

Potential Impacts of Regional Trade Enlargement in East Asia on Laos' Trade*

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January 2011

ABSTRACT

Regional Trade Agreements (RTAs) has increasingly played an important role in promoting trade flows in the region. Given the possibility of ASEAN enlargement into ASEAN+3 and ASEAN+6, it is unclear whether the small country as the Lao PDR stands to gain from such enlargement.

The primary objective of this paper is to evaluate the potential gains of Laos' trade in the context of ASEAN+3 and ASEAN+6. This is done in two steps. First, we utilize panel data on bilateral export flows to empirically analyze the international trade determinants of ASEAN and its six partners. More precisely, the study focuses on how relative factor endowment differences, overall bilateral country size, similarity in country size, transportation costs, and tariff rates determine bilateral trade in the regional trading blocs. The study then conducts some counterfactual simulations to see whether trade flows between Laos and its trading partners could further be enhanced through tariff reduction or elimination.

In order to achieve our objective, we construct the dynamic gravity models of trade based on the partial adjustment hypothesis. The gravity models contain five key variables (overall bilateral country size, relative factor endowment differences, similarity in country size, distance, and import tariffs), four multilateral terms (MR terms of relative factor endowment differences, similarity in country size, distance, and import tariffs), and one lagged bilateral exports. Among other variables, import tariffs serve as a key indicator to evaluate the potential enhancement of the proposed trading blocs on trade flows of its members, especially on Laos' trade. The models are then estimated by the system generalized method of moment (system GMM) using the unbalanced panel dataset of ASEAN+3 and ASEAN+6 trade flows from 1989–2009.

To assess the potential impacts of the formations of ASEAN+3 and ASEAN+6 on Laos' trade, we conduct the simulations in three scenarios, taking 1999–2009 as our base years. In *Scenario 1*, we consider a cut in the tariff rates to the current regional average (11.34% for ASEAN+3 and 10.82% for ASEAN+6) so that no country sets its tariff rates over this threshold. *Scenario 2* performs the same exercise for 50% reduction in tariff rates of all countries. *Scenario 3* considers the elimination of tariff barriers of all members.

We find that bilateral trade flow is positively related to the overall bilateral country size and similarity in country size and inversely related to the relative factor endowment differences, transportation costs, and import tariffs. Our simulation results show that the Lao PDR stands to gain from the formations of ASEAN+3 and ASEAN+6 if the tariff barriers are gradually decreased. However, these integrations could harm the Laos' trade if all tariff barriers are completely removed due to its low competitiveness.

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