

ASEAN's FTAs and Rules of Origin

November 2004

**Japan External Trade Organization
Overseas Research Department**

Introduction

Rules of origin are international rules for determining the “nationality” of goods. To enjoy the benefits of common effective preferential tariffs, the respective rules of origin established in the FTAs that continue to emerge in East Asia must be cleared. However, rules of origins have multiple standards, and the standards used differ by FTA. Rules of origin occupy an important place within FTA negotiations.

From the standpoint of companies using FTAs, rules of origin are crucial in that they have an impact on procurement strategies in the countries concerned. The time-consuming and laborious task of acquiring certificates of origin constitutes a cost for companies, so the screening methods, the time required for procedures, and other aspects of the implementation of these rules become extremely important.

This report summarizes from this perspective the implementation of rules of origin and the utilization of these rules through interviews conducted with government-related organizations and Japanese-affiliated companies on the AFTA (ASEAN Free Trade Agreement), the forerunner of FTAs in the region, the ASEAN-China FTA, under which the Early Harvest Program has begun, and other FTAs.

We would be very pleased indeed if this report proves a useful reference for companies expanding or considering future expansion into ASEAN/Asia and for other parties interested in business within the region. We would also like to take this opportunity to offer our sincere thanks to all company participants who took time from their busy work schedules to assist us in our research.

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Summary

Chapter 1 AFTA (CEPT) rules of origin and implementation

<Expanding CEPT trade>

With the AFTA bringing about reductions of intra-regional tariffs, trade utilizing common effective preferential tariffs (CEPT) has increased substantially. Thailand's CEPT exports for 2003 swelled 250%, and the numbers of certificates of origin (Form D) issued in Malaysia and Vietnam have also climbed rapidly.

<Certificates of origin: screening and procedures>

Screening and procedures for Form D are for the most part similar in all countries, but they do differ in details. There is also a wide variance in the number of days required for acquisition. Singapore and Thailand (to a degree) are introducing EDI.

<Utilization and assessment of CEPT by Japanese-affiliated firms>

Companies overall view the standard of ASEAN content of 40% or higher as easy to meet, but some parts manufacturers dependent on imports for materials regard it as quite strict. In countries such as the Philippines where supporting industries are weak, companies find it difficult to procure sufficient goods/materials locally to clear the standard, but they do achieve a high local procurement rate in terms of ASEAN content. A number of respondents called for simplifying and speeding up procedures.

<Other problems connected with CEPT>

Full-scale introduction of the ASEAN Harmonized tariff Nomenclature (AHTN) began at the start of 2004, and CEPT has also been authorized for use in intermediary trade through third countries.

Chapter 2 ASEAN-China FTA rules of origin and implementation

<ASEAN-China FTA rules of origin>

Similar to CEPT, the rules of origin demand that products have ASEAN-China content of 40% or more. The certificate of origin is called Form E.

<Implementation of the Early Harvest Program>

Targeting agricultural products, the Early Harvest Program has particularly expanded trade between China and Thailand. However, exporters in Thailand complain of non-tariff trade barriers on the Chinese side.

<Procedural methods for, and problems involving, certificates of origin (Form E)>

The issuance procedures for Form E are exactly the same as those for Form D.

While some confusion arose initially when the Early Harvest Program was launched, there do not appear to be any major problems at present.

<Utilization by Japanese-affiliated firms>

As the Early Harvest Program covers agricultural products, few Japanese-affiliated firms appear to utilize it. One Japanese confectionary manufacturer based in Thailand, however, has been using the import tariff refund system for raw materials, and that company remarked that it has benefited greatly in terms of procedures by the abolition of tariffs.

Chapter 3 Rules of origin under Thailand's and Singapore's bilateral FTAs

<Thailand's bilateral FTAs>

The Early Harvest Program begun with India on September 1, 2004 requires that products simultaneously satisfy a 40% or higher local procurement rate and the standards for changing tariff codes, making it stricter than CEPT. Thailand's FTA with Australia uses the standards for changing tariff codes as the basis, but separate rules have been set out for each commodity item.

<Singapore's bilateral FTAs>

FTAs have already gone into effect with New Zealand, Japan, EFTA, Australia and the US. Although many of the rules of origin are based on the standards for changing tariff codes, value added standards (local procurement rate standards) have been adopted in the FTAs with New Zealand and Australia.

Chapter 4 Summary: rules of origin and their impact on business activities

Rules of origin can be considered to be constraining factors for companies in terms of both procurement and production. When rules of origin differ by FTA, procedures become even more complicated.

Procurement and production are carried out within ASEAN to ensure sufficient ASEAN content, and procurement networks continue to widen to China and India as well as Japan. In line with this situation, it is important that the FTAs now being implemented piecemeal at some future point converge into a "plane." Hurdles should be made as low as possible and the current scope of ASEAN-based cumulative origin should be broadened through common rules of origin.

Chapter 1 AFTA (CEPT) rules of origin and implementation

1. Expanding CEPT trade

<Thailand's CEPT exports up 250%>

Intra-regional tariffs are being lowered through the ASEAN Free Trade Area (AFTA). In accordance with AFTA's CEPT (Common Effective Preferential Tariff) scheme, intra-regional tariffs were reduced on January 1, 2003 to 0 - 5% for all but certain exceptional commodity items (except the new member countries of Vietnam, Laos, Myanmar, and Cambodia). The original member countries (Brunei, Indonesia, Malaysia, Philippines, Singapore, and Thailand) are scheduled to eliminate tariffs altogether by 2010 and the new member countries to do so by 2015.

