Chapter 6

ROOs in ASEAN+1 FTAs and the Value Chain in East Asia

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CHAPTER 6

ROOs in ASEAN+1 FTAs and the Value Chain in East Asia

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This paper discusses the nature of the rules of origin (ROOs) in the ASEAN+1 FTAs, particularly with respect to features and characteristics that could either facilitate or hinder the development of value chains, and the participation of firms in the increased globalization of production. By examining both the types of ROOs used and the origin certification procedures employed in these FTAs, the paper arrives at recommendations for reforms that could facilitate trade and the linkages in the value chain system in the region. Case studies on automotive and electronic sectors provide further insights.

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1. Introduction

The role of the value chain systems in regional economic integration has become increasingly important, especially in East Asia with the growth of production networks led by Japan. Identifying and understanding the factors affecting them are necessary to provide corresponding policy handles for the development process, not only at the regional and global level, but at the national and local level as well. Numerous factors affect the linkages between firms in the value chain, from the local to the global level, and the shape of the development that takes place. Among the factors that need close attention would be free trade agreements (FTAs), as they directly affect the flow of goods and investments. This paper, as part of the ERIA project on FTAs and the global value chain in East Asia, focuses on the ROOs – in particular, the ROO regimes in the various ASEAN+1 FTAs.

There has been a lot of discussion about the 'noodle-bowl syndrome' created by the proliferation of FTAs during the past decade. Central to this issue is the set of ROOs that necessarily accompany any FTA. Thus, we have multiple FTAs with as many (non-uniform) ROO systems, compounding the set of rules that FTA (actual and potential) users would need to hurdle, and customs administration would have to implement. This has special implications when viewed within the context of the global value chain because of hurdles it could add to the flow of goods in the value chain. This paper aims to look more closely at these implications of the ROOs in the ASEAN+1 FTAs with the end in view of providing recommendations that could facilitate trade and linkages within the region's value chain system.

The paper starts with a brief discussion of the nature of the ROOs in the ASEAN+1 FTAs – the basic types of ROOs and their variation across products. Some comparison across FTAs will also be made. The paper then examines the implications of the ROO regimes – the ROO criteria *per se* and the accompanying procedures used – for the value chain. The particular ROO criterion used in itself (and how this varies across products and across FTAs) would have direct implications for the links in the value chain. In addition, the impact of the ROO regime would depend not only on the nature of the ROOs *per se*, but also on the origin certification procedures (OCP). The paper then looks at special sectors where global production networks (GPNs) play key roles –

the electronics and automotive sectors – to highlight key issues and concerns. The last section provides the conclusion and recommendations.

2. Features and Characteristics of the ROOs in ASEAN+1 FTAs[2]

In the various ASEAN+1 FTAs, there are four basic rules used to determine origin (see Table 1):

1. Wholly obtained (WO)
2. Regional value content (RVC)
3. Change in tariff classification (CTC), and
4. Specific process rule (SPR)

There is no question about conferring origin on products that are wholly obtained (WO) or produced. However, with technological change and increased globalization of production, the majority of products are no longer strictly wholly obtained. As such, for most FTAs, the WO criterion is usually used mainly for primary products. Prime examples are in the early chapters of the Harmonized System (HS) code, e.g. covering plants and animals.

With the blurring of geographical boundaries in production, there was general consensus that conferring origin should be on some basis of 'substantial transformation'. In this regard, the last three basic rules are considered as acceptable criteria. The second, regional value content (RVC), requires that a minimum share in value added should come from member parties. In the ASEAN Trade in Goods Agreement (ATIGA) and the various ASEAN+1 FTAs, the usual norm is a regional value content of not less than 40 per cent of value added, or RVC(40), for the good to be considered originating from that FTA area. Change in tariff classification (CTC) is another criterion used, that is, the inputs from non-member parties have been 'sufficiently transformed' in production thereby acquiring a change in classification in the output according to the HS code. The usual requirement is for a change in

[2] This draws from Medalla (2011).

classification at the four-digit level, but chapter and tariff sub-heading levels (six-digit) are also sometimes used. Finally, many FTAs, especially earlier agreements, confer origin on the basis of the specific process rule (SPR), that is, a certain process is required for the good to be considered originating from that FTA area.

Table 1. Basic Methods of Origin Determination

Agreements	Methods of determining origin	General rule
ASEAN Trade in Goods Agreement (ATIGA)	1. Wholly obtained (or produced) (WO)	RVC(40): RVC of at least 40% or
	2. Regional value content (RVC)	CTH: CTC at 4-digit
	3. Change in tariff classification (CTC)	
	4. Specific process rule (SPR)	
ASEAN--China Trade in Goods Agreement (ACFTA)	1. WO	RVC(40)
	2. RVC	
	3. SPR	
ASEAN--Korea Trade in Goods Agreement (AKFTA)	1. WO	RVC(40) or CTH
	2. RVC	
	3. CTC	
	4. SPR	
ASEAN--Japan Comprehensive Economic Partnership (AJCEP)	1. WO	RVC(40) or CTH
	2. RVC	
	3. CTC	
	4. SPR	
ASEAN--Australia/New Zealand FTA (AANZFTA)	1. WO	RVC(40) or CTH
	2. RVC	
	3. CTC)	
	4. SPR	
ASEAN--India Trade in Goods Agreement	1. WO	35% RVC+ CTSH
	2. 35% RVC+ CTSH	

The advantages, disadvantages and key issues using the different methods are highlighted in Table 2 below as summarized by Brenton (2003).

