From Aid to Autonomy: Decreasing Dependency and Tax Treaty Renegotiation

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Abstract

Many middle and low income countries have tax treaties in place that are highly exploitative and cause them to lose out on tax revenue, often with former colonizers. In recent years, countries have begun to renegotiate tax treaties to resolve harmful clauses and improve their tax outcomes. In this project, I ask: why does tax treaty renegotiation occur, and under what conditions are countries able to do so? I argue that the likelihood of tax treaty renegotiation is contingent on states' dependency on official development aid. When aid dependency decreases, low and middle income states are less vulnerable to high income state's potential backlash through changes to aid. Therefore, low and middle income states will be more likely to renegotiate when aid dependency is low. I test these theoretical expectations using data on bilateral and aggregate foreign aid. To address issues of endogeneity, I also corroborate these results with an instrumental variable analysis using UNSC temporary seats. I find evidence that dependence on foreign aid is an important determinant of the likelihood of bilateral tax treaty renegotiation. However, I do not find evidence for alternative arguments that domestic changes to tax revenue are associated with the timing of renegotiation. These results speak to the literature on bilateral cooperation, the political nature of foreign aid, and the path dependency of colonial institutions.

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In December 2023, Niger and Mali announced that they were revoking their bilateral tax treaty with former colonizer, France. Both countries stated that the cancellation was a response to the "unbalanced character of these agreements" (Okafor 2023) and the asymmetric power of France over taxing rights. The cancellation by Niger and Mali join a host of changes to bilateral tax treaties with France in recent years. Over the last 20 years, the Philippines, Syria, Botswana, Mauritania, and Argentina have renegotiated their tax treaties with France due to similar concerns about the unequal distribution of taxing rights. France is just one example of a broader pattern of renegotiation and cancellation of bilateral tax treaties due to concerns over unfair distribution of taxing rights and preservation of national sovereignty.

Approximately half of the 3000 tax treaties in existence are between a developing country and a developed country (Action Aid 2016), and tax treaties cover 81% of foreign direct investment (FDI) in developing countries (Hearson 2021). Bilateral tax treaties are often discussed as an investment promotion tool for low and middle income countries, but there is limited evidence that FDI significantly increases after the ratification of a tax treaty (Christians 2006). However, with investment promotion as the ostensible goal, these treaties are often rife with inequalities and compromises made by low and middle income countries in the hopes of attracting FDI. Low and middle income countries are therefore limited in the tax revenue that they can collect from multinational companies (MNCs). As one example of the financial losses due to the structure of bilateral tax treaties, The International Monetary Fund (IMF) estimates that non-OECD countries lost around $1.6 billion in 2010 because of the structure of their tax treaties with the United States (Action Aid 2016).

Countries on the African continent have faced particular challenges in retaining their taxing rights, with "each additional tax treaty concluded by an African country ... associated with a 5 percent reduction in its corporate tax revenues" (Hearson 2021, p. 12). At the same time, low and middle income countries operate their social services and government budgets primarily from multinational tax revenues, depending on this revenue source to a much

larger extent than high income countries (Hearson 2021). Therefore, even small changes to tax treaties have large scale effects on the future trajectory of social services in the country.

Given the recent increases and fiscal importance of tax treaty renegotiation, in this paper I ask: why does tax treaty renegotiation occur, and under which conditions are countries willing to do so? I argue that one mechanism that drives the renegotiation of tax treaties is aid dependency. When a high percentage of a country's GNI consists of official development aid, I argue that countries will be less likely to attempt tax treaty renegotiation given the potential risk of retaliation by reducing foreign aid. Alternatively, when states have low dependency on foreign aid, they are able to push back against high-income states' tax treaties without significant fears of retribution by developed countries. Therefore, I argue that renegotiation is more likely when aid dependency decreases.

To test these theoretical expectations, I leverage observational data on the content and renegotiation of bilateral tax treaties from the International Centre for Tax & Development. First, I illustrate that renegotiated treaties are more favorable to low and middle income states (relative to high income states), and therefore have the potential to provoke backlash from developed states in other arenas. Next, I use data on bilateral and aggregate foreign aid dependency to test whether there is a relationship between aid dependency and the likelihood of tax treaty renegotiation. To address issues of endogeneity in these models, I also corroborate the results with a two-stage least squares instrumental variable analysis. I use temporary seats on the United Nations Security Council to instrument for aid dependency. I find that when developing states are more aid dependent, they are less likely to renegotiate their bilateral tax treaties, across all model specifications. Finally, I test an alternate explanation: states potentially renegotiate in response to domestic necessity and changes to their tax revenue. I use data from the OECD Global Revenue Statistics Database to test whether is a relationship between changes in domestic tax revenue and the likelihood to renegotiate. I do not find sufficient evidence that domestic factors are related to the timing of renego-

tiation. In sum, decreased aid dependency is strongly associated with the likelihood of tax treaty renegotiation. However, I do not find evidence that domestic changes are related to renegotiation outcomes.

This project contributes to a strong literature in international cooperation about the formation of bilateral international agreements and their effect on international and domestic outcomes. The majority of this work focuses on bilateral investment treaties (BITs),[1] specifically on their creation and content (Elkins, Guzman, & Simmons 2008; Simmons & Elkins 2004). The literature has also considered the effects of BITs on foreign direct investment (Rose-Ackerman & Tobin 2005; Tobin & Rose-Ackerman 2011; Liu & Ma 2024), the extent to which these agreements constrain domestic leaders (Bodea, Chen, Kerner, & Ye 2024; Simmons 2014), and how BITs affect other international processes (Tobin & Busch 2010). Additionally, BIT termination is associated with decreased FDI flows in the aftermath (Hartmann & Spruk 2023). I extend this work on BITs to another type of bilateral agreement that has received significantly less attention in political science: bilateral tax treaties. Both bilateral investment and tax treaties are susceptible to negative outcomes for low and middle income countries given the serious asymmetries in political and economic power between treaty participants. The literature on bilateral tax treaties thus far has explored their content and the timing of initial signature (Hearson 2021; Barthel & Neumayer 2012; Arel-Bundock 2017). This project builds on this work to examine the other side of the process: the timing and rationale of renegotiation.

