



Cynthia M. Pornevalai
Partner
cynthia.p@tilleke.com

Cross-border Investment and International Trade Compliance in ASEAN and ACFTA

As both China's Belt and Road Initiative and the US-China trade war continue to impact the decisions of investors around the world, Southeast Asia has witnessed exponential growth in its cross-border investment and international trade with China. In recent years, and most especially in recent months, ASEAN-bloc countries have stepped up to present a more stable, sheltered option for investors looking to operate internationally.

The 10 ASEAN-member countries of Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Vietnam are home to 630 million people, or roughly 10% of the world's population. This is twice the size of the US. Although the ASEAN median income level is still far below that of the US, its vibrant young population, with a median age of 30 and an expanding middle class, is a force to be reckoned with—and an opportunity. Trade between the ASEAN countries and China has reached almost as much as that between China and the US. Moreover, China-ASEAN trade is relatively more balanced, meaning a truly two-way trade.

The economic vibrancy of the combined region is one of the reasons why the ASEAN-China Free Trade Area (ACFTA) pact was inked, initially as a framework agreement in November 2002 and gradually upgraded in the following years. Through various protocols, the most recent of which became effective on July 1, 2016, the ACFTA is aimed at advancing two-way trade and investment between ASEAN and China.

The agreement has made headway in eliminating tariffs on goods traded within the ACFTA, but there is still room for expansion and acceleration of both sides' schedules for tariff reduction.

An important tool to consider under the ACFTA is its Rule of Origin (ROO). ROOs are the criteria for determining the national source of a product. The importance is derived from the fact that duties and restrictions in many cases depend upon the national source of imports. One important use of ROOs, especially in this era of the US-China trade war, is the determination of whether imported products receive most-favored nation (MFN) treatment or preferential treatment.

Under the ACFTA, a product is deemed to be obtained from a certain country if meets one of the following criteria:

1. It is wholly obtained or harvested from that country (e.g., plants, animals, marine, minerals).
2. The 40% local content rule. Its raw material content is at least 40% sourced from that country.
3. The cumulative rule of origin. Products whose materials are sourced from the various ACFTA countries cumulatively consist of 40% local content, and the work and processing are done in that country.
4. The direct consignment rule. Goods must generally be transported directly from the place of production to the

preferential destination, but an exception is made for goods in transit, not undergoing any transformation in the transit state, where justified (for example by geographical limitations).

In a trade war situation, a notable example of the use of the ROO is the transfer of manufacturing facilities. For example, many businesses have now moved out of the US and China to third-party countries, such as ASEAN countries (especially Thailand and Vietnam), to manufacture their products there in an attempt to avoid the tariffs on both sides. But simply using raw materials from China to assemble a product in Vietnam does not necessarily make that product "made in Vietnam." The keys to this determination are the ROOs of both the exporting and the importing countries. While these rules may vary from country to country, the ACFTA has harmonized them for trade between China and ASEAN.

“

The keys to this determination are the ROOs of both the exporting and the importing countries. While these rules may vary from country to country, the ACFTA has harmonized them for trade between China and ASEAN.

”

It is also important for business owners to consider the operating environment for foreign investors in prospective host countries. Both restrictions and promotional privileges can play a large role in determining the profitability of a foreign business venture. Most ASEAN countries—if not all—are export-oriented economies and as a result offer many incentives to foreign investment, including tax and non-tax incentives through their respective investment authorities (such as the Board of Investment in Thailand).

With offices throughout Southeast Asia, we have been advising many clients on the available measures and opportunities that are open to them. Our advice has generally centered around four main courses of action:

1. Enhancing mutual relationships to counter the effects of the trade war and lessen dependence on non-ACFTA trade.
2. Taking advantage of ACFTA opportunities by assessing what is available and being a voice for the acceleration and expansion of trade benefits among ACFTA member states.
3. Considering the opportunities and challenges of investment relocation into the investment climate of another country.
4. Using established ROO procedures in exporting outside of the ACFTA block.

The unique challenges facing international investment today also present opportunities from which judicious entrepreneurs can benefit. A well-informed, circumspect approach can help to not only mitigate the risks and obstacles but also turn the difficulties into profitable developments. 🍷