CHAPTER 2
LITERATURE REVIEW

2.1 Literature Review

Trading began at the very beginning of human history. Started from the original trade style, Barter system, which was a directly exchanging in goods or services between two traders toward to the day that money had introduced as a medium of exchange. Trade has been developed so far as well as relationship among countries. When domestic trade did not respond to the needs of people within country or it was cheaper to buy some products from the foreigners, an international trade was presented. Smith (1904) introduced the concept of the absolute advantage as a basis of international trade. He wrote that “If a foreign country can supply us with a commodity cheaper than we ourselves can make it, better buy it of them with some part of the produce of our own industry employed in a way in which we have some advantage”.

Maneschi (1998) also described the theory of comparative advantage as a theory of work income generated by individuals, companies or countries due to differences in factor endowments or technological advances.

Through economic reform, China has become the world trade center, and many companies in the world have come to invest in China. Millions of dollars flowed in and out. How fast will China’s economy grow after economic reform? What drives and attracts people from all over the world to come to this country? Some documents refer to China's trade. According to Yan, Qing and Qing (2015), they claimed that “The direct investment from South Korea to China, the market size both in China and South Korea, all of the per capita GDP gap in China and South Korea, economy scale in industrial of China and technological progress in China have influences on the level of intra-industry trade between China and South Korea, but the degree of the influence on industrial manufactured goods on different types is different”. While the study from Supriana (2013) stated that “The larger the GDP, the greater the amount of goods and services can be traded. Moreover, China has a positive distance elasticity compare to ASEAN countries since relatively cost is lower than others. Exchange rate is not significant for Thailand to trade with China”.

Some journals mention trade agreements that affect trade. Banik and Gilbert (2008) studied SAFTA integration and transaction costs. In their study, they argued that “Both the imports and exports of a country tend to increase with external sector liberalization. Under small country assumptions, a fall in tariff barriers reduces the price of imports and causes imports to rise. Exports also increase, and this is true whether the economy has a fixed or flexible exchange rate regime”. Additionally, they also mentioned, “The low trade can be attributed to the presence of high tariff barriers. A reflection of high tariff barriers is a lower trade-GDP ratio in many of these SAFTA member countries”.

At the same time, Hong (2013) said, “with the establishment of CAFTA, the collapse of the global economy and the re-emergence of global trade protectionism have highlighted the importance of regional economic cooperation”. Economic complementarity between China and Thailand is in many ways related to the diversity of these two countries.

Mbekeani (2013) revealed, “The more fundamental determinants of RTA performance seem to be policies and conditions that shape the overall trade environment. This makes reductions in trading costs at the border critical”.

Later, Elshehawy, Shen, and Ahmed (2014) also supported Yutaka that RTA affected on trade. They claimed, “The regional trading agreements (RTA) variable is highly significant. This implies that the importer country that has RTA with Egypt can affect Egypt’s exports. The common border between Egypt and its neighbors encouraged the exports, where the results indicated the significance and positive effect of this variable on the flows of Egyptian exports”.

In 2013, the European Commission's director-general for trade studied the economic impact of signing the EUSFTA, a free trade agreement between Europe and Singapore. The analysis of trade flows from Singapore and other countries shows that, in many cases, trade flows have a strong positive evolution since the free trade agreement came into effect. For Europe, the results show that both the eu and Singapore have economic growth and are expected to achieve within a decade.

Lejárraga, Shepherd and Tongeren (2015) also studied the impact of trade agreements on export value. Their research shows that “there are some developments or potential developments in the evolution of the regional trading architecture that has the greatest impact or potential impact on China's exports”. Vice versa, China's exports to China's trading partners have also increased.

In addition, Gouvea, Kapelianis and Montoya (2014) insisted that “the transparency of RTAs led to an increase in agricultural trading volume”. Clearly, the agricultural sector trade tends to when additional transparency provisions are applied in RTA. Another supportive research from Shaikh (2009) concluded that “As a member of SAFTA, each country benefited by maximize scale of production, attain specialization, increase competitiveness and diversify their export basket result hence assisting domestic economic reform. SAFTA allows the participating countries to achieve larger economies of scale in production, attain specialization, increase competitiveness and diversify their export basket, thus assisting domestic economic reform”.

Besides, Samuel (2015) who was worked on trade and revenue effects, also found out that “high tariff rates show larger revenue effects, while low tariff rates show lower revenue effects. However higher tariff rates show lower trade volumes and lower tariff rates high trade volumes”.

Nevertheless, the paper wrote by Nicita (2013) who proved that "The exchange rate misalignments do affect international trade flows in a substantial manner. Currency undervaluation is found to promote exports and restrict imports, while the converse holds in the case of overvaluation".

Olayungbo, Yinusa and Akinlo (2011) also support Nicita by studying on Effects of Exchange Rate Volatility on Trade in Some Selected Sub-Saharan African Countries. The result showed that "exchange rate volatility positively related to trade. This simply suggested that volatility of the exchange rate enhances aggregate trade in the sub-Saharan African countries. This possibly suggested that traders are risk takers who see increase in volatility as opportunity for profit". Moreover, "The results show that a 10 percent increase in tax would reduce trade by 0.8 percent. This means that higher tax tends to increase trade costs, which depresses exports".

