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# Utilization of GSP Schemes as a Political and Economic Determinant of the Utilization of North-South FTAs

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## Abstract

Many works have examined the variables driving the formation of North-South free trade agreements (FTAs) between developed and developing countries. This study analyzes the determinants shaping their utilization in the contexts of their political economy and of Generalized System of Preferences (GSP) schemes that are unilaterally granted by developed economies to developing countries' exports. Most of the goods liberalized through GSP are liberalized from early on in North-South FTAs; however, since FTA concessions are legally binding, goods that are excluded or only partially liberalized in GSP will be also excluded or protected in FTAs. As GSP schemes are subject to unilateral restriction/elimination by the developed country, exporters using GSP tariffs will lobby for the non-removable liberalization of their exports through an FTA and subsequently will have a high FTA utilization. These scenarios result in North-South FTAs being used to a great extent to export goods covered by GSP, thus consolidating pre-FTA trade patterns. These arguments were tested by analyzing disaggregated and rarely accessed data on Thailand's and Malaysia's exports through the Japanese GSP and their bilateral FTAs with Japan, as well as interviews with key actors involved in the policymaking of these FTAs. Most sectors in Thailand and Malaysia that benefited from GSP lobbied for FTA liberalization with Japan. Goods previously exported through GSP account for most of FTA utilization and the previous use of GSP preferences has a higher predictive value of subsequent FTA utilization than FTA tariff savings.

Running Title: Utilization of GSP and North-South FTAs

Keywords: Free trade agreements (FTAs); Generalized system of preferences (GSP); FTA utilization; GSP utilization; Unilateral liberalization; East and Southeast Asia

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## 1. Introduction

The international trade regime—centered on non-discriminatory multilateral trade under the rules of the World Trade Organization (WTO)—has been deeply transformed by the web of free trade agreements (FTAs) implemented in the last two to three decades. Independent of the long-standing debate about whether trade openness is an outcome or a prerequisite of economic growth, developing countries seek to integrate themselves into the international trading system at some point in their development strategies and have been important players in the proliferation of FTAs. A North-South FTA between a developed and a developing country allows firms in the latter to export their goods to the developed partner under reciprocal and mutually agreed preferential tariffs that are below multilateral tariffs. In the absence of FTAs, many goods exported by developing countries can benefit from non-reciprocal preferential tariffs—such as those included in the *Generalized System of Preferences* (GSP) and related programs—offered unilaterally by some developed economies.

The economic and non-economic determinants behind the formation of North-South FTAs have been extensively studied (e.g., Aggarwal & Urata, 2006; Chase, 2005; Manger, 2009, 2012; Shadlen, 2005). Instead, this article sought to identify the determinants that drive their utilization. Similarly, a vast political economy literature has characterized the factors that explain the heterogeneity in firms' preferences over trade liberalization;<sup>1</sup> however, it is not clear whether heterogeneity of preferences among exporting firms in developing countries with respect to the different forms of trade liberalization (multilateral, GSP, FTAs) is associated with heterogeneity of preferences among these firms on the formation and subsequent utilization of specific

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<sup>1</sup> Neoclassical trade theory associates this variation with differences in competitive advantage as well as with factor endowment and industry cleavages (Hiscox, 2001; Milner, 1999). Later contributions have identified investment and vertical intra-industry trade as major drivers in the formation of FTAs and heterogeneity in FTA preferences between firms (e.g., Chase, 2005; Kim & Osgood, 2019; Manger, 2009, 2012).

North-South FTAs. Overall dependence on GSP programs has been causally linked with FTA formation; high aggregate “political trade dependence” by developing countries on a GSP scheme increases their likelihood of forming an FTA with the developed economy granting the GSP (Manger & Shadlen, 2014; Shadlen, 2008). This finding leads to several related questions about whether and how the utilization of a GSP scheme is linked with the subsequent utilization of the FTA that replaces it. Does sectoral variability in the utilization of a GSP program account for sectoral variability in FTA utilization? If so, how is this association operationalized? In addressing these questions, the present study identifies the utilization of a GSP scheme as a political and economic determinant of the subsequent utilization of a North-South FTA with the GSP-granting country; businesses in a developing country that use GSP preferential tariffs for the export of a given good lobby for the liberalization of that good in the FTA first and have a high utilization of FTA preferential tariffs afterward.

This work also contributes to discussions on the political economy of East and Southeast Asian FTAs. Except in Japan, businesses in the region were largely shunned in the policymaking of early FTAs;<sup>2</sup> however, over time and particularly for North-South FTAs with key developed partners, concerned business associations and individual firms in East and Southeast Asia have taken the initiative and pressured governments in support of or against FTA liberalization (Manger, 2005, 2009, 2012; 2014; Park, 2017; Postigo, 2014, 2016; Tham, 2008, 2014; Yoshimatsu, 2008). Nevertheless, it is not well understood which businesses in Southeast Asian developing countries have benefited and to what extent from the existing North-South FTAs and how the utilization of these FTAs is related to that of the available GSP schemes.

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<sup>2</sup> Most of the regional and some of the early bilateral FTAs in East Asia have been portrayed as dominated by foreign policy motivations rather than by a trade liberalization rationale; the policymaking of these FTAs was largely top-down driven and arose out the initiative of politicians and/or bureaucrats while the private sector had only a minor role (e.g., Aggarwal & Govella, 2013; Aggarwal & Urata, 2006; Higashi, 2008; Ravenhill, 2010). In contrast, pressure from Japanese businesses was key in the move by the Japanese government to embrace regionalism (Manger, 2005; Yoshimatsu, 2005).

Several studies have used firm-level surveys to assess the utilization of FTAs and GSP schemes by exporters in Southeast Asia (e.g., Ing & Urata, 2015; JETRO, 2019, and previous years; Wignaraja, 2014). However, those surveys only evaluated the responses by a limited number of firms to a binary variable, the use or non-use of a GSP and/or FTA, irrespective of the value of trade for which these preferential regimes were used. Instead, this article uses preferential export data from official administrative records in two developing countries in Southeast Asia to calculate the utilization of GSP and FTA preferential tariffs by all exporters in those countries and for all goods at a disaggregated level.<sup>3</sup> GSP and FTA utilization data were then analyzed in the context of the political economy of those FTAs using qualitative data from semi-structured interviews with government officials and business representatives.

Several related arguments and hypotheses are presented. First, evidence shows that governments—in developed and developing countries alike—try to maximize their control of import tariffs to protect their most import-sensitive sectors. It would be expected that most goods that developed countries had liberalized through GSP would be also liberalized, and from early on, in their FTAs with developing countries. In turn, developed countries will use existing flexibilities in FTAs to exclude from FTA liberalization (or maintain high tariffs on them) those goods that they already exclude (or protect) in their GSP and at the multilateral level. Second, the literature shows that economic actors are more likely to mobilize to avoid losses from trade liberalization than to secure gains from it (e.g., Baldwin, 1995). The utilization of GSP preferential tariffs is subject to restrictions and even elimination at the exclusive prerogative of the developed economy granting the GSP (Shadlen, 2008). To shield themselves from that risk, exporters in developing countries that make a large use of GSP preferential tariffs

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<sup>3</sup> Additionally, these firm-level surveys do not consider the goods for which GSP schemes and FTAs have been used or they aggregate all goods in just 4-12 sectors. This article analyzes GSP and FTA utilization for up to 1,300 or 6,200 categories of goods.

will pressure governments for the tariff liberalization of their exported goods through a legally binding North-South FTA. If the trade preferences of those exporters are eventually embodied in the FTA, they will subsequently make early and high utilization of it. Third, the above scenarios should result in North-South FTAs being initially utilized for and concentrated on goods that were already liberalized through a GSP and/or that do not receive high multilateral tariffs. Therefore, North-South FTAs will not necessarily broaden the product composition of developing countries' exports but to a large extent lock-in pre-FTA export patterns.

To test these arguments, we analyzed the utilization of the Japanese GSP and the bilateral FTAs signed by Thailand and Malaysia with Japan by exporters in these two Southeast Asian developing countries. Several reasons informed this choice of case studies. First, Thailand and Malaysia were among the first and, during much of the 2000s, the most active developing nations in East Asia to pursue FTAs. Additionally, during the first part of that decade, both countries ranked just after China as the largest users of the Japanese GSP program. Third, unlike some of the other GSP schemes, a developing country is not automatically removed as beneficiary of the Japanese GSP program once it has established an FTA with Japan. It was only recently—in April 2019, more than a decade after their respective FTAs with Japan entered into force—that Thailand and Malaysia lost access to the Japanese GSP, thus allowing to examine during the entire period of GSP eligibility whether, when, and why exporters in both countries switch from using GSP preferences to use those in FTAs.<sup>4</sup> Lastly, and importantly, Thailand and Malaysia are the only countries in Asia that collect administrative records of exports through GSP and FTAs although disaggregated preferential export data from these records are rarely accessed, particularly in Malaysia.

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<sup>4</sup> As discussed below, exporters may continue using a GSP scheme instead of switching to the FTA if the FTA offers tariff rates that are initially (or permanently) above those granted by the GSP.

An analysis of the utilization of these preferential trade regimes in both countries rendered similar findings. The utilization of both FTAs has been highly concentrated, and from early on, on a relatively small number of goods, most of which were previously traded under the Japanese GSP program. In fact, the earlier utilization of GSP tariffs by the exporters of a given good has a higher predictive value of the subsequent utilization of the FTA for the export of that good than the tariff savings offered by the FTA or trade volumes.

