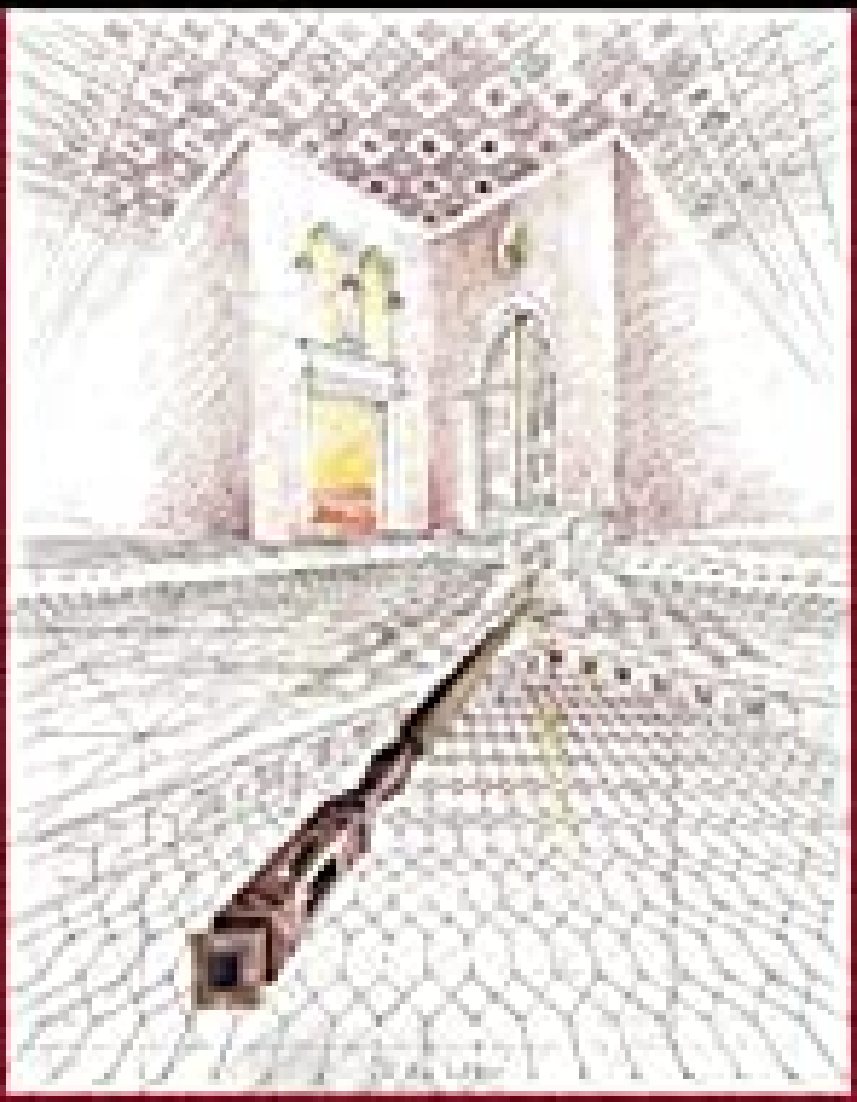
SECOND EDITION

Rules of Origin in International Trade



Stefano Inama

CAMBRIDGE

RULES OF ORIGIN IN INTERNATIONAL TRADE

This book provides comprehensive, in-depth analysis of the different sets of rules of origin adopted by major trading partners and worldwide, as well as efforts to establish multilateral rules at WTO and WCO. It discusses the status of non-preferential as well as preferential rules of origin in international trade, their evolution during the last decades and their tendencies and future. With its multidisciplinary approach, this book's contents provide comparative analysis of the relevant legal and economic features of different rules origin compilation sets, reviewing their drafting differences and their implications and impact on the economic and industrial environments. This edition has been updated and expanded to include the latest developments on rules of origin at multilateral level in WTO and WCO and on rules of origin in recent FTAs. Drawing from his thirty years of experience, Stefano Inama provides insights from trade negotiations along with practical tools for policy makers and practitioners, orientation for the private sector and analytical tools for researchers.

STEFANO INAMA is a chief and trade lawyer for the United Nations Conference on Trade and Development in Geneva, Switzerland and is widely considered one of the world's leading experts on rules of origin. He has advised governments in trade negotiations at WTO, WCO and in FTAs, as well as the private sector in complying with rules of origin. He has authored four books and numerous articles in leading magazines.

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Preface to the First Edition

As I start writing the preface to this book, my mind goes back to the late 1980s, when technical issues on rules of origin began to arise from the surge of exports of the "Asian Tigers" and the trade defense mechanisms by the European Community (EC) and United States. The issue was mainly related to the alleged circumvention of such trade defense mechanisms in which manufacturers affected by the anti-dumping (AD) investigations relocated some working or processing operations in neighboring countries or directly in the export market. This move was counteracted by origin findings of the EC and the United States that indicated that the product exported from the neighboring countries or manufactured in their territory was in fact subject to only minimal working or processing, resulting in the product's having the same origin of the product subject to AD duties.

These were the times when rules of origin started to make headlines in the press. The trading community and AD lawyers were suddenly interested in origin issues. I quickly realized that rules of origin were an ideal issue for contention because they provided the grounds for arbitrary or discretionary practices under the cover of technical and obscure details. Only a select few were part of these early developments. Hardly any international rule, convention, or multilateral instrument could provide guidance to these initial debates. Administrations were slow to answer, demonstrating once again that business life evolves at a faster pace than rule-making, and, to put it simply, rules of origin were, and to some extent still are, a no man's land in international trade law. Apart from the Kyoto Convention, the first international effort to put rules of origin on a multilateral track was carried out under the United Nations Conference on Trade and Development, which convened in the beginning of the 1970s in the context of the Generalized System of Preferences working groups on rules of origin without much success, but a lot of useful technical work was carried out.

About twenty years later, the World Trade Organization Agreement on rules of origin started the Harmonization Work Program of nonpreferential rules of origin.

Once again, a lot of excellent technical work was carried out, but final agreement, although close, is still pending at the time of this writing. I have had the privilege to be exposed to the multidisciplinary nature of rules of origin, and I have drafted this book with the deliberate intent of covering these different aspects. A second important feature of this book is linked to my personal career, which has allowed the mixing of academic and research experiences with technical assistance to developing countries in the field for two decades. Much of the material in this book derives from the unfolding of these experiences. The drafting of this book has also been guided by the desire to maintain a certain degree of pragmatism and to provide the reader with a multidisciplinary instrument to understand rules of origin and their implications.

The views expressed in this book are entirely mine and do not necessarily reflect the views of the United Nations Conference on Trade and Development or any other United Nations agency.

Preface to the Second Edition

More than a decade separates the first edition of the book from the present one.

The multilateral trading system continues to be unable to get an agreement on rules of origin. The Harmonization Work Program (HWP) undertaken in the context of the World Trade Organization (WTO) Agreement on Rules of Origin (ARO) stopped in 2008. Although recent initiatives have been undertaken for the updating of Annex K on rules of origin of the revised Kyoto Convention in the context of the World Customs Organization (WCO), it seems that the road is still a long and perilous one.

This second edition reflects the developments of rules of origin in international trade deriving from the proliferation of free-trade areas (FTAs) and megaregionals that have multiplied rules of origin and related administrative procedures.

This second edition is a completely new book updating and expanding the previous edition. Chapters 1 and 2 discuss the recent initiatives undertaken at multilateral level in the WTO on rules of origin; namely, efforts to impart transparency on nonpreferential rules and the work undertaken on preferential rules of origin for least-developed countries (LDCs) leading to the Bali and Nairobi WTO decisions and subsequent developments.

Chapter 3 on preferential rules of origin has been updated and expanded to cover USMCA and the latest EU free-trade agreements with Canada and Japan as well as a comparison of these free-trade agreements.

Chapter 4 on economics contains most recent developments in economic literature related to origin. This chapter illustrates how utilization rates are a useful tool to measure the effectiveness of trade preferences granted under unilateral preferences or free-trade agreements and recent studies on the links among utilization rates and rules of origin.

The recent developments in free-trade agreements around the world are now covered by a new Chapter 5 analyzing the evolution of rules of origin in Africa, Asia, and Latin America, including megaregionals such as the African Continental Free-

Trade Area (AfCFTA), the Regional Comprehensive Economic Partnership Agreement (RCEP), and the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CP-TPP)

Chapter 6 is a new chapter dedicated to the drafting of product-specific rules of origin (PSRO) using an input–output matrix I developed using the Harmonized System and trade flows. This technique, used in combination with a comparative text analysis identifying convergence and divergence on PSRO, provides detailed tailored advice to negotiators, firms, and researchers.

Administration of procedures related to rules of origin contained in the plethora of free-trade agreements is extensively analyzed and compared in a new Chapter 7, including best practices and lessons learned.

This book, as the previous edition, is the result of a multidisciplinary approach to rules of origin and field experience advising governments, firms, and researchers to better understand and deal with the multifaceted and, at times, fascinating world of rules of origin.

The views expressed in this book are entirely mine and do not necessarily reflect those of United Nations Conference on Trade and Development or any other United Nations agency.

Abbreviations

AANZFTA	ASEAN–Australia–New Zealand Free-Trade Agreement
ACFTA	ASEAN–China Free-Trade Area
ACP	African, Caribbean, and Pacific
AD	anti-dumping
ADA	Anti-dumping Agreement
AfCFTA	African Continental Free-Trade Area
AFTA	ASEAN Free-Trade Area
AGOA	African Growth and Opportunity Act
AIFTA	ASEAN–India Free-Trade Area
AJCEP	ASEAN–Japan Comprehensive Economic Partnership
AKFTA	ASEAN–Korea Free-Trade Area
ALADI	Associación Latinoamericana de Integración
ARO	Agreement on Rules of Origin
ASCM	Agreement on Subsidies and Countervailing Measures
ASEAN	Association of Southeast Asian Nations
ATIGA	ASEAN Trade in Goods Agreement
AU	African Union
BTN	Brussels Tariff Nomenclature
CA	certifying authority
CACM	Central American Common Market
CAFTA	Central American Free-Trade Area
CAFTA–DR	CAFTA–Dominican Republic
CARICOM	Caribbean Common Market
CBI	Caribbean Basin Initiative
CBP	Customs and Border Protection (US)
CC	change of chapter
CCCN	Council Cooperation Customs Nomenclature

CEEC	Central and Eastern European Countries
CEPT	Common Effective Preferential Tariff
CETA	Canada–EU Comprehensive Economic and Trade Agreement
CIF	cost, insurance, and freight
CIS	Customs Information System
CITA	Committee for the Implementation of the Textiles Agreements
CMA	critical mass agreement
CO	certificate of origin
COMESA	Common Market for Eastern and Southern Africa
CP-TPP	Comprehensive and Progressive Agreement for Trans-Pacific Partnership
CRO	Committee on Rules of Origin
CTC	change of tariff classification
CTH	change of tariff heading
CTHS	change of tariff heading split
CTSH	change of tariff subheading
CTSHS	change of tariff subheading split
CUSFTA	Canada–US Free-Trade Area
DFQF	Duty-Free Quota-Free (Initiative)
DRAM	dynamic random-access memory
DSU	Dispute Settlement Understanding
EAC	East African Community
EBA	Everything But Arms (Initiative)
EC	European Community
ECCAS	Economic Community of Central African States
ECJ	European Court of Justice
ECOWAS	Economic Community of West African States
ECSC	European Coal and Steel Community
EEA	European Economic Area
EEC	European Economic Community
EEZ	exclusive economic zone
EFTA	European Free-Trade Association
EPA	Economic Partnership Agreement
EPROM	erasable programmable read-only memory
EPZ	export processing zone
ESA	Eastern and Southern Africa
EU	European Union
EUI	European University Institute
FDI	foreign direct investment
FIFO	first in, first out
FOB	Free On Board
FTA	free-trade area

GAAP	generally accepted accounting principles
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GC	General Council
GIR	General Interpretation Rule
GPT	General Preferential Tariff
GSP	Generalized System of Preferences
HRO	Harmonized Rules of Origin
HS	Harmonized System
HTS	Harmonized Tariff Schedule
HTSUS	Harmonized Tariff Schedule of United States
HWP	Harmonization Work Program
ICC	International Chamber of Commerce
ITA	Information Technology Agreement
LAIA	Latin American Integration Association
LDC	least-developed country
LDCT	LDC tariff
LIFO	last in, first out
Mercosur	Southern Common Market
MFN	Most-Favored Nation
MMTZ	Malawi, Mozambique, Tanzania, and Zambia
MSMEs	micro, small, and medium-size enterprises
NAFTA	North American Free-Trade Agreement
NAMA	Non-Agricultural Market Access Negotiations
nes	not elsewhere specified
NOM	non-originating material
OCP	Operational Certification Procedure
OCT	overseas countries and territories
ODI	Overseas Development Institute
OECD	Organisation for Economic Co-operation and Development
OJ	Official Journal of the European Communities
OLAF	Office Européen de Lutte Anti-Fraude
OM	originating material
PEM	Regional Convention on Pan-Euro-Mediterranean Preferential Rules of Origin
PSRO	product-specific rules of origin
PTA	Preferential Trade Agreement
QUAD	quadrilateral countries (the EU, United States, Japan, and Canada)
RCEP	Regional Comprehensive Economic Partnership Agreement
REC	Regional Economic Community
REX	Registered Exporter
RKC	Revised Kyoto Convention

RMG	ready-made garment
RoO	rules of origin
RoW	rest of the world
RTA	regional trade agreement
RVC	regional value content
SAARC	South Asian Association for Regional Cooperation
SACU	South African Customs Union
SADC	Southern African Development Community
SAP	Stabilisation and Association Process
SEZ	special economic zones
SME	small and medium-sized enterprise
SPS	sanitary and phytosanitary
TAO	Tariff Analysis Online
TAXUD	Taxation and Customs Union Directorate-General (European Commission)
TCRO	Technical Committee on Rules of Origin
TDCA	EU–South Africa Trade and Development Cooperation Agreement
TECH	technical requirement
TFTA	Tripartite Free-Trade Area
TPP	Trans-Pacific Partnership Agreement
TRIPS	Trade-Related Aspects of Intellectual Property Agreement
TTIP	Transatlantic Trade and Investment Partnership
TWG	Technical Working Group
UEMOA	West African Economic and Monetary Union
UNCTAD	United Nations Conference on Trade and Development
UNIDO	United Nations Industrial Development Organization
UR	utilization rates
URAA	Uruguay Round Agreements Act
USMCA	US, Mexico, Canada Free-Trade Area
USTR	US Trade Representative
VC	value content
VNOM	value of non-originating material
VOM	value of originating material
WAEMU	West African Economic and Monetary Union
WCO	World Customs Organization
WITS	World Integrated Trade Solutions
WO	wholly owned
WTO	World Trade Organization

1

Efforts to Establish Multilateral Rules

Rules of origin have long been considered a rather technical customs issue, with little bearing on trade and economic policy. However, origin has far-reaching implications, not only for trade policy but also for domestic disciplines regulating the marketing and labeling of products to final consumers as recently recognized in several initiatives.[1] Marks of origin, linkages with geographical indications, or the definition of "domestic industries" may not be directly linked to the traditional view of origin limited to a border control device. The relevance of rules of origin (a "secondary trade policy instrument") may be fully grasped only when they are associated with primary trade policy instruments that they support, such as tariffs, contingency protection measures, and trade preferences and labeling.

Rules of origin are often associated with preferential trade regimes, as the fulfilment of origin criteria is a precondition for the application of a preferential tariff. Nonpreferential rules of origin apply to trade flows that do not benefit from tariff or other trade preferences. One of the main differences between nonpreferential and preferential rules of origin is that the former should always provide for an exhaustive method to determine origin. In the case of preferential rules of origin, if the origin criterion is not met, the preferential tariff will not be applied. Unless there are more than two parties involved in a preferential tariff treatment,[2] there is often no need to fall back

[1] See the WTO "made in the world" initiative (www.wto.org/english/res_e/statis_e/miwi_e/background_paper_e.htm). See also a proposed regulation by the EU Commission on product safety and market surveillance linking the concept of origin of goods to marking (Made in . . .) and consumer safety to rules of origin. This proposal included the requirement to indicate the country of origin on the product determined according the nonpreferential rules of origin contained in the Community Customs Code. Such proposal is a sign of how traditional trade policy instruments are reacting to value chains of production of goods see www.europarl.europa.eu/RegData/bibliotheque/briefing/2013/130513/LDM_BRI(2013)130513_REV1_EN.pdf. For some views on the concept of origin "Made in Sweden? A new perspective on the relationship between Sweden's exports and imports," Swedish National Board of Trade, 2010.

[2] This is the case, for instance, when parties to free-trade areas have different tariff phaseout schedules (as in the case of RCEP or CP-TPP further discussed in Chapter 5 of this book, section 5.5) or when under a unilateral preference scheme such as the European Union

on alternative methods to secure an origin outcome. Recently the growth of mega-regional free-trade area (FTA) agreements such as the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CP-TPP) and the Regional Comprehensive Economic Partnership Agreement (RCEP) and African Continental Free-Trade Area (AfCFTA) have brought this issue to the forefront. As many of these FTAs provide for tariff offers with tariff dismantling phase-out periods that may be differentiated among the parties to the free-trade agreement, it is obvious that, during the transitional phase of such tariff dismantling, the determination of origin at country level is necessary when more than one of the parties have been involved in the manufacturing of the finished product.[3]

In the case of nonpreferential origin rules, there must still be a method to determine the origin of the good to administer trade policy measures, even if the primary origin criterion is not met. Thus, other rules should be provided to determine origin when the primary rule has not been met, as customs administrations must determine where goods are originating from. Such ancillary rules to determine origin whenever the primary rule is not met are commonly referred to as "residual rules."

The origin of goods in international trade has traditionally been considered one of the instruments of customs administration associated with preferential tariff arrangements through colonial links, granted by, for instance, the British Empire.[4] At the outset, the granting of these tariff preferences was conditional on compliance with rules of origin requirements often based on a value-added criterion.

A notable exception to this principle, derived from a different historical background, is the United States' rules of origin, which were first associated with origin marking[5] and not with the granting of preferential tariff treatment. As discussed in the following section, this difference has had direct consequences in the evolution of the origin concept in US legislation.

The issue of rules of origin (as opposed to origin markings, to which GATT Article IX is devoted, because of US influence) did not attract much attention in the

Generalized System of Preferences (EU GSP) scheme there is regional cumulation granted to a regional group comprising both least-developed countries (LDCs) and non-LDC developing countries. In those cases, and when two or more countries have been involved in the manufacturing of a finished product subsequently exported to the preference-giving country or to another party of a FTA agreement, there is a need for a "residual" rule to allocate origin among the beneficiaries of a unilateral scheme or among parties to a FTA agreement because different preferential tariffs may be applicable. For an example of residual rules in the context of unilateral preference scheme, see Article 86 of Commission Regulation (EU) No. 1063/2010, November 18, 2010 amending Regulation (EEC) No. 2454/93 laying down provisions for the implementation of Council Regulation (EEC) No. 2913/92 establishing the Community Customs Code, OJ L2011. See also Chapter 5 of this book, section 5.5.

For examples of residual rules in cumulation, see also: Globalization and the International Trading System: Issue Relating to the Rule of Origin (UNCTAD ITCD/TSB/2, March 24, 1998). For the issue of residual rules or, better defined, origin allocation in the context of FTAs, see Chapter 3 of this book.

[3] This issue is further explained and discussed in Chapter 3 of this book.

[4] See UK Finance Act of 1919.

[5] See Tariff Act of 1890, Chapter 1244, para. 6, 26 Stat. 567, 613 (1891).

negotiation of the original General Agreement on Tariffs and Trade (GATT). On the contrary, during the second session of the Preparatory Committee in 1947, a subcommittee considered that "it is to be clear that it is within the province of each importing member to determine, in accordance with the provisions of its law, for the purpose of applying the most-favored-nation (MFN) provision whether goods do in fact originate in a particular country."[6] Only later – in 1951 and 1952[7] – were the first attempts made (without success) to address the question of harmonization of rules of origin.

The scant attention devoted to the issue of rules of origin in the original GATT was probably because of the preoccupation of the drafters with establishing the unconditional MFN principle contained in Article I. In an MFN world there is no need to examine the origin of goods. This implied that, as a general concept, origin entered into world trade with a discriminatory bias: origin needs to be ascertained whenever a discriminatory measure is in place.[8]

Besides these early discussions in GATT, one of the first attempts to establish a harmonized preferential set of rules of origin was made during the discussion in the United Nations Conference on Trade and Development (UNCTAD) in connection with the Generalized System of Preferences (GSP). In point of fact, UNCTAD member states, when discussing the establishment of the GSP, realized the need to examine "origin" at the multilateral and systemic level.[9] However, the preferential nature of the rules, their policy objectives, and the unilateral nature of the GSP did not permit the elaboration of a single set of GSP rules of origin. At the end of the first round of negotiations, preference-giving countries opted to retain their own origin systems and extend them with some adjustments to the GSP. After almost fifty years and in spite of the general lowering of MFN duties, the same reluctance to multilaterally discuss rules of origin under the Duty-Free Quota-Free (DFQF) initiative, which was launched at the World Trade Organization's Hong Kong Ministerial Conference in 2005, has remain unaltered in preference-giving

[6] See PCT/174, 3–4.

[7] See, for instance, the 1951 report on "Customs Treatment of Samples and Advertising Material, Documentary Requirements for the Importation of Goods, and Consular Formalities: Resolutions of the International Chamber of Commerce" (GATT/CP.6/36, adopted October 24, 1951, II/210) and the 1952 report on "Documentary Requirements for Imports, Consular Formalities, Valuation for Customs Purposes, Nationality of Imported Goods and Formalities connected with Quantitative Restrictions" (G/28, adopted November 7, 1952, 15/100).

[8] This consideration, however, does not fully explain why an origin determination was not considered necessary in the framework of Article VI of GATT on anti-dumping, although an explicit reference is made to the cost of production in the country of origin in para. I B ii.

[9] For a brief summary of the work and proceedings of the UNCTAD Working Group on Rules of Origin from 1967 to 1995, see "Compendium of the work and analysis conducted by UNCTAD working groups and sessional committees on GSP rules of origin," Part I (UNCTAD/ITD/GSP/34, February 21, 1996). See also S. Inama, "A comparative analysis of the generalized system of preferential and non-preferential rules of origin in the light of the Uruguay Round Agreement: It is a possible avenue for harmonization or further differentiation," *Journal of World Trade*, vol. 29, no. 1 (1995), 77–111.

countries. Only recently in 2013 and 2015 efforts to discuss preferential rules of origin for least-developed countries (LDCs) resumed as further discussed in section 1.3.

Efforts to codify and strengthen a general concept of origin in the absence of multilateral disciplines were made at the multilateral level during the Kyoto Convention negotiations in 1973.[10] However, Annex DI of the Convention, containing guidelines, was not sufficiently detailed and left member states freedom to choose different and alternative methods of determining origin. The low level of harmonization achieved, combined with the fact that few countries ratified this annex, meant that the annex became little more than general guidance used in determining origin at a national level.

These meager results achieved at the multilateral level with regard to harmonizing rules of origin or even determining a valid method of origin assessment contrast with the efforts to negotiate the Customs Valuation Code, negotiated during the Tokyo Round in 1979, and the entry into force of the International Convention on the Harmonized Commodity Description and Coding System, negotiated under the auspices of the Customs Cooperation Council in 1988. Thus, until the Uruguay Round Agreement, rules of origin remained the only one of the three basic customs laws operating at the national level not subject to multilateral discipline. Yet, as discussed in Chapter 2, such agreement contained a built-in agenda for the harmonization of nonpreferential rules of origin that has not been finalized to date and limited best endeavors provisions on preferential rules of origin with no practical impact.

1.1 FIRST ATTEMPTS TO ESTABLISH RULES OF ORIGIN AT THE MULTILATERAL LEVEL: THE KYOTO CONVENTION OF 1973 AND 2000

At the time of writing, the Kyoto Convention of 1973[11] and 2000 (Revised Kyoto Convention – RKC) still provides the most comprehensive multilateral text about rules of origin. Specifically, RKC Annex K on rules of origin provides for three

[10] International Convention on the Simplification and Harmonization of Custom Procedures, adopted in 1974 by the Customs Cooperation Council at its forty-first and forty-second sessions, held in Kyoto. In substance, Annex DI did not provide for ready-to-use rules of origin. Although the criterion for products "wholly produced in one country" was sufficiently precise, the "substantial transformation criterion when two or more countries have taken part in the production" was not better specified other than by listing the three different ways in which the substantial transformation may be interpreted: change of tariff heading, ad valorem percentage rules, and specific manufacturing or processing operations; see H. Asakura, "The Harmonized System and rules of origin," *Journal of World Trade*, vol. 27, no. 4 (1993), 5–22.

[11] In the Kyoto Convention of 1973, the provisions concerning rules of origin were contained in Annex D1.

chapters covering the different aspects of rules of origin. Chapter 1 deals with the origin criteria, Chapter 2, documentary evidence, and Chapter 3, verifications of proof of origin.

The RKC needs updating as discussed later. Yet, its content needs to be recalled as the first multilateral text providing guidance and recommended practices that have assisted the multilateral community for a decade.

The RKC provides basic principles and tenets that may be found in many protocols of rules of origin attached to trade agreements.

The rules applied to determine origin employ two different basic criteria: the criterion of goods "wholly produced" in a given country, where only one country enters into consideration in attributing origin, and the criterion of "substantial transformation," where two or more countries have taken part in the production of the goods. The "wholly produced" criterion applies mainly to "natural" products and to goods made entirely from them, so that goods containing any parts or materials imported or of undetermined origin are generally excluded from its field of application. The "substantial transformation" criterion can be expressed by a number of different methods of application.

As a general definition, goods that have been manufactured in a country wholly or partly from imported materials, parts, or components including materials of undetermined origin are considered as originating in that country if those materials, parts, or components have undergone "substantial transformation" or "sufficient working or processing."

The general concept definition of "substantial transformation" or "sufficient working or processing" is further specified in different multilateral texts or national provisions reflecting, on one hand, a common understanding of the need to better define what "substantial transformation" is and, on the other hand, the beginning of different "models" to define "substantial transformation."

In modern times, one of the oldest definitions of "substantial transformation" was made by a judge in a celebrated case:[12]

> A substantive transformation occurs when an article emerges from a manufacturing process with a name, character or use which differs from those of the original materials subjected to the process.

In the European context, the first definition at European Union (EU) level appeared in 1968:[13]

[12] See *Anheuser-Busch Brewing Assn.* v. *United States*, 207 US 556 (1907).
[13] Council Regulation 802/68, OJ L148/1 (1968).

> Goods whose production involved more than one country shall be deemed to be originated in the country where they underwent the last, substantial, economically justified processing or working in an undertaking equipped for that purpose and resulting in the manufacture of a new product or representing an important stage of manufacture.

In the following decades, it becomes progressively clear that such general definitions did not match the evolving and growing nature of international trade. Annex DI of the 1973 Kyoto Convention was one of the multilateral attempts to clarify some of the conceptual issues arising from the definition of "substantial transformation":

> In practice the substantial transformation criterion can be expressed:
>
> - by a rule requiring a change of tariff heading in a specified nomenclature, with lists of exceptions, and/or
> - by a list of manufacturing or processing operations which confer, or do not confer, upon the goods the origin of the country in which those operations were carried out, and/or
> - by the ad valorem percentage rule, where either the percentage value of the materials utilized or the percentage of the value added reaches a specified level.

The advantages and disadvantages of these various methods of expression, from the point of view of the customs administrations and of the user, may be summed up as follows:

> A CHANGE OF TARIFF HEADING
>
> The usual method of application is to lay down a general rule whereby the product obtained is considered to have undergone sufficient manufacturing or processing if it falls under a heading of a systematic goods nomenclature different from the headings applicable to each of the materials utilized.
>
> This general rule is usually accompanied by lists of exceptions based on the systematic goods nomenclature; these specify the cases in which a change of heading is not decisive or imposes further conditions.
>
> - **Advantages**
>
> This method permits the precise and objective formulation of the conditions determining origin. If required to produce evidence, the manufacturer will normally have no difficulty in furnishing data establishing that the goods do in fact meet the conditions laid down.
> - **Disadvantages**
>
> The preparation of lists of exceptions is often difficult, and moreover such lists must normally be constantly updated to keep them abreast of technical

developments and economic conditions. Any descriptions of manufacturing or qualifying processes must not be unduly complicated, since otherwise they might lead manufacturers to commit errors in good faith.

In addition, a prerequisite for use of the structure of a systematic goods nomenclature for determining origin is that both the country of exportation and the country of importation have adopted the same nomenclature as a basis for their respective tariffs and apply it uniformly.

B LISTS OF MANUFACTURING OR PROCESSING OPERATIONS

This method is generally expressed by using general lists describing each product's technical manufacturing or processing operation regarded as sufficiently important ("qualifying processes").

- **Advantages**
  The advantages are the same as those described in Section A.
- **Disadvantages**
  Apart from sharing the disadvantages referred to in Section A, the general lists are longer and more detailed, so their preparation is even more difficult.

C AD VALOREM PERCENTAGE RULE

To determine origin by this method, one must consider the extent of the manufacturing or processing undergone in a country, by reference to the value thereby added to the goods. When this added value equals or exceeds a specified percentage, the goods acquire origin in the country where the manufacturing or processing was carried out.

The value added may also be calculated by reference to the materials or components of foreign or undetermined origin used in manufacturing or producing the goods. The goods retain origin in a specific country only if the materials or components do not exceed a specified percentage of the value of the finished product. In practice, therefore, this method involves comparison of the value of the materials imported or of undetermined origin with the value of the finished product.

The value of constituents imported or of undetermined origin is generally established from the import value or the purchase price. The value of the goods as exported is normally calculated using the cost of manufacture, the ex-works price, or the price at exportation.

This method may be applied:

- either in combination with the two other methods, by means of the lists of exceptions referred to in Section A or the general lists referred to in Section B, or
- by a general rule prescribing a uniform percentage, without reference to a list of individual products.

- **Advantages**
  The main advantages of this method are its precision and simplicity.

The value of constituent materials imported or of undetermined origin can be established from available commercial records or documents.

Where the value of the exported goods is based on the ex-works price or the price at exportation, as a rule both prices are readily ascertained and can be supported by commercial invoices and the commercial records of the traders concerned.

- **Disadvantages**
  Difficulties are likely to arise especially in borderline cases in which a slight difference above or below the prescribed percentage causes a product to meet, or fail to meet, the origin requirements.

  Similarly, the origin attributed depends largely on the fluctuating world market prices for raw materials and also on currency fluctuations. These fluctuations may at times be so marked that the application of rules of origin formulated on this basis is appreciably distorted.

  Another major disadvantage is that such elements as cost of manufacture or total cost of products used, which may be taken as the basis for calculating value added, are often difficult to establish and may well have a different makeup and interpretation in the country of exportation and the country of importation. Disputes may arise as to whether certain factors, particularly overheads, are to be allocated to cost of manufacture or, for example, to selling, distribution, or other costs.

Although these various rules for determining origin all have, in one degree or another, advantages and disadvantages, it must be stressed that the absence of common rules of origin, at both importation and exportation, not only complicates the task of customs administrations and of the bodies empowered to issue documentary evidence of origin but also causes difficulties for those involved in international trade. This points to the desirability of moving progressively toward harmonization in this field. Even where different methods have been introduced to reflect economic conditions or negotiating factors in preferential tariff arrangements, it seems that they should exist within a common or standard framework, for ease of understanding by traders and ease of application by customs. However, these objectives, although laudable, are in practice not realistic. [Excerpts from 1973 Kyoto Convention]

The revised Kyoto Convention of 2000 contained in Annex K two chapters of the original Annex DI of 1973 Kyoto Convention. These chapters concerning rules of origin were modified probably because the harmonization work in the World Trade Organization (WTO) started. Effectively, the new Chapter 1 of Annex K of Kyoto Convention 2000 redefined substantially the order of recommended practices reflecting the preference for the change of tariff classification (CTC) as recommended practice to define substantial transformation as contained in Article 9(c)(ii) of the WTO Agreement on Rules of Origin (ARO):

3. Recommended Practice
Where two or more countries have taken part in the production of the goods, the origin of the goods should be determined according to the substantial transformation criterion.

4. Recommended Practice
In applying the substantial transformation criterion, use should be made of the International Convention on the Harmonized Commodity Description and Coding System.

5. Recommended Practice
Where the substantial transformation criterion is expressed in terms of the ad valorem percentage rule, the values to be taken into consideration should be:

- for the materials imported, the dutiable value at importation or, in the case of materials of undetermined origin, the first ascertainable price paid for them in the territory of the country in which manufacture took place; and
- for the goods produced, either the ex-works price or the price at exportation, according to the provisions of national legislation.

In fact, not only does the new Chapter 1 of Annex K of the revised Kyoto Convention place the CTC as the preferred method to define substantial transformation but it also deleted the other method of defining substantial transformation commonly referred as the list of manufacturing operations or specific working or processing. This is rather surprising since the EU, for instance, still uses such criteria to define substantial transformation for garments of Harmonized System (HS) Chapters 61 and 62 in almost every free trade agreement and the US, Mexico, Canada Free-Trade Area agreement (USMCA) recently introduced a list of specific working of processing operations as criteria for a number of HS chemical chapters to define substantial transformation.[14]

It is extremely important to note that Chapter 2 of Annex K of the revised Kyoto Convention is the only existing multilateral text on administration and certification on rules of origin.[15] In fact, this chapter explicitly covers aspects related to documentary evidence and certificates of origin that are not dealt with by the WTO ARO. This chapter of the revised Kyoto Convention, which covers documentary evidence of origin, contains, among other things, the following standards and recommended practices:

- Documentary evidence of origin shall be required only for the application of preferential customs duties, or economic or trade measures.

[14] See Chapter 6 of this book for more discussions on the pros and cons of using specific working and processing requirements to define substantial transformation.

[15] See also Chapter 7 of this book for further details on administration and certification of origin.

- Documentary evidence shall not be required for small consignments, goods granted temporary admission, goods in transit, or exemption by bilateral or multilateral agreements.
- Documentary evidence shall be required in case of suspected fraud.
- The use of a model form of a certificate of origin.
- The certificate of origin shall also be printed in English or French.
- No translation of the particulars given in certificates of origin shall be required.
- Provision shall be made for sanction against any person who prepares or causes to be prepared a document containing false information.

As will be further discussed at length in Chapter 7 of this book, at present the World Customs Organization (WCO) Secretariat has undertaken initiatives to update and build upon the general guidelines contained in the Kyoto Convention 2000. As pointed out by the WCO flyer of the revised Kyoto Convention published in 2006,[16] one of the major innovations of the revision process was to establish a dedicated Management Committee for the Convention.

This Committee, which is required to meet at least once each year, was mandated to have a broad range of responsibilities including reviewing and updating the Guidelines and recommending amendments to the Convention. However, it seems not much action has been undertaken in an area where initiatives would have filled a conspicuous gap in the field of rules of origin. Moreover, action on administration and certification of rules of origin would have been hardly resisted by WCO member countries since the stalemate on rules of origin derived from trade policy implications encountered in nonpreferential rules of origin in the Committee on Rules of Origin at the WTO and not from operational issues. Quite on the contrary it may be expected that initiatives to address these topical issues would have been welcomed since certification of origin and related proof of origin are extremely relevant in international trade, as well illustrated by the initiatives and activities of the International Chamber of Commerce illustrated in section 1.4.

It was only recently that the WCO managed to unlock the process for complete overhaul of the Kyoto Convention. The Revised Kyoto Convention Management Committee recommended at its 18th Meeting in May 2018 such update and the June 2018 Policy Commission approved the setting up of the Working Group on the Comprehensive Review of the International Convention on the Simplification and Harmonization of Customs Procedure and its terms of reference, recognizing the need to ensure that the RKC remains the blueprint for modern and efficient customs procedures in the twenty-first century.[17] At the time of writing, an ambitious

[16] See www.wcoomd.org/-/media/wco/public/global/pdf/topics/facilitation/instruments-and-tools/conventions/kyoto-convention/brochures/kyoto_yourquestionsanswered.pdf?db=web.

[17] www.wcoomd.org/en/media/newsroom/2018/september/wco-working-group-on-the-comprehensive-review-of-the-rkc-holds-its-first-meeting.aspx.

proposal aiming at a complete update and expansion of Annex K on rules of origin has been tabled by a number of countries namely the EU, Japan, New Zealand, Switzerland, China, the Eurasian Customs Union, one international organization (UNCTAD), and two private firms (Fonterra and Nissan Renault). This initiative at WCO is further discussed in Chapter 2, section 2.12.

The WCO published a number of manuals and materials (available on the WCO website) on rules of origin and on the administrative issues related to rules of origin and procedures on certification of origin,[18] as follows:

- **Rules of Origin – Handbook:** This handbook of twenty-two pages covers a general introduction, outlining the major features of preferential and nonpreferential rules of origin.
- **Comparative Study on Preferential Rules of Origin:** This extensive and comprehensive study is developed according to modules ranging from general subjects to specific topics related to origin and specific agreements: that is, ranging from structure of an origin protocol in a free-trade agreement to very specific topics and agreements, like calculation of ad valorem percentage rules in the Trans-Pacific Partnership Agreement (TPP). It is a hands-on tool, rich in useful and practical examples.
- **Database:** According to the WCO this is a global database of preferential trade agreements and related rules of origin to improve the understanding and application of preferential rules of origin endorsed by the WCO Council in June 2007.
- **Tools related to origin certification:**
  (a) *World Trend in Preferential Rules of Origin Certification and Verification*

  This study of twenty-one pages aims at assisting WCO members in their development and review of the implementation of preferential rules of origin by providing a snapshot on the trends on the implementation of certification and verification of rules of origin in free-trade agreements. This study compiles the replies provided by WCO member states to a questionnaire elaborated by the Secretariat in 2010. According to the WCO, out of 177 WCO member customs administrations, 109 responses were analyzed for this study. The number of free-trade agreements covered by the responding members equals approximately 86 percent of all the free-trade agreements in which the WCO members participate.

  (b) *Comparative Study on Certification of Origin*

  This short study of eleven pages has been compiled on the basis of responses to a questionnaire made out of the WCO Secretariat in 2013. The responses were received from sixty-six members. Albeit

[18] See www.wcoomd.org/en/topics/origin.aspx.

short, this study is one of the few available attempts to map out the administrative and verification procedures related to origin.

(c) *Guidelines on Origin Certification (endorsed 2014)*

This publication contains a number of WCO Guidelines on Certification of Origin offering practical explanations. This publication provides useful explanations and guidance for WCO members to design and develop management of origin-related procedures.

- **Irregularities of rules of origin:** According to the WCO this study is primarily based on the experiences of WCO member customs administrations. In order to develop the study, the WCO Secretariat has requested the members to provide information relating to irregularities in the area of rules of origin. From April 2012 to February 2013, thirty-six members provided inputs to the Secretariat, which corresponds to approximately 20 percent of WCO members.
- **Relations with HS:**

(a) *Study on the use of "Change of Tariff Classification-based rules" in Preferential Rules of Origin*

This study consisting of fourteen pages depicts the use of CTC by a variety of WCO members.

(b) *Guide for Technical Update of Preferential Rules of Origin*

This is a rather technical and sophisticated guide on how to update product-specific rules of origin (PSRO) that are drafted using the HS. The study covers a growing area of concern since many rules of origin contained in the free-trade agreements are nowadays drafted using the CTC.

- **Tool related to origin verification:**
  World Trends in Preferential Origin Certification and Verification
  This study (see item (a) above) concerns issues related to origin certification.

1.2 THE UNCTAD WORKING GROUP ON RULES OF ORIGIN

Well before the Kyoto Convention and the ARO, the first attempt to establish multilateral rules of origin was carried out in UNCTAD.

The idea of preferential tariff rates in the markets of industrialized countries – currently known as GSP – was presented by the first Secretary-General of UNCTAD, Raul Prebisch, at the First Session of the United Nations Conference on Trade and Development (UNCTAD I) in 1964. The idea of the GSP was ultimately adopted in New Delhi, in 1968, in the context of UNCTAD II.

Developing countries are granted preferential tariff treatment in the markets of developed countries under the GSP, in order to help them increase export earnings, promote industrialization, and accelerate rates of economic growth. The GSP is a

nonreciprocal and nondiscriminatory system of preferences in favor of developing countries. Select GSP products originating in developing countries are subject to lower or zero tariff rates. Furthermore, the LDCs are allowed to receive special preferential tariff treatments in terms of wider coverage of products.

At GSP's inception, it was immediately clear that a set of rules of origin was necessary to determine what products were eligible for preferential tariff rates.

Drafting a uniform set of origin rules to be applied to the different GSP schemes of preference-giving countries was the principal aim of the Special Committee on Preferences, at its second session.[19] Hence, the Special Committee decided to establish the Working Group on Rules of Origin with the task of initiating consultations on technical aspects of the rules of origin with the objective of preparing draft origin rules to be applied uniformly in the GSP system.

In drawing up the boundaries for work to be undertaken by the Working Group, the Special Committee recalled that rules of origin requiring a very high degree of product transformation to qualify for preferential treatment would have enabled only a very small number of developing countries to benefit from the scheme of preferences. On the other hand, it was pointed out that extremely liberal rules of origin "would have many disadvantages."[20] With rules requiring only minor transformation of the product or small value added, there was the risk that developed countries could receive benefits of the preferential tariff treatment by dispatching products via a developing country, where they would undergo only some minor processing.[21] "Rules that permitted such exports would not appear to be in the interest of the developing countries and neither would the scheme achieve its objective of encouraging the expansion and diversification of industrial production and exports in developing countries."[22]

Furthermore, rules requiring an important degree of processing in developing countries would seem likely to encourage the establishment of production units, encourage investment, and the transfer of technology. Such action would facilitate the expansion and diversification of developing country exports.[23] Thus, it was mandated that the Working Group, in drawing up the rules of origin, "should take care to see that they are as simple as possible to administer, as liberal as practicable taking into account the industrial potential of the developing countries, but at the same time as strict as necessary to promote the industrialization and diversification of the economies of developing countries. A reasonable compromise between these

[19] However, in the Summary and Conclusions of the Report of the Second Session, the Special Committee retained that "it seemed premature to attempt even a first draft for rules of origin because a thorough discussion of all the aspects involved has yet to take place at the international level." See UNCTAD document TD/B/AC.5/3, November 29, 1968, iii.

[20] Ibid. para. 7.

[21] Ibid. para. 7.

[22] Ibid. para. 7.

[23] Ibid. para. 8.

requirements must be worked out."[24] In light of the above, the application of fairly similar rules of origin was considered by the Special Committee to be a prerequisite for comparable conditions of access to developed countries' markets, thereby ensuring, to the extent possible, equivalence in "burden sharing" by developed countries. The Special Committee also recognized that "multiple rules of origin would obviously cause great practical difficulties for the developing countries, and would be likely to hinder an expansion in the exports of these countries."[25]

To fulfill the mandate of the Special Committee, the Working Group initially focused its attention on the rules of origin applied by each developed country in the preferential trade regimes they had established with various developing countries. In particular, the preferential trade arrangements of the following countries were analyzed: Australia, the European Community (EC), the European Free-Trade Area, the United Kingdom, and the United States. At the first[26] and second[27] meetings (both held in 1970), the Working Group, after having identified the most important features of the origin rules (criteria for determining the origin – substantial transformation and wholly produced goods, documentary evidence, verification, mutual cooperation, unit of qualification, sanctions, treatment of packing, treatment of mixtures, consignments of small value, exhibitions, certification, minimal processes, direct consignment)[28] analyzed the differences and the points in common in the rules of origin applied by the donor countries in trade with developing countries. The analysis was made through a comparison of the rules of each of these preferential arrangements with regard to the main components of the origin rules previously mentioned.[29] It was only in the third meeting[30] (also held in 1970) that the Working Group elaborated an agreed text[31] concerning various aspects (with the exception of the criteria for determining the substantial transformation) of the rules of origin to be applied in the GSP.[32]

At the same time, the objective of the harmonization of rules of origin for individual GSP schemes of donor countries, and in particular the harmonization of the criteria to determine the origin, was one of the main subjects of the work of the Working Group. However, the solution explored within the Working Group – that is, the "acceptance of a uniform criterion or criteria by all preference-giving countries" – met with opposition from these countries.[33] In the Organisation for Economic Co-operation and Development (OECD) Ad Hoc Group of the Trade

[24] Ibid. paras. 10–74.
[25] Ibid. para. 9.
[26] See UNCTAD document TD/AC.5/3/Add.4, March 19, 1970.
[27] See UNCTAD document TD/B/AC.5/31, July 10, 1970.
[28] See UNCTAD document TD/AC.5/31, para. 24.
[29] See UNCTAD document TD/B/AC.5/3.
[30] See UNCTAD document TD/B/AC.5/38, December 21, 1970.
[31] See ibid.
[32] See ibid, Appendix 1.
[33] See UNCTAD document TD/B/AC.5/31, paras. 14, 16, 18, and 22.

Committee on Preferences[34] (Paris, 1970), the preference-giving countries expressed the view that, as preferences were being granted unilaterally and noncontractually, the general principle had to be that donor countries were free to decide on the rules of origin that they thought were appropriate after hearing the views of the beneficiary countries. It was thus considered that the texts eventually elaborated by the Working Group regarding some harmonized aspects of rules of origin would be no more than general illustrations, for the information of beneficiary countries, of the kind of elements that donor countries were likely to include in the general statement of their national GSP rules of origin.

In particular, preference-giving countries felt the harmonization process conducted in the UNCTAD Working Group had to be limited to some practical aspects such as certification, control, verification, sanctions, and mutual cooperation. This view was considered in the second session of the Working Group, when it was noted that "in regard to the basic element for any rules of origin, namely the criterion for substantial transformation, it was not considered feasible to arrive at common views at this stage on a single set of uniform criteria."[35] However, the third meeting (December 1970) was an important step toward the aim of harmonization. The Working Group was able to conclude agreed texts on many subjects and designed appropriate forms to define: (a) wholly produced goods; (b) minimal processes; (c) consignments of small value; (d) direct consignment; (e) documentary evidence; (f) verification; (g) sanctions; (h) mutual cooperation; (i) treatment of packing; (j) unit of qualification; and (k) exhibitions and fairs.[36]

The fifth meeting of the Working Group on Rules of Origin was dedicated to carrying out a comparative analysis of the rules of origin adopted by each preference-giving country.[37] This session also indicated the extent to which the text agreed in the previous meeting had been considered in drafting the rules as well as the nature and possible effects of departures from this text. As stated in the third session, the majority of countries based their requirements for substantial transformation on the process criterion.[38] For countries using this criterion, transformation took place, in general, when exported goods were classified under a Brussels Tariff Nomenclature heading other than that relating to any of the materials and/or components imported or of undetermined origin that were used in production. However, in a great number of cases, these countries drew up two separate lists. List A specified certain working or processing operations that resulted in a change of tariff heading (CTH)

[34] See OECD, Ad Hoc Working Group of the Trade Committee on Preferences, Rules of Origin, second report, TC/Pref./70.25, Paris, September 25, 1970, 9.

[35] See UNCTAD document TD/B/AC.5/31, July 10, 1970, para. 45.

[36] See UNCTAD document TD/B/AC.5/38, December 21, 1970, para. 48.

[37] See, for the fifth meeting, UNCTAD document TD/B/C.5/2, November 30, 1992.

[38] These countries were Austria, Bulgaria, Denmark, European Economic Community, Finland, Ireland, Japan, Norway, Switzerland, and the United Kingdom; see UNCTAD document TD/B/C.5/2, November 30, 1972, para. 8.

without conferring the status of "originating" products on the products undergoing such operations, or that conferred the status only subject to certain conditions. List B specified working or processing operations that did not result in a CTH but conferred the status of "originating" products on the products undergoing such operations.[39] Other countries[40] based their requirements for substantial transformation on the value-added criterion, with percentages required varying from 50 percent to 100 percent.[41] It was agreed at the fifth meeting, that preference-giving member countries of the OECD would make every effort to complete their work on linguistic and substantive harmonization of GSP rules of origin. In pursuance of that agreement, the Secretary-General of the OECD transmitted to UNCTAD a compendium of GSP rules of origin applied by the OECD preference-giving countries.[42]

With the entering into force of the different national GSP schemes, the role of the Working Group was destined to change. In fact, in 1974, all GSP schemes had entered into force.[43]

The new mandate contained in the resolution of the Special Committee[44] at its fifth session was carried out in subsequent sessions of the Working Group through various actions:

(1) Preparation of analytical studies that:
   (a) analyzed the problems that had arisen from the application of rules of origin under GSP (these studies also resulted in some concrete proposals for the solution of the abovementioned problems)
   (b) monitored existing differences between the rules of origin applied by preference-giving countries in their different national schemes and those contained in texts agreed at previous meetings of the Working Group.

(2) Collection of information regarding the difficulties encountered in preference-receiving and preference-giving countries in the area of rules of origin through the use of questionnaires addressed not only to governments of both preference-giving and preference-receiving countries,[45] but also to certain nongovernmental organizations in

[39] See UNCTAD document TD/B/C.5/2.

[40] Czechoslovakia, Hungary, and New Zealand; see ibid. para. 10.

[41] Czechoslovakia specified that for goods to be considered as originating in a developing country they must have undergone a manufacturing process in the developing country, as a result of which they had acquired their basic characteristics, provided that the manufacturing process had increased their original value by at least 100 percent: ibid.

[42] See UNCTAD document TD/B/626.

[43] See UNCTAD document TD/B/442, for the date of the entering into force of the different GSP national schemes.

[44] See ibid.

[45] Since the entering into force of the GSP schemes, three questionnaires had been addressed by the Working Group, through the Secretary-General of UNCTAD, to the governments of the member countries; see, for the texts and the replies, the following documents:

preference-giving countries that had interests in or were concerned with GSP.[46]

(3) Preparation of compendia that assembled the different rules of origin applied by each preference-giving country in its GSP scheme.[47]

(4) Examination of the studies mentioned under item (1) and of the replies to the questionnaires and the formulation of concrete proposals.

In 1987, the Working Group was transformed into a Sessional Committee of the Special Committee on Preferences.[48] This mandate was enlarged in scope, placing particular attention on the harmonization of the different criteria for determining substantial transformation.

Consequently, at the seventeenth session of the Special Committee[49] in 1990, it was agreed that:

(1) Consideration should be given in the course of the next review to examining the current definitions of "substantial transformation," namely the process criterion and the percentage criterion.

(2) Preference-giving countries, in the course of their review of their schemes, should examine both definitions in the light of their experience over two decades and exchange views thereof during a future session of the Special Committee on Preferences.[50]

The Sessional Committee held in 1992 during the nineteenth session of the Special Committee[51] was entirely dedicated to a comparative analysis between the process and the percentage criteria, to assess what system would better suit the objectives of GSP schemes.[52]

Although further sessional committees were not established until 1995, discussions on GSP rules of origin continued during the twentieth[53] and twenty-first[54] sessions of the Special Committee on Preferences. The Chairman's Summary[55] of

TD/B/C.5/WG(VII)/5, August 11, 1978
TD/B/C.5/WG(X)/2, August 19, 1985
TD/B/SCP/AC.1/2/Add.1, May 8, 1995.

[46] See UNCTAD document TD/B/C.5/WG(VII)/5, para. 2.

[47] See UNCTAD document TD/B/626, October 8, 1976, Compendium of rules of origin applied under the GSP by OECD preference-giving countries; this compendium was presented during the sixth session of the Working Group on Rules of Origin, held in 1976.

[48] See UNCTAD document TD/B/C.5/WG(XI)/2, 2.

[49] UNCTAD document TD/B/C.5/132, paras. 144–167.

[50] See UNCTAD document TD/B/1263, May 14–20, 1990.

[51] See UNCTAD document TD/B/39(1)/2, paras. 47–65.

[52] See UNCTAD document TD/B/C.5/141, February 28, 1992, Examination of definitions of substantial transformation and implications of harmonization: possible initiatives in regard to simplification and liberalization.

[53] See UNCTAD document TD/B/40(1)/10.

[54] See UNCTAD document TD/B/41(1)/2.

[55] See UNCTAD document TD/B/42/(2)/4.

the twentieth session of the Special Committee reported the concern of developing countries "over the lack of progress in harmonizing the rules of origin, which were at present based on two different criteria." Some developing countries expressed dissatisfaction over the fact that "the problem of the rules of origin had not been adequately discussed at the current session of the Committee" and suggested that the next session should undertake a comprehensive and detailed review.

During the twenty-first session of the Special Committee, intensive discussions took place on possible ways and means to revitalize the GSP system as a whole. As part of this effort, it was decided to proceed toward harmonization, simplification, and improvement of GSP rules of origin and to establish an Intergovernmental Group of Experts on Rules of Origin as part of the preparation for the 1995 GSP policy review.[56] In fact, the Intergovernmental Group of Experts recommended the Special Committee adopt the following points:

- follow and monitor, as an observer, the work carried out within the Technical Committee on Rules of Origin (TCRO) and, when appropriate, contribute to the technical aspects of its work
- report annually to the Special Committee on Preferences on the progress made and results achieved by the Technical Committee with a view to progressing toward harmonization of GSP rules of origin
- propose, once the TCRO achieved its objectives and taking due account of the WTO's work, a harmonized set of rules of origin, including modifications and amendments where appropriate, to UNCTAD member states, for their consideration and adoption.[57]

The reform of the UNCTAD secretariat carried out in 1996 during UNCTAD X in Midrand (South Africa) eliminated all UNCTAD standing committees including the Special Committee on Preferences and its subsidiary bodies; namely, the Sessional Committee on Rules of Origin. Since then, the international trading community lost the only intergovernmental forum to discuss GSP rules of origin. To date, no other intergovernmental expert meeting has been established in UNCTAD on the issue of preferential rules of origin. This has been a formidable gap that has not been filled by any other intergovernmental organization like the WTO and WCO for years. It was only in 2014, and with a number of caveats, that multilateral discussions on preferential rules of origin in the context of unilateral preferential arrangements resumed in the aftermath of the Bali Decision[58] on preferential rules of origin in the Committee on Rules of Origin (CRO) at the WTO. The efforts made by the LDC WTO group, supported by the author, to

[56] See UNCTAD document TD/B/SCP/14.

[57] See "Agreed Conclusions of the Intergovernmental Group of Experts on Rules of Origin," UNCTAD document TD/B/SCP/14, August 24, 1995.

[58] Ministerial Decision, December 7, 2013 on Preferential Rules of Origin for LDCs, WT/MIN (13)/42 – WT/L/917.

revive the intergovernmental debate on preferential rules of origin leading to the Nairobi Decision[59] on preferential rules of origin for LDCs is further discussed below in section 1.3.

1.3 THE HONG KONG DECISION ON DUTY-FREE AND QUOTA FREE AND EFFORTS TO ESTABLISH SIMPLE AND TRANSPARENT RULES OF ORIGIN FOR LDCS: THE BALI AND NAIROBI DECISIONS ON PREFERENTIAL RULES OF ORIGIN FOR LDCS

1.3.1 *From Hong Kong to the Nairobi Decision*

As outlined in the previous sections of this chapter, efforts to establish multilateral disciplines on rules of origin made in different fora have been multiple; however success has been limited so far. One of the areas that has recorded movement in the last decade, especially since 2013, is the preferential rules of origin for LDCs.[60]

The foundations for providing special treatment to LDCs within the general scope of preferential tariff treatment is embedded in paragraph (d) of the Enabling Clause:

1. Notwithstanding the provisions of Article I of the General Agreement, contracting parties may accord differential and more favourable treatment to developing countries, without according such treatment to other contracting parties.
2. The provisions of paragraph 1 apply to the following:
   (a) Preferential tariff treatment accorded by developed contracting parties to products originating in developing countries in accordance with the Generalized System of Preferences,
   (b) Differential and more favourable treatment with respect to the provisions of the General Agreement concerning non-tariff measures governed by the provisions of instruments multilaterally negotiated under the auspices of the GATT;
   (c) Regional or global arrangements entered into amongst less-developed contracting parties for the mutual reduction or elimination of tariffs and, in accordance with criteria or conditions which may be prescribed by the CONTRACTING PARTIES, for the mutual reduction or elimination of nontariff measures, on products imported from one another;
   (d) Special treatment on the least developed among the developing countries in the context of any general or specific measures in favour of developing countries.

[59] Ministerial Decision, December 19, 2015 on Preferential Rules of Origin for LDCs, WT/MIN (15)/47 – WT/L/917/Add.1.

[60] This section draws from S. Inama, "*Ex ore tuo te iudico*: The value of the Bali Decision on preferential rules of origin," *Journal of World Trade*, vol. 49, no. 4 (2015), 591–618. See also, "Getting to Better Rules of Origin for LDCs: Using Utilization Rates – From the World Trade Organization Ministerial Decisions in 2005, 2013, 2015 and Beyond," UNCTAD 2021.

Since the launching of the DFQF initiative in the 1996 Singapore Ministerial Declaration[61] rules of origin for LDCs started to be a subject of debate. The LDC Ministerial Declarations of Dhaka and Livingstone contained language that referred to origin[62] without, however, expressly mentioning what kind of rules of origin was needed by the LDCs. The decision reached at the Hong Kong WTO Ministerial in 2005, as contained in Annex F of the Ministerial Declaration, states "inter alia" that WTO members agreed to ensure that "preferential rules of origin applicable to imports from LDCs are transparent and simple, and contribute to facilitating market access."

Although useful, this language did not define what "transparent and simple" rules of origin might be. Nor did it provide for or establish a working group to define such concepts. In the immediate discussions that followed the post-Hong Kong framework, preference-giving countries entrenched themselves into the fact that, since preferences are unilateral, then rules of origin under the DFQF cannot be discussed or negotiated. This was an exact replica of the failure in the early 1970s[63] to agree on a common set of rules of origin, when GSP rules were discussed in the UNCTAD Working Groups.

Such a stance, even if legally justifiable, may be perceived as simply anachronistic after more than forty years and successive multilateral rounds of negotiations that have substantially lowered the preferential margins available.[64] Yet, even the most cynical negotiator would have been surprised by the amount of hours and harsh debates that have been spent to reach consensus on the wording and content of the Bali and Nairobi Decisions on rules of origin. During the negotiations of the Nairobi Decision there was significant resistance from WTO "developing countries"[65] membership on agreeing on a text that finally could have relative implications for these countries. The real issue at stake was the principle that these developing countries wanted to be recognized as "developing" in granting trade

[61] www.wto.org/english/thewto_e/minist_e/min96_e/wtodec_e.html.

[62] For instance, para. 12 of the Livingstone Declaration provides as follows: "Incorporation of provisions in the modalities on realistic, flexible and simplified rules of origin, certification and inspection requirements and technical and safety standards."

[63] However, in the OECD Ad Hoc Group of the Trade Committee on Preferences, held in Paris in 1970, the preference-giving countries expressed the view that, as preferences were being granted unilaterally and noncontractually, the general principle had to be that donor countries were free to decide on the rules of origin that they thought were appropriate after hearing the views of the beneficiary countries.

[64] Preferential margin is commonly referred to as the difference between the MFN rate and the preferential rate granted under the GSP or other preferences.

[65] The definition of developing countries in the WTO is unclear. In the context of the negotiations on preferential rules of origin for LDCs, there was a group of new preference-giving countries to LDCs – led by China, India, South Korea, Brazil (not yet providing any kind of trade preferences), and Chile – that participated actively in the negotiations of the Nairobi Decision on preferential rules of origin.

preferences and related rules of origin to LDCs in order to safeguard their status in the WTO rather than focusing on the content of the Decision.

In order to initiate implementation of the above commitment on rules of origin contained in the Hong Kong Decision of 2005, the WTO LDC group started as early as 2006 to work on a draft that could serve as a concrete proposal to make progress on the issue of rules of origin for DFQF.

This initiative was aimed at setting the stage for a sensible debate on rules of origin between LDCs and preference-giving countries on the basis of a legal text, rather than on declarations of principles and statements. Zambia, in its capacity of WTO LDC coordinator, submitted the first full-fledged proposal to operationalize the wording[66] of the Hong Kong Decision. The text provided for (1) a narrative explaining the reasons and background for the LDC proposal and (2) a draft legal text to make it operational.

The responses from preference-giving countries to such a proposal were not satisfactory, nor the level of comprehension of the LDC proposal. A series of meetings were held in 2007 with delegations of preference-giving countries, including the United States, EU, and Japan. However, these meetings were not particularly productive, since the focus of the preference-giving countries was on defending the "status quo" rather than being aimed at discussing possible ways to multilaterally achieve the objectives of rules of origin for LDCs that are "transparent and simple, and contribute to facilitating market access."

There were also misguided perceptions that LDCs knew neither what they actually wanted nor how to proceed.[67] This was despite the fact that the WTO LDC group presented the abovementioned detailed proposal on rules of origin to the Non-Agricultural Market Access (NAMA) Committee in 2006. There was also an assumption[68] that the main objective of the LDCs' submission was aimed at achieving harmonization of preferential rules of origin. Although desirable, the WTO LDC group never argued for harmonizing rules of origin.

The statement of the NAMA Chair of 2007, on the adoption of "best practices," was in line with the position of preference-giving countries, who all believe that their particular preferential rules of origin constituted a "best practice," rather than discussing or even acknowledging the mere existence of the articulated proposal of Zambia on behalf of LDCs circulating among WTO members.

[66] See WTO document (TN/CTD/W/29 and TN/MA/W/74 and TN/AG/GEN/18, June 6, 2006) to the NAMA and Agriculture Committees and to the Committee on Trade and Development.

[67] In his introduction to the Draft NAMA Modalities (JOB/07/126) on July 17, 2007 the NAMA Chair, in para. 38, stated that "On the issue of improving rules of origin for duty-free, quota-free market access, neither the proponents nor the Members more broadly have a precise idea on how to proceed."

[68] The Chair in Draft NAMA Modalities, ibid. stated that "I would note that harmonizing preferential rules of origin may not be the optimal solution and that there are best practices among Members that could be readily adopted to enhance the effectiveness of these programs."

It was only after protracted negotiations, that the summary of the NAMA Chair recognized the existence of the Zambian proposal: "ensure that preferential rules of origin applicable to imports from LDCs, will be transparent, simple and contribute to facilitating market access, in respect of non-agricultural products. In this connection, we urge Members to use the model provided in document TN/MA/W/74, as appropriate, in the design of the Rules of Origin for their autonomous preference programs."[69]

Between 2008 and 2013, the LDC proposal on rules of origin underwent two other revisions, the first one with Bangladesh being the coordinator of the WTO LDC group,[70] and the second one with Nepal who coordinated the LDC group until the Bali WTO Ministerial.

These two texts of the LDCs' rules of origin proposal were circulated among WTO members to update their content in the light of:

(a) the relevant changes on rules of origin introduced by some preference-giving countries
(b) providing more narrative background and explanations to the technical choices made by the LDCs in drafting the legal text of the LDCs' proposal
(c) further refining certain technical issues, such as recognition that in certain sectors, like textiles and clothing, PSRO may be necessary.

Several briefings were carried out by UNCTAD with the respective LDCs' WTO coordinators and LDCs' delegations to discuss the technical details and various options.

A major boost of confidence to the value of the LDCs' proposal and recognition of the extreme need to reform the LDCs' regime for rules of origin (which were almost unchanged for the last forty years), came from the changes in the Canadian rules of origin in 2003, and the EU reform on the rules of origin which entered into force in 2011.[71]

The EU reform introduced drastic changes to the EU rules of origin, in favor of both the LDCs and developing countries, as follows:

- It introduced a differentiation in favor of the LDCs that are benefiting from more lenient rules of origin than developing countries in many sectors.
- It allowed a single transformation process in textiles and clothing[72] – for which the LDCs have been advocating for more than a decade.

[69] See WTO document TN/MA/W/103/Rev.3, December 6, 2008.

[70] See WTO documents TN/CTD/W/30/Rev.2; TN/MA/W/74/Rev.2; TN/AG/GEN/20/Rev.2.

[71] See Commission Regulation 1063/2010, November 18, 2010 amending Regulation (EEC) No. 2454/93 laying down provisions for the implementation of Council Regulation (EEC) No. 2913/92 establishing the Community Customs Code. See also S. Inama, "The reform of the EC GSP rules of origin: *Per aspera ad astra*?, *Journal of World Trade*, vol. 45, no. 3 (2011), 577–603.

[72] The EU reform was preceded by the Canada reform of their DFQF in favor of LDC and rules of origin in 2003, expanding product coverage to textiles and clothing and cumulation among all beneficiaries of the Canadian GSP schemes.

- It raised the threshold of the use of non-originating materials, in many sectors from 40 percent to 70 percent for LDCs.
- It eased the cumulation rules.[73]

On the way leading to the Bali WTO Ministerial, the LDC proposal on rules of origin was mainly discussed in the context of an LDC package. Such package took the final form of a WTO document[74] presented by Nepal as coordinator of the WTO LDC group and containing the following elements:

(1) a decision on the implementation of the DFQF Decision (Annex 1)
(2) adoption of simple and flexible preferential rules of origin criteria, to further enhance exports from LDCs and in line with the LDC proposal (Annex 2)
(3) a submission in the area of cotton, covering both trade and development assistance aspects (Annex 3)
(4) a submission on the operationalization of LDCs' Services Waiver (Annex 4).

During the summer of 2013 until late fall, a series of informal meetings were held between Nepal as LDC coordinator and the various preference-giving countries. On May 31, 2013 the rules of origin proposal was inserted in the so-called LDC package circulated among WTO members.[75] During summer of 2013 it became clear that preference-giving countries were not prepared to discuss a technical legal text on rules of origin as contained in the LDC proposal. According to their view there was not sufficient time and/or will to engage in such negotiations. Thus Nepal, as LDC coordinator, was required to prepare a "Draft Decision" condensing the major rules of origin (RoO) principles contained in the legal text into a decision. Thus, in a little more than one month since they presented the LDC package with a full legal text on rules of origin, the LDCs were convinced to formulate their request in the form of a short nonbinding decision that was first put on the table in mid-July 2013.

The July text in the form of a decision[76] was elaborated by Nepal, drawing on the draft document circulated on May 31 as the LDC package mentioned above. The new text contained a series of binding guidelines on percentage criterion, level of percentages, and use of the CTC method together with other detailed provisions excerpted from the legal text of the LDC proposal. However, the migration from the legal text contained in the LDC package to the Draft Decision elaborated by Nepal

[73] The value of this provision was severely diminished by the graduation of many GSP beneficiaries from cumulation in the case of the new EU GSP that entered into force in 2014.
[74] See WTO document TNC/C/63, May 31, 2013.
[75] See WTO document TN/C/W/63, May 31, 2013.
[76] Further discussed in Chapter 3 of this book.

was not smooth sailing. In fact, the draft text of the July Decision contained wording that was not sufficiently precise on what the LDCs wanted. For instance, the Draft Decision made reference to a value-added calculation rather than to a value-of-materials calculation that was the essence of the LDC original proposal since 2007.[77]

In September a new version of the Draft Decision was presented at a WTO meeting chaired by the WTO Director General. This version of the Decision, as the previous one of July, contained a number of imprecisions in language, weakening its technical value. This version attracted concerns voiced by delegations during the meeting over some of the specificities – percentage threshold, cumulation, use of "must" and "shall" etc. However, most delegations expressed that they could work on the basis of the proposed draft text and hoped to find a deliverable form for Bali. The next steps were undertaken in technical discussions led by the Facilitator.[78]

These sessions led by the Facilitator were conducted in the early days of October 2013. The preference-giving countries continued to oppose any binding language or specific benchmarks contained in the Draft Decision with the final draft agreed by October 23, well ahead of the Bali Ministerial.

It has to be noted that this last phase of the negotiations was conducted in Geneva at meetings mainly led by Geneva-based delegations. Thus capital-based experts on rules of origin were not directly involved in the final drafting of the Decision, nor was external advice requested by the WTO LDC group. This explains in part the "constructive ambiguity" of its drafting.

A technical analysis of the Decision is provided in Chapter 3 of this book. As will be further discussed, the level of expertise on customs and rules of origin matters of Geneva-based delegations at WTO tilted the final content of the Decision.

During the fall of 2013 one of the surprising factors that opened the way to the Decision was the interest shown by the United States in providing the CRO with an agenda item besides the Harmonization Work Program (HWP) of nonpreferential rules of origin. As is widely known, the US stance on the HWP has been the stumbling block in the CRO that progressively brought the deliberations of the CRO to a complete standstill. In this context the opening of the United States to consider issues related to LDC rules of origin served a double purpose: On the one hand it appeased the LDCs that obtained very little from the United States in the DFQF negotiation except a vague promise to get at 85 percent of the tariff line.[79] On the other hand, it provided the opportunity to give some work to the Committee

[77] See Chapter 5 of this book for an explanation.

[78] Ambassador Steffen Schmidt.

[79] See WTO document WT/MIN(13)/44 WT/L/919, December 11, 2013 where it is stated: "Developed-country Members that do not yet provide duty-free and quota-free market access for at least 97% of products originating from LDCs, defined at the tariff line level, shall seek to improve their existing duty-free and quota-free coverage for such products, so as to provide increasingly greater market access to LDCs, prior to the next Ministerial Conference." All other QUAD countries have achieved more than 97%, if not 100%, of tariff lines for LDCs. According to calculations, the US stands at 85% of the tariff lines. Even if the US achieve

on Rules of Origin given the languishing mode of the negotiations on nonpreferential rules of origin.

In fact, the opposition of a number of WTO members, including the United States, to the conclusion of the HWP left the CRO with not many items to discuss once that the HWP was off the agenda. Hence the interest of the United States in providing the CRO with an agenda item to discuss LDC preferential rules of origin that finally found their place on the Decision. Obviously, this was not equivalent to opening a negotiation or an in-depth discussion on preferential rules of origin for LDCs in the CRO, as witnessed in the convoluted language contained in the Decision about the mandate of the CRO in discussing preferential rules of origin for LDCs.

Equally surprising was the EU stance in the negotiations surrounding the Decision that was, reportedly, almost exclusively focused on making sure that no language of the Decision was implicitly requesting additional adjustments to the recently concluded EU reform of rules of origin.

The EU started from the most advantageous negotiating position one can imagine: The preamble of the proposed LDC rules of origin contained extensive quotes from the EU impact assessment study[80] that gave rise to the EU reform of rules of origin. In short, the LDC proposal, contained in the May 31 document mentioned above, described the EU reform of rules of origin, together with that of Canada,[81] as a model of what the preference-giving countries should do to improve their rules of origin according to the LDC request.

Given this extremely favorable starting point the EU negotiators missed the opportunity to orient the LDCs' focus toward the United States and Japan for a reform of their rules of origin (US and Japanese rules of origin for LDCs have been unchanged for decades[82]). This point remains to be wholeheartedly considered by the EU Commission at the time of this writing,[83] even if some progress can be recorded from some recent statements made at the WTO.[84] What is certain is that the outcome of the Decision has been favorable to the United States in terms of substance and image. The United States emerged from the negotiations as being friendly and supportive of the LDC "cause" while the EU stance was perceived as being "difficult," to say the least.

97% at the next Ministerial conference, there is still ample latitude to use the remaining 3% to virtually exclude all LDC exports from duty free.

[80] See Impact assessment on rules of origin for the Generalized System of Preference (GSP) European Commission, Brussels, October 25, 2007, Taxud/GSP-RO/IA/1/07.

[81] See preamble and text of the LDC package contained in WTO document TNC/C/63, May 31, 2013.

[82] Some changes have been introduced in the case of Japan lately, as discussed in Chapter 3.

[83] The representatives of the EU Commission at the CRO and during the negotiations leading to the Bali and Nairobi Decisions have been conspicuously shy in branding the EU reform as a model in spite of the written and oral support of the LDCs. This has been a missed opportunity.

[84] See para. 1.67 of WTO document G/RO/M/69, April 5, 2018.

Once the clamoring of the Bali Ministerial subsided the question on how to make further progress on the issue of preferential rules of origin for LDCs remained open. The text of the Bali Decision contained a series of "best endeavors" paragraphs and statements of different quality and nature but no wording or roadmap on how to make further progress. In fact paragraph 1.10 of the Bali Decision referred to "annually review developments in preferential rules of origin applicable to imports from LDCs." This language, apparently neutral, in reality defended the "status quo": if there were no "developments" amounting to changes in LDCs' rules of origin undertaken by preference-giving countries, there was no LDCs' RoO issue to be discussed in the CRO. Hence the Bali Decision was destined to become a dead end, or close to it.

At the CRO meeting of April 10, 2014, the first held after the Bali Decision, the Chair recalled that the last WTO Ministerial adopted a Decision on Preferential RoO for LDCs (WT/L/917). Paragraph 1.10 of the Decision mandated the CRO to "annually review developments in preferential rules of origin applicable to imports from LDCs" and "report to the General Council."

The Chair at that time of the Netherlands Mission to WTO in Geneva, Mahrjin Visser, first made clear that this new mandate provided limited scope for opening the debate at the CRO meeting on the text of the Decision and how to build on it. For this reason, the Chair skillfully proposed in addition and as a separate initiative, "to intensify efforts in the CRO to exchange information regarding existing preferential rules of origin for LDCs."

Uganda, on behalf of the LDCs, welcomed the proposal of the Chair and informed the CRO that "the LDC Group would prepare a paper outlining the challenges faced by LDCs in complying with existing rules of origin to facilitate discussions and foster exchange of information in the CRO."

The CRO then agreed to the proposal made by the Chair to engage in a transparency and outreach exercise:

> where the Secretariat would prepare a background note describing the current state of notifications to be examined during a dedicated agenda item by CRO. An additional contribution to this dedicated agenda item would be the paper to be submitted by the LDCs about their specific challenges. While the results of the first proposal would be part of the CRO's report to the General Council and the LDC sub-committee, the results of the second would not. Such meeting of the CRO marked a watershed of the fortunes of the CRO Committee that was about to remain with no agenda item to discuss given the stalemate on non preferential rules of origin. Some Member states even proposed that in future the CRO should only meet on request by members.

In fact, the initiative of the Chair of the CRO at that time was well prepared in advance through extended consultation among WTO members. In addition, he called upon the technical assistance of UNCTAD represented by the author in providing the necessary backstopping and funding for training the delegates of the LDC group.

At the CRO meeting of October 30, 2014, the LDC paper[85] (the Paper), prepared with the assistance of the author, was presented by Uganda on behalf of the LDCs under the abovementioned agenda item. Uganda stated that the LDC group was in the process of identifying further evidence and concrete cases that would serve as additional elements for further contributions to be discussed at the next CRO meetings. The intent and negotiating agenda of the LDC group was not only to present the Paper but to maintain the momentum gained to make further advances to keep the LDCs' RoO issue on the agenda of the CRO.

The Paper argued that the world's economy has changed since the 1970s. Yet, among quadrilateral (QUAD) countries – namely the EU, United States, Japan, and Canada – only Canada and the EU substantially reformed rules of origin for LDCs. Other preference-giving countries are still adopting rules of origin conceived decades ago.

The Paper made ample use of the utilization rates of existing trade preferences to show the impact of the Canadian and EU reforms generating higher utilization rates and an increase in exports compared to the stagnant performance of United States and Japan in the absence of such reforms.

The key message that the LDCs flagged in the Paper is that rules of origin for LDCs should reflect global value chains and be drafted such a way that they are commercially meaningful and viable for foreign direct investment (FDI) and local businesses to boost manufacturing in LDCs.

The Paper and the presentation made by the LDC were successful in the sense that CRO members agreed to further examine the issues raised by the Paper at the next meeting of the CRO in 2015.

During 2015 the activities carried out particularly focused on the adoption of a Decision on Preferential Rules of Origin for LDCs in the Nairobi Tenth WTO Ministerial Conference pursuing the LDCs' intention of making progress on the implementation of the Bali Decision.

There was a growing interest and a series of events on the issue of rules of origin for LDCs in the first months of 2015: First, Bangladesh became the LDC coordinator of the WTO. Second, the Netherlands decided to fund a dedicated training program for the LDC Geneva-based and capital-based delegates on the issue of rules of origin implemented by UNCTAD.

A first Executive Training on Negotiation and Drafting Rules of Origin was organized on April 20–24 in collaboration with the Academy of Global Governance of the European University Institute (EUI) in Florence, Italy.

In spite of the paper submitted in October 2014, the demands of LDCs were still uncertain in the minds of preference-giving countries. This was, and continues to be, a formidable challenge for the LDC delegates since, on the one hand, they have to formulate technically valid submissions well in advance of formal CRO meetings

[85] See WTO document G/RO/W/148, October 28, 2013. The author has been heavily involved in the drafting of the paper.

in order to make sure that their concerns and demands are reflected in the agenda of the CRO and, on the other hand, they have to confront delegates in the preference-giving countries who may not be prepared to discuss in depth such issues or simply may not be conversant with the technical issue of rules of origin. These delegates, especially when they are not coming from capitals, are bound by messages sent from capitals and are unable to further elaborate on the technical issues raised by LDCs' delegations. This uneven negotiating ground makes the dialogue and progress difficult and time consuming. To obviate such difficulties, recently bilateral meetings have been held. Still the overall setting complicates at times meaningful progress in the CRO. As the WTO LDC group pointed out in the submission of March 2020, prepared with the assistance of the author:

> As briefly summarized above, there is an imbalance between the efforts deployed by LDCs in the CRO since the Nairobi Decision in terms of submissions, analysis, and the level of the response so far received from preference-granting Members. Implementation of the Ministerial Decision should remain a shared responsibility and not rest exclusively on evidence brought by the LDC group.[86]

To further clarify unequivocally the request of the LDCs, the LDC group elaborated, with the assistance of UNCTAD, a document titled "Elements for a discussion of preferential Rules or Origin for LDCs,"[87] submitted to the CRO by the Delegation of Bangladesh on behalf of the LDC group. The document included a set of questions to WTO preference-giving members relating their current rules of origin to the guidelines contained in the Bali Decision. The intent of the document was to serve as a basis to engage in a dialogue with preference-giving countries during the April 30, 2015 meeting of the CRO held in Geneva.

During that meeting, LDC representatives took the floor to advocate their interest and urge movement on implementing the Bali Decision on preferential rules of origin. The responses of the preference-giving countries proved rather elusive, partly because some their delegates gave the impression during the meeting of either not understanding the requests of the LDCs, and/or disregarding the requests of the LDCs by stating that their rules of origin were the best.

Following the CRO of April 30, 2015, consultative meetings were again organized among UNCTAD and the LDC group to discuss best strategies on how make progress and how to engage the preference-giving countries on the road to the Nairobi Ministerial.

At the end of the consultations with preference-giving countries held in the WTO, it was decided that the CRO would hold a dedicated session on July 23–24, 2015 to further discuss the challenges faced by LDCs in complying with rules of origin and using unilateral trade preferences. The WTO LDC group representatives prepared intensively for this dedicated session and were able to deliver a detailed

[86] See WTO document G/RO/W/194, March 5, 2020.
[87] See WTO document (G/RO/W/154), April 15, 2015.

presentation and requests on the seven fundamental items addressed by the Bali Decision, namely:

(1) Substantial transformation: value added, percentage thresholds (paragraph 1.3 of the Bali Ministerial Decision)
(2) Substantial transformation: methods of calculation of value added (paragraph 1.4 of the Decision)
(3) Substantial transformation: CTC rules (paragraph 1.5 of the Decision)
(4) Substantial transformation: specific manufacturing or processing operation rules (paragraph 1.6 of the Decision)
(5) Cumulation (paragraph 1.7 of the Decision)
(6) Documentary requirements and certification (paragraph 1.8 of the Decision)
(7) Review of legislation currently notified to the WTO Secretariat (paragraph 1.9 of the Decision).

Each agenda item was presented by an LDC representative addressing some of the specific issues that were affecting the capacity of LDCs in meeting the RoO requirements of preference-giving countries. A number of concrete and relevant examples were given.

In light of the variety of rules of origin adopted by the preference-giving countries, and the fact that the Decision clearly spelt out that WTO members "should endeavour to develop or build on their individual rules of origin arrangements," the LDCs had to address the different shortcomings that they encountered under the different rules of origin.

For instance in item 1 the calculation methodology of the US rules of origin was addressed and compared to the other methodologies based on a value-of-materials calculation, while under item 2 the issue of the level of thresholds was discussed to show (a) how the current thresholds did not respond to industrial realities and value chains and (b) that the percentage criterion has intrinsic limitations as an RoO criterion for certain sectors.

Also discussed under item 1 was the proposal of the LDCs to deduct the cost of insurance and freight from the value of non-originating materials that was not dismissed by the EU, stating that the value of imported material is subject to the application of national legislation in the importing LDC.

Under item 2, two telling examples were made by contrasting some slides of value chains excerpted from OECD materials[88] and the rules of origin calculations. The

[88] See presentation of Dirk Pilat, Deputy Director Directorate for Science, Technology and Industry at the Center for Strategic and International Studies Washington, DC, October 30, 2013.

rather famous example of the sport shoes and the i-Phone often used to illustrate the different breakdown cost of a value chain were compared with RoO requirements.

First it was noted under the example of the shoe that the actual entry point for an average LDC for accessing the value chain shown in Example 1 was limited to manufacturing since it is rather obvious that LDCs are not providing at the moment any distribution or branding services that are representing the lion's share of the cost of the shoe to the consumer. Thus, out of the 100 euro cost of the shoes to the consumer, the LDC can play a role in the value chain only in relation to the 12 dollars represented by manufacturing. Once the RoO requirements are applied to the element of manufacturing, the calculation shows that either the RoO requirements are barely met as in the case of the EU and the proposal by the LDCs of not exceeding 75 percent of non-originating materials, or they are not met as in the case of the United States and Canada[89] percentage rule.

MEETING PERCENTAGE CRITERION REQUIREMENTS – EXAMPLES

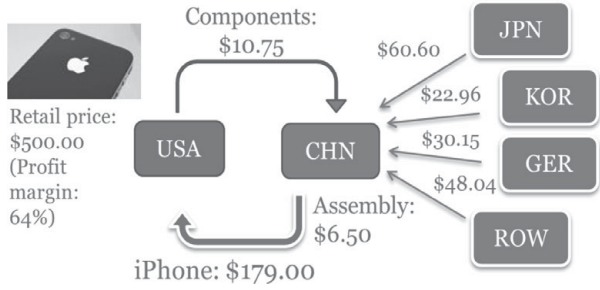
Example 1: Value chain of Sport Shoe

[89] The example did not make use of cumulation.

Costs breakdown:	8 EUR
(a) Raw material	
(b) Wages	0.4 EUR
(c) Direct costs of processing	1.6 EUR
• Allowable (assumed)	0.8 EUR
• Nonallowable (assumed)	0.8 EUR
(d) Profits producer	2 EUR
Total Cost (Ex-Works Price)	**12 EUR**

Country	Calculation	Conclusion
EU:	$\frac{VNOM}{EW} = \frac{(a)}{EW} = \frac{8}{12} = 67\%$	$< 70\%$ Originating
CAN:	$\frac{VNOM}{EW} = \frac{(a)}{EW} = \frac{8}{12} = 67\%$	$> 60\%$ Non-originating
USA:	$\frac{VOM + DCP}{EW} = \frac{(b) + (c.1)}{EW} = \frac{0.4 + 0.8}{12} = 10\%$	$< 35\%$ Non-originating
LDCs:	$\frac{VNOM}{EW} = \frac{(a)}{EW} = \frac{8}{12} = 67\%$	$< 75\%$ Originating

Example 2: iPhone



Source: Y. Xing and N. Detert, "How the iPhone widens the United States trade deficit with the People's Republic of China," Trade Working Papers from East Asian Bureau of Economic Research, 2010.

Costs breakdown:	
(a) Material and components	172.5 EUR
(b) Direct costs of processing	6.5 EUR
(c) Profits producer (assumed ~ 8%)	14 EUR
Total Cost (ex-works price)	**193 EUR**

Country	Calculation	Conclusion
EU:	$\frac{VNOM}{EW} = \frac{(a)}{EW} = \frac{172.5}{193} = 89.4\%$	> 70% Non-originating
CAN:	$\frac{VNOM}{EW} = \frac{(a)}{EW} = \frac{172.5}{193} = 89.4\%$	> 60% Non-originating
USA:	$\frac{VOM + DCP}{EW} = \frac{(b)}{EW} = \frac{6.5}{193} = 3.4\%$	< 35% Non-originating
LDCs:	$\frac{VNOM}{EW} = \frac{(a)}{EW} = \frac{172.5}{193} = 89.4\%$	> 75% Non-originating

Example 1 assumes that all raw material originates in the countries where no cumulation is applicable and is based on the ad valorem percentage criterion applied by the respective preference-giving country.

Example 2, relating to the iPhone, shows eloquently that even the world's largest manufacturer, China, cannot meet the RoO percentage under the different rules of origin of the EU, Canada, the United States, or even under the LDC group proposal. A clear sign of the limitations of using the percentage criterion for electronics products and the inadequacy of existing percentages to match industrial realities and value chains.

Item 3 touched upon the change of CTC method to define substantial transformation used by Japan and the EU and compared the different use made of the CTC by the EU and Japan.

From the comparison it emerged clearly that, following the reform, the EU has adopted a more lenient use of the CTC compared with Japan. Japan makes more frequent use of multiple chapter exceptions making compliance with rules of origin more demanding (see Table 1.1).

These examples excerpted from the presentations made by the LDCs showed the amount of concrete facts and issues brought forward during the dedicated CRO session. Faced with this amount of information some preference-giving countries admitted that there was more clarity on the issues raised by the LDCs. The EU provided a valuable interpretation of the existing rules on customs value and extended cumulation that met some of the LDCs' initial concerns. Other preference-giving countries routinely restated their applicable rules of origin, not answering the queries and objections raised by the LDCs. Other preference-giving countries decided to report the matter to their capitals to get instructions but never came back to the CRO reporting what was the capital position on this issue.

In terms of the WTO negotiating agenda, the outcome of the July dedicated session was positive as it paved the way for the second Ministerial Decision on

TABLE 1.1 *Comparison of CTC use by EU and Japan*

	Japan*		EU	
Rules of origin Stringency criteria	**Coverage by chapters**	**Coverage by headings**	**Coverage by chapters**	**Coverage by headings**
1. Manufacture from any heading	0	0	5	17
2. Simple CTH	0	0	6	52
3. CTH with one exception	2	16	21	27
4. CTH with exceptions **or** ad valorem percentage	0	0	32	44
5. CTH with Multiple exceptions	1	89	0	7
6. CTC with one HS chapter exception	5	0	0	0
7. CTC with multiple chapter exceptions	4	24	0	0
8. CTC with exceptions **and** ad valorem percentage	6	16	14	21

Source: Author's calculation.
* This calculation concerns only products and sectors included in the list of PSRO.

preferential rules of origin for LDCs at Nairobi. From the point of view of the technical content of the discussions and the willingness demonstrated by the preference-giving countries, both developing and developed, the results were however rather meager. Mostly each of the preference-giving countries asserted that their individual rules of origin were the best and did not show any sign of being ready to consider changing them. This holds especially true for the United States and Japan since among QUAD countries these countries have substantially maintained the rules of origin for LDCs unaltered for decades,[90] apart for Japanese changes on HS Chapter 62.[91]

One observation made at the conclusion of the CRO dedicated session by a preference-giving country pointed out the need to prioritize the issues raised by the LDCs. This seemed to throw the ball again into the court of the LDCs. While there is some merit in prioritizing the issues, this is a task made complex by the different varieties of the existing rules used by preference-giving countries and the fact that the Decision indicates "that Members should endeavour to develop or build on their individual rules of origin arrangements." Thus, it is difficult to prioritize issues,

[90] More specifically the US since 1974, when the US GSP scheme was established. In the case of Japan a number of changes have taken place over the years as pointed out by the Japanese delegate during the CRO meeting. However, the changes made are far short of a comprehensive reform of rules of origin as embraced by the EU and Canada.

[91] See Chapter 3 of this book.

and addressing different shortcomings in individual schemes at the same time is rather a cat-and-mouse game. What is needed, as reaffirmed by the WTO LDC group, is a more genuine engagement of preference-giving countries.

The outcome of the July dedicated session strengthened the prevailing sentiment in WTO circles that a new Decision on preferential rules of origin for LDCs was a possible target for the Nairobi WTO Ministerial.

This positive spirit led the WTO LDC group to submit an ambitious draft text of a Decision in September 2015[92] to the Trade Negotiations Committee (TNC). This draft was elaborated and discussed within the LDC group led by Bangladesh as LDC coordinator throughout the month of September. Various versions and amendments were discussed in the LDC group.[93] In the end, the text that emerged from these discussions reflected the rather maximalist expectation of the LDC coordinator, at that time, Bangladesh and especially of the individual delegate at that time in charge of rules of origin.

The original text of the Decision submitted by the LDCs was the object of a series of further drafts and counterproposals during about twenty informal TNC consultations meetings lasting an estimated total of more than forty-two hours from October until the end of November. The draft text arrived at during the Nairobi Ministerial was not an easy journey even in the final hours of the negotiations.

While the technical content of the Nairobi Decision was at first sight richer than the Bali Decision, a closer look demands a much more sobering assessment.

The Nairobi Decision failed – like its predecessor, the Bali Decision – to provide a clear mandate within a framework to discuss preferential rules of origin for LDCs in the context of the CRO. The Decision did not provide the CRO with a clear mandate to further develop or even discuss how to build upon the existing rules of origin for LDCs.

Paragraph 4.4 of the Nairobi Decision simply restates the outcome of the former Bali Decision in this respect: "The CRO shall annually review the implementation of this Decision in accordance with the Transparency provisions contained in the Ministerial Decision on Preferential Rules of Origin for Least Developed Countries adopted at the Bali Ministerial Conference."

It was only after major efforts by the LDCs' delegations, with the assistance of the author, that the process of considering the rules of origin in the CRO restarted in the aftermath of the Nairobi Decision. The leverage was made possible thanks to a rather last-minute insertion suggested by the author to the WTO LDC group in the course of the negotiations of two precious items that were ultimately reflected in paragraph 4.3 of the Nairobi Decision:

> Preferential rules of origin shall be notified as per the established procedures. In this regard, Members reaffirm their commitment to annually provide import data to the

[92] See WTO document JOB/TNC/53, September 24, 2015.

[93] See Chapter 3 of this book.

> Secretariat as referred to Annex 1 of the PTA Transparency Mechanism, on the basis of which the Secretariat can calculate utilization rates, in accordance with modalities to be agreed upon by the CRO. Furthermore, the CRO shall develop a template for the notification of preferential rules of origin, to enhance transparency and promote a better understanding of the rules of origin applicable to imports from LDCs.

Leveraging on this paragraph, the LDC group, assisted by the author, first managed to prepare a template for the new notification that was only finally agreed at the CRO meeting of March 2017 and subsequently developed the template for notification of the utilization rates.[94] Many observers, and some LDC delegates, expected that the new notifications of the rules of origin made according to the template, and the call for annual reviews of the implementation of the Nairobi Decision, would trigger reforms in preference-giving countries to comply with the content of the Nairobi Decision.

As expected by the author, the language of the Nairobi Decision provided such wide latitude of interpretation that each preference-giving country stated in subsequent CRO meetings that they were in full compliance with the Nairobi Decision. This in turn implied, once again, a reversal of the burden of proof where the LDCs had to take the initiative into their hands once more with a series of technical notes.

The most important development inserted in paragraph 4.3 was the introduction of the obligation of notifying the utilization rates of the existing DFQF regimes. This was a rather dead obligation contained in the preferential trade agreement (PTA) transparency mechanism[95] that was given a new lease of life by its insertion into the Nairobi Decision. As explained in Chapter 4 of this book, the utilization rates were used by UNCTAD since 1975 to monitor the utilization of GSP preferences. However, with the reform introduced in 1996, the UNCTAD intergovernmental machinery ceased to annually review the utilization rates, which never came back to the attention of UNCTAD member states at intergovernmental level.

The author believes that his suggestion made to the WTO LDC group to insert in their proposal for the Nairobi Decision an obligation of preference-granting countries to notify utilization rates was timely in order to revamp the use of utilization rates to monitor trade preferences and to trigger new dynamics in the debate within the CRO.

This intuition proved to be successful first with the acceptance of such notification of utilization rates in the Nairobi Decision, second with the adoption of a definition of utilization rates that is identical to the one used by UNCTAD, and third by the fact that the issue of utilization rates is now firmly on the agenda of the CRO gaining prominent attention and effectively used by the WTO LDC group. The new agenda of utilization rates also provided the WTO Secretariat with a new mandate in producing notes on the utilization rates[96] and the establishment of a

[94] See WTO document G/RO/M/68, August 21, 2017. For the template see WTO/RO/84.
[95] See WTO document WT/L/806, December 16, 2010.
[96] See for instance WTO document G/RO/W/185, May 9, 2019.

database[97] that ignited a new and lively debate in the CRO after years of stagnation and deadlock on nonpreferential rules of origin.

