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PAPER

How do Institutions matter for International Business? Evidence from SAARC Countries

Rukhsana Kalim[*] • Anam Javaid[**] • Muhammad Hassan Danish[***] • Noman Arshed[****]

Abstract Institutions matter for smooth businesses within the country and across countries, and their role in international trade and finance has caught much attention in the last decade. Many institutional and governance factors affect the volume of export, import and foreign direct investment, which are the crucial source of earnings for the populous region of SAARC. This paper examines the impact of institutions on international business by using the Feasible Generalized Least Square (FGLS) method from 2001 to 2019. The selected institutional indicators are government stability, external conflict, corruption, law and order, and democratic accountability. Estimation indicates that democratic accountability and political stability promote trade and FDI, while external conflict negatively affects international business. Control of corruption promotes trade. The research findings can guide policymakers in devising the policies related to the institutions.

Keywords: Corruption, Political Stability, Democracy, Exports, Imports, FDI, FGLS, SAARC.

JEL Classification Codes: F3, F4, F11, F13, F15, F16.

1. Introduction

"Institutions are the rules of the game in a society, ... the humanly devised constraints

Rukhsana Kalim[*], Anam Javaid[**], Muhammad Hassan Danish[***], Noman Arshed[****](✉)
[*] Professor, Department of Economics and Statistics, University of Management and Technology, Lahore Pakistan.
E-mail: drrukhsana@umt.edu.pk
[**] PhD Scholar, Department of Economics and Statistics, University of Management and Technology, Lahore Pakistan
E-mail: anamjavaid760@gmail.com
[***] Lectruer, School of Commerce and Accountancy, University of Management and Technology, Lahore Pakistan.
Email: hassan.danish@umt.edu.pk
[****]Assistant Professor, Department of Economics, University of Education, Lahore Pakistan.
Email: noman.arshed@ue.edu.pk

that shape human interaction" (North, 1990). This definition highlight three main points related to institutions. First, humans devise institutions with fundamental causes, i.e., geographic factors that are outside of human control. Second is the "rules of the game" that restrain human behavior. The third is that institutions shape incentives. If institutions are the determinants of incentives, these should have a significant effect on economic growth and development.

International business refers to the trade of goods and services and financial exchange across national borders or globally. Many factors affect the export, import and foreign direct investment, but this study explores the institutional side. The role of institutional quality in deciding Foreign Direct Investment (FDI) has gotten much attention in the last decade, with few empirical studies supporting the idea that good institutes attract FDI in the country and help to drive capital mobility internationally (Alfaro et al., 2005). Here good institutes block the dirty industry FDI and encourage clean FDI as per the pollution haven hypothesis.

According to endogenous growth theories, trade is argued to complement the economic growth of emerging economies because it urges them to invest in the technology transfer and physical capital (Luis Rivera-Batiz, 1991). Besides trade, FDI also has a significant positive impact on the growth of the host country because this process includes a transfer of technology and knowledge in that country. Management skills and advanced technology are transferred from advanced countries to host countries (Borensztein et al., 1998; Kalim et al., 2019). Foreign Direct Investment is important for two reasons. FDI will increase physical capital and the domestic capital in the country, but it also brings in new technology, better management skills, knowledge, and techniques, denoted as intellectual capital, that enhance capital and labor productivity (Kukeli, 2006). The long-run growth effect of international trade depends on two key factors, Institutional arrangements and market configuration (Klaus & Wood, 2004). The impact of FDI depends on the economic scale and institutions of the host country (Mello, 1999a).

SAARC was established to undertake the collective effort toward the collective progress of all the member nations of South Asia. Member countries of SAARC are Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka. A significant achievement of SAARC is South Asian Free Trade Agreement (SAFTA). SAFTA provides a platform that allows people to work together to attain the common objective of quality life through social progress, cultural development and rapid economic growth in the region. Combined, SAARC is the third-largest economy after the United States of America. It covers 3% of World geographic territories with 9.1% of total global wealth and approximately 21% of the entire world's population (Abdin, 2015).

