The First Walsh School of Foreign Service Undergraduate Working Paper Series in International Political Economy:

Foreign Policy Goals and Preferences in International Political Economy
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Acknowledgement

Privilege is the word that comes to mind when I think about my experience in teaching the 2014 Krogh Honor Seminar. As a group, the students who took this class represent one of the absolute finest that I have yet worked with in my career. I would like to express my gratitude to them for taking the class and for being such wonderful students. I hope we will always stay in touch. Working with them and, more importantly, getting to know them as individuals throughout the course, has truly been a privilege.

Professor Vreeland
June 16, 2014
Abstracts

**Double Dutch: the Two Faces of Dutch Foreign Aid**
*Erin Sielaff and Kristen Skillman*

Small-donor governments are widely considered altruistic, allocating aid based on humanitarian concerns rather than on foreign policy goals. Consider the Netherlands, whose government has consistently expressed a commitment to human rights, and has formally linked this goal to its development aid program. Previous studies of Dutch aid, however, are inconclusive as to the relationship between aid received and human rights records; some even find a negative correlation between the two. We therefore conduct a focused analysis, testing the relationship between Dutch foreign aid and a country’s physical integrity rights and civil and political liberties. Ultimately, we find that the Netherlands does reward countries with better civil and political liberties, but not those with better overall physical integrity rights. We do, however, find that the Dutch allocate less aid to countries with records of torture or extrajudicial killing, in line with the Netherlands’ stated human rights priorities. In other words, the Dutch strategically allocate funds to promote those human rights that they deem most important. This suggests that small donors may in fact make strategic choices in their aid allocation to support certain foreign policy goals.

**United Nations Peacekeeping Operations and Sex Trafficking: Evaluating the Long Term Effects of Missions on the Industry**
*Maria Hamdouchi and Annalise McGrail*

Does the presence of UN peacekeeping missions provoke the subsequent creation of a sex trafficking market? While the United Nations seeks to promote the peaceful resolution of conflict, observers have alleged that presence of UN personnel may exacerbate weak governance, corruption and poverty, leading to the increased exploitation of women and children (Agathangelou & Ling 2003; Ferstman 2013; Murray 2002). Much of the existing literature supporting these claims relies heavily on qualitative analysis. Our study takes a quantitative approach and examines a dataset of 179 countries over the period 2000-2011 to demonstrate that the presence of UN missions in fact decreases levels of sex trafficking over time. Our results are statistically significant at the 1% level, even after accounting for economic and political factors, country fixed-effects, and duration dependence.

**Money, Influence, and Power: Australia and the Bretton Woods Institutions**
*Trellace Lawrimore and Reno Varghese*

Do small foreign aid donors trade money for political power in international organizations? Large donors, like the United States, famously distribute aid for strategic gain, but scholars often assume that small donors follow more humanitarian motives. Focusing on Australia, this study quantitatively examines how the desire for power in international institutions compels countries to give aid to those that provide it political support. Specifically, we consider countries that elect Australia to the Executive Boards of the Bretton Woods Institutions—the International Monetary Fund (IMF) and the World Bank. Using aid data from 1960 to 2009 for 186 countries, we test whether Australia rewards members of its voting bloc with more foreign aid. Regression
analyses controlling for common aid motivations and country and region fixed-effects support our hypothesis. We find that Australia cultivates its international power in major financial institutions by controlling BWI Executive Directorships with foreign aid disbursements.

**Israeli Diplomatic Relations & Foreign Aid Disbursements**  
**Geeva Gopalkrishnan and James Gadea**

Arab governments often deride Israel in public but may secretly support Israel’s foreign policy behind closed doors. We use the disbursement of foreign aid from the Arab Fund to identify the preferences of Arab donor governments over Israel. Our key variable of interest is the presence or absence of diplomatic relations with Israel. Analyzing a dataset of 22 (Arab) countries observed during 1974 – 2012, we find a robust, statistically significant positive relationship between the existence of a diplomatic relationship between the recipient country with Israel and aid from the Arab Fund, rather than the negative relationship as previously hypothesized by the prevailing literature. At a minimum we find no evidence that the members of the Arab League punish the establishment of diplomatic relationship with Israel through the Arab Fund. In fact, we find significant evidence that point to the contrary. The Arab Fund may value security and peace within the Middle East and therefore rewards countries that have diplomatic relationships with Israel.

**Weapons for Peace? The Unexpected Benefits of UNSC Membership**  
**Anirudha Vaddadi and Josi Sinagoga**

Does the political importance of countries on the international stage result in them receiving more arms? Given the tendency for governments to attempt to buy favor of politically important countries vis-a-vis international benefits such as foreign aid and IMF program support, we hypothesize that the arms trade is another possible means of gaining political influence. We apply this logic to the case of Germany, whose unique situation in the international political arena, political institutions, and historical legacy give it motivation to exert influence over other countries. After analyzing data that control for factors such as economic development, regime type, trade relationships and war, we find that a robust relationship exists between Germany’s arms exports and the recipient nation’s political importance as defined by non-permanent UNSC membership. These results may suggest that it uses its arms industry to give itself a larger political voice on the world platform.

**Arms Sales and Foreign Aid: The Case of Germany**  
**Austin Baker and Abby Cooner**

Do arms sales drive foreign aid? Many studies contend that donors pursue their own self-interest when providing foreign aid to developing countries; however, it is worth exploring whether arms imports play a role in aid allocation. We investigate this question by focusing on Germany because of the Federal Chancellor’s unique influence over arms export licenses and foreign aid decision-making processes. Using data from 1990-2009, we show that importing German arms has a positive, statistically significant impact on the amount of aid countries receive from Germany. This finding holds true when controlling for a country’s political importance, regime type, key economic and trade variables, as well as country and year fixed-effects. We theorize
that Germany increases aid to countries that buy arms in order to incentivize their continued purchase in a hypercompetitive arms market and to reap the domestic benefits of the arms industry.

**Foreign Aid and Retaliation in the WTO**
Zachary Kay and Matthew Quallen

Powerful states can exert their influence over less powerful ones, using all variety of policy instruments to assert themselves. Does this dynamic dominate in the World Trade Organization? Following mounting evidence that states use foreign aid as a political instrument, we ask whether one great power – the United States – uses reductions in bilateral foreign aid to punish states that file against it in the WTO. We compare bilateral aid receipts from the United States with instances of state aid recipients filing or joining suit against the United States in the WTO. We find no significant evidence that any relationship – immediate, premeditated, or delayed – exists between the two variables. This result complicates our understanding of the picture, suggesting that great powers may seek to be filed against and lose in the WTO, possibly as part of a two level game; that foreign aid is not so versatile a political instrument as many scholars suggest; or that these states are willing to restrain themselves to the arena of the WTO, avoiding extramural coercion.

**A Clear Advantage: The Benefits of Transparency to Foreign Direct Investment**
Elaine Shen and Mike Sliwinski

Does transparency attract foreign direct investment (FDI)? The relationship between transparency and FDI has been complicated by the nature of existing transparency indicators; existing measures tend to omit either the quality of aggregate data or the accessibility of data provided. Our study takes a new approach, focusing on the dissemination of economic data as a key facet of transparency. We argue that the more transparent a government is in terms of the release and dissemination of economic data, the greater FDI that country will receive. Using the Hollyer, Rosendorff, and Vreeland (HRV) Index, which tracks data dissemination to the World Bank over 30 years in 125 countries, we demonstrate through quantitative analysis that there is a positive correlation between transparency and FDI. Our findings remain robust after controlling for a wide range of country-specific economic factors. We conclude that greater transparency does, in fact, correlate with greater FDI.
Introduction to the First Walsh School of Foreign Service Undergraduate Working Paper Series in International Political Economy James Raymond Vreeland

Bread and peace stand as the ideal pillars of any society. Citizens desire governments that can provide prosperity and safety domestically, and governments, in turn, can use their foreign policy to promote an international environment conducive to these goals. Indeed, economic well-being and national security represent the central concepts in the study of international relations. Yet, how can governments best provide them? As former Secretary of State Madeleine Albright has observed, the toolkit with which to conduct foreign policy is extremely limited.

In this volume of working papers, we examine the strategies and goals of governments when conducting foreign policy. Most of the studies here within focus on a key tool of foreign policy: aid. Some of the scholars examine the determinants and others the consequences, while still another considers the effect of government transparency on international financial flows. While researching different factors and focusing on different sets of countries, all of the studies address a central question of political life: What do governments want and what means do they use to achieve their objectives?

The contributors to this volume all participated in the 2014 Krogh Honor Seminar, named for Dean Emeritus Peter Krogh, in the Walsh School of Foreign Service at Georgetown University. Each of the working papers uses sophisticated quantitative methodologies to examine large databases covering thousands of statistics from countries all over the world during the decades since the end of World War II. The students worked together in pairs and the author names for each chapter are listed in alphabetical order. The order of the chapters themselves corresponds to the various research themes explored by the class.
The volume begins with an examination of two relatively small donors: the Netherlands and Australia. The motives of countries like these are often overshadowed by those of the most powerful donors, like the United States. Different governments may have different motivations behind their foreign aid policy, however, and discovering them requires close inspection. Erin Sielaff and Kristen Skillman explore the foreign aid policies of the Netherlands. They find that this country pursues specific humanitarian goals. The Dutch government gives more aid to countries with better civil and political liberties and gives less aid to countries with records of torture or extrajudicial killings, in line with the Netherlands’ stated human rights priorities.

Trellace Lawrimore and Reno Varghese change the pace in their study, which explores political motivations behind foreign aid that reflect realpolitik. They find evidence that Australia uses its foreign aid policy (in part) to augment its influence within international organizations. Specifically, Australia has historically controlled seats on the Executive Boards of the World Bank and the International Monetary Fund. Australia has enjoyed this position of power due to the political support of several small developing countries, which help to elect Australia to the boards. In return, the Australian government appears to provide more foreign aid to these countries that are strategically important for Australia to maintain its position.

Geeva Gopalkrishnan and James Gadea continue the examination of small donors, shifting attention to international organizations: the Arab League and the Arab Fund. They use the disbursement of foreign aid from the Arab Fund to identify the preferences of Arab donor governments over politically sensitive Israel. They test whether the presence or absence of diplomatic relations with Israel influences Arab Fund aid disbursements. Contrary to the negative relationship proposed by the prevailing literature, they find, at a minimum, no evidence that the members of the Arab League punish the establishment of diplomatic relationship with
Israel through the Arab Fund. In fact, they find evidence that aid may even increase. The authors propose that Arab governments may use the Arab Fund for political cover to reward peaceful relations with Israel even while in public they may deride Israeli policies.

Anirudha Vaddadi and Josi Sinagoga continue the theme of trading aid for political influence, but switch the focus from economic development to military assistance, and focus on one of the most important producers of arms in the world: Germany. Despite being a major international power, Germany lacks a seat on the world's premiere security organization, the United Nations Security Council. Vaddadi and Sinagoga thus propose that the country might favor governments serving on the Security Council in order to augment its voice within the institution. They find, in fact, that Germany’s arms exports increase to countries when they are serving two-year terms on the Security Council. The result suggests that Germany may use its arms industry to give itself a larger political voice on the world platform.

The volume continues to examine German arms sales with the contribution of Austin Baker and Abby Cooner. They turn the question around and ask whether arms sales drive foreign aid. They focus on Germany because of the Federal Chancellor’s unique influence over arms export licenses and foreign aid decision-making processes. Their analysis shows that importing German arms has a positive impact on the amount of aid countries receive from Germany. They argue that the reason for this has to do with the domestic political economy of Germany: the government increases aid to countries that buy Germany arms in order to incentivize their continued purchase in a competitive arms market. This pattern benefits of the politically important domestic arms industry.

Of course, the ostensible purpose of foreign aid, as discussed in the opening chapter by Sielaff and Skillman, is not to achieve political goals but rather to improve people’s well-being.
And while most of the studies in this volume focus on the determinants of foreign aid, at least one of them look at individual well-being. We delve deeper into the question of human rights with the contribution of Maria Hamdouchi and Annalise McGrail. One of the ways in which governments might use foreign policy to promote peace and the general well-being of citizens around the world is through their contributions to the United Nations. Thus, it is most disappointing when tales of corruption emerge surrounding this institution. One of the worst allegations against the United Nations is that its peacekeeping missions provoke the subsequent creation of a sex trafficking market. With no interest in excusing UN personnel from ever engaging in these kinds of illicit markets, the authors of this study seek to take a broad and systematic approach to the question of whether the overall impact of UN peacekeeping missions have a positive or negative impact on sex trafficking. They find that the presence of UN missions in fact decreases levels of sex trafficking over time. Thus, we conclude this chapter, and the previous, with some good news about efforts to use international aid to promote good causes.

We have more good news in the following chapter. Not all of our studies find evidence of political motivations behind foreign aid disbursements. Zachary Kay and Matthew Quallen explore whether one great power – the United States – cuts foreign aid to punish states that file trade disputes against it in the World Trade Organization. They find no significant evidence that any relationship – immediate, premeditated, or delayed – exists between foreign aid and trade disputes. This result complicates our understanding of the picture, suggesting that great powers do not use their aid to pursue all foreign policies.

All of the studies in the volume rely on available data to explore and test their hypotheses. Unfortunately, datasets often suffer from missing data, which has posed a methodological problem for many of the studies in this volume. Elaine Shen and Mike Sliwinski
turn this problem on its head and take advantage of the availability of data to explore the role of transparency in the international political economy. They suspect that international financiers may be more likely to invest in a country if the government provides more aggregate data about the economy. They use an index measuring the availability of economic data to explain patterns of foreign direct investment and find a positive connection. Transparency increases investment. Having explored the underbelly of foreign aid, the volume thus concludes with a study proposing yet another potential path to economic development beyond foreign aid: private markets.

Of course, none of the studies in this volume have the final word. Many of the contributors plan to continue their research with the eventual goal of publication in a peer reviewed academic journal. And still many other questions remain: What are the effects of politically driven foreign aid? Do they promote or undermine economic development? What about their effects on human rights? Do private markets perform better, or are their also downsides to foreign investment? These questions and many others will be explored in future volumes of The Walsh School of Foreign Service Undergraduate Working Paper Series in International Political Economy.
1. Introduction

Small donors are altruistic. Scholars and policy-makers have accepted this mantra for decades, often assuming that small donors do not use their aid dollars to "invest" in certain foreign policy goals, and choose instead to distribute aid based on altruistic criteria (Hoadley 1980; Kilby 2006: 175; Stokke 1989; Alesina and Dollar 2000). While these donors might selectively allocate funds to countries with higher poverty rates or better human rights records, they do not do so in order to achieve specific objectives (beyond alleviating poverty and reducing repression), in the way that large donors might buy political favors from developing countries (Cooner and Baker 2014; Vreeland and Dreher 2014). Some recent work, however, has begun to challenge this notion (Lawrimore and Varghese 2014; Vreeland 2011).

We test both of these widely held beliefs about small donors—that they are altruistic and that they are not strategic in their aid allocation—by considering the example of the Netherlands. A broad portion of the literature considers the Dutch foreign aid program to be altruistic in nature. (Hoadley 1980; Kilby 2006: 175; Stokke 1989; Alesina and Dollar 2000). Nevertheless, scholars debate whether the Netherlands truly uses its aid-euros to back up its consistent rhetorical commitment to human rights. Eric Neumayer’s study of twenty-one different donor nations finds that while on the one hand, the Dutch reward countries that protect civil and political liberties, on the other, they also give more aid to countries with worse physical integrity rights records (Neumayer 2003). These divergent findings call into question the true nature of the Dutch aid program. We build off of Neumayer’s study, but we look exclusively at the

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We would like to thank the 2014 Krogh Scholars for their feedback, and James Vreeland for his extensive support and advice during this process. We credit James Gadea for our title.
Netherlands, and use new methods to test the robustness of our findings. We find that the Netherlands not only rewards states with better human rights records, but that—as Neumayer’s results suggest—it also targets specific categories of rights. Therefore, our results may indicate that the Dutch government uses its limited aid budget strategically, supporting the humanitarian-oriented goals it deems most important.

The Netherlands has long prided itself on its support and promotion of human rights at home and abroad. By hosting a number of human rights bodies, including the International Criminal Court and the International Criminal Tribunals for Rwanda and Yugoslavia, the country has gained a worldwide reputation for its commitment to human rights. This commitment appears to permeate many aspects of Dutch policy, including development aid distribution. In 1979, the Dutch Foreign Minister issued a policy memo establishing a relationship between aid and human rights (Baehr et al. 2002). Despite the formalized linking of these two issues, foreign aid allocation involves the consideration of a multitude of political and economic factors. Given their limited aid budget, it is possible that the Dutch prioritize some goals over others in the allocation of development aid.

We use Dutch official development assistance (ODA) data and the Cingranelli and Richards (CIRI) human rights dataset to analyze the relationship between Dutch foreign aid and two classes of human rights: physical integrity and empowerment rights. To test the robustness of our results we employ both country and year fixed-effects models, in addition to our preliminary ordinary least squares (OLS) regressions. Our results suggest that the Netherlands provides more foreign aid to countries with better empowerment rights (also known as civil and political liberties), but not to those with better overall physical integrity rights. Notably, however, we find that the Dutch allocate less aid to countries with records of torture or
extrajudicial killing, in line with the Netherlands’ stated human rights priorities. In contrast, we find that women's economic and political rights have no statistically significant relationship with Dutch foreign aid. We believe this is because CIRI's women's rights variables do not measure those specific types of women's rights that the Netherlands most emphasizes. We therefore argue that the Dutch choose to prioritize the human rights goals they find most important, suggesting that even small donors strategically allocate funds.

While our regression results indicate that the Netherlands does care about human rights, some of our control variable effects suggest that Dutch aid allocation may also be motivated by economic considerations. We find that countries that import more from the Netherlands receive more aid. In other words, it seems that the Netherlands might focus its aid towards achieving economic goals, in addition to promoting certain human rights.

Our paper is structured as follows. The next section outlines background information on the Netherlands’ aid policies, including a case study of its historic aid relationship with Indonesia. It also reviews the existing literature on human rights, foreign aid, and the Netherlands. The third section describes our data, and the fourth, our methodology. The fifth section discusses our results, and we conclude with an analysis of the implications of our paper and areas for further research.

2. Dutch Foreign Aid Policy

The promotion of human rights around the world is, in fact, one of the main tenets of the Netherlands' stated foreign policy. The Foreign Ministry’s 1979 policy memorandum made this clear when it emphasized “an indissoluble connection between human rights and development policy,” even though it did not contend that the Netherlands would necessarily use development aid to reward or punish countries for their human rights records (Baehr et al. 2002: 17).
Since 1979, human rights promotion has remained a “cornerstone of Dutch foreign policy” (Ministry of Foreign Affairs 2013; Baehr et al. 2002; Brysk 2009: 119). According to the Dutch government, the country’s top three priorities when promoting human rights on the international stage are all empowerment rights: the protection of human rights defenders, women’s rights, and lesbian, gay, bisexual and transgender (LGBT) people’s rights. The Netherlands also gives special mention to two serious integrity rights violations—the death penalty and torture—as well as to free speech and freedom of religion (Ministry of Foreign Affairs 2014). As such, it seems that the Netherlands has made, at the very least, a rhetorical commitment to human rights abroad.²

One illustration of this commitment is the story of the turbulent relationship between the Netherlands and Indonesia, a former Dutch colony. Violations of human rights by General Suharto’s New Order administration strained relations between the Dutch government and Indonesia in the early 1990s (van den Ham 1993: 532; Stokke 1995: 140). The tension between the two countries peaked in 1990, when Suharto made grave threats against the lives of four political prisoners (Stokke 1995: 140). The Dutch Minister for Development Cooperation responded by cutting 27 million guilders (approximately 25 million 2005 US dollars) of aid to Indonesia (Stokke 1995: 140). This action, combined with the continuing human rights violations in Indonesia, sparked a discussion in the Netherlands about the relationship between development aid and human rights. The Dutch government debated which violations of rights merited the cutting of aid, and whether the actions of Indonesia met this threshold (Stokke 1995: 145).

The 1991 Santa Cruz Massacre in East Timor brought the issue to a head once again (Stokke 1995: 153). As Dutch ministers seriously considered cutting aid to Indonesia in response to the massacre, Jakarta questioned the Dutch government's decision to link human rights and humanitarian aid. Suharto himself “referred to the ‘reckless use of development aid as an instrument of intimidation or as a tool to threaten Indonesia’” (Baehr 1997: 369). Before the Netherlands could make a decision regarding allocation of funds to Indonesia, however, Suharto decided to block aid from the Netherlands, turning the tables on the relationship (van den Ham 1993: 532; Stokke 1995: 155).

The case of Indonesia, where human rights violations resulted in a cessation of Dutch aid in the early 1990s, spurs our examination of the broader aid allocation trends in the Netherlands. In this paper we investigate whether this positive correlation between human rights and aid holds for the Netherlands' distribution of development aid to other countries. As background to this research, consider the existing scholarship on human rights, foreign aid, and the Netherlands:

In keeping with the prevailing scholarly consensus, we distinguish between two categories of human rights. Neumayer (2003) argues that a critical distinction exists between integrity rights and empowerment rights, which requires that the two be analyzed separately. As he puts it, physical “integrity rights violations are without doubt [inexcusable] and [unlike empowerment rights] are not subject to the relativist challenge” (Neumayer 2003: 652). Violations of physical integrity rights, then, are generally condemned by world leaders. Empowerment rights, on the other hand, are sometimes considered a Western construction, making them less applicable to other regions of the world (Neumayer 2003: 652). They therefore simply “do not carry quite the same status” on the international stage as integrity rights.
(Neumayer 2003: 652). Thus, breaking the broader concept of human rights into these two categories provides us with greater insight into the aid priorities of the Netherlands.

With this understanding of human rights in mind, we address the relationship between human rights and foreign aid allocation. Literature on this topic tends to distinguish between different kinds of donors. First, multilateral institutions are much more likely to reward good human rights practices than are individual donor nations (Neumayer 2003a; Lebovic and Voeten 2009). Among donor nations, “small” donors\(^3\), like the Netherlands, are believed to follow more altruistic giving patterns than “large” donors like the United States. A small donor, therefore, is more likely to allocate aid based on the recipient-need model, taking into account poverty or humanitarian concerns, than on the donor-interest model, which emphasizes the political and economic motivations of the donor (Hoadley 1980; Kilby 2006: 175; Stokke 1989; Alesina and Dollar 2000).

The Netherlands, in particular, has been included in the regressions of several larger studies about overall trends in foreign aid allocation (Neumayer 2003; Berthélemy 2006; Alesina and Dollar 2000). On the whole, this literature tends to assume that the Netherlands' motivations are the same as other small donors\(^4\), even going so far as to compare the Dutch aid program with the famously altruistic Scandinavian aid programs (Hoebink 1999). Similarly, the seminal study by Alesina and Dollar (2000) finds that the recipient country’s level of democratization plays an important role in Dutch aid allocation, indicating, once again, the humanitarian focus of the Netherlands' aid program (Alesina and Dollar 2000: 18).

\(^3\) Taking into account the existing literature on small states, Hoadley (1980) defines small donors as those donor nations with populations of less than 15 million, plus Canada, whose history and foreign policy are closer to those of small nations than large (Hoadley 1980: 123). The full list of small donors is, then: Australia, Austria, Belgium, Canada, Denmark, Finland, the Netherlands, New Zealand, Norway, Sweden, and Switzerland.

Still, a number of studies that examine more specifically the role that human rights have historically played in the Netherlands’ foreign aid allocation reveal a more nuanced picture. Overall, quantitative and qualitative studies regarding the humanitarian motivations behind Dutch aid have had mixed findings. Stokke’s (2006) and Baer’s (2010) qualitative studies of the Netherlands’ aid policies suggest that the country does reward human rights with development aid. Neumayer (2003) and Alesina and Dollar (2000) support this claim with regression analysis, finding a positive relationship between empowerment rights and receipt of Dutch aid.

On the other hand, Neumayer also finds a negative correlation between physical integrity rights and Dutch aid. In other words, Neumayer’s results suggest that the Netherlands actually gives more foreign aid to governments that violate inalienable human rights by torturing, disappearing, and even killing individuals for political purposes. This more pessimistic image of the Dutch foreign aid program is supported by a number of qualitative studies. For example, Baehr (2002) writes, “the [Dutch] government rejects the idea that aid should be used to reward countries with respect (to) human rights,” calling into question the real relationship between Dutch aid and human rights records (Baehr 2002: 17-18). Similarly, Hoebink (1999) argues that the Netherlands’ commitment to human rights is merely rhetorical. He claims that commercial interests have long motivated Dutch aid allocation, and that despite attempts to shift to a humanitarian focus, these interests might still be influential (Hoebink 1999).

Thus, there is disagreement in the literature regarding the Netherlands’ aid policies. Part of the problem may be that no quantitative study exists that exclusively examines the Netherlands’ aid program. Our paper offers such a focused econometric analysis. In addition, we

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utilize robustness checks for our results that have not yet been applied in relation to Dutch foreign aid.

Consider the stated policies of the Netherlands. The Dutch government has indicated that, while the Netherlands attempts to promote all human rights, it tends to focus its efforts on civil and political liberties—a distinction that Neumayer also highlights (Ministry of Foreign Affairs 2014; Neumayer 2003). Given that the Netherlands is a small country, with limited aid resources, we expect that it privileges certain sets of human rights over others, in order to make its aid-euros go further. We therefore address the following distinct hypotheses regarding Dutch aid distribution:

\[ H_1: \] The Netherlands gives more foreign aid to countries with better human rights records.

\[ H_2: \] The Netherlands gives more foreign aid to countries with better empowerment rights records.

We now turn to an empirical analysis of Dutch aid data in order to test our hypotheses.

3. Data

We use Dutch ODA data\(^6\) from the Development Assistance Committee (DAC) of the Organization for Economic Cooperation and Development (OECD) (Vreeland 2011: 374). We take the natural logarithm of the Dutch ODA data, measured in constant US 2001 millions of dollars, to normalize the distribution of the data. Our measurement of human rights comes from

\(^6\) We take this data from Vreeland’s (2011) analysis of Swiss foreign aid.
the Cingranelli-Richards (CIRI) Human Rights Data Project. Following Neumayer (2003), we examine both integrity rights and civil and political rights (Neumayer 2003: 652).  

CIRI scores countries on their respect for human rights using a combination of the *US Department of State Country Reports on Human Rights Practices* and the *Annual Reports* from Amnesty International (Cingranelli et al. 2013: 3). The CIRI database includes a range of variables, which fall into two main categories: physical integrity rights and empowerment rights.  

CIRI’s physical integrity rights index variable accounts for the following: political and extrajudicial killings, deprivation of life, disappearances, torture, and political imprisonment (Cingranelli et al. 2013: 1). Physical integrity rights scores range from 0 to 8, with a score of 0 reserved for those countries with the worst rights records.  

The empowerment rights index variable includes freedom of speech and press, freedom of religion, freedom of domestic movement, freedom of foreign movement, freedom of assembly and association, electoral self-determination, worker’s rights, independent judiciary and two women’s rights variables: political rights and economic rights (Cingranelli et al. 2013: 1). The empowerment rights variable is coded from 0 to 14, with 0 again indicating the worst violators.  

With this understanding of the data, we turn to descriptive statistics. To begin, we break the aid data into three groups for each variable. First, we examine the amount of aid allocated to those countries that scored between 0 and 4, 5 and 10, and 10 and 14 for the empowerment rights variable. Then, we look at the amount of aid allocated to countries based on their physical

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7 Like Neumayer, we do not address economic or social rights in this paper, because it is difficult to determine whether economic rights violations stem from poor government policy or from poverty (Neumayer 2003: 652).

8 We choose to use CIRI instead of other measures of human rights because it provides a comprehensive assessment of the main human rights indicators that we are interested in testing: civil and political rights and integrity rights. Neumayer (2003), on the other hand, uses the Purdue Political Terror Scales and the Freedom House rights index (Neumayer 2003: 654). It is important to note that all human rights measures are imperfect and prone to semi-subjective coding systems and inconsistent data.
integrity rights scores, once again breaking them into three groups: 0-2, 3-5, 6-8. The descriptive statistics are shown in Tables 1 and 2.

