



# The impact of armed conflict and terrorism on foreign aid: A sector-level analysis

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## ABSTRACT

We examine whether armed conflict, international and domestic terrorism affect distribution of bilateral and multilateral foreign aid. We argue that the two types of aid may respond differently to security challenges because of donors' disparate objectives and aid-giving motives. The results show that armed conflict reduces the amounts of obtained aid of all types, conditional on a country being an aid recipient. Multilateral donors are also less likely to include a conflict-ridden country on a recipient list. Domestic terrorism increases bilateral aid, but this effect appears to be entirely driven by assistance from the United States, arguably a terrorist prime-target country. When we disaggregate aid flows by their purposes, we find that international and domestic terrorism are associated with increases in bilateral aid for promotion of governance, education, health and society.

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## 1. Introduction

What is the impact of armed conflict and terrorism that occur within a state on the probability of receiving foreign aid and its amounts? Are the effects of domestic and international terrorism identical? In spite of recent improvements in the understanding of the linkages between foreign aid, conflict and security (e.g. Balla & Reinhardt, 2008; Boutton, 2014; Bezerra & Braithwaite, 2016; Young & Findley, 2011), the full answer to this question has remained largely obscured by the complexity of the aid allocation picture where various types of aid are allocated by a number of heterogeneous donors to an even larger number of heterogeneous recipients. For example, many donors appear to specify sector-level objectives for their assistance, however, much of the debate does not disaggregate aid flows but instead treats them uniformly (e.g. Alesina & Dollar, 2000; Azam & Thelen, 2010; Nielsen, Findley, Davis, Candland, & Nielson, 2011). But why should we expect different types of aid to respond in the same way to varying levels of development, democracy, peace, stability or security? By distinguishing between bilateral and multilateral donors and disaggregating aid flows by key purposes this article uncovers some of this complexity and provides empirical evidence on the effect armed conflict and terrorism have on foreign aid receipts.

Traditionally, aid giving has been seen as an altruistic redistribution of resources from developed nations to developing countries to fight poverty and promote economic growth, good

governance and social development (Azam & Laffont, 2003). Nonetheless, economists and political scientists have long recognized that aid may also serve a number of strategic purposes: it may be used to extend donor's cultural, economic and political influence, strengthen military allies, achieve security objectives, or as an incentive or reward for behavior desired by the donor.<sup>1</sup> Whether donor's intentions are altruistic or strategic, conflict and terrorism may affect their aid allocation calculus. For example, conflict and terrorism have been shown to have negative effects on economic growth and social development (Blomberg, Hess, & Orphanides, 2004; Collier, 2006; Gaibullov & Sandler, 2009), thus donors whose objective is to promote growth and development may be discouraged from providing assistance to affected countries. On the other hand, a donor driven by strategic considerations may choose to use aid to support an ally in conflict or help another state in fighting terrorism before it directly affects donor's interests (Boutton & Carter, 2014). Thus, the overall relationship between aid and political violence is likely to be an outcome of opposing factors and mechanisms, which may differ across types of aid, recipients, donors and time periods. This underpins the importance of disaggregating aid flows into their respective types and components when asking whether donors give more or less aid to countries

<sup>1</sup> Bueno de Mesquita and Smith (2016) present a theoretical model and evidence on buying policy concessions with foreign aid. Kuziemko and Werker (2006) provide evidence on the United States' behavior of buying the UN Security Council votes with foreign aid. The effectiveness of aid in achieving these objectives as well as factors influencing donors' behavior have been debated, with mixed and often contradicting results (e.g. Alesina & Dollar, 2000; Bjerg, Bjornskov, & Holm, 2011; Nourou, 2014).

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affected by armed conflict and either international or domestic terrorism. Our analysis expands the existing evidence by adding the following dimensions.

First, we consider bilateral and multilateral aid separately, whereas most studies focus only on bilateral aid (e.g. Boutton & Carter, 2014; Savun & Tirone, 2011; Young & Findley, 2011). The two types of donors are expected to react differently to various factors because of their differing policy objectives. Multilateral aid should be more responsive to the quality of policies and government in receiving countries and promote military expenditure reductions (Boyce & Pastor, 1998). This is because intergovernmental institutions are less likely to be influenced by commercial interests, strategic alliances, and geopolitical or historical considerations which often drive decisions of bilateral donors (Alesina & Weder, 2002; Bueno de Mesquita & Smith, 2016; Kuziemko & Werker, 2006; Mamoon, 2016; Nunn & Qian, 2014).

Second, we disaggregate aid into four sectors: (i) governance, (ii) education, (iii) health and social assistance, and (iv) business and trade. As discussed in the next section, investments in these sectors tend to have different implications for peace and security as well as donors' strategic interests. Thus, we may observe different patterns across these aid flows.

