

A nighttime photograph of a city skyline. In the foreground, a body of water reflects the lights of the buildings and a large Ferris wheel. The Ferris wheel is illuminated with red and white lights. In the background, several modern skyscrapers are lit up, and a construction crane is visible. The sky is a deep blue.

# A Step-by-Step Guide To FTA Optimization

For Global Trade and Supply Chain



ASIAN TRADE CENTRE



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# Contents

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# Introduction

The COVID-19 pandemic has highlighted the need for Asia-based organizations to respond to a changing global trade landscape with agility.

According to Thomson Reuters' Global Trade Report, 54%<sup>1</sup> of business leaders are experiencing supply chain disruption as their organization's biggest barrier to global trade. A further 48%<sup>2</sup> have identified lack of transparency across the supply chain, and complicated and changing regulations as significant hurdles to global trade in Asia.

Within an increasingly complex economic and regulatory environment, many multinational organizations are adopting strategies to support supply chain resiliency.

**This guide is for Global Trade and Supply Chain executives who want to deepen their understanding of Free Trade Agreement (FTAs) and leverage it as a strategic tool to optimize their supply chains.**

<sup>1</sup> 2021 Special Survey Report: 10 Global Trade Discoveries About Organizations in Asia by Thomson Reuters.

<sup>2</sup> Asia Regional Integration Center, Asian Development Bank.



# Asia is home to over half of the world's FTAs

Asia is home to over half the world's FTAs, with the region seeing a five-fold increase in agreements over the past two decades. It includes comprehensive regional trade deals that link regional markets with key trading partners in Europe, North America, and Oceania. In particular, the

Regional Comprehensive Economic Partnership (RCEP) and the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), two of the region's premier and comprehensive trade agreements, are set to deepen economic interlinkages and change trade landscapes.

