

# The Utilization of Free Trade Agreement Preferences: The Case of Thai Agricultural Exports\*

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Recently, free trade agreements (FTAs) have dominated the trade policy of Thailand. The country has concluded eight FTAs and is currently engaged in more than 10 FTA negotiations.<sup>1</sup> These FTAs allow or will allow Thai exporting firms to gain advantage over competitors through FTA preferences. An important question concerns the extent to which the firms use FTA preferences. Some existing studies (TDRI 2006 and 2008) find that, in many tariff lines, a number of Thai businesses do not fully utilize the tariff preferences provided by the existing FTAs. Specifically, TDRI (2006 and 2008) find that preference utilization rates are quite low in many tariff lines. However, those studies focus on the industrial sector only. In this paper, we assess to what extent agricultural exporting businesses use tariff preferences under four selected FTAs already in effect, namely ASEAN FTA (AFTA), ASEAN-China FTA (ACFTA), Thailand-Australia FTA (TAFTA), and the early harvest scheme between Thailand and India.<sup>2</sup>

In spite of a declining trend in its contribution to the overall economy, Thailand's agricultural sector remains an important component of the economy as the sector generates significant trade value and tremendous levels of employment. In 2007 the agricultural sector employed about 43 percent of the total number of persons employed, and in 2006 the value of agricultural exports accounted for 16.3 percent of the total export value. Thailand exported agricultural products worth US\$ 3.4 billion or 16.9 percent of the total exports to Japan in 2006. Agricultural exports to the United States ranked second with a 15.6 percent share, followed by those to China (11.8%), Malaysia (6.8%), the United Kingdom (2.9%), Republic of Korea (2.9%) and Hong Kong (2.2%). Among the major export markets, Vietnam, Cambodia, and China grew the fastest at rates

of 99.5, 46.8 and 37.2 percent respectively during the period 2003-2006. In view of the importance of the agricultural sector and rising demand for agricultural products in the FTA partners' markets, there is a need for a systematic analysis of utilization rates of the agricultural sector under the existing FTAs. Identifying the causes of the low utilization rate is crucial to enable policy makers to help Thai agricultural exporters adjust to new opportunities and reap more benefits from the FTAs.

The structure of the paper is as follows: following the introduction, section 2 briefly reviews important aspects of the four FTAs. The third section shows the utilization of preferences for Thailand's agricultural and related products. Section 4 identifies key reasons why Thai businesses fail to benefit from the FTAs. The last section concludes the paper and provides a set of policy recommendations.

## BRIEF OVERVIEW OF THE FTAS

In this section, we briefly review the four selected FTAs on four important aspects: product coverage, tariff margins, rules of origin, and non-tariff barriers.

### Product Coverage

Figure 1 shows the coverage of agricultural products (HS codes 01-24 and 4001) in the FTAs. The product coverage of AFTA, ACFTA, and TAFTA are quite comprehensive, as more than 90 percent of the 6-digit tariff lines are included in the FTAs. However, in the case of AFTA and TAFTA, the majority of products

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in inclusive lists receive zero tariff margin (preferential tariffs from FTAs equal MFN tariffs), and thus the FTAs should not affect the export volume of those products. Despite broad coverage in ACFTA, that FTA has little impact on Thai agricultural exports because the majority of high-volume products exported from Thailand are contained in sensitive/highly sensitive lists. The early harvest scheme between Thailand and India offers negligible coverage, as only 1.5 percent of the 6-digit tariff lines (11 items) are included in that agreement.

### Tariff Margins

Tariff margins (the difference between MFN tariffs and preferential tariffs) comprise one of the important determinants of the utilization of FTA preferences. The higher the tariff margins, the larger is the extent to which exporting firms gain advantage over foreign competitors. Figure 2 shows the weighted-average MFN and FTA tariff rates for eligible agricultural products with tariff margins (using trade value as a weight). The tariff margins of agricultural products in AFTA, ACFTA, and TIFTA are substantial. The weighted-average tariff margin of TIFTA is more than 23 percent, while those of AFTA and ACFTA are 15.53 and 13.04 percent, respectively. Even though the weighted-average tariff margin of TAFTA is relatively small at 5.00 percent, TAFTA grants significant advantage to Thai exporting firms.

