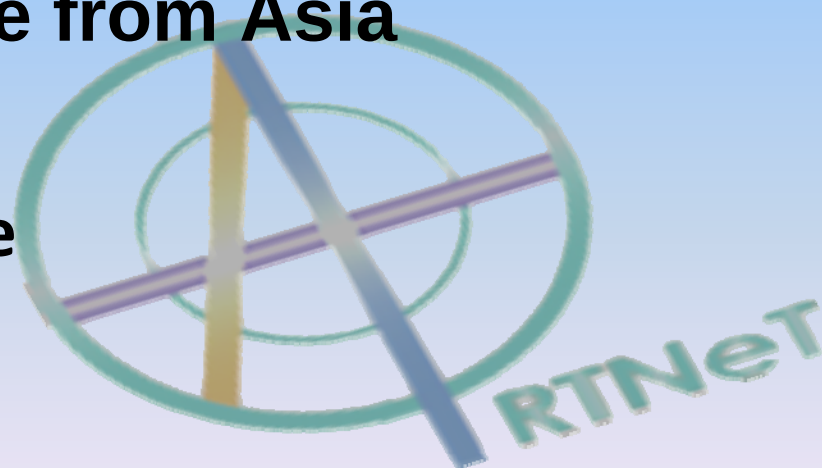


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Does Governance Matter for Enhancing Trade?
Empirical Evidence from Asia

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Outline

- Motivation of the study
- Institutions and Governance for Development: Literature Review
- Measuring Governance in Asia and the Pacific Region
- Impact of Governance on Trade in Asia: Empirical Evidence
- Conclusions and policy implications

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Motivation of the Study

- Asia's participation in the international economy has increased, with greatly reduced barriers to international transactions. However, poor governance makes countries isolated from best practice global markets.
- Countries face significant constraints in improving trade – institutions and governance are few of them.
- Good governance in institutions is similar to what tariff liberalisation to trade.
- Countries (and regions) with higher income, stronger institutions, good governance, and more open economies are likely to have higher levels of regional infrastructure.
- Economic integration becomes successful when the higher trade and investment coupled with good governance supports the region's growth and prosperity.
- Economic integration is successful where “prosper-thy-neighborhood” sentiment becomes stronger; its pace escalates when well-planned policies, institutions and governance enforce the regional projects - physical or otherwise - towards building a regional harmony and unity.
- Ongoing financial and economic crisis has refocused our attention on the governance aspects of economies, but to which economists have not paid enough attention.
- The primary objective of this paper is to find out whether or not the governance matters for enhancing Asia's trade.

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Research Objectives

1. To understand Asian countries performance in governance over time;
2. To assess the empirical relationship between governance and trade in context of Asia;
3. To estimate the strength (and intensity) of essential factors including governance influencing trade in Asia at sub-regional level



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Definition of Institutions

- Institutions can be defined as humanly devised constraints that structure political, economic and social interactions (North, 1990).
- One of the objectives of institutions is to reduce uncertainties that arise from incomplete information concerning the behaviour of other individuals in the process of interaction.
- Main agents imposing institutions (formal) are rulers, parliaments and bureaucracies.
- The outcome of their actions can broadly be defined as governance, that is, either good or bad governance.

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Definition of Governance

- **“Governance” can be defined as the process of decision-making and the process by which decisions are implemented (or not implemented).**
 - Governance is outcome of quality of institutions (Rodrik et al, NBER, 2002)
- Governance has several dimensions such as economic governance, corporate governance, international governance, regional governance, national governance and local governance (Dixit, AER, 2009)
- An appropriate institutional and policy framework is required for the functioning of an effective governance framework.

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Governance is Crucial for Economic Growth and Development

- Institutional quality (governance) is positively associated with
 - higher economic growth and income levels (Campos and Nugent, 1998; Acemoglu et al., 2002; Rodrik et al., 2002; Lee and Kim, 2009),
 - public and private investment (Knack and Keefer, 1995; Alfaro et al., 2005),
 - stock of human capital (Arimah, 2004),
 - better management of (ethnic) conflicts (Easterly, 2001)
 - less income inequality (Chong and Gradstein, 2004)
 - better financial development (Beck et al., 2001)
 - efficient allocation of aid (Epstein and Gang, 2009)
 - sustaining 'common resource pools' through human cooperation (Ostrom, 2005)
- Regulatory quality influences the interaction between trade and economic growth and that countries with excessive regulations do not benefit from trade (Bolaky and Freund, 2004).
 - excessive regulations may encourage a country to produce goods for which the country has no comparative advantage and/or the terms of trade have been unfavourable over recent decades.
- Weak institutions act as significant barriers to trade (Anderson and Marcouiller, 2002)
- Increasing transparency reduces trade costs (Helble et al., 2009)
- Institutional quality in trading partners is positively associated with bilateral trade (De Groot et al., 2004).

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Governance Indicators

indicators:

Political
Stability &
of Violence/
Government
Quality
Law
Corruption

- Period: 1996 to 2007
- 174 countries worldwide
- Database: World Bank Institute (WBI)
 - Daniel Kaufmann, Aart Kraay and Massimo Mastruzzi (2008). "Governance Matters VII: Governance Indicators for 1996-2007". World Bank Policy Research, June 2008.

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