



2

Does Democracy Cause Regional Disintegration? The Effect of Democracy on ASEAN Intra-regional and Extra-regional Trade

Faris Maulana and Fithra Faisal Hastiadi

Background

The Association of Southeast Asian Nations (ASEAN) is one of the most successful regional cooperations in the world. Founded in 1968 by five of its founding countries, the member countries of the organization have committed themselves toward the economic, political, security, and socio-cultural integration of the region. Over the course of time, ASEAN has proved its commitment and is striving closer toward its fundamental goal of integration in several aspects, especially economic integration. The first milestone of ASEAN economic integration was the formation of ASEAN Free Trade Area (AFTA) in 1992. ASEAN member countries have made significant progress in the lowering of intra-regional tariffs through the Common Effective Preferential Tariff (CEPT) Scheme for AFTA. The CEPT scheme for AFTA has successfully moved ASEAN toward the

F. Maulana (✉)
Ministry of Industry, Jakarta, Indonesia

F. F. Hastiadi
Universitas Indonesia, Depok, Indonesia

elimination of internal tariff, which ultimately fosters its internal trade, as seen in Fig. 2.1.

Despite the success of AFTA in its early years, since 2007, the intra-regional trade share has been stagnating or even decreasing, showing the possibility of other existing factors that still hinder ASEAN intra-regional trade. According to Plummer and Click (2006), in order to foster its intra-regional trade and reach a greater degree of regional economic integration, ASEAN needs to move toward common external tariff agreement, similar to that of European Union. On the other hand, according to Ing et al. (2016), ASEAN has not shown any real commitment in addressing the problem of internal non-tariff barrier (NTB) that potentially hinders ASEAN economic integration. While the general tariff of ASEAN member countries showed a declining trend throughout the observed period of 2000–2015, the non-tariff barrier demonstrated an increasing trend. Unlike internal tariff, the non-tariff barrier of ASEAN is not discriminating between ASEAN and non-ASEAN countries, thereby not giving an advantage for ASEAN member countries to trade with each other compared to trading with non-ASEAN countries that encourages intra-regional trade.

Another characteristic of ASEAN country is the diversity of governmental regimes of its member countries. This difference in the governmental regime of each countries implies a varied level of democracy.

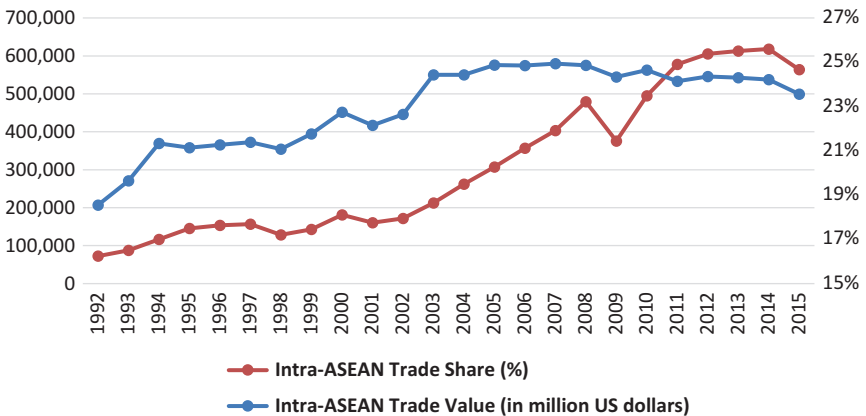


Fig. 2.1 ASEAN intra-regional trade value and trade share (1992–2015). Source: Authors, from Asia Regional Integration Center

According to Polity IV, a dataset which comprises democracy measurement of 180 countries over the period of 1800–2015 by Marshall et al. (2016), the polity score of an ASEAN country which indicates democracy varies from 9, indicating a democracy, to -7 , indicating autocracy, as seen in Fig. 2.2. The difference in the ASEAN level of democracy indicates the difference in the political and institutional factors that affect how domestic policy is determined in each member country. The domestic policy that is affected by the political and institutional factors includes trade policy. The determination of trade policy by the country government is highly tied by the purpose of government to promote trade or the opposite. As it has been explained that trade has brought abundant benefits to the country's economy, international trade does not always benefit everyone in the country. There are several groups of economic agents who are worse off due to international trade. Government may choose to determine its trade policy depending on which part of the populace it attempts to please in order to maximize the electorate support it receives. Democracy, or how much government depends on the people to stay in power, might determine how trade policy will be decided, which in turn can affect its international trade. Therefore, ASEAN countries' difference in democracy may affect their regional integration by restricting trade among ASEAN member countries.