Besides these achievements, SAARC countries are facing many types of challenges. Main challenges include a large amount of poor population of the world, deficiency of human development initiatives, political conflict between member countries, criminal and illegal occurrences, political instability and corruption (Arshed et al., 2018). Employment generation, entrepreneurship and attracting foreign direct investment are the best solutions to tackle these problems. It will increase GDP, export earnings of member nations, and ensure the region's economic growth. FDI and the quality of intuitions matter a lot. Good governance and FDI are significantly related. It is associated with democratic governance, political stability, and sound macroeconomic conditions of the host country (Bitzenis & Zugic, 2016).

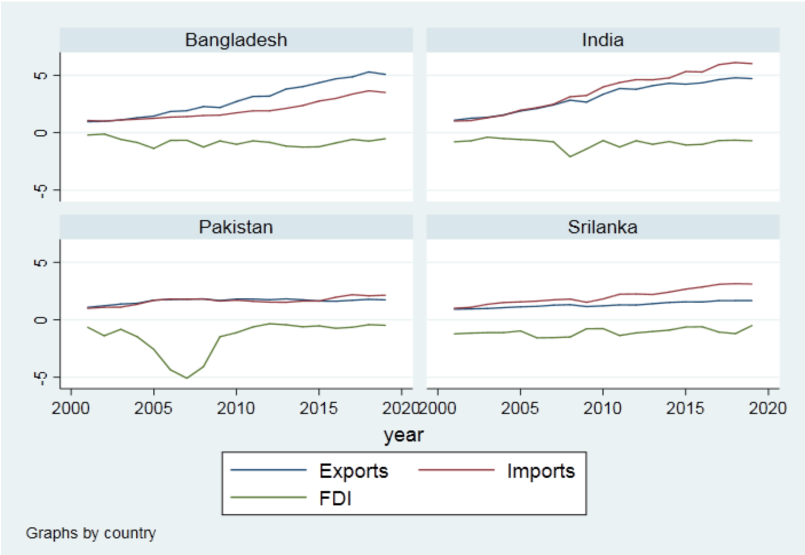

Figure 1. International Trade and Foreign Direct Investment of SAARC Countries
Source of Data: WDI

Figure 1 indicates trends in trade and FDI of SAARC Countries. In India and Sri Lanka, imports are more significant than their exports, showing a trade deficit. The net FDI of Pakistan and India is not stable. After 2005 these countries experience a negative shock. Corruption is the main reason for the poor quality of institutions in SAARC countries. According to Corruption Perception Index 2019, Afghanistan ranked 173, Bangladesh 146, Bhutan 25, India 80, Maldives 130, Pakistan 120, and Sri Lanka 93 out of 180 countries (Transparency International, 2019). Corruption culture is present in almost all institutions and regions. In Pakistan, corruption is considered the third major problem after poor infrastructure and government bureaucracy for companies doing business in Pakistan. In Sri Lanka, more than 50 % of the public pay bribe to public official and politicians to speed up things.

Corruption has become a permanent feature in all the institutions and it has become a way of life for the poor segment of the society because these people have to bribe the public officials and politicians to fulfill their needs. Another objective of the Regional

Corporation (SAARC) is to build up stability and peace in the region. Conflicts-free relations with neighboring countries can reduce defense expenditure and create regional stability, which are the main factors that attract FDI in the country (Desai, 2010). Regional peace and internal stability are highly desirable. When a country faces external security threats and political instability, it hurts its businesses. Foreign investors consider all these factors while making their investment decisions (Kalim et al., 2019).

These South Asian countries are facing many structural challenges that include several external and domestic downside risks. External factor includes trade disputes, climate change, and geopolitical uncertainty. Failure in global coordination hinders economic growth. Domestic factors are various. Prospects of many countries are dampened by the uncertainty of politics, corruption, security threats, and their adverse effect on consumer sentiments and investment. Corruption is prevailing worldwide, but this problem is severe in SAARC countries.

