

**The London School of Economics and Political Science**

*Production networks and regionalism in East Asia: Firms and states in the bilateral free trade agreements of Thailand and Malaysia*

Antonio Postigo

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## Abstract

Investment and trade flows across East Asia during the last three decades have fostered the development of production networks and economic integration. However, only since the turn of the century, have East Asian countries begun to institutionalize such integration through free trade agreements (FTAs). With the exception of Japan, the literature portrays East Asian FTAs as driven by political elites on primarily foreign policy motivations and with marginal participation of businesses in their formulation and utilization. Most of these narratives have, however, overlooked endogenous sources of trade preferences, shortcoming that this Thesis attempted to correct by analyzing how FTAs fit within the strategies of states and firms. The project investigated the mutual interaction between evolving trends within East Asian production networks and states' and firms' preferences on FTA liberalization using as case studies the bilateral FTAs negotiated by Thailand and Malaysia within the context of key production networks, particularly the automotive industry. Research involved extensive process-tracing through semi-structured interviews and trade data analyses. The main findings of this dissertation were: 1) Compared to multilateral liberalization, greater technical complexity and easier assessment of impacts in bilateral FTA negotiations resulted in more intense government-business consultations and corporate lobbying. Successive FTA negotiations strengthened the technical capacities of bureaucrats and firms and prompted the emergence of new institutional structures for intermediation and coordination among all actors; 2) Sectors that had successfully lobbied *ex-ante* for FTA liberalization and/or benefited from unilateral liberalization schemes have made extensive utilization of FTAs; 3) Governments and firms in both countries sought and extracted selective rents in FTAs to improve their relative position not only with respect to states and firms outside the bloc but also inside, and; 4) The interplay between overlapping FTA areas and the investment sunk in them shaped governments' and firms' positions on further FTA liberalization.

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*To my parents*

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## 1

# Introduction

Exploring the interplay between regionalization and regionalism in East Asia

## Abstract

Cross-border flows of investment and trade within East Asia during the last three decades have prompted the growth of sophisticated production networks and a *de facto* regional economic integration (*regionalization*). Distinct from other regions, regionalization in East Asia has occurred in the absence of formal inter-governmental institutions establishing a *de jure* regional integration (*regionalism*). Until the turn of the century, East Asia was virtually untouched by the global proliferation of Free Trade Agreements (FTAs) that began in the early 1990s. However, since 2002, East Asia has become one of the most active focus of regionalism with close to 60 FTAs already implemented, mostly as bilaterals. Dominant accounts in the literature on East Asian regionalism argue that, apart from Japan, geopolitical and security motivations have primed over economic ones in East Asian FTAs, which have been formulated with little participation of the private sector in their formulation or interest in their utilization afterwards. This Thesis will argue for the need of a more nuanced analysis of East Asian regionalism that problematizes parsimonious systemic explanations and, rather, pays more attention to the structure of incentives and strategies driving state and business actors. The research project is concerned on whether and how evolving trends within East Asian production networks have influenced states' and firms' preferences regarding FTA liberalization and, in turn, whether and how particular configurations in FTAs have affected dynamics between and among states and firms in the context of production networks. This Introduction provides the background for the four essays to follow. First, it outlines the evolution of regionalization and regionalism in East Asia and their interplay from the perspective of states and firms. Secondly, it introduces and reasons the choice Thailand and Malaysia as case studies. Lastly, it establishes the overall objectives and research questions for the Thesis and brings forth some general hypotheses to develop and test in the Essays.

**Abbreviations:**

AFTA: Association of South East Asian nations free trade agreement  
APEC: Asia-Pacific economic cooperation  
ASEAN: Association of South East Asian nations  
ASEAN4: Malaysia, Thailand, Indonesia, Philippines  
FTA: Free trade agreement  
FDI: Foreign direct investment  
GATT: General Agreement on tariffs and trade  
GSP: Generalized System of preferences  
MFN: Most-favored-nation  
NAFTA: North America free trade Agreement  
NIE: New industrialized economies  
ROOs: Rules of origin  
WTO: World Trade Organization

## 1. Introduction

The present Thesis is the result of a research project that started in July 2006 and involved desk research and two field research trips in 2008 and 2009. Although its content was continuously updated with information from personal communications, secondary sources and academic literature, the bulk of the research and draft writing was completed in September 2010.<sup>1</sup> The project aimed to shade light on the reasons *why*, and the circumstances under which, states and firms seek particular forms of trade relations. As new and evolving patterns in international investment, production and trade have altered power dynamics between and among states and firms, the main concern of this research was twofold, to explore: 1) *whether/how* these changes in power relations have influenced states' and firms' generic preferences and specific institutional choices regarding trade liberalization, and, in turn, 2) *whether/how* particular configurations in unilateral or reciprocal arrangements regulating trade flows have affected inter- and intra- states and firms dynamics and existing investment, production and trade patterns. Nevertheless, it should be noted from the start that while the project explored the *impacts* of specific configurations in international trade relations, its main focus was on the dynamics of institutional *creation*.<sup>2</sup>

Institutions reproduce the power relations that set them in place (Przeworski, 2004) with their impacts shaped and distributed according to what Khan (1997:77) referred as the *political settlement*, “the balance of power between the groups affected by the institution”. Few cases illustrate better the distributional effects of international institutions among states and firms as the regime regulating global trade. A relatively new phenomenon in the trade regime has been the rapid proliferation of Free Trade Agreements (FTAs), most as bilaterals (WTO, 2011). By providing preferential tariffs only to members within the

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<sup>1</sup> Essays 1, 3 and 4 were written between July 2009 and August 2010. Essay 2 was written in August 2012.

<sup>2</sup> The reason of this focus is that assessing many of the impacts of trade arrangements requires a long-term analysis that exceeded the time frame of this Thesis project.

bloc, FTAs constitute an exception to the most-favored-nation (MFN) treatment principle that governs trade in goods under the World Trade Organization (WTO) multilateral trading system.<sup>3</sup> Compared to the multilateral system, bilateral FTAs, especially those between developed and developing countries, accentuate the preponderance of national power asymmetries (Shadlen, 2005; Pekkanen et al., 2007).

Advances in transportation and progressive trade liberalization occurred over the last two decades have allowed in many industries the fragmentation of production across national and/or firm boundaries (Arndt and Kierzkowski, 2001). Firms undertake fragmentation and offshoring of their production process (with or without outsourcing) when *production costs* elsewhere are sufficiently lower to offset *service links costs*, the costs of linking dispersed production blocks.<sup>4</sup> Fragmentation has been key in the emergence and growth of cross-border production networks, where multinational and domestic firms engage in complex intra- and inter-firm linkages. In no other region have these production

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<sup>3</sup> The MFN treatment principle, enshrined in Article II of the General Agreement on tariffs and trade (GATT), establishes that WTO members should extend to all members the most favorable tariff treatment granted to any given member. Members to the WTO can claim exception to the MFN principle under few circumstances, one of them being the formation of a *Regional Trade Agreement* that should be notified to the WTO under four official categories: ([http://rtais.wto.org/UserGuide/RTAIS\\_USER\\_GUIDE\\_EN.html#\\_Toc201649637](http://rtais.wto.org/UserGuide/RTAIS_USER_GUIDE_EN.html#_Toc201649637), last accessed on June 15, 2013); 1) *Free Trade Agreements* (FTAs) in “which the duties and other restrictive regulations of commerce [...] are eliminated on substantially all the trade between the constituent territories” (Article Paragraph 8(b) of Article XXIV GATT). At the latest WTO update (August 8, 2013), of the 252 individual Regional Trade Agreements on goods and/or services in force, 214 have been notified as FTAs. Of all FTAs notified to the WTO up to date, not necessarily including all FTAs in force, over 85% have been implemented since 2000 (<http://rtais.wto.org/UI/PublicMaintainRTAHome.aspx>, accessed on August 11, 2013); 2) *Customs Unions*, referred as “the substitution of a single customs territory for two or more customs territories, so that duties and other restrictive regulations of commerce [...] are eliminated with respect to substantially all the trade between [or of products originating within] the constituent territories of the union” and when “the same duties and other regulations of commerce are applied by each of the members of the union to the trade of territories not included in the union” (Paragraph 8(a) of Article XXIV of GATT); 3) *Economic Integration Agreements*, that liberalize trade in services and must have “a substantial sectoral coverage” and eliminate substantially all discrimination among the parties (Article V of GATS); and, 4) *Partial Scope Agreements*, which cover only a limited number of products and are notified under Paragraph 4(a) of the Enabling Clause of GATT. Countries may also sign *Early Harvest Agreements*, that liberalize from the start a limited number of items while the full fledge FTA is negotiated. Although, in practical terms, Early Harvest agreements could be considered as Partial Scope Agreements under WTO terminology, they are often not notified to WTO and, consequently, they are not included in the official Regional Trade Agreements Information System database (<http://rtais.wto.org/UI/PublicMaintainRTAHome.aspx>). In addition to Regional Trade Agreements, countries could breach the MFN principle and unilaterally offer tariff preferences as part of what WTO refers as *Preferential Trade Arrangements* (<http://ptadb.wto.org/?lang=1>, last accessed on June 15, 2013) such as those in the *Generalized System of Preferences* (GSP) programs (see Essay 2). Of these types of trade tariff agreements, this Thesis will only examine FTAs and Preferential Trade Agreements (GSP). When appropriate, I will also analyze selected Early Harvest agreements (e.g., Thailand-India). Some authors consider the term “Free Trade” in FTAs a misnomer as flexibilities under GATT Article XXIV mean that many FTAs maintain significant levels of protectionism. Thus, in the academic literature, FTAs have also been referred to as *Preferential Trade Agreements* (but without the meaning given under WTO terminology; e.g., Scollay, 2001; Bhagwati, 2008:xi) or as *Regional and Bilateral Trade Agreements* (but excluding the other three types of Regional Trade Agreements under WTO definition; e.g., Shadlen, 2008). Governments themselves have also used names different from FTAs to refer to their agreements such as *Closer Economic Relations Trade Agreement* (as in the Australia-New Zealand FTA), *Economic Partnership Agreement* (most FTAs signed by Japan), *Comprehensive Economic Cooperation Agreement* (e.g., India-Singapore FTA), etc. With these caveats in mind, this Thesis will adhere to the official terminology by WTO and use the term FTA to refer exclusively to trade agreements classified as such under WTO (Article XXIV of GATT), independently of whether they involve two (bilateral FTAs) or several (regional FTAs) countries.

<sup>4</sup> Fragmentation is also referred, *inter alia*, as “vertical specialization” and “production unbundling”. Moving some production stages overseas could reduce production costs due to specific locational advantages (e.g., lower labor costs, physical infrastructure, agglomeration economies, policy environment, etc.). Service link costs are mostly related to trade barriers and transportation and logistics costs (Kimura, 2006a; Kimura, 2006b).

networks achieved greater breadth, depth and sophistication than in East Asia (Jones et al 2005; Kimura and Ando, 2005; Athukorala and Yamashita, 2006; Kimura, 2006a; Kimura et al., 2007; Kimura and Obashi, 2011; Baldwin and Okubo, 2012).<sup>5</sup>

Cross-border flows of investment and trade within East Asian production networks have contributed to the rapid *regionalization—de facto* but informal economic integration—experienced by East Asia, especially since the mid-1990s (Higgot, 1997; Borrus et al, 2004; Kim, 2004; Ernst, 2006; Fouquin et al., 2006; Munataka, 2006; Aminian et al., 2009). While in other regions regionalization followed government-led functional cooperation and formal institutional arrangements, most renderings in the literature argue that regionalization in East Asia has resulted from a market-led division of labor across countries. Until the turn of the century, East Asia was virtually untouched by the wave of *regionalism—de jure* economic integration through intergovernmental institutions—sweeping through every other continent since the early 1990s (Soesastro, 2006; Yue and Pangestu, 2006; Siddique, 2007). This gap between *de facto* and *de jure* integration has been, however, rapidly bridged as East Asia has become one of the most FTA-active regions in the world.

This introductory chapter outlines the context and objectives for the rest of the dissertation. Sections two and three below briefly examine the emergence and evolution of regionalization and regionalism in East Asia. Finally, section four sets up the generic research questions of the research project and the overall analytical framework and hypotheses of the four essays that follow.

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<sup>5</sup> Throughout this dissertation, and following convention in the literature, East Asia refers to Japan, South Korea, China (including Hong Kong), Taiwan and the ten countries integrating the Association of South East Asian nations or ASEAN (Thailand, Malaysia, Indonesia, Singapore, Philippines, Brunei, Cambodia, Myanmar, Vietnam, Laos).

## 2. From flying geese to regional production networks

The sequential process of industrialization catching up that is taking place in East Asia since the Second World War has been often explained by the “flying goose” model (Kojima, 2000).<sup>6</sup> First, the new industrializing economies (NIEs) of Korea, Taiwan, Singapore and Hong-Kong, afterwards Malaysia, Thailand, Indonesia and Philippines (often referred as ASEAN4)<sup>7</sup>, and more recently China, have replicated the industrialization strategies of Japan, entering initially into light industries and moving later to heavier and more advanced ones (Hiratsuka, 2006).

Rapidly increasing wages in Japan since the 1960s and currency appreciation in 1985 began eroding Japanese comparative advantage in manufacturing, especially for labor-intensive industries. Japanese firms responded by fragmenting production and establishing plants in ASEAN4, mainly Thailand and Malaysia, to conduct final manufacturing stages (Hiratsuka, 2006; Baldwin 2008).<sup>8</sup> Japanese foreign direct investment (FDI) into ASEAN4 fostered regional trade, rather than replaced it, as these assembly operations were initially largely dependent on imported intermediate inputs and capital goods from Japan. Final products were eventually destined to domestic markets or exported to the United States and Europe as part of a triangular pattern of production and trade (Hiratsuka, 2006; Kimura, 2006a; Kimura et al., 2007; Baldwin, 2008).<sup>9</sup>

In 1985, Japan provided for almost all of the Asian-originating parts and components imported by Japanese subsidiaries in ASEAN4. Firms from the NIEs began to offshore operations to ASEAN4 since the 1980s, and their home countries also became an important source of parts and components. Eventually, backward linkages to local suppliers prompted upstream intra-industry catching-up by latecomers. By the early 2000s, ASEAN4

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<sup>6</sup> See Bernard and Ravenhill (1995) for a critique of the flying-geese model.

<sup>7</sup> These countries are, excluding Singapore, the four most advanced economies of ASEAN (see footnote 5).

<sup>8</sup> Compared to NIEs, lower public and private capabilities in ASEAN4, forced their governments to rely more on foreign direct investment for their import-substitution and export-oriented industrialization.

<sup>9</sup> Exports back to Japan from Japanese subsidiaries in East Asia were low or negligible for most sectors and have declined since then (Chase, 2005; and see below).

and China were not only suppliers of parts and components to each other but also to Japan and the NIEs (Kimura et al., 2007; Paprzycki and Ito, 2010; Baldwin and Okubo, 2012).<sup>10</sup> Nevertheless, Japan continues to be, along with Singapore, the main Asian source of manufacturing parts and components for assembly plants in ASEAN4, particularly for Japanese subsidiaries that, on average across all sectors, import 33% of their inputs from home (Baldwin and Okubo, 2012).<sup>11</sup>

Compared to networks elsewhere, East Asian production networks span across more countries and have higher penetration by local firms at the first-tier supply level (Dyker, 2006; Athukorala, 2008). Evolving dynamics in the organization and governance of production networks (Gereffi, 2013), along with intra-industry catching up and technological leapfrogging in upstream production and processes by latecomer firms (Hiratsuka, 2006) are transforming traditional models of industrialization and technological diffusion in East Asia. FDI and trade in East Asian production networks have become, if anything, more intertwined in what Baldwin and Okubo (2012) referred as “networked FDI”, particularly prevalent in the electronic equipment, textiles, chemical and machinery sectors.<sup>12</sup>

In most East Asia countries, the general machinery, electronics and automotive industries account for 50-70% of total imports and exports. The emergence and deepening of East Asian production networks has been manifested in a sharp increase in the trade of parts and components, also referred as *input trade*, particularly for general machinery and transport equipment (Kimura et al., 2007). The share of machinery parts and components in

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<sup>10</sup> The contribution of both Japan and the rest of the world to the intermediate inputs imported by ASEAN4 has progressively declined in favor of ASEAN4 itself and, increasingly, China (Paprzycki and Ito, 2010). There has also been considerable technological leapfrogging and the quality of many parts and components from ASEAN4 and Chinese suppliers reaches international quality standards (Kimura, 2006b; Hiratsuka, 2006; METI, 2006).

<sup>11</sup> Using firm-level data, Baldwin and Okubo (2012) computed sectoral patterns of sourcing and sales by Japanese subsidiaries in East Asia. Among the sectors analyzed in this Thesis, in 2005, the automotive and iron and steel industries sourced over a third of their parts and components from Japan, for 25% in the textiles and garments sector, and less than 5% by processed food firms.

<sup>12</sup> Between 1996 and 2005, pure horizontal (market-seeking) and vertical (efficiency-seeking) FDI have declined in favor of networked FDI, where a significant share of the sourcing and exports of Japanese subsidiaries does not involve either the home or host countries (Baldwin and Okubo, 2012).

intra-regional exports has increased from 30% in 1987 to 53% by the mid-2000s and reaches up to 80% in some countries (Ando and Kimura 2005; Kimura et al., 2007).<sup>13</sup> However, East Asian production networks still depend to a large extent on Western markets for exports of their final goods (Paprzycki and Ito, 2010; Athukorala and Kohpaiboon, 2012).<sup>14</sup>

Production networks have spread geographically as firms untapped new pools of labor in successive East Asian latecomers to lower production costs. Regional production networks have also expanded due to reductions in service link costs. Lower transportation and time costs have been coupled with declining applied tariffs in the wider Asia Pacific region since the early 1990s, particularly for parts and components (Kimura et al., 2007; Baldwin, 2010; WTO, 2011). Liberalization has been larger in the electrical machinery sector, to the point that tariffs have been argued to play a negligible role in current fragmentation and organization of the production network (Paprzycki and Ito, 2010). Nevertheless, and besides the heavily protected agricultural sector, high multilateral tariffs persist on final goods as well as intermediate inputs in a number of manufacturing sectors, including the automotive, steel, chemical, textiles and processed food industries.<sup>15</sup> It is therefore not surprising that some of these sectors have been among the major proponents of FTA liberalization (see below).

Much of the liberalization in East Asia has occurred through unilateral reductions of applied tariffs and tariff rebates as part of export-promoting strategies (e.g., duty drawbacks, export processing zones) (Baldwin, 2008; Baldwin, 2010). Unilateral liberalization has spurred the development of regional production networks that, in turn, have fostered further unilateral liberalization. However, at this point, two aspects of

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<sup>13</sup> East Asia accounted in 2011 for 44.6% of world's exports and 35.9% of imports of parts and components, up from 26.9% and 19.2% in 1990, respectively (RIETI-TID database).

<sup>14</sup> In many industries, paramountly in electronics, production networks have also been fostered by the modularization and higher standardization of parts and components, facilitating multiple-supplier procurement, offshoring and outsourcing (Ernst, 2004).

<sup>15</sup> The competition faced by Japan-based producers of parts and components from suppliers in ASEAN4 as a result of the technological upgrading undergone by the latter is compounded by high tariff barriers still prevailing in these latecomer countries (interviews).

unilateral liberalization in regard to production networks merit attention. First, unilateral tariff concessions are most often not bound and could be eliminated at the discretion of the granting country, as occurred during the 1997 Asian crisis, without violating WTO rules.<sup>16</sup> In the absence of legally binding rules, reversals in unilateral concessions or trade wars could threaten the smooth functioning of production networks (Baldwin, 2008). Secondly, unilateral liberalization in ASEAN4 countries has not been uniform and has been deeper and proceeded faster for lower tariffs, thus leading to higher tariff dispersion and concentration of tariff peaks around sensitive sectors (Jongwanich and Kohpaiboon, 2007). As elaborated in Essays 2 and 3, I will argue in this Thesis that both factors are related to the ongoing proliferation of FTAs in East Asia.

In contrast to other regions, where regionalization has followed or has been fostered by intergovernmental institutions, most narratives depicted East Asian regionalization as market-driven. Regional production networks flourished in response to FDI and trade flows and proceeded independently and in the absence of rule-based institutions (Kawai, 2005; Soesastro, 2006; World Bank, 2007).<sup>17</sup> These views resonate with neoliberal interpretations of East Asian development and overlook the role of government policies and government-business coordination in East Asia industrialization (MacIntyre, 1994). Starting in the 1980s, and as part of their individual export-oriented assembly operations, many East Asian governments not only introduced unilateral liberalization schemes but also actively coordinated upstream and downstream producers. At the regional level, ASEAN governments established during the same period cross-border growth zones and

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<sup>16</sup> WTO establishes that members cannot impose import duties above the level tariffs have been bound but they are free to apply lower tariffs. The difference between the level at which a tariff on a given item has been bound and the applied tariff is known as binding overhang.

<sup>17</sup> Borrowing from Polanyi, East Asian production networks are envisioned as self(un)-regulated entities shaped by the dictates of a market-led regional division of labor.

complementation programs for regional trade in parts and components, especially in the automotive industry (Yoshimatsu, 1999; Yoshimatsu, 2002; Busser and Sadoi, 2004).<sup>18</sup>

### 3. Enter East Asian regionalism

As preferential tariffs in FTAs apply only to goods traded among members, they could *potentially* divert trade from more efficient producers outside the bloc to less efficient ones inside (reviewed in Schiff and Winter, 2003 and in Freund and Ornelas, 2010).<sup>19</sup> To limit their discriminatory and trade-diverting impacts, GATT Article XXIV establishes that FTAs should eliminate trade barriers on substantially all intraregional trade within a reasonable period of time and that trade barriers applied to outside countries should not be higher than prior to the establishment of trade area.<sup>20</sup> Today's FTAs are often more than deals over tariff reductions and include regulatory provisions that expand the concessions and/or issue scope under WTO.<sup>21</sup>

Qualifying for preferential tariffs in FTAs also requires that goods comply with established rules of origin (ROOs), determining whether goods originated and/or underwent sufficient transformation within the FTA area.<sup>22</sup> Increasing intra-regional trade in parts and components has resulted in a decline in the domestic value content in most East Asian manufacturing industries (Kuroiwa, 2006).<sup>23</sup> Consequently, ROOs are especially relevant in bilateral FTAs and for sectors where production fragmentation and input trade are

<sup>18</sup> For instance, the Brand-to-Brand Complementation the ASEAN Industrial Cooperation (see Essay 3). Manuscript in preparation by the Author.

<sup>19</sup> Seminal works by Grossman and Helpman (1995) and others (see also Essay 4) contend that only FTAs that provide enhanced protection and divert trade are politically feasible. However, theoretical and empirical evidence indicates that formation of a FTA reduces incentives for import-competing sectors to lobby in favor of maintaining high external tariffs (Ornelas, 2005a; Ornelas, 2005b; Calvo-Pardo et al., 2011). Consequently, when external tariffs are endogenously determined, only FTAs that are sufficiently trade-creating are likely to be politically viable (Ornelas, 2005a).

<sup>20</sup> In the case of FTAs, this has been often interpreted as liberalizing at least 90% of the existing trade between members within a maximum of 10 years. In reality, many FTAs do not fulfill these conditions.

<sup>21</sup> Many FTAs, particularly those anchored around the United States and the European Union, incorporate regulatory provisions beyond trade in goods and services as the so-called Singapore issues (investment, government procurement, competition, trade facilitation) and/or intellectual property rights (WTO, 2011). These are not only often the most contentious issues at negotiations but they also have potentially the largest economic and developmental impacts. This Thesis focuses on trade in goods for two main reasons: first, most East Asian FTAs provide limited concessions beyond goods trade and, secondly, the dearth of disaggregated data on beyond trade issues and the difficulty in controlling for the impacts of FTAs on them.

<sup>22</sup> ROOs specify that the imported item has a minimum regional value content, classifies under a different tariff code than its parts and components, and/or has undergone a specific process within the bloc. Most FTAs establish product-specific ROOs for each tariff code.

<sup>23</sup> For instance, in a survey of Japanese firms based in ASEAN4, only 20-50% could outsource at least 40% of the value content of their products from within the host country (Wakamatsu, 2004).

prevalent. Although ROOs are included in FTAs for technical reasons, to avoid strategic tariff-shopping by exporters outside the area (trade deflection), they could also be strategically used for protectionist purposes (Krueger, 1995). ROOs impose procurement and administrative costs on exporters that, depending on their restrictiveness and the sector, could amount to an *ad-valorem* tariff of up to 6-10%, eroding by that level (or even potentially voiding) the preferential margin afforded by the FTA (Anson et al., 2005; Cadot et al., 2006).<sup>24</sup> It has been often argued that, at the extreme, disparate ROOs across hubs and spokes of overlapping FTAs—the so-called spaghetti or noodle bowl effect—may not only impose a large burden on exporting firms but potentially interfere with the functioning of cross-border production networks (Bhagwati, 1995).<sup>25</sup>

The prospect of failure of the Uruguay Round and the creation of the European Community prompted a policy shift in the United States toward regionalism and the signing of the North American FTA (NAFTA) in 1994.<sup>26</sup> Embracement of regionalism by Western economic powers raised fears that a proliferation of FTAs would create stumbling blocks for global liberalization. In turn, and around the same time, countries party to the Asia-Pacific Economic Cooperation (APEC) forum, which includes NAFTA as well as most East Asian nations, introduced the concept of “open regionalism”, as opposed to otherwise discriminatory regionalism, with the goal of extending multilaterally preferential liberalization among themselves.<sup>27</sup>

Since the early 1990s, FTAs began to spread across the globe but spared East Asia where the only FTA in force by the turn of the century was the Association of Southeast

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<sup>24</sup> To benefit from preferential tariffs, exporters need to adapt their existing procurement and production processes to ROOs. This research found that in some sectors, particularly light industries (e.g., textiles, processed food), manufacturers established separate production lines based on requirements to comply with different ROOs.

<sup>25</sup> Using FTA preferential tariffs is nevertheless voluntary and our results indicated that ROOs may have had a limited effect in the utilization of Thai and Malaysian FTAs (see Essay 2).

<sup>26</sup> The Treaty on the European Union (Maastricht Treaty) was signed in 1992. In turn, Bergsten and Schott (cited in Freund and Ornelas, 2010:155) argued that the United States used NAFTA to pressure Europe for the conclusion of the Uruguay Round.

<sup>27</sup> At the 1994 meeting, APEC pledged for full liberalization in developed countries by 2010 and by 2020 in developing ones (Bogor goals). However, APEC’s unilateral and voluntary approach to liberalization has reduced its role to that of a mere trade forum and most of the liberalization undertaken by APEC members has occurred independently of APEC.

Asian Nations (ASEAN) FTA (AFTA). Still, AFTA was notorious for its slow implementation and, lacking enforcing mechanisms, poor compliance (Bowles, 2002; Yoshimatsu, 2006a; Ravenhill, 2008). Although signed in 1992, it was not until 2010 that AFTA was fully implemented.<sup>28</sup> ASEAN members were highly dependent on the United States and Europe as export destinations for their final goods. Therefore, departing from most other FTAs elsewhere, AFTA was not conceived as a discriminatory bloc to promote intra-ASEAN trade but primarily as an open regionalism area and a tool to attract FDI.<sup>29</sup>

The signing of the Japan-Singapore FTA in 2002 marked the official start of East Asia's jumping onto the FTA bandwagon. Since then, nowhere else has regionalism exploded so dramatically with close to 60 FTAs already implemented, most as bilaterals (reviewed in Kawai and Wignaraja, 2013).<sup>30</sup> Since desk research for this project began in July 2006, a plethora of works have explored the move of East Asia toward regionalism.<sup>31</sup> Most scholarly attention has centered on accounting for its origins (Aggarwal and Urata 2006; Dent, 2006; Dent, 2007; Dieter, 2007; Aggarwal and Koo, 2008; Katada and Solis, 2008; Manger, 2009; Solis et al., 2009; Aggarwal and Lee, 2010). FTA proliferation in East Asia has been explained on the compound effect of multiple forces, some more generic and also driving regionalism elsewhere (e.g., slow progress in multilateral negotiations) and other specific to East Asia (e.g., slow implementation of AFTA, 1997 Asian financial crisis).

Nevertheless, in the same manner that regionalization in East Asia is considered to have occurred largely independent from intergovernmental actions, for the majority of

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<sup>28</sup>Until the mid-2000s, AFTA implementation was fraud with exemption lists and non-tariff barriers. The less developed countries of Cambodia, Myanmar, Vietnam and Laos are allowed for slower implementation. In May 2010, AFTA was superseded by the *ASEAN Trade in Goods Agreement*.

<sup>29</sup>Nesadurai (2003) contends that Malaysia and Indonesia, where domestic capital had closer relationships with the political leadership, favored AFTA not only to advance open regionalism but also to privilege local champions through “developmental regionalism”.

<sup>30</sup>As of August 11, 2013, there are 56 FTAs in force in East Asia, 50 of them as bilateral FTAs (Databases from ADB-ARIC, undated and WTO-RTAIS, undated). Even regional so-called ASEAN+1 FTAs (FTAs between the ASEAN bloc and a third country) could be considered as multiple bilateral FTAs as negotiations and FTA texts include separate schedules for each ASEAN member. ASEAN+1 FTAs tend to provide for shallower and slower liberalization than corresponding bilateral FTAs as concessions converge on a minimum common denominator.

<sup>31</sup>Close to 70% of the academic literature containing “FTA” and “East Asia” in Google Scholar have been published since 2007 (scholar.google.com).

accounts in the literature, ramping regionalism in East Asia over the last decade is portrayed has been decoupled from the concurrent regionalization process. Just as earlier paucity of regionalism was argued on political rivalries, economic and ethnic diversity and American influence in the region (Katzenstein, 1997; Katzenstein, 2005), most analyses of East Asian FTAs emphasize the primacy of foreign policy, diplomatic, geopolitical and security dimensions over economic ones to explain their present proliferation (e.g., Desker, 2004; Aggarwal and Urata, 2006; Dieter, 2007; Hoadley, 2007; Aggarwal and Koo, 2008; Ravenhill, 2008; Aggarwal and Lee, 2010; Ravenhill, 2010; Lee and Hooi, 2011; Lee, 2013). Given that bilateral FTAs are second-best options to multilateral liberalization in classical economics, their rationale is explained on political and security factors, not economic ones (See Essay 1 for further elaboration on this strand of the literature).

At the policymaking level, according to most scholarly works, East Asian FTAs have emerged from a cognitive consensus among political elites in strong states where the influence of organized business in FTA formulation has been limited or absent altogether (Aggarwal and Koo 2006; Koo, 2006; Sally 2006; Hoadley, 2008; Terada, 2009; Ravenhill, 2010; Aggarwal and Lee, 2010) (see Essay 1 for further discussion). Some studies have taken a constructivist approach, emphasizing the role of shared ideas and identities among the political leadership—particularly in the aftermath of the Asian crisis—in the increasing *de jure* East Asia integration (e.g., see Acharya, 1999; Terada, 2003; Calder and Ye, 2004; Eaton and Stubbs, 2006; Ravenhill, 2009). Only Japan seem to have departed from this regional trend as evidence shows that pressure by Japanese firms and business associations were key in the shift of the Japanese government's stance in favor of FTAs (Solis, 2003; Manger, 2005; Yoshimatsu, 2005; Yoshimatsu, 2006b; Noble, 2007; Solis and Urata, 2007; Katada and Solis 2010; Solis, 2010). At the same time, and given low tariffs covering most East Asian trade, firm surveys indicate little interest in FTAs on the part of business

(Haddad, 2007; Ravenhill, 2010; Kawai and Wignaraja, 2011a; Kawai and Wignaraja, 2011b).

Most of the above-mentioned analyses of East Asian regionalism are unlikely to fully capture the rationale and dynamics of FTA formation as they essentialize politicians' ideas and neglect the sources of countries' preferences in policymaking. At the same time, systemic-level variables fail to explain the diversity in outcomes of bilateralism across East Asia as well as of sector coverage among FTAs. Postulating strong states and insulated bureaucracies, autonomous from interest groups pressures, to explain FTA policymaking overlooks the way bureaucracies in East Asian countries engaged business while maintaining their "embedded autonomy" (see below). Likewise, inferring the economic relevance of East Asian FTAs for business in the region from estimates and firm-level surveys on FTA utilization is prone to provide, at best, an incomplete picture of reality. Assessing FTA utilization requires instead the collection of administrative records certifying compliance of exported items with ROOs. In addition, most accounts do not pay sufficient attention to why countries and firms may differentially pursue unilateral, multilateral or preferential liberalization paths. Certainly, as their ultimate signatories, FTA negotiations are the exclusive prerogative of states, as strategic trade and investment decisions within production networks are of firms. However, this could not ignore the interdependence of regionalism and regionalization, the way evolving trade patterns influence states preferences for FTAs and, in turn, how emerging regionalism affect the strategies of firms operating in production networks.

#### **4. Objectives, research questions and general hypotheses**

This research project attempted to address some of the puzzles and questions left open by the received literature, arguing for the need of a more nuanced analysis of East Asian regionalism that problematizes parsimonious systemic explanations around constructivist

and/or geopolitical motivations and, rather, pays more attention to the structure of incentives and strategies driving state and business actors. The central theme of this Thesis revolves around the interaction between regionalism and regionalization, on why particular bilateral FTAs have taken specific configurations and whether and how FTAs fit within the generic interests and specific policy preferences of states and firms.

The project used as case studies the evolution of FTA formation in Thailand and Malaysia, the two most FTA-active developing nations in the region, within the context of key production networks potentially affecting and affected by regionalism.<sup>32</sup> These cases were selected because their commonalities and differences on several dimensions (see individual Essays) provide a rich empirical ground to test the hypotheses. Primary research involved 212 in-depth semi-structured interviews with government officials, private sector and civil society representatives and academics in both countries during two independent trips in 2008 and 2009 complemented and updated by numerous personal communications during 2010-2012 (see Appendix). Some studies on the policymaking of East Asian regionalism codified the preferences and preference intensities of actors around FTAs (e.g., Aggarwal and Koo, 2006; Dent, 2006). Instead, this Thesis opted not to collapse the rich evidence obtained through qualitative research into the few codes of a scale as this would have detracted from a nuanced analysis of the forces behind FTAs. Instead, taking advantage that Thailand and Malaysia are the only countries in East Asia that collect official records on exports using preferential tariffs, this Thesis has quantified FTA utilization at a highly disaggregated level as well assessed the variables potentially affecting it.

Among East Asian nations, Thailand was only second to Singapore in start pursuing bilateral FTAs and, until 2006, also one of the most prolific. Instead, Malaysia was initially

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<sup>32</sup> As of August 2013, the top 5 countries in East Asia by the number of FTAs participated are: Singapore (17 FTAs, including AFTA and ASEAN-centered FTAs), Malaysia (12 FTAs, also including AFTA and ASEAN-centered FTAs), Thailand (11 FTAs, including AFTA and ASEAN-centered FTAs), Korea (9) and China (7) (ADB-ARIC, undated; WTO-RTAIS, undated).

reluctant to enter bilateral FTAs but has later signed a number of them. Both countries belong to the second generation of East Asian industrialized economies although controversy remains about their categorization as developmental states (e.g., see Doner and Hawes, 1995 *versus* Jomo, 2001 or Rock, 2001). Both countries pursued more liberal policies toward trade and investment than the NIEs and trailed behind them in state capacity and bureaucratic coherence and autonomy (Doner and Hawes, 1995; Crouch, 1996). This technocratic deficit has been more pronounced in Thailand where responsibility over economic planning falls across multiple and competing agencies that are not always sufficiently coordinated or autonomous from political or business pressures (Abbott, 2004). Malaysian bureaucracy enjoys greater capacity, coherence and autonomy from business interests than in Thailand although still non-immune to interference from the Cabinet (Trezzini, 2001; Abbott, 2004).<sup>33</sup> Nevertheless, Thailand and Malaysia have used a panoply of state-led targeted policies to promote industrialization, in some instances with significant success (Felker, 2001; Rock, 2000; Jomo, 2001; Rock, 2001; Abbott, 2004; Kuchiki 2007; Stubbs, 2009; Hayashi, 2010).<sup>34</sup> Governments in Thailand but particularly in Malaysia have fostered linkages between lead firms in production networks and indigenous firms, providing good cases to explore the preferences and influence of upstream and downstream producers in FTA policymaking. The project has investigated the most relevant sectors in the Thai and Malaysian economies with special attention to the automotive sector, that was at the center of many of their FTAs and where both countries present diverging policies, trajectories and outcomes. The automotive industry remains one of the most protected and

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<sup>33</sup> Since the late 1960s, economic policymaking in Malaysia has been guided by the goal of achieving developed economy status as well as to promote the participation of the ethnic Malay/bumiputera population in the economy.

<sup>34</sup> Contention regarding its characterization as a *bona fide* developmental state is higher for Thailand. Some narratives argue that consistent macroeconomic management was achieved by insulation of the Thai central bank and planning agencies but that inefficient line ministries were dominated by competitive clientelism (Doner and Hawes, 1995; Doner and Ramsay, 2001; Kohpaiboon, 2006; Doner, 2009). Instead, Rock (2000, 2001) found evidence of highly targeted microeconomic intervention “mirror[ing] that in Korea” (2001:194). In their industrialization strategies, Thailand and Malaysia have relied in multinational firms more heavily than their Northeastern neighbors, although Malaysia has nurtured national champions in strategic sectors, often through government-linked companies.

influential in Thailand and Malaysia but while the former has relied exclusively in international firms, Malaysia has pursued the creation of national carmakers (see recent accounts in Natsuda and Thoburn, 2013 and Natsuda et al., 2013).

However, despite differences between both countries in their policymaking setting and national trade and industrial strategies, here it was found a significant convergence in the formulation of Thai and Malaysian FTAs as well as in the engagement of the private sector in the process. Thus, comparison of both case studies has served in many instances to confirm findings across both countries (Essays 1, 2 and 3), while in other allowed us to contrast them (Essay 4).

#### ***4.1. Developing governments and FTAs***

As advanced earlier, the extant literature highlights foreign policy and security motivations as key determinants of recent East Asian FTAs, which have been formulated by the political leadership in each country with little involvement of businesses. In the context of bilateral treaties, governments certainly use economic diplomacy to pursue non-economic interests.<sup>35</sup> However, it is this author's contention that foreign policy and security determinants have stronger power informing why some FTAs did not materialize than why others are formed.<sup>36</sup> In other words, the like-mindedness among domestic political elites argued by those defending the primarily geopolitical nature of East Asian regionalism is a necessary but not sufficient condition for the establishment of an FTA. Neither shared ideas nor foreign policy arguments could explain existing variability in liberalization coverage and sequencing within and among FTAs. The potential economic impacts of FTA

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<sup>35</sup> Interpretation of FTAs through a security prism has also been made for United States FTAs (e.g., Higgott, 2004). See Phillips (2007) for a rebuttal of the argument. History provides countless examples on the use of economic diplomacy for foreign-policy objectives in peace as in war. But, as Bayne and Woolcock (2007:4) put it: "economic diplomacy [...] is sensitive to market developments [...] and will not succeed if the market offers a more attractive alternative".

<sup>36</sup> For instance, foreign policy issues help explaining the paucity of FTAs by Taiwan or the lack of a China-Japan FTA, despite the strong and explicit interest of Japanese firms in surveys for the latter.

liberalization do not evade negotiation teams as if FTAs were signed mostly for foreign policy considerations, discussions will not drag on for years, as it is most often the case.

Research for this Thesis found that initiatives for some early FTAs in Thailand and Malaysia may have indeed originated in the context of intergovernmental summits and involved only limited formal consultations with organized business. However, eventually, negotiations on FTA proposals that lacked clear economic rationale and business support—even if only narrowly sectoral—died in early round talks or dragged on for years (Essay 1). Beyond finding evidence for the economic rationale of Thai and Malaysian bilateral FTAs (see below and Essays 2 and 3), this dissertation also attempted to provide an analytical framework that helps explaining why developing governments enter bilateral FTAs as well as other key questions, namely: a) whether (and why) trade officials engage businesses in consultations during bilateral FTA negotiations (Essay 1), b) whether (and how) FTAs offer developing states options, not available at other trade fora, to achieve their economic objectives and strategies (Essay 3), and c) whether (and how) the FTAs that a country has signed in the past impinge on its negotiation preferences and strategies in subsequent FTAs (Essay 4). Some general hypotheses to address these three questions are outlined below and further developed in the corresponding Essays.

Contrary to FTAs anchored around the United States or the European Union, FTAs in most East Asian countries do not respond to set templates and displayed significant variance (Solis et al., 2009; Dent, 2010). Even a cursory look at the legal texts of bilateral FTAs reveals great level of specification with long lists of tariff schedules and ROOs, suggesting that highly sectoral motivations have been at play beyond the generic utility function of politicians to improve overall terms of trade, let alone simply nurturing diplomatic relations.

This Thesis will argue that, even if/when FTAs emerged primarily from the initiative of governments, in an increasingly democratic East Asia, trade officials need to engage the private sector in FTA formulation, not only to secure its support to government trade policies or to heed its preferences, but also because of factors intrinsic to bilateral FTAs. Essay 1 will contend that, compared to unilateral or multilateral liberalization (or even regional FTAs), bilateral FTAs involve, *inter alia*, wider issue coverage and greater technical complexity. These features pose greater sectoral and technical information demands on trade officials, particularly those in developing countries, that should encourage them to engage in more frequent and intense consultations with other government agencies and business associations with sectoral technical expertise. As countries negotiate more FTAs, sometimes simultaneously, trade officials should find incentives to invest in building their own technical capabilities and institutionalizing consultations with the private sector. Essay 1 provides empirical evidence supporting these arguments and shows that successive FTA negotiations compelled Thai and Malaysian officials to intensify consultations with businesses to fill gaps in sectoral and technical expertise and led to the creation of institutional arrangements to reduce transactions costs in FTA consultations and negotiations.

**Background 1:** Dominant narratives on East Asian regionalism argue that prevalence of strong states and insulated bureaucracies have resulted in FTAs being top-down formulated without significant involvement of the private sector. In turn, it will be argued in this Thesis that, compared to other forms of trade negotiation, bilateral FTAs involve wider issue coverage and greater technical complexity that pose greater information demands on trade officials.

**Question 1:** How do trade officials access sectoral information to negotiate bilateral FTAs? Has the engagement (or lack of) of the private sector during FTA formulation evolved over time?

**General Hypothesis 1:** *In bilateral FTAs, trade officials are compelled to intensify their consultations with the private sector not only to secure their support but also to solve sectoral and technical information gaps. Over time, as governments negotiate more FTAs, institutions would be created to reduce transaction costs in FTA consultations and negotiations.*

Any form of trade liberalization necessarily has distributional economic effects among nations. If the weaker position of developing countries at multilateral rounds has led to concessions in their economic sovereignty (Gallagher, 2008), the asymmetry is heightened in North-South bilateral FTAs where they often surrender significant policy space still available under WTO (Shadlen, 2005; Pekkanen et al., 2008).<sup>37</sup> This begs the recurrent question on the economic reasons that prompt developing countries to seek bilateral FTAs with industrialized economies. The query is especially puzzling in the case of East Asia where, to different degrees, states have actively used their policy space to advance developmental goals. Following the Asian crisis, regional economies embarked in economic reforms that prioritized liberal markets over sectorally targeted state-driven policies. Independently of whether or not the developmental state model still exist or is longer viable (Park, 2006; Stubbs, 2009; Hayashi, 2010), the transformation undergone by states and firms in East Asia over the last two decades has reduced the capacity of the former to steer industrialization while integration of national and foreign firms into regional production networks has increased their autonomy vis-à-vis the state (Yeung, 2013).

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<sup>37</sup> Although none of the FTAs implemented by Thailand and Malaysia up to date involves important concessions beyond trade and services, aborted bilateral FTA negotiations by both countries with the United States (or ongoing ones with the European Union or the Trans-Pacific Partnership grouping) could have entailed significant regulatory concessions.

A large body of scholarly works has explored the economic rationale behind the move by many developing nations to seek FTAs with developed countries. They may look for the Vinerian returns of larger markets and improved terms-of-trade or for non-traditional gains such as signaling commitment to liberal markets to attract investment (Ethier, 1998; Fernandez and Portes, 1998). Developing countries may also enter FTAs even when these are not their preferred trade liberalization option as part of “domino effect” or “fear of exclusion” dynamics: as other nations form an FTA, the cost of non-participation for outsiders with similar comparative advantage rises, changing their utility function, and prompting them to enter the bloc or create a new one (Baldwin 1995; Shadlen, 2008; Baldwin and Jaimovich, 2012).

These generic motivations inform about economic grounds for developing countries in bilateral FTAs but leave out the question of whether and how they fit with the economic preferences and strategies of these countries. East Asian countries have pursued their trade preferences through multilateralism, unilateral liberalization, open regionalism and, more recently, FTAs, each offering different opportunities and limitations. Essay 3 will submit that the nature of FTAs and the legal basis that support them present developing countries with options, not available through other liberalization paths, to pursue their national economic interests, not only with respect to other states but also in relation to multinational lead firms organizing production networks.

First, bilateral FTAs provide governments with flexibility in regard to the choice of partner, sectoral coverage and sequencing of liberalization not available under multilateral rounds. Unilateral liberalization in ASEAN has had only limited impact on tariff peaks still existing around sensitive sectors. Essay 3 will argue that, facing increasing concentration of sectoral interests and uncertainty about the impacts of multilateral liberalization,

developing states, like firms (see below), should favor bilateral FTA liberalization because of the flexibility offered by FTAs.<sup>38</sup>

Second, for developing countries, integration of local suppliers into knowledge-intensive and high value-added segments of production networks offer possibilities for technological transfer and spillovers to the rest of the economy. As FDI does not necessarily generate backward linkages from multinational lead firms to local suppliers, developing countries introduced localization and technology transfer requirements. Although the former are not longer allowed under WTO, Essay 3 will posit that FTAs could be designed to promote local procurement in ways resembling WTO-illegal local content requirements.

Lastly, while technology transfer requirements and horizontal subsidies for research and development are still permitted under WTO, they are difficult to enforce and monitor, particularly by developing country governments. It will be contended here that FTAs offer opportunities—not available at other trade fora—to target sector-specific assistance. A common feature in many North-South bilateral FTAs, including Japanese FTAs with ASEAN, is the inclusion of cooperation provisions that go beyond government-to-government capacity building in trade-related issues and target funds and capacity building to specific sectors. Essay 3 will argue that if so designed by a motivated developing government, cooperation chapters in North-South bilateral FTAs could amount to sector- (even firm-) specific subsidies.

Empirical data obtained in this project show that the Thai and Malaysian governments were well aware of these options in bilateral FTAs. Both countries facilitated or restricted the operations of sectors and firms through selective liberalization or exclusion as well as fostering procurement and technical linkages with local suppliers. In some

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<sup>38</sup> In addition to the single-undertaking approach in WTO negotiations (items in a negotiation package cannot be agreed separately), the ongoing Doha Round proposes reducing high tariffs more rapidly than lower ones (Gallagher, 2008), while bilateral FTAs allow tariff peaks to be reduced gradually or excluded altogether.

instances, the Thai and Malaysian governments have later identified these options as explicit policy goals. Obviously, this is not to say that the above arguments are driving developing countries into North-South bilateral FTAs. But, as bilateral FTAs narrow (or close) some developmental options still available under WTO, they could potentially open others and, in an increasingly rule-based regime, developing countries may want to set precedent in FTAs for future WTO negotiations.<sup>39</sup>

**Background 2:** The WTO has limited some of the developmental options previously available to developing countries, whose policy space has been further restricted in their bilateral FTAs with developed economies. Globalization has also decreased the capacity of states to steer industrialization and their leverage over multinational lead firms organizing production networks.

**Question 2:** Do (and how) bilateral FTAs fit with the economic interests and strategies of developing countries? Do FTAs offer developing countries alternative options to achieve their economic preferences?

**General Hypothesis 2:** *Bilateral FTAs offer developing countries opportunities, not available under the multilateral regime, to pursue their economic objectives not only with respect to other states but also in relation to lead firms. FTAs offer states opportunities to selectively protect sensitive sectors and promote the integration and upgrading of the local supply base into international production networks.*

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<sup>39</sup> Confronted with overlapping institutions, countries engage in strategic forum-shopping to resolve trade disputes (Busch, 2007). In regard to trade liberalization, developed countries must balance the trade-off between their maximization of economic gains (higher at the WTO) and their capacity to control the agenda (higher in FTAs) (Pekkanen et al., 2007). Shadlen (2004) presented a similar argument regarding intellectual property rights where developing nations may be willing to sacrifice policy space in exchange for the predictability afforded by WTO agreements.

As discussed earlier, the formation of an FTA spurs the creation of new ones by those outside the trade bloc as part of the domino effect logic. FTAs also affect multilateral liberalization although the net impact remains an unresolved debate between those scholars that see them as obstacles for multilateral liberalization (e.g., Levy, 1997; Panagariya, 2000; Limão, 2006) and those that consider FTAs as stepping-stones toward it (e.g., Ornelas, 2005b; Ornelas, 2005c; Ornelas, 2008; Calvo-Pardo et al., 2011). But what is the impact of the FTAs that a country has signed on its own negotiation options in subsequent FTAs? Essay 4 will argue that the interaction between and among the FTAs that a country has signed in the past and the FDI sunk in those FTA areas could restrict its bargaining options and alter its preferences in future FTAs.

When a government is protecting a sensitive sector, the FDI sunk into that sector in the territory of partners from previous FTAs opens the sector in the first country to direct competition from third countries and could preempt the protectionist position of its government when it negotiates FTAs with the FDI source countries. Put simply, once a country A has liberalized a sector as part of an FTA with country B, FDI into country B could facilitate the opening of the sector in country A's future FTAs, thus acting as a stepping stone for further FTA liberalization.

Preferential tariffs granted in an FTA could be eroded (or even lost) if the partner later offers similar (or better) FTA concessions to a third country (Ethier, 2001). To avoid preference erosion some FTAs incorporate a MFN clause deterring the FTA partner from granting better access to third countries. Countries may also refuse to liberalize a sensitive sector, independently of the competitiveness of the FTA partner, in order to avoid creating a precedent for future FTAs and to prevent the preempting effect of FDI mentioned earlier. In that way, the shadow of existing and future FTAs could act as a stumbling block for further FTA liberalization.

Empirical evidence in Essay 4 confirmed these arguments and supports the contingent nature of the impact of FTAs on subsequent FTA liberalization.<sup>40</sup> Thailand resisted liberalization of the automotive sector in its FTA with Japan, not only to protect existing investment but also to prevent similar demands from other automotive-producing countries also negotiating FTAs with Thailand at the time. In turn, Malaysia's attempt to protect its national automotive industry from Japanese imports in its FTA with Japan was preempted by the previous existence of AFTA and the FDI sunk by Japanese firms in other AFTA members.

**Background 3:** Creation of an FTA could prompt countries outside to form a new FTA. However, controversy remains on how FTAs affect the stand of countries inside and outside FTA blocs toward multilateral liberalization.

**Question 3:** In the context of increasingly overlapping FTAs, how the FTAs that a country has signed affect its own preferences in future FTAs?

**General Hypothesis 3:** *When a country has liberalized a sector in an FTA, the investment made into that sector in the FTA partner by other countries could preempt the first country from protecting the sector in future FTAs. In turn, a government could refuse to liberalize a sensitive sector in an FTA, even to non-competitive partners, in order to prevent extending similar preferences to other countries by either creating a precedent or through the effect of investment by third countries.*

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<sup>40</sup> Since FTA liberalization has been argued to trigger a reduction in external MFN tariffs (Ornelas, 2005a), enhanced or reduced liberalization in subsequent FTAs could eventually impact on multilateral liberalization (see Essay 4).

#### **4.2. Private sector and FTAs**

As other areas of policymaking, trade policy is a function of the preferences of actors with interest on its outcomes and the institutional setting that determines how preferences are aggregated and which actors are favored. A large body of literature in endogenous trade theory has modeled trade policy as a competitive political process between the interests of firms and those of the government (e.g., Grossman and Helpman, 1994; Grossman and Helpman, 1995). Numerous scholars have questioned the applicability of these theoretical models of economic policymaking to “East Asia’s authoritarian and quasi-democratic polities” that formulate FTAs with little engagement or “resistance” by the private sector (Ravenhill, 2010:187-191 and references therein). Nevertheless, while East Asian states have certainly been less concerned for the median voter, business associations in East Asia are less developed and autonomous and their lobbying may take different forms that in Western policymaking, in an increasingly democratic East Asia and in the context of globalization, business groups cannot longer be sidelined from policymaking, as the crucial test case of China testifies (Kennedy, 2008; see also Essay 1).

The preferences of firms regarding protection or liberalization in FTAs are determined not only by variables internal to firms and the market where they operate but also by the actions of the host government and the institutional context. The institutional setting shapes businesses options for collection action (Schneider, 2002) or their access to policymaking (Thacker, 2000) but, by determining which options are available, it could also influence firm’s interests and preferences themselves and their specification into specific policy strategies (Crystal, 2003; Woll, 2008). Limited or no involvement of business groups in the formulation of East Asian FTAs has been attributed not only to their low engagement by host governments but also to private sector’ own apathy toward regionalism (Sally, 2006; Dieter, 2007; Sally, 2007; Hoadley, 2008; Terada, 2009;

Ravenhill, 2010). In contrast, the key influence of businesses on FTA policy has been empirically documented at great extent in other regions (Avery, 1998; Mayer, 1998; Woolcock, 2005). In East Asia, only in Japan has the private sector participated in FTA formulation, in some cases proactively, and affected government's position on regionalism (Solis, 2003; Manger, 2005; Yoshimatsu, 2005). However, evidence from a not so distant past indicates that the private sector was also instrumental in the decision of other East Asian governments to proceed with unilateral and multilateral liberalization. Demands by Japanese and Western firms on ASEAN governments were central in the liberalization of trade in parts and components during the 1980s and 1990s (Yoshimatsu, 1999; Yoshimatsu, 2002), and in the elimination of tariffs in the electronics industry in ASEAN (and the rest of East Asia) during the 1990s (Baldwin, 2008).

Considering the economic impacts potentially entailed in any form of trade liberalization, this Thesis was originally set to understand the puzzle of why businesses in East Asian countries other than Japan had purportedly not mobilized around recent bilateral FTAs and/or utilized their preferences once implemented.

Finding evidence of lobbying by a given sector for specific policy choices in an FTA does not necessarily mean that these get translated into the final FTA text, and *vice versa*, concessions (or the lack of them) in an FTA do not imply that *ex-ante* lobbying pressures to that effect had existed. *Ex-ante* preferences by a firm could be modulated (or cancelled out) by the opposing preferences of other actors as well as by cross-sectoral concessions. The final text of an FTA is the result of domestic and international bargaining that include, à la Putnam (1988), not only the interests of firms but also of negotiation teams, bureaucrats and politicians.<sup>41</sup> In this Thesis, private sector's preferences regarding

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<sup>41</sup> As actors' preferences are not directly observable, scholars have to deduce or induce them, each approach fraught with its own dilemmas. In regard to economic issues, preferences are frequently deduced from existing theories. However, although firms' underlying preferences could be derived from their goal of profit maximization (Frieden, 1999:62), these do not inform us about their specific policy preferences (Crystal 2003:408). Deriving preferences from actors' behavior risk conflating preferences with the strategic response to

FTAs and evidence of its lobbying pressure and success in affecting FTA policy have been assessed and cross-validated through semi-structured in-depth interviews (Essays 1 and 3). This information has been later confronted with concessions in FTA texts and highly disaggregated data on FTA utilization (Essay 2).

In contrast to dominant renderings in the literature, this project yielded empirical evidence that business groups in Thailand and Malaysia have indeed participated in the formulation of FTAs and subsequently utilized them to a larger extent than firm surveys seemed to indicate. In fact, for some trade partners, the private sector took the lead and pushed governments for establishing an FTA. While these findings contribute to correct common narratives of East Asian regionalism, they would be hardly surprising to students of trade policymaking and regionalism elsewhere or suffice to justify this research project. Thus, like for states, this Thesis also aimed at developing a framework to help understanding why firms support or resist bilateral FTA liberalization by addressing the following subsidiary questions: a) whether (and how) bilateral FTAs generate incentives for business collective action and lobbying that are different from those in other forms of liberalization (Essay 1), b) which specific business sectors (and why those) have made higher use of FTA preferences (Essay 2), and c) why firms seek particular bilateral FTA configurations and how FTAs fit with their interests and strategies (Essay 3). Addressing these three questions requires to problematize the interaction between regionalization and regionalism by accounting for current organizational structures in East Asian manufacturing, and disaggregate the interests of firms within the value chain. To address

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environment (Frieden, 1999:60). Thus, although deriving firms' policy choices in FTAs from final outcomes in FTA treaties is a common methodology in the study of trade preferences (e.g., Chase, 2003; Chase, 2005; Milner and Kubota, 2005), caution should be exercised when the strategic environment (e.g., domestic institutions, inter-governmental bargaining) varies across industries. In turn, in regard to inducing firms' preferences from interviews, Crystal (2003:412) warns that "lobbying groups have myriad incentives to misrepresent their true preferences". Indeed, in some interviews for this Thesis, key business sectors and firms have downplayed their otherwise proved influence over government policies, while others boasted about their leverage. Thus, conclusions presented here involved a thorough cross-validation of all information through in-depth interviews with a large number and a wide range of actors.

these questions, some general hypotheses have been generated and are briefly introduced below before they are explored at length in the corresponding Essays.

The vast literature on the political economy of trade has emphasized the role of factor endowments (capital *versus* labor) and industry (import-competing *versus* exporting industries) cleavages as key determinants of trade liberalization preferences among non-state actors (Rogowski, 1989; Hiscox, 2001). Multilateral liberalization maximizes the possibilities of exporters to expand markets and scales. However, firms with unexploited economies of scale and that have fragmented and relocated their production regionally could actually favor FTAs over multilateral liberalization, precisely because FTA's discriminatory effects over firms outside the bloc (Milner, 1997; Chase, 2004).

Essay 1 will argue for the existence of specific features in bilateral FTAs that should generate greater interest within the private sector to affect their formulation than do other forms of liberalization. Business groups are more likely to mobilize, in favor or against, around reforms with clear and immediate impacts (Schneider, 2010). While unilateral and multilateral liberalization have unambiguous negative impacts for import-competing sectors, gains for exporters are uncertain. Instead, bilateral FTAs allow for a clearer assessment of impacts and greater access to policymakers and should increase incentives for business lobbying by both winners and losers.<sup>42</sup>

As it was argued for government agencies, bilateral FTAs pose higher information demands on the private sector than other forms of liberalization. Trade officials are more likely to consult with business associations if the latter are able to intermediate unified positions among their members and assist them with technical information needed at

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<sup>42</sup> In contrast to unilateral and multilateral liberalization, bilateral FTAs offer exporters explicit gains and, therefore, incentives to lobby. Import-competing sectors would also be expected to pressure host governments to exploit ambiguities and flexibilities in FTAs to accommodate long tariff phase out or outright exclusions.

negotiations, thus creating incentives for business associations to invest in their institutional and technical capacities (Essay 1).

**Background 4:** Most academic works indicate that, outside Japan, the private sector in East Asia has neither been involved nor interested in FTA formulation. In contrast, evidence indicates that, during the 1980s and 1990s, business groups successfully lobbied countries in the region for unilateral and multilateral liberalization.

**Question 4:** Does bilateral FTA liberalization generate different lobbying incentives for business than unilateral and multilateral liberalization?

**General Hypothesis 4:** *Compared to unilateral and multilateral liberalization, more explicit impacts in bilateral FTAs should elicit stronger incentives for business lobbying. Greater coordination and information demands on the private sector during the formulation of bilateral FTAs should encourage businesses to organize and invest in their institutional and technical capacities.*

Low engagement of the private sector in FTA formulation has been compounded, according to most accounts, by little interest on the part of firms to utilize FTAs once implemented. By the standards of FTAs elsewhere, utilization of East Asian FTAs is reported to be very low (Ravenhill, 2010). Only 5% of the trade within ASEAN is estimated to use AFTA preferences (Haddad, 2007) and, in a 2007 survey among Japanese subsidiaries in East Asia, only 13.3% of firms used or planned to use any of the then

existing East Asian FTAs (JETRO, 2007).<sup>43</sup> This low FTA utilization is reasoned on two main grounds (Ravenhill, 2008; Ravenhill, 2010): the prevalence of low applied tariffs across the region, largely due to unilateral schemes (e.g., duty drawbacks), and the geographical asymmetry between regional production networks and mostly bilateral FTAs. However, as submitted earlier, unilateral liberalization has left many tariff lines unbound or with large binding overhangs. In addition, for firms in production networks, bilateral FTAs provide specific and selective benefits (see below and in Essay 3).

Starting from the obvious proposition that FTAs are used by those benefiting the most from them. Essay 2 will contend that business sectors that succeeded in lobbying for FTA liberalization should make high use of FTA preferential tariffs. In the same line, it will be argued that sectors that profit from unilateral tariff reduction schemes would lobby for binding these privileges under an FTA and make high use of FTA preferences afterwards. Consequently, only highly disaggregated sectoral data on FTA utilization would inform about the potential relevance of FTAs for business. However, the above-mentioned studies rely on estimates of unspecified methodology or on firm-level surveys not weighted by trade values and are referred only to overall or highly aggregated utilization.<sup>44</sup> Calculation of the *real* utilization of an FTA requires instead gathering of preferential certificates of origin (PCOs), administrative records certifying that traded goods comply with ROOs.

Research for this Thesis gained access to PCO data in Thailand and Malaysia for trade flows under FTAs, Generalized System of Preferences (see footnote 3) and duty drawbacks and at a very high level of specification (close to 5,500 tariff lines per trade regime, trade direction, country, and year). Analysis of these official records confirmed my arguments. With some exceptions, overall utilization of most FTAs has been low but has

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<sup>43</sup> Although later JETRO surveys reported increasing FTA utilization over time, data for 2008 onwards is aggregated for all Japanese FTAs and includes utilization of FTAs with countries outside East Asia.

<sup>44</sup> Some published surveys disaggregate responses on FTA utilization but for a very limited number of sectors (three in Wignaraja et al., 2010; sixteen in JETRO, 2009).

hidden large sectoral variability with high utilization concentrated in sectors that lobbied earlier for FTA liberalization. Results also showed correlation between sectoral utilization of unilateral liberalization schemes in the past and subsequent sectoral utilization of FTAs, indicating that the latter have replaced trade previously undertaken under the former.

**Background 5:** The low utilization of East Asian FTAs reported by estimates and surveys has been explained on the prevalence of low applied tariffs across the region. However, unilateral liberalization in East Asia has left many tariffs with large binding overhangs. In addition, estimates and surveys do not necessarily reflect real FTA utilization and overlook large sectoral variability.

**Question 5:** Have FTAs created new trade opportunities? Have *ex-ante* sectoral business preferences for FTA liberalization translated into *ex-post* higher utilization of FTAs? Did FTAs bind existing unilateral tariff reductions?

