

## **The Transparency Paradox: Why do Corrupt Countries Join EITI?**

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## Abstract

Rules that require actors to make their finances transparent have become a key part of the anti-corruption toolkit, under the assumption that sunlight is the best disinfectant. This logic underpinned the creation, in 2002, of the Extractive Industries Transparency Initiative (EITI), an international club aimed at reducing corruption in oil, gas and mining. The initiative has proved popular, with 16 countries now EITI compliant and 23 others having achieved candidate status. However, as a soft law standard to which countries voluntarily commit, EITI presents a paradox: why would corrupt governments voluntarily expose themselves to sunlight? Does its popularity imply that it is meaningless? We argue that governments join because they are concerned about their reputation with international donors and expect to be rewarded by increased aid. Our quantitative analysis demonstrates that countries do gain access to increased aid the further they progress through the EITI implementation process. However, we also find that EITI achieves real results in terms of reducing corruption. We suggest that this is because EITI requires countries to build multi-stakeholder institutions which improve accountability, and provide qualitative evidence about how this has worked in several countries.

Resource-rich countries tend to perform poorly in terms of economic development despite their natural wealth (Auty, 1993, Karl, 1997). Some scholars attribute this 'resource curse' partly to high levels of corruption (Sala-I-Martin and Subramanian, 2008, Mehlum et al., 2006, Robinson et al., 2006). Indeed, many countries that are rich in oil, gas and mineral resources are perceived to be highly corrupt, according to widely used measures such as the Transparency International Corruption Perceptions Index (CPI), while the extractive industries are regarded as among the most corrupt areas in international business.<sup>1</sup> It is therefore not surprising that the extractive industries have been the target of many anti-corruption measures in recent years. Many of these efforts have focused on transparency initiatives, which have become a key part of the anti-corruption toolkit on the assumption that sunlight is the best disinfectant. Thus, in August 2012, the United States imposed transparency requirements on oil, gas and mining companies to fulfill a section of the 2010 Dodd-Frank Act, requiring them to disclose payments made to foreign governments.<sup>2</sup> The European Union introduced similar changes in June 2013 as part of a review of its accounting directive.

However, these 'hard law' requirements aimed at companies were preceded by a 'soft law' project aimed at changing the behavior of the *governments* of resource-rich countries. Launched in 2002, the Extractive Industries Transparency Initiative (EITI) seeks to reduce corruption in oil, gas and mining by persuading governments to make revenues earned in these sectors transparent. It grew out of the Publish What You Pay campaign, a global network of civil society organizations (CSOs) campaigning for transparency in the extractive industries.<sup>3</sup> Countries that sign up to EITI commit to publishing government revenues from the extractive industries and requiring companies that operate on their territory to do the same. Any discrepancies are revealed and must be reconciled ahead of the publication of the EITI Report. This transparency on both sides of the business relationship is expected to deter corruption and, therefore, increase the likelihood of revenues being spent in ways that contribute to social and economic well-being, particularly in developing countries (Ölcer, 2009).

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<sup>1</sup> On the TI Bribe Payers Index 2011, mining is ranked 15<sup>th</sup> most corrupt out of 19 sectors while oil and gas is ranked 16th. Mining scores 6.3, oil and gas 6.2, where a maximum score of 10 corresponds with the view that companies from that country never bribe abroad and a zero corresponds with the view that they always do.

<sup>2</sup> US oil and mining companies were to be required to disclose payments of taxes and other fees in excess of \$100,000 made to foreign governments. However, on 2 July 2013 the DC District Court gave a summary judgement vacating this portion of the Dodd-Frank Act.

<sup>3</sup> See <http://www.publishwhatyoupay.org/>

The initiative has proved extremely popular, with 23 countries now rated as EITI compliant, 16 having attained candidate status and many others having signaled their commitment to implementing EITI (see Table 1 below). However, as a soft law organization, to which countries voluntarily commit, the Initiative's popularity is a puzzle: why would corrupt governments voluntarily expose themselves to sunlight and thereby forgo future corrupt revenues? Does the Initiative's success in attracting members imply that it is meaningless and hence that it does not achieve its aim of reducing corruption?

**Table 1. Countries at different stages of implementation**

<b><u>Intent to Implement</u></b>	<b><u>Candidate Status</u></b>	<b><u>Compliant</u></b>
Australia	Afghanistan	Albania
Brazil	Cameroon	Azerbaijan
Colombia	Chad	Burkina Faso
France	Democratic Rep. of Congo*	Central African Republic*
Myanmar	Guatemala	Cote d'Ivoire
Ukraine	Guinea	Ghana
United Kingdom	Honduras	Iraq
United States	Indonesia	Kyrgyz Republic
	Kazakhstan	Liberia
	Madagascar*	Mali
	Sao Tome & Principe	Mauritania
	Sierra Leone*	Mongolia
	Solomon Islands	Mozambique
	Tajikistan	Niger
	Philippines	Nigeria
	Trinidad & Tobago	Norway
		Peru
		Republic of the Congo
		Tanzania
		Timor-Leste
		Togo
		Yemen*
		Zambia

Our research contributes to the literature on how the establishment of voluntary standards systems that allow actors to demonstrate commitment to an emerging international norm – in this case, transparency - can regulate the behavior of governments. Voluntary private regulation is becoming increasingly common, particularly in the area of environmental standards. However, EITI has an unusual governance structure in that it requires three parties - governments, companies and civil society organizations - to implement standards together. EITI engages this tripartite group in “regulatory standard-setting” (RSS) in an effort to fill perceived gaps in state and international regulation, effectively contracting out a small area of policy-making to the multi-stakeholder group. The closest relatives of EITI in terms of global regulatory institutions include the International Labor Organization Declaration on Multinational Enterprises, the Kimberley Process on conflict diamond trade and the Apparel Industry Partnership (Abbott, 2009).

We suggest that, although EITI implementation is voluntary, governments are motivated to make this commitment because they seek to improve their reputation with the international community. This, in turn, brings tangible benefits, since states that are regarded as behaving in line with international norms are often rewarded by other international actors. Specifically, we argue that many resource-rich governments are motivated to join EITI at least partly by the promise of increased foreign aid. We put forward evidence that governments perceive that they are offered such rewards and demonstrate that such benefits are forthcoming when they commit. We qualify this by arguing that it is only for a certain set of countries that the expected benefits of joining outweigh the costs of implementation. EITI may be a particularly easy win for countries that are only moderately corrupt or that are perceived to be more corrupt than they really are. The promise of aid commands much weaker leverage in countries that are wealthier and less dependent on aid.

Despite the fact that commitment to EITI reflects instrumental behaviour, we also argue that EITI achieves real results in terms of reducing corruption in the countries that join. We analyse how corruption levels (as measured by CPI country scores) improve after countries sign up to EITI, both over time and in comparison to matched-pair countries that do not join. We argue that EITI works because of the nature of the implementation process and the way in which it improves the capacity of civil society to hold governments to account, whether governments like it or not.

The paper proceeds as follows. First, we set out our argument and hypotheses about why countries join EITI, and report our findings in this area. Second, we develop a theoretical argument for how implementation might result in reduced corruption. We then present the data and methods by which we test this hypothesis, before reporting our results. Third, although we acknowledge the

difficulty of demonstrating that EITI implementation *causes* a reduction in corruption, we seek to improve the robustness of our results by conducting another check on the mechanism by which we expect this relationship to occur, i.e., by testing how accountability levels mediate the effects of EITI implementation on corruption levels. Our conclusions draw out key implications relating to how third-party benchmarks can be used to refine aid conditionality, the role of transparency initiatives in reducing corruption, and the conditions necessary for EITI to retain its transformative power in the future.

