The AFTA Rules of Origin as Amended by the 17th Meeting of the AFTA Council (1 September 2003)

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Recently, the AFTA Rules of Origin have been amended and extended with two annexes at the occasion of the 17th Meeting of the ASEAN Free Trade Area (AFTA) Council, 1 September 2003, Phanom Penh, Cambodia. In any free trade area, rules of origin are crucial in determining which imports will benefit from tariff reductions. In this article, the author discusses and compares the AFTA rules of origin from a practical perspective, particularly vulnerability of abuses.

1. Introduction

In 1992, the members of the Association of South-East Asian Nations[1] ("ASEAN") significantly stepped up their economic and trade cooperation. The free trade system of ASEAN is developed through a series of three documents. The first of these documents, the Singapore Declaration, summarizes the agreements reached by the ASEAN heads of government in a variety of fields including politics and external relations as well as economic integration. The Declaration sets out a broad-based program for economic integration which is flexible enough to encompass the needs of the various ASEAN nations. The other two documents signed at the same summit deal

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[1] The Association of South-East Asian Nations (ASEAN) was found through the signing of the Bangkok Declaration on August 8, 1967. (Reprinted in 6 I.L.M. 1233). ASEAN was expanded on January 7, 1984 to include the newly independent Sultanate of Brunei. The Association is currently comprised of Singapore, Thailand, Malaysia, Indonesia, the Philippines, Vietnam, Laos, Myanmar, Cambodia and Brunei Darussalam.

directly with the challenge of economic integration through a system of conventions. The ASEAN Free Trade Area (AFTA) is one aspect of a larger scheme of economic cooperation described in the second document, the Framework Agreement on Enhancing ASEAN Economic Cooperation (Framework Agreement) AFTA itself is to be implemented primarily through the provisions of a third documents entitled Agreement on the Common Effective Preferential Tariff Scheme (CEPT-AFTA Agreement). The Framework Agreement provides a set of principles and goals for the development of ASEAN economic cooperation, outlining broad areas of concurrence while leaving the specifics of integration to further subsidiary agreements such as the CEPT-AFTA Agreement. While the Framework Agreement outlines potential cooperation in a variety of fields, the CEPT-AFTA Agreement regulates tariffs, and ostensibly other trade barriers. It is the only actually binding instrument for achieving economic integration[2].

The reduction of tariffs on almost all goods traded between ASEAN-members to 0-5% is one of the main pillars of AFTA. Moreover, in 1999, ASEAN leaders agreed to eliminate all import duties among the original six members by 2010 and by 2015 for the newer members[3]. However, it is to be noted that not all goods are included in the system and chronology of tariff reductions[4]. When a member regards a certain good as sensitive, it may categorize this under its Temporary Exclusion List ("TEL"). These goods may later be transferred to the "Inclusion List". To avoid that the system would be hollowed out by enormous exclusion lists, the members must agree on the composition of the TEL. Moreover, it was agreed that products on the TEL would nevertheless gradually be included in

[2] Kenevan, P. and Winden, A., "The Asean Free Trade Area", 34 Harvard International Law Journal, Winter, 1993, pp.224-225.

[3] Joint Press Statement of the Fifteenth Meeting of the AFTA Council, 14 September 2001, Hanoi.

[4] A "fast track" and a "normal track" of implementation was introduced.

tariff reductions[5]. Finally, AFTA provides in the existence of "Highly Sensitive' goods, for which special arrangements are developed[6].

Tariffs are by the way not the only trade barrier that is meant to be reduced or eliminated by AFTA. Non-tariff trade barriers such as quantitative restrictions[7], product standards[8], customs valuation and tariff nomenclature harmonization are also addressed[9], although with varied degrees of detail in terms of obligations for the members[10]

AFTA is meant to operate much like a customs free zone; goods imported into the zone may be subject to import duty but once in, they move freely from member to member. However, ASEAN does not harmonize the customs tariffs its members levy on imports from outside ASEAN. It may in other words be possible that one ASEAN member charges a much lower import duty than another member when a certain product is imported from outside ASEAN. Once in the AFTA, however, the basic idea is that products can be transported freely to other ASEAN members. The lack of external tariff harmonization combined with an internal free zone may thus result in significant reduction of customs duty for importers.

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[5] The products concerned will be subject to the following tariff reduction program:
1) For products with an existing tariff of over 20%, the tariff will be lowered to 20% on the 1st of January 1998 and to 0-5% on the 1st of January 2003.
2) For products with an existing tariff of 20% or below, the tariff will be reduced to 0-5% on the 1st of January 2003.

