

The Role of Institutional Quality and Institutional Quality Distance on Trade: The Case of Agricultural Trade within the Southern African Development Community Region

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Abstract : The study applies a New Institutional Economics (NIE) analytical framework to trade in developing economies by assessing the impacts of institutional quality and institutional quality distance on agricultural trade using a panel data of 15 Southern African Development Community (SADC) countries from the years 1991-2010. The issue of institutions on agricultural trade has not been accorded the necessary attention in the literature, particularly in developing economies. Therefore, the paper empirically tests the gravity model of international trade by measuring the impact of political, economic and legal institutions on intra SADC agricultural trade. The gravity model is noted for its exploratory power and strong theoretical foundation. However, the model has statistical shortcomings in dealing with zero trade values and heteroscedasticity residuals leading to biased results. Therefore, this study employs a two stage Heckman selection model with a Probit equation to estimate the influence of institutions on agricultural trade. The selection stages include the inverse Mills ratio to account for the variable bias of the gravity model. The Heckman model accounts for zero trade values and is robust in the presence of heteroscedasticity. The empirical results of the study support the NIE theory premise that institutions matter in trade. The results demonstrate that institutions determine bilateral agricultural trade on different margins with political institutions having positive and significant influence on bilateral agricultural trade flows within the SADC region. Legal and economic institutions have significant and negative effects on SADC trade. Furthermore, the results of this study confirm that institutional quality distance influences agricultural trade. Legal and political institutional distance have a positive and significant influence on bilateral agricultural trade while the influence of economic, institutional quality is negative and insignificant. The results imply that nontrade barriers, in the form of institutional quality and institutional quality distance, are significant factors limiting intra SADC agricultural trade. Therefore, gains from intra SADC agricultural trade can be attained through the improvement of institutions within the region.

Keywords : agricultural trade, institutions, gravity model, SADC

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