

DOES CHINESE DEVELOPMENT ASSISTANCE UNDERMINE GOOD GOVERNANCE: EVIDENCE FROM THE WESTERN BALKANS

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AUTHOR'S DECLARATION

I, the undersigned, Ivana Rudinac, candidate for Master of Arts in International Public Affairs, declare herewith that the present thesis is exclusively my own work, based on my research.

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A handwritten signature in blue ink, appearing to read 'J. Rudinac', is written below the 'Signature' label.

ABSTRACT

Aid is usually considered a fungible resource that, under certain circumstances, has the potential to undermine governance in recipient countries, which has been addressed by DAC donors' allocation of conditional aid. The emergence of China as a favorable donor in the developing world, and its no string attached approach has been a subject of wide research interest in the previous decade. This thesis revisits theoretical aspects of aid, asking the question of whether Chinese assistance undermines good governance in recipient countries. Combining the traditional approach with the recent trends in the field, this thesis explores the association between Chinese flows and governance outcomes on the national and subnational levels in Western Balkans region. Expert-based, national-level indicators show significant degradation of the rule of law in countries with more aid flows from China. Subjective, citizen perceptions, on the other hand, show a significantly higher prevalence of corruption in regions with active Chinese projects. The findings suggest the importance of a multi-layered approach to assessing the effects of Chinese interventions: both on the geographical level and in terms of different forms of delivery.

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INTRODUCTION

"The hallmark of a developed society is a government that exhibits the attributes of good governance—transparency, effectiveness, rule of law, lack of corruption, voice and participation"

Dani Rodrik

The 2015 wiretapping scandal¹ (Radio Free Europe 2017) in North Macedonia exposed irregularities surrounding the *Kicevo-Ohrid Motorway Construction Project*, funded by a loan from Chinese Exim Bank (\$490 million). As China Observers in Central and Eastern Europe (CHOICE) reported, Prime Minister engaged in direct negotiations with potential contractors, passing a special law to legitimize the selection of firm *Sinohydro*, despite its questionable reputation and previous debarments by the World Bank and the African Development Bank. (Choice 2019) As this is not the sole case, the question is what does this mean for the Western Balkan countries'² governance? Does China's engagement initiate the malgovernance or simply expose the existing institutional weaknesses?

Foreign aid from non-traditional donors, commonly referred to as *autocratic aid* (Lindberg 2019), has gained increased significant attention from scholars and policymakers over the past decade. In his famous article published in 2009, Naim highlights China, Venezuela, and Saudi Arabia as examples of what he labels "rogue donors". This designation has become a significant component of the discourse surrounding autocratic aid, as these donors are observed to prioritize strategic

¹ Corruption affair that took place in 2015, when thousands of illegally recorded conversations were leaked, implicating high-ranking officials in corruption and abuse of power. The scandal led to widespread public outrage, protests, and a political crisis that resulted in the resignation of the Prime Minister and early parliamentary elections.

² In this thesis, when referring to Western Balkans, I mean the following countries: Serbia, Bosnia and Herzegovina, North Macedonia, Montenegro and Albania. Kosovo is typically part of this category, but since this country is not recipient of Chinese aid, it is excluded from the analysis.

interests over development policy objectives espoused by Western donors, thereby potentially undermining their efforts. (Naim 2009a) Within the broader discourse surrounding autocratic donors, China has emerged as a focal point of discussion, primarily because of the scope of its engagement. Currently, data on 13,427 projects in 145 countries, worth \$843.1 billion (2000-2021) are available for analysis, while the engagement is still growing. (Malik et al. 2021)

Aid is typically allocated based on self-interest or donors, the needs of developing countries, and their policy and governance merit (Hoeffler and Outram 2011) Firstly, empirical evidence has demonstrated that, among various considerations, donors allocate aid based on strategic interests and in support of their political alliances. (Alesina and Dollar 2000) Considering the wider backdrop of geopolitical shifts and the competition among global powers, this raises important debates if aid could be regarded as a tool for China's global influence (e.g., Wellner et al. 2022).

Furthermore, the debate on aid allocation has also centered around the needs of recipient countries. However, it is important to note that while some studies indicate that the needs of recipient countries were occasionally neglected by traditional donors, (Hoeffler and Outram 2011) China's approach, characterized by a focus on non-interference in policy making of recipient countries and addressing countries' developmental needs (in particular in sectors such as infrastructure, energy, and telecommunications), has opened up a new realm of discussion concerning the agency of developing countries in their development efforts.

Finally, the notion of recipient merit, which pertains to the quality of institutions and governance in recipient countries, has been a key aspect of the aid selectivity debate. Namely, Western donors have traditionally prioritized countries with better governance by rewarding them with more aid

(Hout 2007) while in contrast, studies have shown that China does not place significant emphasis on recipient countries' institutions when allocating aid (Dreher, Nunnenkamp, and Thiele 2011)

By zooming in the last aspect, in this thesis I focus on the aid-governance dyad, seeking to address the direct or indirect implications of Chinese aid flows on governance in recipient countries. Taking a political economy standpoint, I conceptualize aid as a non-tax-based, and fungible resource that under certain circumstances may i) end up captured and used for other purposes than intended and/or ii) have the potential to change the domestic policy and governance dynamics. Using a political economy of aid and policy of development aid literature, on the broadest level I aim to add to the understanding of the dynamics between emerging (non-democratic, or non-traditional) donors and recipient countries' policy environments, focusing on China as a donor with the highest salience at the time.

In addition to the theoretical dimensions, I aim to fill in the existing empirical gap. Namely, the majority of existing studies are focused on African countries, even though Chinese engagement is widely present in other parts of the world. For instance, Western Balkans countries collectively received a substantial sum of \$6.7 billion in Chinese assistance spanning the period from 2000 to 2017. Notably, these five nations have been subject to limited representation in both the analyses concerning the broader implications of foreign aid, as well as specifically about aid received from China. Situated at the intersection between developed and developing worlds, these countries possess relatively fragile institutional structures, rendering them crucial case studies for comprehending the ramifications of Chinese development engagement within a European context.

The thesis proceeds as follows. Chapter 1 presents the theoretical framework of the analysis. It starts with a review of the theoretical properties of aid that makes it a relevant channel of influence

on governance in recipient countries, continues with a discussion on good governance, and finalizes by breaking down two competing models of development cooperation and incentives they set. To test the theoretical arguments in the Western Balkans context, in Chapter 2, I analyze national and subnational levels, aiming to see how different types of Chinese assistance interact with governance outcomes. Even though the models have their limitations, the empirical results are partly in line with theoretical arguments. Chinese flows are associated with the degradation of the rule of law on the national level, while a subnational study reveals the more prevalent corruption in regions with active Chinese projects. In the final section, I discuss the implications of the analysis, along with the suggestions for further research. The existing body of knowledge on the implications of Chinese development assistance in regions outside of Africa is still in its early stages. Therefore, this research endeavor, although limited in scope, serves as a foundation for further comprehensive examinations that can: i) expand the geographical scope of research, ii) differentiate between various types of Chinese flows, and iii) integrate national and sub-national perspectives for a more nuanced understanding.

CHAPTER 1: THEORY

In this chapter, I comprehensively examine the theoretical framework of aid, governance, and their interplay. In section 1.1, I present through analysis of the main properties of aid, drawing from existing literature, followed by the concept of good governance and its profound implications for development. Subsequently, I present the features of traditional DAC donors and China, shedding light on their divergent approaches. Finally, I conclude with the formulation of hypotheses derived from the established theoretical framework, which will be empirically tested in Chapter 2.

1.1. Characteristics of development aid

According to conventional wisdom, foreign aid refers to the cross-border transfer of capital, goods, or services from a country or international organization to benefit the recipient country or its population. (William 2023) In the context of this thesis, my understanding of aid is more nuanced and specifically focused on development aid, which includes Official Development Assistance (ODA) and Other Official Flows (OOF) as introduced in section 1.1.4. Within the framework of development aid, I identify three key properties of aid that have significant linkages with governance in recipient countries: aid as a fungible resource, aid as non-tax revenue, and conditional aid.

1.1.1. Fungibility

The question of aid as a fungible resource has been widely explored within the context of aid effectiveness and impact, as well as the accountable use of allocated resources. In a general sense, depending on the way the aid is distributed, it contains a risk of misuse by local actors. As commonly understood, aid is considered fungible if the recipient government uses allocated

resources in a way to change public spending decisions in the same sector. (Foster & Leavy, 2014)

This would be the situation, for instance, when donors provide funding for the health sector, and it results in the recipient government cutting its spending for health purposes, while using initially planned funds for other purposes. This opens a channel of close interconnection between donor and recipient, where for the donor it matters what kind of governance structures are in place in the recipient country. (Leiderer 2012)

Aid becoming fungible is closely interconnected with the governance structures in the recipient country in both directions. On the one hand, better governance and institutions benefit from fungibility as it introduces flexibility of budget. On the other hand, when governance structures are lower quality and corruption is widespread, it opens a space for the misuse and capture of aid funds. This is the reason why donors very commonly earmark and condition their aid (explained in section 1.1.3 below), and allocate it to a specific purpose, even a specific project.

