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978-1-107-47244-0 - Rules of Origin in Asean: A Way Forward

Stefano Inama and Edmund W. Sim

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## RULES OF ORIGIN IN ASEAN

*Rules of Origin in ASEAN* is the first in-depth exploration of the complex rules of origin in ASEAN's trade agreements. Written by two leading practitioners, it explains with clarity the existing ASEAN Rules of Origin (RoO) practices and their administration regimes in a comparative context and provides a recommendation for reform. The ASEAN RoOs can be simplified by imparting transparency and predictability to the legal drafting, focusing on a calculation method based on value of materials and lowering the regional value content required to qualify as ASEAN origin. The administration of ASEAN RoOs can be improved by expanding the use of self-certification, moving away from document-based verification to more modern post-entry audit and trade facilitation approaches. This is a timely and important topic that will be insightful to practitioners, policymakers and businesses in understanding how commerce and trade are conducted in Southeast Asia.

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The views expressed are those of this author and do not necessarily reflect the views of UNCTAD or any other UN institutions or agencies.

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## INTEGRATION THROUGH LAW

The Role of Law and the Rule of Law in ASEAN Integration

*General Editors*

J. H. H. Weiler, European University Institute

Tan Hsien-Li, National University of Singapore

Michael Ewing-Chow, National University of Singapore

The Association of Southeast Asian Nations (ASEAN), comprising the ten member states of Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam, has undertaken intensified integration into the ASEAN Community through the Rule of Law and Institutions in its 2007 Charter. This innovative book series evaluates the community-building processes of ASEAN to date and offers a conceptual and policy toolkit for broader Asian thinking and planning of different legal and institutional models of economic and political regional integration in the region. Participating scholars have been divided up into six separate thematic strands. The books combine a mix of Asian and Western scholars.

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#### GENERAL EDITORS' PREFACE

This monograph is published within the context of a wide-ranging research project entitled, *Integration Through Law: The Role of Law and the Rule of Law in ASEAN Integration (ITL)*, undertaken by the Centre for International Law at the National University of Singapore and directed by J. H. H. Weiler, Michael Ewing-Chow and Tan Hsien-Li.

The Preamble to the ASEAN Charter concludes with a single decision: "We, the Peoples of the Member States of the Association of Southeast Asian Nations . . . [h]ereby decide to establish, through this Charter, the legal and institutional framework for ASEAN." For the first time in its history of over four decades, the Legal and the Institutional were brought to the forefront of ASEAN discourse.

The gravitas of the medium, a Charter: the substantive ambition of its content, the creation of three interlocking Communities, and the turn to law and institutions as instruments for realization provide ample justification for this wide-ranging project, to which this monograph is one contribution, examining ASEAN in a comparative context.

That same substantive and, indeed, political ambition means that any single study, illuminating as it may be, will cover but a fraction of the phenomena. Our *modus operandi* in this project was to create teams of researchers from Asia and elsewhere who would contribute individual monographs within an overall framework which we had designed. The

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project framework, involving several thematic clusters within each monograph, is thus determined by the framework and the place of each monograph within it.

As regards the specific content, however, the authors were free, indeed encouraged, to define their own understanding of the problem and their own methodology and reach their own conclusions. The thematic structure of the entire project may be found at the end of this Preface.

The project as a whole, and each monograph within it, display several methodological sensibilities.

First, law, in our view, can only be understood and evaluated when situated in its political and economic context. Thus, the first studies in the overall project design are intended to provide the political, economic, cultural and historical context against which one must understand ASEAN and are written by specialists in these respective disciplines. This context, to a greater or lesser degree, also informs the sensibility of each monograph. There are no “black letter law” studies to be found in this project and, indeed, even in the most technical of areas we encouraged our authors to make their writing accessible to readers of diverse disciplines.

