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7

Thailand and New Regionalism

Bhanupong Nidhiprabha

Introduction

The world economy has been increasingly integrated through trade, investment and financial markets over the last three decades. The degree of synchronization of economic activities in the world has become more pronounced. Consequently, developing economies have been adversely affected by fluctuations of the world business cycle. Nevertheless, there is no doubt that high economic growth in developing countries can be attributed to outward-oriented policy which relies on export growth as a driving force. Pro-trade and pro-investment policy has led to continued expansion of industries and increased inflows of foreign direct investment in developing countries. High growth also enables developing countries to successfully reduce their poverty levels.

For Thailand, the process of globalization or closer integration with world commodity markets has been on-going for the last three decades. The share of international trade to GDP also increased tremendously, partly due to the reduction of the government's dependence on international trade taxes. As shown in Figure 7.1, the value of exports and imports has exceeded GDP since 1996. The increasing degree of globalization continues unabated despite the recession of 1998. By 2005, the degree of trade openness had reached 250 per cent of GDP.[1] The size of the international trade sector has doubled the size of GDP, thanks to the economic expansion generated by export growth and importation of capital and intermediate goods for the manufacturing sector. In addition, the fragmentation production processes has led to more trade volume in parts and components of manufactures (Deardorff, 2001).

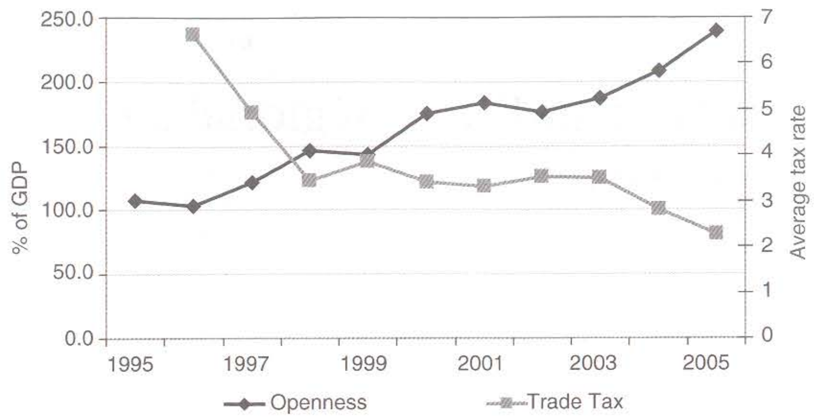

Figure 7.1 Degree of trade openness and average trade tariff

Source: Bank of Thailand and Customs Department.

Thailand's exports of manufactures also responded to tariff reductions in industrial countries through GATT liberalization. According to Abreu (1966), the high tariff wall on manufactures of industrial countries of around 50 per cent in the 1940s was reduced to only 4 per cent by 1988 at the early stage of the Uruguay Round. Similarly between the early 1980s and the late 1990s, the average tariff rates in developing countries were cut in half; by 1999 the average tariff rates of developing countries were only 11 per cent (Martin, 2003). In Thailand, trade reform through the dismantling of tariff walls employed to protect infant industries in the 1960s was undertaken earnestly in the 1980s and continued throughout the 1990s.

The Thai government has relied less on tariff revenue and depended more on revenue collected from direct taxation and value-added taxes. The percentage of international trade tax revenues in total international trade value, a proxy for the tariff rate, had been declining until it became stagnant around 3 per cent between 2000 and 2003 (Figure 7.1). Thailand has reached the stage where it is difficult to further reduce tariff rates, unless further reform is forced by liberalization through commitment imposed by regional trade blocks. Integration into the global economy requires that the tariff rate must fall further. If Thailand cannot do so, it would miss the opportunity to grow, since the structure of world trade has substantially changed from the past decade. Developing countries have shifted from dependence on exports of commodities to relying more on exports of manufactures to developed countries (Martin, 2003). Thailand must open more to take

the opportunities to integrate into the rest of the world by allowing free flows of intermediate and capital goods to support the manufacturing sector to compete effectively in the world market.

This chapter addresses prospects and problems of Thailand's attempt to comply with the globalization trend via regional and cross-regional free trade agreements. The remainder of the chapter is divided into five further sections. The next section discusses the nature of Thailand's regional integration. This is followed by an examination of the role of foreign direct investment in Thailand in bringing the country into an integral part of the world markets. Future consequences of public infrastructure investment in the Greater Mekong Sub region are discussed. Section 4 deals with Thailand's attempt simultaneously formulate Free Trade Agreements (FTAs) with countries of various sizes and distances. Motivations, potential benefits, and pitfalls from each proposed FTAs are discussed. Section 5 explores the problems that might arrive from having multiple FTAs. Section 6 provides concluding remarks.

Intensifying regional integration

The share of trading volume intensity between Thailand and ASEAN partners has increased over the years. It demonstrates that Thailand has engaged more in trading with ASEAN countries at the expense of the rest of the world. Thailand previously depended on imports from USA, whose share in total imports of Thailand was 14 per cent in 1980; the share declined to 9.4 per cent in 2003. Import dependence on the EU also declined at a less drastic rate from 13.3 to 10 per cent. The declining import trends from both the EU and US will continue. On the other hand, the share of imports from ASEAN increased gradually from 12 to 16 per cent during the same period. Does it mean that the ASEAN free trade area has created a trade diversion effect? Imports from Japan, China and Korea (JCK) increased more dramatically to 36 per cent in 2002 (Figure 7.2). The currency realignment after 1998 partly explains the shift in Thailand's import structure. Because the baht depreciates against the yen less than the euro and the dollar, imported goods from Japan, Korea and China were relatively cheaper than those goods from USA and the EU, resulting in the rapid rise in Thailand's imports from the Asian region.

As far as Thailand is concerned, FTAs among ASEAN plus three would have a greater impact than FTA between ASEAN and other economic blocks.[2] Consumers and importers of intermediate inputs would benefit considerably from tariff reduction through FTAs among Thailand, Japan and China.

