

THE IMPACT OF GLOBAL INSTITUTIONALIZATION WITHIN THE WTO ON FOREIGN TRADE FLOWS, THE CASE OF UKRAINE

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Since the establishment of the World Trade Organization (WTO) as the main institutionalizing force in the trade area more than 20 years ago, developing countries have sought to gain special recognition and treatment within the multilateral system in order to solve their structural and systemic problems. However, the impact of global institutionalization within the WTO on member-countries' foreign trade remains debatable.

The subject of research of the article is the impact of global institutionalization within the WTO on Ukraine's foreign trade flows. The objective is to evaluate the impact the global institutionalization within the WTO has on the foreign trade of Ukraine and develop a roadmap for national institutional environment improvement. The main method used is gravity modelling. Heritage Foundation's Index of Economic Freedom, World Economic Forum's Index of Global Competitiveness and World Bank's world governance indicators are used separately in constructed models as institutional variables. All the models also include dummy variables, which indicate WTO – or RTA-membership of two countries. The sample includes all the countries, which have been trade partners of Ukraine during last 20 years.

The following results were obtained: 6 gravity models are constructed, which allows to calculate the possible percentage of Ukraine's exports increase due to the enhancement of Ukraine's institutional variables to the average European level and develop a roadmap for national institutional framework improvement. Conclusions: the calculated percentage of increase proves that the global institutionalization within the WTO may have a positive impact on Ukraine's foreign trade flows, gravity modelling helps in determining how Ukraine's national institutional framework can be improved.

Keywords: global institutionalization, institutions, national institutional framework, the World Trade Organization, the WTO, foreign trade, Ukraine.

Problem setting. Transitioning to a market economy entails big changes over a short period of time. It demands a transformation of institutions as well as of a regional structure and a commodity disposition of foreign trade. The main issue is, whether an institutional improvement can lead to an exports increase among other things. It should be noted that country's WTO accession is not an event, but a process, which in case of Ukraine as well as in other post-Soviet countries, overlapped with transition from the plan to the market economy. It has improved the national institutional framework for the better, but to a much lesser extent than one can expect.

Despite a common legacy of central planning and of a 'fresh start' in the 1990s, some former USSR countries have already successfully transitioned to market economies. Others, Ukraine included, still have economic performances. The implementation of reforms depends upon economic growth, which in turn cannot be achieved without the reforms. And that is where institutions can step in.

Analysis of the later researchers and publications. The importance of institutions for economies has been noted by T. Veblen [18]. However, only in the second half of the XX century economists attempted to formulate an exhaustive definition of an institution and to qualitatively evaluate their influence. Summarizing the theoretical conclusions, R. Matthews [10] in his article emphasizes the importance of institutions, but points out that it is not possible to assess their impact on the

economy because they are very complex structures. M. Olson [12] turns to institutions to explain the difference between the poor and rich countries. A. Greif [7] attempted to make a qualitative evaluation of institutions' influence on country's foreign trade. In his opinion, institutional changes determine the efficiency, volume and geographical distribution of trade flows.

The first attempt to make a quantitative evaluation of the influence of institutions on foreign trade was made by J. Anderson in 2000 [2]. He considered the difference between real international trade volumes and predicted and explained its existence by the influence of factors such as the development of institutions, access to information, imperfect contract execution, risk and non-diversified risks. J. Anderson's further research focused on the qualitative influence of informal institutions.

The impact of institutions on economic growth received much more study than their impact on foreign trade. The study of an impact of institutions on economic growth was undertaken by foreign scholars such as R. Hall, K. Jones [8], D. Acemoglu, S. Johnson, S. Robinson [1], D. Rodrik, D. Sabramanian, D. Trebbi [15], D. Piazzolo [14] and others.

