

Institutional Governance and Trade - The Case for COMESA Region



BY

MASHURA SHINGIRIRAI

AFRICAN ECONOMIC CONFERENCE

ADDIS ABABA, ETHIOPIA

4-6 DECEMBER 2017

Outline of the Presentation



1. Introduction
2. Institutions and trade performance in the COMESA region
 - Quality of institutions
 - Trade performance
 - ✦ Extra-COMESA trade
 - ✦ Intra-COMESA trade (trade between member states and the rest of the world)
3. Empirical model and data
4. Estimation results
5. Conclusions and policy implications

1. Introduction



- International trade theories have failed to recognise the role of institutions in determining trade between and across political and economic entities.
- North (1991:97) argued that institutions determine:
 - transaction costs,
 - profitability and
 - feasibility of economic activities,
- therefore collective impact of institutions, technology, and factor endowments determine actual magnitude and direction of trade at each given time
- Empirical studies (Anderson and Young, 1999; Anderson and Marcouiller, 2002; Groot et-al., 2004) started to examine direct effects of institutions on bilateral trade flows

Introduction Cntd.....



- Although previous researches agree on the role played by institutions in stimulating exports, the relations between institutions and trade remains ambiguous.
- This paper intends to solve this puzzle by investigating the relationship between institution and trade in the context of COMESA region.
 - region has not been the subject matter regarding the relationship between institutions and trade
- The specific questions this paper set out to answer are:
 - (i) What are the patterns of institutional quality and export flows in the COMESA region?
 - (ii) How do institutional factors explain export flows in the COMESA region?
 - (iii) What policy implications can be drawn?

Background: Institutions



- “Institutions are rules of the game in a society” (north, 1997:3)
- Various aspects of institutional infrastructure are determined with ambiguity
 - Time series data is incomplete
- To address this lacuna the study adopts world governance indicators to measure institutional quality.
 - ✦ These indicators include: government effectiveness, Regulatory quality, Rule of law, Control for corruption
- In the four selected institutional indicators, the percentile rankings of COMESA member states are quite alarming.
 - The least performing countries include: Burundi, Comoros, DR Congo, Eritrea Libya and Zimbabwe
 - Rwanda, Mauritius and Seychelles are better performing with percentile ranks more than median (50) in all indicators.

Institutions cntd...



