Effect of Trade Openness on inflation in developing countries: A case of Rwanda

BYUKUSENGE MARIE ROSE

University of Lay Adventists of Kigali (UNILAK); Faculty of Economic Sciences and Management

E-mail: rosebyuka@yahoo.com

Abstract

The development of technology in transportation and communication have boosted international trade. The expansion of trade is also attributed to the effort of nations to remove policy barriers (tariff and non-tariff barriers). The role of trade openness in economy is undeniable. For developing countries, improved resource allocation and higher export revenue contribute to national income and increase the pool of resources available for development-related investment. Furthermore trade openness is seen as a tool of anti-monopoly and it helps to control the inflation.

The aim of this study is to examine theoretically and empirically the relationship existing between openness and inflation. Inflation is a complex and dangerous phenomenon because it can destroy income and wealth. Monetarists think that inflation is a monetary phenomenon while Keynesian economic theory places its causes in demand pull and cost push factors. Proponents of trade openness argue that trade openness is associated with declining prices. In contrast, opponents argue that trade openness does not necessary reduce inflation, rather it increases inflation. Our hypothesis was that there is a negative relation between trade openness and inflation in Rwanda. However, using annual time-series data, the empirical analysis has shown a positive relation between inflation and trade openness in Rwanda.

Key words: trade openness, inflation, time series data, stationarity.