



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

Policy Issues for the ASEAN Economic Community: the Rules of Origin

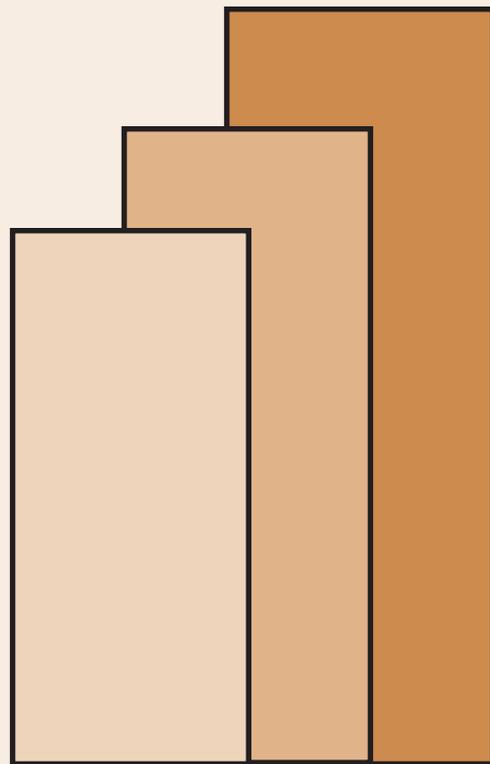
Erlinda M. Medalla and Josef T. Yap

DISCUSSION PAPER SERIES NO. 2008-18

The *PIDS Discussion Paper Series* constitutes studies that are preliminary and subject to further revisions. They are being circulated in a limited number of copies only for purposes of soliciting comments and suggestions for further refinements. The studies under the *Series* are unedited and unreviewed.

The views and opinions expressed are those of the author(s) and do not necessarily reflect those of the Institute.

Not for quotation without permission from the author(s) and the Institute.



July 2008

For comments, suggestions or further inquiries please contact:

The Research Information Staff, Philippine Institute for Development Studies
5th Floor, NEDA sa Makati Building, 106 Amorsolo Street, Legaspi Village, Makati City, Philippines
Tel Nos: (63-2) 8942584 and 8935705; Fax No: (63-2) 8939589; E-mail: publications@pids.gov.ph
Or visit our website at <http://www.pids.gov.ph>

Policy Issues for the ASEAN Economic Community: the Rules of Origin

Erlinda M. Medalla and Josef T. Yap

Abstract

Striking a balance between trade facilitation and preventing trade deflection is the single most difficult challenge with regard to the issue of rules of origin (ROO). ASEAN ROO is already considered as among the simplest in the world and still, in practice, results fall short of expectations. Haddad (2007) made the following observations about the ASEAN ROO: (1) low AFTA preference utilization rate, (2) difficult compliance even for supposedly simple value-added rule, (3) administrative cost of compliance to prove origin acting as deterrent, (4) low margin of preference for goods traded within ASEAN, and (5) the bulk of intra-ASEAN trade occurring in commodities where preference margins are below the threshold that would justify the cost of compliance.

Lessons from the EU experience indicate that there are a number of factors which could further lessen the negative effects of restrictive rules of origin schemes. This is related to the wide spectrum of ROO among the various East Asian FTAs. According to Manchin and Pelkmans-Balaoing (2007), the burden of production costs induced by restrictive rules of origin can be somewhat reduced by allowing less restrictive cumulation rules (e.g. diagonal or full cumulation), allowing duty drawback, outsourcing and higher *de minimis* levels. Furthermore, administrative costs can also be reduced by more trader-friendly approaches, such as self-certification methods.

The reforms in ASEAN ROOs are indeed heading toward the direction of less restriction and simplification as described by Manchin and Pelkmans-Balaoing (2007):

“The relatively ample allowance for imports in the AFTA stems from the realization that for many heavily-traded products in the region, like electronics, production processes may be so splintered that the value of local content is often a small percentage of the product’s total value. Very early on in the formation of AFTA, it was recognized that the 40 percent ASEAN origin rule may often not be met in the case of trade in textile and textile products. In 1995, it was therefore decided that either the percentage value-added or the substantial transformation rule may be used by ASEAN exporters. The AFTA ROO underwent further overhaul, starting in 2003, when operational procedures were further clarified and simplified. In the same year, the decision was reached to adopt a change in tariff heading rule for determining the origin of the product as a general alternative rule “applicable to all products which cannot comply with the 40 percent local/ASEAN content requirement, giving priority to sectors which are the subject of private sector requests and those sectors prioritized by the AEM for accelerated integration. As of last year (2006), the change of tariff heading rule is fully endorsed for four sectors: wheat-flour, wood-based products, aluminum products and iron and steel.”

