THE EFFECTS OF THE EUROPEAN UNION ON CORRUPTION CONTROL IN CENTRAL AND EASTERN EUROPE BEFORE AND AFTER ACCESSION

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ABSTRACT

Svet Derderyan: The Effects of the European Union on Corruption Control in Central and Eastern Europe before and after Accession
(Under the direction of: Milada Vachudova)

This dissertation evaluates the effectiveness of the EU in promoting lasting liberalizing reforms in Central and Eastern Europe (CEE) before and after accession. It focuses on an area of governance with deep implications for both the quality of democracy and the prospect of economic development in the region – corruption control. The major finding is that since enlargement the EU has not had such strong direct and far-reaching effects as it did before accession.

In analyzing corruption control both as a dependent variable as well as an independent one affecting FDI, I make three claims and substantiate each using a mixed-method approach featuring both time-series analyses and qualitative methods, such as case studies and expert survey data analyses.

First, civil society development has stagnated since accession and so has its otherwise positive influence on corruption control: the exodus of most external donors and the EU's complicated procedures for applying for funding have crippled anti-corruption NGOs' capacities to monitor and advocate reforms.

Second, EU leverage has been weaker after accession and anti-corruption reform has consequently slowed down: supranational pressures from the EU in the form of conditional

funding and Cooperation and Verification Mechanism (in the cases of Bulgaria and Romania) as well as spillover effects from various chapters of the acquis have sufficed to prevent backsliding per se, but have not been able to reverse the post-accession trend of a slowdown in reform.

Third, looking at corruption control as an independent variable, the effects of its stagnating trend post-accession include a decline in FDI. Encouraged by positive signaling from the EU confirming CEE countries' progression towards membership, FDI was steadily increasing during the pre-accession period and corruption control, improving or stagnant, was irrelevant for investors at that time. However, rates of investment have surprisingly dropped soon after accession, as investors have become less driven by cognitive shortcuts (the availability heuristic) causing them to assign disproportionate weight to information that is vivid or striking, such as the positive signals by the EU. In this new environment their concern about lack of progress in corruption control has led them to be more cautious.

TABLE OF CONTENTS

LIST OF TABLES…………………………………………………………………….......viii

LIST OF FIGURES………………………………......…………………………………......x

LIST OF ABBREVIATIONS……………………………………...………………………xii

CHAPTER I: THE LIMITS OF THE EU'S "TRANSFORMATIVE POWER"…………………1

Overview and Contributions……………………………………………………………....3

Conclusion……………………………………………………………………………...8

References……………………………………………………………………………..11

CHAPTER II: INCAPACITATED? THE ADVERSE EFFECTS OF EU ACCESSION ON ANTI-CORRUPTION CSOS' CAPACITIES TO AFFECT CORRUPTION CONTROL IN CENTRAL AND EASTERN EUROPE……………………………………………………………13

Civil Society and Corruption…………………………………………………………15

Theoretical Framework……………………………………………………………… 17

The EU pre-accession process and the anti-corruption struggle: Conditions enabling and undermining the empowerment of CSOs in the pre-accession period…………………………………………………………………………17

Accession and the anti-corruption struggle: Conditions undermining the empowerment of the CSO sector ………………………………………………..21

Hypotheses: Increasing Capacity Before Accession, Declining Capacity After...23

Methodological Framework…………………………………………………………...24

Results…………………………………………………………………………26

Time Series……………………………………………………………………29

Model Specification…………………………………………………………...30

Survey Results……………………………………………………………………...34

Selecting anti-corruption NGOs for process tracing……………………………..37

Case Studies……………………………………………………………………...39

Center for Economic Development (CED)……….…………………...40

Center for the Study of Democracy (CSD)………………………………47

Conclusion……………………………………………………………………….56

References……………………………………………………………………….59

Appendix A: Civil Society Weakness and Corruption Control in the 10 post-communist countries of the 5th Enlargement 1997-2011………………………...62

A1: Cross-validation: Civil Society Weakness and Corruption in the in the 10 post-communist countries of the 5th Enlargement 1999-2012 as measured by Freedom House……………………………..72

Appendix B: Variable measurement and Descriptive Statistics…………………77

Appendix C: Examples of mechanisms of corruption control utilized by Bulgarian NGOs……………………………………….……….81

CHAPTER III: CORRUPTION ON THE ROPES: THE EFFECTIVENESS OF EU LEVERAGE IN FIGHTING CORRUPTION IN CENTRAL AND EASTERN EUROPE BEFORE AND AFTER ACCESSION……………………………………………………………..82

Corruption in CEE: The state of play……………………………………………………84

Challenges to post-accession compliance in various areas. Is corruption different?.........88

Theoretical Framework and Hypotheses……………………………………………...90

Methodological Framework…………………………………………………………...92

Operationalization of the dependent variable – Corruption……………………...93

Operationalization of the independent variables - EU Candidacy Process and Full Membership…………………………..……………………………...96

Control Variables and Alternative Explanations………………………………...98

Statistical Analysis and Results…………………………………………………...101

Causal Mechanisms……………………………………………………………….106

Conclusion……………………………………………………………………...116

References………………………………………………………………………119

Appendix A: Variable measurement and Descriptive Statistics………………..122

CHAPTER IV: BENEATH THE VEIL OF HOPE: THE EFFECTS OF EU SIGNALING ON FOREIGN INVESTORS' SENSITIVITY TO CORRUPTION BEFORE AND AFTER EU MEMBERSHIP…………………………………..…………...126

EU accession, corruption, and FDI……………………………………………..129

Theoretical Framework…………………………………………………………133

Hypotheses……………………………………………………………………...137

Methodological Framework…………………………………………………….139

Alternative Explanations………………………………………………………..141

Time Series Analysis…………………………………………………………...146

Survey…………………………………………………………………………..150

Interviews……………………………………………………………………….159

Conclusion……………………………………………………………………...162

References………………………………………………………………………164

Appendix A: FDI in the 12 countries of the 5th enlargement 1996-2012………………167

Appendix B: Variable measurement and Descriptive Statistics ……………………….174

Appendix C: FDI Stock per Capita in the EU28………………………………………..182

LIST OF TABLES

Chapter II

Table 1: Alternative Explanations……………………………………………………………….30

Table 2: Effects of Civil Society Weakness on Corruption Control Before and After EU Accession…………………………………………………………………………...…………32

Table 3: Drivers of CSO Empowerment before Accession…………………………………...35

Table 4: Reasons why access to funding sources became more difficult after accession……….37

Table 5: Descriptive Statistics and Difference of Means Test…………………………………...39

Table 6: CSD Grants by sponsor……………………………………………………………...50

Table B.1: Variable Measurement……………………………………………………………….77

Table B.2: Descriptive Statistics…………………………………………………………………80

Chapter III

Table 1: Independent Variable – EU Candidacy Process………………………………………..96

Table 2: Independent variable – Full Membership………………………………………………97

Table 3: The Effects of EU Candidacy and Membership on Corruption Levels………………103

Table A.1: Variable Measurement…………………………………………………………...122

Table A.2: Descriptive Statistics……………………………………………………………..125

Chapter IV

Table 1: Stages of Conditionality and When They Applied to Particular Countries…………...141

Table 2: FDI Drivers Before and After EU Accession…………………………………………147

Table 3: FDI Post-accession of a Fund of Funds……………………………………………….159

Table 4: FDI in EU and non-EU post-communist countries……………………………………161

Table B.1: Variable Measurement…………………………………………………………...174

Table B.2: Descriptive
Statistics……………………………………………………………………………………...181

LIST OF FIGURES

Chapter II

Figure 1: Bulgarian civil society weakness before and after EU accession (2007)……………...27

Figure 1.1: Bulgarian corruption control before and after EU accession………………………..27

Figure 2: EU pre-accession effect on NGOs and NGO's impact on Corruption………………..34

Figure 3: NGO Collective impact after Membership and Sources after accession……………...36

Figure 4: Relevance score of various Bulgarian anti-corruption CSOs before and after accession………………………………………………………………………………38

Figure 5: CED Number of Corruption-related projects…………………………………………43

Figure 5.1: CED Percentage of Corruption-related projects……………………………………..43

Figure 6: CED Number of Corruption-related publications……………………………………..44

Figure 6.1: CED Percentage of Corruption-related publications……………………………….……..44

Figure 7: CED before accession……………………………………………………………46

Figure 7.1: CED after accession……………………………………………………………46

Figure 8: USAID and EU grants to CSD 2001-2011…………………………………………….50

Figure 9: CSD publications 2002-2012……………………………………………………….51

Figure 9.1: Percentage Corruption-related publications by CSD 2002-2012……………………52

Figure 10: Open Society publications 2002-2012………………………………………………53

Figure 10.1: Percentage Corruption-related publications by Open Society 2002-2012…………53

Figure 11: CSD before accession……………………………………………………………...54

Figure 12: CSD after accession………………………………………………………………….54

Figure 13: OS before accession………………………………………………………………….55

Figure 14: OS after accession…………………………………………………………………56

Chapter III

Figure 1: Corruption levels in Percentile Ranks……………………………………………………85

Figure 2: Corruption in Bulgaria 1997-2011…………………………………………………...109

Figure 2.1: Corruption in Romania 1997-2011…………………………………………………110

Figure 3: Government Promotion of Private Sector Development……………………………..112

Figure 4: Quality of Public and Civil Service…………………………………………………..114

Figure 5: Quality of the Police and the Courts…………………………………………………115

Chapter IV

Figure 1: Corruption Control and FDI in the 12 countries that joined the EU in 2004-07……..127

Figure 2: FDI in Bulgaria in millions of USD 1996-2012……………………………………...151

Figure 3: Effects of corruption on FDI before and after accession……………………………..153

Figure 4: Current state of FDI and the reasons for it…………………………………………...154

Figure 5: Conditions for the Availability Heuristic…………………………………………….155

Figure 6: Reasons to invest in Bulgaria………………………………………………………...157

Figure 7: Reasons why EU announcements matter…………………………………………….158

LIST OF ABREVIATIONS

BG	Bulgaria
CC	Corruption Control
CED	Center for Economic Development
CEE	Central and Eastern Europe
CEO	Chief Executive Officer
CIDA	Canadian International Development Agency
CLS	Center for Liberal Strategies
CPI	Corruption Perception Index
CSD	Center for the Study of Democracy
CSO	Civil Society Organization
CSP	Center for Social Practices
CVM	Cooperation and Verification Mechanism
DfID	UK Department for International Development
EBRD	European Bank for reconstruction and Development
ERDF	European Regional Development Fund
EU	European Union
FDI	Foreign Direct Investment
FIA	Foreign Investment Act
GDP	Gross Domestic Product
GTZ	German Association of Technical Assistance
LDV	Lagged dependent Variable
NGO	Non-governmental Organization
NIT	Nations in Transit

NORAD	Norwegian Agency for Development and Cooperation
OECD	Organization for Economic Cooperation and Development
OPAC	Operational Programme Administrative Capacity
OS	Open Society
PHARE	Poland and Hungary: Assistance for Restructuring their Economies
S&C	Structural and Cohesion Funds
SAPARD	Special Accession Programme for Agricultural and Rural development
SIDA	Swedish International Development Cooperation Agency
TI	Transparency International
TSCS	Time Series Cross-Sectional
UN	United Nations
UNDP	United Nations Development Project
USAID	United States Agency for International Development
USD	United States Dollar
WB	World Bank
WGI	World Governance Indicators

Chapter I: The limits of the EU's "transformative power"

The European Union's (EU) eastern enlargement that took place between 2004 and 2007 incorporated ten post-communist countries into the Union, expanded its population by more than a 100 million citizens, and turned it into the world's largest commercial and financial market, with a GDP of more than $13 trillion. The significance of this historic event, however, extends far beyond geography, demography and economics and has deep symbolic implications. As the EU Commission President at the time Romano Prodi put it, "Five decades after our great project of European integration began, we are celebrating the fact that Europeans are no longer kept apart by artificial ideological barriers." This was a moment when after more than a decade of difficult and painful transitions, ten post-communist Central and Eastern European (CEE) countries finally broke free from their communist legacies and joined the ranks of the developed world. The implementation of the EU's membership conditionality meant that authoritarianism and central planning were now buried in the past. Democracy and the free market were "the only game in town."

But 25 years after the end of communism and ten years after these countries' accession to the EU, challenges to democratic consolidation, such as populism and nationalism, concentration of power, corruption and state capture, and others, raise questions about the limits of the EU's "transformative power." Thus, this dissertation takes on the task to evaluate the effectiveness of the EU in promoting lasting liberalizing reforms in CEE before and after accession. It focuses on an area of governance with deep implications for both the quality of democracy and the prospect of economic development in the region – corruption control. To what extent have the EU accession process and subsequently membership enabled CEE states to catch up with the older and more established democracies and more developed economies of Western Europe? To answer this question I look at the interplay between supranational (EU) and domestic pressures (civil society) for corruption control as well as the consequences of corruption control or lack thereof for Foreign Direct Investment (FDI), one of the key sources of economic growth, in the region.

The major finding is that since enlargement the EU has not had such strong direct and far-reaching effects on corruption control as it did before accession. This finding falls in line with the arguments of several scholars who demonstrate that the EU's effect on democratic development (unlike economic development) after accession has been modest at best (Epstein and Jacoby, 2014). They show that corporate state capture and political competition (Innes, 2014), democratic backsliding (Sedelmeier, 2014), extreme current account deficits (Jacoby, 2014) and consumption growth that is faster than productivity gains (Epstein, 2014) limit CEE's prospects for catchup with west European countries.

My work contributes to this literature by suggesting that progress in corruption control has been stymied in CEE as a result of EU membership. In analyzing corruption control both as a dependent variable whose trends have to be explained as well as an independent one which affects other important aspects of post-communist development, such as FDI, I make three claims.

First, civil society development has stagnated since accession and so has its influence on corruption control: the exodus of most external donors and the EU's complicated procedures for applying for funding have crippled anti-corruption NGOs' capacities to monitor and advocate reforms.

Second, EU leverage has been weaker after accession and anti-corruption reform has consequently slowed down: supranational pressures from the EU in the form of conditional funding and Cooperation and Verification Mechanism (CVM) (in the cases of Bulgaria and Romania) as well as spillover effects from various chapters of the acquis have sufficed to prevent backsliding per se, but have not been able to reverse the post-accession trend of a slowdown in reform.

Third, looking at corruption control as an independent variable, the effects of its stagnating trend post-accession include a decline in FDI: although FDI was steadily increasing during the pre-accession period (and corruption control was irrelevant for investors at that time), rates of investment have surprisingly returned to pre-enlargement levels soon after accession, as investors have become more concerned about lack of progress in corruption control.

Overview and Contributions

While the liberal economic literature sees strong prospects for CEE's convergence with the west by virtue of EU membership (European Commission, 2010; World Bank, 2012), certain historical and sociological analyses anticipate a continuing east–west divide (Janos, 1989, 2000). Indeed, there are a number of areas where EU influence has been substantial and lasting - trade policy (Kaminski, 1999), single market rules (Mayhew, 1998), agriculture (Fernández, 2002), structural funds (Jacoby, 2004), competition policy (Drahokoupil, 2009), enterprise/industrial policy (Ellison, 2006), implementation of EU law (Sedelmeier, 2008), bank privatization

(Epstein 2008), pension reform (Orenstein, 2008), enhancing liquidity after the financial crisis (Jacoby, 2014) etc.

At the same time, the EU's influence has been weaker and declining after accession with regards to taxation (Appel, 2011), budgetary controls (Hallerberg and Yläoutinen, 2010), the application of minority rights rules (Sasse, 2008), political party platforms (Vachudova, 2008; Haughton,2014), political competition and corporate state capture (Innes, 2014), democratic backsliding (Sedelmeier, 2014), anti-corruption reform (Pop-Eleches and Levitz, 2010), and civil society (Mungiu-Pippidi, 2010).

What these studies point at is that on balance the EU has had stronger economic effects than political, and that its new post-communist members have had significant problems with various aspects of democratic consolidation (Epstein and Jacoby, 2014). Corruption control is no exception.

Given the established importance of domestic factors in effecting policy change (Vachudova 2005, Börzel and Risse, 2003; Jacoby, 2004; Haughton, 2012; Dimitrova and Buzogány, 2014), the first article of the dissertation explores the role of civil society organizations (CSOs) in inducing anti-corruption reforms. The main question it raises is how the EU has impacted CSOs' capacity to fight corruption. Utilizing a mixed-methods approach, the article shows that first the EU pre-accession process amplified the impact of CSOs but then, paradoxically, EU membership undermined their significance.

Looking at the ten post-communist states that joined the EU in 2004-07 I first employ time-series analysis to establish the positive influence of CSOs on corruption control before accession as well as the lack thereof post-accession. I then focus on the qualitative case study of Bulgaria and, drawing parallels to the other nine Eastern European EU members, apply historical process tracing and expert survey data analysis to test how exactly the EU affected the capacity of CSOs to shape domestic incentives before and after accession.

My contributions to the existent literature on civil society and corruption fall in several areas. First, I offer an alternative theoretical argument to the debate whether the EU accession process helped or hurt CSOs in CEE. I show that the EU had a nuanced effect first strengthening, but then inadvertently undermining the impact of these organizations. Second, I identify and trace the two causal logics behind this dynamic. Before accession, CSOs took advantage of empowerment opportunities, such as more funding and the EU's encouragement of collaboration with governments. In making this argument I also unpack the tools that this empowerment provided – advocacy and monitoring – and demonstrate how CSOs employed these tools to effect specific anti-corruption reforms. After membership, the withdrawal of most external donors from the area and the EU's insistence that CSOs apply for EU funding through the various ministries of their own state led to specific problems with the financing of projects and the retention of staff which translated into weakening capacities.

But is the declining influence of civil society post-accession justification to expect backsliding in corruption control in this time period? To shed more light on this question, my second dissertation article takes a broader perspective[1]. Taking into account various aspects of the EU pre–accession process and post-accession pressures this article asks whether corruption levels were curbed during the pre-accession period and more importantly whether any such gains were sustained after that. Utilizing a mixed-methods approach I show that supranational pressures from the EU were strong both pre- and post-membership and the ten post-communist

[1] A version of this article was published in an edited volume, *EU Enlargement: Current Challenges and Strategic Choices*, in August 2013.

countries performed well in both time periods, although there is definitely evidence of a slowdown in reform after accession.

There are several contributions to the literatures on EU leverage and post-accession compliance that I make. First, employing time series analysis and accounting for an array of alternative explanations I refute the skepticism about these countries' success in trying to curb corruption before membership as well as the expectation for backsliding afterwards. Second, I unpack the causal mechanisms behind this result. Using historical process tracing I show that corruption received a lot of visibility during the accession period through the Commission Regular Reports in which the EU demanded reforms that served to decrease corruption levels during the pre-accession period. After accession, gains in the fight against corruption were not negated, albeit progress in reform slowed down, as the relative loss of leverage in this time period was compensated by the combined effect of three causal mechanisms. First, there were positive pressures coming from continued EU leverage - conditional Structural and Cohesion Funds and CVM reports (in the cases of Bulgaria and Romania). Second, there is evidence of increased linkage - socialization effects leading to higher demands for accountability of public officials. Third, there are substantial spillover effects from implementing the *acquis* in other areas – the reduction of the role of the state in the economy, increasing bureaucratic capacity and improvements in the legal system.

My third article takes a slightly different perspective on the corruption control dynamic before and after accession. Instead of regarding corruption as a dependent variable as the other two articles, it incorporates corruption into the analysis as an independent one. It then focuses on one of the most important sources of economic growth in the region since 1989, FDI, and asks how corruption has influenced FDI inflows in the region before and after accession. More specifically, the article raises the question of whether positive signaling during the EU pre-accession process trumped other important factors for FDI, such as corruption, only for them to resurface after membership and have the expected impact on investor confidence. Put more simply, the article evaluates the differential effect of corruption on FDI inflows in Central and Eastern Europe during the different stages of the EU accession progress.

I hypothesize that explicit signaling by the EU during the negotiations phase increases investor confidence and causes investors to discount the importance of otherwise relevant factors, such as corruption. The situation changes after accession as the EU no longer sends such signals to investors. Thus, once a country is part of the bloc, technical factors reemerge as important and investors punish countries that are perceived as lagging behind or backsliding in the area of corruption.

The article features a mixed method approach. First, I use time-series analysis covering data from 1996 to 2011 to establish that corruption did not have a significant impact on FDI before accession but did afterwards. Then, I present the results of expert survey data and a brief case study to demonstrate the specific psychological mechanisms that allowed signaling to cause investors to be less risk avert prior to EU membership.

There are two main contributions that this article makes to the literatures on FDI, corruption, and institutional signaling. First, I show that corruption matters for FDI differently in different contexts. When countries are perceived as developing as opposed to developed, which was the case with the ten post-communist candidates as they were applying for EU membership, corruption may not be a significant factor and other considerations (such as positive signaling from international institutions) may take prevalence. Alternatively, when they are considered developed and are part of an established international organization like the EU, rational guidebook principles dominate economic actors' decision-making, corruption matters, and its effect on FDI is negative. Second, I suggest that cognitive shortcuts, such as the availability heuristic, help explain behavior when investors operate in information-scarce environments as they tend to assign disproportionate weight to signals perceived as legitimate.

Conclusion

So what do these findings suggest about the EU's longer-term effects, and particularly the CEE prospects for catching-up and overcoming the east-west divide? There are three conclusions and lessons that this dissertation draws.

First, it is clear that EU pressures work best when they take place in conjunction with domestic factors (Dimitrova and Buzogány, 2014). The fact that the EU provided opportunities, including funding, for civil society organizations to be a part of the accession process and alert the Commission of problems and inefficiencies enabled civil society to exert meaningful influence on corruption control. Since accession, complicated EU procedures for accession funding have led to a stagnation of the sector as many civil society actors have found it hard to finance anti-corruption activities. The lesson to be drawn here is the following: the key to revival of the sector is for the EU to remove the funds application process from the grip of domestic governments, which do not want anti-corruption funded and would methodically create barriers preventing CSOs from getting funded and exposing them. Given the close correlation between corruption control and strength of civil society it seems that this would be the sensible way to restore some of these countries' more hopeful pre-accession anti-corruption track record.

Second, the levelling off of corruption control trends post-accession is a mixed bag. On one hand it is encouraging that gains in corruption control realized during the accession process were not negated by the granting of membership (Pop-Eleches and Levitz, 2010). Continued EU leverage in the form of conditional funding and CVMs combined with increased linkage with western Europe and spillover effects of other chapters of the acquis have prevented backsliding. On the other hand, however, these countries still remain much more corrupt than the western European members (except for Greece and Italy). The lessons here is the following: the EU can exert much more pressure on countries during the accession period as its leverage post-accession naturally decreases. The implications of this lesson can be nicely traced in the context of the Croatian accession in2013. Croatia's negotiations were much slower, especially in their final phase as the Commission required the country to jump through many more hurdles than Bulgaria and Romania, particularly on corruption and judicial reform. It is too early to say whether this approach has led to a markedly different post-accession trajectory in anti-corruption in Croatia, but the idea of the Commission updating its strategies based on learning is encouraging.

Finally, CEE was able to attract massive FDI in the pre-accession period but the rates of post-accession FDI have slowed down within a few years after the initial "bump" that accession generated. CEE was an attractive destination for FDI because of the communist legacies of industrialization (Bohle and Greskovits, 2012), because of the EU's policies aimed at promoting FDI (Medve-Bálint, 2014), and importantly because of the promise of eventual membership (signaling) which the accession negotiations implied. Once membership was granted investors could no longer hope for further reforms of the same scale and rate, so they become much more focused on the macroeconomic reality that was as opposed to the one that would be if further liberalization would follow. Thus, post-accession, investors became less interested in moving in, both because many opportunities have already been captured but also because the fundamentals on the ground, including slowdown in corruption reform, made it difficult to justify high rates of investment.

The lessons here are mainly for the investors. Decision makers can be affected by bold, striking, and vivid information, such as the EU's positive endorsement of a country's accession path. Rather than constructing careful cost-benefit analyses they may draw conclusions based on limited data and over-extrapolate, especially if others are doing the same (herding behavior). Thus, one could say that bounded rationality and inferential shortcuts can be partially responsible for overinvestment in CEE in the pre-accession period, and the drop in FDI shortly after accession merely signifies the return of comprehensive rational approaches.

So what do my three articles suggest about CEE's opportunity to overcome the east-west divide? Progress in corruption control after accession has been stagnant or slow at best, the impact of civil society on reform has declined, and issues with corruption are partially responsible for the slowdown in FDI in the region. Thus, one could speculate that the divide is likely to persist, at least in these areas and at least for a while. That said, one could also see glimmers of hope in that the Commission is updating some of its approaches to corruption control by emphasizing the issue more in the pre-accession stage, in that civil society exerts meaningful influence when having access to funding, and in that rates of FDI, despite having declined after accession, continue to be high comparatively speaking.

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Chapter II: Incapacitated? The adverse effects of EU accession on anti-corruption CSOs' capacities to affect corruption control in Central and Eastern Europe

A lot of the literature on the EU's 5th enlargement has focused primarily on leverage, compliance, and the possibility of backsliding (Grabbe, 2006; Schimmelfennig and Sedelmeier eds. 2005; Pop-Eleches & Levitz, 2010a; 2010b; Vachudova, 2009). Most of these works look at the direct EU efforts to affect governance but also underline that EU leverage works only in conjunction with domestic pressure, either through cooperation of governments or through opposition parties pressing political leaders to deliver certain results (Vachudova, 2005). Given the established importance of domestic factors, it is then justified to also explore the role of civil society organizations (CSOs) in affecting policy outcomes (Morrof and Pfister, 2010). In this article I evaluate the impact of civil society, and particularly non-governmental organizations (NGOs), on one of the most problematic areas of governance in the post-communist world - corruption.

The main question I raise is how the EU pre-accession process and post-accession institutional changes have impacted CSOs' capacities[2] to fight corruption. Drawing on the literature on Europeanization and civil society I argue that during the EU pre-accession process the impact of CSOs on corruption was amplified through conditional and direct funding as well as the EU's insistence that civil society actors participate in the implementation of various reforms associated with the acquis. I also argue that paradoxically EU membership then

[2] I define capacities as the ability to access financial resources that can be used to fund successful anti-corruption projects.

undermined the influence of CSOs as the complicated bureaucratic procedures associated with applying for EU funds combined with the exodus of other institutional actors that provided financial support before accession led to a funding crisis that incapacitated many anti-corruption CSOs.

The article features a mixed-method approach. Looking at the 10 post-communist states that joined the EU in 2004-07 I employ time-series analysis to establish the positive influence of CSOs on corruption control before accession as well as the lack thereof post-accession. I then focus on the qualitative case study of Bulgaria and, drawing parallels to the other nine Eastern European EU members, apply historical process tracing and expert survey data analysis to test how exactly the EU affected the capacity of CSOs to shape domestic incentives before and after accession.

In terms of contributions to the existent literature on civil society and corruption I offer an alternative theoretical argument to the debate whether the EU accession process helped or hurt CSOs in Central and Eastern Europe (CEE). I show that the EU had a nuanced effect first strengthening, but then inadvertently undermining the impact of these organizations. I identify two causal logics behind this dynamic. Before accession, CSOs took advantage of empowerment opportunities, such as more funding and the EU's encouragement of collaboration with governments. In making this argument I unpack the tools that this empowerment provided – advocacy and monitoring – and demonstrate how CSOs employed these tools to effect specific anti-corruption reforms. After membership, the withdrawal of most external donors from the area and the EU's insistence that CSOs apply for EU funding through the various ministries of their own state led to specific problems with the financing of projects and the retention of staff which translated into weakening capacities.

The rest of the paper is organized as follows. First, I review the literature on the ways in which civil society improves governance and on its state in CEE. Then, I trace the historical involvement of the EU in seeking to empower the sector. In this section I outline the ways in which it strengthened CSOs before accession but I also show how granting membership led to a series of changes in the institutional terrain that translated into weakening the sector. Based on this background I then generate my hypotheses and test them using time-series analysis, expert survey analysis, and historical process tracing. I conclude by outlining the implications of my findings for the prospects of civil society and corruption control in CEE.

Civil Society and Corruption

As much academic literature has demonstrated, building civil society has been a central priority in the post-communist democratization agenda. According to liberal democratic theory, while the state should provide a government that is subject to free and fair elections, a strong and plural civil society guards against excesses of the state and legitimates its authority when based on the rule of law (Diamond, 1994). Such guarding against excesses and legitimating of authority take place by checking the government's accountability, a dynamic directly related to effective corruption control (Klitgaard, 2000):

$$Corruption = m\ (Monopoly\ of\ power) + d\ (Discretion\ by\ officials) \\ - a(Accountability)$$

A vibrant civil society contributes to increasing accountability and thus decreasing corruption in two distinct ways. First, through monitoring CSOs can diagnose problems, assess actual situations, and point out publically or specifically to shortcomings in government policies. Second, through policy advocacy CSOs can clarify the specific changes needed, identify the possible coalitions necessary for the outcomes to be achieved, and build popular support for an issue (NGO Corruption Fighters' Resource Book).[3] For these reasons scholars overwhelmingly agree on the importance of civic organizations for achieving better democratic outcomes and greater government accountability (Carothers, 2006; Linz and Stepan, 1996; Schedler, Diamond and Plattner, 1999). In fact, focusing on CEE specifically, some empirical analyses (Karklins, 2005; Holmes, 2006) have shown that the media and civil society have been the most effective promoters of anti-corrupt politics in the region.

At the same time, the effectiveness of CSOs as a major corruption fighter has also been criticized. Compared to Western Europe and the United States, civil society in CEE has not been as active and influential (Howard, 2003; Toepler and Salomon, 2003). Similarly, NGOs in the region are often viewed with distrust by the government and by the public (Grodeland, 2006). Furthermore, given that in the nascent democracies of CEE CSOs are almost exclusively externally funded, they have felt little need to engage in constructive dialogue with the wider community in which they operate (Fagan, 2005) and often operate with little prospects of long term financial sustainability (Carothers and Ottaway, 2000). It is exactly this dynamic that has made them so vulnerable to the eventual exit of these external donors. Therefore, while there are many ways in which a strong civil society can lead to better democratic outcomes and less corruption, it is questionable whether CSOs in CEE have the capacities to do this in a sustained

[3] http://www.ndi.org/files/NGO-Corruption-Fighters-Resource-Book-ENG.pdf (accessed on December 21, 2013).

manner. To what extent have these organizations been empowered by the EU pre-accession process and how resilient are their capacities to continue to effect change in the post-accession period? What specific mechanisms and technical tools do they use to build up pressure for reform? It is these questions that the rest of this article addresses.

Theoretical Framework

The theoretical section of this study is organized as follows. First, I present the ways in which the EU pre-accession process sought to empower CSOs as well as the arguments as to why these measures may not have had much impact. Then, I outline the institutional changes in the post-accession period that might have undermined the capacities of many CSOs to exert influence.

The EU pre-accession process and the anti-corruption struggle: Conditions enabling and undermining the empowerment of CSOs in the pre-accession period

Corruption became an important topic on the agenda of both academics and policy makers as soon as the CEECs started their transitions in 1989 – well before the EU entered the field in 1997. Initially, organizations, such as USAID and the World Bank soon followed by others[4], took the lead in encouraging awareness raising and capacity building (Michael and Bowser, 2010). When the EU entered the stage in the late 1990s it sought to empower civil

[4] The OECD, UNDP and a range of bilaterals – the German Association of Technical Assistance (GTZ), the UK Department for International Development (DfID), the Norwegian Agency for Development and Cooperation (NORAD), the Swedish International Development Cooperation Agency (SIDA), the Canadian International Development Agency (CIDA), and the Soros Foundation

society further granting these organizations participatory rights, encouraging cooperation between them and the government, and providing them with funding and knowledge transfer opportunities. This was a broad platform but it also focused specifically on anti-corruption CSOs since corruption was considered one of the main challenges of the post-communist transition, as featured in the EU Regular Reports on Hungary in 1999 and 2000, Latvia 1999, Poland 2002, Bulgaria 2001, and Romania 2001 among many others (Derderyan, 2013).

In order to assist CEEC with the adoption of the acquis and the Copenhagen criteria, the EU offered CSOs encouragement in four broad areas specified in the civil society literature. At the same time the pre-accession process also sustained certain conditions that were not conducive to the emergence of a strong civil society.

So how did the EU pre-accession process empower civil society in CEE? First, CSOs were granted participatory right and had the opportunity to alert the Commission of implementation problems during the pre-accession period by monitoring activities of the state. In this way the EU was aiming to increase both the effectiveness, by tapping into the knowledge base of non-state actors, and the democratic legitimacy of the process (Finke, 2007).

Secondly, the EU provided funding (Boerzel and Buzogany, 2010) for projects which was explicitly made subject to the partnership principle that the Commission had initially introduced in the 1980s to deepen the relationship between national governments and their regions (Hooghe ed., 1996). The Commission made this funding conditional on the cooperation of national and subnational governments with different business and non-governmental organizations (Bruszt, 2008; Gasior-Niemiec, 2010; Grosse, 2010). Similarly, joint commissions were set up for the monitoring of the SAPARD and PHARE programs which enabled some CSOs to considerably strengthen their capacities (Bruszt, 2008).

Third, the EU also allocated direct payments for CSOs in order to strengthen their capacities (Kutter and Trappman, 2010; Andonova, 2004; Iankova, 2009). The objective was to enable these organizations to participate in the political arena and to strengthen their own democratic and organizational structure. CSOs could apply for short term project grants to perform services related to the implementation of EU law.[5] Such grants could be used for both monitoring and policy advocacy activities.

Finally, the EU Commission tried to also increase CSOs' levels of expertise by encouraging collaboration with like-minded organizations on the EU level. CSOs from CEEC were assisted in building relationships with transnational networks and European umbrella organizations (Euro-groups) to learn more about implementation of EU law (Pleines, 2010, Koutalakis, 2010). Thus, CSOs were given the opportunity to both raise their domestic profile and also gain greater international recognition (Kuttern and Trappman, 2010).

Some scholars, however, doubt the impact and durability of these capacity-building measures. They point at potential vulnerabilities created or sustained by EU involvement in the pre-accession period.

First of all, while supporting civil society, the eastern enlargement, in conjunction with the legacies of the communist system, also entailed countervailing forces that served to empower the state. The pressure to meet the deadlines set by Brussels encouraged a top-down approach to the implementation of the acquis, often decreasing the opportunities for CSOs involvement

[5] More on these grant opportunities: http://ec.europa.eu/transparency/civil_society/general_overview_en.htm#9

(Raik, 2006). In fact, this dynamic may have strengthened the positions of the state in this relationship by strengthening the core executives (Zubek, 2008).

Second, the extreme reliance on external funding and donors impeded the development of strong internal capacities of CSOs. It made them responsive to these donors' agendas rather than their own priorities and detached them from any nascent grass-root constituencies that were in the process of formation (Kutter and Trappmann, 2010). Facing funding problems, CSOs found it difficult to retain qualified personnel as experienced activists often left for jobs in the private sector. This further weakened their capacities by introducing organizational instability.

Third, a political culture unconducive to openness and collaboration with non-state actors persisted (Kohler-Koch, 2000). Thus, even as the EU encouraged and required cooperation between the state and CSOs in the pre-accession period, this cultural antagonism often translated into limited collaboration (Fagan, 2004).

In conclusion, despite the empowerment opportunities provided by the EU pre-accession (funding, networks, and rights), CSOs also faced conditions that raised questions about their long term ability to take full advantage of these opportunities. Perhaps most importantly, their failure to build sustainable capacities limited their potential to be influential after accession, when many of their external donors withdrew and funding through the EU was made conditional to approval by and cooperation with the state bureaucracy.

Accession and the anti-corruption struggle: Conditions undermining the empowerment of the CSO sector

While there are questions about whether the pre-accession process truly empowered civil society in CEE or not, little research has been done on what happened afterwards or whether the effects of pre-accession empowerment persisted, especially in the area of corruption. In order to contextualize the conditions conducive to declining capacity of anti-corruption CSOs in post-accession period, it is useful to briefly outline the change in the institutional scenario after EU membership. While I discuss this in the context of data on Bulgaria, the dynamic described below was identical for all countries that joined in 2004-07 and varied slightly only based on how fast a country was approaching membership.

First, before 2007 (the year when Bulgaria joined), external donors were abundant. Collectively they accounted for more than 80% of all funding for NGOs (NIT Bulgaria 2006). USAID, the German Association of Technical Assistance (GTZ), the UK Department for International Development (DfID), the Norwegian Agency for Development and Cooperation (NORAD), the Swedish International Development Cooperation Agency (SIDA), the Canadian International Development Agency (CIDA), and the Soros Foundation all sponsored NGOs in various good governance initiatives. As EU accession was knocking on the door, all these agencies were withdrawing and relocating their capital and expertise to the Western Balkans (mainly Croatia, Macedonia and Serbia).

USAID, for example, began working in Bulgaria in 1990. Over the next 17 years, Bulgaria received more than $600 million in development assistance. USAID's funding, however, was always following a diminishing trajectory, from the Early Transition Years (1990-

1996): $206 million, to the Years of Political Stability and Rapid Reform (1997-2001): $192 million, to the Years of Consolidation, Stability and EU Accession (2002-2007): $166 million.[6] The funding cycles of the other major international donors followed the same logic.

The other major change in the institutional context was the manner in which CSOs could apply for EU, now the dominant source of sponsorship. There were two avenues. The first one was following the application procedures familiar from the pre-accession days. According to these, one could apply for grants directly with the European Commission but only if they are in a consortium with CSOs from at least another five countries and if they could independently finance at least 20% of the project cost. In other words, big NGOs with international network of contacts and some funding available at hand were favored.

Second, after acceding to the Union, every country became part of the common cohesion policy and is eligible for financial assistance through the European Regional Development (ERDF) and Social Funds (ESF), managed within the framework of seven operational programs. One of these programs is the Operational Program Administrative Capacity (OPAC) and one of its main purposes is to provide for trained and active civil society structures. It is financed by the ESF and implementation of the partnership principle, the enhanced interaction between the civil society sector and the public authorities, is believed to be of central strategic importance (Todorakov, 2010). The presumption is that this interaction could bring greater effectiveness, transparency and accountability in the policy-making process. Thus, starting in 2007, CSOs could apply for these funds only through the various ministries of the state, which in turn made them vulnerable to the incompetency or corruption of the state's administration (Index of Bulgarian Civil Society 2008-2010, Open Society).

[6] http://transition.usaid.gov/locations/europe_eurasia/countries/bg/bulgaria.pdf (accessed on January 11, 2013).

Collectively, these two changes in the institutional context might have substantially diminished the capacity of most CSOs (except for the very big ones) to exert influence.

Hypotheses: Increasing Capacity Before Accession, Declining Capacity After

This historical overview about the opportunities and limitations that CSOs faced in the pre- and post- accession periods informs my expectations. In the pre-accession period, the issue of corruption was characterized by a high level of visibility through the Commission Regular Reports (Derderyan, 2013). Because of this reason the state had significant incentives to cooperate and respond to pressures from the EU since it did not want to be delayed or excluded from the process (Vachudova, 2005). At the same time CSOs had access to funding opportunities from various sources, which allowed them to temporarily possess greater action capacities and organizational stability. In other words, in terms of financial resources, CSOs were in a good position to employ skilled personnel and fund projects related to corruption control. Because of these two reasons, greater willingness of the state to cooperate and especially greater financial capacity, I hypothesize that CSOs were able to exert pressure for reform in this time period (through being more engaged in the policy proposal (advocacy), implementation, and evaluation (monitoring) stages of anti-corruption initiatives).

However, as accession came closer, the EU started to increase its funding, but the other external donors withdrew. There are two major problems that make the absorption of EU funds difficult. The first is that the state plays a “gatekeeping” role of EU funds for NGOs and has discretion over the bureaucratic procedures that CSOs have to go through to become eligible (Index of Bulgarian Civil Society 2008-2010, Open Society). In other words, it is the government that can to a large extent determine how easy or how difficult it would be for an NGO to receive funding from the EU. This naturally introduces a bias that can diminish the chances of (watchdog) CSOs trying to get funding for a project that would expose the corrupt or incompetent nature of the current government. This process is generalizable to all EU member states. Second, in order to compete for funding on the EU level without the state's assistance, CSOs need to have resilient internal bureaucratic organizations, provide high matching funds (between 20 and 80 percent), and be a part of strong international networks, something that only the larger and more established organizations are (Index of Bulgarian Civil Society 2008-2010, Open Society). Thus, given the key role the state plays in securing EU funding for most CSOs post-accession, I expect that anti-corruption CSOs (looking to expose and criticize the government) would have a difficult time accessing funds and would hence experience decreasing capacities.

My argument, therefore, is three fold: 1) Anti-corruption CSOs exerted a significant influence before accession but there was a sharp decline in their effectiveness after accession; 2) Reduced variation in funding sources has been decisive in this as external donors moved out; 3) Also key are the EU high bureaucratic capacities for direct individual applications and/or greater governmental mediation in selecting projects and funding for CSOs.

Methodological Framework

I employ three methods to evaluate my argument. First, I run a time-series analysis on data on the ten post-communist countries that joined the EU in 2004-07 to establish that civil society had a positive and statistically significant effect on corruption control before accession and that this effect was not sustained after accession. Second, I supplement the findings from the statistical analysis by evaluating the results of an expert survey I administered in Bulgaria in the summer of 2012. Its focus is on the sources of funding and empowerment as well as the relative strength of the CSO sector before and after the EU accession. The survey was administered in person and via email and featured leaders of specific CSOs (6), journalists (3), academics (4), and businessmen (2). Third, I present a qualitative study on Bulgaria based on interviews with key actors in the CSO sector and archival research conducted in the summers of 2011 and 2012. The purpose of this case study is to identify the causal mechanisms through which the publicity of corruption that NGOs create introduces incentives for government officials to reform. The qualitative data that I collected allowed me to conduct detailed historical process tracing and draw the causal lines between the availability of funding, the actual anti-corruption projects, and the specific reforms that the government implemented before and after accession.

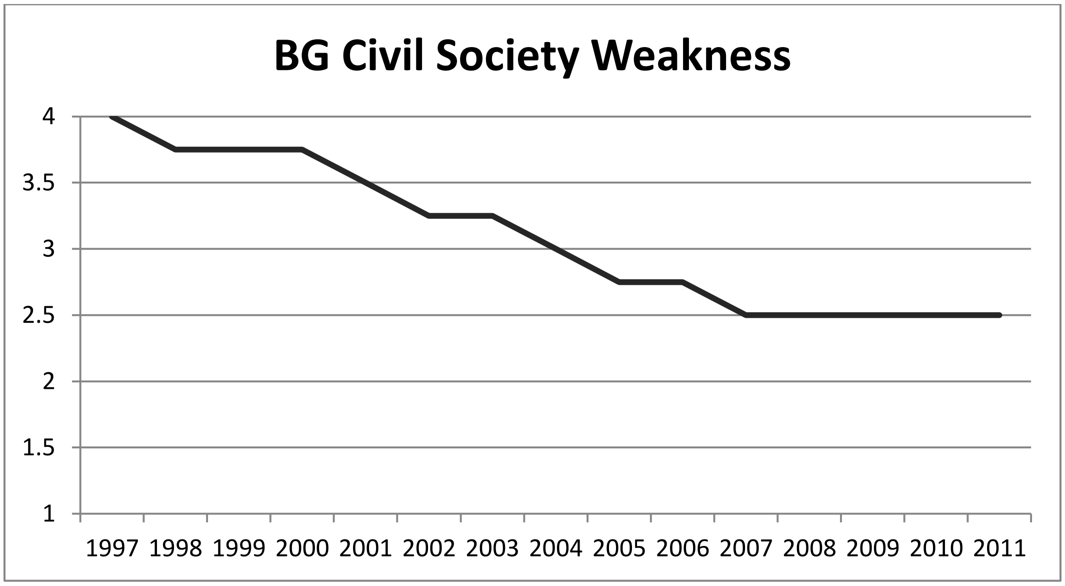
Using the data from the interviews and the archival research I show that anti-corruption CSOs were more involved in anti-corruption activity before EU accession. Such activity included both greater partnerships with the government trying to implement an anti-corruption strategy and eventually evaluate it (monitoring) as well as greater opportunities for criticism through policy advocacy and exposing questionable government activities. In making these arguments I present two mini case studies linking CSOs to specific reforms prior to 2007. Similarly, I also present how funding problems in the post-accession period limited CSOs capacity to exert influence. The mini case studies focus on the Center for Economic Development (CED) and the Center for the Study of Democracy (CSD), but the analysis features others as well, such as the Open Society Institute and Bolkan Assist.

