

Identifying the Democratizing Effects of EU Aid: The European Council Presidency as an Instrument*

Nikolay Marinov

nikolay.marinov@yale.edu

Yale University

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Abstract

While some scholars have argued that Western aid has helped countries democratize, there are many who doubt that aid is good for anything. Much of the debate in the cross-national literature stems from the difficulty of identifying the true effects of foreign aid given its non-random allocation with respect to unobservable country-level characteristics. This paper considers the case of European Union (EU) aid, and proposes the use of the rotating Presidency of the European Council as an instrument to help identify the true effect of aid on democratization. EU members are assigned to the Presidency in a manner exogenous to the process of democratization in the developing world: what counts for assignment is the position in the alphabet of the first letter of the country's name. EU Presidencies enjoy significant agenda-setting power which gives them influence over aid allocations. Using characteristics of the presiding country as instruments to predict aid provides leverage over the problem of estimating the effect of assistance on democratization. The instrumented effect of foreign aid on democratization indicates that, at least for the case of the EU as an actor, foreign aid has been good for democracy.

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1 Introduction

Does aid promote democracy? While most of the research to date has focused on the question of whether aid promotes economic growth,¹ some scholars have suggested a link between overseas assistance and the growth of democracy. Joining international organizations, that are in turn suppliers of aid and other benefits, has been found to promote democracy (Pevehouse, 2002). Aid to African countries has been related to democracy, for the period after the end of the Cold War (Dunning, 2004).² Yet, empirical studies disagree substantially, with Knack (2004) making the case for no effect of foreign assistance on democratization. Scholars have warned that aid dependence may even endanger the prospects of home-grown democratic institutions (Smith, 2008; Morrison, 2009).

This paper focuses on the case of European Community aid, and asks whether countries receiving more EU aid have been more likely to democratize.³ There are three principal justifications for focusing on EU aid. First, the EU is an important actor in world affairs, due to the size of the European common market and due to the historical connections between Europe and much of the developing countries. Second, the European Union is a multilateral institution committed to the goals of democratic government by virtue of its founding treaty.⁴ Third, by focusing on a specific donor, we can parse out the decision-making process that determines how aid is allocated. Focus on decision-making and institutions can help us deal with the problem of non-random allocation of aid flows to recipients.

A central difficulty in studying the effect of foreign assistance on democratization, or any other outcome, is that aid is not allocated independently of specific country-level characteristics in recipient that may in turn drive democratization. Because the ability of the researcher to control for these characteristics is likely to be limited by their unobservable nature, any estimates of the effects of aid may be unreliable due to

¹The literature on aid and growth has come to the conclusion that aid has not been able to promote economic growth (Easterly, 2006). Among the many possible culprits, scholars have cited the bad policies of the receiving government (Burnside and Dollar, 1997) and the politically-motivated targeting of aid by donor governments (Alesina and Dollar, 2000; Schraeder, Hook and Taylor, 1998). Perversely, aid may simply be growing the size of government (Remmer, 2004).

²See Goldsmith (2001) for a more skeptical view.

³Strictly speaking, bilateral aid by the EU country members is usually counted toward EU aid but for purposes of the paper EU aid will be used to refer to European Community aid only, the chunk of assistance that comes out of the pooled money at the EU level under the Commission's administration.

⁴The treaty of Rome, establishing the EC, explicitly mentioned the need to defend democracy. This commitment has been strengthened since 1991.

omitted variable bias. One way to deal with the problem is to identify a process that drives foreign allocations and is, plausibly, exogenous to a country's democratization prospects. This paper presents one candidate for such a process, drawn from a closer look at how the EU functions as an institution.

EU aid is part of the budget negotiations between three institutions within the Union: the European Council, the European Parliament and the European Commission. Of these, the Council, comprised of state representatives, has the last, and in some ways, the first word on how much aid is entered into the budget. Within the Council, not all member states are equal: the country holding the EU Council Presidency has considerable control over agenda-setting and other key procedures of EU policy-making. The Council Presidency, in turn, rotates among member states according to preset rules, based on where the country's name is in the alphabet. While the rules have changed somewhat over time, they are arguably exogenous to the process of democratization in the world. The special influence yielded by the presiding country suggests that its leaders may influence the aggregate level of resources allocated as official developmental assistance.

