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LEADING THE WAY

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Thailand and the European Union opened the first round of free trade agreement (FTA) negotiations in May this year. A number of Thai businesses now enjoying low or zero import duties in the 28-country EU market (Croatia joined on July 1) hope the FTA will help them maintain their competitiveness in the EU market.

The FTA talks have taken on some urgency because Thai products will no longer enjoy favourable duty treatment under the EU Generalised System of Preferences (GSP) from 2015, as Thailand will be deemed sufficiently developed to not need preferential access to the market. Other exporters that do not currently benefit from GSP will be expecting to gain a benefit for their exports as well.

Some of the concerns in Thailand are intellectual property protection related to access to medicines and opening the market for sensitive EU exports. However, there is still a looming issue that has not been as widely publicised and would affect almost all Thai exporters using the EU FTA. In short, the rules required by the EU in FTAs differ from those in other FTAs that Thailand has signed.

EU FTAs generally contain a provision that prohibits a duty rebate or suspension on imported goods contained in finished exports to the EU. If this provision is included, duty rebate and duty exemption could not be used for any raw materials used in production.

Thailand provides several duty rebate and exemption schemes as a means to promote the country as a hub for investment and export. The Thai duty rebate and exemption schemes include those under the Board of Investment (BoI), Industrial Estate Authority of Thailand (IEAT), manufacturing bonded warehouses under Customs Section 19 bis and Free Zones.

A prohibition of this nature would discourage the import of materials from countries where duty is payable into Thailand. This will increase the landed cost and therefore inflate the value of non-originating materials, thus making it more difficult for the products to satisfy a value-based rule of origin.

A further complication is that the current GSP allows the use of most Asean goods as originating content, which complements the Asean sourcing strategies of many regional manufacturers. This would no longer be possible. This rule will typically favour EU-based companies as the potential supply base of originating materials is much greater than in Thailand. An exporter from Germany can source components from Thailand, Germany and the other 27 EU nations.

Although Thai exporters to the EU have the same choice to source originating components, the distances involved make it much less cost-effective to source from the EU than from within Asean.

The relative duty rates between the EU and Thailand are also a factor in determining the cost-effectiveness of utilising the FTA. The average duty rate on industrial products into the EU is approximately 4%, and into Thailand it is 8%. Given that raw materials imported into Thailand also have a higher duty rate than in the EU, the restriction on reclaiming or suspending import duty on export will quickly add up to more than the potential 4% saving on the finished goods into Europe.

Sectors with higher duty rates into the EU include textiles, automotive products and agriculture, so it will be interesting to see how quickly the EU is prepared to offer full preferential access to Thai products in these traditionally sensitive sectors.

In addition to a complex cost-benefit analysis, Thai business using the EU FTA would also have the burden of tracking exports to the EU and not claiming duty rebate, or in the case of duty suspension, actually paying the duty.

Many companies have significant difficulties managing their duty privilege systems with only two variables: domestic and export sales. Adding a third variable of export sales with no duty privilege would create more challenges, and add administrative cost and potentially also add the risk of denial of preferences into the EU if duty was not correctly paid on raw materials in Thailand.

For the Thai government agencies (the Commerce, Finance and Industry ministries), it is important that they encourage discussions with the private sector, especially those operators that might be adversely affected by the prohibition of duty rebates and suspensions. Malaysia is currently in negotiations with the EU and is having similar consultations to understand the challenges that its exporters will face.

The recent FTA the EU concluded with South Korea may be a good precedent for Thailand to look at, as it contains a grace period for continuing duty rebates and suspensions. However, after the grace period is over, it will still be necessary to carefully analyse the benefits on offer, because as we noted above, they will differ from other FTAs that Thailand has signed.

Written by Chet Suksang, a manager with PwC Thailand. We welcome your comments at leadingtheway@th.pwc.com