

Regional Integration: ASEAN Economic Community (AEC) and RCEP

Mr. Bhanupong

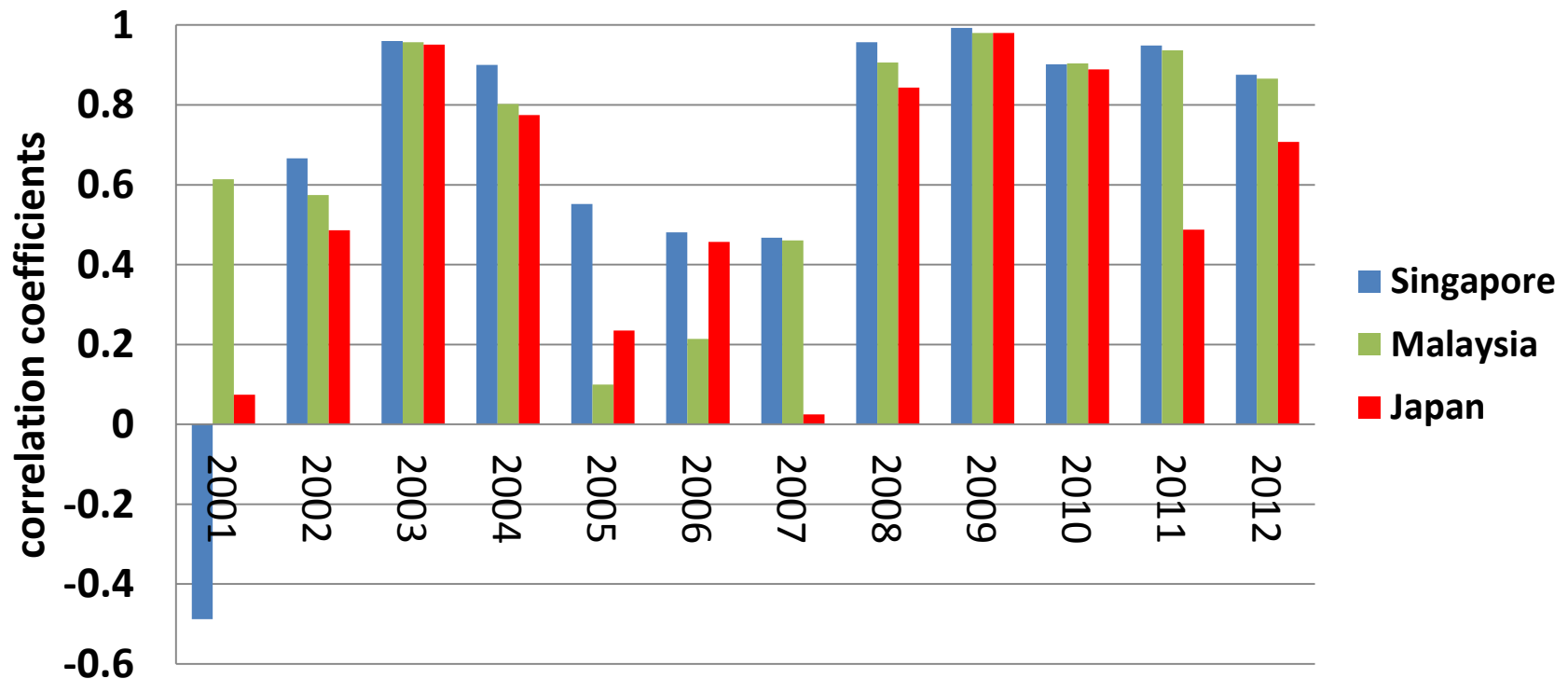
Lecture 19

Outline

- ASEAN integration: Trade, investment, and capital flows
- Infrastructure development plans
- Factor Endowment Theory of Trade
- New economic geography
- New regionalism: Multiple Free Trade Agreements
- AEC: Progress and challenges
- TPP vs RCEP

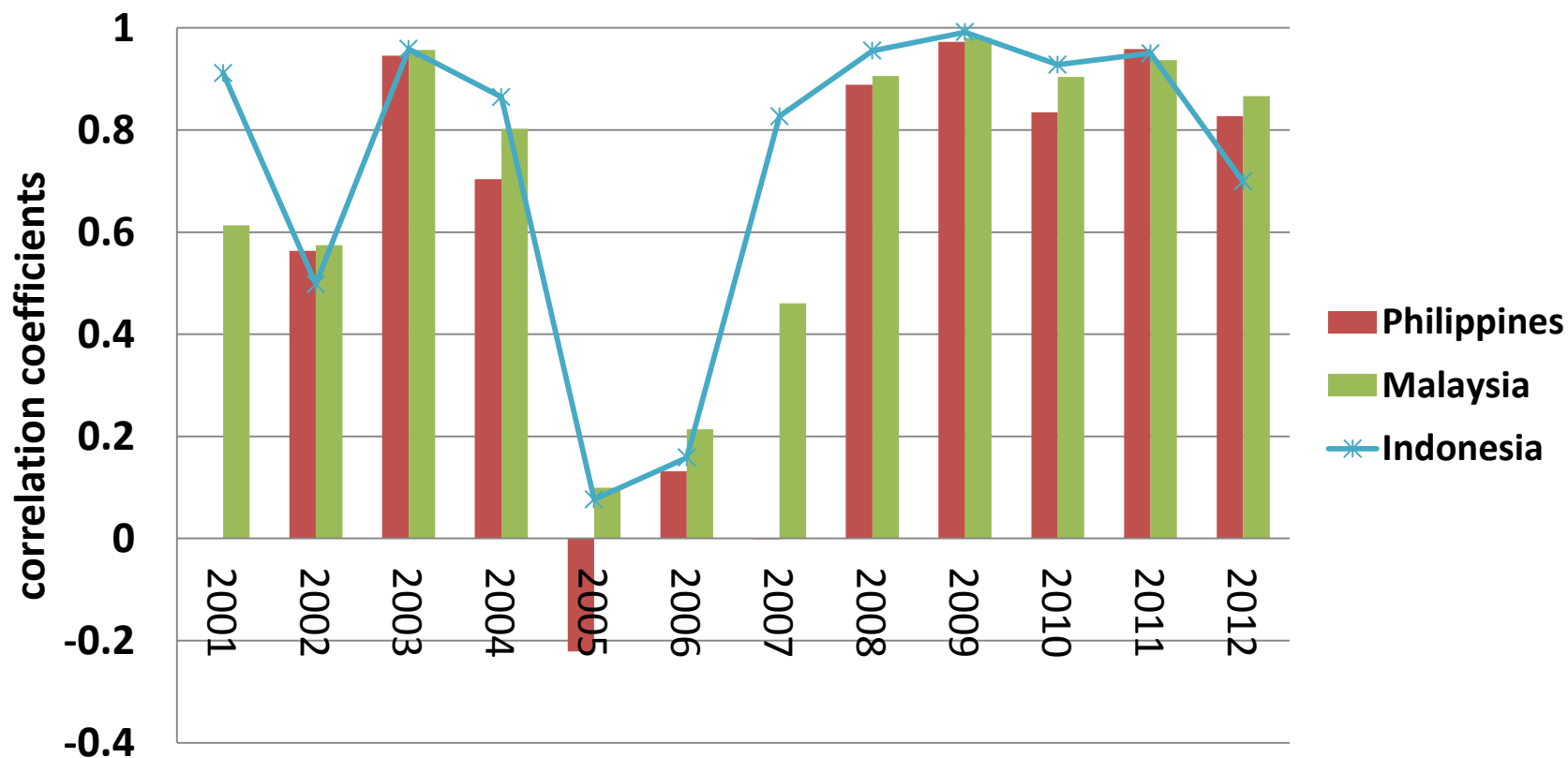
Integration indicators

Correlation coefficients of Thailand's stock market returns (% change in stock prices)



Integration indicators

Correlation of Thailand's stock market returns



Integration via FDI

- Cumulative foreign direct investment (FDI) share is the percentage of regional FDI inflows to total FDI from the investing region beginning 1995.
- A higher share indicates a stronger preference for the region and a higher degree of integration.