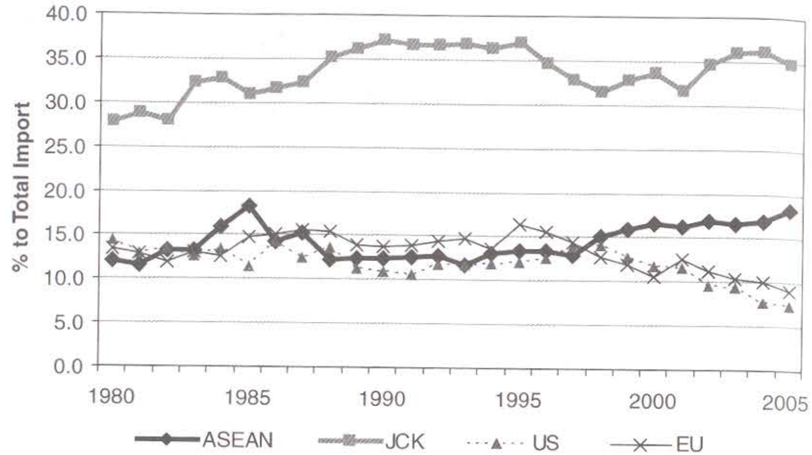

Figure 7.2 Thailand's Asian integration through importation

Source: Bank of Thailand.

In terms of integration through expansion of exports, there has been a considerable increase in exports of Thai products to ASEAN countries, rising from 16 per cent in 1980 to 21 per cent in 2003 (Figure 7.3). When Japan, China, and Korea are included, the corresponding figures rise from 34 to 44 per cent, clearly indicating the benefit that Thailand obtained by gaining access to the three markets. Between 1995 and 1997, the overvaluation of the Thai baht depressed export growth in

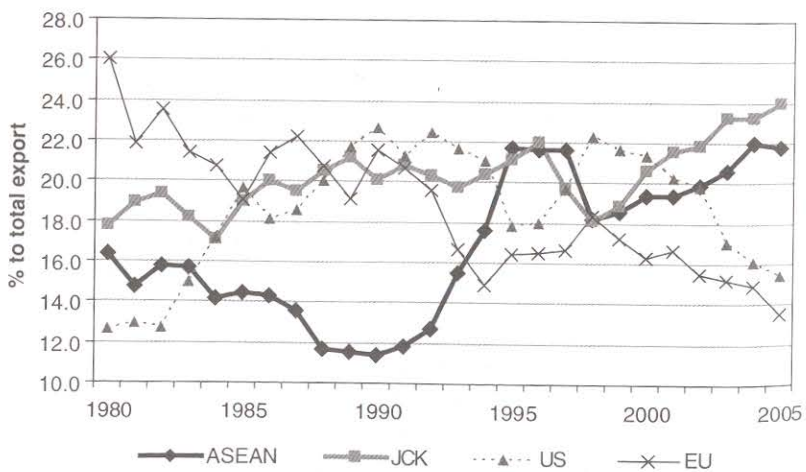

Figure 7.3 Thailand's Asian integration through exportation

Source: Bank of Thailand.

the US market, but the declining trend continued even after the massive baht depreciation. The export share of the ASEAN in totol Thailand's exports has currently surpassed those of the EU and USA. Thailand has more than ever become more and more integrated with her Asian partners.

When analysing import structures of individual ASEAN countries, there is a positive relationship between Thailand's market shares in total imports of ASEAN members and the level of economic development in each country. The old members of ASEAN countries' shares of Thai commodities in their imports are less than 5 per cent, suggesting that Thailand's products do not fit well with their demand patterns. Nevertheless, the Philippines and Indonesia's shares of Thai products increased continuously from 1985 to 2002 (Figure 7.4), while the shares in imports of Singapore and Malaysia exhibit a declining trend since 1995. The two countries have outgrown the specific production structure of Thailand, due to their higher living standards. However, this is not the case for new members of the ASEAN countries. Laos, Cambodia and Myanmar imported more Thai products between 1985 and 2003 as their economy experienced higher income levels. With relatively low transportation cost, the share of Thai goods imported into Laos amounted to 70 per cent in 2004 (Figure 7.5). There would be a great potential for Thai products to gain access to the CLMV countries if the transportation costs and trade barriers can be reduced further. Moreover, as the CLMV countries are growing, their pattern of imports would follow the pattern of the old ASEAN members. The difference

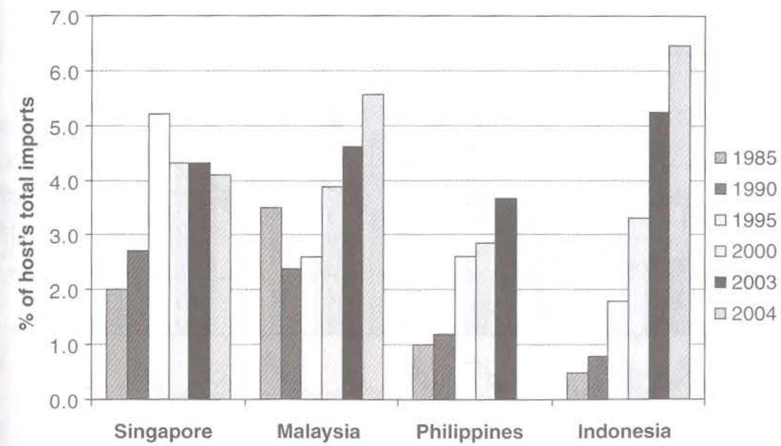

Figure 7.4 Thailand's market access to ASEAN (% of total imports)

Source: UN trade statistics.

would be their closer proximity to Thailand and hence the lower cost of transportation.

If we expand the scope of regional integration to cover all other countries in Asia, ASEAN countries indeed have been trading with other countries in Asia more than ever. This is illustrated in Figures 7.6 and 7.7, which depict cross-sectional data and the snapshots of percentage shares of imports and exports with countries in Asia between 1990 and 2004. The evidence suggests that ASEAN nations increased

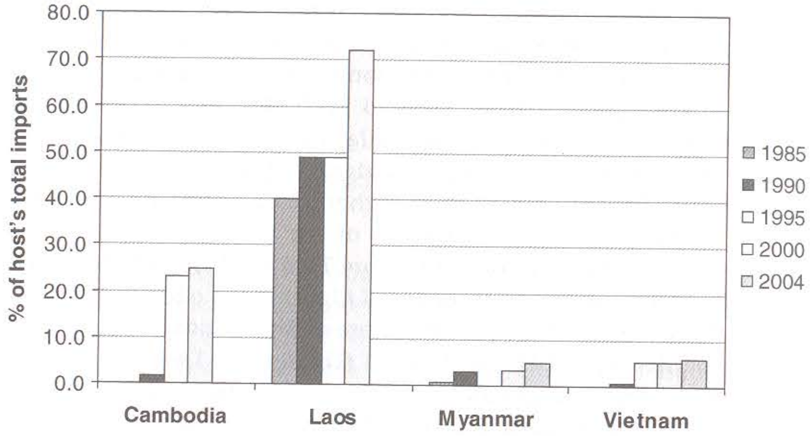

Figure 7.5 Thailand's market access to CLMV (% of total imports)

Source: UN trade statistics.

