

The Impact of Political Relations Between Countries on Economic Relations

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1. Introduction

Since the Second World War (WWII), the US economy has been, and continues to be, the largest economy in the world; and because of this, political and diplomatic relations of countries with the USA could be expected to have a significant effect on their economic conditions, especially if the country happens to be developing. In an earlier paper (Najafi *et al.*, 2010) in this review, we made a preliminary assessment of the economic importance of a political relationship with the USA for developing countries. In this paper, we hope to sharpen our focus by looking at the economic impact of defined political events as opposed to all significant political events over a long time period.

At the international level, trade, capital flows (including foreign direct investment or FDI), and aid are the most frequently studied in international political relations. Trade and capital flows are important factors shaping international relations between countries because they affect broad economic developments that include resource transfer, job creation, and knowledge transfer. Polins (1989), in a seminal study, found support for the hypothesis that trade flows between countries are influenced by the quality of political relations. In another important study, Summary and Summary (1995) discovered that both economic and political variables affect US direct investment in developing countries. In a case study – focusing on China-Japan relations and the two-way causation between conflict and trade – the results suggest that economic relations underpin and constrain political relations, while positive political developments could promote trade somewhat (Armstrong, 2010). However Knill *et al.* (2009) provide evidence that is contrary to

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the FDI literature regarding investment decisions of sovereign wealth funds (SWF). Their findings indicate that SWFs are more likely to invest in nations with whom they have relatively weak political relations, although this result is shown to be dependent on the pair of countries selected. An explanation for this somewhat surprising result could be that some FDI and trade or any kind of investment are likely to persist, or even expand, between two countries, despite deteriorating or even hostile bilateral relations, due to the likelihood of higher and abnormal economic returns (Henisz *et al.*, 2010).

Political relations shape foreign aid. Aid may be channeled in different forms: loans, grants, humanitarian, technical, economic, and military assistance, and through multilateral or bilateral channels. Regardless of its form, foreign aid is designed to serve the political and economic interests of the donor while supporting economic development in the recipient country; this dual purpose invariably reduces the benefits to the recipient. It is also important to recognize that even on the level of multilateral aid, handled by international organizations such as the World Bank, donor countries play an influential role in directing and designing aid programs.

On the level of political resources, war, sanctions, arms exports, migration, and international status (engagement of countries in international agreements, international organizations, or diplomatic relations) are all means commonly manipulated on the global stage to serve economic and political agendas. Although sanctions are normally intended to change the political policies of those in power in target countries, they may also serve the economic agenda of countries that impose sanctions; for instance, the US sanctions on Iran effectively eliminated the construction of oil pipelines from the Caspian across Iran to the Persian Gulf, the most cost effective route, in favor of a pipeline to Ceyhan in Turkey, to the benefit of US energy companies. The USA is the main user of unilateral economic sanctions because of its economic power. Relations between countries also affect the arms trade, which in turn have a multitude of effects on recipient countries.

While immigration or travel facilitation or restrictions are resources that are increasingly utilized by countries of destination to serve

economic and political ends, especially the United States after September 11, 2001, developing countries also use the flow of undocumented migrant workers to further their own aims. The international status of a country is a political resource that is also affected by economic resources. It is apparent that wealthy countries are more involved in international agreements and cooperation than poor countries because of their more abundant economic resources.

While there is extensive theoretical and empirical literature on the impact of political events on some specific dimensions of international economic relations – mainly bilateral trade and FDI – there is little empirical work examining the impact of changed bilateral political relations between the USA and other countries more comprehensively, taking into account other variables such as economic and military assistance, student exchange, and the trade in arms. In our first study, published in this review in 2010, we tried to address this question by examining the effect on developing countries of improved or deteriorated relations with the US. The different time frames and global economic and political contexts of the selected events may have affected our results. In this, our second study, we attempt to address this issue by including new variables and indices and selecting similar countries/events – both in terms of context and time frame – and grouping countries more selectively. In this way, we hope to address some of the heterogeneity issues raised in our first study.

2. Methodology and data

To assess the implications of changes in diplomatic relations while controlling for some time specific factors, we first identified two historic and significant milestones in the past three decades; the collapse of the Soviet Union and the Eastern Bloc and the September 11th attacks. We then selected countries whose relations with the USA changed markedly after these two profound events and put them into two separate event groups. We also identified a third group of countries that changed their relationship with the USA significantly after their leftist governments

failed or collapsed in early 1990s, due either to losing the former superpower's support or their failing domestic popularity. These three events resulted predominantly in cases where relations with the USA improved; the cases of deteriorated relations were too few to be useful for analysis.

By limiting our sample exclusively to countries whose relations with the USA improved under each of these three events, we also hoped to control for as many time, context and region specific factors as possible. For example, the first group consists only of four former Eastern Bloc countries, and another one includes four countries in the Middle East and Kazakhstan (a country, which from an economic standpoint shares a number of common characteristics with countries in the Middle East).

Even though the third group represents three different continents, we believe that the countries at least share the common characteristic that they improved their political relationship with the USA in the early 1990s after their leftist government or policies failed. We should mention that we excluded a number of important Eastern European countries that emerged after the dissolution of the Soviet Union and Eastern Bloc – for example, Ukraine, Czech Republic and Serbia – because of the limitations of economic data from the Soviet era.

