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Trade implications of Lao PDR’s graduation from LDC status

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Abstract

ITC estimates that Lao PDR could face a trade loss of \$102 million with its envisaged graduation from the status of least developed country (LDC) in 2024, corresponding to 1.2% of its projected exports in that same year. The novel methodology uses projections of trade and tariffs, thereby accounting for a geographical shift of exports that will ease Lao PDR’s exposure to tariff changes by the time of graduation. The paper suggests three strategies for Lao exporters to mitigate the trade losses: first, attaining the EU Generalized System of Preferences Plus (GSP+) rather than the standard GSP could reduce the trade loss by 70%. Second, targeted trade promotion to remove market frictions will help sectors that currently do not exhaust their export potential in certain markets – this is the case for rice exports to the EU and food product exports to Japan. Third, export diversification could help focusing resources on alternative products and markets that offer room to increase exports and thereby compensate the graduation-induced losses.

¹ For the UN official (and more comprehensive) LDC graduation impact assessment, please refer to UNDESA (2020): Ex ante assessment of the impacts of the graduation of Lao PDR from the category of Least Developed Countries (LDCs), mimeo.

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Introduction

Lao PDR is set to graduate from the status of least developed country (LDC) in 2024. Upon graduation, the country will no longer be eligible to export under the unilateral preferential tariff schemes that 24 markets around the globe have in place for LDCs.³ This implies trade losses of \$102 million, corresponding to less than 1.2% of Lao PDR's projected exports. At the same time, the ITC export potential methodology⁴ suggests that Lao PDR's export products affected by the tariff increase have an unrealized trade potential worth \$29 million in the same group of markets and \$776 million in other markets. The analysis uses a partial equilibrium model to calculate the impact of tariff changes on potential trade outcomes. It extends the existing literature in two directions:

First, we project current trade to the expected level in 2024 (year of expected LDC graduation) using forecasts of each country's gross domestic product (GDP), population, and estimates of income elasticities. Using projected rather than current exports is important to account for a likely geographic shift of Lao PDR's exports towards faster-growing markets that do not have the most beneficial LDC schemes in place. Traditional approaches based on current trade values tend to overestimate the impact of LDC graduation. Likewise, we take tariff rates from that same year to account for changes in Lao PDR's tariff advantages over competitors. This is achieved by including information on tariff reduction schedules from trade agreements that are currently being implemented.

Second, the resulting trade loss is contrasted with untapped trade potential – a figure calculated using the ITC export potential methodology. Whenever the trade loss exceeds the untapped trade potential, Lao PDR may seek better market access through bilateral or plurilateral negotiations. Alternatively, whenever untapped trade potential exceeds the trade loss, Lao PDR may invest in trade promotion and advisory to help companies overcome the frictions that currently prevent them from unleashing the market opportunities. Besides trade promotion, we highlight market and product diversification as alternative strategies for companies to adapt to the trade reduction.

The approach thus provides with estimates of the expected trade changes in 2024 and gives concrete recommendations on actions to buffer the effects and maximize Lao PDR's future exports.

Methodology

In many of the markets granting unilateral preferences to LDCs, Lao PDR benefits from existing free trade agreements (FTAs) or may revert to non-reciprocal preferential tariff schemes that are offered to developing countries. The assessment of trade policy options therefore aims to compare the tariffs from which Lao PDR benefits as an LDC with those available post-graduation. Tariff increases in important markets may lead to trade losses that could in turn call for the conclusion of additional FTAs. The analysis advises at the detailed product and market level where losses are expected to be significant. At the same time, it makes use of the ITC export potential methodology to identify untapped export potential that may be realized subject to targeted trade promotion and that could possibly compensate for any graduation-induced loss of market share.

³ The EU27 and UK are considered as one market.

⁴ Results of this methodology are disseminated through a free online tool, the ITC Export Potential Map: <https://exportpotential.intracen.org>. For a technical documentation, please see Decreux and Spies (2016): Export potential assessment – a methodology to identify export opportunities for developing countries, https://umbraco.exportpotential.intracen.org/media/1089/epa-methodology_141216.pdf.

Alternative tariff regimes available following Lao PDR's LDC graduation

Lao PDR benefits from special tariff regimes thanks to its LDC status in 24 markets. Removing them could imply severe consequences for some of Lao PDR's exporting companies if alternative schemes fail to buffer the effects.

The European Union's (EU) Everything But Arms (EBA) scheme for LDCs offers a three-year transition period during which graduated countries continue to benefit from duty-free quota-free (DFQF) market access.⁵ In 2027, Lao PDR would become eligible for the EU's Generalized System of Preferences (GSP). Under certain circumstances, the extended GSP+ scheme may be available, which grants more preferential market access than standard GSP, but requires Lao PDR's additional commitment to sustainable development and good governance.⁶ The United Kingdom has announced it will grant trade preferences to the same countries as the EU and the new framework will replicate the EU's market access conditions for these countries.⁷

Nine other countries that currently grant preferential access to LDCs also have GSP schemes in place that offer some tariff reductions to developing countries. With eight countries (including three which also have a GSP scheme), Lao PDR could trade under an existing FTA. In some cases, these FTAs overlap. The analysis assumes that Lao PDR's exporters can benefit from the minimum tariff available in cases of overlapping FTAs or FTAs and unilateral preferences both being available. Finally, five countries have no alternative scheme in place so that Lao PDR would export under Most-Favoured Nation (MFN) tariffs to these markets following graduation.