Results

As a starting point it is useful to look at the strength of the civil society sector in CEE. I use the *Civil Society* measure from the Freedom House *Nations in Transit* dataset[7], which taps into the “organizational capacity and financial sustainability, and the legal and political environment” in which civil society groups operate (NIT, 2010). Importantly, in this Freedom house index lower values indicate greater strength of the sector. Thus, to make the graphs easier to read I have relabeled the index Civil Society Weakness clarifying that a decreasing trend means that the weakness of the sector also decreases. Figures 1 and 1.1 below illustrate the evolution of Bulgarian civil society and Bulgarian corruption control (higher values indicate better corruption control) between 1997 and 2011.

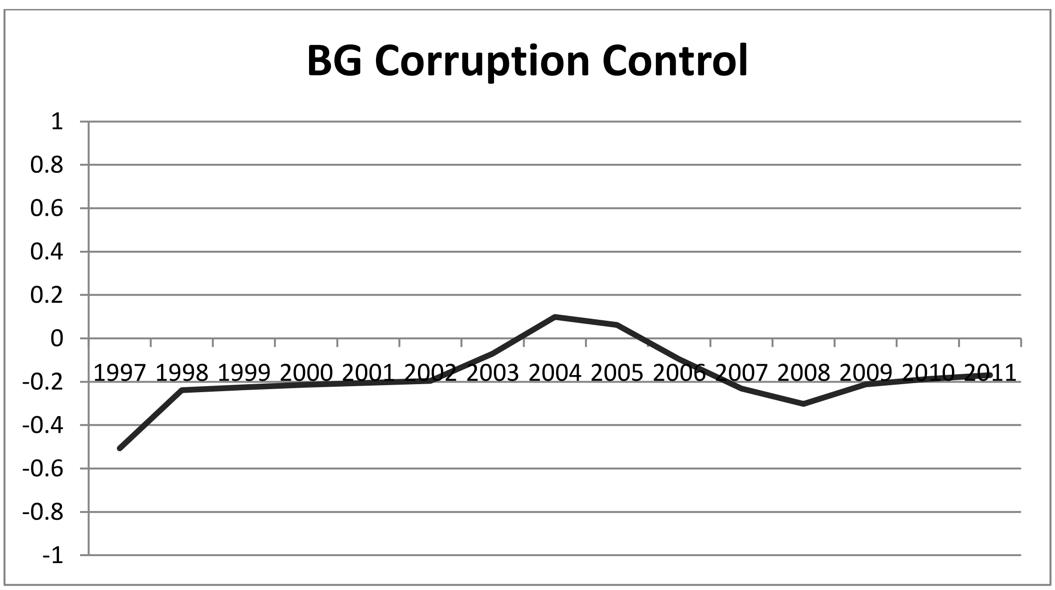
[7] The ratings are based on a scale of 1 to 7, with 1 representing the highest and 7 the lowest level of democratic progress. For more information, see http://www.freedomhouse.org/report-types/nations-transit#.U1wHIPldWL0

Figure 1: Bulgarian civil society weakness before and after EU accession (2007)



Source: Civil Society Index, Freedom House. Available at: http://www.freedomhouse.org/country/bulgaria, accessed on September 9, 2013

Figure 1.1: Bulgarian corruption control before and after EU accession



Source: Control of Corruption Index 1997-2011, World Bank. Available at: http://info.worldbank.org/governance/wgi/index.aspx#doc, accessed on January 7, 2015

There are two interesting trends in this graph. First is the clear high correlation between civil society weakness and corruption control in the pre-accession period (Correlation Coefficient = -0.84) and the lack of such strong relationship the post-accession (Correlation Coefficient = -0.12). Second, while evidently civil society in Bulgaria has not regressed or backslided per se after 2007, it has also not continued to improve. In all the four years after Bulgaria's EU accession the strength of the sector has remained stagnant at 2.5. Similarly, corruption control has at best only modestly improved in this time period. The 2012 Freedom House Nations in Transit (NIT) report points at the lack of financial stability as the main reason for the stagnation: "the ability of nongovernmental organizations (NGOs) to raise funds domestically remains limited, impeding the emergence of rich feedback links between NGOs and local communities.[8]" Interestingly, the 2007 report, the last time when Bulgarian civil society showed any signs of progress, also stresses this problem and delineates the issues that would end up haunting the sector with remarkable predictive capacity: "Over the last 17 years, Bulgaria has managed to develop a vibrant civil society. However, the nongovernmental organization (NGO) sector has still not developed sustainable fund-raising mechanisms. The Bulgarian civil society sector was formed with a top-down approach, led by donor demands and visions and not by Bulgarian citizens. This is the major reason most NGOs are still heavily dependent on foreign donors and do not enjoy public support. A significant number of large foreign NGOs and their donors began to withdraw from Bulgaria in 2006, which will likely cause funding problems for some organizations …. On the other hand, the accession of Bulgaria to the EU will open new funding possibilities to Bulgarian NGOs. New challenges are arising in developing special skills and capacity for writing project proposals and managing projects under the strict and

[8] http://www.freedomhouse.org/report/nations-transit/2012/bulgaria (accessed on December 20, 2013).

bureaucratic rules of the European Commission."[9] Impressively, this analysis written in 2007 sums up nicely the problems the sector has continued to experience ever since.

Importantly, the trend of a stagnating or mildly backsliding civil society development after membership and a slowdown (or backsliding) in corruption control is not unique to Bulgaria. It is generalizable to eight out of the ten post-communist countries that joined in 2004-07 (with only Poland where corruption improved significantly after accession despite lack of further development of its (otherwise very strong) civil society sector and Estonia where civil society improved slightly but corruption control remained largely unchanged after its accession). Graphs on all ten countries displaying these trends are available in Appendix A.

Time Series

The statistical part of this study utilizes a panel data approach to examine the effects of civil society weakness on corruption in the CEE countries before and after accession. Data on corruption control and a number of alternative explanations which may affect corruption (Table 1) are available for the ten post-communist EU members over the period 1997-2011. Appendix B details the operationalization of the dependent and independent variables.

[9] http://www.freedomhouse.org/report/nations-transit/2007/bulgaria (accessed on December 22, 2013).

Table 1: Alternative Explanations

Drivers of Corruption	**Studies Identifying these factors**	**Relationship**
Civil Society Weakness	Karklins (2005)	A vibrant civil society serves as a check on corruption
Economic Development	Sandholtz and Gray (2003)	Effect varies among low, middle and high-income countries
Competition	Ades and Di Tella (1999)	Open economies must be less corrupt
Level of Democracy	Montinola and Jackman (2002)	Democratic practices inhibit corruption
Freedom of the Press	Karkins (2005)	Independent media is a check on corruption
Abundance of Natural Resources	Ades and Di Tella (1999)	Abundance of natural resources may create opportunities for rent seeking
Neighborhood Diffusion Effects	Sandholtz and Gray (2003)	Corruption is higher in countries surrounded by corrupt neighbors
Size of the Public sector	LaPalombara (1994)	Greater size of the public sector is negatively correlated to corruption control

Model specification

To test whether civil society weakness had a differential effect on corruption control before and after accession I run two time series models each focusing on one of the two periods. Time series data presents an array of challenges to researchers. Autocorrelation in the time dimension within units can lead to inefficient estimates and biased standard errors. Structural issues related to the units' distinct histories can cause biased and inconsistent estimators. In order to control for autocorrelation and for the possibility of an omitted variable bias due to unit effects, I include a lagged dependent variable in both the pre- and post-accession models (Keele and Kelly, 2006; Beck and Katz, 2011). Furthermore, because TSCS data typically displays contemporaneous correlation across units and unit level heteroskedastisity, I also employ panel-corrected standard errors (Beck and Katz, 1995). This diminishes the possibility of making incorrect inferences from the standard errors. The results presented in the table below are robust to jackknifing and bootstrapping.

Table 2: Effects of Civil Society Weakness on Corruption Control Before and After EU Accession

Drivers	**Before Accession**	**After Accession**
Lagged Corruption Control	.809*** (.025)	.984*** (.059)
Lagged Civil Society Weakness	-.067** (.031)	.041 (.042)
Economic Development	-.003 (.003)	.001 (.001)
Neighbors' corruption	1.528*** (.149)	-.512** (.227)
Size of the Public sector	.002*** (.001)	.001 (.001)
Competition	-.002 (.001)	-.001 (.001)
Natural resources	-.040** (.016)	.015 (0.33)
Level of democracy ("Freedom in the World" score)	-.038 (.079)	.038 (.074)
Freedom of the press	-.001 (.009)	-.019* (.012)
Constant	.833* (.439)	.689 (.553)
R-squared	0.95	0.95
Number of Observations	52	74

Before accession and *After accession* Models are LDV regressions with panel-corrected standard errors. ∗∗∗p < .01; ∗∗p < .05; ∗p < .10. One-tailed tests where appropriate.

The results of the two models (before and after accession) confirm the hypotheses that civil society has a positive and significant effect on corruption control before accession but becomes insignificant after accession. The negative coefficient of the civil society weakness variable in the before accession model is to be expected, since in this NIT index, higher scores correspond to less power suggesting that for a unit increase in civil society weakness (decrease in civil society strength) we have a decrease in corruption control. The post-accession model shows no significant relationship between civil society and corruption. A number of control variables, including neighboring countries' corruption, size of the public sector, and abundance of natural resources before accession and neighboring countries' corruption after accession, are also found to be significant drivers of corruption. Although they are of no particular interest in the present study, these control variables have signs and levels of statistical significance broadly consistent with theory and prior studies.

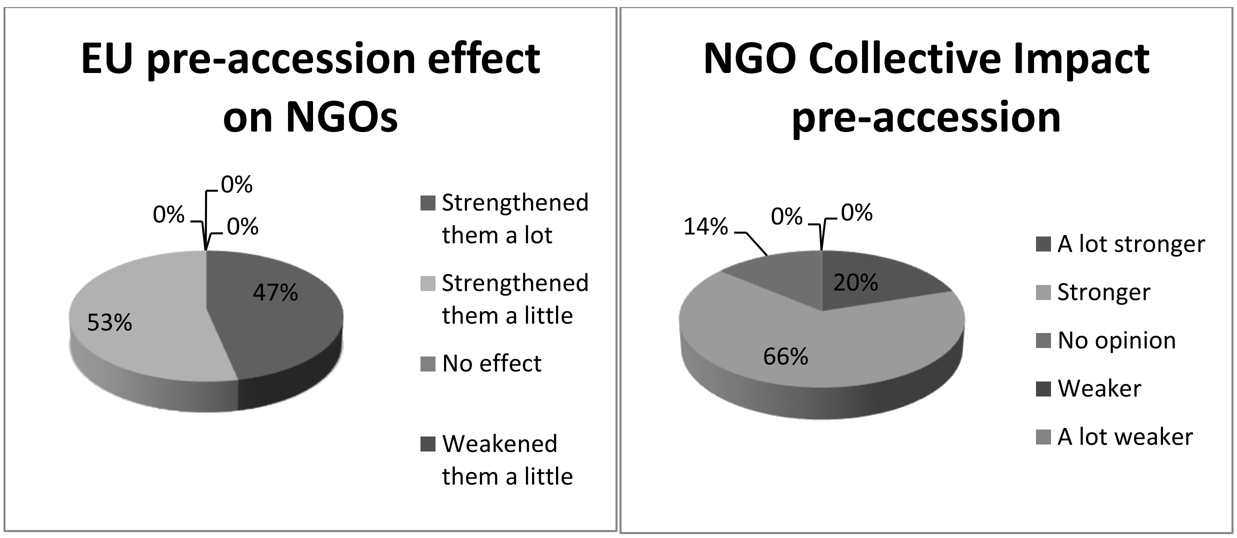
The results of the statistical analysis and the descriptive country graphs in Appendix A suggest that the trend of stagnating or increasing civil society weakness after accession and slower progress in corruption control shown in Figures 1 and 1.1 is one that is generalizable beyond the context of Bulgaria. There are reasons, however, that justify looking at the Bulgarian case in some more detail. First, Bulgaria is the country where the corruption climate after accession worsened most significantly. Only a year after joining the EU and within the first attempts of disbursement of structural funds, blatant corruption schemes in the management of the funds were exposed. As a result the Commission froze a substantial amount of funds for Bulgaria thus drawing a direct link between the government's low administrative capacity and its inability to tackle corruption. Second, the EU's rules for applying for funding are universal for all members, so looking at how these rules may inhibit the ability of anti-corruption CSOs to apply for grants in any one country (especially the one whose corruption problems are the most serious) can reveal to a large extent the causal story in all.

Thus, in order to shed more light on the causal story on why anti-corruption CSOs in CEE were able to influence policy outcomes more effectively before 2007 and why their capacities decreased after 2007, I now turn to the results of the survey as well as two case studies featuring two of the most influential CSOs in Bulgaria – the smaller but very active CED and the bigger and more established CSD

Survey results

The results of the survey confirm the main expectations outlined above. First of all, the fifteen experts overwhelmingly agree that the EU accession process strengthened the CSO sector in Bulgaria and that CSOs had a strong collective impact on the battle against corruption before accession.

Figure 2: EU pre-accession effect on NGOs and NGO's impact on Corruption



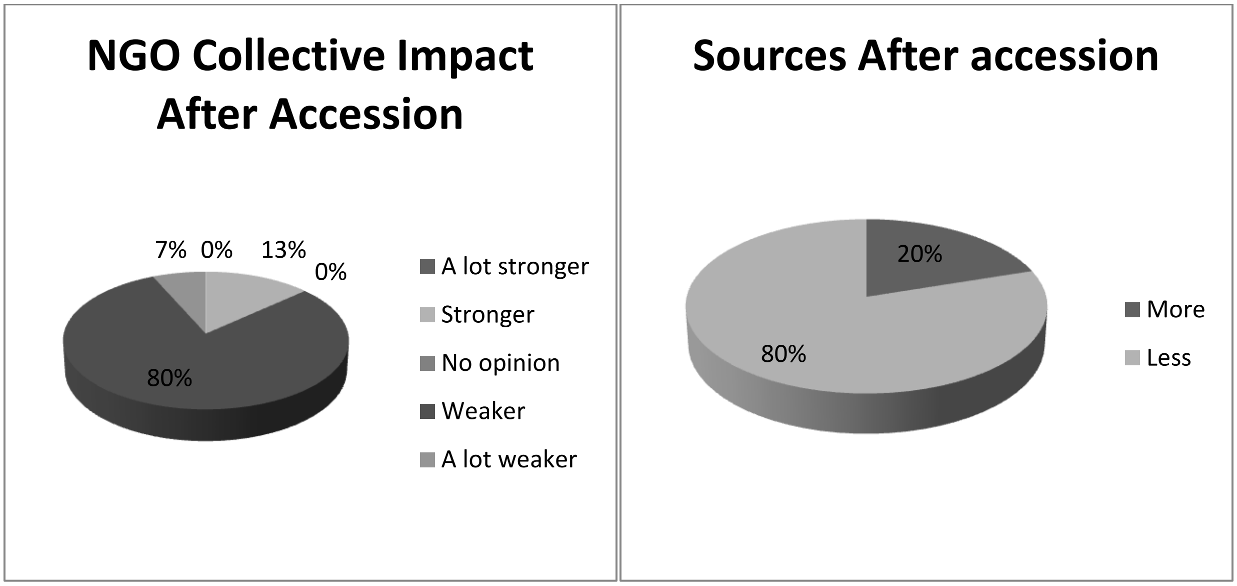
In answering how exactly the pre-accession period empowered the civil society sector, the experts are unanimous that the presence of more donors was crucial. In terms of the EU in particular, 74% identify the participatory rights given by the EU as important in the empowerment of CSOs. 53% agree that direct funding from the EU was key with only 26% disagreeing. Indirect funding conditional on cooperation with the state or local governments is identified as a more prominent mechanism: 66% agree and only 13% disagree. Providing more expertise and opportunities for cooperation is identified as a strong mechanism of empowerment by 33% of the experts with 27% disagreeing.

Table 3: Drivers of CSO Empowerment before Accession

	Strongly agree	Agree	No opinion	Disagree	Strongly disagree
More Donors	80%	20%	0%	0%	0%
Participatory Rights	54%	20%	7%	20%	0%
Direct EU Funding	20%	33%	20%	13%	13%
Indirect funding conditional	33%	33%	20%	13%	0%
More expertise and cooperation	13%	20%	40%	27%	0%

Discussing the post-accession period, an overwhelming majority, 87%, thinks that the collective impact of the CSO sector on the effort to curb corruption is weaker providing evidence for part one of my argument. Another overwhelming majority of 80% claims that there are fewer funding opportunities in the post-accession period.

Figure 3: NGO Collective impact after Membership and Sources after accession



The table below provides further insight into the reasons why experts believe the availability and acquisition of financial resources is more limited in the post-accession period. Some 80% specify the absence of as many donors as before accession as the main reason for lack of resources providing evidence for part two of my argument. Another majority of 80% points at the EU's insistence on the partnership principle requiring CSOs to go through the complex and lengthy bureaucratic processes of the state when applying for EU funding. About half the experts suggest that the difficulty to apply for grants directly (given the matching funds and transnational network requirements) is another impediment to financial stability for CSOs. These results are in line with part three of my argument.

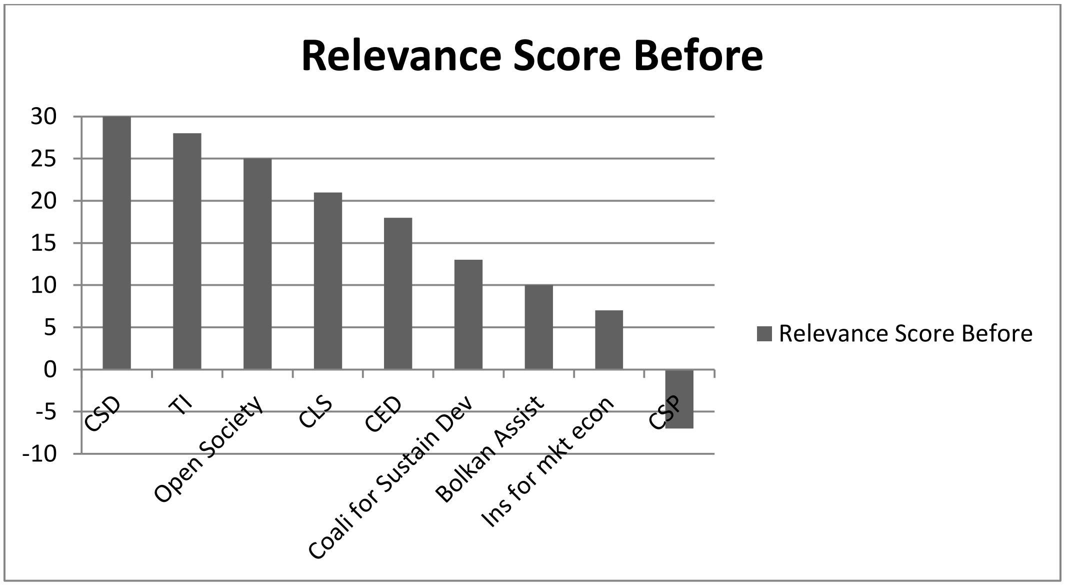
Table 4: Reasons why access to funding sources became more difficult after accession

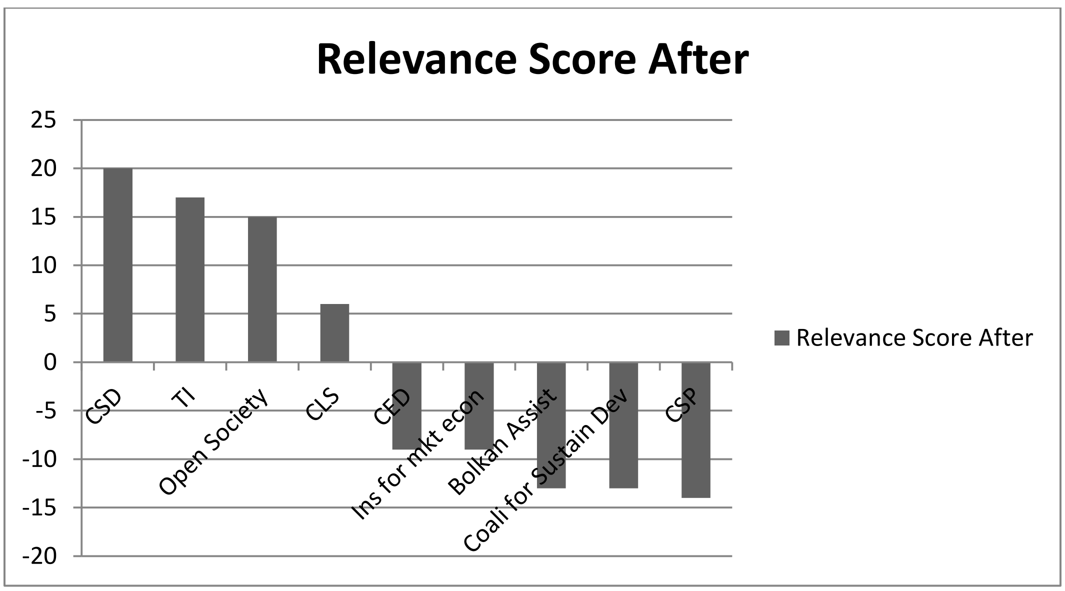
	Strongly agree	Agree	No opinion	Disagree	Strongly disagree
Fewer donors present	66%	14%	0%	20%	0%
Control of state government over selection of EU fundees	47%	33%	7%	7%	0%
Higher bureaucratic and financial burden to apply for grants individually	27%	20%	20%	33%	0%

Selecting anti-corruption NGOs for process tracing

The case selection pertaining to the process tracing is based on the survey responses of the 15 NGO experts. Each of them was asked to assign a score between 2 and -2 to each of the more prominent anti-corruption organizations depending on whether they believed the organization was highly important in terms of anti-corruption activity (2), important (1), of low importance (-1) or not important (-2), with 0 meaning "no opinion". Additionally, the experts provided these scores for the pre-accession and post-accession periods separately. After all scores were collected they were averaged to produce a composite score. The results are presented in the graphs below.

Figure 4: Relevance score of various Bulgarian anti-corruption CSOs before and after accession





Source: Survey data; 15 NGO experts, 2012

While eight of the nine organizations were identified as having a strong impact on the fight against corruption prior to accession, four of these become considerably less important in the post-accession period. The variance in relevance among the major anti-corruption CSOs between the two periods is also supported by the difference in standard deviations: 11.75 before accession and 14.61 after. Furthermore, a difference of means test shows statistical significance at the 0.05 level for every single CSOs when the mean scores for the two periods were compared.

Table 5: Descriptive Statistics and Difference of Means Test

	Before Accession				**After Accession**				
	Sum	Mean	Median	StdD	Sum	Mean	Median	StdD	P(T<=t) difference of means
CSD	30	2.00	2	0.00	20	1.34	2	1.04	0.027*
TI	28	1.87	2	0.35	17	1.13	1	0.99	0.000*
CED	18	1.20	1	0.41	-9	-0.60	-1	0.74	0.000*
Open Society	25	1.66	2	0.48	15	1.00	1	1.13	0.012*
CLS	21	1.40	1	0.50	6	0.40	0	0.74	0.000*
CSP	-7	-0.40	0	1.18	-14	-0.93	-1	0.96	0.029*
IME	7	0.47	1	0.74	-9	-0.60	-1	0.82	0.002*
Bolkan Assist	10	0.67	1	0.62	-13	-0.87	-1	0.51	0.000*
Coali for Sustain Dev	15	0.86	1	0.35	-13	-0.87	-1	0.35	0.000*

Case studies

In order to get a sense of what factors may have caused the decline of relevance in these four CSOs, I compare one of them (CED) to one that remained highly relevant after 2007 (CSD). This comparison aims to also shed more light on the various mechanisms CSOs use to exert influence and to explain why the changing institutional conditions post-accession have affected some organizations more than others.

Center for Economic Development (CED)

The Center for Economic Development was far more able to exert influence targeted at corruption control before the accession to the EU. There were two main reasons for this. First, the organization had access to more and more variable funding sources with more simplified procedures for applying for funds. This increased its independent capacity for action. Second, due to explicit EU requirements and the fact that the country was still on the accession queue, there was greater willingness by the state and local governments to cooperate on various projects pertaining to corruption control. After accession, limited funding opportunities beyond the EU and complicated procedures for applying for EU grants decreased the capacity of the organization to induce policy change.

During the accession period, the EU encouraged NGOs to participate in the political process and alert the Commission of various challenges. Thus, in 2002-03 CED championed the "Transparency of the public auctions" project which led to several publications outlining the underlying reasons for corruption in this field as well as suggested measures that should be taken to eliminate it. This advocacy project was sponsored by the Open Society Institute and the Soros Foundation and raised awareness about the problem resulting in the explicit inclusion of this issue in the EU Commission Regular Reports for the next few years until the Bulgarian government took measures to ameliorate the problem on the eve of accession. Thus, the EU's encouragement to identify issues that need attention combined with the availability of funds through external donors, strengthened the CED capacity in the accession period.

The availability of funding in this period resulted into another meaningful project in 2004 – "Encouraging the Collaboration between businesses and NGOs to curb corruption in the

Velingrad municipality", financed by USAID (expert interview, Summer 2012). The project led to the development of sustainable monitoring and communication mechanisms through which business organizations and local authorities can identify and target corrupt practices. The project was so successful that the EU was willing to provide more funding through its PHARE programme to expand its scope and include another 12 municipalities. The PHARE funding was conditional on the cooperation of national and subnational governments with different businesses and NGOs (Bruszt, 2008; Gasior-Niemiec, 2010; Grosse, 2010), which made both the willingness and the capacity of these actors to cooperate more pronounced.

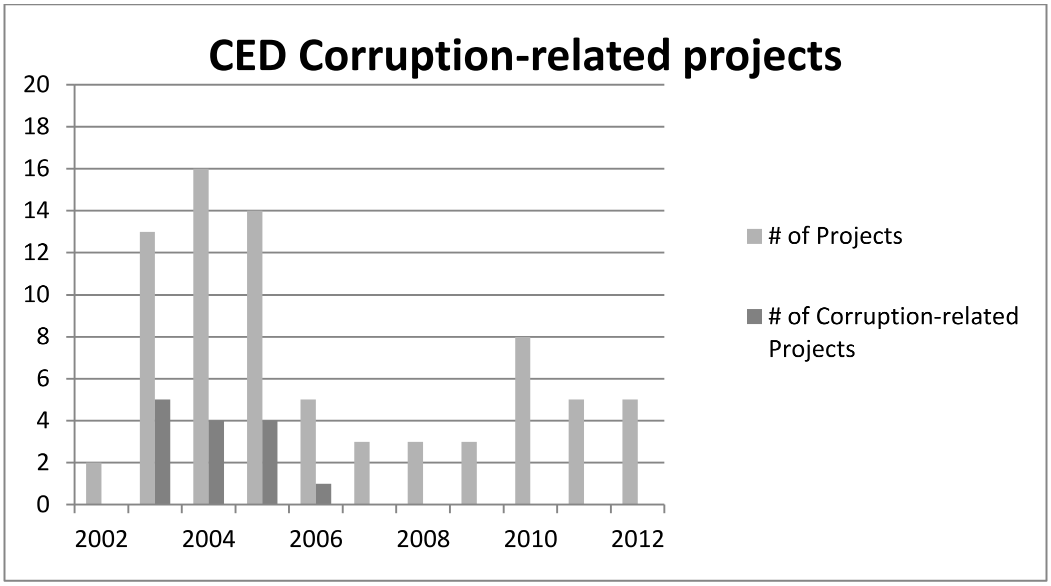
While funding available through the EU and other sources strengthened the capacity of CED in that time period, its operational logic also opened a can of worms for what was to follow after accession. As other external donors withdrew from Bulgaria after 2007, conditional funding through the EU became the dominant avenue for NGOs to secure financing. Thus, in 2009 for example, millions of euros of structural funds were spent on partnerships between local governments and NGOs promoting anti-corruption, while at the same time the EC was cutting Bulgaria's funds for fraud. NGOs quickly realized that gaining access to structural funds directly was going to be extremely difficult unless they formed partnerships with local governments. But who will then expose these local governments if they misappropriate the funds? As Mungiu-Pippidi (2010) claims, "If funding is distributed only through governments, the EU deliberately gives up any expectation that civil society can act as a permanent monitor and auditor of public spending" (The Experience of Civil Society as an Anticorruption Actor in East Central Europe, p.29). Expectedly, the willingness of local governments to co-apply with CED for anti-corruption-related projects with the EU after 2007 decreased. In fact CED has not been able to get the cooperation of the state or a local government for any anti-corruption projects after 2007.

Furthermore, having lost valuable staff members after accession (now down to nine) the organization has found it difficult to master the elaborate EU grant application process operated by the state administration. As its other donors (most notably USAID) withdrew and the opportunities for funding through the EU became more limited (due to their conditional nature and the state's limited willingness to cooperate and the "gatekeeping" role of the Bulgarian state), the capacity of CED to exert influence drastically decreased, thus providing evidence for parts two and three of my argument.

Bolkan Assist dealt with similar types of pressures. According to one of the interviewed experts, the organization was "unlucky" enough to actually qualify for funding for one of its projects through the Structural funds. The bureaucratic hurdles that the state administration created then in terms of requiring additional materials were quite substantial to put it mildly. The organization struggled to meet all requirements and its employees found the process "exhausting" and "demeaning". Eventually, it took more than a year until Bolkan Assist received the funds that it had rightfully qualified for (expert interview, Summer 2011).

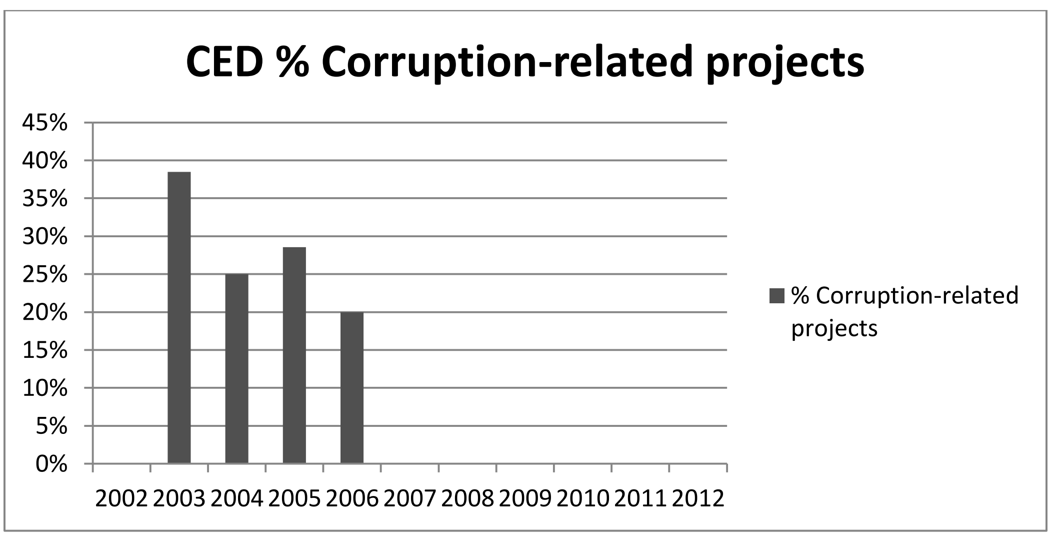
The figures below provide a graphical illustration of CED's declining capacity to engage in anti-corruption activity post-accession.

Figure 5: CED Number of Corruption-related projects



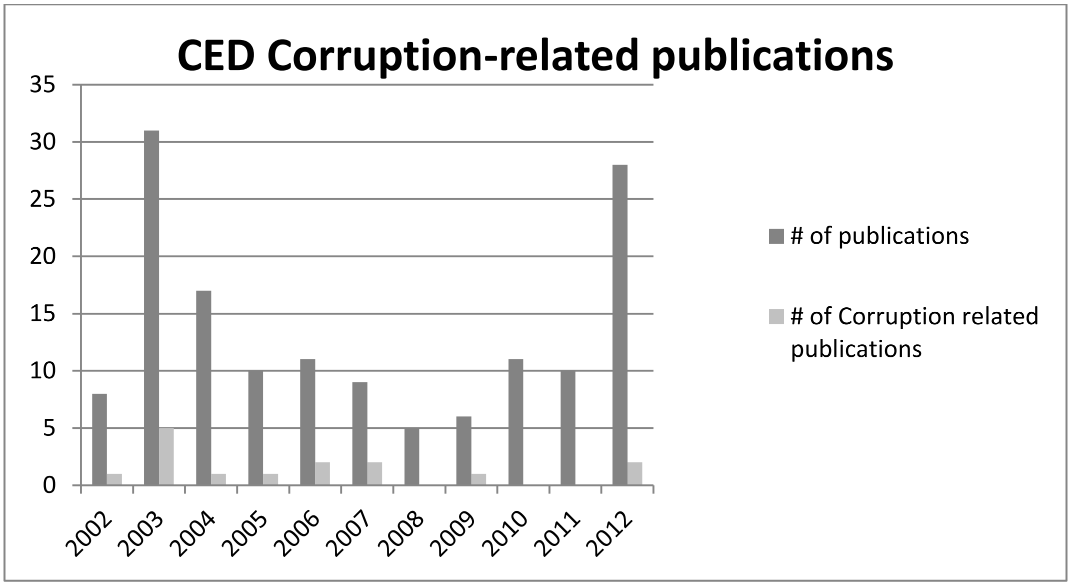
Source: http://ced.bg/projects.php, accessed on January 1, 2013

Figure 5.1: CED Percentage of Corruption-related projects



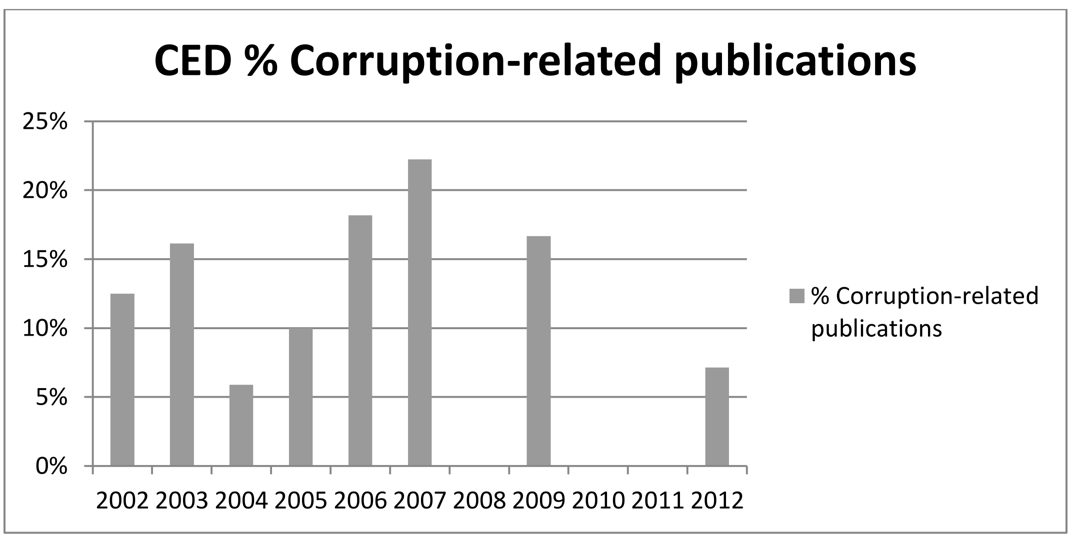
Source: http://ced.bg/projects.php, accessed on January 1, 2013

Figure 6: CED Number of Corruption-related publications



Source: http://ced.bg/publications.php, accessed on January 1, 2013

Figure 6.1: CED Percentage of Corruption-related publications



Source: http://ced.bg/publications.php, accessed on January 1, 2013

Using corruption-related projects and publications as a proxy for the relevance of the organization in the fight against corruption, the graphs show a sharp decline in capacity after 2007 as the organization has engaged in almost no anti-corruption activity.

Thus, before accession 27% of the CED projects and 14% of its publications were corruption-related while after 2007 these numbers were 0% and 5% respectively with the NGO issuing only two corruption-related publications in 2012. Before accession, these projects and publications served as an important mechanism to exert influence by means of both monitoring and advocacy. They were presented at official events, with great media coverage (at the Boyana residence formerly the residence of Todor Zhivkov), with ambassadors, representatives from the business community, and ministers present (expert interview Summer, 2012). The publicity of these presentations created pressure that often resulted in explicit government action. After accession, however, with no official projects and few publications, CED has resorted to other means to advancing its mission. Importantly, this has not been due to lack of initiative or willingness as plenty of proposed projects lay idly waiting on the shelf for lack of funding.

This is not to say that CED exerts no influence on the fight against corruption after accession. In the context of no funded anti-corruption projects, the organization is still trying to influence the political process through alternative mechanisms that mainly focus on monitoring. Between 2006 and 2009, for example, it was invited along with four other prominent NGOs to write evaluations on the implementation of the Anti-corruption strategy of the Saxe-Koburg government and concluded that the strategy has failed. Overall, however, there is no doubt that its relevance after 2007 has diminished.

The survey data that I collected from Bulgarian NGO experts further reinforces the notion of CED's declining capacity.

Figure 7: CED before accession

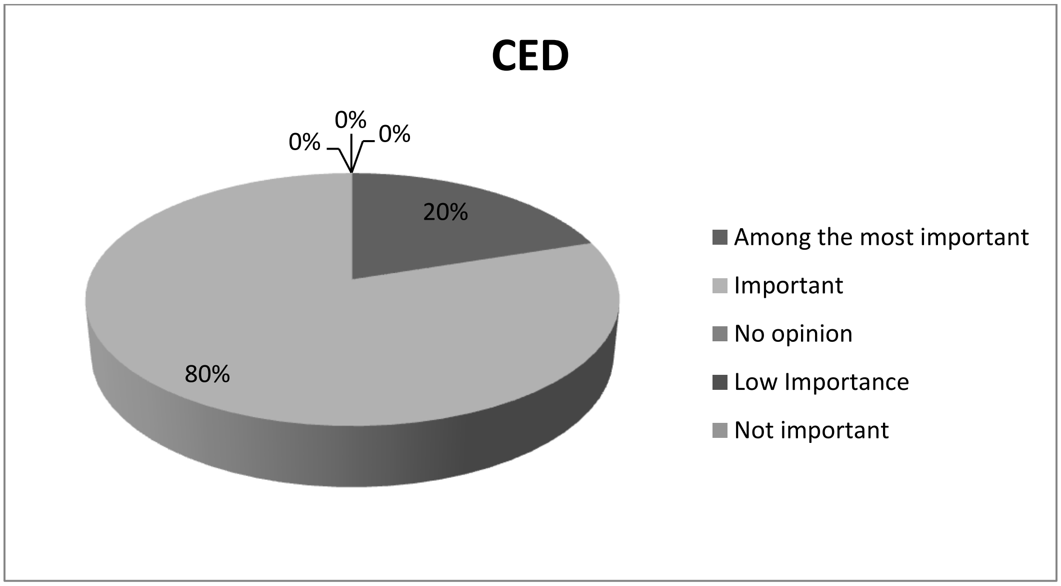
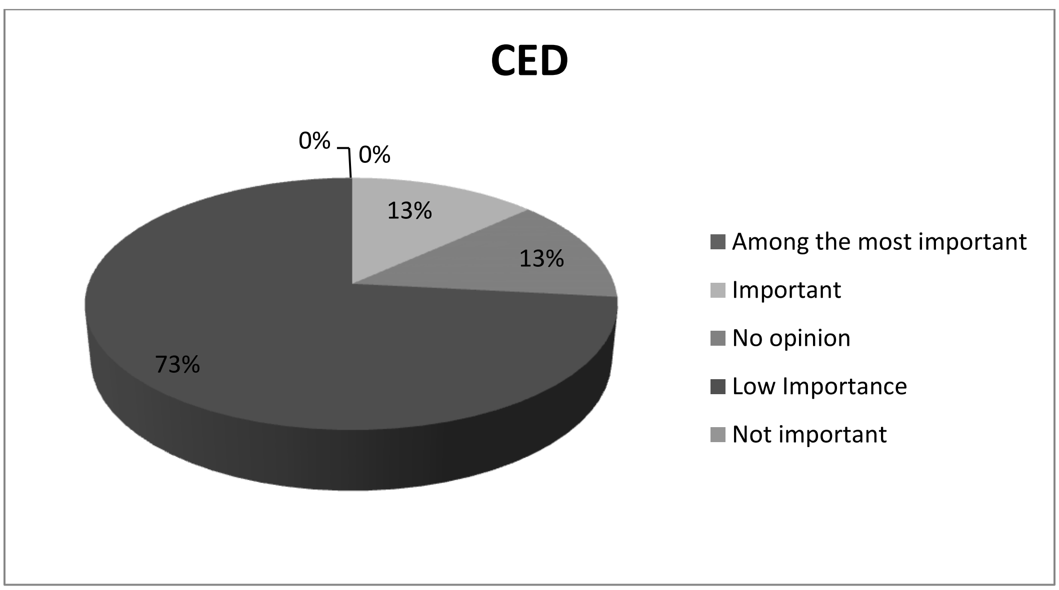


Figure 7.1: CED after accession



The surveyed experts agree that CED was one of the very important NGOs in the fight against corruption prior to 2007. Remarkably, only 13% have the same opinion about the post-accession period, and an overwhelming 73% think that the organization is of low importance in this time period.

Center for the Study of Democracy (CSD)

The CED experience is the modal experience of most grass-roots Bulgarian anti-corruption CSOs that were not embedded in extensive international networks and had to develop their capacities somewhat independently. Importantly, the capacity of bigger and more powerful organizations, such as the Center for the Study of Democracy, has also declined post-accession, though less drastically. Since 1998 CSD has been the champion of anti-corruption initiative among all NGOs in Bulgaria. It has benefited from the pre-accession process by getting both direct and conditional funding from the EU and USAID for various anti-corruption projects and by developing collaborations with like-minded organizations on the EU level. It is exactly this factor that sets it apart from the majority of the other (smaller) anti-corruption NGOs in Bulgaria, who having failed to develop strong international networks and bureaucracies or grass-root support, became incapacitated upon the departure of their external donors in 2007. Among CSD's extensive network of partners are the World Bank, the Heritage Foundation, the Konrad Adenauer Stiftung, the Friedrich Ebert Stiftung etc.[10]

During the pre-accession period CSD had access to substantial resources provided by USAID and other external donors. For example between 2002 and 2005 USAID disbursed $9.76 million to CSD and the DPK Consulting Center as part of the Anti- Corruption Open

[10] http://www.csd.bg/index.php?id=183 (accessed on December 20, 2013).

Government Initiative [11]. The main focus of the programme was strengthening and streamlining public procurement, internal controls and government audit systems. CSD played a leading role in the project and published an elaborate case study drawing public attention to the problems with the Public Procurement Register. It pointed out that the removal of the Public Procurement Register from the mandate of the courts is a necessary anti-corruption measure (expert interview, Summer 2011). Until that moment if "anyone wanted to check whether a firm was clean, whether it had debt, or was being sued, they could have gotten this information only after a court hearing" (expert interview, Summer 2011). CSD lobbied the US Embassy and the US State Department, which exerted tremendous pressure on the Bulgarian government until the register was removed from the courts' jurisdiction (The Public Procurement Law, in force since October 1, 2004). CSD was involved in every step of the way first lobbying for the change (advocacy), then participating in the actual crafting of the legislation, and finally providing input to parliamentary committees reviewing the proposed reform. As a result the new register reinforced the principles of "transparency and openness" and "will be a vehicle for connecting Bulgaria to the EU internal market, fostering a "higher level of trust in Bulgaria" and encouraging additional investment.[12] Thus, due to its stable financial situation, CSD was able to sponsor real anti-corruption reforms and measures before 2007.