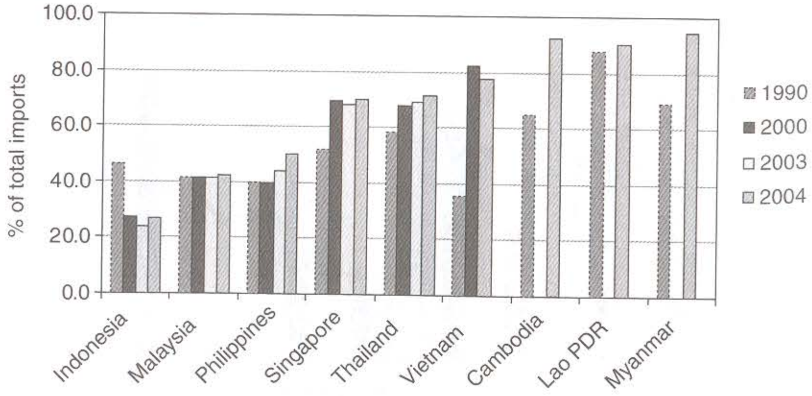

Figure 7.6 Asian regional integration (% of imports from Asia)

Source: WTO.

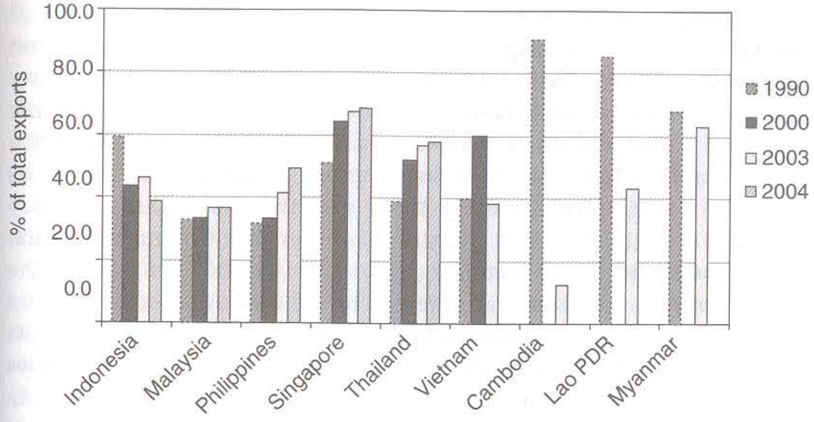

Figure 7.7 Asian regional integration (% of exports to Asia)

Source: WTO.

their trading volumes, both in imports and exports, within Asia as well as within ASEAN countries. The exceptions to the trend are those countries that obtained foreign direct investment in export-oriented industries. Because Cambodia, Indonesia, Lao PDR and Vietnam found their export markets outside Asia, their export to countries in Asia are not large. Furthermore, the comparative advantages of their export products are high relative to the rest of the world, but may be lower than other ASEAN countries.

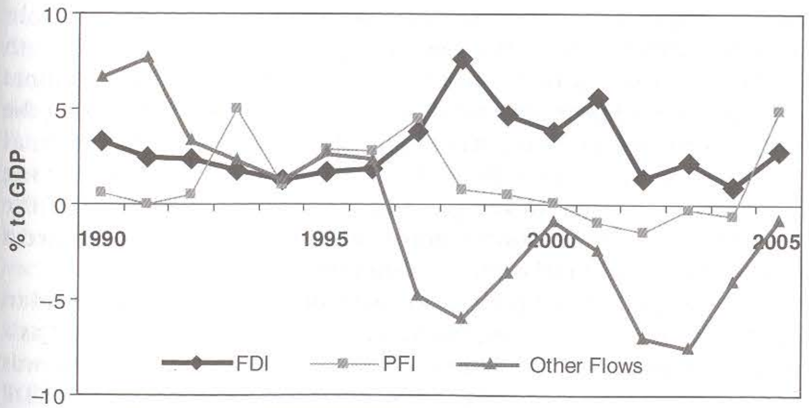

Figure 7.8 FDI and financial integration

Source: Bank of Thailand.

The other measurement of the world integration is the ratio of capital inflows to GDP. Figure 7.8 shows percentage to GDP of the net foreign direct investment (FDI), portfolio investment (PFI), and other flows (for example, trade credit and foreign borrowings). The volatile nature of hot capital flows is obvious and their virulent impact on the macro stability has been well documented. Thailand opened up its capital account since the early 1990s and the subsequent currency crisis has brought the Asian countries together. The Chiang Mai initiative for swap lines and credits agreed to by ASEAN plus three is the product of such cooperation to prevent future shortage of international reserves. Nevertheless, as argued by Eichengreen (2003), such attempts to support a system of common basket pegs for East Asian currencies may not be able to enhance financial stability. The financial resources should instead be devoted to developing securities markets in the region. The establishment of the Asian bond markets is a good example of resource pooling among Asian countries to increase flows of financial resources within Asia.

The role of FDI and infrastructure investment

Foreign direct investment has transformed Thailand's traditional agriculture-based economy into a modern manufacturing economy. Another form of regional integration can be seen from the rising trend of foreign direct investment in the region. Net FDI from ASEAN countries has exceeded those of the US and EU since 2001, while Japan has always been a major investor in Thailand.[3] As pointed out by Kojima (2002), pro-trade-FDI from comparative disadvantage investing countries like Japan that flows to comparative advantage host countries can augment comparative advantage and productivity growth in both home and host countries. The FDI-led growth pattern of a regional economy is a prime motive for building regional integration along the line of the flying-geese model of industrial development. However, as the Japanese economy suffered from a long stagnation, the driving force from the leader of the geese to spur growth for the rest of the flock in Asia has been slowing down, while China also has attracted a substantial share of FDI from the rest of the world.