In India, economic growth fell from 6.8% in 2018 to 5.7% in 2019. A decrease in investment and manufacturing growth dampened the export growth across the region. It negatively affected the economies of Nepal and Afghanistan because these countries heavily relied on the trade of raw materials and minimally processed goods with India. Pakistan is struggling with severe balance of payment crises and the burden of high public debt. High inflation, political uncertainty and security concerns affect domestic demand and private investment. According to United Nations, the export growth of Pakistan has fallen to 0.4% due to disappointing sales of textiles that constitute 60% of exports of goods. The GDP growth rate of Pakistan remained at 3.3% in both years, which is below than 4-6% range of previous years. While the economies of Bangladesh, Bhutan and Maldives exceeded their growth expectations. They take advantage of significant opportunities created by turmoil. By taking advantage of trade disputes between China and USA, Bangladesh expanded its garment industry and experienced exceptional growth of 8.1% in 2019. The Maldives benefited from the strong growth of its tourism sector and experienced growth of 6.4% in 2019. In Bhutan, the growth rate exceeded 5.3% in 2018 to 6.0% in 2019 due to increased investment (United Nations, 2020).

Though sufficient literature is available on the quality of intuitions, trade, and FDI for different countries, there is still a dearth of exploring the phenomenon in the SAARC region regarding the multi-dimensional impact of institutional quality on international business. This study fills this gap and explores the impact of institutions on international business, i.e., trade and FDI in SAARC countries. It will help investors in their investment decisions and policymakers in designing their optimal regulations. Moreover, the empirical findings will provide practical insight into institutions' positive or negative influence on international businesses. It can also set the foundations for further research on the same topic in different geographical regions and times. Data from SAARC countries covers the period from 2001 to 2019. The choice of variables is mainly based on the availability of data. These variables are taken from WGI and International Country Risk Guide (ICRG) World Bank Data Base. The subsequent sections of the paper are structured as follows. The literature review is discussed in section 2, followed by the research hypothesis and theoretical framework. Methodology and variables are explained in section 3. Estimation techniques and results are explained in section 4. Conclusion and policy implications are discussed in section 5.

2. Literature Review

Institutions play a vital role in enhancing international trade and the attractiveness of FDI. Many studies were conducted to examine the relationship between different institutions, international trade and FDI. Previous studies investigated the influence of institutions on international trade in seven countries separately. Results show that institutes have a significant impact on trade. Both domestic and international institutions played their role in promoting trade (Ogundipe et al., 2014).

Bailey (2018) conducted his study to examine the relationship between FDI and institutional factors used to synthesize literature to investigate this relationship by using the meta-analytic technique. Results indicate that the countries with positive institutions in terms of stability of politics, democratic institutions, the rule of law attract foreign direct investment. At the same time, corruption, tax rate, and cultural distance negatively influence foreign direct investment.

Institutions affect international business. Exploring the different dimensions of bureaucratic quality, corruption, government stability, law, and order, and external conflicts are very important. Many researchers have investigated their relationship with trade and FDI. Few studies on the impact of these components on international business are discussed below.

2.1 Corruption and international business

Corruption affects the flow of trade, raises the cost of investment projects, reduces the return on investment and discourages foreign direct investment. Many studies examined the effect of corruption on trade and FDI. The main channel of effect is that corruption lowers capital productivity (Lambsdroff, 2003). A study investigated the effect of corruption on the flow of international trade of 47 African countries and their 180 trading partners by using the gravity equation and Weighted Least Square approach. Results revealed that corruption badly affects the flow of exports and imports of African countries and their trade partners (Musila & Sigue, 2010). Another study examined the effect of corruption on bilateral trade to investigate whether corruption reduces or enhances trade. The corruption-augmented gravity equation is used in the analysis. Corruption taxes the international trade when corrupt customs officers extort bribes from exporters, while in high tariff situations, corrupt officers permit exporters to evade tariff barriers. Results indicate that corruption taxes the trade while in a high tariff environment, it enhances the trade (Dutt & Traca, 2010).

A modified version of the corruption-augmented gravity equation based upon the gravity approach incorporates trade effects of institutional quality and national price indices to investigate the multifaceted corruption impact on international trade. GMM is used as an estimation approach. Results indicate that an individual effect of corruption is and more significant on trade than the trade impact of other distance factors (Thede & Gustafson, 2012).