After 2007 its financial capacity decreased slightly mainly triggered by the departure of USAID as a sponsor, but its ability to influence policy persisted. One of its main projects immediately after accession was the closing of the duty free gas stations on the Turkish, Macedonian, and Serbian borders. Having developed a wide transnational network of contacts and with as many as 41 full-time staff members, CSD was able to remain competitive in the

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[11] http://bulgaria.usaid.gov/113/28/product.html (accessed on January 23, 2013).

[12] http://bulgaria.usaid.gov/anti-corruption/page.html (accessed on January 23, 2013).

grant application processes. Obtaining funding from both the British Embassy and the EU (with the British embassy helping meet the EU requirement of matching grants), CSD produced a study showing that close to 40% of all gas sales in Bulgaria comes from duty free stations as the massive traffic from Turkey to Austria through Serbia takes advantage of these opportunities leading to huge foregone revenues for the state (expert interview, Summer 2011). After establishing the issue, CSD made it a topic of public debate through publications and press-conferences. As a result the subject entered the EU's Regular Report as well as the US State Department Annual Report in 2007. Eventually, a deadline of February 2008 for the closure of these stations was set by the Bulgarian government.

So what makes the CSD more special? How was it able to continue to be influential after accession even as most other NGOs were seeing their capacities decline? The organization's ability to effectively switch its main income source from USAID to the EU allowed it to continue to exert pressure for reform. Although it encountered similar problems as all other NGOs (needing to forge alliances with the government and/or having to form transnational coalitions to apply for funding), its access to transnational networks and its better bureaucratic capacity enabled it to successfully apply for EU funding.

The table below illustrates the ability of CSD to remain financially stable after accession by retaining a steady revenue stream even after USAID's withdrawal in 2008. Importantly, USAID grants averaged 40% of the CSD revenue during the years in which the agency was financing the NGO. Furthermore, although the EU's contributions have historically accounted to only 29% in the 10 years of data, its share after accession was 47% demonstrating its dominance in this period. One can also observe the steady increasing trend in percentage of projects sponsored by the EU climbing from 8% in 2001 to 67% in 2011.

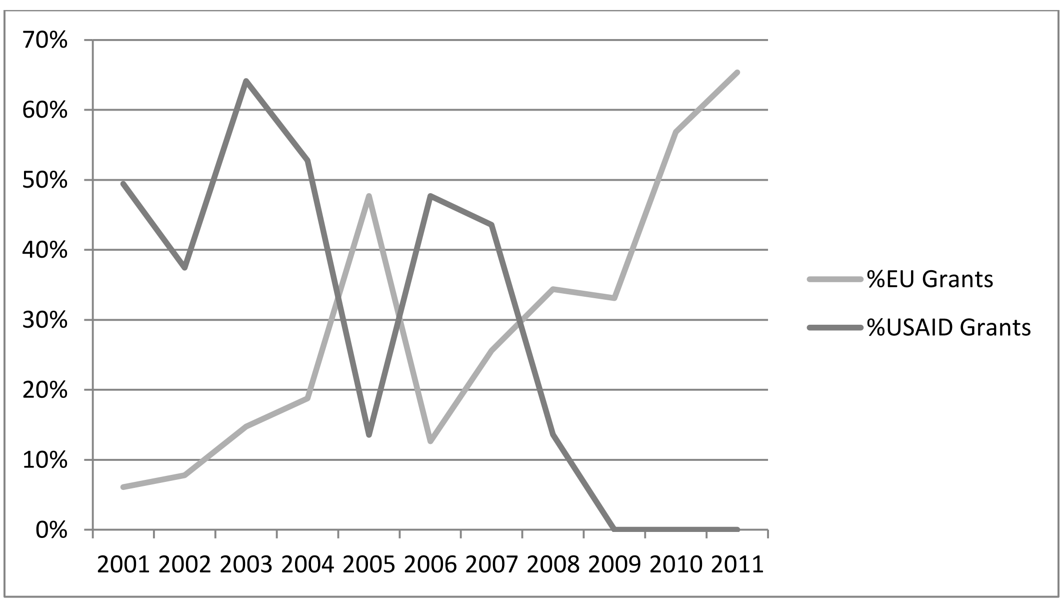
Table 6: CSD Grants by sponsor

CSD Grants								
Year	Grants BGL	EU Grants	%EU Grants	USAID Grants	%USAID Grants	EU projects	Other projects	%EU projects
2001	1853	113	6%	916	49%	1	11	8%
2002	1565	122	8%	586	37%	1	7	13%
2003	3196	472	15%	2050	64%	3	13	19%
2004	1980	372	19%	1045	53%	2	12	14%
2005	1157	552	48%	157	14%	3	14	18%
2006	1122	142	13%	535	48%	2	16	11%
2007	886	227	26%	386	44%	3	10	23%
2008	471	162	34%	64	14%	4	5	44%
2009	662	219	33%	0	0%	3	7	30%
2010	959	545	57%	0	0%	3	3	50%
2011	1157	756	65%	0	0%	8	4	67%
Total	**15008**	**3682**		**5739**		**33**	**102**	

Source: CSD Annual reports 2001-2011.

Figure 8 below displays the relationship between the funding from the EU and USAID and the effective switch in dominance in 2008, when USAID withdrew.

Figure 8: USAID and EU grants to CSD 2001-2011

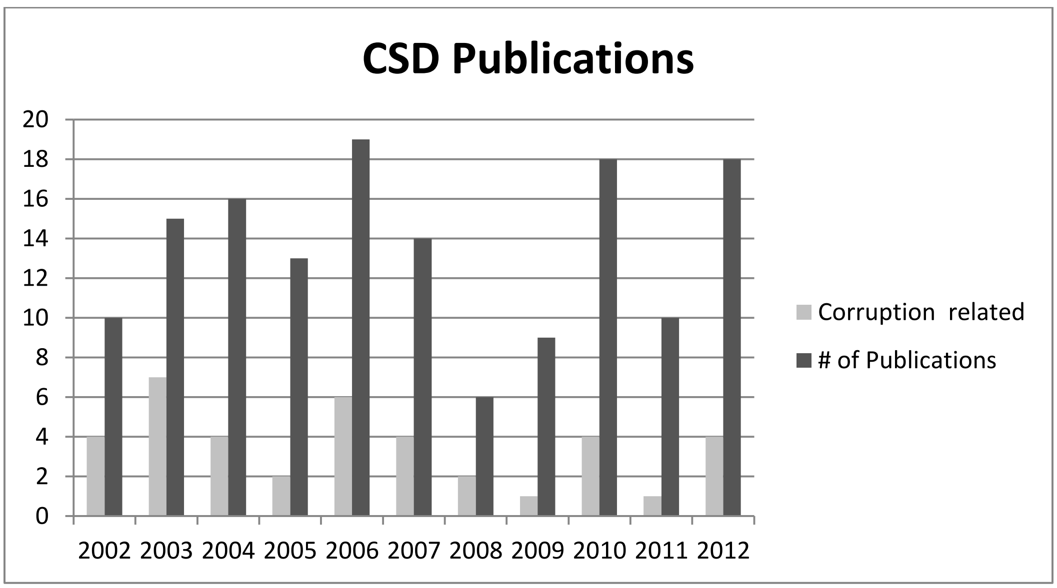


Source: CSD Annual reports 2001-2011.

*(The peak in EU funding in 2005 is due to a one-time grant of 362,000 BGL by the EU Commission to promote human rights and establish an ombudsman institution in Bulgaria)

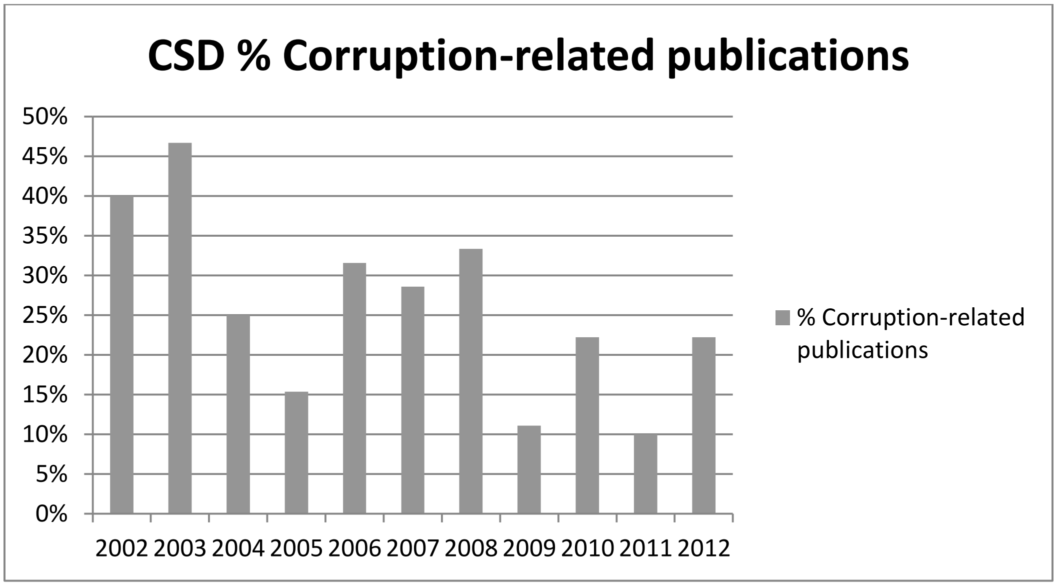
Although financial stability has definitely enabled CSD to remain a force in Bulgaria's battle against corruption, its declining absolute revenue in the first few years after accession has impacted its ability to be as influential as before. Figures 9 and 9.1 below display a declining trend in corruption-related publications after 2007.

Figure 9: CSD publications 2002-2012



Source: http://www.csd.bg/index.php?id=162, accessed on January 1, 2013

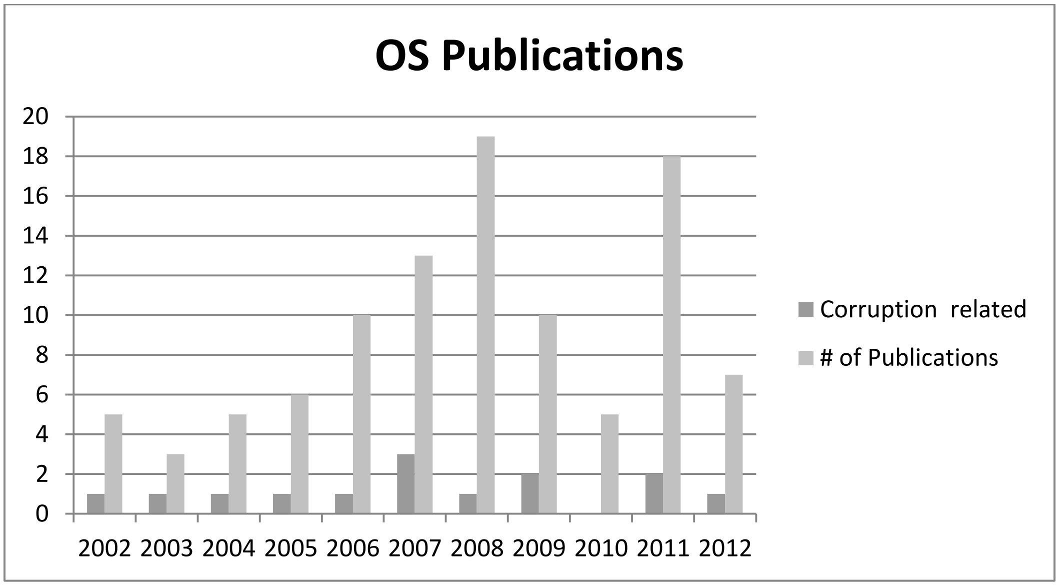
Figure 9.1: Percentage Corruption-related publications by CSD 2002-2012



Source: http://www.csd.bg/index.php?id=162, accessed on January 1, 2013

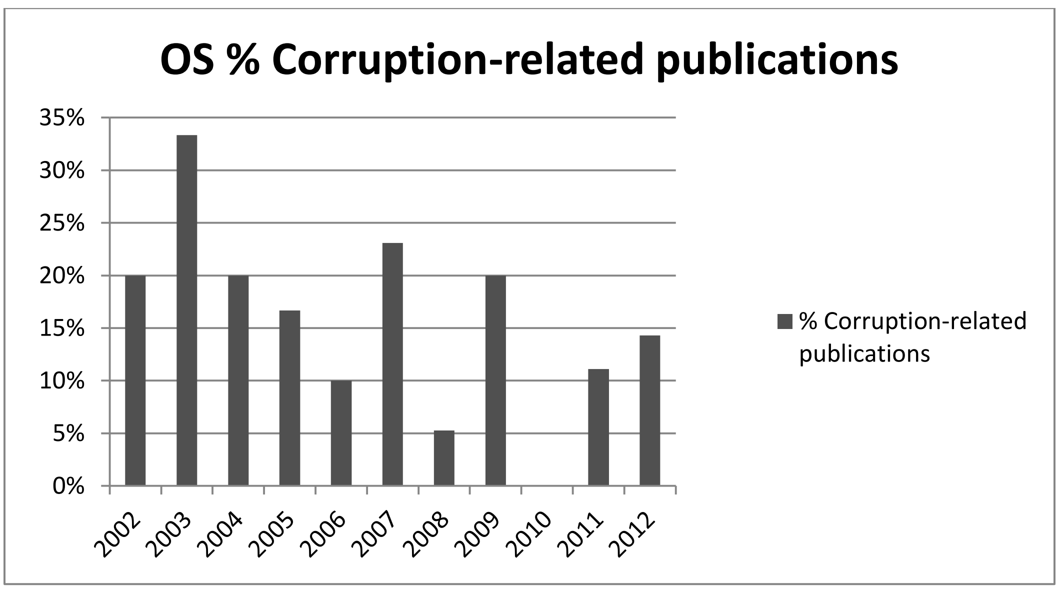
While Bulgarian corruption control in the post-accession period has not improved and has remained stagnant, an average of only 20% of CSD publications have explicitly featured corruption, down from 31% in the pre-accession period. As a validity test, I also look at the corruption-related publications of another major Bulgarian CSO, whose financial stability was not compromised by the EU accession – the Open Society Institute. As displayed by Figures 10 and 10.1 below, the situation is similar.

Figure 10: Open Society publications 2002-2012



Source: http://www.osf.bg/?cy=38&lang=1, accessed on January 9, 2013

Figure 10.1: Percentage Corruption-related publications by Open Society 2002-2012



Source: http://www.osf.bg/?cy=38&lang=1, accessed on January 9, 2013

Thus, one could argue that the withdrawal of donors and the change in the institutional structure for obtaining funding from the EU affected even some of the biggest Bulgarian NGOs, though to a more limited extent. This intuition is reinforced by the expert survey, which also suggests a somewhat decreased influence for CSD after accession.

Figure 11: CSD before accession

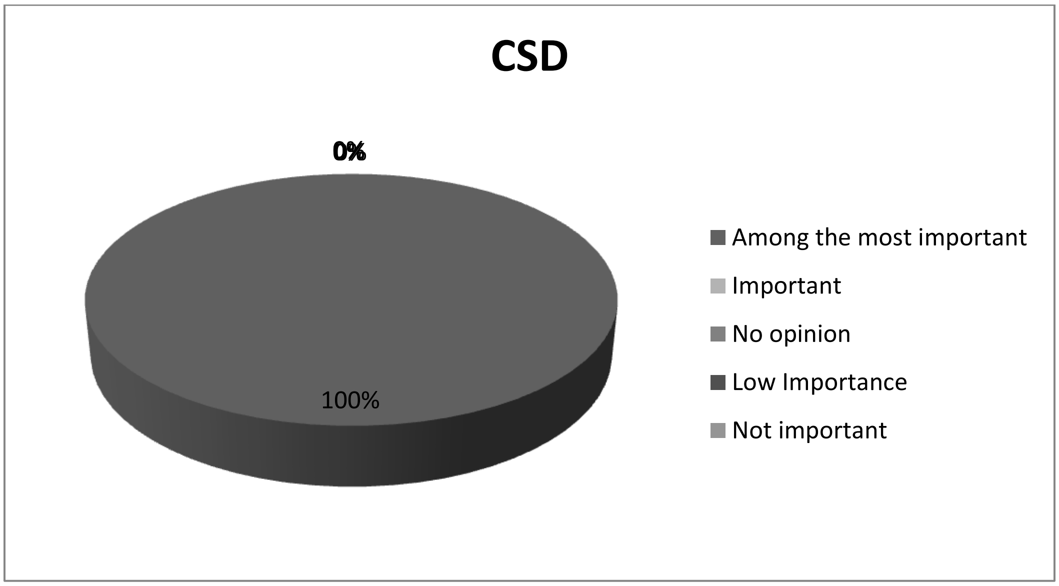
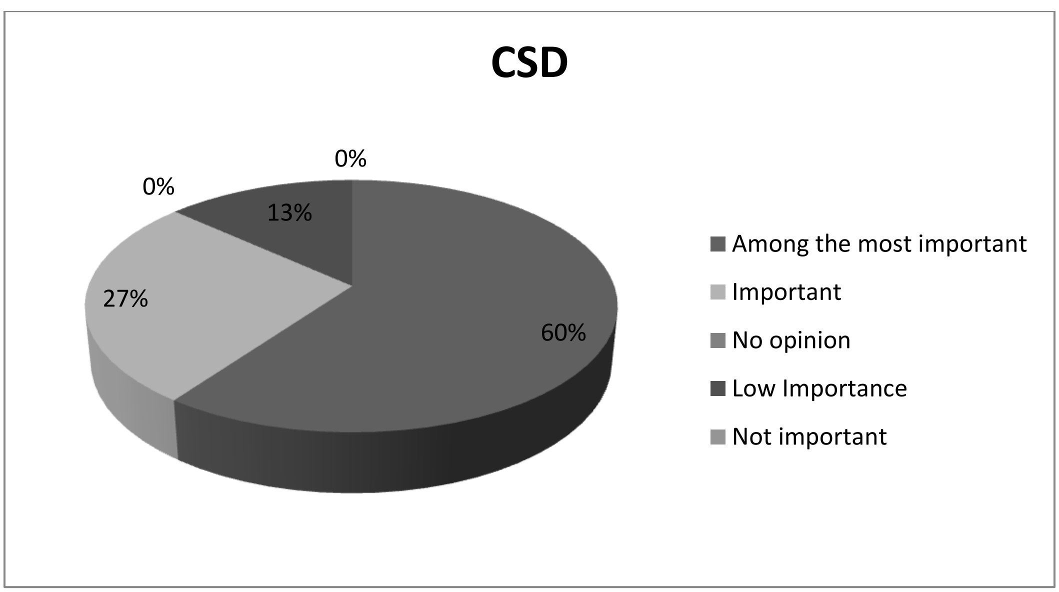


Figure 12: CSD after accession



As one can see, CSD is undoubtedly still a major anti-corruption actor. However, 40% of the experts no longer place it as among the most important actors, while they unanimously agreed that its influence before accession was among the strongest. The results for Open Society seem similar with a healthy minority doubting the relevance of the organization in the post-accession period, an increase from 0% before to 20% after.

Figure 13: OS before accession

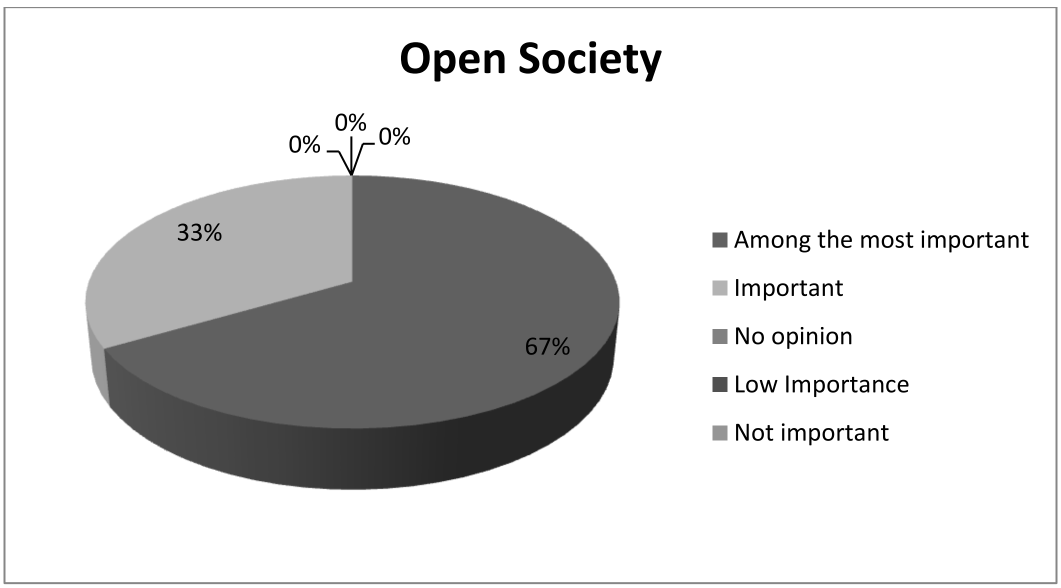
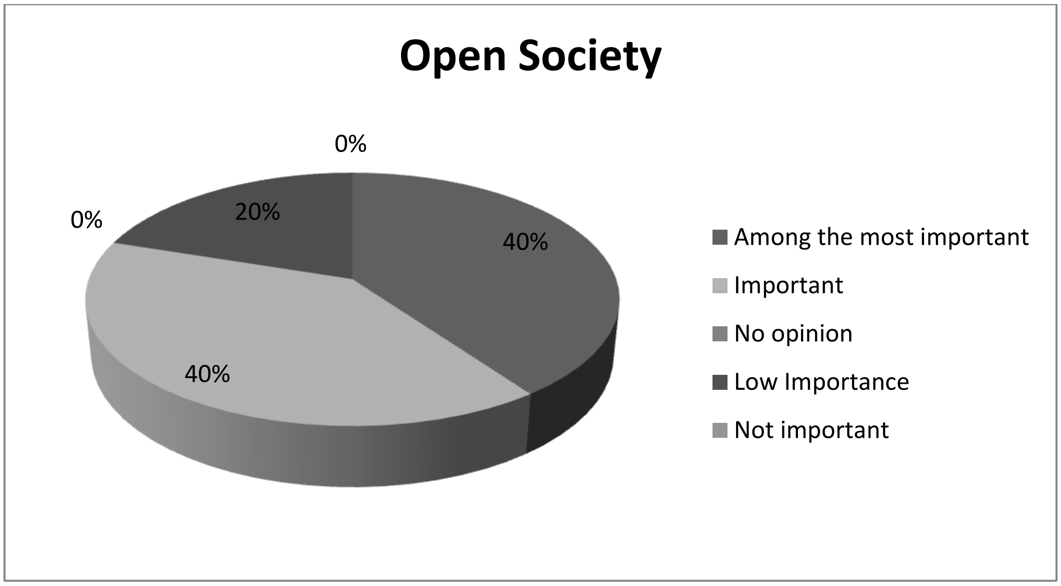


Figure 14: OS after accession



Conclusion

This article pursues two fundamental objectives. First, it explains the underlying reasons behind the strengthening of the civil society sector in Eastern Europe before accession as well as its eventual stagnation after membership. Second, it reveals the types of mechanisms through which CSOs influenced anti-corruption activity, namely monitoring and advocacy.

So, what were the reasons behind the weakening of the CSO sector after EU membership? The withdrawal of most external donors and the requirements for government collaboration to apply for EU funding post-accession constituted structural changes which decreased the capacities of all anti-corruption CSOs. Due to the top-down nature of the funding process pre-accession, no CSO was able to build an independent capacity to raise funds domestically. Thus, after this change in the institutional environment, only the bigger organizations that had developed transnational networks and internal bureaucratic capacities to follow complicated application procedures continued to play an important role.

Initially, the EU pre-accession process provided good opportunities for CSOs to get involved and exert influence on policy outcomes. Explicit requirements for cooperation with governments and conditional funding provided strong incentives for both local governments and CSOs to work together towards common goals. The two sectors collaborated and state and local governments were eager to craft proposals and implement measures pertaining to decreasing corruption. Both smaller and bigger CSOs played a meaningful role in this time period as the strength of the sector was increasing and corruption levels were falling. Once a country was accepted to the EU, however, the partnership requirements of the EU accidentally became a mechanism of curtailing the capacity of CSOs to pressure for anti-corruption reform. No longer fearful of the possibility of membership denial, the government actively sought to create bureaucratic hurdles for CSOs either proposing projects or obtaining the funding for projects that had already been approved. This, combined with the lack of availability of alternative funding sources, paralyzed many smaller CSOs.

In terms of mechanism and modes of inducing change, CSOs have engaged in different forms of monitoring and advocacy including publications and projects, lobbying, and directly contacting the EU. Importantly, it seems that the most significant policy changes, such as establishing a transparent Public Procurement Register in Bulgaria (in 2005) or crafting a new Public Procurement Law (in 2004), take place after CSOs provide powerful external actors like the EU and the US with information and tools to exert pressure on the government.

So, is there hope for the stagnant civil society sector in CEE? Yes, and the hope lies in Brussels. The key to revival is for the EU to remove the funds application process from the grip of domestic governments, which do not want anti-corruption funded and would methodically create barriers preventing CSOs from getting funded and exposing them. Given the close correlation between corruption control and strength of civil society it seems that this would be the sensible way to restore some of these countries' more hopeful pre-accession anti-corruption track record.

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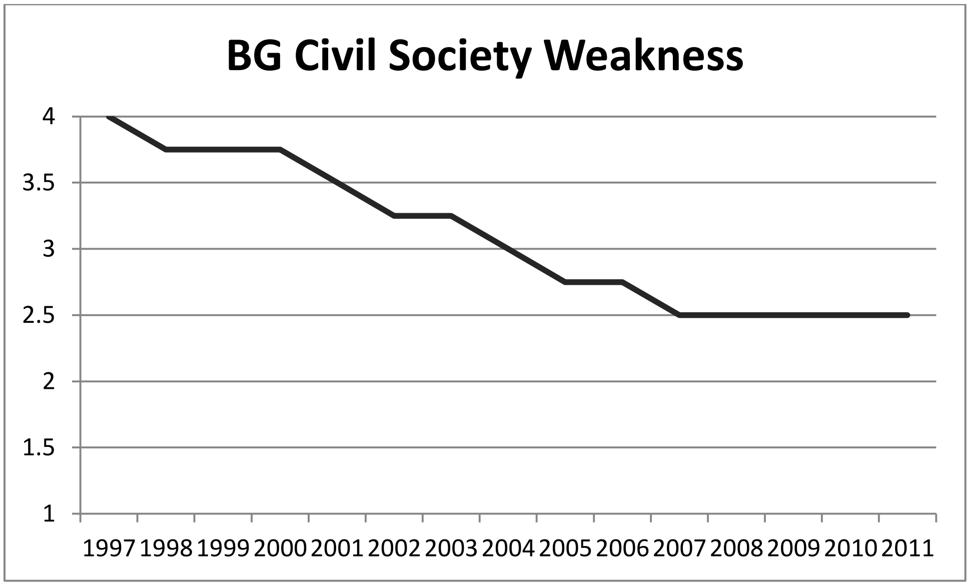
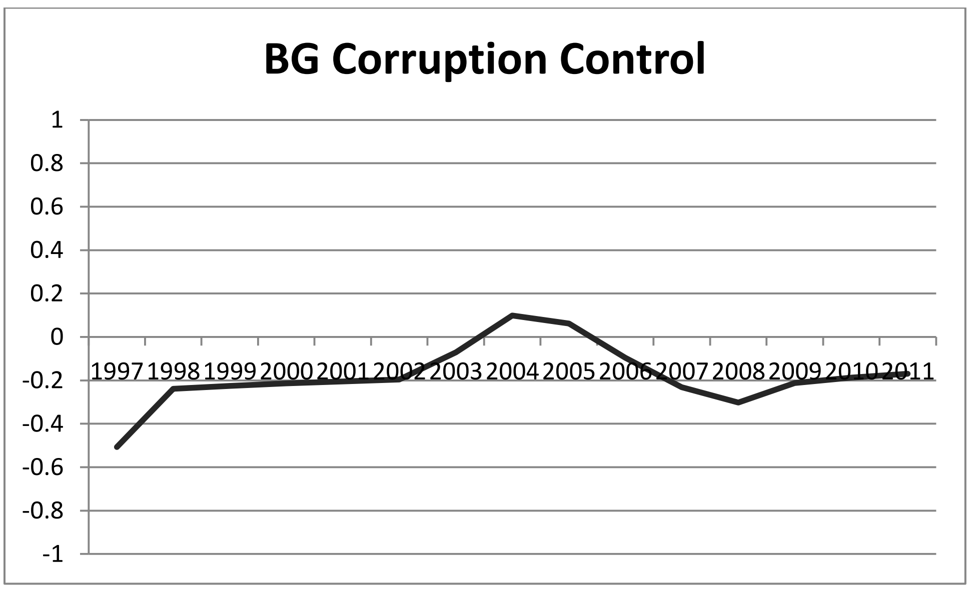
APPENDIX A: Civil Society Weakness and Corruption Control in the 10 post-communist countries of the 5th Enlargement 1997-2011[13]





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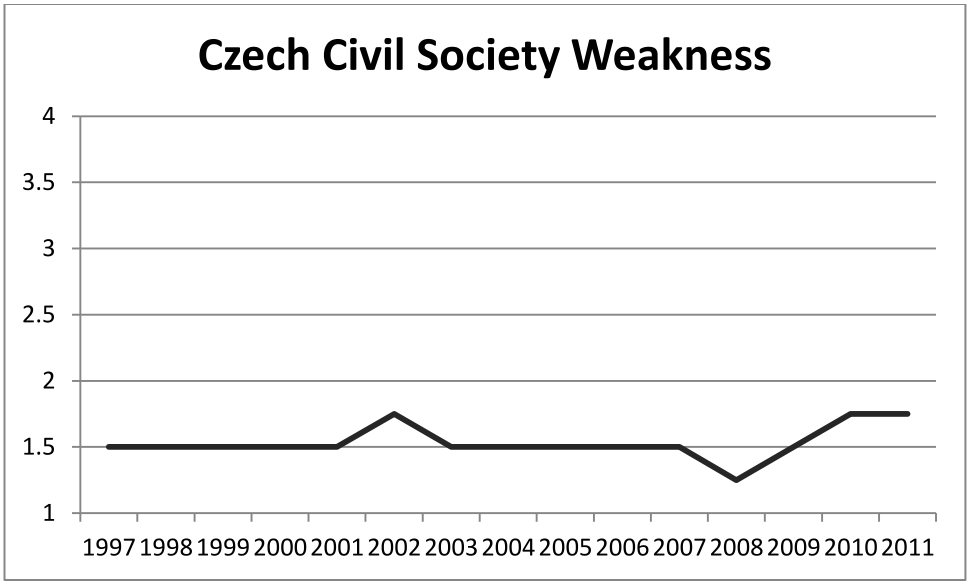
Control of Corruption Index 1997-2011, World Bank. The index runs from -2.5 to 2.5, with higher values corresponding to better outcomes. Available at: http://info.worldbank.org/governance/wgi/index.aspx#doc, accessed on 07.09.14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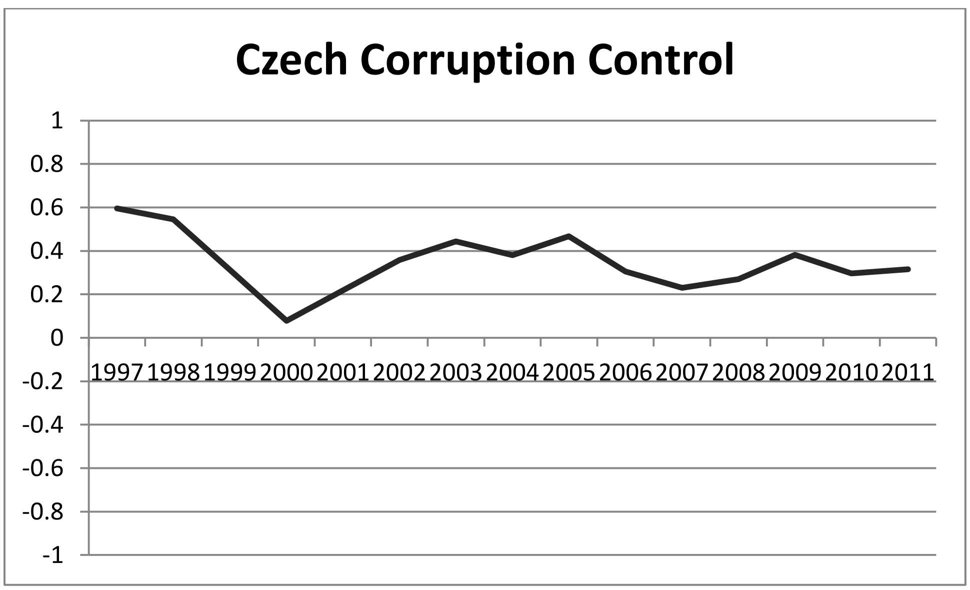
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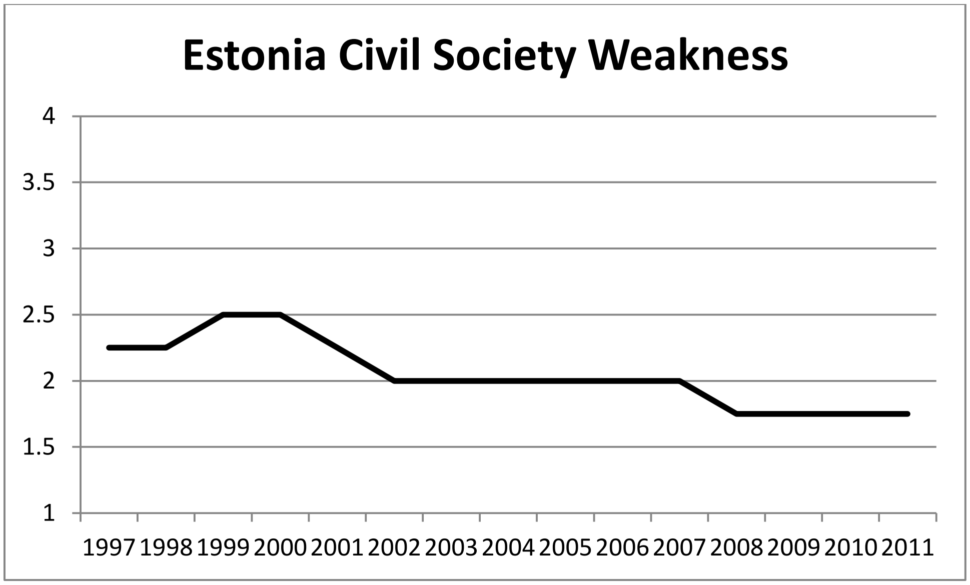
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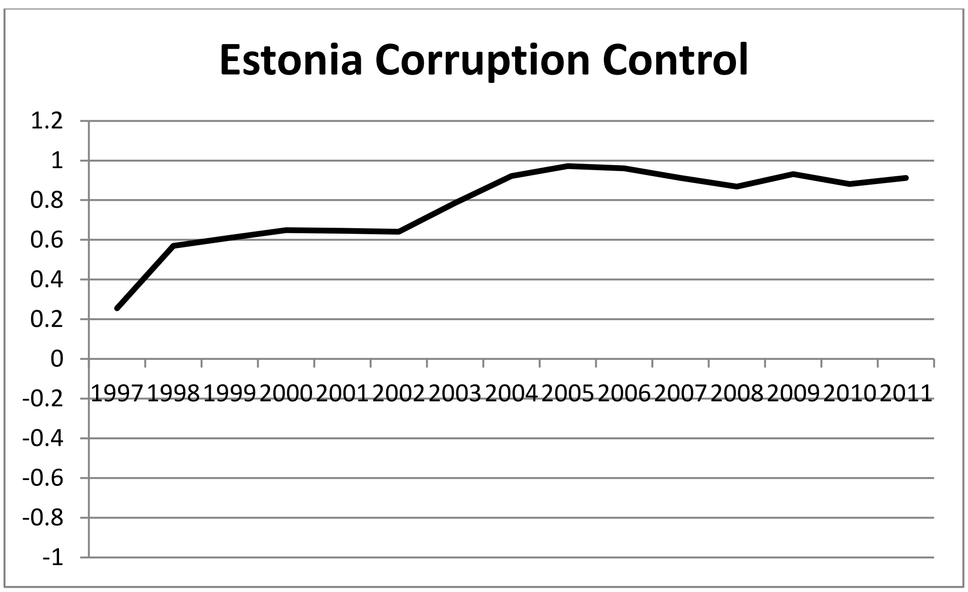
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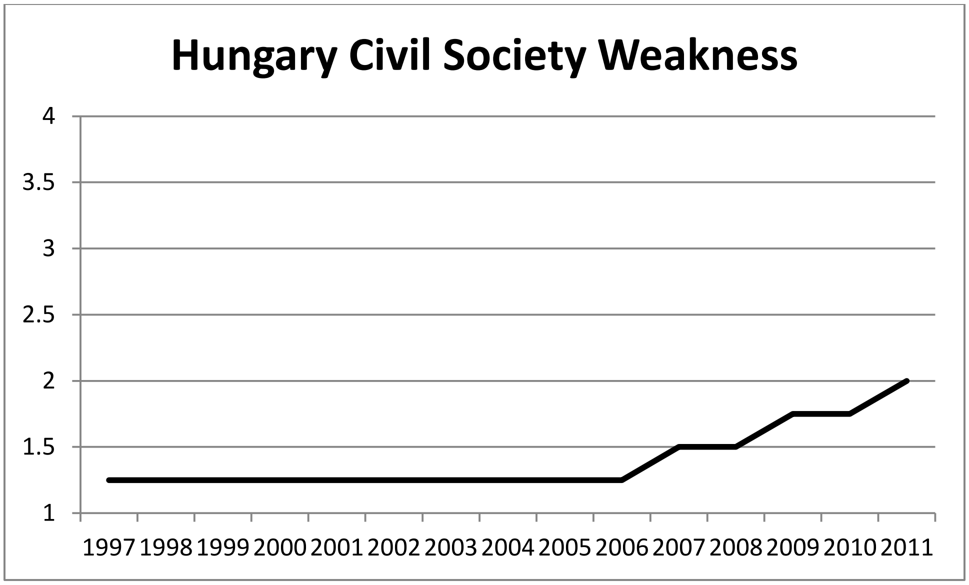
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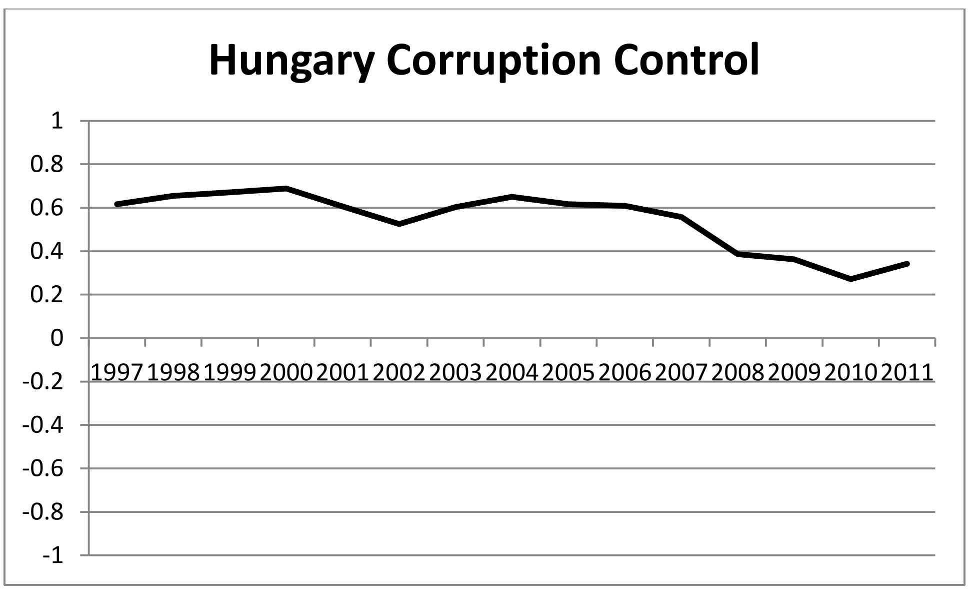
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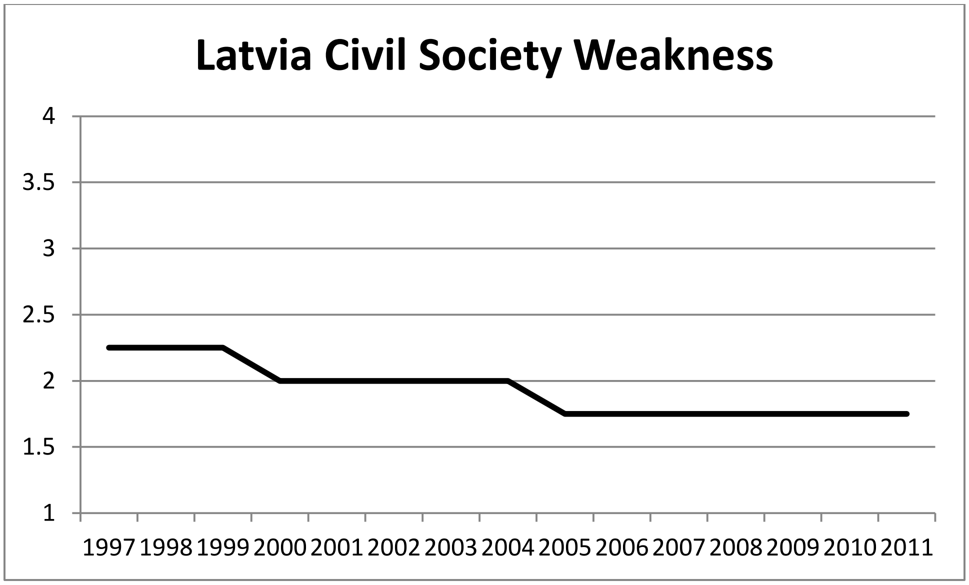
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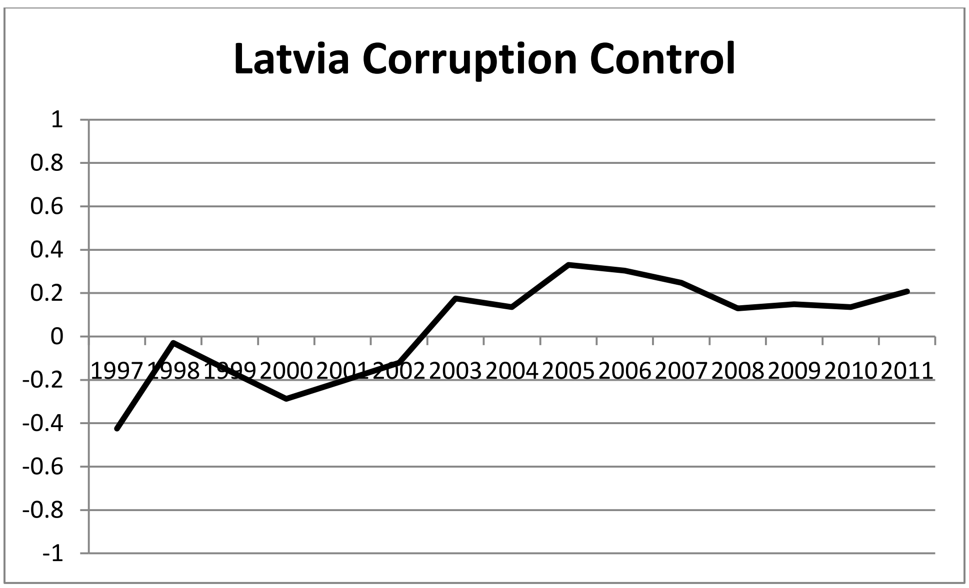
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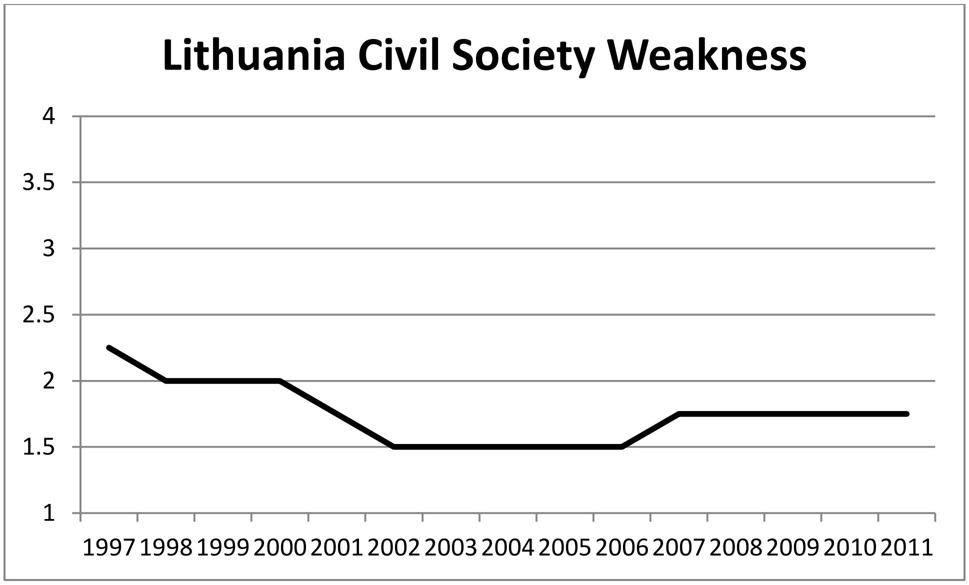

