EE460: Regional Integration

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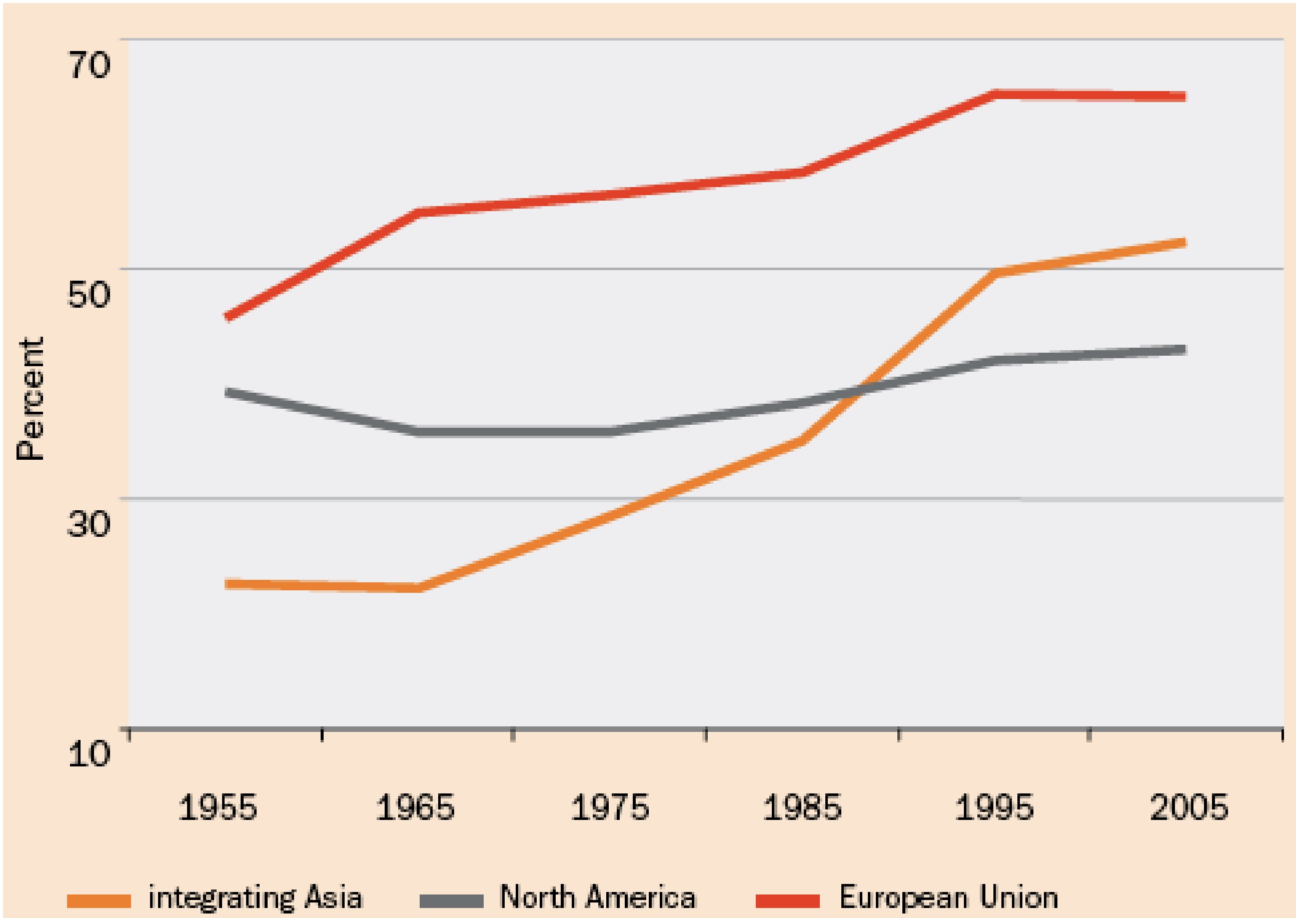
Lecture 20

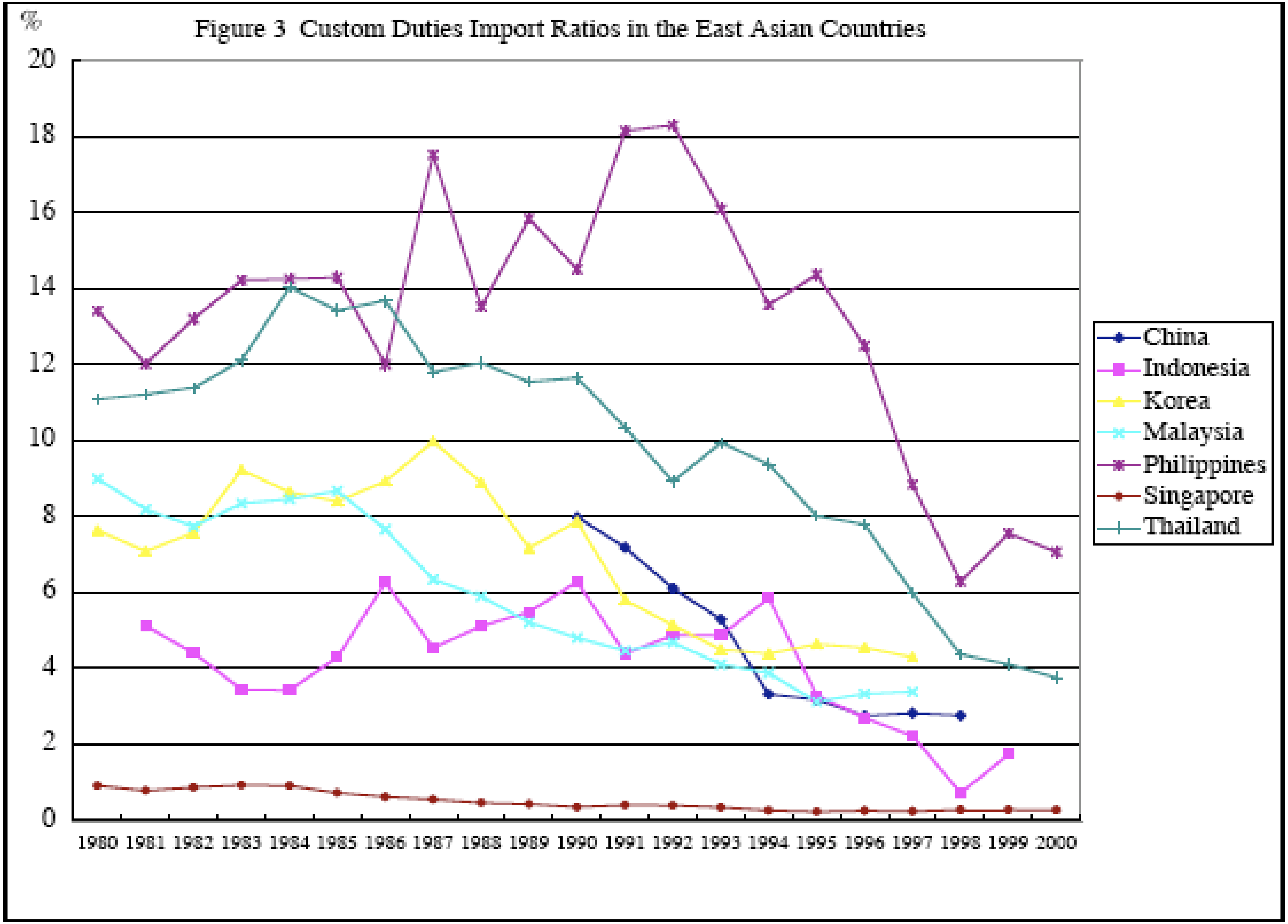
Outline

- Greater regional integration
- New economic geography
- New regionalism
- FTA critiques