The notion of fungibility is highly relevant within the aid-governance framework. Even though the causality is reversed, when there are no safeguards introduced by the donor, the recipient country (especially when the government is weak) is at risk of further undermining good governance principles.

1.1.2. Aid curse

The existing body of literature widely acknowledges the occurrence of negative economic and political ramifications for countries abundant in natural resources, commonly referred to as the "resource curse" or "paradox of plenty." Theory indicates that these countries, on average, experience adverse economic effects such as reduced economic diversification, increased income inequality, and heightened economic volatility. Additionally, resource-rich nations often exhibit

negative political outcomes, including a propensity for authoritarianism, weakened governance structures, and diminished institutional quality.

During the 1990s, analysis of foreign within the *resource curse* framework gained prominence, in particular when it comes to effects on political institutions and governance. (Brazys 2016) In general, the prevailing argument suggests that the inherent characteristics of non-tax-based resources enable governments to pursue alternative means of maintaining their hold on power while simultaneously diminishing their accountability to citizens by reducing reliance on tax revenue. (Morrison 2012) This pattern holds for foreign aid in its various forms. The underlying logic is straightforward: when donors provide goods or services, such as infrastructure projects, that are not financed by citizens' contributions, the accountability tends to be directed towards the donors rather than the citizens themselves.

It was recently empirically shown by some scholars (e.g. Bermeo 2016) that aid and natural resources do have not the same outcome because the aid largely depends on the intent of donors and their approach, which is not the case for natural resources. The argument says that *aid is not oil*, but to the extent that donors are dealing with the potential of aid to have properties of natural resources.

Understanding aid as non-tax-based revenue highlights its unique characteristics and its close interconnection with the accountability of governments to their citizens. (De La Cuesta et al. 2021) Traditional domestic revenue sources, such as taxes, are directly linked to citizen contributions and are often subject to accountability mechanisms. In contrast, aid, as external funding, introduces a different dynamic in the governance equation.

1.1.3. Conditionality

With the widespread acceptance of the concept of good governance in development policy during the 1990s, the introduction of *conditional aid* emerged as a significant aspect of aid delivery. The notion of conditionality is driven by the previously introduced features of aid as a resource: its fungibility and non-tax origin. Namely, conditioning aid reflects the significance of institutions, but it could also be considered a strategic move for donors who want to reduce rent-seeking opportunities and prevent moral hazard problems that could potentially come with aid distribution. (Dietrich 2021)

Typically, conditions are attached on two levels: i) spending of aid funds and ii) pushing for policy reforms in developing countries (Collier et al. 1997) The first type of conditions are different safeguarding mechanisms to prevent misuse of funds and ensure they are used for the initial purpose. For example, World Bank uses cost-benefit analysis to screen projects and employ a blacklist of corrupt firms.

The second type of conditionality, i.e. policy conditionality, is a more contested issue, as it aims to change the course of action of the government in the recipient country (Morrison 2012) and hence it was sometimes proven ineffective. On top of that, evidence shows that despite pushing strongly for governance reforms through aid flows, in practice donors do not punish more corrupt governments but even reverse – they receive more aid. (Alesina and Weder 2002) This is simply because donors have different strategic motivations when distributing aid and sometimes it will be distributed anyways in order to not disturb other factors (trade, investment).

However, conditionality, when present, is still posing incentives to recipient governments to take policy action that would otherwise not decide to take. This comes with the assumption that the recipient government put a high enough value on aid received. (Foster & Leavy 2014)

1.1.4. Categories of development aid

In this analysis, I employ two widely recognized categories of development assistance. Even though these concepts are not officially accepted by new donors, they are employed by researchers for comparison purposes. Concepts of *official development assistance (ODA)* and *other official flows (OOF)* have served as a global standard for foreign aid tracing since 1969 when they were accepted by Development Assistance Committee (DAC).³ The main distinguishing features of ODA and OOF are concessionality and development intent, and today they appear in every single analysis of development aid as both theoretical concepts and statistical categories. (OECD 2013)

At the time of adoption, ODA included those transactions/flows which are made to promote of economic and social development of developing countries and concessional financial terms. In 1972, it was added that concessionality is measured by a *grant element*⁴ of at least 25% calculated at a rate of discount of 10%. (Führer 1996) In practice, this measure shows the generosity of aid, i.e. how much is taken back from what is given. Thus, it typically includes grants and so-called *soft loans* with no or below-market interest rates.

The concept of ODA is separated from the *other official flows (OOF)*⁵, which represent transactions by the official sector with developing countries that do not meet the conditions for

³ Previously Development Assistant Group (DAG), formed in 1960.

⁴ The idea behind grant equivalent is to measure developmental efforts of donors. Economically, it represents (if) how much the value to be repaid is lower than the value of the loan, taking into account changing value of money throughout the time. In case of market term loans, grant element is 0%, while it is 100% in case of grants.

⁵ Development oriented, but not concessional

eligibility as Official Development Assistance or Official Aid, either because they are not primarily aimed at development, or because they have a grant element of less than 25 percent. (Bracho et al. 2021)

1.2. Good governance

Good governance has been one of the most widespread concepts in development research and practice for decades, and an important ingredient of donor policy prescriptions since the 1990s. In the broadest discussions of development, when introduced in the 1980s, this concept was part of the debate on the role of the state in the development process (Grindle 2010) Back then, it was intended to encompass a wide range of factors, including the role of institutions, citizen-state relations, checks and balances, and the "rules of the game". In the 2000s, interest shifted towards the institutions and their importance for development, and so the understanding of governance became closely connected with this body of knowledge. (Acemoglu and Robinson 2012)

Good governance is a broad concept and an umbrella term for both institutions and decision-making processes that determine interactions between political and economic systems. (Grindle 2010) However, today there is no consensus about the definition, neither in academia nor the policy world. Hence, different actors, i.e. typically donors in the policy arena define it differently, adjusting the concept to their approach and agenda. In addition, the concept is sometimes referred to as *vague* as it includes various aspects that are difficult to capture.

One of the most important contributions to the wider agreement on what governance as a concept encompass is provided by Daniel Kaufman, who defines it as “the process by which governments are selected, monitored and replaced; the capacity of the government to effectively formulate and implement sound policies; and the respect of citizens and the state for the institutions that govern

economic and social interactions among them” (Kaufman et al. 2011) Components of governance are also operationalized by the same author, to create indicators that allow following accountability, political stability, government capacity, control of corruption, sound economic policies, and rule of law. This conceptual framework will be used in this analysis too.

1.3. Competing models of development cooperation

After providing an overview of the theoretical considerations surrounding aid and governance, this section delves into the introduction of two contrasting models of development cooperation, emphasizing the incentives generated by each model in practice. The analysis is based on the acknowledgment of the inherent heterogeneity between donors and hence the implications and incentives associated with the aid they deliver.

1.3.1. DAC model of development cooperation

Development Assistance Committee (DAC) donors, often referred to as traditional or Western donors, have played a central role in the global donor architecture since the aftermath of World War II. Hence, it is important to emphasize the shared principles that underpin their cooperation, as evidenced by their membership in the DAC forum and international aid initiatives.

1.3.1.1. Overview of the Legacy of the DAC System

The historical origins of aid allocation can be traced back to the colonial era, but significant developments in the contemporary aid system emerged after World War II. One of the crucial events was the establishment of the Bretton Woods Institutions - the International Bank for Reconstruction and Development (commonly known as the World Bank) and the International

Monetary Fund (IMF) - in 1944.⁶ (Führer 1996) The World Bank was created to reconstruct war-affected infrastructure, while the IMF aimed to restore the international financial system (International Monetary Fund).

Further significant historical development in aid provision was the implementation of the Marshall Plan in 1947. Led by the United States, this initiative aimed to provide financial support for the reconstruction of war-torn European countries, with a budget of US\$13 billion (Moyo 2010)⁷ Additionally, in 1948, the Organisation for European Economic Co-operation was established to oversee the distribution of aid provided under the Marshall Plan. In 1949, President Truman introduced *Point Four*, a development aid program specifically targeting developing countries (Moyo 2010). These initiatives marked important milestones in the expansion of foreign aid and the recognition of its role in promoting post-war reconstruction and development.