**General Hypothesis 5:** *Overall FTA utilization rates could hide significant sectoral variability. Only highly disaggregated data of official records could assess the real relevance of FTAs for East Asian business. Sectors that succeeded in lobbying for FTA liberalization and/or benefited from unilateral tariff reduction schemes should make high use of FTA preferences.*

Central to any bilateral FTA is improving market access in the partner. Milner (1997) argued that industries with increasing returns-to-scale favor FTAs over multilateral liberalization in order to benefit from tariff reductions while displacing outside competitors. Other accounts have also stressed the gains offered by discriminatory FTAs for firms inside the FTA area but incorporated the role of FDI and production fragmentation (e.g., Ethier

1998; Chase 2005). In a number of insightful and influential works, Chase (2003, 2004, 2005, 2008) found that producers characterized by unexploited economies of scale and that: a) have fragmented production and relocated some stages overseas and b) are involved in intense two-way intra-industry/firm trade, support regional blocs not only to liberalize trade flows but also because the possibility to discriminate against outside firms through preferential tariffs and ROOs. These arguments help explain why firms would favor regional FTAs but not necessarily bilaterals, the majority of FTAs nowadays. Manger (2009, 2012) uses the same arguments to explain several bilateral FTAs, including those of Japan with ASEAN countries. Reverse exports by Japanese subsidiaries based in Thailand in sectors like the automotive industry are argued to have been at the heart of its liberalization in the Japan-Thailand FTA while opposition by domestic carmakers hampered it in Malaysia (Manger, 2009; Manger, 2012). However, reverse imports from Japanese subsidiaries in East Asia have been traditionally low across most manufacturing sectors, being the lowest in the automotive industry and have, if anything, declined over time (Chase, 2005; Baldwin and Okubo, 2012).<sup>45</sup> In fact, given low levels of two-way intra-industry/firm trade between Japanese subsidiaries in East Asia and Japan and high dependence of East Asian exporters on extra-regional markets, Chase (2005:236,254) wrongly predicted that regionalism would not emerge in East Asia over the near term.<sup>46</sup>

Firms not simply attempt to improve their overall efficiency but they strive to gain comparative advantage *with respect to* other competing firms or sway in lead firms/suppliers relationships. To that effect, firms seek to acquire intrinsic resources and capabilities and use them *more* efficiently than other in order to provide a superior or

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<sup>45</sup> Exports back to Japan of final goods assembled at Japanese subsidiaries in East Asia have been low outside optical instruments and precision apparatus and have been negligible in vehicles (Chase, 2005). In fact, reverse exports of automobiles to Japan have declined since the mid-1990s, representing in 2005 only 15% of the production of Japanese subsidiaries in the region (Baldwin and Okubo, 2012). In addition, as argued in Essays 3 and 4, contrary to Manger (2009, 2012), while Thailand barely opened its automotive sector to Japan, Malaysia fully liberalized it. Manger's (2009) argument still holds well for services where FTA liberalization could provide a first-mover advantage that is followed by defensive FTAs by other countries (see also Montout and Zitouna, 2005 for a similar proposition).

<sup>46</sup> One has to assume that the original draft of Chase's (2005) was written before the rapid proliferation of FTAs in East Asia since 2001.

unique good or service at a given price. But firms also attempt to enhance their comparative advantage vis-à-vis other firms and states by using their internal sources of leverage to lobby and capture rents available through the institutional setting. Essay 3 will posit that a firm could favor a specific FTA to secure selective benefits not only with respect to firms outside the FTA—discrimination inherent to any FTA—but also in relation to others already inside the bloc. Possibilities for flexibility and selectivity in GATT Article XXIV mean that FTAs could be designed as to generate asymmetric benefits among members within the bloc. It will be argued that these selective rents are not necessarily distributed according to the firm's home country but rather to its procurement patterns and the geographical distribution of its production blocks. Liberalization of particular trade flows through bilateral FTAs asymmetrically benefits firms that depend to a higher degree on inputs from the FTA partner or that have plants in both countries.

In turn, Essay 4 explores why a foreign firm that has relocated production in a developing country could paradoxically opt out from exploiting the selective benefits of an FTA between its home and host countries and rather accept the *status quo*. It will be contended that if that firm holds a dominant position in the host country, it could potentially relinquish (or soften) its demands to prevent that future FTA partners of the host country could get similar concessions, especially if the FTA incorporates assurances (a MFN clause) that no other country will ever obtain better treatment from the host.

Essays 3 and 4 provide empirical evidence for these arguments using the automotive industry in Thailand and Malaysia as case study. Individual carmakers and first-tier suppliers in both countries pushed for bilateral FTAs that fit their unique existing patterns or future strategies for procurement and production. In other circumstances, when firms could not secure their first-best preferences in an FTA, they sought to prevent that the privileges they enjoy could be extended to competing firms in future FTAs.

**Background 6:** A number of works have shown that firms with unexploited economies of scale and that have fragmented production may favor regional FTAs over multilateral liberalization as to liberalize two-way trade while discriminating against outside firms. But these arguments could not account for the development of bilateral FTAs in East Asia.

**General Question 6:** Why firms seek specific bilateral FTAs? How bilateral FTAs fit with the interests and strategies of firms that operate in regional production networks?

**General Hypothesis 6:** *FTAs could be designed to generate asymmetric rents that are distributed among firms within an FTA area based on their specific procurement patterns and location of production blocks.*

The above questions and hypotheses are explored and tested in the following four Essays. Essay 1 examines the political economy of Thai and Malaysian FTAs over time. Essay 2 analyzes the utilization of selected Thai and Malaysian FTAs in the context of unilateral liberalization schemes. Essay 3 studies how firms and states seek particular configurations in bilateral FTAs that suit their specific preferences and strategies and discriminate not only against firms and states outside the FTA area but also inside. Finally, Essay 4 explores how interplays between and among existing investments and previous FTAs shape the preferences and strategies of governments and firms regarding future FTAs.

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## 2

## Essay 1 — Formulation of East Asian Free Trade Agreements: Top-down, bottom-up and across Borders

Government-Private Sector Consultations and Business Lobbying in the Policymaking of Thai and Malaysian Bilateral Free Trade Agreements<sup>48</sup>

### Abstract

During the last decade, East Asia has become one of the most active sites of regionalism worldwide with close to 60 free trade agreements (FTAs) implemented, mostly as bilaterals. With the exception of Japan, the extant literature presents East Asian FTAs as driven primarily by political and security motivations and emerged from the political leadership with marginal involvement of the private sector. Instead, this Essay contends that, compared to multilateral trade rounds, bilateral FTA negotiations entail greater sectoral and technical information demands on government officials that should encourage consultations with business associations. At the same time, clearer identification of impacts and greater chance to affect policymaking in bilateral FTAs should generate stronger incentives for businesses to lobby governments for their preferences. Trade officials are more likely to heed business associations that intermediate unified positions among members and assist them with technical information needed at negotiations. Lastly, the coordination and technical information demands engendered by successive bilateral FTAs should prompt government agencies and organized business to invest in their capacities, spurring institutional change and creation. To test these hypotheses, the policymaking of Thai and Malaysian bilateral FTAs was examined. It was found that, over time, government officials in both countries have intensified consultations with the private sector, not just to attend to their trade preferences but also to gather complex technical information needed for negotiations. FTAs have stimulated domestic and cross-border collective action and lobbying by the private sector that has become more pro-active, and, for some key partners, it has taken the initiative and pressed governments to establish certain FTAs. Iterative FTA negotiations have not only strengthened the technical and institutional capacities of government agencies and business associations but has also led to the emergence of new institutional structures for inter-agency coordination, private sector collective action and government-business intermediation.

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<sup>48</sup> Essay 1 was originally written in March 2010. Tables 1 through 3 were updated in August 2013 to reflect recent developments. In addition to its critical evaluation by Professor K. Shadlen, this Essay was reviewed by Professor J. Ravenhill (Australian National University, Canberra, Australia) in February 17, 2011 and Professor M. Solis (American University, Washington D.C., USA) in February 2, 2011.

**Abbreviations:**

AFTA: ASEAN FTA

APEC: Asia Pacific Economic Cooperation

ASEAN: Association of South East Asian nations

FTA: Free trade agreement

FMM: Federation of Malaysian manufacturers

FTI: Federation of trade industries

JSCCIB: Joint Standing Committee of commerce, industry and banking

JTEPA: Japan-Thailand economic partnership Agreement

JTF: Japan Textile Federation

MEUFTA: Malaysia-European Union FTA

MFN: most-favored nation

MITI: Ministry of International Trade and Industry [of Malaysia]

MJEPA: Malaysia-Japan economic partnership Agreement

MOC: Ministry of Commerce [of Thailand]

MOI: Ministry of Industry [of Thailand]

MTMA: Malaysian textile manufacturers Association

MUSFTA: Malaysia-United States FTA

NGO: non-governmental organization

PCO: Preferential certificate of origin

ROO: Rules of origin

TAFTA: Thailand-Australia FTA

TCC: Thai chamber of commerce

TFFA: Thai frozen food Association

TFPA: Thai food processors' Association

TGMA: Thai garments manufacturers Association

TPP: Trans-Pacific Strategic Economic Partnership

TTMA: Thai textile manufacturers Association

TUSFTA: Thailand-United States FTA

WTO: World Trade Organization

## 1. Introduction

The proliferation of free trade agreements (FTAs) in East Asia since the turn of the century constitutes one of the most significant developments in the region's political economy during the last decade. Except for the ASEAN (Association of Southeast Asian Nations) trade bloc, East Asia initially eschewed the global wave of FTAs that began in the mid-1990s. However, nowhere else has regionalism exploded so rapidly with close to 60 FTAs, mostly bilaterals, implemented since 2001.

Prevailing analyses of East Asian FTAs have downplayed their economic relevance and emphasized foreign relations and/or security motivations as their main thrust and rationale (e.g., Desker, 2004; Aggarwal and Urata, 2006; Dent, 2006; Dieter, 2007; Aggarwal and Koo, 2008a; Ravenhill, 2008a; Ravenhill, 2010; Aggarwal and Govella, 2013; Lee, 2013).<sup>49</sup> From a political economy perspective, and with the exception of Japan (see below), these narratives have portrayed FTAs in East Asia as driven by shared ideas and identities among political elites in the context of strong states, with interest groups being sidelined and “play[ing] a relatively minor role in the politics of new bilateralism” (Aggarwal and Koo, 2006:295; Lee 2006; Sally, 2006; Terada, 2009; Lee and Hooi, 2011). At the same time, and in line with low tariffs covering most intra-regional trade, surveys indicate little interest among East Asian firms to utilize existing FTAs (Ravenhill, 2010; Kawai and Wignaraja, 2009; Kawai and Wignaraja, 2011a).

Of note, although often overlooked in the literature, the initiative for some FTAs in Latin America is reported to have originated from governments that engaged business associations only at the implementation stage as to enroll their political support for the agreement (Schneider, 2004; Gardini, 2006; Fairbrother, 2007).<sup>50</sup>

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<sup>49</sup> The primacy of security motivations in the FTA policy of the United States has also been the subject of intense debate (e.g., see Higgott, 2004 *versus* Phillips, 2007).

<sup>50</sup> For instance, the integration accord between Brazil and Argentina that preceded Mercosur or Mexico's decision to seek an FTA with the United States were driven by their respective government elites without prior business consultation. Business in these countries

It will be contended here that many of these constructivism and security-based interpretations of East Asian FTAs have essentialized the role of autonomous states and politicians' ideas at the cost of a deeper analysis of private sector preferences. Instead, this Essay will argue that, compared to other forms of liberalization, a number of specific features in bilateral FTAs should foster government-private sector consultations and increase incentives for business lobbying.

Formulation of bilateral FTAs imposes greater sectoral and technical information demands on government agencies and business associations than do multilateral rounds, and therefore necessitates of more intense consultations within and between both actors. At the same time, compared to unilateral and multilateral liberalization, bilateral FTAs allow for clearer identification of impacts, thus increasing incentives for interest groups to influence policymaking, and create favourable conditions for government-business consultation and lobbying across borders. Government officials are more likely to consult and heed the preferences of business associations that intermediate unified positions among their members and that assist them with technical information needed during bilateral FTA negotiations. These coordination and information demands placed on government and organized business during the course of successive FTAs should encourage all actors to invest in developing their capabilities, spurring institutional change and creation.

To test these hypotheses, I conducted an extensive process-tracing analysis of the bilateral FTAs negotiated by Thailand and Malaysia, the two developing countries in East Asia that have implemented more FTAs.<sup>51</sup> Thailand was one of the first and originally more prolific East Asian nations seeking FTAs, while Malaysia, initially reluctant to embark into

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initially reacted with indifference to the government proposal for market integration (Schneider, 2004, Gardini, 2006; Fairbrother 2007). This parallelism in the policymaking of East Asian and Latin American FTAs was also recently noticed by Solis (2013:93).

<sup>51</sup> Primary research for this Thesis involved 212 in-depth semi-structured interviews with government officials, private sector and civil society representatives and academics in Thailand and Malaysia during two independent trips in 2008 and 2009 complemented and updated by numerous personal communications during 2010-2012 (see Appendix at the end of this dissertation). Among government officials, interviews were conducted with members of trade negotiation teams and officials at ministries and technical supporting agencies relevant to the study. Within the private sector, interviewees included peak and sectoral business associations as well as individual firms, both domestic and foreign, across a wide range of sectors and levels within the value chain.

bilateral FTAs, has later implemented a number of agreements. Empirical evidence confirmed my initial arguments revealing a more nuanced picture of the roles played by government and private sector in the formulation of East Asian FTAs than the one depicted in most of the extant literature. Despite different institutional and policymaking settings in Thailand and Malaysia, findings and conclusions in these case studies substantiate each other and, for the most part, evolution of FTA policymaking in both countries has followed a similar pattern.

Although many Thai and Malaysian FTAs, especially earlier ones, may have responded to government initiatives, their economic rationale, even if only narrowly sectoral, has been essential because whenever this was missing, negotiations eventually faltered. Over time both governments intensified their consultations with the private sector during the formulation of FTAs, not just to attend to its preferences but also to access technical information needed at negotiations. In turn, organized business and individual firms have progressively taken greater interest in influencing FTA policymaking—whether in favor or against and to secure gains or reduce losses—to the point that, for some key partners, it was the private sector that took the initiative and pressed governments to launch FTA negotiations. As business associations in Thailand and Malaysia grew stronger during the 1980s and 1990s, formalized mechanisms were introduced to channel private sector inputs into policymaking (Laothamatas, 1992; Laothamatas, 1995). This research found that bilateral FTAs created new configurations of business collective action and lobbying. More intense interactions between and among government agencies and business associations in the context of FTA formulation have contributed to better specification of actors' preferences, strengthened their technical capacities and institutionalized the consultative process.

The rest of the Essay is organized as follows. Next section briefly outlines the current literature on East Asian FTA policymaking and develops the hypotheses. Sections three and four present empirical evidence of the evolution of FTA formulation in Thailand and Malaysia. Section five discusses findings and concludes.

## 2. Specific dynamics in government-business relations in the context of bilateral FTAs

Worldwide expansion of FTAs has been attributed, *inter alia*, to a number of systemic-level factors, such as the slow progress of multilateral talks at the World Trade Organization (WTO), or the need for countries to attract foreign investment (e.g., Fernandez and Portes, 1998; Ravenhill, 2003).<sup>52</sup> FTAs have also proliferated on the so-called “domino” or “fear of exclusion” effects—the trade diversion engendered by an FTA prompts outside firms to lobby their governments to enter the FTA or create a new one (Baldwin, 1995; Shadlen, 2008).

The lack until recently of institutional arrangements regulating reciprocal trade relations in East Asia was not an obstacle for countries in the region to achieve significant economic integration through the development, since the mid-1990s, of sophisticated regional production networks.<sup>53</sup> Thus, when East Asian countries began to enter into FTAs from 2001 onwards, most scholarly analyses dismissed the economic dimensions of these FTAs and emphasized their foreign policy and security motivations (e.g., Desker, 2004; Aggarwal and Urata, 2006; Hoadley, 2007a; Aggarwal and Koo, 2008b; Ravenhill, 2008a; Ravenhill, 2009; Aggarwal and Lee, 2010; Ravenhill, 2010; Aggarwal and Govella, 2013; Lee, 2013).<sup>54</sup> The “explosion [of FTAs in East Asia] has been driven by a ‘political domino

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<sup>52</sup> In turn, WTO multilateral liberalization rounds prompts countries to form FTAs (Freund, 2000; Mansfield and Reinhardt, 2003).

<sup>53</sup> The ASEAN FTA (AFTA), the only FTA in East Asia before the turn of the century, was signed in 1992 but implementation was poor and initially allowed exclusion of long lists of sensitive sectors (Yoshimatsu, 2006; Ravenhill, 2008b). Only in 2003 were intra-ASEAN tariffs capped at 5% (see below in Section 3).

<sup>54</sup> In Dent (2006), “strengthening diplomatic relations” or “consolidating security alliances” ranked the highest among the motivations for entering FTAs in all five East Asian countries studied except for Japan. By enhancing economic ties among like-minded partners, FTAs set “the context for regional security institution building rather than the other way around” (Aggarwal and Koo, 2008b:302-303). External shocks like the end of the Cold War, the 1997 Asian crisis, September 11 or the Japan/China rivalry for regional hegemony have

effect”, by “governments unhappy at the prospect of missing out on new diplomatic opportunities” (Ravenhill, 2010:199,200).

From a political economy perspective, and in line with the reported lack of economic rationale of East Asian FTAs, dominant narratives of East Asian regionalism outside Japan have downplayed the importance of business lobbying in FTA formation. In Putnam’s (1988) classic two-level game—establishing that a government’s position in international negotiations is determined by the interplay between the stance of the counterpart government (level I) and its strategic interaction with interest groups at home (level II)—, interactions at level II in East Asian FTAs have been limited or missing. FTAs in East Asia are portrayed as top-down deals, driven primarily by the constructivism forces of shared ideas and identities among political elites and with little involvement or interest on the part of business (e.g., Calder and Ye, 2004; Aggarwal and Urata, 2006; Aggarwal and Lee, 2010).<sup>55</sup>

The minor role accorded to interest groups in the formulation of East Asian FTAs is interpreted as these countries’ being “strong states relatively free from societal pressures” (Aggarwal and Koo, 2006:292,295). Thus, South Korea’s shift toward FTAs was shaped by changes in the political leadership and bureaucracy rather than by economic actors (Koo, 2006). FTA policy in Singapore is defined as technocratic and “almost entirely government-led and planned, [with] little concrete evidence on business pushing for or against FTAs” (Sally, 2006; Terada, 2009; Lee and Hooi 2011:125). The influence of businesses on FTA formulation in other Southeast Asian countries was characterized as “limited or unidentified” (Nagai, 2003; Kiyota, 2006; Sally, 2006; Hoadley, 2007a;

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provided impetus for emerging East Asian economic institutionalization (Desker, 2004; Aggarwal and Koo, 2008a; Ravenhill, 2008a; Ravenhill, 2010; Lee, 2013).

<sup>55</sup> Aggarwal and Koo’s (2006:292,295) analysis of the forces behind bilateral FTAs in seven East Asian countries found that “institutional setting” and “ideas” topped each country, except for China and Taiwan, while “influence of interest groups” scored among the lowest. Calder and Ye (2004) derive East Asia FTAs from decision-makers’ choices—autonomous from the institutional context—in the aftermath of the Asian crisis. Embracing of FTAs by the United States and the European Union would have helped to create a cognitive consensus among the East Asian leadership to accept regionalism as a complementary approach to unilateral and multilateral liberalization in the pursue of national interests.

Hoadley, 2007b; Hoadley, 2008; Terada, 2009:165). As Terada summarized (2009:165): “interest group politics is neither necessarily an important factor for the proliferation of FTAs in Southeast Asia, nor directly relevant to the FTA diffusion in the region”. This lack of engagement of the private sector by East Asian governments in FTA policymaking has been compounded by apathy of businesses toward FTAs, both during negotiations and after implementation. For Ravenhill (2003:303) “the supply or regionalism often exceeded the demand for it”. Only Japan departs from this regional trend as evidence shows that the private sector took an active role and pressed the government to embrace regionalism and launch a number of FTAs (Solis, 2003; Manger, 2005; Yoshimatsu, 2005; Yoshimatsu, 2006; Solis and Urata, 2007; Manger, 2009; Katada and Solis 2010; Solis 2010).<sup>56</sup>

Until 2006, Thailand was second only to Singapore in East Asia in the number of FTAs negotiated. The extant literature presents Thai bureaucrats as lacking sufficient trade negotiation expertise and to have eschewed formal consultations with the private sector during FTA formulation (Sally, 2006; Sally, 2007). Consequently, Thai FTAs have been launched in a rush, with no clear economic strategy but with “foreign policy aspirations loom[ing] large”, and are rather “the result of tourism by Thai leaders” and closely linked to the personalized decision-making style of Prime Minister Thaksin (Nagai, 2003; Kiyota, 2006; Hoadley, 2007a; Hoadley, 2007b; Sally, 2007:1606; Hoadley, 2008:111; Sally and Sen, 2011).<sup>57</sup>

Malaysia has taken a more cautious approach, being initially opposed to bilateralism and only jumping on the bandwagon under the threat of trade diversion from other FTAs (Okamoto, 2006). The driving force of Malaysian FTAs has also been linked to changes in the political leadership, namely the stepping down of Prime Minister Mahathir, while their

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<sup>56</sup> The leading role of Japanese businesses in Japan’s FTA policy has been downplayed by Ravenhill (2010) that considered it rather as reactive.

<sup>57</sup> The 1997 Thai Constitution centralized power in the executive and away from the bureaucracy, which lost further influence over the allocation of rents after the 2002 bureaucratic reform that allowed Thaksin to appoint businessmen to senior bureaucratic posts (Ockey, 2004; Phongpaichai and Baker, 2004; Prasirtsuk, 2007; Chaiwat and Phongpaichit, 2008). See also below in footnote 69.

formulation is reportedly confined to the top rank bureaucracy (Okamoto, 2006; Hoadley, 2008).<sup>58</sup>

Of the two levels in Putnam's model (state-state and state-society), this Essay is particularly interested in the latter, how domestic win-sets for FTAs were formed in each country. However, postulating the existence of strong states to account for low involvement of the private sector in FTA formulation overlooks the different ways in which East Asian bureaucracies, including those in Thailand and Malaysia, have traditionally engaged organized business in policymaking (Laothamatas, 1995; MacIntyre, 1995; Doner and Schneider, 2000). In that line, unilateral liberalization in East Asia during the 1980s and 1990s, key in the emergence of production networks, was shaped by pressures from the private sector (Yoshimatsu, 2002; Baldwin, 2006).<sup>59</sup> In addition, as argued below and compared to other forms of liberalization, bilateral FTAs offer greater incentives for government and business groups to increase their interactions through consultations and lobbying.

### ***2.1 Increasing government consultation with the private sector in FTAs***

It is argued here that even when FTAs emerge from the initiative of governments, trade officials need to engage the private sector in their formulation, not only to gather business support for the country's trade policy or to heed its preferences, but also as a result of several features that are inherent to bilateral FTAs. As compared to unilateral or multilateral liberalization, bilateral FTA negotiations present government officials with specific challenges regarding issue coverage, technical complexity, timeframe, and potential bargaining asymmetries, all of which should encourage enhanced consultation

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<sup>58</sup> In fact, it could be argued that Malaysia's decision to launch its first and most important FTA so far, with Japan, occurred during Mahathir's tenure (1991-2003) and his long-time trade minister Rafidah oversaw the negotiation and implementation of several FTAs until her removal from office in 2008.

<sup>59</sup> Lobbying by Japanese and Western firms was key for the regional liberalization of electronics and information technology products (Baldwin, 2006) and of parts and components, mostly in the automotive industry, within Southeast Asia (Yoshimatsu, 2002; Yoshimatsu, 2008).

with the private sector. Expansion of the WTO trade regime to areas beyond tariffs led some scholars to distinguish classical *pressure lobbying* from a new form referred as *regulatory lobbying* (Woll and Artigas, 2007; Woll, 2008) In the former, firms support governments with some reward in return for implementing trade policies that benefit them. Instead, in regulatory lobbying, governments engage businesses in the formulation of regulatory regimes in exchange for technical information.

Technical complexities and information demands are even greater in most bilateral FTAs as even less comprehensive ones bundle tariff reduction schedules with provisions covering areas beyond WTO's agenda. While East Asian FTAs with partners other than the United States or the European Union tend to take on fewer disciplines, most include provisions on investment and complex regulatory frameworks (e.g., standards recognition, technical cooperation) requiring that negotiation teams have appropriate technical expertise. Even when FTAs are exclusively (or mostly) focused on tariff liberalization, broader product coverage in FTAs than in multilateral rounds calls for the involvement of government agencies that do not normally participate in trade formulation. Also departing from WTO, *all* FTAs establish rules of origin (ROOs) that in most bilateral FTAs are product-specific and therefore require from trade officials a very precise understanding of the production process for each tariff line.<sup>60</sup> These sectoral and technical information demands are compounded by the reduced timeframe of FTA negotiations as compared to multilateral rounds. During the negotiation of bilateral FTAs, technical gaps in government officials' expertise should be more severe in disciplines outside the WTO where officials have less experience. Finally, in the context of bilateral negotiations, developing countries face capacity asymmetries when confronting well-prepared teams of American, European

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<sup>60</sup> ROOs determine where a product originates and, consequently, whether it qualifies for preferential tariffs based on compliance with a minimum level of transformation within the FTA bloc. Although included in FTAs to avoid trade deflection, strict ROOs could also be used for protectionist purposes. ASEAN-centered FTAs adopt universal ROOs across lines but most bilateral FTAs establish product-specific rules.

or Japanese officials. Altogether, it could be argued that bilateral FTAs, more so than multilateral rounds, should induce government officials to seek more intense and frequent consultations with business representatives (Figure 1).<sup>61</sup>

**Hypothesis 1:** *Compared to other forms of trade liberalization, government officials should be compelled to involve the private sector more frequently and intensely in the formulation of bilateral FTAs—especially with large developed partners—in order to fill gaps in their technical expertise.*

## 2.2 Greater incentives and effectiveness of business lobbying in bilateral FTAs

In certain circumstances, firms could favor FTAs over multilateral liberalization. Firms with unexploited economies of scale and that have fragmented and relocated their production overseas would support FTAs to reduce tariff barriers in the partner country or to introduce investment provisions outside WTO purview while discriminating against firms outside the FTA area (Milner, 1997; Chase, 2005).

Low or no involvement of the private sector by East Asian governments in FTA formulation has reportedly been compounded by a limited interest for FTAs on the part of business. Thus, earlier apathy among businesses toward ASEAN FTA (AFTA) and other regional initiatives such as the Asia Pacific Economic Cooperation (APEC) (Okamoto, 2004; Ravenhill, 2008b; Yoshimatsu, 2008), seems to have also been mirrored in bilateral FTAs (Sally, 2006; Ravenhill, 2008a; Kawai and Wignaraja, 2011).<sup>62</sup> Geographical

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<sup>61</sup> The above arguments have been recently supported by Solis (2013:95) who also contends on the importance of the technical expertise provided by business associations during FTA negotiations.

<sup>62</sup> Much of the driving force behind early ASEAN complementation programs and later of AFTA itself came from foreign firms rather than from indigenous businesses. The effectiveness of ASEAN-wide business organizations (ASEAN Chamber of Commerce and Industry, ASEAN Business Advisory Council) as interest groups was limited by their broad representation and modus operandi based on consensual decisions, when not by their cooptation by governments. This led former ASEAN Secretary General Severino to lament in 2002 that: “the call for regional economic integration has come particularly from the business sectors of Japan and the United States [...] what we need is pressure from the ASEAN business community [...]” (as quoted in Yoshimatsu, 2008:55). Nevertheless, our interviews found that some indigenous firms, like the influential Thai conglomerate Charoen Pokhong Group, has been a strong supporter of intra-ASEAN liberalization and of many other Thai bilateral FTAs (see footnote 77). As AFTA liberalization proceeded, its preferences have been used not only by foreign firms but also by ASEAN indigenous ones (see Essay 2).

inconsistency between regional production networks and (mostly bilaterals) FTAs, along with the prevalence of low tariffs and import duty exemptions schemes covering much of East Asian trade, have tamed down business enthusiasm for FTAs (Ravenhill, 2008a; Ravenhill, 2010). Such business indifference about FTAs has been correlated with, when not inferred from, firm-level surveys showing low utilization of existing East Asian FTAs (e.g., Haddad, 2007; JETRO, 2009; Kawai and Wignaraja, 2009; Wignaraja et al., 2010; Kawai and Wignaraja, 2011).<sup>63</sup>

Interest groups are more likely to mobilize, for or against, around reforms with clear and immediate impacts than on those that are diffuse, uncertain or longer-term (Schneider, 2010). First and foremost, unilateral and multilateral liberalization focuses the attention of import-competing sectors, because tariff reduction to every potential exporter in the world has unambiguously negative consequences for them. In contrast, in the context of global competition, gains for export-oriented firms from unilateral, multilateral, and even regional liberalization are uncertain at best, which reduces their incentive to lobby.

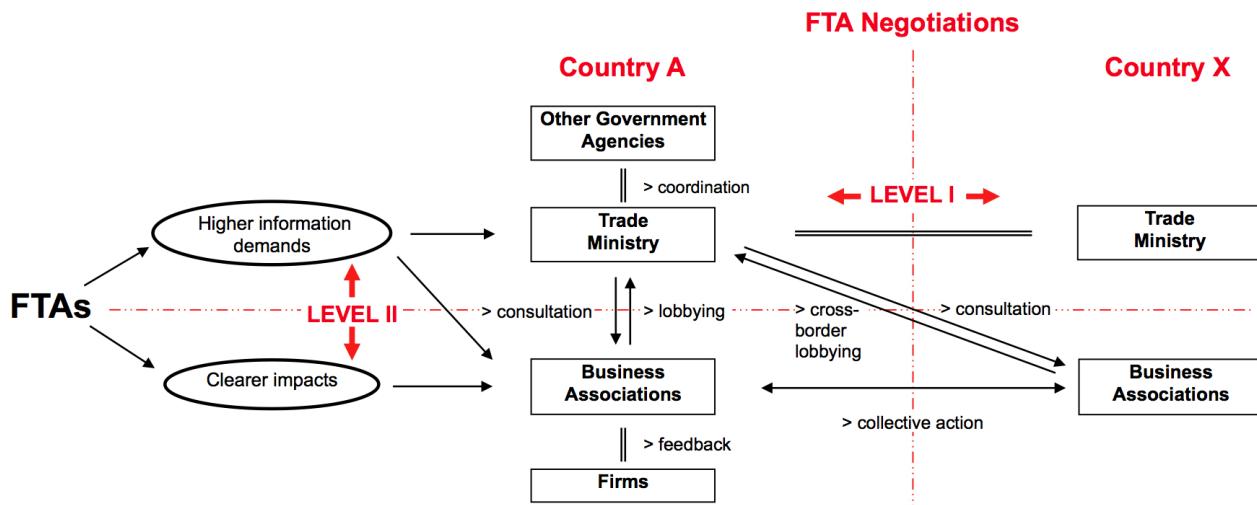
It is contended here that bilateral FTAs should attract greater interest from firms than do other forms of liberalization. Bilateral FTAs allow for a clearer identification and assessment of impacts, which should increase incentives for businesses, winners and losers, to influence their formulation. Compared to multilateral and regional liberalization, bilateral FTAs generate more explicit gains for exporters while they could accommodate long tariff phase-out periods or even exclusions for import-competing sectors.<sup>64</sup> Additionally, since bilateral FTAs are negotiated over shorter periods and provide firms

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<sup>63</sup> These estimates and surveys are prone to misrepresent real FTA utilization (see Essay 2 for discussion). Calculation of *real* FTA utilization requires compilation of official records, known as Preferential Certificates of Origin (PCOs), certifying that the exported product complies with ROOs. Most East Asian countries do not collect PCOs but research for this Thesis was able to obtain PCOs for selected FTAs and other preferential regimes in Thailand and Malaysia (see below and in Essay 2).

<sup>64</sup> In addition to discriminatory tariffs and ROOs, ambiguities in Article XXIV of the General Agreement on Tariffs and Trade—regulating FTAs involving at least one developed country—and flexibilities in the Enabling Clause—regulating FTAs among developing countries—leave room for governments to carve out from FTAs some sensitive sectors. FTAs should liberalize substantially all trade within a reasonable period. This has been most commonly interpreted as liberalizing at least 90% of existing trade within a maximum period of 10 years. In the same of line of argument, Solis (2013:96) posits that business groups are more likely to mobilize around FTAs that amend or avoid economic losses than with respect to FTAs that maximize gains.

more readily access to policymakers, the private sector has a greater chance to effectively affect policymaking in a bilateral context than in multilateral rounds. In sum, both exporters and import-competing sectors should have stronger incentives to lobby and assert their policy preferences in bilateral FTAs than in other forms of liberalization (Figure 1).



**Figure 1:** Policymaking of bilateral FTAs

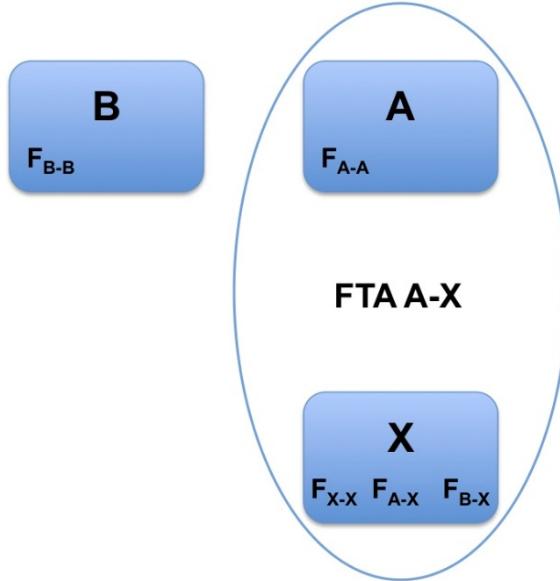
**Hypothesis 2:** *Clearer assessment of impacts and the possibility of protecting sensitive items in bilateral liberalization provide both exporters and import-competing firms with stronger incentives to influence the formulation of bilateral FTAs than in other forms of liberalization.*

### 2.3 Bilateral FTAs provide unique opportunities for consultation, collective action and lobbying within and across borders

Although clientelist channels persist, strengthening of business associations in Thailand and Malaysia during the 1980s introduced formal and cooperative mechanisms for government-

business consultation and lobbying in both countries (Laothamatas, 1988; Laothamatas, 1995; Doner and Schneider, 2000).

A major contention of this Essay is that FTAs create different possibilities for business collective action and influence than unilateral or multilateral liberalization. Consider a firm  $F_A$  from country A seeking to export a final product from its factory in A ( $F_{A-A}$ ) to country X, which imposes high-tariffs on the product (Figure 2). Under the multilateral regime,  $F_A$  could pressure directly the government in X for unilateral and universal reduction of most-favored nation (MFN) tariffs on that product in X or could lobby indirectly through its own government in A. However, as argued above, in the context of global competition, gains to  $F_A$  from unilateral or multilateral liberalization by X are uncertain. In addition, it would be difficult for  $F_A$  to recruit other firms to take collective action and lobby the government of X when firms are dispersed across multiple countries. As per Chase (2005), independently of whether  $F_A$  produces only at its factory in A ( $F_{A-A}$ ) or has fragmented production and relocated some stages to X (subsidiary plant  $F_{A-X}$ ),  $F_A$  would favor an FTA between A and X that reduces all tariffs in X (on both final and intermediate inputs coming from A) and, at the same time, discriminates against firms outside the A-X bloc. Arguably, a firm  $F_B$  from country B would oppose any liberalization by X of final goods coming from A that are perfect substitutes for its own products (Figure 2). This opposition by  $F_B$  to FTA A-X would occur independently of whether  $F_B$  is based only in B (plant  $F_{B-B}$ ) or also has production stages in X (subsidiary plant  $F_{B-X}$ ). However, if  $F_{B-X}$  procures inputs from A,  $F_B$  could potentially favor—and even jointly lobby with  $F_A$ —for liberalization by X of intermediate inputs coming from A through FTA A-X.



**Figure 2:** A bilateral FTA between A and X opens distinct possibilities for collective action and lobbying than multilateral liberalization and which would depend on the organization of production among firms (see main text for details).

In these scenarios, FTAs provide for different configurations of business collective action and influence than multilateral or unilateral liberalization. In addition to stronger incentives for business lobbying at each level II (Hypothesis 2), bilateral FTAs should also foster business collective action and lobbying *between* levels *across* borders, namely, between levels II of each country and between level II in one country and level I in the other (Figures 1 and 2).

The possibility that both governments (level I) reach a deal increases when negotiators at both sides are presented with similar proposals from their respective levels II. Cross-border coordination of positions between businesses in A and X (e.g., input suppliers in A and producers of final goods in X) would therefore improve the possibility of both governments agreeing during negotiations. Likewise, firms with a presence in both countries [e.g., F<sub>A</sub> with plants in A (F<sub>A-A</sub>) and X (F<sub>A-X</sub>)] would be able to present their preferences from levels II in both A and X.

Of note, joint lobbying by businesses at both levels II could occur not only in vertically integrated producer-driven industries but also through collective action between

producers and buyers in buyer-driven commodity chains—e.g., textile and garment producers in country X and wholesale buyers and trading companies in country A. Lastly, compared to unilateral and multilateral liberalization, bilateral FTAs could also encourage a government to consult with private sector actors in the partner country (between levels I and II but across borders) to find out about positions and potentially to seek alliances.

**Hypothesis 3:** *Bilateral FTAs provide unique opportunities for governments and business in their relations within and across borders. Bilateral FTAs should encourage collective action between private sectors in both countries (between both levels II) as well as consultation and lobbying between government and businesses across borders (between level I in one country and level II in the other).*

#### **2.4 Government and business capacity building and institutional creation by iterative FTAs**

Regulatory lobbying depends on government officials soliciting information from private sector representatives (Woll and Artigas, 2007; Woll, 2008). By allowing businesses to participate in policymaking, governments create incentives for firms to organize, overcome collective action problems and invest in the institutional capacity of business associations (Schneider, 2004; Schneider, 2010). To get invited by the government in consultations, business associations have to compete in credibility as sources of knowledge to the government. Cohesion is required for business associations to achieve collective action in pressure lobbying. As illustrated by the case studies below, in regulatory lobbying only associations with strong technical capabilities and that contribute to the public good beyond particularistic interests intermediating unified positions of their members would be reliable

for their government.<sup>65</sup>

It is posited here that, as for government agencies, FTAs and particularly bilateral FTAs generate greater information demands on business associations than do multilateral negotiations. If in the context of unilateral and multilateral liberalization, import-competing industries simply lobby for sectoral exclusion, in FTA negotiations they need to learn about additional restrictive measures available to them, such as stringent ROOs or long tariff phase out periods. Likewise, exporters would not only lobby for tariff reductions in the FTA partner, but they would also need to make themselves aware of existing regulatory obstacles in the destination market and pressure trade officials for their removal and for the use of relaxed ROOs.

Negotiation and formulation of successive and simultaneous FTAs constitutes a learning process for officials and the private sector alike. At the least, FTAs contribute to a better specification of preferences and positions by actors but, potentially, could also strengthen their respective institutional capacities. For trade officials, complex FTA negotiations should provide incentives to gain further expertise, to coordinate inputs from other agencies and consult more often with business. In turn, FTAs should encourage business associations to improve their capabilities to fulfill government's information requests. As these exercises are repeated over time with successive FTAs, the information and coordination costs entailed should spur institutional change and creation within government agencies and business associations as well as in the channels of communication among them (Figure 1).

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<sup>65</sup> As noted in footnote 61, Solis (2013:106) also came to very same conclusion as she recently argued on the role that business associations play in the context of trade negotiations serving government officials in intermediation of preferences and as source of technical expertise.

**Hypothesis 4:** *Demands on governments and the private sector by the negotiation of iterative FTAs should improve their specification of preferences and generate incentives for both actors to invest in their respective capabilities, spurring institutional change and creation.*

These four hypotheses will be tested empirically in the FTAs negotiated by Thailand and Malaysia described in turn below. Findings confirmed the initial arguments and show that government-business consultations and lobbying in the context of FTA policymaking in both countries have evolved in similar manner, serving as further corroboration of the hypotheses.

### **3. Thailand FTA policymaking**

Trade policymaking in Thailand is fragmented across several agencies but the main actors are the Ministries of Commerce (MOC), of Finance, of Industry (MOI) and of Agriculture.<sup>66</sup> At the cabinet level, the Committee on International Economic Relations Policy provides guidelines on international trade and investment.<sup>67</sup> Peak business associations in Thailand, namely, the Federation of Thai Industries (FTI), the Thai Chamber of Commerce/Board of Trade (TCC), and the Thai Bankers Association, are collectively represented by the *Joint Standing Committee of Commerce, Industry and Banking* (JSCCIB) and all four participate in consultative committees within government

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<sup>66</sup> Our field research found evidence that, in broad terms, the MOC's Department of Trade Negotiations holds a liberal stance on trade liberalization, and it is the main focus of influence by foreign multinationals and Thai companies with international ties. Meanwhile, domestically-oriented manufacturers find greater leverage within MOI's Office of Industrial Economics.

<sup>67</sup> In 2002, a Trade Representative Office was created directly under the Prime Minister Office to promote trade opportunities abroad. The Office has not played a major role in the formulation of most Thai views of the FTAs except in the ongoing Thailand-European Union FTA, where it is leading the Thai negotiation agency.

agencies.<sup>68</sup> The *Joint Public-Private Sectors Consultative Committee* is the highest-level government-business forum, but it has played a lesser role since the mid-1990s.<sup>69</sup>

The participation of Thailand at the Uruguay Round, that led to the creation of the WTO, and at APEC's most important attempt of sectoral liberalization in 1998 was hampered by the limited expertise of Thai officials and the low capability and interest of the private sector (Okamoto, 2004; Sally, 2004; Rothgeb and Benjamas, 2007; Yoshimatsu, 2008; interviews). Thai positions originated from MOC senior officials who barely consulted businesses, apart from for peak and a few other well-organized associations. It was only in 1999 that the JSCCIB established the *Joint WTO Committee* to organize private sector participation in multilateral negotiations. However, sluggish progress at the Doha Round has slowed down government's involvement in WTO matters and abated business interest.<sup>70</sup>

Thailand is founding member of ASEAN, whose agenda, including launching of the AFTA, has historically been largely driven by high-level political summity with limited business input (Ravenhill, 2008b). During the 1990s, and especially after the 1997 Asian financial crisis, ASEAN governments accelerated liberalization in response to pressure from Japanese and Western firms established in the region (Yoshimatsu, 2002; Yoshimatsu, 2008). However, it was only after 2003 that intra-AFTA tariff barriers were significantly reduced and eventually eliminated in 2010.<sup>71</sup> In Thailand, AFTA liberalization has been supported, and to a significant extent driven, by key benefiting sectors like automotive,

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<sup>68</sup> In addition to its function as peak association, FTI serves as umbrella to 40 sectoral associations ("Clubs") spanning all industrial sectors. The TCC encompasses about 100 associations in the primary sector, services but also some manufacturing industries.

<sup>69</sup> An analysis of the political leadership and the bureaucracy in Thailand and Malaysia is outside the scope of this Thesis. Thai policymaking before 1973 has been described as a bureaucratic polity, where macroeconomic policy was controlled by an autonomous bureaucratic elite (Laothamatas, 1988; Ockey 2004). Business associations started emerging as influential policy actors in the 1980s and the creation of the Joint Public-Private Sectors Consultative Committee in 1981 has been hailed as the beginning of a new era of group-based business lobbying and corporatist policymaking in Thailand (Laothamatas, 1988; Laothamatas, 1992; Laothamatas, 1995). Nevertheless, clientelistic networks persisted and during Thaksin's tenure many business tycoons enter politics as members of parliament or the Cabinet (Prasirtsuk, 2007; Bowornwathana, 2011). See also footnote 57.

<sup>70</sup> Involvement of Thai businesses in WTO issues is greater in the context of litigations, where the private sector not only often exceeds in expertise to officials' but also hires foreign legal experts (Rothgeb and Benjamas, 2007; interviews).

<sup>71</sup> AFTA was replaced in 2010 by the ASEAN trade in Goods Agreement. Full implementation of the Agreement in the less developed ASEAN countries (Cambodia, Myanmar, Laos and Vietnam) will occur in 2015, when ASEAN countries have scheduled the creation of the ASEAN Economic Community with the goal of achieving full economic integration.

food, and textiles and garments. Utilization of AFTA by Thai exporters increased from 10.7% in 2002 to 31.5% in 2010 (data provided by MOC).

None of the FTAs explored by Thailand immediately after the Asian crisis at the initiative of the bureaucracy progressed into negotiations. Slow progress at WTO and AFTA prompted Singapore to embark on bilateral FTAs after 2000, a move followed by Thailand where much of the initiative came from Prime Minister Thaksin (2000-2006) himself.<sup>72</sup> As of August 2013, in addition to AFTA and five bilateral agreements analyzed below, as member of ASEAN, Thailand is also party to five ASEAN-centered (also known as ASEAN+1) regional FTAs (Table 1).<sup>73</sup>

### ***3.1 Early FTAs: marginal economic benefits and little interest by a mostly reactive private sector***

Before negotiating with its larger partners, Thailand approached some small and distant economies such as Bahrain or Peru (Table 1). Research for this Essay confirmed that proposals for these early agreements originated from Thaksin himself and that, given their weak economic basis, negotiations proceeded with little involvement or interest by the private sector. In line with the existing literature (Sally, 2007; Phongpaichit and Baker, 2004), it was also found that Thai bureaucrats initially had little choice but to follow on Thaksin's initiatives. However, interviews also revealed that, despite their declined policymaking power, trade officials questioned certain FTA proposals and often succeeded in persuading Thaksin about their lack of economic rationale so some proposals or even

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<sup>72</sup> FTAs assumed a central position in Thai economic policy during Thaksin's tenure, being associated with his highly personalized decision-making style, often proposed in the context of state visits and summits (Hoadley, 2008).

<sup>73</sup> ASEAN has FTAs with China, Japan, Korea, Australia/New Zealand and India. The bilateral early harvest agreement between Thailand and China was subsumed into the ASEAN-China FTA. Thailand also participates of the Bay of Bengal Initiative for Multi-Sectoral, Technical and Economic Cooperation FTA. As for other ASEAN members, Thai bilateral FTAs tend to be more comprehensive and provide for faster liberalization than their respective ASEAN-centered FTAs that have aroused limited interest by business.

negotiations, such as those with Bahrain and Peru, were postponed or abandoned altogether.<sup>74</sup>

**Table 1: Thai Bilateral FTAs \***

| Official Name**                     | Coverage***                          | Timeline  | Status   |
|-------------------------------------|--------------------------------------|---|--|
| <b>Thailand-Bahrain CEPA</b>        | EHS of 626 lines at HS6              | Negotiations started in early 2002. EHS signature and implementation: Dec 2002. FTA Negotiations: started in 2003-suspended in 2005   | Abandoned  |
| <b>Thailand-China EHS</b>           | EHS of 188 agricultural lines at HS6 | EHS implementation: Oct 2003. Superseded by ASEAN-China FTA   | Bilateral FTA Subsumed into ASEAN-China FTA                      |
| <b>Thailand-India EHS &amp; FTA</b> | EHS for 84 lines at HS6              | Joint Study: May-Dec 2002. EHS negotiations: Dec 2002-Oct 2003. EHS signature: Oct 2003. Implementation: Sept 2004. FTA negotiations: abandoned and resumed several times. Resumption of talks on services liberalization in late 2013. Signing of the agreement projected for Dec 2013 or early 2014 | EHS active. Negotiations abandoned/resumed multiple times        |
| <b>Thailand-Australia FTA</b>       | Comprehensive                        | Joint study: July 2001-May 2002. Negotiations: June 2002-Oct 2003. Signature: July 2004. Implementation: Jan 2005   | Active   |
| <b>Thailand-Peru CEPA</b>           | EHS/FTA on 4000 lines at HS6         | Joint Study: July 2002. Framework signed in Oct 2003. Negotiations: Jan 2004-Nov 2005. Protocols on ROOs signed in Oct 2009 and 2010. Implementation: Jan 2012  | Abandoned between Nov 2005-Oct 2009 Active                       |
| <b>N. Zealand-Thailand CEPA</b>     | Comprehensive                        | Negotiations: April-Nov 2004. Signature: April 2005. Implementation: July 2005  | Active   |
| <b>Japan-Thailand EPA</b>           | Comprehensive with exclusions        | Joint Study: Dec 2003. Negotiations: Feb 2004-Aug 2005. Signature: April 2007. Implementation: Nov 2007   | Active   |
| <b>Thailand EFTA FTA</b>            | Comprehensive                        | Negotiations: Oct 2005-Jan 2006. Abandoned  | Abandoned  |
| <b>Thailand-US FTA &amp; TPP</b>    | Comprehensive                        | Proposal: Oct 2002. Impact study: Oct 2003. Negotiations: July 2004-Jan 2006. Abandoned<br>Government expressed interest in TPP in Dec 2012   | Bilateral FTA abandoned<br>Pending decision by Parliament on TPP |
| <b>Thailand-Chile FTA</b>           | Comprehensive                        | Impact study: March 2006. Negotiations: April 2011-Aug 2012. Endorsed by the Thai Parliament in May 2013. Signature expected for Oct 2013 and implementation for early 2014   | Pending signature (expected for Oct 2013)                        |
| <b>Thailand-EU FTA</b>              | Comprehensive                        | Negotiations for ASEAN-EU FTA started in May 2007 and abandoned in early 2010<br>Bilateral Thailand-EU negotiations were endorsed by the Cabinet (Dec 2012) and Parliament (Jan 2013). Negotiations: launched March 2013. First round: May-June 2013  | Regional FTA abandoned<br>Bilateral FTA under negotiation        |

Source: Governments' websites complemented with information in local press (updated as of August 2013)

\* Only bilateral FTAs that have reached negotiation status are included

\*\* Abbreviations in this Table: CEPA: Closer Economic Partnership; EHS: Early Harvest Scheme; EFTA: European Free Trade Association (Switzerland, Norway, Iceland, Liechtenstein); EPA: Economic Partnership Agreement; TPP: Trans-Pacific Partnership

\*\*\* HS6 level refers to the 6-digit level of specification under the Harmonized Commodity Description and Coding System, which is the international nomenclature for goods developed by the World Customs Organization. HS6 includes around 5,500 items.

In November 2002, ASEAN and China signed an FTA to be realized over eight years but Thaksin, eager to gain a first-mover advantage in China, struck a separate bilateral Early Harvest Scheme (EHS) covering fruits and vegetables with plans for a fully-fledge Thailand-China FTA to follow. The import surge of produce from China prompted by the EHS adversely impacted Thai farmers, who had not been consulted on the deal

<sup>74</sup> Thailand and Bahrain signed an Early Harvest Scheme—liberalizing from the start a reduced number of items—but negotiations for the full-fledge FTA were eventually abandoned. Thailand and Peru agreed on an FTA in 2005 but it was never implemented and it was only in 2009, because of the renewed interest of some sectors, that talks were resumed (see below).

(interviews). The EHS brought FTAs into the public eye for the first time and sparked the creation of *FTA Watch*, a coalition of NGOs that has become instrumental in channeling civic opposition to FTAs.<sup>75</sup>

Likewise, ahead of FTA negotiations between ASEAN and India, Thailand signed a bilateral EHS with India and started negotiations for a comprehensive FTA. Research for this Thesis confirmed that overall consultation with organized business in this EHS was superficial, mostly at the peak level. However, interviews uncovered evidence that some firms in the automotive and electronics sectors strongly supported the EHS. Over the last decade, Thailand has become the hub for multinational carmakers in Southeast Asia and beyond. The automotive industry is the country's second largest source of export revenue and, consequently, politically very influential. Some carmakers based in Thailand lobbied for the EHS as to integrate India into their Thai/ASEAN procurement network.<sup>76</sup> Japanese producers of consumer electronics were keen to level the playing field with Korean firms established in India. Reflecting these business interests, over 85% of the early utilization of EHS by Thai importers was concentrated in automotive components, despite representing only 3% of the items included in the EHS. In turn, over 40% of the EHS utilization by Thai exporters corresponded to electrical appliances (data provided by MOC). Persisting reluctance by India to liberalize other sectors has damped the interest of Thai officials and businesses in concluding FTA negotiations, which have dragged on for over a decade (Table 1).

Having failed to engage the European Union in a bilateral FTA, Thaksin approached the smaller European Free Trade Association (Table 1). The marginal economic benefits to be realized in this small FTA grouping and the opposition by FTA Watch to WTO-plus

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<sup>75</sup> FTA Watch claimed that the EHS benefited contract-farming operators like the Charoen Pokhand Group (*Bangkok Post*, August 13 2006; interviews), with links within Thaksin's cabinets like Wattana Muangsuk, then Minister of Industry and Commerce (interviews).

<sup>76</sup> Toyota, which accounts for 40% of Thai automotive production, lobbied for the EHS that eliminated import duties on components from a factory it had established in India a year earlier.

provisions on intellectual property rights resulted in the suspension of negotiations after only two rounds.

In line with my initial arguments, these early FTAs demonstrate that political willingness, even at the highest level, is not a sufficient condition to conclude an FTA when it is not accompanied by clear and certain economic impacts, even if these are limited to a small number of economic sectors.

### ***3.2 FTAs with Australia and Japan: push from sectoral business interests***

The Thailand-Australia FTA (TAFTA) was Thailand's first comprehensive FTA with a developed nation and to include provisions on investment and services and product-specific ROOs. These features posed unprecedented demands on Thai officials that, as revealed by interviews and in line with Hypothesis 1, had to rely on technical expertise from business associations. The FTI and the TCC collected highly detailed sectoral data on the production structure in Thailand and elaborated the Thai proposal regarding ROOs in TAFTA. To agree on particular tariff and ROO levels, peak and sectoral associations also had to coordinate the often opposing positions of upstream and downstream producers within and across sectors. In turn, FTI clubs, TCC and many individual sectoral associations had the chance to present their preferences to trade officials although smaller groupings could not participate on equal terms.<sup>77</sup>

As advanced by Hypothesis 2, sectors anticipating large impacts from TAFTA tried to influence its formulation.<sup>78</sup> At the time, Thai textiles and garments faced strong competition in Australia from producers of other developing countries. Accordingly, the proactive and well-organized textile (TTMA) and garment (TGMA) manufacturers

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<sup>77</sup> A number of sectoral associations outside the FTI complained that they were not given enough time by trade officials to consult back with their members while others lacked the expertise required to participate efficiently (interviews). FTA Watch criticized TAFTA negotiations for their lack of transparency and the alleged collusion of interests of some cabinet members with the Thai conglomerate Charoen Pokphand Group (see footnote 75) (*The Nation*, July 12, 2004 and February 1, 2005; interviews).

<sup>78</sup> Although small-scale farmers and dairy producers in Thailand were projected to lose from TAFTA, they lacked the needed organization and leverage, and their interests were defended by FTA Watch (interviews).

associations lobbied in favor of Australian liberalization of their sector in the agreement. But the key sponsor of TAFTA was the automotive industry. International carmakers based in Thailand have always opposed any unilateral or multilateral liberalization that would expose them to competition from outside ASEAN. However, a bilateral FTA with Australia—historically, the single largest market for Thailand-made vehicles, which accounted for over a quarter of total exports—would help many Japanese and American carmakers with plants in both countries to rationalize their procurement and production activities. Indeed, my research found that automotive firms lobbied the Thai government in favor of TAFTA as soon as both countries launched a joint feasibility study. The Australian Ambassador to Thailand and the President of General Motors (GM) Thailand paid a visit to the Thai Industry Minister and pressed for the speedy opening of negotiations. The Automotive Industry Club at FTI—representing all carmakers—and the two auto-parts manufacturers' associations in Thailand lobbied the MOC and Thaksin himself for total and reciprocal liberalization of vehicles and auto-parts. In Australia, carmakers also made submissions to the government in support of the deal (Parliament of Australia, 2004).<sup>79</sup> With the automotive sector in both countries (both levels II)—actually the same firms—pushing for TAFTA, negotiating teams (level I) found it easy to conclude the agreement. The final treaty provided for the full and reciprocal opening of the Thai and Australian automotive industries—the first and only time Thailand has done so outside ASEAN (DFAT, undated). Thailand also gained improved access in Australia for its textiles and garments.<sup>80</sup>

In contrast to the reported lack of interest on FTAs by the private sector in Thailand, my analysis of official preferential trade records shows that overall utilization of TAFTA

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<sup>79</sup> Production of vehicles and automotive parts in both countries were largely complementary and the Australian Federal Chamber of Automotive Industries supported the agreement ([sic], [www.aph.gov.au/hansard/joint/committee/J7814.pdf](http://www.aph.gov.au/hansard/joint/committee/J7814.pdf), accessed on July 25, 2009; not longer accessible at that link but available upon request).

<sup>80</sup> See Table 3 in Essay 4 for details on Thai and Australian concessions in the automotive sector. Thailand obtained up to twenty years to liberalize its dairy sector.

among exporters has been high from the start, averaging 62.3% in 2005-2011 (data provided by MOC). The active role played by the automotive industry in the formulation of TAFTA is illustrated by its disaggregated sectoral utilization. In early years, well over half of all Thai exports using TAFTA preferences were vehicles and automotive parts, for which utilization is virtually complete (data provided by MOC).<sup>81</sup> Within days of concluding TAFTA negotiations, Thailand started talks with New Zealand, eager to cancel out trade diversion of its dairy industry by TAFTA. Interest on the Thailand-New Zealand FTA among businesses in Thailand was much reduced compared to TAFTA although preferences were distributed along similar sectoral lines. Eventually, concessions in this FTA closely followed those in TAFTA.<sup>82</sup>

Specific sectoral business interests also drove the Japan-Thailand Economic Partnership Agreement (JTEPA). As the main investor, first source of imports and a major export destination, Japan was a natural FTA partner for Thailand.<sup>83</sup> According to my interviews, the main goals in JTEPA for Thai businesses were improving access in Japan to food, and textile and garment products and attracting further investment. JTEPA also ranked as one of the most sought-after FTAs for Japanese firms that hoped to reduce Thai tariffs on automobiles and steel, better integrate Japanese and Thai/ASEAN textile and garment producer chains and extract Thai concessions in investment and services (MOFA-JTEPA 2003; interviews).

Negotiation teams for JTEPA aimed not only at the liberalization of bilateral goods trade but also of investment and services and to incorporate in the agreement sectoral cooperation. The broader scope of the agreement with respect to previous FTAs meant the

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<sup>81</sup> Since implementation, exports of Thailand-made vehicles have trebled. As TAFTA preferential tariffs have been progressively reduced and eliminated in most sectors, the relative share of automotive products in total exports under TAFTA have slightly declined. Nonetheless, utilization of TAFTA for Thai exports of vehicles continues to be close to 100%.

<sup>82</sup> There are no data on the utilization of the Thailand-New Zealand FTA utilization because application for certificates of origin is not required.

<sup>83</sup> At the start of negotiations and until 2009, Japan was the second export market for Thai products after the United States. Since 2009, continues to occupy the second position but behind China (Trade Map database).

participation at JTEPA negotiations of government agencies that are not normally involved in multilateral rounds.<sup>84</sup> In line with Hypothesis 1, field research found that during the formulation of JTEPA the government conducted more *ex-ante* impact studies and more frequent and effective consultations with the private sector than in previous FTAs. As in TAFTA, JTEPA establishes product-specific ROOs and the government depended again on the information provided by FTI and TCC to prepare a proposal. Likewise, formulation of mutual recognition agreements for the removal of the technical and standards barriers faced in Japan by key Thai exports (e.g., electrical appliances, food products), required detailed feedback from business associations and, in turn, from their members. The peak and main concerned business associations were engaged throughout JTEPA negotiation rounds and inter-round meetings.<sup>85</sup> Still, sectoral associations or individual firms seeking to secure their influence on JTEPA formulation had to take a proactive role, preparing impact reports and using their contacts within peak associations, ministries, or even the cabinet.

Greater and more efficient participation by the private sector during JTEPA negotiations was helped by improved capacity among officials and business associations. As contended by Hypothesis 4, after several FTAs both actors had improved their internal capabilities and some channels of communication became institutionalized (see Table 4 in the Discussion). Thus, in mid-2004, soon after the start of JTEPA negotiations, FTI and TCC established their respective *Committee on FTAs* as well as a separate *Subcommittee on JTEPA* (and on other ongoing FTAs at the time) to coordinate inputs from members and serve as focal points for government officials. Individual FTI clubs and sectoral

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<sup>84</sup> Agencies like the Ministry of Education, of Science and Technology, and of Information and Communications also participated in JTEPA. Talks were led and coordinated by the JTEPA Office at the Ministry of Foreign Affairs but negotiations around market access were responsibility of the MOC.

<sup>85</sup> Nevertheless, some smaller associations interviewed indicated that consultations with them were part of cross-sectoral and mostly informative gatherings and lamented the lack of time to prepare positions and/or of government receptiveness to them. FTA Watch recognized that, compared to previous FTA negotiations, consultations with businesses and civil society increased in JTEPA but the civic grouping declined to attend some of these meetings arguing that the government only sought to get the NGO stamp of approval (interviews). The private sector is not allowed to attend official FTA negotiations but our interviews found that representatives from peak and key sectoral associations but also some influential individual firms were present in the “next room” (a common phenomenon in trade negotiations; Jordana and Ramio, 2003) and consulted along the process when needed, even travelling with Thai negotiators when rounds took place in Japan (interviews). FTA Watch claimed that while negotiations were kept outside the scrutiny of the Thai Parliament, representatives from some firms were occasionally embedded within the Thai negotiation team (interviews).

associations also created their own *FTA Taskforces*. In November 2004, in the midst of negotiations with Japan and just after the second round of the Thai-United States FTA, the Thai government established the cabinet-level *National Committee on FTA Strategy and Negotiations* to provide direction and coordination across multiple FTAs.

In Thailand, JTEPA got the support of the influential textile and garment, food, and jewelry industries and of Japanese carmakers. For Thai garment manufacturers, Japan has traditionally represented the second largest market after the United States and their associations lobbied to improve market access to their products in Japan via JTEPA. On its part, the Japan textile Federation (JTF) favored the establishment of FTAs with ASEAN members as a way to break Japanese dependence on Chinese imports. Japan is also one of the top destinations for the competitive Thai food processing industry. Interviews found that the Thai frozen food (TFFA) and food processors producers (TFPA) associations pressed the Thai government to negotiate the elimination of barriers in Japan not only through scheduled consultations but also proactively via more direct channels within the MOC and the cabinet.

Business efforts to influence JTEPA were more public and intense in the automotive sector. Japanese carmakers sought to eliminate Thai tariffs on passenger cars, automotive parts and steel. Liberalization of vehicles produced in Japan was strongly opposed by American and European assemblers and automotive parts manufacturers based in Thailand.<sup>86</sup> Japanese and Western firms lobbied the Thai government and strategically went to the media to air their strongest positions.<sup>87</sup>

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<sup>86</sup> Even though Japanese carmakers produce locally about 90% of the vehicles sold in Thailand, Japanese firms sought liberalization of vehicles made in Japan in order to increase flexibility for future production strategies and to gain free access for large-engine luxury models, which are still manufactured in Japan. The Automotive Industry Club opposed liberalization of small and medium-size engine vehicles made in Japan but accepted some tariff reduction on vehicles over 3000 cc. Liberalization of automotive parts and steel was naturally opposed by parts manufacturers but had partial support from American assemblers that import some inputs from Japan. Automotive part manufacturers eventually accepted a long tariff phase-out so to avoid confrontation with their mostly Japanese clients.

<sup>87</sup> Thai officials met not only with automotive business associations based in Thailand but also with individual companies. Some carmakers, especially highly influential Toyota, also proactively lobbied cabinet ministers and Thaksin himself (interviews).

In support of Hypothesis 3, JTEPA also illustrated the possibilities in bilateral FTAs for business collective action and lobbying across borders (between levels II of both countries). Field research revealed that, even before negotiations had started, JTF dispatched representatives to Thailand to discuss with Thai counterpart associations (mainly TTMA and TGMA) on potential tariff reductions and ROOs to be included in JTEPA. Interestingly, Japanese government officials often participated in these meetings. Similar cross-border business collective action occurred in the food sector; TFFA and TFPFA contacted wholesale buyers and trading companies in Japan to consolidate positions to be passed to their respective governments.

The Thai government was concerned that JTEPA could make redundant existing investment (or jeopardize future one) in the automotive sector. Accordingly, Thailand accepted the progressive liberalization of automotive parts from Japan but refused liberalization of vehicles, except for a tariff reduction from 80% to 60% on larger-engine cars, which represent less than 0.5% of the total market. In turn, Japan reduced tariffs on garments and textiles, footwear, jewelry, and processed food (METI-JEPA, undated). The official treaty signing was postponed indefinitely due to the political instability in Thailand that eventually led to a coup d'état that ousted Thaksin in September 2006. Far from remaining passive, Thai businesses proactively and openly pressed the new interim government to sign and implement JTEPA. After some reticence, the government yielded to business pressure and ratified the agreement.<sup>88</sup>

Since being implemented in November 2007, the overall utilization of JTEPA has stood low, at around 25% for exports, which could be partly explained because many items

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<sup>88</sup> Immediately after the coup, Thai businesses requested the military-backed government (October 2006-January 2008) to ratify JTEPA (*The Nation*, October 20, 2006). When a few months later, in February 2007, the government signalled that all pending FTAs would be put on hold until after elections—at least a year later—TCC and 16 business associations publicly urged the government to sign JTEPA and resume negotiations for other FTAs (*Matichon*, February 15, 2007). The government eventually signed JTEPA two months later. Among the associations that pushed the interim government for JTEPA ratification were sectors likely to benefit from it such as jewelry, processed food, textiles and garments, and footwear.

are still covered by long tariff phase-out periods.<sup>89</sup> In addition, as further elaborated in Essay 2, low overall utilization hides significant sectoral variability. Utilization of JTEPA by Thai exporters of processed food, jewelry and textiles and garments items exceeds 70% (data provided by MOC; see below in Essay 2).<sup>90</sup>

Of note, proactive cooperation and lobbying across borders between the Thai and Japanese private sectors did not end with the enforcement of the agreement. The all-encompassing Thai JSCCIB and Japanese peak Keidanren associations met in February 2011 to publicly demand from their respective governments a review of JTEPA to expand coverage and accelerate liberalization schedules (*Bangkok Post*, February 19, 2011).

