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From EUSFTA to EU-ASEAN FTA
Truth and myths surrounding rules of origin

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Introduction

The recent ruling made by the Court of Justice of the European Union to classify the EU-Singapore Free Trade Agreement (EUSFTA) as a "mixed" agreement, one that cannot enter into force formally without consent of all member states, put an end to the lengthy uncertainties surrounding the competencies and corresponding ratification procedure of modern, comprehensive trade deals in the EU. As the first FTA negotiated by the European Commission after the Lisbon Treaty came into force which incorporated EU-wide disciplines on investment protection, the EUSFTA was put in front of the Court to clarify if the Commission alone can finalise it.

The Court confirmed that all chapters – excluding provisions pertaining to portfolio investment and Investor-State Dispute Settlement – fall within the purview of the Common Commercial Policy where the EU has the so-called "exclusive competence" to act by itself. After European Parliament gives consent to the agreement, the EU-only chapters which constitute lion's share of the FTA can be applied provisionally while awaiting the final approval from 38 national and regional parliaments in the EU.

While nowadays Europe speaks of the value of the deal and the decision mainly in terms of restoring the credibility of the bloc's trade policy and sketching a blueprint for striking future "next generation" FTAs with Japan, MERCOSUR and, possibly, post-Brexit Britain, the overriding consideration of launching the EUSFTA negotiations back in 2010 was to pave the way for the eventual region-to-region agreement with the Association of Southeast Asian Nations (ASEAN), at a time when direct engagement with the 10-nation bloc proved intractable following nearly two years of futile negotiations.

Rules of Origin Debate

The 96-page long rules of origin (ROOs) built into the agreement, however, lead some commentators to feel uneasy about both the true merit of the deal for Singapore and the practicality of it being used as a template for the prospective EU-ASEAN FTA. ROOs – an integral feature of all preferential and reciprocal trade arrangements – are necessary to ensure

only goods and services originating within the jurisdiction of the FTA receive negotiated benefits, in an attempt to prevent transhipment. Depending on the agreement, normally country of origin (sometimes referred to by the misnomer "nationality") is conferred if a product satisfies one or more of the three requirements: change of tariff classification (e.g. importing tomatoes and exporting ketchups), local value added and specific manufacturing process. While trade accords involving the EU typically adopt restrictive rules – in terms of higher local content or mixed criteria certification (referring to the use of two or more of the above criteria in determining origin), the ROOs contained in the EUSFTA are not as much of a concern as they seem.

The EU estimates that privileged access to 500 million consumers in Europe will increase Singapore's real GDP and exports by €2.7 billion (0.94%) and €3.5 billion (10.4%) respectively. But sceptics say Singapore, which lacks indigenous inputs to add into exports, will face difficulty in meeting origin requirements for it to benefit as predicted from the actually conditional free market access to Europe. A closer scrutiny of the FTA text reveals that such fear is largely misplaced as several provisions each in their own way facilitate preference utilisations for both Singaporean firms and many EU subsidiaries operating in the regional hub of Southeast Asia.

First of all, under the EUSFTA, the EU agrees lifted thresholds on import content ranging from 40 to 60 per cent, whereas caps on non-originating materials under earlier EU agreements fluctuate between 30 and 50 per cent. To put the EUSFTA's relaxed local value added requirement into perspective, the average import content of gross exports for Singapore during 2001 and 2011 were approximately 39 per cent according to OECD statistics. Acknowledging Singapore's uniqueness as an entrepôt economy, re-exports for certain products are also permitted as long as Singapore adds 10 per cent local content to the final exports – given Singapore's relatively high wage vis-à-vis imported goods, the requirement conceivably can be met with ease most of the time.

For some products of key export interests to Singapore such as pharmaceuticals, petrochemicals and electronics, the EUSFTA generally applies co-equal rules to accord producers some degree of flexibility to cherry-pick a less stringent origin-certifying method to prove compliance. Moreover, a specified list of final goods of and intermediate inputs to those industries (e.g. petroleum oils and gases, rectifiers and electrical insulators) originating in ASEAN countries are allowed to count towards Singapore's local content.