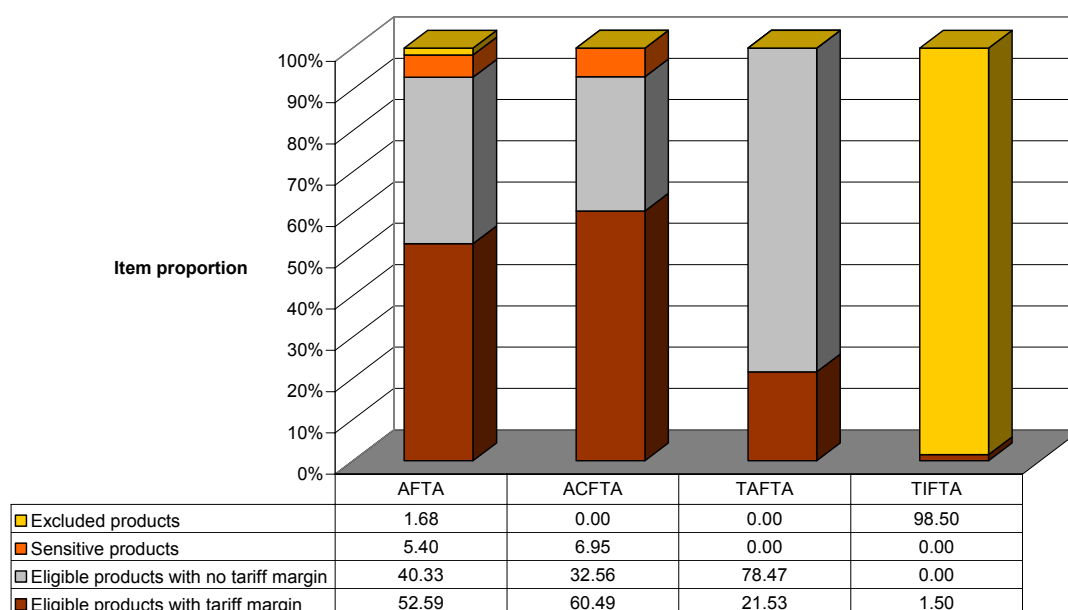
### Rules of Origin

Although an FTA might have broad product coverage and offer significant tariff margins, firms could

fail to utilize FTA preferences owing to the difficulties and costs involved in complying with the rules of origin. The rules of origin could vary across FTAs. The rules of origin can be divided into three broad categories: wholly obtained (WO), value content (VC), and change of tariff classification (CTC). Under the WO requirement, the originating product must be wholly obtained in the country. Under VC, the originating product must have a certain percentage of local content based on the value added. For CTC, the originating product must be transformed from a product in one tariff classification to a product in another tariff classification, according to criteria specified in the FTA concerned, for example CTC at 2, 4, or 6 digits of HS code.