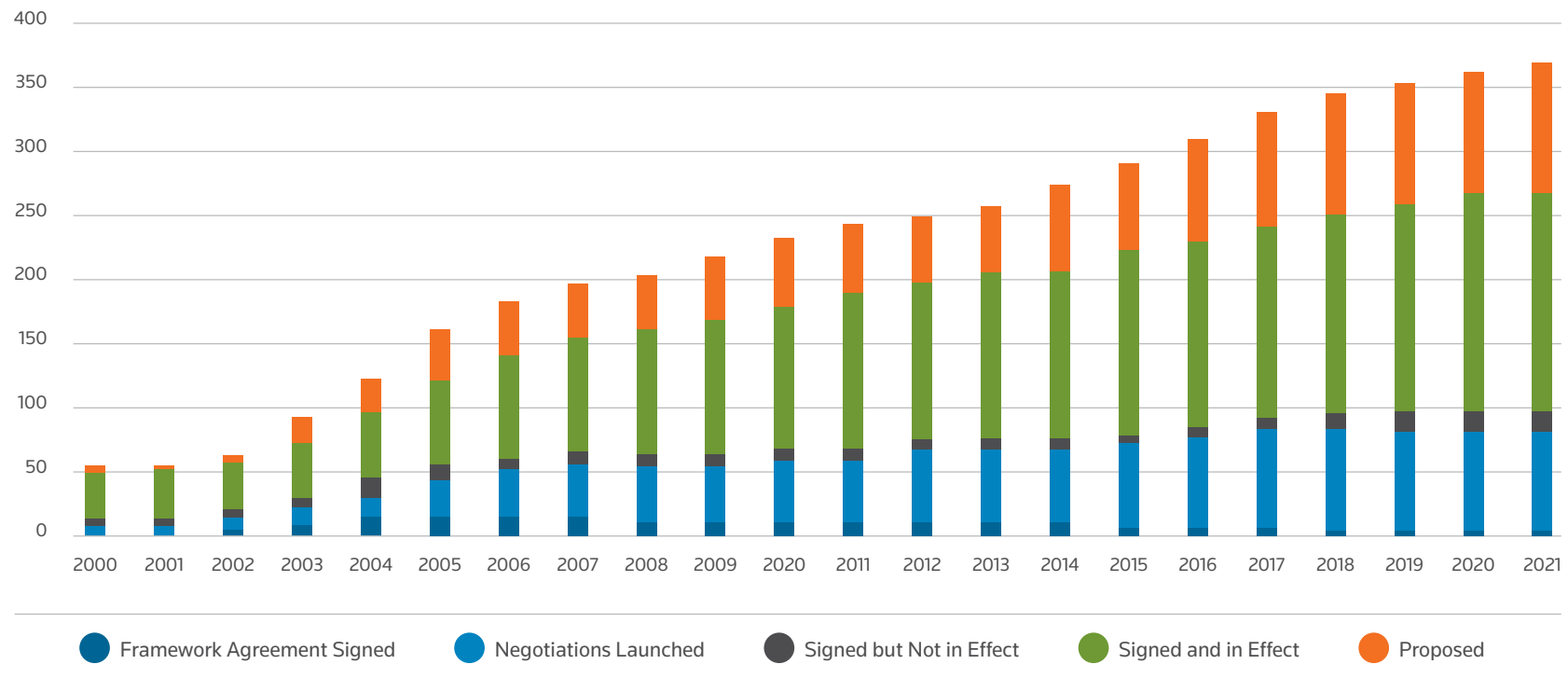


Image 1: List of Trade agreements at various stages from "signed & in effect" to proposed from 2000-2021

# Objectives of this guide

## Opportunity

The sheer number of agreements available to organizations means that they have multiple opportunities to rejig their supply chain strategies. In addition to cost savings and market access, FTAs can reduce the uncertainty attached to trade and regulatory conditions.

## Current Reality

FTAs remain underutilized. Only 23%<sup>3</sup> of the companies utilize the FTAs available to them. Many companies may choose not to participate because they struggle with identifying opportunities to qualify goods under FTA-specific rules of origin. In a nutshell, a lack of awareness of potential benefits, perceived complexity, fear of non-compliance and cost are primary reasons companies are not fully taking advantage of FTAs.

3 KPMG International & Thomson Reuters. (2016)

### 01 Gain Insights:

Gain essential insights on how FTAs across Asia can be fully leveraged for organizational advantage

### 02 Evaluate:

Learn how to evaluate new trade agreements to minimize costs and widen market access

### 03 Compare:

Compare multiple FTAs across the region and determine how to frame organizational strategy around these agreements

### 04 Review:

Review the long-term impact of FTA optimization through real-world examples to evaluate your organization's response

# Benefits of FTAs for regional supply chains



## Raising Competitiveness, Lowering Costs

By leveraging FTAs, your goods will be more competitive in markets covered by such agreements compared with competitors with no equivalent pacts or an inability to leverage them. This is true even if tariffs are low given sufficient trade volumes. Meanwhile, FTAs can lead to savings of millions of dollars on input costs by lowering or eliminating customs duties, while simultaneously diversifying supplier risks.

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## Customs Treatment

FTAs often include binding decisions by customs officials to maintain a consistent classification of goods, customs valuation, and rule of origin qualification for up to three years. Thus, it helps to ensure stability and predictability in tariff rates and treatment of goods.

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## Lowering Restrictions

FTAs can provide greater certainty about access and trade protection in services like logistics, warehousing and retail.



## Supply Chain Resilience

Countries with FTAs have committed to strengthening commercial ties, reducing the disruption in trade flows. It means firms that leverage FTAs can limit the effects of sudden shifts in the regulatory environment.

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## Saving Time, Cutting Costs

FTAs require that customs authorities adopt efficient customs procedures, ensuring the expeditious release of goods from customs to shorten delivery schedules. They also allow for trade documentation to be processed efficiently, leading to time and cost savings.

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## Protecting Business

FTAs often include intellectual property protections for businesses and can reduce investment restrictions for foreign companies, such as local hiring, technology transfers, and data localization regulations.

# Snapshot view: A 5-step process to optimizing FTAs

1

## Establish potential benefits

Determine the benefits of entering into FTAs. Your organization can do this through quantifying the cost savings of improving supply chain efficiency and lowering tariff payments.

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2

## Assess preferential duties

Examine tariff schedules under selected agreements operational in specified trade lanes and compare preferential tariffs and phase-out periods when more than one agreement is applicable.

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3

## Assess eligibility of products

Assess Rules of Origin (ROOs) under each FTA, map them to existing production processes and consider adjustments for improved compliance. Use preferential duties and ROO as a basis to select the best agreement.

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4

## Implement alternative sourcing

Evaluate alternative sourcing and manufacturing set-ups to improve FTA eligibility and price competitiveness in key markets.

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5

## Develop a trade compliance strategy

Assess certification requirements, ensure compliance with transit and trans-shipment rules, implement a supplier management program and respond proactively to new protectionist measures. Use a Global Trade Management solution to reduce the cost of compliance and raise efficiency.

