

## Facilitating ASEAN Trade in Goods\*

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### Key Issues:

- Trade facilitation should be viewed as a strategic issue rather than a technical one
- ASEAN's trade facilitation must focus on rules of origin (ROO), NTM (non-tariff measure) transparency, and NTM streamlining

This brief presents three recommendations to move the trade facilitation agenda forward in ASEAN. These focus on rules of origin, transparency of non-tariff measures (NTM), and NTM streamlining. Although the ASEAN Trade in Goods Agreement's rules of origin have a relatively simple structure, these require supervision as recent research puts their ad valorem equivalent at about 3.40%. Meanwhile, the transparency of NTMs rests on two pillars: accurate data, and open dissemination and dynamic disciplines. Further, the move to streamline NTMs should not be viewed as a trade negotiation issue because NTMs are not purely trade policy instruments.

With its sound economic growth and successful integration, the East Asia and Pacific (EAP) region is becoming the world economy's engine in terms of size and growth, with the Association of Southeast Asian Nations (ASEAN) at its core. Today, ASEAN is one of the most integrated regions in the world; its markets have moved towards a 'single production base' and its macroeconomic policies are markedly synchronized.

Deep integration has also led to increased specialization at the country level, which enhances efficiency by tapping its comparative advantage. The region's high-income countries (e.g. Japan) typically supply upstream capital-intensive and high-tech components while low- or medium-income ones provide downstream assembly services, and several ASEAN countries participate in the midst of the value chains. As a result, each Asian economy becomes increasingly interdependent with its regional partners.

Despite the progress in the region's integration, nations remain vulnerable economically. First, global trade growth is slowing down, particularly for China, a key market for ASEAN exporters. Such is also expected to lead to a slowdown in poverty reduction, where the manufacturing sector is key in many ASEAN countries.

Second, regional trade in the EAP region is vulnerable to commodity prices and exchange rate shocks, which (i) create uncertainty for exporters and investors; (ii) reduce the incentives to invest in market penetration; and (iii) even generate a risk of competitive devaluations in the region.

Third, in the (unlikely) event of a breakdown of goodwill in the region, the World Trade Organization (WTO) disciplines could prove weak in the face of pressures

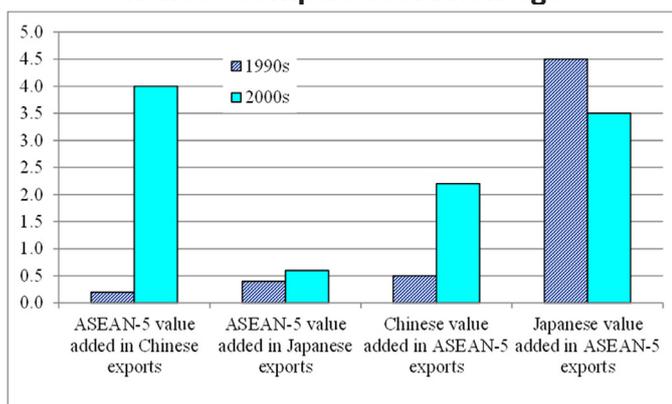
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**Figure 1. Asia's Vertical Specialization Patterns Reflect Comparative Advantage**



Note: The value-added content in exports is expressed as a percentage of the exporter's GDP.

Source: Adapted from Duval et al. (2014), Figure 7.

for tit-for-tat trade protection measures. One reason is that most ASEAN countries have bound their tariffs at levels substantially higher than those currently applied, leaving room for discretionary changes (Baldwin, 2007). In addition to tariffs, non-tariff measures (NTMs) can also play a substantial role as low-visibility trade barriers and can potentially threaten regional integration.

In the face of these economic vulnerabilities, EAP regionalism lacks a strong institutional anchor. Although ASEAN commitments to the ASEAN Trade in Goods Agreement (ATIGA) has progressed better than in many other regional blocs in the world, agreements come laden with complicated rules about where products originate, which leads to the 'noodle bowl' situation. In particular, as discussed by Inama and Sim (2016), countries of the ASEAN Economic Community—especially the smaller and poorer ones—that were left out of the Trans-Pacific Partnership and/or key bilateral agreements with the European Union (EU) may find themselves in a disadvantageous position in terms of attractiveness for foreign investments, as well as may risk a permanent growth slowdown.

