The Linkage of Trade Reform and Poverty Reduction in East Asian Transition Economies

Hoang Hai Ha

***Abstract*—The relationship between trade reform and poverty reduction is likely to provide the foundation of one of the most critical debates of the Doha Round of international trade negotiations as well as national debates. For transition economies, trade and trade-policy reform are fundamental features of economic transition to a market oriented-economy. The reforms included significant changes not only in trade policies but also in property rights, price regimes, and in the institutions coordinating economic exchanges which create impacts on poverty and food security in transition countries. A clearer understanding of the often-obscured effects of trade reform on food security is therefore essential if the drivers of further reform are to result in changes to the benefit of insecure and vulnerable groups in transition countries. The aim of this paper is to investigate whether the choice of the reform program—and in particular implementing a strategy geared at trade openness -has had a material impact on poverty reduction.**

***Index Terms*—Transition economies, trade reforms, East Asia, poverty reduction, food security.**

I. Introduction

Economic transition is a process of institution building and policy reforms designed to establish an effective system of macroeconomic management and resource allocation based on market mechanisms [1]. According to literature, due to the different initial conditions during the emerging transition process, there is no convergence on the forms moving towards a market economy. Some argue that the gradualism approach is likely to work better than a "big-bang" (or "Shock therapy"), because the adjustment cost involved is so large that the implementation of a comprehensive reform would create strong political resistance, and because the amount of information needed to make such reform feasible would be never fully available. In contrast, others refer to the risk of sliding towards a piecemeal and partial reform of the step-by-step approach that would not necessarily bring about successful results in the long run. East Asian countries (China, Vietnam, Lao, Cambodia) are often referred to as illustrative cases of the "gradualist" approach, compared with reform and growth experiences in the Central and Eastern European Countries (CEECs).

In the case of transition countries, poverty alleviation is not only the first and foremost objective but also the main reason leading to economic reforms. The concept of poverty reduction is quite broad and controversial so far. The complexity of measurement mirrors the complexity of definition, and the complexity increases where participatory methods are used and people define their own indicators of poverty. We do not want to make an emphasis on this debate, so, by default, this paper is limited to only two aspects concerning household-level income and food security in evaluating how trade reform impacts on poverty alleviation.

In our view, a critical feature of East Asian's transition strategy exits in an essential shift in the orientation of trade. Trade-policy reform is component and parcel of their economic transition to a market economy. Before reforms, foreign trade in these countries was just a balancing factor to fill gaps in supply and demand under national strategy. There was no need for a trade policy as such. The imposition of tariffs was purely for revenue-raising purposes. However, as decentralization of export activities took place and as more and more imports were conducted outside of mandatory planning, trade policy came to play an increasing role in their economic transition from the viewpoint of development strategies, especially both incomes and food security. As yet, there is no clear consensus on answers to general questions, such as "will transition countries gain benefits from trade openness in economies?", let alone more specific questions which might involve whether their poverty situation can be improved by reforms in market and trade policy.

II. Trade Reform in East Asian Transition Economies

Trade reform is generally one of ingredients composing a wider set of economic and institutional reforms. Under a classical planned-economy trade regime, trade in each product is monopolized by a foreign trade corporation. The role of policy measures such as tariffs, quotas, licenses, and exchange rates is modest, since most decisions about the level and composition of exports and imports are controlled through the planning system. Reform of such a system to a more market oriented trading system needs following steps:

1) Opening up the trade system to competing traders
2) Developing indirect policy instruments such as tariffs and quotas and moving progressively to price-based measures
3) Removing exchange rate distortions,
4) The possible introduction of measures to reduce the impact of continuing distortions.

These steps must take place in the framework of full and fundamental reforms in the domestic economy. In particular, it is required property rights to be defined in a manner that provides sufficient autonomy for managers to respond to market signals rather than, or in addition to, planning

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mandates. Additionally, mechanisms must be introduced to allow market prices to exist, and to link with world prices through the trade regime. These adjustments can potentially be made all at once, or they can be phased in. Either approach can work quite well. Cambodia also followed a relatively rapid, and relatively successful, approach to reform. A phased approach has been used, with great success, in China, whose growth in trade and output during the reform period has been extremely rapid. The performance of most of the East Asian transition economies has been very strong over the periods during the 1990s. The average export growth rate of the East Asian transition economies was 22%. Connected with this was an extremely strong growth average GDP growth rate of 7.5%. Notably, in none of the East Asian economies was there anything resembling the sustained and deep output contractions that have been carried out in the Former Soviet Union. Of the East Asian transition economies, only Mongolia had a minimal growth rate, and even here the average economic growth rate over the period increased slightly, at 0.7% per year [2]. Cambodia and Vietnam did quite well, recorded a growth of almost 50% and around 70%, respectively, in export volume as percentage of GDP between 1989 and 2009 [3].