Table 1: Descriptive Statistics for Empowerment Rights

<table>
<thead>
<tr>
<th>Empowerment Rights Score</th>
<th>Mean aid received (US 2000 millions of dollars)</th>
<th>Median aid received (US 2000 millions of dollars)</th>
<th>Standard Deviation</th>
</tr>
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<tr>
<td>0-4</td>
<td>1.55</td>
<td>1.11</td>
<td>1.57</td>
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<td>5-9</td>
<td>1.94</td>
<td>1.85</td>
<td>1.55</td>
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<td>10-14</td>
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<td>0.72</td>
<td>1.48</td>
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</table>

Table 2: Descriptive Statistics for Physical Integrity Rights

<table>
<thead>
<tr>
<th>Physical Integrity Rights Score</th>
<th>Mean aid received (US 2000 millions of dollars)</th>
<th>Median aid received (US 2000 millions of dollars)</th>
<th>Standard Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>0-2</td>
<td>2.39</td>
<td>2.60</td>
<td>1.52</td>
</tr>
<tr>
<td>3-5</td>
<td>1.82</td>
<td>1.57</td>
<td>1.54</td>
</tr>
<tr>
<td>6-8</td>
<td>1.03</td>
<td>0.26</td>
<td>1.34</td>
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</tbody>
</table>

This initial evaluation of the descriptive data reveals the following: for the empowerment rights variable, it seems that the middle range of countries (scores from 5 to 9) receives the largest amount of foreign aid from the Netherlands. For the physical integrity rights variable, it appears that, interestingly, countries with the worst scores receive substantially more aid from the Netherlands. These descriptive statistics support the findings of Neumayer (2003), who argues that physical integrity rights are negatively correlated with aid allocation (Neumayer 2003: 664). As is the case for many other states that claim to support human rights abroad, it appears at first glance that the Dutch promise is hollow.
4. Method

It is important, however, to recognize that these descriptive statistics fail to account for many other factors that can influence foreign aid allocation, and it is possible that a set of countries is driving these numbers. We therefore turn to multivariate regression analysis to determine the true relationship between Dutch foreign aid and human rights. We control for post-communism, GDP per capita (in millions of US 2000 dollars), population, democracy, trade (both imports from and exports to the Netherlands, measured in constant 2005 millions of US dollars), foreign direct investment (FDI), oil, ethnic fractionalization, religious fractionalization, and former Dutch colony status. We take the natural logarithm of GDP per capita, population, and our trade variables to lessen the effects of possible outliers. In addition, we lag all control variables, as well as our independent variables (empowerment rights and physical integrity rights) by one year, because aid allocation decisions are generally made using information from the preceding year (Neumayer 2003: 654).

We include GDP per capita because of the Netherlands’ reputation as an altruistic donor, allocating aid based on recipient need. Democracy and population are variables that are almost universally considered important in the literature on foreign aid (Alesina and Dollar 2000). Trade, FDI, post-communism, and colony status are used as indicators of donor-interest motivated aid. Keeping with Alesina and Dollar (2000), we also control for ethnic and religious fractionalization.

Before beginning our analysis, it is important to address the issue of endogeneity. It is possible that foreign development aid improves the human rights records of violators. We doubt, however, that Dutch foreign aid has a large enough impact on a country’s economy to encourage

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9 We take our trade variables from the Correlates of War database.
10 We use Cheibub et. al.’s (2010) dichotomous democracy indicator.
the country to stop its violations or to allow it to build the institutional capacity to improve empowerment rights. Regardless, we include country fixed-effects to capture any unobserved heterogeneity across countries, and we also lag our independent variables to help address the problem of endogeneity. We do remain cognizant of this issue as we move forward, since endogeneity has the potential to undermine the strength of the relationship we find between human rights and receipt of Dutch aid.

We first examine both physical integrity rights and empowerment rights using OLS regressions and controlling for the factors discussed above. This initial approach mirrors Neumayer’s (2003) work on the relationship between human rights and foreign aid. Neumayer, however, looks at many donor nations, and gives an overview of general patterns worldwide. In our more focused study of the Netherlands, we are concerned with patterns within recipient countries. We therefore use a country fixed-effects model, and then a country and year fixed-effects model, for our second and third sets of regressions. When country fixed-effects are included, the colonial status, oil, ethnic fractionalization and religious fractionalization variables are omitted due to collinearity, since they are time invariant.

In addition to our examination of the physical integrity rights and empowerment rights indices, we perform a similar analysis for each of the component variables of these indices.11

5. Results

Our regression analysis of the relationship between empowerment rights and the allocation of Dutch aid lends support to the image of the Netherlands as an altruistic donor. As

11 The individual component variables, as described in Section 3, are: political and extrajudicial killings or deprivation of life, disappearances, torture, and political imprisonment, freedom of speech and press, freedom of religion, freedom of domestic movement, freedom of foreign movement, freedom of assembly and association, electoral self-determination, worker’s rights, independent judiciary and two women’s rights variables: political rights and economic rights.
shown in column 1 of Table 3, under the OLS regression model, we initially find a positive relationship between empowerment rights and receipt of Dutch aid, statistically significant at the 0.01 level. The relationship holds even when we control for country and year fixed-effects (see columns 2 and 3 of Table 3). In these models, the effect of better empowerment rights on the logged amount of Dutch aid is positive and significant at the 0.05 level. In their aid allocation, therefore, the Dutch seem to live up to their rhetoric of supporting empowerment rights.

Many of the control variable effects merit discussion as well. The only two controls that remain significant when we include country and year fixed-effects in our regressions are imports and FDI. We find a positive relationship between the natural logarithm of the recipient country’s total imports from the Netherlands and the receipt of Dutch aid, significant at the 0.1 level. In contrast, we find FDI to have a negative relationship with Dutch aid, indicating that countries that receive more FDI receive less Dutch aid. This relationship is also significant at the 0.1 level. These findings perhaps give credence to the possibility that Dutch aid is not entirely altruistic in nature.
### Table 3: The Effect of New Empowerment Rights of Log of Dutch Aid

<table>
<thead>
<tr>
<th>Variable</th>
<th>(1)</th>
<th>(2)</th>
<th>(3)</th>
</tr>
</thead>
<tbody>
<tr>
<td>New Empowerment Rights</td>
<td>0.0647***</td>
<td>0.0570**</td>
<td>0.0576**</td>
</tr>
<tr>
<td></td>
<td>(0.0108)</td>
<td>(0.0223)</td>
<td>(0.0232)</td>
</tr>
<tr>
<td>Democracy</td>
<td>0.0521</td>
<td>0.0291</td>
<td>0.0218</td>
</tr>
<tr>
<td></td>
<td>(0.0769)</td>
<td>(0.227)</td>
<td>(0.222)</td>
</tr>
<tr>
<td>Log of GDP per Capita</td>
<td>-0.377***</td>
<td>-0.453*</td>
<td>-0.422</td>
</tr>
<tr>
<td></td>
<td>(0.0476)</td>
<td>(0.252)</td>
<td>(0.305)</td>
</tr>
<tr>
<td>Log of Population</td>
<td>0.461***</td>
<td>-0.240</td>
<td>-0.308</td>
</tr>
<tr>
<td></td>
<td>(0.0369)</td>
<td>(0.330)</td>
<td>(0.697)</td>
</tr>
<tr>
<td>Post-Communist</td>
<td>-0.532***</td>
<td>0.00879</td>
<td>-0.332</td>
</tr>
<tr>
<td></td>
<td>(0.0819)</td>
<td>(0.493)</td>
<td>(0.537)</td>
</tr>
<tr>
<td>Log of Exports to Netherlands</td>
<td>-0.0590**</td>
<td>-0.0705</td>
<td>-0.0560</td>
</tr>
<tr>
<td></td>
<td>(0.0252)</td>
<td>(0.0471)</td>
<td>(0.0472)</td>
</tr>
<tr>
<td>Log of Imports from Netherlands</td>
<td>-0.0197</td>
<td>-0.0140</td>
<td>0.0984*</td>
</tr>
<tr>
<td></td>
<td>(0.0314)</td>
<td>(0.0491)</td>
<td>(0.0543)</td>
</tr>
<tr>
<td>FDI</td>
<td>-0.313</td>
<td>-0.378**</td>
<td>-0.306*</td>
</tr>
<tr>
<td></td>
<td>(0.279)</td>
<td>(0.188)</td>
<td>(0.175)</td>
</tr>
<tr>
<td>Dutch Colony</td>
<td>0.0961</td>
<td>omitted</td>
<td>omitted</td>
</tr>
<tr>
<td></td>
<td>(0.0798)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Oil</td>
<td>-0.471***</td>
<td>omitted</td>
<td>omitted</td>
</tr>
<tr>
<td></td>
<td>(0.0989)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ethnic Fractionalization</td>
<td>0.275**</td>
<td>omitted</td>
<td>omitted</td>
</tr>
<tr>
<td></td>
<td>(0.122)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Religious Fractionalization</td>
<td>0.197</td>
<td>omitted</td>
<td>omitted</td>
</tr>
<tr>
<td></td>
<td>(0.147)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Constant</td>
<td>-3.265***</td>
<td>8.787*</td>
<td>9.180</td>
</tr>
<tr>
<td></td>
<td>(0.764)</td>
<td>(4.970)</td>
<td>(12.24)</td>
</tr>
<tr>
<td>Country Fixed-Effects</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Year Fixed-Effects</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Observations</td>
<td>1,844</td>
<td>1,844</td>
<td>1,844</td>
</tr>
<tr>
<td>Adjusted R-squared</td>
<td>0.371</td>
<td>0.038</td>
<td>0.116</td>
</tr>
</tbody>
</table>

Standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.10
Our results, then, seem to support Hoebink's (1999) critical examination of the commercial motives of the Dutch aid program. It is also interesting to note that while the bureau in charge of Dutch foreign aid allocation is the Ministry of Foreign Affairs, trade and development aid are grouped together under the authority of the Minister for Foreign Trade and Development Cooperation, perhaps affirming the link between trade and aid. In fact, according to the Dutch government, "More and more low- and middle-income countries are not only recipients of aid but also trade partners. The government therefore encourages investment and trade activities in these countries" (Ministry of Foreign Affairs 2014).12

Surprisingly, GDP per capita is insignificant once we employ our country and year fixed-effects model. The insignificance of GDP per capita, which does not vary much within a country, is likely due to the inclusion of country fixed-effects. Recall that in the model without country fixed effects, the effect of GDP per capita is negative. So, on average, poorer countries do receive more Dutch foreign aid, but the effect is likely driven by differences across countries rather than within countries.

One of our other control variables, democracy, is accepted throughout the literature as having a significant positive effect on foreign aid (Alesina and Dollar 2000; Vreeland 2011; Bermeo 2008: 11). However, we find that Cheibub et al.’s (2010) minimalist conception of democracy, based on the alternation of power through contested elections, has no significant effect on Dutch foreign aid when controlling for country and year fixed-effects. This is particularly surprising because one component of CIRI’s new empowerment rights index is an indicator for “electoral self-determination,” which rates the level of a country’s democratization on a zero to two scale. The lack of effect observed with the democracy variable may be because

Cheibub et al.’s dichotomous indicator does not change in value for countries that deepen their democratic institutions once they already exist at a minimum level.

In addition, CIRI’s electoral self-determination variable takes into account citizens’ experiences of democracy (such as violence during election times), rather than just the presence of democratic institutions (like the existence of competitive elections). This suggests that the Netherlands is concerned with the reality of democracy on the ground in recipient countries, rather than simply the legal basis of democracy, a perspective that may be related to its focus on human rights.

When we examine overall physical integrity rights, we find that, in all three of our regression models, these rights do not have a statistically significant relationship with Dutch foreign aid (see Table 4). It is thus clear that receipt of Dutch aid is correlated with empowerment rights, but not with integrity rights. This is a somewhat surprising result for a country that claims to actively combat torture and the death penalty, but it also diverges from Neumayer's (2003) finding that countries with worse physical integrity rights receive more Dutch aid. Finally, note that all of the control variables have the same effects as when we test empowerment rights.
Table 4: Effect of Physical Integrity Rights Index on Log of Dutch Aid

<table>
<thead>
<tr>
<th>Variable</th>
<th>(1)</th>
<th>(2)</th>
<th>(3)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Physical Integrity Rights</td>
<td>-0.00520</td>
<td>0.00427</td>
<td>0.00326</td>
</tr>
<tr>
<td></td>
<td>(0.0172)</td>
<td>(0.0209)</td>
<td>(0.0197)</td>
</tr>
<tr>
<td>Democracy</td>
<td>0.333***</td>
<td>0.112</td>
<td>0.108</td>
</tr>
<tr>
<td></td>
<td>(0.0640)</td>
<td>(0.245)</td>
<td>(0.243)</td>
</tr>
<tr>
<td>Log of GDP per Capita</td>
<td>-0.335***</td>
<td>-0.513**</td>
<td>-0.460</td>
</tr>
<tr>
<td></td>
<td>(0.0477)</td>
<td>(0.258)</td>
<td>(0.313)</td>
</tr>
<tr>
<td>Log of Population</td>
<td>0.429***</td>
<td>-0.289</td>
<td>-0.303</td>
</tr>
<tr>
<td></td>
<td>(0.0396)</td>
<td>(0.330)</td>
<td>(0.688)</td>
</tr>
<tr>
<td>Post Communist</td>
<td>-0.572***</td>
<td>0.0451</td>
<td>-0.316</td>
</tr>
<tr>
<td></td>
<td>(0.0836)</td>
<td>(0.491)</td>
<td>(0.539)</td>
</tr>
<tr>
<td>Log of Exports to Netherlands</td>
<td>-0.0564**</td>
<td>-0.0725</td>
<td>-0.0555</td>
</tr>
<tr>
<td></td>
<td>(0.0255)</td>
<td>(0.0462)</td>
<td>(0.0461)</td>
</tr>
<tr>
<td>Log of Imports from Netherlands</td>
<td>-0.0396</td>
<td>-0.0122</td>
<td>0.100*</td>
</tr>
<tr>
<td>FDI</td>
<td>(0.0315)</td>
<td>(0.0499)</td>
<td>(0.0559)</td>
</tr>
<tr>
<td></td>
<td>-0.230</td>
<td>-0.373**</td>
<td>-0.305*</td>
</tr>
<tr>
<td></td>
<td>(0.282)</td>
<td>(0.183)</td>
<td>(0.165)</td>
</tr>
<tr>
<td>Dutch Colony</td>
<td>0.0973</td>
<td>omitted</td>
<td>omitted</td>
</tr>
<tr>
<td></td>
<td>(0.0806)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Oil</td>
<td>-0.651***</td>
<td>omitted</td>
<td>omitted</td>
</tr>
<tr>
<td></td>
<td>(0.0959)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ethnic Fractionalization</td>
<td>0.347***</td>
<td>omitted</td>
<td>omitted</td>
</tr>
<tr>
<td></td>
<td>(0.123)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Religious Fractionalization</td>
<td>0.171</td>
<td>omitted</td>
<td>omitted</td>
</tr>
<tr>
<td></td>
<td>(0.148)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Constant</td>
<td>-2.582***</td>
<td>10.37**</td>
<td>9.755</td>
</tr>
<tr>
<td></td>
<td>(0.806)</td>
<td>(4.838)</td>
<td>(12.10)</td>
</tr>
</tbody>
</table>

Country Fixed-Effects | No | Yes | Yes |
Year Fixed-Effects    | No | No  | Yes |
Observations          | 1,847 | 1,847 | 1,847 |
Adjusted R-squared    | 0.359 | 0.027 | 0.105 |

Standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.10
Table 5 presents the results of our regressions for each of the component variables in the CIRI human rights dataset. Our component variable analysis shows a close alignment of the stated goals of the Dutch government and their actual allocation of aid. Recall the human rights priorities of the Dutch government. While it focuses on empowerment rights, “the Netherlands [also] works to combat the use of the death penalty and torture” (Ministry of Foreign Affairs 2014). In line with this discourse, we find that extrajudicial killings and torture are both statistically significant at the 0.05 level, indicating that violators of these rights receive less aid (see Table 5a). Interestingly, the numbers of disappearances and political prisoners do not have a statistically significant relationship with receipt of Dutch aid—and they are not referenced as priorities by the Dutch, perhaps explaining this lack of relationship.

Turning to empowerment rights, Tables 5b and 5c show our results for this set of variables. Freedom of speech, religious freedom, freedom of domestic movement, freedom of foreign movement, freedom of association, electoral self determination, and worker’s rights all have a positive, statistically significant relationship with Dutch aid, indicating that countries with better records on these issues are rewarded with more aid. Once again, these rights reflect the rhetoric of the Dutch government—religious freedom and freedom of speech are highlighted as two of the top human rights priorities for the Netherlands.

In contrast, the regressions for the relationship between foreign aid and women’s economic and political rights and freedom of the judiciary do not produce a statistically significant result. We hypothesize that no relationship is found between the women’s economic and political rights variables and Dutch foreign aid because these variables may not capture the goals of the Dutch government. The CIRI variables focus on the empowerment of women in the

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economic and political realm. In contrast, although the Dutch government highlights women’s rights as a priority, its focus is on women, peace and security, and on preventing violence against women—issues separate from women’s empowerment rights (Ministry of Foreign Affairs 2014).\footnote{Government of the Netherlands, “Equal rights for all,” http://www.government.nl/issues/human-rights/equal-rights-for-all}

\begin{table}[h]
\centering
\caption{Effect of Component Human Rights Variables on Log of Dutch Aid}
\begin{tabular}{lccccc}
\hline
Variable & Extrajudicial Killings & Disappearances & Torture & Political Prisoners \\
\hline
Component Variable & 0.00896** & 0.000262 & 0.00893** & 0.00155 \\
& (0.00348) & (0.000631) & (0.00350) & (0.00103) \\
Democracy & 0.111 & 0.0906 & 0.111 & 0.0937 \\
& (0.233) & (0.231) & (0.233) & (0.232) \\
Log GDP per Capita & -0.526* & -0.503* & -0.528* & -0.503* \\
& (0.297) & (0.300) & (0.297) & (0.298) \\
Log Population & -0.366 & -0.199 & -0.368 & -0.219 \\
& (0.652) & (0.649) & (0.653) & (0.646) \\
Post-Communist & -0.318 & -0.284 & -0.322 & -0.290 \\
& (0.533) & (0.534) & (0.533) & (0.534) \\
Log Imports from Netherlands & -0.0595 & -0.0639 & -0.0593 & -0.0638 \\
& (0.0460) & (0.0463) & (0.0460) & (0.0463) \\
Log Exports to Netherlands & 0.101* & 0.103* & 0.102* & 0.104* \\
& (0.0558) & (0.0564) & (0.0557) & (0.0562) \\
FDI & -0.298* & -0.283 & -0.298* & -0.285 \\
& (0.166) & (0.181) & (0.168) & (0.178) \\
Constant & 11.21 & 8.384 & 11.25 & 8.712 \\
& (11.35) & (11.21) & (11.37) & (11.17) \\
Country Fixed-Effects & Yes & Yes & Yes & Yes \\
Year Fixed-Effects & Yes & Yes & Yes & Yes \\
Observations & 1,886 & 1,886 & 1,886 & 1,886 \\
Adjusted R-squared & 0.113 & 0.105 & 0.113 & 0.107 \\
\hline
\end{tabular}
\footnotesize{Standard errors in parentheses} \\
*** p<0.01, ** p<0.05, * p<0.10
\end{table}
Table 5b: Effect of Component Human Rights Variables on Log of Dutch Aid (continued)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Component Variable</td>
<td>0.00916***</td>
<td>0.00938**</td>
<td>0.00941***</td>
<td>0.00914***</td>
<td>0.00727*</td>
</tr>
<tr>
<td></td>
<td>(0.00344)</td>
<td>(0.00366)</td>
<td>(0.00344)</td>
<td>(0.00346)</td>
<td>(0.00381)</td>
</tr>
<tr>
<td>Democracy</td>
<td>0.111</td>
<td>0.112</td>
<td>0.111</td>
<td>0.109</td>
<td>0.107</td>
</tr>
<tr>
<td></td>
<td>(0.233)</td>
<td>(0.233)</td>
<td>(0.234)</td>
<td>(0.233)</td>
<td>(0.233)</td>
</tr>
<tr>
<td>Log GDP per Capita</td>
<td>-0.528*</td>
<td>-0.525*</td>
<td>-0.540*</td>
<td>-0.537*</td>
<td>-0.528*</td>
</tr>
<tr>
<td></td>
<td>(0.297)</td>
<td>(0.289)</td>
<td>(0.292)</td>
<td>(0.292)</td>
<td>(0.299)</td>
</tr>
<tr>
<td>Log Population</td>
<td>-0.366</td>
<td>-0.368</td>
<td>-0.363</td>
<td>-0.356</td>
<td>-0.319</td>
</tr>
<tr>
<td></td>
<td>(0.652)</td>
<td>(0.651)</td>
<td>(0.652)</td>
<td>(0.652)</td>
<td>(0.655)</td>
</tr>
<tr>
<td>Post-Communist</td>
<td>-0.315</td>
<td>-0.315</td>
<td>-0.321</td>
<td>-0.320</td>
<td>-0.309</td>
</tr>
<tr>
<td></td>
<td>(0.531)</td>
<td>(0.534)</td>
<td>(0.533)</td>
<td>(0.533)</td>
<td>(0.533)</td>
</tr>
<tr>
<td>Log Imports from Netherlands</td>
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<td>-0.0584</td>
<td>-0.0595</td>
<td>-0.0595</td>
<td>-0.0586</td>
</tr>
<tr>
<td></td>
<td>(0.0461)</td>
<td>(0.0458)</td>
<td>(0.0457)</td>
<td>(0.0457)</td>
<td>(0.0460)</td>
</tr>
<tr>
<td>Log Exports to Netherlands</td>
<td>0.101*</td>
<td>0.101*</td>
<td>0.101*</td>
<td>0.101*</td>
<td>0.102*</td>
</tr>
<tr>
<td></td>
<td>(0.0557)</td>
<td>(0.0556)</td>
<td>(0.0556)</td>
<td>(0.0556)</td>
<td>(0.0558)</td>
</tr>
<tr>
<td>FDI</td>
<td>-0.298*</td>
<td>-0.295*</td>
<td>-0.292*</td>
<td>-0.294*</td>
<td>-0.311*</td>
</tr>
<tr>
<td></td>
<td>(0.166)</td>
<td>(0.168)</td>
<td>(0.168)</td>
<td>(0.169)</td>
<td>(0.164)</td>
</tr>
<tr>
<td>Constant</td>
<td>11.23</td>
<td>11.23</td>
<td>11.24</td>
<td>11.11</td>
<td>10.47</td>
</tr>
<tr>
<td></td>
<td>(11.34)</td>
<td>(11.32)</td>
<td>(11.33)</td>
<td>(11.33)</td>
<td>(11.38)</td>
</tr>
</tbody>
</table>

Country Fixed-Effects      Yes     Yes     Yes     Yes     Yes
Year Fixed-Effects          Yes     Yes     Yes     Yes     Yes
Observations                1,886   1,894   1,896   1,896   1,886
Adjusted R-squared          0.114   0.114   0.114   0.114   0.111

Standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.10
Table 5c: Effect of Component Human Rights Variables on Log of Dutch Aid (continued)

<table>
<thead>
<tr>
<th>Variable</th>
<th>Electoral Self-Determination</th>
<th>Worker’s Rights</th>
<th>Women’s Economic Freedoms</th>
<th>Women’s Political Freedoms</th>
<th>Independent Judiciary</th>
</tr>
</thead>
<tbody>
<tr>
<td>Component Variable</td>
<td>0.00948***</td>
<td>0.00890**</td>
<td>-0.000302</td>
<td>0.000148</td>
<td>0.00148</td>
</tr>
<tr>
<td></td>
<td>(0.00347)</td>
<td>(0.00349)</td>
<td>(0.000244)</td>
<td>(0.000183)</td>
<td>(0.000969)</td>
</tr>
<tr>
<td>Democracy</td>
<td>0.107</td>
<td>0.111</td>
<td>0.0856</td>
<td>0.0903</td>
<td>0.0889</td>
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<tr>
<td></td>
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<td>(0.231)</td>
<td>(0.231)</td>
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</tr>
<tr>
<td>Log GDP per Capita</td>
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<td>-0.525*</td>
<td>-0.514*</td>
<td>-0.504*</td>
<td>-0.509*</td>
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<tr>
<td></td>
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<tr>
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<tr>
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<td></td>
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<td>(0.532)</td>
<td>(0.535)</td>
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<td>(0.0473)</td>
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<tr>
<td>Log Exports to Netherlands</td>
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<td>0.100*</td>
<td>0.105*</td>
<td>0.103*</td>
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<td>(0.0564)</td>
<td>(0.0563)</td>
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<tr>
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<td>-0.295*</td>
<td>-0.277</td>
<td>-0.285</td>
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<td>(0.166)</td>
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<td>(11.34)</td>
<td>(11.21)</td>
<td>(11.22)</td>
<td>(11.19)</td>
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<td>1,885</td>
<td>1,885</td>
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<td>0.113</td>
<td>0.106</td>
<td>0.105</td>
<td>0.107</td>
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</tbody>
</table>

Standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.10
6. Conclusion

While the political motivations of large donors are widely accepted in the literature, the intentions of small donors remain contested. It has long been assumed that small donors act solely in the interest of alleviating poverty or achieving humanitarian goals, but recent literature has been challenging this belief (Vreeland 2011; Lawrimore and Varghese 2014). Though they do not have the same degree of sway on the international stage as larger donors, small donors may still allocate aid strategically in order pursue goals important to their economy, security, or national identity. The case of the Netherlands provides further support for this perspective: even when attempting to promote human rights, the Netherlands makes strategic decisions in its aid allocation in order to promote those rights it sees as most important.

The 1979 policy memo and the Dutch rhetorical commitment to human rights protection indicate that the promotion of these rights is an essential part of not only the Dutch identity, but also of their foreign policy. We find that the Netherlands’ stated human rights priorities and its aid distribution patterns are closely aligned. The Dutch government makes it clear that it emphasizes the promotion of empowerment rights around the world, and, correspondingly, it appears to allocate more aid to countries with better records of civil and political liberties. Physical integrity rights, on the other hand, do not have a statistically significant relationship with receipt of Dutch aid.

This strategic selection of rights is perhaps a reflection of the status of different kinds of human rights on the world stage. Physical integrity rights are widely regarded as inalienable: nations do not hesitate to condemn the violations of these rights or to pledge support in their promotion. Civil and political liberties, conversely, do not hold the same status in the international community. They are often subject to the argument of cultural relativism, which
contrasts the Western origin of these rights with the vastly different cultures of other regions; states are therefore less likely to actively promote empowerment rights on the world stage. As a small donor, the Netherlands has limited funds, and so to use its aid-euros to greatest effect, it may choose to support those rights that the international community gives less attention—namely, empowerment rights.

One recent example to support this hypothesis concerns LGBT rights, one of the Dutch government’s top three stated human rights priorities. In February of this year, President Museveni of Uganda signed legislation that expanded the criminalization of homosexual relations. Though LGBT rights are today still controversial, the Dutch government responded immediately by cutting aid to the Ugandan government (Government of the Netherlands 2014).15 In this way, the Dutch have not failed to defend one of their key rights priorities abroad. This further illustrates how the Netherlands uses development aid to support those human rights that it considers most important, and, more specifically, rights that are not yet universally recognized.

While our results do much to explain the true nature of the Dutch aid program, further research is required. Specifically, we would like to determine if the Dutch reward countries with good records of rights, or if they punish rights violators by cutting aid. Though our case studies of Indonesia and Uganda provide individual examples, we would like to do more to determine the direction of this relationship at the systemic level, since it is unclear from our current data set. In addition, we pose the question of whether Dutch aid policies are actually effective in improving human rights around the globe. These issues are beyond the scope this paper, but provide interesting avenues for further research.

Though scholars often focus on the goals and strategies of larger states, which have more resources at their disposal, it is important not to forget that small nations may also execute political maneuvers. As we have shown, the Dutch use their limited aid-euros to promote certain human rights. Thus, the often-overlooked case of the Netherlands perhaps provides insight into the world of small states—indicating that small donors can, and do, use foreign aid as a political and strategic tool.

References


1. Introduction

“[Sex trafficking] is the dirty secret of UN interventions around the world - the nasty underbelly that no one wants to confront.”

~ Martina Vandenberg of Human Rights Watch

How is it possible that an organization striving to help “countries torn by conflict create conditions for lasting peace” has been accused of exploiting vulnerable populations through sex trafficking? Since the early 1990s, the United Nations has been the target of multiple allegations of contributing to sex trafficking industries abroad. Critics tend to argue one of two claims: either the influx of foreign personnel creates a demand for the industry, which is then satisfied through illicit means, or the presence of UN missions has a destabilizing effect on local governments, thereby indirectly creating suitable conditions for a thriving sex trafficking market.