As tariffs have come down, intra-regional trade using CEPT has grown substantially. Exports from Thailand to other ASEAN countries using CEPT achieved year-on-year growth of 250% (\$3.73 billion) in 2003. These exports went primarily to Malaysia (\$1.17540 billion) and Indonesia (\$1.06 billion), followed by the Philippines (\$756.30 million) and Vietnam (\$571.00 million). These top four countries accounted for approximately 96% of Thailand's total CEPT exports. CEPT exports more than doubled their share of total exports to ASEAN from 10.8% in the previous year to 22.5%, a clear indication that use of CEPT by export companies is rapidly increasing.

CEPT exports for the first half (January - June) of 2004 rose by 61.8% year-on-year to \$1.88billion and, while the growth rate was sluggish compared to the previous year, it was nevertheless high.

According to the Department of Foreign Trade, Ministry of Commerce of Thailand, the number of Form Ds (the Certificate of Origin for CEPT) issued has grown significantly from 40,597 in 2001 to 51,277 in 2002 and 69,564 in 2003.

<Sharp rise in issue of Form Ds by Malaysia and Vietnam as well>

On the other hand, CEPT use in Malaysia constitutes only a low 5.2% (2003) of that country's overall exports to ASEAN. With the lowering of CEPT tariffs, though, exports to ASEAN utilizing CEPT reportedly increased by 59.5% year-on-year in 2003, reaching \$1.38billion. Thailand was the destination for an overwhelmingly large share of those exports, accounting for about 43% of the total (\$590.00 million), with second place claimed by Vietnam, to which exports more than tripled to \$240.00 million as a result of a substantial tariff reduction in 2003. The single most important export commodity item was electronics products, making up around 22% of the total, followed by plastic parts and iron/steel products. The number of CEPT applications also climbed sharply from 42,255 in 2002 to 64,266 in 2003.

Vietnam's Ministry of Trade reports that the number of Form Ds issued by its Export-Import Managing Department shot up from 2,745 in 2002 to 4,319 in 2003. The previous year's pace has been surpassed in the first half of 2004, during which 2,499 Form Ds were issued. Offices located in EPZs can also issue Form D but the number issued is not included in the above figures, so the

number of Form Ds actually issued is even larger. Commodity items for which exports have expanded via CEPT include agricultural and marine products (coffee, rice, cashew nuts, marine products, wood products, etc.), textile products, foodstuffs, and electrical/electronic products.

2. Certificates of origin: screening and procedures

<Standard is ASEAN content of 40% or higher>

CEPT is thus expanding steadily, but application of CEPT rates requires compliance with the stipulated rules of origin agreed upon between the ASEAN member countries. Specifically, the final process of the manufacture is performed within the territory of the exporting Member state and local content must be higher than 40%. Parts/raw materials procurement from ASEAN member countries is incorporated in this local procurement rate; this is termed “ASEAN cumulative content (ASEAN content).” The formula for such content in the CEPT rules of origin is:

$$\frac{\text{Value of Imported Non-ASEAN Materials, Parts or Produce} + \text{Value of Undetermined Origin Materials, Parts, or Produce}}{\text{FOB Price}} \times 100\% \leq 60\%$$

ASEAN is seeking to further invigorate intra-regional trade and is currently considering “expanding/easing standards” for the rules of origin. In other words, ASEAN is examining the introduction of a “Change of Tariff codes” as a substitute criterion. An easing/expansion of the rules of origin through the new concept of “partial cumulation” is also under consideration. Components counted as part of ASEAN content have conventionally been required themselves to have ASEAN content of 40% or more. This requirement was eased at the September 2004 AFTA Council Meeting, which also authorized inclusion of the actual value of components with more than 20% of ASEAN content into the calculation of ASEAN content as partial cumulation.

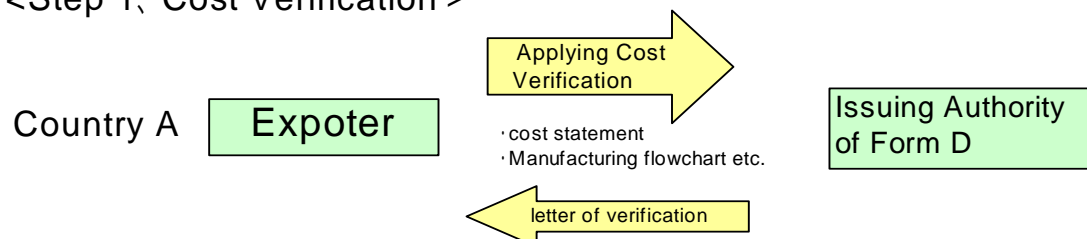
<Procedural flow nearly the same in all countries>

Rules of origin are therefore being reviewed to promote greater use of CEPT, but some of the most important factors from the standpoint of companies are the time and trouble involved in the screening and issuing needed for Form D acquisition.