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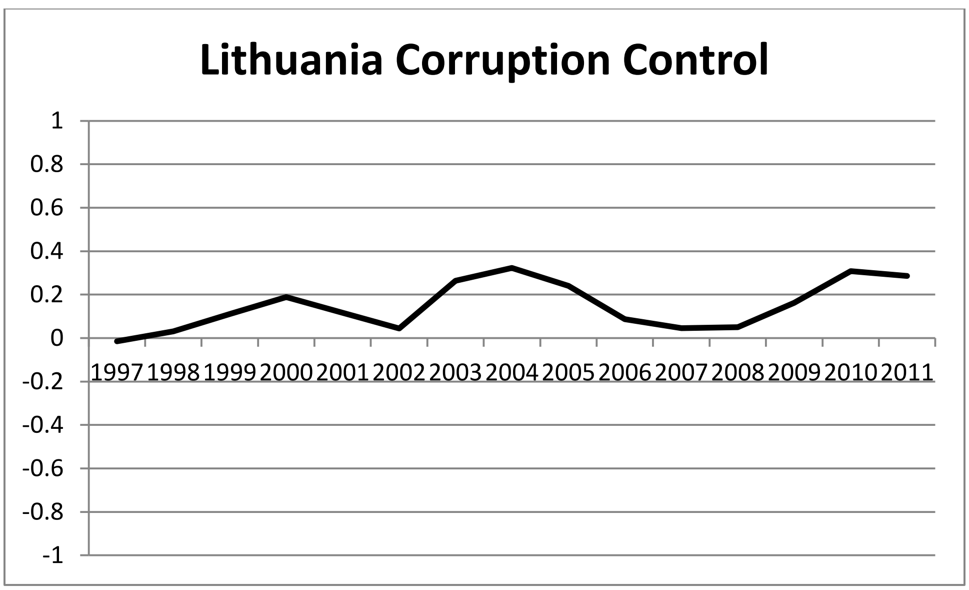

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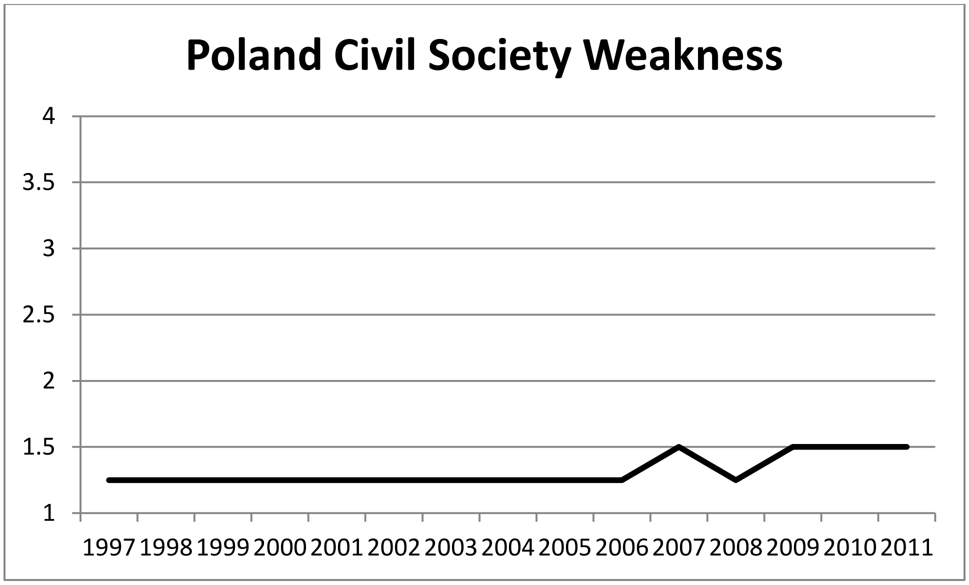
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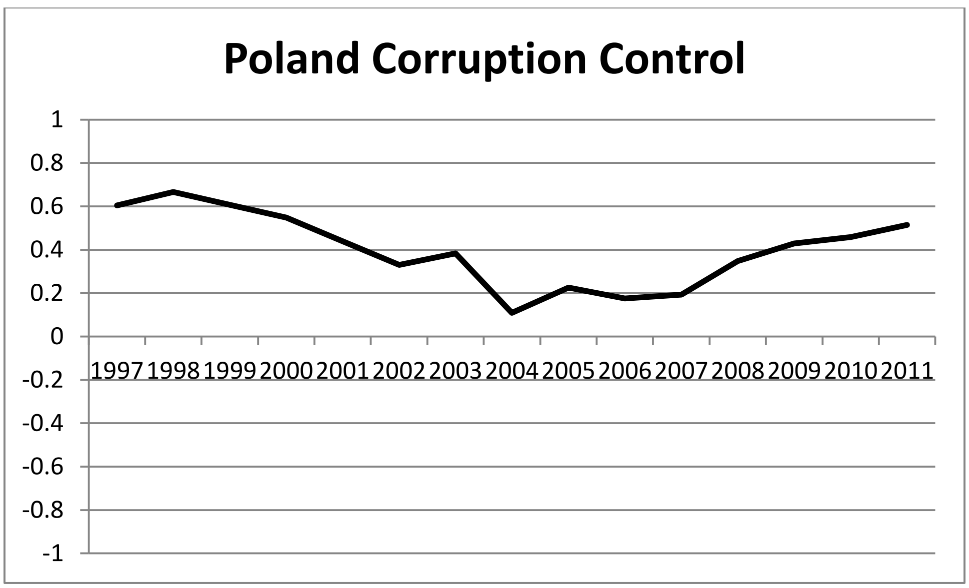
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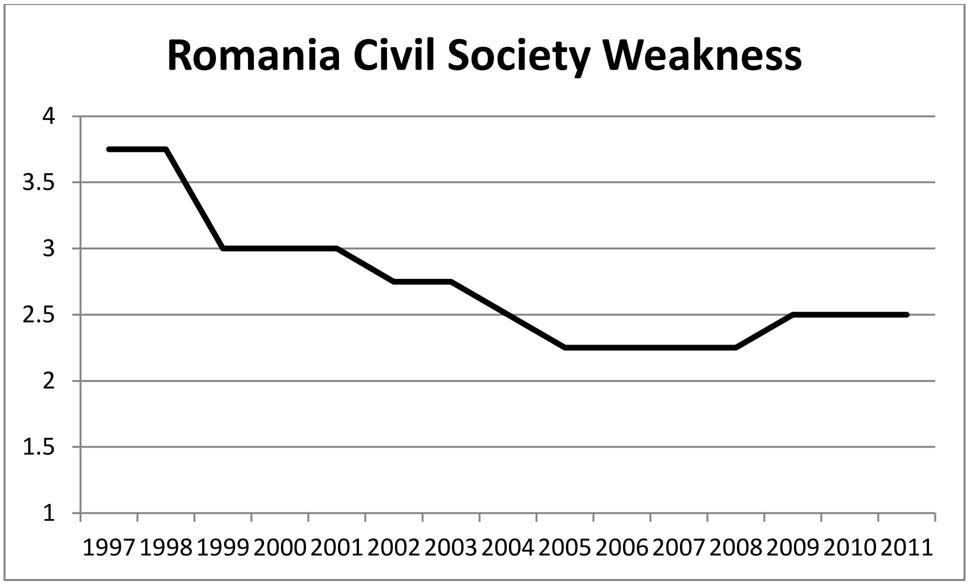
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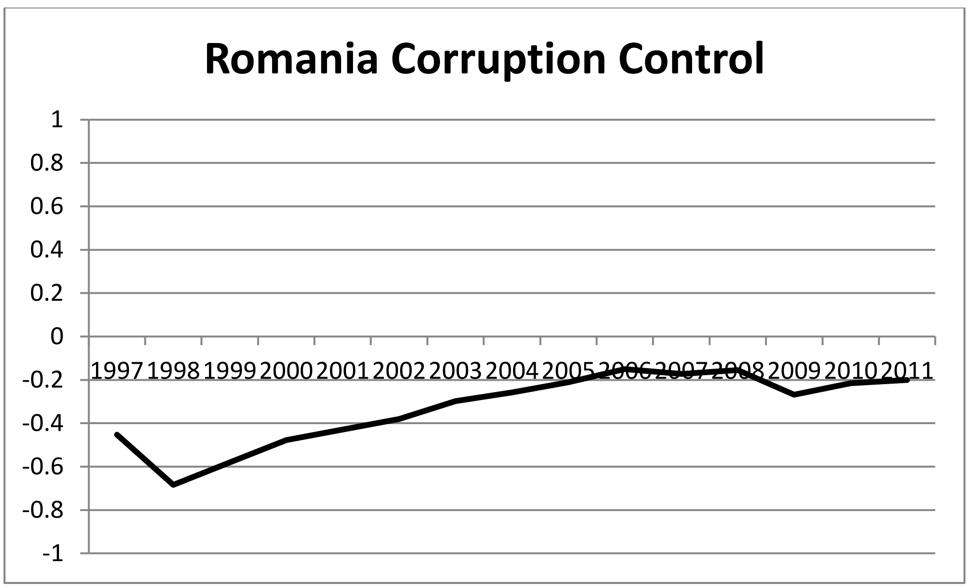
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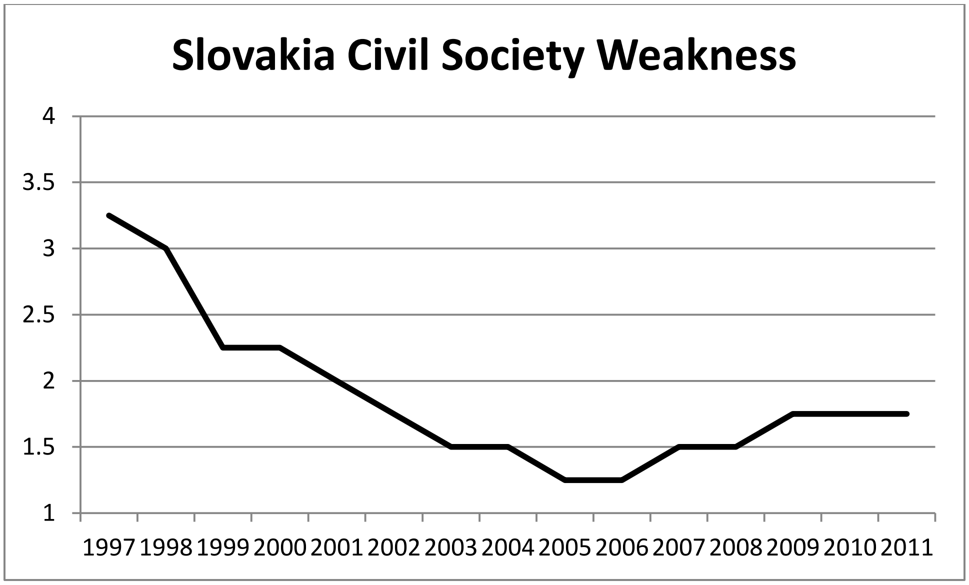
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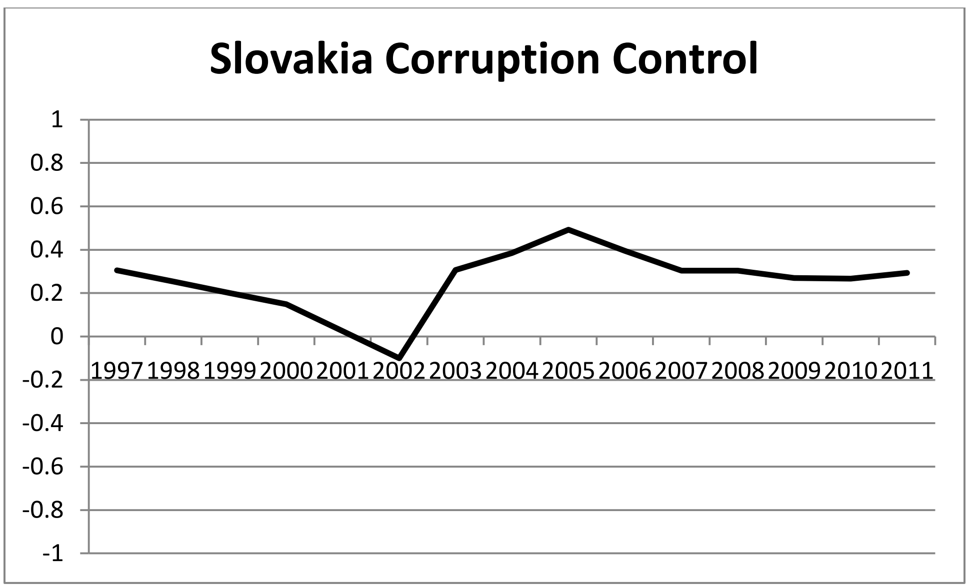
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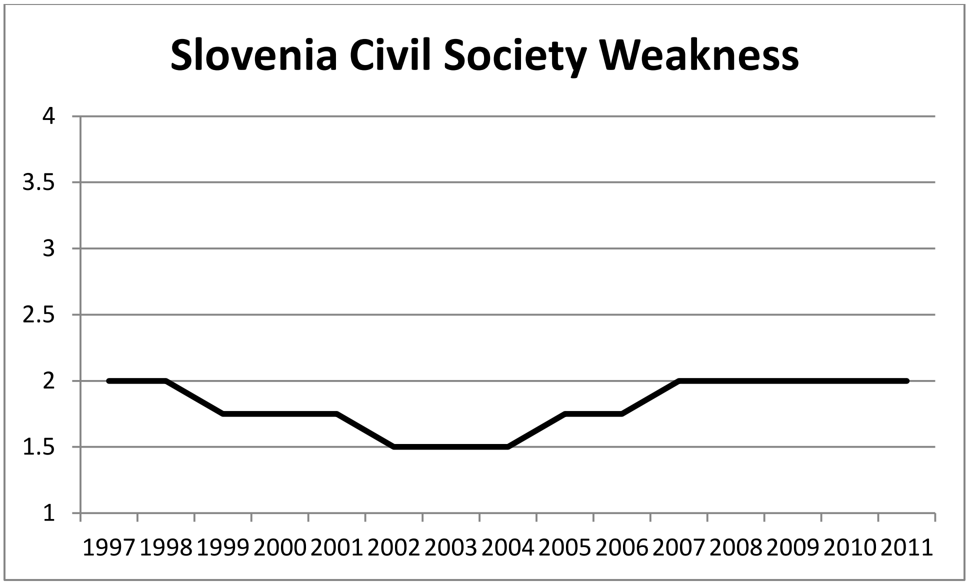
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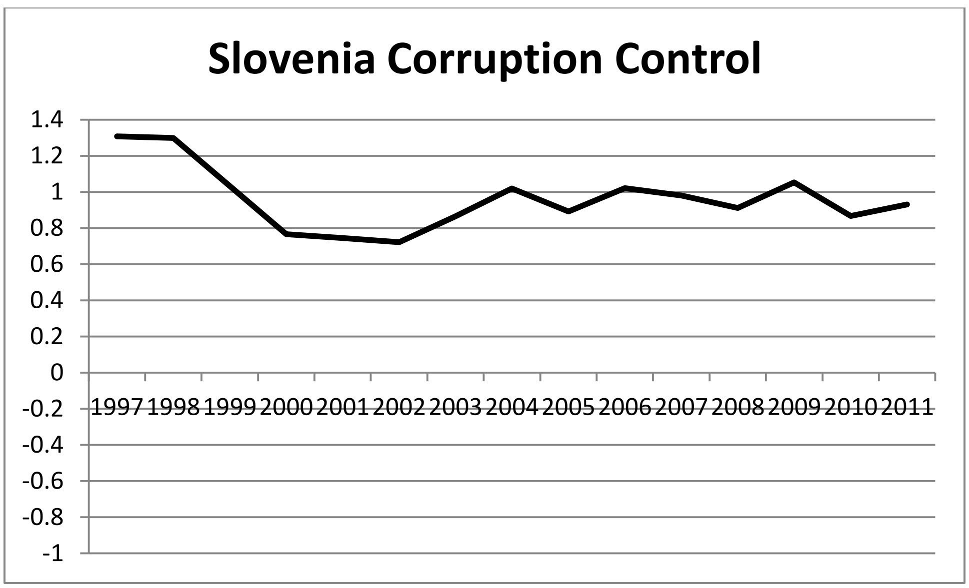
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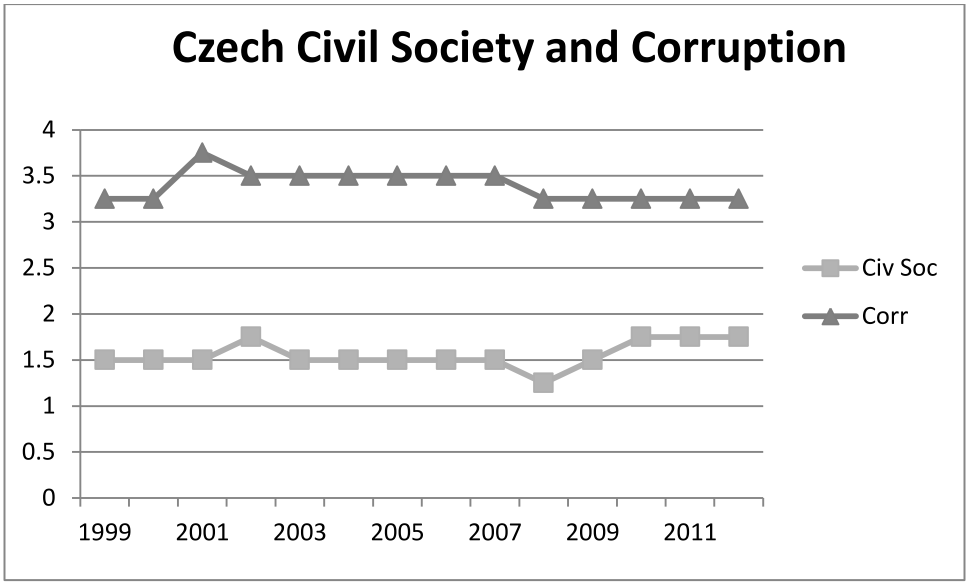
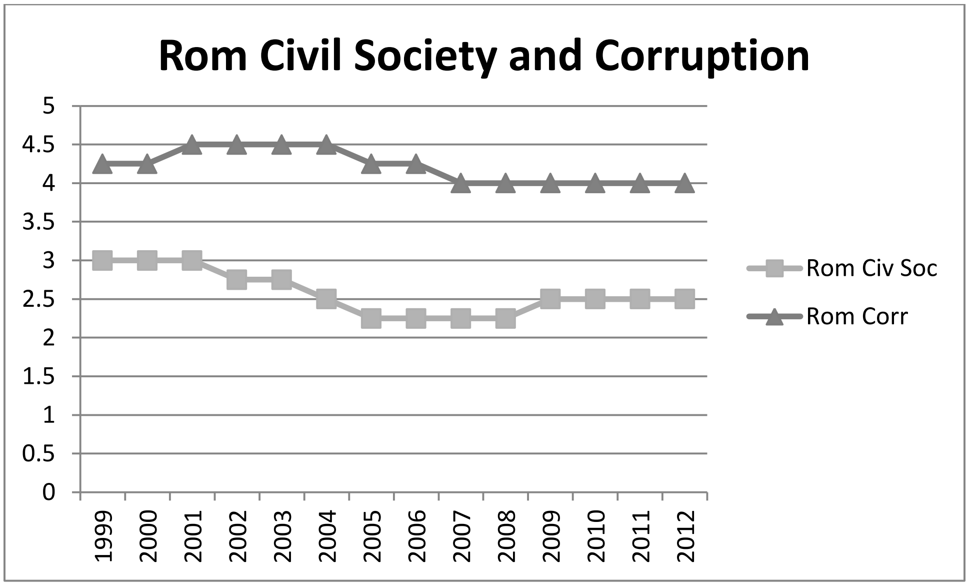
A1: Cross-validation: Civil Society Weakness and Corruption in the in the 10 post-communist countries of the 5th Enlargement 1999-2012 as measured by Freedom House[14]

Czech civil society and corruption levels before and after EU accession

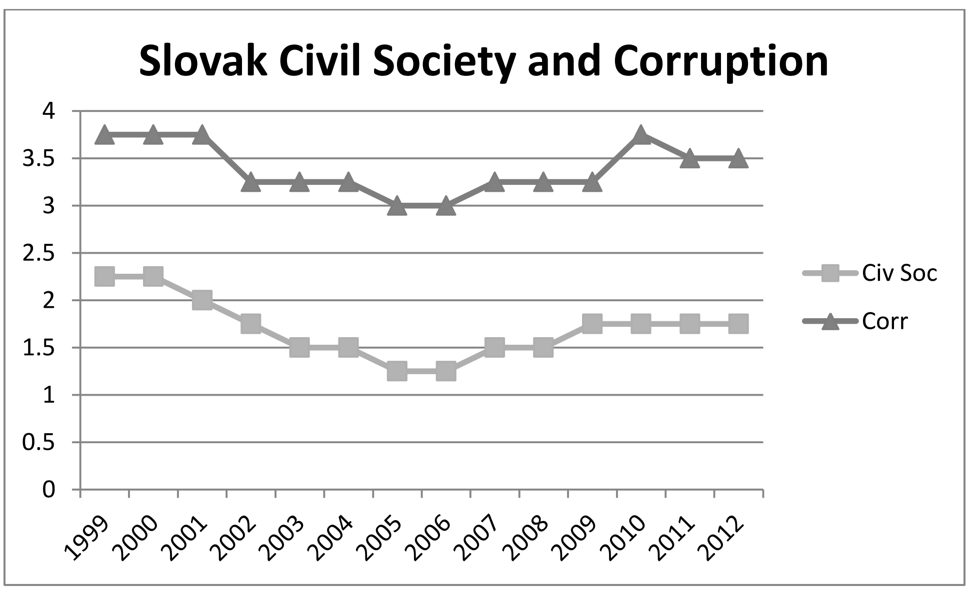


[14] Civil Society Index and Corruption Index, Freedom House. Available at: http://www.freedomhouse.org/country/, accessed on 09.09.13. Note: The Freedom House Corruption index is different from the World Bank index in that it shows corruption levels (higher values mean more corruption) as opposed to the World Bank's corruption control (higher values mean less corruption).

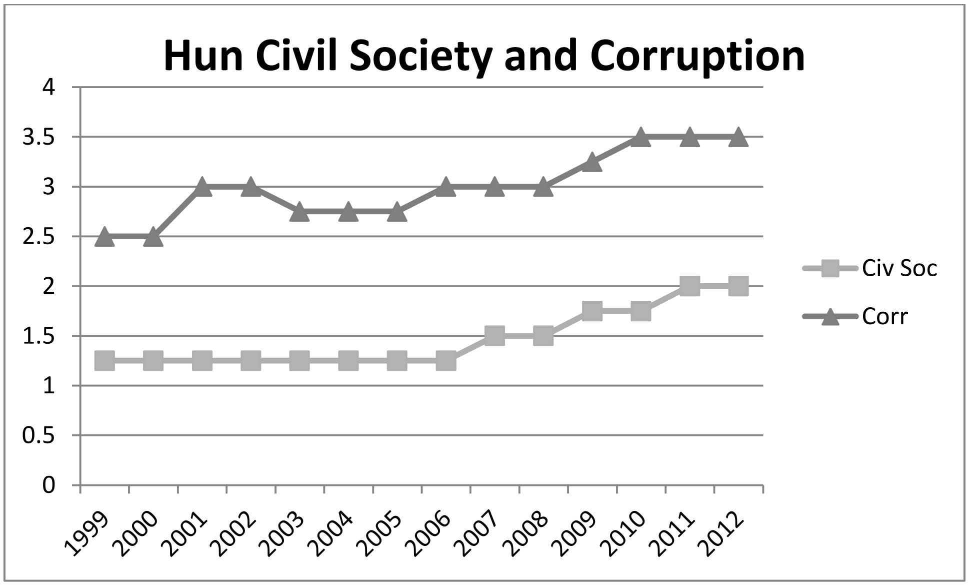
Romanian civil society and corruption levels before and after EU accession



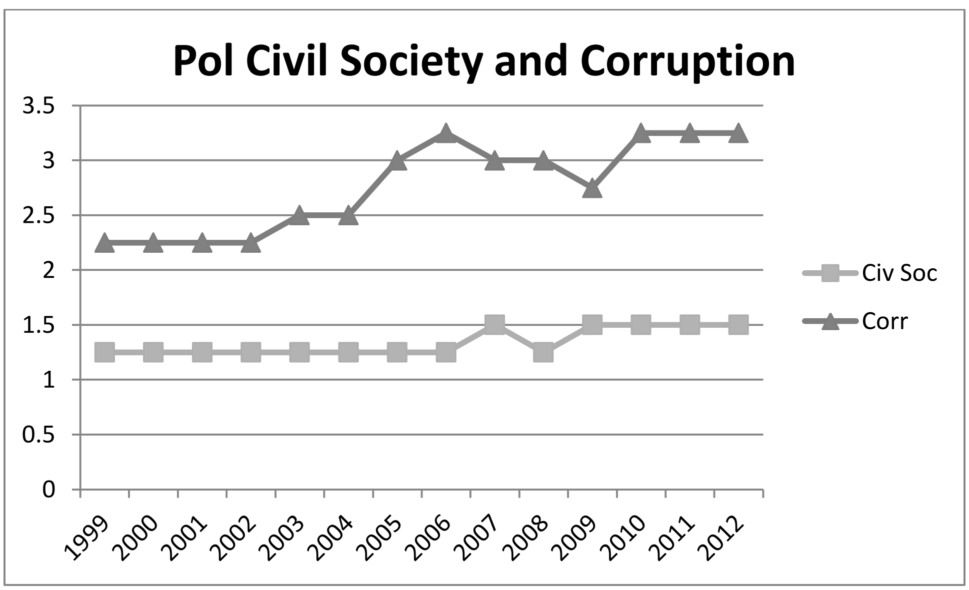
Slovakian civil society and corruption levels before and after EU accession



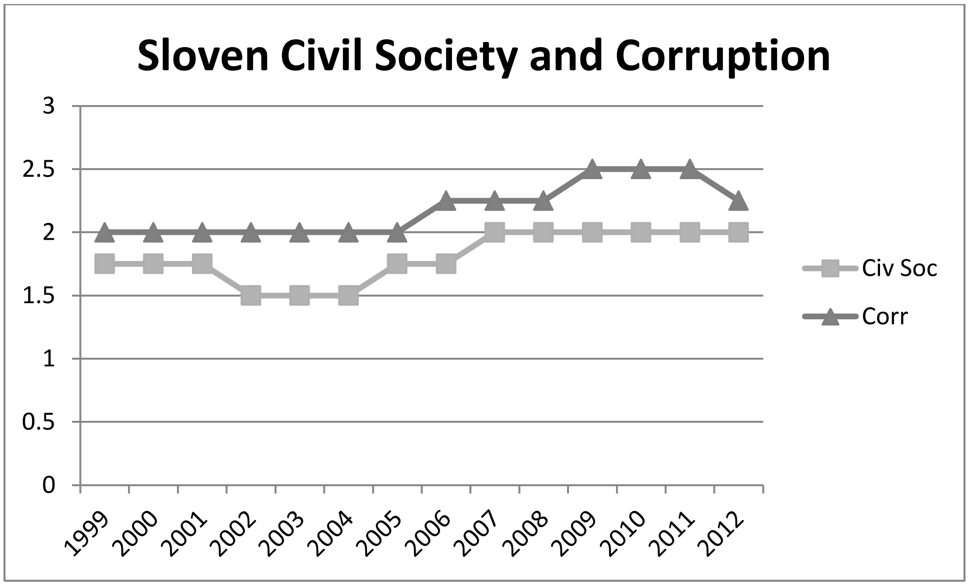
Hungarian civil society and corruption levels before and after EU accession



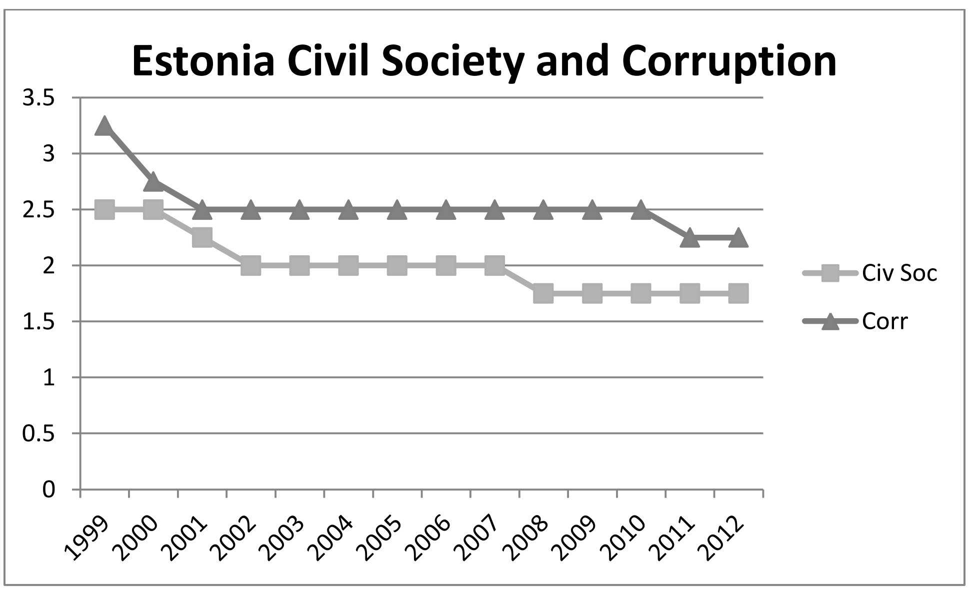
Polish civil society and corruption levels before and after EU accession



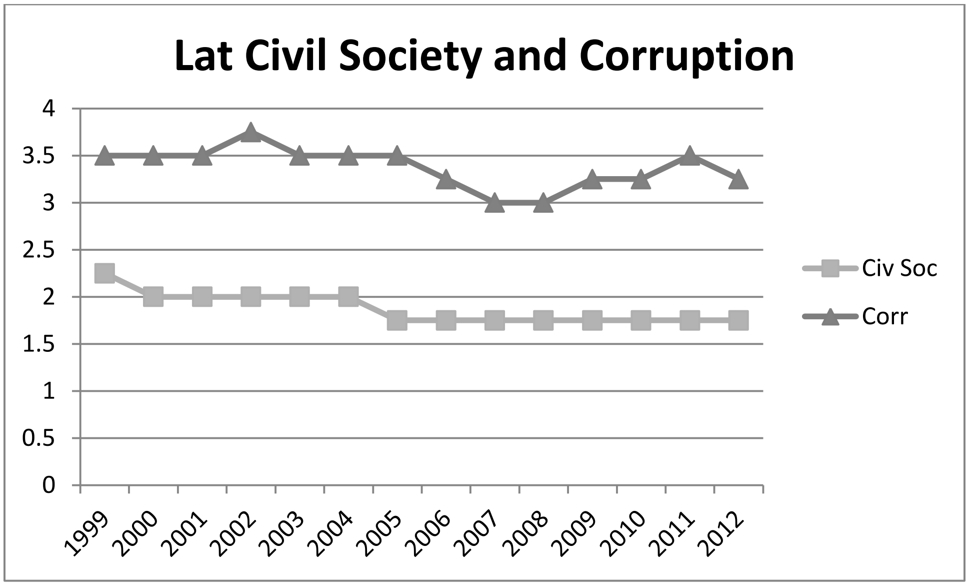
Slovenian civil society and corruption levels before and after EU accession



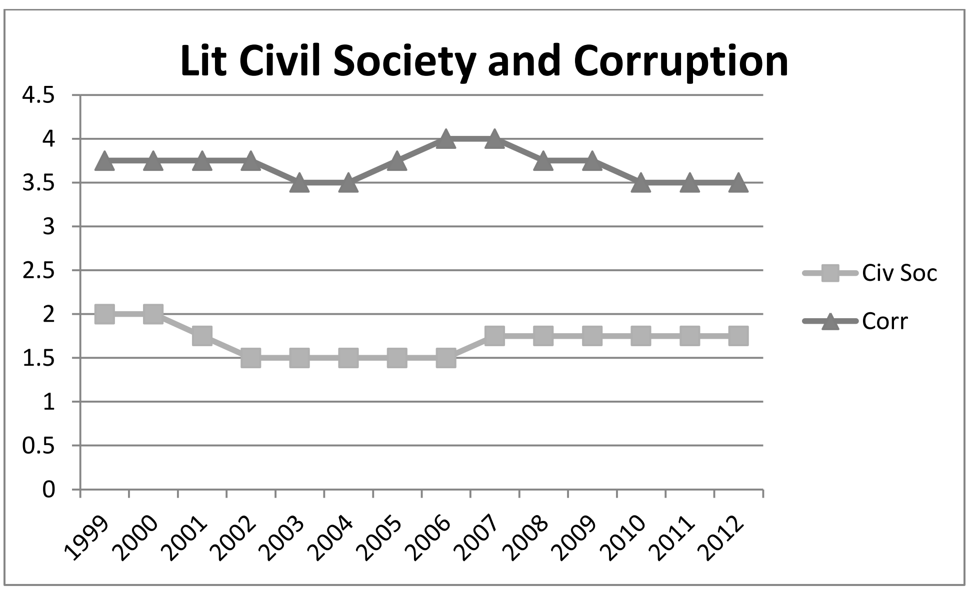
Estonian civil society and corruption levels before and after EU accession



Latvian civil society and corruption levels before and after EU accession



Lithuanian civil society and corruption levels before and after EU accession



APPENDIX B: Variable measurement and Descriptive Statistics

<u>Table B.1: Variable Measurement</u>

Civil Society Weakness	The Freedom House Civil Society Index. The index assesses the growth of nongovernmental organizations (NGOs), their organizational capacity and financial sustainability, and the legal and political environment in which they function; the development of free trade unions; and interest group participation in the policy process. The ratings are based on a scale of 1 to 7, with 1 representing the highest and 7 the lowest level of civil society strength. They follow a quarter-point scale. Minor to moderate developments typically warrant a positive or negative change of a quarter point (0.25), while significant developments warrant a half point (0.50). It is rare for any category to fluctuate more than a half point in a single year. Source: Freedom House: https://www.freedomhouse.org/report/nations-transit/nations-transit-2014#.VJnSNF4Co, accessed in July 2014.
Corruption Control	The Control of Corruption Index (one of the six World Governance Indicators (WGI)). The Control of Corruption Index is a composite governance indicator based on 32 underlying <u>data sources</u>. These data sources are rescaled and combined to create an aggregate using an unobserved components model (UCM). The UCM assumes that the observed data from each source are a linear function of the unobserved level of governance, plus an error term. This linear function is different for different data sources, and so corrects for the remaining non-comparability of units of the rescaled data noted above. The resulting estimates

	of governance are a weighted average of the data from each source, with weights reflecting the pattern of correlation among data sources. The UCM assigns greater weight to data sources that tend to be more strongly correlated with each other. While this weighting improves the statistical precision of the aggregate indicators, it typically does not affect very much the ranking of countries on the aggregate indicators. The composite measures of corruption control generated by the UCM are in units of a standard normal distribution, with mean zero, standard deviation of one, and running from approximately -2.5 to 2.5, with higher values corresponding to better outcomes. The measure is useful as a tool for broad cross-country comparisons and for evaluating broad trends over time. Source: World Bank: http://info.worldbank.org/governance/wgi/index.aspx#doc, accessed in July 2014.
Economic Development	Annual percentages of constant price GDP are year-on-year changes; the base year is country-specific. Expenditure-based GDP is total final expenditures at purchasers' prices (including the f.o.b. value of exports of goods and services), less the f.o.b. value of imports of goods and services. Source: Economist Intelligence Unit, World Development Indicators.
Competition	Percent change in volume of imports of goods and services. Percent change of volume of imports refers to the aggregate change in the quantities of total imports whose characteristics are unchanged. The goods and services and their prices are held constant, therefore changes are due to changes in quantities only. Source: World Bank.

Neighbor's corruption	Average corruption score of neighboring countries, as calculated from the World Bank's Control of Corruption index. Source: Author.
Level of Democracy	Average of political rights and civil liberties scores in Freedom House's "Freedom in the World" report. Political rights enable people to participate freely in the political process, including the right to vote freely for distinct alternatives in legitimate elections, compete for public office, join political parties and organizations, and elect representatives who have a decisive impact on public policies and are accountable to the electorate. Civil liberties allow for the freedoms of expression and belief, associational and organizational rights, rule of law, and personal autonomy without interference from the state. Each country and territory is assigned a numerical rating—on a scale of 1 to 7—for political rights and an analogous rating for civil liberties; a rating of 1 indicates the highest degree of freedom and 7 the lowest level of freedom. Source: Freedom House: https://www.freedomhouse.org/report-types/freedom-world#.VKlrkivF93E, accessed in December 2014.
Size of the Public Sector	General government final consumption expenditure as a percentage of GDP. Total expenditure consists of total expense and the net acquisition of nonfinancial assets. Source: World Bank.
Freedom of the Press	Score on Freedom House's "Freedom of the Press" report. The *Freedom of the Press* index, an annual survey of media independence in 197 countries and territories, is at the core of Freedom House's press freedom project. The index assesses the degree of print, broadcast, and internet freedom in every country in

	the world, analyzing the events of each calendar year. It provides numerical rankings and rates each country's media as "Free," "Partly Free," or "Not Free", so higher scores correspond to less freedom Source: Freedom House: https://www.freedomhouse.org/report-types/freedom-press#.VKloGyvF93E, accessed in November 2014.
Abundance of Natural Resources	Production of minerals and utilities as a percentage of GDP Source: United Nations Statistical Division.

Table B.2: Descriptive Statistics

Measure/Variable	Observations	Mean	Std. Dev.	Min	Max
Corruption Control	150	0.30	0.41	(0.68)	1.31
Civil Society Weakness	160	1.95	0.62	1.25	4.00
Economic Development	160	5.42	12.18	(59.69)	121.90
Competition	157	7.37	20.94	(61.37)	148.17
Size of the Public Sector	151	28.11	14.07	12.10	82.08
Level of Democracy	160	1.42	0.43	1.00	3.00
Freedom of the Press	160	53.45	3.28	50.00	75.00
Natural Resources	152	3.48	0.73	2.25	4.27
Neghbor's corruption	150	(0.23)	0.10	(0.42)	(0.09)

APPENDIX C: Examples of mechanisms of corruption control utilized by Bulgarian NGOs

NGO	Year	Name of Project	Financier	Tools invloved	Mechanism of corruption control	Result
CED	2002-03	"Transparency of the public auctions"	Open Society and Soros Foundation	publications	advocacy	The issue was included in the EU's Regular Report
CED	2004	"Encouraging the Collaboration between businesses and NGOs to curb corruption in the Velingrad municipality"	USAID	publications	monitoring	The project was successful and EU showed interest in expaning the scope
CSD	2002-05	Anti- Corruption Open Government Initiative	USAID	publications	advocacy	The Public Procurement Register was removed from the mandate of the courts after pressure from the US and the EU
CSD	2007	Closing of duty free gas stations	British Embassy and the EU	Analysis papers and publications	monitoring/advocacy	The subject was featured in the EU's Regular Report as well as the US State Department Annual Report in 2007

Chapter III: Corruption on the ropes: The effectiveness of EU leverage in fighting corruption in Central and Eastern Europe before and after accession

The European Union's (EU) eastern enlargement of 2004-07 marked a symbolic moment in Europe's post-Cold War history. After more than a decade of difficult transitions ten Central and Eastern European (CEE) post-communist countries, finally broke free from their communist legacies and joined the ranks of the developed world. Authoritarianism and central planning were now buried in the past. Democracy and the free market were "the only game in town." The task of reforming the CEE countries during the accession process was a challenging one. Nevertheless, the EU's membership conditionality has been widely perceived as a highly effective means of influence. The promise of membership combined with the implementation of the 31 chapters of the *acquis communautaire* during the negotiations phase of the accession period has been credited with the overall alignment of the ten post-communist countries' systems of governance, economies and legal structures with Western European standards. There is no doubt that during the accession period CEE countries had huge incentives to comply and collaborate with EU institutions. As a number of scholars have argued, however, these incentives may have decreased once membership was attained and the EU's leverage correspondingly diminished. It is therefore unclear to what extent the EU has had a system-wide impact and continues to cause political and economic reform in new members after accession. In order to try to shed more light on this ongoing debate, I focus on the area of governance which is most likely to engender skepticism about the ability of the EU to inspire and sustain reform – government efforts to fight corruption.

Corruption was neither part of the acquis nor of the Copenhagen criteria thus presenting a challenge that external pressures on their own, and in the absence of a formal dimension, were unlikely to effectively address. Furthermore, there were few domestic payoffs for politicians to show results and instead, especially in some countries, there were vast incentives for the political elites to collude and maintain the rent-seeking momentum they had adopted in the early 1990s.

Therefore, in this article I ask whether the EU pre–accession process and post-accession pressures have been effective in the fight against corruption in the CEE countries. In other words, were corruption levels curbed during the pre-accession period and more importantly were any such gains sustained after that, when EU leverage diminished? I hypothesize that despite the prediction that gains during the pre-accession period would be modest and perhaps backsliding would take place after the membership is attained, the 10 post-communist countries have, on average, performed well both before and after accession. I employ time series analysis focusing on the time period 1996-2009 to substantiate this argument.

In unpacking the causal mechanisms behind this dynamic, I also use historical process tracing and show that although corruption was neither part of the *acquis* nor explicitly of the Copenhagen criteria, it was an issue that received a lot of visibility during the pre-accession period through the Commission Regular Reports. Thus, taking advantage of its leverage, the EU was able to demand reforms that served to decrease corruption levels during the accession period.

After accession gains in the fight against corruption were not negated as the relative loss of leverage in this time period was compensated by the combined effect of three causal mechanisms. First, there are positive pressures coming from continued leverage - conditional

Structural and Cohesion Funds and Cooperation and Verification Mechanism reports (in the cases of Bulgaria and Romania). Second, there is evidence of increased linkage - socialization effects leading to higher demands for accountability of public officials. Third, there are substantial spillover effects from implementing the *acquis* in other areas – the reduction of the role of the state in the economy, increasing bureaucratic capacity and improvements in the legal system.