### ***3.3 Later FTAs with the largest partners: businesses taking the initiative***

For decades and until just 2010, the United States was the single largest market for Thai exports. Establishing a bilateral Thailand-United States FTA (TUSFTA) was therefore fundamental to improve access to the United States for Thai agricultural products, processed food, textiles and garments, commercial vehicles and jewelry.<sup>91</sup>

Thai officials had to confront teams of experienced American negotiators, opening for discussion issues Thailand had never dealt with at the WTO or in previous FTAs (e.g., labor and environmental standards, financial liberalization, competition policy). Although the multiple dimensions of the accord meant that some chapters of the negotiation were assigned to less trade-savvy ministries (e.g. Ministry of Labor, of Natural Resources and Environment, etc.), the newly established *National Committee on FTA Strategy and*

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<sup>89</sup> Nevertheless, this low overall utilization of JTEPA for exports should be put into context since over half of Japanese tariffs are set at zero. When use of JTEPA is calculated only for tariff lines where Japanese MFN is set above zero, corrected JTEPA utilization for exports in 2011 is 71.2%.

<sup>90</sup> Our interviews also revealed that JTEPA implementation encountered some minor problems that may reflect a lack of understanding and/or communication between officials and business associations during consultations and formulations.

<sup>91</sup> Since 2010 the United States has been surpassed by China and Japan as main destinations for Thai exports (Trade Map). In contrast to Japan or Australia, United States' key interests in TUSFTA fell squarely around services liberalization and stricter intellectual property rights rather than on trade in goods.

*Negotiations* helped with overall coordination.<sup>92</sup> As predicted by my initial arguments, the complexity of these negotiations prompted the Thai government to consult more frequently with concerned peak and sectoral business associations that, in turn, established dedicated TUSFTA Committees to coordinate members' inputs and talks with trade officials (interviews).

Importantly, field interviews also revealed that the American and Thai private sectors took the lead over their respective governments in TUSFTA. Organizations representing some American businesses sectors (or firms with activities in the United States) with interests in Thailand (e.g., Thailand-United States Business Council, American Chamber of Commerce, United States-ASEAN Business Council) mobilized promptly and commissioned a TUSFTA impact study as early as mid-2003 (interviews).<sup>93</sup> In March 2004, before negotiations started, the United States-ASEAN Business Council launched the *United States-Thailand FTA Business Coalition*, to lobby both governments for a comprehensive agreement on behalf of the largest American multinationals.<sup>94</sup>

Likewise, contrary to the reported apathy about FTAs among Thai-owned businesses (Hoadley, 2007a; Sally, 2007; Hoadley, 2008), my field research found that key economic sectors in Thailand acted proactively in TUSFTA (in favor of or against) and lobbied not only Thai but also American authorities. With the United States absorbing then over half of Thai garment exports and a similar share of processed seafood, the corresponding Thai associations urged the Thai government to launch negotiations long before they were initiated. Strong support for TUSFTA also came from the jewelry sector—which at the time accounted for about a quarter of all Thai exports under the

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<sup>92</sup> According to some American-related business groupings, and despite the experience gained through previous FTAs, Thai negotiators may have approached TUSFTA not fully aware of all of its regulatory implications and the need for prior legislative reforms. The same sources also stated that the Thai team lacked expertise on regulatory issues like labor and environmental standards (interviews). At the time, the President of the United States G.W. Bush had so-called “Trade Promotion or Fast Track Authority”, allowing him the negotiation of FTAs that the United States Congress could only approve or reject but not amend.

<sup>93</sup> Mindful of the resistance to TUSFTA among the Thai general public, the study was assigned to an independent Thai think tank.

<sup>94</sup> American sectoral business associations in the pharmaceutical industry, logistics, software and other services also lobbied in favor of TUSFTA.

United States Generalized System of Preferences—and the Pharmaceutical Research and Manufacturers Association, representing multinational pharmaceutical firms in Thailand (interviews). In turn, the Thai Bankers Association pressed the government to resist financial liberalization, but the opposition mounted by other Thai-based businesses was not so effective, reflecting limited leverage and problems organizing collective action.<sup>95</sup> Of all FTAs that Thailand had negotiated until then, TUSFTA stirred the strongest popular opposition, especially by civil society groups resisting broadening of WTO's Agreement on trade-related intellectual property rights (interviews).

TUSFTA also confirmed my initial contention (Hypothesis 3) that bilateral FTAs offer greater possibilities for business collective action and for government-business consultation and lobbying across borders than other forms of liberalization. Even before negotiations started, Thai business associations representing garment (TGMA), and processed food (TFPA) producers, with high stakes in TUSFTA, lobbied directly American officials (interviews; official records).<sup>96</sup> Field interviews also revealed that during its visits to Thailand, the American negotiation team met with key Thai business associations to exchange views.

Although talks were suspended in early 2006 on continuing political instability in Thailand, prospects for an accord were nevertheless low because of the lack of progress on key American demands, opposition by civic groups in Thailand and changes in the political landscape in both countries.<sup>97</sup> Malaysia was also involved in bilateral negotiations with the United States and several Thai sectors (e.g., processed food, garments) kept lobbying the

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<sup>95</sup> The Thai Pharmaceutical Manufacturers Association and the logistics sector, fragmented in three separate associations, also opposed the agreement (interviews). The interests of small-scale farmers, expected to lose from TUSFTA, were represented by FTA Watch (interviews).

<sup>96</sup> As early as June 2004 and throughout 2004-2006, TGMA hired lobbying firms in the United States to pressure the United States Trade Representative in favor of TUSFTA. TFPA also contracted American lobbyists during 2005-2006 for the same purpose (interviews; Clerk US House of Representatives, <http://disclosures.house.gov/ld/ldsearch.aspx> and Office of Public Records, United States Senate, [http://www.senate.gov/legislative/Public\\_Disclosure/LDA\\_reports.htm](http://www.senate.gov/legislative/Public_Disclosure/LDA_reports.htm), accessed on August 29, 2009).

<sup>97</sup> Invalidation of the April 2006 snap elections, forced Thaksin to continue as "Caretaker Prime Minister" but new elections were eventually frustrated by the September 2006 coup d'état. Thaksin, attending a United Nations summit in New York at the time of the coup, had met a few days earlier with American businesses and ensured them that all remaining obstacles in TUSFTA, particularly in the area of intellectual property rights protection, would be solved after elections (interviews).

post-coup interim government, and successive elected ones, to reopen TUSFTA talks (interviews). However, in 2008, the United States discontinued its bilateral approach in Asia in favor of joining the existing *Trans-Pacific Strategic Economic Partnership* (TPP). With the admission into TPP negotiations of Vietnam—the second largest garment exporter to the United States—in late 2008, of Malaysia in 2010, and the possibility of Indonesia following suit over the near future, Thai exporters have maintained their pressure on the government to join TPP (*The Nation*, September 20, 2010 and April 9, 2013).<sup>98</sup>

Slowdown in FTA activity in Thailand since 2006 that has to do not only with the persisting political instability but also with procedural changes introduced by the 2007 Constitution. Under its Article 190, drafted by FTA Watch, international agreements having a significant economic or social impact must not only get parliamentary approval before negotiations are launched and after once are concluded, but the government is also obliged to consult all stakeholders including the public.<sup>99</sup> Aware of public's reluctance about FTAs with the United States and the European Union, the Thai private sector has repeatedly asked for changes in Article 190 (e.g., *Bangkok Post*, December 8, 2012).<sup>100</sup>

In 2007, the European Union proposed to ASEAN the creation of an FTA between both blocs. The European Union is also major market for Thai exporting sectors (e.g., textile and garments, processed food, jewelry, electrical appliances, commercial vehicles), and my interviews found that between 2007 and late 2009 these industries pressed the Thai government to negotiate for the liberalization of their products in the European Union.<sup>101</sup> In 2010, the European Union abandoned its regional approach and started bilateral

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<sup>98</sup> For the short-lived cabinets after the interim government—Thailand had five Prime Ministers during 2008—political survival, not FTAs, was the only priority. Although Yingluck's current government has been receptive to private sectors demands about TPP, and officially expressed interest in the trade bloc (*The Nation*, November 20, 2012), significant opposition needs to be overcome first. As for TUSFTA, TPP is rejected by a number of Thai service providers, small farmers and NGOs working on access to medicines.

<sup>99</sup> In addition, it also requires fair compensation to those negatively affected by FTAs. Although Article 190 puts Thailand at a disadvantage with respect to countries where FTAs are approved through executive order (e.g., Malaysia), it could also arguably strengthen the bargaining position of Thai negotiators.

<sup>100</sup> In April 2013, the government initiated parliamentary proceedings to amend Article 190 but has so far encountered significant political and civic resistance (*The Nation*, April 4, 2013).

<sup>101</sup> Sectors potentially adversely affected by an ASEAN-European Union FTA—mainly small firms in the dairy, logistics and communications sectors—opposed the agreement but their leverage and policy influence was limited (interviews).

negotiations with selected ASEAN countries, beginning with Singapore, Malaysia and Vietnam.<sup>102</sup> Earlier preferential access to the European Union by these countries could put Thai exporters at a disadvantage, especially as 700 Thai exports are expected to lose preferential treatment under the European Union Generalized System of Preferences in 2015. As in TUSFTA and TPP, the European Union-Thailand FTA has been decried by civic groups.<sup>103</sup> Following Article 190's mandate, during 2010 the MOC set in place an unprecedented process of hearings with businesses, small-farmers, civil society and well as other public agencies, whose opinions were forwarded to the Cabinet and Parliament.<sup>104</sup> In line with Hypothesis 1, at these hearings, government agencies acknowledged the complex regulatory framework in the European Union and the need for trade officials to gain detailed information on production processes before negotiating ROOs with the European Union.<sup>105</sup> Over the last couple of years, peak business associations in Thailand have publicly urged the government to speed up the launching of negotiations to avoid losing ground vis-à-vis other ASEAN members (*The Nation*, January 25, 2013). Bilateral talks officially began in May 2013 (Table 1).<sup>106</sup>

Some FTA negotiations with small trading partners, and at different stages of study or negotiation since the Thaksin's administration, remain in a limbo in light of lack of substantial economic rationale, while others have been abandoned. Increased awareness

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<sup>102</sup> At the time, two major obstacles to the ASEAN-European Union FTA were the difficulty for the European Union of embracing a non-democratic Myanmar as a trade partner and the convergence of ASEAN countries on their least common denominator. Negotiations for the European Union-Singapore FTA concluded in December 2012. Our interviews indicated that Thailand was initially second only to Singapore in the priorities of the European Union. However, political instability during 2009-2010 and the difficulties posed by Article 190 have slowed down progress in the bilateral FTA.

<sup>103</sup> The bilateral FTA has been condemned by the Thai Pharmaceutical Manufacturers Association and the Minister of Health himself for its potential implications for access to medicines (*Nation*, August 25, 2009; *Bangkok Post*, July 12, 2012). On December 2012, a coalition of NGOs and consumer groups urged the European Union Parliament to press the European Commission to forgo WTO-plus features on intellectual property rights in the FTA (personal communication).

<sup>104</sup> Between April and July 2010, the MOC commissioned an impact study and established a dedicated Thai-European Union FTA Committee that conducted consultations with 161 business associations, 455 small-scale farmers, 445 civic groups and 80 government agencies (mimeo, available upon request).

<sup>105</sup> Another recommendation from these consultations was the creation of a centralized organization, with business and civil society participation, to conduct cross-sectoral impact analysis on previous and future FTAs (mimeo, available upon request).

<sup>106</sup> In December 2012, the Thai cabinet approved the issues for negotiation, later endorsed by the Parliament (*Bangkok Post*, December 5, 2012; *The Nation*, June 2, 2013). In Thailand, negotiations for this FTA will be lead by the Thailand Trade Representative Office.

about FTAs has prompted some Thai-based export-oriented sectors to reconsider some of these older proposals and proactively lobby for those that could benefit them (Table 1).<sup>107</sup>

After several years of rapid cabinet turnover, a relatively more stable political environment has allowed the last two Prime Ministers to subscribe new FTAs with mid-size partners.<sup>108</sup> Over time, Thai officials and organized business have gained greater expertise on FTA-related issues and developed new institutions to communicate and coordinate between and among themselves. Constitutional checks have improved accountability in FTA policymaking although, given political fragmentation and a highly mobilized civil society, they could block progress on FTAs containing WTO-plus provisions, such as the TPP or Thailand-European Union FTAs.

#### 4. Malaysia FTA policymaking

By developing country standards, Malaysia has a liberal trade and investment regime outside those sectors related to the promotion of the ethnic-Malay/bumiputera population like government procurement, strategic services and some manufacturing industries, most notably the automotive.<sup>109</sup>

In contrast to the more disperse policymaking process in Thailand, international trade and industrial policies in Malaysia are formulated within a single agency, the Ministry of International Trade and Industry (MITI).<sup>110</sup> MITI bears most responsibility for FTA policymaking and coordinates inputs from other agencies and from the private sector before

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<sup>107</sup> FTAs between Chile and several key competitors (e.g. Malaysia, China, Korea) mobilized Thai-based firms in the automotive, electrical appliances, processed food and plastic sectors, who pressed the government to rescue a proposal from 2003 and start negotiations for an FTA in 2011. Likewise, following an increase in automotive exports to Peru by 800% during 2004-2008 (reaching two thirds of total exports), in 2009, carmakers in Thailand lobbied to resume negotiations for the Thai-Peru FTA, on hold since 2004.

<sup>108</sup> As of July 2013, in addition to a pending decision on TPP, Thailand is holding exploratory talks with South Korea, Canada and Turkey (personal communications).

<sup>109</sup> For the last four decades Malaysian economic policy has been guided by two overarching goals: achieving developed nation status and fostering participation of the local ethnic-Malay/bumiputera population in the economy. In the mid 1980s and early 1990s, the government launched several national automotive brands, most notably PROTON and PERODUA, that it has sheltered from internal and external competition.

<sup>110</sup> Malaysia policymaking is highly centralized, especially when compared to Thailand. Policy proposals emerge primarily from the Prime Minister Department and are formulated by the bureaucratic elite largely outside the public debate (Leong, 1992:204; Siddiquee, 2013). Highest levels in the Malaysia bureaucracy have been portrayed as closely linked with the political leadership (Chin, 2011:148; Siddiquee, 2013).

agreements are passed to the cabinet for sanction, not requiring of parliamentary approval.<sup>111</sup> Peak business associations in Malaysia comprise the influential Federation of Malaysian Manufacturers (FMM) and the three smaller ethnic chambers of commerce, all jointly integrated into a national chamber. These associations, especially FMM but also some key independent sectoral groupings, are represented on the advisory boards of government agencies participating in regular consultations with economic ministries.<sup>112</sup> Interviews with government officials attested to the reliability of the technical intelligence provided by FMM that, despite its privileged access to Malaysian policymaking, has avoided cooptation. Compared to FMM's strong secretariat, the weaker Malay, Indian and Chinese Chambers have limited technical capacity and are mostly integrated by small and medium firms. In line with the more centralized and behind doors policymaking process, Malaysian business associations rarely use the media either to pressure or praise the government on specific policies as Thai associations openly do.

Malaysia is a member of the WTO, APEC and ASEAN. Private sector consultation and participation in WTO and APEC liberalization rounds were mostly restricted to MITI's Annual Dialogue (Okamoto, 2004; interviews). Until only recently, Malaysia was a laggard within ASEAN as it resisted early programs for intra-regional liberalization of intermediate inputs and excluded the automotive sector from AFTA schedules in the aftermath of the Asian crisis (Yoshimatsu, 2002).

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<sup>111</sup> Other important players are the investment and export promotion agencies (Malaysian Industrial Development Authority, MIDA, and the export promotion agency, MATRADE, respectively), under the aegis of MITI, and the Economic Policy Unit, within the Prime Minister Office. Ministries frequently contributing inputs on trade policymaking include Finance, Agriculture and Agro-based industries and Plantation Industries and Commodities.

<sup>112</sup> Inspired by Japan, in 1983 Malaysia introduced the concept of *Malaysia Inc*, in reference to the collaboration and consultation between private and public sectors on economic policymaking. The model has often blurred boundaries between the private sector, the state and the ruling party (Gomez and Jomo, 1999; Gomez, 2009). In resource-based sectors, including the largely influential palm oil industry, which has significant participation by government-linked companies and government schemes, business associations are integrated within government-sponsored boards and councils that develop most of the sectoral intelligence and represent their interests at trade fora.

Although initially reluctant to enter into bilateral FTAs, fear of exclusion from the FTAs of competing nations prompted Malaysia to start negotiating its own. In addition to five regional ASEAN+ FTAs, Malaysia already has six bilateral FTAs in force (Table 2).

**Table 2: Malaysian Bilateral FTAs\***

| Official Name**                  | Coverage***   | Timeline   | Status                |
|----------------------------------|---|--|-----------------------|
| <b>Malaysia-Japan EPA</b>        | Comprehensive                                       | Proposal: January 2002. Joint Study: Feb-Dec 2003. Negotiations: Jan 2004-May 2005. Signature: Dec 2005. Implementation: July 2006                       | Active                |
| <b>Malaysia-Pakistan CEPA</b>    | EHS of 125 lines at HS6 level<br>CEPA comprehensive | EHS signature: December 2005. Implementation: January 2006.<br>CEPA negotiations: April 2005-Sept 2007. Signature: Nov 2007.<br>Implementation: Jan 2008 | Active                |
| <b>Malaysia-New Zealand FTA</b>  | Comprehensive                                       | Negotiations: May 2005-May 2009. Signature: Oct 2009. Implementation: August 2010  | Active                |
| <b>Malaysia- India CECA</b>      | Comprehensive                                       | Proposal: Dec 2004. Joint study: Jan 2007. Negotiations: 2008-2010.<br>Signature: Feb 2011. Implementation: July 2011                                    | Active                |
| <b>Malaysia-Chile FTA</b>        | Trade in Goods                                      | Proposal: Nov 06. Negotiations: June 2007-May 2010.<br>Signature: Nov 2010. Implementation in Feb 2012   | Active                |
| <b>Malaysia-Australia FTA</b>    | Comprehensive                                       | Negotiations: April 2005-March 2012. Implementation: Jan 2013  | Active                |
| <b>Malaysia-US FTA &amp; TPP</b> | FTA comprehensive                                   | Bilateral Negotiations: June 2006-July 2008 (eight rounds). Suspended  | Bilateral suspended   |
|                                  | TPP comprehensive                                   | Malaysia joined TPP in Oct 2010. Latest round (17 <sup>th</sup> ) in May 2013  | TPP under negotiation |
| <b>Malaysia-EU FTA</b>           | Comprehensive                                       | ASEAN-EU negotiations: Abandoned in early 2010<br>Bilateral negotiations: Dec 2010-ongoing (last round in Sept 2012)                                     | Under negotiation     |
| <b>Malaysia-Turkey FTA</b>       | Trade in goods                                      | Negotiations: May 2010-ongoing (latest round in Jan 2012)  | Under negotiation     |

Source: Governments' websites (updated as of August 2013)

\* Only FTAs that reached negotiation status are included.

\*\* Abbreviations in this Table: CECA: Comprehensive Economic Cooperation Agreement; CEPA: Closer Economic Partnership; EHA: Early Harvest Agreement EPA: Economic Partnership Agreement; TIFA: Trade and Investment Framework Agreement; TPP: Trans-Pacific Partnership

\*\*\* HS6 level refers to the 6-digit level of specification under the Harmonized Commodity Description and Coding System, which is the international nomenclature for goods developed by the World Customs Organization. HS6 includes around 5,500 items.

#### ***4.1 Early FTAs: top-down policymaking and sectoral interests by a mostly reactive private sector***

During negotiations for the ASEAN-China FTA, the first for Malaysia after AFTA, consultation with the private sector was limited to FMM and key sectoral associations (interviews). ASEAN-China FTA was beneficial for Malaysian producers of palm oil and rubber and negotiation on behalf of these sectors was conducted by their respective government-linked boards. Field interviews found that some relevant sectors, like the steel industry, were not consulted, resulting in the liberalization of some sensitive products under

normal track. This reversal incensed the Malaysian Iron and Steel Industry Federation and prompted it to take a more active role in successive FTAs.

Malaysia initiated its bilateral liberalization approach negotiating an FTA with one of its largest trading partners, Japan. Consequently, it did not have the chance to hone its negotiating skills with smaller partners as Thailand did. With the Malaysia-Japan Economic Partnership Agreement (MJEPA), Malaysia sought not only to expand market access in Japan for some key exports, but also to enhance its position as an investment destination. On its part, Japan's main interest laid in eliminating tariffs on automobiles, steel, and electrical machinery as well as easing non-tariff barriers and restrictions in services (MOFA-MJEPA, 2003; interviews). In contrast to Thailand, FTA impact studies conducted directly by MITI or commissioned to other government agencies or think tanks are never disclosed to the public. Although the initiative for MJEPA rested with the political leadership and top bureaucratic ranks, interviews indicated that business consultation was wider than in ASEAN-China FTA and that MITI gathered technical intelligence from relevant government agencies and a number of business associations. Coordination of MJEPA fell to the Ministry of Foreign Affairs, but MITI dealt with the market access component. Some business associations claimed that the Malaysia government negotiated early FTAs—including MJEPA but also FTAs with Pakistan and New Zealand—using template models and simple trade statistics (interviews)

Outside a few sectors, MJEPA elicited limited enthusiasm among a mostly defensive local business community. Interviews found that support for MJEPA came mainly from the palm oil, plastics, and textiles and garments industries. The Malaysian Plastics Manufacturers Association was consulted but did not take a leading role while the Palm Oil Board and Council conveyed the positions of business associations. Among the most proactive associations in MJEPA were the Malaysian Textile Manufacturers

Association (MTMA) (see below) and Malaysian Iron and Steel Industry Federation. As postulated by Hypothesis 2, the Malaysian Iron and Steel Industry Federation learned from its exclusion during the formulation of the ASEAN-China FTA and pressured the government for adopting its position during MJEPA.

In line with Hypothesis 3, MJEPA fostered cross-border collective action between organized business groups and firms in both countries. As in Thailand, even *before* negotiations between both governments had started, representatives from the Japan Textile Federation met with their counterparts of MTMA to negotiate on a common proposal to put forward to their respective governments. Again, Japanese officials often attended these meetings. Business collective action and lobbying and government-business consultations across borders also occurred in the steel sector. Interviews discovered that the Japan Iron and Steel Federation contacted the Malaysian Iron and Steel Industry Federation to find areas of agreement. Steel producers in Japan lobbied for liberalization in Malaysia not only through the Japanese government, but also directly on the Malaysian government. It is worth noting that Japanese officials also contacted the Malaysian Iron and Steel Industry Federation to learn on its position and offered its support in pushing for domestic reforms (interviews).<sup>113</sup>

Negotiations stumbled over liberalization of the highly protected Malaysian automotive sector. At the time, Malaysian carmaker PROTON was seeking further delays in AFTA implementation, all the while facing financial losses and strong competition from Japanese firms at home. Naturally, PROTON opposed liberalization under MJEPA. MJEPA was endorsed by the Malaysian Automotive Association, which encompasses all foreign assemblers and distributors. The government consulted not only with national carmakers and the Malaysian Automotive Association, but also individual Japanese firms

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<sup>113</sup> The Malaysian Iron and Steel Industry Federation eventually succeeded in obtaining the phase out of tariffs on sensitive items by 2015.

(interviews).<sup>114</sup> Some consultations with the automotive industry involved the MITI Minister or Prime Minister Abdullah himself. Some of the informants for this research indicated that Japanese carmakers threatened to move all their assembly to Thailand if liberalization demands were not met.

In the final text, Malaysia agreed to open its automotive and steel sectors to Japan fully by 2015 (METI-MJEPA, undated). Japan, on the other hand, eliminated tariffs on chemicals, plastics and textiles and garments, and offered technical cooperation in several areas (see Essays 3 and 4). Since implementation in July 2006, overall utilization of MJEPA by Malaysian exporters has been low, at slightly over 10% of total exports. However, reflecting initial lobbying interests, sectoral utilization has been heavily concentrated with palm oil and plastics alone accounting for about half of the value of all Malaysian exports to Japan under MJEPA. Producers in the palm oil, plastics, chemicals, and garments sectors use MJEPA preferences in almost 100% of their exports to Japan (data from MITI and Essay 2). In turn, Malaysian imports of Japanese automotive parts have trebled and constitute now the main import item under MJEPA preferences.

After MJEPA, the Malaysian government stepped up its FTA activity and entertained proposals for FTAs with smaller trading partners and that originated more often from these countries than from its own initiative or Malaysian businesses (Table 2).<sup>115</sup> In 2007, Malaysia signed an FTA with Pakistan, the second single largest export destination for Malaysian palm oil during the early 2000s and that accounted for 65% of total exports to that country. Consultation with the Malaysian private sector was limited to peak associations and the Palm Oil Board and Council. Proposals for bilateral FTAs between Malaysia and India, New Zealand and Australia emerged from the partner side, soon after

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<sup>114</sup> Automotive parts suppliers for PROTON and PERODUA (through their respective Vendors associations) strongly opposed any liberalization, whether through AFTA or bilateral FTAs. By contrast, the Malaysian Automotive Component Parts Manufacturers Association, was content with a sufficiently long phase-out of tariffs.

<sup>115</sup> The rationale for some of these FTAs laid primarily in the partners' interest in gaining access to ASEAN and/or in very specific sectoral preferences. Nevertheless, fostering common Islamic roots has been also a factor in many of these FTAs.

similar FTAs with ASEAN. Only the negotiations for the Malaysia-Chile and Malaysia-Turkey FTAs were launched without being preceded by regional accords. As advanced by my initial argument, minor economic benefits and limited private sector interest in some of these smaller bilateral FTAs have dragged on negotiations.<sup>116</sup> The Malaysia-India FTA is expected to benefit large and politically influential infrastructure sector firms that lobbied for the agreement.<sup>117</sup> My interviews found that support for the other four FTAs was concentrated in Malaysian garments, rubber and electrical goods producers. Expertise gained during previous negotiations helped MITI officials deal with technical issues and beyond-border disciplines in the FTAs with New Zealand, Chile and Australia.

#### ***4.2 FTAs with the largest partners: businesses taking the initiative***

The United States has traditionally been Malaysia's largest market and source of foreign investment.<sup>118</sup> For Malaysia, a bilateral FTA was therefore important to ease access in the United States to its main exports, some like footwear and textiles and garments facing steep duties of up to 48%. In turn, the United States was only interested in a comprehensive FTA that could liberalize Malaysian government procurement and services, introduce labor and environmental standards and enforce stricter competition policy and intellectual property rights.

When bilateral talks started in June 2006, Malaysia was not longer a novice at negotiating FTAs, but the level of complexity involved in the Malaysia-United States FTA (MUSFTA) was far beyond that of any previous FTA. My interviews found that, in line with Hypothesis 1, such complexity compelled MITI officials to conduct not only more *ex-*

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<sup>116</sup> In 2009, Malaysia accepted an FTA proposal from Turkey that has attracted limited business interest in Malaysia. Consequently, negotiations have been slow.

<sup>117</sup> During interviews, trade negotiators confirmed that political drive for the FTA came from the Indian side. Given Indian resistance to opening up key sectors, Malaysia gave low priority to these negotiations.

<sup>118</sup> The importance of the United States as an export destination has declined in recent years. Until 2008, the United States absorbed around 20% of all Malaysian exports for 8.3% in 2011, behind China, Singapore and Japan.

*ante* impact analyses but also more consultations with the private sector and other government agencies, some of them new to trade negotiations.<sup>119</sup>

In the United States, MUSFTA received support from firms in the pharmaceutical and services sectors (e.g. logistics, software, finance). On December 2005, before the start of negotiations, American multinationals party to the United States-ASEAN Business Council created the *United States-Malaysia FTA Business Coalition*, which along the American Chamber of Commerce and other pressure groups lobbied the United States Congress and the Trade Representative for a comprehensive deal in MUSFTA.<sup>120</sup>

As anticipated by the theoretical framework, the relevance of the United States market for Malaysian exporters meant that the push for MUSFTA in Malaysia emerged not from the government—in fact, reluctant to open for negotiation key government-controlled sectors—but from the private sector itself. Interviews found that FMM and MTMA were concerned about the progress in trade negotiations between the United States and other ASEAN countries and urged the Malaysian government to seek its own FTA. The FMM, which traditionally maintains a behind-the-scenes lobbying approach, took an unprecedented active and public position in favor of MUSFTA.<sup>121</sup> With the impending loss of Trade Promotion Authority by the United States President (see footnote 92), FMM pressed for the rapid conclusion of talks that could have put Malaysia several years ahead of competing countries.<sup>122</sup> At the time of negotiations, the United States accounted for almost two thirds of all Malaysian garment exports and, accordingly, MTMA took a

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<sup>119</sup> Liberalizing government procurement and services required changes in highly-sensitive domestic laws favoring ethnic Malay/bumiputeras. Agencies involved in an FTA for the first time in MUSFTA included the ministries of Human Resources, of Natural Resources and Environment, of Energy, Green Technology and Water, of Information, of Communication and Culture, and of Science, Technology and Innovation as well as the Attorney General's Office.

<sup>120</sup> In May 2006, the American Chamber of Commerce in Malaysia (representing firms with interests in United States-Malaysia relations) prepared a report on key areas for liberalization in Malaysia as part of MUSFTA (mimeo).

<sup>121</sup> FMM issued several public statements in support of MUSFTA (e.g., *The Edge Daily*, March 12, 2007; *The Star*, March 23, 2007; *New Straits Times*, August 22, 2006).

<sup>122</sup> For FMM, TUSFTA (and now the TPP) was also a tool to open up and make more transparent Malaysia's government procurement system (interviews).

proactive position and lobbied the Malaysian government in favor of TUSFTA.<sup>123</sup> Another key sponsor of MUSFTA was the Pharmaceutical Association of Malaysia, representing multinational pharmaceutical firms operating in the country. In turn, the three ethnically-based chambers and generic drug producers in the Malaysian Organization of Pharmaceutical Industries opposed the FTA (interviews; *New Straits Times*, February 28, 2007).<sup>124</sup>

As predicted by Hypothesis 3, research found that MUSFTA fostered business collective action and lobbying across borders. As early as July 2006, MTMA hired lobbying firms in the United States to pressure its Trade Representative in favor of liberalization of the textile/garment sectors in MUSFTA. Lobbying to American trade authorities by MTMA continued until late 2009, more than a year after the last negotiation round had stalled (interviews; official records).<sup>125</sup> In turn, the *United States-Malaysia FTA Business Coalition* and the American Chamber of Commerce in Malaysia pressured MITI officials for the liberalization of services and government procurement (interviews). Field interviews also revealed that business communities in different sectors in both countries arranged *ad-hoc* bilateral meetings (between both levels II) to jointly exhort both governments for a comprehensive deal.

As Malaysia embarked on more and more relevant FTAs, the private sector created institutions to reduce the transaction costs entailed in collective action and lobbying. Coinciding with the start of MUSFTA negotiations, FMM led the creation of the *Private Sector Task Force on FTAs*, with the goal of coordinating positions across business associations and provide feedback to MITI officials, who also attend these meetings.

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<sup>123</sup> As in Thailand, the share of the United States market in Malaysian garment exports has progressively declined to an average of 45.3% during the 2010-2012 period (Trade Map).

<sup>124</sup> In Malaysia, civil society mobilization against MUSFTA was limited compared to that in Thailand.

<sup>125</sup> Clerk of the US House of Representatives, <http://disclosures.house.gov/ld/ldsearch.aspx>, Office of Public Records, United States Senate, [http://www.senate.gov/legislative/Public\\_Disclosure/ LDA\\_reports.htm](http://www.senate.gov/legislative/Public_Disclosure/ LDA_reports.htm), accessed on August 29, 2009).

Bilateral negotiations stalled in July 2008 due to Malaysia's resistance to the liberalization of government procurement and services and the change in American FTA policy in the region in favor of TPP. Still, interviews found that the Malaysian private sector kept pushing both governments for a bilateral FTA until late 2009. FMM and MTMA favored a MUSFTA over TPP because the former enhances their leverage during negotiations and discriminates against firms from other ASEAN countries. However, when the United States made it clear that it would only pursue regional talks, both associations started lobbying the Malaysian government to join TPP, pressure that proved key in Malaysia's decision to eventually entering TPP talks in October 2010 (interviews).<sup>126</sup>

Among members of the Malaysian private sector and civil society, only an FTA with the European Union evokes as much interest, in favor or against, as MUSFTA or TPP. Once again, Malaysian exporters favored a bilateral FTA with the European Union that could discriminate against other ASEAN competitors while the government preferred an ASEAN-European Union FTA, more amenable to exclusion of the sensitive automotive and services sectors (interviews). European Union's abandonment in 2010 of a deal with ASEAN in favor of separate bilateral FTAs was welcomed by the FMM and MTMA.

Bilateral negotiations for the Malaysia-European Union FTA (MEUFTA) started in December 2010 (Table 2). European Union's main priorities in MEUFTA are the liberalization of government procurement and services, followed by the opening up of the automotive sector. The greatest beneficiaries and supporters in Malaysia of MEUFTA are palm oil producers—as a group, Europe is their second largest market of Malaysian palm

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<sup>126</sup> In February 2010, at a meeting between the Malaysian private sector representatives and the Deputy United States Trade Representative, the FMM expressed support for TPP and admitted “to be in a position to push the [Malaysian] government toward participation in the TPP” (Leaked cable from the United States Embassy in Malaysia, accessed at: <http://wikileaks.org/cable/2010/02/10KUALALUMPUR96.html>, accessed on November 25, 2011). Despite strong support for TPP by MTMA, some modelling studies have questioned the benefits of TPP for the textile sector (*The Edge*, September 11, 2012). The Malaysian private sector has also supported TPP by way of its participation in the APEC Business Advisory Council. As in MUSTFA, TPP has encountered resistance from generic drug producers and civic groups concerned that provisions in intellectual property rights in TPP would hinder access to medicines, an argument backed by the Malaysian Health Minister himself (*Sun Daily*, August 6, 2012). TPP has also spurred government-business consultation across borders. In his visit to Malaysia, the United States Trade Representative not only met with Malaysian officials and American firms in Malaysia but also with the FMM (*Bernama*, April 25, 2012).

oil—and the machinery, electrical appliance and textile/garment industries.<sup>127</sup> By contrast, MEUFTA is viewed with special concern by automotive firms, generic drugs manufacturers and those that could be adversely affected by the liberalization of government procurement and services (e.g., government-linked companies, small and medium firms, and civil society groups).

FMM and MTMA have taken a proactive role in MEUFTA and pushed the government to speed up negotiations, especially since Thailand and Indonesia are lagging behind in their own deals with the European Union. In a country where consultations with the private sector and civil society and pressures to influence policymaking are not aired to the public arena, MITI took the unusual move of issuing a public statement to dispel NGOs' concerns about the health, environmental and food security implications of MEUFTA.<sup>128</sup>

Although initially reluctant to FTAs, Malaysia has already signed or is negotiating a number of FTAs and in East Asia is now only second to Singapore in the number of FTAs implemented. Like in other areas of Malaysian policymaking, the content and conclusions of government consultations with stakeholders in the context of FTA formulation have remained closely guarded. Still, field research found that MITI officials have expanded and deepened their consultation process and that the preferences and intelligence provided by key business associations have been crucial to the development of Malaysia's FTA negotiating positions. In the case of FTAs with potentially significant economic impacts (e.g., MUSFTA, TPP, MEUFTA), the private sector, particularly FMM and MTMA, has taken an increasingly proactive role. Over time, trade officials and business associations have gained greater expertise in FTA negotiation and formulation. Although the level of

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<sup>127</sup> Although European Union tariffs on palm oil products are relatively low, Malaysian exporters face significant non-tariff barriers in the form of environmental standards.

<sup>128</sup> Accessed on April 3, 2011 at: [http://www.miti.gov.my/cms/contentEmail.jsp?id=com.tms.cms.article.Article\\_ebc576cd-c0a8156f-6f346f34-b884ab1a](http://www.miti.gov.my/cms/contentEmail.jsp?id=com.tms.cms.article.Article_ebc576cd-c0a8156f-6f346f34-b884ab1a)

institutional change and creation spurred by FTAs has not reached (at least yet) that occurred in Thailand, new institutional settings to reduce government and business coordination, collective action and consultation costs have also emerged in Malaysia.

## 5. Discussion

Realist renderings in the FTA policymaking literature contend that systemic constraints and power asymmetries at the international level push developing countries, helplessly one after another, to enter bilateral FTAs with developed nations. This unidirectional determination of national strategies by the international context has often come at the cost of overlooking endogenous sources of trade preferences in developing countries. Under the legacy of statist models and regional political-military rivalries, common understandings of East Asian regionalism have portrayed recent bilateral FTAs as a) driven from political elites and with scant participation or interest of the private sector in the formulation of FTAs first or in their utilization afterwards and, b) launched primarily for foreign policy and/or security motivations rather than economic ones (reviewed in Ravenhill, 2010).<sup>129</sup> Only in Japan has the private sector been reported to have proactively lobbied its government in favor or against FTAs and a clear economic rationale of its FTAs been recognized (e.g., Solis, 2003; Manger, 2005; Yoshimatsu, 2005).

The present study was intended to examine the evolution of bilateral FTA policymaking in the two most FTA-active middle-income countries in ASEAN, Thailand and Malaysia, and analyze how FTAs have shaped government-business relations. Prevailing narratives about East Asian FTAs have emphasized the primacy of political, diplomatic, and security motivations over economic ones. With the exception of Japan,

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<sup>129</sup> Literature on policymaking in Thailand and, particularly, Malaysia after the Asian crisis has been highly influenced by statist models and reinforced by the personalized and centralized decisionmaking styles of Prime Ministers Thaksin and Mahathir, respectively (Gomez and Jomo, 1999; Beeson, 2000; Slater, 2003; Ockey, 2004; Phongpaichit and Baker, 2004; Chaiwat and Phongpaichit, 2008; Siddiquee, 2013). These views may have led to downplay (or dismiss) the role of the private sector in FTA policymaking. While firms in both countries have historically sought to advance particularistic interests through clientelist connections, business associations have gained increasing policy influence. Of note, several studies on FTA formulation in Thailand and Malaysia were based on secondary research.

these FTAs have reportedly emerged from a cognitive consensus among national political leaderships and with little involvement or interest on the part of business. Instead, this Essay contended that, compared to multilateral liberalization, the information demands posed by bilateral FTA negotiations on trade officials should compel them to intensify consultations with the private sector to fill gaps in expertise (Hypothesis 1). At the same time, easier assessment of impacts in bilateral FTAs should generate stronger incentives for firms to influence their policymaking (Hypothesis 2) as well as greater options for business consultations, collective action and lobbying across borders (Hypothesis 3). Information and coordination demands by successive FTAs on government and businesses associations should encourage both actors to invest in their trade expertise and create institutions to reduce transaction costs in FTA formulation (Hypothesis 4).

Field research for this Thesis confirmed all the initial hypotheses. However, and despite differences in their institutional and policymaking frameworks, the evolution of FTA formulation in Thailand and Malaysia has followed similar patterns. While the formulation of some FTAs in both countries, particularly early ones, may have indeed originated from their political leadership, neither constructivism nor foreign policy and security arguments provide a sufficient model to explain sectoral variability in liberalization within or across FTAs. In fact, it was found that whenever the economic argument was weak or unclear, negotiations dragged or were eventually abandoned. This is not to say that the preferences of the private sector have exclusively determined Thai and Malaysian FTA policymaking or that the political and institutional configurations in these countries have not played a critical role. On the contrary, the translation of firms' generic preferences into particular policy choices (e.g. specific levels of tariffs or ROOs, etc) is influenced by factors beyond firms such as the institutional setting that, as in other areas of policymaking, not simply accepts or rejects preferences but determines what options are

available, thus influencing firms' policy preferences in the first place (Crystal, 2003; Woll, 2005). The institutional framework and the contextual interactions between government and business have influenced FTA policymaking. For instance, a more direct policymaking process, a more subdued style of business lobbying and lower civil society contestation against FTAs, has placed Malaysia ahead of Thailand in its FTA negotiations with the European Union and the TPP.

At the same time, as argued throughout this Thesis, FTAs have also fed back to the institutional setting. As more FTAs were negotiated, consultations by trade officials with the private sector and other government agencies became more frequent and formalized—now a constitutional mandate in Thailand, being particularly intense in demanding FTA talks with large developed partners. These government-business consultations were set not only to attend private sector preferences (classical pressure lobbying), but also for Thai and Malaysian trade officials to gain access to complex technical information needed during bilateral FTA negotiations (regulatory lobbying in Woll and Artigas' [2007] and Woll's [2008] terminology). Nevertheless, interviews found that not all sectors were able to participate and not all associations consulted took part on an equal footing.<sup>130</sup> Both case studies illustrated Schneider's (2004) argument on how business collective action and mobilization is influenced by the way governments engage the private sector in policymaking—e.g., exclusion, conflict or cooperation.<sup>131</sup> Lack of engagement of some economic sectors in early FTAs prompted affected firms and business associations, especially peak and more efficient ones, to organize and mobilize, reactively or proactively, in subsequent FTAs. For instance, exclusion of the Malaysian Iron and Steel Industry Federation in the formulation of the ASEAN-China FTA prompted this association to take

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<sup>130</sup> Small and medium firms, farmers and some services subsectors often lacked representation, either independently or within peak associations, and/or did not have the organization, expertise or influence to affect policymaking. When sectors and associations faced internal conflicts or in the case of large firms that could leverage their investment, Thai and Malaysian officials directly involved (and/or were approached by) individual firms.

<sup>131</sup> Business groups react to the way governments engage them in policymaking, being more likely that they mobilize when they are excluded or when their relation with government is marked by conflict (Schneider, 2004).

a more active stand in successive FTAs. Conflict between the Thai government and Japanese automotive firms in JTEPA increased mobilization by the latter. Lastly, cooperation of Thai and Malaysian officials with peak associations strengthened and consolidated the consultation process.

In any case, and independently of the original motivation of an FTA proposal, its text must specify the barriers to be removed or maintained, arguably eliciting preferences among concerned firms in favor or against. The private sector in both countries has been mostly unenthusiastic about previous multilateral and regional liberalization rounds. But clearer *ex-ante* assessment of impacts in bilateral liberalization fostered the involvement in FTA policymaking of business associations and firms that remained passive in other forms of liberalization. The private sector in both countries participated not only through the invited consultation process but, for the most influential and capable associations and firms, also proactively. Contrary to the reported apathy of East Asian business about FTAs, it was found here that for some sectors and high-impact FTAs, the initiative did not originate from the political leadership, but rather from businesses that pushed their host government, and sometimes also the partner's, to initiate and speed up (or delay) talks.

Field research found that Thai and Malaysian FTAs have largely responded to sectoral (even firm-specific) economic interests (see also Essays 2 and 3).<sup>132</sup> During the 1980s and 1990s, multinational firms invested across ASEAN were key supporters of early schemes for regional liberalization of intermediate inputs and AFTA itself (Yoshimatsu, 2002; Yoshimatsu, 2008). As East Asian production networks have expanded and deepened over the last two decades, multinationals based in Thailand and Malaysia and operating within these networks have pressed host governments to enter into bilateral FTAs. But much of the support and push for FTAs in both countries has also originated from domestic

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<sup>132</sup> As benefits from bilateral FTAs could asymmetrically accrue to some firms over others also inside the bloc (Essay 3), private sector lobbying regarding FTAs has not only involved business associations intermediating sectoral positions but also individual firms, as evidenced in our field research (see Essay 3).

exporters involved in traditional one-way horizontal trade (e.g., textiles and garments, processed food) seeking easier access to large destination markets.

Nevertheless, interviews also found that some small firms, including potential beneficiaries, did not use FTAs, nor were they even aware about their benefits because their associations did not inform them, found FTAs too complex or, simply, were not interested in the first place. Whether due to uninterested members, insufficient time to consult them, lack of internal coordination capabilities or capture by the most influential firms, interviews revealed that, in some instances, business associations' position on FTAs may have only reflected the views of their executive committees.

Bilateral FTAs offer business groups incentives and options to influence trade policymaking in ways that have been overlooked by the extant literature and are missing in multilateral negotiations. In any case, increasing private sector involvement in FTA formulation over time does not necessarily mean that it will mobilize in any future FTA as the limited enthusiasm raised by some recent proposals demonstrates. Nevertheless, firms have become increasingly aware of FTA impacts and the institutional setting for business collective action and government-business relations is already in place. It could be therefore expected that businesses that could be potentially affected by prospective FTAs will mobilize, in favor or against, to influence its sectoral formulation.

Both case studies confirmed the initial proposition (Hypothesis 3) that bilateral FTAs foster business collective action and lobbying across borders (Table 3). Likewise, empirical evidence showed that bilateral FTAs facilitate cross-border consultation by a government with business sectors in the partner country (Table 3).

**Table 3: Hypothesis 3: Business collective action and lobbying and government-business consultations across borders \***

| FTA    | Relationship Type   | Example  | Period**  |
|--------|---|--|---|
| JTEPA  | Business collective action across borders (between both levels II)  | Meetings between Japanese and Thai textiles/garments associations to negotiate a common position. Also participated by Japanese officials  | Before and during of negotiations                             |
| JTEPA  | Business collective action across borders (between both levels II)  | Business associations representing Thai processed food producers contacted wholesale buyers and trading companies to consolidate lobbying positions                                    | Before and during negotiations                                |
| JTEPA  | Business lobbying across borders (level II in one country lobbying level I in the other)  | Japanese automotive firms lobbying Thai and Japanese governments   | Before and during negotiations                                |
| JTEPA  | Business collective action (between both levels II) and lobbying (level II in one country lobbying level I in the other) across borders | Thai and Japanese peak business associations coordinated demands to the Thai and Japanese governments to expand FTA coverage and accelerate liberalization schedules                   | After implementation (February 2011)***                       |
| TUSFTA | Business collective action (between both levels II) and lobbying (level II in one country lobbying level I in the other) across borders | American multinationals sponsored United States-Thailand Business Coalition to lobby both governments for a comprehensive FTA  | Before and during negotiations                                |
| TUSFTA | Cross-border government-business consultation and lobbying (between level I in one country and level II in the other)                   | The United States negotiation team met with Thai business associations during visits to Thailand   | During negotiations   |
| TUSFTA | Business lobbying across borders (level II in one country lobbying level I in the other)  | Thai garment and processed food associations contracted lobbyists in the United States to pressure the United States Trade Representative for American liberalization of their sectors | Before and during negotiations. Continued after talks stalled |
| MJEPA  | Business collective action across borders (between both levels II)  | Meetings between Japanese and Malaysian textiles/garments associations to negotiate a common position. Also participated by Japanese officials   | Before and during of negotiations                             |
| MJEPA  | Business collective action across borders (between both levels II)  | Meetings between Japanese and Malaysian iron and steel associations to negotiate a common position.  | Before start of negotiations                                  |
| MJEPA  | Business lobbying across borders (level II in one country lobbying level I in the other)  | Japanese steel producers lobbied directly to Malaysian authorities   | During negotiations   |
| MJEPA  | Cross-border government-business consultation and lobbying (between level I in one country and level II in the other)                   | Japanese officials contacted the Malaysian steel association to learn about its position and offered support in pushing for domestic reforms   | During negotiations   |
| MUSFTA | Business lobbying across borders (level II in one country lobbying level I in the other)  | Malaysian textiles and garments producers contracted lobbyists in the United States to pressure the United States Trade Representative for American liberalization of their sectors    | Before and during negotiations. Continued after talks stalled |
| MUSFTA | Business lobbying across borders (level II in one country lobbying level I in the other)  | American multinationals sponsored the United States-Malaysia FTA Business Coalition to lobby to both governments for a comprehensive FTA   | Before and during of negotiations                             |
| MUSFTA | Business lobbying across borders (level II in one country lobbying level I in the other)  | American interest groups based in Malaysia lobbied Malaysian officials for Malaysian liberalization in MUSFTA  | Before and during of negotiations                             |
| MUSFTA | Business collective action across borders (between both levels II)  | Malaysian and American business communities arranged bilateral meetings to find consensus points on MUSFTA   | Before and during of negotiations                             |

Source: Field research interviews except for \*\*\* (Bangkok Post, February 19, 2011)

\* See text for details. Collective action and lobbying across borders also occurred for civil society groups. Thai civic groups urged the European Union Parliament to avoid that the Thailand-European Union FTA includes provisions beyond the WTO on intellectual property rights.

\*\* Evidence obtained for the indicated period. It cannot be excluded that these relationships also occurred before and after then.

As noted earlier, the opportunity for business associations to be consulted by governments depends on their reliability as sources of information as well as on their capacity to deliver consensual positions. Frequently, as many as 4-5 bilateral and regional FTAs are being negotiated simultaneously, so business associations in Thailand and Malaysia have had to collect more often their members' positions and coordinate them both

internally and with other business groupings. Associations with strong secretariats and that have developed strong technical capabilities and achieved internal collective action (e.g., FTI, TCC, TTMA/TGMA, TFFA/TFPA in Thailand or FMM and MTMA in Malaysia) have had more chance to be heeded by governments. However, this is not to say, as discussed earlier, that individual firms do not have direct access to the new FTA policymaking process or that unintermediated clientelist channels have all but entirely disappeared.<sup>133</sup>

**Table 4: Hypothesis 4: Institutional creation and change by iterative FTAs**

| FTA                           | Institution   | Sponsor   | Functions Served   | Period                |
|-------------------------------|---|---|--|-----------------------|
| JTEPA and successive FTAs     | Overarching committee on FTAs<br>Dedicated subcommittees on JTEPA and ulterior FTAs   | Thai peak (FTI, TCC) and sectoral business associations                                 | * Business collective action and coordination of inputs from members<br>* Business collective action and coordination of positions with other associations in Thailand and FTA partners<br>* Focal point for government officials<br>* Lobbying Thai and FTA partner governments | Mid-2004 onwards      |
| JTEPA and successive FTAs     | National Committee on FTA Strategy and Negotiations   | Thai government (Cabinet level)   | * Government inter-agency consultation and coordination at the cabinet level<br>* Provide direction and coordination among government agencies and across multiple FTAs  | November 2004 onwards |
| Thai FTAs launched after 2007 | Institutionalization of consultations with business and civil society in Thai FTAs: Article 190 of the 2007 Thai Constitution | Sponsored by the NGO FTA Watch and adopted by the government and constituent parliament | * Mandatory consultations by the government with business groups and civil society<br>* Mandatory approval of FTA negotiations and final texts by the Thai Parliament<br>* Mandatory compensation of sectors negatively affected by FTAs   | 2007 onwards          |
| Malaysian FTAs after mid-2006 | Private Sector Task Force on FTAs   | Malaysia peak business association (FMM)  | * Business collective action and coordination of positions across business associations<br>* Feedback and lobbying to government officials also attending meetings   | Mid-2006 onwards      |

Source: Field research interviews

Field research confirmed that successive FTA negotiations have been a formative process for politicians, bureaucracies and businesses (Hypothesis 4). At the least, FTA negotiations have enhanced the technical trade expertise and institutional capacity of government agencies and organized business. But as more FTAs have been pursued (often simultaneously), and interactions within and among agencies and business associations became more frequent, the information, consultation and coordination costs entailed in such iterative process have spurred the creation of *ad-hoc* and permanent institutions for

<sup>133</sup> In both countries, influential and proactive individual firms used any channel available to them to affect FTA policymaking.

government inter-agency coordination, private sector collective action and government-business intermediation (Table 4).

Broader and more frequent consultations with stakeholders, mainly businesses but also civil society, in the course of FTAs negotiations have helped government and firms in both countries to better define their preferences and resulted in a more accountable trade policymaking process. More importantly, and without entering into normative debates about the economic or developmental merits or demerits of FTAs, strengthening of the technical capacities of all stakeholders could potentially be transferred to other areas of policymaking while the institutional structures created for FTA formulation may endure to provide similar functions during WTO rounds.

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## 3

## Essay 2 — Beyond Trade Creation. Explaining Utilization of Free Trade Agreements by Sectoral Interests and Binding of Unilateral Concessions

Utilization of Free Trade Agreements and unilateral liberalization schemes in Thailand and Malaysia<sup>134</sup>

### Abstract

Much of the literature on East Asian regionalism downplays the economic rationale of recent free trade agreements (FTAs) that, accordingly, have been barely used by the private sector in the region. However, evidence published elsewhere for Japan and reported in Essay 1 for Thailand and Malaysia indicate that some business groups in these countries actively pushed governments in support of FTA liberalization. To solve this apparent paradox, this Essay contends that analysis of FTA utilization needs to be conducted at the sectoral level and put into the context of both the political economies that originally set FTAs in place and existing unilateral liberalization schemes. Analysis of highly disaggregated preferential trade records in Thailand and Malaysia—the two most FTA-active developing countries in East Asia—revealed that overall utilization of most bilateral FTAs has been indeed low but hid significant sectoral variability. Sectors that used FTA preferences to the greatest extent included those that successfully lobbied for FTA liberalization during negotiations. It was also found that utilization of Thai and Malaysian FTAs displayed stronger correlation with the previous use of unilateral liberalization schemes (e.g., Generalized System of Preferences and duty drawback programs) than with the preferential tariff margin afforded by FTAs. FTAs should be therefore evaluated not only for their capacity to create new trade flows but also for legally binding tariffs that were unbound (or bound with large overhangs) at the multilateral level and/or were previously offered unilaterally and therefore subject to removal at the discretion of the granting country.

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<sup>134</sup> Essay 2 was originally written in August 2012. It was updated in early 2013 with analysis of trade flows between Thailand and Malaysia and their FTA partners for the period ending in December 2012.

**Abbreviations:**

APEC: Asia-Pacific Economic Cooperation  
ASEAN: Association of Southeast Asian Nations  
DDE: duty drawback or exemption  
FDI: foreign direct investment  
FTA: free trade agreement  
GSP: generalized system of preferences  
JTEPA: Japan-Thailand Economic Partnership Agreement  
MFN: Most-favored-nation  
MJEPA: Malaysia-Japan Economic Partnership Agreement  
PCO: Preferential certificate of origin  
ROO: Rules of origin  
TAFTA: Thailand-Australia FTA  
UR: utilization rate  
WTO: World Trade Organization

## 1. Introduction

Until the turn of the century, and with the single exception of the ASEAN (Association of Southeast Asian Nations) bloc, East Asia was the only region untouched by the worldwide proliferation of free trade agreements (FTAs) that started in the mid-1990s.<sup>135</sup> However, East Asian countries are now among the most active embracing FTAs, with close to 60 already implemented since 2002, most of them as bilateral treaties.<sup>136</sup>

Most scholarly works on East Asian FTAs have pointed to their lack of economic relevance and emphasized instead political, strategic, and/or security rationales as primary motivations (e.g., Desker, 2004; Aggarwal and Koo, 2006; Dent 2006; Sally, 2006; Dieter, 2007; Aggarwal and Koo, 2008; Ravenhill, 2008b; Ravenhill, 2010; Lee, 2013). These narratives portray East Asian FTAs as emerging from political elites in strong states and without significant participation by interest groups (Aggarwal and Koo, 2006; Lee, 2006; Sally, 2006; Terada, 2009; Ravenhill, 2010). The only exception to this pattern of top-down FTA formulation seems to have been Japan, where the private sector has played an important role in the evolution of FTA policy (Solis, 2003; Manger, 2005; Yoshimatsu, 2005; Yoshimatsu, 2006b; Solis and Urata, 2007; Manger, 2009; Katada and Solis 2010; Solis 2010; Manger, 2012).<sup>137</sup> Field research for this Thesis (Essay 1) found evidence that the private sector in Thailand and Malaysia has not only participated in FTA formulation but that in FTAs with significant sectoral economic impacts it actually took the initiative and pushed governments to start negotiations. On the other hand, whenever the *ex-ante*

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<sup>135</sup> Although the ASEAN FTA (AFTA) was signed in 1992, it did not achieve much liberalization until recently. In addition to long tariff phase-out periods, its implementation was poor as many countries moved their sensitive items to exclusion lists (Yoshimatsu, 2006a; Ravenhill, 2008a; Ravenhill, 2009). It was not until 2003 that tariffs were eventually reduced to 0-5% (with the exception of the Malaysian automotive sector) and fully eliminated in 2010. The less developed countries of Cambodia, Myanmar, Laos and Vietnam are allowed longer implementation periods.

<sup>136</sup> As of August 11, 2013, East Asian countries have already signed 56 FTAs with partners inside and outside the region (Databases from ADB-ARIC, undated and WTO-RTAIS, undated).

<sup>137</sup> Some authors in the first camp have downplayed the driving role of business groups in Japanese FTAs and considered them as reactive to earlier initiatives by the Japanese government (Ravenhill, 2010).

economic rationale of Thai and Malaysian FTAs, even if only narrowly sectoral, was missing or unclear, negotiations dragged on for years or suspended altogether.

In addition to question the *ex-ante* economic rationale and engagement of the private sector in the formulation of East Asian FTAs, a majority of academic works in the subject emphasize the *ex-post* indifference by businesses and low *overall* utilization of ASEAN and bilateral FTAs already in place (Sally, 2006; Sally, 2007; Baldwin, 2008; Manchin and Pelkmans, 2008; Ravenhill, 2008a; Ravenhill, 2010). The utilization of ASEAN FTA (AFTA) preferences has been estimated at 5% (Haddad et al., 2007; Baldwin, 2008) and, in a 2007 survey among Japanese subsidiaries in East Asia, only 13.3% of exporters used or planned to use existing FTAs in the region (JETRO, 2007).<sup>138</sup>

Low levels of FTA utilization by businesses in East Asia have been reasoned on several accounts (Sally, 2006; Baldwin, 2008; Ravenhill, 2008b; Ravenhill, 2010). First, the geographical inconsistency between region-wide production networks and mostly bilateral FTAs. Secondly, the fact that a large share of intra-East Asian trade is comprised by parts and components—29.4% of total exports in 2011 (RIETI-TID database)—, that tend to attract low applied multilateral tariffs, making unnecessary the use of FTAs. Lastly, low utilization of FTA preferences has been charged to strict and inconsistent rules of origin (ROOs) across FTAs.<sup>139</sup> As countries sign into multiple FTAs, exporters must adapt their production process to diverging ROOs and the costs imposed by them could reduce (or even cancel out) the preferential margin granted by an FTA and, consequently its appeal (Estevadeordal and Suominen, 2006).<sup>140</sup>

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<sup>138</sup> Although successive firm level surveys by the Japan External Trade Organization (JETRO) have reported an increase in the use (or intention to use) of East Asian FTAs, utilization remained low at 37.7% in 2012, despite this figure also includes FTAs with partners outside the region (e.g., India, Mexico, Chile, Switzerland) (JETRO, 2013).

<sup>139</sup> ROOs determine whether a product has undergone a minimum level of transformation within the FTA bloc. ROOs also apply to other preferential tariff arrangements such as GSP. ROOs are included in FTAs and GSP to avoid trans-shipment across countries with lower external tariffs or that benefit from unilateral preferential treatment, respectively.

<sup>140</sup> This process is often referred as the spaghetti or noodle bowl effect (Bhagwati, 1995; Baldwin, 2008). In addition to the restructuring costs involved in adapting production structure to ROOs, exporters often must submit an application for the use of FTA preferences (preferential certificates of origin, see below), which involves additional fee and logistic costs, sometimes outside the possibilities of smaller firms.

However, this and other Essays in this Thesis provide evidence that counter the three arguments above. First, bilateral FTAs provide specific benefits to firms involved in regional production networks (see Essay 3). Secondly, while tariffs on a large share of parts and components have indeed been reduced, much of this liberalization has occurred through unilateral preferential arrangements such as duty exemptions and drawback schemes (DES/DDS), often linked to export and investment promotion strategies (see below). Most developing economies in the region also benefit from reduced tariffs on some of their exports to developed countries through the Generalized System of Preferences (GSP) programs. But the unilateral nature of DES/DDS and GSP makes them potentially removable at the discretion of the granting country. And third, as quantitative and qualitative research for this Essay found, ROOs in East Asian FTAs may not have had the highly restrictive effect on FTA utilization anticipated by some studies (see below).

In addition, accounts of low FTA utilization in most studies are grounded on estimates of unspecified methodology or on firm-level surveys that, besides the limitations inherent to any survey, do not weight the share of surveyed firms in trade flows (JETRO, 2007; Hiratsuka, 2008; JETRO, 2009; Kawai and Wignaraja, 2009; Wignaraja et al., 2010; Wignaraja et al., 2011). Proper calculation of FTA utilization requires gathering of official administrative records, so-called *Preferential Certificates of Origin* (PCOs), administrative records certifying that the product to be exported complies with the ROOs established by the FTA, or Customs records for preferential treatment of imports at the point of entry. In East Asia, these administrative records are only collected and/or accessible in Thailand and Malaysia and reported publicly only for exports and at the aggregate level.<sup>141</sup>

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<sup>141</sup> In most East Asian countries, exporters could self-report compliance with ROOs so PCOs are not issued or collected. In countries where PCOs are issued, they are granted by government authorities in the exporting country, usually the trade ministry or a surrogate (e.g., a peak business association). Thailand and Malaysia publish overall FTA utilization rates for exports, never for imports. In the case of Malaysia, public data on overall FTA utilization for exports covers only a few years. Disaggregated data on exports and imports under preferential regimes (PCOs and Custom records, respectively), as used in this Essay, are only rarely made available (see below).

It is contended here that collection and analysis of FTA utilization data need to be put into a sectoral context. As East Asian countries have progressively liberalized their tariffs multilaterally, high tariffs and tariff peaks on final products but also on some parts and components have become increasingly concentrated on a reduced number of sensitive sectors. Therefore, only highly disaggregated data on preferential trade and a sectoral analysis of FTA utilization could evaluate the impact and economic relevance of FTAs. To the best of my knowledge, only two publications have made use of disaggregated preferential trade records for Thai bilateral FTAs (Kohpaiboon, 2010; Athukorala and Kohpaiboon, 2011), but none for Malaysian FTAs.<sup>142</sup> Both works conclude that supply factors are more important than tariff savings in FTA utilization. Kohpaiboon (2010) conducts an econometric analysis of variables affecting the use of Thai FTAs (see below).

This Essay will analyze the utilization of FTAs in Thailand and Malaysia, the two most FTA-active developing countries in East Asia, in the context of other preferential trade schemes. As indicated above, Thailand and Malaysia are the only countries in the region that collect administrative records for trade flows under FTAs, GSP and DES/DDS. Of note, Thailand and Malaysia rank among the largest users of the Japanese GSP program for the period immediately before negotiations for JTEPA and MJEPA started (Komuro, 2009). The main aims and arguments of this Essay are two. First, to analyze data on utilization of selected Thai and Malaysian FTAs at a high level of disaggregation and confront them with qualitative data on the domestic and international political economies of their formulation (as reported in Essay 1). It will be posited that economic sectors that lobbied for FTA liberalization and saw their preferences embodied in the final FTA treaties, should make high use of FTA preferences. Secondly, sectoral utilization of FTAs will be examined in relation to utilization of GSP and DES/DDS preferences. The

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<sup>142</sup> In his study of Thai FTAs, Chirathivat (2007) draws only on overall utilization rates and shortly after implementation (2005-2007) when many tariffs had not been reduced yet.

possibility of unilateral removal of GSP and DES/DDS preferences by the granting country creates uncertainty for firms using these schemes. In this line, it has been found that, other things equal, the greater the political trade dependence of a developing country on the United States and European GSP schemes, the higher the likelihood that the developing country enters an FTA with its Northern partners (Shadlen, 2008; Manger and Shadlen, 2013).<sup>143</sup> Consequently, this Essay will argue that goods covered by unilateral tariff reduction schemes are more likely to be included in FTAs and to be liberalized faster, and that producers that benefit from GSP or DES/DDS are also more likely to use FTAs preferential tariffs later.