The initial focus of their trade policy was placed on internal development with emphasis on the development of import-substituting industries and the agricultural sector which use about 70% of the total labor force. As a consequence, their trade regime was strongly inward-oriented at the inception of economic reform. In the second phase, their trade policy has shifted fundamentally in favor of export production. This corresponds to their de facto adoption of the coastal development strategy, an active encouragement of FDI through various fiscal motives. The liberalization and decentralization of export activities are main sources of trade reform in these countries because an open trade regime has at least four major advantages compared with a closed-economy approach to economic development [2]:

1) The comparative-static benefits from trade;
2) The ability of sectors with relatively high productivity to grow far beyond demand in the country itself;
3) Dynamic welfare gains thanks to continuous rises in productivity;
4) Reductions in the incentives for unproductive activities and corruption associated with trade barriers.

It is frequently said that trade policy should have more aims than efficiently linking domestic to world markets. These objectives typically include: revenue raising; the protection of infant industries; and environmental and social goals. The trade-policy reform has also brought about significant changes in trade patterns. As the reforms progress and market forces come to play a greater part in resource allocation, the trade pattern has tended to move towards one which is more determined by its comparative advantage. They had increased the degree of specialization in a relatively narrow range of exports, mainly labor-intensive products. The liberalization and the decentralization of trade controls have released the country's strong comparative advantage in specific activities requiring the intensive use of low-skilled labor. By unleashing strong forces of comparative advantage, trade-policy reforms have fostered exports of labor-intensive goods. Most dramatic in this aspect are shifts in the product composition of their export structure. For example, the diversification in the structure of exports has become more popular with the increasing share of manufactured products in total merchandise exports, from roughly 50% in 1980 to 80% in 1992. The share of Vietnam's machinery and equipment exports grew from 9% in 2005 to 13% in 2010[1].

III. Trade Reform and Poverty Reduction: A Positive Linkage?

Some philosophers ignore and even sometimes reject the crucial finding that, generally, free trade helps the poor. Because, according to Slaughter (2001), free movement of goods, services, and persons will go a long way toward decreasing world poverty, any theory of global justice should employs a difference-in-differences approach to find out the effect of very specific trade liberalization events on income growth dispersion, and sees no systematic link between trade liberalization and per capita income convergence, encourage and foster the establishment of free trade and the reduction of barriers to immigration. However none of the major scholars on distributive justice or socio-economic rights, namely, those concerned with poverty, suggest unrestricted trade, and some of them even claim that free trade hurts the world's poor.

Meanwhile, many commentators recommend that a positive correlation lies between more open trade regimes and economic growth. Barlow (2006) appears to be the contribution that focuses most explicitly on the connection between trade policy liberalization by itself (as well as other separate aspects of liberalization) and growth in transition economies. He thinks that the level of trade liberalization raises the growth rate especially in transition countries in the case of CEECs [4]. Trade liberalization (as represented by the improved Sachs-Warner indicator) has mostly had a positive impact on economic growth in the transition economies. According to [5] it can be argued that trade liberalization appears as a key component of a successful transition strategy when evaluated in terms of growth performance. In this writing, we claim, following the general consensus in the economic literature, that liberalizing trade would go a long way toward reducing poverty. In trade reform of transition economies, trade liberalization implies a change in the relative prices of traded and non-traded goods and factors in a previously protected sector or economy. The change in relative prices will induce shifts in the allocation of resources to different activities and thereby changes in both subsector and aggregate levels of production. In turn, shifts in income levels (which are expected to increase in aggregate as resources are used more efficiently) have the potential both to reduce poverty levels and in doing so, to improve the food security status by increasing the access of the poor to food [6]. The international dimension is significant, since trade policy influences on both global food availability (in

[1] Global Insight 2011; McKinsey Global Institute analysis

the case of a major importer or exporter), and national food availability (through both imports and production). The impacts on food imports will be mediated by any implications of trade policy for foreign exchange earnings. Some authors (Giavazzi and Tabellini (2005), Feyrer (2009)) see that trade has a significant impact on income, qualitatively confirming the Frankel-Romer results (1999). Especially, Giavazzi and Tabellini (2005) also apply a difference-in-differences approach to find a positive and significant effect of economic liberalization on per capita income growth of: 0.9% if a country only opened to trade; 2.2% if a country opened to trade first and then experienced also political liberalization [7].