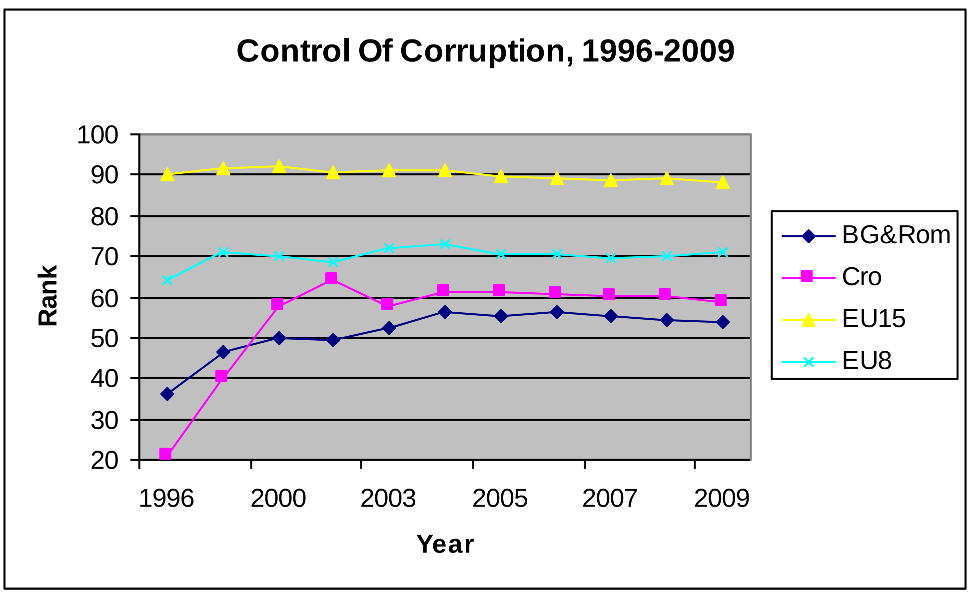
I explore the question of how corruption levels were influenced by the EU in several stages. First, I present the current state of play in the fight against corruption in CEE and explain why it is such a deeply-rooted challenge, detrimental to liberal democracy and endangering the cohesion of the EU. Second, I show how the findings of this study fall in line with the larger literature on EU leverage and post-accession compliance. Then, I present the theoretical framework that I utilize to formulate my hypotheses and explain my methodological approach including a discussion on the choice and operationalization of variables and the results of the time series analyses. Finally, I trace the exact causal mechanisms that were in play before and after accession and suggest some implications for EU policy-making.

Corruption in CEE: The state of play

The purpose of this section is to sketch the problem of corruption in post-communist Europe in three ways. First, I illustrate how the CEE countries are doing compared to other EU members while also showing some variation within the group of ten. Second, I summarize the main explanations of why corruption is so deeply-rooted in CEE. Third, I elaborate on why corruption is detrimental for both liberal democracy and the cohesion of the EU and hence a crucial challenge to good governance.

Although scholars have shown that by 2005 the performance of the eight post-communist countries that joined in 2004 on measures of political rights and civil liberties was virtually indistinguishable from that of the older EU members (Cameron, 2007), severe problems with corruption have remained salient in basically all these countries.[15] Figure 1 below tracks the development of corruption levels in the group of eight who joined in 2004 as well as Bulgaria and Romania who joined in 2007 and the EU -15 from 1996 to 2009.

Figure 1: Corruption levels in Percentile Ranks



Note: World Government Indicators (WGI) 1996-2009, World Bank. Available at: http://info.worldbank.org/governance/wgi/index.asp (accessed on January 17, 2012); higher numbers indicate better performance

[15] http://www.transparency.org/research/cpi/overview#1 (accessed on August 2, 2014).

Both the group of eight and Bulgaria and Romania show improvement, narrowing the gap with the EU-15 substantially between 1996 and 2005. However, there seems to be a stasis in this trend after 2005. Croatia, which I have also included in this graph, as the most recent member of the EU, evolves similarly to the other post-communist members. There are two concerning trends that the graph portrays. First is the one of slowing reform, though no backsliding. Second is that these countries, especially Bulgaria and Romania, still exhibit corruption levels which are significantly higher than those of their Western European counterparts. From the EU point of view the lack of backsliding may seem encouraging, but the fact that these countries absolute levels still remain so high is unacceptable and the need for continued reform is, therefore, crucial.

But why is there so much corruption in post-communist societies to start with? Two main explanations stand out: 1) the legacy of the planned economy has bred a culture of corruption that has prolonged itself past the democratic transition; 2) the transition created a window of opportunity (through privatization) that led to the emergence and entrenchment of a system of corrupt practices. Both explanations have been examined in the literature. Karklins (2005), Treisman (2003), and Holmes (2006) argue that the communist past of these countries has created a specific set of conditions and actors that adversely influence corruption levels. Sandhotlz and Taagepera (2005) show that the lack of competition, legacy of the planned economy, combined with ineffective bureaucratic supervision makes corruption ubiquitous. Hutchcroft (1997) and Holmes (2006) suggest that it has become a socially accepted norm that could not be changed overnight. At the same time there is evidence that privatization opened the door to numerous opportunities for corruption since the process itself was largely devised and managed by the administrators of the old regimes. This created a set of vested interests and positions of power that effectively resisted further reforms (Sandhotlz and Taagepera, 2005). Thus, corruption is a systemic problem in CEE, whose foundations can be traced both to the post-communist transition and the communist period.

Having demonstrated that corruption is a deeply-rooted and ongoing problem in CEE, let me summarize the reasons that justify focusing on it specifically when thinking about challenges to good governance. First of all, it undermines democratic institutions, reduces economic growth, and challenges liberal democracy – “as political elites violate the legal limits of their power, citizens lose trust in state institutions, and civil society is oppressed or co-opted by powerful networks” (Vachudova, 2009, p.44). Along the same lines, Richard Rose (2001, p.105) has called it “the greatest obstacle to progress in post-communist societies”. Furthermore, it endangers the integration and cohesion of the European Union in a way few other governance challenges do. First, if the Structural and Cohesion Funds that become available to new members after accession are not fairly allocated in the absence of mechanisms controlling corruption, they fail to adequately address the economic and infrastructural challenges these countries face and delay their effective integration in the Union. Additionally, while corruption undermines integration on the acceding country end, it also reduces support for enlargement in the older member states. As corruption scandals in CEE countries make more and more headlines, public support for the Union’s integration and further enlargement diminishes as both eastern and western European publics become skeptical of the EU. Thus, corruption is an important issue which deserves the attention of both policy-makers and academics.

Challenges to post-accession compliance in various areas. Is corruption different?

This section outlines the way my findings contribute to the literature on the way the EU has impacted domestic reforms in candidate countries. It is organized in two parts. First, I explain why some scholars would be skeptical about improvements in corruption levels in acceding countries. Here I also outline the findings of scholars who have found evidence of the decreasing effectiveness of EU conditionality after accession. Second, I address the positivist literature on post-accession compliance and show that the lack of backsliding in the ten post-communist members' fight against corruption that this paper identifies falls in line with the findings of several other researchers.

Some scholars would be skeptical about potential improvements in corruption levels. Epstein and Seledmeier (2008), for example, convincingly argue that the power of EU conditionality would be the weakest in areas where the EU never applied specific conditionality, such as rules that are neither part of the *acquis*, nor of the Copenhagen criteria. Such is the case with corruption. Although the membership criteria do call, somewhat broadly, for developing institutional capacities to curb corruption and organized crime, corruption is neither part of the *acquis*, nor of the Copenhagen criteria. Some scholarly evidence suggests that this is not coincidental since there was never a consensus among the older member states to push or emphasize the issue (Vachudova, 2009) and some Council members systematically tried to avoid it. Jacoby (2004) also contributes to the argument that the density of EU rules in each area of reform predetermines its success and longevity. He compares regional and healthcare policy and finds that the sector characterized by more extensive external pressure (stronger EU conditionality), regional policy, made greater progress towards approximating Western European models. The high level of outside incentives and the relative scarcity of domestic actors in the case of regional policy (as opposed to healthcare) compelled and enabled some CEE governments to implement the EU's regional policy rules fairly and faithfully. If we look at the *acquis* or the Copenhagen criteria, corruption is characterized by a relatively low level of outside incentives. Thus, one can legitimately expect only modest improvements in corruption levels during the candidacy period and perhaps backsliding after accession when EU leverage diminishes.

Such skepticism would in a way be justified. Some academics have already identified areas where the impact of EU conditionality has not been not as lasting. Mungiu-Pippidi (2007) emphasizes that challenges like populism and nationalism unfortunately do not end with accession and are likely to continue playing an important role in the domestic political arenas of CEE. Rupnik (2007) also notes a populist backlash against accession in much of the region, though he admits that this effect is not likely to persist over time. Sasse (2008) finds that there are still on-going practical problems with the application of minority rights rules, despite some demonstrated formal legal compliance. Finally, Vachudova (2008) shows that although political parties moderated their agendas to bring them more in line with the EU during the candidacy period, parameters of competition broadened again post-accession as party programs became increasingly more nationalist and culturally conservative. Thus, lack of compliance in difficult areas and backsliding do not constitute exceptional circumstances.

Nevertheless, I demonstrate that as far as corruption is concerned, compliance has largely been maintained and positive gains have not been negated after accession. Thus, I agree with Pop-Eleches and Levitz (2010) who show that EU leverage in new EU members was very strong and they have experienced at most a slowdown in reforms after accession, rather than genuine backsliding. There are three ways in which I build on Pop-Eleches and Levitz's argument. First, I focus specifically on the area of corruption, choosing the control variables for the statistical analysis accordingly. Second, I examine the mechanisms through which EU conditionality may have influenced corruption in CEE in more detail. Finally, the statistical analysis covers all countries of the world for which data are available, allowing for greater flexibility in the choice of reference groups.

As stated earlier, the results demonstrate evidence for the positive impact of both EU candidacy and membership on corruption levels in CEE. In this way this article situates itself in the growing body of literature on issues where compliance endured after membership. For example, my findings fall in line with Sedelmeier's (2008) evidence for the continuation of implementation of EU law among the newest members of the Union. He even argues that compliance after accession was in fact stronger in the new members than in the old ones. Trauner (2009) reinforces these arguments by showing that even in Bulgaria and Romania formal compliance with EU law has continued after accession. Epstein (2008) also adds to this "positivist" literature by delineating patterns of increasing openness to foreign direct investment in the banking sectors of these countries. Finally, Falkner and Treib (2008) explore the pattern of non-compliance with EU law in the CEE member states and find that it is actually similar to that of some existing members. This suggests that there is no evidence for a *sui generis* reaction to any pre-accession overstretch.

Theoretical Framework and Hypotheses

In this section I outline the theoretical background behind my hypotheses. First, I explain why EU leverage was so powerful during the pre-accession process and why it allowed the EU to push for reforms that went beyond the formal scope of the negotiation chapters. In this context I formulate my first hypothesis about decreasing corruption levels in the pre-accession period. Second, I delineate the alternative mechanisms that have continued the pressure for reform post-accession, when leverage was substantially decreased. These mechanisms serve as the basis of my second hypothesis about the lack of backsliding in corruption levels after accession.

In the case of the Eastern Enlargement EU leverage was very powerful during the pre-accession process because the benefits of membership and the costs of exclusion created huge incentives for candidates to try to fully satisfy all formal requirements (Grabbe, 2006; Schimmelfennig and Sedelmeier, 2005; Vachudova, 2005, Pridham, 2005). In fact these benefits and costs were so great that post-communist elites were willing to do more than simply close the negotiation chapters – they were willing to address general institutional and political shortcomings, otherwise highlighted by the EU. Although some scholars have argued that the power of EU conditionality would be the weakest in areas where the EU never applied specific conditionality (such as rules that are neither part of the *acquis*, nor of the Copenhagen criteria), the issue of corruption always received a high level of visibility from the Commission's Regular Reports and domestic elites knew it was critical to try to curb it during the pre-accession period. Thus, in light of the significant power of EU leverage during the accession period and the high visibility of the issue of corruption in these countries, I propose the following hypothesis:

H1: *Corruption levels decrease during the entire candidacy period.*

As stated earlier, many authors have made the case that backsliding is likely to occur in the post-accession period due to the decrease of leverage after the ultimate reward of membership has been granted. There are three mechanisms, however, that compensate for this loss of leverage in this period and suggest that corruption levels may actually continue to improve. As Levitz and Pop-Eleches argue, EU leverage, though transformed, remained an important force after membership (Levitz and Pop-Eleches, 2010). Greater dependence on trade and especially the potential threat of freezing the massive Structural and Cohesion funds available to new poorer members acted as a powerful incentive for elites to stay on the reform path. Additionally, greater linkage and exposure to the West for both elites and citizens was associated with higher expectations of government performance and served as an additional pressure to continue compliance. Finally, spillover effects associated with the gradual removal of the state from the economy, improvements in the legal system and strengthened regulatory institutions also contributed to fewer opportunities for corrupt behavior in the political realm.

Thus, in light of these arguments I propose the following hypothesis related to the post-accession period:

H2: *There is no backsliding in corruption control after accession*

Methodological Framework

The purpose of this section is two-fold. First, I outline the way the dependent variable, levels of corruption, the independent variables of interest, *EU Candidacy Process and Full Membership,* and all the relevant control variables have been operationalized. Then, I present the findings of the statistical analysis and explain the meaning of these results for my hypotheses.

Operationalization of the dependent variable - Corruption

In order to specify the dependent variable, corruption, I refer to the Control of Corruption (CC) index, which is part of the World Bank's World Governance Indicators (WGI). Kaufmann, Kraay, and Mastruzzi (KKM), who have developed the index, define CC as an index "measuring 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."[16]. The index covers 212 countries and territories for the years 1996, 1998, 2000, and 2002-2007. The scores for the years 1997, 1999, and 2001 are manually constructed by averaging the adjoining years.

The CC index is based on a number of individual variables measuring perceptions of corruption, representing 35 separate data sources produced by 32 different organizations from around the world.[17] Importantly, all WGI indicators are based on subjective or perceptions-based data on governance reflecting the perspectives of a wide range of informed stakeholders including thousands of private individual and firm survey respondents, experts working for the private sector, NGOs, and public sector agencies. The aggregation technique KKM use is an unobserved components model which allows for the extraction of the common component of the multiple corruption measures and thereby assigns a single, annual corruption score to every country in the world. The main advantage of this approach is that the aggregate indicators are

[16] http://info.worldbank.org/governance/wgi/index.aspx#faq (accessed on August 11, 2014).

[17] Since the number of data sources varies from year to year, critics of the CC have made the case that comparisons across time are inconsistent and should not be done. However, KKM have argued that since the measure is constructed for the entire dataset at the same time, levels of corruption at different time points can be considered methodologically comparable.

more informative about unobserved governance than any individual data source. The aggregate corruption scores are then scaled to follow a normal distribution with a mean of zero and a standard deviation of one in each period. This means that virtually all scores lie between -2.5 and 2.5, with higher scores corresponding to better outcomes. The measure is constructed for the entire dataset at the same time, so that levels of corruption at different time points can be considered comparable. The dependent variable in this study is defined as the annual level of a country's aggregate Control of Corruption score, as calculated from the publicly available dataset provided by the World Bank.

The CC is one of the most popular indexes measuring corruption. This is not surprising given its indisputable advantages – broader country coverage than any individual data source on corruption and a systematic aggregation of corruption data from over 30 different data sources. Nevertheless, the CC is often criticized for the fact that the index is based on subjective perception-based data and not on objective measures of corruption. KKM defend the appropriateness of CC pointing out at several considerations.

First of all, perceptions do matter immensely because political and economic actors often base their actions on their perceptions, impressions, and views. Thus, if citizens, for example, believe that the courts are ineffective or the police are corrupt, they are likely to downplay their importance as institutions and avoid their services. Furthermore, if investors believe that the investment climate in a given country is inappropriate, they will withdraw their investments even if the fundamentals of the national economy look good on paper. Secondly, as far as corruption is concerned, there are few alternatives to relying on perceptions data since by definition corruption leaves no 'paper trail' that can be captured objectively. Thirdly, KKM point that potential problems with expert assessments, such as, that such assessments can sometimes be tainted by ideological biases, or be biased towards the views of the business elite or by the recent economic performance of the countries in question (i.e. so called 'halo effects') are tested for empirically and proven to be statistically insignificant. Last, even when fact-based data are actually available, the *de jure* notion of national laws may differ substantially from the *de facto* reality that exists on the ground. Relatedly, the legal systems of different countries often define instances of corruption differently, so a measure that may seem objective, such as relative share of verdicts for cases of corruption, may actually be highly inconsistent across countries.

A potential weakness of the CC index is that it measures the public's general perception about corruption, which renders measuring different aspects or forms of corruption (nepotism, bribery, extortion etc) impossible (Heidenheimer 2005). Nevertheless, for the purpose of this study the CC's advantages outweigh its shortcomings. It's broad geographical coverage and the systematic aggregation of data from a variety of sources allows for effective cross-country comparisons of overall corruption trends over time.

An alternative measure that some studies have employed is the Transparency International's Corruption Perceptions Index (CPI), which uses a similar methodological approach to produce its aggregate scores. There are two disadvantages of this index compared to the CC. First, it covers fewer countries and second it uses fewer sources to produce its aggregate scores. That said, I did run a correlation analysis to test for the level of overlap between the CPI and the CC in my sample and the high correlation coefficient of .972 indicated that the two indexes can basically be used interchangeably.

Operationalization of the independent variables - EU Candidacy Process and Full Membership[18]

The two independent variables of interest in this study are EU candidacy process and EU membership. EU candidacy process is defined as the period between the moment when a country has signed an association agreement with the EU (but has not yet entered accession negotiations) and the moment when full membership is achieved. Although the EU candidacy process goes through several stages starting with more general rather than specific conditionality and then moving to actively transposing the full *acquis communautaire* during the negotiations phase, looking at the process as a whole is a sensible approach given that both the softer inactive leverage of the initial phase and the active leverage of the negotiations phase exert powerful influence on acceding members. Per hypothesis 1, I expect a strong improvement in corruption levels during the Candidacy Process.

Table 1: Independent Variable – EU Candidacy Process

Status	**Country and Period**
EU Candidacy Process	Bulgaria 1996-2006, Czech Republic 1996-2003, Estonia 1996-2003, Hungary 1996-2003, Latvia 1996-2003, Lithuania 1996-2003, Poland 1996-2003, Romania 1996-2006, Slovakia 1996-2003, Slovenia 1996-2003

[18] A number of studies (Gray 2009; Pop-Elecech and Levitz, 2010) use time period dummies to operatlionlize the effects of EU conditionality on various policy areas. Importantly, there were also other external actors that exercised pressure for reform in these time periods, so disentangling the unique EU effects is difficult. Nevertheless, it is believed that the EU's conditionality constituted the most powerful influence after the mid-1990s (most WB and IMF programs, for example, aimed at reforms trying to achieve greater macroeconomic stability and the OECD Anti-bribery Convention (1999) focused on a specific component of corruption. The consistency and scale of treatment that the EU Regular Reports provided was more comprehensive.

The second independent variable, EU membership, is defined as the moment when all the existing member states have ratified the Treaty of Accession and a country has become a full-fledged member of the Union. Importantly, at that point, the EU can no longer threaten to withhold membership in order to compel a country to comply with its demands, though it can use other types of leverage such as threatening to stop or stopping Structural and Cohesion Funds to new members. This considerable decrease of leverage after full membership is granted is interpreted by many as the main reason why new members may experience backsliding. Therefore, looking at corruption levels post accession is also extremely important for this study since it will show whether potential gains made during the candidacy process are sustainable. Per hypothesis 2, I expect that the improvement in corruption levels achieved during the candidacy period will be sustained in the post-enlargement period.

Table 2: Independent variable – Full Membership

Status	**Country and Period**
Full Membership	Bulgaria 2007-09, Czech Republic 2004-09, Estonia 2004-09, Hungary 2004-09, Latvia 2004-09, Lithuania 2004-09, Poland 2004-09, Romania 2007-09, Slovakia 2004-09, Slovenia 2004-09

In the two regressions that follow I assign dummies to CEE candidate countries in accordance with the time periods outlined above. For the first independent variable, EU accession process, a country receives a 1 if in any given year it is at any stage of the EU candidacy process (if it has signed an association agreement with the EU, is conducting accession negotiations, or has signed a Treaty of Accession). For years that the country is not part of the process it receives a 0. For the second independent variable, full membership, a country receives a 1 for any year in which it is a full member of the Union. Conversely, for years preceding the year of accession it receives a 0. There are no overlapping years and the eight post-communist countries who joined in May 2004 receive a 1 for the entire 2004.

Control Variables and Alternative Explanations

In order to isolate the effects of the EU candidacy process and EU membership I refer to the academic literature on corruption to identify factors affecting corruption levels. Thus, the control variables included in the statistical analysis are: size of the public sector (government expenditure), level of economic development (GDP), level of economic competition (ratio of imports to GDP), level of democracy (Freedom in the World - average of political rights and civil liberties scores), freedom of the press, abundance of natural resources, neighboring and diffusion effects, and civil society.

Government Spending (General government final consumption expenditure as a percentage of GDP; United Nations Statistical Division)

Several studies, including LaPalombara (1994), Rijckeghem and Weber (1997), Elliott (1997), employ this measure and argue that the incidence of corruption may be related to the size of the public sector. Intuitively, a system entailing more frequent and extensive intervention of the state in the economy may introduce more opportunities for corruption.

Level of Economic Development (Log of GDP per capita; Economist Intelligence Unit, World Development Indicators)

Studies by Kaufman et al (1999), Poirson (1998) and Leite & Weidmann (1999), Sandholtz and Gray (2003), and Dearden (2000) have all confirmed the significance of economic growth for corruption levels. Although the causal story varies somewhat among low, middle and high-income countries, the effects of economic growth on corruption are unquestionable and it therefore seems appropriate to include the log of GDP per capita as a proxy for level of economic development in a given country.

Competition (Imports as a percentage of GDP; United Nations Statistical Division)

The intuition is that opportunities for corruption may increase due to the lack of competition in a national economy. This means that theoretically, more open economies must be less corrupt. Gerring and Thacker (2005) and Ades and Di Tella (1999) prove this correlation empirically by examining the precise relationship between trade openness and levels of political corruption. That is why using imports as a percentage of GDP (like Ades and Di Tella) to account for the level of competition in a national economy seems like a sensible choice.

Level of Democracy (Freedom in the World: average of political rights and civil liberties scores; Freedom House)

Montinola and Jackman (2002) present convincing evidence that democratic practices inhibit corruption especially after a threshold of democratic consolidation is passed. Boerzel, Stahn, and Pamuk (forthcoming) show that the level of corruption in the Eastern Europe is strongly connected to the success of democratic and economic reforms. Thus, I include the Freedom in the World index as a proxy for level of democracy.

Freedom of the Press (Freedom House)

Many scholars argue that the media may serve as a powerful check on corruption. Karklins (2005) finds that the media has proven to be one of the most effective promoters of anti-corrupt politics. Freille et al. (2005), in a 10-year panel study, find that restrictions on press freedom lead to higher levels of corruption. Holmes (2006) provides survey evidence on the effects of the media on public perceptions of corruption in Bulgaria, Hungary, Poland, Russia, and China and concludes that the media in these countries cover corruption extensively, provide most of the knowledge that the public has of corruption, and therefore heavily influences the public's perception of corruption in state institutions.

Abundance of Natural Resources (Production of minerals and utilities as a percentage of GDP; United Nations Statistical Division)

The intuition behind this variable is that abundance of natural resources may create opportunities for rent seeking and thus facilitate corrupt behavior. Leite and Weidemann (1999), Ades and Di Tella (1999), and Ross (2008) review such arguments and prove their statistical significance. For the purposes of this study I will use production of fuels and minerals as a share of GNP to proxy for abundance of natural resources.

Neighborhood and Diffusion Effects (Average corruption score of neighboring countries, as calculated from the World Bank's Control of Corruption index)

Controlling for neighborhood and diffusion effects is also a very good idea. Sandholtz and Gray (2003) argue that international interactions can affect norms and practices that one may think were determined by social and local factors. They focus specifically on corruption and show that corruption tends increase in countries surrounded by corrupt neighbors. Similar regional diffusion effects are also extensively explored in the international political economy literature by Simmons et all (2008).

Civil Society (Freedom House Nations in Transit)

Karklins (2005) makes the case that a strong a pluralist civil society can act as a barrier to corruption and that this is particularly the case in Eastern Europe. She looks at several examples (e.g. Lithuania, Bulgaria) and shows how the incorporation of nongovernmental organizations in anti-corruption programs made them more effective. Thus, I include the Freedom House Nations in Transit index for civil society in Eastern Europe as a proxy for the strength of the sector.[19]

Statistical Analysis and Results

Table 3 below presents the results of the time-series cross-sectional analyses utilizing a Fixed Effects Regression Model (FE). Fixed effects are particularly appropriate in studies like

[19] Due to data availability issues and the explicit theoretical relevance of this variable for Eastern Europe, I include it only in my third regression, where the sample includes only Eastern European states.

this, where unobservable country-specific characteristics and historical differences may affect the dependent variable in ways that the control variables by themselves cannot account for.

The table includes three models (Model 1, Model 2 and Model 3), the difference between which is the choice of the reference group – all countries from around the world in Model 1, the 27 EU countries in Model 2, and only the post-communist countries in Model 3.

Table 3: The Effects of EU Candidacy and Membership on Corruption Levels

Drivers	Model 1	Model 2	Model 3
EU Candidacy process	.089** (.056)	.173*** (.052)	.112 *** (.055)
Full Membership	.116** (.064)	.189*** (.063)	.106* (.065)
Level of Economic Development	.156** (.077)	.406* (.248)	.451*** (.137)
Neighbors' corruption	.093*** (.033)	.007 (.101)	.033 (.094)
Size of the Public sector	.438*** (.162)	-1.83*** (.586)	.009** (.004)
Competition	-.062 (.051)	-.126 (.169)	-.000 (.001)
Natural resources	-.421*** (.122)	-.196 (1.66)	-.003 (.003)
Level of democracy ("Freedom in the World" score)	-.068*** (.009)	.015 (.031)	.090*** (.023)
Freedom of the press	-.221*** (.073)	-.439** (.196)	-.002* (.001)
Civil Society	..	..	-.068** (.031)
Constant	-.289 (.292)	-.372 (1.03)	-1.71*** (.531)
R-squared	0.63	0.26	0.83
Number of Observations	1898	319	330

Standard errors in parentheses. Significant at: * 10%; ** 5%; *** 1%. One-tailed tests where appropriate.

In Model 1 the reference group to which post-communist candidate states are compared consists of the entire set of non-candidate countries. Here I test whether a country's inclusion in the EU candidacy process improves corruption levels in any way. Per Hypotheses 1 I expect that corruption declines while a country is part of the accession process. Per hypothesis 2 I expect that this trend remains unchanged after membership is attained.

The results of this analysis confirm both hypotheses. Relative to the base of non-candidate countries from around the world, CEE countries performed strongly, on average, (positive coefficient of .089) during the EU candidacy process. After accession, the candidate states did not experience backsliding (positive coefficient of .116). Thus, based on this analysis I can infer that the progress made during the accession process led to sound and sustainable results that continued to be present in the post-membership period. Six of the control variables, Level of Economic Development, Neighboring Corruption, Size of the Public Sector, Natural Resources, Level of Democracy, and Freedom of the Press were also found to be significant drivers of corruption levels. Although they are of no particular interest in the present study, these control variables have signs and levels of statistical significance broadly consistent with theory and prior studies. Incidentally, the negative coefficient on the freedom of the press variable is to be expected, since in this particular Freedom House assessment, higher scores correspond to less freedom. This is important because it also provides evidence to the claim that the high visibility of the issue of corruption created by the media allowed EU leverage to work even in this area which was not explicitly emphasized in the *acquis* or the Copenhagen criteria. The findings confirm the hypotheses that during the accession process corruption levels fall and that there is no backsliding even after membership has been obtained.

In Model 2 the reference group to which post-communist candidate states are compared consists of the other EU members. The results of this analysis also confirm both hypotheses. Relative to the base of old EU members, CEE countries performed strongly (positive coefficient of .173) and statistically significantly (p-value: 0.001) both during the EU candidacy process and after they attained membership (positive coefficient of .189 and p-value: 0.003). However, one has to be cautious with the interpretation of these results since old EU members had considerably lower levels of corruption to start with (hence less room and opportunities to improve). That is why it is not surprising that the CEE countries outperformed this base. Nevertheless, the results of this regression are important since they demonstrate that CEE countries are firmly set on a positive trajectory in their fight against corruption and are trying to catch up with their more developed and less corrupt Western European counterparts. Three of the control variables, Level of Economic Development, Size of the Public Sector, and Freedom of the Press were also found to be significant drivers of corruption levels.

Model 3 restricts the sample to the candidate countries plus the non-candidate post-communist states of the former Soviet bloc. The inclusion of this reference group serves a specific methodological goal – to separate the effect of the EU's incentive-based approach from the set of potential domestic issues associated with the post-communist transition period that all these countries were part of. The results of Model 3 are broadly consistent with the results of the previous two. Relative to the reference group of post-communist non-candidate states, candidate countries performed better both during the EU candidacy process and after membership, although the positive coefficient for the post-membership dummy is significant only at the 10 percent level. The lower significance level and the smaller coefficient here suggest an interesting dynamic. We cannot be as confident about the post-communist members' progress in corruption control when comparing them to their other post-communist peers. While these results refute a possible argument for backsliding, they provide some credence to the claim that as far as corruption is concerned there may be a slowdown in reform in the post-membership period. Five of the control variables, Level of Economic Development, Size of the Public Sector, Levels of Democracy, Freedom of the Press, and Civil Society were also found to be significant drivers of corruption levels. Thus, the findings of Model 3 also confirm both the hypotheses that before accession corruption would be falling and no backsliding will occur after membership but also suggest that there may be evidence of a slowdown in reform.

Causal Mechanisms

The purpose of this section is to trace the causal mechanisms through which the EU was able to influence the fight against corruption before and after accession. The question of pre-accession leverage is an important one since it both set the tone for the negotiations and delineated the set of expectations after membership was granted. In this period the Commission Regular Reports included detailed demands to fight corruption as well as recommendations on how this should be done. Responsiveness to these demands and recommendations was explicitly tied to a candidate's chances for membership. The more interesting question, however, is what mechanisms have prevented potential backsliding after accession when EU leverage became weaker. I argue that there are three mechanisms in play that compensate for the presumed loss of leverage after membership: continued leverage (Structural and Cohesion Funds and CVM reports), increased linkage (socialization effects), and spillover effects from other parts of the *acquis* (reduction of the role of the state in the economy and improvements in the legal system). While the first two have already been discussed in the literature, the third has yet not been addressed.

Focusing first on the period before accession, although not part of the *acquis* or the Copenhagen criteria, corruption became a recurrent theme in the Commission Regular Reports, which were becoming more detailed and specific as accession was approaching. This was partly due to the candidates' desire for more explicit targets and for assurances that they are meeting all membership criteria (Grabbe, 2006). By the early 2000s specific and detailed recommendations for anti-corruption measures had replaced the vague and formalistic statements of the earliest reports (Hughes, Sasse, Gordon, 2004). In fact, corruption had become such a salient issue that the EU built into Bulgaria and Romania's accession treaty a safeguard clause (Article 39) allowing for a delay of accession by one year in the event of insufficient progress in tackling corruption. Importantly, such strictness was not confined only to these more corrupt countries. The EU consistently noted the prevalence of corruption in Hungary and identified public procurement as an area of concern in both the 1999 and 2000 Regular Reports. The situation was similar in the 1999 Regular Report on Latvia and in the 2002 Regular Report on Poland asserting that corruption "threatens to undermine the functioning of many public spheres" (Regular Report, 2002). This is just a sample of several reports, but corruption was a central issue in many. Furthermore, the issuance of every report was followed by enormous publicity in the media, thus forging a significant level of domestic pressure for compliance as well. Thus, since corruption was clearly a highly visible and salient issue, EU leverage was substantial. In other words, the incentives for candidates to decrease levels of corruption during the accession period were high since this decrease was directly tied to their prospects of qualifying for membership.

After accession continued leverage, increased linkage and spillover effects resulting from the implementation of other parts of the acquis compensated for the diminished leverage of the EU. First of all, new members became eligible for significant amounts of Structural and Cohesion Funds (S&C) (about one-third of the EU budget). These members' dependence on conditional EU funding (which could be cut off in cases of non-compliance as it happened in Bulgaria), therefore, continued to promote governance reforms. Furthermore, in the cases of Bulgaria and Romania a Cooperation and Verification Mechanism (CVM) was instituted to ensure that both countries comply with their commitments. Progress in fighting corruption was always a special focus in these reports. To elaborate on how the leverage of S&C funds translates into pressure for reform, I will now turn to a brief case-specific discussion of Bulgaria and Romania.

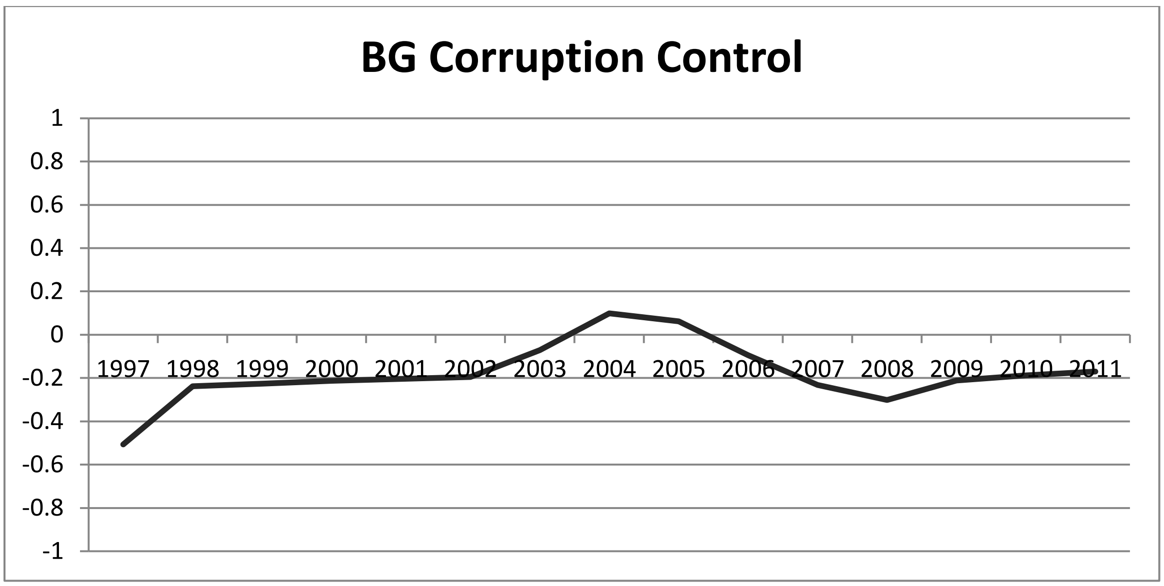
In response to a corruption scandal in Bulgaria with two officials of the National Road Agency in January 2008, the Commission exercised its post-accession leverage by cutting off funding for road construction. Importantly, the investigation was initiated by a scathing article in Bulgaria's leading business newspaper, *Kapital*. In February and March the Commission froze PHARE and SAPARD funding in light of more corruption allegations in the ministries of finance and regional development. As a result of its failure to address its looming corruption, Bulgaria ended up with two ministerial resignations, an irreversible loss of 220 and a freezing of 340 million Euros.

Although the 340 million were later on unfrozen, Bulgarian authorities, and most specifically the new Prime Minister Boiko Borissov realized that the time to "wage a full-scale war" on corruption had arrived. In early 2010 during operation "Octopus" ("Октопод") the government was able to expose and arrest high ranking public officials (associated with the State Agency for National Security with jurisdictions to fight corruption) involved in money laundering, tax evasion and siphoning money from a now-defunct steelmaker, among other allegations (Liubomirska, 2010). A few months earlier during the operation "Impudence" ("Наглите") the Borissov government was able to deal a major blow against organized crime by arresting a number of mafia members involved in kidnappings, contract killings, and trafficking.

In 2007 the Commission threatened to freeze agricultural funds to Romania unless the country filled some corruption-inducing gaps in its payments system. Reforms were quickly implemented and allegations of corruption led to the resignation of Romania's justice minister Tudor Chiuariu two months later (Ivanov forthcoming). All these developments where closely and extensively covered by a series of EU monitoring reports and the media, which criticized Bulgaria and Romania and called for more intense efforts to curb corruption (CVM Reports June

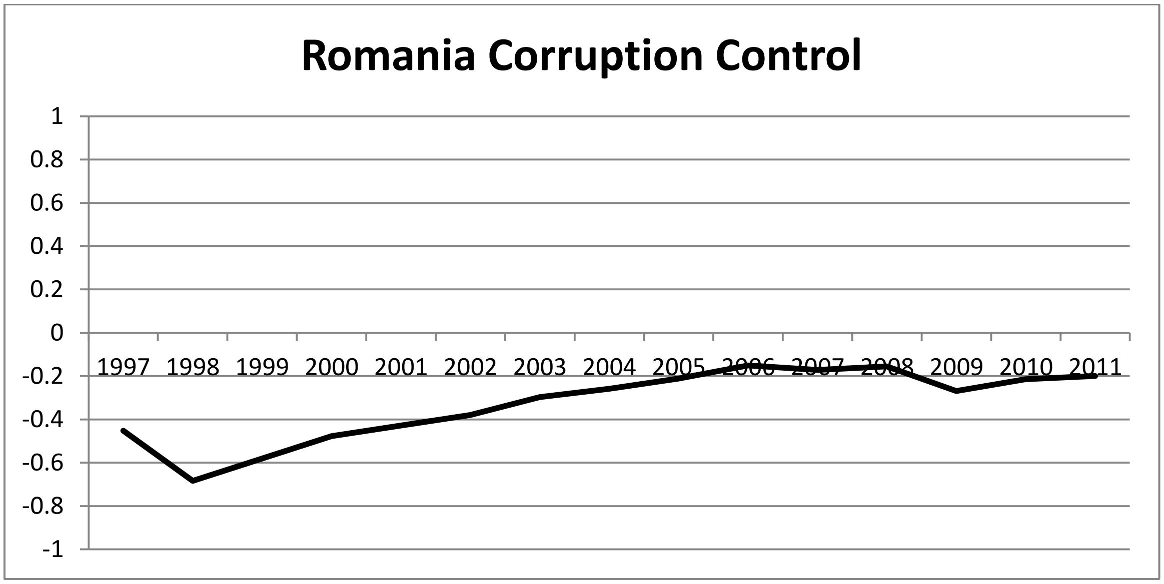
2007; February 2008; July 2008). Even so, one should note that corruption control in Bulgaria and Romania has only slightly improved in the post-accession period and basically remained steady. This suggests that continued EU leverage in the form of conditional funding and CVMs may at best be considered as an effective containment strategy.

Figure 2: Corruption in Bulgaria 1997-2011



Source: Control of Corruption Index 1997-2011, World Bank. Available at: http://info.worldbank.org/governance/wgi/index.aspx#doc (accessed on July 17, 2014).

Figure 2.1: Corruption in Romania 1997-2011



Source: Control of Corruption Index 1997-2011, World Bank. Available at: http://info.worldbank.org/governance/wgi/index.aspx#doc (accessed on July 17, 2014).

The second post-accession mechanism that translates EU influence into domestic changes is the diffusion of democratic norms and values. This includes increasing linkages between new and old EU members, exemplified in more travel and work opportunities in the West for CEE citizens, greater mass media exposure, more joint-business ventures etc, all contributing to greater expectations for good governance (Levitz and Pop-Eleches, 2010). In a study focusing specifically on the lack of new EU members' backsliding along an array of indicators Levitz and Pop-Eleches find a strong negative correlation between international travel and share of CEE citizens living in Western Europe and corruption levels. These findings strongly align with the growing literature on socialization effects (Checkel, 2005; Gheciu, 2005; Epstein and Seledmeier, 2008).

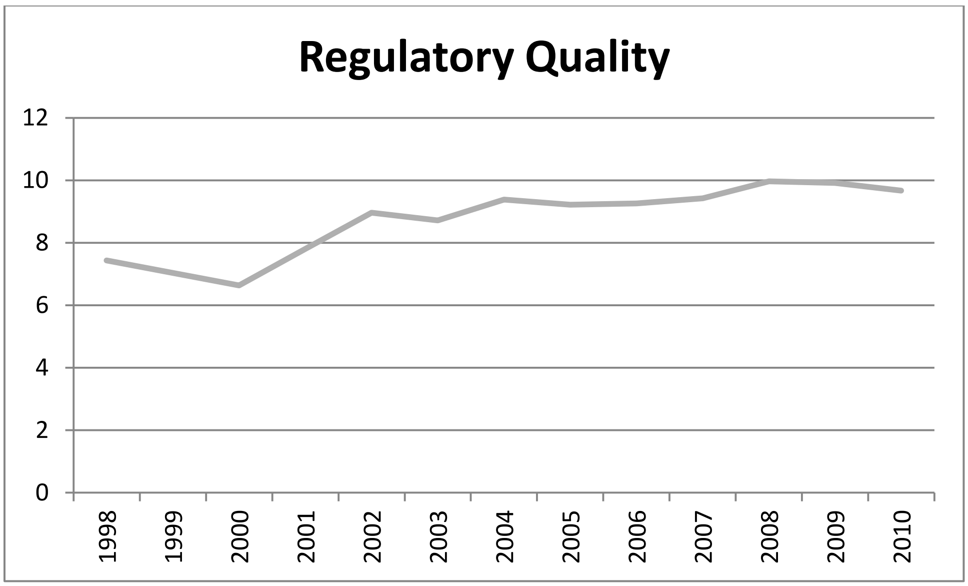
In explaining the puzzling lack of backsliding in CEE countries, Sedelmeier suggests focusing on the "greater susceptibility of the new member states to shaming" (Sedelmeier, 2008, p.806). He argues that extended linkages with the West could have made CEE citizens more sensitive about public shaming and more demanding as far as compliance goes through a process of socialization. Levitz and Pop-Eleches add to this argument by empirically showing that East Europeans working and traveling abroad are steadily turning into an electorate with higher expectations about the rule of law and corruption standards, thus exerting an important positive impact on the political culture in their home countries.

The third mechanism explaining the lack of backsliding in corruption levels after accession can be attributed to spillover effects from the gradual removal of the state from the economy, from stricter and more effective regulatory institutions, and from improvements in the legal system as a result of the implementation of the *acquis*. Using descriptive statistics from the World Bank, I show that the governments in the 10 post-communist countries that joined the EU in 2004 and 2007 have decreased their spending as a percentage of GDP, have encouraged privatization and the growth of the private sector, and have improved the quality of the civil service, the police and the courts. All these developments either limit opportunities for corruption or make it easier for state institutions to combat it more effectively.

In all of the figures that follow, the ten post-communist countries that are depicted are: Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, and Slovenia. Figure 3 pertains to the diminishing role of the state in the economy and figures 4 and 5 pertain to the evolution of more effective regulatory institutions and an improved legal system.

Figure 3 below shows a constant improvement in the ability of the government to formulate and implement policies and regulations that permit and promote private sector development since the early 2000s.

Figure 3: Government Promotion of Private Sector Development

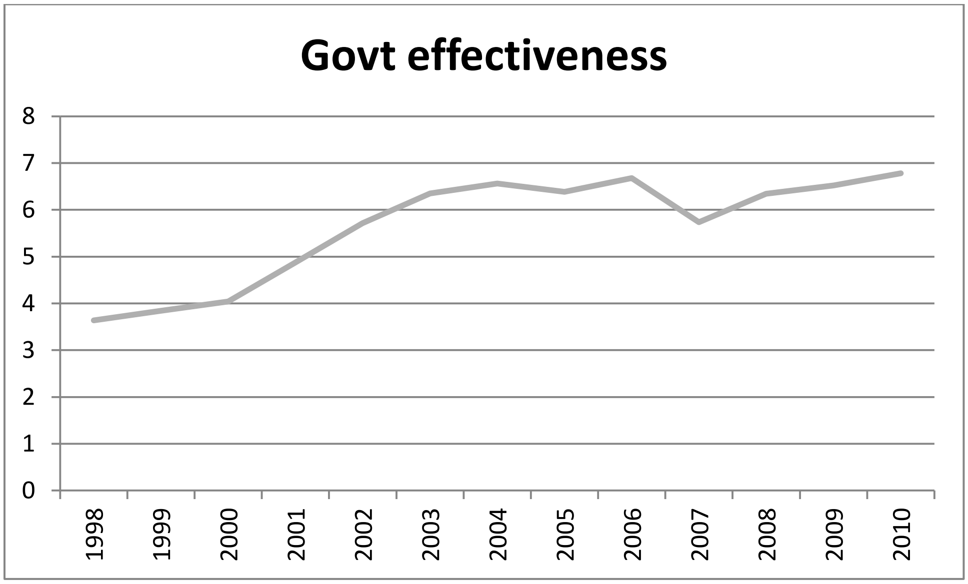


Source: World Government Indicators (WGI) 1998-2010, World Bank. Available at http://info.worldbank.org/governance/wgi/index.asp (accessed on July 17, 2014).