E. Brezis and T. Verdir considered joining the EU as an external 'anchor' that stimulates the development of the national institutional framework [4]. O. Babetska-Kukharchuk notes that WTO membership or even the whole process of its

acquisition can be considered such an 'anchor' [3]. A. Rose, D. Vinkop [16], A. Subramanyan, S. Wai [17], O. Babetska-Kukharchuk, M. Morel [3], D. Li and C. Wu [9], M. Persson, F. Wilhelmsson [13], T. Drautburg, I. Melnikovska, R. Schweickert [6], are among the scholars who explored the role of membership in the GATT/WTO system and the development of the national institutional environment.

Problem definition. In order to evaluate the quantitative effect of global institutionalization within the WTO on foreign trade, most studies use a gravity model with different variables. But the above-mentioned scientists do not focus on the role that the WTO accession as an external anchor for national institutional framework development and therefore foreign trade increase, especially as applicable to Ukraine, merely touching upon this subject, and its evaluation.

The aim of the article is to evaluate the impact of the global institutionalization within the WTO on the foreign trade of Ukraine and develop a roadmap for national institutional environment improvement.

Presentation of the basic material. The majority of countries of Central and Eastern Europe have completed the transition process. At present, some have even joined the EU, while Ukraine is still struggling to carry out efficient market-oriented reforms. The countries that acted immediately upon the dissolution of the USSR are more successful than those, which hesitate to radically change their national institutional framework and go on with institutions that hinder their economic progress. However, the transition can be solicited by the presence of an external anchor. A GATT/WTO membership can be that external anchor for Ukrainian transition.

We consider GATT/WTO accession as a potential factor for an external trade increase in developing countries and aim at estimating this impact. Our empirical strategy is based on the well-known gravity equation. It fits our purpose well, because qualitative variables do not always clearly represent institutional changes, which occur in countries due to the process of their accession to the WTO and RTAs' ratifications.

In our study, the transition from qualitative to quantitative characteristics of the influence of global institutionalization on country's foreign trade is carried out according to the following algorithm:

- assessment of the foreign trade sector of the country;
- a qualitative evaluation of the influence of global institutionalization within the WTO on foreign trade of the country;
- selection and evaluation of factors influencing foreign trade of the country;
- assessment of institutional factors;
- construction of a gravity model;
- assessment of the average European institutional variables;
- comparison of Ukrainian and European institutional variables;

- calculation of the impact of improvement of Ukraine's national institutional framework to the European level on the growth of foreign trade.

Our empirical strategy is based on gravity modelling widely used in the above-mentioned studies. This means that the volume of bilateral trade flows is directly proportional to the size of the economies (their 'masses') and inversely proportional to the distance between them and other trade barriers. We consider accession to the WTO as a factor of the foreign trade growth particularly in developing countries. This is in line with the purpose of our study, because qualitative changes do not always accurately reflect the institutional changes that occur in the country through the process of accession to the WTO and the ratification of regional trade agreements (RTAs), as well as cultural differences, historical ties that have a strong impact on the volume export of the country.

According to the gravity equation, bilateral trade (variable 'Trade') depends on a variety of factors, such as:

- market size of country i (variable 'GDP_i');
- market size of country j (variable 'GDP_j');
- distance between two countries (variable 'D_{ij}');
- bilateral exchange rate volatility (variable 'VOL_{ij}');
- national institutional framework of the country i;
- national institutional framework of the country j;
- both countries are WTO-members (variable 'WTO_{ij}') or RTA-members (variable 'RTA_{ij}').

All these factors contribute to the bilateral trade growth, that is the natural logarithm of exports of the country i from the country j. The market size of the country i (and j respectively) is measured as the natural logarithm of country's real GDP per capita in PPP. The 'Distance' variable entails not only transportation costs, but cultural differences and historical ties, and is measured as the distance between capital of the country i and the capital of country j. Bilateral exchange rate volatility is calculated as a standard deviation of the ratio of the monthly exchange rate over its yearly average.