Despite initial reluctance by WTO member states, the formula used by UNCTAD – and used by the WTO LDC group in a presentation at the CRO[98] and resubmitted in a note of the WTO secretariat – was finally accepted, as recorded in the annual CRO report to the WTO General Council.[99]

The current work in the CRO on rules of origin as well as the new initiative by Switzerland on transparency on nonpreferential rules discussed in Chapter 2 have been largely inspired by the work of the LDCs in the CRO.

The insertion of the use of the utilization rates as a methodology to assess rules of origin will likely have an impact beyond the trade preferences granted to LDCs. Chapter 4 of this book discusses the issue of utilization and the link with rules of origin in detail.

1.3.2 *Developments in the Committee on Rules of Origin after the Nairobi Decision on Preferential Rules of Origin for LDCs*

1.3.2.1 Recent Work on Utilization Rates

As pointed out in the preceding section, the insertion of the notification of utilization rates started a new agenda in the work of the CRO. The WTO LDC group, with the assistance of the author, has lately produced a number of presentations.

Paragraph 4.3 of the Nairobi Decision provides as follows:

> 4.3. Preferential rules of origin shall be notified as per the established procedures. In this regard, Members reaffirm their commitment to annually provide import data to the Secretariat as referred to Annex 1 of the PTA Transparency Mechanism, on the basis of which the Secretariat can calculate utilization rates, in accordance with modalities to be agreed upon by the CRO.

Four years later, most preference-granting members notified their utilization rates, constituting a valuable tool to identify specific difficulties that LDCs may face in complying with rules of origin, such as highlighted in the presentation made by the LDC group at the last CRO meeting applying UNCTAD's methodology.[100]

The LDCs, assisted by the author,[101] quickly realized that utilization rates are critical in assessing the stringency of rules of origin, clearly showing that (1) some

[97] See https://tao.wto.org/welcome.aspx?ReturnUrl=%2f.
[98] See Yemen delegation presentation at the CRO, October 4, 2017.
[99] See WTO document G/L1188, October 11, 2017.
[100] See the forthcoming UNCTAD study, *Drafting Rules of Origin for LDCs*, 2020.
[101] These sections draw on papers presented by the author with Prof. Pramila Crivelli of Goethe University during the LDC thematic retreat held in Lausanne in October 2019 and later adopted by the LDC group and submitted to the WTO Secretariat. See "Further evidence from utilization rates," G/RO/W/186, May 8, 2019; "Further evidence from utilization rates: utilization rates of

preference-granting countries exhibit low utilization rates across all products, and (2) high utilization rates may also hide large pockets of under-utilization in specific sectors, implying a significant share of LDC imports subject to MFN tariffs while eligible for preferential treatment.

The advocacy made by the WTO LDC group in the CRO meetings led to the recognition that further steps to simplify origin rules and improve utilization should be considered. WTO members agreed that more research work was to be conducted in order to better understand the causes behind under-utilization of tariff preferences and identify specific issues.

A first demonstration of the potential of use of utilization rates in the context of the CRO was presented by the WTO LDC group, with Tanzania as core group leader, at the CRO of October 2018. The presentation prepared, with the assistance of the author and other researchers, provided a detailed overview of the utilization rates under various schemes showing in some cases, like India DFQF, extremely low or zero utilization rates.[102] This in turn has stirred debate in the CRO about the reasons for such low utilization and a more careful attitude in notifying trade data on utilization rates. The overall process has considerably increased transparency on the true value of trade preferences granted to LDCs.

Two short studies on the Swiss and Chinese utilization rates reported in the following subsections were elaborated by the author of this book, with other researchers.[103] The analysis served as contribution of the WTO LDC group to the CRO in 2019.

1.3.2.1.1 THE SWISS UTILIZATION RATES. Table 1.2 reports the value of Swiss imports from LDC beneficiaries (column (1)), for tariff lines (column (2)) where the utilization rate (column (8)), defined as the value of imports entering under LDC/GSP (column (6)) divided by the value of imports eligible for the preferential treatment (column (5)), lies below 70 percent. Observations for the year 2017 are sorted in descending order of import values that are entering under MFN while eligible for the preferential treatment (column (7)). It is important to keep in mind that all values reported in Table 1.2 are dutiable. The corresponding MFN specific rate is reported under column (9).

Three main observations can be drawn from Table 1.2:

(1) Several LDCs experienced difficulties in benefiting from preferential treatment in the garment and clothing sectors. Bangladesh and

China's preference," WTO document G/RO/W/192, October 9, 2019; "Direct consignment rules and low utilization of trade preferences," G/RO/W/191, October 9, 2019.

[102] Bilateral consultations were held among the WTO Secretariat and India about the quality of the data that was supplied by India. However, at the time of writing, no reports have been made to the CRO about addressing such data issues, nor the low level of utilization rates.

[103] The notes were elaborated jointly with Prof. Pramila Crivelli of Goethe University.

TABLE 1.2 *Swiss imports from least developed countries 2017 – tariff lines*

Utilization rates (UR) < 70%, sorted in descending value of imports entering under MFN (> 5 million USD)

			Imports (USD thousands)					
					Entering under			
Country	Tariff line	Product description	Dutiable	Eligible	LDC/ GSP	MFN	UR (%)	Specific MFN duty
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Bangladesh	62034200	Men's or boys' suits, ensembles, jackets, blazers, trousers . . . – of cotton	80,555	80,555	27,489	53,067	34	182 Fr./100kg brut
Bangladesh	61091000	T-shirts, singlets and other vests, KoC – of cotton	49,890	49,890	13,469	36,421	27	152 Fr./100kg brut
Bangladesh	61102000	Jerseys, pullovers, cardigans, waistcoats . . ., KoC – of cotton	61,207	61,207	26,609	34,599	43	120 Fr./100kg brut
Tanzania	71039100	Rubies, sapphires and emeralds	30,866	30,866	0	30,866	0	800 Fr./100kg brut
Myanmar	71039100	Rubies, sapphires and emeralds	26,864	26,864	0	26,864	0	800 Fr./100kg brut
Bangladesh	61103000	Jerseys, pullovers, cardigans, waistcoats . . ., KoC – of MMF	42,075	42,075	16,311	25,764	39	300 Fr./100kg brut
Mozambique	71039100	Rubies, sapphires and emeralds	14,425	14,425	0	14,425	0	800 Fr./100kg brut
Bangladesh	62046290	Women's or girls' suits, ensembles, jackets, blazers, dresses . . . – of cotton	24,336	24,336	10,334	14,002	42	302 Fr./100kg brut
Madagascar	71039100	Rubies, sapphires and emeralds	10,229	10,229	0	10,229	0	800 Fr./100kg brut
Bangladesh	62052000	Men's or boys' shirts – of cotton	17,512	17,512	7,737	9,775	44	200 Fr./100kg brut
Bangladesh	61051000	Men's or boys' shirts, KoC – of cotton	11,775	11,775	3,080	8,695	26	130 Fr./100kg brut
Bangladesh	64039100	Footwear with outer soles of rubber, plastics, leather . . . – Covering ankle	8,421	8,421	258	8,163	3	143 Fr./100kg brut

Zambia	71039100	Rubies, sapphires and emeralds	7,865	7,865	0	7,865	0	800 Fr./100kg brut
Bangladesh	62029300	Women's or girls' overcoats, car-coats, capes, cloaks . . . – of MMF	9,249	9,249	1,474	7,775	16	575 Fr./100kg brut
Bangladesh	61099000	T-shirts, singlets and other vests, KoC of other textile materials	8,665	8,665	1,561	7,104	18	391 Fr./100kg brut
Cambodia	62034200	Men's or boys' suits, ensembles, jackets, blazers, trousers . . . – of cotton	8,993	8,993	1,951	7,041	22	182 Fr./100kg brut
Bangladesh	61046200	Women's or girls' suits, ensembles, jackets, blazers, dresses . . . – of cotton	15,415	15,415	8,590	6,825	56	165 Fr./100kg brut
Cambodia	61099000	T-shirts, singlets and other vests, KoC of other textile materials	7,336	7,336	1,183	6,153	16	391 Fr./100kg brut
Cambodia	61046200	Women's or girls' suits, ensembles, jackets, blazers, dresses . . . – of cotton	8,020	8,020	1,914	6,105	24	165 Fr./100kg brut
Cambodia	64039992	Footwear with outer soles of rubber, plastics, leather . . . – other	7,740	7,740	1,666	6,074	22	145 Fr./100kg brut
Cambodia	61046300	Women's or girls' suits, ensembles, jackets, blazers, dresses, skirts, divided skirts, trousers, bib – of synthetic fibres	6,835	6,835	1,137	5,698	17	418 Fr./100kg brut
Bangladesh	62019300	Men's or boys' overcoats, car-coats, capes, cloaks . . . – of MMF	6,196	6,196	904	5,293	15	497 Fr./100kg brut
Haiti	33012930	Essential oils (terpeneless or not) . . . – other	5,230	5,230	0	5,230	0	3 Fr./100kg brut
Bangladesh	62034300	Men's or boys' suits, ensembles, jackets, blazers, trousers . . . – of cotton	6,691	6,691	1,653	5,038	25	500 Fr./100kg brut

Source: TAO database, May 1, 2019.
Note: MMF = man-made fibres; KoC = knitted or crocheted

Cambodia are particularly affected with considerable values that paid MFN specific duties. Considering the first three tariff lines under HS Chapter 61 and 62 together, the value of imports entering under MFN treatment while eligible for preferential treatment amounted to 124 million USD only for Bangladesh. As for Cambodia, out of 9 million USD total imports from Cambodia under a single tariff line (62034200), only less than 2 million USD entered the Swiss market duty-free, leading to 7 million USD imposed by the MFN specific duty.

(2) Tariff line 71039100 is critical for all LDCs exporting rubies, sapphires, and emeralds to Switzerland. All six countries concerned[104] exhibit a utilization rate of zero, for a total import value of 99.7 million USD.

(3) Haiti did not benefit from the preference granted for exports of essential oils (tariff line 33012930) leading to 5.3 million USD that could potentially enter duty-free the Swiss market but that instead are imposed the specific MFN duty.

Given the high number of tariff line–country pairs with utilization rates below 70 percent (8,601 cases out of 11,923 observations), Table 1.3 reports similar information as Table 1.2 but aggregated at the HS chapter level, allowing a better understanding of the magnitude of the trade concerned by low utilization rates. In particular, the following observations can be made:

(1) In the garment and clothing sector, 292 million USD of imports of Chapters 61 and 62 from Bangladesh are receiving the MFN treatment while eligible for duty-free entry. This value amounts to almost 78 million USD for Cambodia, 21.6 million for Myanmar, 14 million for Madagascar and 6.3 million for Lao, with preference margins ranging between 120CHF/100kg and 575CHF/100kg (see Table 1.2).

(2) Cambodia is facing difficulties to benefit from the preferential treatment in other sectors than garments and textile, in particular footwear of HS Chapter 64 (22.5 million USD imports receiving MFN treatment) and bicycles of HS Chapter 87 (4.8 million USD), with preference margins of respectively 145CHF/100kg and 23CHF/100kg.

(3) Under HS Chapter 71, other tariff lines than rubies, sapphires, and emeralds (71039100) are showing zero utilization rates. That is, for example, the case of diamonds imports (HS 71023900) from the Solomon Islands amounting to 4.4 million. Both tariff lines exhibit a preference margin of 800CHF/100kg.

[104] In order of import values: Tanzania, Myanmar, Mozambique, Madagascar, Zambia, and Afghanistan (1.679 million USD imports of product of tariff line 71039100 from Afghanistan not reported under Table 1.2).

TABLE 1.3 *Swiss imports from least developed countries 2017 – HS chapters*

Utilization rates (UR) < 70%, sorted in descending value of imports entering under MFN (> 2 million USD)

Country	HS	Product description	Imports (USD thousands)				UR (%)
					Entering under		
			Dutiable	Eligible	LDC/ GSP	MFN	
Bangladesh	61	Articles of apparel and clothing accessories, knitted or crocheted	259,491	259,491	100,900	158,590	39
Bangladesh	62	Articles of apparel and clothing accessories, not knitted or crocheted	207,387	207,387	74,000	133,388	36
Cambodia	61	Articles of apparel and clothing accessories, knitted or crocheted	76,149	76,149	28,204	47,945	37
Tanzania	71	Natural or cultured pearls, precious or semi-precious stones ...	32,170	32,170	0	32,170	0
Cambodia	62	Articles of apparel and clothing accessories, not knitted or crocheted	41,447	41,447	11,677	29,770	28
Myanmar	71	Natural or cultured pearls, precious or semi-precious stones ...	27,512	27,512	0	27,512	0

(*continued*)

TABLE 1.3 (*continued*)

Country	HS	Product description	Imports (USD thousands)				UR (%)
					Entering under		
			Dutiable	Eligible	LDC/ GSP	MFN	
Cambodia	64	Footwear, gaiters and the like …	28,083	28,083	5,519	22,564	20
Myanmar	62	Articles of apparel and clothing accessories, not knitted or crocheted	23,669	23,669	6,924	16,745	29
Bangladesh	64	Footwear, gaiters and the like …	20,325	20,325	5,016	15,310	25
Mozambique	71	Natural or cultured pearls, precious or semi-precious stones …	14,746	14,746	0	14,746	0
Madagascar	71	Natural or cultured pearls, precious or semi-precious stones …	10,383	10,383	27	10,356	0
Madagascar	62	Articles of apparel and clothing accessories, not knitted or crocheted	8,677	8,677	3	8,674	0
Zambia	71	Natural or cultured pearls, precious or semi-precious stones …	7,920	7,920	0	7,920	0
Bangladesh	63	Other made up textile articles …	8,184	8,184	2,723	5,461	33

TABLE 1.3 (*continued*)

Country	HS	Product description	Imports (USD thousands)				UR (%)
					Entering under		
			Dutiable	Eligible	LDC/ GSP	MFN	
Madagascar	61	Articles of apparel and clothing accessories, knitted or crocheted	7,151	7,151	1,785	5,367	25
Haiti	33	Essential oils and resinoids; perfumery, cosmetic …	5,318	5,318	0	5,318	0
Myanmar	61	Articles of apparel and clothing accessories, knitted or crocheted	9,618	9,618	4,723	4,896	49
Cambodia	87	Vehicles other than railway or tramway	5,624	5,624	808	4,816	14
Solomon Islands	71	Natural or cultured pearls, precious or semi-precious stones …	4,413	4,413	0	4,413	0
Lao PDR	61	Articles of apparel and clothing accessories, knitted or crocheted	3,570	3,570	13	3,557	0
Bangladesh	42	Articles of leather …	3,390	3,390	187	3,203	6
Myanmar	64	Footwear, gaiters and the like …	3,650	3,650	552	3,099	15

Source: TAO database, May 1, 2019.

Finally, it has to be noted that Tables 1.2 and 1.3 represent only a snapshot of the data and the list of tariff lines–country pairs where bilateral discussions could improve market access is not exhaustive. Other countries could potentially also face difficulties in some selected sectors that could be worth investigating further, as shown in Table 1.4.

Preliminary Discussions Linking Swiss Utilization Rates to Rules of Origin

- Swiss utilization rates for garments and clothing imports of HS Chapters 61 and 62 ranging between zero and 49 percent (Table 1.3), are much lower than those observed in the EU, which amount to 95 percent on average.[105] Given that EU and Swiss rules of origin for garments of Chapters 61 and 62 are identical, it is necessary to clarify the reasons for such lower utilization rates in the Swiss market.
- Pearls and precious stones of HS Chapter 71 are primary products that should normally be considered as originating since they are mostly wholly obtained in the LDCs.
- One possible explanation of such low utilization may be linked to the fact that Switzerland is a landlocked country near to large distribution networks and hubs. Hence low utilization may be due to certification and direct shipment requirements and related documentary evidence rather than the substantive rule of origin requirements (substantial transformation). Another explanation could also be the relatively low MFN specific duty.

1.3.2.1.2 THE CHINESE UTILIZATION RATE. This subsection reports the very first attempt to analyze the recently released Chinese utilization rates data of the year 2016.[106]

Figure 1.1 below reports the full distribution of tariff lines over the utilization rates with covered[107] imports from LDCs above 10,000 USD. Chinese utilization rates appear to be relatively polarized around zero and (to a significant lower extend) around 100 percent. More specifically, in 2016, 70 percent (880 out of 1,250) of the tariff lines were reported to have a zero-utilization rate. This percentage remains unchanged (69 percent) when we consider preference margin above 5 percent. This proportion increases to 74.4 percent when considering utilization rates between 0 and 5 percent (930 out of 1,250).

[105] Utilization rates of HS 61 and 62, 2017: 97% for Bangladesh, 96% and 97% for Cambodia, 91% and 95% for Myanmar.

[106] See P. Crivelli and S. Inama, "Selected issues on rules of origin for least developed countries: (1) Direct consignment rule (2) Chinese utilization rates of trade preferences," paper presented at the WTO Retreat in Lausanne, October, 2019.

[107] Covered imports by the preferential scheme referred to as "eligible" in the Tariff Analysis Online (TAO) database.

TABLE 1.4 *Swiss imports from least developed countries 2017 – LDC beneficiaries*

Country	Imports (USD thousands)				UR (%)	Country	Imports (USD thousands)				UR (%)
			Entering under						Entering under		
	Dutiable	Eligible	LDC/ GSP	MFN			Dutiable	Eligible	LDC/ GSP	MFN	
Afghanistan	2,234	2,234	7	2,227	0	**Madagascar**	31,666	31,666	4,939	26,727	16
Angola	13	13	0	13	0	**Malawi**	9	9	0	9	0
Bangladesh	504,850	504,850	185,833	319,017	37	**Mali**	537	526	31	495	6
Benin	380	380	214	166	56	**Mauritania**	329	329	0	329	0
Burkina Faso	1,016	1,016	11	1,005	1	**Mozambique**	34,933	34,933	19,580	15,353	56
Cambodia	158,521	158,521	51,155	107,366	32	**Myanmar**	67,103	67,103	14,000	53,104	21
Central African Republic	88	88	0	88	0	**Nepal**	8,075	8,075	3,428	4,647	42
Chad	10	10	0	10	0	**Niger**	216	113	14	98	13
Comoros	991	991	0	991	0	**Rwanda**	5	4	2	2	41
DR Congo	377	377	243	134	64	**Senegal**	10,813	10,813	7,337	3,477	68
Djibouti	6	6	3	3	45	**Sierra Leone**	345	345	0	345	0
Eritrea	2	2	0	2	0	**Solomon Islands**	20,236	20,236	15,587	4,649	77
Ethiopia	3,945	3,551	1,057	2,495	30	**Somalia**	35	35	0	35	0
Gambia	14	14	0	14	0	**Sudan**	3,941	3,941	3,940	1	100
Guinea	156	156	19	137	12	**Tanzania**	50,574	49,024	16,576	32,448	34
Haiti	5,510	5,510	1	5,508	0	**Togo**	375	372	279	92	75
Lao PDR	8,389	8,389	514	7,876	6	**Uganda**	4,640	4,611	4,128	483	90
Liberia	430	430	14	416	3	**Zambia**	8,073	7,978	18	7,960	0

Source: TAO database, May 1, 2019.

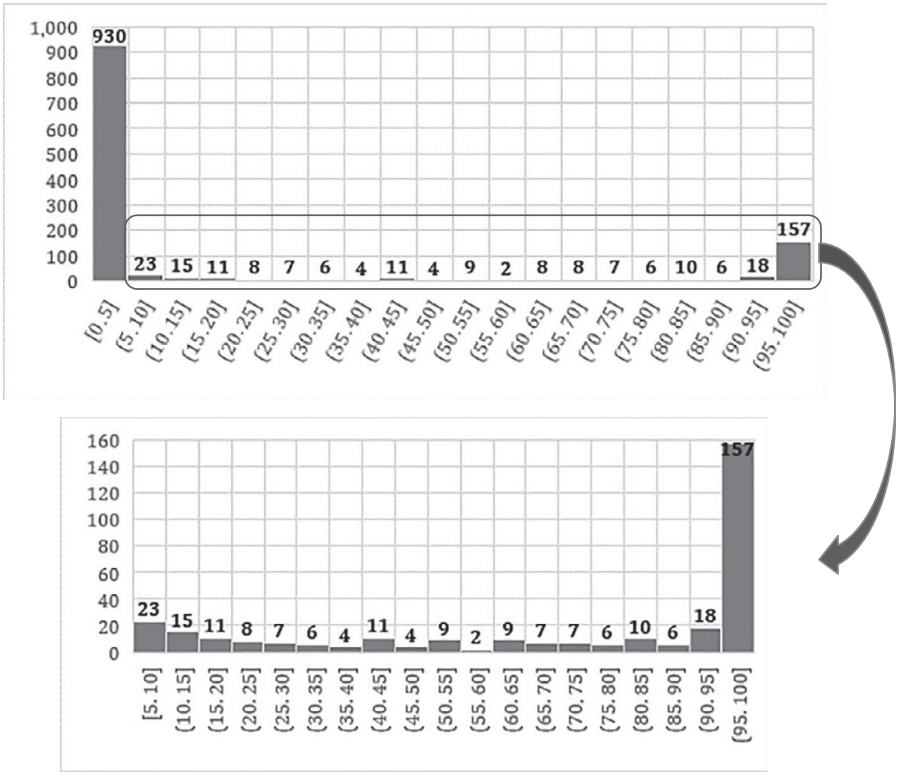


FIGURE 1.1 Distribution of tariff lines over utilization rates values
Imports from LDCs > 10,000 USD

In contrast, 157 tariff lines (12.5 percent of the tariff lines) present a utilization rate between 95 and 100 percent. This frequency of high utilization rate is bigger than those of intermediate values of utilization rates between 5 and 95 percent, with frequency ranging between two and twenty-three tariff lines (see lower part of Figure 1.1). However, it is still far from the 74 percent (930 tariff lines) at the lower level of the utilization rate distribution, with utilization rates between 0 and 5 percent. Therefore, the polarization exists and is heavily biased toward zero.

Strong variations of utilization rates are observed between LDCs. Figure 1.2 depicts utilization rates and imports from LDCs covered by preferential treatment with a value above 50 million USD. While some LDCs exhibit high utilization rates,[108] it is remarkable to observe that the five biggest LDC exporters to China – trade values between 626 million and 2 billion USD – all face difficulties in benefiting from DFQF preferential treatment. Indeed, four of these five

[108] Right part of the graph except Madagascar and Mozambique with mitigated results and Angola with a utilization rate of zero.

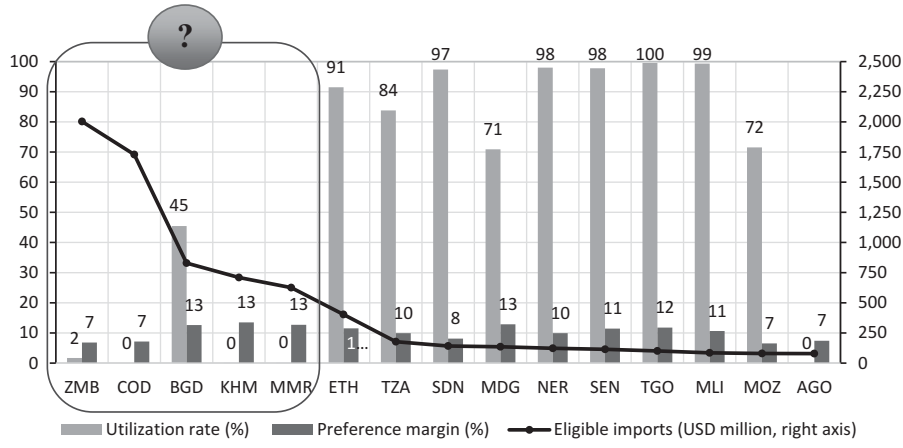


FIGURE 1.2 Chinese utilization rates, preference margin, and eligible imports from LDCs: Covered imports > 50 million USD

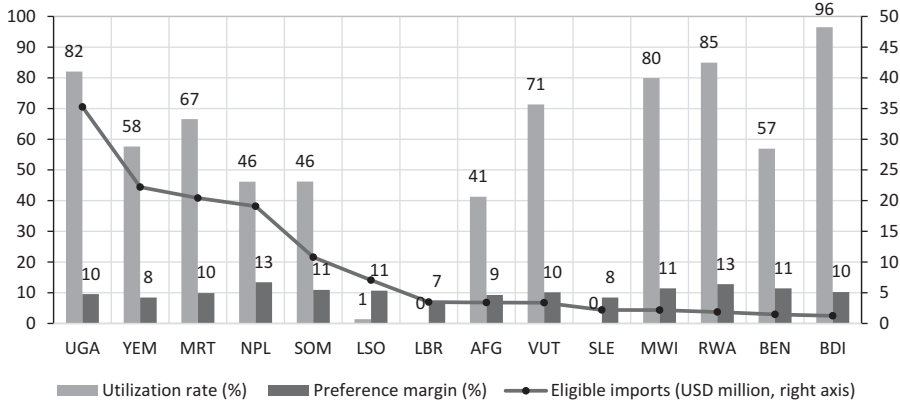


FIGURE 1.3 Chinese utilization rates, preference margin, and eligible imports from LDCs: 1 million USD < Covered Imports <= 50 million USD

LDCs – namely Zambia, the Democratic Republic of Congo, Cambodia, and Myanmar – all report a utilization rate of zero. Bangladesh, the third biggest exporter to China in terms of covered imports, only reaches 45 percent.

For the remaining LDCs with lower export values to China reported in Figure 1.3, the variation of utilization rates is even more important. A more disaggregated analysis is therefore needed to better understand the causes of such variations of utilization among LDCs and the reasons for low utilization of large exporters that in the case of some LDC relates to minerals that are in general wholly obtained products.

Table 1.5 reports the value of Chinese imports from LDC beneficiaries (column (1)), for tariff lines (column (2)) where the utilization rate (column (8)), defined as

TABLE 1.5 *Chinese imports from least developed countries 2016 – tariff lines*

UR < 70%, sorted in descending value of imports entering under MFN (> 15 million USD), PM > 2

			Imports (USD thousands)					
					Entering under			
Country	Tariff line	Product description	Dutiable	Covered	LDC/ GSP	MFN	UR (%)	PM (%)
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
DR Congo	81052010	Cobalt mattes and other intermediate products of cobalt metallurgy; unwrought; powders	703,700	703,700	0	703,700	0.0	4
Cambodia	43021100	Tanned or dressed fur skins, unassembled – of mink	141,431	141,430	0	141,430	0.0	12
Cambodia	90139020	Liquid crystal devices; Parts and accessories	108,990	108,990	0	108,990	0.0	8
Myanmar	71162000	Articles of precious or semi-precious stones (natural, synthetic or reconstructed)	73,111	73,111	0	73,111	0.0	35
Bangladesh	62034290	Men's or boys' suits, ensembles, jackets, blazers, trousers, bib and brace overalls, breeches of cotton	95,739	95,739	40,268	55,471	42.1	16
DR Congo	81052090	Cobalt mattes and other intermediate products of cobalt metallurgy; unwrought; powders	51,343	51,343	0	51,343	0.0	4
Cambodia	35051000	Dextrins and other modified starches	50,770	50,770	0	50,770	0.0	12
Angola	27111200	Propane	50,671	50,671	0	50,671	0.0	5
Bangladesh	61091000		78,065	78,065	31,917	46,147	40.9	14

TABLE 1.5 (*continued*)

Country	Tariff line	Product description	Imports (USD thousands) Dutiable	Covered	Entering under LDC/ GSP	MFN	UR (%)	PM (%)
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
		T-shirts, singlets and other vests, KoC – of cotton						
Bangladesh	62046200	Women's or girls' suits, ensembles, jackets, blazers, dresses, skirts, divided skirts, trousers, bib of cotton	43,999	43,999	6,122	37,878	13.9	16
Myanmar	12129300	Sugar cane	37,718	37,718	0	37,718	0.0	20
Cambodia	61091000	T-shirts, singlets and other vests, KoC of cotton	25,519	25,519	0	25,519	0.0	14
Bangladesh	61102000	Jerseys, pullovers, cardigans, waistcoats and similar articles, KoC of cotton	27,803	27,803	2,846	24,957	10.2	14
Myanmar	71031000	Precious stones (other than diamonds) and semi-precious stones unworked or simply sawn or roughly shaped	22,175	22,175	0	22,175	0.0	3
Cambodia	61112000	Babies' garments and clothing accessories, KoC of cotton	21,856	21,856	0	21,856	0.0	14
Bangladesh	61103000	Jerseys, pullovers, cardigans, waistcoats and similar articles, KoC MMF	26,110	26,110	5,403	20,707	20.7	16

(*continued*)

TABLE 1.5 (*continued*)

			Imports (USD thousands)					
					Entering under			
Country	Tariff line	Product description	Dutiable	Covered	LDC/ GSP	MFN	UR (%)	PM (%)
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Cambodia	61103000	Jerseys, pullovers, cardigans, waistcoats and similar articles, KoC – of MMF	20,275	20,275	33	20,242	0.2	16
Cambodia	61102000	Jerseys, pullovers, cardigans, waistcoats and similar articles, KoC – of cotton	19,852	19,852	0	19,852	0.0	14
Bangladesh	62052000	Men's or boys' shirts of cotton	35,019	35,019	15,251	19,768	43.6	16
Myanmar	71039910	Precious stones (other than diamonds) and semi-precious stones – other	19,767	19,767	0	19,767	0.0	8
Myanmar	90019090	Optical fibres and optical fibre bundles; optical fibre cables other than those of heading 85.44 – other	18,163	18,163	0	18,163	0.0	8
Cambodia	85044014	Static converters	17,372	17,372	0	17,372	0.0	7
Cambodia	85011099	Motors of an output not exceeding 37.5 W	16,859	16,859	0	16,859	0.0	9

Source: TAO database, October 1, 2019.
Note: MMF = man-made fibres; KoC = knitted or crocheted

the value of imports entering under LDC/GSP (column (6)) divided by the value of imports covered by the preferential treatment (column (5)), lies below 70 percent. Observations for the year 2016 are sorted in descending order of import values that are entering under MFN while covered by the preferential treatment (column (7)).

It is important to keep in mind that all values reported in Table 1.5 are dutiable. The corresponding preference margin is reported under column (9).

Three main observations can be drawn from Table 1.5:

(1) Given the low/zero utilization rates a significant amount of imports from LDCs is entering China under high MFN rates. As an illustration, with a preferential margin of 35 percent the 73 million USD imports of precious/semi-precious stones from Myanmar (TL 71162000), could generate a saving of 26 million USD by using the preference.
(2) In the case of DR Congo, despite the lower preferential margin (4 percent) the use of the preferential treatment could also trigger substantial duty savings given the extensive amount of trade. Combining the two tariff lines for cobalt (TL 81052010 and 81052090) the duty saving can be estimated to 30.2 million USD (4 percent of 755 million USD).
(3) Low utilization rates in the case of Chinese DFQF are not confined to a specific type of product but apply to a wide range of tariff lines, from raw materials, natural products, agricultural product (see sugar cane) to garments and other industrial products (motors, static converters, etc.).

Table 1.5 reports values of trade above 15 million USD from LDC beneficiaries. However, other tariff lines–country pairs are affected by low utilization as shown in Table 1.6. This table provides an initial overview for each LDC by reporting the tariff lines with the highest value of covered imports and a utilization rate below 70 percent.

TABLE 1.6 *Chinese imports from least developed countries 2016 – LDC beneficiaries*

First two HS sectors by country with UR < 70, sorted in descending order of eligible imports

			Imports (USD thousands)					
Country	HS 2	Description	Dutiable	Covered	GSP/ LDC	MFN	UR	PM
Afghanistan	51	Wool, fine/coarse animal hair; horsehair yarn and woven fabric	969	969	0	969	0.0	9.0
	12	Oil seeds and oleaginous fruits; miscellaneous grains, seeds and fruit; industrial or medicinal plan	251	251	0	251	0.0	6.0

(*continued*)

TABLE 1.6 (*continued*)

Country	HS 2	Description	Imports (USD thousands) Dutiable	Covered	GSP/ LDC	MFN	UR	PM
Angola	27	Mineral fuels, mineral oils and products of their distillation; bituminous substances; mineral waxes	13,900,000	60,719	0	60,719	0.0	5.0
	25	Salt; Sulphur; earths, stone; plastering materials, lime, cement	13,778	13,778	0	13,778	0.0	3.5
Bangladesh	62	Articles of apparel and clothing accessories, not KoC	266,713	265,782	71,980	193,802	27.1	15.9
	61	Articles of apparel and clothing accessories, KoC	203,225	202,692	49,578	153,114	24.5	15.7
Benin	14	Vegetable plaiting materials; vegetable products nes or included	1,230	1,230	821	409	66.7	4.0
	52	Cotton	14,653	186	0	186	0.0	10.0
Burundi	25	Salt; sulphur; earths, stone; plastering materials, lime, cement	2	2	0	2	0.0	3.0
Cambodia	61	Articles of apparel and clothing accessories, KoC	171,210	171,210	33	171,177	0.0	15.9
	43	Fur skins and artificial fur; manufactures thereof	145,648	145,648	0	145,648	0.0	14.0
Central African Republic	5	Products of animal origin, nes or included	114	114	0	114	0.0	10.0
	85	Electrical machinery and equipment and parts thereof; sound recorders and	46	45	0	45	0.0	12.0

TABLE 1.6 (*continued*)

Country	HS 2	Description	Imports (USD thousands) Dutiable	Covered	GSP/ LDC	MFN	UR	PM
		reproducers, television image and sound recorders and reproducers						
Chad	13	Lac; gums, resins and other vegetable saps and extracts	75	75	0	75	0.0	15.0
	25	Salt; sulphur; earths, stone; plastering materials, lime, cement	59	59	0	59	0.0	3.3
Comoros	33	Essential oils and resinoids; perfumery, cosmetic or toilet preparations	13	13	0	13	0.0	15.0
DR Congo	74	Copper and articles thereof	971,358	971,358	0	971,358	0.0	2.0
	81	Other base metals; cermets; articles thereof	755,395	755,395	0	755,395	0.0	4.0
Djibouti	12	Oil seeds and oleaginous fruits; miscellaneous grains, seeds and fruit; industrial or medicinal plan	18	18	0	18	0.0	10.0
	71	Natural or cultured pearls, precious or semi-precious stones, precious metals, metals clad with precious metals	12	12	0	12	0.0	3.0
Eritrea	25	Salt; sulphur; earths, stone; plastering materials, lime, cement	3	3	0	3	0.0	3.0
	62	Articles of apparel and clothing accessories, not KoC	1	1	0	1	0.0	16.0
Ethiopia	41	Raw hides and skins (other than fur skins) and leather	44,057	43,943	27,853	16,090	63.4	9.4

(*continued*)

TABLE 1.6 (*continued*)

Country	HS 2	Description	Imports (USD thousands) Dutiable	Covered	GSP/ LDC	MFN	UR	PM
	9	Coffee, tea, maté and spices	7,356	7,356	4,759	2,598	64.7	12.7
Guinea	3	Fish and crustaceans, molluscs and other aquatic invertebrates	46	46	0	46	0.0	10.0
	92	Musical instruments; parts and accessories of such articles	22	22	0	22	0.0	17.0
Guinea-Bissau	61	Articles of apparel and clothing accessories, KoC	1	1	0	1	0.0	16.0
Lesotho	85	Electrical machinery and equipment and parts thereof; sound recorders and reproducers, television image and sound recorders and reproducers	6,275	6,217	0	6,217	0.0	9.0
	52	Cotton	702	702	99	603	14.1	10.0
Liberia	74	Copper and articles thereof	2,911	2,911	0	2,911	0.0	1.0
	89	Ships, boats and floating structures	427	427	0	427	0.0	3.0
Madagascar	71	Natural or cultured pearls, precious or semi-precious stones, precious metals, metals clad with precious metals	8,154	8,154	52	8,102	0.6	15.0
	29	Organic chemicals	5,554	5,554	0	5,554	0.0	6.0
Malawi	9	Coffee, tea, maté and spices	718	718	296	422	41.2	11.5
	25	Salt; sulphur; earths, stone; plastering materials, lime, cement	9	9	0	9	0.0	3.0
Mali	8	Edible fruit and nuts; peel of citrus fruit or melons	73	73	0	73	0.0	20.0

TABLE 1.6 (*continued*)

Country	HS 2	Description	Imports (USD thousands) Dutiable	Covered	GSP/ LDC	MFN	UR	PM
	1	Live animals	40	30	0	30	0.0	10.0
Mauritania	3	Fish and crustaceans, molluscs and other aquatic invertebrates	8,938	8,938	4,539	4,399	50.8	11.8
	25	Salt; sulphur; earths, stone; plastering materials, lime, cement	20	20	0	20	0.0	3.0
Mozambique	72	Iron and steel	12,774	12,774	0	12,774	0.0	2.0
	74	Copper and articles thereof	4,597	4,597	0	4,597	0.0	2.0
Myanmar	74	Copper and articles thereof	130,227	130,227	0	130,227	0.0	4.5
	72	Iron and steel	127,610	127,610	0	127,610	0.0	2.0
Nepal	90	Optical, photographic, cinematographic, measuring, checking, precision, medical or surgical instrument	3,675	3,675	0	3,675	0.0	5.5
	83	Miscellaneous articles of base metal	5,686	5,686	2,983	2,702	52.5	12.0
Niger	71	Natural or cultured pearls, precious or semi-precious stones, precious metals, metals clad with precious metals	621	621	0	621	0.0	27.5
	40	Rubber and articles thereof	31	31	0	31	0.0	15.0
Rwanda	9	Coffee, tea, maté and spices	240	240	59	181	24.5	12.7
	12	Oil seeds and oleaginous fruits; miscellaneous grains, seeds and fruit; industrial or medicinal plan	52	52	0	52	0.0	30.0

(*continued*)

TABLE 1.6 (*continued*)

			Imports (USD thousands)					
Country	HS 2	Description	Dutiable	Covered	GSP/ LDC	MFN	UR	PM
Senegal	41	Raw hides and skins (other than fur skins) and leather	86	86	0	86	0.0	14.0
	39	Plastics and articles thereof	47	47	0	47	0.0	8.0
Sierra Leone	71	Natural or cultured pearls, precious or semi-precious stones, precious metals, metals clad with precious metals	1,903	1,903	0	1,903	0.0	3.0
	85	Electrical machinery and equipment and parts thereof; sound recorders and reproducers, television image and sound recorders and reproducers	190	117	0	117	0.0	8.6
Somalia	3	Fish and crustaceans, molluscs and other aquatic invertebrates	4,705	4,705	0	4,705	0.0	12.0
	41	Raw hides and skins (other than fur skins) and leather	994	994	64	930	6.5	14.0
Sudan	13	Lac; gums, resins and other vegetable saps and extracts	933	933	586	347	62.8	9.0
	74	Copper and articles thereof	142	142	0	142	0.0	1.0
Tanzania	74	Copper and articles thereof	12,173	12,173	0	12,173	0.0	1.8
	53	Other vegetable textile fibres; paper yarn and woven fabrics of paper yarn	17,610	17,610	11,831	5,780	67.2	5.0
Timor-Leste	9	Coffee, tea, maté and spices	94	94	0	94	0.0	8.0

TABLE 1.6 (*continued*)

Country	HS 2	Description	Imports (USD thousands) Dutiable	Covered	GSP/ LDC	MFN	UR	PM
	14	Vegetable plaiting materials; vegetable products nes or included	20	20	0	20	0.0	15.0
Togo	25	Salt; sulphur; earths, stone; plastering materials, lime, cement	4	4	0	4	0.0	3.0
	83	Miscellaneous articles of base metal	3	3	0	3	0.0	8.0
Uganda	41	Raw hides and skins (other than fur skins) and leather	18,073	18,073	12,206	5,867	67.5	11.5
	5	Products of animal origin, nes or included	302	302	36	266	11.9	10.0
Vanuatu	12	Oil seeds and oleaginous fruits; miscellaneous grains, seeds and fruit; industrial or medicinal plan	172	172	0	172	0.0	8.0
	5	Products of animal origin, nes or included	99	99	0	99	0.0	12.0
Yemen	74	Copper and articles thereof	8,559	8,559	0	8,559	0.0	1.0
	3	Fish and crustaceans, molluscs and other aquatic invertebrates	426	426	0	426	0.0	10.0
Zambia	74	Copper and articles thereof	1,958,895	1,958,895	0	1,958,895	0.0	1.8
	25	Salt; sulphur; earths, stone; plastering materials, lime, cement	459	459	0	459	0.0	4.0

Source: TAO database, October 1, 2019.
Note: MMF = man-made fibres; KoC = knitted or crocheted

For example, Somalia exported 4.7 million USD of fish and crustaceans of HS Chapter 3 to China but did not receive the preferential treatment and therefore paid 560,000 USD of MFN duties. In Zambia, almost 2 billion USD of copper of HS Chapter 74 have been exported to China in 2016. While the tariff line did not appear in the previous table due to the filtering (preference margin above 2 percent), the duty saving that could be generated by a full use of the preferential treatment amounts to more than 35 million USD. It therefore clearly shows that low preferential margins do not necessarily imply low incentives to make use of the preference.

Finally, Table 1.7 shows for each country the number of tariff lines for different levels of utilization rates: zero utilization, between zero and 50% percent, between 50 and 70%, and finally above 70%.

TABLE 1.7 *Number of tariff lines and trade values over utilization rates categories*

	UR = 0			0 < UR < 50			50 < UR < 70			UR > 70		
Country	#TL	Covered	PM	#TL	Covered	PM	#TL	Covered	PM	#TL	Covered	PM
Zambia	46	1,663,314	30	1	222	3				4	39,934	7
DR Congo	32	703,700	20									
Cambodia	480	141,430	45	1	20,275	16						
Myanmar	352	130,227	35	5	5,875	15						
Angola	20	50,671	35									
Mozambique	37	12,774	14							11	37,700	16
Bangladesh	254	8,831	25	92	95,739	20	3	10,320	17	45	69,734	35
Lesotho	16	6,190	17							1	99	10
Madagascar	167	5,552	35	14	5,047	17	4	4,172	17	19	81,827	15
Yemen	20	5,234	35	1	342	3				3	12,200	6
Tanzania	66	5,040	45	2	330	10	4	17,610	15	18	113,772	35
Somalia	14	4,705	35	1	962	14				1	4,931	10
Mauritania	9	4,166	17							13	10,529	15
Nepal	131	3,672	35	48	291	24	11	5,628	20	109	1,468	35
Liberia	11	2,911	20									
Sierra Leone	66	1,903	16									
Niger	26	615	35							1	121,619	10
Ethiopia	84	384	25	1	1,650	5	5	19,061	14	23	324,283	24
Afghanistan	43	365	20							1	1,739	6
Sudan	31	201	17	2	422	10	1	109	14	12	120,465	15
Benin	9	186	20				1	1,230	4	1	17	20
Rwanda	14	181	35							7	1,114	17
Vanuatu	4	172	15	1	1,000	12				1	2,109	10

TABLE 1.7 (*continued*)

	UR = 0			0 < UR < 50			50 < UR < 70			UR > 70		
Country	#TL	Covered	PM	#TL	Covered	PM	#TL	Covered	PM	#TL	Covered	PM
Central African Republic	7	114	30									
Timor-Leste	15	94	24							1	104	30
Senegal	38	86	30	1	1,401	17				19	97,104	15
Chad	14	75	30									
Mali	26	73	30							4	84,364	15
Uganda	48	62	20	2	298	20	3	3,986	14	9	12,816	15
Guinea	22	46	24									
Djibouti	12	18	16							1	89	14
Comoros	1	13	15									
Malawi	9	9	20	1	717	15				3	1,068	15
Togo	6	4	24							4	92,417	20
Burundi	1	2	3							3	1,070	15
Eritrea	4	2	16									
Guinea-Bissau	1	1	16									

Source: TAO database, October 1, 2019.
Note: MMF = man-made fibres; KoC = knitted or crocheted

It can be noted that only observations in the right part of the table are recorded for only twenty-five LDCs. Only these countries managed to export selected product making use of the preference in at least half of the cases (tariff lines with utilization rates above 50 percent).

This preliminary analysis of the utilization rate of Chinese DFQF shows that there are a significant number of low or zero utilization rates for significant exports from LDCs. In addition, high variations of utilization rates are observed and pockets of low utilization should be further studied.

Both submissions of the LDCs about utilization rates of Switzerland and China stirred a number of debates at the CRO, to the extent that the day after the presentation made by the WTO LDCs at the CRO, the Chinese delegation felt compelled to quickly assemble some complementary data to make a presentation where it argued that such low utilization rates were due, in some cases, to the fact that LDCs have used other trade preferences, such as the ASEAN–China FTA agreement in the case of ASEAN LDCs

(such as Cambodia and Myanmar), or other arrangements provided by China. In the case of Switzerland, the paper on utilization rates resulted in a series of bilateral discussions with Swiss delegations to identify the reasons for such low utilization. Such discussion identified reasons for low utilization of trade preferences linked to the direct consignment requirement as further discussed in the section below and in Chapter 7.

The issue of overlapping trade preferences and utilization rates is an emerging topic that is further discussed in Chapter 4 of this book.

Indeed, it seems that some constructive dialogue on the basis of evidence from utilization rates is possible in order to make progress, even if it is too early to say if such dialogue will be followed by constructive reforms in the rules of origin of preference-giving countries.

1.3.2.2 Recent Work on Change of Tariff Classification and Direct Consignment

1.3.2.2.1 CHANGE OF TARIFF CLASSIFICATION. As discussed in section 1.3.1, the Nairobi Decision failed to provide a mandate and a framework for the CRO to do any further work on the LDCs' rules of origin. This was due, on one hand, to the insistence of the WTO LDC group on the road to Nairobi to have a text as binding as possible on the assumption that preference-giving countries would comply with such a text during the implementation phase of the Nairobi Decision. On the other hand, the preference-giving countries, both developed and developing, entrenched themselves under the tenets that each set of rules of origin they had were the best for the LDCs and that, ultimately, trade preferences are unilateral.

Many, including some delegations of the WTO LDC group expected that the combination of the notification obligations of the rules of origin for LDC and the annual review mechanisms to review implementation included in the Nairobi Decision were the elements for a *redde rationem* where the preference-giving countries were to declare what they did to bring their rules of origin into conformity with the Nairobi Decision. This did not happen as each preference-giving country declared itself to be in conformity with the Nairobi Decision, exploiting the evident loopholes and policy space provided by the wording of the Decision.

It took four years to recognize that, albeit some progress has been recorded in achieving better transparency through the adoption of a notification template, there has not been parallel progress in implementing the substantive part of the Nairobi Decision, more precisely the paragraphs concerning the substantial transformation and certification requirements.

Thus the WTO LDC group, with the assistance of the author and other researchers, elaborated a series of technical notes to focus the debate in the CRO on how to effectively implement the substantive aspects of the Nairobi Decision on preferential rules of origin for LDCs.

In fact the WTO LDC group started an initiative to progressively bring to the attention of the CRO the substantive aspects of rules of origin of preference-giving countries that need reform by contrasting them with the relevant paragraphs of the Nairobi Decision and identified best practices. The ultimate goal is to achieve better utilization of the DFQF and the development objectives of sustainable development goals (SDG); namely, target 17.12: "Ensuring that preferential rules of origin applicable to imports from least developed countries are transparent and simple, and contribute to facilitating market access."

In order to focus the debate, the WTO LDC group are expected to submit a series of technical notes on each of the methodologies to define substantial transformation; namely, (a) ad valorem percentage criterion, (b) CTC, and (c) specific working or processing as well as cumulation and certification procedure.

The first technical presentation on the CTC was made by the LDC group on a previous occasion, namely in 2015 during the special session of the CRO in preparation for the Nairobi Ministerial where several items emerged. The submission made by the WTO LDC group,[109] with the assistance of the author, without being exhaustive, further examined such initial considerations and listed some best practices and areas of improvement for the existing rules of origin, to bring them into line with the Nairobi Decision.

It is recalled that paragraph 1.2 of the Nairobi Decision provides as follows:

> 1.2 When applying a change of tariff classification criterion to determine substantial transformation, Preference-granting Members shall:
>
> a) As a general principle, allow for a simple change of tariff heading or change of tariff sub-heading;
> b) Eliminate all exclusions or restrictions to change of tariff classification rules, except where the Preference-granting Member deems that such exclusions or restrictions are needed, including to ensure that a substantial transformation occurs;
> c) Introduce, where appropriate, a tolerance allowance so that inputs from the same heading or sub-heading may be used.

According to this paragraph the general principle for applying a CTC is a CTH or a change of tariff subheading (CTSH).

Subparagraph (b) calls for an elimination of all exclusions or restrictions on such general principle of applying CTH or CTSH as general rules "except where the Preference-granting Member deems that such exclusions or restrictions are needed, including to ensure that a substantial transformation occurs."

In addition, paragraph 1.4 covers situations where a combination of two requirements have to comply to obtain originating status. As examined in Table 1.8, both the EU and Japan use extensively a combination of CTC with other requirements. These

[109] See WTO document G/RO/W/184, May 7, 2019.

TABLE 1.8 *Examples of EU and Japanese use of CTC rules*

EU		Japan				
EBA HS chapter description of product	EBA	Japan HS chapter description of product	Japan RoO	Comments	Technical elements	Suggested best practice RoO
Chapter 9 Coffee, tea, maté and spices	Manufacture from materials of any heading		Change of tariff heading (CTH)	While in this case the general CTC rule of CTH and CTSH are respected, there is a significant variation between the EU requirements providing for manufacture from any heading that includes the material classified in the same heading, i.e. a change of tariff subheading. In the case of Japan, the CTH requirement excludes that the process of roasting of decaffeinate the coffee is substantial transformation.	Heading 09.01 coffee is subdivided into 09.01 Coffee: 0901.11 – Not decaffeinated 0901.12 – Decaffeinated – Coffee roasted 0901.21 – Not decaffeinated 0901.22 – Decaffeinated 0901.90 – Other	Manufacture from materials of any heading or CTSH. Such rule would recognize that roasting and decaffeinating and blending coffee is a substantial transformation. The PSRO in the EU–Japan FTA agreement is: CTSH; or Blending.
Chapter 16 Preparations of meat, fish or of crustaceans, molluscs or other aquatic invertebrates	Manufacture: – from materials of any heading, except meat and edible meat offal of Chapter 2 and materials of Chapter 16 obtained from meat and edible meat offal of Chapter 2, and – in which all the materials of Chapter 3 and materials of Chapter 16 obtained from fish and crustaceans, molluscs and other aquatic invertebrates of Chapter 3 used are wholly obtained	Preparations of meat, of fish or of crustaceans, molluscs or other aquatic invertebrates		Both CTC requirements are far exceeding the general CTH and CTSH as they exclude a number of HS chapters classifying materials that are the primary components of the products of Chapter 16 i.e. for canned products like tuna and sausages the rules requires that the tuna and the meat are wholly obtained in the case of the EU. In the case of Japan, the exclusions are much more encompassing since they exclude the use not only of meat but also of live animals of Chapter 1.	The manufacture of processed foodstuff from ingredients should be considered a substantial transformation as it is normally a demanding industrial operation.	A change to headings 1601–1605 from any other chapter. (US–Singapore FTA agreement). Such rule would recognize that making food preparations from primary products is a substantial transformation.
		(1) Containing less than 30% by weight of a meat and edible meat offal of bovine animals other than internal organs and tongues (containing rice), and cuttle fish and squid (containing rice) (prepared or preserved) other than those in airtight containers	Manufactured from products other than those of Chapter 1, 2, 3, 5, 10, 11, 16, or 19			
		(2) Other	Manufactured from products other than those of Chapter 1, 2, 3, 5, or 16			

				In addition, the first rule of japan also exclude the use of other ingredients that can be used to prepare finished products of Chapter 16 such as rice, cereals, pasta products of Chapter 19 etc		
Chapter 19 Preparations of cereals, flour, starch or milk; pastrycooks' products	Manufacture from materials of any heading, except that of the product, in which: – the weight of the materials of Chapters 2, 3 and 16 used does not exceed 20% of the weight of the final product, and – the weight of the materials of headings 1006 and 1101–1108 used does not exceed 20% of the weight of the final product, and – the individual weight of sugar (1) and of the materials of Chapter 4 used does not exceed 40% of the weight of the final product, and – the total combined weight of sugar (1) and the materials of Chapter 4 used does not exceed 60% of the weight of final product	19.01 Malt extract; food preparations of flour, groats, meal, starch or malt extract, not containing cocoa or containing less than 40% by weight of cocoa calculated on a totally defatted basis, nes or included; food preparations of goods of headings 04.01–04.04, not containing cocoa or containing less than 5% by weight of cocoa calculated on a totally defatted basis, nes or included:		Both rules by the EU and Japan are going far beyond the general requirement of CTH and CTSH as they are either limiting and/or excluding the use of a number of ingredients that are the essential components of products of Chapter 19. In the case of the EU the rule requires to limit the use (a) of non-originating fish and meat and preparations (b) rice, wheat, starches and sugar. In the case of Japan, the rules are much more demanding since they are excluding altogether the use of non-originating materials classified in entire chapters of the HS as detailed in the rule for the specific headings 19.01–19.05. The practice by Japan of assigning different rules of origin within a heading on the basis of descriptions that are not matching the HS, as in the case of heading 19.01, is quite difficult to administer. In fact, it requires a double	The compliance with such rules requiring not to use portion of ingredients or not use them at all are difficult to administer requiring sophisticated accounting techniques. MSMEs in LDCs may not possess the accounting expertise required to comply with such rules.	A change to headings 1901–1905 from any other chapter. This rule would recognize that the making of pasta products and other products of Chapter 19 products from primary products of other chapters is a substantial transformation.
		(1) Malt extract	Manufactured from products other than those of Chapter 10, 11 or 19			
		(2) Food preparations, containing more than 85% by weight of flour, groats, meal, and pellets of rice, wheat, triticale, or barley, starch, or any combination thereof, excluding cake-mixes and a kind used as infant food or dietetic purpose (mostly containing starch)	Manufactured from products other than those of Chapter 4, 7, 8, 10, 11 or 19			
		(3) Other:				
		(i) Containing not less than 50% of sucrose by weight	Manufactured from products other than those of Chapter 4, 7, 8, 10, 11, 12, 17 or 19			
		(ii) Other	Manufactured from products other than those of Chapter 4, 10, 11 or 19			

(*continued*)

TABLE 1.8 (*continued*)

EU		Japan				
EBA HS chapter description of product	EBA	Japan HS chapter description of product	Japan RoO	Comments	Technical elements	Suggested best practice RoO
				exercise of (1) classifying goods to apply the correct origin requirement and (2) complying with the applicable rules of origin.		
		19.02 Pasta, whether or not cooked or stuffed (with meat or other substances) or otherwise pre-pared, such as spaghetti, macaroni, noodles, lasagne, gnocchi, ravioli, cannelloni; couscous, whether or not prepared	Manufactured from products other than those of Chapter 10, 11 or 19			
		19.03 Tapioca and substitutes therefor prepared from starch, in the form of flakes, grains, pearls, siftings or in similar forms	Manufactured from products other than those of Chapter 7, 8, 10, 11 or 19			
		19.04 Prepared foods obtained by the swelling or roasting of cereals or cereal products (for example, corn flakes); cereals (other than maize (corn)) in grain form or in the form of flakes or other worked grains (except flour, groats and meal), pre-cooked or otherwise prepared, nes or included	Manufactured from products other than those of Chapter 10, 11 or 19			

		19.05 Bread, pastry, cakes, biscuits and other bakers' wares, whether or not containing cocoa; communion wafers, empty cachets of a kind suitable for pharmaceutical use, sealing wafers, rice paper and similar products:				
		(1) Sweet biscuits, Arare, Senbei and similar rice products, biscuits, cookies and crackers, crisp savoury food products, made from a dough based on potato powder	Manufactured from products other than those of Chapter 7, 8, 10, 11 or 19			
			(2) Other			
Manufactured from products other than those of Chapter 11 (excluding those of Chapter 11 manufactured from products of Chapter 7, 8 or 10, in the originating country or territory of the products of 19.05 ((2) on this list) or 19						
Heading 20.06 Vegetables, fruit, nuts, fruit-peel and other parts of plants, preserved by sugar (drained, glacé or crystallised)	Manufacture in which the value of all the materials of Chapter 17 used does not exceed 30% of the ex-works price of the product	Vegetables, fruit, nuts, fruit-peel and other parts of plants, preserved by sugar (drained, glacé or crystallised)	Manufactured from products other than those of Chapter 7, 8, 9, 12, 17 or 20	The EU rules only place a limitation on the use of sugar of Chapter 17. The Japanese rule excludes the use of products classified in Chapters 7 and 8 and other HS chapters as described in the rule. This rule is far exceeding any requirement of substantial transformation since it requires that almost all ingredients are originating.		A change to a good of heading 20.06 from any other chapter. Such rule would be recognized as substantial transformation the process of making of such product from primary products of Chapters 7 and 8 using non-originating sugar of Chapter 17.
Heading 33.02 Essential oils and resinoids;	Manufacture from materials of any heading, except that of the product. However, materials of the same	Mixtures of odoriferous substances and mixtures (including alcoholic solutions) with a basis of one or	Manufactured from products other than those of heading 33.02, provided that the value of non-	Both rules under EU and Japan require in addition to a CTC at CTH level to meet an ad valorem percentage criterion.	Products of heading 3302 are usually obtained by mixing in deliberate	A change to a good of heading 33.02–33.07 from any other heading.

(*continued*)

TABLE 1.8 (*continued*)

EU		Japan				
EBA HS chapter description of product	EBA	Japan HS chapter description of product	Japan RoO	Comments	Technical elements	Suggested best practice RoO
perfumery, cosmetic or toilet preparations; except for:	heading as the product may be used, provided that their total value does not exceed 20% of the ex-works price of the product or Manufacture in which the value of all the materials used does not exceed 70% of the ex-works price of the product	more of these substances, of a kind used as raw materials in industry; other preparations based on odoriferous substances, of a kind used for the manufacture of beverages	originating products used does not exceed 50% of the value of the products	The Japanese rule is more restrictive since it requires a cumulative requirement and each requirement is more restrictive that under the EU rules; i.e. a specific restriction on using heading 33.02 and a lower threshold 40% of VNOM.	components and percentages of other primary materials heading 3301.	
Heading 44.16 Casks, barrels, vats, tubs and other coopers' products and parts thereof, of wood, including staves	Manufacture from materials of any heading, except that of the product or Manufacture in which the value of all the materials used does not exceed 70% of the ex-works price of the product	Casks, barrels, vats, tubs and other coopers' products and parts thereof, of wood, including staves	Manufactured from products other than those of heading 44.16 excluding staves of wood (riven staves only one principal surface of which has been sawn, or sawn staves at least one principal surface of which has been curvilinearly sawn, each of which has not been worked other than sawing)	In this case the EU rules require a CTH or ad valorem percentage requirement of 70%. The CTH requirements means that assembly of staves into barrels is not origin conferring. Thus, the only alternative is to comply with the 70% ad valorem percentage. In the case of Japan, the rule excludes all parts of barrels of HS 44.16 excluding staves of wood as further specified in the rule. In both cases the rules appear overtly stringent as making barrels from staves is a rather complex manufacturing operation.	Heading 44.16 is restricted to products of the coopers' trade. The heading also covers parts of articles of heading 4416. It means that there is no CTC possible within the heading.	Given the complexity of the rule of 44.16, the WTO LDC group will table a proposal at a later stage.

Heading 52.07 Yarn and thread of cotton	Spinning of natural fibres or extrusion of man-made fibres accompanied by spinning	Cotton yarn (other than sewing thread) put up for retail sale	Manufactured from chemical products, from products of heading 47.01–47.06, or from natural textile fibres, man-made staple fibres or textile fibre waste, neither carded nor combed	In this case the EU is not using a CTC but a specific working or processing operations requiring to carry out the spinning and the extrusion. The Japanese rules requires that the textile fibres are not carded or combed and additionally do not use wood pulp or other cellulose materials classified from heading 47.01–47.06. This latter use of CTC rule appears to be an additional requirement of extraordinary complexity.	Heading 5207 is composed of two subheadings: 5207.10: containing 85% or more by weight of cotton 5207.90: other.	Given the complexity of the chapter including products of a different nature, the WTO LDC group will table a proposal at a later stage.
Chapter 65 Footwear, gaiters and the like; parts of such articles; except for:	Manufacture from materials of any heading, except from assemblies of uppers affixed to inner soles or to other sole components of heading 6406	Manufacture from products other than those of the different tariff heading (excluding heading 64.06) of the product		The EU rules is rather liberal since they allow a CTH, only excluding the use of particular parts of shoes that are assemblies of uppers affixed to inner soles or to other sole components. This means that all other parts of shoes can be used to assemble shoes. In the case of Japan, the use of non-originating parts of shoes is not allowed as it excluded all materials classified in heading 6406.	Parts of shoes are classified under heading 64.06, which is further subdivided into five subheadings.	
Heading 72.16 Flat-rolled products, bars and rods, angles, shapes and sections of iron or non-alloy steel	Manufacture from ingots or other primary forms or semi-finished materials of heading 7206 or 7207	Angles, shapes and sections of iron or non-alloy steel	Manufactured from products other than those of heading 72.07–72.16	Under the EU rules The CTC required the manufacturing of angles shape and sections from two specific heading, namely 7206 (ingots) or 7207 (semi-finished products obtained by hot rolling		Given the complexity of the chapter including products of a different nature, the WTO LDC group will table a proposal at a later stage.

(*continued*)

TABLE 1.8 (*continued*)

EU		Japan				
EBA HS chapter description of product	EBA	Japan HS chapter description of product	Japan RoO	Comments	Technical elements	Suggested best practice RoO
				or forging ingots). In the case of Japan, the same rules exclude products of heading 7207. This means the process of forging or hot rolling has to be carried out in LDCs.		
Chapter 84, Chapter rule Nuclear reactors, boilers, machinery and mechanical appliances; parts thereof; except for:	Manufacture from materials of any heading, except that of the product or Manufacture in which the value of all the materials used does not exceed 70% of the ex-works price of the product.	Change of Tariff Heading (CTH)		The EU rules of origin are obviously more lenient than the Japanese since they allow the CTH or fulfilling ad valorem 70% of VNOM. The Japanese rules formally comply with paragraph 2.1 of the Nairobi Decision. However, given the nature of the HS there are a series of headings where a CTH rule applied across the chapter is counterintuitive and demanding. As an example, few would question that the assembly of parts of turbo jets or rocket engines into finished engines of turbo jets and rocket engines of 84.12 is a substantial transformation. However, a CTH rule does not recognize such complex processes as origin conferring.	Chapter 84 is a complex HS chapter with 87 headings and the HS has not been conceived for RoO purposes.	Given the complexity of the chapter including products of a different nature, the WTO LDC group will table a proposal at a later stage.

Chapter 85, Chapter rule Electrical machinery and equipment and parts thereof; sound recorders and reproducers, television image and sound recorders and reproducers, and parts and accessories of such articles; except for:	Manufacture from materials of any heading, except that of the product or Manufacture in which the value of all the materials used does not exceed 70% of the ex-works price of the product.	Electrical machinery and equipment and parts thereof; sound recorders and reproducers, television image and sound recorders and reproducers, and parts and accessories of such articles	Manufactured from products provided that the value of non-originating products used of the different tariff heading from that of the products does not exceed 40% of the value of the products, and the value of non-originating products used of the same tariff heading as that of the product does not exceed 5% of the value of the products	In the case of Japan, the general CTC rule of CTH and CTSH is not respected since there is an additional requirement that the material classified in another heading not to exceed 40% VNOM. The CTC rules of Japan are placing a limitation on the use of non-originating materials classified in another heading of 40% of the value of the finished product. In the context of such rule the 5% allowance of non-originating materials classified in the same heading does not liberalize the rule. The EU rules of origin are obviously more lenient than the Japanese since they allow CTH (a general tolerance rule of up to 15% of the value of the product) or to fulfill ad valorem 70% of VNOM.	Given the complexity of the chapter including products of a different nature The WTO LDC group will table a proposal at a later stage.
Heading 87.12 Bicycles	Manufacture in which the value of all the materials used does not exceed 70% of the ex-works price of the product	Bicycles	Manufactured from products provided that the value of non-originating products used of the different tariff heading from that of the products does not exceed 40% of the value of the products, and the value of non-originating products used of the same tariff heading as that of the product does not exceed 5% of the value of the products	In this case the EU is not using the CTC but an ad valorem percentage criterion of 70% VNOM. In the case of Japan the general CTC rule of CTH and CTSH is not respected since there is an additional requirement that the material classified in another heading not to exceed 40% VNOM. This means that parts of bicycles classified in heading 87.14 can be used up to 40% of VNOM in the case of Japan	Manufacture from materials of any heading, except that of the product or assembly operation of parts of heading 8714 into a complete article provided that such assembly is going beyond minimal working and processing operations.

(*continued*)

TABLE 1.8 (*continued*)

EU		Japan				
EBA HS chapter description of product	EBA	Japan HS chapter description of product	Japan RoO	Comments	Technical elements	Suggested best practice RoO
				and 70% in the case of the EU. The further provision of Japan of allowing materials classified in the same heading up to 5% of the value of the products does not significantly liberalize a restrictive rule.		

combinations take the form of, for example, not using particular materials or combining the CTC requirement with an ad valorem percentage.

> 1.4 Preference-granting Members shall, to the extent possible, avoid requirements which impose a combination of two or more criteria for the same product. If a Preference-granting Member still requires maintaining a combination of two or more criteria for the same product, that Preference-granting Member remains open to consider relaxing such requirements for that specific product upon due request by an LDC.

The CTC rules are mostly applied by the EU, Norway, Japan, and Switzerland. India and China apply a CTH rule as an alternative, in the case of China, or in conjunction with an ad valorem percentage, in the case of India. The scope of the WTO LDC group submission is limited for the time being to the CTC as applied by the EU, Norway, Japan, and Switzerland (the CTC Group).

It is recognized that following the reform of the EU rules of origin in 2011 there have been significant positive changes in the EU rules of origin that have been also adopted by Switzerland and Norway. It is also recognized that Japan has liberalized the rules of origin for Chapter 61 (garments, knitted or crocheted). As outlined in the submission of the WTO LDC group in 2014,[110] in a number of cases the EU rules of origin have provided best practices that should be adopted by the remaining preference-giving countries. Such occurrences have been outlined in the abovementioned submission. Nevertheless, it should be noted that also in the case of the EU, Norway, and Switzerland there are PSRO especially in the agro-processing sector where further improvements may be necessary. As suggested in the submission, several steps could also be undertaken by Japan to engage in an overall reform of rules of origin for LDCs.

The issues to be considered to bring the current use of the CTC criterion by the preference-giving countries that are using it into conformity with paragraphs 1.2 and 1.4 of the Nairobi Decision are threefold:

(a) The exceptions to the general rules of CTH and CTSH are the norm rather than the exception for the CTC Group. For instance, the rules of origin of Japan provide for CTH as a general rule; however, there are twenty-six pages of exceptions[111] to such general rule covering the majority of the HS chapters and, at times, entire HS chapters.
(b) The exceptions to the general rules are by far much stricter than the general rules going beyond any conceivable requirement for substantial transformation, and as such they are not justifiable.
(c) In some cases, the same preference-giving countries have adopted more lenient rules of origin for the same products under free-trade

[110] See WTO document G/RO/W/148 of October 28, 2014, "Challenges faced by LDCs in complying with preferential rules of origin under unilateral schemes."
[111] See the website of the Japanese Ministry of Foreign Affairs, www.mofa.go.jp/files/000077857.pdf.

agreements that they have negotiated with other partners and/or there are existing best practices under other free-trade agreements on how substantial transformation could be achieved adopting less-stringent requirements.

Table 1.8 contains examples of such rules of origin that have been summarized in a comparative table of products specific exception to the general CTH and CTSH of EU, Switzerland, Norway, and Japan. This table is in no way exhaustive and complete and has been assembled to start a constructive debate.

Such comparison highlights a number of examples of reforms that the preference-giving countries are invited to introduce in order to bring such rules of origin into conformity with the relevant paragraph of the Nairobi Decision:

(a) CTC rules of origin with restrictions and exceptions (in the EU, Switzerland, Norway, and Japan): why are they needed and how they can be justified in light of more liberal rules used in free-trade agreements?
(b) CTC rules of origin in combination with value requirements (e.g. CTH and 40 percent value of non-originating material (VNOM)): these rules should be avoided unless they are needed. Can members who use such rules explain why they are needed or justified?
(c) Bring examples of best practices and bring examples of difficulties in meeting combination rules or rules with restrictions.

1.3.2.2.2 DIRECT CONSIGNMENT RULE. The issue of direct consignment as an obstacle to utilization of trade preferences was raised by the LDCs in a number of presentations in July 2015 and subsequently reiterated during the negotiations leading to the Nairobi Decision. The technical nature of the issue at stake, mainly familiar to customs officials rather than to trade diplomats in Geneva, proved impossible to surmount on the way to the Nairobi Decision. The LDCs faced strong opposition from developed (mainly Canada) and developing countries (mainly China and India) in coming to an understanding of the difficulties that direct consignments rules may imply for LDCs.

It took another four years to table again the subject in the CRO after a presentation of the LDCs[112] with the assistance of the author quoting the findings of a major assessment of the EU–Korea FTA agreement where direct consignment rules were quoted as a major obstacle to better utilization on the part of EU exporters. That presentation was followed by the findings of the low utilization rates for Switzerland where once again direct consignment rules were listed as possible reason for low utilization rates.

The document presented by the WTO Secretariat to the Committee on Rules of Origin of May 2019 titled "Utilization rates under preferential trade arrangements for

[112] See presentation of Tanzania at the CRO of October 2018.

Least Developed countries under the LDC duty scheme"[113] (the WTO document) identified a series of issues related to paragraph 3.1 of the Nairobi Decision on documentary evidence.

The main issues discussed in the WTO document relates to the low utilization of trade preferences for agricultural products. More specifically, the WTO document identified a number of country–product pairs where low utilization of trade preferences was recorded and direct consignment requirements were indicated as possible reasons for such low utilization. In fact, the products identified – mainly fruits, vegetables, and mineral products – were subject to a wholly obtained origin criterion[114] that is usually easily complied with given the nature of the products. The WTO document indicated that documentary evidence related to direct consignment requirement could explain the reason for such low utilization.

In particular the WTO document identified a number of cases "show[ing] that direct transportation and certification requirements also have a direct impact on utilization."

In the same vein another WTO document, titled "Impact of the direct consignment requirement on preference utilization by least developed countries,"[115] further corroborates the analysis made in the previous WTO document: "The calculation of utilization rates in this note offers a clear indication that direct consignment requirements have a significant influence on the ability of LDCs to utilize trade preferences, particular those of landlocked LDCs."[116]

The fact that documentary evidence related to direct consignment requirements could be an insurmountable obstacle to utilization of trade preferences by LDCs, especially landlocked and island LDCs, has been initially identified by UNCTAD[117] and repeatedly raised by the WTO LDC group a number of times.

Such concern was in fact reflected in paragraph 1.8 of the Bali Decision of 2003, upon insistence of the WTO LDC group:

> 1.8. The documentary requirements regarding compliance with the rules of origin should be simple and transparent. For instance, requirement to provide proof of non-manipulation or any other prescribed form for a certification of origin for products shipped from LDCs across other Members may be avoided. With regard to certification of rules of origin, whenever possible, self-certification may be recognized. Mutual customs cooperation and monitoring could complement compliance and risk-management measures.

Paragraph 3.1 of the Nairobi Decision reiterates such concern providing the following:

[113] See WTO document G/RO/W185, May 2019.
[114] See paras. 6.5 and 6.6 of WTO document G/RO/W185, May 2019.
[115] See WTO document G/RO/W187, October 1, 2019.
[116] See para. 6.1 of WTO document G/RO/W187, October 1, 2019.
[117] See UNCTAD training materials prepared for the CRO LDCs dedicated session of July 2015 and UNCTAD Handbook on Duty-Free and Quota-Free Market Access and Rules of Origin for Least Developed Countries, UNCTAD/ALDC/2018/5 (Part I), and UNCTAD/ALDC/2018/5 (Part II).

With a view to reducing the administrative burden related to documentary and procedural requirements related to origin, Preference-granting Members shall:

a. As a general principle, refrain from requiring a certificate of non-manipulation for products originating in an LDC but shipped across other countries unless there are concerns regarding transhipment, manipulation, or fraudulent documentation;
b. Consider other measures to further streamline customs procedures, such as minimizing documentation requirements for small consignments or allowing for self-certification.

In this technically complex area, it is important to clarify the issue at stake and what action is required by preference-giving countries to simplify the requirements of documentary evidence related to direct consignment and bring them into conformity with the Nairobi and Bali Decisions.

Direct consignment requirements are provisions inserted in almost all PTAs, either of unilateral or reciprocal nature, to ensure that the originating goods exported from country A are the same as those imported in country B and that they have not been manipulated or further processed during transportation through third countries. Invariably every PTA recognizes that due to geographical or logistical reasons the originating goods from country A may have to transit through a third country in order to be delivered to country B.

However, where the practices of the majority of PTAs and especially the DFQF provisions of preference-giving countries differ widely is the documentary evidence to be provided at the time of importation in country B in case of passage through the territory of a third country.

The majority of administrations require documentary evidence on nonmanipulation during the transit in the territory of the third country and that the goods have not entered the customs territory of the third country. Such evidence in the majority of preference-giving countries is (1) a through bill of lading covering the transit through the third country, and (2) a certificate of nonmanipulation provided by the customs authority of the country of transit stating that the goods have remained under customs control, etc.

The issue is that such documentary evidence is not easy to obtain and/or it may entail a significant cost. As contained in Table 1.9 for QUAD countries and Table 1.10 for other preference-giving countries, the documentary evidence related to direct consignment is often a through bill of lading covering the passage through the third country or a statement by the customs of the third country of transit that the goods have not been manipulated during transit besides unloading, loading, and/or other operations necessary to preserve them in good condition. None of these documents are easy to obtain. Indeed, a through bill of lading may be impossible to produce for the following reasons:

(1) Geographical or commercial reasons: in the case of some landlocked or island countries there may simply be no shipping agent capable of issuing a through bill of lading and/or it may be too expensive or not convenient, and

TABLE 1.9 *QUAD countries' requirements in terms of documentary evidence of direct consignment*[i]

Country/group of countries	Administrative requirements	Other requirements	Compliance with para. 3.1 of Nairobi Decision
EU (EBA)[ii]	Nonalteration principle: documentary evidence of direct consignment is not required unless EU customs have doubts.	In case of doubt EC customs authorities may request evidence and importer may provide evidence of nonalteration by "any means."	**YES,** most liberal since reform of EBA RoO in 2011
United States (GSP)[iii]	(1) They remained under customs control in the country of transit. (2) The US port director is satisfied that the importation results from the original commercial transaction. And (3) They were not subjected to operations other than loading and unloading. (Source: 19 CFR 10.175)	Shipping and other documents must show US as final destination or they have to fulfill a series of administrative requirement as described in the adjacent column on the right.	**NO**, first there is the requirement that the US is shown as final destination and for goods not showing US as country of final destination a number of requirements apply. "Center director is satisfied that the importation results from the original commercial transaction between the importer and the producer or the latter's sales agent."
United States (AGOA)[iv]	Same as above.	Same as above.	**NO**, evidence is required
Japan[v]	(1) A through bill of lading. (2) A certification by the customs authorities or other government authorities of the transit countries. Or (3) Any other substantiating document deemed sufficient.[vi]		**NO**, evidence is required

(*continued*)

TABLE 1.9 (*continued*)

Country/group of countries	Administrative requirements	Other requirements	Compliance with para. 3.1 of Nairobi Decision
Canada[vii]	• The goods must be shipped directly on a TBL to a consignee in Canada from the beneficiary or LDC in which the goods were certified. • Evidence in the form of a TBL (or a copy) showing that the goods have been shipped directly to a consignee in Canada must be presented to the CBSA upon request.	Special waiver exists for goods coming from Mexico Haiti and Hong Kong China where the documentary evidence is substantially relaxed.	**NO**, evidence is required

[i] Table 1.9 has been drafted on the basis of existing notifications made to WTO, expanding the first version prepared with the assistance of the author in 2015 and updated in 2015 and later contained in the official WTO LDC submission.

[ii] See G/RO/LDC/N/EU/1.

[iii] See G/RO/LDC/N/USA/1.

[iv] G/RO/LDC/N/USA/3.

[v] G/RO/LDC/N/JPN/1.

[vi] The provision related to documentary requirement for proof of direct shipment is found in paras. 3 and 5 of Article 31, Cabinet Order for Enforcement of the Temporary Tariff Measures Law (this extract is a provisional translation):

Article 31, paragraph 3

Any person who intends to have paragraph 1 or 3 of Article 8-2 of the Temporary Tariff Measures Law applied to those products enumerated in subparagraph (2) or (3) of paragraph 1 shall, at the time of import declaration of such products, submit one of the following documents, as a document proving that such products fall under either of such subparagraphs. However, this shall not apply to those products for which the total amount of customs value is not more than 200,000 yen.

(1) A copy of a through bill of lading for transportation of such products from a beneficiary of references as their origin, to the port of importation in Japan.

(2) A certificate issued by Customs or any other competent government authorities in a country of non-origin where the products were transshipped, temporarily stored or displayed at exhibitions, etc. as provided for in subparagraph (2) or (3) of paragraph 1.

(3) Any documents which are considered by the Director General of Customs to be appropriate, excluding those enumerated in the preceding two subparagraphs.

Article 31, paragraph 5

The following items shall be described in the certificate provided for in subparagraph (2) of paragraph 3.

(1) Marks, numbers, descriptions and quantities of the products under consideration.
(2) Dates on which such products were loaded on board, and/or unloaded from, a vessel, aircraft or vehicle in the country of non-origin and names, registered marks or kinds of such vessels, aircraft or vehicles.
(3) Details of the handling of such products in the country of non-origin where the loading or unloading as provided for in the preceding subparagraph took place.

[vii] G/RO/LDC/N/CAN 1 and G/RO/LDC/N/CAN 1.

TABLE 1.10 *Non-QUAD countries' requirements in terms of documentary evidence of direct consignment*[i]

Country/ group of countries	Administrative requirements	Compliance/comments
Norway[ii]	• The WTO notification appears not updated. The latest customs legislation available in Internet provides for nonalteration rule.	**YES**, according to latest legislation
Switzerland[iii]	• According to notification Swiss customs may require certificate of nonmanipulation.[iv]	**NO**, to be checked at CRO
New Zealand[v]	• Not required at point of import. Any normal transaction/commercial documents on request.	**YES**
Australia[vi]	• There are no direct shipment requirements for LDC preferences.	**YES**
Eurasian CU[vii]	• Goods must be directly purchased by the importer. • Goods must be delivered directly. • Not clear if documentary evidence of direct delivery is required.[viii]	**NO**, direct purchase is a unique requirement
China[ix]	• As regards imported goods transiting a third country (region), relevant documents that, according to the customs of China, are necessary to certify that the goods remain under customs control.[x]	**NO**, evidence is required
India[xi]	• Requirement of direct shipment.	**NO**, evidence is required

(*continued*)

TABLE 1.10 (*continued*)

Country/ group of countries	Administrative requirements	Compliance/comments
	• The following shall be produced to the customs authority of India at the time of importation: (a) a through bill of lading issued in the exporting country (b) a certificate of origin issued by the issuing authority of the exporting beneficiary country (c) a copy of the original commercial invoice in respect of the product and (d) supporting documents in evidence that other requirements of Rule 7 (direct shipment) have been complied with.	
South Korea[xii]	With respect to the goods which are not imported directly from the country or origin, but via a third country, if the relevant customs office, the institution authorized to issue certificates, or the chamber of commerce and industry of the third country confirms the country of origin of the relevant goods or issues a certificate to that effect, the country of origin and a certificate to that effect shall be confirmed based on the certificate of origin issued by the country of origin for the relevant goods.	**NO,** evidence is required
TPKM[xiii]	Excerpt from notified text: "The exporters from LDCs could present the self-proof documentary of direct shipment to Customs."	Unclear
Thailand[xiv]	(a) An air waybill, a through air waybill, a bill of lading, a through bill of lading, or a multimodal or combined transportation document, that certifies the transport from the exporting DFQF beneficiary country to the Kingdom of Thailand, as the case may be. In the case of not having a through air waybill or through bill of landing, supporting documents issued by the customs authority or other competent entity of other DFQF beneficiary country(s) or non-beneficiary country(s) that authorized this	**NO,** evidence is required

TABLE 1.10 (*continued*)

Country/ group of countries	Administrative requirements	Compliance/comments
	operation, according to its domestic legislation, are required. (b) An original Certificate of Origin (Form DFQF) issued by the issuing authorities of exporting DFQF beneficiary country. And (c) A commercial invoice in respect of the goods.	

[i] Table 1.10 have been drafted on the basis of existing notifications made to WTO, expanding the first version prepared by UNCTAD in 2015.
[ii] G/RO/LDC/N/NOR 1.
[iii] G/RO/LDC/N/CHE 1.
[iv] See Article 19, para. 5 of Ordinance SR 946.39 (available in FR, IT, DE, unofficial translation):

1. If preferential taxation is claimed for an originating product, it must be the same product as that exported from the beneficiary country. Before being taxed at the preferential rate, it must not be modified or transformed in any way. Working or processing is permitted provided that it is necessary for the preservation of the product as it is.
2. The affixing of trademarks, labels or seals or the addition of documentation is permitted if this is necessary for the fulfillment of national regulations in Switzerland.
3. Paragraph 1 shall apply, mutatis mutandis, to originating products imported into a beneficiary country for the purpose of cumulation in accordance with Articles 26 and 33.
4. The storage of products and the distribution of consignments in a country of transit are permitted provided the goods remain under customs control.
5. In order to check that the conditions laid down in paragraphs 1–4 are met, the Swiss customs authorities may require the submission of freight documents, factual or concrete proof or a certificate from the customs authorities of the country of transit.

[v] G/RO/LDC/N/NZL 1.
[vi] G/RO/LDC/N/AUS 1 and G/RO/LDC/N/AUS/rev.1.
[vii] G/RO/LDC/N/RUS 1 and Decision No. 60 of the Council of the Eurasian Economic Commission dated June 14, 2018.
[viii] See for further details Decision No. 60 of the Council of the Eurasian Economic Commission dated June 14, 2018.
[ix] G/RO/LDC/N/CHN 1.
[x] Excerpt from notification made to WTO:

3. Transport documents covered the whole route from the beneficiary country to ports of entry in China;
4. For goods transported into the territory of China through other countries or regions, importers shall submit certified documents issued by customs of that country or region or other documents accepted by China customs. Those certified documents mentioned above are not compulsory when customs has obtained electronic data information of certified documents via related electronic data system for transshipment. If the transport documents are determined by China

customs to be sufficient to fulfil the requirement of the Direct Consignment, importers are not required to submit certified documents. Supporting documents required when the transport of consignment involves transit:

- Customs Announcement No. 57, promulgated in 2015; and
- Customs Announcement No. 52, promulgated in 2016.

[xi] G/RO/LDC/N/IND 1.
[xii] G/RO/LDC/N/KOR 1.
[xiii] G/RO/LDC/N/TPKM 1.
[xiv] G/RO/LDC/N/THAI 1.

(2) the goods are sold by the LDC exporter or producer to an intermediary or to a hub and from that intermediary or hub are subsequently shipped to the country of final destination.

In these cases, it is simply impossible to comply with the kind of documentary evidence of direct consignment demanded by some preference-giving countries such as a through bill of lading or a certificate of nonmanipulation. Such requirements unduly penalize goods that originate in LDCs, especially small and medium-size enterprises (SMEs) that are often selling to traders rather than directly to the client located in the preference-giving country. Landlocked and island countries may be particularly disfavored due to geographical location or for being far from commercial routes.

The Canadian requirements for direct consignment and the Eurasian custom union for direct purchase, on the one hand, and the EU GSP corresponding provisions, on the other hand, are at the opposing poles of the existing practices in this area.

The Canadian General Preferential Tariff (GPT) provisions for the documentary evidence of direct consignment contains unusually strict and detailed requirements as follows:[118]

Direct Shipment Requirements

The goods must be shipped directly on a through bill of lading (TBL) to a consignee in Canada from the LDC in which the goods were certified. Evidence in the form of a TBL (or a copy) showing that the goods have been shipped directly to a consignee in Canada must be presented to the CBSA upon request.

The TBL is a single document that is issued prior to the goods beginning their journey when the carrier assumes care, custody, and control of the goods, and it is used to guarantee the direct shipment of goods from the country of origin to a consignee in Canada. It generally contains the following information:

(a) Identity of the exporter in the country of origin;
(b) Identity of the consignee in Canada;

[118] Available from www.cbsa-asfc.gc.ca/trade-commerce/tariff-tarif/ldct-tpmd-eng.html?wbdisable=true.

(c) Identity of the carrier or agent who assumes liability for the performance of the contract;
(d) Contracted routing of the goods identifying all points of transhipment;
(e) Full description of the goods and the marks and numbers of the package;
(f) Place and date of issue.

Note: A TBL that does not include all points of transhipment may be accepted, if these are set out in related shipping documents presented with the TBL.

On a case-by-case basis, an amended TBL may be accepted as proof of direct shipment where documentation errors have occurred, and the amended TBL corrects an error in the original document.

In such cases, the carrier must provide proof that the amended TBL reflects the actual movement of the goods as contracted when the goods began their journey. Documentation presented must clearly indicate the actual movement of the goods.

Air cargo is usually transhipped in the air carrier's home country even if no transhipment is shown on the house air waybill. Therefore, where goods are transported via airfreight, the house air waybill is acceptable as a TBL.

Under the LDCT treatment, goods may be transhipped through an intermediate country, provided that:

(a) They remain under customs transit control in the intermediate country;
(b) They do not undergo any operation in the intermediate country, other than unloading, reloading or
(c) Splitting up of loads or any other operation required to keep the goods in good condition;
(d) They do not enter into trade or consumption in the intermediate country;
(e) They do not remain in temporary storage in the intermediate country for a period exceeding six months.

A consignee in Canada must be identified in field No. 2 to ensure that the exporter in the beneficiary country certified the origin of the goods according to Canadian rules of origin. The consignee is the person or company, whether it is the importer, agent or other party in Canada, to which goods are shipped under a through bill of lading (TBL) and is so named in the bill. The only exception to this condition may be considered when 100 per cent of the value of the goods originates in the beneficiary country in question, in which case no consignee is required.

The combination of such requirements is simply overwhelming in today's business transactions and does not correspond to commercial realities. The requirement that a consignee in Canada should be identified in Box 2 of the certificate of origin practically nullifies any possibility for trade through intermediaries or third-country invoicing.

Canada has granted special waivers from such stringent consignment requirements to Mexico, Haiti, and China to take into account their special situations but not to LDCs, although it was so requested during the negotiations leading to the Nairobi Decision as stated in paragraph 82 of Memorandum D11–4-4, Ottawa, October 16, 2017:

Some exceptions exist where goods may be entitled to alternative shipping requirements. For more information, please refer to Memorandum D11–4-9, Goods Originating in Mexico, Deemed to be Directly Shipped to Canada for the Purposes of the General Preferential Tariff (GPT), Memorandum D11–4-10. Instructions Pertaining to the China Direct Shipment Condition Exemption Order, or Memorandum D11–4-28, Haiti Goods Deemed to be Directly Shipped to Canada for the Purposes of the General Preferential Tariff (GPT) and the Least-Developed Country Tariff (LDCT).

In the case of US GSP, the provisions are as follows:

§ 10.175 Imported Directly Defined

Eligible articles shall be imported directly from a beneficiary developing country to qualify for treatment under the Generalized System of Preferences. For purposes of §§ 10.171 through 10.178 the words "imported directly" mean:

(a) Direct shipment from the beneficiary country to the United States without passing through the territory of any other country; or
(b) If the shipment is from a beneficiary developing country to the U.S. through the territory of any other country, the merchandise in the shipment does not enter into the commerce of any other country while en route to the U.S., and the invoice, bills of lading, and other shipping documents show the U.S. as the final destination; or
(c) If shipped from the beneficiary developing country to the United States through a free trade zone in a beneficiary developing country, the merchandise shall not enter into the commerce of the country maintaining the free trade zone, and
    1. The eligible articles must not undergo any operation other than:
        (i) Sorting, grading, or testing,
        (ii) Packing, unpacking, changes of packing, decanting or repacking into other containers,
        (iii) Affixing marks, labels, or other like distinguishing signs on articles or their packing, if incidental to operations allowed under this section, or
        (iv) Operations necessary to ensure the preservation of merchandise in its condition as introduced into the free trade zone.
    2. Merchandise may be purchased and resold, other than at retail, for export within the free trade zone.
    3. For the purposes of this section, a free trade zone is a predetermined area or region declared and secured by or under governmental authority, where certain operations may be performed with respect to articles, without such articles having entered into the commerce of the country maintaining the free trade zone; or
(d) If the shipment is from any beneficiary developing country to the U.S through the territory of any other country and the invoices and other documents do not show the U.S as the final destination, the articles in the shipment upon arrival in the U.S. are imported directly only if they:

1. Remained under the control of the customs authority of the intermediate country;
2. Did not enter into the commerce of the intermediate country except for the purpose of sale other than at retail, and the Center director is satisfied that the importation results from the original commercial transaction between the importer and the producer or the latter's sales agent; and Were not subjected to operations other than loading and unloading, and other activities necessary to preserve the articles in good condition; or. . .

In the case of Norway, the legislation provides in the Regulations to the Act on Customs Duties and Movement of Goods (Customs Regulations), January 2019, as follows:

Section 8-4-38 Direct Transport

(1) The products that are declared for importation to Norway, shall be the same as those that are exported from the GSP country where they are regarded as originating from. They must not have been changed, converted in any way or undergone treatments other than treatments that have the purpose of keeping them in good condition before they are declared. Storage of products or consignments and splitting of consignments may occur if this takes place under the responsibility of the exporter or a subsequent holder of the goods and the products remain under the customs authorities' supervision in the transit country(ies).

(2) Sub-section (1) is deemed to be met, unless the customs authorities have reason to believe that the opposite is the case. In that respect, the customs authorities may request that the declarant or customs debtor proves compliance. Proof can be provided with the assistance of any means, including contractual transport documents such as, for example, bill of lading or factual or specific evidence based on labelling or numbering of packages or any form of evidence associated with the actual goods.

(3) Sub-sections (1) and (2) apply correspondingly for cumulation pursuant to Section 8-4-35.

Tables 1.9 and 1.10 report the finding of an analysis carried out on the legal texts of preference-giving countries on the basis of the legislation of preference-giving countries.

The WTO LDC group observed the positive evolution of EU requirements in terms of documentary evidence related to direct shipment. The standard formulation of the documentary evidence of direct consignment in the EU free-trade agreements and previous GSP regulations has traditionally been as follows:

(1) The preferential treatment provided for under the Agreement applies only to products, satisfying the requirements of this Protocol, which are transported directly between the Community and (FTA partner country) or through the territories of the other countries referred to in Articles 3 and 4 with which cumulation is applicable.

However, products constituting one single consignment may be transported through other territories with, should the occasion arise, trans-shipment or

temporary warehousing in such territories, provided that they remain under the surveillance of the customs authorities in the country of transit or warehousing and do not undergo operations other than unloading, reloading or any operation designed to preserve them in good condition.

(2) Evidence that the conditions set out in paragraph 1 have been fulfilled shall be supplied to the customs authorities of the importing country by the production of:

(a) a single transport document covering the passage from the exporting country through the country of transit; or

(b) a certificate issued by the customs authorities of the country of transit:

(i) giving an exact description of the products;

(ii) stating the dates of unloading and reloading of the products and, where applicable, the names of the ships, or the other means of transport used; and

(iii) certifying the conditions under which the products remained in the transit country; or

(c) failing these, any substantiating documents.[119]

As discussed in Chapter 7, and contained in EU *User's Handbook*[120] the proof required for documentary evidence under such standard formulation could take any of the three forms outlined in paragraph (2):

> In the absence of a single transport document (e.g. a through bill of lading) the customs authorities of the countries through which the goods transit must provide documentary proof that the consignment was at all times under their surveillance when on their territory. Such proof must contain the details outlined in paragraph (2) above. In simple terms, such documentary proof must detail the history of the journey of the consignment through their territory and the conditions under which the surveillance has been conducted. This documentary proof is known as a certificate of non-manipulation. In the absence of either of the foregoing proofs any other substantiating documents can be presented in support of a claim to preference. However, it is difficult to envisage any other documents (e.g. commercial documents) that would adequately demonstrate that all the conditions of paragraph 1 of the Article were satisfied.[121]

Most recently, the EU introduced the concept of nonalteration with significant trade-facilitating provisions. According to the nonalteration formulation introduced

[119] "A User's Handbook to the Rules of Preferential Origin used in trade between the European Community, other European Countries and the countries participating to the Euro-Mediterranean Partnership," at https://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/customs/customs_duties/rules_origin/preferential/handbook_en.pdf.