Muganyi and Chen (2016) also point to exchange rates and trade agreements. They concluded: "we were able to ascertain that economic size, market size, regional integration or economic partnership status, language integration and devaluation of China's currency all have a positive influence on its agricultural trade flows with major trading partners in the study period. The coefficient for the exchange rate variable is significant at 1%. It indicates that if China devalues its currency by one percent this will have a positive influence on agricultural trade flows with its major trading partners. Additionally, CAFTA and BRICS membership status had a positive influence on agricultural trade flows between China and its major trading partners".

Another paper based on the debating in revaluation of Renminbi and possibility of free float currency in China. Huang, Wang and Whalley (2012) used the model of international trade between inter-temporal and inter spatial in this study. The outcome shows that for inter-temporal trade increase that it is limited by the regulation while tariff rates base on WTO, free trade in goods will not be the best policy. And they also claimed that "A fixed exchange rate policy with a surrender requirement on exporters and rationing (or auctioning) of foreign exchange among importers can be a welfare improving intervention compared to a free-floating exchange rate".

Wang, Kong and Wang (2012) used the trade gravity model to study the trade between China and ASEAN countries. It used the Central American Free Trade Area of the country's per capita gross domestic product (GDP), the central American free trade area of the foreign exchange reserves, the countries of southeast Asia plaza and the distance between China and southeast Asian countries as the independent variables. Despite China's direct investment in southeast Asian countries, imports from southeast Asian countries and the entry of Chinese tourists into southeast Asian countries are dependent variables. After analyzing the import variables, it proves that the higher per capita GDP of ASEAN countries, the higher the value of China's import from this country. The higher China's foreign exchange reserves, the higher the value of China's imports from this country.

In another view, Exchange in another view, the exchange rate has no effect on transactions, Bahmani-Oskooee, Hegerty, Zhang (2014) pointed out, "the impact of exchange rate changes is limited, even temporary." In the long run, the income effect is the strongest.

As well as, Pattichis (2012) stated that “real exchange rate has a significant effect on trade in services in the short-run for all categories in his study, while travel services part has significant in both short-run and long-run”.

Another piece of support from previous studies by Wang and Zhu (2016) is that “China imports a lot of raw materials and they are not dependent on exchange rate fluctuations. In addition, for developing countries, different countries are affected by different variables, most of which have no statistical significance”.

The three variables discussed in the paper are exchange rate, trade agreement and tariff.

Each country determines the exchange rate regime that will apply to its currency. For example, the currency may be free-floating, pegged (fixed), or a hybrid. If a currency is free-floating, its exchange rate is allowed to vary against that of other currencies and is determined by the market forces of supply and demand. Exchange rates for such currencies are likely to change almost constantly as quoted on financial markets, mainly by banks, around the world.

The trade agreements called preferential by the WTO are also known as regional (RTA), despite not necessarily concluded by countries within a certain region. There are currently 205 agreements in force as of July 2007. Over 300 have been reported to the WTO. The number of FTA has increased significantly over the last decade. Between 1948 and 1994, the General Agreement on Tariffs and Trade (GATT), the predecessor to the WTO, received 124 notifications. Since 1995 over 300 trade agreements have been enacted.

Tariffs are the customs in accordance with the law of in and out of the boundary or close condition of the goods and articles levy a tax. Its characteristic is to perform a unified foreign economic policy, tax on in and out of the boundary or close condition of the goods and the customs shall be responsible for and is closely related with the customs of each work.

2.2 Analyze of The Literature Review

According to the World Trade Organization, there are six factors that affect the future of World Trade: population, investment, technology, energy and other natural resources, transportation costs and institutions. All of these factors have become more influential in today's world, but more common factors, such as exchange rates, trade agreements and tariffs, still act like the day before. Most of the above literature reviews use these common factors to analyze trade rates. There has been a lot of literature on trade agreements, and how it has improved the economies of member states, and some people have found that it has not affected trade, because it should be due to other external factors. Despite two or three documents saying the exchange rate was an important factor in the transaction, one newspaper said the exchange rate was not important for Thailand and China. Although many studies have examined the factors that influence trade, few scholars have spent much time looking at them. Therefore, the results received may only apply to those time periods. Although some papers are analyzed only a year after the implementation of the trade agreement, they do not guarantee the impact of trade agreements on trade. In the analysis of international trade, there are not many studies using more than one independent variable. In another view, there is only discussion about the work of China and ASEAN countries. No research has focused on the trade between Thailand and China, and they always do it in a broader way, rather than in a deep way. To fill these gaps, the study focused only on trade between Thailand and China, thus addressing the deeper issues of the influencers. In addition, the duration of this study was about 24 years.

To achieve the purpose of research and fill in the blanks, this paper first introduces the relationship between Thailand and China, and their good relationship for a long time. Note that in this literature review section, this article will provide a basis for research by identifying existing works involving selected topics. Later, the factors used in this study will be discussed in detail to provide in-depth information for the reader. The study mainly includes four factors: trade agreement, tariff barrier and exchange rate. In the method section, the data used will be conducted between 1992 and 2015, including the day before the central American free trade agreement was established. Therefore, this result will clearly show how CAFTA affects trade between Thailand and China. Then, the analysis method is described. Finally, discussions and conclusions will be presented, but limitations and future work will be included.