

## Regulatory &amp; Trade

## Are There Opportunities In A Trade War?

While news reports of doom and gloom flowing from the ongoing trade tensions between the US and China continue, a curious host of economic opportunities for countries in South-East Asia has emerged.

In late 2018, when China decided to slap tariffs of up to 70 percent on US ethanol shipments, the economics behind any direct sale of US ethanol to China became unprofitable. Industry players knew they needed to respond to these new tariffs by China and find another way to move their goods. The market soon started to notice an unusual trend. The volume of shipments of US ethanol into Malaysia, which have historically been very low, began to increase. It was reported that upon arriving in Malaysia US ethanol is then mixed with Malaysian ethanol and is thereafter exported to China. In doing so, the ethanol, originally from the US where it would have incurred significant tariffs if impacted directly into China, is now able to legally enter China tariff-free so long as it arrives blended with at least 40 percent of ASEAN produced fuel.

### Why the preferential treatment?

This is made possible by the rule of origin requirements set out in the ASEAN-China Framework Agreement on Comprehensive Economic Cooperation (“**ACFTA**”), a set of trading rules which provides a platform for deepening economic engagement between the member states. The members of ACFTA are Brunei, Cambodia, Indonesia, Lao, Malaysia, Myanmar, Philippines, Singapore, Thailand, Vietnam and China.

So long as Malaysian exporters fulfil the origin criteria, their products will enjoy the tariff concessions offered by China under the ACFTA. Under the ACFTA, the current origin criteria imposed is 40 percent Regional Value Content (“**RVC**”). The formula for the 40percent ACFTA content is calculated as follows:

$$RVC = \frac{\text{Value of Non-ACFTA Material} - \text{Value of Materials of Undetermined Origin}}{\text{FOB Price}} \times 100 \% < 60\%$$

In the example above, for Malaysian traders to export US-imported ethanol to China tariff-free, it must be blended with ASEAN-produced fuel and the final product must contain at least 40 percent of fuels originated from the members of ACFTA.

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### **What should businesses do?**

It is not surprising that parties affected by these trade wars are forced to seek alternative measures to ensure not just profitability but, in certain cases, the survival of their businesses. Given the ACFTA, ASEAN countries should consider promoting their respective countries as alternative or intermediary trading partners to companies affected by the on-going US-China tariff spat given the favourable tariffs they enjoy as a result of the various multi-national free trade agreements ASEAN member states have entered into.

From a Malaysian perspective, this is beneficial as it would increase demand for Malaysian products, such as in the case of the ethanol shipments. Malaysian ethanol sales have now increased, and US ethanol products that satisfy the rules of origin under the relevant free trade agreement can continue to be sold to China without being subject to hefty new tariffs – a win-win situation for both US and Malaysian ethanol products. Whilst no similar examples of Chinese products that have been sanctioned by the US and which have been re-routed and re-processed in ASEAN to enter the US market tariff free have been reported to date, one can only imagine the opportunities to by-pass US tariffs that such a measure would offer companies that are able to restructure their production and logistics supply chain to continue to import / export their products into China and the US legitimately at slightly increased costs but without having to pay increased tariffs. Companies should therefore start assessing their business structures not just to mitigate losses due to the trade wars, but to take advantage of free trade agreements such as adapting products to meet rule of origin requirements to increase sales.

Needless to say, any attempt to disguise a product's origin and re-label it as a Malaysian (or ASEAN) product before exporting to its final destination, i.e. a falsification of documents to obtain local certificates of origin, is prohibited and would be a breach of the law, e.g. a ship-to-ship transfer where only a document switch that inserts Malaysia as the origin before being shipped to China. In other words, a pure transshipment of products into Malaysia for re-export would not change the RVC that satisfies the rules of origin to qualify for preferential tariffs.

### **Seize the opportunity!**

Like all opportunities, businesses that are able to quickly restructure their logistics and supply chains, and product compositions, stand to benefit the most while such windows of opportunity exist. There is no telling when or if the US or China might broaden sanctions or tariffs to other “ancillary” countries to plug this loop-hole. Having said this, given that rule of origins is enshrined in FTAs, which in turn are bilateral (or multi-lateral) agreements between nations, it would not be that easy for China or the US to renege on such agreements. There remains a rather decent window of opportunity for Malaysian and ASEAN companies to restructure their businesses to take advantage of the US-China trade wars.

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Should you have any questions or wish to discuss options and strategies for your business, please feel free to contact our Regulatory & Trade team.



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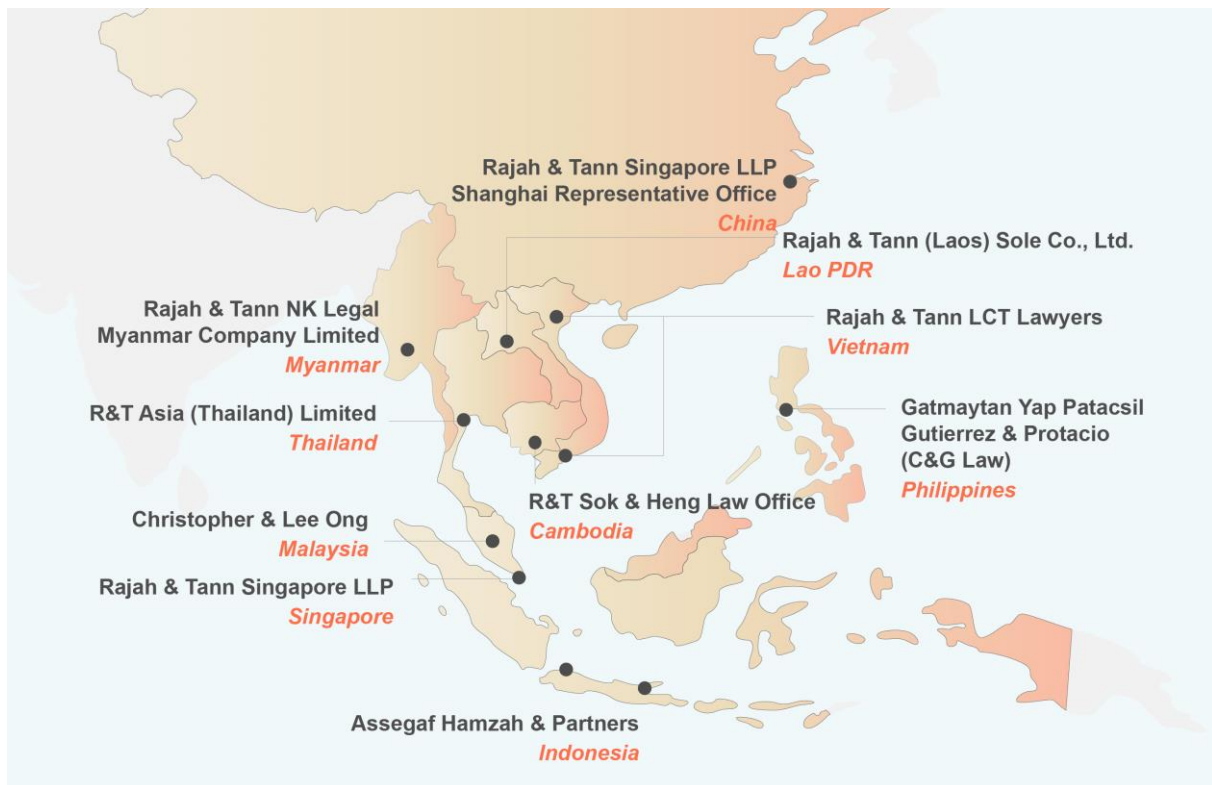
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