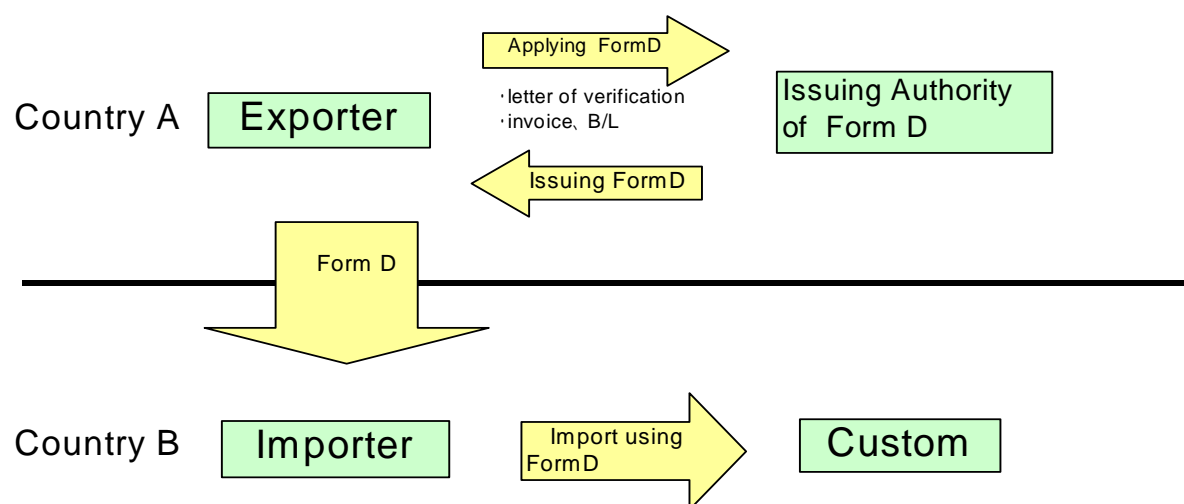
Judging from interviews conducted by JETRO with the issuing organizations in each country, the procedural flow leading to the issue of Form D is mostly the same in all these countries and is shown in Diagram 1. Procedures do, however, differ in certain details.

Table 1. Flowchart of receiving and utilizing Form D

<Step 1, Cost Verification >



<Step 2, Receiving Form D >



(source) JETRO

(1) Thailand

The Trade Preference Division, Department of Foreign Trade, Ministry of Commerce is the organization in Thailand responsible for cost screening and issue of Form D. For products classified as HS Code 84 to 97, a “certificate of production process, cost, price” must be acquired before applying for a Form D. Only Thailand varies its screening methods by HS Code. The overall view among Japanese-affiliated firms was that screening in Thailand is the most right of any ASEAN country.

EDI (Electronic Data Interchange) was introduced in December 2003 on an experimental basis for use in the Form D issue procedures needed for each shipment to be cleared through customs. Thailand is currently negotiating FTAs with nearly ten countries, and Thailand will gradually begin implementing these. A sharp rise can consequently be expected in the number of certificates of origin issued, making the transition to EDI essential.

Form D is issued on the day of application or, at the latest, on the following day, and almost no

companies expressed dissatisfaction in this regard.

(2) Malaysia

In Malaysia, the Trade Support Division, Ministry of International Trade and Industry, issues Form D. According to the division, the initial screening (cost screening of local content) is completed within seven days from the time the application is received. However, the issue of Form D for individual shipments to be cleared through customs takes two to three days, the longest period of any of the major ASEAN countries.

(3) Singapore

Singapore Customs issues Form D. Singapore's progress in EDI and its advanced systems are unmatched by any other ASEAN country. Procedures call for 1) factory registration with the Customs Bureau, which takes about one week, followed by a inspection of the factory by Customs officials, and then 2) cost calculation (local content calculation) and approval for each commodity item, requiring about two to three days.

Form D for individual export shipments must be obtained after 1) and 2). This is done by applying online (EDI) via a personal computer. The application is then screened by a Customs official, who then provides online notification of authorization. Once this notification has been received, the exporter goes to the Customs Bureau to receive Form D, which is issued on the same day the application is submitted.

(4) Indonesia

The Directorate General of International Trade and Industry Cooperation, Ministry of Industry and Trade, is the issuing institution for Form D in Indonesia. Actual issuance is done at the regional offices of the Ministry of Industry and Trade located in each province.

On-site tours of factories may be conducted during the initial cost screening; screening is completed in about three days. After the screening, Form D is issued for each export shipment and can be obtained on the same day the application is submitted.

(5) Philippines

In the Philippines, the Bureau of Customs issues Form D. Obtaining Form D requires a pre-export screening (pre-exportation verification). Factory inspections by Bureau of Customs personnel may also be conducted when necessary. Screening is completed within one week after the application is received.

Form D is issued on the day of application if the application is accompanied by the proper supporting documentation.

(6) Vietnam

In Vietnam, the Export-Import Managing Department, Ministry of Trade is the issuing institution for Form D. An application is submitted to an inspection company authorized by the Ministry of Science to conduct a cost screening to ensure local content of 40% or more. The official in charge at the Export-Import Managing Department noted that VINACONTROL is the largest of these companies, but a rise in the number of authorized companies over the past few years have produced numerous competitors. The time required depends on the products involved, but screening generally takes about one-half to one day.

Applications for the Form Ds needed for each export shipment are submitted to a branch office of the Export-Import Managing Department (9 branches nationwide). The application must be accompanied by a certifying letter from the inspection company, a commercial invoice, a Customs declaration form, a bill of lading, and a copy of the exporter's commercial license; Form D is issued in about two hours.

The EPZ Management Committees in each province also have the authority to issue Form D at present, but a ministerial decree in 2004 will be putting an end to this authority. The Export-Import Managing Department stated that a transition is underway, and that these Committees will no longer be able to issue Form D from 2005.

3. Utilization and assessment of CEPT by Japanese-affiliated firms

<Opinion is that local procurement rate of 40% is easy to meet>

An overview of acquisition procedures has been provided above, but what of the utilization of CEPT by Japanese-affiliated firms and their views on the content and implementation of rules of origin?