Despite some sectoral differences between Thailand and Malaysia and among FTAs, analysis of official preferential trade records in both countries rendered similar findings and conclusions. It was found that overall utilization of Thai and Malaysian FTAs is higher than the projected by estimates and surveys, although in most cases still low by the standards of well-established FTAs in other regions. However, low overall FTA utilization rates hide significant sectoral variability and sectors that lobbied for FTA liberalization and/or use GSP and DES/DDS have made higher utilization of Thai and Malaysian FTAs.

The rest of the manuscript is organized as follows. Next two sections will briefly outline the Thai and Malaysian FTAs object of the study. Section four develops the theoretical framework and hypotheses that would be confronted with empirical evidence presented in sections five and six. Section seven discusses findings and concludes.

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<sup>143</sup> Most of these North-South bilateral FTAs are highly asymmetrical with developing countries surrendering policy space in exchange for securing market access provided by the GSP (Shadlen, 2005; Shadlen 2008).

## 2. Thai preferential trade regimes with Australia and Japan

In addition of being party to WTO, Thailand is founding member of AFTA. In East Asia, Thailand was only second to Singapore to jump into the FTA bandwagon although its initial rush for FTAs has slowed down since 2006. As of August 2013, Thailand has implemented five bilateral trade agreements plus, as member of ASEAN, five regional ASEAN+1 FTAs (see Table 1, Essay 1).<sup>144</sup> Of these, the most relevant bilateral FTAs for Thailand in terms of trade value are those with Australia and Japan.

Australia has historically ranked among the main trading partners for Thailand. Trade flows with Australia are highly concentrated, dominated by petroleum and mineral resources in the import side, and by automobiles and jewelry among exports (Trade Map database). Thailand is eligible to preferential tariffs under the Australian GSP program but there is no information on its utilization as Thai exporters are not required to file PCOs (see footnote 141). The Thailand-Australia FTA (TAFTA) was the first comprehensive FTA signed by Thailand with a developed country. Businesses potentially affected by the accord tried to influence its formulation (Essay 1). Thai textiles and garments producers, facing at the time strong competition in the Australian market from other developing countries, proactively lobbied for the agreement.<sup>145</sup> Field research also found strong support for the TAFTA among the jewelry and food processing sectors. Conversely, Thai dairy producers and small-scale farmers, expected to lose from TAFTA, opposed it. But the key sponsors of TAFTA were automotive firms. Since the late 1990s, Thailand has become the Southeast Asian hub for international carmakers and the Thai government has protected the automotive industry, dominated by Japanese firms, behind high import tariffs (reviewed in Natsuda and Thoburn, 2013). Carmakers based in Thailand supported liberalization of the sector within ASEAN as to rationalize procurement and production strategies but they have

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<sup>144</sup> ASEAN+1 refer to FTAs anchored around ASEAN. ASEAN has FTAs with China, Japan, Korea, Australia/New Zealand and India and tend to be less comprehensive and provide for slower liberalization than their respective bilateral agreements.

<sup>145</sup> Least-developed countries enjoyed lower tariffs from the Australian GSP program.

always opposed any liberalization by Thailand outside ASEAN. However, being Australia the single largest market for Thailand-made vehicles and having presence in both countries, Japanese and American carmakers lobbied both governments for reciprocal liberalization of vehicles and automotive parts in TAFTA. The final TAFTA treaty, which entered into effect in 2005, established the progressive but full opening of the automotive sector in both countries, granted improved access in Australia to Thai textiles and garments and provided the Thai dairy sector with up to twenty years to fully liberalize (DFAT, undated).

For Thailand, Japan has traditionally been not only its main investor and source of imports but also a major export market.<sup>146</sup> Although some key Thai exports are not covered by the Japanese GSP (e.g., many agricultural products, some sensitive textiles and garments, footwear) and others receive only partial tariff reduction (e.g., processed food) (UNCTAD, 2006; UNCTAD, 2011; Japanese Customs, undated), around 10% of all Thai exports to Japan in 2005 took place under this scheme (data provided by the Thai Ministry of Commerce: Japan Customs, undated; see below).<sup>147</sup>

Through the Japan-Thailand Economic Partnership Agreement (JTEPA), Thailand hoped to improve access in Japan for its agricultural and processed food products, textiles and garments and jewelry items as well as attract further investment (Essay 1). JTEPA was also sought by Japanese businesses looking to reduce high tariffs prevailing in the Thai automotive and steel industries, to integrate the textile and garment industries at the ASEAN level and to extract concessions from Thailand in investment and services (MOFA, 2003). Consequently, Japanese textile and food producers and their trading companies favored the agreement. But, as in TAFTA, it was the automotive sector where business efforts to influence JTEPA were more intense (Essay 1). Japanese carmakers produce in Thailand a wide range of automobiles and dominate local sales and exports but, at the time

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<sup>146</sup> Japan is the second export destination for Thailand, behind the United States until 2009 and China since then (Trade Map database).

<sup>147</sup> Between 2000 and 2005, Thailand accounted for 8-10% of all Japanese imports under GSP preferences and was second only to China as beneficiary of the program (Komuro, 2006).

of negotiations, they still imported from Japan higher-engine luxury cars, 30% of all automotive parts and 80% of the flat rolled steel used by the industry. The Thai government did not want that JTEPA could make redundant existing or future investment by international carmakers. Therefore, in the final agreement, implemented in November 2007, Thailand accepted the progressive liberalization of automotive parts and steel but only a reduction from 80% to 60% in the tariffs on luxury vehicles and left unchanged those on smaller-engine cars. In turn, Japan eliminated tariffs on Thai garments and textiles, footwear, jewelry, plastics, processed food and established within quota tariff reductions on some agricultural products (METI-JTEPA, undated).

### 3. Malaysian preferential trade regimes with Japan

As Thailand, Malaysia is also founding member of WTO and AFTA. Although initially reluctant to enter into bilateral FTAs, fear of exclusion from those signed by competing countries prompted Malaysia to initiate FTA negotiations with some of its key trade partners. In addition to AFTA and the five regional ASEAN+1 FTAs, as of August 2013 Malaysia has six bilateral FTAs in force. However, only for the oldest, the Malaysia-Japan economic partnership Agreement (MJEPA), implemented in 2006, there is disaggregated historical data on PCOs for exports. (Table 2, Essay 1).<sup>148</sup>

Historically, Japan has been the main source of imports for Malaysia and a major export market.<sup>149</sup> Around 12% of Malaysian exports to Japan during the mid-2000s benefited of the Japanese GSP, being these highly concentrated in palm oil, wood and furniture and plastics and chemicals that receive full exemption or highly reduced tariffs (data provided by the Malaysian Ministry of International Trade and Industry; Japan

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<sup>148</sup> When field research for this Thesis started, Malaysian only had bilateral FTAs with Japan and Pakistan, the latter just implemented and with a small trading volumes. On recent years, Malaysia has signed bilateral FTAs with New Zealand (August 2010), India (July 2011), Chile (February 2012) and Australia (January 2013).

<sup>149</sup> Only since 2008 has Japan been surpassed by China and, more recently, by Singapore as largest source of imports. On the export side, Japan has been only behind Singapore, and since 2009 also to China, as the main destination (Trade Map database).

Customs, undated; see below).<sup>150</sup> Support for MJEPA among Malaysian businesses was centered among producers of palm oil, textiles and garments, chemicals and plastics that faced high tariffs and non-tariff barriers in Japan (Essay 1). On its part, Japan sought the elimination of all type of trade barriers on the highly protected automotive sector as well as those existing on steel and electrical machinery.<sup>151</sup> As in Thailand, negotiations stumbled around the automotive sector, as the Malaysia government sought to protect its national car manufacturers from Japanese imports. By the final text, which entered into effect in June 2006, MJEPA established the full opening of the Malaysian automotive and steel sectors by 2015 while Japan would progressively eliminate tariffs on palm oil, chemicals, plastics and textiles and garments (METI-MJEPA, undated; MITI, undated) (Essay 1).

#### **4. Analytical framework: Linking FTA utilization to sectoral business interests and binding of unilateral preferential tariff schemes**

A number of studies have questioned the economic relevance of recent East Asia FTAs (e.g., Sally, 2006; Ravenhill, 2008b; Ravenhill, 2010). This Essay started off from the obvious proposition that FTAs are selectively used by those exporters that benefit from them. Consequently, overall FTA utilization rates provide little information about the relevance of an FTA to a given economic sector and that could only be assessed through analysis of disaggregated utilization data.

During the course of this Thesis, two studies analyzing disaggregated data on the utilization of East Asia FTAs have been published, both for Thai FTAs (Kohpaiboon, 2010; Athukorala and Kohpaiboon, 2011). The former examines the utilization of AFTA, TAFTA and JTEPA by Thai exporters in 2008 and finds that utilization was concentrated in highly

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<sup>150</sup> During 2000-2005, Malaysia was either the third or fourth largest user of the Japanese GSP program, representing 6.6-7.2% of all Japanese imports under the scheme (Komuro, 2006).

<sup>151</sup> Malaysian producers of iron and steel also active during MJEPA negotiations but not so much as to expand their market in Japan as to avoid sudden liberalization of sensitive items as it had occurred in previous FTAs (see Essay 1).

traded items. Through an econometric analysis, it also shows that FTA utilization positively correlates with the tariff savings provided by the FTA and inversely with ROOs (see below). The study estimates that ROOs in these FTAs amount to an excess tariff between 2% and 10%.<sup>152</sup> Athukorala and Kohpaiboon (2011) examines the top ten most traded items under TAFTA and compares their share in total trade flows before and after implementation of the agreement. Interestingly, these authors found that TAFTA has not significantly altered previous bilateral trade patterns except for an increase in the share of cars exported by Thailand (see below). The study downplays the trade-creating effects of FTAs and concludes that the largest users of FTAs are already established exporters and that supply factors and ROOs may be more important than tariff savings in FTA utilization.

While these studies are illuminating, several issues are worth discussing here. First, the trade creation effect of an FTA may be difficult to ascertain when trade flows are very concentrated on a small number of goods, as occurs for many countries. Second, FTAs should be valued not only for their trade creation effects but also for establishing a legal commitment to bind preferential tariffs at or below the multilateral applied tariff level (see below). Third, utilization of a particular FTA should be related to evolving dynamics in general and preferential trade flows over time. Fourth, as important as what sectors are the main overall users of an FTA is to investigate what sectors use FTA preferences to the fullest extent, independently of trade value, placing FTA utilization into context with the political economies at the origin of that FTA. Lastly, and related to the second point, FTAs should also be considered for their capacity to replace existing unilateral preferential tariff schemes. I will now take these arguments in turn.

As advanced in the Introduction, much of the liberalization in East Asia over the last two decades has taken place through *unilateral* reductions in applied tariffs, often

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<sup>152</sup> The restricting effect of ROOs in the utilization of Thai FTAs in Kohpaiboon (2010) is corroborated by other econometric studies (Intaravitak et al., 2011) and is in line with the excess tariff equivalent of ROOs in other FTAs (Estevadeordal and Suominen, 2004). A more detailed discussion of the variables specified in Kohpaiboon's (2010) model is described below.

linked to export promotion strategies (e.g., DES/DDS). In fact, East Asian unilateral liberalization has been put forward as an argument for the dispensability of ongoing FTAs (Ravenhill, 2010). However, in addition to the uncertainty about their potential removal by the granting country inherent to any unilateral preferential scheme, pockets of high tariffs and tariff peaks on both finished good and parts and components still exist in many East Asian countries. A substantial share of tariffs are either not bound or bound at a higher level than the applied tariff, creating binding overhangs.<sup>153</sup> Independently of how low applied tariffs in East Asia may have gone over time, FTAs create legal commitments that bind tariffs below the bound tariff level at WTO, thus increasing predictability in trade exchanges. An illustration of the value that developing countries attach to their control over binding overhangs is found in the concession schedules offered by Thailand and Malaysia in their FTAs. Research for this Essay found that for a small share of tariff lines, the initial tariff granted by the FTA is above the applied most-favored-nation (MFN) tariff (DFAT; METI-JTEPA; METI-MJEPA) (see below).

Article XXIV of the General Agreement on Tariffs and Trade establishes that FTAs should fully liberalize a significant share of trade within a reasonable period. While these requirements are most often interpreted as 90% of existing trade and 10 years, respectively, sensitive items in some FTAs are liberalized over longer periods or excluded altogether. When negotiating FTA concessions on sensitive items—which tariffs are either not bound under WTO or bound with large overhangs—it would be expected that a motivated government, one that attaches value to its control over binding overhangs, would strategically use FTA flexibilities regarding coverage and sequencing.

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<sup>153</sup> Tariff binding refers to a country's commitment under WTO rules not to increase the duty on a given item over the specified rate once it has been bound. In 2006, at the time when the FTAs examined in this Essay were negotiated, the average MFN tariff on non-agricultural products applied in Thailand was 3.1 times higher (25.5% versus 8.2%) than the average bound tariff, 1.8 times in the case of Malaysia (14.9% versus 7.9%) (WTO, 2006). Some developed countries also have significant tariff overhang. For instance, for the same year, the average applied tariff on non-agricultural goods in Australia tripled the average bound tariff (11.0% versus 3.9%) (WTO, 2006).

**Hypothesis 1:** *Governments would strategically negotiate FTAs to ensure that sensitive goods—with unbound tariffs or large binding overhangs at the multilateral level—are excluded, phased out over long periods and/or receive FTA duties that are initially above applied tariffs.*

Most FTAs establish several tracks for liberalization. An initial group of tariff codes, mostly products that attract low multilateral tariffs—or as found in this research, items that benefit from unilateral preferential treatment (see below)—receive immediate, often complete, liberalization. For the bulk of goods, tariffs are reduced progressively, frequently with a lag time before any liberalization occurs, until they reach certain level or are completely eliminated. Finally, in some FTAs, a small set of highly sensitive products is excluded from any tariff liberalization. It could be therefore expected that: a) FTA utilization should increase over time, often with a lag and in successive waves, and b) as more items are progressively liberalized, concentration in FTA utilization should decline. A force in the opposite direction could potentially counter the last proposition. Empirical evidence indicates that FTA liberalization prompts members of the bloc to reduce their external MFN tariffs (Ornelas, 2005a; Ornelas, 2005b; Calvo-Pardo et al., 2011). In that regard, FTAs could be considered as a mere accelerated track with respect to multilateral liberalization. As the members of an FTA bind their external MFN tariffs at the level previously established by the FTA, the preferential tariff margin granted by the FTA is progressively eroded and, consequently incentives for FTA utilization decrease while concentration of its use increases.<sup>154</sup>

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<sup>154</sup> In an FTA and for a given good code and point in time, preferential tariff margin refers to the difference between the MFN applied tariff and the preferential tariff granted by the FTA (same applies for GSP or DES/DDS preferences, see below). These opposing trends make falsifiability of the hypothesis more difficult and highlight the need for analyses on FTAs utilization that consider how the preferential tariff margin for any given good evolves over time.

**Hypothesis 2:** *Sequencing of liberalization in FTAs should translate into low but concentrated FTA utilization at initial stages of implementation. As tariffs are phased out, FTA utilization should increase and concentration of its use decline. On the other hand, a subsequent multilateralization of FTA preferences should reduce incentives for FTA utilization and increase concentration of its use.*

Although numerous studies question the participation of the private sector in the formulation of East Asian FTAs (e.g., Ravenhill, 2010 and references therein; see also Essay 1) other works, including research for this Thesis, have argued for the important role played by business groups in the initiation and policymaking of many FTAs in the region (Solis, 2003; Manger, 2005; Yoshimatsu, 2005; Essay 1). Empirical evidence in Essay 1 indicates that selected sectors (and firms) pressured government in support or against specific policy choices (e.g., tariffs, ROOs) in FTAs and that, in many instances, these preferences were eventually reflected in FTA treaties.<sup>155</sup>

It could be argued that sectors and firms that saw their *ex-ante* interests embodied in FTAs, should make high utilization of FTAs once these are implemented.<sup>156</sup> However, two considerations are in order here. First, the fact that a sector accounts for a high absolute share in the utilization of an FTA does not necessarily mean that that sector uses FTA preferences to the full extent. Conversely, sectors accounting for small volumes of trade under an FTA could potentially use its preferential tariffs for most or all of their exports. Even if FTA utilization by these sectors is not revealed by a ranking of top overall users

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<sup>155</sup> Finding evidence of lobbying by a given sector (or firm) for specific policy choices does not necessarily mean that it gets translated into the final FTA text as preferences and lobbying pressures could be modulated (or cancelled out) by the opposing preferences and pressures of other actors as well as by cross-sectoral concessions. In this Thesis, actors' preferences, evidence of lobbying and success in affecting FTA policy have been assessed and cross-validated through extensive semi-structured interviews of a wide range of elite actors (Essay 1).

<sup>156</sup> Accordingly, one would expect high utilization of TAFTA among automotive firms or of JTEPA by Thai exporters of processed food, textiles and garments and jewelry. Likewise, it could be projected a high use of MJEPA by exporters of palm oil, plastics, chemicals and garments.

(Kohpaiboon, 2010; Athukorala and Kohpaiboon, 2011), the FTA could be even more relevant for these lower-volume exporters. Therefore, political economy analyses of FTA utilization should pay attention to sectors beyond the largest absolute users and trace back utilization of an FTA to the economic actors that participated in its formulation, independently of overall trade volumes. Second, official records gained for this research provide data on preferential trade flows for each tariff code but does not identify which firms used FTA (or GSP and DES/DDS) preferences, precluding us from a firm-level analysis of FTA utilization.<sup>157</sup> This is relevant because, as it will be argued in Essay 3, FTAs could grant selective rents to specific firms within a sector and an FTA area.

**Hypothesis 3:** *Independently of trade volumes, business sectors that succeeded in affecting FTA formulation toward greater or faster liberalization should make high use of FTA preferences.*

In addition to regional trade agreements, breach of WTO's principle of non-discrimination is also allowed for GSP and related schemes by which developed countries grant unreciprocated preferential tariffs to selected items originating from developing countries. To benefit from GSP preferential tariffs, that range from zero to just below MFN applied tariffs, products must comply with established ROOs. Most GSP programs also incorporate product- and/or country-specific export ceilings, above which preferential tariffs no longer apply (UNCTAD, 2006; UNCTAD, 2011). Beneficiary countries could also be delisted (graduated) once they reached a certain development status.

Although very different in their nature and purpose, DES/DDS represent another widely used unilateral tariff exemption scheme. They grant full rebate of import duties on

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<sup>157</sup> Although contained in PCO applications, Thai and Malaysian trade authorities did not make this information available to us alleging that would violate confidentiality regarding firms' procurement patterns.

specified capital goods and/or on intermediate inputs that are later incorporated into final goods destined to exports. DES/DDS are often offered as part of export- and investment-promotion strategies.<sup>158</sup> Some DES/DDS, particularly those linked to investment in a specific economic activity or geographical area, are subject to expiration.

In addition to ceilings and expiration in their use, GSP and DES/DDS are subject to removal at the discretion of the granting country. FTAs offer the possibility to make GSP and DES/DDS tariff reductions permanent and non-removable. For the GSP programs offered by the United States and the European Union, it has been demonstrated that the larger is the share of exports that developing country trades under GSP preferences, and therefore its political dependence on them, the higher the likelihood of that country signing an FTA with the United States or the European Union (Shadlen, 2008; Manger and Shadlen, 2013).

It is well accepted that economic actors are more likely to mobilize to avoid losses from liberalization than to secure gains from it (Baldwin, 1995). It is therefore posited here that business sectors in Thailand and Malaysia that benefit from GSP and DES/DDS will support FTA liberalization, especially if suffering from product- or country-specific ceilings and/or as the deadline for graduation approaches. Once the FTA is implemented, those sectors would be expected to be among the first to use its preferences and to use them to a high degree.

It could also be argued that when the country granting GSP preferences negotiates an FTA with one of the beneficiaries, products covered by the GSP program will be liberalized deeper and faster.<sup>159</sup> Nevertheless, because of the argument in Hypothesis 1, FTA liberalization of these products could still take some time to reach the preferential rate granted under GSP, particularly for items subject to product- and country-specific GSP

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<sup>158</sup> DES/DDS are part of the policy toolkit of many countries around the world but they have been particularly prevalent in East Asia.

<sup>159</sup> This is less likely to occur in the case of DES/DDS given the more limited nature of these programs.

ceilings. In any case, as FTA liberalization progresses, utilization of GSP and DES/DDS schemes would be expected to decline and their use to concentrate on fewer items.

**Hypothesis 4:** *Sectors that had previously benefitted from unilateral tariff reduction schemes would be expected to support FTA liberalization ex-ante and to make early and high use of their preferences upon implementation. Utilization of GSP and DES/DDS programs by these sectors would decline as FTA liberalization progresses.*

To test these hypotheses, I analyzed data on trade flows using the preferences provided by selected Thai and Malaysian FTAs and related them to: a) variables potentially affecting FTA utilization, including trade under GSP and DES/DDS programs, and b) qualitative information on the policymaking of these FTAs obtained in the course of semi-structured interviews with government officials and private sector representatives in both countries (Essay 1).<sup>160</sup> Although results in both case studies follow a similar pattern, they will be taken in turn for simplicity of exposition.

## **5. Political economy and variables affecting utilization of Thai FTAs**

As advanced earlier, Kohpaiboon (2010) found that utilization of AFTA, TAFTA and JTEPA by Thai exporters in 2008 is directly correlated with the preferential tariff margin and inversely with ROOs. The study also found positive correlation between utilization of these FTAs and factors that lower administrative costs in the application of PCOs. Thus, factors increasing economies of scale in processing PCOs (e.g., trade volume before the FTA) or variables associated with higher administrative expertise (e.g., foreign presence as

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<sup>160</sup> In addition to preferential trade records (see below), primary research involved 212 in-depth semi-structured interviews with government officials, private sector representatives, academics and civil society in Thailand and Malaysia during two independent trips in 2008 and 2009 (see Essay 1 for further details).

output share and share of conglomerate firms in a sector) correlate with higher FTA utilization. In contrast, by hindering compliance with ROOs, a high share of trade in parts and components in a sector has a negative impact on FTA utilization (Kohpaiboon, 2010).

### **5.1 Source of data and methodology**

The following primary data were obtained for this research:

a) *Value of bilateral trade flows between Thailand and either Australia or Japan.*

Data was retrieved from the Trade Map database (Trade Map, undated), mostly at four-digit level of specification (HS4, around 1,300 lines per year and for each trade direction) in the Harmonized Commodity Description and Coding System, although some analyses were also performed at six-digit level (HS6, around 5,700 lines per year and for each trade direction).<sup>161</sup> Data collected covered from January 2004 to up to July 2013.<sup>162</sup>

b) *Trade values for Thai exports under TAFTA and JTEPA.* Data on PCOs were provided by the Thai Ministry of Commerce at the HS6 level of specification. Export values under both FTAs were then collapsed into HS4 level to allow a better comparison with data on Thai imports from Japan (under TAFTA, JTEPA or DES/DDS) and with available preferential trade data from Malaysia, both provided at HS4 level (see below). For TAFTA and JTEPA, PCOs covered from their implementation date (January 2005 for TAFTA and November 2007 for JTEPA) up to December 2011.

c) *Trade values for Thai exports under Japanese GSP.* Data were provided by the Thai Ministry of Commerce at the HS6 level and collapsed to HS4 for the reasons stated above. PCOs for exports under Japanese GSP covered from January 2004 until December

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<sup>161</sup> The Harmonized Commodity Description and Coding System is a tariff nomenclature established by World Customs Organization ([www.coomd.org](http://www.coomd.org)). It classifies products in 99 chapters (2-digits, HS2, 96 general chapters plus three special chapters), which are subclassified in headings (4-digits, HS4) and subheadings (6-digit, HS6). All countries must use the same nomenclature for HS2 through HS6 but could also adopt additional subdivisions at higher level of specification (8- and 10-digit). The nomenclature is periodically revised, the latest in 2012. Throughout this Thesis, the 2007 version was used as all data provided by trade authorities were in that version.

<sup>162</sup> Although preferential trade data for Thai imports and exports were only available until October 2009 and December 2011, respectively (see below), overall trade flows have been examined up to July 2013.

2011. Of note, although for a very small number of tariff lines, Japanese GSP preferences were still used during 2011. No information is available regarding the use of the Australian GSP scheme as compliance with ROOs involves automatic self-reporting.

d) *Trade values for Thai imports under TAFTA and JTEPA.* Data were provided by the Thai Customs Department (Ministry of Finance) at the HS4 level. Records covered from January 2005 to October 2009 for TAFTA, and from November 2007 to October 2009 for JTEPA.

e) *Trade values for Thai imports from either Australia or Japan under DES/DDS.* Data were provided by the Thai Customs Department at the HS4 level. Records included imports under the two main unilateral tariff exemption schemes, namely, the privileges granted by the Board of Investment and the Customs Department.<sup>163</sup> Despite their different nature, for simplification of analysis, data on imports under both schemes were combined. Records covered from January 2004 to October 2009 for imports from Australia and from January 2007 to October 2009 for imports from Japan.

f) *Applied and bound multilateral tariffs in Thailand, Japan and Australia.* Data were retrieved from the WTO's Integrated Data Base (WTO-IDB, undated) at HS6 level (around 5,500 lines per year) and aggregated down to HS4 level (around 1,300 lines per year) for the reasons stated above. Tariff data was collected for the period between January 2004 and December 2011.

g) *Tariff schedules under TAFTA and JTEPA.* Data were retrieved from the respective FTA treaties, available from government websites (DFAT, undated; METI-JTEPA, undated). Tariff schedules in these FTAs texts are specified at HS8 and HS6,

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<sup>163</sup> The Board of Investment provides incentives to firms, foreign or Thai, investing in the country in selected activities and regions. Incentives include exemption of import duties on capital equipment and parts and components and varying widely depending on the sector and geographical location. These privileges are given for a limited period post-establishment and although could be reactivated by further investment in the same productive location, as time passes, they tend to phase out. Section 19bis of the Thai Customs Act (1939) establishes the refund of duties paid on imported goods that are used in the production, mixing, assembling or packing of goods destined for export. In contrast to Board of Investment privileges, tariff reductions under Section 19bis have no deadline although they are susceptible to restrictions or cancellation by the Thai government without breaking WTO rules.

respectively, and were aggregated down to HS4 in order to match them with trade flows data. Tariff schedules in both FTAs were collected from their implementation date (January 2005 for TAFTA and November 2007 for JTEPA) up to December 2011.

g) *Preferential tariffs under Japanese GSP*. Data were retrieved from the website of Japan's Customs and Tariff Bureau (Ministry of Finance) for the period between January 2004 and December 2011 (Japanese Customs, undated). As for previous data, tariff rates at HS8 level was aggregated down to HS4 for every year analyzed.

h) *Rules of origin in TAFTA and JTEPA*. Data were retrieved from the respective FTA treaties, available from government websites (DFAT, undated; METI-JTEPA, undated).

To analyze utilization of FTAs—as well as of GSP and DES/DDS—and the variables affecting it, primary data were computed to construct and calculate the following variables:

a) *Preferential trade value*: value of trade under the preferences granted by TAFTA, JTEPA, Japanese GSP or DES/DDS using PCOs and Customs records.

b) *Utilization rate (UR)*: Ratio, expressed as a percentage, between the value of exports or imports of a given item (coded at HS4 or HS6 level) under the preferences granted by TAFTA, JTEPA, Japanese GSP, or DES/DDS and the value of total exports or imports flows for that item. In some instances, only items for which FTAs or GSP provide a tariff margin larger than zero were computed (see below).<sup>164</sup>

Two methodological considerations are worth noting here. First, a significant share of the tariffs applied by any country, especially developed ones, is set at zero. For instance, in 2008—a middle year for the period of this study—Japan and Australia applied no tariff to 53.7% and 48.8% of lines, respectively. The same year Thailand and Malaysia applied a

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<sup>164</sup> Contrary to FTAs and GSP, were tariffs may be reduced but not eliminated, DES/DDS provide full exemption/drawback of import duties.

tariff of zero to 18.3% and 57.3% of their lines (WTO, 2009). It could be therefore argued that, in fairness, the UR of an FTA (or GSP) should be calculated only for lines where the FTA (or GSP) offers a preferential margin above zero with respect to applied multilateral tariffs. In fact, recent reports by the Thai Ministry of Commerce on overall UR have shifted to this calculation method. However, in strict sense, applying this methodology would require estimating, for each tariff code, the minimum preferential tariff margin that exceeds the cost of complying with ROOs, information that is not available. In addition, this is not the methodology applied for calculating URs of FTAs in other regions. Therefore, to allow comparison and unless otherwise indicated (e.g., selected cells in Tables 3 and 14), in this and other Essays of this Thesis, URs were computed with respect to total trade flows. Second, as noted by Kohpaiboon (2010), UR calculated out of PCOs could sometimes exceed 100%. This occurs because PCOs are requested before the good is actually traded and exporters could request PCOs for a volume of trade slightly higher than final actual trade. Whenever this occurred UR was adjusted to 100%.

- c) *UR rank*: Ranking of good codes at HS4 (or when appropriate, also at HS6) in descending order of their UR.
- d) *UR rank in reverse order*: As the UR rank but codes are ranked in ascending order of UR.
- e) *Utilization share*: Share, expressed as percentage, of the trade value for a given code and year (or period) under a preferential regimes (TAFTA, JTEPA, GSP, DES/DDS) with respect to the total value of goods traded under that regime during that year (or period).
- f) *Utilization share rank*: Ranking of codes at HS4 (or when appropriate, also at HS6) in descending order of their utilization share.

g) *Utilization share in reverse order*: As the utilization share rank but the ranking of codes is run in ascending order of utilization share.

h) *Preferential tariff margin*: As defined earlier, preferential tariff margin refers to the difference between the MFN applied tariff and the preferential tariff granted by the FTA, GSP or DES/DDS for a given good code and year.

i) *ROO restrictiveness index*. ROOs were obtained from the official FTA treaties and aggregated from H6 to HS4 level, always maintaining the highest level of restriction. ROO restrictiveness was then codified in a 1 to 7 scale as per Cadot et al (2006).<sup>165</sup>

## 5.2. Utilization of TAFTA and JTEPA

Since its implementation in January 2005, Thai exporters have made a high overall use of TAFTA preferences, most often exceeding 60% (Table 1). Considering that at the time Australia had bound as duty-free 20.9% of its lines and applied zero tariffs to 49.8%, TAFTA UR could be considered virtually complete. In contrast, utilization of TAFTA for imports of Australian products has been much lower and, at least for the period for which data are available, has shown a declining trend (Table 1).<sup>166</sup>

**Table 1: Utilization rates (%) of preferential trade regimes in Thai exports and imports to/from Australia**

| Regime*           | Trade Direction | 2004  | 2005  | 2006  | 2007  | 2008  | 2009   | 2010  | 2011  |
|-------------------|-----------------|-------|-------|-------|-------|-------|--------|-------|-------|
| TAFTA (Jan 2005)  | EXPORTS         |       | 67.11 | 63.00 | 70.76 | 62.50 | 50.29  | 59.90 | 62.94 |
| TAFTA (Jan 2005)  | IMPORTS         |       | 21.94 | 33.84 | 22.82 | 11.19 | 8.36** | N/A   | N/A   |
| DES/DDS Australia | IMPORTS         | 15.92 | 17.25 | 20.56 | 17.84 | 14.71 | 6.48** | N/A   | N/A   |

Source: Calculations by the Author using data from official records

\* TAFTA was implemented in January 1, 2005

\*\* Only for January-October 2009

<sup>165</sup> Many analyses of the impact of ROOs in American or European FTAs (Productivity Commission, 2004; Cadot et al., 2006; Portugal-Perez, 2009) code ROO restrictiveness into an ordinal index, often derived from the one originally constructed by Estevadeordal (2000) and Estevadeordal and Suominen (2006).

<sup>166</sup> Of note, whereas TAFTA URs for Thai exports in Athukorala and Kohpaiboon (2011) correspond with those calculated for this Essay, these authors reported lower values for TAFTA URs for imports. The reason for this discrepancy is unknown. In any case, Athukorala and Kohpaiboon (2011) also found declining URs of TAFTA for Thai imports. Contrary to our initial expectation, this decline in TAFTA utilization for Thai imports occurred despite a parallel decline in the use of DES/DDS (see below).

As in Athukorala and Kohpaiboon (2011), I found that utilization of TAFTA, for both exports and imports, is highly concentrated as the top 20 items at HS4 level—which comprises around 1,300 items—accounted for around 80% of all trade under TAFTA (Table 2). Concentration was even higher among the top 20 imported items from Australia that used DES/DDS (see below). However, it is important to note that overall bilateral trade is equally concentrated (Table 2), even after petroleum products, one of the main Thai imports from Australia, are excluded (see also below). In line with Hypothesis 2, there has been a decline in the concentration of TAFTA utilization for exports and imports over the period studied (Table 2). Concentration of overall exports to Australia has also declined but overall imports have experienced the opposite trend (Table 2).

**Table 2: Share of Top 20 items in Thai exports and imports to Australia (total and preferential trade flows) \***

| Regime   | 2004  | 2005  | 2006  | 2007  | 2008  | 2009    | 2010  | 2011  |
|--|-------|-------|-------|-------|-------|---------|-------|-------|
| Top 20 overall exports (% total exports)                     | 64.13 | 64.36 | 70.39 | 70.77 | 74.15 | 78.79   | 74.78 | 64.69 |
| Top 20 exports under TAFTA (% total exports under TAFTA)     |       | 85.56 | 80.14 | 83.34 | 80.70 | 80.55   | 81.34 | 66.86 |
| Top 20 overall imports (% total imports)                     | 81.95 | 86.08 | 84.09 | 84.79 | 85.34 | 84.39   | 88.16 | 87.32 |
| Top 20 imports under TAFTA (% total imports under TAFTA)     |       | 88.92 | 88.08 | 81.66 | 74.69 | 78.03** | N/A   | N/A   |
| Top 20 imports under DES/DDS (% total imports under DES/DDS) | 94.20 | 90.31 | 92.74 | 92.04 | 91.67 | 86.73** | N/A   | N/A   |

Source: Calculations by the Author using data from official records

\* Top 20 items at HS4 level

\*\* Only for January–October 2009

Although Japan has bound 100% of its tariffs and binding overhangs are small, average bound and applied tariffs in the agriculture sector in 2006 were 28.4% and 24.3%, respectively. In line with Hypothesis 1 and reflecting its historical protectionist stand on agricultural items, Japan excluded rice and sugar from its concessions to Thailand in JTEPA, two products that do not receive tariff reductions in the GSP program. In turn, Japan provided full elimination of tariffs within five years of fruits and vegetables, fresh

and processed seafood and processed chicken, all key Thai exports that already benefited from GSP preferential treatment.

In the case of Thailand, and also confirming Hypothesis 1, I found that for some goods with unbound tariffs or with significant binding overhang, Thailand initially offered in JTEPA preferential tariffs that were above the applied MFN tariff. For instance, of the top 20 items at HS6 that Thailand imported from Japan in 2005 (before JTEPA implementation), sixteen were either unbound or bound at two to six times the applied tariff. Interestingly, Thai concessions in JTEPA for seven of these sixteen items initially exceeded by 25-100% the applied tariff and only reached the applied tariff level several years after implementation.

Utilization rates of JTEPA have been significantly lower than for TAFTA in both directions (Table 3). In the case of Thai exports, it is worth noting again that in 2006, a year before JTEPA entered into force, Japan had 55.1% of its tariffs bound as duty-free. When the UR is calculated only for items for which the FTA offered Thai exporters a preferential tariff margin greater than zero, UR of JTEPA for exports during the period 2007-2011 stood at around 60% (see figures inside parentheses in Table 3).

**Table 3: Utilization rates (%) of preferential regimes in Thai exports and imports to/from Japan \***

| Regime**         | Trade Direction | 2004          | 2005         | 2006         | 2007***       | 2008          | 2009          | 2010          | 2011          |
|------------------|-----------------|---------------|--------------|--------------|---------------|---------------|---------------|---------------|---------------|
| JTEPA (Nov 2007) | EXPORTS         |               |              |              | 20.27 (59.68) | 21.30 (52.12) | 25.37 (61.64) | 23.24 (60.94) | 25.08 (63.83) |
| Japanese GSP     | EXPORTS         | 12.28 (38.37) | 9.67 (30.58) | 8.17 (25.81) | 7.13 (23.12)  | 0.66 (1.76)   | 0.57 (1.56)   | 0.52 (1.56)   | 0.19 (0.74)   |
| JTEPA (Nov 2007) | IMPORTS         |               |              |              | 3.25          | 7.72          | 3.50****      | N/A           | N/A           |
| DES/DDS Japan    | IMPORTS         | N/A           | N/A          | N/A          | 44.3          | 28.94         | 8.27****      | N/A           | N/A           |

Source: Calculations by the Author using data from official record

\* Overall utilization rates for JTEPA and GSP for Thai exports were calculated for all tariff codes (figures outside parentheses) or only for tariff codes where JTEPA and GSP offered preferential tariff margins above 0 (figures inside parentheses)

\*\* JTEPA was implemented in November 1, 2007

\*\*\* Utilization of JTEPA (exports, imports) corresponds to the first two months since implementation (November-December 2007)

\*\*\*\* Only for the period January-October 2009

On the import side, I only obtained information of JTEPA utilization for the first 23 months (Table 3). Despite surveys indicating the eagerness of Japanese subsidiaries in Thailand for an FTA that liberalize imports of parts and components (JETRO, 2007), utilization of JTEPA preferences for import of Japanese products was very low during this period. This could be explained on the fact that Thailand liberalization schedules take longer than Japanese ones to provide significant preferential tariff margins as well as on the higher use of DES/DDS (Table 3 and see below).<sup>167</sup>

Although overall trade flows between Thailand and Japan are not as concentrated as for Thailand-Australia bilateral trade, utilization of JTEPA is also highly concentrated within the top 20 items at HS4, especially for imports (Table 4). For the short period for which data are available, concentration in the utilization of JTEPA for imports has declined (Hypothesis 2). Utilization of unilateral schemes for both exports (GSP) and imports (DES/DDS) is also highly concentrated (see below).

**Table 4: Share of Top 20 items in Thai exports and imports to Japan  
(total and preferential trade flows) \***

| Regime  | 2004  | 2005  | 2006  | 2007** | 2008  | 2009     | 2010  | 2011  |
|---|-------|-------|-------|--------|-------|----------|-------|-------|
| Top 20 overall exports<br>(% total exports)                               | 45.80 | 46.44 | 47.21 | 45.50  | 47.60 | 44.44    | 44.00 | 43.39 |
| Top 20 exports under JTEPA<br>(% total exports under JTEPA)               |       |       |       | 71.74  | 72.90 | 73.21    | 67.34 | N/A   |
| Top 20 exports under Japanese GSP<br>(% total exports under Japanese GSP) | 61.04 | 67.08 | 64.00 | 61.90  | 90.76 | 96.10    | 100   | 100   |
| Top 20 overall imports<br>(% total imports)                               | 50.73 | 49.77 | 44.63 | 46.70  | 43.90 | 45.10    | 44.99 | 45.39 |
| Top 20 imports under JTEPA<br>(% total imports under JTEPA)               |       |       |       | 96.42  | 91.70 | 80.29*** | N/A   | N/A   |
| Top 20 imports under DES/DDS<br>(% total imports under DES/DDS)           | N/A   | N/A   | N/A   | 60.53  | 59.42 | 55.64*** | N/A   | N/A   |

Source: Calculations by the Author using data from official records

\* Top 20 items at HS4 level

\*\* Utilization of JTEPA (exports, imports) corresponds to the first two months since implementation (November-December 2007)

\*\*\* Only for the period January-October 2009

<sup>167</sup> Utilization of DES/DDS significantly declined after implementation of JTEPA in November 2007 although this has not been translated into sustained use of JTEPA for imports, JTEPA UR for imports increased in 2008 but declined in 2009. The reason for this discrepancy is not known.

### **5.3. Political economy of TAFTA and JTEPA utilization**

Empirical evidence indicates that over time the private sector in Thailand has been increasingly involved in the formulation of Thai FTAs. For some economic sectors and FTAs, businesses have actually taken a proactive leading role and pushed the government to initiate negotiations (Essay 1). Hypothesis 3 postulates that sectors that succeeded in their lobbying efforts in favor of FTA liberalization should make high use of preferential tariffs once the FTA enters into force. To test this hypothesis, quantitative data on disaggregated sectoral utilization of TAFTA and JTEPA were confronted with qualitative evidence of previous lobbying by those sectors in favor of these agreements.

As elaborated at length in Essays 1 and 3, the main supporters of TAFTA were Japanese and American carmakers seeking to integrate Australia within the Thailand and ASEAN automotive network. Interestingly, between 2005 and 2011, out of the over 1,300 items tradable at HS4, just two codes, 8704 (pickup trucks) and 8703 (passenger vehicles), jointly accounted for 43-62% of TAFTA utilization by Thai exporters (Table 5). In line with Athukorala and Kohpaiboon (2011), it was found that virtually 100% of Thai exports of vehicles to Australia in the period 2005-2011 took place under TAFTA preferences.

Important to the argument is to distinguish between the relative weight that preferential trade of a given item (or sector) has in overall FTA utilization—referred here as UR share—and the extent to which importers/exporters of that item (or sector) have used FTA preferences—UR itself—, independently of whether this utilization translated into high overall trade volumes. Besides automotive products, TAFTA has also been critical for Thai export of other goods that, despite accounting for a small share in total utilization of TAFTA, have made almost complete utilization of preferential tariffs. Thus, during 2005-2011, Thailand-made goods at HS6 exported to Australia that used TAFTA preferences for more than 80% of their value include refrigerators and air conditioners, precious stones and

jewelry, glass products, processed flour, fruits, and footwear, representing some of the sectors that pushed in favor of TAFTA during its formulation stage (Table 5 and Essay 1).<sup>168</sup> In contrast, while Thai garment producers proactively pushed for the liberalization of the Australian market and eventually got their preferences embodied in TAFTA, their UR has averaged 44.3%. The reason for this relatively low UR by Thai garment exporters is to be found in the fact that in 2005, coinciding with the entry into force of TAFTA, Australia multilaterally reduced its applied MFN tariffs on textiles and garments, thus eroding the preferential margin granted by TAFTA. This example supports Hypothesis 1 and illustrates how preferential FTA liberalization is often accompanied by subsequent (or parallel) tariff reductions at the multilateral levels (Ornelas, 2005a; Ornelas, 2005b). On the import side, use of TAFTA has been highly concentrated on importers of metal products and vegetables (Table 5).

As TAFTA liberalization schedules proceeded, the number of goods that utilized its preferences increased. However, high concentration in bilateral trade flows has meant that the largest users off TAFTA have barely changed over time. For the period analyzed, the ranking of the top 20 items at HS4 by utilization share include 34 items in the export side and 35 in for imports (Table 5).

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<sup>168</sup> This analysis was conducted at HS6 level, in addition to the HS4 shown in Table 5, to increase specification in UR.

**Table 5: Top 20 items in Thai exports and imports under TAFTA and evidence of lobbying**

| Top 20 items in Thai exports under TAFTA January 2005-December 2011 *  | Evidence of lobbying *** | Top 20 items in Thai imports under TAFTA January 2005-October 2009 **                              | Evidence of lobbying *** |
|--|--------------------------|--|--------------------------|
| Vehicles and automotive parts (8704, 8703, 8409,4011)  | +                        | Metals, metal ores slag and articles thereof (2608,2609,7204,7208,7225,7403, 7601,7606, 7801,7901) | +                        |
| Air conditioners, washing machines, refrigerators, vacuum pumps and general machinery (8415, 8450,8418,8413,9414, 8419,8421,8409,8481) | +                        | Dairy products (0402,0406)   | +                        |
| Preparation of fish (1604)   | +                        | Edible fruits and nuts (0802,0805,0806, 0808)  |                          |
| Articles of iron and steel (7306, 7308,7312)   | +                        | Cereals and milling industries and preparations of cereals (1001,1003,1107, 1109,1901)             | +                        |
| Jewelry (7113)   | +                        | Automotive parts (8708)  |                          |
| Plastics and components (3920,3923,3901, 3902,3907,3920)   |                          | Wool (5101)  |                          |
| Furniture (9401,9406)  |                          | Dyes and pigments (3206)   |                          |
| Electrical machinery and parts (8544,8501)   |                          | Animal feed (2301, 2309)   | +                        |
| Cosmetics and toilet products (3305,3306)  |                          | Pharmaceutical products (3004)   |                          |
| Paper (4802,4818)  |                          | Edible vegetables (0704,0706,0712)   | +                        |
| Light boats (8905)   |                          | Wood and pulp of wood (4407,4707)  | +                        |
| Optical equipment (9001)   |                          | Wine (2204)  |                          |
|  |                          | Inorganic chemicals (2818)   |                          |
|  |                          | Coal (2701)  |                          |
|  |                          | Bovine meat (0201)   | +                        |

Source: Calculations by the Author using data from official records (\*) and (\*\*) and semi-structured interviews (\*\*\*)

\* Top 20 items at HS4 exported by Thailand to Australia under TAFTA preferences

\*\* Top 20 items at HS4 imported by Thailand from Australia under TAFTA preferences

\*\*\* Evidence of lobbying by producers of the indicated items, as described in Essay 1, is coded by a “+” sign. No symbol indicates that field research could not find evidence of business lobbying, although it cannot be excluded that it actually existed

Hypothesis 3 is also supported in the case of JTEPA. Utilization of JTEPA by Thai exporters has been highly concentrated among sectors whose business associations proactively pushed for the deal before and during negotiations (Table 6). For instance, in 2011, exports of seafood, processed food, plastics and textiles and garments jointly accounted for 70% of all Thai exports under JTEPA. Equally relevant, these Thai sectors made use of JTEPA in most of their exports to Japan.

**Table 6: Top 20 items in Thai exports and imports under JTEPA and evidence of lobbying**

| Top 20 items in Thai exports under JTEPA November 2007-December 2011 *  | Evidence of lobbying *** | Top 20 items in Thai imports under JTEPA November 2007-October 2009 **   | Evidence of lobbying *** |
|---|--------------------------|--|--------------------------|
| Preparations of meat, fish and crustaceans (1602,1604,1605)   | +                        | Iron and steel and articles thereof (bars and tubes) for non-automotive use (7228,7304)  | +                        |
| Fish and crustaceans, molluscs (0304,0305, 0306,307)  | +                        | Vehicles, automotive parts and iron and steel for the automotive industry (4011, 7208,7209,7210,7219,8702,8703,8704, 8708,8482,8483) | +                        |
| Dextrins (3505)   |                          | Machinery and mechanical appliances (8421,8427,8429)   |                          |
| Polyethers, epoxides and polyesters (3907), plastic plates, sheets and films (3920), plastic containers and other miscellaneous (3923,3926) |                          | Synthetic filaments and fibers (5402,5503) and worn clothing (6309)  | +                        |
| Springs of iron and steel (7320)  |                          | Non-crude oil from petrol (2710)   |                          |
| Jewelry (7113)  | +                        | Automatic control instruments and parts (9032)   |                          |
| Organic chemicals (2931,2940)   |                          | Dyes and pigments (3212)   |                          |
| Miscellaneous aluminium articles (7610)   |                          | Organic chemicals (2930), miscellaneous chemicals (3815,3817)  |                          |
| Frozen vegetables (0710) and preparations of fruits and nuts (2008)   | +                        | Electrical machinery and equipment (8504, 8528,8536)   | +                        |
| Miscellaneous edible preparations, sauces and condiments (2103)   | +                        | Glues and adhesives (3506)   |                          |
| Toilet products (3307)  |                          | Apples (0808)  | +                        |
| Synthetic filaments (5402) and nonwovens (5603)   | +                        | Lubricants and antirust preparations (3403)  |                          |
| Apparel and clothing accessories knitted or crocheted, underwear items (6109,6115)  | +                        |  |                          |
| Inorganic chemicals of carbon (2803)  |                          |  |                          |
| Float glass (7005)  |                          |  |                          |

Source: Calculations by the Author using data from official records (\*) and (\*\*) and semi-structured interviews (\*\*\*)

\* Top 20 items at HS4 exported by Thailand to Japan under JTEPA preferences

\*\* Top 20 items at HS4 imported by Thailand from Japan under JTEPA preferences

\*\*\* Evidence of lobbying by producers of the indicated items, as described in Essay 1, is coded by a “+” sign. No symbol indicates that field research could not find evidence of business lobbying, although it cannot be excluded that it actually existed

As described elsewhere in this Thesis, Thailand made very few concessions in JTEPA to liberalize its automotive industry despite strong pressure from Japanese carmakers. Still, and reflecting the strong original interest of these firms in the FTA, in 2009—the latest year for which data were made available to us—rolled steel and vehicles and automotive parts represented 46.1% and 21.1%, respectively of Thai imports under JTEPA (Table 6).<sup>169</sup>

<sup>169</sup> These figures are relatively high when it is considered that Thai tariffs on automotive products will be phased over several years (see Table 4 in Essay 4).

As in TAFTA, the items (and sectors) accounting for the largest utilization share in JTEPA have maintained fairly constant over time and, for the period for which data were obtained, the top 20 items at HS4 included just 27 and 32 items in the export and import sides, respectively (Table 6).

#### **5.4. Variables affecting utilization of TAFTA and JTEPA**

This section, and the corresponding for Malaysia below, sought to expand the analysis of variables affecting FTA utilization conducted by Kohpaiboon (2010). It was found here that the value of preferential trade conducted under TAFTA and JTEPA correlated with all other variables related to FTA utilization, namely, FTA UR, UR rank, UR rank reverse, utilization share, utilization share rank and utilization share rank reverse (not shown). As expected, results indicated that these six variables significantly correlated with the preferential tariff margin granted by each of these FTAs for both export and import flows (Table 7 for UR of JTEPA for exports, not shown for the rest).<sup>170</sup>

Hypothesis 4 projected that Thai producers that benefited from GSP and DES/DDS before an FTA would actively lobby to make reduced tariffs in these schemes non-removable as part of the FTA and that they would also make early and high use of FTA afterwards. To test these arguments, I first explored the utilization of DES/DDS before implementation of TAFTA and of GSP and DES/DDS before entering into force of JTEPA. As expected—although to the best of my knowledge not previously reported—all seven utilization variables for the Japanese GSP correlated with the preferential margin offered by the program (Table 8 for UR, not shown for the rest). All variables associated to the utilization of DES/DDS for imports from Australia and Japan were also significantly correlated to the preferential tariff margin (data not shown).

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<sup>170</sup> No correlation existed between the six utilization variables for TAFTA and JTEPA and the absolute preferential tariff level they offered. If an FTA applies a relatively low tariff on a particular item but there is only a small or no difference with the MFN applied tariff, there is no incentive to use the FTA. Only the preferential tariff margin is relevant to the utilization of FTAs.

**Table 7: Correlation between JTEPA UR for Thai exports and JTEPA preferential tariff margin \***

|   | PTM<br>MFN-JTEPA<br>2007 | PTM<br>MFN-JTEPA<br>2008 | PTM<br>MFN-JTEPA<br>2009 |
|---|--------------------------|--------------------------|--------------------------|
| <b>JTEPA UR<br/>for Thai exports<br/>2007</b> | 0.213 (< 0.001)          |                          |                          |
| <b>JTEPA UR<br/>for Thai exports<br/>2008</b> |                          | 0.208 (< 0.001)          |                          |
| <b>JTEPA UR<br/>for Thai exports<br/>2009</b> |                          |                          | 0.215 (< 0.001)          |

Source: Calculations by the Author using data from official records

Abbreviations: JTEPA UR: JTEPA utilization rate. PTM MFN-JTEPA: preferential tariff margin MFN-JTEPA

\* Values refer to the Pearson correlation coefficient (p value, significance level)

**Table 8: Correlation between Japanese GSP UR for Thai exports and GSP preferential tariff margin \***

|                                  | GSP UR<br>2004  | GSP UR<br>2005  | GSP UR<br>2006  | GSP UR<br>2007 (Jan-Oct) |
|----------------------------------|-----------------|-----------------|-----------------|--------------------------|
| <b>PTM MFN-GSP<br/>2004-2007</b> | 0.206 (< 0.001) | 0.192 (< 0.001) | 0.222 (< 0.001) | 0.217 (< 0.001)          |

Source: Calculations by the Author using data from official records

Abbreviations: GSP UR: Japanese GSP utilization rate. PTM MFN-GSP: preferential tariff margin between MFN and GSP tariffs

\* Values refer to the Pearson correlation coefficient (p value, significance level)

Before JTEPA implementation, utilization of the Japanese GSP program by Thai exporters amounted to around 10% of total exports to Japan (Table 3). As discussed earlier, given that Japan has about half of its tariffs bound as tariff free, when I computed only tariff codes for which GSP offered preferential tariff margins above zero, over a quarter of all Thai exports to Japan (and up to 38.3% in 2004) were conducted under GSP preferences (figures inside parentheses in Table 3). Likewise, and in keeping with the high number of Japanese subsidiaries in Thailand, the UR of DES/DDS privileges for Thai imports of Japanese products before JTEPA was much higher, in fact higher than JTEPA has ever

reached—in 2007, 44.3% of all imports from Japan benefited from DES/DDS (Table 3).<sup>171</sup> Utilization rates of DES/DDS for imports of Australian goods before TAFTA implementation were lower but still relevant at around 16% (Table 1).<sup>172</sup>

As in their corresponding FTAs, utilization of these unilateral schemes has been highly concentrated, particularly in the case of Thai imports from Australia under DES/DDS (Tables 2 and 4). For instance, close to 40% of all Thai exports under the Japanese GSP before JTEPA corresponded to plastic and processed food. As predicted by Hypothesis 4, utilization of Japanese GSP preferences has declined as JTEPA liberalization has proceeded (Table 3) while its utilization has become increasingly concentrated (Table 4).<sup>173</sup> The fact that in 2011, four years into the agreement, some exporters still used GSP preferences points to the resistance by Japan to bind into JTEPA some of the preferences it extends unilaterally under the GSP.

Next, I compared the most traded items under GSP and DES/DDS preferences before FTA implementation with the most traded items under the corresponding FTA (Tables 9, 10 and 11). While there are no data available for the Australian GSP, Thai imports from Australia under DES/DDS in 2004 showed a high overlap with the products imported by Thailand from Australia under TAFTA during 2005-2009 (Table 9, shadowed cells indicate product overlap across both sides of the table). Once again, this overlap between the top 20 most traded items under both regimes is particularly striking when it is considered that HS4 covers over 1,300 items. Likewise, a high degree of product overlap was found between Thai exports to Japan under GSP in the period 2004-2007, before JTEPA implementation, and Thai exports under JTEPA afterwards (Table 10). Some level

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<sup>171</sup> The higher use of DES/DDS compared to JTEPA is explained by the fact that, although limited to selected products, firms and geographical areas, DES/DDS offer full exemption of import duties whereas tariffs concessions by Thailand in JTEPA may take many years to reach tariff free rate.

<sup>172</sup> Contrary to FTAs, that during the phasing out period provide only partial tariff relief, DES/DDS grant complete remission or drawback of import duties.

<sup>173</sup> Also in support of our arguments, utilization rates of DES/DDS for imports from Australia and Japan slightly declined with a lag of several years after TAFTA and JTEPA implementation, although concentration among their users remains high (Tables 1 and 3).

of concurrence was also observed between the top 20 Thai imports from Japan under DES/DDS before JTEPA implementation with the pattern of most imported products under JTEPA (Table 11, see also below). Altogether, these data confirm Hypothesis 4, users of GSP and DES/DDS not only lobbied governments to secure these tariff reductions in an FTA (Essay 1) but they have also made a high use of FTAs once implemented (this Essay).

**Table 9: Top 20 items in Thai imports from Australia under DES/DDS and TAFTA**

| Top 20 items in Thai imports from Australia under DES/DDS<br>January 2004-December 2004 *                      | Top 20 items in Thai imports from Australia under TAFTA<br>January 2005-October 2009*   |
|--|---|
| Articles of cooper (7403,7408), of zinc (7901), of lead (7801)   | Aluminium (7601,7606)   |
| Iron and Steel (7201,7204,7208,7209,7210, 7214,7216, 7217,7228)  | Wool (5101)   |
| Aluminium (7601,7602,7606)   | Edible fruits and nuts (0802,0805,0806,0808)  |
| Metal ores slag (2603,2608,2609,2614,2615)   | Metal ores slag (2608,2609)   |
| General machinery (8419,8420,8424,8479,8481)<br>centrifuges (8421), engines, pumps & turbines (8407,8411,8414) | Cereals and milling industries and preparations of cereals (1001,1003, 1107,1109, 1901) |
| Air conditioning machine (8415), dishwashes (8422)   | Dairy products (0402, 0406)   |
| Automotive parts (8708)  | Automotive parts (8708)   |
| Wool (5101,5105)   | Iron and Steel (7204,7208,7225)   |
| Dairy products (0401,0402,0403,0404,0405)  | Articles of cooper (7403), of lead (7801), of zinc (7901)                               |
| Inorganic chemicals (2804,2808,2818)   | Animal feed (2301,2309)   |
| Paper and articles of paper (4803,4804,4805)   | Edible vegetables (0704,0706,0712)  |
| Plastics and articles of thereof (3907,3919,3921,3923,3926)  | Pharmaceutical products (3004)  |
| Automatic data processing machines (8471,8479,8481)  | Dyes and pigments (3206)  |
| Electrical machinery and equipment (8515),<br>electronic integrated circuits & related (8537,8542, 8544)       | Wood and pulp of wood (4407, 4707)  |
| Mineral fuels and oils (2707)  | Wine (2204)   |
| Cereals and milling industries and preparations of cereals (1001,1101,1901)                                    | Inorganic chemicals (2818)  |
| Miscellaneous chemical products (3810,3811,3816)   | Bovine meat (0201)  |
| Animal feeding (2309)  | Coal (2701)   |
| Dyes (3206)  |   |
| Optical and photographic equip. (9001,9032)  |   |
| Oil seeds and grains (1209,1210)   |   |
| Bovine meat (0202)   |   |
| Wood and articles of wood (4411) and furniture (9405)  |   |
| Albumin and starches (3501)  |   |
| Textiles (5811,6005, 6006)   |   |

Source: Calculations by the Author using data from official records

\* Top 20 items at HS4 level for the indicated regime and period. Shadowed cells refer to product overlap across both sides of the table

**Table 10: Top 20 items in Thai exports to Japan under Japanese GSP and JTEPA**

| Top 20 items in Thai exports to Japan under Japanese GSP<br>January 2004-October 2007 *   | Top 20 items in Thai exports to Japan under JTEPA<br>November 2007-December 2011 *  |
|---|---|
| Processed seafood (1604,1605)   | Processed seafood (1602,1604,1605)  |
| Polyethers,expoxides and polyesters (3907)<br>Plastic plates, sheets and films (3920)<br>Plastic containers and other miscellaneous (3923,3926) | Fish and crustaceans (0304,0306,0307)   |
| Float glass (7005) and safety glass (7007)  | Polyethers,expoxides and polyesters (3907)<br>Plastic plates, sheets and films (3920)<br>Plastic containers and other miscellaneous (3923,3926) |
| Dextrins (3505)   | Dextrins (3505)   |
| Sauces and condiments (2103)  | Springs of iron and steel (7320)  |
| Hats and headgear (6505)  | Jewelry (7113)  |
| Organic chemicals (2916,2917,2922,2940)   | Inorganic chemicals of carbon (2803)  |
| Miscellaneous metals (8301)   | Preparations of fruits and nuts (2008)  |
| Jewelry (7113)  | Nonwovens (5603)  |
| Screws and bolts of iron and steel (7318)   | Frozen vegetables (0710)  |
| Miscellaneous aluminium articles (7610,7616)  | Miscellaneous aluminium articles (7610)   |
| Toys (9503)   | Organic chemicals (2931,2940)   |
| Insulated wire and cable (8544)   | Sauces and condiments (2103)  |
| Wood (4409)   | Toilet paper (3307)   |
| Paper (4802)  | Float glass (7005)  |
| Vacuum flasks (9617)  | Underwear items (6109,6115)   |
| Nonwovens, knotted net of twine (5603,5608)   | Synthetic filament yarn (5402)  |
| Inorganic chemicals of carbon (2803)  |   |
| Synthetic filament yarn (5402)  |   |

Source: Calculations by the Author using data from official records

\* Top 20 items at HS4 level for the indicated regime and period. Shadowed cells refer to product overlap across both sides of the table

**Table 11: Top 20 items in Thai imports from Japan under DES/DDS and JTEPA**

| Top 20 items in Thai imports from Japan under DES/DDS<br>January 2007-October 2007*   | Top 20 items in Thai imports from Japan under JTEPA<br>November 2007-October 2009* |
|---|--|
| Automotive parts (7318,8708) including engines, transmissions and parts thereof (8408,8409,8483,8511)   | Flat rolled steel for the automotive industry (7208,7209,7210,7219)                |
| Flat rolled steel for the automotive industry (7208,7209,7210,7219,7225)  | Passenger and commercial vehicles (8702,8703,8704)                                 |
| Bars and tubes (7213,7227,7228,7304) and miscellaneous articles (7326) of iron and steel  | Automotive parts (4011,8482,8483,8708)   |
| Parts for TV and radios (8529), electrical switches (8536),   | Bars and tubes from iron and steel (7228,7304)                                     |
| Electrical integrated circuits (8542), printed circuits (8534), boards and panels with electrical switches (8537), semiconductors (8541)        | Fork-lift trucks, bulldozers other work trucks (8427,8429)                         |
| Plastics and articles thereof (3907,3919,3923,3925,3926) and synthetic rubber (4002)  | Synthetic filaments and fibers (5402,5503)   |
| Parts for regulating and control instruments (9032) and miscellaneous precision machines (9031)   | Non-crude oil from petrol (2710)   |
| Miscellaneous electrical machines with indicating functions (8543). Parts for electrical machines (8538)  | TV receivers (8528), electrical switches (8536), electrical transformers (8504)    |
| Insulating fittings (8547)  | Glues and adhesives (3506)   |
| Air or vacuum pumps (8414)  | Centrifuges (8421)   |
| Machines for working plastic and rubber (8477), molding boxes for metal foundry (8480), miscellaneous machines (8479), interchange folds (8507) | Miscellaneous chemicals (3815,3817)  |
| Inorganic chemicals (2843,2846)   | Dyes and pigments (3212)   |
| Turbojets and other gas turbines (8411)   | Organic sulfur compounds (2930)  |
| Unrecorded media for sound (8523)   | Parts for regulating and control instruments (9032)                                |
| Phenols (2907)  | Lubricants and antirust preparations (3403)  |
| Parts for typewriters and office machines (8473)  | Apples (0808)  |
| Motorcycles (8711)  | Worn textiles and clothing (6309)  |
| Seats (9401)  |  |
| Synthetic filaments (5402)  |  |
| Cooper and articles thereof (7403,7409)   |  |
| Batteries and cells (8506)  |  |

Source: Calculations by the Author using data from official records

\* Top 20 items at HS4 level for the indicated regime and period. Shadowed cells refer to product overlap across both sides of the table

The overlap between the products that benefited from unilateral regimes (GSP and DES/DDS) and FTAs was then tested statistically for all items traded at HS4, not just the top 20 most traded items. It was found a significant positive correlation between the UR of Japanese GSP in 2007 and the UR of JTEPA since then (Table 12). The strength of this correlation has decreased over time, probably reflecting parallel reductions in external MFN tariffs by Japan and in line with the arguments by Ornelas (2005a, 2005b). Similar correlation between GSP and JTEPA was found for the rest of utilization-related variables (UR rank, UR rank reverse, utilization share, utilization share rank, utilization share rank reverse) (not shown). There has also been a decline over time in the correlation between the utilization share of GSP and JTEPA that could be explained on the fact that, in support of Hypothesis 4, a significant share of the initial utilization of JTEPA corresponded to Thai products previously exported under GSP, share that diminished over time as JTEPA schedules have progressively extended to cover more sectors.

