

Export oriented strategies analysis



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After the Great Depression in the 1930s, countries adopted the import substitution strategy. The aim was to produce the products locally rather than having to import them. Thereby, they provided many incentives in the form of high level of protection- duty-free access to raw materials, monopoly status, and import restriction measures- to attract foreign producers in host countries. However, the benefits that proponents of the import-substitution strategy expected- high employment rate, reduced imports and favourable exchange rate- never materialised. Instead, foreigners repatriated profits and indulged in capital intensive production entailing depreciation of the local currency and high redundancy.

As the World War II came to an end, there was a global consensus: countries foresaw their benefits only in working together. The General Agreement on Trade and Tariffs 1947 was established to promote free trade and exports were seen as the main drivers of economic growth. In the current era of globalisation, trade is believed to be the tool to a robust economy.

Eventually, instead of debating on which strategy commands the most benefits, the importance of export promotion and expansion has been continuously stressed.

The debate on whether export-oriented policies have the ability to spur economic growth has received much attention, although the evidence is mixed and inconclusive (Xu et al. 2009)[1]. Both the theoretical and empirical literature disagrees on the precise relation between exports and growth.

Exports form part of the trade mechanism of an economy. Mercantilists, two centuries ago, have stressed on international trade. The aim of mercantilists was to accumulate gold reserves. Standards of living and economic growth and development were not always their concern. They supported the export promotion strategy as they saw trade surpluses as the only positive outcome of international trade for a country's economy.

Since the mercantilists, classical economists saw that trade stimulated growth in mainly two ways. To begin with, exports expansion allowed for a more optimal distribution of resources and subsequently improved productivity. Economic growth was, thus, achieved. Furthermore, the classical school believed that through foreign trade, one country could gain raw materials and equipment which it could not produce. Those provided the material basis for economic development. The most famous theories are exports of surplus of Adam Smith, comparative advantage of David Ricardo, and “ trade is the engine of economic growth” of D. H. Robert Morrison. All these theories interpreted the relationship to some extent but ignored that the international environment is complex and rule-less.

In his theory on exports of surplus, Adam Smith stated that by being able to export the products of excess capacity that are not demanded in the home market, or simply extending the market, the productivity of the nation increases, thus resulting in an increased wealth of a nation (Kibritçioğlu, 2002 p. 4-5). Smith ([1776] 1937: 415), claimed that

Exports, therefore, played the role of a “vent-for-surplus”. In addition, Smith identified two other important gains from trade, i. e. exports, mainly absolute cost gain and productivity gain.

Ricardo (1817)[2]ascertained that exports will allow specialisation as a country will produce and trade in those goods in which it has competitive advantage. The economy will, hence, earn the benefits of trade. Large scale production will be possible and thereby economies of scale will occur.

In the neoclassical era, Keynes included exports as a component in this aggregate demand function:

$$Y = C + I + X - M$$

Where Y= output in real terms; C= consumption; I= Investment; X= exports and M= imports.

Keynesian economists described exports as one of the main drivers of growth whereby an increase in exports will lead to economic growth.

In the 1920s, as Canada attained economic growth by exporting primary products such as fish, minerals, fur, lumber amongst other, Macintosh and Innis propounded the staple growth theory. They were of the opinion that exports of a raw material in which a comparative advantage generated economic growth. Capital and labour will flow in the country and productivity will increase. Other benefits will be in terms of innovation and technological development. Opponents of the theory suggest that relying on the export of a commodity constitute a development trap and that the theory held only for countries rich in resources.

Romer (1986; 1990), Lucas (1988, 1990) put forth a theory that exports could provide access to advance technology and thus, promote growth. Spillover effects and external stimulation will occur as trade takes place.

Countries owning advanced technologies would through exports, gradually, transfer their technologies and allow others to utilise them. As exports promote technology, long-term economic growth can be ensured. Also a broader market is available whereby there are more frequent exchange of information and increased competition. There will be productivity gains. To add, they stated that in the presence of increasing returns to scale, an investment process may generate a sustained growth in per capita income without causing a decline in the marginal productivity of capital to the level of the discount rate.

Krugman (1979) stated that the increase in demand for output of a country through the growth of exports allows the exploitation of economies of scale for an economy. Also, optimal allocation of resources between materials production sector and knowledge production sector are improved. In this manner, exports served to promote economic growth.

Furthermore, Corden (1992[3]) identified 5 ways in which a country's foreign trade could affect the economy: the revenue effect, the capital accumulation effect, the substitution effect, the income distribution effect and the weighted elements effect. Cumulated together, these effects resulting from exports strengthen the economy gradually.