The role of the global institutionalization within the WTO manifests itself in the national institutional framework development. In order to measure the institutional framework in both countries a few indicators can be used, such as:

- EBRD Transition Indicators;
- Heritage Foundation's Index of Economic Freedom;
- World Bank Governance Indicators;
- Global Competitiveness Index of the World Economic Forum;
- Global Enabling Index of the World Economic Forum;
- World Bank Ease of Doing Business Index;
- World Bank Ease of Doing Business Index;
- World Bank Logistics Performance Index;
- Freedom in the World of the Freedom House;

- Corruption Perception Index of the Transparency International;
- KOF Index of Globalization.

Having considered all advantages and disadvantages of all the indicators, we have chosen to use the Index of Economic Freedom (variables 'Inst'), which consists of 12 subindexes, which influence the institutional setting of economic growth [20], the Global Competitiveness Index, namely 'Institutions' pillar of its Basic requirements subindex (variable 'CompInst') [21], and the World Bank Governance Indicators (variable 'WGI'), which consists of 6 subindexes [22, 23].

'WTO_{ij}' is a dummy variable, which equals 1, if both countries are WTO-members. 'RTA_{ij}' is also a dummy variable, which equals 1, if both countries belong to some regional trade agreement.

Thus, in practice the gravity equations look as follows:

1. On the basis of the Heritage Foundation's Index of Economic Freedom:

$$\ln Trade = a_0 + a_1 \ln GDP_i + a_2 \ln GDP_j + a_3 \ln D_{ij} + a_4 Vol_{ij} + \sum_1^{12} b_k Inst_i^k + \sum_1^{12} b_k Inst_j^k + a_5 WTO_{ij} + a_6 RTA_{ij} \quad (1.1)$$

2. On the basis of the Global Competitiveness Index of the WEF:

$$\ln Trade = a_0 + a_1 \ln GDP_i + a_2 \ln GDP_j + a_3 \ln D_{ij} + a_6 Vol_{ij} + a_7 GCI_i + a_8 GCI_j + a_9 WTO_{ij} + a_{10} RTA_{ij} \quad (1.2)$$

3. On the basis of the World Bank Governance Indicators:

$$\ln Trade = a_0 + a_1 \ln GDP_i + a_2 \ln GDP_j + a_3 \ln D_{ij} + a_4 Vol_{ij} + \sum_1^6 b_k WGI_i^k + \sum_1^6 b_k WGI_j^k + a_5 WTO_{ij} + a_6 RTA_{ij} \quad (1.3)$$

Thus, we were able to construct 6 models, three of which feature Ukraine as an exporter, another three – as an importer.

In order to calculate the percentage of country's exports growth due to the convergence of Ukrainian institutions to the European level, we use the following equation:

$$\Delta Trade = \exp(a \times (Inst_{EU} - Inst_{Ukr}) - 1) \quad (1.4)$$

$\Delta_e Inst_{EU}$ – a certain average European institutional variable;

$Inst_{Ukr}$ – a certain average Ukrainian institutional variable.

The model is constructed on the basis of the countries, that have been trade partners of Ukraine for the last 20 years. Thus, the original sample consists of more than 3500 cases. However, due to the lack of necessary data, the model includes 1915 cases. Alternatively, we evaluate the model which consists of 1381 cases and includes importers of Ukrainian products, that have been trade partners of Ukraine for the last 20 years.

All the variables, besides institutional framework in the country i, 'VOL_{ij}' and government spending in the country j, are significant at 5% level. Positive impact have variables, such as real GDP per capita in PPP in both countries, some factors of the national institutional framework (namely property rights, government integrity, trade freedom and financial freedom), being a WTO – or some RTA-members.

The model utilized all available data from the World Integrated Trade Solution's statistical database of the World Trade Partners, as the State Statistics Service of Ukraine does not provide data for the period between 1995 and 2001. The official website of the State Statistics Service of Ukraine contains information on Ukraine's trade partners in 2016-2017 years, but they have not been used in the model, since the data of previous years contained on the website of the State Statistics Service of Ukraine do not correlate with World Bank's data. Therefore, the modeling was performed on the basis of World Bank's data on foreign trade of Ukraine in 1995-2015.

