



# Democracy's comparative advantage: Evidence from aggregated trade data, 1962–2010

Jiahua Yue<sup>a,\*</sup>, Shangsi Zhou<sup>b</sup>

<sup>a</sup> Department of Political Science, Yale University, 115 Prospect St, New Haven, CT 06520, United States

<sup>b</sup> School of Advanced International Studies, Johns Hopkins University, 1740 Massachusetts Ave., NW Washington, DC 20036, United States



## ARTICLE INFO

### Article history:

Accepted 23 June 2018

### Keywords:

Democratization  
Electoral autocracy  
Comparative advantage  
International trade

## ABSTRACT

Scholars have long debated the nexus between political institutions and economic outcomes. The thesis of democratic advantage has been under careful scrutiny and empirical evidence is notoriously inconclusive. One topic that has drawn extensive scholarly attention is democratic institutions as a source of comparative advantage in international trade. Using a new data set that covers around 140 countries from 1962 to 2010, we find that on average, democratic countries have the comparative advantage in exporting differentiated products, which reflects lower transaction costs in trade and higher economic complexity. Echoing literature on electoral autocracy, we also make the distinction between different subtypes of authoritarian regimes. Similarly, authoritarian countries with electoral institutions have the comparative advantage in exporting differentiated products relative to other authoritarian countries, though the magnitude is much smaller and inconsistent over time. Our results are robust to a large set of control variables and multiple model specifications. In sum, our paper provides new insights into the relationship between democracy and trade and complements existing literature on the effect of authoritarian institutions on economic development.

© 2018 Elsevier Ltd. All rights reserved.

## 1. Introduction

Which political institutions facilitate the emergence of a modern, diversified and innovative economy? Scholars have held strong interests in the question for decades. Intellectual inquiry about the relationship between capitalism and democracy has dominated much of the political theory for the past century. To some, the seemingly unstoppable ascendancy of the free-market economy and the spread of liberal democracies following the collapse of the Soviet Union has put an end to the debate, marking the end of history. Liberal democracy eventually proves to be a superior mode of political system that promotes innovation, competition, and entrepreneurship. The political order of tyranny and servitude under authoritarian regimes is inherently inefficient, unproductive and incompatible with individual economic freedom and competitive market institutions.

Yet the assertion that democracy is a superior form of governance and a prerequisite for economic development often meets the sensible objection that democracy subsists only when there is a functional state with the minimal degree of governance (Grassi & Memoli, 2016). Observation on some least developed

countries suggests that poorly institutionalized electoral competition often adversely incentivizes unsecured incumbents to prey on citizens, resulting in spirals of domestic violence and consequently the failure of state (Bates, 2008). Rodrik (2005, p.973) contended that “there is no unique correspondence between the functions that good institutions perform and the form that such institutions take”. Glaeser, La Porta, Lopez-de-Silanes, and Shleifer (2004) argued that political institutions have at most second-order effects on economic development, and poor countries often get out of poverty trap because of wise policies dictated by a strong authoritarian leader. Indeed, strong developmental countries in Asia, including Singapore, South Korea (before democratization), China, and most recently Vietnam, have successfully adopted market economy and achieved sustained economic growth for years. And well-designed authoritarian institutions facilitate economic activities that are important to sustainable growth, e.g. encouraging investment (Gehlbach & Keefer, 2012; Wright, 2008) and co-opting business elites (Truex, 2014).

To sum, the comparative advantage of democratic institutions in economic development remains a controversial question. In this paper, we evaluate the nexus between basic political institutions and economic outcomes using a new data set on international trade of over 100 countries from 1962 to 2010. Using basic concepts from the international trade theory and the three-product

\* Corresponding author.

E-mail addresses: [jiahua.yue@yale.edu](mailto:jiahua.yue@yale.edu) (J. Yue), [szhou38@jhu.edu](mailto:szhou38@jhu.edu) (S. Zhou).

typology from Rauch (1999), we construct our indicators that measure the comparative advantage of a country in exporting three types of goods: goods that are traded on organized exchange, goods that have reference price, and differentiated goods that are neither sold on an organized exchange nor have a reference price. Rauch's three-product typology offers a preliminary classification of simple versus complex goods, and a well-known interpretation from Nunn (2007) suggested that differentiated goods are relationship-specific and industries more dependent on relationship-specific investments are more "contract-intensive". Other earlier studies, including Berkowitz, Moenius, and Pistor (2006) and Ranjan and Lee (2007), suggested that the quality of national institutions, e.g. the rule of law, has disproportionate influence over the trade of differentiated goods that contains many relationship-based characteristics not fully stipulated in the formal contracts. We argue that the core element of democracy, i.e. electoral institutions, also have a bearing on the formation of such comparative advantage in differentiated goods which holds a greater scope for quality differentiation and poses a higher bar for international transactions.

