

# Integration with ASEAN Economic Community

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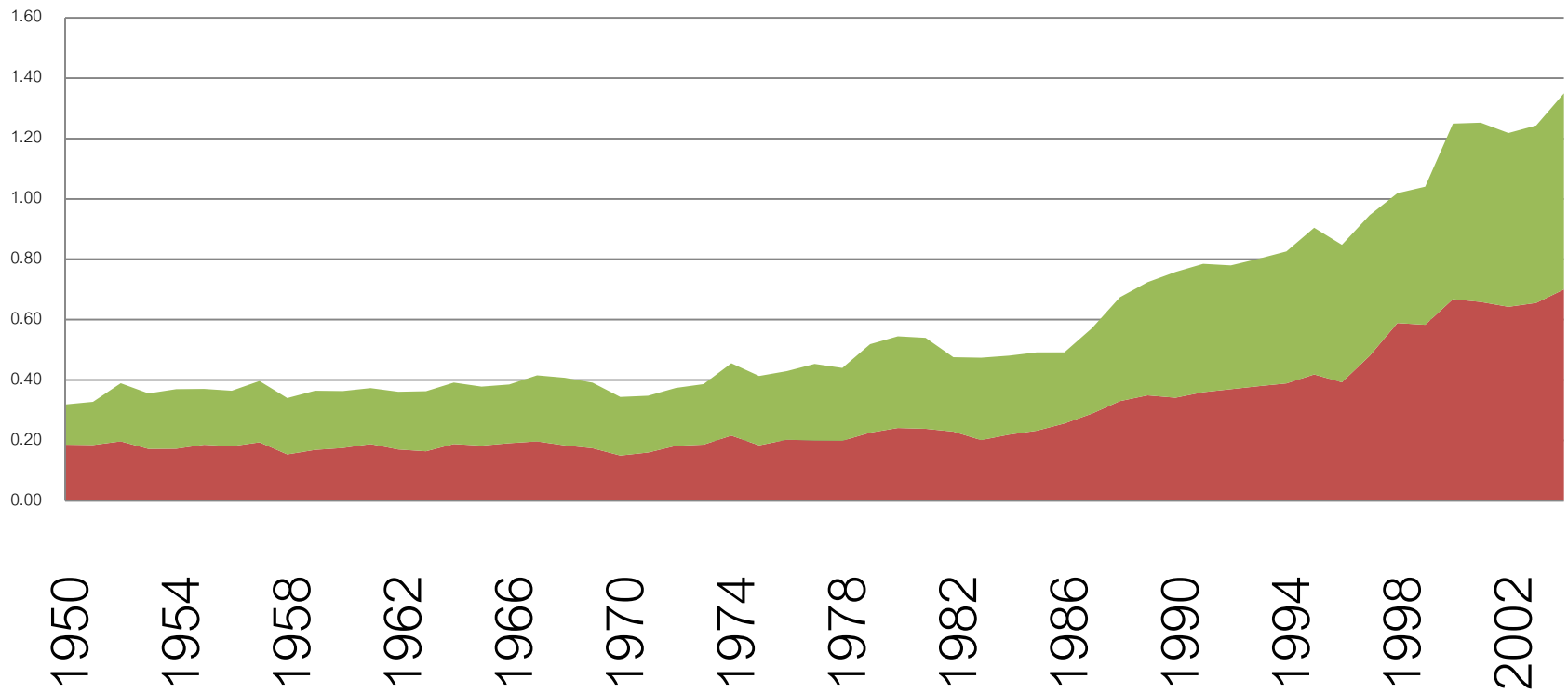
# Main themes

- Globalization
- Free trade agreements
- Trade and geography
- Thailand's direction of trade
- Shocks and transmission mechanism
- Asian Economic Community
- Fiscal and monetary spaces
- Crisis and preparedness