Trade intensity index

- The trade intensity statistic is the ratio of two trade shares.
- The numerator is the country's trade share to the area under investigation.
- The denominator is the share of trade of the country in the world.
- The statistic tells us whether or not a region trade more (as a percentage) to a given destination than the world does on average.
- It is interpreted in much the same way as an export share.

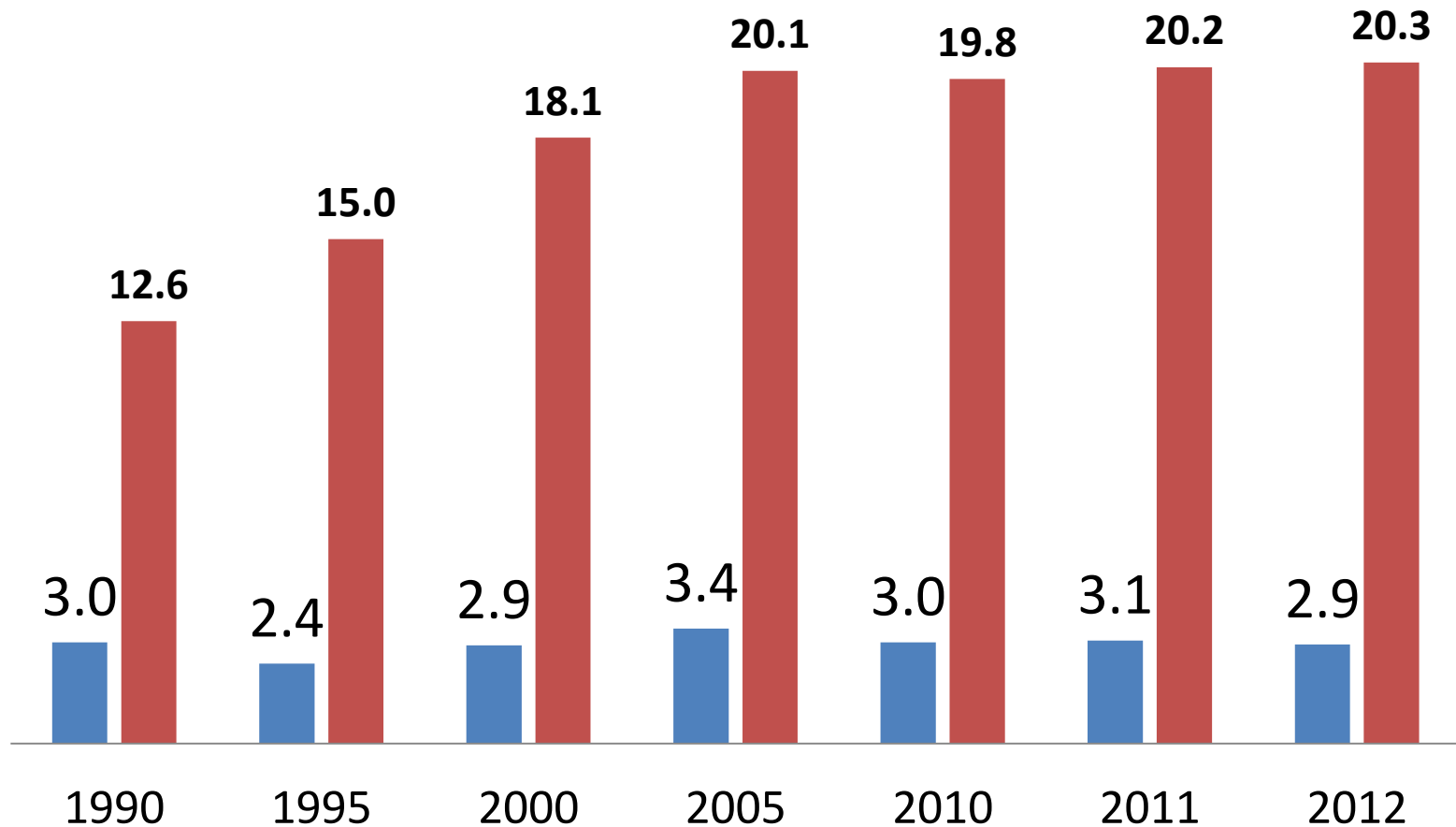
Trade share

Trade share is the percentage of trade with a region to total trade of a country.

A higher share indicates a higher degree of integration between the country and the region.

Thailand: Trade with ASEAN partners

■ Trade Intensity Index ■ Trade Share (%)



Thailand's changing export intensity

Indicator	Partner	1990	1995	2000	2005	2010	2012
Export Intensity	European Union	0.52	0.4	0.42	0.35	0.32	0.29
Export Intensity	ASEAN	2.76	2.97	3.36	4.06	3.64	3.58
Export Intensity	United States	1.56	1.14	1.15	1	0.88	0.84

Thailand's changing export shares

Indicator	Partner	1990	1995	2000	2005	2010	2012
Export Share (%)	ASEAN	11.92	19.79	19.34	21.99	22.93	24.71
Export Share (%)	United States	22.71	16.74	21.32	15.39	10.47	9.94
Export Share (%)	European Union	23.38	16	16.3	13.57	11.18	9.43

Engaging in foreign trade

- Thailand has increasingly become an ***integral part*** of the ***world*** economy.
- The degree of ***Asian regional integration*** of Thailand has been ***more*** pronounced through foreign investment in product fragmentation.

ASEAN achievements

- Common Effective Preferential Tariff (CEPT) rates are zero for ASEAN-6.
- More than 70% of intra-ASEAN trade are now tariff free, and less than 5% subject to tariff above 10%.
- ASEAN-6 are near achieving international best practices in investment liberalization and facilitation.
- Agreement on mutual recognition agreements (MRAs) on service liberalization on three types of goods and seven professions.

AEC Deadline: 2015

- The tariff rates among ASEAN countries were cut to 5 percent in 2005, covering about 95 percent of intra-ASEAN trade.
- Fully liberalized trade among ASEAN took place in 2010; for the *new* members (CLMV) by **2015**.
- The deadline has been set at **2015** for the establishment of ***ASEAN Economic Community*** (AEC).