Different from existing research using trade data with the gravity model specification, we aggregate trade data by country-year and construct new indicators that evaluate a country's export portfolio and further disclose information about its economic structure. The independent variable of our interests is political institutions, i.e. if the incumbent government is empowered via competitive elections. Following existing insights on the variation within authoritarian regimes (Epstein, Bates, Goldstone, Kristensen, & O'Halloran, 2006; Miller, 2015b; Wright, 2008), we code a new category of electoral autocracy that allows multiparty contestation but on a less fair and even ground than that in democracy. We build our theory on the notion that democracy differs systematically from autocracy in terms of political contestation and public accountability, which are frequently linked to policy credibility, law enforcement and protection of property rights that are crucial to economic development. Electoral autocracy with pseudo-democratic institutions, to various degrees, imitates democracy and is different from closed autocracy.

We test our hypotheses with a multitude of control variables and model specifications and address the endogeneity problem with the instrumental variable (IV) approach, leveraging exogenous shocks of regional democratization. We also consider the persistent effect of political institutions, or the "history stock". We present four major findings. First, we find a significant and robust comparative advantage of democracy in exporting differentiated goods. The linkage is arguably strong and is supported by the similar relationship using other indicators of economic complexity constructed from international trade data. Second, electoral institutions under authoritarian regimes are beneficial to the export of differentiated goods, though the effect is much weaker and unstable across different model specifications and shrinks after the Cold War. Third, we report null results using the alternative coding of authoritarian regimes primarily based on leadership types (e.g. monarchies, military regimes, and other civilian dictatorships). Fourth, we explore the interaction between political regime and state capacity, showing the substitution effect of state capacity under electoral autocracy.

## 2. Connecting political institutions and comparative advantage in trade

In this section, we revisit the related literature on political institutions and comparative advantage in trade and present our hypotheses for empirical testing. We argue that on average, democracy differs systematically from autocracy and has a comparative

advantage in exporting differentiated goods that are more complicated and contract-intensive. We highlight two primary dimensions of democracy, political contestation and public participation (Dahl, 1971; Miller, 2015a), and discuss how they 1) make democracy a more trustworthy trading partner, especially in terms of the differentiated goods (transaction cost), and 2) influence the domestic economic structure that gives rise to comparative advantage in producing the differentiated goods (production cost).<sup>1</sup> We also argue that as the flawed replica of democracy, electoral autocracy may possess the advantage over closed autocracy via similar mechanisms, but not to democracy. We suggest the first channel of transaction cost is related to the issue of policy credibility covered mainly by the international political economy literature and the second channel of production cost pertains to the broader debate on the relationship between democracy and development. Although the two channels have the same direction of effects on the export of complicated and differentiated goods (Berkowitz et al., 2006), the distinction is important given separate theoretical motivations. In other research, including Hausmann, Hwang, and Rodrik (2007), Hartmann, Guevara, Jara-Figueroa, Aristarán, and Hidalgo (2017), Hidalgo and Hausmann (2009) and Rougier (2016), a country's export portfolio is directly used as the proxy of the domestic production structure. It is a sensible approximation since a country's specialization pattern in international trade usually manifests its relative strength of producing certain products compared to other countries.<sup>2</sup>

Before turning to our hypotheses on political institutions, here we briefly discuss the role of state capacity which is possibly strengthened by democracy (Grassi & Memoli, 2016). Conventionally, state capacity is defined as the government's legal and fiscal capacity, e.g. protecting property rights, enforcing contracts, and raising taxes. Political stability and inclusive institutions are conducive to building state capacity (Besley & Persson, 2009). Therefore, one may argue that high state capacity also reduces the transaction and production cost and treat it as a potential mediator between democracy and comparative advantage in differentiated goods. To the contrary, Huntington's work on political order has mostly stressed that state capacity bolsters rulers irrespective of the regime type (Huntington, 1968). The impressive record of economic growth in some authoritarian countries, e.g. China and Vietnam, suggests that democratization is not the necessary condition for building state capacity. Authoritarian developmental states can maintain law and order and take advantage of free trade and foreign investment. Existing research also shows that the combination of democracy and state capacity is not synergistic and substitute for each other with respect to economic development and social welfare (Hanson, 2015; Knutsen, 2013). Following Huntington's theoretical cues, we treat state capacity as conceptually distinct from the regime type and investigate the interaction effects between political institutions and state capacity.

### 2.1. Democracy's comparative advantage

Comparative advantage is a classical concept in international trade and contemporary scholars understand it can be traced to a

<sup>1</sup> Democracy, by definition, is marked by high contestation and extensive public participation. There are multiple cases of hybrid regimes featuring high contestation but low participation, e.g. the competitive oligarchies of Britain and Sweden in the late-nineteenth century. On the other hand, some modern authoritarian regimes combine relatively high participation with limited contestation, e.g. the Soviet Union that installed universal suffrage with the secret ballot in 1936. Cox and Weingast (2018) also used the terms, "horizontal accountability" and "vertical accountability", which correspond to political contestation and participation respectively.

<sup>2</sup> Alternatively, one may measure the complexity of the production structure using indicators of sectoral output, employment shares and shares in value added. In the existing literature, the indicators are reversely linked to the specialization pattern in international trade (Imbs & Wacziarg, 2003; Nunn, 2007).

Download English Version:

<https://daneshyari.com/en/article/7391048>

Download Persian Version:

<https://daneshyari.com/article/7391048>

[Daneshyari.com](https://daneshyari.com)