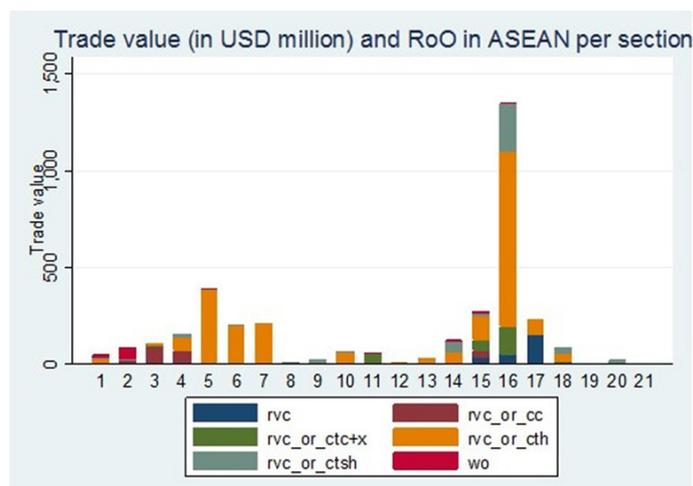
Thus, ATIGA's preferential trade regime does not seem to be perceived as very attractive by the private sector. It has a low utilization rate among many ASEAN countries, which indicates an unfinished trade facilitation agenda, particularly on two key issues. First, the EAP noodle bowl effect creates a conflicting and cumbersome environment in terms of rules of origin (ROO) (Baldwin and Kawai, 2013; Ing and Cadot, 2016; Inama and Sim, 2016). Second, NTMs, on which information is sometimes difficult to find for private sector operators (especially small and medium-sized enterprises), fragment markets and generate a regulatory burden that raises production and distribution costs.

To move forward the trade facilitation agenda in ASEAN, three key trade facilitation issues have been identified as focus areas: (i) ROO, (ii) NTM transparency, and (iii) NTM streamlining.

**Rules of Origin**

The ATIGA ROO consist of choices between a 40% regional value content and a change of tariff heading or tariff sub-heading. In spite of their apparent simplicity, these ROO obtain substantial trade-inhibiting effects, where recent research puts their ad valorem equivalent at about 3.40% (Ing and Cadot, 2016). This means ROO seem to 'nullify' one quarter of the effect of tariff-preference margins. The trade-inhibiting effect of ATIGA's ROO varies substantially across sectors (with 'textile rules' appearing to be the most penalizing) as well as across member states.

**Figure 2. ATIGA's ROOs by Instrument and Section**



Note: Sections 1–3=agricultural products; section 4= prepared foods; section 5= commodities; section 6=chemicals; section 7=plastics; section 8=leather; section 9=wood; section 10=pulp and paper; section 11=textile and apparel; section 12= footwear; sections 13-14=cement, stone etc.; section 15=base metals; section 16=machinery and electronics; section 17=transport equipment; section 18=precision instruments; sections 19–21=miscellaneous. cc = ctc at 2 digit chapter level; ctc = change in tariff classification; ctsh = change in tariff subheading; rvc = regional value content; wo = wholly obtained.

Source: Walz (2014).

As part of the noodle bowl syndrome, the EAP also suffers from fragmented and inconsistent ROOs that complicate with exposure to inconsistency of ROO models in the world's big blocs. This situation needs to be addressed by combining a preferential market access strategy with region-wide ROO streamlining and coordination efforts. The aim here is to strive for a market access/ROO environment where all countries can benefit from the optimal allocation of jobs, particularly in key sectors such as textile and garments, rather than one

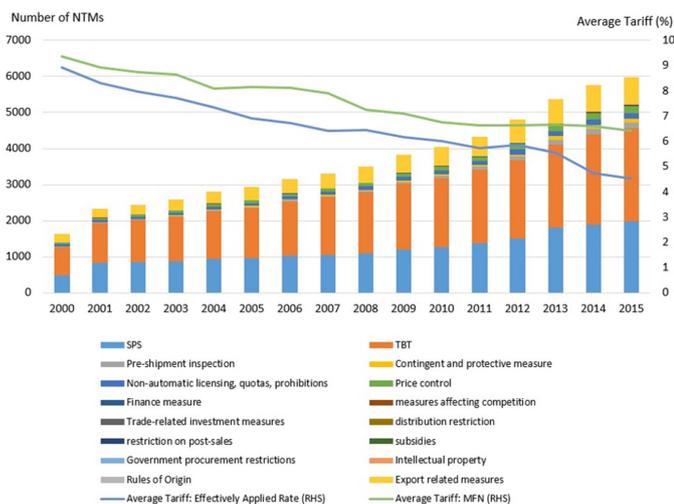
where skewed incentives lead to excessive agglomeration. To do this, ASEAN should focus on two key issues: forward and backward linkages.

In terms of forward linkages, to get a preferential access to EU markets, the CLM countries are the ones in the downstream value chain of the textile-garment industry and thus have the most to gain from preferential access to EU markets. In terms of backward linkages, CLM countries need ROO to allow for the export of garments made of fabrics from countries where these are produced at competitive costs. The first step is for the CLM to create a task force whose mandate is to propose a 'grand design' for ROO in the region, possibly combined with a global market-access strategy tailored to the needs of ASEAN's low-income member countries.

### Transparency of Non-tariff Measures

Many NTMs stem from non-trade policy objectives (for example, food safety or environmental protection). These can also be used as instruments of commercial policy. However, even NTMs pursuing legitimate, non-trade objectives can have restrictive or distortionary effects on international trade.

**Figure 3. NTM Proliferation in ASEAN**



Note: SPS = sanitary and phytosanitary; TBT = technical barriers to trade. Source: Ing et al. (2016).