As observers note, there seems to be a positive trend between the presence of UN missions and the emergence or growth of a domestic trafficking industry. We believe, however, that this may be the result of an inherent selection problem: UN missions tend to exist in destabilized countries with poor governance, so it should come as no surprise that countries experiencing a mission exhibit higher levels of trafficking.

While some scholars focus on isolated incidents in which members of UN missions directly engaged in the trafficking industry, these accusations have often been broadened to

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16 Extracted from Bolkovac 2011: 177
criticize the institutions of foreign intervention and peacekeeping as a whole (Agathangelou & Ling 2003; Ferstman 2013). It is while investigating the latter that we begin to question whether or not these claims may be validated through statistical analysis. When analyzed in context, does the mere presence of UN personnel exacerbate weak governance, corruption and poverty, and lead to the increased exploitation of women and children, as scholars have suggested?

Although the influx of peacekeepers may fuel the demand for sex trafficking in particular instances, the overall effect of reducing the supply of the industry – either directly or indirectly – is more durable. We claim that the defamation of UN peacekeeping missions is due to isolated incidents of trafficking, and once the dynamics are viewed in context, the presence of these missions in fact decreases rates of sex trafficking over time. Our study takes a quantitative approach and examines a dataset of 179 countries over the period 2000-2011. Our results ultimately support our hypothesis and are statistically significant at the 1% level, even after accounting for economic and political factors, country fixed-effects, and duration dependence.

The remainder of this study proceeds as follows. In Section 2, we explain the relationship between United Nations peacekeeping missions and sex trafficking. Section 3 expands on this by discussing the theory behind the relationship, as observed in the existing literature. Section 4 introduces our variables of interest and lays the groundwork for our reasoning. Section 5 presents our methodology in approaching the study. We discuss our results in Section 6, including the analysis of significant control variables. Our findings support our hypothesis and suggest that countries that experience UN peacekeeping missions are less likely to house a human trafficking industry during the years following an intervention. The final section discusses the significance of our findings in the context of recommendations for future United Nations peacekeeping policy and strategy.
2. Background: United Nations peacekeeping missions and sex trafficking

To understand the full magnitude of the global human trafficking phenomenon: the International Labour Organization (ILO) estimates that at least 2,450,000 persons were victims of human trafficking in 2010—of which 79% were sexually exploited (United Nations 2010: 39). For the purpose of our study, we focus on this particular category of human trafficking, sex trafficking, which includes forced prostitution, commercial sexual exploitation, and sexual exploitation of children.

Sex trafficking, like any other illicit network, is driven by motives for economic profit (Talleyrand 2007; Danailova-Trainor & Patrick Belser 2006). Military intervention creates the monetary incentive for the formation of trafficking networks by increasing inflows of both, foreign money and individuals willing to engage in the prostitution industry (Schloenhardt 1999; Salt & Stein 1997). As a result, where there is military conflict, there is usually a rampant sex industry thriving alongside it (Smith 2011).

Scholars argue that there are two primary models by which illicit sex industries emerge in the military sphere. The first is a war tactic in which women are held captive, forced into the industry, and used as sex slaves for soldiers. The second form develops as a government-regulated sex industry—created by the new demand of soldiers—that functions as a means for soldiers to “rest and relax.” In this second model, the military personnel do not directly hold the women captive, nor do they traffic the women themselves; they do, however, create the demand that incentivizes the criminal behavior behind sex trafficking (Talleyrand 2007: 151).
This dynamic is complicated in the context of United Nations peacekeeping missions. On the one hand, UN peacekeeping intervention bears some of the same characteristics as any military intervention; they both carry a demand for sex and the money to pay for it. What differentiates UN peacekeepers, however, is the intention of bringing peace, stability, and protection to civilians in insecure regions. The question then becomes: how do these motives influence the fate of sex trafficking in countries of UN intervention?

United Nations peacekeeping missions were first criticized for sexual misconduct against civilian populations during an operation that took place in Mozambique (UNOMOZ) from 1992-1994 (Fleshman 2005: 16). Following the exposure of this operation, reports flooded in, revealing UN personnel involvement in cases of forced prostitution in Somalia, Bosnia and Herzegovina, Kosovo, and Cambodia (Lupi 1998; Amnesty International 2005; Phal 1995).

In response to these allegations, the United Nations instituted a zero tolerance policy in 2003 entitled “Special Measure for Protection from Sexual Exploitation and Sexual Abuse” (ST/SGB/2003/13). The document outlines that, “the United Nations force conducting operations under United Nations command and control are prohibited from committing acts of sexual exploitation and sexual abuse, and have a particular duty to care towards women and children” (United Nations 2003).

Despite this zero tolerance policy, however, allegations against the United Nations have persisted. In 2005, Jordan’s former Ambassador to the United States, Prince Zeid Ra’ad Zeid Al-Hussein, released a report titled A Comprehensive Strategy to Eliminate Future Sexual Exploitation and Abuse in United Nations Peacekeeping Operations, which exposed the alarming extent to which sexual abuse and engagement in trafficking networks continued to be widespread among UN missions. The report argues that the problems of sexual exploitation
extend beyond the limits of peacekeeping missions, and that they in fact signal a greater issue concerning the efficacy of the UN system as a whole (Al-Hussein 2005).

As a result of these multiple allegations, scholars have reached the consensus that United Nations peacekeeping troops are at fault for directly increasing sex trafficking. Existing literature, however, has so far limited itself to focusing exclusively on the direct effect of UN intervention on isolated incidents of demand, but has yet to explore the stabilizing impact of the presence of missions in quelling the industry on balance.

3. Theory: the sex trafficking industry

An inherent problem in analyzing sex trafficking data is the industry’s illegality and focus on “hidden populations.” Sex trafficking is by nature an illegal and clandestine activity, which is only documented in the case of a specific incident report. As a consequence, trafficking flows far exceed the reported statistics. In addition, sex trafficking involves transactions between “hidden populations,” which Tyldum and Brunovskis (2005) define as “a group of individuals for whom the size and boundaries are unknown, and for whom no sampling frame exists.” Consequently, many of those engaged in sex trafficking exist under the radar and remain undetected.

Despite the difficulties presented in measuring the true scope of sex trafficking, there have been extensive efforts to collect, record, and analyze available data. Therefore, although it may not be possible to measure the exact change in sex trafficking flows, we may observe trends.

The study of human trafficking is divided into two categories: push and pull factors. Push factors relate to the elements that cause individuals to be trafficked from their country of origin,
whereas pull factors are those that drive trafficking flows to a specific destination. Since we intend to analyze the effects of UN peacekeeping missions on the demand for sex trafficking, we address the appropriate pull factors. In “Modelling for Determinants of Human Trafficking,” Cho contends that extant literature lists over 60 potential human trafficking pull factors (Cho 2012). She tests each of these factors in order to identify the “true” variables influencing human trafficking, and finds three variables that prove to be robust: (log) GDP per capita; language fraction; and information flows (Cho 2012: 20).

First, we note that human trafficking is driven by the potential for economic profit (UNODC 2009). Traffickers stand to profit in countries with large markets and wealthy customers; therefore, a large GDP per capita is a pull factor (Jakobsson & Kotsadam 2011: 92). Second, scholars have observed that linguistically divided countries tend to experience greater levels of trafficking. Akee et al. (2010) suggest that this is due in part to the fact that countries with greater ethnic heterogeneity are more likely to host informal and exploitive labor markets. Lastly, Cho argues that information flows decrease human trafficking, suggesting that greater availability of information increases general awareness of the industry, and may lessen the likelihood of exploitation (Cho 2012: 21). Our study controls for these three pull factors, among others, and aims to identify an additional “true” variable influencing levels of human trafficking.

In the context of our study, we hypothesize that the presence of United Nations peacekeeping mission reduces sex trafficking within a country. First, peacekeeping operations have positive economic effects on a country (Ernst et. al. 2014). While it is true that a higher GDP per capita may increase the rate of sex trafficking inflows, it is also possible that economic development might provide options for individuals within the legal private sector, thereby reducing the incentive to engage in the illicit sex trafficking market. Second, UN peacekeeping
missions often aid in strengthening the legal force and police presence (Day 2000:157). By strengthening both of these institutions, peacekeeping missions have the potential to help crack down on the market and reduce sex trafficking rates. As a result, even though some scholars contend that UN personnel are directly at fault for fueling demand for sex trafficking in specific instances, we argue that these institutional reforms act to fundamentally dismantle the industry within a host country.

4. Data

Our study analyzes the impact of United Nations peacekeeping missions on sex trafficking inflows. In order to measure this effect, we rely on data provided by the United Nations that accounts for all UN missions between 2000-2011 (UN 2013). Country-year observations that experience a mission are coded as 1, while those without are 0.

We analyze sex trafficking data from 179 countries between 2000-2011 by using the Human Trafficking Indicators (HTI) dataset, which compiles the US Department of State’s annual Trafficking in Persons (TIP) reports (Frank 2013). This dataset uses a dichotomous indicator of 1 or 0 based on whether or not a country experienced a significant level of forced prostitution, commercial sexual exploitation, or sexual exploitation of children within a year. The International Labour Organization (ILO) defines a significant level as 100 or more reported cases.

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18 The dates of the full data set are 1948-2013. This enabled these authors to account for a lag in the independent variable, so as to address the fact that the effect of the UN on sex trafficking is not immediate. This full dataset can be found at the following url: http://www.un.org/en/peacekeeping/documents/operationslist.pdf

19 This study uses the United Nations definition of human trafficking, defined as “the recruitment, transportation, transfer, harboring or receipt of persons, by means of threat or use of force or other forms of coercion, of abduction, of fraud, of deception, of the abuse of power or of a position of vulnerability or of the giving or receiving of payments or benefits to achieve the consent of a person having control over another person, for the purpose of exploitation. Exploitation shall include, at a minimum, the exploitation of the prostitution of others or other forms of sexual exploitation, forced labor or services, slavery or practices similar to slavery, servitude or the removal of organs” (UN 2004).
in a given year.\textsuperscript{20} It is impossible to measure the true level of human trafficking within a country, and as a result, measuring the change in total number of reports would be misleading and subjective. We can determine, however, with a degree of certainty, whether or not there was a significant level of trafficking within a country of interest. Therefore, our study assesses the potential large-scale impact UN peacekeeping missions have on sex trafficking inflows.

This study specifically focuses on trafficking related to the destination of victims. The distinction between source and destination is important, as different factors influence each in different ways (Cho 2012). As we attempt to explore the claim that United Nations peacekeeping missions increase the demand for forced prostitution and commercial sex exploitation—and therefore the demand for sex trafficking—it is more important to evaluate the trafficking pull factors within a country.

Figure 1 presents the mean level of significant human trafficking, comparing country-year observations with a UN peacekeeping operation to those without. The graph demonstrates that the mean level of significant sex trafficking is in fact higher for countries without a UN peacekeeping mission. Within the range of 0 to 1, the mean level of human trafficking is approximately 0.70 for countries without a mission and 0.65 for counties with a mission. This is a surprising given that current literature claims that countries with a UN peacekeeping mission should in fact experience a higher level of human trafficking than those without.

\textsuperscript{20} There are three widely accepted data sources for human trafficking: The United Nations Office on Drug and Crime (UNODC), the International Labor Organization (ILO), and the US Department of State (Cho 2012: 10-11). The UNODC data only covers years 2006, 2009, and 2012, while the ILO data provides an aggregate number of cases from 1995-2000.
5. Methodology

The descriptive statistics alone are insufficient in illustrating a causal relationship between United Nations peacekeeping missions and sex trafficking. We employ a baseline specification based on the model provided by Cho (2012) that includes GDP per capita (log), language fractionalization, and information flows. While not robust among all three widely accepted human trafficking datasets, Cho also suggests that refugees (log), international tourism (log), and population (log) could be significant factors for human trafficking. Therefore, we adopt these variables in our study.

In addition to the baseline specification provided by Cho, there are two additional major theoretical camps for the causes of human trafficking that we apply: governance and anti-trafficking efforts (Jakobsson & Kotsadam 2011; Cho, Dreher, & Neumayer 2011).

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21 The sources are: World Bank (2013) Alesina et. al. (2003), and Dreher (2006). These are the same sources that Cho uses in her paper, “Modelling for Determinants in Human Trafficking.”
Governance is argued to be an important indicator of human trafficking due to the industry’s difficulty to thrive in countries with accountable governments and stable policies. If a government is successful in developing stable, fair, and predictable policies that yield effective social and economic growth, it is unlikely that the country will experience significant levels of human trafficking (Jakobsson & Kotsadam 2011: 95). In order to address governance, we account for both government effectiveness and regulatory quality, based on the Worldwide Governance Indicators dataset. Government effectiveness is a measure of the quality of government policy, services, implementation, and credibility; whereas regulatory quality is an indicator of a government’s ability to implement policies and regulations that promote a strong private sector (Kaufmann, Daniel, Kraay, Aart and Mastruzzi, Massimo 2010).

We then take anti-trafficking measures into account. The Human Trafficking Indicators (HTI) dataset accounts for factors within the three major forms of combative efforts: prosecution, protection, and prevention.\(^{22}\) We select the most significant variable from each of these three categories for our study: domestic laws, minimal progress in the protection of trafficked individuals, and minimal progress in preventing human trafficking. Lastly, in order to aggregate the data points for total anti-trafficking efforts, we also include a “minimum standards” variable, indicating whether or not a government fully complies with the minimum anti-trafficking efforts, as defined by the US Department of State’s Victims of Trafficking and Violence Protection Act (TVPA) (Frank 2011:3).

In order to assess the impact of United Nations Peacekeeping missions on sex trafficking, we employ logit, conditional logit, and duration dependence conditional logit regression models. We use the logit regression as a standard analysis of the aggregate data. The conditional logit

\(^{22}\) The main proponents of this 3-part model comes from Cho, Dreher & Neumayer (2014)
model controls for country fixed-effects, and the duration dependence conditional logit model accounts for the effect of past sex trafficking on current levels. In this last model we apply the Carter & Signorino (2010) approach to addressing potential duration dependence. Note that in many cases countries go for many years without sex trafficking and then suddenly onset begins and continues for several years. So, observations of the same country across time are not independent. Including cubic polynomial variables for time, as suggested by Carter and Signorino (2010), helps to address this potential problem.\footnote{Carter and Signorino’s approach updates that of Beck, Katz, and Tucker (1998). Our results hold using either approach}

It is important to note that the independent variable, presence of a UN peacekeeping mission, is lagged for three years because our study attempts to measure the long-term role of UN intervention. A significant sex trafficking industry could neither be created nor destroyed immediately upon UN intervention, so it is more appropriate to lag the variable to account for the effect of UN presence over time.

Lastly, there is indeed an issue of potential endogeneity, which we address through our conditional logit model. By including country fixed-effects, we control for unobserved heterogeneity across countries. In other words, each country is analyzed individually with regards to its unique descriptive statistics, instead of in comparison to other countries.
6. Results

Our initial regression results appear to support our hypothesis that United Nations peacekeeping missions decrease sex trafficking rates within a country.

**Figure 2: Relationship Between Sex Trafficking and Lagged UN Missions**

<table>
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<th></th>
<th>Model 1</th>
<th>Model 2</th>
<th>Model 3</th>
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<td>-4.200***</td>
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<td>GDP per capita (log)</td>
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<td>(3.790)</td>
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<td>(2.705)</td>
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</table>

logit country fixed-effects logit duration dependence logit
Model 1 shows our logit results when accounting for sex trafficking rates three years after a country-year observation. The result is negative, but statistically insignificant. This calls our hypothesis into question, and potentially indicates that the United Nations does not have a significant observable effect on the sex trafficking industry.

These insignificant results may be adversely affected by selection bias, where countries that experience constant rates of sex trafficking between 2000-2011 are driving the results. We subsequently move to a conditional logit model in model 2. This model accounts for country fixed-effects, and is in fact significant at the 1% significance level. These results indicate that UN peacekeeping missions do indeed quell sex trafficking in a country experiencing a UN mission, even if the effects are not immediate.

The results become significant after accounting for country fixed-effects because this model solves the problem of selection bias. In this model, our results are only a measure of countries that experience a change in sex trafficking. Consequently, the results are not driven by countries that experience trafficking within all observed years or the lack thereof, unlike in the logit model. As a result, while the initial logit model calls into question the validity of our hypothesis, the conditional logit model effectively controls for the problem of selection bias, thereby strengthening our case.

Model 3 employs a duration dependence conditional logit model. One might argue that a country experiencing a significant level of sex trafficking in one year is likely to experience it in the following year. After accounting for this effect, however, our primary variable of interest remains significant at the 1% level.
Since both, model 2 and model 3, employ more rigorous analysis than model 1, the results lead us to conclude that the presence of UN missions may very well decrease sex trafficking within a country.

The control variables in this study warrant discussion as well. In assessing our most rigorous regression, model 3, the following variables support the human trafficking literature explored in sections 3 and 4: GDP per capita (log), population (log), TIP minimum standards, prevention policy progress, refugees (log), protection policy progress, government effectiveness, and regulatory quality.

We are surprised to find that information flows have the opposite effect of what Cho’s baseline specification suggests. She argues that increased availability of information ought to increase awareness of human trafficking, and thereby prevent the possibility of exploitation; however, our results suggest the opposite. This may be explained by the possibility that women are at times trafficked internally; in these cases the country experiencing a UN mission is both the source and destination of trafficked women. Consequently, the country of interest may be influenced by both pull and push factors. While Cho (2012) indicates that information flows are a negative pull factor, they may also be a positive push factor, and could potentially explain the unexpected results.

We are also surprised to find that domestic laws and tourism have the opposite effect that one might expect. First, our results show a positive relationship between domestic laws and sex trafficking. It is surprising that anti-trafficking laws might actually increase the level of trafficking within a country. This may indicate that the illegality of the industry pushes it further underground, so that it is difficult to effectively combat. It is also possible that this may be tied to a selection case problem: the United Nations is more likely to intervene in countries with poorer
regulatory systems. Lastly, we are surprised by the negative result of tourism. When we use the logit model the results are in line with Cho’s argument. Since Cho does not use a conditional logit model in her study, it is possible that her conclusion that tourism has a positive effect on human trafficking rates may be flawed due to a problem of endogeneity, since it appears not to hold when controlling for country fixed-effects.

7. Conclusion

After conducting rigorous analysis, we find that our results carry critical implications. In accordance with our hypothesis, we discover that the presence of a UN peacekeeping mission is likely to reduce sex trafficking inflows.

This finding presents a contrary image regarding the impact of UN missions. Although the influx of foreign personnel and money is expected to increase the market demand for forced prostitution and commercial sex exploitation – either by direct or indirect means – we find that this theory does not hold.

It is important to note, however, that we do not intend to directly refute those who condemn the United Nations peacekeeping missions for trafficking abuses. We do not argue that UN personnel have been wrongly accused of harming civilian populations or engaging in sex trafficking. Instead, our analysis focuses on extending the discussion to involve the full scope of the dynamics at play in the industry. While it may be true that some UN personnel create demand for the sex trafficking, the stabilizing effect of the United Nations has an overall result of lessening the rate of inflows to a country.
A myriad of factors come into play when addressing our seemingly contrary findings. First, we must consider the fact that the bulk of accusations of UN personnel either engaging or being complicit actors in the trafficking industry occurred before the year 2000, whereas our datasets span 2000-2011. As discussed in Section 2, the United Nations has since taken various proactive measures to combat trafficking by peacekeepers, such as the zero tolerance policy. Although allegations occasionally resurfaced, our results suggest that – regardless of the trend before 2000 – the 21st century has witnessed an overall inverse correlation between peacekeeping intervention and sex trafficking.

Second, not only might UN personnel choose not to engage in the sex trafficking industry and thus combat trafficking directly through their non-action, but they may in addition prove to be a stabilizing force due to their presence and active role in remedying domestic politics. Our regression results demonstrate that a country’s regulatory quality and compliance with Trafficking in Persons (TIP) minimum standards negatively impact levels of trafficking (significant at the 1% level).

As far as regulatory quality is concerned, the United Nations may be helping to create options in the private sector or stabilizing the country so that these options emerge, to an extent where less people find the need to resort to trafficking. In addition to this, the presence and vigilance of UN personnel may also be contributing to increased compliance with the TIP minimum standards, which call for the prohibition of trafficking and a punishment of offenders “that is sufficiently stringent to deter” (Frank 2011:4). Therefore, the institution of the United Nations may not be exacerbating weak governance, as scholars have suggested, but rather strengthening the private sector and helping to enforce domestic anti-trafficking policies.
These are a sample of the many reasons that potentially account for the success of UN peacekeeping missions in decreasing levels of sex trafficking. Moving forward, the United Nations should continue to work to increase its stabilizing presence in countries of intervention. As we have seen, our results suggest a quelling of inflows 3 years after the presence of a mission. When lagging the independent variable by 4 years, we achieve similar results, significant at the 1% level in models 2 and 3. When we look, however, at a two-year lag, our results are insignificant. This suggests that although the United Nations has made great strides in helping to reduce human trafficking during peacekeeping operations, it continues to have room for improvement.

We recommend that the United Nations critically evaluate its peacekeeping missions in the context of human trafficking. The United Nations ought to seek to uncover the particular factors that have enabled missions to stabilize countries, so as to better understand how to effectively reduce the rates of forced prostitution, sexual exploitation, and overall human trafficking. Once these dynamics are understood, it may be possible for the United Nations to institute a focused strategy to create substantial, widespread improvements in peacekeeping missions, so as to best carry out the UN mission statement and truly “create conditions for lasting peace.”
References


Money, Influence, and Power: Australia and the Bretton Woods Institutions  
Trellace Lawrimore and Reno Varghese

I. Introduction

Boasting a program that “save[s] lives [and] promote[s] opportunities for all,” the Australian Agency for International Development (AusAID) prides itself on its humanitarian aid practices (AusAID 2012). Large donors famously distribute aid for political gain, but scholars often assume that small donors, like Australia, follow more humanitarian motives (Hoadley 1980, Sielaff and Skillman 2014). Yet, small donors do have strategic goals, and may use aid as a part of their foreign policy toolkits (Albright). Focusing on Australia, our study quantitatively examines how a country’s desire for power in international institutions compels it to give aid to countries that provide it with political support. We argue that Australia achieves regional hegemonic status in the Bretton Woods Institutions (BWI)—the International Monetary Fund (IMF) and the World Bank—through its strategic aid disbursal.

Existing scholarly research has not reached a consensus on Australia’s foreign aid policy. Some find that trade is the primary motivation (Alesina and Dollar 2000, Berthelemy and Tichit 2004, Berthelemy 2006, Bermeo 2012); while others emphasize the importance of colonial legacies (Alesina and Dollar 2000, Neumayer 2003a) and regional ties (Neumayer 2003a, Isopi and Mattesini 2008). Some even propose strictly selfish motives, whereby Australia benefits directly from distributing food aid or technical assistance (Dollery, Fleming, and Heinecke 2008; Davis 2009; Easterly and Williamson 2011). Still others suggest that Australia’s aid disbursal does not reflect political motivations (Gounder 1995, Gounder 1999, Gounder and Sen 1999, McCawley 2009). These dissonant—and in some cases, mutually exclusive—opinions make it difficult to understand Australia’s foreign aid policy.
We therefore attempt to construct a more comprehensive story of Australian foreign aid. Using aid data from 1960-2009, we analyze variables that support either the Recipient Need (RN) model or the Donor Interest (DI) model.\textsuperscript{24} The RN model questions whether a country distributes aid for humanitarian reasons, and the DI model tests variables that indicate a strategic disbursement of foreign aid. We first rebuff the credibility of the RN model, and then turn to Australia’s DI aid, addressing possible strategic motivations: colonial legacy, regional ties, and bilateral trade. We also introduce an innovative measure of Australia’s foreign policy interests: membership in Australia’s BWI blocs.

Recent foreign aid literature suggests a relationship between BWI voting blocs and foreign aid distribution. Vreeland, the first to use the BWI indicator as such, discusses the flow of bilateral aid from Switzerland to countries in its BWI voting bloc (Vreeland 2011). Mazumder and Vreeland then contest the claim that middle-power countries only disburse aid for humanitarian objectives with their analysis of Canadian aid disbursement to countries in its BWI blocs (Mazumder and Vreeland 2013).

Professor Peter Carroll, an expert on Australian economic and foreign policy at the Tasmanian School of Business and Economics, specifically addresses Australia’s historical relationship with the IMF. After his extensive analysis of Australia’s IMF bloc dynamics, he ponders, “It would be interesting to see if the membership in the IMF by the other small island state members of the constituency was stimulated not only by Australian diplomatic efforts but by increases in development aid, though there is no evidence to support or reject the case of which the author is yet aware” (Carroll 2011: 11).

Our research directly addresses Carroll’s question, and proceeds as follows. In the first section, we synthesize Australia’s history in the BWIs. We then explain AusAID’s foreign aid

\textsuperscript{24} We credit this definition of models to McKinlay and Little, 1977.
policy, and expound on the existing research regarding Australian foreign aid. We proceed by dividing our methodology section into three categories: descriptive statistics, control variables, and regression results. We conclude with implications and a discussion of Australia’s future in the BWIs.

2. Australia and the Bretton Woods Institutions

In the years following World War II, Australia was among the almost 50 countries that congregated in an array of newly founded international organizations, including the BWIs, which Australia joined in 1947. Yet despite this long history in global governance, Australia is largely absent from international power politics today. With its relatively small economy, Australia lacks the clout of G8, G8+5, and BRICS members (World Bank 2009).

It is therefore surprising that Australia consistently exercises power on the BWI Executive Boards. Eight governments, or “great powers” in the BWIs—the United States, Japan, Germany, France, the United Kingdom, China, Saudi Arabia, and Russia (in order of vote-share)—have country-specific directors (Vreeland 2011: 371). The other 180 BWI members choose the remaining 16 (IMF) and 17 (World Bank) directors by forming blocs, usually aligned by geographical region or colonial legacy. Since 1960, Australia has served on one of the BWI Executive Boards for all but two years. Today, Australia’s bloc includes Kiribati, Marshall Islands, Micronesia, Mongolia, New Zealand, Palau, Papua New Guinea, Samoa, Seychelles, Solomon Islands, South Korea, Tuvalu, Uzbekistan, and Vanuatu.

Executive Directors have considerable power. BWI Directors have the final say in the organizations’ most critical decisions: lending, hiring, and evaluations of member-countries’

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25 Australia ranks behind Los Angeles, USA, in a 2009 World Bank analysis of top world economies. And in terms of GDP PPP, Australia falls behind Mexico, Indonesia, Turkey, and Iran (World Bank 2009).
economic policies. Furthermore, the position accompanies a status of prestige and access to private information in board meetings (Vreeland 2011). When considering Australia’s relatively minor role in the global economy, such authority over international economic policy seems even more impressive.

So how does Australia convince these small countries to continue electing it to the Executive Board? Ostensibly, Executive Directors serve as representatives for all of their bloc members. But surely, Vanuatu, say, does not rely on Australia and only Australia to deliver its wants and needs to the Executive Board. If relationships of mutual understanding alone determine IMF blocs, it is unlikely that Mongolia or Vietnam would choose to elect Australia to the Board.

Australia, in fact, sits in a tenuous position in the IMF. In 2012, Australia’s voting bloc had a voting power share of 4.94 percent, 2.68 percent of which was from Korea and Australia alone (IMF 2012). Korea and New Zealand are the only other developed countries in the Australian bloc. Although their levels of GDP per capita are significantly lower than Australia’s, all three are significantly richer than the rest of the bloc. Unsurprisingly, Korea and New Zealand do not need foreign aid, and therefore Australia does not have the option of buying their BWI votes with ODA. Given that Korea and New Zealand have historically rotated the alternate director position, we theorize that Australia secures their memberships by granting them the alternate directorship, and occasionally even the executive position.

In contrast, the smallest vote-share holder in the IMF—Tuvalu—is in Australia’s bloc (IMF 2012). The bloc’s 4.94 percent of the voting share does give Australia a seat on the Executive Board, but its independent share of 1.31 percent holds little gravitas compared to the powerhouse single-country voters like the United States (17.46 percent), or the United Kingdom
and France (both at 5.05 percent). Consequently, without the electoral support of its bloc members, Australia would lose its most authoritative position in global governance. Thus, it is willing to pay for their support with increased amounts of foreign aid.

3. Determining Australian Foreign Aid

AusAID makes a bold proclamation in its 2012-13 Annual Report: “The fundamental purpose of the Australian aid program is to help people overcome poverty. This also serves Australia’s national interests by promoting stability and prosperity both in our region and beyond” (AusAID 2013). The 2011 Partnership Framework between AusAID and the World Bank epitomizes the agency’s lofty goals, as both parties contend to share the objective of having the “most effective aid program possible” (AusAID 2012).

