Does Trade Cause the Growth of Industry? Evidence from Cross-Country Industry-Level Data

Naqibullah Mashal

The intention of this paper is to examine the effect of trade (export + import) and export on the growth of industry (an increase in GDP of industry) by using cross-country industry level data of Textile & Paper industries for 50 developing and developed countries during the period of 2008-2017.

In this paper, output and trade values are modelled with annual data along with two measures of size (population and area). Following Frankel and Romer (1999) and Irwin and Tervio (2002), this paper constructs a geography-based instrument to control for the endogeneity of trade and conducts a two-stage least squares (2SLS) regression.

The study finds that for the textile industry, there is a positive but insignificant effect of trade (export + import) and export on the output for the period of 2008-2017, accepting the null hypothesis that trade does not cause the growth of the textile industry. For the paper industry, on the other hand, there is a positive and significant effect of trade (export + import) and export on the output for the period of 2008-2017, rejecting the null hypothesis that trade does not cause the growth of the paper industry. In addition, it proves that population has a positive and area has a negative effect on trade across different time.

The result of this study for the paper industry is consistent with Melitz (2003) which shows that trade liberalization raises aggregate productivity at the industry-level through intra-industry reallocations, which implies that trade can cause the growth of industry (that is, trade can raise the GDP of industry).