

## Utilisation of Existing ASEAN FTAs by Micro-, Small- and Medium-Sized Enterprises

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### Summary

This policy brief<sup>1</sup> examines the extent to which micro-, small-, and medium-sized enterprises (MSMEs) have benefited from the conclusion of trade agreements involving ASEAN member states. Key findings:

- ASEAN Member States (AMS) are active participants in a growing number of free trade agreements (FTAs). As of 2013, AMS were involved in over 80 FTAs.
- However, MSMEs may not be reaping the full benefits from these trade agreements because of: (i) the lack of information on FTAs amongst ASEAN-based firms; (ii) low margins of preference; and (iii) delays and administrative costs associated with documenting and complying with the agreements' Rules of Origin (RoO).
- Data suggests that the utilisation rates of most FTAs involving ASEAN countries are low and are frequently well below 50%. Utilisation of ASEAN-wide FTAs, appears to be less than for bilateral FTAs initiated by individual AMS, as market access concessions made by trading partners are more limited in ASEAN-wide FTAs.
- To enhance the utilisation of FTAs, it is important that more information be provided to MSMEs. Moreover, improvements in access to finance for MSMEs would also increase their ability to benefit from FTAs. Simplification of Certificates of Origin (CoO) and associated RoO would also encourage MSMEs to take part in trade using preferential agreements.

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## Introduction

As of 2013, the Association of Southeast Asian Nations (ASEAN) and its member states (AMS) were involved in over 80 free trade agreements (FTAs) (table 1). In this brief, a FTA is defined as a treaty between two or more countries to establish a free trade area where commerce in goods and services can be conducted across their common borders, without tariffs or other restricting measures. Despite progress on economic integration within ASEAN, as well as between both ASEAN (collectively) and AMS (individually) with other non-ASEAN countries, there are concerns over the extent to which micro-, small-, and medium-sized enterprises (MSMEs) have benefited from these commercial pacts. Numerous studies, such as Kawai and Wignaraja (2008, 2009, 2010, 2011, 2013), Chia (2010), Dagooc (2013), Chandra and Hattari (2013), and Chandra (2015) suggest that the usage of the preferences agreed under these commercial pacts is relatively low among MSMEs.

**Table 1: Total Number of FTAs led by ASEAN and individual AMS, 2014**

Type of FTAs/EPAs	In effect	Signed but not in effect	Framework Agreement signed/FTA negotiated	Under negotiation	Under consultation /study	Postponed /cancelled	Total
ASEAN FTA (AFTA/ATIGA)	1	0	0	0	0	0	1
Bilateral FTAs involving an AMS and a third party	26	4	2	16	10	0	58
FTA between Individual AMS and a regional group	8	0	0	6	5	0	19
ASEAN-wide FTAs	5	0	0	0	0	0	5
<b>Total</b>	<b>38</b>	<b>4</b>	<b>2</b>	<b>22</b>	<b>15</b>	<b>0</b>	<b>83</b>

Source: ASEAN (2014; 2015); Kawai and Wignaraja (2013)

### ASEAN-wide FTAs: the state of play

ASEAN has not only been playing an active role in promoting FTAs in Asia, but has also been turning itself into an FTA hub in the region. ASEAN's diplomatic and economic significance can be seen in the number of such commercial pacts (as well as other forms of economic cooperation, such as economic partnership agreements) that the grouping has either signed, or is currently negotiating with major economic partners. ASEAN has concluded various trade agreements with external partners, including those with China (in 2002), Japan (2003), the Republic of Korea (2005), Australia and New Zealand (2009), and India (2009). Table 2 provides more details on ASEAN-wide FTAs (Chandra, 2015).

**Table 2: ASEAN-wide FTAs**

	ASEAN-China FTA	ASEAN-Republic of Korea FTA	ASEAN-Japan Comprehensive Economic Partnership	ASEAN-India FTA	ASEAN-Australia-New Zealand FTA
<b>Entry into force</b>	2005	2007	2008	2010	2010
<b>Market size (million)</b>	1,939	647	726	1,814	625
<b>Economic size (in \$ trillion)</b>	7.7	2.9	7.3	3.4	3.2
<b>COVERAGE</b>					
<b>Trade in goods</b>	✓	✓	✓	✓	✓
<b>Rules of origin</b>	RVC 40%	RVC 40% / CTC / PSR	RVC 40% / CTC / PSR	RVC 35% + CTSH**	RVC 40% / CTC / PSR
<b>Trade in services</b>	✓	✓	✓	✓	✓
<b>Investment</b>	✓	✓	✓		✓
<b>FTA-Plus commitments ?</b>			✓		✓
<b>Duty phase out date</b>	2012	2012	2026	2019	2020
<b>Total trade (in \$ billion) YEAR?</b>	751.8	618.4	726.4	575.2	582.6

Source: Nagalingan (2012), cited from Chandra (2015).