Increasing regional trade

Source: ADB



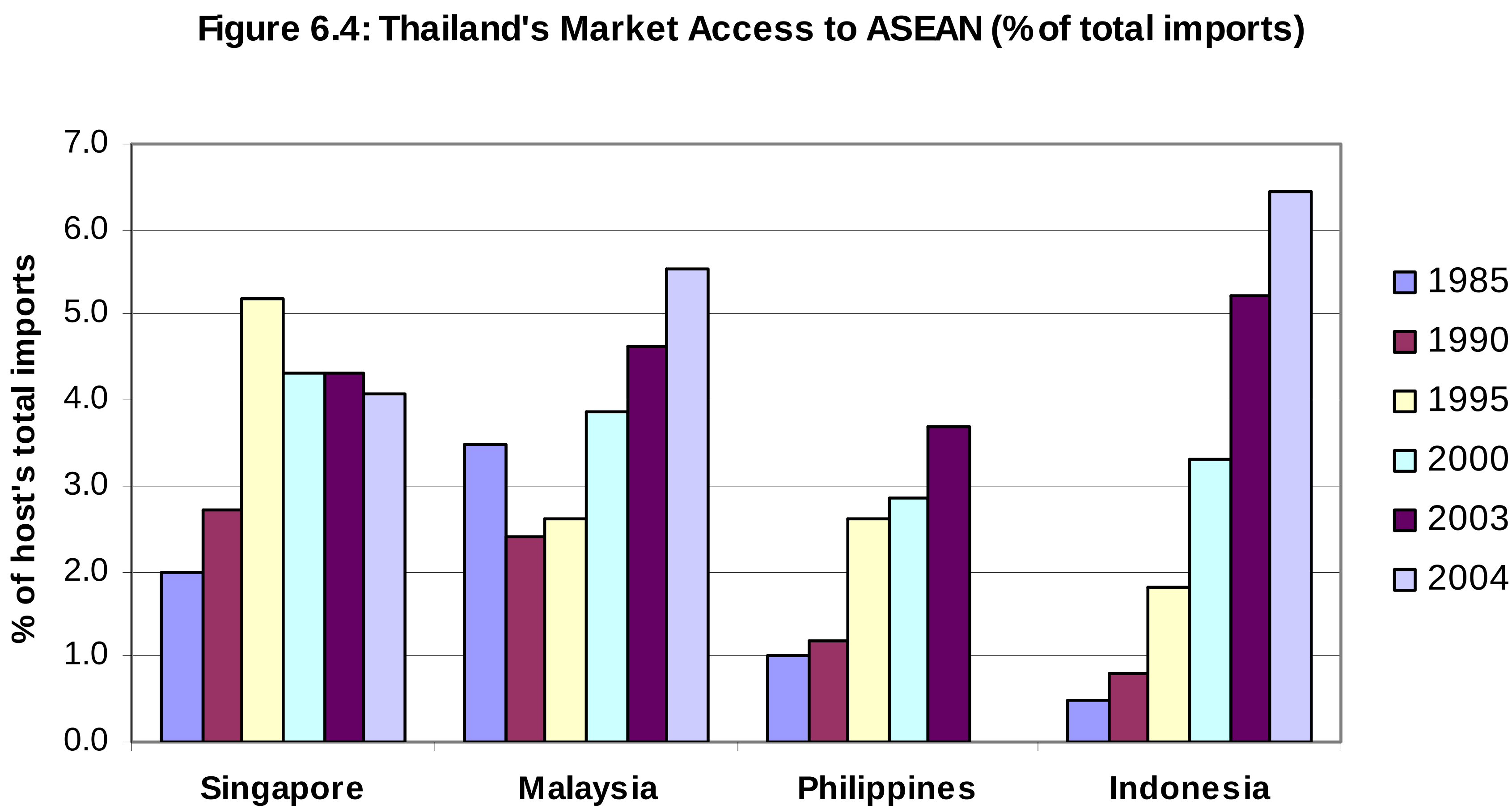


Drawn from Ando and Estevadeordal (2003) (Original data source: World Bank Indocators 2002 (CD-ROM)).

Engaging in foreign trade

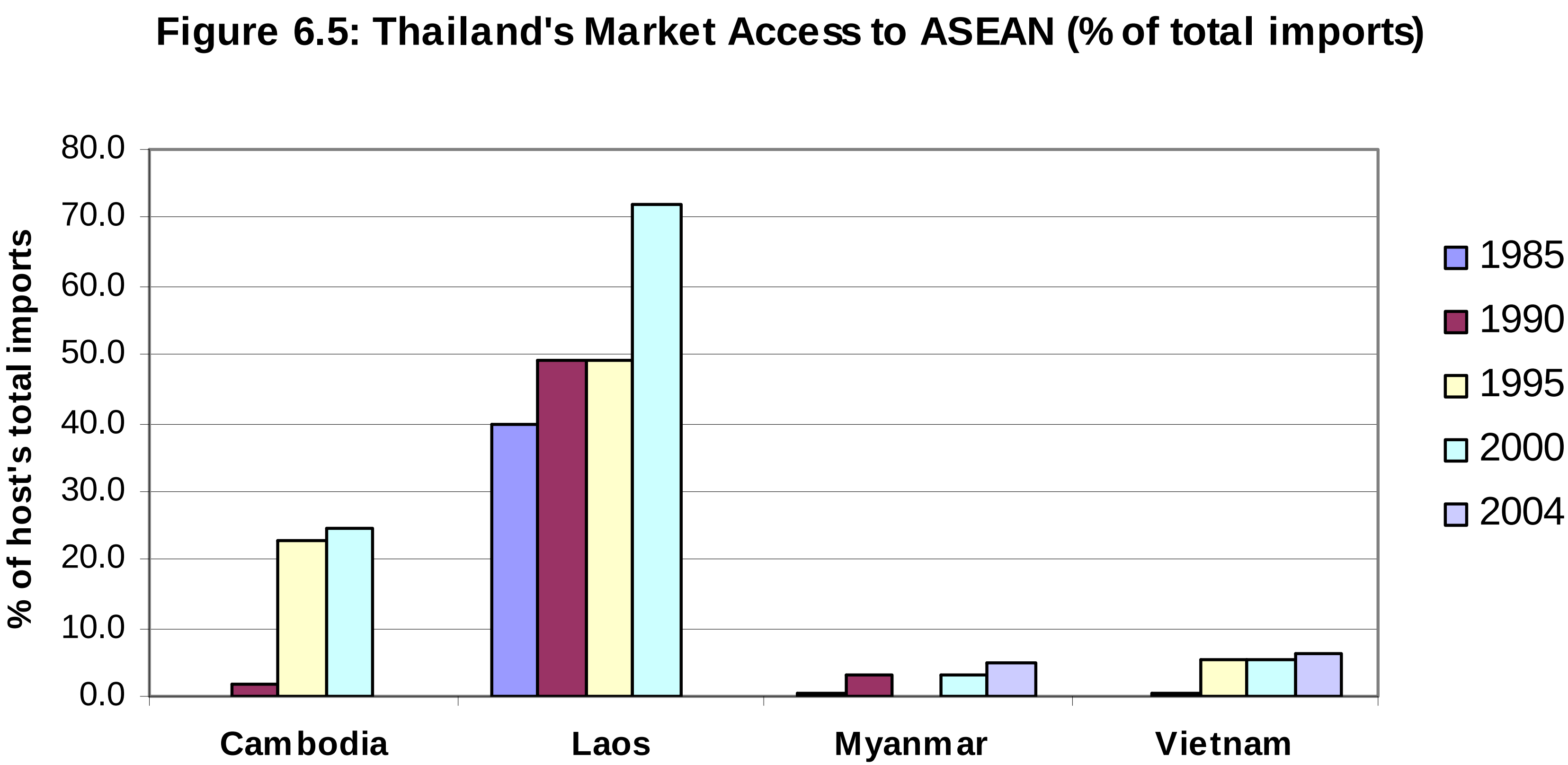
- Thailand has increasingly become an ***integral part*** of the ***world*** economy.
- By 1996, the value of international trade was as large as the size of GDP.
- The degree of ***Asian regional integration*** of Thailand has been ***more*** pronounced through foreign investment in production fragmentation.