Although we recognize the degree of improvement in relations with the USA varied for each country – for example, USA-Pakistan relations were affected more profoundly than USA-Jordan relations after 9/11, or USA-Poland diplomatic ties grew faster and more deeply than USA-Romania relations after the collapse of Eastern Bloc – we can at least be reasonably certain that: firstly, a significant improvement in bilateral diplomatic relations occurred in all the cases; second, that in each group, the improvement realized is almost in the same timeframe or manner; and, that in each group, the context of the improvement (global macroeconomic and political conditions) was comparable. So, in contrast to our first study where different timeframes, contexts, region-specific factors or contingencies existed that made comparisons problematic, we believe that in this second study we have overcome some of these earlier limitations through better country/event selection and grouping of countries. Finally, we should note that the world economy, after both the

collapse of the Soviet Union and the September 11th attacks, exhibited robust growth, reducing the impact of very different macroeconomic conditions on bilateral economic developments.

We chose the following set of economic indices to reflect comprehensive economic ties between a developing country and the United States: imports and exports to and from the US, capital outflows from the USA to the country, economic and military assistance (separately) provided by the US, flow of students to the USA, US arms exports to the country, and the country's military expenditures. Although we wanted to include other indices such as bilateral remittances, tourist flows and tourist expenditures, and capital outflows broken down by FDI and portfolio, we were limited by data availability for all or the majority of the countries selected. But believing in the importance of remittances and FDI and portfolio investment, we decided to include total (as opposed to bilateral) figures for these variables for countries where they were available. And finally, to examine whether a country's general conditions – living standards, corruption perception, and quality of life – improve after it boosts its political relations with the USA or in another words, whether the country becomes a better place for its citizens after the event, we included three indices in our study; GDP growth, Corruption Perception Index, and Human Development Index. We believe that improvement in a country's economic outlook, if sustained and solid, will in the end be reflected in the country's improved standing in these three fundamental indices.

We monitored the selected variables for five and seven years before and for five and seven years¹ after the specific event that led to an improvement in diplomatic relations with the USA. We believe that the five-year period is the appropriate time span to capture the effects of the event while limiting the effect of fluctuations due to other factors (and to meet the minimum number of data required to apply the Mann-Whitney *U-test* technique, discussed below). We also thought it would be interesting to compare the result of the five-year time span with a longer-

¹ We were also interested to use longer time spans (e.g. a 10-year span) to test for robustness of the results and to potentially obtain more reliable results but because of data limitations for the majority of time series this extension of the test was not possible.

term period. We tried to assess the statistical significance of the change in each economic variable after improved relations with the USA. Our data were derived from a number of different sources.²

To construct comparable and consistent figures for the changes in relations across countries, we created an appropriate time series dataset for each variable. In the dataset, for imports and exports, we calculated the US share of each country's aggregate imports and exports and used them as proxies. With respect to students studying in the USA and economic and military assistance, we calculated each country's share of total foreign students studying in the USA, US total economic assistance and total military assistance respectively. With respect to capital flows, military expenditures as percentage of GDP, US arms export, portfolio investment inflow, FDI, economic growth, remittances, CPI, and HDI scores and rankings, we included exactly the same values culled from the databases mentioned above. Thus, the final dataset used in this analysis consisted of fifteen time series for each country.

We used the non-parametric Mann-Whitney *U-test*³ to measure exclusively the significance of change in each variable before and after

² The World Bank's World Development Indicators (WDI) database for total portfolio investment inflow, remittances, FDI, GDP growth, nominal and real GDP, nominal and real aggregate imports and exports, and military expenditures as percentage of GDP; the US Census Bureau for US imports/exports by country in current US dollars; the *Greenbook* published by the US Agency for International Development (USAID), for US economic and military assistance; the US Bureau for Economic Analysis for investment inflows to each country; the Open Doors annual reports for the numbers of foreign students by country in the USA; the Stockholm International Peace Research Institute (SIPRI) database for military expenditures in constant US dollars; Transparency International annual reports for the Corruption Perception Index (CPI); and the United Nations Development Program's Human Development Reports for HDI scores and rankings.

³ Non-parametric statistic refers to a statistic whose interpretation does not depend on the population fitting any parameterized distributions such as the ordinary *t-test*. For example, statistics based on the rank of observations, which are used in the Mann-Whitney *U-test*, are one example of such statistics. The estimation here is based on the rank of observations and its average rather than the value of observations. Also the Mann-Whitney *U-test* is applied since the small sample size makes it unclear whether the population behaves as a normal distribution. In order to apply the test first, we set up H_0 and H_1 hypothesis. H_0 presumes that the value of index does not change after the event. H_1 assumes that the value of index increases after the event. Then we let n_1 and n_2 ($n_1 = n_2$) as the size of sample before and after each event, which is either 5 or 7 here, and rank all the values for both samples from the smallest (=1) to the largest

each event. The general form of the Mann-Whitney is a statistical test to assess whether two independent observations, here the values of each variable before and after an event, have significantly different values.⁴ The test, which itself is the general form of the Wilcoxon *rank-sum test* (Sprent and Smeeton, 2001), usually applies a normal distribution to investigate the significance of the difference between two samples. When the sample size is small, e.g. 5 and 7 as in our case, one cannot tell if they are part of a normal distribution, although we already know that almost all the variables under investigation could not be distributed normally. The Mann-Whitney *U-test* is an appropriate test for such situations. This test can be used for very small samples (at least 5 and up to 20). Using the annual value of each index five (seven) years before and five (seven) years after each event and applying the Mann-Whitney *U-test* technique, we tested the significance of change in the value of each index. The final results are given in Tables 4, 5, 6, and 7.

