effect on the model, and u_{it} is an error term.

As I argued in Chapter 3, the present study will conduct first-stage regression before analyzing the previous model. The first-stage regression model is

$$\log(ODA)_{i(t-1)} = \gamma_0 + \gamma_1 Colony_{i(t-2)} + \sum_{k \in K} \gamma_k I(i = k) + \sum_{j \in J} \gamma_j I(t = j) + e_{it},$$

where $Colony_{i(t-2)}$ is the instrument which shows whether the country i was a former colony of European countries (UK, France, Spain, Italy, Netherland, Belgium, Portugal). Because of the different extent of influence through the EU Council Presidency position (as reviewed in Chapter 3), the present study considers the presidency position only in the later half of the year

(July–December) in period $t - 2$, considering the time lag between the policy decisions and effects caused by the decisions.

4.2 Results

Table 3 reports the results of 2OLS regressions. Column 1 to 6 show the results of 2OLS regressions of each independent variable. The first-stage regressions in all models show that there are statistically significant effects of EU Council Presidency on aid allocation. F-statistics of excluded instruments in the first-stage regressions show the EU Council Presidency has strong power as the instrument. Regarding the main models, the second-stage regressions without covariates (columns 1 to 5) show that EU foreign aid allocation seems to have effects on reducing corruption, yet the magnitude of the effects is quite small. For example, column 1 shows 100-percent increase of aid causes only 0.6 point reduction (10-point scale)¹⁶ of the level of corruption in recipient countries. Other models show even smaller effects. The comparison with the effects of aid allocation on human rights and democracy also shows the scale is small: one-log increase of EU aid allocation has an impact on improving 1.885 human right score (scale: 0-14) and 2.031 democracy score (scale: from -10 to 10) (Carnegie and Marinov, 2017).

Compared among components of v-dem political corruption indicators (column 3, 4, 5), the effects are slightly bigger on executive and public sector corruption (column 3, 4) than on judicial sector (column 5). This slight difference can be attributed to the different extent of understanding of corruption in executive and public sector corruption rather than in judicial corruption. Executive corruption incidents are often revealed in media releases or opposition

¹⁶ Sceptical readers may claim this can be substantial effects, yet the effects of ICRG are indeed small. Although the detailed methodologies of scoring are not published by PSR group, the scoring criteria looks quite rough in comparison with v-dem indicators and scores tend to jump one point in the 0-6 scale only for a year (i.e., more than one point on the 10-point scale; see Appendix C for the visualization of score distribution). Considering this tendency of ICRG scoring, I argue the effects of ICRG are quite small.

Table 3: IV Estimates of the Effects of EU Foreign Aid on Corruption in Recipient Countries

Dependent Variable (Four-Year Average)	ICRG	V dem (Political Corruption)	V dem (Executive Corruption)	V dem (Public Corruption)	V dem (Judicial Corruption)	V-dem (Legislature Corruption)
	1	2	3	4	5	6
Aid Allocation (SE)	-0.631 (0.533)	-0.041 (0.034)	-0.250 (0.151)	-0.262 (0.133)	-0.038 (0.239)	0.136 (0.132)
Countries	65	102	102	102	101	102
Years	18	22	22	22	20	20
Covariates	No	No	No	No	No	No
Fixed Effects (Year)	Yes	Yes	Yes	Yes	Yes	Yes
Fixed Effects (Country)	Yes	Yes	Yes	Yes	Yes	Yes
Observations	1538	2002	2017	2017	1994	1945

Note: ICRG and v-dem scores are rescaled as 0-10 scale (10 means high corruption). First-stage coefficient in each model is the following: (1), 0.195 (SE = 0.067, F= 8.46) (2) 0.149 (SE = 0.039, F = 14.64), (3) 0.162 (SE = 0.046, F = 12.31), (4) 0.162 (SE = 0.047, F= 11.55), (5) 0.150 (SE=0.039, F=14.46), (6) 0.158 (SE=0.050, F=10.03).