Table 1 Overview of alternative tariff schemes available for Lao PDR in countries currently granting LDC preferences

Country/Region granting LDC preferences	Alternative scheme in 2024
EU27, United Kingdom	GSP / GSP + (2027, following a three year transition period with DFQF access)
Armenia, Belarus, Canada, Kazakhstan, Kyrgyzstan, Norway, Russian Federation, Switzerland, Turkey	GSP
Chile, Chinese Taipei, Iceland, Montenegro, Tajikistan	MFN
Australia*, China, India, Japan*, New Zealand*, Republic of Korea, Sri Lanka, Thailand	Regional trade agreement * (and GSP)

Source: Authors' illustration based on data from the ITC Market Access Map (2020).

It is important to consider further tariff reductions that will be phased in for some FTAs until Lao PDR's scheduled graduation from LDC status in 2024. To have a proper picture of the tariff situation in 2024, we make use of already negotiated tariff reduction schedules. This concerns for example further tariff cuts by Australia and New Zealand in the context of the FTA with the Association of Southeast Asian Nations (ASEAN).

Estimating the effect of tariff changes on trade

We customize and apply a partial equilibrium model to assess the trade impact of tariff changes to Lao PDR, based on the following assumptions:

⁵ For reasons of comparability, the analysis considers the situation in 2024, assuming that Lao PDR would directly move to GSP or GSP+ on EU (and United Kingdom) markets.

⁶ UNDESA (2020) reports that Lao PDR meets the vulnerability criteria but (at the time of writing) still has to ratify International Labour Organization (ILO) conventions in order to become eligible for GSP+.

⁷ See: <https://www.gov.uk/guidance/trading-with-developing-nations-during-and-after-the-transition-period>.

- 1) The elasticity of supply is infinite and returns to scale are constant: every country can supply an unlimited amount of the products it currently exports, at current prices.⁸
- 2) The global elasticity of import demand for a product is equal to one.
- 3) Products from different foreign suppliers are substitutable with a constant elasticity of substitution (Armington assumption).⁹
- 4) Preferential tariffs are fully used.¹⁰

Trade projection

The trade and tariff values in the model are projected to 2024. We project trade by (i) forecasting country i 's share in market j for a given product k using country i 's GDP growth rate relative to the GDP growth rate of its competitors and (ii) evaluating how import demand of product k will develop based on its elasticity to market j 's expected growth rates of GDP and population, and expected tariff changes.¹¹ We define

$$X_{ijk} = \text{ProjMS}_{ijk} \times \text{ProjM}_{jk}$$

where

- X_{ijk} : bilateral exports;
- ProjMS_{ijk} : projected market share;
- ProjM_{jk} : projected demand.

Tariff projections assume that Lao PDR will move to the next best alternative tariff that is available following graduation (table 1). For all other countries, we will reflect the tariff situation in 2024 by integrating information from tariff reduction schedules of agreements that are currently under implementation.

Effect of graduation

First, tariff changes reduce Lao PDR's market share by

$$\left(\frac{1 + t_{LDC}}{1 + t_{grad}} \right)^\sigma$$

Then, the sum of market shares in a given market is normalized to one. This ensures that the first order conditions of the demand by origin optimization are met.

Based on old and new market shares, average tariffs with and without graduation are computed. Overall import demand is reduced by

$$\frac{1 + \bar{t}_{LDC}}{1 + \bar{t}_{grad}}$$

⁸ Lao PDR's exporters will not reduce their prices in response to a lower demand for their products.

⁹ Elasticities between origins are product-specific and taken from the Global Trade Analysis Project (GTAP) database.

¹⁰ Note that stricter rules of origin may apply under the alternative tariff regimes, which could prevent Lao exporters from access to the most preferential tariffs.

¹¹ The elasticity of import demand to population is assumed to be equal to 1. The elasticity of import demand to GDP per capita is estimated, see Decreux and Spies (2016). We increase the import demand by the factor $\frac{1 + \bar{t}_{current}}{1 + \bar{t}_{projected}}$ to account for future tariff reductions under trade agreements that are currently being implemented.

where \bar{t} is the average tariff applied by a market to all suppliers weighted by their market shares.¹² This simple procedure leads to the same result as analytically solving the partial equilibrium model described above.