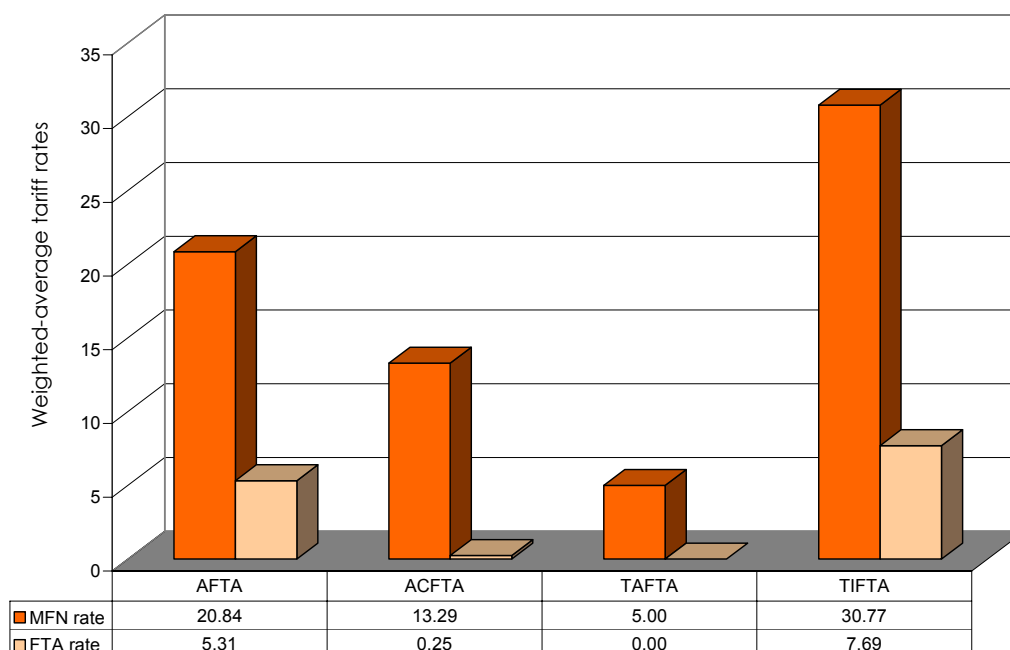
In general, the rules of origin in AFTA are considered more flexible compared with the rules in the other FTAs. Recently, in compliance with AFTA's rules of origin for some tariff lines, businesses could choose to satisfy either a regional value content (RVC) of at least 40 percent of its f.o.b. price or product-specific rules such as CTC at 2 or 4 digits of HS code. AFTA allows for full accumulation, that is, when calculating RVC, a business can sum up raw and intermediate inputs imported from any of the ASEAN members, provided that those inputs are certified as goods that originated in the source country. In addition, AFTA allows for partial accumulation. Under partial accumulation, even if product "A" does not qualify as an originating good, its cost can be summed up in calculating the RVC of product "B" which uses product "A" as an input, provided that the RVC of product "A" is not less than 20 percent of its f.o.b. price. Finally, AFTA adopts the *de minimis* principle to ease the CTC requirement. This principle is useful for businesses when not all of their

**Figure 1 Product Coverage of the Agricultural Products in Selected Free Trade Agreements by Percentage of 6-Digit Tariff Lines in 2006**



Source: Taratorn, Tassanee, and Nuttawut (2008).

**Figure 2 Weighted-average Tariff Rates for Eligible Agricultural Products with Tariff Margin in Various Free Trade Agreements in 2006**



Source: Taratorn, Tassanee, and Nuttawut (2008).

raw materials have undergone substantial transformation. It is still possible to claim preferential treatment for products, provided that those raw materials account for no more than a specified percentage of the product.

The three other FTAs have relatively more stringent rules of origin. ACFTA allows for full accumulation and allows businesses to choose between RVC and CTC for some tariff lines. However, ACFTA does not allow for partial accumulation and the *de minimis* principle. In TAFTA, there is no option to choose between VC and CTC. It is required that most of the products undergo a change in tariff classification, while some products are subjected to the wholly obtained requirement. TIFTA prohibits accumulation. Moreover, the *de minimis* principle cannot be applied under TAFTA and TIFTA.

### Non-tariff Barriers

The existence of non-tariff barriers could prevent businesses from using FTA preferences, even if the FTA coverage is broad and the tariff margins and rules of origin are generous. FTAs regularly include a provision stipulating the elimination of non-tariff barriers. ASEAN has made significant progress in developing a database of non-tariff measures (NTMs) adopted by each member country. Based on their transparency and discrimination, measures are grouped into various colored boxes. The measures grouped within the red box are apparent barriers to trade that need to be abolished. Unclear measures that need further clarification by the adopting country are placed within the amber box. A work

program with clear timelines was set up in order to effectively accelerate the elimination of the measures in the red box. According to the roadmap for the program, the ASEAN-6 countries (except for the Philippines) are expected to eliminate completely NTMs classified in their red boxes before the end of 2010. For the Philippines, the deadline is before the end of 2012, and for CLMV<sup>3</sup> within 2015.