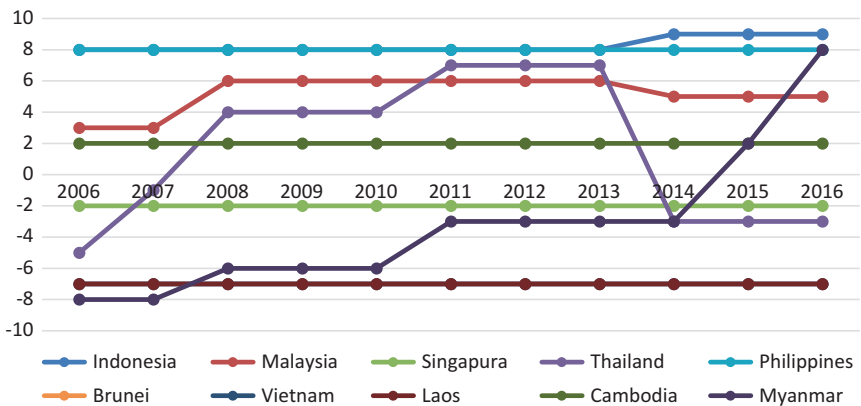


Fig. 2.2 ASEAN member countries polity score (2006–2016). Source: Authors, from *Integrated Network for Societal Conflict Research Polity IV Project*

However, as seen in the initiative of AFTA, the CEPT scheme is embraced by all ASEAN member countries, regardless of their governmental regime, which according to Emmerson (2005), shows that all ASEAN governments favor the elimination of internal tariff. However, the NTB implemented by ASEAN countries is increasing over the time, showing a contradicting act toward the elimination of trade barrier from AFTA. AFTA may have to eliminate tariff as an option for the ASEAN governments to implement a trade barrier, yet, the increase on NTB over the period shows that the governments of ASEAN member countries are still taking a protectionist stance even for the intra-regional trade. Therefore, in ASEAN, the level of democracy is no longer relevant to have impact on government to implement tariff for intra-regional trade, yet still relevant on affecting trade barriers in the form of NTB implementation by the government of each ASEAN member countries. Thus, the effect of democracy to intra-regional trade and extra-regional trade of ASEAN might be different.

From the aforementioned problems, this study attempts to answer the effect of democracy on ASEAN economic integration which is signified by comparing its intra-regional and extra-regional trade patterns and explains how democracy may affect intra-regional and extra-regional trade of ASEAN differently. Therefore this study proposes three research questions, the first being whether democracy affects ASEAN intra-regional trade, the second being whether democracy affects ASEAN extra-regional trade, and the third, whether the effects of democracy on ASEAN intra-regional and extra-regional trade are different.

Literature Review

The outcome of a country's international trade pattern is influenced by how its international trade affects the welfare of its microeconomic actors. According to Heckscher-Ohlin's theorem (1991), which is based on theory proposed by Stolper and Samuelson (1941), trade liberalization will benefit the owners of production factor which is abundant in the country. In a country where the number of labor is much more abundant compared to capital, a trade liberalization of a country will benefit the majority of its economics actor, which is labor, while the owner of non-labor

factors, namely capital, will be worse off from international trade. Grossman and Helpman (1992) state that government of a country attempt to maximize its utility by obtaining greatest possible level of electorate support in order to ratify its power and stay longer in the office. Electorate was defined as the actors that have the power over the election of the head of the government and the power to put the government out of the office. In order to get the maximum support from the electorate, the government will set a policy that satisfies the demand of the electorate. Therefore, the response of the government to the trade policy is influenced by the demand of trade policy by the majority of the electorate. This theory is further developed and proven by O'Rourke and Taylor (2006), whose study showed that a protectionist policy is more likely to be implemented in a democratic country with high endowment in capital while a liberal trade policy is more likely to be implemented in a democratic country with high endowment in labor.

However, different political system among countries and the change of political institution in one country may change the eligibility criteria for the electorates. Mansfield et al. (2002) argue that democratization of a country political system will expand the criteria of the electorate. In a country that embraces a fully democratized system, the criterion for electorate is every citizen of the country, while a less democratized, such as autocratic, country may define electorate more narrowly as much as special council of a government or a more powerful entity such as monarch. In a democratic country, the head of government is more responsive to the demand of the majority of its citizen and, therefore, is more likely to set a trade policy that is more popular to the public. Several literature also support this claim by explaining the indirect effects of democracy on international trade, for example, Barro (1996, 1999) and Rodrik (2000), who state that democracy promotes better regulation and rule of law thus encouraging trade in a country.

