Peace Through Financial Integration?

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Abstract

The literature on the peace-promoting effects of economic integration has predominantly focused on trade. In contrast, using unique worldwide bilateral FDI data from 1985 to 2014, this study demonstrates that financial integration might be more effective at promoting peace than trade. Research has shown that trade's impact on peace is ambiguous : while bilateral trade fosters peace, multilateral trade can increase bilateral conflicts by reducing their opportunity cost. This study presents two key findings. Firstly, bilateral FDI does not affect peace, as the high costs of reallocating FDI prompt firms to account for geopolitical risks and invest in countries with which they have friendly relations. Secondly, multilateral FDI significantly promotes peace, primarily because it allows countries to exploit wealth and resources in various locations worldwide without relying on military conquest. The findings suggest that FDI has contributed more to pacifying our world over the past decades than trade has.

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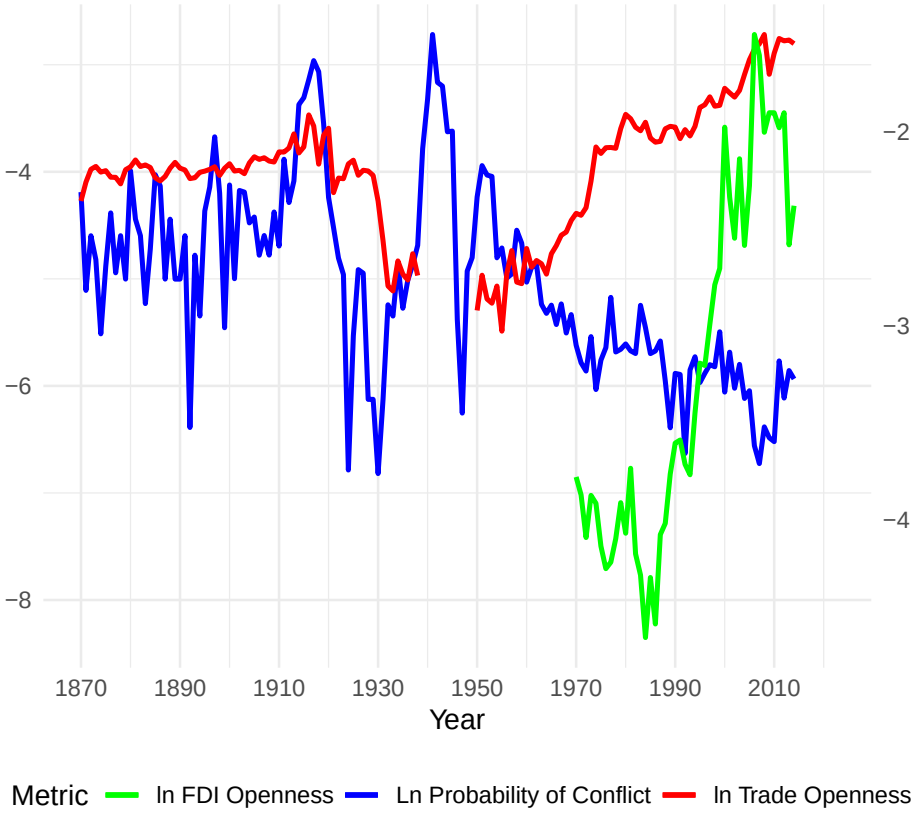


FIGURE 1 – Economic Integration and Military Conflict Probability Over Time

1 Introduction and Literature Review

Financial investments have increasingly become a focal point for their potential to influence international security. Notable examples include Chinese investments in Greece and in other countries as part of China's Belt and Road Initiative (BRI). Similarly, sanctions shift more and more towards targeting financial flows rather than trade ones, as evidenced by the recent sanctions on Russia concerning the war in Ukraine (Felbermayr et al. (2020)). Despite these developments, the literature on the peace-promoting impact of economic integration and interdependence has predominantly focused on trade.

However, Figure 1 illustrates that international finance might have also contributed to pacifying global conflicts over the recent decades. [1] As it is well known, trade openness was already high at the end of the 19th century and the beginning of the 20th century, a period which also saw a high probability of conflict, culminating in World War I. During the interwar and World War II periods, a negative correlation between trade openness and military conflict becomes more apparent. The post-WWII period continues this trend, showing a similar correlation, with conflicts decreasing with the trade globalization. However, notably, the decrease in military conflicts during this time also strongly correlated with a significant increase in FDI openness, which rose more sharply than trade openness starting from 1983 (Krugman (1993)).

There is an established literature assessing the peace-promoting impact of trade. Polachek (1980) theoretically demonstrates that trade promotes peace by acting as a deterrent, aligning with classical liberal theory. Conversely, Barbieri (2002) challenges this view by arguing that trade can create competition over markets and resources, potentially escalating into conflict. Empirical evidence from Oneal and Russet (1997) supports the notion that trade promotes peace. Additionally, Martin et al. (2008) differentiates between bilateral and multilateral trade, showing that

1. Figure 1 plots the logarithm of the probability of a military conflict occurring in a country-pair in a given year. Military conflicts are defined as either displays of force or uses of force. See the Data section for more details. Trade openness data is sourced from Federico and Tena-Junguito (2017). FDI openness is measured as FDI flows/GDP from the World Bank.

while bilateral trade reduces bilateral conflicts, multilateral trade in an increasingly globalized world paradoxically increases those conflicts by reducing their opportunity cost, making countries relatively less dependent.

There exists a smaller body of theoretical literature on the peace-promoting impact of financial integration. Using a classical liberal framework, Souva and Prins (2006) explains that financial investments, particularly Foreign Direct Investments (FDI), act as a deterrent by raising the opportunity cost of conflict. Countries may wish to avoid economic losses stemming from interdependence. This is well-founded, as compared to trade, FDI involves long-term commitments and the transfer of not just capital but also managerial expertise and technological spillovers. FDI also generates corporate taxes and, by dividing value chains, fosters deep economic ties and inter-dependencies between investors and recipient countries.

Using the game-theoretic bargaining theory of war framework, Gartzke et al. (2001); Gartzke and Li (2003) explain that FDI provides more information to countries about their opponent's capabilities, making threats more credible. Another argument is that FDI allows countries to exploit wealth and resources from other countries peacefully, without needing military conquest (Rosecrance (1996); Brooks (1999)). Additionally, Brooks (1999) explains that the dispersion of international production caused by international finance lessens the benefit of conquest, as one part of the value chain is less valuable than the whole. Moreover, this dispersion makes a country less likely to intervene to protect only some of its FDI. Altincekic (2009) follows a related argument, explaining that FDI increases peace better than trade does since while goods can be conquered militarily, capital can easily flight from a geopolitically risky country.

However, empirical studies assessing the peace-promoting impact of financial integration are notably limited. Rosecrance and Thompson (2003) shows a pacifying effect of bilateral FDI flows, but only using data of country-pairs involving the United States. Two other papers use bilateral FDI data only in country-pairs involving OECD countries. For instance, Polachek et al. (2007), using a 3SLS approach, show that bilateral FDI flows had a higher pacifying effect than trade in the 1990-2000 period. Focusing on the same OECD countries, Lee and Mitchell (2012) analyze countries experiencing territorial disputes. They show that bilateral FDI flows reduced the escalation from territorial disputes to fatal (with casualties) Militarized Interstate Disputes (MIDs) during the 1980–2000 period. However, they do not control for trade flows (which are usually correlated with FDI) or for endogeneity patterns. They also show that multilateral FDI flows reduced those bilateral escalations, arguing that this might partly be due to diplomatic pressure from third countries and MNEs trying to protect their investments, or from the potential belligerents trying to maintain a stable peace to attract further investments.

There is also a small literature that assesses that monadic (i.e., country-level and not bilateral) FDI decreases the likelihood of a country being in conflict (Souva and Prins (2006); Gartzke (2007); Bussmann (2010)). Interestingly, Gasiorowski (1986) shows that monadic short-term capital flows, due to their volatility and potential for destabilization, increase the risk of conflict.

On a slightly related topic, Gartzke et al. (2001) find that pegging to the same currency decreases the likelihood of bilateral conflict, but direct currency pegging between two countries increases this risk.

Very recently, scholars have found a strong impact of voting patterns at the United Nations General Assembly (UNGA) on bilateral FDI (Gopinath et al. (2024); Aiyar et al. (2024)), suggesting that countries tend to exchange more FDI with politically proximate countries.

I contribute to this literature in several ways. First, I use a unique worldwide bilateral FDI database from UNCTAD covering an extended period (1985-2014). Secondly, I include all possible country-pairs in my analysis, not solely focusing on pairs experiencing territorial disputes as in Lee and Mitchell (2012). This allows me to considerably extend the coverage of previous analyses, both geographically and temporally. Thirdly, I study FDI stocks rather than flows, as they may be a better indicator of economic *integration*. FDI stock reflects better the *current* ability for a given country to exploit peacefully the resources and wealth of other countries without relying on conquest. Plus, stock may also be a better deterrent for conflicts, as capital can fly or be seized. Fourthly, rather than using event data, as in Polachek et al. (2007), I use the MID data from the Correlates of War project, which is more traditionally used in the trade-conflict literature, in order to derive results directly comparable to the latter literature (and to avoid the traditional drawbacks of event data). I also follow an approach similar to Martin et al. (2008) for trade, in the sense that I differentiate between the impact of multilateral and bilateral financial integration on bilateral conflicts. Finally, I account for endogeneity via an instrumental variable strategy.