Forging ASEAN in an effective regional economic bloc and eventually an economic community, however, would entail more fundamental structural reforms. The argument by the 2003 McKinsey report that “market fragmentation lies at the heart of ASEAN’s competitiveness challenge” is rather simplistic. Fortunately, the six projects currently being undertaken by the Economic Research Institute for ASEAN and East Asia (ERIA) address these fundamental issues. These studies deal primarily with “supply side constraints”

focusing on enhancing the capability of ASEAN member countries to engage with each other and other countries more effectively and meaningfully.

In the medium term, ASEAN member countries can push for an East Asia Free Trade Area that will consolidate the various bilateral and sub-regional FTAs and therefore overcome the noodle bowl syndrome. This would be a direct result of harmonizing the various ROO. It goes without saying that the ultimate or long-term objective would be an equitable and efficient multilateral trading system anchored on lower MFN rates under the auspices of the WTO.

Keywords: rules of origin, ASEAN economic community, free trade agreements (FTAs)

Policy Issues for the ASEAN Economic Community: the Rules of Origin*

*Erlinda M. Medalla and Josef T. Yap***

1. INTRODUCTION

Since its inception in 1967, ASEAN has evolved steadily from being a loose forum for exchanging official views to an organization with stronger bonds and a distinct identity underpinned by the unique “ASEAN” way. Despite the limitations of the non-confrontational and “consensual” nature of ASEAN, it has moved forward on many issues, particularly regional security. One benefit of the “ASEAN way” has been the cohesion and solidarity developed among the member countries.

In this context, it is but logical that ASEAN leaders are looking to establish an ASEAN community. Moreover, the role of ASEAN in the process of East Asian economic integration has become more important. And with the continued dynamism provided by its East Asian neighbors, the goal has grown into the vision of an East Asian community.

Nonetheless, a question is often raised whether ASEAN can meet the challenges of the emerging geo-political and economic environment, which are manifested mainly as obstacles to economic integration and the formation of a community. First of all, the proliferation of preferential trading arrangements in the region and around the globe is a

* This paper is a component of the Economic Research Institute for ASEAN and East Asia (ERIA) project on *Deepening Economic Integration in East Asia – the ASEAN Economic Community and Beyond* - that was funded by the Institute of Developing Economies/Japan External Trade Organization and completed in March 2008. It has previously appeared as Chapter 4 in Part II of ERIA Research Project Report No. 1-2 edited by Dr. Hadi Soesastro.

** Senior Research Fellow and President, respectively, of the Philippine Institute for Development Studies. The usual disclaimer applies.

hindrance to the process of further economic integration. Second, the complexity of administrative procedures and the consequent transaction costs that govern the ASEAN regulatory framework has impeded the utilization of preferences and the growth of intra-ASEAN trade. Third, the large disparity in economic development and different political systems and structures could hinder closer cooperation and integration. Finally, there remains a strong reluctance from individual ASEAN member countries to transfer sovereignty to a supranational authority which is needed to establish a more formal and binding institution that can more effectively support deeper integration.

With all these difficult issues stacked against forging more formal ASEAN integration, not much optimism accompanied the holding of the 12th ASEAN Summit held in Cebu in January 2007. However, on the whole, the Summit yielded promising and significant results which were beyond expectations. Arguably the most important outcome is the Cebu Declaration on the Blueprint of the ASEAN Charter. It is an unequivocal commitment to build a stronger institution and to create a more formal regional body, signifying compromise on the part of member countries with regard to transferring sovereignty to a supranational authority.

Much remains to be done and a number of problem areas have been identified. Among the latter is the issue of ASEAN Rules of Origin (ROO). This paper aims to examine the policy issues surrounding the ASEAN ROO regime, with the end in view of contributing to the on-going efforts to achieve best practice in this area. The ROO is at the heart of any free trade agreement (FTA) and in order to achieve its full benefits, the ROO should not only be an instrument to prevent trade deflection. It should be trade facilitating as well.