Although we believe that our approach to country selection effectively addresses limitations that may arise due to differing global environment and economic conditions, there are at least two other limitations that should be acknowledged. It is important to recognize that some country-specific factors could affect some or all the variables, and consequently our results. We believe the best way to address this problem is to focus exclusively on each country in detail, find a technique or method to control for other factors/agents, and investigate, at a micro-level, the effect of the political improvement on macroeconomic

(=10 or 14). Then we define R_1 and R_2 as the total rank of each sample. The U statistic of this test is defined as:

$$U_1 = n_1 n_2 + \frac{n_1(n_1 + 1)}{2} n_1$$

$$U_2 = n_1 n_2 + \frac{n_2(n_2 + 1)}{2} n_2$$

The critical values of the directional *U-test* for $\alpha = 0.05$ and 0.01 , and $n_1 = n_2 = 5$ are 4 and 1, and for $n_1 = n_2 = 7$ are 11 and 6, respectively. Now, if $U_2 < C_{\text{critical}}$, we can reject the null hypothesis and accept H_1 . In this analysis, we are also interested in whether the opposite direction of H_1 is statistically significant or not. Tables 4, 5, 6 and 7 have summarized the significance tests for all the events and indices.

⁴ The *U-test* is able to statistically examine only the direction of change and cannot yield an estimate of the magnitude of the change.

variables. Needless to say, and as we have already discussed, there are a myriad of other factors or mechanisms, other than these specified political events, during any time span of analysis – either five or seven years before and after the events – affecting the macroeconomic variables under consideration. Unfortunately, due to the nature of the data, methodology and our approach, it is practically impossible to control for all of them.

3. Countries and Milestones

The associated events and milestones that we believe contributed to improved relations included the partial lifting of sanctions, restoring diplomatic relations, signing new agreements, changing regimes, and also adopting favorable policies. Based on these criteria, we were limited to sixteen countries in three groups. The first group consists of a group of Middle Eastern countries (with the exception of Kazakhstan) that improved their political ties with the USA after the September 11th attacks (Table 1). The second group (Table 2) includes various countries – from Southeast and South Asia to Africa and Central America – whose leftist governments or governments with Marxist/socialist inclination/policies failed, collapsed or were replaced by more liberal governments and administrations. The last group (Table 3) consists of four major former Eastern Bloc countries.

4. Results

In this section, using the result of the Mann-Whitney *U*-test (Tables 4, 5, 6, and 7), we examine and discuss the impact of each event that improved relations with the United States for the fifteen selected economic variables.

Table 1 – *Countries that improved their relationship with the USA after 9/11, and the associated events/policy milestones*

Country	Event	Description
1. Algeria	Election of Bouteflika in July 2001	Bouteflika became the first Algerian President to visit the White House since 1985. Moreover, since the September 11 th , 2001 terrorist attacks in the United States, contact in key areas of mutual concern, including law enforcement and counter-terrorism cooperation, intensified. In July 2001, the United States and Algeria signed a Trade and Investment Framework Agreement that established common principles on which the economic relationship is founded and forms a platform for negotiating a bilateral investment treaty (BIT) and a free-trade agreement (FTA).
2. Jordan	September 11 th , 2001	Jordan became a major US ally in so-called war on terror.
3. Kazakhstan	September 11 th , 2001	Kazakhstan-USA relations largely came into play after the September 11 th attacks as the United States sought strategic partners near Afghanistan and later near Iraq. The Kazakh government has been supportive of the US-led war against terrorism. The government offered the use of a major airport for the Iraq War and over 800 US flights over Kazakh territory were approved and went ahead. The US officially gave the Kazakh government \$52.893 million in 2002, \$47 million in 2003, and \$36.2 million in 2004. In addition, US Government agencies spent \$92 million on assistance programs in Kazakhstan in 2003.
4. Pakistan	The September 11 th , 2001 attacks	After 9/11, Pakistan, led by military dictator General Musharraf, reversed course under pressure from the United States and joined the war on terror as a US ally. In return for their support, Pakistan had sanctions lifted and has received some 10 billion dollars in US aid since 2001, primarily military. In June 2004, President Bush designated Pakistan as a major non-NATO ally, making it eligible, among other things, to purchase advanced American military technology.
5. Yemen	Significant improvement in relations after the bombing of USS Cole in 2000 and the 9/11 attacks	President Ali Abdullah Salih visited the USA in November 2001. Since then Yemen has stepped up its counter-terrorism cooperation with the USA.

