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Factor adjustment implications of a free trade agreement between the United States and Thailand

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ABSTRACT

Changes in intra-industry specialization indicators are used to assess factor adjustment pressures that may be experienced by U.S. and Thai industries from a proposed U.S.–Thailand Free Trade Agreement (FTA). Many industries experienced large increases in intra-industry trade over the 2000–2008 period. Ten U.S. industries are found to be candidates for factor adjustment pressures based on past experiences. These industries account for 38% of all U.S. imports from Thailand and 4% of imports from all trading partners. Results also show that nine Thai industries face possible adjustment pressures. These industries account for 9% of Thai imports from the United States. An FTA should result in a larger increase in U.S. exports to Thailand than U.S. imports from Thailand because Thai exporters face much lower tariffs in the U.S. market than do U.S. exporters in the Thai market.

1. Introduction

The U.S. and Thailand launched negotiations in 2004 to establish a free trade agreement (FTA). Two negotiation sessions were held in 2004. Three additional sessions were conducted in 2005. Negotiations were suspended in 2006 following a year-long Thai political crisis and subsequent military-led coup against Prime Minister Thaksin's government. Although formal negotiations have not resumed, U.S. and Thai officials continue to discuss bilateral trade issues. Informal meetings were conducted in Washington, DC, in June 2008 and March 2009. Negotiating parties seek to establish a comprehensive agreement that would liberalize trade in goods, agricultural products, services, and investment. A bilateral agreement to liberalize trade would result in a larger increase in U.S. exports to Thailand than U.S. imports from Thailand because Thai exporters face much lower tariff and nontariff barriers in the U.S. market than do U.S. exporters in the Thai market. Issues related to technical trade barriers, financial services, competition policy, government procurement, investor and intellectual property rights, environmental and labor standards, customs procedures, and dispute settlement were addressed.

An FTA between the U.S. and Thailand would increase production and stimulate trade in both countries. Resulting trade flows will have two components: inter-industry and intra-industry trade. Inter-industry trade is the exchange between countries of totally different products, such as trading apparel for transport equipment. Specialization will entail shifting productive factors from one industry to another within each country. Opponents of free trade agreements focus on expected employment effects in import competing activities. They maintain adjustment costs are high because specialization takes place across rather than within industries. Factors displaced from contracting activities are not easily employed in the expanding ones.

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Economic integration has a less disruptive effect on resource flows when it enables countries to achieve greater specialization within the same industry. Intra-industry trade (IIT) is two-way trade of products falling within the same industry classification.[1] Factors of production stimulated by IIT will shift with minimal internal disruption between segments of the same industries. According to Weintraub (1997), the most direct test of the effectiveness of a free trade agreement will involve determining the extent to which two-way trade will increase. Intra-industry specialization also enables producers to realize efficient scale operations. Consumers will benefit from lower import prices and greater product varieties through imports. Trade growth stimulated by free trade agreements will result in both IIT and inter-industry trade.[2]

This paper examines changes in intra-industry specialization in U.S.–Thailand trade over an eight-year period to assess factor adjustment pressures that may arise in the U.S. and Thailand with trade growth resulting from a proposed U.S.–Thailand FTA. An agreement to liberalize bilateral trade would cause economic adjustments in both countries as patterns of production, employment, exports, and imports respond to the liberalization of trade barriers. The Uruguay Round Agreements, the Agreement on Textiles and Clothing (ATC), and trade preference programs such as the Generalized System of Preferences (GSP) and offshore assembly provisions in the U.S. tariff code reduced trade barriers faced by Thai exporters in the U.S. market. Thai exporters face much lower tariffs in the U.S. market than do U.S. exporters in the Thai market. Full implementation of an FTA between the two countries would improve access for U.S. exporters to the Thai market and lower tariffs faced by Thai exporters on products excluded from multilateral trade agreements and preference programs. A U.S.–Thailand FTA is expected to accelerate the pattern of intra-industry specialization, production, and factor adjustments that had been taking place in both countries prior to a bilateral agreement.[3]

This paper is organized as follows. Background information on the proposed U.S.–Thailand Free Trade Agreement is provided in Section 2. Section 3 reports Grubel–Lloyd (GL) intra-industry trade index values for sixty-two industries. A theoretical model and discussion of factor adjustment implications associated with greater trade are presented in Sections 4 and 5. Section 6 reports results of the analysis. Conclusions are summarized in the final section.

