International Review of Economics and Finance 42 (2016) 36–53

Contents lists available at ScienceDirect

International Review of Economics and Finance

journal homepage: www.elsevier.com/locate/iref

New Zealand's trade with Asia and the role of good governance

Azmat Gani [a,*], Frank Scrimgeour [b]

[a] Department of Economics and Finance, College of Economics and Political Science, P.O. Box 20, Al Khod 123, Muscat, Oman
[b] Department of Economics, Waikato Management School, The University of Waikato, Hamilton, New Zealand

ARTICLE INFO

Article history:
Received 4 February 2015
Received in revised form 14 October 2015
Accepted 14 October 2015
Available online 23 October 2015

JEL classification:
F1
O5

Keywords:
Governance
New Zealand
Asia
Trade
Contract enforcement
Regulatory quality

ABSTRACT

This paper investigates if achievements in good governance in Asian countries matter for New Zealand's trade by testing augmented equations of New Zealand's exports to and imports from Asia within the gravity model framework. The empirical findings based on the instrumental variable method of estimation confirm statistically significant inverse correlation of contract enforcement with New Zealand's exports to and imports from Asia. The findings also reveal that New Zealand's exports to Asia are negatively and statistically significantly correlated with Asian political rights and New Zealand's imports from Asia are negatively but statistically insignificantly correlated with Asian political rights. We conclude that as part of wider trade integration New Zealand's Asian trading partners should invest more resources in improving their governance such as instituting mechanisms for better enforcement of contracts and allowing greater political openness.

1. Introduction

The central focus of this paper is to empirically investigate if achievements in good governance in Asian countries matter for New Zealand's trade. Available statistics indicate that New Zealand's long-term international trade reach has expanded significantly with more and more countries added to its list of trading partners. One of the likely drivers of New Zealand's increased trade over the last two decades has been the governments comprehensive market-oriented reforms of 1984–87 where the economy was opened to foreign capital and international trade with the abandonment of price controls, tariffication of import quotas and reduction of tariffs and removal of export incentives, among others (Stillman, Velamuri & Aitken, 2010). In particular, its growing economic emphasis on Asia has translated into strong growth in trade in the last decade. Since its membership to the World Trade Organization in 1995, New Zealand has pursued bilateral or plurilateral preferential trade agreements intensively with major Asian countries (World Trade Organisation, 2009). According to the New Zealand Ministry of Foreign Affairs and Trade, New Zealand managed to sign six trade agreements with the Asian countries that are currently in force and three agreements are under negotiation. Poot and Strutt (2010) provide a good summary of New Zealand's trade agreements in force. Analysis of the effects of bilateral trade agreements on the New Zealand's economy by Winchester (2006) revealed significant positive impact.

Asian countries have been expanding their trade reach with the aim of greater participation in the global trading environment. The global financial and economic crisis (GFC) that originated in the USA in 2007 (reviewed in Duttagupta & Cashin, 2011), severely strained the global financial and economic system. This compelled many countries to focus within their respective regions

* Corresponding author. Tel.: +968 24142950; fax: +968 24414043.
E-mail addresses: azmat@squ.edu.om (A. Gani), scrim@waikato.ac.nz (F. Scrimgeour).

http://dx.doi.org/10.1016/j.iref.2015.10.017

for trade, finance and investment opportunities. While New Zealand's economy has performed relatively well during the global financial crisis (see for example, Lane, 2013), the economic downturn of USA (New Zealand's third largest export market) triggered New Zealand to secure a more diversified export market base in order to cushion the unforeseen risks of economic recessions in major export markets. At the same time, the rapidly rising per capita incomes in Asia including those of the large economies of China and India offer tremendous potential for New Zealand exporters to secure long-term export markets. New Zealand, a land based economy, has much to offer to the growing demands of the large Asian population in terms of food, tourism and technology transfer. New Zealand together with Australia also has shared interests going beyond international trade and covering areas of regional peace and security as Dixit (2009) notes that countries that trade more with each other are less likely to go to war with each other while Polachek (1980) notes that there are significant causal effects of trade on peace. New Zealand's intensive engagement with Asia in international trade can be a lever to facilitate long-term peace and security within the Asia-Pacific region.