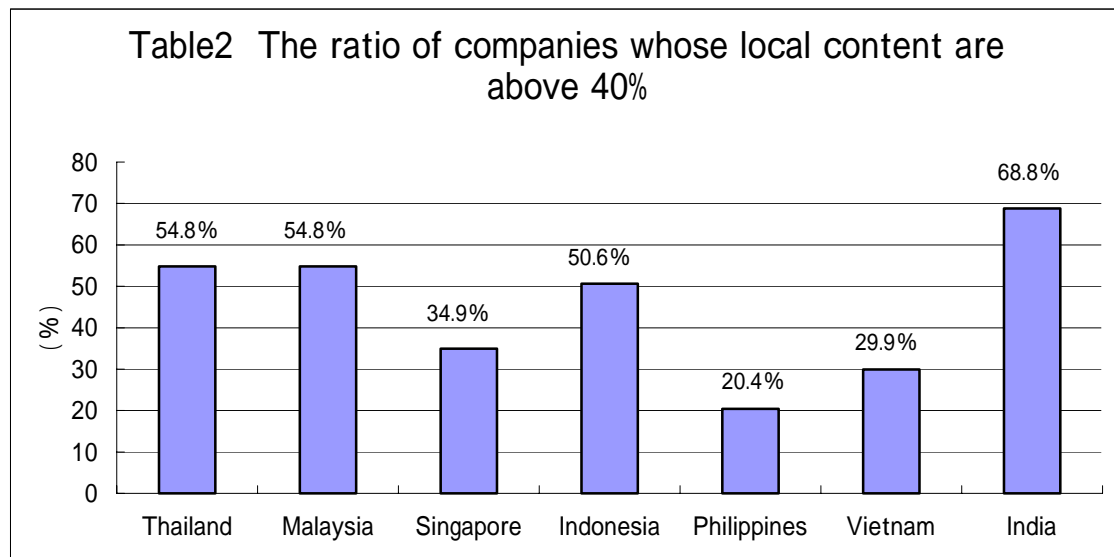
Many of the Japanese-affiliated firms interviewed in the JETRO survey asserted that the rules of origin requiring "ASEAN content of 40% or more" on the whole present a low hurdle that can be met with no problem.

"ASEAN content of 40% is low as a standard and, as we have reached a local procurement rate of 70-80%, it is no problem at all" (Japanese automobile manufacturer in Thailand).

"Local content of 40% is generally a moderate standard, and ordinarily we clear this without any problem" (automobile parts manufacturer in Singapore).

According to a JETRO questionnaire survey of Japanese-affiliated firms operating in six major ASEAN countries and India (2,345 companies, 48.2% response rate), more than half of the companies in Thailand (54.8%), Malaysia (54.8%) and Indonesia (50.6%) satisfied the local procurement rate of 40% (Diagram 2). It appears that in many cases companies are able to obtain Form D because personnel costs, direct costs, domestic transport costs, profits, etc., can be included in calculating the actual local procurement rate. In addition, the availability of steel, textile and other

material industries in India has enabled 68.8% of the companies operating there to achieve local procurement rates of 40% or more, and the local procurement rates are remarkably high in comparison with ASEAN countries.



(Source) Japanese-Affiliated Manufacturers in Asia - Survey 2003, JETRO

However, while it is easy for automobiles, household appliances, and other finished products to meet the standard, the parts industry tends to depend on components and materials from outside the region and some companies reported difficulties in clearing the standard. “The local content standard of 40% is often extremely tough to meet when many raw materials have to be brought in from Japan and other countries” (automobile parts manufacturer in Malaysia).

<ASEAN content holds the key>

In countries such as the Philippines where supporting industries are relatively weak, companies remarked that it was difficult to clear the standard relying solely on local content. In the aforementioned questionnaire survey, an extremely low 20.4% of Japanese-affiliated firms in the Philippines had local procurement rates of 40% or higher. In terms of ASEAN cumulative procurement rates, however, these companies are substantially surpassing the standard, and it can be seen that the framework of ASEAN content plays an extremely important role.

“We import major parts such as compressors for air conditioners from Malaysia. Our parts procurement rate within the Philippines is no more than 10-20% but, as ASEAN content is accepted, we are able to acquire Form D without problem” (household appliance manufacturer in the Philippines).

“We import components from Thailand, Indonesia, Malaysia and other countries, and have thereby achieved a local procurement rate of 80% in terms of ASEAN content. However, our procurement

rate in the Philippines has fallen considerably to about 20% because there are so few supporting industries in the country” (automobile parts manufacturer in the Philippines).

Similar comments were heard with regard to Indonesia.

“The local procurement rate for televisions is a low 30% or so, depending on the model, but procurement of parts from Malaysia and other ASEAN countries pushes the ASEAN content up to 70-80%” (household appliance manufacturer in Indonesia).

<Important to simplify and speed up procedures>

How do companies view procedural matters? An interview survey of Japanese-affiliated firms revealed that Form D acquisition procedures are flowing smoothly and that there are no obstacles large enough to hinder use of the system; the overall assessment was that the system is working. This does not necessarily mean, however, that the system is easy to use.

“The preparation of documents for the initial cost screening takes two months and the screening procedures themselves about one month. There are 1,000 to 2,000 parts in a completed vehicle, and we must collect documentation (invoices, Form Ds, etc.) certifying local procurement from each supplier” (automobile manufacturer in Thailand).

“The documentation procedures for acquiring Form D are cumbersome and should be simplified. For example, if we have 700 parts, 300 of which are locally procured (including ASEAN products), we must prepare a parts list and attach 300 invoices and other evidentiary documents issued by the individual parts manufacturers” (Japanese-affiliated AV manufacturer in Thailand).

To reduce the burden on users, individual national governments should reconsider the information required on application forms and should carefully select the documentation to be attached. To accelerate screening, all countries should increase the number of screeners and otherwise could hinder their systems.

