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## ASEAN Rules of Origin: Lessons and Recommendations for Best Practice

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**Philippine Institute for Development Studies**  
*Surian sa mga Pag-aaral Pangkaunlaran ng Pilipinas*

## ASEAN Rules of Origin: Lessons and Recommendations for Best Practice

*Erlinda M. Medalla and Jenny D. Balboa*

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# **ASEAN Rules of Origin: Lessons and Recommendations for Best Practice**

*Erlinda M. Medalla and Jenny D. Balboa*

## **Abstract**

Rules of Origin (ROO) set the criteria in determining the nationality of a product and where a product was made. The importance of ROO has increased in the past years as more countries engage in Free Trade Agreements (FTAs) and begun treating goods differently according to where the product was made, along with trade-specific preferences or restrictions to the imported good once its origin is determined. This study is done to cull the lessons from ASEAN's experience in determining and implementing the Rules of Origin. It draws the important lessons and makes recommendations for best practice that would contribute to the cooperation and integration efforts in the region. The paper examines the various design and implementation practice in ROO regimes, focusing on RTAs where the ASEAN is involved. The paper presents findings from recent studies on the cost of ROO compliance and the FTA utilization rates. It concludes with recommendations on simplification of ROO and some reforms on administrative procedures, bringing in the development country dimension, and some general guidelines to follow to improve ROOs.

*Key words: Rules of Origin, Free Trade Agreements, ASEAN*

## **Executive Summary**

Rules of Origin are usually specific to trade agreements and are a product of intense negotiations between parties before finalizing a trade deal. From these ROOs, one could determine the degree of liberalization or restrictiveness of trade between the Parties. Determining ROOs could be technically complex and administratively burdensome. It could be a daunting task for countries that do not have sufficient human resource skills to implement the fundamentals of ROOs. This is especially apparent in developing countries that lack the resources and sophisticated techniques to maximize the gains from a trade agreement.

ASEAN is acknowledged to be one of the most economically dynamic economic groups in the world and an active player in the global FTA movement. ASEAN's economic liberalization started in 1992 with the creation of the ASEAN Free Trade Area (AFTA). With this instrument, ASEAN was successfully able to eliminate trade barriers in intra-regional trade in its six major economies by 2002. ASEAN is at the center of East Asia's regional integration and cooperation.

Third country dialogues had been initiated and created revolving around ASEAN (ASEAN-China, ASEAN-Korea, and ASEAN-Japan). Beyond this, there are other mechanisms which are exploring larger grouping such as the East-Asia wide initiative (EAFTA) under the “ASEAN Plus Three” (APT) and the CEPEA (Comprehensive Economic Partnership for East Asia) under the East Asian Summit. ASEAN’s economic network has been expanding, with FTAs being sealed and negotiated not just in the region, but also in other parts of the world.

Rules of Origin in ASEAN’s trade agreements are guided by the ASEAN-Common Effective Preferential Tariff (ASEAN-CEPT) Scheme. The Guidelines under the CEPT scheme determine product origin (whether it is wholly obtained or not wholly obtained), the list of products that could be considered as wholly produced or obtained, and the criteria in determining non-wholly obtained products. It also provides specific conditions on cumulation and direct consignment, treatment of packing, Certificate of Origin that would be issued by a government authority of the exporting member state, and some guidelines for review.

The Rules of Origin for ASEAN originally applied the value-added criteria in determining origin. Originating status is conferred under one of two conditions: a) products wholly produced or obtained in the exporting member states. Wholly obtained products include agricultural products, animals, and animal products, and mineral and mineral products and waste and scraps from production as defined by Rule 2, or b) products not wholly produced or obtained. For non-wholly obtained products, the Regional Value Content (RVC) of at least 40 percent applies as a general rule. Overtime, shortcomings of this ROO design became visible, resulting in low FTA utilization rate (JETRO, 2004; Estevadeordal and Suominen).

More recently, reforms had been introduced to relax the ROO rules to keep up with the changing economic landscape of East Asia and the demands of the time. Procedures are simplified and co-equal rules are used. CTC (Change in Tariff Classification) are used as alternative to the original Regional Value Content (RVC) or value added. ASEAN is also further refining its cumulation rule and developing a “partial” cumulation approach to allow goods of “partial” origin that do not satisfy the 40 percent threshold to be cumulated as part of the RVA. Further, ASEAN has also agreed to reduce the percentage content requirement from 40 percent to 20 percent of ASEAN content. This move is envisioned to help most developing ASEAN member countries, whose sources of inputs, given the GPN structure, would come from outside the region.

ASEAN adopts the policy of certification thru designated government agency. There have been efforts to further liberalize and simplify the rules of origin, particularly on the screening and procedural aspect of acquiring certificate of rules of origin. In addition, policy reforms are made on post-audit checks by creating “green lanes” to speed up ROO administration.

To illustrate ROO implementation and administration, the paper showed the certification processes for the Philippines and Malaysia. What was observed is that both countries use similar

procedures in issuing COs. The case of Malaysia and the Philippines is reflective of the harmonized procedures in ASEAN in as far as ROO implementation is concerned.

Nonetheless, some steps could still be introduced to further refine the process, e.g. the use of back to back certificate, or allowing the interchangeable use of different forms (Form D of ASEAN and Form E for the ASEAN + 1). This will not only simplify procedures but would make a more seamless use of the cumulation rule.

In comparing ROOs in ASEAN and ASEAN + 1 FTAs, the following has been observed:

- The AFTA has a relatively simple and liberal ROO provision, characterized by generality in application. In addition, reforms being sought lean towards more liberal rules by “expanding/easing standards.”
- The existing FTAs in East Asia (limited to those which involve only the 13 East Asian countries) are more or less consistent with AFTA ROO, with the use of 40 percent RVA. AKFTA appears to be generally the least restrictive.
- Most sensitive sectors for most countries include automotive, textile and garments sectors. In addition, various rules are applied across countries and across specific commodity classifications.
- There is increasing use of CTC as an alternative rule, being defined for specific products.
- Even Japan, with a greater tendency in the past to have restrictive ROO have become more liberal, using alternate rules for majority of cases in the recent AJCEP.
- ACFTA, on the other hand can be considered simpler, using only RVC (40) in the majority of cases. However, the lack of alternative rule could be constraining. Reforms are being made to accommodate greater flexibility with more alternate rules being developed.
- However, in general, there is a trend towards progressively more liberal ROO regime in East Asia.

A key concern of the paper is cost of compliance and utilization rates. Various studies have attempted to estimate the cost of ROO compliance (Manchin, 2006; Cadot et al, 2005; Carrere and de Melo, 2004; Hayakawa et al). What these studies commonly showed is that reducing the ROO compliance to within 5 percent should be the target of reforms. While there had been some improvements in CEPT utilization rate through the years, all in all, margin of preference for AFTA is still low, falling below 5 percent in total in all of ASEAN and barely making it to the 5 percent threshold for most ASEAN countries, except Thailand.

Cost of compliance could be minimized in two ways: either the fundamentals of ROOs are itself reformed, or the administrative procedures involving ROOs, particularly the certification process, are reformed. Some suggestions on both areas are tackled in the paper.

In sum, the paper offers the following general guidelines in crafting best practice of ROOs:

1. The AFTA ROO is considered relatively simple and liberal. The generality in application is a plus factor. In addition, reforms being sought lean towards more liberal rules by

attempts toward “expanding/easing standards.” (Needless to say, a lot more can be done to improve the system.)

2. Rules toward adopting full cumulation, and roll-up (absorption) process should be further developed and adopted.
3. The *de minimis* provision should be applied more extensively. This could yield significant impetus for deeper regional integration.
4. Another key measure that should be explored is self-certification. This could contribute substantially to simplification and cost reduction. This should be balanced by some monitoring system (and least burdensome verification process) that would keep importers honest.
5. Applying restrictive ROOs targeted at sensitive products is not an effective mechanism for protecting domestic industry and should be limited.
6. Special and Differential Treatment: ROO be devised by taking into account the different levels of development of countries in the Ease Asia region, e. g. using lower Value Added content
7. Another challenge is to craft a system of ROO that would be SME friendly. One aspect of this is capability building to enable SMEs to comply with ROO requirement. Modules and templates for value-added accounting, could probably be developed over time for SMEs to use.
8. There is a need for greater harmonization of customs procedures for the benefits from ROO reforms to be maximized. In particular, the region should work towards a Harmonized System of Customs Classification.
9. Finally, the formulation of the ROOs should have both simplification and liberalization elements. At the same time, however, there should be adequate provisions that would control for potential abuse.

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# ASEAN Rules of Origin: Lessons and Recommendations for Best Practice \*

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*Erlinda M. Medalla and Jenny Balboa<sup>1</sup>*

## 1. Introduction

Countries around the globe, under any system of government and economic regime, have become increasingly interdependent. While growth and development would vary across and within countries, how one economy performs would affect others. Market driven factors have been the major determinant about gains and distribution. Nonetheless, government policies would have a significant impact on the pace and distribution of gains during good times, and alleviation and distribution of costs during crisis, whether at the national or international level. On the latter, many have chosen to forge regional trading agreements (RTAs), starting a string of engagements leading to its proliferation during the past decade.

ASEAN started early in the game in 1967 for the original members, but only as a loose organization, with minimal economic integration. With the global developments, including times of crisis and need to address development gaps, ASEAN leaders saw a need for a closer partnership, creating a vision of an ASEAN community. The ASEAN membership has since grown into a grouping of 10 countries, from a loose talk shop forum into an organization with a formal Charter (though still underpinned by the unique “ASEAN” way).

After two major crises, ASEAN remains steadfast in its vision of a community. Moreover, the role of ASEAN in the East Asian region has become more important, and the vision has grown into an East Asian community.

Admittedly, there are many impediments towards realizing the vision of an ASEAN community (and more so for an East Asian community). During its decades of existence, reforms have been sought and many problem areas have been identified. Among the latter is the issue of ASEAN Rules of Origin (ROOs).

The ROO provision is at the heart of any free trade agreement (FTA). However, as a means to prevent trade deflection, it could become in itself an impediment to intra-regional trade.

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<sup>1</sup> Senior Research Fellow and Research Associate, respectively, of the Philippine Institute for Development Studies. The usual disclaimer applies.

In order to maximize the benefits from the RTA, the ROO should not only be an instrument to prevent trade deflection but should be formulated to be as trade facilitating as possible. It should also provide enough safeguard for inclusive development both within and across countries in the region.

This paper attempts to tackle the ROO issue, particularly within the context of ASEAN. The ultimate objective is be able to draw the important lessons and make recommendations for good (if not best) practice in ROO that would enable member parties to achieve its vision of a community.

