The Value of Making Commitments Externally: Evidence from WTO Accessions

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Summary

One way a country can acquire strong commitment to pro-growth policy reforms and convince investors that it has done so is by making the commitment a part of its international obligations. Examples of such external commitment include tariff reductions in a treaty that governs the terms of a country′s accession to the World Trade Organization (WTO), foregoing the right to impose capital controls in the future in a free trade agreement (FTA), a privatization scheme made as a part of the conditionality in a World Bank loan, or a tax reform plan made as a part of the conditionality in an International Monetary Fund (IMF) supported program.

The value of such an external commitment is intuitive. While a government′s unilateral announcement or implementation of a policy reform can be reversed or undone unilaterally, a policy reform embedded in an international treaty would involve a much higher cost of reversal. Non-fulfillment of an external commitment could trigger termination of loan disbursement from the World Bank or the IMF, or sanctions from the dispute settlement mechanism at the WTO or the FTA. In political economy terms, the benefits conferred by the multilateral organization (e.g., more secured access to foreign markets through the WTO, or loans from the IMF) can be used by the reform-minded government to buy political support from the originally anti-reform interest groups.

It is not a foregone conclusion, however, that the value of such external commitment is positive. For example, some have accused IMF supported programs of having made some countries economically worse off, as they might advocate a rigid recipe of policy changes that may not be suitable for the countries. Moreover, even if the commitments are good, there is a separate question of whether they can be enforced or sustained in the long run.

This paper studies the case of accessions to the WTO (or its predecessor, the GATT). Unlike an IMF program, policy reforms mandated in a WTO accession agreement are legally binding as long as the country remains a member of the WTO. In recent years, the applicant countries have typically been required by existing members to undertake a wide range of policy changes before membership can be granted and to promise to do more within a certain timeframe after the start of membership. The required policy changes typically go beyond a reduction in tariff rates, and can encompass termination of state monopoly, greater transparency in policy making process generally, reduction in restrictions on payment and foreign exchange arrangement, and better protection of intellectual property rights.

We investigate whether and how WTO/GATT accessions since 1990 alter a country′s growth trajectories. The empirical method we employ is in spirit a difference-in-differences strategy: comparing the change in the growth rate of the acceding countries before and after accessions with the change in the growth rate of nonacceding developing countries. Our results show that, relative to other developing countries, countries that became WTO members did generally grow faster than before, and the increments in their ratios of investment to GDP were greater as well.