NÚMERO 227

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Foreign Aid and Investment in Post-Conflict Countries

JUNIO 2011

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Acknowledgements

Earlier versions of this paper were presented at the 2009 APSA Annual Meeting, the 2010 ISA Annual Meeting, the World Politics Workshop at the University of Pittsburgh, and the Seminar Política y Gobierno at Centro de Investigación y Docencia Económicas. We thank the participants for their feedback. Special thanks go to David Bearce, Charles Gochman, Michael Goodhart, Julia Gray, Joy Langston and Mariana Magaldi for their thorough comments, and to Deborah Klodowski for her research assistance.

Abstract

Does development aid attract FDI in post-conflict countries? This paper contributes to the growing literature on the determinants of FDI and on the effects of foreign aid by explaining how international aid is a signal that can attract FDI. Post-conflict situations are arguably the least attractive environment for FDI because of the effects of conflict on the economic system and on political institutions, and because of information deficiencies. Before investing in these countries, firms look at a variety of signals. We argue that investors look at aid because aid allocation can signal the donors' trust of local authorities. This effect of aid has not yet been addressed. What matters is the presence of aid, whether or not the aid has actually accomplished the goals set forth by donors. We also argue that the signaling effect of aid is conditional on whether the aid can be viewed as geostrategic or not. Our results show that aid that is not motivated by geopolitical interests signals a better environment for FDI, while geostrategic aid deters investors. We also show that the aid's effect on FDI decreases as time elapses since the end of the conflict. This suggests that aid's signaling effect is specific to low-information environments, and helps rule out alternative causal mechanisms linking aid and FDI.

Resumen

La ayuda al desarrollo: ¿atrae inversión extranjera directa (IED) a los países que experimentaron conflictos armados recientemente? Al explicar cómo la ayuda internacional opera como una señal que puede atraer IED, este artículo representa una contribución a la literatura sobre los determinantes de la IED y sobre los efectos de la ayuda internacional. Los países que experimentaron conflictos armados recientemente son probablemente los menos atractivos para la IED. Esto se debe tanto a los efectos del conflicto sobre el sistema económico y sobre las instituciones políticas, como a deficiencias de información que caracterizan a estas situaciones. Antes de invertir en estos países, las empresas prestan atención a variadas señales. En este artículo argumentamos que los inversionistas toman en cuenta la ayuda al desarrollo porque la ayuda proporciona una señal de la confianza de los donantes en las autoridades locales. Este efecto de la ayuda aún no ha sido estudiado. Lo que importa es la presencia de la ayuda, independientemente de si la ayuda alcanzó los objetivos que los donantes se fijaron o no. También sostenemos que el efecto de señal de la ayuda está condicionado por la posibilidad de que la ayuda sea vista como geoestratégica o no. Nuestros resultados muestran que la ayuda que no es motivada por intereses geopolíticos brinda una señal de un mejor ambiente

para la IED, en tanto la ayuda geoestratégica repele a los inversionistas. También mostramos que el efecto de la ayuda sobre la IED decrece a medida que pasa el tiempo desde el final del conflicto. Esto sugiere que los efectos de señal que proporciona la ayuda internacional se limitan a contextos de baja información, al tiempo que ayuda a desestimar otros mecanismos causales que conectan ayuda e IED.

Introduction

"Mr. Baker pledged to seek from Congress $1 billion… to signal private foreign investors that it is safe to commit their own funds to the Philippines."[1]

Does development aid attract FDI in post-conflict countries? This paper contributes to the growing literature on the determinants of FDI by explaining how international aid is a signal that can attract FDI. Post-conflict situations are arguably the least attractive environment for FDI because of the effects of conflict on the economic system and on political institutions. Furthermore, these states are relatively information-poor. Before investing in these countries, firms look at a variety of signals. We argue that the decision to send aid to a country signals the donors' trust of local authorities. This effect of aid has not yet been addressed. What matters is the presence of aid, whether or not the aid has actually accomplished the goals set forth by donors. We also argue that this impact of development aid is conditional on whether the aid can be viewed as geostrategic or not.[2] Most aid should signal a better environment for FDI, but aid seen as geostrategic could deter investors. Our results provide support for our argument, suggesting that in post-conflict countries non-strategic aid attracts FDI, and that geostrategic aid offers a different kind of signal.

This topic has important implications for the literatures on FDI and aid. Global FDI flows have increased substantially in the past few decades, and recent studies have attempted offer explanations for why some countries receive more FDI inflows than others.[3] At the same time, a separate and substantial body of literature attempts to determine the effects of foreign aid on recipients.[4] While most of the studies deal with aid's efficacy, our study shows there are important unintended consequences, regardless of whether aid works as intended. A few recent studies have shown various relationships between aid and FDI,[5] but ours provides a new angle on the subject.

This study contributes not only to the FDI and aid literatures separately, but in a broader sense by finding connections between these lines of research. Furthermore, our work contributes to studies of development in post-conflict countries. In line with recent efforts to integrate the field of international

[1] Friedman, Thomas. "Baker Says U.S. Seeks $1 Billion in Economic Aid to the Philippines". NYT, 07/05/1989.
[2] By "geostrategic" we mean development aid that is motivated by global security interests, as opposed to development aid that is given because of more strictly economic (e.g., trade) or humanitarian reasons. This is discussed more below.
[3] E.g., Blanton and Blanton, 2007; Busse and Hefeker, 2007; Büthe and Milner, 2008.
[4] E.g., Burnside and Dollar, 2000; Doucouliagos and Paldam, 2008; Easterly, 2001.
[5] E.g., Asiedu, Jinc and Nandwa, 2009; Kimura and Tod, 2010; Selaya and Sunesen, 2008.

relations, the project brings together three areas of study that speak to each other, but are not often enough evaluated jointly.

In addition to contributing to these bodies of literature, this study has substantial normative implications. Our sample, post-conflict countries, is especially worthy of researchers' attention. FDI is crucial for developing countries generally, as it not only provides considerable income flows, but also technology transfer[6] and other benefits.[7] These benefits can be particularly valuable to the states upon which we focus. These states —generally the most disadvantaged in the world— already likely suffered infrastructure damage from the conflict, and might be prone to lapse back into more conflict,[8] so they are especially worth understanding.

There is an additional normative and policy-relevant value to our study, beyond the fact that our sample of states merits attention. We argue that efforts to help these disadvantaged states through foreign aid can have substantial unintended consequences, in ways that the extant literature has yet to argue or show. This should encourage donor states to more carefully evaluate their aid allocation decisions. Aid has the potential to draw FDI, an important complement, but donor states that donate for geostrategic reasons can actually discourage foreign investment. This unintended consequence should be more carefully considered by donor states.

The rest of the paper proceeds as follows. In the next section, we review the literature on determinants of FDI, and the debate about the effects of aid. Then, we discuss the growing literature on the relationship between aid and FDI. In the third section, we present a theory of aid as a signal to investors, and corresponding hypotheses. We argue that the type of signal should differ depending on whether aid is viewed as geostrategic or not, and that the informational effect of aid should vanish as time elapses since the end of the conflict. In the fourth section, we describe our empirical analysis. The fifth section concludes.

[6] E.g., Borensztein, Gregorio and Lee, 1998; Carkovic and Levine, 2005.
[7] Albuquerque, 2003; Lipsey, 2001.
[8] Collier, 2003.

Literature review

Determinants of FDI

Previous research on the determinants of FDI explores the impact of economic and political factors on the decision to invest in a particular country. Economic and political factors are important either because they influence the expected profitability of the investment, or because they may affect the risk that political decisions affect the investment's returns after the investment is made. Regarding economic factors, there is some consensus regarding host country's characteristics that affect the profitability of investment and, therefore, incentive the location of FDI in a given country. Because FDI becomes relatively immobile after the investment is made, the size of the market, development, rate of growth of the economy, and trade openness are among the most important economic determinants of FDI.[9]

In addition to economic factors, certain political factors affect FDI location because they affect the credibility of the host country. Scholars have pointed out the effects of political regime, institutions, veto players, and international commitments on the decision to invest in a country. For example, FDI is associated with democracy,[10] rule of law,[11] political stability and regime durability,[12] strength of political institutions,[13] candidate-centered electoral rules,[14] and the signing of preferential trade agreements[15] and of bilateral investment treaties.[16]

Less explored in the literature is how information availability affects FDI. Hooper and Kim used the 2000 Price Waterhouse Coopers' Opacity Index and found that higher opacity tends to reduce capital inflows, but opacity regarding accounting and regulations are associated with more foreign direct investment flows.[17] However, how do investors make decisions about countries where information is scarce? This paper presents a theory about how foreign aid can provide information to investors about a particular set of countries where reliable information is particularly scarce.