Milner and Kubota (2005) also extend the literature regarding the difference in behavior between a democratic government and an autocratic government on the determination of trade policy in the developing country based on the study by Grossman and Helpman. A developing country, in which the political institution has not matured yet and is still troubled with political instability and is signified by dynamic and often

unpeaceful revolution-style transfer of power, tends to reform its trade policy when it is going through the process of democratization. The democratization in developing country means shifting its electoral power from the ruling political elites to the people. In the context of labor-abundant country, these political elites are often those who hold power in strategic public-owned corporation, hence capital owners who have been using their power to bribe the policy maker for a protection in a form of restrictive trade barrier. In a situation where the government is democratic, a political scandal emerging from accepting bribery may result in a loss of support from the majority of the electorate who perceives this as an act of rent-seeking. Therefore, when a developing country is going through democratization, the government which now depends more on the majority, that is labor, to stay in power will be less likely to implement a protectionist policy and in turn implement a more open trade policy. However, in a country with an autocratic system, due to weaker political power of the labor majority not being an electorate and the absence of political opposition to point out rent-seeking behavior, the government is more likely to ratify its power by gathering support from the political elites of the country. Therefore, such government is more likely to accept bribery in exchange of implementing a protectionist policy that benefits the political elites of the country that consist of wealthy capital owners.

Kono (2006) argues that the effects of democracy to trade policy is somewhat ambiguous. While Kono agrees that democratization could lead developing countries to lower its trade barrier, which is in form of tariffs, his study shows that democracy may have a contradictory effect on another form of trade barriers such as NTBs. The proposition of the study is based on the same assumption that the government will attempt to maximize its electoral support to stay in power through the implementation of popular trade policy. However, this study utilizes additional assumption that a trade barrier in a form of tariff is simpler and more transparent to the public compared to its non-tariff counterparts. This simplicity implies that the political opposition is more likely to point out the adverse effect of emerging from tariff implementation to the welfare of the public, thereby costing the ruling government significant amount of electoral support. However, by utilizing NTB as trade barriers, government may disguise the policy as a protection measure toward consumer's

well-being, thereby minimizing the loss of electorate support from the public, compared to implementing tariff. In addition, while the effect of tariff on public welfare could be easily explained to the public by the political opposition, the effect of NTB on public welfare is not as clear as the tariff counterpart and is therefore much more difficult for the opposition to point out. This proposition implies that the government may raise trade barriers in order to gain electoral support from interest groups while minimizing its electoral support loss from the public by implementing NTB. In a democratic system, where the government tries to maximize its utility by gathering electoral support from both public and interest groups, the government is more likely to implement NTB compared to tariff. Meanwhile, in a less democratic country, due to the less dependency of public electoral support, the government is more likely to implement tariff barriers compared to NTB since tariff offers additional government revenue, while NTB does not.

Regional trade agreements often include the elimination of tariff measures between all of its member countries. The participating country has to remove all of its tariff for its regional partner and is not allowed to implement another tariff barrier for the regional partner after the trade agreements come into effect. Consequently, in the period where the trade agreements have come into effects, internal tariff is no longer a trade protection instrument option for domestic governments of the member countries. Nevertheless, according to Manchin and Pelksman-Balaoing (2008), in the situation of regional trade agreements where the member countries have removed all the tariff barriers, domestic government will more likely shift its protective trade policy toward the implementation of non-tariff barriers. Since according to the theory of optimal obfuscation the process of democratization may lower country's tariff but increase its NTB, democratization under the condition of regional trade agreements may affect intra-regional trade among the member countries negatively due to the absence of change in tariff and increase in NTB. Yet, under the situation when the countries also trade with countries outside its regional trade agreements, the domestic government still may impose and change its external tariff for imported goods from its non-regional trading partners. Therefore, democratization will decrease a country's trade with its regional trading partner and on the other hand increase its trade with its non-regional trading partner.

While several studies have attempted to explain how democracy of a country may affect its international trade behavior, for example, Mansfield et al. (2000), Morrow et al. (1998), Yu (2010), and Yogatama and Hastiadi (2016), the majority of the said studies find that importer fosters bilateral trade and only Yogatama and Hastiadi find that importer's democracy affects bilateral trade negatively. However, the said study uses a different theoretical framework compared to that used in the three previous studies. Meanwhile in this study, the theoretical framework is based on that of Mansfield, Milner, and Rosendorff.

Methodology

The model used in this study is based on gravity equation of international trade, which was first used by Tinbergen (1962). This, according to Anderson (1979), has been the most successful method of predicting bilateral trade flow between countries due to its theoretical consistency. Gravity equation is utilized to predict bilateral trade flow based on economic size of both economy and distance between two countries. In this research, the gravity model is augmented with democracy variable and the economic variable is divided into economic size and level of development.

