

CORRUPTION AND INTERNATIONAL TRADE

Africa Under Focus

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Jacob Wanjala Musila, PhD
Simon Pierre Sigué, PhD

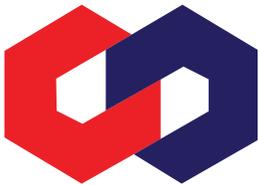


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ABOUT THE AUTHORS



DR. SIMON SIGUÉ is a Professor of Marketing at Athabasca University, Canada. He is the Chair of the Marketing, Entrepreneurship and Information Systems Academic Department. In addition to his position at Athabasca, Dr. Sigué is a Professor Extraordinaire at Tshwane

University of Technology, South Africa, an honorary professor at the Universidad de Los Andes (AACSB & EQUIS accredited), Colombia, and an adjunct professor at Kwame Nkrumah University of Science and Technology, Ghana. Previously, Dr. Sigué taught at ESSEC of Douala in Cameroon and worked as a visiting researcher at the University of Southern Denmark, Denmark. Before joining academia, he served as a sales manager for two years. Dr. Sigué obtained his DESC from ESSEC of Douala and his MSc and PhD in business administration with a concentration in marketing and management science from HEC Montreal (AACSB & EQUIS accredited). His research covers the following topics: franchising, marketing channel, customer relationship management, game theory, international marketing and trade, and corruption. Dr. Sigué has received several academic awards, including the Best Ph.D. Thesis Award at HEC Montréal, the Best Conference Paper Award of the Academy of Marketing Science, and the Outstanding Service Award of the International Academy of African Business and Development. One of his co-authored papers was a 2006 Journal of Service Research Best Article Award finalist. Dr. Sigué is the former editor of the Journal of African Business and serves on the editorial boards of Asia Pacific and Globalization Review, Cameroon Management Review, Journal of Business Research, and Journal of Marketing Channels. He also serves as a referee for several other leading marketing, management science, and

operational research journals, including Automatica, Dynamic Games and Applications, European Journal of Operational Research, International Game Theory Review, Journal of Optimization Theory and Applications, Journal of Retailing, Management Science, and Marketing Science.



DR. JACOB MUSILA is a Professor of Economics at Athabasca University, Canada. He is the Chair of the Economics, Finance & Operations Management Academic Department at Athabasca. Dr. Musila completed his Ph.D. in Economics at Dalhousie University in 1998. He worked as Economist

for the Department of Finance of Nova Scotia from 1998 to 2001 and spent the Academic Year 1999-00 as a visiting scholar at the University of Malawi. Prior to his doctorate he worked as Economist for the Kenyan Government. Dr. Musila joined Athabasca University in September 2001. His areas of expertise include Development Economics, International Economics and Macroeconomics.

EXECUTIVE SUMMARY

CORRUPTION REMAINS THE BANE of good governance and development in Africa. This paper attempts to estimate the effect of corruption on the flows of exports and imports of African countries. Using the gravity model approach and annual data for the period 1998–2007, Jacob Musila and Simon Sigue⁷ show that corruption adversely affects international trade. Their estimates suggest that if a country with Africa's average corruption perception index of 2.8 were to improve its corruption level to Botswana's 5.9, its exports would improve by about 15 per cent and imports by about 27 per cent.

Unlike the early cross-country studies, which analysed only the effect of corruption in one trading partner (importing countries), the authors estimate the effect of the level of corruption in both trading partners (i.e. the exporting country and importing country).

Their analysis is premised on the belief that as far as international trade is concerned, corruption in the exporting country is as important a factor as corruption in the importing country. The level of corruption in both countries, they say, would determine the cost of doing business between the two countries.

The significance of this study is obvious. Besides contributing to the empirical literature, the study also addresses one of the key challenges of economic development in Africa. More specifically, the link between export trade and corruption has direct implications for economic growth and development of the African continent since the majority of the countries now follow an export-oriented development strategy.





1.0 INTRODUCTION

THERE IS A CONSIDERABLE LITERATURE on the various aspects of corruption; the general conclusion is that cross-country variation in instances of corruption is partly attributed to differences in religious traditions, colonial experiences, level of development, trade openness, level of civil service wage, and natural resource endowment.

On the economic impact of corruption, researchers have investigated the effect of corruption on investment and growth (Mauro, 1995; Tanzi and Davoodi, 1997; Campos et al., 1999); the effect of corruption on inflation (Al-Marhubi, 2000); and the effect of corruption on international trade (Lambsdorff, 1998; Anderson and Marcouiller, 1999). However, the empirical evidence on the effect of corruption on international trade is split. While Anderson and Marcouiller find evidence that corruption reduces trade, Lambsdorff finds only exports of a small number of countries to be significantly associated with the level of corruption.

More specifically, of the 19 countries that Lambsdorff studied, four (Belgium/Luxembourg, France, Italy and South Korea) showed a statistically significant positive association between their export trade and the level of corruption in the importing countries and only one (Sweden) showed a statistically significant negative association between her export trade and the level of corruption.