Since China engaged fully in world trade, the level of FDI in Asian countries has been declining. There was a persistent decline in FDI as a percentage of GDP in Thailand from 1990 to 1996. However there was a surge in FDI that occurred in 1998, amounting to 8 per cent of GDP (Figure 7.8). These increased flows were investment from the EU and

Singapore. They were not in the form of green field investment that flowed in before the Thai banking crisis. They were inflows from capital injection to overtake troubled Thai banks. One might argue that had Thailand opened her banking sector to foreign investors earlier, the cost of financial bailout could have been lowered. However, there is growing opposition to liberalize the service sector because of the fear of competition from more efficient service providers from abroad.

Foreign direct investment that follows trade liberalization can enhance dynamic gains from FTAs. The accumulated stock of foreign direct investment raises the supply capacity of the manufacturing sector; thereby raising the level of exports. The empirical evidence provided by Redding and Venables (2003) shows that more than half of the quadruple increase in Thailand's exports between 1982–85 and 1994–97 stemmed from improvement in internal supply-side conditions. In addition, own-region foreign market access and other-region foreign market access contributed to 43.6 per cent and 17.3 per cent of total export growth, respectively. Export performance is, therefore, strongly related to market access. Differential foreign market access growth can explain the superiority of export performance of South-East Asian nations, when compared to Sub-Saharan Africa, because of ASEAN's higher level of geographical concentration. Regional integration is motivated by close proximity of geographical location.

According to Velde and Morrissey (2004), FDI has raised wage inequality in Thailand because of the consequent impact on increased wages for both skilled and low-skilled workers. Thus FDI could be a source of income inequality within the country. Nevertheless, income inequality depends also on inequality of assets including human capital. The concept of Economic Partnership Agreement (EPA) is very crucial, because it can reduce the cost of adjustment to regionalization. Adverse consequences of FDI across borders must be minimized. Financial assistance toward improving the quality of human capital is needed to accompany increased flows of regional investment.

FDI in the Asian region has been declining as large investments has been diverted into China. Foreign direct investment in the industrial sector of Thailand declined sharply after 2001. There is also an increase in FDI in real estate and service sectors. This is a disturbing trend since that kind of investment would only give more pressure to the appreciation of the real exchange rate. The fact that the proportion of FDI in industry has reduced indicates the decline in capability to export in the future, unless domestic investment can offset the fall.

The decline in FDI can lead to a slowdown in poverty reduction. Mirza and Giroud (2004) produce the evidence that FDI in Thailand has a strong direct effect on poverty reduction through employment generation and consumption multipliers, while its impact on value-chain multipliers and spillovers remain low. The export-oriented manufacturing subsidiaries resulted in little development of forward linkages, while the industries' quality assurance requires high-tech products which must be imported from foreign countries.

To restore the attractiveness of FDI in the region, ASEAN countries need to form a regional economic block to attract Foreign direct investment. Since Japan and Hong Kong are the largest investors in Thailand, the idea of establishing ASEAN plus three or an Asian Economic Community (AEC) provides some hope and lessens the fear of losing FDI to China. But the date set for AEC is the 2020, which is too far in the future. For this reason, Thailand has tried hard to establish FTAs with its major trading partners by breaking away from multilateralism.

Greater Mekong Subregion (GMS) nations, comprising Cambodia, Laos, Myanmar, Thailand, Vietnam and Yunnan province in China, have agreed to promote trade and investment in the region. The Asian Development Bank has agreed to provide loans worth $770 million to finance transportation projects by establishing networks of roads between GMS countries and building bridges across the Mekong River. The East–West Economic Corridor will connect four countries from the port city of Da Nang on the South China Sea in Vietnam to Mawlamyine, a port city on the Andaman Sea in Myanmar, via connecting roads passing through Khon Khan and Phitsanulok in Thailand, and Suvanakhet in Laos. On the North–South Economic Corridor, Chiang Rai province in Northern Thailand can be linked to Kunming in Yunnan via roads passing through Myanmar. On another route on the North–South Economic Corridor, goods can be transported from Kunming to Chiang Rai via Laos. Furthermore, Bangkok can be linked to Phnom Penh and Ho Chi Min City by the Southern Economic Corridor. The infrastructure development in the GMS would develop secondary cities along the road networks and provide access of hinterlands to ports. The planned road networks would connect six countries in the Greater Mekong Region, integrating these countries geographically more than ever.

Transportation cost as well as transaction cost of goods within the subregion can be further reduced by the GMS agreement, effective by 2008, to reduce customs procedures and non-physical barriers for cross border transportation. The role of distance in reducing trade flows has been well established in economic geography literature through gravity

trade models (Krugman and Venables, 1995). Economic cost of trade depends on distance and tariff costs. The integration between Thailand and GMS countries would be intensified, because the distances by sea among them are much higher than the planned road network. The expected increase in the trading volume within the GMS region can be thought of as emerging from establishing natural trading blocks, the concept developed by Krugman (1991). The GMS subregional trading bloc is a natural consequence of the reduction in non-tariff trade cost, reinforcing the trade pattern. Lower tariff rates among CLMV countries in the region would not create much trade diversion because their trade volumes with countries outside the bloc are small. On the contrary, trade creation effect would be welfare improving for the subregion.

As pointed out by Venables (2003) globalization can lead to inequality of nations under certain conditions. Integration between low income countries would lead to income divergence, while integration between high income countries can lead to convergence. In the future when all of the economic corridor road networks have been completed, the distance between cites in Thailand and in other CLMV countries can be greatly reduced. When the cost of transportation is reduced, industry may spread out from the centre to periphery countries or clustering of industry may take place in Thailand, because complementary activities to industries are thinly spread in the CLMV countries. As a result, wage rates in CLMV countries may rise or fall relative to the wage rates surrounding the Bangkok areas. If divergence of income occurs, some kinds of economic partnership programmes between GMS areas are required to offset the unintended consequences of regional integration.

Thailand with multiple FTAs

The debacle of the Doha Round of WTO Ministerial meeting in Cancun in September 2003 can be attributed to the objectives in the WTO agenda that go beyond tariff liberalization.[4] The EU pushed the mandate on the so-called 'Singaporean issues', which include regulations on investment, competition policy and government procurement. The EU initiative on compensatory benefits for any concessions on agricultural liberalization was rejected by developing countries led by Brazil, China and India, resulting in the breakdown of the Cancun meeting. As long as the agricultural reform proposed by developed countries was too limited, the successful conclusion of the agreement will be almost impossible.