Lewis (1954) through his dual sector model- a capitalist segment, i. e. a modern industrial and non-capitalist segment, i. e., a transitional

agricultural- emphasised that the industrial part promoted economic growth by absorbing surplus labour from the agricultural segment and making profits. Also, increased export earnings will ease constraints on growth by enhancing the capacity to import essential goods in the form of intermediate and capital goods. Thus export expansion promotes capital accumulation and consequently economic growth.

Nevertheless, neoclassical trade theory put forth that economic growth may itself granger-cause exports in contrast with the normal export-led growth. Economic growth affects the supply side, i. e., factor endowments, of an economy positively. Consequently, the demand for exports grows, thus, increasing the local production. The country becomes more competitive on the international front.

On the other hand, radicals suggest that exports from less developed countries to industrialised nations constitute an important mechanism to exploit the poorer countries. Empirical research was much centred on this aspect of the export expansion hypothesis.

The above analysis of theoretical literature indicates that economists in favour of the expansion of the export sector advocate that the latter is the most efficient pillar of a country. An economy benefits through economies of scale arising as increased exports allow for specialisation in production. Firms are driven by global competition and are forced to be as efficient as possible. Hence, profits are high and employees are well paid. Standard of living in countries prone to export expansion is improved. In the same line, other theorists support that exports enable transfer of technology between

trade partners. Innovations taking place on the eastern side of the globe, e. g. in Japan, China or Korea is accessed by economies worldwide. It should be stressed that technology is primordial for developing countries. Exports make inflow of foreign capital and technology possible through its receipts. Export expansion is seen by theorists as an instrument to achieve economic growth.

To critically assess the theories acclaiming the merits of the export expansion hypothesis, several studies have been conducted. There are mainly three important extant of literature: researchers have, in the first place, advocated the export expansion hypothesis; other colleagues have questioned its merits while many have emphasised the positive effects given some conditions.

The theories discussed above are supported by various empirical studies. Export expansion contributed to economic growth in various ways. Using cross sectional data and ordinary least squares, researchers, have found that exports is a strong determinant of economic growth. Balassa (1978)

[4]concluded in favour of the export expansion hypothesis by directly weighing export-oriented strategies against import-substitution policies:

Jun (2007) conducted a panel-data analysis of the export-driven growth theory in 81 countries for the period 1960-2003. Cointegration testing and estimation technique were employed. Exports were found to positively cause output growth. In the same line, Bahmani-Oskooee and Oyolola (2007), moving from traditional cointegration techniques to analysis, introduced the bounds test to examine the exports-growth nexus in 44 developing

countries. The study concluded for the export-led hypothesis in 60% of the countries.

Moreover, researchers have analysed the validity of the export-expansion hypothesis by testing macroeconomic variables of individual countries. Jordaan and Eita (2010) evaluated the nexus in Namibia over the time span 1970 to 2005 using granger causality and cointegration techniques. Empirical results suggested that exports granger caused economic growth. The export-expansion hypothesis was upheld in Namibia. Similar conclusions were drawn by Awokuse (2003) in testing the hypothesis of a growth strategy led by exports in Canada. A vector error correction model and an augmented VAR were applied and it was found that the ELG strategy has a positive impact on growth. Another study investigating the hypothesis in Spain by Balaguer and Jorda (2002) indicated a long-run steady relationship from exports to growth. The trade liberalisation process employed by the Spanish authorities over four decades was successful. Portugal was also tapped for support of the export-expansion hypothesis. Andraz and Rodriguez (2009) applied a three-stage analysis: unit root, cointegration and causality tests to 1977 to 2004 data. The granger causal flow was unidirectional from exports to growth.

In addition to the above, Vohra (2001) applied time series variables from 1973 to 1993 to assess the export-growth linkage in 5 countries namely Thailand, Malaysia, Philippines, Pakistan and India. Findings revealed that exports did contributed positively and significantly to economic growth. Felipe (2003), likewise, investigated some developing Asian countries. A domestic demand led-growth was weighed against the ELG strategy. Felipe

uncovered that though growth was gradually been driven by domestic demand, an export-expansion hypothesis was not “ passé”. As a development strategy, the policy still had its merits. It was viewed as the most important way for developing Asian countries to gain economies of scale.

