

Preface

In this book, I provide a formal theory of institutions and aid effectiveness in the post-Soviet space. While Eastern Europe and the former Soviet Union have been the recipients of extensive development assistance from both bilateral and multi-lateral donors such as OECD member states, the Bretton Woods system, and regional economic institutions, the TACIS program of the European Commission maintains a key position in the market transitions of post-Soviet economies in the 1990s and 2000s. As the main instrument of EU development aid for the transformation of the former Soviet Union, the TACIS program had to face a series of crucial tradeoffs, inherent to the complex institutional nature of central planning and the hybrid structure of the EU itself. The first tradeoff has been between sovereignty and transnationality. The collapse of the Soviet Union marked the end of sovereign monopolies and a strict definition of the public domain, where ministries and state-owned companies dominated production and set the goals of egalitarian development under conditions of imperfect bureaucratic monitoring. EU development aid is modeled as a soft budget constraint that finances the development strategies of the recipient. The donor reserves the right to reject the continuation of financing the same project in the next period, if the recipient has not completed the aid contract in the current period.

This enforcement mechanism of the European Commission induces contractual compliance by the recipient. Furthermore, it suggests that foreign aid allocation depends on the administrative organization and the political constraints of the donor herself. Hierarchical monitoring and U-form administrative organization have led to the treatment of development aid as an insurance mechanism for trade and investment. I define this donor type as *reciprocal* or *strategic*. Existence of multiple veto players and a complex administrative structure make the overall approval of development aid budget harder and require a higher degree of transparency both in the decision-making process and the financial objectives of the donor government. I define donors that advance institutional transformation in the territory of the recipient as *normative*. Long-run convergence and reinforcement of economic ties between the donor and the recipient require not only an increase in bilateral trade and intensive foreign direct investment by the donor. They primarily depend on the emergence of civic institutions, the modernization of public administration, and private sector development. The main difference of normative donors from

reciprocal advocates of aid for trade is that they condition aid effectiveness on the recipient's adjustment to their own institutional and political priorities such as democracy and the rule of law. The aid systems of the United Kingdom and Germany are analyzed as prototypical strategic and normative donors respectively. The European Union is an intermediate aid system between the corner systems of the United Kingdom and Germany. The EU aid system is defined as just, because it achieves a fair balance between development aid as an insurance mechanism for trade and investment, and development aid as a set of strategies that offer incentives for the institutional and political approximation between the donor and the recipient. The TACIS Program is modeled and evaluated on the basis of that assumption.

This book is the one of the first—if not the first one—to address aid effectiveness from the perspective of comparative economics. Since the collapse of the Soviet Union and the transition of its republics to market structures and representative forms of government, the European Commission had recognized the necessity of a closer economic cooperation with Russia and Eurasia. EU development aid provided a set of reform incentives to post-Soviet planners. It created the grounds for the institutional and social transformation of the bureaucracy at both central and regional levels by integrating it into the aid allocation process. In the former Soviet Union, the subordination of civil society to the developmental choices of recipient bureaucracies occurred at the expense of diversity and political openness. Nevertheless, it led to the emergence of transnational sovereignty partnerships (TSPs) between recipient bureaucracies and NGOs or businesses funded by the donor. Their complex organizational structure and transnational financing facilitated higher compliance with aid contractual conditions and thus aid effectiveness.

Statistical modeling alone is not sufficient to delineate all aspects of aid effectiveness. The effect of the recipient's state capacity on aid effectiveness and the treatment of socialist legacies as part of the aid delivery process induce the combined use of formal modeling and qualitative analysis, which is the main methodological contribution of this book. Evaluation reports indicate the problems and challenges faced by aid bureaucrats and suggest that the weakly institutionalized environments of Ukraine and Central Asia are less conducive to aid effectiveness than the heavily bureaucratized environment of Russia. The proposed system of incentives for the implementation of development aid links EU foreign policy with bureaucratic decision-making and reflects the choice sets of the donor and the recipient. Multiple definitions of aid effectiveness are provided in the course of the book chapters. Those include contractual completeness under conditions of imperfect monitoring and the soft budget constraint, optimization of donor policy preferences, and *ex post* evaluation of program objectives.

Aid in Transition contributes to the existing literature by offering new theoretical insights to the study of development aid in transition economies. The model presented in Chap. 1 proposes the existence of three distinct aid systems in the European Union: strategic, normative, and just. In donor-driven aid effectiveness the selection of recipients occurs on reciprocal, ideological, or balanced criteria respectively. In Chap. 2, the emergence and inclusion of transnational sovereignty partnerships (TSPs) in the post-Soviet development process is a key condition of

aid effectiveness in the territory of the post-Soviet recipient. The transnational nature of EU aid explains its role as the new soft budget constraint to the economies of Russia, Ukraine and Central Asia with a primary focus on Kazakhstan. EU development aid has been decided in Brussels and fulfills the developmental plan of a bureaucrat in Moscow, Kiev, St. Petersburg, or Crimea. In Chap. 3, the delivery of EU development aid to the former Soviet Union is modeled as an infinitely repeated Prisoner's dilemma with private signals. Field evidence from the *ex-post* evaluation of EU development aid projects in the areas of social policy and infrastructure is in line with the insights of the dynamic game proposed. Chapter 4 summarizes the strategic environment of aid delivery and discusses the transition from the TACIS Program to the European Neighborhood and Partnership Instrument (ENPI) and the Development Cooperation Instrument (DCI). Formal results and field evidence from Chaps. 1 to 3 are utilized to explain the effects of EU development aid on regional integration in the post-Soviet space with focus on the Eurasian Economic Community and its forthcoming successor, the Eurasian Economic Union. Russia's new donor status is analyzed in view of an emerging aid competition between the European Union and Russia in the post-Soviet space.

Post-socialist bureaucracies can contribute to aid effectiveness rather than being continuous sources of corruption and rent-seeking, when they become an active part of the aid delivery process. The regulatory coordination of foreign aid is a key step in that direction, as it induces aid complementarities at the local level and reveals the conditions under which bureaucratic commitments can be an inherent component of global development. *Aid in Transition* is genuine in its focus to provide the first series of formal definitions on aid effectiveness and discuss the institutional features of aid delivery to transition economies.

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