Table 2. Summary of the Different Approaches to Determining Origin

Rule	Advantages	Disadvantages	Key issues
Change in tariff classification (CTC)	● Consistency with non-preferential rules of origin.	● Harmonized system not designed for conferring origin, increased possibility to be influenced by domestic industries	● Level of classification at which change required – the higher the level the more restrictive
	● Once defined, the rule is clear, unambiguous and easy to learn	● Documentary requirements maybe difficult to comply with	● Can be positive (which imported inputs can be used) or negative (defining cases where change of classification will not confer origin) test[a] – negative test more restrictive
	● Relatively straightforward to implement	● Can be conflicts over the classification of goods which can introduce uncertainty over market access	
Value added	● Clear and simple to specify and unambiguous	● Complex to apply – requires firms to have sophisticated accounting systems	● The level of value added required to confer origin
	● Allows for general rather than product specific rules	● Uncertainty due to sensitivity to changes in exchange rates, wages, commodity prices, etc.	● The valuation method for imported materials – methods which assign a higher value (e.g. CIF) will be more restrictive on the use of imported inputs
Specific process requirement	● Once defined, clear and unambiguous	● Documentary requirements can be burdensome and difficult to comply with	● The formulation of the specific processes required – the more procedures required the more restrictive
	● Provides for certainty if rules can be complied with	● Domestic industries can influence the specification of the rules.	● Should test be negative (processes or inputs which cannot be used) or a positive test (what can be used) – negative test more restrictive

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

These basic rules could be used singly, or in combination whether as co-equal (alternative) or dual (plus) rules, and with some variation. The minimum cut-off could be raised or reduced, the disaggregation level required for change in classification could be amended, or the required process specifically defined. Agreements would provide a

general ROO, and some variations of the basic rules are usually adopted for specific products, according to negotiation outcomes.

At the start, AFTA--CEPT (ASEAN Free Trade Agreement – Common Effective Preferential Tariff, before ATIGA) almost uniformly adopted the RVC rule. This was intended to be liberal enough, as the rule is theoretically straightforward and ostensibly fair, compared for instance to the SPR, which could be very limiting. However, over time, it became more apparent that there are practical problems in applying RVC, contributing to the low AFTA utilization rate. The CTC has become a viable alternative. In more recent FTAs and in ROO reforms, co-equal rules are increasingly being used.

In general, reforms and improvements in ROOs towards simplification have been introduced in ATIGA, and more recent FTAs generally tend towards more liberal ROOs. The approach, however, has been to refine ROOs on a per product basis. While in general, this has led to easing ROO restrictiveness,[3] this product specific approach, without an overall framework, could lead to numerous variations in ROOs, not only across products within FTAs, but also variations across FTAs for the same product. Both could have adverse implications on linkages in the regional value chains, especially those dealing with multiple products and multiple countries. This could mean, for example, that there will be the need to have separate accounting, different expertise, etc. to deal with possible inconsistencies.

In Medalla (2011), the author compiles and presents a frequency table of various types of ROOs used by six-digit HS (2002) classification for the various ASEAN+1 FTAs in East Asia. The table is reproduced below as Table 3.

[3] There are, of course, likely to be instances where ROOs negotiated are designed for protection. However, the ROO reforms are generally aimed at encouraging FTA utilization.

Table 3. Frequency of ROO Used by FTA

ROO type	ATIGA	AKFTA	ACFTA	AJCEP	AANZFTA	Japan-India [a/]
WO	185	458	8	3	302	756
CC		61	1	735	288	
CTH		4		157	117	225
CTSH				8		638
RVC(<40)		36				
RVC(40)	147	22	4,659	219	286	
RVC(>40)		6				
CC with exception				258	3	
SPR (Textile Rule)						805
CC + RVC(40)		2				
CTH + RVC(<40)						12
CTH + RVC(40)						15
CTH + RVC(>40)		1				3
CTSH + RVC(<40)						2,693
CTSH + RVC(40)					3	52
CTSH + RVC(>40)						22
RVC(40) or CC	437	487	7	126	585	
RVC(40) or CC or SPR	33				33	
RVC(>40) or CTH		4				
RVC(40) or CTH	2,782	4,076	122	3,057	2,205	
RVC(40) or CTH or SPR	16				24	
RCV(40) or CTSH	706	61		33	1,072	
RVC(50) or CTSH						2
CC or Textile Rule				350	15	
CTH or Textile Rule				277	91	
RVC(40) or Textile Rule			427	1		
RVC(40) or CC or Textile Rule	453					
RVC(40) or CTH or Textile Rule	340					
RVC(40) or CTH or RVC(35) + CTSH	125				200	
WO or CTSH						1
WO or RVC(>40)		6				
Total tariff lines (HS 2002)	**5,224**	**5,224**	**5,224**	**5,224**	**5,224**	**5,224**

Source: Lifted from Medalla (2011)

Notes: WO - wholly obtained; CC - change in commodity classification; CTH - change in tariff heading; CTSH - change in tariff subheading; RVC - regional value content; GR - general ROO rule

* Tariff lines not included in PSR list but can be classified according to the general ROO rule

a/ in lieu of ASEAN--India FTA (PSR)

In summary, from the Medalla (2011) study, we note the following key observations about the features and characteristics of ROOs of the ASEAN+1 FTA:

- There are numerous types of ROOs used, even after the author tried to group together similar types under one category. A lot more variations exist within each grouping. The variations come from the following:
  - Some combination of rules – co-equal or 'plus' rules
  - For SPR, different specific processes required
  - For RVC, variation in cut-off level
  - For CTC, variation in the level of classification where change is required, e.g. change in chapter (CC), change in tariff heading (CTH), change in tariff sub-heading (CTSH)
  - Additional specific requirements, e.g. CTSH 'except change coming from some classification, or provided the materials are sourced' accordingly
- The co-equal rule, RVC(40) or CTH, is the general rule for ATIGA, ASEAN--Korea (AKFTA), ASEAN--Japan (AJCEP) and ASEAN--Australia--New Zealand (AANZFTA). For ASEAN--China (ACFTA), the general rule is RVC(40). For ASEAN--India FTA (AIFTA), the general rule is the dual rule, RVC(35) + CTSH, which is considered the most restrictive as both rules need to be complied with.
- ACFTA uses RVC most extensively, while AJCEP relies more on CTC. ATIGA has been undertaking ROO reforms, coming up with product specific rules (PSRs) that are generally intended to encourage better utilization of the FTA. As a result, it has more HS lines with the co-equal rule using 'RVC(40) or CTSH', more liberal than the general rule (RVC[40] or CTH). At the time of writing, PSRs for India were still under negotiation, such that only the general rule is currently applicable (refer again to Table 3).
- How much commonality or divergence exists in the ROOs of the different ASEAN+1 FTAs is also examined by the author. This is done by going over the ROOs of the five different FTAs by six-digit HS lines and counting how many HS lines there are where all five FTAs share at least one rule, where only four FTAs share at least one common ROO and so on down the line. When down to one, the frequency indicates how many HS lines have no common ROO used at all (see