Calculation of untapped trade potential

ITC has established a methodology to calculate potential trade values based on a country's potential share in a given market and the market's projected demand,

$$EPI_{ijk} = MS_{ijk}^{EPI} \times ProjM_{jk}$$

with

$$MS_{ijk}^{EPI} = ProjMS_{ik} \times Ease_{ij} \times MAccess_{ijk}$$

The potential market share of country i in product k and market j combines information of i 's world market share, the ease of trade between i and j , and market access. $ProjMS_{ik}$ is projected based on the growth rate of i relative to its competitors. $ProjM_{jk}$ is projected based on the elasticity of import demand for k to j 's expected growth rate and expected tariff changes.

Any gap between potential and actual trade indicates room for export growth.¹³ This untapped export potential may be realized through targeted trade promotion, e.g. by helping firms to overcome non-tariff measures, comply with the rules of origin or meet the consumer preferences in the target market. Contrasting the untapped potential with the potential trade losses at the sector and market level helps Lao PDR set priorities – either on the negotiation of better tariff regimes or on trade promotion.

Data

The model uses trade and tariff data, coming from the ITC Trade Map and Market Access Map databases, respectively. For trade projections, we use an arithmetic average of direct and mirror flows when both countries are estimated to be reliable reporters of their trade statistics (or when neither is reliable but both report a trade flow for the same given product).¹⁴ When only one of the trade partners is reliable, this country's reported trade flow is retained. Over the analysed timeframe, Lao PDR has reported its trade between 2010 and 2016, but it has not been assessed as a reliable reporter of its exports or imports; hence, mirror data is used. For the calculation of export potential, we use a geometric average of reliable direct and mirror flows. To reduce the impact of outliers, a weighted average of 2014-2018 data is calculated with a higher weight given to years that are more recent. Import demand and Lao PDR's exports in current \$ are projected to 2024 using the International Monetary Fund's (IMF) April 2020 GDP forecasts and an estimation of import demand elasticities.¹⁵

Two sets of tariffs feed into the calculations: the first one corresponds to tariffs during the observation period (2014-2018), while the second one corresponds to tariffs during the projection period (2024). The elasticity of substitution is taken from the GTAP database. GTAP elasticities are computed at the sector level and applied to product groups based on the 6-digit level of the Harmonized System (HS).

¹² The indices *LDC* and *grad* refer to the specific situation of Lao PDR in 2024.

¹³ Please refer to Decreux and Spies (2016) for a detailed description of the method.

¹⁴ An earlier version of the reliability assessment is described in Decreux and Spies (2016). An update will be published soon.

¹⁵ The April 2020 forecast has been made under the impression of the Covid-19 pandemic. An earlier version of this paper used the IMF's October 2019 GDP forecasts. The trade loss as a share of Lao PDR's projected exports has remained stable at 1.2% (see also box: Effects of the Covid-19 pandemic).

Results

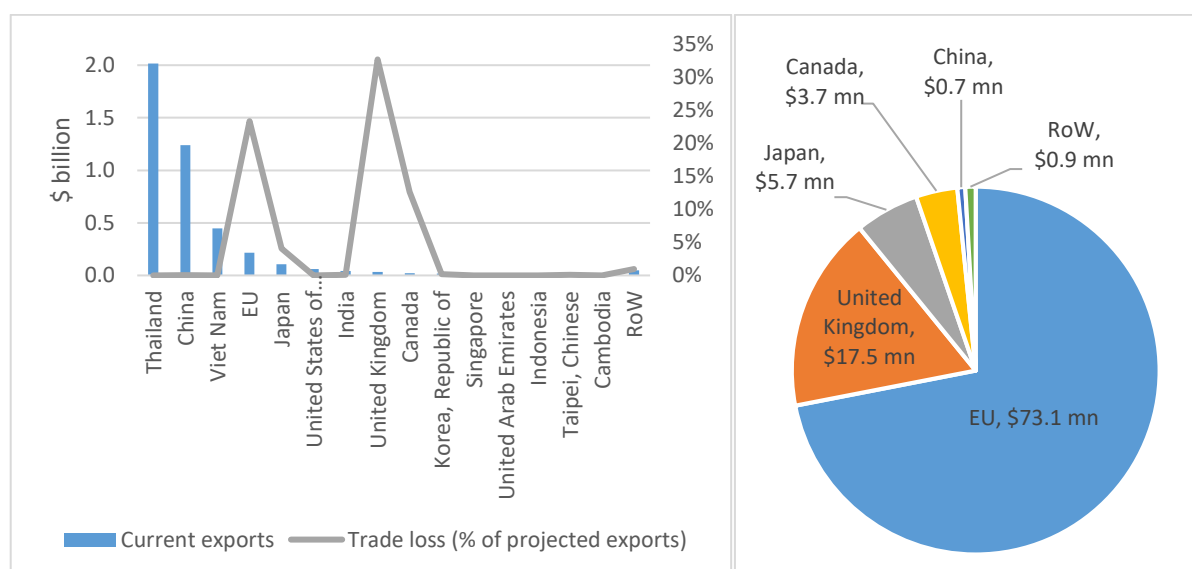
Lao PDR has exported products worth almost \$4.3 billion on average over the period 2014-2018. According to our projections, Lao PDR may expand its exports to \$8.6 billion by 2024 in a hypothetical situation where it continues to benefit from LDC preferences. Moving to the next best alternative regime would result in a total trade loss amounting to \$102 million, which could be compensated thanks to targeted trade promotion aiming to unlock Lao PDR's unrealized export potential of \$3.2 billion.