The study will be conducted using a data panel from 2005 to 2014 on eight ASEAN member countries which fall into the category of labor-abundant countries, of which capital per labor ratio is lower than the region average of importer country. Using Penn World Table 9.0 which was formulated by Feenstra et al. (2015), by dividing the real capital stock to number of labor employed, eight countries are found to have capital per labor ratio lower than the region average and are therefore categorized as relatively labor-abundant countries. These countries are Indonesia, Malaysia, Thailand, Vietnam, Cambodia, Laos, Myanmar, and the Philippines. As for the exporter country, other than the eight aforementioned countries as the intra-ASEAN exporters, eight countries outside ASEAN which have not concluded trade agreement with ASEAN and have the highest export value to ASEAN for the year 2005 are chosen as the exporter countries, namely, the United States, Hong Kong, Saudi

Arabia, United Arab Emirates, Argentina, Brazil, Germany, and Switzerland. The country pairs will be divided into two groups, the Intra-ASEAN pair and the Extra-ASEAN pair. The sample of Intra-ASEAN pair will consist of 56 pairs and the sample of ASEAN with Extra-ASEAN will be 64 pairs. By dividing the samples into two groups, the different effects of democracy on international trade flows between country pairs with regional agreement and those without could be observed.

In order to answer the first research question, the study will conduct a panel data regression on the econometrics model specified in the earlier part of this chapter for the samples with regional trade agreement (ASEAN country with ASEAN country) as follows:

$$\begin{aligned} \ln\text{TRADE}_{ijt} = & \beta_0 + \beta_1 \ln\text{GDPCAP}_{it} + \beta_2 \ln\text{GDPCAP}_{jt} \\ & + \beta_3 \ln\text{POP}_{it} + \beta_4 \ln\text{POP}_{jt} + \beta_5 \ln\text{DISTW}_{ijt} \\ & + \beta_6 \text{DEMOC}_{it} + \beta_7 \text{DEMOC}_{jt} \end{aligned}$$

$\ln\text{TRADE}$ is the natural logarithm of import value to country i from country j during the period of t which is collected from *Centre d'Etudes Prospectives et d'Informations Internationales*' (CEPII) TRADHIST dataset. GDPCAP is the PPP GDP per capita of both countries. POP is the country's population. DISTW is the geographical distance of both countries weighted with each country's population density, which was developed by Head and Mayer (2014). GDPCAP , POP , and DISTW are collected from CEPII Gravity dataset. DEMOC is the democracy variable, which is the variable of interest of this study. The democracy variable used in this study is Polity IV score from The Integrated Network of Societal Conflict Research's (INSCR) Polity IV Dataset. Polity IV Score is utilized based on its reliability in capturing democracy as an economic variable in several past studies such as Davenport and Armstrong (2004), Gerring et al. (2005), Knack (2004), and Hollyer et al. (2011).

For the first research question, it is hypothesized that democracy of importer (ASEAN member) country affect trade negatively, therefore, the variable democ_{jt} will be negatively significant on bilateral trade value.

As for the second question, a regression with same model specification as the first question will be utilized on the samples without regional trade agreement (ASEAN country with non-ASEAN country). For the second research question, it is hypothesized that democracy of importer does affect trade positively. Thus, the variables and $democ_{jt}$ will be statistically significant on bilateral trade value.

As for the third research question, a fixed effect regression on combined sample will be conducted using the model which has been augmented with RTA variable and its interaction with democracy variables of both countries is as follows:

$$\begin{aligned} \ln\text{TRADE} = & \beta_0 + \beta_1 \ln\text{GDPCAP}_{it} + \beta_2 \ln\text{GDPCAP}_{jt} + \beta_3 \ln\text{POP}_{it} \\ & + \beta_4 \ln\text{DISTW}_{ijt} + \beta_5 \ln\text{POP}_{jt} + \beta_6 \text{DEMOC}_{it} + \beta_7 \text{DEMOC}_{jt} \\ & + \beta_8 \text{RTA}_{ijt} + \beta_9 \text{RTA}_{ijt} \text{DEMOC}_{jt} \end{aligned}$$

Even though a similar model is not found in the previous studies utilizing gravity model of trade, the method of interacting dummy with explanatory variable has been discussed by Yip and Tsang (2007). Using this method, Yip and Tsang explain that, by comparing the result coefficient of observation with 0 value for the dummy variable and those with 1 value, the difference on how explanatory variable on the sample with different category can be explained. For the purpose of this chapter, in order to see the difference on the effect of democracy on ASEAN intra-regional trade and extra-regional trade, the variable RTA dummy will be interacted with variable $democ_j$. The coefficient result of the $democ_j$ will be interpreted as the effect of democracy on extra-regional trade (RTA equal to 0), while the combined value of $democ_j$ and its interaction with RTA dummy will be interpreted as the effect of democracy on ASEAN intra-regional trade. It is hypothesized that when two countries are engaged in the same regional trade agreement, the democracy will affect trade negatively. For that reason, the interaction variables between RTA and importer's democracy (RTAdemoc) will be statistically significant in a negative way.

