CHAPTER SIX: CONCLUSION

6.0 INTRODUCTION

This paper was motivated to address certain important issues confronting open economies like Malaysia with regard to export-driven factors and related policies. In particular, this paper tried to examine the export-led growth hypothesis for Malaysia.

There have been conflicting views concerning the concept of export-led growth. Many economists **(like Balassa, 1978; Jung and Marshall, 1985; Bhagwati, 1988)** consider international trade as an engine of growth while others **(such as Frank, 1970; Santos, 1970)** argue that developing countries should adopt import-substitution strategies.

The extent to which export growth in Malaysia drives GDP growth or vice-versa and the extent to which exports exert spill-over effects on the non-trade sector are issues that we attempt to address in this paper.

6.1 SIGNIFICANCE OF FINDINGS

This paper had the main objective of finding whether a causal link exists between exports and GDP. Based on the results of our findings, a summary of which is presented below, it can be said that we have been able to meet the objectives. In other words, a very strong feedback causal relationship exists between export growth and economic growth and also exports exert very significant impact on the non-trade sector.

The findings bear significant policy implications on the Malaysian economy especially in the context of globalisation, trade liberalization and the cropping up of the World Trade Organisation. In particular, they give an indication as to whether Malaysia can benefit from adopting a free trade policy.

6.1.1 Summary of Key Findings

This paper has attempted to test the export-led growth hypothesis for Malaysia using recent advances in time series econometric methodology. The empirical result of a positive long run relationship between exports and GDP has received sufficient econometric support by both the Johansen (1988) and Engle and Granger (1987) two-step procedures and again tends to confirm the significant role played by the export sector, which is so often advocated, in increasing economic growth in Malaysia. In addition to the long run relationship, a feedback causal relationship between the two variables is also found. The results of the error-correction modeling-based causality tests stand against the findings of **Afxentiou and Serletis (2000)** who did not find any causal relationship between export growth and output growth in the Malaysian case. Therefore, the most important policy implication of our findings is that any export promotion strategy will contribute to economic growth in Malaysia and vice-versa.

Our findings support the export-led growth hypothesis over the last 30 years and thus highlight the importance of export promoting policies. A finding that the prediction of GDP would improve if past export growth rates are considered could have important policy implications. It would mean that sustainable growth could be attained if economic policies aim at increasing the growth rates of exports. In particular, exports can be increased by sharpening the competitive edge of the Malaysian products in the world market and by improving the quality standards of these products. Also, Malaysia can diversify its export base to establish export "niches" in order to access new markets which were previously unexplored. This can be done by producing high value added products.

This paper has presented empirical evidence that export promotion is associated with faster growth. The relationship is economically significant and hence the benefits of a policy that promotes exports are large in the case of Malaysia. Thus exports, as vehicles if not as engines of growth, are important to Malaysia by improving their factor utilization, expanding factor endowments, generating a multiplicity of forward and backward linkages and earning valuable foreign exchange.

As shown in the results, exports were also seen to be strongly related to the non-trade sector and this suggests strong ties with the economy. Thus, exports can propel the economy and act as a leading sector in the development process.

The most important result emerging from this study suggests that there is a feedback causal relationship between economic growth and exports. This type of feedback is also noted by **Helpman and Grossman (1991)**.

By lending strong support to the existence of a bi-directional causality between GDP and exports, this study has addressed the shortage in this area of trade and development analysis in the case of Malaysia. To our knowledge, the papers that have tested the export-led growth hypothesis using the Malaysian data are **Afxentiou and Serletis (2000)**, **Ahmed and Harnhirun (1995)** and **Rana (1986)**. Since, they are among the few and perhaps the only papers exploring the exports and GDP relationship in the Malaysian case, it is important to say a few words regarding their approach and how they differ from ours. Firstly, these papers have used Malaysian data as part of a large sample coverage. For example, **Rana (1986)** used fourteen Asian LDCs among which was Malaysia and **Afxentiou and Serletis (2000)** used fifty developing countries as their sample. However, this present study is based uniquely on Malaysian data.

Secondly, these studies have employed the standard causality tests in examining the export–led growth hypothesis while it is well established in the econometric literature that these tests are flawed in the presence of cointegrated variables (**Granger, 1987**). Thus, the present study has been able to employ a much more modern technique in finding the feedback relationship.

6.2 SHORTCOMINGS OF THE PRESENT ANALYSIS

The shortcomings of the method employed should be kept in mind when interpreting the results. First, we could have captured the impact of government expenditure on growth, using a three-gap model as a basis for our theoretical framework instead of the two-gap model applied throughout this analysis. However, such considerations are beyond the scope of this paper.

Second, the model specifications which have been used, might not be comprehensively adequate to test Granger causality. For example, growth in exports may increase foreign earnings of a country and allow increases in productive intermediate imports and hence result in the growth of output. This may involve a long time process that we are not able to capture in our analysis.

Third, it should also be noted that whereas, empirically, it has been determined that changes in export volume lead to changes in GDP growth, a possible extension is to test whether export-promotion measures also have a significant effect on growth, that is, using both export volume and incentives simultaneously in the models. However, quantifying incentives would be a difficult task.

Similarly, even though, this study finds that international trade plays a crucial role in the process of development, it should not be forgotten that development forces are also derived from domestic sources. After all, exports constitute only a fraction of the demand side of the economy. Also, these results do not imply that adding distortions to the domestic economy to promote exports will improve long term growth. Distortions to international trade and market-oriented resource allocation that run counter to a country's comparative advantage can have adverse effects on economic efficiency and growth performance **(see Al-marhubi, 2000)**.

Of great significance, however, are the long run implications of the trade pattern. Economic development has been widely accepted as involving a structural transformation **(Kuznets, 1966; Syrquin, 1988)**. For a country following an export-led growth strategy, it is important to assess whether its trade profile contributes to this transformation. To this end, this study is not able to ascertain the structural transformation associated with exports which falls outside the scope of the paper.

6.2.1 Possible Areas For Future Research

Future research can deal with the shortcomings of the present analysis discussed above. Moreover, it is well established in econometric literature that causality analyses are sensitive to structural changes (**see Engle et al., 1983**). This raises an important question as to whether exports and growth are invariant to policy interventions. Thus, further studies can test the invariance assumption of the export–led growth hypothesis.

According to **Kwan et al. (1999)**, agents' expectional mechanisms will alter as policies change if the regression estimates lack structural invariance. This means that it is a necessary but not sufficient condition to test for the causal relationship between exports and growth only. Testing for structural invariance is as important.

6.3 CONCLUSION

It is indeed undeniable that exports have been a powerful engine of growth in Malaysia as the findings of this present study strongly support the export-led growth hypothesis and therefore suggest that export-promotion strategies have the potential of bearing growth in Malaysia. In addition, it is found that there exists a strong bi-causal relationship between exports and GDP. This bi-causality result has very important implications in that an increase in exports tends to be self-perpetuating.