Because of the WTO deadlock, there has been growing attempts by countries in Asia to forge ahead with alternative free trade agreements. Dent (2003) argued that the proliferation of Asia-Pacific bilateral free trade agreements represents the failures of APEC, the WTO and the AFTA of ASEAN.[5] The new bilateral trend has departed significantly from diffuse reciprocity principle, upon which WTO multilateralism and APEC's open regionalism are based. The new trend is based on a specific reciprocity basis on which the free trade agreements are negotiated. Desker (2004) argued that multilateral agreement at the WTO, though optimal, is not practical. Asian countries should adopt the bilateral and regional FTA negotiations which are more pragmatic in the short run, while they can pursue global trade negotiations in the long run.

Thailand's rush to negotiate FTAs with many countries, including Chile and Peru, can be attributed to a reaction to other countries' attempts to formulate free trade agreements with Thailand's major trading countries like Japan and the US. Thai negotiators are well aware of the 'spaghetti bowl' effect, as dubbed by Bhagwati *et al.* (1998), where firms have difficulties comprehending a wide range of different foreign trading arrangements caused by overlapping bilateral FTAs. It should be noted the fear of the spaghetti bowl effect may be over stressed. Small and medium size firms would not be able to diversify their export markets to the extent that they are 'confused' by specific requirements in the FTAs. Large firms with higher degree of export diversification would be rational and capable enough to exploit selective markets that yield maximum profits made available to them through multiple FTAs.

Thailand does not want to be too late, as FDI might be lured away into countries that have established FTAs with the US and Japan. In addition, Thailand's export competitiveness can be eroded due to the tariff concession given to countries that form FTAs with Thailand's major trading partners. Multiple FTAs are a new logical trade strategy for Thailand.

FTAs are only part of the New Economic Partnership (NEP), which includes cooperation in other areas, including financial assistance to alleviate the burden of adjustment costs. This is also a strong argument for having FTAs with large countries such as Japan, USA and China. According to Urata and Kiyota (2003), Thailand would gain most from establishing FTAs with East Asian nations because of existing high tariff barriers.

Table 7.1 Thailand's free trade agreements status

	Status of FTA				
Country	*Under feasibility study*	*Process of negotiation*	*Early implementation*	*Date of implementation*	*Year to complete FTA framework agreement*
Bahrain		x	x	Dec-02	n.a.
ASEAN-China		x	x	Oct-03	2015
India		x	x	Oct-03	2010
Australia		x	x	Jan-05	2025
New Zealand		x	x	Jul-05	2015
Peru		x	x	Nov-05	2015
BIMSTEC*		x	x	Jul-06	Fast track by 2011 and Normal track by 2017
Japan		x			
USA		x			
EPTA		x			
Mexico	x				
ASEAN-Korea	x				
Thailand–China	x				

* Economic cooperation between Bangladesh, Bhutan, India, Myanmar, Nepal, Sri Lanka and Thailand.

Source: Ministry of Commerce.

It is always easier to negotiate between the two parties if they have fewer conflicts and issues to resolve, especially if they are small, although the gains would not be large. Bahrain was the first country with which Thailand concluded a FTA (Table 7.1). Although the volume of trade between the two countries is less than $150 million annually, it is the first FTA that Thailand has ever formulated. Thailand has been in the process of learning by negotiating with Bahrain, a small country which exports fertilizer, oil and aluminum to Thailand. Those imported products were subject to an average 20 per cent tariff rate. As a result of the conclusion of the negotiations, the agreed tariff rate was reduced to 3 per cent, which is even lower than the rate Thailand imposes on ASEAN countries at 5 per cent. The FTA with Bahrain, though not comprehensive, is important since it implies that FTAs can actually reduce, instead of increasing, the trade diversion effect since the tariff rate imposed on the new FTA partners is lower than the one imposed on member ASEAN countries.

The FTA with Australia is the most comprehensive agreement because of the inclusion of the service sector. Thai investors can hold 100 per cent of equity in all sectors except those related to security. On the commodity side, tariff reductions came into effect in January 2005. The Australian government has reduced the tariff rates on 80 per cent of the import items to zero. Textile and automobile sectors in Thailand will benefit from the agreement. In 2003, imports of textiles from Thailand were less than 1 per cent of Australia's total textile imports. Hence, there would be more room for Thailand's textile industry, which suffered from the end of the 40 years of import quota system up to January 2005. The low-cost textile and clothing industries in China and India would gain market shares in the US at the expense of other developing countries including Thailand and Cambodia.[6] The FTAs with Australia would immediately cut the existing tariff rate of 25 per cent to 12.5 per cent, bringing in the cost advantage of Thai products over China, Indonesia and India whose products are subject to the 25 per cent tariff rate. Furthermore, the local content is set at 30 per cent, while 25 per cent of raw materials can come from other developing countries.

Thailand pick-up trucks and Australia's large cars are complementary in the automobile markets of both countries. Intra-industry trade in the automotive sectors can enhance the efficiency of the industries in both countries due to the FTA-enhanced opportunity to exploit economies of scale through expansion of sales between the two countries. While imports of Japanese pick-up trucks amount to 41 per cent of the Australian market, Thai pick-up trucks and small cars account for 38 per cent, and 2 per cent respectively. It is expected that sales of Thai pick-up trucks and passenger cars after 2005 would increase considerably.

Some inefficient and small farm sectors in Thailand would not be able to compete with cheap Australian products. However, Thailand has been importing more than the minimum requirement of 55,000 tons of milk, as committed by Thailand at the Uruguay Round. Furthermore, Thailand barely charges any tariffs on milk. Thus the fear of adverse impact of FTAs on the Thai milk industry is exaggerated. Nevertheless, non-tariff barriers such as sanitary and phytosanitary conditions must be agreed upon to make sure that they are not substitutes for the tariff reductions. As it turns out, Thailand has been slower than Australia in the reduction of the tariff rates. Some of Thailand's manufacturing sector could take the full benefit of importing metal such as iron ore, copper and zinc from Australia.