2. U.S.–Thailand FTA

A U.S.–Thailand FTA would increase U.S. exports to Thailand and provide increased market access to Thailand's leading trading partner.[4] The U.S. is the third largest exporter to the Thai market. Thailand is the United States' 19th largest trading partner. The U.S. is the second largest market for Thai export of agricultural products and the largest supplier of Thai agricultural imports.[5] U.S. exporters face much higher tariff and nontariff barriers in the Thai market than do Thai exporters in the U.S. market. Imports from Thailand under most tariff-line categories already enter free of duty either unconditionally, or under a variety of duty-free programs. U.S. tariffs imposed on Thai manufactured exports average around 2–3%, but U.S. tariffs on textiles and apparel products and light trucks are much higher. Higher tariffs are imposed by the U.S. on agricultural products than on manufactured goods. The U.S. average most-favored nation (MFN) tariff on agricultural products is 7%. About 1.3% of U.S. agricultural product tariff lines face tariff rates that exceed 20%.

Thailand maintains relatively high tariff and nontariff barriers.[6] The average applied MFN tariff rate is 11.4%. Highest tariff rates are on imports of agricultural products, auto and auto parts, alcoholic beverages, textiles and apparel, footwear and headgear, paper and paperboard products, and some electrical appliances. For example, the tariff on passenger cars and sport utility vehicles is 80%, while the tariff on motorcycles is 60%. Tariffs on textile and apparel products range from 25 to 40%. The Thai average MFN tariff rate on agricultural products is about 24%. More than 40% of Thai agricultural product tariff lines have applied rates that exceed 20%. Consumer ready food products, meats, fresh fruits and vegetables face tariffs ranging from 40 to 60%.

A variety of non-tariff barriers are used by Thailand to restrict imports. Included here are quantitative restrictions, import licensing, nontransparent tariff-rate quotas, licensing fees, and customs barriers. The U.S. uses tariff-rate quotas to regulate imports of some agricultural products. Thai officials have voiced concerns over the use of antidumping duties by the U.S. to restrict Thai exports of frozen or canned shrimp, polyethylene products, and certain steel products.

A U.S.–Thailand FTA would resemble the U.S.–Singapore FTA or the proposed Korea–U.S. FTA.[7] Tariffs on most products would be eliminated upon implementation of the agreement or in the first few years. Most remaining tariffs and most non-

[1] Many studies have investigated determinants of IIT in Asia. See, for example, Sawyer et al. (2010), Xing (2007), Thorpe and Zhang (2005), Chemsripong (2004), and Chow et al. (1994).

[2] Sawyer et al. (2010) found the free trade area created by the Association of Southeast Asian Nations (ASEAN) in 1992 promoted IIT among members. Thailand's entry into the Asia Pacific Economic Cooperation Agreement (APEC) in 1989 stimulated IIT in manufactures. See Chemsripong (2004).

[3] Changes in intra-industry specialization indicators resulting from increases in trade between the U.S. and Mexico over the 1993–1997 period are examined in Clark et al. (2001). Clark (2010) repeated the analysis for the 1993–2007 period. Five of seven industries that may have experienced factor adjustment pressures during the recent period were also candidates for adjustment pressures during the first five years of the North American Free Trade Agreement. This suggests changes in intra-industry specialization indicators may be used to identify industries that may have experienced factor adjustment pressures from trade growth stimulated by bilateral, regional, or multilateral agreements.

[4] Background information on a proposed U.S.–Thailand FTA is presented in Ahearn and Morris (2005) and Thailand Development Research Institute (2003).

[5] See U.S. Trade Representative (2009a).

[6] U.S. Trade Representative (2009b) and Thailand Development Research Institute (2003) publications discuss the magnitude and incidence of tariff and nontariff barriers used by Thailand.

[7] Features of these FTAs are discussed in Thailand Development Research Institute (2003) and Clark (2009).