The rest of the article is organized as follows. Section two elaborates on the above arguments and submits the hypotheses. Section three, which is supplemented by the Appendix, presents the empirical data and conducts the statistical tests. Lastly, section four discusses the findings and concludes.

## **2. Utilization of GSP schemes as a political and economic determinant of the utilization of North-South FTAs**

Under WTO rules, a member country cannot discriminate between its trading partners and must offer the same multilateral tariff rates (the most-favored-nation rates) to the exports of all members. The application of the most-favored-nation principle is only waived for trade among partners in an FTA and for developing countries' exports under GSP programs. In FTAs, countries are legally committed to binding their import tariffs on most goods—but not necessarily on all goods—at a rate between zero (elimination of tariffs) and the applied multilateral rate. When exporting a good to an FTA partner, firms will use the FTA instead of exporting the good under multilateral tariffs when the tariff savings the FTA provides exceed the additional costs involved in using the FTA

(e.g., compliance with rules of origin).<sup>5</sup> Historically, multilateral and unilateral liberalization have first reduced or eliminated lower tariffs, leaving pockets of high tariffs in less competitive sectors. FTAs allow greater flexibility regarding the coverage, sequencing, and pace of liberalization than does multilateral liberalization, thus offering governments more options to protect import-sensitive goods; in FTAs those goods not only receive higher tariffs but they are also subject to stricter rules of origin, are liberalized last or after a long phase-out period, or are excluded altogether.<sup>6</sup>

Some developed economies have established GSP and other related programs that offer unreciprocated preferential tariffs—which range from rates just below the most-favored-nation level to complete tariff exemption—on selected goods exported by developing countries. Dependence on GSP tariffs drives FTA formation; the larger the aggregate dependence of a developing country on the GSP programs offered by the United States or the European Union, the higher the likelihood of that country signing an FTA with these two developed economies (Manger & Shadlen, 2014; Shadlen, 2008). But what does the disaggregated utilization of a GSP program can tell us about the policymaking and subsequent utilization of the FTA whose formation it stimulated?

Given developed economies' discretionary control of their own GSP schemes, less-competitive goods that they protect at the multilateral level tend to be excluded from or receive limited tariff reductions in GSP programs. To benefit from GSP tariffs, goods exported by developing countries must abide by the rules of origin established by the developed economy. Most GSP programs also incorporate product- and/or country-specific export ceilings, above which reduced tariffs no longer apply, as well as

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<sup>5</sup> The utilization of FTA (and GSP) preferential tariffs requires abidance by specified "rules of origin" that establish whether a good has undergone sufficient transformation within the FTA bloc (or the GSP beneficiary developing country). Compliance with these rules may impose costs on producers if they need to modify their procurement and/or production patterns (Anson et al., 2005). Although rules of origin's main goal is to prevent that exports from a third country enter the FTA through the country with the lowest tariffs, FTA member countries (or GSP-granting countries) can set stricter rules of origin for protectionist purposes.

<sup>6</sup> Article XXIV of the General Agreement on Tariffs and Trade states that FTAs should *fully* liberalize a *significant* share of trade within a *reasonable* period. Although these requirements are usually interpreted as applying to 90% of all existing trade within 10 years, many FTAs do not comply with these limits. The WTO Doha Round also proposed reducing higher tariffs more rapidly than reducing lower tariffs, whereas in FTAs higher tariffs can be reduced more slowly or simply excluded.



provisions to withdraw a developing country as a beneficiary once it reaches a certain development stage.<sup>7</sup> Some GSP schemes also require developing countries to comply with non-trade-related conditionalities.<sup>8</sup> Developed countries can (and they often do) force the inclusion of many of these trade and non-trade GSP conditionalities into their bilateral FTAs with developing nations (Shadlen, 2005, 2008). Consequently, it would be expected that most goods that developed economies had liberalized unilaterally through a GSP—with the safeguard of those conditionalities—will be also liberalized and from early on in North-South FTAs. In turn, developed countries will use flexibilities in FTAs to negotiate that certain import-sensitive goods that are excluded from the GSP—or included in the GSP but that receive only a partial tariff reduction and/or are subject to restrictions—they are also excluded, protected with high tariffs or only liberalized after a long period in North-South FTAs.

The unilateral nature of GSP preferential tariffs makes them potentially removable (or restricted in their utilization) at the sole discretion of the granting country, thus creating uncertainty for firms using these schemes (Shadlen, 2008). In contrast, as international treaties, FTAs tariff concessions are legally binding and non- or non-easily-removable.<sup>9</sup> Economic actors mobilize more intensively to avoid losses from trade liberalization than to ensure gains from it (Baldwin, 1995:34). Therefore, it can be expected that firms that use GSP tariffs to export a large share of their goods—particularly, if goods suffer from product-specific ceilings and/or if the termination of GSP eligibility is in sight—will lobby governments for the non-removable liberalization of those goods through a FTA with the GSP-granting country. For exporters in

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<sup>7</sup> The Japanese GSP program has a two-step system for withdrawing access. Under “partial graduation”, a good cannot claim GSP preferences for at least a year when it has achieved a high level of global competitiveness. Under “entire graduation”, a developing country is excluded as a beneficiary when it has reached a certain development stage and/or its exports exceed a specified share of the total value of world exports. See UNCTAD (2017:4,14-15) for current graduation criteria.

<sup>8</sup> For instance, GSP programs may require beneficiaries to adhere to preconditions related to, *inter alia*, good governance, human rights, sustainable development, and labor standards.

<sup>9</sup> FTAs include arrangements to settle disputes and most also have provisions for suspension of commitments during emergencies, as well as for a negotiated amendment or even possible termination of the agreement. However, and unlike in GSP schemes, the unilateral withdrawal of FTA commitments carries an international reputation cost.

developing countries, the negotiation of a North-South FTA also opens the possibility to improve market access with respect to the GSP, not only by expanding the number of goods that are liberalized and/or reducing tariffs below what GSP does but also, for instance, by establishing more lenient rules of origin or lowering non-tariff barriers in the developed economy.<sup>10</sup> Those exporters that, after having used a GSP and pressured for FTA liberalization, find that their exported goods have been liberalized in the FTA treaty, will make high use of that FTA. Also, since these firms already have the procurement of inputs, production, and administrative logistics for trade under the GSP all in place—including compliance with likely stricter rules of origin in the GSP—they would be expected to use FTA tariffs from early on. In those North-South FTAs where the developing country can maintain its GSP eligibility after the FTA has been implemented, the utilization of GSP preferential tariffs will be replaced by the use of those in the FTA once the latter has liberalized those goods that they were previously exported under the GSP.

The above arguments can be summarized in the following hypotheses:

**Hypothesis 1**: The lower the tariff rate and the greater the tariff saving that a developed economy offers on a given good in its GSP program, the lower tariff rate and the greater the tariff saving that the good will receive in the North-South FTAs signed by that developed economy

**Hypothesis 2**: The higher the utilization rate of a GSP program by the exporters of a given good: a) the more likely it is that these businesses

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<sup>10</sup> In a GSP scheme, product coverage, tariff rates, product-specific ceilings, and rules of origin are all unilaterally established by the granting country. Likewise, unilateral liberalization via GSP does not address potential non-tariff barriers in the developed economy. However, all of these issues are open to potential improvement during FTA negotiations.

will lobby governments to legally bind the liberalization of that good through an FTA first, and b) the higher the utilization rate of the FTA by these exporters afterward

Table 1 below summarizes the data source and methods used to test each hypothesis and the figures and tables showing the results. The analyses relied on both quantitative and qualitative data. The quantitative data, which originated from administrative records of preferential exports from Thailand and Malaysia to Japan, were used to calculate the utilization rate of GSP and FTA tariffs and to assess the potential statistical association between both variables.<sup>11</sup> In turn, qualitative data from semi-structured interviews with business representatives and government officials in both countries were used to reconstruct the policymaking of these FTAs through a process-tracing approach (Beach & Pedersen, 2019; van Evera, 1997:64-67).<sup>12</sup> Hypothesis 1 was tested through the analysis of the preferential tariffs and tariff savings offered by Japan in its GSP scheme and FTAs followed by a correlation test of tariffs and tariff savings between both trade regimes. The first proposition of Hypothesis 2 was tested by analyzing semi-structured interviews and data on preferential exports through the GSP for the evidence (or lack of evidence) of business lobbying across economic sectors that did or did not use the GSP scheme. The second proposition of Hypothesis 2 was assessed by analyzing preferential exports through the GSP and FTAs using independent and complementary tests, namely, a comparison of the most exported goods under GSP and FTAs, the statistical correlation between the utilization rates of

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<sup>11</sup> See Section 3 and the Appendix for details on how the quantitative data were processed and analyzed.

<sup>12</sup> See the Appendix for details on how qualitative data were collected and on how the evidence of business lobbying was assessed from the semi-structured interviews.

both regimes, and regression analyses of the predicting value of GSP utilization in subsequent FTA utilization.