[6] Thailand has only one such good, namely rice.

[7] Art 5 CEPT

[8] Asean Framework Agreement on Mutual Recognition Arrangements [dated on the 16th December, 1998]

[9] It is noteworthy that AFTA adheres to the WTO rules on tariff classification (the so-called "Harmonized System" (Agreement on rules of origin) and on valuation (Agreement on the Implementation of Art. VII of the GATT Agreement). This is of particular note as there are ASEAN members who are not WTO-members, namely Lao PDR, Myanmar and Cambodia.

[10] Kenevan, P. and Winden, A., Recent Development: Flexible Free Trade: The Asean Free Trade Area, Harvard International Law Journal, Winter, 1993, p. 237.

Obviously, this is a problem that faces all free trade areas. If a tariff reduction is granted to products that originate from another member, how will "origin" be defined? This is one of the central questions for all free trade areas addressed by the so-called "rules of origin". These rules in essence ensure that only goods originating from participating countries enjoy preferences[11]. The rules of origin of AFTA and the duty planning connected to it are the main focus of this contribution.

2. Different Approaches to Rules of Origin

Internationally, various approaches are used to define the origin of a product. Brenton identifies three main approaches: (i) change of tariff classification (ii) value added and (iii) specific manufacturing process

Change of tariff classification. Origin is granted if the exported product falls into a different part of the tariff classification to any imported inputs that are used in its production. This approach has been made easier by the widespread adoption of the Harmonised System. There is however, the problem of the level of the classification at which change is required. Most agreements specify that the change should take place at the heading level (that is at the 4-digit level).

However, the Harmonised System was not designed as a vehicle for conferring origin, its purpose being to provide a unified commodity classification for defining tariff schedules and for the collection of statistics. Thus, in particular cases if can be argued that change of tariff heading will not identify sufficient processing whilst in other cases it can be that substantial transformation can occur without change of tariff heading.

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[11] Please see **http://www.iadb.org/intal/foros/LAbrenton_paper.pdf**, Paul Brenton, Note on Rules of Origin with Implications for Regional Integration in South East Asia, International Trade Department, The World Bank, p. 1.

Value Added. This requirement can be defined in two ways either as (1) the minimum percentage of the value of the product that must be added in the exporting country or (2) the maximum percentage of imports in the value of the product. In practice it is the latter which is more commonly used. On average a threshold on domestic content of between 40 to 60 per cent is the norm. In general these percentage value rules are often combined with other tests of origin.

In actual application the value added rule can become complex and uncertain. First, there is the issue of the valuation of materials, which may be based upon ex-works, f.o.b, c.i.f, or into-factory prices. Second, the practical application of this method can be costly for firms who will need complicated cost-accounting programs. Also, under the value added method the rules of origin are sensitive to changes in the factors determining production cost differential across countries, such as exchange rates, wages and commodity prices.

The value added criterion has been praised for its simplicity but its actual calculation depends heavily on factors that are prone to fluctuation and even manipulation. As has been remarked in the literature on the subject, changes in exchange rates, overheads, intra-group costs such as royalties and profit may result in a different origin[12]. This issue will be revisited below.

Specific manufacturing process. This rule defines certain manufacturing or processing operations that a product must undergo in the exporting country in order for the goods to qualify for origin. Rules as this specify often what type of input must or may not be used. Rules based upon specific manufacturing processes are widely used, often in conjunction with other change of tariff classification and/or the value added criterion, and are a particular feature of the rules applied to the textiles and clothing sectors.

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[12] Joseph A. LaNasa III, Rules of Origin and the Uruguay Round's Effectiveness in Harmonizing and Regulating Them, The American Journal International Law, October 1996, pp. 632-634.

3. AFTA Rules of Origin

General Principles

The basic principle underlying the AFTA rules of origin is specified in the CEPT Agreement itself. It is further detailed in the Interpretative notes to CEPT, in the agreement "Rules of Origin for the CEPT Scheme for AFTA" and its two new Annexes (A and B)[13].

As was mentioned above, AFTA has chosen for the (almost) sole application of the value added-approach[14]. Art. 2(4) of the CEPT provides that

> "A product shall be deemed to be originating from ASEAN Member States, if at least 40% of its content originates from any Member State".

The interpretative notes to CEPT further specify in this regard that

> *"The 40% local content requirement refers to both single country and cumulative ASEAN content."*

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[13] The AFTA Rules of Origin were amended and extended with Annex A and B at the occasion of the 17th Meeting of the ASEAN Free Trade Area (AFTA) Council, 1 September 2003, Phnom Penh, Cambodia.