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[9] Büthe and Milner, 2008; Jensen, 2006. Other studies include economic freedom in the host country; see Bengoa and Sánchez-Robles, 2003.

[10] Jensen, 2003, 2006; Li, 2006; Li and Resnick, 2003.

[11] Daude and Stein, 2007; Li, 2006, 2009.

[12] Busse and Hefeker, 2007; Li and Resnick, 2003.

[13] Bénassy-Quéré, Coupet and Mayer, 2007; Du, Lu and Tao, 2008; Seyoum, 2009.

[14] Garland and Biglaiser, 2009.

[15] Büthe and Milner, 2008; Manger, 2009. Note that Manger's logic contrasts with Büthe and Milner's argument.

[16] Desbordes and Vicard, 2009; Neumayer and Spess, 2005.

[17] Hooper and Kim, 2007: 36. They argue that opacity might in fact be a source of profitable opportunities for those who can exploit them. It is not clear however, why sources of opacity are more transparent to some investors but not to others.

Consequences of development aid in developing countries

A substantial body of research attempts to determine if foreign aid improves economic growth in developing countries, but the results are mixed. While some single-country studies have shown a positive impact of aid on growth, macro studies have often not offered support.[18] This is the so-called "micro-macro paradox" of aid.[19] The dominant argument for why aid does not "work" is that the aid tends to be used for government consumption, not investment.[20]

Some studies have found aid to improve economic situation in developing countries, but only conditionally upon other factors. For example, Burnside and Dollar find that aid can lead to economic growth in countries with good economic policy.[21] Dalgaard, Hansen, and Tarp find that aid only leads to growth in non-tropical countries, and argue that this relates to "deep" structural characteristics.[22] Kosack and Tobin find that aid is positively associated with growth only in countries with higher levels of health and education infrastructure.[23] However, the results of the conditional relationships seem fragile. Irandoust and Ericsson find a positive relationship using time-series data, but only examine a sample of five countries.[24] Roodman tests the robustness of 14 conditional models of aid and growth, and finds the results very sensitive to model specification and sample size.[25]

Overall, the effects of aid on growth are not entirely clear.[26] It appears that aid only affects growth conditionally. The studies discussed in this section, however, have generally examined whether aid has had its intended consequences, and few studies have analyzed aid's unintended consequences or consequences other than direct contribution to growth. The next section discusses research on ways that aid can affect FDI.

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[18] E.g., Boone, 1996; Easterly, 2001, 2003. Karras (2006) is one exception, as he finds a positive unconditional relationship between aid and economic growth.
[19] Mosley, 1986.
[20] A number of studies have shown that aid seems to be fungible, allowing governments to substitute it for various purposes. This leads to increased government spending, but decreased government revenue. The effect has been shown in both single-country studies (e.g., Pack and Pack, 1993) and in global studies (e.g., Remmer, 2004).
[21] Burnside and Dollar, 2000.
[22] Dalgaard, Hansen and Tarp, 2004.
[23] Kosack and Tobin, 2006.
[24] Irandoust and Ericsson, 2005.
[25] Roodman, 2007.
[26] Even surveys of the empirical literature reach markedly different conclusions. Hansen and Tarp 2000 survey 29 studies, from the late 1960s through 1998, and find that generally the impact of aid on growth is positive. They argue that this is usually not necessarily in the form of aid directly affecting growth; they include results that show positive relationships between aid and savings, and between aid and investment. McGillivray *et al.*, 2006 argue that, although before the mid-1990s, there was no consensus in the literature, the majority of the literature since the mid-1990s has supported the notion that aid increases growth, "one way or another". They point to the various and competing conditional arguments, such as Burnside and Dollar, 2000, as evidence of this conclusion. However, Doucouliagos and Paldam's survey of 97 articles up to 2004 finds that the majority of articles do not support the notion that aid encourages growth.

The impact of foreign aid on FDI

There is a less explored channel through which aid can contribute to development: it is possible that foreign aid stimulates FDI inflows. This issue is not addressed by the discussion around whether foreign aid and FDI are complementary or substitutes for growth.[27]

In theory, there are several channels that could link foreign aid to increased FDI. For example, Kimura and Tod mention three channels with positive effects on FDI (infrastructure, finance and vanguard effects) and two with negative effects (rent-seeking and "Dutch disease" effects).[28] However, the few articles that empirically examine the direct connection between foreign aid and FDI generally find no significant impact of total aid on FDI.[29] These studies analyze the impact of both aggregate aid,[30] and distinguish between aid for infrastructure or for non-infrastructure.[31] Among the positive results, Karakaplan et al. find that aid leads to FDI only in cases of good governance and financial market development.[32] Finally, Kapfer et al. include up to six-year lags and find that aid for infrastructure has a significant and substantive effect,[33] but Kimura and Tod find that only Japanese aid for infrastructure seems to promote Japanese FDI.[34] This appears to be a phenomenon *unique* to Japan, because they do not find this result for any other donor.

Overall, while there are many channels through which aid might encourage FDI, empirical results thus far have not shown much support for these channels, or for a relationship generally between aid and FDI. In this paper we explore a different channel through which aid can contribute to increased FDI, signaling, in a particular set of countries: countries that have experienced international or civil conflict in their territory.

[27] E.g., Kosack and Tobin, 2006; Selaya and Sunesen, 2008.

[28] Kimura and Tod, 2010: 482-483. On the one hand, aid can increase FDI (1) by contributing to the formation of economic and social capital in the host country ("infrastructure effect", discussed by Harms and Lutz, 2006; Kapfer, Nielsen and Nielson, 2007); (2) by funding FDI profit repatriations ("financing effect"); and (3) by promoting FDI from the country giving aid ("vanguard effect"). On the other hand, aid can have negative effects on FDI: (4) by encouraging unproductive activities ("rent-seeking effect", Harms and Lutz, 2006; Svensson, 2000); and (5) by shifting resource allocations (FDI) from sectors that do not receive aid to sectors receiving aid, resulting in substantial welfare losses ("Dutch-disease effect", Arellano *et al.,* 2009; Hodler, 2004, 2007; Rajan and Subramanian, 2010). Finally, there is another channel not mentioned by Kimura and Tod: some scholars have considered the possibility that aid works as a form of insurance either by mitigating the problem of government appropriation of FDI (Asiedu, Jinc and Nandwa, 2009), or by reallocating aid as a form of insurance against macroeconomic shocks (Pallage, Robe and Bérubé, 2006). However, while Asiedu, Jinc and Nandwa find that aid mitigates but cannot eliminate the adverse effect of expropriation risk on FDI, Pallage, Robe and Bérubé do not consider the effects of aid on FDI flows.

[29] Harms and Lutz, 2006; Kapfer, Nielsen and Nielson, 2007; Karakaplan, Neyapti and Sayek, 2005, Kimura and Tod, 2010.

[30] Harms and Lutz, 2006; Karakaplan, Neyapti and Sayek, 2005.

[31] Kimura and Tod, 2010.

[32] Karakaplan, Neyapti and Sayek, 2005.

[33] Kapfer, Nielsen and Nielson, 2007.

[34] In line with Blaise, 2005.

Theory: The informational effect of development aid

Information is a crucial component in the decision to invest in a country.[35] However, while the literature has individualized a series of determinants of FDI, it assumes that the *ability* of investors to access information about these factors (e.g., market size or potential, institutions that may affect investments), and the reliability of such information are relatively homogeneous across countries.[36] This is problematic for two reasons. First, investors do not always have access to all the relevant information that would be desirable before investing in a particular country. Second, potential recipient governments have incentives to offer enticements for investment, but information about the government's commitments' credibility may not be available. Therefore, investors may find difficult knowing the government's type, such as whether the government is willing or able to commit to certain policies or not. Lack of information about the economic environment and/or the government's type is challenging for investors because some of these situations where information is scarce can offer particularly high returns for investment. How do investors decide whether to take advantage of opportunities without all the relevant information? Recent work in the field of behavioral finance uses psychology to explain investor behavior that cannot be explained with traditional financial and economic theory.[37] Furthermore, it seems likely that investors rely on informational shortcuts, and recent studies find support for this idea.[38]

We argue that in contexts where information is scarce, investors will look for signals about the government's credibility. We look at a particularly low-information environment, post-conflict countries, because this is where such signals should matter the most. In post-conflict situations, the decision to send funds to a country signals the donors' trust of local authorities. This signal indicates investors which countries are trusted to handle international funds and commit to certain policies.