The first step towards the system that we know today was the formation of the Development Assistance Group (DAG) in 1960,⁸ to establish a forum for cooperation related to aid distribution and it represents the origins of today's system. At the time, the need for cooperation and a coherent approach towards aid effectiveness.

1.3.1.2. Features of DAC aid

DAC donors claim to comply with the international standards of aid effectiveness, transparency, and sustainability, as reflected in key declarations such as the Paris Declaration (PD) in 2005, the Accra Agenda for Action (AAA) in 2008, and the Busan Declaration in 2011.

⁶ These two institutions started operating in 1946.

⁷ European recovery program.

⁸ Original Members: Belgium, Canada, France, Germany, Italy, Portugal, the United Kingdom, the United States and the Commission of the European Economic Community. The Japanese government is immediately invited to participate in the work, and the Netherlands join the DAG in July.

Mostly the form of delivery is ODA type, through various channels. Namely, DAC donors are not only providing aid directly to the government but sometimes bypassing aid to other actors such as NGOs. (Dietrich 2021) In addition, the 2005 Paris Declaration on Aid Effectiveness emphasized the recipient countries' ownership, harmonization of donors' approaches, as well as mutual accountability. (Bracho et al. 2021) Hence, the debate was for a long time centered around aid effectiveness.

DAC donors practice conditional aid in various forms (as discussed in section 1.1.3.) and put a high value on good governance (as discussed in section 1.2)

1.3.2. The Chinese model of development cooperation: No strings attached

Development assistance from China expanded significantly during the previous decade, both in terms of geographical coverage and funds provided. However, China's development assistance is characterized by its unique approach, which differs from traditional Western models of aid.

1.3.2.1. Historical overview

China is not a new donor. Contrary, it has been an important development partner in African countries during the previous 70 years. (Strange 2019)⁹ Important continuities of Chinese aid marked by Strange are that it was always open for financing large infrastructure projects, it was always prone to wider international skepticism, and geopolitical considerations were always part of Chinese aid allocations. (Strange 2019)

⁹ Austin Strange provides systematic overview of Chinese engagement in Africa from 1960s until today.

China's engagement as a donor traces back to the 1960s when China as a developing country itself, began assisting African countries. Over time, China's approach to aid in Africa has evolved, transitioning from primarily concessional aid, which included grants and interest-free loans (1960-1970), to a more mixed approach that incorporates a significant amount of non-concessional aid, such as loans with market-based terms. In the 1970s, China underwent a reform of its aid system, driven by China's desire to align its aid policy with its economic interests and pragmatic considerations. (Dreher, Nunnenkamp, and Thiele 2011)

The beginning of Chinese engagement as we know it today begins in 1999, with the *Going out strategy*, where China started increasing its presence in globally and promoting the global expansion of Chinese companies. China Exim Bank and China Development Bank became engines for the growth of Chinese companies overseas. (Dreher et al. 2022)

1.3.2.2. Features of Chinese aid

In his provoking article in *Foreign Policy*, Naim claimed that China and other autocratic donors are providing *rogue aid*. (Naim 2009b) The term spilled over to academic circles, followed by a series of questions on whether these donors undermine the policy reforms promoted by Western donors. (e.g. Dreher and Fuchs 2012) But, what do we know about Chinese aid?

Contrary to DAC donors, who set ODA targets and put a strong emphasis on ODA as a form of aid, only 23% of overall China's development funding portfolio (2000-2014) was ODA (Dreher et al. 2022). China is even not using the term aid, but "international development cooperation" defined as China's bilateral and multilateral efforts, within the framework of South-South cooperation, to promote economic and social development through foreign aid, humanitarian assistance, and other means. (The State Council Information Office, 2021)

The focus of activities of Chinese aid (The State Council Information Office 2021) is on the developmental needs of recipient countries. There are priorities, but it is intended to follow their needs. Chinese development assistance is directed towards largely neglected sectors by DAC donors, e.g. infrastructure, energy, and telecommunications. (D. Bräutigam 2011)

It is worth noting the *mutually beneficial* aspect of Chinese aid. Namely, while DAC aims to promote united aid, Chinese aid is largely tied to specific economic conditions. In the majority of cases, Chinese aid is linked to the involvement of Chinese companies in project implementation and the procurement of goods and services from China. This tied nature of Chinese aid reinforces economic connections between China and recipient countries, potentially benefiting Chinese industries and contributing to the growth of China's export markets. (in line with Going Out strategic orientation from 1999). (Dreher et al. 2022)

Another important feature of Chinese assistance is the claim of the *non-interference* principle of development cooperation reflected in the so-called White Paper (The State Council Information Office, 2021). In other words, contrary to DAC donors, China is not posing policy conditions attached to aid. That China tends not to pay attention to local politics and the quality of policies and institutions in recipient countries, shows Dreher and Fuchs's study (sample 1956-2006) that Chinese aid allocation is independent of the regime type and institutional quality in the recipient countries. (Dreher and Fuchs 2012).

1.4. How does aid impact governance?

There is a significant body of knowledge that states that aid creates perverse incentives in recipient countries and encourages rent-seeking. (e.g. Moyo 2010, Easterly 2008) One of the potential challenges is that empirical evidence shows that more aid is distributed to corrupt

countries.(Alesina and Weder 2002, Bauhr, Charron, and Nasiritousi 2013) Moyo even introduced a vicious cycle of aid (Moyo 2010), explaining it as a situation when aid becomes a source that reinforces corruption in already corrupted countries. Namely, by providing aid to corrupt countries, donors influence the domestic environment by providing additional resources, which leads to further degradation of the rule of law, transparency, and good governance in the broader sense. As a result, in weaker governance environments, corrupt bureaucrats and politicians undermine development efforts by capturing aid or allocating it to the activities of their benefit. (Gisselquist 2012)

It is important to distinguish between aid from traditional donors such as those in the Development Assistance Committee (DAC) and aid from autocratic donors such as China. While both are susceptible to political capture, Chinese aid is more directly linked to political elites in the recipient country. Theoretically, Chinese aid is fungible as it may open the space for the governments to provide public goods and function without raising taxes. Empirically, the evidence is mixed. On the one hand, a recent study (Dreher et al. 2019) highlighted the susceptibility of Chinese aid to political capture by presenting empirical evidence from Africa that demonstrates that African leaders' home regions receive a disproportionate amount of aid. On the other hand, some scholars, including Bader, contend that the effect of Chinese engagement on political governance is overstated and insignificant. (Bader 2015)

Considering the properties of Chinese aid, it is reasonable to anticipate differentiated effects between different types of Chinese aid, namely Official Development Assistance (ODA) and Other Official Flows (OOF). It is argued that OOF projects, characterized by their long-term nature and strategic importance, hold a greater potential for undermining good governance principles. These projects often involve the provision of public goods, such as infrastructure development, which

can compromise accountability to citizens and disregard the rule of law. The absence of adequate safeguard mechanisms and conditionality further contributes to the erosion of accountability principles.

Moreover, at the national level, how OOF projects are committed and announced creates opportunities for political elites to capture funds by avoiding public procurement. This delivery format may exacerbate existing weaknesses within a regime or even contribute to the consolidation of autocratic tendencies, as leaders have less incentive to allocate resources responsibly.

Based on these considerations, the first hypothesis to be empirically tested is:

H1: Countries that receive more OOF type of assistance from China are more likely to experience worse governance outcomes (corruption and rule of law).

In contrast, when examining ODA, it can be argued that its relatively small share as a percentage of China's overall aid provision may limit its impact on governance outcomes. Therefore, the second hypothesis is proposed:

H2: Countries that receive more ODA-type development assistance from China are not more likely to experience worse governance outcomes.

It was raised by Dietrich and Winter that the provision of public goods with the assistance of donors has an impact on the citizens-state relationship. (Dietrich and Winter 2015) The argument is that new actors represent the contrasting approach and further lead to a reevaluation of their perceptions of how the Government is operating. In the context of Chinese assistance, there is not only an actor in terms of donor agency, but plenty of other actors that are part of an aid package. This is particularly the case for OOF-like projects, where Chinese companies are typically those

who implement the projects. In this way, a whole new approach to doing business and managing the economy is present. As already raised in empirical studies, part of this approach may include corrupt practices such as bribes to local officials to ensure better conditions. This practice was confirmed in recent studies that show that citizens perceive more corruption around active Chinese project sites, which is the opposite in the case of the World Bank (Isaksson and Kotsadam 2018). The same study showed that it is the opposite in the case of World Bank projects, but this relationship disappears when Chinese project is close (Brazys, Elkink, and Kelly 2017).

In addition, Chinese projects tend to be characterized by lower levels of transparency compared to projects funded by traditional DAC donors. This lack of transparency can contribute to citizens perceiving that the law is not implemented effectively around Chinese project sites. Unlike DAC projects where transparency and citizen participation are often emphasized, Chinese projects typically involve limited involvement of citizens in decision-making processes. As a result, contract agreements, financial transactions, and conditions of cooperation are often negotiated behind closed doors, without the active engagement or scrutiny of the local population.