4. Other problems involving CEPT

<Introduction and issues of AHTN (ASEAN harmonized tariff nomenclature)>

CEPT as a system is seen to be functioning well, but technical problems have arisen in actually implementing Form D procedures. One problem frequently pointed out is that Form D cannot be obtained because the listed HS Code does not match the import country code.

A harmonized tariff nomenclature is being introduced within ASEAN as one resolution of this problem. The ASEAN Harmonized Tariff Nomenclature (AHTN) comprises a total of eight digits, the six digits of the HS Code (used worldwide) and the two digits of ASEAN’s own unique classifications. The number of tariff commodity items has climbed to 10,689. Singapore took the initiative in introducing this tariff code from January 2003, and Vietnam introduced the code from July of that same year. At the August 2003 ASEAN Finance Ministers Meeting the participating

ASEAN countries agreed to switch over to AHTN by January 1, 2004 at the latest, with the remaining ASEAN countries to move gradually toward introduction from the beginning of 2004. At present all member countries have completed introduction.

Information was not adequately disseminated through the Customs offices when AHTN was first introduced, and confusion resulted as AHTN was combined and used with the old tariff code. Even now the shift to AHTN could still be said to be in the transition period, but major confusion has subsided.

However, another view has been expressed: “There are times when the interpretations of tariff code numbers by the local Customs officials and the other country’s Customs officials will differ. This is not a problem that can be easily resolved, and it will not be resolved simply by introducing AHTN” (Thailand Customs).

<Intermediary trade also made available>

As the CEPT scheme did not envision intermediary trade, there have been cases where, for goods being directly transported between ASEAN member countries through an intermediary in a third country, the shipper and the FOB price differ on the invoice and Form D and thus the Form D is not accepted by Customs officials in the importing country.

The AFTA Council Meeting in September 2003 approved a revision of the operational rules for the CEPT rules of origin, making it possible for a Form D issued on the basis of an invoice submitted by a company in a third country to be accepted by the importing country. However, details regarding the methods for completing Form D were not stipulated and were instead left to the discretion of individual countries. According to Thailand Customs, though, “the invoice price must be the same or higher than that listed on Form D.”

<Discussions of operational procedures for Back-to-Back Form Ds>

The CEPT operational rules authorized the issuing of a Back to Back Form D (hereinafter, B to B Form D) based on the original Form D when goods are imported from a country in the region and re-exported to a different country in the region through a third ASEAN country.

In fact, the ASEAN logistics hub of Singapore is used for shipments exported to Singapore and then re-exported to another ASEAN country. In conducting such trade, Malaysia and Thailand require that the original Form D be submitted along with the B to B Form D for imports, and approaches to this shipment method are being discussed among the countries involved.

One Japanese-affiliated manufacturer in Singapore commented: “We initially tried using the B to B Form D, but we quit after some countries refused to accept them. Singapore has become a logistics hub within the ASEAN region and goods are often consolidated in Singapore for cross-docking, especially for small shipments, and then exported to their respective destinations. We have tried stocking goods in Singapore and then repacking and exporting the needed quantity, using the B to B Form D. Now we divide up goods into several shipments and acquire Form Ds for small lots.”

Chapter 2 ASEAN-China FTA rules of origin and implementation

1. ASEAN-China FTA (ACFTA) rules of origin

<As with CEPT, ASEAN-China content of 40% or more is the applicable standard>

The FTA between ASEAN and China has taken the lead in lowering the tariffs for agricultural products of HS Code 1 - 8 to a maximum tariff rate of 10% since January 1, 2004 as part of the Early Harvest Program. These tariffs are scheduled to be abolished altogether on January 1, 2006. In advance of this, Thailand abolished its tariffs on HS Code Class 7 - 8 vegetables and fruits on October 1, 2003. The commodity items targeted by the Early Harvest Program already underway have been limited to agricultural products, and the applicable rules of origin use the “Wholly Obtained” standard.

Negotiations on lowering tariffs for industrial products other than Early Harvest Program commodity items are ongoing. Tariffs are scheduled to be lowered on July 1, 2005, and the present ASEAN member countries will abolish tariffs, except on some sensitive commodity items, by 2010. New countries will abolish their tariffs by 2015.

However, like the CEPT, the rules of origin basically incorporate a local content rate of 40% or higher as a standard (Note 1). Components from other ASEAN countries and from China are included in the local procurement rate. If ASEAN-China cumulative origin—which includes China in the CEPT rules of origin—is 40% or higher, the goods will be deemed FTA-eligible products and a certificate of origin issued. The ASEAN-China FTA certificate of origin is called Form E.

Although the basic rule of origin is a local content rate of 40% or higher, now ASEAN and China are negotiating about Product Specific Rules for a certain limited items.

$$\frac{\text{Value of Imported Non-ASEAN Materials,} + \text{Value of Undetermined Origin}}{\text{FOB Price}} \times 100\% \leq 60\%$$

2. Implementation of the Early Harvest Program

<Sharp rise in both imports and exports of agricultural products>

Pioneering the way for other ASEAN countries, Thailand has instituted Early Harvest Program measures with China, but to what degree is this FTA actually being utilized? According to the Department of Foreign Trade of Thailand's Ministry of Commerce, a total of 13,981 Form Es were issued in the one-year period October 2003 - September 2004. In monetary terms, these forms represent 13.83136 billion baht.

Statistics from Thailand Customs show that exports of agricultural products (HS Code 01 - 08) from Thailand to China during the period January - August 2004 expanded to 9.50 billion baht, a

year-on-year increase of 36.6%. The growth rate in Thailand's total exports to China was 16.9% during the same period, greatly surpassing the overall growth rate. The principal commodity items were tapioca, longan (dried and fresh), frozen shrimp, frozen fish, and durian.