ACFTA stipulates that the parties shall identify for elimination non-tariff barriers other than quantitative restrictions. However, given that there is no specific timeframe, there is no strong evidence yet concerning the elimination of non-tariff barriers. Moreover, at the Sixth Consultations between the ASEAN Economic Ministers and the Minister of Commerce of the People's Republic of China held in August 2007, all member countries agreed to begin addressing the issue of non-tariff barriers by exchanging information on the non-tariff measures applied by each party.

TAFTA contains provisions to ensure that the parties will (a) not introduce or maintain any measures that have proven to be non-tariff barriers, and (b) resolve any related issues. There has been cooperation on sanitary and phytosanitary measures (SPS) issues aimed at improving understanding of each country's measures and regulatory systems, and working together to improve efficiencies in quarantine operations and associated regulatory processes. Nonetheless, TAFTA itself provides a special safeguard measure (SSG), under which the import of certain sensitive products from a party would no longer benefit from the preferential zero tariff rate if the volume of the import exceeds a

particular level specified for that year. Therefore, it is somewhat controversial whether or not this type of measure constitutes a new barrier.

With regard to the early harvest scheme between Thailand and India, there is still no provision on a commitment to eliminate NTMs. It requires only that the parties shall endeavor to refrain from using non-tariff measures that adversely affect the trade in early harvest products. The parties thus are seeking to negotiate the issue under the full agreement.

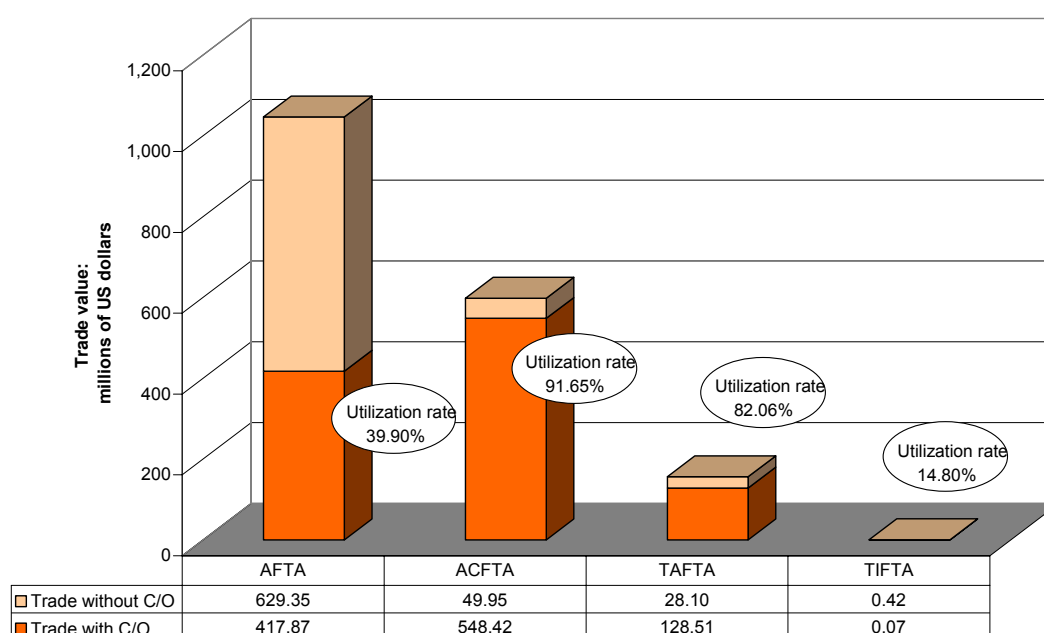
### UTILIZATION OF PREFERENCES FOR THAILAND'S AGRICULTURAL AND RELATED PRODUCTS

In this section, we calculate the preference utilization rate in order to show the extent to which Thai exporting firms in the agricultural sector utilize FTA preferences. The preference utilization rate is defined as the proportion between the value of exports that exporters claim for preferential tariff treatment and the total value of exports eligible for the preferential tariff under the relevant agreement. The numerator can be formed by aggregating the value appearing on each requested certificate of origin (C/O) issued by the Ministry of Commerce's Department of Foreign Trade.<sup>4</sup> The denominator can be obtained from the database collected by the International Trade Centre. Note that it is possible that C/Os might not always be used to claim the preferential tariff treatment available on the import side. Thus, it is possible that the calculated utilization rates could be overestimated, as the rate can exceed 100 percent.