Relatively small, but increasing



Source: UN Trade Statistic

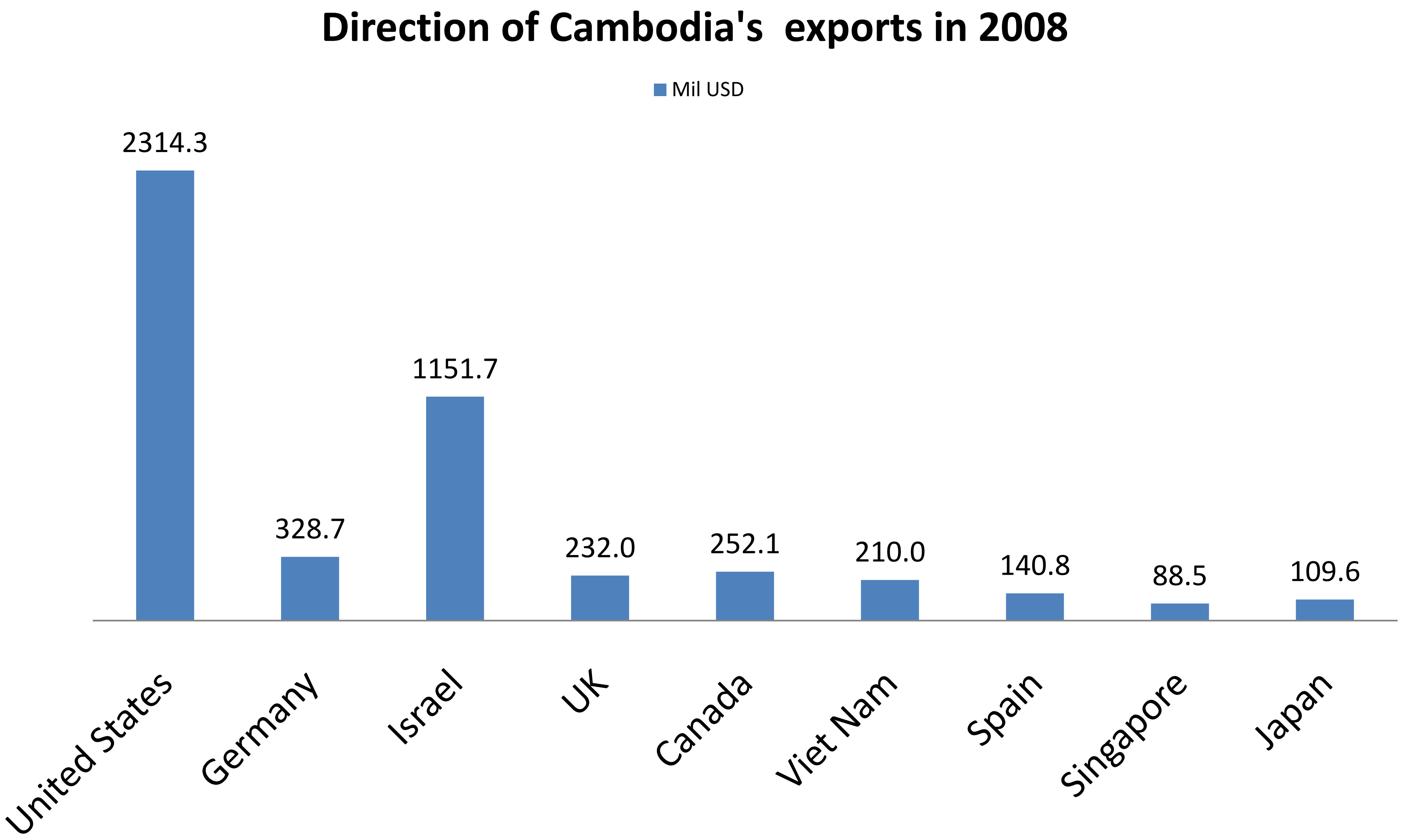
Greater integration with closer neighbors



