

# Trade Openness And Its Relationship With Economic Growth A Review Study

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## Abstract

Many economists generally agree that openness accelerates economic growth. This paper provides a comprehensive review of the empirical research that has previously been conducted on the case of how openness to trade affects economic growth. The ongoing inconsistent results, mostly on the empirical side, which have produced confusion among researchers and policy makers over the trade-growth relationship have served as the basis for the current study. Specifically, this paper concludes that the available literature provides an affirmative answer to the question of whether or not trade openness causes economic growth. However, various issues still exist in the current literature, which needs an appropriate approach to handle them, in order to establish an explicit relationship between trade openness and economic growth.

**Keywords:** economic growth, technology, trade.

## INTRODUCTION

Throughout the last few decades, researchers have applied a variety of econometric techniques to objective and subjective measures of trade openness in order to ascertain a robust association between trade openness and economic growth. The compelling message from the literature is that indeed there is a favorable association between trade openness and economic growth. The recent growth experiences of the giant economies of India and China have brought about significant changes in policies regarding foreign trade, particularly in the developing world. These changes have been brought about in response to the phenomenal growth performances of the Asian Tigers (Singapore, Taiwan, Hong Kong, and South Korea) over the course of the years (Tahir et al., 2014; Alzghoul, 2017). Given that transition economies have followed a similar economic liberalisation path and implemented trade liberalisation policies in the early years of transition, this question becomes even more

problematic. In light of this, it is unsurprising that the benefits of trade liberalisation have remained disputed and have been the subject of increased international and academic policy conversation.

Despite the fact that trade is seen as a significant determinant of income and growth, with well-established mechanisms of welfare transmission through trade, the impacts of trade policy are theoretically less known or unclear. Through economies of scale and scope as well as enhanced competition, trade integration provides for more effective deployment of resources. It allows the dissemination of knowledge and the transfer of technology, all of which influence costs and productivity patterns that foster technological advancement and contribute to improved efficiency (Al-kasasbeh, 2022). To counteract market and coordination inefficiencies, theories about the importance of 'investment coordination,' 'the infant industry argument,' and the inherent risks and complexities of investing in (new) technology, as well as the tacit elements of

technological interdependence and complementarity have all given rise to targeted state intervention, primarily through protection of strategic sectors. This is to say that although trade and in particular export-led growth are usually considered significant growth process determinants, trade policy is very controversial. In accordance with propositions (Alzghoul, 2013; Silajdzic & Mehic, 2018), the effects of trade policy and trade despite being interrelated are dichotomous and provide conceptually distinct challenges that must be incorporated into empirical research.

The last fifty years of experience, according to Panagariya (2004), bolster the case for free trade. In order to demonstrate an explicit relationship between trade openness and economic growth, the current literature still contains a number of unresolved questions that necessitate a suitable method for addressing them. Nevertheless, the existence of such concerns does not mean that the observed association between trade openness and economic growth is unstable. Fiestas (2005) argued that despite methodological concerns, there is no evidence that trade liberalization is detrimental to economic growth. The benefits associated with outward-oriented policies are quite visible and have been widely accepted by both researchers and policy makers.

Different factors can explain why researchers have been unable to provide a definitive answer to the topic of whether trade openness is essential for obtaining higher economic growth. First, the measurements of trade openness employed in earlier studies and the methodology used to construct models that link trade openness to economic growth remain uncertain (Busse & Königer, 2012). Secondly, there is apparent mechanism by which trade openness affects economic growth is ambiguous. Future research should concentrate on determining the mechanisms through which trade openness affects economic growth, as Hallak and Levinsohn (2004) have correctly underlined. According to Ulasan (2012), one cannot rely on a theoretical framework because theories do not provide a definitive answer to the trade-growth relationship. The only option researchers do have is to deal with the trade-growth relationship

empirically. Some researchers such as Alkasasbeha et al. (2018) Tahir and Haji (2014) and Dava (2012) believe that the available literature is not exhaustive to produce an acceptable conclusion regarding the trade-growth relationship. Furthermore, the evidence in favor of a positive relationship prevailing between trade openness and growth has been criticized by Alkasasbeh & Al-kasasbeh (2022); Kasasbeh (2021) and Salahuddin & Gow (2016).

## EMPIRICAL LITERATURE REVIEW

In this section of the paper, a series of previous research and studies on the subject of trade openness and its relation to economic growth in a number of countries will be presented in order to gain a deep understanding of the nature of the relationship between the trade openness and economic growth, as follows:

Hye and Lau (2015) examined the association between the trade openness and the economic growth in the Indian economy. This study adopted a new endogenous growth model for theoretical justification, the ARDL technique and the rolling-window regression technique was utilized to examine the short run and long run association amongst the trade openness and the economic growth. Furthermore, the “granger causality” technique is also used to find the short and long run causal directional associations. The findings conclude that in the long run, human capital and the real capital are significant and positively connected with the economic growth. While in the long run the trade openness index show negative effects on the economic growth. Thus, the rolling-window regression findings provided new empirical evidence that the effect of trade openness index on the economic growth is instable all through the sample. However, trade openness index is found to be positively associated to the economic growth in the short-run. The finding of the granger causality test also justifies the validity of human capital-led growth and the trade openness-led growth supposition in the short and long-run growth.