Agricultural imports from China rose sharply 48.7% year-on-year to 3.45 billion baht during the same period. The principal commodity items were apples, frozen fish, pears, and shiitake mushrooms. The trade balance for agricultural products shows a large trade surplus of over 6.0 billion baht for Thailand, but this trade surplus continues to shrink in the face of a higher growth rate of imports from China. Exporters in Thailand complain that quarantine and other import procedures on the Chinese side take time, and that exports cannot be expected to grow due to regulations differing by ministry and other non-tariff barriers.

<Early Harvest, with a focus on Thailand>

According to the State General Administration for Quality Supervision and Inspection and Quarantine, the organization responsible for issuing certificates of origin in China, there were 1,524 Form Es issued representing \$32.38 million between January and April 2004. Of these, 1,422 forms (94.6%) amounting to \$25.44 million (78%) were for Thailand. Export to Thailand thus constitutes the core of export via the ASEAN-China FTA Early Harvest Program. In addition to geographical proximity, this can be attributed to the initiative taken by Thailand and China in abolishing their respective tariffs on HS Code 07 and 08 (vegetables and fruits) while the tariffs of other ASEAN countries will be removed in stages by January 1, 2006.

The Trade Support Division of Malaysia's Ministry of International Trade and Industry noted that "the number of Form Es issued has increased since the start of the Early Harvest Program in January of this year, with those for palm oil being especially numerous," and export to China through the Early Harvest Program is also expanding from countries other than Thailand.

3. Procedural methods and problems involving certificates of origin (Form E)

<Procedures the same as those for CEPT>

The issuing procedures for Form E are exactly the same as for Form D in the case of ASEAN countries. In China the aforementioned China State General Administration for Quality Supervision and Inspection and Quarantine is the issuing institution for Form E. Applications are submitted to one of the 35 regional offices located in each province. EDI was introduced into the application process in 2001.

Exporters wishing to acquire Form E must first register using the stipulated form. Upon registration an official will inspect the applicant's factory to check on the production process. Form E is required for each export shipment, and can be obtained in three business days; in reality, issue usually takes less time than this.

At the start of the Early Harvest Program, “there was an instance of a Form E being rejected because China’s Customs said that the stamp on Form E was different from the pre-registered stamp” (Malaysia’s Ministry of Industry Trade and Industry), and “we confronted such problems as information not being thoroughly disseminated at Thai Customs and the common effective preferential tariffs not being applied” (China State General Administration for Quality Supervision and Inspection and Quarantine); it therefore appears that there was some confusion in both China and ASEAN. At present, however, there are no particular problems and common effective preferential tariffs are being applied via Form E.

4. Utilization by Japanese-affiliated firms

<FTA to bring tariffs from 30% to 0% on imports of azuki beans from China>

As mentioned earlier, the ASEAN-China FTA has only implemented the Early Harvest Program measures for agricultural products. For that reason, not many Japanese-affiliated firms can be found actually utilizing this scheme. A Japanese-affiliated foodstuff manufacturer operating in Thailand might envision the procurement of raw materials from China, but almost of all the companies utilizing raw materials produced in China have themselves directly expanded their operations into China.

One example of a company actually utilizing the FTA is that of a Japanese confectionary manufacturer in Thailand who imports azuki beans from China, makes red bean paste, fills the confectionaries with this paste, freezes them and exports them to Japan. Imports of azuki beans are ordinarily subject to a 30% tariff rate, and a raw materials import tariff refund system applicable to exports was used previously. Systemically, though, the procedures were cumbersome, and the six-month period required for the refund meant that interest costs such as for loans of stopgap funds were incurred. The FTA lifted the tariff on October 1, 2003, allowing companies to enjoy significant benefits financially and administratively.

A tariff reduction schedule for goods other than agricultural products is now being discussed among the countries involved. Tariff reductions on industrial products appear likely to start on schedule from January 1, 2005. Tariff reductions have not yet begun, nor is Form E being issued, for industrial products. However, as the rules of origin are the same as for CEPT, the application form and the screening methods can be expected to be fundamentally the same as for Form D. Consequently, companies operating in ASEAN that have experience in applying for Form D should be able to prepare the documentation for cost screening without problem.

Since the required standard in the rules of origin allows China content (components procured from China) to be added to CEPT’s ASEAN content, the standard should be easier to clear.

(Note 1) The original text of the amended framework agreement can be viewed at the following web page: <http://www.aseansec.org/15157.htm>

Chapter 3 Rules of origin for Thailand's and Singapore's bilateral FTAs

This report has thus far offered an overview of the rules of origin, the problems, and assessments by Japanese-affiliated firms of ASEAN FTAs, primarily the AFTA and the ASEAN-China FTA's Early Harvest Program that are already being put into practice. However, active moves are also being made toward bilateral FTAs within the ASEAN region, especially by Thailand and Singapore.

This chapter will summarize the respective rules of origin of the bilateral FTAs of Thailand and Singapore that are already being implemented or that have been concluded.

1. Thailand's bilateral FTAs

Thailand at present is pursuing FTA negotiations with eight countries (China, Australia, India, Japan, US, Bahrain, Peru, New Zealand) and one region (BIMSTEC, The Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation, comprised of seven countries: Bangladesh, India, Myanmar, Sri Lanka, Thailand, Bhutan, Nepal). Of these, only the Thailand-India FTA launched on September 1, 2004 is being implemented already, with the exception of the Early Harvest Program with China. However, the FTA negotiations with Australia have already finished and an FTA has been concluded.