According to the results, Ukraine's national institutional framework has no impact on its import, 'WTO_{ij}' and 'RTA_{ij}' are significant variables. We had to exclude 'Inst_3' (government integrity), 'Inst_6' (fiscal health) and 'Inst_8' (labor freedom) from the model, because the Heritage Foundation does not provide enough data on them. The variables, such as volatility (immediately after the inclusion of institutional variables), and Inst_5, i.e., government expenditures, became insignificant.

All institutional variable, apart from 'Inst_5' (public expenditure), are significant. Positive influences are institutional variables, such as property rights ('Inst_1'), judicial efficiency ('Inst_2'), trade liberty ('Inst_10') and financial freedom ('Inst_12'). WTO and/or some RTA membership of both countries also positively affects by foreign trade of the country.

The similar results are obtained from the usage of the second and third equation. In that case, all the variables, besides 'VOL_{ij}' and national institutional framework of the country i, are significant at 5% level.

Thus, the results of the calculation within the framework of the first equation show that Ukraine's foreign trade can increase by 106% as the result of the convergence of its national institutional framework to the EU average. However, despite the fact that WTO membership indirectly affects all areas of the national institutional environment, it directly affects trade liberty only. However, unlike M. Morel and O. Babetskaya-Kukharchuk [3], we take into account institutional factors that negatively affect foreign trade. Due to the interconnectedness of all institutional factors, convergence of only certain spheres of Ukraine's national institutional environment to the EU-average level is not possible.

In the case of Ukraine, as well as many other countries, the WTO membership, as well as the EU Accession Agreement, can be an external anchor for national institutional framework improvement. Thus,

we can measure the impact of the institutional improvement on exports volumes of developing countries. In order to do so, we compare the qualitative differences between subindexes of Index of Economic Freedom of Ukraine and EU, as well as between 'Compinst' of Ukraine and EU. It allowed us to estimate the expected growth of exports due to the improvement of Ukrainian institutional framework to the EU-level.

Ukraine's accession to the WTO was a long process, which stimulated harmonization of Ukrainian legislation in accordance with international standards. However, many institutions were reformed only formally, and on the eve 10th anniversary of the Ukrainian membership in the WTO the advantageousness of terms of accession is still debatable.

The estimation in the frame of the first equation suggest that one can expect the growth of volume of Ukrainian exports by 207 per cent (including 2% due to the growth of trade freedom to the EU-level), in the frame of the second equation – by 71 per cent. The difference can be explained by the differences in the methodology of these indexes' calculation. However, the accession to the WTO alone can gradually increase the exports of the country by 198 per cent according to the first equation (95 per cent according to the second), ratification of the RTA – by 326% (148%). Thus, both accession to the WTO and ratification of RTAs have positive direct impact on the bilateral trade, as well as indirect in the form of improvement of country's institutional framework.

The general assessment of the growth of foreign trade due to the convergence of Ukraine's national institutional environment with the EU in the third model is 281%. However, WTO membership directly affects corruption only, that is, it can stimulate the growth of foreign trade by 37%.

We also construct three gravity models for Ukraine as an exporter. They include all those countries that have imported Ukrainian products in the last 20 years. They show that Ukraine's national institutional environment has no effect on the growth of its exports. Nevertheless, its exports is positively influenced by the following areas of the national institutional framework of the partner country, such as the tax burden of the partner country ('Inst_4'), its public expenditure ('Inst_5') and freedom of business ('Inst_7'), negative – judicial efficiency. A similar situation is observed when constructing a gravity model based on the data of Ukraine as an exporter using the 'Institution' pillar of the WEF's Global Competitiveness Index. According to the results of the third model it is evident that the institutional variables, such as quality regulation ('WGI_4'), voice and accountability ('WGI_1') and corruption control ('WGI_6') have negative impact on the increase of Ukrainian exports. Thus, the reduction and prevention of corruption in the partner countries of Ukraine leads to their reorientation to more developed countries.