To provide some background, it is important to have a clear understanding of ROOs -- the design, the implementation, and the ROO regimes, especially in RTAs where the ASEAN is involved. As such, this paper first examines the general approaches to ROOs. Then, the paper discusses the ROO regime in ASEAN and ASEAN plus 1, particularly China, Korea and Japan, including a brief discussion on what have been the issues surrounding ROOs and the reforms sought to address them. The paper then presents some findings from recent studies on the cost of ROO compliance and the FTA utilization rates. The paper concludes with recommendations for ROOs.

## **2. Understanding ROOs<sup>2</sup>**

Rules of Origin have long been a part of recorded cross-border trade, if only for statistical purposes. Over time, however, with increasing use of preferential trade, ROOs have evolved into more complex set of rules to serve different purposes. For example, ROOs need to be defined to grant GSP (Generalized System of Preference) privileges for specific products. For FTAs, ROOs have a central role in making sure that benefits accrue to member parties.

This paper deals with ROOs as they are used in FTAs. They are specific provisions that are established in the agreement to determine the origin of goods, which has become more complicated due to evolving production systems and business models. In effect, ROOs can be designed to suit different purposes of member parties of the agreement. It is a product of intense negotiations between parties during its formation. Hence, even if at the outset, the goal of the member parties is to bring down trade barriers between them, realistically, there would still result elements of protectionism in the ROOs that are eventually adopted. One outcome is some degree of restrictiveness of the ROOs.

The intricacy, restrictiveness of the ROO would largely depend on the rules and definition itself which are adopted. However, it is equally important to understand the procedures and administration of the rules as these could add to the cost and complexity of the ROO. This

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<sup>2</sup> The first part of this section draws heavily from the first author's paper on suggested ROO for EAFTA (East Asia Free Trade Agreement)

section first deals with the approaches, before proceeding to a general discussion of procedures and administration..

### *Approaches to ROO*

In general, there are three (3) basic elements that factor into the setting of ROOs.

- a) First is the distinction between wholly obtained and non-wholly obtained goods.
  - a product is deemed as originating from a particular country if it contains no materials or processing from outside that country (wholly obtained goods)
  - non-wholly obtained goods can also be deemed originating from the particular country if “sufficient working or processing” or substantial transformation has taken place.
- b) For non-wholly obtained goods, sufficient working or processing is in turn determined on the basis of any (or combination) of the following basic criteria:
  - a change in tariff classification (CTC) rule,
  - on the basis of a minimum value added and/or maximum allowable value of intermediate imports as a percentage of the value of the final product or
  - on the basis of conforming to specific production processes.
- c) In turn, allowable intermediate imports could involve:
  - Maximum allowable imports from non-partners to the agreement (as a *de minimis* rule), and
  - Some form of cumulation of inputs (value-added) from partners within the agreement.

For example, the ROO provisions in ASEAN Free Trade Agreement (AFTA) categorizes first between Wholly Produced or Obtained and Not Wholly Produced or Obtained products, then spells out conditions for Not Wholly Produced goods, generally using a minimum regional (cumulation) value added criteria of 40 percent.

‘Wholly obtained’ criteria would apply to goods that are clearly produced domestically. These are more easily identified and have clear HS (Harmonized System) nomenclature and coding. They are mainly in the first 20 HS chapters covering mining, live animals, fruits, with some processing.

For non-wholly obtained products, there are several approaches to defining whether ‘substantial’ transformation has occurred to satisfy originating criteria. In general, these include three major methods, used singly or in combination—the *value-added measure (VA)*, the *tariff heading criterion (CTH)*, and the *specified processes (SP) test*.

The VA test, simply put, requires a product to have a specified minimum percentage of value added created at the last stage of the production process (also the *domestic content*

*test*). The VA test is apparently simple and precise but it can be very costly to comply with. Proving a value-added content could be subject to differences in calculation method, fluctuation in values, among other concerns. There would be costs in tracing the inputs, and a manufacturer of a complex product would need a highly sophisticated inventory and accounting system. (La Nasa 1995) Moreover, the VA criterion has an implicit bias against low-wage, capital-scarce countries. In general, it is easier for high-wage (capital-rich) countries to reach the value added threshold due to its higher labor costs and higher capital intensity, and conversely.

The *tariff-heading criterion*, also referred to as change in tariff classification (CTC), is a rule which confers origin if the activity in the exporting country results in a product to be classified under a different heading of the customs tariff classification from its main intermediate input. This criterion is comparatively simple and predictable, and indeed, it is increasingly resorted to in more recent FTAs (and ROO refinements in older FTAs). Its limitation is that trade classification systems have not been designed with the objective of distinguishing substantial transformation.<sup>3</sup> As such, a question that arises, for example, is what level of disaggregation should the change be determined for “substantial transformation” criteria to be satisfied.

The *specified processes* or *technical test* determines, on a case-by-case basis, specific production activities or specific processing operations that may confer originating status. This prescribes certain production or sourcing processes that may (positive test) or may not (negative test) confer originating status. (UNCTAD 2002) An example is the so-called *yarn forward* (sometimes triple transformation) rule for textile and garment products. The obvious limitation of this test is the rigidity and difficulty of defining a process test for an unending list of products, which need to be continuously updated with corresponding new rules for new products and processes arising from new technologies. The process involved is also susceptible to industry lobbying groups during negotiations (and drafting of rules), because drafters and administrators would have to rely on the industry for information. (La Nasa 1995) Lastly, for negative technical tests, the criterion specifies only which processes do not confer origin and thus, could leave a large gray area, making the particular ROO very restrictive.

The adoption or rejection of particular criteria of substantial transformation as a method of determining origin generally depends on which principle one puts more value on: *flexibility* or *certainty*. Having flexibility in the set of ROOs which allows for evolution over time, adaptive to the need for changes and other developments, would have obvious advantages for member parties. On the other hand there are potential disadvantages in being too

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<sup>3</sup> While the Harmonized System reflects the most sophisticated and refined tariff classification system, it is primarily designed for the dual purposes of commodity classification and compilation of statistics. (La Nasa 1995)

flexible, e. g., inconsistent applications, discretionary nature and the costs of making an origin determination under it.

The advantages, disadvantages and key issues using the different methods are highlighted in Table 1 below as summarized by Brenton (2003).

**Table 1: Summary of the Different Approaches to Determining Origin**

<b>Rule</b>	<b>Advantages</b>	<b>Disadvantages</b>	<b>Key Issues</b>
Change of Tariff Classification (in the Harmonised System)	<ul style="list-style-type: none"> <li>● Consistency with non-preferential rules of origin.</li> <li>● Once defined, the rule is clear, unambiguous and easy to learn.</li> <li>● Relatively straightforward to implement.</li> </ul>	<ul style="list-style-type: none"> <li>● Harmonized System not designed for conferring origin, as a result there are often many individual product specific rules, which can be influenced by domestic industries</li> <li>● Documentary requirements maybe difficult to comply with.</li> <li>● Can be conflicts over the classification of goods which can introduce uncertainty over market access</li> </ul>	<ul style="list-style-type: none"> <li>● Level of classification at which change required – the higher the level the more restrictive.</li> <li>● Can be positive (which imported inputs can be used) or negative (defining cases where change of classification will not confer origin) test<sup>a</sup> – negative test more restrictive.</li> </ul>
Value Added	<ul style="list-style-type: none"> <li>● Clear, simple to specify and unambiguous.</li> <li>● Allows for general rather than product specific rules</li> </ul>	<ul style="list-style-type: none"> <li>● Complex to apply – requires firms to have sophisticated accounting systems.</li> <li>● Uncertainty due to sensitivity to changes in exchange rates, wages, commodity prices etc.</li> </ul>	<ul style="list-style-type: none"> <li>● The level of value added required to confer origin</li> <li>● The valuation method for imported materials – methods which assign a higher value (eg CIF) will be more restrictive on the use of imported inputs</li> </ul>
Specific Manufacturing Process	<ul style="list-style-type: none"> <li>● Once defined, clear and unambiguous</li> <li>● Provides for certainty if rules can be complied with</li> </ul>	<ul style="list-style-type: none"> <li>● Documentary requirements can be burdensome and difficult to comply with.</li> <li>Leads to product specific rules.</li> <li>● Domestic industries can influence the specification of the rules.</li> </ul>	<ul style="list-style-type: none"> <li>● The formulation of the specific processes required – the more procedures required the more restrictive</li> <li>● Should test be negative (processes or inputs which cannot be used) or a positive test (what can be used) – negative test more restrictive.</li> </ul>

*Source: Notes on Rules of Origin with Implications for Regional Integration in South East Asia by Paul Brenton, 2003*

There are other tests utilized for different types of products. Some FTAs also apply so-called “hybrid tests.” One type of hybrid test requires satisfaction of two (or more) criteria. A common example is requiring both a minimum percentage of domestic value-added content *plus* a change in tariff classification for a product to undergo a “substantial transformation.” The second type is the alternative or co-equal rule. This is the more liberal either/or test, which provides a choice among two (or more) rules to use. Given that there are no internationally agreed standards, an importing country can vary rules of origin according to its trading partners and products.

Additional typical features of ROOs are also utilized to simplify or refine the process of conferring origin. Examples of these are provisions allowing a certain degree of *de minimis*, the roll-up principle and various types of cumulation. The *de minimis* rule allows for a specified maximum percentage of non-originating materials to be used without affecting origin. *Roll-up or absorption principle* allows materials that have acquired origin by meeting specific processing requirements to be considered originating when used as input in a subsequent transformation. (Estevadeordal and Suominen 2003) Finally, cumulation is a measure that permits countries to use inputs from a specific country or group of countries without affecting the origin of the products. In essence, cumulation provisions permit inputs to be obtained from *outside* the FTA and be counted as *domestic* for the purposes of determining the origin of the product. (Coyle 2004)

There is a growing trend in the use of the cumulation<sup>4</sup> type of ROO-- in particular, the *diagonal cumulation* which expands the geographical and product coverage of an ROO regime in FTAs. The traditional interpretation of this diagonal cumulation is to permit three or more countries to effectively merge their individual bilateral treaties into a single comprehensive FTA in which inputs can be sourced anywhere within the network. They can also allow even a non-party country to the agreement to be included in the cumulation process. A prime example is the US-Singapore Integrated Sourcing Initiative.