# Growing importance of trade: An engine of growth

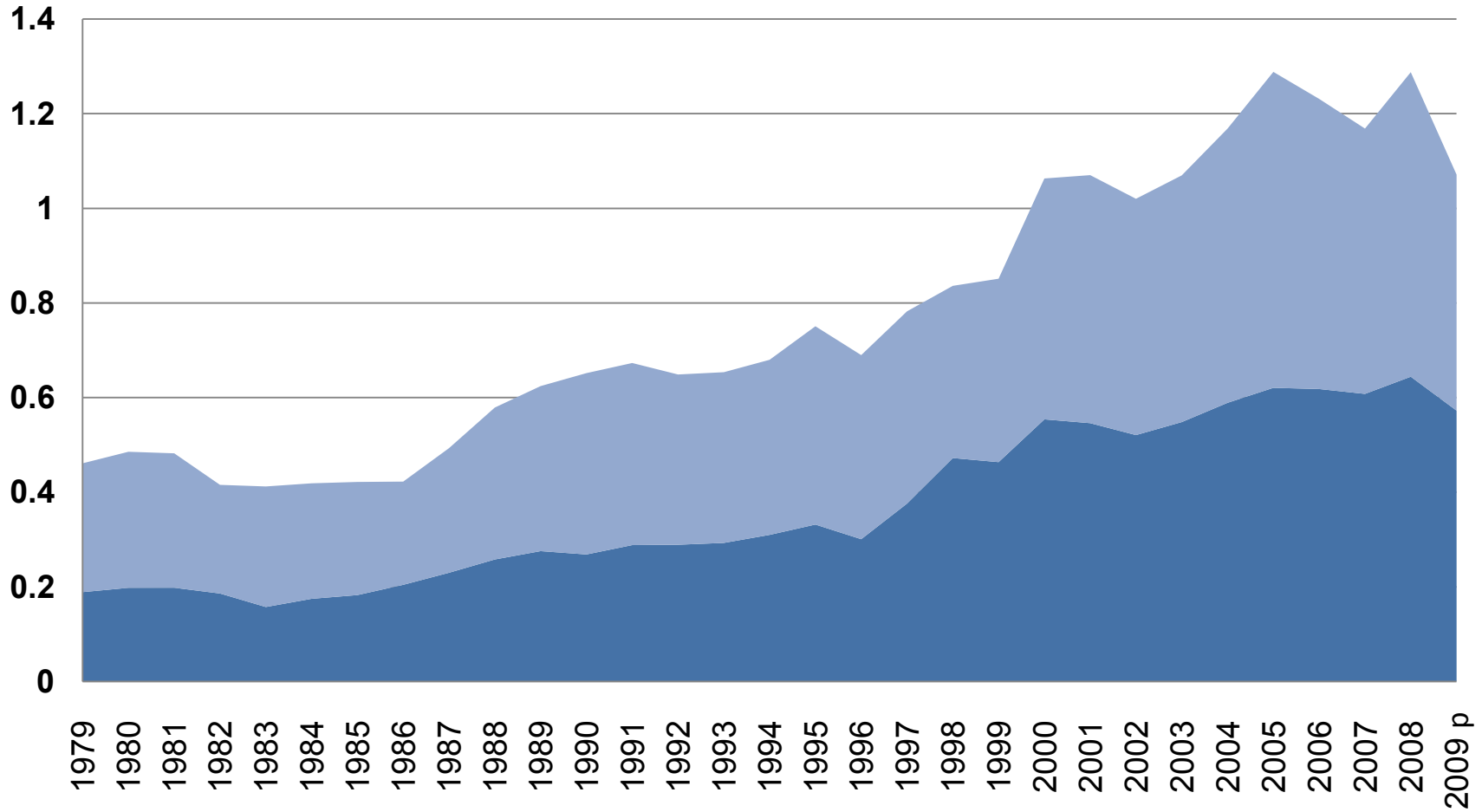
## Trade openness

■ Exports/GDP ■ Imports/GDP



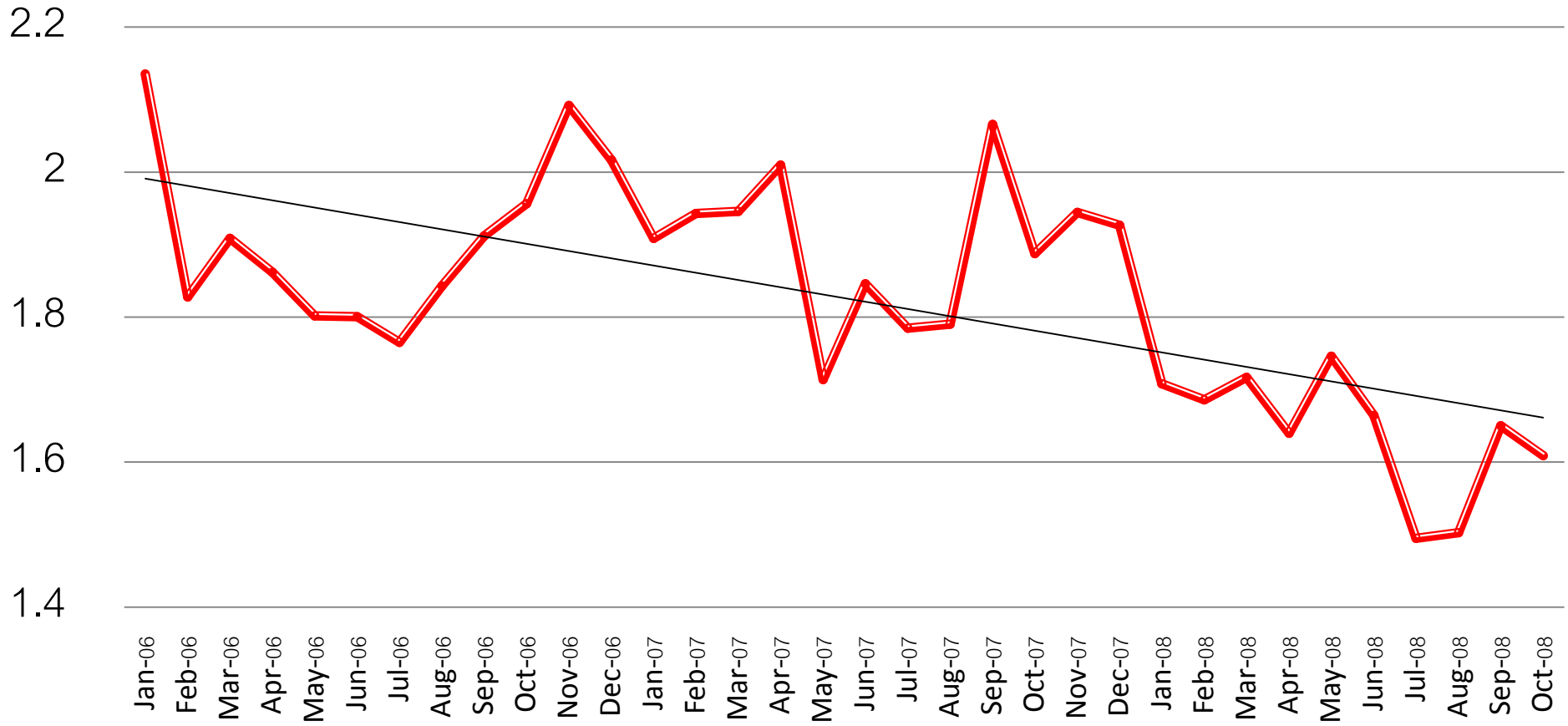
# Degree of Openness to trade

■ Exports/GDP ■ Imports/GDP



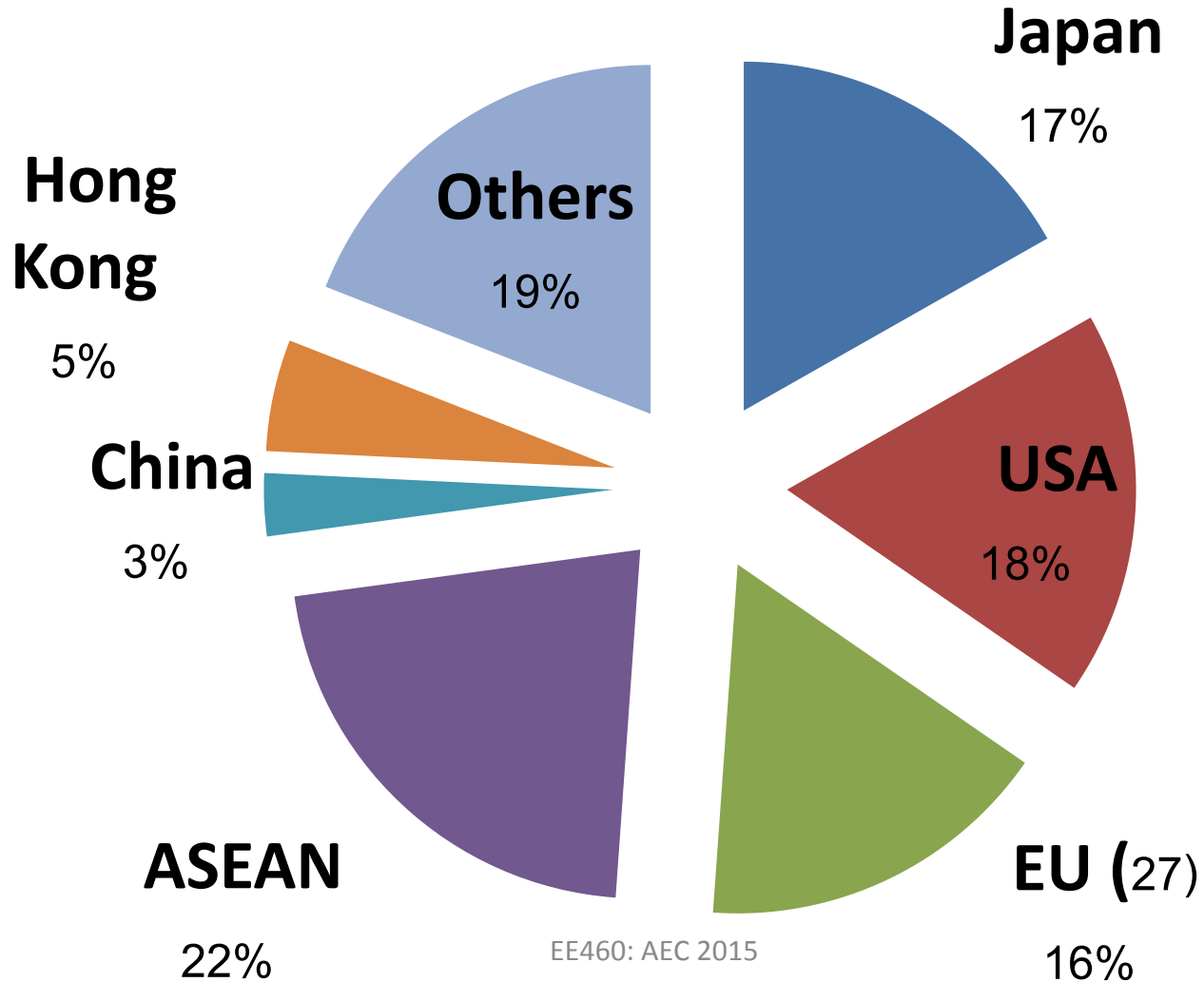
# Thailand's implied tariff rate

*customs revenue to total imports(%)*



# Distribution of Thailand's exports

Shares in 1995



# Thailand's Export market diversification in

2009

Japan

10%

USA

11%

EU (27)

12%

ASEAN

21%

Others

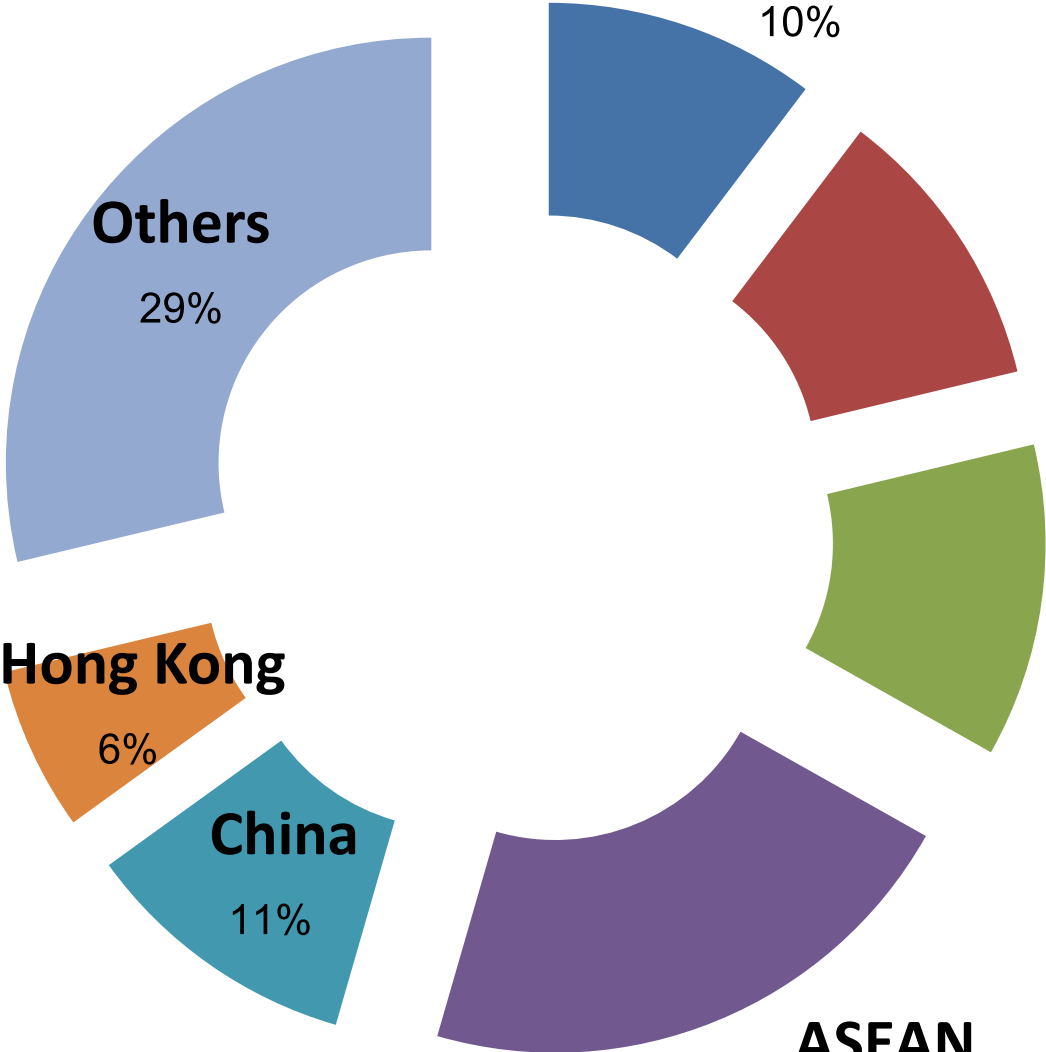
29%

Hong Kong

6%

China

11%



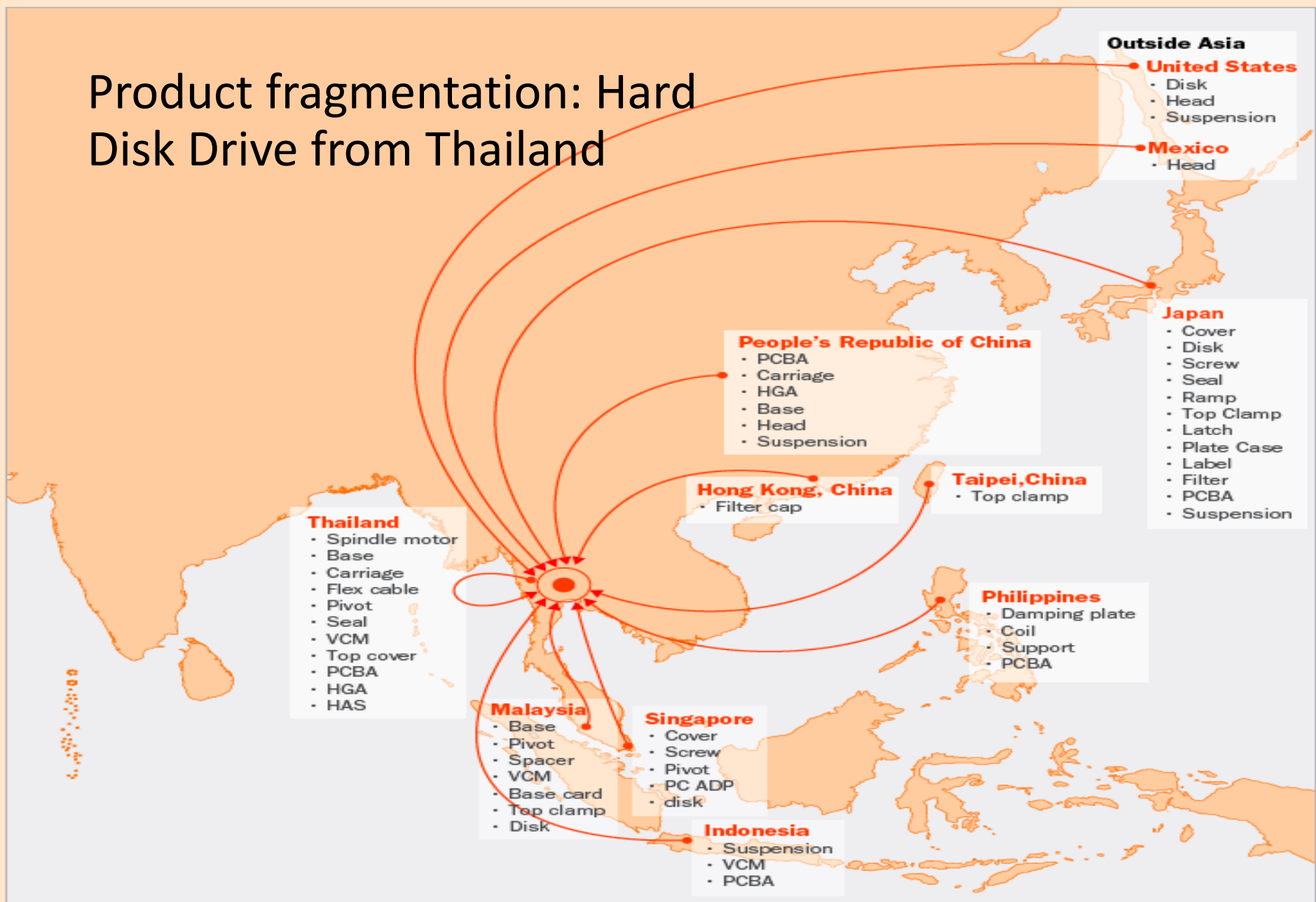
# ASEAN Countries

Small countries in South East Asia can avoid the limitation of their domestic market by exploiting the economies of scale from the ASEAN's 550 million population with a GDP of 1.4 trillion USD

## An integral part of the world economy

- Thailand has increasingly become an ***integral part*** of the ***world*** economy.
- By 1996, the value of international trade was as large as the size of GDP.
- The degree of ***Asian regional integration*** of Thailand has been ***more*** pronounced through foreign investment in production fragmentation.
- Trade fragmentation in parts and components of HDD

# Product fragmentation: Hard Disk Drive from Thailand



Note: The production of hard disk drives requires several parts and components. The example shows the actual sourcing of parts and components of a hard disk drive assembly firm in Thailand. The largest majority of parts and components are sourced from other integrating Asian economies. Hard disk drives are used in several electronic products. The hard disk drive assembler in Thailand exports a large share of its production to electronic firms mostly in other integrating Asian economies.