This project also contributes to discussions about the extent to which colonial institutions persist and under what conditions institutions change. Low and middle income states' ability to tax in a fair and efficient manner is fundamentally tied to a state's sovereignty and capacity. Understanding the patterns of renegotiation therefore provide insight into the ability of developing states to disassemble vestiges of colonialism and neo-colonialism.

[1] I consider the differences in BIT and BTT renegotiation in Appendix A.2.

Security (Mehrl & Choulis 2021; Eck 2018), political (Ricart-Huguet 2021), and economic institutions (Acemoglu, Johnson, & Robinson 2001; Easterly & Levine 2012; Ricart-Huguet 2022) created by former colonizers are still relevant to the current conditions in many low and middle income countries. This project considers under what conditions countries are able to reform inequitable systems between themselves and former colonizers, moving beyond institutions set up during and immediately after colonization. In particular, I show that low and middle income states are more likely to renegotiate bilateral tax treaties when opportunities for retaliation are low.

In this paper, I first illustrate that tax treaty renegotiation improves taxing rights for low and middle income states and imposes costs on high income states. Next, I describe my theory of tax treaty renegotiation, specifically arguing that there will be a greater likelihood of renegotiation when a country has low levels of aid dependency. Next, I discuss the research design and the use of an instrumental variable – UN Security Council temporary seats – as a robustness check to address issues of endogeneity. Finally, I present the results and discuss the conclusions from these findings.

Theory of Tax Treaty Renegotiation

In this section, I argue that countries are more likely to renegotiate bilateral tax treaties when aid dependency is low. I establish that renegotiations are costly to high income countries and beneficial to the taxing rights of low and middle income countries, given that renegotiated treaties include more UN Model Tax Treaty provisions (as compared to the OECD Model). Given these substantial costs to developed states, I argue that low and middle income countries must be strategic about the timing of renegotiation. Specifically, low and middle income countries will avoid renegotiation when high income countries have an important tool for backlash: high dependence on foreign aid. Instead, developing countries will choose to renegotiate when there are limited opportunities for coercion and backlash,

and thus there will be a greater likelihood of renegotiation when aid dependency decreases. I contrast this explanation with domestic motivations to illustrate the importance of international political economy in this process.

Bilateral tax treaties were originally designed to prevent double taxation, with Model Treaties developed in the OECD and the United Nations to guide bilateral negotiations. The OECD Model Tax Rules are used more frequently in bilateral tax treaties overall, but bilateral treaties between two developing countries are more likely to integrate the UN Model Tax Rules (Hearson 2021). Tax treaties were developed to limit tax competition and allow countries to come to mutually agreeable solutions to double taxation. However, these model treaties were created during a time in which many low and middle income states were still colonized (Hearson 2021). In addition, former colonies largely inherited their tax systems from their former colonizers, with limited ability to set a new agenda on tax policy domestically. When there are highly asymmetric relationships between states, evidence shows that there are limited opportunities for fair bargaining and subsequently results in decreased taxing rights for developing countries (Chisik & Davies 2004).

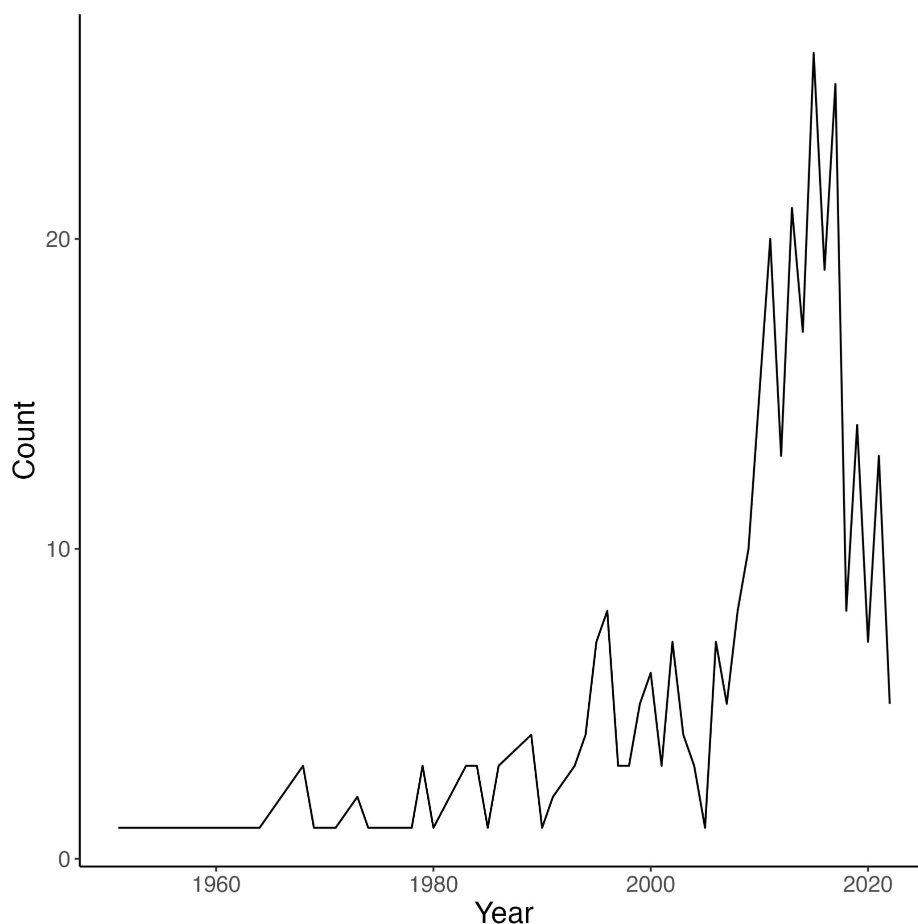
There is an extensive literature that discusses why countries choose to sign tax treaties. Barthel & Neumayer (2012) find that countries are more likely to sign a tax treaty when neighboring states have done so. In addition, the proliferation of tax treaties can also be attributed to treaty shopping, as there is more pressure on countries to sign treaties and adjust their domestic tax policy to align with the preferences of MNCs (Arel-Bundock 2017). Despite the traditional view that the creation of new bilateral tax treaties is driven by the preferences of low and middle income states, Hearson (2021) argues that tax treaties are instead usually initiated by high income countries at the request of and to the benefit of their multinational companies. High income states therefore frame new bilateral tax treaties to low and middle income states as a way to promote inward foreign direct investment – despite the fact that there is limited evidence that FDI increases after the initiation of a

