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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

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 polices, 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.

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

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.

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.

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 at al., 2009)
- Institutional quality in trading partners is positively associated with bilateral trade (De Groot et al., 2004).

Governance Indicators

indicators:
l
bility
Stability &
of Violence/

ent
ness
ry Quality
aw
f 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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