

# The Japan-Thailand Economic Partnership Agreement: Utilization and Implementation Issues from the Perspective of Thailand\*

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## 1. INTRODUCTION

The Japan-Thailand Economic Partnership Agreement (JTEPA), a comprehensive bilateral trade agreement between Thailand and Japan, became effective in November 2007. Shortly after implementing JTEPA, both countries, together with other members of the Association of Southeast Asian Nations (ASEAN), also concluded a regional trade agreement known as the ASEAN-Japan Comprehensive Economic Partnership (AJCEP). Although both agreements are supposed to be comprehensive in scope like other “new-generation free trade agreements (FTAs),” most of their benefits are expected to arise from two components: preferential tariff reductions and cooperation programs.

The objectives of this paper are to examine the benefits realized under both agreements from the perspective of Thailand, identify obstacles that prevent them from being fully utilized, make some policy recommendations to improve their implementation, and provide inputs to the review of JTEPA, which will take place no later than 2012. Owing to the fact that JTEPA had been put into effect before AJCEP and thus can be evaluated in a more systematic manner, it will be the major focus of our analysis.

## 2. RESEARCH METHODOLOGY

Theoretically, the benefits of a preferential tariff reduction scheme granted under an FTA can be measured by the increase in social welfare that the FTA brings about. However, it is impossible to measure the

changes in social welfare brought about by tariff reductions under JTEPA, which has been in effect just over a year. In this study, we argue that the level of tariff savings can be used to measure the benefits. The idea is that tariffs are an important form of trade barrier. As a result, tariff reduction tends to promote more trade and thus increase the social welfare of FTA partners, provided that there is no significant trade diversion.

We decomposed the tariff saving rates into three components: the ratio of trade value under preferential tariff rates, the average preferential tariff margin, and the utilization rate of the preferential tariffs (see Box 1). According to our decomposition, an FTA that generates high tariff savings is one that (a) covers substantially all bilateral or regional trade with few or no exceptions, (b) sets the preferential tariff rates significantly lower than the most-favored nation (MFN) rates or other prevailing rates, including those under the generalized system of preferences (GSP), and (c) can be fully utilized without restrictive rules of origin or other non-tariff barriers. Together with the results from our interviews with exporters and importers, tariff saving decomposition enabled us to identify the remaining problems and propose related policy recommendations to address them, as will be shown in the subsequent sections.

## 3. MAIN FINDINGS

By analyzing the first five months of utilization data (November 2007–March 2008) collected by the Department of Foreign Trade and the Customs Department, we found that JTEPA has so far produced

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tariff savings on Thai exports to Japan worth about \$75 million. The top three beneficiary sectors are processed foods, textiles and garments, and jewelry and ornaments. The overall utilization rate was found to be 55.9 percent (see Table 1). The top three beneficiary sectors in terms of utilization were jewelry and ornaments (96%), textiles and garments (71%), and processed foods (66%).

According to a survey conducted by the Japan External Trade Organization (JETRO), Japanese companies were more interested in JTEPA than in any other FTA that Japan had previously concluded (interview with JETRO officials, 2007). However, according to our study the utilization rate of JTEPA by Japanese exporters has been only 6.5 percent (see Table 2), resulting in tariff savings worth \$48 million.

The three sectors that enjoyed the most tariff savings were automotives and auto parts, iron and steel, and textiles and garments. In terms of utilization rate, however, the top three beneficiary sectors were textiles and garments (20%), automotives and auto parts (14%), and iron and steel (12%).

Although Thai exporters appear to be benefiting significantly from the preferential treatment granted under JTEPA, they still face some problems related to the utilization of JTEPA privileges. For example, some small exporters complain that the procedure for applying for certificates of origin (C/Os) is still too complicated. Others say that the preferential tariff margins are too low and that the rules of origin for some products are too restrictive to be useful.

### Box 1 Decomposition of Tariff Saving Rate

$$\begin{aligned}
 & \text{Tariff savings (\%)} \\
 &= \frac{\text{Tariff saved}}{\text{Total trade}} \\
 &= \frac{\text{Actual preferential trade} \times \text{Mean tariff margin}}{\text{Total trade}} \\
 &= \frac{\text{Actual preferential trade} \times \text{Mean tariff margin}}{\text{Total trade}} \times \frac{\text{Potential preferential trade}}{\text{Potential preferential trade}} \\
 &= \frac{\text{Potential preferential trade}}{\text{Total trade}} \times \text{Mean tariff margin} \times \frac{\text{Actual preferential trade}}{\text{Potential preferential trade}} \\
 & \quad \downarrow \qquad \qquad \downarrow \qquad \qquad \downarrow \\
 &= \text{Coverage of FTA} \quad \times \quad \text{Mean tariff margin} \quad \times \quad \text{Utilization rate}
 \end{aligned}$$

Source: Authors.