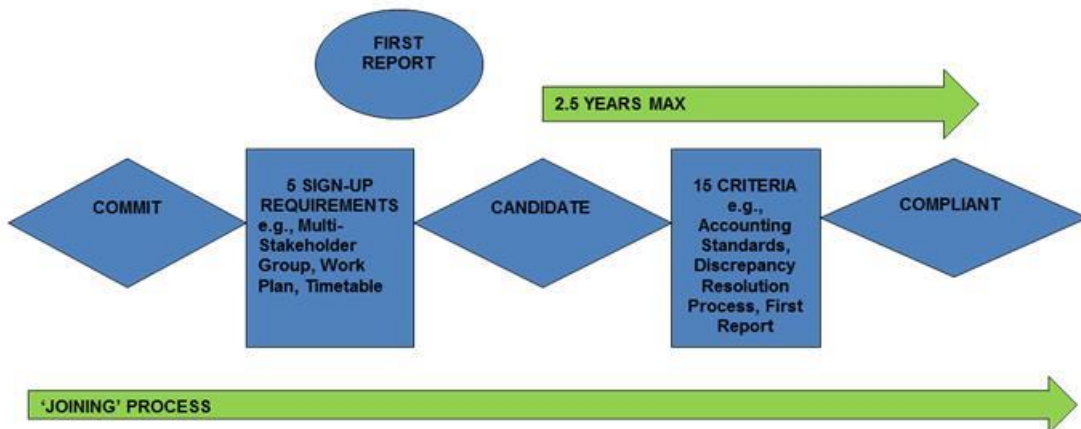
## **THE PROCESS OF EITI IMPLEMENTATION**

For national governments, the process of joining EITI – or becoming EITI compliant – involves fulfilling criteria so as to progress through three defined stages: commitment, candidacy, and compliance (see Figure 1).<sup>4</sup> Governments first signal their ‘commitment to implement’ by making a public announcement that they wish to join EITI. They then work towards obtaining the status of ‘candidate’. To become a candidate, countries must meet five sign-up requirements. In addition to making a ‘commitment to implement’ – i.e., an unequivocal public statement of intention to implement EITI, they must commit to work with civil society and companies on the implementation process, appoint a senior individual to lead on EITI implementation, and establish a multi-stakeholder group to oversee the implementation. The multi-stakeholder group should include – but is not limited to – the private sector, civil society (not only NGOs but also the media and parliamentarians) and relevant government ministries (including the individual appointed to lead implementation). Finally, the multi-stakeholder group, in consultation with key EITI stakeholders, should agree and publish a fully costed work plan, containing measurable targets, a timetable for implementation, and an assessment of capacity constraints. The country should detail how it has met these criteria when it formally applies to become an EITI member. Once the country has completed these steps, an Outreach and Candidature Committee of the EITI Board assesses the application and makes a recommendation to the Board, which ultimately decides whether the country has met the conditions for becoming a candidate.

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<sup>4</sup> We use the term ‘joining’ EITI as a shorthand for engaging in the implementation process in any way, where the particular stage of implementation is not relevant.

**Figure 1. The EITI implementation process**



Countries can hold candidate status for a maximum of two-and-a-half years, during which time they undergo a ‘validation’ process. This involves meeting a further 15 criteria, which functionally prepare the government and relevant companies to be able to disclose payments based on accounts audited to international standards, and to be able to disseminate their reports and encourage public debate. The publication of a report is not itself one of the criteria and indeed some countries publish their first EITI reports after achieving compliance.<sup>5</sup> However, many of the other criteria centre on the process for producing and checking the contents of the report. For example, the multi-stakeholder group must appoint a ‘reconciler’ to compare the payments received by the government with those made by companies and to account for any discrepancies. It must also put in place processes for resolving discrepancies, acting on lessons learnt and ensuring that EITI implementation is sustainable. Once it has met the 15 criteria, the EITI Board declares the country to be ‘compliant’. However, countries can lose their compliant status at any point if they cease to adhere to any of the 21 requirements (the five sign-up requirements, the 15 implementation requirements, and a commitment to maintain adherence to all requirements). EITI has proved highly popular. Table 1 shows the countries that have achieved each of the stages of implementation as of September 2013.

<sup>5</sup> This is partly a historical artefact. When EITI was first established, the publication of the first report was the main objective of countries that committed to implementation. It is only since 2007 that the formal stages of candidacy and compliance have been introduced.



## WHY DO GOVERNMENTS JOIN EITI?

EITI implementation requires governments to voluntarily subject themselves to a significant degree of scrutiny. For any government, undertaking the validation process is an onerous commitment and success is not guaranteed, raising questions as to what expected benefits outweigh these costs. Even for countries where corruption levels are perceived to be low - such as some of the countries that have most recently signaled their intent to implement the standard, including the United States, the United Kingdom and France, for example – the implementation process is costly and time-consuming. However, for high-corruption countries, this puzzle is acute, since EITI implementation increases the risk that their corruption will be exposed and that they will subsequently have to give up a highly lucrative stream of private gain. This raises the question, why do so many (high-corruption) countries seek to join EITI? Yet join they do. Of the 23 countries that have achieved compliance, 20 have a CPI score of 40 or less, on a scale where 0 means that a country is perceived as highly corrupt and 100 means that a country is perceived as very clean.<sup>6</sup>

One answer is that the emergence of oil-sector transparency as an international norm, itself driven by the reputational concerns of several high-profile actors (Gillies, 2010), has changed the costs and benefits of engaging in corruption versus building a reputation for seeking to improve governance. Given the widespread consensus that corruption is detrimental to economic development (Mauro, 1995, Bardhan, 1997, Rose-Ackerman, 1999, Hodge et al., 2011), donors, lenders, companies (at least, clean companies, for whom bribe demands represent an unwelcome cost), and citizens have long had an interest in reducing corruption.

The spread of transparency as a norm has meant that governments generally make much more information available about their activities and their finances, while the media and civil society demand far greater access to such information. The 'right' to information about public spending and public policy is increasingly enshrined in Freedom of Information Acts, for example, while the Open Government Partnership has seen 64 countries making a commitment to more transparent and accountable government. Grigorescu suggests that political elites thus realize that they no longer have a monopoly over information and that their societies will receive information about them directly from other sources (Grigorescu, 2003). They might calculate that they have less to lose from making a commitment to transparency, or at least that transparency is inevitable.

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<sup>6</sup> See Transparency International Corruption Perceptions Index 2012, [http://www.transparency.org/cpi2012/in\\_detail](http://www.transparency.org/cpi2012/in_detail).

At the same time, some actors in the international community have begun to offer explicit incentives to governments in exchange for commitments to greater transparency. Donors and lenders face an asymmetric information problem regarding a government's capacity and intent to use aid for agreed purposes or re-pay loans on time. They have learned that giving money to countries with poor governance rarely pays (Collier et al., 1997, Freytag and Pehnelt, 2009, Presbitero, 2009). As a result, many countries and international organisations now condition lending and aid on anti-corruption provisions. This has long been the case for the World Bank and IMF, while the OECD's Development Assistance Committee (DAC) also requires the inclusion of anti-corruption provisions in aid-funded bilateral procurement contracts (Sandholtz and Gray, 2003). However, these provisions are not easy to monitor or enforce. Donors and lenders need a more reliable method for monitoring and judging whether a country is serious about improving governance or fighting corruption.