Trade policy assessment

Lao PDR's tariff conditions will change in the markets that have specific LDC schemes in place, although several of them offer duty-free access for the products currently exported by Lao PDR under the next-best alternative regime.¹⁶ Most of the countries where tariffs will change are expected to see low growth of import demand in the coming years, implying that the share of Lao exports affected by the tariff change will reduce from 5.6% today to 3.9% by 2024. In total, the estimated trade loss corresponds to less than 1.2% of Lao PDR's projected exports. Yet, individual product-market combinations can be severely affected.

Figure 1 shows that among Lao PDR's largest trade partners, significant losses will likely concentrate in the EU, the United Kingdom's, the Japanese and the Canadian markets. The EU, the United Kingdom and Canada are also the only markets where the expected trade loss accounts for more than a tenth of Lao PDR's projected exports to these markets. Losses in Lao PDR's most important partner markets will be insignificant (China) or zero (Thailand and Viet Nam).

Figure 1 Lao PDR's trade and estimated trade losses, by partner market



Source: Authors' calculation based on data from the ITC Market Analysis Tools (2020).

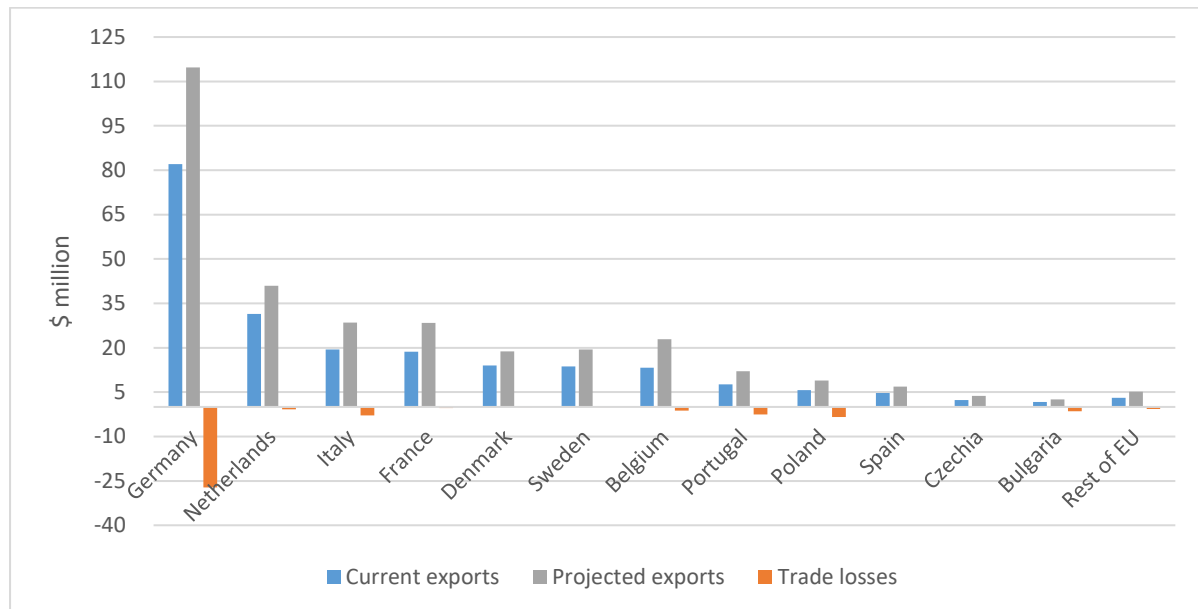
The EU market accounts for 72% (\$73 million) of the expected trade reduction. Among the EU member states, exports to Germany, currently Lao PDR's largest EU trade partner, would be affected the most with a potential loss of over \$27 million of exports (see figure 2).

The trade loss also concentrates in few products. At the HS 6-based product group level, only 21 products will see an export reduction of >\$1 million, of which 17 are in the garment sector. On EU

¹⁶ This is for instance the case under the ASEAN Australia New Zealand FTA.