[120] Ibid.

[121] Ibid. 55.

in the EU GSP and progressively in many EU free-trade agreements such as that of EU–Japan, reproduced below, only in case of doubt will the EU customs authorities request the declarant to provide evidence of compliance.[122] Without reasonable doubts, it will be assumed that direct consignment requirements are met. Systematic evidence of direct consignment is no longer required.

It is important to emphasize that, even in the case where documentary evidence is requested the proof of direct consignment may be given "by any means." The leniency of such a provision contrasts with the usual provisions of many preference-giving countries in Tables 1.9 and 1.10 where often the proof of direct consignment may be given only by a through bill of lading or documentary evidence in the form of a certificate or statement of nonmanipulation provided by the customs authorities of the country of transit.

A guide from the EU further specifies the difference between the old legislation on evidence of documentary evidence and the new nonalteration principle:

> An important difference between the previous direct transportation requirement and non manipulation clause (Non alteration principle) lies in documentary evidence to be provided. Until December 31, 2010, with direct transport in all cases where the goods were transported via another country, except where the country of transit was one of the countries of the same regional group, the EU importer was required to present documentary evidence that the goods did not undergo any operations there (in the country of transit), other than unloading, reloading or any operation designed to keep them in their condition. The types of the referred documentary evidence were strictly defined in the law. The new non-manipulation (Non alteration principle) clause shall be considered as satisfied a priori unless the customs authorities have reasons to believe the contrary; in such cases, the customs authorities may request the declarant to provide evidence of compliance, which may be given by any means.[123]

The WTO LDC group argued at the CRO meeting of October 2019 that the nonalteration principle provision introduced by the EU or similar arrangements, such as those adopted by Australia and New Zealand, may constitute a best practice that should be progressively adopted by other preference-giving countries. The WTO LDC group called the other preference-giving countries to start considering the move to a similar approach, abandoning requirements for through bills of lading and certificates of nonmanipulation that do not adhere to business realities and trade facilitation practices.

[122] See the box feature below.

[123] "The European Union's Rules of Origin for the Generalised System of Preferences: A Guide for Users," May 2016, at https://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/customs/customs_duties/rules_origin/preferential/guide-contents_annex_1_en.pdf.

NON-ALTERATION PROVISION IN EU–JAPAN FTA AGREEMENT

Article 3.10 Non-alteration

1. An originating product declared for home use in the importing Party shall not have, after exportation and prior to being declared for home use, been altered, transformed in any way or subjected to operations other than to preserve them in good condition or than adding or affixing marks, labels, seals or any other documentation to ensure compliance with specific domestic requirements of the importing Party.
2. Storage or exhibition of a product may take place in a third country provided that it remains under customs supervision in that third country.
3. Without prejudice to Section B, the splitting of consignments may take place in a third country if it is carried out by the exporter or under its responsibility and provided that they remain under customs supervision in that third country.
4. In case of doubt as to whether the requirements provided for in paragraphs 1 to 3 are complied with, the customs authority of the importing Party may request the importer to provide evidence of compliance, which may be given by any means, including contractual transport documents such as bills of lading or factual or concrete evidence based on marking or numbering of packages or any evidence related to the product itself.

1.4 THE INTERNATIONAL CHAMBER OF COMMERCE AND RULES OF ORIGIN

The International Chamber of Commerce (ICC) has entered the scene of rules of origin mainly from the perspective of issuance of the nonpreferential certificate of origin (COs).

In fact, requests for COs are invariably part of each international trade transaction, as recently confirmed by a survey,[124] and are often cited as the most irritating factor of rules of origin.[125]

This survey revealed a 100 percent awareness by respondent companies of nonpreferential rules of origin, with some 55 percent of firms perceiving nonpreferential rules to be relevant to their daily operations. Reasons for this included such rules of origin being demanded by clients, by importing country customs authorities and/or financial service providers (e.g. for letters of credit). According to the WCO and the International Trade Center, COs appear to be causing some extra costs in doing

[124] M. Anliker, "Non-preferential rules of origin: High level assessment," paper prepared for the Global Governance Program at the European University Institute (EUI), 2016.

[125] See International Trade Center presentation made at UNCTAD on September 28, 2015 (at http://unctad.org/meetings/en/Presentation/DITC2015_AHEM_Mimouni_en.pdf).

business with certain countries. The average of the issuing fees charged by the Chamber of Commerce was over 30 USD according to a WCO publication.[126]

Chambers of commerce usually deliver COs that are related to nonpreferential rules of origin since most trading partners delegate the power of issuing COs to certifying authorities, these being government authorities, usually customs or trade ministries.[127] There are, however, exceptions to this general practice, such as Japan, which accepts, under certain preferential arrangements such as GSP, COs issued by chambers of commerce.

The ICC has been conspicuously active in setting up a series of business facilitation initiatives such as issuance of E-certificates of origin. Accreditation is mainly available via their website.[128]

[126] www.wcoomd.org/-/media/wco/public/global/pdf/topics/key-issues/revenue-package/comparative-study-on-certification-of-origin.pdf?la=en.

[127] See Chapters 3 and 7 of this book for further details on issuance of certificate of origin under certain GSP and DFQF schemes.

[128] https://iccwbo.org/resources-for-business/certificates-of-origin/.

2

The WTO Agreement on Rules of Origin

The Harmonization Work Program of Nonpreferential Rules of Origin

2.1 INTRODUCTION

As mentioned in this chapter the Harmonization Work Program (HWP) of the nonpreferential rules of origin established pursuant to the World Trade Organization (WTO) Agreement on Rules of Origin (ARO) should have been completed by July 1998. At the time of writing there is no hope of concluding negotiations in the form originally envisaged by the drafters of the ARO. In this chapter a detailed overview of the HWP is provided, making ample use of available materials used during the negotiations. The reason for such analysis stems from the consideration that the value of the technical work of the HWP remains valid even if it remains unadopted. As examined in this book, much of the technical innovation in drafting rules of origin that emerged during the HWP later found its way into the rules of origin protocols in free-trade areas (FTAs). The HWP was the first multilateral effort to achieve agreement on rules of origin, extending over more than a decade.

The preliminary results of the HWP covered three volumes, encompassing more than 2,000 pages and thousands of product-specific rules of origin (PSRO). A cleaned and updated version of the text running to 314 pages is now available.[1]

These figures call for some initial comments. At the technical level, the results of the HWP may represent the pinnacle of rules of origin, even if they are now more than a decade old. The amount of energy and human and financial resources spent

[1] The consolidated text is available as WTO document G/RO/W/Rev.6. These draft rules have been "transposed" to reflect more recent versions of the HS nomenclature (2002, 2007, and 2012). The transposed rules are contained in document JOB/RO/5/Rev.1 and JOB/RO/5/Rev.1/Corr.1. According to WTO secretariat (see G/RO/W/171, September 2017), WTO members validated the accuracy of these (draft) transposed rules in 2016 and have not considered them again in 2017. The Secretariat has not received additional comments or rectifications to these rules. With the 2017 version of the HS nomenclature, a new transposition exercise will have to be considered.

on the HWP is almost unprecedented, although it recalls the more than ten years of negotiations leading to the adoption of the Harmonized System (HS).

During the negotiation process the high technical level in drafting the HWP gave way, in some cases, to compromises in trade policy considerations. The most notable example was the attempt to dilute the obligation contained in Article 1, paragraphs 2 and 3(a) of the ARO to use the results of the HWP equally for all purposes. This was due to the US stance that wished not to use the results of the HWP to determine origin in the context of anti-dumping (AD) proceedings. Another example of such compromises was the open option for WTO members to use for Chapters 84–90 either a change of tariff classification (CTC), mainly supported by the United States, or an ad valorem percentage, supported by the European Union (EU). Notwithstanding such departures due to trade policy considerations the technical nature of the results of the HWP are notable.

Another important point to note is the liberal character of the PSRO that resulted from the HWP. As further discussed in section 2.11, the results of the HWP in terms of drafting techniques and stringency of PSRO anticipated by more than a decade those PRSOs currently contained in the most modern free-trade agreements. Yet most recently the more advanced free-trade agreements have made further progress even with respect to the HWP. Most importantly the conventional wisdom that nonpreferential rules of origin obey different rationales and are linked to trade policy instruments that are different from preferential rules of origin has started to become less rigid in those sectors where business realities made progress in liberalizing trade rules.[2] This holds true particularly where business has taken the initiative beyond governments to start pushing for a convergence of rules of origin.[3] Even bearing that difference in mind, the results of the HWP at a product-specific level were extremely liberal and modern, largely anticipating the future drafting of PSRO in free-trade agreements.

The high participation of industries in the work of the HWP since the early stages may have assisted the negotiators to better evaluate the positive implications of adopting liberal rules of origin. These overall considerations and their implication on other WTO agreements have eventually prevailed on the narrow interests that initially led to restrictive rules of origin in free-trade agreements. Over time it seems that the progressive involvement of business in free-trade agreement negotiation has had a similar effect for rules of origin in free-trade agreements. Yet business and research – as further discussed in Chapter 4 – has not been successful in informing governments about the need to come to a multilateral agreement on rules of origin.

[2] See B. Hoekman and S. Inama, "Harmonization of rules of origin: An agenda for plurilateral cooperation," *East Asian Economic Review*, vol. 22, no. 1 (2018), 3–28.

[3] For instance, during the TTIP negotiations the EU and US Federation of Chemical Industries made a joint proposal on TTIP rules of origin.

This chapter deals with the ARO and the built-in agenda of establishing an HWP of nonpreferential rules of origin, the subsequent work related to nonpreferential rules of origin in the Committee on Rules of Origin (CRO), and the way forward in the absence of a multilateral discipline on nonpreferential rules of origin.

2.2 THE AGREEMENT ON RULES OF ORIGIN

The absence of a clear and binding multilateral discipline in the field of rules of origin has been one of the reasons for opening the way to the utilization of rules of origin as a trade policy instrument. The growing concern over trade policy implications of rules of origin ultimately generated efforts that matured into the long-awaited multilateral discipline.[4] In comparison with past multilateral negotiations on this subject, the Uruguay Round Agreement on Rules of Origin (the Agreement) broke new ground in several aspects, and clearly defines the difference between, and the field of application of, nonpreferential and preferential rules of origin systems.

Article 1, paragraph 1 of the agreement defines nonpreferential rules of origin as follows:

> For the purposes of Parts I to IV of this Agreement, rules of origin shall be defined as those laws, regulations and administrative determinations of general application applied by any Member to determine the country of origin of goods provided such rules of origin are not related to contractual or autonomous trade regimes leading to the granting of tariff preferences going beyond the application of paragraph 1 of Article I of GATT 1994.

Paragraph 2 of Article 1 provides that rules of origin are to be utilized to determine the origin of goods for the following purposes:

- most-favored nation (MFN) tariffs and national treatment
- quantitative restrictions
- AD and countervailing duties
- safeguards measures
- origin marking requirements
- any discriminatory quantitative restriction and tariff quotas
- government procurement and
- trade statistics.

[4] On the US approach leading to the ARO, see D. Palmeter, "The US rules of origin proposal to GATT: Monotheism or polytheism," *Journal of World Trade*, vol. 24, no. 2 (1990), 25–36.

The commitment to using the harmonized rules of origin (HRO) for the trade policy instruments mentioned was one key objective of the Agreement. Article 3, paragraph (a), regulating disciplines after the transition period, is clear that once the HWP is over the harmonized rules should be equally utilized for all purposes:

> Taking into account the aim of all Members to achieve, as a result of the harmonization work programme set out in Part IV, the establishment of harmonized rules of origin, Members shall ensure, upon the implementation of the results of the harmonization work programme, that:
>
> (a) they apply rules of origin equally for all purposes as set out in Article 1

The existence of a transition period was due to the fact that the agreement contained a built-in agenda laying down the HWP to achieve the harmonization of nonpreferential rules of origin in Article 9, paragraph 2:

WORK PROGRAMME

2. (a) The work programme shall be initiated as soon after the entry into force of the WTO Agreement as possible and will be completed within three years of initiation.

(b) The Committee and the Technical Committee provided for in Article 4 shall be the appropriate bodies to conduct this work.

(c) To provide for detailed input by the [Customs Community Code], the Committee shall request the Technical Committee to provide its interpretations and opinions resulting from the work described below on the basis of the principles listed in paragraph 1. To ensure timely completion of the work programme for harmonization, such work shall be conducted on a product sector basis, as represented by various chapters or sections of the Harmonized System (HS) nomenclature.

(i) Wholly Obtained and Minimal Operations or Processes

The Technical Committee shall develop harmonized definitions of:

- the goods that are to be considered as being wholly obtained in one country. This work shall be as detailed as possible;
- minimal operations or processes that do not by themselves confer origin to a good.

The results of this work shall be submitted to the Committee within three months of receipt of the request from the Committee.

(ii) Substantial Transformation – Change in Tariff Classification

- The Technical Committee shall consider and elaborate upon, on the basis of the criterion of substantial transformation, the use of change in tariff subheading or heading when developing rules of origin for particular products or a product sector and, if appropriate, the minimum change within the nomenclature that meets this criterion.

– The Technical Committee shall divide the above work on a product basis taking into account the chapters or sections of the HS nomenclature, so as to submit results of its work to the Committee at least on a quarterly basis. The Technical Committee shall complete the above work within one year and three months from receipt of the request of the Committee.

(iii) Substantial Transformation – Supplementary Criteria

Upon completion of the work under subparagraph (ii) for each product sector or individual product category where the exclusive use of the HS nomenclature does not allow for the expression of substantial transformation, the Technical Committee:

– shall consider and elaborate upon, on the basis of the criterion of substantial transformation, the use, in a supplementary or exclusive manner, of other requirements, including ad valorem percentages[5] and/or manufacturing or processing operations,[6] when developing rules of origin for particular products or a product sector;
– may provide explanations for its proposals;
– shall divide the above work on a product basis taking into account the chapters or sections of the HS nomenclature, so as to submit results of its work to the Committee at least on a quarterly basis. The Technical Committee shall complete the above work within two years and three months of receipt of the request from the Committee.

Although the work program was to be completed within three years of the entry into force of the WTO – that is, mid-1998 – at the time of writing it seems unlikely that the result of such work program is going to be adopted in the foreseeable future in the form and outcome that was originally envisaged.

Article 4 of the Agreement established the CRO and the Technical Committee on Rules of Origin (TCRO) at the WCO. Each of these committees has its own clearly defined responsibilities contained in Article 4, paragraphs 1 and 2 and Article 6 of the Agreement. The specific responsibilities of the TCRO are contained in Annex 1 of the Agreement.

Practically speaking, the bulk of the technical work to lay down and negotiate the harmonized set of rules of origin has been carried out by the TCRO. On the other hand, the CRO was intended as the so-called "political" Committee to deal with policy questions other than technical ones. Later in the negotiations a good part of the technical work was also conducted by the CRO to devise technical solutions to the most intractable issues.

[5] If the ad valorem criterion is prescribed, the method for calculating this percentage shall also be indicated in the rules of origin.

[6] If the criterion of manufacturing or processing operation is prescribed, the operation that confers origin on the product concerned shall be precisely specified.

Some of the main technical aspects of the rules – what methodology has to be applied to determine if substantial transformation was achieved – are clearly spelled out in the Agreement. Article 9, paragraph 2(c) states that the TCRO has to develop harmonized definitions of:

(i) wholly obtained products and minimal operations or processes
(ii) substantial transformation – CTC
(iii) supplementary criteria, upon completion of the work under subparagraph (ii) and on the basis of the criterion of substantial transformation.

The Agreement clearly stipulates that the TCRO should elaborate the criterion of substantial transformation primarily upon the use of a CTC (i.e. change in tariff subheading or heading). In addition, the work of the TCRO should be divided on a product basis considering the chapters or sections of the HS nomenclature.[7]

Article 9, paragraph 2(iii), provides for the TCRO to consider and elaborate upon supplementary criteria to be used "Upon completion of the work under subparagraph (ii) [i.e. the work based on the change of tariff heading criterion] for each product sector or individual product category where the exclusive use of the HS nomenclature does not allow for the expression of substantial transformation."

This precise sequencing on the criteria to be used to develop HRO has informed all the negotiating processes since its inception.

In spite of these relevant achievements, the Agreement failed to regulate preferential rules of origin. This leaves an enormous loophole in the multilateral disciplines of rules of origin. WTO members that are negotiating free-trade areas or are granting autonomous preferences are free to determine their rules of origin. In this area, the WTO members limited themselves to a Common Declaration. In comparison with the specific program for harmonizing the nonpreferential rules of origin and the clear commitments undertaken by parties with respect to these, the Common Declaration contains "best endeavours" commitments. Its main practical outcome seems to be the establishment of an advance origin ruling procedure.[8]

Article 2 of the Common Declaration defines the scope of preferential rules of origin, used to determine whether goods qualify for preferential (better than MFN) tariff treatment under contractual or autonomous trade regimes, discussed in Chapter 3. Examples of preferential rules of origin include:

[7] The Harmonized Commodity Description and Coding System (HS) is a uniform nomenclature employed in the customs tariffs and trade statistical nomenclature of almost 180 countries covering over 90% of world trade.

[8] See para. 3(D) of Annex II of the Common Declaration with Regard to Preferential Rules of Origin of the Agreement.

(1) Autonomous preferential tariff treatment:
- Generalized System of Preferences (GSP) rules of origin, including rules of origin under Duty-Free Quota Free (DFQF) trade preferences granted to LDCs
- African Growth and Opportunity Act (AGOA)
- Caribbean Basin Initiative (CBI) rules of origin.

(2) Contractual reciprocal rules of origin – that is, free trade agreements:
- North American Free-Trade Agreement (NAFTA), actually USMCA, Rules of Origin
- Pan-Euro-Mediterranean (PEM) rules of origin
- Economic Partnership Agreements (EPAs) rule of origin
- Association of Southeast Asian Nations (ASEAN), Common Market for Eastern and Southern Africa (COMESA), Pacific Alliance rules of origin, as well as mega-regionals such as AfCFTA, RCEP, and CPTPP.

Paragraph 3 of the Common Declaration contains the substantive requirements in the area of preferential rules of origin:

> The Members agree to ensure that:
>
> (a) when they issue administrative determinations of general application, the requirements to be fulfilled are clearly defined. In particular:
> (i) in cases where the criterion of change of tariff classification is applied, such a preferential rule of origin, and any exceptions to the rule, must clearly specify the subheadings or headings within the tariff nomenclature that are addressed by the rule;
> (ii) in cases where the ad valorem percentage criterion is applied, the method for calculating this percentage shall also be indicated in the preferential rules of origin;
> (iii) in cases where the criterion of manufacturing or processing operation is prescribed, the operation that confers preferential origin shall be precisely specified;
>
> (b) their preferential rules of origin are based on a positive standard. Preferential rules of origin that state what does not confer preferential origin (negative standard) are permissible as part of a clarification of a positive standard or in individual cases where a positive determination of preferential origin is not necessary;
>
> (c) their laws, regulations, judicial decisions and administrative rulings of general application relating to preferential rules of origin are published as if they were subject to, and in accordance with, the provisions of paragraph 1 of Article X of GATT 1994;
>
> (d) upon request of an exporter, importer or any person with a justifiable cause, assessments of the preferential origin they would accord to a good are issued as

soon as possible but no later than 150 days[9] after a request for such an assessment provided that all necessary elements have been submitted. Requests for such assessments shall be accepted before trade in the good concerned begins and may be accepted at any later point in time. Such assessments shall remain valid for three years provided that the facts and conditions, including the preferential rules of origin, under which they have been made, remain comparable. Provided that the parties concerned are informed in advance, such assessments will no longer be valid when a decision contrary to the assessment is made in a review as referred to in subparagraph (f). Such assessments shall be made publicly available subject to the provisions of subparagraph (g);

(e) when introducing changes to their preferential rules of origin or new preferential rules of origin, they shall not apply such changes retroactively as defined in, and without prejudice to, their laws or regulations;

(f) any administrative action which they take in relation to the determination of preferential origin is reviewable promptly by judicial, arbitral or administrative tribunals or procedures, independent of the authority issuing the determination, which can effect the modification or reversal of the determination;

(g) all information that is by nature confidential or that is provided on a confidential basis for the purpose of the application of preferential rules of origin is treated as strictly confidential by the authorities concerned, which shall not disclose it without the specific permission of the person or government providing such information, except to the extent that it may be required to be disclosed in the context of judicial proceedings.

Paragraph 4 of the Declaration provides as follows:

Members *agree* to provide to the Secretariat promptly their preferential rules of origin, including a listing of the preferential arrangements to which they apply, judicial decisions, and administrative rulings of general application relating to their preferential rules of origin in effect on the date of entry into force of the WTO Agreement for the Member concerned. Furthermore, Members agree to provide any modifications to their preferential rules of origin or new preferential rules of origin as soon as possible to the Secretariat. Lists of information received and available with the Secretariat shall be circulated to the Members by the Secretariat.

In reality, many of the provisions contained in the above paragraphs were already contained in the main set of preferential rules of origin (like the Pan-European

[9] In respect of requests made during the first year from entry into force of the WTO agreement, members shall only be required to issue these assessments as soon as possible.

Rules of Origin or NAFTA) at that time and presently, and therefore do not const, itute a novelty nor require action or further obligations from the major users of preferential rules of origin. In the case of developing countries, it is difficult to measure the degree of implementation of paragraph 3 in relation to the set of rules of origin used in south–south regional trade agreements (RTAs) as the notifications to the WTO Secretariat have been quite limited. The binding origin information in paragraph (d) is the most difficult commitment to implement especially for customs administrations in developing countries.

During the more than two decades since the ARO there has not been any attempt to monitor the implementation of the Common Declaration in the CRO. This leaves little doubt over the intention of WTO members not to discuss issues related to preferential rules of origin at multilateral level. Yet, the experience of the preferential rules of origin for least-developed countries (LDCs) as discussed in Chapters 1 and 3 may shed some light even in this area.

2.3 THE HWP AND THE METHOD OF WORK ADOPTED BY THE TCRO TO DEVELOP HRO

At the outset of the HWP, technical issues were given priority. Only after a number of years is it possible to analyze their development.[10] As explained in the following sections, the TCRO did not embrace the simplest way to draft rules of origin. Whereas the Agreement foresaw that the technical work should have been completed within three years – by July 1998 – the TCRO had, despite major efforts to conclude within the set time frame,[11] requested an extension. The CRO, therefore, requested the TCRO to conclude its work by May 1999 and submit all open questions to Geneva.

Moreover, this last TCRO effort was unable to solve a number of major questions. Once negotiations on the technical work were considered exhausted and the supplementary time voided, the TCRO passed outstanding issues to the CRO. The CRO found itself confronted with 455 open questions.[12] As a consequence, the CRO had to build the capacity to deal with many mainly technical questions.

The HWP was extended a number of times. At the spring meeting of 2001, WTO members agreed on a timetable to complete the HWP by the Fourth WTO Ministerial held in Doha.

[10] For a detailed examination of the history of the negotiating process in the TCRO and CRO see H. Himagawa and E. Vermulst, "The Agreement on Rules of Origin," in P. Macrory, A. Appleton, and M. Plummer (eds.), *The World Trade Organization: Legal, Economic and Political Analysis*, Springer, 2005.

[11] The TCRO devoted an incredible amount of energy and participation of delegations to complete the necessary work by the deadline (i.e. several meetings each of two or three weeks with working hours from 9 am to 7 pm and short lunch).

[12] Contained in G/RO/41 and many additions to that main document (i.e. G/RO/41/Add.1 ecc).

The report of the twentieth session of the TCRO[13] explains that the CRO held five sessions during 2001, and that over 300 outstanding issues were resolved, leaving another 155 outstanding. However, few believed that the HWP would be completed on time because a number of major issues were still outstanding. As the Doha deadline was again missed and the flexibility of members hardened considerably, the General Council (GC) was forced to extend the deadline to the end of 2002. However, the CRO was instructed to only hold two additional sessions in an attempt to resolve remaining issues and also to identify a limited number of core policy-level issues to refer to the GC for discussion and decision by the end of June 2002.

By mid-July 2002, the chair of the CRO reported to the GC ninety-four core policy-level issues.[14] Members considered only about fifty issues as non-crucial and therefore remained at the level of the CRO.

At the GC level, several informal talks failed to provide the desired result of solving the majority of the ninety-four core-policy level issues. Again, the GC extended the deadline for completion of the remaining work from December 2002 until July 2003 and to the end of 2003 for the CRO to complete the remaining technical work.

A major effort was undertaken in 2006 by the chair of the CRO to work out a breakthrough of the negotiating process to meet the deadline for resolution of the core policy issues in July 2006. At the informal consultation in February 2006, the chairperson made a series of suggestions for future work: (a) recognizing that the implications issues and horizontal issues on machinery, due to high sensitivity, need more time and effort for a decision, members would first take up the product-specific issues with a view to completing the work by May 2006; (b) the CRO Chair would circulate by early April 2006, the final package for all PSRO, except those for machinery; (c) members would discuss the proposed final package at the next open-ended consultations on May 30, 2006, with a view to endorsing (or not endorsing) the package as a whole; (d) members, after resolving the product-specific issues, would address the implications issue, PSRO for machinery, and definition 2 of Appendix 1 (fish taken from the exclusive economic zone (EEZ)).

This line of work was accepted by the WTO members and at a July meeting in 2006 convened to examine the chairperson proposal, the majority of delegations expressed their support for the package. However, a series of product-specific issues were still to be considered and some delegations requested more time to consider the package in detail.

The work of the CRO was extended until the end of 2008 and a breakthrough on several issues was widely expected by the end of 2007. The latest version of the drafts provides for the entry into force of the HWP by 2010.

As further discussed in section 2.2 and section 2.9 below, all the deadlines have been missed and since 2010 there has not been any discussion on the HWP.

[13] See TCRO document OC0071E2, February 20, 2002.

[14] See WTO document G/RO/52.

2.3.1 *Some Initial Difficulties and Core Substantive Issues Arising during the Negotiations*

Since it was initially assumed that the whole concept of origin was to allocate the origin of a product to a specific country, the first difficulties emerged on defining "country" and "territorial sea" for the purpose of rules of origin.[15] The implications of this apparently legalistic definition process became rapidly clear when discussions started on whether customs unions should be included within the definition of "country." In such a case, the European Union (EU) would be considered a single country for the purpose of origin and trade measures, such as quotas and AD duties.

The definition of country should have been contained in the "overall architecture,"[16] but it is evident that this issue was dropped during the negotiations of the CRO, as the term country does not appear in the list of definitions. This was also the case in General Rule 3, stating the determination of origin, but lacking guidance as to country identification.

DEFINITION OF COUNTRY

The lack of a clear and predictable principle in the definition of country may have implications during implementation of the Agreement.

A Swiss enterprise, exporting ball bearings from different EU Member States to the United States, declared them as originating in the EU and a certificate of origin was obtained from the competent chamber of commerce. Nevertheless, the United States did not accept this declaration of "EU origin" as they imposed different quotas on ball bearings depending on their country of origin – in this case from Italy, France, and Germany. US authorities consequently levying a fine of more than $20,000 to the Swiss enterprise.

In the absence of a clear definition, determining origin rests with the practices of individual countries. This loophole may create problems and difficulties at the time of implementation. For instance, in the above case the United States held the origin of the ball bearings as Italian, French, or German depending on where they were manufactured. The Swiss on the other hand consider all EU countries as making up a single entity and equally accepted as "country" of origin.

The ARO has largely guided the method of work adopted by the TCRO by putting at the core of its agenda the elaboration of the rules of origin on the basis of the CTC criterion. The structure of the harmonized nonpreferential rules of origin,

[15] See, among other related documents, the report of the first session of the TCRO, document 39–310, February 10, 1995, and WTO document G/RO/W/3, June 7, 1995, "Definition of the term 'country': Request from the Technical Committee on Rules of Origin."

[16] At the time of writing, the latest edition of the HWP is represented by the WTO document G/RO/45 with several additions, as revised and amended. Several unofficial papers used during the negotiations have been used as reference material in this chapter.

although still to be finally agreed, follows to some extent the classical pattern of the rules of origin, which are based on conceptually identical principles of wholly obtained products and minimal operations and processes not considered by themselves as origin-conferring events.

The TCRO spent considerable time harmonizing the definitions of wholly obtained products and of minimal operations and processes. After making progress on these definitions, it then turned its attention toward the elaboration of specific rules of origin on a product-by-product basis, starting with the least troublesome HS chapter: namely, Chapter 25 (salt, sulphur, earths, and stone). As widely expected, the exclusive use of the HS nomenclature to determine the origin of goods was one of the first major problems the TCRO faced, given that the HS was originally intended only as customs classification and not for origin purposes. Thus, some practical adaptation was necessary.

The suitability of the HS for determining the country of origin depends largely on its basic structure. Goods in the HS are first grouped into twenty-one sections and then into ninety-six two-digit chapters, which, in principle, are established by industrial sector. Chapters are divided into four-digit headings and six-digit subheadings. In principle, headings are placed within a chapter in the order based upon the degree of processing.[17] These features make the HS a suitable device for applying the concept of "substantial transformation" in determining the country of origin through the CTC method.

In principle, according to the original CTC criteria a final product is considered to have undergone sufficient manufacturing or processing if its tariff classification is different from that of the non-originating materials used for its manufacture: thus the product acquires the origin of the country in which it is manufactured (i.e. where the "last substantial transformation" occurred).

However, the structure of the HS varies from chapter to chapter or section to section, depending upon the nature of goods being classified. Although in certain chapters (such as those covering wood and articles of wood, cork and articles of cork, base metals and articles of base metals) the principle of classification on the basis of the degree of processing is easily and generally applied, in other chapters, especially the agricultural ones, it is difficult to apply. A typical example is Chapter 1, which covers different kinds of live animals, in respect of which no degree of processing can occur, to be reflected in the HS structure. In other words, there is no chapter classifying what a horse was prior to its birth. In these cases, where a change of chapter (CC) rule is not applicable, the TCRO has developed a particular language which clearly explains the path to be followed to identify the country of origin of the good (see Table 2.1).

[17] For example, Chapter 72, on iron and steel, begins with pig iron (heading 72.01), and the heading number increases as the product is further processed, thus: ingot (heading 72.04), semi-finished products (heading 72.06), flat-rolled products (headings 72.08 to 72.12), bars and rods (headings 72.13 to 72.15), and angles, shapes, and sections (heading 72.17).

TABLE 2.1 *Suggested origin criteria for certain animals and animal products*

HS code number	Description of goods	Primary rule	Comments
01.01	Live horses, asses, mules and hinnies	[The country of origin of the goods of this heading shall be the country in which the animal was born (CH) (MAL) (CAN) (MEX) (US) (ARG) (NZ) (FIJ) (AUS) (THA) (IND) (BRA) (HON)]	Submitted to CRO for decision (Doc. 42.146, Issue 1)
		[The country of origin of the goods of this heading shall be the country in which the animal was born and raised (EC) (JPN) (MOR)]	Please note that, in principle, only the issue relating to the last stage of processing is always indicated in column E
		[The country of origin of the goods of this heading shall be the country in which the animal was fattened for at least 6 months; or the country in which the animal was born (EGY) (KOR) (DOM) (EC) (JPN) (MOR) [(PHI)] (VEN)]	For sausages the issue of raising of animals is not mentioned, because it was already relevant in earlier stages of production (Secretariat)
		[The country of origin of the goods of this heading shall be the country in which the animal was fattened for at least 6 months; or the country in which the animal was born and raised (MOR)]	
02.05	Meat of horses, asses, mules or hinnies, fresh, chilled or frozen.	[The country of origin of the goods of this heading shall be the country in which the animal was born (SEN) (ARG) (PHI)] [CC (CAN) (US) (MEX) (MAL) (AUS) (CH) (JPN) (GUA) (IND)] [The country of origin of the goods of this heading shall be the country in which the animal was born and raised; or the country in which the animal was fattened for at least 3 months (EC)]	Submitted to CRO for decision (Doc. 42.146, Issue 2)

TABLE 2.1 (*continued*)

HS code number	Description of goods	Primary rule	Comments
		[The country of origin of the goods of this heading shall be the country in which the animal was fattened for at least three months; or the country in which the animal was born and raised (KOR) (MOR) (EC) (VEN) (EGY) (JPN) (BRA)]	
05.03	Horsehair and horsehair waste, whether or not put up as a layer with or without supporting material.	CC	Basket 1 (Endorsed by CRO)

Notes: (1) The options in italics have been discarded as a result of discussions in the CRO; and (2) options in square brackets did not meet consensus and are awaiting formal resolution (it is possible that informally the issues in the tables shown are solved but formal endorsement is pending in the CRO). The tables in this section are excerpted from the WTO document G/RO/45 with several additions, as revised and amended. Several unofficial papers used during the negotiations have been used as reference material in this chapter.
Source: WTO doc. G/RO/45/Add.8/Rev.3.

The various solutions offered by delegations during the discussions in the TCRO can be easily analyzed, bearing in mind that "live animals born and raised in one country" are included in the list of the harmonized definitions of wholly obtained products. As regards heading 01.01, option 1 implicitly states that raising imported horses cannot be regarded as reflecting the last substantial transformation. Option 2 perfectly echoes the abovementioned definition of wholly obtained. Options 3 and 4 reflect options 1 and 2 respectively, but imply that raising or fattening imported animals radically transforms the animals concerned, given that their weight, size, and commercial value increase substantially; specific conditions are set forth as to the minimum raising or fattening period required for origin to be conferred on the country where the animals are raised. The same can be said for the criteria proposed for determining the origin of products falling under heading 02.05. The only slight, but meaningful difference can be found in option 2, according to which a change of chapter is required: this means that in order to obtain originating "meat of horses . . ." of heading 02.05, it is necessary to use the "live horses . . ." of heading 01.01 – in other words slaughtering horses is a substantial transformation.

To take another example, the CC criterion applies to all headings in Chapter 5, because this chapter covers a variety of materials of animal origin, which are not

dealt with in any other chapter of the nomenclature. Thus, no degree of processing can occur with respect to products of headings 05.01–05.11 of different animal origin. The change of tariff heading (CTH) role is not applicable in this case because there is no other product in Chapter 5 from which, for example, horsehair could be obtained; therefore, a change of chapter is required.

In the case of coffee (heading 09.01 of the HS), further discussion was required, because no agreement has been reached on the issues of decaffeinating and roasting (see Table 2.2).

TABLE 2.2 *Suggested origin criteria for coffee in various forms*

HS code number	Description of goods	Origin criteria	Comments
	Chapter 9	Coffee, tea, maté, and spices	
09.01	Coffee, whether or not roasted or decaffeinated; coffee husks and skins; coffee substitutes containing coffee in any proportion – Coffee, not roasted:	Proposals as specified for subheadings	
0901.11	– Not decaffeinated	The country of origin of the goods of this subheading shall be the country in which the plant grew	Basket 1 (Endorsed by CRO)
0901.12	– Decaffeinated	[The country of origin of the goods of this subheading shall be the country in which the plant grew (BRA) (CAN) (CH) (CI) (COL) (CR) (ECU) (US) (GUA) (HON) (IND) (JPN) (KEN) (MEX) (UGA) (PER) (PHI) (SEN) (URU) (KOR) (MAL)] (SRI) (VEN) (EC) (NZ) (NOR) (CH) (THA) [CTSH (SG) (ARG) (EGY)]	Submitted to CRO for decision (Doc. 42.146, Issue 30)
	– Coffee, roasted		
0901.21	– Not decaffeinated	[The country of origin of the goods of this	Submitted to CRO for

TABLE 2.2 (*continued*)

HS code number	Description of goods	Origin criteria	Comments
		subheading shall be the country in which the plant grew (BRA) (CI) (COL) (GUA) (IND) (KEN) (MEX) (UGA) (PER) (PHI) (SEN) (URU) (MAL) (KOR)] (SRI) (VEN)(CUB) [CTSH (EC) (CH) (SG) (CAN) (NZ) (JPN) (US)] (ARG) (EGY) (NZ) (THA)	decision (Doc. 42.146, Issue 31)
0901.22	– Decaffeinated	[The country of origin of the goods of this subheading shall be the country in which the plant grew (BRA) (CI) (COL) (GUA) (IND) (KEN) (MEX) (UGA) (PER) (PHI) (SEN) (URU) (MAL) (KOR) (EC) (THA)] [CTSH (SG)] (ARG) (EGY)] [CTSH, except from subheading 0901.21 (CAN) (NZ) (US) (JPN)]	Submitted to CRO for decision (Doc. 42.146, Issues 30, 31)

Source: WTO doc. G/RO/45/Add.8/Rev.3.

On the one hand, coffee, which has not been roasted, or decaffeinated, has origin in the country in which the plant grew – that is, was wholly obtained. On the other hand, if coffee undergoes decaffeinating or roasting, it depends on the applicable rule of origin whether or not one or both of these processes is considered an origin-conferring event. Subheading 0901.12 covers coffee that has not been roasted but has undergone decaffeinating. Although some delegations held the view that decaffeinating is not substantial transformation and consequently should not be considered in determining the origin of the goods, other delegations considered changes in the chemical structure of the input material to imply that decaffeinating should be regarded as resulting in a new product, so that the origin of the goods is the country where this process has taken place as the last substantial transformation. In the latter case, the origin criterion to be applied is the change of tariff subheading (CTSH) rule. The same reasoning can also be applied in the case of roasting. In the case of subheading 0901.22, Table 2.2 shows a third option; namely, roasted, decaffeinated

coffee cannot originate from roasted, caffeinated coffee: in this case, the goods acquire the origin of the country in which the process of roasting has taken place.

2.4 ADAPTING THE HS TO ORIGIN: SOME DECISIVE TECHNICAL ISSUES AND THEIR IMPLICATIONS

Apart from having identified the individual products and product sectors to which the sole wholly obtained, CTH (or CTSH), or CC criteria would be sufficient for determining the country of origin, the TCRO has also proceeded with a more sophisticated adaptation of the HS whenever the exclusive use of the HS nomenclature might have given rise to difficulties in determining origin or when the HS was not structured in a manner that recognized certain manufacturing processes as origin-conferring events. In a 1995 document, the World Customs Organization (WCO) Secretariat clearly enumerated the instances in which this need was likely to arise and proposed the following solutions:[18]

(1) *Cases of products or product sectors in which an unspecified change in subheading or heading is not sufficient to express substantial transformation*

The TCRO may come up with a rule under which the non-originating materials used in the manufacture of the products concerned must be classified under specifically designated subheadings or headings (such as "change to heading xx.xx from heading yy.yy") or, where appropriate, chapters. Where necessary, the expression of substantial transformation for a product or product sector may require the use of a clarifying negative standard, such as "CTH except for subheading zz.zz.zz," "CTH, except for xx.xx to xx.yy," or even "CTH, except for xx.xx with an additional specific condition" (see Table 2.3).

TABLE 2.3 *Example of change of tariff heading with exception*

HS code number	Description of goods	Origin criteria	Comments
72.13	Bars and rods, hot-rolled, in irregularly wound coils, of iron or non-alloy steel	CTH, except from heading 72.14	Basket 1 (Endorsed by CRO)
72.14	Other bars and rods of iron or non-alloy steel, not further worked than forged, hot-rolled, hot-drawn or hot-extruded, but including those twisted after rolling	CTH, except from heading 72.13	Basket 1 (Endorsed by CRO)

Source: WTO doc. G/RO/45/Add.12/Rev.2.

[18] See WCO document 39.486 E, "Method of work for phase II of the work programme," July 10, 1995.

(2) *Cases in which the subheadings or headings do not provide a sufficiently precise description of products to enable those subheadings or headings to be used to express the necessary rule for the particular products in question*[19]

The TCRO may, in these cases, split those subheadings or headings using the designation "ex." The basic rule of origin will be the change of tariff heading split (CTHS) or change of tariff subheading split (CTSHS) rule respectively.

(3) *Cases where origin rules for the product sector or the individual product category cannot be expressed by the exclusive use of the HS nomenclature*

The elaboration of supplementary criteria is then deemed necessary.

It is clear that the suitability of the HS for use in determining the country of origin also depends on its objective and accurate classification, which is a far from easy task given the millions of different kinds of goods on the international market. Moreover, the HS classification does not always reflect all the manufacturing processes that the TCRO may consider as entailing substantial transformation.

As mentioned, the product-by-product analysis started from what was initially considered the least troublesome chapter (Chapter 25). In this context, as a rule at chapter level, the TCRO had in principle endorsed the following terminology to confer origin to mineral substances that occur naturally: "The origin of the good shall be the country in which the material of this heading (to be adjusted as appropriate) is obtained in its natural or unprocessed state." However, a number of delegations held the view that the process of calcination of mineral substances is an origin-conferring process. For example, as shown in Table 2.4, HS heading 25.07 ("kaolin and other kaolinic clays, whether or not calcined") does not present any further subdivision: such clays remain in the same heading even when calcined. In this case, in order to adjust the HS structure for origin purposes and recognize calcination as an origin-conferring process, it is necessary to create two split headings: one for calcined kaolin, whose origin is conferred, through a CTHS rule, on the country where the imported kaolin undergoes calcination, and another one, "other than calcined kaolin," to which the general rule applies. At the end the process, calcination was endorsed as origin-conferring.

On the other hand, HS heading 25.18 ("dolomite, calcined or not calcined . . .") is already adequately subdivided into two subheadings (subheading 2518.10, "dolomite not calcined," and subheading 2518.20, "calcined dolomite"); a CTSH rule easily serves the purpose of allocating the origin of calcined dolomite to the country where the calcination occurs.

[19] Especially "basket" subheadings or headings, which include all items, not covered in the previous subheadings or headings in the chapter. A longer-term approach would be to request the HS Committee, after the completion of the work program, to split the subheadings or headings in question to provide more specific descriptions of the products that accommodate the needs of origin determination.

TABLE 2.4 *Suggested adjustments to the HS structure*

HS code number	Description of goods	Origin criteria
Chapter 25	Salt; sulfur; earths and stone; plastering materials, lime, and cement	
25.07	Kaolin and other kaolinic clays, whether or not calcined	As indicated at the subheading level
ex 25.07(a)	Calcined	CTHS
ex 25.07(b)	Other	Chapter rule
25.18	Dolomite, whether or not calcined; dolomite roughly trimmed or merely cut, by sawing or otherwise, into blocks or slabs of a rectangular (including square) shape; agglomerated dolomite (including tarred dolomite)	As indicated at the subheading level
2518.10	Dolomite not calcined	The country of origin of the goods shall be the country in which the dolomite of this subheading is obtained in its natural or unprocessed state
2518.20	Calcined dolomite	CTSH

Source: WTO doc. G/RO/45/Add.3/Rev.1.

During the negotiation a terminology guide has been developed to explain the variety of formulations that has been used to express the CTC requirement as shown below.

TERMINOLOGY GUIDE

I. **Rules presented at heading level:**
   (a) *If the rule is for the whole heading*:
   CTH – change to this heading from any other heading
   (b) *If the rule is for a split heading*:
   CTHS – change to this split heading from any other split of this heading or from any other heading
   CTH – change to this split heading from any other heading
   (N.B. change from any other split of this heading is excluded.)

II. **Rules presented at subheading level:**
   (a) *If the rule is for the whole subheading*:
   CTSH – change to this subheading from any other subheading or from any other heading
   CTH – change to this subheading from any other heading
   (N.B. change from any other subheading of this heading is excluded.)

(b) *If the rule is for a split subheading*:
CTSHS – change to this split subheading from any other split of this subheading or from any other subheading or heading
CTSH – change to this split subheading from any other subheading or heading (N.B. change from any other split of this subheading is excluded)
CTH – change to this split subheading from any other heading
(N.B. change from any other split of this subheading or from any other subheading of this heading is excluded.)

III. **Rules presented at heading or subheading level**
CC – change to this chapter from any other chapter

2.4.1 *Definition of "Assembly" in Machinery*

A problem encountered by the TCRO in elaborating the harmonized set of origin rules utilizing the HS was the treatment of incomplete or unassembled articles. In fact, the HS provides six general rules for its interpretation, laying down the principle governing classification. One of the most important concepts underlying classification in the HS nomenclature is the "essential character" of goods. In particular, this concept relates to the classification of incomplete or unfinished articles and unassembled or disassembled articles.

The first part of interpretative Rule 2(a) of the HS explanatory notes, on "Incomplete or unfinished articles," extends the scope of any heading that refers to a particular article to cover not only the complete or finished article but also that article in an incomplete or unfinished state, provided that, as presented, it has the essential character of the complete or finished article. The second part of Rule 2(a), on "Articles presented unassembled or disassembled," states that complete or finished articles presented unassembled or disassembled are to be classified under the same heading as the assembled article. When goods are so presented, it is usually for reasons such as the requirements or convenience of packing, handling, or transport.

The explanatory notes to the HS offer many specific examples to clarify the concept of essential character in the context of Rule 2(a). Throughout section XVI on machinery, for instance, any reference to a machine or apparatus covers not only the complete machine but also an incomplete machine. That is, an assembly of parts so far advanced that it already has the essential character of the complete machine. A good example is given by the general explanatory note to Chapter 87 on vehicles, which states:

An incomplete or unfinished vehicle is classified as the corresponding complete or finished vehicle provided it has the essential character of the latter, as for example:

A motor vehicle, not yet fitted with the wheels or tyres and battery;
A motor vehicle not equipped with its engine or with its interior fittings.
A bicycle without saddle and tyres.

Incomplete or unfinished articles, including such articles unassembled or disassembled, constitute one of the most complex areas for determining the country of origin. In general, the TCRO has come to the common understanding that the assembly of a good from parts results basically in a substantial transformation. However, members disagreed on a common rule of origin and have proposed different approaches as reflected in Table 2.5.

The HS identifies three broad categories of parts:

(a) parts for general use
(b) parts suitable for use solely or principally for machines of a particular heading
(c) finished goods which will themselves be used as parts or components for other goods.

TABLE 2.5 *Classification of finished goods and parts in Chapter 87*

HS code number	Description of goods	Primary rule	Comments
Chapter 87	Vehicles other than railway or tramway rolling-stock, and parts and accessories thereof	As indicated at the heading or subheading level	
87.02	Motor vehicles for the transport of ten or more persons, including the driver	[CTH (CH) (JPN) (MEX) (EGY) (MOR) (TUN) (TUR) (SG) (US) (IND) (THA)] (CAN) (PHI) [CTH, except from heading 87.06 (MAL)] [30% value-added rule (IND)] [60% value-added rule (EC) (AUS)] (BRA)	Submitted to CRO for decision
87.15	Baby carriages and parts thereof	[CTH (JPN) (MEX) (SG) (MAL)] [CTH; or 45% value-added rule (EC) (AUS)] [As specified for split heading (CH) (CAN) (US) (KOR) (PHI) (TH)]	Submitted to CRO for decision Issues Nos. 1–6, 8–13
Ex-87.15(a)	Baby carriages	[CTHS (CH) (CAN) (US) (KOR) (PHI) (TH)]	Submitted to CRO for decision Issues Nos. 1–6, 8–13
Ex-87.15(b)	Parts of baby carriages	[CTH (CH) (CAN) (US) (KOR) (PHI) (TH)]	

Note: When a split heading or split subheading is proposed, the description shown is not HS text.
Source: WTO doc. G/RO/45/Add.15/Rev.1.

For some goods, therefore, assembly of parts to produce the finished good will result in a change of heading (for example, manufacture of motor vehicles of 87.01–87.05 from parts of 85.08), for others a change in subheading (for example, trailers and semi-trailers of 87.16 from parts of 8716.90). However, in some cases parts are classified under the heading with the vehicles produced, without subheadings, and thus undergo no change of classification when used for production of the article such as baby carriages of 87.15 (see Table 2.5).

Naturally, the issue of distinguishing parts from the incomplete or complete articles is relevant throughout the whole machinery sector. During the negotiations, the main concern of all delegations consisted in capturing substantial transformation while excluding simple assembly operations (so-called "screwdriver operations," also connected to AD procedures). As a result of those concerns, many delegations presented their own proposals. Some focused largely on the HS recognizing the change from the parts to the finished article as substantial transformation, sometimes with limitations to this change to exclude simple assembly. Chapter notes were proposed to cover different aspects of assembly in the machineries, such as what should happen in the case of disassembly of goods or if the change in classification is achieved through simple operations like retesting or recertification (i.e. the HS classifies some machines or appliances in conformity with their power or voltage). A systemic problem consisted in defining incomplete or unfinished articles (and parts) and what rule should be applied to them.

The EU was concerned about simple assembly and proposed to use largely the value-added rule to confer origin for assembly operations. Brazil also initially joined the EU position; however, support for this approach from the rest of the countries was limited.

Attempts were also made to focus on the different operations taking place during an assembly operation like gluing, soldering, or bolting together parts to form the final article. However, the problem was that, depending of the type of machines, such operations might be considered simple or complicated. Also, a combination of such operations occurring during assembly failed to be considered as a possible solution since the products to be covered were simply too different.

A further difficulty arose from the fact that goods classified as parts could also be assembled substantially from smaller parts and the rule recognizing the assembly from parts to (un)finished machines should give credit to the same operations carried out inside a heading or subheading. Although a rather pragmatic approach led to a proposal of counting the components to assemble a part (recognizing that the assembly of five parts or more would have given origin), the EU value-added criterion would have the apparent advantage of recognizing similar assembly operations at whatever level of the manufacturing stage they were carried out. Also, the third option of defining different processing criterion would take care of such assembly operations.

The excerpts below from an earlier negotiating text demonstrate the variety of approaches that have been raised during the negotiations and the technical complexities:

EXTRACT OF THE PROPOSED APPROACHES TO ASSEMBLY AT CHAPTER LEVEL

[Origin Conferring Primary Rules (Sec)]: (SG) (IND)

[A. Goods of this chapter that are not wholly the product of one country shall be deemed to originate in the last country where one of the following occurs:
(a) Non-originating materials undergo a change of classification from any other sub-heading, including a sub-heading of the same heading (CTSH); or from any other heading (CTH) as indicated in the specific headings or subheadings; or
(b) Obtaining goods from parts by assembly, including sub-assembly, shall be considered as reflecting last substantial transformation; or
(c) Process (such as mounting of integrated circuits) as defined for the specific headings or subheadings which result in new characteristics or use in the finished product. (SG)]

[B. An assembly operation resulting in a new good having new characteristics is considered to be substantial transformation. (IND) (MOR) (SEN for Chapters 84 to 86 only)]

[C. *Finished goods or parts produced from unfinished goods or parts, other than blanks*: (CH).]

Whenever the change of classification rules set out for goods of Chapters 84 to 90 and 93 are not determinant of the country of origin of the good, the following substantial transformation rules are to be applied:

(a) A finished good or part produced from a non-originating unfinished good or part classified in the same heading or subheading as the finished good or part shall originate in the country in which the good or part was finished, provided:
(i) the unfinished good or part is not functioning for its ultimate use in its imported condition and has undergone at least two or more of the following processes:
- assembly by built-up such as but not limited to welding, soldering, shrinking, bolting, gluing, fitting, fixing, spooling, winding, connecting, wiring, coupling; or
- heat treatment or thermochemical treatment such as glowing, tempering, hardening; or
- treatment for the purpose of shaping, forming such as cold or warm forming; or
- mechanical treatment, refining of form, positional and surface tolerances of functional finished shapes such as turning, milling, drilling, broaching, grinding, polishing, honing, eroding; or
- surface treatment such as coating, compressing, condensing, impregnating (excluding temporary conservation for transport and/or storage purpose), insulating; or

- system engineering, software-development and application; and

(ii) The finished good or part has undergone final testing such as but not limited to balancing, spinning, voltage testing, performance or isolation test.

[D. *[Other (US)] [Chapter Residual Rules (Sec)]*: (Issue No. 1)]
Where neither the product specific rules in the matrix nor the preceding legal notes are determinant of origin, the following shall apply: (US) (CH) (AUS) (TUR for ex-8471.60(a) for split subheadings (A) and (B) only)

(1) Goods produced by assembly of 5 or more parts (other than parts of general use, as defined in [Note 2 to Section XV or similar parts of plastic (Chapter 39) (US)] [note 1(g) to Section XVI of the HS (AUS)]) shall have origin in the country of assembly, or (US) (AUS) (TUR for ex-8471.60(a) for split subheadings (A) and (B) only)

(2) Goods produced as a result of processing non-originating components into a device or apparatus capable of performing one or more new mechanical or electrical functions shall have origin in the country of such processing, or (US) (TUR for ex-8471.60(a) for split subheadings (A) and (B) only)

(3) *[Residual rule]*. – Goods produced by the assembly of less than 5 parts (other than parts of general use, as defined in Note 2 to Section XV of the HS or similar parts of plastic (Chapter 39)), and one or more of whose parts (other than parts of general use, as defined in [Note 2 to Section XV of the HS or similar parts of plastic (Chapter 39) (US)] [note 1(g) to Section XVI of the HS (AUS)]) satisfies the requirements for origin in the country of assembly, shall have origin in the country of assembly. (US) (AUS) (TUR for ex-8471.60(a) for split subheadings (A) and (B) only).

Many of the difficulties during the negotiations derived from the fact that industries in Northern America and in Europe use different origin rule systems (also due to different preferential rules of origin). For the machinery sector in general the EU insisted on using the ad valorem percentage criterion while the United States wished to use the CTC. Taking this aspect into account, on the latest proposal of compromise, the GC was to introduce both rules alternatively as primary rules. The latest drafts indicate that the option to apply one or the other method will be left to the importing country when drafting legislation of the HWP. Once the choice is made, the WTO member will have to notify the CRO within ninety days of the choice made.

Leaving this option open will mean that producers and exporters would have to check first what option has been selected by the country of importation to determine

if they comply with origin through the tariff (sub)heading change or through the fulfillment of the value-added rule.

An example of these different approaches could provide some clarifications: if we take the calendering machine as described in Table 2.6, under the CTSH rule proposed for the machine classified under heading 8420.10 itself, the assembly of parts alone would be enough to confer origin using the parts classified in 8420.91 and 8420.99. Taking the EU approach, the assembly of the parts to form the finished (or unfinished) article should lead to a considerable increase in value (the rule shown in Table 2.6 is a simplified version and should read: "Manufacture in which the value of all non-originating materials used does not exceed 55 per cent of the ex-works price of the product").

If the various proposals contained in the excerpt above are considered, the assembly of five or more parts is sufficient to confer origin even within a subheading like 8420.91 or 8420.99 to form, for instance, a bigger part. Similarly, assembly of the goods in 8420.10 is an origin-conferring event if this operation has created a device performing new mechanical or electrical functions or if it had new characteristics. However, some difficulties of interpretation between the members may arise about these "new" functions.

TABLE 2.6 *Classification of finished goods and parts in Chapter 84*

HS code number	Description of goods	Primary rule	Comments
84.20	Calendering or other rolling machines, other than for metals or glass, and cylinders therefore	As indicated at the subheading level	
8420.10	– Calendering or other rolling machines	[CTSH] (JPN) (US) (CAN) (CH) (MEX) (COL) (SG) (PHI) (MOR) (AUS) (HK) [CTH; or 45% value-added rule] (EC) [60% value-added rule] (BRA)	Submitted to CRO for decision Issues Nos. 1–13
	– Parts		
8420.91	– Cylinders	[CTH] (JPN) (US) (CAN) (CH) (MEX) (COL) (SG) (PHI) (AUS) [CTH; or 45% value-added rule] (EC) [60% value-added rule] (BRA)	Submitted to CRO for decision Issues Nos. 1–13
8420.99	– Other		

Source: WTO doc. G/RO/45/Add.15.

2.4.2 *Definition of "Assembly" in Textiles and Clothing*

The issue of assembly of parts is also relevant in the context of textile and clothing products, which represent one of the most sensitive sectors for origin determination. For goods of Chapter 61 (articles of apparel and clothing accessories, knitted or crocheted), alternative proposals were discussed in the CRO. One of the questions concerned the process of assembly of an article of headings 61.01–61.05 – rule at split chapter level) from parts knitted or crocheted to shape and, in particular, whether this process can be regarded as an origin-conferring event, as the assembly is not sufficient to substantially transform the goods in the view of many countries (see Table 2.7).

TABLE 2.7 *Example of a split chapter*

HS code number	Description of goods	Primary rules	Comments
Chapter 61	Articles of apparel and clothing accessories, knitted or crocheted	As indicated at split chapter level	
Ex-Chapter 61(a) (ex-61.01 through 61.17)	Goods including parts and accessories, knitted or crocheted to shape	The country of origin of the goods of this split chapter is the country in which these goods have been knitted or crocheted to shape (option 1)	Basket 1
Ex-Chapter 61(b) (ex-61.01 through ex-61.15)	Goods of heading 61.01 through 61.15 assembled from parts knitted or crocheted to shape	[Change to this split chapter in accordance with chapter note (option 5) (IND)] [Change to goods of this split chapter provided that the goods are assembled in a single country in accordance with chapter Note (option 1) (EC, JPN, PHI, MAL, TUR, CH, NOR, FIJ, CR)] [CC provided that the parts of these goods are both knitted or crocheted to shape and sewn or otherwise assembled in the country claiming origin (ARG, PAK, THA, UR)] (option 2)	Submitted to CRO for decision (Doc. 42.271) Issue 45

(*continued*)

TABLE 2.7 (*continued*)

HS code number	Description of goods	Primary rules	Comments
		[The country of origin of the goods of this split chapter is the country in which the parts of these goods have been knitted or crocheted to shape (US, IND, MEX, CAN, SEN, EGY, GUA, AUS, BRA, JPN, KOR, NZ, PHI)] (option 3)	

Notes: (1) When a split heading or split subheading is proposed, the description shown is not HS text; and (2) (PHI) considers that embroidery of goods including parts and accessories of this split chapter should be considered as substantial transformation with conditions included in ex-Chapter 61(i).
Source: WTO doc. G/RO/45/Add.1/Rev.2.

In order to determine the origin of these goods, the compilation of chapter notes has been deemed necessary.

With regard to option 1 in Table 2.7, some delegations held that the assembly of an article in one country from parts knitted or crocheted to shape is a substantial transformation, if all the main assembly operations following the cutting of the fabric, or the knitting or crocheting, to shape have been performed in a single country. Some minor operations (such as making buttonholes, hemming, or attaching items including accessories, buttons, or other fasteners, pockets, etc.) are not taken into account in determining whether the good has been assembled in a single country. In this case, the applicable rule of origin should be a change to goods of this split chapter, provided that the goods are assembled in accordance with chapter note 1/option 1.

Delegations supporting options 2 and 3 held the opinion that the assembly of an article in one country from parts knitted or crocheted to shape requires only a minor operation to attach the parts together by looping or simple sewing, and thus no substantial transformation is conferred by this kind of process. According to these proposals, the country of origin would be the country where the goods have been both knitted or crocheted to shape and sewn or otherwise assembled, or the single country where the parts were knitted or crocheted, whether or not assembled in the same country.

2.5 SECONDARY OR RESIDUAL RULES OF ORIGIN

As mentioned above, nonpreferential rules of origin are aimed at assigning origin to all goods imported into a country. Thus, there must be an origin determination in

all cases, as the customs authorities must ascertain the origin of the goods in order to administer the trade policy instruments. If the primary origin criterion is not met (CTH, processing requirements, or value-added criterion), secondary, residual rules should be available to determine origin. Even if the Agreement itself is silent on this point, members considered that the abovementioned arguments need to be addressed and thus residual rules should apply.

The second basic question confronted by the TCRO was how to determine the sequence of application of residual rules and their implementation – what happens when the goods cannot be subject to the primary rule of origin and the residual rules come into play. Two basic approaches have been discussed. One approach, supported for a long time by the United States, entails that if the primary rule is not met for a country, then the primary rule should be applied to countries further down the production chain to ascertain if the rule has been met in any of them. Only when the primary rule has not been met in any "preceding" country would the use of residual rules be warranted. This has been called the "tracing-back" option. A second approach, supported by the EC, limits the utilization of the primary rule to the country where the "last production process has taken place." Thus, if the primary rule is not met in the country where the last production process has taken place, residual rules should be utilized there.

It then became essential to assess the potential implications of these alternative rules. Under the tracing-back proposal, the customs administration would, where applicable, have to trace back on the basis of the available documentation the origin through preceding countries. In some cases, this procedure would have been difficult and laborious, as it requires the customs administration to identify the different manufacturing stages a finished product underwent, specifying the operations carried out in different countries. Commercial reasons and confidentiality may also be an impediment to this tracing-back method. For developing-country exporters, producers, and administrations the application of this rule would have demanded a high degree of customs cooperation. Moreover, the provision of relevant information and documentation may require extensive knowledge of the rules and awareness of the possible implications on the part of exporters, producers, and customs administrations.

Under the EU approach, origin determination relies to a greater extent on the ability of customs administrations to determine origin at the time of importation. If the primary rule is not satisfied, the operator or customs official will have to immediately resort to the residual rules. However, this approach would imply that the operator or the official in charge of applying the HRO in the country of importation has knowledge of the origin of all components used in the production.

In November 1999, a partial agreement was reached on this issue in the TCRO. This involved rejection of the tracing-back approach in general, but retaining the tracing-back method in the residual rules and to some extent in the list rules on wholly obtained products in Appendix II (in fact, reading the "Ottawa rules," the origin always refers to a country where a certain process

or operation has occurred implying that the last country of exportation must have some basic knowledge of the processes occurring in other countries.

2.6 THE STATUS OF THE HARMONIZED NONPREFERENTIAL RULES OF ORIGIN

2.6.1 *The Architecture*

The term "architecture" is commonly referred to as the framework and sequencing of application of the HRO.[20] It encompasses the whole structure of the rules and the disciplines applicable to them.

As for the organization and structure of the harmonized rules, the ARO was not providing clear guidelines in many respects. However, it soon appeared clear that there was a need for general provisions that would govern the entire set of rules. The TCRO soon entered on an examination of the product-specific rules and the CRO requested that the TCRO should also devise an overall structure as early as November 1995. In the request the CRO demanded the TCRO to "forward . . . a general format establishing the overall architectural design within which the results of the different phases of the Harmonization Work Program will be finalized as provided in article 9.4."

Although the relevant provisions of the ARO have largely guided the negotiations on architecture and the current structure, there were various questions that remained unanswered and that subsequently emerged as the negotiations progressed.

In particular, Article 9, paragraph 1(b) of the ARO provides that "rules of origin should provide for the country to be determined as the origin of a particular good to be either the country where the good has been wholly obtained or, when more than one country is concerned in the production of the good, the country where the last substantial transformation has been carried out."

It follows that the structure of the HWP should develop definitions of goods that are to be considered wholly obtained in one country, the minimal operations or processes that do not by themselves confer origin to a good (Article 9, paragraph 2(c)(i)) and the use of CTC (Article 9, paragraph 2(c)(ii)). Supplementary criteria, including ad valorem percentages and/or manufacturing or processing operations are envisaged as well (Article 9, paragraph 2(c)(iii)) but only after it was demonstrated that the CTC was not a suitable instrument to define PSRO. This sequencing of methodologies in defining product-specific origin rules was one of the bones of contention between those delegations wishing to adopt supplementary criteria, mainly the EU. The United States favored instead an across-the-board application of the CTC. Such contention has not been totally resolved as demonstrated by the option left open to WTO member importing countries to adopt, in respect of

[20] Section 2.6 has been written using as reference material unofficial records and drafts circulating until the end of February 2010, the last year where technical discussions have arisen in the context of the HWP.

Chapters 84–90, the CTC or the ad valorem percentage as specified at tariff-line level in the respective chapters.

Two key informal meetings (the Ottawa and Meech Lake meetings) were organized to solve some of the crucial issues concerning the architecture. The Ottawa meeting led to the agreements on the scope of application of Appendix 1 (wholly obtained) and Appendix 2 (product-specific rules). It also served to reach a compromise among the EU and the United States and Canada about the utilization of the wholly obtained term in drafting the Appendix 2 rules (the product-specific rules).

According to its own experience in preferential rules of origin, the EU proposed that for live animals classified in Chapter 1 of Appendix 2, product-specific rules refers to the concept of wholly obtained goods. On the one hand this proposal was opposed by those delegations who considered that the concept of wholly obtained goods has to remain confined to Appendix 1, considering the agreed sequential application of the rules. On the other hand, other delegations found it difficult to apply CTC rules because there are no antecedents in the HS to live animals classified in Chapter 1.

A compromise was found on the formulation of the following Ottawa language:

(1) For scrap and waste, the rule was to be based upon the country where the scrap or waste was derived.
(2) For goods having antecedents, the rule was to be based on CTC with exclusions.
(3) For goods not having antecedents, the rule was to be based on the country where the good or material was obtained in its natural or unprocessed state.[21]

The third definition later evolved depending on the chapter in which it was being used. For instance in the case of Chapter 1 the word material was later replaced by animals when drafting product-specific rules for Chapter 1, milk in the case of dairy products, and so on.

The recommendations that emerged from the Meech Lake meeting informed most of the work later conducted on the architecture according to the following agreed principles:

(1) There was no need for a separate appendix 3 dealing with Minimal operations or processes since they can be placed in the appropriate places in the architecture.
(2) Two type of rules could be devised in Appendix 2: "primary rules" and "residual rules."
(3) In Appendix 2 "Primary rules" can be placed at the beginning of the chapter or in the matrix when they are applicable to a particular heading, subheading etc.
(4) The primary rules are co-equal.

[21] See Annex C/2 to WCO document 40.510.

(5) The "primary rules" may preclude certain operations or processes from conferring origin (negative primary rules).
(6) The residual rules are applicable to a good only when the primary rules do not confer origin.
(7) The residual rules could be placed at the beginning of Appendix 2 or at chapter level.
(8) Within the primary rules and within the residual rules the selection of the rule applied is governed by the time sequence; that is, the rule that is last satisfied confers origin on a good.

According to the principles and sequencing of methodologies contained in Article 9 and agreed in the various informal sessions, negotiators have progressively elaborated an overall architecture set up in three parts (General rules, Appendix 1, and Appendix 2).

2.6.2 *The General Rules, Appendix 1 and Appendix 2*

Practically, what are referred to as the general rules reflect the overall architecture of the HWP providing the scope and definitions of the nonpreferential rules of origin, the minimal operations or processes, general rules of application, and, finally, the path for the determination of the country of origin of a good – through the provisions of Appendix 1 and Appendix 2, applied in sequence. The final, not agreed, text of the General Rules, Appendix 1 and Appendix 2, is contained in the WTO document G/RO/W/111/Rev.6 11 November 2010 later revised to update the HS 1996 nomenclature to HS 2012 (hereinafter the final draft). In this section earlier versions of the General Rules, Appendix 1 and Appendix 2 are contrasted to illustrate the complexities of the negotiations and the technical solutions adopted.

The following are the general rules reported together with comments.[22]

THE GENERAL RULES

GENERAL RULE 1: SCOPE OF APPLICATION

Rules of Origin provided in this Annex shall be as defined in Article 1, paragraph 1 of the Agreement on Rules of Origin annexed to the Agreement Establishing the World Trade Organization (WTO), and shall be applied for the purposes set out in Article 1, paragraph 2 of the Agreement on Rules of Origin. (Earlier version.)

(B) In framing its legislation each Member shall provide for its non-preferential commercial policy instruments set out in Article 1, paragraph 2 of this

[22] In this chapter the reference to earlier drafts is to be understood as referring to WTO document G/RO/45/Rev.2. The reference latest draft (February 2007) is to be understood as referring to an informal draft bearing no official record. For ease of reference the t)(wo texts are compared to provide the reader with the complexity of the negotiations, the different negotiating positions, and the progress made. Further proposals were made on a consolidated text circulated on 23 May 2008.

(cont.)

Agreement (hereinafter referred to as "Commercial Policy Instruments") in which Rules of Origin provided in Appendix 2 of this Annex shall be used. Each Member shall notify the Committee on Rules of Origin of its Commercial Policy Instruments within 90 days after the date of entry into force of this Annex, for it. (Latest draft February 2007.)

In the final draft of the general rules this rule has been removed, as discussed below. The earlier version of General Rule 1 (in italics above) mirrors the provision of the ARO and was the main bone of contention during the negotiations. In fact, the reference to "Purposes set out in Article 1, paragraph 2" of the ARO extends the application of the HRO to other WTO agreements. This issue, which is commonly referred to as the "implications on other WTO agreements," is dealt with in the following sections. The second version (i.e. paragraph (B)) provided for two paragraphs. Paragraph 1 (not reported) expressly provided that Appendix 1 defining wholly obtained goods shall be applied equally for the purposes set out in Article 1, paragraph 2 of the ARO. The second paragraph (B) reported above contained wording suggesting that each WTO member will notify its nonpreferential commercial policy instruments where the product-specific rules of Appendix 2 will apply. Undoubtedly this wording leaves discretion to the WTO members to pick and choose what commercial policy instruments will be using the product-specific rules contained in Appendix 2 to determine origin. As later explained in section 2.9, this attempted compromise emerged from a stalemate over the implications of the HWP on other WTO agreements that de facto blocked for decades any progress in the HWP.

GENERAL RULE 2: HARMONIZED SYSTEM

References to headings and subheadings are references as they appear in the Harmonized Commodity Description and Coding System (hereinafter referred to as "Harmonized System" or "HS") as amended and in force. Classification of goods within headings and subheadings of the Harmonized System is governed by the General Interpretative Rules and any relative Section, Chapter and Subheading Notes to that System. Classification of goods within any additional subdivisions created for purposes of the rules of origin shall also be governed by the General Interpretative Rules and any relative Section, Chapter and Subheading Notes to the Harmonized System, unless the rules of this Annex otherwise require.[23]

In view of the periodic changes occurring in the HS nomenclature and the fact that the HWP made extensive use of the Harmonized System in defining PSRO, there was a need for a provision to determine the relations between the two

[23] Alternative text exists as contained in WTO document G/RO/45/Rev.2. See also this text in conjunction with the draft text on amendments to the rules of origin discussed in section 2.6.1.

instruments. This rule should be read in conjunction with Article 6(3) of the ARO where it is provided that the Committee, in cooperation with the TCRO, shall set up a mechanism to consider and propose amendments to the results of the HWP, considering the objectives and principles set out in Article 9. This may include instances where the rules need to be made more operational or need to be updated to consider new production processes or are affected by any technological change.

There was no final agreement on the mechanism to adopt to ensure that amendments to HS are fully reflected in the HRO although these aspects together with a proposal of the TCRO to the CRO have been fully discussed.[24] A draft has been circulated setting the various options available. In fact Article 6.3 of the ARO provides that the CRO should set up a mechanism to consider and propose amendments to the results of the HWP, identifying two possible needs for amendment: first, rules need to be made more operational and, second, rules need to be updated because of technological change or new production processes.

However, it has to be considered that the HRO will become an integral part of the ARO, as provided for in Article 9.4 of the agreement. It follows that the new amendment mechanism envisioned by the ARO would have to be carefully considered in connection with the provisions of Article X of the WTO Agreement which sets out a procedure to amend provisions of the WTO Multilateral Trade Agreements.

The difficulty arises when one is confronting the practical exigencies of amending the HRO and the procedures required under Article X of the WTO Agreement. Especially in the case where changes in the HS necessitate amending the HRO, a collective action by all WTO members will be required. Ideally a proposal for amendments should be initiated as soon as possible after the HS Committee of the WCO completes its work on amendments to the HS.

Such pragmatic exigencies may be frustrated by legal obligations. Two options have been flagged:

(1) The first option would follow the general amendment procedure as set out in Article X of the WTO Agreement: the Council for Trade in Goods, as recommended by the CRO, submits to the GC proposals to amend the HRO; the GC, then, decides to submit the proposed amendments to the members for acceptance, as provided for in Article X of the WTO Agreement. In the case where a member submits its proposal to the GC, a decision could be taken by the GC, taking into consideration the abovementioned report of the CRO.
(2) The second option would be to establish the special amendment mechanism which is to replace Article X of the WTO Agreement. Because the HRO is subject to frequent amendments it seems appropriate to consider its amendments as part of the ongoing responsibilities of the CRO rather

[24] See Annex E/2 to WCO document OC0071E or WTO G/RO/51.

than as a treaty amendment exercise. It should also be noted that amendments to the HRO may alter the balance of interests among members achieved by the current HRO. In this light, the normal decision-making procedures of the CRO and GC could possibly be applied for the amendments to the HRO rather than Article X of the WTO Agreement.

No option provides for an easy solution for the pragmatic exigencies of the HRO. Another draft concerning arrangements for the settlement of disputes relating to customs classifications has been circulated. Customs classification disputes among member countries are primarily governed by Article 10 of the International Convention of the Harmonized Commodity Description and Coding System:

10.1 Any dispute between Contracting Parties concerning the interpretation or application of this Convention shall, so far as possible, be settled by negotiation between them.
10.2 Any dispute which is not so settled shall be referred by the Parties to the dispute to the Harmonized System Committee which shall thereupon consider the dispute and make recommendations for its settlement.
10.3 If the Harmonized System Committee is unable to settle the dispute, it shall refer the matter to the Council which shall make recommendations in conformity with Article III(e) of the Convention establishing the Council.
10.4 The Parties to the dispute may agree in advance to accept the recommendations of the Committee or the Council as binding.

Classification disputes could also be brought before the WTO Dispute Settlement Understanding (DSU) Mechanism according to Articles 7 and 8 of the ARO. The draft seeks an understanding starting from the consideration that since the decision of the DSU is binding, WTO members are likely to use it over the HS system. However, the draft suggests that the expertise of the HS Committee should be used in the panel process to examine the technical aspect of the classification question.

GENERAL RULE 3: DETERMINATION OF ORIGIN

The country of origin of a good shall be determined in accordance with these General Rules and in accordance with the provisions of Appendix 1 and Appendix 2, applied in sequence.

General Rule 3 provides for the sequenced application of the rules according to the classical notion of wholly obtained goods contained in Appendix 1 and goods that are not wholly obtained.

The origin of wholly obtained products will be determined according to the rule contained in Appendix 1. Failing this, for goods that do not meet the definition of wholly obtained, rules contained in Appendix 2 will be applied.

GENERAL RULE 4: NEUTRAL ELEMENTS

In order to determine whether a good originates in a country, the origin of the power and fuel, plant, and equipment, including safety equipment, or machines and tools used to obtain a good or the materials used in its manufacture which do not remain in the good or form part of the good shall not be taken into account.

This is a rather common rule in a number of origin sets indicating elements that are never to be taken into account in the determination of origin. This rule adds certainty and clarity in the administration of the rules of origin.

GENERAL RULE 5: PACKING AND PACKAGING MATERIALS AND CONTAINERS

Unless the provisions of Appendix 1 or Appendix 2 otherwise require, the origin of packing and packaging materials and containers presented with the goods therein shall be disregarded in determining the origin of the goods under General Rule 3, provided such packing and packaging materials and containers are classified with the goods under the Harmonized System. The packing and packaging materials and containers which are not classified with their contents are separate goods, thus their origin shall be determined in accordance with the appropriate rules set forth in Appendix 1 and Appendix 2.

As mentioned in the case above, this provision is rather common in many sets of origin rules and rather self-explanatory. It mirrors General Rule 3 for the interpretation of the HS that provides as follows:

(a) Camera cases, musical instrument cases, gun cases, drawing instrument cases, necklace cases and similar containers, specially shaped or fitted to contain a specific article or set of articles, suitable for long-term use and presented with the articles for which they are intended, shall be classified with such articles when of a kind normally sold therewith. This rule does not, however, apply to containers which give the whole its essential character;
(b) Subject to the provisions of Rule 5(a) above, packing materials and packing containers presented with the goods therein shall be classified with the goods if they are of a kind normally used for packing such goods. However, this provision is not binding when such packing materials or packing containers are clearly suitable for repetitive use.

The issue of "put up for retail sale" discussed in this context was later addressed on a product-specific basis since there are specific HS subheadings covering this expression.

GENERAL RULE 6: ACCESSORIES AND SPARE PARTS AND TOOLS

Accessories, spare parts, tools and instructional or other informational material classified and presented with a good shall be disregarded in determining the origin of that good under General Rule 3, provided they are normally sold therewith and correspond, in kind and number, to the normal equipment thereof.

The classic example provided to explain the scope of this rule is the spare wheel present in a car. In order to determine the origin of the car, the origin of the spare wheel will have to be disregarded. This principle was agreed early in the negotiations. As explained further below this rule became in the final draft Rule 5 and Minimal operations and processes became Rule 6.

Appendix I illustrated in the box below provides the definitions of wholly obtained products.

APPENDIX 1 – WHOLLY OBTAINED GOODS

RULE 1: SCOPE OF APPLICATION

This Appendix sets forth the definitions of the goods that are to be considered as being wholly obtained in one country.

RULE 2: MINIMAL OPERATIONS AND PROCESSES

Operations or processes undertaken, by themselves or in combination with each other for the purposes listed below, are considered to be minimal and shall not be taken into account in determining whether a good has been wholly obtained in one country:

(i) ensuring preservation of goods in good condition for the purposes of transport or storage;
(ii) facilitating shipment or transportation;
(iii) packaging or presenting goods for sale.

Appendix 1 of the final draft is mainly devoted to the definition of wholly obtained products. An earlier version of this appendix contained a Rule 2 reproduced in the box concerning minimal operations and processes that became General Rule 6 in the final draft. The concept of minimal operations and processes is familiar to the majority of origin sets. Minimal operations or processes are normally included in the general rules rather than in a subsection dealing with wholly obtained goods.

Article 9, paragraph 2(c)(i) of the ARO contained an explicit provision for developing harmonized definitions of "minimal operations or processes *that do not wholly obtain goods and by themselves confer origin to a good*."

In fact, during the early stages of the negotiations these rules were contained in Appendix 3. A second formulation split the application of rules in Appendix 1 and 2. During the HWP, there were debates among delegations over the content and the scope of application of this general rule on minimal operations or processes. Drafts containing explanatory notes and descriptions of minimal working or processing were circulated among delegations.

Some delegations were of the opinion that the preparation of product-specific rules and the fact that the issue of minimal operations is often addressed by a chapter note made the provision of a general rule redundant. Other delegations believed a list of minimal operations or processes could be useful.

Lately some delegations believed that there was no need for such rules to apply to Appendix 2 since the applicable primary rules would have already determined whether a certain minimal working or processing operation is origin conferring or not.

Consensus was reached initially by inserting what was originally General Rule 5 as a rule of Appendix 1 only applicable to wholly obtained goods. This appeared to be a pragmatic compromise considering that many issues concerning minimal operations or processes are covered in Appendix 2 at chapter note level. However consensus was later reached to have the issue of minimal operations and processes as General Rule 6.

DEFINITIONS OF WHOLLY OBTAINED GOODS

Definitions		Notes
(1) The following goods are to be considered as being wholly obtained in one country:		
(a)	Live animals born and raised in that country;	In definitions 1(a), (b), and (c) the term "animals" covers all animal life, including mammals, birds, fish, crustaceans, molluscs, reptiles, bacteria and viruses.
(b)	Animals obtained by hunting, trapping, fishing, gathering or capturing in that country;	Definition 1(b) covers animals obtained in the wild, whether live or dead, whether or not born and raised in that country.
(c)	Products obtained from live animals in that country;	Definition 1(c) covers products obtained from live animals without further processing, including milk, eggs, natural honey, hair, wool, semen and dung.
(d)	Plants and plant products harvested, picked or gathered in that country;	Definition 1(d) covers all plant life, including fruit, flowers, vegetables, trees, seaweed, fungi and live plants grown in that country.

(*continued*)

DEFINITIONS OF WHOLLY OBTAINED GOODS		
	Definitions	Notes
(e)	Minerals and other naturally occurring substances, not included in definitions (a)–(d), extracted or taken in that country;	Definition 1(e) covers crude minerals and other naturally occurring substances, including rock or solar salt, crude mineral sulphur occurring in free state, natural sands, clays, stones, metallic ores, crude oil, natural gas, bituminous minerals, natural earths, ordinary natural waters, natural mineral waters, natural snow and ice.
(f)	Scrap and waste derived from manufacturing or processing operations or from consumption in that country and fit only for disposal or for the recovery of raw materials;	Definition 1(f) covers all scrap and waste, including scrap and waste resulting from manufacturing or processing operations or consumption in the same country, scrap machinery, discarded packaging and household rubbish and all products that can no longer perform the purpose for which they were produced, and are fit only for discarding or for the recovery of raw materials. Such manufacturing or processing operations include all types of processing, not only industrial or chemical but also mining, agricultural, construction, refining, incineration and sewage treatment operations.
(g)	Articles collected in that country which can no longer perform their original purpose there nor are capable of being restored or repaired and which are fit only for disposal or for the recovery of parts or raw materials;	
(h)	Parts or raw materials recovered in that country from articles which can no longer perform their original purpose nor are capable of being restored or repaired;	
(i)	Goods obtained or produced in that country solely from products referred to in (a) through to (h) above;	

As of May 2008

As outlined in the previous section, the elaboration of a list of definitions of wholly obtained goods was one of the first tasks of the TCRO.

A list of wholly obtained goods is present in all sets of origin rules. The current version is more precise than the one contained in the Kyoto Convention. In particular, there were intense debates over the definitions of 8(g) and (h) and possible environmental considerations.

Appendix 1 as contained in definition (i) above also covers the origin of a good exported from the country where it was obtained solely from materials or products wholly obtained therein as shown in the following examples:[25]

Country A Exports:

- *ground natural calcium phosphates (2510.20) obtained solely from natural phosphates taken from the natural rock in this country; or*
- *natural honey (0409) obtained solely from bee-hives in this country; or*
- *cereals (1001 through 1008) harvested solely in this country.*

Since these processes are carried out without any foreign material added to the exported good, country A is the country where the goods have been wholly obtained and, consequently, the country of origin of the goods.

Country B Exports:

- *cane sugar (1701) obtained in this country from sugar cane (1212) imported from country* A.

Since the cane sugar in this example is not a wholly obtained product it follows that country B is not the country where the goods have been wholly obtained, even though this country shall be the country of origin of the goods, according to Appendix 2 rules.

There was agreement among all members that the origin of fish and other products taken from the territorial sea (not exceeding 12 nautical miles) of a country should be the coastal State. The outstanding question concerns the origin of fish and other products taken from the EEZ (not exceeding 200 nautical miles). Among the alternative texts, one text was suggesting that the origin of fish and other products taken from the EEZ should be the country of the flag of the vessel. Another alternative suggested that the origin of fish and other products taken from the EEZ should be the coastal State mainly supported by developing countries.

The last alternative text suggested that the best way to address this issue should be to leave the importing country to determine the origin of the good in accordance with its legal standpoint of the Law of the Sea.

[25] These examples are excerpted from WTO document G/RO/W/56.

After lengthy negotiations lasting several years the most recent draft shows a tentative agreement on the thorny issue of rules of origin on fishery products:[26]

Definitions

(2) (i) Products of sea-fishing and other products taken from the sea outside a country are considered to be wholly obtained in the country whose flag the vessel that carries out those operations is entitled to fly.

(ii) Goods obtained or produced on board a factory ship outside a country are considered to be wholly obtained in the country whose flag the ship that carries out those operations is entitled to fly, provided that these goods are manufactured from products referred to in subparagraph (i) originating in the same country.

(iii) Products taken from the sea bed or subsoil beneath the sea bed outside a country, are considered to be wholly obtained in the country that has the rights to exploit that sea bed or subsoil in accordance with the provisions of the UN Convention on the Law of the Sea.[26]

Given the current globalization of production where goods are increasingly manufactured in more than one country, Appendix 2 contains the rules applicable to the majority of goods currently produced and traded.

Appendix 2 contains seven rules of which Rules 1–3 relate to the most crucial issues relevant to the overall architecture. The final draft provides for two rules, Rule 1 determination of origin and Rule 2 application.

APPENDIX 2 — PRODUCT-SPECIFIC RULES OF ORIGIN

RULE 1: SCOPE OF APPLICATION

This Appendix sets forth rules for determining the country of origin of a good when the origin of the good is not determined under Appendix 1. (earlier version)

a This Appendix sets forth rules for determining the country of origin of a good when the origin of the good is not determined under Appendix 1.

b In framing its legislation each Member shall provide for the application of one out of each of two optional primary rules of Chapters 84–90 referred to in columns C and D, which are set out at the levels of heading, split heading, subheading or split subheading, for it. Each Member shall notify the Committee on Rules of Origin of its application within 90 days after the date of entry into force of this Annex, for it. (As of May 2008.)

[26] It is understood that these definitions are without prejudice to members' rights and obligations who are not States Parties to the United Nations Convention of the Law of the Sea.

As earlier noted, paragraph (b) in the latest draft (above) appears to be a compromise among the EU and United States as to whether product-specific rules in Chapters 84–90 have to be drafted using the CTC or an ad valorem percentage. The compromise reached at that time was that each WTO member will have to notify what system will be used by its national administration within ninety days.

RULE 2: APPLICATION OF RULES

(a) The tariff classification change rules provided in this Appendix are to be applied to goods based upon their classification in the HS and any additional subdivisions created thereunder, as referred to in General Rule 2 of this Annex.
(b) All primary rule specified at the levels of specific chapter, heading, subheading or split (sub)heading in this Appendix are co-equal. The country of origin of a good is determined, provided that a primary rule applicable to the good is satisfied in that country according to Rule 3(a) to (c).
(c) Primary rules based on tariff classification shall apply only to non-originating materials.
(d) Where the primary rules require a change in classification, the following changes in classification shall not be considered in determining the origin of the good:
  - changes which result from disassembly;
  - changes which result from packaging or repackaging;
  - changes which result solely from application of General Rule of Interpretation 2(a) of the HS with respect to collections of parts that are presented as unassembled or disassembled articles;
(e) Where none of the primary rules are satisfied, origin shall be determined according to Rule 3(c) through (f)[(g)] of this Appendix.

(As of May 2008.)

Rule 2(a) above provides that application of rules of origin begins with classification of the goods in the HS and the identification of the corresponding product description in the harmonized nonpreferential rules of origin.

Rule 2(b) provides that all primary rules that may be found at chapter or matrix level are co-equal; that is, they are equally origin conferring.

These rules reflect some of the basic understandings reached at the Meech Lake meeting. The need for such rules emerged during discussions of the chemical chapters where more than one rule was proposed at chapter level (chemical reaction) and at product-specific subheading (CTSH). However, it was considered that thousands of chemicals can be substantially transformed into other chemicals and remain in the same subheading. The TCRO estimated that it was simply not feasible to split a subheading into thousands of subheadings in order to use a change of tariff subheading split (CTSHS) rule to capture all these occurrences. The preference

was to place the chemical reaction rule at the beginning of the chapter. This however created a possible confusion between the chapter rule and the CTSH rule at a product-specific level. Hence the need for Rule 2(b).

Rule 2(d) covers a number of situations related to a change of classification that is not origin conferring. Normally operations such as packaging and repackaging as well as disassembly are part of the debate over "minimal operations or processes" and are covered by a provision defining minimal working or processing operations as explained above. However, during the negotiations it was preferred to address it in different contexts rather than in a unique provision to provide more specific guidance.

During the negotiations, it was agreed that disassembly is not an origin-conferring event. The first paragraph deals with a rule covering origin of a disassembled (recovered) part or a removed article from the good that would have performed its original purpose or would have been restored or repaired.

Thus, this issue deals with parts or articles that are not subject to definitions (f), (g), and (h) of the wholly obtained goods.

It covers situations in which used and depreciated parts are disassembled into parts and components. For instance, it is common practice to upgrade computers by replacing a new processor, though the PC itself is still used. In those cases, there is a change of tariff heading since the old processor moves from heading 84.71 to a cartridge contained microprocessor of heading 84.73. It follows that if the rule of 84.73 is a CTH or CTSH rule, the disassembly would be origin conferring. Since it would have been impossible to cover at a product-specific level such occurrences, the TCRO agreed to this negative rule.

The second issue in Rule 2(d) refers to a change of classification by virtue of packaging or repackaging. It should also be noted that during the negotiations it was agreed that a repackaging would not lead to a change of classification. At its twenty-third session, the HS Committee took note of this. However, to ensure that in all cases a packaging or repackaging cannot be considered as an origin-conferring event, this rule has been proposed.

The third paragraph of Rule 2(d) refers to a situation where goods are presented to customs unassembled or disassembled. The General Rule for the Interpretation (GIR) 2(a) of the Harmonized System provides as follows:

> 2(a) Any reference in a heading to an article shall be taken to include a reference to that article incomplete or unfinished, provided that, as presented, the incomplete or unfinished article has the essential character of the complete or finished article. It shall also be taken to include a reference to that article complete or finished (or falling to be classified as complete or finished by virtue of this Rule), presented unassembled or disassembled.

In international trade a situation may occur where components and parts of goods are imported in one country and then exported as kits to another country. In this situation a change of tariff heading by application of GIR 2(a) may apply.

The scope of this rule is to avoid a situation as described above where the simple collection of parts of a finished good classified in other headings may change heading by virtue of (GIR) 2(a) and therefore confer origin. The final draft simplify substantially the text of Rule 2 concerning application that become Rule 3.

2.6.3 *Determination of Origin According to Rule 3*

Rule 3 is the core of Appendix 2 and provides for the sequential application of the primary rules and the residual rules. As of May 2008, there were seven paragraphs in Rule 3 and different drafts proposed by some delegations. Since Rule 3 covers a number of complex situations and alternative drafts, this rule is further subdivided in primary rules and residual rules in the boxes below.

RULE 3: DETERMINATION OF ORIGIN

The country of origin shall be determined in accordance with the following provisions, applied in sequence:

Primary Rules

(a) *[The country of origin of a good is the country designated as such in the applicable primary rule.] (EC) [NOR] (JPN)*

[When a primary rule specifies that the origin of a good is the country in which the good was obtained in its natural or unprocessed state, the country of origin of the good shall be the [single (IND)] country in which the good was obtained in that condition;] (IND)

[When a primary rule requires that the country of origin of a good is the country in which:

(i) *the good was obtained in its natural or unprocessed state, the country of origin of the good shall be the single country in which the good was obtained in that condition; or*

(ii) *a specifically designated stage of production was attained, the country of origin of the good shall be the single country in which such stage of production was attained;] (US)*

[The country of origin is the country determined as such by the application of the primary rule] (CAN)[NOR]

(b) *The country of origin of a good is the last country of production, provided that a primary rule applicable to the good was satisfied in that country*[27] *(Earlier draft)*

RULE 3: DETERMINATION OF ORIGIN

The country of origin shall be determined in accordance with the following provisions, applied in sequence:

[27] This applies also to primary rules requiring that the country of origin of a good is the country in which the good was obtained in its natural or unprocessed state. (PHI)

Primary Rules

(a) When a primary rule itself designates the country in which a good was obtained in its natural or unprocessed state as the country of the good, or designates otherwise the country of origin of a good, the country of origin of the good shall be the single country designated as such;
(b) The country of origin of a good is the last country of production, provided that a primary rule applicable to the good was satisfied in that country.

(As of May 2008)

As pointed out at the beginning of Rule 3, it is important to highlight the sequenced conceptual application under Rule 3 because paragraph (a) and (b) applies to the primary rules while the remaining paragraphs (c) and (f) further below are dealing with residual rules. This overall structure of Rule 3 has remained unchanged in the latest draft of May 2008.

As shown in the earlier draft above, different drafting techniques divided some delegations in the drafting of Rule 3(a). However, the difference was not substantial but was instead based on questions of definitions.

Rule 3(a) portrays a situation where a product-specific primary rule at chapter level is met in a single country.

Example: The primary rule for heading 1602(b), cooked preserved meat, meat offal, or blood is change of chapter (CC). A manufacturer in country A imports raw meat of Chapter 2 and transform it into canned cooked meat classified in 1602(b). The primary rule is met since there has been a change of chapter (from Chapter 2 to Chapter 16)

Different drafting techniques divided some delegations in the drafting of Rule 3(a).

The former EU proposal under Rule 3(a) refers to the PSRO in the Appendix at a product-specific level, such as that described in the preceding example.

The US former version of Rule 2(a) explicitly refers to the so-called "Ottawa language" and to other "specific designated stage of production" that may be required in the product-specific rules. There are examples of this latter kind of rule in the machinery sector in which it may be expressly requested to manufacture the display to acquire the origin of TV sets.

The May 2008 draft of Rule 3(a) and (b) reported above showed considerable progress and convergence, that later resulted in the final text of 2010 contained in WTO document G/RO/W/111/Rev.6 of 11 November 2010, not adopted.

Rule 2(b) covers a situation where originating and non-originating goods are processed in the last country of production. This last country of production is considered the country of origin as far as a primary rule is satisfied as contained in the example below:

Example

Country B Exports

- *either cocoa shells (1802), or iron slag (2619) or cotton waste (5202) that result from the processing of, respectively, originating and non-originating cocoa beans (1801), iron ores (2601) and cotton (5201); or*
- *fruits preserved by sugar (2006) obtained from originating and non-originating fruits (0810) and cane-sugar (1701); or*
- *organic chemicals of Chapter 29 obtained by chemical reaction, or mixture, or purification of originating and non-originating organic chemicals of the same HS chapter; or*
- *shape-cut industrial diamonds (7102.29) obtained from imported unworked diamonds (7102.21)*

In all four situations, country B satisfies the primary rule applicable to the exported goods; namely, the Ottawa language in the first paragraph, the CC in the second paragraph, the chapter rule in the third paragraph, and the change of subheading plus a specific process in the fourth paragraph.