Source: Adapted from Hiratsuka 2006.

# Existing bilateral trade agreements

- Australia
- New Zealand
- Japan
- China
- India
- Preferential exports contributed only 14.8 % of total exports in 2009.

# ROO and NTBs

- **Rules of origin** must be simplified to facilitate administration procedure without causing trade diversion or act as a hidden instrument to protect domestic industry.
- If Thailand continues to reduce **MFN tariff** rates, the cost associated with the rules of origin can also be reduced.
- The spaghetti bowl effect has been exaggerated.
- **Non-tariff barriers** such as Sanitary and Phytosanitary (SPS) conditions must be agreed upon to make sure that they are not substitutes for the tariff reductions.

# Political economy and leaders' willpower

- The comparative **disadvantage** sectors would ***strongly oppose*** FTAs, fearing that they would not be able to compete and would soon be wiped out.
- Political economy plays 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.

# To forge ahead with integration

- There are **trade-offs** between benefits and adverse consequences of 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 micro** adverse impacts obscure the **long-term macro dynamic gains** from rapid integrating into the world economy.

# New Regionalism: Multiple FTAs

- Thailand's rush to negotiate FTAs with many countries, including USA, Japan, Australia, New Zealand, Bahrain, India, China, Chile, and Peru, can be described as *new regionalism*.
- Although Japan had already established FTAs with Singapore, Thailand was a *more difficult* case for Japan, since negotiations involved agriculture and labor issues.
- *Singapore* had already removed most of her tariff barriers, while the two countries' levels of per capita income do not differ much.

# Food security remains an issue

- Thailand had to withdraw ***rice*** from the FTA negotiation with Japan.
- Rice is also excluded from Korea FTAs with other countries
- Other **sensitive products** for Japan are chicken, sugar, and tapioca.
- Most of bilateral trade agreements **exempt** agriculture.
- *What commodity is exempted from the FTA between USA and Australia?*

# Four sensitive items

- ASEAN Free Trade Agreement (AFTA) is the most comprehensive free trade agreement, but Thailand cannot afford the removal of protection in four commodities:
  - Fresh-cut flowers
  - Dried coconut
  - Potatoes
  - coffee

# Aspects of economic integration

- Free flows of trade
- Free flows of services
- Mobility in skilled labor
- Free flows of capital
- Free flows of investment

# ASEAN Economic Community

- Trade liberalization under the AEC builds upon achievements over the past decades which began with trade integration under the ASEAN Free Trade Area (AFTA), signed in 1992.
- Under AFTA, a substantial reduction of tariffs has already been achieved.
- As of January 2010, ASEAN-6 applied zero tariffs to 99 percent of goods, while the CLMV countries plan to achieve the same goal by 2015.

# The AEC blueprint

- What the AEC aims to “transform ASEAN into a single market and production base, a highly competitive economic region, a region of equitable economic development, and a region fully integrated into the global economy”.
- “Open regionalism” in a single market and production base is expected to minimize transaction costs and maximize trade gains.
- But we need to standardize VAT and corporate income tax rates

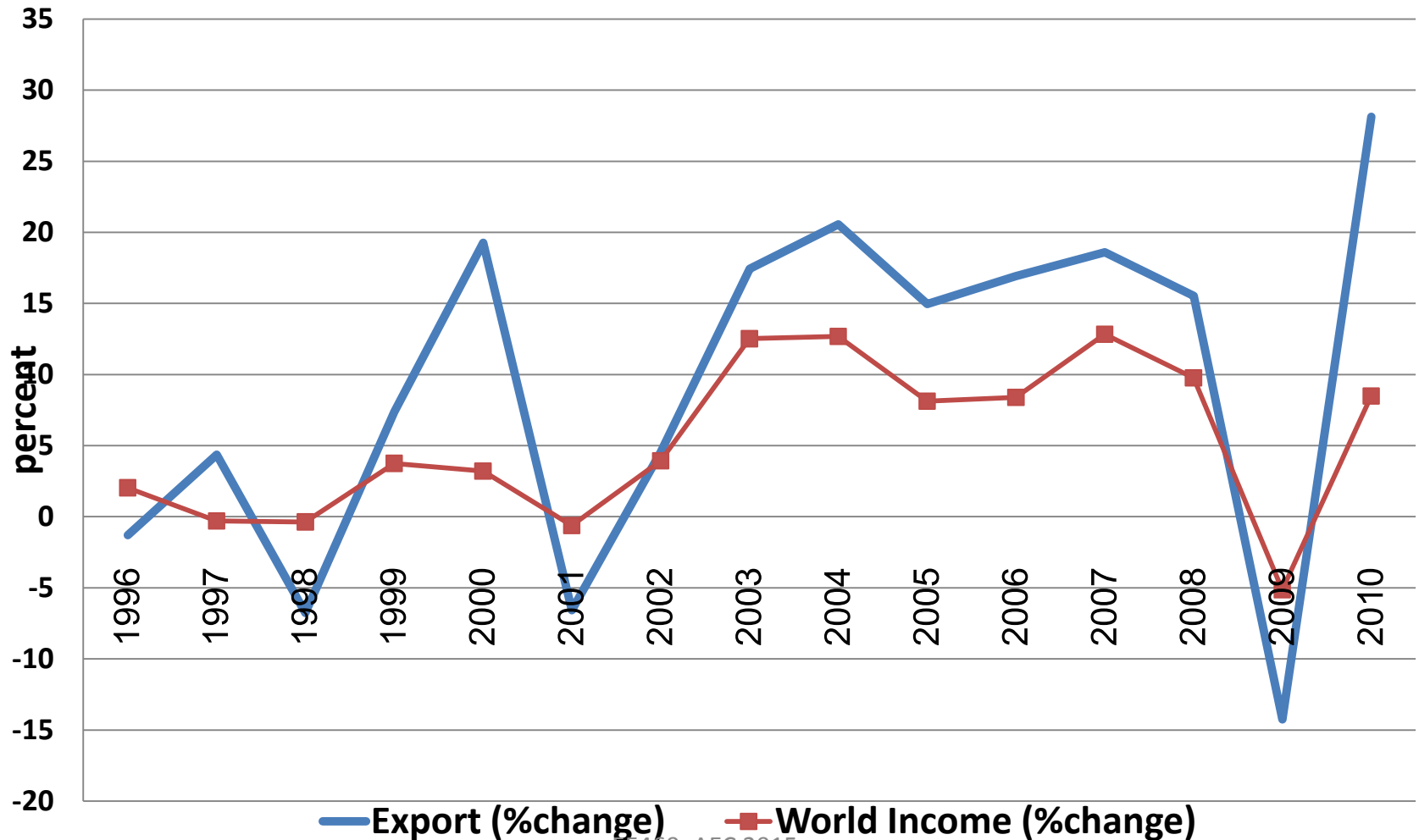
# Foreign ownership in service sector

- Healthcare
- Tourism
- Air transport
- Banking sector
- ASEAN investors should have already been allowed to hold up to 70% of equity share in these sensitive sectors.

# Adverse consequences of globalization

- Exposure to external shocks
- Export dependency
- Increase business synchronization
- Destroy traditional (uncompetitive) sectors

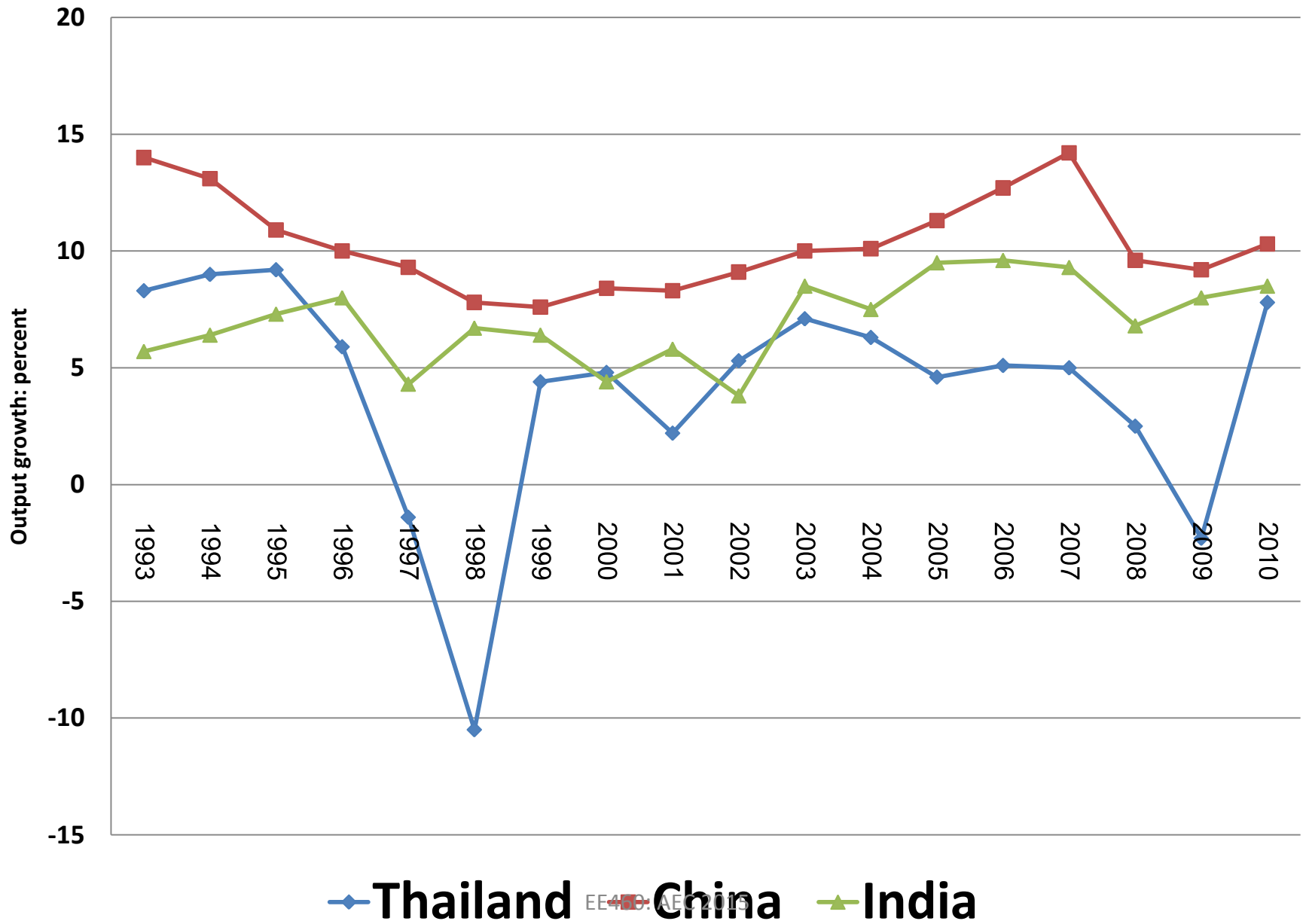
# *Thai exports fell precipitously and rise spectacularly with fluctuations in world output*