Table 4). It appears that in 64 per cent of all tariff lines, all five FTAs have at least one ROO in common.[4] On the other hand, only 0.4 per cent of HS lines have ROOs that are all totally different. However, most of the commonality is in the use of the RVC(40). If we count only those with almost the same ROO,[5] the frequency of lines with a common ROO is more than halved, at around 30 per cent. In most cases, the ASEAN--China FTA would be the odd FTA out.[6]

Table 4. Commonality of ROOs Across FTAs

Degree of commonality	Frequency distribution of HS lines (6-digit HS2002)	
	No.	%
In all 5 FTAs	3,318	64.00%
In only 4 FTAs	766	14.80%
In only 3 FTAs	825	15.90%
In only 2 FTAs	255	4.90%
No common ROO	23	0.40%

Source: Table 5 in Medalla (2011)

Other Relevant ROO Provisions

There are other ROO provisions aside from the general rules (GR) and the product specific rules (PSR) that govern origin determination. Of significant importance with respect to trade facilitation are the *de minimis* rule when CTC is applicable, and the treatment of intermediary trade.

Certain products could be using a host of intermediate goods as inputs. Under a CTC rule, requiring a change in classification for each and every input could be daunting. To simplify administration and ease the ROO restrictiveness, a *de minimis* rule could be very useful. ATIGA and the ASEAN+1 FTAs all have *de minimis* provisions, with the exception of AIFTA.

[4] Where the ROO provision of the FTA uses a 'plus' rule, the dual/multiple rule is treated as one ROO. When co-equal rules are used, they are treated as separate rules.
[5] That is, treating the co-equal rule as one.
[6] This excludes the ASEAN--India Trade in Good Agreement, for which, at the time of writing, only a general rule of 'CTSH or RVC(35)' applies for all, while PSRs are still being negotiated.

Especially for GPNs and value chains, a smooth flow of intermediary goods could be crucial. These are cases, for example, when a batch of goods enters first one (member) country in the chain, and some portion is later re-exported to another (member) country. If the invoice comes from a member party, it will be useful if a back-to-back Certificate of Origin (CO) is allowed (a fresh CO is issued on the basis of the original CO from a member country). It could also be possible that the invoice is from a third country (e.g. Japan, but the FTA used is, say, AANZFTA) although the good qualifies as originating using the relevant FTA ROO criterion. In this case, the useful provision is one that allows for third-party invoicing.

Except for ACFTA, the ASEAN+1 FTAs allow back-to-back certificate and third party invoicing. However, for ACFTA, an agreement was reached in October 2010 to amend the OCP to accommodate intermediary trade using these instruments. By January 2011, except for Indonesia, Myanmar and Cambodia, member countries have signed the revised OCP. This is indicative of the importance of intermediary trade and the direction of reforms being made to improve the system.

3. The Origin Certification Procedure

Equally important to examine is how the ROO system is implemented. In this regard, we examine the OCPs of ATIGA and the ASEAN+1 FTAs.

There appear to be efforts to harmonize procedures and learn from each other's systems. This is manifested in the almost identical CO forms used. ATIGA uses form D; ACFTA – form E; AKFTA – form AK; AJCEP – form AJ; and AANZFTA – form AANZ. All require COs on a per shipment basis; all forms have the same cells for required information; and all require pre-export verification. Still, some implementing procedures and required documents could vary.

3.1. Issuing Body/Authority

For Japan, Korea, Australia and New Zealand, the issuing authority has been assigned to their designated private Chamber(s) of Commerce and Industry. In addition,

for Korea, its customs service also has CO issuing authority. For the rest (i.e. ASEAN and India), the issuing authority is a designated government agency. However, for ATIGA, self-certification will be allowed by 2012. The procedure is being piloted in Singapore, Malaysia and Brunei.

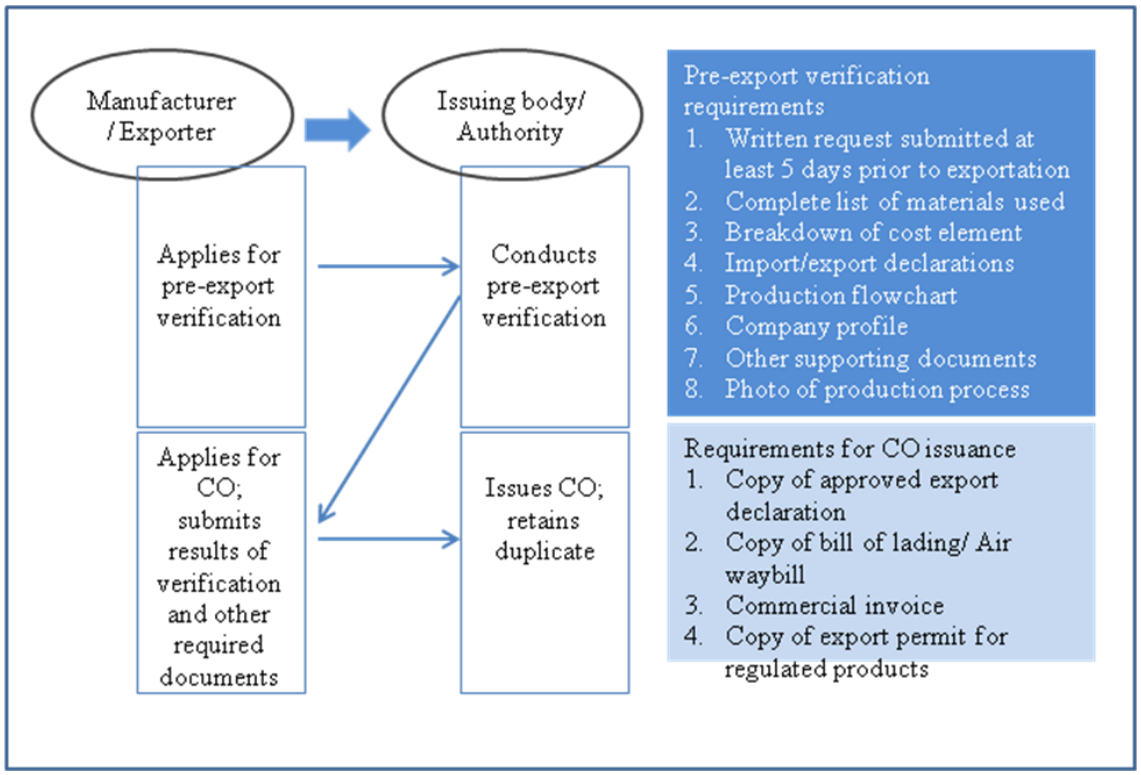
3.2. Typical OCP Process and Documentation Requirements