One aspect of Asia that is likely to influence the New Zealand–Asia trade relationship is their achievements in good governance: the process by which governments are selected and replaced; the capacity of the government to effectively formulate and implement sound policies; and the respect of citizens and the state for the institutions that govern economic and social interactions among them (Kaufmann, Kraay & Mastruzzi, 2004). This branch of new institutionalism (for example, North, 1990, 2005; Rodrik, 2007; Williamson, 1975, 2002) highlights the importance of institutions (law and order, property rights, contracts; independence of the courts, low corruption and cronyism and traditions of civic responsibility) that are fundamental to the effective functioning of market-based economies. Market based economic activity cannot succeed unless appropriate institutions that support this are in place (Rodrik, 2007). Jalilian, Kirkpatrick and Parker (2006) note that institution building reduces information imperfections, maximizes economic incentives and reduces transaction costs. The argument is that for countries to fully integrate in the global trading environment and to benefit from outward oriented trade strategies, the level of achievements in good governance can matter.

While national governance frameworks, practices, policies and outcomes vary widely across the world, Kaufmann, Kray and Mastruzzi (2012) and their several works have made it possible to get a reasonable understanding of achievements in governance at the national level for a range of countries around the world including several of New Zealand's trading partners in Asia and elsewhere. The findings of these authors reveal large gaps in the institutional achievements between the developing and the advanced economies and while New Zealand's achievements in governance are exemplary as measured by several dimensions of governance, several Asian countries seem to fall short on the same measures of governance (discussed in Section 2). It is worthy to note Olson's (1996) point of view that much of the developing world does not appear to have a well developed structure of incentives to facilitate productive cooperation, for example, legal systems that can impartially enforce contracts, secure property rights and enforcement mechanisms.

Among other things, achievements in good governance have been the hallmark of New Zealand's long-term economic prosperity and political advancement. New Zealand has a history of making strong, effective and enforceable laws and conventions that form the basis of successful market production and exchange process as well as attaching high priorities in making its laws transparent, enforceable and easily accessible. In terms of commercial policies and laws applied to the business environment, New Zealand is considered to be among the leading economies of the world with a reputable and an impartial judiciary and with appropriate laws that govern the business environment supported by highly efficient and effective regulatory institutions. These developments, among others, have elevated New Zealand to a level where it is now perceived as one of the best countries in the world in terms of doing business. For example, according to the *Doing Business Report 2013* (www.doingbusiness.org), New Zealand ranks first out of the 189 countries surveyed in terms of starting a business and protecting investors and ranks third in terms of ease of doing business. In additions, according to Transparency International's (www.transparancy.org), measure of public sector corruption in 2014, New Zealand is the second cleanest or least corrupt country in the world.

It is now well known in the trade literature that trade has a positive impact on the prosperity of nations. Singh (2010) provides an extensive survey of the microeconomic and macroeconomic evidence on the gains from trade. Countries throughout the world are aiming to expand their trade structure with the aim of greater integration and participation in the global trading environment in order to achieve higher levels of economic growth (Chang, Kattani & Loayza, 2009).

The issue of governance is now a widely discussed topic largely pertaining to growth and development but research focus on trade and governance link is rare. Theoretically, it can be argued that poor achievements in governance can be an impediment to trade. While trade theory makes it clear that trade is determined by country endowments, the level of technology, preferences and the degree of competition in the global trading environment, North (1990) notes the vital role played by institutions in explaining the economic outcomes. Williamson (1975 and 2002) and North (1990 and 2005) have argued that the quality of institutions (law and order; property rights; contracts; independence of the courts; low corruption and cronyism; and traditions of civic responsibility) is fundamental to the effective functioning of market-based economies.

It is known that poor institutional quality particularly in the low-income countries contributed to lower trade volumes (Francois & Manchin, 2013). Rodrik, Subramanian and Trebbi (2004) in their investigation of the respective contributions of institutions, geography and trade in determining income levels around the world found that the quality of institutions “trumps” everything else. Acemoglu, Johnson and Robinson (2005) provide a comprehensive survey on the quality of domestic institutions as a key explanation for cross-country difference in both growth rates and income per capita. Acemoglu et al. (2007) have argued that in countries with weaker judicial systems, the courts have limited capabilities of verifying contractual contingencies due to a lack of their judges' competencies. Levchenko (2007) tested empirically whether institutions act as a source of trade using data on US imports disaggregated by country and industry. His empirical results provide evidence on the “institutional content of trade”: institutional differences are an important determinant of trade flows.