Figure 3 shows the overall utilization rates under the selected FTAs in 2006. The overall utilization rate under ACFTA is very high (91.65%) corresponding to the large tariff margin. Although TAFTA provides a relatively small tariff margin, the utilization rate is high (82.02%). Even though the tariff margin provided by AFTA is almost 16 percent, its utilization rate is surprisingly low (39.90%). Similarly, the tariff margin under TIFTA is very high, but its utilization rate is only 14.80 percent. Therefore, in making comparisons across the FTAs, the relationship between the overall utilization rate and the overall tariff margins seems to be unclear.

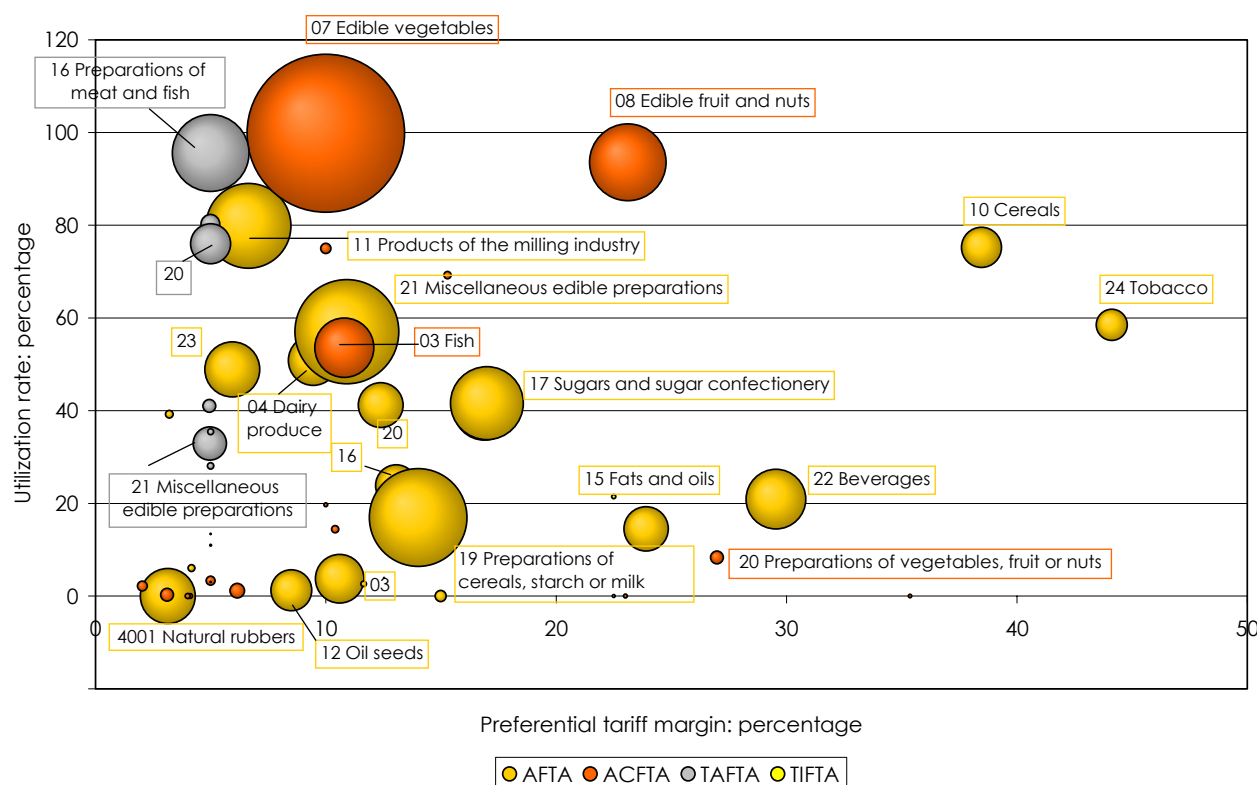
At the sectoral level, Figure 4 shows roughly the relationship between the margins of preference and preference utilization rates in the selected FTAs. The result is rather mixed. A counterintuitive and unexpected relationship exists between tariff margins and preference utilization rates in certain sectors and FTAs, that is, a large tariff margin might not necessarily lead to a high utilization rate and vice versa. For example, in AFTA, reasonably high utilization rates for cereals (HS 10) and, to a smaller extent, tobacco (HS 24) are associated with large tariff margins, while a high utilization rate for products of the milling industry (HS 11) is achieved with much smaller margins of preference. In TAFTA, the small tariff margins are associated with high utilization rates for preparations of meat and fish (HS 16) and of vegetables, fruit or nuts (HS 20), but with much lower utilization rates for miscellaneous edible preparations (HS 21). This is because the small tariff margins might implicitly incorporate impacts of other sector-specific factors that could influence the utilization rates. In other words, there might be other factors driving this result.

