Trade Adjustment Costs in Developing Countries: Impacts, Determinants and Policy Responses

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(Eds.)
Objective

- Why is this important?
Objective

- Why is this important? Without adjustment there are no gains from trade.
Objective

• Key concerns
  - How do agents adjust to take full advantage of the new trading opportunities?
  - How do agents ease the burden of adjusting to reforms?
  - How big are adjustment costs?
  - What factors drive the adjustment?
  - What can governments do?
  - Distributional conflicts when easing adjustment costs?
Objective

• The Goals of this Project are:
  – Summarize the state of knowledge in the economic literature on trade and development regarding the costs of adjustment to trade openness
  – Describe how adjustment takes place in developing countries
  – Pull together in one place what is known and to use this as the basis for identifying areas for additional research

• The book comprises 23 contributions by experts who focus on different dimensions of adjustment processes in developing countries

• The authors were asked to summarize their own research and the state of play in their area of expertise
Overview of Contributions

- The book is divided into four parts
  - Magnitude of trade adjustment costs
  - Adjustment impacts of trade shocks and greater trade openness
  - Factors that affect the way the economy adjusts
  - Trade adjustment assistance programs in the U.S. and compensation schemes for farmers in the EU
Magnitude of Adjustment Costs

- Davidson and Matusz: general equilibrium model of labor market frictions
- Artuc and McLaren: quantification of industry switching costs in Turkey
- Casacuberta and Galdeman: factor adjustment functions in Uruguay
- De Melo: adjustment costs in cashews in Mozambique and in vanilla in Madagascar
- Cadot, Dutoit, Olarreaga: estimates of transaction-related costs (variable, fixed, and sunk) in Madagascar
Example

- Subsistence farming in Madagascar
  - Estimate the costs of move out of subsistence farming in Madagascar by comparing revenue for market and subsistence farmers
  - Selection is important an identified with price volatility in the past and positive price shocks in the past.
  - Value subsistence farming using a price equation based on farm, regional and individual characteristics...
  - The sunk cost to shift out of subsistence is estimated at 120 to 150% of the annual output
Example

- Who faces higher sunk cost to exit subsistence?
  • Large and young HH
  • No access to credit
  • High transport costs
  • With access to a national road
  • With access to association
  • Educated
Adjustment Impacts

- Hanson: overall adjustment of the manufacturing sector
- Muendler: the nature of labour reallocation in Brazil
- MacMillan: the consequences of offshoring on labor markets
- Hanson: the consequences of migration on labour markets
- Krishna: the role of labour income risk
- Edmonds: adjustment in child labour and schooling
- Javorcik: the consequences of increased FDI
- Harrigan: general patterns of adjustment to changes in trade policies
- Bown: adjustments to trade policies of trade partners
Harrigan: describes the adjustment of exporters from developing countries to the elimination of the ``Multi Fiber Arrangement’’ (MFA)

Four major findings:

- China, which had been severely constrained by the MFA, registered a steep decline in export prices and soaring export volumes after the MFA ended, reflecting the country’s comparative advantage in low-wage products;
- Other low-wage MFA-constrained exporters also saw big increases in their exports to the U.S.;
- The ``East Asian Miracle’’ exporters experienced steep declines in export values, despite having large shares of filled quotas in 2004---the consequence of higher real wages and the end of preferential access to the U.S.;
- Mexico suffered losses from the end of the MFA, as it lost its previously-privileged access to the U.S. market, but these losses were somewhat cushioned by its proximity to the U.S., a factor that insulated Mexico from competition from lower wage Asian exporters
Factors that Affect Adjustment

• Hummels: transportation costs
• Besedes and Prusa: duration of exports and search costs of trade partners
• Arkolakis and Timoshenko: market penetration costs
• Tybout: broad export costs (transport, marketing, market signaling)
• Krishna: the role of distortions
• Manova: credit constraints
• Swinnen and Maertens: product standards
Adjustment Assistance Programs

• Richardson: discusses the Trade Adjustment Assistance (TAA) program of the US
• Swinnen: describes the history of the EU Common Agricultural Policy (CAP)
Future Research

• Interaction between adjustment costs and institutions:
  – E.g., Necessity for credible reforms, otherwise subsistence is optimal

• Interaction between domestic and trade reforms

• More on low-income countries, where missing markets are prevalent

• How to assist?