Also, trade policy will have implications for poverty alleviation through the correlation with incomes and expenditures. Any change in the trade regime will have a direct effect on both rural and urban incomes, and employment and through these on income distribution. Furthermore, there will be an impact on government revenues through, for example, a change in the level of revenue from import levels. Both effects of national food availability and government revenues at the household level have influences on household access to food directly and indirectly through household incomes.

According to [9], in a comprehensive paper on this topic, winter [8] identifies several key linkages, which are reiterated in large part by Bannister and Thugge (2001). Potential links include changes in:

1) The price and availability of goods;
2) Factor prices, income, and employment;
3) Government taxes and transfers influenced by changes in revenue from trade taxes;
4) The incentives for investment and innovation, which affect long-run economic growth;
5) External shocks, in particular, changes in the terms of trade;
6) Short-run risk and adjustment costs.

In general, on the basis of above arguments, the causal relationship between trade reforms and poverty reduction can be depicted in following Figure:

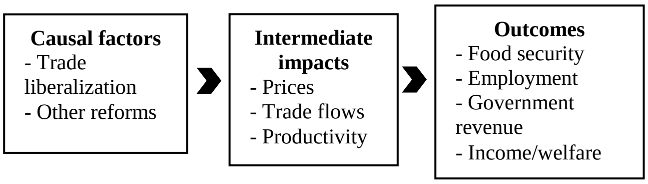

Fig. 1. An analytical framework for linkage trade reforms and poverty alleviation.

The policy used by individual countries to improve their food security status is one of the key factors in understanding the relationship between trade liberalization and food security. Two broad options have generally been followed by countries attempting to chive adequate levels of food security include food self-sufficiency and food self-reliance. (1)Food self-sufficiency or the provision of a level of food supplies from national resources above that implied by free trade, represents a strategy followed by a wide range of countries. (2) Food self-reliance: this strategy reflects a set of policies where the sources of food are determined by international trade patterns and the benefits and risks associated with it. This strategy has become more common because global trade has become more liberal. In this strategy, agricultural sectors in poor economies are often not well placed to benefit from trade liberalization even when this has had a significant influence on both income levels. This is due to the inflexible structure of production and trade in this sector, often manifested in limited market access and weak institutional development, as well as limited capacity to respond to increase motivations. However, food importers are impacted in the short-term via higher import bills. Consequently, there is often a hiatus during which the food security situation worsens.

IV. Case Study: East Asian Transition Economies

During the past two decades, East Asian transition countries have enjoyed substantial benefits in food production and real incomes. Although some scholars see the relative modest progress on structural reform in East Asian transition economies, Fischer (2000) and Martin (2001) agree that the performance of the East Asian transition economies in export and income growth has been more positive than Eastern Europe [2]. Several factors contribute to this growth, including long-term investments in infrastructure, education and agricultural research. The major factors behind these trends in food production are well-known: long-term investments in infrastructure, education and agricultural research, coupled with rapid labor-intensive growth and productivity increases in non-agricultural sectors often associated with outward-oriented development strategies. However, the specific role that trade and related economic reforms played is far less well understood. The experiences of several countries propose that specific agricultural trade reforms have often led to increased real incomes and improvements in food security. In China, Vietnam, Lao, Cambodia, the evidence suggests that trade and related economic reforms also played an important role in these positive developments. The changes that were sprung from the first reforms undoubtedly have effects on agricultural performance and food security in transition countries. Amongst them, the highest levels of economic growth can be seen in China and Vietnam that achieved the most significant reductions in poverty. It is contrasted with the Cambodian experience of high growth but low rates of poverty reduction. In China, incomes and food security have increased dramatically within the rural population. Daily energy intake was about 2100 kcal per capita per day and levels or severe poverty in the 1980s reached 44.7% (about 3044 kcal per capita).