To date, the main tools used by donors have been indices based on perceptions and experience of corruption, such as the CPI and the World Bank's Worldwide Governance Indicators (WGI). These 'reputational intermediaries' provide information about a country's track record on controlling corruption and help shape expectations about how the country will behave in future. Eigen writes that, "*donor nations and institutions are constantly on the lookout for signals of improved governance as they seek to protect and give good account for the usage of their taxpayers' money*" (Eigen, 2006-07). Indeed, research suggests that countries with good governance according to these indicators are 'rewarded' by the international community through increased foreign aid, while governments that are perceived to be corrupt typically receive less foreign aid (Alesina and Dollar, 2000, Wright, 2009, Neumayer, 2002, Alesina and Weder, 2002, Knack, 2004).

This kind of corruption-related aid conditionality has been developed most strikingly by the Millennium Challenge Corporation (MCC), a US aid agency established under the Bush administration. Potential MCC recipient countries must score higher than the median compared with peers in the same income category on at least one-half of a set of governance criteria. Of these, 'control of corruption', measured according to the WGI, has special status as a mandatory prerequisite. The MCC appears to have been effective in promoting corruption control through this method. Research shows that countries with a reasonably good chance of gaining access to the MCC fight corruption more effectively than other potential candidates (Ohler et al., 2012, Dreher et al., 2012). Moreover, MCC has begun to operate as a reputational intermediary, with other donors

using the signal and granting more aid to countries that have signed compacts with the MCC (Ohler et al., 2012).

However, the MCC relies on external indicators of the control of corruption. These governance indicators are a rather imperfect signal of commitment to fighting corruption. They tend to be based largely on perceptions of corruption and on 'expert accounts', making them vulnerable to charges of subjectivity, lack of comparability across time and countries, and selection bias. Moreover, on an issue where political will and leadership are of key importance, such indicators may not provide a very accurate guide to the current government's commitment to fighting corruption. By contrast, EITI implementation, by virtue of being so onerous and costly, may be a more credible way for governments to demonstrate that they are committed to fighting corruption. EITI implementation is itself an explicit – and ongoing - commitment to greater transparency and accountability. As a result, we would expect donors to start conditioning aid on EITI implementation, and governments to start signing up to EITI as a way of improving their reputation with the international community and accessing such aid.

On the donor side, there is evidence that many IOs, donors and lenders, including the United Nations, IMF, World Bank, European Union and African Union, actively promote EITI to resource-rich country governments. The EITI secretariat is also explicit about the benefits that countries can expect to gain from joining, listing them in its core documents. Some of these benefits derive from efficiency gains, such as the value of having more regular or predictable tax revenues. Others are more reputational: an increase in foreign direct investment, for example, might come about as a result of improved *perceptions* of the business environment. EITI also lists 'reputation management' explicitly, although it describes this primarily as an inward-looking concept, pertaining to the government's reputation with its own population rather than with the international community.

From the perspective of resource-rich governments, the use of EITI as a condition for accessing aid might make it worthwhile to commit to transparency. We assume that governments implement EITI when they expect to derive significant benefits from membership – e.g., in terms of aid - which make it worthwhile to incur the costs and risks of joining. Aid is a short-term gain that gives governments discretionary power over additional resources, and hence may compensate for forgone corruption rents.

However, governments will face different balances of costs and benefits depending on the prior level of corruption in the country and their degree of commitment to reducing it. Not all governments will find it worthwhile to ‘pay’ for the signal by embarking on EITI implementation. For highly corrupt governments that wish to continue being corrupt, for example, EITI implementation does not make sense. It would either expose evidence of corruption and make leaders vulnerable to punishment of some kind (e.g., criminal prosecution, political opposition, loss of an election), or it would constrain future corruption opportunities, thereby causing them to forgo revenues. This may explain why some resource-rich but highly corrupt countries have never shown an interest in implementing EITI – for example, Angola, the original target country for the ‘Publish What You Pay’ campaign. Such countries are typically not very integrated into the international community, and hence are not exposed to anti-corruption norms (Sandholtz and Gray, 2003). EITI may also be non-viable in countries with weak or non-existent governments, where corruption levels are high, but they are unable to maintain sufficient order to achieve EITI implementation. This raises some doubts about the transformative power of the EITI for the most corrupt countries.

On the other hand, for governments that are seriously committed to reducing corruption, or that think they have an unjustly poor reputation for being corrupt, the costs of implementing EITI will be low and the benefits potentially great. Committing to implement EITI is therefore a truthful signal by which clean governments can distinguish themselves from less clean governments, build a reputation for integrity and thereby unlock economic benefits. This may also explain why some countries – e.g., Myanmar - seek to join immediately after a change of government, as the incoming government looks for ways to distinguish itself from its predecessor and access resources with which it can reward voters.

Although we cannot test whether governments join *because* they expect to receive aid, which would require a much more detailed exercise in process-tracing, Eigen offers evidence that implementing governments at least *expect* EITI to yield concrete benefits. This suggests that donors and lenders may offer such incentives explicitly, at least in some cases:

*“A Nigerian minister, recently commenting for the first time on her country’s acquiring an attractive credit rating, attributed a sovereign debt rating in substantial part to the reputational effect of its energetic application of EITI to uncover, for public scrutiny, the previously hidden fiscal flows of the oil and gas industry.”(Eigen, 2006-07)*

Ölcer meanwhile refers to the view of a member of the Cameroon Publish What You Pay coalition that there was a perception that the government was using EITI to gain Heavily Indebted Poor Country (HIPC) status and thereby become more eligible for special assistance from the IMF and World Bank (although this is not formally one of the IMF's requirements for HIPC status) (Ölcer, 2009). Further, a leaked cable from the US embassy in Yemen reporting on a dialogue with donors about governance objectives, published by wikileaks, states that *“one of the primary donor recommendations was that the ROYG join the Extractive Industries Transparency Initiative (EITI) at the soonest possible opportunity.”*<sup>7</sup> This evidence lends weight to the argument that some countries join because they expect to receive aid and other forms of support. Although we cannot claim to have stronger evidence about governments' motivations for joining EITI, we do seek to demonstrate that there is a relationship between EITI implementation and aid receipts. We postulate the following hypotheses about this relationship.

**Hypothesis 1a:** *Countries that are highly corrupt and have access to substantial natural resource rents are less likely to participate in EITI than countries which are moderately corrupt and/or have access to lower natural resource rents.*

**Hypothesis 1b:** *Countries that implement EITI receive an increased amount of foreign aid.*

**Hypothesis 1c:** *The amount of aid that implementing countries receive is greater the further the country has progressed with EITI implementation.*

## **AID CONDITIONALITY: METHOD AND RESULTS**

Data is taken from the World Bank World Development Indicators, Transparency International and from EITI. The sample size is a maximum of 185 countries, although data limitations reduce this for many regressions. We do not include developed countries in the regressions for the impact of joining EITI, hence Norway is not part of the sample for countries that are compliant and the United States and Australia are excluded from the sample of countries that commit to EITI. We use the Transparency International Corruption Perceptions Index (CPI) as an annual measure of the level of corruption in a country. Although other measures of corruption are available, such as the World

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<sup>7</sup> See <http://www.cablegatesearch.net/cable.php?id=06SANAA146>. Accessed 4 October 2012.