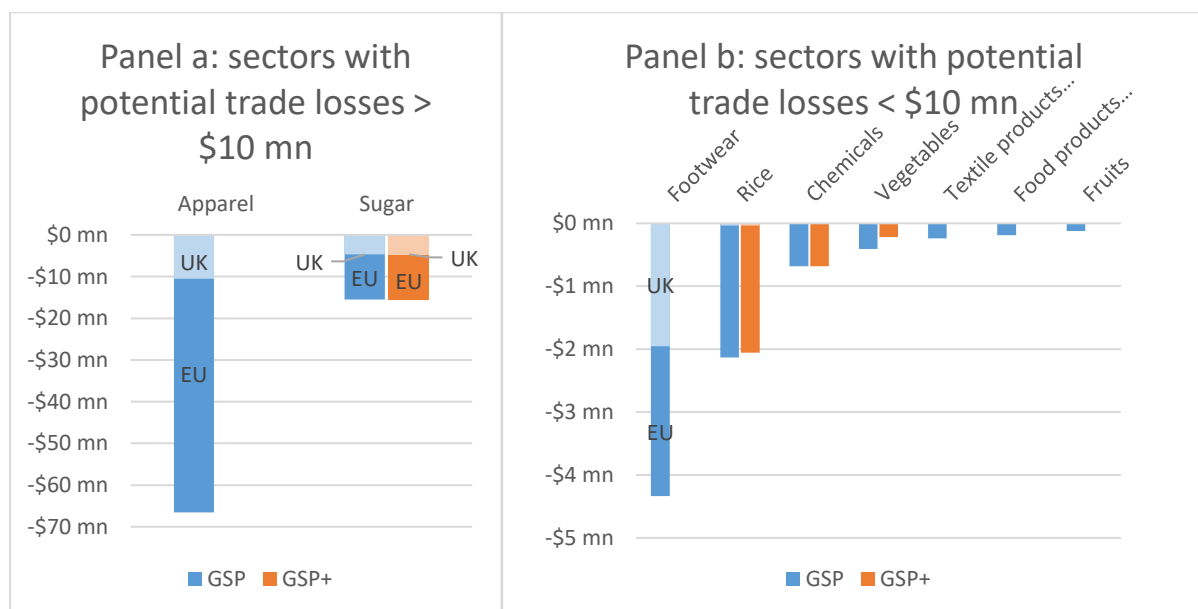
markets, this sector should expect trade losses amounting to \$56 million. Sugar will see a reduction of \$11 million, followed by footwear with \$2.4 million and rice with \$2.1 million. No other sector's exports will decline significantly following the LDC graduation-induced tariff changes. On non-EU markets, only apparel and footwear exporters should prepare for losses of \$15 and \$7.6 million, respectively.

Figure 2 Lao PDR's trade and estimated trade losses, by EU partner market



Source: Authors' calculation based on data from the ITC Market Analysis Tools (2020).

Figure 3 Trade loss on EU market, by sector (GSP versus GSP+) (> \$100,000)



Source: Authors' calculation based on data from the ITC Market Analysis Tools (2020).

GSP+ would give Lao PDR's exporters more preferential access to markets in the EU and the United Kingdom for some of its key export sectors and therefore reduce the global trade loss to \$30 million. Apparel and footwear exports would enjoy duty-free access under the EU's GSP+ scheme if exporters

manage to comply with the more stringent rules of origin.¹⁷ Sugar and rice would not or only hardly benefit under GSP+ (see figure 3).

Effects of the Covid-19 pandemic

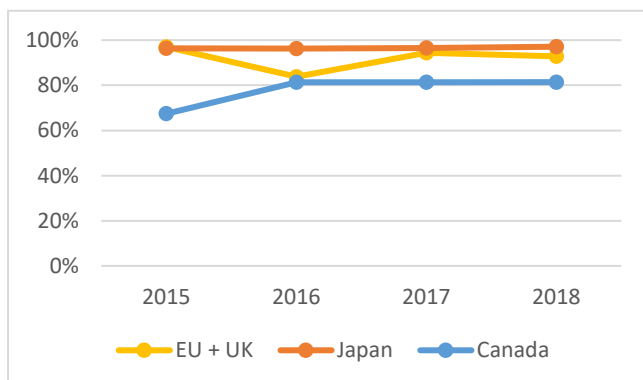
In order to identify the effects of the Covid-19 pandemic on Lao PDR's exports, we have recalculated the results based on a hypothetical scenario where the pandemic did not take place. This scenario projects trade to the expected level in 2024 (year of expected LDC graduation) using pre-pandemic forecasts of each country's gross domestic product (GDP).

Lao PDR's export projections in 2024 are 5.5% down compared to the pre-pandemic scenario. The decline differs across markets: markets where Lao PDR will move from LDC preferences to a less preferential tariff regime on average see a larger reduction in import demand than markets where tariff conditions remain unchanged for Lao exporters. This implies that the trade loss with Covid-19 GDP forecasts (\$102 million) is smaller than the trade loss that would have been expected with GDP forecasts prior to Covid-19 (\$109 million). Lao PDR thus already anticipates the changing market access conditions by gradually shifting its exports to faster-growing markets that have no LDC preference scheme in place.

Utilization rate of preferences

Tariff changes are problematic only for those exporters that have taken advantage of the LDC preferences in the past. Information from the World Trade Organization's (WTO) Integrated Database (IDB) indicates that on those markets where Lao PDR's exporters will see the largest impact, the utilization rate of preferences has ranged between 67% (Canada, 2015) and 97% (EU, incl. the United Kingdom, 2015 and Japan, 2017 and 2018).