Why would a presiding country push for more aid? Countries differ in terms of what we characterize as donor generosity: some countries, for historical, cultural or a plethora of other reasons favor giving more to the rest of the world. Dutch society and Greek society have different attitudes to aid giving, which may explain why the Netherlands is more generous in its bilateral (government-to-government) foreign assistance than Greece. As it turns out, past bilateral aid generosity (which we will refer to simply as generosity) of the country holding the rotating EU Presidency is correlated with higher amounts of aid allocated by the Union for the following year. This, together with the exogenous assignment of countries to the Presidency, makes the presiding country's generosity a plausible candidate for an instrumental variable. An instrumental variable should be able to predict aid flows while being uncorrelated to the various omitted variables in a model of democratization as a function of foreign aid.

This paper shows empirical results for a panel of 134 countries, observed between 1978 and 2001. Regressing the effects of EU aid on democratization through OLS yields no significant relationship between European aid and liberalization. Once the foreign allocation is instrumented with the donor generosity variable for the country holding the rotating EU presidency, the picture changes. European assistance is positively and strongly related to political liberalization in the countries it is directed to. These

results lend support to the view that foreign aid, at least in the case of the European Union, can be a force for democratization.

Instrumental-variable estimation on a cross-national panel of data is one way to further the study of aid effectiveness. Other methods include the design of randomized field experiments within a specific country (Fearon, Humphreys and Weinstein, 2009). In combination, observational and experimental studies can offer further advances on what works and what does not in international aid-giving.

2 The European Union As a Donor and Why Aid May Produce Liberalization

The EU typically sets aside about 5 % of its total operating budget for foreign aid purposes, or some 7-8 billion euros a year. This Community aid budget is administered by the European Commission, the professional bureaucracy in charge of day to day policy execution of Community policies. Member states provide additional allocation in the form of bilateral aid flows. Those are government-to-government and are administered by the respective European capitals.

A good proportion of EU aid lately goes to Eastern Europe and the Community's partners in the Mediterranean. There are traditional strong aid links to countries in Africa and Asia, with Latin America getting the smallest share of the aid pie.

The EU's approach to aid has always approached the problem of encouraging development in more than strictly economic terms, emphasizing good governance and competent administration. While before the end of the Cold War aid was not linked to democracy per se, at least not explicitly, the collapse of the Berlin wall saw a change in that. In 1991, the EU adopted a commitment to use its influence in the world to promote democracy, clean government, and human rights.

Perhaps the most direct case for a link between democracy and European aid can be made in the case of democratic conditionality. Democratic conditionality seeks to tie external resources to progress on elections and liberal government. To the extent that the policy is applied consistently across the board, we may expect to find a democratizing effect associated with higher levels of EU development assistance.

On the other hand, development aid may deliver progress in fighting disease, building classrooms, fostering a more accountable administration. These and other indicators may in turn be linked to democratic outcomes, making the case for an indirect

effect of foreign assistance on liberalization.

The peculiar nature of the EU as an actor mitigates some of the usually biting critiques against Western donors. Unlike the U.S. or France, the EU as an actor does not have competing strategic interests such as a need for military bases. Competing interests may distort the allocation of aid by funnelling it to friendly governments bent on bad policies. The European Union has a strong tradition of demanding democratic government from its member states. When Greece experiences a coup, the country's pending application for membership was frozen. The delegated nature of executive authority (many decisions rest with the Commission) isolates to some extent the process of providing aid from the changing needs of specific member states.

3 The Presidency of the European Council

3.1 Responsibilities and Power

Political authority in the European Union is concentrated in the Council of the European Union, a body of high-level political representatives of the member governments. The Council's composition varies depending on the issue area in question, and may include the foreign ministers or the ministers of agriculture, for example. While much of the bureaucratic work in running the EU is delegated to the European Commission, and the European Parliament can veto some decisions made by the Council, in the end, most key decisions either originate in the relevant Council or are given a green light by the Council.