The Thai–Australia FTAs are employed as a model for establishing FTAs between Thailand and New Zealand. Both agreements are comprehensive. Nevertheless, the timeframe for cutting the tariff on dairy products was suggested by New Zealand to be shortened below the 20 years' timeframe agreed in the Australia–Thai FTAs. Thailand has already imported butter and cheese from New Zealand, but the high transportation costs prohibit imports of fresh milk.

The Thai–New Zealand FTAs can serve as a model for the creation of the regional trade pact between ASEAN and the Closer Economic Cooperation (CEC) countries of Australia and New Zealand. The Thailand–China FTA can be served as a basis for an ASEAN–China FTAs. According to the statistics obtained from almost 14,000 rules of origin certificates issued by Customs Department, one year after the introduction of the fast track FTAs with China, exports of Thai fruits and vegetables increased to almost 14 billion baht. The Thai tapioca industry also benefited because of the strong demand from China to manufacture alcohol and acid. Tapioca exports to China increased by more than 35 per cent in 2004.[7]

While Thailand can substantially increase her exports of tropical fruits like durian, longan, mango and mangosteen to China, imports of Chinese pears and grapes also increase tremendously. The demand for imported Chinese vegetables such as garlic, carrots, onions and potatoes is price elastic. The volume of imports increased dramatically as a result of the tariff cut. Consumers in both countries have enjoyed the benefit in terms of cost and varieties. There is no doubt that FTAs can reduce the inflationary pressure of agriculture products during off seasons and drought. Thai farmers cannot compete with Chinese farmers producing garlic and onions; their costs of production are as low as 40 per cent of the farm-gate prices in Thailand. Resistance to these adjustments through subsidies or guaranteed prices would only prolong the problem of inefficiency. There is no need for intervention by the government, because Thai farmers would be able to adjust in the long run by responding to a new price structure established by the FTAs to reallocate resources to more efficient production. It should be noted that China–ASEAN FTAs would be completed by 2010. An early harvest programme with China and Thailand would serve as a stepping stone toward a wider regionalism.

FTAs between Thailand and India are similar to China's due to the initiation of the fast track deal. Tariff reduction on 82 products is covered under the fast track programme that came into effect in September 2004. The two countries have larger population but lower average income than Thailand. In this sense, Thailand would not be at disadvantage as many Thai products are complementary to those in India and China. Both China and India are growing rapidly for different reasons. China is growing fast by the heavy foreign direct investment and public infrastructure investment, while India is growing rapidly because of the enlarging private sector. Three hundred million Indian consumers would become very attractive to Thai investors, after Thai exports have made their impact in the Indian markets of electronic products, machinery and jewellery. At the same time, Thai jewellery industry would benefit from imported gems as cheap inputs to their industry. Viewed in this light, Thailand has made an important selection of FTA partners that are full of dynamism and great potential.

The other benefit from establishing a FTA with India is that it is a foundation for strengthening the regional grouping of the BIMST–EC (Table 7.1) between the two ASEAN (Thailand and Burma) and the five South Asian countries of India, Bangladesh, Bhutan, Nepal and Sri Lanka). The group has a plan to negotiate free-trade agreements for goods, investment and services and cooperation in the field of technology, communications, energy, and tourism. In the long run, BIMST–EC can serve as a bridge between ASEAN and the South Asian Association for Regional Cooperation (SAARC). Again, these kinds of bilateral FTAs initiations do not totally depart from the spirit of regional integration and multilateralism; they strengthen the foundation for future regional integration.

Under WTO agreements, contingency measures are authorized in the forms of safeguards, countervailing duties and anti-dumping duties (ADD). Because Thailand's exports to the world market are growing rapidly, they are subject to targets of ADD by importing countries. According to empirical evidence provided by Head and Ries (2004), between 1995 and 2002, Thailand had been targeted by importing countries with ADD more proportionately than her share of world's exports, but Japan seldom uses ADD although her share in world's imports is more than 5 per cent. However, boneless chicken has been a trade dispute between Thailand and Japan for many years. Other sensitive products that Japan feels uncomfortable with during FTA negotiations are rice, sugar and tapioca. Thailand's sensitive commodities include hot-rolled steel sheets.

The benefits that Thailand would receive from the free trade negotiation with Japan are probably the greatest among all FTA deals. For Thailand, Japan is the largest trading partner and the biggest source of foreign direct investment. There are more than one million Japanese visitors to Thailand each year. The negotiations extend beyond free trade agreements. The so-called Economic Partnership Agreement (EPA) includes cooperation in education, environment, energy, sciences and technology, tourism and human resource development. Note that EPA goes beyond what WTO has stipulated since it allows partners to take advantage of each other's strength and recognize the value of cooperation.

Although Japan has already established FTAs with Singapore, Thailand is a more difficult case for Japan, since negotiations involve agriculture and labour issues. Singapore had already removed most of her tariff barriers, while the two countries' levels of per capita income do not differ much. The success of the FTA negotiation is so important that Thailand had to withdraw rice from the negotiation.[8] Obviously the outcome of the negotiations depends on the bargaining power of each party. But international politics are also important as China is exerting its power in economic cooperation with ASEAN countries. Thailand would like to have large countries such as China, India and the US involved to reduce the dominant power of a single large economy. Withdrawing rice and hot-rolled steel sheets from trade liberalization would make negotiations in other sectors possible if rice is as important for Japan as much as hot-rolled steel sheets for Thailand. Furthermore, Thailand would have gained much more than having struck no deal at all. Rice is not the only agricultural product that Thailand has comparative advantage in the world markets, but there must be a limit to such compromise. The exclusion list cannot go on until most protectionists are happy about the deal.

As pointed out by Naya (2004), FTAs are crucial for structural adjustments of Japan in order to maintain her global competitiveness and remain a leader in the world economy. FTAs with Thailand and other ASEAN countries can provide Japan an opportunity to grow closer to other Asian countries, while collectively protecting themselves from negative effects of regional agreements in Europe and Northern America. The successful conclusion of the FTAs between Thailand and Japan would benefit the two countries more if they do not hold on to the protection of comparative disadvantage sectors. Bhagwati (2004) argued that most bilateral trade agreements exempt agriculture and few exist between countries with competing farm sectors. Perhaps the FTAs between Thailand and Japan can be an example of the FTAs that include agricultural sectors – albeit without rice.