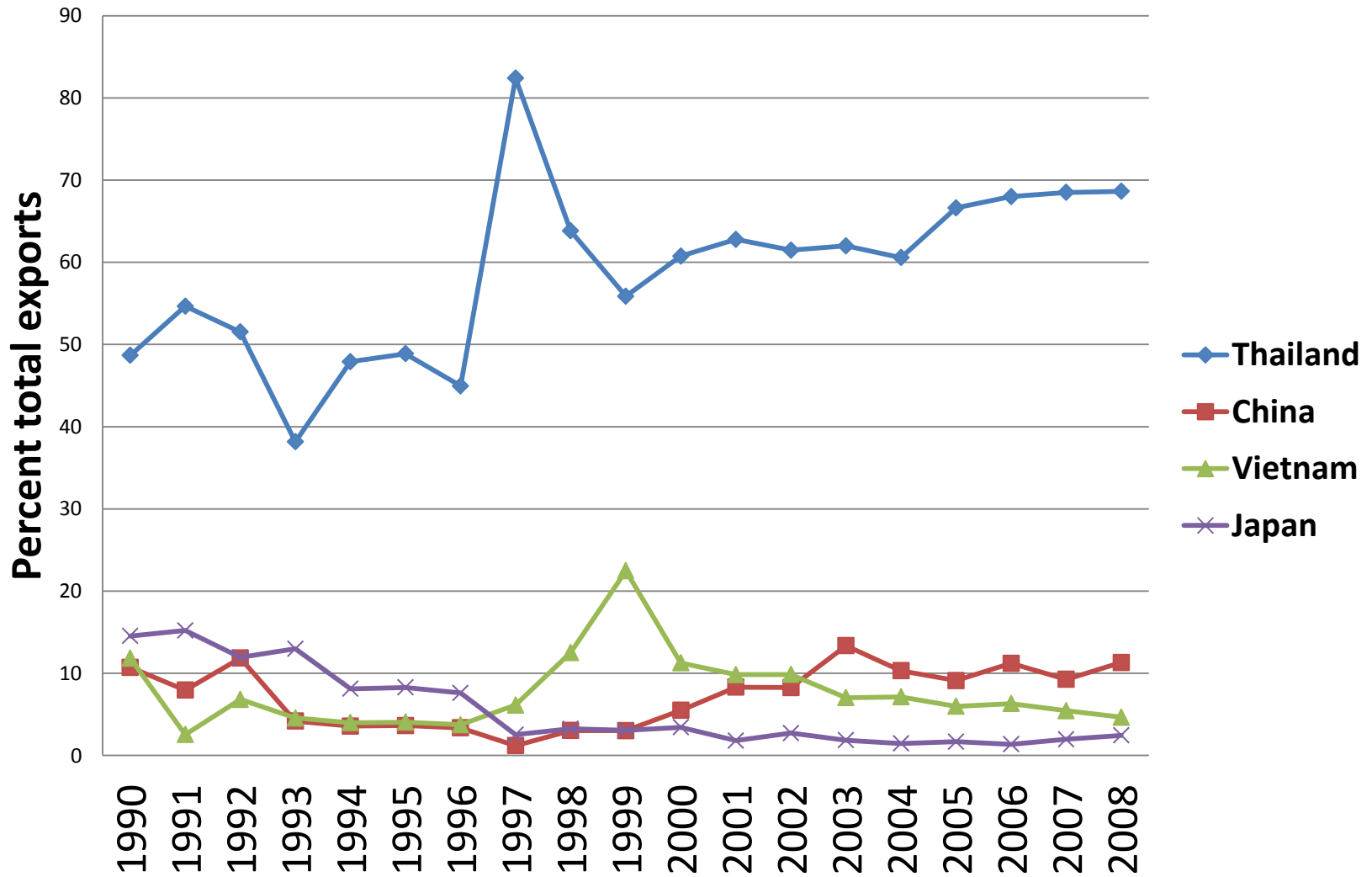
AEC Background

- AFTA (Asean Free Trade Agreement) has been the main vehicle prior to AEC.
- Thailand is the key proponent that brokered AFTA
- Ambitious liberalization program was achieved by original ASEAN members, reducing external tariffs among members.
- AFTA has accelerated the pace of multilateral trade liberalization in the ASEAN-6.
- The long-standing commitment of ASEAN-6 to openness.

Remaining Challenges

- December 31, 2015 will not see ASEAN achieving *all* of its AEC targets.
- Removing barriers to trade in sensitive areas: agriculture, steel, and important services.
- Removing behind-the-border constraints related to logistics, transport, and infrastructure.
- Promoting greater labor mobility to include unskilled not just skilled labor

Laos' export destinations



Regional economic bloc in Asia

- FDI in Asian region had been *declining*; a large part of investment was diverted into China.
- For restoring the attractiveness of FDI in the region, ASEAN countries formed a **regional economic bloc** to *attract* foreign direct investment.
- Since Japan and Hong Kong are the largest investors in Thailand, the idea of establishing **ASEAN plus 3** and **ASEAN Economic Community** (AEC) provides some hope and lessens the fear of losing FDI to China.

Greater Mekhong Subregion

- GMS nations, comprising Cambodia, Laos, Myanmar, Thailand, Vietnam, and **Yunnan** province in China, have agreed to promote trade and investment in the region.
- Asian Development Bank provided loans worth 770 million USD to finance transportation projects by establishing ***networks of roads*** between GMS countries and building bridges across Mekong River.

GMS Economic Corridors

- The ***East-West Economic Corridor*** (R9) connects 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, connecting roads passing through **Khon Khan** and **Phitsanulok** in **Thailand**, and **Suvanakhet** in **Laos**.
- The ***North-South Economic Corridor*** (R3-through Myanmar)
Chiang Rai province in Northern Thailand can be linked to Kunming in Yunnan via roads passing through Myanmar
- **Infrastructure-led growth Hypothesis**
If this hypothesis is correct, heavy investment in GMS economic corridors would stimulate regional trade and growth in the region.

Routes to link three ASEAN countries

- Laos and Vietnam jointly opened a highway for trucks in June 2009.
- The road is aimed to facilitate low-cost freight transportation.
- The 500-kilometre route links Thailand's northeastern province of Mukdahan with Laos' Suvannakhet and its Dansavan trade zone, and Vietnam's Lao bao.

Infrastructure development and **investment creation** effect of regional integration

- **Trade creation** effect may not be as high as previously expected from Free Trade Agreement
- But the impact on **Investment creation** would be substantial within the region

North-South Economic Corridors and **non-tariff trade cost**

- Another route on the North-South Economic Corridor, goods can also be transported from Kunming to Chiang Rai via **Laos**.
- Bangkok can also 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 sea ports.

North-South Economic Corridors and **non-tariff trade cost**

- The planned **road networks** would **connect** six countries in the Greater Mekong Region, integrating these countries geographically more than ever.
- ***The GMS sub-regional trading bloc is a natural consequence of a reduction in non-tariff trade cost, reinforcing the trade pattern which reflects comparative advantage.***

Thailand is at disadvantage by high logistic costs

- The NESDB has set a five-year target to lower logistics costs from **19%** of GDP to 15% by the end of the 11th national economic and social development plan in 2016.
- The previous cabinet endorsed a rail system overhaul worth 1.7 trillion baht, including upgrading 660 kilometers of existing track and signaling infrastructure, buying more locomotives, and constructing five double-track routes to the northern, northeastern and southern regions.
- The proposed budget for infrastructure development by Ying Luck Government was 2.2 trillion baht.

To reduce logistic costs

- Logistics costs relative to Thailand's gross domestic product (GDP) fell just one percentage point in 2010 year from 2009, due mainly to higher oil prices and interest rates.
- **Rising oil prices** have had a significant impact on logistics costs because the country is so overwhelmingly dependent on **road transport**.
- Evaluate the newly proposed 3.3 trillion baht infrastructure projects of the PC-O-C government to connect Thailand with neighboring countries with high speed train.

Southeast Asia regular and high speed rail network likely to be substantially complete by 2022

The proposed network consists of three main routes from Kunming, China to Bangkok, Thailand:

the Eastern Route via Vietnam and Cambodia;

the Central Route via Laos, and the Western Route via Myanmar.

The southern half of network from Bangkok to Singapore has long been operational, though a high-speed line has been proposed.



High Speed Train

- As of January 2014, construction of sections connecting China with Vietnam, China with Myanmar and Laos with Vietnam are under way.

China is helping Thailand to build High speed rail starting in 2015. Laos and the Singapore -Malaysia high speed rail sections appear likely to be agreed this year with Chinese construction companies.

[China Railway Construction Corporation \(CRCC\)](#) looks likely to win the bid for the first Southeast Asia high-speed railway line stretching from Kuala Lumpur to Singapore, expected to begin construction in 2016.