Post-conflict situations are arguably the least attractive environment for FDI because of the effects of conflict on the economic system and on political institutions.[39] First, countries that have experienced conflict recently are likely in worse overall economic condition than other states, given the damages caused by war.[40] Second, conflict and political violence make countries less attractive for investment.[41] Therefore, FDI is likely to decline

35 Mody, Sadka and Razin, 2003.
36 Many scholars highlight the association between democracy and transparency (e.g., Broz, 2002; Kono, 2006). However, our claim goes beyond this association between regime type and access to information: there are situations in which similar regimes may be able to provide different levels of access to information.
37 Krishnamurti, 2009: 628.
38 Biglaiser, Hicks and Huggins, 2008; Gray, 2009.
39 Busse and Hefeker, 2007.
40 Collier, 1999; Murdoch and Sandler, 2002.
41 Jensen, 2006: 49; Brunetti, Kisunko and Weder, 1997.

during conflict.[42] Because post-conflict countries are likely to have less cumulative FDI than other developing countries, FDI has the potential to have a substantial impact on growth, and this is especially valuable to post-conflict countries. That makes post-conflict governments more willing to offer concessions to attract FDI, but there are few indicators regarding these commitments' credibility.

Third, these types of states are more likely to be information-poor environments for foreign firms considering investment. Regarding developing countries generally, investors can access information about the economic and political situation from government sources, the press, international governmental and non-governmental organizations (IGOs and NGOs), and private sources such as other companies. In post-conflict countries, however, data from official sources can be unreliable because of the consequences of the conflict on the country's administration (and its ability to gather and report accurate and complete information), or because of possible government's incentives to misrepresent the data.[43] Additionally, a significant part of the information distributed by IGOs comes from governmental sources. Depending on the magnitude of the conflict and the type of the ruling government, the work of the press and of NGOs can be limited. Furthermore, the information gathered by these two sources does not necessary provide the data required for investment decisions. Finally, conflicts are usually associated with FDI withdrawal, potentially limiting the information provided by established foreign companies. Overall, then, post-conflict developing countries are especially low-information environments.

These characteristics of post-conflict countries suggest that information provision should be especially valuable. In brief, before investing in these countries, firms look at a variety of data sources. Given the heightened need for financing, sources affiliated with the potential recipient government may not be credible. Investors could rely on third parties information to decide whether to invest in a post-conflict country but, as a collateral consequence of the decline in investment during conflicts, information produced by the private sector about the country or the economic environment is likely to be scarce. Where can investors look for information? We argue that, as in other low-information environments, actors look for signals. A particularly important signal here is *foreign aid*.

Foreign aid received by a country after a conflict is a useful signal to investors for two reasons. First, foreign aid is an accessible signal. Aid packages are typically announced through the press to a global audience. This makes the signal clear and available to investors independently of the nationality of the donor. Governments not only make public announcements

[42] Busse and Hefeker, 2007.

[43] Given post-conflict countries' need for recovery, governments have incentives to distort or selectively disseminate information, misrepresenting actual indicators.

of aid programs,[44] but they also announce aid denial,[45] cuts[46] or suspensions.[47] Furthermore, the very aid announcements are frequently joined by statements about the trust in the recipient country,[48] and sometimes, joined by statements of the intention of giving a signal to other international actors, particularly, investors.[49] The global availability of the signal distinguishes our argument from another informational mechanism: the "vanguard" effect suggests that aid gives private information to investors from the donor country.

Second, aid is a costly signal. Donor states invest resources in determining their aid allocation decisions, and of course aid is an expenditure as well. This makes aid a costly, and therefore meaningful, signal. Because aid is costly, it is a better indication of trust in the local authorities than mere declarations. The costliness of the signal, combined with the likely lack of credible alternatives, makes aid an important indicator for potential investors.

What is it exactly that aid signals? We argue that aid is a costly signal indicating that the recipient is trusted to handle international funds and to commit to certain policies. Aid often has attached conditions regarding the use that the recipient should make of the received funds, or commitments to pursue domestic or international policies.[50] This type of signal is valuable to investors, who seek information about the reliability of the government, yet lack such information in post-conflict environments.

Our assertion thus far is that aid provides a signal that a country is safe to invest in, compared with other post-conflict countries. Here we add a substantial caveat or condition: in order for aid to work in the manner that we describe, it should not be seen as a geostrategic enticement in a geopolitical relationship. There is evidence that some aid is more likely to be intended to provide security benefits to the donor (see below) and this aid should not provide such a positive signal. Aid that cannot be considered geostrategic,

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[44] A few examples of that can be found in the press are "Upheaval in the East: France; Paris Is Pressing Aid for Rumanians". NYT, 12/26/1989; "Japan Giving Peru $11 Million for Development". NYT, 04/29/1997; "Canada Announces $2M More for Sierra Leone". *Canadian Press Newswire*, 05/02/2000; "Donors Pledge New Aid for War-Torn Sierra Leone". *Associated Press Worldstream*, 02/08/2002; "How U.S. Aid to El Salvador Could Miss Out". *The Washington Post,* 12/08/2006.

[45] I.e., Japan to South Korea ("Japan Foreign Unpolicy". *NYT*, August 28, 1981) or the U.S. ban on Azerbaijan ("Oil, Politics and a Blacklist". NYT, March 2, 2000).

[46] I.e., "France, in a Shift, Reportedly Plans to Reduce Financial Aid to Algeria". *NYT*, 04/19/1995; "U.S. Suspends $30 Million to Honduras". NYT, 09/04/2009.

[47] I.e., "Japan Cuts Aid to China Over Nuclear Bomb Test." *NYT*, 05/23/1995; "Cambodia: Quandary for Diplomats". NYT, 07/12/1997; "Niger: France Suspends Aid". NYT, 04/14/1999.

[48] "Bush, in Warsaw, Unveils Proposal for Aid to Poland". NYT, 07/11/1989; "France, in a Shift, Reportedly Plans to Reduce Financial Aid to Algeria". NYT, 04/19/1995; "Japan Cuts Aid to China Over Nuclear Bomb Test". NYT, 05/23/1995; "Japan Giving Peru $11 Million for Development". NYT, 04/29/1997; "Donors Consider Larger Increase in Aid to Palestinians". NYT, 12/17/2004.

[49] "Baker Says U.S. Seeks $1 Billion in Economic Aid to the Philippines". NYT, 07/05/1989; "Upheaval in the East: Japanese Aid; $1 Billion Plan for Poland and Hungary". NYT, 01/10/1990.

[50] For example, the recipient countries commit to efforts for increased democracy ("France Ties Africa Aid to Democracy". NYT, 06/22/1990), or peace with neighbors ("Effort to Repair Armenia and Azerbaijan Ties". NYT December 10, 2000; "Donors Consider Larger Increase in Aid to Palestinians". NYT, 12/17/2004).

however, should provide an important signal about trust in local authorities regarding the "acceptable" use of aid. This is particularly the case because most donors tend to reduce aid to a recipient with an in-house or nearby intense conflict.[51] This signal shows investors which countries are trusted to handle international funds and commit to certain policies. Therefore, in post-conflict countries, non-geostrategic foreign aid should have a positive signaling effect and attract FDI.

Hypothesis 1: In post-conflict situations, non-geostrategic foreign aid is positively associated with FDI

It could be argued that international aid fosters investment through channels other than information. For example, it is possible that the connection between aid and FDI is through aid's contribution to economic and social capital (the "infrastructure effect").[52] There are two reasons why this is not necessarily the case. First, the literature discussed above indicates, it is far from clear that aid regularly has a positive effect on the economy. A systematic relationship between aid and FDI through aid's effectiveness would require aid to be systematically effective, and this does not appear to be the case.[53] Additionally, for aid to affect FDI through aid's real and intended effects, investors would have to believe in the efficacy of aid. This is not a given, considering the general level of skepticism of aid in business circles and the popular press.[54] Second, aid's information effect on FDI will be almost immediate, whereas it will take longer lags for aid for infrastructure to actually increase the host country's economic or social capital, and then attract FDI. According to our argument, in the first years after a conflict, the amount of aid received by the host country should have a signaling effect regarding some level of confidence in the country. What matters is the presence of aid, whether or not the aid has actually accomplished the goals set forth by donors.

While we argue that aid should not be causally connected to FDI through its efficacy, it is likely that investors pay attention to the *donors*: different types of donors should send different signals to investors. U.S. aid is more likely to be motivated by geostrategic reasons, and therefore we expect it to have different effects than aid provided by other states.

[51] Balla and Reinhardt, 2008.
[52] Dollar and Easterly, 1999: 573.
[53] Doucouliagos and Paldam, 2008.
[54] E.g., Dorn, 2004; Mills, 2009; Stephens, 2010.