**Table 12: Correlation between URs of JTEPA and Japanese GSP for Thai exports**

|   | GSP UR<br>2004  | GSP UR<br>2005  | GSP UR<br>2006  | GSP UR<br>Jan-Oct 2007 |
|---|-----------------|-----------------|-----------------|------------------------|
| <b>JTEPA UR<br/>for Thai exports<br/>Nov-Dec 2007</b> | 0.531 (< 0.001) | 0.533 (< 0.001) | 0.557 (< 0.001) | 0.595 (< 0.001)        |
| <b>JTEPA UR<br/>for Thai exports<br/>2008</b>         | 0.533 (< 0.001) | 0.508 (< 0.001) | 0.511 (< 0.001) | 0.563 (< 0.001)        |
| <b>JTEPA UR<br/>for Thai exports<br/>2009</b>         | 0.569 (< 0.001) | 0.528 (< 0.001) | 0.531 (< 0.001) | 0.546 (< 0.001)        |
| <b>JTEPA UR<br/>for Thai exports<br/>2010</b>         | 0.396 (< 0.001) | 0.399 (< 0.001) | 0.424 (< 0.001) | 0.442 (< 0.001)        |

Source: Calculations by the Author using data from official records.

Abbreviations: JTEPA UR: JTEPA utilization rate. Jap GSP UR: Japanese GSP utilization rate.

\* Values indicate Pearson correlation coefficient (p value, significance level)

In line with Table 11, there was also a significant positive correlation between DES/DDS and JTEPA when the items imported by Thailand from Japan under both

regimes ranked by their share in overall utilization (utilization rank share and utilization share rank reverse) was compared (Table 13 and data not shown).<sup>174</sup>

**Table 13: Correlation between utilization share rank (in reverse order) of JTEPA and DES/DDS for Thai imports**

|   | DES/DDS utilization share rank reverse for Thai imports from Japan January-October 2007 |
|---|---|
| <b>JTEPA utilization share rank reverse for Thai imports November-December 2007</b> | 0.271 (< 0.001)   |
| <b>JTEPA utilization share rank reverse for Thai imports 2008</b>                   | 0.427 (< 0.001)   |
| <b>JTEPA utilization share rank reverse for Thai imports 2009</b>                   | 0.477 (< 0.001)   |

Source: Calculations by the Author using data from official records.

\* Values indicate Pearson correlation coefficient (p value, significance level)

It would be expected that once producers that previously benefited from GSP or DDS/DDS start using FTAs, their utilization of these unilateral schemes will decrease and concentration among users increase (Hypothesis 4). Indeed, it was found that the UR of Japanese GSP declined from 7.13% of total Thai exports to Japan during 2007 to just 0.66% in 2008, once JTEPA entered into force in November 2007, while concentration in its use increase (Tables 3 and 4). These results reinforce the argument as JTEPA liberalized completely and from the start most items for which Japan offered tariff reductions through GSP (Hypotheses 1 and 4). Nevertheless, as also posited by Hypothesis 1, as FTAs involve non-removable binding of concessions, liberalization of relatively more sensitive items, even if included in the GSP regime, have been phased out over long periods. Thus, although utilization of GSP in 2011 represented less than 0.2% of total Thai exports to Japan, GSP was still used for the export of 21 codes at HS6 levels. Most of these items correspond to processed fish products—that will be liberalized under JTEPA during

<sup>174</sup> However, there was not statistically significant correlation between the absolute level of utilization (UR) of JTEPA and DES/DDS for Thai imports from Japan (not shown).

2013—but also processed cereals and some chemicals that, remarkably, are excluded from liberalization under JTEPA but continue to be eligible under GSP. The resistance of Japan to liberalize in JTEPA items already benefiting from GSP attest to the relevance that developed countries attach to the unilateral character of GSP schemes and their exclusive discretion to maintain or remove these concessions.

Next, it was also examined the impact of ROOs in the utilization of Thai FTAs. Econometric analysis in Kohpaiboon (2010) estimated that in 2008 the cost imposed by ROOs restricted the use of Thai FTAs by the equivalent of an excess tariff of 2-10%. To my surprise, I did not find a negative correlation between the restrictiveness index of ROOs in TAFTA and JTEPA at HS4 level and the URs of these FTAs (not shown). Several arguments trying to account for this paradoxical result are provided in the concluding section of this essay.

## **6. Political economy and variables affecting utilization of Malaysian FTAs**

Next, it was analyzed the utilization of MJEPA and the variables affecting it. Malaysian has five more bilateral FTAs but they have been implemented very recently, so there is no sufficient historical data about their utilization, and/or they involve relatively small partners (see footnote 148). MJEPA also offers the possibility to compare its utilization with that of the Japanese GSP.

### ***6.1. Source of data and methodology***

The following primary data were obtained for this research:

a) *Value of bilateral trade flows between Malaysia and Japan.* Data were retrieved from the Trade Map database (Trade Map, undated). Data were collected mostly at the HS4 level (around 1,300 lines per year and for each trade direction) although some analyses

were also performed at HS6 level (around 5,700 lines per year and for each trade direction).

Data collected covered from January 2003 to up to July 2013.<sup>175</sup>

b) *Trade values for Malaysian exports under MJEPA.* Data on PCOs for MJEPA were provided by the Malaysian Ministry of International Trade and Industry. All the trade data was at HS4 level in the 2007 version of the Harmonized System. Collected PCOs covered exports under MJEPA from its implementation in July 2006 up to December 2010.<sup>176</sup>

c) *Trade values for Malaysian exports under Japanese GSP.* Data on PCOs were provided at HS4 level by the Malaysian Ministry of International Trade and Industry. PCOs for exports under Japanese GSP covered from January 2003 until December 2010. In 2010, GSP preferences were still used for the export of a very small number of items.

d) *Applied and bound multilateral tariffs in Malaysia and Japan.* Data were retrieved from the WTO's Integrated Data Base (WTO-IDB, undated) at HS6 level of tariff specification (around 5,500 lines per year) and aggregated down to HS4 level (around 1,300 lines per year). Tariff data were collected for the period between January 2003 and December 2010.

e) *Tariff schedules under MJEPA.* Data were retrieved from the MJEPA treaty, available from government websites (METI-MJEPA, undated; MITI, undated). Tariff schedules in MJEPA are specified at HS6 but collapsed to HS4 for comparison with PCO data. Tariff schedules were collected from its implementation date up to December 2010.

f) *Preferential tariffs under Japanese GSP.* Data were retrieved from the website of Japan's Customs and Tariff Bureau (Ministry of Finance) (Japan Customs, undated) for the

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<sup>175</sup> Although preferential trade data for Malaysian exports to Japan cover only until December 2010 (see below), overall trade flows have been examined up to July 2013.

<sup>176</sup> This research was unable to obtain administrative records for Malaysian imports from Japan under MJEPA preferences.

period between January 2003 and December 2010. Tariff data at HS8 level were aggregated down to HS4 for every year analyzed.

h) *Rules of origin in MJEPA*. Data were retrieved from the MJEPA treaty, available from government websites (METI-MJEPA, undated; MITI, undated).

To analyze the utilization of MJEPA and Japanese GSP preferences for the export of Malaysian products to Japan, I defined and computed the same variables described for the Thai case, namely: a) *Preferential trade value*, b) *UR*, c) *UR rank*, d) *UR rank in reverse order*, e) *Utilization share*, f) *Utilization share rank*, g) *Utilization share rank in reverse order*, h) *Preferential tariff margin*, and i) *ROO restrictiveness index*.

## 6.2. Utilization of MJEPA

Since its implementation in July 2006, utilization of MJEPA preferences for Malaysian exports to Japan has been even lower than for JTEPA, with URs around 10% (Table 14). As in JTEPA, the same disclaimer regarding the high level of Japanese tariffs bound as duty-free applies. As in JTEPA, this low level of overall utilization could be partly explained by the high level of Japanese tariffs bound as duty-free as well as the existence of long phase out periods.<sup>177</sup> When the UR is calculated only for tariff codes for which MJEPA offered a positive preferential tariff margin, UR of MJEPA for exports during the period 2006-2010 stood at around 20% (see figures inside parentheses in Table 14).

**Table 14: Utilization rates (%) of preferential trade regimes in Malaysian exports to Japan \***

| Regime**  | 2003          | 2004          | 2005          | Jan-June 2006 | July-Dec 2006 | 2007          | 2008          | 2009          | 2010         |
|---|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|--------------|
| <b>MJEPA UR for Malaysian exports (July 2006)</b> |               |               |               |               | 11.61 (22.58) | 12.22 (22.24) | 11.66 (18.64) | 11.53 (19.60) | 8.14 (17.30) |
| <b>Japanese GSP UR</b>                            | 10.51 (20.44) | 12.18 (24.73) | 12.48 (25.03) | 14.20 (22.45) | 0.37 (0.20)   | 0.04 (0.09)   | 0.07 (0.11)   | 0.06 (0.11)   | 0.02 (0.06)  |

Source: Calculations by the Author using data from official records

\* Overall utilization rates of MJEPA and GSP were calculated for all tariff codes (figures outside parentheses) or only for tariff codes where MJEPA and GSP offered preferential tariff margins above 0 (figures inside parentheses)

\*\* MJEPA was implemented in July 2006

<sup>177</sup> In 2006, the year before JTEPA entered into force, Japan had 55.1% of its tariffs codes bound at zero.

MJEPA, the first FTA implemented by Malaysia, did not gather from the local private sector the enthusiasm and support of later FTA negotiations with the United States (and TPP) or the European Union (Essay 1 and below). I was unable to obtain official records for imports under MJEPA, although considering that: a) Malaysian tariff schedules in MJEPA take longer to achieve complete liberalization than Japanese ones and b) Malaysia also provides DES/DDS, one could speculate that utilization of MJEPA preferences for the import of Japanese products could be also low.

As in the Thai case, utilization of MJEPA by Malaysian exporters has been highly concentrated among the top 20 codes at HS4 level that account for over 70% of total FTA utilization (Table 15). Of note, just four HS4 codes, namely, palm oil (1511) and plastics (3907, 3920, 3923) represent almost half of the value of all Malaysian items exported to Japan under MJEPA. Similar level of product concentration is observed for overall Malaysian exports to Japan (Table 15). Contrary to the initial proposition, concentration in MJEPA utilization has not declined in the first four and half years since implementation although since most tariffs phase out in waves, it could still decline in coming years. Alternatively, it is possible that Malaysian producers are using MJEPA mainly to export to Japan products previously traded under the Japanese GSP so the pattern has barely changed once GSP preferences were subsumed into MJEPA (see below). For the period preceding MJEPA implementation, utilization of GSP was also highly concentrated (see also below).

**Table 15: Share of Top 20 items in Malaysian exports to Japan  
(total and preferential trade flows) \***

| Trade regime   | 2003  | 2004  | 2005  | Jan-June 2006 | July-Dec 2006 | 2007  | 2008  | 2009  | 2010  |
|--|-------|-------|-------|---------------|---------------|-------|-------|-------|-------|
| Top 20 overall exports (% total exports)                               | 73.60 | 71.72 | 72.22 | 71.92         | 73.82         | 77.72 | 74.23 | 75.58 |       |
| Top 20 exports under MJEPA (% total exports under MJEPA)               |       |       |       |               | 71.20         | 70.91 | 72.78 | 72.12 | 73.38 |
| Top 20 exports under Japanese GSP (% total exports under Japanese GSP) | 67.10 | 73.20 | 77.34 | 79.59         | 71.45         | 100   | 100   | 100   | 100   |

Source: Calculations by the Author using data from official records

\* Top 20 items at HS4 level

### 6.3. Political economy of MJEPA utilization

In Malaysia, MJEPA was supported mainly by producers of palm oil, plastics, chemicals, and textiles and garments that eventually received lower tariffs in Japan thanks to MJEPA.

In line with Hypothesis 3, these items were among the top 20 exports to Japan under MJEPA preferences at HS4 level (Table 16). Firms in the wood and furniture, and metals industries also accounted for a large share of MJEPA utilization. Palm oil and plastics alone represented 45% of all Malaysian exports to Japan that used MJEPA preferences in 2011 (data from the Ministry of International Trade and Industry). It is worth noting that the list of the top 20 largest users of MJEPA in absolute terms has remained very homogeneous over time including only 28 items—out of 1,300 items traded at HS4—during the 2006-2010 period.

**Table 16: Top 20 items in Malaysia exports to Japan under MTEPA and evidence of lobbying**

| Top 20 items MJEPA exports<br>July 2006-December 2010 *  | Evidence<br>lobbying ** |
|--|-------------------------|
| Palm oil and its fractions (1511) and palm kernel, coconut and babassu oil (1513), cocoa butter, fat and oil (1804)  | +                       |
| Plastics plates, sheets and films (3920), plastic containers (3923), polyethers, exposides, polyesters and polymers of vinyl chloride in primary forms (3904,3907)                 | +                       |
| Organic chemicals (acyclic alcohols and halogenates, acyclic nonocarbox acids and halogens and polycarboxylic acids and anhydrous, halogenates and sulfurs, etc.) (2905,2915,2917) | +                       |
| Wood and articles thereof (wood sawn or chipped, wood continuously shaped, fileboard, veneered panels and similar laminated wood) (4407,4409,4411,4412) and furniture (9403)       |                         |
| Miscellaneous chemical products (insecticides, industrial monocarboxylic fatty acid oils from refining, binders for foundry moulds or cores (3808,3823,3824)                       | +                       |
| Wadding, felt and nonwovens and clothing accessories (gloves and mittens, nonwovens) (5603,6116)   | +                       |
| Electric transformers, static converters and inductors (8544)  | +                       |
| Cooper products (7410)   |                         |
| Crustaceans live (0306)  | +                       |
| Vacuum flasks and vessels (9617)   |                         |
| Automotive parts (8708)  |                         |
| Miscellaneous articles of base metal (8302)  |                         |
| Toilet paper (4818)  |                         |
| Refractory bricks and other ceramic construction articles (6902)   |                         |
| Handtools and tools used in agriculture (8001)   |                         |

Sources: Calculations by the Author using data from official records (\*) and semi-structured interviews (\*\*)

\* Top 20 items at HS4 exported by Malaysia to Japan under MJEPA preferences during the period July 2006-December 2010

\*\* Evidence of lobbying by producers of the indicated items, as described in Essay 1, is coded by a “+” sign. No symbol indicates that field research could not find evidence of business lobbying, although it cannot be excluded that it actually existed

#### 6.4. Variables affecting utilization of MJEPA

To the best of my knowledge, there are no studies on the utilization of Malaysian FTAs using official records. Therefore, I investigated whether or not the variables determining FTA utilization for Thai FTAs also apply to MJEPA. First, correlations among MFN, MJEPA and GSP tariffs at HS4 level were run. Importantly, it was found a strong correlation among tariffs in all three regimes, suggesting that, in line with Hypotheses 1 and 4, items protected behind high tariffs at the multilateral level receive higher tariffs in preferential regimes (Table 17). Or, in other words, preferential regimes, whether unilateral or reciprocal, tend to liberalize faster and more those items that already receive low MFN tariffs.

**Table 17: Correlation between tariffs under MFN, MJEPA and Japanese GSP regimes \***

|                                   | MJEPA tariffs 2006 | MJEPA tariffs 2007 | MJEPA tariffs 2008 | MJEPA tariffs 2009 | MJEPA tariffs 2010 | MFN tariffs 2007-2010 ** | GSP tariffs 2003-2005 ** |
|-----------------------------------|--------------------|--------------------|--------------------|--------------------|--------------------|--------------------------|--------------------------|
| Japanese GSP Tariffs 2003-2005 ** | 852 (<0.001)       | 0.852 (<0.001)     | 0.849 (<0.001)     | 0.815 (<0.001)     | 0.844 (<0.001)     | 0.884 (<0.001)           |                          |
| MFN tariffs 2007-2010 **          | 0.844 (<0.001)     | 0.841 (<0.001)     | 0.836 (<0.001)     | 0.829 (<0.001)     | 0.824 (<0.001)     |                          | 0.884 (<0.001)           |

Source: Calculations by the Author using data from official records

\* Values shown indicate Pearson correlation coefficient (p value, significance level)

\*\* For most items, MFN and Japanese GSP tariffs suffered relatively small changes during the indicated periods. MFN and GSP tariffs used to calculate correlations were the average of the duty applied for each code at HS4 level during the indicated period

Next, it was examined the potential correlation between the six utilization variables for MJEPA and the tariff savings afforded by the FTA for each HS4 code over the 2006-2010 period. As for Thai FTAs, it was found that the UR of MJEPA correlated, although only at moderate strength, with the preferential tariff margin (Table 18 for UR and not shown for the rest of utilization variables).<sup>178</sup> Interestingly, although the MJEPA UR has not increased since implementation (Table 14), its correlation with the preferential tariff margin did (Table 18), probably indicating that Malaysian exporters that make use of

<sup>178</sup> As in the case of TAFTA and JTEPA, there was no correlation between the utilization variables for MJEPA and the absolute preferential tariff level.

MJEPA preferences started using them early on and that the progressive increase in the preferential margin has not enticed higher utilization.

**Table 18: Correlation between MJEPA UR for Malaysian exports and MJEPA preferential tariff margin \***

|   | PTM<br>MFN-MJEPA<br>2006 | PTM<br>MFN-MJEPA<br>2007 | PTM<br>MFN-MJEPA<br>2008 | PTM<br>MFN-MJEPA<br>2009 | PTM<br>MFN-MJEPA<br>2010 |
|---|--------------------------|--------------------------|--------------------------|--------------------------|--------------------------|
| <b>MJEPA UR<br/>for Malaysian exports<br/>July-Dec 2006</b> | 0.126 (< 0.001)          |                          |                          |                          |                          |
| <b>MJEPA UR<br/>for Malaysian exports<br/>2007</b>          |                          | 0.225 (<0.001)           |                          |                          |                          |
| <b>MJEPA UR<br/>for Malaysian exports<br/>2008</b>          |                          |                          | 0.253 (<0.001)           |                          |                          |
| <b>MJEPA UR<br/>for Malaysian exports<br/>2009</b>          |                          |                          |                          | 0.267 (<0.001)           |                          |
| <b>MJEPA UR<br/>for Malaysian exports<br/>2010</b>          |                          |                          |                          |                          | 0.268 (<0.001)           |

Source: Calculations by the Author of data from official administrative records

Abbreviations: MJEPA UR: MJEPA utilization rate; PTM MFN-MJEPA: preferential tariff margin MFN-MJEPA

\* Values shown indicate Pearson correlation coefficient (p value, significance level).

Next, it was tested if, as projected by Hypothesis 4, utilization of MJEPA relates to previous use of Japanese GSP.<sup>179</sup> In the four years previous to the implementation of MJEPA, over 10% of Malaysian exports to Japan used the preferences granted by the Japanese GSP program (see figures outside parentheses in Table 14). It was found that utilization (UR and related utilization variables) of Japanese GSP by exporters in Malaysia correlated, although only weakly, with the preferential tariff margin between GSP and the applied MFN tariffs (Table 19). When only items for which GSP offered preferential tariff

<sup>179</sup> This research was unable to obtain official records for the utilization of DES/DDS for imports from Japan as it is considered sensitive information. Section 93 of the 1976 Malaysia's Customs Act establishes that firms could claim drawback of 90% of the duties charged on inputs used in the manufacturing of goods for exports. The Malaysian Investment Development Authority also provides exemption of import duties on intermediate goods based on fulfillment of different criteria (e.g., export, research and development, etc.). In contrast to Thailand, import privileges in DES/DDS are often negotiated with firms on a case-by-case basis (interviews).

margins above zero were computed, around a quarter of all Malaysian exports to Japan used the GSP program (see figures inside parentheses in Table 14).

**Table 19: Correlation between Japanese GSP UR and GSP preferential tariff margin \***

|                                  | GSP UR<br>2003  | GSP UR<br>2004  | GSP UR<br>2005  | GSP UR<br>2006 (Jan-June) |
|----------------------------------|-----------------|-----------------|-----------------|---------------------------|
| <b>PTM MFN-GSP<br/>2003-2006</b> | 0.193 (< 0.001) | 0.151 (< 0.001) | 0.050 (< 0.001) | 0.152 (< 0.001)           |

Source: Calculations by the Author using data from official records

Abbreviations: PTM MFN-GSP: preferential tariff margin MFN-GSP; GSP UR: Japanese GSP utilization rate.

\* Values shown indicate Pearson correlation coefficient (p value, significance level)

Examination of the top 20 items by trade value exported under GSP during the period immediately before to MJEPA implementation revealed a highly constant and concentrated pattern of exports. Palm oil, wood and furniture, plastics, and chemicals account for over 70% of Malaysian exports under GSP (Table 20). There was also a remarkable overlap, even higher than in Thailand, between the top 20 Malaysian exports conducted under GSP preferences before June 2006 and under MJEPA after then (Table 20). This comparison was then extended to all tariff codes at HS4 level and it was found a positive statistical correlation between exports under both preferential regimes (Tables 21, 22 and 23, not shown for the rest of utilization variables). Altogether these results confirm Hypothesis 4 and indicate that, to a significant extent, Japanese concessions in MJEPA have replaced preferential tariffs offered unilaterally through its GSP program.

**Table 20: Top 20 items in Malaysian exports to Japan under Japanese GSP and MJEPA**

| Top 20 items in Malaysian exports to Japan under Japanese GSP<br>January 2003-June 2006 *   | Top 20 items in Malaysian exports to Japan under MJEPA<br>July 2006-December 2010 *   |
|---|---|
| Palm oil and its fractions (1511) and palm kernel, coconut and babassu oil (1513), animal or vegetal oils chemically modified (1516), glycerol (1520)           | Palm oil and its fractions (1511) and palm kernel, coconut and babassu oil (1513), cocoa butter, fat and oil (1804)   |
| Plastics plates, sheets and films (3920,3921), plastic containers (3923), polymers of styrene, polyethers, epoxides, polyesters and polyamides (3903,3907,3908) | Plastics plates, sheets and films (3920), plastic containers (3923), polyethers, epoxides, polyesters and polymers of vinyl chloride in primary forms (3904,3907) |
| Organic chemicals (2905,2915,2917)  | Organic chemicals (2905,2915,2917)  |
| Industrial monocarboxylic fatty acid oils and alcohols (3823)   | Wood and articles of wood (wood sawn, shaped, fileboard or laminated wood) (4407,4409,4411,4412), and furniture (9403)  |
| Wood and articles of wood (wood sawn, shaped, fileboard or laminated wood) (4407,4409,4411,4412)  | Miscellaneous chemical products (insecticides, industrial monocarboxylic fatty acid oils and alcohols, binders for foundry moulds or cores (3808,3823,3824)       |
| Synthetic filament (5402)   | Wadding, felt and nonwovens and clothing accessories (gloves and mittens, nonwovens) (5603,6116)  |
| Cooper products (7410)  | Electric transformers, static converters and inductors (8544)   |
| Nonwovens (6116)  | Cooper products (7410)  |
| Pigments and dyes (3206)  | Crustaceans live (0306)   |
| Electric transformers, static converters and inductors (8544)   | Vacuum flasks and vessels (9617)  |
| Vacuum flasks and vessels (9617)  | Automotive parts (8708)   |
| Handkerchiefs (6213)  | Miscellaneous articles of base metal (8302)   |
| Screw, bolts and nuts of iron and steel (7318)  | Toilet paper (4818)   |
| Miscellaneous articles of base metal (8302)   | Refractory bricks and other ceramic construction articles (6902)  |
| Miscellaneous articles of aluminium (7616)  | Handtools and tools used in agriculture (8001)  |
| Bread and pastry cakes (1905)   |   |

Source: Calculations by the Author using data from official records

\* Top 20 items at HS4 level for the indicated regime and period. Shadowed cells refer to product overlap across both sides of the table

**Table 21: Correlation between URs of MJEPA and Japanese GSP for Malaysian exports \***

|   | GSP UR<br>2003  | GSP UR<br>2004  | GSP UR<br>2005  | GSP UR<br>Jan-July 2006 |
|---|-----------------|-----------------|-----------------|-------------------------|
| <b>MJEPA UR<br/>for Malaysian exports<br/>Jan-June 2006</b> | 0.453 (< 0.001) | 0.444 (< 0.001) | 0.317 (< 0.001) | 0.421 (< 0.001)         |
| <b>MJEPA UR<br/>for Malaysian exports<br/>2007</b>          | 0.652 (< 0.001) | 0.523 (< 0.001) | 0.309 (< 0.001) | 0.570 (< 0.001)         |
| <b>MJEPA UR<br/>for Malaysian exports<br/>2008</b>          | 0.633 (< 0.001) | 0.499 (< 0.001) | 0.292 (< 0.001) | 0.509 (< 0.001)         |
| <b>MJEPA UR<br/>for Malaysian exports<br/>2009</b>          | 0.589 (< 0.001) | 0.454 (< 0.001) | 0.229 (< 0.001) | 0.489 (< 0.001)         |
| <b>MJEPA UR<br/>for Malaysian exports<br/>2010</b>          | 0.547 (< 0.001) | 0.471 (< 0.001) | 0.278 (< 0.001) | 0.449 (< 0.001)         |

Source: Calculations by the Author using data from official records

Abbreviations: MJEPA UR: MJEPA utilization rate; GSP UR: Japanese GSP utilization rate.

\* Values shown indicate Pearson correlation coefficient (p value, significance level)

**Table 22: Correlation between UR rank reverse of MJEPA and GSP for Malaysian exports \***

|   | GSP UR rank reverse 2003 | GSP UR rank reverse 2004 | GSP UR rank reverse 2005 | GSP UR rank reverse Jan-June 2006 |
|---|--------------------------|--------------------------|--------------------------|-----------------------------------|
| <b>MJEPA UR rank reverse for Malaysian exports July-December 2006</b> | 0.643 (< 0.001)          | 0.664 (< 0.001)          | 0.751 (< 0.001)          | 0.748 (< 0.001)                   |
| <b>MJEPA UR rank reverse for Malaysian exports 2007</b>               | 0.672 (< 0.001)          | 0.677 (< 0.001)          | 0.733 (< 0.001)          | 0.758 (< 0.001)                   |
| <b>MJEPA UR rank reverse for Malaysian exports 2008</b>               | 0.647 (< 0.001)          | 0.629 (< 0.001)          | 0.700 (< 0.001)          | 0.715 (< 0.001)                   |
| <b>MJEPA UR rank reverse for Malaysian exports 2009</b>               | 0.615 (< 0.001)          | 0.594 (< 0.001)          | 0.689 (< 0.001)          | 0.678 (< 0.001)                   |
| <b>MJEPA UR rank reverse for Malaysian exports 2010</b>               | 0.572 (< 0.001)          | 0.590 (< 0.001)          | 0.654 (< 0.001)          | 0.640 (< 0.001)                   |

Source: Calculations by the Author using data from official records

Abbreviations: MJEPA UR rank reverse: MJEPA utilization rate rank reverse; GSP UR rank reverse: Japanese GSP utilization rank reverse.

\* Values shown indicate Pearson correlation coefficient (p significance level).

**Table 23: Correlation between utilization share rank (in reverse order) of MJEPA and Japanese GSP for Malaysian exports \***

|  | GSP utilization share rank 2003 | GSP utilization share rank 2004 | GSP utilization share rank 2005 | GSP utilization share rank Jan-June 2006 |
|--|---------------------------------|---------------------------------|---------------------------------|--|
| <b>MJEPA utilization share rank for Malaysian exports July-December 2006</b> | 0.452 (< 0.001)                 | 0.512 (< 0.001)                 | 0.551 (< 0.001)                 | 0.611 (< 0.001)                          |
| <b>MJEPA utilization share rank for Malaysian exports 2007</b>               | 0.425 (< 0.001)                 | 0.492 (< 0.001)                 | 0.522 (< 0.001)                 | 0.541 (< 0.001)                          |
| <b>MJEPA utilization share rank for Malaysian exports 2008</b>               | 0.392 (< 0.001)                 | 0.418 (< 0.001)                 | 0.447 (< 0.001)                 | 0.460 (< 0.001)                          |
| <b>MJEPA utilization share rank for Malaysian exports 2009</b>               | 0.394 (< 0.001)                 | 0.437 (< 0.001)                 | 0.499 (< 0.001)                 | 0.518 (< 0.001)                          |
| <b>MJEPA utilization share rank for Malaysian exports 2010</b>               | 0.339 (< 0.001)                 | 0.425 (< 0.001)                 | 0.449 (< 0.001)                 | 0.461 (< 0.001)                          |

Source: Calculations by the Author using data from official records.

\* Values shown indicate Pearson correlation coefficient (p significance level).

If MJEPA preferences have replaced GSP, use of the latter should have declined as MJEPA was implemented (Hypothesis 4). Indeed, the UR of GSP dropped drastically from 14.20% of total exports during the first semester of 2006 to just 0.37% in the second half

after MJEPA entered into force in July 2006 (Table 14). In 2010, GSP preferences were used by just five tariff lines at HS4 (0.05% of total exports), mostly processed food items for which MJEPA did not offer liberalization yet. As in Thailand, the fact that some items liberalized under GSP remained protected five years into MJEPA reflects the importance that Japan attaches to the irreversibility of concessions under FTAs, compared to the discretion of those granted unilaterally under GSP.

Analysis of Thai FTAs here failed to find an inverse correlation between their utilization and the restrictiveness of their ROOs and I sought to investigate whether this also occurred for MJEPA. The ROO restrictiveness index of each HS4 code in MJEPA was computed for correlation with all utilization variables. As for Thai FTAs, no significant negative correlation was found (not shown and see below for discussion).

Since there are no econometric studies on the variables affecting MJEPA utilization, I run a linear regression analysis with the UR of MJEPA in 2007 as the dependent variable and GPS UR in 2003 and the preferential tariff margin between MFN tariffs and MJEPA tariffs for 2007 as independent variables. It was found that the explanatory value of GSP was much larger than that of the preferential tariff margin, GSP UR in 2003 explained 42.6% of the UR of MJEPA in 2007 (Table 24). When the regression analysis was repeated for MJEPA UR in 2010 using as independent variables GPS UR in 2003 and the preferential margin afforded by MJEPA in 2010, GSP UR explained 29.9% of MJEPA UR (Table 25). One reason for the declining explanatory value of GSP could be due to changes in the pattern of Malaysian exports to Japan between 2003 and 2010 that were not revealed in the period 2003-2007. However, the contribution of GSP did not increase when MJEPA UR in 2010 was regressed using as independent variable the UR of GSP in the first semester of 2006 (not shown). Instead, the lower weight of GSP in the UR of MJEPA in 2010 could be related to changes in the composition of trade using MJEPA between 2007

and 2010. Despite that concentration among the top 20 codes exported under MJEPA (Table 15) and correlations in Tables 21 to 23 remained stable over that period, it is still possible that more recent exports under MJEPA have started to diverge from those under GSP earlier as tariff schedules in MJEPA are liberalized and its UR for less-traded items increased. Alternatively, the sharp drop in MJEPA UR in 2010 (Table 14) may have affected its correlation with GSP utilization. Regression analyses of MJEPA UR over a longer period would be therefore needed.

**Table 24: Estimated coefficients for linear regression models for MJEPA UR 2007 \***

|                           | Model 1                      | Model 2                      | Model 3                      |
|---------------------------|------------------------------|------------------------------|------------------------------|
| <b>GSP UR 2003</b>        | 0.627 [0.021]<br>(p < 0.001) |                              | 0.609 [0.020]<br>(p < 0.001) |
| <b>PTM MFN-MJEPA 2007</b> |                              | 2.543 [0.311]<br>(p < 0.001) | 1.586 [0.240]<br>(p < 0.001) |
| <b>Constant</b>           | 3.903                        | 6.577                        | 1.267                        |
| <b>R<sup>2</sup></b>      | 0.426                        | 0.051                        | 0.445                        |

Source: Calculations by the Author using data from official records

\* For each model the regression coefficient is followed by the estimated standard error (in square brackets) and the p-value for t-tests of the coefficients (in parenthesis)

**Table 25: Estimated coefficients for linear regression models for MJEPA UR 2010 \***

|                           | Model 1                      | Model 2                      | Model 3                      |
|---------------------------|------------------------------|------------------------------|------------------------------|
| <b>GSP UR 2003</b>        | 0.536 [0.023]<br>(p < 0.001) |                              | 0.509 [0.023]<br>(p < 0.001) |
| <b>PTM MFN-MJEPA 2010</b> |                              | 3.142 [0.298]<br>(p < 0.001) | 2.409 [0.253]<br>(p < 0.001) |
| <b>Constant</b>           | 5.801                        | 5.832                        | 1.402                        |
| <b>R<sup>2</sup></b>      | 0.299                        | 0.081                        | 0.346                        |

Source: Calculations by the Author using data from official records

\* For each model the regression coefficient is followed by the estimated standard error (in square brackets) and the p-value for t-tests of the coefficients (in parenthesis)

## 7. Discussion

Most works on the political economy of East Asian regionalism argue that recent FTAs have been driven primarily for political motivations rather than economic ones and were formulated by the political leadership in these countries with little participation or interest

on the part of the private sector (e.g., Aggarwal and Koo, 2006; Lee, 2006; Sally, 2006; Terada, 2009; Ravenhill, 2010). In addition, a number of estimates and surveys indicate that firms in East Asia have made very low utilization of existing FTAs (Haddad, 2007; Ranvehill, 2008; Ravenhill, 2010; Kawai and Wignaraja, 2011a). Only two studies, both on Thailand, involved analysis of official records on FTA utilization, concluding that FTAs have not made significant impact in terms of trade creation but mainly served to liberalize highly traded goods (Kohpaiboon, 2010; Athukorala and Kohpaiboon, 2011).

Empirical evidence in this Essay and elsewhere in this Thesis has countered most of those arguments. Essay 1 found that the private sector in Thailand and Malaysia played an important role in FTA policymaking, in some cases pushing governments to launch negotiations. This Essay analyzed the utilization of Thai and Malaysian FTAs in the context of both the political economies that originally set them in place and the utilization of existing unilateral tariff reduction schemes. It was found that utilization of FTAs in both countries was larger than most estimates and survey projected but, with the exception of TAFTA, it was nevertheless low. However, low overall utilization hid significant sectoral variability with some sectors making virtually complete utilization of FTA preferences, independently of trade volumes. Sectors that used FTAs to the greatest extent were often among the strongest *ex-ante* supporters of FTA liberalization during negotiations and/or that benefited from GSP and DES/DDS unilateral schemes.

Primary data on preferential trade in both countries were computed to test four main arguments, namely: 1) FTAs establish legally binding commitments on tariff reduction. Consequently, goods for which tariffs are unbound or bound with large overhangs at the multilateral level and/or that are excluded from unilateral schemes would be more likely to receive longer phase out periods in FTA liberalization schedules; 2) Sequencing in FTA liberalization would determine the evolution and sectoral concentration of FTA utilization.

As FTA liberalization schedules are progressively implemented, overall utilization should increase and involve more items. 3) Quantitative analyses of the utilization of FTAs should be coupled with the political economy determinants involved in their formulation. It would be expected that sectors that successfully lobbied for FTA liberalization will make high use of FTA preferences (in absolute and/or relative terms); 4) Producers that benefit from GSP or DES/DDS programs should support the inclusion of these unilateral tariff reductions into binding and non-removable FTA concessions. If they eventually succeeded, their utilization of unilateral schemes should decline in favor of the use FTAs. Analysis of trade administrative records confirmed all four hypotheses that will be discussed in turn.

Overall utilization of TAFTA by Thai exporters exceeds 60% of total exports, which is in line with that of well-established FTAs elsewhere.<sup>180</sup> However, overall utilization of TAFTA for Thai imports and of JTEPA (and probably MJEPA) for both trade directions has been low. As argued earlier, low utilization of JTEPA and MJEPA preferences by Thai and Malaysian exporters should be put into context with the large share of duty-free tariff lines, around half, applied by Japan. When utilization is calculated only for goods for which FTAs provide a preferential tariff margin, utilization of JTEPA by Thai exporters was around 60%.<sup>181</sup> On the other hand, the low utilization of TAFTA and JTEPA by Thai importers (and probably of MJEPA by Malaysian importers) could be reasoned on longer FTA liberalization schedules in Thailand (and Malaysia) compared to Australia and Japan. Meantime Thailand and Malaysia progressively implement FTA tariff schedules, eligible importers in both countries use DES/DDS privileges.

For the three FTAs examined, just 20 items, out of the over 1,300 codes at HS4 level, accounted for between 67.3% and 96.4% of all trade using their preferences. In

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<sup>180</sup> In 2000, overall UR of the North-American Free Trade Agreement, between the United States, Canada and Mexico, was 64% (Anson et al., 2005).

<sup>181</sup> Applying the same methodology to TAFTA would put its utilization by Thai exporters close to 100%. In Australia, the share of applied tariffs set at zero is only slightly lower than in Japan. Dominance of automotive products, 63.5% of total Thai exports under TAFTA in 2011, helps explaining the greater utilization of TAFTA vis-à-vis JTEPA (see Essay 1 and 3).

addition, the identity of these top 20 items has remained fairly constant over time. Such extreme concentration in the overall share of FTA utilization has two important consequences. First, focus on the largest users by overall utilization share overlooks the high UR, often close to 100%, incurred in the export or import of some goods with lower trade volumes and outside the top 20. Arguably, for the exporters and importers of these goods, FTAs could have large economic impacts that escaped studies centered on overall FTA URs (Ravenhill, 2010; Kawai and Wignaraja, 2011) or exclusively on sectors accounting for the largest share of overall utilization (Kohpaiboon, 2010; Athukorala and Kohpaiboon, 2011). Second, the capacity of Thai FTAs to foster trade creation has been questioned (Athukorala and Kohpaiboon, 2011). Indeed, high concentration in overall utilization share—that, incidentally, also occurs in overall trade flows—limits the possibilities of FTAs to drastically change bilateral trade patterns and for overall trade creation. But, while trade creation in less traded sectors would be more difficult to identify, it cannot be excluded that it actually occurred.<sup>182</sup>

Concentration in FTA utilization shows a small declining trend in TAFTA and JTEPA but not in MJEPA. Nevertheless, considering that much of the initial FTA utilization simply replaces use of unilateral schemes and that liberalization of many tariff lines phases out over 5-10 years period, a longer timeframe would be required to assess how concentration in FTA utilization evolves.

This Essay was able to link evidence of business support and lobbying in the formulation of FTAs described in Essay 1 with their sectoral utilization afterwards. In line with the initial argument, it was found that FTAs were used heavily (as a share of total trade under the FTA) and to a large extent (relative to total trade flows for a given item) by sectors that benefit from larger FTA preferential tariff margins and that often corresponded

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<sup>182</sup> In any case, it would be naïve to expect that FTA liberalization, or any other form of liberalization for that matter, would automatically result in trade creation, as this involves more than eliminating tariffs and requires establishing customer and logistic links (see below in the main text).

to those initially lobbying for FTA liberalization. For instance, the leading role of carmakers pushing for TAFTA and JTEPA was reflected in the large FTA utilization and share of automotive products in Thai exports under TAFTA or of steel and automotive products in Thai imports under JTEPA. Likewise, lobbying by key Thai and Malaysian exporters (e.g., processed food, plastics, chemicals, palm oil, textiles and garments, steel) in favor of JTEPA and MJEPA translated later into high URs and UR shares. Nevertheless, while this Essay is, to the best of my knowledge, the first to unearth these links, further and more detailed analyses of the data and over longer periods would be needed.

A wealth of studies have analyzed and quantified the trade restricting effects of ROOs in FTAs (e.g., Estevadeordal and Suominen, 2006), including in Thai FTAs (Kohpaiboon, 2010; Intaravitak et al., 2011). Econometric simulations in the two latter works calculated that ROOs in Thai FTAs amount to a tariff equivalent of 2-10% and that relaxation of ROOs may have greater impact on FTA utilization than tariff liberalization per se. Surprisingly, this Essay found that utilization of Thai and Malaysian FTAs was not inversely correlated with ROOs restrictiveness. Although calculation of the ROO restrictiveness index involved collapsing tariff codes from HS6 to HS4 level, aggregation maintained the highest level of restriction so any restrictive effect of ROOs should have been even amplified. Further analyses would be required to account for the lack of effect of ROOs in my analyses, but two explanations could be advanced. First, the scale of the restrictiveness index used here (Cadot et al., 2006) is potentially too small to capture variability in ROO restrictiveness in Thai and Malaysian FTAs. In that regard, for most tariff lines, the index fell within three out of the seven scores possible.<sup>183</sup> Although controversial, another potential explanation is that ROOs are not as restrictive as the above-mentioned econometric models predict. In support of such argument, Kawai and Wignaraja

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<sup>183</sup> Nevertheless, scales in other ROO restrictiveness indexes are similar.

(2011b) found that only 26% of the firms surveyed in Thailand indicated that ROOs added costs to their business or affected their current or future use of FTAs. Anecdotal evidence from my own qualitative field research also points in this direction.<sup>184</sup>

The low utilization of FTAs has been attributed *inter alia* to the prevalence of DES/DDS programs in many East Asian countries that, by reducing tariffs for firms operating within regional production networks, make redundant (when not harmful) the creation of FTAs (e.g., Ravenhill, 2010). In turn, this Essay found that firms' dependence on these unilateral tariff reduction schemes have in fact fostered the formation first and utilization later of FTAs. Being preferential tariffs in GSP and DES/DDS unilaterally given, they are potentially removable at the discretion of the granting country. In addition, their use is restricted at multiple levels. Utilization of GSP preferences is not only subject to product- and country-specific export ceilings but countries lose their eligibility to GSP once they reach certain development status. Likewise, utilization of DES/DDS privileges is usually limited within a time period, physical location, economic sector and/or to inputs incorporated into export-bound goods.

During the 2000-2005 period, just before JTEPA and MJEPA were implemented, Thailand and Malaysia ranked only after China as the world's largest beneficiaries of the Japanese GSP program. And my analysis found that a sizeable share of Thai imports from Australia and Japan takes places through DES/DDS privileges—15.9% and 44.3% before implementation of their respective FTAs. Economic actors are more likely to mobilize to avoid losses with respect to the status quo than to secure new gains (Baldwin, 2006). Accordingly, producers in Thailand and Malaysia that benefitted from GSP and DES/DDS

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<sup>184</sup> Most firms and business associations interviewed for this Thesis indicated that, independently of whether or not they were using FTAs at the time, they did not find ROOs as a critical factor restricting FTA utilization and that other factors are more important. In Thailand, application to PCOs requires that firms provide information about their cost structure and interviews found that some firms, especially small ones, were hesitant to use FTAs because the potential tax consequences derived from reporting such information. For large firms, an often-mentioned reason for not using FTAs was that they obtained larger tariff savings from DES/DDS privileges, particularly those offered by the Board of Investment, whose application procedures are easier.

sought to integrate these unilateral liberalization schemes into legally binding agreements and were among those sectors more actively lobbying in favor of FTAs. Once FTAs were implemented, these producers were also more likely to be among the first and largest (in absolute or relative terms) users of FTAs, not only because they sought to keep benefiting from preferential tariffs but also because these firms already had in place all the procurement/export linkages as well as the logistics associated to documenting and applying for PCOs. My analyses showed that utilization of Thai and, especially, Malaysian FTAs was highly correlated with the previous use of GSP or DES/DDS. In fact, FTA utilization correlated with greater strength to the utilization of these programs than with the preferential tariff margin that, after all, is at the essence of FTAs. For instance, during the first year of MJEPA, 42.5% of its utilization for Malaysian exports to Japan was explained by previous utilization of the Japanese GSP. This result is in line with evidence showing that the higher the political trade dependence of countries on American and European GSP programs, the highest the likelihood of those countries sought an FTA with the Northern partner (Shadlen, 2008; Manger and Shadlen, 2013).<sup>185</sup>

FTAs should be therefore evaluated not only for their capacity to create and expand new trade flows but, even more importantly, for binding tariffs at two levels. First, in their FTA concessions, Thailand and Malaysia have bound (and even eliminated) tariffs that were either unbound or bound with large overhangs at the multilateral level. Second, FTAs served to bind unilateral tariff concessions in GSP and DES/DDS, which have started to progressively replace. Current utilization of Japanese GSP preferences by Thai and Malaysian exporters has been reduced to a handful of goods not covered yet by JTEPA and MJEPA. The still large utilization of DES/DDS to import goods from Australia and Japan to Thailand is related not only to slow liberalization schedules by Thailand but also to the

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<sup>185</sup> Of note, both studies take a country-level analysis, not an intra-country sectoral approach as in this Essay. They use the concept of *political trade dependence* as “the degree to which developing countries rely on such programs [GSP and GSP-related programs] and [...] [their] market access is subject to political idiosyncrasies in concession-granting developed countries” (Manger and Shadlen, 2013).

fact that DES/DDS eliminate tariffs completely while FTAs may take several years to grant duty free.<sup>186</sup> However, given the above-mentioned restrictions attached to the use of DES/DDS it could be predicted that FTA preferences would also eventually replace them.

FTA liberalization reduces the incentives of import-competing sectors to lobby for high external tariffs—phenomenon known as *rent destruction*—so FTA preferential tariffs are eventually multilateralized and extended to countries outside the bloc (Ornelas, 2005a; Ornelas, 2005b).<sup>187</sup> Just as JTEPA and MJEPA eroded Japanese GSP preferences, FTA preferential margins would eventually shrink and disappear as multilateral tariffs are also progressively reduced. My analysis found that goods attracting the highest tariffs at the multilateral level are also more likely to receive high tariffs in FTAs (and unilateral regimes). As multilateral liberalization progresses, either via WTO rounds or through FTA-induced rent destruction, utilization of FTAs would decline and eventually concentrate around a small set of goods. It could be therefore hypothesized that as FTA liberalization is eventually exhausted, elimination of remaining tariff peaks will only take place at multilateral trade negotiations.

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<sup>186</sup> DES/DDS also involve lower administrative costs than applying for PCOs in FTAs and their users tend to be large firms with strong administrative capabilities.

<sup>187</sup> Reduction of external tariffs by FTA members could potentially result in overall trade creation, reducing incentives for countries outside the FTA bloc to support multilateral liberalization (Ornelas, 2005c).

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## 4

## Essay 3 — Creation and Shifting of Rents within Bilateral Free Trade Agreement Blocs

Firms, States and the Redistribution of Power within Production Networks under Regionalism<sup>188</sup>

### Abstract

Starting in the 1980s, trade and investment flows by lead firms organizing production networks in East Asia have led to significant regional economic integration. In contrast to other regions, it has only been since the turn of the century that East Asian countries have begun to institutionalize their integration through free trade agreements (FTAs). By their nature, FTAs discriminate against firms and states outside the bloc. However, bilateral FTAs could also create and shift rents within the bloc and selectively improve the leverage of some firms and states vis-à-vis other firms and states also inside the FTA area. To the extent that FTAs could be designed to provide asymmetric market, procurement and restructuring advantages to some firms but not others, they could redistribute power among firms within a production network and an FTA area. At the same time, and despite erosion of the policy space and power of states over production networks, compared to other forms of liberalization, FTAs could provide governments with additional sources of leverage over lead firms. FTAs offer greater flexibility in liberalization coverage and sequencing and could be designed to selectively foster procurement and technical linkages between lead firms local suppliers. To test these hypotheses this Essay analyzed the automotive production network in Thailand and Malaysia in the context of recent bilateral FTAs. In pursuing their corporate and national objectives, firms and governments in both countries have made use of FTAs to create and capture selective rents that improved their relative position within national and regional automotive production networks.

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<sup>188</sup> Essay 3 was originally written in August 2010. Figures 3 and 4 and Tables 2 and 3 were updated to reflect recent developments. In addition to its critical evaluation by Professor K. Shadlen, it also received review comments from Professor K.A. Chase (Brandeis University, Waltham, MA, USA) in May 25, 2011.

**Abbreviations:**

APC: automotive parts and components  
AFTA: ASEAN FTA  
ASEAN: Association of South East Asian Nations  
ATIGA: ASEAN Trade in Goods Agreement  
DES/DDS: duty exemption schemes / duty drawback schemes  
FTA: free trade agreement  
GATT: General Agreement on tariffs and trade  
GM: General Motors  
JTEPA: Japan-Thailand economic partnership Agreement  
LCR: local content requirement  
MAJAICO: Malaysia Japan Automotive Industries Cooperation  
MFN: most-favoured nation  
MJEPA: Malaysia-Japan Economic Partnership Agreement  
OEM: original equipment manufacturer  
ROO: rules of origin  
TAFTA: Thailand-Australia FTA  
TIEHS: Thailand-India Early Harvest Scheme  
WTO: World Trade Organization

## 1. Introduction

Introduction in East Asia of export-oriented strategies and unilateral liberalization during the 1980s led to the rapid emergence of production networks where parts and components are traded across national and firm boundaries (Kimura and Ando, 2005; Baldwin, 2008; Hiratsuka and Kimura, 2008; Hiratsuka and Uchida, 2010). During the last two decades, these cross-border production networks have unleashed a significant level of market-driven regional economic integration (regionalization). However, and in contrast to other regions, institutionalization of economic integration in East Asia by means of free trade agreements (FTAs) (regionalism) is only a recent phenomenon (Hiratsuka, 2007). With the exception of the ASEAN (Association of Southeast Asian nations) trade bloc, and until the early 2000s, East Asian countries did not participate in the worldwide proliferation of regionalism but today they stand among the most active signatories of FTAs.

A wealth of works in the global commodity/value chain and global production network literatures has elegantly mapped the distribution of power and value between lead firms, organizing production, and their suppliers, both nationally and across countries (reviewed in Hess and Yeung, 2006). However, most studies in these traditions remain firm-centered, leaving out the way governments' policies influence and are influenced by inter-firm power dynamics.

Much of the scholarly attention around FTAs has focused on how firms inside an FTA area benefit from expanded market access at the expense of outside firms (trade diversion), which consequently increases their power within the cross-border production network (Schiff and Winters, 2003). This Essay delves into why firms and states seek FTAs and how they exploit unique features in them to gain selective advantages. To that end, it will explore the organization of cross-border production networks under regionalism through the conceptualization and analysis of power relations between and among firms

and states, examining the ways FTAs could have altered these power configurations. This Essay contends that FTAs offer opportunities for firms and states to enhance their comparative advantage *selectively*, not only with respect to firms and states outside the bloc, but also vis-à-vis to others already inside. By expanding market and procurement options for lead firms, FTAs increase their power over suppliers and the government in the host country. But, to the extent that FTAs could be designed to provide these benefits asymmetrically, FTAs could also selectively enhance the position of some lead firms in relation to others also *inside* the bloc. In turn, a state could use FTAs to affect lead firms' operations selectively and foster their procurement and technology linkages with local suppliers. By offering asymmetric distribution of rents (selective rents), FTAs foster competition or collaboration among lead firms, suppliers and states within a production network to affect their formulation.

To test the above arguments, I analyzed the Thai and Malaysian automotive sectors in the context of recent FTAs. The automotive industry is one of the most protected manufacturing sectors, having often been at the center, when not at the origin, of regionalism initiatives worldwide (Carrillo et al., 2004). As a grouping, ASEAN represents the world's sixth largest automotive producer, historically led by Thailand and Malaysia.<sup>189</sup> Back in the 1960s and until the early 1980s, the automotive industries of both countries were relatively similar but diverging government policies and corporate strategies engendered different power dynamics between and among firms and the state that have eventually resulted in different outcomes.<sup>190</sup> Thailand and Malaysia also are the two developing countries in East Asia that have implemented more FTAs (see footnote 32).

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<sup>189</sup> In 2012, Thailand accounted for 57.8% and 41.3% of all vehicles produced and sold in ASEAN, respectively. The corresponding figures for Malaysia were 13.4% and 18.0%, respectively (OICA database). In 2009 and 2010-2012, Indonesia surpassed Malaysia as ASEAN's second largest producer (data from OICA database).

<sup>190</sup> Comparison of the evolution of the Thai and Malaysian automotive industries has been object of intense academic research, much of it published since research for this Thesis started (e.g., Abdulsomad, 1999; Abbott, 2004; Doner, 2009; Wad, 2009; Wad and Govindaraju, 2011; Kohpaiboon and Jongwanich, 2013; Natsuda and Thoburn, 2013; Natsuda et al., 2013).

Empirical evidence obtained through extensive sectoral and firm-level research confirmed the initial arguments.<sup>191</sup> Despite differences in their institutional and policymaking environments and in the structure of their automotive sectors, governments and automotive firms in Thailand and Malaysia sought specific configurations in FTAs that enhanced their leverage vis-à-vis other states and firms outside as well as inside the FTA area. As a result, FTAs signed by both countries have altered the organization and distribution of power within their respective automotive industries

The rest of the manuscript is organized as follows. The next section sketches key features of the automotive production network. Section three outlines the analytical framework for the study. Sections four and six analyze the Thai and Malaysian automotive industries prior to regionalism. Section five and seven present empirical data on both industries in the context of FTAs. Section eight discusses findings and offers some concluding remarks.

## 2. The automotive production network

In producer-driven chains, like the automotive industry, the lead firm (e.g., Toyota, Ford) is also the brand-bearing and original equipment manufacturer (OEM) that makes all key decisions regarding design and production strategies and conducts most of the assembly and distribution of final goods (Sturgeon et al., 2008; Sturgeon et al., 2009). To manufacture a vehicle (also referred as a *completely built-up* unit), assembly plants could independently produce and/or outsource all automotive parts and components (APCs) or, when manufacturing capabilities or scales are limited, start instead from a *completely knocked-down* kit that contains most of the elements of a vehicle.

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<sup>191</sup> The Essay focuses exclusively on the automotive sector but draws on many of the 212 in-depth semi-structured interviews conducted for this Thesis with private sector representatives and government officials in Thailand and Malaysia during two independent trips in 2008 and 2009, which were complemented with numerous personal communications and secondary research during 2010-2012.

Because of its multiple spillovers, the automotive industry has been often promoted and protected. During the 1970s and 1980s, Western and Japanese carmakers established independent assembly plants in multiple East Asian countries as a way to jump over high tariffs on vehicles (Doner, 1991; Staples, 2008). Although gradual liberalization across the region since the early 1990s prompted these firms to initiate a rationalization of their procurement and production strategies, technical and logistic factors inherent in the industry prevent the adoption of global sourcing and production patterns prevalent in sectors like electronics (Sturgeon et al., 2009).<sup>192</sup> Consequently, automotive production tends to take place within national and regional networks “nested into the organizational structures” of global suppliers and OEMs (Sturgeon, 2008:302; Sturgeon et al., 2009:10). The way these global business structures are in turn nested within national, regional and global institutional contexts remains understudied.

The structure of the APC supplier base varies by OEM and host country but, especially in Japanese firms, is often organized in tiers, where only the first-tier suppliers serve OEMs directly (Humphrey, 2003; Sturgeon et al., 2008). Since the 1990s, OEMs have been transferring responsibilities in design of key APCs and module pre-assembling to first-tier *global suppliers* mostly Western and Japanese multinationals (e.g., Denso, Delphi), that follow OEMs worldwide.<sup>193</sup> Local suppliers acquire technological know-how from more advanced foreign suppliers or directly from carmakers.<sup>194</sup> Competition among OEMs is passed on to suppliers that are continuously pressured to reduce costs and improve

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<sup>192</sup> In addition to many APCs being costly to transport, lean manufacturing and just-in-time logistics force suppliers to cluster around OEMs. This strong national/regional orientation in the automotive sector results in higher domestic/regional value content than in other industries.

<sup>193</sup> Based on the complexity of inter-firm transactions and suppliers’ capability, the global commodity/value chain literature distinguishes five modes of governance in lead firm-supplier relations that in an increasing scale of power asymmetry range from market linkage (governed by price) to modular, relational, captive and hierarchical (within the firm) (Gereffi et al., 2005). Although it varies according to the OEM’s country of origin, the increasing assumption of responsibilities by global suppliers has made OEM-supplier linkages more relational. Relational links make more costly for OEMs to switch suppliers. Our interviews with Thai and Malaysian suppliers found that, although Japanese OEMs are more supportive (e.g., transferring process engineering knowledge), over time, both Japanese and Western OEMs have reduced their assistance.

<sup>194</sup> For critical APCs, OEMs maintain design and production in-house or import them from their regional headquarter (intra-firm trade). Our research in Thailand and Malaysia found that procurement decisions by suppliers are most often determined by the standards specified by OEMs rather than price. Most APC exports and replacement market sales are indirect through OEMs.

quality standards and delivery. Western carmakers, particularly American firms, favor shorter-term, market relations with their suppliers. In contrast, even when relocated abroad, Japanese OEMs rely more on closer and longer-term links with their suppliers (Humphrey, 2003; Sturgeon et al., 2008).

### **3. Regionalism and the distribution of rents and power within production networks**

In the late 1980s, most of East Asia initiated a process of unilateral liberalization, often reinforced multilaterally, that fostered regional economic integration and the emergence of cross-border production networks (Hiratsuka, 2010). However, with the sole exception of the ASEAN FTA (AFTA), East Asia escaped to the worldwide wave of FTAs that started in the early 1990s.<sup>195</sup> It was not until the turn of the century that East Asian countries started institutionalizing their integration; now close to 60 FTAs have been implemented, most of them as bilateral agreements (reviewed in Kawai and Wignaraja, 2013).

Contrary to previous analysis by the global commodity/value chain literature, global production network theory incorporates non-firm actors into its analysis of production networks, but most of its empirical elaborations share the firm-centric focus of global commodity/value chain studies (Henderson et al., 2002; Coe et al. 2008; Gereffi, 2013). Even when the institutional context is considered, only its unidirectional influences on firms are examined, leaving out how it came about in the first place and the way inter-firm dynamics feedback to the institutional context and shape governmental policies.<sup>196</sup>

The dependent variable explored in this Essay is the distribution of power among actors (lead firms, suppliers and states) in the Southeast Asian automotive production

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<sup>195</sup> AFTA was launched in 1992 but it was only in 2003 that intra-ASEAN tariffs began to be significantly reduced. Still, Malaysia excluded its automotive sector from AFTA liberalization schedules until 2005 (see below).

<sup>196</sup> In fact, the few studies about the impact of regionalism on the organization of production emerged from the global commodity/value chain strand rather than the GPN theory (e.g., Gereffi et al., 2002).

network in the context of recent bilateral FTAs.<sup>197</sup> It will be argued that this is not simply a function of inter-firm governance structures (Gereffi et al., 2005; footnote 193), but also of the mutual interactions between: a) the corporate strategies (domestic, regional, global) of lead firms and suppliers, and b) the domestic regulations and international trade and investment policies of states or, more specifically here, of the interactions between regionalization and regionalism.

The primary concern is to understand why lead firms in a given country and production network seek specific FTAs. The Essay will try to ascertain: a) whether and how FTAs create opportunities for a selective redistribution of rents, power, and value, between and among firms and states operating in production networks and, b) whether and how actors have tried to shape FTAs to their advantage, creating and capturing these selective advantages.

In chain and global production network theories, power in a production network is bestowed on the lead firm as a structural capacity, while suppliers are only at the receiving end of the lead firms' strategies. But, as a relational concept, the power of a firm (or a state) within a national/regional/global production network is exercised with respect to other firms and states. Likewise, power and value are never static, but subject to constant reconfiguration. Inter-firm relations and network governance evolve not only with modifications in technology, suppliers' capabilities and/or lead firms' strategies—as posited by Gereffi et al., (2005:96)—but, arguably, also when market and institutional environments change and firms and states react strategically to the actions of other firms and states.

Firms attempt to build their comparative advantage over competitors or leverage in lead-supplier relationships through the acquisition of specific intrinsic resources and

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<sup>197</sup> Global production network theory also includes in production networks non-firm actors beyond states like trade unions or non-governmental organization. Our interest here is limited to firms and states.

capabilities, but also by seeking, lobbying for and capturing rents available in the institutional setting. For suppliers in developing countries, linkages to lead firms offer opportunities for contracts and technology transfer. In the global commodity/value chain literature suppliers are only at the receiving end of lead firms' strategies. It is contended here that suppliers could not only often develop their own strategies, but could also try to influence policymaking to gain power with respect to lead firms. In that regard, suppliers' source of leverage within a production network is not so much intrinsic, as for lead firms and states, but rather it emanates from a supportive regulatory framework.

Developing states often engage in race-to-the-bottom competitions to offer lead firms the best incentives, so as to attract their investment and host high technology and value-added activities within the production network. Multinationals could leverage their capital and technological assets to extract rents from states but they still depend on the evolving regulatory environment.

In exploring whether, why and how dynamics within the automotive network shaped and have been shaped by FTAs, I will first briefly examine their configuration before regionalism.

### ***3.1. National and regional production networks before regionalism***

Under import substitution, governments enhance the comparative advantage of selected firms (foreign or local) by offering them oligo/monopolistic conditions domestically and trade protection from external competition. To jump over high tariffs, multinational lead firms establish independent plants in multiple countries, producing similar products, initially primarily for local consumption. Except in large markets, production is conducted at suboptimal economies of scale, which added to the simultaneous protection of upstream inputs results in high production costs, eventually passed on to domestic consumers. Once lead firms have sunk investment their leverage vis-à-vis the state declines.

Since foreign investment by lead firms does not necessarily generate backward linkages, many governments introduced regulations that forced lead firms to transfer technology and outsource inputs locally through technical transfer and local content requirements (LCR). Local automotive parts suppliers in Thailand and Malaysia lobbied for their establishment and maintenance (Abdulsomad, 1999).<sup>198</sup> In 2000, the World Trade Organization (WTO) outlawed the use of LCRs although technical transfer requirements are still permitted.

Competition for investment and limitations inherent in import substitution prompted developing countries to turn toward exports and progressively ease trade and investment restrictions, mostly unilaterally. When import substitution is pursued simultaneously with export-oriented strategies, states faced the dilemma of protecting upstream input producers without undermining the international competitiveness of downstream exporters. To that end, governments introduced tariff rebates for imported inputs that are incorporated into goods for exports through duty exemption/drawback schemes (DES/DDS) and export processing zones.

Export orientation coupled with DES/DDS increase production scales and access to inputs at world prices raising the x-efficiency of lead firms. Contrary to LCRs, DES/DDS enhance the power of lead firms over the state and local suppliers. Export promotion exposes local suppliers to external competition, but it could potentially benefit more efficient suppliers.

### ***3.2. Regional production networks under regionalism***

Exporting lead firms could use DES/DDS to import inputs tariff-free, but they may still face high tariffs on their final products at destination markets. For these firms, both

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<sup>198</sup> LCRs promote contracts with and transfer of know-how to local suppliers but not necessarily *indigenous* ones as local content could be achieved by outsourcing from relocated foreign affiliates. The ability of LCRs to upgrade local suppliers in Thailand has been questioned (Kohpaiboon and Jongwanich, 2013), although they fostered a growth in their numbers in Thailand and Malaysia (Abdulsomad, 1999).

multilateral and FTA liberalization grant easier access for their final goods in other markets, at the same time that liberalize input procurement without the export conditionality of DES/DDS. Lead firms that (over)invested across multiple countries under import substitution regimes would oppose any sudden multilateral liberalization of trade barriers on final goods that could lead to redundancy and/or overcapacity. Although multilateral liberalization maximizes scales for exporters, firms may favor FTAs because of their discriminatory effect against competitors outside (Chase, 2003; Chase, 2005). It is posited in this Essay that, in addition to generate rents to exporters inside the bloc, FTAs could also shift selective rents among lead firms already within the bloc. Accordingly, firms and states will support FTA configurations that strengthen their power with respect to other actors within the production network and FTA.