Source: UN Trade Statistic, CEIC

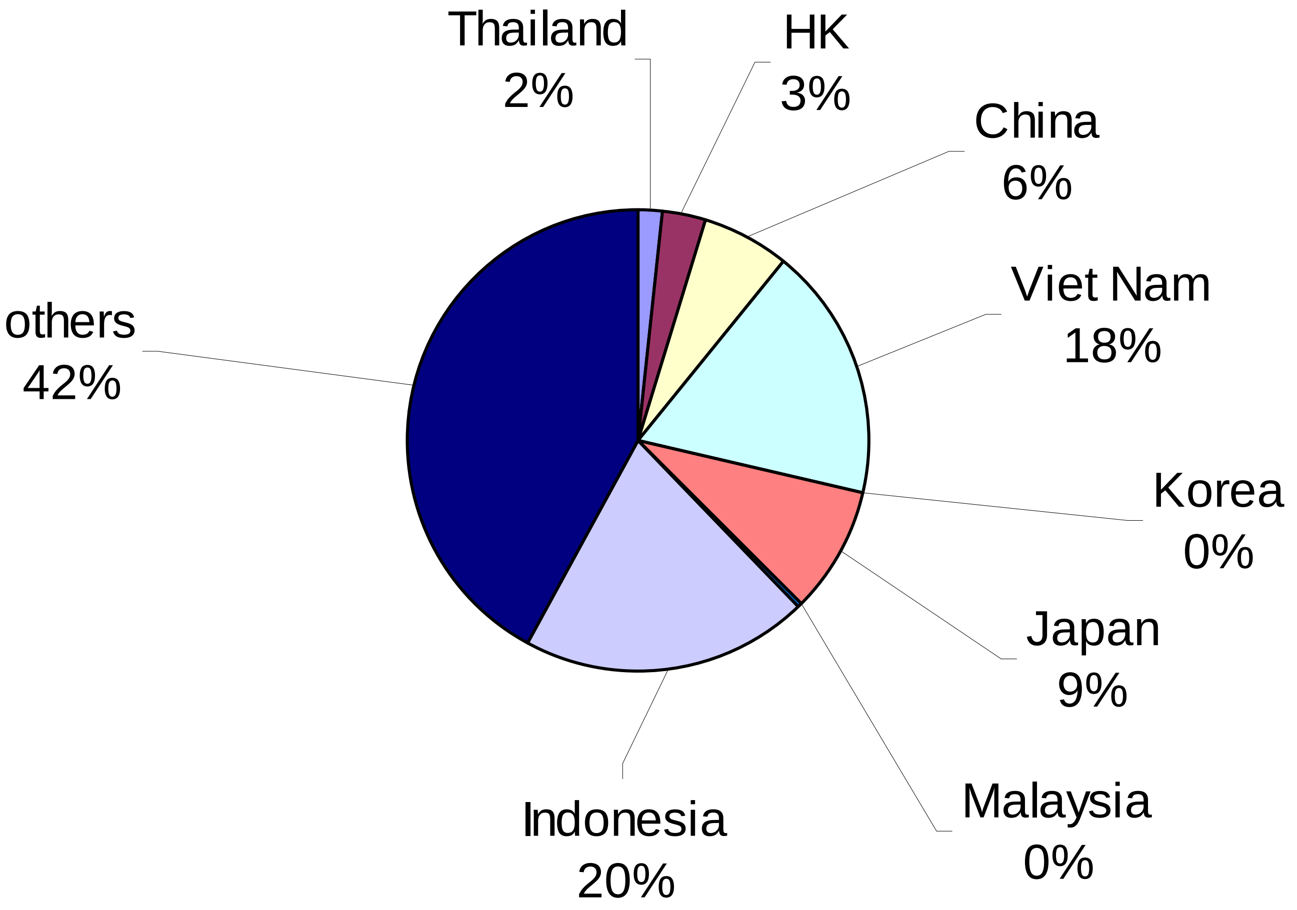
In terms of export markets

- For most of ASEAN 6, Asian markets have been ***increasingly*** significant.
- ASEAN 6 are trading more ***within*** the Asian bloc.
- For ***new*** ASEAN countries, **outside** Asian blocs are more important.
- Different **production structures** lead to different geographical distribution of export markets.

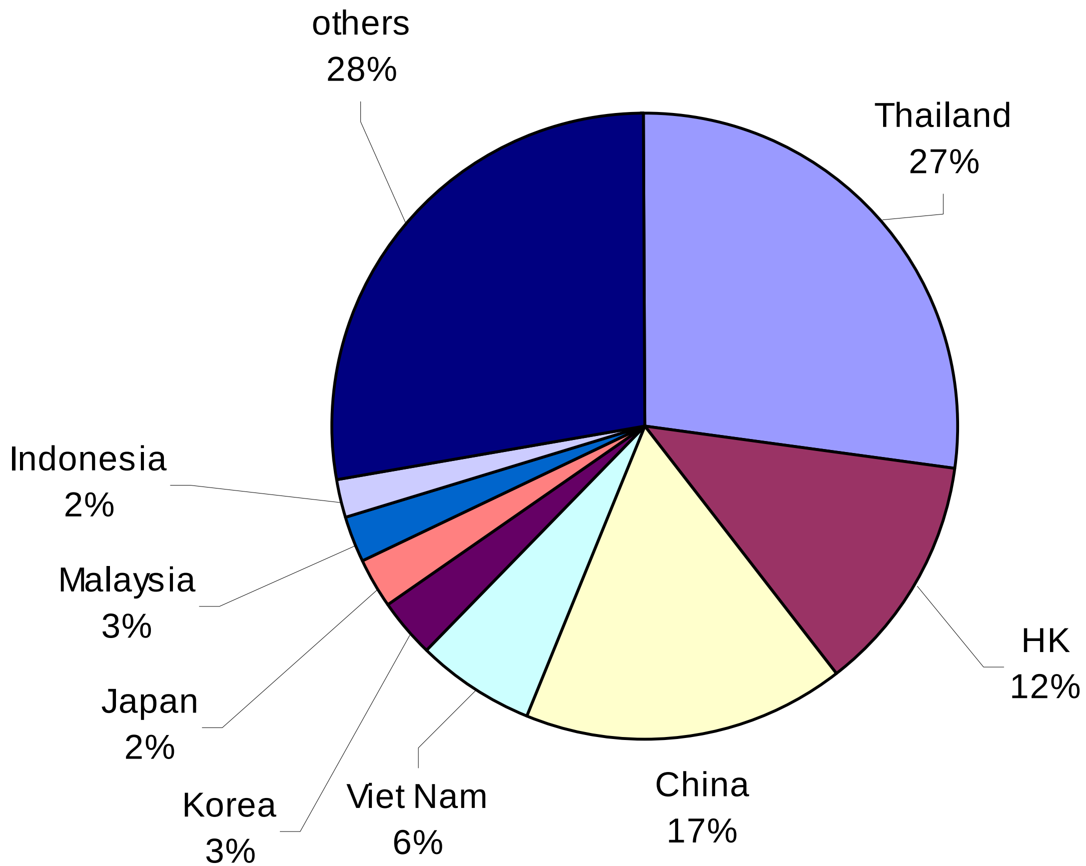


Direction of Cambodia's exports in 2008
Mil USD
2314.3
328.7
1151.7
232.0
252.1
210.0
140.8
88.5
109.6
United States
Germany
Israel
UK
Canada
Viet Nam
Spain
Singapore
Japan