#### *Varying degrees of restrictiveness in types of ROOs*

Depending on how these approaches are implemented, the ROO regime could result in varying degrees of restrictiveness. In general, some would argue that using a single rule makes it simple. However, the single rule could be difficult to comply with depending on the single rule adopted. In general, the most liberal would be the using alternative rules (co-equal rules) where an exporter is allowed to choose among different rules of claiming origin. At the other extreme,

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<sup>4</sup> There are three types of cumulation. *Bilateral cumulation* operates between the two FTA partners and permits them to use products that originate in the other FTA partner as if they were their own when seeking to qualify for preferential treatment. *Diagonal cumulation* means that countries tied by the same set of preferential origin rules can use products that originate in any part of the area as if they originated in the exporting country. *Full cumulation* provides that countries tied by the same set of preferential origin rules among each other can use goods produced in any part of the area, even if these were not originating products. (Estevadeordal and Suominen 2003)

most restrictive would be having to comply with more than one rule (plus rather than either/or), for example, both a CTC and VA rule. Of course, within these two types of hybrid tests, the degree of restrictiveness could vary depending on the restrictiveness of the individual rules included. The ‘plus’ test with the most restrictive individual rules is the most restrictive, and the alternative test with the most liberal options would be the most liberal. (In theory, it should be enough to just have at least one of the alternative rules to be most liberal.)

The more applicable the cumulation principle, the more liberal (and less restrictive) the ROO would be. This is especially true if the VA rule is used in tandem with the roll-up or absorption principle. In ASEAN for example, the AFTA ROO allows so-called partial cumulation (which is essentially full cumulation) of intermediate inputs from other ASEAN members which has passed the VA criteria. In addition, cumulation is for the full value of the intermediate input (hence the term full cumulation), and not just the local value added.

How the *de minimis* principle is used in the agreement would greatly affect how liberal the ROO provision of the FTA. Most existing FTAs use the provision sparingly as a product specific rule. In general, the more extensive the *de minimis* rule is applicable, the more liberal the ROO regime would be. Also, the cut-off rate (the *de minimis* level) tends to be low in many existing FTAs. The lower the cut-off rate, the more restrictive the ROO regime would be.

Another general indicator of restrictiveness is the cut-off level used in the case of the VA rule. The lower the value-added percentage requirement, the more liberal the ROO is. In the case of the CTC rule, the higher the level of aggregation (classification) required for a change, the more restrictive the ROO, and conversely. In addition, the use of the negative test (*i. e.*, excluding certain classifications where change cannot come from) would make it more restrictive.

It is mainly with respect to sectors like textiles and clothing, iron and steel, and automotive products which are most especially sensitive to the type of ROO adopted. These are the sectors usually accorded higher tariff (and often also non-tariff) protection, leading to concerns of protectionist capture in the design of the ROO. (OECD 2002) Ironically, or maybe not, these sectors are also where the FTA would have highest impact. In most cases, this is where specific processes tests (SP) are used in many existing FTAs.

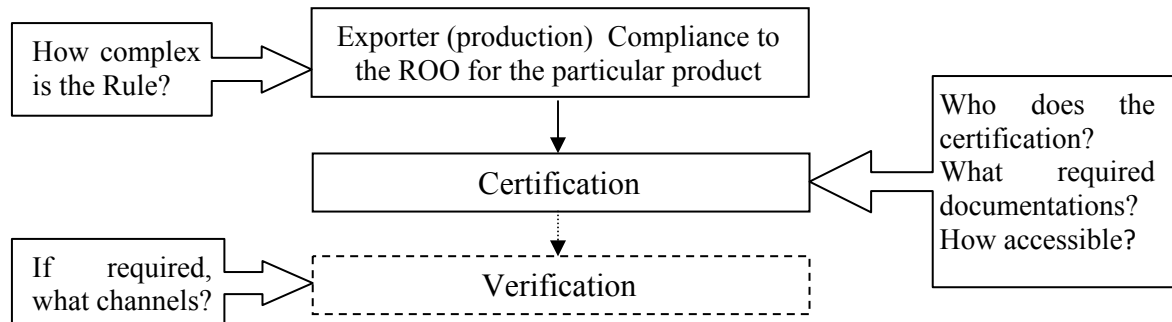
### *Implementing ROO: Certification and Verification Procedures*

ROO administration and compliance necessarily involve costs, both on the part of administration, and more so in terms of compliance efforts by the intended beneficiaries. Much depends on the type of ROO itself. However, a lot also depends on the certification and verification procedures.

First, the exporter would need to comply with the Rule (e. g. whether some VA requirement, CTC, a choice or combination). Then, the exporter would have to have some form of proof. This is done through a process of certification, and if further proof is needed, some process of verification.



In sum, there are 3 possible stages:



In the first stage, for an honest exporter, compliance with ROO involves numerous documentation requirements (including invoices and other evidence for each input used in the final product), which would depend on the type of ROO. For the RVA rule, exactly what formula should be used? How are steps that input into the process documented and supported? These problems are magnified for small firms.

For certification, the type of certification procedure would have direct implication on the cost of compliance- both to the exporter and the government. Some types require involvement by the exporting country government to provide certification, increasing the burden of the exporters. To reduce this burden, other methods are being adopted such as the “self-certification” model, which entails certification by a public or a private umbrella entity approved by the government. This would lower administrative costs to exporters and government by transferring the burden of proof of origin to the importers themselves (Estevadeordal and Suominen 2003).

For verification, some post audit procedures are required. How cumbersome and burdensome these could prove later, is an important concern.

### 3. The ROOs in ASEAN FTA

ASEAN is the largest grouping of countries in East Asia. Through its various mechanisms for dialogue with third countries, the other major trading arrangements in East Asia would revolve around ASEAN, such as the “ASEAN+1” agreements, namely the ASEAN-China agreement (ACFTA), ASEAN-South Korea (AKFTA), and ASEAN and Japan (AJCEP). There are also other mechanisms which are exploring larger groupings such as the East-Asia-wide initiative (EAFTA) under the “ASEAN Plus Three” (APT) mechanism and the CEPEA (Comprehensive Economic Partnership for East Asia) under the East Asian Summit. This section looks at ROOs in concluded agreements focusing on ASEAN.

The ROO in ASEAN-CEPT is spelled out under a number of provisions. These are summarized as follows:

- Originating products: conditions 1) products wholly produced or obtained; 2) products not produced or obtained

- Wholly Produced or Obtained: List of qualified products
- Not Wholly Produced or Obtained: Products with at least 40 percent of its content originates from ASEAN Member States
- Cumulative Rule of Origin: Specific conditions
- Direct consignment: Specific conditions
- Treatment of Packing
- Certificate of Origin: issued by a government authority of the exporting Member State
- Review

The general provision for conferring origin is contained in the following:

- (i) A product shall be deemed to be originating from ASEAN Member States, if at least 40 percent of its content originates from any Member States;*
- (ii) Locally-procured materials produced by established licensed manufacturers, in compliance with domestic regulations, will be deemed to have fulfilled the CEPT origin requirement; locally-procured materials from other sources will be subjected to the CEPT test for the purpose of origin determination;*

The Rules of Origin for the ASEAN Free Trade Area (AFTA) originally applied the value added criteria in determining origin. Originating status is conferred under either one of two conditions: (a) products wholly produced or obtained in the exporting member states. Wholly produced include agricultural products, animals and animal products, and mineral and mineral products and waste and scraps from production as defined in Rule 2, or b) products not wholly produced or obtained. For non-wholly obtained products, the Regional Value Content (RVC) of at least 40 per cent applies as a general rule.

#### *Reforms in the ASEAN FTA ROOs*

In general, a simple and liberal ROO regime for the FTA would be most conducive in promoting deeper regional integration and enhancing the benefits from the FTA. It will serve to improve the competitiveness of member states. Simple rules will reduce compliance costs and administration itself of trade and customs procedures for ROOs. In addition, it will minimize the potential for unproductive rent-seeking and corruption. (ADB 2002) In this regard, it is worth noting that the AEC Blueprint explicitly provides for instituting reforms in ASEAN ROOs towards this end. To wit,

*“Putting in place ROO which are responsive to the dynamic changes in global production processes so as to: facilitate trade and investment among ASEAN Member Countries; promote a regional production network; encourage development of SMEs and the narrowing of development gaps; and promote the increased usage of the AFTA CEPT Scheme.*

*Actions:*

- i. Continuously reform and enhance the CEPT ROO to respond to changes in regional production processes, including making necessary adjustments such as the introduction of advance rulings and improvements to the ROO;*
- ii. Simplify the Operational Certification Procedures for the CEPT ROO and ensure its continuous enhancement, including the introduction of facilitative processes such as the electronic processing of certificates of origin, and harmonisation or alignment of national procedures to the extent possible; and*
- iii. Review all the ROO implemented by ASEAN Member Countries, individually and collectively, and explore possible cumulation mechanisms, where possible.*

Over time, shortcomings of the original ROO regime, resulting in low FTA utilization rate of AFTA, have been found. As noted by Estevadeordal and Suominen (2003), the AFTA ROO is prominent for its generality in application, originally utilizing just the single method of value-added criterion. At least on paper, the rule is simple and relatively applies generous provision for imported inputs. A major problem is the reliance of most ASEAN member countries on electronics and textile and garments for their exports, products produced within GPNs which account for value-added/local content often much lower than 40 percent. Another setback is the difficulty in accounting procedures required, especially for SMEs. Firms have to measure, disclose and certify input costs. This is a problem for many firms. The use of change in tariff classification (CTC) may be easier, and a choice is considered preferable.

In recent years, reforms were adapted to encourage deepening integration among ASEAN by relaxing the ROOs, and by simplifying procedures for ROOs. A major reform is in the use of co-equal rules, generally, using CTC (change in tariff classification), or textile rule, as alternative to the original RVC (regional value content, or regional value added) rule. For example, additional options are adopted for goods such as textile and textile products (process rule), wheat flour, wood-based products, some iron and steel products, and other alternative product specific rules for other products, mostly using the CTC-based criteria. (Medalla, 2008; Tran, 2008; Kirk, 2007). In general, with reforms cumulated up to 2007, alternate rules have become applicable to more than 4400 tariff lines (out of 5224 PSR lines). This will be further discussed below, in conjunction with the ASEAN + 1 Agreements.

ASEAN is also further refining its cumulation rule and developing a “partial” cumulation approach-- that is, even goods of “partial” origin not having satisfied the 40 percent threshold can be cumulated as part of RVA. The practice in ASEAN is to count “components as part of ASEAN content which themselves have ASEAN content of 40 percent or more.” ASEAN has now agreed to the percentage content requirement reduced to 20 percent of ASEAN content.