The typical process for acquiring a CO starts with a pre-export verification, where origin examination/assessment takes place. This presumes that the HS classification has been determined. For some exporters, determining the HS classification can be a problem, as this could be a source of differences in interpretation. This is critical since this forms the basis for what is the applicable ROO in the first place. This is also where provisions for advanced rulings would be very useful, cutting unnecessary delays in releasing the shipments.

Figure 1 below represents a typical OCP process (based on Philippine procedures). It shows two stages of application – first for pre-export verification, and second for CO issuance. Korea and Vietnam merge the two into one application but the processes themselves are basically the same. For most of the ASEAN+1 FTAs, the requirements for the CO application itself are almost the same. In the pre-export verification requirements, the documentation requirements may vary a little. For example, in some countries (China and Brunei), there is the initial requirement of company registration. This would require some additional documentation like business licence, organization code, etc. In the case of Australia, the pre-export verification requirement is simple, based only on exporter registration including an export declaration that the goods meet the ROO criterion and that it will provide any documentation the issuing body may request to confirm origin.[7] It is supported with a profuse education and information campaign about ROO procedures. Also, there are countries with electronic (online) CO application (Australia, New Zealand, Japan, Malaysia, Singapore and Thailand).

[7] Basically, it is a hybrid form of self-certification.

Figure 1. Typical OCP Process Flow and Requirements



Source: Bureau of Customs, Philippines

Processing time from pre-export verification to issuance of CO ranges widely, from one working day (as for Australia and New Zealand); three working days (the minimum in the case of Korea); to not more than 30 working days (for China and Brunei, including company registration). In the case of Australia, the entire processing time could be done within a day, given automatic registration of the exporter for CO issuance. In the case of New Zealand, as part of company registration, if procedures and information provided are in order, the pre-export verification is done within one working day and CO issuance likewise within one working day. For most countries, processing time could take five to 10 working days. See Table 5 for a comparison across countries.

Table 5. Processing Time for OCP

Country	Issuing body/ authority	Pre-export verification (examination of origin)	Issuance of CO
Australia	Australian Industry Group Australian Chamber (ACCI)	Automatic	Within 1 working day 2 hours for electronic application
Brunei	MOFAT, Department of Trade Development	30 days (includes company registration)	1-2 working days
Cambodia	Ministry of Commerce (Department of Multilateral Trade)	Within 7 working days	10 hours, 55 mins
China	Entry-Exit Inspection and Quarantine Bureau	20-30 working days	within 1 day
Indonesia	Ministry of Trade (Export and Import Facilitation)	15 working days for first time users; 1 working day for exporters in database	Within 1 day
Japan	Japan Chamber (JCCI)	Within 3 working days	Within 2 working days
Korea	Korean Customs Service; Korean Chamber (KCCI)	Regular cases: 3 working days; cases needing onsite examination: 10 working days	
Laos	Ministry of Commerce and Industry	3-7 days	3 days
Malaysia	Ministry of International Trade and Industry	5 working days for online, 7 working days for manual application	1 working day for online, 2 days for manual
Myanmar	Ministry of Commerce	7 working days	1 working day
New Zealand	New Zealand Chamber (NZCCI) Independent Verification Services	1 working day, if procedures and information provided are in order Within 1 hour	1 working day Within 4 hours
Philippines	Bureau of Customs	Within 5 working days	Within same day
Singapore	Singapore Customs	Step 1: Factory registration - 1 week Step 2: Manufacturing cost statement - at least 7 days before exportation	2-3 working hours
Thailand	Ministry of Commerce, Department of Foreign Trade	3 working days	Within 1 day; 4 hours for EDI systems
Vietnam	Government issuing authority	Within 5 working days	

Source: ERIA Project (2011): Towards Accessible FTA: The Role of ROO Documentation in FTA Utilization; Interviews

Note: EDI - Electronic Data Interchange

4. Implications for the Value Chain

Part of the rationale for regional FTAs is the increasing importance of global and regional production networks. FTAs are supposed to help countries engage more fully in these growing global/regional production systems, by easing access both to markets and technologies, and creating more opportunities for local producers. In particular, a key feature of the ASEAN+1 FTAs is cumulation, which should encourage the value

chain in East Asia. However, each FTA comes with ROOs intended to limit preference to member parties. Hence, while the FTA would remove trade barriers among member parties, the governing ROOs would present barriers of their own. The challenge is therefore how to strike a balance between trade facilitation and preventing trade preference circumvention.

One could argue, however, that trade facilitation should take priority over the concern about circumvention, as the latter actually brings the preferential arrangement closer to the Most Favoured Nation (MFN) principle, and trade facilitation would always provide benefits (if only to reduce transactions costs). Nonetheless, in keeping with the 'preferential' agreement, the possibility of circumvention would still need to be considered. The bottom line is that ROOs should be as simple and liberal as possible, and reforms should be sought to minimize the transaction costs of ROO compliance.

Hence, in analysing the implications of the system of ROOs on the value chain, one needs to understand the attendant cost of ROO compliance. In this regard, it will help to categorize costs into two basic groups, depending on where these costs are coming from.