The peculiarity of U.S. aid flows and the information they provide

The U.S. is seen as a unique aid donor for two primary reasons: First, it donates more than any other single country.[55] Second, and more importantly for signaling implications, U.S. aid is seen as especially geostrategic. This is because of the hegemonic status the U.S. enjoys, with power projected throughout the world. A number of studies suggest that U.S. aid during the Cold War was based more on geopolitics than actual development,[56] but such geostrategic behavior did not end in the early 1990s. Security goals continued to shape U.S. aid commitments through that decade.[57] Additionally, the "War on Terrorism" seems to currently influence aid provision in ways comparable to those of the Cold War.[58] The prominence of U.S. aid, and its consistent status as a geopolitical instrument, means that investors can look to this aid as a signal regarding investment potential.

Note that the assumption that U.S. aid is more geostrategic than aid from other countries does not imply that non-U.S. aid is altruistic. Some aid might be motivated mostly or solely by humanitarian concerns,[59] but a great deal is probably motivated by economic interests, such as hoping to improve trade with a country or within a region. Bueno de Mesquita and Smith, for example, point out that the poorest countries do not receive the most aid, and present an argument based on donor interests.[60] However, geostrategic interest is different from simple economic interest in that aid given for the former reason is designed to ensure the stability of a regime, and to ensure that the regime follows certain security policies. These goals, as opposed to the goals associated with economically-motivated aid, are less likely to be in line with the interests of investors.

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[55] For example, in 2009, the U.S. donated nearly $29 billion in overseas development assistance. The second-highest donor was Germany, with approximately $12 billion. (Note that while the U.S. donates more than any other state in absolute terms, it tends to donate much less, as a percentage of its overall wealth, than other developed countries). Data come from stats.oecd.org, accessed Jan. 29, 2011.

[56] E.g., Boschini and Olofsgard, 2007; Meernik, Krueger and Poe, 1998.

[57] E.g., Boschini and Olofsgard, 2007; Lai, 2003.

[58] Buzan, 2006; Fleck and Kilby, 2010.

[59] Lumsdaine, 1993.

[60] Bueno de Mesquita and Smith, 2007, 2009.

[61] Lumsdaine, 1993.

[62] Bueno de Mesquita and Smith, 2007, 2009.

different from simple economic interest in that aid given for the former reason is designed to ensure the stability of a regime, and to ensure that the regime follows certain security policies. These goals, as opposed to the goals associated with economically-motivated aid, are less likely to be in line with the interests of investors.

Hypothesis 2: In post-conflict situations, US foreign aid is negatively associated with FDI

This second hypothesis, derived from our argument, is counterintuitive. Investors could view U.S. aid, because of its geostrategic nature, as a *security guarantee*. Developing countries are more likely than others to experience civil conflict,[63] for example, and investors could view the aid as an indication of U.S. commitment to maintaining stability in the country – and thus protecting foreign investments. The United States has militarily intervened in a number of countries receiving its financial support during times of political instability, such as Haiti repeatedly, Panama 1989, and Liberia 2003. In addition to a potential higher likelihood of overt military intervention, higher levels of U.S aid could also signal a greater chance of protection through covert intervention, military funding, or simply increases in aid. Potential investors could anticipate this security guarantee, and be drawn toward developing countries that seem to be under the wing of the U.S. If this story was right, then U.S. aid should have a positive impact on FDI, whereas non-U.S. aid might not have any effect on FDI.

The effect of time on the signaling effect

There is another implication of the argument about aid's informational role in post-conflict situations. We argue that because of the particular characteristics of a post-conflict country, access to information is more problematic right after the end of the conflict. Lacking all the relevant information, particularly about the government's credibility, investors will look at aid as a signal of international actors trust or support of the country. This informational effect of aid however, should fade as time elapses after the conflict. This is consistent with our main argument because we do not posit that aid has a permanent informational role, but that aid assumes that role in a particular context: after a conflict. Therefore, the impact of aid on FDI is the most potent in the years immediately after the war, and diminishes with time.

[63] E.g., Hegre and Sambanis, 2006.

Hypothesis 3: In post-conflict situations, the impact of aid on FDI decreases over time.

Empirical analysis

The dependent variable is *FDI*. This variable measures the country's net inflows of foreign direct investment for the year, as a percentage of its GDP, both in current U.S. dollars. Dividing FDI by GDP is fairly standard in the literature, to scale the amount of FDI by the size of the market.[64] The source of the data is the World Bank's World Development Indicators (2010).

One primary independent variable is *Total aid*. This variable measures the net inflows of OECD Development Assistance Committee (DAC) aid received by the country that year, as a percentage of the host country's GDP in current U.S. dollars. The source of the data is the World Bank's World Development Indicators (2010). We use the same data source and GDP scaling method to create a variable measuring the amount of aid the country gets from the U.S., and another variable that measures the amount it gets from countries other than the U.S. The variables are called *U.S. aid* and *Non-U.S. aid*.

A number of factors have been shown to be associated with FDI levels, and we take them into consideration with control variables. The literature shows a series of economic factors capture aspects of the developing country that might make it more or less attractive to foreign investors. All of the economic variables come from the World Bank's World Development Indicators (2010), except where indicated otherwise. A number of studies use population to capture market size, although results have varied.[65] We measure *Market size* as the natural logarithm of the country's population.

Economic development is measured using GDP per capita in thousands of 2000 U.S. dollars. Countries with more wealthy citizens should be seen as better markets with better infrastructure, and there is substantial evidence of this.[66] *GDP growth* is the percentage of change in the country's GDP in the previous year, and should suggest a financial environment attractive to foreign investors. Growth has been shown to be positively associated with FDI.[67]

Trade openness is a country's trade volume as a percentage of its GDP (exports plus imports over GDP). States that are more open generally receive higher levels of FDI inflows.[68] Finally, we include a control for financial openness. *Capital Openness* is Chinn and Ito's index measuring the extensity

[64] E.g., Blanton and Blanton, 2007; Büthe and Milner, 2008; Jensen, 2004; Jensen and McGillivray, 2005.
[65] E.g., Büthe and Milner, 2008; Neumayer and Spess, 2005; Seyoum, 2009.
[66] E.g., Busse and Hefeker, 2007; Chakrabarti, 2001; Jensen, 2004; Neumayer and Spess, 2005; Schneider and Frey, 1985; Tsai, 1994.
[67] E.g., Blanton and Blanton, 2007; Li and Resnick, 2003.
[68] E.g., Aseidu, 2002; Blanton and Blanton, 2007; Büthe and Milner, 2008; Jensen, 2004.

of capital controls based on the information from the IMF's Annual Report on Exchange Arrangements and Exchange Restrictions.[69]

We include the following political determinants. *Political instability* is a count of the number of disturbances such as riots, strikes, anti-government demonstrations or assassinations in a country in a given year.[70] Instability should make foreign firms less likely to invest in a country, although evidence of this is mixed.[71] *Democracy* is the 1-7 scale from Freedom House (2009), reversed and centered, so that 0 indicates the least-free category, and 6 indicates the most-free category. The literature shows conflicting results for how regime type might affect FDI. On one hand, authoritarian states can offer efficiency that is likely to be attractive to foreign firms.[72] On the other hand, democratic states can offer more information through a free press, more credible commitments, and other characteristics that can shape expectations of foreign firms considering investment.[73] Empirical results have been mixed for regime type.[74]

In addition to economic and political factors of the country under analysis, we take other factors into consideration. It is possible that the intensity of the conflict affects the decision of investing in a post-conflict country. Therefore, we include *Conflict intensity,* a variable that indicates the duration of the past conflict in months. We also use the number of deaths as an alternative measure.[75] The models of the post-conflict sample also include a series of temporal controls. *Year count* measures the number of years that have lapsed since the conflict ended. Cold War alignments affected international relations substantially, so it seems likely they should affect FDI flows. Furthermore, the Cold War affected foreign aid policies,[76] so accounting for this is important in our models that measure the impact of aid. Therefore, we include a dummy variable marking years during the Cold War. *Cold war* is coded 1 for years before 1990. We also include decade dummies.

All independent variables except the temporal controls are lagged one year to avoid reverse causality. Also, it takes time for investors to make decisions regarding FDI and to carry out these decisions.