I find, contrasting with the few existing studies, that bilateral financial integration has no effect on peace. In fact, I find a huge cost in reallocating FDI from hostile countries, and it seems that companies factor in this risk by not investing in potential opponent countries, thus preventing any peace through interdependence. However, I do find that multilateral financial integration significantly decreases the risk of bilateral conflicts, in particular when the potential

TABLE 1 – Conflict Probabilities and Occurrences

	Full Sample	**Restricted Sample**
Overall Conflict Probability	0.212%	0.242%
Occurrences of Force Display	189	175
Occurrences of Force Use	233	196
Occurrences of Deadly Conflict	73	64
Occurrences of War	5	1

Note : The restricted sample is the one including my controls in my preferred specification (model 4 of table 2)

initiator of conflict has a lot of outward FDI, as those FDI might allow this country to exploit the resources and wealth of various countries in a peaceful way that does not require military conquest of a given country. Thus FDI with tier-countries might decrease the risk of conflict within a country-pair. For this reason, International Finance might be more peace-promoting than trade, which, as explained above, has an ambiguous effect on peace.

This paper is presented as follows : the first section presents the data used. The second one provides some empirical motivations. The third one is my main analysis. The final section concludes, offers policy implications, and suggests avenues for further research.

2 Data

2.1 Military Conflicts Data

In my analysis, the dependent variable is the onset of Militarized Interstate Disputes (MIDs) between pairs of countries within a specified year. I utilize data from the Correlates of War (COW) project, widely regarded as the standard among researchers examining military conflict dynamics. This dataset spans from 1816 to 2014, although my analysis is confined to the years 1985 to 2014 to align with the availability of bilateral Foreign Direct Investment (FDI) data. MIDs are classified on a scale of hostility from 1 to 5, where 1 signifies no militarized action and 5 indicates full-scale war, defined specifically as conflicts resulting in over 1,000 military personnel deaths. Given the relative rarity of wars between countries, which complicates the generation of statistically significant predictions about war onset, scholarly focus often broadens to include lower-intensity conflicts as a proxy. This includes displays of force (level 3), such as mobilization decisions, troop or naval movements, border violations, or fortifications ; uses of force (level 4), like blockades, occupations, or attacks ; and war (level 5). I identify military conflicts as an MID onset at levels 3, 4, or 5, defined as the display or use of military force. Table 1 shows the distribution of conflict intensity over 1985-2014 in my sample. I cover mostly uses of force, displays of force, or deadly conflicts (with casualties) rather than full-scale wars. The first reason is obviously the period considered, which is relatively peaceful, as shown in figure 1. The second is that accessing bilateral FDI data between two very hostile countries might be difficult. The overall probability of experiencing an MID in my preferred sample is around 0.24%. In the Appendix section, Table 10 presents some narratives of representative military conflict in my sample.

2.2 FDI Data and Variables Definitions

To measure financial integration between countries, I use FDI as a proxy for several reasons, the foremost being data availability. Additionally, FDI represents the largest investments and may have a significant impact on peace compared to portfolio or bank loans and deposits. FDIs rely on the existence of a long-term relationship between the direct investor and the enterprise and on a significant degree of influence or control over the management of the enterprise. They are often translated into real physical capital investments, job creation, etc. Portfolios, or bank loans and deposits, are way more speculative and volatile. Wacker (2016) and Casella et al. (2023) show that FDI stock is indeed a good proxy to measure the *real* economic activity of multinational corporations of/in a given country.
Two recent papers studying the impact of proximity in United Nations voting patterns on FDI ((Gopinath et al. (2024) ;Aiyar et al. (2024)),) have used the micro-data from the fdimarket database. The latter is an event database

that compiles projects of greenfield FDI from 2003. However, the period covered doesn't fit into my historical coverage question. Plus, most of FDI in the world is M&A instead of greenfield, especially in a lot of developing countries.
My bilateral FDI data comes from a database compiled by the United Nations Conference on Trade and Development. UNCTAD collects bilateral data from national authorities and from other international organizations according to their standards. These data are unique compared to other bilateral data (OECD, IMF) by their historical length and their worldwide coverage, covering almost every country in the world (250 countries or entities). This is critical since, in recent years, FDI from emerging economies has represented up to a third of total FDI outflows, and China has often been the largest source of FDI. Moreover, South-to-South FDI stocks have grown in the 21st century faster than North-to-North, North-to-South, or South-to-North stocks (Broner et al. (2023)). The database I use is unpublished but is available through requests made by scholars. UNCTAD provides one database for each country in the world, which I merge. Previous versions of these data have been used by Broner et al. (2023), Kox and Rojas-Romagosa (2020), and Bruno et al. (2021). I use a more recent and updated version, broader in time and country coverage.
I complete these data when missing with OECD and IMF data bilateral FDI data. When overlapping, these latter data are extremely correlated with the UNCTAD ones (r = 0.90). Merging those in not uncommon in the bilateral FDI literature (Kox and Rojas-Romagosa (2020)).Plus, since UNCTAD already use data from those international organization, it is more about adding 0 values, sometimes unreported by UNCTAD.
I use FDI stock data. FDI stocks represent total assets, such as acquisitions through purchases of equity. Several reasons justify using stocks instead of flows. The first is that FDI stock data are generally more reliable than FDI flow data. The second reason is that my study aims to capture the effect of interdependence between countries. as pointed out by Wacker (2016) FDI *stock* data reflects better the external economic activity of countries. I have to consider that a country-pair that stopped exchanging FDI flows but still exhibits a lot of remaining bilateral FDI stocks might still be interdependent and subject to potential capital flights or seizures. Plus, FDI stock, as explained in the literature review section, can be an alternative to conquest to peacefully exploit wealth and resources. The last reason to use stock is an intent to deal with endogeneity. Indeed, FDI stocks are inherently more stable. Because they involve a lot of sunk cost, they react less immediately to the prospect of conflict than flows. For instance,Li (2008b) note that bilateral FDI flows were already diminished in the year leading up to a conflict, with only a marginal decrease during the conflict year itself, underscoring a high reactivity.
I take advantage of "mirror data" to maximize sample coverage. For many country pairs, I have assets reported by the source country as well as liabilities reported by the destination country. Thus, whenever a source country A does not report its asset holdings in a country B, I use the liabilities reported by country B vis-à-vis country A as the investments for the country pair "A towards B". Using this method, the only case when coverage remains incomplete is for bilateral positions where neither the source nor the destination country report data. This is a very traditional method used in international finance. In my sample, the mirror data, when both available, are extremely correlated (r=0.84). If both sides report, I take the inward stock value, following Casella (2019a). This is because the host country usually has better access to the firms' financial information.
My analysis might be subject to a bias arising from the presence of offshore countries. These countries, by their role as transit places for financial flows, may distort my results by exhibiting a huge amount of "artificial" FDI stocks. However, Casella (2019a) explains that this is less of an issue for developing countries. Wacker (2020) compares FDI data on "immediate" (i.e. potentially transitory) and ultimate ownership and finds a high correlation (r between 0.80 and 0.95). Stricker (2023) shows as well that the differences are not significant. Additionally, when it comes to my study, offshore countries are generally small islands, which I control by territory size. In any case, the UNCTAD data apply absorbing stochastic Markov chains to remove those transitory flows, using micro-data on Special Purpose Entities (SPEs), usually made for this transition (Casella (2019b)).In other words, they measure "Phantom FDI" using a method relatively similar to the one used by Damgaard et al. (2019) to find data from ultimate investors. Casella (2019b) and Damgaard et al. (2019) come to similar results. The OECD nd IMF data are also broke down by ultimate investors. I thus do not expect any bias from offshore countries.
As a robustness check, I compare my bilateral database to what is considered by the International Finance literature as the gold-standard reference for country-level data, the External Wealth of Nations data (Lane and Milesi-Ferretti (2018)). For each year, I sum every one of my bilateral inward FDI stocks data for all countries in the world and then compare them to the sum of the country-level data from the External Wealth of Nations database. Figure 1 shows the results. I find that both the quality and the coverage of the UNCTAD data are extremely high, as it covers the large majority of FDI stock at the country level and follows their main trends. The number of countries covered is also globally stable over years.
Finally when the first non-missing FDI stock data in a country-pair is a 0, I follow Broner et al. (2023) and assume

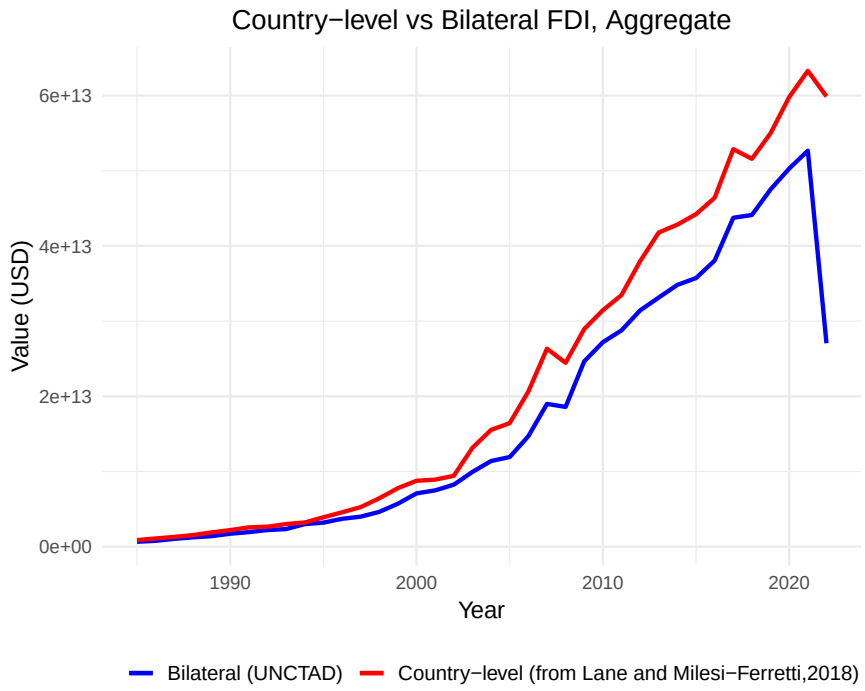


FIGURE 2

that it was a 0 for the previous years.

