

Report on Bachelor / Master Thesis

Institute of Economic Studies, Faculty of Social Sciences, Charles University in Prague

Student:	Bc. Jan Sosnovec
Advisor:	Ing. Vilém Semerák, M.A., Ph.D.
Title of the thesis:	Trade and Politics: Political Determinants of International Trade Flows

OVERALL ASSESSMENT (provided in English, Czech, or Slovak):

Please provide your assessment of each of the following four categories, summary and suggested questions for the discussion. The minimum length of the report is 300 words.

Contribution

Unfortunately, the thesis does not offer any relevant contribution for the contemporary literature. The thesis lacks clearly specified narrow research questions and hypotheses, that would be based on in-depth review of existing literature. I am afraid that the thesis is estimating hypotheses, that have already been tested and brings nothing new to existing knowledge.

Even in case of some interesting results, I have serious comments to the methodology that lead me to the conclusion that the results cannot be trusted and should be revised.

The thesis does not offer also any contribution in term of theory or methodology.

Methods

The thesis is divided into two parts: theoretical one presenting two models and empirical one. I am afraid that both parts have serious flaws that make the results wrong or irrelevant.

The theoretical models are not based on proper treatment of existing literature and the author, in fact, does not represent any thorough derivation of those models (a model is derived just on 1 or 2 pages...). Therefore, a reader does not know the relevance of those models for existing literature and the logic behind the assumptions and causal mechanism. Much more concrete comments with examples are below.

The empirical part suffers from several flaws that make the results doubtful. The critical problem is the treatment of institutional variables where the author ignores the multicollinearity and endogeneity issue. As a result, the coefficients are very likely biased and can be hardly seriously interpreted. At least the correlation matrix shall be presented during the defense to assess the importance of the multicollinearity issue. Much more concrete comments with examples are below.

A) THEORETICAL PART

- 1) I have a serious problem with both models. Let's start with the first one introduced in the chapter 3.
 - First, there is no reference to any literature once the model is introduced. Does it mean that the model was solely invented by the author? This must be clarified.
 - Second, what is the relevance of the model for the related literature about the impacts of institutions on trade? There are many studies examining that utilizing institutional distance or including institutional levels separately for exporters and importers (de Jong & Bogmans, 2011; Francois & Manchin, 2013; Kuncic, 2012). What is the added-value of this exercise?
 - Third, I simply do not trust the assumptions behind the optimization. You assume that "*country can set its institution to whatever level it chooses*". This assumption is crucial for the whole model and I would expect that you properly defend it because it is highly controversial – Can a government simply change informal institutions? What about the path-dependency problem?

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Once the goal is just to present a model that predicts better (approach that would M. Friedman appreciate), then the discussion about assumptions is irrelevant. However, once the author wants to explain, then he should convince his audience about the credibility of his model.

- **Fourth**, the most important problems, at least according to my opinion, are related to your trade cost function $C_{ij} = F$.
 - Problem 1: Can you more precisely define your trade cost function F ? If F is just a function of I_i, I_j and their difference, then one derives institutions with respect to institutions. I do not see any sense in that. If it includes other trade costs (e.g. distance, language, etc.) then I also cannot imagine the result of that exercise (what would be a derivate of a distance with respect to institutions?).
 - Problem 2: I do not trust your deductions from your model because of above-mentioned reasons. At the end of the page 25 you state: *“This means that the country with worse institutions should always improve its institutions at least to the level of the second country, as improving institutions will have positive effect both in terms of institutional quality and in terms on the other hand, improving institutions above the level of the trading partner has positive effect in terms of institutional quality but negative effect in terms of similarity, and overall effect is uncertain”*
Those claims are simplifying the relationship too much. If we look at empirical literature, e.g. about corruption, we find much more complex effects of corruption (different effects for importers and exporters, effects can be negative but also positive, etc. – some reference in the “Literature” part of the review). In other words, the empirical literature is revealing very complex and interesting picture. What is the added-value of those claims compared to the existing literature? Why to test it?
 - Fifth, on page 28 the author presents an interesting hypothesis (derived from the model) that *“A single country cannot move to better institutions without increasing trade costs due to increased dissimilarity.”* I would just add that the author is definitely right once we focus just on one pair of countries. On the other side once a country improves its institutional quality, the improvement makes it dissimilar to some trade partners but more similar to other partners.
- 2) Now I will present few comments related to the second model in the chapter 4.
- First, the model suffers from similar problems. There is no proper and deep (!) treatment of relevant literature. (just some examples: (Djerdjian, 2010; Dutt & Mitra, 2005, 2006)). The model, again, seems to be quite disconnected from literature, or at least its assumptions are not being discussed (whether they are credible and reflect existing theoretical and empirical findings).
 - E.g., why is the ratio of losers an increasing function of volume of trade? So, the highest ratio should be in the most developed countries? Is it based on any relevant empirical/theoretical study?
 - What is the logic of the presented functional forms? Were they chosen arbitrary or is there any support in empirical literature?
 - How are the results of that model related to existing literature?

