The Impact of Trade Liberalization on Poverty

In terms of the impact of trade liberalization on people's livelihoods, the study finds that households in Vientiane would benefit from the tariff cut. In addition, non-poor households in urban areas would benefit from the policy change, but other poor urban and rural households would become worse off. Overall, poor households in rural areas would suffer the most. There are three main reasons for the welfare changes that trade liberalization would bring:

Firstly, urban areas would gain more waged income from trade liberalization in some sectors, such as garment-making and manufacturing. Rural areas would miss out on this extra income because most factories in Laos are concentrated in cities and towns.

Secondly, trade liberalization would lead to lower domestic prices in a range of sectors, however, the cheaper products would be those that are mainly consumed by urban households (such as motor vehicles and parts and machinery and equipment). Rural households would therefore miss out on these cost savings.

Thirdly, rural areas would not be able to significantly benefit from any increase in crop prices brought about by trade liberalization. This is because returns from agricultural sales in rural areas are not very significant - the value of these sales is not as large as the value of wage income.

The Impact of Trade Liberalization on the Environment

When it comes to the environmental impact of trade liberalization, the study shows that the tariff cut would lead to a decrease in CO_2 emissions of 8,300 tonnes (a relatively small decrease). Specifically, trade liberalization would lead to a decline in CO_2 emissions from 15 sectors, including transport, petroleum and coal products. However, it would also lead to increases in CO_2 emissions from sectors such as air transportation, mineral products, recreational and other services and construction.

The study also finds that trade liberalization would lead to a decline in forestry and fishery, but that it would also lead to an increase in the use of coal, gas and minerals. This shows that trade liberalization would increase resource depletion, especially of coal, oil, gas and minerals.

Recommendations and Potential Future Research

As trade liberalization will have winners and losers, the study recommends that the Government in Laos find a way to protect those who will lose out.

The study also highlights the fact that it does not take into account various aspects of the impact of trade liberalization on the environment. This means that the study probably underestimates this part of the impact of trade liberalization. The study therefore recommends that, even though trade liberalization will not increase CO_2 emissions, the Government should strengthen rules and regulations to protect the environment.

The study concludes by highlighting the fact that it has several research weaknesses. For example, as its simulation focuses only on tariff cuts, it may underestimate the wider impacts of WTO accession. It does not capture the dynamic effect trade liberalization might have on the labour market and on technical innovation, and does not take into account any feedback from trade policy changes on productivity and utilities. These issues point to further areas of research that could provide a more complete picture of the impact of trade liberalization in Laos.

EEPSEA is administered by Canada's International Development Research Centre (IDRC) on behalf of EEPSEA's sponsors:

Sida

Canadian International Development Agency | Agence canadienne de développement international

IDRC CRDI

Economy and Environment Program for Southeast Asia
22 Cross Street #02-55
South Bridge Court
Singapore 048421

Phone : (65) 6438 7877
Fax : (65) 6438 4844
E-mail : hfrancisco@idrc.org.sg
Web site : www.eepsea.org

The Economy and Environment Program for Southeast Asia (EEPSEA) was established in May 1993 to support training and research in environmental and resource economics across its 9 member countries: Cambodia, China, Indonesia, Laos, Malaysia, Papua New Guinea, the Philippines, Thailand, and Viet Nam. Its goal is to strengthen local capacity for the economic analysis of environmental problems so that researchers can provide sound advice to pollcymakers.

EEPSEA Policy Briefs summarize the key results and lessons generated by EEPSEA supported research projects , as presented in detail in *EEPSEA Research Reports.*

EEPSEA Policy Briefs and Research Reports are available online at http://www.eepsea.org

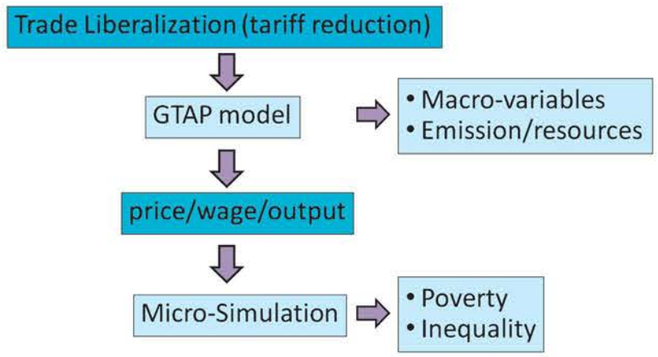
Is Trade Liberalization Good For Developing Countries? – A Case Study From Laos

EEPSEA POLICY BRIEF • No. 2011-PB11

As is the case in many developing countries, the Lao People's Democratic Republic (Laos), is adopting a policy of trade liberalization in an attempt to grow its economy. However, the impact of this approach is not clear, as there have been few studies on trade liberalization in countries such as Laos, which have a predominantly poor, rural population. To give policy makers the information they need, →

A summary of EEPSEA Research Report No. 2011-RR11: 'Trade Liberalization. Pollution and Poverty: Evidence from Lao PDR' by Dr. Phouphet Kyophilavong, Faculty of Economics and Business Management, National University of Laos, P.O.Box 7322, Vientiane, Lao PDR.
Tel: +(856) 21-770067; Fax: +(856) 20-55527321
E-mail: Phuphet20007@hotmail.com

“poor and rural households .... will suffer a drop in income”



The research framework of this study

a new EEPSEA study has looked at the impact of Laos' trade liberalization policies on its economy, the livelihood of its people and its environment.