Figure 4 Lao PDR's utilization rate of preferences in selected markets



Given the high utilization of preferences in the past, it is likely that Lao firms indeed will be affected by the tariff changes.¹⁸ The next-best regimes could also feature more stringent rules of origin that lower the utilization rate of preferences. For the extreme case in which all of Lao PDR's exports that are currently benefiting from LDC preferences would be charged MFN tariffs, we calculate a loss of \$491 million.

Source: Authors' calculation based on data from WTO's IDB (2020).

¹⁷ UNDESA (2020) indicates that double transformation will be necessary for the garment sector to benefit from GSP tariffs.

¹⁸ Even with identical tariffs under newly available preferential regimes (FTAs, GSP), rules of origin may become tougher, making it harder for companies to remain eligible for preferential treatment. Please refer to UNDESA (2020) for a discussion of rules of origin changes and to the ITC Rules of Origin Facilitator for a web-based application hosting country- and product-level information on rules of origin for 347 trade agreements (www.findrulesoforigin.org).

Export potential assessment

Contrasting the results on trade implications of tariff changes with figures on export potential reveals that overall, trade promotion activities addressing the bottlenecks exporters currently face could result in additional exports worth \$3.2 billion.¹⁹ However, the major part of this export growth potential adheres to markets and products unaffected by the trade policy change. Targeted trade promotion in the same markets and products that will face a change in tariff could bring trade gains worth \$29 million and thus, to some extent compensate for the graduation-induced losses. This will be possible in particular for footwear, rice, chemicals, food products, vegetables and fruit exports to the EU and for footwear exports to Canada as well as for food products exports to Japan and the United Kingdom. In all of these sector-market combinations, the untapped potential exceeds the anticipated trade loss (see table 2).

In other sectors, a direct compensation of the trade loss by targeted trade promotion in the same market may not bring significant export increases. Yet, the export potential assessment can also point to alternative (existing or new) markets where Lao PDR still has considerable export growth potential. For instance, lost footwear exports to Japan may be compensated by a diversification of target markets. Viet Nam, China and the EU offer the largest scope for additional exports, summing up to nearly \$26 million. The trade losses of the sugar sector in the EU market could be compensated by tapping into the export potential in alternative markets, including Japan, Viet Nam, and Indonesia. Across all markets, Lao PDR holds a potential for additional sugar exports worth \$12 million, more than the expected loss of \$11 million in the EU market.

A final possibility would be to focus production and exports on products that offer growth potential in the same markets. Such strategy will have good chances of successfully mitigating impacts of LDC graduation if the alternative products are similar to those that are facing trade losses. Similar products should meet the following criteria to be considered as viable alternatives:

- 1) Belong to the same or a related sector as the one facing a trade loss
- 2) Have good chances to compensate for the trade loss by being
 - a. an existing export product of Lao PDR with considerable export growth potential
 - b. a new product for Lao PDR 'within reach' for export diversification

Products 'within reach' are products relying on similar capabilities. Ricardo Hausmann and César Hidalgo have developed an approach (the 'Product Space') that identifies similarities in production factors based on observable trade outcomes.²⁰ For each product pair, conditional probabilities of exporting product B if a country already exports product A are calculated. Calculating a weighted average of these conditional probabilities allows inference of how 'close' a given product is to the existing export basket of a country. Combining this information with demand and market access conditions allows computing an indicator of diversification potential that is used to select products with good chances of being successfully exported to the target markets. Figure 5 identifies alternatives that meet the above criteria for sectors with a global trade loss of \$1 million or above.

¹⁹ For a detailed analysis of Lao PDR's export potential in the processed wood and niche agricultural sectors, please refer to ITC (2019): Export potential in Lao PDR,

https://umbraco.exportpotential.intracen.org/media/1133/lao-report_final-draft.pdf.

²⁰ Hausmann, Hidalgo et al. (2007): The product space conditions the development of nations,

https://www.researchgate.net/publication/6181618_The_Product_Space_Conditions_the_Development_of_Nations.

Table 2 Adaptation strategies for markets and sectors with significant trade losses (> \$100,000) (in \$ million)