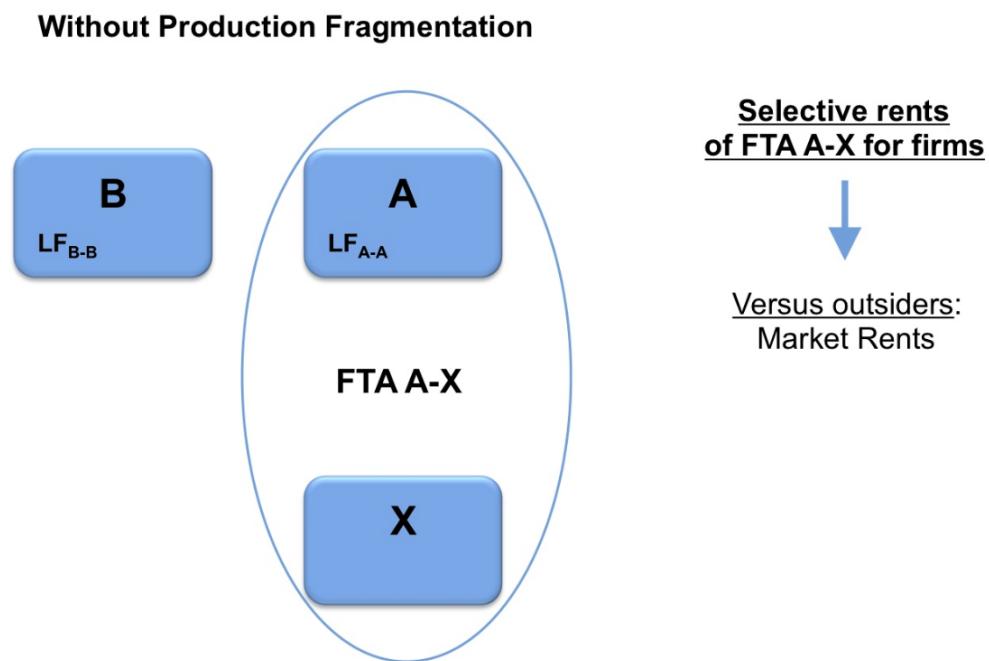
Use of FTAs' preferential tariffs requires that exported goods comply with rules of origin (ROOs) that specify whether a product has undergone sufficient transformation within the bloc. Most often, ROOs establish that the item contains a minimum value content from within the FTA area or that has undergone a change in the tariff line classification. Since final goods could contain inputs from multiple countries, some outside the FTA area, ROOs are particularly relevant in cross-border production networks.<sup>199</sup>

Consider a model in which A and B represent two developed countries and X a developing country.  $LF_A$  and  $LF_B$  are lead firms producing similar final goods in a given production network.  $LF_A$  has its base and a production plant in country A ( $LF_{A-A}$ ) and  $LF_B$  has home and a plant in B ( $LF_{B-B}$ ). If A and X sign an FTA,  $LF_A$  ( $LF_{A-A}$ ) would be able to export its final products to X free of tariffs, as opposed to lead firm  $LF_B$  ( $LF_{B-B}$ ) since country B has no FTA with X (Figure 1). Trade diversion created by FTA A-X generates "*market rents*" for  $LF_{A-A}$  that could expand its production scales and overall power vis-à-vis

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<sup>199</sup> ROOs are included in FTAs to avoid trade deflection, but could be used strategically for protectionist purposes. Disparity in ROOs across overlapping FTAs could have distorting effects in the functioning of production networks, referred as the "spaghetti or noodle bowl effect" (Bhagwati, 1995; Cadot et al., 2006; Baldwin, 2008).

$LF_{B-B}$ .  $LF_{B-B}$  could neutralize trade diversion by setting production within the A-X bloc or by lobbying its government to join FTA A-X (or create FTA B-X) triggering the classical domino of FTAs (Baldwin, 1995; Baldwin and Jaimovich, 2012).



**Figure 1:** Trade diversion inherent to any FTA creates rents for firms within the FTA area (see text for details).

For trade in final goods, firms' preferences regarding FTA liberalization are determined by their import-competing or export-oriented nature (Milner, 1999). In East Asia, where production networks have developed to greater extent than in any other region (Kimura and Obashi, 2011), the way production fragmentation influences preferences for FTAs as well as the impact that FTAs have on production strategies merit consideration and analysis.

It is posited here that certain FTA configurations could increase the relative power of some lead firms with respect to others also *inside* the bloc (Figure 2). In the example above, consider now that  $LF_A$  has fragmented its production and moved some stages (e.g., labor-intensive assembly) to country X (e.g., plant  $LF_{A-X}$ ).  $LF_{A-X}$  would be engaged in the import

of parts and components and the export of final goods (reverse imports) with country A. An FTA A-X would allow  $LF_{A-X}$  to export both items tariff-free. Although subsidiaries of lead firms from other countries that are also present in X (e.g., a subsidiary of  $LF_B$  from country B based in X,  $LF_{B-X}$ ) could also export to A using FTA A-X, this FTA is likely to benefit  $LF_{A-X}$  more than  $LF_{B-X}$  ("reverse imports rents").<sup>200</sup>

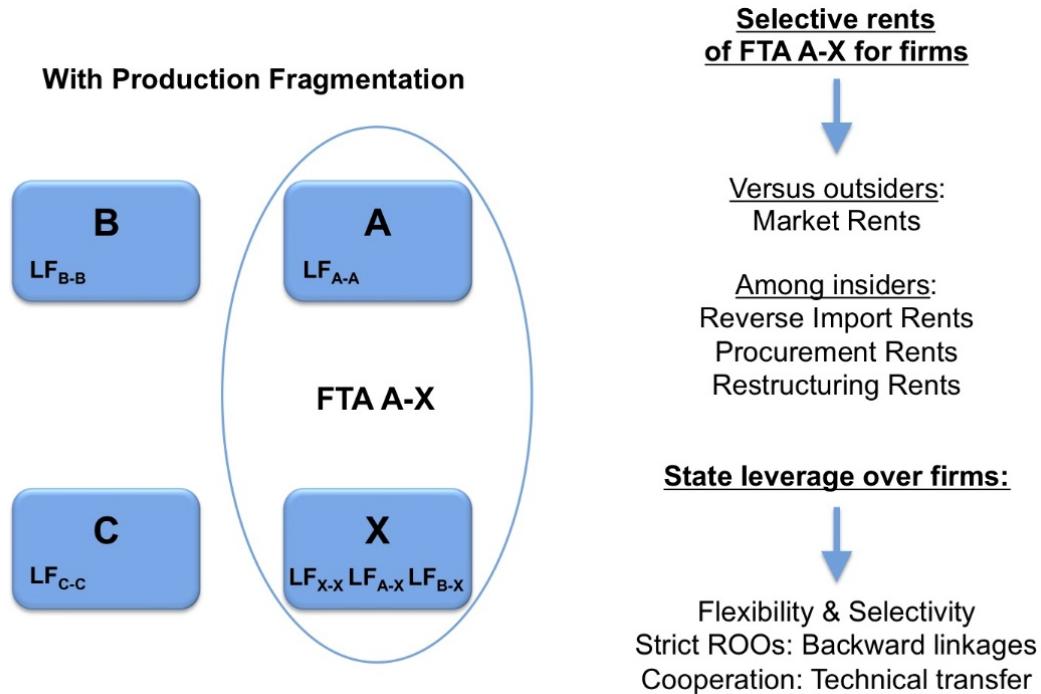
Higher-tariff country X not only applies high tariffs on final goods but also on intermediate inputs. In the absence of FTA A-X, lead firms producing in X could either: a) pass on to consumers the higher costs of protected local intermediate inputs incorporated into goods for domestic consumption or b) use DES/DDS to import intermediate inputs free of duty if these are incorporated into final goods for exports. Therefore, for lead firms producing in X, FTA A-X does not provide additional procurement gains over DES/DDS.

However, the above argument would only hold if procurement patterns were the same among all lead firms, which usually are not. This opens the door for FTAs to generate asymmetric rents in the import of intermediate inputs—"procurement rents"—among lead firms inside the bloc. Under FTA A-X,  $LF_{A-X}$  would be able to import inputs from A tariff-free and independently of the destination of the final good. The possibility for other foreign (e.g.,  $LF_{B-X}$ ) and local (e.g.,  $LF_{X-X}$ ) lead firms in X to benefit from liberalization of inputs from A would depend on their procurement pattern (Figure 2). To the extent that  $LF_{A-X}$  is likely to depend on inputs from A *more* than other firms based in X, FTA A-X would generate selective procurement rents to  $LF_{A-X}$ . For instance, in East Asian production networks, Japanese subsidiaries naturally tend to have stronger procurement links with Japan than Western firms do. Procurement rents will increase the relative power of  $LF_A$  within the production network, not only versus lead firms outside the bloc (e.g.,  $LF_{C-C}$ ) but

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<sup>200</sup> In East Asia, the relevance of these reverse imports rents is limited since exports back to Japan by Japanese subsidiaries in the region are low outside electronics and photographic equipment and are the lowest for the automotive sector (Chase, 2005).

also with respect to others within it (e.g.,  $LF_{B-X}$ ,  $LF_{X-X}$ ) (Figure 2).<sup>201</sup> Following principal-agent theory, by expanding procurement choices for  $LF_{A-X}$ , FTA A-X allows  $LF_{A-X}$  to squeeze suppliers in X.<sup>202</sup>



**Figure 2:** When lead firms fragment production and move some stages to other countries, certain FTA configurations could generate asymmetric rents (reverse import, procurement, restructuring), not only with respect to firms outside the bloc but also among those inside. See text for details.

It is contended here that procurement rents would be more important in at least four scenarios. First, in cross-border intra-firm procurement, as this type of trade is captive and less sensitive to price for switching sources. Second, when lead firms have invested in long-term relationships with suppliers. Third, when domestic-bound production, ineligible for DES/DDS, represents a large share of total production. Lastly, in sectors with less standardized intermediate goods (e.g., the automotive industry), which cannot be procured from multiple sources and countries. Arguably, firms under these circumstances will have stronger incentives to lobby for FTAs that selectively liberalize their main offshore

<sup>201</sup> In industries with limited global outsourcing,  $LF_{B-X}$  may depend more on inputs from the regional hub A than from distant home B. Likewise, not all firms from country A with plants in X have the same procurement dependence on intermediate goods from A. Therefore, the distribution of procurement rents could be firm-specific and cannot be predicted by the lead firms' home country requiring for its assessment of firm-level research.

<sup>202</sup> This should either reinforce market forms of lead firm-suppliers relations or, at the other extreme, hierarchical intra-firm outsourcing.

outsourcing flows.

**Hypothesis 1:** *When lead firms in a country have different sourcing patterns, an FTA between the host country and one of the input source countries could generate asymmetric procurement rents among lead firms inside the FTA bloc.*

For lead firms inside an FTA, liberalization offers the possibility to link dispersed production units and progressively restructure production from the national to the FTA bloc level while being protected from outside competitors by external multilateral tariffs (Chase, 2003; Chase, 2005). It is argued here that efficiency gains from restructuring would also be selective (amounting to “*restructuring rents*”), benefitting more lead firms that have plants in the two countries that form the FTA (e.g.,  $LF_A$  over  $LF_X$ ) (Figure 2).<sup>203</sup> Once again, the key point here is that FTAs could create *selective* benefits among firms inside the bloc, not only versus outsiders.

**Hypothesis 2:** *When lead firms in a given country have also production stages in other countries, an FTA between the host country and one of those other countries could generate asymmetric restructuring rents among lead firms inside the FTA bloc.*

Liberalization—and globalization more generally—has reduced the influence and leverage of states over multinational lead firms and their overall steering of the economy

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<sup>203</sup>As with procurement rents, the distribution of restructuring rents is not determined simply by the firm’s home country, but also by factors intrinsic to each firm. For instance, if before the FTA,  $LF_A$  established plant  $LF_{A,X}$  as a way to jump over high tariffs in  $X$ , FTA A-X may prompt  $LF_A$  to consolidate all production in A ( $LF_{A,A}$ ), or specialize each plant in different products. On the other hand, if  $LF_A$  only produced in A ( $LF_{A,A}$ ) before the FTA,  $LF_A$  may move some production stages to  $X$  once FTA A-X is implemented to profit from investment provisions in the FTA.

(Yeung et al., 2013). Any type of liberalization has distributional effects among nations but in North-South bilateral FTAs developed countries often impose on developing ones regulatory reforms on issues beyond WTO that favor their interests and those of their firms (Shadlen, 2005; Pekkanen et al., 2007). It is submitted here that, in turn, FTAs offer developing countries possibilities to gain leverage over lead firms and developed states that are not possible in other liberalization fora. Compared to multilateral liberalization, FTAs provide developing governments with more options for selective liberalization coverage and sequencing as well as to foster procurement and technological linkages between multinational lead firms and the local supply base.

Ambiguities and flexibilities in General Agreement on Tariffs and Trade's (GATT) Article XXIV and Enabling Clause, regulating coverage and sequencing of FTA liberalization, leave room for states to protect sensitive sectors in FTAs in ways that are not possible under "single undertaking" multilateral WTO liberalization.<sup>204</sup> Since FTAs establish tariff levels and ROOs at the highest level of product specification, liberalization or protection could be targeted to narrow subsectors, potentially to specific firms. This creates another level of asymmetric impacts of FTAs among insiders and increases the leverage of governments over lead firms.

**Hypothesis 3:** *Compared to multilateral liberalization, FTAs offer governments more options for selective targeting and sequencing of liberalization or protection, which should increase their leverage over lead firms.*

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<sup>204</sup> The Doha Round also proposes to reduce high tariffs more rapidly than lower ones while in FTAs tariff peaks could be reduced gradually or excluded altogether.

It is also argued here that FTAs could be negotiated to foster sector-specific backward linkages between lead firms and local suppliers. Independently of whether LCRs were welfare-enhancing or -decreasing, some developing countries valued them greatly and requested from the WTO a temporary extension beyond the original 2000 deadline, particularly for the automotive industry. FTA preferential tariffs could induce a supply switching from firms in third nations to firms in FTA partners, a *tariff-mediated* trade diversion (Schiff and Winters, 2003). This Essay contends that in sectors where production fragmentation is prevalent, strict ROOs could have supply-switching effects that could resemble WTO-illegal LCRs, a *ROO-mediated* trade diversion.

By establishing high levels of intra-bloc transformation, strict ROOs favor outsourcing from suppliers located within the FTA. If country X seeks to promote its domestic supply base in a given industry, it could strategically negotiate its FTA with A to impose strict ROOs on final goods in a highly product-specific manner. In most FTAs, inputs from the partner also qualify towards the “FTA area value content” established by ROOs (e.g., inputs from either A and/or X). A motivated government in X would negotiate equally stringent ROOs in subsequent FTAs with other countries (e.g., B, C, etc.). Once X has implemented multiple FTAs, each with its own ROOs, it is possible that the value content of final goods made by  $LF_{A-X}$ —potentially with inputs from home country A—qualifies to preferential tariffs under FTA A-X, but not under FTAs B-X or C-X. This should encourage  $LF_{A-X}$  (and other firms based in X:  $LF_{X-X}$ ,  $LF_{B-X}$ ,  $LF_{C-X}$ ) to outsource preferentially from suppliers in X in order to qualify for all the FTAs signed by X.<sup>205</sup> To the extent that strict ROOs promote linkages between lead firms and local suppliers, FTAs could enhance the leverage of states and suppliers over lead firms.

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<sup>205</sup> As with LCRs (see footnote 198), strict ROOs promote procurement from local suppliers but not necessarily from *indigenous* firms. Of note, this research project could not find significant inverse correlation between the utilization rate of selected Thai and Malaysian FTAs and the restrictiveness of their ROOs (see Essay 2).

**Hypothesis 4:** *A government seeking to increase local content in manufacturing could strategically negotiate strict ROOs in multiple FTAs to foster backward sourcing linkages from lead firms to local suppliers in ways that would resemble WTO-illegal LCRs.*

For developing countries, forcing or incentivizing lead firms to transfer technology to local suppliers becomes more difficult after firm's establishment but, it is argued here, governments could use FTAs to that effect. A common feature in North-South FTAs in East Asia is the inclusion of cooperation provisions that go beyond government-to-government capacity building in technical trade issues to also include assistance by firms from the developed partner to local firms in the developing country in highly targeted projects. By bundling technical cooperation into a package of reciprocal tariff concessions, developing states and their indigenous supply base could direct funds and know-how to sectors of their choice and gain leverage over lead firms.

**Hypothesis 5:** *In North-South FTAs, a developing government seeking to upgrade the capabilities of its local supply base could strategically negotiate cooperation chapters in FTAs to channel technology transfer and technical assistance by the partner's lead firms to local suppliers.*

As in the scenario before regionalism, the main source of leverage for suppliers in FTA formulation derives from the rents furnished to them by the institutional environment. By eliminating tariffs on intermediate goods and expanding procurement options for lead firms across the bloc, FTAs reduce the leverage of suppliers over lead firms. But, as discussed above, FTAs could also be used to the benefit of suppliers by imposing

procurement restrictions (e.g., strict ROOs), and technical linkages (e.g., cooperation provisions) on lead firms. FTAs would thus increase the power of suppliers inside the trade area with respect to those outside. Eventually, suppliers' preferences regarding regionalism would be contingent on their competitiveness. More advanced suppliers, potentially benefiting from increased production by lead firms, would therefore support FTAs.<sup>206</sup>

#### **4. The automotive production network in Thailand before regionalism<sup>207</sup>**

The investment incentives introduced by the Thai government in the early 1960s fostered the entry of foreign automotive OEMs (mostly Japanese) that, in joint venture with local entrepreneurs, assembled vehicles out of completely knocked-down kits for a protected market. Heavy dependence on imported automotive products contributed to trade deficits, which prompted the government to establish LCRs and a partial ban on imports of fully-assembled vehicles in the mid-1970s. Although secondary to trade balance considerations, LCRs were also introduced to increase the number of local (and indigenous) suppliers. LCRs also benefitted Japanese assemblers that produced more localized models than Western firms. Newly gained influence by suppliers and divisions among carmakers, allowed the government to keep increasing LCRs and postpone rationalization of an overcapacity industry. The departure of several Western OEMs in the 1970s allowed Japanese assemblers to reap all the benefits of rapid growth in domestic vehicle demand during the late 1980s.

Starting in the late 1980s, import substitution began to be coupled with export-promotion strategies, including the strengthening of DES/DDS and export-processing zones. Yet, by 1995, exports accounted for less than 1.4% of total production. Unilateral

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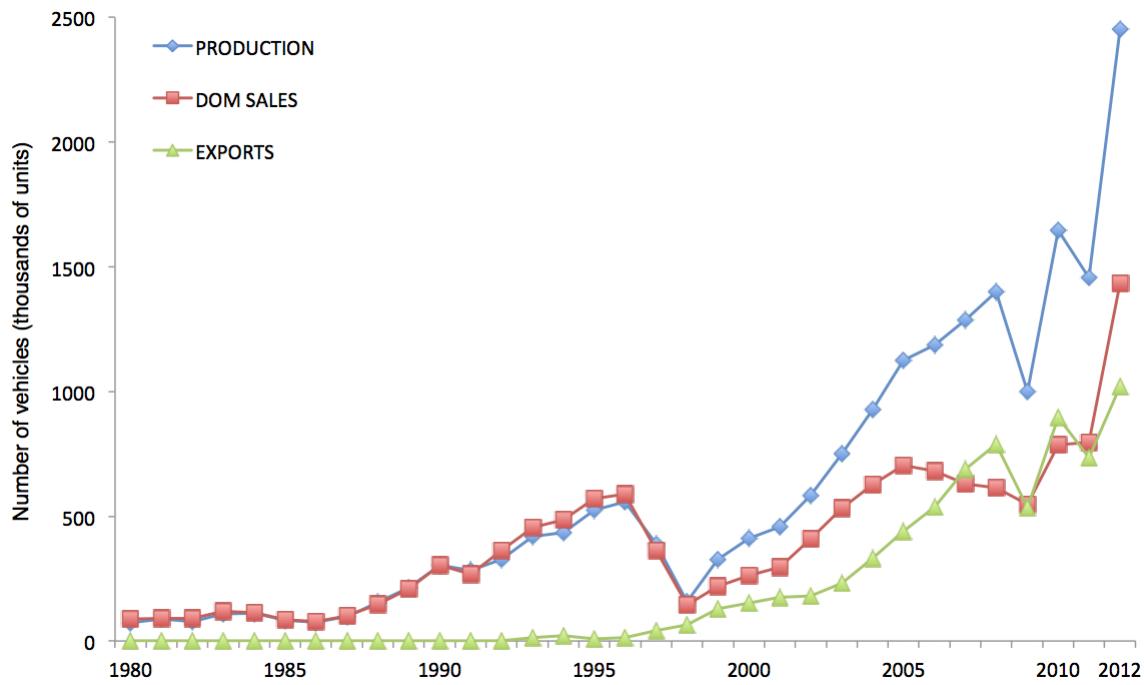
<sup>206</sup> In the automotive industry, where APC exports take place mainly through OEMs, market rents accrue to suppliers only indirectly. As FTAs facilitate procurement of high-tech inputs from more developed countries, they could potentially limit incentives for upgrading of the supply base in the less developed country.

<sup>207</sup> This section draws on secondary literature, *inter alia*, on Doner (1991, 2009), Abdulsomad (1999), Abbott (2004) and Niyomsilpa (2008) complemented with information from interviews.

liberalization was reinforced by commitments under AFTA and GATT's Uruguay Round. Restrictions on assembled vehicle imports were lifted and tariffs reduced.

Rapidly increasing vehicle demand in Thailand instigated a surge of investment into the industry, not only by established Japanese firms and Western carmakers that returned in the late 1990s. Thailand was favored by carmakers over other ASEAN because it had the largest market and supply base, but mainly due to its lack of a national car program. With their eyes on AFTA and WTO, American carmakers did not re-enter Thailand just to serve its domestic market but also to establish an export base for ASEAN and beyond. Nevertheless, most indigenous suppliers were not up to export standards, so this period also witnessed investments by first-tier foreign suppliers.

Vehicle demand and production collapsed in the wake of the 1997 Asian financial crisis (Figure 3). Although applied multilateral tariffs on vehicles from *outside* ASEAN were raised, Thailand maintained its international commitments to abolish LCRs and reduce intra-ASEAN tariffs in line with established AFTA schedules. Domestic sales recovered by 2004 but the crisis deeply transformed the industry (Niyomsilpa, 2008). Local partners in most assembly plants went bankrupt leaving their foreign counterparts in full equity control. Likewise, many Thai suppliers closed down or were bought up by foreign firms, mostly Japanese. Foreign carmakers in Thailand reacted to the Asian crisis by redirecting excess capacity abroad, marking Thailand's takeoff as an automotive exporting country (Figure 3).



**Figure 3:** Production, domestic sales and exports of vehicles (passenger and commercial) in Thailand.  
Source: Thailand Automotive Institute and Thai Automotive Industry Association.

## 5. The automotive production network in Thailand under regionalism

Following the Asian crisis, the Thai government endeavoured to consolidate Thailand as the regional automotive hub through foreign investment and a combination of import substitution with export promotion. In turn, carmakers redoubled their pressure on ASEAN governments for the acceleration of AFTA implementation and started lobbying Thailand in favor of bilateral FTAs with some key partners.

Although most international OEMs and suppliers have production facilities in several ASEAN countries, Thailand holds the largest and most advanced manufacturing operations. Production reached 2.5 million units in 2012, setting Thailand as the world's ninth largest producer, the third for light commercial vehicles (pickup trucks) (Figure 3).<sup>208</sup> Japanese firms have traditionally dominated the Thai automotive industry. On average,

<sup>208</sup> Figures in this section were obtained from interviews with representatives from automotive business associations, individual firms and government agencies in Thailand, complemented by personal communications. In 2007, trying to create a second niche product beyond pickup trucks, the government launched the "eco-car project" for the export-oriented production of low-carbon emission passenger cars. Up to 430,000 eco-cars are projected to be produced in Thailand in 2013 (Bangkok Post, August 6, 2013).

over 85% of vehicles assembled in Thailand over the last decade have been Japanese models compared to around 12% American and only 0.5% European (Table 1 for 2008, a mid-year for the period under study).<sup>209</sup> Japanese carmakers produce in Thailand a range of commercial vehicles and passenger cars, except larger-engine luxury models that are imported directly from Japan. European firms only dominate production in the niche segment of large-engine cars, assembled from completely knocked-down kits imported from Europe.

In 2012, Thailand was the biggest automotive market in ASEAN and the third largest exporter in East Asia after Japan and Korea. Japanese OEMs represent over 85% of domestic sales and over 80% of exports (Table 1). Main export markets are Australia, other ASEAN countries, and the Middle East, while reverse exports to home countries, including to Japan, have been negligible before 2010. Toyota alone accounts for around 40% of total production, local sales and exports, dominance that has translated into significant influence in Thai policymaking with Toyota as key sponsor of several Thai FTAs (see below).<sup>210</sup>

The supply base in Thailand is ASEAN's largest and most developed. Despite the elimination of LCRs, domestic value content of Thailand-made vehicles has progressively increased (Techakanont, 2011; Kohpaiboon and Jongwanich, 2013; interviews). Still, Thailand imports more APCs than it exports, especially some key functional APCs and rolled steel from Japan (including for some American models) or from OEMs' subsidiaries in the region. Although there are over 300 Thai-owned APC manufacturers classified as first-tier, the bulk of indigenous suppliers are specialized on labor-intensive body parts and/or lack independent capabilities in module production, design and research and development and require assistance from OEMs or international suppliers (interviews;

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<sup>209</sup> Japanese influence is actually higher since for some vehicles produced by Ford and General Motors share platforms with Japanese carmakers (Mazda and Isuzu, respectively), therefore also depending to some extent on Japanese inputs.

<sup>210</sup> The large influence of Toyota in Thai automotive policy, and Thai trade and industrial policy more generally, was revealed in interviews with government officials and other carmakers from all nationalities.

Kohpaiboon and Jongwanich, 2013). Interviews revealed that while upgrading of the supply base is a stated policy goal, the government is not necessarily concerned about its ownership, and relies mainly on market forces (e.g., agglomeration of export-oriented foreign firms) to foster technological transfer.

**Table 1: Share (%) of vehicle production, domestic sales and exports in Thailand (2008) \***

|                   | Production | Domestic Sales | Exports |
|-------------------|------------|----------------|---------|
| <b>Toyota</b>     | 41.5%      | 43.7%          | 40.6%   |
| <b>Mitsubishi</b> | 12.4%      | 3.8%           | 18.5%   |
| <b>Isuzu</b>      | 11.3%      | 22.1%          | 6.4%    |
| <b>Honda</b>      | 11.6%      | 15.0%          | 9.31%   |
| <b>Nissan</b>     | 5.2%       | 5.1%           | 5.4%    |
| <b>Mazda **</b>   |            | 1.8%           |         |
| <b>Ford **</b>    | 9.2%       | 1.5%           | 14.6%   |
| <b>GM</b>         | 7.4%       | 3.6%           | 5.17%   |
| <b>Other ***</b>  | 1.4%       | 3.4%           | 0.02%   |

Source: Thai Automotive Industry Association

\* Average market share for total registered vehicles (commercial and passenger cars)

\*\* Mazda and Ford have a joint venture in Thailand (Thai Auto Alliance)

\*\*\* European carmakers hold around two thirds of sales for over 2500cc passenger cars, segment that represents less than 0.5% of the overall market

### 5.1. *Thai FTAs*

Thailand was not only one of the first countries in East Asia to pursue bilateral FTAs, but, during much of the last decade, it was also one of the most active. As of August 2013, in addition to AFTA, Thailand has implemented five bilateral treaties and five ASEAN-centered FTAs (see Table 1 in Essay 1), but only AFTA and the bilateral treaties with Australia, India and Japan are relevant to the automotive industry.

As the ASEAN automotive industry was fragmented along national boundaries, starting in the 1980s, international carmakers, particularly Japanese firms, sought to rationalize procurement and production scales at the regional level. To that effect, they

lobbied ASEAN governments first for the liberalization of regional trade of APCs through “complementation sourcing programs” and later of both APCs and assembled vehicles through AFTA (Yoshimatsu, 2008; interviews; footnote 59).

The impact of AFTA during the 1990s was very limited because it left ample room for protectionism and its poor implementation (Ravenhill, 2008). AFTA schedules were accelerated after the Asian crisis, requiring all intra-ASEAN tariffs to be capped at 20% by 2000, at 0-5% by 2003. Items could be temporarily excluded from this timeline as long as all manufacturing lines returned to normal track by 2003. Intra-ASEAN tariffs among the main ASEAN economies were eliminated in 2010 when AFTA was replaced by the ASEAN Trade in Goods Agreement (ATIGA) (see footnote 71). Raw materials, APCs and vehicles are now sourced, produced and traded within ASEAN according to a division of labor that results from the interplay between the corporate strategies of automotive firms and an inter-governmental agreement as AFTA (Table 2). As the regional automotive hub, Thailand has been the main beneficiary of AFTA that has played a crucial role in attracting investment by international carmakers and suppliers.<sup>211</sup> Although Thailand has protected the automotive industry behind high multilateral tariffs, it complied with AFTA liberalization schedules.

Once automotive firms in Thailand had restructured their productive processes in the context of ASEAN, they started lobbying for bilateral FTAs that fitted their specific procurement, production and export strategies and that could therefore generate selective rents with respect to other firms based in Thailand. Nevertheless, these same automotive firms resisted multilateral reciprocation, with MFN tariffs on automotive products ranking among the highest in Thailand.

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<sup>211</sup> During the period 2006-2010, Thailand attracted US\$ 6.7 billion to its automotive and transport equipment industry, compared to US\$ 2.6 billion and US\$2.3 billion into Indonesia and Malaysia, respectively (interviews; Bank of Thailand, Indonesia's Investment Coordinating Board and Malaysian Investment Development Authority websites).

**Table 2: Division of labor among OEM's subsidiaries in ASEAN**

| OEM   | Plants for functional APC  | Vehicle assembly plants *   |
|---|--|---|
| <b>Toyota</b>   | <u>Thailand</u> : diesel engines, engine parts and press parts<br><u>Malaysia</u> : electronic control unit, steering system<br><u>Indonesia</u> : gasoline engines and pressed parts<br><u>Vietnam</u> : accelerators<br><u>Philippines</u> : transmissions, constant velocity joints   | + <u>Thailand</u> : Camry, Corolla, Hilux, Yarns, Vies, Wish, Fortune, Pries<br>++ <u>Malaysia</u> : Hake, Hilux, Vios, Innova, Fortuner, Camry<br>+ <u>Indonesia</u> : Innova, Fortuner<br>++ <u>Vietnam</u> : Camry, Corolla, Hiace, Innova, Vios<br>++ <u>Philippines</u> : Innova, Vios   |
| <b>Honda</b>  | <u>Thailand</u> : pressed parts, frame panels, electrical parts, interior parts and engine parts<br><u>Malaysia</u> : dashboard assembly, bumper, drive shaft, constant velocity joint, manual gearbox, stamping parts<br><u>Indonesia</u> : in cylinder head assembly, cylinder block, engine valve, steering handle, automatic gearbox<br><u>Philippines</u> : engine fuel system, emission systems, engine electric parts, suspension parts, manual gearbox | + <u>Thailand</u> : City, Jazz, Civic, Accord, CR-V, Brio<br>++ <u>Malaysia</u> : City, Civic, Accord, CR-V<br>+ <u>Indonesia</u> : Jazz, CR-V, Freed (for export to ASEAN)<br>++ <u>Vietnam</u> : Civic, CR-V (NO Export)<br>++ <u>Philippines</u> : City (NO Export)  |
| <b>Nissan</b>   | <u>Thailand</u> : engines  | + <u>Thailand</u> : Frontier, Navara, Teana (export), Tilda, March (export), Almera<br>++ <u>Malaysia</u> : Serena, Sentra, Latio, Frontier, Urban, Sylphy, Grand Livina, Teana, Navara, X-Trail<br>+ <u>Indonesia</u> : Grand Livina, Livina, X-Trail, Serena, March, Juke<br>++ <u>Philippines</u> : Sentra, X-Trail, Grand Livina, Frontier, Navara, Patrol, Urban |
| <b>Mitsubishi</b>   | <u>Thailand</u> : engines<br><u>Indonesia</u> : engines, press parts, body parts<br><u>Philippines</u> : transmissions   | + <u>Thailand</u> : Triton, Lancer, Lancer Ex, Pajero (export), Sport, Mirage (export), Canter<br>++ <u>Malaysia</u> : Canter, Fuso<br>+ <u>Indonesia</u> : Colt, Canter, Fuso<br>++ <u>Vietnam</u> : Grandis, Zinger, Canter<br>++ <u>Philippines</u> : Delica, Adventure, Lancer, Canter, Fuso  |
| <b>Mazda</b><br>(joint venture with Ford in Thailand)   | <u>Thailand</u> : transmissions<br><u>Philippines</u> : engine parts   | + <u>Thailand</u> : Mazda BT-50, Mazda 2, Mazda 3<br>++ <u>Malaysia</u> : Mazda 3<br>++ <u>Vietnam</u> : Mazda 2  |
| <b>Daihatsu</b><br>(joint venture with Perodua in Malaysia)   | <u>Malaysia</u> : engines (Perodua)  | ++ <u>Malaysia</u> : Alza, Myvi, Viva<br>+ <u>Indonesia</u> : Terios, Xenia, Grand Max, Luxio   |
| <b>Suzuki</b>   |  | + <u>Thailand</u> : Ecocars (Swift)<br>++ <u>Malaysia</u> : commercial vehicles<br>+ <u>Indonesia</u> : Grand Vitara, APV, Carry, Futura, Swift, SX4  |
| <b>Isuzu</b>  | <u>Thailand</u> : diesel engines, forged parts, press molds<br><u>Indonesia</u> : diesel engines, casting parts<br><u>Philippines</u> : transmissions  | + <u>Thailand</u> : pickups, commercial vehicles<br>* <u>Malaysia</u> : commercial vehicles, buses, trucks<br>+ <u>Indonesia</u> : commercial vehicles, buses, trucks<br>++ <u>Vietnam</u> : trucks<br>++ <u>Philippines</u> : commercial vehicles, buses   |
| <b>Ford</b><br>(joint venture with Ford in Thailand. Exited Malaysia in 2008 and Philippines in 2012) | <u>Philippines</u> : gasoline engines  | + <u>Thailand</u> : Laser, Protégé, Focus, Fiesta, Ranger, Everest, EcoSport, Mazda-3, Mazda-BT50<br>++ <u>Malaysia</u> : Ranger, Laser, Telstar, Transit, Econovan, Mazda BT50<br>++ <u>Vietnam</u> : Escape, Everest, Mondeo, Ranger, Focus, Transit<br>+ <u>Philippines</u> : Ranger, Lynx, Tribute, Protégé, Focus, Mazda3, Escape                                |
| <b>GM/Chevrolet</b><br>(Exited Indonesia in 2005, back in 2013)                                       | <u>Malaysia</u> : electrical components  | + <u>Thailand</u> : Optra, Blazer, Colorado, Captiva, Aveo, Zafira, Cruze<br>+ <u>Indonesia</u> : Blazer (dctd)<br>++ <u>Vietnam</u> : Aveo, Lacetti, Spark, Captiva, Vivant, Spark Van, Colorado   |
| <b>Volvo</b>  |  | ++ <u>Thailand</u> : S60, S80, XC90<br>++ <u>Malaysia</u> : S40, S60, S80, V50, XC90  |
| <b>BMW</b>  |  | ++ <u>Thailand</u> : Series 3, 5 and 7<br>++ <u>Malaysia</u> : Series 3 and 5<br>++ <u>Indonesia</u> : Series 3 and 5   |
| <b>Proton</b>   | <u>Malaysia</u> : engines and engine parts   | + <u>Malaysia</u> : Preve, Exora  |

Source: Interviews and personal communications with OEMs' representatives complemented with data from websites and reports

\* Only main models are included.

+ Vehicles produced for the domestic market and for exports to other ASEAN markets and beyond. Note that not all models are exported

++ Vehicles produced exclusively (or majoritarily) for the domestic market

Even before negotiations for the Thailand-Australia FTA (TAFTA) started in 2002, Australia was already the largest market for Thailand-made vehicles that accounted for a quarter of all Thai exports to Australia. In contrast, high tariffs in Thailand meant that Australian automotive products had a small presence in the kingdom. In the final treaty, which went into effect in 2005, both countries agreed to fully liberalize their respective automotive industries by 2010.<sup>212</sup>

Despite that India and Thailand have both grown to be among the world's largest automotive manufacturers, trade in vehicles between both countries has been almost negligible. Most international OEMs have plants in India, but the market is segmented differently than in Thailand. When negotiations for a bilateral FTA started in 2002, OEMs in both countries were adamantly against liberalization of bilateral trade in vehicles.<sup>213</sup> However, some of these OEMs lobbied for the liberalization of specific APCs. In October 2003, an early harvest agreement was signed—the Thailand-India Early Harvest Scheme (TIEHS)—to liberalize a small number of tariff lines while the fully-fledged FTA is still being negotiated.

Japan offers tariff-free multilateral access to all automotive products. Therefore, when Japan and Thailand started negotiations for the Japan-Thailand Economic Partnership Agreement (JTEPA) in 2004, the exclusive interest of the FTA for automotive firms was the extent to which Thailand was ready to liberalize its automotive industry.

### ***5.2. Use of selective rents and flexibilities in Thai FTAs***

Most international OEMs and suppliers have benefited from the progressive liberalization of the ASEAN automotive market. However, in line with Hypotheses 1 and 2, Japanese firms—with a longer, broader, and deeper presence across ASEAN—have extracted more

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<sup>212</sup> The automotive industries in both countries are somehow complementary with Thailand's strength is in commercial vehicles and small passenger cars, while Australia's advantage is in larger-engine cars and higher-technology APCs.

<sup>213</sup> Carmakers in Thailand opposed to easier access for competitively-priced Korean or Indian brands produced in India, and OEMs in India demanded protection from imported Thailand-made Japanese models.

selective rents from ASEAN complementation sourcing programs and AFTA than American and European firms.<sup>214</sup> Accordingly, Japanese carmakers lobbied the strongest to ASEAN governments for the implementation of these trade regimes (Yoshimatsu, 2002; interviews). In the most successful complementation program, the ASEAN Industrial Cooperation, 90% of the 129 projects were for the trade of automotive products, mostly completely knocked-down kits.<sup>215</sup> Given Thailand's position as the regional automotive hub, its government supported these programs that were actively used by OEMs and international suppliers in Thailand, but not by indigenous suppliers. Confirming initial arguments, Thailand participated in 67% of all automotive-related projects, of which 82% involved Japanese firms (data from the Thai Ministry of Industry; interviews). Toyota and Honda alone, with the most extensive network of operations in ASEAN (Table 2), accounted for two thirds of all automotive complementation projects.

Thai exports of assembled vehicles to other ASEAN countries increased after AFTA tariffs began to significantly decline in 2003 and have accelerated since 2010 (Table 3). In light of high protection of the industry in most ASEAN countries, automotive products are among the most traded items under AFTA. Overall Thai utilization of AFTA for exports has increased from less than 10% in 2001 to 35.1% in 2010, largely due to trade in automotive products (data from the Thai Ministry of Commerce). For instance, in 2008 (a mid-year for the period under study), about a third of all Thai exports using AFTA preferences were automotive products and out of them more than half were assembled vehicles for which utilization of AFTA was virtually complete (data from the Thai Ministry of Commerce; Kohpaiboon, 2010).

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<sup>214</sup> European firms (e.g. Volvo, Mercedes-Benz, BMW, Peugeot) import kits directly from Europe and supplement them with non-critical parts sourced in the local market. Consequently, they use AFTA less and mostly for trade of finished vehicles.

<sup>215</sup> The Brand-to-Brand Complementation (1988-1995) and the ASEAN Industrial Cooperation (1996-2003, although continued to be used until full AFTA implementation in 2010) programs established specific projects for APC liberalization (Yoshimatsu, 2002). Some firms also used these programs for trade in assembled vehicles (interviews).

Interviews with international OEMs and global suppliers indicated extensive use of AFTA, mostly for intra-firm trade of OEM's proprietary high-technology APCs, engines, transmissions, completely knocked-down kits and assembled vehicles. Because of confidentiality issues, trade authorities in Thailand do not provide disaggregated data on FTA utilization at the firm level (see Essay 2). Nevertheless, considering that Japanese brands account for over 80% of Thai vehicle exports to ASEAN, it is safe to infer that, as in earlier complementation sourcing programs, Japanese OEMs (particularly, Toyota as the larger exporter) have benefited the most from the procurement rents granted by AFTA (Hypothesis 1).<sup>216</sup>

**Table 3: Trade in vehicles (in US\$ millions) among the main automotive producing countries in ASEAN \***

| Importer |                      | 2002        |            |             |             | 2012           |              |              |             |
|----------|----------------------|-------------|------------|-------------|-------------|----------------|--------------|--------------|-------------|
|          |                      | Exporter    |            |             |             | Exporter       |              |              |             |
|          |                      | Thai        | Mal        | Indon       | Philipp     | Thai           | Mal          | Indon        | Philipp     |
| Importer | <b>Thailand</b>      | -           | 0.9        | 9.9         | 18.9        | -              | 107.5        | 476.8        | 25.6        |
|          | <b>Malaysia</b>      | 28.5        | -          | 0.3         | 0.0         | 834.7          | -            | 172.7        | 5.3         |
|          | <b>Indonesia</b>     | 50.5        | 3.1        | -           | 4.9         | 1999.7         | 66.1         | -            | 14.7        |
|          | <b>Philippines</b>   | 7.2         | 0.2        | 0.0         | -           | 808.6          | 0.0          | 335.2        | -           |
|          | <b>TOTAL exports</b> | <b>86.2</b> | <b>4.2</b> | <b>10.2</b> | <b>23.8</b> | <b>3,643.0</b> | <b>173.6</b> | <b>984.7</b> | <b>45.6</b> |

Source: Trade Map database (Trade Map, undated)

\* Total exports of vehicles (commercial and passenger vehicles: codes 8701,8702, 8703,8704 under the Harmonized Commodity Description and Coding System)

Besides tariff liberalization, OEMs have also taken advantage of AFTA to restructure production at the ASEAN level (Hypothesis 2). Japanese firms have profited the most from these restructuring rents but American OEMs have also relocated production as a result of AFTA (Table 2). For instance, Ford closed its assembly operations in Malaysia in 2008 and in the Philippines in 2012, and now serves both countries from its plants in Thailand. In

<sup>216</sup> Although Mitsubishi is the OEM in Thailand that exports the largest share of its production, it operates mainly in export free zones and makes little use of AFTA and other FTAs (interviews).

2009, in anticipation of the complete elimination of AFTA tariffs the following year, Volvo (is European) considered closing down its factory in Thailand and consolidate production in Malaysia (interviews). However, as other European carmakers, Volvo maintained operations in both countries despite AFTA implementation.

Although 85% of Thai trade in APCs with the rest of ASEAN is conducted among OEMs subsidiaries, large first-tier suppliers, particularly foreign firms, have also profited from the selective rents offered by complementation programs and AFTA (interviews). For instance, Japanese APC manufacturer Denso accounted for 6% of all projects under the ASEAN Industrial Cooperation program. Field research also found that utilization of AFTA for APC exports by leading Thai-owned first-tier suppliers has been much lower than for vehicles (even lower among lower-tier suppliers), reflecting not only lower tariffs and preferential margins on APCs, but, more importantly, also logistical issues referred earlier. OEMs usually request that first-tier suppliers follow them to other ASEAN countries and set their plants nearby, instead of exporting their APCs from their home country. Nonetheless, Thai first-tier suppliers interviewed valued AFTA because it will potentially expand their procurement, export and restructuring options for the future.

While AFTA was progressively being implemented, international carmakers sought to integrate Australia within the Thai/ASEAN production network. At the time, the main carmakers in Australia were Japanese Toyota and Mitsubishi and American General Motors (GM) (via its subsidiary Holden) and Ford. Toyota and Mitsubishi supplemented local production in Australia with imports from Thailand and Japan while GM imported some models and APCs from Thailand and Korea (interviews). Honda, without plants in Australia, served demand from Thailand and Japan. However, at the time, Australia lacked FTAs with Japan or Korea. Japanese and American carmakers were expected to benefit from market rents vis-à-vis European firms, especially for Thai exports of vehicles to

Australia. European firms did not project major direct impacts from TAFTA, as Volvo and BMW served Australia directly from Europe, while their position in Thailand could not be challenged by upper segment cars produced in Australia.

TAFTA confirmed the initial hypotheses. The FTA has been beneficial to carmakers based in Thailand—particularly Toyota, and GM/Isuzu with the largest volumes—which have increased production and exports of vehicles to Australia, benefitted from cheaper Australian higher-technology APCs (e.g., engines), and restructured their production at the bilateral level (Hypotheses 1 and 2) (interviews). Some firms started reorganizing beforehand and then lobbied for TAFTA to consolidate restructuring savings (see Essay 1). For instance, in the early 2000s, Toyota had transferred production of some models from Australia to Thailand and wanted to eliminate Australian tariffs on them. Although Toyota has potentially extracted more selective restructuring rents than other firms, other Japanese and American OEMs have also benefited. Thus, Mitsubishi closed its Australian operations in March 2008 and moved them to Thailand, Ford will do the same in 2016, and Honda, without previous presence in Australia, now supplies its market from Thailand instead of from Japan (interviews, *Financial Times*, May 23, 2013).

In the eight years since TAFTA was implemented, Thai vehicle exports to Australia have quintupled, and now account for over a third of total exports. Increased production by OEMs in Thailand has also benefited Thai-based suppliers. Contrary to initial expectations, Australian exports of APCs and vehicles to Thailand increased only modestly because of the changes in Thai excise duties and the repositioning of Australia within OEMs' strategies. Illustrating carmakers' original interest in TAFTA, during 2005-2011, over half of Thai exports to Australia under TAFTA were vehicles (see Essay 2). Likewise, and in line with its strong and early support for TAFTA (Essay 1), GM was the first and main OEM using TAFTA to import cars from Australia (interviews).

As indicated in the previous section, carmakers in Thailand and India were not interested in the bilateral liberalization of vehicles. Instead, some firms, particularly Toyota, sought the TIEHS as a mean to rationalize their procurement network (interviews), as reflected in the final treaty that includes five automotive items, namely, transmissions and some engine and electrical parts. The year before TIEHS was signed, Toyota had established a subsidiary in India to produce transmissions for export to Thailand and planned to expand production of small cars in India with diesel engines sourced from Thailand (interviews).

Interviews found that the TIEHS has been utilized predominantly for intra-firm trade by some OEMs, mainly Toyota and Ford, and global suppliers and has provided them with procurement rents vis-à-vis other competing firms in Thailand. Despite that only 5 of the 84 items included in TIEHS are automotive products, over 85% of its overall utilization in early years was concentrated on transmissions and engine parts, reflecting the interest (and influence) of Toyota in the agreement (TDRI 2006:179; interviews).

Compared to TAFTA or TIEHS, a bilateral FTA with Japan as JTEPA offered Japanese firms greater possibilities for selective market and restructuring rents with respect to American and European carmakers already manufacturing in Thailand.<sup>217</sup> Japanese high-end models (Lexus, Acura, Infiniti) sold in Thailand are imported from Japan as completely-built-up units and attracted an 80% import tariff, whose elimination through JTEPA would enhance the comparative advantage of Japanese carmakers over European brands that dominate the luxury segment in Thailand.<sup>218</sup> Although Japanese OEMs produced a wide range of small- and mid-size cars in Thailand, Japan demanded Thai liberalization for all Japan-made vehicles, so as to gain flexibility in producing future

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<sup>217</sup> Japanese OEMs sought to gain through JTEPA the same free access for APCs and vehicles offered by TAFTA as well as to avoid losing ground to competitors from other nations (United States, European Union, Korea) that were negotiating (or planning to) FTAs with Thailand or ASEAN at the time.

<sup>218</sup> Japanese OEMs produce these cars in Japan at more efficient scales than European OEMs do in Thailand.

models and, therefore, potential restructuring rents (Hypothesis 2). Contrary to TAFTA, where both Japanese and American carmakers benefitted, JTEPA split carmakers as Western firms strongly opposed Thai liberalization of vehicles from Japan.<sup>219</sup>

Field research during 2008-2009 indicated that some OEMs, especially Toyota and Honda, were eager to the full implementation of JTEPA schedules to save on procurement costs (Hypothesis 1). As the largest sellers of passenger cars for the Thai market, ineligible for DES/DDS privileges, Toyota and Honda would disproportionately benefit from procurement rents compared to other firms based in Thailand. For instance, JTEPA offered limited scope for procurement rents to Isuzu that produces commercial pickup trucks with high-domestic content, or to Mitsubishi, which exports over two thirds of its production, and operates mainly from duty free zones. GM and Ford share platforms with Japanese firms but mostly for commercial vehicles, which reduced their dependence on Japanese APCs, although they would still benefit from JTEPA liberalization of Japanese steel. Finally, for European firms complementing completely knocked-down kits with mostly local APCs, liberalization of Japanese inputs would not yield significant procurement advantages either. For Japanese global suppliers, Thai liberalization in JTEPA could bring benefits from restructuring rents through rationalization of the production network. Meantime, for Thai-owned suppliers, liberalization of Japanese APCs and/or assembled vehicles would reduce demand.

The automotive sector became the main stumbling block during JTEPA negotiations (Essay 1). The Thai government resisted any liberalization of vehicles that could make existing investments redundant and exploited flexibilities in FTAs regarding selectivity and sequencing of tariff liberalization (as well as in ROOs, see below) to support the overall

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<sup>219</sup> At the time, Japanese OEMs were not looking to realize selective rents from reverse imports because: a) Japan does not apply tariffs on automotive products and, b) reverse imports of vehicles from Japanese subsidiaries in ASEAN back to Japan have always been negligible and even declined following JTEPA implementation. As recently as 2011, Toyota denied plans to export cars from Thailand to Japan (Bloomberg, Sept 8, 2011). Nevertheless, some reverse exports of eco-cars from Japanese subsidiaries in Thailand have occurred during 2011-2013 in the aftermath of the 2011 tsunami in Japan (Trade Map database; personal communication).

automotive industry (Hypothesis 3). JTEPA was eventually implemented in November 2007 and left unchanged tariffs on cars below 3000cc, and only reduced from 80% to 60% by 2011 those on larger-engine cars (METI-JTEPA, undated). In contrast, the Thai government saw liberalization of APCs and steel as key to improve the competitiveness of the sector. Nevertheless, attending to local suppliers' demands, Thailand negotiated a long tariff phase out for these inputs (see Table 4 in Essay 4).

During the five years that JTEPA has been in force, and despite marginal liberalization and long phased out implementation, Thai imports of APCs from Japan (particularly engines, transmission, ignitions, pumps) have trebled (Trade Map). Field research could only obtain JTEPA utilization data for imports up to 2009 (see Essay 2), when JTEPA utilization for the import of APCs stood at 8%. This low utilization rate could be explained by the fact that most APCs had not been liberalized yet. Of note, in 2009, the utilization of DES/DDS for most APCs was around 20% and was up to 60% for diesel engines (data from the Thai Ministry of Finance; see also Essay 2).

### ***5.3. Procurement and technological linkages in Thai FTAs***

When AFTA entered into force in 1992, ROOs established a 40% regional value content requirement across all tariff lines in order to be eligible for the use of its preferential tariffs. This level of ROO restrictiveness in AFTA suited Japanese and American OEMs in ASEAN that during the 1990s operated under LCRs.<sup>220</sup> As domestic value content in Thailand-made vehicles has progressively increased, ROOs in AFTA have not limited the procurement options of Japanese and American firms based in Thailand. However, most European, Korean and Chinese carmakers in Thailand operate at around this 40% value content level (interviews).

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<sup>220</sup> ROOs in AFTA were relaxed in 2004 to allow partial cumulation and include the value of inputs with more than 20% of ASEAN value content into the final calculation.

Research for this Thesis found that the Thai government has made use, to various levels and with different success, of the options available in bilateral FTAs to promote backward linkages and technical transfer between automotive OEMs and the supply base in Thailand. In contrast to Malaysia, use of LCRs in Thailand was as much related to reduce trade deficits as to increase domestic value content.

TAFTA was the first FTA, and so far the only one, where Thailand has fully liberalized its automotive sector outside ASEAN and ASEAN-centered FTAs.<sup>221</sup> Contrary to AFTA, TAFTA set product-specific ROOs. In setting the level of restrictiveness of ROOs for automotive items, Thailand faced a dilemma. On the one hand, it needed to use sufficiently strict ROOs to avoid tariff-free transhipment of vehicles via Australia and to promote local suppliers. However, ROOs could not be so high as to hamper the procurement options of Thai-based OEMs exporting to Australia, largely Japanese firms that depend on imported inputs from Japan. Field research interviews found that Australia favored ROOs based in change in tariff classification, easier to implement, while Thailand pushed for value content ROOs in order to promote procurement backward linkages. Interestingly, knowing that ROO compliance would be more difficult for other firms, Toyota favored a stringent 50% value content (interviews). Eventually, ROOs established that vehicles attain a minimum of 40% bilateral value content *plus* a change in tariff classification. At the time of TAFTA signing, Thailand was also negotiating other FTAs. Accordingly, and in line with the argument in Hypothesis 4, strict ROOs in TAFTA prompted some Australian suppliers (e.g., Futuris, PBR, FMP, SMR Automotive, MGM Asia Pacific) to open and expand affiliates in Thailand not only to benefit from agglomeration scales but also to qualify for ROOs in other Thai FTAs beyond TAFTA (interviews).

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<sup>221</sup> Liberalization of the automotive industry in ASEAN-centered FTAs has been very limited.

In the TIEHS, ROOs for automotive products are also stricter than in AFTA and require a change in tariff classification *plus* a minimum of 40% of Thai or Indian value content excluding any other ASEAN content. As in TAFTA (and also in support of the initial argument), some Indian suppliers set up plants in Thailand in the aftermath of the TIEHS.

In JTEPA, ROOs for automotive products are more relaxed and require either a minimum value content of 40% *or* a change in tariff classification. Interviews found that, during JTEPA negotiations, Thailand demanded a minimum of 20% value content requirement from each country, proposal that was rejected by Japan, particularly in light of the negative by Thailand to liberalize tariffs on vehicles. Field research also revealed that Toyota, with high levels of localization in both countries, favored ROOs based on value content requirement over change in tariff classification, preferred by Western firms, as the latter is easier to achieve for OEMs with lower production volumes. Although, as general rule, value content toward ROOs is cumulated among FTA members, legally this is *not necessarily* the case when FTAs establish product-specific ROOs (interviews). In that line, JTEPA also includes a note, exclusively issued for automotive products, establishing that the country exporting vehicles (most likely Japan as reverse imports have been negligible so far) would be able to use inputs from the other FTA partner, and still be considered as originating material toward value content. This note was incorporated in JTEPA at the request of the Thai government to benefit Thai-based suppliers (interviews).

JTEPA includes a cooperation chapter that, in regard to the automotive industry, provides training of local suppliers on process management by Japanese experts from Toyota, Honda and Nissan and first-tier supplier Denso. This use of FTAs to channel technology assistance to the local supply base is in line with Hypothesis 5. However, it is my contention that Thailand did not exploit to the full extent the potentiality of cooperation

provisions in JTEPA (see below in Discussion). Although well received by Thai suppliers, the scheme was only fully spelled out in 2008, once JTEPA had entered into force, so the Thai government did not negotiate beforehand detailed targets or specific binding commitments by Japan (interviews), limiting its effectiveness.<sup>222</sup>

## 6. The automotive production network in Malaysia before regionalism<sup>223</sup>

Few other sectors in Malaysia have been shaped by the policy environment as the automotive industry. Starting in the mid-1960s, the government promoted local assembly of vehicles as a mean to substitute imports and spur industrialization. Assembly operations were conducted by joint ventures between foreign OEMs and local ethnic-Chinese firms, whose output was destined exclusively for the domestic market. Production was protected from external competition through high tariffs and import licenses, which were preferentially allocated to ethnic-bumiputera/Malay firms. An early attempt by the government in the 1970s to introduce LCRs was frustrated by the strong resistance from OEMs and lack the political clout of suppliers. During the 1980s and 1990s, the government progressively raised tariffs on imported APCs and imposed on international OEMs LCRs and mandatory lists of APCs to be sourced locally, in an effort to increase local content in Malaysia-made vehicles and to foster local APC manufacturing.

The state-led import substitution drive initiated by Malaysia in 1981 was short-lived outside key strategic sectors like the automotive industry. That year, the government launched the National Car Project aimed not only at creating a national automotive industry but primarily to foster an indigenous supply base and the participation of bumiputeras in the sector. At the same time, foreign automotive OEMs assembling in the country had to

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<sup>222</sup> An earlier version of the *Automotive Human Resource Development Program*, in place since 2005, was expanded in 2008 to be included in JTEPA.

<sup>223</sup> This section draws on secondary literature, *inter alia*, on Jomo (1994), Abdulsomad (1999), Abbott (2004) complemented with information from interviews.

form minority-controlled ventures with local firms, mostly government-linked companies. In 1983, PROTON was established as a venture with Mitsubishi to manufacture mid-size cars.<sup>224</sup> Since its inception, the government protected PROTON with a range of trade barriers and supported it with preferential excise duties and various subsidies. Within only a decade, PROTON captured over 70% of the domestic market, encouraging the government to establish in 1993 another national carmaker, PERODUA, to manufacture subcompact cars in a venture with Japanese Daihatsu.<sup>225</sup> Despite that PROTON and PERODUA were respectively the first and third largest OEMs in ASEAN during much of the 1990s, both firms remained mostly domestically-oriented, with very small export volumes to countries that fitted within Mitsubishi's and Daihatsu's interests (see below). In the early 1990s, GM aired plans to set its regional base in Malaysia on condition that the government scrap LCRs and the National Car Project; Malaysia refused and GM established its regional hub in Thailand.

Introduction of LCRs and the National Car Project boosted the total number of suppliers and of Malaysian-owned suppliers but, by the late 1990s, only a third were bumiputeras. In addition, technology transfer was very limited and most local suppliers produced only simpler and labor-intensive APCs while functional components were manufactured by PROTON itself or were imported from Japan.

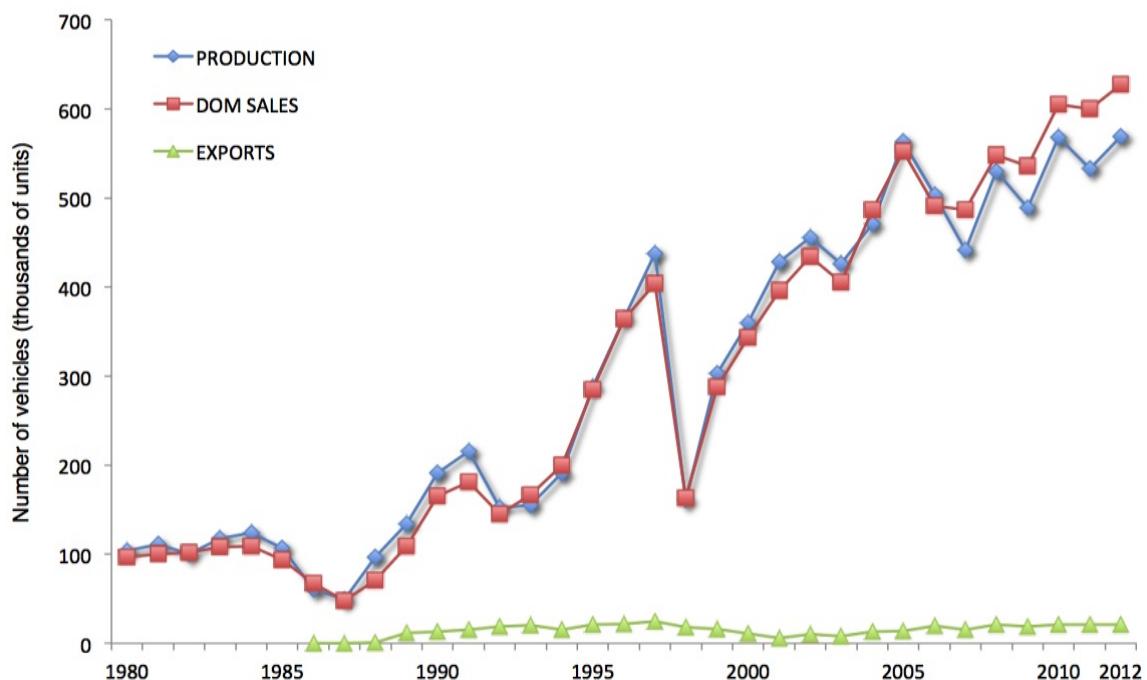
The Asian crisis depressed Malaysian vehicle production and domestic sales by 60% (Figure 4) but, unlike foreign OEMs in Thailand, PROTON and PERODUA did not resort to exports to compensate for lower local demand. In response to the crisis, Malaysia temporarily excluded all automotive items from AFTA liberalization schedules that had targeted intra-ASEAN tariffs to be capped at 5% by 2003. At the multilateral level,

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<sup>224</sup> At first, then government-linked HICOM controlled 70% of PROTON and Mitsubishi 30%. Although listed in 1992, PROTON's controlling stake was held by government-linked firms and its management has always been bumiputera. Mitsubishi sold its participation in 2004. Since January 2012 the majority holder has been the now private conglomerate DRB-HICOM.

<sup>225</sup> Initially, government-linked companies held 68% of PERODUA. It remains unlisted with 53% controlled by Malaysian capital, mostly government-linked companies, and 47% by Daihatsu. As national carmaker, PERODUA benefits from selected privileges but, unlike PROTON, its strategic direction is determined outside Malaysia by Daihatsu.

Malaysia raised tariffs on most automotive products and requested an extension from the WTO for the use of LCRs beyond the 2000 deadline, specifically for its automotive. To attract investment, equity restrictions were relaxed in all manufacturing sectors except in the automotive industry.



**Figure 4:** Production, domestic sales and exports of vehicles (passenger and commercial) in Malaysia. Source: Malaysian Automotive Association (MAA). Data on exports were calculated by the Author based on figures obtained from individual OEMs and includes both assembled vehicles (completely built-up) and vehicle kits (completely knocked down).

## 7. The automotive production network in Malaysia under regionalism

After the crisis, Malaysia continued to shield its national carmakers from competition from foreign automotive firms assembling in Malaysia or elsewhere in ASEAN. Malaysia eliminated LCRs in the automotive sector in 2004 once the waiver from the WTO had expired, illustrating the value Malaysia attached to LCRs to promote backward linkages. The National Automotive Policy, issued in 2006, also reduced multilateral tariffs on

assembled vehicles and completely knocked-down kits and eventually brought Malaysia in line with AFTA schedules (see below) (MITI, 2006).<sup>226</sup>

Nevertheless, Malaysia kept using its regulatory framework to protect national OEMs and promote higher use of local inputs in the automotive industry. Thus, tariff reductions on imported vehicles were accompanied by the introduction of excise duties on passenger cars ranging from 90% to 250%. The excise duty system escalates with engine size, benefiting smaller engine cars producers like PROTON and PERODUA. More controversially, excise duties are exempted for the share of the vehicle representing Malaysian content, which fosters utilization of Malaysian inputs and, once again, favors PROTON, whose models have over 80% of domestic content compared to the 30-40% in Japanese or Korean models.<sup>227</sup>

Automotive production recovered to pre-crisis levels by 2001, but growth has been slower than in Thailand (Figure 4). Since 2006, PERODUA has surpassed PROTON in production and domestic sales (Table 4 for 2008, a mid-year for the period under study). PROTON is also losing ground to Japanese models assembled in Malaysia or imported through AFTA.<sup>228</sup>

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<sup>226</sup> Revision of the National Automotive Policy in 2009 eliminated foreign equity restrictions for OEMs assembling cars outside the core segment of PROTON and PERODUA, namely, cars with engines exceeding 1800cc, electric and hybrid cars and commercial vehicles (MITI, 2009). However, field research interviews revealed that Japanese OEMs plan to maintain their joint ventures with Malaysian firms because of the political clout they provide. The National Automotive Policy was amended again in 2012 and its final text is expected to be released in late 2013.

<sup>227</sup> Excise duties on vehicles were introduced in 2004 and raised in 2005. The maximum excise duty was reduced to 125% in 2006 and 105% in 2007. Although justified on the need compensate for the loss of revenue from lower tariffs, the excise system has benefitted national OEMs and local suppliers. Initially, PROTON and PERODUA received 50% rebate on excise duties but the system was later replaced by the local content-based calculation rule. Malaysian government officials maintain that the excise system is compliant with WTO and AFTA (interviews). Since the 1970s, Malaysia has maintained different forms of non-automatic licensing system of imported vehicles known as Approved Permits, which are issued by the Ministry of International Trade and Industry and distributed among bumiputera firms. Elimination of Approved Permits has been postponed in several occasions, with their current deadline for 2020.

<sup>228</sup> Western and other foreign carmakers make for a small market share. European vehicles are assembled locally out of kits, imported from ASEAN or directly from Europe. Bumiputera conglomerate Naza assembles Kia and Peugeot models. Hyundai and Chery have small assembly facilities. American models are imported, since GM has no plants in Malaysia and Ford discontinued assembly in mid-2008.

**Table 4: Production, domestic sales and exports of vehicles in Malaysia by OEM (2008)\***

|                    | Production | Domestic Sales | Exports |
|--------------------|------------|----------------|---------|
| <b>Proton</b>      | 29.5%      | 25.5%          | 83.7%   |
| <b>Perodua</b>     | 36.0%      | 30.3%          | 13.9%   |
| <b>Toyota</b>      | 12.4%      | 18.4%          |         |
| <b>Honda</b>       | 6.0%       | 5.8%           |         |
| <b>Nissan</b>      | 6.6%       | 5.5%           |         |
| <b>Isuzu</b>       | 1.9%       | 0.9%           |         |
| <b>Mitsubishi</b>  | 0.1%       | 1.6%           |         |
| <b>Daihatsu</b>    | 1.0%       | 1.0%           |         |
| <b>Naza</b>        | 2.1%       | 2.2%           |         |
| <b>Inokom</b>      | 1.0%       | 1.1%           |         |
| <b>American **</b> | 0.1%       | 0.4%           |         |
| <b>European</b>    | 1.5%       | 1.7%           |         |
| <b>Other</b>       | 1.8%       | 5.6%           | 2.4%    |

Source: Malaysian Automotive Association. Exports were calculated by the Author using data obtained from individual OEMs and includes both assembled vehicles and completely knocked-down kits.