Connecting China with Vietnam, China with Myanmar and Laos with Vietnam



From Kunming to Singapore



High-speed trains connecting Thai cities

- In 2014, General Prayut (Thai PM) announced plans to build two high-speed rail lines as a part of 741 billion baht transportation program.
- The Nong Khai to Map Ta Phut line, 737 kilometres (458 mi) in length, would run from the Laotian border near Vientiane to the Gulf of Thailand.
- The Chiang Khong to Ban Phachi line, 655 kilometres (407 mi) in length, would run from Chiang Rai near the northern tip of Thailand to Ayutthaya just north of Bangkok.
- The two lines would allow trains to travel at a top speed of **160 km/h**. Construction is scheduled to begin in 2015 and will be completed in 2021.

Love me, let me borrow your money

- In November 2014, after a meeting between Li Keqiang and Prayut Chan-o-cha, China agreed to lend Thailand funds to build dual-track standard gauge mid-speed railways on the Bangkok-Nong Khai, Bangkok-Map Ta Phut, and Kaeng Khoi-Map Ta Phut routes.
- The loans could be repaid with rice and rubber. On December 4, 2014, the Thai National Legislative Assembly voted 187-0 with seven abstentions to approve loans for the Nong Khai-Map Ta Phut and Kaeng Khoi-Bangkok lines.
- China would undertake construction and development of the lines but would not receive land use rights along the routes.
- On December 19, 2014, the two countries signed a memorandum to build the railways.

Factor endowment theory of international trade

- Until the end of the 1970s, the Heckscher-Ohlin theory for which Bertil Ohlin won the prize--Eli Heckscher died before the Nobel Prize in economics was instituted--dominated the field.
- This theory explained well why labor-abundant countries such as China exported labor-intensive products such as apparel, toys and footwear and capital-abundant countries such as the United States would export machinery and aircraft.
- What is Leontief paradox?

What factor endowment theory cannot explain

- But it could not satisfactorily explain the two-way trade that was widely known to exist:
- Many countries exported automobiles and televisions, but they also imported them (**Intra-industry trade**).
- The Heckscher-Ohlin theory also did not adequately explain why rich entities such as Europe and the United States, which had very similar endowments of capital and labor, traded **more intensively** than those with very dissimilar endowments.
- While descriptive explanations of these phenomena existed, a tight theory explaining them was lacking.

Krugman on product variety

- Starting in 1979, Krugman published a series of papers that successfully tackled these and many other related questions.
- He postulated that consumers like *variety* in what they consume.
- For the same expenditure, their satisfaction is greater if they have a larger variety of products available.
- This creates the incentive for firms to produce a large variety of products.

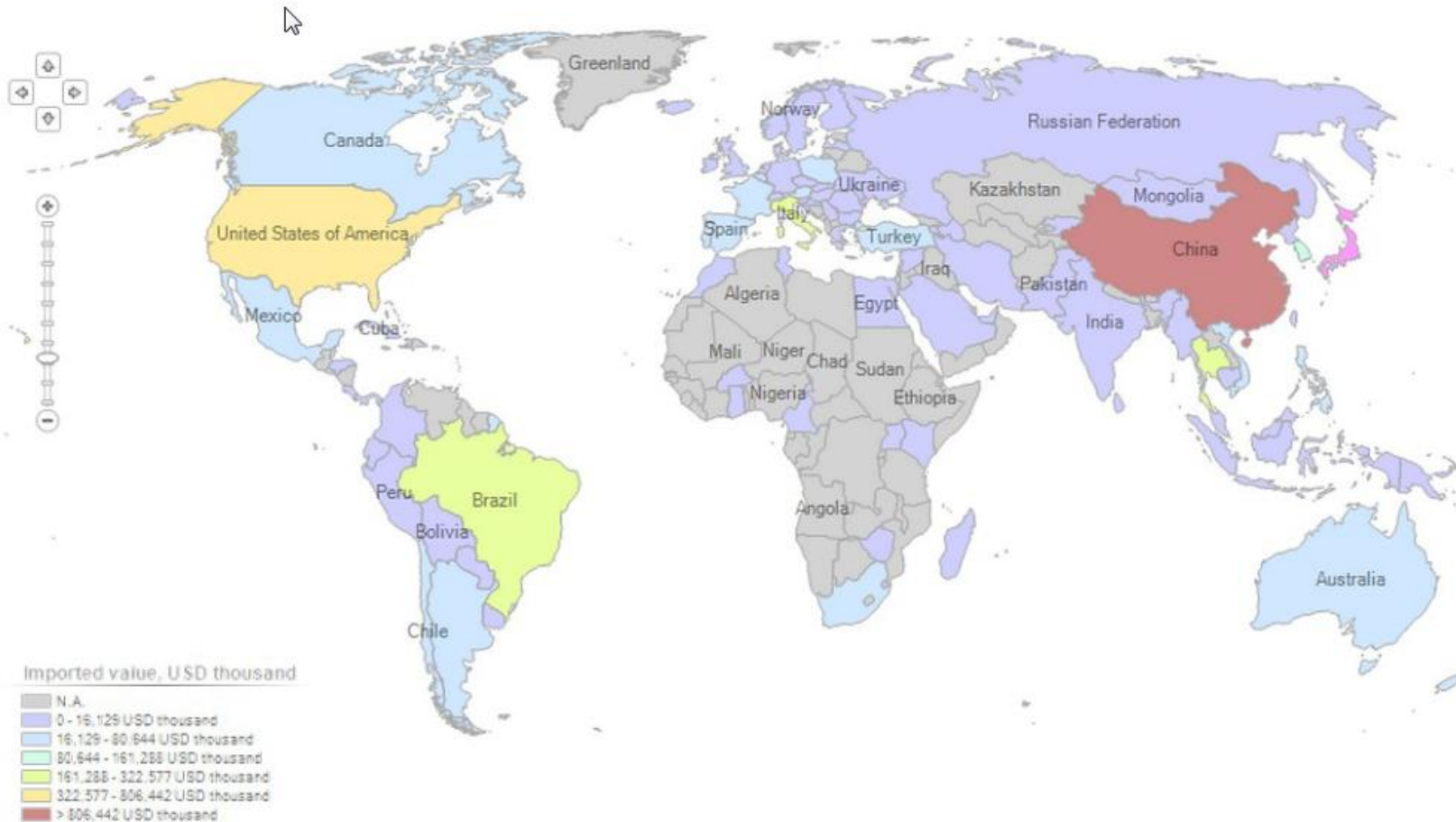
Market size and distance

- But the production of a new variety has setup costs. This leads to declining per-unit costs as a larger quantity of the variety is produced and places a limit on the number of varieties the market can profitably supply.
- ***A firm produces a new variety only if it can capture a large enough market to allow profitable sales.***
- Krugman won the Nobel Prize in 2008.
- Economies of scale (market size) explains **intra-industry** trade, while H-O theorem cannot.