The first is related to the degree of restrictiveness of the rule itself. As discussed above, there are three basic rules used to signify 'substantial transformation' and confer origin: RVC, CTC and SPR. Without specific information on the ROO and the production processes involved, one cannot state categorically that one rule is more restrictive than another. What is clearer is that for RVC, the lower the required minimum RVC, the less restrictive the ROO. In the case of CTC, in general, the higher the digit level of classification where change is required (or the lower level of classification), the less restrictive the ROO. The degree of restrictiveness of the SPR is entirely on a case-by-case basis, but in general, the more SPRs there are for the product, the more restrictive the ROO. In addition, if the exporter has a choice, that is, the co-equal rule, the ROO is more liberal. On the other hand, if the exporter is required to comply with two or more ROO criteria (dual or multiple rule), then the ROO is more restrictive.

The degree of restrictiveness of the ROO could affect compliance costs and the value chain in the most fundamental way. This is when the exporter would have to change the (presumably most efficient) manufacturing process in order to meet the ROO

criterion. Hence, care should be taken that the ROO is not made too restrictive as to induce exporters to resort to a change that will lead to inefficiency in production. Indeed, if there are known cases like these, then this would suggest candidates for appropriate reforms. The other impact of an overly restrictive ROO could, of course, be non-utilization of the FTA preference. In other words, the ROO becomes 'prohibitive'. In this case, the FTA does not contribute to the links in the value chain. This would again point to areas for possible ROO reforms.

What this implies is a need to take a closer look at the ROOs themselves. Is the cut-off rate of 40 per cent regional value content enough to encourage value-chain activities in the region? Could this cut-off rate be lowered? Similarly, could a finer classification be used in the level of change required to confer origin? Perhaps the most cumbersome are the additional requirements and restrictions accompanying many general rules, e.g. as to where certain inputs are sourced; limiting where change in classification comes from; etc. Aside from increasing the restrictiveness of the ROOs, these additional limiting requirements are usually very specific, increasing the variation in ROOs across products within and across FTAs.[8] This has a substantial and direct impact on the value chain. Which among these additional restrictions could be removed or relaxed?

The second group of costs would pertain to the costs of complying with the procedures of origin certification. This would include two main components: (1) the cost of the paperwork and administrative work needed to complete the required documents for certification, including in-house man hours and other fees related to securing these documents; and (2) cost of lead time. Big companies dealing with multiple inputs and outputs, and multiple FTAs, would incur extra costs to manage the different ROOs. This could be in terms of maintaining in-house information and accounting systems and corresponding staff. Delays in securing COs would mean additional costs, e.g. in terms of warehousing costs and production disruptions.

It appears that substantial efforts are being made to simplify and rationalize procedures to reduce ROO compliance costs and speed up the certification process. An example is the treatment of intermediary trade, which is of particular importance to the value chain. As indicated earlier, ACFTA has revised its OCP to include the relevant

[8] Indeed, this variation is pointed out earlier in the discussion about the system of ROOs in the ASEAN+1 FTAs.

provisions on intermediary trade following the other ASEAN+1 FTAs. More countries are adopting an electronic system, with online application. Self-certification, or its hybrid form, using some method of accreditation and endorsement by industry chambers, is increasingly being adopted. Hopefully, these reform efforts will continue.

5. Focus on the Automotive and the Electronics Sectors

To provide further insights, we take a closer look at the automotive and electronics sectors. These sectors are considered prime examples of industries with highly evolved global/regional production networks. Firm interviews were conducted covering one electronic firm and three automotive firms in the Philippines (see Appendix for more details).

First, it will be interesting to examine what types of ROOs have been negotiated in the FTAs for these sectors. These are presented in Tables 6 and 7.

Table 6. ROOs in Electronics

ROO type	ATIGA	AKFTA	ACFTA	AJCEP	AANZFTA
WO	1				1
RVC(40)	13		287	1	15
RVC(40) or CTH	151	265		286	122
RVC(40) or CTH or SPR					8
RCV(40) or CTSH	35	22			40
RVC(40) or CTH or RVC(<40)* + CTSH	87				101
Total with alternate rules	273	287	0	286	271
Total tariff lines (HS 2002)	**287**	**287**	**287**	**287**	**287**

Source: Data from Medalla (2011); authors' calculations.
Notes: This table covers tariff lines under Chapter 85 of HS Code 2002; WO - wholly obtained; CC - change in chapter (2 digit); CTH - change in tariff heading (4-digit); CTSH - change in tariff subheading (6 digit); RVC - regional value content; SPR - specific process requirement

* RVC cut-off level is usually 35%

Table 7. ROOs in Automotive Products

ROO type	ATIGA	AKFTA	ACFTA	AJCEP	AANZFTA
RVC(40)	66		76	47	50
RVC(>40)**		25			
CTSH + RVC(40)					3
RVC(40) or CC					1
RVC(40) or CTH	10	51		29	22
Total number of tariff lines (HS 2002)	76	76	76	76	76

Source: Data from Medalla (2011); authors' calculations.
Notes: This table covers tariff lines under Chapter 87 of HS Code 2002; WO - wholly obtained; CC - change in chapter (2 digit); CTH - change in tariff heading (4-digit); CTSH - change in tariff subheading (6 digit); RVC - regional value content; SPR - specific process requirement
* RVC is usually 35%
** RVC ranges from 45-70%

In the case of the electronics sector (HS Chapter 85),[9] for the majority of the products, the GR is used. In the case of ACFTA, there is no deviation from the GR, which is the single rule of RVC(40). For ATIGA, AKFTA, AJCEP and AANZFTA, the GR is the co-equal rule of RVC(40) or CTH, which is at the outset more liberal, with exporters being given a choice. In the case of AJCEP, there is also almost no deviation from the GR. However, where there are deviations from the GR, the PSRs are designed to be less restrictive, especially in the case of ATIGA and AANZFTA. In ATIGA, 35 out of 287 HS (2002) lines use a more liberal choice of CTC at the six-digit level (CTSH) compared to CTH in the GR, and an additional 87 lines use a third option of RVC(35) plus CTSH. In AANZFTA, even further easing of PSRs are used, 40 lines with CTSH as the second option, and 101 lines with the same third option.