Imports of Cambodia: 1990



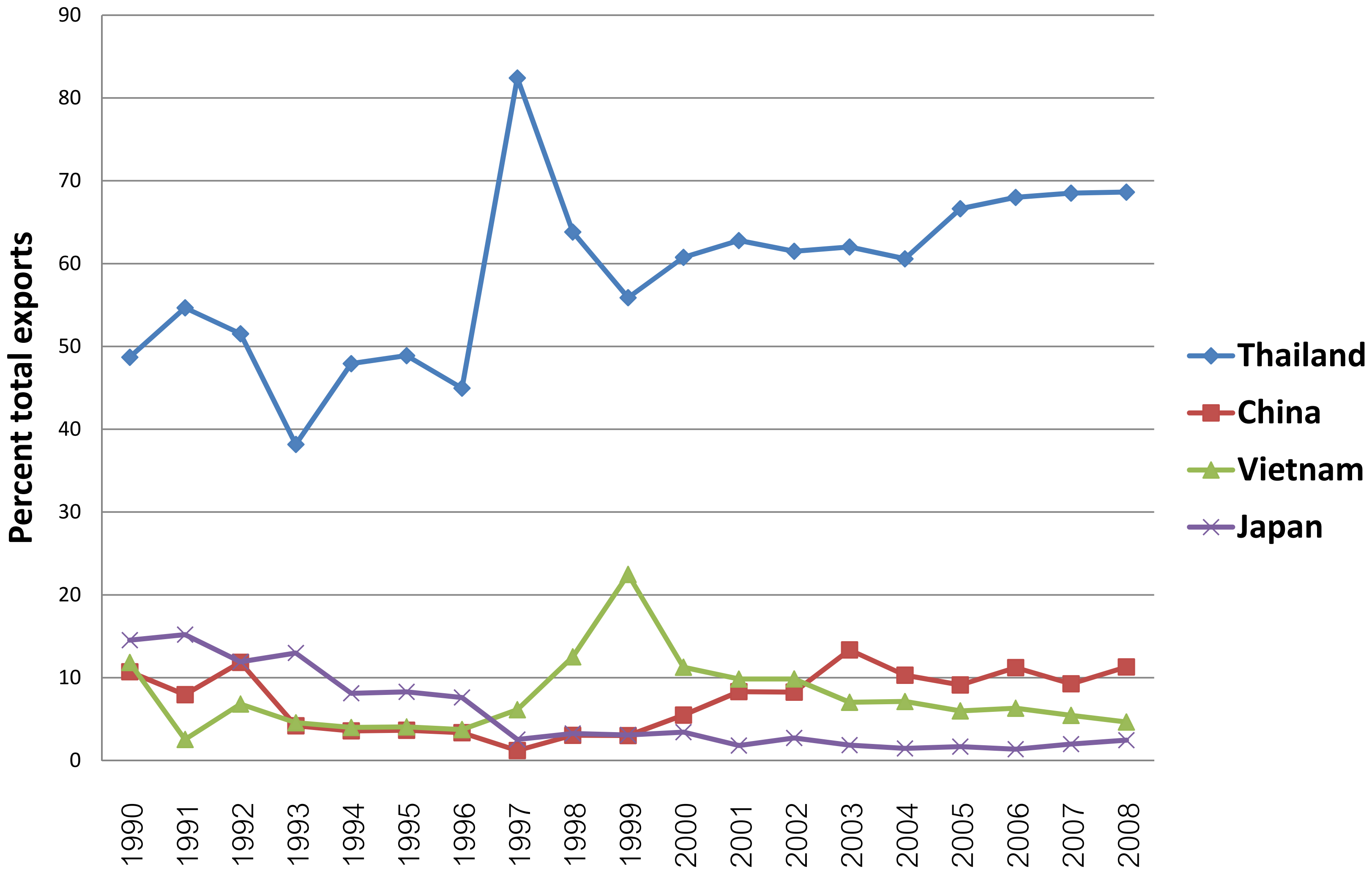
Sources of Cambodia imports: 2007



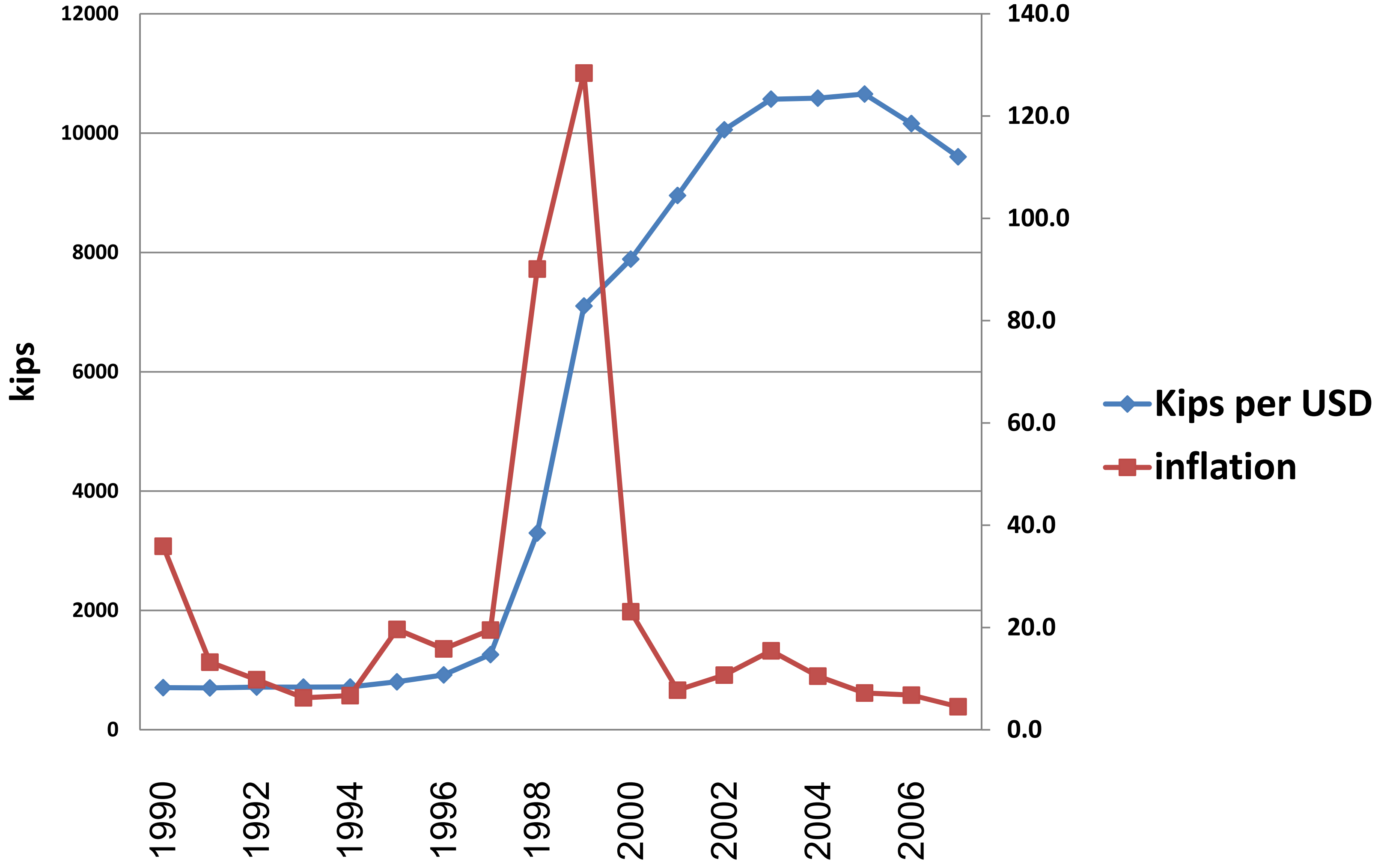
The Way Forward

- The tariff rates among ASEAN countries was cut to 5 percent in 2005, covering about 95 percent of intra-ASEAN trade.
- Fully liberalized trade among ASEAN 6 took place in 2010; for the *new* members (CLVB)by **2015**.
- The deadline has been set at **2015** for the establishment of ***Asian Economic Community*** (AEC).

Lao's export markets



Analyze this: The Kip exchange rate inflation in Lao



Regional economic bloc in Asia

- FDI in Asian region had been ***declining; a*** large part of investment was diverted into China.
- Foreign direct investment in ***industrial*** sector of Thailand declined sharply after 2001.
- 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 Asian 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.**
- On the ***North-South*** Economic Corridor (R3-through Burma) Chiang Rai province in Northern Thailand can be linked to Kunming in Yunnan via roads passing through Burma.
- Uneven qualities of the R3 road in three countries
- Infrastructure-led growth
- Trouble at checkpoints
- A train from Hoa Lumpong to KL?