Table 2 – *Countries that improved their relationship with the USA after their leftist governments collapsed in the beginning of 1990s, and the associated events/policy milestones*

	Country	Event	Description
1.	Angola	Angolan government's renouncement of Marxism in 1992	Relations were tense during the Angolan civil war when the USA backed UNITA rebels. However, after the government renounced Marxism, the USA recognized the Angolan government. US Secretary of State Colin Powell visited Angola in 2002.
2.	Bangladesh	The end of the dictatorship government in 1991	Though after Mujib's assassination, Bangladesh's military dictators condemned socialist policies of the Mujib era and pursued free market policies and moved towards closer relations with the United States, dramatic improvement took place since the restoration of democracy in 1991. Bangladesh also contributed significantly to the First Gulf War as part of the multinational coalition to liberate Kuwait.
3.	Cambodia	US lifting its embargo in 1992	The US mission opened on November 11 th , 1991. On January 3 rd , 1992, the US lifted its embargo against Cambodia, thus normalizing economic relations. The United States also ended blanket opposition to lending to Cambodia by international financial institutions.
4.	Ethiopia	The fall of Mengistu regime in 1991	The International Security and Development Act of 1985 prohibited all US economic assistance to Ethiopia with the exception of humanitarian disaster and emergency relief. In July 1980, the US Ambassador to Ethiopia was recalled at the request of the Ethiopian Government, and the US embassy in Ethiopia and the Ethiopian embassy in the United States were headed by chargés d'affaires. The Tigrayan People's Liberation Front (TPLF) forces advanced on Addis Ababa in May 1991 and Mengistu fled the country for asylum in Zimbabwe, where he still resides. With the downfall of the Mengistu regime, USA-Ethiopian relations improved dramatically. Legislative restrictions on assistance to Ethiopia other than humanitarian assistance were lifted. Diplomatic relations were upgraded to the ambassadorial level in 1992.
5.	India	Liberalization of the economy and the fall of Soviet Union in 1991	Right after the end of the cold war, India-USA relations improved dramatically. The Government of India liberalized the Indian economy. Also after the break-up of the Soviet Union, India started looking for new allies and tried improving diplomatic relations with NATO

			members and particularly the United States.
6.	Laos	Restoration of full diplomatic relations in 1992	Although diplomatic relations were never severed after the communist takeover in 1975, the US mission in Vientiane was downgraded and full diplomatic relations were not restored until 1992.
7.	Nicaragua	Lifting of the United States trade embargo, imposed five years earlier, in March, 1990	In response to both domestic and international pressure, the Sandinista regime entered into negotiations with the Nicaraguan resistance and agreed to nationwide elections in February 1990. In these elections, which were proclaimed free and fair by international observers, Nicaraguans elected as their President the National Opposition Union candidate, Violeta Barrios de Chamorro, widow of the slain journalist and editor of the daily newspaper La Prensa, Pedro Joaquin Chamorro. On March 13 th , 1990 , in a first gesture to the Chamorro government-elect, United States President George H.W. Bush lifted the United States trade embargo that had been imposed five years earlier.

Table 3 – Eastern European countries that improved their relationship with the USA after the collapse of the Soviet Union, and the associated event/policy milestone.

	Country	Event	Description
1.	Bulgaria	The fall of the communist regime in 1989	The communist government was succeeded by a new generation of leaders, who steered Bulgaria toward democracy and a market economy. Opposition parties and independent media began to spring up in Sofia, and the new leaders began to re-orient Bulgaria toward Western Europe and the United States. The US Congress responded to the changes in Bulgaria and Eastern Europe by passing the support for East Europe Democracies Act in 1989, designed to help Central and Eastern European countries to build democratic institutions. The American university in Bulgaria was founded in 1991, with assistance from the United States Government, to provide a liberal arts education to students from Bulgaria and other Balkan countries. Peace Corps volunteers began to arrive in Bulgaria to teach English and aid in community development, and a Fulbright program commission was created to establish university exchanges.
2.	Hungary	Karoly Grosz taking over as	Since 1987, Hungary's top foreign policy goal has been achieving integration into Western economic and security

- premier in **1987** organizations. As Hungary began to pull away from the Eastern Bloc, the USA offered assistance and expertise to help establish a constitution, a democratic political system, and a plan for a free market economy. Between 1989 and 1993, the Support for East European Democracy (SEED) Act provided more than \$136 million for economic restructuring and private sector development.
3. Poland The collapse of the communist government in **1989** The United States and Poland have enjoyed warm bilateral relations since 1989. Every post-1989 Polish government has been a strong supporter of continued American military and economic presence in Europe, and Poland has become one of the staunchest allies of the United States.
4. Romania Congress' restoration of most favored nation status to Romania in **1993** After welcoming the revolution of December 1989, the US Government expressed concern that opposition parties had faced discriminatory treatment in the 1990 elections, when the National Salvation Front won a sweeping victory. The slow progress of subsequent political and economic reform increased that concern, and relations with Romania cooled sharply after the June 1990 intervention of the miners in University Square. Anxious to cultivate better relations with the USA and Europe, and disappointed at the poor results from its gradualist economic reform strategy, the Stolojan government undertook some economic reforms and conducted free and fair parliamentary and presidential elections in 1992. Congress restored MFN in November 1993 in recognition of Romania's progress in instituting political and economic reform. In 1996, the US Congress voted to extend permanent MFN graduation to Romania.
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Table 4 – Change in selected economic indices for a 5-year period of analysis