Market	Sector	Current exports	Trade loss	Trade loss GSP+	Untapped export potential	Untapped potential other markets	Strategy
EU	Apparel	145.7	56.0	0.0	7.4	China (16.7), Japan (15.1), United States of America (11.1)	GSP+ / market diversification
United Kingdom	Apparel	25.6	10.5	0.0	2.9	China (16.7), Japan (15.1), United States of America (11.1)	GSP+ / market diversification
Japan	Footwear	18.9	5.5		0.2	Viet Nam (12.3), China (8.3), EU (5.1)	Market diversification
EU	Sugar	11.4	10.8	10.8	0.9	Viet Nam (2.9), *Indonesia (2.8), *Japan (1.8)	Market diversification
EU	Footwear	8.6	2.4	0.0	5.1	Viet Nam (12.3), China (8.3), United States of America (0.9)	GSP+ / trade promotion
Canada	Apparel	6.0	3.5		1.7	China (16.7), Japan (15.1), United States of America (11.1)	Market diversification
United Kingdom	Footwear	4.4	2.0	0.0	0.3	Viet Nam (12.3), China (8.3), EU (5.1)	GSP+ / market diversification
Switzerland	Apparel	4.3	0.5		0.1	China (16.7), Japan (15.1), United States of America (11.1)	Market diversification
EU	Rice	4.0	2.1	2.0	6.3	*Korea, Republic of (41.4), United Kingdom (1.8), *Japan (0.8)	Trade promotion
United Kingdom	Sugar	3.7	4.7	4.7	0.4	Viet Nam (2.9), *Indonesia (2.8), *Japan (1.8)	Market diversification
EU	Chemicals	2.8	0.7	0.7	4.0	Thailand (4.6), China (3.8), *United Kingdom (1.4)	Trade promotion
EU	Food products n.e.s. (processed or preserved)	2.4	0.2	0.1	3.9	China (14.0), Viet Nam (2.9), Japan (1.9)	Trade promotion
China	Coffee	2.3	0.7		0.5	EU (38.8), Thailand (11.1), United States of America (4.2)	Market diversification
EU	Vegetables	2.0	0.4	0.2	3.6	China (156.5), Thailand (102.5), Viet Nam (35.8)	Trade promotion

EU	Fruits	1.1	0.1	0.0	9.2	Viet Nam (22.2), China (19.2), *Japan (4.2)	GSP+ / trade promotion
EU	Textile products n.e.s.	0.9	0.2	0.0	0.2	China (0.4), United States of America (0.4), *United Kingdom (0.1)	GSP+ / market diversification
Japan	Food products n.e.s. (processed or preserved)	0.7	0.2		1.9	China (14.0), EU (3.9), Viet Nam (2.9)	Trade promotion
United Kingdom	Food products n.e.s. (processed or preserved)	0.6	0.3	0.2	0.6	China (14.0), EU (3.9), Viet Nam (2.9)	Trade promotion
Turkey	Apparel	0.4	0.2		0.0	China (16.7), Japan (15.1), United States of America (11.1)	Market diversification
Canada	Footwear	0.2	0.1		0.5	Viet Nam (12.3), China (8.3), EU (5.1)	Trade promotion

Source: Authors' calculation based on data from the ITC Market Analysis Tools (2020). Notes: *indicates that the market would be new for Lao PDR's exporters in this sector.

Apparel exports face a total potential trade loss of \$71 million when moving from LDC preferences to the next best alternative regimes. The products most affected by the tariff changes are men's trousers of synthetic fibres (HS 620343, expected losses \$18 million), men's shirts of cotton (HS 620520, \$6.1 million), men's underpants (HS 610711, \$6.0 million) and men's trousers of cotton (HS 620342, \$5.7 million). Yet, the sector offers alternatives for which Lao PDR holds significant potential for additional exports, including men's garments of man-made fibres (HS 621133) and cotton T-shirts (HS 610910) (figure 5, left panel).

The footwear sector may experience almost \$10 million in trade losses. Only three products in the sector hold potential for additional exports worth more than \$1 million globally: uppers and parts thereof (HS 640610, \$19 million in additional exports), footwear with leather uppers (HS 6403XX, \$6.9 million) and outer soles & heels of rubber or plastics (HS 640620, \$1.2 million). Additionally, Lao PDR could diversify its export basket to include several other footwear products, as shown in figure 5, middle panel.

Lao PDR's sugar and rice exporters will be confronted with trade losses augmenting to over \$15 million and \$2 million on world markets, respectively. In sugar, neither EU nor other markets seem to offer sufficient export growth potential to fully absorb this reduction. In light of these circumstances, it may be worthwhile for farmers to consider a reallocation of land to the cultivation of other horticultural products. Lao PDR holds an export growth potential for these alternative products worth \$497 million. Roots & tubers of manioc "cassava" (HS 071410) offers most room for additional exports, amounting to \$293 million (figure 5, right panel). An earlier ITC report already identified manioc as a high potential export product but also discussed concerns about its large environmental footprint. Other fruits and vegetables may therefore be considered.²¹

Lao PDR's coffee and wood sectors

The EU-funded ITC project "The ASEAN Regional Integration Support from the EU Plus – Lao PDR (ARISE + Lao PDR)" focuses its trade support interventions in two sectors: coffee and processed wood. These are not among the most affected sectors by Lao PDR's LDC graduation with expected trade losses at \$712,459 and \$25,827, respectively.