bilateral tax treaty. Therefore, high income states took advantage of low and middle incomes countries' limited institutional knowledge and resources for international tax to extract their preferred outcome for their MNCs (Hearson 2021).

However, there has been limited attention to the timing and effects of the tax treaty renegotiation. There have been rising rates of bilateral tax treaty renegotiation in the last twenty years, as shown in Figure 1. While initial negotiations are predominantly spurred by high income countries, low and middle income countries are often the catalyst of the renegotiation process (Hearson 2021). There is significant variation in the timing of renegotiations across countries, which is largely unexplained. Given these differences in who begins negotiations and renegotiations of bilateral tax treaties, it is necessary to illustrate to whom, and to what extent, bilateral tax treaty renegotiations are costly before theorizing about the timing of renegotiations.

To do so, I compare whether renegotiated tax treaties contain more clauses from the OECD or UN Model Tax Treaties. The OECD model is more beneficial for the taxing rights of developed countries, and the UN Model is more favorable to developing countries. The OECD treaty favors residence countries (where the MNC is headquartered) over source countries (where the MNC operates / invests). In addition to the historical legacies of taxing rights, the OECD treaty continues to be negotiated and agreed on by consensus in an organization that represents a "rich club of countries" and often does not take into account the preferences of low and middle income states. There are two primary issues in the OECD treaty which significantly affect tax revenue in developing countries. First, the bar for being considered a permanent establishment in the OECD model treaty is high. Without permanent establishment (PE) status, companies are able to avoid taxes in low and middle income countries and can manipulate their operations to avoid the substance requirement for PE status. Therefore, residence countries can collect the majority of profits and limit the tax revenue that goes to low and middle income countries, even though there may be significant

Figure 1: Number of Bilateral Tax Treaty Renegotiations



Note: This graphic illustrates the number of bilateral tax treaties that have been renegotiated per year from 1955 to 2022. Data from Tax Treaties Explorer, International Centre for Tax and Development.

operations and sales there. Second, the OECD model tax treaty often allows MNCs to avoid paying capital gains taxes to the host government. OECD tax rules are also particularly complex and administratively costly (R. Christensen, Hearson, & Randriamanalina 2020); therefore, some have argued that these types of rules are ill-suited to developing countries that cannot shoulder the implementation of these complex standards.

Given these inequalities inherent in the OECD model, developing countries have increasingly advocated for international tax discussions in the United Nations context. 45 African countries have led this movement, arguing that developing countries' views were not fully

taken into account at the OECD and the solutions largely benefit rich countries (Agyemang 2023). Interviewees discussed the role of the UN as "deciding now to really compete with the OECD because they think they can better serve the interests of developing countries which are UN members, versus the OECD which doesn't have developing countries as its members" (US Trade Association Lobbyist, 2024). An important difference between the two forums is that the United Nations does not require unanimous consent (R. C. Christensen 2024). This decision-making rule may allow for developing countries to form coalitions in favor of their interests and be successful promoting more controversial policies (R. C. Christensen 2024).

The United Nations Model Tax Treaty offers more taxing rights to low and middle income countries. The model agreement reduces the threshold for permanent establishment, which results in more firms being subject to taxation in low and middle income countries. Firms that operate for six months in the country are subject to taxation, relative to the twelve month standard in the OECD (Lennard 2009). The UN also treats services differently than the provision of goods, arguing that a "brick and mortar" presence is not the right standard for taxation for services. Some industries that are exempted from taxation in source countries under the OECD model – such as insurance, shipping, and air transport – are required to pay taxes with the UN model tax treaty.

When comparing renegotiated treaties with the original, there are significantly improved taxing rights for developing countries and greater inclusion of UN Model Tax Treaty standards. Figure 2 illustrates the changes in source taxing rights between the renegotiated and original treaties. In comparison to the original treaties, renegotiated treaties provide significantly more taxing rights to source countries - the location of inward investment, which are predominately low and middle income countries. Therefore, these renegotiated treaties are beneficial for developing countries and reduce the asymmetries in the taxing rights between developing and developed countries. On the other hand, renegotiated treaties result in serious costs for high income countries that had previously been benefiting from the asymmetric

Figure 2: Source taxing rights of renegotiated treaties

This figure illustrates the differences in taxing rights between original and renegotiated treaties by country pairs. Source taxing rights are measured from 0 to 1, with values closer to 1 representing improved taxing rights for source countries, in other words those countries receiving the inward investment. There is a clear increase in source taxing rights - which are beneficial for the country receiving the investment, often developing countries - when the treaty is renegotiated. Data and figure is from the International Centre for Tax and Development Tax Treaties Explorer dataset.

taxing rights in the original treaties.

Given that renegotiated treaties are beneficial for low and middle income states but costly for high income states, I anticipate that low and middle income states must be strategic about when they attempt to renegotiate treaties. The choice of timing is important given that renegotiation may provoke backlash from high income countries because of the increased costs that they will subsequently have to bear. One way that high income countries may retaliate directly against renegotiating countries is to make changes to foreign aid. Foreign aid is an inherently political tool (Dreher, Nunnenkamp, & Thiele 2011; Vreeland 2011; Alesina & Dollar 2000), with political interests driving decision making more than the prospect

of improving economic growth (Boone 1996). Therefore, if aid recipient countries challenge their donor countries on issues like bilateral tax treaty renegotiation, donor countries have the power to subsequently alter their foreign aid attribution. This relationship is particularly important given that the most asymmetric treaties are often with former colonial powers (Hearson 2021) that also continue to maintain high levels of foreign aid to former colonies (Alesina & Dollar 2000; Maizels & Nissanke 1984).