[14] Note however that with respect to textile, AFTA applies the substantial transformation approach. [Joint Press Statement The 10th Meeting of the AFTA Council 11 September 1996, Jakarta, Indonesia] specifies that textiles and textile products can be subjected to an alternative Rule of Origin in order to qualify for CEPT concessions. This would provide greater flexibility in the rules of origin of the CEPT and would enable textiles and textile products to also benefit from the concession offered under AFTA. Currently, all products in the CEPT must be subjected to the substantial transformation process criterion wherein products which are "substantially transformed" through a number of specified processes shall be accorded CEPT status and hence shall be eligible for lower tariffs. The effect of this is to enable an exporter to select the existing 40% criterion of the CEPT or the process criterion when applying for the ASEAN CEPT Certification of Origin.

It can be noted at this point that AFTA has chosen the lower end of the range determined by the WTO as average requirement of domestic content under the value added approach, which is between 40% and 60%[15].

As a principle it can thus be said that it is irrelevant for the determination of origin under AFTA if goods have been subjected to a substantial transformation within an ASEAN member state (with the exception of textile). It is also irrelevant if products have undergone a tariff classification change in the process.

Rule 1 Originating Products

Rule 1 reads as follows:

> *"Products under the CEPT imported into the territory of a Member State from another Member State which are consigned directly with the meaning of Rules 5 hereof, shall be eligible for preferential concessions if they confirm to the origin requirements under any one of the following :*
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> *(a) Products wholly produced or obtained in the exporting Member State as defined in Rule 2; or*
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> *(b) Products not wholly produced or obtained in the operating exporting Member State, provided that the said products are eligible under Rule 3 or Rule 4".*

This rule establishes several basic conditions that must be fulfilled for products to qualify for preferences. First, it is mentioned that goods must be *consigned directly* from an ASEAN member. This means that normally a good must be imported into an ASEAN member from another ASEAN member in order to receive preferen-

[15] To the knowledge of this author, the Canada-Chili FTA is one of the few examples of an even lower requirement (namely between 25 and 35% depending on valuation).

tial treatment. This condition is further detailed in Rule 5[16].

Secondly, Rule 1 provides that there are two different types of goods, namely those that originate wholly from within one or more ASEAN members (i.e. wheat grown in Thailand), and those who still originate from ASEAN member (s) but not wholly (beer brewed in Thailand with Thai wheat and non-Thai additives). Both situations are defined in Rule 2 and 3.

Rule 2 Wholly produced or obtained

Rule 2 reads as follows:

> *"Within the meaning of Rule 1 (a), the following shall be considered as wholly produced or obtained in the exporting Member State :*
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> *(a) Mineral products extracted from its soil, its water or its seabeds;*
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> *(b) Agricultural products harvested there;*
>
> *(c) Animals born and raised there;*
>
> *(d) Products obtained from animals referred to in paragraph (c) above;*
>
> *(e) Products obtained by hunting or fishing conducted there;*
>
> *(f) Products of sea fishing and other marine products taken from the sea by its vessels;*
>
> *(g) Products processed and or made on board its factory ships exclusively from products referred to in paragraph (f) above;*
>
> *(h) Used articles collected here, fit only for the recovery of raw materials;*
>
> *(i) Waste and scrap resulting from manufacturing operations conducted there; and*

[16] See below.

(j) Goods produced there exclusively from the products referred to in paragraph (a) to (i) above."

Under Rule 2, the origin of many products are easily identified. All products consisting of or made exclusively from animal or agricultural products, for example, fall under the scope of this category. As Vermulst points out, there have been little practical problems in this regard[17].

The AFTA rules for Products Wholly Produced or Obtained are obviously closely based on the GATT Rules of Origin on the subject. Rule 2 of the GATT Rules of Origin[18] read as follows:

"Goods produced wholly in a given country shall be taken as originating in that country. The following only shall be taken to be produced wholly in a given country:

(a) mineral products extracted from its soil, from its territorial waters or from its seabed;

(b) vegetable products harvested or gathered in that country;

(c) live animals born and raised in than country;

(d) products obtained from live animals in that country;

(e) products obtained from hunting or fishing conducted in that country;

(f) products obtained by maritime fishing and other products taken from the sea by a vessel of that country;

(g) products obtained aboard a factory ship of that

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[17] Vermulst, E. "Rules of Origin as commercial policy instruments?", in Rules of Origin in International Trade: A Comparative Study, p. 433.

