



# Trade openness and household welfare within a country: A microeconomic analysis of Vietnamese households



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## ARTICLE INFO

### Article history:

Received 8 April 2013  
Received in revised form 16 May 2014  
Accepted 18 May 2014  
Available online 27 May 2014

### JEL classification:

O12  
O17  
O24  
P36

### Keywords:

Trade openness  
Institutional reforms  
Welfare  
Rural household  
Vietnam

## ABSTRACT

The positive effects of trade liberalisation on several dimensions of poverty have initiated studies of the trade–poverty relationship. Trade liberalisation accompanies institutional reforms that help to reduce institutional barriers against the poor. This study examines the impacts of trade openness and institutional reforms on rural household welfare at the provincial level through the analysis of the determinants of welfare of rural households in Vietnam. The study employs a model of micro-determinants of growth and tests it on the data from the Vietnam Household Living Standards Surveys (VHLSSs) of 2006 and 2010. What makes the study different from some other studies of the same vein is that it attempts to directly capture the institutional effect on welfare. The study finds that, in the provinces with high institutional reforms and trade openness, the welfare of rural households improved. Institutional reforms in Vietnam appeared to be sluggish in the late 2000s. In particular, both access to land and lower informal charges were the important determinants of welfare improvement over time. These findings suggest that Vietnam should maintain its development by accelerating the process of institutional reforms, thereby helping poor households to improve standards of living.

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## 1. Introduction

The impacts of trade liberalisation on households and poverty have long been of concern in economics of development. Several studies have agreed that people in open economies benefit more from trade than those in closed economies, at least in terms of standards of living (World Bank, 1990, 2001). The empirical literature on the relationship between trade liberalisation and poverty has widely been criticised for its inadequate methodology and inconclusiveness (Pacheco-Lopez & Thirlwall, 2009; Rodriguez & Rodrik, 2001; Singh, 2010; Wacziarg & Welch, 2008). Some studies argue that the trade-poverty linkage is largely case- and country-specific (Berg & Krueger, 2003; McCulloch, Winters, & Cirera, 2001; Pacheco-Lopez & Thirlwall, 2009). McCulloch et al. (2001) also contend that, although trade liberalisation is believed to have a large potential impact on welfare and poverty, the direct effects on poverty for many dimensions of trade liberalisation are negligible. Generally, and practically, Winters suggests four main channels through which trade liberalisation reaches households: economic growth, employment, market, and government revenue (Winters, 2002; Winters, McCulloch, & McKay, 2004). These four main pathways link trade liberalisation with household welfare, and thereby poverty; they also cover the main

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stakeholders of a market economy: households, enterprises and government. Using the outline of channels as an analytical framework, [Winters et al. \(2004\)](#) conducted an intensive survey of the literature on the relationship between trade liberalisation and poverty.

Trade liberalisation is closely related to institution reforms ([Rodrik, 2002](#)). Institutions are the rules that shape the interaction between citizens, firms, and the state ([World Bank, 2010](#)). The literature on the trade–poverty relationship also shows that institutions are crucial to the impacts of trade liberalisation on welfare. [Acemoglu and Robinson \(2012\)](#) conflate experiences of the development of nations and suggest that a country's own institutions determine its success or failure. Institutions become an important dimension of poverty ([World Bank, 2001](#)) and underpin the linkage between trade liberalisation and poverty.

Many studies of the trade-poverty link for Vietnam can be included in Winters' framework (e.g. [Coello, Fall, & Suwa-Eisenmann, 2010](#); [Glewwe, Gagnolati, & Zaman, 2002](#); [Justino, Litchfield, & Pham, 2008](#); [Minot & Goletti, 1998](#); [Niimi, Vasudeva-Dutta, & Winters, 2007](#); [Seshan, 2005](#)). These studies primarily examine the effects of price and employment on households and poverty, as these effects are prominent in the framework. [Niimi et al. \(2007\)](#) use the household panel data from Vietnam over the period 1993–1998 in a multinomial logit model to evaluate the impact of trade liberalisation on poverty dynamics. Their study finds that trade liberalisation substantially reduced poverty over the period. [Glewwe et al. \(2002\)](#) and [Justino et al. \(2008\)](#) employ a model of micro-determinants of growth to investigate the impacts of price and employment on household welfare, using the same panel data set. [Glewwe et al. \(2002\)](#) reveal that the impressive poverty reduction in the 1990s was a result of the high economic growth and the accelerating trade liberalisation in that period. [Justino et al. \(2008\)](#) provide evidence that trade liberalisation had a material and positive effect on rural household welfare. These studies, however, do not address the institutional effects on welfare. Generally, although institutions have been an important dimension of poverty, few studies of the trade–poverty relationship take into consideration the effects of institutional reforms on household welfare and poverty.

