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Trade, trade openness and macroeconomic performance

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Abstract

The paper examines the link between trade, trade openness and macroeconomic performance. The main methods used in the paper are a descriptive and comparative analysis of significant empirical studies during the past decades. Based on the presented literature, the empirical results indicate a positive effect of trade and trade openness on macroeconomic variables. Therefore, an introduction of appropriate trade policies in an economy is the major source of its economic growth.

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Keywords: international trade; economic growth; trade openness; exports; imports; trade deficits

1. Introduction

In the current global economy characterized by growing globalization, integration of countries into different international structures, creating new global terms, e.g., global value chains, there is an obvious trend of developing countries catching up with developed countries while the rest of the developing world is falling behind. A large number of developing countries have become part of the globalised world which has brought significant increases in trade along with considerable declines in tariffs. Moreover, the economies have become more and more connected with external factors like openness due to liberalization and globalization. History has proved the more internationally active countries being more productive than countries producing only for their domestic market.

Discussions about the importance of international trade in economic growth and productivity promotion have been held for decades. Thus the analysis of the international trade impact upon economic growth could be beneficial to policymakers to apply appropriate policies by determining the source of growth with consideration of international

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trade. International trade affects economic growth positively through capital accumulation, industrialization, technological progress and institutional development. Moreover, as mentioned above, more opened countries have a tendency to be more productive and to apply comparative advantages. The countries in the trade chain have the possibility of consuming and producing goods from other countries worldwide. Components of foreign trade are at the same time part of country's GDP that is equal to their difference known as net exports. Therefore, mutual causal relationship of export and import is fundamental in the external balance evaluation of every country.

Next part discusses theoretical aspects of trade, trade openness and macroeconomic performance. The third part provides a brief overview of various empirical studies that examine possible relationships among considered variables. The final section summarizes and presents conclusions.

2. Theoretical aspects of trade, trade openness and macroeconomic performance

Mercantilists emphasized the importance of exports for national economies in the 16th century as they believed that trade surplus is the most beneficial advantage of international trade. They supported export stimulation and protection of domestic industries. Mercantilism was gradually replaced with the ideas of Adam Smith, one of the leading 18th century thinkers. Smith stressed the positive effects of international trade on the global economy in The Wealth of Nations in 1776. In his theory of international trade, he argued in favour of free trade and free international competition as more beneficial to a nation than the previous mercantilist economic policy widespread in Europe until late 18th century.

Many economists and policymakers started to examine a possible relationship between international trade and economic growth since the 60s. Nations worldwide tried to create conditions for a better quality of life. The reason for this was to reach an important economic goal, i.e., sustainable economic growth. As international trade represents a significant part of economic growth, the question to raise is whether a country should support its export along with its import or should only focus on one of these in order to stimulate its economic growth. The dilemma of proper trade policy selection has been the topic of discussions since the end of World War II.

Openness to trade is closely related to exports and imports as the most used definition of openness is the sum of exports and imports to GDP of a country. WTO (2003) points out that openness to trade can be beneficial in various ways. One of the many benefits is a better utilization of countries' resources due to better production conditions thus achieving a comparative advantage. Another benefit is exploiting the economies of scale that would increase levels of income and efficiency of resource allocation. The above mentioned benefits are known as the static gains from trade. The dynamic effects of trade correspond with the improvement of the total factor productivity through "learning by doing" and the accumulation of human capital. Learning by doing may be more visible in export industries as a result of knowledge and technology spillover effects. Moreover, the benefits of international trade are mainly derived from the external environment, appropriate trade strategy and structure of trade patterns. WTO also states that openness would have a positive long-term impact on growth provided it would lead to an increase in investment's rate or stimulus for technology spread and growth. China represents one of the best-known case studies on trade liberalization and openness along with their positive effects. Lardy (2002) argues that fast economic growth of China has proven that economic freedom and wealth creation are firmly related to each other. China's total trade was 20 billion dollars in 1977. Surprisingly, the value increased to 475 billion dollars by the end of the 20th century. China began to open to the world economy and decided to change its internally oriented regime at the end of the 80s, i.e., years in the period of 1978–2001, the years of trade liberalization, with the 1979 law on joint ventures and the formation of special economic zones in 1980. Government representatives were willing to "sacrifice" the short-term costs by introducing the principles of WTO multilateral trading system to achieve the primary policy goal, i.e., economic growth. The author states that reformers in China saw the joining WTO as an opportunity to expand private sector and establish the conditions for long-term growth. Before joining the WTO, China reduced its tariffs and non-tariffs barriers significantly and extended trading rights for foreign and domestic companies as well. Its trade has improved strikingly during the past decades and China's total trade reached the value of 4274.9 billion dollars in 2014. Thus, China nowadays is number 1 exporter and number 2 importer of the world. Also, the study of Marelli & Signorelli (2011) stressed the positive effects on economic growth caused by China's opening and integration into the global economy.

Furthermore, combined effects of macroeconomic policies, i.e., fiscal and monetary policy and exchange rate are reflected in the volume of international trade. The impact of macroeconomic policies can be evaluated by analysing a