A study was conducted to examine the impact of corruption on bilateral trade using the gravity trade model for a sample of 37 countries. Results revealed that corruption adversely influences the trade flow, and control of corruption increases trade potentialities (Ali & Mdhillat, 2015). A correlation exists between corruption and international trade in emerging and frontier markets. Countries that ranked high in the perception of corruption were those perceived as the most challenging countries in terms of ease of international trade (Shirazi, 2020).

A study examined the effect of corruption on foreign direct investment in East Asia and South Asia by using the GLS methodology. Its results suggested that many factors such as investor's familiarity with the host country, political stability, size of the market, returns on investment, human capital and access to infrastructure boost the foreign direct investment. In contrast, the prevalence of corruption gives the opposite results (Quazi, 2014).

A study investigated the effect of corruption on FDI and its two ways of entry, i.e., cross-border mergers and greenfield investment and cross-border mergers and acquisition using GMM, 2SLS estimation and two-step system GMM estimators. This study shows that corruption hinders FDI inflow in the country. Different results were found when both modes of FDI were tested separately. Corruption discourages cross-border mergers and acquisitions while positively affecting Greenfield investment (Luu et al., 2018).

Another study tested the impact of corruption on FDI inflow in the country by using panel regression method. The gravity model augmented with the combined effect of corruption in trading and host countries determine the differentiated pattern of investment flows between countries. Results indicate that with the improvement of control of corruption, the flow of investment in the countries from the cleaner country increases compared to corrupt countries (Belgibayeva & Plekhanov, 2019).

2.2 Political Stability and international business

Political stability increases the volume of trade and attracts FDI inflows in the country. Different studies examined the effect of government stability on trade and FDI.

A study investigated the link between political risk, business climate, and foreign direct investment in developing countries by using fixed effect and a dynamic model based on GMM estimators. This study indicates that a reduced level of political risk is linked with a higher level of FDI inflows in the country, and business operation conditions are important determinants of foreign direct investment (Krifa-Schneider & Matei, 2010).

A study examined the effect of government stability and other variables on the attractiveness of FDI in 20 developing and developed countries by using a fixed-effects regression method. Results indicate that regulatory quality and political stability are the two variables that significantly impact FDI. Investors consider both political stability and regulatory quality as important factors when making their investment decisions abroad (Saidi et al., 2013).

Shah (2017) studied the effect of political institutions on the FDI of five south Asian countries by using the random effect method. Results indicate that the institutional factors that count the most for the foreign investors are democratic accountability, corruption-free and honest public office holders, military and religious influences on political and efficient bureaucracy.

A study by Goswami and Panthamit (2020), investigated the effect of political risk on trade flow by using data of Thailand with 132 trading partners. The results indicate that the military's role is a prominent indicator in politics at home and abroad, limiting trade flow across borders. It is followed by unstable government, adverse investment profile, internal and external conflicts, and political risk both at home and abroad.

Another study was conducted to test the effect of political instability on trade and international investment in Pakistan by using Error Correction mechanism and ARDL model. Its results indicate that political instability badly hampers international trade and investment in the long run, while it only hinders portfolio investment and exports (Qadri et al., 2020).

2.3 The rule of law and international business

Law and order mean a robust judicial or legal system of a country. In a country where institutions strictly follow law and orders, foreign investment will be high because foreign investors consider all these factors when making their investment decisions. These institutions will enhance the flow of trade and FDI.

A study investigated the reduction in trade due to poor institutions using a structural import demand model. Findings revealed that flawed legal system and transaction costs associated with poor exchange reduce international trade flow. Corrupt officials generate markup prices equivalent to hidden tariffs that decrease trade (Anderson & Marcouiller, 2002).

A study investigated the impact of institutions on FDI. They considered variables of institutions, i.e. law and order, investment profile and bureaucratic quality, and other determinants of FDI, using panel regression estimations of fixed and random effect methods. Findings indicate that institutional variables law and order and investment profile positively influence foreign direct investment while bureaucratic quality negatively influences FDI in 40 developed and developing countries (Siddica & Angkur, 2017).