The estimation technique is an ordinary least squares regression (OLS), because of the continuous nature of the dependent variable. A Wooldridge Test shows first-degree serial autocorrelation to be a problem,[77] so we include

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[69] Chinn and Ito 2008.
[70] Banks, 1999. The data were obtained from Pippa Norris' dataset Norris, 2008, and downloaded from http://www.hks.harvard.edu/fs/pnorris/Data/Data.htm.
[71] Asiedu, 2006; Bollen and Jones, 1982; Büthe and Milner, 2008; Feng, 2001.
[72] E.g., Huntington and Dominguez, 1975; Oneal, 1994.
[73] E.g., Busse and Hefeker, 2007; Oneal, 1994.
[74] E.g., Jensen, 2006; Li and Resnick, 2003.
[75] Conflict intensity data come from the Uppsala Conflict Data Program, especially Lacina, 2005 and Kreutz, 2010. The conflict sample is discussed below.
[76] E.g., Meernik, Krueger and Poe, 1998; Bearce and Tirone, 2010.
[77] Baltagi, 2005: 84-85.

the autoregression factor into the model to address this.[78] We estimate the model using fixed effects, because it seems likely that country-specific effects explain a large deal of the variance in the dependent variable. Furthermore, a series of Hausman tests show there is a systematic difference between the results of the two types of models, and that random effects appears to be inconsistent.

We first run the models on a sample of all developing countries, in order to provide a baseline for reference. Developing countries are defined as countries that are not members of OECD.[79] Then, models are run on a sample that includes post-conflict developing countries from 1970-2008, depending on data availability. Post-conflict countries are defined as countries that have experienced a civil conflict or inter-state war on their own territory[80] within the previous five years. Civil conflict is defined as an incompatibility between a state and a sub-state group over territory or the government that results in at least 25 battle-related deaths in a single year.[81] Civil conflict data come from the Armed Conflict Dataset.[82] Inter-state war is conflict between two or more states that results in 1,000 or more battle-related deaths, and these data come from the Correlates of War data.[83] The Annex lists the country-years included in the sample. Tables 1 and 2 show the descriptive statistics for both samples.

[78] The Stata command is xtregar.

[79] We also include Mexico (an OECD member) as a developing country, because its economic profile is closer to that of developing countries. The exclusion of Mexico does not affect our results.

[80] We only code states as experiencing an inter-state war if some of the conflict occurs on their own territory because states fighting abroad should not experience, for example, adverse effects to their infrastructure or civilian population. These types of effects are what we are attempting to capture by focusing on post-conflict countries. An example of a country that is not considered to be a post-war country for our purposes is Oman, for its participation in Kuwait during the 1991 Gulf War.

[81] Some readers might see a threshold of 25-battle related deaths as an especially low bar. However, civil conflicts, because of their domestic nature, are especially damaging to a country's infrastructure, civilian population, and economy generally (e.g., Ghobarah, Huth and Russett, 2003; Murdoch and Sandler, 2002). Inter-state wars in the postwar era have been more harmful to soldiers than the country generally, when compared to civil conflicts. Most of the civil conflicts in the dataset are coded as conflicts because they experienced far more than the bare-minimum 25 battle-related deaths in a given year, and caused countless other damage to the state in which they occurred.

[82] Gleditsch *et al.,* 2002.

[83] Sarkees, 2000.

TABLE 1. DESCRIPTIVE STATISTICS: POST-CONFLICT DEVELOPING COUNTRIES

VARIABLE	OBS	MEAN	STD. DEV.	MIN	MAX
FDI	582	1.917497	7.401195	-82.8921	72.2609
TOTAL AID	582	.0582687	.0983386	-.0006564	1.031113
NON-U.S. AID	582	.0457193	.0769171	-.0006564	.703531
U.S. AID	582	.0125493	.0313464	-.0021242	.3275818
MARKET SIZE	579	16.21136	1.526741	12.89975	20.87596
ECONOMIC DEVELOPMENT	579	10.58707	55.61559	.0660963	685.173
GDP GROWTH	563	5.063787	8.87014	-30.9	106.2798
TRADE OPENNESS	542	63.06901	32.52046	6.320343	199.6796
CAPITAL OPENNESS	560	-.3863686	1.422937	-1.831187	2.500014
INSTABILITY	555	2.162162	3.757401	0	41
DEMOCRACY	558	2.231183	1.413056	0	6
CONFLICT INTENSITY	577	13.80622	39.7074	.03	556
COLD WAR	582	.3814433	.4861588	0	1
(POST-CONFLICT) YEAR COUNT	582	2.769759	1.414912	1	5
1970	582	.2199313	.4145561	0	1
1980	582	.161512	.3683191	0	1
1990	582	.347079	.4764507	0	1
2000	582	.2714777	.4451044	0	1

TABLE 2. DESCRIPTIVE STATISTICS: ALL DEVELOPING COUNTRIES

VARIABLE	OBS	MEAN	STD. DEV.	MIN	MAX
FDI	4579	3.080987	6.417681	-82.8921	145.2019
MARKET SIZE	4576	15.42268	1.972963	10.59988	21.00954
ECONOMIC DEVELOPMENT	4574	65.67242	990.0341	.0622367	54260.19
GDP GROWTH	4446	3.904365	6.603086	-51.03086	106.2798
TRADE OPENNESS	4043	78.52001	43.6687	6.320343	462.4626
CAPITAL OPENNESS	4288	-.237972	1.406837	-1.831187	2.500014
INSTABILITY	4170	1.803118	3.906111	0	49
DEMOCRACY	4379	2.898036	1.809713	0	6

Findings

In order to examine whether FDI responds to a particular set of determinants in post-conflict countries, we first run a series of models on the full sample of developing countries (see Table 3).[84] Models 1 and 2 include economic and political determinants commonly used in the literature. As expected, FDI is positively associated with *Market size, Economic development, GDP growth, Trade* and *Capital openness* and *Democracy*. *Instability* does not achieve statistical significance.

TABLE 3. BASELINE MODELS: DIFFERENT SAMPLES

	ALL DEVELOPING COUNTRIES		POST-CONFLICT DEVELOPING COUNTRIES	
	MODEL 1	MODEL 2	MODEL 3	MODEL 4
ECONOMIC DETERMINANTS				
MARKET SIZE$_{T-1}$	**1.856** ***(.278)*****	**1.424** ***(.274)*****	.182 *(.139)*	.208 *(.162)*
ECONOMIC DEVELOPMENT$_{T-1}$	-.020 *(.106)*	**.084** ***(.024)*****	.367 *(.649)*	.372 *(.675)*
GDP GROWTH$_{T-1}$	**.048** ***(.014)*****	**.048** ***(.014)*****	**.049** ***(.025)*****	**.049** ***(.025)****
TRADE OPENNESS$_{T-1}$	**.017** ***(.006)*****	**.014** ***(.006)*****	.013 *(.018)*	.012 *(.019)*
CAPITAL OPENNESS $_{T-1}$	**.510** ***(.130)*****	**.573** ***(.137)*****	-.514 *(.518)*	-.525 *(.565)*
POLITICAL DETERMINANTS				
INSTABILITY$_{T-1}$		-.00003 *(.026)*		-.0007 *(.063)*
DEMOCRACY$_{T-1}$		**.232** ***(.127)****		-.039 *(.371)*
INTERCEPT	**-26.867** ***(2.448)*****	**-21.101** ***(2.464)*****	**-2.525** ***(.630)*****	**-2.758** ***(.700)*****
N	3878	3599	425	403
NUMBER OF GROUPS	149	147	78	77
R^2 (WITHIN)	0.027	0.029	0.034	0.034
R^2 (BETWEEN)	0.120	0.003	0.003	0.063
R^2 (OVERALL)	0.025	0.0005	0.0003	0.0000
AIC	22575.06	21078.88	2239.909	2149.495
BIC	22612.64	21128.39	2264.221	2181.486

Notes: Dependent variable is FDI. Estimation is by fixed effects (within) regression with AR(1) disturbances correction. Standard errors are in italics. Two-Tailed Test reported for each estimate. Statistical significance is indicated as follows: *p<0.10, **p<0.05, ***p<0.01

[84] Note that this sample includes countries that have not experienced conflicts as defined in this study, countries that are experiencing conflict, and post-conflict countries.

We run the same models on the subsample of interest, i.e. post-conflict developing countries (Models 3 and 4). Except for *GDP growth* (with a positive sign), none of the determinants of FDI in all developing countries achieves statistical significance in a sample of post-conflict countries. This suggests that investors may not pay attention to the same indicators in developing countries that have experienced a conflict, and that FDI may respond to a different set of determinants of in post-conflict countries.

Two notes regarding Models 1 through 4: first, the presentation of these models intends to show that the variables included behave as the literature would expect on a conventional sample, in order to address potential concerns over operationalization or measurement in the models run on the post-conflict sample. These models also show the explanatory power of the conventional specification (R^2) in both samples when fixed effects are included.[85] Second, it is not our purpose to explain the effect of aid on the general sample because our theory is specific for the post-conflict contexts, that are characterized by the effects of conflicts on the economy, the institutions, aid, FDI, and information.