This study attempts to demystify the impacts of trade liberalisation and institutions on welfare in Vietnam through examining the determinants of rural household welfare. It focuses on rural areas because of the high incidence of poverty often found in these areas. The study differs from previous similar studies. Firstly, it draws on the contention of [Abbott, Bentzen, and Tarp \(2009\)](#) that those models using cross-country data or focusing more on tariff changes as a key element of reforms may be flawed and have failed to incorporate the influence of institutional reforms. Secondly, this study uses internal trade transaction and indices of institutional reforms to capture straightforwardly the effects of institutional reforms on welfare that appear to be ignored by the studies in the field. Both institutional reforms and local trade openness are discernibly important to rural household welfare. This study is expected to shed more light on the institutional effect of trade liberalisation on welfare in Vietnam. Its primary purpose was to analyse the impacts of local trade openness and institutional reforms on rural welfare at the provincial level, using a model of micro-determinants of growth, based on the household survey data over the period 2006–2010. The rest of the study is planned as follows. Section 2 provides an overview of the literature on the link between trade liberalisation and poverty, thereby setting an analytical framework for the study. Section 3 overviews the impacts of trade liberalisation on the economy and the households of Vietnam. Section 4 explains the methods used in the study. Section 5 analyses the results of the model. Section 6 concludes the paper and discusses some policy implications.

## 2. Trade liberalisation and poverty: an overview of literature

The literature on trade and poverty acknowledges the difficulties in establishing the relationship between the two. The main reasons are that both these concepts, trade liberalisation impact and poverty, are multidimensional ([Winters et al., 2004](#)), and that the measures of trade openness and poverty remain contentious. Many channels through which trade can affect households and poverty have been recognised in the literature about the trade-poverty nexus. Several studies examined them both theoretically and empirically (e.g. [Athukorala, Bandaralage, & Kelegama, 2011](#); [Athukorala, 2010b](#); [Bandaralage, 2009](#); [Berg & Krueger, 2003](#); [Harrison, 2007](#); [McCulloch et al., 2001](#); [Nissanke & Thorbecke, 2007](#); [Winters et al., 2004](#); [Winters, 2002](#)). In Winters' framework, trade liberalisation affects households, and thereby poverty, via economic growth, price and/or market distribution of tradeable goods, employment, and government spending.

In Winters' first channel, trade development benefits the poor through the contribution of trade to economic growth. [Bhagwati and Srinivasan \(2002\)](#) divide this process into two stages: that trade stimulates growth through accumulation and innovation; and that growth reduces poverty by providing the poor with more employment. Many studies conclude that a high level of trade openness is associated with high average income and high standards of living in the long run; for instance, [Balassa \(1978\)](#), [Krueger \(1978\)](#), [Tyler \(1981\)](#), [Ram \(1985\)](#), [Ram \(1987\)](#), [Sachs and Warner \(1995\)](#), [Frankel and Romer \(1999\)](#), [Hallaert \(2006\)](#), [Foster \(2008\)](#), and [Singh \(2011\)](#). With respect to the effect of growth on poverty, growth can generate the trickle-down effect that benefits people in general, including the poor ([Winters et al., 2004](#)). Several studies provide evidence that economic growth is associated with poverty reduction (e.g. [Dollar & Kraay, 2002, 2004](#); [Goldberg & Pavcnik \(2004\)](#); [Perkins, Radelet, & Lindauer, 2006](#); [Roemer & Gugerty \(1997\)](#)). In this first channel, trade benefits poor households indirectly through economic growth.

In the second channel, trade liberalisation affects households and alleviates poverty via prices and/or market distribution of tradeable goods ([Justino et al., 2008](#); [Minot & Goletti, 1998](#); [Seshan, 2005](#)). Price changes and/or the characteristics of market distribution greatly affect the poor. One of the most important conditions for the outward-oriented strategy in an economy to be successful is to maintain macroeconomic stability that is indirectly beneficial for the poor ([Bhagwati & Srinivasan, 2002](#)). In this linkage, trade policy can cause price distortions that result from trade

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