RULE 3: RESIDUAL RULES

(c) When a good is produced by further processing of an article which is classified in the same subdivision as the good, the country of origin of the good shall be the single country in which that article originated; (Latest draft May 2008)

[When a good undergoes one or more operations that do not result in a change in its classification, the origin of the resulting food is the single country from which the good originated immediately prior to such operations, provided that any material that might have been added satisfies any change of tariff classification rule applicable to the good] (Earlier alternative draft to (c) above.)

The remaining paragraphs (c) to (g) of the earlier draft of Rule 3 provided for residual rules that apply in sequence when primary rules are not met. As previously explained, the need for residual rules in nonpreferential rules of origin is motivated by their exhaustive nature: there must always be an origin outcome and rules should provide for it. The latest version of February 2007 provides for paragraphs (c) to (h). The two drafts are briefly compared in the following paragraph.

The scope and applicability of residual 3(c) (commonly referred to as the origin-retention rule) cover a situation whereby an originating good is further processed in a second country and this latter process was not sufficient to change the tariff classification of the originating good. In other words, the tariff classification does not change. In these cases, the origin is "retained" by the country producing the originating good. It was agreed that the term classification/subdivision in both earlier drafts refers to the level of tariff classification/subdivision applicable in the primary rule.

Examples[28]

Country A Exports to Country C:

- *originating cider in bulk (2206); in country C this cider is further fermented, sweetened with sugar (1701) from country B and re-exported in bottles (2206); or*
- *wholly-obtained natural cork, raw, (4501.10); in country C this cork is ground and granulated and re-exported (4501.90); or*
- *originating articles of carbon fibres and graphite (ex6815.10(b)); in country C [these] articles are processed and transformed in carbon fibres (ex-6815.10(a)) that are re-exported.*

In these cases, the origin determination for the re-exported goods by Rule 2(c) – both options (i) and (ii) – shall be the origin of the imported materials – namely, country A – insofar as the processes carried out in country C did not change the level of classification requested by the primary rule applicable to those goods (i.e. CTH).

The subparagraphs of Rule 3, and especially those after paragraph (c), have been the most negotiated issues. The examples below excerpted from an earlier WTO document provide an idea of the complexity of the issues at stake when the origin question addressed by subparagraph (c) could not be solved by this paragraph and subsequent paragraphs (d) to (g) reported below have to be used to determine origin.

Country B Imports:

- *natural cork, raw, (4501.10); in country B this cork and originating natural cork is mixed, ground and granulated for exportation (4501.90) to country C; or*
- *articles of carbon fibres (ex-6815.10(b)); in country B these articles are processed with originating articles of graphite (ex-6815.10(b)) to obtain carbon fibres (ex-6815.10(a)) that are exported to country C.*

The major difference with respect to the examples above is that in these cases the goods processed in country B were not originating goods. It follows that Rule 3(c) – both options (i) and (ii) – cannot provide the country of origin of the goods exported from country B, insofar as the goods were obtained in this country from materials, which did not change their classification, of more than a single country of origin. The country of origin of these goods should be determined via a residual rule – Rule 2(f) on major portions.

Country C:

- *produces for exportation not-impregnated or coated bandages for medical purposes (ex3005(b)) from imported fabrics (Section XI); or*
- *imports non-refractory mortars and concretes (3824.50) and produces for re-exportation resin cements (3214.10).*

In these cases, Rule 3(c) – both options (i) and (ii) – cannot provide the country of origin of the goods exported from country C, insofar as the goods were obtained in this country from imported materials that did change the level of classification requested by their primary rules.

[28] These examples are excerpted from WTO document G/RO/W56.

Country C Imports:

- *fresh manioc roots (0714.10) from country A, and produces for exportation pellets of manioc (0714.10), adding dried manioc flour (1106) – whether or not originating; or*
- *rough watch movements (ex-9110(a)) from country B and produces for exportation complete watch movements, unassembled, (ex-9110(a)) using springs, dials and other articles (9114) – whether or not originating;*

In these cases, option (i) of Rule 3(c) would attribute the origin of the exported goods to the country of origin of the manioc roots – country A – and rough watch movements – country B, respectively.

Unlike option (i), option (ii) in this example will not provide an origin outcome. In fact, this option contains the provision "provided that any material that may have been added satisfies a primary rule applicable to the good." Since, in both examples, material has been added (dried manioc flour and springs, dials, and other articles whether or not originating). This addition would require the sequenced application of Rules 2(d) to (f).

Country C Imports:

- *tobacco, not stemmed, (2401.10), or ungrounded natural graphite (2504.90), from country A and, after processing, re-exports stemmed tobacco (2401.20) and flakes of natural graphite (2504.10); or*
- *Wheat flour (1101) and corn flour (1102) from country A and, process them – whether or not with originating cereal's grains and flours – for consumption therein and exportation of pellets (1104).*

These examples cover a situation whereby the primary rule is not requiring a CTC but is expressed as Ottawa language. Thus, it is not clear whether Rule 3(c) is applicable in these cases. Some delegations were of the opinion that Rule 2(a) would eventually provide an origin outcome.

RULE 3: RESIDUAL RULES (EARLIER DRAFT)

(d) The country of origin of the good shall be determined as indicated in the applicable residual rule specified at the chapter level;

(e) When the good is produced from materials all of which originated in a single country, the country of origin of the good shall be the country in which those materials originated;

(f) [When the good is produced from materials (whether or not originating) of more than one country, the country of origin of the good shall be the country in which the major portion of those materials originated, as determined on the basis specified in each chapter, [and in the event of two or more countries equally contributing major portions of those materials, the good shall be assigned a multi-country origin]]; (IND)

When the good is produced from materials (whether or not originating) of more than one country, the country of origin is the single country of origin of the materials that did not satisfy a primary rule applicable to the goods; (US)

[When the good is produced from materials of more than one country, the country of origin of the good shall be the country in which the major portion of the non-originating materials originated, as determined on the basis specified in each chapter. However, when the originating materials represent at least 50% of all the materials used, the country of origin of the good shall be the country of origin of those materials]; (EC)

(g) [When the good is produced from materials (whether or not originating) of more than one country that did not satisfy the primary rule applicable to the good, the country of origin of the good shall be the country in which the major portion of those materials originated, as determined on the basis specified in each chapter]. (US)

Rules 3(d) and 3(e) are rather self-explanatory. In the case of Rule 3(d), it is evident that if there is a residual rule at chapter level, that rule provides an origin outcome. Rule 3(e) covers a situation where the application of Rules 3(f) and 3(g) may make it redundant.

Rule 3(f) is often referred to as the major portion rule. However, the US position in Rule 3(f) bases origin on the country of origin of the material(s) originating in a single country which did not satisfy a primary rule, and thus complements the outcome of the primary rule. If the applicable primary rule is change of heading "except from a specified heading," then obviously the intent of the primary rule was that the specified change did not result in substantial transformation. According to the US proposal, it is thus logical and appropriate to focus on the origin of the materials that did not undergo the required change. The EU proposal contains reference to a value-added approach. During consultations it was commonly understood that the application of the sequenced residual rules would start from the application of primary rules in the last country of production as a first test, the application of the origin retaining concept as a second test, and the major portion concept as a final test. Differences however remained in the earlier draft on how the concept of major portion applies especially between the EU and United States. Some examples provided below may further clarify the application of residual rules.

Examples

Country C Exports:

- *polished-rice (1006.30) that resulted from the processing of paddy-rice (1006.10) originated in country A and husked-rice (1006.20) originated in country B; or*
- *not-impregnated or coated bandages for medical purposes (ex-3005(b)) produced from fabrics (Section XI) imported from countries A and B and originating fabrics; or*

- *X-ray photographic plates (3701.10), produced from X-ray film in rolls (3702.10) originated in country A and country B,*
- *complete watch movements, unassembled, (ex-9110(a)) produced from originating watch parts (9114) and rough watch movements (ex-9110(a)) from country A and country B.*

In these examples, all the materials (whether or not originating) used for the production of the exported goods did not satisfy the primary rule applicable to these goods. Therefore, both options of Rule 2(f) should attribute the origin to the country – A, B, or C – contributing the major portion of the materials or, according to the US approach to the origin of the materials that did not satisfy a primary rule.

Another example has been circulated during the negotiations to illustrate the different scope and outcome depending on alternatives adopted.[29]

Country A exports manioc pellets (heading 0714, 100 kg) produced from originating fresh manioc (cassava) (heading 07.14, 200 kg, 50 USD), together with flour of manioc originating in country B (heading 11.06, 50 kg, 150 USD), and binder (molasses) originating in country C (heading 17.03, 3 kg, 20 USD). The product-specific primary rule for heading 0714 is CTH except from 11.06. Assuming that the criterion to apply Rule 2(g) or (f) is by weight, which country is the origin of the manioc pellets?

It is clear that no primary rule has been met because goods of heading 11.06 have been used. Rule 2(c) is not applicable. Rule 2(e) is not applicable either because the material originates in more than one country.

According to the first alternative of Rule 2(f) supported by India and Rule 2(g) supported by United States the country of origin will be country A since it supplies the major part of the materials.

However, when the third alternative of Rule 2(f) is considered, the origin of the pellets will be country B since it supplies the major portion (in this case weight) of non-originating materials. This difference of outcome is derived from the absence in the third alternative option of Rule 2(f) of the wording "whether or not originating" and the expressed focus on non-originating material present in the text. It follows that by focusing only on the non-originating materials the 200 kg of originating fresh manioc have to be disregarded when determining origin.

RESIDUAL RULES (LATEST DRAFT FEBRUARY 2007)

(d) The country of origin of the good shall be determined as indicated in the applicable residual rule specified at the chapter level;

[29] This example was originally developed by the Secretariat and later used by the WCO during technical assistance activities and it has also been reported in Himagawa and Vermulst, "The Agreement on Rules of Origin" (fn. 10 above), 601–678. In this version it has been adapted to respond to the last version of the architecture rule appearing in WTO document G/RO/Rev.2.

(e) When the good is produced from materials all of which originated in a single country, the country of origin of the good shall be the country in which those materials originated;
(f) When the good is produced from materials (whether or not originating) of more than one country, the country of origin is the single country of origin of the materials that did not satisfy a primary rule applicable to the goods;
(g) When the good is produced from materials of more than one country, the country of origin of the good shall be the country in which the major portion of the non-originating materials originated, as determined on the basis specified in each chapter. However, when the originating materials represent at least 50% of all the materials used, the country of origin of the good shall be the country of origin of those materials;
(h) When two or more countries equally contribute major portions of those materials, the good shall be split and assigned by such countries. When the good cannot be split, a multi-country origin shall be assigned.

In comparing the two drafts it appears that a certain degree of consensus has been reached. The main points to be noted are the following:

- Subparagraphs (d) and (e) have remained unchanged.
- Subparagraph (f) and (g) reflecting the original position of the United States and EU, respectively, have also remained unchanged.
- Subparagraph (h) appears to be the compromise subparagraph where elements of the former alternative text of subparagraph (f) of the Indian proposal has been somewhat merged with the alternative US proposal to rule (g). The result of this merging, as reflected in subparagraph (h), is highly debatable in terms of predictability and ease of administration: assigning a multi-country origin to a good is counterintuitive to the real essence of the agreement that is to provide a single origin outcome for a given good. The final draft provides as follows:

RESIDUAL RULES (DRAFT 2010)

(d) When a good is produced by further processing of a material which is classified in the same subdivision as the good, the country of origin of the good shall be the single country in which the material originated;
(e) When a good is produced by further processing a material that does not satisfy the primary rule for the good, the country of origin of the good shall be the single country in which the material originated.

For the purposes of this rule, account shall be taken of both originating and non-originating material;

(f) The country of origin of a good is the country where a residual rule at the chapter level is satisfied;
(g) The country of origin of a good shall be the country of origin of material or materials incorporated in the good by further processing, provided the origin of material or materials is a single country;
(h) When a good is produced from materials of more than one country, the country of origin of the good shall be the country in which the major portion of those materials originated, as determined by the criterion specified in the Chapter where the good is classified;
(i) Where the criterion for the application of Rule 1 (h) above specified in a Chapter is weight or volume, and that criterion does not allow for origin to be determined, the criterion of value shall be used; where the criterion for the application of Rule 1 (h) above specified in a Chapter is value, and that criterion does not allow for origin to be determined, the criterion of weight or volume, as appropriate, shall be used.

RULE 4: INTERMEDIATE MATERIALS

Materials which have acquired originating status in a country are considered to be originating materials of that country for the purpose of determining the origin of a good incorporating such materials, or of a good made from such materials by further working or processing in that country.

(d) The country of origin of the good shall be determined as indicated in the applicable residual rule specified at the chapter level;
(e) When the good is produced from materials all of which originated in a single country, the country of origin of the good shall be the country in which those materials originated;
(f) When the good is produced from materials (whether or not originating) of more than one country, the country of origin of the good shall be the country in which the major portion of those materials originated, as determined on the basis specified in each Chapter.

This rule reflects the consensus earlier reached in the TCRO that once origin is conferred to a good in a country, the good will not lose origin by subsequent processing operations in the same country. This rule of intermediate material features in mainly preferential rules of origin and is often referred to as absorption rules under the EU preferential rules of origin or roll-up test under the Northern American model of preferential rules of origin.[30] It provides legal certainty and clarity to the rules.

[30] For examples and explanations of these rules see Chapter 3 of this book.

RULE 5: [INTERCHANGEABLE GOODS AND MATERIALS]

Where it is not commercially practical to keep separate stocks of interchangeable materials or goods originating in different countries, the country of origin of each of the commingled materials or goods may be allocated on the basis of an inventory management method recognized in the country in which the materials or goods were commingled. The use of this system shall not give rise to more products originating in a specific country than would have been the case had the commingled materials or goods been physically segregated.

This rule covers a situation where a producer is utilizing fungible materials imported from different countries in order to produce a final good – that is, raw chemicals in bulk – to produce finished goods. For commercial reasons it may be difficult or impossible to stock separately these goods according to their origin and therefore these inputs may be commingled and the origin of these materials will have to be kept according to an inventory management method.

RULE 6: PUTTING UP IN SETS OR KITS

A. [US] Unless otherwise provided in this Appendix, goods put up in sets shall retain the origin of the individual articles in the set.
B. [IND] Goods put up in sets or kits shall retain the origin of the individual articles except when such goods are explicitly mentioned as sets or kits in a heading or sub-heading of the HS or are classified as sets or kits by application of GIR 3(b) of the HS, in which case the origin of the set or kit shall be the country where it is put up.
C. Merely putting articles into sets is not origin conferring: with this option there is no need for a specific provision for sets, although it might be advisable to have this element included in the new Rule 2(b)/old Rule 3 (Application of Rules): the rule in this case might read "a CTH resulting from merely putting up in sets is not considered as origin conferring". (MEX) (earlier draft)

This Rule 6 does not appear in the latest draft of February 2007.

This rule was designed to cover a situation where articles originating in more than one country are put together in one set. There might be three different types of sets:

(1) sets which are explicitly mentioned in the HS (e.g. 82.14 – manicure sets; 3006.50 – first aid boxes and kits; 96.05 – travel sets for personal toilet)
(2) goods which are classified as sets by application of GIR 3(b) or (c)
(3) goods merely put together that are not classified as sets by either GIR 3(b) or (c) or within the HS.

There was growing consensus during the negotiations that putting up in sets was not origin conferring, and that there was no need for a specific rule as well as for

reference in Rule 2(d) of Appendix 2. This has led to the disappearance of Rule 6 in the latest draft of February 2007. The country of origin of a set put up from articles that originate in more than one country shall be determined according to residual Rule 3(f).

[RULE 7: DE MINIMIS]

For the application of the primary rule, non-originating materials that do not satisfy the rule shall be disregarded, provided that the totality of such materials does not exceed [10%] in value, weight or volume, as specified in each chapter, of the good.

Latest version as of May 2008

A *de minimis* approach is familiar to a number of customs administrations as a way to disregard materials that otherwise would prevent an origin rule from being met. In this respect, the *de minimis* rules, or tolerances, as argued by many delegations during the negotiations, give greater possibilities for primary rules to be satisfied and reduce overdependence on residual rules.

There was intense debate over the positive and negative merits of this rule and whether it would be applicable on a horizontal basis or only to Appendix 2. In particular it was considered whether the rule was applicable in the case of an origin rule that was based on specific working or processing, what rationale was to be used to set thresholds, and what difficulties could this rule generate for developing countries. There has been growing consensus on the rule and the square bracketed 10 percent is proposed by the facilitator.

2.7 OUTSTANDING PRODUCT-SPECIFIC ISSUES

Over some years, delegations have been unable to reach consensus on issues concerning some specific goods. Although worded in a technical language they reflected a disagreement over the trade policy implications of a certain origin outcome.

At the end of the TCRO, by May 1999, the product-specific rules for 511 headings (or 41 percent) out of 1,241 were agreed upon by consensus. There were sixty-six referral documents covering 486 product-specific unresolved issues involving 730 headings. The TCRO referral documents included 650 pages of narrative explanation and amounted in total to over 2,000 pages. In 2001 there was considerable progress on solving many of the product-specific issues because over 300 were solved. However, as progress slowed down considerably during 2002, in July of that year the Chair of the CRO submitted to the GC ninety-four core policy issues of which twelve were considered crucial.

At the meeting of WTO GC of July 27, 2005, the Chair reported the limited progress made on the outstanding ninety-four core policy issues. Ninety-three of these

issues are product-specific and the remaining one is related to the cross-cutting issue of the implications of the implementation of the HRO for other WTO agreements.

Although progress has been recorded in a number of areas and there has been a narrowing down of position, until the beginning of 2006 consensus was reached only on two products issues: mixing of coffee and mixing of petroleum products.

Obviously, many delegations felt that the resolution of the remaining outstanding issues has to come as a package. However, it was clear that such a package could only eventually materialize once a common understanding of the implications of the harmonized rules for other WTO agreements relating to trade remedies is achieved.

As mentioned earlier the disentangling of the issue of trade remedies through the reformulation of General Rule 1, scope of application, during the fall of 2006 has opened the way to a series of compromises in view of a final package. The latest documentation of 2007 showed, in fact, a number of developments made in many outstanding issues.[31]

A brief analysis of the most relevant product-specific outstanding issues and their evolution at the time of writing is described in this section. This analysis is based on a former proposal of the Chair of the CRO[32] (hereinafter referred to as the "July 2006 package") grouping and summarizing different issues for ease of reference. It follows that this review is far from complete and detailed in product/issue-specific issues. It aims simply at providing some indications and an overview on certain negotiating issues and their evolution. The CRO chairperson in fact circulated a final package for PSRO pursuant to a series of suggestion made in 2006 . The final draft text explicitly recognizes that: "Product-specific rules of origin in square brackets have not yet been adopted by the Committee, but reflect the proposals by the Chairperson of the Committee."

The package was based on the objectives and principles of harmonizing rules of origin as provided in Article 9.1 of the ARO. The package was also based on the observation that the negotiations on harmonizing rules of origin should minimize any possible impacts to the status quo of the current trade regimes of goods concerned, as clearly provided in Article 9.1(d), which says "notwithstanding the measure or instrument to which they may be linked, rules of origin should not be used as instruments to pursue trade objectives directly or indirectly."

2.7.1 *Fishery Products*

Apart from the outstanding issue on the definition of territorial sea discussed in section 2.6.1, the issues of drying, (heavy) salting of fish, smoking of fish, and filleting of fish are still unresolved.

[31] See WTO document JOB(01)/52/Rev.6, February 22, 2007. In the following text this document is referred to as the "latest draft of February 2007."

[32] See JOB(06)/86/Rev.2, July 17, 2006.

Some delegations, mainly Japan and Korea, are of the view that filleting operations are not origin conferring and that origin should be referred back to the country where the fish has been caught or farmed. In the case of filleting of fish, a compromise proposal by Japan recognized filleting as origin conferring only for those species not subject to conservation measures applied by regional fisheries management organizations. These organizations establish joint measures including import bans to prevent overfishing.

According to Japan and Korea for tuna and tuna-like species of fish, joint measures, including import bans on these species of fish and their products from certain countries, are now taken to prevent overfishing under the existing regional frameworks for conservation and management of these resources. If it was decided that filleting of tuna and tuna-like species can confer their origin, then circumvention on import bans ("tuna-laundering") could easily take place, because it would become extremely difficult for the customs authorities to carry out the necessary import controls to fulfill the obligations under the resource conservation organizations. On such a basis, Japan and Korea considered it inappropriate to authorize an origin rule that can hamper the effective implementation of joint measures for the conservation of these species. If filleting is considered an origin-conferring operation, they argued, it would be easy to circumvent such import bans or quotas under marine resources conservation measures. The issue is still unresolved according to the latest draft of 2007 recording a chair's recommendation toward considering filleting a non-origin-conferring operation.

In the case of drying and smoking fish, there were signs of growing consensus toward recognizing it as an origin-conferring operation. In these cases, Japan and Korea indicated that they were able to join the consensus if their concerns on the implications of the application of the result to labeling requirements and sanitary and phytosanitary measures were duly accommodated.

In particular Japan was of view that:

(i) In certain cases, it is rather inappropriate to thoroughly and automatically apply the results of the ongoing harmonization work to the labeling requirements of foods applied domestically.
(ii) It is not logical in itself to refer to the HRO in deciding whether to apply sanitary and phytosanitary measures.[33]

In practice, the request of Japan and Korea is to disregard the HRO rules in the case of labeling requirements and sanitary and phytosanitary (SPS) measures. In the case of labeling, consumer policy objectives may require a labeling that goes beyond the requirement to show a single origin of the product for the purpose of customs procedures. In the case of processed foods, it may be required, at the domestic level, to declare

[33] See WTO document G/RO/W/74.

the origin of the ingredients in addition to the single origin of the product. Japan argues that harmonized rules should not prevent the necessary labeling often going beyond the declaration of the single origin of the product, in order to satisfy consumer concerns. The same reasoning applies in the case of SPS. A *fortiori* domestic SPS domestic legislation demands not only the origin of the product but the history of the product (where it has been caught, frozen prepared or otherwise preserved, or transported, etc.).

It follows that the HRO should not prevent the application of SPS measures in order to avoid pests or diseases. In the case of heavy salting of fish – that is, a process resulting in so-called "stockfish" – consensus is emerging to consider this process as origin conferring. However, this consensus is emerging for the heavy salting process according to definitions provided by Norway[34] and the Food and Agricultural Organization. Conversely, simple salting of fish is not considered an origin-conferring operation.

In the July 2006 package, the chairperson proposal may be summarized as follows:

- Drying, smoking, or heavy salting of fish are origin-conferring operations.
- Filleting is not an origin-conferring operation and the origin of the fish fillets shall be the country in which they have been captured; or, if farmed, the country in which the fish has been raised from egg or fry (including fingerling).

2.7.2 *Slaughtering*

Slaughtering and fattening of live animals has been one of the issues that have been on the agenda since the inception of the work of the HWP. Similar to the debate over filleting the fish, the bone of contention is related to sanitary and phytosanitary concerns and consumer information.

A group of meat-producing countries including the United States, Argentina, Brazil, and Australia hold that slaughtering is an origin-conferring operation and that SPS concerns should be addressed by appropriate measures like quarantine and not through rules of origin.

A second group of countries, including the EU, Japan, and some Latin American countries, believe that slaughtering confers origin only in combination with a certain period of fattening – four months. The EU is concerned that slaughtering could be used by some countries to circumvent the ban of hormone beef.

Fattening is still a controversial issue where Argentina, Australia, and India appear to be quite isolated according to the latest draft of February 2007 in respect to a growing group of countries including the EU, United States, Japan, and Canada, who consider fattening an origin-conferring operation.

[34] Salted fish under heading 03.05 is a fishery product where the fish meat is fully saturated with salt, such that the amount of salt is at least 26.4 grams per 100 grams of water.

2.7.3 *Dairy Products*

Obtaining recombined or reconstituted milk, condensed milk, milk powder, milk products, cheese, and beverages containing over 50 percent of milk solids are processes that Australia, New Zealand, and other delegations consider origin conferring.

The EU, on the other hand, believes that these processes are not origin conferring. Such divergence of views between members of the CAIRNS group, promoting agriculture trade liberalization, and the EU, one of the most protectionist on dairy products, may be hardly surprising. However, in this case the EU position appears to be motivated by concern of the application of internal rules concerning payment of export subsidies rather than protectionist intents. The EU standpoint that origin always goes back to the country that has produced the milk is to avoid misuse of such subsidies.

Moreover, retaining or losing origin in dairy products may have some implications for marketing the finished products to consumers. This issue is particularly relevant in the case of processed cheese and yogurts. The liberal rules supported by Australia and New Zealand seem to contradict the standpoint of many producers of raw agricultural products that wish to retain the origin of the product when it undergoes further processing.

The CRO chairperson proposed in the July 2006 package that for all the milk-derived products, the country of origin shall be the country in which the milk is obtained in its natural or unprocessed state. However, obtaining yogurts or food preparations containing over 50 percent of milk solids was proposed as a compromise.

Obviously, this compromise did not satisfy all the countries. The concern of New Zealand was over the value added to these milk-derived products through agriculture processing activities.[35] New Zealand observed that there was a lack of coherence in a package that recognized the transformation of cocoa paste to cocoa powder as substantial, but at the same time denied that same recognition to the transformation of milk to milk powder or the transformation of cheese into processed cheeses. Both these processes are sophisticated, highly capital-intensive operations. Just as cocoa powder was a different article of commerce from cocoa paste, so too were milk powder and processed cheeses. The position of New Zealand on these issues was also driven by the instructions provided in Article 9 of the ARO that "rules of origin should not be used as an instrument to pursue trade objectives directly or indirectly." Additionally, in the July package 2006 the CRO chairperson proposed that slaughtering was to be considered as substantial transformation.

[35] JOB(06)/86/Rev.2/Add.1, July 19, 2006.

2.7.4 *Coffee Products*

As in the case of slaughtering, the debate over coffee products arose at the early stages of the negotiations. Countries like Colombia, that are major producers of coffee, wish to retain origin and consider that roasting and decaffeination are not origin-conferring operations. On the other hand, countries that are transforming coffee by roasting, roasting and blending, decaffeination, or making coffee preparations wish to acquire origin through these operations.

As further dealt with in section 2.9, retaining origin for countries growing coffee may be an important marketing tool especially when it is linked to brand image such as "Cafe de Colombia" or "Blue Mountain Jamaica."

On the other hand, commercial realities indicate that different qualities of coffee (Arabica, Robusta, etc.) are often blended to make coffee and coffee preparations. This blending is necessary to make a cup of coffee with varying acidity and different characteristics to meet consumer preferences.

An earlier compromise proposal circulated by the chair of the CRO is to allocate origin to the country that accounts for 85 percent of green coffee beans used in the case of roasting. When such percentage is not met, the origin will be allocated to the country in which the roasting was carried out.

Since coffee or coffee preparations are often made with different kinds of coffee, it is difficult to assess whether a requirement of 85 percent may have practical application. This would leave more scope to the alternative rule (origin is allocated to the country where the roasting takes place).

The July 2006 package proposal suggested splitting the subheading into two split headings and provides for the following requirements:

HS 0901.21

- ex 0901.21(a) (coffee, roasted, of coffee beans of subheading 0901.11, wholly obtained in a single country)
  Origin rule: The country of origin of the goods of this split subheading shall be the country in which the plant grew.
- ex 0901.21(b) (other)
  Origin rule: CTSH

Accordingly, under ex-0901.21(a) roasting without blending of different kinds of coffee is not origin conferring. However, if roasting is accompanied by blending it is an origin-conferring operation. The latest draft of February 2007 reported a growing consensus to consider the decaffeination of coffee as a non-origin-conferring operation.

2.7.5 *Refining Fats and Oils*

The United States, joined by other delegations like Brazil and Argentina, were of the view that refining oils and fats is not an origin-conferring operation since the essential characteristics are not changed by refining.

The EU, joined by Japan and other delegations, holds that the refining process is an origin-conferring operation since it makes the crude oils and fats suitable for consumption or use. They argue that in order to confer origin, the process of refining entails that three operations have to be carried out in a single country; namely, neutralization, decolorizing, and deodorizing. The latest draft of February 2007 does not report any relevant progress in this area.

The July 2006 package proposal adopted the following tentative compromise:

- CTH; or change by refining (origin conferring) for 15.01–15.06, 15.08–15.13, subheadings 1515.11–19, 1515.30–90, heading 15.16 and split heading ex-15.21(a)
- CTH (non-origin conferring) for headings 15.07 (soya-bean oil), 15.14 (rape, colza, or mustard oil), and 1515.21–29 (maize (corn) oil).

2.7.6 *Refining Sugar and Sugar Products and Molasses*

International trade in sugar is a sensitive matter and therefore it is not surprising that there is no consensus on some issues involving sugar. Major sugar producers like Australia, Cuba, and New Zealand hold the view that refining sugar is an origin-conferring operation.

A group of countries, including EU and United States, and some developing countries like Brazil (also a major producer of sugar) are of the view that refining is not an origin-conferring operation. A similar situation is occurring in related matters such as manufacturing invert sugar, obtaining sugar syrups, and obtaining molasses. Countries that are producing and exporting sugar at competitive prices such as Australia and New Zealand may wish to lose origin as soon as possible in order to avoid protective measures applicable to sugar and sugar products.

On the other hand, countries traditionally adopting more protectionist trade policies on sugar, like the EU and United States, wish to have rules retaining origin for the purpose of administration of such policies to avoid the circumvention of trade measures or misuse of domestic subsidies. The CRO chairperson proposal in the July 2006 package stated that refining was not to be considered as substantial transformation.

2.7.7 *Cocoa Products and Chocolate*

The underlying differences among delegations are that countries producing the raw material – namely, cocoa beans – wish to retain origin of the downstream products like cocoa paste and cocoa butter. Other countries are of the view that making cocoa powder from cocoa paste is origin conferring.

A related issue is making finished retail chocolate preparations from chocolate crumb. Countries producing raw cocoa materials argue for more restrictive rules of

origin. Other countries are of the view that preparing retail products from chocolate crumb is an origin-conferring operation.

Industrialized countries with major confectionery industries are of the view that a relatively simple operation as described above is origin conferring. Some other industrialized countries that have specialized in manufacturing certain quality chocolate products may also wish to have a restrictive rule. This may be the case with the Swiss position that considers the processing of chocolate crumb into retail chocolate not an origin-conferring operation.

The July 2006 package proposal put forward the following compromises:

- Processing cocoa beans into cocoa paste is a substantial transformation.
- Processing cocoa paste into cocoa butter is a substantial transformation.
- Processing cocoa powder into sweetened cocoa powder by adding sugar is not a substantial transformation.
- Processing cocoa powder into a cocoa preparation (other than sweetened cocoa powder) in liquid, paste, powder or granular form, of a content exceeding 2 kg is a substantial transformation.
- Processing chocolate crumb into a finished retail chocolate is a substantial transformation.

2.7.8 *Juices and Wines*

As in the case of cocoa preparation, the issue at stake is among the countries producing the raw material (fruits, vegetables, and grapes) and those countries that are transforming this raw material into the finished products.

The countries growing the fruits (mainly developing countries) are of the view that origin of the juices should remain with the country where the fruits were grown and harvested. Other countries hold that the preparation of fruit or vegetable juices from imported fruits and vegetables is origin conferring. Finally, some countries are of view that reconstituting juices and adding oil and essences is origin conferring. This last rule appears very liberal especially when it is contrasted with other proposals. In a recent compromise proposal supported by Brazil and the United States, a more restrictive approach is adopted in the case of citrus fruits (CC) whereas a more liberal one (CTH) is taken in the cases of other juices.

Wines bring about similar disputes between the countries that are traditional producers of wines and countries that either do not produce wines or are relative newcomers in wine producing, like Australia.

However even new producers, such as Argentina and Chile, hold the view that wine is a special product and that the distinctive features of the wine are defined by the quality and thus the origin of the raw material, the grapes, in combination with certain wine-making techniques. Accordingly, these countries consider that in the

case of wine and grape must, the origin should remain with the country where the grapes grew.

The United States and other developing countries are of the view that producing wine from imported grapes or from wine must is an origin-conferring operation. It is obvious that the debate stems from the desire to retain the origin of wines such as those made in France or Italy or the desire to acquire origin by developing new wine-making techniques in the case of newcomers to wine production. Once again, the link between the HRO and its implication on labeling is the real contentious issue.

However, as observed in the following section, it has to be noted that implementation of rules of origin in this field might be quite difficult due to the intrinsic nature of the product since it is difficult to distinguish local grapes and must from imported ones. Moreover, application of residual rules in certain cases may result in an origin outcome that may not reflect the original objective of the rules.

The July package 2006 proposed the following:

For Juices:

- Processing fruits or vegetables of Chapter 20 into juices is a substantial transformation except citrus juices which are produced from fresh citrus fruits.
- Processing fruit or vegetable juice concentrates into reconstituted juices is not a substantial transformation.

For Wine:

- Processing grapes into grape must of subheading 2204.30 is not a substantial transformation.
- Processing grape must (HS 2204.30) into wine is not a substantial transformation.
- Processing grape juice (Chapter 20) into wine is a substantial transformation.

2.7.9 *Mixture/Blends*

Discussions about mixtures took place quite early in the TCRO negotiations but the final text submitted to the CRO did not contain any specific provision and the origin determination was left to the application of residual rules. However, during the negotiations in the TCRO two approaches were proposed: (i) product-specific mixture rules of origin on a case-by-case or sector-by-sector basis, or (ii) a general rule for mixtures covering all products.

The product-specific approach was later pursued in the chemicals and agricultural sector where product-specific rules have been drafted. The main contention derives from blending of wines and whisky, spices, and mixtures of vegetables or fruits. On wines and whisky, for instance, some countries hold the view that blending is an origin-conferring operation.

In general, the mixing of agricultural products is not considered to be an origin-conferring operation. Nevertheless, mixing and blending of agricultural products is a commercial reality that has to be addressed by an appropriate rule.

As a compromise text, the chairperson adopted a former EU proposal.[36] According to this proposal, a specific residual rule has to be established for these agricultural mixtures at chapter level.

Accordingly, in the matrix, the following residual rule should be placed at the beginning of each of the chapters covering agricultural products:

Chapter residual rule applicable to mixtures

(1) For the purposes of this residual rule, "mixing" means the deliberate and proportionally controlled operation consisting in bringing together two or more identical or different fungible materials.
(2) The origin of a mixture of agricultural products shall be the country of origin of the material that accounts for more than X per cent by volume weight of the mixture. The volume/weight of materials of the same origin shall be taken together.
(3) When none of the materials used meet the percentage required, the origin of the mixture shall be the country in which the mixing was carried out.

According to this compromise proposal, the minimum percentage required shall be fixed at 50 percent. Setting this level implies that a country should contribute more than half of the materials used in order to be decisive for the origin of the mixture. As stated above, when this condition is not fulfilled, the product is originating in the country in which the mixing operation is carried out.

However, in order to take account of the specific nature of certain products, higher percentages might be required. The EU has put forward proposals in this context:

- For wine and spirits of heading 2204 and ex-heading 2209, the minimum percentage required is fixed at 85 percent in volume of the mixed product.
- For olive oil (heading 1509), the minimum percentage required is fixed at 75 percent in weight of the mixed product.

The CRO chairperson proposal in the July 2006 package was quite similar: origin shall be conferred to the country of origin of materials that account for more than 50 percent by weight of all materials used. When none of the materials used meets the percentage required, the origin of the goods shall be the country in which mixing was carried out.

Exceptions to this are 85 percent in volume of alcohol content for wine (heading 2204) and spirits (heading 2208), and 75 percent in weight for olive oil (heading 1509).

[36] See WTO document G/7RO/W/64.

2.7.10 *Grinding of Spices*

The divisive issue in this area is the split between those countries that are growing and harvesting spices as part of their natural endowments and those countries that are actually importing and commercializing these spices after crushing and grinding them. The former argues that crushing and grinding spices are minimal processing operations that do not confer any new property to the spices and the latter argues that crushing and grinding change the character of the goods because it increases their surface area, releases essential oils, and creates a form of seasoning that can be easily dispensed.

The July 2006 package proposed that "processing spices into crushed or ground spices is not a substantial transformation."

2.7.11 *Cement*

Cement is obtained from grinding clinker. The EU and other countries are of the view that this process is origin conferring. The United States is of the view that this process is not origin conferring. It appears the main reason underlying these different positions is related to existing AD measures in the United States and the concern that liberal rules of origin may lead to circumvention of these measures. In addition, Australia believes that a specific mixture rule is appropriate for cement because it is a common commercial practice to mix clinkers of different origins to produce cement.

The July 2006 package contained a consensus rule that processing clinker into cement is to be considered substantial transformation. In addition, the CRO chairperson proposed the following residual rule: "The origin of cement produced from the mixture of clinker of different origins, shall be the country of origin of the greatest proportion of clinker by weight of the total clinker in the cement."

2.7.12 *Chemicals*

There are a number of issues applying in a cross-cutting fashion in the chemical chapters (HS 28–40) related to industries carrying out specific working or processing operations. The operations performed by these industries are to standardize or make finished chemical products or components suitable for a specific use. These operations may consist of deliberate and proportionally controlled mixing or blending of materials to conform to predetermined specifications.

In the case of petroleum products a consensus has been reached that "the deliberate and proportionally controlled mixing or blending (including dispersing) of materials to conform to predetermined specifications which results in the production of a good having physical, chemical characteristics which are relevant to the

purposes or uses of the good and are different from the input materials is to be considered to be origin conferring."[37]

Consensus has yet to be reached on whether the increase of particle size is an origin-conferring operation. This issue resembles the one concerning petroleum products and a proposal in this sense argues for a chapter note as follows:

> The deliberate and controlled modification in particle size of a good, other than by merely crushing or pressing, resulting in a good having a defined particle size, defined particle size distribution or defined surface area, which are relevant to the purposes of the resulting good and have different physical or chemical characteristics from the input materials is considered to be origin conferring. A compromise proposal of the chairman would use this rule across all chemical chapters with the exclusion of medicaments classified in heading 30.04.

According to the proponents of this chapter, crude solid chemicals from synthesis are normally in the form of powders with a very broad particle size distribution. In this form, they generally cannot be used by the processing industry, as they also contain very small particles (below 50 microns) behaving as dust. Products with intrinsically valuable chemical characteristics, but their use being prevented by detrimental (mean) particle size, particle size distribution, or surface area can be physically modified into valuable products, by the controlled increase of particle size. Such increase of particle size represents a substantial transformation, which should confer origin.

In the same fashion consensus has to be reached concerning the dilution. The addition of a diluent alone to a chemical or a pre-mix, in deliberate and proportionally controlled conditions, may constitute the critical aspect of a mixing and blending operation and can result in physical or chemical characteristics relevant to the purposes or uses of the good that are different from those of the input matter. Accordingly, some countries are of the view that such process is origin conferring.

Finally, the production of tablets, capsules, and granules from prepared medicaments is also an industrial process that has been the center of debate over whether it is origin conferring or not.

Switzerland and other countries are of view that these operations are origin conferring. On the other hand, the United States holds the opposite view, arguing that the increase in particle size and addition of diluents are not origin-conferring operations. A compromise proposal later emerged on medicaments.

The July 2006 package contained the following proposals:

- for Chapter 30: chapter rule, except for heading 30.04, where the rule on increase of particle size would not apply
- for Chapters 28, 29, 32, 38, and 39: same as above.

[37] G/RO/45/Add.9/Rev.2, November 16, 2001.

The following is the chapter rule:

> The deliberate and controlled modification in particle size of a good, other than by merely crushing or pressing, resulting in a good having a defined particle size, defined particle size distribution or defined surface area, which are relevant to the purposes of the resulting good and have different physical or chemical characteristics from the input materials is considered to be origin conferring.

In addition:

- Processing chemicals into diluted chemicals is not a substantial transformation.
- The proposed rule for heading 30.04 (medicaments) is as follows: CTH, except by mere pressing of tablets or by mere encapsulation.

2.7.13 *Leather*

The leather issues have been progressively solved since consensus has been reached that retanning leather is considered an origin-conferring operation. The remaining issue is the operation of finishing of leather.

The EU and other countries are of the view that carrying out operations such as dyeing, graining, stamping, sizing, polishing, and waxing are origin conferring whereas other leather producing countries like Argentina feel that the finishing of leather may be origin conferring only if at least three operations occur.

The Chair's compromise proposals cut across all kind of finished leather (heading 4104 through 4107) and resulted in the following:

- 4104, leather of bovine or equine animals provisionally prepared = CTH except from heading 4101
- tanned, in the wet state – CTHS
- other – CTHS.

2.7.14 *Textiles and Clothing*

Textiles and clothing is one of the most sensitive sectors in international trade. As expected, the end of the Agreements on Textiles and Clothing transitional period for the abolition of quotas in January 2005 has not brought a period of peace in this sensitive sector. Import increases in the EU and US market triggered a variety of trade contingency protections such as safeguard, quotas, and AD measures that are closely intertwined with origin determination. The concern over circumvention of these trade contingency measures is currently underlying many of the negotiating positions. It is therefore hardly surprising that a number of unresolved issues are concentrated in this sector.

During the early stages of the negotiations in the TCRO a series of important principles were agreed: (i) the production of yarn from fibers, (ii) fabric from yarn,

(iii) apparel, parts, or accessories of garments knitted or crocheted to shape are origin-conferring operations.

This early understanding meant that the criteria of a double or triple transformation present in the textile and clothing sector in many preferential trade agreements was not adopted. It followed that a number of working or processing operations have been recognized as origin conferring and that the HRO introduced a significant element of trade liberalization in this area.

Obviously, a number of differences still exist. The United States and a group of countries hold the view that printing and dyeing of yarns is not an origin-conferring operation. Other countries like the EU, joined by the big yarn producers like India and Egypt, believe that permanent dyeing or printing from unbleached yarn is an origin-conferring operation.

Different proposals have been recorded on the issue of dyeing and printing of fabrics. The United States has recognized that, if accompanied by two or more defined finishing operations, dyeing and printing might be origin conferring.

The EU and a majority of countries including India, Egypt, and Pakistan consider dyeing or printing from unbleached fabrics with at least two preparatory or finishing operations to be origin conferring. A third group of countries, mainly from Latin America, hold the view that dyeing and printing even when performed together are not a substantial transformation.

A similar issue is the coating of fabrics where originally a majority of countries were inclined to consider it as origin conferring. The United States added the condition that the weight of rubber or plastics of the finished good is more than 50 percent of the weight of the product. The latest draft of February 2007 reports consensus – with the exception of Malaysia, Pakistan, and India – that coating of fabrics is not an origin-conferring operation.

Embroidery has also proved to be a divisive process. There are different proposals based on different drafting techniques and different substantive views. In the case of embroidery there is a common understanding that embroidery may be origin conferring; however origin is made subject to either (i) a value-added test in the case of a widely supported proposal from EU, (ii) weight of embroidery in the case of the Mexican proposal, and (iii) distance between the edges of the plain fabric and the embroidery in the case of the proposal by Canada and Japan. In the case of embroidery of flat products, a conservative approach is taken by the United States where origin remains with the country that produced the fabric, provided that the fabric was produced from yarn or fiber. Other countries are of the view that a value-added test could be a valid rule.

The latest draft of February 2007 indicates some consensus on the matter of embroidery without visible ground (CTH) and embroidering in strips or motifs (CTH) as origin-conferring operations.

The major concern of the countries supportive of rather stringent rules of origin in all the abovementioned issues is the circumvention of trade contingency

measures. This concern is also reflected in some of the outstanding issues concerning assembly of textile products to a finished article.

There is almost consensus that assembly of apparel and clothing accessories of parts cut to shape is an origin-conferring operation. Conversely, there are remaining difficulties when considering whether assembly of apparel and clothing accessories from parts knitted to shape is origin conferring.

There were still difficulties in flat products and three-dimensional goods where the United States and other countries are of the view that origin remains with the country that produced the fabric, but some progress has been lately recorded. Other countries, mainly India and Hong Kong, consider that cutting or knitting to shape and assembly in the same country is sufficient to confer origin. The final point of contrast in the textile and apparel sector concerns the need for chapter residual rules for assembly of apparel from parts.

The July 2006 CRO chairperson proposal was as follows:

- Permanent dyeing or printing from unbleached or prebleached yarn/fabrics with at least two preparatory or finishing operations was to be considered a substantial transformation.
- Processing fabrics into coated fabrics with rubber or plastics is a substantial transformation.
- Processing fabric to embroidery in the piece with visible ground and other embroidery is to be considered a substantial transformation. (Change to this heading if the value of non-originating materials does not exceed 50 percent of the ex-works price of the product.)
- Assembling parts knitted or crocheted to shape into apparel is not to be considered as substantial transformation. (The country of origin of the goods of this split chapter is the country in which the parts of these goods have been knitted or crocheted to shape.)
- Assembling parts cut to shape into apparel is not to be considered as substantial transformation. (Change to goods of this split chapter provided that the goods are assembled in a single country in accordance with Chapter Note (option 1).)
- Assembly parts knitted or crocheted to shape into clothing accessories (ties, gloves etc.) is not to be considered as substantial transformation. (The country of origin of the goods of this split chapter is the country in which the parts of these goods have been knitted or crocheted to shape.)
- Assembly parts cut to shape into clothing accessories (ties, headbands, etc.) is to be considered as substantial transformation. (Change to goods of this split chapter provided that the goods are assembled in a single country in accordance with Chapter Note (option 1).)
- Processing fabrics into flat products (scarves, bed linen, etc.) is to be considered as substantial transformation when bleaching, dyeing/

printing, cutting and hemming takes place in a single country. This process should be considered as substantial transformation. (CTH, provided the starting material is prebleached or unbleached fabric.)
- Processing fabrics into three-dimensional goods is to be considered a substantial transformation.

2.7.15 *Footwear*

A series of outstanding issues are related to the manufacturing of shoes. A majority of countries, including the United States, the EU, Japan, and other developing countries, hold the view that the assembly of footwear from parts is origin conferring except for uppers to which an inner sole is permanently attached which corporately closes the bottom. Other delegations – namely, India and Morocco – are of the view that assembly of uppers even with inner sole is origin conferring. Heading 6406 classifies different parts of footwear.

In order to ease the task of defining an origin rule according to tariff/shift criteria, heading 6406 has been split into:

- ex 6406(a) uppers to which an inner sole is permanently attached
- ex 6406(b) others
- ex 6406(c) parts of uppers.

There is a series of outstanding issues around footwear, including production of footwear from unformed uppers and from other parts of footwear.

The CRO chairperson proposal in the July 2006 package was as follows:

Processing uppers and parts thereof is a substantial transformation:

- ex 6406(a) (uppers to which an inner sole is permanently attached which completely closes the bottom): CTHS
- ex 6406(b) (other): CTHS
- ex 6406(c) (parts of uppers): CTH

Processing footwear from uppers is a substantial transformation

CRO chairperson proposal: CTH, except from ex-6406(a) (uppers to which an inner sole is permanently attached which completely closes the bottom).

2.7.16 *Coating of Steel Products*

Like textiles and clothing, steel products are another category of products that are import sensitive and subject to import restrictions or trade contingency measures in various countries. As in previous sensitive sectors, the main concern of those supporting more restrictive rules is the possible circumvention of trade defense measures.

The United States and other countries are of the view that coating or plating of steel, usually with zinc or other base metal, involves dipping the finished product in

the molten material or processing by electrolytic means. The purpose of the operation is to provide a measure of corrosion resistance to the steel, although in time the coating may wear away. The process does not change the steel in any other manner. It does not meaningfully affect its malleability, tensile strength, or other characteristics or its dimensions. Therefore, no substantial transformation takes place as a result of the process. They contrast coating with cladding, which is considered origin conferring. In fact, cladding is a process involving the integration of two or more metals that results in a product with significantly different strength and other metallurgical characteristics from the constituent input materials.

The EU is leading a group of countries arguing that coating of hot-rolled products or cold-rolled products is more than a process involving a simple process of uncoiling the hot coil, sprinkling the spray, painting, and then recoiling. It requires a multistage process that consists of pretreatment, coating, baking, and post-treatment. The surface of the color steel has three layers – zinc coating, chromate coating, and oil coating – which covers the base metal. The colored steel is considered a new product, creating almost 100 percent of added value and is used for interior and exterior decorations of buildings due to its high corrosion resistance and weatherproof qualities, and also for electric home appliances such as refrigerators, air conditioners, and so on due to its attractive appearance.[38]

The July 2006 package proposed the following principles followed by product-specific rules for steel products:

- Processing of flat products, and angles, shapes and section into coated steel products with tin, zinc, etc. is a substantial transformation.
- Processing of wires, tubes, and pipes section into coated steel products with tin, zinc, etc. is non-origin conferring.

2.7.17 *Machinery and Electronics*

The main technical issues concerning the machinery sector have been discussed in section 2.4.1. This subsection will further explain the evolution of negotiating positions using some earlier CRO chairperson proposals as well as the latest update of March 2007.

On the one hand, the complexity of the machinery sector is partly related to the structure of the HS. On the other hand, the fragmentation of production in the machinery and electronics sector has also raised a series of questions that require a technical solution acceptable to all delegations. For instance, the question of assembly of machinery has been the focus of debate since the beginning of the negotiations. Assembly operations are usually conceived as assembling parts of an article to a finished article. However, it was soon realized that in today's business

[38] See unrecorded technical briefs circulated in the CRO at that time.

operation the concept of assembly is also a "parts to parts" issue. Industries are sourcing subassemblies and components to make parts that are later assembled into other parts. This manufacturing chain, where the sourcing of inputs and subassemblies is increasingly diversified, is driven by the need of firms to remain competitive and cost-efficient.

The technical solutions to such increasingly complex fragmentation of production have resulted in two alternative approaches – the assembly approach expressed in the CTC proposed by the United States and the value-added approach supported by the EU. Both options were still on the table and a latest compromise proposal has been advanced in March 2007. These proposals are summarized in the following pages. In any case, even within the proponents of the assembly approach, there have been differences when dealing with the "parts to parts" issue. In particular some countries, like Canada and Japan, insisted in splitting subheadings and headings into split headings in a manner that assembly operations of parts to parts fulfill a CTC. According to their original proposal, this splitting exercise may not need to be exhaustive because residual rules may have been used as a complementary alternative. The United States, supported by India, proposed the establishment of definitions or requirements for such assembly of parts to parts coupled with the use of CTC.[39] Paradoxically this latest methodology is quite similar to the use of manufacturing or processing operations to define substantial transformation as contained in Article 9(2)(c)(iii) of the ARO on supplementary criteria.

The chairperson of the CRO drafted a series of compromise proposals that summarize the main issues arising from the negotiations on the machinery products. The latest proposals combine the EU and US approach, basically providing for alternatives rules of origin.

One of the latest formulations of the chair's proposal was as follows:[40]

(1) For parts produced from articles of other heading (making parts): CTH
(2) For parts obtained from parts of the same heading, for machines obtained from parts and for machines ("goods") finished from machines of the same heading/sub-heading: CTH, CTSH, CTHS, CTSHS
or
Manufacture in which the value of all non-originating materials used does not exceed 60 per cent of the ex-works price of the product

In an attempt to reach a compromise, this proposal adopted both approaches utilizing a value-added criterion and the CTC. Behind this rather simple formulation, there are a series of rather complex technical issues that may be better explained by using a former compromise proposal of the chairperson that dealt with these technical issues separately. Independent from the evolution of the negotiating text and the final result of the negotiations, these issues remain valid and relevant

[39] For a series of examples of this approach see section 2.8.
[40] See JOB(03)/132/Rev.8, May 15, 2005.

because they are related to the structure of the HS when used to determine origin in the area of machinery. Ultimately these cross-cutting issues are key concepts in understanding the different negotiating techniques and positions as well as the final outcome of the HWP. The latest CRO proposal as of March 2007 will be discussed further in the following sections.

2.7.17.1 Parts Produced from Articles of Other Headings

This issue relates to parts of machinery that are produced utilizing articles of other headings. According to the Chair's proposal, the making of parts from articles of other headings is an origin-conferring operation. Because this manufacturing operation (making parts from articles of other headings) normally implies a CTH, there are no particular difficulties in adopting a simple CTH rule; for example, if an electric motor (HS 8501) was imported and fitted to the interior case of a dish washing machine (HS 8422.90 parts).[41]

There are differences among delegations over whether in certain cases making parts from parts is origin conferring. Some delegations like the EU support the CTH rule – that assembly of non-originating engines, motors, or other materials classified in other headings to produce those parts listed above, is to be considered as origin conferring. Others are of view that CTH except electric motors (HS 8501) is the rule to be adopted.

2.7.17.2 Parts Obtained from Parts of the Same Heading

An assembly operation of parts to parts may not imply a CTC since not all manufacturing operations are reflected in the HS. In this case the Chair's proposal was the appropriate CTC or a value-added approach. This issue represents one of the most complicated technical aspects and a number of examples are provided in an annex:

Example: Doors suitable for use solely with dish washing machines (HS 8422.90) were imported and attached to external boxes of dish washing machines (HS 8422.90).

To recognize the assembly operation of doors into external boxes as origin conferring the following alternatives may be used:

(a) create a split subheading and apply a CTSHS rule
(b) define assembly operations with or without CTSHS (i.e. CTSHS by welding doors to external boxes)
(c) a value-added rule.

[41] Vice versa when parts are imported and the outputs of assembly are still those parts; this assembly, under the CTH rule, is not origin-conferring. However, under the proposal "or valued-added rule," origin may be conferred if the value addition complies with the required percentage.

For machines obtained from parts, assembly operations of parts classified in different headings or subheadings of the HS is considered an origin-conferring operation and meets the required CTC.

Example: Assembly of imported parts of dry cleaning machines (845190) to finished dry cleaning machines (8542.10)

2.7.17.3 Machines ("Goods") Finished from Machines of the Same Heading/Subheading

This situation occurs for finishing and assembling operations of machines that have the essential characteristics of the finished product. Normally, these operations are not reflected in the HS. Accordingly, the structure of the HS has to be modified to accommodate origin needs.

Examples: Manufacture of finished spanners of sub-heading 8204.11 from blanks of steel spanner of the same heading. Manufacture of high performance spinning rings of sub-heading 8448.33 from slugs of spinning rings of the same heading through special heat treatment, structuring of the surface and thermo chemical treatment[42]

In addition to these proposed rules, legal notes are now being agreed as reported below.

2.7.17.4 Legal Notes

Independent from the individual negotiating position, the legal notes outlined in the following section are featured, with some variations, in both the US and EU approach.

> **Note 1: Collection of parts:**
> Where a change in classification results from the application of HS General Interpretative Rule 2(a) with respect to collections of parts that are presented as unassembled articles of another heading or subheading the individual parts shall retain their origin prior to such collection.
>
> *Example: Parts and components of a machine or of a good are imported for temporary storing and exported as kits.*
>
> In these cases there might be change of tariff classification of parts to a finished article without any substantial working or processing in the country. This change of tariff classification that occurred by virtue of GIR 2(a) is disregarded and origin will be retained by the parts and components.

[42] This and the following examples are excerpted from unrecorded technical briefs circulated during the negotiations.

Note 2: Assembly of the collection of parts:
Goods assembled from a collection of parts classified as the assembled good by application of General Interpretative Rule 2 shall have origin in the country of assembly, provided the assembly would have satisfied the primary rule for the good had each of the parts been presented separately and not as a collection:

Example: Assuming that the primary rule for HS 8703 (Cars) is "CTH". In this case, if country A imports all parts from country B and assembles a passenger car, origin is to be conferred to country A, because each part would satisfy the CTH rule.

If country A imports semi-assembled cars from country B which have the essential character of a car, as well as other remaining parts, assembly is not origin conferring.

Note 3: Recertification or retesting: (could be fitted under Note 7)
A change of classification which results from the recertification or retesting of the good shall not be considered as the change required by the rule set out in the matrix.

Note 4: Disassembly of goods
A change of classification which results from the disassembly of goods shall not be considered as the change required by the rule set forth in the matrix. The country of origin of the parts recovered from the goods shall be the country where the parts are recovered, unless the importer, exporter or any person with a justifiable cause to determine the origin of parts demonstrates another country of origin on the basis of verifiable evidence such as origin marks on the part itself or documents.

Example: In order to upgrade PCs, old processors may be replaced by more modern ones. This disassembly operation entails a change of tariff classification from heading 8471 to a microprocessor of heading 8473. If the applicable rule for heading 8473 is a CTH or A CTSH this simple disassembly operation may be origin conferring. This rule confers origin to the country where the parts are recovered as it was considered that it was the easiest to administer with the caveat that in some circumstances the original origin may be easily traced back by the means of origin marking.

Note 5: Parts and accessories produced from blanks
The country of origin of goods that are produced from blanks which by application of the HS General Interpretative Rule 2(a), are classified in the same heading or subheading as the complete or finished goods, shall be the country in which the blank was finished provided finishing included configuring to final shape by the removal of material (other than merely by honing or polishing or both), or by forming processes such as bending, hammering, pressing or stamping.

> Paragraph 1 above applies to goods classifiable in provisions for parts or parts and accessories, including goods specifically named under such provisions, and to goods classifiable in headings 84.80 and 84.83.

2.7.17.5 Other Outstanding Issues in Electronics, Motor Vehicles, and Watches

2.7.17.5.1 ASSEMBLY OF MEMORY MODULES. This issue relates to the assembly of electronic integrated circuits or micro-assemblies. The majority of delegations consider this assembly operation to be origin conferring and propose a CTH rule or a value-added rule. The United States proposed a CTH rule except heading 8542 excluding that assembly of memory modules from integrated circuits is origin conferring. In the case of mounted semiconductors and unmounted semiconductors, the majority of delegations referred to the issue of diffusion.

2.7.17.5.2 ASSEMBLY OF TELEVISION RECEIVERS. This issue relates to the assembling of television receivers from cathodes and tubes. The United States held the view that these assembly operations are not origin conferring and that origin remains with the country of origin of the cathode ray tube. Other countries held that a value-added rule is more appropriate.

2.7.17.5.3 ASSEMBLY OF VEHICLES. The EU and other delegations held the view that a value-added rule is the appropriate rule of origin:

> Manufacture where the increase in value acquired as a result of working and processing, and, if applicable, the incorporation of parts originating in the country of manufacture represents at least (45–60 per cent) of the ex-works price of the product.

The United States and other delegations insisted on a tariff-shift approach:

> CTH, provide either the body, chassis, engine, transmission or steering system originates in the country of assembly.

2.7.17.5.4 ASSEMBLY OF WATCHES. The final issue concerns the assembly of watches. Switzerland and the EU held the view that assembly, mainly represented by testing and adjustments, is an origin-conferring operation. On the other hand, Hong Kong, Korea, and the United States held the view that in the case of assembly of watches from movements the origin is retained by the country manufacturing the movements.

CRO chairperson proposal in the July 2005 package was the following:

- Processing movements into watches or clocks is to be considered as substantial transformation.

2.8 THE CHAIRPERSON PROPOSAL ON MACHINERY AND THE ELECTRONIC SECTOR

As mentioned in the preceding section the latest CRO chairperson proposal[43] combined both the EU and US approaches. However, rather than leaving the option open to choose one of the alternative rules as in the former proposal, Rule 1 of the text provides that WTO members will have, at the time of the implementation of the HRO, to choose either the US or the EU rules of origin approach for the machinery sector.

Column C in paragraph (b) below contained the US proposal and column D reproduced the EU proposal.

Rule 1: Scope of Application

(a) This Appendix sets forth rules for determining the country of origin of a good when the origin of the goods is not determined under Appendix 1.
(b) In framing its legislation each Member shall provide for the application of one of the optional primary rules of Chapters 84–90 referred to in either column C or D, which are set out at the levels of heading, split heading, subheading or split subheading, for it. Each Member shall notify the Committee on Rules of Origin of its application within 90 days after the date of entry into force of this Annex, for it.

Contrary to the expectations of some delegations that hoped to find a compromise by adopting alternative rules of origin, it was concluded that for each product the alternative rules or origin could be adopted and that such a choice would have to be made once and for all at the time of implementation of the HRO.

This proposal combined, with some minor adjustments, the earlier US and EU approaches. In the case of the US approach the text below has been excerpted with the relevant examples from an earlier proposal. It is basically identical to the current text of the latest proposal of March 2007 but with a number of examples and comments in order to provide a full technical explanation on how the proponents of a pure tariff-shift approach are solving some technical difficulties that may arise from the structure of the HS.

The first part of the current US proposal is very similar to the legal notes above. Here below the whole text has been reproduced.

PRIMARY RULES FOR CHAPTERS 84–90 APPLICABLE TO PRIMARY RULES CONTAINED IN COLUMN C

1. *Limitations on change in classification rules in the matrix* – Where satisfaction of the rules of this Chapter results solely from the following circumstances, origin shall be determined as indicated herein:

[43] Dated March 8, 2007.

Goods Obtained by Disassembly

A change of classification which results from the disassembly of goods shall not be considered as the change required by the rule set forth in the matrix. The country of origin of the parts recovered from the goods shall be the country where the parts are recovered, unless the importer, exporter or any person with a justifiable cause to determine the origin of parts demonstrates another country of origin on the basis of verifiable evidence such as origin marks on the part itself or documents.

Collection of Parts

Where a change in classification results from the application of HS General Interpretative Rule 2(a) with respect to collections of parts that are presented as unassembled articles of another heading or subheading the individual parts shall retain their origin prior to such collection.

Recertification or Retesting

A change of classification which results from the recertification or retesting of the good shall not be considered as the change required by the rule set out in the matrix.

Assembly of the Collection of Parts

Goods assembled from a collection of parts classified as the assembled good by application of General Interpretative Rule 2 shall have origin in the country of assembly, provided the assembly would have satisfied the primary rule for the good had each of the parts been presented separately and not as a collection.

2. *Additional Primary Chapter Rule* – When Chapter Rule 1 does not apply and the other primary rules in this Chapter are not met in the last country of production, the following shall be applied in sequence:
   a) *Parts and accessories produced from blanks*
      (1) The country of origin of goods that are produced from blanks which, by application of the HS General Interpretative Rule 2(a), are classified in the same heading or subheading as the complete or finished goods, shall be the country in which the blank was finished provided finishing included configuring to final shape by the removal of material (other than merely by honing or polishing or both), or by forming processes such as bending, hammering, pressing or stamping.
      (2) Paragraph 1 above applies to goods classifiable in provisions for parts or parts and accessories, including goods specifically named under such provisions, and to goods classifiable in headings 84.80 and 84.83.
   b) When the good is produced from materials or components that changed classification but did not satisfy the primary rule applicable to the good, the country of origin of the good is the country that furnished all or the major portion of that material or component.

c) The following rules apply only to goods classifiable under provisions for "parts" or "parts and accessories" and which are not described by name in the Harmonized System, applied in sequence.

[Explanation: Chapter Rule 2(C) is to be applied to parts and accessories which are not provided for by name in the Harmonized System. For example, it would not apply to subheading 8420.91 (which provides for cylinders which are classified as parts of rolling machines) but it would apply to 8420.99 (which provides for other non-enumerated parts of rolling machines). The rule also applies to goods assembled from kits.]

2. Goods produced by assembly of 5 or more parts (whether or not originating), other than parts provided for in Rule 2(C)(3) shall have origin in the country of assembly.

[Explanation: Producing parts or accessories by assembling other parts will be an origin-conferring event provided that (1) the assembly involves at least 5 parts and (2) operations other than those enumerated in Chapter Rule 2(C)(3) below are involved. Parts of general use and other parts referred to in Chapter Rule 2(C)(3) are not counted toward the requirements of this rule.]

2. Goods produced as a result of processing non-originating components other than parts provided for in Rule 2(C)(3) into a device or apparatus capable of performing one or more new mechanical or electrical functions shall have origin in the country of such processing.

[Explanation: Producing parts which have a mechanical or electrical function which was not present in the materials used in their production will be an origin-conferring event provided that operations other than those enumerated in Chapter Rule 2(C)(3) below are involved. Examples are attached as an annex to this document.]

3. The following parts shall not be counted for purposes of Rule 2(C)(1) nor shall the operations described be deemed to result in a new mechanical or electrical function for purposes of Rule 2(C)(2):
   (i) the attachment of machinery to a base;
   (ii) the installation of machinery or apparatus into cabinets or similar encasements;
   (iii) the attachment of parts of general use as defined in Note 2 to Section XVI of the Harmonized System or similar parts of plastic (Chapter 39);
   (iv) the attachment of handles, dials, knobs, hand cranks, and other consumer-operated controls;
   (v) the attachment of a power cord or change of mains voltage/frequency by adding transformer, adapter or converter;
   (vi) the installation of batteries, accumulators, sensors, thermostats or other articles not designed to become a permanent part of the good.

CHAPTER RESIDUAL RULES

For purposes of Rule 3(d) of Appendix 2 the following residual rules shall be applied in sequence:

1. For goods classifiable under provisions for "parts" or "parts and accessories" and which are not described by name, the country of origin shall be the country of assembly provided the goods are produced by the assembly of two or more parts (other than parts of general use, as defined in Note 2 to Section XV or similar parts of plastic (Chapter 39)), and one or more of the parts (other than parts of general use, as defined in Note 2 to Section XV or similar parts of plastic (Chapter 39)) satisfies the requirements for origin in the country of assembly. For purposes of this rule, the following parts shall not be counted nor shall the operations described be deemed to be origin conferring operations:

[Explanation: Producing parts or accessories by assembling 2 or more lesser parts will be an origin-conferring event provided that (1) at least one of those parts had origin in the country of assembly and (2) operations other than those enumerated below are involved. This rule is to be applied only to parts or parts and accessories which are not provided for by name in the Harmonized System. For example, it would not apply to subheading 8420.91 (which provides for cylinders which are parts of rolling machines) but it would apply to 8420.99 (which provides for other non-enumerated parts of rolling machines).]

2. When the good is produced from materials originating in a single country that did not undergo the change in classification or did not otherwise satisfy the primary rule applicable to the good, the country of origin is the country in which those materials originated;
3. The country of origin shall be the country of origin of that [material] [functional element] that gives the good its essential character, to the extent to which the principle of essential character can be applied. Otherwise, the country of origin shall be the country in which the major portion of those materials originated, as determined on the basis of weight.]

   C. Primary Rule: Legal note for Subheadings 8471.50, 8471.60, 8471.70 and 8471.80

   For purposes of subheadings 8471.50, 8471.60, 8471.70 and 8471.80, the assembly of goods of those subheadings in the same housing with units of other subheadings within that group shall be origin conferring.

A slightly revised version of the US proposal appeared (without examples) in the latest consolidated version of the WTO Secretariat of May 2008.

EXAMPLES OF PROCESSING COMPONENTS INTO A DEVICE OR APPARATUS CAPABLE OF PERFORMING A NEW MECHANICAL OR ELECTRICAL FUNCTION

1. Assembly of a video recording head for a video tape recorder (VCR) (8522.90) from the following 4 components:
   - Base (8522.90)
   - Printed circuit (8534.00)
   - Head chip (8522.90)
   - Head wire (8544.11)

   Origin would be conferred on the country of assembly because the assembled head would have a new electrical function, e.g., converting variations in electrical current flow into a fluctuating magnetic field for video recording on magnetic tape.
2. Assembly of a plasma display panel for a plasma display unit of an automatic data processing machine (8473.30) from the following 3 components (Issue No. 32):
   - Back panel (8473.30)
   - Front panel (8473.30)
   - NeXe gas

   Origin would be conferred on the country of assembly because the assembled panel would have a new electrical function, e.g., converting an electrical current flow into electromagnetic energy in the visible light spectrum.
3. Assembly of a blade assembly unit for an electrical, hand operated, hedge trimmer (8508.80) from the following components:
   - Top plate (8508.90)
   - Cutting blade (8208)
   - Base plate (8508.90)
   - Parts of general use

   Origin would be conferred on the country of assembly because the assembled unit would have a new mechanical function, e.g., converting horizontal motion into a shearing force.
4. Assembly of an impeller plate for a kitchen waste disposer from the following components:
   - Impeller plate (8509.90)
   - Impeller arm (8509.90)
   - Impeller arm cushion (8509.90)
   - Parts of general use

   Origin would be conferred on the country of assembly because the assembled unit would have a new mechanical function, e.g., using centrifugal force to move the food waste from the center of the disposer chamber to the outside of the chamber where it forces the waste against the shredder ring.

2.8.1 *The EU Proposal: Value-Added Approach*

The value-added approach is preferred by the EU and some other delegations. In spite of the definition of "value added," the way of calculating it is based on a

formula that obtains the value added by subtraction. According to a former submission, the value added according to the proponent was to be calculated as follows:

> the ex-works price of the product obtained minus the value of all the non-originating materials (customs value for imported materials or ex-works price for the other materials).

Such a way of calculating the value added by subtraction was not entirely consistent with the usual practice in the EU preferential rules of origin as further discussed in Chapter 6.

The final draft text of the EU proposal later unilaterally adopted as the calculation methodology in the EU nonpreferential rules of origin[44] is as follows:

> The term "x% value added rule" shall mean manufacture where the increase in value acquired as a result of working and processing, and if applicable, the incorporation of parts originating in the country of manufacture represents at least x% of the ex-works price of the product. "X" is the percentage indicated for each heading.

Such calculation formula does not appear to be completely consistent with the usual formula utilized by the EU in its preferential rules of origin.[45] Moreover it was and still is rather surprising to see that the EU made reference to a concept of value added at a time when, as examined in Chapter 6, drafting rules of origin, the rest of the world (led by the United States) is moving away from such a methodology in drafting rules of origin. This is even more surprising considering the EU seldom used to refer to the concept of value added.

In any case, such value-added calculation text is now reproduced *verbatim* in the EU customs code.[46]

Looking at the product-specific rules for the machinery, amounting to 230 pages in its latest proposal, it may be noted that in the large majority of cases the product-specific rules provide for a CTH or a 45 percent value-added rule. In other cases, a CTH with exception and a 45 percent value-added requirement is required. In a few cases a CTH is required with no alternative. In the case of motor vehicles, the percentage of value added is not specified.

[44] Commission Delegated Regulation (EU) 2015/2446, July 28, 2015 supplementing Regulation (EU) No. 952/2013 of the European Parliament and of the Council as regards detailed rules concerning certain provisions of the Union Customs Code, OJ L343 (December 29, 2015) – hereafter referred to as the Delegated Act – UCC-DA. Articles 31–36, Annex 22-01 – Introductory notes and list of substantial processing or working operations conferring nonpreferential origin.

[45] Compare with Chapter 3 of this book.

[46] See Commission Delegated Regulation Supplementing Regulation (EU) No. 952/2013 of the European Parliament and of the Council with regard to detailed rules of specifying some of the provisions of the Union Customs Code.

The fact that there are no differences in the level of the percentages of value added required contradicts some assumptions made in earlier discussions. A previous negotiating text reported as possible levels of percentages of value added the following:

Electronics:	25%
Electromechanical:	30%
Mechanics:	40%
Commercial vehicles:	40%
Passenger cars:	45–50%

Alternative rules for the same product are also featured in the EU preferential rules but appear more refined in their approach than the widespread use of the CTH or 45 percent in the product-specific rules. There are some specific cases where the approach has been different as in the case of ball bearings where specific processing is required. In some cases, as for TV sets, only the 45 percent value added is required.

Here below the complete text of the EU proposal has been excerpted.

PRIMARY RULES FOR CHAPTERS 84–90 APPLICABLE TO PRIMARY RULES CONTAINED IN COLUMN D

(a) Application of the value added rule

The term "x% value added rule" shall mean manufacture where the increase in value acquired as a result of working and processing, and if applicable, the incorporation of parts originating in the country of manufacture represents at least x% of the ex-works price of the product. "X" is the percentage indicated for each heading.

The term "ex-works price" shall mean the price to be paid for the product obtained to the manufacturer in whose undertaking the last working or processing is carried out (this price shall not include internal taxes which are, or may be, repaid when such product is exported);

The term "value acquired as a result of working and processing and incorporation of parts originating in the country of manufacture" shall mean the increase in value resulting from the assembly itself, together with any preparatory, finishing and checking operations, and from the incorporation of any parts originating in the country where the operations in question were carried out, including profit and the general costs borne in that country as a result of the operations;

The term "value of non-originating materials" means the customs value at the time of importation of the non-originating materials used, or, if this is not known and cannot be ascertained, the first ascertainable price paid for the materials in the country of importation.

(b) Change in classification

2.6.1 Goods obtained by disassembly

A change of classification which results from the disassembly of goods shall not be considered as the change required by the rule set forth in this Appendix. The country

of origin of the parts recovered from the goods shall be the country where the parts are recovered.

2.6.2 Collection of parts

Where a change in classification results from the application of HS General Interpretative Rule 2(a) with respect to collections of parts that are presented as unassembled articles of another heading or subheading the individual parts shall retain their origin prior to such collection.

2.6.3 Recertification or retesting

A change of classification which results from the recertification or retesting of the good shall not be considered as the change required by the rule set out in this Appendix.

2.6.4 Assembly of the collection of parts

Goods assembled from a collection of parts classified as the assembled good by application of General Interpretative Rule 2 shall have origin in the country of assembly, provided the assembly would have satisfied the primary rule for the good had each of the parts been presented separately and not as a collection.

(c) Parts and accessories produced from blanks

The country of origin of goods that are produced from blanks which, by application of the HS General Interpretative Rule 2(a), are classified in the same heading or subheading as the complete or finished goods, shall be the country in which the blank was finished provided finishing included configuring to final shape by the removal of material (other than merely by honing or polishing or both), or by forming processes such as bending, hammering, pressing or stamping.

Paragraph 1 above applies to goods classifiable in provisions for parts or parts and accessories, including goods specifically named under such provisions, and to goods classifiable in headings 84.80 and 84.83.

(d) Application of Residual Rule 3(f) of this Appendix – major portion rule

For the purposes of Chapters 84–90, the criterion used to determine the major portion of the materials as set forth in Rule 3, (f) of this Appendix is their value

2.9 TRADE POLICY IMPLICATIONS OF THE HWP ON RULES OF ORIGIN AND OTHER WTO AGREEMENTS: THE ISSUE OF "EQUALLY ALL PURPOSES"

At the earlier stages of negotiations in the TCRO, trade policy considerations were not openly discussed. However, possible implications and trade policy effects of the harmonized set of rules of origin were already the subject of debate and considerably influenced the positions of WTO members.

Articles 1 and 3(a) of the ARO clearly lay out that, upon implementation of the HWP, WTO members shall "apply rules of origin equally for all purposes as set out in Article 1."

The fact that the harmonized set of nonpreferential rules of origin must be applied in the context of several WTO agreements has resulted in profound repercussions and implications on the slow pace of the negotiations since this provision contradicts prior practices of some WTO members and/or simply represents a novelty for the majority of developing country WTO members. For instance, only fifty-one WTO members have so far notified having nonpreferential rules of origin while sixty have notified not having such rules.[47]

WTO members referred to the issue of "equally all purposes" mentioned in Article 3(a) as "the implication issue."[48]

In fact, the application of origin rules may have various unexpected and unintended implications in a number of areas. If these areas are multiplied for the numbers of products specific rules and the various possible origin outcome the result of such combination is likely to be in the order of countless and to a certain extent unpredictable. In many instances, especially for the agriculture and processed foodstuffs sectors, origin may be attributed to another country as a result of relatively simple processing, with implications for measures such as tariff quotas or the application of sanitary and phytosanitary measures. If origin is conferred to a certain manufacturing or processing operation, this may have implications for the likelihood of triggering contingency protection measures. For example, if a rule of origin regarding manufacturing of shoes from shoe parts is based on where assembly operations are carried out, this may have different implications for the application of contingent protection, depending on the structure of the industry. For instance, if assembly is carried out in many different countries, such a rule will spread the production of "originating shoes" across many countries. Conversely, let us suppose that origin rules for shoes require that origin depends on specific manufacturing operations such as the making of shoe uppers. Suppose also that given the structure of the industry only a few specialized locations carry out such manufacturing, the final result will be that, from an "origin point of view," the production of shoes may become more concentrated in one or more countries, possibly facilitating the targeting of contingency protection measures. Depending on production and industrial strategies, industries will have different incentives in lobbying for alternative rules of origin.

To give another example, if a country is a big producer and exporter of cotton fabrics – commonly a "sensitive product" subject to trade contingency measures – it may have an interest in ensuring that printing or dyeing are origin-conferring operations. In that case, all cotton fabrics exported from this country to third countries for printing or dyeing will obtain the origin of that country once re-exported from these counties to the country of final destination. In this manner the fabric-producing country's exports will be spread and less concentrated, possibly

[47] See WTO document G/RO/92 of November 2020.
[48] See further details in section 2.9.1.

reducing the threat that exports of cotton fabrics will trigger trade contingency protection measures. Conversely, if printing or dyeing are not considered as origin conferring – even if these operations are carried out in third countries – this will have no effect in terms of the origin determination of the fabric and all fabrics will result in the country where the fabric first originated.

For years another issue, concerning the filleting of fish, occupied both the TCRO and the CRO. On one hand, discussions turned around the technical issue whether turning a live fish into a "flat" fillet should be considered as substantial transformation since it may be doubling its value. On the other hand, discussions showed that some members feared implications that go beyond origin matters arising from such a rule. In particular, concern was expressed over the functioning of some regional fishery management methods and quota mechanism and the possibility of circumvention by changing the origin of the fish in a third country through the filleting operation. In fact, the concern was motivated by the fact that not all fishing countries are part of such regional fishery management organizations. Some of these countries however tend to fish protected species as well, such as tuna, in a protected area. The consequence is that the countries that are parties of such fishery management organizations ban the fish from such third countries from being imported into their country.

The concern of the members of such organizations was that through the filleting process in another country, the banned fish could change origin and circumvent such ban nullifying the efforts of management and conservation of the stocks. Consequently, these countries since the beginning of the negotiations held that the filleting should not be considered a substantial transformation.

In some other cases, countries may be interested in "obtaining" origin even if the amount of working and processing is minimal. This can occur in the case of agro-processing and foodstuffs. For instance, in the discussions of the TCRO, one delegation argued that drying and seasoning of imported meat was an origin-conferring operation. The domestic industry involved sold a dried meat product in the domestic market that usually fetched high prices, given consumer perceptions that this product had a distinct character. Traditionally, the meat used also originated in a particular region; however, more recently local manufacturers have begun to utilize imported meat. If this processing conferred origin, the dried and seasoned meat obtained from imported fresh meat could legitimately be sold as originating from the region. Therefore, domestic producers of dried and seasoned meat could utilize cheaper imported meat while retaining origin and labeling of high-quality regional products.

In other cases, a country may have an interest in "retaining" origin even if the exported product is processed in a third country before being sold to consumers. For example, Colombia argued in the TCRO that the processes of decaffeinating and roasting were not origin-conferring operations, while the United States, EU, and Japan hold the opposite view. If roasting and

decaffeinating is considered as origin conferring, the majority of Colombian coffee roasted or decaffeinated in the United States and EU could be marketed as US and EU products. This could severely diminish the image value and marketing potential of Colombian coffee as a quality product with a distinct character and taste.[49]

In summary, a major issue for countries to decide on harmonization of rules of origin is to "lose," "retain," or "obtain" origin. The difficulty is that this must be done by product or by categories of products, and the best rule for each country may depend on industrial base or industrial strategy considerations at global level.

Another issue concerns the relationship between the compilation of trade statistics and the HRO. Applying the same origin rules for both statistical and customs purposes is almost unprecedented in world trade. In the majority of cases, import statistics are classified according to the country of origin indicated in the invoice. This is, for the most part, the country of exportation and not necessarily the origin of the goods for customs purposes. Moving toward greater consistency between customs origin rules and collection of trade statistics could have major implications for the measured magnitude of trade flows and trade balances. This issue has gained prominent attention in the context of US-China trade.

Chapter 1 of this book also reports two more recent and famous cases of iPhones and sneakers that further illustrate the existing links. Following this vein, the WTO started the "made in the world" initiative that could be best summarized by the following preamble:[50]

> Today, companies divide their operations across the world, from the design of the product and manufacturing of components to assembly and marketing, creating international production chains. More and more products are "Made in the World" rather than made in just one economy. The statistical bias created by attributing the full commercial value to the last country of origin can pervert the political debate on the origin of the imbalances and lead to misguided, and hence counter-productive, decisions. The challenge is to find the right statistical bridges between the different statistical frameworks and national accounting systems to ensure that international interactions resulting from globalization are properly reflected and to facilitate cross border dialogue between national decision makers.

In the case of the trade contingency measures, WTO agreements – like anti-dumping, subsidies, and countervailing and safeguards – all *de minimis* thresholds are based on import volume measured using trade statistics. A change of the methodology for collecting statistics may have direct implications on the triggering mechanisms of these latter provisions.

[49] In this specific case, it appears that Café de Colombia is a private trademark owned by a private federation.

[50] For further information, see the WTO webpage at www.wto.org/ENGLISH/res_e/statis_e/miwi_e/miwi_e.htm.

THE SUBSTANTIAL ECONOMIC BENEFIT CRITERIA, GLOBALIZATION AND TRADE STATISTICS

In late 1990s a press report outlined a relevant case that marked the beginning of the discussion on where the real value added is in a finished product: manufacturing or services component related to manufacturing. The case combined the issues of origin criteria, globalization of production, and trade statistics.

A press report outlined a relevant case, which combined the issues of origin criteria, globalization of production, and trade statistics:

> A Barbie doll is for sale in a shop in the United States in a box labeled "made in China," at a price of $9.99. By means of deduction, the writer of the report has been able to establish that through multi-country processing utilizing different intermediate inputs, China is the country of origin of the Barbie doll. The United States customs hold the same view. However, it has been found that out of the $9.99 retail price, China's "substantial economic benefit" is only about 35 cents. The tracing back of the manufacture of the Barbie doll has made possible the following cost analysis:

Retail price	$9.99
Shipping, ground transportation, marketing, wholesaling, retailing and profit	$7.99
Export value from China	$2.00

The export value may be further broken down into the following country figures:

Overhead and management (Hong Kong, China) Intermediate materials	$1.00
Nylon hair (Japan), vinyl plastic (Taiwan Province of China), packaging (United States), oil to produce vinyl plastic (Saudi Arabia), other (China)	$0.65
Labour (China)	$0.35

Since China is the country of origin, it is charged an export value of $2.00 in trade statistics, while the economic benefit deriving from it is just 35 cents. According to the United States Customs, toys imported from China in 1995 totaled $5.4 billion, about one-sixth of the 36.2 billion of the total United States trade deficit. China, however, contends that these U.S. trade figures are distorted because they take into account neither economic reality nor the value-added operation carried out in Hong Kong, China, and other intermediate processing or shipping operations. Thus, in 1995, the U.S. Commerce Department put the U.S. trade deficit at $3.8 billion, while China said it was $8.6 billion.

In this multi-country production chain, the U.S. Mattel holding corporation is estimated to make $1.00 profit on each Barbie doll and most of the Barbie doll cost of $9.99 is estimated to be accumulated in the United States. This finding seems to contradict the fear of job losses often raised in some U.S. trade policy statements.

The Barbie doll case provides a valuable example of the results of a reverse engineering analysis. It reveals the chain of production and the substantial economic beneficiaries. At the same time, it provides an example of the

difficulties of origin determination and its suitability for trade statistics calculations. On the basis of these findings, some analysts have started to put forward the idea of investigating the origin of the company rather than the origin of the goods produced. However, given the current trend of mergers, acquisitions and joint ventures, this may prove as difficult as in the case of goods. [R. Tempest, *The Times*, London, September 22, 1996]

As illustrated, there is a strong linkage between customs origin and marks of origin that are aimed at informing consumers of a product's country of origin. The issue of the relationship between mark of origin (how a finished product is to be labeled before being marketed to final consumers) and origin for customs purposes is addressed in Article IX of General Agreement on Tariffs and Trade (GATT) 1994. A change of the country of origin will also imply a change in the mark of origin. This can have important consequences on consumer choices, especially where brand names or certain quality goods are commonly identified with certain countries. Environmental or humanitarian concerns may influence consumer choices toward products from countries that are recognized as respecting human rights, labor laws, or environmental treaties. While the globalization of production has rendered outdated the notion that a product is wholly produced and obtained in a particular country, consumers may still identify certain quality products with specific geographical regions or countries.

Finally, environmental concerns and recycling industry considerations have entered into the negotiations when the origin of waste and scrap, parts recovered from waste and scrap, and used articles have been discussed. The question revolves around the country to which origin should had been allocated: the country which produces the waste and scrap, has produced the article from which parts have been collected or where the article has been used, or the country which reutilizes these goods? Depending on origin allocation, developing countries are deeply concerned to be classified into different categories.

Allocating origin to the collecting of parts could be a potential incentive to locate recycling or hazardous industries in developing countries. Other concerns could be linked to the fact that used articles might be competing with domestic products in developing countries. Overall, there may be differing perceptions of what is considered to be waste and scrap or used articles in an industrialized country and in an LDC. For example, the average commercial life of a computer in industrialized countries is estimated at two to three years, whereas in a developing country context a computer of that age may still have substantial commercial value.

All these concerns are replaced by a definitive ruling. It was agreed that scrap and waste,[51] derived from manufacturing or processing operations or from consumption

[51] It is specified that waste and scrap mean materials resulting from manufacturing or processing operations or consumption in the same country, scrap machinery, discarded packaging,

in a country and fit only for disposal or for the recovery of raw materials, shall be considered wholly obtained in that country – namely the country that produces the waste retains origin.

Avoiding the danger of locating recycling or hazardous industries in a developing country, the rules on collected stuff refer solely to articles, and not to parts. The goods, which can no longer perform their original purpose nor are capable of being restored or repaired and which are fit only for disposal or for the recovery of parts or raw materials, are considered wholly obtained in the country where they are collected.

Parts or raw materials from articles, which can no longer perform their original purpose nor are capable of being restored or repaired, are considered originating in the country where they are recovered.

A proposal, originally presented by the United States, is to apply these rulings to Appendix II – PSRO. At the same time, particular attention has been given to Chapter 84 of the HS dealing with machinery. The concern is related to the origin of a collected, recovered, or disassembled part or a removed article, thus covering parts or articles, which are not subject to the definition of the wholly obtained goods.

Even if it is stated as general rule that disassembly is not an origin-conferring event, the country of origin of a disassembled or recovered part or a removed article shall be the country where the parts are recovered, unless the importer, exporter, or any person with a justifiable cause to determine the origin of parts demonstrates another country of origin on the basis of verifiable evidence such as origin marks on the part itself or documents. The second part of the rule appears to be intuitive: given a recovered part that clearly shows a mark of origin – for example, a car engine labeled as made in Italy – there is no reason to give a new origin to the country where the part has been recovered.

In general, it may be observed that at product-specific level, the preliminary outcome of negotiations has been, given their technical nature, mostly industry driven. Most unresolved issues are so because of the different views held by domestic industries on what kind of processing should be treated as "substantial transformation." Most domestic industries have tended to defend their case by arguing that the working or processing they carry out on their premises is a substantial transformation and deserves origin. Moreover, there may be genuine technical problems in determining origin or difficulty in understanding processing using new technology.

Because many similar issues were on the table for several years, slowing considerably the pace of the negotiations, one of the main issues that WTO members had to consider was to decide if they wanted to take care of such considerations utilizing rules of origin or if they could solve the problem using other trade policy instruments.

household rubbish, and all products that can no longer perform the purpose for which they were produced, and are fit only for discarding or for the recovery of raw materials. Such manufacturing or processing operations include all types of processing, not only industrial or chemical but also mining, agricultural, construction, refining, incineration, and sewage treatment operations. See Overall Architecture in Integrated Negotiation Text for the Harmonization Work Programme, G/RO/45/Rev.1, April 30, 2001.

2.9.1 *Negotiating Issues and Proposals on the Implications of the HWP on Other WTO Agreements*

The implications of the rules of origin on other WTO agreements was first openly raised in 1998 in a submission from India, other developing countries, and the United States.[52] This submission unveiled the issue, providing a series of illustrative examples of the possible implications of the application of the ARO in relation to agreements such as the Agreement on Textile and Clothing, marks of origin, trade-related aspects of intellectual property (TRIPS), SPS, and so on. It was noted that such implications affect the flexibility of members in attaining consensus on a number of issues because there were concerns as to how to maintain integrity of certain trade policy measures or regimes affecting particular products or product areas.

The United States suggested that one possible solution to this impasse was to agree on a common interpretation of the future obligation of applying rules of origin "equally for all such purposes," which does not necessarily entail that Members have "to use rules of origin for all such purposes." Undoubtedly, for some members this kind of "à la carte menu" may facilitate the creation of a consensus; however, for other members this flexibility may greatly diminish the value of the whole HWP exercise since it will impair the legal certainty and predictability that the whole agreement was designed to play in the absence of multilaterally agreed rules. The final draft contained in WTO document G/RO/W/111/Rev.6, 11 November 2010, does not contain General Rule 1, leaving unsettled the issue of implications of the results the HWP on other WTO agreements.

Developing countries, especially the least developed among them, may find some attraction in such a proposal since it may be understood as relieving them from part of the obligations arising from the ARO and the implementation burden. As earlier stated, the results of the HWP may turn out to be complicated to implement for developing countries and burdensome to apply for their customs administration.

However, one must recall that in any case, even if they decide to "opt out," exports originating in developing countries will remain subject to the disciplines of the HWP when shipped to those WTO members accepting to apply the Agreement in its entirety. Thus, the choice to apply or not to apply the results of the HWP to some commercial policy instruments is in reality limited to the importing side and to national legislation. Ultimately, exporters and producers will remain concerned by the implications of the HWP on other WTO agreements in the importing countries that implement the results of the HWP according to their own priorities and trade interests. Thus, the largest importers, such as the United States and the EU, will be likely to determine the extent of such implications.

An earlier alternative way to proceed that was mentioned in the US submission was to conduct an examination of the possible implication of the HWP on other

[52] For more information, see WTO documents G/RO/W/42, G/RO/W/48, G/RO/W/50, and G/RO/W/65.

WTO agreements through communication with all other WTO bodies responsible for matters outlined in Article 1 of the Agreement. Although this approach may appear theoretically more correct, it was later found to further limit the possibility to conclude the HWP work in a realistic time frame given the amount of implications and the degree of complexity of the issues involved.

A submission by Brazil made on October 7, 2002[53] focused on the implication issue and a possible resolution. Recalling the background of the discussions starting in 1998, Brazil reiterated the principles laid down in Article 3(a) and Article 1 of the ARO and recollected the broad understanding in the CRO as follows:

(a) Members have undertaken to apply rules of origin equally for all purposes (Article 9(a) of the ARO).
(b) Article 1.2 of the ARO limits itself to providing an illustrative list of situations in which, whenever rules of origin are used, the harmonized rules of origin shall be applicable.
(c) It is up to Members to decide, in light of their commitments deriving from other WTO agreements, whether a determination of origin is a mandatory requirement in a particular instance.
(d) In all such instances where a determination of origin is a mandatory requirement as well as in those instances in which a Member autonomously decides to undertake a determination of origin, the harmonized rules of origin annexed to the ARO (once concluded) shall be applied.
(e) It is the responsibility of relevant bodies of the WTO to decide if an interpretation of the respective Agreement is required regarding the instances where a determination of origin is mandatory.
(f) Such an understanding in no way precludes the rights of Members to adopt laws, regulations or administrative determinations that go beyond the specific determination of origin according to the harmonized rules of origin, so long as such actions are consistent with their rights and obligations deriving from other WTO agreements; Members will always retain the right to exercise their rights regarding the manner in which another Member has implemented its commitments.

According to this understanding, it is worth pointing out that the implementation of the ARO is the responsibility of each member. The member must also decide if a determination of origin is a mandatory requirement in a particular issue (i.e. in the application of another agreement). If the member decides that such a requirement exists or decides singularly to use nonpreferential rules of origin, then the HRO should be used.

[53] See WTO document G/RO/90 or WT/GC/W/479.

Brazil also addressed the issue of rules that go further than rules of origin. Such measures are permitted as long as they are consistent with the obligations derived from the other WTO Agreements, such as with SPS measures.[54]

If a member feels that other WTO agreements are unclear on whether to apply rules of origin or not, the Brazil proposal suggested that it is the responsibility of the relevant WTO bodies to decide whether an interpretation of other agreements is necessary. In the final analysis, only the Ministerial Conference is empowered to interpret WTO agreements.

The last statement in the proposal by Brazil indicated that members will always be able to exercise their rights regarding the manner in which another member has implemented its commitments. The clause is certainly not revolutionary, but even if a member believes it is correctly applying WTO agreements, another member disputing the interpretation about the correctness of the implementation of rules of origin could still challenge it. The normal dispute settlement procedure would then take place.