This move is envisioned to help most developing ASEAN member countries, whose sources of inputs, given the GPN structure would come from outside the region. Some estimates show that in most ASEAN countries, for major manufactured exports (e. g. textile, garments and

electronics) total ASEAN content is less than 20 percent . (Manchin and Pelkmanns-Balaoing, 2007)

ASEAN adopts the policy of certification thru designated government agency. There have been efforts to further liberalize and simplify the rules of origin, particularly on the screening and procedural aspect of acquiring certificates of rules of origin. The ASEAN Annual Report 2003-2004 notes the following ASEAN revision in ROO and Operational Certification Procedures:

- standardizing the method of calculating local/ASEAN content,
- adding a set of principles for calculating cost of ASEAN origin and guidelines for costing methodologies,
- treatment of locally-procured materials, and improved verification process including on-site verification

In addition, AFTA imports are subject to random post-audit checks. Policy reforms are being done to create “green lanes” to speed up the ROO administration. Nonetheless, many firms would still prefer to go through the “red” lane to avoid possible harassment that could arise from the “random” post-audit checks (Manchin and Pelkmanns-Balaoing, 2007).

To further illuminate on how the ROOs impact on costs, the certification processes for the Philippines and Malaysia are presented below. As coordination and cooperation to come up with similar procedures are also sought, including, when possible, how certain formulas for Value added could be standardized, these should represent the procedures for ASEAN. Indeed, although different agencies are designated for the Philippines (Bureau of Customs) and Malaysia (Ministry of Trade and Industry), the similarity in the procedures is apparent.

### ***Implementing the CEPT-AFTA ROO Scheme: The Case of the Philippines and Malaysia***

#### ***Philippines***

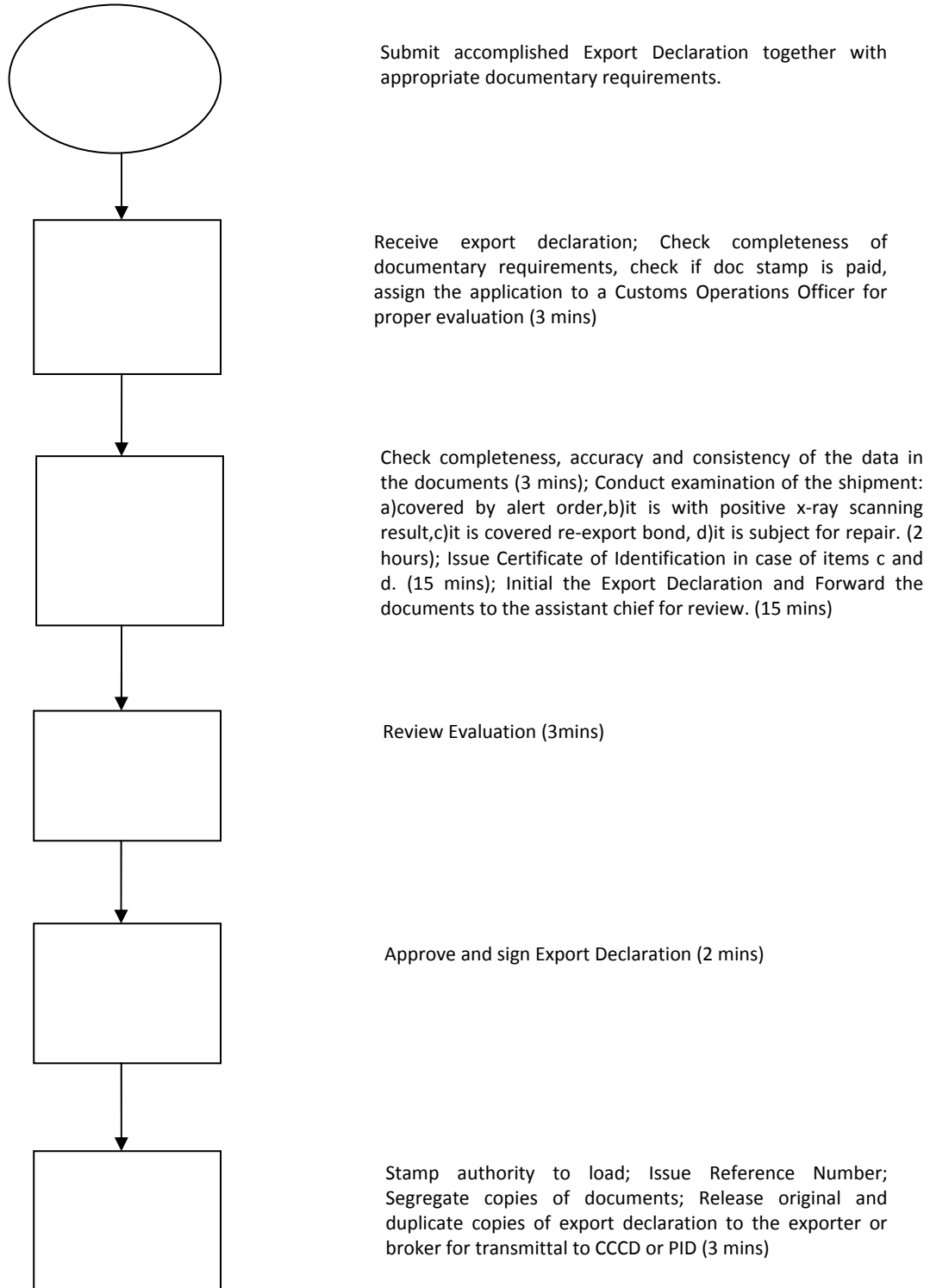
The Philippines uses a single guideline in the issuance of Certificate of Origin for all its FTAs – for ASEAN (and various ASEAN + 1), and JPEPA (Japan Philippines Economic Partnership Agreement). The Bureau of Customs (BOC) facilitates the entire process, starting from evaluation of whether the export product will qualify for Preferential Tariff Treatment up to the Issuance of Certificate of Origin. A prerequisite for availing is pre-exportation evaluation of the product, and submission of the following requirements to the BOC:

- a. written request for evaluation to be submitted at least 5 days prior to exportation
- b. complete list of all materials used in the production (both local and imported)
- c. break down of cost element
- d. import and export declarations
- e. production flowcharts
- f. company profile
- g. other documents to support originating status of the product and

- h. photo of the production process

Upon submission, the Exporter or Broker may already submit a written request for the Issuance of Certificate of Origin, together with all the required documents to the Chief of the Export Division of BOC. **The process can approximately take five working days and two hours** for the BOC to complete verification of all supporting documents, evaluation of data to determine origin status of the product, conduct factory visit and examination of records and preparation of report, including proposed Origin Ruling. The documents will then go to another round of evaluation before it is released to the exporter.

## I. Processing of Export Declaration and Certificate of Identification



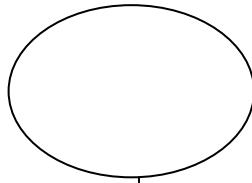
End of transaction

Once the Certificate of Origin is issued, the exporter may submit this to the Bureau of Customs, along with a Copy of the approved Export Declaration, Copy of the Bill of Lading, Commercial Invoice and Copy of Export Permit for regulated products. The concerned BOC official will review the documents, evaluate the completeness, accuracy and consistency of data, and evaluate the application to determine if the product is in the inclusion list covered by preferential tariff and if the Origin Criteria of a particular FTA is complied with. If approved, the document is forwarded for approval of the Assistant Chief for his/her signature and issuance of reference number. It will get stamped by the BOC and the Certificate of Origin will get a Customs Seal. The document will then be released to the applicant. **The exporter may need to wait for 15 minutes for the document to be released.**

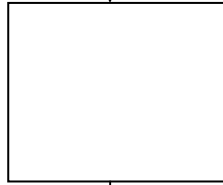
The final leg of the process is Issuance of Certificate of Shipment. To get this document, the exporter or customs broker should submit a copy of the processed Export Declaration, Copy of the Commercial Invoice, and Inspector's Certificate of Lading/CCCD (Containerized Cargo)/PID (Conventional Cargo).

To avail of this service, the Applicant should submit a written request. The said request is checked for completeness of documents and subsequently forward to the Records Officer/Custodian. The application will go through a one-day verification to determine whether the data submitted tallies with records on file. If verified to be authentic, the concerned Officer will prepare and Initial Certificate of Shipment and Transmit the same for review and approval of Officers. The concerned Officer will then sign the Certificate of Shipment and issue a Certified Copy of Inspector's Certificate of Lading and Export Declarations. Finally, the document will be issued a reference number and stamped by the BOC Seal before release to the applicant. **The whole process may take 1-2 days to get completed.**

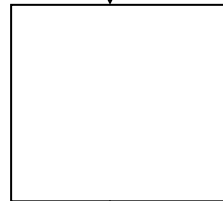
## II. Issuance of Certificate of Origin



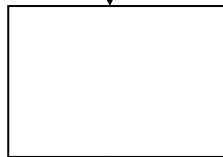
Submit accomplished Certificate of Origin together with the supporting documents



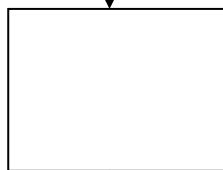
Receive CO Declaration, Check the completeness of the supporting documents, Assign the application to a COOI (3 mins)



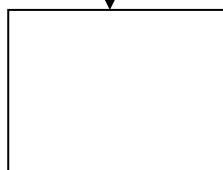
Check completeness, accuracy and consistency of data; Evaluate the application to determine if the product is in the inclusion list covered by preferential tariff; Origin Criteria of a particular FTA is complied with; Initial the CO and Forward to Assistant Chief. (5 mins)



Review actions of COOI (3 minutes)



Approve and sign CO (3 mins)