Because the US is the largest export destination for Thailand, FTA negotiation with the US might be the most difficult. The issue of intellectual property rights covering software and pharmaceutical industries, has become an obstacle to reaching the deal. It is understandable that extending the longevity of patents can maintain the monopoly power of American companies as they would gain more incentives for their research and innovation. But the high prices of these products would also reduce the utilization of products that are crucial for healthcare and the development of the software industry in Thailand. Thai negotiators call for a lifting of compulsory license for retroviral drugs to combat HIV or for vaccines against SARS and avian flu as permitted by the WTO.[9] There are many points to be negotiated before the conclusion of the deal. There are also much more to trade off between the two nations in order to strike a deal if they really want to come up with any fruitful FTAs. Some parties that gain substantially from the deals should be able to compensate those parties that lose considerably after the conclusion of the negotiations.

Tables 7.3 and 7.4 provide percentage changes in trade volume between Thailand and other countries with which Thailand attempts to establish free trade agreements. Although the complete agreements

Table 7.2 Thailand's exports to potential FTA countries (percentage change)

Export destination	*2004*	*2005*
Bahrain	27.4	28.9
China	25.1	29.1
India	43.1	67.7
Australia	14.3	28.9
New Zealand	24.2	58.2
Peru	64.9	41.3
BIMSTEC	37.8	35.1
Japan	18.9	12.3
USA	14.1	10.0
EPTA	–16.1	–3.6
Mexico	12.3	1.6
Korea	17.4	21.6

Source: Ministry of Commerce, Bank of Thailand.

Table 7.3 Thailand's imports from FTA countries (percentage change)

Sources of imports	*2004*	*2005*
Bahrain	–7.0	35.9
China	35.7	37.0
India	30.5	12.4
Australia	42.2	48.0
New Zealand	13.0	6.8
Peru	14.9	6.7
BIMSTEC	38.5	23.9
Japan	23.3	16.9
USA	1.6	20.5
EPTA	18.5	49.3
Mexico	–6.6	25.3
Korea	23.8	8.4

Source: Ministry of Commerce, Bank of Thailand.

have yet to materialize in the future (Table 7.1), Thailand's trade deficits with China and Australia increased as imports rose faster than exports in 2004 and 2005. One of the critiques of Thailand's free trade agreements is based on the FTA impact on worsening trade balances. It should be noted that trade balances between countries are a bad indicator of well-being of a nation, because they do not reflect efficient allocation of resources in production and consumption. Furthermore, there are other factors, such as exchange rates and economic growth, affecting trade flows between countries.

The way forward

Although the new trading strategy of Thailand seems appropriate, success depends on how the plans are executed in detail. Because FTAs always involve losers and gainers, unreasonable fear of changes, frictions and adjustment costs are high in the short run. FTAs always include rules of origin. There are employed to prevent an exporter from exploiting a low tariff 'backdoor' by introducing products that would have been subject to high tariffs since they are not produced in the member countries of the regional trading bloc. These rules, if they are not standardized when Thailand has completed FTAs with various countries, can create high administrative and transaction costs, stifling the intended effect of trade creation. Those rules of origin must be simplified to facilitate administration procedure without causing trade diversion or act as a hidden instrument to protect domestic industry. It should be noted that if Thailand continues to reduce MFN tariff rates, the cost associated with the rules of origin can also be reduced. The upper boundary of those costs is the MFN tariff rate, because it would not be worthwhile for firms if the compliance cost to the rules of origin is greater than the benefit derived from a particular tariff treatment offered by the FTAs.

With the recent trend of increasing degree of trade fragmentation, trade occurs more frequently between nations in the region to obtain parts and components of manufactures. Rules of origin can be manipulated to suppress trade when it diverts trade from efficient producers abroad to high cost intermediate products of domestic industry. It is more likely in the case of manufactures than agriculture since each manufactured product has its own specific nature and production standard. The hidden technical details of the rules of origin can be manipulated to suit protectionists' interests. Thus rules of origin can create trade deflection if they lead to the import of intermediate products from inefficient producers of the FTA partners with the lowest external tariff.

In the case of Thailand, automobiles, textiles and electronics are important manufacturing sectors both in terms of output and employment. These industries might be affected by rules of origin if Thailand does not have enough bargaining power against large economies to establish a series of identical rules of origin among them. To prevent multiple series of FTAs from creating the so-called 'hub and spoke' pattern within the ASEAN region, diagonal cumulation of the rules of origin is needed.[10] Thus exports of textiles from Thailand to Australia can be subject to 30 per cent of local content required by the rules of origin and the Thai textile industry can employ up to 30 per cent of intermediate inputs from another ASEAN country if that particular ASEAN country has already establised FTAs with Australia. Moving to a system of diagonal cumulation of rules of origin widens possible sources of intermediate suppliers to countries which are part of the system, resulting in trade creation and trade reorientation (Augier *et al.* 2004). In that sense, other ASEAN's FTAs negotiations with the countries that Thailand has already concluded negotiations must be encouraged to enhance the intra-industry trade in the region.

Although the WTO permits importing countries to impose regulations on environment, food safety, animal welfare and hygienic standards, negotiations must be carried out to remove arbitrary regulations on such issues. The arbitrary nature of rules and regulations is more serious impediments to trade than tariff rates, because they impose cost as well as risk and uncertainty. Negotiations regarding the non-tariff barriers, safeguard clauses, and Sanitary and Phytosanitary Standard (SPS) must be included in the FTAs deal.

The dynamic impact of the new regional integration would result in differential growth rates of member countries. As argued by Venables (2003), convergence of income depends on relative comparative advantage of the country relative to the rest of the world. The FTAs that Thailand has planned to establish with Japan and the US, therefore, are likely to give net benefit to Thailand. It is highly beneficial for Thailand to engage in establishing FTAs with higher income countries – the 'North–South' agreements – because their economic activities are complementary. However, the exclusion list of sensitive commodities should be kept at a minimum on both sides.

Some of the FTAs that Thailand has made are not comprehensive. The Thai government must negotiate continuously to expand product coverage. The successful results of the fast track agreement would enable the public to reap the benefit of free trade and accept the fact that those comparative disadvantage sectors must adjust themselves to the force of globalization.