Striking a balance between trade facilitation and preventing trade deflection is a difficult challenge. ASEAN ROO is already considered as among the simplest in the world and still, in practice, results fall short of expectations. Haddad (2007), for example, has made the following observations about the ASEAN ROO: (1) low AFTA preference utilization rate, (2) difficult compliance even for supposedly simple value-added rule, (3) administrative cost of compliance to prove origin acting as deterrent, (4)

low margin of preference for goods traded within ASEAN, and (5) the bulk of intra-ASEAN trade occurring in commodities where preference margins are below the threshold that would justify the cost of compliance.

2. ISSUES IN ASEAN ROO

- *Cost of compliance and administration*

The problems in ROO are well recognized. ROOs administration and compliance necessarily involve costs, both on the part of administration, and more so in terms of compliance efforts by the intended beneficiaries.

Even without the spaghetti-bowl effect, costs of implementing ROO could be substantial. The JETRO Survey of Japanese Firm's International Operations (JETRO, 2007) shows that of 97 Japanese MNCs using or planning to use FTA preferences in East Asia, about 30 percent find that dealing with different rules of origin increases costs, either from direct compliance with complicated procedures to prove country of origin or from changes to productions processes to achieve the ROO definition.

Estimates of ROO costs vary: 3 percent of the value of goods traded for EFTA countries (Herin 1986), between 4-4.5 percent (Manchin 2006) and 6-8 percent (Cadot et al., 2005) for other 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.

JETRO surveys in ASEAN countries note the time and paperwork involved in obtaining Form D (the official form to prove origin in AFTA). Compliance with ROO

involves numerous documentation requirements (including invoices and other evidence for each input used in the final product). These problems are magnified for small firms. In addition, ASEAN requires that Form D should be issued by designated government departments, unlike many other FTAs where private sector associations are allowed to issue certificates of origin.

The type of certification adopted would have direct implication on the trading costs. Some types require involvement by the exporting country government, 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). However, this method could be too unconventional for most ASEAN countries, making its acceptability a problem. In addition, with a post-audit check and inadequate safeguards against harassment, traders may find it actually less cumbersome and costly to go the route of obtaining government certification.

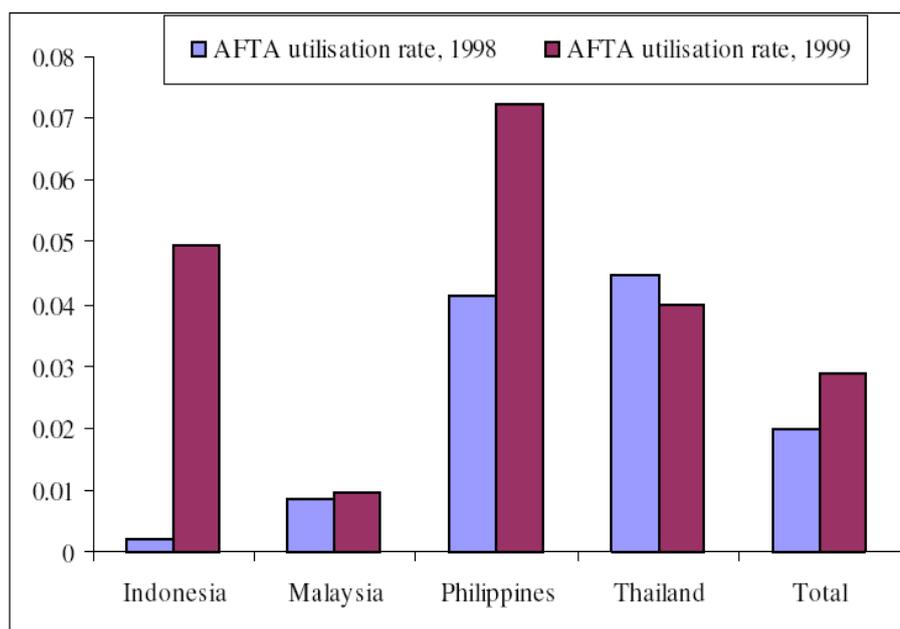
Another problem is that customs valuations differ across in ASEAN countries and pre-export inspection requirements required by AFTA are cumbersome. In particular, inspection requirements would need face-to-face contact with officials, increasing not only the time input, but the room for graft and corruption. In addition, goods utilizing CEPT are subject to random post-audit checks. Indeed, although a lot of effort in terms of policy reform is done to create “green lanes” to speed up the ROO administration, 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 Pelkmans-Balaoing, 2007).

