Economic Analysis and Policy 47 (2015) 1–10

Contents lists available at ScienceDirect

Economic Analysis and Policy

journal homepage: www.elsevier.com/locate/eap

Full length article

Did pre-WTO agreements curb corruption?

Deepraj Mukherjee *

Department of Economics, Kent State University, OH, USA

ARTICLE INFO

Article history:
Received 25 November 2014
Received in revised form 26 June 2015
Accepted 26 June 2015
Available online 29 June 2015

JEL classification:
D73
F13
C23

Keywords:
Corruption
International trade
Preferential trade agreement
Panel data

ABSTRACT

Using country-level panel data, this study tests whether a country's decision to join a preferential trade agreement (PTA) or existing participation in one affects its corruption levels. The sample for this study pertains mostly to first-generation PTAs that arose prior to the World Trade Organization (WTO). The results suggest that member nations that entered into pre-WTO PTAs exhibited higher levels of corruption. This claim is general and is not indicative of the undesirability of trade agreements. Nevertheless, the findings reveal interesting factors related to trade agreements in the pre-WTO period.

1. Introduction

The past two decades have witnessed remarkable globalization, marked by substantial growth in international trade and enhanced diffusion of new products, services, and technologies. A key conduit of such global economic integration is preferential trade agreements (PTAs), which lower trade barriers among member countries by reducing the tariffs associated with certain products. As PTAs have proliferated, intra-PTA trade as a share of world trade has increased to an estimated 35% in 2008, compared with a meager 18% in 1990 (World Trade Report, 2011). Nor does this proliferation show any signs of slowing. World Trade Organization (WTO) members are parties to 13 PTAs each, on average, and PTA activity has transcended both regional boundaries and levels of economic development, such that many PTAs encompass developing countries. On average, African nations belong to four different agreements, and Latin American countries belong to seven (Cardamone and Scoppola, 2012).

In addition to these quantitative averages, anecdotal evidence affirms the importance of PTAs. For example, the Economic Community of West African States (ECOWAS), set up in 1979 (pre-WTO), aimed to create a free-market space among member countries, eliminate redundant immigration procedures, harmonize customs duties, and unify monetary zones. The free movement of persons and goods also has been a long-standing objective of ECOWAS (1979), though this primary objective remains elusive. The West African region continues to be one of the most challenging places in the world for establishing economic and individual freedom (Economic Freedom of the World 2014 Annual Report, 2014). Despite 5.5% gross domestic product (GDP) growth on average in 2014, West African countries continue to rank among the poorest in the world. Economic transparency is virtually nonexistent; trade is paralyzed by high tariffs, bureaucracies, and stiff regulatory barriers. Among ECOWAS countries, intra-regional trade constitutes accounts for only 9.3% of total exports. The Mano River Union (2013),

* Tel.: +1 330 244 3567; fax: +1 330 494 0744.
E-mail address: dmukherj@kent.edu.

http://dx.doi.org/10.1016/j.eap.2015.06.001
0313-5926/

established in 1973, includes Liberia, Sierra Leone, Guinea, and Ivory Coast as member countries. After 42 years, its initial goal to establish an economic union remains elusive; the power struggle for mineral-rich soil still sparks conflicts among the member nations. The Inter-Governmental Authority on Development (IGAD) was established among Djibouti, Ethiopia, Somalia, Eritrea, Sudan, South Sudan, Kenya, and Uganda. Regional instability continues to hamper growth and prosperity in the area though. All three of these pre-WTO agreements indicate serious issues and raise pertinent questions about how PTAs might affect the institutional mechanisms of their member countries.