Figure 3 suggests that the role of the state in the economy has undergone a considerable reduction since the early 2000s. This conclusion is not surprising given the EU's emphasis on the privatization of state owned enterprises, the reduction of price regulation, and the decrease of subsidies. These policy prescriptions followed from the criticisms included in the Regular Reports produced by the Commission and also reflect specific targets and objectives from several of the chapters of the *acquis*. Chapter 6, *Competition Policy*, covers both anti-trust and state aid control policies. It includes rules and procedures to fight anti-competitive behavior by companies and to prevent governments from granting state aid which distorts competition in the internal market. Related to this, Chapter 11, *Economic and Monetary Policy*, contains specific rules prohibiting privileged access of the public sector to financial institutions. Finally, chapters 15, *Industrial Policy*, and 16, *Small and Medium-sized Enterprises*, promote privatization and industrial strategies enhancing internal and external competitiveness. Thus, given that the implementation of these chapters preceded, for the most part, the periods when we observe less state subsidies and better promotion of private sector development, it is likely that it was precisely the development of these EU-driven institutional capacities that played a key role in generating the observed outcomes.

Figure 4 below shows an improving trend in the quality of public and civil services and the degree of their independence from political pressures as well as the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies since the mid-1990s. A brief reversal of the trend occurs after the 2007 enlargement but its positive trajectory is restored the following year.

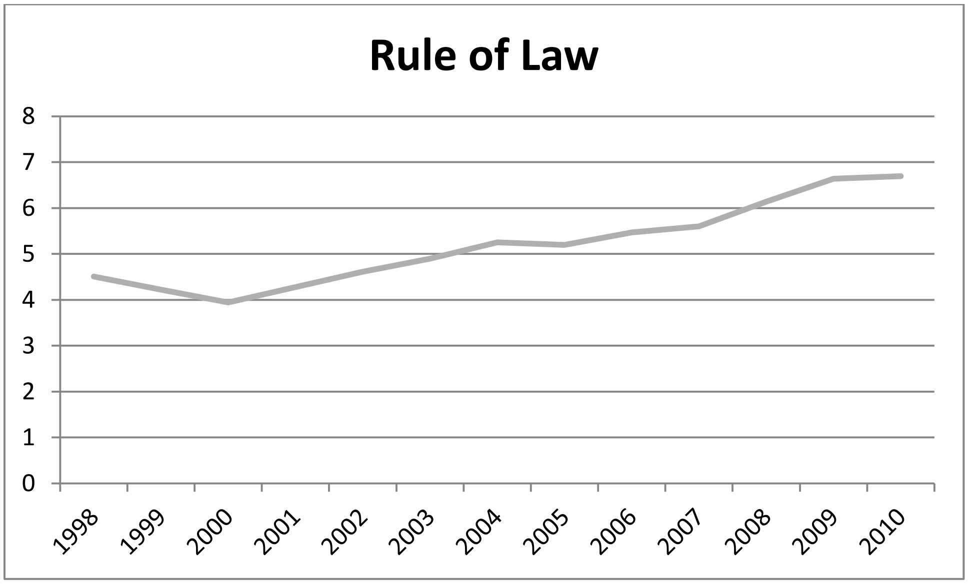
Figure 4: Quality of Public and Civil Service



Source: World Government Indicators (WGI) 1998-2010, World Bank. Available at http://info.worldbank.org/governance/wgi/index.asp (accessed on July 17, 2014).

Figure 5 below also shows an improving trend in the level of confidence that societal actors have in the quality of the police and the courts. The trend becomes even more pronounced after the 2007 enlargement.

Figure 5: Quality of the Police and the Courts



Source: World Government Indicators (WGI) 1998-2010, World Bank. Available at http://info.worldbank.org/governance/wgi/index.asp (accessed on July 17, 2014).

Focusing on government effectiveness and the quality of civil and public service, the adoption of the *acquis* governing the internal market and other common policies (in particular, environment, labor relations, agriculture, transport and energy) represented a massive re-regulatory exercise in these countries. The removal of regulatory differences between the member states in the Single Market was paralleled by a transformation of regulatory standards, i.e. setting EU wide common standards and practices, which in most cases meant a significant improvement in the effectiveness and quality of the work of state agencies in the post-communist members.

As far as the quality of the police and courts is concerned, Chapter 24 of the *acquis*, *Cooperation in the field of Justice and Home Affairs*, emphasizes the establishment of an independent and efficient judiciary combined with a firm commitment devoting adequate financial resources and training to employees of the judicial system. Again, therefore, improvements in civil and public services and in the judiciary can be attributed to the implementation of the *acquis*.

To sum up, before accession, CEE leaders had strong incentives to try to curb corruption since it was a highly salient issue specifically emphasized in the Commission Regular Reports. The asymmetric power relationship between the EU and the candidate members allowed the EU to effectively use its leverage to induce change even in areas that were not formally in the *acquis* or the Copenhagen criteria, such as corruption. After accession, the relative loss of leverage was compensated by three mechanisms which sustained the pressure for reform and prevented backsliding: continued leverage (Structural and Cohesion Funds and CVM reports), increased linkage (socialization effects), and spillover effects (reduction of the role of the state in the economy and improvements in the legal system) from implementing the *acquis* in other areas.

Conclusion

This article's contributions to the larger literature on corruption in post-communist societies fall in two substantive areas: establishing a causal link between EU candidacy and corruption levels and exploring the mechanisms through which corruption challenges are addressed. Regarding the first, this study empirically demonstrates that EU candidacy has a unique and positive impact on corruption levels in acceding members. Although corruption was neither part of the *acquis* nor of the Copenhagen criteria, it was an issue that received a lot of visibility in the CEE countries during the accession period through the Commission Regular Reports. Taking advantage of its leverage, the EU was able to demand reforms going beyond the scope of the *acquis* that served to curb corruption levels during this time. Importantly, as demonstrated by the time series analyses, absolute gains in the fight against corruption were not negated after accession (though there may be evidence for a slowdown). These findings support the arguments against backsliding (Pop- Eleches and Levitz 2010) and cast doubt on studies suggesting that lack of density of formal rules (Jacoby 2004) or lack of explicit conditionality (Epstein and Sedelmeier 2008) negatively affects the success of reforms.

The second important contribution of this study is that it has identified and explored three causal mechanisms that compensated for the relative loss of leverage in the post-accession period and prevented backsliding. While the first two are already familiar in the literature, the third one, "acquis spillover," is new and unique and is worthy of further exploration. The theory behind the three post-accession causal mechanisms goes as follows. First, the EU was able to continue to exert some leverage and thus sustain pressure for reform through the threat of cutting off conditional funding in cases of non-compliance. Having acted on this threat once, in the case of Bulgaria, the EU demonstrated that this was a real and credible punishment mechanism, which it can use if serious violations are uncovered. Second, increased linkages between Western and Eastern Europe, exemplified in the number of people traveling and working in the West, led to the gradual emergence of an electorate of more "europeanized" CEE citizens with higher expectations about the rule of law and corruption. Such socialization effects serve as the silent underpinnings of a new political culture, one that holds politicians to higher standards and demands good governance at all costs. As opinion polls have indicated, Central and Eastern Europeans are a lot more pro-EU than their Western European counterparts and are therefore unwilling to risk marginalization with respect to the EU for lack of compliance. Third, spillover effects associated with the reduction of the role of the state in the economy and improvements in the legal system and the strengthened effectiveness of regulatory institutions as a result of the implementation of the *acquis* either limit opportunities for corruption or allow for more conducive conditions to tackle it. Further research is needed to flesh out the exact causality of these three mechanisms.

Nevertheless, absolute improvements in corruption levels in CEE countries do not necessarily mean that a bright future is inevitable. These countries still remain much more corrupt than the Western European members and corruption continues to undermine economic progress and the citizens' faith in the democratic system. That is why pressure for reform from the EU should persist, especially in the context of the potential slowdown or stasis in the post-accession period.

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APPENDIX A: Variable measurement and Descriptive Statistics

Table A.1: Variable Measurement

EU candidacy	A country is assigned a 1 if it has signed an association agreement with the EU but not yet entered into accession negotiations; 0 otherwise. Source: Author.
EU Membership	A country is assigned a 1 if a it has become a full member of the Union; 0 otherwise Source: Author.
Corruption Control	The Control of Corruption Index (one of the six World Governance Indicators (WGI)). The Control of Corruption Index is a composite governance indicator based on 32 underlying data sources. These data sources are rescaled and combined to create an aggregate using an unobserved components model (UCM). The UCM assumes that the observed data from each source are a linear function of the unobserved level of governance, plus an error term. This linear function is different for different data sources, and so corrects for the remaining non-comparability of units of the rescaled data noted above. The resulting estimates of governance are a weighted average of the data from each source, with weights reflecting the pattern of correlation among data sources. The UCM assigns greater weight to data sources that tend to be more strongly correlated with each other. While this weighting improves the statistical precision of the aggregate indicators, it typically does not affect very much the ranking of countries on the aggregate indicators. The composite measures of corruption control generated by the UCM are in units of a standard normal distribution, with mean zero, standard deviation of one, and running from approximately -2.5 to 2.5, with higher values

	corresponding to better outcomes. The measure is useful as a tool for broad cross-country comparisons and for evaluating broad trends over time. Source: World Bank: http://info.worldbank.org/governance/wgi/index.aspx#doc, accessed in July 2014.
Level of Economic Development	Log of GDP per capita. GDP is expressed in current U.S. dollars per person. Data are derived by first converting GDP in national currency to U.S. dollars and then dividing it by total population. Source: Economist Intelligence Unit, World Development Indicators.
Competition	Imports as a percentage of GDP. Source: United Nations Statistical Division
Neighbor's corruption	Average corruption score of neighboring countries, as calculated from the World Bank's Control of Corruption index. Source: Author.
Level of Democracy	Average of political rights and civil liberties scores in Freedom House's "Freedom in the World" report. Political rights enable people to participate freely in the political process, including the right to vote freely for distinct alternatives in legitimate elections, compete for public office, join political parties and organizations, and elect representatives who have a decisive impact on public policies and are accountable to the electorate. Civil liberties allow for the freedoms of expression and belief, associational and organizational rights, rule of law, and personal autonomy without interference from the state. Each country and territory is assigned a numerical rating—on a scale of 1 to 7—for political rights and an analogous rating for civil liberties; a rating of 1 indicates the highest

	degree of freedom and 7 the lowest level of freedom. Source: Freedom House: https://www.freedomhouse.org/report-types/freedom-world#.VKlrkivF93E, accessed in December 2014.
Size of the Public Sector	General government final consumption expenditure as a percentage of GDP. Source: United Nations Statistical Division.
Freedom of the Press	Score on Freedom House's "Freedom of the Press" report. The *Freedom of the Press* index, an annual survey of media independence in 197 countries and territories, is at the core of Freedom House's press freedom project. The index assesses the degree of print, broadcast, and internet freedom in every country in the world, analyzing the events of each calendar year. It provides numerical rankings and rates each country's media as "Free," "Partly Free," or "Not Free", so higher scores correspond to less freedom Source: Freedom House: https://www.freedomhouse.org/report-types/freedom-press#.VKloGyvF93E, accessed in November 2014.
Abundance of Natural Resources	Production of minerals and utilities as a percentage of GDP Source: United Nations Statistical Division.
Civil Society Weakness	The Freedom House Civil Society Index. The index assesses the growth of nongovernmental organizations (NGOs), their organizational capacity and financial sustainability, and the legal and political environment in which they function; the development of free trade unions; and interest group participation in the policy process. The ratings are based on a scale of 1 to 7, with 1 representing

the highest and 7 the lowest level of civil society strength. They follow a quarter-point scale. Minor to moderate developments typically warrant a positive or negative change of a quarter point (0.25), while significant developments warrant a half point (0.50). It is rare for any category to fluctuate more than a half point in a single year. Source: Freedom House: https://www.freedomhouse.org/report/nations-transit/nations-transit-2014#.VJnSNF4Co, accessed in July 2014.

Table A.2: Descriptive Statistics

Measure/Variable	Observations	Mean	Std. Dev.	Min	Max
Corruption Control	2061	(0.05)	0.99	(2.09)	2.60
EU candidacy	2088	0.06	0.24	-	1.00
EU membership	2088	0.02	0.14	-	1.00
Neghbor's corruption	2072	(0.12)	0.79	(1.59)	2.36
Level of Economic Development	2088	3.69	0.57	2.16	4.89
Size of the Public Sector	2088	0.17	0.08	0.03	0.68
Natural Resources	2088	0.10	0.14	-	0.88
Competition	2088	0.47	0.25	-	2.16
Level of Democracy	2088	3.49	1.94	1.00	7.00
Freedom of the Press	2088	0.47	0.24	0.05	1.00
Civil Society Weakness	360	2.55	0.77	1.25	7.00

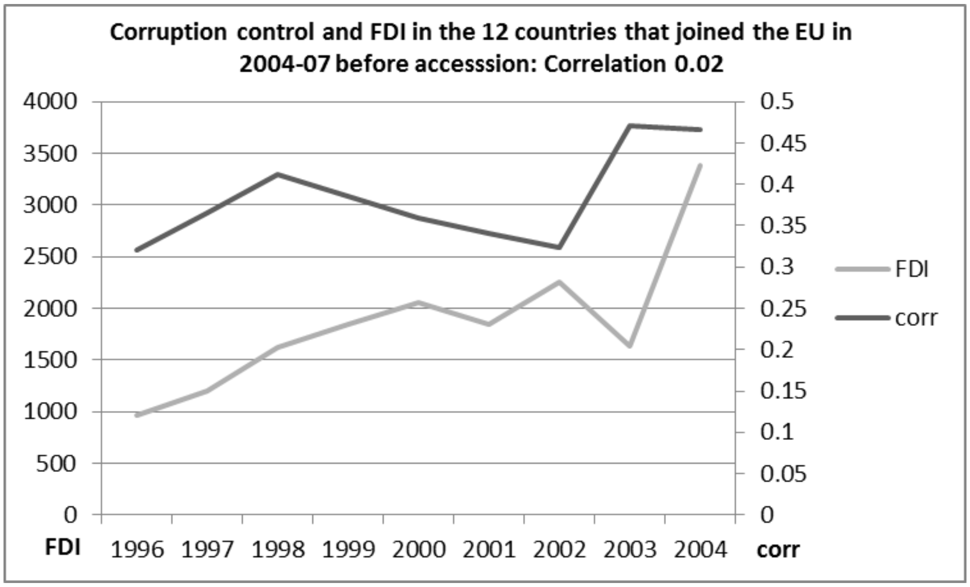
Chapter IV: Beneath the Veil of Hope: The effects of EU signaling on foreign investors' sensitivity to corruption before and after EU membership

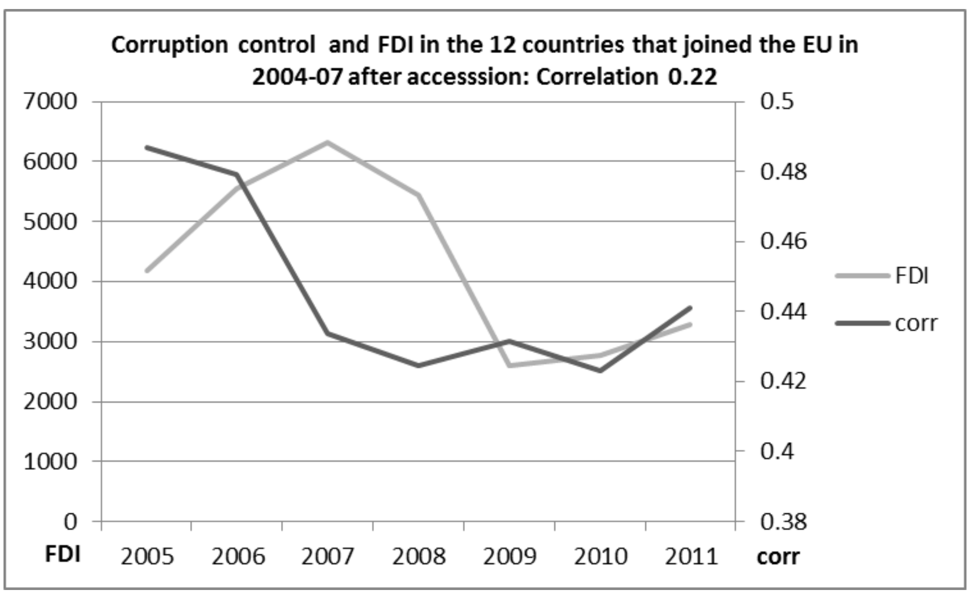
The literature on the effects of corruption on Foreign Direct Investment (FDI) does not point to a conclusive causal logic. Some studies show that high corruption discourages FDI since it is perceived as an additional tax on doing business. Others suggest that it is irrelevant and other factors matter more. Still others argue that it can actually help FDI since it "greases the wheels" of the system. Looking at the relationship between corruption and FDI in the context of the 12 countries (ten of them post-communist) which joined the EU in 2004-07 one can make a puzzling observation (Figure 1). During the pre-accession phase, despite the fact that corruption control was poor over long periods, FDI kept steadily increasing. Post-membership, however, deteriorating corruption control was punished by foreign investors and corruption and FDI were more closely correlated. Why did investors shift from disregarding it to being sensitive to it? In light of the established effect of EU signaling[20] on investor confidence in Central and Eastern Europe (CEE) (Bevan and Estrin, 2000; Gray, 2009), I hypothesize that (1) positive signaling during the pre-accession process trumped other important factors for FDI, such as corruption; (2) these factors then resurfaced after membership was granted (and signaling was over) and had the expected impact on investor confidence.[21]

[20] Positive, public announcements by the EU signifying the closing of accession chapters and the moving along the process towards full membership

[21] The slowdown (or lack of growth) of FDI after accession is unlikely to be the result of saturation effects, the possibility that the majority of the opportunities are already captured and there in little more room for investment. For example, in spite of the large stock of FDI that has entered CEE to date, on a per capita basis this stock is in fact

Figure 1: Corruption Control and FDI in the 12 countries that joined the EU in 2004-07





not great when compared with other European nations or the EU's average. Only Malta and Cyprus have FDI stock per capita that is higher than the EU's average. For more information, see Appendix C (United Nations Conference on Trade and Development).

Correlation coefficient before accession: 0.02. Correlation coefficient after accession 0.22. (World Bank's World Governance Indicators, United Nations Conference on Trade and Development)

I base this intuition on works on institutional signaling and cognitive psychology. Julia Gray (2009) shows that signaling alone, rather than *real* policy reform, can account for increased investor confidence when looking at spreads on sovereign debt. I use this argument and extend it by suggesting that (1) positive signaling can also mask slow (or insufficient) reform and (2) once signaling is over, investor guidebook consideration again become important for economic decision makers and they punish countries that lag behind or backslide. In other words, when signaling is gone, *real* performance matters. In constructing these arguments I also refer to the literature on how inferential shortcuts, such as the availability heuristic, help people process complicated information and navigate uncertainty (e.g. as the one prevalent in information-scarce environments like the non-OECD countries) (Gilovich, Griffin, and Kahneman, 2002). Despite its numerous practical uses, the availability heuristic may cause decision-makers to overestimate the significance of events that tend to be particularly memorable or vivid, such as a positive endorsement by a powerful international institution like the EU. This may in turn affect their risk-versus-reward calculus and make them less risk-averse.

To test my hypotheses I use a mixed method approach. First, I run a time-series analysis covering data from 1996 to 2011 to establish that corruption did not have a significant impact on FDI before accession but did afterwards. Then, I present the results of an expert survey and a brief case study to demonstrate how signaling caused investors to be less risk-averse prior to EU membership by activating a specific psychological mechanisms, namely the availability heuristic. There are two main contributions that I make to the literatures on international institutions, FDI, and corruption. First, I show that corruption matters for FDI differently in different contexts and while it has a clear negative effect when rational guidebook principles dominate decision-making, its significance could be muted by positive signaling by international institutions, such as the EU. Second, I suggest that cognitive shortcuts, such as the availability heuristic, help explain foreign investor's behavior when investors operate in information-scarce environments as they tend to assign disproportionate weight to signals perceived as legitimate.

The rest of this article is organized as follows. First, I review the literatures on EU integration and FDI and corruption and FDI and explain how my arguments and findings contribute to both. Second, I outline the theoretical background informing my hypotheses. Third, I explain my methodological approach, discuss some of the difficulties associated with it, and present the results from the time series analysis, the survey, and the case study. I end by summarizing my contributions to the academic literatures on FDI, EU signaling, and corruption

EU accession, corruption, and FDI

By focusing on corruption and progress towards EU accession, this article contributes to the wide literature on the impact of EU integration on FDI flows. This section outlines the main findings in this literature and explains how my arguments fill some of the existing gaps.

The positive effect of the EU on the quality of the investment climate in a country is well-established. Several studies have found that joining the EU has been beneficial for Western European countries attracting FDI. Similarly, others have explored the CEE countries and have established that the prospect of membership has led to increased FDI inflows. What the literature on EU integration and FDI has not addressed so far is whether FDI flows to new member states continue to be influenced by the same drivers after accession as the ones that mattered before. Numerous challenges associated with the legacy of communism (corruption, state ownership, less stable banking sector) suggest that the dynamic in Eastern Europe, once EU leverage and signaling are gone, can make these countries more susceptible to regression or slowdown. If this is true, foreign investors in the region should have a higher threshold of fundamental justifications for their decisions after accession. No academic study so far has explored this possibility.

This section outlines some of the key arguments and findings about the effects of European integration on FDI in Western Europe. After the foundation of the EU, a notable increase of intra- and inter-regional FDI flows was observed among the member countries. Barry (2002), for example, shows that Ireland has experienced a significant FDI boom after its EU accession in 1973. In this study he traces how a number of US-based MNCs have chosen Ireland as their starting point to expand in Europe. He further demonstrates that FDI has contributed to economic growth, better export sector performance, the reduction of unemployment, and the development of the high-tech sector. Similarly, Barrios (2002) investigates the effects of EU integration on the Spanish economy since its accession in 1986 and calls this story the "Spanish Economic Miracle". He finds that the high FDI inflows resulting from the EU integration process have been responsible for the strong economic performance of the country. Galego (2002) makes a similar contribution to the literature showing that Austria, Finland and Sweden, who joined the EU in 1995, have since also became more attractive to foreign investors and are actually the main destination for FDI in the EU. Importantly, these studies are confined to the Western European context, explore only the effect of membership rather than the process of accession, and claim that membership brings more FDI to new members. My study suggests that membership in the context of the 5^{th} enlargement may have actually raised the bar for FDI in CEE from the perspective of investors.

Many authors have also researched the effects of the EU integration process on FDI flows into CEE candidate countries. While these are more directly related to the research question this study poses, they have focused mainly on the accession process, rather than to what happens after membership. Bevan and Estrin (2000), for example, specifically analyze the impact of the early accession process on FDI flows into the CEE countries and find out that the Essen Council announcement (1994) was associated with a significant increase of FDI received by the three most likely candidates for EU accession (Hungary, Poland, and the Czech Republic). Similarly, Claessens, Oks and Polastri (1998) examined capital flows to 21 transition countries over the 1990s and determined that countries that applied for EU membership attracted more FDI. Finally, Kaminski (2001) compares FDI inflows between CEE countries and former Soviet republics and concludes that the possibility of and progression towards EU accession explains the high level of divergence in FDI inflows between these groups. Although these studies do not address the effect of EU membership on FDI in CEE, they clearly demonstrate that signaling during the accession period is key to FDI inflows. My study confirms this finding by focusing on a longer period (1996 to 2011), but also takes this a step further and argues that signaling may cause investors to temporarily discount other important factors through the availability heuristic.

Finally, my arguments also contribute to the literature on the effects of corruption on FDI. The level of corruption in the host country has been introduced as one factor among the determinants of FDI location since it is perceived as a source of uncertainty and an additional cost of doing business or a tax on profits (Al-Sadiq, 2009; Bardhan, 1997). Thus, countries with lower corruption attract more per capita FDI (Abed and Davoodi, 2000). An array of other studies confirm this finding (Wei and Wu, 2001; Lambsdorff and Cornelius, 2000; and Wei, 2000). Importantly, corruption also discourages FDI indirectly by adversely affecting other conditions that matter for investors. It has a negative effect on the level of investment and economic growth (Mauro, 1995), on the quality of infrastructure and productivity of public investment (Tanzi and Davoodi, 1997), on income inequality (Li, Xu and Zou, 2000), and on health care and education services (Gupta, Davoodi and Tiongson, 2000). All those factors affect investors' perceptions of stability and profitability, thus making them less likely to engage in FDI activity.

Nevertheless, several studies fail to confirm the claim that corruption affects FDI negatively. Wheeler and Mody (1992) and Akcay (2001) find no evidence of a negative relationship between corruption and FDI. Wheeler and Mody combined corruption with 12 other indicators to form a latent variable and Akcay focused only on developing countries. Given these differences in their methodological approach, it is not surprising why their results were different. My study contributes to the debate on the effects of corruption on FDI, by introducing an argument as to when it may and when it may not matter, thus providing a more nuanced view to the question.

There has been plenty of work on how the EU affects FDI levels for acceding members and how corruption affects FDI in general. However, no study has so far attempted to evaluate whether EU signaling can mute the effect of corruption temporarily, but then allow it to resurface as markets realize that the EU's pre-accession process has not addressed the problem in a systemic way. It is this main argument that I contribute to the literatures on EU enlargement, FDI and corruption.

Theoretical Framework

This section explores the theory behind institutional signaling from which I derive my hypotheses about the differential effect of corruption on FDI before and after accession. It is organized in three parts. First, I briefly explain how joining an international institution increases investor confidence by reducing uncertainty. Then, I review some of the social and cognitive psychology literature on how signaling affects behavior and explain why certain signaling may sometimes lead to overconfidence. Third, I explain how the EU's eastern enlargement is a particularly good test case for examining whether positive signaling can mute the importance of other factors, such as corruption.

A lot of the literature on international institutions claims that they can reduce uncertainty (Axelrod, 1981; Keohane, 1984; Koremenos, Lipson, and Snidal, 2001; Morrow, 1994; North, 1990). The main argument in these studies is that by imposing rules and requirements, international institutions regularize members' future behavior resulting in more predictable interactions between members. Similarly, institutions increase the costs of non-compliance as violations of commitments damage a country's reputation and make further cooperation difficult or impossible (Abbott and Snidal, 2000, 427; Simmons, 2000, 594). Therefore, it will not be surprising if investors respond positively to positive signals regarding candidate countries' progress towards joining an institution like the EU. Moreover, EU conditionality covers an array of economic issues that can make the investment climate in these countries more stable and predictable, thus strengthening investor trust even more. In this way, good news about countries closing chapters and moving forward encourages investors. In their attempt to capture a first-mover advantage and be ahead of the competition, they may then pay less attention to certain fundamentals (e.g. progress against corruption).

This is also consistent with a strand in the cognitive and social psychology literature (Kahneman, Slovic, and Tversky, 1982; Gilovich, Griffin, and Kahneman, 2002) which argues that actors rely on inferential shortcuts, such as the availability heuristic, to streamline the processing of overabundant information and navigate uncertainty. The availability heuristic causes people to assign disproportionately higher weight to events that tend to be particularly striking or vivid, such as the positive signaling of a powerful international institution like the EU, and to overestimate their significance, especially if others are doing it too. The prominent example of this heuristic is how drivers react to seeing an accident. In this moment the inferential logic of bounded rationality activates, and they slow down. Based on limited but vivid data they exaggerate the statistical likelihood of crashing and conform to the appropriate speed limit. As time passes and no more car crashes are observed, the drivers' comprehensive rationality kicks back in and provides a more accurate estimate of the probability of an accident, causing them to speed up again. Similarly, faced with a decision-theoretic problem, investors in the pre-accession stage assigned a greater (than warranted) weight to announcements by the EU which enjoyed high levels of publicity and perceived credibility. With positive signaling out of the picture in the post-accession period, the return of comprehensive rational analysis meant that investors would then once again pay due attention to all factors that should matter for their decisions (e.g. corruption).

At the same time, in information-scarce environments, such as non-OECD countries, markets pay special attention to events that can be "easily and uniformly interpreted," visible acts, such as joining an international institution (Gray, 2009; Rodrik, 1989). Bordo and Rockoff (1996) argue that signing onto the gold standard in the nineteenth century served as an endorsement for developing countries. Moreover, the authors show that markets validated close shadowing of the standard almost as much as actual adherence to it. This implies that policy change influenced investors less than nominal membership (Gray, 2009). Thus, one could speculate that it may have been possible for investors to be less concerned with actual reforms than with these countries' "progression" towards the risk-minimizing international institution.

Thinking about corruption in CEE, this may be especially relevant. None of the 31 chapters of the acquis or the Copenhagen criteria focused explicitly on corruption and compliance tends to be the weakest in the areas where no explicit conditionality was applied (Epstein and Sedelmeier, 2008). Thus, corruption should have been an important factor for foreign investors both during the pre-accession process and after. Nevertheless, it is likely that, by the logic of the availability heuristic, they might have overlooked its importance, focusing instead on the positive signals from the EU allowing countries to advance in their negotiations. Julia Gray provides some background to this intuition. She finds that it was not actual policy reform that underpinned investor confidence in terms of spreads on sovereign debt, but merely positive signaling from the EU. Thus, while some of these countries were perhaps not accomplishing enough in terms of corruption control, this was compensated for by their moving further along the pre-accession process. Once membership was granted, real performance regained its relevance and centrality. There are, of course, many other factors that could account for this investor behavior. Lower labor costs before accession and rising wages after, the financial crisis of 2008, or lack of reform in other areas certainly also played a part in first encouraging and then discouraging investors after accession. My research design, however, controls for the independent effects of these factors and isolates the unique effect of corruption.

In terms of case selection, the 5th enlargement is a particularly appropriate setting for examining the effect of institutional signaling on investor confidence. First, although these countries had different levels of wealth and economic conditions in the 1990s, they all (except Cyprus and Malta) emerged from planned economies and needed to undertake a similar set of policy reforms around the same time (Pridham, 2005). Secondly, given that they all represented poorer and politically diverse countries, convinced of the economic necessity EU membership, the EU was able to exercise a stronger and more comprehensive conditionality on them as opposed to previous rounds (Vachudova, 2005) adding credibility to its signaling. Last, Brussels applied ex ante conditionality to the aspiring states and monitored their progress closely by *publicly* assessing their efforts (Vachudova, 2005). Thus, the eastern enlargement constitutes a convenient framework to test whether signaling can sometimes cause investors to discount otherwise important factors, such as corruption.

At the same time it is possible that it is exactly because of the "asymmetrical interdependence" between the CEE countries and the EU that EU signaling may have been perceived as more powerful than it would be in other contexts. There was hardly any aspect of public or private life that remained untouched during the conditionality period. Total overhaul is not easy in an environment of falling incomes, weak institutional capacity, and insufficient familiarity with modern practices. In such a difficult and all-encompassing effort, it was inevitable that the CEE countries would falter in some aspects of reform – and it therefore made sense to seek the expert help of the EU. For example, Bulgaria, which experienced a hyperinflation crisis in 1996-97 decided to implement a currency board and deliberately surrender the conduct of monetary policy to the Bundesbank and, later, the European Central Bank. The point here is that countries not undergoing complete systemic change may be less in need of EU help and expertise and therefore less responsive to EU conditionality than the CEE countries were. In such cases EU signaling may not represent such a meaningful endorsement to a country's progress. To control for this possibility, I also include Cyprus and Malta in my study since they were applying at the same time as the CEE countries, yet they were not undergoing complete systemic change.

In terms of the time-period of this analysis it is likely that risk was perceived as declining during the entire candidacy period, as Brussels made clear public assessments whether a candidate's policy reforms in various areas conformed to EU standards. Signaling by the EU served as reliable public information in an information-scarce environment. When a country's progress got validated by the Commission, this translated into a big decrease in perceived risk. Investors stopped viewing these countries as emerging markets but as stable OECD countries, regardless of the fact that their levels of development might have been the same as before (Gray, 2009). This suggests that markets may pay less attention to the actual reform course than to EU pronouncements on it (Gray, 2009). The universal availability of this information and the credibility of its source were considered enough for investors to make more confident choices.

Hypotheses

This section outlines the institutional specifics of the pre-accession period in the context of the EU's ability to convey credible signals. The EU's influence varied across the different stages of conditionality but the inclusion of a country in the "credible candidate" stage was perhaps the first credible enough signal. During the next stage, the negotiation phase, the EU and the candidate country agree that the rules pertaining to a specific chapter have been transposed and the EU announces this publicly. Studies on signaling in diplomacy (Fearon, 1994) have shown that states act in a way to reveal information about their "type" to international audiences in order to enhance their credibility in diplomatic relations. Thus, by cooperating with the Commission and working diligently to close the chapters, CEE governments also signal that they could be trusted in the future. Thus, in light of the concrete signals that publically deeming a country a credible candidate and announcing its progression along the chapters of the acquis constitute, I propose the following hypothesis:

H1: Positive signaling during the entire pre-accession period overrides otherwise important guidebook considerations for foreign investors, including corruption.

Upon the successful conclusion of the negotiations and the ratification of the Treaty of Accession, a country becomes a full-fledged member of the EU. This is the end of signaling as the granting of membership signifies the full incorporation of the given country into the economic and political structures of the EU. While this means that political risk is now at its lowest relative point, the leverage of the EU to demand further reforms is more limited. Since investors at this point could not reasonably hope for institutional improvement of the same scale and pace, they now return to their rational guidebook style of evaluating whether investments should or should not be made. In light of this intuition, I propose the following hypothesis:

H2: After membership, investor guidebook principles, such as corruption, resurface as important. Corruption control has a positive effect on FDI inflows.

Methodological Framework

The purpose of this section is two-fold. First, I outline the way the dependent variable, FDI inflows, the independent variables of interest, the stages of the EU accession process and corruption, and all the relevant control variables have been operationalized. Then, I present the findings of the statistical analysis, explain the results, discuss their robustness, and analyze the mechanisms behind them.

FDI inflows

This study defines the dependent variable as the annual FDI inflows from 1996 to 2011.

This is the sum of every year's new direct investments in a given "host" country by foreign capital owners. The measure of FDI inflows comes from the United Nations Conference on Trade and Development[22]: "An investment involving a long-term relationship and reflecting a lasting interest of a resident entity in one economy (direct investor) in an entity resident in an economy other than of the investor. The direct investor´s purpose is to exert a significant degree of influence on the management of the enterprise resident in the other economy. FDI involves both the initial transaction between the two entities and all subsequent transactions between them and among affiliated enterprises, both incorporated and unincorporated. FDI may be undertaken by individuals, as well as business entities."[23] The data is expressed in 2011 US dollars.

[22] Developing countries look favorably upon UNCTAD, and these data are least affected by intentional non-reporting

[23] http://unctad.org/en/Pages/DIAE/FDI%20Statistics/Foreign-Direct-Investment-FDI.aspx (accessed on July 21, 2014).

Corruption

In order to specify corruption, I refer to the Control of Corruption (CC) index, which is part of the World Bank's World Governance Indicators (WGI). Kaufmann, Kraay, and Mastruzzi (KKM), who have developed the index, define CC as an index "capturing 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" (KKM, 2008, p.8). Per the existing literature, higher levels of corruption are associated with perceptions of greater political risk and lead to less FDI. Wei (2000), Habib and Zurawicki (2002) and Voyer and Beamish (2004) all find a statistically significant negative relationship between corruption and FDI inflows.

EU Signaling

As discussed previously there are several reasons to expect that positive EU signaling in terms of progress towards accession matters for attracting FDI. First, entrance in to the EU means free access to the Single European Market, the largest commercial market in the world. Second, it means access to a cheaper but skilled labor force. Third, accession will reduce risk by providing more macro-economic, political, institutional, and legal stability. Thus, studies (Bevan, Estrin and Grabbe, 2001; Gray, 2009) have confirmed that announcements of progress towards EU accession have had an impact on investors' attitudes towards these countries.

To operationalize EU signaling, I assigned conditionality dummies to the 12 Eastern Enlargement countries in accordance with the stages outlined above. A country receives a 1 for the "credible candidate" stage if it has signed an association agreement with the EU but has not yet entered accession negotiations; it receives a 0 otherwise. The "accession negotiations" dummy assigns a 1 to countries that have begun accession negotiations but not yet signed a Treaty of Accession, and 0 otherwise. Finally, there is no "membership" dummy since the second statistical design includes only the years in which all 12 countries have already become members. The conditionality dummies are based on the table below.

Table 1: Stages of Conditionality and When They Applied to Particular Countries

Stage	**Candidate Country and Period**
Credible Candidate	Bulgaria 1996-99, Cyprus 1996-97, Czech Republic 1996-97, Estonia 1996-97, Hungary 1996-97, Latvia 1996-99, Lithuania 1996-99, Malta 1998-99, Poland 1996-97, Romania 1996-99, Slovakia 1996-99, Slovenia 1996-97
Accession Negotiations	Bulgaria 2000—04, Cyprus 1998--04, Czech Republic 1998--04, Estonia 1998--04, Hungary 1998--04, Latvia 2000--04, Lithuania 2000--04, Malta 2000--04, Poland 1998--04, Romania 2000-04, Slovakia 2000-04, Slovenia 1998-04
Full Membership	Bulgaria 2007-12, Cyprus 2004-12, Czech Republic 2004-12, Estonia 2004-12, Hungary 2004-12, Latvia 2004-12, Lithuania 2004-12, Malta 2004-12, Poland 2004-12, Romania 2007-12, Slovakia 2004-12, Slovenia 2004-12

Alternative Explanations

The literature on FDI has identified a number of relevant variables affecting FDI into transition economies. These include an array of indicators concerning the health and stability of the economy and the political system: market size, openness of the economy, inflation, foreign reserves, government spending, unit labor costs, and structural reforms providing for a free and predictable investment climate. These alternative explanations are incorporated in the analysis.

Host market size

Host market size is important for FDI for two distinct reasons. First, it can enable investors to capture potential economies of scale in terms of production (Bevan and Estrin, 2000; Buethe and Milner, 2008; Ang, 2008). Secondly, firms can be drawn to bigger markets in search of new market opportunities and consumers (Lankes and Venables, 1996). I operationalize host market size using the World Bank's GDP index (converted into US dollars).

Trade Openness

Trade openness is another factor that influences FDI in that investors often seek to produce for other markets and/or need to import raw or materials for their production from abroad (Caves, 1996; Singh and Jun, 1995). In that sense the presence of tariff or non-tariff barriers to trade can be detrimental for FDI and FDI and openness of the economy will be positively related. I operationalize trade openness as the percent change in volume of imports in a given year (Bevan and Estrin, 2000). The measure comes from the World Bank database.

Macroeconomic Indicators

Inflation and foreign reserves also influence FDI (Bevan and Estrin, 2000; Jimborean and Kelber, 2011) as low inflation and high reserves signify macroeconomic stability. To operationalize these variables I refer to the World Bank's World Development Indicators. Thus, I define inflation as percent change in annual average consumer prices and reserves as total reserves including gold and denominated in current USD.

Government Spending

Levels of government spending also affects FDI in that in an attempt to attract FDI governments decrease levels of capital taxation which leads to less government spending (Jensen, 2006). While there is mixed evidence on this intuition, many studies include this control. I operationalize government spending as the percent change in government total expenditure (World Bank).

Unit Labor Cost

Profitability from the perspective of foreign investors is intrinsically connected to unit labor costs (Holland and Pain, 1998). Access to an affordable labor, exhibiting high levels of skill and training and a solid scientific base (EBRD, 1999), is considered a fundamental comparative advantage of the region (Maeyer, 2006; Bevan and Estrin, 2000). Importantly, investors are attracted to cheap labor only if it is not crowded out by lower productivity or an overvalued currency. Thus, I include gross average wages, denominated in US Dollars, as indexed by the United Nations Economic Commission for Europe.

Structural Reforms

Another possible alternative explanation is that markets simply respond to policy reform by governments and not merely EU signaling. During the negotiations phase of conditionality, many countries underwent stringent periods of policy reform in order to qualify for membership (Schimmelfennig and Sedelmeier, 2005). Therefore, increasing FDI may be just a function of the introduction of or perceived effectiveness of a reform (Forbes, 2006; Campos and Kinoshita, 2008), rather than merely signaling.

To assess the role of reforms I use several EBRD reform indexes, which I average out: large scale privatization, small scale privatization, governance and enterprise restructuring, competition policy, price liberalization, and trade and forex reform. Importantly these measures reflect the degree of reform and not necessarily its effectiveness. The degree being important in its own right, I take additional steps to isolate the effect of structural reforms on the investment climate.

The investment freedom index produced by the Heritage Foundation seems particularly relevant in terms of how reforms have affected the investment environment of a country.[24] The index is based on several assumptions: "In an economically free country, there would be no constraints on the flow of investment capital. Individuals and firms would be allowed to move their resources into and out of specific activities, both internally and across the country's borders, without restriction. Such an ideal country would receive a score of 100 on investment freedom."[25] In reality countries impose an array of restrictions to investment behavior and the index takes many of them into account: investment restrictions based on nationality, burdensome foreign investment code in terms of transparency and bureaucratic structures, restrictions on land ownership, various sectoral restrictions or barriers, commonality of expropriations of investment without due compensation, foreign exchange controls, capital controls in terms of instances of repatriation of profits or need for government approval for various transactions. These are all

[24] The Heritage Foundation produces the index based on information from a variety of sources including the Economist Intelligence Unit, Country Commerce, 2010–2013; Office of the U.S. Trade Representative, 2013 National Trade Estimate Report on Foreign Trade Barriers; and U.S. Department of Commerce, Country Commercial Guide, 2010–2013.

[25] http://www.heritage.org/index/book/methodology (accessed on July 23, 2014).

factors that cater directly to the quality of the investment environment both in terms of its legal underpinning and its practical suitability.

In addition to these specific indicators of degree and practice of reforms, some studies have also suggested an alternative method to evaluate the effectiveness of reform. They include macroeconomic indicators, such as inflation, as proxies for reform given that they represent an economic reality that is directly the result of government policy choices or lack thereof. Such economic indicators are already present in my models.

The Financial Crisis

The credit crunch and recession that ensued coincided with a collapse of FDI inflows to CEE. In 2009, FDI inflows to the CEE region were 50% lower than in 2008 (Economic Review, PriceWaterHouseCooper, 2010). In order to control for the independent adverse effects on FDI inflows generated by the financial crisis of 2008, I employ two strategies. First, I include a control variable for every country for every year measuring the presence and magnitude of the crisis. The variable comes from the Luc Leaven and Fabian Valencia (2012) dataset which covers the universe of systemic banking crises for the period 1970-2012, and also includes data on the resolution and fiscal and economic costs of banking crises. Second, I include a measure for global FDI inflows for every year, thus accounting for the global-level fluctuations of FDI, which are profoundly affected by financial crises, such as the one of 2008. The inclusion of these variables in the time series controls for the negative effect of the financial crisis on FDI inflows.

Time Series Analysis

The statistical part of this article utilizes a time-series cross-sectional regression analysis to examine the effect of EU signaling before and after accession on investor confidence in in the 12 countries of the 5th enlargement. Data on FDI inflows and a number of variables which may affect them are available over the period 1996-2011. Pooled time-series datasets such as this one introduce great challenges for researchers. The presence of relationships within countries and in particular time periods means that there will be serial correlation among observations (as confirmed by the Woolridge test), as well as structure in the error terms. To tackle autocorrelation (and any other unspecified spurious correlation) I employ two methods. First, I include a lagged dependent variable in both the pre- and post-accession models (Keele and Kelly, 2006; Beck and Katz, 2011).[26] Additionally, I utilize panel-corrected standard errors to reduce the possibility for biased standard errors and inefficient estimates resulting from contemporaneous correlation across units and unit level heteroskedastisity (Beck and Katz, 1995). To cross-validate the results of this approach I also use Prais-Winsten transformations, which allow for estimations in the presence of auto-correlated errors, again with panel-corrected standard errors. Finally, I also include a fixed effects model as an additional method to control for potential structural issues in the dataset. The main substantive results are consistent across estimations which serves as a robustness check for the findings. Additionally, the findings do not change under bootstrapping and jack-knifing.[27] Table 2 below presents the results of the six quantitative models.

