FINANCIAL TRANSFER AND ITS IMPACT ON THE LEVEL OF

DEMOCRACY: A POOLED CROSS-SECTIONAL TIME SERIES MODEL

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This dissertation is a pooled time series, cross-sectional, quantitative study of the impact of international financial transfer on the level of democracy. The study covers 174 developed and developing countries from 1976 through 1994. Through evaluating the democracy and democratization literature and other studies, the dissertation develops a theory and testable hypotheses about the impact of the international variables foreign aid and foreign direct investment on levels of democracy. This study sought to determine whether these two financial variables promote or nurture democracy and if so, how?

A pooled time-series cross-sectional model is developed employing these two variables along with other relevant control variables. Control variables included the presence of the Cold War and existence of formal alliance with the United States, which account for the strategic dimension that might affect the financial transfer - level of democracy linkage. The model also includes an economic development variable (per capita Gross National Product) to account for the powerful impact for economic development on the level of democracy, as well as a control for each country's population size. By addressing and the inclusion of financial, economic, strategic, and population size effects, I consider whether change in these variables affect the level of democracy and in which direction.

The dissertation tests this model by employing several techniques. The variables are subjected to bivariate and multivariate analysis including bivariate correlations, analysis of variance, and ordinary least square (OLS) multivariate regression with robust matrix and a lagged dependent variable. Panel corrected standard error (PCSE) was also employed to empirically test the pooled time-series cross-sectional multivariate model. The dissertation analytical section concludes with path analysis testing which showed the impact of each of the independent variables on the dependent variable.

The findings indicate less impact of international financial variables upon the level of democracy than hypothesized. Foreign assistance correlates negatively with economic development levels and has no effect on democracy levels. In contrast, foreign direct investment associates positively to economic development levels and, through increased economic development, contributes to democracy.

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CHAPTER 1

THEORETICAL FRAMEWORK: INTRODUCTION

The transition to democracy is a phenomenon that has won much

attention from political scientists in the last century. They therefore have tried to

trace out the various causes that make regimes more likely to be, or become,

democratic. Some researchers have employed one variation or another of the

'structural features' model in order to explain 'the level of democracy'. They

believe that the development of major different aspects of the economic and

social structure within a regime will lead to democracy (Lipset 1959, 69-105;

Olson 1993, 567-576; Whitehead 1999; Midlarsky 1997, Chaps. 4,5,6,7;

Vanhanen 1990). Others used cultural theories to explain the emergence of

democracy (Almond and Verba 1963; Inglehart 1988; Diamond 1994, Chaps. 1,9;

Almond and Powell 1963). Process theories were also employed to explain the

level of democracy as an end product of several development stages (Huntington

1993; Rustow 1970). This study will attempt to explain the level of democracy in

a different manner; it will emphasize the non-domestic elements and thus will

change the level of analysis from the research cited above. Hence, it seeks to

analyze the level of democracy as the result of international factors, especially

the infusion of foreign assistance and the flow of foreign direct investment.

Therefore, the main research agenda for this dissertation is to investigate

whether foreign aid and foreign direct investment promote or nurture democracy.

Foreign aid and foreign direct investment are sufficient indicators for international

financial transfers in nation states-- a significant political phenomenon with growing importance.

1.1 Significance of Study

The question of whether foreign aid and foreign investment promote democracy requires an answer for several reasons. First, the possibility that international factors could in fact foster democracy has, by and large, been ignored by prior research. Most studies tended to treat only domestic conditions. Although domestic affairs and conditions are obviously substantial, it cannot be left at that; outside elements can work for or against a transition to democracy. International factors are acquiring more importance in the studies that try to explain the level of democracy. Outside assistance and pressure may be the only ways for some societies to enjoy freedom, given their miserable domestic conditions. Secondly, domestic structural factors are indeed connected to, and affected by, the policies and actions of other regimes, especially in the era of globalization. When one nation sneezes, others catch cold; that is, nations are interdependent. Indeed, one of the problems in the political science literature is that comparative politics and international relations topics are researched independently and exclusively because comparative and international relations' scholars do not collaborate enough. One area pf great promise for political science lies at the intersections between comparative politics and international relations. This is logical, for the gap between these two fields seems fictional and definitely bridgeable.

Third, the substantial political change wrought by the end of Cold War has lessened the great power strategic competition. In that struggle the aim, the entire aim, was security oriented. In the United States' case the aim was to beat back the Soviet enemy. Yet the Cold War and the Soviet Union are now no more; consequently, great powers such as the United States have greater leeway to pursue other aims of foreign policy such as the promotion of democracy. The promotion of democracy has risen to the surface and appears achievable and more realistic after the collapse of the Soviet Union. In summary, one might suggest that in the post Cold War era societies are more likely than before to receive international aid that presses for democratization.

Fourth, upon closer examination, domestic factors cannot explain everything about the level of democracy. Any theory which places its hopes upon the supremacy of the domestic environment has theoretical problems and deficiencies that shall be explained in the literature review chapter. Such deficiencies require other approaches, those that do not depend entirely upon domestic factors, and thereby might explain more of the level of democracy. Domestic and international variables should work in conjunction with each other to try to explain the level of democracy.

Fifth, most countries[1] that have yet to turn toward democracy seem to have greater difficulty than prior democratizers in developing and improving their respective internal environment. Indeed, it is sound to say that democracy is a

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[1] Except the minority of countries with a significant economic development progress.

need and a prerequisite for these countries so that they might create a desirable internal environment that can foster favorable structural development.

Sixth, the range and extensive coverage of this study gives it another advantage. More than half of the countries in the world are not or only partly democratic, and are yet to democratize. Seventh, the potential audience for this research, given its range, includes not only political scientists who are interested in the variables under study, especially the level of democracy, but also the decision makers among both the donors and recipients of aid and investment. This kind of research is gaining the attention of practitioners as well as scientists because financial transfers are more feasible than other interventional means such as military intervention.

Eighth, studying financial transfers as a whole as opposed to only, a portion of it like foreign aid or foreign direct investment, is a step forward in the literature[2]. Often, only one of the previous variables was utilized as an indicator of the financial political influence.

Finally, the relation between the receipt of foreign aid and the founding of democracy was usually studied by international relations scholars in an attempt to understand foreign policy behavior. As a result, democracy was treated as an independent variable. In contrast, the research conducted here will treat the level of democracy as the dependent variable, while foreign aid, foreign direct investment, and other control variables are independent ones. As far as can be determined, this is the first time that an empirical study will treat the level of

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[2] Foreign aid is the total of all aid that countries give, not merely the United States' aid which is mostly used in the literature.

democracy as a dependent variable when examining foreign financial transfers – democracy relationship.

The list above is by no measure an exhaustive one. Yet it highlights some of the motivations for research on the unique phenomenon of democratization that drive this paper. The changes that have occurred in the international environment and foreign aid and investment behavior, as well as the deficiencies from which the domestic features suffer, give this research its uniqueness. Explaining the level of democracy is still a current topic in political science and requires further analysis and investigation.

1.2 Structure of the Study

An extensive literature review will constitute chapter 2 of this dissertation. This chapter is important because democracy is on of the most studied topics in comparative politics. Consequently, an overview of the literature of democracy and democratization[3] will pave the way for and reveal the fit of any new study within this crowded field.

The chapter will cover three main sub-fields of political science that are necessary for the scope of this study: the democratic peace ideas and why democracy is worth the effort, theories that address domestic and international factors that improves the level of democracy, and the foreign aid and foreign direct investment – democracy empirical and theoretical links.

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[3] This will be in addition to other needed literature reviews.

The underlying assumption herein is that there is widespread agreement on the desirability and importance of democracy. Most political science literature takes this idea for granted and seldom stops to explain why democracy is indeed a desirable regime or should be so regarded (Lipset 1959, Olson 1993, Whitehead 1999, Midlarsky 1997, Vanhanen 1990, Almond and Verba 1963, Inglehart 1988, Diamond 1994, Huntington 1993, and Rustow 1970). If one wishes to address ideas of democratization and suggest means to further enhance democracy, one must acknowledge that some, especially real world actors, simply disagree that democracy is a desirable goal or should be an end for societies to seek. Thus, the original ideals of the 'democratic peace' literature and its founding father Immanuel Kant will be presented. The democratic peace literature review will be limited to the above declared goal and need: why democracy is worth the effort? It will not go beyond that to explain the broader literature on the democratic peace.

The democracy and democratization literature lie at the core of this chapter. This section of chapter 2 will be subdivided into two divisions: domestic and international theories of democratization. Domestic theories will include structural, cultural, process, and elite reasoning for democratization while international theories will include military intervention, foreign aid, and foreign investment theories of democratization. The literature shows through its breadth and depth alone how important democracy is. Anticipating my later arguments based on the review, the extant literature seems unbalanced, extensively emphasizing domestic explanations of democratization, and undervaluing

international or outside causes (Lipset 1959, Olson 1993, Whitehead 1999,

Vanhanen 1990, Almond and Verba 1963, Inglehart 1988, Huntington 1993).

International theories of democratization will be further divided into military

intervention and financial transfers. Financial transferss as a cause of

democracy seem to gain more attention especially in the era of globalization[4].

However, financial transfers have usually been treated in the literature as a

dependent phenomenon (variable) to better explain theories of foreign policy,

design policies and assist decision makers. That is unlike the intention of this

study, which will investigate the effect of financial transfers as an independent

variable on the level of democracy among recipient countries. The literature with

its three sections outlined and criticized below clarifies some important lacunae

and therefore supports the need for this research.

Chapter 3 will establish the theoretical framework and describe the

expected relations among the variables. This will include a review of the logic of

donors, investors, and recipients. The dynamics of the financial flow between the

two sides of the financial equation (donors-investors and recipients) with its logic

explains why and how the level of democracy may be driven by foreign aid and

foreign direct investment. The better one can understand or isolate the stages of

thinking or decision making and cast light on them, the more one can assess the

working of financial transfers and suggest generalizations and trends as a result.

Only then, in addition, may we be able to suggest improvements that might

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[4] Globalization can be defined as the rapid and politically uncontrolled increase in
the flow of goods and services across national borders.

increase financial transfers' effectiveness on the process of democratization while decreasing any undesirable side effects.

Chapter 4 will outline the research design, which will include hypotheses, operationalization and methodology. Several testable hypotheses will be derived from the theory in the previous chapter. Aid and investment are the two primary independent variables that are hypothesized to have an impact on the level of democracy among the recipient countries. They both are expected to have direct, positive relationships with the level of democracy. These relations, however, are overshadowed and deeply complicated by security and economic interests. Control variables that are believed to have impacts on the level of democracy, especially the ones concerning security and economic interests, will be utilized in order to isolate their effect on the anticipated primary relationships (Meernik, Krueger, and Poe 1998). More specifically, economic development is often quite powerful in explaining democratization. Further, I will introduce a Cold War and alliance variables to control for the strategic and security impact on the relationships hypothesized (Meernik, Krueger, and Poe 1998). These variables will be included as control variables. Population size will also be used. Each one of the variables used will be operationalized and the best method of testing outlined. The data used include 174 countries for a time period of 1976-1994, and will be described in this chapter because its characteristics are vital for the type of statistical tests that will be utilized as well as the interpretation of the data.

Chapter 5 will present the empirical analysis of the data. In this chapter,

Ordinary Least Squares (OLS) regression analysis will be performed on a pooled

cross-sectional time-series data in order to test the hypotheses. This advanced

and widely accepted method, however, has the potential of certain statistical

limitations that can damage the reliability of the results. Therefore and in an

attempt to solve these statistical problems, Panel Corrected Standard Error

(PCSE) and path analysis tests will be performed. These tests do not suffer from

the potential statistical problems of regression analysis in pooled cross-sectional

time-series analysis. The research will end with discussion and analysis of the

results and findings as well as suggestions for future research.

CHAPTER 2

LITERATURE REVIEW

2.1 Introduction

Before diving directly into the literature or advancing this study further, it is necessary to define "democracy." Although there are debates on how to define democracy, a minimum level and satisfactory definition can be found. Democracy is the system that allows for a peaceful transition of power; it is the rule of the many or majority, while respecting the rights of minorities; and it has rules that protect civil liberties and political rights, i.e., the rule of law (Cohen 1971; Sorensen 1998). This definition is often implied, but not declared in the literature, hence it serves the purpose of this study to make it explicit. These principles are treated in the literature as accepted norms and I will employ them in this study because this minimum-level definition conveys the essence of what most researchers and citizens mean by democracy.

The literature review consists of three major areas of scholarship. The first addresses why democracy is desirable and why it produces good outcomes-- what is so special about democracy that makes it desirable. The democratic peace literature will be reviewed in this section. The second and third sections will address scholarship in democratization, the core concept of this research, and international democratization theories. My choice of literature review is guided by the need to give a comprehensive look at the dynamic phenomenon of

democratization in addition to demonstrating where my research fits in the literature.

2.2 The Democratic Peace

The underling assumption in studying democratization is that democracy is a desirable system of government and that it is widely viewed as one of the best systems, if not the best system, in the world. Indeed, many societies and people clamor for democracy. They want to be able to provide more input to the public decision making process and contribute to the way their lives are structured. In fact, the empirical evolution of democracy is that over time more nations are adopting this system. The graph created below (figure 2.1) emphasizes this notion. I have created this graph based on Vanhanen's measure of democratic nations from 1810 to 1998. The graph represents the mean democracy score for all nations in the world for each year. One can easily see the three waves that Huntington (1993) discussed.

Figure 2.1: Vanhanen's Mean Democracy Score for all Nations in the World
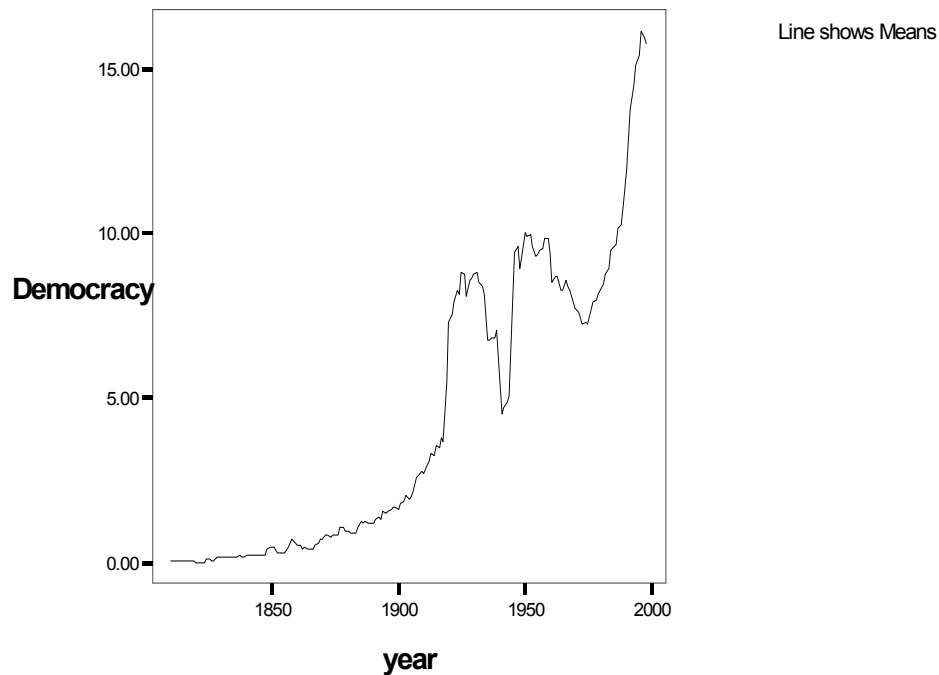
In contrast, authoritarian regimes are viewed as the worst sort of governance that do not comply with basic modern and liberal political values embodied in democratic systems, so much so that people do not wish to live under them (Sun 1999). This observation is substantiated when one notes the number of successful democratic states over and against the number of successful authoritarian ones. What is more, it is widely accepted among researchers that democracy is not only desirable because it is a value, that is, choice worthy for its own sake, but also because it is very efficient in promoting economic growth within a nation and peaceful cooperation between nations (Doyle 1983, Sorensen 1998).

Immanuel Kant (1788, 1795), the father of the democratic peace argument, envisaged a "pacific union," in which he described why democracy could promote peace among nations and would allow prosperity to flourish (Doyle 1983). He believed that democratic nations share a peaceful culture that encourages peaceful interstate conflict resolution. Almond and Verba (1980) talked about a similar culture that they called the "civic culture," one in which tolerance, not harsh intolerance and violence, prevails. For them, the democratic culture is the so-called "civic culture." They believe that the non-governmental formal and informal institutions and organizations (which includes interest groups) plus the network among them are what constitute this culture. They describe the civic culture as a mix of three types of political attitudes and orientations in the society. These attitudes need to be mixed in order to get the civic culture. The attitudes are "parochial" in which people are not aware of the political process and do not participate; "subject" in which people are aware of the political process but do not participate; and "participatory" attitudes in which people are aware of the political process and indeed participate.

Kant also believed that because this culture is common among democratic nations, it creates common norms or "bonds." As a result, democracies would feel that they are closer to each other, that they are related as family, and that they are much more similar than they are different. Democracies would thus have a mutual understanding of issues and therefore would not need to fight in order to resolve disputes. Peace would prevail among democracies because they would share a common moral foundation. Sorensen (1998) added that

peace would also prevail because democratic countries are legitimate and politically stable, which should help them cooperate and ally politically.

Finally, Kant believed that since democracies seek and highly value economic prosperity for their people, they would more likely to cooperate for the sake of "mutual advantages." The more they cooperate the more they will be interdependent. Kant indeed was one of the first who wrote about economic interdependence. Sorensen (1998) agrees with Kant on the democratic-economic prosperity relation because he believes that democracies are more likely to invest in basic human needs and they provide for a stable political environment that fosters economic pluralism. Thus democratic pluralism is very fertile ground for economic growth.

The previous three assumptions are the major cornerstones in the idealists' notion of the democratic peace. Interestingly, these assumptions are very close to some modern realists' views of world peace. Singer (1961), for example, argues that "interaction opportunity," which is the ability of states to interact freely without any pressure from the system, is what promotes global peace.

In addition to the major points outlined, certain features of democracy such as the system of checks and balances (Maoz and Russett 1992) and the idea of "audience cost" (Fearon 1994) have been used to explain the democratic peace as well. Democracies are complex systems with complex structures and have slow decision-making processes because of pluralism and accountability. They are expected to slow decisions for war and consequently to foster peace.

In addition, democratically elected leaders fear the "audience cost" and therefore are more likely to avoid issues that are not popular, or at least have the potential of being unpopular, such as war. At the same time, democracies are less likely to back down if they are engaged in war because of that same audience cost. So, they avoid war as much as possible, but once war is imminent, there is no backing down otherwise the political risk would be too high for leaders. In fact, a high degree of popular mobilization behind war is expected once democracies are at war or close to a war (Fearon 1994).

The arguments for a democratic peace are among the most accepted generalizations in the political science literature. Nonetheless, there are criticisms of the idea. The first question concerning the pacific union is an empirical one. The example of NATO's (North Atlantic Treaty Organization) attack on the former Yugoslavia in the year 2000, which by many measures was a democracy or very close to a democracy when war started, is an empirical falsification to the democratic peace argument. This is a clear observation that contradicts Kant 's expectations. This reveals that one may find observations that contradict the pacific union assumptions, and therefore leads one to question their predictive power.

Aside from this practical falsification, the assumptions suffer from theoretical difficulties. The pacific culture Kant envisaged is actually an issue under debate and a troubling variable. Culture as a variable is vague and can be interpreted in different directions. It has always been treated as a second level variable, whereby one uses it whenever other explanations fail to explain certain

observations. Democratic culture is by no means a sufficient condition for peace among nations and one might even argue that it is not a necessary condition. Almond and Verba (1980) would also criticize the same assumption by saying that "civic culture" is not actually a dichotomous variable, as Kant seems to imply; it is not a black and white issue. Not all democracies have the same level of civic culture, and therefore they are not expected to behave the same. The acquisition of democratic culture is a process that takes many years, decades, or even centuries to grow and mature, and there are enormous factors that contribute to it. New democracies are not expected to behave like old ones. In sum, democracies will take time to reach the maturity to possess the mutual understanding and moral bonds Kant talked about. It is a theoretical and empirical mistake to assume that a pacific union will develop and expand whenever a country becomes a democracy.

The state of interdependence Kant envisioned, although it creates "bonds," also increases the number of issues under discussion. When countries depend on each other, they have more issues to seek agreement upon than if they were not dependent. This problem would seem to become quite severe if we think of the pluralist structure of democracies that is needed for accountability and oversight.

The complex structure of democracies by itself is another story. It has been argued that the structure of democracies is an important factor in democracies' peaceful nature (Maoz and Russett 1992). Democracies are supposedly slow in making decisions, including the decision to go to war.

Democracy implies pluralism in the decision-making process, which renders efficiency more problematic. Democracies' actions and decisions are more difficult because of pluralism (i.e., the existence of many organizations or institutions that must be consulted, not just one man, as in a dictatorship) and accountability. This does not explain, however, why the structure does not prevent democracies from fighting non-democracies. Nor is it clear that one can make the case that non-democracies have less complex structure than democracies.

Finally, the idea of "audience cost" may put more pressure on democratically elected leaders to find peaceful ways of conflict resolution (Fearon 1994). But why is that not also true in non-democracies? One can argue that a decision of a lost war by a democratic leader might cost him or his party elections while it might cost a dictator his head. And that same audience cost might pressure leaders to enter a war and win it. Indeed, some elected leaders, according to the diversionary use of force theories, are aware of that and might nevertheless use outside conflict such as war in order to achieve domestic political gains (Midlarsky 1989).

The main value behind outlining the democratic peace literature is to emphasize the importance of democracy and consequently the rent behind the transition to it. Additionally, the idea advanced by this literature that economic cooperation is likely among democracies seems to coincide with the variables of economic growth, foreign aid, and foreign direct investment. I hypothesize that these variables as parts of economic cooperation are not only benefits from the

existence of cross-national democracy, but also important paths and

mechanisms that lead to democracy.

2.3 Scholarship of Democratization

We might think of this category as the "causation" theories of

democratization. These theories are generalizations that attempt to explain and

predict when, and under what conditions, an authoritarian regime will become a

democratic one. I categorize theories of this sort as either international or

domestic. Domestic factors and theories may be classified as structural,

process, cultural, and elite theories of democratization, and international factors

and theories include military intervention and financial transfers. The latter will

be further broken down into foreign aid and foreign investment. Table 2.1

illustrates this dichotomy. Table 2.1: theories of democratization:

Theories of democratization					
International theories			Domestic Theories		
Military Intervention Theories	Financial Transfers Theories [5]		Structural Theories	Process Theories	Cultural Theories
	Foreign Aid Theories	Foreign Investment Theories			
			Elite Theories		

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[5] Financial intervention theories can indeed be part of domestic structural theories as they function in conjunction with them. The categorization above is to simplify theories of democratization through subcategorize them as extensively as possible.

2.3.1 Domestic Theories

These types of theories deal with domestic or internal features and dynamics that may affect the level of democracy for a certain society. They are believed to be the most persuasive and powerful explanations of democratization and occupy most of the causation literature.

2.3.1.1 Structural Theories

Structural theories generally argue that there are certain types of prerequisites or certain conditions for democracy that predispose a society toward democratization. Once certain conditions are met, democracy is likely. The main assumption is that economic development will increase the standard of living in a society by increasing its aggregate and distributed capital wealth. This should have two effects. First, people will have an interest in public life that transcends a concern for their basic physical needs (Helliwell 1994, Lipset 1959). Prosperous citizens have much at stake and, consequently, have much to protect. They do not want government to attack or to undermine their property or prosperity. As a result, they tend to become more involved in public life to protect or increase the wealth they accumulated. Second, people have the economic capacity to improve and develop themselves. Education requires money and, with money in hand, the prosperous are able to seek a higher level of education (Whitehead 1999). Their level of prosperity allows them to pursue other aims besides the basic physical and essential needs. These two basic

effects of economic prosperity have direct connections to the system of government societies have. It is assumed, however, that the system provides mechanisms for a decent degree of wealth distribution among people. By being more interested in public life and having a higher level of education, people are more aware and capable of judging political behavior. Hence they expect and demand more from the government; they will seek a better public life in general (Olson 1993). More specifically, more prosperous societies demand more liberties and political rights.