Third, we distinguish between international and domestic terrorism. Since this distinction is implemented by using the data from Enders, Sandler, and Gaibullov (2011),<sup>2</sup> we follow their definition of terrorism as “the premeditated use or threat to use violence by individuals or subnational groups against noncombatants in order to obtain a political or social objective through the intimidation of a large audience beyond that of the immediate victims” (Enders et al., 2011, p. 321). An attack is considered to be an act of domestic terrorism when the perpetrators, victims, target and venue all come from one country, i.e. domestic terrorism directly affects citizens and/or property of only one country. In contrast, an international attack involves perpetrators, victims, targets and/or venues from at least two countries (Enders et al., 2011). Majority of existing studies consider either only international terrorism or all terrorist attacks (e.g. Azam & Thelen, 2010; Young & Findley, 2011). We postulate that from a donor's point of view domestic and international terrorism are fundamentally different because of their varying effects on donor's interests and consequently we expect different responses to these two types of violence. In particular, we would expect bilateral aid donors to be more responsive to international terrorism which is more likely to directly threaten their strategic objectives, but we also recognize that donors' sensitivity to this form of violence may be muffled by its relatively low intensity: international attacks are nearly four times less frequent than domestic ones (Enders et al., 2011) and cause significantly less damage than armed conflict (Blomberg et al., 2004; Gaibullov & Sandler, 2009). We also anticipate a degree of sensitivity of bilateral aid to domestic terrorism which over time often leads to international terrorism (Enders et al., 2011). Thus, donors may feel that they cannot ignore home-grown terrorism abroad and choose to provide assistance to affected countries.

Our empirical strategy is based on a two-part model estimated for 184 aid recipients over the period from 1973 to 2007. At the gate-keeping stage a probit model is used to estimate the likelihood of receiving foreign aid, while the allocation stage makes use of the panel data properties and introduces a lagged depended variable, to account for aid-giving inertia, and recipient-fixed effects to estimate the amounts of aid allocated to recipients. Subsequently, we test the sensitivity of our results to various model specifications and estimation methods. Throughout this exercise, we are particu-

larly interested in linkages between foreign aid and armed conflict, defined as a use of armed force causing at least 25 battle related deaths (see Gleditsch, Wallensteen, Eriksson, Sollenberg, & Strand, 2002), as well as international and domestic terrorism.

The results confirm donors' aversion to armed conflict and its substantial impact on aid allocation. Countries experiencing conflict are less likely to become recipients of multilateral aid. Having passed the gate-keeping stage, recipients with armed conflict can expect the amounts of bilateral and multilateral aid to be cut by approximately 22% and 30%, respectively. At the sector level, conflict negatively affects the probability of receiving multilateral aid within all four considered sectors, whereas bilateral donors' aversion is manifested only in aid for health and social assistance, and business and trade.

The estimates show a positive effect of terrorism on bilateral aid. Countries suffering from international terrorism seem more likely to become recipients of bilateral aid (although this effect is only marginally significant), but despite our expectations, international terrorism does not affect the amounts of received aid. The positive effect of domestic terrorism is borne out at the allocation stage: recipients of bilateral aid receive significantly higher levels of aid than their counterparts without domestic terrorism. Nonetheless, this effect appears to be driven by the United States aid. The relationship between terrorism and aid is also visible at the sector level. Both types of terrorism positively affect bilateral aid aimed at governance, education, social and health assistance. In contrast, multilateral aid is not affected by either international or domestic terrorism.

In summary: armed conflict reduces the amount of either bilateral or multilateral aid, conditional on being a foreign aid recipient, whereas terrorism seems to increase bilateral aid for the promotion of governance, civil society, health and education.

The remainder of this article is organized as follows. First, we discuss our research hypotheses along with the existing literature. We then explain our data and their sources as well as lay out our estimation approach. In the two final sections we discuss our results and conclude.

## 2. Background

The economics and international relations literature is abundant with studies of determinants of foreign aid. Bandyopadhyay and Vermann (2013) review recent evidence on the donors' motives and note that over time the focus of foreign aid has moved from development to donors' strategic considerations. In an earlier study, Burnside and Dollar (2000) establish some determinants of bilateral aid and conclude that bilateral donors tend to promote their strategic political interests over poverty reduction, promotion of openness, democracy and good policies. Lis (2013) shows that they are also likely to turn a blind eye on the quality of civil rights, conflict and terrorism in oil exporting countries, but react to the size of recipient's fuel exports. Younas (2008) adds to the debate showing that OECD countries donate more to importers of goods in which the donor has a comparative advantage. A study by Fleck and Kilby (2010) echoes these findings and shows that the importance of need as a condition for aid eligibility decreased in the 1990's and relatively higher income countries have been more likely to receive aid in the aftermath of the September 11 attacks than during the Cold War. In this paper we investigate how allocation of bilateral and multilateral aid responds to armed conflict and terrorism which, as argued below, may influence decisions of donors who are driven by either altruistic developmental motives or strategic considerations. The remainder of this section outlines our main research hypotheses along with a brief overview of the literature informing each of them.

<sup>2</sup> Enders et al. (2011) decompose the Global Terrorism Database into domestic and international terrorism. Unfortunately, employing this decomposed dataset limits the time span of our analysis to 2007.

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