Defending the effectiveness of its program, AusAID declares that its regional focus is the best use of its aid budget, because “two-thirds of the world’s poor—some 800 million people—live in the Asia Pacific.”\(^{26}\) But AusAID’s unsubstantiated claim of regional poverty ignores an important caveat: 46 percent of the world’s poor do live in the Asian Pacific—in India and China, where Australia will allocate no foreign aid after 2014. (World Bank 2010).

AusAID’s questionable position on the economic status of its aid recipients (AusAID 2012), alongside reports that its aid methods may be ineffective and corrupt (Davis 2009; Dollery, Fleming, and Heinecke 2008), surely challenges the RN model of Australian foreign aid. Easterly and Williamson find that Australia is one of the “largest donors of food aid,” an often tied aid\(^{27}\) practice in which “higher income countries. . .shed their excess agricultural products without any concern for the local agricultural markets in the receiving country.” In

\(^{26}\) Furthermore, it claims to have “helped many countries to make progress against the MDGs” (AusAID 2012).

\(^{27}\) The OECD defines tied aid as “legal and regulatory impediments to the procurement of goods and services outside the donor’s own market” (Clay 2009).
addition to food aid, more than 30 percent of Australia’s foreign aid is technical assistance, which “must be used to hire consultants from the donor country” (Easterly and Williamson 2011).

Moreover, when the aid program faced dramatic bureaucratic changes in 2013, it did so at the cost of aid effectiveness. ActionAid Australia noted its concerns after the government announced in September 2013 that AusAID would merge with the Department of Foreign Affairs and Trade (DFAT).

“The government’s short sighted decision to integrate AusAID into DFAT will have massive and devastating effects on Australia’s aid program and on the people living in poverty that the program supports. With AusAID reporting to DFAT, we will inevitably see the aid budget used to promote Australia’s national interests first and foremost. . . The message Tony Abbott is sending to the world’s poor is that Australia is no longer committed to ending poverty.” (SBS 2013).

The merger lends an obvious answer to the question of Australian foreign aid: Australia funds its trade partners. Since Australia’s natural trade partners are in the developing world, its economy will surely benefit if these partners have more money to spend on Australian goods. Alesina and Dollar’s findings support this view. They report that Australia gives about twice as much aid to open rather than closed economies, rewarding good economic policy (Alesina and Dollar 2000). Foreign aid analysis has historically found that countries give to their trade partners, and Australia is no exception to this theme (Bermeo 2012, Berthelemy 2006, Berthelemy and Tichit 2004).\textsuperscript{28}

Notably, many of Australia’s trade partners are also its neighbors in the Asian Pacific. Perhaps Australia merely attempts to exert a sphere of influence by concentrating its aid in the.

\textsuperscript{28} The trend continues today. Australia has recently affirmed that its “highest regional trade negotiation priority is the conclusion of the Trans-Pacific Partnership Agreement” (TPP) (DFAT 2012b).
Asian Pacific, an idea Neumayer defines as “regional bias” (Neumayer 2003).29 Or, considering that many countries in Australia’s region also share its colonial ties, maybe Australia bases its foreign aid policy on colonial history. Alesina and Dollar find that 55.5 percent of Australia’s aid goes to its former colonies, while Isopi and Mattesini find a statistically significant relationship between colonial status and aid received (Isopi and Mattesini 2008).

We recognize that trade, regional bias, and colonial ties influence Australian foreign aid. Yet despite the clear overlap between Australia’s trade partners, physical neighbors, and the members of its BWIs blocs, few scholars have considered how Australia’s desire for power in the BWIs influences its foreign aid distribution. Thus, Carroll’s 2011 research prompts us to explore a new hypothesis regarding Australian foreign aid: Australia buys its power in the Bretton Woods Institutions by exchanging foreign aid for membership in its voting blocs.

4. Methods
A. Descriptive Data

We test whether members of Australia’s BWI bloc receive more foreign aid than non-members when controlling for regional status, colonial past, and bilateral trade with Australia. We analyze a time-series cross-sectional dataset of Australian Official Development Assistance (ODA) from the Organization for Economic Cooperation and Development (OECD). The dataset includes annual observations from 1960 to 2009 for 186 countries; out of the 5,931 country-year observations, Australia provides aid in 2,728.

We generate a dichotomous indicator for membership in Australia’s BWI bloc, which serves as our main independent variable. The indicator is coded 1 for years when a country is a part of the Australian bloc and coded 0 otherwise. The country-years where the indicator is 1 are:

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29 Hugo Dobson also discusses Australia’s motivations for regionalism, but in terms of G20 involvement (Dobson 2011).

Australia disburses approximately 48 percent of its aid budget to its bloc members. Considering that the population of these countries is less than 4 percent of the world’s population, this is a significant amount of aid earmarked for solely Australia’s bloc. However, given the overlap in countries in Australia’s bloc, its trade partners, and its regional neighbors, we recognize that other factors may confound this apparent relationship, and introduce the controls accordingly.

B. Preliminary Analysis
Preliminary tests indicate a positive correlation between membership in the Australian BWI bloc and ODA from Australia. Figure 1 displays striking results. On average, Australian bloc members receive approximately $50 million more dollars in aid from Australia. Figure 2 then addresses whether this correlation persists within Australia’s region. The figure indicates that bloc members in Oceania still receive more—about 20 million dollars more—than non-bloc countries in the same region.

We then examine the RN Model in figures 3 and 4. The Oceania region, despite having a GDP per capita twice the size of Africa’s, receives almost 200 times more aid per capita. Preliminary analysis challenges the RN model and supports the hypothesis, and we engage in more rigorous analysis.
C. Control Variables

Using an Ordinary Least Squares regression (OLS), we first test the RN model by introducing controls for log of GDP per capita and log of population.\textsuperscript{31} We then capture the traditional DI explanations by controlling for past colonial legacies with Australia and with Britain, regional status, and bilateral trade with Australia. We predict that poor countries that have historically strong trade relations with Australia will receive more aid, particularly if they have an Australian or British colonial past.

To control for colonial status, we generate dichotomous indicators for countries with British colonial history and for Australian colonial history. Using colonial status data from the Correlates of War project, we code 1 for countries with a British or Australian colonial history and 0 otherwise. We also use the Correlates of War project for its dyadic dataset on bilateral

\textsuperscript{31} We take the log of numeric variables to normalize the distribution of the dataset.
trade. The dataset measures trade flows from 1870-2009 and contains national export and import data for all countries (Correlates of War).

To control for regional status, we use polity codes\textsuperscript{32} to indicate membership in Australia’s region of Oceania. Countries in Australia’s region include: East Timor, Papua New Guinea, Western Samoa, Marshall Islands, the Federal State of Micronesia, Samoa, Solomon Islands, Vanuatu, Palau, Tonga, New Zealand, Kiribati, Tuvalu, Fiji, and Nauru. These variables are time-invariant, coded 1 for countries belonging to the region, and 0 otherwise.

Finally, we employ region and year fixed-effects to address the issue of endogeneity. We consider the possibility that the regression results actually reflect that countries receiving ODA from Australia are more likely to join Australia’s BWI bloc. We begin to address the issue by including year and region fixed-effects, but problems of collinearity preclude us from adding country fixed-effects.\textsuperscript{33} While year and region fixed-effects should capture unobserved heterogeneity between years and regions, in lieu of countries, we keep the possible effects in mind.

D. Regression Results

The regression results support our hypothesis. Australian bloc status has a statistically significant effect on foreign aid distribution to countries. The coefficient of Australian bloc status is positive and statistically significant at the 0.01 level in all models, including those with all control variables. Table 1 displays descriptive statistics and data sources.

Table 2 illustrates our significant findings. We find the expected negative correlation with GDP per capita, indicating that Australia does follow an RN approach to some extent.

\textsuperscript{32} We thank Professor James Vreeland for providing the polity code data.

\textsuperscript{33} Specifically, the years each member has been a country (as fixed-effects would represent) and the years it has been in the bloc (indicated by the primary dichotomous indicator) are too similar to include both country fixed-effects and the BWI indicator.
Models 2, 3, 4, and 5 include all controls, and models 3, 4, and 5 include year, region, and both fixed-effects, respectively. The BWI indicator is positive and statistically significant at the 0.01 level for all models, and the effects of the DI control variables have the expected results, supporting the existing literature. Our results reflect robust standard errors for all models.
### TABLE 1: Descriptive Statistics

<table>
<thead>
<tr>
<th>Variable</th>
<th>Stata Name</th>
<th>Obs.</th>
<th>Mean</th>
<th>Std. Dev.</th>
<th>Min</th>
<th>Max</th>
<th>Measure</th>
<th>Source</th>
</tr>
</thead>
<tbody>
<tr>
<td>Log of Australian ODA</td>
<td>Inaussieaid</td>
<td>7,435</td>
<td>0.6</td>
<td>1.2</td>
<td>-0.02</td>
<td>7.1</td>
<td>Constant 2010 USD, millions</td>
<td>OECD</td>
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<tr>
<td>Membership in Australia's Bloc</td>
<td>aussieBWI</td>
<td>7,436</td>
<td>0.04</td>
<td>0.2</td>
<td>0</td>
<td>1</td>
<td>Binary</td>
<td>IMF &amp; World Bank Annual Reports</td>
</tr>
<tr>
<td>Log of Population</td>
<td>Inpopulation</td>
<td>7,433</td>
<td>15</td>
<td>2.1</td>
<td>8.7</td>
<td>21.1</td>
<td>Binary</td>
<td>World Development Indicators 2012 (WDI)</td>
</tr>
<tr>
<td>Log of GDP per Capita</td>
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<td>5,748</td>
<td>7.1</td>
<td>1.3</td>
<td>4</td>
<td>11</td>
<td>Constant 2010 USD</td>
<td>WDI 2012</td>
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<tr>
<td>Log of Bilateral Trade</td>
<td>Intotalflow</td>
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<td>0</td>
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<td>Correlates of War</td>
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<td>0.3</td>
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<td>1</td>
<td>Binary</td>
<td>Correlates of War</td>
</tr>
</tbody>
</table>
Notes: Robust standard errors are reported in parentheses. Coefficients for all regions are not provided here, but are available in the replication materials.

*** Indicates significance at the one percent level, ** at the five percent level, and * at the ten percent level

5. Conclusion

Small and mid-level donors go to extensive lengths to gain clout in international organizations. Despite its unassuming character on the world stage, Australia maintains a commanding presence in the world’s preeminent financial institutions by exchanging foreign aid for votes. Since Australia cannot wield great military or economic power, it pays increased costs
in foreign aid to its BWI partners to assert its voice in global financial decisions. Most members of Australia’s bloc reap the benefits of increased aid, and the two members that do not require aid (Korea and New Zealand), have a separate arrangement to rotate the Alternate Directorship. These commitments create a cohesive bloc.

Still, we wonder if Australia’s system of exchanging aid for political power will hold in the future. Reapportionments in the IMF and World Bank quota systems will undoubtedly favor Korea and other Asian countries at the expense of the original 50 Bretton Woods countries (Zamora 1980, Rapkin and Strand 2003, Rapkin and Strand 2006). Perhaps Korea and the developing nations in Australia’s bloc will come to challenge Australia for the Executive Directorship. Australia’s carefully crafted system may fail as their current aid recipients assert themselves on the international stage. While its foreign aid scheme has worked in the past, the future is uncertain. Rising costs, domestic politics, and the emerging Southeast Asian markets imperil the aid-for-votes arrangement Australia has cultivated for the last 50 years.
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1. Introduction

Do governments use international organizations to do their “dirty work”? Some scholars contend that governments may utilize international organizations as “masks”, thereby acting with hidden intentions (Abbot and Snidal 1998; Carrasco et. al. 2008; Dreher et. al. 2008; Krasner 1981; Vaubel 1986; Vreeland and Lim 2013). In their state-driven actions they follow the public consensus but then proceed to act against that will through the channel of international organizations. The international organization allows for participating governments to profit by acting surreptitiously through them. They harvest the fruits of actions that are not in-line with public policy and perception, but still keep their values and integrity intact in the eyes of their constituents (Abbot and Snidal 1998; Vaubel 1986). At the end of the day, the public is none the wiser.

In this paper, we argue that this political calculus applies to the institutions operating in one of the most volatile regions in the world, the Middle East (El-Ghonemy 1998; Hinnebusch 2003; Villanger 2007). According to recent studies, globally, countries receive more Arab aid for “not maintaining diplomatic relations with Israel” (Neumayer 2003: 141). At the heart of the Arab world’s political tension lies a century old animosity: the Arab – Israeli conflict. Publicly, institutions operating in this matrix, deride Israel as a non-legitimate government. Privately, however, these same institutions may have different views. We look specifically at the Arab League. We suggest that while the parent organization the Arab League, publicly opposes the recognition of Israel, the Arab Fund rewards those countries that recognize Israel. Much of the
scholarly research on Arab foreign aid disbursements project globally and have yet to scrutinize the effect of regional politics on regional institutions.

Indeed, the significance placed by the Arab community on solidarity and regional security begs the question of whether Arab states engage in discreet politics within regional organizations – maintaining political rhetoric publically, while acting surreptitiously through regional organizations. Intuitively, souring ties with Israel are expected to increase instability in the Middle East. Our study suggests that regional financial institutions are able to leverage their ability to disburse foreign aid in order to influence political decisions in member states.

In particular, we argue that the Arab states deride the politics of Israel publicly, but support Israel’s foreign policy behind closed doors by providing greater aid disbursements through the Arab Fund for Economic and Social Development (Arab Fund) to countries that have diplomatic ties with Israel. Our robust, statistically significant findings suggest that member-states that have diplomatic relations with Israel receive greater aid disbursements from the Arab Fund.

The Arab Fund warrants attention in particular because the bank was founded by the Arab League as a by Arabs, for Arabs development bank. The member states in both organizations are the same, allowing us to scrutinize regional effects. The Arab Fund, we hypothesize, gives more foreign aid to countries that have diplomatic relations with Israel. Israeli diplomatic relations bolster security in the region and encourage peaceful cooperation.

To test the hypothesis, we explore the relationship between Arab aid from the Arab Fund and the recipient countries' relationship with Israel. The dependent variable is the natural logarithm of total net official development assistance (ODA) disbursed by the Arab Fund to members of the Arab League, measured in constant 2011 US dollars (OECD 2014). The
The independent variable of interest is diplomatic relations with Israel, a dichotomous variable coded 1 for any year a country has diplomatic relations with Israel and 0 otherwise. The information revealing Israeli diplomatic relations is obtained from the Israel Ministry of Foreign Affairs (IMFA 2014). Using Neumayer’s and other’s research on Arab aid allocation, we control for GDP/capita, population, the state of war in recipient country, pariah state status, British colonial legacy, African country status, and US ally status (Neumayer 2003; Momani and Ennis 2012; Villanger 2007; Vreeland 2014).

The Arab Fund does favor those recipient Arab countries that maintain a relationship with Israel, by providing them with more foreign aid. This result is statistically significant and differs from that of Neumayer’s findings. The Arab Fund provides a measurable amount of added aid to countries that do have relationships with Israel. Publicly these countries attack Israel’s existence, but behind the closed doors of the Arab Fund they value the stability that relations with Israel bring to the region.

The rest of the paper proceeds as follows. Section 2 offers a brief background on the Arab League and Israel, provides an overview of the Arab Fund, and discusses the available literature on regional organizations and Arab aid allocation. Section 3 details our argument surrounding why the Arab Fund provides more aid to countries with diplomatic relations with Israel, and Section 4 delves into the data, methodologies, and the results of the analysis. In Section 5, we explore the implications of the correlation between Arab countries’ foreign aid boost and diplomatic relationships with Israel.
2. Background

As background to this research, we first discuss the relationship between the League of Arab States and the State of Israel, then review the structural organization of the Arab Fund, examine existing scholarship surrounding foreign aid allocation and the Arab world, and finally break down the literature on the international organization as a means of masking state intentions.

2.1 The Arab League and the Arab Fund

The League of Arab States, often referred to as the Arab League, has long been publicly against the State of Israel. The Arab League was founded to encourage cooperation and solidarity amongst Arab countries. The historical Arab-Israeli divide has patterned the actions of the Arab League towards their goal of Arab development. With the founding of Israel, the Arab world would mobilize against the new state in solidarity with the Palestinian movement. The Arab League has thus officially boycotted Israel since its inception in 1948, not recognizing the country, its borders, or its citizens (Turck 1977; Weiss 2013)\textsuperscript{34}. However, not all members currently adopt or enforce the League-accepted boycott, with Egypt (1979), the Palestinian Authority (1993), and Jordan (1994), amongst other Arab countries, ending the embargo through agreements (Fenton 2003; Halpern 2008; Weiss 2013). The Arab League has recently again reaffirmed its perspectives on Israel, with leaders from the member states stating in a public address on March 26\textsuperscript{th}, 2014, that the organization provides the world with a “categorical refusal to recognize Israel as a Jewish state” (Saletan 2014). In addition, the Arab League leaders in that

\textsuperscript{34} In fact the Arab League of States actually boycotted what they deemed as Zionist goods even before the founding of Israel, as early as 1945 (Weiss 2013).
same address state that they “hold Israel entirely responsible for the lack of progress in the peace process and continuing tension in the Middle East” (Hendawi 2014).

The Arab League agreed to establish the Arab Fund for Economic and Social Development (hereinafter referred to as Arab Fund) in 1968 to finance economic and social development projects in Arab countries. Thus, all members of the Arab League are also members of the Arab Fund. The League declared the agreement effective in 1971, and the Arab Fund – based in Kuwait – commenced operations in early 1974.

**Figure 1: The Arab Fund Organizational Structure**

At the pinnacle of the top down system in the Arab Fund (*Figure 1*) sits the Board of Governors, who oversees the management of the financial institution. The Board of Governors consists of one governor and one alternate appointed by each member state, and are vested “all the powers of the Fund” (AFESD 2012). The authority is then delegated to eight Directors and their alternates, who are elected by the Board of Governors for a term of two years. The Arab

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Each country has an equal representation in the Board of Governors, and thus, countries, such as Saudi Arabia, that submit relatively larger contributions do not exercise larger influence, at least on the Board of Governors.
Fund claims to primarily finance projects that are deemed to have “priority in national development plans”, which are selected after a “thorough evaluation of … technical and economic feasibility” (AFESD 2012).

Notwithstanding the evaluation criteria, the Governors are in full control of the Arab Fund, illustrating that their decisions have reverberating effects throughout the organization – be it in the allocation of aid, the development projects approved, or the corporate structuring (AFESD 2012). That the Arab Fund is structured such that there exists a process of equal representation at the highest levels of the leadership within the organization, suggests that the decisions that the Arab Fund takes are based on a consensus among Arab States (AFESD 2012). Thus, the findings reveal that there are no organizational biases in terms of substantial increased influence among certain member states, and that member states make decisions collectively. This suggests that any allocation patterns in the Arab Fund’s disbursement are indicative of endemic decision-making values, not of sole actors influencing the disbursement process.

36 The U.S. Senate is an example of this type of equal governance structure. Wyoming is made up of few people but still has two Senators just like every other state. The United Arab Emirates (U.A.E.) gives only $698,400 dollars in aid (relatively low compared to Saudi Arabia or Kuwait) but still has two Governors on the Board, just like every other Arab country in the Fund (Joint Arab Economic Report 2012).
2.2 Arab Aid Allocation

The literature on Arab foreign aid has suggested that the allocation of said aid can be categorized by political, economic, or altruistic motivations much like these motivations have been subdivided in other parts of the world, like Canada (Mazumder and Vreeland 2013: 15). Arab development banks and other regional organizations make decisions driven by these multi-faceted motivations (Desai and Vreeland 2011).

Amongst other factors, political concerns drive foreign aid allocations throughout the globe and also in the Arab world (Alesina and Dollar 2000; Baker and Cooner 2014; Dreher et. al. 2007; Dreher et. al. 2009; Dreher et. al. 2013; Kilby 2006; Kuziemko and Werker 2006; Lawrimore and Varghese 2014; Maizels and Nissanke 1984; Schraeder et. al. 1998; Suh and Vreeland 2013). Momani and Ennis (2012) discuss Saudi Arabia’s aid allocation being driven by disparities in political ideologies during the Cold War. They suggest that Saudi Arabia shuttled aid to countries with the intent to assist in countering socialist movements. Alesina and Dollar (2000) state that democratic countries tend to receive more foreign aid. With some of the Arab Fund members being monarchies, it is unknown if this variable will play a positive or negative role in this case. In addition, Neumayer discovers that countries worldwide “not maintaining diplomatic relations with Israel” as well as those who vote in the United Nations General Assembly with Saudi Arabia receive a greater share of the total aid allocated (2003: 141).

Scholars find that economic motivations also play a significant role in Arab foreign aid allocation. Lundsgaarde, Breunig, and Prakash (2010) find that Arab “aid may also aim to assure the supply of crucial raw materials to donor firms that are produced, extracted or mined in the recipient country” (2010: 739). Lundsgaarde et. al. (2010) provide a wide net of research that attempts to capture the relationship between donor countries and natural resource allocation, and
estimate that countries gain relatively greater foreign aid if they have reserves of valued resources. Neumayer (2003: 137) finds that poorer countries also are more likely to receive more Arab aid, with special emphasis to poorer Arab countries in particular (Salih 1999: 12). Investing in the poverty-stricken areas of the Arab world allow the development banks to kick start foreign investment as well, potentially spurring economic growth for the entire region.

Notwithstanding political or economic motivations to aid disbursements, existing literature does point to some altruistic motives for Arab foreign aid allocation as well as that of aid allocation in general (Sielaff and Skillman 2014; Younas 2008). Shushan and Marcoux (1976: 5) find that Arab aid favors developmental projects regarding “infrastructure, and especially transport, energy, and water”. Aligned with prevailing scholarly consensus, Neumayer (2003: 137) finds “that poorer, Arab, Islamic and sub-Saharan African countries are more likely to receive some positive amount of Arab aid” in comparison to their financially better-off counter parts, and that “more populous countries … receive a higher share of the total aid allocated” (Neumayer 2003: 144).

Overall, the literature finds that Arab countries allocate aid based on political, economic, and altruistic purposes. Countries that are impoverished, Arab, more populous, producers of necessary resources for donor country’s industries, vote with Saudi Arabia at the UN General Assembly, and have no relations with Israel also tend to receive more Arab aid.

3. Theory

Few scholars have considered how regional politics influences foreign aid distribution by respective regional aid institutions – especially one as unique as the Arab League. There exists no region as homogenous in ethnic identity or linguistic, cultural and political traditions as the
Arab world. Surely the political motivations that influence regional institutions are distinct from those on the global scale. Neumayer’s estimate that countries (on the international scale) who maintain diplomatic relations with Israel receive less aid – be it bilateral or from Arab multilateral agencies – prompts us to explore a new hypothesis regarding Arab aid allocation within the Arab League: Arab states deride the politics of Israel publicly, but support Israel’s foreign policy behind closed doors, by providing greater aid disbursements through the Arab Fund to countries that have diplomatic ties with Israel.

Enter Egypt – a country that shares a border with Israel, the first Arab state to officially recognize Israel, and purportedly an important strategic partner of the State of Israel (Kershner 2011). The 1979 Egypt-Israel Peace Treaty laid the cornerstone to what would become the longest diplomatic relation an Arab state has had with Israel – effectively bringing the state of war between the two nations to a close. It is worth noting that the peace treaty was signed sixteen months after Anwar El Sadat, then Egyptian President, visited Israel for intense negotiations in 1977 (Ross 27).

How did the members of the Arab Fund react to Egypt’s recognition of Israel? In accordance with its resolution to “expel any Arab state which reached a separate economic, political or military agreement with Israel”, the Arab League expelled Egypt from its organization, and therefore the Arab Fund, in 1979 (Oded 2002). How did these same members react behind closed doors, with respect to Arab Fund disbursement? They disbursed aid to Egypt at levels never before seen, and in fact the highest disbursement ever provided by the Arab Fund, in 1978 – during the peace negotiations between Egypt and Israel.

A country that was receiving a mere 1 million USD in 1975, was awarded 75 million USD and 177 million USD in 1977 and 1978 respectively – years leading up to the peace treaty –
and has been receiving relatively large aid disbursements ever since. Other Arab countries did not witness the same leap in aid as Egypt over the same period of time. A bar graph exhibiting the pattern of aid distribution for Egypt is seen in *Figure 2*.

![Figure 2: Aid Disbursements Received by Egypt](image)

Taking into account the unique identity of Arab League countries, could the Arab Fund actually be favoring those recipient Arab countries that maintain diplomatic relationships with Israel by providing them with more foreign aid? We theorize this could occur as a result of hidden motivations and political concerns. One possibility is that Arab countries purport a disdain for Israel, but secretly operate in the foreign aid field with a grand strategy in mind, aiding those countries that maintain relationships with Israel to attain absolute gains.

Shushan and Marcoux (2011) find that there is a lack of transparency in the allocation of Arab aid, where: “Gulf states likely do not report certain aid transactions because there is something they wish to hide. For instance, a leader may wish to make a donation which he
knows will be unpopular with his people, due to the identity of the recipient and/or the amount of the gift” (2011: 3). According to Vreeland and Lim, who expound on the Asian Development Bank, countries often hide behind regional organizations for the purposes of “obfuscation,” hiding their actual purposes and obscuring their true beliefs through their role in the international organization (Lim and Vreeland 2014). They choose to use the international organization not only as an arm to manipulate their own power abroad, but also as a means of creating another entity from which the country can act without the constant fears of backlash. This is largely due to the political defense they get by acting through an outside, excised organization. The “mask” of the international organization allows countries to be less fearful of the consequences of their actions within their own country, instead making decisions that are strategically sound while not compatible with the day-to-day life of that country’s perspectives and views. Using international organizations as a mask allows the Arab League members to act as they would otherwise, freeing them from certain fears, and thereby not having to worry about public concerns and political rhetoric.

This dissociation between the Arab Fund aid disbursement trend for Egypt and the anti-Israel rhetoric proclaimed by the Arab League lends credibility to our hypothesis that Arab states deride the politics of Israel publicly, but support Israel’s foreign policy behind closed doors by providing greater aid disbursements through the Arab Fund to countries that have diplomatic ties with Israel. We propose three possibilities explaining this dissociation, though the degree to which each theory affects this dissociation merits further study.

First, it is possible that behind the closed doors of the Arab Fund, the member states reward countries with relationships with Israel because they value security and peace within the region. Unlike Neumayer’s paper (2003), we focus specifically within the Arab region, where
there is much more at stake for Arab countries as aid disbursement choices affect the donor states as well. The Arab countries may not recognize Israel’s right to exist in public, but in reality they also value their own security and peace. Aid disbursements through the Arab Fund could possibly be regarded as a means to further Arab their foreign policy goals. Thus, they reward countries that have positive relationships with Israel. This theory is the one that we believe is most reasonable (Lim and Vreeland 2014).

Another possibility is economic engagement. The Arab Fund may actually still be applying its ideological beliefs to its aid allocation. It may be operating through the carrot system of rewards, which is to say that rather than punishing a country for its relationship with Israel, the Fund gives that country more aid, to attempt to regain its ally.

A third possibility is that more aid goes to countries that do have relationships with Israel, because the Fund is competing with Israel on the ground for influence. In essence, this argument would say that Israel and the Arab Fund (and thus the League of Arab States) would metaphorically fight over influence in a certain country. Israel makes gains in its diplomatic relationship with an Arab country, and the Arab Fund could potentially provide foreign aid as a response, attempting to win over that country and make sure that Arab countries follow accepted ideologies.

Given the dissociation observed in the case of Egypt, is the hypothesis that Arab states deride the politics of Israel publicly, but support Arab countries that have diplomatic ties with Israel through the Arab Fund statistically credible?

4. Quantitative Evidence: Data, Methods & Results

Our data set covers twenty-two member countries of the Arab League from 1974 to 2012. This section begins by presenting the data and descriptive evidence concerning our hypothesis.
We then test the hypothesis more rigorously by employing regression analysis, with potentially confounding variables controlled for in order to test the relative impact of the principal independent variable, while also controlling for year fixed effects (Simmons and Hopkins 2005).

4.1 Data

We measure our dependent variable as the natural logarithm of total net official development assistance (ODA) disbursed by the Arab Fund to members of the Arab League, measured in constant 2011 US dollars (OCED 2014). A natural logarithm of ODA disbursements was taken since it is more sensitive to differences in orders of magnitude – more sensitive to differences when integers are small than when they are large – and thus, produces more robust results than with a linear scale. Annual aid allocations covering the period covering 1974 and 2012 are observed. We select data from 1974 onwards since the Arab Fund commenced operations in that year. The average Arab Fund disbursement is USD 13.5 million, and the disbursements vary from USD 0.02 million (Oman, 1987) to USD 176.5 million (Egypt, 1978).