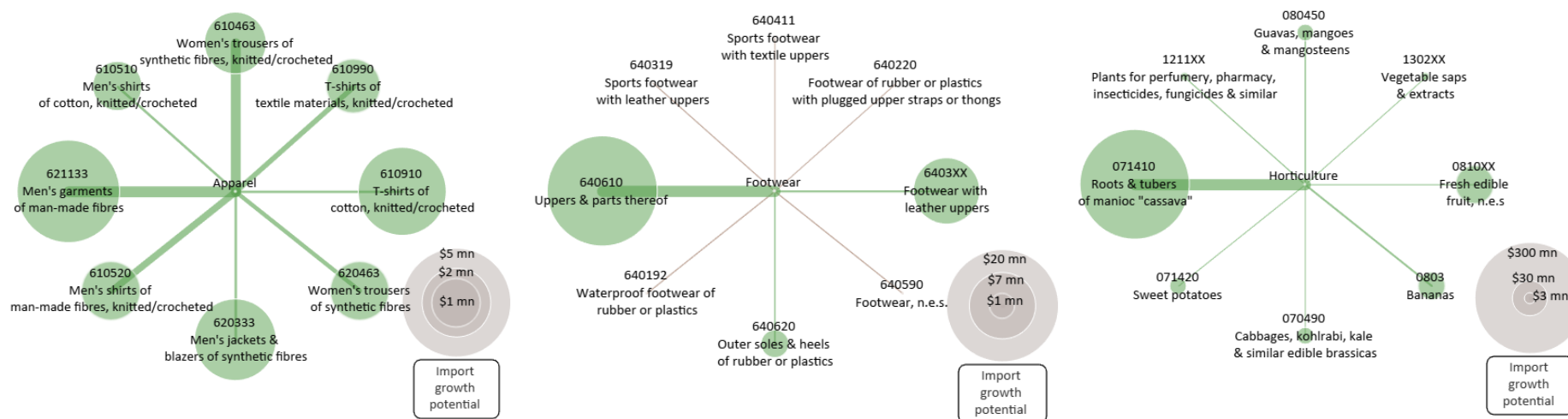
The overwhelming part (89%) of the impact on the coffee sector concerns the export of "Coffee, not roasted, not decaffeinated" (HS 090111) to China. Lao PDR's exporters are already exhausting their potential to export coffee to the Chinese market, but have vast opportunities to realize additional exports worth \$69 million in other markets. Germany (\$24 million) and Thailand (\$16 million) are the most attractive destinations for future Lao PDR's coffee exports. In both markets, tariffs will not change with Lao PDR's graduation from LDC status.

In the wood sector, minor losses mostly concentrate in the Korean market. Given the sector's export growth potential of \$25 million (in products exempt from the export ban), the graduation effect is negligible.

For more details on export growth opportunities in these two sectors, please refer to ITC (2019): Export potential in Lao PDR, https://umbraco.exportpotential.intracen.org/media/1133/lao-report_final-draft.pdf.

²¹ ITC (2019): Export potential in Lao PDR, https://umbraco.exportpotential.intracen.org/media/1133/lao-report_final-draft.pdf.

Figure 5 Alternatives for products with trade losses



Source: Authors' calculation based on data from the ITC Market Analysis Tools (2020). Notes: the graphs show the top alternative products for those facing a trade loss. In green: products currently exported by Lao PDR with a total export growth potential > \$1 million. In brown: products not currently exported by Lao PDR with a diversification rank < 250. Bubble size represents Lao PDR's total export growth potential for its existing export products. Line width indicates the average proximity of Lao PDR to each alternative export product.

Policy recommendations

The analysis in this paper reveals that Lao PDR should prepare for foregone trade revenues worth \$102 million following the tariff changes it will face in several markets upon its graduation from LDC status. While this corresponds to less than 1.2% of the country's projected exports in 2024, in certain product-market combinations, the losses can be significant. Lao PDR may buffer this with a strategic mix of targeted response measures:

- Most of the trade loss will be in the EU market. Aiming at *improved market access under GSP+* tariffs will help lower the total trade loss by 70%. This will mostly benefit Lao PDR's apparel and footwear exporters that would continue to benefit from duty-free access to the EU market, should the more stringent rules of origin be met. In these two sectors alone, GSP+ would help avoid trade reductions amounting to \$71 million.
- In other products and markets, *targeted trade promotion* that helps companies overcome current frictions and fully use their export potential promises to compensate the trade losses. This would be the case for footwear, rice, chemicals, food products, vegetables and fruit exports to the EU as well as in food product exports to Japan and the United Kingdom and footwear exports to Canada. In all these sector-market combinations, Lao PDR has significant export potential that is yet to be exhausted regardless of the tariff regime.
- For apparel, footwear and sugar, coffee, textile products exporters that lose a significant part of their exports to the EU, United Kingdom, Japan, Canada, Switzerland and Turkey among others, *market diversification* may offer a way to balance out the graduation-induced trade losses. While the markets where Lao exporters would face export reductions do not offer space to grow exports through trade promotion, alternative markets are available that do have sufficient room for additional exports.
- A final strategy could be to shift resources into products for which Lao PDR has not yet exhausted its export potential. This will be easiest for products that rely on similar production factors as those that risk significant trade reductions. The footwear sector offers opportunities for *product diversification*. Likewise, sugar and rice producers may consider dedicating part of their land and other resources to the production of horticultural products with more remaining export potential.