

Institutions and Comparative Advantage in Services Trade

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Abstract

Recent studies have highlighted the role of human capital and economic institutions in determining comparative advantage in complex, institutions-intensive goods. Our paper examines whether institutions play a similarly crucial role in determining comparative advantage in services trade. Services provision relies less on infrastructure, availability of large number of inputs, property rights and capital investments than production of complex goods. To isolate the role of institutions on goods and services trade we analyze the determination of comparative advantage in information and communications technology (ICT) goods and ICT services exports. Both ICT goods and services are expected to be intensive in human capital and thus present a good comparison to study differences between goods and services provision.

Such analysis is potentially complicated by the endogenous and reinforcing relationship between institutions and level of human capital. To overcome this complication, we focus on the set of transition economies characterized by high, arguably exogenous, human capital at the level of most advanced countries by the time of the fall of the USSR and Eastern bloc. Although human capital and institutions are strongly correlated, institutional indicators, such as corruption, rule of law, political stability, etc., of transition countries are still below other developing countries.

Our study is motivated by high ICT services (e.g., software development) and low ICT goods exports of transition countries on the backbone of high human capital and low institutional indicators. ICT services exports are thriving. A share of ICT services exports in total services are at a higher level and faster growth than in other countries. In contrast, share of ICT goods in total goods exports of transition economies is significantly below than in other countries, which is consistent with the literature on institutions and comparative advantage in relationship- and investment-intensive goods production.

As the role of services in the world export increases, it is important to understand how institutions affect comparative advantage in services and, consequently, growth and development. We hypothesize that the causal relationship between institutions and comparative advantage in services exports can starkly differ from goods. Moreover, institutional barriers can drive the available human capital from high-technology manufacturing to the provision of human capital-intensive services exports as these are likely to be less intensive in institutions.

We test our hypothesis by estimating the role of institutions on comparative advantage in ICT goods and ICT services. Our panel data on sectoral exports of goods and services, institutional indicators and human capital covers the period between 2000 and 2018. Controlling for year and country fixed effects, we estimate the impact of human capital and institutional quality on revealed comparative advantage in goods and services.

We find that as, expected, human capital has positive significant impact on comparative advantage for both goods and services for developed, transitions countries and other developing countries. Similar to previous literature, we also find that institutions have positive significant impact on comparative advantage in ICT goods exports for different country groups. However, our findings suggest that institutions have no impact on comparative advantage in ICT services exports for developed and developing countries; in the case of transition economies institutions are negatively associated with ICT services exports.

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