The independent variable of interest is diplomatic relations with Israel, a categorical variable coded 1 for any period a country has diplomatic relations with Israel and 0 otherwise. The information revealing Israeli diplomatic relations is obtained from the Israel Ministry of Foreign Affairs. Seven of the twenty-two countries in the Arab League sample have had diplomatic relations with Israel between 1974 and 2012: Egypt (1980 – current), Jordan (1994 –

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37 ODA constitutes grants and concessional loans (grant element consisting of at least 25 percent), with the primary objective of promoting economic development and welfare of recipient countries, and excludes the provision of grants, loans or credits for military purposes.

38 No aid data was available for Comoros within the OECD database for the time frame, while Palestine was not even listed as a country within the database. This limits the data available to only 20 out of the 22 member countries of the Arab League.

### Table 1: Descriptive Statistics for Israeli Diplomatic Relations

<table>
<thead>
<tr>
<th>Israeli Diplomatic Relations</th>
<th>Mean Aid Disbursed by Arab Fund (Constant 2011 USD Millions)</th>
<th>Standard Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>19.81</td>
<td>30.46</td>
</tr>
<tr>
<td>1</td>
<td>39.83</td>
<td>59.93</td>
</tr>
</tbody>
</table>

An initial evaluation of the descriptive statistics for Israeli diplomatic relations and aid disbursements by the Arab Fund (Table 1) reveals the following: It seems that countries in the Arab League that have forged diplomatic relations with Israel (coded 1), on average, receive greater aid disbursements by the Arab Fund – approximately two times greater than countries in the Arab League that do not have diplomatic relations with Israel (coded 0). These descriptive statistics support our hypothesis, and contrast against findings of Neumayer (2003), who find that countries in the world that form diplomatic relations with Israel tend to receive lesser aid from Arab agencies. It appears at first glance that Arab League members utilize the Arab Fund as a “mask”.

Our empirical analysis controls for other variables that may influence aid disbursement by the Arab Fund. With reference to recipient need, data on gross domestic product per capita (GDP per capita) in constant 2005 US dollars is obtained from the World Bank database. It would be expected that countries in the Arab League that are more affluent receive less aid disbursements from the Arab Fund. In addition, we would expect more populous countries to receive greater importance in aid disbursements than less populous ones, and thus, the former would be expected to receive more aid too. Hence, we control for population – with information
obtained from the World Bank. In order to mitigate problems with distributional skewedness and to accurately capture differences in orders of magnitude, both GDP per capita and population are entered in their natural logarithm.

We also include control variables for whether a country in the Arab League was involved in a conflict, and if a country was classified as a pariah state by the international community – identified as countries with “pariah” status in the eyes of one or more of the major powers, and hence subject to U.S. and/or UN sanctions, as defined by Morgan, Krustev, and Bapat (2006). This data is obtained from Vreeland & Dreher (2014). Since the Arab League was formed on the ideals of Arab solidarity, we expect the Arab Fund to support countries that are outcast by the international community as a pariah state or countries that are involved in conflict with non-Arab nations. Though this is counter-intuitive to the observation made by Vreeland & Dreher (2014) where countries involved in conflicts or surmised to be pariah states receive lesser foreign aid from international organizations, we expect the politics of a regional organization with a strong and unitary identity, such as the Arab Fund, to provide more aid to lend a hand of support or to bring the conflict to a quick close. If true, these could lead to an overestimation of the effect of diplomatic relations on aid disbursements from the Arab Fund.

With respect to controlling for donor interests, we include a categorical variable for member countries that are geographically in Africa – indicated 1 and 0 otherwise – in order to control for potential effects on aid allocation by African country status. We expect the variable controlling for African member states to discern any possible regional biases that also might affect results. Other potential control variables introduced are British colonial legacy and US alliance. Data on the latter is obtained from Vreeland & Dreher (2014). Since the Arab Fund is a Kuwait based financial organization, a designated major non-NATO ally of the US and a former
British colony, we address the potential source of bias in our estimation of the effect of Israeli diplomatic relations on aid disbursements, and ensure that their effects do not overshadow the analysis.

Table 2: Descriptive Statistics

<table>
<thead>
<tr>
<th>Variable</th>
<th>Obs.</th>
<th>Mean</th>
<th>Std. Dev.</th>
<th>Min</th>
<th>Max</th>
<th>Measure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Israel Diplomatic Relations</td>
<td>858</td>
<td>0.108</td>
<td>0.311</td>
<td>0</td>
<td>1</td>
<td>Binary</td>
</tr>
<tr>
<td>Arab Fund Aid Disbursements</td>
<td>239</td>
<td>2.600</td>
<td>1.630</td>
<td>-3.912</td>
<td>5.173</td>
<td>Natural Log in Constant 2011 USD</td>
</tr>
<tr>
<td>Population</td>
<td>816</td>
<td>15.364</td>
<td>1.494</td>
<td>11.942</td>
<td>18.207</td>
<td>Natural Log</td>
</tr>
<tr>
<td>GDP/capita</td>
<td>613</td>
<td>7.998</td>
<td>1.405</td>
<td>6.007</td>
<td>11.314</td>
<td>Natural Log in Constant 2005 USD</td>
</tr>
<tr>
<td>War</td>
<td>756</td>
<td>0.073</td>
<td>0.260</td>
<td>0</td>
<td>1</td>
<td>Binary</td>
</tr>
<tr>
<td>African Member</td>
<td>858</td>
<td>0.455</td>
<td>0.498</td>
<td>0</td>
<td>1</td>
<td>Binary</td>
</tr>
<tr>
<td>British Colonial Legacy</td>
<td>858</td>
<td>0.136</td>
<td>0.343</td>
<td>0</td>
<td>1</td>
<td>Binary</td>
</tr>
<tr>
<td>Pariah State</td>
<td>756</td>
<td>0.078</td>
<td>0.268</td>
<td>0</td>
<td>1</td>
<td>Binary</td>
</tr>
</tbody>
</table>

Along with the range of control variables introduced, we also include fixed-effects for country and year. Year fixed-effects account for peculiarities that occur over time, such as Israeli disputes with a number of Arab countries or peace agreements signed within the past decades. We expect the variable controlling for African member states to discern any possible regional biases that might affect results.
4.2 Method

We use regression analysis to estimate the effect of diplomatic relations with Israel on aid disbursements by the Arab Fund. We examine the relationship between Israeli diplomatic relations and aid received, first using OLS regressions and controlling for the factors discussed above. Model 1 controls for economic and demographic variables, GDP/capita and population. Model 2 introduces political controls – war, pariah state status, and British colonial legacy – while Model 3 introduces the regional control – African country. We then use a country and year fixed-effects model for our final set of regression (Model 4), while removing population as a variable due to its statistical insignificance. When fixed-effects are included, the African country and British colonial legacy variables are omitted due to time invariance, while the incidence of war variable is omitted due to collinearity.
4.2 Results

Table 3 – Effect of Israeli Diplomatic Relations on Arab Fund Aid Disbursements

<table>
<thead>
<tr>
<th>Variable</th>
<th>Model 1</th>
<th>Model 2</th>
<th>Model 3</th>
<th>Model 4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Israel Diplomatic Relations</td>
<td>1.479***</td>
<td>1.399***</td>
<td>1.401***</td>
<td>0.939*</td>
</tr>
<tr>
<td></td>
<td>(0.435)</td>
<td>(0.496)</td>
<td>(0.497)</td>
<td>(0.462)</td>
</tr>
<tr>
<td>GDP/capita (ln)</td>
<td>-0.354**</td>
<td>-0.363**</td>
<td>-0.346*</td>
<td>1.393</td>
</tr>
<tr>
<td></td>
<td>(0.144)</td>
<td>(0.173)</td>
<td>(0.176)</td>
<td>(0.873)</td>
</tr>
<tr>
<td>Population (ln)</td>
<td>0.148</td>
<td>0.158</td>
<td>0.136</td>
<td>-0.479</td>
</tr>
<tr>
<td></td>
<td>(0.108)</td>
<td>(0.115)</td>
<td>(0.122)</td>
<td>(0.618)</td>
</tr>
<tr>
<td>War</td>
<td>-0.933*</td>
<td>-0.914*</td>
<td>-0.832*</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.489)</td>
<td>(0.491)</td>
<td>(0.406)</td>
<td></td>
</tr>
<tr>
<td>Pariah</td>
<td>0.146</td>
<td>0.261</td>
<td>0.040</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(1.510)</td>
<td>(1.529)</td>
<td>(0.417)</td>
<td></td>
</tr>
<tr>
<td>British Colonial Legacy</td>
<td>0.091</td>
<td>0.062</td>
<td>omitted</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.434)</td>
<td>(0.438)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>African Country</td>
<td>0.153</td>
<td>omitted</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(-1.86)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>US Ally</td>
<td>omitted</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Year Fixed Effects</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Country Fixed Effects</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Number of observations</td>
<td>186</td>
<td>166</td>
<td>166</td>
<td>166</td>
</tr>
<tr>
<td>Adj. R-squared</td>
<td>0.13</td>
<td>0.11</td>
<td>0.11</td>
<td>0.04</td>
</tr>
</tbody>
</table>

Table 3: Note that * denotes significance at the |P|<.1 level; **denotes significance at the |P|<.05 level; *** denotes significance at the |P|<.01 level, and standard errors in parentheses.

Do diplomatic relations with Israel influence aid disbursements by the Arab Fund? Model 1 of Table 3 presents the ordinary least squares regression results, while controlling for economic and demographic variables. When controlling for member-states’ wealth and population, we find a positive correlation and estimate that diplomatic relations with Israel increases an Arab League member’s aid disbursement by USD 6.1 million, a result significant at the 1% significance level (99% confidence interval). This supports our hypothesis that Israeli diplomatic relations should increase aid received by members of the Arab League. As expected, we find a negative correlation with regard to affluent countries, where countries with higher GDP per capita receive
lesser aid from the Arab Fund – a result statistically significant at 5% significance level. We find no statistically significant results that hint that countries with a greater population receive greater aid from the Arab Fund.

*Model 2* of Table 3 presents the ordinary least squares regression results, adding the political control variables to those in *Model 1*. When controlling for incidences of war, British colonial legacy, and pariah state categorization, we still find a positive correlation between diplomatic relations with Israel and Arab League member’s aid disbursement, significant at the 1% significance level (99% confidence interval). Unlike our prediction, we find that incidences of war actually decreases aid received by those countries as proposed by Vreeland & Dreher (2014) – a result significant at the 10% significance level. This could be due to the fact that a number of conflicts were inflicted by other Arab neighbors and hence, the Arab Fund decided to prize impartiality. However, our prediction on Arab solidarity is valid when it relates to pariah state categorization. Pariah states are observed to receive more aid disbursements than non-pariah states of the Arab League. Countries with British colonial legacy were also noted to receive more aid than countries without. The pariah state and British colonial legacy variables bore results that are statistically insignificant. The variable controlling for alliance with the US was omitted due to collinearity.

*Model 3* of Table 3 includes the regional control variable into the mix presented in *Models 1 & 2*. When controlling for African member-states of the Arab League, we still find a positive correlation between diplomatic relations with Israel and Arab League member’s aid disbursement, significant at the 1% significance level (99% confidence interval) – indicating the robustness of our results. We observe a statistically insignificant positive correlation with regard to African member-states, where African member-states receive greater aid from the Arab aid

Model 4 of Table 3 includes country and year fixed-effects into the regression analysis. Variables of African member-states and British colonial legacy are omitted from this model, since they are time invariant components. When controlling for fixed effects, we still detect a robust, statistically significant positive correlation between diplomatic relations with Israel and Arab League member’s aid disbursement. Though the significance slipped to the 10% significance level (90% confidence level) from the previous 1% significance level (99% confidence interval), this result is still statistically significant after a rigorous regression analysis. We observe that the previously negative correlation between affluent countries and aid received transforms into a positive correlation when factoring fixed-effects – this result, however, is not statistically significant.

5. Conclusion

Our study suggests that members of regional financial institutions are able to leverage disbursement of aid for political gains while veiling their true motives. In particular, we estimate that the Arab states deride the politics of Israel publicly, but support Israel’s foreign policy behind closed doors by providing greater aid disbursements through the Arab Fund to countries that have diplomatic ties with Israel. Our robust, statistically significant findings suggest that member states that have diplomatic relations with Israel receive greater aid disbursements from the Arab Fund.

The results differ from those of Neumayer (2003), who concludes that countries (on a global scale) with diplomatic relations with Israel receive less aid – be it bilateral or from Arab
multilateral agencies (the latter showed no statistical significance). Key differences between the research methodology employed by Neumayer and us possibly explain the starkly varying results. Neumayer referred to Arab Agencies data and the sample size he tested includes all countries of the world while ours simply examines the Arab League countries – a mere 22 out of the 197 – using Arab Fund data.

Why does a discussion that focuses solely on the Arab League deserve merit? This paper analyses the significance of Arab solidarity and its impact on regional politics and foreign aid allocation. The Arab League may stand to gain naught – economically or politically – by rewarding countries worldwide that have relations with Israel. Concessionary benefits to such countries, in fact, erode the Arab League’s political clout and legitimacy in the eyes of other nations, as well as within the League. On the other hand, by rewarding countries neighboring Israel, such as Egypt, Jordan, Oman and Qatar, discreetly through the Arab Fund, peace and stability is promoted within the Arab League. This translates to greater socio-economic prospects and lends itself to greater Arab solidarity. Given the Arab-Israeli relations and the need to maintain political ideologies, however, the Arab League maintains its anti-Israeli rhetoric – at least in public. Only further research on Arab agencies aid comparing patterns within and without the Middle East can address these questions.

As for the research presented in this paper, at a minimum we find no evidence that the members of the Arab League punish the establishment of diplomatic relationship with Israel through the Arab Fund. In fact, we find significant evidence that point to the contrary.


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1. Introduction

Do governments of developing countries take advantage of their strategic importance on the world stage to purchase arms? Many poor governments seek out arms for international and domestic security (Grimmett and 2014). Yet, both financial and political issues often prevent governments from purchasing the arms they desire. Countries may gain an advantage in the arms trade if they are politically important or have high potential to be politically important to a given arms exporting country. They may be able to leverage their political position to gain favor with powerful governments in a position to provide military assistance.

Investigating the impact of a country’s strategic importance on the ability of its government to purchase arms entails measurement difficulties. One problem involves disentangling financial obstacles to purchasing arms from political issues surrounding the international arms market. As an additional hurdle, the research requires an exogenous measure of political importance that is unrelated to a country's ability to purchase arms. The amount of military assistance received by developing countries often acts as a signal to a general perception of that developing nation’s political and/or strategic importance. We might also consider a country's strategic importance by the use of such arms in territorial conflicts. Obviously, our study requires a measure of political importance unrelated to the procuring or use of arms.

We address the first problem of disentangling the financial obstacles from the political issues by focusing on arms sales from Germany. Due to Germany’s particular role in World War II, the government is required to have strict regulations regarding the exportation of both conventional and nonconventional weapons. This policy continues even today, with Federal
Security Council reviewing all applications for arms export licences (Davis 2002: 158).

As an exogenous measure of strategic importance, we follow recent studies employing temporary membership in the United Nations Security Council. More specifically, we analyze an unbalanced dataset of 4,132 observations for 188 countries from the period 1990-2012. We rely first on descriptive statistics and then turn to more rigorous regression analyses, controlling for country and year fixed-effects, as well as other important control variables identified by the literature.

The paper proceeds as follows: In the first section, we discuss the international arms market in general and in regards to Germany. Next, we address the importance of the United Nations, both historically and specifically relating to Germany, and why it serves as useful measure of political importance for the purpose of our study. We then explain our methodology, divided into three parts: descriptive statistics, control variables, and regression analysis and results. We conclude with potential implications and possibilities for further research of the question.

2. Background

Spencer Willardson of the University of Iowa notes that, “arms occupy a middle territory in the international relations literature--they are instruments of “hard power”, the primary currency in the international relations literature--and yet they are treated as simply another variable in most international relations literature”(Willardson, 2013). He goes onto note that although it is clear that the role of arms and arms transfers should be paid more attention on the international scale, little is known about how these arms transfers matter.

At the international level, the arms trade becomes subjected to the multitude of global
economic and political forces that affect other avenues of trade as well. Historically speaking, as in so many international concerns, the atmosphere of the international arms trade changed drastically with the conclusion of Cold War. The bipolar international environment during the Cold War era heavily influenced the patterns of arms trade, resulting in polarized alliances that determined who produced arms and who would receive exports (Baker & Cooner, p. 2, 2014). As the United States emerged as the dominant power leaving a generally unipolar international atmosphere, arms trade influences shifted from largely political to largely economic (Anderton, 1995, p. 532). One could also view this fundamental shift within the international arms market in terms of supply and demand. During the Cold War, the political alliances of arms manufacturers and suppliers played an integral role in the making of international arms deals. As the Cold War political constraints fell away from the international arms market, manufacturers had more options in terms of buyers, resulting in an increase in production of arms and a more competitive, buyer-driven market for arms (Baker & Cooner, p. 2, 2014).

Due to the nature of the international arms trade and the potential of “hard power” transfer in arms deals, the international arms market calls for closer analysis. With so much potential influence hanging in the balance, the standing knowledge gap needs to be addressed. It is in this void of information that our research begins, regarding arms as “hard power” and thus a prime currency in international relations. Who controls this “currency” at the international level? Who are the power players in the international arms market?

According to the Stockholm International Peace Research Institute (SIPRI), the top ten international arms exporters are the United States, Russia, Germany, France, China, United Kingdom, Spain, Italy, Ukraine, and Israel (“The Top 20,” 2013). From 2008-2012, these countries held the top ten greatest shares of arms exports worldwide, and consequently,
controlled significant shares of “hard power” as well. This list is intriguing on a variety of levels; however, we find Germany’s position as world leader in the international arms market particularly interesting.

2.1 The German Arms Trade

Why is Germany’s role in the international arms trade so intriguing? Starting with the end of World War II, the Federal Republic of Germany (FRG) was forced to conform to a set of internationally imposed standards regarding the development, production and transport of and trade in weapons. These confining restrictions not only addressed nuclear, biological and chemical weapons, but offensive conventional weapons as well (Davis, p. 155, 2002). As time passed, the FRG began to slowly but steadily return to arms market as manufacturers; however, they remained on a tight leash in regard to research and development. In the 1960s, West Germany was included in a campaign of providing military aid as an instrument of foreign policy largely to freshly independent African states as well as India, Iran, Israel, and Jordan; due to its national history, however, domestic unease arose in response to such military aid activities. In 1965, the German Cabinet resolved that they would no longer provide arms to “areas of tension” (Davis, 156). By the end of the decade, the FRG had terminated all major military aid programs. The decision to not deal arms to areas of tension shaped Germany’s regulatory and overall position in the international arms market, even to this day (Davis, 156). Between the powers of popular opinion and explicit aspects of the Constitution of the FRG (Grundgesetz fur die Bundesrepublik Deutschland), Germany has one of the most structured and rigid arms export control regimes worldwide. The constitution explicitly states that “weapons intended to be used for war” can only be produced, transported and traded with the permission of the federal government (Davis, p.163). In addition to the Constitution, the German government strengthened
its arms export control regimes through both the Weapons of War Control Act (KWKG) passed on April 20th, 1961 as well as the Foreign Trade and Payments Act (Aussenwirtschaftsgesetz, AWG) passed on April 28th, 1961 (Davis, p.163). The KWKG stipulates that the German government must refrain from exporting any “weapons of war” as defined by the War Weapons List (Kriegswaffenliste) if said weapons could be used in peace-threatening capacity or transgress international law, while the AWG, on the other hand, addresses the allocation of export licenses, specifically regarding dual-use goods (Davis, p. 163-64). Over the years, both policies have been amended in an expansionary nature. Both policies incorporate considerable close cooperation with the Federal Office of Economics and Export Control (Bundesamt für Wirtschaft Und Ausfuhrkontrolle or BAFA)(“Service”).

Interestingly enough, as the German government continued to strengthen its arms export control regime, it also began to substantiate itself as leading weapons manufacturer. By the late 90s, Germany felt increased pressure to promote arms exportation, resulting from the fundamental change in the international arms that resulted from the end of the Cold War. Clearly, several strong and well-structured levels of bureaucracy stand between Germany and finalizing arms deals. In fact, Germany founded the Inter-Agency Foreign Trade Group in 1989 to address the continuous issues regarding proliferation and the consequent legal and regulatory amendments (Davis, p. 168, 2002). This group, led by the Ministry of Economics, includes the representatives from the defence, foreign, and finance ministries, intelligence services, and the Office of the Chancellor. Another national institution--the Federal Security Council--also plays a role in the political decision making (Davis, p.168).

Clearly, Germany has several layers of bureaucracy standing between them and successfully approved arms exports, but what’s the takeaway? At the end of the day, what does
the impressive strength of Germany’s arms export control regime mean? The various obstacles that one must successfully surpass in order to secure the necessary qualifications and clearances to secure an arms deal includes so many political barriers that in order for something to be passed, significant political motivation must be working as the catalyst behind the arms deal (“Service”). Due to the political atmosphere encompassing its arms export regime, Germany provides a near-perfect forum in which to study arms exports as a “prime currency” in international relations. We ask whether or not arms are an accepted form of currency on the international scale, specifically between Germany and non-permanent members of the UNSC.

2.2 Background on the UNSC

The United Nations Security Council, though not perfect, stands as a powerful forum within which nations can vie for power. Detractors directing criticism specific to the United Nations Security Council (UNSC) generally orient their arguments around its unique hierarchical structure. Over the years, numerous parties have suggested reform to the United Nations, yet to date, all have fallen short of the necessary measures to induce visible change. Such stagnance also exists as a result of the unique “balance” of power within the Security Council. With the five UNSC superpowers--the United States, Russia, China, France and the UK--each having veto power, it comes as no surprise that any action that could potentially abate their overwhelming power has failed. Countries such as Germany and Japan see the current balance of power as inequitable, especially considering the degree to which Germany and Japan contribute to the UNSC and the UN in general. Take, for example, the top five providers of assessed contributions to United Nations Peacekeeping operations in 2013: 1. United States (28.38%) 2. Japan (10.83%) 3. France (7.22%) Germany (7.14 %) 5. United Kingdom (6.68%) (“Financing,” 2014). Germany and Japan contributed more than both the UK and China, and over double Russia’s contribution,
who comes in at 8th with 3.15%. In fact, looking at United Nations Regular Budget Contributions since 1990, Japan and Germany have consistently been in the top five contributors. Since 1992, Japan and Germany’s contribution ranked second and third largest respectively (“United States,” 2013).

In the words of a German ambassador to the United Nations, Thomas Matussek, the unreformed post-Cold War hierarchy and format of the United Nations Security Council “sticks out like a sore thumb” (“General,” 2006). Given their record of outstanding participation, dedication, and contribution, it comes as no surprise that countries such as Germany and Japan have grown restless and dissatisfied with the seemingly disproportionate balance of power in favor of countries such as China and Russia, who contribute significantly less. Since these very countries stand between them and reform, change seems unlikely despite the various propositions currently on the table.

2.3 Germany and the UNSC

Germany has a long history regarding the United Nations, seeing that the United Nations was established in 1945 as a response to Germany’s various crimes against humanity during World War II. The United Nations Security Council was established as one of the six main organs of the UN and the only organ that has the authority to put forth resolutions which member states are obligated to implement (“United). Germany wasn’t accepted in the United Nations until September 18th, 1973, with the Federal Republic of Germany and the German Democratic Republic being accepted as the 133rd and 134th full members respectively (“40 Years”). Since its acceptance into the UN, Germany has served five terms as a nonpermanent member to the Security Council.

As previously stated, the balance between contribution and power on the UNSC has been
off kilter to say the least. Substantial literature exists supporting the claim that non-permanent members of the UNSC that play an important and significant role in UN action, specifically Germany and Japan, augment their pre-existing international power via additional influence bought on the UNSC. Lim and Vreeland explain that these two countries both have significant motive to seek an augmentation of political influence on the UNSC, considering that one could argue they stand as two most powerful countries without a permanent seat on the UNSC (Lim & Vreeland, 2013). In fact, they suspect that both Japan and Germany seek influence over the United Nations Security Council by gaining the favor of elected members vis-à-vis increased foreign aid contributions (Vreeland & Dreher, 2014). They contest that this method of favor-gaining acts as “a lower-cost approach toward augmenting their limited power at the UNSC” compared to their generally pricey bids for permanent and elected membership. In fact, Malone (2004) estimates that winning a Western European and other Group (WEOG) seat costs well into the millions of dollars (Malone, 2004). So not only does it offer a vehicle through which greater political affluence can be attained, it also costs less, making it a win-win situation for Germany.

Clearly, Germany has interest and opportunity to augment its political influence when not on the UNSC by providing current non-permanent members with favors such as foreign aid, but the motive does not disappear when they themselves hold non-permanent seats. Simply taking into account the fact that they do not hold veto power even when they do have the opportunity to serve on the UNSC, one can see that exchanging favors such as increased foreign aid support could help countries such as Germany even the playing field against the veto powers by gaining the support and allegiance (however temporary) of other non-permanent members.

So there exists sufficient evidence for motive, reasoning and results in terms of foreign aid; however, this revelation begs the question of what other favors do countries accept as
bargaining chips for influence and power on the United Nations Security Council. Do arms exports act as a “prime currency” in this situation as well?

Interestingly enough, the five permanent members of the UNSC nearly hold the top five arms exporting spots as well, with their reign of the top interrupted only by Germany. We find this occurrence particularly interesting. Given its unique arms export control regime, historical role within the international arms market, and current political position within the United Nations, we decide to focus our research on Germany, its arms exports, and what it uses them to accomplish. Our hypothesis is based on a few key assumptions. First, Germany has significant motive to trade favors for votes and influence on the United Nations Security Council. Second, this behavior should be expected during years that Germany held a non-permanent seat and years that it did not because it has sufficient motive in both situations due to the imbalance between contribution and power within the United Nations as a whole and especially the Security Council. As we look at the different dynamics at play, we note that non-permanent membership on the UNSC imputes an appealing attribute to a given country: political importance. When a country holds political importance within the United Nations, it also holds influence—the exact thing Germany has been deprived. We hypothesize that a positive relationship exists between political importance defined by UNSC non-permanent membership and arms imports from Germany. In essence, we postulate that Germany buys UNSC influence with arms deals.

3. Methodology

Our dataset contains 4,132 observations for 188 countries from the period 1990-2012. Some of our data for specific countries are missing due to varying dates of country independence or lack of reporting.
For the dependent variable of interest, we turn to the Stockholm International Peace Research Institute (SIPRI), which contains a detailed registry of international arms transfers for the past 60 years. By arms transfers, it refers to exchanges of major conventional weapons between countries, rebel groups, or international organizations intended solely for military purposes. Examples of conventional weapons include aircraft, submarines, air-defence systems, armored vehicles, missiles, satellites, and ships (SIPRI 2014).39

SIPRI’s arms transfer data do have an advantage over other comparable sources, such as the UN Register of Conventional Arms, due to its measuring methodology. The SIPRI database is unique in that weapons transfers are not measured by financial indicators, but rather by what it refers to as a trend-indicator value (TIV). The TIV is meant to be a universal unit to measure arms transfers, based on the unit production cost of weapons that accounts for variables such as size, performance, technology and age. In our dataset, arms transfers are measured in millions of TIV.

The benefit of the TIV is that it provides a consistent measure over time, avoiding the price biases that might occur if financial quantities were used instead. Additionally, the dataset focuses on arms exchanged between governments; thus, we can tie our results directly to country interests. Furthermore, SIPRI allows us to narrow arms transfer data based on the exporter country. We use data for arms originating from Germany for our case study. For comparison, we include data for all arms imports regardless of the source country.

For our independent variable, UNSC membership, we used a binary variable, coded 1 if a country served on the UNSC for a particular year and 0 otherwise. We source our data from the

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39 It is important to note that “major weapons” do not include small arms and light weapons - these are weapons such as handguns, automatic weapons, explosive weapons (grenades and rocket launchers) and anti-tank missiles.
work of Vreeland and Dreher.\textsuperscript{40} We also include a binary variable that designates the year a country is elected to the UNSC—in other words, the year before the country’s UNSC term begins.