**Table 1 Coverage, Tariff Preference and Utilization Rates under JTEPA for Selected Manufacturing Sectors (Exports from Thailand from November 2007 to March 2008)**

Sector	Coverage (%)	Tariff preference (%)	Utilization rate (%)	Tariff saving (%)
Food	85.6	12.4	65.6	2.88
Textiles	97.0	7.3	64.5	5.60
Garments	100.0	8.9	71.2	7.10
Leather	92.2	3.8	34.0	2.80
Iron	0.5	3.3	0.0	0.00
Automotive	0.0	0.0	0.0	0.00
Electronics	0.0	0.0	0.0	0.00
Electrical	6.6	4.8	14.4	0.05
Jewelry	38.6	5.4	95.6	2.25
Furniture	1.9	0.6	6.4	0.00
Others	31.2	4.5	47.6	0.80
<b>Total</b>	<b>29.8</b>	<b>7.8</b>	<b>55.9</b>	<b>0.95</b>

Source: Authors' estimations based on Department of Foreign Trade data.

**Table 2 Coverage, Tariff Preference and Utilization Rates under JTEPA for Selected Manufacturing Sectors (Imports to Thailand from November 2007 to March 2008)**

Sector	Coverage (%)	Tariff preference (%)	Utilization rate (%)	Tariff saving (%)
Food	78.3	5.0	0.7	0.09
Textiles	98.2	6.2	17.7	0.71
Garments	99.4	25.0	23.1	6.89
Leather	78.4	1.5	0.1	0.00
Iron	66.4	3.7	11.9	0.37
Automotive	60.3	13.0	13.6	2.22
Electronics	0.5	3.8	0.0	0.00
Electrical	12.8	2.0	0.9	0.00
Jewelry	2.3	14.1	2.2	0.01
Furniture	100.0	1.4	0.0	0.00
Others	41.8	2.1	1.4	0.03
<b>Total</b>	<b>38.6</b>	<b>4.8</b>	<b>6.6</b>	<b>0.37</b>

Source: Authors' estimations based on the Customs Department data.

Our interviews with Japanese trade associations, trade promotion authorities and trading firms also revealed some problems in utilizing JTEPA privileges from the Japanese perspective. The representatives of some companies said that they considered the per-shipment fee charged for issuing C/Os too costly for the just-in-time production system that is widely used in the automotive sector. Some Japanese manufacturers also expressed concern about revealing their production costs to the Japan Chamber of Commerce and Industry (JCCI), the private trade association in charge of issuing C/Os to Japanese exporters. Finally, the issues of re-invoicing,<sup>1</sup> back-to-back certificates,<sup>2</sup> and other aspects of intermediary trade were raised by some multinational companies that have production bases in many countries.

As ACJEP has only recently gone into effect, we can just speculate on the pattern of its utilization. Since the agreement provides a smaller tariff margin than JTEPA for most products, it will be used only for products that are considered non-originating under JTEPA's rules of origins, but are considered originating under AJCEP's rules, which are more relaxed due to their regional accumulative nature. Products that fall into such groups include some electronics equipment whose parts and components are produced in Japan and more than one ASEAN country.

Based on the results shown in Tables 1 and 2, we also analyzed the benefits of JTEPA for eight Thai manufacturing industries, i.e., jewelry, processed food, leather products, textiles and garments, electrical goods and electronics, furniture, automotives and auto parts, and iron and steel:

- **Jewelry and ornaments:** The Thai exporters of jewelry and ornamental products have been major beneficiaries under JTEPA; the utilization rate of 95.6 percent for this sector is high. Even with a modest tariff reduction of less than 10 percent, this high utilization rate

is achieved as no quota is imposed on imports from Thailand. However, in the long run, the tariff margin granted under JTEPA will become even less significant when Japan reduces its tariff under other trade agreements, including the Non-agricultural Market Access (NAMA) under the auspices of the World Trade Organization (WTO).

- **Processed foods:** The Thai processed food industry has utilized JTEPA's tariff preferences at a moderately high level of 65.8 percent. This is due to the substantial preferential tariff margin of 12.4 percent and the large number of products that are granted preferential treatment. However, two major problems remain in utilizing the privileges. First, the rules of origin for some products, such as pet food, are considered too restrictive for Thai exporters. Second, Japan's high standards for food safety impose considerable costs on Thai producers and thus reduce their access to the Japanese market.
- **Leather products:** The utilization rate of JTEPA privileges by Thai leather product exporters is modest at 34 percent. This is due to the long phase-out of tariff reduction over eight years for JTEPA; it is 11 years for AJCEP. In addition, some major Thai export items, such as sport shoes with outer composition leather, have not been granted any preferential tariff treatment. This indicates that the Japanese leather market is still heavily protected. However, the decline of the Japanese leather industry due to high production costs continues to pressure producers to relocate overseas, with Thailand being a potential destination.