As leveraging FTAs can be time consuming, taking a phased and cost-effective approach ensures optimization efforts are aligned with existing supply chain strategies.

# Step 1

## Establish Potential Benefits

Key production and consumer markets may be covered by multiple FTAs. To derive maximum benefit from trade agreements, firms should prioritize only entering into those agreements that are regional and comprehensive in scope.

Organizations must leverage data on product classification, origin and destination markets and preferential duties to identify the most lucrative opportunities. This information can then be used to enter into FTAs operating in those markets where duty optimization would yield the highest cost savings and supply chain improvements.

### Planning Step 1

- Develop a shortlist of FTAs based on Priority end-markets and supply chain footprint
- Assess import duty costs and current FTA management strategy
- Collect key product data based on FTA shortlist and FTA pain points
- Utilize only those FTAs where costs savings are maximized, and supply chains are also enhanced



# Putting step 1 into practice

Let's say there is a Company ABC that produces peach jam in Vietnam with peaches sourced from China. After gathering information on FTAs, Company ABC finds applicable FTAs for all end markets under its current footprint except the United States. This means that the company can potentially minimize or eliminate duties into four of five key markets.

Priority end markets	Available FTAs
United States	No FTA exists
Canada	CPTPP
Japan	CPTPP, Vietnam-Japan, ASEAN-Japan, RCEP
EU	Vietnam-EU
China	ASEAN-China, RCEP

The company proceeds to gather key manufacturing origin and HS classification data. With the list of FTAs and the product-specific data in hand, Company ABC decides to put a duty optimization strategy in place for Canada, Japan, the EU, and China.

Main Input Origin (Peaches)	HS Input (Peaches)	Manufacturing Origin	End Market	Final Product Classification (Peach Jam)	Import Duty Paid
China	080930	Vietnam	United States	2007.99.35	7%
		Vietnam	Canada	2007.10.00	6.5%
		Vietnam	Japan	200710.1 / 2007.1	34%
		Vietnam	EU	2007.10.10	24% + 4.2 EUR/100 kg
		Vietnam	China	20071000	30%

## Step 2

# Assess Preferential Duties

Based on the shortlisted FTAs, firms will need to assess preferential duty rates in key end markets. In cases where there is more than one applicable FTA, firms should compare current preferential tariff rates and phase-out periods.

This is critical as an FTA offering the lowest tariff rate today is not guaranteed to provide the lowest rate in the future. Therefore, businesses must pay attention to current and future tariff rates.

## Planning Step 2

- Assess preferential duty rates into key end markets.
- Examine Tariff Elimination Schedules that outline preferential tariff levels for parties after entering into an FTA. Tariffs can be eliminated promptly or phased out over a period of years, depending on the particular agreement.
- Compare preferential tariff rates and phase-out periods to maximize the reduction in tariffs over time, if more than one FTA is applicable.
- Crosscheck HS classification carefully since their incorrect use can attract higher tariff payments and even substantial fines and penalties.

# Putting step 2 into practice

Based on the HS Classification data seen in step 1, Company ABC consults end-country tariff elimination schedules under the shortlisted FTAs.

Main Input Origin (Peaches)	HS Input (Peaches)	End Market	HS-Code	Import Duty	Rate 2021	Rate 2023	Rate 2028	Rate 2033
Vietnam	Japan	200710.1 / 2007.1	CPTPP	34%	21.6%	18.5%	3%	0%
			Japan – Vietnam FTA	34%	10.625%	4.2%	0%	0%
			ASEAN-Japan FTA	34%	0%	0%	0%	0%
			RCEP	34%	34%	27.6%	17%	6.4%
Vietnam	Canada	2007.10.00	CPTPP	6.5%	0%	0%	0%	0%
Vietnam	EU	2007.10.10	EU -Vietnam FTA	24% + 4.2 EUR/100 kg	0%	0%	0%	0%
Vietnam	China	20071000	ASEAN – China Free Trade Agreement	30%	0%	0%	0%	0%
			RCEP	30%	30%	25.5%	18%	10.5%

Company ABC finds that peach jam enjoys lower tariffs under all the shortlisted FTAs, and import duties into Canada, the EU, Japan, and China are zero under select agreements. For Japan, there are four separate preferential duty rates lower than the current 34 per cent. While the rate is currently lowest under the ASEAN-Japan FTA, tariffs eventually phase out to become zero under all four agreements.