# Global recession is imminent

- **The IMF: Global growth will shrink to 4% in 2012, from 5% last year due to "major financial turbulence in the eurozone".**
- ASEAN needs a new growth pole
- Supply constraint and recovery
- Substitution is the key to resilience

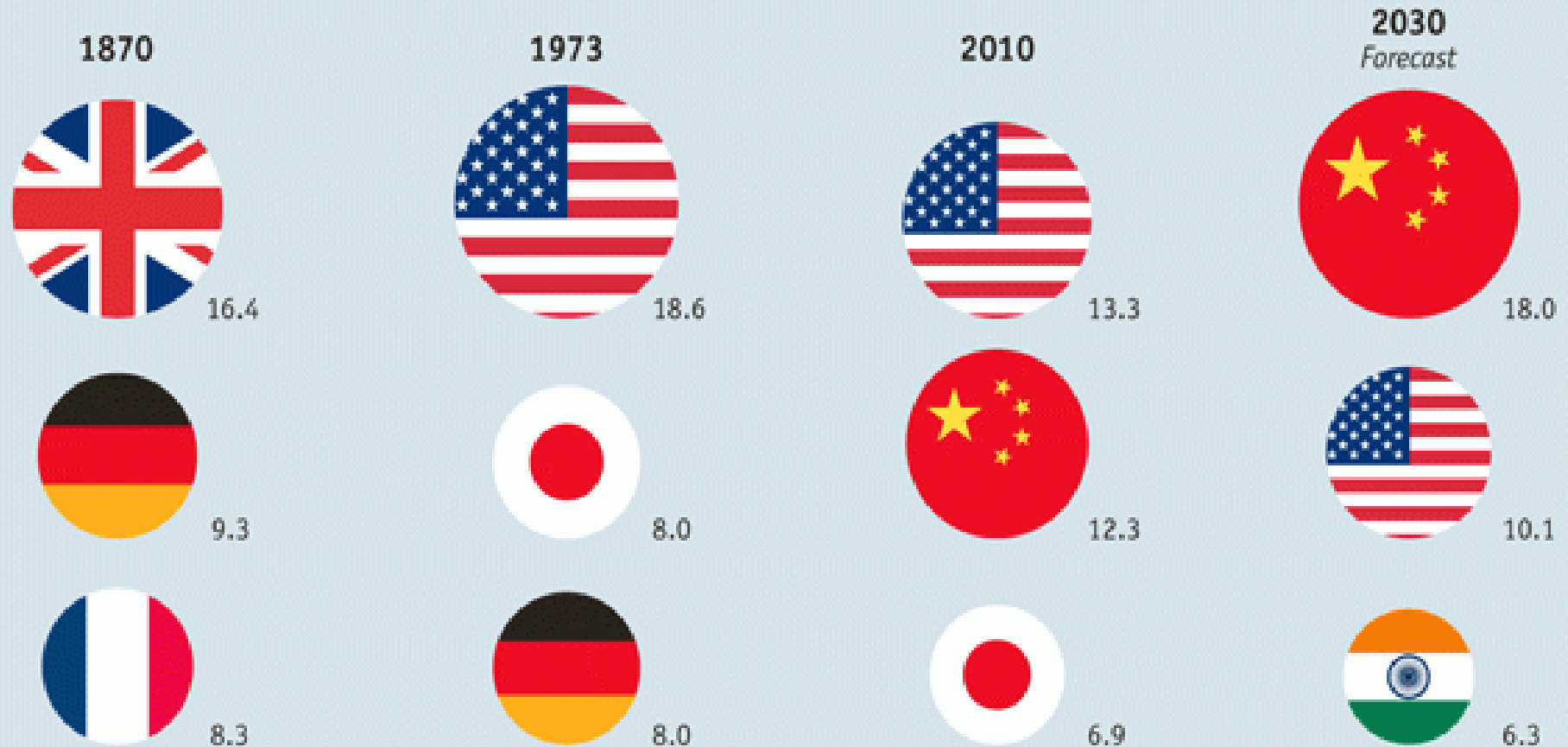
# Asian Growth Synchronization



EE416: AEC 2015

# Waxing and waning

Top three countries by economic dominance, % share\* of global economic power



Source: Arvind Subramanian

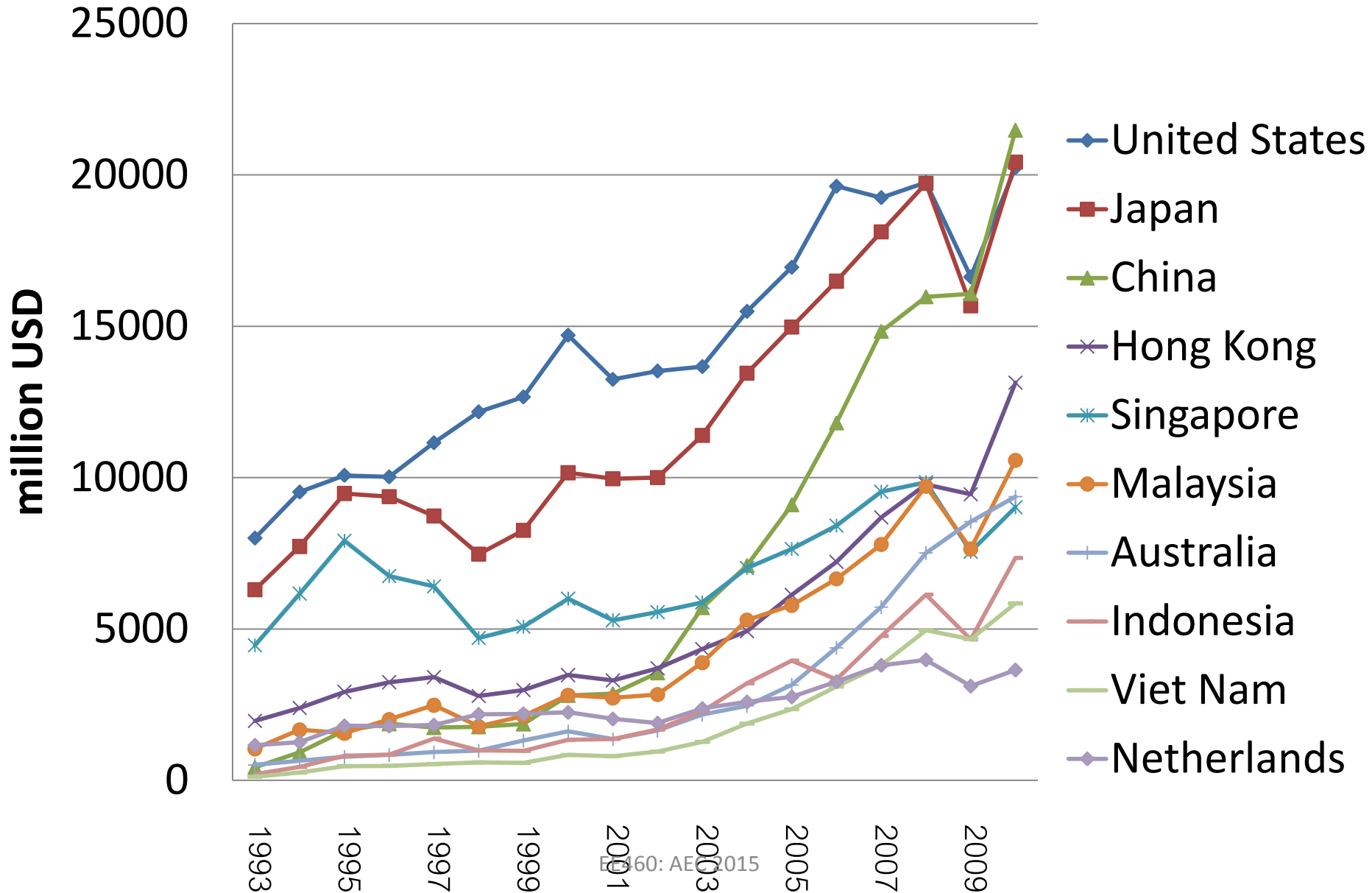
\*Weighted by share of world GDP, trade and net capital exports

Source: Eclipse, Arvind Subramanian  
Peterson Institute for International Economics

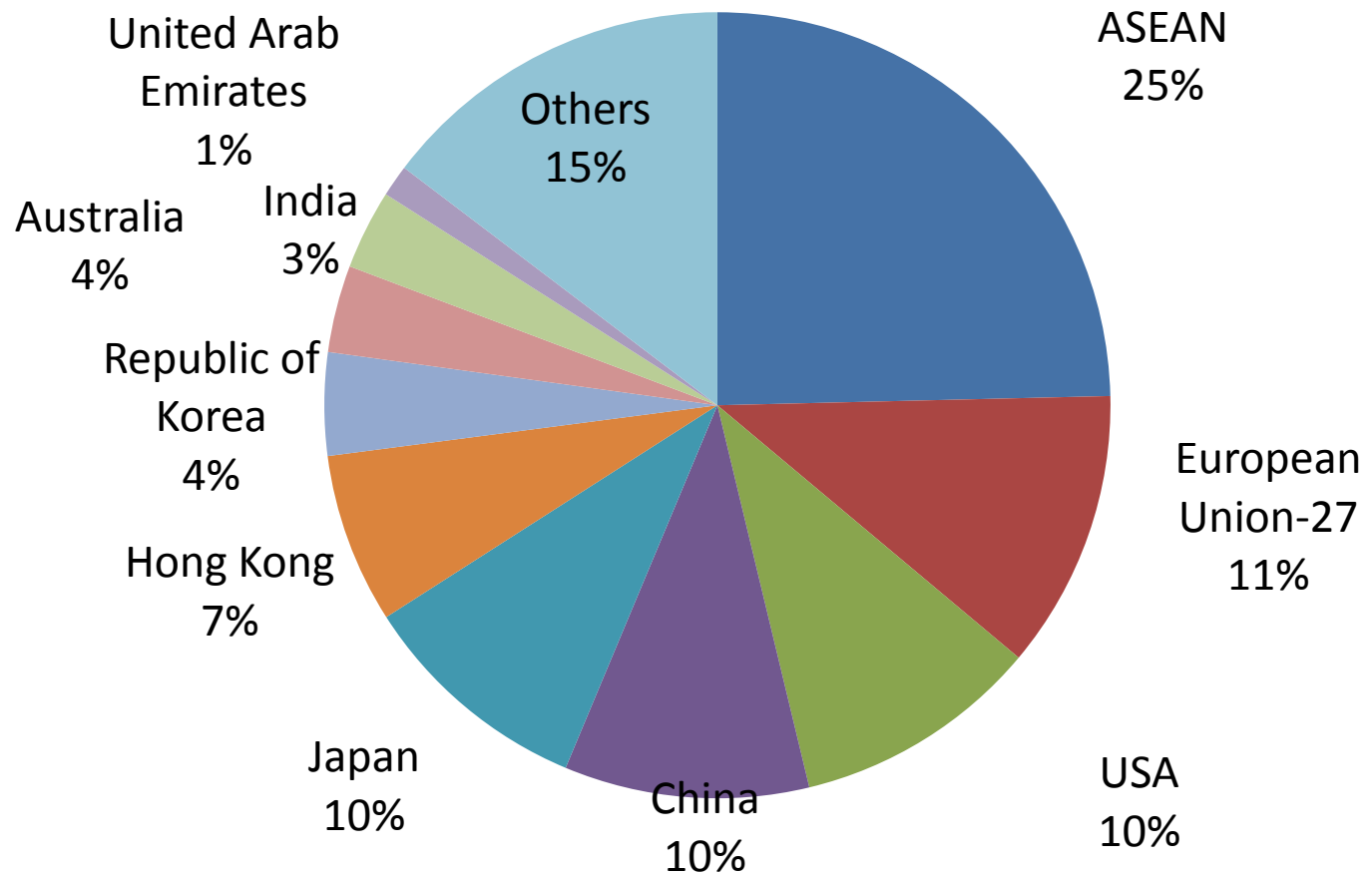
# Transmission of shocks: *export market channel*