		Test of significance of the change in indices – 5 year period													
		Trade with the USA					Other bilateral indices					Country's general indices			
Event	Country	Exports	Imports	Student share	Capital inflow	Military exp.	US arms exports	Mil. assistance	Econ. assistance	Portfolio inv. inflow	FDI	Remittances			
September 11	Algeria	n.s.	n.s.	(***)	n.s.	n.s.	n.s.	***	*	-	***	***			
	Jordan	***	n.s.	(*)	n.s.	(*)	***	n.s.	n.s.	n.s.	n.s.	***			
	Kazakhstan	n.s.	n.s.	n.s.	n.s.	n.s.	n.s.	*	n.s.	*	***	***			
	Pakistan	n.s.	n.s.	n.s.	*	(*)	n.s.	***	***	n.s.	*	***			
	Yemen	-	-	(*)	n.s.	n.s.	n.s.	***	n.s.	n.s.	n.s.	***			
Collapse of leftist governments	Angola	n.s.	n.s.	***	-	n.s.	n.s.	-	***	n.s.	n.s.	-			
	Bangladesh	*	(*)	***	*	***	n.s.	n.s.	(*)	n.s.	***	***			
	Cambodia	-	-	(***)	-	-	n.s.	-	***	n.s.	***	-			
	Ethiopia	-	-	(***)	*	(***)	n.s.	-	***	n.s.	***	***			
	India	n.s.	n.s.	***	***	(***)	n.s.	n.s.	n.s.	***	***	***			
	Laos	-	-	(***)	n.s.	-	n.s.	-	n.s.	n.s.	***	*			
	Nicaragua	***	n.s.	(*)	-	-	n.s.	-	***	n.s.	***	***			
Soviet Union collapse	Bulgaria	-	-	***	n.s.	(***)	n.s.	-	n.s.	n.s.	***	-			
	Hungary	***	*	***	***	(***)	n.s.	-	-	n.s.	***	-			
	Poland	-	-	***	***	n.s.	n.s.	-	n.s.	n.s.	***	-			
	Romania	n.s.	n.s.	***	n.s.	(***)	*	-	n.s.	*	***	-			

H_0 : value of index does not change after event.
 H_1 : value of index changes after event in expected direction.
 -: data not available
 *: significant at $\alpha = 0.05$
 (): opposite of the expected direction of H_1 is accepted

Source: authors' calculation.

Table 5 – Change in economic growth, corruption perception and HDI for a 5-year period of analysis

Event	Country	Change in economic growth, corruption perception and HDI – 5 year period		
		GDP growth	Corruption perception	Change in HDI rank
September 11 th	Algeria	n.s.	-	+3
	Jordan	***	✓	-6
	Kazakhstan	*	✗	-6
	Pakistan	n.s.	✗	+3
	Yemen	n.s.	-	-9
Collapse of leftist governments	Angola	n.s.	-	-5
	Bangladesh	n.s.	-	-3
	Cambodia	-	-	+10
	Ethiopia	n.s.	-	-21
	India	n.s.	-	+2
	Laos	n.s.	-	-7
	Nicaragua	***	-	{{-29}}
	Bulgaria	(***)	-	{{-18}}
	Hungary	n.s.	-	-
Soviet Union collapse	Poland	-	-	{{-17}}
	Romania	*	-	+10

H_0 : value of index does not change after event.

H_1 : value of index changes after event in expected direction.

-: data not available

*: significant at $\alpha = 0.05$

(): opposite of the expected direction of H_1 is accepted.

✗: Decline in index after 5 years

{}: Major INCREASE in the number of countries ranked in 5-year period (14-15)

***: significant at $\alpha = 0.01$

n.s.: not statistically significant

✓: Improvement in index after 5 years

Source: authors' calculation.

Table 6 – Change in selected economic indices for a 7-year period of analysis

		Test of significance of the change in indices – 7 Year Period												
		Trade with the USA					Other bilateral indices					Country's general indices		
Event	Country	Exports	Imports	Student share	Capital inflow	Mil. exp.	US arms export	Mil. assistance	Econ. assistance	Portfolio inv. inflow	FDI	Remittances		
September 11 th	Algeria	*	(*)	(***)	n.s.	n.s.	n.s.	*	***	-	***	***		
	Jordan	***	(*)	(***)	n.s.	(*)	***	n.s.	n.s.	n.s.	***	***		
	Kazakhstan	n.s.	n.s.	*	n.s.	n.s.	n.s.	n.s.	n.s.	*	***	***		
	Pakistan	*	(*)	n.s.	*	(***)	*	***	***	n.s.	***	***		
	Yemen	-	-	(***)	n.s.	n.s.	n.s.	***	n.s.	n.s.	n.s.	***		
Collapse of leftist governments	Angola	n.s.	n.s.	***	-	n.s.	n.s.	-	***	n.s.	*	-		
	Bangladesh	***	(*)	***	***	***	n.s.	n.s.	(***)	n.s.	***	***		
	Cambodia	-	-	(***)	-	-	n.s.	-	***	n.s.	***	-		
	Ethiopia	-	-	(***)	***	(*)	n.s.	-	***	n.s.	***	***		
	India	n.s.	(*)	***	***	(***)	n.s.	n.s.	n.s.	***	***	***		
	Laos	-	-	(***)	(*)	-	n.s.	-	*	n.s.	***	n.s.		
Soviet Union collapse	Nicaragua	***	-	(***)	-	(***)	n.s.	-	***	n.s.	***	***		
	Bulgaria	-	-	***	n.s.	(***)	n.s.	-	***	n.s.	***	-		
	Hungary	n.s.	***	***	***	(***)	n.s.	-	-	*	***	-		
	Poland	-	-	***	***	n.s.	n.s.	-	n.s.	*	***	-		
	Romania	n.s.	n.s.	***	***	(***)	***	-	n.s.	***	***	-		

H0: value of index does not change after event.
 H1: value of index changes after event in expected direction.