Apparently, several delegations appreciated Brazil's efforts and suggestions to solve the issue of implications. However, they found that the solution to add a single phrase in the General Rule 1[55] would be insufficient to incorporate all concerns.

Despite different attempts at the GC level, the solution was to leave with WTO members the discretion to choose and notify the CRO of the commercial policy instruments that will be using the HRO.

Australia and New Zealand also participated actively in the debate and expressed their concern on a former CRO chairperson's implications proposal.[56] Paragraph 2, General Rule 1 of this implications proposal provided:

> Rules of Origin provided in this Annex shall be applied equally for the purposes set out in Article 1, paragraph 2 of the Agreement on Rules of Origin, whenever a Member is required, or in the absence of such a requirement voluntarily decides, to determine the country of origin of a good in the application of an agreement set out in Annex 1A of the WTO Agreement. However, the Rules of Origin in this Annex shall be without prejudice to Members' rights and obligations in respect of the application of non-preferential commercial policy instruments.

Australia and New Zealand observed that the first sentence can be better explained by way of an example, such as the Anti-dumping Agreement (ADA). The ADA provides that a member can either use "country of origin" or "country of export" to

[54] See also section 2.9.4.

[55] General Rule 1 in the Annex to the ARO would then read: "Rules of Origin provided in this Annex shall be as defined in article 1, paragraph 1, of the Agreement on Rules of Origin annexed to the Agreement Establishing the World Trade Organization (WTO). Such Rules of Origin shall be applied equally for all purposes as set out in article 1, paragraph 2, of the Agreement on Rules of Origin and in a manner consistent with the rights and obligations derived from the relevant agreements of the WTO."

[56] See JOB(03)/132.

determine origin. In this case, a member could choose to use the "country of export" criteria, avoiding the need to use harmonized rules. However, there may be cases (possibly where a good is transshipped through a third country or not produced in the country of export) that the member would have to use the "country of origin" criteria. In that case, they would have to use the harmonized rules.

The main target of the Australian and New Zealand comments was, however, the second sentence. They found that it was unclear what the second sentence means. "Rules of Origin used in non-preferential commercial policy instruments" are defined in Article 1 (para. 2) of the ARO to include the application of MFN, National Treatment, Schedules of Concession, Marks of Origin, Quotas, Anti-dumping, and Countervailing Duties and Safeguards Measures. The second sentence could be read to exclude certain measures from the scope of the ARO. Australia and New Zealand questioned whether it would mean that even where a member chooses or is required to determine origin, such as to use the "country of origin" criteria in the ADA, the HRO do not have to be used.

Finally, Australia and New Zealand rightly pointed out that the second sentence could give members too much flexibility to choose how they apply the harmonized rules. In their view it also conflicted with the first sentence in the proposed text and with Article 1, paragraph 2, of the ARO.

A suggestion was made to either delete the second sentence, or amend it to reflect the original wording of Brazil's proposal, including Australia's suggested amendment; that is, "in a manner consistent with the rights and obligations derived from the WTO Agreements." The second sentence of paragraph 2 would therefore read:

> The Rules of Origin in this Annex shall be applied in a manner consistent with the rights and obligations derived from the WTO Agreements.

The Brazil proposal and the Australian and New Zealand comments and suggestions appeared in the latest revision of the chairperson proposal of April 2006.[57] The most recent draft of General Rule 1, circulated in February 2007 and May 2008, has been discussed in section 2.6.2. No solution was in sight on the implication issue during the CRO meeting of October 2008 and later CRO meetings.

2.9.2 *Possible Implications on the Agreement on Implementation of Article VI of the GATT 1994: "Anti-dumping Agreement"*

The first cases where the absence of multilateral disciplines on nonpreferential rules of origin started to attract the attention of policymakers and analysts occurred in the 1980s in connection with the enforcement of AD duties and other trade contingency or protectionist measures.[58]

[57] JOB(03)/132/Rev.11, April 5, 2006.

[58] This section is based on the UNCTAD publication: "Globalization and the International Trading System: Issues Relating to Rules of Origin" (UNCTAD/ITCD/TSB/2, March 24, 1998); and Stefano Inama, Edwin Vermulst, and Piet Eckhout, "Non-preferential rules of

The emergence of AD law as one of the most important trade policy instruments during the 1980s and 1990s has largely been responsible for the growing attention to the use of rules of origin as commercial policy instruments which could influence the interaction between the internationalization of production and its location. Imposition of AD duties coinciding with increasing globalization of production created the first tangible relocation cases of certain companies in strategic markets such as the EU and the United States. Claims by EU and US domestic industries regarding the establishment of screwdriver factories on their territories led the two jurisdictions to adopt anticircumvention legislation in the 1980s.[59]

Anti-dumping proceedings are normally initiated at the request of a complainant domestic industry against products originating in a certain country. Thus, a normal AD procedure requires that, other than findings relating to dumping and injury, the investigating authorities determine the origin of the product exported from the third country. However, the investigating authorities do not always consistently do this.[60]

On the other hand, it may be expected that the origin of the product of the domestic industry, which filed the complaint, will be examined as well. However, proof of domestic industry origin is generally not required of the complainant on the part of the domestic industries. Article 4 of the Uruguay Round ADA (definition of domestic industry) does not require that, in order to file a complaint, domestic producers manufacture originating products.[61] Hence, a double standard is applied where origin is examined as regards exports of allegedly dumped products but not as regards the local industry filing the complaint. On the other hand, domestic industries complain about dumping of products from country A while they are simultaneously importing parts to manufacture the same product. In certain AD proceedings instituted by the EC during the 1980s, this question arose in realistic terms. Especially in the photocopiers case and others,[62] the EC investigating authorities

origin in antidumping law and practice," in Kyle W. Bagwell, George A. Bermann, and Petros C. Mavroidis (eds.), *Law and Economics of Contingent Protection in International Trade*, Cambridge University Press, 2010.

[59] See, for the US legislation, Pub. L. No. 100–418, § 1321, 102 Stat. 1192, adding § 781 to the Tariff Act of 1930, as amended, 19, USCA § 1677j. For an analysis of the US anticircumvention measures, see N. Komuro, "US anti-circumvention measures and GATT rules," *Journal of World Trade*, vol. 28, no. 3 (1994), 5–49. For the European Community legislation on anti-circumvention, see, as originally adopted, Council Regulation 1761/81, June 22, 1987, OJ 2167 (1987). For a detailed discussion of European Community antidumping and the new anti-circumvention measures, see E. Vermulst and P. Waer, *EC Anti-dumping Law and Practice*, Sweet and Maxwell, 1996.

[60] The WTO ADA does not indicate this requirement clearly in its Article 9(2). In a specific AD case involving small-screen color televisions from the Republic of Korea, the European Community Commission opted for the country of production rather than the country of origin. See OJ L324/1 (1990) (provisional); OJ L107/56 (1990) (definitive). An illustration of this case is provided in Vermulst and Waer, *EC Anti-dumping Law and Practice* (fn. 59 above).

[61] See Article 4 of the WTO ADA on definition of domestic industry.

[62] In the photocopiers, outboard motors, video cassette recorders, small-screen color televisions, DRAMs, and EPROMs cases, the EC Commission had to examine the position of certain EC

found out that under EC rules of origin, certain models of photocopy machines consisted of parts imported from Japan. However, because the factory in question was planning to increase the community content, the issue was dropped.

Conceptually, nonpreferential[63] origin rules may be relevant both in the course of an AD investigation and in its aftermath, once AD measures are imposed.

In order to determine whether dumping is taking place, the investigating authorities must select a country that will form the basis for the calculation of the normal value. For this selection process, the authorities may use origin rules (see section 2.9.2.1).

To determine whether the dumping is causing material injury to the *domestic industry* of the like product, the authorities may use origin rules in order to decide whether the *domestic* producers allegedly comprising the domestic industry qualify as such (section 2.9.2.2).

Following the imposition of AD measures, exporters may initiate or increase shipments from other countries. The authorities could then use origin rules to determine whether the AD measures imposed on the original exporting country should also apply to the shipments from the third countries (see section 2.9.7).[64] However, major users of AD like the United States and EU prefer to recur to anticircumvention provisions rather than origin rules.

producers and the position of manufacturing bases in the European Community owned by or having links with producers under investigation for injurious dumping. In particular, during the photocopiers case investigation, the Commission had to examine the position of Rank Xerox, which was one of the complainants. The origin determination carried out by the Commission revealed that at least in one factory most parts of the photocopiers originated in Japan and to a lesser degree in the Community. Nevertheless, and taking into consideration factors not related to origin determination such as "long standing manufacturers in the Community," etc., the Commission accepted Rank Xerox as domestic producer. For a deeper analysis see P. Waer, "Rules of origin in international trade," in E. Vermulst, P. Waer, and J. Bourgeois (eds.), *Rules of Origin in International Trade: A Comparative Survey*, University of Michigan Press, 1994. For the specific investigations see *Outboard motors from Japan*, OJ L152/18 (1983) (provisional); *Plain paper photocopiers from Japan*, OJ L54/12 (1987) (definitive); *Video cassette recorders from Japan and Rep. of Korea*, OJ L240/5 (1988) (provisional); *Small screen colour televisions from Rep. of Korea*, OJ L107/56 (1990) (definitive); *Dynamic random access memories from Japan*, OJ L193/1 (1990) (definitive); *Erasable programmable read-only memories from Japan*, OJ L65/1 (1991) (definitive). In the US context, see, for instance, *Brother Industries* v. *US*, No. 91–11–00794 (slip. op 92–152) (1992), where the US Court of International Trade reversed a determination of the Department of Commerce that Brother lacked standing to file an AD complaint. On this latter case, see N. D. Palmeter, "Rules of origin in the United States," in E. Vermulst, P. Waer, and J. Bourgeois (eds.), *Rules of Origin in International Trade: A Comparative Survey*, University of Michigan Press, 1994.

[63] Preferential origin rules are not used in this context and therefore fall outside the scope of this section.

[64] They might also use anticircumvention rules. For the time being, there is no multilateral agreement on the use of anticircumvention rules in AD proceedings. In the absence of international agreement, the EU, the United States and some Latin American countries have unilaterally adopted anticircumvention rules in the framework of their AD legislation. A draft ADA provides for the possibility of anticircumvention (Valles draft November 30, 2007).

2.9.2.1 Origin in the Dumping Determination

As pointed out by Inama and Vermulst[65] the WTO/GATT do not provide a conclusive answer to the question whether normal value should be based on prices/costs in the country of export, the country of origin or the country of production, all three of which might potentially differ.

The language used in Article VI of the GATT is very imprecise. In Article VI:1, for example, the Contracting Parties recognize that:

> dumping, by which *products of one country* are introduced into the commerce of another country at less than the normal value of the products, is to be condemned … A product is to be considered as being introduced into the commerce of an importing country at less than its normal value, if the price of the *product exported from one country* to another
>
> (a) is less than the comparable price … for the like product when destined for consumption in the *exporting country*, or,
> (b) in the absence of such domestic price, is less than either
> …
> (ii) the cost of production of the like product in the *country of origin*.
>
> [Emphasis added]

Similar language is used in GATT Articles VI:4,[66] VI:5,[67] and VI:6[68] as well as in the two supplementary provisions to Article VI:1.[69]

[65] This section draws from Inama, Vermulst, and Eckhout, "Non-preferential rules of origin in antidumping law and practice" (fn. 58 above); see also a pioneering study in the area that has largely inspired this section, UNCTAD, "Globalization and the international trading system: Issues relating to rules of origin" (UNCTAD/ITCD/TSB/2, March 24, 1998); and E. Vermulst, P. Waer, and J. Bourgeois (eds.), *Rules of Origin in International Trade: A Comparative Survey*, University of Michigan Press, 1994.

[66] "No product of the territory of any contracting party imported into the territory of any other contracting party shall be subject to anti-dumping or countervailing duty by reason of the exemption of such product from duties or taxes borne by the like product when destined for consumption in the country of origin or exportation, or by reason of the refund of such duties or taxes."

[67] "No product of the territory of any contracting party imported into the territory of any other contracting party shall be subject to both anti-dumping and countervailing duties to compensate for the same situation of dumping or export subsidization."

[68] "No contracting party shall levy any anti-dumping or countervailing duty on the importation of any product of the territory of another contracting party unless it determines that the effect of the dumping or subsidization, as the case may be, is such as to cause or threaten material injury to an established domestic industry, or is such as to retard materially the establishment of a domestic industry."

[69] "1. Hidden dumping by associated houses (that is, the sale by an importer at a price below that corresponding to the price invoiced by an exporter with whom the importer is associated, and also below the price in the exporting country) constitutes a form of price dumping with respect to which the margin of dumping may be calculated on the basis of the price at which the goods are resold by the importer.

The explanation for this lack of clarity (apart from bad drafting) might be that the typical case which the GATT drafters presumably had in mind in 1947 would have been the case where products are (wholly) produced in one country and then exported (dumped) from that country to the importing country. Indeed, in such case, the countries of export, origin, and production are identical.

A report by a GATT Group of Experts,[70] established in 1958 to examine the operation of AD laws in various countries for the first time, reflected recognition that the country of export might not be the same as the country of production, a situation they referred to as "indirect dumping":

> the Group then considered the question of dumping of goods where the *exporting country* is not the *producing country* of the goods concerned. Most members of the Group reported that their countries had little or no experience of indirect dumping and that, where legislation existed to deal with this problem, the legislation had not been used. The Group noted that since the wording of Article VI, paragraph 1(a), referred only to the comparable price in the exporting country, there was some doubt whether action against indirect dumping was strictly in accordance with the letter of the Agreement. However, despite this doubt, the Group was generally of the opinion that it was reasonable for countries to have the right to protect themselves against indirect dumping (whether of processed or unprocessed goods)...[71]

Presumably as a result of the Group's discussion, a special provision was devoted to this problem in the Kennedy[72] and the Tokyo Round Anti-dumping Codes and the Uruguay Round ADA. Article 2:5 of the ADA provides that:

> [i]n the case where products are not imported directly from the country of origin but are exported to the importing Member from an intermediate country, the price at which the products are sold from the country of export to the importing Member shall normally be compared with the comparable price in the country of export. However, comparison may be made with the price in the country of origin, if, for example, the products are merely transshipped through the country of export, or such products are not produced in the country of export, or there is no comparable price for them in the country of export.

2. It is recognized that, in the case of imports from a country which has a complete or substantially complete monopoly of its trade and where all domestic prices are fixed by the State, special difficulties may exist in determining price comparability for the purposes of paragraph 1, and in such cases importing contracting parties may find it necessary to take into account the possibility that a strict comparison with domestic prices in such a country may not always be appropriate."

[70] Anti-dumping and Countervailing Duties, Report adopted on May 13, 1959 (L/978), GATT, BISD, 8th Supp. (1960), 145–153.

[71] Ibid. at 148–149.

[72] See Article 2(c) of the Kennedy Round Anti-dumping Code, Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade (1967), GATT, BISD, 15th Supp. (1968), 24–36.

Thus, under the ADA, the starting point for the normal value calculation is the country of *export*. However, the normal value may be based on the prices/costs in the country of *origin* where:

- the exported products are only transshipped through the country of export
- the exported products are not produced in the country of export or
- a comparable price for the exported products in the country of export does not exist.

By essentially focusing on transshipments, the provision does therefore not address the cases where the country of origin and the country of production/assembly differ.

The Republic of Korea[73] argued that AD measures are based on the concept of "exporting country" rather than "origin country." To calculate the dumping margin, derived from the difference between export price and normal price, the domestic price of the like product in the exporting country is used as the normal price. Only in exceptional cases referred to in Article 2.2 and Article 2.5 does the country of origin play a role in the ADA. The first case (Article 2.2) refers to a situation where there are no sales of the like product in the ordinary course of trade in the domestic market of the exporting country or where the low level of sales in the domestic market of the exporting country is not appropriate to be used for the normal price. In such case, the origin country of that product is meaningful. The second case (Article 2.5) refers to a situation where products are imported through an intermediate country (exporting country). If the products are merely transshipped, or such products are not produced in the exporting country, or there is no comparable price for them in the exporting country, the comparison for dumping margin may be made with the price in the origin country.

The view set forth in this description by the Republic of Korea may be difficult to apply in the situation involving the sixty members cited in section 2.9.7 which have notified the WTO that they do not even have nonpreferential rules of origin, even though many of these members are known to utilize AD measures. There are, in fact, an apparent wide variety of practices as to "exporting country" versus "origin country" in AD regimes, and there is also an apparent absence of a common understanding of the implications of the prospective obligation to apply equally the HRO for all purposes.

Until recently, classical transshipment issues have mainly[74] come up in the case of products manufactured in China, but exported from Hong Kong. Where the cases targeted both customs territories, the authorities considered China the relevant starting point for the normal value selection and terminated the investigations against Hong Kong on the ground that products with Hong Kong origin did not exist.[75]

[73] See WTO document G/RO/W/38, Implications of the implementation of the harmonized rules of origin on other WTO agreements.

[74] But see, for example, *Potassium permanganate from USSR*, OJ L14/56 (1991) (termination).

[75] See, for example, *Silicon metal from China, Hong Kong*, OJ L80/9 (1990) (definitive); *Tungsten ores and concentrates from China, Hong Kong*, OJ L83/23 (1990) (provisional, termination). Compare *Gas-fueled non-refillable pocket lighters from China*, OJ L326/1 (1991) (definitive) and

The assessment becomes more complicated if the activities in an intermediate country can no longer be characterized as mere transshipment.

In *Aspartame*,[76] for example, the question arose what should be done with aspartame originating in Japan but exported to the EU from the United States. The Commission decided to use United States prices – that is, prices in the exporting country – as the basis for normal value:

> [t]he investigation revealed that the product was not merely transshipped through the USA but was actually sold to and imported by the US producer/exporter in the USA before exportation to the EC. The investigation also showed that there was substantial production within the USA and that there was a comparable price for aspartame in the USA. In these circumstances the conditions under which ... the country of origin might be considered appropriate as a basis for establishing normal value are not fulfilled. In addition, the investigation showed that the Japanese product was fully interchangeable with the US material, and that almost the entire production of the Japanese manufacturer was purchased and warehoused by the US exporter which subsequently sold the product both in the USA and for export to the EC. The Commission therefore based normal value on US domestic prices.

An even more complex situation arose in *Small screen colour televisions*,[77] where a number of Hong Kong producers assembled the product concerned in Hong Kong without the televisions obtaining nonpreferential Hong Kong origin in the process. While the country of production and the country of export were therefore the same, the country of origin differed. In this case, the Commission based normal value on Hong Kong sales or on Hong Kong constructed value.

In a subsequent proceeding targeting exports of *Colour televisions* of all sizes from China, Korea, Malaysia, Singapore, and Thailand[78] on the other hand, the Commission used constructed normal values in the country of origin in cases where the country of origin and the country of production differed.

The cases discussed above all concerned initial investigations. However, it may also happen that once AD duties are imposed, the producers concerned start or increase exports from other countries. The authorities may then decide to start a new AD investigation against such third countries, normally following an application by the relevant domestic industry, and decide in the course of that investigation that the products manufactured in third countries actually did not obtain local origin but rather still have the origin of the country against which the original AD measures were imposed.[79]

Gas-fueled, non-refillable pocket flint lighters from China, OJ L101/38 (1995) (amendment definitive), where the EC rejected claims by Chinese producers that normal value be based on Hong Kong prices on the ground that there was no Hong Kong production of lighters.

[76] *Aspartame from USA, Japan*, OJ L134/1 (1991) (definitive).

[77] *Small screen colour televisions from China, Hong Kong*, OJ L14/31 (1991) (provisional).

[78] *Colour televisions from China, Korea, Malaysia, Singapore, Thailand*, OJ L255/50 (1994) (provisional).

[79] They may also decide to investigate the origin of the products, see section 3.2.

This happened, for example, in *Ball bearings from Thailand*[80] and *Electronic typewriters from Taiwan*.[81] In these cases,[82] the European Commission terminated AD proceedings it had initiated on the ground that the production processes carried out in these countries were not sufficient to confer Thai and Taiwanese origin on the products manufactured in such countries. The practical consequence of these findings was that the products assembled in Thailand and Taiwan were effectively considered to have Japanese origin, as a result of which they were subjected to the AD duties imposed with respect to such products originating in Japan.

Following a subsequent investigation of the Taiwanese producer concerned – the Japanese company Brother – the German customs authorities decided to levy the Japanese AD duty applicable to Brother *retroactively*. The consequence was that Germans customs ordered Brother to pay over 3 million DM in AD duties. Brother appealed against this decision on the ground that the typewriters produced in Taiwan should be considered as originating in Taiwan on the basis of application of the EU's nonpreferential origin rules: while most of the parts came from Japan, they were mounted and assembled in Taiwan in a fully equipped factory into ready-for-use typewriters.[83]

With reference to the third standard of Annex D.1 of the Kyoto Convention,[84] the European Court of Justice (ECJ) (where the case eventually ended up) distinguished between *simple* assembly operations and other types of assembly operations. It defined simple assembly operations as operations which do not require staff with special qualifications for the work in question or sophisticated tools or specially equipped factories for the purposes of assembly. Such simple operations could never confer origin because they do not "contribute to the essential characteristics or properties of the products in question."

Other types of assembly *could* confer origin depending on fulfilment of one of two tests, in order of precedence:

- an assembly process representing, from a technical point of view and having regard to the definition of the goods in question, the decisive production stage during which the use to which the component parts are to be put becomes definite and the goods in question are given their specific qualities or
- where the above technical test does not lead to a decisive answer, the technical test plus a value-added test as an "ancillary criterion."

[80] *Certain ball bearings from Thailand*, OJ L59/30 (1985) (notice of termination).
[81] *Electronic typewriters from Taiwan*, OJ L140/52 (1986) (notice of termination).
[82] See for more detail E. Vermulst and P. Waer, "European Community rules of origin as commercial policy instruments," *Journal of World Trade*, vol. 24, no. 3 (1990), 55–100.
[83] Case 26/88, *Brother International GmbH* v. *Hauptzollamt Giessen* [1989] ECR 4253.
[84] International Convention on the simplification and harmonization of customs procedures, accepted on behalf of the Community by Council Decision 77/415/EEC, OJ L166/1 (1977).

Specifically with respect to the value-added test, the ECJ held that the assembly operations as a whole must involve an appreciable increase in the commercial value of the finished product at the ex-factory level. The ECJ did not lay down a concrete percentage of value added sufficient to confer origin, but noted that in a production process where only two countries are involved, a value added of less than 10 percent in the assembly process is insufficient.[85]

The German *Finanzgericht* of Hessen subsequently ruled that the operations performed by Brother in Taiwan fell into the category of "simple assembly" because the assembly operations of Brother in Taiwan did not employ staff with special qualifications for the work in question, did not involve use of sophisticated tools, and did not involve specially equipped factories for the purposes of the assembly of the typewriters.[86]

2.9.2.2 Origin in the Injury Determination

Anti-dumping measures may be imposed only if the dumped imports cause material injury to the domestic industry of the like product. The domestic industry is defined as all domestic producers or a major proportion thereof.

Most user countries do not employ origin rules for purposes of the definition of the domestic industry.[87] In fact, footnote 1 to Article 2(1) of the WTO Agreement on Rules of Origin (ARO) explicitly states that Article 2(1) is without prejudice to determinations made for purposes of the "domestic industry" definition, thereby authorizing investigating authorities to ignore rules of origin in this context.

A footnote at the end of Article 1, paragraph 2 of the ARO states that "it is understood that this provision is without prejudice to those determinations made for purposes of defining 'domestic industry' or 'like products of domestic industry' or similar terms wherever they apply." In India's opinion[88] could it mean that the member applying a restriction might define domestic industry by a criterion that is different from the rule of origin applicable to the products in question? This could lead to a situation of domestic industry appearing to suffer greater damage than may be the case if domestic production were defined according to the HRO. If for purposes of anti-dumping the terms "like product" may be defined differently than

[85] In Case 93/83, *Zentralgenossenschaft des Fleischergewerbes e.G. (Zentrag)* v. *Hauptzollamt Bochum* [1984] ECR 1095, the Court issued a similar judgment in a situation where only two countries were involved and the value added in the last country was 22%.

[86] F. G. Hess, Urteil vom 25.5.1992–7 K 552/91, rechtskräftig, reproduced in *Recht der Internationalen Wirtschaft*, vol. 6 (1993), 522–524.

[87] By way of exception, Australian AD law provides by analogy to Australian origin rules that an Australian producer must add at least 25% value in Australia in order to qualify as a domestic producer; see H. K. Steele, "The Australian anti-dumping system," in J. H. Jackson and E. A. Vermulst (eds.), *Anti-dumping Law and Practice: A Comparative Study*, University of Michigan Press, 1989, 223–286, at 265.

[88] See WTO document G/RO/W/42, Implications of certain major proposal for harmonized rules of origin for access under the agreement on textile and clothing: an analysis of possible effects.

for the harmonized rule, then it would be contrary to the principle of the ARO to apply rules of origin equally for all purposes.

Where the origin of the products manufactured by the domestic producers/applicants is questioned, the authorities tend to analyze the situation on a case by case basis.[89] The following examples taken from EU practice may serve as an example.

In *Outboard motors*,[90] several of the Japanese producers questioned whether the major EC complainant, Outboard Marine Belgium, qualified as a European producer. The Commission arrived at the conclusion that on the basis of application of the EU's nonpreferential origin rules the outboard motors produced by Outboard Marine Belgium originated in the Community.

In *Photocopiers*,[91] the EU had to determine whether the factories of the main EU complainant Xerox in the Netherlands and in the United Kingdom could be included in the definition of the domestic industry. As regards the Dutch plant (mid-volume machines), the European Commission found that integrated manufacturing operations were carried out by or on behalf of Xerox in the EU, that the value added within the EU in these manufacturing operations exceeded 70%, and that the Dutch-produced photocopiers had EU origin. However, in the United Kingdom plant (low-volume machines), the photocopiers were found to have been manufactured predominantly from Japanese parts. The production processes carried out in the United Kingdom consisted of the construction of certain sub-assemblies[92] for the production line, completion of the frame assembly, and the final mainline assembly of sub-assemblies and components by testing and packing of the photocopiers. During the investigation period, the EU value added in the United Kingdom plant was found to be between 20 and 35 percent (this would not have been sufficient under the EU's nonpreferential origin rules to confer EU origin on the products). However, the weighted average value added in the EU for all PPCs manufactured by Xerox was in excess of 50 percent. On this basis, and taking into account Xerox's policy of obtaining an increasing proportion of its components from within the Union, the EU decided that Xerox qualified as a domestic producer.[93]

In *DRAMs*[94] and *EPROMs*[95] (respectively, "dynamic random-access memories" and "erasable programmable read-only memories"), the European Commission distinguished between front-end (wafer diffusion and sorting) and back-end

[89] For an overview of the Canadian Import Tribunal's practice, see P. A. Magnus, "The Canadian anti-dumping system," in J. H. Jackson and E. A. Vermulst (eds.), *Anti-dumping Law and Practice: A Comparative Study*, University of Michigan Press, 1989, 167–222, at 209–210.

[90] *Outboard motors from Japan*, OJ L152/18 (1983) (provisional).

[91] *Photocopiers from Japan*, OJ L54/12 (1987) (definitive).

[92] The fusers, modules, develop boxes, cassettes, semi-automatic document handlers, optics and other minor assemblies.

[93] *Photocopiers from Japan*, OJ L54/12 (1987) (definitive).

[94] *DRAMs from Japan*, OJ L20/5 (1990) (provisional); OJ L193/1 (1990) (definitive).

[95] *Erasable programmable read-only memories from Japan*, OJ L65/1 (1991) (definitive).

(assembly and testing) operations in the production of semiconductors and found that wafer diffusion was, from a technological and capital-investment point of view, more significant than the assembly and testing operations, even though as a ratio of total production costs, assembly costs were generally significant, and in some cases exceeded wafer diffusion costs. This finding was significant because the EU producers were generally performing the diffusion process in the EU and the assembly and testing in third countries whereas a number of Japanese manufacturers did the diffusion in Japan and the assembly and testing in the EU.

While the investigation in these AD cases was in progress, the EU also adopted a product-specific origin regulation on integrated circuits (ICs) providing that diffusion[96] (rather than assembly and testing) constituted the last substantial process or operation. The ICs Regulation came at a convenient time for these proceedings because some Member States' customs authorities had held until then that the process of assembly and testing was origin-conferring. If applied to the definition of the domestic industry in the AD cases, this would have entailed that the EU complainants would not have had standing to bring the case.

In *Certain ring binder mechanisms*,[97] the Commission relied on the origin rules to include EU-originating ring binder mechanisms assembled in Hungary by one of the two EU complainants and to exclude Hungary-originating ring binder mechanisms.

Thus, the tendency of the authorities in the cases above has been to apply nonpreferential rules of origin to define the domestic industry where the complaining producers meet such rules and to rely on softer criteria to include them where this is not the case.

In the *Footwear*[98] investigation, it was relatively clear from an origin perspective that the complaining producers made footwear with EU origin while major

[96] Diffusion is the process whereby ICs are formed on a semiconductor substrate by the selective introduction of an appropriate dopant; see Annex 11 ICCC, consolidated version July 1, 2006.

[97] *Certain ring binder mechanisms from Malaysia, China*, OJ L22/1 (1997) (definitive):

> it was found that a limited portion of the sales of one of the complainant Community producers related to products which had undergone their last substantial processing in Hungary and had therefore to be excluded from its Community production. On the other hand, it was established that some products, which were reported in import statistics as being of Hungarian origin, were merely assembled in Hungary from Austrian parts and were therefore considered to be part of the Community production of the producer concerned, since the assembly operation which the products in question had undergone in Hungary did not, on the basis of non-preferential rules of origin, confer Hungarian origin on the finished products. The fact that such products had been reported in import statistics as being of Hungarian origin was considered irrelevant, since their origin had been declared on the basis of the preferential rules of origin, which are not applicable to this investigation.

[98] *Certain footwear with uppers of leather from China, Vietnam*, OJ L275/1 (2006) (definitive).

successful European and international brands and other entities imported footwear with Chinese and/or Vietnamese origin.[99] Yet the importers added high value in the EU through pre- and postproduction activities.[100]

While the EU authorities employed their traditional methodology to define the domestic industry and to eventually impose AD measures, the underlying policy issue was subsequently raised in the context of the reflection process on the use of the EU's Trade Defence Instruments (TDI) in a globalized economy, initiated by Director General in charge of Trade, Commissioner Mandelson, in the aftermath of the case in December 2006.[101]

CASE STUDY – ANTI-DUMPING MEASURES ON LEATHER SHOES, AUGUST 2006

In October 2006 the EU imposed duties of 16.5 percent and 10 percent on certain leather shoes imported to the EU. These duties were the result of an investigation that found both dumping of these exports from certain third countries and consequent injury to EU producers. The application of EU and WTO rules in this highly complex case provoked divisions among EU economic operators and EU Member States. The case illustrated two of the important issues that this Green Paper considers.

Outsourcing by EU producers. Although many EU companies still produce leather footwear in the EU, a significant number of EU companies have outsourced the production of footwear to third countries while keeping other parts of their operations in the EU. Those EU companies that produce leather shoes in the third countries concerned are subject to the AD duty. Moreover, under the existing rules for AD investigations, only producers that keep their production within the EU were considered in determining whether the required proportion of Community industry for the case to be initiated was met. Yet the number of EU companies that are moving elements of their production is growing and these companies account for thousands of jobs in the EU.

Consumer interest. The footwear case also illustrated another problem in the context of determining what is in the wider economic interest of the EU. In the majority of cases, especially those which do not concern consumer products, the impact of AD measures on the prices paid by the consumer has typically not been significant. Nonetheless, it is important to reflect on the question of whether and how consumer interests can be better reflected in AD investigations, and any measures taken.

[99] The EC has a product-specific nonpreferential origin rule for Chapter 64 footwear providing that origin is conferred from manufacture from materials of any tariff heading except for assemblies of uppers affixed to inner soles or to other sole components of heading 6406 (see Annex 11 ICCC, consolidated version, July 1, 2006). In other words, the assembly process should at a minimum include the affixing of the uppers to the (inner) soles.

[100] Design, R&D, marketing, advertising, and distribution. See also H. Isakson, "When anti-dumping meets globalisation: How anti-dumping can damage the supply chains of globalised European companies. Five case studies from the shoe industry," *Global Trade and Customs Journal*, vol. 3, no. 3 (2007), 109–120.

[101] Global Europe – Europe's Trade Defence Instruments in a Changing Global Economy – A Green Paper for Public Consultation (December 6, 2006), 6.

Similar issues arose again in the *Energy saving lamps* review case, this time however pitting multinationals such as Osram/Siemens (complainant) and Philips and GE (respondents) against each other.[102]

2.9.3 *Possible Implications of Article IX of the GATT 1994: Marks of Origin*

The linkage between customs origin and mark of origin derives from US practice. The requirement to mark goods imported into the United States with their country of origin dates back to 1890, and has been reiterated since.[103] The purpose of this requirement was to inform consumers of a product's country of origin, but it could also have the indirect effect of favoring domestic products over competing foreign goods. Thus, as in many "buy national" campaigns periodically launched in certain countries, marks of origin may function as nontariff barriers.

IMPLICATIONS OF MARKS OF ORIGIN

During the early negotiations of the TCRO, the Swiss delegation proposed that the assembly of watches from parts should confer origin since this process involves a series of complex operations requiring specialized services. The comparative rule of origin adopted by Switzerland under its GSP scheme requires, in general, that the foreign inputs used in the manufacture of a watch not exceed 40 percent of its ex-works value and that the value of the non-originating inputs not exceed the value of the domestic input. Also, the Swiss delegation argued that customs origin is not necessarily to be regarded as a sufficient criterion when it comes to marking the goods with the name of the country of production since member states may require additional criteria, such as in the case of Swiss legislation a national geographical indication for watches and their parts. The delegate argued further that the national legislation of his country was to be considered a geographical indication under Article 22 of the WTO TRIPs Agreement and Article IX, paragraph 6, of GATT 1996, and that this kind of geographical indication might go beyond the simple "customs origin" concept. Other delegations, especially those from the Asian region, were of the opinion that origin should be conferred on the country that manufactured the clock movement. They argued that the essential function of a watch is to measure intervals of time. This measurement is performed by the clock movement, and not by the assembly and testing operations.

[102] *Integrated electronic compact fluorescent lamps (CFL-i) from China and extending to imports of the same product consigned from the Socialist Republic of Vietnam, the Islamic Republic of Pakistan and the Republic of the Philippines*, OJ L272/1 [2007].

[103] For a discussion of United States marks of origin see N. S. Samter, "*National Juice Products Association v. United States*: A narrower approach to substantial transformation determinations for country of origin marking," *Journal of Law and Policy in International Business*, vol. 18 (1986), 671–694.

As a possible result, the Swiss proposal on nonpreferential rules of origin would allow Swiss watchmakers to import Japanese or third-country clock movements and retain origin, while third-country watchmakers for GSP purposes would face much stricter rules making it difficult for their products to qualify for GSP benefits. Moreover, the Swiss proposal to link origin marking to the geographical indication under Article 22 of the WTO TRIPs Agreement may have obvious trade policy and marketing implications. This linkage seems to be actually ruled out by the preambles of the HRO in the recent draft where it is expressly stated that the Agreement does not prejudice the rights and obligations under the provisions of Annexes 1B and 1C of the WTO agreement. The Swiss proposal of allowing the change in tariff heading would lead to change in origin due to assembly of movement into a complete watch, but the marking would not be possible due to other constraints by the Swiss-made legislation.

Given the historical background, the question of mark of origin in the United States has been the subject of several dispute decisions involving the US courts, customs, and importers of foreign goods. Usually, most disputes arose in sensitive sectors such as foodstuffs, textiles, steel products, and footwear,[104] where labeling, import sensitivity, and consumer health considerations may have had a bearing on the final outcome. A general analysis of these disputes gives rise to the following points:

(1) Origin determination, given the globalization of production, is difficult. From an importer's point of view, this difficulty is exacerbated by the fact that a wrong declaration of origin or incorrect labeling of origin may give rise to heavy penalties.
(2) Marking and customs origin are becoming increasingly insufficient criteria to determine which countries have derived substantial economic benefit from the sale of a product.
(3) Mark of origin may have a far-reaching effect on consumers' choices in certain categories of products such as foodstuffs, pharmaceuticals, and fashion goods.

[104] One type of controversy encountered in the determination of the country of origin under the marking regulations is illustrated by the decision in *Koru North America* v. *United States*. In this case, vessels caught hoki fish outside New Zealand's territorial waters. The vessels were chartered to a New Zealand corporation, but were flying the flags of New Zealand, the Soviet Union, and Japan. The fish were caught, gutted, and frozen on the catching vessels within New Zealand's Exclusive Economic Zone. They were then landed and consolidated for shipment in New Zealand, and shipped to the Republic of Korea, where they were shipped to the United States. The importer claimed that the hoki fillets' country of origin was New Zealand, while the Customs Service argued that the origin of the fish was New Zealand, the Soviet Union, and Japan. The court determined, however, that the hoki fillets were substantially transformed in the Republic of Korea, and were therefore products of that country. In the textiles sector, a report in the *Financial Times*, April 10, 1997 indicated that a major US retailer was to be charged with millions of dollars of custom duties owed on allegedly mislabeled Chinese products.

TABLE 2.8 *Changes in US textile and apparel rules of origin*

Main category of textile product	Before July 1996 Origin-conferring operations	After 1996 Origin-conferring operations
Apparel	Cutting	Assembly
Fabrics	Dyeing of fabric and printing if accompanied by two or more finishing operations	Weaving from yarn

A trade dispute in the WTO between the United States and the EC on rules and marks of origin may best summarize the implications of a change in rules of origin and open the way to further considerations regarding the impact on rules of origin and trade statistics.

In July 1996, new legislation on textile origin was promulgated in the United States. The new rules of origin for textile articles introduced several changes in relation to past practice and US legislation. Those changes are summarized in Table 2.8.

The Italian Association of Textile Producers lodged a complaint[105] against the changes in the US textile rules with the EC Commission as early as October 1996. Since it contained sufficient evidence, the matter was subsequently taken by the Commission to the WTO, where consultations with the US authorities started in due course.[106] The fact at issue is that, under the new rules, originating status is not granted for scarves which have been dyed, printed, and finished in the EU Member States on loom-state fabrics produced in third countries. A significant aspect of the complaint related to the requirement that the products in question be labeled as originating in the country that produced the fabric, with obvious consequences for US consumers, who may not positively identify EC products.

Although it may be difficult to quantify, it is obvious that in the upper-textile market of haute couture, brand name and mark of origin have a considerable influence on consumer choice, which may justify the concern of producers of finished products. Although the globalization of production has rendered outdated the notion that a product is wholly produced and obtained in a particular country, consumers may still identify certain quality products with specific geographical

[105] See OJ C351 (November 22, 1996). See also the box in section 2.9.5 of this chapter: "The India/US Dispute."

[106] See Commission Decision, February 18, 1997 on the initiation of international consultation and dispute settlement procedures concerning changes to United States rules of origin for textile products resulting in the nonconferral of Community origin on certain products processed in the European Community, OJ L62 [1997], and WTO document G/TBT/D/13, June 3, 1997, "United States measures applying textile and apparel products: Request for consultation by the European Community."

regions or countries. Moreover, the non-inclusion of design and style in expenditure on advertising and research, which may be incurred in the fashion textile industry, together with ownership of the manufacturing plant, may not be in line with the "substantial transformation" concept.

The issue of marks of origin and labels has found recently new literature due to increased trade tensions and the "buy national" or "buy local" campaign.

There have been initiatives in the EU to link the labeling of food products and garments to the concept of origin, and trade policy interest in providing incentives to companies to relocate back to their home countries industries that have delocalized.[107]

However, the attempt to rein back industries that have relocated their manufacturing may not be so appealing to those industries that have an established brand. A paper[108] analyzing the implications of Italian legislation on labeling quoted the example "of the strong link between trademarks and quality, irrespective of the place of manufacture, is the decision by the famous Italian fashion house Prada to introduce a label in the form of 'Prada – made in [place of manufacture]', such as 'Prada Milano – made in Peru', in order to retain the advantage of the trademark, with its powerful evocation of Italian style, in marketing goods that were manufactured abroad."

Similarly, Apple labels its MacBook Air as "Designed in California and assembled in China."

Yet from the point of view of consumer interest it may really matter to be better informed about the real origin of the product; this holds especially true for foodstuff and food preparations. In that case the notion of customs origin may not be adequate as it may be unable to trace back the different processes, an example being the Italian labeling legislation on meat products[109] as further discussed in the following section.

2.9.4 *Possible Implications of the Agreement on the Application of Sanitary and Phytosanitary Measures (SPS)*

A submission by Japan[110] on the relations between the HRO and the labeling requirements on foods addresses the problems that may arise from the implementation of the HWP and other non-WTO agreements such as the Codex General Standard

[107] https://eu.usatoday.com/story/money/business/2018/06/28/manufacturers-bringing-most-jobs-back-to-america/36438051/.

[108] See A. Barbieri and M. P. Peluso, "The value of 'Made in …'," Lexology, October 29 2010, at https://wp.portolano.it/wp-content/uploads/2019/07/The-value-of-made-in%E2%80%A6-Lexology.pdf.

[109] An example is the Italian legislation for meat products requiring an indication on the label of the country of birth, the country of slaughtering, country of raising, and the country where the animal was cut up.

[110] See WTO document G/RO/W/66.

for the Labeling of Prepackaged Foods. Provisions contained in a non-WTO agreement may go beyond what is required for RoO purposes because the objectives are different, as in the case of the Codex, which aims at achieving consumer policy interest (consumer protection) going beyond customs administration purposes.

The fact is that in Article 1 of the ARO, it is stipulated that "origin marking requirements are within the scope of that Agreement." However, as already pointed out in previous sessions of the CRO, the said article makes no mention of whether the Agreement should also apply to origin labeling requirements according to the Japanese submission. In the view of Japan "it was important to reach a common understanding on this matter, in order to avoid any possible disputes arising on the interpretation of the text."

It is important to keep in mind that the principle of the Codex Standard is to prevent consumers from being misled or deceived, as contained in the relevant provisions on this issue included in the Codex General Standard for the Labeling of Pre-packaged Food. These objectives are different from those of harmonization work of rules of origin, which are primarily designed for the purposes of customs procedures.

Furthermore, a discussion paper has been submitted to revise the existing arrangements for origin labeling under the Codex Standard. It has been proposed that the origin of meat shall be that of the sole place where birth, rearing, and slaughter actually took place.[111] Should such place differ, each additional one should be declared accordingly.

The thread of this proposal indeed reflects the reality of matters. This reality is that the requirements necessary for achieving consumer policy objectives when carrying out "origin labeling" (by providing accurate information, including the history of a product to consumers) are quite different from those required for customs administrative purposes (which need only one single origin country for each product).

In light of the above, Japan observed that it is legitimate, as well as appropriate, to argue that a reasonable distinction can be made between the rulings under the

[111] Proposal to revise the Codex General Standard for the Labeling of Pre-packaged Foods:

- The country of origin of the food shall be declared.
- The term "produce of" (or equivalent, such as "product of," "produced in," "origin," "Swiss," etc.) shall only be used where all the significant ingredients or components come from the identified country and virtually all of the production/manufacturing processes associated with the food occur within that place or country. An exception is allowed where significant ingredients cannot come from the country in question.
- For meat, the country of origin is the place of birth, rearing, and slaughter. If these places differ, then each shall be declared.
- Where the term "produce of" or equivalent is not used, the origin declaration should identify the country in which the food last underwent a substantial change in its nature and use appropriate terminology, such as "cured in," "made in," "prepared in," or "manufactured in." Packing, cutting, slicing, mincing, shredding, grating, and other similar processes are not, for these purposes, processes that substantially change the nature of the food.
- Where the label carries other material that may imply origin, the declaration should be sufficiently prominent to avoid misleading consumers.

ongoing harmonization work in the CRO and the labeling standards established in the Codex Alimentarius Commission and that they should not negatively influence each other, in order not to upset the legal stability of domestic food labeling systems applied by members when introducing the HRO.

Also, an SPS concern was aroused by the different options taken by members on the question of slaughtering of live animals. This concern was not prompted just by the issues raised by Japan but, above all, by the sanitary measures taken by some members based on the origin of the goods. It was observed that in case the origin would be conferred to the country where the live animal was slaughtered, this would lead to a nonapplication of imposed SPS measures. In other words, the measure could be circumvented easily. To avoid this circumvention some delegations proposed that the operation of slaughtering was linked to a certain period of fattening of the live animal in the same country.

MAD COW DISEASE, MOVEMENT OF CATTLE, AND LABELING

As reported in the *Herald Tribune*, in 2003 the carcass of a single cow tested positive in Canada for mad cow disease. This provoked the immediate ban on Canadian beef from thirty countries including major importers. Animal health experts slaughtered more than 2,000 cows but no scientific explanation was found for how a single cow in a remote ranch contracted the disease. Thus, the ban continued.

US officials wished to help the Canadian farmers out. However, Japanese officials said that a restarting of US imports of Canadian beef could interrupt US beef exports to Japan unless US beef products were labeled in a way to exclude Canadian beef and by-products from shipment to Japan.

US officials said Japan claimed the labeling process was too costly and time consuming since the US and Canada cattle industries are thoroughly integrated with movements of cattle crossing the border daily.

Such SPS concerns appear to have been reflected and addressed in the preambles of one of the latest draft of the HRO where it is expressly stated that:

> *Recognizing* that rules of origin do not prejudice Members' rights and obligations in respect of the application of domestic requirements for food labelling or for sanitary and phytosanitary measures.

The insertion of this statement seems to carve out SPS from the implication of the HRO.

2.9.5 *Possible Implications of the Agreement on Textiles and Clothing*

According to the view of some countries, rules of origin discussions were greatly influenced during the negotiations by their implication on the quota allocation systems in the textile and clothing area. However, the Multiple Fibre Agreements

with their quota systems have now been lifted, meaning that the implication issue is irrelevant. Some members, however, were of the view that such an issue may become relevant because some quotas still exist and others have been replaced by AD proceedings.

Recognizing printing or dyeing of fabrics as origin-conferring events may have greatly implicated on the "old" quota utilization rates and traditional trade flows. Countries with large exports of greige fabric would have profited from the fact that countries further up in the production chain would have no longer filled the quota of the previous country but their own. Countries with both production chains or with only the printing or dyeing industry would have suddenly faced a reduction of the volumes as third-country greige fabric would have been accounted to their own quota while previously such printed or dyed fabric would have maintained origin of the greige fabric.

According to this view, as not all countries were subject to quota systems, it would have also been possible to utilize the greige fabric of a country that had already exhausted its quota by having it printed or dyed in a third country exempted from such measures.

THE INDIA/US DISPUTE: CHANGES IN US APPAREL RULES OF ORIGIN DURING THE TRANSITIONAL PERIOD

On January 11, 2001, India raised a series of issues concerning US rules of origin for textiles and apparel products set out in section 334 of the Uruguay Round Agreements Act (URAA), section 405 of the Trade and Development Act of 2000, and the customs regulations implementing these provisions.

Section 334 of the URAA, provides new regulations for determining the country of origin of textile and apparel products; for example, certain fabrics, silk handkerchiefs, and scarves are considered to originate where the base fabric is knit and woven, notwithstanding any further processing.

Section 405 of the Trade and Investment Act of 2000, first, amends the textile rules of origin set out at section 334 of the URAA. It restores the pre-URAA rule of origin that existed for fabrics of silk cotton, man-made fibers, and vegetable fibers. Under this rule, where greige fabrics were subjected to printing and dyeing, plus at least two other named finishing operations in a second country, that country would be deemed the country of origin. However, the new law does not change the country of origin rule for wool fabrics; their origin continues to be determined by the country where they were formed (woven or knitted).

Second, section 405 also changes rules of origin for certain nonapparel textile articles, most of which are currently subject to the "Special Rule" of origin set out at 19 USC section 3592(b)(2)(A). Currently, the origin of those products is determined according to the country where their constituent fabric was woven or knitted. Under the new legislation, the origin of some of these products will be determined according to the country where their constituent fabric was dyed, printed, and subject to two or

more specified finishing operations. Other nonapparel textile products, including products composed of cotton or wool fabrics, or of "cotton rich" fabrics (i.e. containing 16 percent or more by weight of cotton), will continue to have their origin determined according to the country where their constituent fabrics were formed in the "greige" state.

As a precedent to the India/US dispute, in May 1997, the EU requested consultations, complaining that the changes to the rules of origin made by URAA violate US obligations under a number of agreements. EU acted on behalf of its scarf-making, fabric-finishing, and bedding industries. A "procès-verbal" was concluded between them in July 1997, which was later amended. Formal consultations were held in January 1999.

In August 1999, the United States and the EU agreed to settle definitively the dispute. A second "procès-verbal" concluded between them included the commitment by the US administration to submit legislation which, as described above, amends the rule-of-origin requirements in section 334 of the URAA in order to allow dyeing, printing, and two or more finishing operations to confer origin on certain fabrics and goods. In particular, this dyeing and printing rule would apply only to fabrics classified under the Harmonized Tariff Schedule (HTS) as silk, cotton, man-made, and vegetable fibers. It would also apply to the various products classified in eighteen specific subheadings of the HTS listed in the bill, except for goods made from cotton, wool, or fiber blends containing 16 percent or more of cotton.

India claimed that the US rules of origin set out in section 334 and modified in section 405 and the customs regulations implementing these statutory provisions, and the application of these statutory provisions and implementing regulations:

(a) are being used by the United States as instruments to pursue trade objectives, thereby violating Article 2(b) of the RO Agreement. Section 334 is being used as an instrument to protect the United States' textile and apparel industry. Section 405 is being used as an instrument to favour imports of the products of concern to the European Communities;
(b) create restrictive, distorting and disruptive effects on international trade and are, therefore, inconsistent with the United States' obligations under Article 2 (c), first sentence, of the RO Agreement;
(c) require the fulfillment of a certain condition not related to manufacturing or processing and pose unduly strict requirements and are, therefore, inconsistent with Article 2(c), second sentence, of the RO Agreement; and
(d) with respect to section 405, discriminate between Members, and in particular, discriminate in favour of the European Communities and are, therefore, inconsistent with the United States' obligations under Article 2(d) of the RO Agreement.

The Panel dismissed India's claims under (a) because India did not provide empirical evidence that the fabric formation rules bring more imports of made-up articles under quota in the United States.

In any case, even if India has provided such information, the Panel noted "that the mere fact of making the quota system more restrictive could not, ipso facto, condemn

the fabric formation rule. A restrictive fabric formation rule may have been adopted in pursuit of legitimate objectives."

In order to understand the Panel's reasoning, one has to consider that, any change in rules of origin would have an effect on trade flows. Thus, to simply claim that the "fabric formation" rule had a restrictive trade effect does not ipso facto entail more protection for domestic industry and use of origin in pursuit of trade objectives. In other words, according to the Panel, India failed to demonstrate that the fabric formation rule had a quantitative restrictive effect and that these effects were "not incidental to the pursuit of legitimate objectives."

With the same kind of reasoning, the Panel dismissed the claim by India that section 405 is being used as an instrument to favor imports from the EU. Again, on the second claim under (b) the Panel found that there was little evidence in quantitative terms, that the fabric formation rule had a restrictive effect.

Other arguments based on (b) were equally dismissed since it cannot simply be inferred that a change in rules of origin creates distorting or disruptive effects in international trade.

2.9.6 *Section 3 of the Agreement on Trade-Related Aspects of Intellectual Property Rights: Geographical Indications*

The linkages with geographical indications, under TRIPS Articles 22.1 and 23, are disputed but they both refer to the issue of origin and originating products. Thus, if the HWP is equally applied to origin under TRIPS, there might be implications for products which are not produced in a specific region but do meet the origin requirements according to the HWP and vice versa. For instance, during the ongoing negotiations, it has been argued by some members that making wine from imported grapes should be considered as an origin-conferring operation. This proposal, if adopted, could potentially have implications on the protection of geographical indications under TRIPS Article 23, since some wine producers could argue that they are producing originating Bordeaux because they are fulfilling the origin requirement laid down in the HWP; that is, making wine from imported grapes is origin conferring. Obviously, traditional WTO member wine producers have opposed this view arguing that the production of wine is only origin conferring if the wine is made from grapes that are grown and harvested in the same country. A compromise proposal has been put forward, which considers the production of wine as an origin-conferring operation only if the whole process from grapes to wine is performed in the same country.

2.9.7 *Nonpreferential Rules of Origin and Circumvention*

From a legal point of view, the basic problem of anticircumvention measures is the absence of multilateral agreed rules and the resulting unilateral discretionary practices

of the investigating authorities.[112] Until recently neither the United States nor the EU – the main users of such measures – had codified detailed nonpreferential rules of origin. Moreover, they sometimes applied different tests of origin depending on the trade instruments within which the origin determination had been carried out.

For example, in US practice, the origin of semiconductors determined by the Commerce Department in the context of AD proceedings was different from that determined by the US Customs Service.[113] Codification of nonpreferential rules was rare or totally absent in the EC legislation until the entry into force of the common customs code in 1992 and recently in 2017. Even at that time such codification was incomplete. Only after the progress made in the HWP did the EU start to apply a consistent policy on nonpreferential rules of origin adopting on a de facto basis the preliminary results of the HWP. Before these developments the EC Commission investigations used to rely on a rule of thumb of a 45 percent value-added test.[114] This, however, did not prevent the EC authorities from developing ad hoc rules on assembly products where the circumstances of the case so required, as was arguably the case for ball bearings,[115] photocopiers,[116] and semiconductors.[117] The draft ADA of the December 1991 Draft Final Act (referred to as the "Dunkel Draft") contained detailed provisions on circumvention. However, the US negotiators were of the opinion that they were "weak" and succeeded in deleting these provisions from the final ADA.

The Draft was replaced by a Ministerial Decision that recognizes the "problem" of circumvention and the desirability of having uniform rules on anticircumvention as soon as possible. The Decision referred the matter to the Committee on Antidumping Practices for resolution.

[112] This section draws from Inama, Vermulst, and Eckhout, "Non-preferential rules of origin in antidumping law and practice" (fn. 58 above); see also a pioneering study in the area that has largely inspired this section, see UNCTAD publication: "Globalization and the international trading system: Issues relating to rules of origin" (UNCTAD/ITCD/TSB/2, March 24, 1998); and Vermulst, Waer, and Bourgeois (eds.), *Rules of Origin in International Trade: A Comparative Survey* (fn. 65 above).

[113] See Palmeter, "Rules of origin in the United States" (fn. 62 above), 74, and the following decision where Customs concluded that assembling and testing conferred origin on a semiconductor: CSD 80–227, 14 Cust. b & Dec. 1133 (1980). In the following case, the Commerce Department decided that, for AD purposes, assembling and testing did not confer origin: *Erasable Programmable Read Only Memories (EPROMs) from Japan*; *Final determination of sales at less than fair value*, 51, Fed. Reg. 39680, 39692 (1986). See also D. Palmeter, "Rules of origin or rules of restrictions: A commentary on a new form of protectionism," *Fordham International Law Journal*, vol. 11, no. 1 (1987), 1–50.

[114] See Vermulst and Waer, "European Community rules of origin as commercial policy instruments" (fn. 82 above).

[115] See Commission Regulation (EEC) No. 3672/90, December 18, 1990 on determining the origin of ball, roller or needle roller bearings, OJ L356 [1990].

[116] See, for instance, Commission Regulation 2971/89, July 11, 1989 on determining the origin of photocopying apparatus, OJ L196/24 [1989].

[117] See Commission Regulation (EEC) No. 288/89, February 3, 1989 on determining the origin of integrated circuits, OJ L33 [1989].

The United States and other WTO members held that the Ministerial Decision constitutes recognition of the legitimacy of anticircumvention measures and does not preclude members from maintaining, modifying, or enacting anticircumvention measures.

In the aftermath of the Uruguay ARO it was considered and hoped that the results of the HWP could be used to satisfactorily address the issue of anticircumvention. As the ARO expressly provided that the results of the HWP would be used in the context of AD proceedings, the HWP could be consistently used to determine if a product exported via a third country is truly originating in that country or if it has been exported via that third country only to circumvent the AD duty.

Some countries make large use of AD procedures to protect their own industries from competition. As pointed out by the United States[118] according to the Secretariat, thirty-six members have notified that they do not have nonpreferential rules of origin.[119] While many of these same members are known to utilize AD measures, it would appear that rules of origin are not being used for such measures – given that these members have notified that they do not have nonpreferential rules of origin. These members, many of which are active in the HWP, are likely to support the adoption of the latest formulation of rule I on the scope of application to maintain their discretional practices in AD proceedings.

The anticircumvention provision contained in the 1980s EC Anti-dumping Regulation was successfully challenged by Japan in the GATT.

CIRCUMVENTION BY TRANSPLANT OPERATIONS

The 1988 EC Regulation on AD contained an anticircumvention provision that allowed the imposition of AD duties on products that were introduced into the commerce of the community after having been assembled or produced in the community, if the following conditions were met:

- assembly or production is carried out by a party which is related or associated to any of the manufacturers whose exports of the like product are subject to a definitive anti-dumping duty;
- the assembly or production operation was started or substantially increased after the opening of the anti-dumping investigation;
- the value of parts or materials used in the assembly or production operation and originating in the country of exportation of the product subject to the anti-dumping duty exceeds the value of all parts or materials used by at least 50 per cent;

[118] See WTO document G/RO/W/65, Implications of the implementation of the harmonized rules of origin on other WTO agreements.

[119] See WTO document G/RO/W/73, Committee on Rules of Origin – Draft – Seventh Annual Review of the Implementation and Operation of the Agreement on Rules of Origin – Note by the Secretariat. According to G7RO/92 of November 2020, sixty WTO members notified not to have non-preferential rules of origin.

In applying this provision, account shall be taken of the circumstances of each case and, inter alia, of the variable costs incurred in the assembly or production operation and of the research and development carried out and the technology applied within the Community.

Under this provision, seven proceedings concerning assembly operations in the EC were initiated from 1987 to 1989. They concerned Japanese transplant operations for the assembly of electronic typewriters, electronic scales, photocopiers, ball bearings, excavators, and so on.

The provision was successfully challenged by the Japanese Government through a GATT panel regulation. The GATT panel examined whether anticircumvention measures could be justified under GATT Article XX(s), which provides that:

> nothing in this Agreement shall be construed to prevent the adoption or enforcement by any Contracting Party of measures ... d) necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement ...

The panel examined whether anticircumvention measures could be considered necessary in order to secure compliance with the regulations imposing a definitive AD duty on the importation of the finished product ("law or regulations"). In this respect, the EC argued that the term "secure compliance with" should be broadly construed to cover not only the enforcement of laws and regulations per se but also the prevention of actions which have the effect of undermining the objectives of laws and regulations. The panel did not accept this broad interpretation. It noted that the text of GATT Article XX(d) does not refer to "objectives" of laws or regulations but only to laws or regulations.

It therefore clearly follows from this GATT panel decision that GATT Article XX(d) cannot be invoked as a general legal basis for adopting anticircumvention measures, which would deviate from the conditions set forth in Article VI (concerning anti-dumping). It is thus clear that any anticircumvention measures can be adopted only in full compliance with the GATT conditions for imposing AD duties; that is, establishment of findings of dumping and material injury and a causal relation between the two.

In the Uruguay Round negotiations, no agreement was reached on anticircumvention measures. In fact, the Marrakesh Final Act only referred this matter "to the Committee on anti-dumping practices" established under that Agreement for resolution. This legal vacuum has been filled by a new and amended version of the original anti-circumvention provision in the most recent EU AD legislation.

The specific issue of circumvention may take the following forms: (i) relocation of assembly factories to the importing country; (ii) relocation of factories to third markets; and (iii) exportation of disassembled articles to be assembled in the importing country – really a variant of (i).[120] The different approaches of

[120] This latter form of circumvention is not further examined here since it is not related to rules of origin but rather to interpretative rules of the HS. See, for instance, the comments made on the *Eisbein* Case (Case C.35/93, *Dr. Eisbein GMBH* v. *Hauptzollamt Stuttgart* [1994], European

complainants and defendants must be considered in order to follow the rationale for anticircumvention. Complainants usually argue that the relocation of a factory to the home market of the complainant or to a third country has as its main purpose the avoidance of AD duties and that the working or processing operations carried out there are only minor and not origin conferring. Thus, they argue that AD duties should also be imposed on products manufactured in the third country or in the home market because they retain the initial origin status of the third country's products subjected to AD duties (see following box). For their part, the exporters tend to argue that the relocation is a genuine foreign direct investment, a simple step in the globalization of production, and that the amount of value added and/or working or processing carried out in the third country or home market is sufficient for acquiring origin.[121]

CIRCUMVENTION THROUGH THIRD-COUNTRY ASSEMBLY OPERATIONS

(1) Change of Origin during Anti-dumping Procedures

In an AD case concerning typewriters from Taiwan Province of China, the EC Commission terminated investigation proceedings it had initiated on the ground that the production processes carried out there were not sufficient to confer Taiwan Province of China origin. The practical consequence of these findings was that the products assembled in Taiwan Province of China continued to have Japanese origin and therefore de facto were subjected to the AD duties imposed with respect to such products originating in Japan.[122] Subsequently, the customs authorities in some member States even took the position that AD duties should be levied retroactively on prior imports of typewriters from Taiwan Province of China. This ultimately gave rise to the Brother case,[123] where the customs authorities in Germany, after an on-the-spot investigation at Brother premises, again determined that the typewriters in question could not be considered as originating in Taiwan Province of China but in Japan, and that the AD duty applied against imports of Japanese typewriters was applied to the typewriters exported from Taiwan Province of China with retroactive effect. The consequence was that the German customs authorities ordered Brother to pay over DM 3 million in AD duties. Brother appealed against this decision on the ground that the typewriters in question should be considered as originating in Taiwan Province of China on the basis of the application of the EC's origin rules. They

Court of Justice Report, 1–2655) in Vermulst and Waer, "European Community rules of origin as commercial policy instruments" (fn. 82 above) where Eisbein, a German factory which imported disassembled typewriters, argued that these kits should be classified as "parts" and not be object of the AD duty charged against the finished typewriters.

[121] For a detailed analysis of the various issues involved in these cases, see ibid.

[122] *Electronic typewriters from Taiwan Province of China*, OJ L140/52 [1986].

[123] See Case 26/88, *Brother International GMBH* v. *Hauptzollamt Giessen*, European Court of Justice Report [1989].

argued that while most of the parts came from Japan, they were mounted and assembled in Taiwan Province of China in a fully equipped factory into ready-for-use typewriters.

(2) Origin-Specific Determination

The absence of multilateral discipline on rules of origin allowed both the United States and the EC to issue ad hoc origin determinations concerning origin disputes with regard to third-country production. In some cases, these decisions led to international criticism and to bizarre or contradictory regulations. In the late 1980s, an investigation conducted on the spot by the EC Commission at the Ricoh photocopier plant in California concluded that such photocopiers should be denied United States origin and should continue to be of Japanese origin. Subsequently, the Commission enacted a specific regulation on the origin of photocopiers, which although couched in general terms was essentially tailored to the Ricoh situation. As a direct consequence of this origin determination, AD duties imposed on direct import of Ricoh photocopiers from Japan were extended to Ricoh exports from California to the EC despite the fact that these photocopiers presumably included substantial United States value added.

This photocopier decision drew criticism from some of the Community's main trading partners. At that time, the United States and Japan argued that these regulations were protectionist because they determined the nature of manufacturing operations carried out by European producers in the Community rather than providing objective criteria for determining origin and/or because they indirectly promoted manufacturing in Europe policies.

For instance, in the Integrated Circuits Regulation, the Commission ruled that diffusion rather than assembly was origin conferring, despite the fact that diffusion is always followed by assembly and testing, that assembly and testing are more labor-intensive than diffusion, and that the value added in the assembly and testing process can be as high as, and sometimes even higher than, the value added in the diffusion process. The regulation tended to work to the advantage of major European companies such as Siemens which (at the time of adoption) carried out the diffusion process in the EU and testing and assembly in third countries, to the disadvantage of Japanese producers which assembled and tested integrated circuits in the EU.[124]

The Integrated Circuits Regulation came at both a convenient and an embarrassing time for the pending AD proceedings concerning DRAMs[125] and EPROMs[126] from Japan. Until the adoption of the regulation, some members' customs authorities had held that the process of assembly and testing constituted the last substantial transformation. Such an attitude could have been disastrous for the outcome of the AD proceedings initiated because it would have led to the inescapable conclusion that the only Community industry that existed was Japanese-owned!

[124] See section 2.9.2.2 and fn. 96.
[125] See fn. 94.
[126] See fn. 95.

The later US objection to the EC's determination to consider diffusion as the last substantial process or operation for determining the origin of integrated circuits seem inconsistent in the light of the fact that the US Commerce Department, for the purposes of applying the AD law, has explicitly held that diffusion rather than assembly constitutes the last substantial transformation, thereby overruling the established practice of the US Customs Service, which for its own purposes had previously rules that assembly and testing conferred origin.

It was considered that once the harmonization program has been completed, the rules of origin may help to resolve the issue of third-country anticircumvention actions. However, such early hopes were quickly dashed away by further developments.

Anticircumvention measures became controversial in the early 1990s, and involved actions against imports of products subject to AD duties from countries not originally subject to such actions. These anticircumvention actions were motivated on the basis of claims that the firms previously found to be dumping had shifted to production facilities located in third countries. As mentioned in the previous section, the WTO ADA does not appear to be clear-cut on the issue of rules of origin since it refers to both "exporting country" and "origin country," as pointed out by the Republic of Korea in its submission (G/RO/W/38), in Articles 2.2 and 2.5 of the Agreement.

Some countries have argued that the utilization of harmonized residual rules of origin in case of third-country circumvention, coupled with Rule 2(A) of the HS,[127] should allow this issue to be addressed. Pending absence of an agreement on this issue of third-country circumvention, a substantial number of countries, including not only the United States and the EU, but also Latin American developing countries, have unilaterally adopted anticircumvention provisions. Thus, nonharmonized, nonpreferential rules of origin continue to be used to enforce AD duties and, consequently, to combat third-country circumvention. A harmonized approach would thus be beneficial.

The last discussions held at multilateral level on the issue of anticircumvention date back to the proposals made in the context of the Doha Development Agenda. In a submission[128] to the negotiating group on rules, Brazil strongly argued that

[127] The first part of Rule 2(a) extends the scope of any heading which refers to a particular article to cover not only the complete article but also that article incomplete or unfinished, provided that, as presented, it has the essential character of the complete or finished article. The second part of Rule 2(a) provides that complete or finished articles presented unassembled or disassembled are to be classified in the same heading as the assembled article. When goods are so presented, it is usually for reasons such as requirements or convenience of packing, handling or transport.

[128] See WTO document TN/RL/W/200, March 3, 2006.

origin determination made AD investing authorities are different from those made for instance by customs valuation authorities. According to Brazil:

> there here seems to be no conceptual or theoretical reason to tie the concept of origin in the ADA to the one in the ARO. Although using the same concepts of "substantial transformation" and "value added", anti-dumping investigating authorities and custom valuation authorities will look at the same t-shirt and ask themselves different questions regarding the origin of that t-shirt. The answers, of course, may differ.

It follows that, according to Brazil: "Any future multilateral disciplines on circumvention shall explicitly recognize that rules of origin, in the sense of the ARO, do not apply in anti-circumvention."

A proposal by the United States[129] further delinked any consideration of origin in possible discipline over anticircumvention.

The United States proposed the insertion in the ADA and Agreement on Subsidies and Countervailing Measures (ASCM) of language aimed at: (1) providing explicit recognition of the two forms of circumvention traditionally recognized by members using trade remedies; and (2) adopting uniform and transparent procedures for conducting anticircumvention enquiries.

The first paragraph of the proposal codifies the practice of enlarging the scope of an AD order without engaging on a new AD investigation:

> Notwithstanding any other provision of this Agreement or of Article VI of the GATT 1994, the authorities may impose [an anti-dumping duty] [a countervailing duty] with respect to a product that was not within the product under consideration in an investigation which resulted in imposition of a duty, if the authorities determine, pursuant to a review carried out in accordance with this paragraph, that exports of the product are in circumvention of the [anti-dumping duty] [countervailing duty] originally imposed.

In a nutshell the US proposal aimed at inserting in the ADA and ASCM provisions ensuring that both Agreements should make explicit the right of authorities to examine the facts and make a determination based upon those facts. One may then legitimately wonder what would change from the current status quo of absence of multilateral rules.

Subsequently the US proposal provides examples of circumvention based on the key concept that the alteration of the original product may be relatively minor, such that the altered product has essentially the same characteristics and uses as the original product covered by the measure. For example, if an exporter adds an additional low-value ingredient to a chemical product that changes its classification,

[129] See WTO document TN/RL/GEN/71, October 14, 2005.

but does not change its essential nature from the point of view of customers, authorities may conclude that the altered product has circumvented the measure on the original product. Once delinked from origin, investigating authorities will have a free hand in determining if the alteration has changed or not the commercial use of the good.

The wide discretion left to the authorities may be drawn from the language below:

> Exports of a product that is not within the product under consideration are in circumvention of the [anti-dumping duty] [countervailing duty] originally imposed if:
>
> (i) subsequent to the filing of the application, exports of the product under consideration have been supplanted, in whole or in part, by exports from the same country of another product that has the same general characteristics and uses as the product under consideration;

A second form of circumvention is involving replacement of trade in a product with trade in its sub-components, which are then assembled or finished either in a third country or in the country of import. According the US proposal, as long as the assembly or finishing operation is relatively minor, there is no reason to consider that moving the locus of this operation should have any effect upon the AD or countervailing duty measure.

This statement seems to forget that issues of what constitute simple assembly and assembly involving substantial transformation have been largely debated during the HWP and a number of technical solutions have been agreed upon.

The real point is that while the United States recognizes that some assembly or finishing steps may be complex and their location of great commercial significance they do not wish to tie their hands and prefer to delegate to the investigating authorities the right to examine the facts and make a determination based upon those facts as contained below:

> Exports of a product that is not within the product under consideration are in circumvention of the [anti-dumping duty] [countervailing duty] originally imposed if: (i) [see above]; or
>
> (ii) subsequent to the filing of the application, exports of the product under consideration have been supplanted, in whole or in part, by exports of parts or unfinished forms of the product under consideration, where only a minor or insignificant process of finishing or assembly is necessary to convert the parts or unfinished forms into the product under consideration.

A proposal on circumvention was contained in the Chair's draft[130] of the negotiating group on rules:

[130] TN/RL/W/213, November 30, 2007.

CIRCUMVENTION

9bis.1 The authorities may extend the scope of application of an existing definitive anti-dumping duty to imports of a product that is not within the product under consideration from the country subject to that duty if the authorities determine that such imports take place in circumstances that constitute circumvention of the existing anti-dumping duty.[131]

9bis.2 Authorities may only find circumvention within the meaning of paragraph 1 if they demonstrate that:

(i) Subsequent to the initiation of the investigation that resulted in the imposition of the existing definitive anti-dumping duty, imports of the product under consideration from the country subject to that duty have been supplanted, in whole or in part:[132]
- by imports from the country subject to the anti-dumping duty of parts or unfinished forms of a product for assembly or completion into a product that is the same as the product under consideration;
- by imports of a product that is the same as the product under consideration and that has been assembled or completed in a third country from parts or unfinished forms of a product imported from the country subject to the existing anti-dumping duty; or
- by imports of a slightly modified product[133] from the country subject to the existing anti-dumping duty;

(ii) The principal cause of the change described in subparagraph 2(i) is the existence of the anti-dumping duty on the product under consideration from the country subject to the duty rather than economic or commercial factors unrelated to that duty;[134] and

[131] Throughout this Article AD duty will be understood as duty or undertaking.

[132] Factors pertinent to a consideration of whether imports of the product under consideration have been supplanted include whether there has been a change in the pattern of trade of the exporters subject to the AD duty, the timing of such change, and any association or compensatory arrangement between the exporter and the importer or a third party. No one or several of these factors can necessarily give decisive guidance.

[133] A slightly modified product is a product that is not within the product under consideration but that has the same general characteristics as the product under consideration. Factors pertinent to a consideration of whether a product is a slightly modified product include general physical characteristics, purchaser expectations, end uses, channels of trade, the interchangeability of the products, the processes, facilities and employees used in production of the products, differences in the costs of production, the manner in which the products are advertised and displayed, and the costs to transform the slightly modified product into the product under consideration. No one or several of these factors can necessarily give decisive guidance.

[134] Factors pertinent to a consideration of the possible role of economic or commercial factors unrelated to the duty include technological developments, changes in customers' preferences and changes in relative costs. No one or several of these factors can necessarily give decisive guidance.

(iii) The imports that have supplanted the imports of the product under consideration from the country subject to the existing anti-dumping duty undermine the remedial effect of that duty.[135]

9bis.3 With respect to imports referred to in 9bis.2 of parts or unfinished forms of a product and imports referred to in 9bis.2 of a product assembled or completed in a third country, the authorities shall only find circumvention if they establish that (i) the process of assembly or completion is minor or insignificant[136] and (ii) the cost of the parts or unfinished forms makes up a significant proportion of the total cost of the assembled or completed product. The authorities shall in no case find that circumvention exists unless they determine that the value of the parts or unfinished forms is 60 per cent of the total value of the parts or unfinished forms of the assembled or completed product or more, and that the value added to the parts or unfinished forms during the assembly or completion process is 25 per cent of the total cost of manufacture or less.

9bis.4 The authorities may extend the scope of application of an existing definitive anti-dumping duty to imports of parts or unfinished forms of the product under consideration assembled or completed in a third country only if they find that such imports are dumped pursuant to Article 2.

9bis.5 A determination of the existence of circumvention within the meaning of this Article shall be based on a formal review initiated pursuant to a duly substantiated request. Except in special circumstances, such a review shall not be initiated unless the authorities have determined, on the basis of an examination of the degree of support for, or opposition to, the request expressed by domestic producers of the like product that the request has been made by or on behalf of the domestic industry within the meaning of Article 5.4.

9bis.6 The provisions regarding evidence and procedure in Article 6 shall apply to any review carried out under this Article. Any such review shall be carried out expeditiously and shall normally be concluded within 12 months of the date of initiation of the review.

9bis.7 If the authorities have determined in accordance with this Article that circumvention exists, they may apply the anti-dumping duty to the imported

[135] Factors pertinent to a consideration of whether the remedial effect of an existing AD duty is undermined include the evolution of the prices and quantities of the product assembled or completed in the importing country or in a third country or of the slightly modified product and whether those products are sold to the same customers and for the same uses as the product subject to the existing definitive AD duty. No one or several of these factors can necessarily give decisive guidance.

[136] Factors pertinent to a consideration of whether a process of completion or assembly is minor or insignificant include the level of investment, research and development related to the completion or assembly, the nature and cost of the production process and the extent of the facilities used for completion or assembly. No one or several of these factors can necessarily give decisive guidance.

products found to be circumventing the existing definitive anti-dumping duty,[137] including retroactively to imports entered after the date of the initiation of the review.

This draft calls for the following preliminary comments:

- the three indents of paragraph 9bis.2 identify the three classic forms of circumvention – (i) import of disassembled products into parts, (ii) circumvention by third-country operations, and (iii) minimal alteration of the original product – and do not significantly differ from previous practice or the US proposal above given the latitude of discretion that the authorities may exert in interpreting these forms of circumvention.
- There are a number of conditions to be filled for imposing AD duties most notably the one contained in the second paragraph of Article 9.3:

> The authorities shall in no case find that circumvention exists unless they determine that the value of the parts or unfinished forms is 60 per cent of the total value of the parts or unfinished forms of the assembled or completed product or more, and that the value added to the parts or unfinished forms during the assembly or completion process is 25 per cent of the total cost of manufacture or less.

However while the formula for the calculation of the first criterion is quite straightforward since it is a value-of-parts test (even if it does not say how the value of materials could be assessed: one may argue according to the WTO agreement on customs valuation), the methodology for calculating the second criterion does not sufficiently clarify the numerator and denominator.

It is not clear at all what is the total cost of manufacture, what are the costs that can be allowed to be counted as cost of manufacture and those that are not. As noted earlier this is one of the inherent difficulties of a value-added calculation of this nature.

Finally, these requirements appear restrictive if we generally compare them to the rather liberal approach adopted in the HWP. Perhaps this once again explains the resistance of some administrations – namely, the United States – not to adopt the results of the HWP for AD purposes.

- Para 9bis 4 provides for a fundamental condition since a funding of dumping is now required before extending the scope of the AD duties.

[137] If a review under this Article has been initiated on a country-wide basis, the authorities shall exempt imports from particular exporters from the scope of any extended AD duty if they find that those imports take place in circumstances that do not constitute circumvention of an existing AD duty.

Summing up, the proposal could be read as a compromise that may allow some progress on the issue of circumvention and may indirectly facilitate a final agreement of the HWP under the ARO.

Nonpreferential origin rules may play a role in the dumping determination (selection of normal value), the injury determination (determination of domestic producers), and in the enforcement of AD measures (to combat third-country circumvention).

In the absence of harmonized nonpreferential origin rules, each importing country is free to use its own origin rules for these purposes.

Even though this lack of harmonization already grants administering authorities substantial discretion, the analysis of EU practice has shown that origin rules are not used in a consistent manner in the context of the dumping and the injury determination.

In the enforcement phase, rules of origin can be applied (as an alternative to or in tandem with third-country anticircumvention legislation) to extend the application of AD measures to third countries, sometimes retroactively. The use of origin rules in this context works well where multinational companies are involved. However, in the case of smaller "fly-by-night" operators, the actual collection of AD duties has proven very difficult, both because of country-hopping by exporters and because of rapid changes of the importers on record.

The eventual harmonization of nonpreferential origin rules would have been helpful to limit administrative discretion and arbitrary application. However, in light of the relatively liberal character of the draft harmonized origin rules, it seems likely that AD-user countries will insist on the use of third-country anticircumvention rules in the context of AD legislation as an alternative means to fight third-country circumvention.

2.10 FROM 2007 AND BEYOND: WHAT IS THE FUTURE OF THE ARO AND NONPREFERENTIAL RULES OF ORIGIN?

2.10.1 *Work in the WTO Committee on Rules Origin 2007–2019*

The work in the WTO CRO from 2007 to 2019 could be summarized in four periods.

2.10.1.1 First Period: Consultation Phase 2007–2011

In this period the CRO:

> conducted intense consultations with Members in order to resolve the 94 core policy issues with regard to the Harmonization Work Programme under Part IV of the Agreement. The General Council, at its meetings on 27 July 2007, recognized that, although important progress had been made over the last year, delegations in

> the CRO felt that the difficulties they had encountered on the "implications" issue and in the sector of machinery was such that guidance from the General Council was now warranted on how to take these issues forward. The recommendation of delegations in the CRO was that work on these issues be suspended until such guidance from the General Council would be forthcoming. The General Council then agreed that, in the meantime, the CRO continue its work with a view to resolving all technical issues, including the technical aspects of the overall architecture, as soon as possible.[138]

As outlined in the preceding sections "Implications" refers to divergences regarding the scope of application of the HRO. In fact, several trade instruments require the determination of origin, as is recalled in Article 1 of the ARO, including: MFN treatment in the determination of import duties; safeguard measures; AD measures; countervailing duties; origin marking and labeling; discriminatory quantitative restrictions or tariff quotas; government procurement; and trade statistics. As reflected in the abovementioned excerpt, members held polarized views regarding whether the harmonized rules should also apply to such other instruments or not. As a compromise, the Chairperson of the CRO proposed in 2006 that each member would choose the instruments to which it would apply the harmonized rules and notify the Secretariat. Nevertheless, a partial or selective application of the rules could not be accepted by all WTO members.

For instance, in the "Dual rule for machinery" WTO members held divergent views on the identification of rules for the machinery sector (about 600 tariff lines in HS Chapters 84–90), largely because of uncertainties regarding the utilization of HRO for trade policy measures. Some members argued that value-added rules should be used for this sector while other members argued the opposite. The Chairperson of the CRO proposed, in 2006, that both tariff-shift rules and value-added rules be used depending on members' preferences ("double approach" or "dual rule"), but this pragmatic solution could not be accepted by all WTO members.

Recognizing members' divergences on these two issues, the GC, on July 27, 2007, recommended that work on these issues be suspended until such guidance from the GC would be forthcoming. Since that time, work in the CRO has focused on marginal technical aspects of the HWP. In 2010, a communication from the delegations of China, India, and Pakistan (WT/GC/W/622 and WT/CG/W/622/Add.1) reminded the GC that a decision on the core policy issues was still pending, but no specific guidance was forwarded to the CRO. Apart from this initiative other significant work concerned the completion of the transposition of G/L/1047, the draft HRO into newer versions of the HS by the Secretariat (HS 2002, 2007, and 2012, documents JOB/RO/2/Rev.1, JOB/RO/3/Rev.1 and JOB/RO/4 respectively).

[138] See WTO document G/L/831.

Indeed from 2007 to 2011 a number of discussions were held during "informal meetings" of the CRO on the overall architecture and product-specific rules. During this period "informal meetings" usually preceding the formal meeting of the CRO were used to negotiate and discuss the substantive issues that were then summarized and reported to the CRO with a short report of five to six pages. While such format was considered more appropriate to facilitate consensus in retrospective it has not helped in building an institutional memory of the negotiating process.

During the initial period delegations were still engaged and proposals on the overall architecture and the PSRO were discussed. However, as it became progressively clear that guidance on the implications issues was not forthcoming from the GC, the scope of the discussion gradually narrowed down, the composition of the delegations attending the CRO started to be limited to Geneva-based delegates, and the debate on the agenda of the CRO gradually reached a standstill.

2.10.1.2 Second Period: 2011–2014, following the Consensus for Updating the HRO

A second period started from 2011 to 2014 thanks to the consensus reached on October 27, 2011,[139] when "the CRO agreed to the immediate initiation of the work to transpose the results of the Harmonization Work Programme to more recent versions of the HS nomenclature by the WTO Secretariat with a view to concluding that work as soon as possible."

The transposition exercise of the results of the HWP to the successive version of the HS gave another lease of life to the work in the CRO where the substantive debates on the HWP were practically limited to the issue of the residual rules of the overall architecture that continued unabated from 2007 till 2014. The WTO Secretariat was instructed to conduct the transposition work in collaboration with members and the Secretariat of the WCO. The CRO reviewed the first two stages of that work in 2012; namely, the transposition of draft rules into the HS 2002 and the HS 2007.[140]

As the scope of the negotiations became even narrower, Australia and Canada questioned the practice of summarizing the results of the informal consultations to the minutes of the formal meeting. This discussion over the format of the CRO meeting protracted in 2014 as it became progressively clear that the aim of the proposal was in reality to shorten as much as possible the duration of CRO meetings as a sign of recognition that work on the HWP reached a complete deadlock.

The CRO meetings of April 18, 2013 and September 26, 2013 saw some developments that would shape the agenda of the CRO for the future. At the April meeting

[139] See WTO document G7/RO/71.
[140] See WTO document G/L/1016.

of the CRO the delegation of San Salvador proposed again to hold a workshop on "non preferential rules of origin and labeling." The proposal was contested by Australia, Canada, and the United States, who were no longer interested even in discussing at a workshop the "implication issues."

As a result of negotiating deadlocks and of the absence of political guidance from the GC, work in the CRO lost momentum. In his bilateral consultations with members in July and during the informal meeting in September 2013, the Chair sought to take stock of members' interests and positions. He asked members if the harmonization of nonpreferential rules of origin continued to be an important trade policy objective eighteen years after the launch of these negotiations and whether members were ready to intensify work, including on some of the core policy issues. Two views emerged clearly from these consultations as reported by the Chairperson to the GC[141] in 2013:

> Some Members believed that fully harmonized, non-preferential rules of origin remain an important objective to facilitate world trade. These Members would support an intensification of the Committee's work to conclude the negotiations. These Members argued that non-preferential rules of origin might have lost importance for tariff treatment, but that their relevance has only increased in the context of trade remedies, government procurement, and labelling, etc. These Members thought, however, that full negotiations could only resume if there was a clear political commitment to conclude the HWP.
>
> Other Members mentioned that concluding the negotiations is no longer a political priority. According to them, world trade had changed dramatically since the late 1990s, when the Work Programme had initiated. The WTO now covered virtually all major trading nations, so distinguishing preferential, MFN and non-MFN origin did not make sense any longer. National customs administrations now needed to focus on preferential origin only. They also argued that products were now "made in the world", so the concept of national origin had lost its importance. For these Members, the Committee should reduce the frequency of its meetings and focus on additional areas, for instance: certification and verification of origin, trade in value chains and global production networks, transparency regarding non-preferential and preferential rules of origin and notifications.
>
> Some Members, from both previous groups, also mentioned that they were ready to explore the possibility of concluding the HWP for a voluntary adoption by Members as "guidelines".
>
> As it is, the implementation and operation of the Agreement is not satisfactory as the adoption of harmonized non-preferential rules of origin constitutes its central objective. During the informal meeting of September, several Members submitted room documents or made presentations describing their current non-preferential rules of origin. The Secretariat delivered presentations on the Agreement, a

[141] See WTO document G/RO/W/145/Rev.1

summary of the notifications available, and the history of the HWP negotiations. To this date, 41 Members have notified to the Secretariat that they apply some type of non-preferential rules of origin, 44 Members have notified that they do not apply non-preferential rules and 46 Members have not submitted a notification yet.

Given this difference in Members' views, it is difficult for the Chairman to draw a future roadmap. In the absence of any guidance from the General Council, it would be difficult for the Chairman of the CRO to put forward any concrete agenda of work on the HWP other than the transposition exercise for the Committee's forthcoming meeting in April 2014.[142]

2.10.1.3 Third Period: 2014–2016, an Initial Stagnation and the Resurgence of the CRO Thanks to Discussion on Preferential Rules of Origin for LDCs

The third phase started in 2014 and it was a sort of litmus test for the relevance of the CRO as outlined above in the 2013[143] Report of the CRO to the GC for trade in Goods.

Faced with an almost total deadlock on the HWP and a rather embarrassing situation where the CRO had almost no items on the agenda for discussion at the next CRO meetings, the chairperson proposed a twofold agenda at the April 2014 meeting of the CRO: first, to turn the forthcoming meetings of the CRO into educational exercises and, second, to "intensify efforts in the CRO to exchange information regarding existing preferential rules of origin for LDCs."[144] Both proposals were accepted by the WTO members.

The main outcome of the educational exercise are outlined in section 2.10.2 below and the results of the exchange of information on LDC preferential rules of origin are discussed in Chapter 1, section 1.3.

In addition, at the April 2014 session the CRO was dedicated to discussing the transposition of the draft harmonized nonpreferential rules of origin from HS 1996 to the nomenclature versions of 2002, 2007, and 2012 that, as reported by the WTO Secretariat, was finalized on the basis of WCO information (correlation tables) and comments from members, the TCRO, and the WCO. The WTO Secretariat presentation illustrated that the rectifications made could be summarized in four categories. In most cases, no adjustment was required since either the HS codes themselves did not change ("no change") or the changes imposed did not call for revision ("no change required"). The latter relates to cases where, for example, the rule was set at the heading level and modifications were applied at subheading level. More complex, technical revisions were only required in some occurrences ("technical rectification"). In these cases, adjustments such as the creation of new

[142] Excerpted from WTO document G/L/1047 of 10 October 2017 the 2013 report of the Committee on Rules of Origin to the council for trade in goods.
[143] WTO document G/L/1047, October 13, 2013
[144] Excerpted from WTO document G/RO/M/62, June 19, 2014

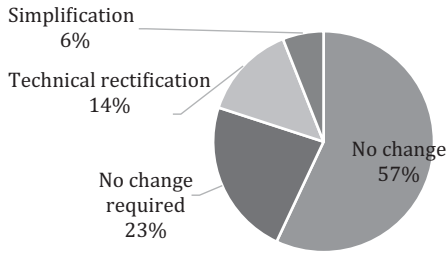


FIGURE 2.1 Summary of rectifications (%): sum of 2002, 2007, 2012

splits to separate products that had been moved into new subheadings or the addition of exceptions to rules, or both, had to be made. Finally, simplifications of "mechanically transposed" rules were made to ensure practical application of the rule ("simplification") (see Figure 2.1).[145]

Finally, the CRO initiated work on preferential rules of origin for LDCs as a result of the adoption of the Bali Ministerial Decision.[146] The CRO agreed on the procedures to review new developments related to such rules and conducted the first review of developments.

The work on preferential rules of origin for the LDC, admittedly supported by the United States,[147] provided a new lease of life to the CRO meetings. From 2015 to 2018 the substantive agenda of the CRO was practically dominated by discussion on preferential rules of origin for LDCs, as discussed in Chapters 1 and 3.

At the CRO meeting of April 22, 2016[148] the WTO Secretariat made a presentation on the Work Program for the Harmonization of Rules of Origin that is worth mentioning since it is the most updated official record of the status of the negotiations of the HWP.

According to this presentation while the CRO had agreed on 1,528 out of 2,744 products to that date, 45 percent remained outstanding, as shown in Figure 2.2.[149]

The lack of consensus was reported for several HS chapters such as 1–4, 7, 9, 15–18, 20–23, 25, 39, 40–43, 50–64, 68, 70, 72, 74–80, 84–90, 91, 92, 94, 95, and 97. In addition to these specific regulations, concerns about the general architecture of the HWP were outstanding. The built-in review of the HRO (Preamble), the regulations regarding fish taken from the economic exclusive zones (Definition 2 of Appendix 1), the residual rules (rules 1 and 2 of Appendix 2), but also the overall coherence of the regulations remained to be resolved. In addition, it was

[145] Excerpted from WTO Secretariat presentation at the CRO meeting of April 2014.
[146] See WT/L/917.
[147] See statement of the US at the CRO meeting of April 2014.
[148] RD/RO/34.
[149] JOB/RO/1/Rev.2.

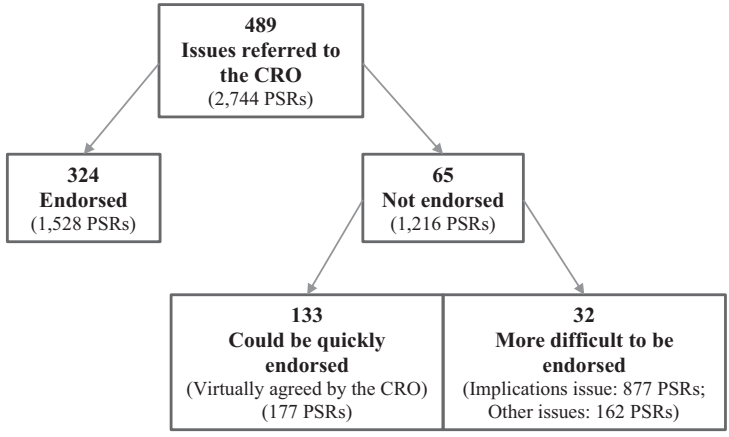


FIGURE 2.2 Summary of unresolved issues
See JOB/RO/1/Rev.1.

highlighted that an amending mechanism needed to be incorporated to ensure the transposition into updated HS nomenclature and the revision of rules toward increased operationality.

Finally, the CRO reviewed and validated the technical accuracy of the results of the transposition exercise conducted by the Secretariat. All draft HRO were transposed to the most recent version of the HS and compiled in a single document (JOB/RO/5/Rev.1 and JOB/RO/5/Rev.1/Corr.1). This document is important since it provides a valuable benchmark of where the HWP has been able to get after almost twenty years of work.

Most importantly the CRO 2016 report to the GC contained a hint about the resumption in some possible forms of a dialogue over the future on nonpreferential rules of origin as follows:

> Drawing on the views heard during this educational exercise, the delegation of Switzerland has proposed to circulate questions to initiate discussions in the Committee about possible principles and guidelines to streamline non-preferential rules of origin.[150]

2.10.1.4 Fourth Period: 2016–Present, the Swiss "Transparency" Initiative

The fourth phase of the CRO started from the initiative of delegation of Switzerland that initiated informal consultations during 2016 that initially took the form of two documents[151] that were circulated and discussed during informal meetings.

[150] See WTO document, GL/1159, 2016.

[151] See JOB/Ro/6, October 13, 2016 and JOB/RO/7, November 17, 2016 titled "Possible recommendations from the 'educational exercise' on non-preferential rules of origin and the 'information session' organized for the Committee of Rules of Origin."

The first document simply posed three basic questions to be used during informal meetings to test the mood of the major delegations on how to move forward on the issue of nonpreferential rules of origin. The three questions were as follows:

(a) What options could be envisaged to reduce compliance costs associated with non-preferential RoO?
(b) How could global value chains and the needs of MSMEs be reflected in non-preferential RoO?
(c) Could non-preferential RoO be inspired by RoO practices in RTAs and other existing agreements?

These questions were designed to test the grounds with other WTO delegations on how to move beyond the HWP that was clearly not a topic for discussions any longer.