The opposite is true in the case of the automotive sector (HS Chapter 87),[10] except for ACFTA, which, as in the case of electronics, does not deviate from the GR of RVC(40). This time, the PSRs for the other FTAs become more like that of ACFTA: a single RVC(40) for many of the products – 66 out of 76 HS lines in the automotive

[9] HS Chapter 85 description: Electrical machinery and equipment and parts thereof; sound recorders and reproducers, television image and sound recorders and reproducers, and parts and accessories of such articles.
[10] HS Chapter 87 description: Vehicles other than railway or tramway rolling stock, and parts and accessories thereof.

sectors for ATIGA, 47 for AJCEP, and 50 for AANZFTA. In the case of AKFTA, the PSRs are made even more restrictive with the cut-off rate for RVC ranging from 45 to 70 per cent for 25 of the 76 HS lines, although many more lines retain the GR.

This appears to be 'consistent' with the MFN tariff structure of these sectors. Tables 8 and 9 provide the figures only for the Philippines, but in relative terms, the structure will be the same for the rest of ASEAN. Tariffs are generally very low for the electronics sector, while tariff peaks could be found in the automotive sector (especially for the assembled products).

In the case of electronics (HS Chapter 85), the simple average tariff is around 3.9 per cent, with minimum at zero duty (78 out of a total 266 HS lines in the sector), and maximum at 30 per cent (one line). The average tariff is higher for assembled products at 6.2 per cent, compared to 1.2 per cent for parts and components.

In the case of the automotive sector (HS Chapter 87), the simple average tariff is around 12.8 per cent, with minimum at zero duty (four out of a total 75 HS lines in the sector), and maximum at 30 per cent (24 lines). As in the case of electronics, the average tariff is higher for assembled products at 23.6 per cent, compared to 6.2 per cent for parts and components.

Table 8. Philippines: MFN Applied Tariffs 2010 for Electronics

HS Code 2007	Description	MFN applied tariff			
		Number of TL	Average of AV duties	Minimum AV duty	Maximum AV duty
Chapter 85	Electrical machinery and equipment and parts thereof				
	MFN tariff (average, minimum, maximum)		**3.9**	**0**	**30**
	No. of TL at HS 6 digits (minimum/maximum AV duty)			78	1
	Total no. tariff lines at HS 6 digits	266			
8532-34; 8540-42	Electronics components				
	MFN tariff (average, minimum, maximum)		**1.2**	**0**	**15**
	No. of TL at HS 6 digits (minimum/maximum AV duty)			31	1
	Total no. tariff lines at HS 6 digits	44			
8509-10; 8516; 8518-24; 8527-28	Consumer electronics and related products				
	MFN tariff (average, minimum, maximum)		**6.2**	**0**	**15**
	No. of TL at HS 6 digits (minimum/maximum AV duty)			14	15
	Total no. tariff lines at HS 6 digits	62			

Source: WTO tariff download facility; authors' calculations.
Notes: AV: ad valorem; TL: tariff lines.

Table 9. Philippines: MFN Applied Tariffs 2010 for Automotive Imports

HS 2007	Description	MFN applied tariff			
		Number of TL	Average of AV duties	Minimum AV duty	Maximum AV duty
Chapter 87	Vehicles other than railway or tramway rolling-stock, and parts and accessories thereof				
	MFN tariff (average, minimum, maximum)		**12.8**	**0**	**30**
	No. of TL at HS 6 digits (minimum/maximum AV duty)			4	24
	Total no. tariff lines at HS 6 digits	75			
Specific HS lines: e.g. 392630; 400921-401019; 700711-21; 700910; 732020; 732020 etc.	Autoparts (i.e. selected HS 6 digit lines)				
	MFN tariff (average, minimum, maximum)		**6.2**	**0**	**30**
	No. of TL at HS 6 digits (minimum/maximum AV duty)			3	6
	Total no. tariff lines at HS 6 digits	84			
8702-8704	Motor vehicles/motor cars and other motor vehicles designed for the transport of persons and goods				
	MFN tariff (average, minimum, maximum)		**23.6**	**0**	**30**
	No. of TL at HS 6 digits (minimum/maximum AV duty)			3	14
	Total no. tariff lines at HS 6 digits	18			

Source: WTO tariff download facility; authors' calculations.
Notes: AV: ad valorem; TL: tariff lines.

Findings from Firm Interviews

Four firms (in the Philippines) were interviewed, composed of one multinational company (MNC) engaged in assembly of motor vehicles; one foreign-owned firm manufacturing wheels; one MNC engaged in production of electronic and mechanic components for automotive applications; and one Filipino-owned electronics firm producing hard disk drive (HDD) components.[11] These firms import from and export to ASEAN and for some to the 'plus one' countries.

From the interviews, some important points can be gathered. One observation is that the two MNCs' utilization of FTAs, and specifically compliance with the ROOs, has been smooth. As expected and as has been found in previous studies, large firms that have been importing or exporting for a long time, frequently or in large volumes and eventually have organized a system and set up a group that takes care of documentations, have a high FTA usage rate. Moreover, they are well informed, by their own efforts, with regards to developments and updates on FTAs. Furthermore, especially because they are able to satisfy requirements in the ROOs, they generally face no difficulty as far as requirements are concerned. There may be different ROO forms but they ask for almost the same information. It was expressed, however, that a lower regional value content and a harmonized ROO are much preferred. A pressing concern for the large companies interviewed is with regards to the logistics side, which affects delivery of goods. There are ports that experience congestion, indicating that the velocity of improvement on process and system in the ports is not on a par with the requirement of the industry.

On the other hand, for the small automotive firm interviewed (Firm B in the Appendix), what is evident is the discouraging effect bureaucratic red tape has on their decision to use FTAs, e.g. troublesome regulatory procedures and the additional cost associated with it. Likewise, lack of information, as in the case of the electronics firm (Firm A), is one reason for non-utilization of FTAs. However, with knowledge about FTAs, both are going to use them and benefit from preferential tariffs. While Firm B will use it primarily as implemented or required by the mother company, Firm A will look into the FTAs for potential use for their upcoming product. Firm A, a 100 per cent

[11] The Appendix presents a summary of interview results.

