12 Economic Growth and International Trade

INTRODUCTION

The topic of economic growth and international trade tries to tackle such interesting questions as: what causes economic growth? what is the effect of economic growth on the pattern and composition of international trade? does a country share the benefits of its economic growth with other countries, i.e. does economic growth affect the terms of trade (t/t)? if economic growth does affect the t/t adversely, it is possible for the t/t effect to outweigh the benefits of economic growth, i.e. it is possible for a country to end up worse off as a result of economic growth? does international trade affect economic growth? and all the familiar questions regarding the effects of economic growth on factor payments, income distribution, etc. That is why the topic forms a substantial part of the theory of international trade and a proper analysis of the subject would require a whole book. However, at this level of exposition one can justifiably be highly selective with regard to the issues requiring specific discussion; the purpose of this chapter is, therefore, to do precisely that in a very brief and concise manner.

THE CAUSES OF ECONOMIC GROWTH

Basically, there are two sources of economic growth. First, since it is assumed that each country is endowed with given factors of production and technical knowledge, it is obvious that accumulation of factors and improvements in technology are a source of economic growth. Secondly, a sudden increase in the foreign demand for a country’s exports, particularly in the presence of unemployment, is obviously a source of growth – this is usually referred to as ‘export-led’ growth.

With regard to growth in factor endowments, it should be apparent that populations grow over time and, given certain institutional
arrangements in each country, this may affect the size of the country’s labour force. Fortunately, some limited aspects of the repercussions of such growth were tackled in Chapter 7 (the Rybczynski theorem), hence one need not discuss them here. However, it should be stressed that population growth creates certain problems since a distinction must be made between this and growth in per capita income: it should be obvious that a growth in population which results in the lowering of per capita incomes will necessarily generate different effects when compared with growth which effectively increases the size of the country’s labour force.

Capital accumulation is of course due to positive investment over time. The increase in the size of a country’s capital stock, given the size of the country’s labour force, means that each worker is aided with more capital over time. Hence labour productivity rises and with it per capita income. Needless to add that the Rybczynski theorem also applies here.

Finally, technical progress as a result of R & D will of course affect the country’s production possibility frontiers (PPF) by shifting it outwards. The precise nature of the shift will be determined by whether technical progress applies to one or both industries, and if it applies to both, whether or not its overall effect is neutral. This is due to the fact that technical progress could be L-saving, K-saving or both. To simplify later discussion, all one needs to know is the exact nature of the shift in the PPF; this will be dealt with as and when it arises.

GROWTH AND THE TERMS OF TRADE

The Rybczynski theorem considered the effects of factor accumulation on the total output of the two commodities in conditions of constant commodity and factor prices, i.e. given constant t/t. This indicates that the analysis is not a general equilibrium one since it fails to take into consideration this crucial factor. The interesting question is: what happens to the t/t as a result of economic growth?

At this juncture it should be pointed out that serious analysis of the effects of economic growth on the t/t was undertaken only after the Second World War (Battra, 1973, p. 129) with the impetus provided mainly by a celebrated but highly criticised article by Hicks (1953) – see Corden (1956 and 1965). Now, to highlight the issues involved and to simplify the analysis without any loss of generality, it is usually