[18] Annex D.1 of the Kyoto Convention. The convention was singed at Kyoto on 18 May 1973 and entered into force on 25 September 1974. It entered into force on 6 December 1977. See CCC Kyoto Convention Handbook, (1977). Annex D.1 is also reproduced in EEC O.J. (1977) L 166/3. We shall occasionally refer to Annex D.1 as the Kyoto Convention, since we will not be dealing with any other parts of the Convention.

country solely from products of the kind covered by paragraph (f) above;

(h) products extracted from marine soil or subsoil outside that country's territorial waters, provided that the country has sole rights to work that soil or subsoil;

(ij) scrap and waste from manufacturing and processing operations, and used articles, collected in that country and fit only for the recovery of raw materials;

(k) goods produced in that country solely from the products referred to in paragraphs (a) to (ij) above."

Rule 3 Not Wholly Produced or Obtained

Rule 3 reads as follows:

"(a) (i) A product shall be deemed to be originating from ASEAN Member States, if at least 40% of its content originates from any Member States.

(ii) Locally-produced 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 origin test for the purpose of origin determination.

(iii) Subject to Sub-paragraph (i) above, for the purpose 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 used does not exceed 60% of the FOB value of the product produced or obtained and the final process of the manufacture is performed within the territory of the exporting Member State.

(b) The value of the non-originating materials, parts or

produce shall be :

(i) The CIF value at the time of importation of the products or importation can be proven; or

(ii) The earliest ascertained price paid for the products of undetermined origin in the territory of the Member State where the working or processing takes place.

The formula for 40% ASEAN Content is as follows:

$$\frac{\text{(Value of Imported Non-ASEAN Materials Parts of Produce + Value of Undetermined Origin Materials, Parts)}}{\text{FOB price}} X\ 100\% << 60\%"$$

Rule 3 effectively defines the origin of goods that have at least some materials, parts or content which are not wholly produced or obtained within ASEAN members[19]. The main principle is, as is provided in the CEPT-agreement, that the content proper to ASEAN must amount to at least 40% of the value of the product. This means of course that non-ASEAN content may not exceed 60% of the same value.

In order to carry out this calculation, one must establish two values and consequently compare them with each other. On the one hand, the value of the imported product for which the preferential treatment is requested. This value must be expressed in FOB terms. In case the price at the time of import is calculated as a CIF-price, the cost of insurance and freight must thus be deducted. The value so obtained constitutes 100% for the purpose of the comparison.

On the other hand, the value of imported non-ASEAN materials, parts or produce (this time the CIF-price must be applied) of the product must be determined. Even though the text of the rules

[19] Rule 2 (j) a contrario; Rule 3 (a) (ii) in fine.

of origin itself only refers to "materials, parts or produce", Annex A of the AFTA Rules clearly establish that intangible factors of production such as overhead, services, royalties and profit are also to be included in this calculation.

Annex A to the agreement "Rules of Origin for the CEPT Scheme for AFTA" (this annex was added on 1 September 2003) (point. 2 and 3) defines "FOB price" mainly with reference to the price ex-factory:

2. FOB price shall be calculated as follows:
   a. FOB Price = Ex-Factory Price + Other Costs
   b. Other Costs in the calculation of the FOB price shall refer to the costs incurred in placing the goods in the ship for export, including but not limited to, domestic transport costs, storage and warehousing, port handling, brokerage fees, service charges, etc.
3. Formula for ex-factory price:
   a. Ex-Factory Price = Production Cost + Profit
   b. Formula for production cost,
      i. Production Cost = Cost of Raw Materials + Labour Cost + Overhead Cost
      ii. Raw Materials shall consist of:
         • Cost of raw materials
         • Freight and insurance
      iii. Labour Cost shall include:
         • Wages
         • Remuneration
         • Other employee benefits associated with the manufacturing process
      iv. Overhead Costs, (non-exhaustive list) shall include, but not limited to:
         • real property items associated with the production process (insurance, factory rent and leasing, depreciation on building, repair and maintenance, taxes, interest on mortgage)

- Leasing of and interest payments for plant and equipment
- Factory security
- Insurance (plant, equipment and materials used in the manufacture of the goods)
- Utilities (energy, electricity, water and other utilities directly attributable to the production of the goods)
- Research, development, design and engineering
- Dies, moulds, tooling and the depreciation, maintenance and repair of plant and equipment
- Royalties or licenses (in connection with patented machines or processes used in the manufacture of the goods or the right to manufacture the goods)
- Inspection and testing of materials and the goods
- Storage and handling in the factory
- Disposal of recyclable wastes
- Cost elements in computing the value of raw materials, i.e. port and clearance charges and import duties paid for dutiable component