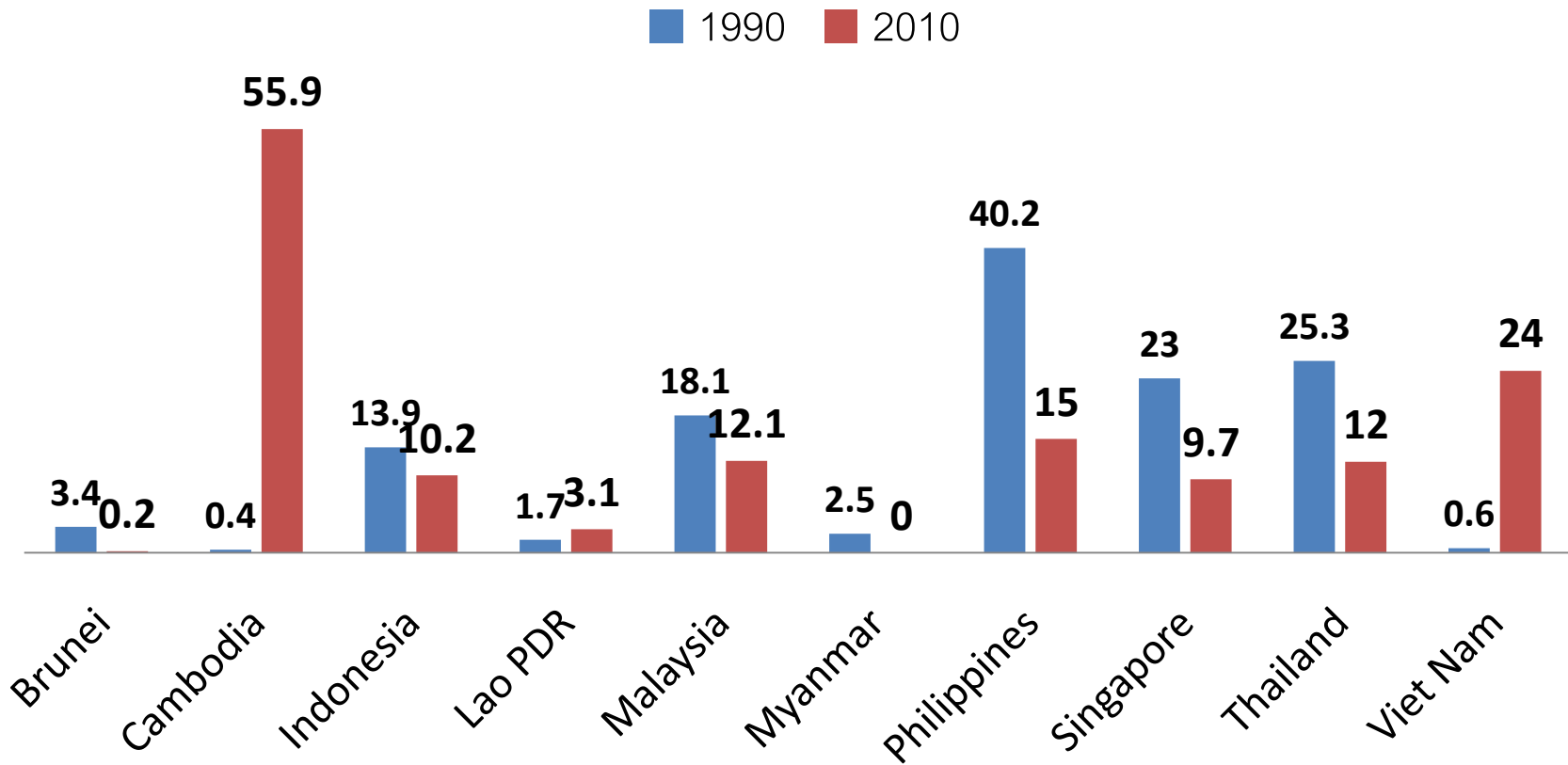
# Thailand's direction of exports



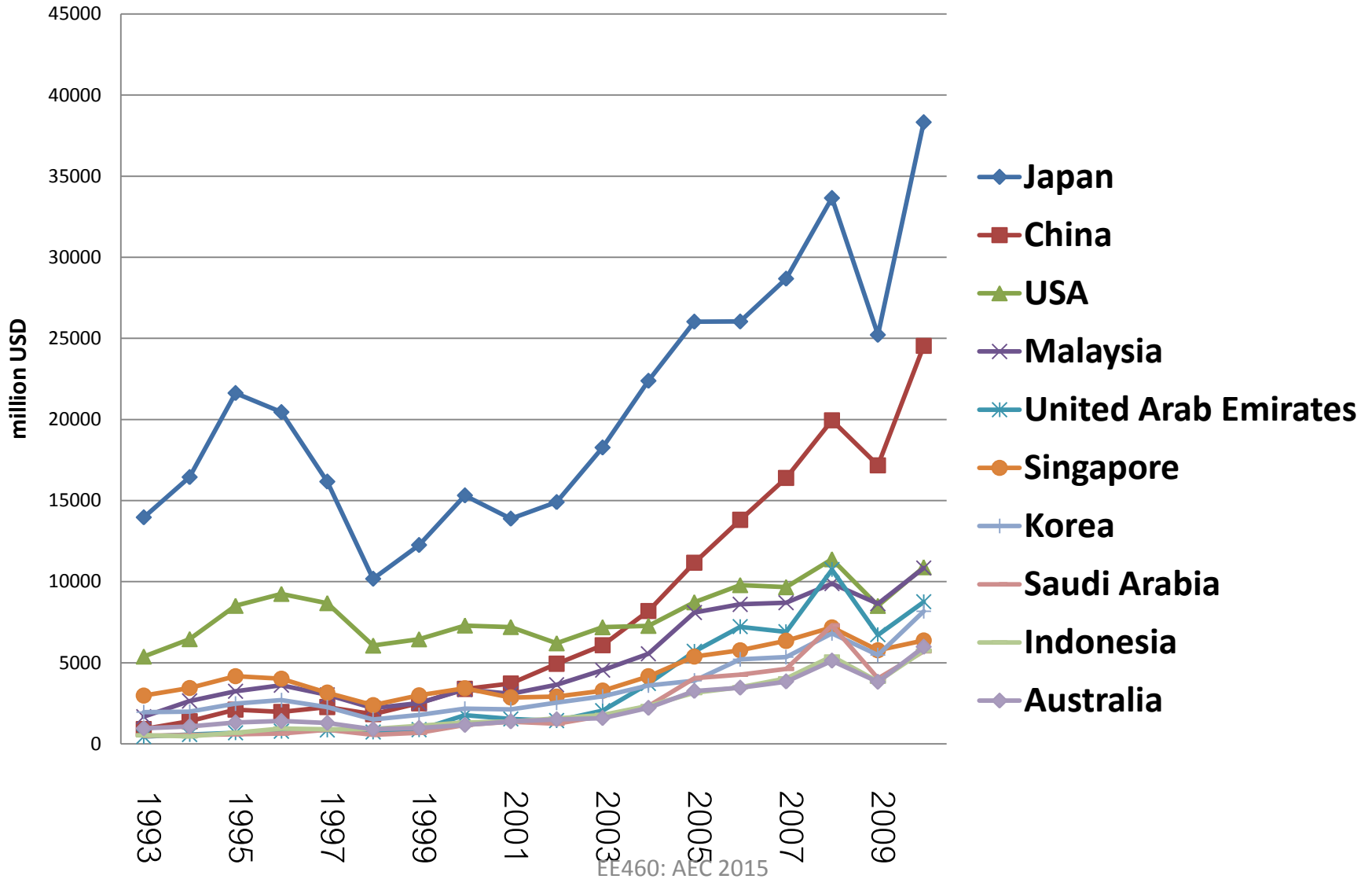
# Share of total ASEAN exports markets 2009