Bank's 'Control of Corruption' score within the Worldwide Governance Indicators, the CPI is the most widely known and used indicator of country-level corruption. The CPI was launched in 1995, while EITI was established only in 2002. We consider the impact on country CPI scores of different stages of EITI implementation – commitment, first report and candidacy – both over time and compared to a matched-pair sample. A summary of the data is provided in Table 2.

**Table 2. Data Summary**

Aid is the aid flows from all DAC countries. Ethnic is ethnic fractionalization of a country, based on Alesina et al. (2003) and supplemented with data from CIA The World Factbook. CPI is the Transparency International Corruption Perceptions Index. Commit, First Report, Candidate, and Compliant are categories of dummy variables set at one in the year that a country chooses to commit, publishes its first EITI report, becomes a candidate or becomes compliant.

Variable	Observations	Mean	Standard deviation	Minimum	Maximum
Aid (US\$ millions)	1656	324.0	879.0	0	22000.0
LnAid	1628	14.6	8.02	0	23.82
Population (thousands)	1656	35,500.0	132,000.0	67.8	1,340,000.0
LnPop	1656	15.71	1.87	11.12	21.01
LnPop^2	1656	250.45	58.35	123.74	441.6
GDP per capita	1651	9944.9	15548.65	0	118218.8
LnGDP_PC	1593	8.7	1.31	5.44	11.4
LnGDP_PC^2	1593	77.38	22.62	29.56	129.89
Debt service (US\$ millions)	1656	16,100	48,100.0	0	549,000
LnDebtServ	1656	22.27	1.82	0	27.03
Ethnic	1611	0.44	0.26	0	0.93
Natural Resources (% GDP)	1656	10.42	19.44	0	206.51
CPI	1377	4.15	2.17	1	9.9

Natural resources x Inverse CPI	1368	7.35	14.73	0	169.34
Commit	1665	0.02	0.15	0	1
First Report	1665	0.01	0.11	0	1
Candidate	1665	0.02	0.14	0	1
Compliant	1665	0.00	0.05	0	1

Using a Cox proportional hazard model (Cox, 1972), we can examine the factors that determine the decision to participate in EITI over time; these results are presented in Table 3. The Cox proportional hazard model removes each country when it carries out one of the four stages of EITI implementation, i.e., when it commits to implement EITI, publishes its first report, becomes a candidate or achieves compliance. In the Cox model, this is known as the time to ‘failure’. We control for factors that have been shown by others to affect the decision to join EITI, such as ethnic fractionalization and the proportion of natural resource rents (Pitlik et al., 2010, Alesina et al., 2003).

**Table 3. Cox Proportional hazard model of commitment to EITI (failure)**

LnAid is the log of DAC countries total aid in current US Dollars. GDPYoY is the year-on-year growth rate of GDP based on current US Dollars, LnGDP\_PC log of GDP per capita in Current US Dollars, LnPop is the log of population, Ethnic is a measure of ethnic fractionalization in the country based on Alesina et al. (2003). Natural resources is natural resource rents as a percentage of GDP divided by 10. InvCPI is Transparency International’s Corruption Perceptions index, inverted so that 10 is the most corrupt and 1 is least corrupt.

	Commit	First Report	Candidacy	Compliant
LnAid	0.102 (1.57)	0.492 (2.41)**	0.218 (1.69)*	0.306 (1.25)
LnPop	0.017 (-0.14)	-0.338 (-1.91)*	-0.144 (-0.99)	-0.336 (-1.52)
GDPYoY	7.480 (3.76)***	-3.818 (-0.86)	6.676 (1.89)*	26.664 (4.16)***
LnGDP_PC	-0.532 (- 3.03)***	-0.348 (-1.59)	-0.453 (- 2.25)**	-0.887 (-2.68)***
Ethnic	2.275 (2.56)**	1.901 (1.85)*	1.561 (1.98)**	-3.292 (-1.65)*
Natural	0.878 (1.05)	2.215 (3.85)***	1.356	2.806 (1.75)*

Resources			(1.99)**	
InvCPI	0.238 (1.05)	0.360 (1.21)	0.431 (1.54)	-0.043 (-0.07)
InvCPI x Natural Resources	-0.091 (-0.84)	-0.256 (- 3.47)***	-0.141 (- 1.66)*	-.276 (-1.25)
Failures	29	20	32	5
N	1269	1269	1269	1269
Clustered	Y	Y	Y	Y
Wald Chi2	97.56	27.68	49.69	64.29

\*\*\* significant at the 1% level, \*\* significant at the 5% level and \* significant at the 10% level.

We test for the hypothesis that extremely corrupt countries with high levels of natural resources will be resistant to joining, showing that the decision to join is tempered by the level of corruption and the level of natural resources (H1a). In other words, countries which stand to lose too much from EITI implementation, in terms of forgone corrupt revenues, will not join. We find that increasing levels of natural resource rents lead to a positive effect on the decision to participate at all four stages, in line with prior research (Pitlik et al., 2010). It is statistically significant at the 1% level for publication of the first report, at the 5% level for candidacy and at the 10% level for compliance. Higher levels of corruption are generally associated with a greater likelihood to participate for three of the four implementation stages, with compliance showing a small negative effect. However, this is not statistically significant. Note that here we have inverted the index so that a score of 10 is the most corrupt. This allows us to examine the effect of increasing corruption and increasing natural resource rents.

We find evidence that the most corrupt countries with access to high levels of natural resources do not join, in support of H1a. The coefficient on the product of natural resource rents and corruption is negative in all four stages and is statistically significant at the 1% level for the first report and at the 10% level for the decision to become a candidate. By inverting the corruption scale and dividing the natural resource rents as a percentage of GDP, we create an index that runs from 1 to 100 (because natural resource rents are sometimes more than 100% of GDP, this is not strictly true, but the general principle is valid). Thus very corrupt and natural resource rich countries score high on this variable.



It is likely that countries which commit to EITI but manage to go no further are those that seek to build a reputation for fighting corruption without making the necessary changes – i.e., countries that are not truly committed to fighting corruption but seek to ‘fake it’ in order to achieve the associated benefits. This would explain why the coefficient for the natural resource rents and corruption is lowest for committers. It is higher for first reporters than for candidates, which may reflect the fact that first reports are a more tangible sign of progress than even candidacy, and there are fewer first reports than there are candidates.

We also find evidence that an increase in aid is associated with the decision to participate (H1b). This effect is positive for all four stages; it is statistically significant at the 5% level for publication of the first report and at the 10% level for the decision to become a candidate. However, we also wish to examine whether further progress towards implementation is rewarded more (H1c). Table 4 shows a panel regression looking at the determinants of the log amount of aid in US Dollars with country fixed effects and clustered standard errors. It is primarily concerned with the impact of the different stages of EITI participation on aid flows to countries.

**Table 4. Determinants of aid**

LnAid is the log of DAC countries total aid in current US Dollars, Commit, First Report, Candidate, and Compliant are categories of dummy variables set at one in the year that a country chooses to commit, writes, its first EITI report, becomes a candidate or becomes compliant to the EITI standards. The subscripts represent years, with  $t_0$  being the year that a country participates in the stage of EITI. LnDebtServ is the log of total debt service costs in current US Dollars. CPI is Transparency International's Corruption Perception index, LnGDP\_PC is the log of GDP per capita in Current US Dollars, LnPop is the log of the population, LnGDP\_PC<sup>2</sup> is the square of the log of the GDP per capita and LnPop<sup>2</sup> is the square of the log of the population.