Table 4 shows models that include aid variables. Model 5 includes a measure of total bilateral development aid. The coefficient associated with *Total aid* is positive but does not achieve statistical significance. Overall, the statistical insignificance of *Total aid* suggests that aid – when not separated by whether it is geostrategically motivated or not – is not related to FDI.[86]

[85] The baseline model's R^2 are significantly higher if these models are run without fixed effects. The overall R^2 is .15 for models 1, 2, and .11 and .10 for models 3 and 4, respectively. For reasons mentioned above, however, we include fixed effects in our models.

[86] The lack of statistical significance is not surprising because we expect part of that aid to have a positive impact on FDI, and the rest to have a negative effect.

TABLE 4. EFFECT OF AID ON FDI IN POST-CONFLICT DEVELOPING COUNTRIES

	MODEL 5	MODEL 6	MODEL 7	MODEL 8	MODEL 9	MODEL 10	MODEL 11 (10 YEARS)	MODEL 12 (10 YEARS)
TOTAL AID $_{T-1}$	4.062 *(3.322)*							
NON-U.S. AID$_{T-1}$		**14.381 *(5.628)*****	**14.176 *(5.674)*****	**14.209 *(5.596)*****	**13.838 *(5.577)*****	**13.541 *(5.583)*****	**26.891 *(8.891)******	**26.514 *(8.873)******
NON-U.S. AID$_{T-1}$*YEAR COUNT							**-4.098 *(1.853)*****	**-4.054 *(1.849)*****
U.S. AID$_{T-1}$		**-16.256 *(9.587)****	**-15.990 *(9.661)****	**-14.791 *(9.555)***	**-16.207 *(9.494)****	**-15.854 *(9.499)****	**-48.507 *(18.790)******	**-48.672 *(18.772)******
U.S. AID$_{T-1}$*YEAR COUNT							**11.450 *(4.978)*****	**11.511 *(4.974)*****
ECONOMIC DETERMINANTS								
MARKET SIZE$_{T-1}$	.204 *(.162)*	.184 *(.160)*	.151 *(.178)*	**.365 *(.179)*****	.171 *(.159)*	-.096 *(.190)*	**.338 *(.146)*****	**.331 *(.146)*****
ECONOMIC DEVELOPMENT$_{T-1}$	.370 *(.673)*	.343 *(.663)*	.344 *(.668)*	.588 *(.668)*	.469 *(.659)*	.480 *(.662)*	.379 *(.470)*	.378 *(.467)*
GDP GROWTH$_{T-1}$	**.050 *(.025)*****	**.049 *(.025)****	**.051 *(.025)*****	**.046 *(.025)****	**.048 *(.025)****	**.046 *(.025)****	.027 *(.020)*	.029 *(.020)*
TRADE OPENNESS$_{T-1}$	.010 *(.019)*	.007 *(.019)*	.008 *(.019)*	.009 *(.018)*	.004 *(.018)*	.004 *(.019)*	.004 *(.014)*	.0009 *(.014)*
CAPITAL OPENNESS $_{T-1}$	-.488 *(.565)*	-.478 *(.558)*	-.539 *(.581)*	-.444 *(.555)*	-.623 *(.556)*	-.566 *(.559)*	.103 *(.343)*	.050 *(.343)*
POLITICAL DETERMINANTS								
INSTABILITY$_{T-1}$	-.004 *(.063)*	-.008 *(.063)*	-.005 *(.064)*	.004 *(.063)*	-.015 *(.062)*	-.016 *(.062)*	-.013 *(.043)*	-.014 *(.043)*
DEMOCRACY$_{T-1}$	-.045 *(.370)*	.135 *(.377)*	.103 *(.381)*	.093 *(.375)*	.117 *(.373)*	.107 *(.374)*	.131 *(.281)*	.124 *(.281)*
OTHER CONTROLS								
CONFLICT INTENSITY			.109 *(.189)*					
YEAR COUNT				**.913 *(.411)*****			**.699 *(.171)******	**.665 *(.171)******
COLD WAR					**-4.430 *(1.652)******			**-1.557 *(.896)****
1970						1.040 *(1.625)*		
1990						**4.997 *(1.700)******		
2000						**4.301 *(1.909)*****		
INTERCEPT	**-2.804 *(.701)******	**-2.889 *(.705)******	**-2.663 *(.729)******	**-11.628 *(1.282)******	**-1.362 *(.714)****	**-1.644 *(.711)*****	**-9.320 *(.825)******	**-8.254 *(.842)******
N	403	403	399	403	403	403	757	757
NUMBER OF GROUPS	77	77	77	77	77	77	84	84
R^2 (WITHIN)	0.038	0.054	0.056	0.070	0.075	0.080	0.050	0.054
R^2 (BETWEEN)	0.003	0.013	0.019	0.010	0.001	0.001	0.004	0.0006
R^2 (OVERALL)	0.001	0.0007	0.0002	0.0002	0.009	0.008	0.006	0.014
AIC	2149.552	2144.741	2128.71	2140.417	2137.696	2139.828	3989.18	3987.275
BIC	2185.542	2184.73	2172.588	2184.405	2181.684	2191.814	4049.362	4052.086

Notes: Dependent variable is FDI. Estimation is by fixed effects (within) regression with AR(1) disturbances correction. Standard errors are in italics. Two-Tailed Test reported for each estimate. Statistical significance is indicated as follows: *p<0.10, **p<0.05, ***p<0.01

In models 6 to 10, we divide aid into non-U.S. and U.S. aid. Holding other things constant, and as expected by the theory, whereas *Non-U.S. aid* is positively associated with *FDI*, *U.S. aid* is negative. Holding other variables constant, a one percentage point increase in aid/GDP is associated with a 13 or 14 percentage point increase in FDI/GDP when the aid is provided by OECD members except the U.S.[87] However, a one percentage point increase in U.S. aid/GDP is associated with a 15 or 16 percentage point decrease in FDI/GDP. Aid from the United States and aid from countries other than the United States have opposite effects on FDI. These results provide support for both hypotheses 1 and 2.[88]

TABLE 5. UNCONDITIONAL EFFECT OF AID ON FDI IN POST-CONFLICT DEVELOPING COUNTRIES: SUBSTANTIVE IMPACT (ACCORDING TO MODEL 6)

INDEPENDENT VARIABLE	EFFECT OF ONE STANDARD DEVIATION ON THE INDEPENDENT VARIABLE ON FDI/GDP
NON-U.S. AID $_{T-1}$	1.106
U.S. AID $_{T-1}$	-0.510
MARKET SIZE $_{T-1}$	0.435

The substantive impact of the aid variables on FDI is considerable. Table 5 shows the effect of a one standard deviation increase in the statistically significant independent variables on FDI. A one standard deviation increase in *Non-U.S. aid* is associated with a 1.11 percentage point-FDI/GDP increase (note that *FDI's* unconditional sample mean is 1.92, and its standard deviation is 7.40). One standard deviation increase in *U.S. aid* is associated with a .51 percentage point FDI/GDP decrease. These substantive impacts are greater than that of a common predictor of FDI in developing countries: a one standard deviation-increase in *Market size* is associated with only a .44 percentage point increase in FDI/GDP.

The coefficients associated with the variables of interest change very little with the inclusion of additional controls. Model 7 controls for the intensity of the conflict. The duration of the conflict does not have a significant effect on the post-conflict aid that the country receives.

Models 8 to 10 include different temporal controls, which generally do not affect the independent variables of interest. In Model 8, when *Year count* is included, *U.S. aid* marginally loses its statistical significance. However, as discussed below, when the aid variables are interacted with *Year count* (a

[87] Note that the sample mean of the variable Non-U.S. aid is .041.

[88] We also run models distinguishing the impact of other individual donors. This negative statistically significant effect of U.S. aid on FDI does not characterize the impact of any other donor.

better way to take time into consideration), *U.S. aid* is significant. The coefficient associated with *Year count* indicates a positive trend in the years after the conflict: additional years elapsed since the end of the conflict are associated with increasing FDI. *Year count* shows that, other variables held constant, FDI/GDP increases almost one percentage point with each additional year that elapses after the end of the conflict. This finding may not seem surprising because of the recovery that countries experience after a conflict. However, note that the dependent variable is FDI normalized over GDP. Therefore, this coefficient indicates that FDI grows faster than GDP in the years after the conflict.