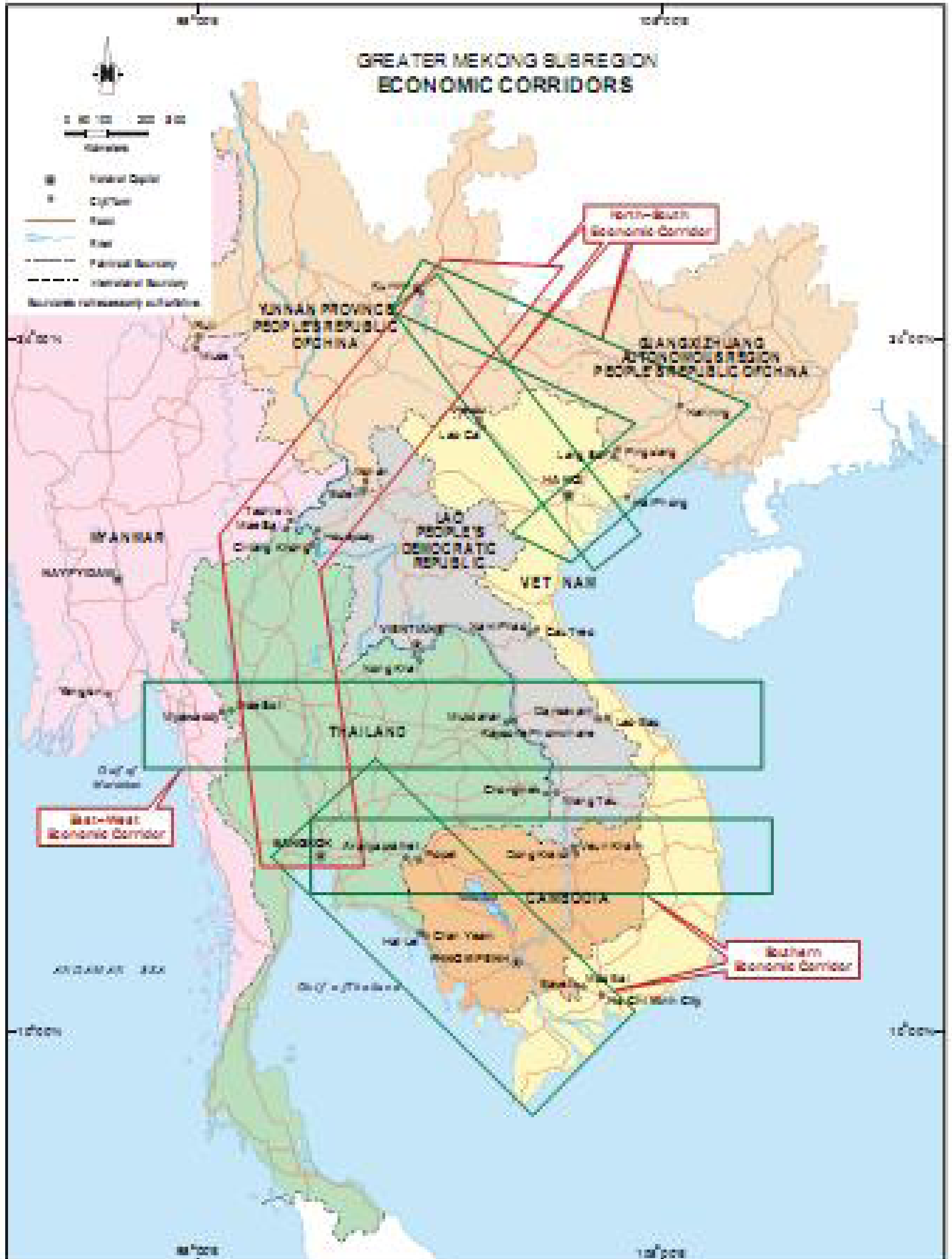
Routes to link three ASEAN countries

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


ASSOCIATED MAP FOR PROTOCOL 1
YUNNAN PROVINCE OF PRC
MYANMAR
LAO PDR
THAILAND
CAMBODIA
VIET NAM
Kunming
Chuxiong
Yuxi
Ruili
Muse
Lashio
Yuanjiang
Hekou
Lao Cai
Jinghong
Mandalay
Kengtung
Tachilek
Mae Sai
Houayxay
Pak Mong
Luang Prabang
Chiang Rai
Chiang Mai
HANOI
Haiphong
Gulf of Tonkin
VIENTIANE
Nong Khai
Udon Thani
Ha Tinh
Cau Treo
Nam Phao
Dansavanh
Lao Bao
Dong Ha
Da Nang
YANGON
Myawaddy
Mae Sot
Tak
Phitsanulok
Khon Kaen
Mukdahan
Savannakhet
Gulf of Martaban
Chongmek
Pakse
BANGKOK
Kabin Buri
Aranyaprathet
Sisophon
Siem Reap
Dong Kralor
Laem Chabang
Petchaburi
Hat Lek
Chan Yeam
PHNOM PENH
Neak Loeung
Bavet
Moc Bai
Ho Chi Minh City
Vung Tau
Sihanoukville
Gulf of Thailand
SOUTH CHINA SEA
Phuket
Songkhla
0 50 100 200 300
Kilometers
National Capital
City/Town
Agreed Routes
River
Provincial Boundary
International Boundary
Boundaries are not necessarily authoritative.

North-South Economic Corridors

- 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.
- 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.***


GREATER MEKONG SUBREGION
ECONOMIC CORRIDORS
North–South
Economic Corridor
East–West
Economic Corridor
Southern
Economic Corridor
MYANMAR
THAILAND
CAMBODIA
VIET NAM
LAO PEOPLE'S DEMOCRATIC REPUBLIC
YUNNAN PROVINCE PEOPLE'S REPUBLIC OF CHINA
GUANGXI ZHUANG AUTONOMOUS REGION PEOPLE'S REPUBLIC OF CHINA
BANGKOK
Ho Chi Minh City

High logistic costs

- Logistics costs relative to Thailand's gross domestic product (GDP) are expected to fall 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, according to secretary-general of the National Economic and Social Development Board (NESDB).
- The NESDB has set a five-year target to lower logistics costs from 19% of GDP to 15-16% by the end of the 11th national economic and social development plan in 2016.
- The cabinet in April 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 logistics industry has potential to generate added value to the economy of about 300 billion baht a year

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 apparel, toys and footwear and capital-abundant countries such as the United States would export machinery and aircraft.

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.
- 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 explains intra-industry trade, while H-O theorem cannot.

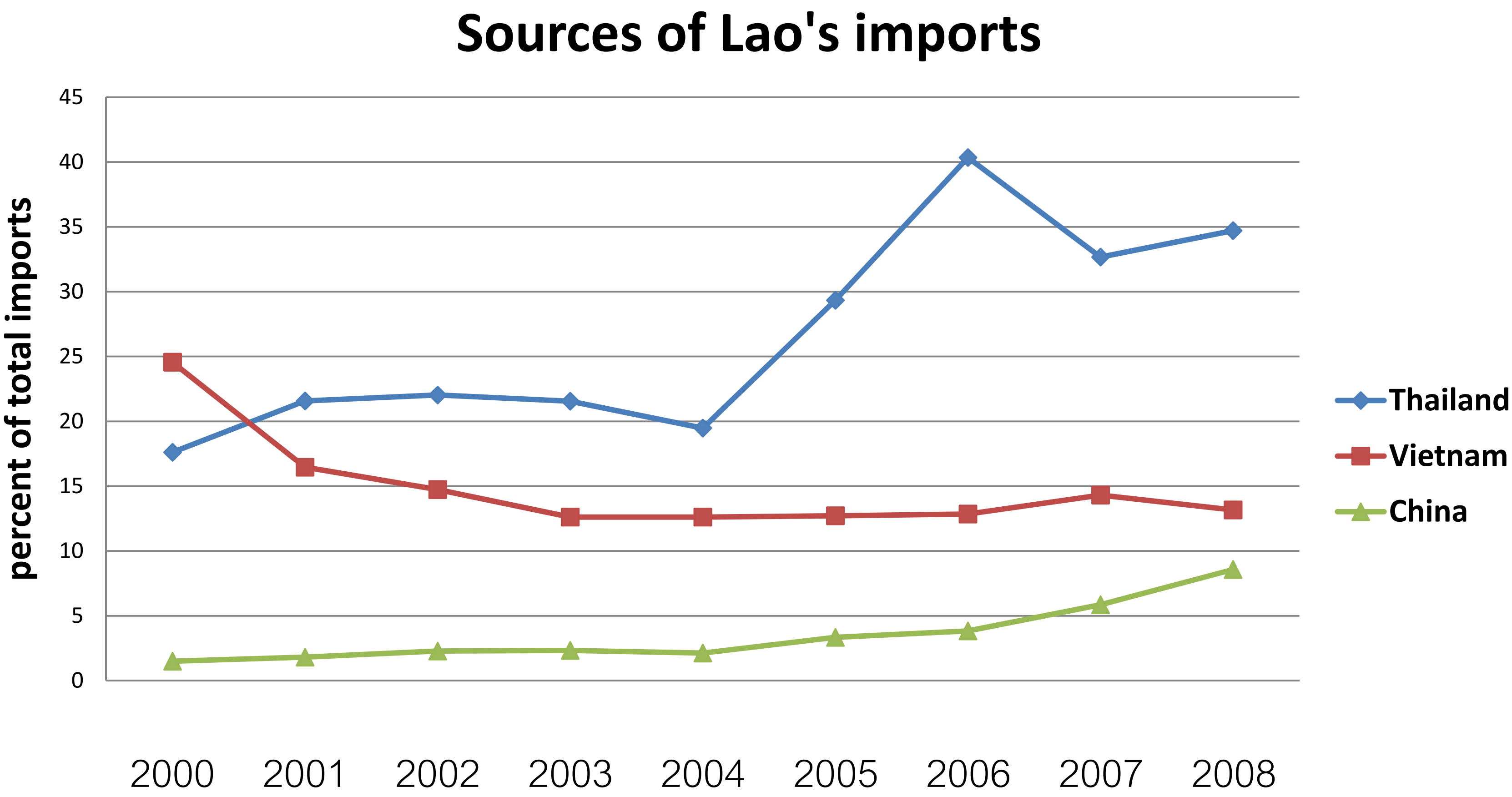
New Economic Geography
Paul Krugman: Four propositions

