

International trade and Economic growth: cross-country evidence

Dushko Josheski¹

Darko Lazarov²

Page | 87

Abstract

Many empirical studies have been done to investigate whether growth is influenced by international trade. But despite the great effort that has been devoted to studying the issue, there is little persuasive evidence concerning the effect of trade on growth. The main subject of our paper is to summarize the main findings based on empirical research that have been done to investigate the relationship between the trade and economic growth by using data for 208 regions and countries in OLS regression analysis.

Our results from empirical investigation show: 1) the ratio of trade volume (sum of exports and imports at current prices-*current openness* or sum of exports plus sum of imports) to GDP as a proxy of trade openness has positive effect on economic growth, 2) black market premium as a proxy for imbalance in macroeconomic policies has negative effect, 3) in the presence of macroeconomic policies, trade has statistically and economic significant positive influence on growth, and 4) in an institutional environment trade lacks influencing growth, the coefficient on institutions is positive and statistically significant.

Keywords: International trade, economic growth, institutions, macroeconomic imbalances

Introduction

Starting from Adam Smith's discussion on specialization and the extent of the market by international trade, to the debates about import substitution versus exported growth (growth based on exporting more goods and services), to recent work on increasing returns and endogenous growth models, there are increasing debates among economists about the international trade and economic growth.

The advances in growth theory avoid (enable) economists to focus on some issues that have long been central to international economics. In addition, we will present some of those issues; 1) to what extent and in what ways, international trade might be "engine of growth"?, 2) Do international exchanges of goods and services naturally enhance the growth performance of individual trading countries? And what economic policies are especially conducive to high levels of income in a growing, open economy?

¹ (Goce Delcev University –Shtip)
Email: dushkojosheski@gmail.com

² (Goce Delcev University –Shtip)
Email: darko.lazarov@ugd.com

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Some theoretical backgrounds of the global economy seem especially important for understanding growth performance in context of endogenous growth models (when growth is based on firms' incentives to invest in creation of knowledge).³ First, comparative advantage may determine to what extent particular countries are led to specialize in the creation of knowledge and in the production of goods that make incentives use of human capital and new technologies. Second, the large scale of the world economy provides great opportunities for the exploitation of research successes and enhancing the incentives that firms have to invest in the generation of new technologies. Third, in a world of rapid and cheap communication, ideas and information spread very quickly across international borders. Countries stand to benefit from the spillovers generated by investments in knowledge in trade partner countries. Finally, participation in international capital markets provides an expanded set of opportunities for financing investments in all forms of capital, including knowledge capital.

The aspects of international trade environment that we have mentioned above we only use as a theoretical background of our empirical research, the research of transmission effects of trade to economic growth is not our primary goal in this paper.

Empirical literature overview

Over the past decades relationship between trade and growth had been of interest among the economists. In the next Table we present the selected studies and their main findings.

Study	Technique	Main findings
Kwan and Cotsomitis (1991)	Granger causality test to study Chinese growth and foreign trade	output was an exogenous variable and there was a one-way causal relationship between the two.
Ghartey (1993)	United States, Japan and Taiwan cross-section data	American GDP promoted its export, but Taiwan is quite the opposite and there was a two-way causal relationship between the two in Japan
Jordan Shan and Fiona Sun (1998)	VAR	There is no relationship between the two variables
Jung and Marshall (1985)	Causality test	No relationship between growth and trade openness
Chengxiang Shen (1999)	Granger causality test	Two way relationship between trade and growth but no long term relationship.

Source: Chen(2009)

Data and models

³ Frankel, Jeffrey A. and David Romer (1999). "Does Trade Cause Growth?" *The American Economic Review*, (June) 379-399.