Supplying markets for vegetables, fruit imported by Japan in 2013

List of supplying markets for a product imported by Japan in 2013

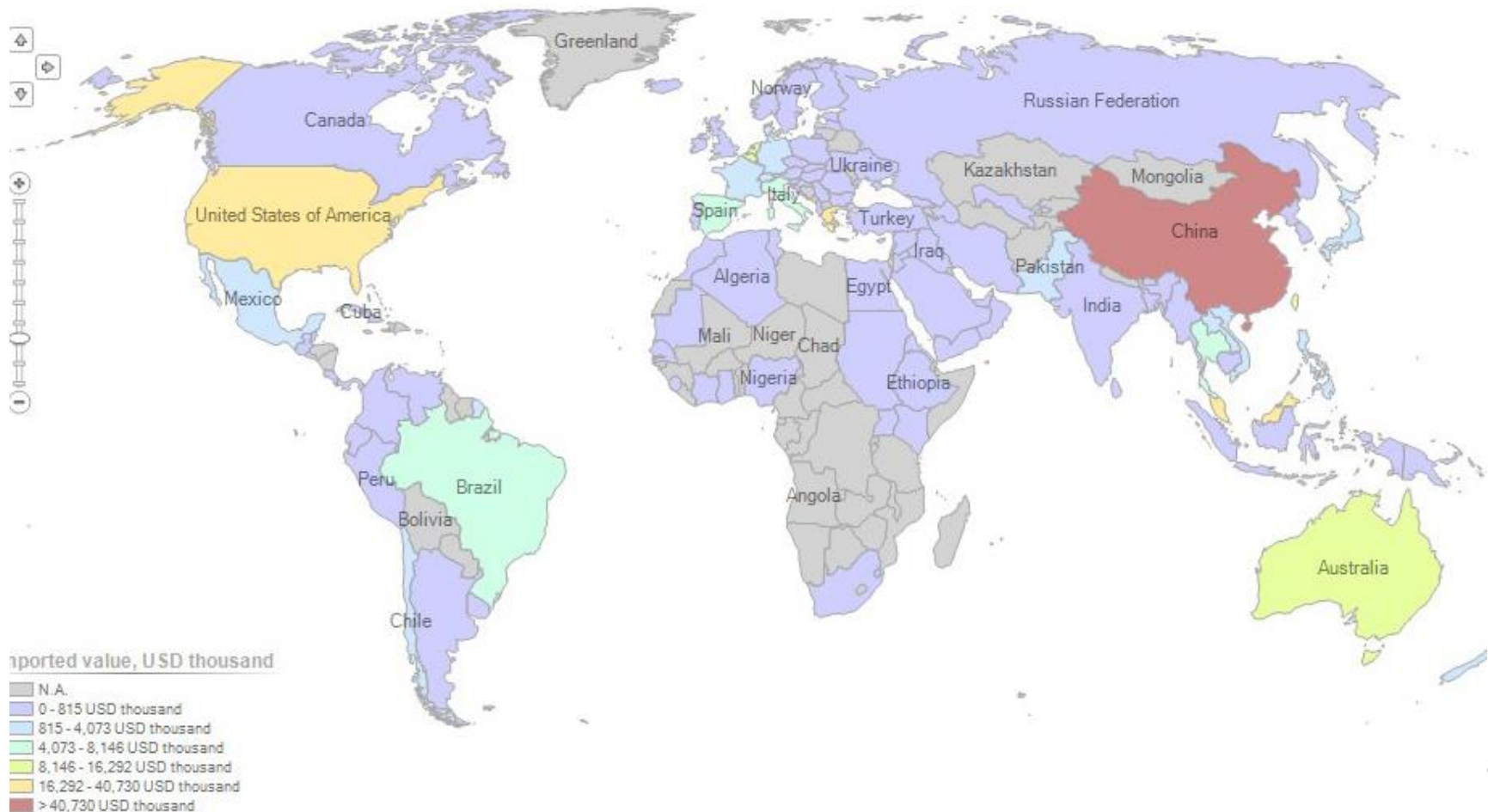
Product : 20 Vegetable, fruit, nut, etc food preparations



Supplying markets for vegetables, fruit imported by Thailand in 2013

List of supplying markets for a product imported by Thailand in 2013

Product : 20 Vegetable, fruit, nut, etc food preparations



New Economic Geography

Paul Krugman

- Transportation costs, or more broadly **transaction costs across distance**, play a crucial role in shaping international and interregional trade. (**Distance matters**)
- The interaction of **market size** with **increasing returns** plays an important role in determining the location of production. Home market effect is a major explanation of trade through differences in population density and localized specialization.

New Economic Geography

Paul Krugman

- A cumulative process in which **large markets attract production** leads to **agglomeration**.
- The same processes that shape economic geography **within** countries also shape international trade.

Newton and law of gravity

- Newton's law of gravity: the gravitational attraction between any two objects is proportional to the product of their masses and diminishes with distance.
- Large economies tend to spend large amounts of imports because they have large incomes.
- They tend to attract larger shares of other countries' spending because they produce a wide range of products.
- Trade between any two economies is larger, the larger in *either* economy.

Gravity model

- The value of trade between any two countries is proportional, other things equal, to the product of the two countries' GDP, and diminishes with the distance between the two countries.

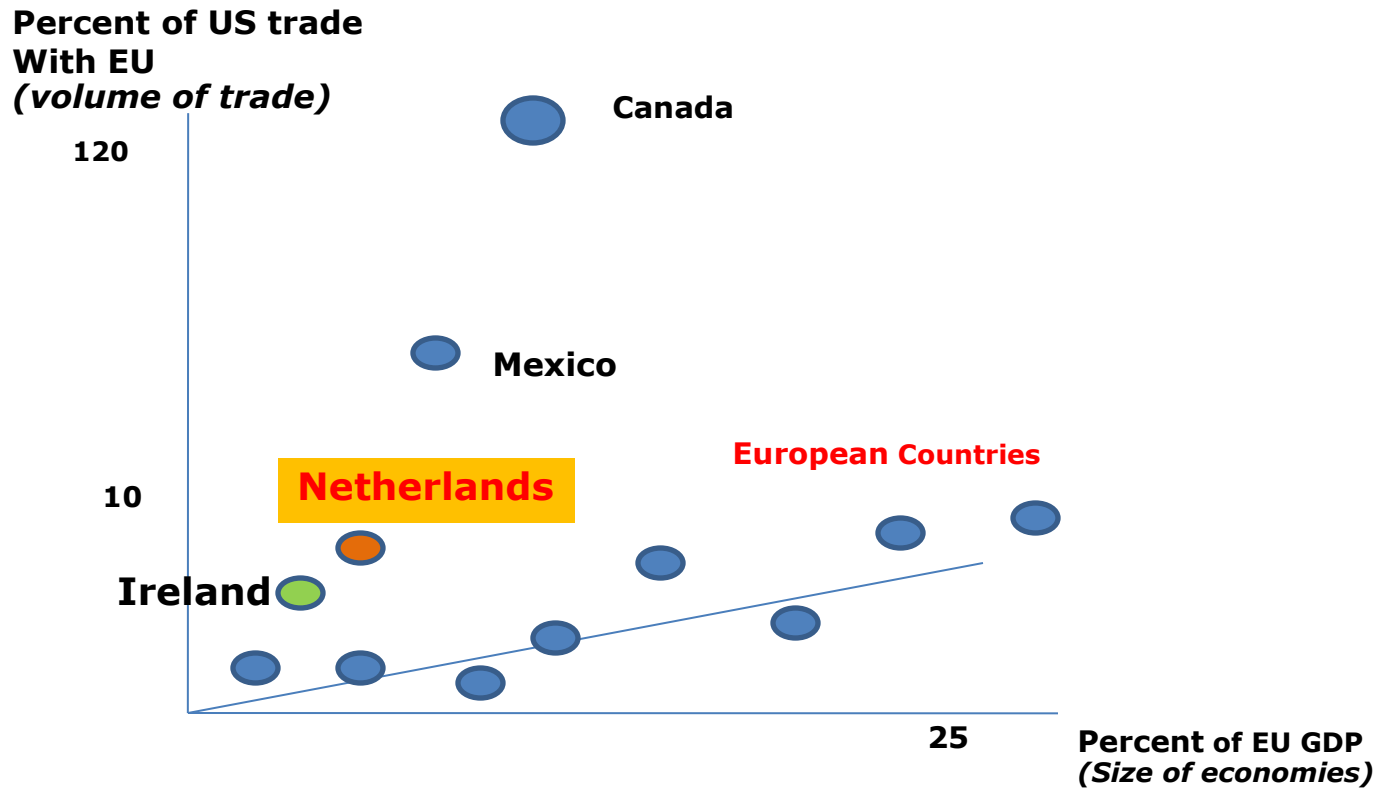
$$T_{ij} = AY_i^\alpha Y_j^\beta / D_{ij}^\delta$$

$$T_{ij} = AY_i^\alpha Y_j^\beta / D_{ij}^\delta$$

$$\log(T_{ij}) = \ln(A) + \alpha \log(Y_i) + \beta \log(Y_j) \\ - \delta \log(D_{ij}) + \varepsilon$$

Trade volume depends on sizes of both economies and the distance between them.