- Transportation costs, or more broadly transaction costs across distance, play a crucial róle 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.
- 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 larges shares of other countries' spending because they produce a wide rage of products.
- Trade between any two economies is larger, the larger in *either* economy.

Does language matter?



Gravity model

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

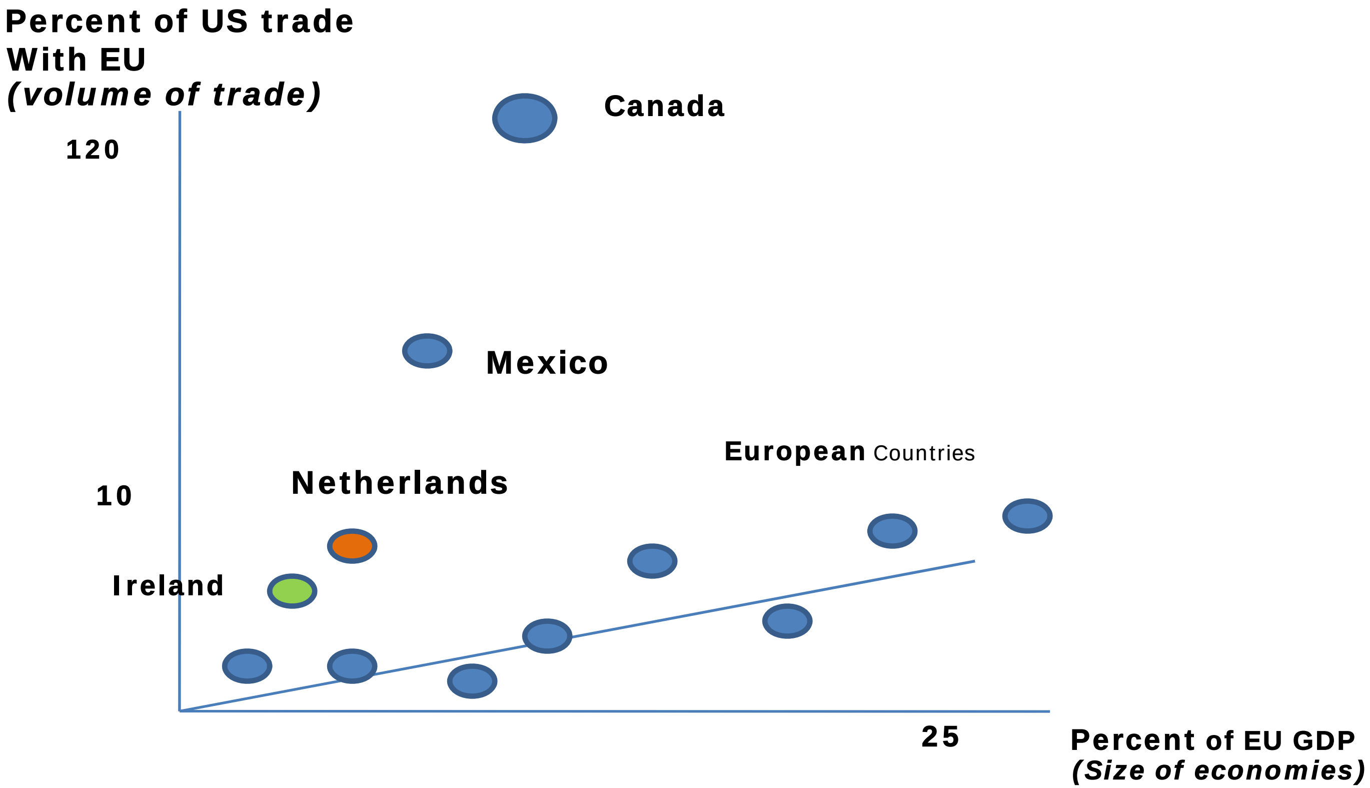
$$T_{ij} = AY_i^{\alpha}Y_j^{\beta} / D_{ij}^{\delta}$$

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

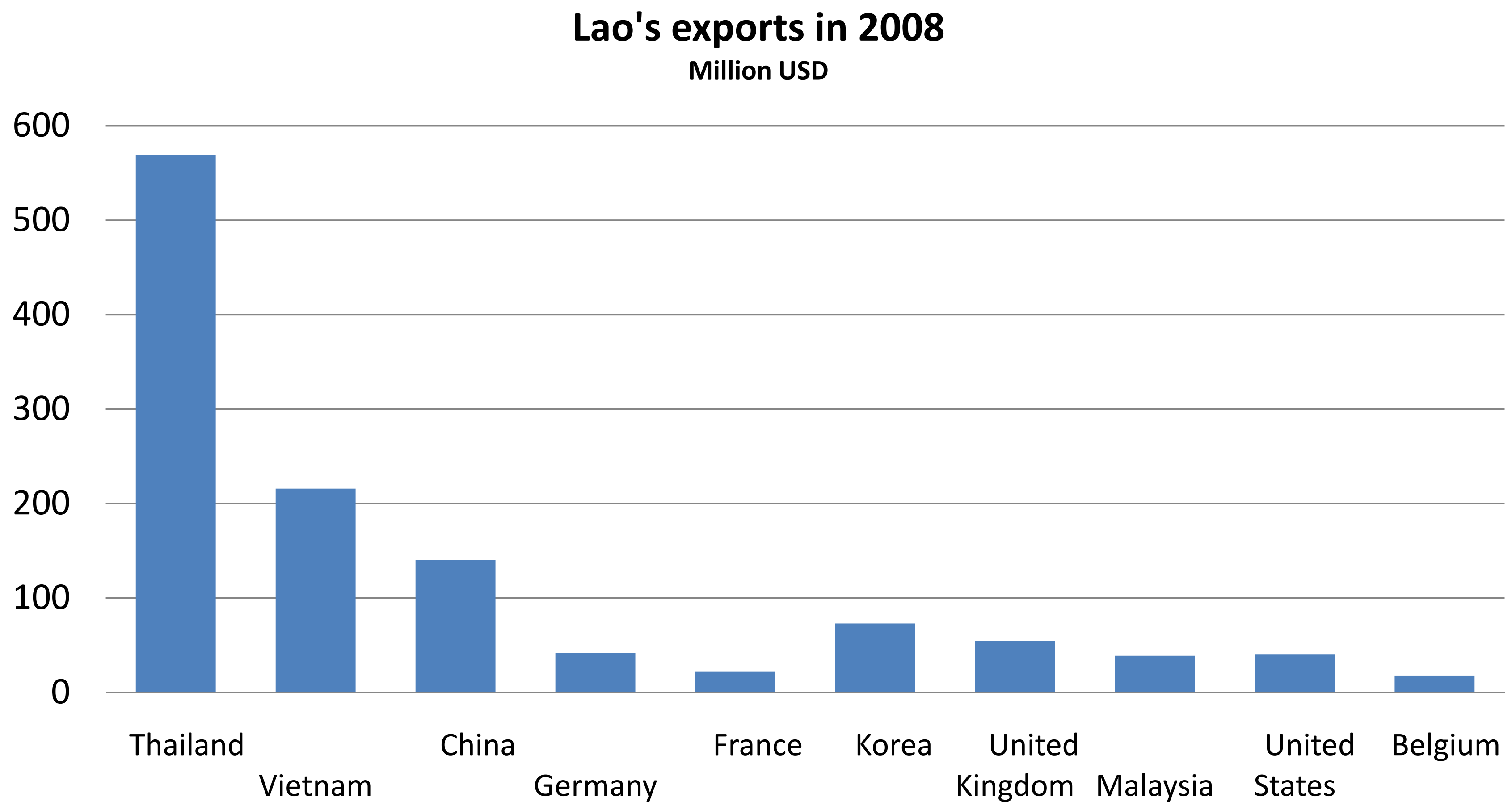
$$\log(T_{ij}) = \ln(A) + \alpha \log(Y_i) + \beta \log(Y_j)$$
$$- \delta \log(D_{ij}) + \varepsilon$$