Result

The regression results for all models are shown in Table 2.1. For the intra-regional trade model, the result that will be used for the model will be the result from the fixed effect regression. As it can be seen in the regression result table, the variable of interest, $democ_j$, which is the variable to represent ASEAN country democracy as the importer in intra-ASEAN trade is not statistically significant on the dependent variable or the natural logarithm form of import value. The hypothesis that democracy significantly affects ASEAN intra-regional trade is therefore rejected.

In order to treat the heteroskedasticity problem in the intra-regional trade model, the regression for this model will be using robust regression for panel data developed by Hoechle (2007). According to Gujarati (2009), by using this regression method, the influence of outlier from the data to the estimation result could be minimized. As for the extra-regional trade model, the result used for the analysis will be the result from random effect regression in order to capture the effect of exporter democracy that is omitted in the fixed effect estimation due to the time invariance in the data. From the result in the table, we can see that $democ_j$, as the variable of interest, affects ASEAN import from its non-ASEAN partner positively, which means that the result of the statistical test is to reject the null hypothesis. The increase of polity score in an ASEAN country by 1 point, which signifies democratization, will increase in its import value from its non-ASEAN trading partner by 4.46%, while the increase in 1 point of polity score by a non-ASEAN exporter country will increase export flow to ASEAN country by 1.8%.

As for the third model, the model that will be observed for the analysis is the fixed effect model. In this model, the variable of interest is not solely $democ_j$, but also the interaction variable between importer democracy and RTA dummy, or rta_democ_j . As seen from the regression result in Table 2.1 for ASEAN trade model, our variable of interest $democ_j$ is significantly affecting trade positively, while the interaction of variable rta_democ_j is statistically significant on lowering trade value. An increase in 1 polity score for ASEAN country as an importer will increase its import value by 3.70%. However, it is evident that the negative

Table 2.1 Regression results

Model	Intra-ASEAN model		Extra-ASEAN model		Total ASEAN model	
	FE	RE	FE	RE	FE	RE
Dependent variable	Intrade		Intrade		Intrade	
Lndistw	Omitted (.)	-3.220*** (0.000)	Omitted (.)	-2.422*** (0.000)	Omitted (.)	-2.609*** (0.000)
lnpop_j	5.297 (0.179)	2.676*** (0.000)	0.635 (0.250)	0.597** (0.018)	0.715 (0.208)	1.321*** (0.000)
lnpop_j	3.594 (0.156)	2.106*** (0.000)	0.905 (0.715)	2.335*** (0.000)	2.815 (0.133)	2.092*** (0.000)
lngdpcap_j	0.468 (0.222)	0.722* (0.072)	0.805*** (0.008)	0.518* (0.055)	0.642** (0.043)	0.728*** (0.009)
lngdpcap_j	0.228 (0.679)	0.441 (0.128)	0.876*** (0.010)	0.930*** (0.000)	0.679** (0.021)	0.667*** (0.000)
democ_j	-0.0107 (0.446)	-0.00892 (0.609)	Omitted (.)	0.180* (0.052)	-0.0216 (0.218)	0.121 (0.155)
democ_j	-0.00643 (0.746)	-0.00396 (0.830)	0.0294* (0.055)	0.0446** (0.015)	0.0370* (0.056)	0.0516** (0.013)
Rta					Omitted (.)	-2.852*** (0.006)
rta_democ_j					Omitted (.)	-0.126 (0.142)
rta_democ_j					-0.0498* (0.090)	-0.0648** (0.022)
_cons	-21.43 (0.219)	14.02*** (0.003)	-2.703 (0.728)	15.91** (0.012)	-6.422 (0.345)	15.92*** (0.000)
N	560	560	640	640	1200	1200
R-sq	0.345		0.217		0.262	
Adj. R-sq	0.338		0.211		0.257	

p-values in parentheses

p* < 0.10, *p* < 0.05, ****p* < 0.01

coefficient of the interaction variable is greater than the positive coefficient of importer democracy. If we sum both coefficients, we achieve the result of $0.0370 + (-0.0498) = -0.0128$. This result shows that for the intra-regional trade, where the value of RTA dummy is 1, an increase in polity score by 1 unit will decrease ASEAN country bilateral trade with its ASEAN partner by 1.28%. Hence, to answer how the effects of democracy on intra-regional trade and extra-regional trade are different, the importer democracy has a negative effect on intra-regional trade flow and a positive effect on extra-regional trade flow.