The second document presented a month later in November 2016 was much more elaborated while maintaining that "Switzerland is circulating this communication in order to feed and facilitate informal discussions about principles and guidelines to streamline non-preferential rules of origin (RoO)."

The document made a rather more ambitious summary of the results of the educations exercises made below in section 2.10.2 attempting topics for discussions in the CRO.

> In order to streamline the processes and reduce compliance costs, Members could consider aligning their rules and procedures for determining the non-preferential origin of a product . . .
>
> . . . In case the criterion "substantial transformation" is used, it should be described in a way to avoid different interpretations by national customs authorities.[152] National rules should be as simple as possible. Harmonization or streamlining of the criteria would be desirable . . .
>
> . . . Countries should not require a proof of non-preferential origin unless it is necessary in order to implement other trade policy measures, such as quotas or anti-dumping duties . . .

Such rather ambitious agenda was later reduced after two years of consultations, which lead the Swiss delegation to come out with a proposal for a template for notification of nonpreferential rules of origin.[153]

This initiative was inspired by the successful format of the Nairobi Ministerial Decision on preferential rules of origin for LDCs that provided for a "template" to notify preferential rules of origin adopted by preference-giving countries for LDCs. Such a template, once adopted by WTO members, demonstrated to be a valuable

[152] According to the Swiss document: "The different interpretations of the substantial transformation criterion engenders uncertainty for firms. As a result, companies may choose to implement costly tracking systems and meet a higher threshold than necessary to support the same origin under multiple jurisdictions."

[153] WTO document G/RO/W/182, January 17, 2019.

transparency tool, allowing comparisons among different sets of rules of origin and clarity on the kind of rules of origin provided by preference-giving countries to LDCs. Before the introduction of such a template, the quality of the notifications was uneven, scattered, and did not contain all the necessary elements of the applicable rules of origin and related administrative procedure. This Swiss proposal needs to be framed and understood in the climate surrounding the debates on nonpreferential rules of origin in the WTO. The United States and other aligned WTO members were suspicious of any attempt to resume any exercise that could be linked to the HWP. Ultimately there was only a tightrope to walk for the Swiss delegation, building on the positive experience of the LDC template for notification of preferential rules of origin.

In fact, the Swiss document is basically centered on a template for the notification on nonpreferential rules of origin and an obligation for WTO members to make fresh notifications of the applicable nonpreferential rules of origin. In a nutshell this proposal replicates the experience of the LDCs when they managed to insert a similar provision in the WTO Nairobi Ministerial Decision on preferential rules of origin for LDCs.

Yet, and most importantly, the Swiss proposal goes beyond the wording of the LDC Nairobi Ministerial Decision insofar it provides a mandate to the CROs in the years to come as follows:

> The Committee on Rules of Origin (CRO) shall examine existing rules of origin and related documentary requirements based on the information notified according to this decision, with a view to identifying trade-facilitating practices and to promoting their international diffusion.

It is too early to assess if such a mandate to the CRO will be maintained in the proposal that is still under discussion.

If and when adopted, this is good news for the international community since it could establish a forum of discussions on nonpreferential rules of origin that has so far been lacking given the extremely limited mandate provided to the CRO and the TCRO.

Ultimately, it will be up to the WTO members and the WTO Secretariat to make good use of this opportunity after more than twenty years of deliberations with no concrete results on nonpreferential rules of origin.

2.10.2 *Main Findings of the CRO "Educational Exercises"*

The presentations made by a number of international organizations, and private sector and nongovernmental organizations, were best summarized by a presentation made by the WTO Secretariat in November 2016.[154]

[154] WTO document RD/RO/48.

The CRO educational exercise welcomed sixteen presentations from various fields. The messages were not univocal. In summary, it was highlighted that there were four main working areas to standardize or simplify rules and procedures for trade enhancement: simplification, transparency, labeling, and certification.

(a) **Simplification:** Nonpreferential rules of origin are very different at national level. There is no common framework or model. The greater the variety, the greater the complexity. From the administrative perspective, the variety of nonpreferential RoO regulations make automated compliance not possible. The proliferation of nonpreferential rules of origin adds to the spaghetti bowl of preferential rules of origin. From business point of view, there is no distinction between preferential or nonpreferential rules of origin: it is a matter of compliance.

(b) **Transparency:** The complex nature of the PSRO at national level in combination with other ancillary rules (tolerance, *de-minimis*, fungible goods, minimal operations, product-specific rules) increases business risk and costs, due to case-by-case compliance assessments. Minor mistakes can, at times, generate overly severe penalties in terms of fines. In addition, in the case of nonpreferential rules of origin, the benefit associated with compliance is unclear, since at least preferential rules of origin allow for duty-free treatment. The wider adoption of international standards, as outlined for example in Kyoto Convention Annex K "Origin," could thus favorably impact trade.

(c) **Labelling:** There is a lack of understanding of the linkage between rules on origin and "country of origin" markings. At the time of production, a firm may not yet know the export destination of the finished product, hence compliance costs and risks may increase. The "country of origin" indicated in labels is not a relevant information for consumers since it shows the last country of production. Traceability is different from origin. It was felt that origin should only be indicated for consumer goods, not intermediaries. A mismatch (real or perceived) between the origin indicated in the label and the customs origin may lead to the rejection of goods.

(d) **Certification:** Lack of uniform practice relating to proof of origin was one of the most common impediments cited by business. There was no uniformity of practices; for instance, different *de minimis* thresholds for which a certificate is not required.

In certain cases, such as the absence of quotas or AD duties, nonpreferential certificates of origin might not actually be needed. There is scope for the simplification of requirements and wider use of electronic certification. Consular or embassy visas add to the administrative costs related to certificates.

2.11 NEW RESEARCH AND WAYS FORWARD: APPROXIMATION AND CONVERGENCE OF RULES OF ORIGIN IN INTERNATIONAL TRADE

As mentioned in preceding sections, the HWP was supposed to be completed in July 1998.[155] Results of the technical review undertaken by the WCO were submitted to the WTO by a revised deadline of November 1999. As of today, however, the HWP and the associated draft text of harmonized nonpreferential rules of origin has been almost completely abandoned.

Despite considerable progress, as witnessed by the development of a draft text, a final consensus could not be obtained. This reflects opposition of some WTO members, notably the United States, to the implications of the results of the HWP for different WTO agreements. The main reason for concern by these countries is that adoption of harmonized nonpreferential rules of origin would affect (constrain) the discretion of government agencies in implementing specific trade policies – such as AD measures. This so-called "implications issue" led to the cessation of formal negotiations in the mid-2000s.[156]

As summarized in the preceding sections, since 2007 the work of the CRO has been limited to updating the draft HWP text on the HRO to reflect new versions of the HS and educational workshops on the consequences of the absence of HRO for business. In 2016, Switzerland initiated informal consultations among WTO members on a limited negotiating agenda aimed at making progress by focusing on areas where pragmatic approaches could be taken to facilitate trade in the absence of full harmonization of nonpreferential rules of origin.

As discussed in section 2.10 of this chapter, the Swiss proposal ultimately took the form of a template for the notification of nonpreferential rules of origin to the WTO and a mandate to the CRO to discuss such notifications. Albeit having an initially limited scope, such initiative may open the way to meaningful debates in the CRO on nonpreferential rules of origin. Much will depend on the efforts that WTO members are prepared to invest in such exercise and the ability of the WTO Secretariat to manage the process.

In the case of preferential rules of origin there have been a number of developments since the late 1990s. One concerns implementation of unilateral preferential programs. Starting in 2005, developed countries committed to facilitating exports of the LDCs by providing these nations with duty-free, quota-free (DFQF) access for at

[155] This section draws from S. Inama and B. Hoekman, "Harmonization of rules of origin: An agenda for plurilateral cooperation?," *East Asian Economic Review*, vol. 22, no. 1 (2018), 3–28.

[156] Since then another "implication" of harmonization has been highlighted by China, which has been a proponent of harmonization of nonpreferential rules of origin as a means of improving the measurement of trade balances by better accounting where value is added in the production of goods (i.e. to reflect the fact that many of the goods that counted as Chinese in the import statistics of trading partners are not of Chinese origin since most of the value embodied in them is associated with inputs originating in third countries).

least 97 percent of product lines. A number of Organisation for Economic Co-operation and Development (OECD) countries, including the EU, have implemented programs that provide DFQF access to all products except arms. This gave rise to discussion in the WTO on rules of origin, with the LDCs arguing that strict rules of origin substantially reduced the value of DFQF access. As a result, there have been deliberations and some progress in agreeing to adopt rules of origin that are simpler and easier to satisfy. The pursuit of incremental convergence of the rules of origin that apply for LDCs has complemented the long-running effort to agree to harmonize rules of origin for nonpreferential trade policy purposes.

2.11.1 *Rules of Origin in Recent Preferential Trade Agreements*

Despite the stalemate on nonpreferential rules of origin, negotiations on preferential rules of origin have thrived as a result of negotiation of new preferential trade agreements (PTAs) and efforts by developing countries to enhance the economic salience of nonreciprocal preferential market access programs. A basic tenet (the conventional wisdom) of most RoO experts and trade officials is that there is no possible spillover among preferential and nonpreferential rules of origin, since they serve different trade policy objectives. Preferential rules of origin serve to determine whether a preferential tariff is applicable under an RTA or a unilateral arrangement, while nonpreferential rules of origin serve to determine the application of MFN trade policies and specific WTO agreements.

Recent research on private industry views and experience and views on dealing with rules of origin reveals that this distinction is not very important for firms. For many, compliance with rules of origin is a normal part of a business transaction that has a cost. The main difference between preferential and nonpreferential rules of origin is that the former are associated with an expected benefit of reduced duty or duty-free entry in the export market but, in many cases, companies are obliged to comply with rules of origin in any event.

A recent survey[157] revealed a 100 percent awareness by respondent companies of nonpreferential rules of origin, with some 55 percent of firms perceiving nonpreferential rules to be relevant to their daily operations. Reasons for this included such rules of origin being demanded by clients, by importing country customs authorities and/or financial service providers (e.g. for letters of credit). This helps to explain why large companies are prepared to incur the cost of buying and maintaining sophisticated IT systems and related personnel in order to more efficiently assure compliance with rules of origin – both preferential and nonpreferential.[158]

[157] M. Anliker, "Non-preferential rules of origin: High level assessment," paper prepared for the Global Governance Program at the European University Institute (EUI), 2016.

[158] R. Soprano, "The challenge of designing 'new' rules of origin in international trade," EUI, Mimeo, 2016.

Smaller companies are generally less aware and less able to assess the importance of rules of origin in their day-to-day business. Most companies favor harmonizing rules of origin as a measure to facilitate trade and bring down cost of compliance, with a clear preference for greater acceptance and use of self-declaration of origin by firms as opposed to having to use certificates of origin issued by certifying authorities or chambers of commerce (the latter generally give rise to fees associated with obtaining such certification).

There has been considerable evolution in the technique and content of drafting rules of origin in PTAs. South–South agreements – such as the Southern African Development Community (SADC); the Common Market for Eastern and Southern Africa (COMESA); Southern Common Market (Mercosur) and the Association of Southeast Asian Nations (ASEAN) – traditionally adopted a simple formula, such as an across-the-board percentage criterion mirroring the percentage rules in the US GSP scheme.[159] In addition, they often adopted as an alternative a change of tariff heading criterion following the EU model. In short, these PTAs have not developed their own RoO model. Over time they developed PSRO, but again borrowing the drafting techniques from the existing US and EU models. This is the case for Asian trading nations – Japan, South Korea, the ASEAN countries – as well, which have borrowed heavily from the North American model for rules of origin.[160]

The current negotiations on rules of origin for the Regional Comprehensive Economic Partnership Agreement (RCEP) in Asia and the rules of origin in the African Continental Free-Trade Area (AfCFTA) are based on PSRO and the negotiating texts are hundreds of pages in length.

In practice the method for calculating the ad valorem percentage criterion in most PTAs is very similar to the method adopted in the PTAs that were concluded by the United States subsequent to adoption of the NAFTA or by the EU with a number of developed and developing countries. In their turn, the EU and US methods for calculating the percentage criterion do not differ widely with the exception of the net cost calculation mostly used by the United States in the automotive sector.[161]

Despite the often-claimed rigid separation between nonpreferential and preferential rules of origin, the border between the two regimes has always been porous. NAFTA had a major influence on the WTO ARO. It was US insistence that resulted in the CTC becoming the preferred methodology for drafting rules for nonpreferential rules of origin, as opposed to the EU approach of using a combination of criteria – the CTC, percentage criterion, and specific working and processing

[159] See S. Inama, "The reform of the EC GSP rules of origin: *Per aspera ad astra*?," *Journal of World Trade*, vol. 45, no. 3 (2011), 577–603.

[160] S. Inama and E. Sim, *Rules of Origin in ASEAN: A Way Forward*, Cambridge University Press, 2015.

[161] See Chapter 5 of this book for more details on the methodologies to calculate the percentage criterion.

requirements. By itself this could be interpreted as a first sign of convergence, even though there are different modalities across PTAs in drafting rules of origin according to the CTC criterion. This primacy of the CTC over other methodologies for determining substantial transformation gave rise to discussions during the initial phases of the HWP negotiations between the EU and NAFTA partners in the TCRO and later in the WTO CRO. The 1996–1999 TCRO negotiations on nonpreferential rules of origin was the first time the EU and the United States confronted each other on this matter. Before that time the EU had for some twenty-plus years been dealing with rules of origin in the context of its PTAs with European Free-Trade Association (EFTA) members and the African, Caribbean, and Pacific (ACP) countries. All these countries were confronted with the then newly matured experience of the United States and its partners, obtained in negotiating the Canada–US Free-Trade Agreement (CUSFTA) and the NAFTA.

While negotiators in the TCRO argued that preferential rules of origin did not have a bearing on the HWP discussions, it was clear, as demonstrated by the dynamics of the negotiations, that the discussions on nonpreferential rules of origin started from their respective national/regional preferential RoO backgrounds and experience, at least at the technical level. In other words, each "bloc" proposed and defended its own model of rules of origin. The eventual draft text that emerged from the HWP largely reflected a compromise between the EU and NAFTA models, with a number of innovations and some disagreement on specific sectors, like machinery.[162] In retrospect, the 1999 draft HRO text, now modernized by the HS transposition,[163] represents a tangible sign of convergence that, even if not adopted, influenced the way rules of origin were negotiated in subsequent PTAs and remains a technically valuable document.

An example is the progressive acceptance of the use of the wholly obtained criterion as a requirement for the list of product-specific rules (a typical EU feature) included in the EU–Mexico agreement and later in the Canada–EU Comprehensive Economic and Trade Agreement (CETA).

Another example is the use of chemical reactions, a concept inherited from the HWP work, as a specific requirement for some chemical products given the inherent technical difficulty of determining the corresponding CTC for chemical products that has been reproduced in the US, Mexico, Canada Free-Trade Area agreement (USMCA). Some of these areas of convergence were later reflected in the rules of origin included in trade agreements that Asian countries negotiated with the EU and United States, and, more recently, those that apply in trade agreements negotiated among Asian and African countries.

[162] The "machinery package" allowed each member to choose either a "change of tariff classification rule" (the preferred US method for origin determination) or a "value-added rule" (the preferred EU method for determining origin in this specific sector and circumstance). This is the so-called dual-rule approach. See WTO document JOB(07)/73.

[163] See WTO document JOB/RO/5/Rev.1.

Despite the HWP coming to a standstill in 2007, the many PTAs that have been negotiated since then have implied that rules of origin are front and center in the negotiating agenda of the majority of WTO members. The EU in particular made substantial changes to its RoO model starting in the early 2000s. First, it progressively abandoned the "straightjacket" model that it imposed on itself as a result of its Pan-European Rules of Origin that were adopted in the early 1990s. According to the pan-European RoO model each EU PTA partner had to adopt an almost identical set of rules of origin set by the EU including the PSRO to allow cumulation among different PTAs and avoid a proliferation of divergent rules of origin across PTAs.[164] While strictly adhered to for more than a decade, this approach was revealed to be excessively rigid when the EU was negotiating with large trading partners because it did not allow concessions to be made on PSRO.[165] Second, the EU undertook a sweeping and unprecedented reform of unilateral rules of origin, especially for the LDCs. While limited to developing countries, this reform provides a potential base on which to build in further reforms of EU rules of origin.

The developments in preferential rules of origin in PTAs have led to some simplification and streamlining of the rules, informed by lessons learned over more twenty years of operation of major PTAs. Progressively, the EU and the United States, as well as counterpart OECD nations (e.g. Japan, South Korea, Australia, and New Zealand) have abandoned methodologies based on calculations of value added in favor of a "value of materials used/ad valorem" percentage calculation.[166] Some innovations have also been introduced, such as the deduction of cost of freight and insurance in recent US PTAs and in the Trans-Pacific Partnership Agreement (TPP). There are, of course, differences in the arithmetical calculations and definitions of what goes into the numerator and denominator, but there is convergence toward determining ad valorem percentages based on a value-of-materials calculation rather than a value-added or net cost approach, as used in NAFTA for automotive products. This tendency is confirmed by the evolution of the use of the net cost method in US PTAs that has been gradually introduced in subsequent agreements, and the introduction of the build-up and build-down method that has replaced the transaction value used in NAFTA.

Thus, developments regarding preferential rules of origin in the PTAs that include the major players are pointing toward simplification and streamlining. This has supported greater trade as shown by the relatively high utilization rate of major PTAs entered into by the EU and United States, which range from 80 to 90 percent.[167] In a nutshell, there has been a lot of work on rules of origin that has had a

[164] See P. Bombarda and E. Gamberoni, "Firm heterogeneity, rules of origin and rules of cumulation," *International Economic Review*, vol. 54, no. 1 (2013), 307–328.

[165] See Chapter 3 of this book for further analysis of this evolution.

[166] See Chapter 6 of this book for a detailed discussion.

[167] See S. Inama presentations at WCO, 2015; and UNCTAD and Swedish Board of Trade, "The use of the EU's Free trade agreements – exporter and importer utilization of preferential tariffs," 2018.

pay-off. This complements reforms of rules of origin that apply to unilateral tariff preferences offered to LDCs. Such reforms were implemented by Canada in 2003 and by the EU for its "Everything But Arms" (EBA) duty-free, quota-free access program for LDCs, with the EBA rules of origin most recently redefined in 2011. More recently Japan also took the initiative to liberalize the rules of origin for LDCs for knitted and crocheted garments of HS Chapter 61. These initiatives have contributed to the debate over simplification and relaxation of preferential rules of origin, brought new life to the discussions in the CRO and helped underpin two WTO Ministerial Decisions on preferential rules of origin for LDCs, illustrating that progress can be made at the multilateral level. The challenge now is to build on this progress to resume work at the multilateral level on nonpreferential rules of origin.

2.11.2 *Assessing Differences in Rules of Origin: A Convergence Trend?*

The lack of progress and meaningful discussions on rules of origin at the multilateral level since 2007 contrasts with the gradual movement toward de facto and de jure convergence across both preferential and nonpreferential rules of origin in major jurisdictions. Divergence certainly continues to exist for some sectors, but it is important to recognize that the situation "on the ground" has been changing. This suggests that multilateral discussions can build on this and focus on the reasons for continued divergence in specific sectors. In pursuing reforms and to better understand RoO regimes it is necessary to distinguish between the policy objectives that underpin a given set of rules of origin (the "substance") and the specific criteria used and how they are administered; that is, the "format" of rules of origin. The substantive dimension of rules of origin is the degree of restrictiveness related to the value chain it impacts on. It is the substance that matters. If countries have common objectives as to what rules of origin are supposed to do, it is much more straightforward to achieve convergence, since the form rules of origin take is mostly a matter of drafting methodology.

Although blocked for almost a decade, the mandate of the CRO to pursue harmonization of rules of origin provides a continuing opportunity to revitalize multilateral discussion on rules of origin at the WTO by drawing on and building on PTA experiences as well as unilateral reforms. Making progress in the CRO – or for that matter in developing the rules of origin associated with new PTAs – can be facilitated by a better understanding of how different rules of origin have evolved and the extent to which they are different. A challenge in assessing this is to compare different rules of origin for a given product. Such comparisons need to be undertaken at the six-digit level of the HS classification (i.e. the subheading level). This spans over 6,000 categories. Ideally, one would concord different sets of rules of origin to each other at the product level and automate the codification of PRSO using algorithms to classify different rules of origin into "types." This is a major challenge given the variations in formats and textual language used to define PRSO in different PTAs and nonreciprocal preferential trade arrangements.

Economic analysis has sought to classify rules of origin by type and assess their relative restrictiveness on an *ex ante* basis using a mix of judgment and econometric estimation. Estevadeordal pioneered such analysis, focusing on NAFTA rules of origin.[168] In this type of approach, each rule or set of rules is codified depending on the type of criterion used to define rules of origin at the product level and a qualitatively ordered index is constructed based on a set of assumptions regarding the relative restrictiveness of alternative types of rules of origin – such as CTC at different HS levels of disaggregation. While a useful approach to quantify the potential effects of different rules of origin, it is not very helpful if the goal is to assess the degree of similarity of different rules of origin for a given product. The key challenge here is to characterize and "map" different approaches and requirements into common and comparable categories at a useful level of disaggregation. If the classification is designed at too broad a level, limiting the coding to the main principles used to define origin, there is little value added since this will result in different sets of rules of origin being compared or lumped together on the basis of oversimplified assumptions that do not reflect their complexity and diversity. On the other hand, if the taxonomy is designed in a very detailed manner, the task of codification becomes very difficult to operationalize in a way that is useful.

In practice any effort to characterize the similarity of different criteria and approaches to determine origin must include some element of expertise and thus subjective judgment.

The author undertook a detailed comparison between the HRO and a selection of recent PTAs.[169] This analysis has been carried out at the HS subheading level (there are 6,366 subheadings in the HS classification), focusing on the applicable PSRO with the aim of identifying instances of convergence, partial convergence, or divergence among: (i) the results of the HWP process as last updated (the draft HRO); (ii) the TPP and the US–Korea agreement as examples of the NAFTA model of rules of origin that are mainly based on CTC and RVC criteria; and (iii) the CETA – the first instance of the European and North American models coming to confront each other – and the EU–South Korea trade agreement. In order to draw such a comparison a taxonomy is developed to compare each of the PSRO contained in the abovementioned PTAs, using the following categories: (a) totally or partially convergent; and (b) divergent. The first category is subdivided into three groups: (i)

[168] See A. Estevadeordal, "Negotiating preferential market access: The case of NAFTA," INTAL Working Paper 3, 1999. See also A. Estevadeordal and K. Suominen, "Mapping and measuring rules of origin around the world," in O. Cadot, A. Estevadeordal, A. Suwa-Eisenmann, and T. Verdier (eds.), *The Origin of Goods: Rules of Origin in Regional Trade Agreement*, CEPR and Oxford University Press, 2006; and "What are the trade effects of rules of origin?" in A. Estevadeordal and K. Suominen (eds.), *Gatekeepers of Commerce: Rules of Origin and International Economic Integration*, Inter-American Development Bank, 2008.

[169] The preliminary results of this work, which is still underway at the time of writing, were presented at the Europena University Institute Executive workshop on rules of origin in May 2017.

TABLE 2.9 *Comparison of six-digit PRSO: HWP, CETA, US–Korea, EU–Korea, and TPP*

Convergence/Divergence categories		# of tariff lines	Share	Average MFN	QUAD imports from the world (million USD)
#	Description				
1	Totally convergent	135	2%	1.52	641,546
2	Partially convergent	1,287	20%	2.76	2,298,623
3	Partially convergent in stringency; different form of drafting	1,994	31%	3.15	1,648,448
4	Divergent, more stringent compared with HRO (HWP) draft rules	823	13%	5.49	960,754
5	Divergent, but less stringent than HRO (HWP) draft rules	2,127	33%	6.00	1,321,871
Total		6,366	100%		

Source: Inama, PPT presentation (2017).

all rules of origin (the four PTAs and the HWP) are identical or similar in terms of stringency and drafting form; (ii) the majority of the rules of origin are identical or similar in terms of stringency and drafting form; and (iii) the rules of origin are identical or similar in terms of stringency but have a different drafting form. Divergence occurs if there is a difference in terms of stringency and drafting form, distinguishing between instances where the rules of origin are either more or less stringent than the equivalent HRO provisions.

The comparisons in Table 2.9 show that governments have been able to make progress at product-specific level in adopting rules of origin that are similar. The comparisons of the draft HRO that came out of the WTO HWP for nonpreferential origin rules with the rules of origin in these recent PTAs suggest there has been progress in simplification and convergence at sectoral level, despite the unwillingness of some governments to embrace the full HRO package. There is evidence of movement toward convergence and simplification of rules of origin: 53 percent of all tariff lines at six-digit level show a degree of convergence (Table 2.9). If tariff lines where the PSRO in the covered PTAs differ from the HRO but are more liberal are added to this (33 percent of the total), some 85 percent of the PSRO taken together are either convergent and/or liberal. These are preliminary results that need to be further refined and validated. Moreover, it should be recognized that this type of analysis is partial as the focus is only on PSRO and ignores other dimensions of RoO regimes such as cumulation or the level of *de minimis* thresholds. That said, their findings reveal that:

- There are sectors where there is significant convergence for some product categories – such as chemicals (helping to explain why this was one

of the sectors where there was an early harvest in the Transatlantic Trade and Investment Partnership (TTIP) negotiations).
- Differences often relate more to "form" than substance – that is, the way in which the rules of origin are drafted frequently differ across PTAs but this need not imply major differences in their degree of stringency.
- For some sensitive sectors, such as clothing and fisheries, there is substantial divergence in rules of origin.

The extent to which the PRSO are convergent/divergent is illustrated further in Tables 2.10 and 2.11. These tables provide examples of cases of convergence for some sectors, as well as continued areas of divergence. Since Asian countries have largely adopted the North American model in setting their PSRO, the results of this research may be particularly relevant since the starting point shows already a certain degree of convergence in the adoption of a model based on similar calculation of ad valorem percentage and use of CTC criteria.

The underlined text in Table 2.10 shows where there is significant convergence or equivalence among the agreements. To some extent, recent progress toward convergence of preferential and nonpreferential rules of origin and more generally simplification of rules of origin has been facilitated by the removal of MFN tariffs for products – for example, because of the Information Technology Agreement (ITA) and analogous zero-for-zero sectoral agreements for chemical products. However, there are also other sectors with positive MFN duties where convergence has been occurring. What is needed now is further research to validate the initial findings and narrow down the results and most of all a political momentum to trigger the change. The results presented here suggest that there is value in seeking to identify emerging "best practices" for sectors where there is convergence and to identify sectors where there is continued divergence (Table 2.11).

2.12 MOVING FORWARD: PLURILATERAL COOPERATION ON RULES OF ORIGIN UNDER WTO AUSPICES?

The experience with the HWP makes clear that a top-down effort to harmonize nonpreferential rules of origin is very difficult, largely because of concerns by some countries that this will constrain their policy space. At the same time, it is important to recognize that at the technical level substantial progress was made on defining a set of HRO in the HWP. Moreover, "bottom-up," à la carte convergence is happening in significant segments of the preferential RoO landscape, as reflected in the rules of origin that are incorporated into recent PTAs and the progress that has been made in simplification of rules of origin for LDCs as part of duty-free, quota-free market access programs. This suggests that there is scope for proponents of simplification and harmonization of rules of origin to leverage the outcome of the HWP and the trend toward convergence of PSRO in PTAs through cooperation between subsets of interested countries.

TABLE 2.10 *HRO, CETA, TPP, EU, and US PTAs with South Korea: signs of convergence*

Example 1

HS code	HRO	CETA	TPP	EU–KOR	US–KOR
28.50 Hydrides, nitrides, azides, silicides and borides, whether or not chemically defined, other than compounds which are also carbides of heading 28.49.	CTH	A change from any other subheading, or: A change from within any one of these subheadings, whether or not there is also a change from any other subheading, provided that the value of non-originating materials classified in the same subheading as the final product does not exceed 20% of the transaction value or ex-works price of the product.	A change to a good of heading 28.50 from any other heading.	Manufacture from materials of any heading, except that of the product. However, materials of the same heading as the product may be used, provided that their total value does not exceed 20% of the ex-works price of the product.	A change to heading 28.10 through 28.53 from any other heading.

Example 2

HS code	HRO	CETA	TPP	EU–KOR	US–KOR
87.12 Bicycles and other cycles (including delivery tricycles), not motorized	CTH, except from heading 87.14; or 35% value-added rule	A change from any other heading, except from 87.14; or A change from heading 87.14,	A change to a good of heading 87.12 from any other heading, except from heading 87.14; or	Manufacture in which the value of all the materials used does not exceed 45%	A change to heading 87.12 through 87.13 from any other heading, except from heading 87.14; or,

	whether or not there is also a change from any other heading, provided that the value of non-originating materials of heading 87.14 does not exceed 50% of the transaction value or ex-works price of the product.	No change in tariff classification required for a good of heading 87.12, provided there is a regional value content of not less than: a) 35% under the build-up method; or b) 45% under the build-down method; or 60% under the focused value method taking into account only the non-originating materials of heading 87.12 and 87.14.	of the ex-works price of the product.	provided that there is a regional value content of not less than: (a) 35% under the build-up method, or (b) 45% under the build-down method.

TABLE 2.11 *HRO, CETA, TPP, EU, and US PTAs with South Korea: signs of divergence*

Example 1

HS code	HRO	CETA	TPP	EU–KOR	US–KOR
16.04 Prepared or preserved fish; caviar and caviar substitutes prepared from fish eggs.	CTH	A change from any other chapter, except from Chapter 3.	A change to a good of heading 16.05 from any other chapter.	Manufacture: – for animals of Chapter 1, and/or – in which all the materials of Chapter 3 used are wholly obtained.	A change to heading 16.05 from any other chapter.

Example 2

HS code	HRO	CETA	TPP	EU–KOR	US–KOR
6203.42 Men's Cotton Pants	Change to goods of this split chapter provided that the goods are assembled in a single country in accordance with Chapter Note.	Weaving accompanied by making up (including cutting); or Making up preceded by printing accompanied by at least two preparatory or finishing operations (such as scouring, bleaching, mercerising, heat setting, raising, calendaring, shrink	A change to a good of heading 62.01 through 62.08 from any other chapter, except from heading 51.06 through 51.13, 52.04 through 52.12 or 54.01 through 54.02, subheading 5403.33 through 5403.39 or 5403.42 through 5403.49, or	Weaving accompanied by making up (including cutting) or Embroidering accompanied by making up (including cutting), provided that the value of the unembroidered fabric used does not exceed 40% of the ex-works price of the product or	A change to subheading 6203.41 through 6203.49 from any other 4-20 chapter, except from heading 51.06 through 51.13, 52.04 through 52.12, 53.07 through 53.08, or 53.10 through 53.11, 54.01 through 54.02, subheading 5403.33 through 5403.39,

	resistance processing, permanent finishing, decatising, impregnating, mending and hurling), provided that the value of the unprinted fabric used does not exceed 47.5% of the transaction value or ex-works price of the product.	heading 54.04 through 54.08, 55.08 through 55.16, 58.01 through 58.02 or 60.01 through 60.06, provided the good is cut or knit to shape, or both, and sewn or otherwise assembled in the territory of one or more of the Parties.	Coating accompanied by making up (including cutting), provided that the value of the uncoated fabric used does not exceed 40% of the ex-works price of the product or Making up preceded by printing accompanied by at least two preparatory finishing operations (such as scouring, bleaching, mercerising, heat setting, raising, calendaring, shrink resistance processing, permanent finishing, decatising, impregnating, mending and hurling), provided that the value of the unprinted fabric used does not exceed 47.5% of the ex-works price of the product.	5403.42 through heading 54.08, or heading 55.08 through 55.16, 58.01 through 58.02, or 60.01 through 60.06, provided that the good is both cut and sewn or otherwise assembled in the territory of one or both of the Parties.

Cooperation on trade policy matters in the WTO generally has been driven by small groups of countries with an interest in an issue. In this regard there is a similarity between PTAs – which are by definition initiatives that span only a limited number of countries – and the WTO, the major difference of course being that small group initiatives in the WTO are aimed at multilateral cooperation that spans all WTO members. However, this need not be the case – WTO members may conclude agreements among subsets of countries under the umbrella of the WTO that do not take the form of PTAs. There are two main mechanisms in the WTO for countries to form a "club" on an issue-specific agenda of common interest: conclusion of a Plurilateral Agreement (PA) under Article II.3 WTO, and so-called critical mass agreements (CMAs). CMAs are agreements in which negotiated disciplines apply to only a subset of countries, but benefits are extended on a nondiscriminatory (MFN) basis. Examples of CMAs include initiatives such as the Information Technology Agreement (ITA) and other so-called "zero-for-zero" agreements in which a group of countries agree to eliminate tariffs for a specific set of products. CMAs are not limited to goods. They have also been negotiated for specific services sectors. Examples are the Agreement on Basic Telecommunications and the Agreement on Financial Services, both concluded under the auspices of the General Agreement on Trade in Services (GATS)[170]

PAs differ from CMAs in that they may be applied on a discriminatory basis – that is, benefits need not be extended to non-signatories. There are currently two PAs incorporated into the WTO: the Agreement on Civil Aircraft and the Agreement on Government Procurement. Because PAs may be applied on a discriminatory basis, their incorporation into the WTO requires unanimity – all WTO members must agree that a subset of countries implement a PA. The constraint that PAs be adopted "exclusively by consensus"[171] is a major hurdle to overcome, and explains why there are only two PAs, both of which were negotiated during the GATT years, long before the WTO entered into force. The rationale for the consensus rule is that it ensures that nonparticipants cannot be confronted with PAs that may negatively affect them even if they do not join them and, more generally, that all WTO members have a say on the salience and appropriateness of a given policy area being administered by the WTO Secretariat.[172]

A number of studies[173] discuss the modalities of club-based initiatives in the WTO. There are good reasons for attempting to do more via CMAs and PAs, given

[170] B. Hoekman and M. Kostecki, *The Political Economy of the World Trading System*, 3rd ed., Oxford University Press, 2009.

[171] See Article X.9 of the Agreement Establishing the WTO.

[172] R. Lawrence, "Rulemaking amidst growing diversity: A 'club of clubs' approach to WTO reform and new issue selection," *Journal of International Economic Law*, vol. 9, no. 4 (2006), 823–835.

[173] B. Hoekman and P. Mavroidis, "WTO à la carte or WTO menu du jour: Assessing the case for plurilateral agreements," *European Journal of International Law*, vol. 26, no. 2 (2015), 319–343; "Embracing Diversity: Plurilateral Agreements and the Trading System," *World Trade Review*,

the increasing difficulty of concluding multilateral agreements – exemplified by the failure of the Doha Development Agenda to reach a successful conclusion and the current deadlock in the WTO. CMAs and PAs cannot reduce the welfare of any country, including those that decide not to join, because CMAs apply on an MFN basis and PAs must be approved by the WTO membership as a whole. CMAs and PAs are more transparent than PTAs as they involve formal scheduling of commitments by signatories and regular reporting on activities to the WTO membership as a whole. They imply less dispersion in rules and approaches – and thus transactions costs and trade diversion – than PTAs. Indeed, they offer a way to multilateralize elements of what may be covered in PTAs. Multiple PTAs dealing with the same subject matter often do so in ways that imply that the rules of the game for firms differ depending on the PTA that applies for a given trade flow. Rules of origin are one of the most obvious examples of a policy area that can lead to this result.

There is no formal constraint on the ability of a club of WTO members to pursue CMAs that involve deepening of disciplines on policies that are already subject to WTO rules, as long as they are willing to apply these on an MFN basis. Nonpreferential rules of origin must apply on an MFN basis, suggesting that plurilateral cooperation initiatives in this area will have to take the form of a CMA.

What might a plurilateral initiative focus on? Recent submissions to the CRO, such as the informal proposals that were made by Switzerland in 2016 and most recently in 2019 on transparency and certification, could be the basis of a plurilateral effort for a club of countries to agree to adopt a common set of rules of origin that are showing convergence.

One straightforward way to proceed that is unlikely to confront significant political constraints would be to start with a focus on zero-rated MFN products and agree to implement harmonized nonpreferential rules of origin for such goods. Given zero MFN rates, it should also be feasible to agree to a single set of rules of origin for such products; that is, apply the same rules of origin to goods from any source, including those originating in PTA partner countries.

Transparency remains a serious problem for firms and other stakeholders – the type of analytical exercise discussed briefly above and continued by the author at the time of writing could be used as a starting point to identify at product-specific level where such convergence has taken place. Such an exercise could be extended to encompass all major PTAs and preferential market access programs under the GSP.

A collaborative effort among interested countries to do so will in any event be a necessary condition for identifying where rules of origin are already very similar and

vol. 14, no. 1 (2017), 101–116; "MFN clubs and scheduling additional commitments in the GATT: Learning from the GATS," *European Journal of International Law*, vol. 28, no. 2 (2017), 387–407.

thus equivalent in terms of underlying regulatory objectives and criteria. Where rules of origin are equivalent, there is scope to formally agree to accept ("recognize") the rules of origin applied by any of the participating members of the club.

CMAs can also be envisaged for cooperation on the administration of rules of origin; that is, processes related to the documentary evidence required to demonstrate compliance with rules of origin that is often quoted by business as the most exasperating aspect of rules of origin. This falls under the heading of "certification" and is an area where the multilateral trading system has been conspicuously absent.

At present Chapter 2 of Annex K of the revised Kyoto Convention 2000 is the only existing multilateral text on administration and certification of origin. Recently WCO members have agreed to an update of this Convention.

The administrative dimensions of rules of origin mostly apply across all products – there are seldom product-specific administrative requirements. When there are, they mostly apply at broad category levels (an example is textiles and apparel in certain US PTAs). In practice there are only a limited number of ways of administering rules of origin. The most used methodologies are: (i) certificate of origin on paper issued by certifying authorities with use of stamps and/or signatures; (ii) certificate or statement of origin issued by the exporter (with or without registration with certifying authorities); and (iii) a statement of origin issued by the importer. Attempts have been made to establish practices of E-certificates of origin that, until recently, have been of relatively concrete application in the real world, as mentioned by the WCO.[174] Yet, there are increasing signs from business that an increased use of IT technology to deal with origin administrative matters is needed, especially in the post-COVID-19 world.[175]

Overreliance by some customs administrations on outdated forms of administering rules of origin based on documentary evidence – such as a certificate of origin, the exchange of seals and signatures of certifying officers, or nonmanipulation certificates issued in the country of transit – can make administration of rules of origin into a nontariff barrier.

[174] See A. Tanaka, "World trends in preferential origin certification and verification," WCO Research Paper 20 (November 2011), which reports that out of 100 customs administrations surveyed, only 5% were reported to be accepting an E-certificate of origin. While in reality this may be considered a first step toward the use of E-certificates of origin, a true adoption of E-certificates of origin may be considered in place only when there is an electronic transmission and acceptance system of E-certificates of origin among customs via national single windows. This is the sort of project that ASEAN is currently implementing. For more detail, see Chapter 7 of this book.

[175] The "Comparative study on certification of origin," June 2020 discusses the adoption of block chain technology and some pilot projects: at www.wcoomd.org/-/media/wco/public/global/pdf/topics/origin/instruments-and-tools/comparative-study/related-documents/comparative-study-on-certification-of-origin_2020.pdf?db=web.

Shifting to a customs-authorized exporter declaration of origin, with retroactive checks and post-clearance recovery, offers one model for reducing RoO-related administrative costs. The 2017 reform of the EU's rules of origin for its GSP regime provides for listing registered exporters in a database administered by national customs agencies. Registered exporters are given a number and may issue a declaration of origin. When this self-declaration is presented at an EU port of entry, customs consult the joint database to ascertain whether the exporter has been registered and, if so, will grant preferential tariff rates. Verification of an exporter's declaration and post-clearance recovery are part of this administrative method. This is an example of a reform in the administration of rules of origin that may facilitate trade. There are other options as well, such as the method employed by US Customs and Border Protection, which is based on importer declarations and disregards evidence provided by exporters or certificates of origin issued by third parties. Whatever method is used, reliance on certificates of origin and the exchange of seals and signatures should be a thing of the past. A CMA on certification among a set of countries interested in adopting a common approach to reducing the costs of administering rules of origin would reduce the heterogeneity of RoO regimes confronting international business.

The level of ambition for plurilateral initiatives will depend on the specific interests and objectives of participating countries. For example, single transformation is arguably a good rule of thumb for drafting rules of origin in a world characterized by global value chain-based production. Given that this type of production involves firms specializing in specific tasks or activities, rules of origin that entail a need for more extensive value addition or transformation will undercut the ability of countries to engage in this type of production and trade unless they are part of larger regional integration arrangements that permit cumulation for RoO purposes. This is not the case for many developing nations and the design of rules of origin therefore should reflect this reality. Traditional protectionist double or triple transformation requirements greatly impede participation in value chains. While it may be difficult to abolish such rules of origin for "sensitive sectors" – such as textiles and clothing for the United States, certain processed agricultural products in the EU and Japan – progress on this front has proved possible in the context of implementing DFQF market access programs for LDCs and that for many products PTAs have been moving to greater use of single transformation-based RoO criteria. Sceptics may argue that such a simple rule of thumb is unthinkable but the evidence from recent PTAs and developments in the administration of nonreciprocal preferences schemes suggests that efforts to bring together the relevant actors (firms, customs and trade officials) can allow reforms to be agreed and implemented. Here again a plurilateral process could form the basis for such deliberations and help to define the potential substance of a CMA.

2.12.1 *The Debate on Methodologies for Origin Determination: Should the Services Embedded in a Product Be New Criteria for the Determination of the Country of Origin?*

The absence of multilateral discipline on rules of origin has not diminished the interest and the discussion in determining the criteria for allocating origin to a given product. The increased globalized production networks have optimized the manufacturing component of a product that is representing for certain categories of products a fraction of entire cost of the product to the consumer.

This has raised the question, at the moment rather theoretical, of whether and how the services component embedded in a good should be counted in the determination of the country of origin of a finished good.

This issue has so far been debated in the context of the Mode 5 of GATS as illustrated in recent literature[176] arguing for the duty-free treatment for the services component included in a good. Such argument stems from the consideration that services embedded in products (Mode 5 services) as in the case of the shoes mentioned below are paying duties and this therefore acts as a tax on services exports.

Albeit in another form, the debate concerning the services component of a good entered in the WTO Committee on Rules of Origin during the presentation made by the LDC in 2015,[177] where it clearly emerged that the major cost of a sport shoe is not represented by manufacturing but by the different service components embedded into it as discussed in section 1.3.1 of Chapter 1.

Two telling examples were made by LDCs contrasting some examples of value chains produced from OECD materials[178] and the rules of origin calculations. The rather famous example of the sport shoes and the iPad, often used to illustrate the different breakdown cost of a value chain, were compared with GSP rules of origin requirements

First it was noted under the example of the shoes that the actual entry point for an average LDC for accessing the value chain shown in example 1 was limited to manufacturing since it is rather obvious that LDCs are not providing at the moment any distribution or branding services that are representing the lion's share of the cost of the shoe to the consumer.

Thus, out of the 100 euros, the LDC can play a role in the value chain only in relation of the 12 euros represented by manufacturing.

[176] See A. Antimiani and L. Cernat, "Liberalizing global trade in Mode 5 services: How much is it worth?" DG Trade, European Commission, July 2017, http://trade.ec.europa.eu/doclib/docs/2017/july/tradoc_155844.pdf.

[177] See S. Inama, "*Ex ore tuo te iudico*: The value of the WTO Ministerial Decision on preferential RoO for LDCs," *Journal of World Trade*, vol. 49, no. 4 (2015), 591–618.

[178] See presentation of Dirk Pilat, Deputy Director Directorate for Science, Technology and Industry at the Center for Strategic and International Studies Washington, DC, October 30, 2013.

Once the RoO requirements are applied to the element of manufacturing, the calculation shows that either the RoO requirements are barely met, as in the case of the EU and the proposal by the LDCs of not exceeding 75 percent of non-originating materials, or they are not met, such as in the case of the US and Canada[179] percentage rule.

The examples reported in box "Meeting Percentage Criterion" (see Chapter 1, section 1.3.1) show the limitations of the current rules of origin that are based on a concept of manufacturing that no longer reflects the cost compositions of a certain product where the services component represents a much higher cost in the physical production of a good.

An interesting research paper by the Swedish Board of Trade[180] discussed the concept of origin of shoes related to a series of AD cases launched by the EU on shoes originating in China and Vietnam in mid-2000, observing that manufacturing of the shoes is often only a relatively limited part of the entire production process, while the most important economic cost of producing shoes is related to the services-component research, development, design, logistics, and marketing, etc. These mostly creative parts of the production process usually add more value than manufacturing and they are mostly carried out in Europe. The study argued that, "even for a low price shoe, EU value added is above 50%. For the medium price range EU value added can reach almost 70% and for up-market shoes, with high design and marketing costs, the EU value added can surpass 80%." The study did not attempt to draw conclusions to such findings but it appears logical that it hinted at a better definition of Community interest when applying and considering the application of AD duties.

2.13 CONCLUDING REMARKS

The nature of rules of origin – a rather technical and complex subject – is not one that attracts the interest of most trade policy officials and ministers. Yet these same actors are prone to use rules of origin when convenient or expeditious to respond to protectionist lobbies. Businesses have been ambivalent on the issue of rules of origin. On the one hand they often complain about the complexity of rules of origin but on the other hand they do not push governments to make the extra effort required to seek a multilateral solution. The focus instead has been on "easy fixes" in the context of PTAs, which are seen as more feasible and less costly than focusing on making progress under the WTO umbrella. An emphasis on PTAs may also reflect the evolving nature of international (regional) trade, as exemplified by the rising intensity of regional value or supply chains – which has led businesses to push negotiators and governments to simplify the rules of origin that apply in PTAs.

[179] In the example use was not made of cumulation.

[180] See Swedish Board of Trade, "Adding value to the European economy: How anti-dumping can damage the supply chains of globalised European companies. Five case studies from the shoe industry," 2007.

Two of the largest trade powers, the EU and United States, have made some progress toward simplification of rules of origin in their PTAs and preferential access programs for developing countries. There have been positive spillovers for trade integration agreements, including in the Asia–Pacific region (e.g. the TPP). The issue at stake for the global trading system is how to leverage these various positive developments and to cross-fertilize (multilateralize) the simplification and partial convergence in rules of origin that are reflected in recent PTAs. One route to achieving this is to break the wall that has separated preferential and nonpreferential rules of origin. In a number of sectors (e.g. chemicals) bridges spanning the preferential and nonpreferential RoO divide have already been built.

Discussions in the WTO CRO aimed at greater harmonization and simplification of nonpreferential rules of origin have not been successful in generating an agreement to apply a set of common rules of origin. This should not preclude countries interested in pursuing these objectives from doing so in a concerted fashion through a plurilateral initiative on rules of origin. The WTO provides a framework for members to do so, and such initiatives have been pursued in the past to liberalize trade in specific types of goods or to agree on specific rules of the game for services sectors. At the Eleventh WTO Ministerial Conference in Buenos Aires at the end of 2017, groups of countries agreed to explore the possibility of plurilateral cooperation in areas such as e-commerce, suggesting an interest and willingness to pursue cooperation on a plurilateral basis. The end result may be new CMAs.

One area that would appear to lend itself well to such plurilateral cooperation are rules of origin, in part because of the nascent trends toward greater convergence in rules of origin observed in recent PTAs for some types of products and sectors. The initiative to review and update Annex K of the Kyoto Convention at WCO supported by a relevant group of countries discussed in section 1.1 above is also another potential area of plurilateral cooperation to fill the existing gap on rules of origin. A necessary condition for determining where such cooperation is feasible and could be pursued is analysis of the type undertaken by the author as described in section 2.11.2. Such exercise, ongoing by the author at the time of writing, is extremely technical and time consuming, identifying at product-specific level the convergences and divergences on PSRO based on the industrial processes that underlie the substance of a given PSRO rather than its form, as further discussed in Chapters 4 and 6 of this book. Further development and use of the methodology outlined in section 2.11.2 to measure convergence in PRSO would help to identify where simplification and convergence has been taking place and thus where it may be possible to agree, on a plurilateral basis, that rules of origin are equivalent, thereby facilitating trade by lowering costs for international businesses and traders of the participating countries.

The issue of the cost of the services component in certain goods needs to be further studied and technical solutions should be identified to address in a timely fashion an emerging reality.

3

Preferential Rules of Origin

3.1 INTRODUCTION

Until the beginning of the 1990s, there were only a handful of preferential rules of origin, mainly regulating some autonomous tariff preferentials like the Generalized System of Preferences (GSP) schemes. Only the European Union (EU), due to the free-trade areas (FTAs) network with the remaining European Free-Trade Association (EFTA) countries, had developed a comprehensive policy on rules of origin.

In the years that followed, and especially after the US–Canada Free-Trade Area and later the North American Free-Trade Agreement (NAFTA) had been concluded, rules of origin proliferated. Such proliferation is following the path of the flourishing of regional trade agreements (RTAs). In fact, every time RTAs are entered into, rules of origin have to be part of the agreement.

According to World Trade Organization (WTO) reports at the end of 2017 there were around 287 RTAs notified to the WTO[1] and each one of these free-trade agreements contains rules of origin.

This chapter deals with (i) unilateral rules of origin contained under autonomous trade regimes like the GSP schemes and other unilateral preferences like the African Growth and Opportunity Act (AGOA) and (ii) contractual rules of origin contained in free-trade areas like the NAFTA/USMCA and the EU rules of origin.

As examined earlier there are no binding multilateral rules on preferential rules of origin, nor are there efforts to harmonize them. It follows that not only are there different rules of origin in the case of the GSP schemes but, because a number of RTAs concluded between developed countries but increasingly among developed and developing countries and among developing countries, there is an increased diversification of the content and nature of preferential rules of origin. However as pointed out in Chapter 2 of this book most recently there have been signs of

[1] See www.wto.org/english/tratop_e/region_e/rtajun-dec17_e.pdf.

convergence among the different sets of rules of origin and some trends toward certain technical solutions have been identified. Some degree of convergence in drafting product-specific rules of origin (PSRO) has been observed, especially among the more developed models of rules of origin; namely, EU and United States.

At the same time the techniques and experience of the main users of rules of origin – namely, the United States and the EU – have been heavily influencing the drafting of the rules of origin in South–South agreements. This holds especially true when one of the partners to the South–South agreement had previously entered into a RTA with one of them. In these cases, experience has shown that the model inherited by the partner of the North will shape the content of the rules of origin of the RTA among the countries of the South.

This has been the case for instance of Mexico who borrowed the NAFTA rules to negotiate rules of origin with Colombia, Venezuela, and Costa Rica as well as South Africa that utilized the rules of origin contained in the RTA with the EU when it negotiated rules of origin with other Southern African Development Community (SADC) partners. Most recently the Eastern Africa Community (EAC), after having signed an Economic Partnership Agreement (EPA) with the EU containing a set of rules of origin largely inspired by the EU model, has adopted a similar set of rules of origin for EAC intraregional trade in 2015.[2]

Most recently the Pacific Alliance[3] in Latin America has heavily borrowed from the North American model further discussed in section 3.4.4. The Association of Southeast Asian Nations (ASEAN) Trade in Goods Agreement (ATIGA) rules of origin and those contained in the ASEAN free-trade agreements with dialogue partners are also inspired by the North American model as discussed in Chapter 5 of this book.

The Draft annex of rules of origin to the African Continental Free-Trade Area (AfCFTA) borrows heavily from the EPAs that African countries have entered with the EU. Yet, at the time of writing, the PSRO of AfCFTA appears to be more stringent than those adopted under EPAs. This issue is further discussed in Chapter 5.

In this chapter, the main preferential rules of origin – either of unilateral or contractual nature – will be analyzed. The EU and the North American model (NAFTA and its successor the US, Mexico, Canada Free-Trade Area agreement (USMCA)) will be outlined in detail to provide an overview of these two major sets of rules of origin.

It has to be emphasized that these two major users of rules of origin have put in place a complex and differentiated set of rules of origin to respond and tailor the trade preferences granted to each partner according to their trade relations.

[2] See www.wto.org/english/tratop_e/region_e/rtajun-dec17_e.pdf.

[3] The members of the Pacific Alliance are Chile, Colombia, Mexico, and Peru.

The rules of origin contained in unilateral trade preferences are explained in section 3.2 and section 3.3 of this chapter.

Unilateral preferential rules of origin are those contained in unilateral preferential trade arrangements, such as the GSP and duty-free quota-free (DFQF) schemes as contained in section 3.2 concerning GSP and DFQF schemes and section 3.3 concerning AGOA.

In the case of both unilateral and contractual preferential rules of origin, their main task is to ensure that tariff preferences are granted exclusively to goods originating in the beneficiary countries or in the member countries of the preferential trade area.

Unilateral rules of origin such GSP and DFQF rules of origin serve to attain specific trade policy objectives, such as the allocation of preferences to products genuinely produced in preference-receiving countries. However, GSP and DFQF rules of origin carry, among the various kinds of existing preferential rules of origin, two clear and distinct connotations.

First, unlike preferential rules of origin of a contractual nature, GSP rules of origin have been implemented autonomously as explained and discussed in Chapter 1 of this book. In short, such rules of origin are determined by the preference-giving countries, even if the Bali and Nairobi Decisions aim at setting guidelines on how these preferential rules of origin should be drafted to respond to development objectives.[4]

As such, these rules of origin are not the result of strenuous bilateral negotiations but are the expression of the autonomous character of the GSP and DFQF concessions as a whole as often reiterated by preference-giving countries.[5] This autonomous nature has been recognized in the Common Declaration annexed to the WTO Agreement on Rules of Origin (ARO), which distinguishes between autonomous and contractual preferential rules of origin.

Second, from the outset, GSP rules of origin have served as an integral part of the GSP system's declared policy objectives – namely, to increase export earnings, promote industrialization, and accelerate the rate of economic growth – that are common to all GSP schemes.[6]

Unilateral rules of origin, such as those included in the GSP and other unilateral instruments like AGOA, may be intended to ensure that beneficiaries derive real benefit in terms of value added and investment. In spite of this laudable objective, the rules of origin contained in the GSP schemes and AGOA[7] have been

[4] See Chapter 1 of this book for the legal framework of these issues and Chapters 1 and 5 for the evolution of the debate about preferential rules of origin for LDCs.

[5] See Chapter 1 of this book about the negotiations leading to the Bali and Nairobi Decisions on preferential rules of origin for LDCs.

[6] As contained in UNCTAD Resolution 21, 1968.

[7] Albeit AGOA rules of origin have been quoted as being liberal by some commentators, in reality they are similar to the US GSP rules of origin as shown in Table 3.1. The main

increasingly indicated as one of the major stumbling blocks of the utilization and use of trade preferences by beneficiaries.[8]

Cumulation, a feature of rules of origin discussed in section 3.2.5 and Chapter 6 of this book, is sometimes described as a panacea encouraging trade among members of a grouping of developing countries or among developing countries in general. However, the technicalities and administrative requirements attached to it, as discussed in Chapter 7 of this book, may frustrate this objective as there is no alternative to liberal rules of origin based on the most price/quality competitive supplier in a market economy system.

In the context of preferential rules of origin of a contractual nature – that is, in the case of free trade agreements and other regional integration arrangements – rules of origin serve to regulate the trade patterns of the members. In FTAs, as distinct from customs unions, member countries retain their own external tariffs. This feature opens the possibility that a product destined for a high-tariff member country will first be imported into the lowest-tariff member country and then re-exported to the former, thus evading the high tariff. More subtly, if inputs imported from outside the FTAs represent a large part of the value added of a product, producers in the member country with the lowest tariffs on inputs can undercut producers in other member countries. Rules of origin in free-trade agreements serve the purpose of guarding against these possibilities. Strict rules of origin may substantially affect upstream or downstream third-country producers of inputs as further discussed in Chapter 4 of this book.

These preferential rules of origin reflect policy objectives. The most obvious is to avoid the deflection of trade in a free-trade area. However, they are often designed to respond to industrial policy objectives of domestic industries. In the NAFTA and later USMCA framework, for example, the United States sought stringent rules of origin even though US tariffs are generally lower than those of Mexico. This means that even in the absence of rules of origin, the possibility of final goods imports coming into the United States through Mexico is minimal except for sensitive products such as garments and automotive. Nor would it have made sense for a US producer to import inputs through Mexico.

The aim of the rules of origin was mainly a protectionist one: a stringent rule of origin is aimed at undermining Mexico's ability to outcompete an inefficient US firm producing final goods and make the internal market for inputs more profitable. In one sensitive area, textiles and clothing, where US tariffs are high and the scope for trade creation substantial, the triple transformation rule of origin has been a constant feature to maintain a high level of protection for US producers.[9]

difference is that they are more lenient than the usual rules of origin used by the US for clothing, allowing the use of third-country fabric. See Chapter 5 of this book.

[8] See Chapter 4 on the economics of rules of origin.

[9] See A. Panagariya, "The regionalism debate: An overview," *The World Economy*, vol. 22, no. 4 (1999), 477–511.

The evident protectionist intention of the NAFTA rules of origin became blatant during the recent Trump Administration, especially in the automotive context. USMCA[10] provides that "auto rule of origin includes a new labor value content requirement and four-year phase-ins for higher regional value content (RVC) requirements covering parts, which could be extended another two years if companies demonstrated 'due diligence' in complying with the rule of origin."[11]

Such protectionist bias is however not limited to NAFTA/USMCA rules of origin as explained in this chapter. Quite on the contrary, similar occurrences have materialized in many different contexts.

3.2 THE CURRENT RULES OF ORIGIN UNDER THE GENERALIZED SYSTEM OF PREFERENCES AND DUTY-FREE QUOTA-FREE MARKET ACCESS FOR LDCS

3.2.1 *Overview of Existing Rules of Origin under the Different GSP Schemes and DFQF Preferences*

For decades the debate concerning rules of origin on GSP schemes focused on the overall category of GSP beneficiaries, developing and least-developed country (LDC) beneficiaries alike. Under this framework the debate in the 1980s and 1990s over stringent rules of origin were a common issue as discussed in Chapters 1 and 5 of this book.

The graduation of major developing countries out of the GSP schemes in recent decades and the fact that the Enabling Clause of 1979 permitted a differentiation in favor of LDCs has gradually focused the debate on preferential rules of origin under the GSP and unilateral trade preferences such as AGOA on LDCs issues.

Such ongoing debate has not diminished the importance of rules of origin that developing countries are demanded to comply with in order to benefit from trade preferences under GSP and other preference trade schemes such as the AGOA. As a matter of fact, a triggering factor, or benchmark, to move from a beneficiary status under a unilateral preferential trade scheme like GSP to an FTA is the opportunity to negotiate better rules of origin.

The sections below depict a series of comparative tables of GSP rules of origin (section 3.2.1.1) and duty-free quota-free (DFQF) rules of origin (section 3.2.1.2).

[10] See Inside US Trade, https://insidetrade.com/inside-us-trade/us-nafta-auto-rules-draft-has-four-year-phase-new-wage-threshold.

[11] See for further details on the US proposals and their impact on the automotive industry: www.cargroup.org/wp-content/uploads/2018/04/nafta_briefing_april_2018_public_version-final.pdf.

3.2.1.1 Generalized System of Preferences

As examined in Chapter 1 of this book, since the start of the GSP system, preference-giving countries decided to implement their national schemes independently.[12] This resulted in different GSP schemes and different sets of rules of origin. Thus, each GSP scheme has its own rules of origin which must be complied with in order to take advantage of the GSP preferential tariff. The technical nature and the diversity of rules of origin have brought additional complexity to the GSP schemes and their utilization. For over twenty years, discussions in the United Nations Conference on Trade and Development (UNCTAD) Working Group on Rules of Origin have concentrated on the best ways and means to attain the final aims of harmonizing the GSP rules of origin, simplifying them, and improving them. However, changes over the three decades of operation of the GSP have been limited, with the exception of the reforms introduced by Canada in 2003 and the EU in 2010, as further discussed below.

Table 3.1 represents an overview of the most relevant regimes of rules of origin as of July 2020 granted by the quadrilateral countries (QUAD: the EU, United States, Japan, and Canada) and selected developed countries to developing countries. The table attempts to summarize the major features of the different sets of rules currently in force.

As may be noted from Table 3.1, preference-giving countries' rules of origin have been traditionally broadly divided into two main categories by the UNCTAD Secretariat: (a) Australia, Canada, United States, and the Eurasian Customs Union use mainly an across-the-board percentage criterion; (b) the EU, Norway, Switzerland, and Japan use a combination of criteria (traditionally referred to as process criteria) based on the CTH criterion with or without exclusion, percentage criterion, specific working, or processing requirements. Moreover, among the preference-giving countries using the percentage criterion, there are marked differences in the definition of the ad valorem percentage criterion calculation and the level of required percentage.

Rules of origin are almost completely harmonized between Norway and Switzerland and the EU, while marked differences persist between the PSRO of these groups of countries and Japan.[13] It must be noted that countries using the process criterion make use of percentages in the requirements laid down in the PSRO that are contained in an annex detailing the specific rules of origin requirements that have to be complied with. The ad valorem percentage criterion is mainly set for machinery and consumer goods where the rules of origin often requires that the value of the imported inputs should not exceed a certain percentage of the ex-works or Free On Board (FOB) prices of the finished products.

[12] See OECD document TC/Pref/70.25, 25.9.1970, para. 37.

[13] For specific examples of such differences, see TD/B/SCP/8, March 3, 1994 and WTO document G/RO/W/184, May 7, 2019.

TABLE 3.1 *Comparative table of GSP and other major unilateral trade preferences to developing countries*

Country/ group of countries	Origin criteria	Requirements	Numerator	Denominator	Percentage level	Administrative requirements
Canada	One single percentage rule across the board, for all products except textile and apparel articles where product-specific rules apply	Maximum amount of non-originating materials	Value of non-originating materials	Ex-factory price	Maximum amount of non-originating materials does not exceed 40%	Form A – certificate of origin or the exporter's statement of origin may be submitted as proof of origin Special certificate of origin for textile and clothing
Eurasian Customs Union	One single percentage rule across the board	Maximum Value of non-originating materials	Value of non-originating material	Ex-works price	Maximum amount of non-originating materials does not exceed 50%	Form A – certificate of origin
EU GSP	Product-specific rules for all products	Change of Harmonized System (HS) heading with or without exemptions, specific working or processing requirements and/or maximum percentage of non-originating materials or combinations of requirements	Value of non-originating material	Ex-works price	Maximum amount of non-originating materials does not exceed 40% or 50% (percentage may vary according to the products)	System of registered exporters (REX) which issues statements of origin

(*continued*)

TABLE 3.1 (*continued*)

Country/ group of countries	Origin criteria	Requirements	Numerator	Denominator	Percentage level	Administrative requirements
Japan	Change of tariff heading (CTH) and product-specific rules	Change of HS heading or Change of chapters (CC) with or without exemptions, specific working or processing requirements and/or maximum percentage of imported inputs or combinations of requirements	Value of non-originating material	FOB price	Maximum amount of non-originating materials 40% (percentage may vary according to the products)	Combined declaration and certificate of origin (Form A); Form A exempted for consignments not exceeding ¥200,000 or goods whose origins are evident
Norway	Product-specific rules for all products	Change of HS heading with or without exemptions, specific working or processing requirements and/or maximum percentage of non-originating materials or combinations of requirements	Value of non-originating material	Ex-works price	Maximum of 40 or 50% (percentage may vary according to the products)	Form A – certificate of origin – or A statement of origin if the value of the originating goods does not exceed 60 000 Norwegian kroner, or if you are an exporter registered in the REX system

Switzerland	Product-specific rules for all products	Change of HS heading with or without exemptions, specific working or processing requirements and/or maximum percentage of non-originating materials or combinations of requirements	Value of non-originating material	Ex-works price	Maximum of 40% or 50% (percentage may vary according to the products)	Form A – certificate of origin; or A statement of origin as provided in relevant Swiss legislation or a statement of origin by Registered Exporter (REX)
Turkey	Product-specific rules for all products	Change of HS heading with or without exemptions, specific working or processing requirements and/or maximum percentage of imported inputs or combinations of requirements	Value of non-originating material	Ex-works price	Maximum amount of non-originating materials does not exceed 40 or 50%. (percentage may vary according to the products)	Form A – certificate of origin Registered exporter from 2019.
United States GSP	One single percentage rule across the board for all products	Minimum value-added requirement	Cost of materials produced in preference-receiving country plus the direct cost of processing carried out there	Appraised value of the article at time of entry into the United States	Minimum 35%	No certificate of origin required, claim of GSP on entry form

(*continued*)

TABLE 3.1 (*continued*)

Country/ group of countries	Origin criteria	Requirements	Numerator	Denominator	Percentage level	Administrative requirements
United States AGOA[i]	Same as above, with exclusion of textiles and clothing	Same as above; PSRO for textiles and clothing	Same as above	Same as above	Same as US GSP	Special requirements apply for textiles and clothing
United States CBERA/ CBTPA[ii]	One single percentage (35%) rule across the board for all products, with exclusion of textiles and clothing	Same as above; Product-specific origin for textiles and clothing	Same as above	Same as above	Same as US GSP	No certification for CBERA required, but for CBTPA specific regulations

[i] AGOA is not a GSP scheme legally speaking but it is included in the table to provide a comprehensive analysis.
[ii] As indicated above CBERA and CBTPA are not GSP schemes but they are included in the table to provide a comprehensive analysis.

The GSP schemes rules of origin[14] followed the codified practice of the Kyoto Conventions of 1979 and 2000, as discussed in Chapter 1 of this book. Products exported from a preference-receiving country may be divided into two groups:

(a) Products that have been entirely grown, extracted from the soil, or harvested within the exporting country, or manufactured there exclusively from any of these products, qualify as being of GSP origin by virtue of the total absence of the use of any imported components or materials, or such of unknown origin.
(b) Products that are made from imported materials, parts, or components – that is, products that are manufactured wholly or in part from materials, parts, or components imported into the preference-receiving country or that are from unknown origin – are termed "products with import content" and qualify only if they have undergone "sufficient working or processing" (as defined under the individual rules of origin of preference-giving countries) in the preference-receiving exporting country.

Following these basic definitions, each GSP scheme lays down detailed rules or definitions of "sufficient working or processing" which have to be satisfied if goods are to be granted GSP tariff treatment as described in these sections.

3.2.1.2 DFQF Market Access for LDCs

As outlined in Chapter 1 of this book, the WTO Enabling Clause[15] provides for a special category of trade preferences that offers special treatment for LDCs. Such provision further matured in the Hong Kong Decision.

[14] See also UNCTAD, "Digest of rules of origin" and UNCTAD Handbook on Duty-Free and Quota-Free Market Access and Rules of Origin for Least Developed Countries – Part I: QUAD Countries; Part II: Other Developed Countries and Developing Countries, UNCTAD/ALDC/2018/5 (Part I and II).

[15] Para. (d) of the Enabling Clause reproduced below provides for the possibility of special treatment for LDCs in the context of "general" measures in favor of developing countries like autonomous preferences such as GSP. The Enabling Clause provides as follows:

Decision of 28 November 1979 (L/4903)

Following negotiations within the framework of the Multilateral Trade Negotiations, the CONTRACTING PARTIES decide as follows:

1. Notwithstanding the provisions of Article I of the General Agreement, contracting parties may accord differential and more favourable treatment to developing countries, without according such treatment to other contracting parties.
2. The provisions of paragraph 1 apply to the following:
   a) Preferential tariff treatment accorded by developed contracting parties to products originating in developing countries in accordance with the Generalized System of Preferences,
   b) Differential and more favourable treatment with respect to the provisions of the General Agreement concerning non-tariff measures governed by the provisions of instruments multilaterally negotiated under the auspices of the GATT;

In fact, the Hong Kong (China) WTO Ministerial Decision[16] relaunched the idea of providing duty-free and quota-free to LDCs as follows:

> We agree that developed-country Members shall, and developing-country Members declaring themselves in a position to do so should:
>
> a. Provide duty-free and quota-free market access on a lasting basis, for all products originating from all LDCs by 2008 or no later than the start of the implementation period in a manner that ensures stability, security and predictability.
> b. Members facing difficulties at this time to provide market access as set out above shall provide duty-free and quota-free market access for at least 97 per cent of products originating from LDCs, defined at the tariff line level, by 2008 or no later than the start of the implementation period. In addition, these Members shall take steps to progressively achieve compliance with the obligations set out above, taking into account the impact on other developing countries at similar levels of development, and, as appropriate, by incrementally building on the initial list of covered products.
> c. Developing-country Members shall be permitted to phase in their commitments and shall enjoy appropriate flexibility in coverage.
> d. Ensure that preferential rules of origin applicable to imports from LDCs are transparent and simple, and contribute to facilitating market access.

Following the 2005 Hong Kong (China) decision, progress has been made by preference-granting countries in order to achieve duty-free and quota-free market access for products originating in LDCs. For this purpose, developments in the DFQF arrangements have taken place over the years. Some major recent changes in the area of rules of origin are as follows:

(a) In November 2010, the EU adopted a regulation revising the rules of origin for products imported under the generalized system of preferences. The regulation simplified the rules of origin for LDCs as further discussed in this chapter. In October 2012, the EU adopted a new GSP cumulation.
(b) In April 2015, Japan applied a simplification measure for preferential rules of origin of Chapter 61 of the HS.
(c) In 2013, Canada carried out a review of its GPT regime. The program was renewed for ten years. The number of GPT beneficiaries was reduced, and the preferential rules of origin for products exported to Canada under the LDCT

c) Regional or global arrangements entered into amongst less-developed contracting parties for the mutual reduction or elimination of tariffs and, in accordance with criteria or conditions which may be prescribed by the CONTRACTING PARTIES, for the mutual reduction or elimination of non-tariff measures, on products imported from one another;
d) Special treatment on the least developed among the developing countries in the context of any general or specific measures in favour of developing countries.

[16] See WTO document WT/Min(05)/DEC, December 22, 2005.

scheme was amended, allowing cumulation with former GSP beneficiary countries.

(d) In June 2015, the US GSP scheme, which had expired on 2013, was extended until 2017 and additionally, AGOA was extended until 2025. In March 2018, the GSP scheme was again retroactively extended for goods entering in the period from January 2018 to December 2020.

As discussed in Chapter 1 of this book, the 2013 Bali Ministerial Declaration and the Nairobi Ministerial Decision of 2015 built upon the commitment contained in paragraph (d) of the Hong Kong Ministerial Decision: "d. Ensure that preferential rules of origin applicable to imports from LDCs are transparent and simple, and contribute to facilitating market access."

Tables 3.2–3.4 provide a comparative summary of the rules of origin schemes provided by various preference-giving countries to LDC under DFQF arrangements.[17]

This section discusses the main features of the GSP rules of origin including some special features of the rules of origin under DFQF schemes. However this section does not analyze in full the details of the DFQF rules of origin contained in Tables 3.2, 3.3, and 3.4.

Section 3.2.2 and other sections below examine in detail the main provisions of the QUAD countries and the Eurasian Customs Union.

3.2.2 *"Wholly Obtained" Products*

Under the GSP rules of origin the "wholly obtained" criterion is interpreted strictly. Even a minimal content of imported materials, parts or components, or those whose origin cannot be determined, make the finished products lose their qualification as "wholly obtained."

Example: Wooden carvings made from wood "wholly obtained" in a preference-receiving country but polished with imported wax are not "wholly obtained" because of the wax. The carving would, however, almost certainly qualify for GSP under either the percentage or the process criterion.

Generally speaking, all preference-giving countries[18] accept the following categories of goods as "wholly obtained" in a preference-receiving country:

(a) mineral products extracted from its soil or from its sea-bed
(b) vegetable products harvested there
(c) live animals born and raised there

[17] For a deeper analysis, see UNCTAD Handbook on Duty-Free and Quota-Free and Rules of Origin, Part I and Part II (n. 14 above).

[18] The United States, while not including a list of "wholly obtained" products in its legislation, recognizes the products listed below as examples which are likely to meet the United States percentage criterion (see section 3.2. 3.2.2).

TABLE 3.2 *Comparative table of rules of origin of DFQF granted by QUAD countries*

Country/ group of countries	Origin criteria	Requirements	Numerator	Denominator	Percentage level	Administrative requirements
Canada	One single rule across the board, for all products except textile and apparel articles where product-specific rules apply	Maximum amount of non-originating inputs	Value of non-originating materials	Ex-factory price	Maximum non-originating materials 60%; for LDCs, 80% with cumulation	Form A – certificate of origin or the exporter's statement of origin may be submitted as proof of origin Special certificate of origin for textile and clothing
EU EBA	Product-specific rules for all products	Change of HS heading with or without exemptions, specific working or processing requirements and/or maximum percentage of imported inputs or combinations of requirements	Value of non-originating material	Ex-works price	Maximum amount of non-originating materials does not exceed 70%[i]	REX system which issues statements of origin, administered by beneficiary countries
Japan	CTH as a general rule and single list of product-specific rules	Change of HS heading with or without exemptions, specific working or processing requirements and/or maximum percentage of imported inputs or combinations of requirements	Value of non-originating material	FOB price	Maximum amount of non-originating materials 40%	Form A to be stamped by Government entities or Chamber of Commerce GSP; Form A exempted for consignments not exceeding ¥200,000 or goods whose origins are evident

United States GSP	One single percentage (35%) rule across the board for all products,	Minimum local content requirement	Cost of materials produced in preference-receiving country plus the direct cost of processing carried out there	Appraised value of the article at time of entry into the United States	Minimum 35%, exact percentage must be written in certificate of origin	No certificate of origin required, claim of GSP on entry form
United States AGOA	Same as above, with exclusion of textiles and clothing	Same as above; Product-specific origin for textiles and clothing	Same as above	Same as above	Same as above	Special requirements apply for textiles and clothing
United States CBERA/ CBTPA	Same as above, with exclusion of textiles and clothing	Same as above; Product-specific origin for textiles and clothing	Same as above	Same as above	Same as above	No certification for CBERA required, but for CBTPA specific regulations
United States NEPAL	Same as GSP, product-specific rules for textiles and clothing	Same as GSP, product-specific rules for textiles and clothing, article belongs to designated 77 categories	Same as GSP	Same as GSP	Same as GSP	Same as GSP

[i] Such percentage may vary according to HS chapters.

TABLE 3.3 *Comparative table of rules of origin in DFQF granted by non-QUAD developed countries*

Country/ group of countries	Origin criteria	Requirements	Numerator	Denominator	Percentage level	Administrative requirements
Australia	Last manufacturing process performed in LDC and ad valorem percentage requirement	Minimum amount of allowable factory cost	Allowable factory cost	Total factory cost	Allowable factory cost should be at least 50% of the total factory cost; For LDCs, 25% with cumulation	Exporter/producer declaration as provided in Australian Customs notice 2003/48
Eurasian Customs Union	Ad valorem percentage requirement across the board for all products	Maximum value of non-originating materials	Value of non-originating material	Ex-works price	Maximum amount of non-originating materials does not exceed 50% progressively rising to 55% in 2020 and to 60% in 2025 as contained in Council Decision n.60 of 2018	Certificate of origin, similar to Form A
New Zealand	Last manufacturing process performed in LDC; and ad valorem percentage criterion	Minimum local content requirement	Cost of materials + Expenditures in other items of factory or work cost in New Zealand or LDCs	Ex-factory cost	At least 50%	Certificates of origin are not required. An exporter declaration or other evidence supporting the claim for preference must be supplied if requested
Norway	Product-specific rules	Maximum value of non-originating products	Value of non-originating material	Ex-works price	70%	REX system Statement of origin for products below NOK 60,000
Switzerland	Product-specific rules	Maximum value of non-originating materials	Value of non-originating material	Ex-work price	70%	Form A, REX system progressively introduced.

TABLE 3.4 *Comparative table of rules of origin in DFQF granted by developing countries to LDCs*

Country/ group of countries	Origin criteria	Requirements	Numerator	Denominator	Percentage level	Administrative requirements
Chile	Ad valorem percentage criterion across the board for all goods	Minimum value of regional content	Difference between the FOB value of final product and the CIF value of non-originating materials	FOB value of final product	Minimum of 50%	Certificate of origin
China	Change of tariff classification (CTC); or ad valorem percentage criterion	Calculation by subtraction of non-originating materials	FOB price minus value of non-originating material	FOB price	Minimum of 40%	Certificate of origin
Chinese Taipei	Ad valorem percentage criterion across the board for all goods	Calculation by subtraction of non-originating materials	FOB price minus the value of non-originating materials	FOB price	Minimum of 50%	Certificate of origin as required by Chinese Taipei Ministry of Finance
India	CTSH and ad valorem percentage	Calculation by subtraction of non-originating materials	FOB price minus the value of non-originating materials	FOB price	Minimum of 30%	Certificate of origin as required by the Indian Government
Republic of Korea	Ad valorem percentage criterion across the board for all goods	Maximum value of non-originating materials	Value of non-originating materials	FOB Price	Maximum of 60%	Certificate of origin as required by Republic of South Korea
Thailand	Product-specific rules	Calculation by subtraction of non-originating materials	FOB price minus value of non-originating material	FOB price	Minimum of 50%	Certificate of origin for originating goods in LDC (Thailand)

(d) products obtained there from live animals
(e) products obtained from hunting or fishing conducted there
(f) products obtained from sea fishing and other products taken from the sea by its vessels[19]
(g) products made on board its factory ships exclusively from products referred to in (f)
(h) used articles collected there fit only for the recovery of raw materials
(i) waste and scrap resulting from manufacturing operations conducted there and
(j) products obtained there exclusively from products specified in (a) to (i) above.[20]

3.2.3 *Products with an Import Content (non-originating materials)*

As indicated above, products which have been manufactured in a preference-receiving country wholly or partly from imported materials, parts, or components, including materials of undetermined or of unknown origin, are considered as originating in that country if those materials, parts, or components have undergone sufficient working or processing there. In general terms, working or processing is regarded as sufficient if it transforms the specific nature and characteristics of the materials used to a substantial degree. This general concept is however defined in detail by each preference-giving country.[21]

3.2.3.1 Process Criterion – EU, Japan, Norway, and Switzerland

The UNCTAD Secretariat determined this criterion according to the use of the CTC by preference-giving countries as applied by the EU, Japan, Norway, and Switzerland.

As a general rule under this criterion, imported materials, parts, or components (non-originating inputs) are considered to have undergone sufficient process or processes when the product obtained complies with the product-specific rules contained in what has been defined in the GSP jargon a "single list."[22] Some of these PSRO require a relatively simple CTH with or without exceptions while

[19] The EU and other European countries apply restrictive definitions of the terms "its vessels" and "its factory ships" that are further discussed under the European rules of origin.
[20] Such as iron sheets, bars produced from iron ore; cotton fabrics woven from raw cotton; recovery of lead from used motor cars batteries; recovery of metal from metal shavings.
[21] The rules applied by most preference-giving countries usually exclude what are called "minimal processes." These are regarded as insufficient working or processing and, therefore, as not qualifying the finished product for GSP tariff treatment. A list of minimal processes is usually contained in each set of GSP rules of origin of the GSP preference-giving country .
[22] Until the adoption of the Pan-European Rules of Origin, the EU, Switzerland, and Norway adopted as a general rule the CTH coupled with a list of product-specific rules. The list of

others require a specific working or processing operations or a percentage requirement or a combination of these elements.

In the case of Japan, the CTH remains as the main general rule coupled with a list of PSRO, while in the case of the EU, Norway, and Switzerland there is no longer a general rule of CTH and such criteria are used in the context of the PSRO contained in the single list.

The CTH is satisfied when the finished product is classified in a heading of the HS[23] at the four-digit level that is different from those in which all the non-originating materials, parts, or components used in the process are classified (referred to as "change in HS heading").

The original scope of the single list was to take care of the fact that the HS has not been designed for rules of origin but as customs nomenclature; that is, for quite a few products a change in HS heading does not always entail sufficient working or processing (or, *per contra*, although sufficient working or processing may occur, in some cases it does not involve a change in HS heading).

For these specific cases, the preference-giving countries originally drew up a list (usually referred to as the single list[24]) of working or processing to be carried out on non-originating materials in order that the product manufactured can obtain originating status. In the case of Japan, the list contains a large number of particular products for which the conditions set out in the list must be fulfilled instead of the basic requirement of change in HS heading. For products contained in the list, the basic requirement of change in HS heading needs to be fulfilled only where it is explicitly mentioned in the list.

The single list contains Introductory Notes which give interpretations to some of the definitions used therein, as well as some further rulings to particular products, in particular in the textile sector. It is to be noted that the provisions of the Introductory Notes also apply, where appropriate, to all products manufactured using non-originating inputs even if they are not subject to specific conditions contained in the list, but are subject instead to the change in heading rule.

At present there is only Japan that maintains general CTH rules and a list of PSRO for the developed countries using the process criterion. The EU, Norway, and Switzerland have now adopted a list of PSRO and no longer have general CTH rule of origin.

exceptions under the product-specific rules contained in the list was however over seventy pages and covered most of the products.

[23] The Harmonized Commodity Description and Coding System, adopted by the Customs Co-operation Council in Brussels on June 14, 1983 and came into effect on January 1, 1988 with thirty-six signatories; referred to as the "Harmonized System" or "HS."

[24] The origin of the term "single list" derives from the fact that originally there were two lists that were subsequently combined into a "single list." In modern sets of rules of origin, especially under RTAs, it is often referred to as an annex containing PSRO.

The conditions specified in the single list may refer, inter alia, to the following:

(a) the requirement that certain starting materials used in the production process must be originating in the exporting preference-receiving country

Example: For dried fruits of HS 0813, and for mixtures of nuts or dried fruits of chapter 08, the list requires that all the fruit or nuts used must be wholly obtained.

(b) the requirement that only certain non-originating inputs may be used as starting material

Example: For sausage and other products of HS 1601, the list requires the use of animals of Chapter 1 as starting material, i.e. use of imported meat would not confer origin.

(c) a combination of (a) and (b) above

Example: For extracts and juices of meat, fish, etc. of HS heading 1603, the list requires manufacture from animals of Chapter 1 as starting materials; however, all fish, etc. used must already be originating.

(d) the requirement that non-originating inputs used must be of a certain – normally low – level of processing

Example:
- *For most articles of apparel and clothing accessories, not knitted or crocheted, of HS Chapter 62, the list requires manufacture from yarn; this means that the use of imported fabric would not confer origin.*
- *For wire of iron or non-alloy steel of HS 7217, the list requires manufacture from semi-finished materials of HS 7207; this means that the use of starting material at a higher level of processing would not confer origin.*

(e) the requirement that non-originating inputs used not exceed a certain percentage of the ex-works price of the finished product

Example: For articles of plastic HS heading nos. 3922–3926, the list requires manufacture in which the value of all non-originating inputs used does not exceed 50% of the ex-works price of the product.

(f) the possibility of using non-originating inputs falling within the same four-digit HS heading as the exported product.

Example: For articles of hard rubber of HS 4017, the list permits manufacture from hard rubber as starting material which itself already is to be classified within the same HS heading as the finished product, i.e. articles made therefrom.

For a number of products contained in the single list, the condition set out requires the value of imported input not to exceed a given percentage of the value of the

product obtained. For the purpose of calculating whether the percentage is satisfied, the following are the numerator and the denominator:

Value of non-originating inputs is identified as their customs value at the time of importation into the preference-receiving country or, if this not known or cannot be ascertained, the first ascertainable price paid for them in that country;

Value of the products obtained is the ex-works price of the products (for Japan, the FOB price), less any internal taxes which are, or may be, repaid when the products obtained are exported. It is defined as the price paid to the manufacturer in whose undertaking the last working or processing is carried out, provided the price includes the value of all products used in manufacture. FOB price includes, in addition, all other costs occurring in the producing country, in particular the cost of transport from the factory to the frontier or port and any cost and profit of intermediate trade in that country.

Customs value is defined as the customs value determined at the time of importation in accordance with customs valuation rules of the importing country as determined under the WTO Customs Valuation Agreement.[25]

3.2.3.2 Percentage Criterion

This criterion is applied by Canada, the United States, and the Eurasian Customs Union. In Canada and the Eurasian Customs Union, a maximum percentage is placed on the value of imported materials, parts, and components (or of unknown origin) which may be used in the manufacture of the exported products. In US GSP rules, a minimum percentage figure is prescribed for their value of domestic materials and processing costs which must be used in the manufacture of the exported product. The percentage criterion as applied by all the preference-giving countries which use it exclusively is described in more detail in the following subsections.

3.2.3.2.1 CANADA. The value of materials, parts, or produce originating outside the preference-receiving country, one or more other preference-giving countries, or of undetermined origin must not exceed 40% (60% in the case of a designated LDC preference-receiving country and up to 80% where cumulation is used) of the ex-factory price of the products obtained as packed for shipment to Canada. The value of materials, parts, or produce originating outside the preference-receiving country, one or more other preference-receiving countries, or Canada, is determined in accordance with the method of determining customs value formally adopted by the preference-receiving countries.

[25] As examined further in Chapter 5 of this book, there are considerable variations among the preference-giving countries on the determination of customs value.

According to the last amendment of the General Preferential Tariff (GPT)[26] rules of origin in the case of LDC countries and textiles and clothing products, the following rules apply. "Apparel goods," described in parts A1 and A2 of the Schedule 1 to the Regulations, must be assembled in an LDC in order to be entitled to the LDC tariff (LDCT). Other requirements are listed below:

(a) The fabric used in the assembly of such goods must be cut in that country or in Canada and produced in any LDC or in Canada from yarns spun or extruded in any LDCT beneficiary, a country included in Schedule 2 (see Annex IV) of the Regulations or in Canada.[27]
(b) If assembled from parts, those parts must be knit to shape in any LDC or Canada and produced in:
    (i) any LDC or in Canada from yarns spun or extruded in any LDCT beneficiary, a country included in Schedule 2 of the Regulations or in Canada and the yarns and fabric do not undergo any further processing outside a lest developed country, Canada, or a country included in Schedule 2 (only in the case of yarns)

    Example: Consider dresses or skirts manufactured in Mali. They will qualify as originating and will be eligible for duty-free LDCT if assembled in Mali from fabric that has been cut in Mali or Canada. The fabric must be produced in an LDC or in Canada from yarns that originate in an LDCT beneficiary, a country included in Schedule 2 of the Regulations, or Canada and the yarns or fabric must have not undergone any further processing outside any LDC, Canada, or a country set out in Schedule 2 of the Regulations. In the case of materials used in the manufacture or production of the good originating in Canada, those are considered to have originated in Mali (the LDC where the goods are assembled).[28]

    (ii) a country set out in Schedule 2 from yarns spun or extruded in an LDC, a country set out in Schedule 2, or Canada, and the yarns and fabric do not undergo further processing outside an LDC, a country set out in Schedule 2, or Canada. Furthermore, the value of any materials, including packing, that are used in the manufacture of the goods, that originate outside the LDC in which the goods are assembled must not be more than 75 percent of the ex-factory price of the goods as packed for shipment to Canada. Nevertheless, any parts, materials, or inputs used in the production of the goods that have entered the commerce of

[26] See www.cbsa-asfc.gc.ca/publications/dm-md/d11/d11–4-4-eng.pdf. This section draws from the UNCTAD Handbook on Duty-Free and Quota-Free, at https://unctad.org/en/PublicationsLibrary/aldc2018d5part1_en.pdf.

[27] It has to be noted that the countries listed in Schedule 2 are practically the majority of developing countries including China. This expands significantly the scope of the cumulation provided by Canada; the argument is further discussed in section 3.2.5.

[28] Canada Border Services Agency, Memorandum D11–4-4.

any country other than an LDCT beneficiary country of Canada lose their LDCT status.

Example: Consider the same dresses or skirts manufactured in Mali. Those shall be entitled to LDCT status if they are assembled in Mali and the fabric used in the manufacture of the dresses or skirts is produced in a country set out in Schedule 2 of the Regulations from yarns spun or extruded in an LDCT beneficiary, a country set out in Schedule 2 of the Regulations, or Canada. Furthermore, the yarns and fabric cannot undergo further processing outside an LDCT beneficiary, a country included in Schedule 2 of the Regulations and the value of the materials, including packing, that are not originating in Mali (the LDC where the dresses or skirts are assembled) does not exceed 75 percent of the ex-factory price of the goods as packed for shipment to Canada.[29]

(c) The 2017 amendments widened the qualifying criteria for apparel products, mainly for t-shirts and pants. Referring to products outlined in A3 of Schedule 1, those are entitled to the LDCT, which are assembled in a least-developed country from parts
   (i) that were cut or knit to shape in a least-developed country, a country set out in Schedule 2 (cf. Annex IV), an FTA partner country or in Canada
   (ii) from fabric or parts made out of yarn originating from an LDC, a country mentioned in Schedule 2 (cf. Annex IV), an FTA partner country, or Canada itself and being produced either:
      – in any LDC or Canada (this only applies if the yarns are not further processed outside a least developed country, a country set out in Schedule 2, an FTA partner country or Canada) and the fabric is not further processed outside an LDC or Canada, or
      – in a country set out in Schedule 2 or an FTA partner country.

   This only applies if the components are not further processed outside an LDC, a country set out in Schedule 2, an FTA partner country, or Canada; and the value of materials (including packing) not originating from the assembling LDC does not exceed 75 percent of the ex-factory price.[30]

Example: Consider the case of raw cotton produced in the United States being exported to Haiti, where it is processed to cotton fabric. Cut pieces are assembled to trousers and thus qualify for LDCT.

In order to be entitled to the LDCT, "made-up textile goods," which are included in part B of Schedule 1 to the Regulations, should be cut or knit to shape and sewn or otherwise assembled in an LDCT beneficiary. Additionally, the fabric or parts knit to shape must be produced in an LDC or Canada from yarns spun or extruded in an LDC, a country included in Schedule 2 of the Regulations, or Canada and

[29] Ibid.
[30] Ibid.

the yarns or fabric or parts knit to shape must not undergo any further processing outside of a country set out in Schedule 2 of the Regulations.

Example: Consider the case whereby wool yarn produced in Afghanistan is exported to Bangladesh. In Bangladesh, the yarn is produced into wool fabric. The wool fabric is shipped directly to the Lao People's Democratic Republic for further manufacturing into a made-up textile good. The production process of such finished good in the Lao People's Democratic Republic must include cutting, or knitting to shape, of the fabric as well as sewing or otherwise assembling in that country in order for the good to qualify for LDCT.[31]

3.2.3.2.2 UNITED STATES. A "certain percentage" of the value of a growth, product, manufacture, or assembly of a preference-receiving country must consist of:

(a) *the cost or value of materials* produced in the preference-receiving country and the cost or value of any article incorporated in the eligible article that has resulted from substantial transformation[32] of any imported materials into a new and different article of commerce, plus
(b) *the direct cost of processing operations* performed in the preference-receiving country.

In addition, section 10.177 of the Federal Register provides that the cost or value of materials produced in the beneficiary developing country should be interpreted as follows:

(a) "Produced in the beneficiary developing country"
For purposes of Section 10.171 through 10.178, the words "produced in the beneficiary developing country" refer to the constituent materials of which the eligible article is composed which are either:
(1) wholly the growth, product, or manufacture of the beneficiary developing country or
(2) substantially transformed in the beneficiary developing country into a new and different article of commerce.

The expression "a new different article of commerce" is used by the US Customs Service in the classification of merchandise. Examples of their rulings are:

- "Raw skins imported into a preference-receiving country and tanned into leather would be regarded as a 'substantially transformed' material when used in the manufacture of a leather coat."
- "A mounting made from an imported gold bar would be similarly regarded when made into a ring in a preference-receiving country."

[31] WTO, WT/COMTD/W/159.
[32] The issue of definition of "substantial transformation" under the US GSP has been object of several rulings that are accessible through the CROSS database: https://rulings.cbp.gov/home.

- "In the case of leather imported into the Philippines, cut into shape pieces, and made into gloves, the shape pieces are 'substantially transformed' and their value may be included in order to meet the 35 percent requirement."
- "For wax imported from Indonesia into Singapore, mixed with additives (dye, perfume, stearic acid) and made into candles, the wax mixed with additives is not regarded as having been substantially transformed and its value cannot be included in determining whether the 35 percent requirement is satisfied."

This percentage must be not less than 35 percent of the *appraised value* of the merchandise in the United States. When origin is acquired on the basis of cumulative treatment (see "cumulative origin," section 3.2.5) – that is, the merchandise originates in a designated association of countries treated as one country for the purpose of the GSP – the percentage must also not be less than 35 percent of the appraised value but it may be acquired with any of the preference-receiving countries forming the designated association.

(a) The expression "*cost or value of materials*" is defined as:
  (i) the manufacturer's actual cost for the materials
  (ii) the freight, insurance, packing and all other costs incurred in transporting the materials to the manufacturer's plant, if these are not already included in the manufacturer's actual cost for the materials
  (iii) the actual cost of waste or spoilage (material lost), less the value of recoverable scrap
  (iv) taxes and/or duties imposed on materials, provided they are not remitted on exportation.