According to the results of the gravity modelling, it is clear that the national institutional environment of Ukraine does not affect the increase of its exports. An interesting observation is that the more developed the institutional framework of the partner country, the less it exports to Ukraine, which undoubtedly hinders the development of the institutional framework of the latter.

It should be noted that accession to the WTO is not a significant variable for Ukraine as an exporter, which is connected both with the specifics of its accession to the WTO against the backdrop of the global financial crisis and the fact that the national institutional framework was reformed in the process of accession prior to the official membership of Ukraine in the WTO. However, this does not explain the fact that all three models using the database of Ukraine as an exporter show that the national institutional framework of Ukraine and its development has no effect on the growth of its exports, while in other countries almost all institutional variables are significant. The fact that control over corruption negatively affects Ukraine's exports is also unexpected. However, all this can be explained, if we only remember that according to D. North institutions are a set of formal and informal rules [11], but all the institutional variables used in the study make it possible to measure practically only changes in formal rules. Therefore, we agree with D. Rodrik that 'the actual change of tariff regimes is only a small part of the process' [15] of the national institutional framework improvement. The most informal behaviors are particularly relevant for Ukraine, since the differences between them and formal rules are extremely important. This explains the difference in the results of the gravity modelling on the basis of the data of Ukraine as an importer and Ukraine as an exporter.

Therefore, the gravity modelling proves that in the process of joining the WTO, the national institutional framework of Ukraine was also reformed only formally. This also applies to the fight against corruption, which further exacerbates the negative impact of the formal reformation of the national institutional environment and does not allow the transformation of formal institutions built on EU standards into generally accepted rules of conduct.

However, reforms must be well thought out and consistent with the real needs of the economy. Only then will they stimulate entrepreneurial activity and economic growth. Otherwise, there may be an opposite result. Membership in the WTO can be seen as an external 'anchor' for building a national institutional environment, utilizing opportunities and leveling up existing threats (Table 1).

The successes or failures of the WTO member countries are largely determined by the strength and quality of the institutions for implementation and for the strengthening of which radical reforms should be undertaken. Moreover, trade reform is only a catalyst for the improvement of the national institutional

framework and, as a result, it gives impetus to economic growth. The effect of accession to the WTO is positive only for countries that have indeed undergone a radical reformation of their national institutional framework by increasing its effectiveness. Thus, we develop a following roadmap for Ukraine's national institutional framework improvement (Fig. 1).

Conclusions. Gravitational modelling proves that the accession to the WTO can contribute the growth of foreign trade in countries, particularly in developing countries. However, it was found that the national institutional environment of Ukraine has no

effect on the growth of its exports, and control over corruption only worsens the situation. It should be noted that the reduction of corruption in the partner countries of Ukraine leads to their reorientation of their trade flows to more developed countries. We can conclude that in the process of joining the WTO, the national institutional framework of Ukraine was reformed only formally. This also applies to the fight against corruption, which further exacerbates the negative impact of the formal reformation of the national institutional environment and does not allow the transformation of formal institutions built on EU

Table 1

SWOT matrix of the national institutional framework of Ukraine

<i>Strengths</i>	<i>Weaknesses</i>
WTO membership EU-Ukraine Association	Corruption, the destruction of important elements of the market, the lack of adequate institutional arrangements for implementing agreements, the weakness of the implementation of laws, non-compliance with the rules of conduct, inconsistency of formal and informal institutions
<i>Opportunities</i>	<i>Threats</i>
Real reforms Interaction between the public and private sector, Changing the structure of the economy The tide of human potential Diversification of exports	The self-destruction of the economy, the disintegration of production, the destruction of economic ties and governance, the increase in poverty