The meetings of the Councils of the European Union are chaired by the member country holding the rotating Presidency. The Presiding country has numerous responsibilities, including deciding what and how many meetings to hold, setting the agenda for meetings, negotiating policy differences with the Commission and with fellow member states, taking down the minutes. These responsibilities confer power. Presiding countries can choose to hold a Council in an area of interest to them, forcing movement in Community policy. The first Tourism Council met when Greece ascended to the Presidency in 1988; subsequent meetings of the Tourism Council picked up under the Italian and Portuguese Presidencies. While decisions need to be adopted by a formal vote, the Presiding country in practice can force policy decisions to conform more closely to its preferences. For example, Presiding countries would sometimes let the discussion go into the night. One alleged motive, according to observers, is to force

policy concessions from ministerial representatives who start to worry that they will miss their last flight home.⁵ In fact, the power of the Presidency has grown sufficiently for insiders to start to claim that it is ‘almost impossible’ to move the Council to adopt decisions contrary to what the Presidency wants.⁶

The power of the Presidency extends to passage of the Community’s budget. The budget contains, among its allocations, most of Community-provided development aid. The Commission begins to work on a draft budget for the Community in the beginning of the year preceding its implementation (i.e., before the money will be spent). While the Commission develops the budget, it consults with the Council to ensure that the document conforms with the Council’s preferences. Two key dates in the passage of the budget occur in late July and in November. July marks the adoption of the draft budget by the Council. The budget then goes to the European Parliament. Whatever amendments are proposed by Parliament, the Council has the last word on the budget. Adoption of the final budget happens by qualified majority in the Council. As is customary, the Presidency of the Council has wide discretion on how to conduct brokerage on the budget, hold meetings, and call the votes.

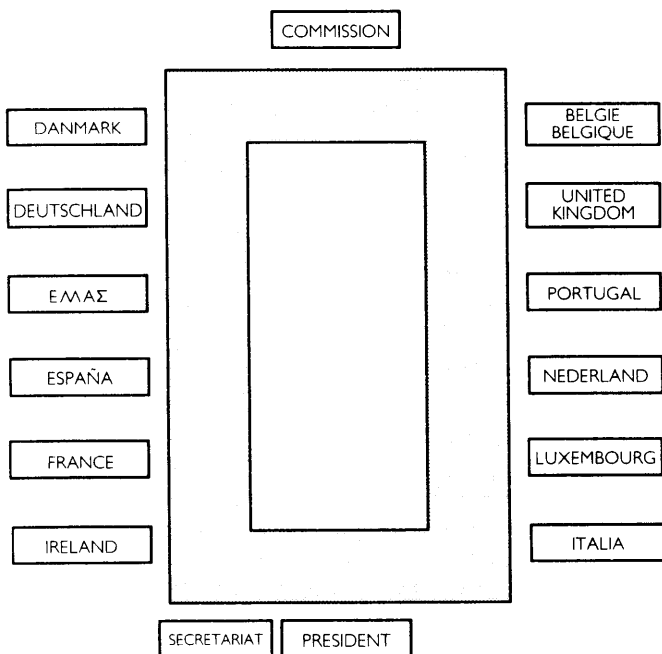
3.2 The Rotation Principle

What is particularly interesting about the institution of the European Council Presidency is the manner in which it is filled. Countries hold the Presidency for six months at a time, being in office from January to June or from July to December. There is a pre-agreed rotation principle governing succession. The order in which the Presidency rotates is alphabetical, according to the name of each member state as spelled in its own language (Germany-Deutschland, Greece-Ellas, and so on). The order corresponds to the seating arrangement for member states at each European Council meeting. Figure 1 shows the positions for 1990 (July-December) when Italy held the rotating Presidency. Opposite Italy, the Presiding member, sits the Commission representative. With each change of Presidency, all states move around one place in clockwise direction. The rules have been amended on a few occasions. For example, one change mandated a switch from clock-wise to anti-clockwise direction periodically, to avoid some states holding the Presidency in the same half of the year (and so as to allow all states to have input in seasonally concentrated activities such as deciding the budget).