Notes: \*RVC: Regional Value Content; CTC: Change in Tariff Classification rule; PSR: Product-Specific Rules;

\*\*CTSH: Change in Tariff Sub-heading

### Utilisation of ASEAN-wide FTAs by ASEAN MSMEs

Although official data on the utilisation of ASEAN-wide FTAs by businesses, particularly the MSMEs, in the region, are hard to come by, studies and commentaries made in some AMS suggest that MSMEs have not generally taken advantage of these trade pacts. Utilisation rates can be defined as the share of exports, which are made under the available preferential tariff rates rather than using the 'Most Favoured Nation' (MFN) applied tariff rates available to exporters from all WTO members. These utilisation rates provide a useful guide to the relevance and usability of FTAs for exporters.

A commentary made by Dagooc (2013) stated that Philippines-based exporters face a number of barriers and perceived disincentives to trading under FTAs. Despite the active stance of the government of the Philippines to encourage firms to make use of the country's existing FTAs, most exporters felt intimidated by the complicated rules and procedures associated with the use of FTAs. In addition, misconceptions about FTAs, complicated trade procedures in the partner countries, unharmonized codes within the ASEAN region, and the difficulty of accessing the most up-to-date information on relevant regulations are the major obstacles preventing Philippines-based MSMEs from fully participating in these FTAs.

For Thailand, there are some important studies that assess the utilisation rate of various Thai- and/or ASEAN-wide FTAs by Thailand's businesses. Kohpaiboon (2008), for example, analysed the use of the AFTA by the country's exporting firms for the period of 2003-2006. Using AFTA administrative records collected from the Bureau of Preferential Trade, the Department of Foreign Trade, and the Ministry of Commerce, the study found that large exporting firms in industries were more inclined to make use of FTAs in cases of large differences between MFN and preferential tariff rates. A survey carried out among 221 exporting firms, both domestic and foreign, in three industries (textiles/garments, electronics, and auto/autoparts) by Wignaraja *et al.* (2010) revealed the extent to which FTAs affect exporting firms in Thailand. Despite a reasonable use of FTA preferences by these firms, a common complaint, especially those larger firms, about Thailand's FTAs was the complex bureaucracy and additional costs associated with acquiring the Certificate of Origin (CoO) and the associated Rules of Origin (RoO). Accordingly, the sample firms, especially domestic ones, requested the government of Thailand to provide more institutional support so as to allow them to take advantage of the FTA's implementation..

Some other studies cited by Chandra (2015) (e.g. Udomwichaiwat, 2012 and Cholvijarn, 2013) reveal a decline in the utilisation of Thailand's FTAs: while the overall utilisation among Thai-based firms reached 61.3% in 2011, the rate fell to 47.3% in 2012 (table 3). Among its FTAs, Thai-based firms appeared to have made the most use of the Thailand-Australia FTA, which had a 90.8% utilisation rate in 2011, though the utilisation rate fell in the subsequent year. An interesting aspect of the utilisation rate in Thailand is the generally higher use of Thailand's bilateral FTAs, rather than ASEAN-wide FTAs. The more attractive preferences available for key products and simplified rules of origin is likely to explain the heavier use of bilateral FTAs rather than those between a country and a regional group (Kawai and Wignaraja, 2013: 18).

**Table 3: Utilisation rates of FTAs by Thai-based firms in 2011 and 2012 (in percentage)**

Trading partners	Type of FTA	2011	2012
<b>ASEAN (AFTA)</b>	ASEAN-wide	51.91	47.36
<b>China (ACFTA)</b>	ASEAN-wide	84.29	80.64
<b>India (TIFTA)</b>	Bilateral	74.61	70.04
<b>India (AIFTA)</b>	ASEAN-wide	28.89	28.91
<b>Australia (TAFTA)</b>	Bilateral	90.82	60.65
<b>Australia (AANZFTA)</b>	ASEAN-wide	26.46	2.81
<b>Japan (TJEPA)</b>	Bilateral	71.18	67.95
<b>Japan (AJCEP)</b>	ASEAN-wide	3.80	0.74
<b>Korea (AKFTA)</b>	ASEAN-wide	58.87	55.78
<b>New Zealand (AANZFTA)</b>	ASEAN-wide	17.67	2.28
<b>Peru (TPCEP)</b>	Bilateral	n.a.	18.53
<b>Total</b>		<b>61.30</b>	<b>47.32</b>

Source: Udomwichaiwat 2012 and Cholvijarn, 2013, cited by Chandra (2015).