B) EMPIRICAL PART

- 1) Few comments about hypotheses that are being tested
- The list of hypotheses (p.51 – 52) is composed of hypotheses from several very general topics (culture, institutions, conflicts, etc.) - the author should have chosen just one topic and based the thesis on that. Each of those topics are not properly treated in literature review part. Therefore, it is simply not clear, what is the reason to examine them; whether the author is simply replicating something that already exists (my impression), etc.
 - Simply to examine the effects of e.g. political relations such as war is the topic for the whole thesis!

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- 2) I have also several comments concerning the methodology of gravity models.
- On page 58 it should be clearly stated that there are two forms of multilateral resistance terms: inward and outward. Not just one...
 - Page 61: equation 5.13 is not outcome of log-linearization (=Taylor expansion of 1st order) but just of taking logs of equation 5.9, if I am not mistaken.
 - I miss final specification that is being estimated. The author provides a list of variables but the crucial question is, how are they exactly incorporated (separately for X and M, distance? – this has direct effect on the form of Taylor expansion the author uses)? How does the specification look like? This is really a serious issue.
 - Which fixed effects were included? Did the author include also time-varying importer and exporter fixed effects (Baldwin & Taglioni, 2006)? Those should have been included for FE treatment of MRT once a gravity bilateral panel dataset is being used...
 - Another serious problem concerns the treatment of institutional variables. The author ignores multicollinearity and endogeneity issues that must be controlled for once we work with institutional variables (Francois & Manchin, 2013).
 - Can the author reveal the correlation matrix of the right-hand side variables?
 - Because of the above-mentioned weaknesses of the applied methodology, I will not comment on results, because I simply do not trust them. Just realize how can be the results reliable in case of ignorance of possible multicollinearity between institutional variables...

Literature

I have serious problem with the literature review. The whole part (chapters 1-4) should be completely revised and elaborated from the very beginning. All the problems are the outcome of the choice of too broad topic (impact of politics on trade). The topic is, as a result, not narrowed and the literature review is covering too many topics, while each of those topics is covered in very simplified manner and ignoring many relevant papers (e.g. subchapter 1.2. about politics and trade has just 1.5 pages).

Second major problem is that the review is composed of many irrelevant parts (subchapters) which can be easily deleted without any harmful effect on the hypotheses and empirical test (e.g., subchapter about the history of international trade models).

My more concrete comments are below:

First, the structure of the review is simply confusing. There are several main chapters (1., 2., 3., 4.) covering literature related to the topic, while the chapter no. 1 is called Literature Review even though all those chapters have in fact the same purpose. Then the chapters 3 and 4 are mixture of literature review and presentation of the theoretical models. I would recommend to clearly structure the thesis that contains transparent literature review part from which (at the end) the hypotheses, research questions or concepts (for further theoretical modelling) are derived.

Third, I do not understand the relevance of the chapter 2 for the thesis. My impression is that the chapter is redundant and can be deleted. If the meaning of the whole chapter is to inform a reader about two general weaknesses of trade models, then those messages can be expressed in much shorter manner.

Fourth, the author is mixing presentations of models to be estimated with literature review. E.g. one of the models is presented on pages 25-27, in the middle of the chapter 3 covering literature about

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institutions. This chapter is then followed by another “literature review” chapter. I would appreciate to separate the models from review.

Fifth, because of the very broad topic of the thesis and (I would say) simplified literature review (that must cover general topics on very limited space) there are several imprecise statements. There are not totally wrong but they ignore the complexity of the problem, simply because the topic is broad and there is no time to deeply investigate those issues.