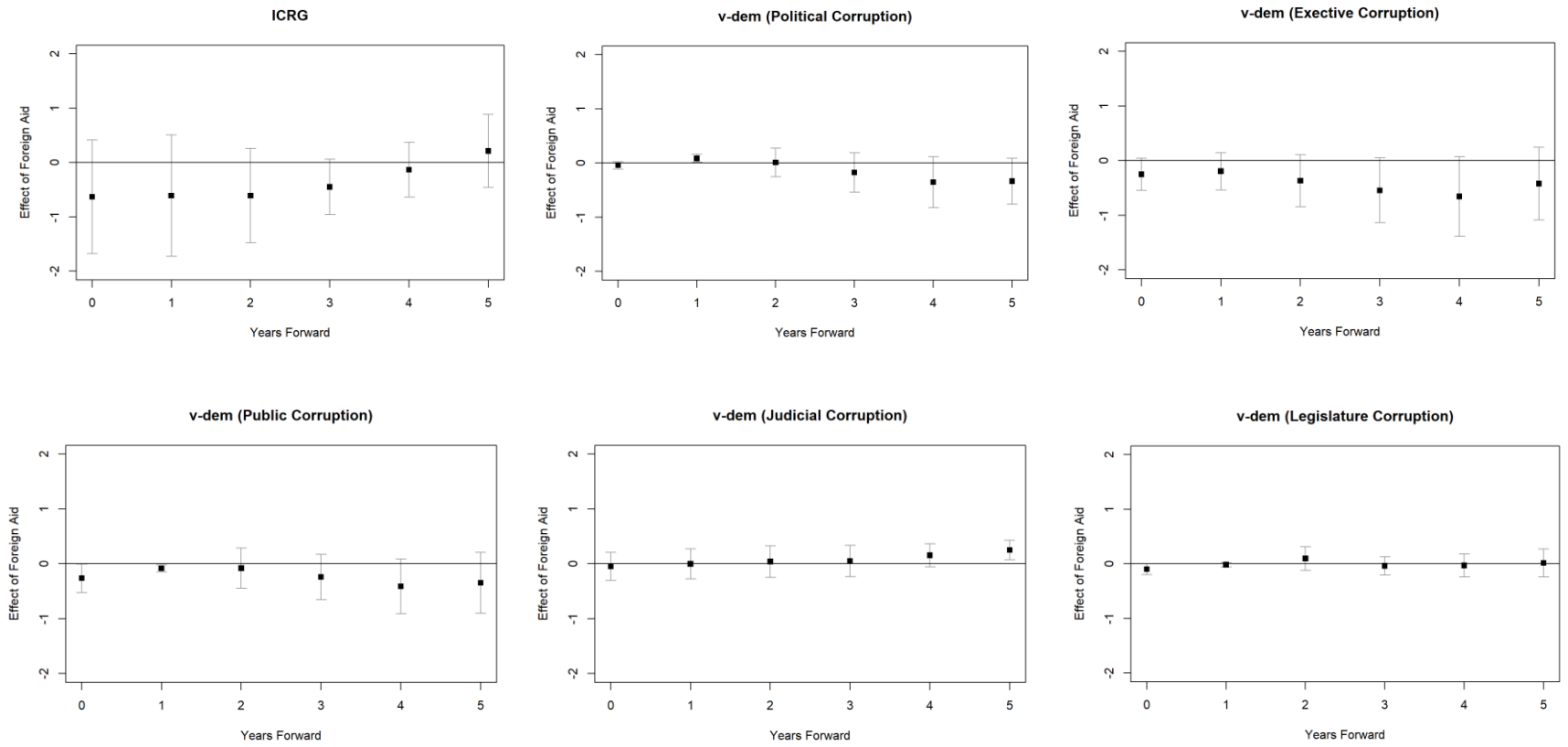


Figure 2: Year-By-Year Effects of EU Aid Allocation on Corruption (t through $t + 5$)

parties (of course, the extent of influence depends on political environment in each country), and public sector corruption can be relatively well-known through aid development policy implementation. In terms of legislature corruption, it is a different result from other models in the sense that the models (column 6) show that they have small effects to fuel corruption. Similar to judicial corruption, this may imply that EU policymakers have less ability to monitor corrupt activities in legislative branches and allow domestic politicians slightly to expand corrupt activities.

Turning to Figure 2, I test the year-by-year effect of EU aid allocation on corruption in recipient countries. Overall, year-by-year effects are also quite small in all models over the period t through $t + 5$. However, the effects over periods differ slightly among ICRG scores, v-dem scores for political, executive, and public sector and for judicial and legislature. While the effects of EU aid on ICRG scores diminished over the period, the effects on v-dem scores (political, executive, and public sector) strengthened slightly during the later period. This may imply that foreign investors slightly change the perception of corruption risk immediately (ICRG), whereas academics take a longer time to change slightly the perception of corruption in recipient countries. Similar to the findings from Table 3, year-by-year effects on judicial and legislature corruption show that the size of effects are much smaller than on corruption risk and specific aspects of corruption regardless of the period after the aid allocation.