**Figure 3 Overall Preference Utilization of Thailand's Agricultural Exporters under Selected Free Trade Agreements in 2006**



Source: Taratorn, Tassanee, and Nuttawut (2008).

**Figure 4 Sector-wise Preference Utilization of Thailand's Agricultural Exporters under Selected Free Trade Agreements in 2006**



Notes: - Bubble size reflects the total trade of each sector in US dollars.  
 - Exports to India in 2006 were much less than those to other countries; as a result, their representative bubbles cannot be seen. The corresponding preferential tariff margins for HS 08, 10, and 16 are 22.50, 75.00, and 22.50, respectively. Meanwhile, the corresponding preference utilization rates are 21.46, 100, and 0 percent, respectively.

Source: Taratorn, Tassanee, and Nuttawut (2008).

### KEY REASONS FOR LOW UTILIZATION RATES

To determine why the utilization rates are low for some products, first, we identified the top 20 lowest utilization rate products (6-digit HS code) in each of the selected FTAs. In this paper, a low utilization rate is defined as one that is lower than 25 percent. Then, we surveyed 71 exporters of relevant products and interviewed selected pertinent firms and the Thai Frozen Foods Association in order to determine the major causes of the low utilization rates for their exported products. As revealed by the survey and interviews, the causes of the low preference utilization of the agricultural products of interest are an insufficiently attractive margin of preference, a lack of information on preferential tariff treatment, difficulties in providing the necessary documentation, and the passivity of the exporters. However, many potential causes, such as strict rules of origin, the complexity of the administrative procedures, the unduly long time of the process involved, and the cost of each C/O issue, are not relevant to the low utilization rates. Table 1 shows the causes of the low utilization rates by product.

An insufficiently attractive tariff margin is clearly one of the main reasons why the businesses failed to use

the FTA preferences. However, as suggested by the analysis in the previous section, an attractive tariff margin is a necessary but not a sufficient condition for the businesses to use the FTA preferences. As reflected in Table 1, when a sufficiently attractive tariff margin is provided, it is possible that some exporters still could not use the FTA preferences if they faced other problems, such as a lack of information on preferential tariff treatment, difficulties in providing the necessary documentation, and the passivity of the exporters or counterpart importers.

A lack of information is the prevailing reason accounting for the low utilization rates in all the products of interest. As revealed by the interviews, there are two particular problems in this regard. First, the exporters do not even know whether their goods are eligible for FTA preferences; the text of the agreement concerned is too difficult for them to understand. In addition, the tariff concession schedule is dynamic and subject to change over time. The exporters might not know when their products have been transferred from the sensitive list to the inclusion list. Second, the exporters acknowledging their eligibility did not know how to make use of the FTA preferences.