- One example is on the page 22 where the author mentions corruption as an example of the so called first mechanism of how institutions affect trade costs. Firstly, especially corruption belongs to both groups – not just levels but also distance is important (Brada, Drabek, & Perez, 2012). Secondly, some “institutional qualities” such as corruption may have impact in both directions (de Jong & Bogmans, 2011).

Minor comments

Why is the chapter about consumer preferences (3.1) positioned in the middle of the chapter about institutions? It is more related to methodology of gravity models.

If it is possible I would recommend to always cite primary source. E.g., on page 4 a quote by Keynes is presented which is cited from the textbook by Screpanti and Zamagni. Keynes’s book can be easily found online or in libraries.

Manuscript form

The manuscript should be significantly revised. The crucial problem is the structure of the literature review (commented above). Second problem concerning the manuscript form can be found in the introduction chapter. The chapter fails to meet standard demands concerning introduction in academic text.

Introduction chapter

The chapter should clearly state the precise topic of the thesis, its position in academic literature, basic results and its contribution. The contemporary state of the chapter unfortunately does not fulfil those demands and should be revised from the very beginning. It partially resembles literature review but unfortunately in the introduction the author cannot properly explain all the terms and refer to relevant literature.

I would explain my critical remarks on one example. The author is trying to define two meanings of the interaction between trade and politics: domestic and international arena.

- First, it is not clear whether the author tries to cover both meanings in his thesis. My understanding based on the last paragraph is that he tries, which I find unfortunate because both topics are very large areas of academic research.
- Second, one can easily refer to vast amount of literature dealing with both areas. Once we look at papers dealing with endogenous policy formation we can find those covering the “international scene” (Gawande, Krishna, & Robbins, 2006) or the “domestic” one (Magee, 2002). Unfortunately, I have found no reference to any relevant work in the chapter (some authors are mentioned in following chapters but the coverage of existing knowledge is unsatisfactory). Simply it is not clear which stream of literature is being followed in the chapter.

I miss here clearly defined and narrow research question. The author tries to “*take a comprehensive look at the relationship between political decision-making and trade*”. I would appreciate much more narrow research problem that is clearly related to concrete academic literature.

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Cited Literature

- Baldwin, R., & Taglioni, D. (2006). *Gravity for dummies and dummies for gravity equations* (No. w12516). Retrieved from <http://www.nber.org/papers/w12516>
- Brada, J. C., Drabek, Z., & Perez, M. F. (2012). The Effect of Home-country and Host-country Corruption on Foreign Direct Investment. *Review of Development Economics*, 16(4), 640–663. doi:10.1111/rode.12009
- de Jong, E., & Bogmans, C. (2011). Does corruption discourage international trade? *European Journal of Political Economy*, 27(2), 385–398. doi:10.1016/j.ejpoleco.2010.11.005
- Djerdjian, D. O. (2010). Economics versus politics in trade policy. *Review of World Economics*, 146(2), 223–240. doi:10.1007/s10290-010-0048-8
- Dutt, P., & Mitra, D. (2005). Political Ideology and Endogenous Trade Policy: An Empirical Investigation. *Review of Economics and Statistics*, 87(1), 59–72. doi:10.1162/0034653053327621
- Dutt, P., & Mitra, D. (2006). Labor versus capital in trade-policy: The role of ideology and inequality. *Journal of International Economics*, 69(2), 310–320. doi:10.1016/j.jinteco.2005.05.011
- Francois, J., & Manchin, M. (2013). Institutions, Infrastructure, and Trade. *World Development*, 46, 165–175. doi:10.1016/j.worlddev.2013.02.009
- Gawande, K., Krishna, P., & Robbins, M. J. (2006). Foreign Lobbies and U.S. Trade Policy. *Review of Economics and Statistics*, 88(3), 563–571. doi:10.1162/rest.88.3.563
- Kuncic, A. (2012). Institutional determinants of bilateral trade: Taking another look. *Kiel Advanced Studies Working Papers*, (462).
- Magee, C. (2002). Endogenous trade policy and lobby formation: an application to the free-rider problem. *Journal of International Economics*, 57(2), 449–471. doi:10.1016/S0022-1996(01)00146-5

Summary and suggested questions for the discussion during the defense

Unfortunately, I find the thesis as being unsatisfactory to meet standards of diploma theses at the institute.