4.3 Discussion

4.3.1 Little Interest to Impose Sanctions against Corruption

Why did all models show only small effects of EU aid allocation on corruption in recipient countries? Previous EU consultation and sanction (aid suspension) implementation illustrates the different extent of EU's engagement in anti-corruption until 2009. Table 4 shows the cases which were under consultation for aid suspension or which EU actually suspended aid

allocation as a sanction. It is clear many countries do not actively impose EU sanctions against corruption. There is only one country (Liberia in 2001) in which EU imposed a sanction against corruption and no former European colonies received sanctions against corruption. Limited interest to impose sanctions against corruption are clearer when it is compared with other possible reasons for sanctions. EU rarely imposes sanctions against corruption in Africa, the Caribbean and the Pacific countries, while it imposed sanctions against violations of Human Rights (13 cases), Rule of Law (23 cases), and Democracy (34 cases).

This trend did not change even after the Cotonou Partnership Agreement in 2000. This was signed between EU member states and Africa, the Caribbean and the Pacific (ACP) states in June 2000 and deals with corruption as one of the fundamental political principles. Article 9 of the Agreement refers not only to human rights and democracy promotion but also good governance as fundamental principles:

2. The Parties refer to their international obligations and commitments concerning respect for human rights. They reiterate their deep attachment to human dignity and human rights, which are legitimate aspirations of individuals and peoples. Human rights are universal, indivisible and inter-related.

3. In the context of a political and institutional environment that upholds human rights, democratic principles and the rule of law, good governance is the transparent and accountable management of human, natural, economic and financial resources for the purposes of equitable and sustainable development. ... Good governance, which underpins the ACP-EU Partnership, shall underpin the domestic and international policies of the Parties and constitute a fundamental element of this Agreement. The Parties agree that only serious cases of corruption, including acts of bribery leading to such corruption, as defined in Article 97 constitute a violation of that element. (European Union, 2000, Article 9)

Unfortunately, the comparison of EU sanctions before and after the Agreement shows that while the number of sanctions against violations of human rights and democracy were increased, the sanctions against corruption did not. Such little interest to impose sanctions against corruption was also the case in a DRC aid program designed during the Belgium presidency in 2001, which this thesis will examine as a typical case study.

Table 4: EU Sanctions on Africa, the Caribbean and the Pacific Countries

	Year	Human Rights	Rule of Law	Democracy	Corruption
Sudan	1990	✓	✓	✓	
Haiti	1991		✓	✓	
Kenya	1991			✓	
DRC	1992			✓	
Togo	1992			✓	
Malawi	1992			✓	
Equatorial Guinea	1992	✓	✓	✓	
Guatemala	1993	✓		✓	
Nigeria	1993			✓	
Gambia	1994		✓	✓	
Comoros	1995		✓	✓	
Nigeria	1996		✓	✓	
Burundi	1996		✓	✓	
Sierra Leone	1997		✓	✓	
Togo	1998			✓	
Niger	1999			✓	
Guinea-Bissau	1999		✓	✓	
Comoros	1999		✓	✓	
Côte d'Ivoire	2000		✓	✓	
Haiti	2000			✓	
Fiji	2000		✓	✓	
Côte d'Ivoire	2001		✓	✓	
Liberia	2001	✓	✓	✓	✓
Zimbabwe	2002	✓	✓	✓	
Central African Republic	2003		✓	✓	
Guinea	2004	✓	✓	✓	
Togo	2004	✓	✓	✓	
Guinea-Bissau	2004		✓	✓	
Mauritania	2005	✓	✓	✓	
Fuji	2007	✓		✓	
Mauritania	2008	✓	✓	✓	
Guinea	2009	✓	✓	✓	
Madagascar	2009	✓		✓	
Niger	2009	✓	✓	✓	

Source: Zimelis, 2011, p.397

4.3.2 Case Study – 2001 Belgium Presidency and EU Aid to DRC

In this section, I will examine the case of the 2001 Belgium EU Council Presidency and its effect on DRC aid programs. This case is categorized as a rare typical case in the sense that it is typical in the instrument mechanism, independent and dependent variable (Rohlfing, 2012).¹⁷ It is derived from the results that not only did the Belgium presidency succeed in allocating EU aid to DRC after 2001¹⁸ (following the decisions in EU council meeting 12330/01, 13802/01, and 15078/01; European Commission, 2001a; 2001b; 2001c) but also most of the indicators of corruption show that there were no changes to the level of corruption in DRC after 2001 (Figure 3). Before Belgium started to actively engage in development cooperation from 2001, the actual intervention to DRC from European countries was limited to diplomatic efforts and did not include much security effort (Kelly, 2007), although EU seemingly increased its intervention to DRC since the late 90s. As Bourque and Sampson (2001) review, most of the intervention from European countries to DRC until the 90s were based on domestic and international NGOs.

