too small domestically to support an efficient scale of production. Increasing exports allows economies to specialize in the production of specific products, exporting production above domestic demand. Export expansion also allows countries to earn foreign exchange, which can promote the importation of advanced capital goods and materials (i.e., facilitating technology transfer). In addition, exposure to foreign competition forces domestic firms to become efficient producers if they wish to survive both domestically (in the absence of restrictive trade barriers) and internationally. An outward orientation also exposes domestic firms to different ideas and methods of production which can lead them to become more efficient producers. In fact, an expansion in exports must by definition increase domestic income.[23] It is also theoretically possible that increasing domestic income may result in an increase in exports. As an economy grows, the small size of the domestic market becomes a limiting factor in increasing the scale of production. Thus, exports provide an outlet for domestic production. Nonetheless, it is equally plausible that increasing domestic incomes will result in a decrease in exports as domestic consumption increases.

Do Higher Exports Lead to Higher Growth Rates?

Despite these theoretical arguments, the case for export expansion is less than overwhelming. While most economists generally subscribe to the notion that export expansion is good for growth, little concrete empirical evidence exists to support this contention. Even a recent *Globe and Mail* article noted that the link between free trade and growth is "one of the most widely held, yet most difficult to prove ideas in economics."[24] Figure 4 shows the relationship between exports and growth for our 71 country sample. This direct evidence fails to support the

[23] In the usual Keynesian national accounting framework, $Y = C + I + G + (X - M)$, an increase in exports (X) must lead to an increase in national income (Y) since exports are an injection into the domestic economy. To avoid this methodological problem, researchers have looked at how changes in X have an impact on Y. This theory, however, is normally used as justification for causality leading from export expansion to economic growth even though most empirical work simply shows the correlation between the two variables.

[24] Peter Passell, "Trade Winds Blowing in Prosperity's Direction," *Globe and Mail*, December 16, 1993, p. B7.