Filipino electronics firm, is very enthusiastic about FTAs. The firm is keen on expanding opportunities and so would like to assess how FTAs could benefit them.

Previous studies, such as Wignaraja et al. (2010), found that FTA utilization is high in the automotive sector and relatively low in the electronics sector. Findings indicate reasons such as high margins of preference especially for the automotive sector, and already low tariffs and use of incentive schemes in economic zones and/or in the World Trade Organization's Information Technology Agreement (ITA) especially for electronics firms. Such is evident in the three automotive firms interviewed, which maximize benefits from the FTAs that the Philippines/ASEAN has with East Asia. As for the electronics firm, it has managed with the incentive they get as a 100 per cent exporter (this is without knowledge of FTAs and the ITA).

It appears that the privilege of fiscal incentives and/or the ITA are reasons for non-utilization of FTAs, but as one interviewee stated, FTAs and incentive schemes go hand in hand. For one, incentive schemes such as duty-free importation of raw materials only apply to products manufactured for exportation, so firms producing for the domestic market and importing inputs from ASEAN or another trading partner will benefit highly from preferential tariffs.

From the interviews, as far as the value chain is concerned and especially with FTAs that entered into force, it is apparent that clear and good understanding of ROOs and compliance thereof for both firms and customs personnel, together with better logistical systems are needed to ensure that the value chain is in order and benefits from free trade are gained. Furthermore, to complement this is an enabling domestic environment for investment such as improvement in infrastructure (especially road networks and ports) and facilitation of industry linkages.

As far as ROO reforms are concerned, there seems to be room for further liberalizing in the two sectors – electronics and automotive. Firstly, in the case of the electronics sector, tariffs are already low. Secondly, these are ASEAN priority sectors, whose production is highly characterized by GPNs. The interviews show that FTAs could matter. They could be supportive of the value chain and overall regional growth of the industry. Reforms in ROOs in simplifying procedures have been helpful. More effort could be made, including better education and information campaign.

6. Conclusion and Recommendations

The discussion above examines the features and characteristics of the ASEAN and ASEAN+1 FTAs, the OCPs and how they impact on ROO compliance costs, and as such, on the value chain.

To summarize, there is substantial commonality in ROOs across the FTAs covered (ATIGA, ACFTA, AKFTA and AANZFTA) although considerable variation still exists (especially with respect to specific restrictions). In addition, reforms being sought are generally aimed at relaxing restrictions and reducing compliance costs. The AIFTA is the newest agreement but appears to have a more restrictive basic ROO. The parties are still to come up with PSRs, which would hopefully benefit from experiences of the earlier agreements.

The type of applicable ROOs (especially in terms of restrictiveness), the number of FTAs the exporter deals with, and the OCP would have impacts on ROO compliance costs, and thus the global value chain. As long as these costs add up to less than the margin of preference provided by the FTA, exporters benefit and the FTA would have a positive impact on the value chain. However, the objective is not for the ROO costs to be lower than the margin of preference. Instead, costs of ROO compliance must be minimized and ROOs made liberal enough, so as to have a greater impact on regional growth and integration.

The ideal scenario that would provide an enabling environment for the value chain in East Asia is harmonization of the ROOs of the ASEAN+1 FTAs. Needless to say, the direction of harmonization should be towards the most liberal ROO and best practice in OCP. This could be the ultimate goal.

Short of this goal, general guidelines for reforms that could be taken have been suggested in the discussion.

1. On the ROOs themselves:
    a. Can the cut-off rate for RVC be lowered?
    b. Can a finer classification be used in the level of change required to confer origin?

c. Perhaps most cumbersome are the additional requirements and restrictions accompanying many PSRs, e.g. as to where the certain inputs are sourced, limiting where change in classification comes from, etc. Can some of these additional restrictions be removed or relaxed?

d. Is there a *de minimis* rule along with CTC?

2. On further measures to streamline the OCP:

a. What are the best practices in OCP?

i. Can an electronic system be put in place?

ii. Is self-certification a viable option? What form and safeguards?

b. Are there outstanding complaints from exporters/importers?

c. Are there sufficient education and information campaigns?

In terms of more specific recommendations, with regards to the first, there are some indicators that could help identify candidates for more liberal ROOs. Among others, these include:

1. the region's share in total world export for the product, and
2. the applied MFN tariff rate.

If the region's share in total world exports for the product is high (the region is the principal supplier), trade circumvention is not a big problem and there is a strong case for a more liberal ROO. Even more compelling, if the MFN tariff is low enough, then protection (and circumvention) is not an issue and the ROO should be made liberal. Indeed, where the MFN rate is lower than say 5 per cent, a waiver of ROO COs should be seriously considered.

With regard to OCP, further streamlining could focus on facilitating cumulation. One possibility is the use of mutual recognition of COs among these East Asian FTAs (the forms could be interchangeable). It is true that the ROOs are not completely harmonized, but, excluding AIFTA, substantial commonality exists. ndeed they have the same basic GR. In addition, if adopted, this would be a concrete step to ROO harmonization. The mutual recognition arrangement (MRA) could be done in stages, by product, and/or by FTA.

Finally, some outstanding issues from exporters/importers that need to be addressed include:

- The interview with customs officials (the case of the Philippines) indicated that the first problem (and the first hurdle) of the exporter is getting the right HS code for their product. Education and information campaign should address this problem. Support should be available at customs (or the authorised issuing body) to help in HS classification.
- If there were conflicts in interpretation between the exporter and the importing authority, it is important that it is possible to resort to advanced ruling.
- Generally, customs personnel have been observed to be lacking in capability and dependability, implying that they need attention and support. Besides the HS classification problem, other issues were the electronic filing system that would repeatedly fail and port systems that would fall short and cause congestion.
- In addition, not only customs personnel but some importers/exporters themselves lack information on ROOs, be it in terms of compliance or lack of knowledge on FTAs. The government, possibly in partnership with the private sector, e.g. industry associations, should exert more effort to disseminate relevant and updated information.