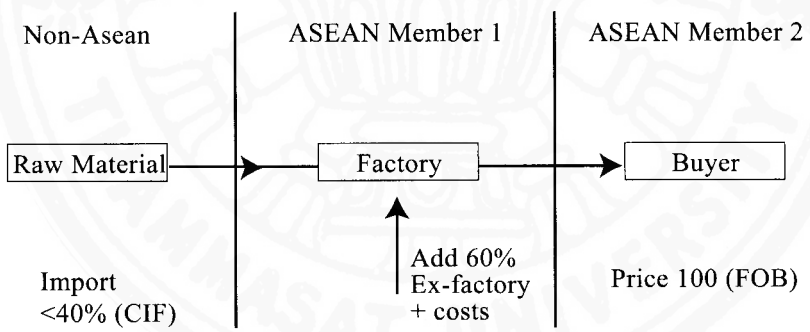
It is established in this Annex that the price charged by the exporting ASEAN member may include (among other things) profit, the cost of services obtained in connection with the manufacturing process, royalties paid in that regard, rent or leasing of equipment and general and administrative expenses. It is also noteworthy that the cost plus calculation referred to must be carried out by using "Generally Accepted Accounting Principles".[20] It is furthermore mentioned that "costing information must be prepared to show the

[20] Annex B (also added on 1 September 2003) to Rules of Origin for the CEPT Scheme for AFTA, Principles and guidelines on the CEPT-AFTA rules of origin A (vi).

avoidance of double-counting of cost items".

Note that packing required for transport or storage may be treated separately for origin determination. If that is not the case, packing is not treated as non-ASEAN to determine the origin of the product.

To the value of non-ASEAN content, the value of materials, parts and produce of undetermined origin is added. As no CIF-price will usually be known for content of undetermined origin, the "earliest ascertained price" paid for such products in the ASEAN member where the process takes place must be applied. The total of "non-ASEAN" and "undetermined" is now compared with the basis of 100% established earlier. If the latter exceeds 60% of the basis, the product does not qualify for preferential treatment. If it does not exceed 60%, preferential treatment may be available provided the other conditions are also fulfilled.



Final process manufacture

Final process of manufacture

The calculation method applied by AFTA raises several questions. As the rules do not specify the nature or characteristics of the 40% which is minimally to be added within ASEAN members, taken in isolation the (erroneous) impression may take hold that any mark-up of prices may result in qualifying products that would otherwise not benefit from the preferences of AFTA.

Rule 3 however prevents the granting of preferences in situations where goods (which do not qualify as having an ASEAN

origin) would be re-exported by any ASEAN member in the exact same condition as they arrived. Besides the 40% condition, it is required that

> "the final process of the manufacture is performed within the territory of the exporting member state"[21]

As Prof. Jaturon noted, this rule is meant to "prevent a re-export of products from a non-member country into other member countries, given that only ASEAN products can benefit from the duty-free privilege when exported onto other member countries".[22]

The provision in my view establishes several conditions that all need to be fulfilled:

1) The product must be created by means of a *manufacturing process*. Products which are harvested or caught but not manufactured, such as shrimp or apples, cannot qualify for this rule;

2) There must be a *final phase*[23] of that manufacturing process which can be identified as such. It is required that "a process" takes place within ASEAN, which can be seen as an integral part of the various combinations of labor and materials to create a product;

3) This final phase is performed within the *territory of an ASEAN member*;

4) Which is the exporting state of the product for which the preferential treatment is requested.

At this point the question may be raised what will constitute "manufacturing" or "a process of manufacturing". In accordance with

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[21] Rule 3 (a) (ii)

[22] Jaturon Thirawat, Salient Aspect and Issues Concerning AFTA, Thammasat Review, Vol.7 No.1, December 2002, p. 31.

[23] Compare with Art. 5 of EEC Regulation 802/68 which also refers to the last transformation. Varona, E.N., "Rules of Origin in the GATT", in Rules of Origin in International Trade, p. 355.

the Vienna Convention on the Law of Treaties, these terms must be read in their ordinary meaning in their context and in the light of the object and purpose of the treaty[24]. Without wishing to engage in an in-depth analysis of this matter at this stage, it may be said that products which are completed in their entirety at the moment of entering AFTA cannot qualify in this sense. This issue is closely related to the definition of the product in question. Is one for example importing garments or blue-colored garments? If applying the color is done in an ASEAN member country, the garments in question may or may not be considered to have an ASEAN origin depending on the answer to that question. Also, it may be noted that AFTA by no means requires the final process to be "substantial". It suffices that there is a process which is a part of the manufacture of a product, and that it is final. It is noteworthy that the European Court of Justice has ruled that assembly may indeed be considered as an act of manufacturing[25]. Heat treatment and polishing may also -depending on the circumstances- be regarded as a "last substantial working or processing" as required under EC law[26].