This trend changed in 2001, after Belgium signed the Agreements with DRC which promised to offer around 20 million Euros as bilateral development aid. The existing researches analyze the potential factors which encouraged Belgium to enhance the relationship with DRC. First, there was a major change of government coalition in Belgium in 1999. The long-ruling conservative party, which was reluctant to engage in active interventions to DRC stepped down after the election in 1999 and the liberal parties that support further interventions to DRC joined in a coalition (Kelly, 2007; Bunse, 2009). For example, the Minister of Foreign Affairs – Louis

¹⁷ The Belgian case is also valuable in that it is an example of an EU presidency which actually influenced EU aid policies. This helps scholars to confirm the mechanism between the presidency and aid allocation – which the instrumental variable in this thesis assumes – occurred in a real case (Seawright, 2016, ch.7).

¹⁸ It should be noted that the particular presidency in Belgium was chosen based on the analysis of Nasra (2011), which found the 2001 presidency had a significant impact in comparison with later policy influence from Belgium.

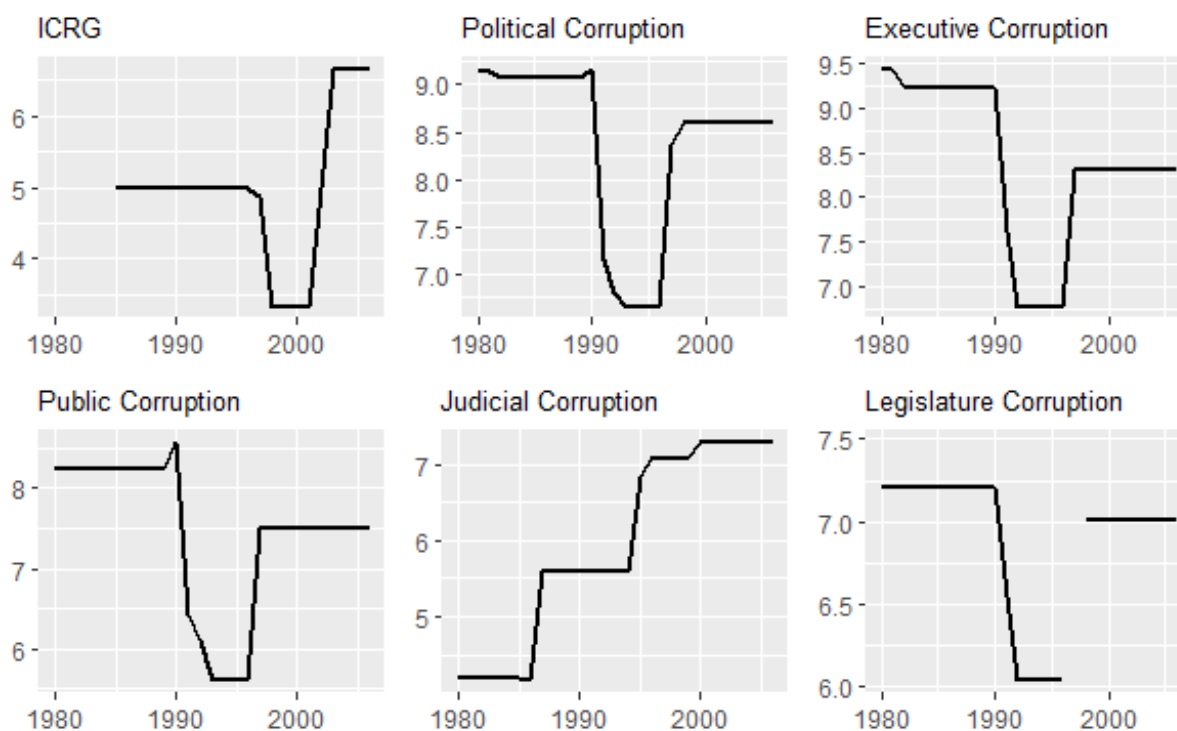


Figure 3: Corruption in DRC (until 2006, 0-10 scale)

Michel – actively promoted development cooperation to DRC. Kelly (2007) notes the active engagement of Louis Michel regarding Belgian intervention to DRC:

When Michel became the Minister of Foreign Affairs at the end of 1999, he called for the reinforcement of the Lusaka Peace Accords in the DRC. He also used his political power to surround himself with other individuals who shared his opinion on intervention in the DRC. In January 2001, he appointed Reginald Moreels his Special Representative for Humanitarian Affairs to advance the Lusaka process (p.77)

Additionally, Bunse (2009) argues Belgium decided to promote development support to African countries also in order to “restore Belgium’s international reputation by taking the lead in peace initiatives, conflict prevention, and humanitarian aid” (p.119).