- *Low AFTA utilization rates*

Compliance costs necessarily dampen the utilization rate of the CEPT preference. Indeed, CEPT utilization rates have been low. Some studies estimate that only 3 percent

of intra-ASEAN trade availed of the CEPT rates (Baldwin, 2006). JETRO reports that in 2002, only 11 percent of Thailand’s exports to AFTA and 4.1 percent for Malaysia used the CEPT. This is far below the utilization rates in the EU which are rarely below 50 percent.

Figure 1. AFTA Utilization rates



Source: PriceWaterhouseCooper (2002) as cited in Baldwin (2006)

In a report on ASEAN’s FTAs and Rules of Origin, JETRO (2004) cites some improvement in the share of CEPT exports. It noted that 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 encouraging trend indicates better utilization of the CEPT preference but it remains to be seen whether it can be maintained.

- *Low tariffs in ASEAN for majority of commodities and the nature of ASEAN trade*

Apart from ROO compliance costs, other factors account for the low CEPT utilization rate. An important aspect is that preference margins for products traded within ASEAN are already low for the major intra-ASEAN exports. These are computer/machinery and electrical equipment where the tariffs are nil or very low (around 1.5 percent). In addition, where margins of preference are high, for most

ASEAN countries, these are also where non-tariff measures are imposed. A prime example would be the various NTM measures on certain automotive products.

The flipside of this is that the majority of intra-ASEAN trade occurs in commodities with low preference margins—lower than the cost of compliance. Over 90 percent of trade among the ASEAN4—Malaysia, Indonesia, Thailand, Philippines—occurs in commodities where preferences are below 25 percent, the estimated threshold by Manchin and Pelkmans-Balaoing (2007). By any standard, a tariff of 10-25 percent is still substantial; on the other hand, an ROO compliance cost of more than 10 percent is simply too high, making the FTA immaterial.

Not only do ASEAN imports have low preference margins, the import content of key manufacturing sectors is relatively high. The low preference margins and high import content reflect the degree of process fragmentation in highly globalized sectors such as electronics. Moreover, intra-ASEAN trade is only about 25 percent of its total trade, indicating its heavy dependence on outside countries. It would be difficult for any form of ROO or trade preference scheme to overcome structural factors that are a result of decades of economic interaction.

- *Further simplification of ROO approach*

Simplifying ROO is a challenging task, often with remedies producing unintended effects. This makes it even more imperative that policy and policy guidelines are as clear and simple as possible. Continuous efforts need to be made by ASEAN to improve ROO administration. There is room for reforms as well in the type of ROO as well. As earlier noted, the ASEAN ROO is among the simplest in the world in theory. AFTA-CEPT ROO provides that:

- (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;*
- (iii) Subject to sub-paragraph (i) above, for the purposes of implementing the provisions of Rule 1 (b), products worked on and processed as a result of which the total value of the materials, parts or produce originating from non-ASEAN countries or of undetermined origin does not exceed 60 percent of the FOB value of the product produced or obtained and the final process of manufacture is performed within the territory of the exporting Member State.*

However, there is still scope for improvement in terms of fine tuning and search for best-practice policy. Practitioners note that when implemented, the RVC rule is difficult to comply with since firms have to measure, disclose and certify input costs. The use of change in tariff classification (CTC) may be easier. The coverage in terms of level, combination, for product list is a further refinement that could be made.

Another example is the use of absorption or Roll Back principle which allows materials that have acquired origin by meeting specific processing requirements to be considered originating when used as input in a subsequent transformation. This is not resorted to in the ASEAN ROO (Kirk, 2007).

3. THE ASEAN ECONOMIC COMMUNITY (AEC) BLUEPRINT AND THE ROO: WHAT IS BEING DONE

ASEAN is fully cognizant that in order to achieve its goal of a single market and production base, progress in eliminating tariffs within ASEAN is not enough. It needs to be accompanied by an enabling ROO regime. Indeed, the AEC Blueprint explicitly provides for instituting reforms in this regard. 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.*

Along these lines, 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

There is agreement that the ROO regime should move towards more simple and unrestrictive ROO. Simpler ROO will help promote regional trade and international competitiveness of member states. Simple rules will reduce compliance costs and administration itself of trade and customs procedures. To minimize the potential for unproductive rent-seeking and corruption, a simple and transparent ROO is important. (ADB 2002)