Obstacle to EU-ASEAN FTA?

The ROOs, in short, is not the bogeyman as far as the EUSFTA is concerned. But if the potential EU-ASEAN FTA following the example of the EUSFTA adopts detailed, product-by-product origin rules – instead of simple and general ROOs incorporated in ASEAN's existing FTAs, will developing Southeast Asian countries with weaker institutional capacity be able to administer the presumably exigent tasks of origin conferring and verifying?

This concern is legitimate to a certain degree, but can be eased by the fact that ASEAN countries have decades of experiences with navigating the EU's ROOs primarily through the latter's unilateral trade liberalising scheme, the Generalised System of Preference (GSP) introduced in 1971. Apart from Singapore, Brunei, Malaysia and Thailand that have graduated out of the GSP,

Indonesia, the Philippines and Vietnam are currently exporting to Europe under reduced tariffs, and Cambodia, Laos and Myanmar are among the beneficiaries of the more generous "Everything But Arms" (EBA) arrangement within the framework of the GSP.

Complying with the complex array of strict and mostly sector- and product-specific ROOs stipulated in the EBA and GSP is no easy task, yet most of the ASEAN countries have managed to meet the origin requirements and successfully claimed the benefits. For example as of the first six months in 2015, 95.4 per cent of EBA eligible imports from Laos entered the EU on a duty-free, quota-free basis despite that the rules governing textiles and clothing products, which Laos specialises in, are among the most onerous provisions of the EU's already restrictive rule regimes. By comparison, the equivalent figures for the year 1997 and 2000 were 19 per cent and 41 per cent respectively.

The high and increasing take-up rates of GSP/EBA preferences reflect the enhanced competence of customs authorities and origin-certifying institutions (and at the same time the declined compliance costs that ROOs impose on exporting business) in Southeast Asia and do not support the case that ASEAN countries will be overwhelmed by the administrative complexity brought about by the prospective EU-ASEAN FTA. Actually, ASEAN could be incentivised to adopt European-style ROOs proactively for two reasons.

On the one hand, detailed and unambiguous ROOs for each tariff lines, once defined, will reduce scope for legal interpretation and on-the-border administrative discretion. Indeed, widely differing interpretations of ASEAN Free Trade Area rules – which centred exclusively on generalised regional value content formula – had led to inconsistent application of ROOs across ASEAN countries and therefore underutilisation of tariff preferences. Embracing the EU model of ROOs would mitigate uncertainties and promote transparency in the furtherance of greater and more effective trade liberalisation.

On the other hand, while restrictive ROOs tend to force some firms to adopt a costlier input mix in order for their finished products to quality for preference, they also act to assist the development of vertically integrated supply chains within the boundary of the free trade area to ensure that it is not just low value added activities are undertaken. Such development externality is broadly in line with ASEAN's own regional integration and modernisation strategies, resonating particularly with ASEAN Economic Community's aspiration of consolidating Southeast Asia's cross-national production sharing networks into a single production base.

Nevertheless, ASEAN can capitalise on these opportunities provided that ASEAN engages in free trade with the EU en bloc. Otherwise, bilateral agreements between individual ASEAN members and the EU would only distort the sourcing and investment patterns in Southeast Asia, potentially resulting in broken value chains, asymmetric growth of exports, and counterproductive overall impacts. After securing the first "building block" to a future inter-regional agreement with ASEAN, Brussels should move swiftly to wrap up on-going talks with notably Malaysia, Thailand and Indonesia. After all, looking ahead the EUSFTA is at best an entrée in anticipation of a main course that should come sooner rather than later.

About the EU Centre

Established in 2008, the EU Centre in Singapore was a joint project funded by the European Union (EU), the Nanyang Technological University (NTU) and the National University of Singapore (NUS). From 2017, the Singapore Management University (SMU) has also become a partner in contributing to the operations of the EU Centre. The EU is now a joint partnership of these three local universities.

The primary mission of the EU Centre is to promote knowledge and understanding of the EU, its policies and development of its relations with Singapore and Southeast Asia through research, publications and different outreach programmes.

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