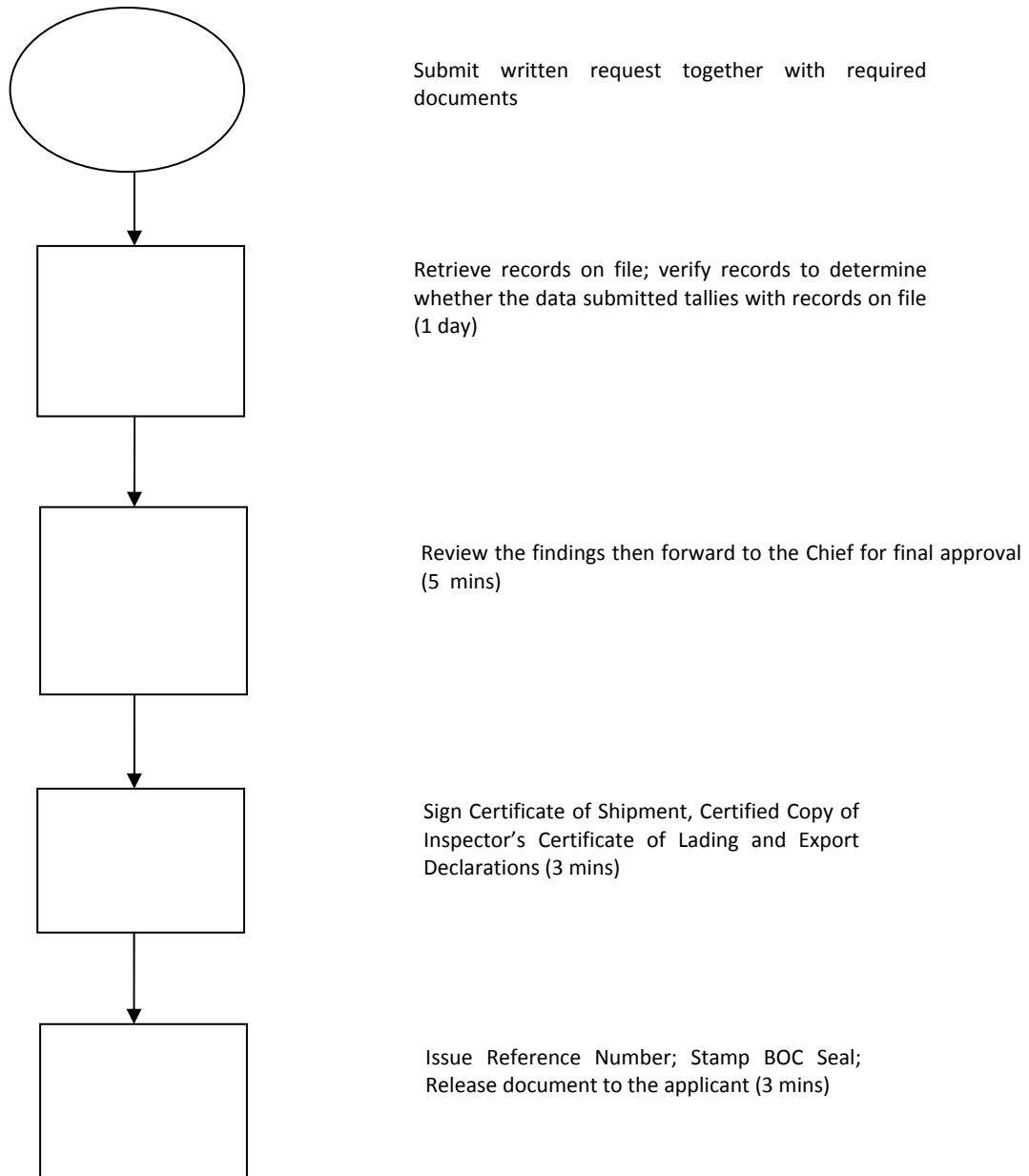


Issue Reference No., Stamp Bureau of Customs Seal to the CO; Segregate copies; Release original and duplicate copies to the applicant. (3 mins)

End of transaction



### III. Issuance of Certificate of Shipment



End of transaction

## *Malaysia*

In Malaysia, the Ministry of International Trade and Industries (MITI) is responsible for overseeing the legal documentation of exporting countries entitled for preferential tariff status. Like the Philippines, the same guidelines and procedures are used for all its FTAs. The Malaysian Customs is responsible for the correct clearance of goods.<sup>5</sup>

Malaysia also uses a standard guideline for endorsement and approval of products undergoing preferential treatment. **The process approximately takes seven days**<sup>6</sup> upon receipt of application. Verification is conducted to review the product's percentage calculation, ex-factory price or FOB value, product's HS/AHTN Code, raw materials' HS/AHTN Code in determining the origin criteria and importing country which receive preferential tariff benefits.

If the documents submitted are complete and satisfied the requirements, the product is endorsed as eligible in the Cost Analysis Processing Report according to the Rules of Origin of the importing country. The file is then forwarded to the Officers for recommendation and approval.

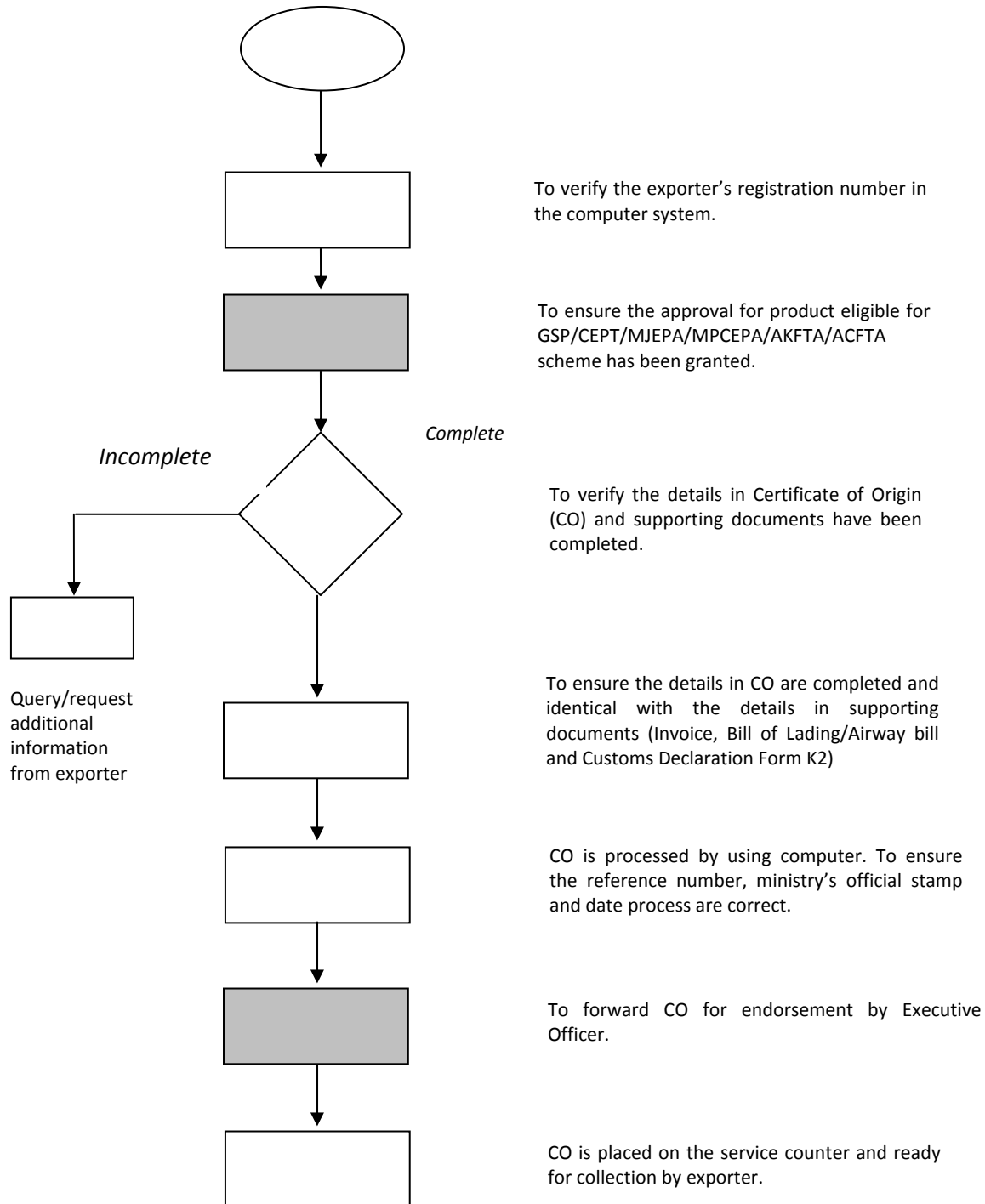
Once the exporter is acknowledged as eligible, he/she may already apply for a Certificate of Origin, **which could take 1-2 days**. The first step is verification of the exporter's registration number in the computer system. Afterwards, verification is conducted to ensure the approval for product eligible under the PTA scheme and to check the details in the Certificate of Origin and supporting documents.

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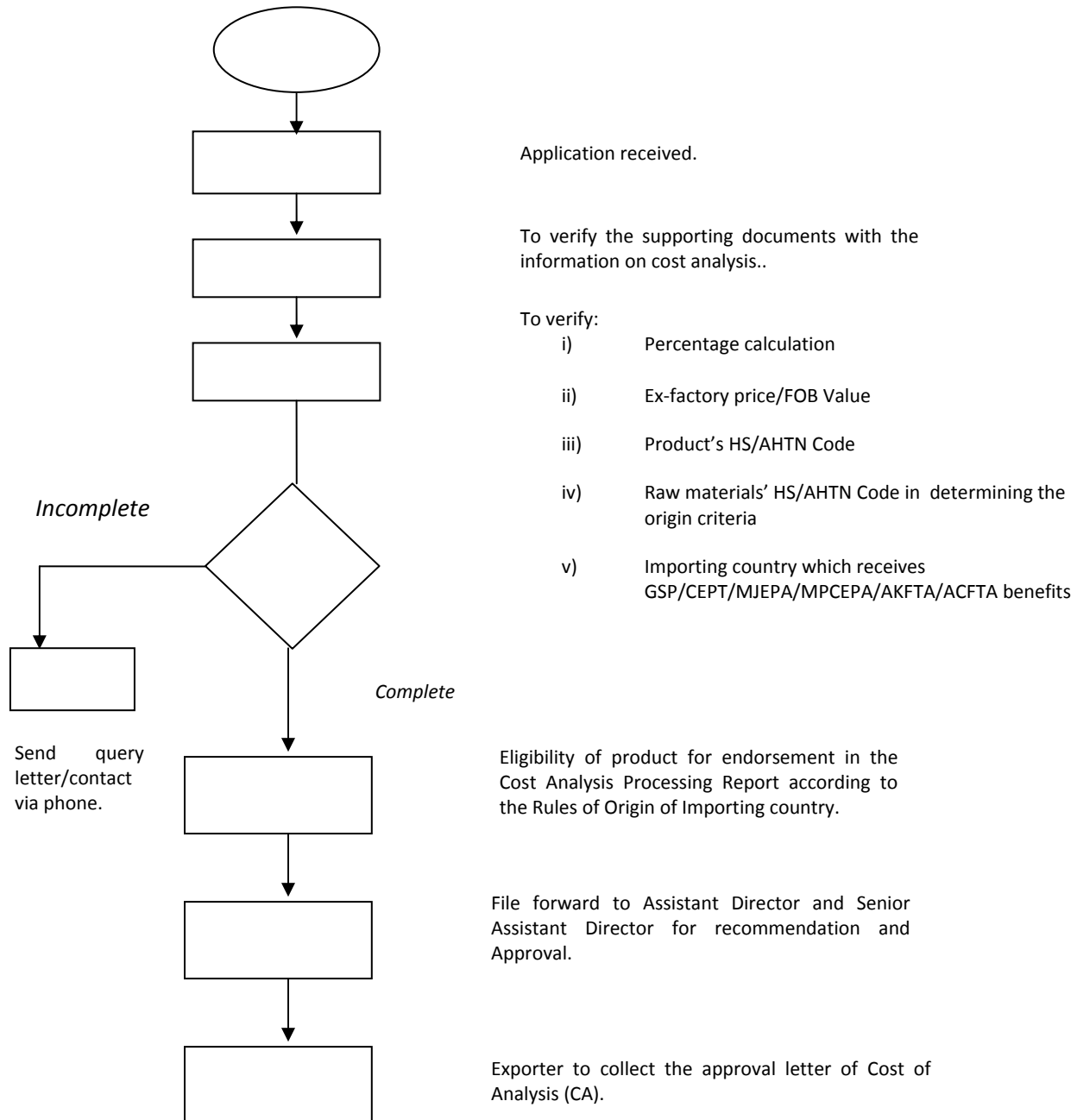
<sup>5</sup> <http://www.asianlii.org/apec>