In this sample we use data for 208 regions and countries (See **Appendix 1 Descriptive statistics**) actually variables are collected from the data set used in one study⁴. We employ neo-classical framework in our models:

$$\log y_i(t) - \log y_i(0) = \alpha_0 + \alpha_1 \log y_i(0) + \alpha_2 \log(n_i + g + u) + \alpha_3 \log K + \alpha_4 \log H + \alpha_5 TrOpen + v_i \quad (1)$$

This model is suggested by Mankiw et al (1992), the left hand side expression is the first difference logarithm of real GDP per worker between 1960 to 2000, other right hand side y_i represents initial output, while $n_i + g + u$ are population growth, technological growth and depreciation in each country or region respectively, K and H represents both the physical and human capital accumulation. The term *TrOpen* denotes country i 's degree of trade openness. Following MRW, we assume that the sum of rates of depreciation and technological progress is constant and equal to 0.05 across countries. We use real investment to GDP as proxy for physical capital and secondary school enrolment rate as proxy for human capital as recommended by MRW (1992). We employ OLS technique to estimate this cross-country regression results are presented in Table 1

Table 1 Economic Growth and Trade Volumes: OLS Estimation results

We start our estimations with the ratio of trade volume to GDP. We obtain two measures for this variable: one is from the World Bank and the other is from Penn World Tables (Version 6.1). One advantage of the World Bank measure is that the data are published in terms of exports and imports. Thus, this allows us to investigate the export-growth connection and import-growth connection separately. On the other hand the trade ratio of the Penn World Tables is published only as a sum of exports and imports at current prices. This is known as *current openness*. Columns 1 and 2 show the regression results using the ratio of exports and the ratio of imports, respectively. Column 3 includes the trade ratio as a sum of the ratio of exports and the ratio of imports. In each regression the coefficient of the openness variable using world bank data is positive but not statistically significant, but Penn world table data current and real openness coefficient is positive and statistically significant suggesting that 10% increase in the trade ratio will increase the growth by 2.7% over the period 1960-2000. In summary, the regression results in Table 1 show a positive association between economic growth and international trade and confirm the findings of previous work⁵. Physical and human capital are positively associated across all five models. Convergence and initial levels of capital are negatively associated with growth which is consistent with neo-classical growth theory⁶ In the next scatter we identify outliers in the scatter real openness vs growth.

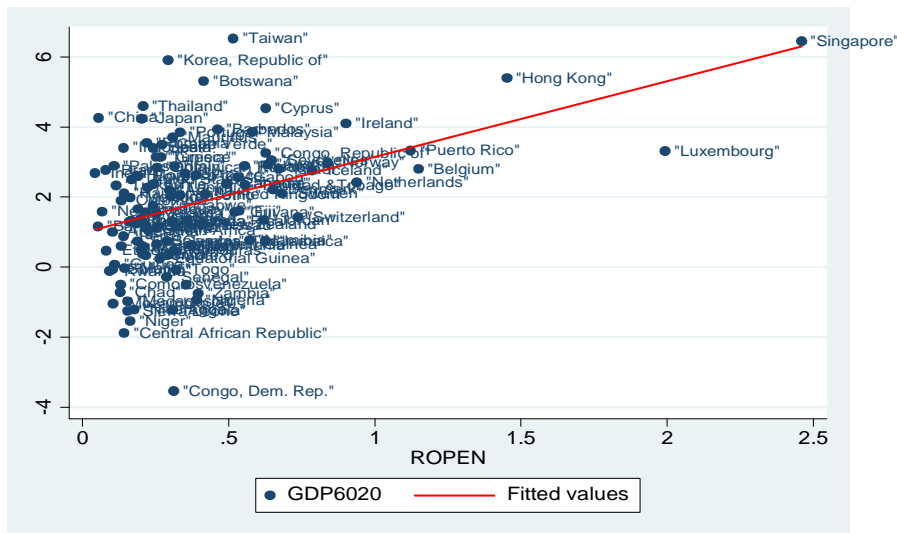
⁴ Bülent Ulaşan, 2012, "Openness to International Trade and Economic Growth: A Cross-Country Empirical Investigation [Dataset]", <http://hdl.handle.net/1902.1/18245> UNF:5:2bZyPUz4MN/u7sAKORnl5A== Economics: The Open-Access, Open-Assessment E-Journal [Distributor] V3 [Version]

⁵ Vamwakidis (2002), Dollar and Kraay (2003), Yanikkaya (2003), Alcalá and Ciccone (2004) are a few examples.

