

dr. Aljaž Kunčič
Faculty of Social Sciences
University of Ljubljana
Kardeljeva pl. 5
1000 Ljubljana
Slovenia

27.06.2013

CERGE-EI: Twelfth Annual GDN Regional Research Competition, Non-technical Summaries

1. Trade and institutions: do not forget institutional distance

This paper examines the effect of institutions on bilateral trade flows within a gravity model. Theoretically, the gravity set up is derived from two accounting conditions on the exporter and importer side, and the case for the inclusion of institutions in the trade costs term is made. In the empirical panel data econometrics, the paper controls specifically for multilateral resistance and the inherent endogenous nature of institutions.

The paper uses a new dataset on institutional quality and pays particular attention to getting unbiased estimates of institutional distances on trade. Both institutional quality levels and institutional distances are included in the gravity equation, and the paper makes the case that it is crucial to control for multilateral resistance with as many fixed effects as possible, and also important to purge the institutional variables of their endogenous nature.

The results of the study show that institutions are in fact important determinants of bilateral trade, but not as uniformly as expected. Both origin's as well as destination's institutions matter in the bilateral trade data. They imply that there is a push factor in the form of good legal environment on the exporter's side, and two pull factors in the form of good political and economic institutions on the importer's side. The marginal effect of economic and political institutions on the exporter's side is negative, that is trade reducing, which points to the fact that in a stable political and good economic environment, domestic market becomes relatively more attractive. Surprisingly, legal institutional distance does not have an effect on bilateral trade on the margin, while political and economic institutional distance have a positive and negative marginal effect, respectively, consistently estimated across specifications. The positive effect of political institutional distance is explained with firms arranging business in less than legitimate ways with the help of politics on one or the other side, while the negative effect of economic distance lies in the increase of costs due to operating in and adjusting to a different business environment.

These results are confirmed with an alternative measure of institutional distance. There are also some important heterogeneities found, most interestingly, the effects of political and economic institutional distances disappear for countries sharing the same regional trade agreement.

Keywords: bilateral trade, gravity equation, institutions, institutional quality, institutional distance.

2. Trade and institutions: extensive and intensive margins

This paper examines exports of Slovenia in particular, starting with a focus on the structure of Slovenian exports and the differences in intensive and extensive margins, and follows with examining the effects of institutional quality and institutional quality distance on both margins. The study uses two ways to disaggregate exports, the first one being on volumes per firm and number of firms, and the second one on volumes per product and number of products. It focuses on summary statistics for the broad examinations of Slovenian exports and trade margins, and panel data econometrics for examining the effects of institutions in a gravity setting. In gravity equations, the paper explicitly controls for multilateral resistance, includes data from a new dataset on institutional quality and deals with the endogenous institutional nature.

An examination of Slovenia's export activity reveals some interesting facts. Firstly, Slovenia is a small open economy and as such very much dependent on exports, which represent up to 70% of its GDP. Out of those, a majority share are manufacturing exports, which represent around 70% of total export value. Out of all the firms in manufacturing, the paper finds that up to 45% of firms export, and out of all possible export markets (countries), in every year, Slovenian firms export to around 70% of them, having no exports to the others. In terms of variance of total exports explained by the two margins, the extensive margin fares better.

The regression results show that all gravity specifications with extensive margins have a much higher explanatory power as compared to the gravity regressions with intensive margins. The results on the effects of institutions and institutional distances leave something to be desired for, as the results are unable to replicate the more salient institutional effects from the literature. The findings imply that the quality of institutions in the destination country is not a significant determinant of exports, and that out of institutional distances, only distance in the quality of political institutions affects exports negatively. This negative effect is based on the intensive margin, whereas no institutional variable seems to have an effect on the extensive margin. There are also heterogeneities in the effect of political institutional distance depending on whether trade is intra-industry, or inter-industry.

Keywords: bilateral trade, intensive margin, extensive margin, gravity equation, institutions, institutional distance.

dr. Aljaž Kunčič