# ASEAN exports to North and Central America (% total exports)



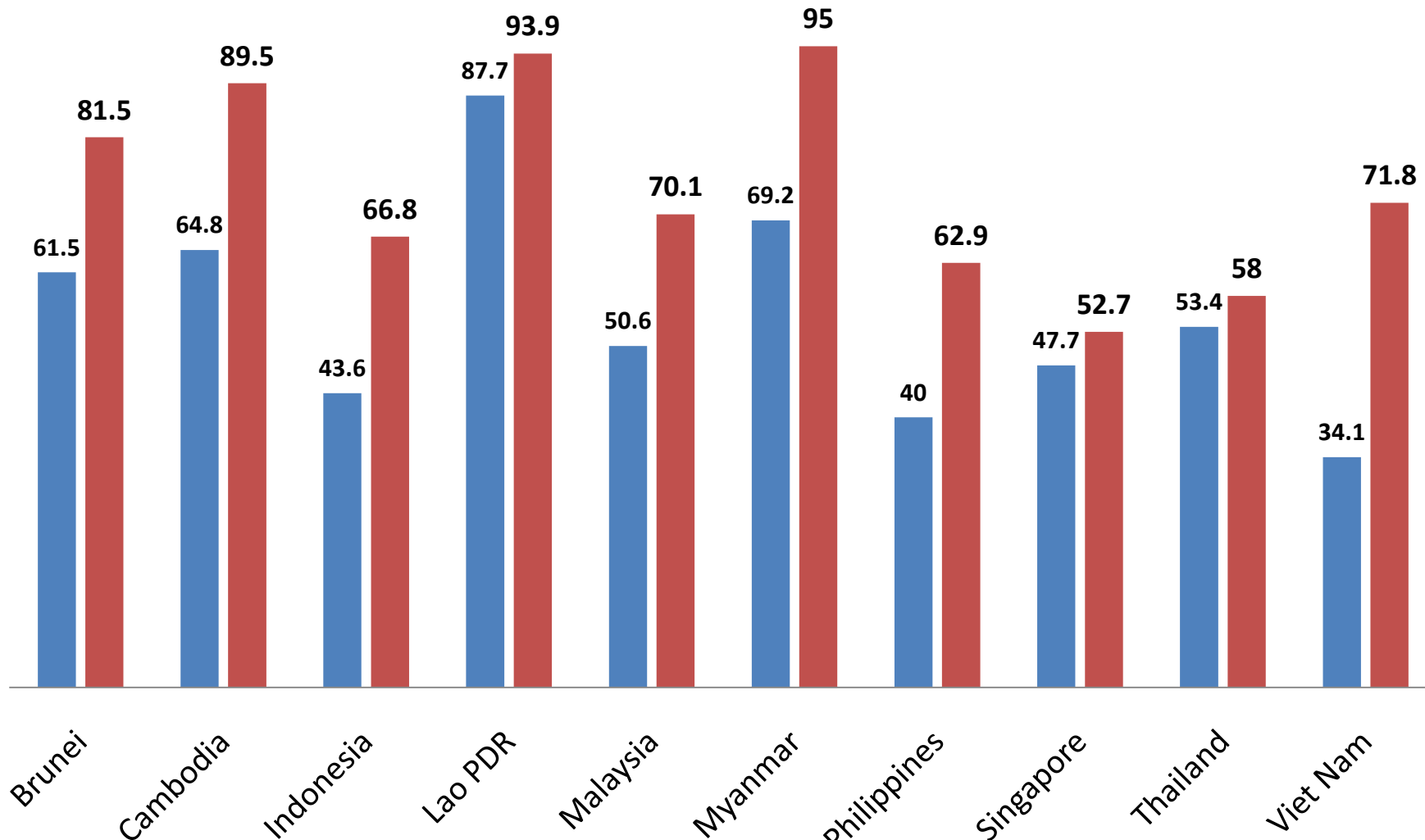
# Thailand's Imports origin



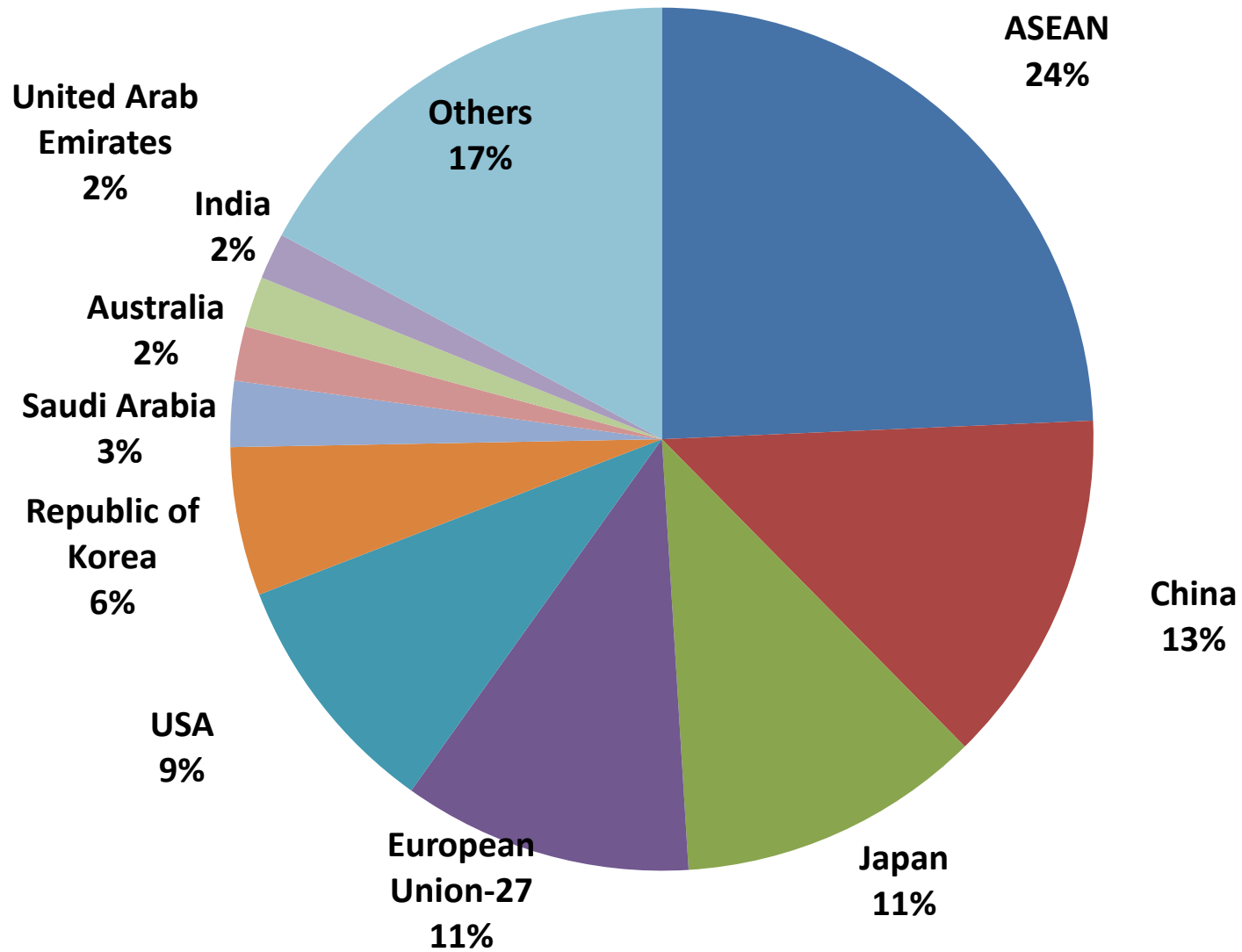
# Trade integration within Asia

## Imports from Asia (% total imports)

1990 2010

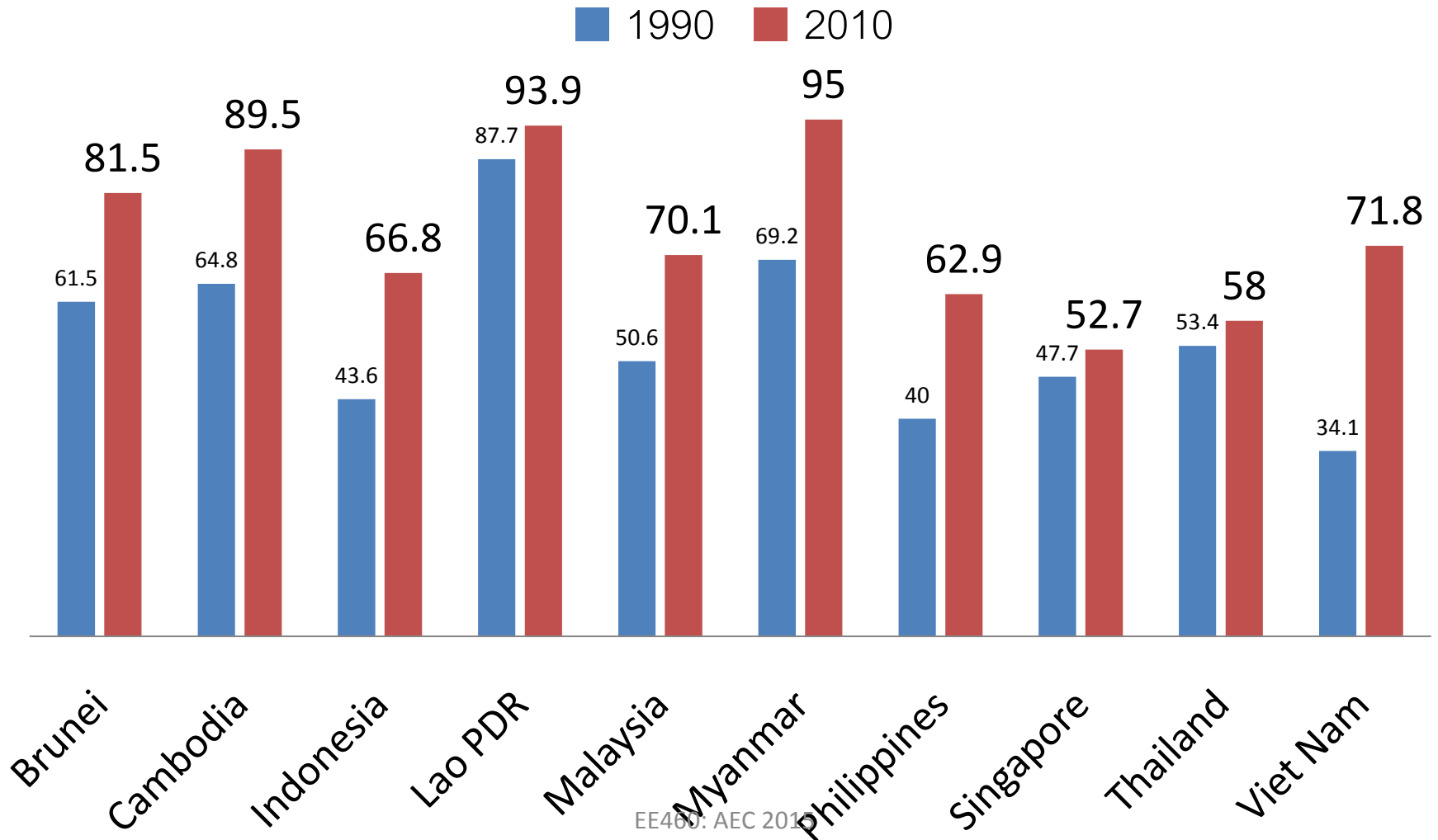


# ASEAN Imports Origins (2009)



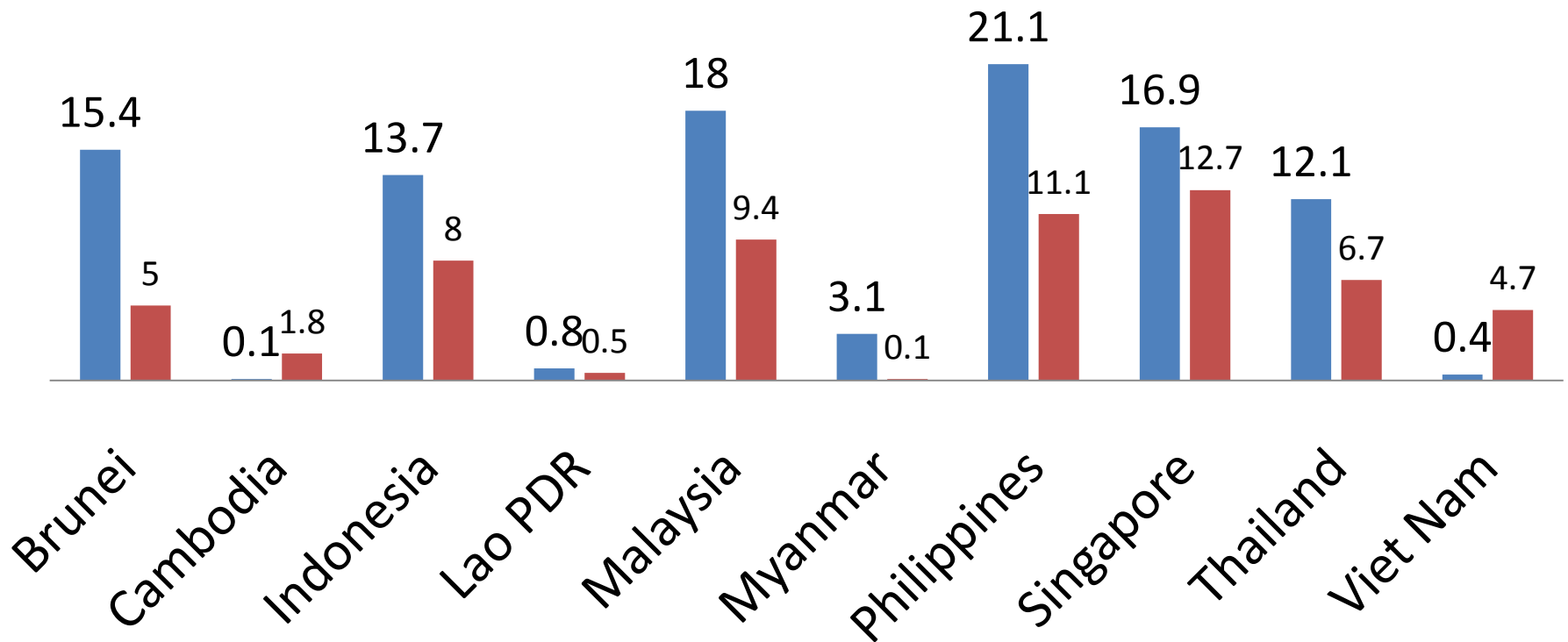
# Direction of Merchandise Trade: Asia

## Imports (% total imports)

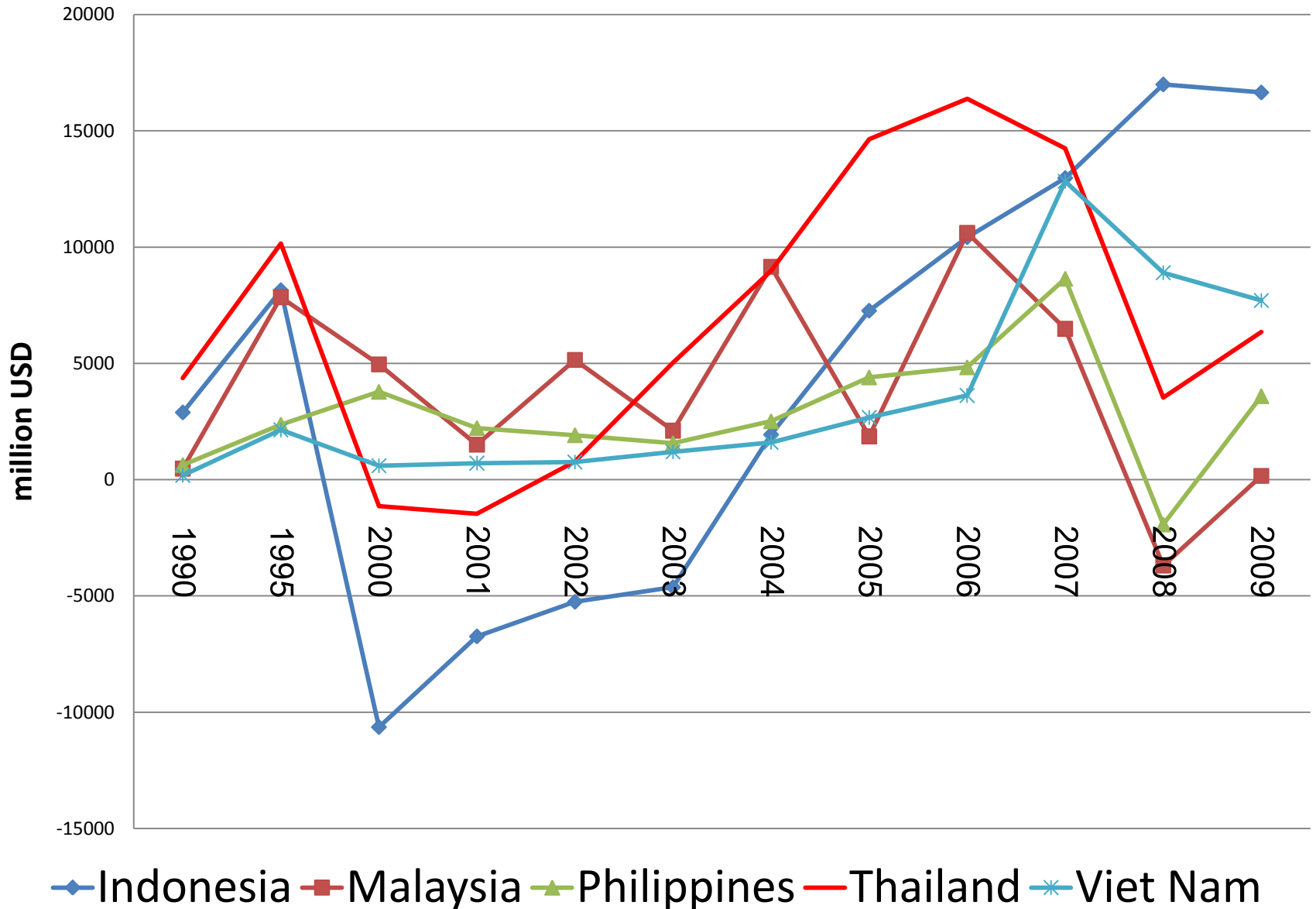


# Imports from North and Central America (% total imports)

■ 1990 ■ 2010

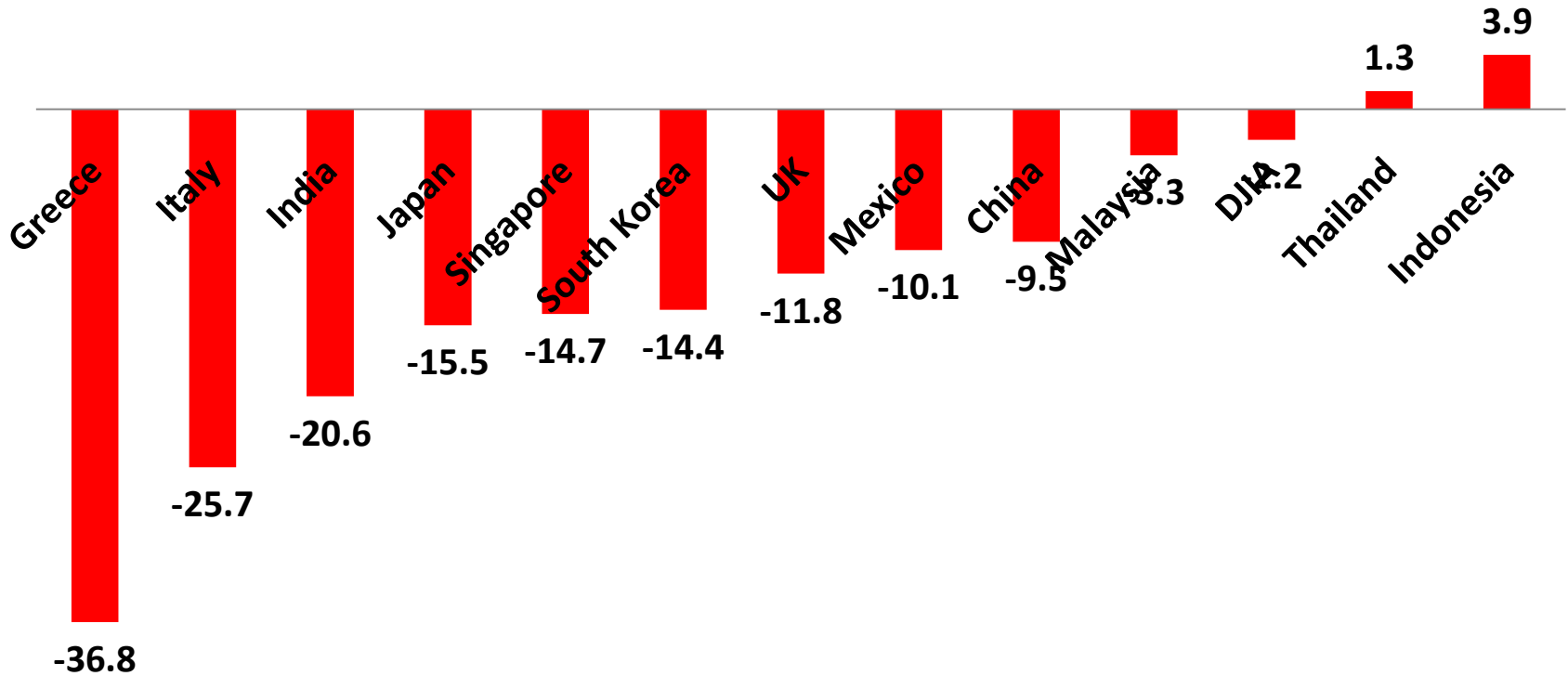


# Net Private Capital Inflows

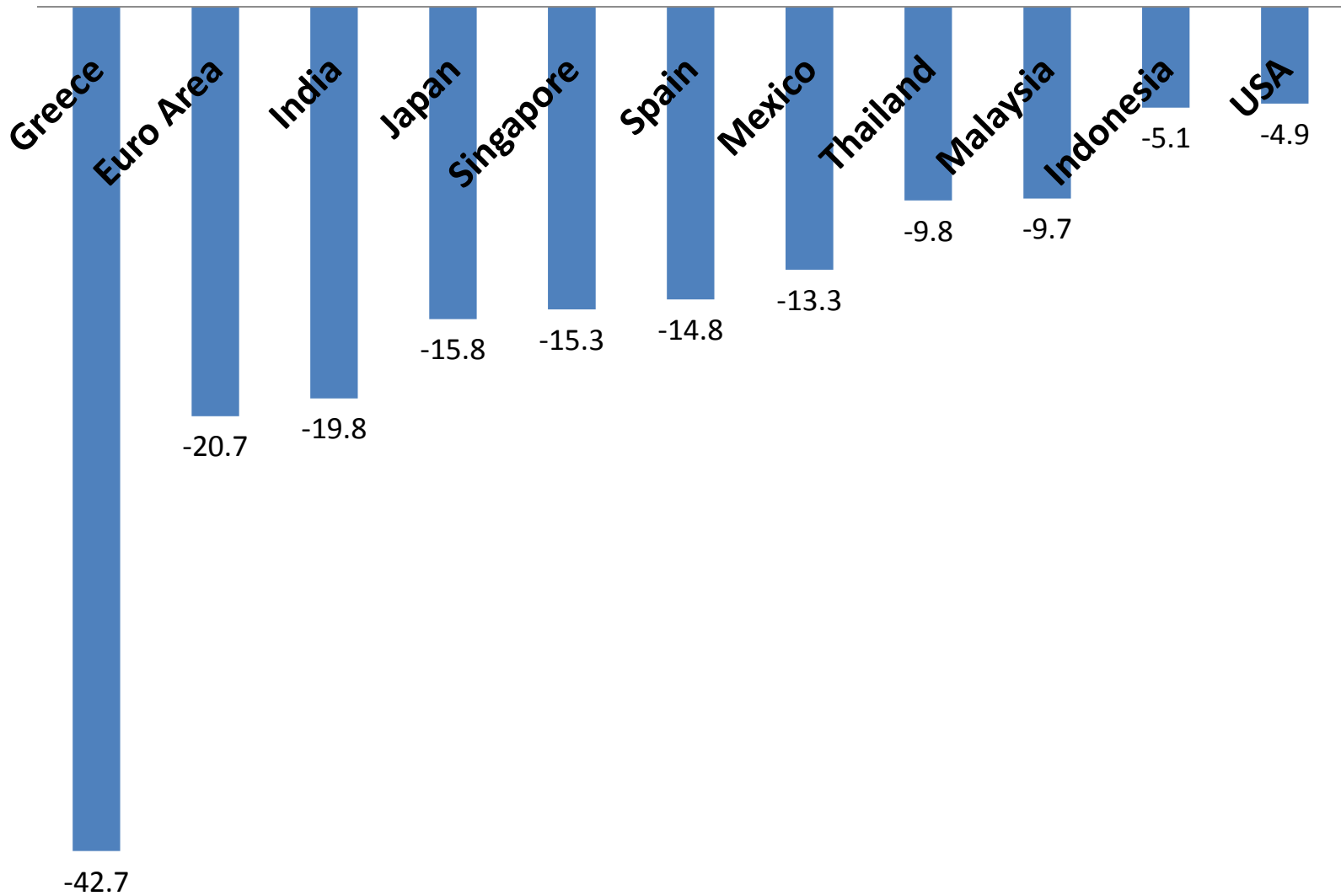


# Transmission of shocks: Capital market channel

% change on Dec 31st 2010  
Stock Indexes: Aug 24th, 2011



# Stock price index on 28 Sep 2011) (% change from Dec 31, 2010)



## Asian labour markets

Selected countries, annual average % increase  
2000-10



Source: Asian Development Bank  
EE460: AEC 2015

Long-term unemployment can lead to labor marginalization through depreciation of skills and a loss of motivation



# Tax reform

- Reduction in corporate income tax rate affects the effectiveness of fiscal automatic stabilizers.
- Tax revenue structure reflects output and employment structure.