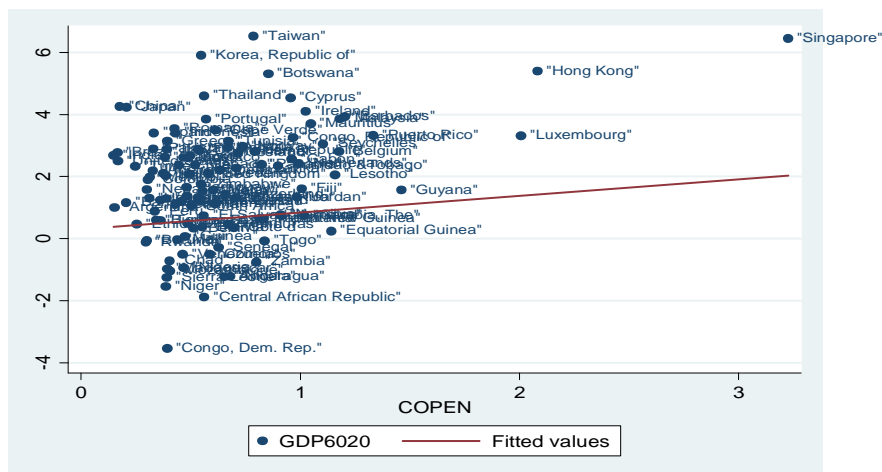
⁶ One of the main implications of Solow-type neoclassical growth models (Solow 1956) is a notion of "convergence" according to which developing countries grow faster than developed countries given the growth rates of technology and population. In particular, if countries are similar with respect to structural parameters, neoclassical growth models predict that a country's per capita growth rate tends to be negatively related to its starting level of income per person. (Fukuda, Toya, 1995).

Variables	Variables definition	Dependent variable is GDPGR6020 log difference of real GDP per worker between 1960 and 2000.									
		1	t-stat	2	t-stat	3	t-stat	4	t-stat	5	t-stat
LY1960	log GDP per worker 1960	-0.43	-7.63	-0.46	-7.43	-0.46	-7.59	-0.46	-7.53	-0.43	-7.03
LNGD	log(n _i + g +)	-1.10	-2.73	-1.06	-2.61	-1.08	-2.66	-1.02	-3.01	-1.10	-3.02
LINV	log of Investment rate	0.36	3.04	0.40	2.99	0.40	3.01	0.34	3.08	0.36	3.44
LSCH	log of School enrolment	0.43	4.98	0.45	5.16	0.45	5.1	0.44	6.12	0.43	6.02
XGDP_WB	Exports ratio of WB	0.27	1.24	-	-	-	-	-	-	-	-
MGDP_WB	Imports ratio of WB	-	-	0.32	1.10	-	-	-	-	-	-
XMGDP_WB	Trade ratio of WB	-	-	-	-	0.18	1.19	-	-	-	-
ROPEN	Real Openness	-	-	-	-	-	-	0.40	3.57	-	-
COPEN	Current Openness	-	-	-	-	-	-	-	-	0.27	2.46
_cons	constant	2.24	2.34	2.73	2.32	2.72	2.33	2.73	2.84	2.24	2.25
Number of observations		93				93		105		105	
R-squared		0.6257		0.6231		0.6248		n.a		0.6486	

(a) Real Openness: Exports plus Imports as a ratio of GDP in PPP



(b) Current Openness: Exports plus Imports as a ratio of GDP in current prices



On the previous scatter we identify Singapore, Hong Kong, and Luxembourg as outliers. Their outstanding characteristics are that they have the highest trade ratios with an average value of 244 percent according to the current openness and experience very high growth performances over the sample period.

Direct Trade Policy Measures and economic growth

In the second step we investigate the openness-growth connection by employing direct trade policy measures namely tariff rates, non-tariff barriers on imports⁷