<sup>6</sup> As per interview with Mr. Supperamaniam

Malaysia Work Flow Chart (1-2 days processing)  
Approval of GSP/CEPT/MJEPA/MPCEPA/AKFTA/ACFTA Certificate of Origin (CO)



Malaysia Work Flow Chart (7 days processing)  
Endorsement and Approval of GSP/CEPT/MPCEPA/AKFTA/ACFTA Cost Analysis (CA)



## **Summary of Findings**

Review of processes in availing of Certificate of Origin in both the Philippines and Malaysia illustrates how compliance with government rules could be costly and administratively burdensome. The process could take several days and paperwork involved could be numerous and intimidating, especially for smaller exporters. (The number of days processing provided are likely on the optimistic side. It is not difficult to surmise that processing could take longer.) The biggest problem could be the manual process of transacting with the government, wherein the exporters or brokers need to conduct business in person, thereby increasing time and cost of transactions and also increases the window of opportunity for graft and corruption. Computerization of processes is an important step to simplify the procedures and to create much more transparent and predictable institutions to implement the PTA Scheme. In ASEAN, only Singapore has a fully computerized Customs Office. As of latest interview, conducted with a Customs Official in the Philippines, the Customs Office of the Philippines is yet to automate application processes. Considering the costs, this may take a long period before realized.

Nonetheless, it is interesting to note that both countries need to set up only one set of procedural guidelines for all its FTA partners. The same competencies are required to implement. Hence, the noodle bowl of FTAs might not be as messy as some would think, at least from the point of view of ROO administration. For sure, the load of work increases with the number of partnerships and higher the use of FTA preferences. Heavier work load and more FTAs might make the system more error prone, but these mistakes are more easily questioned and verified. However, harmonization across FTAs (if not across products) would greatly simplify administration. This has bearing, not just in classifying imports and exports according to product, the FTA and ROO applicable, but in the documentation and forms and other necessary papers that accompany the process. If harmonization is not feasible, mutual recognition of certificates or required forms would also greatly simplify the procedure. This means, for example, allowing the use of back to back certificate, or allowing the interchangeable use of the different forms (Form D of ASEAN and form E, etc for the ASEAN + 1 FTAs). This does not only help to simplify procedures, but make for a more seamless use of the cumulation rule.

#### **4. Comparison of ROOs in ASEAN and ASEAN + 1 FTAs**

In addition to the ASEAN Free Trade Area, ASEAN as a whole is also engaged with various Dialogue Partners to implement or discuss free trade areas under the “ASEAN plus” framework. Agreements have been signed with China (ACFTA), Korea (AKFTA) and Japan (AJCEP).

All the three ASEAN + 1 FTAs (ACFTA, AKFTA and AJCEP) adopt the general 40 percent local/regional value added (RVA) rule, with full cumulation. They also provide for alternative rule using CTC for certain products. ACFTA is more similar to AFTA during its early stage, using mostly the single RVC rule, with some exceptions. AKFTA is the most liberal in terms of number of lines with alternative rules. For the AJCEP, the general rule is CTC, with the more frequent adoption of RVA as an optional rule. This reflects the trend towards more liberal ROO regime for Japan, whose ROOs in earlier FTAs (JSEPA, for example) tended to be relatively more restrictive. The progression for AFTA and ASEAN plus one, thus far, has been towards more flexibility (and thus less restrictiveness).

Reforms in the AFTA ROO introduced more flexibility, covering a larger number of products with alternative CTC rule. These include 424 (HS6) textile and textile products items, 2 items of preserved fish, 6 items of wool, 22 of leather goods, 14 for furskins and 4 item lines of footwear. The AKFTA appears even more liberal with even larger product coverage allowed to use CTC as an alternative rule (except for a few cases in the automotive sector where the RVA requirement is 45 percent). It even introduces the novel approach of back-to-back Certificate of Origin (CO) for re-exports of partner A into partner B of products which was first exported by partner C into A, e.g. transit exports of Singapore from another ASEAN country. (Manchin and Pelkmans-Balaoing, 2007) For the AJCEP, the general rule is CTC, with the more frequent adoption of RVA as an optional rule. This reflects the trend towards more liberal ROO regime for Japan, whose ROOs in earlier FTAs (JSEPA, for example) tended to be relatively more restrictive.

The ASEAN secretariat provides detailed information on ROO by product at the eight digit level for AFTA-CEPT and AFTA + 1. Table 2 below summarizes the frequency by ROO type for ASEAN, AKFTA, ACFTA and AJCEP. It indicates, as noted above, that AFTA is generally liberal, with the AKFTA appearing to be the most liberal, based on the more frequent use of co-equal rules (change in tariff heading-CTH or regional value content-RVC). This, however, should not be considered strict comparisons, with each agreement having its own advantages over others in terms of liberality. AFTA, for example, although having fewer (CTH or RVC) counts, have the highest number of (CTSH or RVC). CTSH is Change in Tariff Subheading, which is at 6-digit level of classification compared to CTH at four-digit level. (CC is the most restrictive, requiring a change in a higher level of commodity classification). As with AFTA, ACFTA started using ‘RVC(40) only’ for almost all lines but has made reforms in recent years to introduce more flexibility, especially in textile products. The important observation is the trend towards a more liberal ROO regime in East Asia, which bodes well for the achievement of a best-practice East Asia ROO.

Table 2. FTA by Type of ROO: AFTA, AKFTA, ACFTA &amp; AJCEP

ROO type	AFTA	AKFTA	ACFTA	AJCEP
WO	169	465	8	3
CC		61	1	1344
CTH		2		434
CTSH				8
RVC(>40)		36		
RVC(40)	146	22	4659	219
RVC(<40)		2		
CC + RVC(40)		2		1
CTH + RVC		4		
CC or RVC(40)	564	487	7	126
CTH or RVC(>40)		4		
CTH or RVC(40)	2583	4078	122	3056
CTSH or RCV(40)	689	61		33
RVC(40) or Textile Rule			427	
CC or RVC(40) or Textile Rule	300			
CTH or RVC(40) or Textile Rule	327			
Total with alternate rules	4463	4630	556	3215
NA*	446			
total	5224	5224	5224	5224

\*no available entry; no available entry; WO- wholly obtained; CC- change in commodity classification; CTH- change in tariff heading; CTSH- change in tariff subheading; RVC- regional value content

Source of basic data: ASEAN Secretariat (Courtesy of MS. Anna Robeniol)

With respect to types of products, similar variations and tendency could be gleaned. The ROOs for AFTA and ASEAN+1 FTAs are generally liberal even in the normally sensitive sectors, albeit in varying degrees. Tables 3a to 3c, for example, provide some information on the ROO for iron and steel, textile, garments, and food and agricultural products. The RVC (regional value content, also referred to in this paper as regional value added or RVA) requirement is generally 40 percent. Moreover, co-equal rules are usually allowed.

The few exceptions of RVC greater than 40 percent are for 7 tariff lines for food and agricultural products in the case of AKFTA (out of 729 in this group of commodities). AKFTA, however, has more than two thirds of the HS lines in this grouping considered wholly-obtained (at 427 HS lines), far more liberal than the rest, even compared with AFTA (at 129 HS lines). This is in stark contrast with ACFTA using almost solely the RV(40) rule, and AJCEP using mainly change in classification. See Table 3c.

For textile and textile products, AFTA and AKFTA appear less restrictive, with majority of HS lines using co-equal rules, with AFTA slightly ahead, using a lower level of classification for more products. ACFTA uses 'RVC only' for majority of lines, while Japan is most restrictive,

using just change of classification, many of which are at high level of classification (CC). See Table 3a.

For iron and steel, Japan and China tend to use more of the RVC rule of 40 percent, while AFTA and AKFTA tend to use more of the co-equal rule of ‘RVC (40) or CTC’, making the latter more liberal. See Table 3b.

In sum, the following are some key observations:

- The AFTA has a relatively simple and liberal ROO provision of AFTA, characterized by generality in application. In addition, reforms being sought lean towards more liberal rules by “expanding/easing standards.”
- The existing FTAs in East Asia (limited to those which involve only the 13 East Asian countries) are more or less consistent with AFTA ROO, with the use of 40 percent RVA. AKFTA appears to be generally the least restrictive.
- Most sensitive sectors for most countries include automotive, textile and garments sectors. In addition, various rules are applied across countries and across specific commodity classifications.
- There is increasing use of CTC as an alternative rule, being defined for specific products.
- Even Japan, with a greater tendency in the past to have restrictive ROO have become more liberal, using alternate rules for majority of cases in the recent AJCEP.
- ACFTA, on the other hand can be considered simpler, using only RVC (40) in the majority of cases. However, the lack of alternative rule could be constraining. Reforms are being made to accommodate greater flexibility with more alternate rules being developed.
- However, in general, there is a trend towards progressively more liberal ROO regime in East Asia.