- Difficult to imitate tax structure in countries with higher level of development

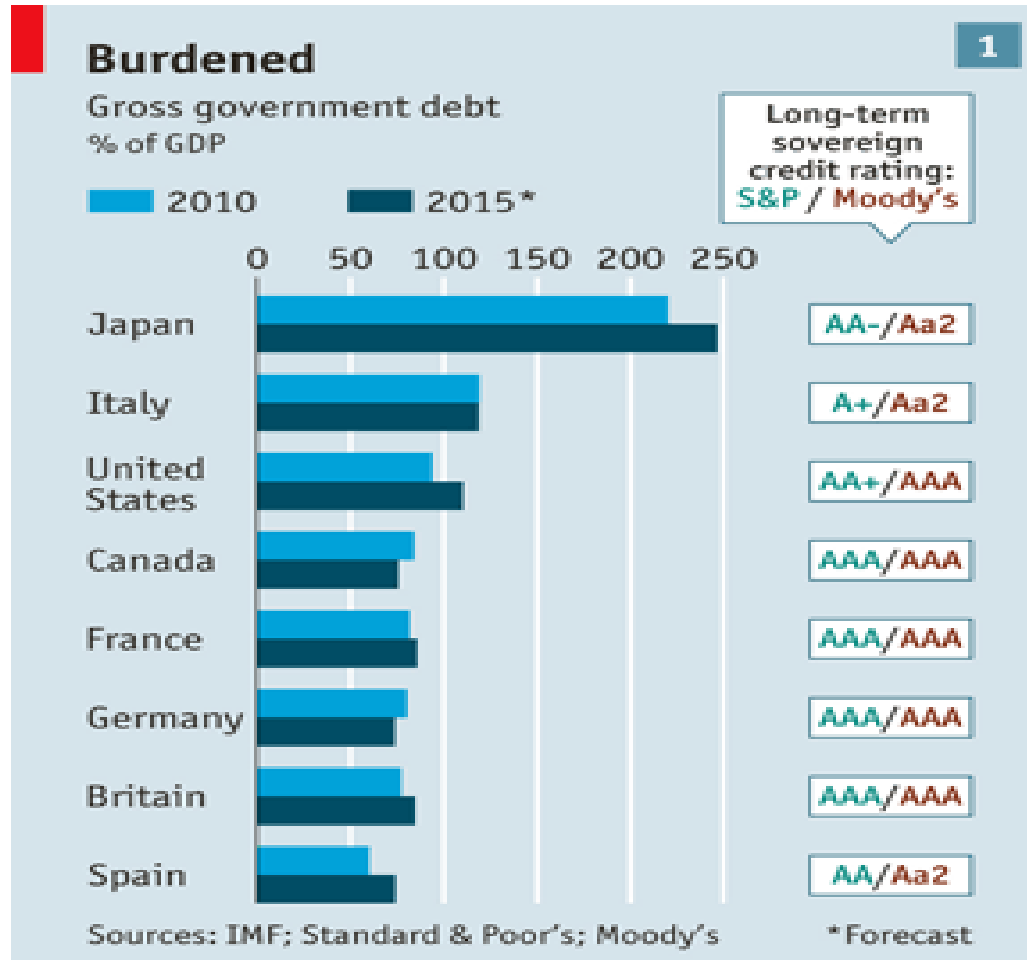
# Don't say no to domestic reform

- Integrating the Thai economy with the regional trade bloc can serve as an instrument to speed up **domestic reform**.
- **Temporary subsidies** to adversely *affected* industries are required to ease adjustment costs.
- **Firm datelines** imposed by AEC imply more enthusiastic efforts to carry out difficult reform.

# The big push

- Utilization of free trade provisions remain relatively low due to high marginal transaction costs imposed by Rules of Origin.
- Watch out: Non-tariff barriers are substitutes for tariff reduction.
- Sensitive commodities are dictated by political interest.
- A surge in the number of Thailand's FTA negotiations should not be interpreted as diminished **commitment** to the **multilateralism**.

# Lack of fiscal space: limit to fiscal stimulus



# Fiscal expenditure

- Productivity and human capital
- Health capital
- Focus spending on high-social rate of return
- Avoid fiscal splurge
- Spender of the last resort

# Monetary space

- Lender of the last resort: the role of central bank
- Too big-to-fail syndrome
- Inflation convergence
- Monetary policy instruments
- Monetary autonomy
- Capital controls?

# After 2015: Need prudential regulations

- Internal and external shocks will be more frequent.