2.4 Democratic accountability and international business

Democratic accountability is the main component of institutions. Urpelainen (2012) conducted his research to investigate the impact of democratic accountability on international cooperation. Results revealed that national democratic accountability effects the actions of foreign governments. The promotion of democratic norms is very important to curb corruption and the nation's development. Institutional development promotes economic growth through investment (Shabbir, 2017).

2.5 External conflict and international business

External conflicts hinder international businesses. Insecurity in terms of defense reduces the flow of trade and FDI. A study investigated the impact of terrorism on international trade of 200 countries by using an augmented gravity model. Results indicate that insecurity arises from terrorism decreases trade volume (Nitsch & Schumcher, 2004).

Another study examines the impact of insecurity on FDI in Nigeria using the ordinary least square technique. They revealed a negative influence of insecurity in terms of killings, bombing, etc., on foreign direct investment inflow (Owolabi Adesegun et al., 2015).

In summary, the literature findings show that institutions play an essential role in promoting international businesses. Better institutional quality, government stability, law and order promote trade and attract FDI in the country, while results are opposite in the case of negative institutions that lack these qualities. Political stability, bureau quality, corruption, law and order, democratic accountability and external conflict are the important components of institutions.

3. Linkage of international business and institutions

In this section, we extend the specific role of institutions in doing international business of the previous section and focus on the role of quality of institutions for the intensity of trade and FDI. The economic justification for including these explanatory variables is very clear. Uncertainty concerning contract enforcement and economic governance is reduced when the institutional framework is of higher quality. This reduces the cost of transactions directly and indirectly by raising the security of the property and level of trust in the economic transaction process (Groot et al., 2004). Furthermore, greater institutional quality fosters trust in doing business (Beugelsdijk & Van Schaik, 2001).

In explaining the FDI, the involvement of institutions, which include property stability, a regulatory system (corruption, tax system, and transparency), economic freedom, rule of law, and a bureaucratic system, is essential. Good institutions reduce investment-related costs (corruption) and sunk costs, which provide more security to multinational firms or enterprises through property rights and effective legal system (Daniele & Marani, 2006). North (1990) states that good institutions affect economic activities in numerous ways, for example, by reducing transaction and production costs. In addition, excellent quality institutions assist in minimizing company costs and enhancing profitability. However, on the other hand, an economy with weak institutions require more time and resources to monitor. If property rights are inadequately safeguarded, and the enforcement of contracts is difficult, more significant risks slow the economic operations. International investors are hesitant to put their money into such a hazardous and unfriendly atmosphere. On the contrary, risk-free environment is favorable for the investor country, and the excellent institutions lead to better use of FDI. According to Lucas (1993), institutional factors significantly influence attracting FDI in emerging nations rather than solely economic factors.

According to Tomassen et al. (2012), reducing transaction costs enhances the level of trust and commitment, improves competitiveness and guarantees a stable and developing environment for the host country. Corrupt officials generate markup prices equivalent to hidden tariffs that reduce trade (Anderson & Marcouiller, 2002). Gani and Al-Abri (2013) point out that the control of corruption, the rule of law, regulatory quality, political stability and effectiveness of government are all positively linked with FDI.

Institutional quality affects the FDI and is also related to international trade (import and export). Martínez-Zarzoso and Márquez-Ramos (2018) argue that good governance facilitates long-term agreements among firms in emerging economies. If the institutional efficacy of both countries is similar, traders can simply function in the institutional environment of each other. This minimizes the uneasiness of transaction contingencies and lowers the adjustment costs resulting from natural unfamiliarity with overseas partners. As a result, nations with similar ethical business conditions are more likely to trade bilaterally (Horsewood & Voicu, 2012). Good governance promotes trust by reducing uncertainty. This enhances importers' confidence in exporters (Yu, 2010) and lowers transaction and trading risk costs.

In short, better institutional quality helps the host companies secure property rights and develop trust on state- and state-owned institutions in minimizing the trade and transaction cost, which leads to an increase in FDI. The rule of law, regulatory authority, control of corruption, and bureaucratic quality also enhance businessmen's confidence while trading (export or import). This study is designed to develop the exploratory role of institutional quality on doing international business in the selected SAARC region. This study considers three key variables of international business, i.e., FDI, exports and imports of the region, because all of these three variables are directly related to international business.