**Table 1 Causes Leading to the Low Preference Utilization of the Top Agricultural Products Exported to Each Free Trade Agreement Partner**

HS	Description	Market	Export value (millions of US dollars)	Preference utilization rate (%)	Causes of low preference utilization **			
					Insufficiently attractive margin of preference	Lack of information on preferential tariff treatment	Difficulties in providing the necessary documentation	Passivity of exporters
400110	Natural rubber latex	ASEAN	730.39	0.05	✓			
100630	Semi-milled/wholly milled rice	ASEAN	278.64	0.07	✓			
170199	Cane/beet sugar & chemically pure sucrose in solid form	ASEAN	191.46	0.25	✓			
400121	Natural rubber (excl. latex) in smoked sheets	ASEAN	163.81	0.00	✓			
400129	Natural rubber other than latex/smoked sheets/technically specified natural rubber	ASEAN	156.59	3.98	✓			
190190	Malt extract	ASEAN	115.46	10.47		✓		✓
230990	Preparations of a kind used in animal feed other than dog/cat food	ASEAN	99.62	20.21	✓			
170111	Raw cane sugar in solid form	ASEAN	89.81	0.00	✓			
220290	Non-alcoholic beverages other than water	ASEAN	86.91	20.77		✓		✓
100640	Broken rice	ASEAN	50.63	0.03	✓			
220300	Beer made from malt	ASEAN	37.20	9.79		✓		✓
151620	Vegetable fats & oils and fractions thereof	ASEAN	31.90	6.00		✓		✓
120799	Oil seeds & oleaginous fruits	ASEAN	31.78	0.07		✓		✓
030613	Frozen shrimp & prawns*	China	14.00	33.05		✓		✓
210690	Other food preparations*	Australia	17.37	34.25		✓	✓	✓
200899	Prepared/preserved edible parts of plants*	Australia	4.92	29.73		✓	✓	✓
081090	Other fresh fruit	India	0.31	21.51		✓		✓
160413	Prepared/preserved sardines	India	0.15	0.00		✓		✓

Notes: \* Evidently, the utilization of preferences by businesses exporting frozen shrimp and prawns (HS 030613) to China and other food preparations (HS 210690) and prepared/preserved edible parts of plants to Australia are not in the low utilization category as defined for this study. Nonetheless, it is worthwhile including them in the scope of the study since their preference utilization is relatively small compared with that of the other products exported to the specified market.

\*\* For each product, the conclusion that the margin of preference is or is not insufficiently attractive is based on analysis of secondary data. When the margin is likely not to be the cause of the low preference utilization, the research team circulated questionnaires and conducted specific interviews to identify all the other causes.

Source: Taratorn, Tassanee, and Nuttawut (2008).



While large businesses are generally aware of the opportunities offered under the preferential schemes, many small and medium-sized enterprises (SMEs), especially those located in rural areas, face difficulties in searching for the necessary information. Some SMEs also claimed that they were not well-informed about the FTA provisions. In an effort to build such awareness, the Department of Commerce and private associations have been conducting workshops and seminars to educate exporters about the exploitation of such preferences. Nonetheless, many respondents criticize the Thai government for insufficiently promoting the FTA preferences and failing to distribute information regarding their provisions among businesses in the agricultural sector, instead paying more attention to the industrial sector. Private associations have also been ineffective in providing relevant information to their members. In addition, a number of businesses have not registered as a member of any private association. Thus, such businesses have more limited access, or no access, to the necessary information.

Certain exporters have failed to make use of the available preferences owing to their inability to provide the required documentation. They have faced difficulties in adopting the accounting procedures needed to demonstrate compliance with the FTA requirements. There is also evidence that certain trading companies have found difficulties in requesting the C/O from the manufacturers.

Finally, there are many exporting firms that know how to make use of the preferences but decided not to use them, unless there is a request to do so from their importers. It is possible that the counterpart importers are ignorant of the FTA preferences and therefore do not request C/O documents from the exporters. This type of situation could occur under some conditions as follows:

- The market is of little commercial value; thus, the exporters do not bother making use of the preferences. This issue was raised by businesses exporting frozen shrimp and prawns (HS 030613) to China and those exporting items under the categories other fresh fruits (HS 081090) and prepared/preserved sardines (HS 160413) to India. Their claim was supported by the fact that the export shares of each product to the relevant market are 1.33, 0.31, and 0.23 percent of total export volume, respectively.
- The nature of doing business relies on trust or long-term personal connections between exporters and importers rather than price competition. The importer trusts and always buys goods from the same exporter regardless of the price. Thus, they do not bother putting in the extra effort required to make use of the preferences. Such personal relationships could be found in the ASEAN countries and China.