First, the thesis lacks clearly specified research question that would be based on thorough discussion of existing and relevant academic literature.

Second, the empirical part contains several flaws that make the results doubtful.

Third, the structure of the thesis and many chapters shall be revised from the very beginning (introduction and literature review chapters).

All the critical comments may be outcome of my misunderstanding of the aims of the author.

Therefore, I see the defense as an opportunity for the student to explain properly his goals, relevance of his research and methodology. In other words, the student should carefully explain that the critical comments are not outcomes of serious mistakes in the analysis and unsatisfactory treatment of literature but outcomes of weak manuscript form.

There are many critical comments and questions from my side. So here, I select just the most important ones:

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GENERAL

Can you explain the topic of your thesis? Can you be more specific and narrow than in your thesis?

What is the contribution of the thesis? Can you relate your models and results to specific academic papers?

THEORETICAL MODELS

To which (concrete) academic papers are both theoretical models related?

What is their added-value compared to the existing literature? Explain the added value of your work e.g. in case of corruption (take into account at least the papers I mentioned in my report).

MODEL 1

- There is no reference to any literature once the model is introduced. Does it mean that the model was solely invented by the author without any relation to existing models?
- Can you more precisely define your trade cost function F ? If it is defined just by institutions, does it make a sense to derivate it with respect to institutions? If it is defined also by other trade costs variables, then again, does the derivation make a sense (what would be a derivate of a distance with respect to institutions?)?
- Existing literature reveals much more complex relationships about the effects of institutions on trade. What is the added value of this exercise?

MODEL 2

- Why is the ratio of losers an increasing function of volume of trade? So, the highest ratio should be in the most developed countries? Is it based on any relevant empirical study?
- What is the logic of the presented functional forms? Were they chosen arbitrary or is there any support in empirical/theoretical literature?
- How are the results of that model related to existing literature?

EMPIRICAL PART

- Are you sure that the hypotheses (p. 51-52) have not been already tested? What is your added-value?
- Can you present the final specification (equation) that was estimated?
- Did you include some RHS variables just in the form of distance or did you include them separately for exporter and importer? The table of results indicates that some of them were treated as distance and others were included separately. Did you modify the Taylor-approximation equation according to the dimensions in which the variables were varying (nice example is the study of Francois & Manchin (2013))?
- Can you present the correlation matrix of the right-hand side variables?
- Have you checked for the presence of multicollinearity?
- Did you consider the problem of endogeneity between institutional and trade variables?

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SUMMARY OF POINTS AWARDED (for details, see below):

CATEGORY	POINTS
<i>Contribution</i> (max. 30 points)	7
<i>Methods</i> (max. 30 points)	13
<i>Literature</i> (max. 20 points)	8
<i>Manuscript Form</i> (max. 20 points)	8
TOTAL POINTS (max. 100 points)	36
GRADE (A – B – C – D – E – F)	F

NAME OF THE REFEREE: *Mgr. Michal Paulus*

DATE OF EVALUATION: *January 24, 2018*


Referee Signature

EXPLANATION OF CATEGORIES AND SCALE:

CONTRIBUTION: *The author presents original ideas on the topic demonstrating critical thinking and ability to draw conclusions based on the knowledge of relevant theory and empirics. There is a distinct value added of the thesis.*

Strong	Average	Weak
30	15	0

METHODS: *The tools used are relevant to the research question being investigated, and adequate to the author's level of studies. The thesis topic is comprehensively analyzed.*

Strong	Average	Weak
30	15	0

LITERATURE REVIEW: *The thesis demonstrates author's full understanding and command of recent literature. The author quotes relevant literature in a proper way.*

Strong	Average	Weak
20	10	0

MANUSCRIPT FORM: *The thesis is well structured. The student uses appropriate language and style, including academic format for graphs and tables. The text effectively refers to graphs and tables and disposes with a complete bibliography.*

Strong	Average	Weak
20	10	0

Overall grading:

TOTAL	GRADE
91 – 100	A
81 - 90	B
71 - 80	C
61 – 70	D
51 – 60	E
0 – 50	F