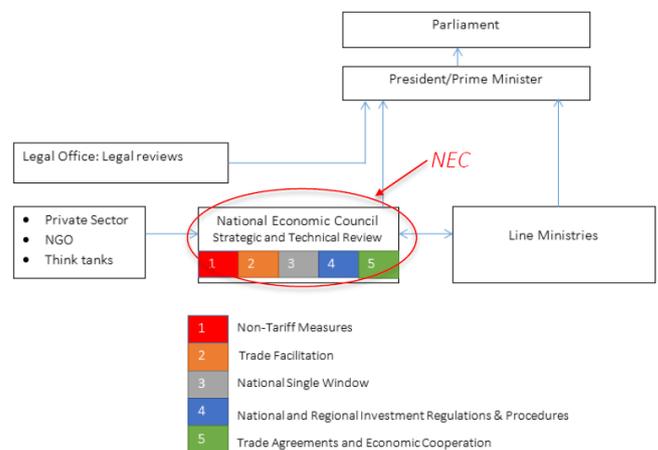
The costs imposed by NTMs on businesses are of three types: enforcement, sourcing, and process adaptation. Enforcement costs relate to the efforts taken by private companies to show compliance with NTMs. Sourcing costs are generated by the switch from low-grade intermediate sources to high-grade ones to meet NTM standards. Process adaptation costs relate to changes in capital equipment needed to meet NTM standards. These costs are compounded when NTMs lack transparency, as uncertainty or lack of understanding can

lead to costly business decisions – in particular, when choices of machinery and capital equipment, typically irreversible, are involved. Indeed, recent World Bank research (Helble, Shepherd, and Wilson, 2013) suggests that the EAP regional trade could be boosted by over USD100 billion through improved regulatory transparency.

The key challenge facing past transparency efforts at both multilateral and regional levels is one of incentives. This is because countries typically do not want to expose themselves to criticisms by betraying excessive and possibly protectionist regulatory activities. Transparency rests on two pillars: accurate data and open dissemination. In 2012, the United Nations Conference on Trade and Development (UNCTAD) has led a conceptual effort to classify all NTMs according to a clear and exhaustive nomenclature, the Multi-Agency Support Team (MAST). Thereafter, UNCTAD led, together with the World Bank, an effort to encourage all countries to collect NTM inventories. In ASEAN, Economic Research Institute for ASEAN and East Asia (ERIA) took in 2015 the responsibility over an exhaustive and consistent NTM data collection project that has now produced data for all 10 ASEAN member - countries. Data consisted of national inventories of all NTMs and all products covered by each NTM, at the most detailed level (i.e. up to 64 types of measures and national tariff lines at HS-8 digit for most of ASEAN countries, HS-9 digit for Malaysia, and HS-10 digit for Indonesia). The data must be updated as frequently as possible (if possible in real time and, at the very least, once a year).

The data and deeper regulatory information must be readily available in each country's trade portal. To do this, the mechanism to be set up must ensure the continuous update and dissemination of information. This brief

**Figure 4. Proposed Institutional Setup**



NGO = non-governmental organization. Source: Ing et al. (2016).

proposes an approach where the ASEAN Secretariat ranks member countries by their transparency based on a methodology proposed in recent research.

### Streamlining Non-tariff Measures

Although NTM streamlining at the regional level can be included as part of a trade facilitation agenda, such should not be treated as a trade negotiation at the country level. The reason is twofold: (i) NTMs are not purely trade policy instruments; the idea of bargaining down consumer protection for more trade does not make sense; and (ii) if the government sees NTM as bargaining chips and expects partners to reciprocate, there can be no 'formula' nor reciprocity in NTM streamlining. Instead, NTM streamlining must be viewed as a means to improve national regulations. Efficient NTMs bring many benefits to a country after all.

Additionally, the complexity of NTMs often does not emanate from a country's intent to limit trade but from the lack of coordination among different agencies that are responsible for trade. One solution is to create, in each ASEAN member-country, an independent regulatory and supervisory body mandated to review all important regulations.

The creation of similar bodies in all ASEAN member-countries and a collective training programme would promote a common vision in terms of regulatory principles. These would foster 'natural' regulatory convergence, while facilitating technical cooperation between member countries – a crucial aspect of deep integration given the relative absence in the EAP region of a supranational institution.

In summary, this brief provides three recommendations:

1. Create an ROO task force at the ASEAN level with a mandate to review the noodle bowl effect of ROO and formulate recommendations for streamlining. This should take into account the crucial linkages between the region's market access strategy with major economies of the Organisation for Economic Co-operation and Development and the need for balanced regional development.
2. Create an institutional mechanism at the ASEAN Secretariat to foster NTM transparency through (i) continuous NTM data collection and dissemination; and (ii) the setup of a 'stick and carrot' mechanism, which could perhaps be linked to the trade facilitation fund allocation;
3. Promote regulatory supervision bodies in all ASEAN member - countries based on the pilot experience in CLM countries, each with a mandate to review and improve key business-relevant regulations.

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