The use of foreign aid as a form of backlash is particularly effective due to the credible and damaging nature of the threat. First, this threat is credible given that suspending foreign aid has asymmetric benefits. Mertens (2024) argues that senders receive positive economic benefits from suspending foreign aid, as the sending government would otherwise transfer resources to the foreign aid receiver. Therefore, it is more likely that this action will be subsequently carried out by the sender and taken seriously by the receiver. Second, there are direct and serious costs to the receiver when aid is suspended. Increased foreign aid offers more resources to the incumbent government and is generally associated with regime survival as these resources can be used to bolster support (Kono & Montinola 2009; Mertens 2024; Licht 2010). Therefore, the deleterious impacts of foreign aid suspension would make governments weary about pursuing (what may be seen as) adversarial actions that threaten their favorable relationship with donors.

There is evidence of coercion, specifically in regard to aid, during tax treaty negotiations. Hearson (2021) offers three examples of this behavior. First, Spain threatened to withdraw aid funds during treaty negotiations. Second, "British civil servants discussed using aid as leverage to obtain tax treaties" (Hearson 2021, p.64). Finally, in the year after a tax treaty was signed, there was a 22% increase in development assistance (Hearson 2021). These examples illustrate anecdotally that high income countries consider aid as a potential lever by which to influence tax treaties. Withholding aid also seems to be effective at changing low and middle income states' behavior toward tax policy. While low and middle income states

pushed for the UN tax committee to be upgraded in 2015, "with development aid at risk if the conference collapsed, the lower-income countries eventually capitulated" (Hearson 2021, p. 152). In addition, there are high political costs to choosing to renegotiate, given that the existing treaty is already the precedent. Hearson (2021) argues that "when terminating, overriding, or renegotiating an international agreement designed to offer stability to investors, there may be diplomatic and economic repercussions" (p. 25). There is also suggestive evidence that this backlash through foreign aid occurs more broadly. In the year after countries' renegotiate a tax treaty, there is an associated decrease in the official development aid that they receive. Table 1 illustrates this trend.

Table 1: Tax Treaty Renegotiation and Subsequent Aid

	Model 1	Model 2	Model 3	Model 4
Tax Treaty Renegotiation	−5.8829***	−3.9667***	−0.2862*	−5.3155***
	(0.8479)	(0.6986)	(0.1527)	(0.2933)
GDP Per Capita (Logged)		−4.1699***		
		(0.1058)		
Natural resource rents (Logged)		−0.4013***		
		(0.0526)		
Num.Obs.	6082	5354	6068	6082
R2	0.008	0.009	0.197	0.034
FE: Country			✓	
FE: Year				✓

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

This table shows the OLS results of the relationship between tax treaty renegotiation and the amount of official development aid in the following year. The dependent variable is the percentage of aggregate ODA relative to a recipient's GNI in a given year. The independent variable is whether the recipient country negotiated a bilateral tax treaty in that year, using data from ICTD.

Therefore, I argue that low and middle income countries consider these potential costs before beginning the renegotiation process. In particular, low and middle income countries are more likely to renegotiate when the costs are low or to maintain the status quo when the costs are high. Consideration of the costs subsequently affects the timing of renegotiation. As discussed above, I consider retaliation through the provision of foreign aid as a direct cost of renegotiation, especially given qualitative evidence that this tool has been used in past tax

treaty negotiations. Therefore, I expect that countries will be less likely to renegotiate when their dependence on foreign aid is high. Under these conditions, the threat of changes to their foreign aid disbursements could have serious effects on regime survival and the provision of public services. These existential costs are too high to bear during periods of high aid dependency, despite the potential benefits of renegotiation. In contrast, when aid dependency decreases, I expect that there will be a higher likelihood of tax treaty renegotiation. In this case, the costs of backlash are lower and do not affect the fundamental interests of the state as deeply. The benefits of tax treaty renegotiation and the prospect of increased domestic tax revenue therefore outweighs the potential costs of backlash. Therefore, I derive the following hypothesis:

H1: As aid dependency decreases, renegotiation of tax treaties is more likely.

This argument positions international factors as a major feature shaping the timing of tax treaty renegotiations, rather than domestic political factors. However, I consider the alternative that domestic factors are important drivers of renegotiation decisions. It is possible that governments choose to renegotiate tax treaties when they are most in need of capital and resources to support the domestic population. However, I do not expect that there will be a strong relationship between changes in domestic tax revenues and subsequent renegotiation of tax treaties. As Hearson (2021) explains, there is limited public debate about tax treaties as they have low political salience. In addition, organized interest group pressure has not been present in developing countries around the issue of tax treaties (Hearson 2021). Tax treaties are not particularly politically salient, and are often ignored by the general public.

H2: Tax treaty renegotiation is not significantly associated with changes to domestic tax revenue.

Empirical Strategy

To test the theoretical expectations, I use OLS regression to investigate whether there is a relationship between aid dependency and the likelihood of the renegotiation of tax treaties. I consider both aggregate and bilateral aid dependency. As aggregate dependent variables, I consider the dependence of the country on foreign aid through two indicators. First, I measure aid dependence as the ratio between the sum of all official development aid and the country's gross national income. Along with this continuous variable, I construct a binary variable that codes countries as aid dependent if the aid dependence ratio exceeds 10. Bräutigam (2000) uses this threshold to code aid dependence because at this level the core functions of government are dependent on foreign aid funds. For these dependent variables, I leverage data on aggregate aid flows from the World Bank World Development Indicators. I also draw control variables for the recipient states from this dataset, including GDP per capita (logged), natural resource rents (logged), and inward FDI. I include additional controls variables in the aggregate models: bureaucratic quality, corruption, government stability (PRS dataset), and left executive (Database of Political Institutions). All control variables are lagged in the main analyses. For the timing of tax treaty renegotiation, I use data from the International Centre for Tax and Development. This dataset includes 3000 bilateral tax treaties from 1960 to present – those that are in force as well as those that have been renegotiated and canceled.