Concluding remarks

Thailand has increasingly become an integral part of the world economy, but the degree of regional integration of Thailand has been more pronounced in Asia. There is an important realization after the 1998 currency crisis that countries in Asia must cooperate in terms of economic policy. The Chiang Mai initiative in May 2000 aims to prevent currency attacks and crisis contagion in the future. Through arrangements made by central banks in the region, countries in trouble must be provided with $40 billion during the period of liquidity shortage. Moreover, the Asian Bond markets are also a product of the Asia Cooperation Dialogue (ACD), aiming at promoting capital markets in the region to lessen heavy dependence on financial resources from other parts of the world.

The tariff rates among ASEAN countries have been cut to 5 per cent, covering about 95 per cent of intra-ASEAN trade. Furthermore, the time frame is set at the year 2010 for fully liberalized trade among the ASEAN Six, and the new members by 2015. The deadline has been set at 2020 for the establishment of an Asian Economic Community (AEC). However, that dateline might be too far for Asian countries to remain competitive in an era of intensified regional groupings. It is possible that investment diversion from Asia can be more overwhelming than the trade diversion impact of other regional groupings. To forge ahead, FTAs are the only choice consistent with the framework of regional integration.

Having multiple FTAs with developed and developing countries would ensure Thailand would obtain benefits from having free trade with many countries in the world at the same time, rather than having to wait forever for the conclusion of the WTO multilateralism. Will more spokes added to the hub lead to the more diluted benefits for each of the spokes? On the contrary, as long as newly established FTAs have more or less similar rules of origin, we can reduce, if it exists, the *spaghetti bowl* effect. After all, the total trade volume between Thailand and negotiated FTAs members (including ASEAN) would amount to more than 60 per cent of Thailand's total trade. Though discriminatory in nature, FTAs proponents have asked the right question: why forsake the opportunity to grow and why wait for the elusive outcome of the multilateral negotiations? FTA supporters are a free trader in a hurry.

Because trade creation and diversion effects depend on price elasticities, the net welfare effect of regional FTAs would depend on whether cross-price elasticities between members and non-members are greater than the price elasticity between products produced within the trading blocs. If Thailand successfully negotiates FTAs with Japan, China and the US, the trade diversion impact would be small, because the three countries' shares in Thailand's trade are substantial. Within the ASEAN countries, the changing comparative advantage would dictate the direction of intra-regional trade pattern. CLMV countries would import more from Thailand, which in turn import more from Singapore and higher income countries in the region. Since manufactured goods produced in high income countries are close substitutes for their imports from low income countries, the impact of regional integration would ensure a considerable welfare gain through trade creation for both importing and exporting countries. At the same time, if these partners in the regional free trade agreement are committed to trade reform, the impact of trade diversion would be minimal as their MFN would continue to decline over time.

But there are some trade-offs and some adverse consequences of the new regionalism. As long as the net benefits of expansion along the line of globalization exist, we should cautiously go ahead with multiple FTAs. We should not let short-term minor adverse impacts obscure the long-term macro dynamic gains from rapid integration into the world economy. Integrating the Thai economy with regional trade blocks can serve as an instrument to speed up domestic reform. Without firm datelines imposed by FTAs, there would be less enthusiastic efforts to carry out difficult reform as the financial crisis might seem to be just a short episode in the Thai economic history. As pointed out by Ethier (1998), an important motivation for countries to sign up for multilateral trade agreements is to help realize economic reform at home, but they are less effective in comparison with preferential trade agreements. Therefore, there is a positive relationship between preferential, regional, and multilateral paths to trade liberalization. The substantial progress at the multilateral level has made FTAs more attractive.

The comparative disadvantage sectors would strongly protest against FTAs, fearing that they would not be able to compete and would soon be wiped out. Political economy will play an important part in deciding the direction of the FTAs. Political will is a crucial factor in determining the speed and the coverage of the regional integration. In addition, economic growth and macroeconomic stability would enable Thailand to forge ahead with regional integration, which must be in line with the goal of multilateralism. The surge in the number of Thailand's FTA negotiations should not be interpreted as diminished commitment to multilateralism. However, the collapse of the Doha round of trade talks in 2006 bodes well for the unrealistic view of multilateralism, trying to avoid hub-and-spoke, and the spaghetti bowl effect of multiple FTAs.

Notes

1. City states such as Hong Kong and Singapore have a higher degree of openness, amounting to 250 and 280 per cent of GDP in 2002. Among other counties in the ASEAN, only Malaysia has a higher level of trade openness around 196 per cent. Small countries tend to have higher degree of trade openness due to their small shares of output in the world markets, while large countries tend to appear insular because of their relative sheer sizes.
2. For an excellent account of the evolution of Asian integration from the formation of APEC to ASEAN plus 3, see Naya (2004).

3. The shares of FDI from Japan, ASEAN and Hong Kong were 43, 36 and 18 per cent respectively in 2003. Other top five investors are USA and the EU, but their relative importance has been declining since the early 2000s.
4. For an optimistic view on the multilateralism, see Bhagwati (2004), who argued that as long as the G-22 and the Cairns Group want agriculture to liberalize, they can only succeed in the context of multilateral agreement. Cancun will serve as a stepping stone to a successful conclusion of the Doha Round of trade negotiation. The Tokyo Round took more than 5 years to finalize, while the Uruguay Round took more than 7 years to complete. Thus the delay of the Doha Round cannot be considered as a failure.
5. According to Dent (2003), Asian Pacific bilateral trade agreements rose from nine participating states with 13 projects by the end of 1999 to 39 projects and 13 perpetrating states by mid 2002.
6. WTO predicted that the market shares of imported clothes to the US from China would increase from 16 to 50 per cent, India from 4 to 15 per cent in the post-quota era.
7. Thailand's major export markets for tapioca are European Union, South Korea, and Japan.
8. The Japanese negotiators would like Thailand to withdraw chickens from the negotiation in exchange for the ratification of the sanitary standard of the Thai chicken industry. This request is unreasonable considering the fact that the share of Thailand's chicken exports amounted to 40 per cent of Japan's total imports, despite the 1.9 per cent import duties.
9. The United Nations World Intellectual Property Organization (WIPO) has adopted a development agenda to consider different intellectual property systems that are appropriate to particular developing countries, which are in dire need for open-source software and drugs for human resource development for the poor.
10. According to Augier *et al.* (2004), rules of origin imposed within the Southern Mediterranean partner countries led to both trade suppression and trade diversion. The lack of cumulation of the rules of origin may restrict trade between non-cumulating countries by up to 80 per cent.

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