

Review on MS 585: "Does corruption facilitate trade for the new EU members?"

General comment:

From my point of view, the contribution of the paper is potentially significant and hence generally worth to be published. The paper is well-organized and the flow of arguments is comprehensible. The used methods and techniques of analysis are appropriate.

The layout of the research hypothesis and its relation to economic theory as well as the correspondence between the question raised and the methods used are among the strong points of the paper. Besides from a sometimes poor syntax, the placement of the contribution within the existent literature on the topic is a potential weakness and the authors should emphasize more clearly the economic relevance of their results.

Specific Comments

Having that said, the authors should address the following issues with regards to content in my point of view (optional suggestions in *italic*):

- Descriptive Statistics, including the data sources, should be included
- Since many abbreviations are used, a list of them should be included
- It would be interesting to compare the results to ones obtained by fixed effects and between effects estimation. Corruption varies over time, so fixed effects can be used. Although the standard error may be large in relation to the estimated coefficient, it would be interesting to see (at least in the appendix and discussed in a footnote) if the estimated parameter is comparable to the one obtained from pooled OLS / random effects regression.
- The authors should discuss the papers - "Corruption and Trade Protection: Evidence from Panel Data" by Bandyopadhyay and Roy (Working Paper) - "The Silver Lining of Red Tape" by Ron B. Davies (Working Paper) - Bardhan, P. (2006). "The Economist's Approach to the Problem of Corruption", World Development, 34 (2), 341-348 - Dutt, P and Traca, D (2010) "Corruption and Bilateral Trade Flows: Extortion or Evasion?", Review of Economics and Statistics, 92(4): 843-860 - Fisman, R. and Wei, S. (2004). "Tax Rates and Tax Evasion: Evidence from "Missing Imports" in China". Journal of Political Economy, 112(2), 471-496 - Mishra, P., Subramaniam, A., and Topolova, P. (2008) "Policies, Enforcement, and Customs Evasion: Evidence from India," Journal of Public Economics, 92, 1907-1925
- The authors should make especially clear in how far their work is distinguished and/or adds to the results of Dutt and Traca (2010).
- The specific (historic) context of transition economies could be emphasized more strongly in sections I and II, especially to distinguish the contribution from previous research in the field listed above. More specifically, it is questionable if the corruption index is really capturing corruption or if it also picks up certain other processes of omitted variables, such as increased market-orientation. The authors should therefore also control for something like "overall (economic) freedom" or – at least – openness of the capital account (Ito/Chinn index).
- *The authors argue (on p. 6) that "it may be the difference between the level of corruption in the two economies that discourages bilateral trade". Unfortunately, this interesting question is not addressed in the empirical section. The authors might consult Blonigen/Davies/Head (2003 AER) how to use differences in education to estimate FDI determinants, in order to apply a similar approach to their data set and research question. Otherwise, this statement should be canceled.*

- The authors should discuss in much more detail the measures of corruption (on p. 7), their pros and cons, and especially the measure they use since the whole analysis is based on this measure.
- *In table 1 it would be nice to have averages over the countries in the last line.*
- It is not straightforward to me why the authors use GDP p.c. instead of overall population as a RHS variable for country size.
- The Hausman-Taylor estimator should be explained in more detail (p. 13).
- It should be explained what it means economically that the Hausman-Taylor estimates are lower than the other estimates (p. 15).
- *On p. 15 the authors state that ... “the influence of corruption level of the exporter is more important than that of the importer”. However, it is not clear if this difference is merely random or statistically significant. A Wald-test can be used. Otherwise, wording should be more conservative.*
- To which patterns are the standard errors robust (heteroskedasticity, autocorrelation, spatial correlation??).
- *A dummy for landlocked countries should potentially go into the regression equation.*
- The authors should spend much more effort on explaining the economic relevance of the effect of corruption! How much does a one-standard-error change in corruption influence trade flows? How large is that compared with a one-standard-error change in another variable? Is the size of the impact reliable? What would happen to trade flows if, say, Poland got its corruption down to the level of, say, France? Statistical significance is nice. Unfortunately it does not tell us anything whether the effect is economically relevant.
- *A further suggestion would be to disaggregate trade flows by sector (using, e.g., UN Comtrade) and see if, for example, R&D-intensive sectors are affected more intensively than lower-tech sectors.*