Next, I consider the bilateral relationship between countries. When countries decide whether or not to renegotiate, they must consider their unique relationship with a specific donor and the extent to which changes in aid from that donor would be detrimental to their development. Therefore, I corroborate the aggregate results by re-estimating the models using bilateral foreign aid data from AidData (Tierney et al. 2011). I consider how changes in aid dependency to a particular donor affect the recipient's likelihood to renegotiate their

tax treaty with that specific donor. The bilateral results therefore draw out the trade-offs of renegotiation more clearly and I expect that the results will be more robust than when considering aggregate foreign aid.

I use the OLS models to establish whether this relationship exists between aid dependency and tax treaty renegotiation in both bilateral and aggregate foreign aid. However, these models are potentially plagued by endogeneity as it is possible that the treatment variable (dependency on foreign aid) is correlated with confounders. Many difficult to measure variables may affect both the level of aid dependency and ability to renegotiate tax treaties. For example, both variables are likely associated with the country's overall level of development. Less developed countries may need more aid, while at the same time having fewer resources and more structural constraints that prevent the successful renegotiation of tax treaties (Hearson 2021). Therefore, I corroborate these baseline models with an instrumental variable analysis.

I use the following variable to instrument for aggregate aid dependency: temporary seats on the United Nations Security Council. UNSC temporary seats are associated with the treatment variable of interest: aid dependency. Temporary seats on the UNSC are a strong proxy for aid dependency (Vreeland & Dreher 2014), given that when countries rotate into a UNSC seats, there is a large increase in the foreign aid that they receive (Kuziemko & Werker 2006). As an example, rotating onto the UNSC is associated with a 59% increase in total aid from the United States and an 8% increase in UN aid (Kuziemko & Werker 2006). Other countries – such as Japan, Germany, the UK, and France – also increase foreign aid provision to countries with a UNSC seat (Vreeland & Dreher 2014). In addition, multilateral funding agencies like the IMF and World Bank, whose projects are largely decided on by the aforementioned states, provide more assistance to countries with a UNSC seat. There is a sharp increase of aid upon rotation onto the UNSC and the levels of aid stay high until their term is completed, at which time foreign aid payments return to their pre-UNSC levels

(Kuziemko & Werker 2006). Therefore, UNSC seat rotation appears to be well-suited to instrument for aggregate foreign aid flows in a given country-year.

The ten non-permanent Council member seats are plausibly exogenous from the process of tax treaty renegotiation. While the process of UNSC temporary membership should not be considered random (Dreher, Gould, Rablen, & Vreeland 2013), the process is theoretically and empirically disconnected from tax treaty renegotiation. First, despite the differences in rules across regions for UNSC nomination and election, there is widespread evidence of a turn taking norm: when countries have not been on the UNSC recently, they are more likely to be endorsed by their region (Dreher et al. 2013). In addition, tax treaty renegotiations operate on the bilateral level and discuss economic issues that are completely outside the purview of the UNSC. Therefore, I do not expect there to be any independent relationship between UNSC temporary membership and a subsequent decrease in tax treaty renegotiations. If there is a relationship, I would theoretically expect it to work in the opposite direction. In other words, while on the UNSC, it is possible that because low and middle income countries occupy an important geo-strategic role during this period, they have enhanced power and leverage more generally. In this case, we would expect that countries with a UNSC seat would be more likely to renegotiate their tax treaties during their tenure given their increased power and geo-strategic value. I find this link to be unlikely, but if the exclusion restriction does not hold, we would plausibly expect to find the opposite results to the predicted hypotheses. Empirically, the instrumental variable is not well predicted by the potential endogenous covariates that I am concerned about in the main analysis. Namely, election to UNSC is not driven by development indicators (Bueno De Mesquita & Smith 2010).

Quasi-randomization of the UNSC temporary seat instrumental variable is more plausible amongst African states. Amongst African states, there is a well established norm of seat rotation across regions. To expand, Carnegie & Mikulaschek (2020) state: "under a formula devised in the 1960s and observed without exception since the 1970s, a Central or North

African state must rotate into one of these seats once every two years, and the second seat must alternate every two years between an Eastern and Southern African state; the third seat is always held by a Western African state." These rules of seat rotation result in a quasi-randomization of whether a country has a UNSC seat. I therefore also run the instrumental variable analysis in the subset of African countries. This process is not completely random, given countries' occasional choices to bypass the line (Vreeland & Dreher 2014). With these concerns in mind, I follow previous authors in including country and year fixed effects to address potential confounders (Vreeland & Dreher 2014).

I therefore estimate the following model:

$$DV_{it} = \beta_0 + \beta_1 * aiddependency_{i(t-1)} + \sum_{k \in K} \beta_k I(i = k) + u_{it}$$

The dependent variable (DV_{it}) is whether there was a tax treaty renegotiation in that country i during that year t. Aid dependency is the percentage of foreign aid that makes up a country's GNI in country i at time $t-1$. Given that the aid dependency variable is reasonably confounded with other factors that could predict the renegotiation of tax treaties, it is not possible to estimate an unbiased estimate for the coefficient of interest (B_1). Therefore, I estimate a two stage least squares (2SLS) instrumental variables model to find an unbiased estimate of the relationship. Below, is the equation that generates predicted values from the first-stage regression, thereby removing the endogeneity from aid dependency.

$$aiddependency_{i(t-1)} = \lambda_0 + \lambda_1 IV_{i(t-1)} + \sum_{k \in K} \lambda_k I(i = k) + e_{it}$$

Using these models, it is possible to consistently estimate β_1 by regressing the tax treaty renegotiation variable (DV_{it}) on the predicted values of aid dependency, along with fixed effects. To conduct this analysis, I draw on aid dependency data from the World Bank World Development Indicators. Next, I use Hearson (2021)'s data on the timing of bilateral

tax treaty renegotiations. Finally, I draw on Vreeland & Dreher (2014)'s coding of UNSC temporary seats for the instrumental variable.