	Aid	Aid	Aid	Aid	Aid
Commit <sub>t-1</sub>	-0.272 (-0.77)				0.391 (1.07)
Commit <sub>t0</sub>	-0.555 (-1.27)				-0.256 (-0.57)
Commit <sub>t+1</sub>	-0.517 (-1.12)				-0.457 (-1)
Commit <sub>t+2</sub>	-0.245 (-0.66)				-0.197 (-0.46)
First Report <sub>t-1</sub>		0.515 (1.41)			-0.033 (-0.1)
First Report <sub>t0</sub>		1.264 (2.35)**			0.43 (1.06)
First Report <sub>t+1</sub>		1.441 (2.44)**			0.574 (1.43)
First Report <sub>t+2</sub>		0.899 (1.81)*			-0.341 (-0.63)
Candidacy <sub>t-1</sub>			0.932 (2.27)**		1.08 (2.55)**
Candidacy <sub>t0</sub>			1.437 (2.71)***		1.597 (2.76)***
Candidacy <sub>t+1</sub>			1.71 (2.58)**		1.492 (2.21)**
Candidacy <sub>t+2</sub>			2.083 (2.4)**		1.145 (1.23)
Compliant <sub>t-1</sub>				2.191 (2.86)***	1.651 (1.89)*
Compliant <sub>t0</sub>				4.734 (4.15)***	4.262 (3.08)***
LnDebtServ	-0.295 (-1.14)	-0.301 (-1.18)	-0.294 (-1.16)	-0.304 (-1.18)	-0.299 (-1.18)
CPI	-1.304 (-1.95)	-1.333 (-1.98)	-1.31 (-1.96)*	-1.312 (-1.96)*	-1.322 (-1.96)*
LnGDP_PC	10.87 (0.65)	10.113 (0.6)	7.444 (0.44)	8.627 (0.51)	6.329 (0.37)
LnPop	-200.8 (-4.29)***	-197.0 (-4.25)***	-191.5 (-4.24)***	-204.9 (- 4.36)***	-198.5 (- 4.19)***
LnGDP_PC <sup>2</sup>	6.329 (3.93)***	6.185 (3.88)***	5.967 (3.83)***	6.46 (4)***	6.209 (3.78)***
LnPop <sup>2</sup>	-1.057 (-1.14)	-1.013 (-1.1)	-0.875 (-0.94)	-0.946 (-1.02)	-0.829 (-0.88)

Constant	1585.6 (4.11)***	1565.6 (4.09)***	1546.5 (4.14)***	1628.3 (4.19)***	1602.5 (4.12)***
Fixed effects	Y	Y	Y	Y	Y
N	1051	1051	1051	1051	1051
R <sup>2</sup>	0.154	0.156	0.16	0.158	0.163

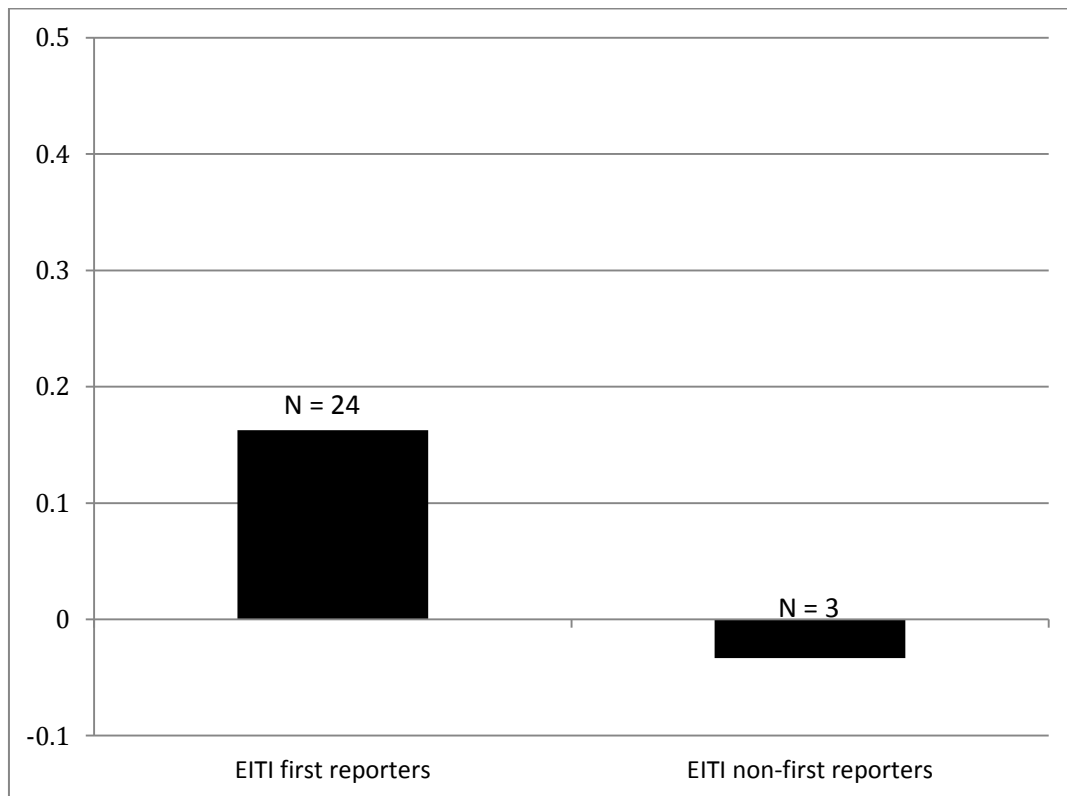
\*\*\* significant at the 1% level, \*\* significant at the 5% level and \* significant at the 10% level.