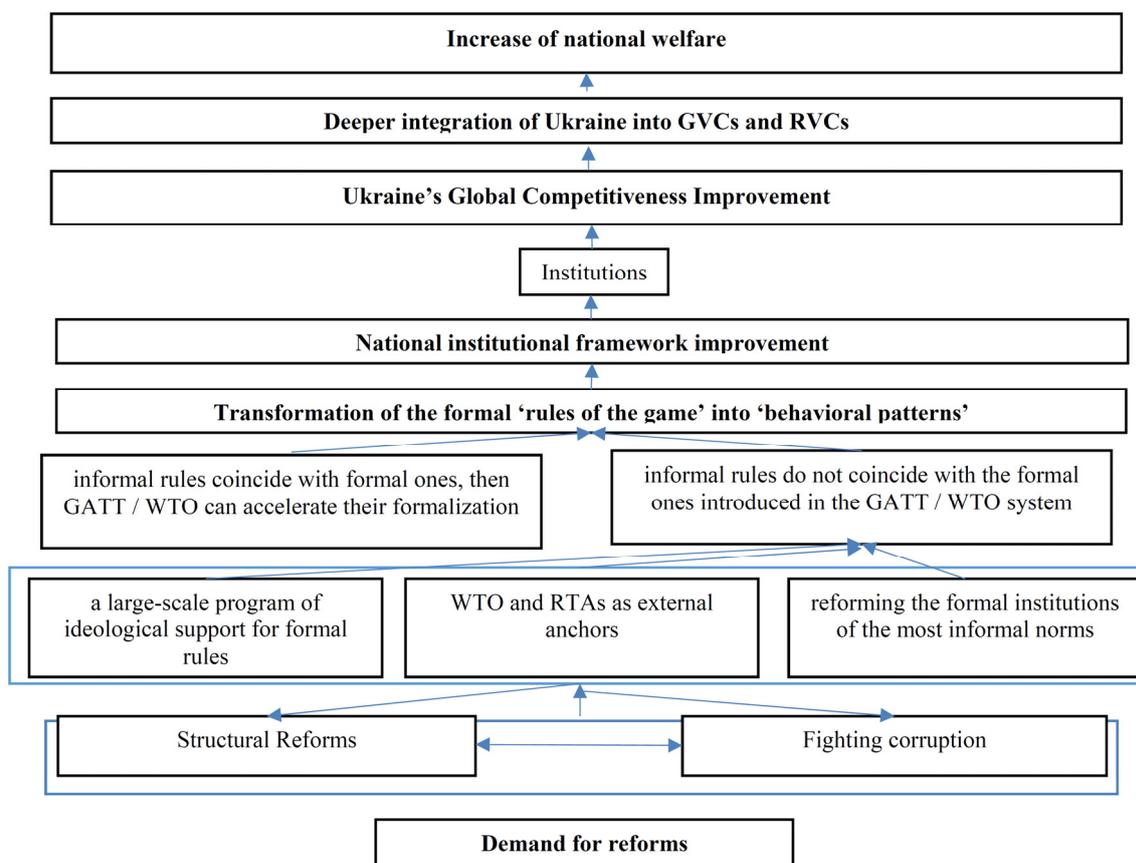


Fig. 1. A roadmap of national institutional environment improvement of Ukraine

standards into generally accepted rules of conduct. Thus, we developed a roadmap of Ukrainian institutional framework improvement, which is based on the demand for reforms.

Further research should be focused on the possibilities of transformation of the formal 'rules of the game' into the 'behavioral patterns' in the context of Ukraine's WTO-membership and the evaluation of its impact on the exports increase.