1) Thailand-India FTA Early Harvest Program

<Rules of origin more stringent than CEPT>

On September 1, 2004, Thailand and India reduced their MFN rates by 50% for 82 commodity items, and they will be lowering these rates by 75% on September 1, 2005 and by 100% (abolition) on September 1, 2006. Although only 82 commodity items are targeted, these items account for about 7% of the countries' bilateral trade. These goods span a wide range, from tropical fruits such as mangosteens, durian, and longan, canned seafood, and polycarbonate and other petrochemicals to household appliances such as fans, air conditioners, refrigerators, televisions, and automobile parts.

The rules of origin for this Early Harvest Program, excepting those tropical fruit and seafood to which the wholly obtained standard applies, require in almost all cases that two standards—a change of 4-digit or 6-digit tariff codes and a local procurement rate of 40% or greater—be simultaneously satisfied. These rules are more stringent than the CEPT rules of origin, which only require a local procurement rate of 40% or greater.

<ASEAN content cannot be used>

The program differs from CEPT (common effective preferential tariffs via AFTA) in its rules of origin and in the fact that ASEAN content is not recognized. In the case of CEPT, components

imported from ASEAN countries other than Thailand can be counted in the local procurement rate. Under the Thailand-India FTA, though, the local procurement rate from Thailand alone must be 40% or greater.

For example, CRTs (cathode-ray tubes) acquired from neighboring Malaysia constitute nearly 50% of the component cost of televisions assembled in Thailand, a targeted commodity item. These instances pose no problem under CEPT as ASEAN content can still clear the 40% standard, but under the Thailand-India FTA “there are cases that are quite challenging, depending on the model” (Japanese-affiliated household appliance manufacturing company in Thailand). The certificate of origin is called Form FTA.

According to the Trade Preference Division, Department of Foreign Trade, Ministry of Commerce, only 32 Form FTAs representing a total of 69.37 million baht were issued in the one-month period September 1 - 30, 2004. Of the targeted 82 commodity items, the primary commodity item was cathode-ray tubes for televisions, which accounted for 45.69 million baht (65.8%) or about two-thirds of the total. This was followed by epoxide resins at 19.05 million baht (27.4%), leather automobile seats at 2.99 million baht (4.3%), and air conditioners at 1.64 million baht (2.4%).

2) Thailand-Australia FTA

<Standard based on change of tariff classification>

The Thailand-Australia FTA was signed between the two countries on July 9, 2004. Only the Early Harvest Program has been agreed upon in the FTAs with China and India, and the tariff reduction schedule for the remaining commodity items is still under negotiation; by contrast, the FTA with Australia covers all commodity items and negotiations have concluded.

The rules of origin have basically adopted a change in tariff codes (4 - 6 digits) standard. With regard to certain commodity items such as textile products, apparel, shoes, iron/steel products, machinery, electronics products, automobiles and automotive parts, however, there are times when a change in tariff classification standard and a local procurement rate standard must both be satisfied. There are also commodity items acknowledged to be of local origin if they meet either of these standards. The local procurement rate standard is 40% or 45%. A higher local procurement rate of 55% or more has been established for apparel and shoes, but only a minimum of 30% of this need be Thailand content; material procured from a developing country can be counted in the local procurement rate for the remaining 25%.

2. Singapore's bilateral FTAs

Singapore, too, is actively pursuing bilateral FTAs. Already five of its FTAs have gone into effect—those with New Zealand, Japan, Australia, EFTA (European Free Trade Association), and the US—putting it ahead of Thailand. These FTAs do not use the same rules of origin, and detailed

stipulations have been set out for individual commodity items (Note 3):

Table 3 Rules of origin for Singapore's bilateral FTAs

FTA	Date of effectiveness	Overview of rules of origin
Singapore-New Zealand	January 1, 2001	Local procurement rate (including personnel costs and miscellaneous expenses) of 40% or higher
Japan-Singapore	November 30, 2002	Based on a change of tariff codes standard (4 digits). However, for some commodity items (264 commodity items), a local procurement rate of 60% or higher can be utilized as a substitute standard.
Singapore-EFTA	January 1, 2003	Based on a change of tariff codes standard (4 digits). For some commodity items, a local procurement rate of 40 - 80% of the factory shipping value is the applicable standard. A process criterion is used for specified chemical products that deems them to have been locally produced if stipulated special production processes are carried out.
Singapore-Australia	July 28, 2003	Based on a local procurement rate of 50% or higher. A local procurement rate of 30% or greater applies to some commodity items.
Singapore-US	January 1, 2004	Based on a change of tariff codes standard. There are also instances where added value standards may be selected as a substitute or used in parallel. The added value standard requires that goods have RVC (Regional Value Content) of either 35% or greater by the build-up method or 45% or more by the build-down method (except for non-originating materials).

(Source) Singapore Customs website (Singapore TradeNet)

Singapore Customs noted that the FTAs with New Zealand, EFTA, and the US do not require that certificates of origin be submitted for import shipments; instead, self-declaration by importers is used. The same applies for imports by Singapore.

In addition to the aforementioned agreements, Singapore has concluded an FTA with Jordan and is negotiating FTAs with Canada, India, three Pacific Rim countries (Chile, New Zealand, Singapore), South Korea and Mexico.