Our results indicate a significant difference in the reception of German arms between

\textsuperscript{40}In order to update the data list to include the year 2012, we use information from the United Nations website.
Figure 1.a.: The Effect of UNSC Membership on Arms Imports from Germany

Figure 1.b.: The Effect of UNSC Membership on Arms Imports from Germany
countries that are on the UNSC and countries that are not. On average, countries receive 80.1 million TIV in arms from Germany when they are temporary members on the UNSC and only 49.2 million TIV when they are not on the Security Council (see Figure 1). Furthermore, we see a reduction in German arms imports for countries in the years before and after they hold membership, with a peak in arms imports (96.5 million TIV) during their election year to the UNSC. In order to test the significance of these results, we turn to more rigorous analysis by including several possibly confounding variables.

3.2 Control Variables

The control variables follow those from similar studies, as well as factors specific to our study. From the World Bank Development Indicators database, we utilize two standard controls: economic development and population. In order to measure economic development, we use the natural logarithm of GDP per capita, with Purchasing Power Parity (PPP) measured in current USD. We take the natural log because it tends to reduce the effects of outliers on the spread of data.

We also control for the presence of inter- or intra-state conflict, as this factor could impact arms and UNSC membership: Dreher, Gould, Rablen, and Vreeland find that countries in conflict are less likely to win an election to the UNSC. For this control, we code 1 if the country is engaged in conflict for a particular year and 0 otherwise.\(^{41}\)

In order to control for the effect of a country’s political regime, we include a variable that indicates whether or not a country has a functioning democracy for a given year (Cheibub, Gandhi & Vreeland, 2010). It is a binary variable coded as a 1 if a country is a democracy and 0

\(^{41}\) An issue with this data is that it only contains information until the year 2009, so any regressions done with this variable exclude the years 2010-2012.
if it is a dictatorship.\footnote{Because the dataset contains observations for only up to the year 2008, we fill in the years until 2012 under the assumption that the only country to have a regime change between 2008 and 2012 is Mali.}

Another consideration we make is regarding whether colonial ties have an effect on arms exports. We utilize a German Colony variable, assigned as 1 for countries that were former German colonies: Tanzania, Cameroon, Namibia and Togo (Past German Colonies). These controls ensure that we take into account any historical connections in our regression analysis.

Finally, we also consider the possibility that arms imports from a particular country are tied to trade with that country. We include a variable that indicates overall trade imports coming from Germany for given year, measured in millions of current USD.\footnote{An issue with this data is that it only contains information until the year 2006, so any regressions done with this variable exclude the years 2007-2012.} The data comes from a dataset compiled by Barbieri and Keshk, which catalogs bilateral trade flows between countries (Barbieri, Katherine & Keshk, 2012).

Table 1: Baseline Specifications

<table>
<thead>
<tr>
<th>Control</th>
<th>Source</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Population</td>
<td>World Bank</td>
<td>Natural log of population</td>
</tr>
<tr>
<td>Economic</td>
<td>World Bank</td>
<td>Natural log of GDP per capita (PPP, in constant USD)</td>
</tr>
<tr>
<td>Development</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Democracy</td>
<td>DD dataset (Cheibub, Gandhi &amp; Vreeland, 2010)</td>
<td>Binary variable coded as 0 or 1, with 1 indicating a democratic government and 0 for a non-democratic government</td>
</tr>
<tr>
<td>War</td>
<td>The Political Economy of the United Nations Security Council (Vreeland) - Chapter 5 dataset</td>
<td>Binary variable coded as 0 or 1, indicating that the country was engaged in inter/intra-state war and 0 for no war</td>
</tr>
<tr>
<td>German colony</td>
<td>“Past German Colonies of Africa”</td>
<td>Binary variable coded as 0 or 1, with 1 indicating that the country is a former German colony and 0 if it is not</td>
</tr>
</tbody>
</table>
3.3 Regression Analysis & Results

In our data analysis, we utilize an ordinary standard least-squares (OLS) regression. Additionally, we use the country and year fixed-effects model and cluster errors by country, when applicable, to control for unaddressed heterogeneity across countries.\(^\text{44}\) We include general arms imports in our regression as a comparison. We also examine the relationships Germany has with a few select countries by performing individual regressions for those select nations.

\(^{44}\) In order to include the German Colony control, we also include analytical models without country/year fixed-effects.
We present our results in Table 2. When we control for economic development, population, war, political regime, trade and colonial ties, we find a positive correlation between UNSC membership and arms imports and Germany, significant at the 1% level. In Model 2, where we additionally control for country/year fixed-effects and utilize clustered errors, this relationship is significant at the 10% level. When we exclude the variables for war and trade in Model 3 to include the years 2010-2012, our results lose significance; however, it is important to note that the p value is barely over the threshold at 10.2%. In contrast, we find no significance between UNSC membership and general arms imports when country/year fixed-effects are

Table 2: The Effects of UNSC Membership and the Importation of Arms

<table>
<thead>
<tr>
<th>Variable</th>
<th>Model 1</th>
<th>Model 2</th>
<th>Model 3</th>
<th>Model 4</th>
<th>Model 5</th>
</tr>
</thead>
<tbody>
<tr>
<td>German Arms</td>
<td>General Arms</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>UNSC Membership</td>
<td>9.615**</td>
<td>8.407*</td>
<td>9.019</td>
<td>96.301***</td>
<td>17.159</td>
</tr>
<tr>
<td>Election Year</td>
<td>11.902**</td>
<td></td>
<td>11.79</td>
<td>132.790***</td>
<td>38.912</td>
</tr>
<tr>
<td>ln(Population)</td>
<td>1.442</td>
<td></td>
<td>2.614</td>
<td>-5.492</td>
<td>-1.427</td>
</tr>
<tr>
<td></td>
<td>-0.899</td>
<td>-2.718</td>
<td>-1.742</td>
<td>-5.045</td>
<td>-6.791</td>
</tr>
<tr>
<td>ln(GDP per capita)</td>
<td>0.316</td>
<td></td>
<td>0.083</td>
<td>2.673</td>
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</tr>
<tr>
<td></td>
<td>-0.51</td>
<td>-0.372</td>
<td>-0.314</td>
<td>-8.672</td>
<td>-2.614</td>
</tr>
<tr>
<td>Political Regime</td>
<td>10.702***</td>
<td></td>
<td>-3.711</td>
<td>60.458***</td>
<td>28.629**</td>
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<tr>
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<td>-5.223</td>
<td>-4.596</td>
<td>-11.054</td>
<td>-11.6</td>
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<tr>
<td>War</td>
<td>19.840***</td>
<td></td>
<td>8.404</td>
<td>226.799***</td>
<td>92.395</td>
</tr>
<tr>
<td></td>
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<td>-8.1</td>
<td></td>
<td>-25.571</td>
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</tr>
<tr>
<td>Trade with Germany</td>
<td>0.001***</td>
<td>0.002**</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>0</td>
<td>-0.001</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>German Colony</td>
<td>-2.131</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>-6.317</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Number of Observations</td>
<td>2677</td>
<td>2694</td>
<td>3790</td>
<td>3289</td>
<td>3289</td>
</tr>
<tr>
<td>Adj. R-squared</td>
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<td>0.01</td>
<td>0.01</td>
<td>0.04</td>
<td>0.02</td>
</tr>
<tr>
<td>Country Year Fixed-Effects?</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Cluster Errors?</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
</tr>
</tbody>
</table>

Notes: Numbers in parentheses are absolute value t-statistics. As per convention, we mark absolute t-statistics with * if p<.10 (statistically significant at the 10% confidence level), ** if p<.05 (statistically significant at the 5% confidence level), *** if p<.01 (statistically significant at the 1% confidence level).
included. This indicates that the effect of being a rotating member on the reception of weapons may be related specifically to in German arms. Additionally, when controlling for country and year fixed-effects, we do not find a statistically significant relationship between the year of election into the UNSC and the reception of arms imports during that period—contrary to what Figure 1 suggests. This may imply that the major period when countries do receive more German arms occurs only when they actually begin their membership.⁴⁵

We also consider the individual relationships that countries may have with Germany. We would expect that if Germany wanted to influence states that are on the UNSC, there would be correlations between UNSC membership and arms imports for individual countries. In order to determine these effects, we conduct individual country analysis on the impact of UNSC membership and the importation of German arms. In these regressions, we utilize all control variables but without country/year fixed-effects, clustered errors and colonial ties.⁴⁶ From these regressions, we narrow our results to only those that yield significant outcomes (see Table 3).

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⁴⁵ Interestingly enough, we find no significant correlation between arms imports from Germany and economic development, war or democracy.
⁴⁶ Because these regressions are on individual countries, we do not include country/year fixed effects, nor do we include clustered errors.
As these results indicate, there are six countries that have significant relationships between UNSC membership and weapons imports from Germany: Bangladesh, Canada, Ireland,
Japan, Romania and South Korea. Interestingly enough, these six countries are scattered across the world--more specifically, into various UN regional groups (see Figure 2). The breakdown is as follows: two in the Western European and Others Group, one in the Eastern European Group, and three in the Asia-Pacific Group (Official List of UN Regional Groups). Does this evidence suggest that Germany targets specific countries when they rotate into the UNSC? The findings do appear to strengthen this proposition.

Our results indicate that Germany appears to stick out from the rest of the field. Not only do countries tend to receive more arms from Germany while on the UNSC, after rigorously controlling for variables such as economic development, political regime and trade, we find that these results to be statistically significant even when taking into account the effects of endogeneity.

4. Conclusion

International relations have never and will never exist as simple or static. Any question situated within the context of the international political economy is constantly subjected to various factors, and as a result, one can easily overlook the importance of any given factor. Spencer Willardson alludes to this exact phenomenon by noting that we often write off international arms exchanges as simply another aspect of the international trade formula. Arms, however, are “hard power” and consequently highly valuable as a primary form of international currency. This characteristic of the arms trade adds weight and importance to every exchange of arms internationally, but one must especially emphasize the significance of such exchanges in countries with strong arms export control regimes--countries like Germany. Due to the various political hoops proponents for a given arms deal must jump through in order to achieve the
necessary licenses and clearances in addition to the incredible amount of red tape that bureaucrats must neatly tie into bows before any arms can be exported from Germany, one can deduce that when Germany approves such an arms deal, significant political motivation exists.

The United Nations is the ideal forum in which to test our hypothesis because we know countries have used it as the arena for international horse trading in the past, and Germany would have ample opportunity and motive. After extensive regression analysis, we conclude that a positive relationship does in fact exist between political importance as defined by UNSC non-permanent membership. Having found these results, we now face the question of, “Why?” Why are countries exerting their influence specifically via arms transfers when they could be doing so via other methods such as increased foreign aid to specific regions or countries, especially given that they already give so much? As in so many things, we believe it comes down to utility, that is, how much influence it will yield both the buyer and the seller. David Baldwin of Princeton directly addresses the question of ‘power resources’:

Although it is common practice to refer to the ‘power resources’ or ‘capabilities’ of a state as if they were possessions of the state, this practice can be misleading. Strictly speaking, the power resources of a state are not attributes of the state in the same sense that population or territory are attributes. To designate something (time, reputation, weaponry, money, oil, and so on) as a ‘power resource’ is to imply something about its usefulness in getting others to change their behavior—and thus to imply something about the value system and capabilities of these others. (Threats do not work very well against masochists.) (Baldwin, 2013)
If Germany was hoping to gain political influence from a specific non-permanent member within the UNSC, according to Baldwin, it would have the most success by first determining what “currency” would be the most appealing to the given member and would consequently result in the greatest change in behavior or “biggest bang for their buck.” Given the fact that arms are a form of “hard power,” they hold significant value on the international market and consequently make them especially valuable. The value of German arms in particular is generally perceived as better than average due to the quality of arms. Even vocal critics of weapons sales such as SIPRI analyst Pieter Wezeman notes the superior quality of German arms, for they are both battle tested and carry the same reputation as other reliable German industrial goods (“No Farewell to Arms,” 2014).

In the end, deals are made because they are mutually beneficial—both parties involved gain something valued. In this particular case, our findings indicate that Germany could be gaining added influence on the United Nations Security Council, combatting its lack of permanent membership. On the other end of the deal, recipient countries enjoy the augmentation of their arsenal.

Although this may seem “mutually beneficial,” one cannot help but to notice the irony of the situation. The United Nations Security Council—a body charged with the mandate to maintain peace and stability through non-violent means whenever necessary—sells votes and the subsequent international influence for arms. This realization draws attention to the need to seriously consider United Nations Security Council reforms so as to lessen the motivation for such pervasive strategies in what is arguably the most important and successful international institution.

Although our findings support existing literature addressing exchanging favors for
increased international influence within institutions, at the end of the day it provides more questions than answers. Our study just scratches the surface of the relationship between political importance and the easier or increased acquisition of arms at the international level. There is great potential for further investigation, and we believe it would be interesting to compare our findings regarding Germany and heavy arms with findings regarding Germany and smaller conventional arms. In terms of comparative analysis, it might also prove interesting to use a different country as a focal point and see if this a more widespread practice.

Lastly, our results provide an interesting angle from which to analyze the United Nations and the liberal perception of international institutions. International relations theory dictates that liberalism promotes the development of international institutions to promote democracy and diplomacy; however, heavy arms would not be a major tool in achieving either of those goals according to liberalism. In fact, many would consider the proliferation of weapons as counterproductive. On the other hand, one could argue that such methods “oil the machine” and increase the efficiency and efficacy of often morbidly slow bureaucratic processes. Perhaps more than anything, our results illustrate that the international relations arena truly is a self-help system. Germany, limited in international political power due to its past transgressions, has to be creative in order to exert influence. The international arms market is one of the many means through which countries can jockey for power. When international institutions fail to reflect the true dynamics of international politics, the “state of anarchy” finds its way back into the supposedly liberal system.
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1. Introduction

Undoubtedly, political motivations drive that foreign aid. Countries provide aid to buy political influence and to strengthen trade relationships with recipient countries (McNeil 1981: 27-29). In contemporary international political economy, globalization has changed the nature of trade relationships. While deregulation, privatization, and the reduction of government intervention have liberalized trade among countries, governments continue to maintain a regulatory role in select industries—including arms manufacturing (Davis 2002: 21). Unlike other trade goods, exporting arms may alter the balance of power within a country and its region, potentially leading to human rights abuses or instability and conflict if sales are not properly controlled.47

The global arms market has changed drastically since the end of the Cold War. The polarized alliances that determined who produced arms and who would receive them is no longer the basis for the global arms trade. This decrease in polarity has also reduced the demand for arms, meaning that the supply of arms today is greater than the demand. As a result, arms producing countries exercise less discrimination when determining which countries will receive arms exports. Countries may claim that they will only provide arms to non-authoritarian, stable countries; however, domestic political and economic motives, rather than international norms and agreements, drive their actual export decisions (Davis 2002: 8).

This competitive, buyer-driven arms market has created a policy environment in which governments are more inclined to support their domestic arms manufacturers (Gold 1999: 249-

We theorize that countries take measures to ensure that they are an attractive supplier of arms to importing countries. Rather than placing stipulations on arms recipients, governments feel a need to reward them for engaging in the highly important arms trade to ensure that their country remains competitive. Our paper explores the possibility that arms exporting countries increase aid to countries that import their arms.

To examine whether importing arms causes countries to receive an increase in aid, we investigate the German case. Germany is the third largest arms exporter in the world a prominent donor of foreign aid (SIPRI n.d.). Germany presents an ideal case study because its institutions provide unusual insight into the relationship between the arms export process and the foreign aid budgeting process. Because of Germany’s historic legacy from World War II, the constitution requires that the government tightly regulate the export of major conventional weapons (Davis 2002: 158). To this day, the Federal Security Council reviews all applications for arms export licenses behind closed doors—providing political cover for German officials.

The head of the Federal Government of Germany—the Chancellor—oversees the Federal Security Council as well as the cabinet ministry that allocates German bilateral aid. Thus, the Chancellor is in a unique position to consider German arms manufacturers’ interests when deliberating foreign aid.

We analyze the effect of purchasing German arms on receiving foreign aid with data from the Stockholm International Peace Research Institute (SIPRI) and the Organization for Economic Cooperation and Development (OECD). Our data ranges from 1990 through 2009 because of the unique nature of the post-Cold War global arms market. To limit confounding variables that could influence German foreign aid, we apply country and year fixed effects and regional quartics in addition to controls for political importance, strategic military importance,
government regime type, pariah state status, war, GDP per capita, and trade. Even when controlling for these variables, we find that countries that import more German arms secure more foreign aid, significant at the 95% confidence level. Thus, there may be reason to believe that some countries increase aid to those that import their arms.

This paper explores the theoretical framework that supports the idea of politically motivated aid. In order to understand the link between aid and the arms trade, the Section 1 examines the changes in the international arms market since the end of the Cold War. Section 2 considers how these theories can be understood in the context of Germany. We delve into the German case by analyzing the political institutions that influence the arms export licensing process as well as the foreign aid budget. In Section 3, we elaborate on the sources of our data and the justification for our control variables. The results of our research in Section 4 suggest that arms sales play a role in driving foreign aid.

2. International Legal Context

As Hans Morgenthau puts it, “much of what goes by the name of foreign aid today is in the nature of bribes” (Morgenthau 1962: 303). Donor countries’ foreign policy interests often drive aid to a greater degree than does recipient country need (Lawrimore and Varghese 2014). McKinlay and Little argue that foreign policy determines countries’ aid allocation because aid enables donors to achieve political goals (McKinlay and Little 1977). Foreign aid is readily used as a policy tool because it gives donor countries leverage over the recipients.

Countries provide aid to encourage the recipient country to take strategic or economic action that benefits the donor. Specifically, countries often give aid to trade partners to strengthen their commercial relationship (McNeil 1981: 27-29). The recipient country is
incentivized to act according to the interest of the donor, because this ensures that the increased flow of aid continues. In the case of commercially oriented aid, this means aid can be used to maintain trade partnerships. As Morgenthau suggests, countries use aid to incentivize recipients to act in the donor’s interest and to “buttress their alliances” (Morgenthau 1962: 307).

Perhaps the trade of certain politically important goods, such as arms, is more likely to drive aid. Since the end of the Cold War, the international political environment, which previously restrained the arms industry, became more open. This was the beginning of a more economic impetus for arms trade. Since the 1990s, there has been a trend towards countries exporting arms more freely compared to the polarized exchange that characterized the Cold War. This pattern has created a more competitive, buyer-driven market for arms. Existing literature shows that when demand for warships exceeds supply, countries export warships to prevent domestic job losses, even when this interferes with their military strategy (Clare 2013). We believe that the same is true for arms exports as a whole. Between the economic benefits of arms trade and the increasingly competitive nature of the market, arms exporting countries have become increasingly willing to shape policy to promote weapons sales since the end of the Cold War (Gold 1999: 249-256). In fact, according to Gold, there has been an “increasing in level of public money being expended to generate business” since the end of the Cold War (Gold 1999: 289).

As a result of the buyer-driven nature of the global arms market, arms-exporting countries are less selective in determining to which countries they will sell arms. The global supply of arms exceeds demand, so importing countries have little reason to accept a sale that imposes unfavorable conditions; they simply can buy arms from another country. Therefore, the

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48 On a macroeconomic scale, exporting arms improves a country’s balance of payments, as well as its income levels and employment rate (Gold 1999: 256).
nature of the arms market has changed. Where exporters used to be able to influence importers, they now must work to remain competitive and attractive within the market (Gold 1999: 289-299).

A number of treaties and agreements attempt to govern international arms trade. The Coordinating Committee on Multilateral Export Control (COCOM) was the primary arms export regime during the Cold War. COCOM aimed to restrict the transfer of arms to Eastern Europe, the Soviet Union, and Asia; after the Cold War ended, arms exports no longer needed to be based on such a polarized precedent (Davis 2002: 34). The Wassenaar Arrangement came into effect in 1995 as a response to the end of the conventional need for COCOM. This shift from COCOM to the Wassenaar Arrangement reflects how the end of the Cold War influenced the global arms market. As the basis for an export regime became less polarized, the market became more open and competitive.

The Wassenaar Arrangement encourages signing states to establish controls that prevent the export of arms to pariah states, and aims to promote the transparency and security of arms export policies. However, the Wassenaar Arrangement is self-enforced, so signing countries choose how, if at all, they incorporate its stipulations into their policy decisions. The effectiveness of the Wassenaar Arrangement is limited because of the risk of free riders enforcing less stringent regulations than other signing states in order to be more competitive (Davis 32).

The Organization for Security and Co-operation in Europe (OSCE) is another security institution that promotes arms export control. Member states are encouraged to avoid exporting

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49 This shift is visible in literature written about the global arms market during the Cold War. In The Weapons Acquisition Process: Economic Incentives (1964), Frederic Scherer referred to the arms market as a “nonmarket environment” in which the “invisible hand” [is] absent.”

arms that would be used to violate human rights or cause political instability (Davis 2002: 37). The European Union (EU) has also taken measures to influence European export policy by passing the EU Code of Conduct on Arms Exports, based on principles that were initially agreed upon in 1992 (Davis 2002: 37). This code similarly pressures countries to not transfer arms to aggressive or unstable countries.

Since the end of the Cold War, the international arms framework has been influenced by multilateral arms export regimes, decreased polarization, and increased competition in the arms market. The nature of the contemporary arms export market creates some motivation for governments to promote their arms industries. We believe that donor countries may use foreign aid to reward the countries that import their arms in order to strengthen their relationship and encourage recipients to continue importing arms. The German case provides a useful lens to understand how governments’ desire to promote arms exports could shape their aid policy.

3. German Institutions

According to Davis, the theoretical framework that shapes state’s arms export policies may not determine their ultimate policy decisions. Domestically, the interaction between public policies, policy stakeholders, and policy environments shape the arms export policy system (Davis 2002: 6). Furthermore, the conflicting and divergent interests of different stakeholders, such as defense companies and the government, influence the process of negotiating arms exports (Davis 2002: 8).

The evolution of Germany’s arms export policy demonstrates the interaction among domestic institutions. After World War II, the Allied powers placed restrictions on the German
arms industry. The Weapons of War Control Act and the Foreign Trade and Payments Act require that the government regulate arms production and exports (Davis, p. 163, 2002).

The government regulates the sale of German weapons primarily through arms export licenses, issued by the Federal Security Council. Typically, less than one percent of arms license applications are denied, which might suggest that those parties that doubt the eventual success of their applications choose not to apply (Davis 2002: 176). Another theory could be that Germany is simply not that selective. The politics of the arms export licensing process reveals the interaction between international and domestic norms regarding export policies, as well as how policy implementation can contradict these principles.

The Federal Chancellor exerts considerable influence over the Federal Ministry for Economic Cooperation and Development and the Federal Security Council. In the Federal Security Council’s confidential meetings, this body approves or denies applications for arms export licenses to non-NATO countries. These deliberations are influenced by the previously described international arms export agreements and by domestic policy.

The key document in this process is Germany’s Policy Principles on the Export of Major Conventional Weapons (Federal Republic of Germany 2000). This document, which went into effect in 2000, calls for export restrictions on major conventional weapons in accordance with principles including human rights records, regional stability, and respect for international arms control and disarmament regimes. Furthermore, this policy explicitly states that gains in employment and domestic output “must not be a decisive factor” (Federal Republic of Germany 2000: 5). Evidence produced by Der Spiegel, however, indicates otherwise. In February 2014, Der Spiegel reported that government support for a billion-euro contract to sell patrol boats to Saudi Arabia was directly motivated by domestic benefits. A classified letter from a high ranking
official in the Finance Ministry describes the deal as “high importance in terms of economic[s] and employment” (“Arms Exports: Berlin Backs Large Defense Deal with Saudi Arabia,” 2014). As this example and numerous others demonstrate,51 the lucrative nature of these major conventional weapons sales push Germany to ignore key principles in its own arms export control policy. Thus, just as Davis suggested, policy making is not always congruent with policy decisions.

The German arms market gradually expanded during the 1950s and 1960s, and was established as a top arms manufacturer by the 1970s (Davis 2002: 156). At the end of the Cold War, Germany sought to reduce the restrictions on arms exports by advocating for diminished COCOM regulations (Davis, p. 159, 2002). Simultaneously, the Federation of German Industries (BDI) sought a less complex licensing process, and there was pressure on the government to more actively promote arms exports. The Federal Security Council reinterpreted the arms export guidelines to automatically authorize export licenses for private-sector orders from NATO and EU countries and to annually report arms exports to the Bundestag (Davis, p. 171, 2002). The global arms market became more competitive and buyer-driven, and Germany reacted accordingly.

As previously mentioned, German law requires that the Federal Security Council’s deliberations of arms export licenses remain confidential. BDSV, the subgroup of BDI that represents the interests of all security and defense industry businesses, is in favor of this “observance of business secrets” (BDSV Defense Exports). Gold suggests that the increasingly

51 Other articles on controversies surrounding Germany’s arms exports can be found through the following articles: (Gebauer 2013), (Gebauer & Nassauer 2013), (DER SPIEGEL Staff 2012). Articles on the Federal Security Council and Chancellor Merkel’s role include (DER SPIEGEL Staff, “Secret Weapons Deals” 2012), (DER SPIEGEL Staff, “German Weapons for the World” 2012), and (Demmer, Neukrich, & Stark 2012).
competitive nature of the global arms market has increased governments’ willingness to support arms industries (Gold 1999: 249-256). Accordingly, BDSV states on its website that “from an industry point of view, it is vitally important for the competitiveness of the German security and defense industry to receive support from the government” (BDSV Defense Exports).

We hypothesize that support from the German government comes in the form of foreign aid to recipient countries to encourage them to continue to import German arms. But how is the foreign aid budgeting process linked to the Federal Security Council’s approval of export licenses?

Under the German constitution, the largest parliamentary group of the Bundestag, the lower house of the legislature, elects a President who in turn nominates the Federal Chancellor to lead the new coalition government’s executive ministries. In this system, the Federal Chancellor is incredibly influential in the budgeting process (Linn and Sobolewski, 2010). The Federal Ministry for Economic Cooperation and Development leads the government’s development policy in cooperation with numerous other agencies. It provides oversight and policy guidance over these development programs, many of which are considered Official Development Assistance (ODA) (European Commission, 2013). The Bundestag may fund the Federal Ministry for Economic Cooperation and Development, but the Chancellor’s nominated head of this department determines the allocation of its funds.

As a result, the Federal Chancellor maintains significant influence over the ministry that determines the allocation of Official Development Assistance while also playing a direct role in the licensing process for arms exports. From this unique position, the Chancellor may subtly choose to reward those states that support the German arms industry with foreign aid. Thus,
Germany has the means, motive, and opportunity to ensure that countries that import German arms continue to do so—perhaps through “rewarding” them by increasing their foreign aid.

4. Data and Methods

Turning now to the quantitative evidence, we first describe our dependent and independent variables in addition to their sources and methodology. We then break down our control variables, their sources, and briefly address issues of endogeneity. Finally, we explain our results and how they confirm our hypothesis regarding the relationship between German arms sales and foreign aid.

Our data for the dependent variable in this study, the distribution of German bilateral aid, come from the Organization for Economic Co-operation and Development (OECD 2012). This country-year dataset utilizes the natural logarithm of Overseas Development Assistance (ODA) from 1990-2009 in millions of constant 2009 U.S. dollars (Vreeland and Dreher 2014).

To measure our independent variable, German arms imports, we look to the Stockholm International Peace Research Institute (SIPRI), which maintains a database of information on the international arms trade. Specifically, the SIPRI Arms Transfers database provides information on “actual deliveries of major conventional weapons…using a common unit, the trend-indicator value (TIV)” (SIPRI n.d.). SIPRI determines the TIV of a weapon by using its production cost—measuring the “transfer of military resources rather than the financial value of the transfer” (SIPRI n.d.). With this measurement of the military utility of a weapon, we can evaluate arms transfers across regions and over time with the TIV as a common measure in units of tens of millions of TIV.52

52 Factors such as quality, previous use, component transfers, and production licenses are evaluated in their system as well. One must note that SIPRI defines major conventional weapons and military equipment along the following
Combining this TIV data on German weapons imports with our OECD data from 1990-2009, we turn to multivariate regression to analyze a total of 1321 country-year observations from 68 countries. On average during this period, Germany provides $12.8 million in ODA and sells major conventional weapons worth 2.3 tens of millions of TIV. Further descriptive data for these dependent and independent variables can be found in Table 1.