Based on this reasoning, the third hypothesis I aim to test is:

H3: Citizens of regions with active Chinese projects are more likely to have worse perceptions of governance and the rule of law.

CHAPTER 2: EMPIRICAL ANALYSIS

Following the theoretical underpinnings from Chapter 1, in this chapter, I empirically test the hypotheses based on theoretical assumptions, through a comprehensive two-level analysis: a national-level analysis and a sub-national analysis, both focusing on Chinese aid flows within the countries of the Western Balkans region.

2.1. Overview of donor environment in Western Balkan

In the 2000s, the countries of the Western Balkans embarked on a journey of economic and political transformation, transitioning towards market economies and democratic systems. Parallel with this, some countries, such as Serbia and Bosnia and Herzegovina, were not only undergoing economic and political transitions but also recovering from the aftermath of war periods. Hence the amount of foreign aid coming from different donors was on the rise. For instance, in 2000 the proportion of ODA as a percentage of gross national income in Serbia was 16.5%, while in Bosnia it was 12.1% in the same year. (OECD 2023)

All Western Balkan countries together received \$45.1 billion of ODA and OOF disbursements between 2000-17. (OECD 2023) DAC aid is predominant, while the European Union (EU) institutions emerge as the largest contributor in the region, ranging from 22% (Albania) to 56% (Montenegro) of net ODA and OOF. (World Bank 2023)

During the previous decade, non-DAC donors are increasingly active in the Balkans (e.g. United Arab Emirates, among others), posing questions about the impact of their engagement in these countries. (Bieber, 2020) China is part of the broader picture, with increasing activity throughout the previous two decades. The main recipient of Chinese assistance is Serbia with 2.6 billion (16%

value of overall DAC aid in comparative terms), which is followed by Bosnia, Macedonia, Montenegro and Albania (Figure 1)

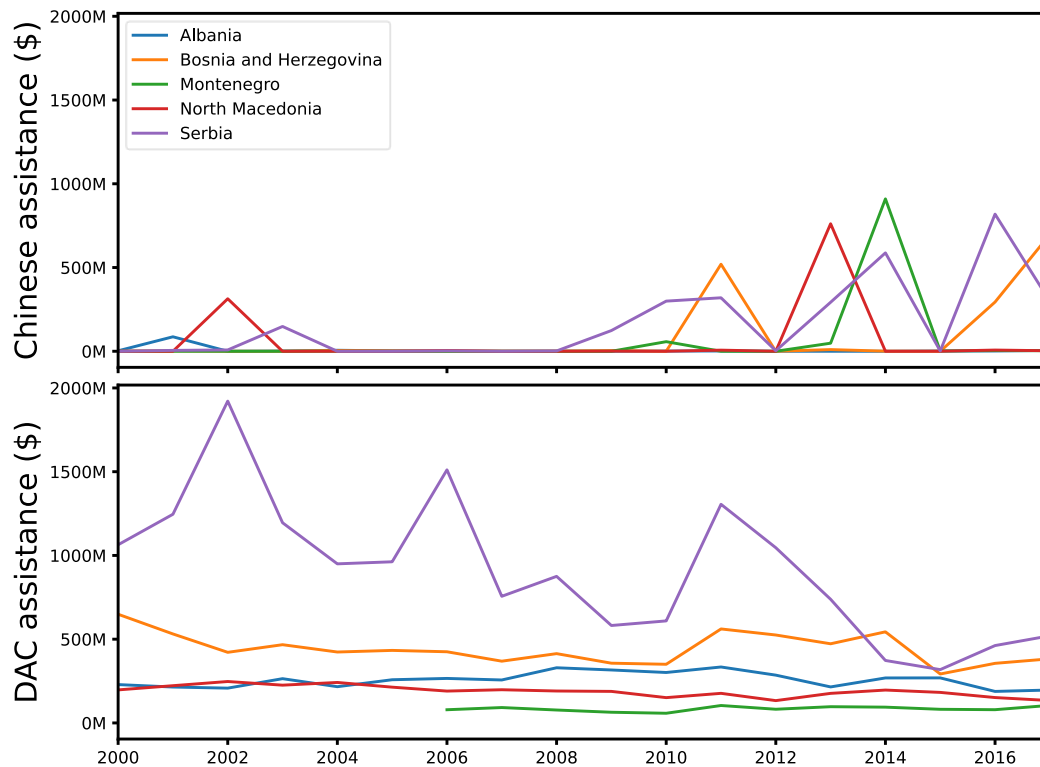


Figure 1: Temporal distribution of Chinese versus DAC assistance in Western Balkans (2000-17), created by the author based on the AidData dataset and OECD aid statistics

The recent study conducted on aid in the Balkans revealed notable donors' oversight in addressing weak governance structures. (Bartlett 2021) Namely, despite the provision of substantial amounts of Official Development Assistance (ODA) and significant institutional support from the European Union, these countries continue to grapple with weak governance, which stands as a major obstacle to their economic development.

2.2. Empirical strategy

Traditionally, research on aid and its implications has relied on cross-national time series data, utilizing aggregated values of aid flows and comparing them with other national indicators. This

approach offers certain advantages as it provides a broad understanding of general trends across countries over time. However, due to the increased availability of geocoded data, a more recent trend in the field is sub-national geospatial analysis which provides a balanced perspective on aid interventions and their impact. (Isaksson 2017)

To test the hypotheses presented in Chapter 1, I aim to go a step further and get a comprehensive picture, by combining national (H1, H2) and subnational (H3) analysis. This strategy also allows the combination of objective (expert evaluation) and subjective (perceptions of citizens) measures of governance.

For national analysis, by selecting countries with relatively similar characteristics: geographic location, cultural background, relatively similar political systems, and economic conditions, I partly overcome the limitations of large sample studies. At the same time, the subnational analysis examines subnational allocation trends and investigates variations in effects across different regions within the five countries. This analysis employs a quasi-experimental design utilizing propensity score matching (PSM) methodology.

2.3. National analysis

In the first stage of empirical analysis, I conduct panel regression analysis with fixed effects, on a dataset that contains data for 5 Western Balkan countries during 18 years time period (2000-2017). I choose the fixed effects model to make use of time and unit variation and control for unobserved heterogeneity of countries throughout time. The model I apply in the following section is:

$$\begin{aligned}
gov_{i,t} = & \beta_0 + \beta_1 chinese\ flows_{i,t} + \beta_2 DAC\ aid\ flows_{i,t} + \beta_3 GDP\ per\ capita_{i,t} \\
& + \beta_4 natural\ resources\ rents_{i,t} + \beta_5 population_{i,t} + \beta_6 unemployment_{i,t} \\
& + \beta_7 regime\ type_{i,t} + F_i + d_t + \varepsilon_{i,t}
\end{aligned}$$

In line with hypothesis 1, I expect the β_1 coefficient to be negative, i.e. that increased Chinese aid flows are associated with the decrease of governance indicators, keeping all other things equal.

2.3.1. Data

To build a dataset for this analysis, I used five datasets: *AidData's Global Chinese Development Finance Dataset* (Strange, et.al., 2021), *The Worldwide Governance Indicators (WGI) dataset* (Kaufmann 2023), *World Bank's World Development Indicators* (World Bank 2023), and *Varieties of Democracy Dataset* (Lindberg et. al. 2023)

2.3.1.1. Independent variable

Measuring Chinese aid is challenging and poses the main barrier to the effective evaluation of Chinese aid flows. The main challenges are: i) lack of transparency of Chinese contracts and aid flows, ii) China's categorization of aid is not in line with the international standards of ODA and OOF categories, while a large part of China's development assistance is not ODA (D. Bräutigam 2011)

To tackle these challenges, AidData Institute developed TUFF (Tracking Underreported Financial Flows) methodology, which is based on the triangulation of data from various sources such as media, government reports, websites, available project documentation, taking the necessary steps for verification and quality control. (Strange, et.al. 2021) Besides the systematic data collection, the AidData team divides projects into two categories based on international standards (ODA and

OOE, introduced in Chapter 2), while projects that are outside of these two categories are in the *Vague* category. For this reason, as an independent variable, I use AidData's Global Chinese Development Finance Dataset, Version 2.0 (Custer et al. 2021)

I perform a country-level aggregation of the value of Chinese project commitments for each year in Western Balkan countries between 2000 and 2017, selecting only projects recommended for aggregation to increase the reliability of data.¹⁰ Given the predominantly large-scale and long-term nature of Chinese projects, I employed a cumulative sum approach to capture the variation while preserving the information from previous years. In addition, to not use absolute values, I created a cumulative sum variable for GDP to not make distortion in data by using consistent values of GDP and cumulative values of Chinese assistance. The final variable was the following:

$$chn_assistance_gdp_cumulative_ratio(t) = \frac{cumulative_chn_assistance(2000, t)}{cumulative_country_GDP(2000, t)} \times 100$$

Where $cumulative_chn_assistance(2000, t)$ is the cumulative sum of Chinese project value starting from the year 2000 up until time t and similarly, $cumulative_country_GDP(2000, t)$ is the cumulative sum of a specific country's GDP, starting from the year 2000 up until 2017. Finally, $chn_assistance_gdp_cumulative_ratio(t)$ is defined as the ratio of the two aforementioned variables (multiplied by 100 to obtain percentages), which should indicate the relative value of Chinese assistance as it develops through time.