3 Empirical Motivations

I begin by addressing the classical liberal argument that FDI might promote peace by acting as a deterrent for conflict, thus raising its opportunity cost. If FDI does decrease due to conflict, countries might seek to avoid this economic loss, thereby providing a peace-promoting incentive.

Li and Vashchilko (2010), studying country-pairs involving OECD countries, find no significant impact of military conflict on FDI flows. Similarly, Li (2006, 2008a) show that FDI flows are already low before the onset of potential conflicts, as companies factor the risk into their investment decisions. Lee (2008) also concludes that there is no significant effect. However, Biglaiser and DeRouen Jr (2007) find that US investors are sensitive to conflicts. Barry (2018) shows that while conflict reduces incoming FDI flows, it does not lead to capital flight (outgoing stocks).

To test the hypothesis that FDI decreases because of conflict, I aim to assess the impact of conflict on FDI. The gravity equation is the most widely used method in International Economics to assess the determinants of economic exchanges. It has been extensively shown that FDI, like trade, follows gravity equations (Kox and Rojas-Romagosa (2020) ; Wacker (2020)). To measure the impact of military conflicts on FDI, I use a structural gravity equation (Head and Mayer (2014)) within a Local Projection setting (Jordà (2005)) [2]. The equation is as follows :

$$\Delta_{h+1} \log\left(\text{Inward FDI stock}^{ij}_{t+h}\right) = \alpha^h_i + \alpha^h_j + \alpha^h_{ij} + \gamma^h_t + \beta^h \text{Conflict}_{ijt} + \varepsilon^h_{ijt}$$

Where α_i represents the receiver fixed-effect, capturing all unobserved factors specific to the importing country that affect its inward FDI, such as economic size and trade policies ; α_j denotes the sender fixed-effect, accounting for similar unobserved characteristics that influence the sending capabilities of a country ; α_{ij} is the country-pair fixed-effect, specifically addressing unique bilateral factors like historical ties or trade agreements that are not encompassed by individual country effects ; and γ_t, the year fixed-effect, adjusts for global economic shocks or policy changes affecting all countries uniformly in a given year. These fixed effects collectively help isolate the influence of bilateral FDI

2. I thank Martin Bernstein for suggesting this specific gravity-setting

barriers and correct for both bilateral and multilateral resistance, as discussed in Anderson and Van Wincoop (2003). Conflict_{ijt} is a dummy for the *start* (i.e. not the continuation) of a military conflict at time t. I run the equation for $h \in \{1:12\}$. Conflict_{ijt} can approximately be interpreted as the change in the growth of FDI stock from one year to another. I use Driscoll-Kraay standard errors with a bandwidth of 2 years to account for both time and cross-sectional auto-correlation in a non-parametric way (Driscoll and Kraay (1998)).

Sub-figure 3a displays my results with 90% Confidence Intervals. I find that it takes eight years after the conflicts to observe a significant impact on FDI stock. However, this impact is substantial : eight years after a conflict, FDI stock have grown by 75 percentage points less than it would have grown without conflict. FDI stock growth seems to recover to its former level nine years after the conflict. Thus, conflict appears to have an impact on FDI flows, contrary to what the existing studies cited above have shown, but not enough to decrease stock . Still, the loss in FDI flows may possibly act as a deterrent for countries, encouraging them to avoid this cost by maintaining peace.

The finding that FDI stocks do not drop immediately because of a conflict clarifies two things. First, asset seizures by governments involved in military conflict might be relatively rare (assuming this would be reflected in the data). Secondly, this finding is consistent with Barry (2018) who find, using firm-level FDI data, that capital flight does not occur except during the most intense and persistent military conflicts. This likely reflects the difficulty for companies to divest from a country where they have invested, given the complexities involved, such as the need to sell off capital, the potential for incurring significant taxes, and the presence of high market exit barriers. For instance, numerous Western companies have recently faced high challenges in divesting their financial assets in Russia. FDI, by inherently involving substantial sunk costs, creates a cost of reallocation that makes it difficult for countries to redirect their assets toward other, more peaceful partners. This might lead countries to invest only in friendly partners, in order to avoid being "stuck" in a hostile country without being able to reallocate their FDI, as pointed out by Li (2008b). I thus expect that FDI act as an ambiguous deterrent for conflict : while conflict will stop FDI flows, those flows might already be very low in country pairs with a high probability of conflict, as firms will avoid spending high sunk costs in potentially hostile countries.I therefore expect a non-significant impact of bilateral FDI on bilateral conflicts. However, the high inertia of FDI stock make sure one point : I might not find a positive impact of multilateral FDI on bilateral conflict, as Martin et al. (2008) found for multilateral trade. If those scholars show that trade can be easily reallocated to alternative partners, the very low reactivity of FDI stock reveals how difficult this reallocation is when it comes to investments. I thus expect that multilateral FDI integration does not decrease the opportunity cost of bilateral conflicts. I therefore expect, in my analysis, at least a non-significantly positive effect of multilateral FDI on conflict.

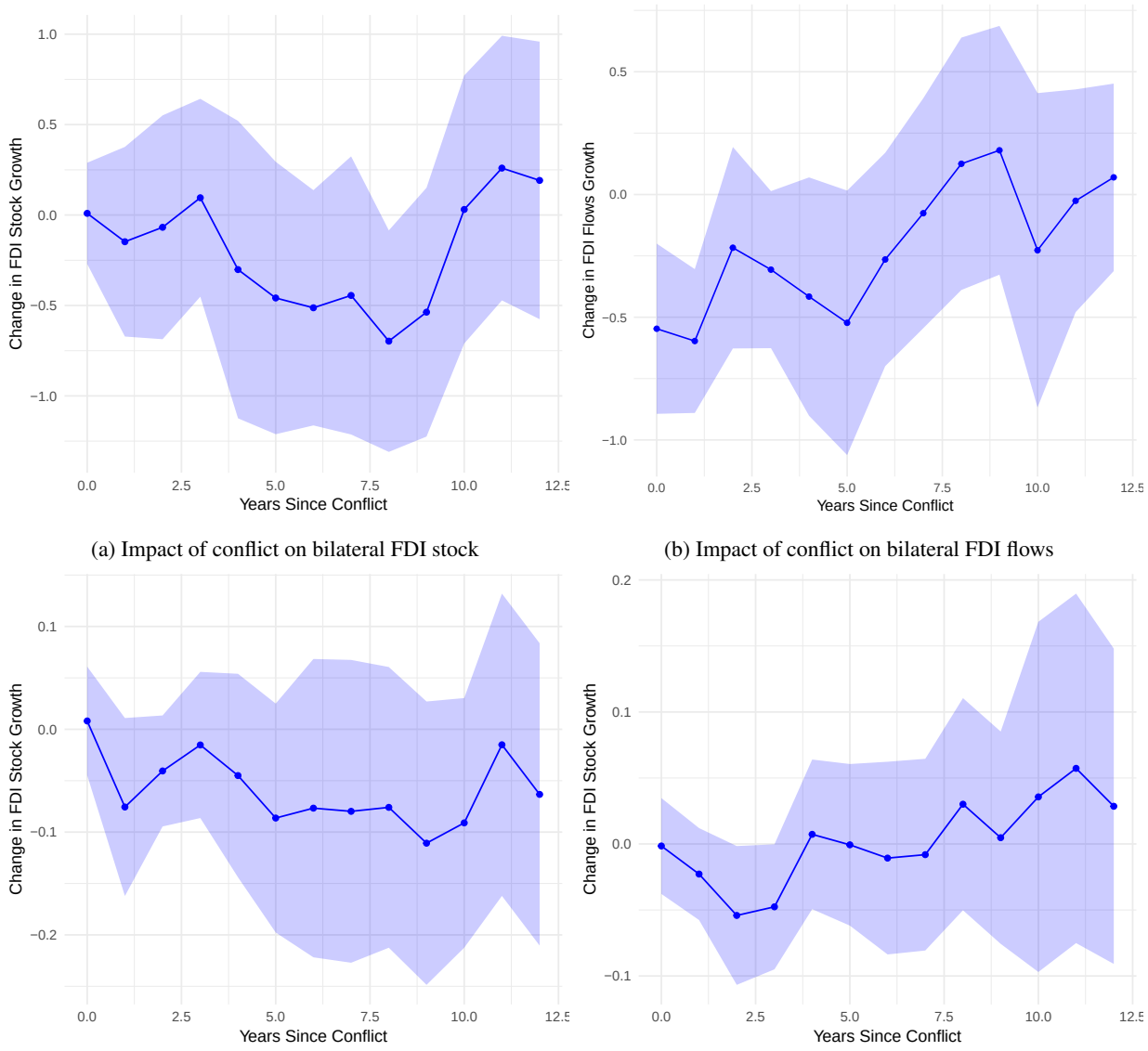
I now extend my analysis to assess the impact of conflict not only on bilateral FDI but also on multilateral FDI. The rationale is that if both countries in the country-pair lose FDI from third countries, this might also act as a potential deterrent. To examine this, I replace the dummy variable for conflict within the country-pair with a dummy variable for conflict *with a third country* and observe the reaction of FDI *within* the country-pair. This analysis is conducted from both the sender's and the receiver's points of view.

Sub-figure 3c plots my results from the receiver's perspective. I find that military conflicts do not affect inward FDI coming from third countries, contrary to the expectation of a decrease due to increased risk premiums. This subfigure also shows that the loss observed in 3a does not come from a decrease in the *value* of the stocks due to conflict risk, as this decrease in value would also affect the investments from tiers-country in a similar way. I can thus reasonably reject the hypothesis that multilateral FDI acts as a deterrent that prevents bilateral conflicts because of the opportunity cost of losing risk-averse investors.