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Appendix

Appendix 1. Summary of Firm Interviews

Firm A is an electronics firm that assembles components for HDD and exports 100 per cent to Japan. The firm is 100 per cent Filipino-owned and has 850 regular employees (large enterprise). The company is registered with the Philippine Economic Zones Authority[12] (PEZA). PEZA offers incentives schemes[13] to companies that are registered with them, usually those that are located in special economic zones such as Firm A. As a 100 per cent exporting company, Firm A receives duty free importation of parts or raw materials used in their production. To this end, the firm is satisfied with the incentives they are getting from PEZA. Their assembly of HDD components has been going on for years, such that the chain has already been established and paperwork has become easier. However, with the introduction of a new product, they would like to learn about FTA provisions, and be able to use them as it might help them be competitive, and give options for low-cost components that they will need in the manufacturing of this new product. The firm is eager to get information about FTAs as well as the ITA. One particular problem they foresee concerns the HS classification of parts in their new product, as they have encountered this problem in the past.

Firm B is an Australian automotive firm that designs and manufactures wheels. The firm exports 60 per cent and the rest goes to the local market. Forty per cent of inputs are imports (mainly steel) and 60 per cent are local (mainly chemicals). Firm B is an example of a firm that has had a bad experience in the Customs procedure. The red tape in the process has made filing costly for them, even with an electronic filing system. The firm hires a broker that takes care of applying for their CO (a regular one since they use MFN rate). The CO can be obtained quickly but 'is not cheap'. The company imports indirectly via a local firm because of the troublesome paperwork, aside from the

[12] PEZA is the Philippine government agency tasked to promote investments, extend assistance, register, grant incentives to and facilitate the business operations of investors in export-oriented manufacturing and service facilities inside selected areas proclaimed as PEZA special economic zones.

[13] Incentives include income tax holiday or exemption from corporate income tax for four years (extendable) or 5 per cent tax on gross income; exemption from duties and taxes on imported capital equipment, spare parts, supplies and raw materials; exemption from wharfage dues and export taxes, imposts and fees; simplified import and export procedures; permanent resident status for foreign nationals and immediate family; and employment of foreign nationals, among others.

reason that this is their way of supporting the local company. The interviewee expressed lack of information dissemination as regards the FTAs. He found out only recently, through their mother company, that AANZFTA had entered into force in 2010 and therefore will be availing of the preferential tariff. Firm B however could not avail of fiscal incentive schemes related to exemption from duties or taxes on imports or exports because it does not meet the requirement of 70 per cent exports to sales ratio.

Firm C is an American MNC engaged in assembly of motor vehicles and engines and exportation of completely knocked down (CKD) kits. The firm exports completely built-up (CBU) units (70 per cent of production) to ASEAN, CKD kits to Vietnam, engines to South Africa, and cylinder heads to Taiwan. The firm uses ATIGA--AFTA and JPEPA. The firm participated in the ASEAN Industrial Cooperation (AICO) scheme before, but with the FTAs, it does not find any need for AICO extension. The firm is able to meet the 40 per cent RVC since on average their regional content is 40-45 per cent, with ASEAN origin at 2-5 per cent. Though the firm is able to meet this requirement, preference is for lower RVC, as well as a harmonized RVC for all FTAs. As far as local content is concerned, the idea is to increase local content as much as possible but some local parts are not available or quality is not assured.

Moreover, documentation is not found to be difficult. There may be different origin forms, but the same information is basically asked and so it is not much of a concern. There are costs related to complying with ROOs, but the benefits of preferential tariff rates offset the cost of compliance. In terms of submission and processing of documents, there is a chronic red tape problem. To address this, the Customs Department has introduced the electronic filing system, which the firm welcomed but then implementation is becoming a problem. The persons responsible for the system are not sufficiently capable and knowledgeable such that when the system fails, the problem cannot be addressed immediately. On another note, as a PEZA-registered firm, Firm C enjoys fiscal incentives. However, while the firm receives duty free importation for inputs to exported products or for importation of vehicles, FTAs still matter to them in terms of products that are intended for the domestic market.

Firm D is a German MNC that produces electronic and mechanic components for automotive applications. Its products include electronic braking systems and seat/door/roof/access control that are 100 per cent exported to Germany, Belgium,

Japan, China and Korea. The firm uses ACFTA, AKFTA and Philippines-Japan Economic Partnership Agreement (PJEPA). At present, the firm is looking at the ASEAN--India or AANZFTA and assessing potential benefits. They would like the Philippine plant to be more competitive in terms of cost, and the FTAs are deemed to be a good vehicle to promote competitiveness. Firm D finds no difficulty as regards the rules of origin. For instance, they are able to satisfy the 40 per cent RVC (ACFTA) as many materials come from ASEAN and the CTC (AKFTA). They submit a complete set of required documents, get a CO within a week, with no additional costs. The set of documents they submit consist about seven different documents which in volume could go up to two inches thick depending on the shipment. The firm has no complaints because these are requirements and part of the process. The different ROO forms ask for almost the same information and so it is not much of a problem. Moreover, there may be different ROOs in the FTAs, but the interviewee/manager leaves this matter to the leaders whom she feels are working toward optimizing the benefits from FTAs.

Firm D has staff that take care of document submissions to customs. It helped that they have been doing this for a long time and therefore have established this side of their operations. In addition, there is a conscious effort to be informed and updated on FTAs. The manager herself reads up on the FTA websites. Access to information is generally smooth, except that for ACFTA it is rather difficult and a viewing fee is asked (there are private websites). The firm is PEZA registered, and located in a special economic zone, and therefore enjoys fiscal incentives such as free duty on imported equipment and on materials for exported products. Even with these fiscal incentives, the firm highly utilizes the preferential tariffs in FTAs. The interviewee/manager infers that fiscal incentives and FTA provisions address separate concerns. The PEZA fiscal incentives attract investors to invest in the country, while the FTAs provide exporters with a push and a channel to the global market.