

Abstract

- In this paper I use South Asian firm-level data to examine whether the impact of corruption (political instability) on firm level export decision depends on political instability (corruption).
- This study uses the IV Probit model to analyze the data collected by the World Bank.
- The results confirm that Political instability (corruption) reduces the impact of corruption (political instability) on firm-level export decision.
- In addition, this analysis yields meaningful policy implication regarding political instability, corruption and a firm-level decision entering the foreign market in developing countries.

Introduction

- Corruption and Political Instability (PI) are related phenomena and the most significant impediments to economic development.
- Firms might perceive corruption and political instability as an obstacle differently with their sizes, trade orientations, and sectors.
- Heterogeneous firms differ in terms of their productivities, and there are fixed costs associated with exporting (Melitz Model, 2003)
- Up to now, the two literatures 'corruption & exporting' and 'PI & exporting' have developed in a parallel fashion. But, the interaction effect of corruption and PI on a firm level export decision has not been addressed.
- The paper investigates the causal relationship between corruption and firm-level export decisions, and how that relationship is affected by political instability.
- The results suggest that both corruption and political instability increase the probability that a firm enters the foreign market. Further, I find that the impact of political instability (corruption) on firm's export decision decreases if the level of corruption (political instability) is high.

Mechanism: Corruption, Political Instability and Exporting

- Corruption and PI impose an additional fixed cost on firms and make them more costly to operate. As a result, firms who can afford the extra fixed cost enter the foreign market and firms who can't manage that cost either sell only in the domestic market or exit the market.
- When the level of PI is high, firms can influence the politician to get things done, and hence the impact of corruption on firms' exporting decisions would be lower compared to the business environment when the level of PI is low.
- When the degree of corruptibility is high, firms have to pay bribe to get things done no matter what (political channel may not work) and hence, the impact of PI on firms' exporting decision would decrease. Similarly, when the degree of corruptibility is low, firms use the politician to get things done, and hence, the impact of PI on firms' exporting decisions would increase.

Econometric Model

$$Export_dum_{ijtc} = \theta_0 + \theta_1 Corrupt_Obstacle_{ijtc} + \theta_2 PI_dum_{ijtc} + \theta_3 Corrupt_Obstacle_{ijtc} * PI_dum_{ijtc} + \gamma X_{ijtc} + \delta I_f + \lambda I_j + \vartheta I_c + \mu I_t + \epsilon_{ijtc}$$

$$Export_dum_{ijtc} = \theta_0 + \theta_1 PI_Obstacle_{ijtc} + \theta_2 Corruption_dum_{ijtc} + \theta_3 PI_Obstacle_{ijtc} * Corruption_dum_{ijtc} + \gamma X_{ijtc} + \delta I_f + \lambda I_j + \vartheta I_c + \mu I_t + \epsilon_{ijtc}$$

- $Export_dum_{ijtc}$ => export dummy variable for firm i in two-digit industry j , year t , and country c . It takes value one if the firm exports and zero otherwise.
- $Corrupt_Obstacle_{ijtc}$ is the corruption obstacle variable takes values from zero (no obstacle) to four (very severe obstacle).
- $PI_Obstacle_{ijtc}$ is the political instability obstacle variable takes values from zero (no obstacle) to four (very severe obstacle).
- PI_dum_{ijtc} => Political Instability dummy variable. It takes value one if the firm perceives the business environment is politically unstable.
- $Corruption_dum_{ijtc}$ => Corruption dummy variable. It takes value one if the firm perceives the business environment is corrupted.
- X_{ijtc} is a set of firm level control
- $I_f, I_j, I_c,$ and I_t are firm-size fixed effects, industry fixed effects, country fixed effects and survey year fixed effects
- ϵ_{ijtc} is a classical error term