Elsewhere in ASEAN, the utilisation of the grouping's FTAs remain modest, if not low. In Indonesia, for instance, although the total number of CoO issued under the ASEAN FTA, Indonesia-Japan Economic Partnership Agreement (EPA), ASEAN-China FTA, ASEAN-Korea FTA, and the ASEAN-India FTA had been on the rise from 26,085 certificates in 2007 to

205,775 certificates in 2010 (Ing, 2013: 6), a study conducted by Friawan (2012), cited in Chandra and Hattari (2013), suggests that only 16-17% of Indonesian-based firms were using FTAs agreed either at the national level or through ASEAN. This was somewhat lower than the rates observed in Viet Nam (31% in 2011), and Thailand (the above-mentioned 47.3% for 2012).

As for Malaysia, as cited by Chandra (2015), the Asian Development Bank (ADB) in collaboration with the ADB Institute (ADBI) carried out a study in 2012 that also showed that only 24% of the country's firms exported under FTAs. Despite this, the Ministry of International Trade and Industry of Malaysia reported in 2012 the increased use of CoO among Malaysian-based firms under different FTA schemes. While in 2009 the total number of CoO issued reached 232,860, equal to about \$19.0 billion of total value of trade, a total of 436,094 CoO were issued in 2011, amounting to roughly \$32.1 billion of the country's total trade with the rest of the world. The largest number of CoO issued in 2011 was under the AFTA scheme, with 230,400 CoO, while the CoO under the ASEAN-Australia-New Zealand FTA came under the second place with 47,387 CoO (Chandra, 2015).

Among the newer AMS, only Viet Nam has relatively recent data concerning the utilisation of ASEAN-wide FTAs. Although showing a relatively low overall use of FTAs, as in the case with the majority of the country's ASEAN neighbors, the utilisation rates of FTAs among Viet Nam-based firms nearly trebled from 11% in 2008 to 31% in 2011. Exporting firms who used these FTAs made particularly heavy utilisation of the ASEAN-Korea FTA (at 90.8% utilisation rate) and the ASEAN-Japan CEPA (at 31.23% utilisation rate). Surprisingly, despite sharing land and maritime borders with China, the use of the ASEAN-China FTA among Viet Nam-based businesses was relatively low (at 23.1% utilisation rate), though this was higher than the use of AFTA (at 20.2% utilisation rate) during the same period (Tran, 2012).

Comprehensive assessments on the utilisation of ASEAN-wide FTAs among MSME's in particular are largely absent. However, Lim and Kimura (2009) argued that with the increased integration of the region's MSMEs into regional and global value chains, especially in electronics, machinery, information and communication technologies, automobiles, and service industries, the use of FTAs by these enterprises can be expected to increase as well. Notwithstanding such an expectations, both authors also maintained that production networking and value chains have not really benefited from the internal and external economic integration of ASEAN. As observed by both authors, AFTA and other ASEAN-wide FTAs contain too many exceptions (often on key sectors), include inadequate harmonisation of rules and regulations (including the existence of non-tariff barriers), and lack adequate infrastructure and institutions to successfully implement these trade pacts.

Overall, there are at least three reasons why the utilisation rates of these FTAs are generally low: (1) a lack of information on FTAs amongst ASEAN-based firms; (2) low margins of preference; and (3) delays and administrative costs associated with documenting and complying with the Rules of Origin (ROO). Other factors contributing to the low use of FTAs

includes the existence of other trade-related initiatives, such as export processing zones and Information Technology Agreements, which provide alternative incentives for exporters, and the non-tariff measures in partner countries that inhibit imports, and, accordingly, inhibit the use of FTA preferences (Kawai and Wignaraja, 2013).