**Table 3a. ROO frequency by type: Textile and Textile Products  
Chapters 50-60**

<b>CEPT PSR for 2007 ROO</b>	<b>HS lines</b>
RVC(40) or CC	26
RVC(40) or CC or Textile Rule	83
RVC(40) or Textile Rule or CC	44
RVC(40) or CC or Textile Process Rule	30
RVC(40) or CTH (GR)	2
RVC(40) or Textile Rule or CTH	324
no entries (i.e.#N/A)	45
<b>Grand Total</b>	<b>554</b>
<b>AKFTA</b>	<b>HS lines</b>
CC or RVC(40)	209
CTH with exceptions for certain tariff headings	8
CTH or Printing or dyeing accompanied by at least two preparatory or finishing operations or RVC(40)	18
CTH or RVC(40)	93
CTH or RVC(40) (GR)	226
<b>Grand Total</b>	<b>554</b>
<b>ACFTA</b>	<b>HS lines</b>
Obtained from sheep, lambs or other animals raised in ACFTA	6
RVC(40) or Textile Rule	135
RVC(40)(GR)	413
<b>Grand Total</b>	<b>554</b>
<b>AJCEP (Nov 07)</b>	<b>HS lines</b>
CC	71
CC, with exceptions for certain tariff headings	120
CC, with specific conditions	60
CTH	4
CTH, with exceptions for certain tariff headings	6
CTH, outside specified subheadings & with specific conditions	290
CTH, with specific conditions	3
<b>Grand Total</b>	<b>554</b>

Source of basic data: ASEAN Secretariat, courtesy of Ms. Anna Robeniol

**Table 3b. ROO frequency by type: Iron and Steel  
Chapters 72-73**

<b>CEPT PSR for 2007 ROO</b>	<b>HS lines</b>
RVC(40)	50
RVC(40) or CC	32
RVC(40) or CC with exceptions for certain tariff headings	66
RVC(40) or CTH (GR)	83
RVC(40) or CTH with exceptions for certain tariff headings	42
RVC(40) or CTSH	6
no entries (i.e.#N/A)	13
<b>Grand Total</b>	<b>292</b>
<b>AKFTA</b>	<b>HS lines</b>
CTH except from 72.19	2
CTH or RVC(40) (GR)	290
<b>Grand Total</b>	<b>292</b>
<b>ACFTA</b>	<b>HS lines</b>
CTH or RVC(40)	9
RVC(40)(GR)	283
<b>Grand Total</b>	<b>292</b>
<b>AJCEP (Nov 07)</b>	<b>HS lines</b>
RVC(40)	158
RVC(40) or CC	123
RVC(40) or CC with exceptions for certain tariff headings	3
RVC(40) or CTH (GR)	7
RVC(40) or CTH with exceptions for certain tariff headings	1
<b>Grand Total</b>	<b>292</b>
Source of basic data: ASEAN Secretariat, courtesy of MS. Anna Robeniol	

**Table 3c. Food and Agri Products: Chapters 1-24**

<b>CEPT PSR for 2007 ROO</b>		<b>HS lines</b>
RVC(40)		3
RVC(40) or CC		268
RVC(40) or CC or no CTC is required, provided that the good is produced by refining		32
RVC(40) or CTH (GR)		199
RVC(40) or CTSH		50
WO		129
no entries (i.e.#N/A)		48
<b>Grand Total</b>		<b>729</b>
<b>AKFTA</b>		<b>HS lines</b>
CC		2
CC + RVC(40)		2
CC or RVC(40)		30
CC, with exceptions for certain chapters, tariff headings		13
CTH + RVC(60)		1
CTH or RVC(40) (GR)		175
CTH, with exceptions for certain chapters, tariff headings		15
CTH, in conditions that the de minimis rule shall not be applied to a non-originating material		1
CTH, provided that materials from Chapters 7 & 9 are WO from any AKFTA Party; or RVC(40), provided that materials from Chapters 7 & 9 are WO from any AKFTA Party		1
RVC(35)		2
RVC(40)		17
RVC(40), with exceptions for certain tariff headings, subheadings		4
RVC(45)		4
RVC(60), provided that materials from Chapters 1, 2 & 5 are WO from AKFTA Party		2
RVC(70)		1
WO		427
WO from any AKFTA Party		26
WO from any AKFTA Party or RVC(45)		6
<b>Grand Total</b>		<b>729</b>
<b>ACFTA</b>		<b>HS lines</b>
CC		1
CC or RVC(40)		7
Manufactured from fats or oil wholly obtained in the ACFTA		1
RVC(40)(GR)		720
<b>Grand Total</b>		<b>729</b>
<b>AJCEP (Nov 07)</b>		<b>HS lines</b>
CTH and RVC(40) for Imitation sake and White sake;		1
CC		536
CC with exceptions for certain chapters, tariff headings		130
CTH		40
CTSH		8
RVC(40)		7
RVC(40) or CTH except heading 22.07		7
<b>Grand Total</b>		<b>729</b>

Source of basic data: ASEAN Secretariat, courtesy of Ms. Anna Robeniol

## 5. Cost of Compliance and Utilization Rates: Some Findings

It is well recognized that complying with ROOs would cost: both on the part of administration, and more so in terms of compliance efforts by the intended beneficiaries. The immediate impact of this would be on the utilization rate of the FTA.

Various studies have attempted to estimate the cost of ROO compliance. Manchin (2006) estimates the cost to be around 5 percent and Cadot *et al* (2005) to be around 6-8 percent for EU schemes. For NAFTA, Carrère and de Melo (2004) estimate the cost of ROO to be around 6 percent of the value of goods traded. Manchin and Pelkmans-Balaoing (2007), using a gravity model, find that for the preferential trade to positively influence trade flows within ASEAN, the margin of preference should be higher than 25 percent, suggesting an equivalent cost of ROO administration and compliance much higher than estimates for EU and NAFTA.

In an ongoing ERIA study by Hayakawa et al, their survey of Japanese affiliated firms in ASEAN shows the threshold rate in preferential tariff margin where exporters would consider using FTA to be around 5.2 percent. (See Table 4.) Though not a direct measure, this is an indication of the perceived ROO cost of compliance by exporters surveyed. Most likely, the perceived threshold reported is an underestimate (as this reflects only potential use of FTA, and thus, would tend to be optimistic). Nonetheless, this indicates a much lower ROO cost estimate than that indicated by the Manchin-Pelkmans-Balaoing gravity model, closer to the estimates for EU and NAFTA. In any case, reducing the ROO compliance cost to within 5 percent should be the target for reforms.

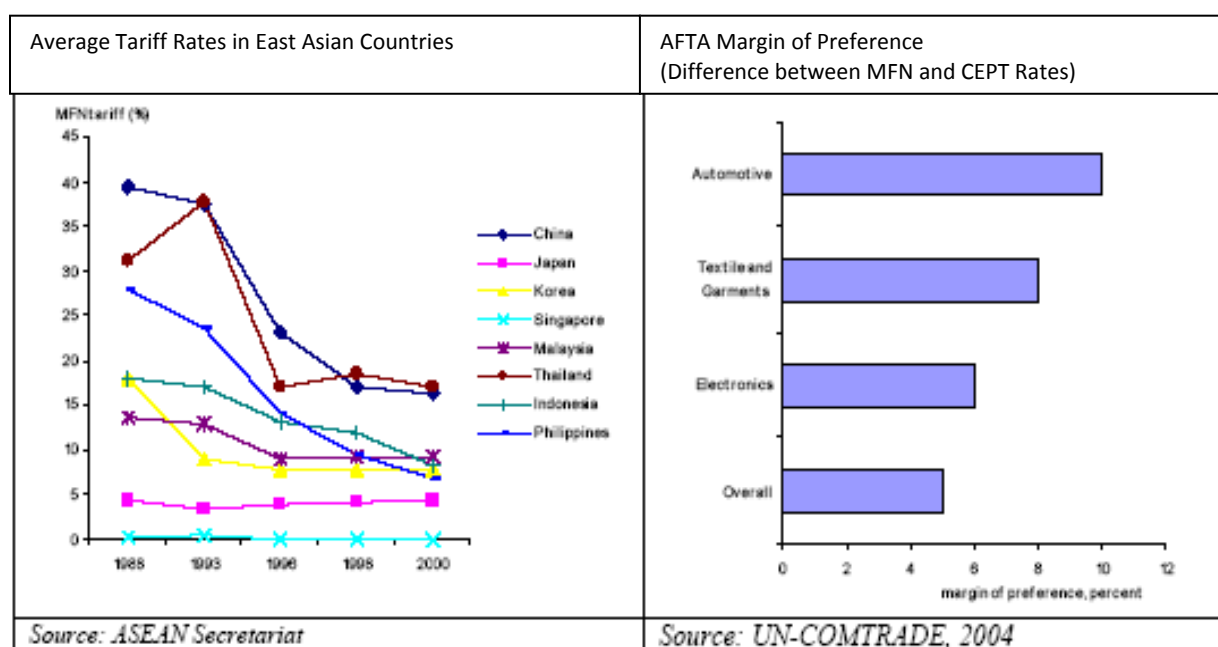
Table 4. Preferential tariff margin needed to consider use of FTA: Survey of Japanese-affiliated firms (Exporting)

Margin	ASEAN	Thailand	Indonesia	Malaysia	Philippines	Vietnam
<1%	6.8	7.2	10.6	5.1	2.8	0
1-3%	14.7	17.1	15.3	12.8	13.9	11.5
3-5%	28.9	23.7	40.9	25.6	38.9	23.1
5-7%	28.6	28.9	22.7	43.6	16.7	34.6
7-9%	2.7	3.9	4.5	0	0	0
9-10%	4.7	6.6	1.5	2.6	5.6	7.7
>10%	13.6	13.2	4.5	10.3	22.2	23.1
Average	5.2	5.3	4.3	5.2	5.6	6.3
Respondents #	339	152	66	39	36	26

Source: Table 7, Hayakawa, Hiratsuka, Shiino, & Sukegawa. "Maximizing Benefits from FTAs in ASEAN", *Forthcoming ERIA paper*

The immediate impact of the ROO compliance costs is on the FTA utilization rate. This, of course, is not an indicator of the magnitude of benefits derived from the FTA, since many factors are not captured, e. g. actual trade creation, or even just trade flows. Nonetheless, low utilization rates indicate shortcomings in the design of the ROOs which bring up the costs of availing the preferences from the FTA.

JETRO (2004) Report on ASEAN's FTAs and Rules of Origin finds some improvement in the share of CEPT exports. The share of CEPT exports to total ASEAN exports more than doubled from 10.8 percent in 2002 to 22.5 percent in 2003. This likely indicates CEPT preference is more utilized and that reforms undertaken have had a positive impact.



Source: Kirk, 2007

There are, of course, other important reasons for the low utilization of AFTA. Among them is the low margin of preference. The graph shows AFTA's low margin of preference, falling below 5 per cent for most ASEAN countries and overall margin of preference barely making it to the 5 percent threshold, except for some distinctive products as automobiles and textiles and garments, among the more notable ones. Among the middle income countries in ASEAN, only Thailand (9.74%) has a relatively high margin of preference, attributable to the still high average MFN rates.

Nonetheless, a restrictive ROO is undoubtedly an important factor in the level of utilization of FTA. Indeed, reforms instituted in AFTA since 2002 have been designed to liberalize and simply the ROO and recent surveys have shown improvements in the AFTA CEPT utilization. The estimates are generally higher than previous JETRO reports (and certainly much higher than the Baldwin estimate of around 3 percent), indicating that the reforms mattered.