¹⁰ As noted in TUFF methodology, *recommended for aggregation* category includes only formally approved, active, and completed Chinese government-financed projects, while excluding cancelled projects, suspended projects, and projects that never reached the formal approval (official commitment) stage.

2.3.1.2. Dependent variable

As suggested by Gisselquist (Gisselquist 2012), researchers should avoid focusing on the macro concept of governance. Following this logic, I consider specific aspects of governance that I consider the most relevant for Chinese engagement (as elaborated in Chapter 1). For this reason, I use two out of five of Kaufman's and Kray's *World Governance Indicators (WGIs)*, in particular control of corruption and the rule of law.

WGIs are composite indicators that are created based on a variety of sources (surveys with citizens, firms, and experts) and subsequently analyzed and standardized to allow comparison among the countries.¹¹ Despite the criticism, these are the most prominent governance indicators at the moment, when it comes to objective expert evaluation of governance.

Control of corruption variable captures "perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as "capture" of the state by elites and private interests. ", while the *rule of law* variable captures" perceptions of the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence. " (Kaufmann 2023)

Both indicators are given in a range between -2.5 and 2.5, with higher values meaning better governance (in case of corruption, higher values reflect less prevalent corruption, while in case of rule of law, higher values mean stronger adherence to the principles of rule of law).

¹¹ It is noted by WGI team that governance indicators are not used for the allocation of funds by the World Bank.

2.3.1.3. Control variables

DAC aid as a share of GDP variable serves to capture the level of dependence on and the activity of donors adhering to the shared standard of aid (DAC).

The natural resources rents variable is included to integrate and test the aid curse argument. This variable is expressed as total natural resources rents as a share of gross domestic product.

Regime type is a variable taken from the V-Dem dataset, and it is a categorical variable: 0: Closed autocracy, 1: Electoral autocracy, 2: Electoral democracy, 3: Liberal democracy (Elaborated in Appendix) This variable is included in the model to control for the political environment in which aid transfer takes place, as it was considered as relevant in the previous studies. (e.g. Bermeo 2011)

Finally, the following economic variables are included: i) *unemployment*: total share of the total labor force, modeled ILO estimate), *poverty*: poverty headcount ratio at \$6.85 a day, according to the category of countries included in the analysis, and *GDP per capita*.

2.3.2. Models

The analysis incorporates state and year-fixed effects for both categories of Chinese aid (as presented in the equation at the beginning of this section), as well as for the selected governance indicators of the rule of law and control of corruption.

	Dependent variable:					
	Control of Corruption			Rule of Law		
	State fixed effects model (1)	Year fixed effects model (2)	2-Way fixed effects model (3)	State fixed effects model (4)	Year fixed effects model (5)	Two-Way fixed effects model (6)
Chinese ODA/GDP (cumul.)	0.080 (0.152)	0.001 (0.156)	0.073 (0.134)	-0.257 (0.136)*	-0.257 (0.136)*	-0.293 (0.115)**
DAC aid/GDP	-0.023 (0.024)	0.022 (0.016)	-0.008 (0.015)	-0.019 (0.036)	-0.019 (0.036)	-0.018 (0.035)
GDP per capita	0.0003 (0.00005)**	0.0001 (0.00001)***	0.0002 (0.0001)**	0.0002 (0.0001)***	0.0002 (0.0001)***	0.0002 (0.0001)
Population	0.00000 (0.00000)***	0.000 (0.000)	0.00000 (0.00000)***	-0.00000 (0.00000)	-0.00000 (0.00000)	-0.00000 (0.00000)
Natural resources rents	-0.031 (0.023)	-0.050 (0.021)**	-0.065 (0.025)***	-0.031 (0.007)***	-0.031 (0.007)***	-0.056 (0.020)***
Unemployment	0.027 (0.002)***	0.019 (0.003)***	0.035 (0.004)***	0.025 (0.002)***	0.025 (0.002)***	0.033 (0.008)***
Regime type	-0.027 (0.030)	-0.051 (0.035)	-0.073 (0.019)***	-0.033 (0.015)**	-0.033 (0.015)**	-0.041 (0.022)*
Observations	85	85	85	85	85	85
R ²	0.684	0.645	0.566	0.684	0.684	0.499
Adjusted R ²	0.636	0.511	0.361	0.637	0.637	0.261

Note:

Table 1: Chinese ODA and governance indicators (control of corruption and rule of law). All models include clustered standard errors.

*p<0.1; **p<0.05; ***p<0.01

	<i>Dependent variable:</i>					
	Control of Corruption			Rule of Law		
	State fixed effects model	Year fixed effects model	Two-Way fixed effects model	State fixed effects model	Year fixed effects model	Two-Way fixed effects model
	(1)	(2)	(3)	(4)	(5)	(6)
Chinese OOF/GDP (cumul.)	-0.029 (0.049)	0.020 (0.052)	0.021 (0.050)	-0.059 (0.031)*	-0.148 (0.043)***	-0.050 (0.036)
DAC aid/GDP	-0.018 (0.025)	0.018 (0.023)	-0.013 (0.026)	-0.004 (0.040)	0.006 (0.019)	-0.003 (0.036)
GDP per capita	0.0003 (0.0001)***	0.0001 (0.00001)***	0.0002 (0.0001)*	0.0003 (0.0001)***	0.0001 (0.00002)***	0.0002 (0.0001)
Population	0.00000 (0.00000)***	0.000 (0.000)	0.00000 (0.00000)***	-0.00000 (0.00000)	-0.00000 (0.000)***	-0.00000 (0.00000)
Natural resources rents	-0.033 (0.022)	-0.052 (0.021)**	-0.067 (0.026)***	-0.031 (0.006)***	-0.047 (0.018)***	-0.050 (0.020)**
Unemployment	0.028 (0.003)***	0.019 (0.002)***	0.035 (0.004)***	0.025 (0.002)***	0.016 (0.002)***	0.033 (0.008)***
Regime type	-0.034 (0.033)	-0.048 (0.035)	-0.073 (0.025)***	-0.041 (0.012)***	0.003 (0.036)	-0.037 (0.023)
Observations	85	85	85	85	85	85
R ²	0.685	0.646	0.567	0.684	0.716	0.492
Adjusted R ²	0.638	0.512	0.362	0.637	0.609	0.252

Note:

Table 2: Chinese OOF and governance indicators (control of corruption and rule of law). All models include clustered standard errors.

*p<0.1; **p<0.05; ***p<0.01

2.3.3. Findings

Results show that relationship between the cumulative value of Chinese ODA and control of corruption is slightly positive but statistically insignificant. However, the opposite sign is in the case of the rule of law, which is statistically significant in all of the three models: year, state, and both year and state fixed effects. The most robust model is the third one (two-way fixed effects). What could be concluded is that the cumulative effect of Chinese ODA is associated with the deterioration of the rule of law, controlling for unobserved heterogeneity on time and country levels.

When it comes to OOF, the results are similar, which was not expected. In this case, the year fixed model is the most robust (R squared is 71%, while the coefficient of cumulative OOF is at the highest level of statistical significance).

Remarkably, the analysis reveals a noteworthy negative correlation between natural resource rents and both control of corruption and the rule of law, aligning with the theoretical proposition that non-tax revenues, in general, are associated with poorer governance outcomes. This finding supports the resource curse theory, but aid curse, however, is only partly confirmed in this case.

Finally, while DAC aid coefficients are not significant in any model, economic indicators have expected effects: more autocratic countries have worse governance outcomes, while countries with higher GDP per capita have better governance outcomes.¹²

¹² Multicollinearity check is presented in Appendix.

2.4. Sub-national analysis

Following the trends in the sub-national analysis of aid flows (e.g. Isaksson and Kotsadam 2018, Isaksson and Kotsadam 2020, Brazys, Elkink, and Kelly 2017), I utilize locations of Chinese and World Bank projects, to find *hidden experiments* in the existing data, dividing regions in Western Balkans on treated (active Chinese projects) and control (no active Chinese projects). In this way, I aim to overcome the challenges of observational studies, i.e. non-random distribution of Chinese funds.