Reflecting on such political environment, Belgium also promoted EU to engage in multilateral development cooperation in the Great Lake region (including DRC) during the Belgian presidency in 2001. During the presidency, Belgium effectively used the presidency’s agenda-setting role and reported them as council conclusions (Nasra, 2011). Belgium repeatedly raised development cooperation to DRC as an agenda in weekly meetings (12330/01,

13802/01, and 15078/01: European Commission, 2001a; 2001b; 2001c). Although the first meeting ended up with just expressing EU's view that they were in favor of financial support to DRC (12330/01: European Commission, 2001a), Belgium successfully led the following meetings to conclude further on the issue. Weekly meeting 13802/01 concluded to confirm the support (European Commission, 2001b) and weekly meeting 15078/01 discussed further both signing an aid program in DRC and ways to implement aid programs through National Indicative Program¹⁹ (NIP) (European Commission, 2001c).

Furthermore, the Belgian presidency succeeded in concluding multiple EU development programs in DRC for later years.²⁰ Starting from the decision in 2001 to offer 1.9 million Euros for DRC conflict resolution, EU boosted its amount of development cooperation: 5.5 million Euros in 2002 and 106 million Euros in 2003 (Bobineau and Gieg, 2016). Considering the aid suspension from 1992 to 2001 (Arnould and Vlassenroot, 2016), these increases of aid allocation to DRC from 2001 (particularly from 2003) are indeed significant in terms of DRC's development cooperation with EU.

The EU aid programs to DRC after the Belgian presidency were a comprehensive package of development cooperation: it consists in democracy and human rights promotion, judicial sector reforms, and humanitarian supports (Bunse, 2009; Arnould and Vlassenroot, 2016). Examples include civilian protection from being attacked, "capacity-building of judicial officials", allocation of more resources for judicial officials to expand law enforcement, and support for and observations of local and national elections (Hoebeke, Carette, and Vlassenroot,

¹⁹ NIP "defines the sectors and fields which will receive the aid, explains how the aid will fulfil its objectives, gives a timetable for implementation, and specifies how NGOs will be involved in the programme (if relevant)" (European Commission, 2002, p.22).

²⁰ There are several analyses which examine why the Belgian presidency succeeded in not only discussing in the European Council but also reaching multiple conclusions and agreements. For example, Nasra (2011) and Bunse (2009) similarly point that it was effective that the Belgian presidency emphasized EU's role of aid allocation to African countries due to "historical responsibility" (Bunse, 2009, p.129) rather than stating Belgian political and economic interests. Bunse (2009) noted Belgium encouraged the EU to allocate aid to DRC prior to the Belgian presidency through, for example, initiating a dialogue with African countries in 2000.

2007; Arnould and Vlassenroot, 2016, p.12). However, despite these programs being implemented after the Cotonou Agreement, relevant evaluation reports reveal that EU did not actively engage in anti-corruption through the aid programs (Davis, 2015). The case in point is the lack of documentation of corruption risks in DRC:

The programme documents do not mention a number of major risks — notably the lack of political will, fraud and corruption — which are a serious matter for concern in the DRC. (European Court of Auditors, 2013, p.22)

In addition, not only did EU not document any corruption risks in the implementation of aid programs, but also it arguably increased the risk of corruption in aid programs. As Bourque and Sampson (2001) note, the budget for the programs were flexible, which permits locals to use the budget without any prior justification. Although this can be effective to respond immediately, this may allow locals to use it as a source of corruption. Hoebeke, Carette, and Vlassenroot (2007), indeed, reveal an aid program which was launched to support salary payments to soldiers, which allowed corrupt executive soldiers to embezzle most of the payment, as well as to gain additional payment for their personal use via registering ghost soldiers.