-: data not available
 *: significant at $\alpha = 0.05$
 (): opposite of the expected direction of H1 is accepted
 ***: significant at $\alpha = 0.01$
 n.s.: not statistically significant

Source: authors' calculation.

Table 7 – Change in economic growth, corruption perception and HDI for a 7-year period of analysis

Event	Change in economic growth, corruption perception and HDI – 7 year period				
	Country	GDP growth	Corruption perception	Change in HDI rank	HDI score
September 11 th	Algeria	n.s.	-	-	-
	Jordan	***	✓	-	-
	Kazakhstan	***	*	-	-
	Pakistan	n.s.	✓	-	-
	Yemen	n.s.	-	+4	-
Collapse of leftist governments	Angola	n.s.	-	{+18}	✓
	Bangladesh	n.s.	-	-11	✓
	Cambodia	-	-	{+32}	✓
	Ethiopia	n.s.	-	-33	✓
	India	n.s.	-	-7	✓
	Laos	n.s.	-	{+7}	✓
	Nicaragua	***	-	{{-36}}	✓
	Bulgaria	(***)	-	{{{-30}}	*
Soviet Union collapse	Hungary	(*)	-	-	-
	Poland	-	-	{{-3}}	✓
	Romania	n.s.	-	+13	✓

H_0 : value of index does not change after event.

H_1 : value of index changes after event in expected direction.

-: data not available

*: significant at $\alpha = 0.05$

(): opposite of the expected direction of H_1 is accepted.

*: Decline in Index after 7 years

{ }: Major INCREASE in the number of countries ranked in 7-year period (14-15)

{{ }}: Major DECREASE in the number of countries ranked in 7-year period (11)

***: significant at $\alpha = 0.01$

n.s.: not statistically significant

✓: Improvement in index after 7 years

Source: authors' calculation.

4.1. Trade

Five-Year Time Span

Out of the five countries that improved their relations with the USA after the 9/11 attacks, only one country – Jordan – experienced a significant increase (see first two columns of Table 4) in its exports to the USA. For the other countries, both exports and imports did not change significantly. Even in the case of Yemen, where the data were not available, we can reasonably conclude that the values were not large enough to be included in the US Census Bureau database. So it seems sensible to conclude in almost all the cases in this group of countries, trade with the USA did not increase significantly after political ties were improved. The result is similar for the second group of countries – those whose new governments/administrations enhanced their political relations with the USA in the early 1990s. Except for Nicaragua and Bangladesh, the value of exports and imports did not change significantly, and for Bangladesh imports from the USA decreased significantly after improved relations. For the third group, Hungary had a significant increase in both its imports from and exports to the USA after the improvement in relations. For the other countries in this category, either the data were not available or the result did not show a significant change.

In conclusion, after improved relations, the majority of the countries in our sample did not experience a statistically significant positive effect on imports from and exports to the USA, and consequently in total trade; this stands in contrast with our a priori expectations. The conclusion is even more surprising when we consider the fact that in almost all cases of improved relations, both aggregate (with all countries including the USA) exports and imports increased significantly after the selected events.

Seven-Year Time Span

The striking pattern revealed here (see Table 6) is that three out of four countries in the first group with available data witnessed a

significant decline in their imports from the USA, while two experienced an increase in their exports to the USA. In the second group two countries experienced a significant decrease in their imports from the USA while two other countries had a significant increase in their total exports to the USA. The results of the last group – four former Eastern Bloc countries – showed no significant difference from the five-year results.

In sum, the results not only do not generally support the expectation that a country's exports to and imports from the USA grow as its political relations with the USA improve – the result seen in the five-year time span – but also in some cases – the result seen in the seven-year time span – contradict general expectations. It would appear that trade is affected more significantly by a number of other factors than improved political relations between countries or may be especially sensitive to patterns of comparative advantage among countries.

4.2. Student Exchange

Five-Year Time Span

In the first group, student exchange – the share of each country's students of the total number of foreign students in the USA – either did not increase or decreased after 9/11. It seems these countries did not benefit from the US academic and education system after their enhanced relations. One explanation could be the higher security measures adopted by the US government after 9/11 impeded the smooth flow of foreign students into the USA, especially from Middle Eastern countries. In the second group the results were mixed. For three countries student exchange increased while for the remaining four countries, it declined. However, the result for the former Eastern Bloc countries is significant and in line with expectations; all of them witnessed a significant increase in student exchange after the collapse of the Soviet Bloc.