Ahmed et al. (2008) examined the effect of exports on economic growth in Sub-Saharan African economies. In the early 1990s, these countries were reformed with the main objective of promoting export activities. The ARDL approach applied indicates that exports were, indeed beneficial for economic growth in those countries. Also, a granger-causality test provided evidence of a causal relationship from exports to growth. The results recommended that SSA economies should encourage a liberal environment and export-expansion policies.

There exists, also, real success stories backed by export oriented policies. According to the World Bank (1993), agreement on export-led growth emerged amongst economists due to the success of free-market and export policies of the East Asian Tigers. In the 1980s, countries like Japan, Malaysia, Korea, opened up their economy and promoted exports. As a result, they became the “ Tigers” of the world economy surpassing even the United States. Yoon (2008) using granger causality tests, found that market liberalisation measures employed by East Asian economies encouraged exports. In turn, exports fostered investment in the region and eventually made the economies successful. In a World Bank report of 1987, exports-orientation is said to have shaped the development of a number of countries as well as policies of the World Bank itself.

Along with empirical evidence of exports leading to economic growth, it has also been suggested that growth in output, in turn, causes increase in exports. There exists, hence, a reciprocal causal relationship between the two variables.

Gupta (1985) suggests that exports granger causes economic growth in the Republic of Korea. Chow (1987)[5] used a sample of eight newly industrialised countries to assess the effects of export expansion. Strong bidirectional causality was found between export growth and industrial development in seven countries. In small open countries, for example Singapore and Israel, development of manufacturing industries and exports accompanied and reinforced each other in achieving economic growth.

Ghartey (1993), using cross-sectional data, analysed a vector autoregressive (VAR) model for three countries: United States, Japan and Taiwan. In Taiwan, the export-expansion hypothesis held while the opposite was true in US. Surprisingly, in Japan, there was evidence of a two-way causal relationship between GDP growth and exports. A granger causality test by Shan and Sun (1998) reached the same outcome with data from 1987 to 1996 and 6 variables: output, export, import, investment, labour and energy consumption. Jun (2007), in a study involving 81 countries with data from 1960 to 2003, established that the bi-directional relationship between exports and growth was positive and even stronger for the causal flow from output to exports.

Furthermore, Constant (2010) employed the bounds testing approach to econometrics modelling for the period 1980-2007 in Ivory Coast. Exports

were found not only to stimulate economic growth but a VAR granger test indicated a two-way causal relationship between the variables. The dominance of the export sector was, hence, justified as a driver of economic growth in the country.

As compared to the one way causal relationship from exports to growth, it should be highlighted that some studies do conclude in favour of the supply side theory, i. e., economic growth causes exports growth. Lancaster (1980) argued about productivity driven exports as enhanced productivity improved efficiency in terms of skills and technology. Costs went down and the economy enjoyed comparative advantage. Exports were, thereby, easier. Kwan and Cotsomitis (1991), through a Granger causality test, stated that in China, output was the independent variable and there is a “ one-way causal relationship between the two.” Kwan and Kwok (1995) obtained the same results. Besides, Salvatore and Hatcher (1991) and Chartey (1993) emphasised that the export expansion hypothesis was reversed only in countries with low degree of openness yet large amount of local resources.

Afzal et al. (2010) found evidence against the export-expansion hypothesis but in favour of “ growth-driven exports hypothesis” in Pakistan for the time span ranging from 1970 to 2009. A bivariate ARDL framework was used to test the inter-relationship between exports and economic growth. The same was investigated for Nigeria by Chimobi and Uche (2010). The Johansen cointegration showed no long run relationship between the variables. A causality test to establish the short run linkage, nevertheless, ascertained that economic growth granger caused exports in Nigeria.

Empirical research indicated, also, that the effect of exports on economic growth depends largely on the level of development of the country under study.

Michaely (1977)[6] stated that there exists correlation between economic growth and exports “ only once countries achieve some minimum level of development.” His sample included 41 less developed countries. This view was agreed and backed by Moschos (1989). The latter found that there exists a threshold for the development level below and above which output growth responds differently to its factors including exports. Sheehey (1992) [7] in his study explained that the positive effect of the growth of exports share is only important for the most industrialised countries. His results were even inclined towards a negative impact for countries at a different level of industrial development.

Vohra (2001) in his analysis of the export-expansion hypothesis in 5 countries: India, Pakistan, Philippines, Malaysia and Thailand concluded that:

Therefore, the importance of free-market policies and foreign investments were stressed to achieve the pre-required level of development. Henceforth, the export expansion strategy's benefits could be reaped. In addition, Singer and Gray (1998)[8] confirmed that export driven growth is successful only when market conditions are favourable. When external demand is strong, export earnings grew at a high rate. Thus, the export expansion policy is not highly effective in developing countries as external demand is merely nonexistent.