I employ the propensity score matching (PSM) technique that is based on the idea of assigning the probability of being treated to each observation, based on selected variables. I match regions based on: country, year, geographical latitude and longitude, nightlights, and population. I ended up with 106 matched observations, out of 150 (a graphical representation of balance in the sample is in Appendix). The idea behind matching in general is that by matching observable factors, we match and create pairs based on unobservable factors as well.

2.4.1. Data

I created a new dataset collecting data for 30 regions in Western Balkan, using the datasets used in the national analysis, with the addition of *Balkan Public Barometer*, and *GeoQuery tool for extraction of geocoded data*, developed by AidData institute.

2.4.1.1. Independent variable

For the independent variable, I use the same data source as in the national analysis, but this time with making use of more nuanced information about the projects. As the level of analysis are regions in 5 Western Balkan countries, I make use of project descriptions as well as geographic

location information for each project (when available). By utilizing these details, I aim to enhance the granularity of the analysis and capture a more comprehensive understanding of regional dynamics.

While analyzing Chinese projects in the Western Balkans, it is important to note that not all of these projects have been geocoded by the AidData team. This is primarily due to certain projects having national coverage or lacking a physical location, such as projects involving equipment provision, among others. However, for this analysis, I make use of the available project locations and employ an additional approach. Specifically, I assign additional projects to their corresponding regions, but only if the project's full description mentions the name of a location.

Finally, instead of relying solely on project values, I create a variable that represents the number of active project in region in specific year. This approach is based on the assumption that capturing the perceptions of citizens concerning Chinese projects is most relevant when there is an active project taking place in the observed region.

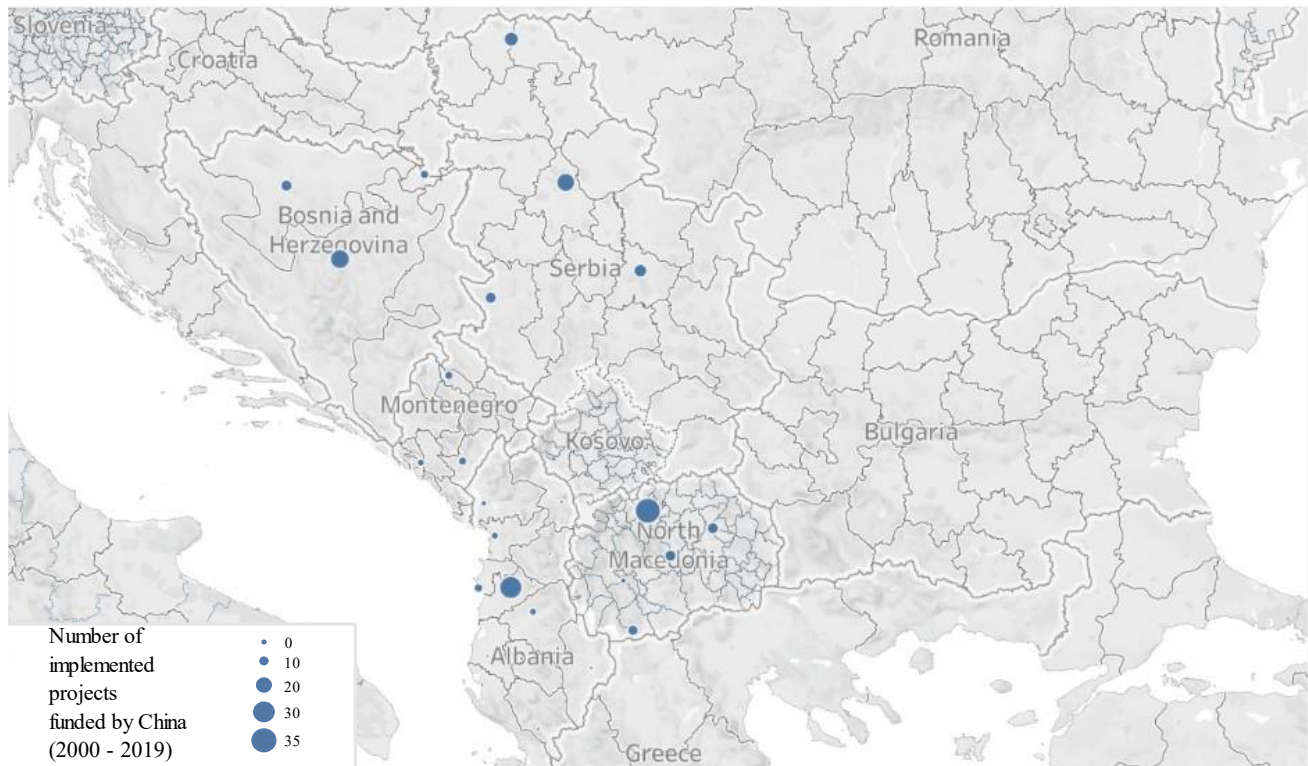


Figure 2: Aggregated active Chinese projects in observed regions in Western Balkans (2000-2019), size of the circle represents the variability of the number of active projects. Created by the author base on AidData dataset.

2.4.1.2. Dependent variable

As I aim to capture subjective perceptions of governance at the sub-national level, I select governance perceptions collected through *Balkan Public Barometer Survey*. Balkan Barometer started in 2014 and currently contains data with 53,169 respondents from Western Balkan during the eight survey waves between 2014 and 2021. This survey is conducted once per year to collect data about public opinion on socio-economic and political trends.

To align the survey responses with the Chinese projects, I tailor the analysis to the available data from the Balkan Barometer. In this dataset, the lowest level of geographical location available for the respondents is region. It is important to note that the definition of regions varies across

countries, so in some cases, they correspond to administrative divisions, while in others they are statistical units (NUTS).

For this analysis, I select two governance-related questions, consistent through the years of analysis (2015-2019). To make the analysis comparable to the national level, I use the same aspects of governance: corruption and the rule of law.

The corruption variable is determined by the answers to the following question: *What do you think are the two most important problems facing your economy?* I aggregated the share of respondents who perceive corruption as the most serious problem in their country and calculated a ratio from 0 to 1 (taking into account the region weights). Furthermore, the rule of law variable is based on responses to the following question: *Do you agree that in your place of living the law is applied and enforced effectively?* Offered responses were: 1 – totally disagree 2 – tend to disagree 3 – tend to agree 4 – totally agree 5 – I don't know. I counted mean response for each region, only for responses 1-4, while not taking into account response 5, to avoid overinflation of the results. This makes the analysis focused only to those citizens that had some opinion.

2.4.1.3. Covariates

Unfortunately, due to the uneven classification of regions in different countries, it was not feasible to collect data on all covariates from the national analysis. Fortunately, the Aid Data Geo Query platform allowed data collection adjusted to this analysis, as the platform offers extraction on a few sub-national levels for each country. The following covariates are included in the analysis:

Population data: Since population data are not consistently measured, typically it is possible only to use different types of estimates. For this analysis, I use World Pop (WorldPop 2023) data as they are particularly suitable for the sub-national level. Namely, World Pop provides gridded estimates

counted by spatial disaggregation of data into grid-like units. Each grid cell represents a specific geographic area and is assigned a population value.

Nightlights data: To address the challenges of aggregating economic indicators at a lower level of analysis, I utilize a dataset DMSP-like VIIRS nighttime lights. (DMSP 2023) This dataset captures the intensity of lights emitted during the night, as observed from satellite imagery. By using this data, I can gain insights into the level of economic activity and urbanization within specific regions. Nightlights data are widely used in development economics, typically as proxy indicators of economic activity, as they correlate with other economic indicators. (Gibson, Olivia, and Boe-Gibson 2020) I use the mean value in a specific region in a selected year, which reflects the average intensity of lights in the region, indicating economic development. In addition, empirical evidence suggests a relationship between nightlights and political outcomes, particularly in the context of public goods provision., I assume that some part of this effect is also captured by this variable. (Min 2015)

World Bank project data: To account for the activity of other donors, I use *World Bank Geocoded Research Release, Version 1.4.2* (AidData 2017), which contains data about World Bank projects around the world between 1995-2014 (commitment years) and 1995-2019 (implementation years). To align the variable with Chinese projects, I also take the number of projects in the implementation phase in a specific region in a particular period. However, the main limitation is that I miss data for projects committed after 2014.

