

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

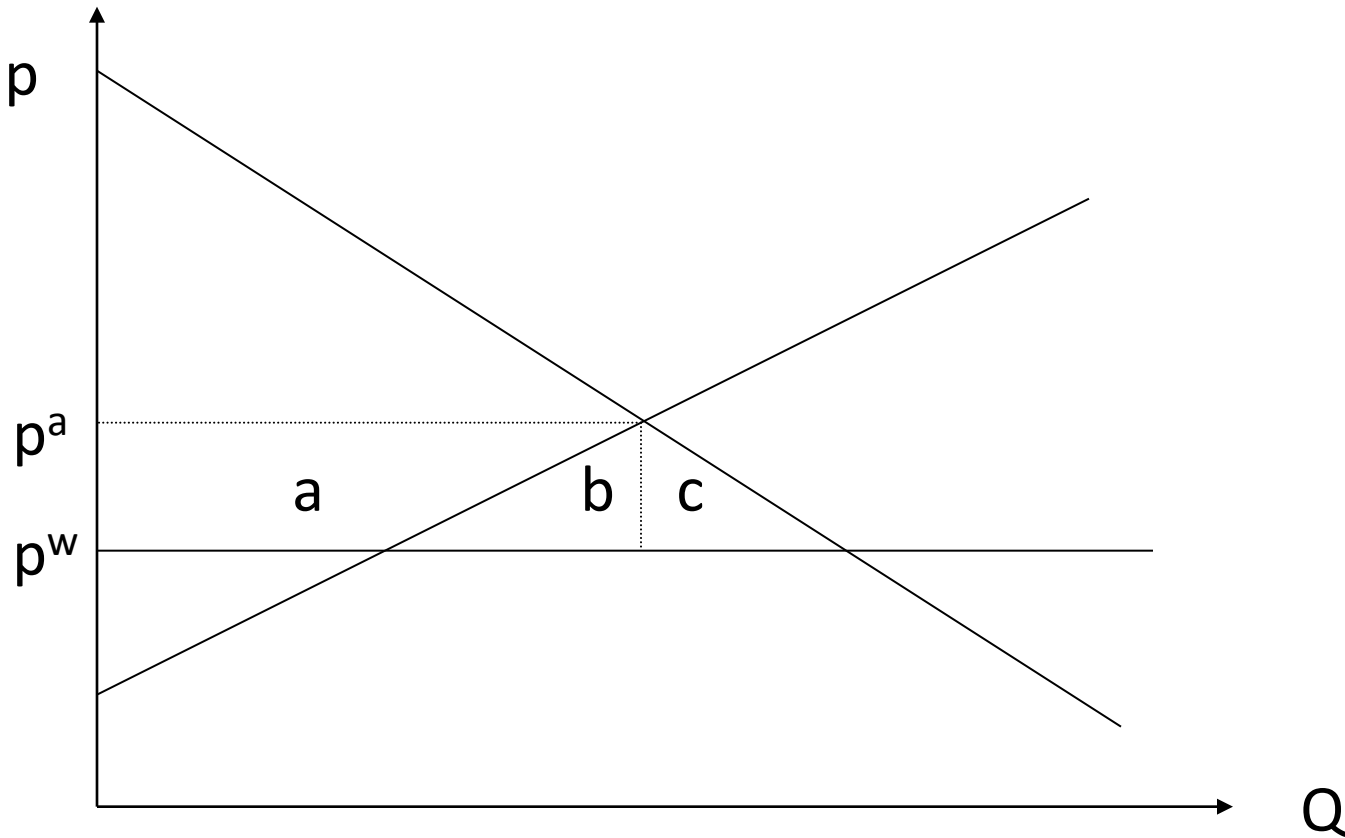
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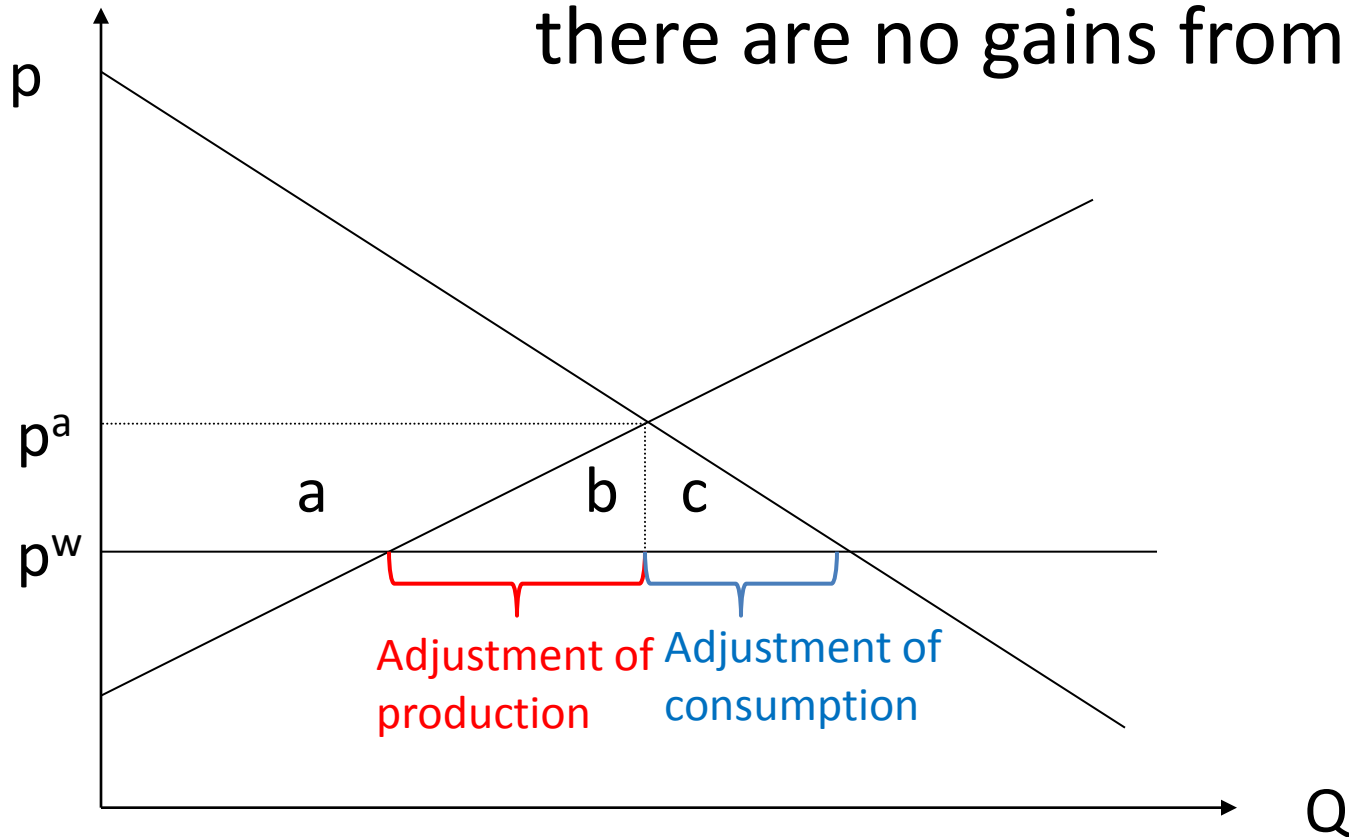
Objective

- Why is this important?



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



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- 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

Example

- 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?