Sub-figure 3d plots my results from the sender's perspective, examining the impact when the sender is in conflict with a third country. I find a very weak impact on outward FDI to third countries (When significant, the loss in FDI growth is around 5 percentage points), contrary to the expectation of a decrease due to a redirection towards domestic war production.

As a robustness check, I reproduce in subfigure 3b the analysis in 3a but using FDI flows. I face here a specification issue : since flows include negative values (disinvestments), I cannot log them. Rather than adding as a constant the absolute minimum value in order to log, I prefer, to avoid any distortion, to rely on a Inverse Hyperbolic Sine (IHS) transformation, (Burbidge et al. (1988)). This transformation is defined by $\sinh^{-1}(y) = \sinh^{-1}(y) = \log\left(y + \sqrt{y^2+1}\right)$ and has approximately (for large enough absolute values) the same properties as the logarithmic transformation (i.e., reduction in skewness and relative normalization) as well as the same interpretations in regressions. This transformation is not uncommon when working with FDI flow data (Busse et al. (2010)). My equation thus becomes here :

$$\Delta_h \sinh^{-1}\left(\text{Inward FDI flows}^{ij}_{t+h}\right) = \alpha^h_i + \alpha^h_j + \alpha^h_{ij} + \gamma^h_t + \beta^h \text{Conflict}_{ijt} + \varepsilon^h_{ijt}$$



(a) Impact of conflict on bilateral FDI stock

(b) Impact of conflict on bilateral FDI flows

(c) Impact of conflict on inward multilateral FDI stocks

(d) Impact of conflict on outward multilateral FDI stocks

FIGURE 3 – Impulse Response Functions of FDI to Conflicts by Local Projections

Sub-figure 3b displays the results. As expected, FDI flows react immediately, with a growth reduced by 50 percentage points over the first two years after the conflicts. They then seems to retrieve their original growth level from the third year.

4 Impact of FDI on conflict

4.1 Method

I now start my main analysis i.e. assessing the impact of integration through FDI on the probability of military conflict. In this analysis, I regress the log-odds ratio of the onset of Militarized Interstate Disputes (MID) against both the logged average in a country-pair of bilateral FDI stocks, inwards and outwards, weighted by GDP ("bilateral FDI"), and against the logged average of total FDI stocks, excluding bilateral FDI stocks, weighted by GDP ("multilateral FDI") for country-pair observations each year. This distinction aims to separate the influences of multilateral and

bilateral FDI. I incorporate various controls, including trade, into my logit model as described by the equation :

$$\log\left(\frac{Pr(MID_{ijt})}{1-Pr(MID_{ijt})}\right) = \gamma_0 + \gamma_1 \text{controls}_{ijt} + \gamma_2 \ln\left(\frac{1}{2}\left(\frac{FDI_{ijt}+FDI_{jit}}{GDP_{it}} + \frac{FDI_{ijt}+FDI_{jit}}{GDP_{jt}}\right)\right) + \gamma_3\left(\ln\left(\frac{1}{2}\left(\sum_{h\neq j,i}\left(\frac{FDI_{iht}+FDI_{hit}}{GDP_{it}} + \frac{FDI_{jht}+FDI_{hjt}}{GDP_{jt}}\right)\right)\right)\right)$$

I aim to assess the impact of *integration* through FDI on the likelihood of military conflicts, contrasting my variable definitions with those used by Polachek et al. (2007), who analyze the absolute value of total FDI flows, controlling in their specification for GDP. In contrast, my approach is more closely aligned with Martin et al. (2008), who employ a weighted average of imports in the two countries, adjusted by their GDP. This method allows for a precise measurement of economic openness relative to the size of the economies involved. Martin et al. (2008) focus exclusively on imports, following new trade theory (Krugman et al. (1980)), which posits that imports, by diversifying consumed varieties, primarily enhance trade welfare. My analysis considers both inward and outward FDI as a traditional measure of openness, reflecting the mutual dependency between the investor and recipient. While the recipient can be dependent on the capital provided (and its externalities), dependency from the sender's point of view is illustrated by the recent freezing or seizure of Russian assets in Western countries, highlighting the need for stable relations. Additionally, investors often benefit from repatriated profits, further emphasizing the mutual benefits of FDI. Finally, when it comes to benefit rather than costs, having outward FDI can be a way to exploit resources and wealth in an alternative, peaceful way, to military conquest.

UNCTAD data provide both bilateral and country-level aggregated data, defined as the sum of their bilateral data. The country-level aggregated data is highly correlated with Lane and Milesi-Ferretti (2018) (r=0.86). For the construction of my multilateral FDI variable, when the UNCTAD country-level aggregated data is missing, I thus rely on Lane and Milesi-Ferretti (2018)

A major challenge in my study is the varied likelihood of disputes among country pairs. Lee and Mitchell (2012) choose to narrow their focus to pairs with territorial disputes, I incorporate interaction terms between distance and my FDI variables, following Martin et al. (2008), who do it for trade. This approach accounts for primary conflict drivers, such as territorial or ethnic disputes : countries involved in a conflict with one another are usually the closest ones.

Endogeneity, especially due to reverse causality—where countries may diminish investments in response to escalating tensions—presents another hurdle. This prompts me to lag my economic integration variables (FDI stock and trade controls) by four years, aiming to mitigate some endogeneity issues under the premise of negligible time-autocorrelation beyond this period. This method is also motivated by my willingness to compare the effect of FDI with the effect of trade, which is more reactive and might need to be lagged by 4 years, following Martin et al. (2008). However, I still face endogeneity coming from the fact that, no matter the time, countries invest more in politically friendly countries (when it comes to the bilateral coefficient) or in politically stable countries(when it comes to the multilateral one). My IV analysis also aims to account for endogeneity.

Measurement errors constitute an additional concern, particularly as countries approach conflict, potentially leading to incomplete or inaccurate data on FDI with prospective adversaries. Consequently, I expect my bilateral FDI coefficient to be biased towards zero.

4.2 Control variables and data

The data for GDP in my FDI integration variables come from the World Bank, the IMF, and the Penn World Tables (Feenstra et al. (2015)). My control variables largely mirror those used in Martin et al. (2008), drawn from similarly updated sources. These controls are critical, especially considering the expected negative coefficient for bilateral FDI, which is anticipated to present endogeneity concerns, as previously explained.

For traditional trade gravity controls—including weighted distance based on large cities, former colonial ties, having a common colonizer, and sharing an official language—I utilize data from CEPII. These factors are expected to positively correlate with FDI and inversely with the likelihood of MID.

Additionally, I incorporate inverse correlation in United Nations General Assembly voting patterns, using the updated "Ideal point distance" data by Bailey et al. (2017), and the presence of a Free-Trade Area (FTA), with data from Egger and Larch (2008). These variables help capture political proximity and economic integration levels, respectively.

The Democracy index from the Polity V database is also included, reflecting the known association between democratic governance and both increased FDI and decreased conflict likelihood.

Given the known correlation between FDIs and trade (Aizenman and Noy (2009)), I control for trade using data from Barbieri et al. (2012), derived from the IMF's Direction of Trade Statistics (DOTS). Trade is GDP-weighted. I construct both a bilateral trade integration variable and a multilateral trade integration variable (they are defined using imports, similarly as in Martin et al. (2008)).

To account for the cross-sectional auto-correlation of military conflict, concurrent engagements in MIDs with third countries are also considered for both countries in the pair, as well as the average distance of the country-pair to the nearest conflict at time t.

The sum of the two countries' areas (from World Bank data) is included, as smaller countries, particularly islands, tend to be more globally integrated (Frankel and Romer (2017)) but less likely to engage in war.

Membership in GATT/WTO is controlled for, using WTO data, to account for historically higher openness to trade and FDI, and an expected lower (or higher) likelihood of conflict among member countries.

GDP per capita is another crucial control, reflecting the correlation between a country's development level and its integration into international finance. This variable is particularly important as wealthier nations tend to experience fewer MIDs. Data from the World Bank are supplemented by IMF data and the Penn World Tables . Recognizing the dual role of power imbalance in determining conflicts and attracting FDI (through gravity), I include both the sum and difference of GDP per capita in my analysis

I control for the inverse level of (de-facto) currency pegging, positing that monetary integration or treaties designed to enhance financial flows indicate also close international relations, thereby reducing the likelihood of military conflicts. I use data from Harms and Knaze (2021). These data follow the classification by Ilzetzki et al. (2019) : it ranges from 1 to 13, with 1 being a common currency and 13 being free floating.

Lastly, I control for 20 lags of military conflict occurrence for the 20 previous years in a given country-pair in order to prevent time-auto-correlation. I also control by 20 lags of the *same* conflict that the one being (still) ongoing at date t. This comprehensive approach to control variables aims to rigorously analyze the impacts of FDI and trade on military conflict likelihood, accounting for a wide range of economic, political, and demographic factors.

4.3 Benchmark results

Table 2 presents my findings. In Model 1, I narrow my sample following the approach of Martin et al. (2008), focusing exclusively on contiguous country-pairs with major cities within 1000 km of each other—areas traditionally more prone to conflict. This model is constrained by its limited observations and presumes a constant distance effect of FDI, a simplification that might not reflect reality. All the coefficients' signs are as expected. Both bilateral trade and FDI exhibit a negative sign. I observe a positive sign of multilateral trade on bilateral conflict, consistent with Martin et al. (2008). This also shows that their results still hold in the recent period. As expected, multilateral FDI does not exhibit a positive sign, likely due to the cost of reallocation observed in the previous section. While multilateral trade decreases the opportunity cost of conflict by providing more alternative partners, multilateral FDI does not, due to the high costs of reallocation. Only the bilateral trade coefficient is significant in this first model.