Secondly, the impacts of trade liberalization would be considered in association with other realms of economic integration in the regional and global economy such as increased flows of capital and labor. Capital inflows from the West gone along with integration in WTO and regional trade agreements have contributed to not only macro-economic stability but also social welfare, household incomes. In detail, these FDI has played a key role in creating strong and sustainable productivity growth in their agricultural economies. Large foreign investments in the food industry and input supply industries have provided productivity gains and institutional innovations throughout the food chain, with important spill-over effects on domestic companies and on farms, and thereby rural households. Moreover, increased involvement with global markets has, in the second phase of transition, also strong brought about growth in these economies. The effect was indirect through contributing to new jobs and growth in non-agricultural sectors, hence allowing rural labor to move out of agriculture into higher learning activities, and reducing the pressure on agricultural incomes.

For example, in China, processing export-oriented enterprises became one of the major channels absorbing excess labor released from the primary sector in rural areas. The migrants, many of whom used to live in poverty in the rural areas, got the chance for employment in these enterprises and finally divorced poverty. They sent a large portion of their income back home for the family in rural areas, to support the elderly and children and to build new houses for better living standards. From 1986 to 1993, the average per capita income in poverty counties rose from 206 to 483.7 Yuan (US$28.44 to US$44.82), the population under poverty line in the rural areas dropped from 125 to 80 million, and the ratio of poverty population to total rural population decreased from 14.8 to 8.7% [10].

In the case Vietnam, the overall net impact on poverty of export liberalization was found to be positive. Thanks to the liberalization of Vietnamese agriculture beginning with the introduction of the contract system in 1981, by which cooperatives contracted farm households to produce a specified amount of crops on the household’s own plots, but any surplus could be sold on the open market. This meant that farmers can buy, own and sell agricultural inputs, with the allowed amount of 40% of production produced under contracts on cooperative-owned land. Some studies found that increased production of the principal agricultural exports raised a household’s chances of escaping from poverty. In 1989, Viet Nam began exporting rice, made profitable by a substantial depreciation of the currency, in 1989. In 1997, Viet Nam had become the world’s second largest rice exporter after Thailand. Rice producers/farmers, those for which 75% of the production value is from rice, initial higher yield made considerable contribution to moving them out of poverty. For coffee, the influences of trade liberalization were more highly visible. Being a net coffee producer increased the probability of a household moving out of poverty by 800%. However, multi-market model simulations by [11] showed that eliminating the rice export quota would raise domestic rice prices by 14 to 22% (depending on whether internal marketing restrictions were also removed) and have a negative effect on urban households, non-farm rural households and households in the central highlands of Viet Nam. Net gains to farmers and consumers, however, would be US$200 million; three-quarters of this net gain would represent a transfer from the state-owned enterprises that received the implicit export quota rents (estimated to be the equivalent of a 22% export tax). Besides, there are some good results regarding employment due to the reduction of trade barriers. For example, Textile and garment (T&G) manufacturing as well as footwear have become a major source of non-farm employment, particularly women migrating from rural areas. T&G increases at an annual average rate of 10% during the 1990s, much higher than the national GDP growth and the share of T&G in manufacturing output was about 10.5 % in 2000. In terms of employment generation, T&G industries account for 23% of manufacturing jobs in 2002. In 1993-2006, Vietnam’s trade openness (the sum of exports and imports in relation to GDP) more than doubled with exports as the leading engine of growth, thereby increasing real GDP on average by 7.5% a year. On a Purchasing Power Parity basis, per capita income grew more than four-fold from $630 in 1990 to $2700 in 2008. Vietnam’s country’s poverty rate – measured as the percentage of people who live below US$1 a day – has decreased from about 58% in 1993 to 13.5% in 2008. Accordingly, about 35 million people have escaped poverty [12].

V. Conclusion

The induced growth effect of trade reform would bring about changes in poverty through the increase in the average income per capita and also through increased resources available for poverty reduction programmes. Trade liberalization (or more broadly, a liberalized domestic and international trade regime) may guarantee food security through increasing real incomes of farmers in Viet Nam or food production in China. Arguably, trade reform has been a decisive factor behind the escape from poverty of hundreds thousand of rural households. Whether liberalized trade regimes played a major role or not, increases in domestic production have increased availability of food at the national level across many countries in Asia. Because deeper world markets for rice and other grains, availability of foreign exchange from increased export earnings, and trade liberalization have also helped to stabilize availability of food through more reliable opportunities for imports in years of domestic production shortfalls. As a result, availability of food at a national level is no longer a binding constraint for food security in most countries in most years. Trade and economic integration have mainly re-enforced these effects in direct and indirect ways at national, regional and household levels. General trends indicates that trade is combined positively with lower poverty and food security in transition economies.

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