Discussion

To explain the lack of statistical significance in the first model, according to Anderson and Van Wincoop (2004), non-tariff barriers do not always increase the cost of trade, unlike tariff. Thus the effect of NTB on trade is still somewhat ambiguous. As for the exporter democracy variable, it is found that the exporter democracy does not significantly increase bilateral trade. This could be a sign that in low- to middle-income developing countries such as the ASEAN countries used as the importer country in this study, high quality of goods from highly democratic country is not really the deciding factor for demand for goods because according to Minten and Reardon (2008) lower price is still more favorable compared to the higher quality of goods. On the other hand, this lack of statistical significance also shows that, unlike the previous research, democracy does not always increase trade. This is because democracy affects trade from the decrease of tariff. However, in the situation of regional trade agreement where internal tariff is no longer variable, a country government is no longer able to use internal tariff as a political tool to gain electorate support. Thus, when democratization happens, intra-regional trade does not increase.

This result from model 2 is explained by the theory from Milner and Kubota (2005), which states that when a developing country is undertaking a process of democratization, the government will set a lower tariff in order to gain more electorate support from the now politically empowered labor. The decrease of tariff will encourage more trade to the country

and in turn increase its import value. Consequently, the effect of importer democracy on trade is positively significant, in accordance to the existing theory and previous researches such as by Yu (2010) and Mansfield, Milner, and Rosendorff. Contrary to the result of the intra-regional trade model, in this model, exporter's democracy significantly increases trade value. The difference in this result might be caused by the more variability in quality of goods by non-ASEAN countries compared to ASEAN countries. Therefore, the quality effect caused by democracy is more apparent in this model. Nonetheless, this result is in accordance with the theory and previous research by Yu (2010) and Yogatama and Hastiadi (2016). This answers the research question of how the effect of democracy may differ on intra-regional trade and extra-regional trade of ASEAN.

This result of model 3 could be explained by looking back at the theoretical framework used by this study. The increase in democracy will cause the importer country to lower its tariff and encourage trade. Yet, this situation is only possible if the importer country still has power over its tariff above any agreements like bilateral or regional trade agreements that set or eliminate internal tariff. Therefore, ASEAN, which has established a free trade area where the internal tariff is sought to be eliminated, does not show any commitment to eliminate non-tariff barriers. This causes democratization to only affect non-trade barrier for intra-regional trade. Conversely, in the intra-ASEAN model, the result regarding the effect of democracy on intra-regional trade is different from the result in this model. While the first model shows the lack of statistical significance, this model indicates that it significantly has negative impact on intra-regional trade. The possible explanation for this is that the mixed model captures the trade diversion caused by the decrease in external tariff at the absence of the decrease in internal tariff. According to Bohara et al. (2004), the elimination of internal tariff will create a trade diversion from non-regional partner to regional partner due to the decrease of relative cost of trade to regional partner. Nonetheless, as we see in the theoretical framework used in this study, when democracy of an ASEAN country increases, its external tariff is lowered while its internal tariff stays the same. This causes a trade diversion from ASEAN to non-ASEAN partner due to the relatively lower cost of trade. This trade diversion causes the trade with regional partner to decrease, while the trading activity moves to non-

regional partner and increases its value. The net effect of this phenomenon on ASEAN total trade value is uncertain in terms of trade share, due to the increase of extra-regional trading. While the intra-regional trade does not increase, ASEAN total trade share will shift more toward extra-regional trading.

Conclusion

Departing from the problem of ASEAN countries' diverse political regimes, lack of political commitment to address problems such as the rise of internal non-tariff barrier, and lack of common external tariff in order to achieve more robust regional economic integration, this study attempts to find out whether the level of democracy among ASEAN member countries affects their intra-regional and extra-regional trade patterns. In addition, this study attempts to distinguish the effect of democracy on ASEAN intra-regional trade and extra-regional trade. This study establishes two hypotheses: democracy affects intra-ASEAN trade negatively, while it affects extra-ASEAN trade positively. The study finds that democracy does not affect ASEAN intra-regional trade. This result is produced due to the theory that argues that democracy affects tariff decrease yet increases NTB. Thus, in a situation where internal tariff is fixed, democracy only affects internal trade through NTB. However, the lack of statistical significance shows that NTB might not have a significant impact on trade. On the other hand, ASEAN democracy affects ASEAN extra-regional trade positively. This is due to the democracy that has the effect of lowering external tariff, thereby creating more opportunity for ASEAN country to trade more with its non-ASEAN trading partner. And lastly, it is found that while ASEAN democracy affects extra-ASEAN trade positively, democracy affects intra-ASEAN trade negatively. Other than how democracy might affect internal and external trade barriers differently, this result could also be explained by trade diversion caused by the lowering of external trade barrier in the absence of the lowering of internal trade barrier. Therefore, when an ASEAN country is going through democratization, it is expected that it will increase its trade with a non-ASEAN trading partner, while its trade with

an ASEAN partner decreases, which, in relative term, translates into an increase of extra-regional trade. While intra-regional trade decreases, thus driving those countries, as a consequence, the whole ASEAN itself is farther from economic integration.