In view of the mixed empirical evidence about the effect of corruption on international trade, and the few existing studies examining the implications of corruption on trade, more studies using different datasets and techniques are needed to contribute to our understanding of the impact of corruption on international trade.

2.0 CORRUPTION IN AFRICA

ALTHOUGH CORRUPTION IS PERVASIVE AND SIGNIFICANT around the world, casual empiricism suggests that corruption is not only widespread but appears to be on the rise in the third world countries, particularly in Africa. In some African countries such as Kenya, corruption accounts for a large share of the gross domestic product (GDP). For example, the scandal involving Goldenberg International Limited of Kenya (a firm that purported to be exporting gold and diamonds) accounted for more than 7 per cent of the country's GDP and almost 40 per cent of the government's budget in the 1992 /93 fiscal year . Corruption income in Africa is attributed to rising external debt and global capital flows and trade in exchange commodities such as diamonds, gold, weapons and illicit drugs. In the early 1990s, for example, Nigeria became a major transshipment centre in the international illicit trade of cocaine and heroin.

The intensity and prevalence of corruption in Africa varies from one society to another. In some African countries corruption is the order of the day and is extreme. For example, in Mobutu Sese Seko's Zaire (1965–97), the state was a mechanism for self-enrichment of a clique that surrounded President Mobutu.

Similarly, there has been gross, high-level and systematic corruption in Sierra Leone (Riley, 1998), while in other African countries, such as Botswana or Tanzania (until the 1990s), corruption has been relatively low-level, or petty, in form.

Some analysts attribute the variations in the intensity and prevalence of contemporary forms of corruption in Africa to the institutional legacy of colonial rule. For example, some features of former British colonies such as free press, durable legal institutions, an emphasis on elite education, and the British civil service norms of probity and impartiality make them less vulnerable to corruption than their francophone counterparts. Other analysts (such as Little, 1996) attribute the variations in the intensity and prevalence of corruption to the dominance of the state in economic and political affairs, a situation that creates opportunities for rent-seeking and weakens the ability of citizens to hold politicians and state officials accountable for their actions.

Riley (1998) classifies corruption in African societies into three categories – incidental, systematic and systemic. Incidental corruption is a feature of life in most African countries. It is normally small-scale or petty corruption that involves an isolated and small number of junior public officials such as policemen and soldiers manning roadblocks, customs officials

at airports and seaports, and tax officials. Although incidental corruption may not have a huge impact on the macroeconomy, it can profoundly alienate the citizens and public resources. In addition, petty corruption can degenerate into grand corruption.

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Porta and Vannucci (1997) document how petty corruption escalated to grand corruption within the Italian administrative system. Systematic corruption involves large numbers of public officials and is associated with an element of organisation and conspiracy. It is common in government departments or parastatals such as procurement agencies and marketing boards. Some systematic corruption also concerns specific government contracts.

Examples of systematic corruption include the scandals surrounding the contracts that led to massive importation of cement by the Nigerian government in the mid-1970s, the massive importation of sugar in Kenya in the late 1990s, and the supply of telecommunications equipment to Cameroon's Ministry of Telecommunication in the late 1990s, where certain government officials demanded 30 per cent kickbacks in exchange for contracts. Gerddes-Cameroun (1999) and Sigue' and Amougou (2002) document many more cases of systematic corruption in Cameroon. Systematic corruption has a profound impact on the economy through the extensive diversion of government revenues and the distortion of priorities, including international trade.



Systemic corruption involves a wholly corrupt system that is led by a corrupt leadership. In societies with systemic corruption, it is irrational to be honest as the diverse forms of corruption are so pervasive. This type of corruption is believed to have huge detrimental effects on the economy's development process. Examples of countries with systemic corruption include Sierra Leone and Zaire. In Sierra Leone's case, systemic corruption was associated with President Siaka Stevens' one-man rule of 1968–85 and the one-party All People's Congress regime that lasted until 1992. These corruption cases involved extensive theft of government revenues, which were mainly generated through the official and smuggled export trade in diamonds, gold, other minerals and agricultural produce. Similar theft of government resources also took place in Zaire during Mobutu's rule of 1965–97. Askin and Collins (1993) document evidence of how the proceeds of the theft of Zaire's state resources were spent, including expensive properties in Western Europe, gifts, luxury travel and other forms of conspicuous consumption.

3.0 THE CORRUPTION-TRADE NEXUS

THE LITERATURE SUGGESTS a number of channels through which corruption may affect international trade. In this section, we provide a brief overview of three main channels, namely: the efficiency channel, transactions cost or price mark-up, and contract-awarding. In the efficiency channel, corruption affects economic progress by changing the efficiency of the economy. In an environment in which pervasive and cumbersome regulations are exogenous, corruption such as 'speed money' may improve economic efficiency and help growth. Leff (1964) and Huntington (1968) argue that in cases where bribes work as a piece rate for government employees, such employees would work harder. They also claim that bribes may enable individuals to bypass bureaucratic delays. Such efficiency-improving corruption can lead to an increase in international trade.