Due to the complex nature of the international arms market and the allocation of foreign aid, we acknowledge the possible role of endogeneity in our analysis. To address this issue, we employ controls for country-fixed effects, year-fixed effects, and regional quartics. This accounts for any unobserved heterogeneities across countries and years in our data set as well as the regional time trends that may influence our quantitative analysis. For this study, it is especially difficult to determine the direction of causality, but we believe that the control variables and the aforementioned fixed effects minimize the chances that our analysis mistakes the direction of

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Table 1. Descriptive Data of Dependent and Independent Variables

<table>
<thead>
<tr>
<th>Variable</th>
<th>Observations</th>
<th>Mean</th>
<th>Std. Dev.</th>
<th>Minimum</th>
<th>Maximum</th>
</tr>
</thead>
<tbody>
<tr>
<td>German bilateral aid (Office of Development Assistance, mill.)</td>
<td>1321</td>
<td>12.82</td>
<td>7.38</td>
<td>0</td>
<td>21.4</td>
</tr>
<tr>
<td>Value of German arms imports (SIPRI TIV, tens of mill.)</td>
<td>1321</td>
<td>2.26</td>
<td>7.70</td>
<td>0</td>
<td>75.8</td>
</tr>
</tbody>
</table>
causality. Furthermore, the causal logic between arms imports and foreign aid is supported by our qualitative analysis of the international legal context and German institutions.

We also control for significant political and economic determinants that may play a role in aid allocation, including a country’s form of government and human rights record. We control for political regime type using Polity II data (Vreeland and Dreher 2014). Similarly, Germany’s 2000 Policy Principles document also claims that their decision to distribute foreign aid and approve arms exports licenses depends on a country’s human rights record (Federal Republic of Germany 2002). For arms exports, German policy supposedly prevents the sale of dual use systems which may be turned against civilians by autocratic regimes. To account for this common influence on aid and arms exports, we control for a country’s human rights record with CIRI’s measure of physical integrity rights over this period (Cingranelli, Richard, and Clay 2013).

Our next control variable, United Nations Security Council (UNSC) membership, is used as a measure of a state’s political importance (Vreeland and Dreher: 2014). For our dataset, UNSC membership is represented with a dichotomous variable (United Nations n.d.). As Vreeland and Dreher explain in their book on the UNSC, a country’s relative political importance is often linked to greater bilateral foreign aid from key countries like Germany which seek to advance their own interests in the international community (Vreeland and Dreher: 2014). While UNSC membership measures political importance in the international community, US military aid controls for a state’s global strategic importance—countries that are pivotal to international security are more likely to receive aid and arms (Vreeland and Dreher: 2014). Controlling for political and strategic importance is necessary to properly analyze the relationship between arms sales and foreign aid.
We also control for a country’s status in the international community as a pariah state and whether or not it is in a state of war. Pariah states are categorized according to their relationship with the United States. Information on wars during this period is adapted from Vreeland and Dreher’s book as well (Vreeland and Dreher 2014). Both of these dichotomous variables may play significant roles in Germany’s decision to approve arms export licenses and the distribution of foreign aid, and controlling for them increases the rigor of our regression models.

Due to the commercial aspects of the relationship between arms imports and aid, larger economic forces may confound the results—because of this, we control for the natural log of GDP per capita, the value of German goods imported by their trade partners, and the value of trade partners’ goods imported by Germany. Bilateral trade information draws on the Correlates of War database (Barbieri, Keshk, and Pollins 2009). If German arms sales are merely a product of bilateral trade, this variable should capture any biases which such a scenario may produce in our results.

5. Results

Table 2 presents the results of our analysis. While Model 1 analyzes the bivariate relationship between German foreign aid and arms imports, Model 2 includes the control variables described in the paragraphs above. Model 3 drops all insignificant control variables to provide an even more rigorous regression. Across the board, the analysis indicates a positive, statistically significant relationship between the military value of German arms imports and the bilateral foreign aid it receives. Specifically, these models suggest that if a country purchases ten million TIV worth of military equipment, they can expect a 5% increase in their bilateral foreign aid from Germany.
Table 2. Effect of German Arms Imports on Bilateral Aid Received From Germany

<table>
<thead>
<tr>
<th>Variable</th>
<th>Model 1</th>
<th>Model 2</th>
<th>Model 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value of German arms imports</td>
<td>0.05**</td>
<td>0.06***</td>
<td>0.05**</td>
</tr>
<tr>
<td>Membership on the UNSC</td>
<td>1.04*</td>
<td>1.18**</td>
<td></td>
</tr>
<tr>
<td>U.S. military assistance</td>
<td>0.09**</td>
<td>0.10*</td>
<td></td>
</tr>
<tr>
<td>Political regime type</td>
<td></td>
<td></td>
<td>(2.37)</td>
</tr>
<tr>
<td>Human rights record</td>
<td></td>
<td>0.3</td>
<td>(1.38)</td>
</tr>
<tr>
<td>Pariah state</td>
<td></td>
<td>-1.58</td>
<td>(0.96)</td>
</tr>
<tr>
<td>War</td>
<td></td>
<td>-0.52</td>
<td>(0.84)</td>
</tr>
<tr>
<td>ln(GDP per capita, real)</td>
<td></td>
<td>0.8</td>
<td></td>
</tr>
<tr>
<td>Value of German goods imported by their trade partner</td>
<td></td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>Value of a trade partner’s goods imported by Germany</td>
<td></td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>Number of observations</td>
<td>923</td>
<td>837</td>
<td>922</td>
</tr>
<tr>
<td>R-squared</td>
<td>0.26</td>
<td>0.36</td>
<td>0.27</td>
</tr>
</tbody>
</table>

Notes: All regressions include country and year fixed-effects and regional quartics. Numbers in parentheses are the absolute values of t-statistics. We mark absolute t-statistics with * if p<0.10 (statistical significance at the 10% confidence level); with ** if p<0.05 (statistical significance at the 5% confidence level); and with *** if p<0.01 (statistical significance at the 1% confidence level).

Turning to our control variables, our multivariate regression finds a positive, statistically significant relationship between German bilateral aid and our control variables for political and strategic importance, UNSC membership and US military assistance, which is consistent with Vreeland and Dreher’s findings. On the other hand, a state’s regime type, human rights record, status as a pariah state, and state of war are not statistically significant in the allocation of German foreign aid. Surprisingly, our economic variables are not statistically significant either. The natural log of GDP per capita does not hold, suggesting that the German aid is not driven by
donor need, but rather by its own interest. Notably, the fact that trade variables are not statistically significant ensures that any increase in aid associated with importing arms is not simply a result of general commercially oriented aid. As Table 2 demonstrates, the positive impact of German arms sales on the distribution of bilateral foreign aid persists at the 95% level of statistical significance even under the rigorous conditions of Model 3 in which all insignificant variables are dropped.

6. Conclusion

Do arms sales drive foreign aid? Our analysis suggests that if a country purchases major conventional weapons from Germany, they can expect an increase in bilateral foreign aid from Germany.

In spite of numerous international agreements and norms regarding weapons sales, the hyper-competitive nature of the arms market drives countries to support domestic manufacturers and corporations with political tools like foreign aid. Although Germany’s stated policy discourages consideration of the domestic economic benefits of a weapons deal in its deliberations, reporting by Der Spiegel indicates that these forces do play a significant role in the decision making process. Similarly, our analysis suggests that the Federal Government of Germany is willing to provide such support to arms manufacturing through foreign aid to arms importers. Ultimately, these contracts for major conventional weapons contribute to job growth, job security, and a healthier economy. Arms production also has especially important political implications because of its influence on national power and international security. While the influence of the arms industry may be small within the German economy as a whole, what they represent symbolically to voters and the politicians is of great significance.
Our results indicate that domestic incentives and a desire to remain competitive provide sufficient motivations for politicians to actively approve and support German arms sales abroad through foreign aid. The concrete connection between arms sales and foreign aid in Germany is the Federal Chancellor, who plays a direct role in licensing arms exports and in distributing of ODA. The Chancellor not only chairs the Federal Security Council, which secretly reviews all applications for arms export licenses, but also nominates the cabinet level official to head the Federal Ministry for Economic Cooperation and Development.

From this position, the Federal Chancellor may reward those states that purchase German arms by increasing their foreign aid. Because we recognize that not all states share Germany’s arms export restrictions or institutions, the evidence presented in this paper suggests that further research on the relationship between arms sales and foreign aid in other countries is required. When looking at Germany, the quantitative and qualitative evidence suggests that arms sales do in fact influence the distribution of foreign aid. With further research on this question, scholars may find that Morgenthau is still right: “Much of what goes by the name of foreign aid today is in the nature of bribes.”

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Foreign Aid and Retaliation in the WTO
Zachary Kay and Matthew Quallen

1. Introduction
Great powers dominate the international system, or so the argument runs. They design institutions that serve their needs, and exert considerable power to maintain the status quo, even when that means exploiting emerging economies or circumventing the conventions of the international system. In this scheme, relationships reduce to exploitation; innocuous policy instruments become the means of political enforcement as states bring to bear every tool at their disposal. For states that vote against stronger peers in the UN, for example, foreign aid dries up before election time; but for those that vote with them, the opposite occurs (Faye and Niehaus 2011). For states seeking IMF loans, United Nations Security Council alignment with its major stakeholders is key (Dreher, Sturm and Vreeland 2009). Even trade relations fall prey to great power manipulation, as states receive more foreign aid in exchange for importing more from donors (Schraeder et. al 1998; Younas 2008). These are the carrots and sticks of international enforcement and it is the most powerful states that wield them.

We consider the case of the World Trade Organization (WTO) – an organization which would appear to level the economic playing field. In the WTO, powerful states have no formal advantage over weak ones; panels arbitrate disputes and states level penalties against one another. And yet, although the WTO seems to provide an arena in which states meet on equal footing, the WTO is the subject of considerable concern. Most of these concerns orbit a single dispute: Do economically advanced, more powerful states dominate the WTO? We are skeptical that an international organization can escape the will of its most dominant members. Even if the structure of the WTO encourages equality among its members, the levers of power do not cease to operate in Geneva.
We are not the first scholars to contemplate such a possibility. Guzmán and Simmons (2005) posit one possibility they call the “power hypothesis.” They propose that weak states are deterred from filing against powerful states in the WTO by the fear of costly retaliation. They argue that because weak states do not appear to avoid filing against powerful defendants in the WTO, that there is no clear evidence that powerful states attempt to deter them from filing. However, they do not search for actual instances of retaliation. Instead, by using the selection of defendants by weak states (ie, against whom they file) as a proxy for retaliation, Guzmán and Simmons overlook the possibility that retaliation still takes place within the WTO, but that it does not effectively deter weak states from filing against stronger ones.

Davis and Bermeo (2009) confirm the idea that states retaliate against each other in the WTO. They find patterns of direct retaliation. Specifically, they find that states file retaliatory suits against one another in the WTO, constituting as many as 22% of all WTO filings. Their findings, taken in concert with Guzmán and Simmons’ (2005), demonstrate that some form of retaliation does indeed take place, even if it does not affect state behavior. (Davis and Bermeo 2009).

The possibility of retaliation without effective deterrence finds precedent in trade sanctions. Despite claims of their ineffectiveness, sanctions still exist as retaliatory mechanisms seeking to control state behavior. In sanctions, we see clearly that the relative ineffectiveness of a retaliatory technique does not necessarily rule out its use.

Returning to the WTO case, we consider one such potential means of retaliation – foreign aid – which recent scholarship has proven versatile in its political uses (Morgenthau 1962; Alesina and Dollar 2000; Kuziemko and Werker 2006; Lawrimore and Varghese 2014). We
imagine that states may use bilateral aid as a stick, punishing those states that file against them in the WTO by reducing bilateral commitments.

To investigate this possibility, we test whether the United States – for which the greatest number of WTO suits and foreign aid data are available – reduces foreign aid to those states that file against it. We compile an original dichotomous indicator using records from the WTO Dispute Settlement Gateway for country years in which states file or join suit against the United States. We draw data on US official development assistance (ODA), from the OECD database. Scrutinizing the relationship between the two variables using a variety of treatments, we actually find no significant evidence that one exists.

The results of our analysis suggest that the United States may be uninterested in using foreign aid as a political instrument in the WTO context. Alternatively, the US may not always consider losing WTO cases to be detrimental to its interest. WTO disputes may be part of a two level game in which the WTO functions as political cover for states accountable to special interests to relinquish protectionist policy (Allee and Huth 2006). In either case, our results fail to suggest that states apply external modes of power to influence WTO filings. This calls into question criticisms of the WTO based on such reasoning and suggests that even powerful states may respect the boundaries of multilateral mechanisms such as the Dispute Settlement Understanding.

The remainder of this paper proceeds as follows. First, we discuss our data and how we code WTO filings. Next, we discuss the methods by which we examine the relationship between our variables of interest. We then present the results of our analysis; and we position our results within the literature. Finally, we draw on our conclusions and their importance to suggest
avenues for potential additional research. It is within this concluding section that we consider how to theoretically accommodate this result.

2. Data

We rely upon two datasets for our data: one from the OECD and the other sourced from the WTO. The first dataset codes observations of foreign aid from OECD countries, several multilateral institutions, and a variety of other control indicators across most countries since 1960. In addition to this dataset, we code dichotomous indicator variables to correspond to suits filed against the United States in the WTO. We code indicators to represent the origination of a suit or joining of a suit, aggregating the two. We code instances of either suit as one and all other country-years we code as zero.

Our principle variables of interest are bilateral receipts of development assistance from the United States – our dependent variable – and whether a given country filed a suit against the United States, our independent variable. We drop instances where no foreign aid data from the United States is available. Our dataset then includes 5039 observations of our chief variables. Table 1 presents the descriptive statistics of these variables (as well as the descriptive statistics for other variables we use in our analysis).
### Table 1 – Variables of Interest

<table>
<thead>
<tr>
<th>Variable</th>
<th>Observations</th>
<th>Mean</th>
<th>Standard Deviation</th>
<th>Minimum</th>
<th>Maximum</th>
</tr>
</thead>
<tbody>
<tr>
<td>Development Assistance from the United States</td>
<td>5039</td>
<td>16.71325</td>
<td>2.641485</td>
<td>0</td>
<td>21.48686</td>
</tr>
<tr>
<td>Suit against the United States (three year lag)</td>
<td>4309</td>
<td>0.024368</td>
<td>0.154206</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>ln(imports)</td>
<td>1208</td>
<td>5.107114</td>
<td>2.216575</td>
<td>-2.20728</td>
<td>12.02256</td>
</tr>
<tr>
<td>ln(exports)</td>
<td>1161</td>
<td>4.616215</td>
<td>3.103992</td>
<td>-2.30259</td>
<td>12.80488</td>
</tr>
<tr>
<td>ln(total trade flow)</td>
<td>1204</td>
<td>5.806514</td>
<td>2.441775</td>
<td>-1.30933</td>
<td>13.09579</td>
</tr>
<tr>
<td>Pariah Indicator</td>
<td>5039</td>
<td>0.020441</td>
<td>0.141516</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>War</td>
<td>5039</td>
<td>0.067077</td>
<td>0.25018</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>ln(GDP per capita, real)</td>
<td>4805</td>
<td>7.782267</td>
<td>1.049182</td>
<td>4.821158</td>
<td>11.17807</td>
</tr>
<tr>
<td>Polity2 Score</td>
<td>4584</td>
<td>-0.37064</td>
<td>6.811275</td>
<td>-10</td>
<td>10</td>
</tr>
<tr>
<td>ln(U.S. Military Assistance, Constant 2011 Obligations)</td>
<td>5039</td>
<td>10.4889</td>
<td>6.996785</td>
<td>0</td>
<td>23.33687</td>
</tr>
</tbody>
</table>

### 3. Methodology

We begin by comparing US development assistance to those nations that file against the United States with US development assistance to those that do not. Figure 1 offers a comparison.
Mean US ODA to states in years that state has initiated no suit against the US is coded zero, and mean ODA to states in years where such a suit took place is coded one. The difference is stark, and bears out the fear that retaliation takes place. In fact, a basic regression seems to confirm this. US ODA is related negatively with our dichotomous indicator, to the 1% level of significance. Filing against the United States appears to be a bad move for aid recipients.

**Figure 1:** Mean ODA disbursements from the United States to countries in years in which they file against the US in the WTO versus years in which they do not

However, a variety of factors play into any apparent relationship. Among these is the small number of observed suits against the US by ODA recipients, which gives greater than usual weight to high regression leverage cases. We take several steps to resolve these concerns.
First we choose to normalize several variables.\textsuperscript{53} Figures 2 and 3 below demonstrate the original and normalized distributions of our aid data for the United States.

**Figure 2 – Unadjusted US Aid Data**

**Figure 3 – Normalized US Aid Data**

Figure 1 is a histogram plot of aid receipts from the United States, in millions of constant 2009 dollars. In figure 2, these data have been normalized through the application of a natural logarithm, which is what we use as our response variable.

Our choices to scale certain variables and introduce new controls influence our results. Moreover, when we normalize the ODA data, we eliminate any apparent relationship between our indicator of WTO litigation against the United States and ODA receipts from the United States. This ought to both inform our choices to normalize most skewed data, such as population and real GDP per capita, and explain the importance of the effect these choices will have on our results.

We believe that foreign aid may be used as a retaliatory mechanism, and yet neither WTO disputes nor foreign aid policy are adjudicated immediately. Retaliation, then, may not be

\textsuperscript{53} Initially, the distribution of our response variable – development assistance from the United States – demonstrates itself as problematic. The minimum lies within one standard deviation of the mean, while the maximum value lays almost thirty deviations above the mean. To normalize this distribution and negate potential regression leverage of extreme cases, we take the natural log of development assistance as our response variable instead of raw data.
contemporary with cause. We thus consider the possibility that retaliation will require years to materialize. In our regression analysis we employ various lag structures (from zero to seven years). We also consider the possibility that conference request dates do not accurately reflect the beginning of a dispute. These dates, which mark a request to initiate formal WTO proceedings, reflect neither the beginning of the actual trade dispute, nor the completion of the WTO dispute settlement procedure. Certain trade disputes may precede conference requests by years, and policymakers may attempt to reduce aid even before formal proceedings to signal the credibility of a threat. Therefore, we also consider versions of our causal variable that lead for up to seven years.

As control variables we include: pariah status, the presence of war (greater than 1000 deaths), real GDP per capita (natural logged) polity2 data, and US military assistance in constant 2011 dollars (natural logged). We also add imports, exports, and total trade flow with the United States (each natural logged). We control for pariah status because pariah states (which we treat as states under US or UN sanction, following Morgan, Krustev and Bapat (2006); Combs (2012); and Levy (1999)), such as Iran, often receive dramatically curtailed aid disbursements. Additionally, we control for the presence of war, which tends to diminish development aid disbursements, sourcing our method from Themnér and Wallensteen (2012). We also control for GDP per capita, which affects ODA disbursements in a recipient need model, taking data from Heston et. al (2012). To control for regime type, we use polity2 data (Marshall et. al. 2002), recognizing a preference for democracy by certain donors. We control for US military assistance, as a possible measure of security importance (USAID 2011). Finally, we control for trade flows with the United States (imports, exports, and total bilateral trade) on the suspicion that the United States will reward economic allies with foreign aid or that foreign aid recipients will respond by
buying American goods and services. We source this data from Barbieri and Keshk (2012) and Barbieri et. al (2009)

In addition to specific control variables, we employ country fixed-effects in our analysis. By doing this, we combat the issue of endogeneity by taking into account any unobserved heterogeneity across countries.

4. Results

Our analysis fails to suggest that filing a suit against the United States, or being a third party to one, has a statistically significant effect upon the foreign aid that a country receives from the United States. Once we normalize our ODA data, this non-finding remains consistent across a variety of treatments, including country fixed-effects. We summarize these findings in Table 3

While we tested for both delays and leads in our independent variable—seven years in each direction—we have chosen to present the three-year lag: the most nearly significant results of the various lags and leads that we examined. Despite representing the closest we come to significant results, our independent variable fails to achieve statistical significance in every of our four models and regardless of controls, implying a non-finding consistent across rigorous modes of analysis.

In our first model, we test our baseline specification without country fixed-effects and find no significant correlation between our independent and dependent variables. Regarding our control variables, we see that imports, real GDP per capita, pariah status, and US military assistance are the only statistically significant controls. These results remain largely in line with our expectations, as pariah status and a higher real GDP per capita would sensibly lead to a
decrease in bilateral assistance from the US, while receiving US military assistance and strong trade relations, represented by imports, would logically lead to an increase in aid.

In the second model, we drop each of our insignificant control variables, but this does not improve the significance of the WTO variable. The only notable result here is that the pariah indicator control loses its significance once we drop the insignificant controls from the first model. While this might suggest an oddity in the data, the small number of pariah states more likely means that there exists some phenomena related to a few pariah states, not any larger trend in the data.

In our third model, we employ country fixed-effects and find that as a result, not only does significance continue to elude our independent variable, but nearly all of our controls as well, save for real GDP per capita.

In model 4, we retain country fixed-effects and drop control variables that are not statistically significant, keeping only real GDP per capita. In this final model, our independent variable, filing against the US in the WTO, again proves to be an insignificant factor in determining US bilateral aid. Our independent variable of interest remains statistically insignificant across each of our models. Accordingly, we decline to conclude that the US uses its foreign aid as either a stick or a carrot to react to those who file against it in the WTO.
### Table 3 – Effect of WTO Filing on US Foreign Aid Receipts

<table>
<thead>
<tr>
<th>Variable</th>
<th>Model 1 Baseline Specification, no fixed effects</th>
<th>Model 2 Insignificant controls excluded, no fixed effects</th>
<th>Model 3 Baseline with fixed effects</th>
<th>Model 4 Baseline with fixed effects, insignificant effects excluded</th>
</tr>
</thead>
<tbody>
<tr>
<td>Suit against the United States (lagged three years)</td>
<td>-0.06 (0.2)</td>
<td>0.01 (0.04)</td>
<td>0.25 (1.21)</td>
<td>0.36 (0.91)</td>
</tr>
<tr>
<td>ln(imports)</td>
<td>0.51*** (3.36)</td>
<td>0.35*** (4.77)</td>
<td>0.22 (0.9)</td>
<td></td>
</tr>
<tr>
<td>ln,exports</td>
<td>0.01 (0.14)</td>
<td></td>
<td>0.06 (0.6)</td>
<td></td>
</tr>
<tr>
<td>ln(total trade flow)</td>
<td>-0.14 (-0.71)</td>
<td></td>
<td>0.11 (0.41)</td>
<td></td>
</tr>
<tr>
<td>Pariah Indicator</td>
<td>-1.78*** (-3.84)</td>
<td>-0.7 (-1.56)</td>
<td>-1.05* (-1.72)</td>
<td></td>
</tr>
<tr>
<td>War</td>
<td>-0.07 (-0.31)</td>
<td></td>
<td>-0.14 (-0.65)</td>
<td></td>
</tr>
<tr>
<td>ln(GDP per capita, real)</td>
<td>-1.06*** (-5.88)</td>
<td>-1.25*** (-6.19)</td>
<td>-1.26* (-1.84)</td>
<td>-0.63** (-2.59)</td>
</tr>
<tr>
<td>Polity2 score</td>
<td>0 (0.23)</td>
<td></td>
<td>0.01 (0.69)</td>
<td></td>
</tr>
<tr>
<td>ln(U.S. Military Assistance, Constant 2011 Obligations)</td>
<td>0.05*** (3.93)</td>
<td>0.05*** (3.93)</td>
<td>0.02 (0.81)</td>
<td></td>
</tr>
<tr>
<td>Number of observations</td>
<td>1064</td>
<td>1143</td>
<td>1049</td>
<td>4030</td>
</tr>
<tr>
<td>R-squared</td>
<td>0.17</td>
<td></td>
<td>0.08</td>
<td></td>
</tr>
</tbody>
</table>

Table 3: Note that * denotes significance at the $|P|<.1$ level; **denotes significance at the $|P|<.05$ level; *** denotes significance at the $|P|<.01$ level. We include $t$-values in parentheses.

### 5. Conclusions

We can point to no significant evidence that the United States retaliates against those states that file against it in the WTO by reducing foreign assistance. While this cannot disprove the possibility that such retaliation occurs, it ought to lead any scholar who would so suppose to question their conviction, particularly in light of Guzman and Simmons’ inability to find evidence of the presumptive deterrent effect of such retaliation.
We should, however, seriously consider the possibility that we have too little data. Many control variables that we would expect to be statistically significant lose their significance in our own regressions, suggesting that even some accepted trends could not be supported through the analysis of our data. In fact, only real GDP per capita proves robust to all of our statistical treatments. And yet a relationship between filing in the WTO and US development assistance proves especially difficult to tease out of the data. Across fifteen distinct time treatments, in which we lag and lead our independent variable up to seven years in each direction, and in every treatment in which we normalize our variables none produces a significant result, regardless of whether we introduce fixed effects or eliminate or include insignificant control variables. In other words, our results do not provide us any confidence that a larger data set or set of controls would produce a finding.

Why, however, would a state not use foreign aid to punish states for WTO filings? A number of possibilities exist, many of which offer directions for further research. The first is that the United States and other powers seek to lose certain cases in the WTO. Allee and Huth (2006) write that international dispute settlement mechanisms may provide an opportunity for governments to legitimize declining to support the interests of particular sectors, in this case businesses enjoying protectionist policy. A government that could not end a protectionist policy unilaterally without suffering the cost of lost support from an interest group may welcome the opportunity to play a two-level game in the WTO, potentially resolving the problem of dispersed incentives on protection issues by saving face to organized interests. This does not mean that there are not cases the United States wants to win in the WTO. In fact, forms of intramural retaliation, particularly the filing of retaliatory suits, provide evidence that the United States may seek to punish states in response to certain suits (Davis and Bermeo, 2009). Perhaps foreign aid
retaliation does take place among suits the United States seeks to win. Identifying these suits and running that analysis would make a worthwhile addition to our own investigation.

Second, foreign aid may simply not function as ubiquitously as a political instrument as the power hypothesis initially lets on. Although states bring a variety of policy instruments to bear on the most pressing issues – often those with a relationship to security and the most obvious exercises of power – states may not be interested in or capable of pursuing every objective at once. As much as a lobbyist in the Chamber of Commerce, an attorney in the office of the Trade Representative, and a member of the administration allocating foreign aid might collectively possess the impetus and instrument ascribed to the unitary state, there is no clear reason for the three of them to sit down together and plan their policy response. The linkage between impetus and action is really quite tenuous.

But even if the United States does possess the capacity to wield its foreign aid in a politically motivated way, it may lack the desire. Undermining the WTO’s legitimacy might prevent the United States from realizing the WTO’s potential as a liberalizing instrument. However, by keeping its retaliatory strikes within the confines of the WTO, possibly in the form of counter-filing, the United States preserves member states’ trust in the WTO as a legitimate institution for liberalizing trade and resolving trade disputes. If the United States were to engage in such controlling behavior over disputes, the WTO may lose member states’ trust, vitiating functionality the United States values.

Given that freer trade has been a high-priority foreign policy goal of the United States for decades, there exists little incentive for the United States to pursue such a course and undermine the remarkable cooperation and strong reputation the WTO has achieved. The gains from manipulating other states filing patterns by using what some states might consider to be “unfair”
extra-institutional tactics are likely much smaller than those from the organization’s primary role as a catalyst for trade liberalization. Thus, the United States has a strong stake in maintaining the WTO’s legitimacy and refraining from using foreign aid to punish those states that file or join trade disputes against it.

This would appear to be good news for the WTO. By joining Guzman and Simmons (2005) in finding no significant evidence that great powers muscle out weaker ones in the WTO, we align ourselves with those scholars who suggest that the WTO may provide a reasonably level institutional playing field for disputes among member states. If further developments in the literature bear out our results, we may find the WTO to provide a compelling counterexample to the paradigm that international institutions inevitably succumb to the politics of power.

References


1. Introduction

Attracting foreign direct investment (FDI) is a critical goal in the growth and sustainability of a healthy economy. Nations in pursuit of development can fuel their growth in part by encouraging a steady flow of outside capital; this can prove particularly important for nations in which domestic savings and investment capital are scarce. The availability of capital, the structural ability to direct such capital, and economic risk factors are common forces which affect the amount of FDI received by a country. FDI represents a fixed investment, so foreign investors incur special risks when making this kind of commitment. These investments are typically illiquid and generate payoffs only with a long-term time horizon. In this setting, transparency regarding the state of the economy takes on greater importance.