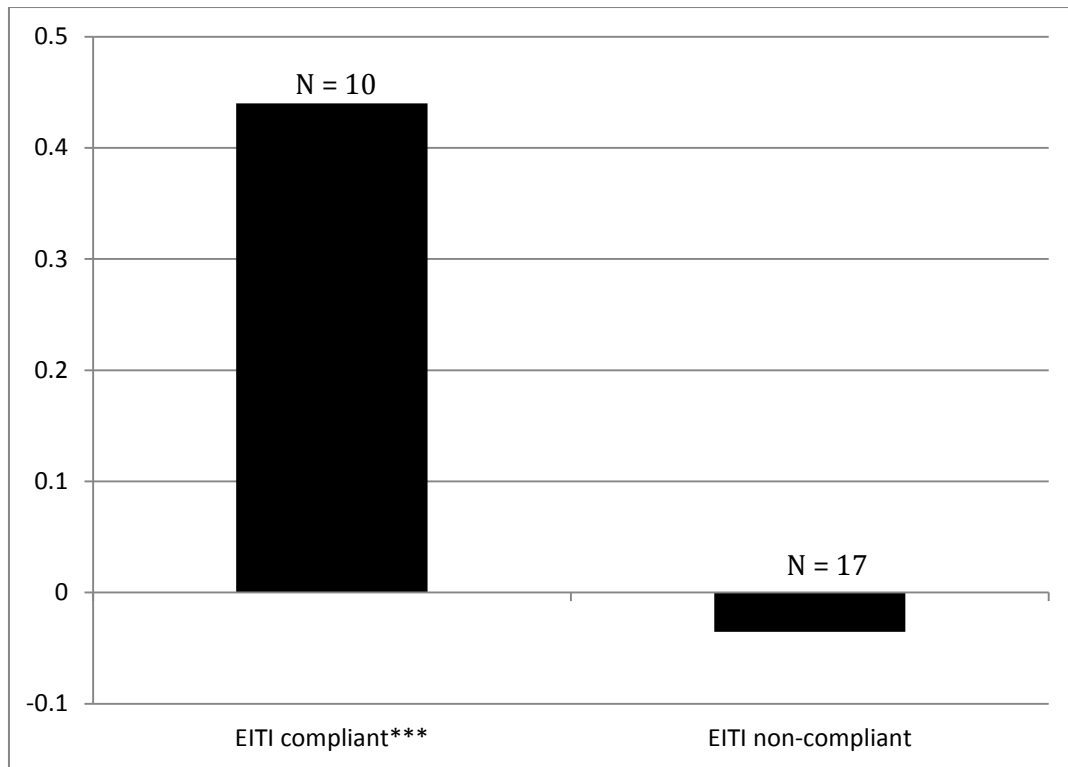
We find that the earliest stage of EITI participation, commitment, is not rewarded. There is no evidence of statistically significant shifts in aid associated with commitment. Perhaps commitment to EITI is an insufficient signal of determination to reduce corruption. However, there are positive shifts in aid prior to and after a country has published its first EITI report, a much more meaningful signal, and the boost in aid is statistically significant at the 5% level. There is a slightly larger effect with candidacy, with statistically significant rises in aid in the year prior to candidacy, the year of candidacy and two years thereafter. The most significant increases occur with full compliance, however, with very large boosts in aid immediately before and after compliance. This effect is statistically significant at the 1% level, but should nevertheless be treated with caution given the smaller sample size of compliant countries for whom data on aid is available. Note also that data limitations mean we do not know how aid shifts in the years subsequent to compliance. Including all stages of EITI participation in a single regression shows the most statistically significant of the intermediate stages appears to be candidacy rather than the publication of the first report. There remains a statistically significant effect with candidacy in three of the years around the event, whereas for the first report statistical significance fails to reach even the 10% level. The results support H1c.

The results lend support to the view that donors are engaging in substantial conditionality, although it should be noted that it may not just be conditionality on EITI participation. This period is marked by substantial disbursements of aid based on the MCC, which is well known for its conditionality. It is possible that aid is going to countries with generally improving governance, not just EITI participation. However, it would appear that the achievement of progressively more difficult stages of EITI implementation is rewarded with increasing levels of aid. This is consonant with the observation that the two-year relative improvement in CPI is highest for the committers who go on to become compliant or publish their first report as shown in Figures 2A and 2B. The direction of causality is not certain: countries which improve more on the CPI may be more likely to become compliant or publish their first report, rather than vice versa. However, the fact that aid appears conditional on these latter stages of implementation would support the view that donors are looking

for tangible improvement – either in the form of improved CPI scores or in the form of EITI implementation.

**Figures 2A and 2B: Two-year relative CPI change post-commitment based on whether countries go on to write their first report or become compliant**





\*\*\* significant at the 1% level, \*\* significant at the 5% level and \* significant at the 10% level.

### IMPACT OF EITI IMPLEMENTATION ON CORRUPTION

Much research suggests that the promise of membership of international clubs can be an important factor in motivating countries to undertake reforms that they otherwise find too politically costly or unappealing. The transformational power of conditionality requirements is frequently linked to the nature, complexity and length of the accession process: conditionality is more effective in achieving substantive change where it is more ambitious and where compliance is more carefully monitored. Thus, the Central and East European countries benefited from a long and thorough process of harmonization with the European Union's *acquis communautaire* (Grabbe, 2006, Schimmelfennig and Sedelmeier, 2004). Similarly, the countries that engage in the most rigorous accession process to the World Trade Organization experience the greatest post-accession gains in trade (Allee and Scalera, 2012). If accession is complex and lengthy, then it is more difficult to 'fake' compliance by ticking the right boxes, for example by passing the right laws but failing to implement them.

We suggest that the process of implementing EITI has a substantive effect in terms of reducing corruption because the implementation process builds institutions which increase accountability.

This reasoning draws on a key academic model of corruption, which argues that corruption occurs when public officials have discretionary power and monopoly power but lack accountability (Klitgaard, 1988). These two types of power are necessary for governing, but raise risks that power will be abused; therefore accountability is necessary to check the abuse of power. Discretionary power, i.e., the power to alter or shape a decision, is clearly a necessary condition for a public official to engage in corruption. Without it, there would be no point in another agent seeking to influence him or her. Even if offered a bribe or some kind of private benefit, he or she would not have the power to alter policy outcomes in such a way as to benefit the bribe-payer. Monopoly power allows the corrupt public official to solicit bribes in the knowledge that the other party cannot simply find another official to execute the policy – either without a bribe or for a cheaper bribe. Discretionary and monopoly power therefore create the opportunity for a public official to engage in corruption. However, many public officials utilize such power without doing so corruptly. According to Klitgaard, this is because they face accountability. It is only when there is an absence of accountability that public officials exercise their power for private ends unchecked by scrutiny, complaint, or the threat of punishment.

The implication is that, if accountability can be improved, the potential for corruption will be reduced. Klitgaard's model raises a number of issues which are beyond the scope of this article, but this theoretical claim about the relationship between accountability and corruption is supported by a considerable body of literature which shows that corruption is negatively associated with good governance and democracy (Sandholtz and Koetzle, 2000). Note that our argument is not that EITI reduces corruption because it increases transparency per se, although many scholars do associate greater transparency with better governance (Stiglitz, 2002), but rather because it increases accountability through its long multi-stakeholder implementation process.

Kolstad and Wiig examine the impact of EITI on corruption levels, and also argue that transparency in itself is not a sufficient condition for reducing corruption (Kolstad and Wiig, 2009). They suggest that transparency must be accompanied by other policies if it is to have the desired effect. Other recent work also shows that active civil society can reduce corruption by increasing societal accountability providing other conditions are met, including political competition, press freedom and government transparency (Grimes, 2012). We agree that transparency alone may be ineffective at reducing corruption, but we argue that EITI implementation involves much more than transparency. As well as improving transparency (which *facilitates* accountability), the implementation process also builds institutional capacity for holding governments to account, opens up channels for civil society to influence government, and helps the diffusion of anti-corruption norms.

In the EITI implementation process, the establishment of a multi-stakeholder group (MSG) is the critical factor which increases accountability. It opens a channel for dialogue among various stakeholders, bringing corporations, governments, CSOs, the media and politicians together in a way that is unprecedented in some implementing countries. As such, it improves the public's ability to hold government to account over the way that it sells the country's resources. The EITI implementation process empowers civil society actors to comment on the performance of the government within a clear framework of expectations, as well as giving legitimacy to those expectations. Thus, CSOs can use 'naming and shaming' tactics, as they do elsewhere, to encourage states and corporations to comply with the standards (Keck and Sikkink, 1998).