Comparative experience suggests that the success of achieving some of the more ambitious objectives outlined in Article 1 of the Charter will depend in no small measure on the effectiveness of legal principles, legal rules and legal institutions. This is particularly true as regards the success of establishing “an ASEAN Community comprising the ASEAN Security Community, the ASEAN Economic Community and the ASEAN Socio-Cultural Community as provided for in the Bali Declaration of ASEAN Concord II”. Article 2(2)(n)

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stipulates the commitment of ASEAN Member States to act in accordance with the principle of “adherence to multilateral trade rules and ASEAN’s rules-based regimes for effective implementation of economic commitments and progressive reduction towards elimination of all barriers to regional economic integration.” The ASEAN Member States therefore envisage that rules of law and the Rule of Law will become a major feature in the future of ASEAN.

Although, as seen, the Charter understands itself as providing an institutional and legal framework for ASEAN, the question of the “role of law and the rule of law” is not advocacy but a genuine enquiry in the various substantive areas of the project as to:

- the substantive legal principles and substantive rules of the various ASEAN communities;
- the procedural legal principles and rules governing institutional structures and decision-making processes;
- implementation, enforcement and dispute settlement.

One should not expect a mechanical application of this scheme in each study; rather, a sensibility that refuses to content itself with legal enactments as such and looks to a “living” notion of law and institutions is ubiquitous in all the studies. Likewise, the project is sensitive to “non Law.” It variously attempts to locate the appropriate province of the law in this experience. That is, not only the role of law, but also the areas that are and should remain outside the reach of legal institutionalization with due sensitivity to ASEAN and Asian particularism and political and cultural identities.

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The project, and the monographs of which it is made, are not normatively thick. They do not advocate. They are designed, for the most part, to offer reflection, discuss the pros and cons, and in this way enrich public awareness, deepen understanding of different options and in that respect contribute indirectly to policymaking.

This decisive development of ASEAN has been accompanied by a growing Asian interest in various legal and institutional forms of transnational economic and political cooperation, notably the various voices discussing and showing an interest in an East Asia Integration project. The number of Free Trade Agreements (FTAs) and Regional Trade Agreements (RTAs) has increased from six in 1991 to 166 in 2013, with a further 62 in various stages of negotiations.

Methodologically, the project and many of the monographs are comparative in their orientation. Comparative law is one of the few real-life laboratories that we have in which to assess and understand the operation of different legal and institutional models designed to tackle similar objectives and problems. One should not need to put one's own hand in the fire to learn that it scorches. With that in mind a couple of monographs offer both conceptual reflection and pragmatic "tool boxing" on some of the key elements featuring in all regional integration systems.

Comparative law is in part about divergence: it is a potent tool and means to understand one's own uniqueness. One understands better the uniqueness of Apples by comparing them to Oranges. You understand better the specialness of a Toyota by comparing it to a Ford.

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Comparative law is also about convergence: it is a potent tool and means to understand how what are seemingly different phenomena are part of a broader trend, an insight which may enhance both self-understanding and policy potentialities.

Although many studies in the project could have almost immediate policy implications, as would the project as a whole, this is not its only or even principal purpose. There is a rich theory of federalism which covers many countries around the world. There is an equally rich theory of European integration, which has been associated with the advent Union. There is also considerable learning on Free Trade Areas and the like.

To date, the study of the legal aspects of ASEAN specifically and other forms of Asian legal integration has been derivative of, and dependent on, theoretical and conceptual insight which were developed in different contexts.

One principal objective of ITL and these monographs will be to put in place the building blocks for an authentic body of ASEAN and Asian integration theory developed in, and with sensitivity to, the particularities and peculiarities of the region and continent. A theory and conceptual framework of Asian legal integration will signal the coming of age of research of and in the region itself.

Although the monographs form part of an overarching project, we asked our authors to write each as a “stand-alone” – not assuming that their readers would have consulted any of the other titles. Indeed, the project is rich and few will read all monographs. We encourage readers to pick and choose from the various monographs and design their own

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menu. There is, on occasion, some overlap in providing, for example, background information on ASEAN in different studies. That is not only inevitable but desirable in a project of this amplitude.

The world is increasingly witnessing a phenomenon of interlocking regional organization where the experience of one feeds on the others. In some way, the intellectual, disciplinary and comparative sensibility of this project is a microcosm of the world it describes.