Model 2 restricts the analysis to country-pairs experiencing territorial disputes in a given year, using data from Wiegand et al. (2021). The rationale follows Lee and Mitchell (2012) and relies on the fact that these country-pairs are more prone to conflict. However, because some territorial disputes concern territories far from the countries' main cities, we incorporate interaction terms between economic variables and distance (unreported),as those particular territorial disputes are less likely to lead to conflicts. Again, all coefficients have the expected sign. Only the bilateral coefficients are significant in this model.

Expanding to a full sample, Model 3 also incorporates these interaction terms with distance. All coefficients again have the expected sign. While both trade coefficients are significant, only the multilateral FDI coefficient is significant, whereas the bilateral one is not. It is also worth noting that the coefficient on bilateral FDI is lower than that of bilateral trade. Bilateral FDI does not seem to reduce conflicts as much as bilateral trade does, despite the losses in FDI flows caused by conflicts observed in the previous section. The reason certainly comes from our observation of low-reacting stocks : Firms anticipate the risk of conflicts and do not invest in potential military opponents Li (2008b) because they need to take into account the (high) cost of a potential reallocation. Firms may be forward-looking and rather choose to invest primarily in friendly countries (Gopinath et al. (2024) ; Aiyar et al. (2024)). In any case, my finding of no peace-promoting effect of bilateral FDI contrasts with the few existing studies (Lee and Mitchell (2012),Polachek et al. (2007)). When it comes to the significant negative impact of multilateral FDI on conflict, I showed that multilateral FDI do not react to conflicts, and thus cannot act as a deterrent (via threats from foreign firms to leave or to not invest anymore in a country-pair escalating towards conflict). The reason might rather come from the benefits of FDI. FDI

TABLE 2 – Benchmark Results : Impact of FDI on Conflicts, 1985-2014

	Dependent variable :					
	Military Conflict					
	(1)	(2)	(3)	(4)	(5)	(6)
ln(bil FDI openess) t-4	−0.018	−0.186*	−0.079	−0.013	−0.036	−0.023
	(0.015)	(0.106)	(0.064)	(0.072)	(0.072)	(0.126)
ln(mult FDI openess) t-4	−0.068	−1.054	−0.998**	−1.559***	−1.212*	−2.074*
	(0.127)	(0.955)	(0.405)	(0.515)	(0.623)	(1.184)
ln(bil trade openess) t-4	−0.080***	−0.747**	−0.848***	−0.453**	−0.373*	−0.341
	(0.031)	(0.358)	(0.321)	(0.188)	(0.210)	(0.332)
ln(mult trade openess) t-4	0.380	1.328	2.639*	3.479**	3.685**	4.308*
	(0.296)	(2.054)	(1.403)	(1.528)	(1.544)	(3.272)
ln(distance)	1.656***	0.591	0.073	−1.082***	−1.534***	
	(0.340)	(0.378)	(0.312)	(0.306)	(0.331)	
# Peace years	−0.165***	0.001	−0.011**	−0.004	−0.002	0.020**
	(0.028)	(0.035)	(0.004)	(0.005)	(0.005)	(0.008)
Contiguity		0.264	1.168***	0.926***	0.688**	
		(0.251)	(0.255)	(0.283)	(0.324)	(0.324)
# Other conflicts at t				0.294***	0.345***	0.283***
				(0.036)	(0.035)	(0.044)
ln(abs diff (gdp per cap) t-4)				0.212*	0.360***	0.425***
				(0.119)	(0.097)	(0.162)
ln(sum (gdp per cap) t4)				−0.207*	−0.377***	−0.410**
				(0.125)	(0.105)	(0.167)
Free Trade Area				−0.268	−0.309	−0.806*
				(0.280)	(0.247)	(0.476)
ln(distance to nearest war)				0.522**	0.646***	1.201***
				(0.225)	(0.220)	(0.265)
ln(sum area)				0.520***	0.526***	−4.128
				(0.120)	(0.121)	(7.074)
# WTO members				0.069	0.185	0.389
				(0.107)	(0.136)	(0.303)
Dummy for 0 FDI				−0.233	−0.014	−0.014
				(0.217)	(0.222)	(0.222)
Flexibility of exchange rate				−0.026	0.016	−0.083
				(0.020)	(0.020)	(0.062)
Former colonial link				0.576**	0.818**	
				(0.330)	(0.340)	
Common official language				0.198	0.361	
				(0.307)	(0.293)	
Common colonizer				0.557**	0.641**	
				(0.285)	(0.268)	
Alliance				−0.638**	−0.672**	−0.186
				(0.271)	(0.264)	(0.409)
Distance in UN votes t-4				0.105	0.203**	0.242
				(0.096)	(0.094)	(0.252)
Joint Democracy				−0.002	0.0002	−0.049
				(0.010)	(0.011)	(0.027)
Sample	Contiguous and $\leq$ 1000 km	Territorial Issue	Full	Full	Full	Full
Year FE	No	Yes	Yes	Yes	Yes	Yes
Conflict lags (20 years)	No	Yes	Yes	Yes	Yes	Yes
Same conflict lags (20 years)	No	No	No	No	Yes	No
Method	Logit	Logit	Logit	Logit	Logit	2WFE Logit
Observations	1,738	911	199,183	153,286	153,286	2373
Akaike Inf. Crit.	515	697	3,053	2,391	2188	2,391

Note : *p<0.1 ; **p<0.05 ; ***p<0.01.SEs clustered by country-pair. Column 2,3,4,5,6 include interaction terms with distance for trade and FDI variables (unreported)

allows countries to exploit resources and wealth in different parts of the world as a peaceful alternative to military conquest. I thus expect this negative impact of multilateral FDI to comes mainly from *outward* FDI (I test later that hypothesis).
With the introduction of my comprehensive set of controls in Model 4, the results remain significant. All controls also exhibit the expected signs. The bilateral FDI coefficient decreases even more and is almost null. In model 5, I add dummies for 20 lags of the *same* conflict that is (still) ongoing at date t, to control for time-auto-correlation.
In model 6, I attempt to follow a conditional logit approach (Chamberlain (1984)) to include country-pair fixed effects. However, since the analysis only includes 25 years for a large number of country-pairs, I face the incidental parameter bias problem (Lancaster (2000); Neyman and Scott (1948)). Fernández-Val (2009) points out that this bias is even stronger in non-linear models such as logistic models and derives a method to reduce it. I thus follow their correction method. The drawback of the conditional logit is that the observations from all country-pairs that exhibit only peaceful years in my sample (or, conversely, only military conflicts i.e. no variation in outcome) are dropped. The multilateral FDI coefficient is, however, still significant in this specification (model 6).
In table 3 I present some robustness checks to my preferred specification i.e. model 4 of Table 2. For readability purposes, I do not display the former controls, even though they are included in all models of table 3. First, in model 1, I use the two-way clustering Standard-Errors (Cameron et al. (2011)) to account for both time and cross-sectional auto-correlations. In model 2, I change the dependent variable. Instead of defining a conflict as both the display and the use of military forces, I only define it as the use of those forces. In model 3, I employ a probit model instead of a logit one. My results are robust to those specifications. In model 4, I control for bilateral economic sanctions, both trade and financial ones, using data from the Global Sanction Database (Felbermayr et al. (2020)). The rationale here is that countries imposing sanctions on each-other might exhibit both a higher probability of conflict and lower economic exchanges. The multilateral FDI coefficient remains significantly negative.
In table 4,in model 1, I incorporate interaction terms between bilateral FDI and bilateral trade, as well as between multilateral FDI and multilateral trade. The rationale behind this is multifaceted. Firstly, trade may have a more significant role in promoting peace in the absence of FDI, which is often observed in developing countries, and vice versa. Additionally, bilateral trade could become more crucial in the presence of FDI, as FDI might fragment the production process (vertical FDI), thereby increasing the importance of trade for transporting inputs at various stages of the value chain. Lastly, FDI might be less significant when trade is prevalent, as many FDI activities are limited to the distribution of traded products. My results remain significant. Given the very global scale of my research question, I want to convince the reader that I do not face omitted variable bias. In model 2, I control for the presence of a Bilateral Investment Treaty (BIT) in the country-pair, with data from UNCTAD. Indeed, such country-pair might exhibit both good diplomatic and financial relations. In model 3, I also interact my multilateral FDI coefficient with dummies for different decades to make sure that my result is not driven by a particular period. In model 4 I control for the presence of a Double Taxation Treaty (DTT) with data from the Tax Treaty Explorer. The motivation is the same as for the BIT. My results, in particular the multilateral FDI coefficient, remain highly significant.