I also conduct a placebo test, focusing on dependence on FDI as the independent variable instead of foreign aid. I do not expect that dependence on FDI should strongly predict the likelihood of renegotiation, given that developed countries do not have as much independent control over FDI relative to the fungible nature of foreign aid. If anything, we might expect FDI to have the opposite effect: when there are high rates of inward FDI, the country might choose to renegotiate their tax treaty in the interest of increasing their taxing rights. Therefore, there should not be any significant relationship between changes to FDI and the likelihood of bilateral tax treaty renegotiation.

Finally, I evaluate the alternate hypothesis: tax treaty renegotiations are instead motivated by changes in domestic tax revenue. If there is a decrease in domestic tax revenue, countries may choose to renegotiate their bilateral tax treaties to increase their domestic coffers with funds from multinational companies. I use OLS regression to test whether there is a relationship between changes in domestic tax revenue and the likelihood of bilateral tax treaty renegotiation. I use data on domestic tax revenue from the OECD Global Revenue Statistics Database. I compute an indicator that measures the change in tax revenue by year. Then, I lag this indicator of revenue change and use OLS regression with fixed effects to measure whether there is increased renegotiation of tax treaties in the year after depressed tax revenues.

Results

First, I test the effect of aggregate aid dependency on the likelihood of renegotiating bilateral tax treaties using OLS regression. The full results are in line with my expectations, and are shown in Table 2. As aid dependency increases, there is a decreased likelihood of

Table 2: Aggregate ODA and Renegotiation of Bilateral Tax Treaties

	(1)	(2)	(3)	(4)
Aggregate ODA / GNI	−0.0020***	−0.0020***	−0.0020*	−0.0039**
	(3×10^{-4})	(0.0004)	(1.013×10^{-4})	(0.0018)
GDP Per Capita (Logged)		−0.0098***		−0.0704***
		(0.0037)		(0.0232)
Natural Resources (Logged)		−0.0018		−0.0054
		(0.0016)		(0.0035)
Inward FDI		0.0000***		0.0000***
		(0.0000)		(0.0000)
Bureaucratic Quality				0.0750***
				(0.0234)
Corruption				0.0210
				(0.0127)
Government Stability				−0.0128
				(0.0091)
Left Executive				−0.0096
				(0.0309)
Num.Obs.	6068	5308	6068	939
R2	0.006	0.143	0.178	0.252
FE: Country			✓	
FE: Year				✓

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

This table shows the OLS results of testing Hypothesis 1 with aggregate ODA data from the OECD. The independent variable is the percentage of aggregate ODA relative to a recipient's GNI in a given year. The dependent variable is whether the recipient country negotiated a bilateral tax treaty in that year, using data from ICTD.

renegotiating a bilateral tax treaty in that year. These results are robust to inclusion of country and year fixed effects, as well as a series of control variables. I find substantively similar results when using the alternate binary measure for aid dependency (see Appendix A.1).

Next, I test the hypothesis using OLS regression with bilateral official development aid data. Table 3 illustrates the results. When a recipient country is more reliant on a donor for official development aid, there is a decreased likelihood that the recipient will renegotiate the tax treaty with the donor. The coefficient in the bilateral results is almost ten times that of the aggregate coefficient results, indicating that the effects are much stronger when

Table 3: Bilateral ODA and Renegotiation of Bilateral Tax Treaties

	Model 1	Model 2	Model 3	Model 4	Model 5
Bilateral ODA / GNI	−0.014**	−0.015**	−0.013**	−0.012*	−0.012*
	(0.006)	(0.006)	(0.006)	(0.006)	(0.006)
GDP Per Capita (Logged)		−0.026	−0.021	−0.004	−0.011
		(0.031)	(0.037)	(0.039)	(0.040)
Inward FDI				0.000	0.000
				(0.000)	(0.000)
Natural resource rents (Logged)					−0.008*
					(0.004)
Num.Obs.	3737	3737	3737	3737	3737
R2	0.052	0.052	0.052	0.053	0.054
FE: Donor Country	✓	✓	✓	✓	✓
FE: Recipient Country	✓	✓	✓	✓	✓
FE: Year	✓	✓	✓	✓	✓

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

This table shows the results of testing Hypothesis 1 with bilateral ODA data from AidData. The dependent variable is the percentage of bilateral ODA relative to the recipient's GNI in a given year. The independent variable is whether the recipient country negotiated the bilateral tax treaty with that specific donor in that year, using data from ICTD Tax Treaties Explorer. All models include donor, recipient, and year fixed effects.

examining this relationship bilaterally. These differences in magnitude align with the theory: recipients of aid are making strategic decisions based on the potential for backlash from donor states.