Furthermore, according to existing reviews, the implementations of aid programs on judicial reforms, which can reduce corruption indirectly,²¹ were not strong enough to reduce corruption. As Rubbers and Gallez (2012) conclude, judicial reforms “did little or nothing to stem corruption” (p.5) and corruption by judicial officers remained regardless of the reforms. Although it is challenging to find the reasons why it was not effective to contribute to tackling corruption through judicial reforms, there seems to be two main factors which prevented deeper reforms: idealistic discourse and fragmented reforms. First, the judicial reforms in DRC were

²¹ Anti-corruption through judicial reforms can be achieved through increasing both resources and impartiality of judicial decisions (Mendelski 2012). Examples include establishment of anti-corruption specific courts in Indonesia from 2002 to 2010 when its resource was significantly diminished by separation of its power into provincial courts (Butt and Schütte, 2014)

implemented with an idealistic discourse that judicial reforms such as increasing resources to judicial offices themselves could reduce corruption without any further detailed reforms.

Rubbers and Gallez (2012) clearly reveal this point from an interview with a local officer:

We are always confident that justice will win out, except that there are some people who have come there to make a mockery of justice through corruption. But the truth is, the truth will always find a way to make itself known, or to win out. (p.101)

Second, the reforms were so fragmented that these did not lead to fundamental changes including corruption control. The scope of reforms was limited to just increasing judicial capacity (i.e., not increasing impartiality as well) and not connected well with other relevant programs such as security aid programs (Arnould and Vlassenroot, 2016).

4.4 Summary

This chapter analyzed the effects of EU aid allocation on corruption in recipient countries. The results show that while EU aid allocation until 2006 reduced most types of corruption, the magnitudes of these effects were quite small. It was also revealed that the effects were different depending on the measurements of corruption. The reduction effects on corruption risk (ICRG) as well as political (aggregated indicator), executive, and public sector corruption were slightly bigger than judicial corruption. It was also reported that EU aid allocation had potential to fuel legislature corruption during the analyzed period. In addition, this chapter tested year-by-year effects of EU aid allocation. Whereas there were slight effects on ICRG scores immediately, there were small effects on other types of corruption over a longer period. Similar to the results of four-year average effects, the effects of political (aggregated indicator), executive, and public sector corruption were slightly bigger than judicial corruption and there was a slight opposite effect on legislature corruption. Furthermore, I confirmed the quantitative evidence by analyzing qualitatively the EU sanctions against violations of human rights, democracy, the

rule of law, and good governance, as well as the rare case of DRC, to which the 2001 Belgian presidency had a concrete influence on aid allocation.

Chapter 5: Conclusion

The effects of foreign aid on the level of corruption in recipient countries were one of the popular topics among anti-corruption and political economy scholars. While some researchers find foreign aid can reduce corruption through mechanisms such as imposing aid conditionality, other researchers find foreign aid can fuel the level of corruption. Considering the endogeneity issue on the relationship between the two, they tend to analyze the effects through instrumental variable approaches or Generalized Method of Moments.

However, such works often poorly justify their theoretical and methodological foundation. Most of the studies do not provide possible justifications of their analyses and findings from theories of corruption – principal-agent theory and collective action theory. These studies also often fail to justify their use of methodology with methodological literature. This is particularly the case in the use of instrumental variables (IV), which just replicate the previous usages of IVs. Additionally, previous studies examine the effects with proxy measurements of corruption, such as International Country Risk Guide (ICRG), or aggregated indicator which measure the overall level of corruption, such as World Governance Indicators (WGI) and Corruption Perception Index (CPI).

Reflecting the innovative study by Carnegie and Marinov (2017) and recent developments of new corruption indicators, the present study applied their approach to the study of corruption with multiple new corruption indicators. In other words, this thesis addressed the issues of theoretical justification, measurement, and methodologies, using EU council presidency rotation as an as-if randomization and incorporating multiple corruption indicators, including ones measuring particular aspects of corruption (such as executive and public sector corruption) with an extensive theoretical review of aid and corruption. Not only analyzing average effects of EU aid allocation, this thesis also examined the year-by-year effects of EU aid allocation on each aspect of corruption.

The presented analyses until 2006 showed that the size of effects of EU aid allocation on corruption risk as well as on political, executive, public sector, and judicial corruption were quite small. The comparison among each v-dem corruption indicator (executive, public sector, and judicial corruption) also revealed the former two types of corruption were more likely to be affected by EU aid allocation than judicial corruption. Regarding legislative corruption, the result even shows EU aid allocation can slightly fuel corruption. Additionally, the present study also tested year-by-year effects of EU aid. While the effects on corruption risk diminished over the period, the effects on political, executive, and public sector corruption strengthened slightly in the later period.