4.4 Directional analysis

To assess the robustness of my results, I now switch to a directional analysis. Instead of considering the likelihood of conflict in a country-pair, I observe the probability for a *given* country of the country-pair to *initiate* the conflict. This approach allows me to refine my findings further. For instance, I might be able to discern whether it is the inward or the outward FDI of a given country that influences its decision to initiate or avoid conflict.
By focusing on the initiator of the conflict, I can better understand the specific motivations and economic conditions that lead a country to take aggressive actions. This directional approach adds depth to the analysis by highlighting the role of economic factors in conflict initiation. It provides a more granular understanding of the economic underpinnings of conflict and peace.
Since the analysis is now directional, I consider two observations for each country-pair and year, one for each country in the pair. Thus, instead of taking an average of FDI openness in the country-pair, I regress the log-odds ratio of initiating a conflict for the country in question against its bilateral and multilateral FDI positions, divided by the country's GDP. The equation is specified as follows :

TABLE 3 – Impact of FDI on Conflict,Robustness Checks

	Dependent variable :			
	Military Conflict	Use of Military Force	Military Conflict	
	(1)	(2)	(3)	(4)
ln(bil FDI openess) t-4	−0.013	−0.013	0.014	−0.013
	(0.072)	(0.095)	(0.030)	(0.072)
ln(mult FDI openess) t-4	−1.559***	−1.427*	−0.612***	−1.595***
	(0.515)	(0.735)	(0.203)	(0.518)
ln(bil trade openess) t-4	−0.453**	−0.534***	−0.234***	−0.457**
	(0.188)	(0.195)	(0.078)	(0.186)
ln(mult trade openess) t-4	3.479**	3.441*	1.176*	3.627**
	(1.528)	(2.013)	(0.621)	(1.532)
ln(trade sanctions) t-4				−0.126
				(0.392)
ln(financial sanctions) t-4				0.789*
				(0.462)
Year FE	Yes	Yes	Yes	Yes
Conflict lags (20 years)	Yes	Yes	Yes	Yes
Method	Logit	Logit	Probit	Logit
Observations	153,286	153,286	153,286	153,286
Akaike Inf. Crit.	2,391.274	1,631.424	2,336.281	2,392.003

Notes : All models include the same controls and interaction terms as model 4 of Table 2 (unreported). SEs are two-way clustered in model 1 and clustered by country-pair in the others. Significance levels : * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$;

TABLE 4 – Impact of FDI on Conflict,Robustness Checks Continued

	Dependent variable :			
	Military Conflict			
	(1)	(2)	(3)	(4)
ln(bil. FDI openess) t-4	−0.046	−0.018	−0.019	−0.018
	(0.071)	(0.073)	(0.074)	(0.073)
ln (mult FDI openess) t-4	−1.561***	−1.574***	−1.616***	−1.626***
	(0.509)	(0.521)	(0.585)	(0.584)
ln (bil trade openess) t-4	−0.493***	−0.454**	−0.458**	−0.456**
	(0.143)	(0.186)	(0.194)	(0.192)
ln(mult trade openess) t-4	3.485**	3.639**	3.517**	3.497**
	(1.536)	(1.545)	(1.532)	(1.531)
DDT				−1.583
				(1.584)
BIT		0.183	0.169	0.178
		(0.215)	(0.215)	(0.214)
ln(mult trade openess) t-4 x ln (mult FDI openess) t-4	−0.021***			
	(0.090)			
ln (bil trade openess) t-4 x ln(bil FDI openess) t-4	−0.007			
	(0.003)			
ln (mult FDI openess) t-4 x 1990s			0.136	0.135
			(0.276)	(0.275)
ln (mult FDI openess) t-4 x 2000s			−0.341	−0.354
			(0.266)	(0.265)
Year FE	Yes	Yes	Yes	Yes
Conflict lags (20 years)	Yes	Yes	Yes	Yes
Method	Logit	Logit	Logit	Logit
Observations	153,286	153,286	153,286	153,286
Akaike Inf. Crit.	2,386.995	2,392.763	2,392.023	2,391.564

Notes : All models include the same controls and interaction terms as model 4 of Table 2 (unreported). SEs are clustered by country-pair. Significance levels : * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$;

$$\log\left(\frac{Pr(\text{Initiating }_{ijt})}{1-Pr(\text{Initiating }_{ijt})}\right)=\beta_0+\beta_1\text{controls}_{ijt}+\beta_2\ln\left(\frac{FDI_{ijt}+FDI_{jit}}{GDP_{it}}\right)+\beta_3\ln\left(\frac{\sum_{k\neq j}(FDI_{ikt}+FDI_{kit})}{GDP_{it}}\right)+\varepsilon_{ijt} \quad (1)$$

In this equation, $Pr(\text{Initiating }_{it})$ represents the probability that country i initiates a conflict in year t. The term $\log\left(\frac{Pr(\text{Initiating }_{it})}{1-Pr(\text{Initiating }_{it})}\right)$ is the log-odds ratio of initiating a conflict, which is modeled as a function of various predictors. The controls include, as before, all the relevant variables ensuring a comprehensive analysis.

The other advantage of a directional analysis is that I can use individual fixed-effect without dropping too many observations. The individual fixed-is here designed for the country that initiates the conflict. I am thus left with the remaining observations for all countries that initiated at least one conflict during the sample period. Table 5 displays the results. The multilateral FDI coefficient is still very significantly negative, while the bilateral one is still insignificant.

In Table 6,I presents a similar directional regression, focusing on the perspective of initiating a conflict. This regression differentiates between the impacts of imports, exports, outward FDI, and inward FDI. The aim is to validate the theoretical perspective that it is mainly multilateral *outward* FDI that primarily promotes peace. This is because it enables the exploitation of resources and wealth in various regions worldwide without the need for military conquest, as highlighted by Brooks (1999). Moreover, it avoids the high costs associated with having only indirect access to these resources through imports. The results align with expectations : multilateral outward FDI has a negative coefficient and is the only significant variable when considering FDI. Regarding trade, multilateral imports have a significantly positive effect on bilateral conflicts. This finding supports the model introduced by Martin (2008), which suggests that countries are primarily dependent on imports, and that this dependency is relatively mitigated by globalization, thus decreasing the opportunity cost of conflict.

4.5 IV analysis

I face potential endogeneity in my regressions when it comes to the significant multilateral FDI coefficient that I found. Indeed, countries might invest less in partner countries with a high probability of conflict, due to risk-aversion. Similarly, countries engaged in military conflict might invest less outward due to war production,, reconstruction, etc. I already addressed this reverse causality issue in the empirical motivation section by showing that conflict do not have an effect on multilateral FDI. However, to convince the reader, I still rely on an instrumental variable strategy. I use two instruments to predict my two endogenous variables : bilateral and multilateral FDI.

The first instrument is designed for the multilateral FDI variable and is the Multilateral Investment Guarantee Agency (MIGA), which is an insurance policy from the World Bank that covers FDI in all kinds of countries against political risk. This information is particularly important for my purpose since the coverage of a given country by this insurance is uncorrelated with the risks (including military conflict risks). MIGA was created in 1988 and reached 100 member countries in 1991 and then 150 in 2000. I use the average number of years of membership in MIGA within a country-pair, as FDI stocks are expected to increase over time due to the protection offered by this insurance. One might argue that developed countries, less prone to conflict, join as first members these kinds of organizations. However, I control for both GDP per capita and WTO members in both stages.

The second instrument is designed for both the bilateral and multilateral FDI variable coefficients and is financial remoteness to the rest of the world, which is an indicator that I create. The idea is to followMartin et al. (2008), who instrumented the impact of trade on conflict by the well known "economic remoteness indicator" from the trade literature. I try to build an equivalent of this indicator designed for financial investments. I define it as a sum of all alternative partners' financial markets outside a country-pair, weighted by their distance, following this equation :

$$\text{Financial remoteness}_{ijt}=-\ln\left(\sum_{k\neq j,i}\frac{FinancialMarket_{kt}}{d_{ik}}+\sum_{k\neq j,i}\frac{FinancialMarket_{kt}}{d_{jk}}\right)$$

In a traditional remoteness index (used in trade), Financial Market would be replaced by GDP. I use as a proxy for Financial Market the Financial Development Index from the IMF who compiles several indicator (credit/GDP ratio etc. that facilitate investments). The idea is to capture the time-variation of the "natural" potential of FDI that a country-pair can have, following a market potential approach and the fact that, as it is well known, FDI follows gravity patterns. If neighboring countries of the country-pair experience relative economic growth over the years, then the country-pair might decrease its bilateral FDI and increase its multilateral FDI toward these revived partners. Similarly, an increase

TABLE 5 – Impact of FDI on Initiating a Conflict (directional)

Dependent Variable :	Initiating Conflict		
Model :	(1)	(2)	(3)
ln(bil. FDI openess) t-4	-0.0606	-0.0583	0.0292
	(0.0547)	(0.0711)	(0.0863)
ln (mult. FDI openess) t-4	-0.9411***	-0.8093**	-1.651***
	(0.3060)	(0.3474)	(0.5717)
ln (bil. trade openess) t-4	-0.2588***	-0.1346	-0.1047
	(0.0815)	(0.1121)	(0.1367)
ln(mult. trade openess) t-4	1.223	-0.0979	2.783**
	(0.8006)	(0.9649)	(1.297)
Contiguity	1.367***	0.7560***	0.8797***
	(0.2444)	(0.2688)	(0.2883)
ln(distance)	-0.2250	-0.8349***	-1.406***
	(0.1879)	(0.2184)	(0.2906)
# Peace Years	-0.0032	-0.0009	-0.0035
	(0.0030)	(0.0042)	(0.0044)
Joint Democracy		0.0001	0.0179*
		(0.0099)	(0.0106)
Former colonial link		0.3700	0.4503
		(0.3410)	(0.3011)
Common official language		0.0640	0.1619
		(0.2720)	(0.3502)
Common colonizer		0.4542*	0.5433*
		(0.2398)	(0.3138)
Distance in UN votes t-4		0.2510***	0.2724***
		(0.0709)	(0.0787)
Alliance		-0.3279	-0.1626
		(0.2279)	(0.2374)
ln(distance to nearest war)		0.4976***	0.5571**
		(0.1916)	(0.2333)
Dummy for 0 FDI		-1.126***	-0.2637
		(0.2013)	(0.2677)
# Other conflicts at t		0.3132***	0.3520***
		(0.0256)	(0.0312)
ln(abs diff (gdp per cap) t-4)		0.0689	0.1168
		(0.0865)	(0.0815)
ln(sum (gdp per cap) t4)		-0.0465	-0.0948
		(0.0949)	(0.0893)
Free Trade Area		-0.0209	0.0306
		(0.2630)	(0.2561)
ln(sum area)		0.3158***	0.3446***
		(0.0843)	(0.0994)
# WTO members		-0.0895	-0.2630**
		(0.0865)	(0.1046)
Flexibility of exchange rate		-0.0321*	-0.0256
		(0.0191)	(0.0194)
Year FE	Yes	Yes	Yes
Conflict Initiator FE	No	No	Yes
Observations	510,153	381,554	198,013
McFadden R^2	0.40788	0.50719	0.51390
Bayesian Information Criterion	6696	4773	5190