The creation of the MSG may also have important spillover effects. The MSG provides CSOs with status and access, helping them to build capacity in environments where civil society is traditionally weak. Thus, once a country has embarked upon EITI implementation, it is more likely to move towards other governance and transparency reforms. Evidence from countries that have implemented EITI supports this proposition. For example, in Nigeria, EITI implementation has prompted much broader scrutiny of the natural resources sector than that required by EITI, including the commissioning of 10 years of retrospective audits of national accounts. These audits revealed that \$2.6 billion dollars' worth of revenues were unaccounted for and that there were numerous irregularities in the process for allocating oil licenses. Such revelations are likely to increase scrutiny of future contracts and may deter misconduct. Moreover, Nigeria's EITI implementation process has helped to foster a broader civil society movement for government transparency, ultimately leading to the passage of a Freedom of Information Act. It has also increased scrutiny over companies; the work of the reconciliation team – external auditors who seek to reconcile the revenues declared by governments with the payments disclosed by companies – drew attention to the fact that there were several weaknesses in the tax authorities' system for assessing tax liability. Ultimately, this led to more tax being collected from those companies, an outcome which, as one external auditor interviewed for this research pointed out, helped to garner support from politicians eager to earn political capital on being seen to make companies pay more tax.

In Indonesia, the CSOs involved in implementing EITI have embarked on a number of initiatives beyond the scope of the multi-stakeholder group, lobbying government for revisions to the oil and gas law and the freedom of information act. The latter might extend the reach of transparency to all areas of government, far beyond the extractives sector. In Tanzania, EITI implementation has given significant momentum to the public debate on the resource sector. An evaluation of the impact of EITI also found that the process has created links to the broader governance reform process and

allowed governments to identify institutional weaknesses (Caspary, 2012). Other IOs have also helped to extend the benefits of EITI by funding spin-off projects - for example, the World Bank has set up a Multi-Donor Trust Fund to provide technical assistance to countries implementing – or considering implementing – EITI. This has, for example, supported peer-to-peer learning and knowledge exchange among EITI candidate countries Yemen and Kazakhstan. Revenue Watch Institute has produced a governance index which examines wider issues around how revenues are managed, giving the civil society stakeholders more ways to hold the government to account. The Soros Foundation has funded training for CSOs aimed at helping them to understand how the extractives industries work, so as to better equip them to evaluate EITI reports and ask the right questions of other stakeholders. A survey of CSOs participating in EITI found that the organizations themselves consider their participation in the policy dialogue to be one of the most successful aspects of the implementation process (Dykstra, 2011). It is difficult to quantify the impact of multi-stakeholder group activities on accountability and on reducing corruption. However, the examples support the claim that EITI implementation creates conditions in which accountability is likely to increase and corruption to fall, hence our second hypothesis.

**Hypothesis 2:** *For countries that participate in EITI, the level of perceived corruption falls.*

## **CORRUPTION IMPACT: METHOD AND RESULTS**

We find that the decision to commit, to write a first report, or to become a candidate has a positive impact on a country's CPI score in the two years following the event.<sup>8</sup> This result contrasts with that of Ölcer, who analyses the impact of commitment on CPI levels and finds no significant effect; however, it is only in the last two years that the sample has become large enough to be amenable to statistical testing (Ölcer, 2009). In order to control for time-specific factors, as well as the impact of natural resources, level of development, geographic location and level of corruption, we match the EITI joiners with a matched sample of paired non-joiners to EITI. Each sample country is paired with another country based on three criteria: the CPI, the level of natural resource rents as a percentage of GDP – since increasing oil rents are associated with increasing corruption (Arezki and Bruckner, 2011) - and geographic distance. The paired sample excludes any countries that commit to EITI in the analysis period. Sample selection is with replacement. Matching takes place in the year of the EITI action (commitment, first report or candidacy). CPI is known to be related to

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<sup>8</sup> While TI advises against comparing individual CPI scores on a year-on-year basis, we take the mean of the sample countries, which should result in comparable effects.



factors such as GDP per capita and measures of government effectiveness, hence these factors should also be covered by this matching process (Pitlik et al., 2010). In Table 5 we show that for candidates, first reporters and committers, there are absolute improvements in CPI and relative improvements in CPI, a result which is statistically significant at the 10% level for candidacy and commitment, although not for first reporters. Note that we do not calculate the impact for those countries which have reached compliance as the sample size is too small.

Figure 3 shows the relative shift in the CPI for EITI candidates against the shift in the CPI of the paired sample from two years prior to candidacy to two years afterwards. Owing to data limitations, this is a slightly different paired sample from that used in Table 5; the matching takes place two years prior to the candidacy rather than in the year of candidacy. It should be noted that the effect of commitment and candidacy are nearly cumulative overall. Only two countries out of 29 achieve candidacy in the same year as commitment. The mean and median gaps between commitment and candidacy are two years. The sum of the two effects in Table 5 is a cumulative relative improvement of 0.276 points in the CPI for EITI committers and candidates. This is reasonably close to the 0.235 point improvement seen in Figure 3. The difference of 0.235 points is statistically significant at the 5% level.

**Table 5. Impact of EITI actions on corruption**

CPI is the Transparency International Corruption Perceptions Index, the subscripts represent the year of the EITI-related action with  $t_0$  being the year of action. Student t-test based on the standard deviation of all CPI 2-year changes in the period when EITI is active. Commit, First Report and Candidate are when a country chooses to commit to EITI, publishes its first EITI report and becomes a candidate for EITI standards. Paired sample is matched based on geographic proximity, CPI score and natural resource rents as a percentage of GDP in the year of the EITI action.

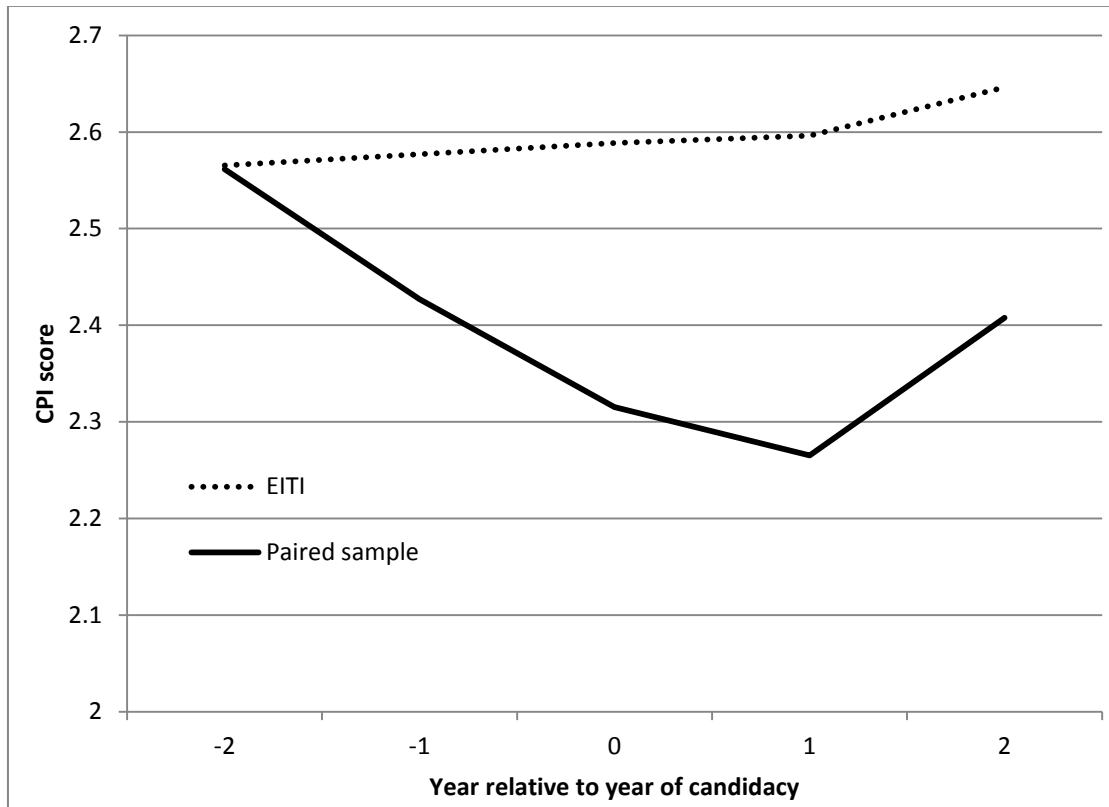
		Commit	First report	Candidate
EITI countries	$CPI_{t_0}$	2.519	2.706	2.569
	$CPI_{t_2}$	2.574	2.756	2.645
	Change	0.056	0.050	0.076
Paired sample	$CPI_{t_0}$	2.585	2.669	2.590
	$CPI_{t_2}$	2.500	2.588	2.531

		Change	-0.085	-0.081	-0.059
EITI	- Paired				
sample		Change	0.141	0.131	0.135
T-test			*		*
		N	27	16	29

\*\*\* significant at the 1% level, \*\* significant at the 5% level and \* significant at the 10% level.