Recommendation

The result of this study has shown that democracy promotes extra-regional trade while affecting intra-regional trade negatively. The implication of this result is that democratization of ASEAN member countries potentially affects the region economic integration negatively. It would be a shame if the success of greater regional integration brought by AFTA is undone by the democratization process that might or might not be inevitable for the region. Instead of being averse to the democratization of the region, the member countries of ASEAN should focus more on improving several key factors that may promote trade as overall, such as better product quality with higher value added (Yu 2010) and better domestic government institution (Yogatama and Hastiadi 2016). Better government institution will go a long way in encouraging domestic government to implement a better trade policy that focuses more on maximizing welfare instead of fulfilling political motives. By increasing the quality of institution, government will only implement NTB for a genuine purpose (Mansfield and Busch 1995) instead of political obfuscation. This will reduce the possible trade barrier that may restrict intra-regional or extra-regional trade. Moreover, other than increasing each of its member countries' domestic institutional quality, in order to further eliminate NTB, the enforcement and commitment from ASEAN governing body is also necessary. The trade diversion in this study could happen due to the lack of external tariff in the region. In order to avoid trade diversion in general, ASEAN governing body should set common external tariff for all of its member countries (Kennan and Riezman 1990). By doing so, when there is a democratization in ASEAN, government of each ASEAN member countries will be no longer able to change its tariff, thereby making the ASEAN trade more resilient from internal political shock of its member countries. Lastly, in order to avoid the adverse effect of democ-

racy to ASEAN regional integration, political commitment from each ASEAN member countries to address several problems regarding internal or external trade barrier in any form is necessary.

References

- Anderson, J. E. (1979). A Theoretical Foundation for the Gravity Equation. *The American Economic Review*, 69(1), 106–116.
- Anderson, J. E., & Van Wincoop, E. (2004). Trade Costs. *Journal of Economic Literature*, 42(3), 691–751.
- ASEAN. (n.d.). *ASEAN Free Trade Area* (AFTA Council). Retrieved April 9, 2018, from <http://asean.org/asean-economic-community/asean-free-trade-area-afta-council/>.
- Asia Regional Integration Center. (n.d.). *Integration Indicators*. Retrieved April 9, 2018, from <https://aric.adb.org/integrationindicators>.
- Barro, R. J. (1996). Democracy and Growth. *Journal of Economic Growth*, 1(1), 1–27.
- Barro, R. J. (1999). Determinants of Democracy. *Journal of Political Economy*, 107(S6), S158–S183.
- Bohara, A. K., Gawande, K., & Sanguinetti, P. (2004). Trade Diversion and Declining Tariffs: Evidence from Mercosur. *Journal of International Economics*, 64(1), 65–88.
- Centre d'Etudes Prospectives et d'Informations Internationales. (n.d.-a). TRADHIST. Retrieved March 20, 2018, from http://www.cepii.fr/cepii/en/bdd_modele/presentation.asp?id=32.
- Centre d'Etudes Prospectives et d'Informations Internationales. (n.d.-b). Gravity. Retrieved March 20, 2018, from http://www.cepii.fr/cepii/en/bdd_modele/presentation.asp?id=8.
- Davenport, C., & Armstrong, D. A. (2004). Democracy and the Violation of Human Rights: A Statistical Analysis from 1976 to 1996. *American Journal of Political Science*, 48(3), 538–554.
- Emmerson, D. K. (2005). Security, Community, and Democracy in Southeast Asia: Analyzing ASEAN. *Japanese Journal of Political Science*, 6(2), 165–185.
- Feenstra, R. C., Inklaar, R., & Timmer, M. P. (2015). The Next Generation of the Penn World Table. *American Economic Review*, 105(10), 3150–3182.
- Gerring, J., Bond, P., Barndt, W. T., & Moreno, C. (2005). Democracy and Economic Growth: A Historical Perspective. *World Politics*, 57(3), 323–364.