Clustered (country-pair) standard-errors
*Signif. Codes : *** : 0.01, ** : 0.05, * : 0.1*

TABLE 6 – Impact of FDI on Initiating a Conflict (directional)

Dependent Variable :	Initiating Conflict
Model :	(1)
ln(mult. outward FDI openess) t-4	-0.5493***
	(0.1378)
ln(mult. inward FDI openess) t-4	0.2288
	(0.7862)
ln(bil. outward FDI openess) t-4	-0.0385
	(0.0723)
ln(bil. inward FDI openess) t-4	0.0900
	(0.0735)
ln(mult. exports) t-4	-1.714
	(1.664)
ln(mult. imports) t-4	4.044**
	(1.971)
ln(bil. exports) t-4	-0.1476
	(0.1711)
ln(bil. imports) t-4	-0.0204
	(0.1746)
Year FE	Yes
Initiator Country FE	Yes
Observations	193,718
McFadden R^2	0.51798
Bayesian Information Criterion	5,059.1

Clustered (country-pair) SEs. All controls in model 3 of table 5 are included and unreported.
*Signif. Codes : *** : 0.01, ** : 0.05, * : 0.1*

in remoteness might lead to an increase in bilateral FDI. However, the geographical component of this instrument is subject to endogeneity, since country-pairs surrounded by well-financially-developed countries often exhibit fewer military conflicts. I thus use two-way fixed effects to account for this geographical component.
Scholars are increasingly trying to adapt the 2SLS method to logistic regression. The Two-Stage-Residual-Inclusion (2SRI) method (Terza et al. (2008)) is the best example. However, I still face the issue of having to drop a lot of observations from country-pairs that do not exhibit variation in outcomes (military conflict). I thus follow Wooldridge (2010) and rely on a linear probability model (OLS) to use a 2SLS model. A LPM has its drawbacks since it is inherently heteroskedastic, but is still convenient for my purpose. The fact that my endogenous variables are interacted with distance also complicates the exercise. I follow again Wooldridge (2010) and simply interact the 2 instruments with distance in the first stage. table 7 displays the first stage results. All F-stat pass the Rule of Thumb from Staiger and Stock (1997), and instruments have all the expected signs. Surprisingly, financial remoteness is only significant for multilateral FDI, while MIGA is only significant for bilateral FDI. Table 8 displays the second stage results. The multilateral FDI coefficient remains significant.

4.6 Receiver operating characteristic-Area under curve analysis

In this section, I aim to thoroughly evaluate the goodness of fit of my main specification as well as its potential for over-fitting. I faced a trade-off in my main analysis : the global and historical scope of the research question I am addressing compels me to include a significant number of controls. However, this might lead to overfitting, and I wish to assure the reader that this is not the case.
To evaluate the robustness and predictive power of my main model, I employ both in-sample and out-of-sample validation techniques. Initially, I perform an in-sample evaluation using the entire dataset, which involves assessing the model's performance on the same data used for training, providing an initial gauge of its fit. Subsequently, I conduct an out-of-sample analysis to further verify the model's generalizability and predictive accuracy. For this, I train the model (4) of 2 on data from the period 1985-2000 and then test it on data from the period 2000-2014.
A key metric I use for these evaluations is the Area Under the Receiver Operating Characteristic Curve (AUC-ROC) Hanley and McNeil (1982). The ROC curve is a graphical representation that illustrates the diagnostic ability of a

TABLE 7 – 2SLS-First-stage

Dependent Variables :	ln(bil. FDI)	ln(mult. FDI)	ln(bil. FDI)xln(distance)	ln(distance)xln(mult. FDI)
Model :	(1)	(2)	(3)	(4)
MIGA IV	1.535***	0.0078	11.30***	-0.1705***
	(0.0648)	(0.0076)	(0.5089)	(0.0602)
Financial remoteness IV	2.003	-4.606***	39.70**	-26.59***
	(2.046)	(0.2532)	(16.02)	(2.009)
MIGA IV x ln(distance)	-0.1615***	-0.0003	-1.184***	0.0254***
	(0.0072)	(0.0008)	(0.0572)	(0.0067)
Financial remoteness IV x ln(distance)	-1.495***	0.1529***	-15.40***	-0.1840
	(0.2318)	(0.0283)	(1.846)	(0.2263)
Joint Democracy	-0.0357***	-0.0051***	-0.2867***	-0.0446***
	(0.0029)	(0.0004)	(0.0254)	(0.0037)
Alliance at t	1.108***	0.0779***	7.721***	0.6726***
	(0.1607)	(0.0119)	(1.250)	(0.0933)
Distance in UN votes t-4	-0.2620***	0.0412***	-2.002***	0.3586***
	(0.0341)	(0.0052)	(0.2929)	(0.0445)
ln(bilateral trade) t-4	-0.1963***	0.0285***	-1.041***	0.2251***
	(0.0431)	(0.0082)	(0.3301)	(0.0671)
ln(multilateral trade) t-4	2.265***	1.684***	12.97***	8.442***
	(0.5865)	(0.1272)	(4.565)	(0.9499)
# Peace years	-0.0081	-0.0014***	-0.0805	-0.0103***
	(0.0057)	(0.0003)	(0.0493)	(0.0028)
# Other conflicts at t	0.0555***	0.0086***	0.4770***	0.0743***
	(0.0162)	(0.0014)	(0.1380)	(0.0122)
ln(abs diff (gdp per cap) t-4)	-0.1515***	-0.0047*	-1.246***	-0.0302
	(0.0207)	(0.0027)	(0.1778)	(0.0232)
ln(sum (gdp per cap) t4)	0.1185***	-0.0070**	0.9931***	-0.0769***
	(0.0223)	(0.0029)	(0.1917)	(0.0251)
Free Trade Area	-0.3693***	0.1016***	-2.452***	0.9501***
	(0.1086)	(0.0132)	(0.8616)	(0.1148)
ln(sum area)	3.908***	-0.5509***	31.23***	-4.915***
	(0.9529)	(0.1485)	(8.008)	(1.266)
# WTO members	0.1629***	-0.0189***	1.120***	-0.2171***
	(0.0463)	(0.0059)	(0.3967)	(0.0511)
Flexibility of exchange rate	0.0176**	0.0078***	0.2014***	0.0717***
	(0.0071)	(0.0009)	(0.0590)	(0.0077)
Dummy for 0 FDI	-2.872***	-0.0505***	-25.08***	-0.4438***
	(0.0605)	(0.0045)	(0.5281)	(0.0396)
ln(distance to nearest war)	-0.1572***	0.0188***	-1.456***	0.1596***
	(0.0266)	(0.0030)	(0.2297)	(0.0264)
F-stat on IVs	775	1566	534	1,348
Year FE	Yes	Yes	Yes	Yes
Country-pair FE	Yes	Yes	Yes	Yes
Observations	151,226	151,226	151,226	151,226
R^2	0.73249	0.83348	0.76136	0.83366
Within R^2	0.07772	0.18559	0.06879	0.17100

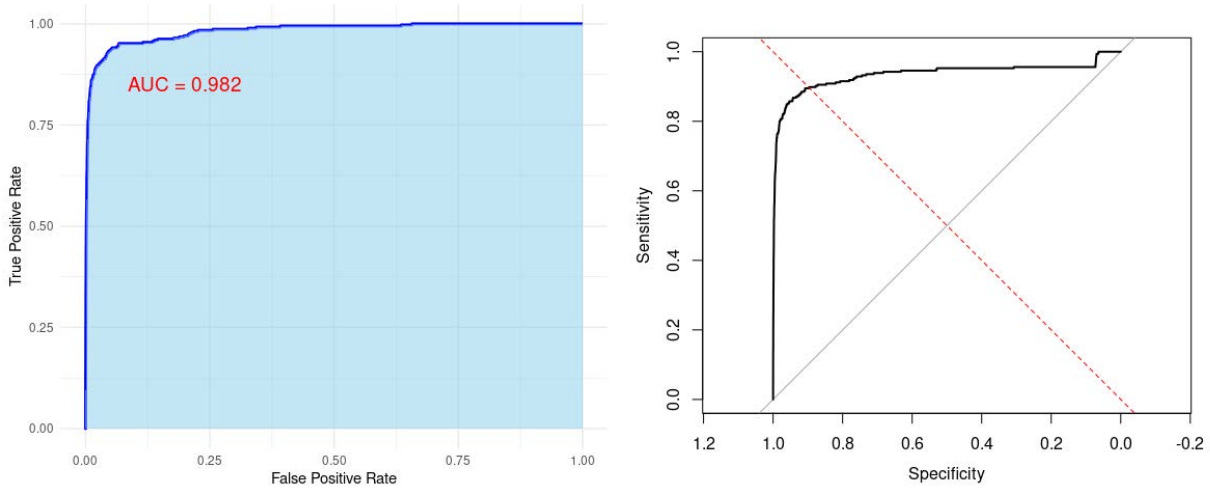
Heteroskedasticity-robust standard-errors in parentheses.
Models include interactions between distance and trade variables (unreported).
*Signif. Codes : *** : 0.01, ** : 0.05, * : 0.1*