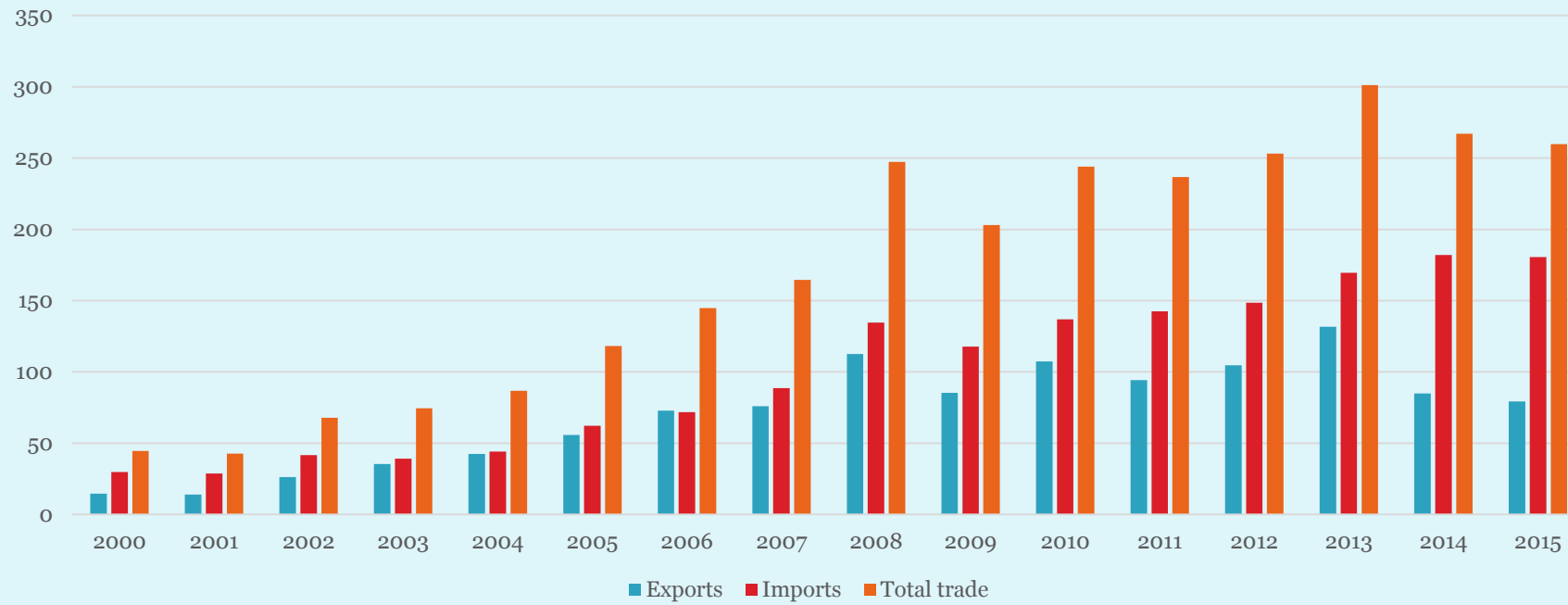
	Government Effectiveness			Regulatory Quality			Rule of Law			Control for corruption		
	1996	2015	D. of Change	1996	2015	D. of Change	1996	2015	D. of Change	1996	2015	D. of Change
Burundi	2.90	12.0	9.1↑	4.40	27.4	23↑	2.90	11.5	8.6↑	4.90	10.1	5.2↑
DR Congo	3.40	3.80	0.4↑	2.90	6.30	3.4↑	1.40	3.40	2↑	0	9.10	9.1↑
Djibouti	17.1	16.3	0.8↓	19.1	28.4	9.3↑	19.1	18.3	0.8↓	36.1	33.7	2.4↓
Egypt	47.8	22.1	25.7↓	52.5	24.5	28↓	53.6	35.6	18↓	56.6	35.1	21.5↓
Eritrea	11.2	4.80	6.4↓	13.7	1.40	12.3↓	38.8	4.80	34↓	70.2	5.30	65.9↓
Ethiopia	6.30	28.8	22.5↑	8.80	14.4	5.6↑	21.1	38.5	17.4↑	8.80	42.8	34↓
Kenya	43.4	43.8	0.4↑	36.3	43.3	7.0↑	16.3	36.5	20.2↑	15.1	13.5	1.6↓
Libya	19.0	1.92	17.1↓	3.43	0.48	2.95↓	15.3	1.92	13.3↓	25.9	24.0	1.9↓
Madagascar	31.2	8.65	22.6↓	17.2	26.0	8.8↑	33.0	28.8	4.2↓	63.9	24.0	39.9↓
Malawi	33.7	26.4	7.3↓	38.7	23.1	15.6↓	35.4	44.2	8.8↑	49.3	23.1	26.2↓
Mauritius	63.4	80.8	17.4↑	50.5	82.2	29.7↑	78.5	77.4	1.1↓	73.2	67.8	5.4↓
Rwanda	11.2	51.4	40.2↑	7.40	60.6	53.2↑	2.40	60.1	57.7↑	20.0	75.0	55↑
Seychelles	75.6	68.6	7.0↓	62.3	50.5	11.8↓	69.4	62.0	7.4↓	82.4	77.9	4.5↓
Uganda	24.4	37.0	12.6↑	57.8	46.2	11.6↓	30.1	43.3	13.2↑	28.8	12.0	16.8↓
Zambia	13.7	33.2	19.5↑	33.8	37.9	4.1↑	29.7	47.1	17.4↑	15.1	43.3	28.2↑
Zimbabwe	47.3	11.5	35.8↓	18.6	3.84	14.8↓	25.4	6.25	19.2↓	44.3	7.20	37.1↓

Background: Trade



- Global-COMESA trade grew from US\$44.5 bn in 2000 to US\$301 bn in 2013, before it plunges to US\$259.1 bn in 2015.

Global-COMESA Trade in Million US\$: 2000-2015



Trade ctd....



- Specifically,
 - total exports declined from US\$131.6 bn in 2013 to US\$79.3 bn in 2015.
 - Total imports declined from US\$182 bn by the end of 2014 to US\$180.6 bn in 2015.
- Regarding the major export markets for COMESA products:

	Exports		Imports	
Rank	Market	US\$ Million	Market	US\$ Million
1	EU	42,918	China	31,139
2	China	11,154	EU	20,323
3	COMESA	9,561	India	10,838
4	South Africa	4,517	South Africa	10,168
5	Saudi Arabia	4,447	COMESA	9,738

Trade ctd....



- Establishment of FTA has partly led to an increase in intra-COMESA trade from US\$3.1 bn in 2000 to US\$19.3 bn in 2015.
- Intra-COMESA exports increased from US\$9.2 bn in 2014 to US\$9.7 bn in 2015, while imports declined from US\$9.9 bn in 2014 to US\$9.6 bn by the end of 2015.
- In 2015, Egypt, DR Congo and Kenya registered the largest shares of intra-COMESA export market with 18.6%, 18.2% and 15.4% resp.
- DR Congo and Zambia recorded the largest intra-COMESA import market share of 21% and 20.9% respectively.

Brief Review of Literature



- 1. Direct relationship between institutions on trade

Author(s)	Sample	Results
Anderson and Young (1999)	Simple model with paradoxical comparative statics	Lack of enforcement of contracts may act as a tariff on risk-neutral traders and therefore reduce trade.
De Groot et al, (2004)	Set of more than 100 countries	Institutional quality has a significant, positive and substantial impact on bilateral trade flows. The results support the hypothesis of the study that institutional variation is an important determinant of informal barriers to trade.
Matthias, et al (2007)	The Asia Pacific Economic Cooperation (APEC) member economies.	Improving trade-related transparency in APEC could hold significant benefits by raising intra-APEC trade.