The range of topics covered in this series comprises:

The General Architecture and Aspirations of ASEAN

The Governance and Management of ASEAN: Instruments,  
Institutions, Monitoring, Compliance and Dispute Resolution

Legal Regimes in ASEAN

The ASEAN Economic Community

ASEAN and the World

The Substantive Law of ASEAN

P R E F A C E

The rules of origin (RoOs) constitute a fundamental foundation for any preferential trade agreement (PTA) involving trade in goods. RoOs are similar to nationality and citizenship rules for natural persons in a nation-state, in that both sets of rules establish the rights and privileges applicable to qualifying persons or goods. Nationality and citizenship rules determine who may enjoy the benefits of citizenship, such as freedom of movement, permanent residency and the like. Similarly, RoOs determine the applicable duty rate and other treatment for goods in the PTA.

RoOs generally fall into three types:

- a. RoOs based on the “wholly originating” principle apply to goods which are naturally occurring (such as minerals) or grown/harvested (such as agricultural products). Human involvement in the production of such goods is limited to extracting, cultivating and/or harvesting the goods. In such circumstances, the country of origin is where the extraction, cultivation or harvest has taken place, i.e., the product “wholly originates” in that country.
- b. RoOs based on qualitative analysis examine the extent to which a good has been further processed into another good, with an emphasis on the processing that has taken place in that country. In the “substantial transformation” standard, the relevant authorities examine the nature of the



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processing and whether the product has been fundamentally changed into another product. Another approach is the “change in tariff classification,” which examines whether the initial product and the processed products are classified differently under the Harmonized Tariff Schedule (HTS); sufficient deviation in HTS classification confers origin under this type of RoO. Finally, there are special product-specific RoOs that provide for specific processes as conferring origin on the product; these product-specific rules are commonly used for textiles.

- c. RoOs based on quantitative analysis examine the value added by the processing in the country. This approach is known as “regional value content,” under which the relevant authorities examine the value of the goods input into the production process, labor, overheads, and other costs. If after processing the resulting product meets a specified criterion, that product will satisfy the RoO.

The authors note that these are broad generalizations and that some RoOs may involve both qualitative and quantitative criteria. However, maintaining a broad view will guide readers as they parse our specific, critical approach to the RoOs used in ASEAN. Wholly originating goods usually do not cause controversy in the operation of PTAs, except where they are wrongly used for non-natural products (e.g., for products which are not extracted, cultivated or harvested) or where the products may be mobile (e.g., fish swimming across maritime boundaries). Qualitative RoOs have their own complications, as the “substantial transformation” standard tends to be very product specific and difficult to administer consistently,

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and the “change in tariff classification” approach is heavily dependent on a customs classification system that was not developed for determining origin. Quantitative RoOs require that manufacturers maintain detailed accounting and financial records, which may be difficult for small and medium-sized enterprises (SMEs).

Taken in this context, the ASEAN RoOs, originating in the ASEAN Preferential Trade Agreement (APTA), developed in the ASEAN Free Trade Area (AFTA) agreement and purportedly refined in the ASEAN Trade in Goods Agreement (ATIGA), have created a relatively muddled and confused trading situation in trade in goods within the ASEAN Economic Community (AEC).

The poor definition of ASEAN RoOs dates back to the APTA and AFTA. The APTA and AFTA generally applied quantitative RoOs that conferred origin on products which met a specified regional value content (RVC) of ASEAN-related inputs. The RVC rules were not clearly articulated or administered, resulting in much confusion, particularly among ASEAN SMEs, which do not have the capability to comply with the accounting and financial requirements of the RVC approach. Nor did ASEAN customs authorities have sufficient training to administer the RVC approach consistently, with ASEAN customs authorities and practitioners having to fill out the details through trial and error, often to the detriment of the business sector. As a result, use of the APTA and AFTA trade preferences was relatively limited, with only those industries with sufficient institutional resources and regionalization (e.g., the Japanese automobile industry) making full use of the RoOs.

