HOW DOES TRADE TRANSMIT TO GROWTH? THE IMPACT OF TRADE ON INNOVATIONS, EDUCATION AND CAPITAL ACCUMULATION

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Abstract

Following the seminal paper of Frankel and Romer (1999), 'Does Trade Cause Growth', most literature has found statistically significant positive productivity effects of trade openness; however, the economic significance of trade remains implausibly small suggesting either that trade has second-order effects on productivity or that the income effects have not been fully captured in the reduced form regressions. Constructing a unique panel data set for 21 OECD countries over the period 1820-2016, this paper shows that trade transmits to productivity through education, innovations and investment with lags up to 58 years. In addition to geographical characteristics, time-varying shipping distance is constructed as an instrument for trade. The results suggest that the productivity effects of trade are substantially larger than have been found previously.