**Table 1: Summary of the assessment of hypotheses**

Hypotheses	Assessment method	Source of data	Tables/Figures showing the results of the analyses	
			Thai exports to Japan	Malaysian exports to Japan
<b>Hypothesis 1</b> For a given good, the lower the tariff rate and the greater the tariff saving in a GSP, the lower the tariff rate and the higher the tariff saving in the North-South FTA	Analysis of tariff concessions by Japan in the GSP scheme and the FTA  Pearson's correlation test of tariffs and tariff savings between the GSP and the FTA	Legal texts of the Japanese GSP scheme and FTA treaties	Table 2	Table 2
<b>Hypothesis 2</b> For a given good, the higher the GSP utilization rate,  a) the more likely their exporters will lobby for FTA liberalization of that good, and  b) the higher the subsequent FTA utilization rate for its exports	Evidence of business lobbying for FTA liberalization by sectors that did or did not use GSP preferences  Decline in the utilization of the GSP after FTA implementation  Comparison of the most exported goods under the GSP and FTAs  Pearson's correlation test between GSP and FTA utilization rates  Regression analysis of GSP utilization as a predictor of FTA utilization	Semi-structured interviews  Data on preferential exports through GSP  Data on preferential exports through GSP and FTAs  Data on preferential exports through GSP and FTAs  Data on preferential exports through GSP and FTAs  Data on preferential exports through GSP and FTAs	Main text Table 3 Suppl. Table S1  Figure 1  Table 3 Figure 3  Table 5  Table 6	Main text Table 4 Suppl. Table S2  Figure 2  Table 4 Figure 3  Table 5  Table 7

From the above arguments, it follows that the use of North-South FTAs by developing country exporters would be initially concentrated on goods that had already been liberalized by and exported through the corresponding GSP and/or were not subject to high multilateral tariffs. Accordingly, at least in the early stages of their implementation, North-South FTAs would largely consolidate existing export patterns but would not necessarily create new trade by diversifying the composition of exports.

### **3. Utilization of the FTAs with Japan by Thai and Malaysian exporters in the contexts of the utilization of the Japanese GSP and of FTAs' political economy**

Of the six bilateral FTAs that Thailand has in place, the *Japan-Thailand Economic Partnership Agreement* (JTEPA), which was implemented in November 2007, is the largest in trade value and has a long historical record of trade data for analyses.<sup>13</sup> Initially, the Malaysian government was reluctant to enter into bilateral FTAs, mainly due to concerns about the impact of FTAs on its protected automotive industry and service sector (Okamoto, 2006; Postigo, 2014; Tham 2008). The possibility of trade diversion from the FTAs signed by other Southeast Asian countries eventually encouraged Malaysia to negotiate its own FTAs and seven have already been implemented.<sup>14</sup> The *Malaysia-Japan Economic Partnership Agreement* (MJEPA), which entered into force in July 2006, was Malaysia's first and remains its most relevant bilateral North-South FTA, and is the only one for which there are sufficiently long trade data. JTEPA and MJEPA are also the only North-South FTAs signed by Thailand and Malaysia for which there is a parallel record of export data under a GSP scheme.<sup>15</sup>

This section is structured in four subsections. Subsection one tests Hypothesis 1 and analyzes tariff liberalization under the Japanese GSP, JTEPA, and MJEPA. Hypothesis 2 is assessed in subsections two to four. Thus, the second subsection examines the overall utilization of the GSP and FTAs by Thai and Malaysian exporters to Japan. Subsection three analyzes the disaggregated utilization of both FTAs in the contexts of the previous utilization of the Japanese GSP and the political economy

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<sup>13</sup> Thailand has a limited scope trade agreement with India (implemented in 2004) and full-fledged FTAs with Australia (2005), New Zealand (2005), Japan (2007), Peru (2011), and Chile (2015). As a member of the Association of Southeast Asian Nations (ASEAN), Thailand is also a party of six ASEAN-centered FTAs—with China, Japan, Korea, Australia/New Zealand, India, and Hong-Kong—which are less comprehensive and liberalize goods more slowly than their corresponding bilateral agreements.

<sup>14</sup> Malaysia has implemented bilateral FTAs with Japan (2006), Pakistan (2008), New Zealand (2010), India (2011), Chile (2012), Australia (2013), Turkey (2015). Malaysia is also a member of the six ASEAN-centered FTAs.

<sup>15</sup> Thailand and Malaysia have not only established bilateral FTAs with Australia and New Zealand, but they have also benefited from the GSP programs offered by these two developed economies; however, there are no disaggregated data on the utilization of these GSP schemes by Thai and Malaysian exporters.

bargain of these FTAs. The last subsection conducts regression analyses of the utilization of both FTAs.

### ***3.1 Tariff liberalization in the Japanese GSP, JTEPA, and MJEPA***

Hypothesis 1 argued that developed economies would liberalize most goods that are covered by their GSP schemes in their North-South FTAs, while, given the legal commitment of concessions in FTAs, developed economies would use the flexibilities available in FTAs to protect import-sensitive goods that are excluded or receive some protection (partial tariff reduction, quotas) in the GSP.

In this study, goods are categorized according to the *Harmonized Commodity Description and Coding System*, also known as the Harmonized System (HS), which identifies goods with a code of up to a 6 digits (HS6).<sup>16</sup> The Japanese GSP scheme excludes 80% of all agricultural and fisheries goods on which Japan imposes a multilateral tariff greater than zero and offers partial to complete tariff reduction on the remaining 20% (Komuro, 2009).<sup>17</sup> Likewise, it also excludes about 25% of all manufactured goods, including footwear and most garments. Consistent with Hypothesis 1, Japan kept out of JTEPA and MJEPA liberalization highly import-sensitive goods that are excluded in its GSP, including some important Thai and/or Malaysian exports—e.g., rice, sugar, some fish preparations, and certain categories of wood products.<sup>18</sup> Relative to the Japanese GSP, JTEPA and MJEPA have expanded the number of goods that Japan has liberalized. Both FTAs liberalized the vast majority, but not all, of the goods that are covered by the GSP program; for most of these goods, JTEPA and MJEPA set lower Japanese import tariffs and more lenient rules of origin than the GSP scheme. However, since FTAs involve the non-removable binding of

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<sup>16</sup> Countries can subdivide HS codes beyond the 6-digit level.

<sup>17</sup> These percentages refer to goods at the 9-digit (HS9) level in the regime for developing countries not classified as “least developed countries”.

<sup>18</sup> Author’s analyses of FTA texts (MOFA-J, 2006a, 2006b).

tariff concessions, relatively more import-sensitive goods, but for which the Japanese GSP does provide a partial tariff reduction, were only liberalized in JTEPA and MJEPA after 5-10 years or, in the case of a limited number of goods, they have been permanently excluded.<sup>19</sup> Thai and Malaysian exporters of these latter goods were able to use the preferential tariffs in the Japanese GSP until April 2019, when both countries were removed from the list of beneficiaries.

As proposed by Hypothesis 1, there is a strong correlation between the tariff rates and tariff savings—the latter variable known as the preferential tariff margin, the difference between the most-favored-nation tariff rate and the preferential tariff rate—that Japan granted under its GSP and those Japan offered in JTEPA and MJEPA (Table 2).<sup>20</sup> The strength of these correlations declined over time as FTA liberalization proceeded, although only slightly.<sup>21</sup> There is also a strong correlation between Japan's most-favored-nation tariff rates and Japanese tariff concessions in GSP, JTEPA, and MJEPA.

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<sup>19</sup> JTEPA and MJEPA exclude some products that are covered by the Japanese GSP; for instance, sorbitol (HS6 code 290544) and some goods at level HS6 or higher within the following categories: alcoholic preparations, lobsters and crabs, decaffeinated coffee beans, coffee and tea extracts, and fur skins (MOFA-J, 2006a, 2006b). Dextrin and glues, as well as certain types of plywood and laminated wood are partially liberalized by the Japanese GSP, but JTEPA imposes quotas on the former group and excludes the latter.

<sup>20</sup> More detailed definitions of all the variables are in pages S2 and S3 of the Appendix.

<sup>21</sup> Japan applies a zero most-favored-nation tariff to about half of all tradable goods at HS6 level, but both the strength and the level of statistical significance of the correlations in Table 2 hold when they are calculated only for goods for which Japan applies a multilateral tariff greater than zero (data not shown).

**Table 2: Correlation between the tariff rates and savings offered by Japan in the Japanese GSP and those offered in JTEPA / MJEPA or multilaterally #**

		Japan' tariffs in its GSP	Preferential tariff margin offered by Japan in its GSP	Japan's most- favored-nation tariffs
		2004-2007	2004-2007	For the same period than the GSP / FTA
Japan's tariffs in its GSP	2004-2007			0.89 ***
Japan's tariffs in JTEPA	Nov 2007-2009	0.87 ***		0.85 ***
	2010-2015	0.83 ***		0.80 ***
	2016-2019	0.77 ***		0.74 ***
Preferential tariff margin offered by Japan in JTEPA	Nov 2007-2009		0.62***	
	2010-2015		0.60***	
	2016-2019		0.53***	
Japan's tariffs in MJEPA	July 2006-2009	0.87 ***		0.85 ***
	2010-2015	0.80 ***		0.74 ***
	2016-2019	0.71 ***		0.63 ***
Preferential tariff margin offered by Japan in MJEPA	July 2006-2009		0.63***	
	2010-2015		0.63***	
	2016-2019		0.56***	

Source: Calculations by the Author from the legal texts of the Japanese GSP scheme and FTA treaties, and from WTO's tariff download facility (see Appendix). Tariff rates were averaged at the HS4 level.

# The values shown are the Pearson's correlation coefficient followed by the p-value where \*\*\* indicates significance at the 99.9% level of confidence. Number of observations: 1250 categories of goods.