There has been debate among AFTA members about a requirement that a certain percentage of the 40% ASEAN content should be added in the last exporting member State. The compromise reportedly adopted by a SEOM working group is that 10% of the total 40% should be added in the exporting country[27] but it is not entirely clear if this requirement is legally binding.

Rule 4 Cumulative Rule of Origin

Rule 4 reads as follows:

"Products which comply with origin requirements provided

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[24] Art. 31 Vienna Convention on the Law of Treaties. (interpretation of treaties)

[25] Brother International v. Hauptzollamt 26/88 (1989) ECR 4253.

[26] Commission Regulation No. 1836/78 of 27 July 1978 O.J. (1978) L 210/49.

[27] Jaturon Thirawat, Salient Aspects and Issues Concerning AFTA, Thammasat Review, Vol.7, No.1, December 2002, p. 30.

for in Rule 1 and which are used in a Member State as inputs for a finished product eligible for preferential treatment in another Member States shall be considered as products originating in the Member State where working or processing of the finished product has taken place provided that the aggregate ASEAN content of the final product is not less than 40%".

Rule 4 of the AFTA rules of origin establishes the principle of cumulative application. It is as a principle irrelevant in which ASEAN member state value is added, as long as the final process is completed in the member state of export[28]. Prof. Jaturon describes aptly the pros and cons of single local content and cumulative local content approaches:

> "With regard to the issue of "local content", it is noteworthy that ASEAN countries were at first reluctant and divided in preference between the so-called "single local content" and the "cumulative local content" formulae - in other words, between the formula requiring that the entire 40% of the local content must come from any one of the ASEAN countries and the formula allowing the local content to come from more than one member country. In view of the fact that the underlying intent of ASEAN is to assimilate the situation in AFTA to that of a country, where products manufactured in any province or any part of the country, regardless of where and how much of the local content of such products comes from within that country, the "single local content" formula should, from the idealistic standpoint, be adopted. It is undeniable, however, that under the prevailing circumstances, this rationale is not as yet entirely applicable, simply because the degree of integration in AFTA is still far too remote from that

[28] Rule 3 (a) (ii) last sentence.

of a single state. In a single state, the single local content formula is entirely admissible in view of the fact that the enrichment of any part of the country can always contribute either directly or indirectly to the improvement of the economy and well-being of the country as whole through an appropriate distribution of wealth by the central government. The case is entirely different for ASEAN and, by extension, AFTA, because neither of them is comparable to a country in spite of the ambitious so-called economic integration of the "new generation". If and when ASEAN's integration has already become analogous to that of a highly integrated collectivity like the EU, the single local content formula will surely have to prevail. A premature application of such an ambitious criterion will be beneficial only to member countries that are endowed with a high degree of technological development, to the detriment of member countries of a lower degree of development, whose markets will inevitably be flooded by an overwhelming influx of goods that they are still incapable of producing. It was probably for this reason that the single local content formula was rejected, and the more pragmatic cumulative local content formula was ultimately adopted by the AFTA Council."[29]

Rule 5 Direct Consignment

Rule 5 provides essentially that in order to qualify, goods must be transported directly from one ASEAN member to another, although some exceptions are allowed. It reads as follows:

"The following shall be considered as consigned directly from the exporting Member State to the importing Member State :

[29] Jaturon Thirawat, Salient Aspects and Issues concerning AFTA, Thammasat Review, Vol.7, No.1, December 2002, pp.28-29.

(a) If the products are transported passing through the territory of any other ASEAN country;

(b) If the products are transported without passing through the territory of any other non-ASEAN country;

(c) The products whose transport involves transit through one or more intermediate non-ASEAN countries with or without transshipment or temporary storage in such countries, provided that :

(i) The transit entry is justified for geographical reason or by consideration related exclusively to transport requirements;

(ii) The products have not entered into trade or consumption there; and

(iii) The products have not undergone any operation there other than unloading and reloading or any operation required to keep them in good condition."

4. Planning Considerations

As was mentioned above, the design of AFTA's rules of origins leaves some room for importers to ASEAN countries to reduce customs duties, also when not the entire production process of the goods takes place in the ASEAN region. The diverse nature of the ASEAN members-which is reflected in their import duty tariffs and free trade agreements with non-ASEAN members-is a contributing factor in this regard. Countries such as Singapore with few local resources may have lower import duties on many products than ASEAN members with local industries to protect. With some import duties amounting to 30% or more, a reduction under AFTA to 0% constitutes a considerable savings.