Table 2 Economic Growth and Direct Trade Measures: OLS Estimates

Variables	Variables definition	Dependent variable is GDPGR6020 log difference of real GDP per worker between 1960 and 2000.							
		1	t-stat	2	t-stat	3	t-stat	4	t-stat
LY1960	log GDP per worker 1960	-0.49	-6.76	-0.48	-7.05	0.083	-5.38	-0.48	-6.13
LNGD	log(mi + g +)	-1.29	-3.07	-1.27	-3.12	0.443	-2.5	-1.06	-2.8
LINV	log of Investment rate	0.43	3.18	0.43	3.19	0.153	2.89	0.4	3.35
LSCH	log of School enrolment	0.42	4.52	0.43	4.93	0.091	4.89	0.448	5.44
OWTI	Own-import weighted tariff rates, 1983-1985 period	-0.33	-1.08	—	—	—	—	—	—
OWQI	Own-import weighted non-tariff barriers, 1983-1985 period	—	—	-0.12	-0.6	—	—	—	—
M_DUTY	Collected import duties ⁸	—	—	—	—	0.997	0.38	—	—
UWATR	Unweighted average tariff rate, 1990-99 period.	—	—	—	—	—	—	-0.48	-0.85
_cons	constant	2.56	2	2.50	2.04	1.542	1.72	3.109	2.35
Number of observations		87		85		93		101.00	
R-squared		0.62		n.a		0.58		0.63	

In columns 1 and 2 of Table 2, we only include tariff rate and non-tariff barriers, respectively. Both measures enter the regressions with negative but insignificant coefficient estimates. The coefficient on import duties is positive but statistically insignificant. It is well known fact that the ratio of collective import duties in a country's overall imports is a problematic measure in order to reflect a country's tariff structure due to the fact that a country with very high tariff rates may appear open by this measure.

Black Market Premium: A Proxy for Trade Policy or Macroeconomic Imbalances?

Most of the countries in Africa and Latin America experience higher levels of black market premium.

⁷ It is obvious that the first two measures directly affect a country's trade volume and reducing or removing them clearly indicates a more open trade regime.

⁸ Collected import duties as ratio of imports over 1970-1998 period

3 Black Market premium and economic growth OSL estimates

Dependent variable is GDPGR6020 log difference of real GDP per worker between 1960 and 2000.	Variables definition	Coef.	t	Coef.	t	Coef.	t	Coef.	t
LY1960	log GDP per worker 1960	-0.53	-6.5	-0.51	-7.48	-0.48	-7.36	-0.50	-7.37
LNGD	log(n_i + g +)	-1.09	-2.88	-1.25	-3.65	-1.05	-3.12	-1.11	-3.19
LINV	log of Investment rate	0.28	3.29	0.24	3.27	0.23	3.28	0.26	3.5
LSCH	log of School enrolment	0.57	6.13	0.52	6.41	0.52	6.55	0.54	6.62
LogBMP60	log (1+BMP) in 1960s	-0.16	-1.39	-	-	-	-	-	-
LogBMP70	log (1+BMP) in 1970s	-	-	-0.29	-2.2	-	-	-	-
LogBMP80	log (1+BMP) in 1980s	-	-	-	-	-0.20	-3.21	-	-
LogBMP90	log (1+BMP) in 1990s	-	-	-	-	-	-	-0.23	-1.9
_cons	constant	3.22	2.97	2.57	2.57	2.86	2.91	2.93	2.83
Number of observations		93		107		107		107	
R-squared		0.6061		0.6323		0.6505		0.628	

it is more likely that negative and significant connection between black market premium and economic growth over the period 1960-2000 reflects the adverse relation between macroeconomic imbalances and growth. Black market premium in 1960's,70's,80's,90's is negatively and statistically significantly associated with GDP growth⁹.

Macroeconomic policy variables

First, we include two variables related to macroeconomic policy, namely inflation rate and government consumption expenditures. Inclusion of these variables is particularly important since an important criticism on the openness-growth literature is that openness measures are proxy for other macroeconomic policies rather than trade policy.

Table 4 Economic growth and macroeconomic policy variables including trade ratio as macroeconomic policy.

Panel Between Effects models			
Dependent variable is GDPGR6020 log difference of real GDP per worker between 1960 and 2000.	Variables definition	Coef.	t
LY1960	log GDP per worker 1960	-0.36	-3.35
LNGD	log(n_i + g +)	-1.23	-2.02
LINV	log of Investment rate	0.58	3.72
LSCH	log of School enrolment	0.35	2.4
XMGDP_WB	Trade ratio by World Bank	0.37	2.21
INFLATION	inflation rate	0.12	1.36
GOVCONS	government consumption/GDP	0.48	0.33
_cons	constant	1.45	0.81
Number of observations		46	
R-squared(Overall)		0.65	

⁹ This mainly depends on the high level and high variation in the black market premium during the 1980s in which many developing countries launched the liberalisation programs after the debt crises in the late 1970s and the early 1980s.

