

Trade openness and economic growth: a cross-country empirical investigation

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Abstract

This paper demonstrates that trade liberalization does not have a simple and straightforward relationship with growth using a large number of openness measures for a cross section of countries over the last three decades. We use two groups of trade openness measures. The regression results for numerous trade intensity ratios are mostly consistent with the existing literature. However, contrary to the conventional view on the growth effects of trade barriers, our estimation results show that trade barriers are positively and, in most specifications, significantly associated with growth, especially for developing countries and they are consistent with the findings of theoretical growth and development literature.

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1. Introduction

Do open economies grow faster than closed economies? Almost all empirical growth studies have provided an affirmative answer to this question. The reason for this strong bias in favor of trade liberalization is partly based on the conclusions of a wide range of empirical studies, which claimed that outward-oriented economies consistently have higher growth rates than inward-oriented countries. It is also partly due to the tragic failures of import-substitution strategies, especially in the 1980s and overstated expect-

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ations from trade liberalization. This is probably best described by Rodrik (1999, p. 25) that “(j)ust as the advantages of import-substitution policies were overstated in an earlier era, today the benefits of openness are oversold routinely in the policy-relevant literature and in the publications of the World Bank and the IMF.” It is, however, very difficult to understand this unconditional optimism in favor of trade liberalization among the economics profession and in policy circles. Although there is a near consensus about the positive association between trade flows and growth, the theoretical growth literature, which studied the growth effects of trade restrictions reported that these effects are very complicated in the most general case and the results are mixed as to how trade policies play a special role in economic growth. Furthermore, the fact that empirical studies describe openness very differently makes the classification of countries according to their level of openness a formidable task. Hence, it is not a surprise that use of different measures obtains very diverse openness rankings among countries.

Accordingly, this study examines the growth effects of a large number of measures of trade openness. Using the same specification for various openness measures where each variable measures a different aspect of openness, we try to accomplish two things. First, we believe that our results provide a more complete picture of the relationship between openness and growth as compared to empirical studies that used a subset of openness measures. Second, it enables us to compare regression results across individual measures and across groups.

We divide our trade openness measures into two broad categories: measures of trade volumes and measures of trade restrictions. On the one hand, our estimation results for various measures of trade volumes indicate that there is a positive and significant association between trade openness and growth. They are also consistent with the conclusions of empirical and theoretical growth studies. On the other hand, our estimation results for trade barriers contradict the conventional view on the growth effects of trade restrictions, which suggests an adverse association between trade barriers and growth. Using various new measures of trade restrictions along with commonly used average tariff rates, our estimation results from the most specifications show a positive and significant relationship between trade barriers and growth. Equally important, these results are essentially driven by developing countries and thus, consistent with the predictions of the theoretical growth literature that under certain conditions, developing countries can actually benefit from trade restrictions.

The outline of this paper is as follows. The next section reviews the theoretical and empirical literature on trade openness. Section 3 describes a standard growth equation and the data sources and definitions. Section 4 separately reports the estimation results for various measures of trade flows and restrictions on these flows. In this section, we further address the potential problems of the cross-country growth framework. Section 5 concludes the paper.

2. Literature review

The relationship between trade openness and growth is a highly debated topic in the growth and development literature. Yet, this issue is far from being resolved. Theoretical

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