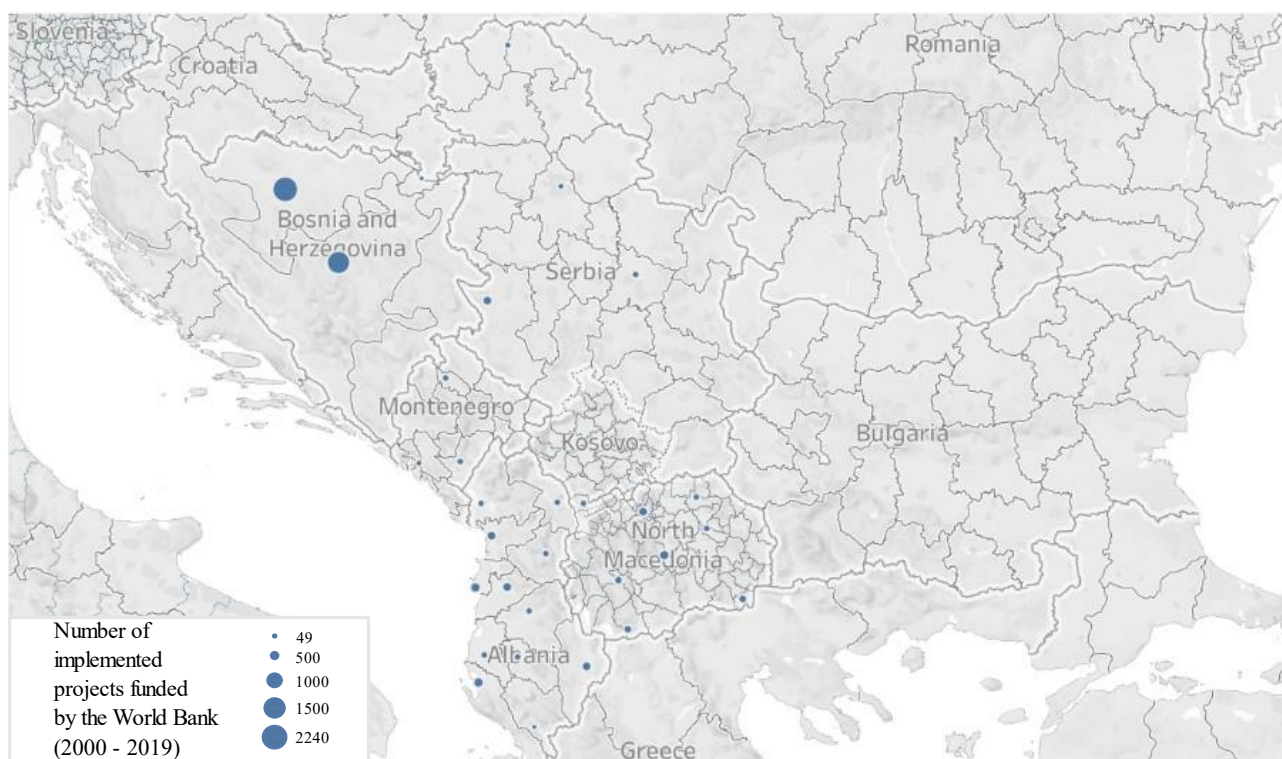


Figure 3: Aggregated active World Bank projects in observed regions in Western Balkans (2000-2019), size of the circle represents the variability of the number of active projects. Created by the author base on AidData dataset.

2.4.2. Model

I run fixed effects models on matched samples (year fixed effects and two-way fixed effects: region and year). To increase robustness, I control for covariates used for creating pairs.

	<i>Dependent variable:</i>			
	Corruption		Law	
	Year fixed effects model	Two-way fixed effects model	Year fixed effects model	Two-way fixed effects model
	(1)	(2)	(3)	(4)
Active Chinese projects	0.040 (0.018)**	−0.016 (0.008)*	0.040 (0.016)**	−0.017 (0.007)**
Population	0.00000 (0.000)***	−0.00000 (0.00000)	0.00000 (0.000)***	−0.00000 (0.00000)
Nightlights (average)	−0.007 (0.002)***	0.023 (0.005)***	−0.006 (0.002)***	0.022 (0.004)***
Active World Bank projects	0.006 (0.001)***	−0.0004 (0.001)	0.005 (0.001)***	−0.0003 (0.0005)
Observations	106	106	106	106
R ²	0.320	0.136	0.311	0.157
Adjusted R ²	0.264	−0.226	0.255	−0.196

Note:

*p<0.1; **p<0.05; ***p<0.01

Table 3: Perceptions of corruption and rule of law in regions with active Chinese projects (all models include clustered standard errors)

2.4.3. Findings

Results are to some extent conflicted with the national analysis. This time, more significant coefficients are for the corruption perception, while it is the opposite for the rule of law.

Namely, it seems that citizens living in regions with active Chinese projects have the worse perceptions of the implementation of law in their area, controlling for unobserved time heterogeneity, while this sign is the opposite after including region-fixed effects in the equation.

Two-way fixed effects models are in both cases less robust, while year fixed effects models give the higher significance of all coefficients. Consequently, the finding is that corruption is perceived as problem number one in regions with active project sites, while at the same time, these respondents have better perceptions of the rule of law on average. The result is the same for the World Bank projects.

2.5. Limitations

A few methodological challenges are important to note and relevant to consider for further research. First of all, national analysis has a selection effect problem, i.e. aid allocation is a contested issue but it is barely ever random. In the case of Chinese aid, there is also a risk of self-selection, i.e. that countries with worse governance, in general, have a higher demand for Chinese assistance. Methodologically, this is a problem of reverse causality that could be addressed by introducing an instrumental variable that would be a source of exogenous variation to identify the causal effect. In addition, the analysis would benefit from time lags and measurement of time of the effect. At this stage, analysis is based on commitment years.

When it comes to sub-national analysis, the main limit is a risk of omitted variable bias and lack of data on a lower geographical level. Further endeavors could go in the direction of either designing the surveys that will subsequently be geocoded or geocoding the existing dataset. Geospatial analysis is the most beneficial when there is a chance to measure how far the respondent lives from the active Chinese project site. (Isaksson 2017) This would enable exact geographical matching that would further enable causal inferences in the later stages. However, even though this analysis has limitations reflected in too big geographical units, it is still indicative as Chinese projects (OOF in particular) are large and their effects most likely are spreading around the regions.

As regards matching methods and selection of propensity score matching technique, it is worth noting that PSM has been treated as a sometimes problematic method, as it could have the opposite effect than intended, i.e. increasing imbalance, inefficiency, model dependence, and bias. (King and Nielsen 2019) This goes in line with the previous argument, and further analysis should aim to use exact matching on a more granular level of analysis (either survey respondents, or projects).

As the research is in its infancy, the analysis would benefit from qualitative insights, such as analysis of the case studies (specific projects), and/or conducting interviews with those involved. Qualitative research allows for in-depth exploration of individual cases and can provide context and understanding that quantitative analysis alone may not capture.

Finally, future research may consider other governance indicators. While the analysis in this study is based on perceptions of governance, future research could consider incorporating other indicators related to transparency, procurement practices, and other dimensions of governance.

CONCLUSION

In Chapter 1, I introduced the main properties of aid as a resource, that links it to the governance outcomes in recipient countries. I argued that aid is a fungible resource that brings a risk of misuse by recipient governments, hence undermining the principles of good governance and reform prospects. I ended up presenting two different models of development cooperation that are currently present in donor architecture. By distinguishing Chinese assistance from DAC aid flows (focusing on the non-interference principle, lack of transparency, and typical practices of China on the ground), I hypothesized that Chinese flows (OOF more than ODA) are likely to be associated with worse governance outcomes in recipient countries.

In Chapter 2, I empirically test the theoretical linkages between Chinese assistance and governance indicators in five Western Balkans countries. I found a significant negative relationship between the rule of law and cumulative Chinese flows (both ODA and OOF) and a significant positive relationship with corruption perceptions on the sub-national level.

What are the implications of this study? In the academic context, the fungibility of aid should be revisited, with particular attention to distinguishing features of Chinese aid. With the new forms of aid delivery, a new theoretical framework is to be established. Empirical studies should avoid aggregating all Chinese flows, and rather aim to break down different categories and layers of the effects. On the policy level, it should be recognized that statements about rogue aid and undermining Western conditionality may be an oversimplification of the complex engagement of China as a development cooperation partner. Western donors should carefully use empirical evidence on specific effects that different types of Chinese flows may have in recipient countries.

This and similar studies might be used as a contribution to the development of more effective aid strategies, particularly in contexts where two types of donors coexist.

Creating effective aid strategies was always challenging due to the complexity of this type of intervention and the potential for unintended consequences. Today, it is probably more challenging than ever in the previous decades. With several questions opened by the emergence of new ways of supporting developing countries (introduced by China), it remains open debate what is the most effective way of development cooperation and how (or whether) external parties should employ policy reform conditions as it was the case in the previous decades.