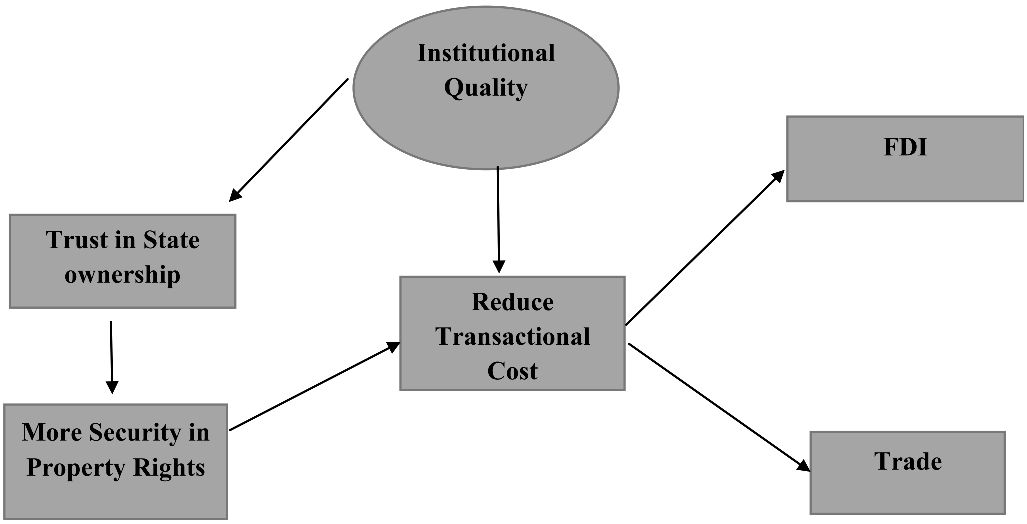

Figure 2. Research Mechanism for the Relationship between Quality of Institutions, FDI and Trade

4. Data and Methodology

4.1 Data

Export volume index, import volume index and FDI as % of GDP are used as dependent variables in three different models. Data on export volume index, import volume index and FDI as a percent of GDP, are taken from the World Bank website, WDI. At the same time, the empirical investigation of this paper focuses on the impact of five institutional indicators on the flow of trade and FDI.

These five indicators of institutions are Democratic Accountability, the rule of law, political stability, control of corruption, and external conflicts. The main institutional variables and political risk variables sources are WGI and the Political Risk Services (PRS) ICRG. The data for analysis covers the period 2001 to 2019 for SAARC countries. Period is selected based on the availability of data. This sample covers four SAARC countries, namely Pakistan, Bangladesh, India and Sri Lanka. A sample is selected based on the availability of data.

4.2 Model specification

To investigate the impact of institutions on international businesses three different models are used. Followings are the models of study:

$$EXP_{it} = \alpha + \beta_o DA_{it} + \beta_1 ROL_{it} + \beta_2 CC_{it} + \beta_3 PS_{it} + \beta 4\ EC_{it} + \varepsilon_{it} \quad (1)$$

$$IMP_{it} = \alpha + \beta_o DA_{it} + \beta_1 ROL_{it} + \beta_2 CC_{it} + \beta_3 PS_{it} + \beta_4 EC_{it} + \varepsilon_{it} \quad (2)$$

$$FDI_{it} = \alpha + \beta_o DA_{it} + \beta 1\ ROL_{it} + \beta_2 CC_{it} + \beta_3 PS_{it} + \beta_4 EC_{it} + \varepsilon_{it} \quad (3)$$

Where subscript *i* signifies countries, while t signifies time.

Choice of variables is motivated by existing literature. Cleeve (2012) and Saidi et al. (2013) used these institutional indicators as explanatory variables in their model. They considered these components as an important indicator of institutions, and by using these indicators, they investigated the impact of institutions on FDI. Corruption, political stability, poor government, and rule of law are the major problems of member countries of SAARC (Arefin, 2018). While, Ogundipe et al. (2014) used export as a dependent variable in the model to examine institutions' impact on international trade. The following hypotheses are developed: The first hypothesis is "Government Stability is positively related with trade and foreign direct investment". The second hypothesis is that Control of Corruption is positively correlated with international trade and FDI. The third hypothesis is that Democratic Accountability and law and order are positively related to international trade and FDI. While the fourth hypothesis is, external conflict is negatively correlated with international trade and FDI.