⁵See Sherrington (2000, p.44).

⁶See Johnston (1994, p.25).

Figure 1: **Rotation of Council Presidency between the states and seating arrangements in Council Meetings** Nugent (1991, p125).



The nature of the rotation process for one of the most important positions in the European Union is both rare and remarkable. Usually, agenda-setting in international organizations is dictated by the most powerful country among its members. If countries do take a turn for some desirable position, it is customary to have a vote on who will serve. The remarkable aspect of the EU system is that it produces variation in who commands power at the top of the EU Council in a manner that is not at all associated with power, or politics. This creates an opportunity to exploit the mechanistic, or exogenous assignment of countries to the office.

4 Analysis

4.1 Identification

Given that the problem of assessing the effect of aid flows on democratization centers on the non-random assignment of aid to countries, we need to establish some source of exogenous variation in the aid allocation process to be able to recover the effect of aid. The rotating Presidency of the EU offers one potential solution. Countries hold

the position by virtue of a process that is plausibly exogenous to democratization. The Presiding country has considerable clout, extending to the amount of aid built into the Community budget. We still need an argument linking some characteristic of the country holding the Presidency to preferences over more or less aid to be able to apply this insight empirically.

One candidate for a variable dictating preference for more aid is ‘generosity’. Generosity is a variable constructed as on the average bilateral aid allocated in the past 3 years by the country, in per capita terms. Some countries, due to traditional, historical and cultural reasons believe more or less strongly in the need to help the rest of the world. Italy is less generous than France but more generous than Ireland, among the member states of the EU. These preferences are reasonably stable over time and reflect the outcome of domestic political discourses and budgetary preferences in the member countries.

Table 1 shows the donor generosity variable for countries holding the EU Presidency from 1978 to 2001. Because the bulk of budgetary discussion and adoption occurs in the later half of the year, only the July-December presidencies are reported.⁷

These data can be used to predict EU aid allocations, and so can qualify as candidates for instrumental variable in a regression of democratization on aid.

4.2 Data

The data for the empirical model come from the Polity IV dataset (their *polity2* score is used), GDP per capita data is due to the World Bank, and the aid flows variables come from the OECD. The aggregate bilateral aid provided by EU member countries was used to derive the generosity score. The EU aid variable is logged (after adding 1 to deal with 0 values). The calendar year was used to control for monotonous time trends in the data.

4.3 Results

Table 2 shows a simple test of model of democratization in 132 non-Western countries between 1978 and 2001. The table reports OLS and 2SLS estimates. Democratization is modelled as a recursive process in which a country’s polity score in year t depends on $t - 1$. EU aid is a shock to the system, impacting current polity scores and the future evolution of polity through the $t - 1$ to t feedback loop.

⁷See Nugent (1991, p.125).

Table 1: **Countries Holding the Rotating Presidency of the European Council (2nd half of year) and Their Past Generosity As Bilateral Donors**

| year | period | country | donor generosity |
|------|----------|-------------------------|------------------|
| 1978 | July-Dec | German Federal Republic | 34.10 |
| 1979 | July-Dec | Ireland | 0.86 |
| 1980 | July-Dec | Luxembourg | 0.00 |
| 1981 | July-Dec | United Kingdom | 32.41 |
| 1982 | July-Dec | Denmark | 78.60 |
| 1983 | July-Dec | Greece | 0.00 |
| 1984 | July-Dec | Ireland | 3.54 |
| 1985 | July-Dec | Luxembourg | 0.00 |
| 1986 | July-Dec | United Kingdom | 15.57 |
| 1987 | July-Dec | Denmark | 67.31 |
| 1988 | July-Dec | Greece | 0.00 |
| 1989 | July-Dec | France | 53.36 |
| 1990 | July-Dec | Italy | 41.95 |
| 1991 | July-Dec | Netherlands | 105.89 |
| 1992 | July-Dec | United Kingdom | 24.31 |
| 1993 | July-Dec | Belgium | 49.25 |
| 1994 | July-Dec | German Federal Republic | 83.44 |
| 1995 | July-Dec | Spain | 21.19 |
| 1996 | July-Dec | Ireland | 14.02 |
| 1997 | July-Dec | Luxembourg | 74.92 |
| 1998 | July-Dec | Austria | 59.17 |
| 1999 | July-Dec | Finland | 36.15 |
| 2000 | July-Dec | France | 47.66 |
| 2001 | July-Dec | Belgium | 29.06 |