If regimes are flexible enough in the sense that they try to address these demands, a peaceful transformation from authoritarianism to democracy is expected (Hyden 1999). However, if regimes do not respond to the public demands, a violent transformation of systems is expected (Bessinger 1998). Nonetheless, in both scenarios societies are likely to gain more liberty. The higher the level of economic development, the more likely societies that enjoy this development will become democratic. This hypothesis is important not only because of its statistical validity, but because it stands behind the explanation of democracy in North America and Western Europe, the world's oldest democracies. Old democracies became democratic after they gained a significant level of economic development and prosperity (Lipset 1959; Huntington 1993; Sorensen 1998). To best draw a more comprehensive picture and to organize the rich literature of structural theories, three major arguments by pioneer scholars shall be utilized.

2.3.1.1.1 Economic Development

No serious discussion about structural theories can be done without mentioning probably the most influential structural theorist, Seymour Martin Lipset (1959). He outlines what he believed to be the basic features that are necessary supporting conditions for democratization. He argues, that in themselves, these conditions are not sufficient but rather necessary. His major independent variables and prerequisites for democracy are wealth, urbanization, education (which is most significant), and industrialization. He used these as indicators of economic development. Modernization derived by the interplay of these variables allows societies to democratize. Lipset, however, dichotomized the dependent variable of democracy and thus overlooked its full variability.

Another criticism of the argument that economic development leads democracy is a possibly negative correlation between economic development and democracy in some instances. This refers to the low degree of political participation, especially voting, in most industrialized countries that have reached and maintained a great level of prosperity (Midlarsky 1997). This turnout decline has sufficiently alarmed some industrialized democracies, such as Germany and Italy, that they have enacted mandatory voting under penalty of fines. The assumption behind low participation is that people with a high level of prosperity will no longer care about public life because they have already gained most of what they need or want. People in prosperous countries become indifferent to public life after they reach prosperity (Midlarsky 1997; Gibson 1999). The

positive correlation between development and democracy holds only so long as people pursue prosperity; that is, especially at lower and middle levels of development. Once citizens have attained adequate means, they will no longer care so much and therefore will participate less. "Post materialism" as identified by Inglehart (1988) seems applicable to this discussion. People in industrial societies have witnessed a long period of affluence that changed their political attitudes. People can become indifferent to political life as a result of affluence.

One might argue that economically developed democracies with low participation may not be healthy. Although participation alone does not fully delineate democracy, citizens' involvement is an essential part. Healthy democracies, therefore should sustain high levels of participation under all economic circumstances. Falling participation might be threatening to the very foundation of democracy and its definition. The negative correlation between turnout and development in rich countries, poses a serious correction to the original economic development-democracy theory by suggesting that the relationship of democracy to economic development is non-linear.

Another problem of these theories is the direction of causality. Does economic development engender democracy or visa versa? Is economic development a prerequisite for democracy? Or must democracy exist first in order to have economic development? Empirical testing shows that while economic development is a major factor for democratization in many cases, economic development is a result of democratization in other cases (Burkhart and Lewis-Beck 1994). Societies by seeking better economic conditions may

change their political systems toward political liberalism, which can help generate economic prosperity. East Europe in the third wave seems an example that can fit this generalization. The assumption is that capitalism is one of the best economic systems for development and it can only succeed, or best function, in societies with liberal political systems. The theoretical arguments that use the economic development variable make it clear that it is a variable that can be used in different directions and it is often significant. This subjects any hypothesis that uses such a variable to internal validity problems, wherein the direction of the relationship between variables can flow either way. The process of democratization needs hypotheses and assumptions that do not suffer internal validity problems.

The last criticism that can be leveled against the economic development argument is that it is unable to specify the lapse of time that must pass before the democratizing effects of economic development manifest themselves. What is the time between the occurrence of economic development and the transition to democracy? How much development is needed in order to achieve democracy? When is the "take off" stage? Moreover, if any time frame could be defined, the question then becomes why this particular amount of time? This is another question that justifies and encourages further study in the field. The economic development theories, although important theoretically and empirically, are not sufficient enough to explain democratization and indeed suffer from substantial shortcomings.

Economic development is a variable of choice to this research for two major reasons. The first is to control for its effect on the overall model, as any model that attempts to explain democratization cannot afford to ignore economic development variables or will be better off when accounting for such variables. Second, economic development is at the heart of the model herein as it serves as an important part of its dynamics.   Understanding the functioning of the two main independent variables employed, foreign aid and foreign direct investment, is better done through analyzing their interaction with economic development. Economic development is an intermediate variable in my model.

2.3.1.1.2 Social Structure

Rueschemeyer, Stephens and Stephens (1992) lay out another important structural theory. They argue that power must be distributed widely among members of the society before that society would develop democracy. Societies with large middle classes are more likely to have distributed power. One would expect large middle classes to pressure regimes in pursuing their interests. This relation should move their societies toward democracy as a response to the interests of middle classes. Another structuralist is Tatu Vanhanen (1990). He also used the idea of power distribution in the society as necessary for democratization. He created the Power Resources Index that consists of education, urbanization, tolerance, size of the middle class, and wealth to capture this distribution. The more these variables are aggregated and

distributed among citizens, the more likely democracy will prevail in a given society.

The previous two structuralists explain democracy using social structure and the distribution of power. The optimal type of power distribution to foment democracy exists when the middle-income class controls substantial share of the society's power. With such a large middle class, no other part of the society will be strong enough alone to dominate the society. Competition among the societal elements and classes is expected as a natural outcome of this kind of power distribution. This in turn creates pressure toward a system that can allow compromises amongst competing political issues, and encourages peaceful settlements of conflicts among the different parts of the society. This system should be capable of managing and institutionalizing competition and conflict. A democratic system, where laws and roles are what organize societies, is the best system to manage and institutionalize societal competition and conflict.

As smooth and logical as these theories are, one of the problems that can be noticed in this literature is that social structural theorists rarely took the time to explicitly and thoroughly address the differences among classes. They imply but never discuss this issue because they assume that most agree on the importance of a middle class. Also the factors and elements that are required in order for the middle class to exist, i.e., how societies can actually create such a class, are not addressed. Scholars stress the need for a middle-income class for the promotion of democracy yet they never explain how it is created. This is not an easy task, however the literature may have cavalierly treated it. As matters

stand now, the only hint that the author could track down is that middle classes come as a result of economic development that can help a large portion of the society be in the middle income zone. This argument undermines the independence and persuasiveness of the social structure logic and makes it look like an intervening variable to the economic structural model. Consequently, the argument reinforces the need for alternative explanations that can theoretically stand on their own.

2.3.1.2 Process Theories

Although structural theories occupy a significant part of the democratization literature, probably the biggest part, other theories and explanations have been advanced and accepted by the scientific community as intuitive and promising. Process theories simply assume that countries have to go through several "stages" before becoming democracies. Democracy does not happen overnight; it evolves and develops. There is no clear agreement on what are the stages required for democracy. Different scholars have various takes on the subject. To best understand the logic of these theories, three leading scholars' arguments will be utilized.

Samuel Huntington (1991), although he has contributed to many aspects of comparative politics including the structural, cultural, and international theories of democratization, is best viewed as a process theorist. Huntington believes that rapid economic growth will lead to either modernization or political development. If modernization is faster than political development, a developing

country will end up with political decay and if political development is faster than modernization it will enjoy stability. Political development has to happen before modernization in order for a society to have stability. It is only in this case that the transition to democracy is likely, Huntington implied. If modernization happens first, it would overload the system that is not developed and does not have the equipped institutions. He defines political development as the institutionalization of political organizations and procedures. He defines institutionalization as the process by which organizations and procedures acquire regularity, value and stability, and modernization as the mobilization of citizens to act politically. The diagram below describes Huntington's major argument:

```
                          A-Modernization
                        ↗                 ↘
Economic Growth                              Political decay or stability
                        ↘                 ↗
                          B-Political development
```
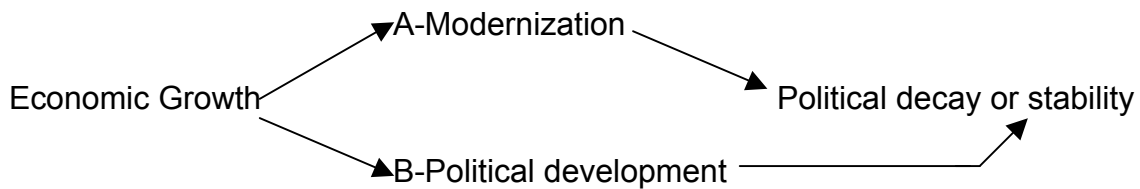
If A happens before B, then will be political decay.
If B happens before A, then will be political stability.

Huntington justifies this logic by arguing that political development is reversible while modernization is not. This is one of his major contributions to the literature of political development. Arguably Huntington is concerned with political development and most significantly stability, implying that they will lead to democracy. From a process theory point of view, one can say that economic

growth[6], modernization, political development, and stability are the stages that Huntington believes will foster democratization and lead to democracy in a given society.

In addition, Huntington (1993) argues that understanding authoritarian regimes typology is vital for understanding the transition to democracy. Authoritarian regimes are very diverse and share only the absence of democracy. He classifies regimes into three types "one-party systems, military regimes, and personal dictatorships" based on who holds power. The first two categories are more institutionalized as the head of the regime may change over time. In contrast, personal regimes focus all authority and power in one figure. Huntington designed a model which utilizes this typology and matches regime type with a certain type of transitions to democracy. He categorized democratic transitions into three categories: transformation, when the authoritarian regime gives up power willingly; replacement, when the democratic opposition overthrows the authoritarian regime; and transplacement, a mix of the previous two in which the regime elite and the opposition negotiate a transition to democracy. These are the three scenarios by which authoritarian regimes may become democratic. Personal dictatorship is likely to experience the replacement scenario which is often violent, while one-party systems would experience the transformation scenario which is likely non-violent. Transplacement is likely to occur with military regimes as the new democratic regime would need military for

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[6] Huntington's interest in this variable makes one safely say that he can also be characterized as a structuralist and belongs to this section of the literature.

the state and therefore the military from the old regime will have a role to play in the new political arrangement.

Dankwart Rustow (1970) is another scholar that came up with his own stages that will lead to democracy. Rustow's most significant stage and major contribution is the stage of the elite response to changes in society. He argues that the initial stage is one where conditions are set for political change. These conditions can be a level of modernization and economic growth. The conditions function effectively because they require some change in the political, social, and economic arrangements in the society. They try to push for new rules and change in the formal and informal traditional structure of the political system in a given society. The second stage, according to Rustow, is one where the elites feel the need for new compromises and indeed reach some sorts of accommodation among themselves. They are expected to agree on democratic goals and norms as an effective system to institutionalize conflict. A successful end of the previous two stages should create the third stage whereby a new and stable equilibrium is born. This in turn fosters and encourages higher levels of modernization. This cycle is what can bring democracy to societies.

Adam Przeworski (1986) is a third process theorist. He too emphasizes the elite's role in the process of transition toward democracy. He argues that the key to democracy is that the elite arrive at some sort of "rules of the games." The negotiation to reach this stage should be peaceful. These rules should not ensure any "winner", but rather function as binding procedures that institutionalize conflict and competition among societal powers.

Process theories do make sense theoretically and practically. Democratization is a comprehensive and a dynamic phenomenon that must necessarily evolve through time and stages. In fact, it is hard to argue that other theories of democratization including structure, elite, and cultural do not produce a staged process of change. This last point of praise is my first critique of process theories. It seems that the only thing these theories come up with is a sequence of steps or a time order to develop arguments advanced by other democratization theories. Process theories have limited ability to stand alone without borrowing heavily from other explanations of democratization.

A second critique is that these theories have not developed any consensus on one process or a set of stages in democratization. The three examples outlined above depict rather different processes. Thus process theory appears to be loose and to lack boundaries. It is also clear that the question of how much of each stage we need in order to jump to the next one cannot be answered. Some stages might take longer in some societies than in others. This legitimate concern affects negatively the generalizability and predictability of these kinds of theories.

My last concern is supported by the game theory logic of strategic interactions. Process theories seem to suggest a linear development or a sequential evolution of stages. I am not sure that the world is that simple. Most of these theories do not assume any reverse in processes. Huntington's suggestion is not even close to the idea of stage reversal. He assumed that a certain stage "political development" might go negative after being positive but he

does not suggest a reverse in the whole process. Complex interaction among stages seems more realistic than a linear one and this might in fact be the future of process theories.

2.3.1.3 Cultural Theories

The last part of the domestic theories of democratization is comprised of what might be termed cultural theories of democratization. Culture is a problematic variable because it is hard to define. However, scholars seem to agree that political culture is the set of attitudes, values, ideas, and orientations that citizens of a country have toward their political system (Almond and Verba 1980). Cultural theories assume that the type of culture societies acquire affects how they are governed, in particular democratization. Some types of culture favor democracy whereas others do not (Huntington 1993). The best culture according to many of these theories is the "northern culture", which is the culture of most of North America and West Europe. The two cultural features that are used to distinguish the North are its being significantly Protestant and being supportive of individualism. Other cultures do not have these characteristics to such a degree, so they are not expected to make the transition to democracy, as does the North's culture (Huntington 1996). On the face these theories are supported by the map of democratic distribution in the world, which shows that the oldest democracies in the world are located in North America and West Europe, the cultural center of Protestantism and individualism.

The previous argument constitutes what might be called classic or traditional political culture literature, yet this does not account for the whole story of political cultural and its connection to democratization. The best approach to understand the literature of political culture is the "historical" one; tracing the historical evolution of cultural theories. The first significant attempt to push for political culture theories was advanced by Almond and Verba in 1963 when they came up with their influential 'The Civic Culture'. They studied five nations for five years using five thousand surveys. They suggested that there are three types of political culture: parochial, in which people are not aware of the political process and do not participate; subject, in which people are aware of the political process but do not participate; and participatory attitudes, in which people are aware of the political process and indeed participate. A mix of these cultures is what constitutes the civic culture and the latter is the best one for promoting and maintaining democracy. The ideal civic culture is one that can promote associational behavior, tolerance, and interpersonal trust.

Almond and Powell (1966) also contributed to political culture and tried to answer what shapes core political values and concluded that political, economic, and social institutions can best do that. In 1980, Almond and Verba wrote the 'Civic Culture Revisited'. They argued that ideally, in the ideal civic culture that is receptive to democracy, people should voice their opinions through participation but not to become so involved that they reject decisions, compromises and outputs made by the elite. Huntington (1982) and in 'the Clash of Civilizations' (1996) argues that cultural change is a crucial factor for the transition to

democracy. Cultural differences are substantial among different civilizations and it is a fundamental element in defining the political setting and behavior of nations.

The above overview gives a sufficient picture of the landscape of political culture; however, what is of the interest in this research and indeed a significant part of the literature of political culture is the question of whether culture "causes" democracy or any political setting. Or does the exact opposite occur? Diamond (1994) rejects the notion of cultural determinism for political systems. Culture constrains behavior but does not determine it. It is the type of regime and elites who determine political culture, including the democratic culture. Booth and Seligson (1993) disagree with this, suggesting that political culture does not seem to be fixed by regime type. They compared attitudes between two countries with different histories of democratic governance (Costa Rica and Nicaragua) and find that there was little difference in citizens' support for democracy between them despite the fact that Costa Rica had longer history of democracy and Nicaragua had long experience of oppressive regimes. They suggest that there is no clear, direct linkage between regime type and political culture.

Inglehart (1988) contends that cultural variables have been neglected as a cause of political outcomes. He argues that the development of democracy seems related to and driven by economic development and cultural change, measured in terms of interpersonal trust and life satisfaction. So for Inglehart, culture is one of the causes of democracy. He measured democracy's intensity

in terms of its persistence, which is highly questionable. He studied Western

democracies since 1900 using the Euro-barometer surveys to arrive at this

conclusion. According to Muller and Seligson (1994), Inglehart's measurements

and statistics were problematic, but his theoretical arguments seemed

structurally weak. They contend that he has his causal sequence reversed.

Specifically they suggest that his cultural variables are effects of the persistence

or age of democracy (persistence $\longrightarrow$ culture) and not a cause of it

(culture $\longrightarrow$ persistence).

       Theories basing their arguments on the culture variable fail to explain *why*

and *how* culture matters. Culture as a political variable can be bent to many

purposes. Indeed, it has always been treated in the literature as a second level

variable; whenever the major variables fail to explain certain observations,

culture is utilized. Culture is a relatively vague concept that may include many

things. Consequently, one can find elements in a certain culture that may

support his theory and other elements that do not support it. One can always

find values and attitudes in a society that support a certain phenomenon and

another that do not support that same phenomenon. Finally, cultural variables

tend to be ethnocentric, which reduces their power of generalizability. As a result

of these deficiencies, cultural variables will not be used in this research and

therefore are outside the scope of this study.

2.3.1.4 Elite Theories:

Elite theories of democratization include elements from the previous three approaches to democratization: structural, process, and cultural theories. To begin, an elite is a small set of people that controls much of the power in the society and has great influence in the decision-making process. Elite theories of democratization argue for the necessity of elite agreement and accommodation as a mean to reach democracy. Burton, Gunther, and Higley (1992), for example, emphasize the importance of elite "settlements" as the key to democratization and consolidation processes. Stable democracy is likely to become consolidated, whereby most key actors in the society institutionalize their behavior around democratic rules of the game. They distinguish between three types of elites. First, disunified elite, whereby elites do not agree on ideology or bargaining principles; as a result, there will be not much hope for democracy. Second, consensually unified elites, whereby elites do not agree on ideology but do agree on bargaining principles (positive sum game); as a result, there expected to be stable and limited democracy. In this case, a deeper democracy is possible. Third, ideologically unified elites, where they agree on ideology and bargaining principles. In the last type, there is little hope for democracy and a totalitarian or authoritarian regime is likely.

Diamond (1994) argues that the skills, values, strategies, and choices of political leaders affect greatly political outcomes. A flexible and accommodative style of leadership is better than one that is militant and uncompromising. This

accommodative style will help the leadership succeed and, Diamond contends, help deepen democracy.

Elite theories incorporate elements from each of the structural, process, and cultural approaches to democratization. Elite settlement can be viewed as a stage in the process of democratization, a reaction to or a function of structural elements in the society, and elites are the most critical repositories of political culture in the society. However, these theories are very hard to falsify. Many social and political phenomena happen as a result of some sort of agreement among elites. This is very simplistic and abstract. If we are to look closer and develop these theories, we need to identify which actors are "elites" and then try to model their behavior. We would have to understand and model elites' utility functions. Doing this nonetheless brings us very close to the rational-choice area of study and we have to accept the critiques this area receives. This kind of work is very complicated theoretically and very hard to falsify empirically.

2.3.2 International Theories of Democratization

To this point I have focused on what I called the domestic explanations of democratization. I now turn to discuss a relatively small yet growing and important literature on what can be referred to as the international impacts on democratization. Diamond (1999) illustrates this approach as he argues that:

 Perhaps the most distinctive feature of the third wave…is the considerable contribution that international actors have made to democratic development by enhancing the resources, skills, techniques, ideas, linkages, and legitimacy of civil society organizations, civic education efforts, the mass media, legislatures,

local governments, judicial systems, political parties, and election commissions in the developing and post-communist worlds. The prospects for democracy in the world will be much brighter if these many currents of practical engagement are sustained, refined, and widened (p. 272).

Despite the fact that some democratization theorists like Huntington (1993), Diamond (1999), and Sheahan (1986) utilized external causes of democracy, this approach to democratization has not been adequately studied as the following section will reveal. My research attempts to contribute to this literature and to help correct this deficiency. This section will be divided to military and financial transfers and the latter will be further subcategorized into foreign aid and foreign investment.

2.3.2.1 Military Intervention Theories

Direct military intervention has been used by states as an accepted and effective foreign policy tool. This tool is also expensive and risky, so it is usually saved as a very last resort and is seldom used for anything other than national survival or a similarly high-priority goal. It is thus difficult to make the case that military intervention will occur solely for the sake of promoting democracy in another country. It is for this very reason that theories of military intervention have been largely discredited in the literature of democratization. States are supposedly rational actors, and hence not expected to use the sword unless there are strategic reasons or threats. Despite this logic, scholars suggest that while there is agreement on the strategic motivation of military interventions, one must examine other impacts of these interventions might achieve. Pursuing this

line of thinking, the relation between military interventions and democratization comes into play.

Peceny (1999) investigated the relationship between U.S. military intervention and democratization in target states. His study is longitudinal, ranging from 1898 to 1992. He was not comfortable (nor am I) that most literature on the transition to democracy emphasizes the purely domestic sources of democratization. Even cases when military intervention failed to promote democracy were justified and explained using domestic reasons (and military intervention was not to blame) by scholars such as Lipset (1959), who argued that local factors that are not under the control of the interventionists stand behind democracy failure. Peceny disagrees with these scholars and argues that military interventions are important events that generate fundamentally significant political consequences.

Using the Polity III data base to measure democracy, and employing 90 U.S. military intervention cases, Peceny found through the use of a multivariate logit model that military interventions by themselves do not have a statistically significant relationship with the level of democracy. He added, and this is his major contribution, an intervening variable that was significantly related to both the independent (military intervention) and the dependent (the level of democracy) variables. He found that the interveners would promote democracy when they sponsor "free and fair" elections in the target states. Military interventions almost never led a target democratic state to experience a democratic breakdown after the intervention. A significant number of target non-

democratic states ended in a transition to democracy and indeed maintained

democracy for years after the intervention. In fact, Peceny's data show that the

number of democracies was doubled in the 90 intervention cases he examines

as a result of military intervention. Most countries that became democracies after

interventions remained so for at least ten years, while those that were non-

democratic after interventions stayed authoritarian for the following ten years. He

points out that these states became democratic while living under unfavorable

domestic structural conditions and he attributed that to military intervention. The

theoretical logic behind his conclusion is that once fair elections are held, it is

likely that repressed social forces that seek moderation, invest this opportunity

and strengthen their political position or even occupy political power (Peceny

1999).

Peceny's results may be questioned because of the methodological

problems his study entailed. The main problem is that he dichotomized his ten-

point scale (Polity III) dependent variable, democracy, in order to achieve

statistical significance. He thus reduced and distorted the variation in his major

variable.

Huntington (1982), despite his great emphasis on the effect of domestic

factors on democracy, occasionally argues that international factors promote

democracy. In his attempt to address the American ideals and institutions,

Huntington contends that Americans intervention brought democracy to the

Caribbean early this century and that democracy failed when they left. Others

such as Lepgold and Mckeown (1995) agree with Huntington. They believed that

values are a significant part of America's foreign policy and that promoting democracy's expansion is one of these values. Also, Hermann and Kegley (1996) find that states which experience military intervention become more liberal after the intervention is over. Diehl, Druckman, and Wall (1998) used another type of military intervention to study the impact of target countries or what they called host countries. International peacekeeping troop usage is their dependent variable. Among their many independent variables was "nation building." They believe that peacekeeping missions contribute to nations' political improvement because of the stability and control they provide to societies.

Certainly there is some truth to the idea that military intervention may help democracy such as in the examples of Germany and Japan after World War II and Panama lately, but similar interventions failed to produce similar results as in the examples of Somalia and Vietnam. Despite that military intervention has both successful and failed attempts to foster democracy, theories that attempt to link military intervention with the level of democracy can be refuted on two grounds. First, democracy as we understand it is a comprehensive and sophisticated phenomenon that develops as a result of many variables which eventually play themselves throughout the political maturity of societies. Local actors themselves eventually must make the decision to democratize. In other words, democracy is not something that can be imposed. Imposed democracy is not actually a democracy since the very definition of democracy requires the freedom and will to choose politically. Second, military intervention as a foreign policy tool is highly discredited and indeed is expected to decrease. This tool is

very expensive and many of its objectives can be met by other means. Military intervention is specifically discredited when trying to promote democracy as this is not a task for militaries, the most authoritarian of institutions. For these two reasons, the very theoretical logic[7] behind military intervention theories is shaky and does not carry much weight in the literature.

2.3.2.2 Financial Transfers Theories

Financial transfers theories are gaining more attention from both scholars and policymakers for they are practically feasible and interesting theoretically. Money has proven an effective foreign policy tool that helps change regimes and state behavior. It is a vehicle and variable that drives democracy and development. To better assess financial transfers, I break it into the two phenomena of foreign aid and foreign investment.