Cold war has a negative effect, indicating that the ratio FDI/GDP was lower between 1970 and 1989 than after 1990 (see Model 9).[89] Model 10 includes decade dummies. Regressions with different omitted decade variables[90] indicate the following statistically significant differences: Holding other things constant, FDI/GDP was 4.12 percentage points lower in the 1970s than in the 1990s. In the 1980s, it was 5 and 4.3 percentage points lower than in the 1990s and in the 2000s, respectively; and there is no statistically significant difference between the last two decades. Again, the inclusion of decade controls does not affect the effect of the variables of interest.

The last models go beyond exploring the direct impact of time, and look at how time conditions the impact of aid on FDI. They provide a test of hypothesis 3. According to this hypothesis, the informational effect of aid in post-conflict countries should decrease as time elapses. Models 11 and 12 include interactions between the aid variables and *Year count* to test this hypothesis. For these models, we use a broader sample, including ten years after the conflict, for theoretical and methodological reasons. First, a larger time span after the conflict allows us to better test aid's signaling effect as time elapses since the end of the conflict. Second, models including all the variables and the interaction terms run on the 5-year sample risk of being over-specified. However, the magnitude and significance of the linear combination of the aid variables and *Year count* in the smaller sample are similar to the results plotted in Figure 1.

The magnitude of the coefficients associated with the aid variables is higher in these models, indicating the effect of both sources of aid when *Year count* equals zero (that is, the last year of the conflict).[91] The interaction terms have the opposite direction of the aid variables (the interaction is negative for *Non-U.S. aid*, and positive for *U.S. aid*). This indicates that the effect of both types of aid decreases as time elapses since the end of the conflict. Figure 1 plots the linear combination of *Non-U.S. aid* and *U.S. aid* with their interaction terms, according to Model 12. The positive association

[89] This is consistent with Bearce and Tirone, 2010.
[90] Only one of these regressions is reported in Table 4.
[91] This is a statistical artifact, given that these years are not included in the sample.

between *Non-U.S. aid* and *FDI* decreases in the years following a conflict. This positive association is statistically significant at the .01 level until the third year after the conflict, and at the .05 level in the fourth year. Similarly, the magnitude of the negative association between *U.S. aid* and *FDI* decreases in the years following a conflict. This negative association becomes statistically insignificant after the third year since the conflict ended.[92]

FIGURE 1. IMPACT OF AID ON FDI, CONDITIONAL ON TIME SINCE THE END OF THE CONFLICT, AS OF MODEL 12. POST-CONFLICT DEVELOPING COUNTRIES (1970-2008)

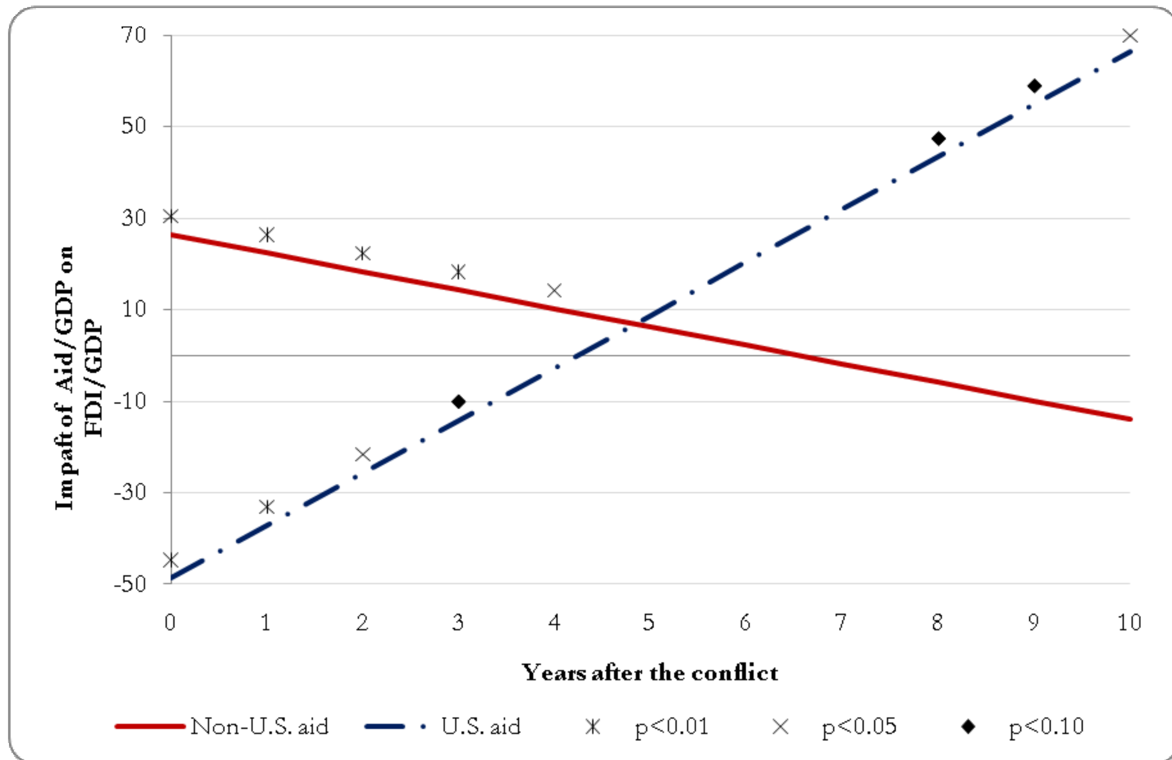

Table 6 shows the substantive impact of a standard deviation increase in aid on FDI, at different years since the end of the conflict. A one standard deviation increase of *Non-U.S. aid* is associated with a 1.73 percentage point increase in FDI/GDP in the first year after the end of the conflict. However, this effect diminishes to 1.42; 1.10 and .79 percentage point increases in the second, third and fourth year after the conflict, respectively. Similarly, the magnitude of the negative impact of one standard deviation increase in *Non-*

[92] Interestingly, the results suggest that U.S. aid starts having a positive and statistically significant effect on FDI eight years after the end of the conflict. This positive effect may be related to other mechanisms through which aid can affect FDI in developing countries, which are not tested in this paper. We speculate that eight years have elapsed since the end of the conflict without conflict recurrence may place the post-conflict country in the same situation as any other developing countries.

U.S. aid on *FDI* is reduced from 1.15 to .80 and .44 in the following years. These findings provide support for hypothesis 3.

TABLE 6. CONDITIONAL EFFECT OF AID ON FDI IN POST-CONFLICT DEVELOPING COUNTRIES: SUBSTANTIVE IMPACT ON POST-CONFLICT YEARS (ACCORDING TO MODEL 12)

	EFFECT OF ONE STANDARD DEVIATION ON THE INDEPENDENT VARIABLE ON FDI/GDP			
INDEPENDENT VARIABLE	1ST YEAR	2ND YEAR	3RD YEAR	4TH YEAR
NON-U.S. AID $_{T-1}$	1.728	1.416	1.104	0.792
U.S. AID $_{T-1}$	-1.165	-0.804	-0.443	

Note on alternative mechanisms and endogeneity concerns

The results presented above support the empirical implications derived from our theory. They also suggest the implausibility of alternative mechanisms.

First, for foreign aid to cause FDI through the "infrastructure effect,"[93] aid should boost the host country's economic and/or social capital and make the host country more attractive for investors. Several factors suggest this is not the mechanism driving our results. First, our models include a measure of economic development that should reflect this effect. Economic development is consistently insignificant in the post-conflict sample. Second, the formation of capital should take longer lags than a year (as used in our models). We believe that it is aid's informational effect what explains such an immediate effect on FDI. Third, one may argue that it is not the actual infrastructure building that attracts FDI, but the expectation that aid will increase it in the near future. In that case, the infrastructure effect would require that foreign aid had a positive effect on the host country's economy, and that investors believed that such a positive effect exists. However, as noted in the second section, this effect is not uncontested in the academic literature and it is even questioned by the general press. Fourth, if the causal mechanism linking aid to FDI is actual or expected infrastructure building, it is hard to explain the differential effect of U.S and non-U.S. development aid in post-conflict countries. Finally, it is not clear why aid's infrastructure effect would decrease over time and become insignificant after the fourth year in post-conflict developing countries.

Regarding the "financing effect," we find no literature or qualitative evidence suggesting that foreign aid is used to fund FDI profit repatriations. Finally, we do not find evidence a statistically significant effect of U.S. aid on U.S. FDI. Models that exclude U.S. FDI from total FDI inflows produce similar

[93] Dollar and Easterly, 1999; Kapfer, Nielsen and Nielson, 2007.

results to the reported here. As Kimura and Tod[94] found, the "vanguard effect" does not seem to link U.S. aid and FDI.