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

Size and distance matter for trade among nations



Distance matters



Cross-boarder trade

- The closure of the Thai-Burmese border checkpoint between Mae Sot and Myawaddy 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 the market place"

Trade diversion vs. creation

- 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 sub-region.
- Check the two definitions of static impact of trade integration

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 FTAs with other countries
- Other sensitive products for Japan are chicken, sugar, and tapioca.
- Most of bilateral trade agreements exempt agriculture.
- *What commodity was exempted from the FTA between USA and Australia?*
- ***Perhaps*** the FTAs between Thailand and Japan can be an example of the FTAs that include agricultural sectors—albeit without rice.

Economic Partnership Agreement: 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**.

- Thai businesses recommended that Japan lift the export quota of processed pork from Thailand, allow exports of Thai sugar to Japan, and speed up import tariff reductions on Thai processed chicken.
- "We want to increase the processed pork quota to 12,000 tonnes a year from 1,000 tonnes at present.
- This would benefit CP (Charoen Pokphand) and Betagro as well as Japanese firms operating here like Ajinomoto,"

- Japan cites low sweetness content for its ban on sugar imports from Thailand, he said.
- Thai firms want tariffs on processed chicken to Japan be eliminated by 2015 from 3.5% at present. Under the agreement, the duty is to be lowered by 0.5% annually from 5.5% during the first five years of implementation. The JTEPA was introduced in 2007.
- Mr Pornsil said the pact was scheduled for its first revisions next year.
- The Keidanren will gather the proposals for submission to the Japanese government and the two parties will meet again at the Asean Business Summit in Tokyo on April 5, 2011.

- Japan also wants Thailand to reduce the obstacles to registration of intellectual property rights to ensure convenience and faster registration.
- Mr Yonekura said new applications from Japanese investors in Thailand totalled 100 billion baht last year, with most coming from small and medium-sized enterprises (SMEs).
- Nippon Keidanren represents 1,295 Japanese companies in 129 industrial sectors.

- Dusit Nontanakorn, chairman of the Thai Chamber of Commerce, said the arrival of more Japanese SMEs would require as many as 700,000 Thai workers. These companies will invest in supporting industries for the automotive and electronics sectors.
- "Thailand needs to look at ways to prepare an adequate number of personnel to serve Japanese investments," said Mr Dusit.
- "If we are not able to meet their demand, it is highly likely these Japanese SMEs will turn to countries such as Vietnam, which is more attractive in terms of economic growth and doesn't have the same political problems."

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.

Some critiques

- In March 2007, opponents of the draft Japan-Thailand Economic Partnership Agreement (JTEPA) asserted that the government must take two controversial issues in the pact seriously:
- First, Thailand could become a dumping ground for electronic and nuclear waste through the emergence of recycling businesses.
- Note the illogical argument: plea to bad consequences)
- Thai Action on Globalization is now silent.

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 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.

As of January 2010

- ASEAN Free Trade Area (**In Effect**)
- ASEAN-Australia and New Zealand Free Trade Agreement **(In Effect**)
- ASEAN-China Comprehensive Economic Cooperation Agreement (**In Effect**)
- ASEAN-EU Free Trade Agreement (Under Negotiation)
- ASEAN-India Regional Trade and Investment Area (**In Effect**)
- ASEAN-Japan Comprehensive Economic Partnership Agreement **(In Effect**)
- ASEAN-Korea Comprehensive Economic Cooperation Agreement (**In Effect**)
- Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC) Free Trade Area ((FA) signed/FTA Under Negotiation)
- Comprehensive Economic Partnership for East Asia (CEPEA/ASEAN+6) (Proposed/Under consultation and study)
- East Asia Free Trade Area (ASEAN+3) (Proposed/Under consultation and study)
- India-Thailand Free Trade Area ((FA) signed/FTA Under Negotiation)
- Japan-Thailand Economic Partnership Agreement (**In Effect**)

FTA galore

Source: Asian Regional Integration center www.aric.adb.org

- Korea-Thailand Free Trade Agreement (Proposed/Under consultation and study)
- Laos-Thailand Preferential Trading Arrangement (**In Effect**)
- Pakistan-Thailand Free Trade Agreement (Proposed/Under consultation and study)
- People's Republic of China-Thailand Free Trade Agreement (**In Effect**)
- Thailand-Australia Free Trade Agreement (**In Effect**)
- Thailand-Bahrain Free Trade Agreement ((FA) signed/FTA Under Negotiation)
- Thailand-Chile Free Trade Agreement (Proposed/Under consultation and study)
- Thailand-European Free Trade Association Free Trade Agreement (Under Negotiation)
- Thailand-MERCOSUR Free Trade Agreement (Proposed/Under consultation and study)
- Thailand-New Zealand Closer Economic Partnership Agreement (**In Effect**)
- Thailand-Peru Free Trade Agreement ((FA) signed/FTA Under Negotiation)
- United States-Thailand Free Trade Agreement (Under Negotiation)

Multiple FTAs, as of January 2010

COUNTRY	Proposed	UNDER NEGOTIATION Framework Agreement Signed/Under Negotiation	 Under Negotiation	CONCLUDED Signed	 In Effect	TOTAL
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

Definition of terms

- **Proposed** - parties are considering a free trade agreement, establishing joint study groups or joint task force , and conducting feasibility studies to determine the desirability of entering into an FTA.
- Framework Agreement Signed/Under Negotiation - parties initially negotiate the contents of a framework agreement (FA), which serves as a framework for future negotiations.
- Under Negotiation - parties begin negotiations without a framework agreement (FA).
- **Signed** - parties sign the agreement after negotiations have been completed. Some FTAs would require legislative or executive ratification.
- **In Effect** - when the provisions of an FTA becomes effective, e.g., when tariff cuts begin.

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.
- Without **firm datelines** imposed by FTAs, 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 negotiations should not be interpreted as diminished **commitment** to the **multilateralism**.