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[26] In addition to addressing this methodological challenge, including a lagged FDI is theoretically justified since researchers have consistently found FDI to be self-reinforcing (Wheeler and Mody 1992).

[27] Using subsets of available data (jackknifing) or drawing randomly with replacement from a set of data points (bootstrapping) produces estimates of the precision of coefficients.

Table 2: FDI Drivers Before and After EU Accession

	Before Accession			**After Accession**		
Drivers	Model A LDV	Model B Prais-Winsten	Model C Fixed Effects	Model D LDV	Model E Prais-Winsten	Model F Fixed Effects
Lagged FDI	.210 (.258)		-.123 (.178)	.427*** (.180)		.189** (.101)
Credible Candidate	1342.716*** (365.209)	1260.529*** (325.051)	1380.85** (712.937)			
Accession Negotiations	1145.011*** (194.969)	952.090*** (205.957)	992.047** (551.348)			
Corruption Control	147.773 (348.738)	-170.028 (370.491)	330.821 (1057.837)	3179.355*** (987.865)	4007.583** (1789.634)	3695.363* (2698.353)
Structural Reform	38.169* (24.164)	59.410** (28.582)	107.362 (98.777)	-69.024 (101.140)	-87.496 (142.060)	-57.682 (351.086)
Investment Climate	7.010 (11.991)	18.961** (10.393)	1.611 (21.799)	-52.689** (24.949)	-83.627** (39.419)	.373 (51.409)
Market Size	-.276 (1.645)	.339 (2.338)	-11.484 (50.741)	-4.678 (3.921)	-9.732** (5.222)	-4.714 (16.668)
Trade Openness	.803 (10.220)	-8.347 (6.840)	-3.277 (12.038)	25.862** (13.677)	27.163** (10.778)	44.013*** (18.243)
Inflation	2.010 (2.091)	2.486** (1.300)	-.129 (9.908)	-.972 (1.272)	-1.374 (1.348)	-6.794** (3.505)
Reserves	1.530** (6.860)	1.960*** (3.960)	1.560 (8.710)	9.760*** (3.900)	1.380*** (3.680)	-2.510 (3.680)
Unit Labor Costs	-.220 (.473)	-.329 (.432)	.702 (1.742)	-2.303*** (.534)	-3.084*** (.732)	-4.670*** (1.953)
Government Spending	-7.890 (9.742)	-21.741** (10.773)	-17.605 (38.639)	-51.252** (22.779)	-77.645*** (32.850)	-43.316 (54.503)
Global FDI	.001 (.001)	.001 (.001)	-2.470 (.001)	.002*** (001)	.003*** (.001)	004*** (.001)
Financial Crisis	767.455 (1023.969)	453.752 (437.931)	-302.200 (864.3414)	-494.907 (666.477)	-82.174 (874.730)	1839.152 (1235.37)
Constant	-2876.364** (1308.769)	-3829.83*** (1093.076)	-3625.707 (6409.586)	8065.217 (4276.881)	11962.01** (6207.93)	7752.874 (14473.02)
R-squared	77	83	13	75	61	36
Wald Chi2	355.42	834.31		491.46	85.55	
Number of Observations	72	80	72	95	95	95

Models *A (pre-accession)* and *D (post-accession)* are LDV regressions with panel-corrected standard errors; models *B (pre-accession)* and *E (post-accession)* are Prais-Winsten regressions with panel-corrected standard errors; models *C (pre-accession)* and *F (post-accession)* are Fixed Effects models. $***p < .01$; $**p < .05$; $*p < .10$. One-tailed test where appropriate.

The results of all the LDV, the Prais-Winsten, and FE models confirm the hypotheses that corruption control has a positive and significant effect on FDI after accession but is insignificant before, when EU signaling is a strong (the strongest) predictor of FDI inflows. A number of other important factors for investors, including trade openness and unit labor costs, exhibit the same relationship – insignificant, while the countries were applying to the EU and were receiving positive endorsements from the EU about their progress, and significant after membership, when signaling was no longer present, and investors no longer felt that they can discount guidebook principles in the short-run in the name of a more hopeful promise for the future.

The results from the pre-accession models provide some evidence of how the availability heuristic might have affected investors' attitudes and decision making in this period. Looking at the more restrictive LDV and FE models one can see that while most investor guidebook considerations are insignificant in the pre-accession period, EU signaling in both the "credible candidate stage" and during the "accession negotiations" had positive and significant effects on investor confidence. All three model specifications focusing on this time period demonstrate that positive signaling inspired investor confidence to an extent that overshadowed a wide array of other considerations that should theoretically matter (trade openness, market size, wages).

There are a few other insights based on the LDV and Prais-Winsten models worth mentioning. First, both return significant results for foreign reserves. Expectedly, *ceteris paribus* higher foreign reserves served as ground for greater investor confidence in the macroeconomic resilience of a country and encouraged more FDI inflows. One can also notice that the two models provide some evidence that structural reforms mattered in the pre-accession period. Expectedly, to the extent that the degree of reforms, as defined by the EBRD, affected investors, these effects were positive and FDI increased as a result of the introduction of the various structural reforms.[28] Last, the pre-accession Prais-Winsten model also provides some support for the conjecture that increased government spending would have a negative effect on FDI inflows.

The results from the post-accession models add further insights into the psychological state of foreign investors making decisions in evolving investment environments. With EU signaling no longer available to help investors filter information, channel inferences, and form (positive) expectations, the natural biases and distortions that come with the availability heuristic are now gone. Traditional guidebook approaches to investment, based on comprehensive rationality rather than bounded rationality, resurface in this time period and a great number of theoretically relevant FDI drivers again become significant. Greater openness to trade, higher reserves, lower government spending, lower wages, and notably, better corruption control ($p < 0.10$ in the FE model), each lead to more FDI inflows, all else equal. These variables come with signs and levels of statistical significance consistent with theory and prior studies.[29]

[28] Large scale privatization, small scale privatization, governance and enterprise restructuring, competition policy, price liberalization, and trade and forex reform.

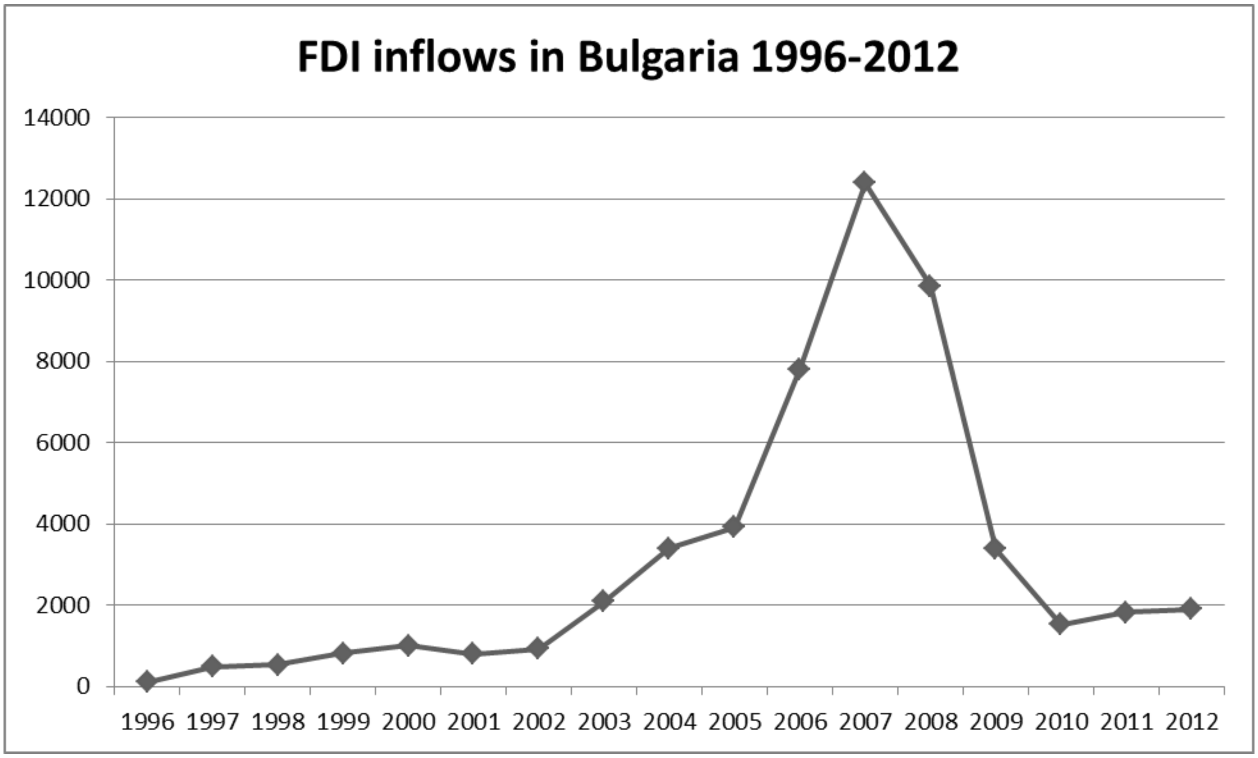
[29] Interestingly, the variable estimating the friendliness of the investment climate comes with a negative sign and is also statistically significant. The index (investment freedom), produced by the Heritage Foundation, deals with issues, such as restrictions based on nationality, expropriations of property without due compensation, and various capital and exchange rate controls. One interpretation would be that in the post-accession period most of these considerations have been addressed to a satisfactory degree in the context of the Single Market. If so, attempts at further liberalizations, perhaps to capture more FDI, may at this point not be as impressive to investors as other factors, such as wages or reserves, both exhibiting very high levels of statistical significance. Thus, for example, if we compare the performance of the three least restrictive countries Estonia (average score of 90), Hungary (average score 73) and Latvia (average score 73), and the most restrictive one, Bulgaria (average score of 55) in the post accession period, one can notice that Bulgaria attracted more FDI than each of the three and it also had lower wages (roughly 30% of wages in Estonia and Hungary and 45% of wages in Latvia) and higher reserves.

Survey [30]

In order to explain how signaling affected the way investors perceived the importance of corruption and other factors, I now turn to a discussion of the survey I was able to administer. The survey attempts to shed more light into the psychological state of investors and explain to what extent corruption mattered and matters for their decisions and affects trends in FDI.

[30] The results discussed here feature the answers of 36 respondents who are engaged in FDI activity, 32 in Bulgaria and four in Cyprus.

Figure 2: FDI in Bulgaria in millions of USD 1996-2012 [31]



(United Nations Conference on Trade and Development: http://unctad.org/en/Pages/DIAE/FDI%20Statistics/Interactive-database.aspx, accessed in July 2014)

The results of the survey confirm the findings from the regression analysis. They show that although corruption mattered for investors both before and after accession, the perceived

[31] This trend is generalizable to all 12 countries that joined in 2004-07 as FDI inflows declined post-accession in Cyprus 2007, Bulgaria 2007, Latvia 2007, Lithuania 2007, Poland 2007, Romania 2008, Slovenia 2008, Malta 2006, Slovakia 2006, Estonia 2005, Hungary 2005, and Czech Republic 2005. Importantly, all but two (Slovenia and Romania) of these declines took place soon after these countries' accessions, but before the financial crisis (Note: Slovenia's and Romania's FDI as a percent of GDP had actually also started to decrease before the crisis, in 2007 and 2006 respectively). Even in the five cases when the decline is shown to have started in 2007 (also the accession year for Bulgaria and Romania), the monthly data on the downward trend in 2007 precede the crisis's beginning, which can be dated August 9, 2007, when BNP Paribas stopped withdrawals from three hedge funds citing "a complete evaporation of liquidity" (Elliot 2012, available at: http://www.theguardian.com/business/economics-blog/2012/aug/05/economic-crisis-myths-sustain). Relatedly, the crisis truly peaked in 2008 and FDI by nature does not respond to market trends as instantaneously as the stock market. In the other cases the decline started within one or two years after accession and before the crisis.

economic and institutional benefits of membership were high on investors' minds before accession and disproportionally affected their decisions. The questions asked focused on two broad categories – investors' attitudes toward corruption before and after accession as an important factor for FDI and their susceptibility to EU signaling as a trigger to activating the availability heuristic. The survey was administered in person and via email in the summer of 2013 and featured 32 respondents representing several countries, including the USA, Greece, Germany, Austria, and the United Arab Emirates, with investments in core sectors of the Bulgarian economy, such as real estate, financial services, communications, agriculture, and retail.[32] There were four additional respondents investing in Cyprus.[33] The respondents occupied mid and high-level management positions and were involved either in the initial investment decision or current decisions about further investments.

The first round of questions assesses attitudes towards corruption before and after accession. Notwithstanding the limitation that questions like that are prone to "backward" misremembering or biased updating, the results reveal an interesting story. Most respondents confirm that corruption was an important consideration for them both before and after EU membership, but a greater majority of investors (33 v. 28) seem to be more concerned about corruption in the post-accession period.[34] Nevertheless, I expected the difference here to be more

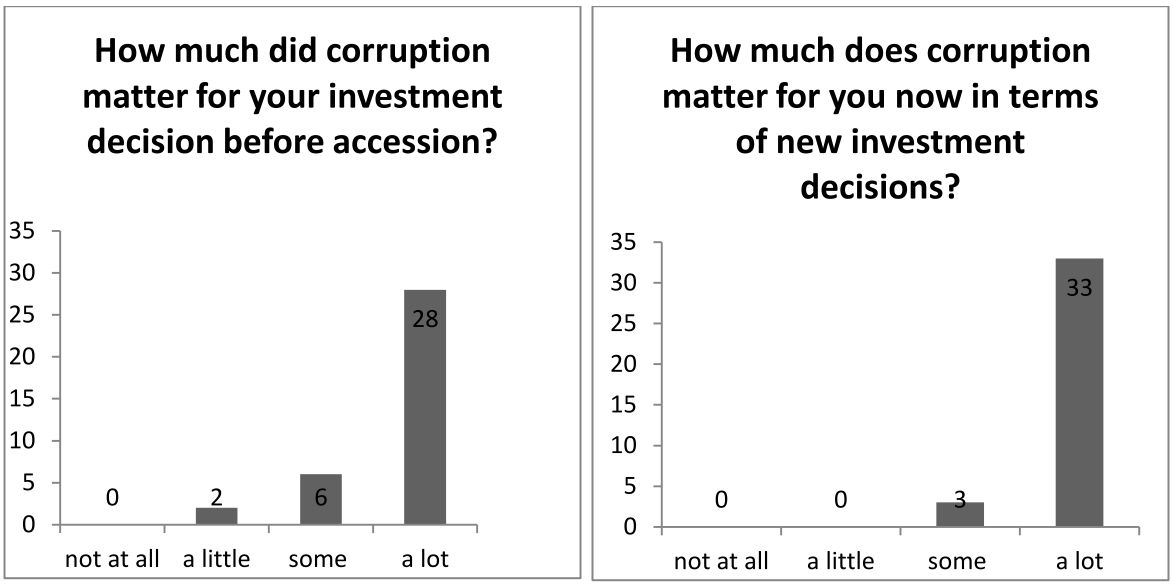
[32] The sample frame included 54 potential respondents, representing firms with investments in four of the top five sectors of the Bulgarian economy (Real Estate (1st), Financial Intermediation (2nd), Retail (4th), and Communications (5th) as well as four of the top ten investing countries (Austria (2nd), Greece (3rd), Germany (6th), USA (10th)). Source: US Department of State 2013 Investment Report on Bulgaria. Available at: http://www.state.gov/e/eb/rls/othr/ics/2013/204610.htm (accessed on January 9, 2015).

[33] The sample frame included four potential respondents, three from Greece and one from the US investing in real estate and development.

[34] A review of a number of issues of the Global Competitiveness report cross-validates these findings as it shows that corruption increased in importance as a "problematic factor for doing business" between the pre-accession and post-accession periods in five out of the six countries (Czech Republic, Slovenia, Slovakia, Bulgaria, Estonia, and Hungary) that I found information on, with only Estonia being an exception. The Global Competitiveness report is

pronounced which makes me wonder whether there could be some biased updating as investors do not want to admit that they really discounted or overlooked such an important factor before accession.

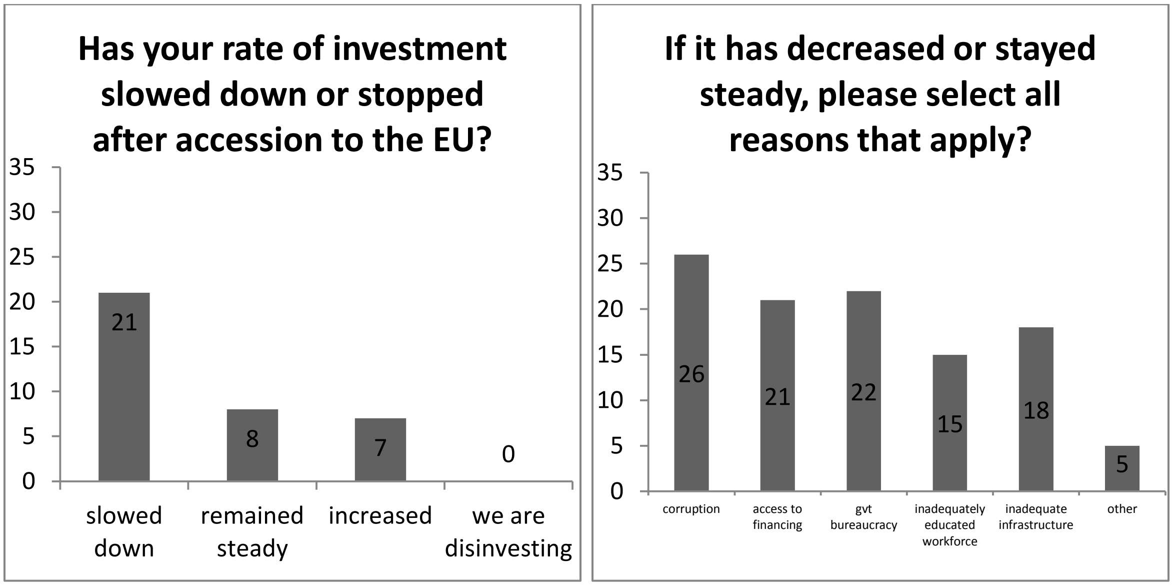
Figure 3: Effects of corruption on FDI before and after accession



The next couple of questions try to establish the current rate and state of these investments and ask for the potential reasons for their slowdown or stagnation.

based on the opinions of an average of 98 experts per country representing the main sectors of the economy (agriculture, manufacturing industry, non-manufacturing industry, and services). For more info: http://www3.weforum.org/docs/GCR2011-12/6.GCR2011-2012Chapter1.3EOS.pdf (accessed on July 26, 2014).

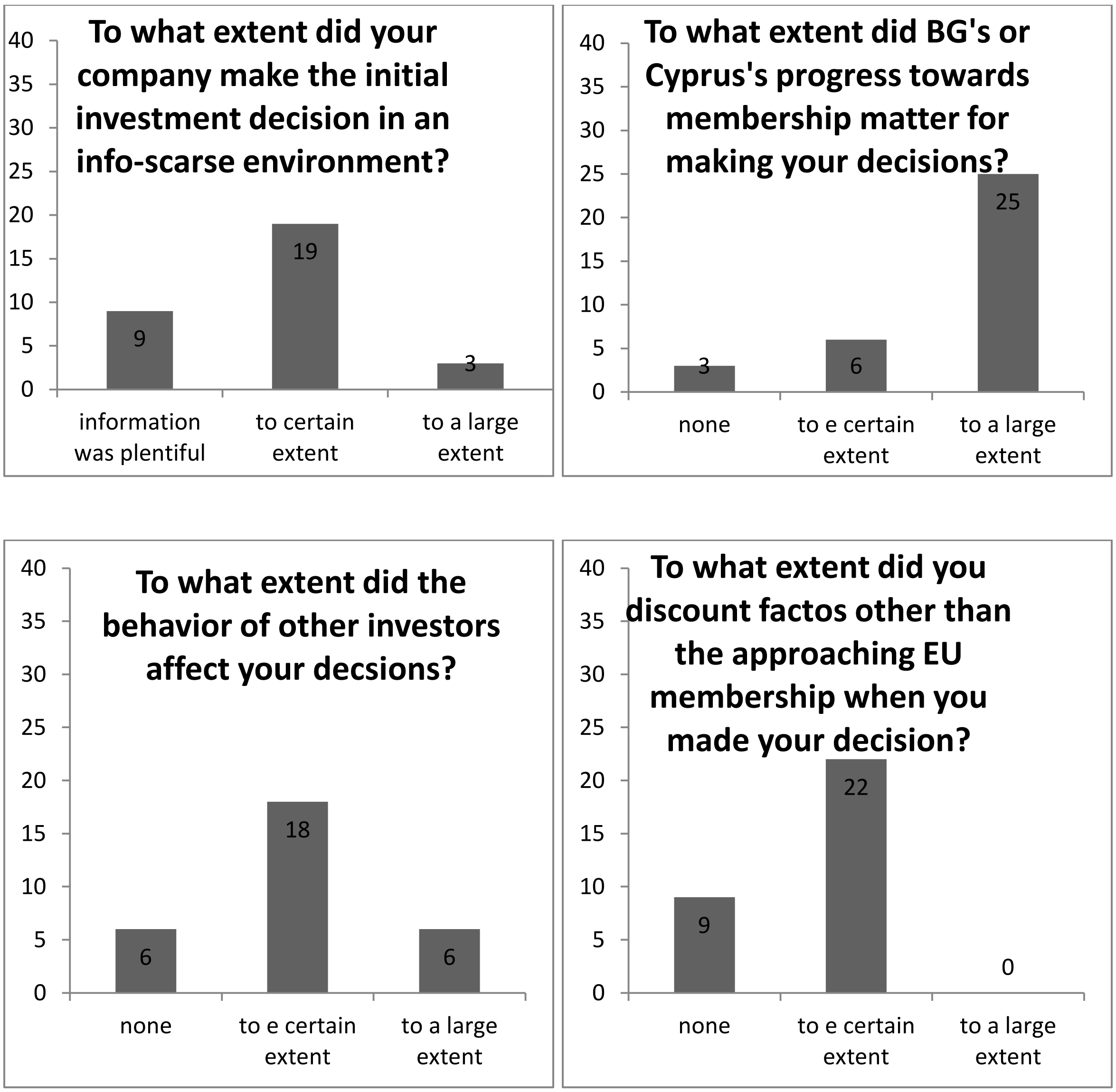
Figure 4: Current state of FDI and the reasons for it



The results here are interesting. Expectedly, zero participants said that their firm was disinvesting or withdrawing since FDI tends to be very sticky (Liebscher 2007). Interestingly, however, 26 out of the 29 who said that their investment rate has slowed down or remained the same, pointed out coprruption as one of the main reasons for this. In fact these people singled out corruption as the most important reason, ahead of “inefficient government bureacracy” (22 answers) and “access to financing” (21), the main corrolary of the financial crisis of 2008. These answers raise an intersting question: If corruption mattered for investment decisions before accession almost as much as it matters now, and it is a top reason to slow down investment now, why did people invest back then? Why was corruption discounted? Could it be the case that as much as it mattered, or was supposed to matter, EU-related factors overrode its relevance?

The next set of questions aim to establish investors’ susceptability to signaling as well as the rationalized effect of signaling on their behavior. The first four questions attempt to directly assess the possibility of behavior having been driven by the availability heuristic. They try to answer the question of how signaling affected behavior.

Figure 5: Conditions for the Availability Heuristic

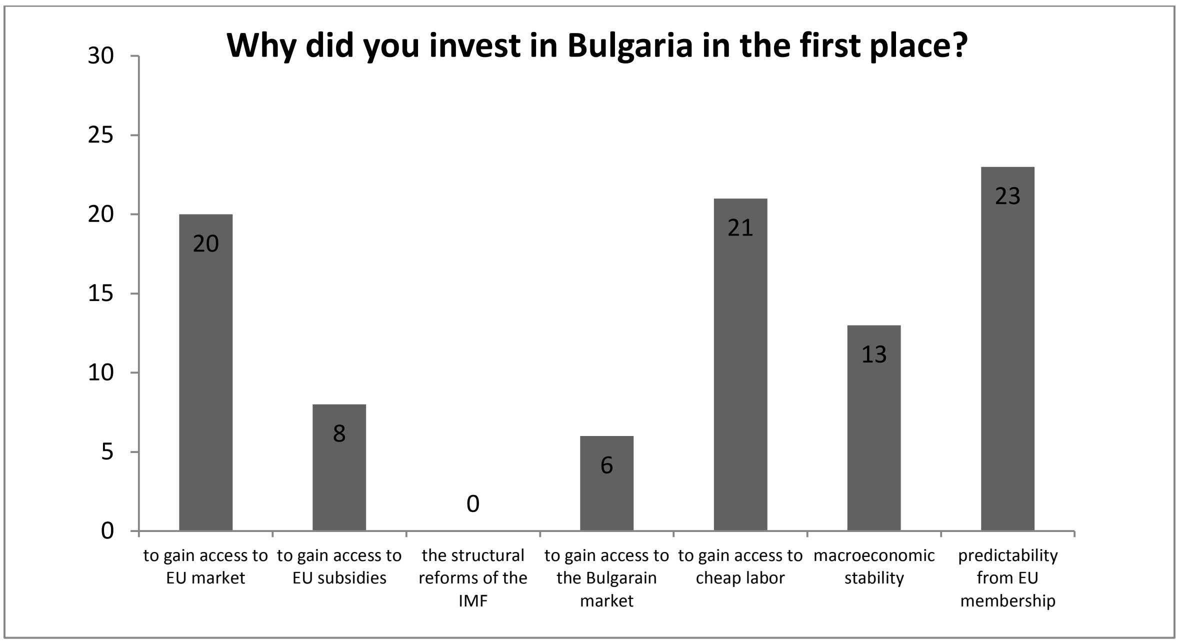


About two-thirds of the respondents did think that they were making the initial decision in an information-scarce environment (at least to a certain extent) and more than two-thirds were influenced by Bulgaria's or Cyprus's progress towards membership, both constituting necessary conditions for the availability heuristic. There are two psychological states that these two answers point at. As reform often preceded the actual closure of negotiating chapters, those who felt that their access to reliable information was good or adequate (9), saw the EU's endorsements as credible public knowledge and felt encouraged. At the same time those who felt that the information environment in a young democracy was uncertain (22), elected not to search for more information as comprehensive rationality would entail, but turned to the inferential strategies of bounded rationality and perceived the EU signals as fundamental information in its own right. In both cases then investors were affected by signaling, either more than, or as well as by their individual (objective) assessment of the actual quality of the investment environment.

The other two questions in this section look at other, more obvious aspects of the availability heuristic, namely the influence of the behavior of others and the tendency to exaggerate the importance of vivid information, such as EU endorsements. Only a small minority of investors say that they were influenced by others to a large extent, but half admit that they were influenced at least to a certain one. This is not surprising because from an economic perspective the CEE countries constituted new markets where a first-mover advantage could be crucial. Similarly, from a psychological perspective the (herding) behavior of groups in its own right can be seen as legitimating, as evidenced by the wide and growing literature in behavioral economics (Banerjee, 1992; Shiller, 1995). Finally, although some investors expectedly refuse to admit that they discounted factors other than the EU when making their decision, about two-thirds says that this might have been the case, though only to a certain extent.

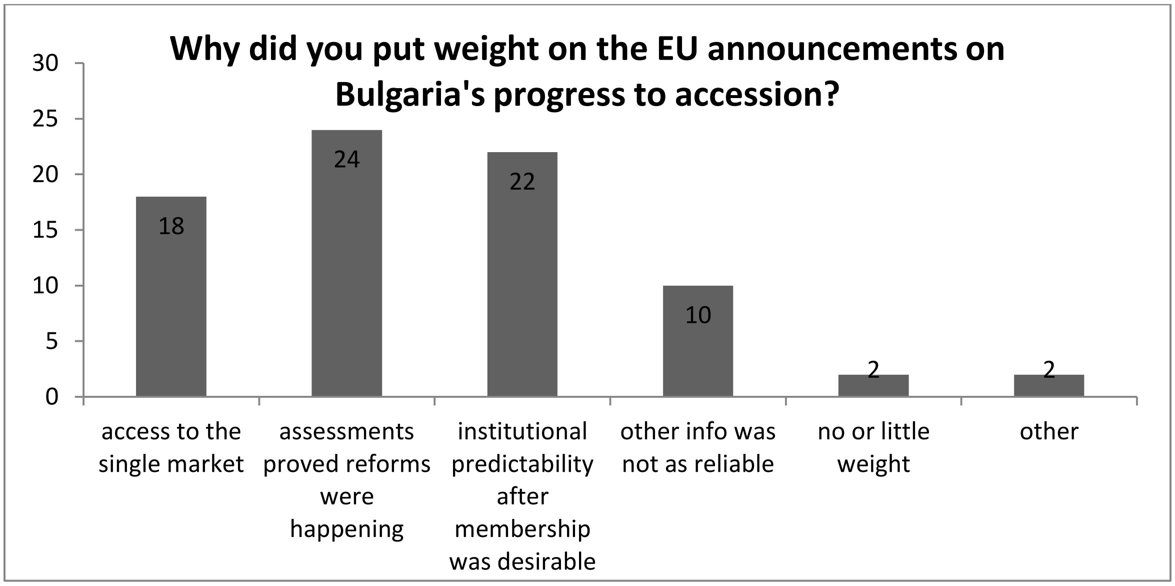
The last two questions in this section try to answer the question of why signaling had the strong and positive effect it did. When asked why they invested in Bulgaria in the first place, two of the top three reasons pointed at have something to do with the EU – predictability from EU membership and access to the single market, with low wages being the other important factor. Thus, it is evident that although investors say that they cared about everything and they took every guidebook factor into account, EU-related factors were high one their minds.

Figure 6: Reasons to invest in Bulgaria



The next question asks about the reasons why the EU announcements had an effect on their decision-making.

Figure 7: Reasons why EU announcements matter



There are a couple of observations worth noticing here. A great majority (24) accepted the EU assessments as proof that reforms were happening. Indeed, the accession process was highly meritocratic (Vachudova, 2005) and it made sense for investors to take progress as valuable information. However, more than a third of these 24 respondents (10) also said that other information was not reliable, which means that they did allow the EU signals to trigger the availability heuristic, which helps channel information but also creates the risk of significant distortions of and biases against other sources of information, such as other fundamentals. Finally, more than two-thirds of investors also said that the promise of institutional stability and predictability mattered to them, an argument firmly in line with established theories of international relations (Keohane, 1984; Morrow, 1994; North, 1990).

Interviews

To supplement the findings from the statistical analysis and the survey I also conducted interviews with Greek and American investors who are engaged in FDI activity in Bulgaria. The interviews showed that investors did indeed resort to using the inferential shortcuts that the EU progress reports provided during the accession period and selectively discounted other information in the hope for post-accession appreciation of their assets and more streamlined penetration of their services. The interviewees were involved in several sectors of the economy including real estate, financial services, construction, agriculture, and energy. All interviewees were univocal that the investment environment in the country was uncertain until 1997 as Bulgaria had no specific legislation on FDI. In October 1997 the Foreign Investment Act (FIA) created the first legal framework for foreign investment which was up to par with accepted international standards. This precedent as well as the aggressive privatization reform of the late 1990s created a fertile ground for investment. One of the companies, a fund of funds, which I interviewed, invested a total of $250 million between 1999 and 2006. This company provided me with specific data regarding their investments (in thousands of Euros) since 2007.

Table 3: FDI Post-accession of a Fund of Funds

Year	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**
FDI	44,445	25,533	2,416	1,339	2,086	1,426	300

One can notice the sharp slowdown of the investment rate following the accession of Bulgaria to the EU (2007) and the beginning of the financial crisis (2008). Following the hypotheses of this article, I asked about the major investment drivers before accession and the main reasons for the slowdown: “It was easier to sell ideas to investors [before accession], both because we had the EU accession chip to play and because credit access conditions at home were more favorable…Now, even when money is available, the bar is higher and the corruption-ridden energy sector is raising questions with our investors,” said the manager of this fund which manages an array of investments in several sectors (Interview summer 2013). Evidently, before accession US investors were eager to invest and were encouraged by the prospect of membership. After accession, capitalizing on “hope” was more difficult even if funding was available. Thus, in 2008 this fund created a platform that secured €50 million in equity to invest in renewable energy projects (solar, wind, geothermal, and hydroelectric). With the money secured, however, the project was put on hold due to corruption considerations (amidst otherwise strong macroeconomic fundamentals). Such strict due-diligence was not the norm before accession when corruption was just as relevant and influential in the Bulgarian market. Since 2008 the company has slowed down its investment rate, employed less staff, and actively sought other sectors of the economy to invest in where predictability is high, barriers to entry low, and the government involvement less.

Such marked change in attitudes towards investing in Bulgaria is not unique to just this fund of funds. Twenty-two out of the twenty-five investors I interviewed stated that the prospect of EU accession was overwhelmingly more important for their companies than other factors and that positive EU announcements encouraged investments. Nineteen defined decision-making now using words such as “more structured”, “risk-averse”, “unemotional”, “critical”, “rational”, “objective”, “straight-forward”, “cautious”, “programmatic”, and “piecemeal”, alluding to the return of the more rational approach to investing in the absence of vivid endorsements stimulating the availability heuristic. Importantly, when asked whether they regret investing in

Bulgaria or feel misled by the EU accession process, again twenty-two said that they had higher expectations for corruption control post-accession and that their companies probably overinvested in the years leading to membership. This intuition can be corroborated by comparing the average FDI inflows in the new EU post-communist members before and after accession to the FDI inflows in post-communist countries that have never been part of the accession process.

Table 4: FDI in EU and non-EU post-communist countries [35]

Foreign direct investment, net inflows (% of GDP)		
	New EU post-communist member avg	Non EU post-communist country avg
Before Accession	5.63	4.74
After Accession	6.48	7.20

EU applicant countries attracted significantly more FDI as they were moving along the accession process (5.63% vs. 4.74%) due to the "EU bump" – the fact that investors anticipated economic predictability and political stability associated with EU membership. Interestingly, however, non-EU post-communist countries have attracted more FDI (7.20% vs. 6.48%) in the post-accession period suggesting that when signaling (and hope) is out of the picture, FDI rates in post-communist EU members are actually lower than those in a peer group with a similar communist legacy.

Commenting on the change in the investment climate in Bulgaria after its accession, some foreign investors have publically singled out corruption as an impediment to their operations. Complaining about the business environment in the film industry, David Varod, CEO

[35] The non-EU post-communist countries here are: Russia, Ukraine, Moldova, Georgia, Armenia, Azerbaijan, Kazakhstan, Turkmenistan, Uzbekistan, Tajikistan, Belarus, Kyrgyzstan, and Serbia. The time period is 1998-2011.

of Nu Boyana Film Studios[36], recently said that, "Corruption eats the country." Similarly, Alex Nestor, vice president of the American Chamber of Commerce in Bulgaria, admitted that "The investment climate in the country is not something we can be proud of," when speaking precisely of the corruption-ridden energy sector (New York Times, July 7, 2014).[37]

The interviews, therefore, also provide credence to the notion that before accession progress towards the EU encouraged investors and might have caused them to discount or overlook otherwise important factors. Similarly, when the hope for further improvements decreased after membership as a result of lower EU leverage, other ("more structured", "rational", and "straight-forward") factors, and corruption in particular, reemerged as influential considerations for FDI.

Conclusion

This article shows that corruption has a differential effect on FDI inflows in the countries of the 5th enlargement before and after their accession to the EU. The main finding is that when the EU sends clear positive signals during the accession period, foreign investors' confidence gets boosted to the extent that they discount an array of fundamental considerations that are otherwise important, such as corruption. The situation changes after accession as the EU no longer sends such signals. Thus, once a country is part of the bloc, fundamental factors reemerge as important and investors may choose to punish countries that are perceived as lagging behind, static, or backsliding. There are several contributions that this article makes. First, it introduces

[36] This was the venue where "The Expendables 3" starring Sylvester Stallone and Arnold Schwarzenegger, was shot.

[37] http://www.nytimes.com/2014/07/08/business/international/bank-runs-in-bulgaria-expose-fragility-and-flaws.html?_r=4 (accessed on July 26, 2014).

the possibility that the post-accession FDI dynamic might be different for Western and Eastern Europe. FDI in Western European democracies became easier after these countries joined the EU but in the East countries had to in some ways satisfy stricter criteria after their accession. While the EU integration literature has established a definite positive and lasting effect of EU membership for Western European countries, there has been no systematic study evaluating the membership effect on CEE. Second, this article sheds more light on the question whether corruption matters for FDI. Although the consensus seems to be that it does, there are some dissenting voices. What my argument contributes to this debate is that different conditions may make corruption more or less salient of an issue for foreign investors. Finally, my arguments contribute to the literature on institutional signaling. Building on it I show how signaling progress and granting actual membership may have differential impact on investor confidence through first triggering psychological inferential shortcuts, such as the availability heuristic, but then returning the levers of decision making to comprehensive rational analysis.

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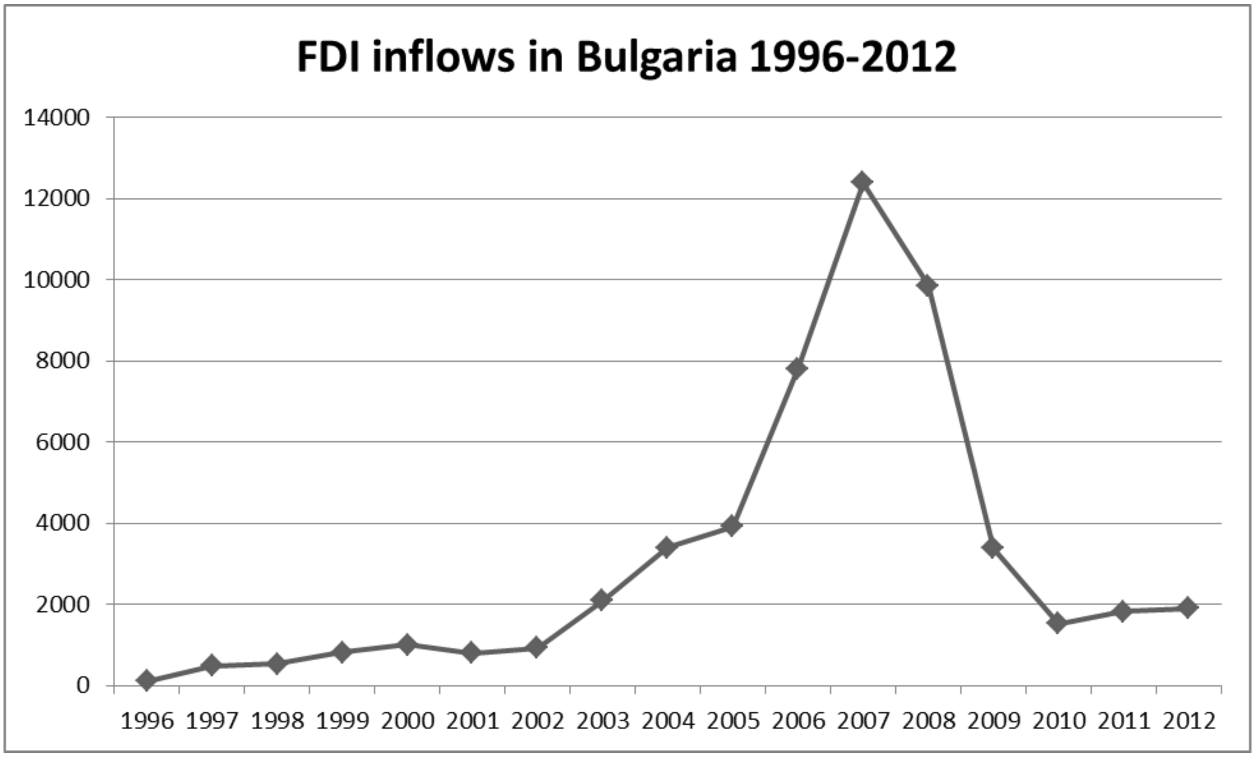
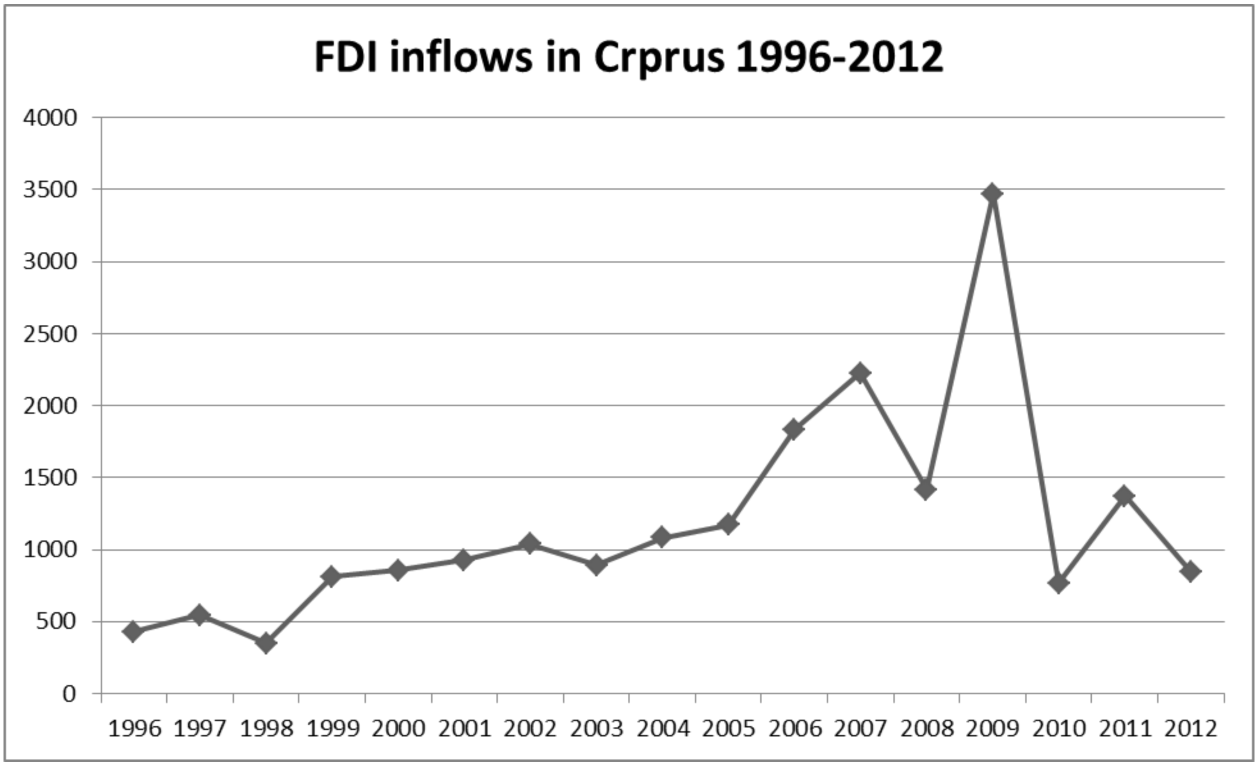
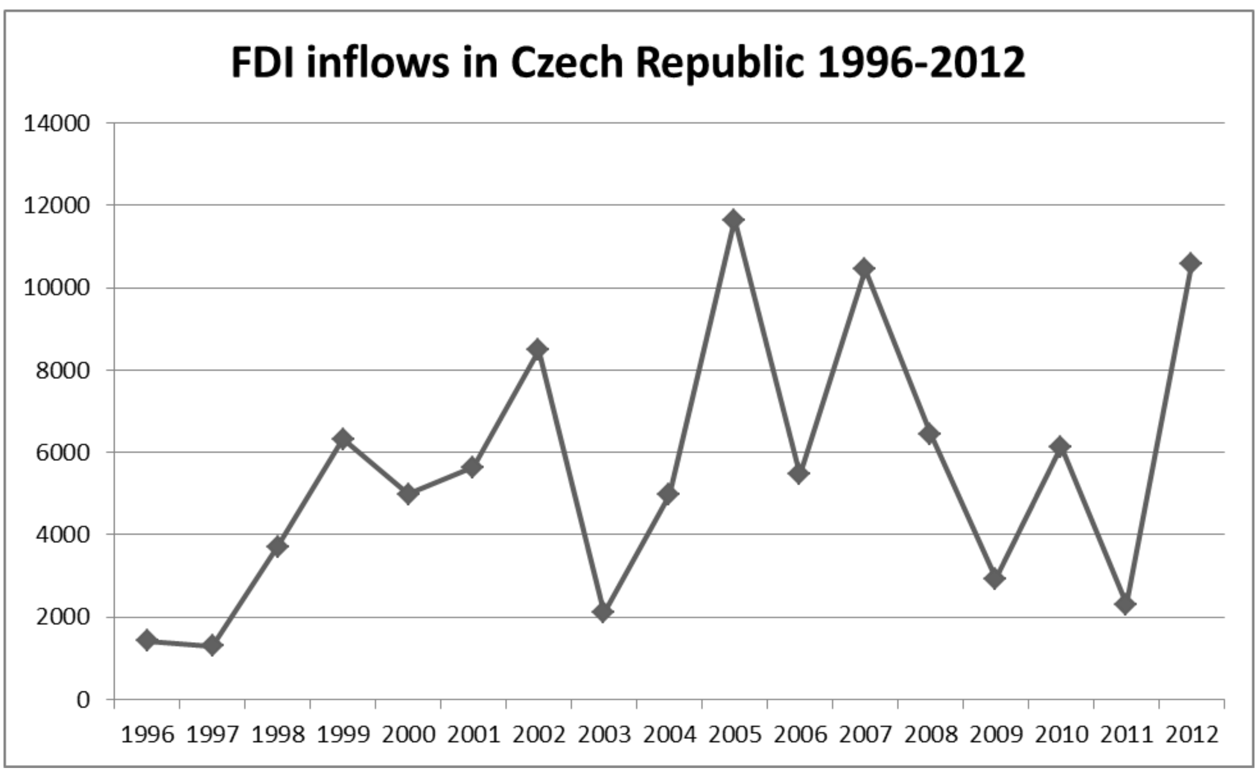
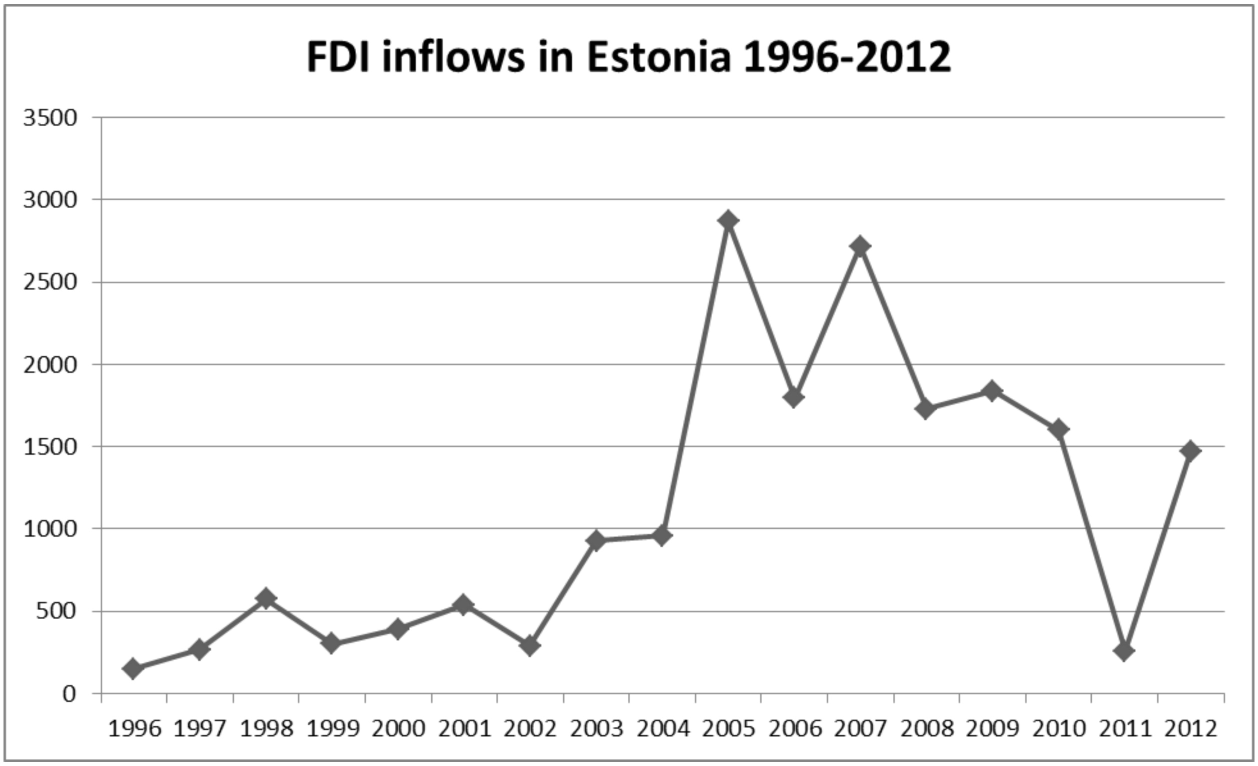
APPENDIX A: FDI in the 12 countries of the 5th enlargement 1996-2012[38]