Because lagging the aid variables may not sufficiently mitigate endogeneity concerns, we tested whether FDI determines development aid. We found that FDI is consistently statistically insignificant in regressions predicting both non-U.S. and U.S. aid. Furthermore, neither type of aid predicts the other type of aid, rejecting concerns about substitutability of aid from different donors.

[94] Kimura and Tod, 2010.

Conclusions

This article has examined how foreign aid provides an important signal to investors, affecting FDI flows into post-conflict developing countries. We argued that post-conflict situations are uniquely low-information environments, and therefore investors look for signals to indicate the potential return on their investment. Aid functions as a signal because it suggests some level of trust of the recipient government, on the part of the donor government. However, we also argued that U.S. aid, due to its especially geostrategic nature, could function in a different way than aid from other countries.

Our empirical results, analyzing developing countries and post-conflict developing countries between 1970 and 2008, provided support for our argument. First, FDI in post-conflict situations does not respond to the same determinants as FDI in developing countries. Whereas a series of economic factors (such as market size, economic development, trade and capital openness) are associated with FDI in developing countries generally, they do not seem to drive investors' decisions in post-conflict countries.

Second, we showed that development aid affects FDI in post-conflict countries, but that the direction of the effect is conditional upon whether the aid came from the United States or from other countries. Aid from countries outside the United States appears to be a positive signal in post-conflict countries, as our argument suggests. This finding is robust to different model specifications, and it is substantively important. The positive association between aid and FDI is almost immediate, suggesting that aid's signaling effect takes place before and independently from whether development aid has accomplished its intended purpose. In other words, aid can bring unintended benefits in post-conflict countries.

However, U.S. aid seems to function as a warning sign, and not a security guarantee that safeguards or attracts investments. We describe it as a warning sign because of the U.S. tendency to aid countries not because of their economic potential or need, but instead for geostrategic reasons. We are somewhat cautious when interpreting the U.S. aid finding, however, because the statistical significance of U.S. aid is relatively low. Regardless, the substantial difference between the effect of U.S. and non-U.S. aid on FDI is consistent with our theory about aid as a signal, and the importance of whether or not it can be seen as geostrategic.

Finally, the effect of aid on FDI exists right after the conflict, but vanishes over time. It is likely that as time elapses since the end of the conflict, more information become available about the economic and political environment, and that investors rely mainly on that information and not on signals. This apparent time effect adds weight to our argument that aid is a signaling mechanism, especially valuable in the low-information post-conflict setting.

This project has implications for several areas of research. Regarding FDI literature, we have shown that post-conflict environments are different from other environments. Are there other sets of countries or periods that have unique determinants of FDI? Our theory suggested the importance of signaling in low-information environments. Researchers should take into consideration the availability of information in the cases they study, and consider the potential for signal effects when information is not as available.

The project also speaks to the aid literature. While a number of recent studies examine links between aid and FDI,[95] ours is unique for the signaling argument. It seems likely that aid can function as a signal in other situations as well, and future research can consider this. One possible avenue of investigation would be to disaggregate different types of aid, as they could suggest different signals. We showed that aid from the U.S. was unique, but aid is non-homogenous in a number of ways. For example, in addition to development aid, there is also democratization aid, and its consequences are only starting to be analyzed.[96] Our research also adds to the literature on the geostrategic nature of U.S. foreign aid,[97] and offers an as-of-yet-unreported implication of this aid.

Finally, the research is of normative interest to policymakers. Post-conflict developing countries are especially fragile, with damaged infrastructure and civilians at risk.[98] The international community benefits when these countries stabilize and develop, and increased FDI offers a path to these outcomes. Aid is a potential remedy, and our research shows that aid from countries other than the United States can offer important *unintended* benefits. Aid from the United States, however, seems to concern investors more than draw them. We do not suggest that the United States should curtail aid, but instead think about the geostrategic basis for its aid distribution patterns, as well as for the public justification of the aid. The United States could increase its work to encourage FDI in developing countries generally, in addition to (the admittedly less likely outcome of) distributing its aid based factors other than geostrategic concerns.

95 Asiedu, Jinc and Nandwa, 2009; Harms and Lutz, 2006; Kapfer, Nielsen and Nielson, 2007; Kimura and Tod, 2010.
96 Azpuru *et al.,* 2008; Finkel *et al.,* 2007.
97 E.g., Boschini and Olofsgard, 2007; Meernik, Krueger and Poe, 1998.
98 E.g., Ghobarah *et al.,* 2003.

Anexos

ANNEX 1: OBSERVATIONS INCLUDED IN THE 5-YEAR POST-CONFLICT SAMPLE

COUNTRY	YEAR
AFGHANISTAN	2002
ANGOLA	2003, 2005-2008
ARGENTINA	1978-1981, 1983-1987
AZERBAIJAN	1996-2000, 2006-2008
BANGLADESH	1993-1997
BOLIVIA	1970-1972
BOSNIA AND HERZEG.	1996-2000
BURKINA FASO	1988-1992
BURUNDI	1993
CAMBODIA	1999-2003
CAMEROON	1985-1989
CENTRAL AFRICAN REP.	2003-2008
CHAD	1995-1996, 2003-2004
CHILE	1974-1978
CHINA	1980-1984, 1988-1992
COMOROS	1990-1994, 1998-2002
CONGO, DEM. REP.	1970-1972, 1979-1983, 2002-2004, 2006
CONGO, REP.	1995-1996, 2000-2001, 2003-2007
COTE D'IVOIRE	2005-2008
CROATIA	1994-2000
CYPRUS	1975-1979
DJIBOUTI	1995-1998, 2000-2004
DOMINICAN REPUBLIC	1970
EGYPT	1971-1972, 1974-1975, 1977-1978,1999-2003
EL SALVADOR	1970-1971, 1974-1977, 1992-1996
ERITREA	2001-2002, 2004-2008
ETHIOPIA	1992-1995
GAMBIA	1982-1986
GEORGIA	1997-1998, 2005-2008
GHANA	1970-1971, 1982, 1984-1988
GUATEMALA	1996-2000
GUINEA	2002-2006
GUINEA-BISSAU	2000-2004
HAITI	1990, 1992-1996, 2005-2008
HONDURAS	1970-1974
INDIA	1973-1977
INDONESIA	1970-1974, 1993-1996, 2006-2008
IRAN	1970-1973, 1975-1978, 1989, 1994-1995, 1998, 2002-2004
IRAQ	1971-1972, 1997-2001
JORDAN	1972, 1974-1978
KENYA	1983-1987
KUWAIT	1992-1996
LAO, PDR	1991-2003
LEBANON	1991-1995
LESOTHO	1999-2003
LIBERIA	1981-1985, 1996-1999, 2004-2008

COUNTRY	YEAR
MACEDONIA	2002-2006
MADAGASCAR	1972-1976
MALAYSIA	1970-1971, 1976-1980, 1982-1986
MALI	1991-1993, 1995-1999
MÉXICO	1995, 1997- 2001
MOLDOVA	1993-1997
MOROCCO	1972-1974, 1990, 1992-1996
MOZAMBIQUE	1993-1997
NICARAGUA	1980, 1990-1994
NIGER	1993, 1995, 1998-2002
NIGERIA	1971-1975, 2005-2008
OMAN	1976-1980
PAKISTAN	1970, 1972-1973, 1978-1982, 1991-1994, 1997-1998, 2000-2003
PANAMA	1990-1994
PAPUA NEW GUINEA	1991, 1997-2001
PARAGUAY	1990-1994
PERU	1970-1971, 2000-2004
ROMANIA	1990-1994
RUSSIAN FEDERATION	1992, 1997-1998
RWANDA	1995-1996, 2003-2007
SAUDI ARABIA	1974-1978, 1980-1984, 1992-1996
SENEGAL	1991, 1994, 1996, 2002, 2004-2008
SERBIA	2000-2004
SIERRA LEONE	2001-2005
SOMALIA	1979-1980, 1997-2000, 2003-2005
SOUTH AFRICA	1989-1993
SRI LANKA	1972-1976, 2002, 2004
SUDAN	1973-1975, 1977-1981
SURINAME	1989-1993
SYRIAN ARAB REPUBLIC	1970, 1972, 1974-1977, 1983-1987, 1992-1996
TAJIKISTAN	1997, 1999-2003
THAILAND	1983-1987
TOGO	1987-1990, 1992-1996
TRINIDAD AND TOBAGO	1991-1995
TUNISIA	1981-1985
UGANDA	1973, 1975-1977, 1980, 1992-1993, 2008
URUGUAY	1973-1977
UZBEKISTAN	2001-2003, 2005-2008
VENEZUELA	1993-1997
VIETNAM	1988-1992
ZIMBABWE	1980-1984

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