Cudmore and Whalley (2003) argue that corruption can enhance welfare if queuing costs are replaced with resource-transferring bribes. Corruption, however, may also lead to inefficiency. Myrdal (1968)

argues that corrupt government officials may create administrative delays in order to attract more bribes instead of speeding up the process. Kaufmann and Wei (1999) find that firms that pay more bribes are also likely to spend more management time with bureaucrats negotiating regulations, and face a higher cost of capital.



In the transactions cost or price mark-up channel, corruption may help to facilitate or reduce trade, depending on whether it is accompanied by theft. Shleifer and Vishny (1993) argue that in the case of corruption with theft (also known as collusive corruption (Bardhan, 1997)), government officials (agent) may levy bribes that are less than the official tax. In this case, a shipment can come into (leave) a country at a lower transactions cost. The decrease in transactions cost reduces the price mark-up which, in turn, increases trade. In the case of corruption without theft, the agent levies the official duty for the government but also charges something extra for herself. This extra charge acts like a hidden tax which increases the transactions cost and therefore decreases international trade. Anderson and Marcouiller (1999) provide an account of this channel in their model of predation. They argue that in a predatory state, shipments are subject to attacks by corrupt officials. Any shipment that is not defended by customary measures is identifiable as easy prey, attacked with certainty and completely lost. Under these circumstances, exporters and importers will take the normal defensive measures and corrupt officials will attack randomly. In such an environment, losing a shipment becomes a game of chance.

The probability of losing a shipment on a given trade route determines the transactions cost and the corresponding price mark-up. This probability comprises the chance that a shipment has of successfully leaving the source country and the chance that it will successfully cross into the destination country. The mark-up is some proportion of the value of each shipment that is expected to be lost. Accordingly, higher levels of corruption (which indicate high probability of loss) result in higher price mark-ups. A high price mark-up (which is analogous to a hidden tax on international trade) will work to reduce trade between the two countries. In Africa, where production costs are already relatively high, such hidden tax would make exports even less competitive. In the contract-awarding channel, contracts to supply a particular commodity can be awarded in favour of those competitors who pay the highest bribes (Lambsdorff, 1998). Therefore, exporting or importing firms that are willing to engage in corrupt practices can obtain a competitive advantage over those that are reluctant or unable to pay bribes. Accordingly, corruption in an importing country can enhance or reduce trade depending on whether or not firms in the exporting country are willing and able to pay a competitive bribe.



The basic conclusion of the discussion of the channels through which corruption affects international trade is that the impact of corruption on international trade is an empirical issue. In the present study, we let the data determine whether corruption affects cross-border trade negatively or positively in the case of African countries.

4.0 CONCLUDING REMARKS

THE EMPIRICAL EVIDENCE showing how corruption and international trade are related has just begun to emerge following the development of better datasets. However, the little evidence garnered in our paper appears to be mixed and adds to the confusion. The split in the evidence in the early analyses of corruption and international trade, the rising intensity and prevalence of corruption and the faltering export sector in Africa, and the lack of a comprehensive study of the African economies, have motivated this paper.

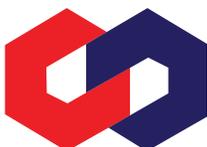
Using annual data for the period 1998–2007, we find that corruption in both the African countries and their trading partners adversely affects the flow of exports and imports. Our findings are consistent with the views that corruption increases transaction costs, leads to imperfect contract attribution, and creates inefficiencies that are detrimental to international trade (Myrdal, 1968; Anderson and Marcouiller, 1999; Kaufman and Wei, 1999). Thus, the conclusion of this study is that the export and import trade of African countries would increase if both African countries and their trading partners became highly clean.

Given the critical role of export trade in the development process of African countries, and the empirical evidence that suggests that corruption adversely affects exports, we recommend that policymakers in Africa make war on all levels/types of corruption a priority. Of course, the war on corruption must run in parallel with other measures to facilitate the growth of exports. This study shows that regional trading agreements and common currency arrangements have a positive impact on export trade. Accordingly, we urge policymakers in African countries to vigorously pursue open regionalism and monetary integration. The rest of the countries of the world can also help in the war on corruption by following the lead of the US and OECD countries and making bribery of foreign officials a criminal offence. 🇨🇪

ABOUT US

The Global Economic Institute for Africa (GEIA) is an Ottawa, Canada-based non-profit research and development organization fostering public-private dialogue on global issues, with a pan-African perspective.

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45 O'Connor Street Suite 1150
Ottawa ON Canada K1P 1A4
Phone: 1.613.755.4093
Toll Free: 1.877.308.6899
Fax: 1.613.237.9145
Email: info@econinstitute.org
Website: www.econinstitute.org