Kaushal, and Pathak (2015) examined the causal relationship among economic growth, financial development and trade openness during the period 1991-2013 in India. The study employed a Vector auto-regression (VAR) test and Granger Causality test. The empirical outcome shows that growth of India leads to trade openness (export and import). Growth is also seen as a significant factor to impact private credit which in turn is seen to cause trade openness. Financial development (Private credit and money supply) have causal impact on trade openness by effectively allocating resources to promote productivity growth along with technological upgradation. Hence the findings support the philosophy of growth-led trade. Neo classical growth model attributes technological change as the cause of growth which is possible with the wisely crafted economic policies like FDI in various sectors of the country and India seems to be pretty active on this front.

Musila and Yiheyis (2015) analysed the Influence of trade openness on investment and economic growth in the case of Kenya using annual time series data. The aggregate trade openness and trade-policy induced openness are evaluated. Controlling for a number of factors, aggregate trade openness is found to have positively affected the level of investment and the rate of economic growth, although the effect on the latter is statistically insignificant. On the other hand, we find trade-policy induced openness to have negatively and significantly affected investment and the rate of economic growth. Granger Causality tests suggest that a change in trade openness influences the long-term rate of economic growth through the interaction with physical capital growth in the case of Kenya.

Dritsakis and Stamatiou (2016) investigated the association between the trade liberalization and economic growth by analysing the newly included thirteen European Union member countries economic data. The study covered a time period of nineteen years (1995 to 2013). The research study applied various analytical tests i.e. cointegration and the causality techniques to investigate the empirical association of the

sampled variables in long-run. The findings concluded that trade openness and economic growth are co integrated with each other, in sampled economies. The study also applied the “Error correction model (ECM)” method and “Two-steps Engle and Granger” techniques to examine the short and long-run associations. The study found positive relationship between the economic growth and trade openness. At last, the Granger causality results explored that, unidirectional causal association directed from trade openness to economic growth, both in long and short-run.

Sallahuddin and Ghow (2016) investigated the association between the Internet usages, financial growth and the trade openness on the economic growth by analysing a time series analysis in the economy of South Africa during sampled time period (1991–2013). The study utilized the Structure unit-root technique, Johansen cointegration and ARDL techniques to examine the association between Internet usages, financial growth, trade openness and the economic growth in the long run. The empirical findings ARDL and cointegration analysis concluded that long run relationships are present between sampled variables. Furthermore, the results also revealed that a significantly positive association between the financial growth and the economic growth. Though, the empirical results concluded insignificant relationship between the sampled variables in the short-run.

Nursini (2017) empirically investigated the influence of the “fiscal policy” and the trade liberalization on the economic growth of Indonesian economy during the time period (1990-2015). The fiscal policy consists of government expenditure on the infrastructure development, enhancement of human resources standards, and the day to day spending. However, the tax revenues and the foreign debts are considered as main source of funding. The study conclude that the government expenditure on the infrastructure development and the human resources enhancement have significantly positive effect on the economic growth, if financed through the tax revenues, while be

insignificant if these are funded by the foreign debts. The day to day spending of government has negatively insignificant effects on the economic growth for both mode of financing i.e. taxes or foreign debts. Trade openness factor has significantly positive association with the economic growth. The suggestion is the quantity of expenditure on infrastructure development and the human resources enhancement must be maximized by the tax financing rather by foreign debts. The development of the domestic industries must be developed to attain a considerable influence of the trade openness.

Keho (2017) also investigated the influence of the trade openness on the economic growth for the "Cote d'Ivoire" during the time period 1965 to 2014 in a "Multivariate framework" including the capital stock, labour and trade openness as the regressors variables. It utilized the ARDL bounds technique for co-integration and additionally the "Toda and Yamamoto Granger causality tests". The results concluded that the trade openness has positive influence on the economic growth in the short as well as in long run. In addition, it revealed a positive and strong relationship amongst the trade openness and the capital formation in the economic growth.

Pradhan, Arvin, Hall, Bennett and Bahmani (2017) investigated the "Age-old trade-and-economic-growth controversy". The study conducted it by using the data concerning to the G-20 economies during 1988 to 2013. The study attempted to establish a formal empirical connection between the trade openness and economic growth in the interactions of financial depths, gross capital formation, and the foreign direct investment. They analysed the "Panel vector autoregressive model" to achieve the estimates. The results found that the sampled variables are significantly cointegrated to each other. Thus, there is a long-run relationship exists amongst the sampled variables. Additionally, the trade openness, gross capital formation, financial depth and foreign direct investments are causing factors in the context of economic growth in long run in the G-20 economies. Similarly, the short-run finding

concluded that there is also causal relationship between the variables.