In addition to these quantitative analyses, this thesis also conducted qualitative analysis and found the EU did not impose any sanctions against corruption in former European colonies that received EU aid until 2006. EU rarely imposed sanctions against corruption, whereas it actively imposed sanctions against other violations (i.e., democracy, human rights, and the rule of law) over the period. This was revealed not only from general records of EU sanctions but also from a case study of the effects of aid on corruption in DRC after the 2001 Belgian presidency – a rare typical case which gave a concrete influence over EU aid policies using the Council presidency position. Despite the Cotonou Agreement, the present study found reducing corruption has not been paid enough attention as one of the conditions of aid distribution by the EU.

The findings, overall, suggest EU aid conditionality does not have substantial effects on reducing corruption in recipient countries in comparison with effects on other development issues such as democracy promotion and human rights improvement due to little interest to impose sanctions against corruption. Although the present study limits the scope and period of the analysis, the findings will also be applicable to EU aid allocation in recent years, as the EU still rarely imposes sanctions against corruption in aid recipient countries (Crawford and

Kacarska, 2019). Anti-corruption scholars and practitioners need to work further on how to ensure reduction of corruption in recipient countries through aid conditionality (i.e., imposing sanctions). Otherwise, aid allocation would not be convincing for citizens who oppose foreign aid allocation and would not effectively help combat corruption in recipient countries.

Furthermore, this thesis suggests scholars of anti-corruption need to re-consider the effects of foreign aid based on different corruption indicators. The results of IV models in the thesis showed different effects of EU aid on corruption depending on measurements of corruption – corruption risk (ICRG), political corruption (v-dem), and each component score (executive, public sector, judicial, and legislative corruption; v-dem). These findings imply it is important to examine effects of aid on specific aspects of corruption in addition to general level of corruption using different multiple corruption indicators.

The present study limits the scope of analysis in terms of time (until 2006; due to methodological reasons) and places (former European colonies), which limits the generalizability of the research. However, the findings should be considered in future research. First, the findings do not indicate any effects of other multilateral and bilateral aid on corruption. Since the aid allocation strategies differ from each donor institution, such effects should be examined with rich theoretical and methodological foundations, as well as a variety of measurements. Second, the thesis neither includes any covariates in the models nor directly covers effects of EU aid allocation on corruption after 2007. Future research should include covariates in the models with theoretical justification for variable selection in order to estimate the models more precisely and should examine whether the recent policy revisions²² by EU policymakers have had any changes on the effects.

²² For example, from 2008, the “governance incentive tranche” instrument was introduced to aid programs to Africa, the Caribbean and the Pacific Countries (Mungiu-Pippidi 2019, p.75). This policy is different from traditional negative aid conditionality in that “governance incentive tranche” is categorized as an example policy which is actually based on the idea of positive aid conditionality.

Third, further researches are required to find the reasons why the EU is not keen to impose aid conditionality against corruption in recipient countries. While collective action theories in corruption studies suggest the lack of interest is caused by collective action dilemma, I could find no convincing data to prove the point. This should be analyzed with more primary sources (e.g., interviews). Finally, future studies should extend the present study by addressing the heterogeneity effects of the aid allocation on the level of corruption. Qualitative and quantitative comparisons between countries with low and high institutional capacity for anti-corruption (from the perspectives of monopoly, discretion, and accountability; Klitgaard, 1988) deserve attention as a further explanation of possible differences of the effects of aid allocation.

Appendix

Appendix A. List of States

1. Former Spanish Colonies

Argentina
Barbados
Bolivia
Chile
Colombia
Costa Rica
Cuba
Dominican Republic
Ecuador
El Salvador
Equatorial Guinea
Guatemala
Guyana
Haiti
Jamaica
Mexico
Honduras
Nicaragua
Panama
Paraguay
Peru
Suriname
Trinidad and Tobago
Uruguay
Venezuela

2. Former Portuguese Colonies

Angola
Brazil
Cape Verde
Guinea-Bissau
Mozambique
Sao Tome and Principe

3. Former British Colonies

Bahamas
Bahrain
Bhutan
Botswana
Brunei
Burma/Myanmar
Cyprus
Egypt
Eritrea
Eswatini
Fiji
Ghana
India
Iraq
Jordan
Kenya
Lesotho
Malawi

Malaysia
Maldives
Mauritius
Namibia
Nigeria
Oman
Pakistan
Qatar
Seychelles
Sierra Leone
Singapore
Solomon Islands
South Africa
Sri Lanka
Sudan
Tanzania
The Gambia
Uganda
Vanuatu
Yemen
Zambia
Zimbabwe

4. Former French Colonies

Algeria
Benin
Burkina Faso
Cambodia
Cameroon

Central African Republic
Chad
Comoros
Côte d'Ivoire
Djibouti
Gabon
Guinea
Laos
Lebanon
Madagascar
Mali
Mauritania
Morocco
Niger
Republic of the Congo
Senegal
Syria
Togo
Tunisia
Vietnam