### ***3.2 Overall utilization of the Japanese GSP, JTEPA, and MJEPA by Thai and Malaysian exporters***

For the arguments discussed here, it is important to distinguish the *utilization rate* of a GSP scheme or an FTA from their *utilization share rate*. The overall (or specific for a given good) utilization rate of a preferential trade regime is the share that the total value of exports (or the exports of the given good) through GSP or FTA preferential tariffs represents in the total value of exports (or the exports of the given good) under all tariff regimes, preferential and non-preferential. In turn, the utilization share rate of a given good in a GSP or an FTA is the percentage that the total exports of that good through GSP or FTA preferential tariffs represents in the total value of exports—for all the exported goods—that take place through that GSP or FTA.<sup>22</sup>

<sup>22</sup> The exporters of a given good may use GSP or FTA preferential tariffs for most of its exports (a high utilization rate) but if export values are low, the use of the GSP or FTA for the export of that good may represent a small share of the overall GSP or FTA utilization (a low utilization share rate). Conversely, the fact that a good accounts for a large share of the overall GSP or FTA utilization (a high utilization share rate) does not necessarily mean that its traders use GSP or FTA tariffs for most of their exports. These dynamics are discussed below and illustrated in Suppl. Tables S1 and S2.



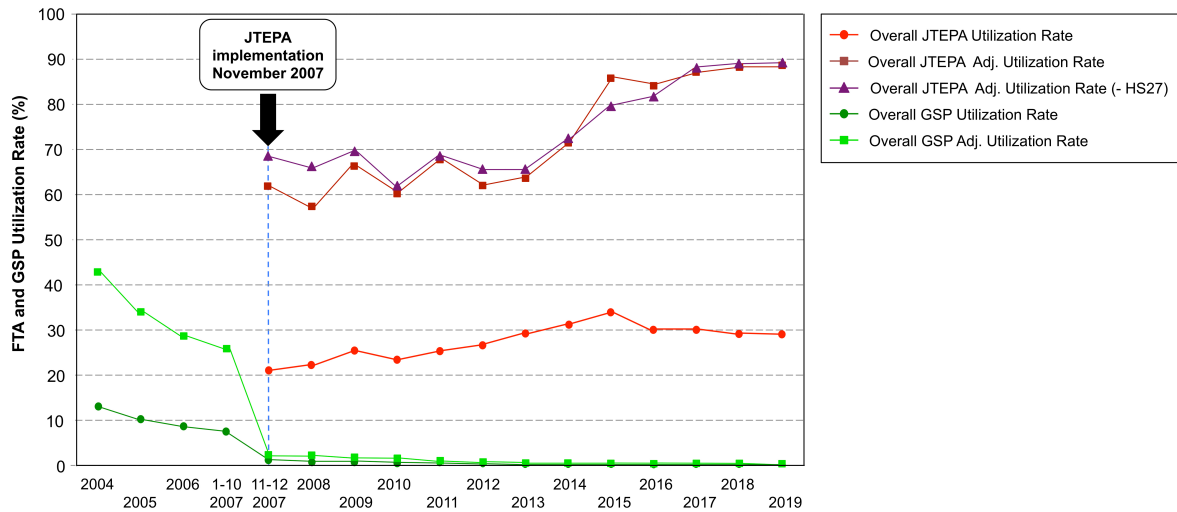


Figure 1: Overall utilization rates (%) of the Japanese GSP and JTEPA for Thai exports to Japan

Source: Calculations by the Author using preferential export data provided by the Thai Ministry of Commerce

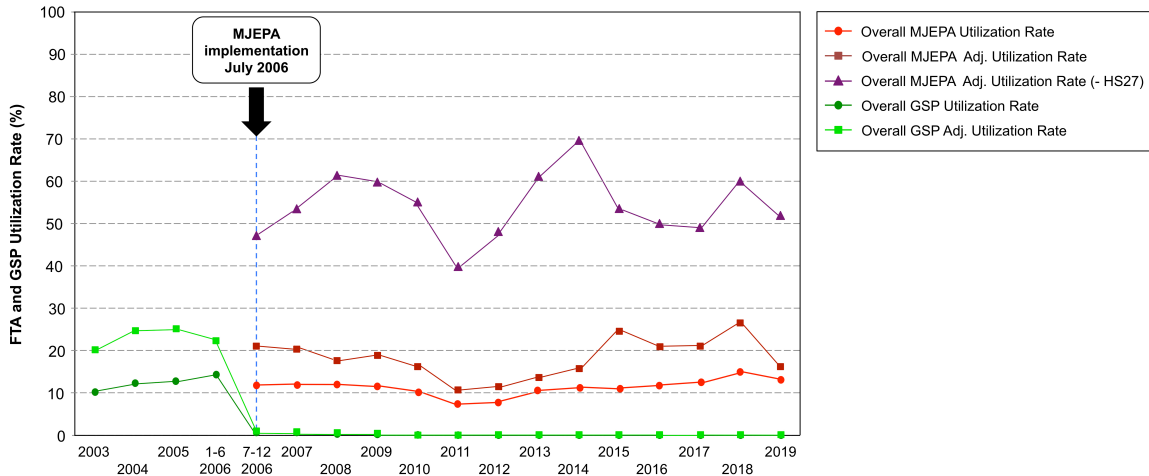


Figure 2: Overall utilization rates (%) of the Japanese GSP and MJEPA for Malaysian exports to Japan

Source: Calculations by the Author using preferential export data provided by the Malaysian Ministry of International Trade and Industry

Even though the Japanese GSP excludes key Thai and Malaysian exports, approximately a tenth of all exports from each country to Japan before JTEPA and MJEPA used GSP preferences (utilization rate) (Figures 1 and 2). As around half of all tradable goods can enter Japan with zero multilateral most-favored-nation tariffs, the GSP utilization rate was calculated—and referred hereafter as *adjusted utilization rate*—only for goods for which the GSP provides a saving (a preferential tariff margin

greater than zero) over multilateral tariffs.<sup>23</sup> Before JTEPA and MJEPA entered into effect, the overall adjusted utilization rate of the Japanese GSP by Thai and Malaysian exporters was an important 30.9% and 23.1%, respectively (Figures 1 and 2).

In line with Hypothesis 2, GSP utilization in both countries declined to below 1% immediately after FTA implementation suggesting that a share of the goods that these FTAs liberalized from the start corresponded to those formerly covered by and exported through GSP (see below). Some Thai and Malaysian exporters continued using GSP tariffs until both countries lost their eligibility to export a small number of goods (less than 0.1% of total exports in the last five years) which, although covered by the GSP, were not liberalized by JTEPA and MJEPA until several years after their implementation or, in some cases, were permanently excluded in these FTAs.

Since entering into force, Thai exporters have made increasing utilization of JTEPA with average overall utilization and adjusted utilization rates standing at 27.9% and 72.7%, respectively (Figure 1).<sup>24</sup> Although petroleum products represented only 1.5% of Thai exports to Japan during 2007-2019, the adjusted utilization rate was also calculated excluding these products to allow its comparison with MJEPA utilization.<sup>25</sup> In 2019, JTEPA's adjusted overall utilization rate by Thai exporters, including and excluding petroleum products, amounted to 88.6% and 89.4%, respectively (Figure 1), figures that are similar or even higher than those of other well-established FTAs elsewhere.<sup>26</sup>

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<sup>23</sup> See the Appendix for details. The adjusted GSP (or FTA) utilization rate does not take into account the export value of goods for which the *preferential tariff margin* offered by the GSP (or FTA) is zero; that is, it not only excludes the export value of the around 50% of goods at HS6 that can enter Japan tariff-free under the multilateral regime, but also that of goods for which the tariff rate in the GSP (or FTA) is the same as the multilateral tariff rate.

<sup>24</sup> The relatively low unadjusted average overall utilization indicates that most Thai exports enter Japan under zero most-favored-nation tariffs (e.g., mechanical and electrical machinery), whereas the higher adjusted utilization rate indicates that Thai exporters have a high use of the tariff savings offered by JTEPA.

<sup>25</sup> Japan's most-favored-nation tariff on petroleum products (HS6 codes 200900 to 271390) averages only 1.1%. JTEPA and MJEPA eliminated tariffs on most of these products.

<sup>26</sup> For instance, the overall utilization by Mexican exporters of the North-American Free Trade Agreement stood at 64.0% in 2000, with 82.7% for adjusted utilization (Anson et al., 2005).

The utilization of MJEPA for Malaysian exports to Japan have been lower than that of JTEPA; from its implementation until 2019, the overall utilization and adjusted utilization rates of MJEPA by Malaysian exporters averaged 11.3% and 18.3%, respectively (Figure 2). A large and highly fluctuating share of Malaysian exports to Japan corresponds to petroleum products—on average, 41.4% during this period. When these products are excluded, MJEPA’s average overall adjusted utilization rate during 2006-2019 increases to 54.3% (with large year-to-year variations in parallel with Malaysian exports of these products), which is still below JTEPA’s. As discussed in the next section, the lower overall utilization of MJEPA compared to JTEPA can be interpreted when the political economy that led to the formation of these FTAs is taken into account. Additionally, and unlike JTEPA, MJEPA utilization has not increased over time, suggesting that, as also elaborated below, MJEPA has been primarily used for the export of goods that were liberalized from the beginning.

### ***3.3 High utilization of FTAs to export goods previously exported through GSP and whose exporters pressured for FTA liberalization***

The value of exports under the Japanese GSP, JTEPA, and MJEPA were then examined at the 4-digit (HS4) and 6-digit (HS6) levels of product specification, corresponding to around 1,300 and 6,200 categories of goods, respectively. The value of total (preferential and non-preferential) Thai and Malaysian exports to Japan has been concentrated on relatively few goods and this concentration has been even higher for Thai exports under preferential tariffs (Suppl. Figures S1 and S2). During the period between the time of implementation of each FTA until December 2019, the value of the 20 most exported goods through JTEPA and MJEPA at the HS4 level represented on average 67.5% and 73.1%, respectively, of the total value of exports through these

FTAs. For the same period, the value of the 20 most exported goods through JTEPA at the HS6 level represented on average 15.8% of total exports under JTEPA. Although both FTAs have liberalized more goods over time, the utilization share of these top 20 exports and, more importantly, the identity of these goods have changed little.<sup>27</sup> This uniformity indicates that these goods were liberalized and began to be exported through these FTAs from the moment of their implementation or shortly thereafter.