2.3.2.2.1 Foreign Aid Theories

Theories of foreign aid's impact on the level of democracy fall in the intersection of the subfields of comparative politics and international relations. Foreign aid is the financial and material assets that are given from governmental or external non-governmental actors to other nations. Foreign aid as a variable has mostly been employed as a dependent variable, which contrasts completely the approach of this study. I employ foreign aid as an independent variable that

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[7] Statistically there has been an accepted statistical results, but one needs to account for potential statistical problems that exist in this literature.

may affect recipient country democratization. Nonetheless, outlining the literature that treated foreign aid as a dependent variable is beneficial, especially because national human rights performance, which is correlated with democracy, shapes foreign aid flows. One observation worth making is that most of this literature is concerned with United States' foreign aid. This is justified as most studies done were on the U.S. foreign policy determinations. The theoretical reason behind such observation is that the U.S. has the largest foreign aid program and is *the* biggest donor among states and non-state donors. Secondly, the range that is covered by U.S. aid is quite wide and global in reach. These two reasons kept the use of U.S. foreign aid alone from being a substantial deficiency in the research. U.S. aid is indeed an accepted indicator for foreign aid in general. This dissertation is trying to distinguish itself by employing foreign aid in general and not merely U.S. foreign aid. It employs a pool of overall foreign aid flows from states and non-state institutions as compiled by the World Bank. Using a pool of foreign aid flows should assess the ability to make solid generalizations regarding this variable, not only for the U.S. but also for any other donors. This will validate our results and make them applicable globally.

An empirical study by Apodaca and Stohl (1999) found evidence that human rights considerations shape foreign aid allocation, but they are neither the primary nor the only considerations for foreign aid. Countries that received aid in the past and those which have U.S. military presence are the most likely to receive aid. The third most significant independent variable after past aid and military presence is the human rights variable. Since the "past aid" variable

means that aid at *t* is best explained by aid at *t-1* (the previous year), which is of little theoretical significance, we are left with the strategic variable (military presence) as the most important in determining foreign aid. Controlling for the security variable will leave human rights statistically significant. A similar study by Meernik, Krueger and Poe (1998) suggests that security concerns are becoming less important in the post-Cold War era in determining U.S. foreign aid allocation; "ideological variables" are gaining more significance. Military presence, a communist border, and alliance membership are security variables that lost part of their importance in determining foreign aid decisions in the post Cold War era. Democracy and human rights, on the other hand, gained more influence in foreign aid decision-making.

The other significant study is Regan's (1995) study of U.S foreign aid programs' impact on human rights behavior. Human rights in this study is the dependent variable, unlike previous studies. Regan's attempt is the first of its kind to evaluate the impact of change in economic assistance on changes in the amount of political abuse. He distinguishes between the Carter and Reagan administrations to conclude that while Carter denied aid to states with bad human rights records, Reagan thought this was a negative approach and instead used the states' democratic status to decide on aid since it is highly correlated with human rights. Regan used neither of these criteria in his study. Rather, he established a "political repression" variable by constructing an index composed of five indicators based on issues related to "integrity of person." He found that economic aid is not an effective mechanism with which to alter political

repression in recipient countries. Aid might, however, serve as an indicator of a diplomatic message of the American disapproval on repressive policies.

Carothers (1999) devoted quite an effort to study the U.S. foreign aid - democratization linkage. His research and arguments are at the heart of this dissertation. He asserts that the United States has always believed that its political ideals and principles, most notably democracy, are universally applicable. However, the role that these ideals play in American foreign policy has been a matter of dispute between pessimists and optimists. The optimists' position has been strengthened in the aftermath of Cold War. The collapse of communism has left democratic capitalism as the world's dominant political and economic ideology and therefore more persuasive and likely to be adopted.

Pessimists on the other hand are skeptical about intervening in other nations affairs and argue that the transition to democracy may foster more conflict rather than less at the initial stage. While optimists do not completely disagree with this idea, they emphasize that democracies are less likely to threaten the United States interests and more likely to cooperate with it. They even cite the Clinton administration when it utilized "promoting democracy" as one of its three national security pillars along with "enhancing U.S. security" and "promoting prosperity at home."

Carothers suggests a middle ground as he believes that both sides have a legitimate concern. He thinks that promoting democracy should be based on "idealistic aspirations" and guided by "realist considerations." He distinguished

between liberalism and democracy as the former is the one that help the U.S. foreign policy. Newer democracies symbolize a new version of democracy that is not as liberal as western democracies. They tend to be procedural or electoral democracies and yet not as liberal as the western democracies.

Carothers, nonetheless, is mostly famous for his 'Aiding Democracy Abroad: The Learning Curve', which is an attempt to assess democracy promotion programs. He tries to reflect on their failure or success and to answer whether they are working and worth the time and effort. These programs, he asserted, often have modestly positive effects on recipient countries and occasionally negative effects. They mainly suffer from problems related to the lack and ineffectiveness of legislative assistance, judicial or "rule of law" assistance, and civil society assistance. Democracy promoters assume a linear movement from some liberalization to elections and to eventual consolidation. Carothers believes that this is simplistic, unrealistic, and indeed wrong. In the end, he maintains, hope should not be lost and these programs should not be terminated even if they do not bring about decisive democratic change. This simply means that such programs must be dealt with differently. It must be understood that promoting democracy is a long term, complicated and uncertain task that requires substantial capabilities or resources, and skills to maneuver these resources and to make this task workable.

Carothers is speaking to an audience of decision makers and politicians. As logical and creative as arguments by Carothers seem, they have not been accepted by mainstream political science. He utilizes a case study approach on

most of his arguments, and they are not quite systematic in the sense that we cannot generate from them generalizable and scientific hypotheses. Nevertheless, he suggests that foreign aid may promote democratization, an important and testable proposition.

2.3.2.2.2 Foreign Direct Investment Theories

Foreign investment represents another important side of financial transfers, and perhaps its most significant side because of its economic character and functions. Its strength comes from its direct and often strong relationship with economic growth, which is often cited for its powerful political implications and consequences. Foreign investment is often able to alter the structural features of recipient countries, most notably their economic features. Dependency theory accepts this proposition but counters that foreign investment decreases rather than promotes development and enhances inequalities by making recipient economies dependent (conditioned and controlled by outside economies). Nevertheless, the argument that foreign direct investment promotes growth and other structural changes in societies is still a widely accepted argument by both political scientists and foreign policy makers.

Through promoting growth and economic development, foreign investment exercises influence over the political settings in societies, among which is the process of democratization. Foreign investment's immediate effects stem from the economic incentives related to production process elements such as labor and raw material. Money has no nationality or patriotism; it goes where

conditions are most favorable. Investors simply want profit and behave in terms of basic cost-benefit analysis. They also take into consideration the risk of their investments. This is pure economic and business logic.

Democratic countries tend to favor foreign investments, protect property rights over time, and reduce risks as well as transaction costs for foreign investors (Li and Resnick 2001). Investors know that, and recipient countries know that as well. Consequently, countries use the level of democracy as one of the mechanism they employ to attract foreign investments. For example, they may try to develop an independent and unbiased system of law to insure and reduce the risk of investing in their economies so that investors will feel that their money is safe in a country with a well-established legal system. If it were recipient countries' own decision, one might argue, they would probably prefer to get investments without having to go through the trouble of democratization. Indeed, some countries, like Malaysia, Indonesia, and even China, did accomplish that. These countries have huge amount of foreign direct investment mainly because of their cheap and relatively skilled labor as well as their potential markets and yet they are not democracies. Nonetheless, on principle, all countries are encouraged to democratize if they want to gain the economic development that comes as a result of investment, and it is just a matter of time until all countries find themselves in need of democratization if they want to get or sustain foreign direct investment. This is the core logic behind the level of democracy-foreign direct investment linkage.

The debate over the above logic and dynamics of foreign direct investment is one that is shared by several disciplines among which economists, business scholars, and political scientists, especially in the area of international political economy. They all have a stake on studying this phenomenon for different reasons. The question that we are concerned with is the political effects and consequences of foreign direct investment, especially those related to the process of democratization. Li and Resnick (2001) conceptualize foreign direct investment as an effect rather than a cause of democratization -- the reverse of theories discussed so far. Their study is beneficial for this research as it shows that there is something to the relation between the level of democracy and foreign direct investment. It does find foreign direct investment is more likely to flow to democratic nations with significant property rights protection. They also argue that democratic nations are more likely to offer fiscal and financial incentives to investors. Simply put, democratic nations are more receptive to foreign investments for they often offer opportunities that curtail less risk and more incentives. Sorensen would agree with this by arguing that accountable governments, often democratic, are more likely to pursue economic prosperity aggressively. If foreign investments bring prosperity, then attracting them will be a goal of these governments.

In another study that tried to identify the conditions under which regimes liberalize their capital policies, Li and Smith (2002) argue that governments are very reluctant to relax their capital control policies and they only do that when there is a serious societal demand and support for this adjustment. Relaxed

capital policies have direct effect on foreign direct investment and indeed attract them. The change has to be demanded by societies, because governments prefer the stats quo with its virtue of predictability and stability. Societies will demand that relaxation when they reach this level of political and economic sophistication and awareness that will allow them to understand the importance of foreign direct investment and relaxed capital control policies. When governments relax capital policies, one can conclude, it would be the beginning of more liberalization in other societal areas. Capital liberalization may, therefore, lead to a broader political liberalization, on the theory that the former is contagious. The idea is supported by the notion that capitalism and democracy are integrated and once one of them starts, it is only a matter of relatively short time when the other follows. The function of a free market society definitely requires a degree of political liberalism, the minimum of which is an access to independent and fair judicial system.

Foreign investors seem to be interested more in stability than in democracy per se and these two variables are quite different. O'Neal (1994) tried to investigate this generalization and while he agreed that profits of foreign investments are often higher when investing in stable authoritarian regimes, most foreign investments still largely favor doing business and investing in democracies. So he obtained mixed results: part of his study supported the notion of the importance of stability as it brings more profits, while another part seemed to favor investing in democracies regardless of stability. Using 48 countries for a span of 35 years, he concluded that regime type has very weak

relationship with foreign investment. O'Neal can be criticized because he

contradicts himself. The very finding that foreign investors still prefer doing

business with democracies despite the fact that more profit may be made in non-

democracies strongly suggests that democracy (regime type) is what fosters

foreign investment and not short term profit alone.

One cannot review the foreign investment literature without touching on

the dependency theory arguments, which deny that foreign investment has

positive consequences. The core of dependency theory regarding foreign

investment is that it is a variant of imperialism. Investors explore and abuse

recipient societies and economies for the sake of capital profit. Investors

become richer while host economies become poorer. Dixon and Boswell (1996)

tested this argument statistically and concluded that countries which depend on

foreign capital investments face slower economic growth and higher income

inequality. They fail to tell us, however, why income inequality is bad for the

economic growth or whether the disappearance of foreign investments will speed

up economic growth. One may imagine the contrary case -- that slow economic

growth may be even slower if foreign investment disappears. Despite

dependency theory, one cannot neglect the fact that more and more countries

are striving for foreign investments because their leaders view it as an effective

mechanism to foster growth and flee economic hardships.

The literature above suggests a direct and an indirect links between

international factors among which foreign financial transfers and the transition to

democracy. The literature reveals an interesting dynamic between the level of

democracy, foreign direct investment, and economic growth. The level of

democracy is not only a cause for foreign direct investment, but also an effect of

it through the interplay of economic growth. These three variables form a

political cycle (as shown in the figure 2.2 below) that has the potential of being

self-driven and therefore carry a great promise for societies to democratize. It

will be a worthwhile research to investigate and identify the time lags of the

effects between the variables in this political cycle.

Figure 2.2

The level of democracy

Economic Growth ← Foreign Direct Investment
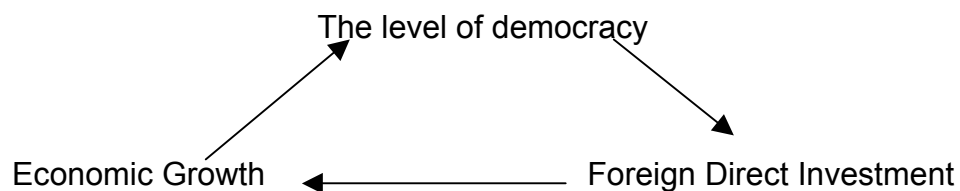
Studies of foreign direct investment were mainly concerned with what

might affect foreign investment behavior as their dependent variable. The level

of democracy as a dependent variable for foreign investment behavior was not

the interest. This relationship thus constitutes a lacuna in research and its

dynamics remain to be explored and understood. This study is a contribution in

that direction. Unlike human rights performance, democracy has rarely been

used by mainstream political science as a dependent variable to be explained by

such independent international variables as foreign direct investment.

CHAPTER 3

THEORETICAL PROSPECTIVE: The Financial Transfer Theory of

Democratization

3.1 Introduction

A theory is comprised of a series of generalizations that describe, explain,

and predict certain phenomena. Such generalizations are supposed to expose

and illuminate the relationships among variables. To build a causal theory that

explains democratization is particularly difficult for two reasons. First, the field is

already blessed with several well-grounded theories that have become accepted

as persuasive and plausible. Structural theories in particular and, despite their

weaknesses, have been widely held to be reasonable explanations for

democracy. Second, one cannot easily make the case that democratization as a

fundamental phenomenon can be explained by examining only one or two

variables. The more one reads about the phenomenon, the more one becomes

convinced that several, perhaps even dozens, of variables are part and parcel of

any cogent explanation of democratization. Democratization, as I perceive it, is a

complex and dynamic phenomenon that requires a deep, thick, detailed and

comprehensive explanation.

As far as the research here under consideration is concerned, this

understanding of democratization is essential. Although I employ the effect of

foreign aid and foreign direct investment on the level of democracy as primary

hypotheses, the explanatory power of other variables is not disregarded. At

bottom, the intent of this study is to discover to what extent foreign aid and

foreign direct investment are at work in the level of democracy, in what manner

foreign aid and investment may promote democracy, and whether these

independent variables take the lion's share of explanation from other

independent variables. Despite the two hazards mentioned above, theories are

needed for the reasons stipulated in the introduction. Financial transfers and its

effect on the level of democracy is a longitudinal process that requires decision

makers to make important decisions. Going through the logical timely stages of

financial transfers of both foreign aid and investment, including the stages of

decision making and muting these stages, then analyzing them thoroughly is the

best way to draw a theoretical framework for this study. Taking this dynamic and

integrated phenomenon apart, understanding and analyzing these parts, and

then re-linking them logically and coherently should help provide an in-depth

explanation of this phenomenon. While my two primary variables are somewhat

interdependent, I will begin with the foreign aid effect on the level of democracy

and then move on to foreign direct investment.

3.2 Democratization and Foreign Aid

3.2.1 Major Foreign Aid Operation Actors

The best way to identify these actors is by distinguishing and describing

the two sides of the foreign aid operation: donors and recipients. The donors

are those countries that can afford to lend or grant money upon less fortunate or

more impoverished states. Most of the donors of the world are the industrialized democracies, so-called because they have attained comparatively great wealth in part through economic development. Despite their great wealth, not all of these states have foreign aid programs. Rather, the only ones that have such programs are the industrialized democracies, which understand that such largesse can be an effective means to advance certain foreign policy ends. Some states that have global interests are more likely to give foreign aid. An ideal example for this sort is the United States. On the other hand, other states give money despite the fact that they do not have global interests because they are generally concerned with issues such as human rights and economic opportunities as well as their own international prestige. Scandinavian countries are ideal examples for this kind of donor.

In addition to nation states as donors, international and regional governmental and non-governmental organizations give foreign aid to many countries. In fact, one might argue that international organizations are especially important because they facilitate much of nation states' aid since states tend to use these organizations as a distribution mechanism given their credibility and often effective management style. These organizations tend also to be less prone to be influenced by security concerns or strategic calculations when they give aid; their motivation is simpler and clearer than that of nation states.

A pool of the above major donors of foreign aid will be utilized to measure aid because this will provide a more accurate indicator of the foreign aid variable than one that exclude such donors. The major donors in the pool include

Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, Luxembourg, Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, United Kingdom, and the United States. No single nation can fully represent this variable and its international impacts. As a single country, the United States comes the closest to being a comprehensive donor, yet a pool of all foreign aid programs is preferable. Another reason why the U.S. alone might be chosen is simply because it gives the most money, with a foreign aid expenditure of almost $5.9 billion per annum[8], and donates to the greatest number of states. The other donors in the sample seem to donate in respect to their economic standing; consequently, Japan and Germany seem to come next in order to the United States.

On the other side of the foreign aid operation are the recipients, those countries that need foreign money and cannot produce wealth internally, besieged as they are by economic hardships. Their political systems range from being authoritarian to partly free to free and open democracies. Their economic problems force them to seek any kind of succor whatsoever, including, understandably enough, foreign aid. The major actors of my study that constitute an important part of its theoretical scope, then, is the set of countries that are recipients of international foreign aid. The research concerning this part of the study will investigate the effect of an international foreign policy behavior, foreign

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[8] Excluding Israel and Egypt, which receive almost the same amount of aid by themselves. The last two cases are excluded from any analysis because they bias the sample; they take much aid with no clear reason of why they should receive it, other than the aim of maintaining the balance of power in the Middle East.

aid, on the level of democracy among these recipient nations with economic

hardships.

3.2.2 Recipient Countries' Dilemma

The other major step needed to construct a theoretical argument of the

foreign aid–democracy relationship is to explain the dilemma the recipient

countries face. To address this fundamental step, I distinguish between two

operational stages of the dynamics of recipient countries political development or

democratization process: preparation stage and decision-making stage.

Structural conditions work at the democratization's preparation stage while

foreign aid works at the decision-making stage.

3.2.2.1 Preparation Stage

The preparation stage sets up the political and social environment in

recipient societies for political change. This stage can be analyzed by

understanding the socio-economic conditions of recipient countries. Economic

and social factors are often viewed as interactions between societies and their

governments. These factors are the conditions under which citizens live.

Economic and social conditions vary from being basic and minimal ones that deal

with fundamental societal needs such as food and shelter[9], to being maximal –

far exceeding basic needs. In authoritarian countries the underlying assumption

and the unwritten contract of politics is that regimes occupy power and do not

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[9] Maslow's (1954) basic physical needs level.

share it because they are taking care of the society's needs and demands. But even the most authoritarian regimes still have to run propaganda and mobilize political support to retain legitimacy, and almost often their argument would be that these regimes are the best option for their societies because they are taking care of its interest in the best possible way.

Their performance of this societal duty is expected to be either a success or a failure. In case of success, the economic and the societal aspects of the country are expected to develop. People would become wealthier and more educated. As a result, political development in the direction of more liberty is likely. Liberty will work its way through the new healthy structural features of the society which are quite powerful in terms of affecting the level of democracy. Liberty will come at the expense of the same government that brought prosperity. Governments think that performing well and helping the society to prosper will enhance their legitimacy and secure their political power. The legitimate question becomes why would people want to change a government that brought wealth and prosperity to them? The answer comes by way of Lipset (1959). First, people's level of awareness increases through more afforded education and therefore they demand better government. Second according to Olson (1993), the middle class and the informal parts of the society become stronger than the government as a result of economic development, to the point that the latter can no longer control them. The cases of Taiwan and South Korea, examples from the third wave of democratization (Huntington 1993), are those of

governments that performed well and brought prosperity to society and as a result that same society demanded democracy.

But what would happen if regimes could not achieve acceptable levels of economic and social development? What would happen if they did not succeed? This scenario frequently occurs in the world around us, and we therefore expect bad performance from unaccountable rulers who were not elected based on their qualifications or programs. As long as the regime meets basic needs and demands, this minimal performance would be expected to mitigate against the societal uprising. Members of the society do not have any incentive to challenge the regimes based on cost-benefit analysis. Such a challenge might face severe consequences from the sitting regime should it fail, and the reward is not known clearly or guaranteed in case of success. Societies tolerate authoritarian regimes not because they think these regimes are good or efficient, but because of rational thinking based on cost-benefit analysis. It is only when domestic conditions become so severe and unacceptable that members of the society cannot handle them any more that an uprising is expected.

Authoritarian regimes will thus try to keep meeting the minimal needs of the society until they reach a point where they no longer can do so. These regimes are aware that at this point any further decline of their performance will shift the society to the confrontation level. This point marks the end of the preparation stage and the start of the decision-making stage.

Structural conditions and interactions pave the way for the infrastructure of democracy but the decision to implement it has to be made by someone. It is the

vision, process and the rules negotiated by decision-makers that will determine how democracy will come. The structural conditions prepare the environment for decision-makers to decide on democracy. The preparation stage supplies an essential input for leaders as well as puts pressure on them to act. It is defined and mature at the point when rulers believe that they can no longer improve the economic and social conditions and as a result no longer maintain political stability and power at this moment. They would also believe that the society is willing to do whatever it takes to improve life conditions. Whether these beliefs are right or wrong they certainly make rulers think that it is time to make changes and to take fundamental decisions that will eventually affect the society either for the worse or better. The importance and logic of this stage will be fully clarified by borrowing from Maslow's Needs Theory. Maslow (1954) distinguishes among four sets of human needs. The first and most basic are the physical needs, the safety needs, the self esteem needs, and finally the level of self actualization. Physical needs are fundamental and tolerate no compromise. People are more willing to carry out change if their basic needs are undermined.

3.2.2.2 Decision-Making Stage

At this point of structural conditions status, decision makers have to make fundamental decisions on how to proceed as rulers; earlier I called this stage the decision-making stage. I assume that political actors, like states and politicians, desire to acquire and retain power if possible. These elites, however, are at a point where they need to redefine the amount of power they have. Their

preferences are expected to vary among elites as follows: hardliners would prefer

the use of the coercive power; moderates would prefer to share responsibility

and therefore authority with the public; and, finally, a group who would seek help,

most notably, international help to improve the domestic conditions and, as a

result, restore the stability of political authority.

The last group of decision-makers is expected to prevail for the following

reasons. First, seeking international help seems the best alternative among the

three options outlined above. Using the military machine, the coercive and most

important tool used by authoritarian regimes, has its drawbacks. Not only are

members of the military part of the society and therefore affected by the severe

conditions under which societies live, but also the military option is not a real

solution for structural problems and rulers know this. The military as an option

does not look very efficient and leaders cannot keep using it for all sorts of

problems, including fixing the economy. On the other hand, although

liberalization entails giving up some responsibilities, it also requires that leaders

give up part of their political power. Leaders are rational actors and not expected

to give up power unless they exhausted all of their other options, including asking

for foreign aid.

Second, the international help option is likely because rulers tend to think

that they still can address their countries' problems with some help. Rather than

giving up, they simply think that they need more resources to overcome their

problems. International help seems an ideal resource provider. Third, foreign

aid as a form of international help does not look threatening to the leaders'

political authority since it is under their control. The leaders would trust this

option because they view it as a source of help or enhancement to their authority.

Because of the previous three reasons, authoritarian leaders are expected to turn

to the international community to seek help for the deficiencies of their societies.

Once the third option of seeking international help is at the table, its

empirical applications and workings should be discussed. Two fundamental

questions must be answered. First, what do recipients states have to offer in

order to get aid? And second, why would donors be interested in giving aid? At

this point it is beneficial to address the issue of what recipient states think of aid

or how they would define it, and what they would get if they receive foreign aid.

Foreign aid may be defined as the amount of cash money and material and non-

material goods and services that are given to states on an annual basis. This

money, though it be little, is significant to many recipient countries given their

severe economic standing.

Given this definition of foreign aid, what would states do to obtain such

aid? It is fair to say that recipient countries often tend to have little to offer, given

all the hardships they live through. Although most of these states believe that

they are offering much in return for the aid that they receive, it is not really

viewed that way by the donors in terms of what they donate. Nonetheless,

recipients do have some things to offer, most importantly their strategic

relationship with the donor countries. States can be military allies if they receive

foreign aid. They can help the U.S., for example, with their fights or even fight on

behalf of them. This is meaningful for the U.S. not only because of the former

Cold War, but also because of regional balances of power. Countries with many and varied global interests are interested in having strategic friends that could help if needed. Along with their strategic benefits countries that receive aid are more likely to become political allies whatever the amount of political capital they can actually offer. Along the political line, countries may be a source of regional political stability if they receive aid. In addition, recipient countries are expected to be and are being helped to be good world citizens. These countries offer their respect to international Human Rights standard as a way to get international aid. Finally, states that receive aid are potential markets for the donors' products. If these states get their economies up and running they might have the potential of expanding the world market. These offers in return of aid vary from state to state, and the more significant a state is, the more likely that these offers will be attractive to the U.S.

