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ASIECO-965; No. of Pages 15

ARTICLE IN PRESS

Journal of Asian Economics xxx (2014) xxx–xxx

Contents lists available at ScienceDirect

Journal of Asian Economics

Agricultural liberalization, poverty and inequality: Indonesia and Thailand☆

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A R T I C L E I N F O

Article history:
Received 10 November 2013
Received in revised form 13 August 2014
Accepted 29 October 2014
Available online xxx

JEL classification:
D58
I32
F14

Keywords:
Indonesia
Thailand
Trade liberalization
Poverty incidence
General equilibrium modeling

A B S T R A C T

The effects of agricultural and general trade liberalization in Indonesia and Thailand are analyzed and compared using a multi-household, multi-sector integrated general equilibrium framework. In both countries agricultural protection contributes a relatively small part of the total cost of protection because when the protection is removed the gain in welfare is much smaller in the case of agricultural liberalization than across the board liberalization. In both countries the poor, urban and rural, have a strong interest in across the board liberalization of trade policy. The urban poor also have an interest in agricultural trade liberalization, but not the rural poor.

1. Introduction

The countries of Southeast Asia are engaged in an ongoing process of economic reform. Some of this reform is currently occurring under the aegis of the Association of Southeast Asian Nations (ASEAN) Economic Community (AEC) Blueprint for 2015, which involves a limited degree of intra-ASEAN trade liberalization for most of the ASEAN countries. Nevertheless, over the longer term, most trade liberalization occurring among these countries has been unilateral and not restricted to trade with other ASEAN countries. Trade liberalization implies substantial economic adjustment, affecting countries' economic structures, their relationships with one another, and the welfare of their citizens.[1] These effects are especially sensitive in agriculture. In the past, most of the ASEAN countries have been highly resistant to relaxing protection of their domestic agricultural sectors. This has been true, not only in food importing countries such as Indonesia, but even in major food exporters like Thailand, where the rationale for protective barriers against imports of agricultural products is less obvious, not to mention the intense resistance to reducing these barriers.

Indonesia and Thailand make an interesting comparison for the effects of agricultural liberalization. Almost all of Indonesia's staple foods are net imports while for Thailand almost all are net exports. This study examines the effects of trade

☆ The helpful comments of an anonymous referee and participants in an ERIA workshop on AEC trade reforms, along with the modeling assistance of Arief Anshory Yusuf and Krisada Bamrungwong, are gratefully acknowledged. The author is responsible for all defects.
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[1] Singapore is an exception because of its very low rates of protection.

http://dx.doi.org/10.1016/j.asieco.2014.10.003
1049-0078/© 2014 Published by Elsevier Inc.

liberalization in these two economies, with a particular focus on agriculture. The study asks how the economic structure of these two economies, along with poverty incidence and inequality within each, are affected by trade policy liberalization in general and in agriculture in particular. The focus is thus on the effects of trade liberalization as such and is not confined to the particular set of limited reforms being implemented under AEC 2015. The analysis draws upon applied general equilibrium models of the Indonesian and Thai economies, respectively. Although the underlying economic structures of these two models are very similar, they each rest on economic data and parametric assumptions specific to the countries concerned.

Section 2 sets out the trade policy background in each country. Section 3 argues the case for using a general equilibrium framework and then reviews the general equilibrium modeling approach to be used in the study. Section 4 summarizes the simulations performed, Section 5 presents the results and Section 6 concludes by comparing the results for the two countries.

2. Trade policy background

2.1. Indonesia

For almost all of the period since its independence, Indonesia's trade policies have taxed agriculture relative to manufacturing. But since around 2000, the net impact of the country's trade policy has been roughly neutral between these broad sectors. The reversal occurred immediately following the Asian financial crisis of the late 1990s in the form of increased protection of the import-competing commodities sugar and rice, reduced taxation of agricultural exports, especially rubber and copra, and reduced manufacturing protection. The movement to a more democratic form of government after 1998, following the chaos associated with the Asian Financial Crisis, weakened the influence of Indonesia's economic 'technocrats', who had hitherto generally favored more liberal trade policies than most of the country's politicians. Greater protection of some key agricultural commodities has been a consequence.

Protection of Indonesian agriculture primarily consists of import restrictions in the import-competing sugar and rice sectors. Other agricultural sectors receive virtually no direct protection. Subsidies to fertilizer and other inputs have been an indirect source of assistance to agriculture, but these rates of subsidy have declined. The political background to protection of the sugar and rice industries is quite different. Protection of the sugar industry is a consequence of the political power of the highly concentrated sugar refining industry, including the state-owned component of this industry, closely linked with large-scale sugar plantations.[2]

On the other hand, farm-level production of rice (paddy) is dominated by small-scale producers. The rice-milling sector is much more concentrated and politically organized, however, and this is relevant because imports compete directly with milled rice rather than the raw, unmilled product (paddy) produced by the farmer. The political power of rice millers has been an important source of support for protection of the rice industry, bolstered by the more assertive economic nationalism that has dominated the new parliament. Since 2004 imports of rice have officially been banned, raising rice prices within Indonesia, relative to non-food prices, by at least 40%. In part, this policy of protecting the rice sector has reflected the long-standing desire of Indonesia's policy makers to eliminate the country's dependence on rice imports, but it has also reflected the claim, frequently advanced by supporters of rice industry protection, that restricting rice imports reduces poverty because it benefits poor farmers.

2.2. Thailand

As Thailand has industrialized, successive Thai governments have become increasingly interested in intervening on behalf of producers in the principal declining sector, agriculture.[3] Agricultural producers and processors are the intended beneficiaries of these interventions, but the fact that Thailand is a major agricultural exporter has limited the scope for protection policy as a mechanism for influencing the domestic prices of agricultural commodities. Over time, the direct taxation of agricultural exports has been gradually eliminated. This has been important in the case of rice, where the once high rates of export taxation were abolished in 1986. Similarly, rubber exports, taxed prior to 1990, have not been taxed since then. Cassava exports have continued to be taxed to a minor extent by the system of export quotas. Taxes on imports of fertilizer, a major input into agricultural production, have been steadily phased out since the early 1990s. Maize exports have been consistently untaxed, as have chicken exports. Most of these policy changes consist of eliminating interventions formerly acting against agricultural exporters.

As of mid-2014, four commodities departed from this general story of liberalized agricultural markets. Soybean was an export prior to 1992 and has remained a net import since then, with imports subject to quota restrictions. The change from net export to net import coincided with a switch from negative to positive nominal rates of protection. Since the early 1990s the domestic soybean industry has received a nominal rate of protection of between 30 and 40%. Sugar is an export

[2] For a fuller discussion of agricultural assistance in Indonesia, see Fane and Warr (2008).
[3] Structural change in the Thai economy is reviewed in Warr (2007) and a fuller discussion of Thailand's agricultural trade policies is provided in Warr and Kohpaiboon (2009).