But what are these goods? In support of Hypothesis 2, the value of the goods at HS4 that overlap between the 20 most exported goods through the Japanese GSP prior to JTEPA implementation and the 20 most exported goods through JTEPA in the first four years complete since its implementation accounted for half of total Thai exports through the Japanese GSP and JTEPA (utilization share rate) during these periods (Table 3). The utilization share rate of the goods that overlapped between the top 20 Malaysian exports under the Japanese GSP before MJEPA and the 20 exports under MJEPA was higher, around two-thirds (Table 4).<sup>28</sup> In addition, the high utilization share rate by the top 20 goods exported under these FTAs was accompanied by a high or even complete FTA utilization rate; exports of these goods via both FTAs have not only replaced all exports previously conducted under GSP tariffs but, in most cases, also expanded their share in total exports (values above 100% in last column of Tables 3 and 4).

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<sup>27</sup> In the more than 12 years under study, only 39 and 54 goods at HS4 were represented among the top 20 exports through JTEPA and MJEPA, respectively (data not shown).

<sup>28</sup> Of the top 20 Thai and Malaysian exports at HS4 through JTEPA and MJEPA in the first four complete years after implementation, 16 and 18 goods, respectively, overlapped with the top 20 Thai and Malaysian exports that used the Japanese GSP program during the previous four years (Tables 3 and 4). The cumulative utilization share of the non-overlapping top 20 Thai exports (not included in Table 3) between GSP (14 goods) and JTEPA (10 goods) were 15.6% and 22.8%, respectively. In turn, the cumulative utilization share of the non-overlapping top 20 Malaysian exports (not included in Table 4) between GSP (9 goods) and MJEPA (7 goods) were 11.4% and 6.8%, respectively. The description of goods at HS4 in Tables 3 and 4 has been shortened because of space limitations.

**Table 3: Overlap between the top 20 Thai exports to Japan under GSP and JTEPA \***

Categories of Goods	Thai Exports to Japan under GSP Jan 2004-Oct 2007		Thai Exports to Japan under JTEPA Jan 2008-Dec 2011			Export value under JTEPA as % of export value under GSP
	Average Utilization share (%)	Average Utilization (%)	Average Utilization share (%)	Average Utilization (%)	Evidence of Lobbying **	
Preparations of meat and seafood (1602,1604,1605)	14.0	28.7	535.9	93.4	Yes	535.9
Plastic polyethers & polyesters (3907); Plastic plates, sheets & films (3920); Plastic containers (3923,3926)	15.2	52.2	257.4	88.6		257.4
Float glass (7005)	4.6	100.0	70.9	100.0		70.9
Dextrins & modified starches (3505)	4.3	57.3	318.8	100.0	Yes	318.8
Sauces and condiments (2103)	2.7	100.0	157.5	100.0	Yes	157.5
Nonwovens (5603)	2.6	91.5	303.9	100.0	Yes	303.9
Aluminium structures (761090) ***	2.6	7.3	440.2	75.7		440.2
Pure sugars not included elsewhere (2940)	1.5	100.0	196.2	100.0		196.2
Jewelry (7113)	1.9	40.6	353.1	100.0	Yes	353.1
Carbon & carbon blacks (2803)	1.4	37.1	411.3	100.0		411.3
Synthetic filament yarn (5402)	1.4	89.1	209.0	79.7	Yes	209.0
<b>Cumulative utilization share of the goods overlapping between the top 20 exports under GSP and JTEPA (%)</b>	<b>52.2</b>		<b>49.1</b>			

Source: Calculations by the Author using data provided by the Thai Ministry of Commerce.

\* See footnote 28 for details on the data shown in this table.

\*\* Cells marked with a “Yes” indicate that there is evidence of lobbying in favor of JTEPA liberalization by the exporters of those goods.

\*\*\* HS6 code 761090 is the only good in heading HS4 7610 that is exported under JTEPA because Japan applies a zero multilateral tariff on 761010

The *utilization share rate* that the goods previously exported through GSP represent in the subsequent use of both FTAs was then calculated for all categories of goods at HS4 and/or HS6 level, beyond the 20 most exported. In the period immediately after FTA implementation, goods that had been previously exported through GSP accounted for 64.4% of the value of all Thai goods at HS4 level (and 55.4% at HS6) exported under JTEPA and an even higher 91.4% of the value of all Malaysian goods at HS4 level exported under MJTEPA (Figure 3). As expected, the share of these goods in total FTA utilization has declined with time but it did it only moderately.

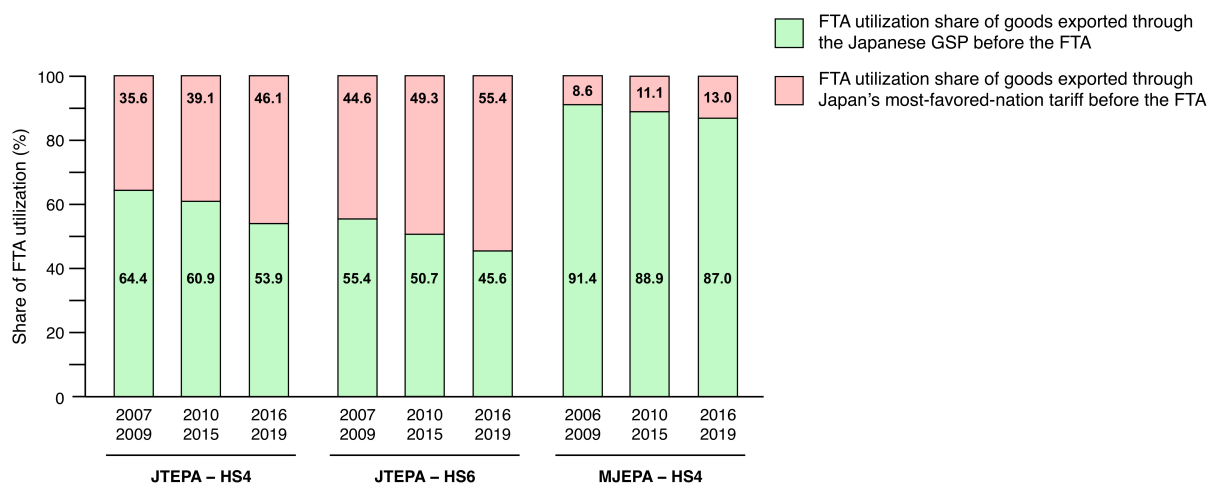
**Table 4: Overlap between the top 20 Malaysian exports to Japan under GSP and MJEPA \***

Categories of Goods	Malaysian Exports to Japan under GSP Jan 2003-June 2006		Malaysian Exports to Japan under MJEPA Jan 2007-Dec 2010			Export value under MJEPA as % of export value under GSP
	Average Utilization share (%)	Average Utilization (%)	Average Utilization share (%)	Average Utilization (%)	Evidence of Lobbying**	
Palm oil & its fractions (1511) and palm kernel, coconut, babassu oil & fractions (1513)	14.6	60.9	20.3	100.0	Yes	376.2
Wood & articles of wood (4407,4409,4411,4412),	13.9	49.3	8.8	71.6	Yes	178.0
Polyethers, epoxides & polyesters (3907); Plastic plates, sheets & films (3920); Plastic containers (3923)	10.3	41.1	18.7	92.9	Yes	366.4
Organic chemicals (2905,2915,2917)	8.9	54.9	7.5	94.0	Yes	210.5
Cooper products (7410)	6.3	100.0	1.4	85.6		47.6
Vacuum flasks & vessels (9617)	4.4	100.0	0.8	90.1		24.9
Industrial monocarboxylic fatty acids (3823)	2.7	58.7	2.9	90.5	Yes	232.4
Gloves, mittens and mitts (6116)	1.1	28.6	1.8	99.9	Yes	351.4
Insulated electric wire, optical fiber cable (8544)	1.9	88.7	1.3	100.0		138.9
Base metal mountings (8302)	0.9	51.7	0.9	87.8		200.3
<b>Cumulative utilization share of the goods overlapping between the top 20 exports under GSP and MJEPA (%)</b>	<b>65.0</b>		<b>64.4</b>			

Source: Calculations by the Author using data provided by the Malaysian Ministry of International Trade and Industry.

\* See footnote 28 for details on the data shown in this table.

\*\* Cells marked with a “Yes” indicate that there is evidence of lobbying in favor of MJEPA liberalization by the exporters of those goods.



**Figure 3:** Utilization of JTEPA and MJEPA to export goods that were previously exported through the Japanese GSP. For each FTA and period, the percentages indicate the share that the value of goods (at HS4 and/or HS6 level) exported from Thailand and Malaysia to Japan using either Japanese GSP preferences (green) or Japan's most-favored-nation tariffs (pink) during the 4 years before FTA implementation represents in total value of exports through the FTA.

Source: Author's calculations using preferential export data provided by the Thai and Malaysian trade ministries

Likewise, the *utilization rate* of both FTAs was calculated for every category of goods at HS4 and/or HS6 level, not just the overall utilization as in Figures 1 and 2. Although only a relatively small number of goods at HS4 have FTA utilization rates  $\geq$  80%—their exporters used these FTAs in 80% or more of their exports to Japan—these goods represented more than three-quarters and two-thirds of the overall JTEPA and MJEPA utilization, respectively.<sup>29</sup> In sum, not only just the 20 most exported goods under each FTA accounted for most of the overall FTA utilization but also only a small number of goods have high or complete utilization of FTA preferential tariffs; most of these goods with high FTA utilization and utilization share rates are goods that were previously exported with high utilization and utilization share rates under the GSP.