Let me turn now to address why donors would give aid to these states. What is the rationale behind the decision? While all of the reasons above can serve as incentives for the donors to give aid, they are, amazingly, not enough. In most foreign aid relationships, the offers of the recipient countries are actually taken for granted. Donors pursue more goals when giving aid and these goals are often achievable. Recipient countries are the weak side that are in need of aid and therefore they do not get to set its conditions; it is the other way around. Donors are rational political actors who weigh things carefully and employ cost-benefit analysis. They look at foreign aid as a way to advance and implement their foreign policy agendas. Not only will aid help donors achieve political,

humanitarian and strategic goals, but also they will develop potential markets for their products and introduce better citizens to the world.

Aid is often delivered in the form of national products of donors and not just dollars which will benefit the donors economy. Let us call these incentives the immediate or midrange ones. The long-term incentive would be the spread of the donors' main ideology like democracy and capitalism and therefore the promotion of world peace and stability. Democracy and capitalism are, thus, viewed as values for most donors today because they would eventually create world peace -- Kant's notion of the pacific union.

In addition to such incentives, foreign aid is actually an inexpensive foreign policy tool, which makes it desirable. The U.S., a case in point, pays around eleven billion dollars out of a total annual budget of three trillion dollars. Cost-benefit analysis tells us clearly that foreign aid is very much worth the cost. While this amount of money may seem to be minimal for the U.S., it is perceived as most valuable to recipient countries and this is exactly what makes it a very effective tool.

Once the decision to grant foreign aid has been taken, it is expected to help states overcome their structural problems. By help improving the structural conditions within recipient countries, aid works indirectly to promote democracy. For example, improved structural conditions could help elevate the level of education by making it affordable, and that will make the public understand and demand democracy. It should also help distribute power in the society by creating a larger middle class. People who benefit from these aids through the

various programs should be, at the minimum, strong members of the middle class. Finally, improved structural conditions increase citizens' interest in public life since people have more stake in it. This is the basic logic that stands behind structural theories of democratization.

Foreign aid works not only through the structural factors of the society but also through the decision-making process that promotes democracy. Through the decision-making process foreign aid works directly. Donors ask for specific democratic steps in exchange for aid such as decentralization and free elections. Decision-makers have a clear bargaining position; if they want the money, then they must do what is requested of them. As discussed above, decision-makers are expected to accept and implement more democracy in their societies in exchange for aid. They tend to start with the least important democratic aspects that are not threatening to their authority. They might for example allow municipal elections. These elections may be fraudulent and fixed, but are better than nothing at all. In fact, Diamond (1994) argues that local democracies such as at the municipal level would eventually promote democracy. He even contends that federal systems are the best for democracy because they allow local government and promote decentralization. The assumption is that small, seemingly ineffective steps like this will eventually lead to bigger, more effective ones. Recipient countries are expected to promote procedural democracy until their societies reach a point of no return where only more democracy is possible, not less. Both the direct "decision-making" and the indirect "structural effects"

are possible effects of foreign aid and expected to push societies more toward democracy.

3.3 Democratization and Foreign Direct Investment

The theoretical dynamics of foreign direct investment do not differ dramatically from those of foreign aid ones because they both belong to the financial family of variables. Indeed, much of the argument applied to foreign aid can fit foreign direct investment. They are also connected or highly correlated, because aid is usually followed by investment. Companies often feel more comfortable investing in countries that receive aid because they know that these countries are more likely to comply with political pressure. Receiving aid is also a sign of economic difficulties and therefore investors will be in a stronger position to bargain.

3.3.1 Major Foreign investment Operation Actors

Foreign investment actors have one major difference with those involved in foreign aid. This is an important and sensitive issue because it is directly related to sovereignty principles. Investment comes from non-sovereign or economic actors and almost always interacts with the same sub-national levels. Aid, in contrast, is likely to be a nation-state decision or behavior which makes recipients states' reaction to it a politically sensitive one because they are expected to guard their sovereignty. Because investments appear to impinge less on sovereignty, recipient countries are often more hospitable toward them

than they are toward foreign aid and indeed seek them out. This simply makes foreign investment "political" job easier. The political effects of foreign investment thus come about more easily than those of aid because investment is viewed with less hostility and skepticism.

The potential for gain helps explain the powerful nature of foreign direct investment. Investors invest for the sole reason of gaining economic profit. They are simply businessmen or companies seeking to increase their share of capital. As a result of this clear objective, they are only interested in the conditions that will help reach this objective or hinder it. Investors are not willing to lose or else they will go invest somewhere else. Money is cowardly, it goes where safety and profitability are. The economic conditions are what investors look for first and then they seek political stability. Inexpensive economic resources and inputs like labor and raw material are what mainly attract investors. They use these inexpensive production inputs to increase their profit margin. Political stability may be the main risk foreign investors take; they are often afraid of revolutions and the nationalization of their investment. They seldom interfere directly with the political system; they just keep a close eye on it and direct their business decisions as a result.

Inexpensive economic inputs and stability are exactly what certain recipient state can offer investors. In fact, their mission becomes the realization of these conditions in order to attract foreign investment. In return they gain economic growth because part of their labor supply will be employed and thus get wages that cause local multiplier effects. They also gain growth because

investors bring with them technological and business expertise in addition to the capital which recipient countries often lack. The very profit seeking character of foreign investors makes growth in recipient countries likely.

The gains expected and risks involved makes the recipient countries' dilemma regarding the decision of foreign direct investment less complicated than that of the foreign aid one. It seems that they have little to lose and much to gain. This is particularly true for the apparent lack of sovereignty implications. The decision of whether recipient countries ought to open the doors for investors or not is one of pure economics because it does not appear to entail much political risk in the short or middle term.

3.3.2 Actualization of Democracy

Foreign direct investment helps democracy develop in two ways. The first is by creating a more hospitable environment or infrastructure for present and future foreign investment, and the second is through effects on the structural features of societies.

3.3.2.1 Hospitable Infrastructures

As most countries strive for foreign investments, they in effect try to create more favorable environment for these investments to entice them to come. Recipients who are interested in foreign investments know the business nature of these investments, which generally means that they cannot be attracted solely by a political decision or a high level political invitation. Investment comes if the right business conditions exist and profit is very likely. The creation of such an

environment or infrastructure for business also involves taking certain steps and developing conditions for democracy to flourish. While there is no precise or specific set of business conditions that guarantee democratization, one can easily identify several important elements.

First, social and political stability, are important and attractive to investors. No one wants to invest in places where there is very little predictability. While stability might, or might not, come as a result of oppression, stability itself can open up intellectual space within societies to allow thinking about public issues, including political ones. Much of this thinking may generate improvement in the political setting. The more improvement societies witness, the more democratization is likely. Second, an independent, unbiased and fair legal system is another important issue investors look at when trying to locate business. Legal systems are indicators of countries' stability and supply a high degree of predictability and minimize risks. It basically tells the investor whether his rights will be respected by law. Established legal systems give their countries respect and credibility, for these systems often come as a result of many political debates which is an indication of political maturity. The motivation of states to create legal systems with these characteristics to attract business is by itself a significant step toward democratization. Justice is a contagious idea that can spread all the way to the political arrangements by providing citizens protection from arbitrary actions by rulers. Third, an open economic system that supplies economic freedom and incentives and attract investors is also an essential step toward democratization because political freedom tends to follow economic

freedom. Capitalism, as a free economic system, tends eventually to promote democracy because the very economic freedom capitalism entails cannot be separated from political liberalization. For example, states cannot have free economic systems and retain restrictions on travel, or communications. Also, once businesses grow enough as a result of economic freedom, they constitute independent interests that can constrain and place demand on the political authority demanding more liberalization.

3.3.2.2 Structural Features

Foreign direct investment strength is realized through its link with the structural features among recipient countries. Foreign investment is a highly business oriented variable, and therefore its theoretical argument is an economic one unlike foreign aid which is mostly politically oriented. Investors and recipients go through economic cost-benefit analysis when deciding to invest. Because foreign direct investment is directly related to the economic and structural features in the recipient countries, it is expected to have political impacts on these countries, including their level of democracy. This is the same logic used by the structural theories of democratization. Furthermore and as a result of the cost-benefit analysis nature, foreign investment is expected to succeed economically and this will help recipient societies positively because their economies will grow. Economic growth consequently will improve the level of democracy positively as the structural theorists would argue. Structural changes can have very powerful impact on the level of democracy and because

foreign investments can promote such structural change as broader distribution of power resources, thus foreign investment becomes a factor tending toward the transition to democracy.

Additionally, when investors succeed they will develop interests that are distinct from the state's interests. This in turn will put more pressure and demand on the government for more service, favorable regulations and so on. Consequently, these demands will constrain government and give more space to other political entities to allow them to take advantage of this liberal atmosphere. Governments will try to accommodate the new interests of investors and as a result will enact more liberal regulations that they themselves will have to follow. The more this process takes place, the more the economy grows and consequently more resources will be won by non-governmental actors. The more of the power resources of societies distributed among citizens and outside government, the more likely are democracy and liberalism (Vanhanen1990).

3.4 Financial Transfers Cultural Impact and Effectiveness

An important dimension of understanding the foreign aid and foreign direct investment-the level of democracy linkage is the cultural one. By working directly and indirectly, foreign aid and investment can have a long run cultural influence. Aid and investment-the level of democracy interactions are more likely to influence the political culture and image of the donors and investors. People in recipient countries may start to think of these aid donors from democracies and foreign investors as friends and therefore accept their liberal and democratic

principles and political norms. People may adopt the democratic way of life

because they come to view it as the best and the most favorable. In fact, a

significant part of donors' foreign aid[10] targets this aspect of cultural development

by focusing on education systems and emphasizing scholarships and training in

democratic donor countries.

The last block of this theory addresses the question of how effective

foreign aid and investment can be in promoting democracy based on the

previous theoretical discussion. Deriving a generalization concerning this issue

is not an easy task for two reasons. First, democracy is a comprehensive

phenomenon that is affected by many variables so that it is very unlikely that

financial transfers alone stands behind the level of democracy. Second, financial

transfers can be a multipurpose tool and it is hard to connect it to a single goal

such as democracy. Foreign aid in particular is a multipurpose tool.

Nonetheless, that at least some influence of financial transfers on democracy is

likely is supported by two political facts. First, the end of the Cold War has

cleared the way for reprioritizing foreign aid goals. The immediate goals

mentioned above, such as strategic alliance, no longer held superior priority

since the major threat to the democratic donors, the former Soviet Union, had

collapsed. Foreign aid from major western democracies began to give more

attention to the long run goals such as democracy and world peace. Most

donors no longer needed to use aid to entice recipient nations for strategic

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[10] This rarely happens with foreign direct investment and applies only to foreign
aid.

reasons in competition with the Soviets. The donors' bargaining position has been enhanced and is able to achieve other foreign aid goals. The end of the Cold War also marks a victory for capitalism and its economic strategies. Investors are now more welcomed and indeed sought after. Investment appears less risky because no major global conflict is imminent. These factors create and facilitate favorable circumstances for foreign investment, and in turn for the dynamics of democratization.

Second, most recipients of aid have small populations and one may assume that foreign aid would work better in small countries because it can be more significant relative to their size. Smaller countries are more likely to be affected by foreign aid strategies and consequences. Also, ceteris paribus, small countries are more prone to be democratic or more receptive to democracy than very large countries (Diamond 1994). Since small countries tend to be more democratic and more likely to benefit from aid, then aid to them is more likely to promote democracy. This does not work for foreign direct investment because countries with big populations are more likely to receive foreign direct investment given their potential market and cheap labor forces. Nonetheless, the idea that population size may interact with foreign assistance to promote democracy is worth pursuing.

The financial transfers theory of democratization above is intended to establish the general framework of all the variables under consideration. It attempts to explain the dynamics of the foreign aid and foreign direct investment variables as a stimulus of democracy. The theory contains elements of each of

the structural, process, elite, and international theories of democratization. It

borrows from the structural theories the preparation stage outlined above. It

borrows from the elite theories the decision-making stage whereby elites need to

make compromises and decide on the future of their regime after economic

change alter national structural conditions. It borrows from the logic of the

process theories that democratization comes as a result of several developing

stages and in this case, these stages are the preparation and the decision-

making stages. And finally, the theory borrows from the international explanation

that democratization happens as a result of an outside factors.

CHAPTER 4

EMPIRICAL ANALYSIS: RESEARCH DESIGN

4.1 Introduction

Earlier chapters have focused on theories of democratization and what

financial transfers might contribute to it. The literature review and theoretical

arguments reveal how the level of democracy may be affected positively by

financial variables such as foreign aid and foreign direct investment. This

theoretical suggestion seems to be supported by rapid globalization, which can

be defined as the rapid increase of the flow of capital, goods and services, and

labor across nation states' borders[11]. In addition, the end of the Cold War means

that aid is now provided more often than before for various non-strategic

purposes such as improving the status of political freedom and the level of

democracy.

The remainder of this study will try to evaluate this argument by testing

empirically falsifiable hypotheses that are derived from this theory. In this

research design chapter a multivariate model will be developed and the variables

under study will be operationalized. The sample will also be described. Chapter

5 will explain the statistical techniques that will be used in my analysis and

present the finding. Bivariate, multivariate regression analyses, and path

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[11] Globalization can also be defined as the degree to which states are involved
with the overall international political and economic regimes.

analysis will be the two techniques to be applied on the pooled cross-national time series data.

4.2 Hypotheses

The theory outlined above lays out the general relationships among the variables and this section will derive measurable and testable hypotheses using the variables outlined by the theory. The level of democracy within states is the primary and ultimate phenomenon that I am attempting to explain and investigate. I seek to know what factors affect the level of democracy, and how they affect it. The level of democracy is the dependent variable in all of my hypotheses.

4.2.1 Foreign Aid and Foreign Direct Investment

Democratization is a comprehensive phenomenon that is affected by a wide variety of factors, among which may be external financial factors. To be specific and based on the theory outlined, higher amounts of foreign aid and foreign investment are expected to affect the level of democracy positively. In terms of foreign aid, recipient countries are willing to become more democratic in exchange for outside aid. Donors are generally wealthy industrialized democracies, and recipient countries tend to be less industrialized autocracies. When the recipient countries ask for or need aid, the donor countries often condition their aid on reforms that promote democracy. Wealthy industrialized

democracies may utilize their relative economic advantage in order to press for specific steps toward democratization. As such I hypothesize that:

Hypothesis 1:

An increased level of foreign aid increases the level of democracy among recipient states.

The null hypothesis would be that there is no relationship between foreign aid and the level of democracy. To pursue this hypothesis further, let me address the scenarios that occur when foreign aid is denied or declined. The Carter administration, for example, believed that foreign aid should be denied to those countries with less respect for human rights (Regan 1995). These countries should be punished until they comply with human rights standards. Under this situation, a negative relationship is expected between foreign aid and the level of democracy[12] because a denial of aid should encourage countries to democratize. However, this scenario is unlikely because when aid is denied for regimes, their authority is undermined because they lose some of their resources. They are more likely move to protect their authority by being more repressive or authoritarian. They will try to enhance their political power at the expense of democracy. The more likely scenario resulting from the denial of

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[12] Human rights is an important part of substantive democracy and therefore a strong indicator of democracy.

foreign aid is a decline in the level of democracy. This argues for a positive relationship as I hypothesized.

Countries also are said to move toward democratization when they prepare and adjust themselves to be more receptive to foreign direct investment. In order to attract foreign direct investment, states will try to create the conditions that will make them an attractive target for investment (Friedrich and Frey 1985). This by itself is a step closer to democracy and suggests a direct link between democracy and foreign investment. Most countries, including those authoritarian states with economic hardships, view foreign direct investment positively and in purely economic terms, as it is not linked to the governments of investor countries and does not threaten the sovereignty of the recipient countries. When foreign investment, with its economic character, strength, and logic comes to a country, it is expected to improve the economic conditions of that country. Consequently, improved economic conditions (and often improved social conditions) will affect the level of democracy positively follows the logic of the structural theories of democratization. As such I hypothesize:

Hypothesis 2:

Increased levels of Foreign Direct Investment will increase the level of democracy in recipient countries

The null hypothesis is that there is no relationship between foreign direct investment and the level of democracy among countries that host foreign direct investment.

The two hypotheses above address the direct relationship of foreign aid and foreign direct investment to the level of democracy. The indirect function or relationship, however, supposedly works through the structural aspects in the society, especially the economic and social aspects. Foreign aid and investments are supposed to alter the structural conditions under which societies live in ways that tend to increase the level of democracy for these societies. Foreign aid is a resource or input that states can use for pursuing their economic well being in addition to the normal set of domestic resources available to them. Foreign direct investment, however, should be even more influential in that regard for the reasons explained above. In both cases, an economic element is expected to accompany the working of these two variables. Consequently, I hypothesize:

Hypothesis 3:

Foreign Aid will correlate positively with economic development among recipient countries

And

Hypothesis 4:

Foreign Direct Investment will correlate positively with economic development among recipient countries

The null hypotheses are that the relationships outlined above do not exist as hypothesized.

In terms of the relationship between these two variables, foreign aid and foreign direct investment do influence each other as theorized earlier. Specifically, one might suggest that foreign direct investment tends to follow foreign aid because investors believe that countries that receive aid are more subject to political pressure than those that do not receive aid, and that this in turn may reduce the capital risk by investors. Also, recipients of aid are supposedly facing economic hardships, a situation that usually indicates a need for investment. Consequently, they are willing to make concessions to investors in order to make their countries appear more attractive. Thus, potential investors see a greater potential for profits in these countries than would otherwise be the case. As a result I hypothesize that:

Hypothesis 5:

Increased Foreign Aid has a positive effect on the level of Foreign Direct Investment.

4.2.2 Control Variables

Economic development is an influential variable when it comes to its relationship with the level of democracy and one wants to make sure that it is controlled for by including it in the theory and analysis. In fact, this variable is an

important part of my theory as it serves as the stage between foreign financial transfers and the level of democracy. This is the content of my sixth hypothesis, which addresses the economic structural features that are most likely to affect the level of democracy. It has been argued in the literature and in this paper that the level of economic development and growth are among the variables that most enhance democracy (Lipset 1959). Although the relationship between economic development and democracy has been specified to occur in many different ways, in countries that have the potential to be exposed to foreign financial transfers, development is expected to have a positive linear correlation with the level of democracy. In other words, economic development is expected to correlate positively with the level of democracy in countries that face economic hardships. As such I hypothesize that:

Hypothesis 6:
Economic development positively affects the level of democracy

The previous six hypotheses are interactive and affect each other as well as on the ultimate dependent variable: the level of democracy. These interactions can be modeled as shown in figure 4.1:

Foreign Aid

+

Foreign Direct Investment

+

+

+

Economic Development

+

+

+

Level of Democracy

+
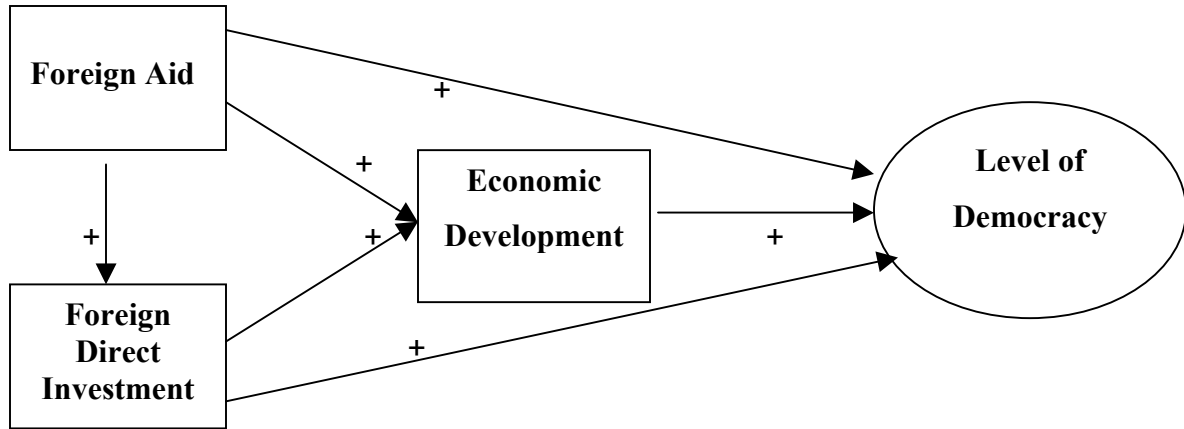
The model is multivariate and interactive, which allows or even demands the use of two established statistical testing techniques, Ordinary Least Square regression analysis and path or causal analysis. Path analysis is especially useful given the interactive character of the model. It is basically a technique that allows a researcher to fully explore the causal relationship among several variables, allowing for estimation of both direct and indirect effects of the independent variables on the dependent variable. Consequently, it should help analyze the indirect effects and relationships in the model.

This model is by no means all-inclusive, and the relationships in it are or can be more complicated. Specifically, another variable that cannot be ignored is related to the strategic dimension of financial transfers. The Cold War was a major determining factor in the flow of foreign aid and foreign direct investment during the postwar period. Foreign aid has goals other than democracy, but the end of Cold War raised the importance of the level of democracy. Foreign aid used to be preoccupied with strategic concerns. Therefore states that were key players to the U.S. and the western bloc's balance and relationship with the

former Soviet Union could expect to receive aid. Turkey is a good example in this regard. The Cold War was a global, military, economic, and ideological confrontation that affected almost all political phenomena in the world, including democracy. This war took the priority over democratization as a goal of foreign aid. It is very logical to assume that this war affected the linkage of foreign aid and investment to the level of democracy in a negative manner. In fact, the whole notion of financial transfers was highly influenced by the Cold War because nations and investors were encouraged to intervene financially in some countries and prohibited from doing so in others. The two poles of the Cold War era and most aid donors engaged in alliance formation as they competed to gather support for their camps from all over the world. During the Cold War, countries received aid or investment not because of their level of democracy but as a result of their strategic importance and what side they were aligned with. If these countries were U.S. or Western allies, then foreign aid and investment were the rewards regardless of the degree of political freedom. The end of the Cold War gave more space to foreign aid and foreign direct investment to achieve other domestic political goals such as improving the level of democracy. Based on this I hypothesize that:

Hypothesis 7:

Foreign aid and foreign direct investment negatively affect the level of democracy during the Cold War and a positively in the post-Cold War era.

Or

Foreign aid and foreign direct investment to allies, negatively affects the level of democracy.

The null hypotheses will be that the Cold War or alliance formation do not affect the impacts of foreign aid and foreign direct investment on the level of democracy among the recipient countries.

My last hypothesis will control for expected effects of the variation of the size of recipient countries. Because small countries are supposed to be more receptive to democratization than large ones, small countries that receive aid or direct investment are more likely to democratize than the big countries. Even if the amount of aid or investment is different, bigger states are less likely to democratize. This is because financial transfers works more effectively in small countries. By small countries I mean those with small populations. Based on this I hypothesize that:

Hypothesis 8:
The smaller countries are, the more democratic they are likely to be

These eight hypotheses collectively will be combined into a multivariate model that is designed to sufficiently explain the level of democracy. It contends that the level of democracy can be explained by these six major variables. Alliances and population size are control variables that are believed to have an effect on the level of democracy as theorized previously. The alliance and the

Cold War variables control for the strategic dimension of the foreign financial

transfers linkage to the level of democracy. Economic development can be

viewed as part of the theory because it is an essential interactive part of my two

primary variables. However, it can also be viewed as a control variable, for

economic development is expected to have an effect on the level of democracy.

It is highly advisable to use economic development in any attempt to explain

democracy. Consequently, I model these relationships in the following linear

multivariate equation:

The Level of Democracy = a + B$_1$ Foreign Aid + B$_2$ Foreign Direct
Investment + B$_3$ Economic Development + B$_4$ Cold
War + B$_5$ Alliances + B$_6$ Population Size + $\in$

4.3 Operationalization

4.3.1 The Level of Democracy

The level of democracy, the major dependent phenomenon under study,

will be measured by using Vanhanen's measure of democracy. While there have

been many attempts to measure this crucial political phenomenon, the Vanhanen

measurement of democracy has some unique advantages. The key advantage

of this measure is the fact that it uses objective criteria to rank states' democratic

status as opposed to subjective evaluations by country experts. For example,

the Freedom House Indexes of political rights and civil liberties and Gurr's Polity

II and III data sets use experts to rank states' levels of democracy. However much as one might respect the expertise of these scholars and the quality of guidelines governing their scoring of countries, the possibility of judgment error or ideological bias cannot be ruled out.