- Maintain prudential rules and regulations to provide sufficient fiscal space when the time comes.
- Reduce debt-to-GDP ratio to 40% during economic upturn to provide ample fiscal space for the next downturn.

# Beyond the integration

- Labor migration and wage differentials
- Income convergence
- Low unemployment
- Price stability
- Crisis contagion
- Poverty
- Income inequality

## Mostly getting worse

Income inequality, Gini coefficient\*

Mid-1980s

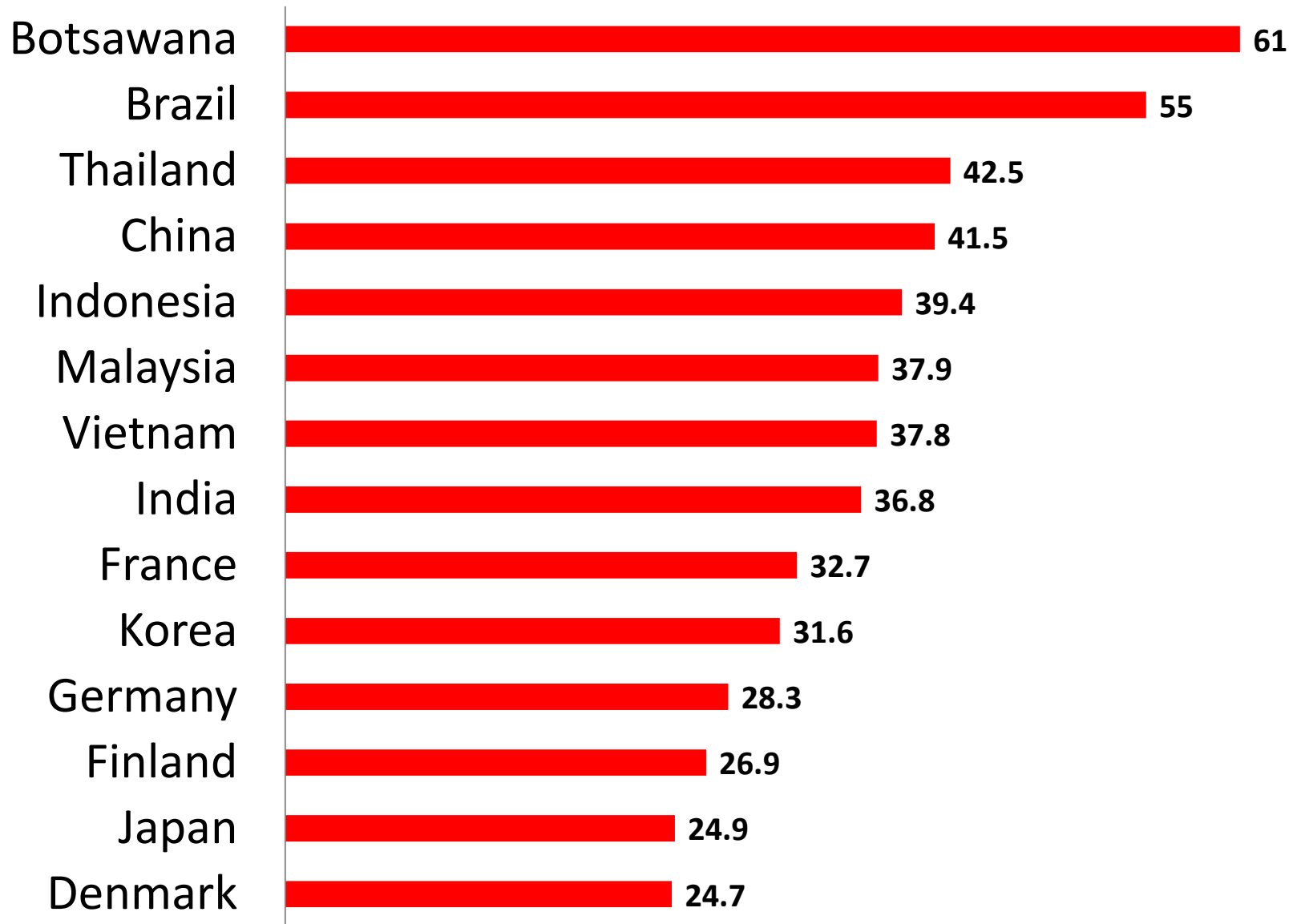
Late 2000s



Source: OECD

\*0=complete equality, 1=complete inequality

### Gini coefficient: 1992-2007



# The way forward: After 2015

- The baht exchange rate must be allowed to move more freely to cushion export fluctuations—less intervention.
- Don't have too much high hope on the Asian Economic Community
- Its main benefit would be the breakup domestic monopoly power
- Be cautiously optimistic

# Conclusion

- Integration of Thailand with ASEAN Economic Community is going ahead as scheduled.
- Direct investment can be promoted with revival of investment opportunity
- Thailand and ASEAN nations are facing similar economic problems: income distribution, lack of quality employment, and monopoly.
- Lessons can be learned from each other by examining policy mistakes in the past.