Hypothesis 2a posited that the higher the utilization rate of a GSP scheme to export a given good, the more likely their exporters are to lobby for the non-removable liberalization of that good through an FTA. Thai and Malaysian government officials and business representatives across economic sectors in both countries were interviewed on the policymaking of JTEPA and MJEPA and how this was shaped by the utilization of the Japanese GSP, as well as on businesses' trade preferences and lobbying pressures during FTA negotiations. This information was then confronted with disaggregated data on GSP and FTA utilization.

At the time of negotiations for JTEPA, Japan was the largest market for Thai exports of fresh seafood and processed meat and seafood and the second-largest destination for garments and processed fruits and vegetables. Thai exporters in the influential agricultural, processed food, jewelry, plastics, and textiles industries, which until then had used the Japanese GSP scheme, although for some goods with important

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<sup>29</sup> It should be noted that because a high utilization rate is not necessarily accompanied by a high utilization share rate, the cumulative share of the goods with the highest utilization rate in Suppl. Tables S1 and S2 is different from that of the top 20 exports in Suppl. Figures S1 and S2. Thus, both FTAs have also been used almost entirely (utilization  $\geq$  80%) to export some goods that account for a small share of total FTA utilization (utilization share  $\leq$  0.1%) (Suppl. Tables S1 and S2).

exclusions and/or restrictions, pressured in favor of JTEPA (marked with “Yes” in Table 3 and Suppl. Tables S1).<sup>30</sup> Producers of garments and footwear, whose goods are excluded from the GSP and who faced relatively higher multilateral tariffs in Japan than other sectors, also lobbied in favor of JTEPA.<sup>31</sup> Businesses in all these sectors sought not only the binding and further liberalization of Japanese import tariff rates on their products relative to the GSP but also the reduction of non-tariff barriers and, for some goods (e.g., some processed food, metal articles, and textiles), more lenient rules of origin.<sup>32</sup> With some exceptions, the FTA has improved access in Japan for most of these goods and their exporters are among those with the highest utilization and utilization share rates of JTEPA (Table 3 and Suppl. Table S1).<sup>33</sup>

Before MJEP, Japan absorbed one-third of all Malaysian exports of wood products and one-tenth of those of organic chemicals and plastics and it was also a relatively smaller market for Malaysian garments and palm oil. Compared to Thailand, overall support for MJEP among Malaysian businesses was tepid and led by producers in the wood, plastics, chemicals and palm oil industries—all of which had previously benefited from GSP tariffs—and the garments sector, not covered by the Japanese GSP (Table 4 and Suppl. Table S2).<sup>34</sup> All these exporting sectors lobbied and largely

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<sup>30</sup> Interviews with government officials (mainly in the Thai Ministries of Foreign Affairs, of Commerce and of Industry) as well as representatives from the peak and sectoral business associations and individual firms in Thailand. See the Appendix for details. Goods marked with a “Yes” in Table 3 and Suppl. Table S1 refer to those for which there is evidence that their Thai exporters pressed in favor of FTA liberalization. Businesses pressured the Thai government for or against JTEPA liberalization, not only at invited consultations but also through direct connections within government agencies and/or even the Cabinet. On the import side, Japanese automakers also lobbied for the removal of Thai tariffs on vehicles and intermediate inputs imported from Japan, a liberalization opposed by Western automakers (Manger, 2005, 2009; Postigo, 2014, 2016).

<sup>31</sup> The Japanese GSP offers lower or no tariff on certain types of yarns, textiles and fabrics, but excludes footwear (HS2 code 64) and most garments (HS2 61 and 62). Japan’s most-favored-nation tariffs on footwear and garments average a high 16.2% and 9.2%, respectively. Thai exporters of organic chemicals as well as copper and articles thereof benefited from GSP preferential tariffs and now have high utilization and utilization share rates of JTEPA; however, except for Thai dextrins producers, there was no evidence in this study that these sectors had lobbied for liberalization in JTEPA.

<sup>32</sup> Interviews with the heads of the committees on rules of origin in the Federation of Thai Industries and the Chamber of Commerce.

<sup>33</sup> See footnote 19 for goods covered by the GSP but excluded by JTEPA. During 2007-2019, just three processed food goods at HS4 level (1602,1604,1605) accounted for on average a quarter of total JTEPA utilization. The share that the exports of garments in HS2 code 61 represents in total exports to Japan has doubled since JTEPA implementation. However, although JTEPA eliminated tariffs on footwear and on garments included in HS2 code 62, their exports have barely changed probably due to the trade diversion of these products from the FTA between Japan and Vietnam (Author’s calculations from data in [www.trademapp.org](http://www.trademapp.org)).

<sup>34</sup> Interviews with officials from different government agencies (mainly in the Ministry of International Trade and Industry) and representatives in business associations and individual firms in Malaysia. See the Appendix for details. Goods marked with a “Yes” in Table 4 and Suppl. Table S2 refer to those for which there is evidence that their Malaysian exporters pressed in favor of FTA



succeeded in making MJEPA consolidate and, in most cases, but not all, improve the tariff rates offered by the GSP but also relax the rules of origin; these sectors are also among those that have had, and from the beginning, a high use of MJEPA preferences and account for a high share of FTA utilization (Table 4 and Supplement Table S2).<sup>35</sup> However, unlike in Thailand, beyond the garments industry, the interest of businesses that had not used the GSP in influencing MJEPA's policy formulation first and then use its preferential tariffs has been limited.

### ***3.4 Previous utilization of the Japanese GSP as a determinant of subsequent utilization of JTEPA and MJEPA***

Consistent with the above data, and as postulated by Hypothesis 2b, there is a strong statistical correlation between the earlier utilization of the Japanese GSP by Thai and Malaysian exporters of a given good and their subsequent utilization of JTEPA and MJEPA ( $\rho = 0.63$  and  $0.75$ , respectively) (Table 5). The strength of these correlations has declined only slightly over time, even though the product coverage of both FTAs has progressively expanded beyond that of the GSP. Notably, the use of JTEPA and MJEPA by Thai and Malaysian exporters correlates more strongly with their previous use of the GSP than with the preferential tariff margin offered by these FTAs, which constitutes their essential element. For JTEPA, the correlation between its utilization rate and its preferential tariff margin increased as FTA liberalization proceeded. FTA utilization is also correlated with the export value under each FTA, but not with the total export value.

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liberalization. In contrast to Thailand, where sectoral business associations and individual firms carried much of the lobbying in favor or against JTEPA, lobbying in Malaysia was mainly channeled through the peak business association, the Malaysian Manufacturers Federation; the most notable exception was the Malaysian Textile Manufacturers Association which, as in Thailand and for similar reasons (footnote 31), played a proactive role in favor of MJEPA. Also as in Thailand, on the import side, Japanese automakers also pushed for the liberalization of Malaysia's protected automotive sector, but Malaysian and Western automotive firms assembling in Malaysia opposed opening up to imports from Japan (Manger, 2009; Postigo, 2014, 2016).

<sup>35</sup> See footnote 19 for goods covered by the GSP but excluded by MJEPA. Just four goods at HS4 level, namely, plastic items (3907,3920,3923) and palm oil (1511) account for around a third of the overall utilization of MJEPA. Since 2012, both total palm oil exports to Japan and the use of MJEPA preferences for its exports have been halved.

**Table 5: Correlation between the utilization of JTEPA or MJEPA by Thai and Malaysian exporters and the utilization of the Japanese GSP, FTA preferential margin, and export value #**

Average JTEPA Utilization Rate by Thai exporters	GSP Utilization Rate	JTEPA Preferential Tariff Margin	JTEPA Export Value	Total Export Value
	2004-2007	For the same period than the FTA	For the same period than the FTA	For the same period than the FTA
Nov 2007-2009	0.63 ***	0.22 ***	0.41 ***	0.13
2010-2015	0.50 ***	0.48 ***	0.27 ***	0.15
2016-2019	0.47***	0.43***	0.22***	0.50
Average MJEPA Utilization Rate by Malaysian exporters	GSP Utilization Rate	MJEPA Preferential Tariff Margin	MJEPA Export Value	Total Export Value
	2003-2006	For the same period than the FTA	For the same period than the FTA	For the same period than the FTA
July 2006-2009	0.75 ***	0.24 ***	0.29 ***	-0.003
2010-2015	0.65***	0.28***	0.32***	-0.09
2016-2019	0.56***	0.21 ***	0.34 ***	-0.003

Source: Author's calculations using preferential export data at HS4 level provided by Thai and Malaysian trade ministries, tariff rates from WTO and legal texts for both FTAs and the Japanese GSP, and total trade values from www.trademap.org. See Appendix for details.

# The values shown are the Pearson's coefficient followed by the p-value where \*\*\* indicates significance at the 99.9% confidence level; no asterisk indicates the lack of statistical significance for p-values > 0.05. For each good at HS4 level, JTEPA and MJEPA utilization rates were averaged for the indicated time periods. Number of observations in the Thai correlation matrix: 1252. Number of observations in the Malaysian correlation matrix: 1258.