Vanhanen's criteria of measurement can be best comprehended by highlighting his understanding of democracy:

> In modern societies democracy means that people and groups of people are free to compete for power and that power holders are elected by the people and responsible to the people. As a consequence of free competition, political power is assumed to be widely distributed among various groups in democracies. (Vanhanen 1984)

The key terms in this definition are "compete" and "elected," as these are the criteria that Vanhanen uses to rank countries. He constructed an "index of democratization (ID)" in which "powersharing" in "electoral systems" are defined and can be formulated as:

Index of Democracy = (Competition x participation) / 100

where competition is calculated by subtracting the percentage of the votes won by the largest party from 100; in other words, it is the percentage of votes won by non-wining parties using the most important type of national elections in a given

regime. Participation is the percentage of the total population that actually voted, voter turnout. The output scores for the index ranges from 0 to 49 where 49 is the most democratic.

Vanhanen's measure of democracy is calculated from objective indicators rather than from judgmental criteria. A problem with such a measure, however, is that turnout constitutes measure on the democratic scale. Thus, many countries that are fully democratic by other criteria but have a low voting turnout rank low in Vanhanen's rank of democracy. The United States, for example, is a democracy that ranks low in this measure simply because of its low voter turnout. Also, one might argue that competition and participation do not seem to capture all the richness of a phenomenon like democracy. These criteria can be insufficient in capturing the level of civil liberties for example, which is considered very important as an indicator of democracy as the Freedom House Index and polity data sets assume. Also, Vanhanen's measure gives the immediately prior years' scores to any years when no election took place. Despite these shortcomings, the measure is still persuasive in the sense that it uses actual hard data to rank states from across the world. The measure also shares with the other main measures of democracy, Freedom House and Polity II and III, the advantages of covering a large number of countries for a large number of years.

Freedom House Index data are constructed on a scale from 1 to 7; one being the most democratic (Sussman 2002) while Polity II and III use a scale of 0 to 10; ten being the most democratic (Jaggers and Gurr 1995). The Freedom House measure is designed to capture the level of procedural democracy, using

the criteria of open elections, access to courts, and civilian control over the

military. Sorensen (1998) summarizes procedural democracy in two words:

competition and participation. Also the scale accounts for substantive

democracy, and includes such criteria as freedom of speech, freedom to

demonstrate and assemble, and the substantive level of human rights. Polity II

and III also incorporate these characteristics, for they develop longitudinal

indicators of political structures and regime change and consist of "annual

codings of regimes' structural characteristics, institutional changes, and the

directionality of changes on underlying dimensions of democracy, autocracy, and

power concentrations" (Gurr, Jaggers and Moore 1990).

Despite using different mechanisms to rank a country's level of

democracy, the Vanhanen and Freedom House measures are not very different

in their outputs, as the graphs in Figures 4.2 and 4.3 show. While the Freedom

House and Polity measures use experts to code and rank their sample, I choose

to employ the Vanhanen measure due to the desirability of an objective measure

of democracy for the purposes of quantitative analysis. Nonetheless, OLS

regression analysis will be performed employing the three measures of

democracy for further validation of the results.

Vanhanen's Measure of Democracy of the World (1976-1994)
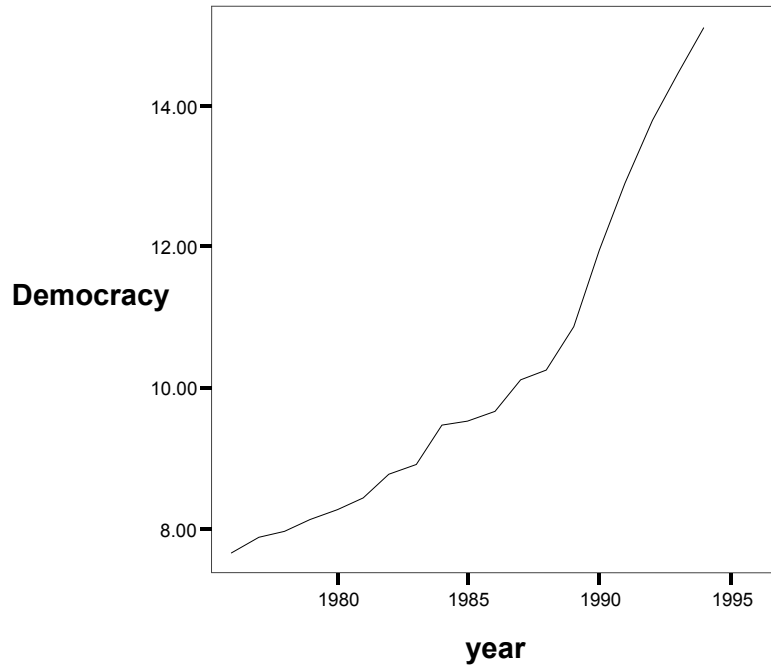
Freedom House Measure of Democracy of the World (1976-1994)
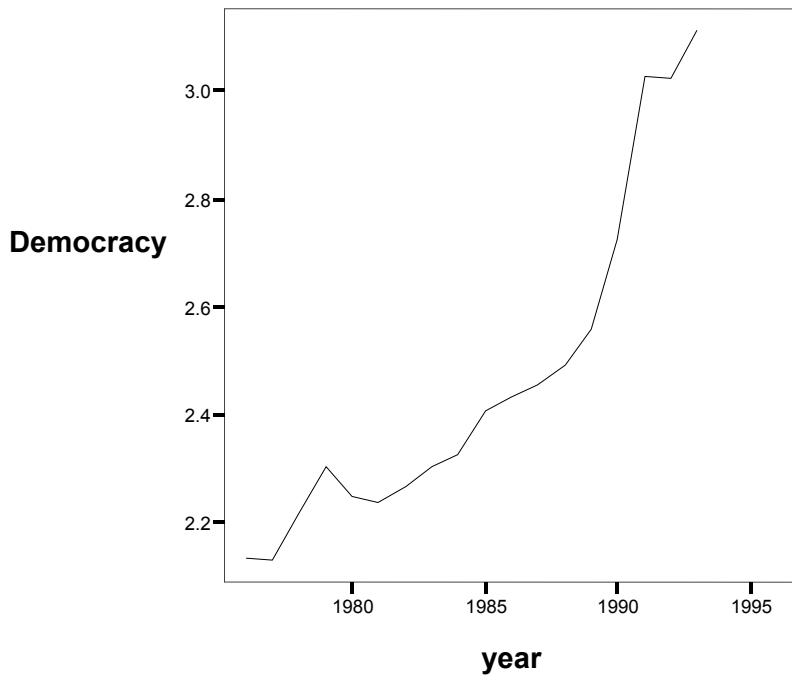
4.3.2 Financial Transfers: Foreign Aid and Foreign Investment

Foreign aid operationalized as the amount of per capita foreign aid as measured by the World Bank. The World Bank has compiled aid data that represents a pool of foreign aid from all sources, and therefore can be regarded as a sufficient indicator for this variable. Aid per capita total scores for the global sample for the years 1977, 1987, and 1994 were $3982.14, $7219.15, and $15037.75 respectively, in U.S. dollars. The data consists of the "net disbursements of loans and grants made on concessional terms by official agencies of the members of Development Assistance Committee (DAC) [13] and certain Arab countries to promote economic development and welfare in recipient economies listed as developing by DAC." Aid per capita "includes both Official Development Assistance (ODA) and official aid." It is calculated by "dividing total aid (in U.S. dollars) by the midyear population estimate"(World Bank 1998). The data in expressed per capita terms is quite useful, as one billion dollars worth of aid to Indonesia, with 228 million people, is a completely different story than a billion dollars of aid to Panama, with only 2.8 million people. Per capitalization serves as a weighting mechanism.

Foreign direct investment was also compiled from the World Bank data set. Foreign direct investment is the percentage of Gross Domestic Product (GDP) and it represents the "net inflows of investment to acquire a lasting management interest in an enterprise operating in an economy other than that of

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[13] The DAC which include 23 members. A list of all members can be found in Appendix A.

the investor. It is the sum of equity capital, reinvestment of earnings, other long-term capital, and short-term capital as shown in the balance of payment" (World Bank 1998). Foreign direct investment expressed as part of GDP is a more useful indicator of the relative impact of this phenomenon in the economy. Since foreign investment functions primarily through the economic development that it brings to recipient countries' economies, the way this variable is operationalized in my analysis is more adequate than the use of GDP data unadjusted for country size. This serves as a weighting mechanism, as a one billion dollar investment in a small economy is a completely different story than a one billion dollar investment in a large one. Since countries vary in size, they require a different amount of investment in order to generate the same effect. Foreign direct investment seems to have increased in the 1990s. The average net foreign direct investment as a percentage of a country's GDP in 1976, 1984, and 1993 was .82%, .76%, and 1.79%, respectively.

4.3.3 Control Variables

Gross National Product (GNP) is a measure of wealth and a sufficient indicator for measuring a state's relative economic development. It is the total value of all products that states produce divided by their population. It accounts for all the citizens' economic production whether it happens inside the state's borders or outside them. So American production in Malaysia will be counted and attributed to U.S. GNP. In mathematical terms the expression for Gross National Product is:

GNP = Consumption + Investment + Government Spending + (Imports –

    Exports)

This should effectively indicate to us how much development a certain country

has achieved [14].

    Well-known structuralist researchers such as Lipset (1959) have used

GNP as their measure of economic development. This paper agrees with the

reliability of this indicator and therefore will use it. GNP is expressed in the per

capita terms. An advantage of using this proportionate style of measurement

such as foreign direct investment as percentage of GDP and per capita GNP and

per capita foreign aid is that it helps avoid some of the complicated statistical

challenges such as multicollinearity that time series analysis may confront.

    To control and account for the strategic dimension of financial transfers,[15]

the choice was between either a Cold War variable or an alliance variable. The

Cold War variable is a dichotomous variable, with "1" denoting the existence of

the Cold War and "0" denoting its absence[16]. This is an easy concept to

operationalize, yet since it is dichotomous it does not create as much variation as

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[14] Gross Domestic Product (GDP) is another indicator for economic development
that is widely used. GDP accounts for economic activities and production inside
the state's geographic border even if it is done by non-citizens. It has a similar
mathematical equation to GNP but it does not account for the net of export-
import flow. GDP = Consumption + Investment + Government Spending.
[15] Financial intervention is a multipurpose process and might indeed have
strategic goals and objectives
[16] Cold War has been coded "1" in the data for the years 1976-1990 and "0" for
the years 1991-1994.

might be generated by a scaled variable. In addition, there is a theoretical problem for using such a variable because merely dichotomizing the Cold War does not reflect the true nature of this phenomenon which arguably varied in intensity over time.

The alternative is to use the level of alliance to one of the superpowers, as measured by the Correlates Of War (COW) project. The problem with using such a variable, however, is that it is based on the dyadic relationship between the country in question and a potential superpower ally in a given year. This is rather different than the other variables employed and as a result could not be used the way its constructed. However and due to the fact that alliance variables are dyadic by definition, choosing a single-country alliances and employ it in the analysis will solve the dyadic problem and make it disappear and therefore such measure is warranted. I chose the United States alliances because I believe this country might capture the phenomenon of alliances more than any others. It appears to make the most sense to use alliance with the United States as the variable that captures the strategic importance of foreign aid and foreign investment in the model. This is another dichotomous variable with "1" denoting the existence of an alliance and "0" denoting its absence of an alliance. Despite the criticisms cast on the Cold War and alliance variables for their dichotomous character, including both of them in the model as control variables should account for the strategic dimension of the central relationships explored in the model.

Population size is another control variable that is purported to have an impact on the model and its major concern: the process of democratization. Diamond (1994) assigned the threshold of one million inhabitants to distinguish between big and small states. However, I will not use this threshold to measure population. Instead, I will use the log of population, which captures a greater degree of variance in this variable without truncating part of its distribution.

4.4 Sample Description

The data utilized consist of 174 states[17] (units) for the time period of 1976 through1994. A sample of this size is advantageous for generating generalizable and persuasive results since it covers not only a significant amount of geographical space (most of the world's nations), but also a significant period of time as well. The data include all countries that receive foreign aid and investment from investors and donors. In addition, it includes states that do not receive aid or investment, but might be democratizing and have a potential to receive aid and investment. Including countries that do not receive aid or investment is essential to serve as a kind of control group that would validate my results. If I am to say that foreign aid and foreign direct investment affect the level of democracy positively, I need to ascertain the democracy performance of countries that do not receive these financial goods.

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[17] A list of all the countries included in this study can be found in appendix B.

The size of the sample is one of the strengths of this paper because most prior research on the topic (e.g. Carothers 1995, Dixon 1996, Graham 1996) used case studies, regional samples, or a smaller sample than the one utilized herein[18]. Also, until recently studies tended to use a sample of a wide range of units, but researchers were very reluctant to combine that with the dynamics of time due to the many statistical challenges inherent in this kind of research. Given the number of states and contrasting it with the period of time, I can fairly say that most of my explanations and results will be more driven by the number of cases than by the time period used. In other words, the sample of 174 countries[19] is more likely to drive the results of this research than the 18 years time period. This is not to say, however, that the time period utilized is not significant or sufficient to produce persuasive results. With the number of states (units) multiplied by the number of time periods, the sample consists of (3524) cases or scores. Table 4.1 presents the statistical descriptive summary of all the variables used in the analysis. The variables include Vanhanen's level of democracy (vdemoc), polity III (polity3), Freedom House Index (Fhouse), foreign

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[18] Because of the nature of the data we use in political science, it is beneficial to get big samples to try to make the case of our theories. For example, we tend to have a decent amount of "missing values" in political science data because such data can be very sensitive. As a result, for a sample of 174 countries, one might get a 100 or less "N" (number of observation) because for each missing value the whole unit or country will be dropped.

[19] Although this number is often less because of the missing values that will result in dropping the whole unit for that year.

aid (faid), foreign direct investment (finvest), per capita GNP (pcgnp), the Cold

War (Coldw), United States alliance (ally), and population size (logpop).

Table 4.1:

Variable	Obs	Mean	Std. Dev.	Min	Max
vdemoc	2779	10.07703	12.91466	0	47.11
polity3	2429	3.681762	4.357718	0	10
Fhouse	2849	4.074061	5.455173	1	7
faid	2453	44.31494	70.28461	-15.68*	619.58
finvest	2370	1.162528 **	2.787882	-30.453*	39.2113
pcgnp	2136	3751.377	5891.288	52	36410
Coldw	3222	.8333333	.3727358	0	1
ally	2815	5.282771	21.68864	0	1
logpop	2132	6.967126	.6371212	5.342422	9.073718

* Faid can be negative when the amount of money the country spends servicing
its loans, grants… is more than the aid it receives for that year. Finvest can be
negative when the inflow of funds from exports was partially offset by continued
capital outflow.
 ** 1.16%

4.5 Specification of Methodology and Testing

A Multivariate Ordinary Least Squares regression analysis of a pooled

time series data set will be utilized to test my hypotheses. This will be

supplemented by path analysis, which should be helpful to analyze the indirect

effects of the variables on my model. My method is most appropriate for the

amount of data I will be using. Statistical analysis is desired with such amounts

of data, and provides the surest path to solid generalizations. With the luxury of

large N, statistical analysis can be a powerful tool to draw causal inferences.

OLS regression is most common with pooled time series data, but is

subject to several common statistical problems that can be very challenging

(Stimson 1985). Heteroskedasticity is one problem that implies that variance are

not equally distributed around the mean. In other words, variance of the error

term is not constant, a violation of one of the basic regression assumptions. This

needs to be controlled for, and there are two methods to solve this problem. One

is by including several dummy variables that will standardize the variance of the

error term, and the other is the Robust Matrix technique. The Robust Matrix

technique is a statistically accepted way to resolve this problem (ibid).

Another potential problem is serial autocorrelation, whereby the causal

relationship between the dependent and independent variables comes as a result

of them traveling together over time. It is not that they cause each other, but

rather that they exhibit parallel changes over time. It is a problem that comes as

a result of the time dimension in the data utilized. This problem can be resolved

by lagging the dependent variable and including it in the right hand side of the

multivariate equation. This solution not only makes sense statistically but also it

makes sense theoretically. The level of democracy at time *t-1* should affect the

level of democracy at time *t*.

I will be using OLS regression, which allows the use of techniques that

can control for the previous two problems. In addition, I will be using the Panel

Corrected Standard Error (PCSE) technique, an approach that should control for heteroskedasticity and serial autocorrelation.

The final and most serious problem in time series research is the multicollinearity problem whereby there is a correlation or association among the independent variables themselves. This is a common problem among studies that use cross-national or cross-sectional time series data (Beck and Katz 1995). It exists when there is a linear or non-linear relationship among some of independent variables of the multivariate equation (ibid). If two independent variables are highly correlated, this may indeed bias the results and take the statistical significance away. In this case, inferences drawn from the regression estimates may be very unreliable and doubtful.

Several techniques can be used to solve this problem. The first, and most used, is readjusting the model by including or eliminating some variables. This technique, although effective, is not desired because it might affect the theoretical logic of any research and make any research looks very inductive and data driven. The second technique is lagging the independent variables with different time lags. This needs theoretical explanation and can be complicated. Third is combining the variables into indexes or breaking them into several entities and indicators. Vanhanen's (1990) power resource index is an example of an index of this type.

Fourth is the use of different numerical measures to account for the same value of a certain variable. For example, if GNP is used in the model and it happens to be collinear with another independent variable one can replace it with

per capita GNP, which consists of different numbers and yet measure the same thing in a theoretically relevant manner. Another example is the use of percentages instead of raw numbers. In this case, the numeric value might differ between the two indicators, but they still measure the same phenomenon with the same reliability. This technique is the one utilized by this study. By using foreign direct investment as a percentage of GDP, per capita foreign aid, and per capita GNP, I was able to avoid the issue of multicollinearity. I utilized Pearson's *r* test of correlations to detect for multicollinearity and found no evidence that this statistical problem exists in my model.

CHAPTER 5

DATA ANALYSIS AND INTERPRETATIONS: REGRESSION AND PATH
ANALYSES

5.1 Introduction

The statistical analysis in this chapter tests the relationships hypothesized

in chapter 4 between the level of democracy and several international and

domestic variables. The analysis employs Ordinary Least Squares Regression

analysis, which is conducted on a Pooled Cross-Sectional Time Series data. The

unit of analysis used in the data (the cross sections) is the nation-state. Analysis

of such data is quite challenging because the data vary greatly across time and

space. The analysis therefore employs a variety of techniques to control for the

special statistical problems and obstacles inherent in this kind of data.

The chapter will start with simple analytical techniques that may capture

the variation in the data and then move to more advanced techniques. Bivariate

regressions will be the opening analyses. Then, a simple regression analysis will

be conducted on the major variables of interest: level of democracy, foreign

direct investment, and foreign aid. Other control variables will be added to the

model to eventually arrive at the multivariate model, which will construct a test of

sufficiency to explain the endogenous variable (the level of democracy). It is

beneficial to develop the multivariate model step by step because this will give an

in depth idea of how an applicable model of democratization can evolve and

develop, and may help us identify influential variables. After doing that, the major

problems of multivariate regression analysis on pooled cross-sectional time series data most notably, heteroskedasticity, serial autocorrelation, and multicollinearity, will be addressed. Certain widely practiced techniques to control for the possible difficulties, such as Robust Matrix that controls heteroskedasticity and lagging the dependent variable for serial autocorrelation problem, are simple techniques that will be used.

Finally, path or causal analysis will be performed to further validation of the results and to reveal more information about the dynamics of the model. It is, however, quite complicated to use such analysis with pooled cross-sectional time series data sets. Thus, selected years rather than the whole time series will be chosen in order to conduct such analysis. The chapter will end with a discussion and analysis of the results the path findings.

5.2 Bivariate Analyses

One can think of this kind of analysis as the basic building block of most statistical analyses as it shows the individual relationships between the dependent and independent variables separately. Bivariate analysis is seldom used in pooled cross-sectional time series data because of its weak theoretical significance. But there is no reason why it should not be used because it is helpful for giving an idea of the basic statistical relationships of the dependent and independent variables. Bivariate analysis should also shed more light on the variables utilized. All the bivariate analyses are conducted using one-tailed (1-tailed) hypotheses because all of my hypotheses are specified to occur in one

direction. All the hypotheses indicate whether the assumed relationships are positive or negative.

My first bivariate analysis represents the relationship between foreign aid and the level of democracy as shown in table 5.1.

Table 5.1

Pearson Correlation Between Vanhanen's Level of Democracy (VDEMOC) and Foreign Aid (FAID)

		FAID
VDEMOC	Pearson Correlation	.022
	Sig. (1-tailed)	.152
	N	2254

The Table reveals that the Pearson's *r* correlation coefficient between foreign aid and the level of democracy is .022 which is rather low and statistically insignificant (probability = .152).[20] Consequently, at first glance foreign aid does not appear to contribute significantly to democracy levels and therefore we fail to reject the null hypothesis of no relationship between them. These numbers were generated by employing the global sample of the study (174 countries from 1976 to1994) with its variation across space and time.

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[20] The significance level essentially tells us how many times our hypothesized relationship is likely to be correct as a result of chance alone; .05 is an accepted level of significant in social and political science, indicating a likelihood of a chance relationship only one time out of twenty.

Table 5.2 examines the relationship between my second financial transfers variable, foreign direct investment, and the dependent variable, the level of democracy.

Table 5.2

Pearson Correlation Between Vanhanen's
Level of Democracy (VDEMOC) and Foreign Direct Investment (FINVEST)

		FINVEST
VDEMOC	Pearson Correlation	.060**
	Sig. (1-tailed)	.002
	N	2436

**Correlation is significant at the 0.01 level (1-tailed).

The value of Pearson's r correlation coefficient's for the relationship between foreign direct investment and the level of democracy is .06 and is statistically significant (probability = .002). Consequently, I can reject the null hypothesis of no relationship between foreign direct investment and the level of democracy. This bivariate relationship is statistically significant but very weak. It means that foreign direct investment accounts for only .0036 (r^2) of the level of democracy. Thus at first blush foreign direct investment has an almost meaningless effect on the level of democracy.

Table 5.3 indicates the Pearsonian correlation between Per Capita General National Product as an aggregate measure of wealth and economic development and the level of democracy.

Table 5.3

**Pearson Correlation Between Vanhanen's
Level of Democracy (VDEMOC) and Per Capita General National Product
(PCGNP)**

		PCGNP
VDEMOC	Pearson Correlation	.593**
	Sig. (1-tailed)	.000
	N	2118

**Correlation is significant at the 0.01 level (1-tailed).

The table reveals a positive relationship between Per Capita GNP and the level of democracy. This is expected from an economic development variable with its influential explanatory power. A Pearson's *r* correlation of .593 both strong and significant at the .01 significance level. We thus reject the null hypothesis of no relationship between per capita GNP and the level of democracy. The relationship suggests that per capita GNP accounts for 36% (r^2) of the level of democracy.

Tables 5.4, 5.5, and 5.6 display the correlations of my control variables with the dependent variable in order to examine the magnitude of the relationships.

Table 5.4

**Pearson Correlation Between Vanhanen's
Level of Democracy (VDEMOC) and Population Size (LOGPOP)**

		LOGPOP
VDEMOC	Pearson Correlation	.013
	Sig. (1-tailed)	.278
	N	2114

The correlation between population size and the level of democracy is not statistically significant as Table 5.4 reveals. Diamond's argument for a link between population size and the level of democracy is falsified on the basis of this bivariate relationship. Pearson's *r* correlation coefficient of .13 is statistically insignificant (probability = .278, indicating a high chance of occurrence of the relationship hypothesized by chance only). The positive direction of the relationship is also counter to Diamond's expectation of an inverse link between population size and the level of democracy.

Table 5.5

**Pearson Correlation Between Vanhanen's
Level of Democracy (VDEMOC) and Cold War (CWAR)**

		CWAR
VDEMOC	Pearson Correlation	-.160**
	Sig. (1-tailed)	.000
	N	3058

**Correlation is significant at the 0.01 level (1-tailed).

Table 5.5 shows a significant correlation value of -.160 for the relationship between Cold War and the level of democracy in the sample of countries studied. This relationship is as hypothesized, negative. These results are remarkable and may be partly driven by the dichotomous nature of the Cold War variable (Dichotomous variables tend to reduce variation, which may obscure actual relationships).

Table 5.6

**Pearson Correlation Between Vanhanen's
Level of Democracy (VDEMOC) and Alliances (ALLY)**

		ALLY
VDEMOC	Pearson Correlation	.057**
	Sig. (1-tailed)	.001
	N	2771

**Correlation is significant at the 0.01 level (1-tailed).

The alliance variable[21] is a weak but statistically significant .057 Pearson's

r correlation value at .001 significance level. What table 5.6 reveals is that the

U.S. tends to have more democratic alliances than non-democratic ones.