In the OLS model, foreign aid has no impact on democracy. The 2SLS model shows that, after the process of allocating aid is included in the model, with Presiding country generosity as an instrumental variable, the picture changes. Foreign aid has a strong effect on democratization. The first-stage process has variables signed as expected - more democratic countries get more aid, and poorer countries get more aid. Donor generosity predicts higher volumes of annual EU aid as expected.

5 Conclusion

The question of whether foreign aid can encourage democratization has received considerable interest in the scholarly literature. This attention is richly deserved. The relatively large volume of foreign aid flowing toward the developing world and its potential to foster political freedoms and good governance make this a problem of prime importance.

While scholars have identified a number of causal pathways through which aid may foster the adoption of democratic practices, including the threat of economic sanctions and the promise of rewards, the literature attempting to estimate the effect of aid flows on democracy has been plagued by difficult inference problems. Because donors allocate money strategically, and recipients choose to accept or decline aid, any attempt to identify variation in levels of democracy off variation in observed aid flows encounters endogeneity problems. One way this problem could be solved, and further progress made in the study of aid effectiveness, is to find a source of exogenous variation in aid flows and use that to estimate the true effect of aid on democratization outcomes.

This paper looks at the rotating Presidency of the European Union as a source of variation of annual aid flows independent of the propensity of countries to democratize and of the strategic choices made by individual donors. When the (alphabetical) process assigning states to leadership in the Council is used to recover the independent effect of aid flows on levels of democracy, we find that European aid has produced a movement in a more democratic direction among recipients. While the findings apply to European multilateral aid only, the approach adopted here helps move a more general debate forward by showing that EU aid has worked and asking us to think just what about EU aid has helped produce this effect, and whether this is replicable elsewhere.

Table 2: **Effect of EU Development Aid on Democratization.** Standard errors, clustered by country, are in parentheses. * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$, two-tailed tests. Calculations performed in IC STATA 10 for Mac.

| <i>IV (2SLS)</i> | | <i>OLS</i> | |
|------------------------------|------------|------------------------------|------------|
| <hr/> | | | |
| <i>First Stage</i> | | | |
| <i>Dep. Variable: Polity</i> | | | |
| <hr/> | | | |
| polity2 lag | 0.022*** | | |
| | (0.003) | | |
| GDP pc | -0.0012*** | | |
| | (0.000005) | | |
| year | -0.0515*** | | |
| | (0.003) | | |
| EU CP Generosity lag | 0.0218** | | |
| | (0.0008) | | |
| constant | -99.93*** | | |
| | (7.77) | | |
| R^2 | 0.25 | | |
| <hr/> | | | |
| <i>Second Stage</i> | | | |
| <i>Dep. Variable: Polity</i> | | <i>Dep. Variable: Polity</i> | |
| <hr/> | | <hr/> | |
| Log of EU Aid | 2.094** | Log of EU Aid | 0.04 |
| | (0.801) | | (0.025) |
| polity2 lag | 0.907*** | polity2 lag | 0.954*** |
| | (0.031) | | (0.006) |
| GDP pc | 0.002* | GDP pc | -0.00001* |
| | (0.001) | | (0.000005) |
| year | -0.098** | year | 0.014** |
| | (0.041) | | (0.005) |
| constant | 191.58** | constant | -28.52** |
| | (80.33) | | (10.02) |
| R^2 | 0.75 | R^2 | 0.91 |
| N observations | 2826 | N observations | 2826 |
| n countries | 134 | n countries | 134 |
| <hr/> | | | |

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