In both aggregate and bilateral aid dependency models, there is a negative relationship between aid dependency and the likelihood of bilateral tax treaty renegotiation. However, as discussed above, there is the potential of endogeneity in the OLS models given the unobserved factors that could be driving changes in aid dependency and bilateral tax treaty renegotiation. Therefore, I also test this relationship using an instrumental variable. The results from the instrumental variables model align with theoretical expectations, as shown in Table 4. Using UNSC temporary seats to instrument for aid dependency, there is a negative relationship between aid dependency and the likelihood of treaty renegotiation at the 0.01 level. In other words, as aid dependency increases in the year after rotating into a UNSC

Table 4: Instrumental Variables Analysis (All)

	First Stage	Model 1	Model 2	Model 3	Model 4
Aid Dependency		−0.393**	−0.810**	−0.269*	−0.210*
		(0.180)	(0.412)	(0.160)	(0.125)
UNSC Temporary Seat	0.029				
	(0.020)				
GDP Per Capita (Logged)				−0.065	−0.120**
				(0.055)	(0.055)
Inward FDI				0.000	0.000
				(0.000)	(0.000)
Bureaucratic Quality				0.008	0.029*
				(0.007)	(0.015)
Num.Obs.	4063	4063	4063	1182	1182
FE: Country	✓		✓		✓
FE: Year	✓		✓	✓	✓

* p < 0.1, ** p < 0.05, *** p < 0.01

This table presents the results of the two stage least squares instrumental variables analysis. The instrumental variable is whether the country had a UNSC seat during that year. This variable instruments for the country's dependence on official development aid. The dependent variable is whether the country renegotiated a bilateral tax treaty in this year. I include control variables for GDP per capita and inward FDI. The sample includes all states that received aid from 1974 to 2009.

seat, it is less likely that a bilateral tax treaty will be renegotiated.

In addition, the empirical results illustrate that the data is well suited for instrumental variable analysis. First, the null hypothesis that the instrument is weak is rejected at the 0.001 level. The F statistic is approximately 55, which is a sufficiently strong instrument. Second, the Wu-Hausman test describes whether the instrumental variable analysis and OLS are equally consistent – if they were to be equally consistent, it would be best to use OLS as this analysis is less biased on the whole. The hypothesis that the instrumental variable analysis and OLS are equally consistent is rejected at the 0.01 p value. Therefore, empirically, the choice of instrumental variable analysis is supported. The instrumental variables model therefore provides further confidence in the results, given that the theoretical expectations hold when using as-if random IV. I present results for a placebo test in Appendix 9 to further bolster the validity of these findings.

Table 5: Instrumental Variables Analysis (African States)

	First Stage	Model 1	Model 2	Model 3	Model 4
Aid Dependency		−0.116*	−0.186**	−0.040*	−0.042*
		(0.067)	(0.092)	(0.023)	(0.026)
UNSC Temporary Seat	0.022				
	(0.026)				
GDP Per Capita (Logged)				−0.024	−0.046
				(0.031)	(0.039)
Inward FDI				0.000*	0.000**
				(0.000)	(0.000)
Bureaucratic Quality				0.003	0.004
				(0.005)	(0.008)
Num.Obs.	1497	1497	1497	553	553
FE: Country	✓		✓		✓
FE: Year	✓		✓	✓	✓

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

This table presents the results of the two stage least squares instrumental variables analysis. The instrumental variable is whether the country had a UNSC seat during that year. This variable instruments for the country's dependence on official development aid. The dependent variable is whether the country renegotiated a bilateral tax treaty in this year. I include control variables for GDP per capita and inward FDI. The sample includes all African states that received aid from 1974 to 2009.

Next, I subset to African states for the instrumental variable analysis as the rotation rules provide the most plausible quasi-random assignment of UNSC temporary seats. Table 5 shows the results. In this sample, as above, increased aid dependency is associated with a decreased likelihood of renegotiation of bilateral tax treaties.

Finally, I evaluate whether changes to domestic tax revenue are related to the likelihood of tax treaty renegotiation. Across all model specifications, I fail to reject the null hypothesis. There is no statistically significant relationship between changes to domestic tax revenue and the likelihood of tax treaty renegotiation, and the coefficients are small and close to zero. These results demonstrate that I do not find sufficient evidence for the domestic explanation, and that changes in the international political economy seem to be the stronger motivation for renegotiation of a bilateral tax treaty.

Table 6: Domestic Tax Revenue and Likelihood of Renegotiation

	Model 1	Model 2	Model 3	Model 4
Change in Tax Revenue (Lagged)	0.000	0.000	0.000	0.000
	(0.000)	(0.000)	(0.000)	(0.000)
Num.Obs.	5722	5722	5722	5722
R2	0.000	0.018	0.071	0.089
FE: Year		✓		✓
FE: Country			✓	✓

+ $p < 0.1$, * $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$

This table shows the results of testing Hypothesis 3. The dependent variable is the whether there was a bilateral tax treaty renegotiation, coded as 1 if so and 0 otherwise. The dependent variable measures the change in tax revenue from one year to the next, with a one year lag. In other words, the model shows the likelihood of tax treaty renegotiation depending on the change in tax revenue in the previous year. I also include year and country fixed effects in Models 2, 3, and 4.

Conclusion

In conclusion, I find that increased aid dependency is associated with a decreased likelihood of renegotiating bilateral tax treaties. When countries are heavily aid dependent, they are less likely to pursue renegotiation because of the serious costs associated with potential donor backlash. In contrast, when aid dependency decreases, the costs of renegotiation subsequently decrease and allow for a greater likelihood of tax treaty renegotiation. These results hold when considering OLS models of aggregate and bilateral aid dependency as well as with a two-stage least squares instrumental variable approach. I do not find sufficient evidence that renegotiation of tax treaties is instead driven predominantly by domestic factors such as changes to domestic tax revenue. Therefore, changes in the international political economy seem particularly pertinent to decisions about altering the conditions of bilateral treaties and international cooperation.

These results illustrate an additional avenue through which official development aid can be politically motivated. As discussed earlier, developed countries are able to use aid as a political tool in many contexts - including in the decision to provide more aid or to target

aid to a specific country due to political considerations. This project outlines another path by which developed countries can use foreign aid as a political tool: maintaining high levels of aid dependency with developing countries can sustain asymmetric and systematically unequal treaty relationships. This project therefore contributes to literature on foreign aid as a form of neo-colonialism and illustrates an additional pathway by which foreign aid can disadvantage developing countries in pursuing improved economic development. At the same time, the project illustrates that developing countries have opportunities to change these structures as they decrease their dependency on foreign aid and reduce opportunities for donor countries to retaliate.