# Step 3

## Assess Eligibility of Products

Using preferential customs duty rates under a particular FTA is not automatic. Rules of Origin (ROOs) are used as qualifying criteria for access to preferential duty rates. Under most FTAs, goods are considered “originating” from a country if wholly obtained or produced there.

Goods can also qualify for preferential rates when processed or “substantially transformed” in an FTA member country if certain conditions specified in the agreement in question are met.

### Planning Step 3

- Establish if the goods originate from a country party to the FTA. This is done through the criteria established by the ROO of the specific agreements.
- Match the right ROOs to the right FTA as every FTA has different ROOs so firms must be careful. Some agreements have only one eligible criterion for accessing lower tariffs and others may allow more than one way to achieve the ROO.
- Identify if goods can qualify under specific conditions in the chosen agreement such as follows
  - **Regional Value Content (RVC):** Products must meet a certain percentage of originating content locally or in FTA member countries.
  - **Change in Tariff Classification (CTC):** Non-originating materials used in the production of a good must have a different HS classification than the final product at the 2-, 4- or 6-digit level of classification.
  - **Specific Process Rules (SPR):** Goods are considered originating only if they are produced through specific processes that occurred in an FTA member country, mainly used for chemicals and plastics.

# Putting step 3 into practice

After consulting the text of all four agreements, Company ABC finds that its products are eligible under at least one agreement for each of its key end markets.

Origin	End Market	FTA	Import Duty	Preferential Rate 2021 - 2028	ROO	Eligible / Ineligible
Vietnam	Japan	CPTPP	34%	21.6% - 3%	CTC	✓
		Japan – Vietnam FTA	34%	10.6% – 0%	CTC except from Chapter 8.	✗
		ASEAN-Japan FTA	34%	0%	CTC except from Chapter 8.	✗
		RCEP	34%	34%-17%	CTC	✓
Vietnam	Canada	CPTPP	6.5%	0%	CTC	✓
Vietnam	EU	EU -Vietnam FTA	24% + 4.2 EUR/100 kg	0%	CTC as long as the weight of sugar does not exceed 20% of the weight of the final product.	✓
Vietnam	China	ASEAN – China FTA	30%	0%	RVC 40% or CTC	✓
		RCEP	30%	30%-18%	CTC	✓

While the ASEAN-Japan FTA provides duty-free access for peach jam into Japan, the ROOs mean that Company ABC does not meet the conditions under the agreement, as the peaches are sourced from China. This means that company ABC will either need to choose a different agreement to access the lowest possible tariff rate or look at shifting their sourcing strategy.

## Step 4

# Implement alternative sourcing

For companies looking to diversify the geographic scope of their suppliers, alternative sourcing should be a high-priority step in addressing the cost competitiveness of those suppliers.

Firms should factor FTA optimization into their supplier and manufacturing diversification strategies and consider shifting sourcing locations to become eligible for relevant FTAs. This can be done so that a product can meet an FTA's ROO criteria.

Firms may also consider alternative manufacturing set-ups to improve price competitiveness in end markets. This can allow businesses to leverage FTAs in multiple locations, cutting costs and increasing competitiveness.

## Planning Step 4

- Evaluate alternative sourcing set-ups to improve FTA eligibility
- Identify eligibility for large FTAs such as RCEP and other agreements not in force
- Evaluate alternative manufacturing set-ups to improve price competitiveness in key end markets. This allows businesses to leverage FTAs in multiple locations, cut costs and gain a competitive edge.

# Putting step 4 into practice

Peach jam could become eligible for the ASEAN-Japan FTA, which currently offers duty-free access if Company ABC sources its peaches from Vietnam or Japan.

Agreement	Duty 2021	Duty 2028	ROO	Eligible / Ineligible			
				China	ASEAN	Vietnam	Japan
CPTPP	CPTPP	3.00%	CC	✓	✓	✓	✓
ASEAN-Japan FTA	ASEAN-Japan FTA	0.00%	CC except from Chapter 8.	✗	✓	✓	✓
Vietnam-Japan FTA	Vietnam-Japan FTA	0.00%	CC except from Chapter 8.	✗	✗	✓	✓
RCEP	RCEP	17%	CC	✓	✓	✓	✓

Since there are no FTAs in force between Vietnam and the United States, the United States remains the only of Company ABC's key markets where they cannot optimize duties. The company may consider a different production location with an existing FTA with the United States and other priority end markets.