One particular challenge to the exploration of the relationship between transparency and FDI is measuring transparency precisely. Broadly understood, economic transparency refers to the public availability of accurate aggregate economic data. Even this broad understanding is bound by a number of conditions that require clarification and nuance, particularly regarding the access to and quality of such data. Our study utilizes the HRV Index of transparency, developed by Hollyer, Rosendorff, and Vreeland (Hollyer, Rosendorff, and Vreeland 2013), because it takes a multifaceted approach to understanding transparency. By evaluating the provision of macroeconomic data and controlling for the fixed differences in data provision, the measure treats both inclusion and omission of such data as indicative of the overall transparency of the
country. This index is therefore both inclusive of a wide range of data and tailored in its relevancy to the countries it aims to quantify.\textsuperscript{54}

We contend that as a nation’s transparency increases, the amount of FDI received will also increase. Governments that accurately collect and effectively disseminate aggregate economic data are more likely to see greater inflows of FDI.

Our study differs from the previous literature in both quantitative and substantive ways. By incorporating countries of diverse geography, economy, and political identity, and examining these countries over three decades, our study takes a more comprehensive approach to evaluating the relationship between transparency and FDI. The utilization of the HRV Index serves as a more objective measure for the purpose of accurately capturing transparency in practice. Our analysis takes a broader scope than previous studies, which are limited by data provision, and tests the relationship between transparency and FDI for 125 nations between the years 1980-2010. Our findings confirm our hypothesis: we find a positive relationship between transparency and FDI that is statistically significant at the 99 percent confidence level. Ultimately, this study aims to show that increasing transparency does in fact cause greater amounts of FDI.

Our study proceeds as follows: in Section 2, we explore the existing literature on transparency and FDI, noting its strengths and shortcomings. Next, in Section 3, we elaborate on the theoretical underpinning of our study to explain why the value of FDI increases with greater transparency. Section 4 and Section 5 respectively describe our independent and dependent variables and our methodological approach to analyzing the data. Our results are presented in Section 6. We conclude in Section 7 by discussing the implications of our findings, as well as areas for potential future research.

\textsuperscript{54} See Section 4 for a detailed explanation of the HRV Index.
2. Existing Measures of Transparency

The research in the field of transparency and its effect on economic factors often evaluates transparency alongside corruption and democracy—factors which impede the isolation of the effect of aggregate data dissemination specifically. Furthermore, the studies analyze a limited set of countries and years, which narrows the scope of their analysis and its broader significance. Our investigation addresses conceptual discrepancies and dataset limitations in these studies in order to make the relationship observed between transparency and FDI clear. Despite these differences, we draw from existing studies to form our baseline specifications.

Transparency is often measured in relation to business practices or government corruption. This association, though theoretically defensible, conflates the identity of transparency with other institutional and political factors. The inclusion of these factors makes the measurement of this broader definition of transparency more difficult. This in turn makes the link between transparency and FDI less clear. Zhao, Kim, and Du (2003), for example, study the relationship between corruption and FDI. Though their analysis operates on similar causal grounds as our own assertions, their study’s primary focus is not on transparency as understood as the provision of aggregate economic data, but rather on a broader characterization of a nation as “corrupt” in business practices. They evaluate corruption by ranking countries based on the competitiveness of businesses domestically and abroad. This study is hindered in its reliability by the highly subjective nature of its independent variable.

Jensen’s work on regime type and FDI inflows (2003) evaluates whether or not democracy has a significant effect on economic variables, including FDI. His findings indicate that regime type, measured using the Polity III Project dataset, influences the amount of FDI received by a country, finding specifically that more democratic governments tend to attract
more foreign investment. Jensen’s multi-angled approach to testing the relationship includes controls for regime type, trade level, and market size as possible influential factors. His study, like that of Zhao, Kim, and Du (2003), does not objectively define transparency, but rather considers it indirectly through democratic governance. Our study accounts for the close relationship between democracy and transparency by controlling for the former.

The existing measures of transparency are flawed by their subjectivity. While these variables purport to provide a quantifiable insight into transparency, they fail to do so without introducing bias. One such variable is the Freedom House ranking of press freedom (Freedom House 2013), which is an annually-published measure of how free a nation’s press is. This measure is generated by a group of experts from Freedom House and is based on their qualitative, subjective analysis of “country narratives”. These narratives include political regime, media, and other social factors. The measure is flawed since its only quantitative facet is a trichotomous label of “Free”, “Partly Free”, or “Not Free”. Additionally, it does not examine the availability of aggregate economic data.

The Heritage Foundation creates an Index of Economic Freedom, which is a wide-ranging unit that aims to capture everything from individual economic freedoms to property rights and government corruption (Heritage Foundation 2014). Again, this is compiled by experts at the Heritage Foundation in a largely subjective process. As a result, the scope of the index confounds the variable of transparency with the other variables it examines. Even indices that focus directly on the quantitative effect of public sector corruption in business, such as the Transparency International Corruption Index (Transparency International 2013), are based on subjective expert opinion. The Index measures the perceived level of public sector corruption on a scale from 0 (most corrupt) to 100 (least corrupt), accounting for bribery, scandals, and overall
reputation of businesses. In short, measures such as the Freedom House rankings, the Heritage Foundation Index, and the Transparency International Index may properly examine the quality of economic data provided, but do not fully consider the dissemination of that data or its objective provision by individual governments.

In contrast, other studies utilize more objective quantitative measures such as newspaper circulation (Adserá, Boix, and Payne 2005). This measure aims to capture not the substantive quality of information provided, but rather its dissemination. While this does consider the reach of data, which is not addressed by Freedom House, the Heritage Foundation, and Transparency International, it lacks qualitative substance. Newspapers, for example, could be provided en masse by the government, but may contain inaccurate information. There exists, then, a dilemma between finding a transparency measure which is both objective and accurately captures the data provision of an entire country.

Our study utilizes the HRV Index in order to reconcile the disparity between the quality and dissemination of aggregate economic data. The HRV Index, as stated before, looks at the credibility and provision of data from countries to the World Bank’s WDI database, and therefore is both objective and pertinent to our study.

Furthermore, while the studies performed by other scholars in the field (Drabek and Payne 2002; Seyoum and Manyak 2009; Gelos and Wei 2002) may be similar to our own in vision and theory, they tend to be limited to a narrow timespan of approximately three years and about 20-50 countries. By limiting the scope of investigation, these studies may miss patterns that are only evident over longer periods of time, an important consideration when managing investment. A study with so few countries either runs the risk of focusing too narrowly on a certain subset (i.e. developing nations, as in Seyoum and Manyak 2009) and thereby missing the
experience of different subsets, or not thoroughly investigating each subset to make credible
claims (i.e. only looking at a small number of countries in Africa, as in Drabek and Payne 2002).
Our dataset, which contains 125 countries over 30 years, addresses the selection bias found in
these studies in order to offer a more comprehensive analysis. This, in turn, informs our
theoretical underpinning of the relationship between transparency and FDI.

3. Why Transparency Matters for FDI

Investors have a long-run stake in an economy when they undertake FDI. At lower levels
of transparency, where the provision of aggregate economic data by governments is low, we
expect to see less interest by foreign companies to entrust these nations’ economies with their
investments. By contrast, countries that provide more credible information about their
economies can attract more foreign investment. The logic for the relationship we propose is
threefold. Greater transparency is advantageous because it 1) reduces detrimental fixed costs
associated with opaque regimes, 2) decreases a company’s risk by facilitating the accurate
prediction of returns, and 3) better facilitates a company’s ability to manage the investment
through knowledge of macroeconomic policy.

First, increased transparency is linked with lower costs for companies with foreign
investment endeavors (Zhao, Kim and Du 2003). It is not the nature of the data itself that is as
influential in the explanation of this factor, but rather whether aggregate economic data is
provided at all: countries which provide less data tend to do so because of inefficient or
ineffective bureaucracies. This increases the transactions costs of doing business in that country
by adding potential hidden costs such as slow licensing procedures, unpredictable or unclear
changes in regulations on investments, and even bribes in order to accomplish regular business
functions. It is in the best interest, therefore, of companies seeking to direct their investment
capital to do so in transparent regimes, and thereby avoid the associated structural costs of
opaque economic data provision.

Since FDI comes from companies that seek to establish direct business investments in a
country, it is more than merely buying stock in a foreign company. FDI is the wholesale
establishment of business in a country—be it the building of factories, the opening of offices or
vendors, or the joint ownership of domestic companies. As such, these companies seek, as with
any investment, a degree of certainty in the security of their investment, particularly as FDI has a
longer return horizon. If a country provides aggregate economic data, which includes the
performance of the market as a whole, a company can more accurately predict the value of risk
costs for that investment, which translates in turn to their ability to anticipate returns. While
there would still be the normal risk associated with any business investment, transparency
reduces the additional risk of an unclear economic profile in a country.

Lastly, transparency provides the added benefit of characterizing an economy’s
performance over time. This includes the actions of central banks, fiscal actors, and other
macroeconomic forces and their summative effects on companies in that country. Monetary
policy actions, which cause changes in real interest rates, have a very direct effect on investor
decisions, and companies seeking to invest in foreign countries would benefit from knowledge of
such macroeconomic policy. Additionally, information about how a certain country reacts to
economic fluctuations and crises can provide illustrative insights into how investments in that
country are affected. The provision of aggregate data would therefore help companies more
accurately predict the stability of their investments in light of the business cycle.
In short, we contend that transparency has a substantial effect on increasing FDI because it makes investment less costly, more predictable, and more secure. These costs are progressively lower as transparency increases, and it is this fundamental causal mechanism which leads us to expect greater FDI with increasing transparency. In the next section, we describe how our measure of transparency demonstrates the benefit that aggregate data provision has on FDI.

4. Descriptive Data

We test the relationship between transparency and FDI using the HRV Index for our independent variable and the net inflows of FDI in millions of 2005 constant United States dollars (USD) for our dependent variable. These variables are defined in detail herein, as well as analyzed for their accuracy and precision in measuring our desired phenomenon.
Independent Variable

We use the HRV Index as our measure of transparency because it objectively measures the dissemination of credible aggregate economic information. The HRV Index is a continuous variable scaled from -10 to 10, with -10 being least transparent and 10 being most transparent. In this index, a country’s transparency is treated as a term that predicts the provision or omission of data using a Bayesian item response theory model. The creators of this Index select 240 economic indicators which aim to capture the transparency of the countries evaluated. These indicators come from the World Bank’s World Development Indicators (WDI), a wider set of 1,265 variables which detail a wide range of data across a variety of topics. The HRV Index pares down the dataset by dropping variables that are not measured in the time frame of the study, which are 1980-2010.

Furthermore, HRV drop data that is irrelevant to certain countries (such as development assistance incomes for non-aid-receiving nations); data that is produced by outside agencies and not directly provided by individual governments; data that is a subset of a larger indicator (such as male labor force participation rate vs. total labor force participation rate); and data that reports the same variable in different units (such as measuring GDP in current USD, current local currency units, constant USD, etc.). The number of countries evaluated by HRV is limited to 125 because all microstates and all countries that did not exist, or which were unified from separate countries, between 1980-2010 are dropped. This leaves, in total, a dataset of 3,875 observations for the 125 countries over 31 years.
For our dependent variable, we focus our examination on the net inflow of FDI into a country. FDI is the value of direct investments in production or businesses in a foreign country, and we measure FDI in net inflows of millions of constant USD (World Bank 2013). We choose this measure as our dependent variable because among economic variables, we believe it to be the easiest to isolate from other influential factors; other possible variables such as foreign aid are affected by a wide array of economic, political, and social influences (Lawrimore and Varghese 2014, Sielaff and Skillman 2014, Gadea and Gopalkrishnan 2014).

**Figure 1a:** This shows a histogram of the dependent variable, foreign direct investment (net inflows) without taking the natural log

**Figure 1b:** This shows the more normally-distributed natural log of foreign direct investment
Descriptive Statistics

Table 1a. Descriptive Statistics for Transparency (HRV Index)

<table>
<thead>
<tr>
<th>Transparency (HRV Index)</th>
<th>Observation</th>
<th>Mean</th>
<th>Standard Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transparency (all values)</td>
<td>3875</td>
<td>1.178</td>
<td>2.300</td>
</tr>
<tr>
<td>HRV Index [-10-0]</td>
<td>1482</td>
<td>-0.887</td>
<td>1.137</td>
</tr>
<tr>
<td>HRV Index (0-10]</td>
<td>2393</td>
<td>2.456</td>
<td>1.868</td>
</tr>
</tbody>
</table>

Table 1b. Descriptive Statistics for Foreign Direct Investment (net inflows, BOP)

<table>
<thead>
<tr>
<th>Foreign Direct Investment</th>
<th>Observations</th>
<th>Mean</th>
<th>Standard Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>All Values</td>
<td>3659</td>
<td>4953.794</td>
<td>20380.97</td>
</tr>
<tr>
<td>HRV Index [-10-0]</td>
<td>1285</td>
<td>444.958</td>
<td>2237.616</td>
</tr>
<tr>
<td>HRV Index (0-10]</td>
<td>2374</td>
<td>7394.339</td>
<td>24912.68</td>
</tr>
</tbody>
</table>

The descriptive statistics of our dataset, at first glance, support the hypothesis that FDI and transparency are indeed related. Tables 1a and 1b provide the statistics of our independent and dependent variables. We find that for countries with an HRV Index value of less than or equal to 0, the mean values of FDI are lower than those greater than 0. Values less than or equal to 0 have an average FDI of about $4.9 billion, while those greater than zero have an average of almost $7.4 billion of FDI.

It seems that there is a positive relationship between the level of transparency and the amount of FDI a country receives. This is shown in Figure 2, which presents a graph of the relationship between transparency and foreign direct investment (natural log of net inflows, BOP). However, the understanding gained from looking at only the descriptive statistics and
graph leaves out numerous other important considerations, and ultimately may provide an erroneous analysis of the data. Due to the problem of multicollinearity, multiple factors may be driving the relationship between the level of transparency and FDI. It may also be the case that a limited set of countries is responsible for the relationship observed. In our Methodology section (Section 5) we describe a more sophisticated analysis, utilizing controls for the possible mitigating factors and country-specific conditions, which allows us to assert with greater confidence that there is a statistically significant relationship between transparency and FDI.

**Figure 2**: This graph demonstrates the relationship between transparency and FDI (net inflows).
5. Methodology

Our study uses an ordinary least squares (OLS) regression to examine the relationship between transparency and FDI. We control for a set of relevant factors discussed below. Additionally, all of our models control for country fixed effects and year fixed effects in order to address any unobserved heterogeneity across countries or over time.

The control variables are drawn from relevant literature. Some studies argue that the amount of FDI that a country receives is impacted by the size of its economy (Drabek and Payne 2001; Zurawicki 2003; Seyoum and Manyak 2009; Jensen 2003). We thus control for the natural log of GDP. We also control for the natural log of GDP per capita and GDP growth rate (Lim 1983). Jensen (2003) further suggests controlling for export growth rate and trade, and argues that it is important to control for natural resource dependency when looking at FDI inflows to account for the correlation between FDI and natural resource wealth (2008). We control for these variables accordingly in our models.

Controls for democracy and natural resource dependency, measured by total natural resource rents as a percentage of GDP, are used to account for the possibility that the political regime of a country influences its prospective investments. Some studies (Jensen 2003; 2005; 2008) discuss the relationship between democracy and lower levels of risk, suggesting that this increases the amount of FDI that a country receives. Russett and Oneal (2001: Chapter 6) argue that democracies are more likely to trade with other democracies. By controlling for level of democracy, we also control for political corruption, which is often associated with certain

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55 Kim, Zhao, and Du (2003) use the export growth rate to quantify trade relations, measuring how a country’s external trade could affect its foreign direct investment inflows. Jensen uses a trade variable of exports plus imports divided by GDP to measure overall trade interactions with foreign countries, with respect to the size of the country’s economy. We utilize both measures and find that after controlling for other factors, neither trade variable is statistically significant.
political regime types (Lederman, Loayza, and Soares 2005). We use Polity IV’s Polity2 data as our measure of democracy, where democracy is measured on a 0-20 scale with 0 representing a low democracy level and 20 representing a high democracy level (Polity IV 2014). In Model 2, level of democracy is statistically significant, but it does not remain statistically significant as further controls are introduced.

Finally, we control for other economic factors that might affect investment in a country. These controls include real interest rate (in percentage), exchange rate (in average LCU per USD for a given period of time), and inflation in consumer prices, in annual percent. We base these controls on studies done by Drabek and Payne (2001) and Zhao, Kim, and Du (2003) that look at the relationship between transparency and FDI. Additionally, Seyoum and Manyak (2009) use CPI to control for the impact inflation would have on FDI. All three economic variables do not remain statistically significant or impact the relationship between transparency and FDI.

We recognize the potential endogeneity in the relationship between FDI and transparency in that there may be other omitted variables or reverse causality. It is possible that there are other factors driving the relationship, or that FDI causes an increase in transparency. However, we address this by controlling for a wide range of factors that may influence the relationship. Our findings are robust, as the relationship remains statistically significant after applying a number of controls. Furthermore, after controlling for country fixed effects and year fixed effects, our results remain significant at the 99 percent confidence level, leading us to conclude that there is a relationship between FDI and transparency and that our results are not driven by the unique conditions of particular countries or any other influential factors. In future

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56 Consumer price index (CPI) is utilized as the measure of inflation in our study because the GDP deflator only accounts for domestically produced goods and excludes price changes in imports.
studies, we plan to use other methods such as an instrumental variable approach and the differences in differences method to address endogeneity. This is discussed further in the Conclusion section (Section 7).

6. Results

Our results are summarized in Table 2 (see below). In Table 2, transparency and the natural log of FDI are the primary independent and dependent variables. Model 1 on Table 2 presents an OLS regression of transparency and the natural log of FDI. Controls for variables that are expected to affect net inflows of FDI are then added in Model 2. These controls include GDP (taken as a natural log), GDP growth (annual % growth), a trade variable that measures imports and exports as a percentage of total GDP (Jensen 2003), and democracy (measured with Polity2).

Model 3 utilizes the same controls as Model 2, but adds additional controls for GDP per capita (taken as a natural log), exports (annual % growth), real interest rate, exchange rate, inflation (CPI, annual %), and natural resource dependency (resource rents as a % of GDP). Finally, in Model 4 the statistically insignificant controls are dropped, leaving the controls of GDP, GDP growth, GDP per capita, exchange rate, and natural resource dependency.

As shown by the first row of Table 2, our results demonstrate that there is a statistically significant correlation between transparency and FDI. Even after controlling for the wide variety of factors, our results remain statistically significant at the 99% confidence level.

57 In our appendix, we include Table 4, a comprehensive table of the bivariate regression between the independent variable (transparency, HRV index) and depending variable (natural log FDI, net inflows), including all the controls that were used.
<table>
<thead>
<tr>
<th>Variable Name</th>
<th>(Model 1)</th>
<th>(Model 2)</th>
<th>(Model 3)</th>
<th>(Model 4)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transparency</td>
<td>0.246***</td>
<td>0.099***</td>
<td>0.164***</td>
<td>0.191***</td>
</tr>
<tr>
<td></td>
<td>(0.025)</td>
<td>(0.027)</td>
<td>(0.032)</td>
<td>(0.027)</td>
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<tr>
<td>Lagged FDI</td>
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<td>0.000</td>
<td>0.000</td>
<td>0.000</td>
</tr>
<tr>
<td>GDP (natural log)</td>
<td>1.090***</td>
<td>1.001**</td>
<td>1.401***</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.146)</td>
<td>(0.392)</td>
<td>(0.129)</td>
<td></td>
</tr>
<tr>
<td>GDP Growth (annual % growth)</td>
<td>0.036***</td>
<td>0.024***</td>
<td>0.023***</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.005)</td>
<td>(0.006)</td>
<td>(0.004)</td>
<td></td>
</tr>
<tr>
<td>Trade Variable (imports+exports/GDP)</td>
<td>0.109</td>
<td>0.038</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.070)</td>
<td>(0.077)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Democracy (Polity2)</td>
<td>0.015**</td>
<td>-0.009</td>
<td></td>
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<tr>
<td></td>
<td>(0.007)</td>
<td>(0.009)</td>
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<td></td>
</tr>
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<td>GDP/capita (natural log)</td>
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<td></td>
<td>0.162</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>(0.377)</td>
<td></td>
</tr>
<tr>
<td>Exports (annual % growth)</td>
<td></td>
<td></td>
<td>0.000</td>
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</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>(0.001)</td>
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</tr>
<tr>
<td>Real Interest Rate</td>
<td></td>
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<td>0.002</td>
<td></td>
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<tr>
<td></td>
<td></td>
<td></td>
<td>(0.002)</td>
<td></td>
</tr>
<tr>
<td>Exchange Rate</td>
<td>-0.000**</td>
<td>0.000</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.000)</td>
<td>(0.000)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inflation, consumer prices (annual %)</td>
<td>-0.000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.000)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Natural Resource Dependency (resource rents as % GDP)</td>
<td></td>
<td></td>
<td>0.013**</td>
<td>0.013***</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>(0.006)</td>
<td>(0.003)</td>
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<tr>
<td>Year Fixed Effects</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Country Fixed Effects</td>
<td>Yes</td>
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<td>Yes</td>
<td>Yes</td>
</tr>
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<td></td>
<td>(0.132)</td>
<td>(3.492)</td>
<td>(7.206)</td>
<td>(3.049)</td>
</tr>
<tr>
<td>Number of observations</td>
<td>3360</td>
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<td>1895</td>
<td>3076</td>
</tr>
<tr>
<td>Adj. R-squared</td>
<td>0.39</td>
<td>0.43</td>
<td>0.41</td>
<td>0.40</td>
</tr>
</tbody>
</table>

Notes: Standard errors in parentheses.
*** indicates significance at the one percent level, ** at the five percent level, and * at the ten percent level.
<table>
<thead>
<tr>
<th>Variable</th>
<th>(Model 1)</th>
<th>(Model 2)</th>
<th>(Model 3)</th>
<th>(Model 4)</th>
<th>(Model 5)</th>
<th>(Model 6)</th>
<th>(Model 7)</th>
<th>(Model 8)</th>
<th>(Model 9)</th>
<th>(Model 10)</th>
<th>(Model 11)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transparency</td>
<td>0.578***</td>
<td>0.209***</td>
<td>0.198***</td>
<td>0.182***</td>
<td>0.188***</td>
<td>0.188***</td>
<td>0.198***</td>
<td>0.186***</td>
<td>0.182***</td>
<td>0.180***</td>
<td>0.186***</td>
</tr>
<tr>
<td>GDP (natural log)</td>
<td>2.498***</td>
<td>3.020***</td>
<td>2.946***</td>
<td>3.067***</td>
<td>3.173***</td>
<td>2.734***</td>
<td>2.810***</td>
<td>2.651***</td>
<td>2.725***</td>
<td>2.650***</td>
<td>2.660***</td>
</tr>
<tr>
<td>GDP/capita (natural log)</td>
<td>-0.943***</td>
<td>-0.885***</td>
<td>-1.154***</td>
<td>-1.335***</td>
<td>-0.749***</td>
<td>-0.849***</td>
<td>-0.619**</td>
<td>-0.686**</td>
<td>-0.626**</td>
<td>-0.626**</td>
<td>-0.626**</td>
</tr>
<tr>
<td>GDP Growth (annual % growth)</td>
<td>0.027***</td>
<td>0.035***</td>
<td>0.038***</td>
<td>0.028***</td>
<td>0.030***</td>
<td>0.030***</td>
<td>0.027***</td>
<td>0.027***</td>
<td>0.027***</td>
<td>0.027***</td>
<td>0.027***</td>
</tr>
<tr>
<td>Exports (annual % growth)</td>
<td>0.002***</td>
<td>0.002***</td>
<td>0.001***</td>
<td>0.001***</td>
<td>0.001***</td>
<td>0.001***</td>
<td>0.001***</td>
<td>0.001***</td>
<td>0.001***</td>
<td>0.001***</td>
<td>0.001***</td>
</tr>
<tr>
<td>Trade Variable (imports+exports/GDP)</td>
<td>0.159**</td>
<td>0.124**</td>
<td>0.131*</td>
<td>0.092**</td>
<td>0.094**</td>
<td>0.094**</td>
<td>0.094**</td>
<td>0.094**</td>
<td>0.094**</td>
<td>0.094**</td>
<td>0.094**</td>
</tr>
<tr>
<td>Real Interest Rate</td>
<td>0.003*</td>
<td>0.003**</td>
<td>0.001**</td>
<td>0.001**</td>
<td>0.003**</td>
<td>0.003**</td>
<td>0.003**</td>
<td>0.003**</td>
<td>0.003**</td>
<td>0.003**</td>
<td>0.003**</td>
</tr>
<tr>
<td>Exchange Rate</td>
<td>-0.000*</td>
<td>-0.000**</td>
<td>-0.000**</td>
<td>-0.000**</td>
<td>-0.000**</td>
<td>-0.000**</td>
<td>-0.000**</td>
<td>-0.000**</td>
<td>-0.000**</td>
<td>-0.000**</td>
<td>-0.000**</td>
</tr>
<tr>
<td>Inflation, consumer prices (annual %)</td>
<td>-0.000*</td>
<td>-0.000**</td>
<td>-0.000**</td>
<td>-0.000**</td>
<td>-0.000**</td>
<td>-0.000**</td>
<td>-0.000**</td>
<td>-0.000**</td>
<td>-0.000**</td>
<td>-0.000**</td>
<td>-0.000**</td>
</tr>
<tr>
<td>Democracy (Polity)</td>
<td>-0.012</td>
<td>-0.011</td>
<td>-0.000</td>
<td>-0.000</td>
<td>-0.000</td>
<td>-0.000</td>
<td>-0.000</td>
<td>-0.000</td>
<td>-0.000</td>
<td>-0.000</td>
<td>-0.000</td>
</tr>
<tr>
<td>Natural Resource Dependency (resource rents as % GDP)</td>
<td>0.018***</td>
<td>0.018***</td>
<td>0.018***</td>
<td>0.018***</td>
<td>0.018***</td>
<td>0.018***</td>
<td>0.018***</td>
<td>0.018***</td>
<td>0.018***</td>
<td>0.018***</td>
<td>0.018***</td>
</tr>
</tbody>
</table>

Table 3: The Effect of Transparency on Foreign Direct Investment (net inflows, millions of constant USD)

Notes: Standard errors in parentheses. *** indicates significance at the one percent level, ** at the five percent level, and * at the ten percent level.
7. Conclusion

The relationship between our variables empirically demonstrates that as a nation’s transparency increases, the amount of FDI it receives also increases. The provision of aggregate economic data is therefore clearly linked to inflows of investment from abroad. The causal logic states that due to the lower cost of business in transparent regimes, the increased ability to predict returns, and the added stability of investments through traceable economic policy, foreign investments are more favorable in transparent countries. Our data confirms this relationship, which remains robust when controlling for mitigating economic factors that could otherwise influence FDI.

Our finding has pragmatic implications for both economic and political actions in nations evaluating future policy. Given the interplay between transparency and FDI, nations seeking to improve the attractiveness of their economies to foreign investors can improve their provision of accurate and accessible aggregate data. By doing so, they can demonstrate to investors the quality of their investment by presenting their economy candidly. Transparency serves as a benchmark of reliability. Greater FDI can serve as a source of capital in savings-strapped economies, which can facilitate greater production activity.

Further studies into the relationship between transparency and other economic variables could provide interesting insights into ways that transparency helps growth as a whole. While we narrowed our study to FDI, other influential growth factors like foreign aid, trade activity, and GDP growth rate could also be affected by transparency. These factors may contribute to a more complete picture of economic growth theory and the factors that affect it.

We recognize that our own study does not completely account for endogeneity in the relationship between transparency and FDI. Nonetheless, we begin to address this through our
control variables, lagging the dependent variable, and country fixed effects. Further utilization of techniques such as an instrumental variable approach or the differences-in-differences method would enhance our ability to argue a causal link. A measure of countries providing funding to other countries for the express purpose of encouraging them to release economic data could be used as such an instrumental variable, while the differences-in-differences method would utilize a natural experiment to isolate our independent variable.

A transparent economic profile presents a country with an opportunity to increase its FDI. Our study lends strength to the notion that FDI is affected by investor pragmatism, and that if a more complete economic picture is provided, a country can increase investor confidence and thereby capital. When it comes to investment, the ready provision of aggregate economic data provides a clear advantage.

Acknowledgements

We would like to thank a number of people for their substantive and emotional contributions to our paper. First, Professor James Vreeland, who worked tirelessly to improve our paper while also keeping our stress in check; without his work, this paper would never have come to be. Next, we’d like to thank the 2014 Krogh Scholars for their thorough edits, their insightful contributions, and their incredible attitude; we are very lucky to count them all as friends. Lastly, a shout-out to the (full) Team Transparency, which includes Danny Aherne and Erika Lim, for providing us with moral support and late-night snacks.
References