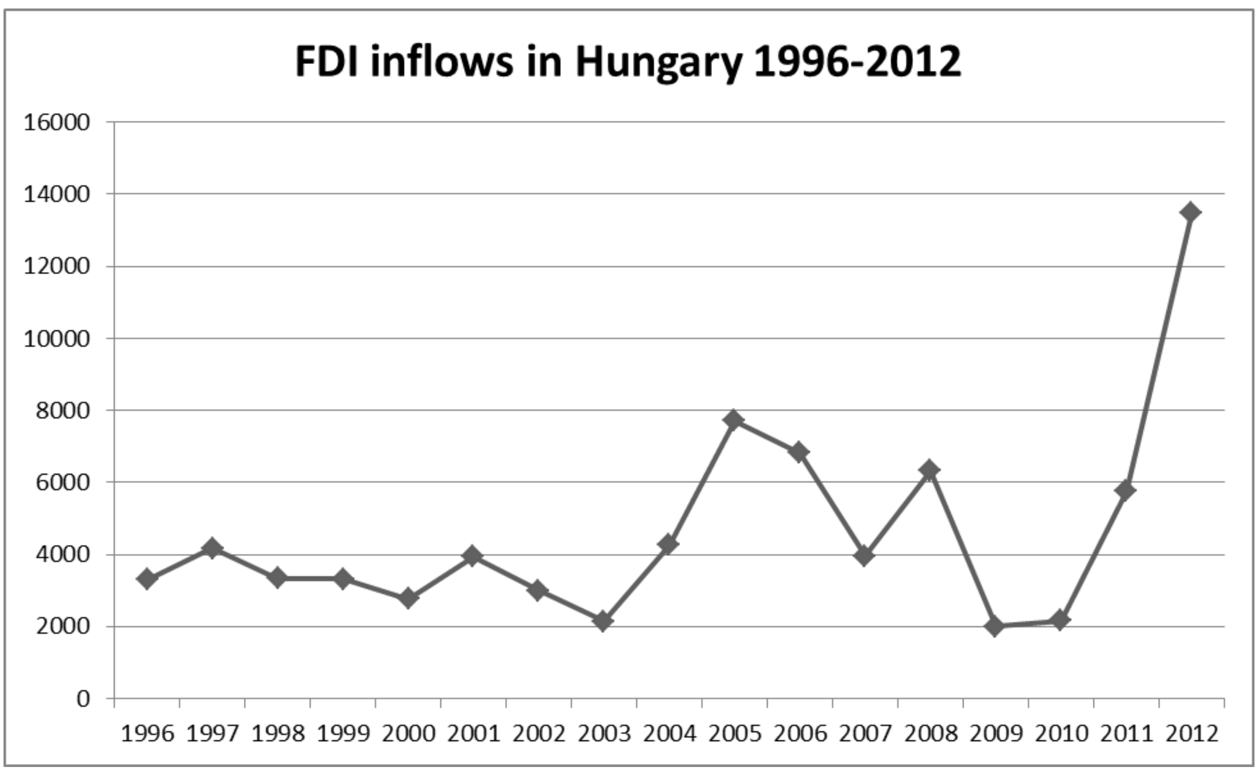


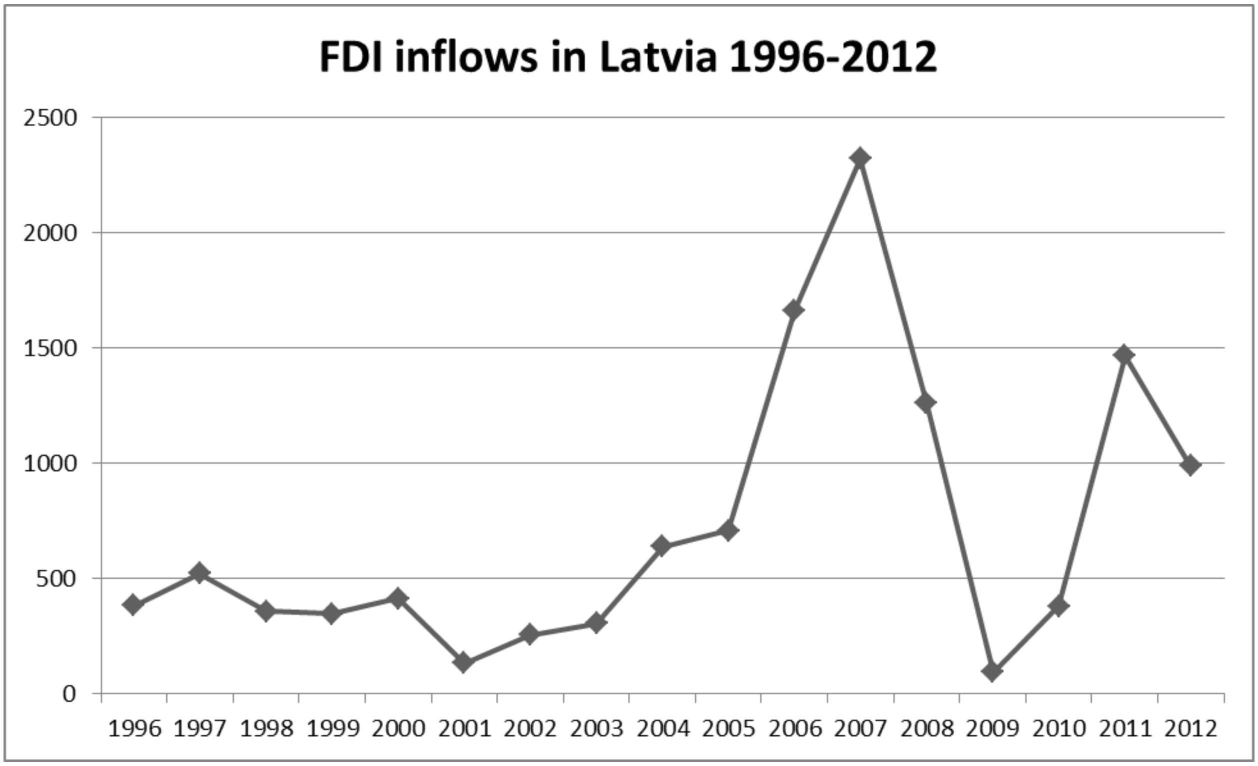
[38] United Nations Conference on Trade and Development. Available at: http://unctad.org/en/Pages/DIAE/FDI%20Statistics/Interactive-database.aspx, accessed in July 2014


FDI inflows in Crprus 1996-2012
4000
3500
3000
2500
2000
1500
1000
500
0
1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012


FDI inflows in Czech Republic 1996-2012
14000
12000
10000
8000
6000
4000
2000
0
1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012


FDI inflows in Estonia 1996-2012
3500
3000
2500
2000
1500
1000
500
0
1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012


FDI inflows in Hungary 1996-2012
16000
14000
12000
10000
8000
6000
4000
2000
0
1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012


FDI inflows in Latvia 1996-2012
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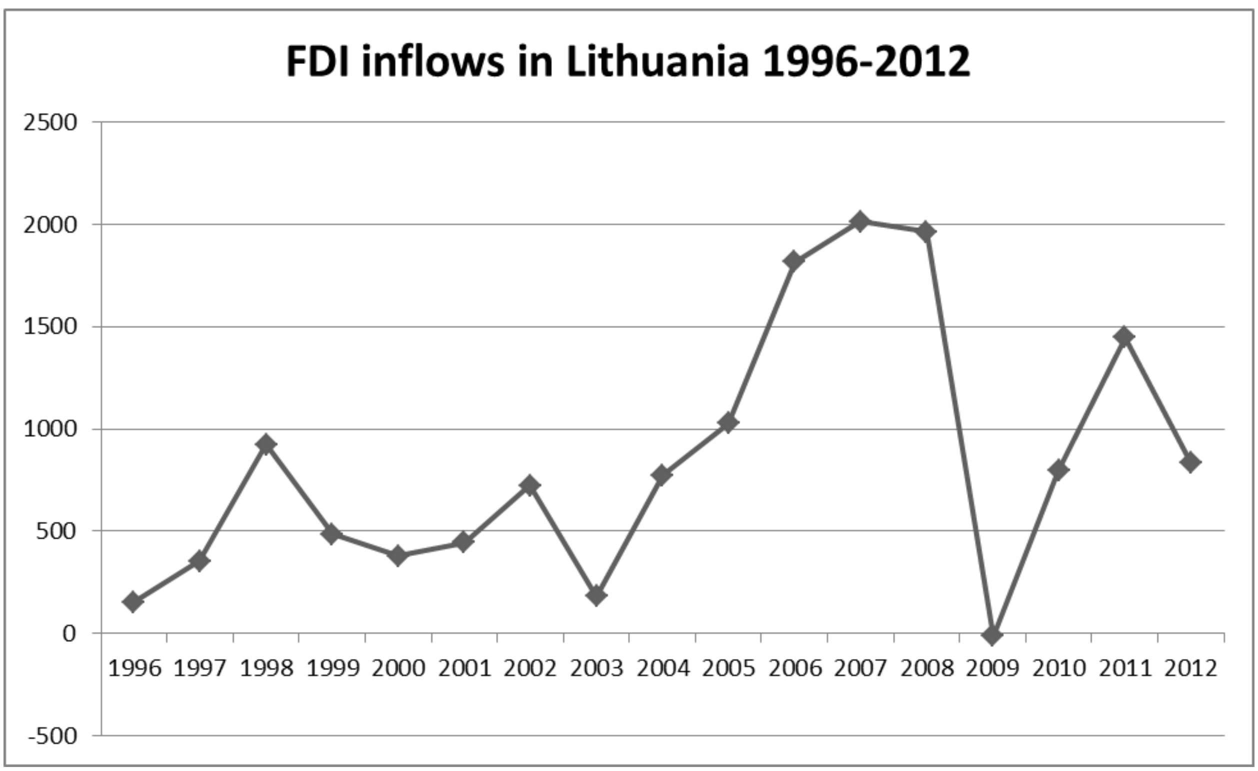
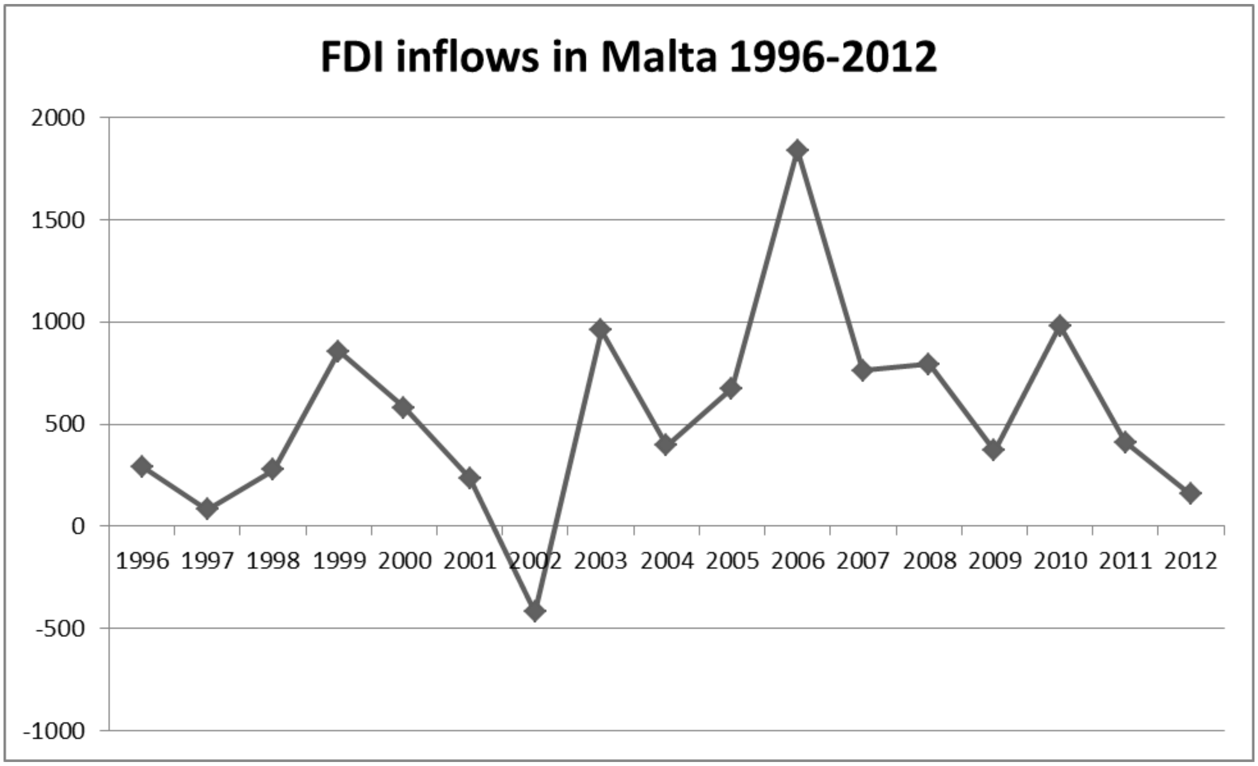
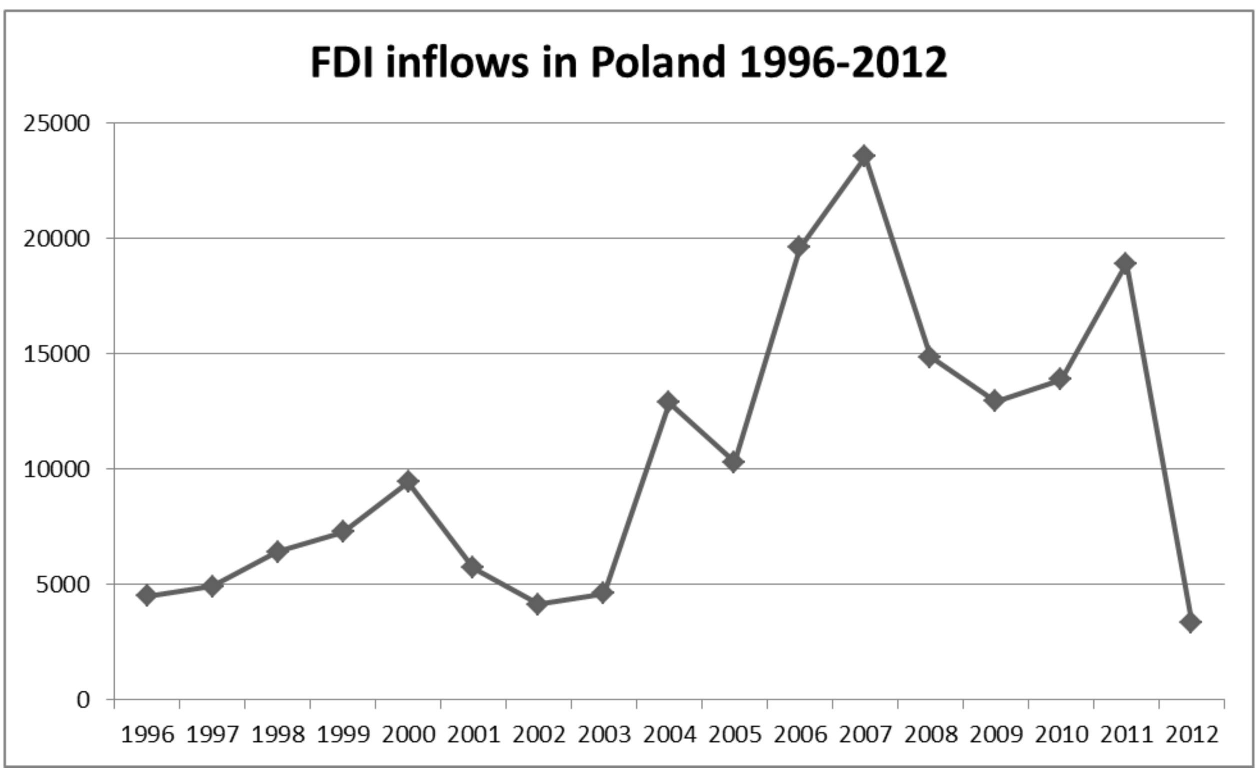
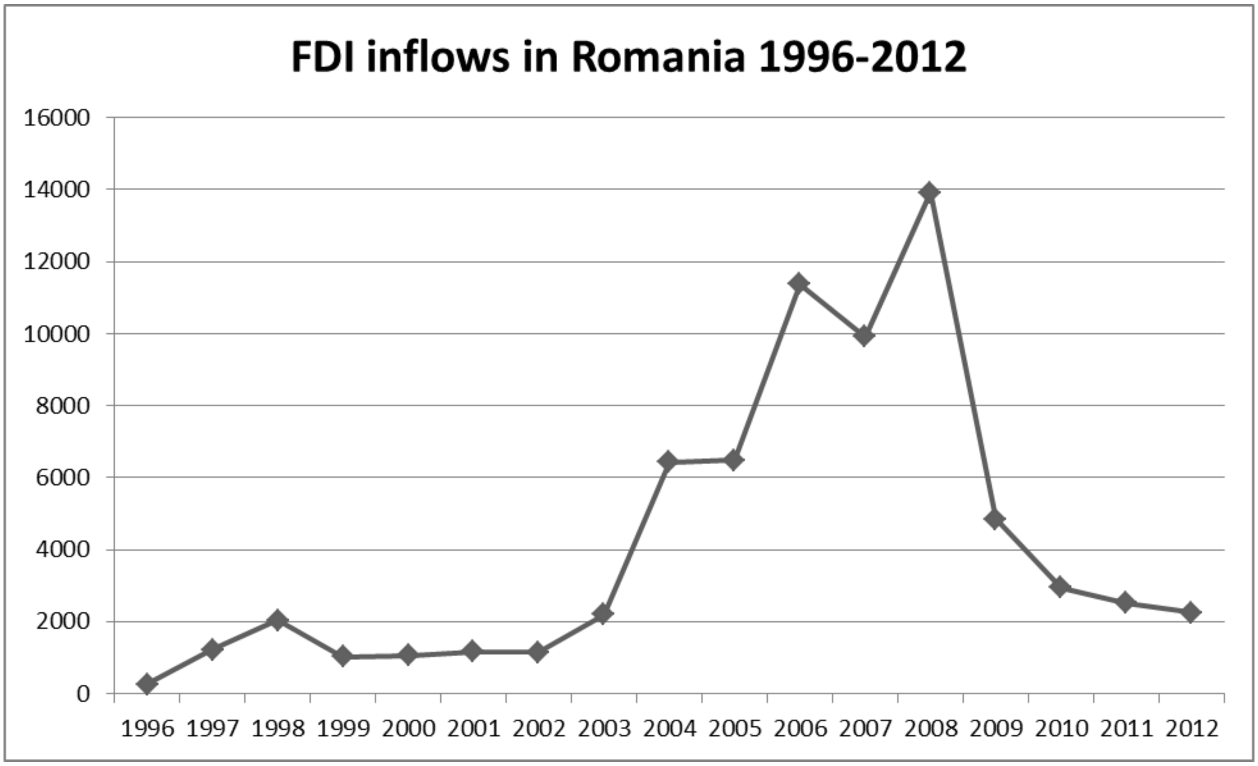
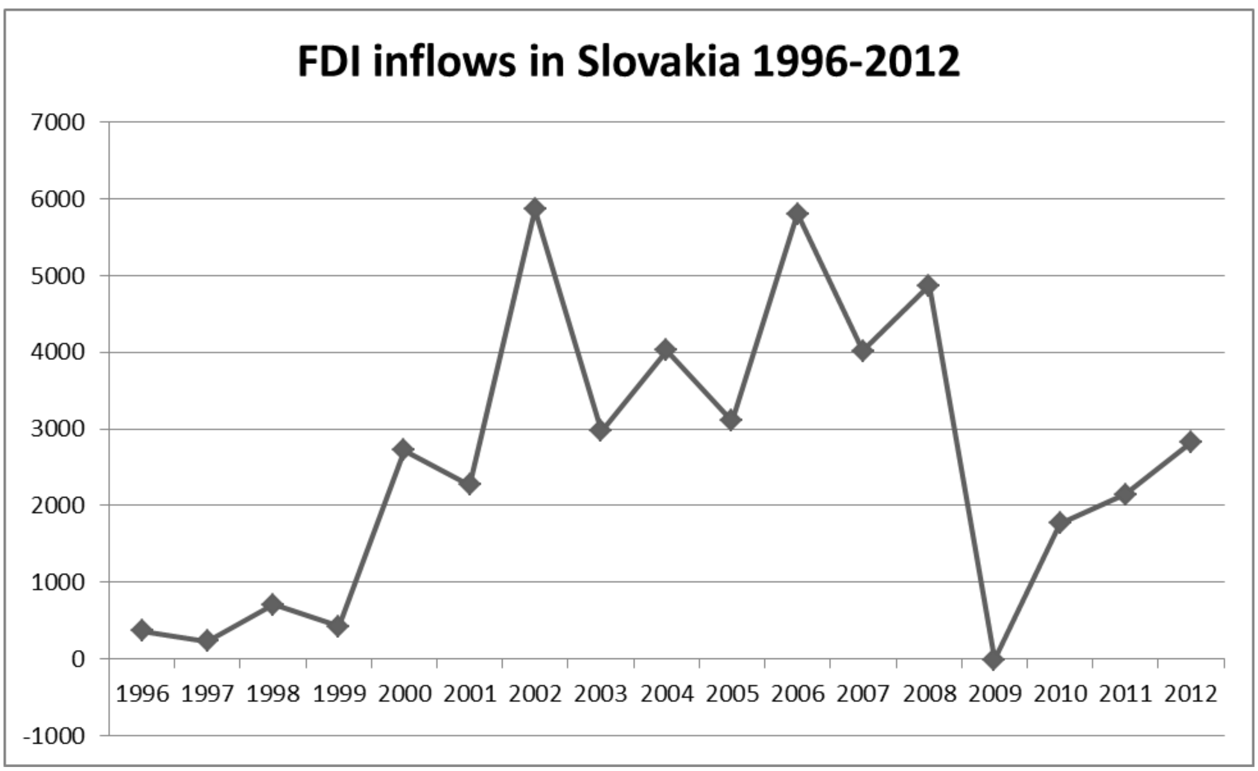
2000
1500
1000
500
0
1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012

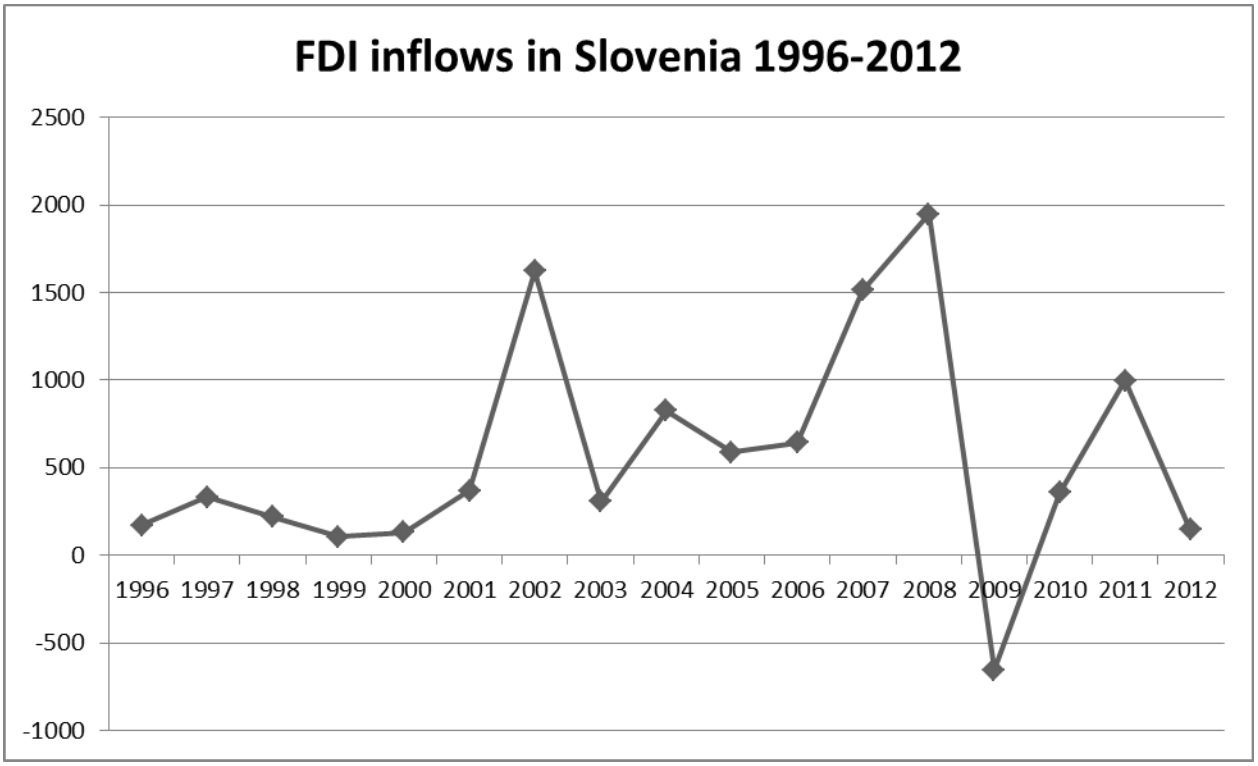

FDI inflows in Lithuania 1996-2012
2500
2000
1500
1000
500
0
-500
1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012


FDI inflows in Malta 1996-2012
2000
1500
1000
500
0
-500
-1000
1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012


FDI inflows in Poland 1996-2012
25000
20000
15000
10000
5000
0
1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012


FDI inflows in Romania 1996-2012
16000
14000
12000
10000
8000
6000
4000
2000
0
1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012


FDI inflows in Slovakia 1996-2012
7000
6000
5000
4000
3000
2000
1000
0
-1000
1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012


FDI inflows in Slovenia 1996-2012
2500
2000
1500
1000
500
0
-500
-1000
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012

APPENDIX B: Variable measurement and Descriptive Statistics

Table B.1: Variable Measurement

Foreign Direct Investment	The sum of all annual new FDI inflows in US Dollars at 2012 prices and 2012 exchange rates in millions. An investment involving a long-term relationship and reflecting a lasting interest of a resident entity in one economy (direct investor) in an entity resident in an economy other than of the investor For associates and subsidiaries, FDI flows consist of the net sales of shares and loans (including non-cash acquisitions made against equipment, manufacturing rights, etc.) to the parent company plus the parent firm´s share of the affiliate´s reinvested earnings plus total net intra-company loans (short- and long-term) provided by the parent company. For branches, FDI flows consist of the increase in reinvested earnings plus the net increase in funds received from the foreign direct investor. FDI flows with a negative sign (reverse flows) indicate that at least one of the components in the above definition is negative and not offset by positive amounts of the remaining components. Source: United Nations Conference on Trade and Development: http://unctad.org/en/Pages/DIAE/FDI%20Statistics/Interactive-database.aspx, accessed in July 2014.
EU Signaling	Signaling dummies to the 12 Eastern Enlargement countries are assigned in accordance with the application stages they were in during the respective years in the dataset. A country receives a 1 for the "credible candidate" stage if it has signed an association agreement with the EU but has not yet entered accession negotiations; it receives a 0 otherwise. The "accession negotiations" dummy

	assigns a 1 to countries that have begun accession negotiations but have not yet signed a Treaty of Accession, and 0 otherwise. Source: Author.
Corruption Control	The Control of Corruption Index (one of the six World Governance Indicators (WGI)). The Control of Corruption Index is a composite governance indicator based on 32 underlying data sources. These data sources are rescaled and combined to create an aggregate using an unobserved components model (UCM). The UCM assumes that the observed data from each source are a linear function of the unobserved level of governance, plus an error term. This linear function is different for different data sources, and so corrects for the remaining non-comparability of units of the rescaled data noted above. The resulting estimates of governance are a weighted average of the data from each source, with weights reflecting the pattern of correlation among data sources. The UCM assigns greater weight to data sources that tend to be more strongly correlated with each other. While this weighting improves the statistical precision of the aggregate indicators, it typically does not affect very much the ranking of countries on the aggregate indicators. The composite measures of corruption control generated by the UCM are in units of a standard normal distribution, with mean zero, standard deviation of one, and running from approximately -2.5 to 2.5, with higher values corresponding to better outcomes. The measure is useful as a tool for broad cross-country comparisons and for evaluating broad trends over time. Source: World Bank: http://info.worldbank.org/governance/wgi/index.aspx#doc, accessed in July 2014.

Host Market Size	Gross domestic product, current prices. Values are based upon GDP in national currency converted to U.S. dollars using market exchange rates (yearly average). Exchange rate projections are provided by country economists for the group of other emerging market and developing countries. Exchanges rates for advanced economies are established in the WEO assumptions for each WEO exercise. Expenditure-based GDP is total final expenditures at purchasers' prices (including the f.o.b. value of exports of goods and services), less the f.o.b. value of imports of goods and services. Annual figures in billions of USD. Source: World Bank.
Trade Openness	Percent change in volume of imports of goods and services. Percent change of volume of imports refers to the aggregate change in the quantities of total imports whose characteristics are unchanged. The goods and services and their prices are held constant, therefore changes are due to changes in quantities only. Source: World Bank.
Inflation	Inflation, average consumer prices. Expressed in averages for the year, not end-of-period data. A consumer price index (CPI) measures changes in the prices of goods and services that households consume. Such changes affect the real purchasing power of consumers' incomes and their welfare. As the prices of different goods and services do not all change at the same rate, a price index can only reflect their average movement. A price index is typically assigned a value of unity, or 100, in some reference period and the values of the index for other periods of time are intended to indicate the average proportionate, or percentage,

	change in prices from this price reference period. Price indices can also be used to measure differences in price levels between different cities, regions or countries at the same point in time. [CPI Manual 2004, Introduction] For euro countries, consumer prices are calculated based on harmonized prices. For more information see http://epp.eurostat.ec.europa.eu/cache/ITY_OFFPUB/KS-BE-04-001/EN/KS-BE-04-001-EN.PDF.] Source: World Bank.
Government Spending	Government Expenditure as a percent of GDP. Total expenditure consists of total expense and the net acquisition of nonfinancial assets. Note: Apart from being on an accrual basis, total expenditure differs from the GFSM 1986 definition of total expenditure in the sense that it also takes the disposals of nonfinancial assets into account. Source: World Bank.
Unit Labor Cost	Gross average wages, denominated in US Dollars at current exchange rates. Gross average monthly wages cover total wages and salaries in cash and in kind, before any tax deduction and before social security contributions. They include wages and salaries, remuneration for time not worked, bonuses and gratuities paid by the employer to the employee. For most countries wages cover total economy and are expressed per full-time equivalent employee. This enables comparison of different countries irrespective of the length of working time and the share of part-time and full-time workers. Source: UNECE Statistical Database: http://w3.unece.org/pxweb/dialog/varval.asp?ma=60_MECCWagesY_r&path=../database/STAT/20-ME/3

	MELF/&lang=1&ti=Gross+Average+Monthly+Wages+by+Country+and+Year, accessed in July 2014.
Foreign Reserves	Total reserves (includes gold, current US Dollars). Source: World Bank.
Structural Reforms	Average of the six EBRD transition indicators: large scale privatization, small scale privatization, governance and enterprise restructuring, competition policy, price liberalization, and trade and forex reform. These have been used to track reform developments in all countries of operations since 1989. Progress is measured against the standards of industrialized market economies, while recognizing that there is neither a "pure" market economy nor a unique end-point for transition. The measurement scale for the indicators ranges from 1 to 4+, where 1 represents little or no change from a rigid centrally planned economy and 4+ represents the standards of an industrialized market economy. Source: EBRD: http://www.ebrd.com/what-we-do/economic-research-and-data/data/forecasts-macro-data-transition-indicators.html, accessed in July 2014. An additional measure of the extent of structural reforms is the Investment Freedom Index of the Heritage Foundation. The *index* evaluates a variety of regulatory restrictions that are typically imposed on investment. Points are deducted from the ideal score of 100 for each of the restrictions found in a country's investment regime. It is not necessary for a government to impose all of the listed restrictions at the maximum level to effectively eliminate investment

	freedom. Those few governments that impose so many restrictions that they total more than 100 points in deductions have had their scores set at zero. Investment restrictions are divided into seven categories: investment restrictions based on nationality, burdensome foreign investment code in terms of transparency and bureaucratic structures, restrictions on land ownership, various sectoral restrictions or barriers, commonality of expropriations of investment without due compensation, foreign exchange controls, capital controls in terms of instances of repatriation of profits or need for government approval for various transactions. The *index* relies on the following sources for data on capital flows and foreign investment, in order of priority: official government publications of each country; Economist Intelligence Unit, Country Commerce, 2010–2013; Office of the U.S. Trade Representative, 2013 National Trade Estimate Report on Foreign Trade Barriers; and U.S. Department of Commerce, Country Commercial Guide, 2010–2013. Source: The Heritage Foundation: http://www.heritage.org/index/book/methodology, accessed in July 2014.
The Financial Crisis	A dummy variable for every country for every year measuring the presence a banking crisis. The variable comes from the Luc Leaven and Fabian Valencia (2012) dataset (Systemic Banking Crises Database: An Update) which covers the universe of systemic banking crises for the period 1970-2011. The database includes all systemic banking, currency, and sovereign debt crises during the period 1970–2011. A banking crisis is defined as systemic if two conditions are met: 1) Significant signs of financial distress in the banking system (as indicated by

significant bank runs, losses in the banking system, and/or bank liquidations)

2) Significant banking policy intervention measures in response to significant losses in the banking system.

The first year of the crisis is the one when both criteria are met. Source: IMF: https://www.imf.org/external/pubs/cat/longres.aspx?sk=26015.0, accessed in July 2014.

An additional control for the effects of the financial crisis on investment is global FDI. This is the sum of the FDI inflows in all countries in the world for every year in the dataset. Source: United Nations Conference on Trade and Development: http://unctad.org/en/Pages/DIAE/FDI%20Statistics/Interactive-database.aspx, accessed in July 2014.

Table B.2: Descriptive Statistics

Measure/Variable	Observations	Mean	Std. Dev.	Min	Max
FDI inflows	204	2,952.68	3,899.84	(652.50)	23,560.76
Lagged FDI inflows	192	2,934.99	3,887.08	(652.50)	23,560.76
Credible Candidate	204	0.17	0.37	-	1.00
Accession Negotiations	204	0.25	0.44	-	1.00
Corruption Control	192	0.41	0.49	(0.82)	1.80
EBRD Structural Reforms	204	47.14	5.81	24.00	54.00
Global FDI	204	1,106,143.00	471,895.50	391,439.30	2,002,695.00
Trade Openness	200	8.05	19.45	(61.37)	148.17
Unit Labor Cost	202	899.14	684.66	75.60	3,078.70
Foreign Reserves	204	13,000,000,000.00	18,200,000,000.00	207,000,000.00	109,000,000,000.00
Investment Freedom	204	66.67	12.15	30.00	90.00
Host Market Size	204	48.32	67.27	0.53	267.94
Inflation	204	181.93	223.08	14.35	1,688.83
Government Spending	192	28.92	13.31	12.10	82.08
Current Account Balance	204	4.44	18.91	(52.29)	50.73
Financial Crisis	204	0.14	0.35	-	1.00

APPENDIX C: FDI Stock per Capita in the EU28

(United Nations Conference on Trade and Development)

Country	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Luxembourg	84,701	126,027	158,864	132,312	171,589	273,874	245,322	319,968	308,586	343,854	232,385
Belgium	22,383	34,116	45,047	36,312	45,953	76,949	80,503	90,761	88,955	92,354	93,714
Ireland	46,470	55,563	50,823	39,329	37,027	47,465	43,257	56,685	63,889	55,609	65,092
Sweden	13,384	17,793	22,017	19,038	24,990	32,085	30,184	35,672	37,012	36,448	39,617
Malta	5,845	8,167	9,974	10,507	15,896	19,755	18,750	21,271	38,965	37,462	37,716
Netherlands	21,810	28,395	32,017	29,402	33,750	46,621	39,120	38,906	35,234	35,130	34,281
Denmark	15,417	18,607	21,594	21,486	24,581	29,736	28,101	28,384	25,919	25,982	26,404
Cyprus	6,783	9,374	11,532	11,191	17,841	23,165	21,023	23,020	21,600	25,690	26,016
United Kingdom	9,216	10,606	12,315	14,082	18,650	20,118	15,653	17,841	18,671	18,906	20,962
Austria	5,554	7,086	8,639	10,028	13,426	19,550	17,758	20,626	19,201	18,042	18,758
France	7,164	10,532	13,891	14,139	17,500	19,594	14,127	16,131	16,273	14,683	16,723
Finland	6,539	9,645	10,979	10,450	13,401	17,334	15,713	15,944	16,161	16,503	16,657
EU27 (European Union)	6,149	8,135	9,926	9,673	12,136	15,188	13,374	14,847	14,824	14,604	15,453
Estonia	3,119	5,188	7,449	8,380	9,450	12,482	12,209	12,531	12,449	12,478	14,052
Spain	6,216	8,079	9,536	8,861	10,485	13,135	13,044	13,853	13,637	13,391	13,567
Czech Republic	3,788	4,440	5,613	5,935	7,783	10,899	10,906	12,053	12,247	11,445	12,914
Portugal	4,282	5,789	6,374	6,007	8,363	10,870	9,400	10,764	10,462	10,461	10,950
Hungary	3,566	4,770	6,089	6,058	7,964	9,506	8,781	9,878	9,079	8,475	10,408
Slovakia	2,300	4,025	5,209	5,465	7,113	8,785	9,265	9,636	9,206	9,375	10,185
Germany	3,613	4,783	6,205	5,767	7,166	8,429	8,096	8,509	8,708	8,639	8,737
Slovenia	2,065	3,163	3,799	3,626	4,478	7,144	7,748	7,502	7,128	7,424	7,611
Croatia	1,360	1,930	2,790	3,275	6,173	10,180	6,992	8,299	7,944	7,022	7,205
Bulgaria	516	813	1,298	1,790	3,054	4,965	5,804	6,526	6,302	6,354	6,741
Poland	1,264	1,515	2,273	2,381	3,295	4,672	4,299	4,842	5,634	5,175	6,018
Latvia	1,171	1,404	1,953	2,138	3,260	4,752	5,080	5,131	4,774	5,391	5,931
Italy	2,343	3,252	3,978	4,048	5,289	6,328	5,475	6,049	5,418	5,581	5,854
Lithuania	1,150	1,439	1,862	2,404	3,236	4,457	3,854	3,956	3,993	4,313	4,798
Romania	356	557	938	1,186	2,094	2,909	3,146	3,343	3,270	3,328	3,468
Greece	1,405	2,021	2,555	2,610	3,680	4,728	3,376	3,717	3,083	2,561	3,310