Size and distance matter for trade among nations

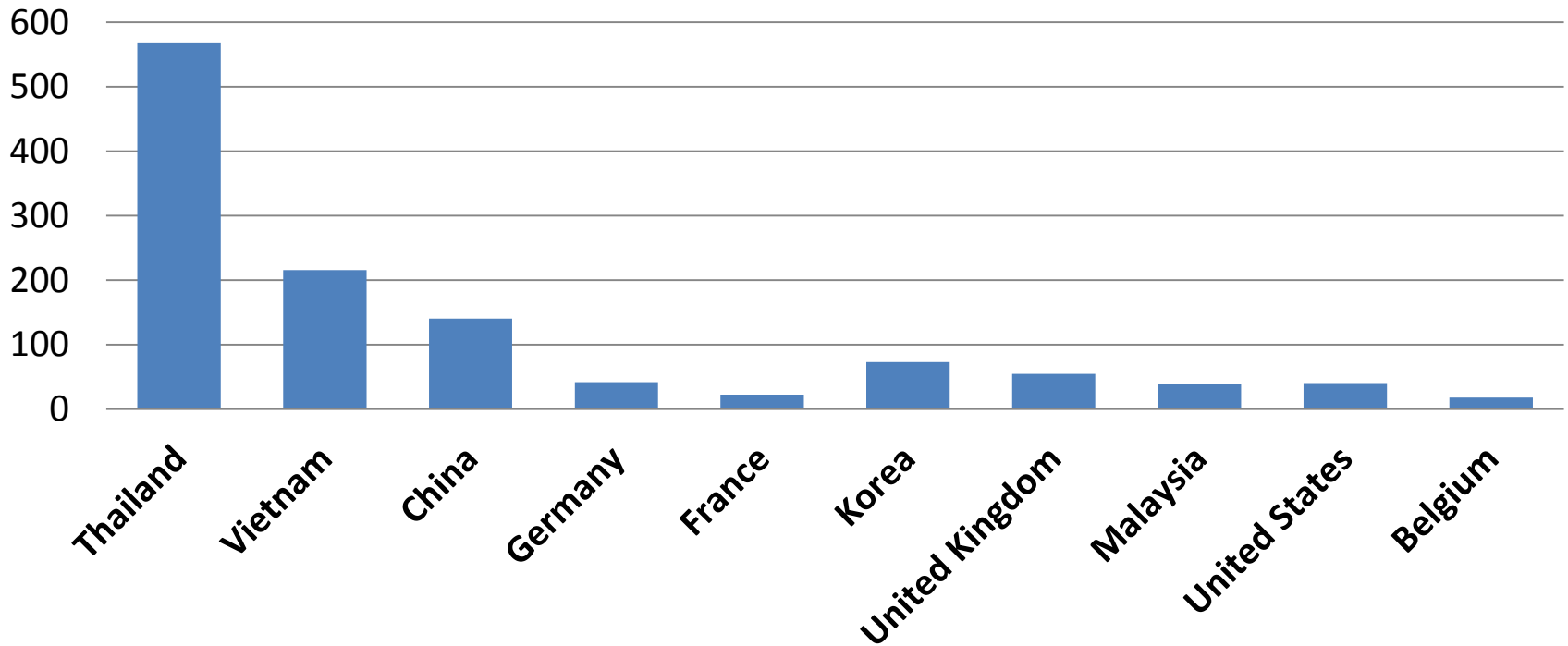


Explain the outliers

Distance matters

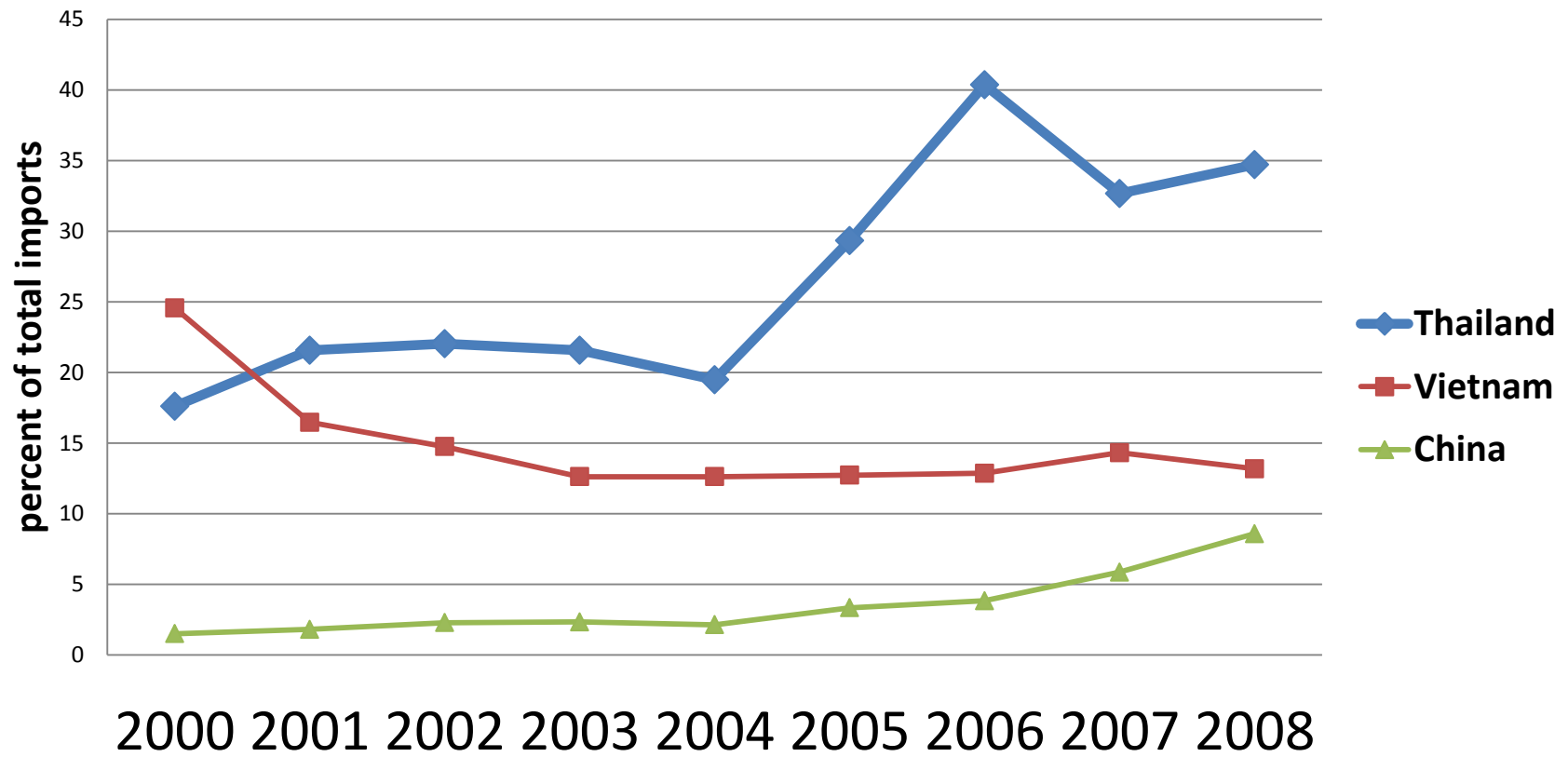
Lao's exports in 2008

Million USD



Does a common language matter?

