

Title: Foreign Trade Flows and the Trade Potential of Bhutan

Author: **Lhakpa Bhuti**, Faculty of Economics, Chulalongkorn University

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Abstract: This paper provides an initial exploration and analysis of bilateral trade flows of Bhutan since there is almost a total absence of empirical analysis investigating factors determining the trade flow of Bhutan and the future trade potential of Bhutan. The gravity model applied in this paper provides some light on the actual trade patterns, characteristics and expected future trade potentials of Bhutan. The estimation results indicate that Bhutan's trade is positively determined by the size and openness of the economies and FTA with India and influenced negatively by the distance. We also specify and estimate the gravity model of Bhutan's exports and imports and use the coefficient obtained to estimate the future trade potential of Bhutan. Our results indicate that the magnitude of the trade potential is higher with the countries within the region compared to countries outside the region. Further, the "natural trading partner's" hypotheses seem to hold for Bhutan and India.

JEL Classification: C33; F14; F15; O53

Keywords: Gravity model; Trade potential; Trade policies; Natural trading partners; Panel Data