Brief Review of Literature



- Ambiguous relationship between of institutions on trade

Author(s)	Sample	Results
Lambsdorff (1998)	2 importing developing countries and 6 exporting developed countries.	The degree of corruption in importing countries affects the trade structure of exporting countries. It is concluded that these findings are due to the differentiated inclination of exporters to offer bribes.
Lavallée (2005)	145 countries 1984-2002	Corruption must be analysed as a Directly Unproductive Profit-seeking activity (DUP), such as tariff evasion or smuggling.

Empirical model and data



- The gravity model continues to be the workhorse in the international trade economics
 - Reason: consistent results and comparatively compact specification (Grant and Lambert, 2008).
- The augmented gravity model can be specified as follows:
 - $$\ln EXP_{ijt} = \beta_0 + \beta_1 \ln GDP_{it} + \beta_2 \ln GDP_{jt} + \beta_3 \ln DIST_{ij} + \beta_4 LANG_{ij} + \beta_5 \ln TP_{it} + \beta_6 GE_{it} + \beta_7 RQ_{it} + \beta_8 RL_{it} + \beta_9 CC_{it} + \varepsilon_{ijt} \quad (1)$$
 - Model 1: benchmark specification which controls for the overall impact of trade policy and institutional quality on trade flows
 - Estimation technique:
 - ✦ either random effects or fixed effects.
 - ✦ Hausman specification tests – failure to reject H_0 imply adoption of random effects

Estimation results



- **Diagnostic tests**

- Panel unit root – LLC test and IPS test - result stationary
- Hausman specification test – Ho could not be rejected – REM applied

- ✦ **Regression results – Random Effects Model**

	Intra-COMESA	Extra-COMESA
GDP Exporter	0.1898* (3.3205)	0.7482*** (6.3633)
GDP Importer	1.3108*** (5.9477)	0.4557** (2.3205)
Distance	-3.0399*** (-5.5498)	-1.2228*** (-4.883)
Common Language	-0.7754*** (9.3071)	0.0682 (0.1750)

Results



Trade Policy	-0.2897*** (-1.0213)	-0.1293*** (-4.4556)
Corruption	-0.33631*** (-1.4662)	-0.4786*** (-3.1407)
Government Effectiveness	0.3192** (1.1504)	0.2109* (1.2135)
Regulatory Quality	0.6334** (2.4040)	0.5102** (2.4955)
Rule of Law	-0.1811 (-0.6519)	-0.2156 (-0.8873)
Constant	12.822*** (3.5205)	4.9560** (2.0782)

Discussion



- GE -expected positive and statistically significant coefficient at both intra-COMESA and extra-COMESA trade flows.
 - support the findings by Francois and Manchin (2006) who note that government effectiveness positively improve the propensity to export in the developing countries.
 - The implication of the regression result is that improvement in competence and efficiency of the civil services in carrying out governments' day to day duties will improve exports by significant margins.
- RL - statistically insignificant coefficient at both intra-COMESA and extra-COMESA trade levels.

Discussion



- RQ - positive and significant in influencing export flows for COMESA countries, at both regional and international levels.
 - ✦ improvement in regulatory quality by 1 unit will increase exports by 0.63% at intra-comesa level and 0.51 at extra-comesa level.
 - ✦ Implication is that improvement in government's ability to formulate sound policies and regulations that permit and promote private sector development open up new opportunities
 - ✦ support De Groot et-al. (2004) who note that regulatory quality has a significant, positive and substantial impact on bilateral trade flows
- CC – expected negative and statistically significant coefficient.
 - presence of corruption adds more to the costs of exporters and the possibility of bribery and kickbacks increases the cost of doing business, hence, reduced productivity
 - support the argument by Hall and Jones (1999) who found that corruption reduce aggregate productivity

Conclusion and policy implications



- In conclusion, the empirical results provide evidence that:
 - presence of corruption significantly reduces exports;
 - improvements in government effectiveness is significantly associated with increased exports;
 - improved regulatory environment positively significantly facilitates increased levels of exports,
 - deterioration in the rule of law seems to be working against improved exports of the COMESA countries.
- The following policy implications are drawn:
 - COMESA member states need to go further than just the study of several forms of institutions to focus on the improvement in quality of these institutions

Conclusion and policy implications



- capacity building and training on effects on institutional quality on trade for easy understanding by policy-makers is worth considering
- preparedness to break away from traditional ideologies and contemplate institutional reforms - reconsidering governance and challenging orthodoxy
 - ✦ reduction of red tape and streamlining of administrative and bureaucratic procedures (Rwanda and Zambia)
 - ✦ investigating and prosecuting corruption cases involving high-ranking officials
- reduction of transaction cost associated with exports through infrastructural development and
- reduction in bureaucracy surrounding export document processing at ports



Thank You

Zikomo

Muito obrigado

Asenteni

Ke a leboga