\* Average market share for total registered vehicles (commercial and passenger cars)

\*\* Ford stopped assembly in Malaysia in mid-2008

As in Thailand, the Malaysian government has sought to couple import substitution with export promotion. However, production by national and foreign OEMs in Malaysia continues to be mostly oriented toward the domestic market (Figure 4 and Table 4). During 2003-2009, PROTON exported on average 10% of its production (data from Ministry of International Trade and Industry), while PERODUA exports stand at less than 2%. Low export volumes—mainly to the United Kingdom and to developing countries—are explained on the weak international competitiveness of national OEMs (particularly of PROTON), low technology transfer by their partners and, in the case of PERODUA, little interest by Daihatsu in creating an export-oriented brand (interviews).<sup>229</sup> Restrictions on foreign participation in the automotive industry have limited investment by international

<sup>229</sup> Following Mitsubishi's sale of its stake in PROTON in 2004 (see footnote 224), the company and the government have been looking for an international OEM partner but all efforts were frustrated by the government's refusal to give up management control to foreigners (interviews). After a decade of declining sales and, for many years, of fiscal deficits, PROTON's main option for expanding scales, and even for survival, is to seek markets abroad.

OEMs and suppliers, which has hampered the competitiveness not only of foreign affiliates in Malaysia but also of national carmakers. Japanese and Korean OEMs in Malaysia cater almost exclusively to the domestic market.

Many foreign first-tier suppliers are present in Malaysia but, unlike in Thailand, the majority of APC manufacturers are local firms. In late 2009, nearly 90% of suppliers served PROTON and/or PERODUA and many depend on them exclusively (interviews). Malaysia has succeeded in developing an indigenous supply base but low technical capabilities and small scales limit the competitiveness of most Malaysian suppliers, and in turn, that of PROTON. Nevertheless, some Malaysian suppliers (e.g., Ingress, Hi-Com Tek See, Sapura, Delloyd, APM) have achieved international competitiveness exporting and/or setting plants abroad to serve global OEMs. Given their simpler operations, the supply base of Japanese and Korean OEMs is much smaller. Malaysia imports APCs mainly from Japan, other ASEAN countries, China and India.

### ***7.1. Malaysian FTAs***

During the 1980s and 1990s, Malaysia opposed intra-ASEAN liberalization of automotive products and defended that regional ASEAN complementation programs were only beneficial to non-ASEAN OEMs. Consequently, its government initially hindered the implementation of the ASEAN Industrial Cooperation scheme (Yoshimatsu, 2002; interviews; see below).

Later, in the aftermath of the Asian crisis, Malaysia excluded the entire sector from AFTA liberalization. In 2005, following pressures from other ASEAN members, Malaysia began reducing import duties on ASEAN automotive products, and topped them in 2006 at 5% (the limit established by AFTA for 2003) before full elimination in 2010.

Within ASEAN, Malaysia is a net importer of automotive products. Although Malaysia uses AFTA preferences to exports APCs (mostly electronic components to

Thailand and Indonesia), and of PROTON cars (mainly to Thailand), these are very small in comparison to imports of key functional APCs and assembled vehicles from ASEAN, mostly Japanese models from Thailand and Indonesia.

Malaysia was initially reluctant to enter into bilateral FTAs, but fear of exclusion from other FTAs prompted Malaysia to negotiate its own. As of August 2013, in addition to AFTA and ASEAN-centered regional FTAs, Malaysia has six bilateral FTAs in force (see Table 2 in Essay 1). Only AFTA and the Malaysia-Japan Economic Partnership Agreement (MJEPA) are pertinent to the automotive industry. Malaysia started negotiating its FTA with Japan in 2003. At the time, Thailand was not yet the export base it is today and Malaysia sourced from Japan one third of all APCs and two thirds of all vehicles it imported. Although AFTA liberalization was on course, and Japanese carmakers planned to make Thailand their regional hub, they were still eager to liberalize the Malaysian automotive sector to Japanese imports (interviews).

### ***7.2. Use of selective rents and flexibilities in Malaysian FTAs***

The Malaysian government eventually conceded and approved projects in the ASEAN Industrial Cooperation complementation program and eventually participated in about half of all projects pertaining to the automotive sector. However, except for one project with PERODUA and four between Volvo subsidiaries, all other automotive-related projects with Malaysian participation involved Japanese OEMs that, as in Thailand, benefitted to the largest extent from the procurement rents offered by this scheme (data from the Ministry of International Trade and Industry; interviews).

As recently as 2006, PROTON and PERODUA were pressing the government to delay the alignment of Malaysian tariffs on automotive products with AFTA schedules (interviews). Likewise, most Malaysian-owned suppliers resisted AFTA liberalization and counted on the government to keep protecting the sector as well as on national OEMs to

maintain their contracts (interviews). Field research revealed that, in 2003, the government had lifted informal procurement restrictions on national OEMs to source inputs from foreign suppliers inside or outside Malaysia. Although both national OEMs, particularly PROTON, signalled their commitment to indigenous suppliers' development, they are now nominally free to procure APCs based exclusively on commercial criteria.<sup>230</sup>

AFTA has made procurement more flexible for all OEMs in Malaysia, both national and foreign. Malaysian imports of APCs from ASEAN have quintupled since 2004, while imports of vehicles have grown from just US\$3.5 million to over US\$1.2 billion (Trade Map). In 2012, 42.2% of all Malaysian imports of APCs originated in ASEAN (of which 78.3% came from Thailand), and 27.4% came from Japan. Meanwhile, 42.5% of vehicles imports came from ASEAN (of which 85% from Thailand) and 42.14% from Japan. Importantly, and in line with my initial arguments, 75% of all vehicles imported by Malaysia from the rest of ASEAN during 2005-2009, even before intra-AFTA tariffs were fully eliminated, were of Japanese brands (interviews). Field research could not obtain firm-level data on the utilization of AFTA for these trade flows in automotive products. However, from my interviews, it would be safe to assume that Japanese OEMs in Malaysia have benefited from selective procurement and restructuring rents with respect to national OEMs (and Western carmakers) (Hypotheses 1 and 2). PERODUA has some procurement linkages with Daihatsu plants in Indonesia but lack the extensive network of other Japanese OEMs in ASEAN (Table 2).

Exports of automotive products from Malaysia to ASEAN have also grown although at a lower pace than imports. Since 2010, exports of PROTON cars to ASEAN have increased, but they only amount to around 1% of the market in Thailand, its major destination in ASEAN (interviews). The bulk of Malaysian exports of automotive products

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<sup>230</sup> This was facilitated by full implementation of AFTA in 2010 and increasing competition among OEMs in Malaysia.

to ASEAN are APCs, mostly by OEMs and Japanese suppliers.

AFTA has also allowed foreign OEMs, but not national carmakers, to restructure their production strategies in Malaysia in the context ASEAN. For instance, as noted earlier, in 2008, in anticipation of full AFTA liberalization, Ford closed down its plant in Malaysia, which it now serves from Thailand. Nevertheless, this does not mean that foreign OEMs with presence in both countries have consolidated their production in a single country. For instance, at the time of field research, Toyota, BMW, and Volvo announced plans to start assembling some of their models in Malaysia rather than importing them from Thailand using AFTA (interviews). Part of the reason behind these strategic moves is found on the fact that local assembly of vehicles significantly reduces excise duties. But interviews also found that political and marketing considerations weighted heavily in their decision to maintain local production.<sup>231</sup> In line with my initial arguments, although AFTA (and FTAs in general) could have spelt doom for the automotive sector in Malaysia, its government has used the regulatory framework to promote national OEMs and local suppliers at the expense of imported vehicles.

As in other Japanese FTAs, the automotive sector took center stage during MJEPA negotiations (Essay 1). At that time, Malaysia had its automotive sector still waived from LCRs at WTO and excluded from AFTA schedules. Japanese carmakers and first-tier suppliers sought the elimination of Malaysian tariff and non-tariff barriers on assembled vehicles, APCs and steel.<sup>232</sup> In addition, and more so than AFTA, MJEPA offered Japanese automotive firms the possibility of selective procurement and restructuring rents with respect to national OEMs and Malaysian subsidiaries of Western carmakers that depended

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<sup>231</sup> If Japanese OEMs were to leave Malaysia and serve its market from Thailand, their political clout and capacity to influence policymaking would be considerably reduced.

<sup>232</sup> At the start of negotiations in December 2003, automotive and steel products jointly represented over 18% of Japanese exports to Malaysia for only 0.2% in the opposite direction. Since Japan has zero tariffs on automotive products, benefits from MJEPA were unidirectional.

on APCs and completely-knocked down kits from either Thailand or from their home country.

PROTON imported inputs from Japan but it received tariff rebates and it was also moving toward virtually complete localization following the introduction of its own engine technology. Consequently, PROTON opposed MJEPA not only because it would increase imports of Japanese vehicles, but also because it would reduce procurement costs for competing Japanese OEMs assembling in Malaysia (interviews).<sup>233</sup> As in Thailand, European carmakers opposed liberalization of vehicles, completely knocked-down kits and APCs from Japan that would save Japanese OEMs import tariffs as well as excise duties (interviews). The Malaysian Automotive Association, encompassing the interests of all foreign OEMs and distributors, but dominated by Japanese firms, endorsed MJEPA as an opportunity to start opening up the Malaysian automotive sector.

The main competition to Malaysian-owned suppliers' comes from ASEAN, particularly from Thailand, but the two associations of suppliers to PROTON and PERODUA opposed MJEPA not so much because it would increase procurement options for national OEMs, but mainly because it could reduce the market share of PROTON and PERODUA.<sup>234</sup>

Eventually, Malaysia accepted to fully open its automotive sector in MJEPA but, in line with Hypothesis 3, it used available options in FTAs for selectivity and flexibility in liberalization coverage and sequencing. Tariffs on completely knocked-down kits were eliminated from the start and those on APCs and cars of more than 2000cc were progressively phased out by 2010 but liberalization for vehicles below that level, in direct

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<sup>233</sup> At the time, PROTON had started loosing market share to Japanese OEMs and PERODUA. Field research found that PERODUA maintained a mixed disposition due to its higher dependence on Japanese inputs than PROTON.

<sup>234</sup> Suppliers in the Malaysian Automotive Component Parts Manufacturers, many less dependent on national OEMs, lobbied instead for a long phase-out of tariffs on APCs.

competition with national OEMs, will only be fully realized by 2015.<sup>235</sup> Still, between the implementation of MJEPA in 2006 and December 2012 imports of vehicles over 2000cc from Japan have multiplied by more than five times, and imports of some key functional APCs have quadrupled. Disaggregated data on Malaysian imports under MJEPA are not available but interviews found that completely knocked-down kits are the main item imported under its preferences. Japanese OEMs but also PERODUA have been the main beneficiaries of this FTA, and have improved their competitiveness vis-à-vis PROTON, which has made less use of it. At least until late 2009, PERODUA was not only the first but also the largest importer of completely-knocked-down kits under MJEPA, even ahead of Toyota and Honda (interviews). Local and Japanese suppliers in Malaysia have made little or no utilization of MJEPA.

### ***7.3. Procurement and technological linkages in Malaysian FTAs***

The establishment of a national automotive industry in Malaysia was largely related to the government's goal to develop the local supply base. In that regard, Malaysia has used strict ROOs in FTAs to support this objective (Hypothesis 4). For instance, the Malaysian government succeeded in its demands to Japan of a high ROO of 60% value content for vehicles in MJEPA, as compared to the 40% that applies to most other tariff lines (METI-MJEPA, undated; MITI, undated; interviews). Such highly restrictive ROOs would limit OEMs in Japan (or Malaysia) from relying too heavily on imported APCs from suppliers elsewhere and potentially promoting backward linkages with Malaysian suppliers.<sup>236</sup>

As part of MJEPA's cooperation chapter, Japan offered Malaysia the *Malaysia-Japan Automotive Industries Cooperation* program (MAJACO) that provided technical assistance in the automotive sector (Hypothesis 5). During five years, ending in June 2011,

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<sup>235</sup> Malaysia's decision to open its protected automotive sector to Japan is partially explained in the context of AFTA, which allows Japanese models produced elsewhere in ASEAN to enter Malaysia tariff-free anyway. In such a situation, Malaysia had little option but to liberalize its automotive sector while trying to extract other concessions (see Essay 4).

<sup>236</sup> Unfortunately for Malaysia, the ASEAN-Japan FTA signed later required only 40% ASEAN-Japan value content.

MAJAICO implemented a number of projects, including training by Nissan's experts of Malaysian APC manufacturers and PERODUA as well as business matching with Japanese firms. Field research found that, as in Thailand, specific projects in MAJAICO were only detailed at the implementation stage, once the agreement had been officially signed. Although Japan carried through with its commitments and participating suppliers have reported benefits, Malaysia could not fully exploit all possibilities in cooperation provisions.<sup>237</sup>

Interestingly, and also confirming Hypothesis 5, the 2009 revision of the National Automotive Policy openly stated that cooperation chapters in FTAs should be geared to enhance the capabilities of local suppliers and that the government should use FTAs to promote the integration of domestic suppliers into the supply chains of international OEMs (MITI, 2009).

## 8. Discussion

The automotive sector is one of the most regulated manufacturing industries and, considering the large investments involved, automotive firms are very sensitive to the policy environment. In the late 1980s, as ASEAN countries embarked on unilateral liberalization and export-orientation, foreign carmakers established in the region sought to reorganize their procurement at the ASEAN level and pushed governments to introduce APC complementation sourcing programs. Only later did they look for restructuring their production across the region through liberalization of assembled vehicles in AFTA. More recently, international OEMs and suppliers have lobbied for bilateral FTAs with countries outside ASEAN in order to reduce costs in their specific extra-regional procurement and export flows.

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<sup>237</sup> Several projects in MAJAICO had limited success and some suppliers claimed the existence of bias in favor of suppliers that had technical agreements or ventures with Japanese firms or that used Japanese technology (interviews)

A significant body of the literature on regionalism has centered on the burden imposed by FTAs on firms operating in production networks (e.g., diverging and costly ROOs) and on developing states (e.g., loss of policy space). Less attention has been given to why some firms and developing states seek bilateral FTAs for reasons beyond generic expansion of markets or access to cheaper inputs and whether and how these actors maximize the possibilities presented by FTAs to capture selective advantages.

Thailand and Malaysia protect their automotive industries at the multilateral level with high tariffs and, particularly in the case of Malaysia, regulatory barriers. Thailand liberalized investment in the sector and moved into global exports. In contrast, the low international competitiveness of PROTON and PERODUA and foreign OEMs in Malaysia have meant that the Malaysian automotive sector remains mostly domestically-oriented. Despite these differences in their policy environment and in outcomes, both case studies yield similar findings and confirm the hypotheses. Most global first-tier suppliers and carmakers are *already* established across ASEAN, including in Thailand and Malaysia. Still, this research found that these firms have lobbied for (and later exploited) specific configurations in Thai and Malaysian FTAs to create asymmetric rents that discriminate not only against firms outside the FTA area but also with respect to other firms that are already inside. At the same time, as the ultimate initiators and signatories to international agreements, the Thai and Malaysian governments have used FTAs to pursue their national interests not only vis-à-vis other states but also in relation to multinationals lead firms like those in the automotive production network. Lastly, local suppliers have resisted FTA liberalization of the automotive industry and have to rely on the institutional framework to derive leverage in their relation with OEMs.

### 8.1 FTAs and lead firms

In production networks, where production is fragmented and inputs cross several borders, lead firms are not only interested to expand access for their final goods abroad but also to reduce the costs of imported inputs. During the last three decades, automotive OEMs in ASEAN have lobbied for liberalization for raw materials and APCs either via unilateral liberalization—in complementation sourcing programs or as part of export-promoting schemes (e.g. DES/DDS, export processing zones)—or, of late, through AFTA and bilateral FTAs.

Although the automotive sector is moving toward shared inter-brand and inter-model platforms, when compared to other industries, lower standardization and greater specificity of intermediate inputs in the automotive industry generates more possibilities for differentially exploiting procurement patterns among carmakers in FTAs. Functional APCs are often highly specific to OEM and model. As a result, procurement of a particular item by an OEM in a given country is often limited to a few suppliers, sometimes to a subsidiary, or to a long-term supplier back home. By liberalizing particular trade flows, a bilateral FTA could selectively benefit OEMs that depend on inputs from the FTA partner. Research for this Essay found that whenever an FTA offered possibilities for asymmetric rents, potential beneficiary firms pressured governments to capture them.<sup>238</sup>

FTA liberalization of the automotive sector in East Asia has disproportionately favored Japanese OEMs over those of other nationalities because their longest, largest, and deepest presence in the region. Nevertheless, case studies showed that procurement rents not only (and also not necessarily) accrued to OEMs with home in one of the FTA partners, and that these rents are often highly firm-specific. For instance, some American firms (e.g.,

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<sup>238</sup> Given that trade authorities in Thailand and Malaysia do not provide data on FTA utilization at the firm-level and that individual firms interviewed for this Essay did not release information on the tariff savings afforded by FTAs as it was not available or considered sensitive, quantification of how procurement rents have been distributed among firms was not possible. Instead, this research had to rely on qualitative information from interviews with business associations, firms and government officials.

Ford, which shares production platforms in Thailand with Mazda) benefit from cheaper Japanese inputs through JTEPA, but Japanese Mitsubishi hardly uses this FTA. Meanwhile, given its sourcing pattern, GM in Thailand would not only profit the most from a bilateral FTA between Thailand and Korea (arguably, the most undesirable FTA for all other OEMs in Thailand), but would do it to a greater extent than it would through an FTA with the United States.<sup>239</sup>

FTAs allow firms to progressively restructure their scales and production from the national to the bloc level while still being protected behind external tariffs and ROOs (Chase, 2005). It was contended here that the benefits from restructuring have been often asymmetrically distributed, having been capitalized mainly by firms with investments across the FTA bloc.<sup>240</sup> For example, as AFTA was being implemented, most OEMs have restructured their supply-chains and production plants but Japanese firms, with the largest network, have profited the most. In anticipation of or following TAFTA, Japanese and American OEMs and Australian suppliers reorganized their division of labor across Thailand and Australia. Nevertheless, as illustrated by the case studies selected here, consolidation of all production at a single location within the FTA it is unlikely to be fully realized for several reasons. First, governments could change their regulatory framework rapidly, so OEMs prefer spreading risks across several countries. Second, large sunk investments and difficult to transfer assets in the automotive industry plus long implementation periods in most FTAs also mean that restructuring in response to a new FTA could take several years. Consequently, global OEMs and suppliers have not only adapted their strategies *ex post-facto* to the implementation of FTAs, but they often first developed their business plans for ASEAN, India, Australia, etc. and only later pressured

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<sup>239</sup> The ASEAN-Korea FTA barely liberalizes the sector (Medalla, 2011).

<sup>240</sup> Quantification of how restructuring rents have been distributed is hindered by the impossibility to establish a direct and unequivocal relationship between investments made by OEMs and suppliers and the establishment of given FTA. Instead, this Essay has relied on qualitative evidence obtained through interviews.

governments for FTAs that support their *ex-ante* strategies (e.g., Toyota in TIEHS, Japanese OEMs in early complementation programs or in AFTA, JTEPA and MJEPA or GM and Toyota in TAFTA).<sup>241</sup> Finally, my field research also found that restructuring of production within an FTA bloc has been dictated not only by production strategies and agglomeration economies but also by political sensitivities. Even though Japanese OEMs could now serve the Malaysian market from more efficient plants in Thailand or Japan using AFTA and MJEPA, respectively, Toyota and Honda are staying in Malaysia. This is not only related to the Malaysian regulatory system, which penalizes foreign content, or to average future risks but also to the marketing advantages and political clout that firms can only derive from their physical presence in the country.

In sum, lead firms could seek FTAs for different objectives, some more amenable to selectivity than others, that allow us to distinguish at least three types of FTAs. A first group of FTAs aimed chiefly at expanding markets for final goods (e.g., TAFTA). Although there is scope to generate selective benefits from restructuring production blocks across the FTA area, these are lower. In a second group of FTAs, OEMs primarily endeavoured to extract procurement rents through liberalization—in the most firm-specific manner—of APCs from subsidiaries or long-term suppliers (e.g., ASEAN complementation programs, TIEHS, JTEPA, MJEPA). Although MJEPA and, to a very limited extent, JTEPA also liberalized vehicle imports, field research found that the main goal of Japanese OEMs in both FTAs was to save on input costs (procurement rents) and gain future flexibility (restructuring rents) vis-à-vis Western carmakers. Lastly, in other FTAs, both expanding markets and facilitating procurement have been equally important (e.g., AFTA). In line with my argument above, while AFTA/ATIGA does not involve foreign OEMs' home countries and is a regional FTA—therefore less amenable to selective rents—, AFTA

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<sup>241</sup> As an OEM executive indicated, “firms cannot predict policy [...] nor are [they] certain that they would be able to influence it”.

has generated selective market and procurement rents for Japanese carmakers. In the case studies analyzed here, there was no room for reverse import rents for Japanese OEMs because Japan does not impose tariffs on automotive products and exports of vehicles from ASEAN back to Japan are low.

Arguably, the same way firms outside an FTA could neutralize market rents from trade diversion by investing inside the bloc, procurement or restructuring rents asymmetrically distributed among firms within an FTA area could also be neutralized by the formation of other FTAs. This highlights the importance to OEMs of not only securing selective rents that may be available in FTAs, but also locking them in for the future. This was illustrated by Japan's request to add into the JTEPA treaty the Thai commitment not to extend better FTA concessions in the automotive sector to other countries (see Essay 1).

### ***8.2 FTAs and the state***

Although globalization has reduced the power of states with respect to multinationals, states control the regulatory framework over the right of investment and tax and incentives systems. Pending of the negotiations for FTAs with the United States (in the TPP) and the European Union, none of the developed FTA partners of Thailand and Malaysia had introduced significant regulatory reforms beyond some changes in the investment regime. It was argued here that FTAs offer states additional sources of power over lead firms. Through FTAs, states could facilitate or restrict the operations of lead firms within production networks by selectively liberalizing or excluding specific tariff lines and by fostering procurement and technical linkages with local suppliers through ROOs and cooperation chapters.

Empirical data showed that the Thai and Malaysian governments were well aware of these options in FTAs, having later on identified some of them as explicitly stated policy goals. To pursue their national interests and accommodate those of OEMs and suppliers

based in the country, both governments have made ample use of GATT/WTO flexibilities for liberalization coverage and sequencing, which has enhanced the leverage of the state over OEMs lobbying for/against liberalization (Hypothesis 3). For instance, Malaysia temporarily excluded its automotive sector from AFTA, Thailand's maintained protection of most vehicle segments in JTEPA and both Thailand and India limited liberalization of the automotive sector in TIEHS to just five items.

Thailand's main goal for the automotive industry has been to expand export-oriented investment and production by foreign OEMs and global suppliers, using a relatively liberal regulatory regime, while shielding the industry from external competition through high tariffs. This research found that Thailand's early use of LCRs was intended as much to create backward linkages as to reduce trade deficits. Certainly, Thai policymakers strive to strengthen the local supply base, but they are not necessarily concerned about the nationality of its ownership. Increased localization in the Thai automotive industry has occurred mainly through the market forces of agglomeration. Meanwhile, for the Malaysian government, establishment of the National Car Project was largely a means to develop a Malaysian- (and bumiputera-) owned APC industry. Accordingly, Malaysia not only extended LCRs beyond the original WTO's deadline, but still uses its domestic regulatory framework to increase procurement linkages with local suppliers (e.g., linking excise duties and tax incentives to local content). These diverging objectives have been reflected in the way both countries used ROOs in FTAs. Despite high content in Thailand-made vehicles, the Thai government has favored procurement flexibility for OEMs, and has not requested overly strict ROOs for the automotive sector in its bilateral FTAs. In contrast, in line with Hypothesis 4, Malaysia succeeded in introducing strict ROOs of 60% of value content for vehicles in MJEPA to foster procurement linkages.

However, it is equally true that, for the FTAs analyzed herein, neither government was entirely successful (or skillful) at exploiting some of the possibilities offered to them by FTAs in terms of policy tools. Enforcing and monitoring technological transfer from multinationals to local firms is a difficult task for most developing countries. As part of JTEPA and MJEPA, Japan offered training of local suppliers, but arguably, Thailand and Malaysia did not maximize their options during negotiations. Cooperation provisions in both FTAs were vaguely defined and implementation targets were only detailed in separate protocols once the agreements had been signed, which left no room for Thailand and Malaysia to link Japanese technical assistance to reciprocal concessions in market access. However, to the extent that FTAs establish periodic reviews, developing countries still maintain a bargaining chip to ensure they received the anticipated assistance. It is worth remarking that the possibility of using cooperation chapters in FTAs to upgrade the local supply base and foster its integration into international production networks has been now incorporated into Malaysia's National Automotive Policy (Hypothesis 5) (MITI, 2009).

Obviously, this is not to say that developing countries enter FTAs only for the above reasons. But just as they surrender some policy instruments in North-South FTAs, FTAs could still potentially offer them other options to regulate some of the activities of firms and production networks. Whether developing countries actualize these possibilities during negotiations is a different matter.

### ***8.3 FTAs and suppliers***

Although most trade in key functional APCs is accounted for by OEMs, global first-tier suppliers have also benefited from the procurement and restructuring rents generated by bilateral FTAs. In contrast, indigenous Thai and Malaysian suppliers, particularly lower-tier ones, not only had less political clout to influence FTA formulation, but they have also made little use of FTAs once implemented due to insufficient knowledge about them and/or

lack of administrative expertise to handle applications for their utilization. Even among Thai and Malaysian first-tier suppliers, utilization of bilateral FTAs has been limited because of the logistical reasons in the industry referred to in previous sections. Instead, local suppliers were more familiar with the use of DES/DDS and AFTA, which have been in place for long time.

In Thailand, most benefits to suppliers from FTAs have come indirectly through the increased vehicle production they fostered (e.g., AFTA, TAFTA). Suppliers have not always consolidated their production in response to FTAs. For instance, Thai and Malaysian first-tier suppliers, with presence in each other's country did not merge production in their home base as result of AFTA.<sup>242</sup> Likewise, many independent Indian and Australian suppliers opened operations in Thailand, instead of trading APCs through TIEHS and TAFTA, to benefit from agglomeration economies near their OEM customers and to qualify for ROOs in multiple Thai FTAs.

Many FTAs signed by the United States or the European Union restrict or prohibit that their partners grant DES/DDS on inputs from outside the bloc that are later incorporated into goods traded within the FTA. Banning DES/DDS in FTAs further reinforces diversion in favor of suppliers inside the bloc. No such provisions exist in any of the Thai or Malaysian (or East Asian) FTAs currently in force.<sup>243</sup>

Trends in the automotive industry and their interplay with the ongoing proliferation of FTAs are affecting lead firm-suppliers relations in multiple, even opposing, directions. The industry is moving toward more relational and modular linkages between OEMs and first-tier suppliers. In turn, liberalization tends to foster market-driven linkages as mutually captive relations developed under import substitution are dissolved. Liberalization could

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<sup>242</sup> As of April 2013, first-tier suppliers like Thai Summit (Thailand) or Ingress (Malaysia) maintain operations in other ASEAN countries.

<sup>243</sup> Interviews also revealed that elimination of DES/DDS was never requested by any party involved in FTA negotiations. This could be reasoned because multinationals in East Asia production networks depend on a wider geographical area for their procurement than those operating elsewhere.

also promote regional clustering of first-tier suppliers around specialized OEM plants, thus reinforcing asymmetric relations, especially once suppliers have sunk their investments. Lastly, field research indicated that most of the use of FTAs for input procurement involved trade among OEM subsidiaries (hierarchical relations) or between OEMs and long-term suppliers (captive, relational).

#### ***8.4 Concluding Remarks***

Institutions serve and reproduce the interests of those that created them in the first place (North, 1990). FTAs have become arenas for cooperation and competition between and among firms and states providing frameworks to regulate the distribution of power within production networks. As far as the automotive sector is concerned, Thai and Malaysian FTAs have primarily served OEMs, especially Japanese firms and particularly Toyota, which have leveraged their power to affect FTA formulation in their favor at the expense of competing OEMs, local suppliers and states.

At the state level, neither Japan nor Australia used FTAs to extract significant regulatory concessions from developing partners. However, if the FTAs of the United States and the European Union with Korea and Singapore serve as indication, future East Asian FTAs involving these Western powers may include demands for reforms that could undermine some of the policy space ASEAN states still maintain for regulating firms and production networks.

Following the Asian crisis, Thailand and Malaysia deepened their integration into production networks as a mean to foster industrial development. FTAs could reinforce these efforts by increasing investment, production and exports, and by indirectly enhancing local technological capabilities. On the other, by reducing the cost of high-technology finished products and inputs imported from developed partners, FTAs may potentially lock, and even downgrade, indigenous firms into low value-added production. Whether the

impact of existing and future FTAs goes in one or the other direction would largely depend on the domestic and international political economies that shape FTAs negotiations. The ability of developing firms and nations to use some of the options available in FTAs described here could contribute to enhance their leverage within production networks in their pursue to catch up with advanced economies.

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## 5

## Essay 4 — Negotiating Protection under overlapping Free Trade Agreements

Dynamic Interplay between Free Trade Agreements and Investment<sup>244</sup>

### Abstract

Two decades into the most recent wave of regionalism many of its implications remain to be fully understood. A vast literature has explored the impacts of free trade agreements (FTAs) on investment flows, but less attention has been given to how existing patterns of investment alter FTA liberalization. It is contended here that the dynamic interplay between overlapping FTA areas and the investment sunk in them shapes governments' and firms' positions regarding further FTA liberalization. During trade negotiations, a country may decide to exclude a sector from FTA liberalization to prevent future FTA partners from making similar demands. Similar sectoral exclusion could occur when a foreign firm, holding a dominant market position in a host country, relinquishes liberalization demands in an FTA between host and home countries to prevent that its current position is eroded if the host country grants similar (or better) concessions to competing firms from other countries in future FTAs. Conversely, investment sunk into a country's sensitive sector in the territory of partners from previous FTAs could preempt the protectionist position of that country when it subsequently negotiates FTAs with the investment-source countries. These arguments were tested in the negotiations on the liberalization of the automotive industry that Thailand and Malaysia had with Japan in their respective bilateral FTAs. The distinct interaction between investment and the FTAs in which these countries participate resulted either in entrenchment of protectionism in the sector or its liberalization across subsequent FTAs.

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<sup>244</sup> Essay 4 was originally written in July 2009. Tables 1 and 2 were updated in 2013. In addition to its critical evaluation by Professor K. Shadlen, it also received review comments from Professor R.E. Baldwin (The Graduate Institute, Geneva, Switzerland) in December 20, 2010 and Dr. E. Ornelas (LSE) in March 22, 2011.

**Abbreviations:**

AFTA: ASEAN FTA

ASEAN: Association of South East Asian nations

FDI: Foreign direct investment

FTA: Free trade agreements

JTEPA: Japan-Thailand economic partnership agreement

LCR: Local content requirement

MAJAICO: Malaysian-Japan Automotive Industries Cooperation

MFN: Most-favored-nation

MJEPA: Malaysia-Japan economic partnership agreement

ROOs: Rules of origin

TAFTA: Thailand-Australia FTA

WTO: World Trade Organization

## 1. Introduction

Since the early 1990s, the worldwide number of free trade agreements (FTAs) has been rapidly increasing. This wave of regionalism initially spared East Asia, which, with the sole exception of the ASEAN (Association of South East Asian Nations) bloc, was the only geographical area that by the turn of the century still remained untouched by FTAs. Today, East Asia has become one the main focus of FTA activity, with close to 60 FTAs implemented since 2002.

The impact of FTA proliferation on global trade is the subject of an unresolved debate between those seeing FTAs as stepping stones toward multilateral liberalization and those considering them rather as stumbling blocks preventing it (reviewed in Baldwin, 2005 and Freund and Ornelas, 2010).<sup>245</sup> Existence of empirical evidence in support of both arguments (e.g., Estevadeordal et al., 2008 *versus* Limão, 2006; see below) indicates that other factors, still unaccounted for, affect the balance between protectionist and pro-liberalization groups with respect to FTAs.

While a large body of literature has studied the impact of FTAs on foreign direct investment (FDI) flows (e.g., Te Velde and Bezemer, 2006; Jang, 2011), less attention has been given to how already sunk investment affects firms' and governments' positions on FTA liberalization. It is argued here that, in the context of overlapping FTAs, these positions are influenced by interplays among FTAs and between FTAs and the investment sunk in them. Concessions granted by a country to another in an FTA inform its future FTA partners about that country's ultimate bargaining positions. During FTA negotiations, that country may protect or exclude a sensitive sector, even from an uncompetitive partner, so as to prevent future FTA partners from making demands to liberalize that sector. Similar

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<sup>245</sup> Scholars arguing that regionalism facilitates global free trade contend that, *inter alia*, FTAs strengthen export-oriented sectors, eventually leading to the multilateralization of preferential tariffs. By contrast, the other camp stresses the trade-diverting effects of FTAs that bolster protectionist groups and perpetuate high multilateral tariffs.

protection/exclusion can also occur when a foreign firm holding a dominant market position in the sensitive sector of the host country foregoes liberalization demands in an FTA between host and home countries in order to prevent the host from making similar concessions to other countries in future FTAs. This would entrench protectionism of sensitive sectors across FTAs and multilaterally, creating a stumbling block to future liberalization. On the other hand, the FDI sunk into previous FTA partners can constrain, or even preempt, the bargaining position of a country trying to protect its sensitive sector(s) in subsequent FTA negotiations with countries that have invested in previous FTA partners. This interplay between past FTAs and the FDI sunk in them can compel a country to open up a sensitive sector in future FTAs, thus acting as a stepping stone toward global liberalization.

To test these arguments, I explored the extent of liberalization of the automotive sector in the FTAs signed by Thailand and Malaysia—the two most FTA-active developing nations in East Asia—with Japan. In many countries, the automotive sector is one of the most protected manufacturing industries, becoming a contentious issue during bilateral and multilateral trade negotiations. As global automotive production takes place largely within regional clusters, multinational carmakers have often been key proponents of regionalism (Yoshimatsu, 2002; Carrillo et al., 2004). As a group, ASEAN, led by Thailand and Malaysia, has consolidated itself as the world's sixth largest automotive producer (Wad, 2009).<sup>246</sup> Although the sector is protected behind high multilateral tariffs in both countries, a more liberal policy on automotive investment in Thailand has attracted large FDI inflows, creating a competitive export-oriented industry heavily dominated by Japanese carmakers. Malaysia has instead pursued the development of state-led national automotive brands, but after three decades of heavy protectionism, its national carmakers suffer from weak

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<sup>246</sup> Historically, Thailand and Malaysia have been the largest automotive producers in ASEAN but, since 2010, Indonesia has surpassed Malaysia (OICA database; see footnote 189 in Essay 3).

international competitiveness and remain overwhelmingly domestically-oriented, yet they face increasing competition at home from Japanese firms. In light of this scenario it was surprising that, when both countries negotiated their respective FTAs with Japan, Thailand resisted tariff reductions on vehicles, but Malaysia agreed to complete liberalization of the sector with Japan. Considering their market dominance and political influence in Thailand, why did Japanese carmakers failed to achieve liberalization of the Thai automotive sector in the Thailand-Japan FTA? Or, as is even more surprising, why, after years of fierce protectionism, did Malaysia expose its fragile national car project to Japanese automotive imports? (see Tables 1 and 2 in Essay 1 for the timeline of the Thailand-Japan and Malaysia-Japan FTAs).

This study attempts to shed light on this puzzle through the above-mentioned arguments, analyzing whether and how the interaction between FDI and FTAs affected the preferences and positions of carmakers and governments with respect to FTA liberalization. A detailed process-tracing analysis of FTA formulation in Thailand and Malaysia confirmed the initial hypotheses.<sup>247</sup> Thailand resisted automotive liberalization with Japan not only to protect existing investment, but also to prevent similar demands from other partners (e.g., United States, European Union, etc.) in future FTAs. Likewise, for Japanese carmakers based in Thailand, even more important than improving their already dominant position by lifting of tariffs on vehicles imported from Japan was preventing firms from other countries from extracting better concessions in their FTAs with Thailand, which goal was achieved by the inclusion in the Thailand-Japan FTA of a specific clause to that effect. By contrast, the FTA that Malaysia previously had with Thailand (as members of ASEAN), and the FDI sunk in Thailand by Japanese carmakers, was going to open Malaysia to tariff-

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<sup>247</sup> This Essay focuses in the automotive sector but draws on 212 in-depth semi-structured interviews with private sector representatives, government officials, academics and civil society in Thailand and Malaysia during two independent trips in 2008 and 2009 complemented with numerous personal communications and secondary research during 2010-2012.

free Japanese vehicles made in Thailand starting in 2010, thus preempting Malaysia's protectionist position in its bilateral FTA with Japan.

The rest of the article is organized as follows: the next section outlines the analytical framework of the study; section three briefly reviews the automotive sector in Thailand and Malaysia in the context of ASEAN; sections four and five analyze the policymaking of Thai and Malaysian bilateral FTAs with Japan in relation to the automotive sector, and section six discusses main findings.

## **2. Protectionism and liberalization in the presence of sunk investment across overlapping FTAs**

The debate on the influence of FTAs on multilateral liberalization remains unsettled. Theoretical and empirical studies provide supporting evidence that regionalism could either hinder (e.g., Levy, 1997; Panagariya, 2000; Limão, 2006) or foster multilateral liberalization (e.g., Ornelas, 2005a; Estevadeordal et al., 2008; Ornelas, 2008; Calvo-Pardo et al., 2011). One of the factors considered in the argument is the impact that previous liberalization—multilateral or through earlier FTAs—has on the preferences of interest groups in regard to further liberalization. Those who see regionalism as an obstacle to global free trade contend that the interest of export-oriented groups in additional liberalization weakens as the share of exports covered by FTAs continues expanding. At the same time, since FTAs can accommodate protection (or even exclusion) for sensitive items, over time FTA proliferation strengthens the political leverage of protectionist coalitions vis-à-vis exporters, which allows high tariffs in protected/excluded sectors to be consolidated across FTAs and into the multilateral regime. Authors who instead defend FTAs as positive steps toward multilateral liberalization argue, to the contrary, that by expanding their market size, employment and output, FTAs progressively increase the political influence over trade policy of exporters at the expense of import-competing

sectors. In addition, regionalism also reduces incentives among import-competing sectors to lobby for high external tariffs (*rent destruction*), eventually leading to the multilateralization of FTA preferential tariffs to countries outside the bloc.<sup>248</sup>

Global liberalization offers greater opportunities than regionalism to expand economies of scale; however, under certain circumstances firms may still prefer FTA liberalization. For instance, producers which have: a) unexploited economies of scale and/or b) fragmented production across several countries could favor regionalism over multilateral liberalization because of FTAs' discriminatory effects against competing firms outside the bloc through preferential tariffs and strict rules of origin (ROOs)<sup>249</sup> (Milner, 1997; Chase, 2003; Chase, 2005; Chase, 2008).

Firms' and states' preferences regarding FTA liberalization are influenced exogenously by the FTAs signed (or projected to sign) by other countries. FTAs generate "club goods" for businesses inside the bloc, while they raise relative costs for those outside. Excluded firms may attempt to redress this discrimination by pressing their governments to join the FTA (or form a new one), leading to a "domino effect" of proliferating FTAs (Baldwin, 1995).<sup>250</sup> This implies that an FTA cannot guarantee that the preferential market access it provides to firms inside the bloc vis-à-vis outside competitors will continue into the future. Tariff preferences extracted from an FTA partner are subject to *concession erosion* (or even *diversion*) if the partner later offers similar (or better) preferences to a third country (Ethier, 2001; Hallaert, 2008). Although no country can prevent its FTA

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<sup>248</sup> In addition, reductions in external tariffs following the creation of an FTA could also undermine incentives for countries outside the bloc to pursue multilateral liberalization (Ornelas, 2005b).

<sup>249</sup> ROOs determine the origin of a product—and therefore, whether or not it qualifies for FTA preferential tariffs—based on compliance with a minimum level of transformation within the bloc. Included in FTAs to avoid trade deflection, strict ROOs could also be used for protectionist purposes.

<sup>250</sup> Proliferation of FTAs have also been explained by "fear of exclusion" (Shadlen, 2008).

partners from signing other FTAs, concession erosion or diversion can be limited if the original FTA includes a most-favored-nation (MFN) clause (Ethier, 2001).<sup>251</sup>

Here it is argued that preferences on FTA liberalization by a given country are influenced not only by the FTAs established by competing nations, but also by that country's own agreements. The FTAs that a country has already signed—or could sign in the future—and the FDI sunk in these FTA areas alter the balance between liberalizing and protectionist coalitions, and constrain the position of that government in subsequent FTA negotiations.

Attracting FDI is an explicit goal for developing countries' entering FTAs. A vast number of academic works have explored the multiple mechanisms through which FTAs influence investment flows (e.g., Medvedev, 2006; Te Velde and Bezemer 2006; Jang, 2011).<sup>252</sup> However, less attention has been given to how existing investment alters the preferences and strategies of firms and governments regarding FTAs with FDI source countries.

Because of its numerous spillovers, the automotive industry is one of the sectors governments have most often promoted for investment and/or protected. Until the 1990s it was common for multinational carmakers to engage in tariff-jumping FDI, setting up plants in multiple countries and assembling similar models for each respective domestic market. In most cases those factories operated at suboptimal scales and required host governments to maintain tariff protection and grant oligopoly rents. Increasing liberalization since the

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<sup>251</sup> MFN refers to the principle under the World Trade Organization regime by which any member country should receive equal trade privileges than the MFN by the country granting the treatment. FTAs constitute one of the few exceptions to the MFN principle allowed by the World Trade Organization with no obligation to extend FTA preferential tariffs to countries outside the FTA bloc. Nevertheless, some FTAs also include MFN clauses to avoid concession erosion.

<sup>252</sup> For instance, many FTAs include provisions liberalizing investment regulations and/or increasing investors' protection. Firms outside an FTA may neutralize trade diversion by investing and producing within the bloc. Depending on the intended goal several types of FDI have been distinguished of which only *market-seeking* and *efficiency-seeking* FDI are of interest here. Efficiency-seeking FDI is pulled in by location-specific advantages that enhance the competitiveness of firms processing inputs for exports. Market-seeking FDI is pulled by the larger market created by an FTA, which could also generate efficiency gains attracting vertical efficiency-seeking FDI. Market-seeking FDI is also attracted to sectors protected by tariff (and non-tariff) barriers, being referred then as *tariff-jumping FDI*. Another way by which FTAs could lure FDI, especially into developing countries, is by signaling commitment to liberal economic policies (Ethier, 1998; Büthe and Milner, 2008). On the other hand, for producers inside a FTA area, FTA liberalization reduces the cost of serving the region through trade, potentially discouraging tariff-jumping FDI from other FTA partners. The latter situation is more likely to occur in bilateral FTAs between developed countries (Jang, 2011).

1990s prompted carmakers to initiate a rationalization of procurement and production. Since sudden multilateral liberalization could lead to excess capacity, firms have instead pushed for FTAs that suit their regional strategies and allow a gradual reorganization from the national to the regional level while discriminating against outside competitors through preferential tariffs, strict ROOs and trade-related investment measures (Milner, 1997; Chase 2004; Chase, 2008).<sup>253</sup>

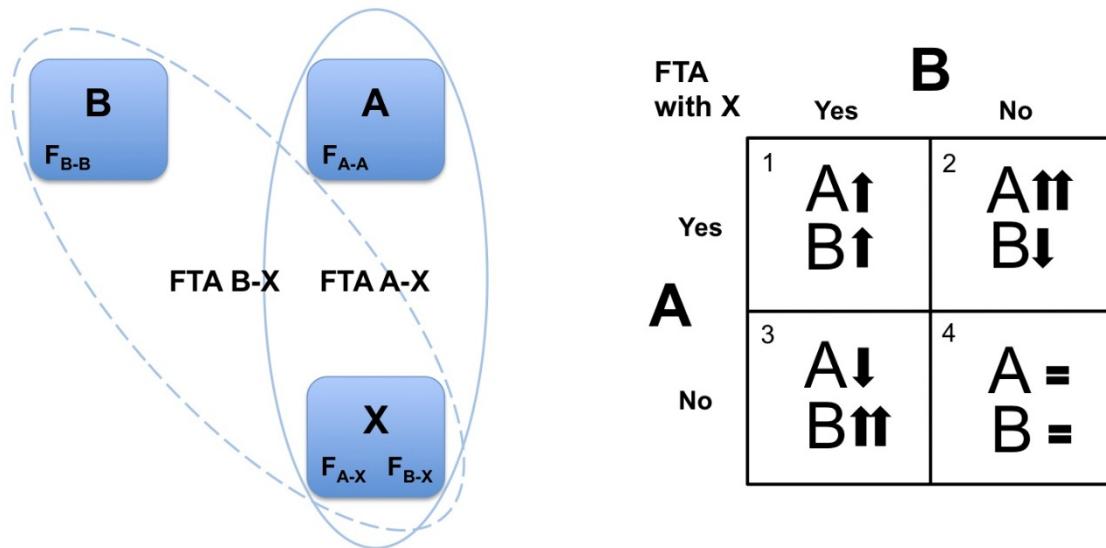
Consider a firm  $F_A$  from developed country A with a production factory at home (plant  $F_{A-A}$ ), but that has also invested and produces in a protected sector of developing country X (plant  $F_{A-X}$ ) (tariff-jumping FDI) (Figure 1, left panel). In order to improve its economies of scale, firm  $F_A$  would lobby the government in A for an FTA between A and X that *gradually* eliminates trade barriers in X to final and intermediate goods coming from A. Upon liberalization,  $F_A$  may decide either to divest from its plant  $F_{A-X}$ , and serve X directly from  $F_{A-A}$  (replacing FDI with trade), or to integrate  $F_{A-X}$  into the regional network through specialization (complementing FDI with trade) (Figure 1, left panel). A competing firm  $F_B$  from country B, which also has tariff-jumping FDI in X (plant  $F_{B-X}$ ), will oppose liberalizing imports of final goods from A in FTA A-X since  $F_{B-X}$  would be unable to compete with plants in country A operating on more efficient economies of scales. If  $F_{B-X}$  procures inputs from A it may still welcome FTA liberalization by X on intermediate goods (but not final goods) coming from A.

The existence of FTA A-X will prompt country B to form its own FTA with X (FTA B-X) as part of the classical FTA domino effect (Figure 1, left panel). In this setting, firms in countries A and B face a non-zero-sum game (Figure 1, right panel). Although each country will gain the most from an *exclusive* FTA with X (quadrants 2 and 3), and the

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<sup>253</sup> The Agreement on trade-related investment measures at the World Trade organization is limited to banning local content requirements (LCRs), trade balancing or foreign exchange. The Agreement imposes costs on investors but provide rents for incumbents. Firms tend to favor FTA over multilateral liberalization for a gradual elimination trade-related investment measures that, at the same time, discriminates against outsiders (Chase, 2004).

worst scenario is not to have an FTA with X while the other does, both would still benefit more from the existence of two separate FTAs with X (quadrant 1) than from no FTA at all (quadrant 4).



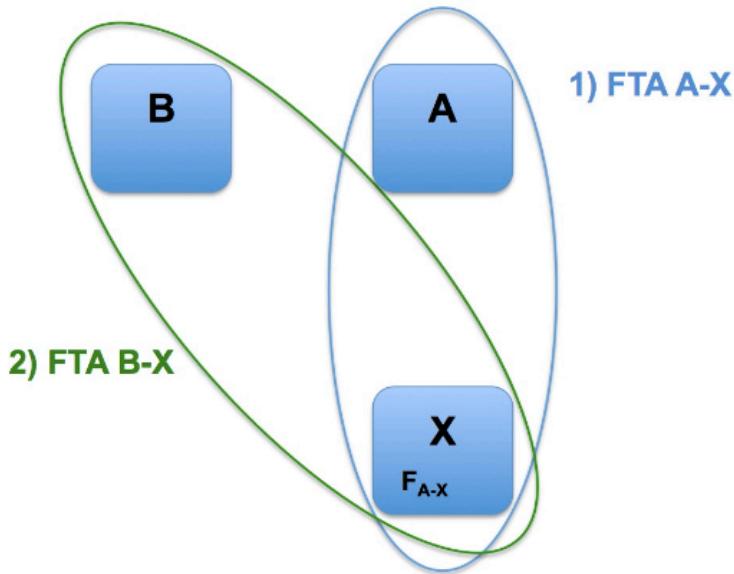
**Figure 1:** *Left panel:* Firm  $F_A$  from country A with production at home ( $F_{A-A}$ ) and tariff-jumping investment and production in X ( $F_{A-X}$ ) will favor a FTA between A and X (FTA A-X) that eliminates trade barriers in X while also discriminates against firms from country B. Trade diversion from FTA A-X will prompt country B to create its own FTA with X (FTA B-X). See text for details. *Right panel:* Firms from A and B face a non-zero sum game where each gains the most from an exclusive FTA with X. Gain with respect to the initial situation is represented by an upward arrow (two upward arrows indicate enhanced gains) and loss by a downward arrow. See text for details.

The net effect of FTA liberalization on tariff-jumping FDI in X is contingent on multiple factors, as would also be the preferences of government and local suppliers in X.<sup>254</sup> If, as discussed earlier,  $F_A$  decides to divest from  $F_{A-X}$  and serve country X from home country A ( $F_{A-A}$ ) upon FTA liberalization, country X will experience employment losses. In addition, the government in host country X will also lose unrecoverable sunk “investments” made in the sector in the form of forgone taxes and other incentives to foreign producers ( $F_{A-X}$ ,  $F_{B-X}$ ). Local firms in X supplying intermediate inputs to plant  $F_{A-X}$  would resist liberalization of final products and/or intermediate inputs coming from A, but would

<sup>254</sup> Businesses are more likely to react in avoiding potential losses from liberalization than in securing potential gains (Baldwin, 1995).

benefit from FTA A-X liberalization if  $F_A$  integrates  $F_{A-X}$  into its regional network and expands its production toward exports.

It is posited here that the above preferences could also be shaped by the FTAs that X has already signed or might sign in the future. A country may decide to protect a sensitive sector from FTA liberalization independently of whether or not the FTA partner is a competitive producer. But it may also decide to liberalize that sensitive sector to a non-competitive partner as part of the multi-sectoral package of concessions exchanged during negotiations. One could safely assume the existence of some path-dependence in FTA formulation, in the sense that concessions granted by a country in previous FTAs signal future FTA partners about the boundaries around sensitive sectors. In this line, during negotiations for FTA A-X, country X may refuse to liberalize its sensitive sector to final and intermediate goods coming from A as to prevent other countries' making equivalent demands in subsequent FTAs. Furthermore, if firm  $F_{A-X}$  holds a dominant market position in country X,  $F_A$  may favor the pre-FTA *status quo* of protectionism over a scenario where liberalization by X to country A is followed by X making similar or better concessions to country B in a future FTA (concession erosion or diversion, as noted earlier). In this case,  $F_A$  itself can paradoxically relinquish (or soften) its demands for liberalization by X in FTA A-X (Figure 2).  $F_{A-X}$  is more likely to forego its liberalization demands in FTA A-X if it can secure assurances—through the inclusion of an “MFN clause” in the FTA—that X will not give country B a better deal in their subsequent FTA. In either case, concession prevention would reduce the chance of country X granting concessions to country A in the given sector. The interplay between tariff-jumping FDI and the imprint of past and future FTAs would prompt that the sector is protected in future FTAs and in the multilateral regime (Figure 2).



**Figure 2:** Country X can refuse liberalization of a sector to country A in FTA A-X as to prevent equivalent demands from country B in a subsequent FTA B-X. If firm  $F_{A-X}$  has a dominant market position in X,  $F_A$  could also potentially relinquish on its liberalization demands in FTA A-X in order to prevent creating a precedent for future FTAs. In either case, country X would be less inclined to grant concessions in that sector to country A, prompting the sector to be protected/excluded across FTAs. See text for details.

**Hypothesis 1a:** *Concessions on a sensitive sector granted by a country in an FTA potentially signal ultimate bargaining positions. That country may therefore decide not to liberalize a sensitive sector in an FTA, even with a non-competitive FTA partner, to prevent similar demands by other countries in future FTAs.*

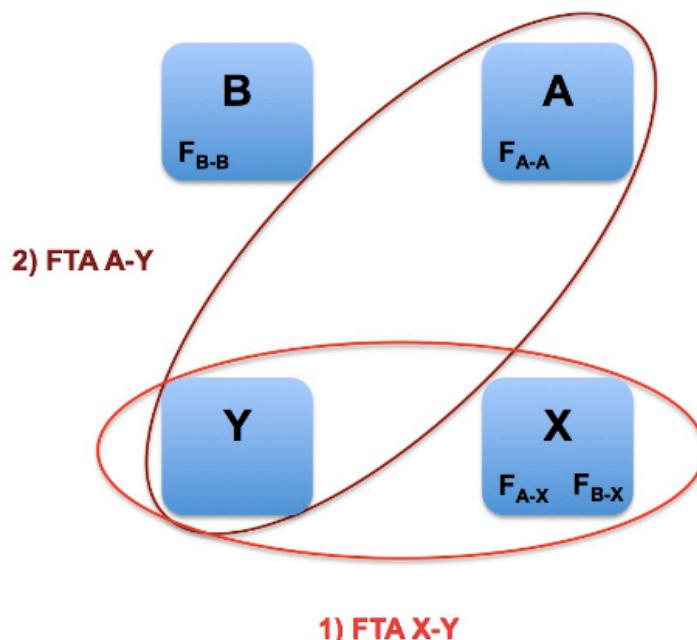
**Hypothesis 1b:** *A foreign firm holding a dominant market position in a protected sector of the host country can potentially favor the status quo—accepting current protectionism—and relinquish liberalization demands in an FTA between home and host countries, to avoid similar concessions by the host to other countries in subsequent FTAs, especially if the FTA incorporates an MFN clause.*

**Hypothesis 1c:** *Following the two previous hypotheses, protection or exclusion of a given sensitive sector in an FTA would result in the entrenchment of protectionism around that sector in subsequent FTAs and multilaterally.*

At trade negotiations it is impossible to know *ex-ante* a partner's future comparative advantage. Signing a bilateral FTA opens up a country to competition not only from firms already established in the partner but also from those that may invest there in the future. Continuing with the previous setting, let us introduce an additional country, Y. Country Y protects a given sensitive sector at the multilateral level, but Y may have liberalized that sector—from the start or gradually—to country X as part of bilateral FTA X-Y if X was not competitive in that sector at the time of FTA negotiations. However, country Y has little or no leverage over investment policy in X, whose competitiveness may change, even rapidly, as a result of FDI from other countries (e.g.,  $F_{A-X}$  from country A). As long as products comply with ROOs,  $F_A$  could use its production base in X ( $F_{A-X}$ ) plus FTA X-Y to tariff-jump into Y (Figure 3).

Country Y continues to shield its sensitive sector from imports originating in countries A or B—with high comparative advantage in that sector—through high MFN tariffs. Therefore, if Y should decide later on to negotiate a separate FTA with A, Y may still wish to protect the sensitive sector from A in the bilateral FTA A-Y. However, the FTA that Y signed previously with X (FTA X-Y) and the FDI of  $F_A$  into X ( $F_{A-X}$ ) in Y's sensitive sector means that  $F_{A-X}$ 's products are already entering duty-free into Y by way of FTA X-Y. The concessions and protections that Y could negotiate with A are therefore paradoxically constrained and preempted by the FTAs that Y has itself signed in the past and the FDI sunk into Y's FTA partners (Figure 3). The situation will repeat itself when Y

negotiates with B or any other country that has invested into X in Y's sensitive sector. In a context of proliferating and overlapping FTAs, as the current scenario in East Asia, a country may find that the FDI sunk over time into partners of previous agreements could compel that country to open up a sensitive sector in future FTAs, sensitive sector that until then was protected multilaterally from direct imports from other countries. The iteration of this process would therefore act as a stepping stone toward further liberalization (Figure 3).



**Figure 3:** Country Y has opened up a sensitive sector to uncompetitive country X as part of FTA X-Y. If firm  $F_A$  from country A invests into country X ( $F_{A-X}$ ) in Y's sensitive sector,  $F_{A-X}$  could use FTA X-Y to export freely to Y. If Y later decides to sign an FTA with A, FTA X-Y and the FDI sunk by  $F_A$  into X ( $F_{A-X}$ ) could preempt the protectionist position of Y during negotiations with A. The situation will repeat when country Y negotiates FTAs with other countries that have invested in X (e.g.,  $F_{B-X}$  from country B). The FDI sunk in partners from previous FTAs will compel Y to open up sensitive sectors in future FTAs. See text for details.

**Hypothesis 2a:** *If a country seeks to shield a sensitive sector from external competition, the FDI sunk into that sector in the territory of previous FTA partners could constrain and preempt its protectionist position when it later negotiates FTAs with the FDI source countries.*

**Hypothesis 2b:** *Following the previous hypothesis, in a context of ever growing and overlapping FTAs, the FDI sunk in previous FTA areas would prompt that country to open up its sensitive sector(s) in future FTAs and eventually multilaterally.*

### 3. The Thai and Malaysian automotive sectors in the context of ASEAN

#### 3.1 Thailand

Appreciation of the yen in the 1980s and high trade barriers protecting the automotive industry in many countries fostered the relocation of Japanese carmakers overseas, favoring Thailand as their preferred FDI destination in Southeast Asia largely because it lacked a national car program (Doner, 1991; Staples, 2008). Thailand began to unilaterally reduce trade and investment barriers in the automotive sector in 1991, liberalization that was reinforced by the signing of the ASEAN FTA (AFTA) in 1992 and the World Trade Organization (WTO) Agreement on Trade-Related Investment Measures in 1994 that bound Thailand to gradual intra-ASEAN liberalization and to the elimination of local content requirements (LCRs) by 2000, respectively. Nevertheless, high multilateral applied tariffs maintained the automotive industry as one of the most protected sectors in Thailand. Strong economic growth during the mid-1990s prompted a new surge of FDI into the Thai automotive sector, which was targeted by international carmakers not only as the largest market in ASEAN, but also as a potential regional base for exports (Abbott, 2004; Doner, 2009).

Many of these investment projects ran aground after domestic vehicle demand and production collapsed in the aftermath of the 1997 Asian financial crisis (see Figure 3 in Essay 3). The government reacted to the crisis by loosening foreign equity restrictions on investment but raising multilateral applied tariffs on vehicles with the vision of

transforming Thailand into the regional automotive hub through a combination of import substitution and export-oriented manufacturing by international firms. Despite the crisis, Thailand complied with its commitments to abolish LCRs and to progressively eliminate tariffs on ASEAN automotive products.

Although vehicle production recovered by 2002 the Asian crisis represented a turning point in the structure and orientation of the Thai automotive industry.<sup>255</sup> Most Thai firms involved in vehicle assembly went bankrupt and sold their stakes to foreign carmakers while many Thai-owned automotive part producers disappeared, were bought up by foreign firms, mostly Japanese, or downgraded to lower tiers in the supply base. Importantly, the crisis accelerated foreign carmakers' plans to use Thailand as an export base. Since the crisis, vehicle production has grown steadily on the back of strong exports and Thailand is now the world's ninth largest automotive producer and Asia's third largest exporter after Japan and Korea (Trade Map and OICA databases).<sup>256</sup> Since 2007 around half of Thai automotive production is exported, compared to just 2.5% before the crisis (Figure 3 in Essay 3). This strong export-orientation of the Thai automotive industry attests of the international competitiveness of assemblers and automotive parts producers established in the country.

Automotive production, domestic sales and exports in Thailand are heavily dominated by Japanese firms that have transferred to Thailand manufacturing of all commercial vehicles (pickup trucks) and an array of mid-range passenger cars. For larger-engine luxury models, Japanese firms conduct all the assembly in Japan and export them directly to Thailand, unlike European carmakers that assemble their high-end models in Thailand using kits imported from Europe. Of all vehicles manufactured in Thailand during

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<sup>255</sup> Data for the rest of this section were obtained from the Thai Automotive Industry Association, Thailand Automotive Institute, Automotive Industry Club, Auto Parts Industry Club, Thai Autoparts Manufacturers Associations, Office of Industrial Economics (Thai Ministry of Industry) and individual carmakers and suppliers.

<sup>256</sup> Thai automotive production experienced declines in 2009 and 2011 as a result of the global economic crisis and floods in central Thailand, respectively (Figure 3 in Essay 3).

2004—the start of Thailand-Japan FTA negotiations—over 80% were Japanese models. Most of the remaining production is of American brands, with only around 1% being European and smaller shares for models of other origins. Over the last decade Japanese carmakers have accounted for over 85% of local market sales (Table 1). European firms only have an important presence in the niche segment of over-2500cc passenger cars. Vehicle exports are also dominated by Japanese makers, which accounted for over 85% of all units exported in 2003-2012, mainly to Australia, ASEAN and the Middle East.

**Table 1: Vehicle market share in Thailand by the home country of the carmaker \***

| Carmaker Nationality                         | 1999-2000 | 2003-2004 | 2005-2006 | 2007-2008 | 2009-2010 | 2011-2012 |
|--|-----------|-----------|-----------|-----------|-----------|-----------|
| <b>Japan</b>                                 | 88.8%     | 89.0%     | 91.3%     | 92.3%     | 91.8%     | 88.6%     |
| <b>United States</b>                         | 7.2%      | 9.1%      | 7.1%      | 5.8%      | 4.1%      | 8.4%      |
| <b>European Union **</b>                     | 3.1%      | 1.5%      | 1.2%      | 1.2%      | 1.2%      | 1.2%      |
| <b>Other</b><br>(Korean, Chinese, Malaysian) | 0.9%      | 0.4%      | 0.4%      | 0.7%      | 2.9%      | 1.8%      |

Source: Thailand Automotive Institute, Thai Automotive Industry Association, Automotive Industry Club and individual assemblers

\* Average market share for total retail vehicle sales (commercial and passenger vehicles) during the indicated period

\*\* European carmakers hold over 60% of the market in the over 2500cc passenger car segment, which represents less than 0.5% of the overall market

The supply base in Thailand is the largest and most developed in ASEAN with the biggest share at the first-tier level in the hands of Japanese firms. Despite the elimination of LCRs, domestic value content in Thailand-made vehicles has kept increasing, and although Thailand produces many automotive parts locally, it still imports some higher-technology components and steel, mainly from Japan. Japanese firms' weight in the Thai automotive sector and in overall Thai FDI inflows, especially in the case of Toyota, translates into significant leverage in policymaking as emerged during interviews with both government officials and other carmakers.

### 3.2 Malaysia

Malaysia's economic development policy during the last four decades has been guided by two overarching goals: achieving developed-country status and fostering the participation of the ethnic-Malay/bumiputera population in the economy. In 1983, in a bid to develop indigenous technological automotive capabilities, the Malaysian government entered directly into vehicle manufacturing by launching the *National Car Project* and the national carmaker PROTON to produce mid-size cars.<sup>257</sup> From the start the government has supported and protected PROTON from foreign competition—within Malaysia and from abroad—with a panoply of trade and regulatory measures (Abbott, 2004; Rosli and Kari, 2008; Natsuda et al., 2013). PROTON's share in the Malaysian market increased to 74% after only ten years encouraging the government to set up another firm, PERODUA, in 1993 to manufacture subcompact cars in a venture with Japanese Daihatsu.<sup>258</sup> By 1996, PROTON and PERODUA commanded a joint domestic market share of 85%. During much of the 1990s, PROTON and PERODUA were the first and third largest carmakers in ASEAN by production volume; yet, both remained primarily domestically-oriented.<sup>259</sup>

The Asian crisis caused a sharp decline in Malaysian automotive production and domestic sales (see Figure 4 in Essay 3), which reignited protectionism. Malaysia requested and obtained from the World Trade Organization (WTO) an extension in the use of LCRs until 2004, exclusively for its automotive sector. More controversially, Malaysia unilaterally excluded its automotive sector from AFTA liberalization schedules (see below). It was only in 2005—later consolidated with the *National Automotive Policy*, issued in 2006—that the government accepted to progressively reduce tariffs on ASEAN-originated vehicles and automotive parts until they were completely eliminated in 2010 as

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<sup>257</sup> Although PROTON initially relied on technology from Japanese Mitsubishi—then a minority shareholder in the firm—its management has always been Malaysian bumiputera.