To estimate the effect of each of these variables on the subsequent utilization of the FTA, a linear regression model was run with JTEPA and MJEPA utilization rates as the dependent variable, and the utilization rate of the Japanese GSP before FTA implementation, the preferential tariff margin offered by the FTA, and the export value (of total exports or of exports through the FTA) as independent variables:<sup>36</sup>

$$\text{FTA Utilization Rate}_{x,t} = \beta_0 + \beta_1 \text{GSP Utilization Rate}_{x,t} + \beta_2 \text{FTA Preferential Tariff Margin}_{x,t} + \beta_3 \text{Export Value}_{x,t} + \varepsilon_{x,t}$$

The dependent and independent variables were calculated for every tradable good (x) at the HS4 level exported by Thailand or Malaysia to Japan, under the GSP

<sup>36</sup> FTA and GSP utilization rates and the FTA preferential tariff margin are expressed as percentages. The value of total exports and exports through the FTA are in current United States dollars as "free-on-board" (see Appendix).

program or the respective FTA, during a specified period ( $t$ ).<sup>37</sup> The formulation of this model does not foresee the existence of endogeneity,<sup>38</sup> and there is no colinearity among the independent variables.<sup>39</sup> Heteroscedasticity was assessed using the Breusch-Pagan and Koenker tests, and the significance tests used robust standard errors.<sup>40</sup>

Tables 6 and 7 show the estimated coefficients (figures outside the parentheses) with their corresponding significance tests, as well as robust standard errors (figures in parentheses) for the different models. The past utilization of the Japanese GSP scheme and the preferential tariff margin offered by the FTA were statistically significant in all models. Trade value under the FTA was significant in some of the specifications. Total trade value was not significant in any of them (not shown). The results obtained support Hypothesis 2b: the higher the previous utilization of the GSP, the higher the subsequent utilization rate of the FTA. Holding the other two variables unchanged, an increase of 1% in the GSP utilization rate before FTA implementation increases 0.7% and 1.0% the early utilization rate of JTEPA and MJEPA, respectively. The variation in the previous utilization of GSP has a larger explanatory value of the observed variation in early FTA utilization (39.8% in the case of JTEPA and a higher 56.0% for MJEPA) than the variation in the FTA preferential tariff margin or FTA export value. Consistent with Table 5, the power of the previous GSP utilization to predict the subsequent utilization of both FTA has declined with time, but less in MJEPA.<sup>41</sup> Also in parallel with Table 5, the explanatory power of the variation in the preferential tariff margin offered by JTEPA, but not by MJEPA, increased as its product coverage expanded over time.

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<sup>37</sup> The utilization of the Japanese GSP was averaged over the four years prior to the implementation of each FTA, while FTA utilization, preferential tariff margin, and trade volume were averaged for periods of 2 or 3, 6, and 4 years, as indicated in Tables 6 and 7. The results obtained when calculating individual years were similar to calculating the mean of several years (not shown).

<sup>38</sup> The utilization of an FTA should not influence the previous use of the GSP, the FTA tariff concessions that both countries agreed to, or trade volumes.

<sup>39</sup> Colinearity analyses in the most complete specification (model 4) showed that for both FTAs and in all periods examined, tolerance coefficients were all  $> 0.9$  and variance inflation factors (VIF) were all  $< 1.1$ .

<sup>40</sup> The robust standard errors were calculated with the HC3 estimator (Davidson & Mackinnon, 1993).

<sup>41</sup> The declining capability of variation in GSP utilization to explain variation in FTA utilization over time is due not only to the expansion in FTA coverage to goods not included in the GSP but also to changes in the overall composition of exports to Japan (data not shown).

Two main conclusions can be drawn from these analyses. First, to a large extent and from the beginning, these FTAs were used to export to Japan goods formerly exported through the GSP (Figure 3 and Tables 3, 4, and 5). Second, the fact that those goods continue to represent a large share of the current utilization of both FTAs (Figure 3), and that their previous export through the GSP continues to be a predictor for the utilization of these FTAs more than a decade after their implementation (Tables 6 and 7) indicate that, even in the medium-term, these North-South FTAs have served to a large extent to consolidate previous trade flows under the GSP.

**Table 6: Estimated coefficients for the effect of GSP utilization, FTA preferential tariff margins and export values on the utilization of JTEPA (2007-2019) #**

	Model 1	Model 2	Model 3	Model 4
<b>Average JTEPA Utilization Rate Nov 2007-2009</b>				
GSP Utilization Rate 2004-Oct 2007	0.751*** (0.060)			0.664*** (0.088)
Preferential Tariff Margin JTEPA Nov 2007-2009		2.051 *** (0.308)		1.095*** (0.257)
Export Value JTEPA Nov 2007-2009			4.66 E-7* (0.000)	3.53 E-7 (0.000)
Constant	2.413*** (0.393)	2.991*** (0.522)	5.582*** (0.999)	0.106 (0.391)
Observations	1252	1252	1252	1252
R <sup>2</sup>	0.398	0.049	0.171	0.508
Adjusted R <sup>2</sup>	0.398	0.049	0.170	0.507
<b>Average JTEPA Utilization Rate 2010-2015</b>				
GSP Utilization Rate 2004-Oct 2007	0.853*** (0.042)			0.679*** (0.063)
Preferential Tariff Margin JTEPA 2010-2015		5.489*** (0.336)		4.623*** (0.310)
Export Value JTEPA 2010-2015			2.63 E-7 (0.000)	1.58 E-7 (0.000)
Constant	15.399*** (0.820)	8.694*** (0.745)	18.984*** (1.206)	5.906*** (0.649)
Observations	1252	1252	1252	1252
R <sup>2</sup>	0.249	0.231	0.074	0.438
Adjusted R <sup>2</sup>	0.249	0.230	0.074	0.436
<b>Average JTEPA Utilization Rate 2016-2019</b>				
GSP Utilization Rate 2004-Oct 2007	0.824*** (0.048)			0.699*** (0.078)
Preferential Tariff Margin JTEPA 2016-2019		4.363*** (0.419)		3.727*** (0.384)
Export Value JTEPA 2016-2019			1.55 E-7 (0.000)	9.39 E-8 (0.000)
Constant	15.272*** (0.858)	10.479*** (0.936)	19.070*** (1.459)	7.362*** (0.818)
Observations	1252	1252	1252	1252
R <sup>2</sup>	0.219	0.172	0.49	0.363
Adjusted R <sup>2</sup>	0.219	0.172	0.48	0.361

Source: Calculations by the Author using data as in Table 5.

# In each model, the regression coefficient is followed by the p-value for t-tests of the coefficient, two-tailed tests, where \*\*\* indicates statistical significance at the 99.9% level of confidence, \*\* significance at the 99.0%, \* significance at the 95.0%, and no asterisk indicates the lack of statistical significance for p-values > 0.05. Robust standard errors are shown in parenthesis below each regression coefficient.

**Table 7: Estimated coefficients for the effect of GSP utilization, FTA preferential tariff margins and FTA export values on the utilization of MJEPA (2006-2019) #**

	Model 1	Model 2	Model 3	Model 4
<b>Average MJEPA Utilization Rate 2006-2009</b>				
GSP Utilization Rate 2003-June 2006	1.086*** (0.042)			1.021*** (0.050)
Preferential Tariff Margin MJEPA July 2006-2009		2.197*** (0.282)		1.268*** (0.211)
Export Value MJEPA July 2006-2009			5.12 E-7 (0.000)	1.68 E-7 (0.000)
Constant	2.797*** (0.360)	5.864*** (0.572)	8.975*** (0.752)	0.751* (0.330)
Observations	1258	1258	1258	1258
R <sup>2</sup>	0.560	0.058	0.083	0.587
Adjusted R <sup>2</sup>	0.560	0.058	0.082	0.586
<b>Average MJEPA Utilization Rate 2010-2015</b>				
GSP Utilization Rate 2003-June 2006	1.081*** (0.054)			0.974*** (0.057)
Preferential Tariff Margin MJEPA 2010-2015		2.273*** (0.263)		1.620*** (0.225)
Export Value MJEPA 2010-2015			4.84 E-7** (0.000)	2.06 E-7* (0.000)
Constant	5.162*** (0.494)	7.083*** (0.639)	10.891*** (0.692)	1.833*** (0.438)
Observations	1258	1258	1258	1258
R <sup>2</sup>	0.427	0.079	0.102	0.484
Adjusted R <sup>2</sup>	0.426	0.078	0.102	0.483
<b>Average MJEPA Utilization Rate 2016-2019</b>				
GSP Utilization Rate 2003-June 2006	1.031*** (0.065)			0.938*** (0.070)
Preferential Tariff Margin MJEPA 2016-2019		1.611*** (0.265)		1.232*** (0.230)
Export Value MJEPA 2016-2019			4.75 E-7** (0.000)	2.13 E-7 (0.044)
Constant	5.849 *** (0.617)	8.605*** (0.765)	11.281*** (0.789)	3.040*** (0.558)
Observations	1258	1258	1258	1258
R <sup>2</sup>	0.310	0.43	0.79	0.350
Adjusted R <sup>2</sup>	0.310	0.42	0.78	0.348

Source: Calculations by the Author using data as in Table 5.

# In each model, the regression coefficient is followed by the p-value for t-tests of the coefficient, two-tailed tests, where \*\*\* indicates statistical significance at the 99.9% level of confidence, \*\* significance at the 99.0%, \* significance at the 95.0%, and no asterisk indicates the lack of statistical significance for p-values > 0.05. Robust standard errors are shown in parenthesis below each regression coefficient.