ВПЛИВ ГЛОБАЛЬНОЇ ІНСТИТУЦІОНАЛІЗАЦІЇ В МЕЖАХ СОТ НА ЗОВНІШНЮ ТОРГІВЛЮ, НА ПРИКЛАДІ УКРАЇНИ

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З моменту заснування Світової організації торгівлі (СОТ) як основної інституціоналізуючої сили у сфері торгівлі більш ніж 20 років тому, країни, що розвиваються, намагалися домогтися спеціального визнання та ставлення в рамках багатосторонньої системи з метою вирішення власних структурних та системних проблем. Проте вплив глобальної інституціоналізації в межах СОТ на зовнішню торгівлю країн-членів залишається дискусійним.

Предметом дослідження статті є вплив глобальної інституціоналізації в межах СОТ на зовнішньоторговельні потоки України. Мета полягає в оцінці впливу глобальної інституціоналізації в рамках СОТ на зовнішню торгівлю України та розробці дорожньої карти для вдосконалення національного інституційного середовища. Основним методом є гравітаційне моделювання. Індекс економічної свободи Фонду «Спадщина», Індекс глобальної конкурентоспроможності Світового економічного форуму та світові показники Світового банку використовуються окремо в побудованих моделях як інституційні змінні. Всі моделі також містять фіктивні змінні, які вказують на членство в СОТ або РТУ двох країн. Вибірка включає всі країни, які протягом останніх 20 років були торговельними партнерами України.

Було отримано такі результати: побудовано 6 гравітаційних моделей, що дозволило розрахувати можливий відсоток зростання українського експорту завдяки покращенню інституційних змінних України до середньоевропейського рівня та розробити дорожню карту для вдосконалення національного інституційного середовища. Висновки: обчислений відсоток збільшення свідчить про те, що глобальна інституціоналізація в рамках СОТ може мати позитивний вплив на зовнішньоторговельні потоки України, гравітаційне моделювання може допомогти визначити, як покращити національне інституційне середовище України.

Ключові слова: глобальна інституціоналізація, інституції, національне інституційне середовище, Світова організація торгівлі, СОТ, зовнішня торгівля, Україна.

ВЛИЯНИЕ ГЛОБАЛЬНОЙ ИНСТИТУЦИОНАЛИЗАЦИИ В РАМКАХ ВТО НА ВНЕШНЮЮ ТОРГОВЛЮ, НА ПРИМЕРЕ УКРАИНЫ

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С момента основания Всемирной торговой организации (ВТО) как основной институционализирующей силы в сфере торговли более 20 лет назад, развивающиеся страны пытались добиться специального признания и отношения в рамках многосторонней системы с целью решения собственных структурных и системных проблем. Однако влияние глобальной институционализации в рамках ВТО на внешнюю торговлю стран-членов остается дискуссионным.

Предметом исследования статьи является влияние глобальной институционализации в рамках ВТО на внешнеторговые потоки Украины. Цель заключается в оценке влияния глобальной институционализации в рамках ВТО на внешнюю торговлю Украины и разработке дорожной карты для совершенствования национального институциональной среды. Основным методом является гравитационное моделирование. Индекс экономической свободы Фонда «Наследие», индекс глобальной конкурентоспособности Всемирного экономического форума и мировые показатели Всемирного банка используются отдельно в построенных моделях как институциональные переменные. Все модели также содержат фиктивные переменные, которые указывают на членство в ВТО или РТУ двух стран. Выборка включает все страны, которые в течение последних 20 лет были торговыми партнерами Украины.

Были получены следующие результаты: построено 6 гравитационных моделей, что позволило рассчитать возможный процент роста украинского экспорта благодаря улучшению институциональных переменных Украины до средневропейского уровня и разработать дорожную карту для совершенствования национальной институциональной среды. Выводы: рассчитанный процент увеличения свидетельствует о том, что глобальная институционализация в рамках ВТО может иметь положительное влияние на внешнеторговые потоки Украины, гравитационное моделирование может помочь определить, как улучшить национальную институциональную структуру Украины.

Ключевые слова: глобальная институционализация, институции, национальная институциональная среда, Всемирная торговая организация, ВТО, внешняя торговля, Украина.

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