

2. Trade and Economic Growth

The traditional view of the relationship between trade and economic growth suggests that trade is an important contributor to economic growth by allowing the optimal allocation of resources resulting from the specialized production of goods and services. Trade also helps increase inputs to growth such as natural resources, capital goods and technology by exchanging those goods and services that a country can produce efficiently and relatively inexpensively for goods and services which the country either cannot produce or can produce only at a relatively high cost. Thus, countries trade according to their comparative advantages.

In addition to increasing specialization, expanding the efficiency-raising benefits of improved resource allocation and providing access to critical inputs, trade and particularly exports also induces growth by offering greater opportunities for economies of scale due to an enlargement of the effective market and greater capacity utilization due to the addition of external demand. The competition faced in international markets for exports and in home markets through imports provides incentives for fostering more rapid technological change and better management in all sectors of the economy, thus raising overall productivity and growth.

Trade has played an important role in world economic growth and integration in previous decades, particularly the 1950s and 1960s, when world trade in manufactured products grew in real terms at an annual average rate of 9 per cent, while world manufactured output rose at 7 per cent. Experiences of several individual countries also underline the association between trade and growth, particularly between trade in manufactured products and growth in manufacturing output. For instance, the Asian newly industrializing economies - Hong Kong, Republic of Korea, Singapore and Taiwan - increased their shares of world trade in manufactured products between 1973 and 1988 from 4 percent to 10 percent. This matched their faster growth of manufacturing output, rising to 10 percent per annum between 1970 and 1989, in comparison with 3 percent in the United States and just 2 percent in the European Community.¹ The view that exports are one of the causal factors in economic growth is the result of research which has shown that developing countries with higher than average export growth have also tended to experience higher than average economic growth. In addition, further research, while broadly supporting the positive role of exports in encouraging growth, has shown that the direction of causality may run both ways, that is, exports and output growth reinforce each other.

While the growth-promoting effects of trade are often associated with exports, imports can contribute to growth by reducing domestic supply constraints on goods and services, as well as technology. For developing countries, the absence of an efficient domestic capacity to produce intermediate and capital goods as well as some producer services, results in imports often being the primary source of the machinery, equipment, services and other items essential to investment programmes and growth. A number of studies have concluded that imports are a significant factor in explaining the growth performance of developing countries. The economic

¹ GATT, *International Trade, selected editions*.