It follows from the above that to design a duty planning in this regard will involve several steps. In first instance, there must be an ASEAN Member which applies lower tariffs on the goods in question than the others country. Moreover, it must be verified if the

values added in the production process, the actual production phases itself and the transport arrangements meet (or can be made to meet) the conditions setout in the AFTA rules of origins.

Reaching the 40% threshold

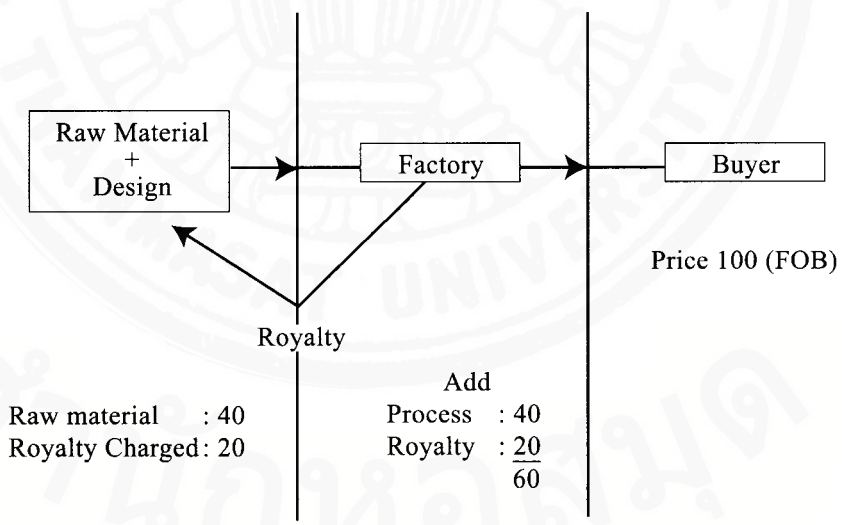
As was mentioned above, the AFTA rules do not impose a substantial transformation to take place on ASEAN soil. What matters is reaching 40% local content. A simple but relatively expensive addition or process may thus suffice in this regard. Importers to ASEAN countries will therefore attempt to design the completion of the production process in such a way that a final, relatively expensive phase can be undertaken in ASEAN territory.

Example:
A US manufacturer of sauces currently imports its bottled product to various ASEAN members, subject to import duties between 5% and 25%. The importer decides to reorganize and import the basis of the product in bulk to one ASEAN member which applies the 5% rate. Once arrived, a highly important ingredient produced by a local subsidiary of the group will be added, the sauce is blended, sampled and bottled. This process results in a local content of 45%. The product can now be exported to other ASEAN members without duty.

The example above already illustrates an issue that is sure to be associated with AFTA duty planning: transfer pricing. Especially for groups of enterprises that have subsidiaries in ASEAN territory, the temptation may exist to overprice the local supplies made, so as to reach the 40%-threshold. The AFTA rules do not specifically address the possibility of transfer pricing, but there seems no apparent reason to disable any anti-abuse provisions that may exist in the national laws of the exporting or the importing ASEAN

member.[30] Another, related issue is which valuation rules need to be applied to establish the prices used. If imports were made from another ASEAN member which is a member of GATT/WTO, there may be cause to refer to the GATT valuation code.[31] On the other hand, it is not certain if customs valuation methods are always the most appropriate body of rules to determine "added value" which is the object and purpose of AFTA Rule 3.

Intra-group services and royalties constitute a particular issue. As the exporting ASEAN member may normally include the cost of services and royalties which are directly or indirectly connected to the production of the goods, international groups with manufacturing facility in ASEAN may see an opportunity to enhance their local content this way. The ASEAN subsidiary will be charged important royalties or services which as a principle it must include in the FOB price when the goods are exported to another ASEAN member.



[30] Both countries may exercise verification measures: See Rule 6 and 16 of the "Operational Certification Procedures for the Rules of Origin of the ASEAN CEPT for the AFTA".

[31] Under international law, treaty terms must (among other things) be interpreted in accordance with "rules of international law in force between the parties" art. 31 (3) c) Vienna Convention on the Law of Treaties.

The planning techniques outlined above raise several questions, the answers to which are less than obvious. Will the exporting country be obliged to issue a certification of origin ("form D")? Will, even if the exporting ASEAN member issued the form D, the importing ASEAN member be required to grant the privileges connected to it? This question is closely connected to the examination rights and duties of the ASEAN members under the AFTA rules of origin.