Trade ratio as proxy for openness in such environment is positive and statistically significant unlike macroeconomic variables that are insignificant.

Institutions effect on economic growth

We measure institutional quality by using a composite index based on the data set of *International Country Risk Guide* (ICRG)¹⁰.

Table 5 Institutions as factor on economics growth vs trade openness

Panel Between Effects models			
Dependent variable is GDPGR6020 log difference of real GDP per worker between 1960 and 2000.	Variables definition	Coef.	t
LY1960	log GDP per worker 1960	-0.30	-2.44
LNGD	log(ni + g +)	-1.52	-2.32
LINV	log of Investment rate	0.61	3.78
LSCH	log of School enrolment	0.28	1.65
XMGDP_WB	Trade ratio by World Bank	0.26	1.2
INFLATION	inflation rate	0.16	1.73
GOVCONS	government consumption/GDP	-1.10	-0.68
ICGR	Institutional Quality Index based on the ICRG data	0.15	2.12
_cons	constant	-0.26	-0.12
Number of observations		41	
R-squared(Overall)		0.67	

Coefficient on the institutions proxy variable is positive and statistically significant, while coefficient on trade in the presence of institutions variable has diminished significance and it is insignificant.

Conclusion (resumé)

Overall trade openness has positive effect on economic growth, black market premium as a proxy for imbalance in macroeconomic policies has negative effect, in the presence of macroeconomic policies (government consumption and inflation) trade has statistically and economic significant positive influence on growth, and in an institutional environment trade lacks influencing growth, the coefficient on institutions is positive and statistically significant.

¹⁰ Published by a private international consulting company *Political Risk Services*, this index consists of equally weighting an average of four ICRG components for the years 1984-2000: i) investment profile as a average of three subcomponents namely, contract viability, profits repatriation and payment delays; ii) law and order; iii) corruption; and iv) bureaucratic quality.

Appendix 1 Descriptive statistics of the variables

Variable	Variables definitions	Obs	Mean	Std. Dev.	Min
GDPGR6020	Log difference real GDP per worker btw 1960 and 2000	118	0.67284	0.663944	-1.35254
LY1960	Log of Real GDP per worker in 1960	118	8.315269	0.838991	6.573731
LNGD	Log of sum of rates of population growth, TP and depreciation over 1960-2000 period.	191	-2.67835	0.166289	-3.06888
LINV	Log of Average investment share in GDP at constant prices over the 1960-2000 period.	116	-2.00554	0.605964	-3.87963
LSCH	Log of Average secondary school enrolment rate over the 1960-2000 period.	125	-1.01186	0.848931	-3.11522
M GDP_WB	Imports share by the World Bank (M GDP WB)	107	0.337736	0.188695	0.072298
X GDP_WB	Exports share by the World Bank	107	0.295786	0.18485	0.065576
XM GDP_WB	Trade ratio by World Bank	107	0.633522	0.358251	0.145264
COPEN	Current Openness of Penn World	114	0.643167	0.416541	0.147656
ROPEN	Real Openness of Penn World	114	0.373446	0.352563	0.043561
OWTI	Own-import weighted tariff rates, 1983-1985 period	104	0.168817	0.162973	0
OWQI	Own-import weighted non-tariff barriers, 1983-1985 period	102	0.185794	0.237151	0
M_DUTY	Collected import duties	117	0.12293	0.088828	0
logBMP6020	log (1+BMP), 1960-2000 period.	121	0.377613	0.671639	-0.00443
logBMP60	log (1+BMP) in 1960s.	103	0.213121	0.409949	-0.0009
logBMP70	log (1+BMP) in 1970s.	121	0.232322	0.346003	-0.07214
logBMP80	log (1+BMP) in 1980s.	121	0.398824	0.634852	-0.0142
logBMP90	log (1+BMP) in 1990s.	121	0.274288	0.7994	-0.00351
UWATR	Unweighted average tariff rate, 1990-99 period	121	0.149564	0.093249	0.0032
ICGR	Institutional Quality Index based on the ICRG data	124	3.77601	1.144813	1.11152
INFLATION	Average Inflation Rate over the 1960-2000 period	118	0.399947	1.257691	0.02486
GOVCONS	Government Consumption	121	0.155383	0.05326	0.059789

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