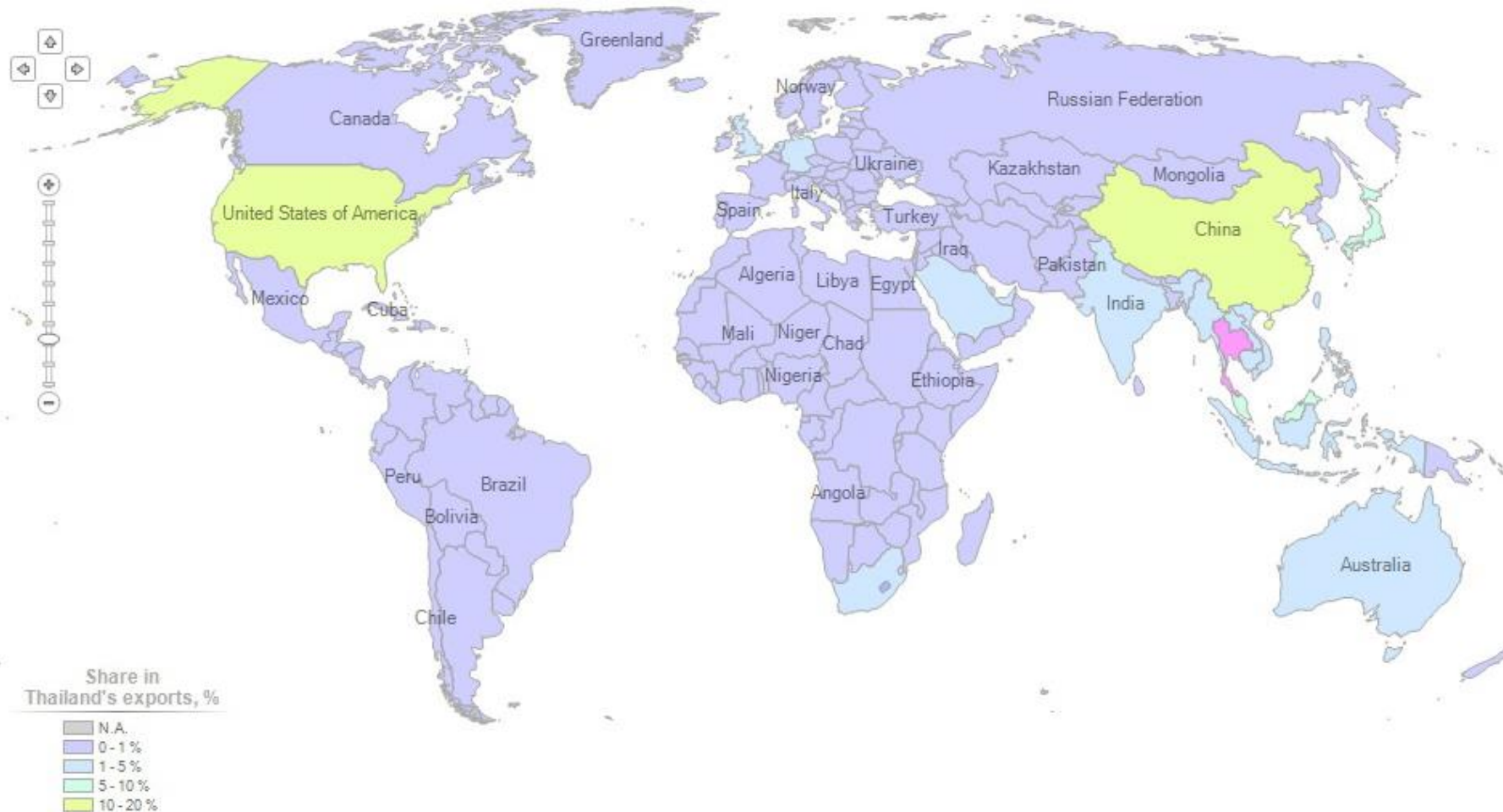
Sources of Lao's imports



Force of gravity

List of importing markets for a product exported by Thailand in 2013

Product : TOTAL All products



Cross-border trade

- The ***closure*** of the Thai-Burmese border checkpoint between Mae Sot and Mayawaddy since early July 2010 ***cost*** traders about **88** million baht a day, according to Commerce Minister (August 8, 2010).
- Both sides must negotiate to settle the problem. Cross-border trade had suffered significantly as goods could not be transported between the two countries.
- “Changing the battle field to a market place”

Trade diversion vs. creation

- Lower tariff rates among **CLMV** countries in the region would not create much **trade diversion** if CLMV's trade volumes with countries **outside** the bloc are small.
- On the contrary, **trade creation** effect would be welfare improving for the sub-region.
- Always compare these two **static** impacts of trade integration
- The **dynamic** impacts involve long-run impact on investment flows, which has a long run growth-enhancing impact.

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.

Regrettably?

- Thailand had to withdraw **rice** from the FTA negotiation with Japan.
- Rice is also excluded from Korea's FTAs with other countries
- Most of bilateral trade agreements **exempt** agriculture.
- *What commodity was exempted from the FTA between USA and Australia?*
- There are always sensitive commodities for each country in any free trade agreements.
- Don't be a perfectionist.

Economic Partnership Agreement (EPA): Beyond the FTA

- **EPA** between Thailand and Japan includes cooperation in education, environment, energy, sciences and technology, tourism, and human resource development.
- 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**.

ROO and NTBs

- **Rules of origin (ROO)** 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* Most Favor Nations (**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.

To forge ahead with FTAs

- 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.

Multiple FTAs, as of January 2010

COUNTRY	UNDER NEGOTIATION			CONCLUDED		TOTAL
	Proposed	Framework Agreement Signed/Under Negotiation	Under Negotiation	Signed	In Effect	
Australia	6	1	5	0	8	20
China	8	2	4	1	9	24
India	12	4	6	1	10	33
Philippines	4	0	1	0	7	12
Singapore	5	0	9	2	18	34
Viet Nam	2	0	2	0	7	11
Thailand	6	4	3	0	11	24

Mega Trade Blocs

- The stalemate in the WTO Doha Round negotiations gave rise to a surge in FTA activities.
- The latest emergent negotiation of mega-trade blocs in 2014 are: The Asian RCEP, the Trans-Pacific partnership (TPP), and the trans- Atlantic partnership (TAP)

TPP (12 countries): Trans Pacific Partnership

- Brunei, Singapore, Chile, *New Zealand*, *Australia*, Peru, Vietnam, Malaysia,
- Canada, Mexico, Japan, and **USA**
- It involves 11 % of world population, 39% of world income, and 25 % of world goods trade.
- Participating of *mega blocs* would have liberalized and rationalized their trade rules rather than under WTO.
- RCEP and TPP are likely to merge and consolidate into a wide free trade agreement of APEC.

Regional Comprehensive Economic Partnership (RCEP)

- Thailand would benefit from the pact's collectiveness in terms of rules of origin, which would be more flexible than in other free-trade agreements.
- RCEP covers 16 countries: **ASEAN (10) and six other nations: China, Japan, South Korea, India, Australia and New Zealand.**
- RCEP reinforces ASEAN centrality in regional economic integration, using framework set by ASEAN+6 proposal.
- The 16 members' combined gross domestic product would be worth more than US\$17.1 trillion (Bt606 trillion), or **27** per cent of global GDP.