5. Former Belgian Colonies

Burundi, Democratic Republic of the
Congo, Rwanda

6. Former Italian Colonies

Libya, Somalia

7. Former Dutch Colonies

Indonesia

Appendix B: List of Variables

1. Instrumental Variable

l2CPcol2: Former colony status (twice lagged in the second half of the year)

(Source: Replication data of Carnegie and Marinov, 2017)

2. Independent Variable

EV: aid allocation (EU net ODA)

(Source: Replication data of Carnegie and Marinov, 2017)

3. Dependent Variables (Rescaled 0-10 scale; 10 means high corruption)

icrgavg: ICRG corruption score (averaged over four years)

(Source: International Country Risk Guide - The Corruption Index)

v2x_corravg_rs10: Political corruption score (averaged over four years)

v2x_execoravg_rs10: Executive corruption score (averaged over four years)

v2x_pubcoravg_rs10: Public sector corruption score (averaged over four years)

v2jucorrdc_rs10: Judicial corruption decision (averaged over four years)

v2lgccpt_rs10: Legislature corrupt activities (averaged over four years)

(Source: V-Dem Institute, 2019)

Appendix C: Distributions of ICRG and V-dem (Political Corruption) score

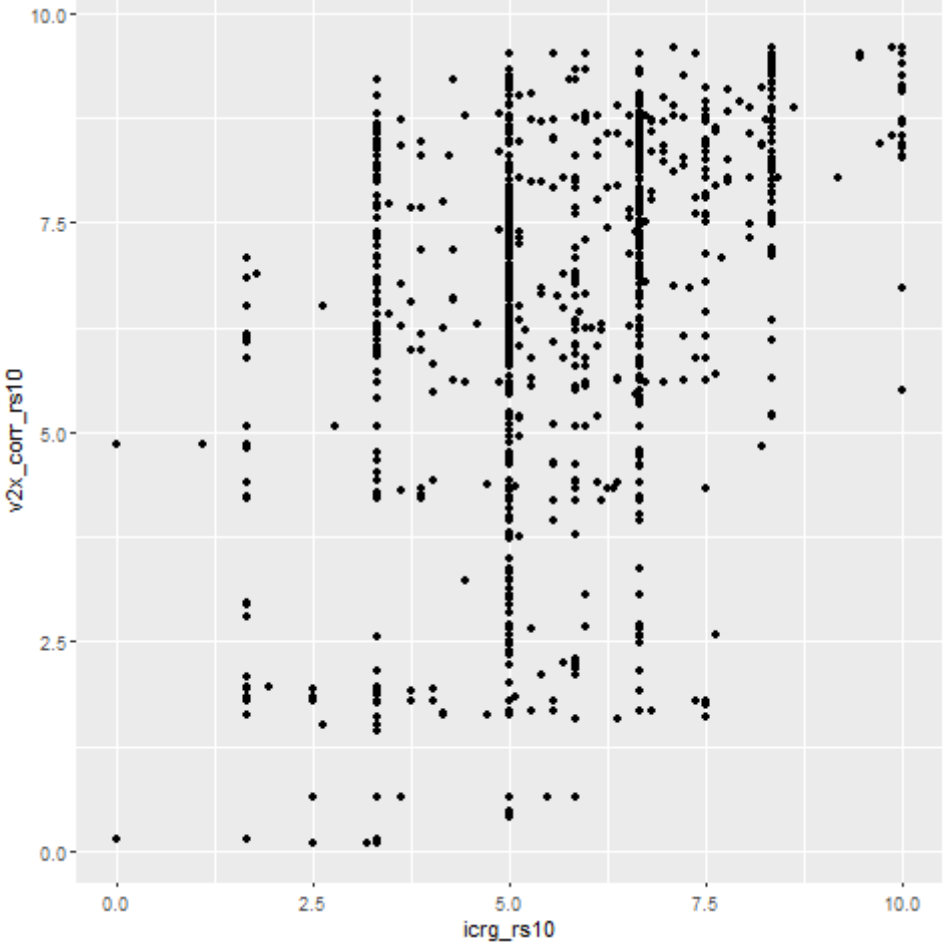


Figure 4: Distributions of ICRG and V-dem (Political Corruption) score

Appendix D: Replication Data

Replication data (data files, codes for merge and analysis) is stored in Harvard Database <https://dataverse.harvard.edu/dataset.xhtml?persistentId=doi:10.7910/DVN/9L2LLQ>.

All data is available upon request.

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