Both the exporting and the importing member have the right to examine if the goods applying for privileges actually meet the conditions established under the AFTA rules of origin. The exporting member has the primary duty to "carry out proper examination upon each application for the Certificate of Origin" to ensure that:

(a) The application and the Certificate of Origin are duly completed and signed by the authorized signatory;

(b) The origin of the products is in conformity with the Rules of Origin;

(c) The other statements of the Certificate of Origin correspond to supporting documentary evidence submitted;

(d) Description, quantity and weight of goods, marks and number of packages, number and kinds of packages, as specified, conform to the products to be exported.

(e) Multiple items declared on the same Form D shall be allowed provided each item must qualify separately in its own right.[32]

The customs authorities have also the right, however, to reject a form D issued by another member. In such a case, the form D must be marked accordingly (in box 4) and both original and triplicate copies must be returned to the customs department of the

[32] Rule 6 Operational Certification Procedures for the Rules of Origin of the ASEAN Common Effective Preferential Tariff Scheme For the ASEAN Free Trade Area endorsed by the 17th AFTA Council.

issuing country.[33] The rejection must be motivated. The issuing country may provide clarifications on the Certificate that was rejected, in which case "it should be accepted by the importing country".[34] The clarifications must however be detailed and address the grounds for rejecting the privilege given by the importing country.

The importing member state may also ask for a retroactive check at random or when it has suspicions with respect to a certain import or importer. This retroactive examination is conducted by the member that issued the Certificate in the first place. It involves the cost accounting and any specific grounds that the importing country may have mentioned. The issuing country shall reply within 3 months.[35]

Anti-abuse rules

Contrary to the EEC Basic Origin Regulation, the CEPT-Agreement or the AFTA rules of origin do not contain any specific anti-circumvention clause. Art. 6 of the EEC Regulation in question reads as follows: "Any process or work in respect of which it is established, or in respect of which the facts as ascertained justify the presumption, that its sole object was to circumvent the provisions applicable in the Community or the Member States to goods from specific countries shall in no case be considered, under Article 5, as conferring on the goods thus produced the origin of the country where

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[33] Rule 7 e) Operational Certification Procedures for the Rules of Origin of the ASEAN Common Effective Preferential Tariff Scheme For the ASEAN Free Trade Area endorsed by the 17th AFTA Council.

[34] Rule 7 f) Operational Certification Procedures for the Rules of Origin of the ASEAN Common Effective Preferential Tariff Scheme For the ASEAN Free Trade Area endorsed by the 17th AFTA Council.

[35] Rule 17 Operational Certification Procedures for the Rules of Origin of the ASEAN Common Effective Preferential Tariff Scheme For the ASEAN Free Trade Area endorsed by the 17th AFTA Council.

it is carried out."[36]

It is only provided that "(a) When it is suspected that fraudulent acts in connection with the Certificate of Origin have been committed, the Government Authorities concerned shall cooperate in the action to be taken in the respective State against the persons involved. (b) Each Member State shall be providing legal sanctions for fraudulent acts related to the Certificate of Origin"[37]

This does however not mean that the ASEAN members cannot invoke any legal basis for curbing fraud or circumvention of the AFTA Rules of Origin. The AFTA rules do not address or limit the general provisions in the domestic customs laws of the ASEAN members with respect to evasion of duties and furnishing incorrect information or documents. As a principle, these domestic rules retain their force of application in AFTA-situations also. It must be noted, however, that the members may not frustrate the object and purpose of the AFTA agreement under the guise of anti-fraud regulations or actions.[38]

Concluding Remarks

The evolving legal framework of ASEAN and AFTA has taken a significant step towards a more efficient and predictable application of privileges for intra-ASEAN trade. Since the introduction of AFTA, there have been uncertainties related to the actual calculation or application of the "40% local content" principle which is central to its rules of origin. With the Annexes adopted in 2003, the AFTA rules of origin are now not only increasingly

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[36] EEC Regulation 802/68, supra note 60.

[37] Rule 22 of Operational Certification Procedure for the Rules of Origin of the ASEAN Common Effective Preferential Tariff Scheme For the ASEAN Free Trade Area.

[38] Such would constitute a breach of that Member State's duty to perform an international treaty in good faith; Art 26 Vienua Convention on the Law of Treaties.

detailed and transparent but also more clearly in accordance with international trade principles. Importer will welcome some of the possibilities under the AFTA rules of origins for increasing local content by means of intra group supplies of services. It remains largely up to individual members of AFTA if and how will be reacted to such practices. Inevitably, this raises new issues of harmonization.

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