  Where the material is provided to the manufacturer without charge or at less than fair market price, its cost or value is determined by computing the sum of:
  (i) all expenses incurred in the growth, production, manufacture or assembling of materials including general expenses
  (ii) an amount for profit and
  (iii) freight, insurance, packing, and all other costs incurred in transporting the materials to the manufacturer's plant.

(b) "*Direct cost of processing operations*" means those costs which are either directly incurred in or can be reasonably allocated to the growth, production, manufacture, or assembly of the specific merchandise under consideration. Such costs include:
  (i) all actual labor cost involved in the growth, production, manufacture, or assembly of the specific merchandise, including fringe benefits, on-the-job training, and the cost of engineering, supervisory, quality control, and similar personnel

(ii) dies, molds, tooling, and depreciation on machinery and equipment that are allocable to the specific merchandise
(iii) research, development design, engineering, and blueprint cost insofar as they are allocable to the specific merchandise and
(iv) cost of inspecting and testing of the specific merchandise.

The items that are not included within the meaning of the term "direct cost of processing operations" are those that are not directly attributable to the specific merchandise under consideration or are not "costs" of manufacturing the products. These include mainly:

(i) profit, and
(ii) general expenses of doing business which are either not allocable to the specific merchandise or are not related to the growth, production, manufacture, or assembly of the merchandise, such as administrative salaries, casualty and liability insurance, advertising, and the salesmen's salaries, commissions, or expenses.

Examples for Illustrating the Application for the US Origin Criteria

Suppose motorcycles with an ex-factory price of $500 are manufactured in a beneficiary country and exported to the United States. (It should be noted that the ex-factory price will normally be the appraised value.)

Case 1: The Bicycle Is Manufactured Entirely from Local Materials:
The bicycle qualifies for preferential treatment as wholly the manufacture of the beneficiary developing country.

Case 2: The Bicycle Is Manufactured as Follows:

i	*Gears imported and incorporated into the bicycle*	$100
ii	*Domestic materials*	$150
iii	*Direct cost of processing*	$100
iv	*Indirect cost (overheads, profit, etc.)*	$150
	Total:	$500

The bicycle qualifies for preferential treatment because the sum of domestic materials and costs of direct processing, namely $250, represents 50 percent of the ex-factory price – not less than 35 percent of the appraised value.

Case 3: The Bicycle Is Manufactured as Follows:

i	*Imported gear*	$100
ii	*Chain, manufactured from imported special steel* *Note: Imported special steel has been substantially transformed*	$50
iii	*Saddle (manufactured from imported hide)* *Note: Imported hide has been substantially transformed*	$25
iv	*Domestic materials*	$50
v	*Direct costs of processing*	$75
vi	*Indirect costs of processing (overheads, profits, etc.)*	$200
	Total:	$500

In this case, the costs of domestic materials will consist of items (ii), (iii), and (iv), because the chain [item (ii)] and saddle [item (iii)] are products of imported materials that have been substantially transformed in the beneficiary country. Thus, the cost of domestic materials ($200) represents 40 percent of the ex-factory price ($500) – not less than 35 percent of the appraised value. Therefore, the bicycle qualifies for GSP treatment.

Case 4: The Bicycle Is Manufactured as Follows:

i	*Imported materials (gears $100, saddle $25, tires $50)*	$175
ii	*Domestic materials*	$75
iii	*Direct costs of processing*	$50
iv	*Indirect cost (overheads, profits, etc.)*	$200
	Total:	$500

In this case, the sum of domestic materials [item (ii)] and costs of processing [item (iii)], namely $125, represents 25 percent of the ex-factory price, i.e. less than 35 percent of the appraised value. Therefore, the bicycle does not qualify.

The *appraised value* under the US customs valuation system is usually equal to the ex-factory price of the export product.

3.2.3.2.3 EURASIAN CUSTOMS UNION. Under the last rules of origin of the Eurasian Customs Union, goods are considered to have undergone sufficient working or processing in a preference-receiving country according to the *substantial transformation* definition below:[33]

(a) The following are substantially transformed goods from a beneficiary country:

i. Goods have undergone working or processing in a beneficiary country and the value of materials (raw materials, semi-finished or finished products) originating from other countries, that do not benefit from preferential tariff treatment, or goods of unknown origin used in the production does not exceed 50% of the value of goods exporting from such beneficiary country;
ii. Goods have undergone working or processing in several beneficiary countries and the value of materials originating from other countries, that do not benefit from preferential tariff treatment, or goods of unknown origin used in the production does not exceed 50% of the value of goods exporting from such beneficiary countries (Decision 60 of Council of Eurasian Customs Union has raised the percentage to 55% in 2020 and to 60% from 2025);
iii. Goods have been produced in a beneficiary country and have undergone working or processing in one (or several) of the beneficiary countries.

(b) The non-originating goods values will be determined based on the customs value of those goods in the country producing the exported goods.

[33] Source: Section III of Rules for determining origin of goods from developing and least developed countries provided by Eurasian customs union.

The values of goods of unknown origin referred to in subparagraphs (a) and (b) of this section, shall be the earliest ascertained price paid for those goods in the territory of the beneficiary country producing the exported goods.

Goods ranging from raw materials to finished products exported from a single customs territory of the Parties to the beneficiary country and utilized for production of goods exporting to the common customs territory of the Parties will be considered as originating goods from a beneficiary country.

The goods exported from a beneficiary country have values that are based on the ex-works price of manufacturer[34] adopted for customs purposes by the Parties.

3.2.4 *Preference-Giving Country or Donor Country Content Rule*

Some preference-giving countries apply the rule which allow products (materials, parts, and components) of their manufacture when supplied to a preference-receiving country and used there in a process of production, to be regarded as of that preference-receiving country's origin for determining whether the finished product qualifies for GSP treatment.

Example: Embroidered handkerchiefs (classified HS 6213) to obtain GSP origin in a beneficiary country, the criteria to be applied is "Manufacture from unembroidered fabric, provided that the value of the unembroidered fabric used does not exceed 40% of the ex-works price of the product"; meaning that non-originating unembroidered fabric may be used but representing a value not exceeding 40% of the ex-works price of the product. However, if the fabric used originates in the EU, then the donor country provisions allow it to be considered to be originating in the beneficiary country.[35]

The rule on preference-giving country content (or bilateral cumulation as it is often referred to) is applied by the EU, Canada, Japan, and the Eurasian Customs Union. For all these countries, except Japan, any finished product may benefit. For Japan, however, the rule does not apply to a number of finished products.

Products originating in the EU which are subject to sufficient working or processing in a beneficiary country are to be considered as originating in that beneficiary country. This provision further expands the cumulation options by allowing the use of inputs or intermediate products which have already acquired originating status in the EU.

Proof of originating status of EU products has to be provided either by production of an exporter statement or by an invoice declaration. Additional information on procedures for the issuance of GSP Form A and Form EUR.1 and the changes following the introduction of the REX system is contained in Chapter 7 of this book.

[34] In accordance with international rules of Inconterms.

[35] Adapted from "The European Union's Rules of Origin for the Generalised System of Preferences: A Guide for Users," May 2016, at https://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/customs/customs_duties/rules_origin/preferential/guide-contents_annex_1_en.pdf.

The EU "donor country content" rules are also extended to products originating in Norway, Switzerland, and Turkey, insofar as these countries grant generalized preferences and apply a definition of the concept of origin corresponding to that set out in the EU scheme. Cumulation with Norway, Switzerland, or Turkey shall not apply to products falling within Chapters 1–24 of the HS.

Japan requires special documentary evidence to support a claim under this rule. It requires, in addition to the normal certificate of origin Form A, the following evidence relating to the materials imported from Japan: a "certificate of materials imported from Japan" issued by the authority entrusted with the issuance of certificates of origin Form A.

3.2.5 *Cumulative Origin in the GSP Schemes*

The GSP rules are, in principle, based on the concept of single country origin; that is, the origin requirements must be fully complied with in *one* exporting preference-receiving country that must be, at the same time, also the country of the manufacture of the finished products concerned. Under the schemes of some preference-giving countries adopting a diagonal cumulation this rule has been liberalized to permit that a product can be manufactured and finished in a preference-receiving country using imported materials, parts, or components from other preference-receiving countries and this material could be considered as originating in the preference-receiving country claiming the preferential tariff treatment. Under a more liberal scheme of cumulation – full cumulation – not only originating materials but also processes or value added in more than one preference-receiving country may be added together to comply with origin requirements.

As mentioned, rules of origin in the context of autonomous or unilateral contractual preferences are to be complied with within the customs territory of a single beneficiary country. However, some preference-giving countries, as shown in Table 3.5, considered that this requirement per se was not adequate to the existing realities in developing countries, especially in view of the regional trade initiatives taking place among them. First, isolated and stringent requirements to comply with rules of origin may demand excessive "verticalization" of production, which does not exist in developing countries. Second, an excessive requirement demanding multistage operations or value-added operations would frustrate trade creation effects expected from tariff preferences.

Examples of Full Cumulation

- *Some origin rules for fabrics require the processes of spinning the yarn and weaving to be undergone in one preference-receiving country. Under some systems of cumulative origin, however, the first process of spinning may be completed in one preference-receiving country and the second process (of weaving) carried out in a second preference-receiving country and the fabric would qualify for GSP.*

TABLE 3.5 *Rules of origin: scope of cumulation and derogation*

Country/ Group of countries	Scope of cumulation		Donor country content	Documentation	Additional requirements/ Information	Other conditions
	Full or diagonal	Global to regional				
EU EBA	Partial/ diagonal	Regional	Yes	Exporter statement needed to indicate use of regional cumulation	Coordinating body of regional grouping undertakes to comply with rules. At present SAARC, ASEAN, ANDEAN, Mercosur[i]	Regional groups must make application and possess central organization capable of ensuring administrative cooperation
Japan GSP	Full	Regional	Yes	Additional certificate required to indicate cumulation	At present, only some ASEAN members have been granted regional cumulation	Regional groups must make an application
United States GSP	Full	Regional	No	Not specified	At present, ASEAN, CARICOM, SADC, and WAEMU are granted regional cumulation	(a) regional cumulation granted (on application to free trade-areas and customs unions) (b) competitive need limits are assessed only against the "country of origin" and not the entire regional grouping
United States AGOA*	Full	All sub-Saharan beneficiaries	Yes	Not specified	Not applicable	
Canada[ii] GSP	Full	All beneficiaries	Yes	Not specified	Not applicable	

[i] For a detailed discussion of the scope of cumulation in the context of these various regional groupings, see section 3.2.5.2.
[ii] For textile and apparel products, refer to Table 3.8 (AGOA) and section 3.2.5.5.1 for Canada.

- *A sub-assembly for a radio receiver produced in preference-receiving country A from imported parts may be exported to preference-receiving country B where it is manufactured, together with other imported materials, etc. into a finished radio. The value of the materials and work done in a country A may, under a full global system of cumulation, be added to the work done in country B in order to determine whether the radio satisfies the percentage criterion applied by some preference-giving countries.*

There are marked differences between preference-giving countries as to the possibilities for cumulation. In this regard, Canada and the Eurasian Customs Union, as well as Australia and New Zealand, rank at the top insofar as they grant full and global cumulation and donor country content to all beneficiary countries.

Under the schemes of Canada and the Eurasian Customs Union, all preference-receiving countries are regarded as one single area for determining origin. All value-added and/or manufacturing processes performed in the area may be added together in order to meet the origin requirements for products to be exported to any of the abovementioned preference-giving countries. This is called *full and global cumulation* (some qualifications apply for textiles and clothing in the case of LDCs as discussed in section 3.2.5.5).

The EU, Japan, Norway, Switzerland, and the United States have chosen to grant what is called regional cumulation to certain regional associations. The scope of the regional cumulation facility under the scheme of the EU differs, however, from that granted by United States and Japan. The EU grants what is called diagonal regional cumulation as opposed to the full regional cumulation accorded under the schemes of the United States and Japan. Diagonal regional cumulation means that inputs imported from another member of the regional association and utilized for further manufacturing or incorporated in the final exporting country must already have originated there in order to be considered as domestic content.

This limitation does not exist under the regional cumulation option of the schemes of Japan and the United States, which consider the members of a regional association as one single customs territory and any working or processing operations may be counted as domestic content in compliance with rules of origin requirements.

To sum up three kinds of cumulation are used, as far as qualitative aspects are concerned, in autonomous or unilateral contractual trade preferences:

(1) full cumulation
(2) diagonal or partial cumulation
(3) bilateral cumulation or donor country content.

As far as quantitative aspects are concerned, the concept of cumulation is linked to geographical extensions of the cumulation; for example, all beneficiary countries under the Canadian GSP scheme, or limited to regional groupings such as ASEAN, ANDEAN, SAARC, and Mercosur under the EU GSP scheme.

The most delicate and complex differences relating to cumulation belong to the distinction between full and partial cumulation. This distinction is also valid in the context of contractual preferential rules of origin and has decisive economic effects on the functioning and utilization of trade preferences.

Generally speaking, full cumulation of origin allows more scattered and divided-labor operations among the beneficiary countries since, in order to fulfill the origin criteria, the distribution of manufacturing may be carried out according to business exigencies within the members of the regional grouping; that is, working or processing may start in A, continue in B, and finish in B according to a cost/benefit analysis. This perspective seems to match the globalization and interdependence of production, whereby developed countries may be attracted to farming out low-tech or labor-intensive production processes in low-cost countries. Diagonal cumulation does not particularly favor this approach because it requires higher value-added or more complicated manufacturing processes. On the other hand, and in view of preference-giving countries, diagonal cumulation may be able to attract more capital-intensive investments accompanied by improved technical know-how and labor skills.

Economic consideration of the impact of full or diagonal cumulation suggests that full cumulation allows the massive employment of low-wage, low-skill labor, which some may argue to be a potentially negative factor because these workers often receive less than average wages and save less than average workers. Reality suggests, however, in spite of the argument of preference-giving countries suggesting a long-term objective of industrial policy through the adoption of restrictive rules of origin, labor-intensive lighter industries tend to compete most effectively with a similar industry in developed countries. Thus, the argument for full cumulation is strengthened.

In evaluating the effects of the different cumulative systems, one fundamental distinction must be made between cumulative systems in unilateral trade preferences and contractual ones. In the first case, whatever form of cumulation is granted, it aims in principle to facilitate compliance with rules of origin by expanding geographical coverage. In the second case, cumulation may be used as an argument to strengthen the potential inhibitive use of third-country materials outside the contracting parties, as discussed below in section 3.4.

3.2.5.1 The Difference between Full and Partial Cumulation

As mentioned earlier, there are intrinsic differences between the regional cumulation granted by the EU and the one offered by Japan and the United States. In fact,

under their regional cumulation schemes, Japan and the United States consider all ASEAN countries as one single customs territory (except that the United States has graduated Malaysia, Singapore, and Brunei out of its GSP program and progressively also the EU and Japan have done the same). Therefore, all processing or manufacturing carried out in an ASEAN country, irrespective of whether it acquires origin or not, will be counted as local content.

Under the "partial" regional cumulation schemes of the EU, only the materials which acquire origin in one member state of the regional association will be counted as domestic content. Thus, only those products which already originate in other countries of the association, according to the EU GSP rules of origin, could be counted as local content when utilized for further manufacturing or incorporated into the finished product manufactured in the final member state.

Figure 3.1 provides a graphic representation of the difference between full and diagonal cumulation in the case where a rule of origin requiring a 40 percent value added is applied to countries A and B.

In the case of diagonal or partial cumulation, country B can only use the input of country A if this input has already acquired originating status by complying with the 40 percent value added.

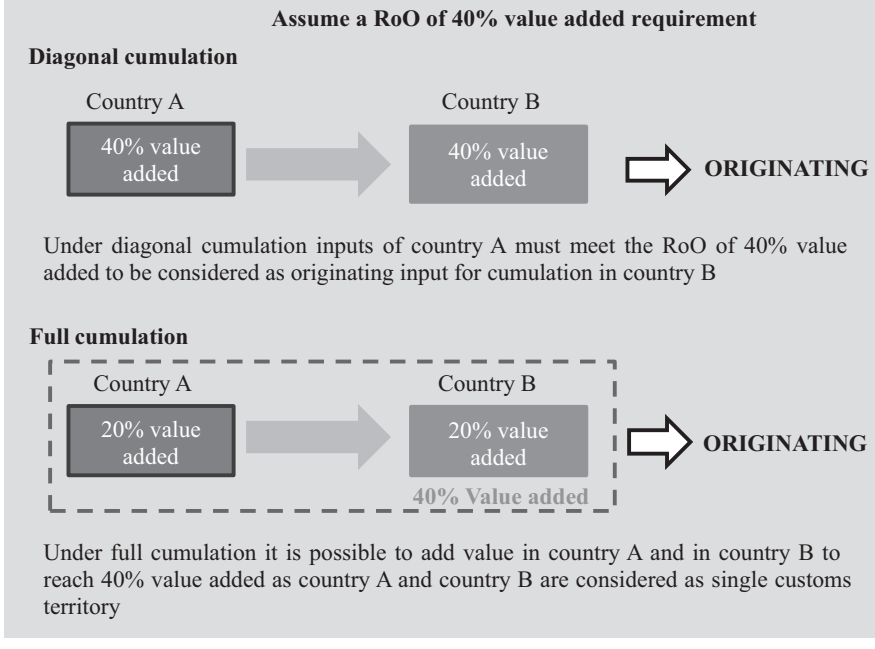


FIGURE 3.1 Diagonal vs. Full cumulation

In the case of full cumulation country A and country B are considered as a single customs territory and therefore can cumulate the 20% value added acquired in A with the 20% acquired in country B to meet the 40% value-added requirement.

Figure 3.1 and Tables 3.6 and 3.7 illustrate the difference between diagonal and full cumulation under rules of origin that include a working or processing requirement. The examples are applicable in the case of a scenario under a GSP scheme or in the case of multiple partners to a network of free-trade agreements.

In this specific example an EU PSRO requiring a double working or processing requirement (often referred to as double transformation) has been used.

The EU rules of origin for garments[36] normally require that the manufacturing process for apparel not knitted or crocheted (HS 62), when non-originating inputs are used, starts from non-originating yarn. This means the two processes are required as follows: (1) weaving the yarn into fabric and (2) cut, make, and trim the fabric into the finished garment.

TABLE 3.6 *Production chain of garments in a partial/diagonal cumulation scenario*

Country A outside the regional group or not FTA partner		Country B member of regional grouping of FTA partner		Country C member of regional grouping of FTA partner		Country D preference-giving country or FTA partner
Natural fiber	⇒	Natural fibers to fabrics = originating	⇒	Fabrics to apparel = originating	⇒	Donor country or FTA partner

TABLE 3.7 *Production chain of garments in a full cumulation scenario*

Country A outside the regional group or not FTA partner		Country B member of regional grouping of FTA partner		Country C member of regional grouping of FTA partner		Country D preference-giving country or FTA partner
Yarn	⇒	Yarn to fabrics	⇒	Fabrics to apparel = originating	⇒	Donor country preference-giving country or FTA partner

[36] This in the case of HS Chapter 62 under the EU GSP rules of origin for developing countries and most EU FTAs. Different rules of origin for Chapter 62 apply for LDCs and in EPAs with African countries.

With diagonal cumulation, however, preference-receiving country C may utilize fabrics from country B – a member of the same regional grouping or same free-trade agreement network – and the finished jacket is considered as an originating product because the non-originating fabric is counted under the cumulation rules as a domestic input.

However, this applies only when the fabric manufactured in country B is already originating according to PSRO applicable to fabric under the respective GSP or PSRO applicable in the network of FTA partners. In the specific case of the EU, as illustrated in Table 3.6, either the fabric is wholly obtained or it has been manufactured from non-originating natural fibers (two processes: yarn spinning and weaving of the yarn into fabric) according to EU PSRO applicable for fabrics. This production chain may be visualized as described in Table 3.6.

Thus, if the fabrics are produced in country B from non-originating natural fibers and the apparel if further cut, made, and trimmed in country C, the final apparel will be considered as originating.

In the case of full cumulation, the production chain is as described in Table 3.7.

As in the example provided in Figure 3.1, under a full cumulation scenario country A and country B are considered as a single custom territory. Accordingly, it is possible to cumulate working and processing carried out in country A (weaving yarn to fabrics), with the working and processing carried out in country B (cut, make, and trim the fabric into the finished garment). In so doing, the double transformation requirement has been fulfilled within the same customs territory and the requirement for double transformation has been met.

It is clear from the above example that a full cumulation system permits saving one step in the manufacturing process; that is, in the case of partial cumulation under the GSP, yarn-spinning facilities must be established, in principle, within the regional grouping to process the natural fibers into yarn while, in the case of full cumulation, the yarn can be directly imported from a third country outside the region.

As in the case of the GSP, EU rules of origin in the EUROMED countries[37] still require that the manufacturing process, when imported inputs are used, start from imported yarn. Since under the annexes to the Regional Convention on Pan-Euro-Mediterranean Preferential Rules of Origin (PEM Convention)[38] rules Tunisia, Morocco, and Algeria are regarded as one single customs territory for RoO purposes, it is sufficient that this requirement is fulfilled within the area. Thus, the intermediate materials imported from another partner country group do not need to be already originating, as shown in the following example:

> Chinese yarn is imported into Tunisia where it is manufactured into fabric. The fabric retains its Chinese origin as the origin rules for fabric demands manufacture from fibre.

[37] The EUROMED countries are Turkey, Algeria, Egypt, Israel, Jordan, Lebanon, Morocco, Tunisia, and Palestinian Authority of the West Bank and Gaza Strip.

[38] See Annexes II, III, and IV of the PEM Convention.

> The non-originating fabric is exported from Tunisia to Morocco where it is manufactured into garments. In Morocco, the finished garments obtain preferential origin status because the processing carried out in Morocco is added to the processing carried out in Tunisia to produce originating garments. The double transformation requirement – like in the example above – has been fulfilled in the territory of the countries benefiting from full cumulation. The final product obtains Moroccan origin and can be exported to the Community. However, since the full cumulation between the EC, Tunisia, Morocco and Algeria is not recognised by the Pan-Euro-Med partner countries – the product cannot be re-exported within the zone under preference.[39]

3.2.5.2 Cumulation under the EU GSP Scheme

Under the EU GSP scheme, partial cumulation is permitted (subject to conditions) on a regional basis as follows according to Article 55 of the DA:[40]

(a) Group I: Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar/Burma, Philippines, Thailand, and Vietnam
(b) Group II: Bolivia, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Nicaragua, Panama, Peru, and Venezuela
(c) Group III: Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka
(d) Group IV: Argentina, Brazil, Paraguay, and Uruguay.

Under the EU rules for partial and regional cumulation, materials or parts imported by a member country of one of these four groupings from another member country of the same grouping for further manufacture are considered as originating products of the country of manufacture and not as third-country inputs, provided that the materials or parts are already "originating products" of the exporting member country of the grouping. Originating products are those that have acquired origin by fulfilling the individual origin requirements under the EU rules of origin for the GSP purposes.

The scope for regional cumulation under the EU GSP scheme has been severely limited by the introduction of a new article under the GSP Regulation,[41] entered into force in 2014.

[39] Excerpted from: https://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/customs/customs_duties/rules_origin/preferential/handbook_en.pdf.

[40] The EU GSP rules of origin are contained in Articles 70–112 and Annexes 22-06 to 22-10 of Commission Implementing Regulation (EU) 2015/2447 (the implementing provisions of the Union Customs Code – hereafter referred to as Implementing Act (IA)) and Articles 37, 41–58 and Annexes 22-03 to 22-05 of Commission Delegated Regulation (EU) 2015/2446 (the delegated provisions of the Union Customs Code – Delegated Act (DA)).

[41] Regulation (EU) No. 978/2012 of the European Parliament and of the Council, October 25, 2012 applying a scheme of generalized tariff preferences and repealing Council Regulation (EC) No. 732/2008.

Former practice under previous EU regulations[42] provided that the withdrawal of one country or territory from the list of the countries and territories benefiting from generalized preferences by virtue of the criteria on country graduation mechanism does not affect the possibility of using products originating in that country under the regional cumulation rules. The EU GSP Regulation[43] 2014 discontinued such practice, substantially diminishing the scope of cumulation.

In fact, Article 4 of the EU GSP 2014 provides as follows:

> 1. An eligible country shall benefit from the tariff preferences provided under the general arrangement referred to in point (a) of Article 1(2) unless:
>
> (a) it has been classified by the World Bank as a high-income or an upper-middle income country during three consecutive years immediately preceding the update of the list of beneficiary countries; or
>
> (b) it benefits from a preferential market access arrangement which provides the same tariff preferences as the scheme, or better, for substantially all trade.

According the GSP Guide[44] the inputs of the following countries, formerly listed as members of the regional groupings mentioned above, can no longer be used in regional cumulation:

(a) "From 01.01.2014, the following countries are no longer beneficiary countries: Brunei and Malaysia (for Group I); Venezuela (for Group II); Argentina, Brazil and Uruguay (for Group IV)."
(b) "From 01.01.2015, the following countries are no longer beneficiary countries: Thailand (for Group I), Ecuador (for Group II), Maldives (for Group III)."
(c) "From 01.01.2016, the following countries are no longer beneficiary countries: Colombia, Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, Panama and Peru (for Group II)."

[42] See para. 3 of Article 5 of EU Council Regulation (EC) No. 732/2008, July 22, 2008 applying a scheme of generalized tariff preferences for the period from January 1, 2009 to December 31, 2011 and amending Regulations (EC) No. 552/97 and (EC) No. 1933/2006, and Commission Regulations (EC) No. 1100/2006 and (EC) No. 964/2007 providing as follows: "3. Regional cumulation within the meaning and provisions of Regulation (EEC) No 2454/93 shall also apply where a product used in further manufacture in a country belonging to a regional group originates in another country of the group, which does not benefit from the arrangements applying to the final product, provided that both countries benefit from regional cumulation for that group."

[43] Regulation (EU) No. 978/2012 of the European Parliament and of the Council, October 25, 2012 applying a scheme of generalized tariff preferences and repealing Council Regulation (EC) No. 732/2008.

[44] See: https://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/customs/customs_duties/rules_origin/preferential/guide-contents_annex_1_en.pdf.

A significant change that has occurred from graduation is the exclusion of originating inputs and materials of the graduated countries from regional cumulation. Given its technical nature this factor has been largely unnoticed since the effective utilization of cumulation is relatively limited outside the Asian region according to available data and research.

Under the EU GSP regulation 2014, there has been a significant change in the treatment of the inputs and materials originating in graduated countries that has caused significant and concrete implications, especially for the remaining countries that are still benefiting from GSP preferences.

Paragraph 3 of Article 5 of the EU GSP Regulation 2008 provided as follows:

> Regional cumulation within the meaning and provisions of Regulation (EEC) No 2454/93 shall also apply where a product used in further manufacture in a country belonging to a regional group originates in another country of the group, which does not benefit from the arrangements applying to the final product, provided that both countries benefit from regional cumulation for that group.

There is no equivalent provision in the EU GSP Regulation 2014. The absence of such provision means that the inputs of the graduated countries can no longer be used for cumulation purposes under the regional cumulation provisions. The implications of such provision on Cambodia and other beneficiaries of the EU GSP is further discussed in Chapter 5 of this book.

3.2.5.3 Cumulation under the Japanese GSP Scheme

Under the Japanese arrangement for full and regional cumulation which applies to countries that are members of ASEAN in respect of products exported to Japan by a member country of this grouping, the member states of ASEAN are treated as a single entity for acquiring origin status. Inputs from any member state of ASEAN or from Japan (there is however a list of products that are excluded from the preference-giving country content rule) are regarded as "ASEAN inputs" regardless of the originating status of the intermediate materials which have been manufactured in the other member country/countries of ASEAN.

The Form A issued in respect of the finished product must be supported by a "Cumulative Working/Processing Certificate." This certificate is to be issued in the final exporting member state of ASEAN by the same certifying authority (CA) as the certificate Form A.

It has to be recalled that under Japan's GSP the notion of ASEAN counties is limited to Indonesia, Malaysia, the Philippines, Thailand, and Vietnam. In other words, the ASEAN LDCs are excluded from cumulation.

3.2.5.4 Cumulation under the US GSP Scheme

Under the scheme of the United States, preference-receiving countries belonging to an association of countries that contributes to comprehensive regional economic integration among its members may jointly request to be considered as one area for meeting the origin requirements. Merchandise that is the growth, product, manufacture, or assembly of two or more of such member countries would qualify for preferential tariff treatment if the sum of the cost or value of the materials produced in those countries, plus the direct cost of processing operations performed in such countries, is not less than 35 percent of the value of the article as appraised by customs upon entry into the United States.

In other words, the 35 percent value added can be spread across more than one country when imported from GSP-eligible members of certain regional associations. Articles produced in two or more eligible member countries of an association will be accorded duty-free entry if the countries together account for at least 35 percent of the appraised value of the article, the same requirement as for a single country. The competitive-need limits will be assessed only against the country of origin and not against the entire association. There are currently six associations that may benefit from this provision: the Andean Group, ASEAN, the Caribbean Common Market (CARICOM), SADC, the West African Economic and Monetary Union (WAEMU), and the South Asian Association for Regional Cooperation (SAARC)[45]

3.2.5.5 Cumulation under the Canadian GSP Scheme

In the case of Canada, the recently amended rules of origin for textiles and clothing allow for a liberal cumulation of rules of origin. The following examples contained in this section are excerpted from materials of Canadian customs providing valuable guidance on the application and implications of the rules.

The basic concept underlying the functioning of full and global cumulation for LDCs is that in order to calculate the qualifying content, all LDC beneficiary countries are regarded as one single area. All value-added and manufacturing processes performed in the area may be integrated to meet the qualifying content requirement. Any Canadian content used in the production of the goods is also regarded as content from the LDC beneficiary country where the goods originate. In addition, the 40 percent of the ex-factory price of the goods as packed for shipment to Canada may also include a value of up to 20 percent of the ex-factory price of the

[45] GSP-eligible countries within benefiting associations: ASEAN (Cambodia, Indonesia, the Philippines, Thailand); CARICOM (Belize, Dominica, Grenada, Guyana, Jamaica, Montserrat, Saint Lucia, Saint Vincent, and the Grenadines); SADC (Botswana, Mauritius, the United Republic of Tanzania); WAEMU (Benin, Burkina Faso, Côte d'Ivoire, Guinea-Bissau, Mali, Niger, Senegal, Togo); SAARC (Afghanistan, Bangladesh, Bhutan, India, Nepal, Pakistan, Sri Lanka).

goods from GPT-eligible countries. However, any parts, materials, or inputs used in the production of the goods that have entered the commerce of any country other than an LDC beneficiary country or Canada lose their LDC status.

Example:[46] *Wool of Yemen is combined with spandex of Hong Kong and sewing thread of India to manufacture wool socks in Yemen. Under this subsection, a textile or apparel good must contain parts and materials of LDC origin that represent no less than 40 percent of the ex-factory price of the good as packed for shipment to Canada. The wool of Yemen origin represents 35 percent of the ex-factory price. The sewing thread of India and spandex of Hong Kong represents an additional 7 percent. This subsection permits inputs from GPT beneficiaries, in this case Hong Kong and India, to be included in the 40 percent parts and materials requirement. The 35 percent input of wool from Yemen combined with the 7 percent sewing thread and spandex inputs from the GPT countries exceed the 40 percent minimum input requirement under this subsection. The socks therefore qualify for the LDCT.*

3.2.5.5.1 SPECIAL CUMULATION RULES FOR LDCS IN THE CASE OF TEXTILES AND CLOTHING. According to the special rules of origin for LDCs under the Canadian scheme as described in section 3.2.3.2.1, yarns or sewing threads must be spun or extruded in a beneficiary country. Once spun or extruded, the goods cannot undergo any further processing outside any LDC beneficiary.

Example: Cotton of any country of origin is imported into Bangladesh and spun into yarn in Bangladesh. The yarn is sent to Cambodia to be dyed. When the yarn is returned to Bangladesh, it is sanitized and packed for shipment to Canada. Such goods would be entitled to the LDC.

However, if after the spinning process, the yarns were further processed in China (a developing country benefiting from Canadian GSP benefits defined as General Preferential Tariff but not a LDC), returned to Bangladesh, then exported to Canada, the goods would not be entitled to be certified as originating in a LDC because further processing occurred outside a LDC beneficiary.

To acquire LDC originating status, fabrics must be produced in an LDC beneficiary from yarns that originate in any LDC or GPT (any developing country benefiting from GPT) or Canada.

The yarns used in the "fabrics" must not undergo any further processing outside any LDC or GPT beneficiary or Canada. The "fabrics" must not undergo any further processing outside any LDC beneficiary or Canada.

Example: Cotton yarn produced in India is exported to Mali where it is woven into cotton fabric that is exported to Canada. As the cotton fabric meets the conditions of this subsection, the goods are entitled to be certified as originating in an LDC.

[46] All these examples are excerpted from memorandum D11–4-4 Ottawa, August 29, 2003, Rules of Origin Respecting the General Preferential Tariff and Least Developed Country Tariff as amended in 2017.

Example: Yarn produced in Spain is exported to Mali where it is woven into fabric for export to Canada. The fabric would not be entitled to be certified as LDC originating as the yarn does not originate in an LDC beneficiary country, a GPT beneficiary country or Canada.

To acquire LDC originating status, apparel goods must be assembled in an LDC beneficiary. The fabric used in the assembly of such "apparel goods" must be cut in *that LDC* or Canada, and, in the case where apparel goods are assembled from parts, those parts must be knit to shape in an LDC or Canada.

Furthermore, the fabric, or parts knit to shape, must be produced in any LDC or in Canada from yarns originating in any LDC or GPT beneficiary or in Canada. The yarns or fabric, or parts knit to shape, must not undergo any further processing outside any LDCT beneficiary or Canada.

Example: Dresses or skirts manufactured in Mali will qualify as originating and be eligible for duty-free LDCT provided that the dresses or skirts are assembled in Mali from fabric that has been cut in Mali or Canada. The fabric must be produced in any LDC or in Canada from yarns that originate in any LDC, GPT country, or Canada and the yarns or fabric have not undergone any further processing outside any LDC or Canada.

In addition, a second variant of the rules permits acquiring LDC originating status even if the fabric used has been imported from another GPT beneficiary. In order to acquire LDC originating status, such "apparel goods" must be assembled in an LDC beneficiary. The fabric used in the assembly of such "apparel goods" must be cut in *that LDC* or Canada.

Furthermore, the fabric or parts knit to shape must be produced in a GPT beneficiary from yarns originating in any LDC or GPT beneficiary or Canada. The yarns or fabric, or parts knit to shape, must not undergo any further processing outside an LDCT beneficiary, a GPT beneficiary or Canada.

Finally, the value of any materials, including packing, that are used in the manufacture of the goods, that originate outside the LDC in which the goods are assembled must not be more than 75 percent of the ex-factory price of the goods as packed for shipment to Canada. However, any parts, materials or inputs used in the production of the goods that have entered the commerce of any country other than a LDCT beneficiary country or Canada lose their LDC status.

Example: Those same dresses or skirts manufactured in Mali will qualify as and be eligible for duty-free LDCT provided that the dresses or skirts are assembled in Mali and the fabric used in the manufacture of the dresses or skirts is produced in a GPT country from yarns originating in a LDC or GPT beneficiary or Canada. The yarns and fabric cannot undergo further processing outside a LDCT or GPT beneficiary or Canada. When using fabric manufactured in a GPT, the value of any materials, including packing, that does not originate in the LDC in which the dresses or skirts are assembled must not exceed 75 percent of the ex-factory price of the goods as packed for shipment to Canada.

To acquire LDC originating status, "made-up textile goods" must be cut, or knit to shape, and sewn or otherwise assembled in an LDCT beneficiary.

Furthermore, the fabric or parts knit to shape must be produced in a LDCT beneficiary or Canada from yarns originating in any LDCT or GPT beneficiary or Canada. The yarns or fabric or parts knit to shape must not undergo any further processing outside a LDCT beneficiary or Canada.

Example: Wool yarn produced in Afghanistan is exported to Bangladesh where the yarn is produced into wool fabric. The wool fabric is shipped directly to Lao People's Democratic Republic for further production into a good classified as "Other Made-up Textile Article." The production process of the finished good in Lao People's Democratic Republic must include cutting, or knitting to shape, of the fabric as well as sewing or otherwise assembling in that country in order for the good to qualify for the LDC.

3.3 RULES OF ORIGIN UNDER THE AFRICAN GROWTH OPPORTUNITY ACT

The African Growth and Opportunity Act (AGOA) is the most recent United States initiative authorizing a new trade and investment policy toward Africa. Signed into law on May 18, 2000, it is a meaningful opportunity for eligible sub-Saharan African countries, which could result in a substantial improvement of conditions for preferential access to US markets. AGOA legislation has subsequently been amended and renewed. Since its enactment, AGOA legislation has been modified four times, in 2002, 2006, 2006, and 2015. Currently, it is extended until September 30, 2025.

Under Title I-B of the Act, beneficiary countries in sub-Saharan Africa designated by the president as eligible for the AGOA benefits are granted what could be called a "super GSP." In contrast to the GSP that has a duty-free tariff line coverage of 82.4 percent, the AGOA regulation covers 97.5 percent.[47]

While the current standard GSP program of the United States is subject to periodic short-term renewals and contains several limitations in terms of product coverage, AGOA amends the GSP program by providing duty-free treatment for a wider range of products. This would include, upon fulfilment of specific origin and visa requirements, certain textile and apparel articles that were heretofore considered import-sensitive and thus statutorily excluded from the program. It covers around 6,600 tariff lines duty free, extending duty-free treatment to certain apparel and footwear products not eligible under GSP, including for LDCs. Furthermore, AGOA beneficiaries are excluded from some caps on duty-free imports under the GSP scheme. The Trade Act of 2002, aiming to improve the utilization of the AGOA program, contained amendments to apparel and textile provisions under the program (AGOA II). It modified certain provisions under AGOA by including knit-to-shape articles, doubling the cap on apparel imports, granting AGOA less-developed beneficiary status to Botswana and Namibia, and revising the technical

[47] WTO, WT/COMTD/LDC/W/65/Rev.1.

definition of merino wool to allow sub-Saharan countries to take advantage of the AGOA benefit for merino wool sweaters. Furthermore, it clarified the origin of yarns under the special rule for designated LDCs and made hybrid apparel articles eligible for preferences (i.e. cutting that occurs both in the United States and in AGOA countries does not render fabric ineligible).

In 2004, provisions of the AGOA were amended by the AGOA Acceleration Act (AGOA III). The Act extended preferential access for imports from beneficiary sub-Saharan African countries until December 2015, and the third-country fabric provision, from September 2004 until September 2007. It also included a modification of the rules of origin for textiles and apparel to allow articles assembled either in the United States or sub-Saharan Africa to qualify for AGOA treatment (hybrid) and the *de minimis* rule was increased from 7 percent to 10 percent. Furthermore, it expanded the "folklore" AGOA coverage to include selected ethnic machine-printed fabric made in sub-Saharan African countries or the United States.

AGOA was subsequently amended by the Africa Investment Incentive Act of 2006 (AGOA IV). The new legislation extended textile and apparel provisions until 2015, and the third country fabric provision, for five years, from September 2007 until September 2012. It furthermore increased the cap to 3.5 percent and added an abundant supply provision. Additionally, duty-free treatment for textiles or textile articles originating totally in one or more less-developed beneficiary countries was extended.

The AGOA Extension and Enhancement Act of 2015 introduced the latest modification of AGOA by extending the duty-free treatment of the products of beneficiary sub-Saharan African countries until 2025.[48] Furthermore, such extended period applies to the preferential treatment of apparel articles wholly assembled, or components knit-to-shape and wholly assembled which have been assembled in one or more beneficiary sub-Saharan African countries from yarns originating in the United States or in one or more beneficiary sub-Saharan African countries and/or former beneficiary sub-Saharan African countries. It also applies to the third-country fabric program. Additionally, the rules of origin for duty-free treatment of articles of beneficiary sub-Saharan African countries have been revised, extending cumulation with former beneficiary countries of AGOA and including direct costs of processing operations in order to achieve the required minimum local value content.

3.3.1 *Country Eligibility*

The US Government aims to allow the largest possible number of sub-Saharan African countries to take advantage of AGOA. In October 2000, when AGOA was implemented, thirty-four countries in sub-Saharan Africa were designated as eligible for the trade benefits of AGOA. Currently, thirty-nine countries are eligible for preference treatment (see Table 3.8).

[48] Legislation available from www.congress.gov/114/plaws/publ27/PLAW-114publ27.pdf.

TABLE 3.8 *Overview of AGOA beneficiaries*

Country	Date declared AGOA eligible	Date eligible for "wearing apparel" provisions	Qualification third-country fabric rule for LDCs	Category 9		
				Handloomed/ Handmade	Folklore annex	Ethnic printed fabrics
Angola	Dec. 30, 2003	NOT ELIGIBLE	–	–	–	–
Benin	Oct. 2, 2000	Jan. 28, 2004	Yes	N/A	N/A	N/A
Botswana	Oct. 2, 2000	Aug. 27,2001	Yes	Yes	No	No
Burkina Faso	Dec. 10, 2004	Aug. 4,-2006	Yes	Yes	Yes	Yes
Burundi	Lost eligibility Jan. 1, 2016	NOT ELIGIBLE	–	–	–	–
Cameroon	Oct. 2, 2000	Mar. 1, 2002	Yes	No	No	No
Cape Verde	Oct. 2, 2000	Aug. 28,-2002	Yes	No	No	No
Chad	Oct. 2, 2000	Apr. 26,-2006	Yes	No	No	No
Central African Republic	Reinstated Dec. 15, 2016	NOT ELIGIBLE	–	–	–	–
Comoros	Jun. 30, 2008	NOT ELIGIBLE	–	–	–	–
Congo (Republic)	Oct. 2, 2000	NOT ELIGIBLE	–	–	–	–
Congo (DRC)	Declared ineligible Jan. 1, 2011	NOT ELIGIBLE	–	–	–	–
Cote d'Ivoire	Oct. 25, 2011	Mar. 19, 2013	–	–	–	–
Djibouti	Oct. 2, 2000	NOT ELIGIBLE	–	–	–	–
Ethiopia	Oct. 2, 2000	Aug. 2, 2001	Yes	Yes	Yes	No
Gabon	Oct. 2, 2000	NOT ELIGIBLE	–	–	–	–
Gambia	Lost eligibility Dec. 23, 2014 Regained eligibility Dec. 22, 2017	NOT ELIGIBLE	–	–	–	–

TABLE 3.8 (*continued*)

Country	Date declared AGOA eligible	Date eligible for "wearing apparel" provisions	Qualification third-country fabric rule for LDCs	Category 9		
				Handloomed/ Handmade	Folklore annex	Ethnic printed fabrics
Ghana	Oct. 2, 2000	Mar. 20, 2002	Yes	Yes	Yes	No
Guinea	Oct. 25, 2011	NOT ELIGIBLE	–	–	–	–
Guinea-Bissau	Regained eligibility Dec. 23, 2014	NOT ELIGIBLE	–	–	–	–
Kenya	Oct. 2, 2000	Jan. 18, 2001	Yes	Yes	No	No
Lesotho	Oct. 2, 2000	Apr. 23, 2001	Yes	Yes	No	No
Liberia	Dec. 29, 2006	Feb. 7, 2011	Yes			
Madagascar	Regained eligibility Jun. 27, 2014	Dec. 15, 2014	Yes	–	–	–
Malawi	Oct. 2, 2000	Aug. 15, 2001	Yes	Yes	No	No
Mali	Regained eligibility Jan. 1, 2014	NOT ELIGIBLE	–	–	–	–
Mauritania	Jan. 1, 2010	NOT ELIGIBLE	–	–	–	–
Mauritius	Oct. 2, 2000	Jan. 18, 2001	Yes	No	No	No
Mozambique	Oct. 2, 2000	Feb. 8, 2002	Yes	Yes	Yes	No
Namibia	Oct. 2, 2000	Dec. 3, 2001	Yes	Yes	No	No
Niger	Oct. 25, 2011	Oct. 25, 2011	Yes	Yes	Yes	Yes
Nigeria	Oct. 2, 2000	Jul. 14, 2004	Yes	Yes	Yes	Yes
Rwanda	Oct. 2, 2000	CURRENTLY NOT ELIGIBLE (Jul. 31, 2018)	Yes	No	No	No
Sao Tome and Principe	Oct. 2, 2000	NOT ELIGIBLE	–	–	–	–

(*continued*)

TABLE 3.8 (*continued*)

Country	Date declared AGOA eligible	Date eligible for "wearing apparel" provisions	Qualification third-country fabric rule for LDCs	Category 9		
				Handloomed/ Handmade	Folklore annex	Ethnic printed fabrics
Senegal	Oct. 2, 2000	Apr. 23, 2002	Yes	Yes	No	No
Seychelles (graduated)	Declared ineligible effective Jan. 1, 2017	Graduated out of AGOA	–	–	–	–
Sierra Leone	Oct. 23, 2002	Apr. 5, 2004	Yes	Yes	Yes	No
South Africa	Oct. 2, 2000	Mar. 7, 2001	No	Yes	No	Yes
South Sudan	Lost eligibility Dec. 23, 2014	NOT ELIGIBLE	–	–	–	–
Swaziland	Lost eligibility during 2014 Regained eligibility Dec. 22, 2017	NOT ELIGIBLE	–	–	–	–
Tanzania	Oct. 2, 2000	Feb. 4, 2002	Yes	Yes	Yes	Yes
Togo	Apr. 17, 2008	Aug. 22, 2017	–	–	–	–
Uganda	Oct. 2, 2000	Oct. 23, 2001	Yes	No	No	No
Zambia	Oct. 2, 2000	Dec. 17, 2001	Yes	Yes	No	No

Source: US Government Information, adapted by Trade Law Centre, available from https://agoa.info/about-agoa/country-eligibility.html.

Sub-Saharan countries are designated as eligible to receive the benefits of AGOA if they are determined to establish, or are making progress toward establishing:[49]

(a) market-based economies
(b) rule of law and political pluralism

[49] Legislation Public Law 106-200, section 104, available from www.congress.gov/106/plaws/publ200/PLAW-106publ200.pdf.

(c) elimination of barriers to United States trade and investment, including national treatment and measures to foster an investment friendly environment, protection of intellectual property; resolution of bilateral trade and investment disputes
(d) efforts to combat corruption
(e) policies to reduce poverty, increasing availability of health care and educational opportunities
(f) protection of workers' rights and elimination of certain child labor practices.

The eligibility criteria for GSP and AGOA are overlapping, for countries must be GSP eligible in order to receive AGOA's trade benefits including both expanded GSP and the apparel provisions. However, GSP eligibility does not imply AGOA eligibility.

Table 3.8 lists AGOA eligible countries, the effective date of their eligibility, and the effective date of their eligibility for AGOA textile and apparel benefits, if applicable.

3.3.2 *Rules of Origin under AGOA*

An AGOA article must meet the basic requirements set out in the rules of origin of the US GSP origin and related rules to receive duty-free treatment.[50] In the context of AGOA specifically, rules of origin are subject to the following:[51]

(a) The cost or value of materials produced in the customs territory of the United States may be counted toward the 35 percent requirement up to a maximum amount not to exceed 15 percent of the article's appraised value.
(b) The cost or value of the materials used that are produced in one or more beneficiary sub-Saharan African countries shall be applied in determining the 35 per cent requirement.
(c) Excluded from this regulation are articles that have only undergone simple combining or packaging operations or dilution with water.[52]

[50] Section 503(a)(2) of the Trade Act of 1974 (19 USC 2463: Designation of eligible articles), available from https://legcounsel.house.gov/Comps/93-618.pdf.
[51] Section 506A(b)(2) of Public Law 106 – 200, available from www.congress.gov/106/plaws/publ200/PLAW-106publ200.pdf.
[52] See also section 3.2.3.2.2 on US GSP.

3.3.3 *Specific Provisions on Textile/Apparel Articles*

3.3.3.1 Country Eligibility

AGOA provides preferential tariff treatment for imports of certain textile and apparel products from designated sub-Saharan African countries, provided that these countries:[53]

(a) have adopted an effective visa system and related procedures to prevent illegal transshipment and the use of counterfeit documents and
(b) have implemented and follow, or are making substantial progress toward implementing and following, certain customs procedures that assist the customs service in verifying the origin of the products and
(c) agree to reporting mechanisms and cooperation with the US Customs Services.

3.3.3.2 Rules of Origin and Preferential Articles of Textile and Apparel

AGOA provides duty-free and quota-free access for selected textile and apparel articles if they are imported from designated sub-Saharan African countries under the textile/apparel provision.[54] The 35 percent value-added requirement for AGOA GSP treatment is not required for the textile/apparel provision. Apparel products eligible for benefits under the AGOA must fall within one of ten specific preferential groups and meet the related requirements. The Trade Act of 2002 modified certain rules by making knit-to-shape articles eligible for duty-free and quota-free treatment in the preferential groups. Furthermore, the Africa Investment Incentive Act of 2006 increased the cap for AGOA apparel made of third-country fabric to 3.5 percent of the total, provided special rules governing fabrics or yarns that are produced in commercial quantities (or abundant supply) in designated sub-Saharan African countries for use in qualifying apparel articles, and expanded duty-free treatment for textile or textile articles (e.g. towels, sheets, made-ups) originating entirely in one or more less-developed AGOA beneficiary countries.

Qualifying articles for duty-free and quota-free treatment include:[55]

(a) Apparel
    (i) made of U.S. yarns and fabrics;

[53] See section 113, Protection against Transhipment of Public Law 106 – 200, at www.congress.gov/106/plaws/publ200/PLAW-106publ200.pdf.

[54] See section 112, Treatment of Certain Textiles and Apparel of Public Law 106 – 200, available from www.congress.gov/106/plaws/publ200/PLAW-106publ200.pdf.

[55] WTO, G/RO/LDC/N/USA/. The specific rules of origin for these articles: 19 CFR 211-213, available from www.ecfr.gov/cgi-bin/text-idx?SID=61efe140c8a30e01ae54661a8c33c917&rnc=true&node=sp19.1.10.d&rgn=div6; the full list of AGOA eligible products available from https://agoa.info/about-agoa/products.html.

(ii) made from sub-Saharan African yarns and fabrics (subject to a cap);
(iii) made in a designated lesser-developed country of lesser-developed country yarns and fabrics (subject to a cap);[56]
(iv) made from yarns and fabrics not produced in commercial quantities in the United States;
(v) certain cashmere and merino wool sweaters;[57]

(b) textile or textile articles originating fully in one or more beneficiary sub-Saharan African countries;
(c) eligible handloomed, handmade, or folklore articles as well as ethnic printed fabrics.[58]

3.3.4 *Administrative Rules on the Provision of Textile/Apparel Articles*

Certain apparel imports are subject to a cap that will be filled on a "first-come, first-served" basis.[59]

The current limitations are:

> For the one-year period, beginning on October 1, 2020, and extending through September 30, 2021, the aggregate quantity of imports eligible for preferential treatment under these provisions is 1,856,390,368 square meters equivalent. Of this amount, 928,195,184 square meters equivalent is available to apparel articles imported under the special rule for lesser developed countries. Apparel articles entered in excess of these quantities will be subject to otherwise applicable tariffs.[60]

To date, the cap has not been an effective quote, since aggregate AGOA apparel exports were within the limitations.[61]

3.3.5 *Abundant Supply*

AGOA IV provides special rules on determining whether fabrics or yarns are produced in commercial quantities (or, "abundant supply") in designated sub-Saharan African countries for use in qualifying apparel articles. AGOA IV provides that the US International Trade Commission will make such determinations, and also provides that 30 million m^2 equivalents of denim are determined to be in abundant supply

[56] For the purposes of the special rule for apparel under AGOA, less-developed sub-Saharan African countries are defined as those with a per capita gross national product of less than 1,500 USD a year in 1998. For current eligible countries see Table 3.8.
[57] For merino wool sweaters: containing 50 percent or more by weight of wool measuring 21.5 microns in diameter or finer.
[58] See Table 3.8 for details.
[59] Latest information on caps available from http://otexa.trade.gov/AGOA_Trade_Preference.htm.
[60] http://otexa.trade.gov/PDFs/AGOA_new_12-month_cap_on_duty-free_quota-free_benefits-Oct%201_%202017-Sept_30_2018.pdf.
[61] https://agoa.info/about-agoa/apparel-rules-of-origin.html.

beginning October 1, 2006. Subject to these rules, certain apparel goods may be excluded from AGOA third-country benefits. However section 3 of the Andean Trade Preference Extension Act (Public Law 110-436) revoked this provision.[62]

3.3.6 *Commercial Availability*

The Committee for the Implementation of the Textiles Agreements (CITA) may grant duty-free benefits for apparel made of fabric or yarns that cannot be supplied by the domestic industry in commercial quantities in a timely manner. As of 2017, eighteen commercial availability petitions have been approved and seven were denied.[63]

Furthermore, in any year when the cap is filled, products may still be imported; however, normal trade tariffs will be assessed at the time of entry. It is important to note that the benefits for apparel and textile provision are significant for certain countries.[64] This could mean that those countries that have traditionally exported apparels to the United States might account for a large portion of the cap.

3.3.7 *Other Special Rules on the Provision of Textile/Apparel Articles*

An article is eligible for preferential treatment even if it contains findings or trimmings of foreign origin, if the value of such findings or trimmings does not exceed 25 percent of the cost of the components of the assembled article. Examples of findings and trimmings include sewing thread, hooks and eyes, snaps, buttons, bow buds, decorative lace trims, elastic strips, and zippers, excluding sewing thread.[65]

Certain interlinings are also eligible for duty-free treatment. These include only a chest-type plate, a hymo piece, or sleeve header made of woven or weft-inserted warp-knit construction, and made of coarse animal hair or man-made filaments. An article is eligible for preferential treatment even if the article contains interlinings of foreign origin, if the value of those interlinings and any findings and trimmings does not exceed 25 percent of the cost of the components of the assembled article.[66]

Under the AGOA *de minimis* rule, an article is eligible for preferential treatment because it contains fibers or yarns not wholly formed in the United States or one or more beneficiary sub-Saharan African countries if the total weight of all such fibers and yarns is not more than 7 percent of the total weight of the article.[67]

[62] https://legacy.trade.gov/agoa/legislation/agoa_main_002132.pdf.

[63] Details on products available from http://otexa.trade.gov/AGOA_Trade_Preference.htm, "Commercial Availability."

[64] For a country-by-country examinations for tariff treatment of principal US imports from sub-Saharan Africa, see UNCTAD/ITCD/TSB/2003/1.

[65] AGOA, section 112(d)(1)(A), available from www.congress.gov/106/plaws/publ200/PLAW-106publ200.pdf.

[66] AGOA, section 112(d)(1)(B), available from www.congress.gov/106/plaws/publ200/PLAW-106publ200.pdf.

[67] AGOA, section 112(d)(2), available from www.congress.gov/106/plaws/publ200/PLAW-106publ200.pdf.

3.3.8 *Documentation Requirements*

Generally, a certificate of origin is not required, but when the article is not wholly obtained in a single beneficiary country, the exporter shall be prepared to submit a declaration about the details.[68]

A certificate of origin is required for each shipment of textiles and apparel claiming the preferential trade benefits for textiles and apparel, in addition to the visa. The US importer must obtain the certificate of origin from the manufacturer prior to presentation of entries to the US Customs Service claiming an AGOA preference. The importer is required to possess the certificate of origin and to be able to present it upon demand by the US Customs Service. The visa arrangement establishes documentary procedures for each shipment of eligible textile and apparel products from a designated beneficiary sub-Saharan African country to the United States.[69]

3.4 CONTRACTUAL RULES OF ORIGIN IN FREE-TRADE AREAS

Rules of origin are clearly at the very core of regional economic integration schemes because they ensure that preferential market access will be only granted to goods that have actually been "substantially transformed" within the area, and not to goods that are produced elsewhere and simply transshipped through one of the countries participating in the scheme. In the absence of rules of origin, it would not be possible to discriminate against imports from third countries, so the significance of regional integration would be drastically diminished.

The main reason for the existence of rules of origin in free-trade agreements is the preoccupation with trade deflection. In FTAs, each country maintains its own external tariff and commercial policy in relation to outside trading partners. To the extent that the tariffs and commercial policy are different with regard to third countries, there is always the incentive to import goods through the country with the most liberal import regime and tariffs. In such a case, importers/producers will eventually operate minimal transformation and finally re-export goods toward the country(ies) with the higher tariffs. To sum up, it would be equivalent to a tariff circumvention operation.

Trade deflection does not, per se, have a negative economic effect. In fact, it may be, from an economic point of view, considered equivalent to a reduction in the tariff of the country having the higher tariff of the free-trade agreements to the country having the lower tariff and thus indeed positive for economic efficiency. It is, however, regarded as a negative phenomenon since it does not correspond to the objectives of the free-trade agreements' contracting parties. Taken to its extreme, trade deflection could go beyond the original intention of the contracting parties by

[68] WTO Committee on Rules of Origin, Notification of Preferential Rules of Origin for Least Developed Countries (G/RO/LDC/N/USA/3), Section III: Documentary Requirements.

[69] Specimen available from www.ecfr.gov/cgi-bin/text-idx?SID=61efe140c8a30e01ae54661a8c33c917&mc=true&node=sp19.1.10.d&rgn=div6, 19 CFR.10.214, Certificate of Origin.

transforming the original FTA into a customs union where de facto the external tariff country applying the lower tariffs will determine the external tariffs.

The traditional "remedy" for trade deflection is stringent rules of origin. However, the more stringent they are, the more prevalent trade diversion may become, since producers in the FTAs will have an incentive to buy intermediate inputs originating there in spite of their higher cost/lower quality in comparison with inputs from countries outside the FTAs.

Thus, trade diversion will be greater the higher the preferential margin associated with origin compliance and the less costly the compliance with rules of origin and related administration costs.

To determine the possible effects of rules of origin in a free-trade agreement, it is first necessary to examine the general level of industrial and economic development of the countries involved. It is possible to determine three categories of free-trade agreements:

(1) among developed countries (i.e. NAFTA and its successor USMCA or the European Economic Area (EEA) Agreement)
(2) among developed and developing countries (i.e. US free-trade agreements with Latin American countries such as the Central American Free-Trade Area (CAFTA), EPAs of the EU with African countries, Euro-Mediterranean partnership agreements, EU EPAs with ASEAN countries, and the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CP-TPP), Regional Comprehensive Economic Partnership Agreement (RCEP))
(3) among developing countries (i.e. AfCFTA, Southern African Development Community, ATIGA, Mercosur, Pacific Alliance).

Rules of origin adopted in the context of FTAs as in the original NAFTA and the EEA Agreement, are mostly guided by the principle of integration, specialization of domestic industries, and preference for domestic intermediate inputs over imported ones as well as by the control of trade deflection. Obviously, the more sophisticated the level of industrial development, the more rules of origin may be restrictive as regards third-country inputs without substantially reducing the trade creation effects.

In this chapter the rules of origin of the two major players in drafting and developing models of rules or origin are examined. We will discuss the evolution of the Pan-European Rules of Origin and the NAFTA rules into today's formulation; namely, USMCA.

3.4.1 *The EU Model of Rules of Origin*

3.4.1.1 From Pan-European Rules of Origin to Pan-Euro-Mediterranean Rules of Origin

The EU practice in the field of rules of origin has been consistent since the adoption of a basic set of rules of origin early in the 1970s, which has been evolving over the

years. Thus, detailed rules of origin were and are a common feature of each free trade agreement or unilateral trade concession granted by the EU. Overall, the main characteristic common to all EU preferential rules of origin was the adoption of the CTH criterion in defining the concept of "substantial transformation" coupled with a list of PSRO, requiring CTH with or without exceptions, specific working or processing, or maximum import content percentages.

This adoption of the CTH and product-specific rules distinguished for many years the EU practice from the one adopted by the United States and Canada in autonomous preferential arrangements such as their GSP or the Caribbean Basin Initiative (CBI). In fact, as examined in section 3.2.1.1, the US GSP rules of origin still apply an across-the-board percentage criterion for all products.

This apparent simplicity in dealing with preferential rules of origin in the US administration took a dramatic change when the US–Canada Free-Trade Area and later NAFTA rules of origin were negotiated.

The apparent consistency of the EU policy toward origin did not necessarily mean that the EU adopted a single set of rules of origin for all the preferential arrangements it entered into with third countries. On the contrary, given the CTH and product-specific rules' common starting point, the EU's trade policy on rules of origin has traditionally been as different and complex as its trade agreements with third countries. In fact, rules of origin have been one of the preferred policy instruments adopted by the EU in modulating and tailoring according to its priorities the content of the concessions contained in the trade agreements with third countries.

In contrast to this traditional approach, a communication by the Commission of November 30, 1994 introduced a new policy toward rules of origin[70] by progressively adopting a uniform set of rules of origin commonly referred a "Pan-European Rules of Origin." According to this Communication, the European Community (EC) at that time started to revise and substitute the old protocols on rules of origin annexed to the Europe Agreements[71] with standard protocols that have been utilized to negotiate rules of origin protocols with South Africa, the Mediterranean countries, and have been gradually applied to all the other trading partners benefiting from tariff preferences, including the GSP and the Cotonou Partnership Agreement. Free-trade agreements with Mexico and Chile have also been negotiated using this standard set of Pan-European Rules of Origin. The Pan-European Rules of Origin regulated all trade relations conducted under the former Europe agreements with Central and Eastern European countries for more than a decade. The concept of Pan-European Rules of Origin was extended to the Mediterranean countries with

[70] Communication from the Commission to the Council, concerning the unification of rules of origin in preferential trade between the Community, the Central and East European countries and the EFTA countries, SEC(94) 1897 final.

[71] This process is almost completed at the time of writing.

whom the EU launched the Barcelona process for the creation of a Euro-Mediterranean FTA by 2010.

Following the accession to the EU of the Central and Eastern European countries, and as a coronation of the Euro-Mediterranean process, a system of Pan-Euro-Mediterranean cumulation of origin has been created as originally envisaged in the Barcelona Declaration. The Council of the EU on October 11, 2005 adopted the amended protocols on rules of origin annexed to the various agreements. The diagonal cumulation was then applicable between the EU and Algeria, Egypt, Israel, Jordan, Lebanon, Morocco, Syria, Tunisia, West Bank and Gaza Strip, the EEA/EFTA countries (Iceland, Norway, and Switzerland (including Liechtenstein)), the Faroe Islands, and Turkey.

Curiously enough, almost at the same time of the culmination of the implementation process of adopting pan-European rules lasting more than a decade, in the following years from 2015 to 2017 there has been quite a clear bifurcation on the EU policy toward rules of origin. On the one hand, the Pan-European Rules of Origin, rather than a pervasive model to be adopted in all EU free-trade agreements,[72] turned into the Pan-Euro-Mediterranean cumulation and the PEM Convention.[73] On the other hand, the Green Paper on the Future of Rules of Origin in Preferential Trade Arrangements[74] (the Green Paper) was launched. The Green Paper was originally conceived as a tool to re-examine the EU GSP rules of origin and has been, together with other analysis as discussed in section 3.4.1.3.9, at the center stage of the reform of the EU GSP rules of origin. In reality the Green Paper marked a decisive turning point in the EU rules of origin as the reformed GSP rules of origin influenced the drafting of PSRO, especially in newly negotiated free-trade agreements discussed in section 3.4.2.

The initiative of creating a single PEM Convention was endorsed by the Euro-Mediterranean trade ministers during their meeting in Lisbon on October 21, 2007. In addition to the Euro-Mediterranean countries the PEM Convention is open to the Western Balkans participating in the EU Stabilisation and Association Process (SAP)[75] (namely Albania, Bosnia and Herzegovina, the former Yugoslav Republic of Macedonia, Montenegro, Serbia, and Kosovo). According to paragraph 1, Article

[72] Even the Mexican and Chile FTAs contain rules modeled on the Pan-European Rules of Origin. Only limited, transitional deviation was allowed from the model in the EU/Mexico Agreement for certain specific products. This trend changed as examined in section 3.4.2.

[73] See Council Decision, March 26, 2012 on the conclusion of the Regional Convention on Pan-Euro-Mediterranean Preferential Rules of Origin, OJ L56 (February 26, 2013).

[74] Communication from the Commission to the Council, "The Rules of Origin in Preferential Trade Arrangements: Orientations for the Future," Brussels, March 16, 2005, COM(2005) 100 final.

[75] The SAP "is the European Union's policy towards the Western Balkans, established with the aim of eventual EU membership. Western Balkan countries are involved in a progressive partnership with a view of stabilising the region and establishing a free-trade area." Excerpted from https://ec.europa.eu/neighbourhood-enlargement/policy/glossary/terms/sap_en.

5 of the PEM Convention, accession is open to third countries according to the following criteria:

> 1. A third party may become a Contracting Party to this Convention, provided that the candidate country or territory has a free trade agreement in force, providing for preferential rules of origin, with at least one of the Contracting Parties

At the time of writing Georgia, Moldova, and Ukraine have acceded to the PEM Convention. A matrix[76] periodically updated provides a synopsis of the countries who are members of the PEM Convention.

The Green Paper opened the way for a gradual rethinking of the EU preferential rules of origin in the near future. According to the Green Paper, the review of the EU rules of origin was not expected to be immediately touching the substance of the rules. In retrospect, something started to change in the overall thinking of rules of origin in the EU for those rules of origin falling outside the scope of the PEM Convention. The initial content of the Green Paper appeared to be rather heavily focused on the management procedures related to the administration of the rules of origin. In particular, issuance and verification of certificates of origin and the role played by importers, exporters, and certifying authorities were closely examined in the Green Paper and various alternative options were clearly spelled out for opening a debate between the Commission, EU member states, the private sector, and the civil society. The content and options contained in the Green Paper are examined in Chapter 7 of this book as well as the evolution of the registered exporter (REX) system.[77]

The spirit of the Green Paper went beyond the boundaries of a mere reform of the administrative aspects of the EU rules of origin, as appeared in a document[78] of the Commission outlining a drastic change to the Pan-European Rules of Origin in the framework of the negotiations with the African, Caribbean, and Pacific (ACP) countries to conclude EPAs. Such document did not go very far but it was an evident sign that an era was about to end in the thinking of EU drafting of rules of origin.

[76] www.consilium.europa.eu/en/documents-publications/treaties-agreements/agreement/?id=2010035.

[77] https://ec.europa.eu/taxation_customs/business/calculation-customs-duties/rules-origin/general-aspects-preferential-origin/arrangements-list/generalised-system-preferences/the_register_exporter_system_en.

[78] Commission Information Paper presented at the 133 Committee and to the Customs Committee, March 2007. According to the approach outlined in that paper, the originating status is conferred on goods meeting a local value content calculated as the difference between the ex-works price and the customs value of non-originating materials. A basic value threshold will be established, coupled, in some cases, with additional value conditions and specific thresholds for some products. In addition, new provisions on cumulation and procedures for control on origin based on exporter declarations are proposed.

Accordingly the following sections provide, on the one hand, the progressive evolution of the Pan-European Rules of Origin into the Pan-Euro-Mediterranean cumulation and PEM Convention and, on the other hand, the evolution of the EU preferential rules of origin namely the EU GSP reform of rules of origin and recent developments in EPAs with different trade partners.

3.4.1.2 The EU Policy on Preferential Rules of Origin: The Progressive Adoption of the Pan-European Rules of Origin and the Pan-Euro-Mediterranean Rules of Origin

Under the different protocols of rules of origin in force before the introduction of the Pan-European Rules of Origin, the proliferation of different sets of preferential rules of origin was extremely complicated and burdensome for all those involved in an international transaction, especially exporters, importers, and customs officials. Moreover, the lowering of the most-favored nation (MFN) tariffs following the Uruguay Round negotiations eroded the preferential margin and thus the scope for complying with excessively stringent or complicated preferential rules of origin. These facts and the administrative costs involved in maintaining the complex system of different rules of origin tailored to the commercial policy objectives of each of the preferential trade agreements led the EU Commission at the beginning of the 1990s to adopt a new approach toward this aspect of commercial policy.

In particular, the flourishing, following the fall of the Berlin Wall during the 1990s, of an intricate network of regional agreements in Western and Central Europe, each one with a different set of rules of origin, caused difficulties for manufacturers and opened certain loopholes leading to circumvention and trade deflection. The Pan-European Rules of Origin were first introduced to address this tangle of regional and subregional agreements through harmonizing and simplifying the rules of origin for the EC/EFTA/Central and East European Countries (CEEC) area, and the EEA.

The EU policy toward the progressive harmonization of preferential rules of origin proceeded from the consideration that the systems of cumulation detailed in the agreements which made up the EU/EFTA/CEEC zone only provided for cumulation to take place between partners in the same agreement (or set of agreements), and that there was no link between the different sets of agreements. For example:

- The original agreements between the EU and the CEEC did not provide for any cumulation with the EFTA countries.
- The Central European Free-Trade Agreement did not provide for cumulation between the Visegrad countries (Poland, Hungary, Czech Republic, and Slovak Republic), and Bulgaria or Romania.
- The FTAs between the EU and the EFTA countries, and the EEA Agreement, did not provide for cumulation with the CEEC.

The harmonization process required the progressive elimination of all differences among the various sets of rules of origin through their alignment with the pan-European model and the progressive extension of diagonal rules of origin.

In addition to the abovementioned harmonization policy, the conclusions of the European Council meeting in Essen (Germany) on December 9 and 10, 1994 outlined the new policy toward the Mediterranean countries, which was finally endorsed by the Barcelona Declaration adopted by the Council at the Euro-Mediterranean Conference (November 27 and 28, 1995).[79] It emerged that the EU, whose political and economic attention was mainly devoted at the beginning of the 1990s to supporting the changes in Eastern European countries and the entry into force of the Europe Agreements, had developed a new strategy and model for partnership with the Mediterranean countries. This new policy entailed:

- negotiation with Mediterranean countries of FTA agreements of a reciprocal nature covering aspects beyond mere trade in goods
- creation of a Mediterranean FTA by 2010
- substantial financial assistance to support the necessary adjustments.

The first step toward the creation of this FTA was the conclusion of a full set of Euro-Mediterranean association agreements between the EU and its partners in the Mediterranean, establishing FTAs for a new generation. These agreements replaced the cooperation agreements concluded in the 1970s, that implied unilateral trade preferences. From 1998, Euro-Mediterranean association agreements with Tunisia, Morocco, Israel, Jordan, Lebanon, the Palestinian Authority, and Egypt have entered into force. The agreement with Algeria entered into force on September 1, 2005. The association agreement with Syria was initialed on October 18, 2004.

As a corollary of the new policy a system of Pan-Euro-Mediterranean cumulation of origin has been progressively established in a process that took more than a decade. This process entailed the gradual replacement of the original agreement that the EU negotiated with the Mediterranean countries in the seventies with new reciprocal FTAs including a new protocol on rules of origin based on the pan-European model and the progressing evolution of these protocols until the establishment of the Pan-Euro-Mediterranean cumulation.

The accession to the EU by a number of former Eastern European countries, Malta, and Cyprus and the progressive evolution of the Pan-Euro-Mediterranean

[79] See also Communication from the Commission to the Council and the European Parliament, "Strengthening the Mediterranean Policy of the European Union: Establishing a Euro-Mediterranean Partnership," October 19, 1994, COM(94) 427 final, and Communication from the Commission to the Council and the European Parliament, "Strengthening the Mediterranean Policy of the European Union: Proposals for Implementing a Euro-Mediterranean Partnership," March 8, 1995, COM(95) 72 final.

cumulation of origin meant a replacement of the original protocols contained in the EEA agreement and in the Euro-Mediterranean agreements.

The Council of the European Union on October 11, 2005 adopted the amended protocols on rules of origin annexed to the various agreements launching the diagonal cumulation system now applicable between the EC-25 and Algeria, Egypt, Israel, Jordan, Lebanon, Morocco, Syria, Tunisia, West Bank and Gaza Strip, the EEA/EFTA countries (Iceland, Norway, and Switzerland (including Liechtenstein)), Romania, Bulgaria, the Faroe Islands, and Turkey (including coal and steel and agricultural products).

The initiative of creating a single PEM Convention was endorsed by the Euro-Mediterranean trade ministers during their meeting in Lisbon on October 21, 2007. As stated in the preamble of the PEM Convention:

> the main aim is to allow for a more effective management of the system of pan-Euro-Med cumulation of origin by enabling the Contracting Parties to better react to rapidly changing economic realities. A single legal instrument may indeed be amended more easily than a complex network of protocols and should pave the way towards the long expected adaptation of the pan-Euro-Med rules of origin to the current market conditions.[80]

The PEM Convention has also been considered a tool to better integrate the participants in the EU's Stabilization and Association Process (SAP), the hub and spokes created by the Pan-Euro-Mediterranean system of cumulation of origin where diagonal cumulation can apply subject to a number of requirements that are going to be spelt out in the following section. The Convention has been under renegotiations for almost a decade. The EU has posted a proposal at the time of writing, which is a step towards the modernization of the PEM Convention. The modernized PEM convention was presented by the EU at Ninth Meeting of the PEM Joint Committee in November 2019 for adoption. However, consensus was not reached as some parties to the Convention expressed reservations or amendments. The EU announced at the Tenth Meeting of the Joint PEM committee in August 2020 a proposal for the progressive adoption of the revised PEM Convention as an alternative to the existing PEM Convention for those PEM parties that are willing to adopt the EU proposal. The provisions contained in the EU proposal will make it easier for products to benefit from trade preferences, such as:

- simpler product-specific rules, such as the elimination of cumulative requirements, thresholds for local value added, more adapted to EU production needs, and new double transformation for textiles

[80] See preamble to the PEM Convention in Council Decision, March 26, 2012 on the conclusion of the Regional Convention on Pan-Euro-Mediterranean Preferential Rules of Origin, OJ L56 (February 26, 2013).

- increased thresholds of tolerance for non-originating materials, from 10% to 15%
- the introduction of "full" cumulation, under which the manufacturing operations needed to acquire origin for most products can be split among several countries
- the possibility of duty-drawback (repayment of duties on imported components) for most products to help EU exporters compete.

The new rules, which are the result of ten years of negotiations, will apply alongside those of the PEM Convention, for those PEM parties that are willing to adopt the EU proposal.

3.4.1.3 The Common Structure of the Pan-Euro-Mediterranean Rules of Origin

It is important to recall that, while the PEM Convention was an impressive effort to bring into a plurilateral instrument over sixty protocols on rules of origin, the content of the rules of origin Protocol did not change drastically from the original ones contained in each singular Euro-Mediterranean Agreement.[81] In order to explain the common structure of the Pan-Euro-Mediterranean rules of origin, Appendix 1, concerning the definition of the concept of originating products and methods of administrative cooperation[82] of the PEM Convention, has been used to illustrate the content of the rules of origin of the PEM Convention.

It has to be born in mind that the PEM Convention is under revision as discussed in the above section. Pending the approval of the revised PEM convention by all parties, the EU has made public a proposal for the modernization of the Convention that is going to be applied as an alternative route to the current PEM Convention for those PEM contracting parties that are willing to follow this course of action as mentioned in the preceding section. Economic operators will choose the most convenient route. As an example of this arrangement the preambles of draft EU Council decision of the EU–Egypt agreement[83] and the attached technical notes explains in clear words the intentions of the EU.

[81] See also on the subject of this section the "User's Handbook to Rules of the Preferential Origin Used in Trade between the European Community and, other European Countries and the Countries Participating from the Euro-Mediterranean Partnership 2006 and Explanatory Notes Concerning the Pan-European-Mediterranean Protocol on Rules of Origin," OJ 2006/C 16/02 (January 21, 2006).

[82] See Regional Convention on Pan-Euro-Mediterranean preferential rules of origin,OJ L54/4 (February 26, 2013).

[83] Proposal for a Council Decision on the position to be taken on behalf of the European Union within the Joint Committee established by the Regional Convention on pan-Euro-Mediterranean preferential rules of origin as regards the amendment of the Convention, Brussels, 24.8.2020 COM(2020) 391 final.

3.4.1.3.1 PRODUCTS WHOLLY OBTAINED. Usually, each protocol on rules of origin contains a list of products considered to be "wholly obtained." Products fall into this category by virtue of the total absence of non-originating inputs in their production as contained in Article 4 of the PEM Convention, as reproduced below:

> The following shall be considered as wholly obtained in a Contracting Party when exported to another Contracting Party:
>
> (a) mineral products extracted from its soil or from its seabed;
> (b) vegetable products harvested there;
> (c) live animals born and raised there;
> (d) products from live animals raised there;
> (e) products obtained by hunting or fishing conducted there;
> (f) products of sea fishing and other products taken from the sea outside the territorial waters of the exporting Contracting Party by its vessels;
> (g) products made aboard its factory ships exclusively from products referred to in (f);
> (h) used articles collected there fit only for the recovery of raw materials, including used tyres fit only for retreading or for use as waste;
> (i) waste and scrap resulting from manufacturing operations conducted there;
> (j) products extracted from marine soil or subsoil outside its territorial waters provided that it has sole rights to work that soil or subsoil;
> (k) goods produced there exclusively from the products specified in (a) to (j).
>
> 2. The terms "its vessels" and "its factory ships" in paragraph 1(f) and (g) shall apply only to vessels and factory ships:
>
> (a) which are registered or recorded in the exporting Contracting Party
> (b) which sail under the flag of the exporting Contracting Party;
> (c) which are owned to an extent of at least 50% by nationals of the exporting Contracting Party, or by a company with its head office in the exporting Contracting Party, of which the manager or managers, Chairman of the Board of Directors or the Supervisory Board, and the majority of the members of such boards are nationals of the exporting Contracting Party and of which, in addition, in the case of partnerships or limited companies, at least half the capital belongs to the exporting Contracting Party or to public bodies or nationals of the said Contracting Party;
> (d) of which the master and officers are nationals of the exporting Contracting Party;
> (e) and of which at least 75% of the crew are nationals of the exporting Contracting Party.
>
> 3. For the purpose of paragraph 2(a) and (b), when the exporting Contracting Party is the European Union, it means a Member State of the European Union.

EU rules of origin for fishery products are extremely stringent and closely linked to the EU policy on the fisheries and fishery agreements that have been concluded with partner countries.

"Territorial waters" within the context of these rules of origin is strictly limited to the 12-mile zone, as laid down in the UN International Law of the Seas (1982 Montego Bay Convention). The existence of an exclusive economic zone (EEZ) with more extensive coverage (up to a 200-mile limit) is not relevant for this purpose.

Fish caught outside the 12-mile zone ("on the high seas") can only be considered to be wholly obtained if caught by a vessel that satisfies the definition of "its vessels." Fish caught inland or within the territorial waters is always considered to be wholly obtained.

The following are examples of wholly obtained products:[84]

1 Wood felled in Germany is imported into France where it is manufactured into chemical pulp (heading 4701 of the HS) using only chemical products originating in the Community. The product is wholly obtained in the EC.
2 Wine bottle corks manufactured in Portugal using natural cork or waste cork produced in Portugal. The corks have been wholly obtained in the EC.
3 Linen fabric woven in Italy from flax harvested and spun in France has been wholly obtained in the EC.
4 Basketwork and wickerwork manufactured in Morocco from willow, reeds, rushes etc., harvested in Morocco is wholly obtained in Morocco.
5 Articles of non-treated natural wood manufactured in Morocco using wood from trees felled in Morocco are considered to be wholly obtained in Morocco.
6 Fish are caught in Norwegian territorial waters by Spanish fishing vessels and are landed in Spain. In this instance the fish are regarded as wholly obtained in Norway as they are caught in the territorial waters of Norway.
7 Fish are caught in the open sea (outside territorial waters) by a vessel flying the Egyptian flag and satisfying the other nationality conditions of the Protocol. They are prepared and frozen on the vessel before being landed in a French port. In this case the fish are regarded as being wholly obtained in Egypt.
8 Fish caught in the open sea by a vessel flying the Turkish flag are landed in a Turkish port and then transported by road to the Community (for example to Germany) under transit arrangements. The fish are regarded as being wholly obtained in Turkey.

3.4.1.3.2 SUFFICIENT WORKING ON PROCESSING: THE PSRO UNDER THE PAN-EURO-MEDITERRANEAN RULES OF ORIGIN. As previously mentioned, the adoption of the PEM Convention meant common rules and a single list containing identical PSRO. Paragraph 1 of Article 5 of the PEM Convention provides as follows:

[84] The examples under this section have been excerpted from the "User's Handbook to Rules of the Preferential Origin used in Trade between the European Community and, other European Countries and the Countries Participating from the Euro-Mediterranean Partnership 2006."

> 1. For the purposes of Article 2, products which are not wholly obtained shall be considered to be sufficiently worked or processed when the conditions set out in the list in Annex II are fulfilled.
>
> The conditions referred to above indicate, for all products covered by this Agreement, the working or processing which must be carried out on non-originating materials used in manufacturing and apply only in relation to such materials. Accordingly, it follows that if a product, which has acquired originating status by fulfilling the conditions set out in the list, is used in the manufacture of another product, the conditions applicable to the product in which it is incorporated do not apply to it, and no account shall be taken of the non-originating materials which may have been used in its manufacture.

Paragraph 1 clearly spells out that the list of product-specific rules contained in Annex II is comprehensive; that is, there are not horizontal rules but rather each product has its own product-specific rules.

The second subparagraph of paragraph 1 embodies the so-called absorption principle from the explanatory notes (see section 3.4.1.3.6) and incorporates it in the main text of the PEM Convention. The following example excerpted from Introductory Note 3 to Annex II of the PEM Convention contains a valuable example of the operational impact of this rule:

Example: An engine of heading 8407, for which the rule states that the value of the non-originating materials which may be incorporated may not exceed 40 percent of the ex-works price, is made from "other alloy steel roughly shaped by forging" of heading ex-7224. If this forging has been forged in the EU from a non-originating ingot, it has already acquired originating status by virtue of the rule for heading ex-7224 in the list. The forging can then count as originating in the value-calculation for the engine, regardless of whether it was produced in the same factory or in another factory in the EU. The value of the non-originating ingot is thus not taken into account when adding up the value of the non-originating materials used.

Paragraphs 2 and 3 of Article 5 of the PEM Convention provide for additional rules related to the value tolerance:

> 2. Notwithstanding paragraph 1, non-originating materials which, according to the conditions set out in the list in Annex II, should not be used in the manufacture of a product may nevertheless be used, provided that:
>
> (a) their total value does not exceed 10% of the ex-works price of the product;
>
> (b) any of the percentages given in the list for the maximum value of non-originating materials are not exceeded by virtue of this paragraph.

> This paragraph shall not apply to products falling within Chapters 50 to 63 of the Harmonised System.
> 3. Paragraphs 1 and 2 shall apply subject to the provisions of Article 6.

Article 5(2) above grants a tolerance allowing the use of a small amount of non-originating materials to be used in the manufacture of goods. The concession allows for non-originating materials to be used up to a maximum value of 10 percent of the ex-works price.

Example: A doll (classified HS 9502) will qualify if it is manufactured from any imported materials which are classified in different heading. This means a manufacturer in a beneficiary country is allowed to import raw materials such as plastics, fabrics, etc. which are classified in other chapters of the HS. But the use of dolls' parts (e.g. dolls' eyes) is not normally possible as these are classified in the same heading (HS 9502). However, the tolerance rule allows the use of these parts if they amount to not more than 10 percent of the doll's value.

However, where there are percentages listed in Appendix II of the PEM Convention for a maximum value of prohibited non-originating materials, the maximum in the list cannot be exceeded by applying this 10 percent tolerance. The 10 percent tolerance rule can be used, for example, when applying the change of tariff heading rule.

Textile goods of Chapters 50–63, inclusive, are excluded from benefiting from the value tolerance. However, tolerances are granted to textiles products of Chapters 50–63, inclusive, as explained in Introductory Note 5 to Annex II which are set out in Annex I of the PEM Convention. Notes 5.1 and 5.2 provide as follows:

> 5.1. Where, for a given product in the list, reference is made to this Note, the conditions set out in column 3 shall not be applied to any basic textile materials used in the manufacture of this product and which, taken together, represent 10% or less of the total weight of all the basic textile materials used. (See also Notes 5.3 and 5.4)
>
> 5.2. However, the tolerance mentioned in Note 5.1 may be applied only to mixed products which have been made from two or more basic textile materials.

Example: A yarn, of heading 5205, made from cotton fibers of heading 5203 and synthetic staple fibers of heading 5506, is a mixed yarn. Therefore, non-originating synthetic staple fibers which do not satisfy the origin rules (which require manufacture from chemical materials or textile pulp) may be used, provided that their total weight does not exceed 10 percent of the weight of the yarn.

3.4.1.3.3 PSRO REQUIREMENTS CONTAINED IN ANNEX II OF THE PEM CONVENTION. The PSRO requirements contained in Annex II of the PEM Convention are listed according to HS chapters and headings as shown in Table 3.9. The working or processing referred to in columns 3 and 4 refers to

TABLE 3.9 *CTH requirements*

HS heading no.	Description of product	Working or processing carried out on non-originating materials that confers originating status	
(1)	(2)	(3) or	(4)
1501	Pig fat (including lard) and poultry fat, other than that of heading 0209 or 1503:		
	– Fats from bones or waste	Manufacture from materials of any heading, except those of heading 0203, 0206, or 0207 or bones of heading 0506	
	– Other	Manufacture from meat or edible offal of swine of heading 0203 or 0206 or of meat and edible offal of poultry of heading 0207	

operations which must be carried out on non-originating materials before they can obtain originating status which would make them eligible for the benefits of preferential origin. The listed operations are the minimum that goods must undergo in order to obtain origin. Processing may start at an earlier stage but never at a later one. In some cases, as in Tables 3.12 and 3.13 below, alternative rules of origin are provided.

Example: Shirts for men or boys are classified in heading 6205 regardless of what fabric they consist of. As Annex II does not have a specific rule for such garments the rule applicable is "manufacture from yarn." This means that in order for the shirts to obtain preferential origin the non-originating materials used in their manufacture cannot have been manufactured beyond the stage of yarn. However, you may manufacture the yarn from non-originating fibers and still obtain origin but you cannot benefit from preference if you manufacture the shirts from non-originating fabric.

Column 1 of the list indicates the tariff heading or the chapter. This column covers every tariff heading in the HS, even though they may not be specifically mentioned. If a product does not have a specific rule attached to it then the applicable rule may be found at chapter or heading level.

Example: Microwave ovens are classified in tariff heading 8516. Column 1 in the single list makes no reference to a specific rule for goods of 8516. In this case, the rule is to be found at the beginning of the section at "ex-Chapter 85."

When all of the goods falling within a chapter or heading are not subject to the same rule, "ex" is placed before the chapter or heading number. In the above example "ex-Chapter 85" means that the corresponding rules shown in columns 3 and 4 apply to goods classified in Chapter 85 with certain exceptions.

The exceptions are then listed beneath the heading description in column 2 with their corresponding tariff classification in column 1 and rules in columns 3 and 4. These rules may apply only to some goods falling within the heading.

Example: Letter pads are classified with registers and diaries in heading 4820. A search down column 1 leads to a reference to "ex-4820" alongside a reference to letter pads (column 2) and a specific rule (column 3). The "ex" indicates that not all products of heading 4820 are covered by the rule shown in column 3. Although diaries and registers are classified in the same heading as the letter pads, they are not specifically mentioned in column 2 and therefore are subject to the general rule that applies to Chapter 48.

Additional excerpts from the Annex II of the PEM Convention are listed in the following section with some examples of product-specific rules.

Headings 0203, 0206, or 0207 and bones of 0506 refer respectively to meat of swine, edible offal of bovine animals or swine, meat and edible offal of poultry, and bones, unworked. The rule requires that these materials may not be used to obtain fats classified in heading 1501. In other words, this rule aims at avoiding a situation where the simple removal of fat from non-originating meat of swine or bones classified in heading 0506 is origin conferring. (See Table 3.9.)

As mentioned above the "ex" in front of heading 1701 means that the rule in column 3 is only applicable to the product described in column 2. The rule in column 3 provides for a limitation on the use of other non-originating material in the manufacturing of cane or beet sugar; that is, the mixing of flavorings, colorings, and non-originating sugar with originating sugar is allowed up to 30 percent of the value of the finished product. (See Table 3.10.)

The rule of origin for Chapter 16 requires that the meat or the fish used in the manufacturing of food preparations like canned meat or fish is already originating; that is, the use of imported meat or fish is not allowed. (See Table 3.11.)

The rule of origin for garments, shown in Table 3.12, classified in Chapter 62 and described in column 2 is that the manufacturing operations have to start from yarn; that is, the use of imported fabric to manufacture garments of Chapter 62 is not

TABLE 3.10 *CTC requirements and percentage rules*

HS heading no.	Description of product	Working or processing carried out on non-originating materials that confers originating status	
(1)	(2)	(3) or	(4)
ex 1701	Cane or beet sugar and chemically pure sucrose, in solid form, containing added flavouring or colouring matter	Manufacture in that the value of any materials of Chapter 17 used does not exceed 30% of the ex-works price of the product	

TABLE 3.11 *Specific manufacturing processes or requirements*

HS heading no.	Description of product	Working or processing carried out on non-originating materials that confers originating status	
(1)	(2)	(3) or	(4)
Chapter 16	Preparations of meat, of fish or of crustaceans, molluscs or other aquatic invertebrates	Manufacture from animals of Chapter 1 and/or in which all the materials of Chapter 3 used are wholly obtained	

TABLE 3.12 *Textile rules mainly involving products classified in ex-heading and basket rule headings*

HS heading no.	Description of product	Working or processing carried out on non-originating materials that confers originating status	
(1)	(2)	(3) or	(4)
Ex-Chapter 62	Articles of apparel and clothing accessories, not knitted or crocheted except for:	Manufacture from yarn	
ex 6202, ex 6204, ex 6206, ex 6209 and ex 6211	Women's, girls' and babies' clothing and clothing accessories for babies, embroidered	Manufacture from yarn	Manufacture from unembroidered fabric provided that the value of the unembroidered fabric used does not exceed 40% of the ex-works price of the product

considered an origin-conferring event. This rule is often referred as a double processing requirement since in order to acquire origin two manufacturing operations are required: (1) weaving the yarn into fabric and (2) cut the fabric to shape and sew it together into finished garments. In the case of women's, girls', and babies' clothing an alternative rule is provided where the use of unembroidered fabric is allowed subject to a percentage requirement.

The PEM Convention introduced alternative percentage rules for some products classified in Chapters 28, 29, 31–39, 84–91, and 94. An example of such alternative rules is shown in Table 3.13 where for "Other monitors and projectors," one rule allows a higher value of non-originating materials (40 percent) but places a limitation on the value of non-originating material used that should not exceed the value of originating materials. The alternative rule of origin in column 4 does not contain this latter limitation but allows a lower allowance of non-originating material (25 percent).

TABLE 3.13 *Alternative rules of origin* in addition to the usual rules – an example

HS heading no.	Description of product	Working or processing carried out on non-originating materials that confers originating status	
(1)	(2)	(3) or	(4)
8528	Monitors and projectors, not incorporating television reception apparatus; reception apparatus for television, whether or not incorporating radio-broadcast receivers or sound or		
	– Monitors and projectors, not incorporating television reception apparatus, of a kind solely or principally used in an automatic data-processing system of heading 8471	Manufacture in which the value of all the materials used does not exceed 40% of the ex-works price of the product	
	– Other monitors and projectors, not incorporating television reception apparatus; reception apparatus for television, whether or not incorporating radio broadcast receivers or sound or video recording or reproducing apparatus;	Manufacture: – in which the value of all the materials used does not exceed 40% of the ex-works price of the product – where the value of all the non-originating materials used does not exceed the value of the originating materials used	Manufacture in which the value of all the materials used does not exceed 25% of the ex-works price of the product

3.4.1.3.4 ADDITIONAL FEATURES OF THE PAN-EURO-MEDITERRANEAN RULES OF ORIGIN. **Relaxation of the Principle of Territoriality** Rules of origin are based on a principle of territoriality, which requires that the conditions for the acquisition of originating status be fulfilled without interruption in one or more of the territories of the contracting parties. As with the introduction of a general tolerance, a provision for limited derogation from the territorial principle of up to 10 percent was introduced into the EC–EFTA/EEA agreements on January 1, 1994 in order to facilitate trade. This feature was not included, however, in any other EU preferential arrangement, except the EC–Israel Euro-Mediterranean Agreement; neither was it included in the

new protocols to the Central and Eastern European countries. This principle has however been introduced in Article 11 of the PEM Convention:

PRINCIPLE OF TERRITORIALITY

1. Except as provided for in Article 2(1)(c), Article 3 and paragraph 3 of this Article, the conditions for acquiring originating status set out in Title II shall be fulfilled without interruption in the exporting Contracting Party.
2. Except as provided for in Article 3, where originating goods exported from a Contracting Party to another country return, they shall be considered as non-originating, unless it can be demonstrated to the satisfaction of the customs authorities that:
   (a) the returning goods are the same as those exported; and
   (b) they have not undergone any operation beyond that necessary to preserve them in good condition while in that country or while being exported.
3. The acquisition of originating status in accordance with the conditions set out in Title II shall not be affected by working or processing done outside the exporting Contracting Party on materials exported from the latter Contracting Party and subsequently re-imported there, provided:
   (a) the said materials are wholly obtained in the exporting Contracting Party or have undergone working or processing beyond the operations referred to in Article 6 prior to being exported; and
   (b) it can be demonstrated to the satisfaction of the customs authorities that:
      (i) the re-imported goods have been obtained by working or processing the exported materials; and
      (ii) the total added value acquired outside the exporting Contracting Party by applying the provisions of this Article does not exceed 10% of the ex-works price of the end product for which originating status is claimed.
4. For the purposes of paragraph 3, the conditions for acquiring originating status set out in Title II shall not apply to working or processing done outside the exporting Contracting Party. However, where, in the list in Annex II, a rule setting a maximum value for all the non-originating materials incorporated is applied in determining the originating status of the end product, the total value of the non-originating materials incorporated in the territory of the exporting Contracting Party, taken together with the total added value acquired outside this Contracting Party by applying the provisions of this Article, shall not exceed the stated percentage.
5. For the purposes of applying the provisions of paragraphs 3 and 4, "total added value" means all costs arising outside the exporting Contracting Party, including the value of the materials incorporated there.
6. The provisions of paragraphs 3 and 4 shall not apply to products which do not fulfil the conditions set out in the list in Annex II or which can be considered sufficiently worked or processed only if the general tolerance fixed in Article 5(2) is applied.