APPENDICES

1) *Multicollinearity in the national analysis dataset*

To check for multicollinearity, I report the correlation matrix which shows the correlation among the independent variables. The only case where the correlation is very high is between poverty and GDP per capita. (close to 0.7) For this reason, I excluded poverty from the models.

	Chinese OOF/GDP	Chinese ODA/GDP	GDP per capita	Population	Natural resources rents	Unemployment	Poverty	Regime type
Chinese OOF/GDP								
Chinese ODA/GDP	-0.19							
GDP per capita	0.40****	-0.43***						
Population	-0.32**	0.15	-0.12					
Natural resources rents	-0.09	-0.07	-0.02	0.27**				
Unemployment	0.19	-0.35***	-0.15	-0.34**	0.05			
Poverty	-0.07	0.51****	-0.69***	-0.1	0	0.11		
Regime type	-0.28**	-0.08	-0.06	0.41****	0.39***	-0.03	-0.16	
DAC aid/GDP	-0.23*	0.08	-0.58****	0.18	-0.13	0.03	0.14	0.11

Table 4: Correlation matrix in national analysis dataset.

2) *Visualization of Chinese ODA and OOF throughout time*

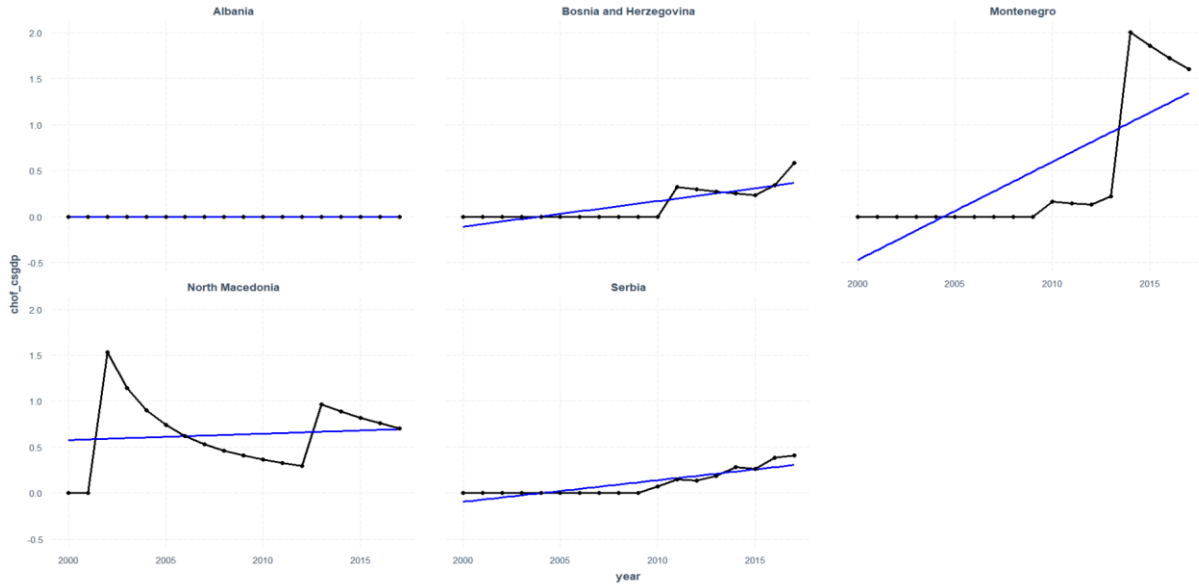


Figure 4: Distribution of OOF in selected countries

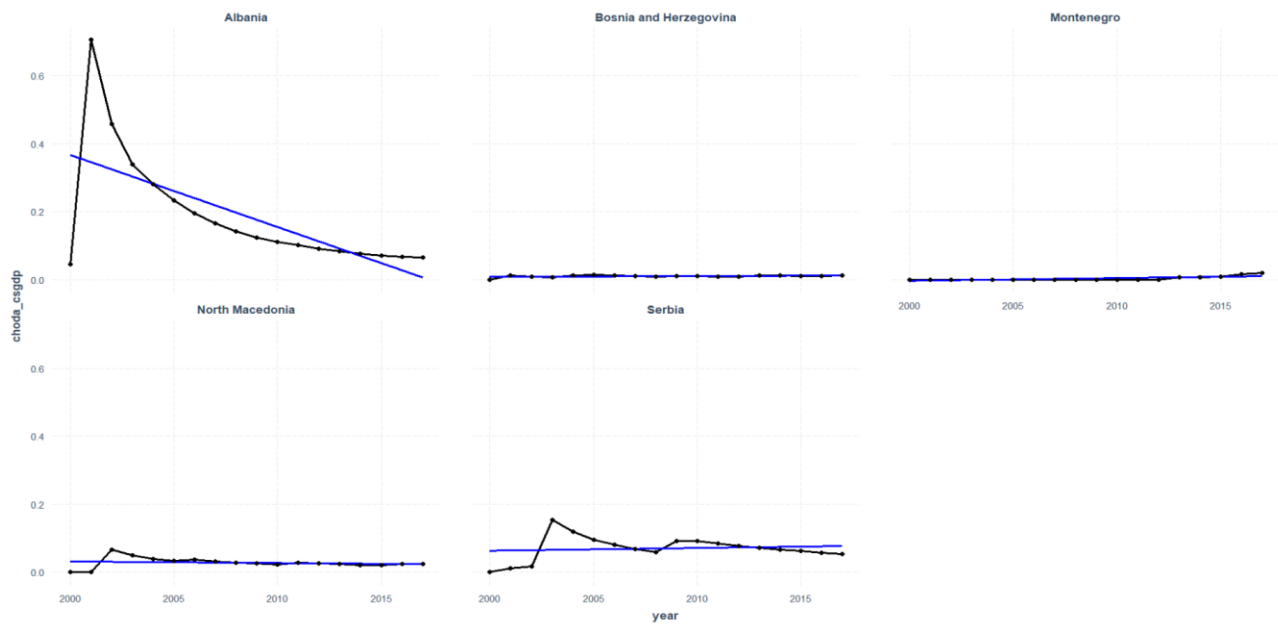


Figure 5: Distribution of ODA in selected countries

3) *Covariate balance in the matched sample in the subnational analysis*

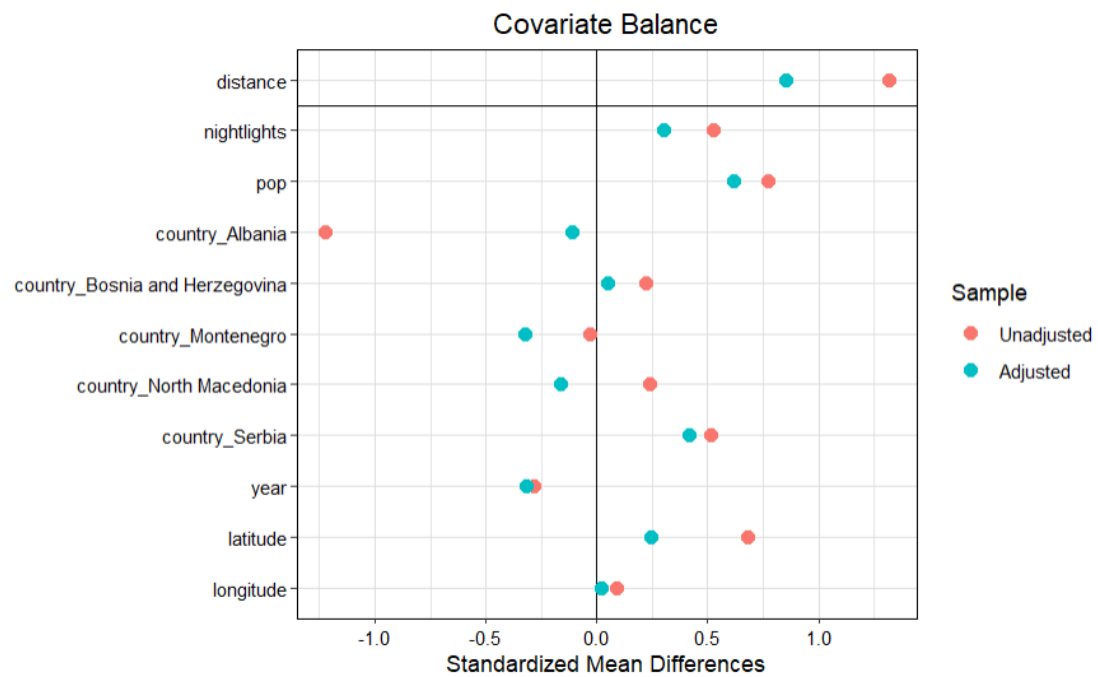


Figure 6: Covariate balance in matched sample

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