(Note 1) The protocol on the implementation of the Thailand-India FTA's Early Harvest Program can be viewed at the following URL:

http://commerce.nic.in/thailand_protocol.htm#protocol

(Note 2) The text of the Thailand-Australia FTA, the tariff reduction schedule, the rules of origin for different commodity items, etc., can be viewed at the website of the Australian Department of

Foreign Affairs and Trade:

<http://www.dfat.gov.au/trade/negotiations/aust-thai/>

(Note 3) The rules of origin, procedural methods, etc., of Singapore's FTAs can be viewed at the website of Singapore Customs:

http://www.tradenet.gov.sg/trdnet/index_home.jsp

Chapter 4 Summary: Rules of origin and their impact on corporate activities

<Rules of origin are a constraining factor in terms of procurement>

Rules of origin can be viewed as a constraining factor in terms of procurement and production for companies. Established local procurement rates and production processes to clear the standards of FTAs are needed to enjoy the benefits of FTAs. To give one example, the vast majority of automobile manufacturers in Thailand exports to Australia and pay 15% tariffs on passenger vehicles and 5% on 1-ton pickup trucks. These tariffs will be abolished on January 1, 2005 under the FTA. To enjoy the benefits of these common effective preferential tariffs, naturally the stipulated rules of origin must be cleared. For passenger vehicles, two standards—a local procurement rate of 40% or higher and a change of tariff classification (4 digits)—must be simultaneously fulfilled. This constitutes a constraining factor. For example, were a Japan-Thailand FTA to be realized and parts from Japan exempted from tariffs, the import of parts from Japan might increase too much and make it impossible to achieve the local procurement rate of 40% required by the Thailand-Australia FTA.

Thus far, a variety of rules of origin for FTAs commenced or agreed on, including those on a bilateral basis, within ASEAN have been examined, from those like CEPT where the only common rule is a value-added criterion (local procurement rate standard) to those that combine an added value standard with a change of tariff classification standard and establish differing standards for individual commodity items. Should FTAs continue to multiply in these varied formats, the constraining factors for companies will also increase. “If FTAs increase and their respective rules of origin differ, companies will need to understand them and likely need to coordinate their production processes” (Singapore Customs).

<Concerns about the spaghetti bowl phenomenon>

With rules of origin differing by FTA, procedures for acquiring certificates of origin become all the more bothersome, costing companies much time and labor; administrative costs of issuing certificates of origins by each government authorities also increase. Multiple FTAs create a complexity of differing rules of origin and barriers to smooth trade known as the “spaghetti bowl phenomenon.” Furthermore, individual countries have reduction/exemption systems other than FTA

such as export processing zones and reduction or exemption/refund systems for component import tariffs, and companies will need to unravel these systems and the formulae used in different FTAs to achieve optimal procurement and production.

Common rules of origin should be introduced as far as possible to avoid the “spaghetti-bowl phenomenon.” Regulations must impose hurdles of a certain height in light of the possibility that products from countries other than those with which FTAs have been concluded might only be superficially processed before being shipped for roundabout export. Given that rules of origin are a constraining factor for business activities, however, the rules should establish hurdles as low as possible. Highly transparent systems must also be constructed to eliminate any arbitrariness in their operation. Nevertheless, “rules of origin are tied to the trade and investment policies of each country. Uniform rules would be desirable, but in reality they will not happen” (Mr. Li, Senior Officer, ASEAN Secretariat).

Still, general tariff rates (MFN rates) not requiring certificates of origin continue to drop in keeping with WTO agreements, etc. As of 2003, the simple average tariff rates for major ASEAN countries were high in Vietnam at 16.5% and Thailand at 13.8%, but had fallen to single digits in Malaysia, Indonesia, and the Philippines at 9.3%, 7.2%, and 5.3% respectively (Note 1). The tariff rates for raw materials and parts overall have been set low in many cases. Indeed, considerable import and export goes on without the use of FTAs when the volume of goods is low and the general tariff rate just several percentage points. This fact can be said to contribute to dampening the impact of the “spaghetti-bowl phenomenon.”

<Importance of cumulative origin>

ASEAN content (cumulative origin) has important connotations for Japanese-affiliated firms expanding within the ASEAN region, as procurement and production based on ASEAN content are being pursued through the use of production networks within ASEAN through AFTA. Household appliance products and automobiles (pickup trucks in Thailand, etc.) produced on the basis of ASEAN content have achieved sufficient competitiveness to be exported worldwide. Companies also continue to expand their procurement networks beyond ASEAN into China, India and other countries. Although procurement from Japan is in a downtrend as local procurement increases, there remain not a few items such as high-tech parts, precision parts, and materials that cannot be procured from anywhere else but Japan.

Looking long and hard at these circumstances and at FTA developments involving ASEAN countries, one sees many FTA negotiations being carried out on both multilateral and bilateral bases. ASEAN as a body intends to begin negotiations from 2005 not only with India and China but also with Australia-New Zealand (CER: Closer Economic Relations Trade Agreement), South Korea, and Japan. If these negotiations are successful, ASEAN will have an FTA network covering East Asia, India, and Oceania. Japan, too, is currently negotiating bilateral FTAs with South Korea, Thailand, Malaysia, and the Philippines; as mentioned above, negotiations with ASEAN will commence around April 2005, and a bilateral FTA with India is also being considered. An important next step

will be to link these disparate FTAs into a “plane” so that it will serve as much broader FTA. In doing so, harmonizing rules of origin is an absolutely essential task.

A press statement from the AFTA Council released in September 2004 emphasized the importance of maintaining consistency with CEPT rules of origin in FTAs being negotiated now by ASEAN with countries outside the region. It is difficult at the moment to forecast the actual outcome of these negotiations, but best for Japanese-affiliated firms would be to have common rules of origin with hurdles as low as possible that expand the scope of cumulative origin in ASEAN where they have already formed production networks.

(Note 1) Extracted from APEC website, Individual Action Plan (IAP)