### **ASEAN-wide FTAs: key challenges and opportunities for ASEAN MSMEs**

In terms of opportunities for MSMEs, existing ASEAN-wide FTAs can provide:

- 1) Potential market expansion, be it within the ASEAN region, or in the markets of the grouping's trade agreement partners;
- 2) New business opportunities for MSMEs by allowing MSMEs to integrate themselves into wider regional value chains (Kaplinsky and Morris, 2000);
- 3) Facilitation of intra-ASEAN trade and trade between ASEAN and its trade agreement partners. Key components of ASEAN-wide FTAs, such as trade facilitation, often encourage all the participating countries to establish more efficient custom procedures, greater transparency in trade policies, and greater mutual recognition of technical standards adopted by all the involved parties; and
- 4) Encouragement of greater foreign investment in AMS. While large investment projects, such as infrastructure development, can generate positive spill-over impacts to MSMEs, foreign investment could also spur the transfer of technologies and know-how, all of which allow MSMEs to enhance their business opportunities.

When it comes to the utilisation of ASEAN-wide FTAs, the series of MSMEs Dialogue Forums that were carried out by the ASEAN-Business Advisory Council, the International Institute for Sustainable Development, and their local partners in the second half of 2013 and early 2014 in several major cities of ASEAN (Manila, Jakarta, Bangkok, Hanoi, and Yangon), in which the author was involved, also revealed that the lack of information, especially concerning foreign markets and the technical know-how to use these commercial agreements, was considered as the major stumbling block for local MSMEs from using these FTAs. In addition, resource persons and participants in these forums also cited the lack of opportunities for MSMEs to network with their foreign counterparts as another common challenge preventing MSMEs from engaging more effectively with ASEAN-wide FTAs. The participants in these Forums, in fact, suggested the necessity of similar forums being organised more regularly in other cities and/or regions outside the capitals.

At the policy level, the complex RoO, and the associated CoO, in the implementation of ASEAN-wide FTAs are also seen as burdensome by local MSMEs. This is not to mention high administrative costs attached to the compliance requirements to prove a product's country of origin. In addition, multiple and often overlapping FTA commitments by the AMS often

generates confusion among MSMEs. These also make many ASEAN-wide FTAs redundant. It has been suggested that divergent RoOs across different FTAs are likely to fragment, rather than integrate regional markets (Tran, 2012). Traders are also likely to face higher administrative and production costs. All these constraints eventually lead to the low utilisation rates of ASEAN-wide FTAs.

## **Conclusion and policy recommendations**

In order to enhance the utilisation of ASEAN-wide FTAs among MSMEs, and ensure more equal opportunities among economic actors across the region, the paper proposes the following:

### **(1) An institutionalised, forceful, well-coordinated, and interactive information campaign**

- As many MSMEs still lack basic information, an information campaign alongside expanded networking activities within ASEAN needs to be organized more regularly, and be made available beyond capitals and/or major cities in the region;
- Information campaigns and networking around ASEAN-wide FTAs should be a two-way process. In this context, such activities should not only provide the opportunity for AMS or major business associations to consider these commercial pacts, they should also serve as venues for gathering practical and policy inputs from relevant stakeholders, including the MSMEs, in the region;
- More interactive and practical methods for communicating components of ASEAN-wide FTAs should be strongly considered;
- The government of the Philippines, through its 'Doing Business in FTAs' initiative, has provided a very good example on how a well coordinated information campaign and networking activities. Such an institutionalised information campaign can serve as a model for similar activities not only at the regional, but also at the national level in other AMS.

### **(2) Improving access to finance for MSMEs**

- MSMEs should have more access to finance as it is also a key determinant for them to engage more effectively in ASEAN-wide FTAs;
- Financial sector reform through liberalisation alone, however, is unlikely to be a sufficient means to improve access to finance to MSMEs. ASEAN and the AMS, for example, could establish a financial infrastructure that would stimulate income gains among the region's MSMEs.

(3) The simplification of CoO/RoO requirement

- Efforts to further simplify CoO requirements and spread the technical knowledge needed to comply with CoO/RoO requirements among MSMEs must be intensified;
- While the creation of the ASEAN Single Window is progressing well, this initiative should be expanded to include countries with which the grouping has FTA arrangements;
- ASEAN should accelerate the negotiation process of the Regional Comprehensive Economic Partnership (RCEP), which at the moment is being set for the end of 2015. RCEP provides an opportunity to consolidate existing FTAs and reduce complex overlapping rules though there is a risk that this opportunity may not be fully seized.

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