Available online at www.sciencedirect.com
ScienceDirect
Journal of Policy Modeling 31 (2009) 637–647
Journal of Policy Modeling
www.elsevier.com/locate/jpm

Trade openness and manufacturing growth in Malaysia

V.G.R. Chandran [a,b,*], Munusamy [c,1]

[a] Department of Economics, KM 12 Jalan Muar, University Technology MARA, 85009 Segamat, Johor, Malaysia
[b] Department of Economics, Faculty of Economics and Administration, University of Malaya, 50603 Kuala Lumpur, Malaysia
[c] Department of Business, Nilai International University College, 71800 Putra Nilai, Negeri Sembilan, Malaysia

Received 1 November 2008; received in revised form 1 May 2009; accepted 1 June 2009
Available online 8 July 2009

Abstract

This study investigates the long-run relationship between trade openness and manufacturing growth and further assesses the causal relationship between these variables. Contrary to some scholars belief that at national level, openness does not contribute to growth in Malaysia, our sector specific analysis suggest otherwise. In this aspect, we believe that in any attempt to establish relationship between openness and growth, the analysis should be sector specific since it is more relevant as well as assures a meaningful insight for policy makers. The results suggest that in the long-run, trade openness is positively related to manufacturing growth in Malaysia. Furthermore, the results also suggest that openness should be viewed as the long term policy initiative for the sector to benefit. Therefore, the policy direction for Malaysian manufacturing sectors should focus on long term trade openness policies. Nevertheless, to ensure sustainability, emphasis should be placed on how (which manufacturing sub-sectors) or when openness is actually important. Importantly, policy makers and scholars should understand that leveraging the benefits of openness also depend on whether the liberalized sector has the comparative advantage.

JEL classification: F41; C22

Keywords: Trade openness; Autoregressive distributed lag; Manufacturing growth; Granger causality

* Corresponding author at: Department of Economics, KM 12 Jalan Muar, University Technology MARA, 85009 Segamat, Johor, Malaysia. Tel.: +60 17 6843705.

E-mail addresses: vgrchan@perdana.um.edu.my (V.G.R. Chandran), munusam@nilai.edu.my (Munusamy).

1 Tel.: +60 12 6142596.

0161-8938/$ – see front matter © 2009 Society for Policy Modeling. Published by Elsevier Inc. All rights reserved.
doi:10.1016/j.jpolmod.2009.06.002

1. Introduction

Trade openness has emerged as the main argument among economists and policy makers in explaining the growth phenomena in developing countries (Dawson, 2006; Dutta & Ahmed, 2001; Edwards, 1992; Salehezadeh & Henneberry, 2002; Weinhold & Rauch, 1999). Besides, due to continuous interest on the issue, new methods were also proposed (Lloyd & MacLaren, 2002; Ruíz Estrada & Yap, 2006). The positive contribution of trade openness towards growth stemmed from the notion that liberalization increases specialization and division of labor thus improving productivity and export capability as well as economic performance. In addition, with greater efficiency as a result of trade openness, many of the developing countries followed suit with the export-led strategies. It is widely recognized that trade openness has a positive effect towards economic growth. It is found that countries with more trade openness relatively outperformed the countries, with less openness (Thirwall, 1994; World Bank, 1993). A study by Lloyd and MacLaren (2000) among the East Asian economies supported a similar opinion that the rapid growth was largely caused by East Asia's economic openness. Other noteworthy studies supporting the openness and growth relationship include Urata and Yokota (1994), Osada (1994), Kajiwara (1994), Hwang (1998), Edwards (1998) and Jonsson and Subramanian (2001). In contrast, some scholars (Harrison, 1996; Rodríguez & Rodrik, 2001), however, have been more reserve in supporting the openness-led growth nexus.

Although there are a considerable number of studies examining the relationship between trade liberalization and growth in developing countries (including Dollar, 1992; Edwards, 1992; Sachs & Warner, 1995; Sarkar, 2008; Yanikkaya, 2003), these studies are still far from complete. First, in the case of Malaysia, previous empirical studies relying on cross-country panel data analysis showed mixed results. Second, while many studies have provided empirical evidence on the impact of trade openness and economic growth at nation level, analysis within the framework on manufacturing industries are solely lacking. The lack of analysis at sectoral level may have contributed to the empirically mixed results reported in the previous literature. This study shows that giving emphasis to the wrong sectors or treating all countries to be homogenous in nature may lead to biasness. Contrary to the previous studies (e.g. Sarkar, 2008; Yanikkaya, 2003), it shows that in the case of Malaysia, openness is important for manufacturing sectors. The preferred country and sector specific analysis in this study captured and accounted for the complexity of economic environment and histories of the manufacturing industry in Malaysia. Besides, Malaysia appears to be a suitable case study given the fact that it is one of the highest growth open economies among the developing countries. Malaysian gross domestic product (GDP) grew at an average rate of 6.7% between 1971 and 1990, while during the period between 1990 and 2000 Malaysia had the highest growth rate averaging 8.1% per annum outperforming other ASEAN economies (Malaysia, 1971, 1990, 2001). Malaysia was one of the most active among the ASEAN countries in liberalizing its investment regime in the manufacturing sector during the 1980s and 1990s. This policy offered many incentives including pioneer status tax holidays, expanded investment tax allowances for expansion projects, tax deduction for export promotions, the establishment of Free Trade Zones and other types of incentives to attract and draw FDI. Malaysia, compared to other ASEAN economies has somehow progressed well with its outward orientated strategies. Furthermore, the tariff rate in Malaysia has declined considerably over the years (Urata, 1994). The manufacturing sector has been regarded as the main driver for export performance as well as for the impressive economic growth in Malaysia. In 2006, the strong growth in manufacturing output (7.1%) contributed around 31.3% to real GDP growth (Malaysia, 2009). Hence, interference drawn from this study provides general understanding and guidance for policy formulation.