4.3 Variable's Description

To test the magnitude of the effect of five institutional factors on international trade and Foreign Direct investment different variables are used in the analysis. There description is as follows:

4.3.1 Dependent Variables

***Foreign direct investment, net (% of GDP)*:** "Foreign direct investment are the net inflows of investment to acquire a lasting management interest (10 percent or more of voting stock) in an enterprise operating in an economy other than that of the investor. It is the sum of equity capital, reinvestment of earnings, other long-term capital, and short-term capital as shown in the balance of payments. This series shows the total net FDI. In BPM6, financial account balances are calculated as the change in assets minus the change in liabilities. Net FDI outflows are assets and net FDI inflows are liabilities".

Export volume index: "Export volume indexes are derived from UNCTAD's volume index series and are the ratio of the export value indexes to the corresponding unit value indexes".

Import volume index: "Import volume indexes are derived from UNCTAD's volume index series and are the ratio of the import value indexes to the corresponding unit value indexes" (The World Bank, 2020).

4.3.2 Independent Variables

Five institutional indicators are used as explanatory variables in the model. There description is as follows:

***Democratic accountability (DA)*:** "A measure of, not just whether there are free and fair elections, but how responsive government is to its people. The less responsive it is, the more likely it will fall" (Political Risk Service Group, 2020).

***Rule of Law (ROL)*:** "Two measures comprising of one risk component. Each sub-component equals half of the total. The "law" sub-component assesses the strength and impartiality of the legal system, and the "order" sub-component assesses popular observance of the law" (World Governance Indicators, 2021)

***Control of Corruption (CC)*: "**Control of corruption captures perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as "capture" of the state by elites and private interests" (World Governance Indicators, 2021).

Political Stability (PS): "It measures perceptions of the likelihood of political instability and/or politically motivated violence" (World Governance Indicators, 2021).

External Conflict (EC): "Includes all forms of violent and nonviolent external pressures such as war, cross-border conflict and foreign diplomatic pressures" (Political Risk Service Group, 2020).

4.4 Empirical Methodology

Fixed Effects method and Random effect methods are two prominent static panel approaches that are used in the literature (Arefin, 2018; Goswami & Panthamit, 2020; Saidi et al., 2013; Shah et al., 2016; Siddica & Angkur, 2017). Hausman (1978) test is applied to select between Fixed Effect and Random Effect approaches. However, this conventional model lacks the ability to handle heteroskedasticity and autocorrelation. Hence FGLS is used in this analysis. In micro-panel data, this is among one of the advanced methods (Quazi, 2014). It is a more efficient method than the ordinary least square method in the presence of heteroscedasticity and serial correlation (Bai et al., 2020).

5. Results and Discussion

Econometric results of the regression are provided in this section. Table 1 provides the summary statistics about the dataset. It provides information about the nature of data and it is the starting point of analysis. This table includes the number of observations, its mean value, standard deviation, and minimum and maximum values.

Table 1. Descriptive Analysis

Variable	Observation	Mean	Std. Dev.	Min	Max
EXP	76	2.245	1.256	0.923	5.295
IMP	76	2.329	1.292	0.997	6.109
FDI	76	-1.049	0.818	-5.085	-0.119

DA	76	3.303	1.037	0.000	5.000
ROL	76	39.226	16.608	15.789	62.376
CC	76	30.508	15.586	1.463	53.883
PS	76	13.497	10.796	0.473	50.476
EC	76	9.224	1.1839	6.916	12.000

Author's own calculations

This study first used the panel approaches of Fixed and Random Effects estimation techniques. The diagnostic tests pointed to the presence of heteroscedasticity; hence the Feasible Generalized Least square method are reported.