<sup>258</sup> PERODUA is also considered a national carmaker but its production strategy is controlled by Daihatsu and lacks some of the perks granted to PROTON.

<sup>259</sup> Historically, and until 2010, Malaysia represented ASEAN's largest passenger car market and was arguably poised to have become the regional hub for automotive multinationals had its government not launched the National Car Project.

mandated by AFTA. However, these tariff reductions were accompanied by the introduction of a system of excise duties on vehicles that exempts Malaysian-value content, directly benefitting national carmakers with lower import content, especially PROTON. The National Automotive Policy continues to stress the need to promote PROTON and bumiputera participation in the sector. Malaysia has a liberal investment regime in most manufacturing sectors but this has remained restricted in the automotive industry. Foreign carmakers cannot have a controlling stake in their Malaysian subsidiaries, and must set up minority ventures with local firms, most often government-linked companies.<sup>260</sup>

Vehicle production and domestic sales regained pre-crisis levels in 2001, but growth since then has been slow compared to Thailand (Figure 4 in Essay 3). Although together both national carmakers still account for over half of total production and domestic sales, PROTON has been losing ground not only to PERODUA but also to competitively-priced Japanese models, both locally-assembled and imported (Table 2). Since 2003—just before Malaysia-Japan FTA negotiations started—Japanese brands’ market share has grown from 21% to around 30% (Table 2). As Malaysia started reducing AFTA tariffs on vehicles in 2005 (see below), imports of Japanese models assembled in ASEAN—mainly in Thailand and Indonesia—raised, doubling between 2005 and 2009 (interviews). European and American models represent 3-6% of the local market, in the case of the latter mainly as imports from Thailand. Vehicle exports, mostly by PROTON, have been low due to weak international competitiveness of national carmakers and PERODUA’s lack of independence in determining its own export strategy. Likewise, Japanese assemblers in Malaysia cater almost exclusively to the domestic market, following their principals’ production and sales plans. Establishment of the National Car Project boosted an

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<sup>260</sup> The 2009 revision of the National Automotive Policy eliminated foreign equity restrictions for the assembly of cars with engines over 1800cc, electric and hybrid cars and commercial vehicles (outside the core segment of PROTON and PERODUA). A new revision of the National Automotive Policy is expected for late 2013 (see footnote 226 in Essay 3).

indigenous automotive parts industry, although of mostly low technical capabilities. In contrast to Thailand, the large majority of suppliers are locally-owned and serve national carmakers.<sup>261</sup>

**Table 2: Vehicle market share in Malaysia among main carmakers \***

| Carmaker                      | Ownership  | 1999<br>2000 | 2003<br>2004 | 2005<br>2006 | 2007<br>2008 | 2009<br>2010 | 2011<br>2012 |
|-------------------------------|--|--------------|--------------|--------------|--------------|--------------|--------------|
| <b>Proton</b>                 | Malaysian (National carmaker)                                  | 52.1%        | 36.7%        | 26.9%        | 25.0%        | 26.8%        | 27.6%        |
| <b>Perodua</b>                | Malaysian (National carmaker)                                  | 28.3%        | 27.8%        | 28.5%        | 31.8%        | 31.1%        | 33.9%        |
| <b>Japanese carmakers</b>     | Joint ventures with Japanese minority                          | 10.7%        | 21.2%        | 24.2%        | 31.2%        | 31.8%        | 27.3%        |
| <b>Naza Kia **</b>            | Malaysian (Private, bumiputera)                                | N/A          | 1.4%         | 4.8%         | 3.2%         | 1.8%         | 1.5%         |
| <b>European carmakers ***</b> | Joint ventures with European minority                          | N/A          | 1.7%         | 1.8%         | 1.9%         | 2.4%         | 5.2%         |
| <b>American carmakers</b>     | Joint venture with US minority or imported after mid-2008 **** | 1.2%         | 1.7%         | 1.4%         | 0.6%         | 0.5%         | 1.1%         |
| <b>Other</b>                  | Korean, Chinese, Indian  | N/A          | 9.5%         | 12.4%        | 6.3%         | 5.6%         | 3.4%         |

Source: Malaysian Automotive Association

\* Average market share for total registered vehicles (commercial and passenger vehicles) during the indicated period. Note that figures for 1999-2000 do not add to 100% because information for some carmakers was not available

\*\* Naza is a Malaysian business conglomerates that locally assembles and rebadges Korean Kia cars. Since 2010 it also assembles small Peugeot cars and distributes other European and American models

\*\*\* Include Peugeot cars assembled in Malaysia by Naza

\*\*\*\* General Motors has no plants in Malaysia and Ford stopped production in mid-2008

Following Mitsubishi's sale of its stake in PROTON in 2004, the national carmaker has seen its market share position progressively deteriorating while repeated financial losses started threatening its viability. The Malaysian government looked for another global partner that could help PROTON with technological upgrading and marketing but negotiations with several international carmakers failed due to the government's refusal to give up managerial control to a foreign firm.<sup>262</sup>

### **3.3 ASEAN FTA (AFTA)**

National and corporate interests around the automotive industry were pivotal in the formulation and establishment of early ASEAN functional cooperation programs and AFTA itself. In the late 1980s and mid-1990s, Japanese carmakers succeeded in getting

<sup>261</sup> Small economies of scales limit the competitiveness of Malaysian-owned suppliers, and their high dependence on PROTON and/or PERODUA compromises their future if national brands' market share continues to shrink.

<sup>262</sup> In January 2012, government-linked investment company, Khazanah, sold its shares in PROTON to Malaysian private holding DRB-HICOM (*New Straits Times*, January 16, 2012; *The Edge*, January 17, 2012).

ASEAN governments to implement complementation schemes (e.g., Brand-to-Brand complementation and ASEAN Industrial Cooperation programs) that liberalized pre-approved trade flows in intermediate goods among specific subsidiaries within the region (Yoshimatsu, 2002). Since these programs mostly benefitted foreign multinationals, Malaysia was initially loath to grant approvals, while Thailand, as the regional hub of international carmakers, supported them from the start.<sup>263</sup>

AFTA schedules established that intra-ASEAN tariffs were to be capped at 20% by 2000 and although items could be temporarily excluded, tariffs had to be reduced to 0-5% by 2003 and totally eliminated by 2010. Full liberalization is delayed to 2015 for ASEAN less developed members Cambodia, Myanmar, Laos and Vietnam. As indicated earlier, following the Asian crisis, Malaysia transferred its automotive sector to the exclusion list and increased tariffs on vehicles coming from ASEAN to up to 300%. Malaysia maintained the sector excluded from AFTA schedules beyond the 2003 deadline and tariffs on ASEAN automotive products were only brought down to 20% in 2005 before there were scrapped in 2010.

Small margins between multilateral and AFTA tariffs in many sectors have limited businesses' incentive to use AFTA (Manchin and Pelkmans, 2008; Ravenhill, 2008). However, since the automotive industry has been heavily protected in most ASEAN countries, primary data collected in this research found close to complete utilization of AFTA preferences for trade in automotive products (data from the Thai Ministry of Commerce; interviews). Elimination in 2010 of all intra-ASEAN tariffs allows carmakers, especially Japanese firms with a larger presence, to rationalize scales and strategies on a

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<sup>263</sup> Eventually, Malaysia approved complementation projects in the ASEAN Industrial Cooperation scheme and automotive firms established in the country participated in about half of all automotive-related projects in this program. In line with Malaysia's early concerns, the vast majority of projects covered trade exchanges among Japanese firms and only one involved PROTON (data from the Ministry of International Trade and Industry; interviews). Initially projected to be phased out by 2003, the ASEAN Industrial Cooperation program continued in use until 2010.

regional basis, using their largest plants in Thailand to serve demand in other ASEAN countries, including Malaysia.

Japanese and Western carmakers have later become interested in integrating neighbouring countries (e.g., Japan itself, Australia) into their ASEAN network. To that effect, they have lobbied ASEAN governments—particularly in major automotive producers, Thailand, Malaysia and Indonesia—for the creation of a number of bilateral FTAs. However, for Malaysia, further liberalization of its automotive sector beyond AFTA, particularly to highly competitive automotive producing nations like Japan, could be ominous for PROTON and its suppliers.<sup>264</sup>

#### **4. The automotive sector in the Thailand-Japan FTA**

Over the last decade, most ASEAN countries, with Singapore, Thailand and Malaysia in the lead, have been actively pursuing FTAs with partners within East Asia and beyond (Sally, 2007; Hoadley, 2008; Sally and Sen, 2011). As of August 2013, Thailand is signatory to AFTA, five bilateral agreements, and five regional FTAs as a member of ASEAN (see Table 1 in Essay 1). The Thailand-Australia FTA, which fully liberalized the Thai automotive sector for the first (and so far only) time outside AFTA, merits attention here before the Japan-Thailand FTA is analyzed.

Even before the Thailand-Australia FTA (TAFTA) was implemented in January 2005, Australia represented the main market for Thailand-made vehicles, which accounted for 25% of total Thai exports to Australia. Field research for this Thesis found that pressure by Japanese and American carmakers on both governments was instrumental in TAFTA negotiations (Essay 1).<sup>265</sup> Australia was not a direct competitor to the Thai automotive industry and, in fact, automotive production structures in both countries were

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<sup>264</sup> Given significant overcapacity and increased competition at home the firm remains at a crossroads.

<sup>265</sup> General Motors and Toyota lobbied the Thai government to speed up the opening of negotiations for TAFTA. Automotive associations in Australia also lobbied for TAFTA to the Australian Parliament (Essay 1).

complementary.<sup>266</sup> Consequently, Thailand agreed to open its automotive industry fully and relatively rapidly to Australia. Thailand eliminated from the start all tariffs on commercial vehicles and large passenger cars and phased out by 2010 those on smaller cars and automotive parts (Table 3).<sup>267</sup>

**Table 3: Thai and Australian concessions in the automotive sector under TAFTA**

|                                    | Thai concessions | Australian concessions      |
|------------------------------------|------------------|-----------------------------|
| <b>Passenger cars &lt; 3000 cc</b> | 0% by 2010       | 0% at entry                 |
| <b>Passenger cars &gt; 3000 cc</b> | 0% at entry      | 0% at entry                 |
| <b>Commercial Vehicles</b>         | 0% at entry      | 0% at entry                 |
| <b>Automotive parts</b>            | 0% by 2010       | 0-5% at entry<br>0% by 2010 |
| <b>Hot- and cold-rolled steel</b>  | 0% by 2015       | 0% at entry                 |

Source: TAFTA treaty (DFAT, undated)

As Thailand's main foreign investor, first source of imports and key export market, Japan was a natural FTA partner for Thailand (Manger, 2005). Through the Japan-Thailand Economic Partnership Agreement (JTEPA), Thailand aimed at improving access for its agricultural products and attracting investment, while Japan sought to liberalize the Thai automotive and steel sectors and extract concessions on services.

When JTEPA negotiations began in February 2004, Thailand had just agreed to fully open its automotive sector to Australia under TAFTA, and was about to start bilateral negotiations with the United States, the world's largest automotive producer at the time. In addition, as member of ASEAN, Thailand was also party to ongoing discussions for an FTA with Korea and to plans for another with the European Union. Together, these agreements would place Thailand at the heart of a network of overlapping FTAs with most of the major automotive producing countries. In keeping with the initial arguments, the

<sup>266</sup> Thai strength in light commercial vehicles and small- and medium-size passenger cars was matched by Australia's advantage in large-engine vehicles and higher-technology automotive parts.

<sup>267</sup> On its part, Australia eliminated from the start all tariffs on vehicles and by 2010 on automotive parts.

imprint of previous FTAs on JTEPA negotiations became patent early on and interviews revealed that Japanese carmakers, as the largest investors in the Thai automotive sector, expected to extract in JTEPA the same preferential treatment Thailand had offered to Australia.<sup>268</sup> But these interviews also found that, over all else, Japanese automotive firms wanted to preserve their dominant position in Thailand, avoid the erosion of any preferences they could eventually obtain in JTEPA, and prevent Thailand from later liberalizing its automotive sector with other countries, as it had done with Australia.

An agreement in principle for JTEPA, including the contentious agricultural sector, was reached in March 2005 only for talks to get tangled up over the automotive sector. To cancel the tariff advantage enjoyed by European brands established in Thailand and that dominate the luxury segment, Japan requested the scrapping of Thai tariffs on vehicles of over 3000cc. In addition, and although they already produce small- and medium-size vehicles in Thailand at internationally competitive costs, Japanese carmakers also demanded the gradual elimination of tariffs on models below 3000cc.<sup>269</sup> Finally, and more importantly, Japanese firms also wanted to improve the competitiveness of their plants in Thailand by liberalizing imports of higher-technology automotive parts and steel from Japan.

While liberalization to Australian automotive products posed little threat to the Thai automotive industry, a range of Japan-made vehicles was in direct competition with those produced in Thailand. Also differing from TAFTA, JTEPA's potential benefits were only unidirectional—affecting only Japanese exports to Thailand—, since Japan already offered tariff-free multilateral access to all automotive products. Field research found that Western

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<sup>268</sup> Even the Thai Prime Minister made reference to Japanese carmakers' demands for similar treatment than Australia (*The Nation*, April 12, 2005). Also in line with our argument, although in a different sector, having made Japan some concessions on agriculture in its FTA with Mexico, Thailand entered JTEPA talks with high expectations for obtaining greater access for its agricultural products but soon found out that Japan resisted liberalization of the sector.

<sup>269</sup> Liberalization to imports of small- and mid-size vehicles made in Japan would give Japanese carmakers flexibility in planning for future platforms and technologies.

assemblers strongly opposed tariff reductions on vehicles imported from Japan.<sup>270</sup> Japanese and Western assemblers both threatened Thailand with divestments if their interests were not considered. The Thai government, which had been nurturing the sector for decades, did not want JTEPA to make existing investments redundant or to jeopardize future inflows.<sup>271</sup>

Research indicated that the Thai government was well aware and concerned that yielding to Japanese demands would cause the United States, European Union, and Korea to press for similar concessions in ongoing FTA negotiations (Hypothesis 1a).

Despite their significant leverage on Thai policymaking, Japanese carmakers eventually obtained only limited concessions in JTEPA (Table 4). Thailand granted a very lengthy liberalization (over a period of up to eleven years) for Japanese automotive parts and steel that, in line with the initial arguments, was made conditional upon the full implementation of AFTA by 2010, being otherwise delayed accordingly. Thai concessions on vehicles were only marginal as tariffs on passenger cars below 3000cc, representing 99.9% of the Thai automotive market, were left unchanged and those on vehicles of over 3000cc were only reduced from 80% to 60%. JTEPA also includes a cooperation chapter whereby, among other programs, Japan provides skill-training for Thai automotive workers.<sup>272</sup>

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<sup>270</sup> Strong resistance by Western carmakers occurred despite that, given Japanese firms' dominance of the Thai automotive market, total liberalization to Japan-made vehicles was unlikely to cause drastic changes in market share distribution in Thailand. European firms also opposed liberalization of the Thai large-engine vehicle segment to cars produced at more efficient scales in Japan. In contrast, American carmakers were willing to accept some compromise on less price-sensitive larger models. For some models, American firms also depended on imports of automotive parts and steel from Japan. The two associations of automotive part producers in Thailand opposed liberalization of both vehicles and parts. See Essay 1 for details on JTEPA negotiations.

<sup>271</sup> In any case, given the large sunk investments involved, the automotive sector reacts slower than other industries to changes in the policy environment. As with market share distribution, it was therefore unlikely that full liberalization to Japanese vehicles in JTEPA could have led to significant divestments, at least in the short-term.

<sup>272</sup> The program, known as the Automotive Human Resource Development Program, extended an already existing scheme for technical assistance in the automotive sector. Despite limited automotive liberalization in JTEPA, until December 2009, 41.3% of all imports of luxury cars and 10.0% of automotive parts used JTEPA preferences (data provided by the Thai Ministry of Finance). Low utilization reflects long tariff phase-out periods for automotive parts and availability of other import tariff exemption schemes for parts incorporated into vehicles destined for exports (Essay 2).

**Table 4: Thai concessions in the automotive sector under JTEPA \***

|  | Thai concessions  |
|--|---|
| <b>Passenger cars &lt; 3000 cc</b>               | unchanged   |
| <b>Passenger cars &gt; 3000 cc</b>               | 60% by 2011<br>(maintained at 60%)  |
| <b>Commercial Vehicles</b><br><b>&lt; 5 tons</b> | 0 % by 2018   |
| <b>&gt; 5 tons</b>                               | 20% by 2018   |
| <b>Automotive parts</b>                          | * Most items: unchanged or capped to 20% at entry and 0% by 2013<br>* Sensitive items (engines and their parts): unchanged at entry and 0 % by 2015 |
| <b>Hot-rolled steel</b>                          | 0% within quota<br>0% by 2018   |

Source: JTEPA treaty (METI-JTEPA, undated)

\* Japan offers tariff-free multilateral access to all automotive products

While Japanese carmakers failed to achieve the liberalization initially sought, their dominance in the local market meant that maintaining the *status quo* was not so unattractive scenario after all, especially since they also succeeded in preventing competing carmakers from other countries from gaining any better access to Thailand in future Thai FTAs (Hypothesis 1b). In what effectively amounts to an “MFN clause”, Japan got in JTEPA the compromise by Thailand not to extend any better tariff treatment to any “other major automotive manufacturing country in its future FTAs than that extended to Japan” (MOFA, 2007).

As derived from Hypothesis 1c, exclusion of vehicles in JTEPA was followed by parallel exclusion in subsequent FTAs, namely ASEAN-Japan, ASEAN-Korea and ASEAN-India.<sup>273</sup>

<sup>273</sup> Negotiations on the Thailand-United States and ASEAN-European Union FTAs were eventually abandoned, although the latter is currently under negotiation as a bilateral Thailand-European Union FTA. From Hypothesis 1c and the MFN clause included in JTEPA, it would be expected that the automotive sector would be excluded in the Thailand-European Union FTA.

## 5. The automotive sector in the Malaysia-Japan FTA

Just a decade ago, Malaysia was not only reluctant to enter into bilateral FTAs, but it was also critical of those signed by Singapore and Thailand. As recently as 2001, Prime Minister Mahathir criticized Singapore FTAs with non-ASEAN countries for opening a “back door” into ASEAN (Desker, 2004). However, fearing trade diversion from the FTAs signed by other ASEAN members, it took Malaysia only a year to reverse that position and declare its interest in an FTA with Japan. As of May 2013, Malaysia has implemented six bilateral FTAs plus five ASEAN-centered FTAs (see Table 2 in Essay 1).<sup>274</sup>

Japan’s main interest in MJEPA laid in eliminating tariffs on automobiles and steel.<sup>275</sup> In a 2003 joint feasibility study conducted before MJEPA negotiations were launched, Malaysia stressed the difficulty of liberalizing its sensitive automotive sector, which at the time remained still excluded from AFTA liberalization schedules and enforced the use of LCRs (MOFA, 2003). Significantly, in the same document Japan linked MJEPA with AFTA, emphasizing the need for Malaysia to fulfill AFTA commitments in the automotive sector and beyond. Such linkage confirms my initial arguments and reflects Japan’s interest, and that of its firms, in exploiting the possibilities offered by overlapping FTAs for its regional strategy.

Bilateral talks began in January 2004 and although by late that year an initial agreement had already been reached, negotiations slowed down over automotive and steel products. Interviews with government officials and national and foreign carmakers in Malaysia indicated that, at the time, it was widely expected that Malaysia would eventually exclude the entire automotive sector from MJEPA. The same interviews showed that Japanese carmakers lobbied Malaysia for the liberalization of vehicles, automotive parts and steel, while PROTON and PERODUA, still seeking further delays in liberalization

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<sup>274</sup> Malaysia has implemented FTAs with Japan, Pakistan, New Zealand, India, Chile and Australia.

<sup>275</sup> In 2003, before MJEPA negotiations started, automotive and steel products jointly represented over 18% of Japanese exports to Malaysia, with only 0.2% going in the opposite direction.

under AFTA, resisted opening up the sector.<sup>276</sup> One key reason the Malaysian government established the National Car Project was to develop an indigenous automotive part manufacturing industry. Consequently, the two associations encompassing PERODUA and PROTON suppliers—most of them largely, some completely, dependent on the two national carmakers—maintained a strong protectionist position against the introduction of more competition for national carmakers and/or any increase in their options for procuring automotive parts (interviews).

To sweeten its demands, and as part of the MJEPA cooperation chapter, Japan offered Malaysia technical assistance for human resource development in the automotive sector—the Malaysian-Japan Automotive Industries Cooperation (MAJAICO) program.<sup>277</sup> Even so, Malaysia remained reluctant to liberalize its iconic automotive sector, which persisted as the only sticking point for the conclusion of MJEPA negotiations (interviews).

In January 2005, Malaysia eventually had to start moving its automotive sector back into AFTA’s liberalization schedules, slashing tariffs on vehicles from 70-300% down to 20%, with the prospect of their eventual elimination by 2010. Starting in early 2005, Japanese carmakers in Malaysia—with simpler assembly operations than those of subsidiaries in Thailand—were thus able to import Thailand-made Japanese models at reduced tariffs through AFTA.

AFTA liberalization plus Japanese carmakers’ investment in Thailand preempted Malaysia’s MJEPA bargaining position. Malaysia eventually gave in and, in May 2005, agreed to open up its automotive industry to Japan entirely and within a relatively short

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<sup>276</sup> PROTON had broken its equity and technology tie-up with Mitsubishi in 2004 but PERODUA depended (and still does) to a larger extent upon Japanese inputs. The Malaysian Automotive Association—encompassing non-national carmakers—naturally supported liberalization with Japan as a first step toward breaking down decades of protectionism.

<sup>277</sup> In MAJAICO, that expanded an existing scheme, Japan provided assistance to Malaysian firms in automotive skill training, standards and business matching during 2006-2011.

time (Table 5).<sup>278</sup> At the time of the entry into force of MJEPA in July 2006, Malaysia eliminated all tariffs on unassembled vehicle kits and, by 2010, on passenger cars with engines larger than 2000cc. Tariffs on cars below 2000 cc, at the heart of the PROTON's and PERODUA's market, will be eliminated by 2015. Equally important to Malaysia, given National Car Project's goals and large local ownership of suppliers, tariffs on automotive parts were rapidly liberalized; they were reduced to 0-5% in 2008, and scrapped altogether in 2010. Tariffs on hot-rolled steel for the automotive industry received duty exemptions and will be brought down to zero by 2015. By eliminating all tariffs on Japan-made automotive products, MJEPA effectively puts Japan on the same level as other ASEAN members within roughly the same period. Even though Japanese carmakers could access Malaysia tariff-free through AFTA after 2010, MJEPA gave them additional flexibility in planning their production strategies.<sup>279</sup> Of note, Malaysia did not grant Japan any other significant concession outside the automotive sector.

**Table 5: Malaysian concessions in the automotive sector under MJEPA**

|  | <b>Malaysian concessions</b>         |
|--|--------------------------------------|
| <b>Passenger cars &lt; 2000 cc</b>   | 0% by 2015                           |
| <b>Passenger cars 2000-3000 cc, trucks, buses and multi-purpose vehicles</b> | 0% by 2010                           |
| <b>Passenger cars &gt; 3000 cc</b>   | 0-5% in 2008<br>0% by 2010           |
| <b>Unassembled Vehicle Kits (complete knocked-down, CKD)</b>                 | 0% at entry                          |
| <b>Automotive parts</b>  | 0-5% in 2008<br>0% by 2010           |
| <b>Hot-rolled steel</b>  | Import duty exemptions<br>0% by 2015 |

Source: MJEPA treaty (METI-MJEPA, undated; MITI, undated)

<sup>278</sup> According to interviews, Malaysia's decision to liberalize its automotive sector was taken very close to the agreed deadline for the conclusion of negotiations. Several interviewees indicated that Japan threatened to pull out investments in the automotive industry and beyond if requests for liberalization of the automotive sector were not attended.

<sup>279</sup> Between MJEPA's entry into force in July 2006 and December 2012, imports from Japan of large-engine vehicles, unassembled vehicle kits and functional automotive parts have multiplied by more than four times despite negative economic growth during several quarters in this period and the fact that full liberalization of larger vehicles was only realized in July 2010.

With Thailand as the regional hub not only for Japanese but also American and European firms, Malaysia may find itself in a similar concession pre-emption quandary as it negotiates FTAs with the United States and the European Union.<sup>280</sup> The FDI sunk into partners of previous FTAs would compel Malaysia to open its automotive sector in future FTAs thus acting as a stepping stone toward further liberalization. However, as additional evidence for the argument posited here, Malaysia was able to exclude the automotive sector in later FTAs with Pakistan, India and Korea (e.g. Malaysia-Pakistan, Malaysia-India, ASEAN-Korea and ASEAN-India FTAs) because automotive firms from these countries had very limited (if any) investment in Malaysia's previous FTA partners.<sup>281</sup>

## 5. Discussion

The case studies analyzed here showed how the interplay of FTAs among one another and with the investment sunk in them influenced positions regarding liberalization or protection. The preferences and policy strategies of governments and firms regarding FTAs are determined not only by the agreements signed by competitor countries—the classic “domino effect” (Baldwin, 1995)—but also by its own FTAs and the investment in them. The Thai and Malaysian cases also illustrate the contingent nature of the stumbling block versus stepping stone dilemma. The interaction between investment and FTAs may lead either to the liberalization of previously protected sectors or, instead, to the entrenchment of pockets of protectionism across FTA blocs.

Empirical evidence in this Essay allowed us to conclude that, in the presence of tariff-jumping FDI, protectionism for sensitive sectors could potentially perpetuate itself across multiple overlapping FTAs through at least three mechanisms. One occurs when

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<sup>280</sup> Malaysia has joined negotiations for a regional FTA that includes the United States (the Trans Pacific Partnership FTA) and is in the midst of talks with the European Union for a bilateral FTA.

<sup>281</sup> Output by Korean firms in Indonesia during 2005-2011 amounted to less than 1.0% of total production, even lower in Thailand. Vehicle production by Indian carmakers in ASEAN countries remains negligible.

sequential games of FTA negotiations between a host country and its FDI source countries are engulfed in collective action problems dominated by defection (quadrant four in Figure 1, right panel). A foreign firm would oppose FTA liberalization by the host nation with any other except with its own home country and/or where the firm has investment and production stages (e.g., Japanese carmakers supported JTEPA, which was opposed by Western assemblers in Thailand). The eventual result is either no FTA or exclusion of the sector(s) in every FTA negotiated by the host with FDI source countries, even though investing firms would benefit more from multiple and separate bilateral FTAs than from no FTA at all or from the exclusion of the sector in all of FTAs (Figure 1, right panel).<sup>282</sup>

Sectoral protection could also be preserved across overlapping FTAs by the shadow of existing and future FTAs. Concessions or exclusions on sensitive sectors made by a country in a FTA set expectations for future FTA partners. For instance, opening the Thai automotive sector in TAFTA created a precedent that Japan sought to replicate in JTEPA. A country may decide to exclude a sensitive sector from liberalization in an FTA independently of the partner's competitiveness as to prevent other countries from making similar demands in subsequent FTAs. In refusing to liberalize its automotive sector in JTEPA, the Thai government wanted to protect existing investment, but also to prevent similar demands by the United States, the European Union or Korea, then also negotiating FTAs with Thailand/ASEAN.

Lastly, protection/exclusion of a given sector across multiple FTAs could also emerge from firms of an FDI source country. A foreign firm with a dominant market position in a host country could potentially favor the *status quo* and relinquish demanding liberalization between its home and host countries to prevent other countries' competing

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<sup>282</sup> The precise win set depends on the market share distribution in the host country and the comparative advantage of the given foreign firm vis-à-vis other firms in the host country and at home. Given their dominance in Thailand, it could be argued that Japanese automotive firms could have extracted larger concessions in JTEPA if Western automotive firms, especially American, had had less of a presence in Thailand. Firms may nevertheless still favor FTA liberalization by the host to inputs coming from a country different from their home, if they are dependent on those inputs as illustrated by the partial support by American carmakers to the liberalization of automotive parts and steel from Japan in JTEPA.

firms from getting a similar (or better) deal in the host country's future FTAs, especially if the *status quo* could be locked in by including an MFN clause in the FTA. Field research found that Japanese carmakers in Thailand actively sought to liberalize the Thai automotive sector, without concern about creating a precedent since the precedent already existed in TAFTA. But interviews also revealed that, given their overwhelming dominance in Thailand, their primary interest was not so much to improve their market position as to avoid or limit future losses. Japanese automotive firms wanted to prevent the then ongoing ASEAN-Korea FTA negotiations from allowing competitively-priced Korean vehicles to enter Thailand tariff-free.<sup>283</sup> By including an "MFN clause-like" in JTEPA—solely for the automotive sector—, Japanese firms prevented that the concessions it extracted from Thailand, small as they were, could be exceeded by concessions Thailand might make later to other countries.

Either way, protection/exclusion of a sector in an FTA through these mechanisms increases the chances that the FDI host country will protect/exclude the sector in subsequent FTAs and multilaterally. In that regard, inclusion of the automotive MFN clause in JTEPA will deter Thailand from granting meaningful tariff reductions in the automotive sector in future FTAs.

By contrast, Malaysia's most protected manufacturing sector was suddenly liberalized the first time its government negotiated a bilateral FTA, and with Japan, one of the world's most competitive automotive producers. There is no question that both the more liberal government of current Prime Minister Najib but also of his predecessor Prime Minister Abdullah (2003-2009), which negotiated MJEPA, had slowly realized the impossibility (and costs entailed) of maintaining indefinitely the protection for PROTON and PERODUA. However, automotive concessions in MJEPA cannot be explained as the

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<sup>283</sup> Korean Hyundai started a very small assembly operation in Thailand in 2007. Japanese carmakers based in Thailand also wanted to shield their position from concessions to the United States and the European Union in FTAs that Thailand was negotiating at the time.

result of cross-sectoral bargaining or as the Malaysian government's seizing an opportunity to implement externally-imposed structural reforms that would otherwise have proven unachievable.<sup>284</sup> Field research interviews indicated that final negotiations on the automotive industry occurred once talks on all other sectors have been closed and that the Malaysian government resisted automotive liberalization until the very end of MJEPA negotiations. In addition, as elaborated elsewhere in this Essay, Malaysia continued to shield the sector in its National Automotive Policy and in subsequent FTAs with automotive producing-countries that lack significant investment in ASEAN (e.g., ASEAN-Korea, ASEAN-India and Malaysia-India). Although Malaysian government officials interviewed accorded MAJAICO a significant weight in the decision to liberalize the sector with Japan, this is little more than a face-saving exercise toward local automotive firms, since MAJAICO cannot compensate for potential loses resulting from liberalization.<sup>285</sup>

The reason the Malaysian automotive sector was fully opened in MJEPA is to be found elsewhere. Countries may liberalize a sensitive sector in an FTA when the partner is not considered a competitor (e.g., Thailand to Australia in TAFTA) but also at the end of a long tariff phase-out period (e.g., all ASEAN countries, including Malaysia, in AFTA). The Malaysian case shows that FDI sunk into a given sector in partners of previous Malaysian FTAs (e.g., AFTA), shaped its liberalization strategy in later FTAs (e.g., MJEPA). Since establishment of the National Car Project, Malaysia has fiercely protected its automotive sector against competition within ASEAN and beyond through trade barriers and FDI restrictions. But, obviously, Malaysia could not control investment policy in other ASEAN fellow members. When Japanese and Western carmakers started steeping up their FDI in Thailand, and more recently in Indonesia, they gained a potential beachhead for their

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<sup>284</sup> Malaysia considered as highly sensitive economic sectors with significant participation of the bumiputera population such as government procurement, many services sectors and the automotive industry itself.

<sup>285</sup> MAJAICO, already provided at a smaller scale before MJEPA, lasted only five years. In addition, a similar arrangement was also granted to Thailand despite marginal Thai concessions to Japan.

automotive products to enter other ASEAN countries freely once AFTA was fully implemented. Malaysia reinforced the protection of its automotive sector in the wake of the Asian crisis. However, in January 2005, seven years after Malaysia had withdrawn the automotive sector from AFTA liberalization and just four months before negotiations on MJEPA concluded, the Malaysian government could no longer maintain the sector excluded and eventually conceded to pressures from other ASEAN countries to start bringing it back into AFTA schedules. In little over a year, Malaysian tariffs on vehicles from other ASEAN countries were reduced from 70-300% in December 2004 to just 0-5% in March 2006, four months before MJEPA finally came into effect. It could be therefore argued that Malaysia's liberalization of its sensitive automotive sector in MJEPA amounted to no more than a *fait accompli*. With Japanese carmakers exporting automobiles from Thailand to Malaysia at tariffs of 20% in 2005, 5% in 2006, and tariff-free since 2010, Malaysia saw her protectionist stand in MJEPA preempted. Consequently, Malaysia eventually accepted to extend to Japan the same level of liberalization (and at about the same time) as to other ASEAN countries.<sup>286</sup>

AFTA has opened the Malaysian automotive sector to competition not only from carmakers established elsewhere in ASEAN at the time of AFTA creation back in 1992, but also to any other automotive producer that has invested in ASEAN since then, or that may invest in the future. With all tariffs among the main ASEAN economies now eliminated, Malaysia will therefore see its negotiating position constrained once again when trying to protect the sector in future FTAs with countries with automotive investment and production in ASEAN (or other FTA areas in which Malaysia participates). The interaction between previous FTAs and the FDI sunk in them may thus act as stepping stones toward further liberalization of the Malaysian automotive sector.

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<sup>286</sup> Even though a larger presence of Western carmakers in Malaysia would have hindered collective action among non-national firms in support of automotive liberalization in MJEPA—as occurred in Thailand—, foreign carmakers (both Japanese and Western) in the Malaysian Automotive Association saw MJEPA as an opportunity to start opening up the sector.

At least on paper, the interaction between FDI and FTAs could also allow circumvention of the high tariffs on vehicles applied by Thailand at the multilateral level. For instance, firms with limited or no assembly presence in Thailand (e.g., Korean and Indian firms or Japanese luxury carmakers) could potentially take advantage of the fully open Thai automotive sector under AFTA and TAFTA by investing and establishing production in other ASEAN countries or in Australia. However, firm- and locational-specific advantages may favor investment into Thailand itself. Historically, high multilateral tariffs on vehicles in Thailand have helped to maintain and increase FDI into the Thai automotive sector (tariff-jumping market seeking FDI), but, more recently, investment has also (and primarily) been attracted by the indirect rents derived from the agglomeration economies associated with Thailand being an automotive parts cluster and export-oriented hub (efficiency seeking FDI). The network of Thai FTAs and a liberal investment regime also contributed to attracting FDI into the Thai automotive sector. All these reasons would help persuade those potential firms to invest directly into Thailand rather than in other ASEAN countries or in Australia.

Malaysian Prime Minister Mahathir's early predictions about bilateral FTAs being a "back door" to AFTA ended up, ironically, working the other way around. Liberalization under AFTA constrained Malaysia's position in its bilateral FTA with Japan, and has the potential to do the same in regard to future FTA partners. As ASEAN countries—and Asian nations more generally—keep signing into more overlapping FTAs, such situations will only become more frequent.

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## 6 Appendix

### Interviews with key informants in Thailand and Malaysia

#### Notes

Research for this Thesis has largely drawn on in-depth semi-structured interviews with key informants in Thailand and Malaysia. The vast majority of interviews were voice-recorded. Informants received assurance that their name (or any identifying information) would not be shown linked to their comments in any of the outputs of the project. The average duration of interviews was 106 minutes.

In the list below, professional positions correspond to those held at the time of interview. When appropriate and relevant to this research, reference to a previous position is also included. Interviewees holding multiple positions are categorized by the position more relevant to the interview.

#### **1. Thailand**

##### ***1.1 Government***

###### Ministries and Government Agencies

Mr. Winichai Chaemchaeng

Commercial Advisor to the Minister of Commerce. Ministry of Commerce  
Former Director General, Department of Trade Negotiations, Ministry of Commerce

Mr. Chana Kanaratanadilok

Deputy Director General, Department of Trade Negotiations. Ministry of Commerce

Mrs. Pimchanok Vonkhorporn.

Executive Director, Multilateral Trade Negotiations, Department of Trade Negotiations.  
Ministry of Commerce  
Former member of several FTA negotiation teams

Mr. Duanggarthit Nidhi-u-tai

Director, Non-Tariff Measures Division. Department of Trade Negotiations. Ministry of  
Commerce

Focal point for negotiations in Rules of Origin in Thai FTAs

Dr. Narongchai Akrasanee

Advisor to the Deputy Prime Minister on Economic Affairs  
Advisor, Board of the Federation of Thai Industries (FTI)  
Chairman, Export-Import Bank of Thailand  
Former Minister of Commerce (1996-1997) and Advisor to the Minister of Finance (2002-  
2003)

**Ms. Anongkasiri Kulkumthorn**  
Senior Trade Officer, Bureau of ASEAN Affairs. Dept. of Trade Negotiations. Ministry of Commerce.

**Ms. Prewprae Chumrun.**  
Senior Trade Officer. Bureau of Goods Negotiations. Dept. of Trade Negotiations. Ministry of Commerce.

**Mr. Thananchon Rojkittikhun**  
Trade Officer, Non-Tariff Measures Division. Dept. of Trade Negotiations. Ministry of

**Mr. Thalerngsak Vongsamsorn**  
Trade Officer, Department of Trade Negotiations. Ministry of Commerce  
Commerce

**Mr. Pitak Udomwichaiwat**  
Director, Bureau of Trade Preferences, Dept of Foreign Trade, Ministry of Commerce

**Ms. Natruja Chaikongla.**  
Senior Trade Officer, Bureau of Trade Preferences, Dept. of Foreign Trade, Ministry of Commerce  
Focal point for consultations with business and civil society

**Ms. Monta Pantong**  
Trade Officer, Bureau of Trade Preferences, Dept. of Foreign Trade, Ministry of Commerce

**Ms. Supavadee Chaiyanukulkitti**  
Trade Officer, Bureau of Trade Preferences, Dept. of Foreign Trade, Ministry of Commerce

**Mr. Thanakrit Luangasnathip**  
Trade Officer, Dept. of Foreign Trade, Ministry of Commerce

**Mr. Cherdchai Chaivaivid**  
Counsellor, Japan Desk, ASEAN Division IV, Ministry of Foreign Affairs  
Focal contact, JTEPA implementation review Committee

**Dr. Soonthorn Chaiyindeepum**  
Director, Department of ASEAN Affairs. Division II. Ministry of Foreign Affairs

**Mr. Supark Prongthura**  
Counsellor, Dept. ASEAN Affairs. Division III, Ministry of Foreign Affairs.

**Mrs. Vilawan Mangklatanakul.**  
Counsellor. Division of International Economic Policy. Department of International Economics. Thai Ministry of Foreign Affairs.  
Former focal point on investment chapters in TAFTA and JTEPA

Ms. Arjaree Sriratanaban  
 Second Secretary, Office of the Minister, Ministry of Foreign Affairs  
 Former Counsellor in the Thai team during negotiations for JTEPA

Mr. Rit Syamananda.  
 Section Head, Fiscal Policy Office, Bilateral and multilateral trade liberalization, Ministry of Finance

Dr. Pich Nijsamer.  
 Deputy Director, Fiscal Policy Research Institute. Ministry of Finance

Dr. Apichart Prasert  
 Program Director, Fiscal Policy Research Institute. Ministry of Finance

Mr. Eggaluck Suwannakarn  
 Researcher, Fiscal Policy Research Institute. Ministry of Finance

Mr. Chutiwat Watanaphol  
 Director, Customs Tariff Bureau. Customs Department. Ministry of Finance

Ms. Suchaya Chinwongse  
 Senior Customs Officer, Customs Department. Ministry of Finance

Dr. Somchai Hamhirun  
 Deputy Director General, Office of Industrial Economics, Ministry of Industry

Mr. Siriruj Chulakaratana.  
 Senior Expert, International Industrial Economics Bureau. Ministry of Industry  
 Former Director, Division of Industrial Economics.

Mr. Montol Jeamchareon  
 Deputy Secretary General, Office of Agricultural Economics. Ministry of Agriculture and Cooperatives

Mr. Vinit Atisook  
 Senior Policy and Plan Analyst, Office of Agricultural Economics. Ministry of Agriculture and Cooperatives

Dr. Vichai Chokevivat  
 Director, Institute for the Development Research Protection, Ministry of Public Health  
 Chairman of the Board, Government Pharmaceutical Organization  
 Focal point on health-related issues in FTAs, Ministry of Public Health

Dr. Suchart Chongpraset  
 Senior Pharmacist, Food and Drug Administration. Ministry of Public Health

Dr. Sripen Tantivess  
 Senior Researcher and Head of International Relations Div., Health Intervention and Technology Assessment Program, Ministry of Public Health

Dr. Pongsadhorn Pokpermdee  
Senior Expert, National Health Security Office  
Focal point on health-related issues in FTAs

Mr. Songsak Limbanyen.  
Director, Investment Promotion Bureau 2 (Automotive Mining and Metal Industries)  
Board of Investment

Mr. Yuthasak Kanasawat  
Director, Investment Strategy and Policy Bureau, Board of Investment.

Ms. Vasana Mututanont  
Executive Director, International Affairs Bureau, Board of Investment

Mr. Arkhom Termpittayapaisith  
Secretary General, National Economic and Social Development Board

#### Public-Private Institutes

Ms. Rachanida Nitipathanapirak  
Manager, Automotive Business Analysis Section. Thai Automotive Institute

Ms. Aunchalee Koy  
Officer, Thai Automotive Institute

Dr. Narong Warongkriengkrai  
Director, Thai-German Institute

Mr. Thodsapol Laovatin  
Advanced Machining Technician, Thai-German Institute

Mr. Virat Tandaechanurat  
Executive Director, Thai Textile Institute

Ms Wanida Pichalai  
Director, Policy and Plan Dept., Thai Textile Institute

Dr Chamchai Sirikasemlert  
Director, Technology Dept., Thai Textile Institute

Ms. Thitiporn Saengbudda  
Officer, Thai Textile Institute

#### Foreign government and government-related organizations

Mr. Jean-Jacques Bouflet  
Minister-Counsellor, Delegation of the European Commission, European Union

Mr. Jun Yamada  
Minister for Economic Affairs, Japanese Embassy in Thailand

Mr. Hideyasu Tamura

Representative for the Asia Pacific Region, Japan Overseas Development Corporation

Mr. Ryoichi Miyazaki

Deputy Representative, Japan Overseas Development Corporation

Mr. Atsusuke Kawada

Deputy Director, Japan External Trade Organization, Bangkok.

Mr. Yoji Shibata

Senior Advisor on FTAs, Japan External Trade Organization, Bangkok

Mr. So Umezaki

Research Fellow, Japan External Trade Organization. Bangkok Research Center.

Research Fellow, Institute of Development Economies-Bangkok

Ms. Maki Aoki-Okabe

Visiting Research Fellow. Japan External Trade Organization, Bangkok Research Center.

Research Fellow, Institute of Development Economies-Bangkok

## ***1.2 Private Sector***

### Business Associations and Individual Firms

Mr. Pramon Sutivong

Chairman, Thai Chamber of Commerce

Former Chairman, Toyota Motor Thailand

Dr. Piyanuch Malakul Na Ayuthya

Vice-Chairwoman, Thai Chamber of Commerce

Director, Committee on Trade Rules and International Trade, Thai Chamber of Commerce

Mr. Pornsilp Patcharintanakul

Deputy Secretary General, Thai Chamber of Commerce

Senior Vice-President, CP Group

Mr. Dissalai Chongcharoen

Officer, International Trade Negotiation Coordination Office, Thai Chamber of Commerce

Dr. Nilsuwan Leelarasamee

Deputy Secretary General, Federation of Thai Industries

Chairman, Committee on Rules of Origin and Non-Tariff Barriers. Federation of Thai Industries

Dr. Katiya Greigarn.

Chairman, Electrical and Electronic Industry. Federation of Thai Industries

Mr. Payungsak Chartsutipol Chairman

Vice Chairman, Iron and Steel Industry Club, Federation of Thai Industries

**Dr. Songwoot Graipaspong**  
Director, Iron and Steel Industry Club, Federation of Thai Industries  
Managing Director, TC Asia Public Co. Ltd.

**Mr. Aroon Laowatanakul**  
Vice-Chairman of the Automotive Industry Club, Federation of Thai Industries  
Chairman, Foreign Affairs Working Group. Federation of Thai Industries  
General Manager, Volvo, Thai Swedish Assembly Co., Ltd.

**Ms. On-Uma Monthasuwan**  
Officer, Industrial Promotion and Support Department, Federation of Thai Industries

**Ms. Pajnapa Peamsilpakulchorn**  
Consultant, World Bank, Thailand  
Former consultant at the Federation of Thai Industries Committee on FTAs

**Dr. Kanchana Thaichon**  
Director, Joint Standing Committee for Commerce, Industry and Banking (Thai Chamber of Commerce, Federation of Thai Industry, Thai Bankers Association)

**Ms. Supawan Pornvuthikorn**  
Associated VP for Foreign Affairs, Thai Automotive Industry Association  
Manager, Thailand Toyota Corporation

**Ms. Oranuch Boonskulsophit**  
Officer, Thai Automotive Industry Association

**Mr. Anuwat Wangvanichakorn**  
Director, Thai Auto Parts Manufacturers Association  
Director, Business Affairs, Denso International Asia Co., Ltd.

**Ms. Panitta Sattatammakul**  
Foreign Affairs Coordinator, Thai Auto Part Manufacturers Association

**Ms. Jeeraporn Nimitranun**  
Officer, Economic Section, Thai Auto Part Manufacturers Association

**Dr. Panisuan Jamnarnwej**  
President, Thai Frozen Food Association  
Managing Director, Pakfood Public Co. Ltd.

**Mr. Paiboon Ponsuwan**  
Chairman, Thai National Shippers' Council  
Former President, Thai Frozen Food Association (1999-2002)

**Mr. Nat Onsri**  
President, Thai Food Processors' Association  
Chairman, Tuna Processors Group  
General Manager, Kingfisher Co., Ltd.

Mr. Chaiwat Intrachatorn  
Executive Director, Thai Food Processors' Association

Ms. Supatra Rewpairoj  
Trade Manager, Thai Food Processors' Association

Mr. Phongsak Assakul  
President, Thai Textile Manufacturing Association  
Vice-Chairman, Thai Chamber of Commerce  
Chairman, AFTEX Ltd.

Mr. Kamol Tantivanich  
Manager, Thai Textile Manufacturing Association

Mr. Chen Namchaisiri  
Chairman, Thai Synthetic Fiber Manufacturers' Association  
President, Asia Fiber Public Co., Ltd.

Mr. Dej Pathanasethpong  
President, Thai Textile Garment Manufacturing  
Managing Director, Thong Thai Textile Company Limited.

Dr. Sasitorn Kittvoravitkul  
Deputy Secretary General, Thai Pharmaceutical Manufacturers Association  
Managing Director, Bio-Innova and Synchron

Mr. Thunha Pungcharoenkul  
Project Manager, Thai Pharmaceutical Manufacturers Association

Mr. Teera Chakajnarodom  
President, Pharmaceutical Research Manufacturers Association

Mr. Pornsit Sriorathaikul  
Senior Chairman, Thai Gem and Jewelry Traders Association

Ms. Anchalee Kertngern  
Global Network Manager, Thai National Shippers' Council

Mr. Takeo Sakurai  
Corporate General Manager, Office of the President, Mitsubishi Motors (Thailand) Co., Ltd.

Mrs. Pienporn Wongvitavas  
Manager, Government and Legal Affairs Department, Mitsubishi Motors Thailand, Co. Ltd.

Mr. Khanchit Chaisupho  
Director, ASEAN Policy & Government Affairs, General Motors Thailand

**Mr. Arnupab Tadpitakkul**  
Director of Government Affairs, Auto Alliance (Ford/Mazda),  
Deputy Secretary General of Automotive Industry Club. Federation of Thai Industries

**Mrs. Kusuma Naruputi**  
Senior Manager, Industrial Policies Dept., Tri Petch Isuzu  
Director, Automotive Industry Club, Federation of Thai Industries

**Mr. Theeraphat Kaosaiyanant**  
Director, Industrial Policies Dept., Tri Petch Isuzu

**Mr. Sompong Phaoenchoke**  
Managing Director, Thai Rung Union Car Public, Co., Ltd.

**Mr. Ariya Tountong**  
General Manager of Siam Senater Co., Ltd.

**Mr. Ted Arunwechpipat**  
Engineer, Production Engineering Dept., Nissan Powertrain Thailand, Co., Ltd.

**Mr. Hideo Takenaka**  
Executive Vice-President, Hyundai Motor Thailand, Co., Ltd.

**Mr. Yongkiat Kitapanich**  
Director and Executive vice-president, Somboon Advance Technology Public Co., Ltd.  
Former Director, Thai Auto Parts Manufacturers Association

**Mr. Worapan Loonpae**  
Business Development Manager, Somboon Advance Technology Public Co., Ltd.

**Mr. Chumpol Rangson**  
Director Overseas Operations, Thai Summit Autoparts Industry, Co., Ltd.

**Mr. Jaturong Trinetra**  
Project Coordinator, Thai Summit Autoparts Industry, Co., Ltd.

**Mr. Vitedmytri Lekakul**  
Managing Director, Pt Indonesia Thai Summit Autoparts Industry Co., Ltd.

**Mr. Chinawut Bunnag**  
Director, Thai Auto Conversion, Co., Ltd.

**Mr. Apichart Karoonkornsakul**  
President, Asia Precision Co., Ltd.

**Mr. Preecha Leelawilailak**  
General Manager, Costing Department, Summit Auto Seats Industry Co., Ltd.  
Member, Board of Directors, Thai Auto Part Manufacturers Association  
Member, Board of Directors, Thai Automotive Industry Association

Mr. Yeap Swee Chuan  
President and CEO, AAPICO Hitech Co., Ltd.

Dr. Sven Koops  
Associate Director, Indirect Tax, Corporate Services, Ernst & Young

Mr. Arthorn Suthisomboon  
Marketing Business Manager, Beauty Gems, Co., Ltd.

Mr. Sayan Chanvipaswongse  
Chairman, EBCI Ltd. International Trade, Logistics and Management Consulting.

Mr. R. J. Gurley  
Director, ASEAN Competitiveness Enhancement Project, Nathan Associates, Inc.

Mr. Sarit Sanguanwongse  
Deputy Director, ASEAN Competitiveness Enhancement Project, Nathan Associates, Inc.

Dr. Achara Eksaengsri  
Director, Research and Development Institute, Government Pharmaceutical Organization

#### Foreign Business Associations and Chambers of Commerce

Ms. Judy Benn  
Executive Director, American Chamber of Commerce in Thailand

Mr. Tsuyoshi Inoue  
Secretary General, Japanese Chamber of Commerce, Bangkok

Mr. Praab Pianskool  
Thailand Representative, US-ASEAN Business Council

#### ***1.3 Academia, Think Tanks and International Organizations***

Dr. Suthiphand Chirathivat.  
Professor, Center for International Economics. Faculty of Economics. Chulalongkorn University

Dr. Khemarat Teerasuwanajak Talerngsri.  
Assistant Professor, Faculty of Economics. Chulalongkorn University  
Formerly, Counselor at the Thai team during negotiations for JTEPA

Dr. Somsak Tambunlertchai  
Professor, Faculty of Economics. Thammasat University

Dr. Thamavit Terdudomtham  
Associate Professor, Faculty of Economics. Thammasat University.

Dr. Kriengkrai Techakanont  
Associate Professor, Faculty of Economics, Thammasat University

Dr. Suphat Suphachalasai  
Associate Professor, Faculty of Economics, International Cooperation Study Centre,  
Thammasat University

Dr. Kitti Prasirtsuk.  
Assistant Professor, Faculty of Political Science, Thammasat University

Dr. Kiriya Kukolkarn  
Lecturer, Faculty of Economics, Thammasat University

Dr. Witada Anukoonwattaka.  
Lecturer, Faculty of Economics, Thammasat University.

Dr. Medhi Krongkaew.  
Commissioner, National Counter Corruption Commission  
Professor, Thammasat University.  
Professor, National Institute of Development Administration

Dr. Sakkarin Niyomsilpa.  
Director, Research Division. International Institute of Trade and Development

Ms. Sirinad Pornsiripratharn  
Researcher, FTA Research Group. Research Division. International Institute of Trade  
and Development

Ms. Jittikarn Wongkampoo  
Researcher, FTA Research Group. Research Division. International Institute of Trade  
and Development

Dr. Somkiat Tangkitvanich.  
Research Director, Thailand Development Research Institute.  
Advisor to Minister of Commerce on Thai FTAs

Dr. Jirawat Panpiemras.  
Research Specialist, International Economics Relations Program.  
Thailand Development Research Institute

Mr. Taratorn Ratananarumitsorn  
Researcher, FTA Evaluation. Science and Technology Development Program.  
Thailand Development Research Institute

Mr. Nuttawut Laksanapanyakul  
Researcher, FTA Evaluation. Science and Technology Development Program.  
Thailand Development Research Institute

Mr. Edouard Ereno Blanchet  
Consultant, World Bank, Thailand

Dr. Fukunari Kimura <sup>287</sup>

Chief Economist, Economic Research Institute for ASEAN and East Asia  
Professor, Faculty of Economics, Keio University

Dr. Masahiro Kawai <sup>288</sup>

Dean and Chief Executive Officer, Asian Development Bank Institute

Dr. Toshiro Nishizawa

Senior Advisor, International Research Office, Corporate Planning Dept. Japan Bank for International Cooperation

#### ***1.4 Civil society***

Mr. Buntoon Sethasirote

Member, FTA Watch

Executive Director, Good Governance for Social Development and the Environment Foundation

Mr. Jacques-Chai Chomthongdi

Member, FTA Watch

Director, Focus on the Global South, Thailand

## **2. Malaysia**

### ***2.1 Government***

#### Ministries and Government Agencies

Mr. Ravidran P.

Senior Director, ASEAN Economic Cooperation, Ministry of International Trade and Industry

Mr. J. Jayasiri

Senior Director, FTA Policy And Negotiations Coordination, Ministry of International Trade and Industry

Former member of MJEPA negotiation team

Mr. G. Alagasan

Senior Director, Investment Policy and Trade Facilitation, Ministry of International Trade and Industry

Mr. Norazman Ayob

Special Officer to the Secretary General, Ministry of International Trade and Industry

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<sup>287</sup> Interviewed in Bangkok while attending the conference “The Future of Economic Integration in Asia” organized by the Faculty of Economics at Thammasat University and Japan Bank for International Cooperation, November 20-21, 2008.

<sup>288</sup> As in footnote 287.

**Mr. Nik Rahmat Nik Taib**  
Senior Director, Sectoral Policy and Industry Services, Ministry of International Trade and Industry

**Ms. Noor Wahida Noordin**  
Director, Sectoral Policy I, Ministry of International Trade and Industry

**Mr. Gan Mui Huei**  
Senior Principal Assistant Director, Sectoral Policy II, Ministry of International Trade and Industry

**Mr. Mohd Radhi Abd. Razak**  
Director, Sectoral Policy II, Ministry of International Trade and Industry

**Mr. Azmir Musyabri Abdul Mutallib**  
Principal Assistant Director, Sectoral Policy II, Ministry of International Trade and Industry

**Ms. Wong Pek Cheng**  
Trade Officer, Trade Cooperation and Industry Coordination Section, Ministry of International Trade and Industry

**Ms. Jamilah Haji binti Hassan**  
Trade Officer, Trade Cooperation and Industry Coordination Section, Ministry of International Trade and Industry

**Dr. Sandra Kumar (died on February 25, 2010)**  
Deputy Director, Transport and Metal Industries, Malaysian Industrial Development Authority

**Ms. Jasbir Kaur**  
Senior Deputy Director, Electronics Industries Division, Malaysian Industrial Development Authority

**Ms Aizah Abdullah**  
Deputy Director, Electronics Industries Division, Malaysian Industrial Development Authority

**Mr Jeyasigan Nair**  
Senior Deputy Director, International Cooperation Division, Malaysian Industrial Development Authority

**Dr. Wong Lai Sum**  
Deputy Chief Executive Officer, Malaysia External Trade Development Corporation

**Mr. Prakas Nair**  
Director, Americas Section, International Network and Trade Promotion Div., Malaysia External Trade Development Corporation

Mr. Mohd. Mustafa Abdul Aziz  
 Director, East Asia/ASEAN Section, International Network and Trade Promotion Div.,  
 Malaysia External Trade Development Corporation

Government-linked companies

Ms. Wan Kathina Nawawi  
 Senior vice-President, Research and Investment Strategy, Khazanah Nasional Bhd.

Ms. Aidonna Jan Ayub  
 Officer, Khazanah Nasional Bhd.

Foreign government and government-related organizations

Ms. Emi Teshima  
 Director, Research and Information Service, Japan External Trade Organization, Kuala Lumpur

Mr. Shuji Nishimura  
 Trade and Investment Advisor, Japan External Trade Organization, Kuala Lumpur

Mr. Antonio Garcia-Rebollar  
 Counsellor, Economic and Commercial Office, Embassy of Spain

***1.2 Private Sector***

Business Associations and Individual Firms

Mr. Paul Wang  
 Deputy Chief Executive Officer, Federation of Malaysian Manufacturers

Datuk Supperamaniam Manickam,  
 Advisor, WTO/FTA Negotiations, Federation of Malaysian Manufacturers

Ms. Shamini Sakthinathan  
 Assistant Manager, Policy Unit, Federation of Malaysian Manufacturers

Mr. Wan Joon Lian  
 Assistant Manager, Federation of Malaysian Manufacturers

Mr. Nur Hafizah Sulaiman  
 Executive, Policy Unit, Federation of Malaysian Manufacturers

Mr. Lee Keng Bin  
 Chairman, ASEAN Affairs Committee, The Associated Chinese Chambers of Commerce and Industry and Malaysia  
 Chairman, ASEAN Chamber of Commerce and Industry

**Mr. Yong Chee Soon**

Assistant Executive Secretary, The Associated Chinese Chambers of Commerce and Industry and Malaysia

**Mr. Rajini Ramlan**

General Manager/Senior Researcher, Malay Chamber of Commerce Malaysia

**Mr. Noorzee Bin Othman**

Officer, Malay Chamber of Commerce Malaysia

**Dato' Mamat Salleh**

Chief Executive, Malaysian Palm Oil Association

**Mr. Balu a/l Nambiappan**

Head, Trade Development Unit, Malaysian Palm Oil Board

**Mr. Andrew Hong**

Chief Executive Officer, Malaysian Textile Manufacturer Association

**Dato' Y.H. Tan**

Deputy President, Malaysian Textile Manufacturers Association

Director, Pen Apparel Sdn. Bdn.

**Mr. S.C. Chan**

Manager, Malaysian Plastics Manufacturers Association

**Datuk Aishah Shaikh Ahmad**

President, Malaysian Automotive Association

**Mr. Goh Cheng Meng**

Secretary General, Malaysian Automotive Association

**Ms. Eliza Goh**

Vice President, Policy and Regulations, Malaysian Automotive Association

Senior Manager, Marketing and Intelligence Department, Tan Chong Motors

**Ms. Chew Swee Leng**

Chief Executive Officer, Malaysian Iron and Steel Industry Federation

**YBhg Datuk Dr. Wan Mohamed Wan Embong**

President, PROTON Vendors Association

Managing Director, WSA Group of Companies

**Mr. Theodore Wong Kit Choy**

Honorary Secretary, PERODUA Vendors Club

General Manager, Administration, Sales and Marketing, Sumitomo Electric Sintered Components Sdn. Bhd.

Mr. Peter Lim Yoke Cheong  
President, Malaysian Automotive Components Parts Manufacturers  
Vice-Chairman, Automotive Federation of Malaysia  
Group of General Manager, United Industries Sdn. Bhd.

Mr Syed Faisal Syed Abd Rahman  
Senior Manager, Corporate Planning Office, PROTON Holdings Bhd.

Mr Shairulnizam Zuall Cobley  
Senior Manager, Corporate Planning Office, PROTON Holdings Bhd.

Mr. Abidullah Mohd Omar  
Deputy General Manager, Corporate Planning Department PERODUA Manufacturing Sdn. Bhd.

Mr. Mohd Mazwan Mohd Safwan  
Manager, Government & Industrial Affairs, UMW Toyota Motor Sdn Bhd,

Mr. Halami Hussain  
Executive Advisor, Corporate and Government Affairs, Naza Kia Sdn. Bhd.

Datuk Kamrulzaman Darus  
Director of Manufacturing, Naza Automotive Manufacturing Sdn. Bhd.

Dato' Frank Steinleitner  
Director, FS Consulting Sdn. Bhd.  
Advisor to PROTON and Ministry of International Trade and Industry  
Former CEO & President, Mercedes Group Malaysia,

Mr. Thomas Lim Teck Ling  
Executive Director, Proreka Sdn. Bhd.

Mr. Leong Chok Hong  
General Manager, Business Development, Proreka Sdn. Bhd.

Mr. Raymond Sim Mou Hooi  
Senior Manager, Research and Development, Proreka Sdn. Bhd.

Mr. Kazuo Iwasaki  
Director, Proreka Sdn. Bhd.

Mr. Jeffrey Chu Yoon Kong  
Plant Manager, Proreka Sdn. Bhd.

Mr. Mohammad Ruslan Mispan  
Senior General Manager, Sapura Industrial

Mr Mohd Faridh Dol  
General Manager, Sapura Industrial

Mr. Mohd Daud Abdullah  
Executive Director, PATCO Malaysia Bhd.

Mr. Aslan Hazdi Bin Ahmad  
Managing Director, PATCO Malaysia Berhad

Mr. Mohd Sorihan Mohamad  
Managing Director, Ingress Autoventures Thailand Co., Ltd.

Mr. Nik Mohd Zaim  
General Manager, Ingress Corporation Bhd.

Mr. Mohd Mazlan Abd Malek  
Manager, Ingress Corporation Bhd.

Mr. Mansuriatus Shahrir  
Head of Legal, Secretarial & Corporate Planning, Ingress Corporation Bhd.

Mr. Tee Boon Keat  
Executive Director, Delloyd Ventures Bhd.

Mr. Radzaif Mohamed  
Chief Operations Officer, Hicom Teck See Manufacturing Malaysia Sdn. Bhd.

Mr. Terence Soo Thean Hin  
Chief Financial Officer, Hicom Teck See Manufacturing Malaysia Sdn. Bhd.

Ms. Adlina Ilyasak  
Manager, Purchasing & Shipping, Hicom Teck See Manufacturing Malaysia Sdn. Bhd.

Ms Shuhaida Nun  
Manager, Injection Moulding, Hicom Teck See Manufacturing Malaysia Sdn. Bhd.

Mr Mohd Faizal B. Sarkawi  
Engineer, Quality Control Dept. Hicom Teck See Manufacturing Malaysia Sdn. Bhd.

Dr. Ling Ngat Chin  
Director, Advisory Services, Ernst & Young

#### Foreign Business Associations and Chambers of Commerce

Ms. Fui K. Soong  
Executive Director, American Malaysian Chamber of Commerce

### ***1.3 Academia, Think Tanks and International Organizations***

Dr. Mohd Rosli Bin Mohamad

Associate Professor, Dept. of Development Studies. Faculty of Economics and Administration, University of Malaya.

Dr. Rokiah Alavi

Associate Professor, Dept. of Economics and Management, International Islamic University

Dr. Mohamed Ariff.

Executive Director, Malaysian Institute of Economic Research

Prof. Tham Siew Yean

Director, Institute of Malaysian and International Studies. Universiti Kebangsaan Malaysia

Dato' Dr. Mahani Zainal Abidin (died on June 22, 2013)

Director General, Institute of Strategic and International Studies

Mr. Terence Too Yang-Yau

Analyst, Institute of Strategic and International Studies

Datuk Mohamed Ariff

Executive Director, Malaysian Institute of Economic Research

### ***1.4 Civil society***

Mr. Charles Santiago

Member of the Parliament of Malaysia, Democratic Action Party

Member, Monitoring Sustainability of Globalisation Malaysia

Asia Researcher, FTA Project, Transnational Institute

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