- Grossman, G. M., & Helpman, E. (1992). *Protection for Sale* (No. w4149). Massachusetts: National Bureau of Economic Research.
- Gujarati, D. N. (2009). *Basic Econometrics*. New York: Tata McGraw-Hill Education.
- Head, K., & Mayer, T. (2014). Gravity Equations: Workhorse, Toolkit, and Cookbook. In *Handbook of International Economics* (Vol. 4, pp. 131–195). Amsterdam: Elsevier.
- Heckscher, E. F., & Ohlin, B. G. (1991). *Heckscher-Ohlin Trade Theory*. Massachusetts: The MIT Press.
- Hoehle, D. (2007). Robust Standard Errors for Panel Regressions with Cross-Sectional Dependence. *Stata Journal*, 7(3), 281.
- Hollyer, J. R., Rosendorff, B. P., & Vreeland, J. R. (2011). Democracy and Transparency. *The Journal of Politics*, 73(4), 1191–1205.
- Ing, L. Y., de Cordoba, S. F., & Cadot, O. (2016). *Non-Tariff Measures in ASEAN*. ERIA Discussion Paper Series. Jakarta: ERIA and UNCTAD.
- Integrated Network for Societal Conflict Research. (n.d.). *INSCR Data Page*. Retrieved March 20, 2018, from <http://www.systemicpeace.org/inscrdata.html>.
- Kennan, J., & Riezman, R. (1990). Optimal Tariff Equilibria with Customs Unions. *The Canadian Journal of Economics*, 23(1), 70.
- Knack, S. (2004). Does Foreign Aid Promote Democracy? *International Studies Quarterly*, 48(1), 251–266.
- Kono, D. Y. (2006). Optimal Obfuscation: Democracy and Trade Policy Transparency. *American Political Science Review*, 100(3), 369–384.
- Manchin, M. & Annette O. Pelkmans-Balaoing (2008). Clothes without an Emperor: Analysis of the preferential tariffs in ASEAN. *Journal of Asian Economics*, 19(3), 213–223.
- Mansfield, E. D., & Busch, M. L. (1995). The Political Economy of Nontariff Barriers: A Cross-National Analysis. *International Organization*, 49(4), 723–749.
- Mansfield, E. D., Milner, H. V., & Rosendorff, B. P. (2000). Free to Trade: Democracies, Autocracies, and International Trade. *American Political Science Review*, 94(2), 305–321.
- Mansfield, E. D., Milner, H. V., & Rosendorff, B. P. (2002). Why Democracies Cooperate More: Electoral Control and International Trade Agreements. *International Organization*, 56(3), 477–513.
- Marshall, M. G., Gurr, T. D., & Jagers, K. (2016). Polity IV Project. Political Regime Characteristics and Transitions, 1800–2015. Dataset Users' Manual. Center for Systemic Peace.

- Milner, H. V., & Kubota, K. (2005). Why the Move to Free Trade? Democracy and Trade Policy in the Developing Countries. *International Organization*, 59(1), 107–143.
- Minten, B., & Reardon, T. (2008). Food Prices, Quality, and Quality's Pricing in Supermarkets Versus Traditional Markets in Developing Countries. *Review of Agricultural Economics*, 30(3), 480–490.
- Morrow, J. D., Siverson, R. M., & Tabares, T. E. (1998). The Political Determinants of International Trade: The Major Powers, 1907–1990. *American Political Science Review*, 92(3), 649–661.
- O'Rourke, K. H., & Taylor, A. M. (2006). *Democracy and Protectionism* (No. w12250). Massachusetts: National Bureau of Economic Research.
- Plummer, M. G., & Click, R. W. (2006). *The ASEAN Economic Community and the European Experience*. Asian Development Bank, Working Papers on Regional Economic Integration.
- Rodrik, D. (2000). Institutions for High-Quality Growth: What They Are and How to Acquire Them. *Studies in Comparative International Development*, 35(3), 3–31.
- Stolper, W. F., & Samuelson, P. A. (1941). Protection and Real Wages. *The Review of Economic Studies*, 9(1), 58–73.
- Tinbergen, J. (1962). *Shaping the World Economy: Suggestions for an International Economic Policy*. New York: Twentieth Century Fund.
- Yip, P. S., & Tsang, E. W. (2007). Interpreting Dummy Variables and Their Interaction Effects in Strategy Research. *Strategic Organization*, 5(1), 13–30.
- Yogatama, A. R., & Hastiadi, F. F. (2016). The Role of Democracy and Governance in the Enhancement of Indonesian Exports to the Organization of the Islamic Cooperation (OIC) Countries. *Journal of Economic Cooperation & Development*, 37(4), 51.
- Yu, M. (2010). Trade, Democracy, and the Gravity Equation. *Journal of Development Economics*, 91(2), 289–300.