Benefits to Thailand

- In 2013, trade among RCEP countries was valued at \$260 billion, and accounted for **57** per cent of Thailand's trading value.
- Thai exports to RCEP countries were worth \$127 billion - some 56 per cent of the overall shipment value of the Kingdom - while imports were worth \$133 billion, or 58 per cent of overall import value.
- Major exports from Thailand to RCEP markets are automobiles and parts, oil, chemical goods, plastic, rubber and rubber products, machinery and parts, iron and steel, and electronic and electrical goods.

Effective in 2016

- **Regional Comprehensive Economic Partnership (RCEP) had finally agreed to *eliminate tariffs* on **65** per cent of trade in goods among them, creating huge benefits for all and helping to compensate for potential losses as a result of Thailand's current non-involvement in the Trans-Pacific Partnership (TPP).**
- The RCEP agreement is expected to be signed during the ASEAN leaders' summit to be held in Malaysia in November 2015, and enforced in 2016.

Nature of the partnership

- The RCEP accomplishment of waiving tariffs for 65 per cent of trade in goods - equivalent to 8,000-9,000 items - represented the ***greatest start*** to full market liberalization between the pact's signatories.
- In the next phase, tariffs on another 20 per cent of trade in goods will be gradually reduced to zero within 10 years, while import duties for the remaining 15 per cent will remain in place or be gradually reduced to 5-10 per cent, as those products comprise the list of ***sensitive goods*** drawn up by member states

More flexible Rules of Origin

- Thailand would benefit from the pact's collectiveness in terms of ***rules of origin***, which would be more flexible than in other free-trade agreements since the RCEP covers ASEAN and six other nations: China, Japan, South Korea, India, Australia and New Zealand.

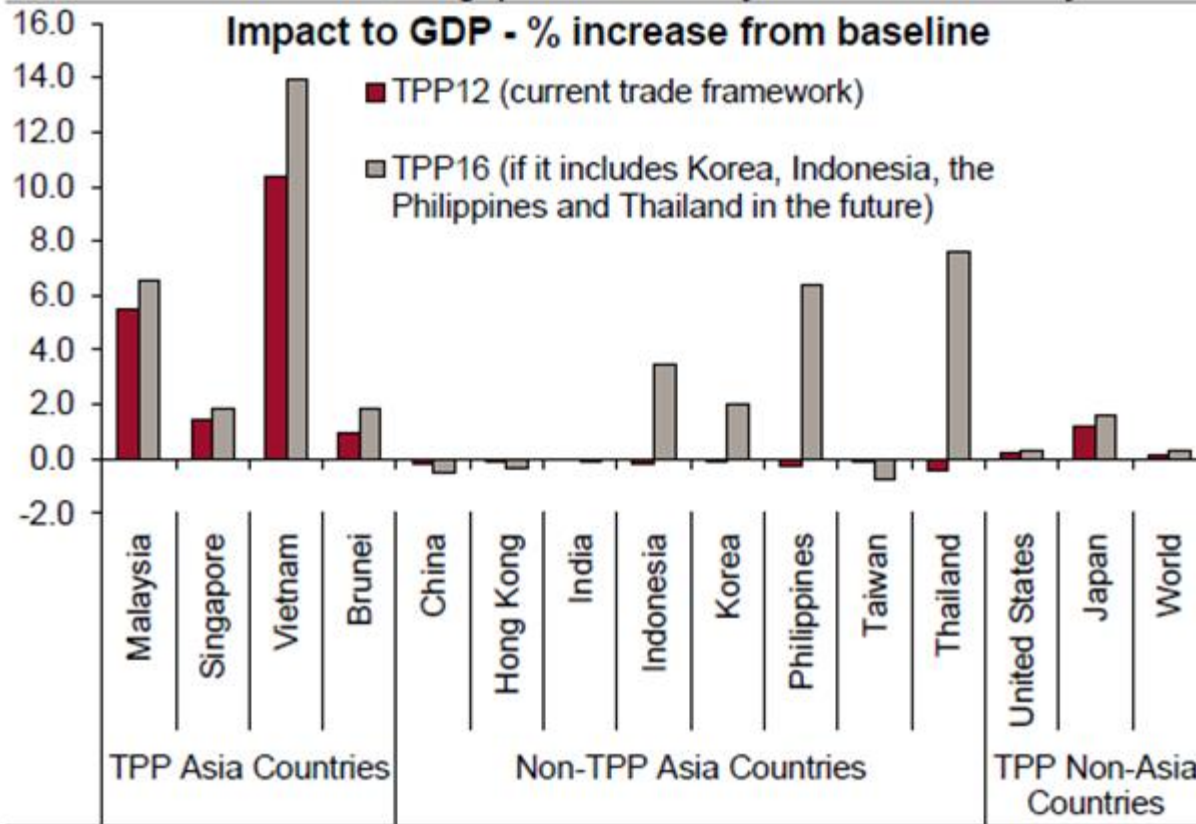
TPP likely to spur a shift in foreign investment from Thailand to other Asean members

- **FROM 2016 onwards, Malaysia may overtake Thailand in terms of foreign direct investment (FDI) inflow thanks to its participation in the Trans-Pacific Partnership (TPP)**
- Vietnam would see an increase in FDI for the same reason. Among the 12 countries participating in the TPP, Vietnam is the most attractive due to its low-cost and labor-intensive production base, its energetic young labor force, low labor cost, which is 50 per cent lower than Thailand, and its dynamic economy.

"Malaysia stands to benefit from foreign investors seeking to establish production base for shipping to the US and other TPP members, particularly in electronics and automotive parts industries.

- Vietnam is expected to draw more investment from joining TPP than it previously did, particularly in garments, textile and electronics.

Figure 1: Vietnam and Malaysia are likely to be the biggest potential beneficiaries from TPP; Singapore a relatively smaller beneficiary



Source: Petri et. al (2012), www.asiapacifictrade.org (March 2015 update), Credit Suisse.

Figure 2: Estimated change in sectoral output by 2025 (green for positive impact, red for negative impact)

		Primary (agri and mining)	Manufacturing	Services
TPP Asia	Malaysia	1.4	11.3	1.5
Countries	Singapore	1.4	4.5	0.2
	Vietnam	-0.6	22.9	3.7
	Brunei	1.6	1.0	0.3
Non-TPP Asia	China	-0.1	-0.3	-0.2
Countries	Hong Kong	-0.3	-0.8	-0.1
	India	0.0	-0.2	0.0
	Indonesia	0.0	-0.4	-0.1
	Korea	0.1	-0.6	0.0
	Philippines	-0.2	-0.6	-0.1
	Taiwan	0.2	-0.3	0.0
	Thailand	0.0	-1.1	-0.1
TPP Non-Asia	USA	0.1	-1.4	0.5
countries	Japan	-4.4	3.5	0.8

Source: Petri et. al (2012), www.asiapacifictrade.org (March 2015 update), Credit Suisse estimates.

Concluding remarks

- Integrating the Thai economy with regional trade blocs can serve as an instrument to speed up **domestic reform**.
- **Temporary subsidies** to adversely *affected* industries are required to ease adjustment costs.

Concluding remarks

- Without **firm datelines** imposed by the trade pacts, there would be less enthusiastic efforts to carry out difficult reform.
- Utilization of FTA provisions remain relatively low due to high marginal transaction costs imposed by Rule of origin.
- A surge in the number of Thailand's FTA and regional cooperation should not be interpreted as diminished **commitment** to the **multilateralism**.