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PRESS RELEASE

Institutions and export dynamics

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Imperfect enforcement of contracts can prevent mutually beneficial transactions from taking place. This problem tends to be particularly severe for transactions that involve agents in different jurisdictions, as in international trade. Empirical research using aggregate data has found that weak contract enforcement indeed depresses aggregate trade levels significantly. Yet we know virtually nothing about how contracting institutions shape the dynamics of trade at the firm level; this is our focus in this paper.

We first develop a theoretical model to describe how economic agents build reputations to overcome the problems created by weak enforcement of international contracts. We find that, all else equal, exporters start their activities with higher volumes and remain as exporters for a longer period in countries with better contracting institutions. However, conditional on survival, the growth rate of a firm's exports to a country decreases with the quality of the country's institutions. We test these predictions using a rich panel of Belgium exporting firms from 1995 to 2008 to every country in the world. We adopt two alternative empirical strategies. In one specification we use firm-year fixed effects to control for time-varying firm-specific characteristics. Alternatively, we model selection more explicitly with a two-step Heckman procedure using information of past year export activity as our exclusion restrictions. Results from both specifications support our predictions. Overall, our findings suggest that weak contracting institutions cannot be thought simply as an extra sunk or fixed cost to exporting firms; they also significantly affect firms' trade volumes and have manifold implications for firms' dynamic patterns in foreign markets.