

DOES INTERNATIONAL TRADE CAUSE ECONOMIC GROWTH? A SURVEY

by

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Introduction

Causality between international trade and growth remains a critical debate among scholarly, politically, and policymakers. This led to tremendous research, both theoretically and empirically, to satisfy one's view. Thus, the role of world trade organizations on international trade and the rising of preferential trade agreements are raising concerns whether these elements have either a positive or negative impact on international trade and growth.

This synthesizes paper aim to answer the question, does international trade cause economic growth?

To answer this question, we will first outline the correlation between trade and growth based on macroeconomic and microeconomic evidence. Next, we will discuss protectionism versus trade liberalization following evaluating the role of WTO and the effects of PTAs.

Trade and Growth

In this section, the study discussed the relationship between trade and growth by using the empirical evidence built upon two models, such as time series models and the cross-section and panel data models.

The time series models aim to explain the non-causality test, and the hypothesis of export-led growth versus growth-led export. In the 1960s, a study asserted that trade is the engine of growth for developed countries in the 19th century but not for developing countries in the 20th century. Nevertheless, in the early 1970s, a study argued that trade is not the engine of growth, but it is a handmaiden of successful growth; thus, growth is a consequence of favorable internal factors, and exportation is an added stimulus. The studies during the 1960s-1970s mostly used unconditional correlation and static regression analyses, which have a weakness of ignoring feedback effects and did not provide information on reverse causation from growth to trade. Later on, there had been seen the development of the non-causality test, which take into account feedback effects and addressing export-led growth versus growth-led export hypothesis. This test mainly studies the short-term business cycle. In the 1980s, a new approach was developed to tackle trade growth relationships, scilicet estimators and error correction models, which was thought to be a remarkable discovery. Then in the 1990s, numerous studies strongly support, others partially support, and the rest have mixed results to support the export-led growth hypothesis.

The cross-section and panel data models examining the effect of trade at the macroeconomic level and microeconomic level. At the macroeconomic level, the study aims to explain supply-side effects and productivity of trade on GDP and growth of capital accumulation and total factor productivity (TFP). In terms of supply-side effect, government policies to reduce tariffs and trade barriers will trigger specialization in industries that having economies of scale then lead to an increase in efficiency and productivity in the long run. On the contrary, imposing tariffs on imported intermediate goods will harm the TFP and increase competition tension; instead if there is loosening the restrictions, firms will gain access to more favorable inputs, which then foster TFP. In terms of productivity to trade, openness to trade led to growth in TFP and has a positive impact on GDP per capita growth, thus reducing the income distribution gap

in the country. The study found that trade encourages growth through investment and capital stock because the traded goods sector uses more capital intensive. However, a positive correlation between openness and growth is only a recent phenomenon. At the microeconomic level, the study aims to examine the effect of trade at the industry or firm level. Some studies found no relationship at all between openness measures and productivity. Then in the 1990s, a study had been conducted by using longitudinal data and test two hypotheses aim to illustrate higher productivity and efficiency of exporters versus non-exporters. The first hypothesis, namely the self-selection hypothesis, stated that firms with a high level of productivity would export their product to the foreign market. The second hypothesis, scilicet learning by exporting hypothesis, argues that internationalization is the source of technological innovations and managerial inputs for the exporting firms. These firms will have productivity improvements after entering the export market. However, studies supporting the self-selection hypothesis outweigh learning by exporting hypotheses, and this discovery supports the effects of productivity and growth on trade.

After showing concrete empirical evidence, we can conclude that if we study at the country level, the studies will discover the effect of trade on productivity and growth. However, at the firm level, we found a contrary view that it is the effect of productivity and growth on trade.

Protectionism Versus Trade Liberalization

In this chapter, the study outlined critical views on protectionism compared with liberalization and the role of world trade organization (WTO) in support the trade, thus highlight the term preferential trade agreements (PTAs)

Barriers to trade are the mechanism to gain from trade and favored by protectionism. In the 1980s, this mechanism was popularized among developing countries, cultivating protectionism and replacing the import goods with domestic products. This was then criticized as a lack of insight that was blindly focused on short-term growth, led to negative real growth, increased inefficiency, and caused a higher price for consumers. On the contrary, some studies prior to trade liberalization and free trade will lead to rapid and sustainable growth, a rise in the standard of living, and poverty reduction.

GATT was introduced in 1947, which then transformed into WTO in 1995, which aim to reduce tariffs and non-tariff barriers to support free trade in goods, services, and capital. In terms of the impact on the world economy, WTO had seen as significant in the long term. Other studies also support that WTO is encouraging world trade and having a positive effect on trade in nearly all periods and for most countries. On the contrary, other studies argued that WTO members have a minimal positive effect on trade and an insignificant dampening effect on the volatility. Plus, there had been found little evidence that the countries joining WTO have different trade patterns in terms of tariff rate and other measures of trade policy from the outsiders. In terms of PTAs, there has been lots of concern about whether it will eventually replace the multilateral trading system and if it generates trade creation and building block or deflects the trade and stumbling block. Numerous studies have distinctive reasons to support on each side.

In conclusion, liberalization and free trade will encourage fabulous long-term positive impact, whereas protectionism only brings harm in the long run. Plus, there are different views and supports in terms of WTO's role in the world trade; thus, the issue arises whether PTAs helped either foster or hinder the multilateral trading system, and various studies shown the support on both sides resulting from PTAs effects.

Conclusion

This paper is dedicated to outlining the relationship between international trade and growth. At the macroeconomics level, studies shown that international trade is the pillar of productivity and growth. Surprisingly, at the microeconomics level, studies found that productivity and growth encourage international trade. Moreover, most studies strongly support the role of WTO in spurring a positive impact to free trade. However, there are some issues with methodological and measurement issues on the trade growth empirical data, which is beyond the scope of this synthesis paper to cover.

The final thought on this paper is that it helped expand my knowledge in the field of international economics and let me realized my blind spot on many contents, especially on the trade agreements section. Due to the inexperience and shallow knowledge in the filed, it required me a tremendous amount of time to fully understand and link the concepts to one another. However, some concepts are beyond my ability to outline even self-study, and intensive research was applied to study, especially about methodological and measurement issues. This would require interactive with professors, along with personalized guidance.

Reference

Singh, T. (2010). Does International Trade Cause Economic Growth? A Survey. *The World Economy*, 33(11), 1517–1564.