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Results and Contributions

- The estimates suggest that for a one-unit increase in corruption, we expect 7 percentage points increase in the probability that a firm exports. Also, for a one-unit increase in the political instability, we expect 32.2 percentage points increase in the probability a firm exports.
- Even though, coefficients of interaction terms are not statistically significant, interaction term and other two variables are jointly significant. Hence, this indicates that in the corrupt climate the impact of PI on firm's export decision decreases. Similarly, if the PI is high, the effect of corruption on firm's export decision decreases.
- This article contributes to the existing literature in three important ways:
 - First, to the best of my knowledge, this is the first article to examine the interaction effect of the corruption and political instability on the firm's decision to enter the foreign market.
 - Second, this paper proposes various instruments (such as average corruption by country, year and industry for corruption and average PI for political instability) to address endogeneity issues.
 - Third, these results have important policy implications for developing countries, in particular, South Asian region where corruption prevalence is relatively high.

Table 1: Effect of corruption and PI on firm-level export decisions (probit IVs results)

Dependent variables: Export Dummy (col. 1, 3 and 5) and Global Firm Dummy (col. 2, 4 and 6)

VARIABLES	(1)	(2)	(3)	(4)	(5)	(6)
	Export Dummy	Global Firm Dummy	Export Dummy	Global Firm Dummy	Export Dummy	Global Firm Dummy
Corruption Obstacle	0.070** (0.031)	0.088** (0.036)			0.068** (0.030)	0.086** (0.036)
Political Instability Obstacle			0.322** (0.154)	0.286* (0.156)	0.311* (0.161)	0.325** (0.164)

Reported values are estimated marginal effects (Probit model) with robust standard errors clustered at the country-industry-year level in brackets. All regressions include firm-size effects, country effects, industry effects, and year effects. Also, all regressions are controlled for labor productivity (lag3), age, foreign technology dummy, international quality certificate, female manager dummy and female owner dummy. Dependent variables are export dummy and global firm dummy. *** p<0.01, ** p<0.05, * p<0.1.

Discussion and Conclusions

- Investigates the impact of Corruption and PI on firm's decisions to enter the foreign market (i.e., Export dummy and Global Firm dummy are used as dependent variables)
- The estimation results conclude that corruption and PI increase the firm's probability of entering the foreign market, and the impact of corruption (PI) on exporting decreases when the level of PI (corruption) is high.
- Uses South Asian firm-level data collected by the World Bank
- Estimates many specifications with IV probit model
- Instruments are strong enough and valid
- Suggests public policies in developing countries, mainly in South Asia
- Smaller firms disappear as Corruption and/or PI increase while bigger firms (who can manage additional fixed cost) enter the foreign markets
- Results are robust for both intensive and extensive margin of trade.

Table 2: Effect of interaction of corruption and political instability on firm-level export decisions

Dependent variables: Export Dummy (col. 1 and 3) and Global Firm Dummy (col. 2 and 4)

VARIABLES	(1)	(2)	(3)	(4)
	Export Dummy	Global Firm Dummy	Export Dummy	Global Firm Dummy
Corruption Obstacle	0.070** (0.035)	0.095** (0.041)		
PI Obstacle Dummy	0.082 (0.052)	0.147** (0.064)		
Corruption Obstacle * PI Obstacle Dummy	-0.021 (0.023)	-0.043 (0.028)		
Estimated PI Obstacle			0.336** (0.157)	0.303* (0.162)
Corruption Obstacle Dummy			0.050** (0.022)	0.054* (0.028)
PI Obstacle *Corrupt. Obstacle Dummy			-0.014 (0.011)	-0.012 (0.016)

Reported values are estimated marginal effects (Probit model) with robust standard errors clustered at the country-industry-year level in brackets. All regressions include firm-size effects, country effects, industry effects, and year effects. Also, all regressions are controlled for labor productivity (lag3), age, foreign technology dummy, international quality certificate, female manager dummy and female owner dummy. Dependent variables are export dummy and global firm dummy. *** p<0.01, ** p<0.05, * p<0.1.

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