## CONCLUSION AND POLICY RECOMMENDATIONS

This paper examines to what extent exporters in the agricultural sector utilize the preferences offered by the ASEAN FTA (AFTA), ASEAN-China FTA (ACFTA), Thailand-Australia FTA (TAFTA), and the early harvest scheme between Thailand and India. We find that the overall utilization rate under ACFTA is very high (91.65%) corresponding to the large tariff margin. Although TAFTA provides a relatively small tariff margin, the utilization rate is high (82.02%). Even though AFTA offers an almost 16 percent tariff margin, its utilization rate is surprisingly low at 39.90 percent. Similarly, the tariff margin under TIFTA is very high, but its utilization rate is only 14.80 percent. Therefore, in comparing FTAs, the relationship between the overall utilization rate and the overall tariff margins seems to be unclear.

At the sectoral level, the result shows a counterintuitive and unexpected relationship between tariff margins and preference utilization rates in certain sectors and FTAs, that is, a large tariff margin might not necessarily lead to a high utilization rate and vice versa. This is because our simple analysis might implicitly incorporate the impacts of other sector-specific factors that could influence the utilization rates. In other words, there might be other factors driving the result, such as barriers to the utilization of the FTA preferences.

As revealed by the surveys and interviews with firms and the business association, there are four major causes of the low utilization rate of the agricultural products: an insufficiently attractive margin of preference, a lack of information on preferential tariff treatment, difficulties in providing the necessary documentation, and the passivity of exporters. In view of these findings, we recommend the following policies as they would help exporters reap more benefits from FTAs.

1. The government should put more effort into disseminating information related to the FTAs among SMEs, especially those located in rural areas and not members of any business association. The government should work more closely with business associations to promote widely the distribution of information to the businesses concerned. The relevant government agency should also provide guidebooks and information on best practices in order to help businesses better understand the FTAs.
2. The government should negotiate with the FTA partners in order to accelerate tariff reduction.
3. The government should prepare for further liberalization in order to exchange concessions with FTA partners by developing a

roadmap toward further liberalization. In addition, the government needs to get all stakeholders involved in the planning of the roadmap.

4. The government should continuously monitor preference utilization under the existing FTAs. The perspectives of businesses with regard to making use of preferences should be explored either through surveys or direct interviews. The information obtained from the surveys and interviews would be helpful to the government in identifying problems and finding proper solutions.

## ENDNOTES

- <sup>1</sup> The concluded agreements that have already been implemented include the Association of Southeast Asian Nations (ASEAN) FTA (AFTA), ASEAN-China FTA (ACFTA), Thailand-Australia FTA (TAFTA), Thailand-New Zealand Closer Economic Partnership (CEP) (TNZCEP), and the early harvest scheme between Thailand and India. The agreements that have been concluded but not yet implemented include ASEAN-Japan CEP (AJCEP) and ASEAN-Republic of Korea FTA (AKFTA). The agreements that are still being negotiated are, for example, Thailand-United States of America FTA (TUSFTA), Thailand-Peru FTA, Thailand-European Free Trade Association (EFTA) member countries FTA, Bay of Bengal Initiative for Multi-sectoral Technical and Economic Cooperation (BIMSTEC), ASEAN-India FTA, ASEAN-Australia-New Zealand Closer Economic Relations (CER), ASEAN+3 and ASEAN+6 initiatives.
- <sup>2</sup> AFTA has been in effect since 1993. After the implementation of the early harvest scheme between Thailand and China in 2001, the comprehensive ACFTA went into effect in 2005. TAFTA has also been in effect since 2005. The early harvest scheme between Thailand and India, which is referred to in the paper as TIFTA, has been in effect since 2004.
- <sup>3</sup> CLMV = Cambodia, Lao People's Democratic Republic, Myanmar and Vietnam.

- <sup>4</sup> In order to utilize FTA preferences under all existing FTAs, except the Thailand-New Zealand CEP, it is necessary to submit the certificate of origin issued by the Department of Foreign Trade.

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