- **Textiles and garments:** As discussed previously, the Thai textile and garment industry is a major beneficiary of JTEPA, with a high utilization rate of 71 percent. However, there remain certain problems that prevent greater utilization. In particular, the rules of origin for certain products, such as carpets, are overly restrictive for Thai producers. In addition, cooperation programs for the sector, which are expected to generate great mutual benefits, have yet to be finalized.
- **Electrical appliances and electronics:** Tariff reduction for electrical and electronic products has not been an issue for JTEPA as the tariffs for most products have already been cut to zero under WTO's Information Technology Agreement. Instead, the main focus of JTEPA is to establish a mutual recognition agreement (MRA) that would reduce duplicated testing costs. The implementation of the scheme is still ongoing, as conformity assessment bodies on both sides are applying for accreditation from each other's competent authority. The electrical and electronics industry is also likely to benefit from AJCEP since it would enable producers to relocate their production bases optimally anywhere they might choose within ASEAN and Japan.
- **Furniture:** The Thai furniture industry gains very little from JTEPA; its utilization rate is low at 6.4 percent. This is because Japan has either cut its MFN tariff rates to zero or granted GSP to Thai furniture products.
- **Automotives and auto parts:** Japanese assemblers and auto parts producers are major beneficiaries of JTEPA. Within the first five months of JTEPA implementation, they had already enjoyed total tariff savings of \$6 million. Almost all of the savings are related to the import of Japanese auto parts and components into Thailand. As car production is based on the just-in-time system, the per-shipment fee for issuing C/Os has been cited

as a barrier to trade. Another issue to be resolved is whether the proposal to establish the automotive human resource development institute (AHRDI), currently under discussion, should be treated as a new cooperation project under JTEPA or as an extension of the existing Automotive Human Resources Development Program (AHRDP).

- **Iron and steel:** Because Thailand is the third largest market for the Japanese iron and steel industry, Japanese producers expect to benefit from Thailand's tariff reduction under JTEPA. However, the level of utilization has so far been modest and Thailand's import quota of steel has not been fully utilized. Another issue to be resolved is the gap in understanding between both sides concerning the scope of the cooperation programs. In particular, Thai steel producers find the Japanese proposals for technical cooperation either too elementary or too limited in that only Japanese affiliates are allowed to participate. The fact that Japan's Ministry of Economics, Trade and Industry (METI) has been in charge of the negotiations while the Ministry of Education, Culture, Sports, Science and Technology (MEXT) is responsible for implementing the agreed human resources development programs also complicates the issue.

#### 4. CONCLUSION AND POLICY RECOMMENDATIONS

While JTEPA and AJCEP have the potential to significantly increase the bilateral trade between Thailand and Japan, our study shows that many issues still need to be addressed before the agreements can be fully utilized. From the Thai perspective, we propose the following policy recommendations:

- The Thai government should establish a JTEPA secretariat to follow up pending issues and to promote greater utilization of JTEPA privileges by Thai companies. That office should provide a forum to receive complaints and suggestions from the private sector. The office should provide a quarterly report to the JTEPA Committee and should be responsible for providing background information and recommendations for the review of the agreement.
- The Thai government should aim at negotiating for further tariff reductions and relaxation of rules of origin for certain products. In particular, for products that enjoy GSP privileges, JTEPA's tariff rates should

be lowered to those of the GSP rates. The rules of origin should be relaxed on products such as animal feed, carpets, and bed covers.

- The Thai Ministry of Industry should strengthen the capacity of its affiliated industry-specific institutes to enable it to better respond to the needs of the private sector. The governance of cooperation projects under JTEPA should also be made more open to inputs from the private sector.
- The Thai government should closely follow changes in Japanese trade policies and regulations and provide the private sector with early warnings to help enable its constituents to better adjust to the changes. Furthermore, in-depth market studies that provide insights into the nature of Japanese markets, including consumer preferences and the functioning of its distribution systems for each major export product, should be made available.
- The Thai government should put more effort into finalizing pending cooperation projects and make them more open to Thai companies. Priority projects that need to be finalized include human resources development for the automotive industry and consumer safety regulations for the processed food industry.
- The Customs Department and the Department of Foreign Trade should dedicate more

resources to raise awareness and increase understanding of JTEPA among Thai companies.

#### ENDNOTES

- <sup>1</sup> Re-invoicing occurs in a commercial flow in which invoices are issued from a home office or regional headquarters in a third country other than the country of origin. This kind of re-invoicing is a matter of general business practice in Asia. It is common for invoices to be issued from Singapore, where many regional headquarters are located, or from head offices in Japan. For more details, see JETRO (2007).
- <sup>2</sup> Back-to-back certification is a phenomenon that occurs in FTAs concluded by three or more countries. In addition to re-invoicing, both the goods and the country of origin certificates are shipped through a third country. For more details, see JETRO (2007).

#### REFERENCE

- Japan External Trade Organization (JETRO). 2007. JETRO White Paper on International Trade and Foreign Direct Investment – Increasing Utilization of Asian FTAs and Growth Strategies for Japanese Companies. Available from the website of the Japan External Trade Organization ([www.jetro.go.jp](http://www.jetro.go.jp))