Seven-Year Time Span

The results for the seven-year span are almost the same as for the five-year time span. We can conclude that there is a huge difference between the groups in terms of exploiting benefits from the highly regarded US academic and education system. Except for India and Bangladesh with an already strong background in sending students to the USA – and Angola – all other countries in the first two groups witnessed either no positive change or a decline in their student exchange.

Besides the heightened security measures adopted by the USA after 9/11, another explanation, specifically for the second group of countries, could be the lack of strong educational institutions and systems in these countries. The opposite could be the case for the third group of countries where a strong, well-founded educational and academic system existed in the former Eastern Bloc countries long before the collapse of their communist governments.

4.3. Capital Inflow

Five-Year Time Span

In the first group of countries, only Pakistan showed significant growth in capital inflows after 9/11. In the second group, for the five countries for which data were available, three countries experienced a significant rise in capital inflows from the USA while two did not exhibit a significant change. Among the four former Eastern Bloc countries, capital inflows from the USA increased for two countries and the other two saw little change.

Seven-Year Time Span

There were only two minor differences when the period was extended from five to seven years, that is capital inflow from the USA

into Laos declined significantly after the improvement in relations while inflows to Hungary rose.

In total the results suggest improvement in relations with the USA has a generally positive effect on capital inflows from the USA. The results indicate that former Eastern Bloc countries benefitted the most from their improved relations with the USA, while countries in the first group – with the exception of Pakistan – gained little from their improved diplomatic ties with the USA.

4.4. Military Expenditures, US Military Assistance and US Arms Exports

Five-Year Time Span

US arms exports to almost all countries in all three groups – except Jordan and Romania – did not change significantly after relations improved. Military expenditures as a percentage of GDP in two countries in the first group declined significantly and did not change in the rest. At the same time, however, US military assistance to four out of five countries in this group increased significantly. In the second group, the results were mixed. Out of four countries where military expenditure data were available, two had a significant decline in their expenditures while the other two did not see any significant change. Military assistance data, however, was available for two countries and for both the change in assistance was not significant. In all former Eastern Bloc countries – except Poland – the change in military expenditures was negative and significant – in Poland it was negative but not significant.

Seven-Year Time Span

These were not that different from the five-year results. By increasing the time span the number of countries that had a significant increase in arms imports from the USA increased from two to three. Also the results indicate that three out of four former Eastern Bloc countries

cut their military budgets after their improvement events. The military assistance data were almost unchanged.

There is a popular belief in developing countries that once a country improves its political ties with the USA, sooner or later, it will become an attractive target for USA arms exports and the chances are high that the country will also increase its military budget and expenditures. Our results do not support this belief and suggest that the mechanism may be not as simple and straightforward as some expect. For example, one explanation as to why military expenditures declined or did not change significantly in countries in the first group could be that improved relations with the USA may afford countries more security – and possibly more military assistance which is supported by our data – resulting in a decline in their own military expenditures. In the last group, we believe that the end of the Cold War and dissolution of the communist regimes in the former Eastern Bloc countries accounted for the sharp decline in military expenditures.

4.5. US Economic Assistance

Five-Year Time Span

Our results are inconclusive. In the first group, two countries experienced a significant increase in economic assistance from the USA, while for the rest economic assistance was unchanged. In the second group, the result was about the same except for Bangladesh, where economic assistance decreased after relations improved. In all the former Eastern Bloc countries where data were available, the flow of economic assistance from the USA remained unchanged after improved relations.

Seven-Year Time Span

The only significant change for the longer time span was that economic assistance for Bulgaria turned positive. There were also a few

minor changes in the significance levels for other countries. In sum, the results of both time spans were similar.

In conclusion, out of fifteen countries with available data, eight countries experienced a significant rise in the flow of economic assistance after improved relations with the USA. The results, though not solid, at least lend some support to the expectation that improved relations with the USA have a generally positive impact on the flow of economic assistance.

4.6. Total Portfolio Investment Inflow, FDI and Remittances

Five-Year Time Span

Besides the bilateral indices discussed thus far, we thought it might be useful to investigate some total (as bilateral data were not generally available) figures for critical variables such as total remittances and FDI. As can be seen, the last three columns of Table 5 show that in all the three groups of countries, portfolio investment inflow did not change significantly. However, remittances and FDI actually increased for all countries in the three groups. This is a significant and important result.

Seven-Year Time Span

The interesting pattern revealed after extending the time span from five to seven years is that the portfolio investment inflow for the former Eastern Bloc countries increased significantly after improved relations. It indicates that over a longer term, only former Eastern Bloc countries were able to benefit from international flow of portfolio investments after improving their relations with the USA and thus the West – the largest origin of the flow of international portfolio investments. In view of the long hiatus in relations with the USA, it is not surprising that it took time for these flows to resume. In the case of the non-Eastern Bloc countries the results could indicate that the

passage of time was not an important factor that could stimulate portfolio investments.

4.8. *Economic Growth, Corruption Perception and HDI*

Although we recognize that there are a myriad of factors that contribute to corruption, living conditions, quality of life and economic growth in a country and that improved relations with the USA would not be an overriding factor in their determination, we thought it would be interesting to see how overall improved political relations with the USA affected these variables and indices. We monitored the trend in annual GDP growth rate five and seven years before and five and seven years after the selected event for each country. We picked two widely accepted global indices, CPI and HDI, to examine the degree of perceived corruption and the general level of human development.⁵ For these two indices we checked if the status, or score of each country, improved or declined five and seven years after the associated improvement event. In Tables 5 and 7, we present the results for the two different time spans.