Parsa and Sajjadi (2017) also investigated the causality association between economic growth, energy consumptions and the trade openness in Iran during the period 1967–2012. The research utilized the latest combined co-integration technique developed by the Bayer and Hanck (2013). The "Vector Error Correction Model (VECM)" was also utilized to detect the causality relationship amongst the three sampled variables. The findings of "Bayer-Hanck cointegration technique" reveal that the presence of the cointegration relationship between the variables. The causality results analysis showed that only a unidirectional causality exists between energy consumption and trade openness in the short run. The case of long run, the causality analysis concluded bidirectional causality association between the economic growth and the energy consumption and the trade openness and the energy consumption with unidirectional "Granger causality" from trade openness and economic growth. Additionally, the research used "variance decomposition method" and "impulse response functions" to represent the dynamics of such relationships that justified the lower energy efficiency.

Rafindadi and Ozturk (2017) examined whether the financial growth, trade openness and the economic growth have impact on the energy consumptions in the economy of South Africa and find which policy must be developed in respect to the energy consumptions in the industrialization procedure of the African economies during the sampled period 1970-2011. The study examined the unit root features of the sampled data by using the "Ng-Perron unit root tests" and the "traditional structural break unit root tests" developed by Zivot-Andrew. While, the co-integration attributes of the sampled data were examined by analysing the "Autoregressive distributed lag bounds test" for co-integration analysis and the "Bayer-Hanck combined co-integration test", while the VECM approach is also used to investigate the causal association amongst the series. The results concluded that

financial development initiates the energy demands in the economy of South Africa; and is positively associated with the energy consumptions, while the trade openness also maximizes the energy consumptions.

Rahman, Saidi, and Ben Mbarek (2017) also examined the influence of the population growth, environmental condition and trade openness on the economic growth of the major developing and developed economies. They used the panel unit root, panel co-integration tests and Granger causality test during the period 1960-2013. Their results conclude that there exists a bidirectional association between the economic growth and trade openness, and a unidirectional association, directing from the trade openness to the CO<sub>2</sub> productions in the main three developed economies. The population growth shows a positive influence on the economic growth in main three developing economies. Moreover, there are bidirectional associations amongst the CO<sub>2</sub> productions and the population growth, and a unidirectional association from the population growth to the economic growth and from trade openness to the economic growth. In addition, there also exists a unidirectional association from the population growth to the economic growth and bidirectional association between the trade openness and the economic growth for the six sampled economies.

Lastly, Khobai, Kolisi, and Moyo (2018) examined the relationship amongst the trade openness and economic growth in Ghana and Nigeria in the long run covering the time period 1980 and 2016. It included the investments, exchange rates and the inflation as control variables. They utilized the “Augments Dickey-Fuller (ADF), the “Phillips and Perron (1988)” and the DF-GLS empirical test developed by the Elliot, Rothenberg and Stock (1996). The ARDL technique was also employed in the study to investigate the relationship amongst the variables in long run. The results suggested the existence of relationship amongst the variables in long run both economies. The findings further concluded that the trade openness show a positive effect on the economic growth and is significant at 1%

level in case of Ghana while in case of Nigeria the trade openness show a negatively insignificant relationship with the economic growth. The results show that the different policy development could be implemented for each of these economies.

The various empirical studies analyzed here reported inconsistent and inconclusive outcomes. For example, there are substantial positive and bidirectional relationships between economic growth and trade openness, and negative relationships have been documented in some studies. Other studies record various results. This mixture of outcomes and conclusions comes from differences in methodology, specific times of study and variables used.

## CONCLUSION

This paper is a review of trade openness and economic growth through previous research. The relationship between trade openness and economic growth is a very important issue, which has been a key issue for many economists and policymakers who have differed over the impact of trade openness on economic growth. The paper also notes that economic conditions differ from country to country according to the economic and political systems prevailing in each country, and therefore cannot provide a single study that is valid for all these systems. It also indicates the need to find out which variables are most influential to economic growth. Influential papers that have dealt with the trade-growth relationship during the last couple of decades are analyzed. The objective was to see what has been done so far and what could be done next regarding the trade-growth relationship.

Future studies must address the contentious issues in order to resolve the observed differences regarding the relationship between economic growth and trade openness. Existing problems in the literature have numerous alternate fixes available. Researchers should make an effort to select the most effective measure of openness from the options available. However, it is not a simple task. Researchers must consider data

integrity, endogeneity, sample heterogeneity, and the possibility of a nonlinear relationship between trade openness and economic growth in order to produce accurate results. It is advised that future study should also seek out new methods of data analysis in order to identify important or marginal data.

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