This project also encourages a broader discussion of bilateral tax treaties in the international political economy literature, in concert with the strong knowledge that has been generated on bilateral investment treaties. Changes to the effective tax rates of multinational companies have important implications for citizens' public services and the evolution of firm power in the international system. The amount of tax revenue from MNCs is particularly important in the developing world, in which domestic coffers are overwhelmingly dependent on corporate taxation (relative to individual taxation). Therefore, it is important to understand when developing countries are able to enhance their taxing rights of MNCs and subsequently increase funds available to them for public services. Additionally, the presence and makeup of bilateral tax treaties have important implications on the attraction of foreign direct investment. Future research should continue to investigate the creation and subsequent changes to bilateral tax treaties and their effect on the international political economy.

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A Appendix

A.1 Aggregate ODA

In Table 7, I use an alternate measure for aid dependency - a binary variable that is coded as 1 if the ratio between the sum of all official development aid and the country's gross national income is greater than or equal to 10. The results are robust to the use of this alternate independent variable.

Table 7: Aid Dependency and Renegotiation of Bilateral Tax Treaties

	Model 1	Model 2	Model 3	Model 4
Aid Dependency	−0.042***	−0.034***	−0.004	−0.082***
	(0.008)	(0.009)	(0.004)	(0.026)
GDP Per Capita (Logged)		−0.008**		−0.073***
		(0.004)		(0.023)
Natural Resources (Lagged)		−0.002		−0.005
		(0.002)		(0.004)
Inward FDI		0.000***		0.000***
		(0.000)		(0.000)
Bureaucratic Quality				0.078***
				(0.024)
Corruption				0.023*
				(0.013)
Government Stability				−0.012
				(0.009)
Left Executive				−0.013
				(0.031)
Num.Obs.	6068	5308	6068	939
R2	0.005	0.143	0.178	0.253
FE: Recipient Country			✓	
FE: Year				✓

* p < 0.1, ** p < 0.05, *** p < 0.01

This table shows the results of testing Hypothesis 1 with a binary aid dependency measure from the OECD. The independent variable is a binary measure of aid dependency – if more than 10% of a country's GNI comes from aid, the country is coded as aid dependent with a value of 1, 0 otherwise. The dependent variable is whether the recipient country negotiated a bilateral tax treaty in that year, using data from ICTD.

A.2 Differences from BIT Renegotiation / Termination

I consider whether the renegotiation of other bilateral treaties - namely, bilateral investment treaties – is associated with the timing of bilateral tax treaty renegotiation. There is not a statistically significant relationship between the renegotiation or termination of a bilateral investment treaty and subsequent renegotiation of bilateral tax treaties. Therefore, these processes seem to work through different mechanisms. Namely, BIT renegotiation / termination is well predicted by ISDS cases and subsequent backlash to the use of this tool beyond the traditional cases of direct expropriations (Huikuri 2023).

Table 8: Relationship between BIT and BTT Renegotiation

	Model 1	Model 2	Model 3	Model 4
BIT Renegotiation / Termination	−0.039	−0.043	−0.014	−0.019
	(0.072)	(0.072)	(0.011)	(0.018)
GDP Per Capita (Logged)		−0.011***		0.266
		(0.003)		(0.198)
Natural Resources (Lagged)		0.001		−0.025
		(0.002)		(0.016)
Inward FDI		0.000***		0.000
		(0.000)		(0.000)
Bureaucratic Quality				−0.024
				(0.021)
Corruption				0.011
				(0.011)
Government Stability				−0.007
				(0.006)
Left Executive				0.012
				(0.018)
Num.Obs.	5958	5265	5958	1503
R2	0.000	0.023	0.247	0.442
FE: ccode			✓	✓
FE: Year			✓	✓

* p < 0.1, ** p < 0.05, *** p < 0.01

Ideally, I would also consider how dispute settlement affects the renegotiation of bilateral tax treaties, given the strength of this explanatory variable in the case of BITs. Bilateral

tax treaties often include provisions for Mutual Agreement Procedures (MAP), the primary dispute settlement mechanism. The OECD has data on the number of MAPs initiated in a country in a given year from 2018-2023. However, the available data on MAP proceedings from the OECD shares the number of MAP proceedings at the home country level, rather than offering additional information about the target of the MAP proceeding. This data is therefore limited both in the number of years available (2018-2023) and the non-dyadic nature of the data. There is no overlap between AidData's bilateral aid data (1947-2013) and the MAP data. Therefore, I am not able to consider whether there is a strong relationship between these variables. However, these processes are less controversial in general than ISDS cases. First, MAP proceedings are conducted between states and through diplomatic means to resolve any potential double taxation. Therefore, there are fewer issues of wealthy private investors overpowering the resources of low and middle income states. In addition, the scope is more limited given that MAP handles specifically double taxation issues in which a company was potentially taxed in both its home and host jurisdiction.

A.3 FDI Placebo Test

I also present the results of the placebo test in Table 9. I substitute the independent variable as foreign direct investment (FDI). As discussed previously, I do not anticipate that countries will be able to manipulate FDI as easily in response to bilateral tax treaty renegotiation. As expected, I do not find evidence that aggregate FDI has a statistically significant relationship with the likelihood of tax treaty renegotiation. The coefficient is small and substantively equivalent to zero.

Table 9: Effect of FDI on Likelihood of Renegotiation

	Model 1	Model 2	Model 3	Model 4
Inward FDI	0.000***	0.000***	0.000	0.000***
	(0.000)	(0.000)	(0.000)	(0.000)
GDP Per Capita (Logged)		−0.008***		−0.055***
		(0.002)		(0.017)
Natural Resources (Lagged)		0.001		0.000
		(0.001)		(0.002)
Bureaucratic Quality				0.062***
				(0.020)
Corruption				−0.022***
				(0.006)
Government Stability				0.006
				(0.006)
Left Executive				0.011
				(0.018)
Num.Obs.	8789	7429	8789	1504
R2	0.012	0.017	0.167	0.069
FE: Country			✓	
FE: Year				✓

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$