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Continued underutilization of the ASEAN trade preferences led to further tinkering with RoOs by ASEAN authorities, such as the introduction of product-specific RoOs as well as the alternative rule of change in tariff classification, a qualitative approach. Yet despite these revisions, implemented in their latest form in the ATIGA, the ASEAN RoOs remain relatively ill-defined and difficult to administer, and utilization rates of the ASEAN trade preferences also remain relatively low.

Further compounding the confusion have been the inconsistent RoOs used in ASEAN's FTAs with its main dialogue partners of Australia-New Zealand, China, India, Japan and Korea. Not only are the RoOs for the ASEAN FTAs mutually inconsistent, but they are inconsistent with the RoOs currently applied by the ATIGA.

The poor administration of ASEAN RoOs also has been a persistent problem. Despite repeated attempts to ease administrative burdens on importers and exporters, and thereby expand use of the ASEAN trade preferences, ASEAN customs authorities remain wedded to the verification and authentication of Form D certificate of origin (CO) documents rather than using modern trade facilitation approaches that would focus on the data contained in those documents instead of the documents themselves.

This book surveys all of these problems in the context of the APTA, AFTA, ATIGA and ASEAN FTAs. After surveying both the ASEAN RoOs and their administration, the authors recommend that ASEAN leaders reform both.

The RoOs in the ATIGA and ASEAN FTAs can be simplified by focusing on (1) an overall improvement of the

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legal texts in terms of transparency and predictability; (2) applying a percentage criterion based on value of materials; (3) lowering the RVC required to qualify as ASEAN origin; and (4) clarifying the text of product-specific rules of origin (PSROs).

The administration of ASEAN RoOs can be improved by (1) expanding the use of self-certification; (2) moving away from document-based verification; and (3) shifting to modern post-entry audit and trade facilitation approaches.

By imposing greater clarity in the RoOs and their administration, ASEAN authorities can encourage the use of the ASEAN trade preferences by all segments of the business community, including the SMEs. This reform should take place in conjunction with Regional Comprehensive Economic Partnership talks taking place among ASEAN and its FTA partners to harmonize the terms of its FTAs. Only with more effective and simplified RoOs can all sectors participate in the AEC and enjoy its benefits.

ABBREVIATIONS

AANZFTA	ASEAN–Australia–New Zealand Free Trade Agreement
ACFTA	ASEAN–China Free Trade Agreement
AEC	ASEAN Economic Community
AFTA	ASEAN Free Trade Area
AICO	ASEAN Industrial Cooperation
APTA	ASEAN Preferential Trade Agreement
ASEC	ASEAN Secretariat
ASEAN	Association of Southeast Asian Nations
ATIGA	ASEAN Trade in Goods Agreement
BOI	Binding Origin Information
CCCA	The Coordinating Committee on the Implementation of the CEPT Scheme for AFTA
CIF	Cost Insurance Freight (INCOTERMS)
CEPT	Common Effective Preferential Tariff
CO	Certificate of Origin
CTC	Change in Tariff Chapter
CTH	Change in Chapter
CTSH	Change in Tariff Sub-heading
FOB	Free-On-Board (INCOTERMS)
FTA	Free Trade Agreement
GSP	Generalized System of Preferences
HLTF	High Level Task Force on Economic Integration

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ABBREVIATIONS

HS	Harmonized System
HTF	Harmonized Tariff Schedule
ITA	Information Technology Agreement
MFN	Most Favored Nation
MS	Member States
NAFTA	North American Free Trade Agreement
OCP	Operational Certification Procedures
PSRO	Product-Specific Rule of Origin
PTA	Preferential Trade Agreement
RoO	Rule of Origin
ROOTF	Rules of Origin Task Force
RVC	Regional value content
SCAROO	ASEAN Sub-committee on Rules of Origin
SEOM	Senior Economic Officials Meeting
SME	small and medium-sized enterprise
TOR	Terms of Reference
UNCTAD	United Nations Conference on Trade and Development
WTO	World Trade Organization