Table 5 shows a summary of the results of a recent survey done by Hayakawa et al (in an ongoing study for ERIA) covering Japanese affiliated exporting companies located in ASEAN. Except for Singapore with numerous FTA partners (and possibly Thailand), the applicable FTA is generally the AFTA. Hence, this would be a good indicator of the trend in utilization of AFTA-CEPT. For the whole of ASEAN, the number of Japanese companies (and affiliates) using FTA have risen, with more than 23 percent availing of FTA preferences in 2008.

**Table 5. Use of FTA by Japanese Affiliated Exporting companies**

	2006	2007	2008
ASEAN	19.7	19.3	23.0
Indonesia	18.5	14.7	35.9
Singapore	32.5	27.3	43.2
Thailand	18.2	18.8	22.5
Philippines	15.2	15.7	11.8
Vietnam	6.6	14.3	9.4
Malaysia	26.8	23.00	23.8

Source: Hayakawa et al, Maximizing Benefits from FTAs in ASEAN, forthcoming ERIA paper

The trend for Malaysia is going down but it still maintains higher than average utilization rate. The Philippine utilization rate dropped in 2008, which maybe just part of a business cycle. Additional information on the Philippines is available on CO issued. It shows that the use of CO (and hence AFTA- ROO) is not insignificant at 17 percent of total COs.

**Table 6. Use of Certificates of Origin in Port of Manila, 2007**

Certificates of Origin	Entries	% of Total
GSP Form A	21,443	28.4
CEPT Form D	12,828	17.0
General CO (white)	40,659	53.9
ACFTA	507	0.7
<b>Total</b>	<b>75,437</b>	<b>100.0</b>
<i>Source: Export Division, Port of Manila, BOC</i>		

## 6. Suggested Recommendations

Reforms to minimize costs could come from two sources- reforms in the ROOs itself in the form of simplification and easing of standards, and reforms in the administrative procedures, particularly the certification process.

### *On ROOs: simplification and liberalization*

There is a consensus that more simple and liberal ROO would greatly reduce the cost of ROOs and maximize benefits from the FTAs. For one, it would mitigate trade diversion costs of FTAs. More directly, this would reduce the cost of doing business involving FTAs. Simpler ROO will help promote regional trade and international competitiveness of member states. Simple rules will reduce compliance costs and administration.

In general and in theory, this means using a single, least restrictive rule. But in practice using co-equal rules would be more practical. The flexibility it provides would have a liberalizing as well as cost-reduction impact for exporters.

In this regard, the use of CTC as an alternative (co-equal) method to the VA rule would help. The CTC method is easy for Customs authorities to implement. At the same time, SMEs might also find it easier to comply with, simply needing to show import and export invoices with different classification code. The question is determining the level of disaggregation the member countries would deem to satisfy “substantial” transformation, which would vary across commodities. Here, protectionist tendencies would surface and agreements (especially between developed and developing countries) might be difficult. Nonetheless, the general rule should lean towards less restrictiveness. This implies using a common rule across products, possibly at a 4 to 6-digit level, and if any, with very limited product-specific exemptions.

Indeed, this is among the most significant reforms undertaken in ASEAN ROO. At the start, it used the single cumulated value-added rule of 40 percent. Reforms introduced CTC as a substitute criterion. An increasing number of products are now being covered to apply CTC as alternative criteria to the VA rule, some even with three co-equal rules.

Another reform measure that should be considered pertains to *de minimis* rules (which allow for a specified maximum percentage of non-originating materials to be used without affecting origin). While the use of *de minimis principle* appears to become a common feature in newer partnership agreements, upon closer examination, application is usually on a product specific (PSR) basis. A wider application of *de minimis* rule using generous ceiling would be a major step to simplifying ROO and lowering the cost of compliance.

ROO provision for cumulation would be another key recommendation. Full cumulation is an important factor allowing for the development of regional production networks. This provides for deeper integration and allows for more advanced countries to outsource labor-intensive production stages to low-wage partners and make it easier for regionally-based firms to exploit the economies of scale. (Brenton 2003) In addition, cumulation provisions would address

problems of protectionist tendency in the ROO and investment (and trade) diversion effects, at least within the wider grouping of member countries.

Aside from cumulation, roll-up or absorption principle, which allows materials that have acquired origin by meeting specific processing requirements to be considered an originating good when used as input in a subsequent transformation, could also be recommended for a more liberal ROO approach.

For its part, ASEAN is developing a “partial” cumulation approach. The practice in ASEAN is to count “components as part of ASEAN content which themselves have ASEAN content of 40 percent or more.” Upon recommendation during the September 2004 AFTA Council Meeting, the percentage content requirement was reduced to 20 percent of ASEAN content.

Customs clearance is still a problem in most of the less developed countries of East Asia. A complex ROO regime accompanying a free trade agreement can further complicate rather than facilitate trade in the region. Along with harmonization of ROO standards, there is even greater need for the streamlining of customs procedures and simplification of customs clearances including the introduction of paperless trading in many FTAs. The objective is to minimize documentation costs. Harmonization of customs procedures in general would be a big step in this direction. Related to this is the harmonization of commodity classification regionwide. ASEAN has developed a Harmonized System at a 6-digit level. Work should be done to come up with a harmonized system for all of East Asia.

Another practical option is for the countries to work towards becoming a signatory to the Kyoto Convention. This however could be costly for developing countries, most of which are unable to comply with the requirements.

#### *Developing country Dimension*

Developing countries need to be able to latch on to the GPN. This means gearing the ROO regime towards the preparation, development, and internationalization of SMEs. The ideal ROO therefore should have a developing country dimension. What would this entail? Needless to say, capacity building is crucial, for exporters, importers and administrators in developing countries, if the region is to achieve the best practice in the rules of origin. Developments in the EC for development-friendly ROO includes a single value-added method, use of statement of origin by registered exporters, and training and technical assistance to improve evaluation, information flows and monitoring of compliance. A key element is allowing alternative means of proving origin more suited to the development stage of the developing country member.

A logical concession to developing member countries is to lower the VA criteria for its exporters. Findings for the EU shows that a decline in the value-added threshold would tend to increase utilization rates. This could be a most useful incentive for CMLV countries.<sup>7</sup> This will also mitigate the implicit bias of the VA rule against low-wage countries.

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<sup>7</sup> The value-added requirement should be based on whether the potential gains in terms of greater regional trade significantly outweigh the risks of trade deflection. Kirk (2007) suggests 30% value-added requirement would be sufficient to prevent significant trade deflection.



*On administrative procedures: certification and verification*

The need to work more closely to refine customs rules and administrative procedures should be a priority in trade facilitation in ASEAN. More particularly, since ASEAN uses the RVC rule, it is important to come up with a standardized method of calculating value by creating more specific set of principles for calculating both local and foreign inputs. Guidelines for costing methodologies should factor in price and exchange rate fluctuations as they can change the input costs over time. (USAID/Nathan Associates, 2006)

Furthermore, efforts should be extended to assist the exporters in calculating inputs arising from different FTA and non-FTA sources. This could be a very tedious task, especially for SMEs, and the sheer task of additional record-keeping and tracing of materials could increase costs and result to reluctance to claim preferential treatment. It would be helpful if Customs offices would have a special desk or a task force that will help exporters.

Another possibility that was suggested in the discussion is the use of some form of ‘mutual recognition of papers and documentation across overlapping FTAs. As previously noted, this could include, for example, allowing the use of back to back certificate, or allowing the interchangeable use of the different forms (Form D of ASEAN and form E, etc for the ASEAN + 1 FTAs). This would not only help to simplify procedures, but make for a more seamless use of the cumulation rule.

Another option is self certification. This could serve the dual purpose of decreasing the workload of the Customs office and also develop the expertise of the private sector in understanding ROO technicalities and administrative procedures.

Self certification can take two forms. The first is a hybrid approach which would allow self certification by accrediting industry associations or individuals to certify if the good is qualified for preferential treatment. The second is full self certification, where the exporter can certify origin in his individual capacity and responsibility.

These are radical moves, especially for ASEAN. Nonetheless, it is not completely unrealistic to offer exporters different options. There are ways to minimize abuse. This is especially true for the hybrid approach, which is currently used by the EU (with partnership with EFTA, Mexico, Chile) and EFTA partnerships with the same countries. The government (or its designated agency) authorizes exporters (industry associations, for example). The government agency would establish procedures for accreditation, where exporters/associations could apply. The main responsibility of the certifying body is to be able to address verification issues.

The key is to institute procedures that would keep exporters (importers) honest. This could be done through clear ROO provisions on verification.

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The verification process should be improved and should not serve as a disincentive to the exporters. One way to do this is to minimize direct interaction between Customs officers and exporters in post-audit checks. ASEAN should work on creating a system of automated verification process that would lessen dealings between the Customs and exporters. Manual or face-to-face verification processes such as onsite inspection is not only administratively and financially burdensome, but could also be intimidating for some exporters. As much as possible, onsite inspections should be a “last resort” procedure. Clear guidelines should be set in cases and circumstances where exporters would be subjected to post-audit checks, and this information should be made easily available to exporters. In this regard, setting up a database system that would have necessary and relevant information and documentation (which could be made secure) would be facilitative (and reduce face-to-face confrontation between government officials and private sector). It would also be helpful if the private sector is involved in the post-audit check instead of leaving the task solely in the hands of one agency, in this case, the Customs office.

In sum, the discussion above suggests the following general guidelines in crafting best practice ROOs.

1. The AFTA ROO is considered relatively simple and liberal. The generality in application is a plus factor. In addition, reforms being sought lean towards more liberal rules by attempts toward “expanding/easing standards.” (Needless to say, a lot more can be done to improve the system.)
2. Rules toward adopting full cumulation, and roll-up (absorption) process should be further developed and adopted.
3. The *de minimis* provision should be applied more extensively. This could yield significant impetus for deeper regional integration.
4. Another key measure that should be explored is self-certification. This could contribute substantially to simplification and cost reduction. This should be balanced by some monitoring system (and least burdensome verification process) that would keep importers honest.
5. Applying restrictive ROOs targeted at sensitive products is not an effective mechanism for protecting domestic industry and should be limited.
6. Special and Differential Treatment: ROO be devised by taking into account the different levels of development of countries in the East Asia region, e. g. using lower Value Added content
7. Another challenge is to craft a system of ROO that would be SME friendly. One aspect of this is capability building to enable SMEs to comply with ROO requirement. Modules and templates for value-added accounting, could probably be developed over time for SMEs to use.

8. There is a need for greater harmonization of customs procedures for the benefits from ROO reforms to be maximized. In particular, the region should work towards a Harmonized System of Customs Classification.
9. Finally, the formulation of the ROOs should have both simplification and liberalization elements. At the same time, however, there should be adequate provisions that would control for potential abuse.

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