In practice a simple and less restrictive ROO regime means using a single rule that is the least restrictive. Indeed, this has been the prescription followed by ASEAN even early on, with the use of the Value-added criterion for almost all products. A narrative provided by Manchin and Pelkmans-Balaoing (2007) describes the process in reforming the ASEAN ROO:

“The relatively ample allowance for imports in the AFTA stems from the realization that for many heavily-traded products in the region, like electronics, production processes may be so splintered that the value of local content is often a small percentage of the product’s total value. Very early on in the formation of AFTA, it was recognized that the 40 percent ASEAN origin rule may often not be met in the case of trade in textile and textile products. In 1995, it was therefore decided that either the percentage value-added or the substantial transformation rule may be used by ASEAN exporters. The AFTA ROO underwent further overhaul, starting in 2003, when operational procedures were further clarified and simplified. In the same year, the decision was reached to adopt a change in tariff heading rule for determining the origin of the product as a general alternative rule “applicable to all products which cannot comply with the 40 percent local/ASEAN content requirement, giving priority to sectors which are the subject of private sector requests and those sectors prioritized by the AEM for accelerated integration. As of last year (2006), the change of tariff heading rule is fully endorsed for four sectors: wheat-flour, wood-based products, aluminum products and iron and steel.”

The reforms in ASEAN ROOs are indeed heading toward the direction of less restriction and simplification. AFTA has started to introduce CTC as a substitute criterion for an increasing number of products. From a product coverage for CTC limited to: iron & steel products in HS Chapter 72, textiles and textiles products, wheat flour, aluminum and wood-based products, there are more products now covered by CTC, namely: (i) agro-based products; (ii) automotives; (iii) e-ASEAN; (iv) electronics; (v) fisheries; (vi) healthcare; (vii) rubber-based products; (viii) textiles and apparels; and (ix) wood-based products.

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.

Another area for reform is using cumulation type ROO more fully. 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. Coupled with simple ROO, this full cumulation will make it easier for regionally-based firms to exploit the economies of scale. (Brenton 2003)

For its part, ASEAN is 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.” Upon recommendation during the September

2004 AFTA Council Meeting, the percentage content requirement was reduced to 20 percent of ASEAN content.

This move is envisioned to help most developing ASEAN member countries, whose sources of inputs, given the global production network 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).

Table 1, below summarizes the draft revisions in the AFTA ROO.

Table 1. Comparison between Draft Revised and Existing CEPT ROO		
	Revised CEPT-ROO ¹	Existing CEPT-ROO
Contents	Rule 1 Definitions Rule 2 Origin Criteria Rule 3 Wholly Obtained or Produced Rule 4 Not Wholly Obtained or Produced Rule 5 Accumulation Rule 6 Minimal Operations and Processes Rule 7 Direct Consignment Rule 8 De Minimis Rule 9 Treatment of Packages and Packing Materials Rule 10 Accessories, Spare Parts and Tools Rule 11 Neutral Elements Rule 12 Identical and Interchangeable Materials Rule 13 Certificate of Origin Rule 14 Review and Modification	Rule 1 Originating Products Rule 2 Wholly Produced or Obtained Rule 3 Not Wholly Produced or Obtained Rule 4 Cumulative Rule of Origin Rule 5 Direct Consignment Rule 6 Treatment of Packing Rule 7 Certificate of Origin Rule 8 Review
Specific Provisions Changes: Not Wholly Obtained or Produced	<p>A good shall be deemed to be originating in the Member State where working or processing of the good has taken place:</p> <p>(a) if at least 40 percent of its content (hereinafter referred to as “ASEAN Value Content” or the “Regional Value Content (RVC)”) originates from that Member State or it has undergone a change in tariff classification at four-digit level (change in tariff heading) of the Harmonised System</p> <p>The formula for calculating ASEAN Value Content or RVC is as follows:</p> <p><i>a) Direct Method:</i></p> $RVC = \frac{\text{ASEAN Material Cost} + \text{Direct Labour Cost} + \text{Direct Overhead Cost} + \text{Other Cost} + \text{Profit}}{\text{FOB Price}} \times 100\%$	<p>A product shall be deemed to be originating from ASEAN Member States, if at least 40% of its content originates from any Member States.</p> <p>The formula for 40% ASEAN Content is as follows:</p> <p>Value of Imported Non-ASEAN Materials, Parts or Produce +</p>

¹ As of December 2007, still subject to final confirmation from ASEAN Member countries.