The study is the work of Dr. Phouphet Kyophilavong from the National University of Laos. The results show that trade liberalization in Laos will have a positive effect on growth, but that this effect will be relatively small. From an environmental point of view, it shows that trade liberalization will decrease CO_2 emissions but will also increase the rate of resource depletion in some sectors. In terms of socio-economic impact, it shows that households in Vientiane, the capital of Lao PDR, and non-poor households in other urban areas will benefit from trade liberalization, but that many poor and rural households will suffer a drop in income. In light of these findings, the study recommends that the Laos government should find a way to protect those who will lose out. It also suggests that the government should strengthen rules and regulations to protect the environment.

Laos – Making the Leap from Least Developed Nation Status

Currently, the Lao People's Democratic Republic (Laos) is in transition from a centrally-planned to a more market-oriented economy. Laos has achieved high rates of economic growth with low inflation. However, the country still has serious macroeconomic issues to overcome: It is facing chronic deficits in both government spending and international trade, there is a huge gap between savings and investment and it faces a high burden from external debts. What is more, while poverty in the country has fallen from 45% (1992-93) to 39% (1997-98), levels of poverty are still high and inequality has increased.

The Government of Laos' national development goal is to graduate from Least Developed Nation status by the year 2020, while balancing economic, social and environmental issues. To this end, the government is liberalizing trade in order to increase economic growth and reduce poverty. Laos joined the ASEAN Free Trade Area (AFTA) in 1998 and will join the World Trade Organization (WTO) in the next few years. According to the free trade agreements it has entered, Laos must reduce its tariffs. By doing so, the Government expects to gain key benefits such as an increase in both exports and foreign direct investment.

Will Trade Liberalization Work?

The exact impact of trade liberalization on Laos (and other developing countries) has been the subject of much debate. While trade liberalization can increase employment opportunities and reduce the price of consumer goods, it is not clear whether these changes benefit the poor and help mitigate inequality. For example, around 80% of Laos' population lives in rural areas and the roads connecting them to urban centers are poor. Therefore, simply lowering the price of goods at the country's border is unlikely to benefit this section of society.

The impact of trade liberalization on the environment in Laos has also been the subject of uncertainty. As in other LDCs, environmental regulation in Laos is weak. It has therefore been argued that trade liberalization could increase pollution and natural resource depletion and degradation; this, in turn, could lead to increased poverty and inequality.

Overall, due to a lack of research on these issues, the impact of trade liberalization on pollution and poverty in Laos has been unclear. Dr. Phouphet Kyophilavong's study is an attempt to find out what the true picture is.

Modelling the Impact of Trade Policies

The study used the Global Trade Analysis Project (GTAP) model to undertake its analysis. The GTAP model is a multi-region computable equilibrium (CGE) model. It is one of the most popular ways of analyzing the impact of trade policies. The study used version seven of the GTAP data base. This comprises information on 57 economic sectors.

There are various advantages to the GTAP model. Firstly, since it is a multi-regional model of world production and trade, it can take into account the overall trade implications of trade liberalization, as well as the implication of the involvement of third-party countries. Secondly, it contains a data base for different sectors and can therefore explore the trade implications of trade liberalization for various sectors of the country's economy.

Focusing on Tariff Reductions

The study first used the GTAP model to analyze the impact of Laos' accession to the WTO – specifically the impact of the reduced tariff rates that this change will bring. Because the final tariff commitment of WTO accession was not available, it was assumed that Laos' final tariff rate commitment in the agricultural, non-agricultural and service sectors would be the same as in the Common Effective Preferential Tariff (CEPT) Scheme for AFTA. In the study simulation, tariff rates to Laos were cut by 2.5% in all sectors (except the service sector) from nine regions, including Southeast Asia.
The results of the GTAP model (prices, wages and outputs) were then used in a micro-simulation to analyze the impact of trade liberalization on poverty. Due to the lack of data on pollution, the study used carbon emissions as a proxy for environmental pollution. It did not take into account the impact of trade liberalization on other forms of air pollution and on water pollution, soil erosion and solid waste.

The Impact of Trade Liberalization on Growth

The results from the GTAP model show that trade liberalization, in the scenario under test, would have a positive effect on growth, but that this effect would be relatively small. Trade liberalization would increase equivalent variation (EV) and real GDP but reduce the terms of trade and the trade balance. EV would increase by USD 1.67 million and real GDP by 0.53%. It is clear that the effects of trade liberalization would be slight because Laos already has low tariffs from joining AFTA and because the economy of scale in Laos is relatively small.

The study also finds that trade liberalization would increase Laos' trade deficit. This would happen for two reasons. Firstly, Laos does not produce a diverse range of goods. Besides minerals and electricity, Laos only exports a few other commodities such as clothes, coffee and a few crops. Secondly, some of Laos' exported goods are not competitive in the world market but are propped up by preferential treatment. For instance, Lao labour productivity in the garment sector is lower than that in neighbouring countries; garments are exported mainly to the EU and the US, which use the Generalized System of Preferences (GSP). Additionally, some of Laos' agricultural products are given unilateral preferential treatment by the original ASEAN members.

Impact on macroeconomic variables

Macroeconomic variables	Simulation 1
EV (million USD)	1.67
Real GDP (%)	0.53
Term of trade (%)	-0.93
Trade balance (million USD)	-43.08
Import volumes (%)	7.74
Export volumes (%)	5.29

Source: author's GTAP model results