#### **4. Discussion**

The proliferation of FTAs in East Asia since the mid-2000s has been paralleled by a wealth of works examining the determinants of their formation. More than a decade into the life of many of these agreements offers the perspective to investigate the determinants that shaped their utilization. Analysis of the utilization of the FTAs signed by Thailand and Malaysia with Japan in the contexts of their political economy and the previous utilization of the Japanese GSP scheme supported the initial arguments (Table 1). Almost all of the goods that Japan liberalizes in its GSP were also liberalized early on in JTEPA and MJEPA; in turn, import-sensitive goods that were excluded or received only partial liberalization in the GSP were also excluded or protected in the FTAs. Most of the sectors that benefited from GSP tariffs lobbied for the liberalization of their exported goods in the FTA and have had early and high use of the FTA once it was implemented. Significantly, the prior use of the Japanese GSP has a greater predictive power of the subsequent utilization of JTEPA and MJEPA than the tariff savings offered by these FTAs. As a result, these North-South FTAs have largely consolidated pre-FTA trade flows, including those previously conducted through the GSP.

Can the above findings on JTEPA and MJEPA be generalized to other North-South FTAs where the developed economy offers a GSP program? As elaborated in Section 2, Manger & Shadlen (2014) identified aggregate dependence on GSP as a determinant of FTA formation. It could be expected that, at least for those FTAs for which the overall dependence on GSP was a correct predictor of their formation—77% of all FTAs analyzed (Manger & Shadlen 2014:89)—businesses that depended on a

GSP would make a high utilization of the FTA once the latter is in place.<sup>42</sup> In addition, whilst Thailand and Malaysia are the only two Asian countries that collect disaggregated data on preferential exports<sup>43</sup>—thus precluding carrying out similar analyses for other countries in the region—some indirect data suggest that the findings here might also hold for other Southeast Asian countries. In the early 2000s, Indonesia, the Philippines, and Vietnam ranked just after China, Thailand, and Malaysia among the largest beneficiaries of the Japanese GSP (Komuro, 2009:117), with all three eventually signing bilateral FTAs with Japan. As in Thailand and Malaysia, the value of exports of highly-traded goods covered by the Japanese GSP (e.g., seafood, chemicals, plastics, wood products) from Indonesia, the Philippines, and Vietnam to Japan has increased since the implementation of their respective FTAs,<sup>44</sup> suggesting that exporters in these countries that were already using the GSP probably switched to FTAs later and account for an important share of FTA utilization.

Exporters in Thailand and Malaysia have had a high utilization rate of their FTAs with Japan if the FTA lowered tariff rates on their exported goods relative to the GSP and/or multilateral regime, established relatively lenient rules of origin, and/or reduced non-tariff barriers in Japan.<sup>45</sup> A high utilization rate of FTA tariffs was often associated with those exporters who had a greater interest in influencing FTA policymaking. In turn, a high FTA utilization share rate reflected not only a greater interest in shaping FTA formulation but also greater leverage to do so during negotiations.<sup>46</sup> Some exporting sectors in Thailand and Malaysia, particularly

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<sup>42</sup> In that line, during the 2006-2011 period, 62.1% of the value of exports from Honduras—the country with the greatest dependence on the United States' GSP in Manger & Shadlen (2014:89)—to the United States via the Dominican Republic-Central America FTA corresponded to goods at HS4 level that Honduras had previously exported using preferential tariffs granted unilaterally by the United States (GSP and the Caribbean Basin Initiative schemes); this figure is similar to that of JTEPA with respect to the Japanese GSP (Author's calculations from data in <https://www.usitc.gov>).

<sup>43</sup> Most Asian countries have moved to a self-certification system of compliance with the rules of origin in FTAs. The FTA between the European Union and Vietnam entered into force in August 2020 and there is no historical data for analysis.

<sup>44</sup> Author's calculations using data from Trade Map ([www.trademap.org](http://www.trademap.org)).

<sup>45</sup> The restrictiveness of rules of origin in most Japanese FTAs is lower than those in the Japanese GSP (Kniahin et al., 2020).

<sup>46</sup> See footnote 22.



agricultural producers, lobbied for improved market access in Japan, but tariffs on their goods were not liberalized in JTEPA and MJEPA.<sup>47</sup> In turn, among the goods that JTEPA and MJEPA liberalized and that have been exported through these FTAs with high utilization and/or utilization share rates (Tables 3 and 4, Suppl. Tables S1 and S2) it can be distinguished three groups regarding the evidence (or lack of evidence) of business lobbying in favor of FTA liberalization. First, most exporters that had made extensive use of the GSP lobbied for the liberalization of their exported products through a legally binding FTA treaty. Second, a smaller group of Thai and Malaysian exporters, particularly garments and footwear producers, did not benefit from the Japanese GSP—and, therefore, did not seek to bind GSP tariffs into an FTA—but they lobbied for JTEPA and MJEPA liberalization and have had a high use of both FTAs because they face higher multilateral tariffs in Japan than do other sectors.<sup>48</sup> Finally, some exporters used the Japanese GSP and are now using these FTAs, but there is no evidence that they had lobbied for FTA liberalization. With some exceptions, almost all exporters in this third group account for relatively small shares of total FTA utilization and total exports and had only limited participation and/or influence during FTA policymaking.<sup>49</sup>

One of the conclusions of the study is that JTEPA and MJEPA have served mainly to consolidate pre-FTA trade patterns. Although both FTAs have liberalized and increased exports of goods not covered by the Japanese GSP, their utilization has been highly concentrated on goods that were previously traded under GSP. This finding is likely to also apply to at least other North-South FTAs in the region; although there are no data on which goods are exported through these FTAs, it has been found that the bilateral FTAs between Japan and Indonesia, the Philippines, and Vietnam have not

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<sup>47</sup> Most of these goods are also excluded from the Japanese GSP (page xx and footnote 19).

<sup>48</sup> See footnotes 31, 33, and 34.

<sup>49</sup> See footnote 31.

significantly broadened the overall product composition of exports (Nguyen, 2014). Therefore, North-South FTAs should be evaluated not only (nor necessarily) for the creation of new trade opportunities but also (or even primarily) for the non-removable binding and reduction of tariffs that were offered unilaterally through GSP and for consolidating and increasing export values within existing patterns, including those previously conducted through GSP.

Tariff liberalization through GSP shapes the subsequent liberalization of tariffs through North-South FTAs. While developed countries have discretionary control over the goods included and the tariff rates offered in a GSP scheme, they are legally bound by the tariff concessions agreed to in their FTAs with developing countries. Thus, in JTEPA and MJEPA, Japan liberalized more deeply/rapidly goods covered by its GSP (or that received lower tariffs multilaterally) while it more shallowly/slowly liberalized or excluded from these FTAs import-sensitive goods that were subject to restrictions or had been excluded in the GSP (or that are protected multilaterally). In fact, some sensitive goods were excluded in these FTAs despite being partially liberalized in the GSP. These circumstances help explain why goods previously exported through the Japanese GSP account for the largest share of JTEPA and MJEPA utilization, but also why some Thai and Malaysian exporters continued to use GSP preferences until 2019 for a small number of goods. Japan's reluctance to liberalize from the beginning in JTEPA and MJEPA (or even exclude from these FTAs) goods that it liberalizes unilaterally in its GSP, even if only partially, attests to the importance that developed economies attach to their discretionary control of tariff concessions granted through GSP relative to the irreversibility of those offered in North-South FTAs.

In turn, the impacts that liberalization through GSP and FTAs have on the future of multilateral liberalization and the political coalitions supporting it remain

controversial. GSP programs have been found to hinder multilateral liberalization both in the developed economy that grants the GSP and in the beneficiary developing country (Ketterer et al., 2015; Özden & Reinhardt, 2005). Whether FTAs are stepping-stones toward multilateral liberalization or rather stumbling-blocks preventing it seems dependent on multiple factors, including the countries that form the FTA and the design of the FTA (Freund & Ornelas, 2010). FTA liberalization, particularly in the context of the growing overlap between FTAs, reduces the incentives and influence of less-competitive sectors to lobby for protection and encourages FTA member countries not only to extend tariff concessions on goods liberalized by the FTA to other FTAs but also to reduce most-favored-nation tariffs on those goods, a multilateralization of FTA tariffs (Freund & Ornelas, 2010; Ornelas, 2005; Postigo, 2014). Nonetheless, it remains open to debate whether FTAs can ultimately function as an accelerated track for multilateral liberalization, and in the same way as FTAs erode the utilization of GSP tariffs, the utilization of FTAs will be eroded as multilateral tariffs are lowered.

Given the stalemate in the WTO Doha Round and the renewed push for bilateralism in international trade relations, trade liberalization, at least in the short-term, is likely to occur mainly through bilateral FTAs. The possibility in FTAs—exploited by developed and developing countries alike—to exclude less-competitive goods already protected at the multilateral level can lead to a situation where high tariffs are progressively entrenched on a small set of highly import-sensitive items that have resisted unilateral, multilateral and FTA liberalization; for instance, agricultural goods in most developed economies. The type of trade forum through which a developing country seeks to gain better access to the markets of developed countries has potentially important consequences for it. Compared to WTO rounds, North-South FTA negotiations bring to the forefront the power asymmetries between developed and

developing countries, with the former often imposing regulatory reforms beyond WTO provisions on the latter (Pekkanen et al., 2007; Shadlen, 2005).<sup>50</sup> Developing countries may be eager to bind (and improve) GSP tariff concessions permanently into FTAs with their developed partners, but a scenario of increasing bilateralism in North-South trade relations may not be the most conducive to the pro-development growth strategies of many developing countries

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<sup>50</sup> The WTO framework still offers developing countries room to implement some country-specific development strategies. However, developing governments often surrender this policy space in exchange for market access in their bilateral FTAs with developed economies (Shadlen, 2005).

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