**Figure 3. Impact of EITI candidacy relative to paired sample**

CPI is the Transparency International Corruption Perceptions Index. Candidacy is when a country becomes a candidate for EITI standards. Paired sample is matched based on geographic proximity, CPI score and natural resource rents as a percentage of GDP in the year of the EITI action.



### **ACCOUNTABILITY AND REDUCED CORRUPTION**

In line with our argument that EITI implementation reduces corruption to the extent that it increase accountability, we expect to find that the creation and activities of the multi-stakeholder groups lead to a reduction in the level of corruption.

**Hypothesis 3:** *For countries with stronger accountability, there will be a greater reduction in corruption levels upon implementing EITI.*

We use the Worldwide Governance Indicators Voice and Accountability (VAE) measure and assume that where there is a higher level of VAE relative to the corruption level, committing to EITI leads to a larger decline in corruption. The underlying assumption is that a society in which accountability is greater will be better able to benefit from the EITI process.

Taking the difference between the VAE and the CPI in the year of commitment to EITI (having adjusted both to a range between 0 and 1), we find that the 14 countries with the highest gap between the VAE and CPI have an aggregate improvement of 0.15 points in the CPI, while the 14 lowest see a decline of 0.04 points in the two years following commitment (see Table 6). The difference between the top half and the bottom half is statistically significant at the 5% level<sup>9</sup>.

It is possible that such a gap between a high VAE and relatively poor CPI leads to a decline in the level of corruption regardless of EITI implementation. We test this using a panel regression, controlling for fixed effects, year effects and the absolute level of CPI. This finds that whilst a gap between VAE and CPI is consonant with a rise in the CPI over the following two years, the rise is only statistically significant where the country has chosen to join EITI. This holds true at the 5% level for a continuous variable for EITI post joining and at the 10% level for the one-year effect of a decision to commit.

***Table 6: How accountability affects the impact of EITI on corruption***

The dependent variable is the 2-year change in the Transparency International Corruption Perception Index (CPI). The independent variables are the CPI – the World Governance Indicators Voice and Accountability measure (VAE). The CPI and VAE are both rebased to a 100 point scale and the VAE score is subtracted from the CPI score. EITI\_C is a dummy variable equal to one if a country chooses to commit to EITI. EITI is a dummy variable equal to one if a country chooses to commit to EITI and in all subsequent years.

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<sup>9</sup> This is the raw change in the CPI rather than a relative change compared to a paired sample since the aim is to examine the effect of the gap between a relatively high VAE and low CPI.

	CPI $\Delta$ 2Yr	CPI $\Delta$ 2 Yr
CPI-VAE	-0.464 (-1.00)	-0.532 (-1.17)
EITI x CPI-VAE	-0.421(-2.40)**	
EITI_C x CPI-VAE		-0.269 (-1.77)*
CPI	-0.806(-13.21)***	-0.799 (-13.18)***
Constant	3.142 (9.68)***	3.104 (9.64)***
Year		
dummies	Y	Y
Fixed effects	Y	Y
N	997	997
R <sup>2</sup>	0.483	0.481

### Endogeneity

It is impossible to attribute causation in the relationship between EITI implementation and the reduction of corruption. Whilst the matching of CPI, geographic proximity and natural resource rents can control for some factors, we cannot rule out that the improvement in absolute and relative CPI reflects a different causal factor that is also driving EITI implementation. One obvious factor that could be causing both is a shift in political regime, such as the developments taking place in 2012 in Myanmar. We do know that EITI membership is correlated with a small but measurable reduction in corruption and this accords with evidence about steps taken to increase accountability in the field. The results would suggest that EITI is not used deceptively to qualify for aid even as corruption levels worsen.

Even the finding that EITI improves corruption levels where a country has a higher level of Voice and Accountability (VAE) only indicates that EITI has a contributory role and does not prove causation.

## CONCLUSIONS

We find evidence that countries attract additional aid when they implement the EITI standard. We cannot demonstrate conclusively that the expectation of receiving such benefits motivated these countries to join, but we have provided some evidence that governments see EITI membership as a way of building a reputation *for* seeking to improve governance *with* the international community. Part of EITI's value for governments lies in the way that it allows them to distinguish themselves from their peers. However, EITI's leverage will only work on governments that care about building such a reputation. On the donor side, we note that many donors have begun to condition aid on indicators of governance, and we suggest that EITI implementation offers a much more credible signal of commitment than such indicators. EITI therefore serves as a reputational intermediary. It provides a way for governments to build a reputation for being committed to achieving greater transparency and accountability. It helps donors to overcome the asymmetric information problem that they have in assessing the anti-corruption efforts of recipient countries, by outsourcing the tasks of judging a government's credibility and monitoring compliance directly to the country's multi-stakeholder group, which is supported by the EITI framework and secretariat.

Although countries may be motivated to implement EITI partly for these instrumental reasons, we find that implementation is nevertheless associated with an improvement in the level of corruption, as measured by the Transparency International Corruption Perceptions Index. The effective is cumulative, growing as countries progress through different stages of EITI implementation, and the results are statistically significant. We suggest that this reflects the impact of the EITI implementation process in terms of increasing accountability over governments more broadly, rather than the effect of greater revenue transparency per se. However, further research in this area could help to arrive at a more detailed understanding of how EITI implementation improves accountability and reduces corruption.

Finally, our results have implications for how EITI might develop over time. As more and more countries sign up, the value of being compliant – relative to others – will decline. We might thus expect the appetite for joining – and perhaps the incentive to remain compliant - to decline over time. Such an effect is evident for the MCC: once countries have attained eligibility, the incentive to continue reforming is weak. The EITI Board's constant efforts to raise the bar and ratchet the standards upwards is thus a sensible way of ensuring that EITI remains relevant as more countries join. However, the fact that most of the G8 countries have recently committed to implement EITI suggests that the initiative has now become a minimum standard which resource-rich countries (at

least, most of them) feel compelled to implement in order to be seen as legitimate members of the international community.<sup>10</sup> As such, EITI represents an innovative model of global governance which has used voluntary standards and a tripartite implementation mechanism to create a new international norm. This model might be replicated in other areas where there is a gap in global and national regulation.

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<sup>10</sup> The United States is already implementing EITI; the United Kingdom, France and Italy have all committed to do so; Germany is to pilot the process; Canada is to introduce Publish what you Pay legislation; and Russia and Japan are to become EITI supporters.

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