Alliance is the other control variable that was included in the analysis to capture

the strategic dimension of the overall model. The idea that the level of

democracy might be affected by some strategic calculations seems appealing

and justifies the inclusion of such variables. This variable, like the Cold War

variable, seems to capture the strategic dimension of the level of democracy;

however, its relationship with the level of democracy is in the opposite direction

as hypothesized by the study. Pearson's *r* correlation coefficient reveals a

positive relationship while the study hypothesized that allies that receive foreign

aid and foreign direct investment are more likely to have less levels of

democracy. This finding may merely be an artifact of using bivariate analysis

and not a multivariate one, so we will revisit this relationship in the multivariate

analysis.

The Pearson's correlation coefficients above give us an initial look at each

independent variable's relationship with the dependent variable, the level of

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[21] Alliance is a dichotomous variable of "1" indicating an alliance with the U.S. and "0" indicating no alliance. Alliance variables are dyadic by definition, therefore one needs to choose one country's alliance and the U.S. seems the best candidate. The study hypothesized that the U.S. will not make democracy a priority when making and maintaining alliances but rather security, which implies a negative relationship between alliance formation and the level of democracy. However, the results of this bivariate analysis reveal a different picture.

democracy. The next step is to see how these variables behave collectively in a multivariate regression analysis.

5.3 Multivariate Analysis

Multivariate analysis is a statistical test of sufficiency. In other words, one claims when conducting such a test that a change in the independent variables is a sufficient explanation for a change in the dependent variable. The dependent variable's behavior can be fully explained by the collection of the independent variables employed. This section of multivariate analysis will start by conducting the standard Ordinary Least Squares Regression. Then, the major statistical limitations this type of regression confronts will be discussed. The classical as well as the modern advanced techniques for controlling such limitations will also be outlined.

The biggest advantage of multivariate analysis is that it allows for the idea of statistical control, which essentially means identifying and including alternative explanations and therefore distinguishing the true effects of the variables of interest. Among the things we know about the political world is that a phenomenon is seldom driven or influenced by a single variable rather than by a collection of variables. If we want to study the effect of a certain variable on the dependent phenomenon, we need to isolate and control for other variables that might be affecting that same phenomenon. This is usually done by including such variables and explanations in the analysis, which creates a multivariate model.

5.3.1 Standard OLS Multivariate Regression

Regression analysis is a statistical technique that is widely used in social

science because it can identify the associational, e.g. partial coefficients, and the

causal, e.g. *t*-scores, relationships between exogenous and endogenous

variables. If Chi-Square tells us that there is (or is not) something in a certain

relationship, the *t*-statistic tells us whether that relationship is statistically

significant or not. But neither Chi-Square nor the *t*-statistic can tell us the

magnitude of the relationship and therefore we refer to coefficients of association

like Beta coefficients[22]. Beta coefficients are reliable statistical inferences

because they are standardized meaning that all variables in the model were

standardized to a mean of 0 and a standardized deviation of 1. They provide an

indicator of the magnitude of the relative contribution and weight of each

independent variable in their attempt to explain and predict the dependent

variable (Thompson and Borrello 1985). Beta ranges from 1.0 to –1.0 and it is a

relative measure based on the values of other competing variables. For

example, if the Beta value for the alliance variable is .4 and for foreign aid is .2,

then we conclude that the former has twice influence as of the latter[23]. Both *t*-

statistic and Beta coefficients will be the major two statistical tests utilized by this

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[22] Other regular coefficients might be used when the statistical tests do not allow
for beta coefficients.
[23] In case we regress one independent variable, Beta value will be calculated
relative to the constant.

research. My first regression equation will consist of three variables, which are the main focus of the study.

The Level of Democracy = a + b_1 Foreign Aid + b_2 Foreign Direct Investment

When regressing these two independent variables with the endogenous variable, one can assume that they both serve as control variables for each other. For example, foreign aid performed statistically the way it did in Table 5.7 in part because of the inclusion of foreign direct investment in the analysis. Have foreign aid been analyzed individually without foreign direct investment, we would have expected different results. Table 5.7 presents the statistical result of this model:

Table 5.7

OLS Estimates of the Parameters for the General Model of the Level of Democracy (VDEMOC) Using Foreign Aid (FAID) and Foreign Direct Investment (FINVEST)

	R-Square	Adjusted R-Square	Standardized Coefficients	t	Sig.
			Beta		
(Constant)	.016	.015		25.508	.000
FAID			-.014	-.640	.522
FINVEST			.127	5.616	.000

N = 1861

The table above is consistent with the bivariate analysis and shows that foreign aid's contribution to democracy is statistically insignificant. Also, the

negative sign is opposite of what I hypothesized. In contrast, foreign direct

investment's association with democracy is statistically significant at .001

significance level. The Beta coefficient of this variable is .127 meaning that every

unit change of foreign direct investment associates with a .127 change in the

level of the democracy measure. The allover fit of the model of these two

variables can be inferred to from the R-Square value of .016 and the adjusted R-

Square value of .015. This means that these two variables collectively can

explain 1.5 percent of the endogenous variable.

The next regression shown (table 5.8) includes all the variables including

the control variables of population size, alliance, and the Cold War, in addition to

the economic development variable. All hypotheses are assumed one-tail.

Table 5.8

OLS Estimates of the Parameters for the General Model of the Level of Democracy (VDEMOC) Using All the Independent Variables

	R-Square	Adjusted R-Square	Standardized Coefficients	t	Sig.
			Beta		
FAID			-.069	-2.488	.013
FINVEST	.127	.124	.068	2.718	.007
PCGNP			.155	6.196	.000
LOGPOP			.010	.358	.721
CWAR			-.250	-10.020	.000
ALLY			.123	5.009	.000

N = 1465   One-tail hypotheses

Adding the economic development variable and the three control variables of national population size[24], alliance with the United States, and the Cold War does add some significant explanatory power to the model. Adjusted R-Square is now .124. Of all the variables and factors considered by this model, the Cold War had the greatest impact on democracy, followed by per capita GNP and alliance with the United States. Foreign aid and foreign direct investment are weakly associated with democracy. Population size is insignificant.

The population size and alliance variables are positive in direction contrary to my hypotheses 7 and 8. The impact on democracy of the Cold War era, however, is negative and that consistent with the research hypothesis. Foreign direct investment and per capita GNP maintained their statistical significance with t scores of 2.718 and 6.196 respectively. Their Beta coefficients are .068 and .155 respectively. Combined, these two variables change of one unit is associated with .223 change in the dependent variable. After adding the control variables and filtering out some intervening effects, foreign aid becomes significant with a t score of –2.488 and a beta coefficient score of -.069. Nevertheless, the direction of the variable is opposite what I hypothesized. It seems possible that foreign aid may have very weakly contributed more to authoritarian regimes than to democratic ones.

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[24] Population size is logged to account for the gaps among populations' sizes. Given the difference in population size among countries of the sample, data are expected to be 'spiky' and logging data should correct for that. It is essentially condensing population sizes and representing them with relatively closer numbers while still accounting for the variation among them.

When looking at the whole model, one can claim that the model suggested by earlier theoretical discussion has some utility. All the variables utilized by the model gain significance except for the population size variable. We thus reject their null hypotheses of the absence of relationship with the dependent variable and accept the hypotheses of the existence of such relationships. These results suggest the utility of further investigation. It is worth emphasizing that the analysis above has been conducted on a pooled cross-sectional time series data, which requires controls for the statistical problems that often plague such analysis, to which I turn in the nest section.

5.3.2 Limitations on OLS Regression Analysis when conducted on Pooled Cross-Sectional Time Series Data and the Classic Techniques for Corrections

Linear regression analysis rests on certain assumptions that must be satisfied in order for the theory of regression to be reliable. Any results that are generated utilizing data that do not meet these assumptions may be highly flawed. The three most challenging of these problems are heteroskedasticity, serial autocorrelation, and multicollinearity. Such problems are specifically challenging and deepen when the data employed are pooled cross-sectional time series data.

5.3.2.1 Heteroskedasticity

Heteroskedasticity refers to the unequal variance in the regression error terms. It means that the residuals are not distributed normally around the

regression line or mean. This implies the existence of outliers which may bias

the sample and make it give false trends and tendencies, and as a result may

lead to false generalizations.

Two concerns regarding heteroskedasticity need to be mentioned. First,

the bigger the sample is, the more likely it is that outliers (an indication of

heteroskedasticity) will have little effect on the trend of the data. My sample is a

large one and is therefore less likely to suffer from problems of

heteroskedasticity. On the other hand, this sample's variation across time and

space may be more prone to heteroskedasticity. Not only do we need to assure

that no variable is heteroskedastic for all the eighteen years of the sample, but

also that no sample units (nation states) are heteroskedastic within any year

(Katz and Beck 1995).

An ocular test is often used to identify the existence of a

heteroskedasticity problem, but this is simply impossible in the case of pooled

cross-sectional time series data such as those employed in this research. The

only way that a sensible graph of the scatter plots can be generated is when we

do it for every year individually. Such measure, however, would undermine the

very idea of pooled cross-sectional time series analysis which is the choice of

this research. Another test of heteroskedasticity is the Cook-Weisberg test (the

hettest) supplied by STATA. The error variances are assumed to be constant

according to the null hypothesis of this test. An evidence of heteroskedasticity

essentially indicates that standard error and hypothesis tests might be unreliable.

We reject the null hypothesis if hettest is significant (White 1980 and Leblang

1996). Applied to my data set, the Cook-Weisberg test for heteroskedasticity using fitted values of the level of democracy (vdemoc) indicated the existence of heteroskedasticity. With Chi-square value of 181.50 and Chi-square probability of 0.0000, I can conclude that the hettest shows significance so we reject the null hypothesis of equal variance. In summary, the data indeed suffers from heteroskedasticity and correction mechanisms are warranted.

The standard control for heteroskedasticity is to include dummy variables for the units utilized in the analysis. A dummy variable is a numerical variable used in regression analysis to represent subgroups of a sample (Kennedy 1992). In this case it means adding dummy variables for each country or year used in the analysis.

The other procedure that may be used to address the problem of heteroskedasticity is the Robust Matrix technique that "computes a robust variance estimator based on a varlist of scores and a covariance matrix. It produces estimators for ordinary data (each observation independent), clustered data (data not independent within groups, but independent across groups), and complex survey data with stratified cluster sampling" (STATA 6.0, 1999). Tables 5.9 and 5.10 below show the regression results with and without the use of the Robust Matrix correction.

Table 5.9
OLS Estimates of the Parameters for the General Model of the Level of Democracy (VDEMOC) Using All the Independent Variables

	R-Square	Adjusted R-Square	Standardized Coefficients	t	Std. Err.
FAID			-.069	-2.488	.0056702
FINVEST	.127	.124	.068	2.718	.1150295
PCGNP			.155	6.196	.0001314
LOGPOP			.010	.358	.3987504
CWAR			-.250	-10.020	.5978677
ALLY			.123	5.009	.0858201

N = 1465

Table 5.10
OLS Estimates of the Parameters for the General Model with the use of Robust Matrix Correction

	R-Square	Adjusted R-Square	Standardized Coefficients	t	Robust Std. Err.
FAID			-.0141072	-3.59	.0039253
FINVEST			.3126198	2.78	.1123169
PCGNP	0.127	0.127*	.0008144	4.50	.0001811
LOGPOP			.1425939	.37	0.897904
CWAR			-5.990881	-8.53	.7022496
ALLY			.4299025	2.08	.2062275

N = 1465

One notices some differences in the regression results in table 5.9 and

5.10 when the Robust Matrix technique is utilized (table 5.10), which indicates

that heteroskedasticity has been controlled for. Foreign aid and foreign direct

investment seem to perform better when controlled for heteroskedasticity while

the impact of U.S. alliance, the Cold War, and per capita GNP's performance is

weakening. Population size remains statistically insignificant. The magnitude of

the relationships indicated in the *r* coefficient and the R-Square's values do not

seem to be affected. Foreign aid is significant along with foreign direct

investment, per capita GNP, Cold War, and being a U.S. ally. The change that

occurs here indicates that the model in general performs differently when

correcting heteroskedasticity. After controlling for this limitation, the explanatory

power of the financial variables is enhanced while the strategic variables and per

capita GNP lose some explanatory power.

5.3.2.2 Serial Autocorrelation

The second problem of the type of analysis herein is serial autocorrelation.

This error arises as a result of the time series element in the data. It simply

means that the relationships between the dependent and independent variables

develop as a result of them traveling together across time and not because of

any causal function, as would be desired. It is not that they drive each other but

rather change in rough parallel over time. Serial autocorrelation, as an

assumption of classical linear regression, statistically means that the

"disturbance term relating to any observation is not influenced by the disturbance term relating to any other observation. Put simply, the error terms of the Ordinary Least Squares (OLS) equation estimate must be independently distributed of each other and hence the covariance between any pair of error or residual terms must be zero. Should this covariance be non-zero, then the residuals are said to be autocorrelated and a relationship between present and past values can be observed. Serial autocorrelation therefore refers to the existence of a linear equation involving the residuals of the regression" (Greene 1997).

The presence of serial autocorrelation in OLS regression may still result in an unbiased coefficient estimates. But, such estimates are not the most efficient ones. Another unbiased and more efficient estimator can be found when controlling for serial autocorrelation. The standard control is to include a lagged dependent variable in the right hand side of the multivariate equation. This technique should stop the interdependency between the dependent and the independent variables that might occur because of the time series element. This produces the following new equation that include the lagged dependent variable:

The Level of Democracy = a + b_1 Lagged Level of Democracy + b_2 Foreign Aid + b_3 Foreign Direct Investment + b_4 Economic Development + b_5 Cold War + b_6 Alliances + b_7 Population Size + $\in$

Table 5.11 shows the regression results when controlling for heteroskedasticity (Robust Matrix) and Serial Autocorrelation (including lagged dependent variable).

Table 5.11

OLS Estimates of the Parameters for the General Model Using Robust Matrix Command and the Lagged Level of Democracy

vdemoc	Coefficients	Robust Std. Err.	t	R-squared
lvdemoc	.815337	.0198044	41.17	
faid	-.005888	.0020946	-2.81	
finvest	.0308011	.0725643	0.42	0.7751
pcgnp	.0000133	.0000513	0.26	
ally	1.821387	.3627546	5.02	
cwar	-1.052052	.2881554	-3.65	
logpop	-.2830268	.2079221	-1.36	

N = 1464

Foreign aid, the Cold War, and alliance with the United States are the only variables that are statistically significant. The results in table 5.11 are significantly different from table 5.10 when running the regression without controlling for serial autocorrelation. The most surprising changes are those observed for foreign direct investment and per capita GNP, which maintained their statistical significance until we controlled for serial autocorrelation. Based on the results of table 5.11, I can claim that there is sufficient evidence that the data suffer from serial autocorrelation which affected the statistical significance of several variables. R-Square is .7751 which is rather high, but with no significant meaning because adding the lagged dependent variable to the group of

independent variables is probably behind this inflation. It is to be expected that the lagged level of democracy will have a great explanatory power for the level of democracy because democracy levels do not change much from year to year. It seems that the lagged dependent variable is generating almost all the explanatory power in the model.

On the other hand and contrary to the conclusion that the data suffer from serial autocorrelation, the Durbin- Watson test indicates that such problem does not exist and therefore we should not control for it. A test using the Durbin-Watson statistic produces a score of 2.099069. With six explanatory variables and an N of 1462, the lower and upper significant points are 1.707 and 1.831 respectively at a .05 level of significance. Since the calculated Durbin-Watson is 2.0990 and this exceeds the upper significant point of 1.831, it suggests the absence of serial autocorrelation (Gujarati 1988). Consequently one should probably not attempt to control for it as this might bias the regression results.

We are thus left with a dilemma: on the one hand the Durbin-Watson test shows the absence of serial autocorrelation, but on the other hand running the regression with and without controlling for this limitation produces widely different results implying the existence of the problem. For the purposes of this analysis, I will assume that political and government phenomena including the variables employed by this study evolve incremental (a tendency widely and repeatedly ascribed to regimes and public budgets), and therefore I will correct for the serial autocorrelation limitation. Nonetheless, regressions without correcting for such

limitation will also be performed. Table 5.10 shows the regression results without controlling for serial autocorrelation.

5.3.2.3 Multicollinearity

The final problem that needs to be addressed concerning the classical linear regression assumptions is the issue of multicollinearity. Multicollinearity essentially means that two or more of the independent variables have a high correlation between or among each other (when two independent variables are highly correlated). This will simply bias the results as it may absorb some of the variation, which can be beneficial for the relationship with the dependent variable. In this case, neither of the correlated variables may contribute significantly to the model. This can be a very challenging problem given that solving it might require re-specifying the model, which implies many theoretical re-adjustments. Re-adjusting the model as a result of statistical limitations is problematic and ethically questionable because what we are essentially doing is being inductivists and data driven. We are sacrificing our logic and theory for the sake of statistical significance.

Several techniques may be used to correct for the problem of multicollinearity. Re-specifying the model is one of them and yet was not utilized herein because of the reasons outlined above. Another way to control for this problem is to combine or break down the independent variables that are highly correlated. In other words, this technique creates an index that can combine the correlated variables or create new variables that may divide or break down one

variable. Nonetheless, the technique that was utilized by this study is measuring

variables with non-absolute terms or scores. Using ratio, percentage, or per

capita measures may very well control for multicollinearity. These kinds of

measure give the same theoretical and substantial meaning and yet different

numbers. These different numbers may not be collinear as the absolute value of

variables. Measuring foreign aid and GNP as per capita and foreign investment

as percentage of GDP seem to pay off and mute the problem of multicollinearity.

A test of multicollinearity shows that there is no evidence that such a problem

occurs among my independent variables. A Pearson's *r* correlation coefficient

test that support the lack of multicollinearity are shown in table 5.12

Table 5.12
**Pearson Correlation Among All the Independent Variables Including the
Lagged Dependent Variable**

	lvdemoc	Faid	Finvest	Pcgnp	Ally	Cwar	Logpop
lvdemoc	1.0000						
Faid	0.0404	1.0000					
Finvest	0.0620	0.1924	1.0000				
Pcgnp	0.5929	-0.1085	0.0465	1.0000			
Ally	-0.0444	-0.1136	-0.0067	0.0257	1.0000		
Cwar	-0.1801	-0.0744	-0.1366	-0.1267	0.0534	1.0000	
Logpop	0.0180	-0.4219	-0.1409	-0.1000	0.0170	-0.0334	1.00

The coefficients in table 5.12 do not indicate any signs of multicollinearity.

There is no specific threshold that one needs to look for in order to say that the

model suffers or does not suffer from multicollinearity. However, a common rule

of thumb usually holds that a correlation of .8 that would usually establish the

suspension of multicollinearity. Even this .8 score might be overly high, so one

might worry about multicollinearity when Pearson's correlation is .6 or above.

The evidence above shows that none of the Pearson's *r* scores are .6 or above.

All the coefficients are actually below this score except in the case of the lagged

dependent variable (lvdemoc), which should not be a matter of great concern

given that the lagged dependent variable is not theoretically part of the

explanatory variables or part of the original model. The highest Pearson's *r*

score is -.4219, which is the correlation between population size and foreign aid.

The table, therefore, reveals no multicollinearity.

To further confirm the absence of multicollinearity, I ran the regression

without the population size variable. If the deletion of this variable substantially

alters the regression's results or, more significantly, the signs and directions,

then there might a problem of multicollinearity. After running the regressions with

and without population size, I can again confirm that the model does not show

any evidence of multicollinearity. Appendix C shows both results of these two

regressions.

5.3.3 Advanced Techniques for Corrections

The previous analysis has outlined the major problems that may occur

as a result of violating some assumptions of the linear OLS regression analysis

with pooled cross-section time series data. The classical methods of control

have also been addressed. The results after controlling these problems were

significant for only three variables: foreign aid (t = -2.81), the Cold War (t = -

3.65), and alliance with the U.S. (t = 5.02) variables. Foreign aid has a negative

relationship with the level of democracy, contrary to hypothesis, and the alliance

variable has a positive sign, also contrary to expectation. The shift of variables'

statistical significance came when attempting to fix the serial autocorrelation

problem which signals that data suffer from such a problem due to its time series

character. The following section will utilize recently developed and more

advanced techniques that may correct for statistical deficiencies such as

Heteroskedasticity and serial autocorrelation.

The strategy of using Panel Corrected Standard Error (PCSE) supplied by

STATA seems to be the most used and accepted technique for generating

reliable results from the linear regression analysis that uses pooled cross-

sectional time series data. This technique allows for the proper reading and

analysis of the type of data utilized herein and therefore generates more reliable

regression results (Beck and Katz 1995). Specifically, it controls for the problems

of heteroskedasticity and serial autocorrelation. PCSE

produces panel corrected standard error estimates for linear cross-sectional
time-series models where the parameters are estimated by OLS or Prais-
Winsten regression. In computing the standard errors and the variance-
covariance estimates, the disturbances are, by default, assumed to be
heteroscedastic and contemporaneously correlated across panels (STATA 6.0,
1999).

PCSE make sure that units are not heteroskedastic across time and within each year. Accounting for heteroskedasticity within each year is rather important given that my data have a high number of units (174) and only 18 years. PCSE's "hetonly" procedure specifies that the disturbances are assumed to be panel-level heteroskedastic. STATA simply can read the data better through this technique and therefore account for all of its variation while muting heteroskedasticity.

PCSE can also control for serial autocorrelation by employing an autocorrelation (AR 1) function. Linear regression with AR (1) specifies a first order serial correlation correction. Correlation AR (1) assumes that, within panels, "there is first-order, AR (1), autocorrelation and that the coefficient of the AR (1) process is common to all of the panels" (STATA 6.0, 1999). The logic behind AR (1) is related to the theoretical judgment regarding the time serial effect. Most political research uses a one-year effect, a convention that I will follow here.

Table 5.13 shows the PCSE regression results for the model while controlling for heteroskedasticity (hetonly) and serial autocorrelation (correlation AR 1). PCSE was also performed without controlling for serial autocorrelation (AR 1 was not included) and the results are included in appendix D. The results in appendix D show that all variables performed relatively similar for the exception of foreign aid which became statistically significant.

Table 5.13

**OLS Regression Estimates of the Parameters for the General Model
Using Panel Corrected Standard Error**

	Coefficients	Het-corrected Std. Err.	**Z**	P>z	R-square
Faid	.0049167	.0031472	1.56	0.118	
Finvest	.0636618	.0332547	1.91	0.056	0.0408
Pcgnp	.0004917	.0002077	2.37	0.018	
Ally	.2791937	.0221173	12.62	0.000	
Cwar	-1.899288	.4048681	-4.69	0.000	
Logpop	.8836336	.8102631	1.09	0.275	

N = 1465

Table 5.14 represents our most reliable statistical results because it controls for all the serious limitations on pooled cross-sectional time-series analysis. Neither foreign aid (Z = 1.56, p = .118) nor population size (Z = 1.09, p = .275) are statistically significantly related to levels of democracy. Neither variables passed the threshold of 1.65 for one-tail hypotheses in their "Z" scores[25] and their probabilities are higher than .10 so they are statistically insignificant.

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[25] For two-tail hypotheses, the threshold would be 1.95 for statistically significant results.

Foreign direct investment and per capita GNP are statistically significant

with a "Z" score of 1.91 and 2.37 respectively. Foreign direct investment's

coefficient of .064 indicates, however, a marginal effect on the level of

democracy. It essentially means that for an increase in foreign direct investment

equivalent to 1% of the total value of the country's GDP, there will be .064 of a

point increase in the level of democracy. Per capita GNP's coefficient of .0005

means that every dollar increase in per capita GNP will lead to a .0005 increase

of the level of democracy. This means that it would take 2000 dollars of

investment to have a one-point increase on Vanhanen's democracy scale[26] that

ranges from 0 to 49. This is expected given the sample of rich democracies and

poor non-democracies.

Our strategic control variables turned out to be the most influential ones.