	<p>(b) <i>Indirect Method :</i></p> $RVC = \frac{\text{FOB Price} - \text{Non-Originating Materials, Parts or Produce}}{\text{FOB Price}} \times 100 \%$	<p>Value of Undermined Origin Materials, Parts or Produce</p> <hr/> <p>FOB Price</p> <p>x 100% ≤ 60%</p>
Cumulation	<p>If the Regional Value Content of the material is less than 40 percent, the qualifying ASEAN Value Content to be cumulated using the RVC criterion shall be in direct proportion to the actual domestic content provided that it is equal to or more than 20 percent. The Implementing Guidelines are set out in <u>Appendix B</u>.</p> <p><i>a) a good shall be deemed to be eligible for partial cumulation, if at least 20 percent of the Regional Value Content (RVC) of the good is originating in the Member State where working or processing of the good has taken place...</i></p>	<p>If the material has less than 40 percent ASEAN content, the qualifying ASEAN national content shall be in direct proportion to the actual domestic content provided that it is equal to or more than the agreed threshold of 20%²</p>
<i>De Minimis</i>	<p>A good that does not undergo a change in tariff classification shall be considered as originating if the value of all non-originating materials used in its production that do not undergo the required change in tariff classification does not exceed ten (10) percent of the FOB value of the good and the good meets all other applicable criteria set forth in this CEPT-AFTA Agreement for qualifying as an originating good.</p>	
<p><i>Source: Documents from ASEAN Secretariat</i></p>		

To summarize, the origin criteria in the Draft Revised CEPT-ROO will be as follows:

- 1) goods wholly produced in the country of exportation
- 2) goods satisfying rules on Regional Value Content (40 percent) or Change in Tariff Classification (actual CTC rule) or specific processes
- 3) goods satisfying partial cumulation rule (at least 20 percent of RVC)

² The implementation of this provision would be based on the Implementing Guidelines, which was endorsed by the AEM Retreat, April 2005.

4. THE IMPACT OF OTHER EAST ASIAN FTAS

The proliferation of bilateral and sub-regional FTAs in East Asia has complicated the issue of ROO. The main reason is that FTAs by East Asian countries have a wide spectrum in terms of the stringency of ROO. The likely impact is an increase in administrative cost for traders and production cost for firms. Manchin and Pelkmans-Balaoing (2007) argue that cost of operating in several preferential trade agreements might become so high that producers in the spoke countries might only be able to trade under one single preferential agreement. This is definitely an inferior outcome compared to a liberalized multilateral trading regime under the WTO.

5. CONCLUSIONS AND RECOMMENDATIONS

From the perspective of ASEAN, creating an economic community would entail increasing intra-regional flow of goods, capital and services. Certainly reforming the ROO can contribute to this goal, but if social and economic development is the primary objective, then the benefits from this measure should be put in proper perspective.

It should be noted that reforming the ROO system is couched in the context of maximizing the effectiveness of FTAs, whether they be bilateral, sub-regional or regional. What should be emphasized, however, is that FTAs have never been an integral part of economic development of countries in the region.³ Hence, the domestic reform process should not be constrained by the noodle bowl syndrome and neither should the latter be a major obstacle to social and economic development.

Nevertheless, there are benefits to reforming the ROO in AFTA. Lessons from the EU experience indicate that there are a number of factors which could further lessen the negative effects of restrictive rules of origin schemes. This is related to the wide spectrum of ROO among the various East Asian FTAs. According to Manchin and

³ Japan, Korea, Taiwan, China in particular achieved high economic growth without the benefit of any FTA.

Pelkmans-Balaoing (2007), the burden of production costs induced by restrictive rules of origin can be somewhat reduced by allowing less restrictive cumulation rules (e.g. diagonal or full cumulation), allowing duty drawback, outsourcing and higher *de minimis* levels. Furthermore, administrative costs can also be reduced by more trader-friendly approaches, such as self-certification methods.