In contrast with the above theories and empirical evidence, some studies reject the export expansion hypothesis.

As from the late 1940s, extant literature increasingly criticised the gains from international trade. This was prevalent mainly in less developed countries. These economies had difficulties in implementing the export-expansion hypothesis. Exports growth deteriorated the terms of trade of economies as despite exporting several goods, developing economies still had to import basic goods such as food from abroad. An example will be the case of Mauritius which still imports milk, rice, and flour in large amounts from international markets despite increased export of textiles, sugar and financial services. The exports did not serve to meet domestic demand at all. Research indicates that pursuit of export expansion policies left an economy vulnerable to vagaries of foreign demand. Exporters have to compete on international markets against experienced competitors. Also, developed countries often preach protectionism which, hence, makes the export-led strategy unsuccessful as those economies are the main markets for exports. Hence, economic growth is not fostered by an expansion in exports.

Prebisch (1962) was in favour of the import substitution approach as trade protection allowed an economy to become self-sufficient. Similarly, Jung and Marshall (1985) studied the export-growth nexus in 37 developing countries. The hypothesis was rejected on 33 cases. Evidence of an export-led growth was found in Indonesia, Egypt, Costa Rica and Ecuador only. Other economists at the instance of Darrat (1986, 1987) found that the hypothesis held in only one out of four economies. More conclusive yet, Colombatto

(1990) did not find any evidence in favour of the export-economic growth relationship in a sample of 70 countries.

Moreover, Dodaro (1993) tested the export-led growth hypothesis for more than 80 countries for the period 1960- 1986. He found weak support for both the notion that trade was an “ engine” and a “ handmaiden” of growth.

Herzer (2010), similarly, challenged the common view that exports expansion lead to an increase in economic growth. Using a sample of 45 developing countries with a panel cointegration technique, Herzer (2010) ascertained that though exports contributed to growth in the short-run, the same did not hold in the longer run. The long-run effect was generally negative.

Country-specific empirical studies are, as well, against the export oriented policies in the case of India (Xu, 1996) and five ASEAN countries (Ahmed and Harnhirun, 1996). Researchers have widely studied the ASEAN economies as there is much scepticism on the role of trade in the East Asian miracle. Ismail and Harjito (2003) studied the ASEAN countries across 1966 till 2000.

Exports were found to granger cause economic growth in only two instances: Indonesia and Philippines. The Johansen cointegration technique, however, indicated linkage between exports and growth in Indonesia and Singapore.

Eusuf and Ahmed (2008) stated that

An error correction model was applied to data from South East Asian countries: Pakistan, India, Sri Lanka, Bhutan, Nepal, Maldives and Bangladesh. The granger causality test indicated no convincing results supporting the link between exports and economic growth.

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Studying the Central and Southeast European countries, Naghspour and Sergi (2010) advocated that the export-expansion hypothesis was an unfeasible one. To them,

Balaguer and Jorda (2001), also, investigated the dynamics of growth in the European Union. The findings indicated that no support for the export-expansion hypothesis. Exports did not spur economic growth at all. In the case of Egypt, Abou-Stait (2005) used a VAR and impulse response analysis to assess the validity of the ELG paradigm. The hypothesis of whether exports and economic growth is linked and that the former caused the latter was rejected over the period 1977-2003.

Despite the number of empirical research conducted on the export expansion hypothesis, literature fails to provide consistent results on the relationship. Henceforth, in developed as well as developing countries, the subject is a still highly debated one.

As far as the export-expansion hypothesis is concerned, three researchers have undertaken a meta-analysis in the field, namely, R. Mookerjee (2006) and Martins and Yang (2009) and Tingwall and Kungwall (2010).

Mookerjee (2006) used a sample of 76 countries to meta analyse the export-growth relationship. Analysis indicated that studies using aggregate exports had lower t-ratios as compared to those with oil and manufactured exports[9].

In a working paper of the Stockholm School of Economics in 2010, Tingwall and Kjungwall meta-analysed whether exports have been more significant

for growth in China. A sample of 68 country-specific studies was used and results indicated that China did benefit more from exports as compared to other countries.

Martins and Yang (2009) conducted a meta-analysis of more than 30 studies on the causal relationship between exports and firm productivity. They found that the impact was more important in developing countries and in the first year of business.