The "Z" score for the alliance variable is 12.62 which is significant. The Cold War

control variable is also significant with a "Z" score of -4.69. Their coefficients

scored more than the influential per capita GNP variable. The coefficient score is

.2791937 for the ally variable indicating that if a country is a U.S. ally, this means

a .28 of a point increase in the level of democracy. The variable is positively

linked with the level of democracy, but is contrary to the expected direction. It is

very influential in the model and the positive sign (direction of the variable)

seems to show that the alliance with United States does contributes to

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[26] We get this number by conducting the mathematical formula: 1*1/.0005. We get this equation when we ask: if 1 dollar generates .0005 increase of the level of democracy, then how many dollars we need of per capita GNP to generate 1 point increase of the level of democracy.

democracy, contrary to our predictions. The Cold War coefficient indicates a decrease (as hypothesized) of 1.9 point in the level of democracy for years when the Cold War was present, the largest effect among all variables. Thus, the end of the Cold War alone elevated the level of democracy 1.9 points on Vanhanen's democracy scale.

To try to tease more information from the data, I conducted PCSE regressions using the two major components of the level of democracy measurement, competition and participation, as my dependent variables. The results for financial variables did not improve. In fact, foreign direct investment became insignificant when regressed against competition and participation. The alliance variable's coefficient increased from .28 to .3 when regressed against participation and to .46 when regressed against competition and in both cases remained significant. The population size gained significance and the coefficient's value became 4.8 when it is regressed against competition. It was not significant when regressed against participation. The Cold War has an insignificant relationship with participation, but a significant relationship with competition. The coefficient's value for the Cold War - competition relationship is -5.8. This validates the belief that many authoritarian countries had elections and people participated even during the Cold War, but they did not have viable competition. The end of the Cold War seems to contribute greatly to the degree of competition among authoritarian countries while participation has remained stable. The PCSE regressions for participation and competition are included in appendix E.

For further validation of the results, I also performed the regression employing the two other measures of democracy discussed in the operationalization section: Polity III and the Freedom House Index. The Polity III and the Vanhanen's data sets performed very similarly. The Freedom House measure also performed relatively similarly with the exception of foreign aid, which turned out to be significant. This might in part be because the Freedom House structure of data puts more emphasis on the civil liberties dimension of democracy (human rights). Given this slightly different output for the measures, it would be a very worthwhile study to explore the differences among the performance of these measures. Appendix F includes the regression results for all the three measures of democracy.

5.4 Path or Causal Analysis

Although using path analysis in time series data can be complicated and might generate questionable results, it would be beneficial to try to use such analysis because of the dynamic nature of the model herein. It should be done, therefore, only if we can avoid the complexities caused by the time series data. Path analysis will be employed using specific years with specific time lags to avoid the complications caused by the pooled cross-sectional time series element. Path analysis will be conducted on the years 1991, 1992, and 1993 to escape the Cold War's effect, constant in all these years, because the study is interested more in the effects of the financial variables. Path analysis is useful for this kind of research given its interactive and dynamic character and for

helping trace causal effects. In comparison to regular or panel corrected

standard error regression, path or causal analysis can isolate and identify

genuine individual causal trends (Herbert 1983). The former two types of

regression can be thought of as a kind of aggregate regression of all the

variables for the global sample, while causal analysis is specific and

individualistic because it deals with specific variables for specific periods of time.

Path analysis involves staging or building the model through several

regression stages in order to discover the indirect effect among the model's

variables. This should produce more insights and understanding of how the

relationships hypothesized might occur and through which paths. The model that

will be staged is the same general model used in the multivariate regression

analysis. The signs represent the direction of the relationships as hypothesized.

Figure 5.1[27] represents this model.

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[27] This is a very similar model to the one used in chapter 4 which drew the general relationships among the variables. The difference is that I have no arrow at this point between foreign aid and foreign direct investment because I want foreign direct investment to be an exiguousness variable for the sake of a persuasive path analysis.

Figure 5.1: General Path Analysis Model
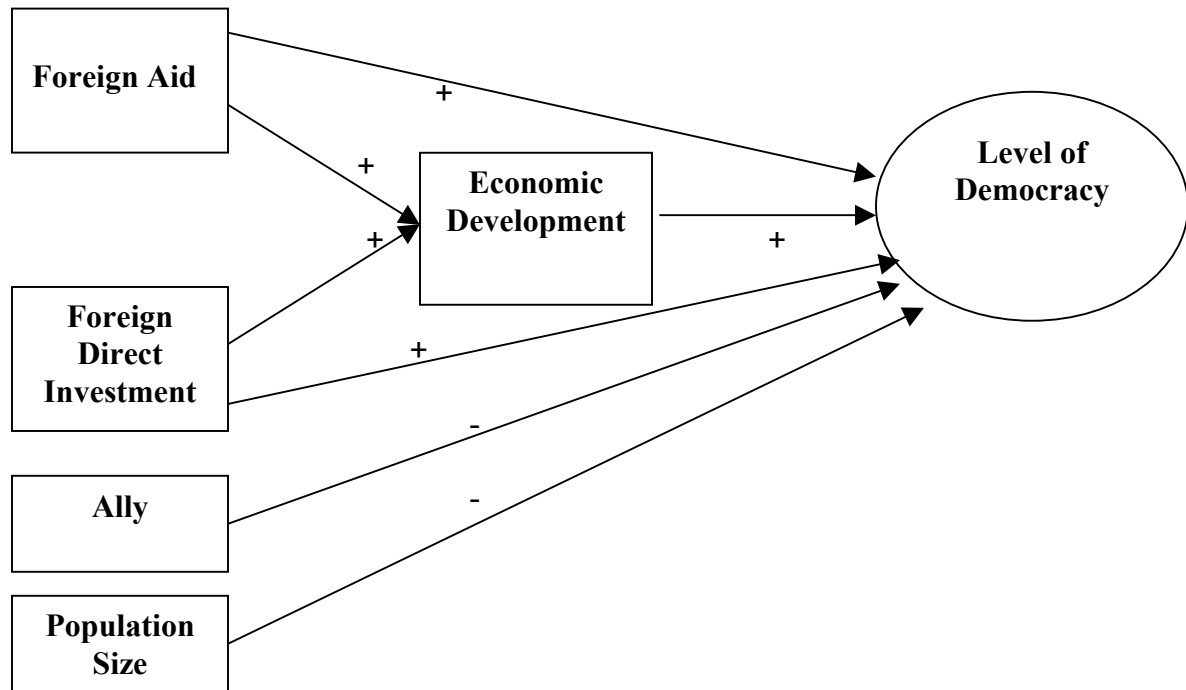
The first step or path one should draw is the general regression path that treats the level of democracy as the ultimate endogenous variable.

The Level of Democracy = a + Per Capita GNP + Foreign Direct Investment

+ Foreign Aid + Alliance + Population Size

Logically, the level of democracy will be affected after a year or two by the other independent variables (Figure 5.2). Consequently, we can use the 1993 score of democracy as an indicator of our endogenous variable, hypothesizing that it was driven by several factors among which was per capita GNP in 1992. And per capita GNP in 1992 and the level of democracy in 1993 were partially results of foreign direct investment, foreign aid, alliance with the U.S., and

population size in 1991. The political causal impacts of these variables are not expected to occur immediately, but rather take time to be realized. A one-year time lag is among the most accepted time lag for the causal effect of social variables to be realized. Figure 5.2 shows the significant beta coefficients of the equation above.

Figure 5.2: Path Analysis With Significant Beta Coefficients
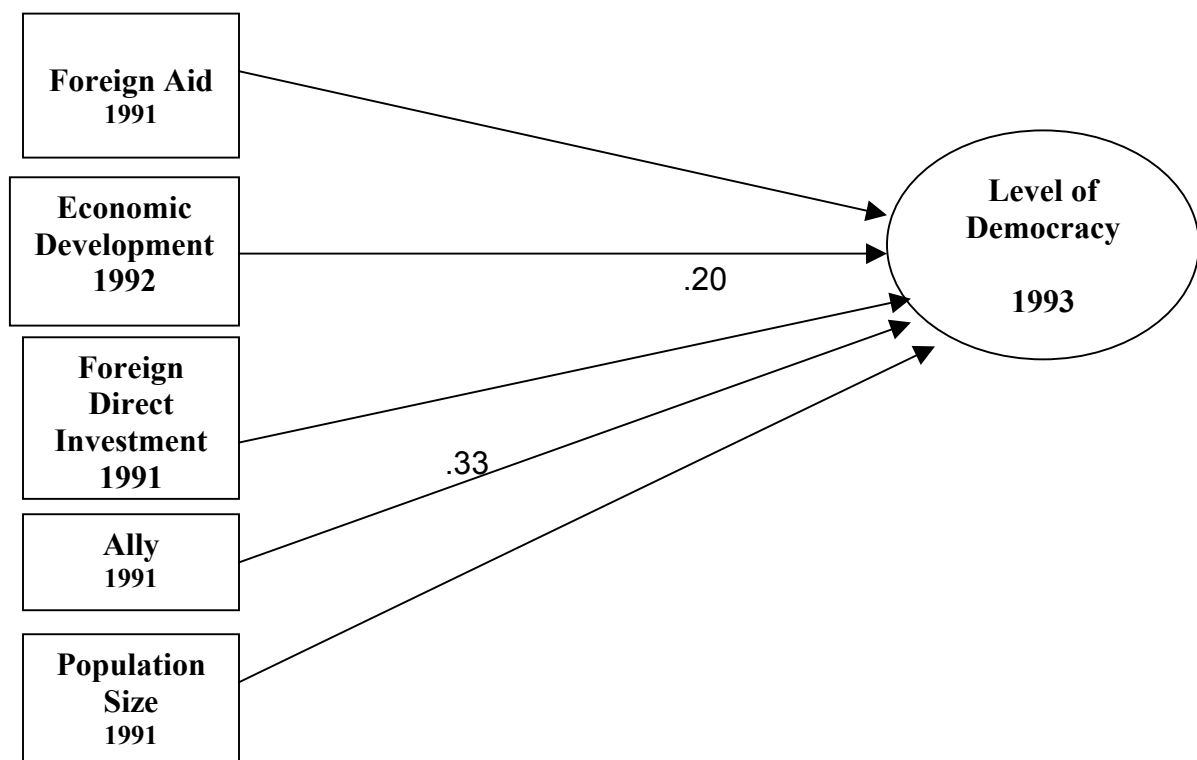
All the variables were regressed on the endogenous variable, the level of democracy, given the specified time lags. The next equation is specifically concerned with the intervening variable, per capita GNP, and treats it as the endogenous variable.

Per Capita GNP = a + Foreign Direct Investment + Foreign Aid

These two variables were the only ones employed because both the ally and population size variables are not assumed to have a direct theoretical relationship with per capita GNP. Figure 5.3 shows the beta coefficients of the significant relationships in the equation above.

Figure 5.3: Path Analysis for Per Capita GNP, FDI, and Foreign Aid
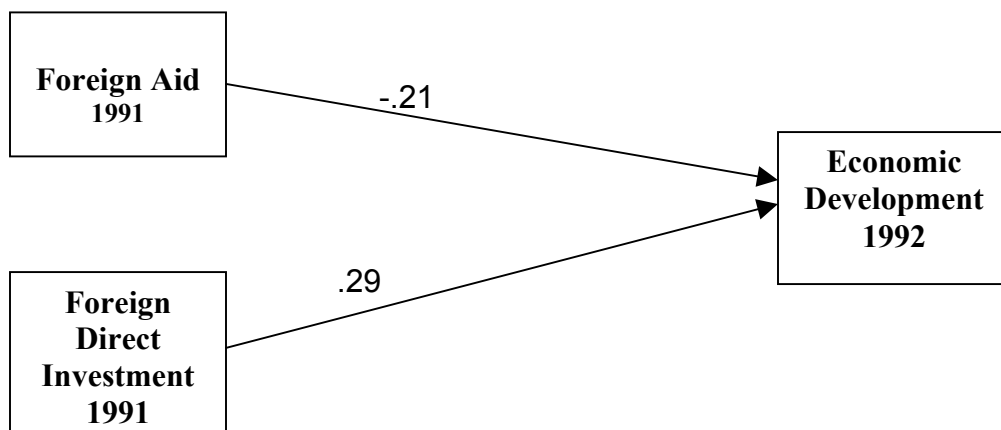
Figure 5.4 shows the beta coefficients of the significant regressions of the previous two equations for the specified periods of times.

Figure 5.4: General Path Analysis With Significant Beta Coefficients
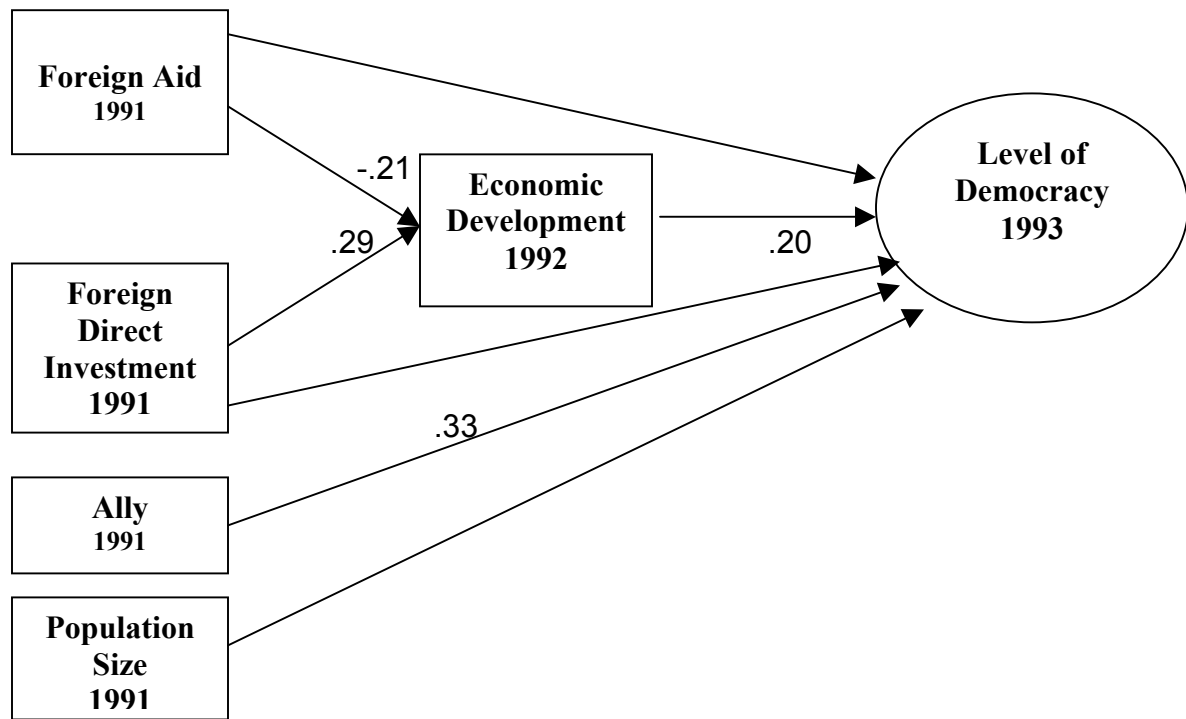
Only the coefficients of statistically significant relationships are shown in the figure above. One needs to look for statistically significant relationships in the regression analysis and then report the beta coefficients for them. The following table illustrates the direct and indirect relationships in the general causal model.

Table 5.14

The Direct and Indirect Relationships of the General Causal Model

VARIABLES	DIRECT RELATIONSHIP (BETA) N = 79	INDIRECT RELATIONSHIP (BETA) N = 83	TOTAL[28] BETA
Per Capita GNP	.20		.20
Foreign Aid	Not significant	-.04 (-.21*.20)	-.04
Foreign Direct Investment	Not significant	.06 (.29*.20)	.06
Ally	.33		.33

Foreign aid's indirect relationship was calculated by multiplying the beta coefficient of foreign aid - economic growth relationship, with economic growth - the level of democracy's beta coefficient:

-.04 = -.21*.20

The same formula was used for foreign direct investment:

.06 = .29 * .20

If we are to add an arrow indicating a relationship between foreign aid and foreign direct investment, then the relationships will be as shown in figure 5.5 below.

Figure 5.5: Path Analysis With a relationship between foreign aid and FDI
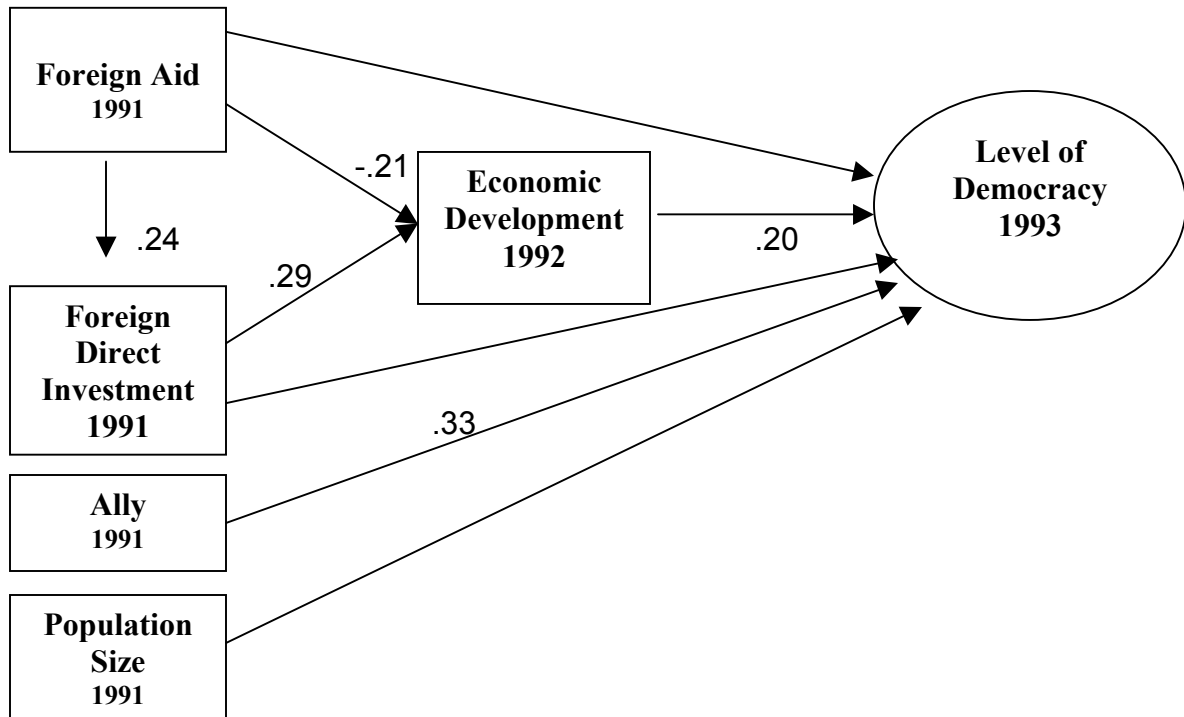
The figure reveals three stages or paths that are statistically significant. It indicates three indirect and significant relationships that link foreign aid to the level of democracy:

$$\text{FAID} \xrightarrow{.24} \text{FINVES} \xrightarrow{.29} \text{PCGNP} \xrightarrow{.20} \text{the level of democracy}$$

Total path effect = .24*.29*.20
                   = .01

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[28] The sum of direct and indirect relationships.

This does not add any strength to the model. To the contrary, it weakens

foreign aid total path. This is partially due to the negative sign of the beta

coefficient of foreign aid-economic development relationship.

Table 5.15

**The Direct, Indirect, and Indirect Indirect Relationships of the General
Causal Model**

VARIABLES	DIRECT RELATIONSHIPS	INDIRECT RELATIONSHIPS	INDIRECT-INDIRECT	TOTAL BETA
Per Capita GNP	.20			.20
Foreign Aid	Not significant	-.04 (-.21*.20)	.01(.24*.29*.20)	-.03
Foreign Direct Investment	Not significant	.06 (.29*.20)		.06
Ally	.33			.33

The causal analysis reveals that the alliance variable dominates the model

followed by per capita GNP variable. Thus the path model shows that if a

country is a U.S. ally, there is a .33 increase in the level of democracy among the

sample for the specified period of time. Per capita GNP channels the effect of

both financial variables on the level of democracy. It remains an influential

variable not only because of its significant relationship with the level of

democracy, but also because it serves as an intervening variable in the model.

Foreign aid and foreign direct investment thus affect the endogenous variable only indirectly through their contribution to per capita GNP. The absence of any direct effect strongly suggests that the decision making phase outlined in the theory-- the one decision makers follow in trying to improve the level of democracy by shaping foreign aid and foreign direct investment--lacks empirical grounding for the period studied. The overall direct and indirect effect on democracy for both variables is marginal.

In addition, foreign aid's net effect is actually negative, indicating that it does not help the overall per capita GNP but rather harms it. This might be in part because most countries that receive aid tend to be experiencing economic hardships. So aid may be stopping the economy from getting even worse but not necessarily improving the economy. Also, one may speculate that a larger time lag between foreign aid's donation and the measurement of per capita GNP might allow for a positive effect to be observed. It might be the case that aid takes long time before affecting the per capita GNP positively. This possibility opens an interesting venue of future research that might attempt to identify such time lags.

5.5 Analyses and Data Interpretation

This chapter has analyzed the effect of foreign aid, foreign direct investment, per capita GNP, the Cold War, Alliance, and population size on the level of democracy. The primary concern is to see the impact of financial transfers on the level of democracy. Non-financial transfers variables were

added as control variables. However, the analysis shows that control variables,

especially the ones that were included to control for the strategic dimension of

the study, were the most powerful variables contributing to democracy. Even

when trying to escape the Cold War's impact on the model using path analysis,

the alliance variable stood out with high explanatory power. Consequently, I

believe that the analysis reveals four levels of explanatory power for the

independent variables; strong, medium, marginal, and insignificant. Table 5.16

summarizes the significance of each independent variable in both cross-sectional

time series and path analyses.

Table 5.16

**The Empirical Significance of Panel Corrected Standard Error (PCSE) and
Path Analysis of the Exogenous Variables on the Level of Democracy**

	PCSE (1976-1994)	Path Analysis (1991-1993)
Foreign Aid	Not Significant	Significant (-) **
Foreign Direct investment	Significant	Significant **
Per Capita GNP	Significant	Significant
United States Ally	Significant	Significant
Cold War	Significant (-)	
Population Size	Not Significant	Not Significant

(-)   The relationship is negative
**   Only indirectly and through per capita GNP

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The population size variable has been consistently insignificant in both analyses implying that the size of a country's population does not seem to affect or correlate with the level of democracy during the period under study. This is a falsification of Diamond's (1994) theory that small countries are more likely to be democratic. His argument does seem logically appealing, however. Small countries could be expected to be less sophisticated socially and politically, meaning that the structure of the sociopolitical arrangements would be clear and hierarchies weaker. Political actors and powers would be more likely to reach new political balances and create new rules of the games easily. The empirical results of this study that undermine Diamond's theory might do so because of the characteristics of the sample employed. Many of the small countries in the sample (174 countries overall), are relatively new states (mostly as a result of being former colonies) and as yet non-democratic. Small countries might thus still be able to be democratic more easily than big countries, but this particular set may not have had the chance yet. Consequently, size might still matter when holding other things equal.

The variables in the strong explanatory power category are the strategic variables of United States alliance and the Cold War. These two variables, although not the primary concern of this study, affect the level of democracy more than any other variables in the model. Alliance with the U.S. has proven significant to democracy in both analyses while the Cold War was significant in the time series analysis (but was not included in the path analysis). Theoretically, this finding means that the level of democracy is indeed positively

affected by alliance with the U.S. but was negatively affected by the Cold War. International strategic calculations and concerns thus show significant power in both enhancing or reducing the level of democracy and the process of democratization.

Contrary to hypothesis, alliance with the U.S. increases the level of democracy. Either the United States allies itself more with democracies or alliance with the U.S. contributes to increased levels of democracy. This is not to discount U.S. alliances with non-democracies, but for the sample utilized of countries receiving aid or foreign direct investment, the net effect of U.S. alliance is that it increases the level of democracy. But one can read more into this finding than just the U.S. tendency to form alliance with democracies. This finding gives hope that countries with political and strategic alliance with the U.S. are being affected positively in terms of their level of democracy. Whether allies are imitating the ideology of the U.S. because of their strategic relationship with it or the U.S. is trying to promote democracy among its allies, the result in either way seems good news for the people of these countries.