Table 2. FGLS regression and Fixed Effect Method

Model	**1**	**2**	**3**
VARIABLES	**EXP**	**IMP**	**FDI**
DA	0.6601*** (0.1212)	0.5507***(0.1291)	0.5471*** (0.0861)
ROL	-0.0295 (0.0190)	-0.0209 (0.0202)	0.01311 (0.0134)
CC	0.0522***(0.0198)	0.0669***(0.0211)	-0.01822 (0.0141)
PS	0.0414***(0.0124)	0.0497***(0.0132)	0.02941*** (0. 0088)
EC	-1.1967***(0.1326)	-1.0030***(0.1413)	-0.3507*** (0.09428)
Constant	10.1078***(0.9690)	7.8696***(1.0327)	0.0228 (0.6890)
Observations	76	76	76
Number of id	4	4	4

Standard errors in parentheses. *** $p<0.01$, ** $p<0.05$, * $p<0.1$
Author's own calculations

Table 2, column 2 provides the first model's regression results in which export volume index is used as the dependent variable. These results suggest that democratic accountability, control of corruption, and political stability positively and significantly impact exports while external conflict negatively impacts exports. A 1 unit increase in democratic accountability increases the export volume index by 0.66 units. 1 unit control of corruption increases the export volume index by 0.05 units. There is a positive association between exports and control of corruption. Control of corruption increases the potentialities of trade (Ali & Mdhillat, 2015). Political stability also matters in terms of trade. Political stability promotes trade, while political instability hampers international trade (Qadri et al., 2020). There is a positive link between political stability and exports. One unit increase in political stability leads to an increase in the export volume index by 0.04 units. External conflict has a negative and significant impact on export volume. One unit increase in external conflict reduces the export volume index by 1.19 units. This finding is similar to the results of (Nitsch and Schumacher, 2004).

Column 3 provides the results of the effect of institutions on imports. These results indicate that democratic accountability, control of corruption, political stability and external conflict significantly impact imports. There is a positive relationship between democratic accountability and imports. An increase in democratic accountability can increase the import volume index by 0.55 units. Control of corruption and political stability also has a positive connection with imports. Control of corruption also increases the import volume index by 0.06 units, while political stability increases the import volume index by 0.04 units. External conflicts have negative and significant impacts on imports. 1 unit increase in external conflict reduces the import volume index by 1.0 units. Rule of law variable is insignificant in the case of both models.

Column 4 provides the regression results of model 3. Democratic accountability and political stability have a positive and significant effect on FDI. These findings are similar to the work of (Shah, 2017). 1 unit increase in democratic accountability increases FDI by 0.54 percent, while 1 unit increase in political stability increases FDI by 0.02 percent. External conflict has a negative and significant effect on FDI. It is similar to the findings of Adesegun et al. (2015). One unit increase in external conflict decreases GDP's foreign direct investment percentage by 0.35 percent. Control of corruption and Rule of law are insignificant. Political stability is the major component of institutions that increases foreign direct investment (Saidi et al., 2013).

6. Conclusion and Policy implications

Institutional environment matters for doing business both within the country and internationally. It serves as the ecological factor that determines how the business will proceed. International business refers to the trade of goods and services across national borders or globally. This paper examined the impact of institutions on international business. Institutions are indicated by democratic accountability, the rule of law, political stability, control of corruption, and external conflict. The sample comprised four SAARC countries, namely Pakistan, Bangladesh, India, and Sri Lanka. Three different models are used to test the impact of institutions on exports, imports and FDI. FGLS indicates that political stability and democratic accountability are positively and significantly correlated with international trade and foreign direct investment. Control of corruption will also promote international trade. At the same time, external conflict is negatively correlated with international trade and foreign direct investment. The rule of law does not play any significant role in trade volume and foreign direct investment in these four member countries of SAARC.

Institutional factors play a major role in promoting international trade and FDI. To increase international trade government should formulate anti-corruption policies. Implementation of these policies may be complex in the short-run in these developing countries due to political interest, but it may give good results in long-run. Political stability matters a lot both for international trade and FDI. Its findings suggest that destabilizing events badly affect trade volume and the flow of FDI in the countries. As external conflict negatively affects international trade and foreign direct investment, better security measures will surely increase the trade and flow of FDI. This paper will help policymakers in formulating better policies for these countries.

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