TABLE 8 – 2SLS-Second Stage

Dependent Variable :	Military Conflict	
Model :	(OLS (LPM))	(2SLS (LPM))
ln(mult. FDI openess) t-4	0.007	-1.293*
	(0.053)	(0.756)
ln(bil. FDI openess) t-4	-0.002	0.507
	(0.006)	(0.314)
ln(mult. trade openess) t-4	0.131	0.578**
	(0.115)	(0.274)
ln(bil. trade openess) t-4	-0.015	0.014
	(0.012)	(0.020)
Joint Democracy	-0.00036	-0.00020
	(0.00039)	(0.00057)
Alliance at t	-0.038	-0.105**
	(0.027)	(0.054)
Distance in UN votes t-4	0.004	-0.004
	(0.003)	(0.009)
# Peace years	0.011***	0.009***
	(0.003)	(0.003)
# Other conflicts at t	0.040***	0.042***
	(0.006)	(0.006)
ln(abs diff (gdp per cap) t-4)	0.005*	-0.002
	(0.003)	(0.006)
ln(sum (gdp per cap) t4)	-0.005*	0.004
	(0.003)	(0.007)
Free Trade Area	-0.011	-0.020
	(0.011)	(0.016)
ln(distance to nearest war)	0.006***	-0.014
	(0.002)	(0.014)
ln(sum area)	-0.018	0.189
	(0.139)	(0.227)
# WTO members	0.009	0.013
	(0.007)	(0.008)
Flexibility of exchange rate	-0.00073	0.001
	(0.00071)	(0.002)
Dummy for 0 FDI	0.001	-0.193
	(0.004)	(0.133)
Year FE	Yes	Yes
Country-pair FE	Yes	Yes
Observations	153,286	151,226
R^2	4.1940	0.0468

Heteroskedasticity-robust standard-errors in parentheses
Models include interactions between distance and trade variables (unreported).
*Signif. Codes : *** : 0.01, ** : 0.05, * : 0.1*
Note : All coefficients and standard errors are multiplied by 10 for readability purposes.

binary classifier system by plotting the true positive rate (sensitivity) against the false positive rate (1-specificity) at various threshold settings. It fits well to logistic regressions. Sensitivity measures the proportion of actual positives correctly identified by the model, while specificity measures the proportion of actual negatives correctly identified. The AUC quantifies the overall ability of the model to discriminate between positive and negative cases. An AUC



(a) In Sample ROC (1985-2014)

(b) Out of Sample ROC (2000-2014)

FIGURE 4 – In and Out-of-sample ROC analysis

of 1 indicates perfect predictive power, whereas an AUC of 0.5 suggests no predictive power, equivalent to random guessing.
By employing both in-sample and out-of-sample analyses, I ensure a comprehensive evaluation of the model's performance. Figure 4 displays the results. In both exercises, my model achieves an extremely high AUC (0.98 in in-sample and 0.93 in out-sample), demonstrating strong predictive accuracy and reliability across different time periods of my model.

4.7 Quantification-Interpretation

Interpreting results in a logit model is not always straightforward, especially when the independent variable is interacted with another variable, such as distance in this case. As pointed out by Ai and Norton (2003), due to the non-linear nature of the logit model, linear adjustments to the coefficients for different levels of distance are not feasible. Therefore, I rely on a counterfactual exercise, following the approach of Martin et al. (2008), to simulate the effect on military conflict probability of changes in my main independent variables while holding others constant. This involves recalculating the probabilities obtained from the model after these changes. Specifically, the main question this paper addresses is : "Did the sharp increase in international financial integration over the last decades (as shown in Figure 1) contribute to pacifying the world ?" To explore this, I first calculate the predicted probabilities of military conflict for the year 2014 using my prefered model (model 4 of table 2). I then adjust the level of multilateral FDI integration for each country-pair back to their 1985 levels, and recalculate the probabilities. Finally, I average the predicted probabilities over different groups of countries depending on their bilateral distances. Figure 5 display the result. I find that the sharp increase in FDI in the last decades drastically decreased the likelihood of conflict between proximate countries. Surprisingly, I find a positive impact on the likelihood of conflict between more distant countries. This might comes from raising international competition over resources that FDI can create. It seems that if FDI decrease the likelihood of conflict between neighbours countries by providing alternative, peaceful way, to extract wealth and resources from various places in the World, part of the problem is just "redirected" elsewhere, as these extraction rise new security concerns and competition with newly revealed opponents. This is in a way consistent with Gartzke (2007) who explains that FDI helps states project forces over greater distances and who predict actually exactly that we should observe increasing conflicts from distant countries due to FDI.

5 Conclusion and Further Research

I demonstrate that FDI might be better at promoting peace than trade. Building on Martin et al. (2008) who shows an ambiguous impact of trade on peace,with bilateral trade generally reducing bilateral conflicts and multilateral trade

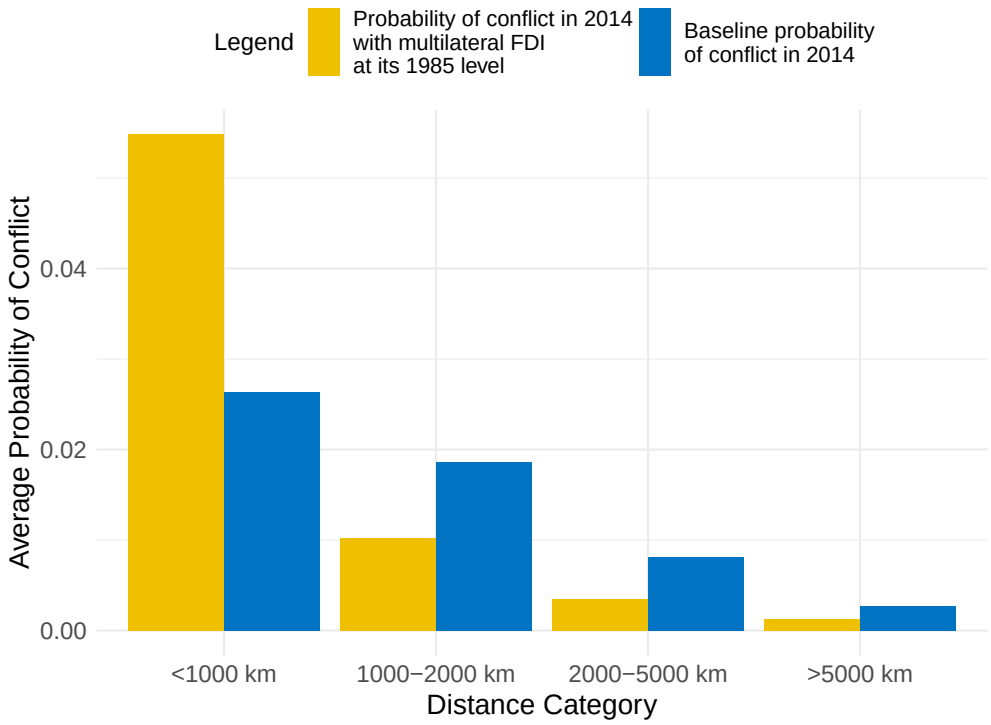


FIGURE 5 – Counterfactual : Impact of the International Financial Globalization on Conflicts Across Distances

increasing them, I show that FDI do not have such ambiguous effect.
First, I do not find a positive impact of bilateral FDI on bilateral peace, offering a contrast to previous findings in a notably small literature (Lee and Mitchell (2012), Polachek et al. (2007)). The large sunk costs and costs of reallocation of FDI (that I observe) diminish its potential deterrent effect. These costs lead companies to be forward looking and to factor this risk of being stuck in an enemy country by investing primarily in friendly countries (Aiyar et al. (2024),Gopinath et al. (2024), thus preventing any peace-promoting effect through interdependence.
However, I show that multilateral FDI, and in particular outward multilateral FDI, prevent countries from engaging in conflicts because they provide an alternative way to exploit resources and wealth peacefully, without relying on military conquest. Trade does not allow for similar exploitation of territorial economic resources.
I show that the sharp increase in FDI over the recent decades contributed in pacifying proximate countries.
Future research could explore the impact of financial investments across different sectors, considering their strategic importance. Another valuable direction would be to investigate other types of investments beyond FDI, such as portfolio investments or bank loans and deposits, contingent on the availability of data.

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A Appendix

TABLE 9 – Narratives of Representative Military Conflicts

Countries Involved	**Category**	**Short Narrative**
USA and China	Display of Forces	In 1999, the bilateral relations between the United States and China were strained by the U.S. bombing of the Chinese embassy in Belgrade during the NATO air campaign against Yugoslavia. This led to a significant diplomatic crisis, with both nations showcasing military capabilities, including naval deployments in the Taiwan Strait.
China and Japan	Display of Forces	In 2007, China and Japan's relations were tense due to disputes over the East China Sea. China deployed naval vessels and aircraft near the contested Diaoyu/Senkaku Islands, asserting its sovereignty claims and regional influence.
USA and Haiti	Use of Force	The U.S. military intervention in Haiti in 1994 aimed to oust the military regime that deposed President Jean-Bertrand Aristide. Operation Uphold Democracy involved significant deployment of U.S. forces to reinstate Haiti's democratic institutions.
China and Vietnam	Use of Force	In 2010, China and Vietnam engaged in military activities over the South China Sea, including naval skirmishes and live-fire drills near disputed territories. These actions highlighted the ongoing territorial disputes and sovereignty claims in the region.
India and Pakista	Deadly Conflicts	The 1999 Kargil War between India and Pakistan involved direct military engagement in Kashmir, resulting in significant casualties. The conflict was triggered by Pakistani soldiers infiltrating positions on the Indian side of the Line of Control.
Uganda and Rwanda	Deadly Conflicts	In 2000, Ugandan and Rwandan forces clashed in the town of Kisangani, DRC, as part of the Second Congo War. The conflict over resource-rich areas resulted in significant casualties and highlighted the regional instability and rivalry.