The other strategic variable, the presence of the Cold War, has shown significance. The finding shows that the world is better off in terms of the level of democracy as a result of the end of the Cold War. The status of democracy as foreign policy goal and as a domestic goal was elevated once the Cold War was no longer a concern. As a result of the end of the Cold War, democracies do not have to ignore the lack of democracy elsewhere for strategic calculations. Non-democracies cannot use the Cold War to justify the lack of democracy. And,

non-democracies have seen democracies emerging preeminent from the Cold War and consequently presenting a successful model to the world.[29]

Economic development (per capita GNP) has medium explanatory power in the models. Once again and similarly to what Lipset (1959) and Olson (1993) argued, economic development contributes to democracy. It is less powerful than strategic variables during the period under study here, but is an important part of the explanatory power of the model. Further, economic development gains power in the study because it functions as an intervening variable. Not only is it important because of how much it explains of the level of democracy, but also because it functions as a bridge between the endogenous variable and our primary financial variables. Indeed, the only way foreign aid affects the level of democracy is through economic development. Foreign direct investment, meanwhile affects the level of democracy both directly and indirectly through economic development. Lipset's (1959) and Olson's (1993) arguments seems to have validity: economic development and wealth will increase the people's interest in public affairs as a result of their increased public stakes; wealth will increase the educational level and consequently increase the demand for better political performance and liberty; and that economic development will increase the number and resources of non-governmental economic and political actors which enhances pluralism, thus enhancing democracy.

The variables that fall within the marginal explanatory power category are the financial transfers variables, foreign aid and foreign direct investment. These

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[29] Both of the strategic variables present high significance level which might be in part because they are dichotomous. Dichotomous variables do not vary

variables proved to be the weakest part of the model, with weak magnitude effects (coefficients). In fact, foreign aid was not even significant according to the panel corrected standard error regression, but was included in this category because it has an indirect effect on the level of democracy through economic growth according to the results of the path analysis.

Foreign direct investment affects the level of democracy marginally and positively. The coefficients are weak and do not seem likely to convince decision makers to formulate policies based on the foreign direct investment – level of democracy linkage. This happens directly, arguably through the decision making phase outlined in the theory, and indirectly through helping the economy and employing the logic of the economic development variable. Countries also democratize when their economies improve as a result of foreign direct investment.

Foreign aid on the other hand affects the level of democracy only indirectly through the economic development variable, but surprisingly, this effect is negatively associated with the level of democracy. Foreign aid has a negative impact on the economic development variable, which makes its overall impact on the level of democracy negative. This might be because recipient countries do not use aid in a way that would help the economy and only use it for political reasons, which may include repression. Indeed, during the Cold War, much U.S. aid went to undemocratic countries that were also anti-communist and/or fighting insurgencies. In contrast, democracies like Costa Rica and Uruguay got little aid. It might also be because aid is given to some very poorly performing economies

considerably which makes it easier for them to achieve statistical significance.

where aid is simply not enough to foster growth. Economic performance might have been much worse were it not for foreign aid. Countries that could make it on their own or those that could survive are simply not good candidates of receiving aid. To summarize, foreign aid does little to affect either the economy or the level of democracy. To the contrary, it seems that it is hurting them both. One needs to acknowledge, however, that this net negative effect is marginal according to the beta coefficient scores. This finding contradicts even Carothers' (1999) very cautious and skeptical argument that aid programs are at best secondary in helping the level of democracy. These programs are not even secondarily but rather slightly negatively affecting the level of democracy among the recipient countries.

The model's overall R-square and adjusted R-square are small and do not reflect high collective explanatory power of the model's variables. The goodness-of-fit of the model is not as strong as the theory has expected, especially in the financial transfers side of it. However, the model does reveal interesting insights regarding the effectiveness, dynamics and behavior regarding the foreign direct investment and foreign aid on the one hand and ally and the Cold War on the other hand. The limited goodness-of-fit comes in part because of the limited number of variables employed, which reflects positively on the parsimony of the study. The model is arguably parsimonious and only interested in exploring the political effects of the variables utilized. I did not want to include in the study all the possible variables that might be affecting the level of democracy, but rather, wanted to explore the effects of the variables of interest.

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CHAPTER 6

CONCLUSION

6.1 Major Findings

This dissertation has attempted to answer questions regarding the process of democratization and why some countries became more democratic and others do not. Its main focus was whether the international financial influence and transfers foster democracy or whether they are irrelevant to explaining the level of democracy. This dissertation introduces the theory of financial transfers and the transition to democracy in an attempt to investigate questions regarding why, when, and how international financial transfers matters for the level of democracy.

The second chapter, the literature review, explained prior research in the field of democracy and democratization and identified certain gaps and weaknesses that exist in that literature therefore designates a place for the research herein.

The third chapter, the theoretical framework, introduced the financial transfers and the transition to democracy theory. The theory paints the picture of how, when, and why countries might democratize as a result of two main financial elements: foreign aid and foreign direct investment. The theory describes the steps that might take place in the process of financial transfers from the initial stages of such transfers to the final realization or non-realization of democracy. It explains and analyzes the actors and structure of the financial

transfers process. Recipients and donors' economic, democratic, and political standing, ambition, and motivation were among the issues explained and analyzed. By explaining and describing the structure and the process, the financial transfers theory supplied what I believe to be among the most comprehensive treatments of the relationships between foreign aid and foreign direct investment, on the one hand, and the level of democracy on the other. The theory distinguishes between direct and indirect phases regarding these relationships. The direct phase was called the decision making stage when foreign aid and foreign direct investment work directly through the decision makers to influence the level of democracy. The indirect phase utilized an intermediate variable through which the financial factors will affect the level of democracy. Economic growth is the intermediate variable, which will work as a bridge to channel the effects of the financial transfers variables on the level of democracy. The theory assumes that foreign aid and foreign direct investment will positively affect the level of democracy through their positive effect on economic development in the recipient societies.

The fourth chapter, the research design, described the sample and the data, operationalized the variables, introduced eight testable hypotheses, and suggested the best possible ways of falsifying and testing these hypotheses. I have compiled what I believe to be one of the most comprehensive studies yet concerning democracy and democratization. The study covers 174 countries for 18 years from 1976 through 1994. Such a range of study is important because it allows us to compare over time and across space the variation in the level of

democracy for the largest number of countries in both the developed and the developing world. Variables were operationalized using indicators to reflect the maximum reliability and validity possible.

The fifth chapter empirically tested the relationships hypothesized. Ordinary Least Square regression analysis and path or causal analysis were the tests of choice. Ordinary Least Square analysis was conducted on the whole pooled cross-sectional time series sample while path analysis was conducted on three years only (1991-1993) in order to avoid the complications that path analysis may experience because of the pooled cross-sectional time series nature of the sample. The chapter devoted a significant portion of the discussion for the major and most serious limitations and problems of OLS regression with pooled cross-sectional time series data. Problems of heteroskedasticity, multicollinearity, and serial autocorrelation were discussed and analyzed. Then the chapter utilized the major and yet traditional techniques of controlling for these problems. Panel Corrected Standard Error (PCSE) was also utilized as the most advanced techniques for correcting for these problems.

This dissertation studied the effect of six major variables on the level of democracy: foreign aid, foreign direct investment, economic development level, the Cold War, United States alliance, and population growth. While the population growth variable proved not statistically significant in either of the tests employed, the study found that the strategic measures of the Cold War and the United States alliance to be statistically significant and to affect the level of democracy with a substantial magnitude. In fact, these two strategic variables

seem to be driving the whole model. The Cold War negatively affected the level of democracy, while alliance with the United States had a positive effect. Panel Corrected Standard Error showed that both variables were significant and their coefficients were high. Path analysis produced the same result for the United States alliance variable. Path analysis did not test the Cold War since it has no variation for the 1991-1993 time span. The economic development level variable (GDP per capita) also affected the level of democracy positively and substantially according to both statistical tests.

Foreign direct investment was significant according to the PCSE analysis and affected the level of democracy positively. According to path analysis however, this variable's effect on the level of democracy could only be felt indirectly by affecting the level of economic development. Foreign aid, however, was not statistically significant according to the PCSE analysis. The only time this variable became significant was when used in path analysis, but even then, the impact occurred only indirectly through the economic development variable. What is more, its effect was negatively rather than positively associated with the level of democracy, indicating that foreign aid did not promote democratization as hypothesized during the period examined. Foreign aid, was indeed associated with lower levels of economic development and thereby indirectly lowering their democracy levels. It is worth noting that both of the financial variables effect, whether directly in PCSE or indirectly in path analysis, were effects with a tiny impact on democracy overall. (Table 5.16 in chapter 5 summarizes these major statistical findings.)

The absence of a foreign aid contribution to democracy was the most surprising finding since it challenges the conventional wisdom regarding the utility of foreign aid. Apparently, it operated only indirectly and through economic development in societies. However, the indirect function was weakly negatively associated with the level of democracy, meaning if anything that foreign aid slightly harmed the democratic standing of recipient countries, and more strongly harmed their attempt to develop economically by having a negative affect on their per capita gross domestic products. Foreign aid discouraged democratization by negatively affecting one of democracy's major contributors, economic development. Carothers (1999) skeptical conclusion that "aid programs are at best secondary in promoting democracy" thus turns out to be excessively optimistic as far as the findings of this analysis. Foreign direct investment, in contrast, performs much better by having both direct and indirect effects, and above all, a net positive influence on democracy.

6.2 Policy Implications

The results of this study are counterintuitive to politicians' conventional wisdom regarding foreign aid. Foreign aid does not help increase the level of democracy or economic development, as politicians seem to believe. Its effect on democracy at best is felt indirectly, but even then the overall effect is negative. This finding should come as some surprise to the major two audiences of this study, foreign policy decision makers and scholars. This news will probably surprise the scientific and academic communities (Regan 1995, Apodaca and

Stohl 1999) given the expectations of a mildly positive effect of foreign aid on the

level of democracy. However, for foreign policy makers the news must be

shocking given their faith that aid is positively linked to growth and freedom.

From the Marshall Plan in 1948 to President John F. Kennedy's foreign

assistance program in 1961 and all through President George W. Bush's

proposal of a 50 percent increase in foreign aid by 2004, the promotion of both

economic development and democracy figured among the major goals of these

three important foreign aid initiatives (USAID 2002).   The Foreign Assistance Act

of 1961 established the major U.S. foreign assistance agency, U.S. Agency for

International Development (USAID). According to this agency:

USAID became the first U.S. foreign assistance organization whose primary
emphasis was on long-range economic and social development assistance
efforts…USAID was able to offer direct support to the developing nations of the
world…the agency, and the legislation creating it, represented a recommitment
to the very purposes of overseas development. USAID was established to unify
assistance efforts, to provide a new focus on the needs of a changing world,
and to assist other countries in maintaining their independence and become
self-supporting (USAID 2002).

In Asia, USAID's first emphases were on countering the spread of communism,
particularly the influence of the People's Republic of China. This quickly
ballooned into a large program of assistance based on counter-insurgency and
democratic and economic development in Vietnam, which lasted until the
withdrawal of American troops in 1975. In Africa, USAID focused on such
initiatives as the education of the leadership of the newly-independent countries
and meeting other economic and social imperatives.

While there is a clear emphasis on the promotion of democracy, the

agency also puts great emphases on economic growth and development. This

study demonstrates that for the nations and period studied, neither goal was

accomplished. President Kennedy in 1961 alluded to the freedom dimension of

foreign aid but perhaps presciently questioning its economic growth value:

> Although our aid programs have helped to avoid economic chaos and collapse, and assisted many nations to maintain their independence and freedom-- nevertheless, it is a fact that many of the nations we are helping are not much nearer sustained economic growth than they were when our aid operation began. Money spent to meet crisis situations or short-term political objectives while helping to maintain national integrity and independence has rarely moved the recipient nation toward greater economic stability. (USAID 2002).

In that same speech, Kennedy justifies the need for foreign aid despite these

shortcomings using a moralistic tone and the principle of defending, and arguably

promoting, democracy and freedom:

> The answer is that there is no escaping our obligations: our moral obligations as a wise leader and good neighbor in the interdependent community of free nations--our economic obligations as the wealthiest people in a world of largely poor people, as a nation no longer dependent upon the loans from abroad that once helped us develop our own economy--and our political obligations as the single largest counter to the adversaries of freedom.

> To fail to meet those obligations now would be disastrous; and, in the long run, more expensive. For widespread poverty and chaos lead to a collapse of existing political and social structures which would inevitably invite the advance of totalitarianism into every weak and unstable area. Thus our own security would be endangered and our prosperity imperiled. A program of assistance to the underdeveloped nations must continue because the Nation's interest and the cause of political freedom require it. (USAID 2002).

According to the USAID, the first major new development regarding the

United States foreign assistance programs since the Kennedy Administration

was when President George W. Bush announced the; "New Compact for

Development." President Bush said that "combating poverty is a moral imperative and that he has made it a U.S. foreign policy priority." To accomplish this goal, President Bush has proposed "increased accountability for rich and poor nations alike, linking greater contributions by developed nations to greater responsibility by developing nations." President Bush proposed that foreign development assistance would increase by half in 3 years; a total of $5 billion (ibid). This fund should support initiatives that help developing nations improve their economies and standards of living. It is yet to be seen whether this will occur especially now that the U.S. economy is in recession. It is likely that it will gain the political support since Democrats in Congress are expected to advocate an increase in foreign aid and the Republicans are expected to support the Republican administration.

All of these three major initiatives of the U.S. foreign aid policy have had at their core a belief that aid will promote economic growth and to a lesser extent help freedom. These policies, however, appear at best misguided by a flawed conventional wisdom. In contrast, foreign direct investment is the variable that seems to coincide with the expectation of this conventional wisdom and can perform the function that politicians erroneously believe foreign aid is doing. Foreign direct investment does mildly positively affect economic growth and the level of democracy as precluded for foreign aid. It also acquires a mild effect, just like the one scholars thought foreign aid would do. If decision makers are concerned with economic growth and democracy, they should put more emphasis on investment or at the minimum readjust foreign aid so it can actually

and realistically achieve these two vital goals. The same should apply for recipient countries if they want to achieve economic prosperity and political freedom. These countries should understand that foreign aid may be harming their economies in the overall analysis.

It is worth noting that the size of foreign direct investment is bigger than foreign aid in the overall analysis. This does give the former variable some advantage on affecting the socioeconomic conditions of the recipient countries including economic development and the level of democracy. Also, in a continually globalized world, foreign direct investment is expected to increase and grow while foreign aid appears to be a temporary international financial tool.

6.3 Future Research

This research should inspire several future studies. The very next step should be investigating more international variables' effects on the level of democracy in general, especially the international financial transfers variables. As I argued above, the only way for democracy to be realized in many developing countries seems to be through some international mechanism. I reached this conclusion when I realized that many domestic variables that tend to promote democracy are at best hard to implement in most of these countries. One finds many countries that have little hope of achieving economic development as in the case of the majority of African countries and other countries were elite and rulers become very powerful and skilled in maintaining political power like the cases in much of central Asia and the Middle East.

Countries like these are even acquiring a culture of non-tolerance and authoritarianism as a result of these socio economic and political conditions. International variables, therefore, should attract far more attention. The next development on the financial transfers model developed by this study should be investigating the effect of foreign trade, economic sanctions, and globalization variables on recipient countries' levels of democracy.

Another interesting angle that can be further explored is to break down foreign aid and foreign direct investment and see what specific kinds and subtypes of these variables affect the level of democracy. What kind of investment is more helpful for promoting democracy, and what kind of aid is better for democracy are questions worth perusing.

Trying to explain why foreign aid performed the way it did in this analysis seems a task worth pursuing as well. What is it about foreign aid itself that makes it harm economic development? Issues like corruption or dependency as by products of foreign aid might be of interest.

The foreign investment literature and the model herein do reveal an interesting dynamic between the level of democracy, foreign direct investment, and economic growth. The level of democracy is not only an end for foreign direct investment both directly and through economic growth variable, but can also be a cause for it. These three variables form a political cycle (as shown in the figure below) that has the potential of being self-driven and therefore carries a great promise for societies to democratize. It will be a worthwhile study to

investigate and identify the time lags of the effects among the variables in this political cycle.

Figure 6.1

The level of democracy

Economic Development ← Foreign Direct Investment
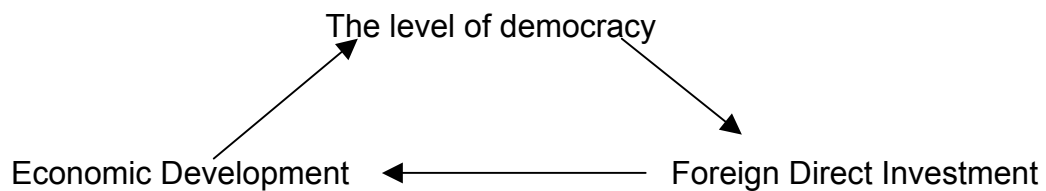
Finally and once we identify the most influential international variables that can help the promotion of democracy, I think the next step should be to try to investigate the effect of this democratic transition on societies which can be other than more democracy as Snyder (2000) would argue. He argues that while democracy leads to peace, according to the democratic peace literature, the transition to democracy may or seems to be leading to the rise of nationalism (national movements) and ethnic conflict. This in turn, I argue, might lead to political instability and therefore negatively affect the level of democracy. Exploring the effects of the transition to democracy is an interesting topic that seems to be treated as a black box in the literature. We study how democracy can come about and the effect of it once it happens, but do not study the effects of the in-between stage.

APPENDIX A

MEMBERS OF THE DEVELOPMENT ASSISTANCE COMMITTEE (DAC)

AUSTRALIA
AUSTRIA
BELGIUM
CANADA
DENMARK
FINLAND
FRANCE
GERMANY
GREECE
IRELAND
ITALY
JAPAN
LUXEMBOURG
NETHERLANDS
NEW ZEALAND
NORWAY
PORTUGAL
SPAIN
SWEDEN
SWITZERLAND
UNITED KINGDOM
UNITED STATES

APPENDIX B

COUNTRIES INCLUDED IN THE CROSS-SECTIONAL TIME SERIES
ANALYSIS

Afghanistan	Ghana	Poland
Albania	Greece	Portugal
Algeria	Grenada	Qatar
Angola	Guatemala	Romania
Argentina	Guinea	Russian Federation
Armenia	Guinea-Bissau	Rwanda
Australia	Guyana	Sao Tome and
Austria	Haiti	Principe
Azerbaijan	Honduras	Saudi Arabia
Bahamas, The	Hungary	Senegal
Bahrain	Iceland	Seychelles
Bangladesh	India	Sierra Leone
Barbados	Indonesia	Singapore
Belarus	Iran	Slovak Republic
Belgium	Iraq	Slovenia
Belize	Ireland	Solomon Islands
Benin	Israel	Somalia
Bhutan	Italy	South Africa
Bolivia	Jamaica	Spain
Bosnia and	Japan	Sri Lanka
Herzegovina	Jordan	St. Lucia
Botswana	Kazakhstan	St. Vincent & the
Brazil	Kenya	(Grenadines)
Brunei	Korea, Dem. Rep.	Sudan
Bulgaria	Korea, Rep.	Suriname
Burkina Faso	Kuwait	Swaziland
Burma	Kyrgyz Republic	Sweden
Burundi	Lao PDR	Switzerland
Cambodia	Latvia	Syrian Arab
Cameroon	Lebanon	Republic
Canada	Lesotho	Taiwan
Cape Verde	Liberia	Tajikistan
Central African	Libya	Tanzania
(Republic)	Lithuania	Thailand
Chad	Luxembourg	Togo
Chile	Macedonia, FYR	Trinidad and
China	Madagascar	Tobago
Colombia	Malawi	Tunisia
Comoros	Malaysia	Turkey
Congo	Maldives	Turkmenistan
Costa Rica	Mali	Uganda
Croatia	Malta	Ukraine
Cuba	Mauritania	United Arab
Cyprus	Mauritius	Emirates
Czech Republic	Mexico	United Kingdom

Denmark	Moldova	United States
Djibouti	Mongolia	Uruguay
Dominica	Morocco	Uzbekistan
Dominican	Mozambique	Vanuatu
Republic	Namibia	Venezuela
Ecuador	Nepal	Vietnam
Egypt, Arab Rep.	Netherlands	West Samoa
El Salvador	New Zealand	Yemen, Rep.
Equatorial Guinea	Nicaragua	Yugoslavia, (FR
Eritrea	Niger	Serbia/Montenegro)
Estonia	Nigeria	Zaire
Ethiopia	Norway	Zambia
Fiji	Oman	Zimbabwe
Finland	Pakistan	
France	Panama	
Gabon	Papua New Guinea	
Gambia	Paraguay	
Georgia	Peru	
Germany	Philippines	

APPENDIX C

A REGRESSION WITH AND WITHOUT THE POPULATION SIZE VARIABLE

vdemoc	Coef.	Robust Std. Err.	t
lvdemoc	.815337	.0198044	41.17
faid	-.005888	.0020946	-2.81
finvest	.0308011	.0725643	0.42
ally	1.821387	.3627546	5.02
Coldw	-1.052052	.2881554	-3.65
pcgnp	.0000133	.0000513	0.26
logpop	-.2830268	.2079221	-1.36

vdemoc	Coef.	Robust Std. Err.	t
lvdemoc	.8146457	.0199542	40.83
faid	-.0040702	.0017176	-2.37
finvest	.0389703	.071724	0.54
ally	1.83064	.3632042	5.04
Coldw	-1.003249	.2829558	-3.55
pcgnp	.0000267	.000051	0.52

APPENDIX D

PCSE REGRESSIONS WITHOUT CONTROLLING FOR SERIAL
AUTOCORRELATION

```
Group variable:   ccode                 Number of obs      =    1465
Time variable:    year                  Number of groups   =    104
Panels: heteroskedastic (unbalanced)    Obs per group: min =    1
Autocorrelation:  no autocorrelation                   avg =    14.08654
                                                       max =    18
Estimated covariances      =    104      R-squared       =    0.1272
Estimated autocorrelations =      0      Wald chi2(6)    =    162.17
Estimated coefficients     =      7       Prob > chi2    =    0.0000
```

	Coef.	Het-corrected Std. Err.	z	P>z	[95% Conf.	Interval]
faid	-.0141072	.0043247	-3.26	0.001	-.0225834	-.0056311
finvest	.3126198	.1034883	3.02	0.003	.1097864	.5154532
pcgnp	.0008144	.0001742	4.67	0.000	.0004729	.0011559
ally	.4299025	.2056408	2.09	0.037	.026854	.8329511
Coldw	-5.990881	.5965383	-10.04	0.000	-7.160074	-4.821687
logpop	.1425939	.387181	0.37	0.713	-.6162669	.9014548
_cons	9.19894	2.92315	3.15	0.002	3.46967	14.92821

.

APPENDIX E

PCSE REGRESSIONS OF PARTICIPATION AND COMPETITION

The level of competition

		Het-corrected					
	Coef.	Std. Err.	z	P>z	[95% Conf. Interval]	
faid	.006811	.0099887	0.68	0.495	-.0127665	.0263885
finvest	.0894361	.11132	0.80	0.422	-.1287471	.3076193
pcgnp	.0010535	.0004008	2.63	0.009	.0002681	.001839
ally	.4575614	.0727088	6.29	0.000	.3150548	.600068
Coldw	-5.848023	1.086061	-5.38	0.000	-7.976663	-3.719382
logpop	4.808082	1.987347	2.42	0.016	.9129532	8.70321

The level of participation

		Het-corrected					
	Coef.	Std. Err.	z	P>z	[95% Conf. Interval]	
faid	.0025714	.0074613	0.34	0.730	-.0120525	.0171954
finvest	-.1226117	.0987308	-1.24	0.214	-.3161206	.0708971
pcgnp	.0010504	.000398	2.64	0.008	.0002704	.0018305
ally	.3054504	.0176579	17.30	0.000	.2708416	.3400592
Coldw	-1.225162	.8460078	-1.45	0.148	-2.883307	.4329825
logpop	.6452444	1.629661	0.40	0.692	-2.548832	3.839321

APPENDIX F

PCSE REGRESSIONS USING VANHANEN, POLITY III, AND THE FREEDOM
HOUSE MEASURES OF DEMOCRACY

	VANHANEN	POLITY III	THE FREEDOM HOUSE
	Z Coef.	Z Coef.	Z Coef.
Foreign Aid	1.56* .0049167	0.98* .0012319	1.74 .0012016
Foreign Investment	1.91 .0636618	2.58 .0369378	1.99 .0012016
PCGNP	2.37 .0004917	1.80 .0001205	1.71 .0000553
Ally	12.62 .2791937	8.85 .0738774	2.61 .0155166
The Cold War	-4.69 -1.899288	-5.02 -.6897699	-3.98 -.2595729
Population Size	1.09* .8836336	0.69* .221434	-0.22* -.0292638

N = 1465   * not significant

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