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The implications of deregulation & liberalization on the logistics service industry in Lao PDR

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ABSTRACT

This study analyses the development of the Lao freight logistics sector with a special focus on factors influencing freight logistics services efficiency after the processes of liberalization and deregulation of the economy. Based on empirical data, the study focuses on two main dimensions of the Lao freight logistics sector: (i) the development of a private freight logistics sector since the formulation of the New Economic Mechanism (NEM) that progressively opened the Lao economy to the world; (ii) the Lao freight logistics sector's awareness of opportunities and challenges arising from Lao PDR's participation in ASEAN, GMS and hopefully the WTO in the near future.

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1. Introduction

Since the launch of market reforms during the late 1980s, Lao PDR has shown a strong record of economic growth. Economic reforms in Lao PDR started at a major scale in November 1986, when the New Economic Mechanism (NEM) was adopted and major steps towards transition from a centrally planned economy to a market economy were taken (World Bank, 2008). Under the NEM, the Lao government announced measures to promote the development of the private sector. It deregulated price, production controls, and granted managerial and financial autonomy to state-owned enterprises. These reforms, together with Lao's participation in the Association of South East Asian Nations¹ (ASEAN) and its free trade area ASEAN Free Trade Area (AFTA), the Greater Mekong Subregion (GMS) co-operation program under the auspices of the Asian Development Bank and its willingness to become a

member of the World Trade Organization (WTO), have created a challenging environment for all types of business activities, in particular for local firms.

The objective of this paper is to: (i) provide an overview of factors influencing the efficiency of the domestic market for freight logistics within the context of an economy in transition towards market economy with large geographical constraints and challenging institutional changes such as deregulation, liberalization of the economy and increased integration with neighboring countries; (ii) analyze the development of the Lao freight logistics sector with a special focus on the demand for freight logistics services. Based on empirical data, the study focused on two main dimensions of the Lao freight logistics sector by studying the development of a private freight logistics sector and its components with a particular focus on components within the logistics industry influencing the level of efficiency and to study the Lao freight logistics sector's awareness of opportunities and challenges arising from Lao PDR's participation in ASEAN, GMS and the WTO in the near future. The first part of the paper propose a framework for how to analyze the national logistics system and its components from a efficiency perspective, the second part of the paper seek to map the development over time and

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¹ Members of ASEAN are Brunei, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, Singapore, Philippines, Thailand and Vietnam.

provide a report of the current status of the Lao freight logistics sector with special reference to the transition towards a market economy, while the last part tries to explore more long-term consequences on the local freight logistics sector as a consequence of increased integration with regional and international markets (Table 1).

2. The importance of the transportation and logistics sector in a transition economy

The rationale behind the link between transport infrastructure investment and transition to market economy can be divided into three functional economic categories:

(i) *Keynesian stimulus*: This category refers to the effects from investments in transport infrastructure on aggregated demand and employment stimulus. The government use their budget on public investment in transport infrastructure with the purpose to stimulate the economy by providing employment opportunities.

(ii) *Ricardian stimulus*: This refers to transport infrastructure's effect on cost of transport and distribution. Increased transport investments reduce transport costs, thus providing better scope for higher market efficiency (Jacoby, 2000). Reducing trade margins can have a potent effect on final prices and the competitiveness of both domestic and international trade. One important benefit of infrastructure investment is the fall in unit costs for each type of traffic using the infrastructure in question, multiplied by the amount of traffic. This would represent the costs saving for existing traffic, and is believed to encourage economic performance in various ways (Banister and Berechman, 2001). Here transport infrastructure investments facilities are not only dependent on the existence of physical transport infrastructure such as roads, ports and airports but also on effective logistics services. This is of particular importance in countries with poor transport networks and low levels of transport infrastructure investments. High distribution costs are an important source of price distortions that can significantly limit market access and reduce economic efficiency gained from trade. Distribution is one factor of the production of goods and services, representing a cost to individual businesses.

(iii) *Endogenous stimulus*: Modern economic theory recognizes transport infrastructure's contribution to increasing productivity by advancement in the technology embodied in transport, communication and distribution

systems. Innovations and technological advancement increases the efficiency of search, transactions and shipments. Greater efficiency in the logistics sector can help stimulate greater demand, so that firms may enjoy enhanced scale economies, a virtuous circle of further cost reductions and sales growth is set in motion. These effects are called endogenous growth factors as they can facilitate and accelerate economic growth (Fujita et al., 1999). It is important to note that these endogenous growth factors affect the economic growth as they provide higher efficiency in the economic interaction between different locations in the country and/or between countries.

Within the logistics and transport geography literature it is common to draw a direct link between economic growth and an increase in freight transport (Banister and Berechman, 2001; Hesse and Rodrigue, 2004). The casual relationship between the economic growth and transport infrastructure is the main basis for the division. Van de Vooren (2004) distinguishes between two main types of models linking the demand for transport to economic development: (1) transport models in which exogenous economic factors influence the demand for transport and (2) the neoclassical production function and general equilibrium models, in which transport influences the growth of the economy positively. However, it is important to note that these two types of models with opposite causal directions do not necessary need to contradict each other, because the relationship between economic growth and investments into transport infrastructure can also be portrayed in a circular manner (Talley, 1996) having similar reasoning to the endogenous growth theory.

A critical component for the successful integration of the local economy into regional and global markets and to achieve an efficient transmission of benefits from trade to the domestic economy is an efficient and well-functioning national transport logistics system (Banomyong et al., 2008; Goh and Ang, 2000; van de Vooren, 2004). The performance of the national logistics system is an important facilitator for the export and import trade, but also for domestic distribution (Sadoulet and de Janvry, 1995) as the demand for freight transport can be derived from a demand for the goods that are transported (Hesse and Rodrigue, 2004). Efficient distribution systems with low transaction costs are expected to transfer goods produced elsewhere to the local consumer at a competitive price, at the same time as local producers can get a competitive price for their commodities (Pelton et al., 2002). Geographical factors such as location, distance

Table 1

Total road length. Source: UNESCAP (2007).

Surface type	Administrative classification						
	National	Provincial	District	Rural	Urban	Special	Total
Paved	3771	198	31	14	429	54	4497
Gravel	2244	3038	1826	1815	871	304	10097
Earth	1126	3240	2008	9527	465	249	16615
Total (km)	7141	6476	3865	11356	1765	607	31210

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