Origin / Manufacturing	End Market	FTA	Import Duty	Rate at Y/E 2020	Rate at Y/E 2023	Rate at Y/E 2028	ROO	Eligible
Singapore	United States	United States - Singapore FTA	12%	0%	0%	0%	CC	✓
Singapore	EU	EU -Singapore FTA	24% + 4.2 EUR/100 kg	20% + 4,2 €/100 kg/net	4% + 4,2 €/100 kg/net	0%	CC	✓
Singapore	Japan	CPTPP	34%	24%	18.5%	3%	CC	✓
Singapore	Canada	CPTPP	6.5%	Free	Free	Free	CC	✓
Singapore	China	ASEAN-China	30%	0%	0%	0%	RVC 40% or CC	✓

# Step 5

## Develop a trade compliance strategy

Given the speed at which new FTAs are implemented across the region, firms must respond proactively to new trade agreements such as the RCEP and have the operational and administrative procedures that allow them to comply with FTAs.

### Planning Step 5

- Ensure compliance of Preferential Certificate of Origin (PCO) requirements.
- Ensure understanding of and compliance with transit and trans-shipment rules.
- Implement a supplier management program to collect the information required to remain compliant with ROOs and PCOs. Few recommendations to establish a robust system:
  - Establish a communication channel through which suppliers can expect to receive requests
  - Ensure there is adequate data gathering on country of origin and HS classification
  - Establish a structure to gather the information from suppliers in a format compatible with existing operations and procedures
- Consider using a GTM software to minimize compliance costs and accommodate FTAs



# Putting step 5 into practice

To qualify for preferential tariffs into its key end markets, Company ABC must ensure that it meets the requirements under the selected agreements. Under the ASEAN-Japan FTA, ASEAN-China FTA, and the Japan-Vietnam FTA, the firm needs to certify a copy of a standardized form specific to the individual agreements. Under the CPTPP and RCEP, Company ABC may be able to develop its own origin certification, so long as it meets minimum information requirements.

FTA	Type of COO Requirement	Requirements
Japan – Vietnam FTA	Standardized Form	Form JV (issued by Japan) / Form VJ (issued by Vietnam) (Original and two copies for Viet Nam; original for Japan)
ASEAN-Japan FTA	Standardized Form	Form AJ (original and two copies for ASEAN; original for Japan)
CPTPP	Self-Certification	Information provided must meet minimum data requirements in Annex 3B
EU -Vietnam FTA	Self-Certification/ Standardized Form	REX system (for EU exporters) / movement certificate EUR.1 (issued by Vietnam)
ASEAN – China FTA	Standardized Form	Form E (original and two copies)
RCEP	Self-Certification	Information provided must meet minimum data requirements in Annex 3B

# Thinking ahead

Many organizations may think that they already utilize FTA benefits or that they have done an assessment and decided against using trade deals to provide greater leverage. However, those do not follow best-practice techniques to optimize FTAs may be leaving opportunities on the table.

For organizations not taking full advantage of FTAs, a robust optimization strategy can be implemented to:

- Minimize or eliminate import duty costs across a company's global supply chain footprint
- Reduce supplier risk by limiting the limit the effects of sudden shifts in government regulations, policies, tariffs, and services and investment restrictions
- Ensure cost-effective and timely compliance with multiple FTA requirements
- Offer cost and supply chain optimization strategies in keeping with FTA norms across the company's geographical sphere of operations
- Identify potential risks and evaluate opportunities arising from new FTA agreements

# Laying the foundation for success

Evaluating these key considerations can be complex and time-consuming process since it involves evaluating multiple products, agreements and export markets. As a result, organizations without the right software capabilities and strategies in place would likely be unable to extract maximum benefits from such agreements.

Global trade software simplifies the process by allowing companies to factor in multiple FTA considerations simultaneously. Effectively, it offers more to the user than a non-specialized software solutions. Key features of global trade management software include:

- Optimization of HS classification
- Comparison of duty rates between multiple trade partners
- Assessment of FTA eligibility based on complex ROO criteria
- Automating the process of seeking out suppliers
- Access to multi-source data which is needed for proper scenario planning and zeroing on the most effective supply chain routes

# As you plan, ask yourself the following

1

Do you allocate significant resources and time to ensure FTA compliance if you enter such agreements?

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2

Are there opportunities from an FTA that your organization is failing to capitalize on and risks that it remains unaware of?

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3

What other specialized information would you require to leverage the potential benefits of FTA agreements?

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