To its credit, ASEAN is fully cognizant of the need to simplify and improve the ROO system. Indeed, the AEC Blueprint explicitly mandates continuous reforms to “*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 and 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.*”

Forging ASEAN in an effective regional economic bloc and eventually an economic community, however, would entail more fundamental structural reforms. The argument by the 2003 McKinsey report that “market fragmentation lies at the heart of ASEAN’s competitiveness challenge” is rather simplistic. Fortunately, the six projects currently being undertaken by the Economic Research Institute for ASEAN and East Asia (ERIA) address these fundamental issues.⁴ These studies deal primarily with “supply side constraints” focusing on enhancing the capability of ASEAN member countries to engage with each other and other countries more effectively and meaningfully.

Some of the measures that would arise from these studies are as follows:

⁴ The projects are as follows: In the area of *Deepening Integration*, Project No. 1: Deepening economic integration; Project No. 2: International infrastructure development in East Asia: toward effective and balanced regional integration; and Project No. 3: Analyses of industrial agglomeration, production networks and FDI promotion. In the area of *Narrowing Gaps of Economic Development*: Project No. 4: Development strategy for CLMV countries (Cambodia, Lao PDR, Myanmar and Viet Nam) in the age of economic integration; and Project No. 5: SMEs in Asia and globalization. In the area of *Sustainable Economic Growth*, Project No. 6: Energy security issues such as energy conservation, standardization of biodiesel fuel for vehicles and sustainable utilization of biomass

- Narrowing the development gap in the region through infrastructure projects and capability building including technology transfer.
- These infrastructure projects and capability building will enable more firms from ASEAN, particularly small and medium enterprises, to participate in global production networks, indirectly through large domestic firms or by directly latching to regional and global supply chains.
- Harmonization of product standards and customs procedures that will facilitate greater trade in goods and services.

In the medium term, ASEAN member countries can push for an East Asia Free Trade Area that will consolidate the various bilateral and sub-regional FTAs and therefore overcome the noodle bowl syndrome. This would be a direct result of harmonizing the various ROO. It goes without saying that the ultimate or long-term objective would be an equitable and efficient multilateral trading system anchored on lower MFN rates under the auspices of the WTO.

REFERENCES

- ADB (2002). *Preferential Trade Agreements in the Asia and the Pacific*. Asian Development Outlook.
- Baldwin, R. (2006). “Managing the Noodle Bowl: The Fragility of East Asian Regionalism”. *Discussion Paper Series*, No. 5561. Center for Economic Policy Research, UK.
- Brenton, P. (2003). “Notes on Rules of Origin with Implications for Regional Integration in South East Asia”, The World Bank.
- Cadot, O., Carrere, C., De Melo, J. and B. Tumurchudur (2005). “Product Specific Rules of Origin in EU and US Preferential Trading Agreements: An Assessment”, *Discussion Paper Series*, No. 4998. Center for Economic Policy Research, UK.
- Carrière, C. and J. de Melo (2004). “Are Different Rules of Origin Equally Costly? Estimates from NAFTA”, *Discussion Paper Series*, No. 4437. Center for Economic Policy Research, UK.
- Estevadeordal, A. and K. Suominen (2003). “Rules of Origin in FTAs in Europe and in the Americas: Issues and Implications for the EU-Mercosur Interegional Association Agreement”, *INTAL Working Paper* No. 16.
- Haddad, M. (2007). “Overview: Rules of Origin in East Asia: How Are They Working in Practice?” in *Trade Issues in East Asia: Preferential Rules of Origin*, Policy Research Report. East Asia and Pacific Region, Poverty Reduction and Economic Management. The World Bank.
- Herin, J. (1986). “Rules of Origin and Differences Between Tariff Levels in EFTA and in the EC”, EFTA Secretariat, Geneva.
- Japan External Trade Organization (JETRO). (2007). *FY2006 Survey of Japanese Firms’ International Operations*, Tokyo.
- JETRO (2004). “ASEAN’s FTAs and Rules of Origin”, Japan External Trade Organization Overseas Research Department
- Kirk, R. (2007). “Rules of Origin in East Asia” in *Trade Issues in East Asia: Preferential Rules of Origin*, Policy Research Report. East Asia and Pacific Region, Poverty Reduction and Economic Management. The World Bank.
- Manchin, M. (2006). “Preference utilization and tariff reduction in EU imports from ACP countries”, *World Economy*, forthcoming

Manchin, M. and A. O. Pelkmans-Balaoing (2007). “Rules of Origin and the Web of East Asian Free Trade Agreements”, *World Bank Policy Research Working Paper 4273* (July)