Using comprehensive, cross-country panel data, this study investigates in particular whether pre-WTO agreements help to reduce corruption. The results, contrary to what might be expected, show that entering into or participating in a PTA agreement boosts the level of corruption shown by members. Rather than improving their institutional quality, countries seemingly use these agreements to pursue private interests (lobbying and bribery). The current analysis involves an extensive panel of 140 countries, and it does not differentiate the other members of the trade agreement. Thus, these results should not be taken to indicate that all PTAs increase corruption; instead, they indicate that not all PTAs enhance development. This conclusion may reflect the makeup of many pre-WTO PTAs, which include developing countries where the agreements had no binding constraints to reduce corruption specifically. If such pacts included developed countries or countries with already low corruption levels, the member countries might have an incentive to reduce their corruption, possibly due to a binding constraint set by the developed or less corrupt country. Instead, the dominance of PTAs among nations with relatively high corruption levels in the study sample resulted in higher corruption once the countries entered into agreements. Following a review of studies of national corruption, this article therefore elucidates a central hypothesis, and then explains the data and methodology adopted. The final two sections illustrate the empirical findings and key conclusions.

2. Literature review

Corruption is among the greatest obstacles to the socio-economic development of a country. High levels of corruption disrupt poverty reduction efforts, distort the rule of law, and weaken countries' institutional foundations. In 2008, the World Bank allocated 18.8% of its total lending budget to improving public sector governance in various countries. Yet its own indicators reveal that corruption still prevails as the most compelling factor plaguing developmental initiatives in developing and poor nations.

Because corruption reduces economic growth (Mauro, 1995), distorts government expenditures (Mauro, 1998), retards foreign investment (Wei, 2000), and reduces the effectiveness of foreign aid (Princeton Survey Research Associates, 2003), the need to combat corruption has increased with growing globalization. In a global economy, corruption is transnational in nature, demanding new and strengthened international responses. Seldadyo and Haas (2006) find that welfare levels are important determinants of corruption levels, as are the quality of the government, military, and institutions (e.g., political freedom, judiciary, and information).

Both theoretical research and anecdotal evidence suggest that a set of determinants influences corruption levels. For example, substantial research notes that the degree of trade openness, income and income distribution, and size of the public sector are key economic factors that affect national corruption levels. Krueger (1974) shows that quantitative trade restrictions shift resources from directly productive activities to unproductive, rent-seeking ones. Bhagwati and Srinivasan (1980) expand this analysis to consider revenue seeking, where economic agents try to obtain revenues obtained from protectionist tariffs. In a literature review, Bhagwati (1982) summarizes the effects of trade restrictions on such unproductive, profit-seeking activities.

Despite the proliferation of conceptual research, only a handful of studies examine the impact of trade openness on corruption. Ades and Di Tella (1997) find that industrial policies favoring certain industries increase corruption, and Gurgur and Shah (2005), Brunetti and Weder (2003), and Knack and Azfar (2003) affirm this finding, establishing the negative relationship between trade openness and corruption. Among socio-demographic factors, schooling and population are closely associated with corruption. Economies with high human capital (proxied by years of schooling) exhibit lower levels of corruption (Brunetti and Weder, 2003; Van Rijckeghem and Weder, 1997), though using panel data models with fixed effects, Frechette (2001) finds that schooling aggravates corruption levels. Conflicting evidence also emerges regarding a country's population: Knack and Azfar (2003) show that corruption increases as population rises, whereas Tavares (2003) reports that population negatively affects corruption.

A general consensus instead affirms that democracy reduces corruption, because it makes political parties more accountable to the electorate and enables the press to operate more freely (Brunetti and Weder, 2003; Kunicova and Rose-Ackerman, 2005). However, some aspects of democratic elections may create opportunities for corruption (Kunicova and Rose-Ackerman, 2005; Persson and Tabellini, 2003). Political instability is widely believed to increase corruption (Leite and Weidmann, 1999; Park, 2003). Furthermore, both bureaucracy and the regulatory framework can serve key functions in controlling corruption (Becker, 1968). The role of the legal system and the rule of law feature prominently in many studies of governance quality and its consequences for development (Easterly and Levine, 1997; North, 1990). Strong legal foundations and efficient legal systems with well-specified entry deterrents protect property rights and provide a stable framework for economic activity. But legal systems also differ in the degree to which they protect property rights and the quality of government they provide. Extant empirical literature suggests that a common law system, mostly found in the former colonies of Britain, offers better protection of property rights than the civil law system typically associated with the former colonies of continental Europe (La Porta et al., 1998).