Firstly, the first column reveals that all the countries did not experience a significant rise in growth rates after improving their relations with the USA in both the five and seven-year time span. Second, the results for corruption perception index – only available for three countries – suggest that both Pakistan and Kazakhstan became more corrupt five years after they improved their political ties with the USA; in the seven-year time span, however, Pakistan's status became slightly better.

HDI scores generally tend to increase over time. It can be seen in both Table 5 and Table 7 that almost all countries improved their HDI scores over both five and seven-year time spans. So we decided to use the HDI rank instead of the score to assess each country's relative performance. However, the problem was that the total number of countries ranked in the annual *Human Development Reports* has been changing, both increasing and decreasing over time. To indicate this

⁵ The index is composed of data on life expectancy, education and per-capita GNI (as an indicator of standard of living) collected at the national level.

problem we used brackets to show any ‘large’ increase (values in double brackets) or decrease (values in single brackets). In the five-year period after the improvement of relations with the USA, three out of five countries in the first group declined in HDI ranking. In the second group, the standing of five out of the seven countries declined after five years – in the case of Nicaragua fourteen more countries were added to the HDI ranking table during the period of analysis, which by no means fully explains Nicaragua’s plummet in the rankings. Over a seven-year period the result for the second group changed due to a large decrease in the number of countries included in the index. Four countries declined again; in all the three cases of improvement, the number of countries in the ranking declined though improvements for Cambodia and Angola are large enough to reasonably offset the effect of the decrease in the number of countries included in the ranking. Among the former Easter Bloc countries, data were not available for Hungary. In the five-year time span, Poland and Bulgaria experienced a significant decline in their ranking, while Romania improved its standing. The major increase in the number of countries in the ranking is not large enough to explain the collapse in the rankings of Poland and Bulgaria. Over the seven-year time span, Poland improved its rank significantly and Romania advanced. However Bulgaria continued its deterioration as suggested by the results in Table 7.

In total, the results of Tables 5 and 7 and the analysis suggest, as expected, that a country’s improved relations with the USA or even the West generally are of little importance when it comes to corruption, standard of living, human development status and higher rates of economic growth. As to be expected, there are numerous other more critical underlying factors – institutional, cultural, economic, commercial and geopolitical – in play.

5. Conclusions

In this paper, we have explored the effect of bilateral political developments on bilateral economic relations. This analysis would be

further enhanced by additional data, case studies at the individual country level, and by more robust statistical techniques and tools.

By looking at a diverse set of variables that may enter into assessing economic conditions and economic relations between developing countries and the USA, we were limited to sixteen countries and with a restricted set of economic and financial variables that could be examined. Although we grouped the sample countries based on their general similarities and the context in which they improved their relations with the USA, still the events that were identified as milestones varied in their importance and thus in their relative impact on the selected economic variables. Moreover, there are a number of other key factors besides change in a country's political relations with the USA, that influence a country's macroeconomic climate. Also we cannot reject the hypothesis that improvements in political relations might be used as a means to promote trade or strengthen US economic/social influence on other countries.

The results do not generally support the conventional belief that a country's trade with the USA and its trade dependency on the USA grows as its political relations with the USA improve. We found that in the majority of cases exports to and imports from the USA did not change significantly. There are a number of possible explanations; given the size of the US economy, trade is less important;⁶ given the size of US export/import contracts, changed political relations with smaller countries may not be translated into profitable trading relations; and it is also possible that for the US, other factors, such as global security or securing oil flow or global hegemony, are much more important than trade in considering improved political relations with other countries.

The results also suggest that restoring or improving relations with the USA may not necessarily enhance the flow of students. The results indicate too that there is a huge difference between the country groups in terms of exploiting the opportunity to benefit from the highly regarded US academic and educational system. In this regard, the former Eastern

⁶ US exports account for less than 10% of its GDP, which is strikingly low in comparison to other developed countries where this percentage is more in the range of 15-35%.

Bloc countries seem to have benefitted the most from their improved relations with the USA.

As for capital inflows, the results suggest improvement in relations with the USA had a generally positive effect on capital inflows. The results here again indicate that the former Eastern Bloc countries benefitted the most from their improved relations with the USA.

There is a popular belief that once a country improves its political ties with the USA, sooner or later, it will become an attractive market for US arms exports and the chances are high that country will increase its military expenditure. Our results did not support this expectation.

The results, though not conclusive, to some extent support the idea that improved relations with the USA has a generally positive impact on the flow of economic assistance. Furthermore, the results suggest that while nearly all the countries experienced a significant increase in the flow of FDI and remittances, only the former Eastern Bloc countries – over the seven-year period – were able to benefit significantly from the international flow of portfolio investment after relations improved.

Though not unexpectedly, the results suggest that a country's improved relations with the USA by no means supports assertions that the country would become less corrupt, have a higher standard of living, better human development status and higher economic growth rates. These broader developments are more likely to be affected by fundamental factors such as those that are institutional, cultural, economic, commercial and geopolitical.

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