7. The provisions of paragraphs 3 and 4 shall not apply to products of Chapters 50 to 63 of the Harmonised System.
8. Any working or processing of the kind covered by the provisions of this Article and done outside the exporting Contracting Party shall be done under the outward processing arrangements, or similar arrangements.

No-Drawback Rule The no-drawback rule refers to a provision included in the EEA Agreements, the bilateral EC–EFTA Agreement and the Stockholm Convention establishing EFTA, but not in the old generation of Mediterranean Agreements.[85] This procedure is a common customs procedure whereby imported inputs for further manufacturing and re-export are not charged any customs duty in the country of manufacturing. The no-drawback rule prohibits such customs procedure.

In practice, the possible consequences of the absence of the no-drawback rule in the FTA agreements are best described by an old example provided by the EU Commission in the context of the former Europe agreements:

> Alternators destined for the EC market are manufactured in Poland from components originating in Taiwan. Without a no-drawback rule, no customs duty is paid on the components in Poland. Neither is any customs duty paid in the EC, for the alternators are considered to originate in Poland within the meaning of the Europe Agreement. If the alternators had been manufactured in the EC and put onto the EC market, the Taiwanese components would have been subject to 5.6 per cent customs duty. Similarly, Polish manufacturers would have to pay customs duties on components imported from Asia and used in the manufacture of a product destined for the Polish market, whereas an EC manufacturer would avoid paying duties for the same components when the manufactured product was exported to Poland.[86]

The absence of a no-drawback rule may thus lead to undesired effects such as tariff circumvention, and is also an incentive to import third-country materials rather than utilize the inputs originating in the FTA – that is, exactly the situation that the EU wishes to avoid. The issue of drawback in FTAs is further discussed in Chapter 7, section 7.1.3.5.

This rule was originally not included in the Euro-Mediterranean agreements with Tunisia, Morocco, and Algeria. It was later introduced in the Protocol of Tunisia and Morocco.[87]

[85] The no-drawback clause was included in the protocol on rules of origin attached to the Euro-Mediterranean Association Agreements with Israel, Tunisia, and Morocco.

[86] Commission Communication SEC(94) 1897 final (fn. 70 above).

[87] This rule was included in the Euro-Mediterranean agreements with Israel, PLO, Egypt, Lebanon, Jordan, and Algeria. Four agreements also provided for the suspension of this rule for a certain period of time after the entry into force of the agreement itself; that is, in the agreements with Egypt, Lebanon, and Algeria this period is six years and in the agreement with Jordan it is four years. This means that this rule was not applicable respectively until December

As provided for in Article 14, the PEM Convention also applies a general prohibition of drawback with some flexibilities and derogations since the customs duties applicable to non-originating materials in some countries are considerably higher than those applicable in the Union and by allowing a refund to a certain level the imbalance, which could be seen as favoring EU producers, is reduced.

ARTICLE 14

Prohibition of Drawback of, or Exemption from, Customs Duties

1. Non-originating materials used in the manufacture of products originating in a Contracting Party for which a proof of origin is issued or made out in accordance with the provisions of Title V shall not be subject in the exporting Contracting Party to drawback of, or exemption from, customs duties of whatever kind.
2. The prohibition in paragraph1 shall apply to any arrangement for refund, remission or non-payment, partial or complete, of customs duties or charges having an equivalent effect, applicable in the exporting Contracting Party to materials used in the manufacture, where such refund, remission or non-payment applies, expressly or in effect, when products obtained from the said materials are exported and not when they are retained for home use there.
3. The exporter of products covered by a proof of origin shall be prepared to submit at any time, upon request from the customs authorities, all appropriate documents proving that no drawback has been obtained in respect of the non-originating materials used in the manufacture of the products concerned and that all customs duties or charges having equivalent effect applicable to such materials have actually been paid.
4. The provisions of paragraphs 1, 2 and 3 of this Article shall also apply in respect of packaging within the meaning of Article 7(2), accessories, spare parts and tools within the meaning of Article 8 and products in a set within the meaning of Article 9 when such items are non-originating.
5. The provisions of paragraphs 1 to 4 shall apply only in respect of materials which are of the kind to which the relevant Agreement applies.
6. (a) The prohibition in paragraph 1 of this Article shall not apply in bilateral trade between one of the Contracting Parties referred to in Article 3(1)[88]

31, 2010 for Egypt, until February 28, 2009 for Lebanon, until April 30, 2006 for Jordan, and until August 31, 2011 for Algeria. At the end of this period, the agreements with Lebanon, Egypt, and Algeria provide for the application of partial drawback, which implies the payment of a partial duty rate (10 percent for textile products and 5 percent for all the other products, excluding agricultural products) on non-originating materials imported from a third country. Even though the agreement with the PLO provides for the application of this rule from January 1, 2000, it was suspended. The Morocco and Tunisia protocol on origin allowed for partial drawback for a limited period.

[88] The parties referred to in Article 3(1) are Switzerland (including Liechtenstein), Iceland, Norway, Turkey, and the EU.

with one of the Contracting Parties referred to in Article 3(2),[89] excluding Israel, the Faroe Islands and the participants in the European Union's Stabilisation and Association Process, if the products are considered as originating in the exporting or importing Contracting Party without application of cumulation with materials originating in one of the other Contracting Parties referred to in Article 3.

(b) The prohibition in paragraph 1 of this Article shall not apply in bilateral trade between Egypt, Jordan, Morocco and Tunisia, if the products are considered as originating in one of these countries without application of cumulation with materials originating in one of the other Contracting Parties referred to in Article 3.

7. Notwithstanding paragraph 1, the exporting Contracting Party may, except for products falling within Chapters 1 to 24 of the Harmonised System, apply arrangements for drawback of, or exemption from, customs duties or charges having an equivalent effect, applicable to non-originating materials used in the manufacture of originating products, subject to the following provisions:

(a) a 4% rate of customs charge shall be retained in respect of products falling within Chapters 25 to 49 and 64 to 97 of the Harmonised System, or such lower rate as is in force in the exporting Contracting Party;

(b) an 8% rate of customs charge shall be retained in respect of products falling within Chapters 50 to 63 of the Harmonised System, or such lower rate as is in force in the exporting Contracting Party.

The provisions of this paragraph shall not be applied by the Contracting Parties listed in Annex V.[90]

8. The provisions of paragraph 7 shall apply until 31 December 2012 and may be reviewed by common accord.

As provided in paragraphs 6 and 7, Article 13 provides for a number of exceptions to the general prohibition of drawback, provided that drawback is applied under bilateral trade.[91]

Examples

1. Example of the Possibility of Drawback in Bilateral Trade

Aluminum originating from the United Arab Emirates is imported into Egypt where aluminum screws (HS 7616) are manufactured. The final product originating in Egypt is exported to the Community.

Since Egyptian originating status is obtained on the basis of sufficient working and processing and not on the basis of cumulation with materials originating in one of the countries referred to in Articles 3 and 4, Egyptian customs authorities can grant drawback

[89] Faroe Islands, any participant in the Barcelona Process other than Turkey, or any Contracting Party other than those referred to in para. 1 of this Article.

[90] Faroe Islands, any participant in the Barcelona Process other than Turkey, or any Contracting Party other than those referred to in para. 1 of this Article.

[91] Ceuta and Melilla.

for non-originating materials used in the manufacture of the originating products when it is exported to the Community.

However, the screws cannot be used in the Community for the purpose of pan-Euro-Mediterranean cumulation. In this example the screws originating in Egypt can only be exported to the Community with a movement certificate EUR.1 or an invoice declaration.

2. *Example of the Prohibition of Drawback in Diagonal Trade*

Oranges from Costa Rica (HS 0805) and sugar originating in the EC (HS 1701) are imported into Jordan where orange juice (2009) is produced. The value of the EC originating sugar exceeds 30 percent of the ex-works price. The Jordanian originating product is exported to Egypt. Since the origin of the final product is obtained in Jordan on the basis of cumulation with one of the countries referred to in Article 3 and 4, in this case the EC, the non-originating materials cannot be subject in Jordan to drawback of, or exemption from, customs duties of whatever kind. Thus, if a preferential proof of origin is made out in Jordan, customs duties need to be paid on the oranges originating in Costa Rica. In this example the product originating in Jordan can be only exported to Egypt with a movement certificate EUR-MED or an invoice declaration EUR-MED. Moreover, the juice can be re-exported in the context of diagonal cumulation from Egypt to other countries referred to in Articles 3 and 4. [The use of movement certificates EUR.1 and EUR-MED is explained in Chapter 7 of this book.]

3.4.1.3.5 INSUFFICIENT WORKING OR PROCESSING. In some cases, some manufacturing processes are considered irrelevant or insufficient in order for the final product to obtain originating status. The common rules of origin usually provide a list of what is considered insufficient working or processing (see Article 6 of the PEM Convention):

1. Without prejudice to paragraph 2, the following operations shall be considered as insufficient working or processing to confer the status of originating products, whether or not the requirements of Article 5 are satisfied:
   (a) preserving operations to ensure that the products remain in good condition during transport and storage;
   (b) breaking-up and assembly of packages;
   (c) washing, cleaning; removal of dust, oxide, oil, paint or other coverings;
   (d) ironing or pressing of textiles;
   (e) simple painting and polishing operations;
   (f) husking, partial or total bleaching, polishing, and glazing of cereals and rice;
   (g) operations to colour sugar or form sugar lumps;
   (h) peeling, stoning and shelling, of fruits, nuts and vegetables;
   (i) sharpening, simple grinding or simple cutting;
   (j) sifting, screening, sorting, classifying, grading, matching (including the making up of sets of articles);
   (k) simple placing in bottles, cans, flasks, bags, cases, boxes, fixing on cards or boards and all other simple packaging operations;
   (l) affixing or printing marks, labels, logos and other like distinguishing signs on products or their packaging;

(m) simple mixing of products, whether or not of different kinds;
(n) mixing of sugar with any material;
(o) simple assembly of parts of articles to constitute a complete article or disassembly of products into parts;
(p) a combination of two or more operations specified in (a) to (n);
(q) slaughter of animals.

2. All operations carried out in the exporting Contracting Party on a given product shall be considered together when determining whether the working or processing undergone by that product is to be regarded as insufficient within the meaning of paragraph 1.

Insufficient working or processing is sometimes referred to (although not in the legislation) as minimal processing or minimal operations.

Certain processes are considered as having such a minor effect on the finished product that they can never be regarded as conferring originating status, whether carried out individually or in a combination of processes. Simply put, those operations prevent the acquisition of origin; in the context of cumulation, such operations do not confer the origin of the country where they are carried out on goods.

Examples[92]

(i) *Raw coffee is imported in bulk into the Community from Colombia. The origin rule for coffee is "manufacture from materials of any heading." In the EU, it is dusted, sorted, and split up into different packaging. As neither dusting nor splitting up and repackaging are sufficient operations to confer origin, the coffee retains its Colombian origin.*

(ii) *Raw coffee is imported in bulk into the Community from Colombia. In the EU it is dusted, roasted, ground, sorted and split up into different packaging. As the operations carried out in the Community are sufficient to confer origin ("manufacture from materials of any heading"), the coffee obtains Community origin.*

The first example details a combination of three minimal operations being carried out on the raw coffee. As has already been stated, such operations whether carried out singly or in a combination do not confer origin. Therefore, the coffee retains its Colombian origin.

In the second example the coffee has not only been dusted and split up into different packaging, but also has also been significantly processed. Therefore,

[92] The examples are excerpted from "A User's Handbook to the Rules of Preferential Origin used in trade between the European Community, other European Countries and the countries participating to the Euro-Mediterranean Partnership," https://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/customs/customs_duties/rules_origin/preferential/handbook_en.pdf. This handbook refers to the rules of origin contained in the previous Euro-Mediterranean Agreement and has not been updated following the entry into force of the PEM Convention. The examples have been adapted to the new PEM Convention where applicable.

although some minimal operations have been carried out the more substantial processing must also be considered and it is that processing which, because it fulfils the rule listed in Annex II, results in the end product obtaining Community origin.

Article 6 of the PEM Convention reported above sets out those processes carried out on non-originating materials which singly or in combination do not confer origin. The list is exhaustive but should be interpreted in the broadest sense. For example, sifting or screening can be carried out on both foodstuffs as well as on industrial products.

Examples

(i) *Perfume of Community origin is exported in vats from Austria to Morocco where it is decanted into EU originating bottles and packaged into EU originating packaging. As both operations carried out in Morocco are deemed to be insufficient for conferring Moroccan origin or Czech origin, the final packaged product will retain its Community origin.*

However, in this case another aspect must be considered. If the bottles and/or the packaging are wholly obtained in Morocco or have obtained Moroccan origin their value would have to be taken into account when determining the origin of the final product.

(ii) *The components of a sewing set having German origin are exported to Morocco where they are assembled into sets and put into plastic sleeves and packaged.*

Neither of the operations carried out in Morocco are sufficient to confer Moroccan origin, therefore the packaged sets retain their Community origin. However, the origin of the plastic sleeve and the packaging may have a bearing on the final origin of the finished product.

It is clear from these examples that neither the perfume nor the components for the sets have undergone any working or processing which has resulted in them being changed in any way.

The perfume remains perfume. The components of the set have only been assembled into sets and have not been changed in any way. However, the value of the local input into the final product in both instances must also be considered due to the containers and packaging being manufactured in the partner country. Whilst the operation of filling bottles or packaging alone will not confer origin the other elements must be considered in order to have a balanced view of the production costs of the overall final product.

3.4.1.3.6 EXPLANATORY NOTES IN THE LIST OF PRODUCTS SPECIFIC TO THE PEM CONVENTION. Given the complexity encountered in interpreting the rules of origin, the inclusion of explanatory notes in the PEM Convention containing product-specific rules could be regarded as particularly welcome.

Such notes are particularly relevant and important in determining the origin of the intermediate material used in the manufacturing of a final product. Note 3 provides the following:

Note 3:

3.1. The provisions of Article 5 of this Appendix, concerning products having acquired originating status which are used in the manufacture of other products, shall apply regardless of whether this status has been acquired inside the factory where these products are used or in another factory in a Contracting Party.

Example: An engine of heading 8407, for which the rule states that the value of the non-originating materials which may be incorporated may not exceed 40% of the ex-works price, is made from "other alloy steel roughly shaped by forging" of heading ex-7224. If this forging has been forged in the European Union from a non-originating ingot, it has already acquired originating status by virtue of the rule for heading ex-7224 in the list. The forging can then count as originating in the value-calculation for the engine, regardless of whether it was produced in the same factory or in another factory in the European Union. The value of the non-originating ingot is thus not taken into account when adding up the value of the non-originating materials used.

The concepts expressed in Note 3 of the explanatory notes are the following: if an intermediate product acquires originating status before being incorporated in the final product, the non-originating material in the intermediate product should obviously not be counted as an imported input.

Only recently following the progressive adoption of the "pan-European" rules of origin, this principle has been openly reflected in the main text of the protocols (see, for instance, Article 3 of the PEM Convention).

Other explanatory notes refer to textile articles and their accessories, as contained in the PEM Convention Introductory Notes 6.1, 6.2, and 6.3:

6.1. Where, in the list, reference is made to this Note, textile materials (with the exception of linings and interlinings), which do not satisfy the rule set out in the list in column 3 for the made-up product concerned, may be used, provided that they are classified in a heading other than that of the product and that their value does not exceed 8% of the ex-works price of the product.

6.2. Without prejudice to Note 6.3, materials, which are not classified within Chapters 50 to 63, may be used freely in the manufacture of textile products, whether or not they contain textiles.

Example: If a rule in the list provides that, for a particular textile item (such as trousers), yarn must be used, this does not prevent the use of metal items, such as

buttons, because buttons are not classified within Chapters 50 to 63. For the same reason, it does not prevent the use of slide-fasteners, even though slide-fasteners normally contain textiles.

6.3. Where a percentage rule applies, the value of materials which are not classified within Chapters 50 to 63 must be taken into account when calculating the value of the non-originating materials incorporated.

3.4.1.3.7 PROGRESSIVE ADOPTION OF THE DIAGONAL CUMULATION UNDER THE PAN-EUROPEAN RULES OF ORIGIN DURING THE 1990S. The provisions on cumulation under the PEM Convention are the result of a long process that started in the 1990s.

Under the strategy for the implementation of the Pan-European Rules of Origin adopted at the Essen Council of 1994, the progressive simplification and harmonization arrangements were carried out by replacing the original Protocol of the Europe Agreements by a new Protocol extending diagonal cumulation to Baltic countries (Latvia, Lithuania, and Estonia), Romania, Bulgaria, Iceland, Norway, and Switzerland. The Protocol aligned to the EEA Protocol contained the no-drawback rule, a revised single list and simplified provisions for origin administration and documentary evidence. The progressive implementation of the "pan-European" rules of origin entailed the amendment of the original protocols, including those attached to the EEA Agreement,[93] the former Europe Agreements with the Czech Republic, the Slovak Republic,[94] Lithuania,[95] Poland,[96] Hungary,[97]

[93] See EEA Joint Committee Decision 71/96 amending Protocol 4 to the EEA Agreement on Rules of Origin, OJ L21 (1997).

[94] Decision 2/97 (97/483/ECSC, EC, Euratom) of the Association Council, association between the European Communities and their member-states, of the one part, and the Slovak Republic, of the other part of 9 January 1997 amending Protocol 4 to the Europe Agreement establishing an association between the European Communities and their member-states, of the one part, and the Slovak Republic, of the other part, OJ L212 (1997).

[95] Decision 1/97 (97/30/ECSC, EC, Euratom) of the Joint Committee, between the European Communities, of the one part, and the Republic of Lithuania, of the other part of 25 February 1997 amending Protocol 3 to the Agreement on free trade and trade-related matters between the European Community, the European Atomic Energy Community and the European Coal and Steel Community, of the one part, and the Republic of Lithuania, of the other part, OJ L136 (1997).

[96] Decision 1/97 (97/593/ECSC, EC, Euratom) of the Association Council, association between the European Communities and their member-states, of the one part, and the Republic of Poland, of the other part of 30 June 1997 amending Protocol 4 to the Europe Agreement establishing an association between the European Communities and their member-states, of the one part, and the Republic of Poland, of the other part, OJ L221 (1997).

[97] Decision 3/96 (96/230/ECSC, EC, Euratom) of the Association Council, association between the European Communities and their member-states, of the one part, and the Republic of Hungary, of the other part of 28 December 1996 amending Protocol 4 to the Europe

Romania,[98] and Bulgaria.[99] The Association Agreement with Slovenia[100] directly adopted the Protocol.

The accession to the EU of the Czech Republic, Estonia Cyprus, Latvia, Lithuania, Hungary, Malta, Poland, Slovenia, the Slovak Republic, Romania, and Bulgaria meant a geographical redistribution of the application of Pan-European Rules of Origin. The pan-European cumulation system created in 1997 on the basis of the EEA agreement (1994) between the EC, the EFTA countries, the CEEC countries, and the Baltic states was applicable between the Community, the member states of EFTA (Iceland, Liechtenstein, Norway, and Switzerland), Bulgaria, Romania, and Turkey.

At the same time, the approval by the EU Council of Ministers of the implementation of a system of a Pan-Euro-Mediterranean cumulation entailed the progressive replacement of the origin protocols contained in the EEA, Euro-Mediterranean agreements, and the Europe Agreement with Bulgaria and Romania.

3.4.1.3.8 FROM PAN-EUROPEAN RULES OF ORIGIN UNDER THE EUROPE AGREEMENTS TO THE SYSTEM OF EURO-MEDITERRANEAN CUMULATION UNDER THE PEM CONVENTION: DIFFERENCES OF DIAGONAL AND FULL CUMULATION. The implementation of the Pan-European Rules of Origin started with a first amendment made to the Protocol on Rules of Origin of the EEA introducing full cumulation[101] among EEA contracting parties and adopting diagonal cumulation between EEA contracting parties, CEEC countries, and Switzerland. The main differences between the EEA Protocol and the Protocol later adopted by all CEEC

Agreement establishing an association between the European Communities and their member-states, of the one part, and the Republic of Hungary, of the other part, OJ L92 (1997).

[98] Decision 1/97 (97/127/ECSC, EC, Euratom) of the Association Council, association between the European Communities and their member-states, of the one part, and Romania, of the other part of 31 January 1997 amending Protocol 4 to the Europe Agreement establishing an association between the European Communities and their member-states, of the one part, and Romania, of the other part, OJ L54 (1997).

[99] Decision 1/97 (97/302/ECSC, EC, Euratom) of the Association Council, association between the European Communities and their member-states, of the one part, and the Republic of Bulgaria, of the other part of 6 May 1997 amending Protocol 4 to the Europe Agreement establishing an association between the European Communities and their member-states, of the one part, and the Republic of Bulgaria, of the other part, OJ L134 (1997).

[100] Council and Commission Decision, 96/752/Euratom, ECSC, EC, of 25 November 1996 on the conclusion of the Interim Agreement on trade and trade-related matters between the European Community, the European Coal and Steel Community and the European Atomic Energy Community, of the one part, and the Republic of Slovenia, of the other part, OJ L344 (1996).

[101] See Article 2, Title II, of the EEA Joint Committee Decision 71/96: "A product shall be considered to be originating in the EEA within the meaning of this Agreement if it has been either wholly obtained there within the meaning of article 4 or sufficiently worked or processed in the EEA within the meaning of article 5. For this purpose, the territories of the Contracting Parties to which this Agreement applies, shall be considered as a single territory."

countries was the relaxation of the principle of territoriality,[102] the full cumulation among EEA countries, and some administrative procedures. Such architecture of having full cumulation within the EEA and diagonal cumulation with the remaining parties has remained one of the constant features of the evolution of the EU rules of origin.[103]

The second step of the implementation was to replace the original protocols contained in the Europe agreement with the new Protocol containing the Pan-European Rules of Origin and the diagonal cumulation.

In the case of the Mediterranean countries the first kind of regional cumulation granted by the EC was originally limited to the Maghreb countries (Algeria, Morocco, and Tunisia), and was contained in the agreements concluded in the 1970s. The cumulative option for other Mediterranean countries such as Lebanon and Egypt was limited to the "bilateral cumulation" with the EC.

Upon adoption of the Pan-European Rules of Origin strategy the Euro-Mediterranean Association Agreements with Morocco, Tunisia, and Israel started to be the subject of the Commission's harmonization effort, with mixed results.[104] Thus, the Protocols on Rules of Origin attached to these Agreements were partially modeled according to the new EEA Protocol and are substantially similar to the new Protocol adopted by CEEC countries. However, many differences remained after the first effort of harmonization:

(1) the maintenance of the CTH rule as central criterion (Article 7, paragraph 1, of the Tunisian Euro-Med)
(2) the granting of full cumulation to countries of the Maghreb Union[105] (Algeria, Morocco and Tunisia)
(3) the non-inclusion of the no-drawback clause in the Tunisia and Morocco Agreements[106]

[102] See Article 11, paras. 3 to 7, of the EEA Joint Committee Decision 71/96. The principle of territoriality is also contained in the Euro-Mediterranean Agreement with Israel. This difference in respect of the other Euro-Mediterranean Agreements with Tunisia and Morocco and the CEEC is partly explained by the fact that a similar provision was contained in the earlier agreements of the 1970s.

[103] With the exception of the issue of full cumulation among Tunisia, Morocco, and Algeria, discussed further in this section.

[104] The Commission's harmonization process continued during the negotiations with other Mediterranean countries (Algeria, Egypt, Jordan, Lebanon, and the Syrian Arab Republic), together with the necessary amendments to the already signed Euro-Mediterranean Agreements with Israel, Morocco, and Tunisia. This latter consideration holds particularly true when it is remembered that the European Community Barcelona Ministerial Conference considered the extension of diagonal cumulation between CEC and Mediterranean countries.

[105] Full cumulation was also granted to Algeria, Morocco, and Tunisia under the former Cooperation Agreements.

[106] The non-inclusion of the no-drawback clause will require an additional harmonization effort to bring these agreements into line with the CEEC Protocols.

(4) the inclusion of the relaxation of the principle of territoriality and the no-drawback clause in the Israel Agreement[107]
(5) other differences concerning the single list, simplified procedure for the issuance of Form EUR.1 and the cumulation administrative procedures.

The concept of diagonal cumulation introduced by the Pan-European Rules of Origin was also rather complex to understand and appreciate in the legal drafting of the Agreements. It is therefore extremely interesting to understand and compare the wording used. A comparison among provisions in the former EU–Slovak Agreement[108] and the former EU–Tunisia Agreement may better clarify where the differences in the wording define diagonal and full cumulation. Such wording is in fact used by the EU not only in the context of the Pan-European Rules of Origin or the PEM Convention but also in all free-trade agreements that the EU has entered into the last decades.

Under the Protocol to the Slovak Agreement adopting the Pan-European Rules of Origin, Article 4 spelled out the following conditions for diagonal cumulation:

1 Without prejudice to the provisions of Article 2(2), products shall be considered as originating in the Slovak Republic if such products are obtained there, incorporating *materials originating in Bulgaria, Switzerland (including Liechtenstein*[109]*), the Czech Republic, Estonia, Hungary, Iceland, Lithuania, Latvia, Norway, Poland, Romania, Slovenia, the Slovak Republic, Turkey*[110] or in the Community in accordance with the provisions of the Protocol on Rules of Origin annexed to the Agreements between the Slovak Republic and each of these countries, provided that the working or processing carried out in the Slovak Republic goes beyond the operations referred to in Article 7. It shall not be necessary that such materials have undergone sufficient working or processing.
2 Where the working or processing carried out in the Slovak Republic does not go beyond the operations referred to in Article 7, the product obtained shall be considered as originating in the Slovak Republic only where the value-added there is greater than the value of the materials used originating in any one of the other countries referred to in paragraph 1. If this is not so, the product obtained shall be considered as originating in the country which accounts for

[107] The relaxation of the principle of territoriality and the no-drawback clause was already contained in the former European Community–Israel Agreement.
[108] The examples in the following section refer to the original protocol on rules of origin of the EC–Slovak Republic Agreement, O.J. L 360 (1994). The new protocol on rules of origin will be discussed in detail in the following section.
[109] The principality of Liechtenstein has a customs union with Switzerland, and is a Contracting Party to the Agreement on the EEA.
[110] Cumulation as provided for in this article does not apply to materials originating in Turkey that are mentioned in the list at Annex V.

the highest value of originating materials used in the manufacture in the Slovak Republic.

3 Products, originating in one of the countries referred to in paragraph 1, which do not undergo any working or processing in the Slovak Republic, retain their origin if exported into one of these countries.

4 The cumulation provided for in this Article may only be applied where the materials used have acquired the status of originating products by an application of rules of origin identical to the rules of origin in this Protocol.

5 The Slovak Republic shall provide the Community, through the European Commission, with details of the Agreements and their corresponding rules of origin, which are applied with the other countries referred to in paragraph 1.

The highlighted words in the above excerpt emphasize the fact that the cumulation was allowed only with "materials originating in Bulgaria, Switzerland (including Liechtenstein), the Czech Republic, Estonia, Hungary, Iceland, Lithuania, Latvia, Norway, Poland, Romania, Slovenia, the Slovak Republic, Turkey." This means that the materials must have already acquired their originating status in those countries according to the rules contained in the single list before being used as inputs for further manufacturing in the Slovak Republic. According to this reasoning, if these materials have undergone working or processing in their own country which is insufficient for the acquisition of originating status, they cannot be considered as originating materials and will be considered as imported inputs which have to comply with the specific rule of origin.

Full cumulation is usually expressed through different wording in the EU rules of origin especially mentioning that not only "materials originating" can be used as inputs but also "working and processing" carried out in other countries could be considered as an input. Article 5 of the former Protocol of the Euro-Mediterranean Tunisian Agreement provides for full cumulation and further clarifies the difference between that form of cumulation and diagonal cumulation.

Article 5:

1 For the purpose of implementing Article 2(1)(b), working or processing carried out in Tunisia, or when the conditions required by Article 4, paragraphs 3 and 4 are fulfilled in Algeria or in Morocco shall be considered as carried out in the Community, when the products obtained undergo subsequent working or processing in the Community.

2 For the purpose of implementing Article 2(2)(b), working or processing carried out in the Community or when the conditions required by Article 4, paragraphs 3 and 4 are fulfilled in Algeria or in Morocco shall be considered as carried out in Tunisia, when the products obtained undergo subsequent working or processing in Tunisia.

TABLE 3.14 *Granting of full cumulation*

Allocation of origin in the Tunisian Agreement	Allocation of origin in the Slovak Agreement
4. "where the originating products are obtained in two or more of the States referred to in these provisions or in the Community, they shall be considered as originating products of the State or the Community according to where the last working or processing went beyond that referred to in Article 8 (insufficient working or processing)."	Article 3, paragraph 2: "Products which have acquired originating status by virtue of paragraph 1 shall only be considered as products originating in the Community or in the Slovak Republic when the value added there exceeds the value of the materials used originating in Poland, Hungary or the Slovak Republic. If this is not so, the products concerned shall be considered, for the purpose of implementing this Agreement or the Agreements between the Community and Poland, Hungary and the Slovak Republic, as originating in Poland, Hungary or the Slovak Republic, according to which of these countries accounts for the highest value of originating materials used."

Thus, according to Article 5, paragraph 1, any amount of working or processing carried out in Tunisia, the EU, Algeria, and Morocco, could be cumulated to comply with the origin requirement.

The granting of full cumulation to the Maghreb countries also entailed a difference in wording and substance with regard to the allocation of origin when more than one country has been involved in the manufacturing, in respect of the wording used in the Slovak Protocol. These differences are summarized in Table 3.14.

Thus, during the process of harmonizing rules of origin in European trade agreements with third countries, the abovementioned full cumulation system among the Maghreb countries was retained in the Euro-Mediterranean Association Agreements in spite of the widespread adoption of the diagonal rules of origin under the Europe agreements. This represented a transitional exception to the harmonization efforts under the Pan-European Rules of Origin that finally found its way also into the PEM Convention where full cumulation among Algeria, Morocco, and Tunisia has been maintained.[111]

The Protocol to the EU–Moroccan Agreement provided for the bilateral cumulation of origin between the Community and Tunisia, and for full cumulation of origin between the Community, Tunisia, Algeria, and Morocco and harmonization of many of the previous inconsistencies.

The Protocol extended cumulation to use materials originating in the Community, Bulgaria, Romania, Iceland, Norway, Switzerland (including

[111] See Annexes II, III, and IV of the PEM Convention.

Liechtenstein), the Faroe Islands, Turkey, or in any other country that is a participant in the Euro-Mediterranean partnership, based on the Barcelona Declaration (Algeria, Egypt, Israel, Jordan, Lebanon, Syria, Tunisia, West Bank, and Gaza strip).

However, this extended system of cumulation was applicable between the countries which fulfilled the necessary conditions that may be summarized as follows: (1) the countries must have concluded an FTA agreement and (2) the provisions on rules of origin contained in the Protocol also apply in the context of the free-trade agreements entered between the countries.

Paragraph 2 of Article 2 of the Protocol on Origin to the Euro-Mediterranean Agreement with Morocco provided for the general origin requirements:

GENERAL REQUIREMENTS

1 For the purpose of implementing the Agreement, the following products shall be considered as originating in the Community:
   (a) products wholly obtained in the Community within the meaning of Article 5;
   (b) products obtained in the Community incorporating materials which have not been wholly obtained there, provided that such materials have undergone sufficient working or processing in the Community within the meaning of Article 6;
   (c) goods originating in the European Economic Area (EEA) within the meaning of Protocol 4 to the Agreement on the European Economic Area.

2 For the purpose of implementing the Agreement, the following products shall be considered as originating in Morocco:
   (a) products wholly obtained in Morocco within the meaning of Article 5;
   (b) products obtained in Morocco incorporating materials which have not been wholly obtained there, provided that such materials have undergone sufficient working or processing in Morocco within the meaning of Article 6.

3 The provisions of paragraph 1(c) shall apply only provided a free trade agreement is applicable between, on the one hand, Morocco and, on the other hand, the EEA EFTA States (Iceland, Liechtenstein and Norway).

In practice Article 2 reflected the usual drafting of the general requirement of other protocols, with the exception of the introduction of products originating in the EEA subject to the provision of paragraph 3 requiring the existence of a free-trade agreement among EEA and Morocco to make this kind of cumulation operational.

Paragraphs 1–4 of Article 4 (Cumulation in Morocco) of the Protocol provided for the application of the diagonal cumulation.

In particular paragraph 1 provided for diagonal cumulation among Morocco and Bulgaria, Switzerland, Iceland, Norway, Romania, Turkey, and the EU. Paragraph

2 provides for diagonal cumulation among Morocco, the Faroe Islands, and the other Mediterranean countries.

DIAGONAL CUMULATION IN MOROCCO

1 Without prejudice to the provisions of Article 2(2), products shall be considered as originating in Morocco if they are obtained there, incorporating materials originating in Bulgaria, Switzerland (including Liechtenstein) (1), Iceland, Norway, Romania, Turkey or in the Community, provided that the working or processing carried out in Morocco goes beyond the operations referred to in Article 7. It shall not be necessary for such materials to have undergone sufficient working or processing.
2 Without prejudice to the provisions of Article 2(2), products shall be considered as originating in Morocco if they are obtained there, incorporating materials originating in the Faroe Islands or in any country which is a participant in the Euro-Mediterranean partnership, based on the Barcelona Declaration adopted at the Euro-Mediterranean Conference held on 27 and 28 November 1995, other than Turkey, provided that the working or processing carried out in Morocco goes beyond the operations referred to in Article 7. It shall not be necessary that such materials have undergone sufficient working or processing.

Paragraphs 3 and 4 of Article 4 provided for an allocation of origin criterion when more than one country is involved in the manufacturing of a finished product. In this context it may be reminded that Article 7, quoted in paragraph 3, refers to minimal working or processing operations:

3. Where the working or processing carried out in Morocco does not go beyond the operations referred to in Article 7, the product obtained shall be considered as originating in Morocco only where the value added there is greater than the value of the materials used originating in any one of the other countries referred to in paragraphs 1 and 2. If this is not so, the product obtained shall be considered as originating in the country which accounts for the highest value of originating materials used in the manufacture in Morocco.
4. Products originating in one of the countries referred to in paragraphs 1 and 2 which do not undergo any working or processing in Morocco shall retain their origin if exported in to one of these countries.

In order to fully appreciate the application of the Euro-Mediterranean Cumulation, two concepts have to be further discussed and explained:

Allocation of Origin As in the case of regional cumulation under the EU GSP rules of origin, in general, the origin of the final product will be determined through

the "last working or processing" carried out provided that the operations carried out go beyond minimal processing or working operations.

If, in the country of final manufacture, the originating materials from one or more countries are not subject to working or processing going beyond minimal operations, the origin of the final product shall be allocated to the country contributing the highest value. For this purpose, the value added in the country of final manufacture – including the value of non-originating materials which have been sufficiently processed – is compared with the value of the materials originating in each one of the other countries (as provided in paragraph 3 above).

If no working or processing is carried out in the country of export, the materials or products simply retain their origin if they are exported to one of the countries concerned.

Variable Geometry Another concept introduced under the Euro-Mediterranean cumulation is variable geometry. Under this rule, cumulation can only be applied if the countries of final manufacture and of final destination have concluded free trade agreements, containing identical rules of origin, with all the countries participating in the acquisition of originating status; that is, with all the countries from which all the materials used originate. Materials originating in the country which has not concluded an agreement with the countries of final manufacture and of final destination shall be treated as non-originating.

The following examples from the *User's Handbook* explain how to determine origin according to paragraphs 3 and 4 reproduced above:

1. *Example for allocation of origin through the last working or processing carried out.*

   Fabrics (HS 5112; obtained from lambs' wool not combed or carded) originating in the Community are imported into Morocco; lining, made of man-made staple fibre (HS 5513) is originating in Norway. In Morocco, suits (HS 6203) are made up.

   The last working or processing is carried out in Morocco; the working or processing (in this case, making up suits) goes beyond operations referred to in Article 7.

   Therefore, the suits obtain Moroccan origin and can be exported to other countries with which cumulation is applicable. If in this example, there is no free trade agreement with Pan-Euro-Med rules of origin between Morocco and Norway, the variable geometry implies that the Norwegian lining would need to be treated as non-originating and thus the suits will not obtain originating status.
2. *Example for allocation of origin if the last working or processing does not go beyond minimal operations; recourse has to be taken to the highest value of the materials used in the manufacture.*

   The different parts of an ensemble, originating in two countries, are packed in the Community. The trousers and a skirt, originating in Switzerland, have a value of 180 Euros; the jacket, originating in Jordan, has a value of 100 Euros. The minimal operation ("packing") carried out in the Community costs 2 Euros. The operator uses plastic bags from Ukraine, of a value of 0,5 Euros. The ex-works price of the final product is 330 Euros.

As the operation in the Community is a minimal one the value added there has to be compared with the customs values of the other materials used in order to allocate origin:

Value added in the Community (which includes 2 Euros for the operation and 0,5 Euros for the bag) = 330 Euros (ex-works price) – (minus) 280 Euros (180+100) = 50 Euros = Community "added value"

The Swiss value (180) is higher than the value added in the Community (50) and the values of all other originating materials used (100). Therefore, the final product will have Swiss origin and can be exported to other countries with which cumulation is applicable. If in this example there was no free trade agreement with Pan-Euro-Med rules of origin between the Community and Switzerland the ensemble would have to be treated as non-originating since the Swiss input has neither been sufficiently processed nor allowed to benefit from cumulation of origin.

3. *Example for products that are exported without undergoing further working or processing.*

   A carpet, originating in the Community, is exported to Morocco and is, without undergoing further operations, exported to Syria after 2 years. The carpet does not change origin and still has Community origin upon exportation to Syria.

   In this example, a preferential proof of origin can only be issued for exportation from Morocco to Syria if the free trade agreement with Pan-Euro-Med rules of origin between the Community and Syria is in place.

Paragraph 4a provided and maintained the full cumulation provision that originally existed in the former origin protocols of Tunisia, Morocco, and Algeria examined earlier:

> 4a. For the purpose of implementing Article 2(2)(b), working or processing carried out in the Community, in Algeria or Tunisia shall be considered as having been carried out in Morocco when the products obtained undergo subsequent working or processing in Morocco. Where, pursuant to this provision, the originating products are obtained in two or more of the countries concerned, they shall be considered as originating in Morocco only if the working or processing goes beyond the operations referred to in Article 7.

Example of Cumulation of Working or Processing

Non-originating cotton yarn (HS 5205) is imported into the Community where it is woven into fabrics (HS 5208). The fabrics are then exported from the Community to Tunisia where they are cut and where men's shirts (HS 6205) are sewn.

According to the rules of cumulation of working and processing, the weaving carried out in the Community is considered as having been carried out in Tunisia. In this way the rule for HS 6205 requiring manufacture from yarn is satisfied and the men's shirts obtain originating status. However, since the originating status is obtained in a way which is not compatible with the pan-Euro-Mediterranean requirements, according to which the weaving and sewing should take place in one single country, the men's shirt cannot be exported under preferences from Tunisia to countries other than Maghreb and the EC.

Paragraph 5 provided the conditions that have to be fulfilled to make the above system of Pan-Euro-Mediterranean cumulation operational that has been maintained under the PEM Convention as further explained below:

> 5. The cumulation provided for in this Article may be applied only provided that:
> (a) a preferential trade agreement in accordance with Article XXIV of the General Agreement on Tariffs and Trade (GATT) is applicable between the countries involved in the acquisition of the originating status and the country of destination;
> (b) materials and products have acquired originating status by the application of rules of origin identical to those given in this Protocol; and
> (c) notices indicating the fulfilment of the necessary requirements to apply cumulation have been published in the Official Journal of the European Union (C series) and in Morocco according to its own procedures.
>
> The cumulation provided for in this Article shall apply from the date indicated in the notice published in the Official Journal of the European Union (C series). Morocco shall provide the Community through the Commission of the European Communities with details of the Agreements, including their dates of entry into force, and their corresponding rules of origin, which are applied with the other countries referred to in paragraphs 1 and 2.

In fact, this provision points out that the most important condition for Mediterranean countries is the fact that the system of cumulation adopted makes conditional the application of this principle on the existence of a free-trade agreement according to Article XXIV of GATT 1994 among them.[112]

Such condition has been always present since the inception of the extension of Mediterranean cumulation, as witnessed for instance by "Joint Declaration on Article 29" attached to the Jordan Agreement:

> JOINT DECLARATION ON ARTICLE 29
>
> In order to encourage the progressive establishment of a comprehensive Euro-Mediterranean free trade area, in line with the conclusions of the Cannes European Council and those of the Barcelona Conference, the Parties:
>
> – agree to provide the Protocol 3 on the definition of "originating products," for the implementation of diagonal cumulation before the conclusion and entry into force of free trade agreements between Mediterranean countries;

[112] See A. Tovias, "The European Union and Mediterranean countries," in P. Demaret, J.-F. Bellis, and G. Garcia Jimenez (eds.), *Regionalism and Multilateralism after the Uruguay Round*, European University Press, 1997.

– reaffirm their commitment to the harmonisation of rules of origin across the Euro-Mediterranean free trade area. The Association Council shall take, where necessary, measures to revise the Protocol with a view to respecting this objective.[113]

Paragraph 5 (reproduced above) required not only the establishment of a free-trade agreement among Mediterranean countries but also explicitly required that the rules of origin under the FTA have to be identical to those entered with the EU.

This condition has been for a long time a stumbling block since a series of bilateral agreements were in place among Mediterranean countries but they did not liberalize "substantially all trade" and their implementation lagged behind.

Another extremely important point that is recurrent in EU rules of origin is the second requirement of the application of the diagonal cumulation; that is, the utilization of identical rules of origin when they are applied among Mediterranean countries. Although the terms of this condition were not clearly spelled out under the former protocols, this provision clearly indicated that Mediterranean countries should utilize the same EU rules of origin they have under the Euro-Mediterranean Agreements when establishing a free-trade agreement among them if they wish to use the Pan-Euro-Mediterranean cumulation. However it has to be clear that the requirement of having identical rules of origin only apply for using cumulation under the Euro-Mediterranean agreements i.e. for bilateral trade the Mediterranean countries were and remain free to adopt their own rules of origin.

The architecture and features mentioned above and used in the protocols used in the Euro-Mediterranean Agreements have been the building blocks of the PEM Convention that reflects and updates such features in a single convention.

Article 3 of the PEM Convention dealing with cumulation borrows from the previous experience discussed in this section and provides as follows:

ARTICLE 3

Cumulation of Origin

1. Without prejudice to the provisions of Article 2(1), products shall be considered as originating in the exporting Contracting Party when exported to another Contracting Party if they are obtained there, incorporating materials originating in Switzerland (including Liechtenstein), Iceland, Norway, Turkey or in the European Union, provided that the working or processing carried out in the exporting Contracting Party goes beyond the operations referred to in Article 6. It shall not be necessary for such materials to have undergone sufficient working or processing.
2. Without prejudice to the provisions of Article 2(1), products shall be considered as originating in the exporting Contracting Party when exported to

[113] See COM(97) document 554 final, October 29, 1997.

another Contracting Party if they are obtained there, incorporating materials originating in the Faroe Islands, any participant in the Barcelona Process other than Turkey, or any Contracting Party other than those referred to in paragraph 1 of this Article, provided that the working or processing carried out in the exporting Contracting Party goes beyond the operations referred to in Article 6. It shall not be necessary for such materials to have undergone sufficient working or processing.

3. Where the working or processing carried out in the exporting Contracting Party does not go beyond the operations referred to in Article 6, the product obtained shall be considered as originating in the exporting Contracting Party only where the value added there is greater than the value of the materials used originating in any one of the other Contracting Parties referred to in paragraphs 1 and 2. If this is not so, the product obtained shall be considered as originating in the Contracting Party which accounts for the highest value of originating materials used in the manufacture in the exporting Contracting Party.
4. Products originating in the Contracting Parties referred to in paragraphs 1 and 2 which do not undergo any working or processing in the exporting Contracting Party shall retain their origin if exported into one of the other Contracting Parties.
5. The cumulation provided for in this Article may be applied only provided that:
   (a) a preferential trade agreement in accordance with Article XXIV of the General Agreement on Tariffs and Trade is applicable between the Contracting Parties involved in the acquisition of the originating status and the Contracting Party of destination;
   (b) materials and products have acquired originating status by the application of rules of origin identical to those given in this Convention; and
   (c) notices indicating the fulfilment of the necessary requirements to apply cumulation have been published in the Official Journal of the European Union (C series) and in the Contracting Parties which are party to the relevant Agreements, according to their own procedures.

   The cumulation provided for in this Article shall apply from the date indicated in the notice published in the Official Journal of the European Union (C series).

   The Contracting Parties shall provide the other Contracting Parties which are party to the relevant Agreements, through the European Commission, with details of the Agreements, including their dates of entry into force, which are applied with the other Contracting Parties referred to in paragraphs 1 and 2.

Paragraph 1 of Article 3 above provides for diagonal cumulation for the parties of the PEM Convention with EAA countries while paragraph 2 provides for diagonal cumulation with originating products of "the Faroe Islands, any participant in the Barcelona Process other than Turkey, or any Contracting Party other than those referred to in paragraph 1 of this Article."

The abovementioned provisions for full cumulation among Algeria, Tunisia, and Morocco are contained in Annexes II, III, and IV of the PEM Convention.

Paragraph 3 provides for the criteria of allocation of origin that has been explained above.

Most importantly paragraph 5 reproduces the conditionalities and requirements for the implementation of the cumulation that are inherited with some updating from the similar paragraph 5 of Article 4 of the EU–Morocco former Euro-Mediterranean Protocol on Rules of Origin.

3.4.1.3.9 THE REFORM OF THE EU GSP RULES OF ORIGIN AND THE WAY FORWARD. As mentioned in section 3.3.1, following the publication of the 2005 Green Paper[114] the European Commission and most notably the Directorate General in charge of customs and fiscal affairs (TAXUD) and the Directorate General in charge of Trade (TRADE) embarked on a gradual rethinking of the EU preferential rules of origin.

The Green Paper opened the way for a reform of EU preferential rules of origin. According to this communication, the review of the EU rules of origin was not meant to immediately touch the substance of the rules of origin contained in the product-specific list rules.[115]

In fact, the original plan of the reform was heavily focused on the management procedures related to the administration of the rules of origin.

Rather than addressing the restrictiveness of the rules of origin, the Commission was mainly concerned that, following a stream of European Court cases,[116] the existing system based on the authorities of beneficiary countries to certify the origin of products was leading to a loss of Community resources. According to the existing system, where the declared origin proves to be incorrect, importers frequently may not have to pay duty because they acted in good faith and an error was made by the competent authorities in beneficiary countries. Under these circumstances, the EU suffered a double jeopardy: (1) a loss of customs revenue due to (2) a misinterpretation of EU rules by the certifying authorities in beneficiary countries.

Issuance and verification of certificate of origin and the role played by importers, exporters, and certifying authorities were closely examined in the Green Paper and various alternative options were clearly spelled out for opening a debate between the Commission, EU member states, the private sector, and the civil society.

[114] See n. 74 above.

[115] The list rules refer to the seventy-pages-long annex of product-specific rules annexed to the Common Customs Code in the case of the GSP rule or to any free-trade agreement that the EC has signed with a third country.

[116] See Joined Cases C-153/94 and C-204/94 *Faroe Seafood and Others* [1996] ECR I-2465, paras. 92 and 97; Case C-15/99 *Sommer* [2000] ECR I-8989, paras. 35–37; Case C-30/00 *William Hinton & Sons* [2001] ECR I-7511, paras. 68–73, and *Ilumitrónica*, paras. 42 and 43. See also Judgment of the Court of March 2006 in case C-293/04 *Beemsterboer*. See also on the consequences of this latter case, the Commission document of TAXUD//2006/1222–Final, Working Paper, Internal document, June 24, 2008.

In the more interesting and crucial area of the criteria for determining origin the Green Paper did not start under the better auspices. It contained a major departure from the traditional path of EU policy toward rules of origin. First, it adamantly expressed that the Commission favored using a method of evaluation of sufficient processing based on a "value-added test" as the starting point of its reform.

> The Commission favours using a method of evaluation of sufficient processing based on a "value added test" as the starting point. Under this method, a product resulting from the working or processing of imported non-originating materials would be considered as originating if the value added in the country (or in a region in the event of cumulation), amounts at least to a certain threshold (a minimum "Local or Regional Value Content"), expressed as a percentage of the net production cost of the final product.[117]

Second, such value-added criterion was to be applied across the board for all products, or the majority of them. These statements of the Commission in favor of a value added across the board broke away from more than three decades practice. The EU has traditionally used a combination of the criteria based on the change of tariff heading, a maximum allowance of non-originating material and specific working or manufacturing operations for its list of product-specific rules.

This shift was even more surprising since the elements of the calculations referred to a value-added test. When a percentage rule was used in preferential rules of origin, it has been a common EU practice since the 1970s to use the concept of maximum amount of non-originating inputs out of the ex-works price and not to use a value-added calculation. The method of calculation based on a maximum allowance of non-originating materials has been consistently recognized to possess a series of advantages by beneficiaries of the GSP schemes over a value-added calculation.[118]

Another astonishing fact was that the percentage of the value added was supposed to be expressed as a percentage of the net production cost. The net production cost is a concept borrowed from the NAFTA practice requiring sophisticated accounting details, as discussed in section 3.4.4.5. For this reason, its use has been limited by US negotiators in following free-trade agreements and has been progressively reduced.[119]

During meetings with EU officials in charge at that time the author made these observations and he was told that one of the reasons to adopt an across-the-board percentage was to fend off the lobbies behind each set of product-specific rules that is sectoral-industry oriented. As expected by the author, this did not happen and the net cost method was one of the first elements of the reform to be dropped from the agenda, and luckily so.

[117] See Commission document COM(2003) 787.
[118] See Chapter 6 of this book.
[119] With the exception of automotive products.

The Commission Green Paper outlined a gradual approach since the new policy would be first applied in the framework of the GSP rules of origin, and later in the framework of the EPAs.

Perhaps due to the number of drastic changes from EU traditional policy toward origin and some debatable technical choices proposed in the Green Paper, the implementation of the new policy and its concrete elaboration was met by a number of criticisms and comments even within the EU Commission. Difference of views on the substance of the reform and its sequencing within the services of the Commission ultimately delayed the reform. A document[120] of the Commission circulated during 2007 outlined a drastic change to the Pan-European Rules of Origin in the framework of the negotiations with the ACP countries to conclude an EPA. Suffice here to remember that according to that approach the originating status was to be conferred to goods meeting a local value content calculated as the difference between the ex-works price and the customs value of non-originating materials. A basic value threshold will be established coupled, in some cases, with additional value conditions and specific thresholds for some products.

The pressing deadline of the EPAs negotiations and the emphasis of the ACP countries on the renegotiation of the rules of origin in the EPAs were not sufficient to overcome differences and achieve a rapid conclusion of reform of the rules of origin[121] that could also be applied in the context of EPAs.

In the same year, the 2007 proposal of the GSP rules of origin contained a number of striking changes from traditional EU policy on rules of origin. First it replaced the PSRO-approach maintained for over thirty years with a horizontal, across-the-board percentage criterion set at 30 percent for LDCs and 50 percent for developing countries, albeit with a substantial number of exceptions contained in a reduced list of product-specific rules. Second, it changed the administrative procedures, verification requirements, as well as administrative cooperation from a system based on the certifying authorities to an exporter-based one.

At a first meeting of the EU Customs Committee this proposal was largely criticized by EU member states in several respects and merits.

As expected, the adoption of the value-added criterion marked a substantial shift on the EU policy toward rules of origin and different criticisms were leveled against such approach from a substantive and technical point of view. The criticisms were mainly coming from the consulted European federations representing agricultural

[120] Commission Information Paper presented at the 133 and to the Customs Committee, March 2007.

[121] In fact, rules of origin contained in the interim EPAs initialed with African countries and the EU–Cariforum EPA did not dramatically differ from the EU "standard" rules of origin except for clothing where double transformation was replaced with single transformation and other flexibilities on fishery products and crew requirements. For a more detailed discussion of EC–Cariforum rules of origin see S. Inama, A. Zampetti, and J. Lodge, *The EU–Cariforum EPAs*, Kluwer, 2011.

and industrial interests. The participation of the beneficiary countries in the consultation process initiated by the Commission in 2004 was rather limited.

A number of versions emerged from a series of internal debates. The version of November 2008 did not yet include the list rules for agricultural products and processed agricultural products and related elements. This was a sign of the sensitivity of the sector. That version was later completed and updated by a version published in July 2009.

The comprehensive revised proposal was the subject of in-depth discussions with stakeholders which brought further significant improvements to the text.

Difference of views on the substance of the reform and its sequencing within the services of the Commission ultimately delayed the reform that took five years to see the light. On January 1, 2011 a new regulation on EU GSP rules of origin[122] (hereinafter referred to as "the Regulation") finally entered into force, ending a reform process that was initiated by the Green Paper of 2003 on the future of rules of origin in preferential trade arrangements,[123] and the 2005 Communication entitled "The Rules of Origin in Preferential Trade Arrangements: Orientations for the Future."[124]

The final outcome of the reform of the EU GSP rules of origin could be summarized by the following excerpts from the impact assessment conducted by the EU Commission as part of the internal procedure before the introduction of legislative acts into the approval process:[125]

Rules of origin are old and have not followed evolutions in world trade. The present rules were initially drawn up in the 1970s and they have not materially changed much since, whereas the commercial world has. They were also based on the need to protect Community industry and on the premise that beneficiary countries should be encouraged to build up their own industries in order to comply. In most cases, this has not happened. Instead, there has been a trend towards the globalisation of production, but rules of origin have not been adapted to this. At the same time, compliance costs are high and the paper-based procedures are outdated.

Lower preferential margins combined with high compliance costs make preferences unattractive. As a result of successive rounds of trade agreements, preferential margins are much smaller than they used to be.

The dilemma of LDCs is well illustrated by the information received from countries requesting derogations from rules of origin. Such countries have little or no domestic

[122] See Commission Regulation 1063/2010, November 18, 2010 amending Regulation (EEC) No. 2454/93 laying down provisions for the implementation of Council Regulation (EEC) No. 2913/92 establishing the Community Customs Code.

[123] See Commission document COM(2003) 787.

[124] See n. 74 above.

[125] See S. Inama, "The reform of the EC GSP rules of origin: *Per aspera ad astra*?," *Journal of World Trade*, vol. 45, no. 3 (2011), 577–603.

fabric production, which means they have to import it (so failing to comply with the "two stages of processing" rule) and add only between 27% and maximum 40% in value.[126]

The final outcome of the reform was an outstanding achievement. The sentences above could be easily exchanged for the kind of wording that was usually associated with the EU rules of origin, widely criticized for being restrictive and nondevelopment friendly. Yet, such statements were contained in an official EU document as recognition that time changed and reform was needed. There are simply no precedents to this open, public, and transparent acknowledgment by any Administration that their rules of origin are obsolete and need to be updated.

The new EU GSP rules of origin contained in the regulation herald a new era: they are far more liberal than the previous one with the notable exception of fishery products and processed agricultural food.[127] The regulation also introduced a new administration of rules of origin whereby origin declarations are made by registered exporters designated by the certifying authorities and maintained in a database. This new REX system is presently being introduced after a transitional phase lasted until 2020.

Preferential rules of origin are, in general, of a trade-restrictive nature and the former EU rules of origin were a classic example. Many RTAs and preference-giving countries have founded their rules of origin on the EU model as others have adopted a North American model. Thus, a change toward leniency in rules of origin in a major model like the EU has been long awaited and originally it was hoped that such a reform would have been used as an example by other preference-giving countries and in RTAs.[128]

Most notably, such reforms toward liberalization of rules of origin in the Japanese and US rules of origin under their respective GSP schemes would be welcomed as well as under the rules of origin applicable under the DFQF initiative for the LDCs progressively implemented by developed and developing countries alike.[129]

Many South–South regional agreements having restrictive rules of origin inspired by the EU model could also be candidates for reform. Some trade policymakers and inward-looking technicians may advance the argument that since the GSP is a

[126] From European Commission, "Impact assessment on rules of origin for the Generalized System of Preference (GSP)," Brussels, October 25, 2007, TAXUD/GSP-RO/IA/1/07, 16.

[127] The changes in the PSRO of agricultural and processed agricultural HS chapters would deserve an analysis on their own since they are rather complex and should be interpreted in the light of the sugar reform and the lowering of MFN duties in certain sectors.

[128] As discussed in Chapter 1, this has yet to be the case in spite of the Bali and Nairobi WTO Decisions on preferential rules of origin for LDCs.

[129] For an overview of the DFQF implementation and their rules of origin by developed and developing countries see the UNCTAD Handbook on Duty-Free and Quota-Free and Rules of Origin, Part I and Part II (n. 14 above).

unilateral instrument, the EU reform has no bearing in preferential rules negotiated in RTAs. This is a misleading argument purposely made not to engage in a reform.

The simple fact is that the new EU rules of origin are far more liberal than many others applied in RTAs, especially but not only in sub-Saharan Africa where utilization of intraregional trade preferences granted under African free-trade agreements is stagnating for decades. This should be sufficient to engage in reform.[130] Already the rules of origin under the much-criticized interim EPAs for textiles and clothing and fishery products are more liberal than those under some of the RTAs in Southern Africa.[131]

However, reform of the rules of origin is a complex and technical exercise that many administrations and RTAs are unwilling to undertake. In this context the methodology and analysis used by the EU in its rule of origin reform could be used as a springboard lessening the costs of undertaking such reforms.

Although belated, the EU reform of rules of origin demonstrates to policymakers that even in one of the most resilient and technical subjects, substantial progress can be made toward trade liberalization, in spite of conspicuous absence of such progress at multilateral level. The more than a decade of delay in coming to a final agreement of the harmonization work program (HWP) of nonpreferential rules of origin undertaken under the WTO rules of origin agreement has resulted in a diffused skepticism among negotiators on the possibility of reaching any multilateral solution to issues related to origin. Hopefully this reform, agreed by the EU's twenty-seven member states could also bring a ray of light even in such context.

One of the issues that was debated during the EU reform of rules of origin was the method of calculation of the ad valorem percentage criterion.

According to some earlier versions circulated during the reform process, the new rules of origin were to be based on an across-the-board percentage criterion with some additional requirements for specific products. According to the previous Commission draft, "such a method offers simplicity, flexibility and transparency. However, for certain specific products such as agricultural products or fisheries products additional or different conditions are required in order to support

[130] See, for instance, Common Market for Eastern and Southern Africa (COMESA) Statistical Brief 2006, December 2007, analyzing the utilization rate of COMESA trade preferences. The paper found that utilization of COMESA preferences ranges from a low 2 percent for Uganda to a high 64 percent for Zambia. However, Uganda's low utilization could be partly explained by the fact that it utilizes EAC preferences in its trade which mostly originates from Kenya. This, however, is a rather exceptional case as most COMESA countries have utilization rates of around 30 percent and/or slightly over. The paper also found that some COMESA originating trade was made subject to positive MFN rates. This was another informative finding in understanding non-utilization of preferences. Rwanda had the highest rate of 57 percent of its COMESA originating trade being dutiable in 2006 followed by Zimbabwe at 53 percent.

[131] See, for instance, the SADC rules of origin for Chapters 61 and 62 as contained in the list of Appendix I of Annex I, August 5, 2002 and later versions.

development through encouraging the continued use of materials which are wholly obtained in the beneficiary country concerned."

There were no clear definitions of the formula but there were definitions of the formula numerator, denominator, and threshold as follows:

A *sufficient processing threshold* of 50 percent (30 percent for LDCs) of the ex-works price where:

- "**Sufficient processing threshold**" was supposed to mean the minimum local value content required to consider a manufacture as working or a processing sufficient to confer originating status on the product, expressed as a percentage of the ex-works price.
- "**Ex-works price (ExP)**" means the price paid for the product ex-works to the manufacturer in whose undertaking the last working or processing is carried out, provided that the price includes the value of all the materials used, minus any internal taxes which are, or may be, repaid when the product obtained is exported.
- "**Local value content**" means the value added in the beneficiary country, being the difference between the ex-works price and the value of the non-originating materials (VNOM) used, expressed as a percentage of ex-works price.

These definitions may be expressed as the following formula:

$$\text{Local Value Content} = \frac{\text{ExP} - \text{VNOM}}{\text{ExP}} \times 100 \geq 30\%$$

At a first internal meeting,[132] the European federations complained about the adoption of an across-the-board percentage, especially in fishery and textiles and clothing sectors. Many EU member states questioned the use of a percentage value-added criterion as it brings more complications than simplification. It may safely be said, at a technical level, that the use of a percentage value added is not the best rule in some sectors such as chemicals and steel products, and many would also argue in textiles and clothing.

The method that the EU had always used was as follows:

Previous calculation method: Maximum amount of non-originating material

$$\frac{\text{VNOM}}{\text{ExP}} \times 100 < 40\%$$

In the interim period the formula was as follows:

[132] See Report of the Customs Code Committee – Origin Section, November 20, 2007, TAXUD/C5/ADL/RL D(2007)cr\16.

Proposed (July 2009)

$$\text{Value added, local value content} = \frac{\text{ExP} - \text{VNOM}}{\text{ExP}} \times 100 \geq 50\% \textit{ or } 30\% \ (LDC)$$

Current regulation (2011)

$$\frac{\text{VNOM}}{\text{ExP}} \times 100 < 50\% \ \textit{ or } \ 70\% \ (LDCs)$$

The formula adopted in the final regulation is identical to the formula previously used but the percentages have been increased for a number of products to 50 percent for developing countries beneficiaries and 70 percent for LDCs.

The Major Changes and Improvement in the EU Regulation Introducing the Reform of GSP Rules of Origin With respect to the previous Regulation, the following changes have been introduced in these three areas in order of practical importance:

- *Changes in PSRO*: More lenient criteria for a number of sectors have been introduced, especially for LDCs. The new regulation introduces a differentiation among developing beneficiary countries and LDCs that did not exist before. In a number of HS chapters and headings, especially in the textile and clothing sector but also in machinery and electronics, more lenient rules of origin are set for developing countries and LDCs. For developing country beneficiaries the double transformation is still in place but the dyeing process has been recognized as a processing requirement. In the case of LDCs the double processing has been replaced with a single processing requirement, a major achievement argued for years by LDCs. In machineries of Chapter 84 and electronics of Chapter 84, the chapter rule[133] previously requiring a CTH *and* a maximum allowance of non-originating materials of 40 percent out of the ex-works price has been replaced with a CTH *or* a maximum allowance of 70 percent of non-originating materials out of the ex-works price for developing countries and LDCs alike. More complex is the analysis in agricultural and processed agricultural products: in some chapters with high MFN duties like Chapter 15 the rules of origin have been substantially liberalized; in others, like Chapter 4, dairy products, limits concerning the use of non-originating sugar have been introduced

[133] The chapter rules are defined as applying to all headings that are not singled out as a specific exception within the chapter.

while the use of non-originating fruit juices previously restricted has been liberalized. There are also a number of technical improvements to the rules of origin where in certain cases the tolerance rule is expressed as a percentage of weight rather than value. The tolerance rule has been generally raised from 10 to 15 percent and could also be applied to the wholly obtained product when used as a PSRO criterion as explained below.

- *Cumulation of origin*: Regional cumulation has always featured in the EU GSP rules of origin. Mercosur has been added as new entity benefiting from regional cumulation. The rule for the allocation of origin among the different members of a regional organization has been relaxed. Under the previous Regulation, origin was conferred on the country of last manufacturing only if the value added there was greater than the customs value of the imported inputs from other member states of the regional organization. In practical terms it meant that a Cambodian producer wishing to use fabrics originating in Thailand did not obtain Cambodian origin since the value of the fabrics was greater than the value added achieved in Cambodia (see Table 3.16 for a text comparison). In the new Regulation this requirement has been lifted as far as the inputs originating in the other member states of the regional group have undergone working or processing going beyond minimal working processing operations. Some agricultural and fishery products are excluded from cumulation.[134]

  In addition, a new type of cumulation is introduced: *extended cumulation*. Such cumulation may be applied between GSP beneficiary countries and EU Free-Trade Agreement partner countries under certain conditions further discussed in this section.
- *The reform drastically changes the EU administration of rules of origin*: The rules provide a transitional period until 2017 and beyond. The system of certification of origin based on certificate of origin Form A officially stamped by the certifying authorities has been progressively replaced by statements on origin to be given directly by registered exporters. This entails a drastic change of business practices for the certifying authorities of beneficiary countries who will be responsible for maintaining and administering the database. Only exporters

[134] The list of excluded products is contained in Annex XIII B. The products excluded are changing depending on the regional groups.

> registered in the database could issue statements of origin for receiving trade preferences. The current system will remain in place until 2017 with a provision for extension until 2020 for beneficiaries asking for additional transitional period.[135]

According to the EU Commission the ultimate deadline for the application of the REX system by all beneficiary countries was June 30, 2020. However, an update of the Commission of June 2020 reports as follows:

> Because of the COVID-19 pandemic, some beneficiary countries of the third group (2019) are facing serious difficulties to respect the 30 June 2020 time-limit for the application of the REX system. Those countries in which the REX system could not be deployed or used due to the pandemic may benefit from another extension of the transition period to 31 December 2020, as established by Regulation (EU) 2020/750. The beneficiary countries willing to benefit from that possibility should notify DG TAXUD (TAXUD-UNIT-E5@ec.europa.eu) in writing by 15 July 2020 at the latest, providing:
>
> - an explanation why an extension of the transition period is necessary due to the COVID-19 pandemic
> - a work plan containing detailed information on how the notifying country intends to fully apply the REX system by 31 December 2020
>
> A beneficiary country which benefits from that extension of the transition period shall submit to DG TAXUD (TAXUD-UNIT-E5@ec.europa.eu) by 30 September 2020, a report detailing the progress made in implementing the work plan, and elaborating on any corrective measures necessary to meet the time-limit of 31 December 2020 for the application of the REX system.

General Changes to EU GSP Rules of Origin and Modifications of PSRO A number of changes were made to the PSRO. A sample of these changes with comments are contained in Table 3.15.

In addition, a number of across-the-board changes have been made that are liberalizing the general content of the rule.

First there has been a relaxation of the criteria for fishery products whereby the requirement of nationality of the crew and officers for the vessels definitions in the wholly obtained category has been dropped. The requirements according to the Regulation are now limited to the following:

[135] For an update of the status of implementation of REX see: https://ec.europa.eu/taxation_customs/business/calculation-customs-duties/rules-origin/general-aspects-preferential-origin/arrangements-list/generalised-system-preferences/the_register_exporter_system_en#:~:text=The%20Registered%20Exporter%20system%20(the,so%2Dcalled%20statements%20on%20origin.

TABLE 3.15 *A comparison of selected PSRO before and after EU reform of rules of origin*

HS chapter or heading	Description	EU min and max MFN rates	Previous EU GSP rules	New EU GSP rules	New EU GSP rules	Comments/ explanation of the changes
4	Dairy produce; birds' eggs; natural honey; edible products of animal origin, nes	Specific duties applied	Manufacture in which all the materials of Chapter 4 used are wholly obtained For 0403 Buttermilk, curdled milk and cream, yoghurt, kephir and other fermented or acidified milk and cream, whether or not concentrated or containing added sugar or other sweetening matter or flavoured or containing added fruit, nuts, or cocoa Manufacture in which: all the materials of Chapter 4 used are wholly obtained, – all the fruit juice (except that of pineapple, lime or	Manufacture in which: – all the materials of Chapter 4 used are wholly obtained; and – the weight of sugar (1) used does not exceed 40% of the weight of the final product	Same	Introduction of a limit of use of non-originating sugar previously not present at chapter level. Elimination of the requirements that the fruit juices had to be originating in heading 0403.

(*continued*)

TABLE 3.15 (*continued*)

HS chapter or heading	Description	EU min and max MFN rates	Previous EU GSP rules	New EU GSP rules	New EU GSP rules	Comments/ explanation of the changes
			grapefruit) of heading 2009 used is originating, and – the value of all the materials of Chapter 17 used does not exceed 30% of the ex-works price of the product			
12	Oil seeds and oleaginous fruits; miscellaneous grains, seeds and fruit; industrial or medicinal plants; straw and fodder	Free to 5.8% or 23 EUR/100kg net	Manufacture in which all the materials of Chapter 12 used are wholly obtained	Manufacturing from materials of any heading except that of the product	Same	Liberalization since non-originating seeds could be used, for instance, for the manufacturing of flours of heading 1208.
15	Animal or vegetable fats and oils and their cleavage products; prepared edible fats; animal or vegetable waxes; except for:[i]	Free to 12.8% or 8.3% + 28.4 EUR/ 100kg net	Manufacture in which all the materials of Chapter 15 used are wholly obtained	Manufacture from materials of any subheadings or in certain headings CTH	Same	Liberalization since non-originating products of Chapter 15 can be imported to make products of Chapter 15 Ex making margarine of heading 1517 using non-originating fats and oils of heading 1516.

16	Preparations of meat, of fish or of crustaceans, molluscs or other aquatic invertebrates	Specific duties applied as high as 276.5 EUR/100kg net or from 5.5 % to 20% or 24% for majority of fish preparations	Manufacture from animals of Chapter 1. All the materials of Chapter 3 must be wholly obtained material	Manufacture: – from materials of any heading, except meat and edible meat offal of Chapter 2 and materials of Chapter 16 obtained from meat and edible meat offal of Chapter 2, and – in which all the materials of Chapter 3 and materials of Chapter 16 obtained from fish and crustaceans, molluscs and other aquatic invertebrates of Chapter 3 used are wholly obtained	Same	Basically, the same rules but introduction of the 15% tolerance rule as discussed under value tolerance above under changes in PSRO.
18	Cocoa and cocoa preparations	Free to 8% or 8% + 41.9 EUR/100kg net	Manufacture from materials of any heading, except that of the product	Manufacture from materials of any heading, except that of the product,	Same	Increased allowance of use of non-originating sugar from 30% to

(*continued*)

TABLE 3.15 (*continued*)

HS chapter or heading	Description	EU min and max MFN rates	Previous EU GSP rules	New EU GSP rules	New EU GSP rules	Comments/ explanation of the changes
			and, in which the values of materials of Chapter 17 does not exceed 30% of the ex-works price of final product	in which – the individual weight of sugar (1) and of the materials of Chapter 4 used does not exceed 40% of the weight of the final product, and – the total combined weight of sugar (1) and the materials of Chapter 4 used does not exceed 60% of the weight of final product		40% and change in the method of calculations from value to weight. Introduction of a limit of non-originating materials of Chapter 4 previously not there.
Ex-39	Plastics and article thereof	Free to 6.5%	Manufacture in which the value of all the materials used does not exceed 50% of the ex-works price of the product and within the above limit materials of Chapter 39 used does not exceed 20% of the ex-works	All Chapter 39 except ex-3907, ex-3920, 3921 Manufacture from materials of any heading, except that of the product or Manufacture in which the value of all the materials used does not	Manufacture from materials of any heading, except that of the product or Manufacture in which the value of all the materials used does not exceed 70% of the ex-works price of the product	Liberalization since introduction of CTH criterion as alternative and increase of use on non-originating materials for LDCs and deletion of a limit of 20% of use for materials classified in Chapter 39.

			price or in selected headings limitations to the use of materials of Chapter 39	exceed 50% of the ex-works price of the product		
4104–4106	Tanned or crust hides and skins, without wool or hair on, whether or not split, but not further prepared	Free to 6.5%	Re-tanning of tanned leather or Manufacture from materials of any heading, except that of the product	Re-tanning of tanned or pre-tanned hides and skins of subheadings 4104 11, 4104 19, 4105 10, 4106 21, 4106 31, or 4106 91 or Manufacture from materials of any heading, except that of the product	Same	Liberalization since it allows use of certain subheadings previously excluded as classified within heading.
42	Articles of leather; saddlery and harness; travel Goods, handbags and similar containers; articles of animal gut (other than silk worm gut)	2.7% to 9.7%	Manufacture from materials of any heading except that of the product	Manufacture from materials of any heading, except that of the product or Manufacture in which the value of all materials used does not exceed 70% of the ex-works price of the product	Same	Liberalization since the introduction of the possibility to use non-originating materials of the same heading provided up to 70% of the ex-works price of the product.

(*continued*)

TABLE 3.15 (*continued*)

HS chapter or heading	Description	EU min and max MFN rates	Previous EU GSP rules	New EU GSP rules	New EU GSP rules	Comments/ explanation of the changes
61	Articles of apparel and clothing accessories; knitted or crocheted – Obtained by sewing together or otherwise assembling, two or more pieces of knitted or crocheted fabric which have been either cut to form or obtained directly to form,	8.9% to 12%	Manufacture from yarn	Knitting and making up (including cutting)	Manufacture from fabric	Liberalization since LDC countries are now allowed to use imported fabric to assemble finished product. Knitting operation is no longer required for LDCs. Rule unchanged for developing countries.
	– other		Manufacture from natural fibres	Spinning of natural and/or man-made staple fibres or extrusion of man-made filament yarn, in each case accompanied by knitting (knitted to shape products) or Dyeing of yarn of natural fibres	Same	Liberalization since the dyeing of yarn is recognized as an origin-conferring operation. However, two processing requirements are still needed: spinning or dying and knitting.

				accompanied by knitting (knitted to shape products) (73)		
62	Articles of apparel and clothing accessories not knitted or crocheted	6.5% to 12%	Manufacture from yarn	Weaving accompanied by making up (including cutting) or Making up preceded by printing accompanied by at least two preparatory or finishing operations (such as scouring, bleaching, mercerising, heat setting, raising, calendering, shrink resistance processing, permanent finishing, decatising,	Manufacture from fabric For specific headings only of Chapter 62 such as 6213 and 6214, handkerchiefs: Weaving or making up preceded by printing accompanied by at least two preparatory finishing operations (such as scouring, bleaching, mercerising, heat setting, raising, calendering, shrink resistance processing, permanent	Liberalization since LDC countries are now allowed to use imported fabric to assemble finished product of Chapter 62. Rule also liberalized for developing countries since the alternative was not provided under former rules at chapter level.

(*continued*)

TABLE 3.15 (*continued*)

HS chapter or heading	Description	EU min and max MFN rates	Previous EU GSP rules	New EU GSP rules	New EU GSP rules	Comments/ explanation of the changes
				impregnating, mending, and burling)	finishing, decatising, impregnating, mending and burling), provided that the value of the unprinted fabric used does not exceed 47.5% of the ex-works price of the product	
Ex-84	Nuclear reactors, boilers, machinery and mechanical appliances; parts thereof; (chapter rules, specific rules apply for certain headings)	Free to 3%	Manufacture from materials of any heading, except that of the product *and* in which the value of all the materials used does not exceed 40% of the ex-works price of the product	Manufacture from materials of any heading, except that of the product or Manufacture in which the value of all the materials used does not exceed 70% of the ex-works price of the product	Same	Liberalization since introduction of alternative criteria rather than cumulative and increased allowance of the amount of non-originating materials from 40% to 70%.
Ex-85	Electrical machinery and equipment and	Free to 14%	Manufacture from materials of any heading, except	Manufacture from materials of any heading, except	Same	Liberalization since introduction of alternative criteria

	parts thereof; sound recorders and reproducers, television image and sound recorders and reproducers, and parts and accessories of such articles; (chapter rules, specific rules apply for certain headings)		that of the product *and* in which the value of all the materials used does not exceed 40% of the ex-works price of the product	that of the product or Manufacture in which the value of all the materials used does not exceed 70% of the ex-works price of the product		rather than cumulative. Increased allowance of the amount of non-originating materials from 40% to 50%.
87	Vehicles other than railway or tramway rolling-stock, and parts and accessories thereof; except for:	Free to 10%	Manufacture in which the value of all the materials used does not exceed 40% of the ex-works price of the product	Manufacture in which the value of all the materials used does not exceed 50% of the ex-works price of the product	Manufacture in which the value of all the materials used does not exceed 70% of the ex-works price of the product	Increased allowance of the amount of non-originating materials from 40% to 50% (70% for LDCs).
8711	Motorcycles (including mopeds) and cycles fitted with an auxiliary motor, with or without side-cars; side-cars:	8%	Manufacture in which: – the value of all the materials used does not exceed 40% of the ex-works price of the product, and	Manufacture from materials of any heading, except that of the product or Manufacture in which the value of	Manufacture from materials of any heading, except that of the product or Manufacture in which the value of	Increase allowance of the amount of non-originating materials from 40% to 50% (70% for LDCs). In addition, the

(*continued*)

TABLE 3.15 (*continued*)

HS chapter or heading	Description	EU min and max MFN rates	Previous EU GSP rules	New EU GSP rules	New EU GSP rules	Comments/ explanation of the changes
			– the value of all the non-originating materials used does not exceed the value of all the originating materials used or Manufacture in which the value of all the materials used does not exceed 20%, (25% for exceeding 50 cm^3, 30% for other) of the ex-works price of the product	all the materials used does not exceed 50% of the ex-works price of the product	all the materials used does not exceed 70% of the ex-works price of the product	requirement under the first rule that the value of not non-originating materials should not exceed the value of originating material is dropped.
	– Not exceeding 50 cm3 – Exceeding 50 cm3 – Other					
	– With reciprocating internal combustion piston engine of a cylinder capacity:	8%				
ex 8712	Bicycles without ball bearings	14%	Manufacture from materials of any heading, except	Manufacture in which the value of all the materials	Manufacture from materials of any heading, except	The first rule requiring CTH but excluding parts

	those of heading 8714 or Manufacture in which the value of all the materials used does not exceed 30% of the ex-works price of the product	used does not exceed 50% of the ex-works price of the product	that of the product or Manufacture in which the value of all the materials used does not exceed 70% of the ex-works price of the product	classified in 8714 has been dropped. Increase allowance of the amount of non-originating materials from 30% to 50% (70% for LDCs).

[i] For Chapter 15 there were some headings that were completely liberalized such as 1505 (respectively, wool grease and fatty substances derived therefrom (including lanolin)); 1506 (other animal fats and oils and their fractions, whether or not refined, but not chemically modified); and 1520 (glycerol, crude; glycerol waters and glycerol lyes) where the new EU rules provided for manufacture from any heading. Conversely 1509 and 1510 olive oil were made more stringent with respect to previous rules of origin: manufacture in which all the vegetable materials used are wholly obtained.

The terms "its vessels" and "its factory ships" in paragraph 1(h) and (i) shall apply only to vessels and factory ships which meet each of the following requirements:

(a) they are registered in the beneficiary country or in a Member State,
(b) they sail under the flag of the beneficiary country or of a Member State,
(c) they meet one of the following conditions:
  (i) they are at least 50% owned by nationals of the beneficiary country or of Member States, or
  (ii) they are owned by companies:
    – which have their head office and their main place of business in the beneficiary country or in Member States, and
    – which are at least 50% owned by the beneficiary country or Member States or public entities or nationals of the beneficiary country or Member States.

In spite of the improvements made, such requirements remain demanding. A previous version of the rule of origin for fisheries introduced a tolerance of 15 percent rules for certain headings of Chapter 3 (live fish) and Chapter 16 (processed fish). Such flexibility has been maintained, to a certain extent, in the context of the value tolerance that takes different forms and level of percentage according to the products concerned except for processed fishery products of Chapter 16.

Article 79 of the Regulation provide for such *value tolerance* as follows:

1. By way of derogation from Article 76 and subject to paragraphs 2 and 3 of this Article, non-originating materials which, according to the conditions set out in the list, in Annex 13a are not to be used in the manufacture of a given product may nevertheless be used, provided that their total value or net weight assessed for the product does not exceed:
   (a) 15% of the weight of the product for products falling within Chapters 2 and 4 to 24 of the Harmonized System, other than processed fishery products of Chapter 16;
   [Previous value tolerance in these products was 10% of the ex-works price of the products.[136]]
   (b) 15% of the ex-works price of the product for other products, except for products falling within Chapters 50 to 63 of the Harmonized System, for which the tolerances mentioned in Notes 6 and 7 of Part I of Annex 13a, shall apply.
   [Previous value tolerance in these products was 10% of the ex-works price of the products.]

[136] See Article 71 of the GSP rules of origin as contained in the Common Customs Code, No. 2454/93, July 2, 1993 laying down provisions for the implementation of Council Regulation (EEC) No. 2913/92 establishing the Community Customs Code, OJ L253 (October 11, 1993), 1, as amended.

2. Paragraph 1 shall not allow to exceed any of the percentages for the maximum content of non-originating materials as specified in the rules laid down in the list in Annex 13a.
3. Paragraphs 1 and 2 shall not apply to products wholly obtained in a beneficiary country within the meaning of Article 75. However, without prejudice to Article 78 and 80(2), the tolerance provided for in those paragraphs shall nevertheless apply to the sum of all the materials which are used in the manufacture of a product and for which the rule laid down in the list in Annex 13a for that product requires that such materials be wholly obtained.

Paragraph 3 is important as it introduces a trade liberalizing factor. Normally, as correctly stated in the first sentence of paragraph 3, wholly obtained products do not contain any non-originating materials. This is the reason why they are excluded from application of the value tolerance according this sentence. However, according to the proviso of the second sentence of paragraph 3, the value tolerance may be applied when the wholly obtained products are used as origin criteria in the product-specific list.

Cumulation The rules for regional cumulation have also undergone improvement and trade liberalizing reforms. The most important changes are (1) the addition of Mercosur as a new entity for regional cumulation, (2) the relaxation of the principle of allocation of origin, and (3) the extended cumulation.

In Table 3.16 the wording of the two articles concerning the allocation of origin are compared and commented on:

TABLE 3.16 *Cumulation under old and new EU GSP regulation*

Old regulation	New regulation[i]	Comments
Article 72a 1. When goods originating in a country which is a member of a regional group are worked or processed in another country of the same regional group, they shall have the origin of the country of the regional group where the last working or processing was carried out, provided that:	Where products manufactured in a beneficiary country of Group I (ASEAN) or Group III (SAARC) using materials originating in a country belonging to the other group are to be exported to the European Union, the origin of those products shall be determined as follows: (a) materials originating in a country of one regional	In the case of the old regulation under paragraph (a) the value-of-materials calculation was carried out automatically while in the case of the new regulation under (a) the test is *not* carried out unless the imported materials only undergo insufficient working or processing as contained in Article 78(1) and the operations described

(*continued*)

TABLE 3.16 (*continued*)

Old regulation	New regulation[i]	Comments
(a) the value added there, as defined in paragraph 3, is greater than the highest customs value of the products used originating in any one of the other countries of the regional group, and (b) the working or processing carried out there exceeds that set out in Article 70 and, in the case of textile products, also those operations referred to at Annex 16.	group shall be considered as materials originating in a country of the other regional group when incorporated in a product obtained there, provided that the working or processing carried out in the latter beneficiary country goes beyond the operations described in Article 78(1) and, in the case of textile products, also beyond the operations set out in Annex 16. (b) where the condition laid down in point (a) is not fulfilled, the products shall have as country of origin the country participating in the cumulation which accounts for the highest share of the customs value of the materials used originating in other countries participating in the cumulation.	in Annex 16 for textiles and clothing.[ii]

[i] Paragraph 4 of Article 55 of the EU customs code contains new wording for regional cumulation as follows: "Regional cumulation between beneficiary countries in the same regional group shall apply only under the condition that the working or processing carried out in the beneficiary country where the materials are further processed or incorporated goes beyond the operations described in Article 47 (1) and, in the case of textile products, also beyond the operations set out in Annex 22." This wording in this column of the table has been changed in a new formulation in the EU customs code as contained in Chapter 7 of this book.

[ii] Working such as:
– fitting of buttons and/or other types of fastenings
– making of button-holes
– finishing off the ends of trouser legs and sleeves or the bottom hemming of skirts and dresses etc.
– hemming of handkerchiefs, table linen etc.
– fitting of trimmings and accessories such as pockets, labels, badges, etc.
– ironing and other preparations of garments for sale "ready-made"
– or any combination of such working.

The *extended cumulation* that could be granted by request has a number of conditionalities, as can be easily detected from the wording of paragraph 7 of Article 86 of the new Regulation:

> 7. At the request of any beneficiary country's authorities, extended cumulation between a beneficiary country and a country with which the European Union has a free-trade agreement in accordance with Article XXIV of the General Agreement on Tariffs and Trade (GATT) in force, may be granted by the Commission, provided that each of the following conditions is met:
>
> (a) the countries involved in the cumulation have undertaken to comply or ensure compliance with this Section and to provide the administrative cooperation necessary to ensure the correct implementation of this Section both with regard to the European Union and also between themselves.
>
> (b) the undertaking referred to in point (a) has been notified to the Commission by the beneficiary country concerned.
>
> The request referred to in the first sub-paragraph shall contain a list of the materials concerned by the cumulation and shall be supported with evidence that the conditions laid down in points (a) and (b) of the first sub-paragraph are met. It shall be addressed to the Commission. Where the materials concerned change, another request shall be submitted. Materials falling within Chapters 1 to 24 of the Harmonized System shall be excluded from extended cumulation.

These conditionalities could be summarized as follows: first the extended cumulation is not automatic, second it does not apply to agricultural products, third there are a number of procedures to be followed upon request and during implementation. Only practice would say how useful such provision could be. Cambodia recently tried to activate such provision and was provided with a series of steps to be undertaken that were not exactly user friendly.

Extended cumulation could be of use to Mercosur countries for inputs originating in Mexico and Chile and to ASEAN countries wishing to cumulate with South Korea or Japan inputs. At the time of writing there has been little use of this provision due to the fact that the procedures for the application are not entirely transparent.

It was expected that the EU reform of the rules of origin may have had positive spillover effects in other preferential rules of origin, especially for LDCs. As further discussed in Chapters 1 and 5 of this book, the WTO LDC group described the EU reform as the model to follow for other preference-giving countries and some initial traction matured in the Bali and Nairobi WTO Ministerial Decisions on rules of origin for LDCs. However, as yet there are no other followers of the EU reform of rules of origin, except Canada, which introduced such reform even earlier than the EU.

Against this background the EU has showed that reform could be done even in the case of this most intractable subject involving twenty-eight member states. The EU Commission and the EU decision-making progress has also remarkably demonstrated its ability to self-correct the initial proposals contained in the Green Paper. However, more could have been done on processed agricultural products and fisheries. The change in the administration of rules of origin and its implementation modalities with the adoption of the REX system has created a new model that is shaping a modern way of dealing with origin certification and administration.

The EU reform process and the impact assessment have contributed significantly in shedding light on the decision-making of such major reform and the instruments and methodologies used. Perhaps this is one of the major outcomes in the area of research on rules of origin as discussed in Chapter 4 of this book.

Most notably the methodology adopted in the EU impact assessment on the basis of UNCTAD research could be further refined for use in other negotiating contexts. This is the object of further work by the author as discussed in Chapters 4 and 6 of this book.

Negotiations on rules of origin and related administrative procedures feature in the multilateral and regional negotiating agenda. There is hardly a country that is not involved in negotiating rules of origin and in many cases the negotiations are overlapping at multilateral, subregional, and interregional level.

One of the most disturbing facts is that many developing countries that have bitterly complained about the stringency of the rules of origin proposed by their developed partner when involved in an FTA are the very same ones that have proposed, if not imposed in some cases, the same rules of origin that they were criticizing to their neighbors when negotiating rules of origin in the context of an RTA. This trend is discussed more in detail in Chapters 5 and 6 of this book.

The EU reform has taken away much of the ammunition in the arsenal of such countries. They may continue to argue that the EU reform has been undertaken in the context of an autonomous regime and not in free-trade agreements. This self-defeating argument is not tenable given the low utilization rates of those free-trade agreements having restrictive rules of origin, as discussed in Chapter 4.

There is no argument or excuse of whatsoever kind, instead, for the preference-giving countries, be they developed or developing, granting trade preferences to LDCs either under their own GSP or under the aegis of the DFQF commitment.

For those preference-giving countries the EU reform of the GSP rules of origin is the new benchmark against which their rules of origin are assessed in terms of being development-friendly as much as the Everything But Arms (EBA) initiative has become in the case of tariffs preferences granted to LDCs.

The discussion in Chapter 1 of this book about the implementation of the Bali and Nairobi Decisions on preferential rules of origin examines these two aspects further.

3.4.2 *The Evolution of the European Model in Bilateral Free-Trade Agreements*

3.4.2.1 The Rules of Origin in Free-Trade Agreements with Canada, South Korea, Vietnam, and Japan

As outlined in the preceding section the EU has progressively abandoned the approach of the Pan-European Rules of Origin where an identical Protocol on Rules of Origin was presented to the different partners as *a condicio sine qua non* to allow diagonal cumulation among the different partners.

The new free-trade agreements entered with Canada and with Asian countries as well as the EPAs with African countries maintained the main features of the EU model but have also introduced significant flexibilities and changes. As discussed in detail here in recent years the EU had to adapt the traditional stand of the Pan-European Rules of Origin of the 1990s to negotiate concessions with different partners, especially when the latter were capable of proposing alternative rules of origin and the EU had significant interests in concluding a free-trade agreement given the economic size of the partner (i.e. South Korea, Canada, and Japan). With respect to previous pan-European models of EU rules of origin that clearly outlined the objectives and modalities, this recent trend does not seem to be guided by a consistent trade policy document containing an EU vision of rules of origin.

As analyzed earlier the EU has been capable of reforming rules of origin under the GSP but has not ventured to define a policy of reform for rules of origin under free-trade agreements that are much more important and relevant in economic terms. The more significant and visible impact of the reform outside the EU GSP rules of origin is the progress made toward the implementation and adoption of the REX system.[137] However, while acknowledging entirely the merit of the EU reform of rules of origin, especially concerning LDC rules of origin in the EBA initiative, the reform did not design a systemic and innovative view about what would be the EU rules of origin of the future, especially in free-trade agreements. Issues such as new rules of origin for chemical products that are addressed widely under other free-trade agreements, for instance USMCA, seem to have been introduced in most recent free-trade agreements because of the insistence of the negotiating partner rather than being motivated by an in-house matured vision. The issue of new rules of origin capturing the services component aspect embedded in a good[138] that has been aired has yet to materialize even if the EU–Japan FTA agreement provided the opportunity to test this new frontier with such important trading partners. Under these lenses the EU–Japan FTA agreement has not signaled any significant innovation in the field of rules of origin.

[137] See Chapter 7 for a discussion of the REX system.
[138] See Chapter 2.

This holds true especially when compared with the activity of the United States, which has not hesitated to introduce a labor cost component in the automotive sector to foster an inward-looking policy in USMCA.

On the EU side, similar labor-related rules of origin, but based on totally different scenarios and aims, were contained in the amendment to the Protocol on Rules of Origin of the EU–Jordan agreement, which provided that selected products produced by factories having a work force of a minimum 15 percent composed of Syrian refugees are originating provided that they comply with simplified PSRO similar to EBA.[139]

Discussions held by the author with different EU officials hinted that, de facto, the reform of GSP rules of origin has a bearing on the negotiations of PSRO in EU free-trade agreements in addition to the REX. However, it has to be remembered that the reform of GSP rules of origin, as applauded as it can be, dates back almost a decade and concerned a number of beneficiaries with relative economic and trade potential.[140]

To sum up, it seems that the result of RoO negotiations in the various free-trade agreements examined below is the outcome of negotiations driven by the individual Commission official dealing with such portfolio at a precise point in time rather than a logical and coherent vision. This is also due to the rotation-of-staff policy of the EU Commission where valuable, experienced, and technically prepared officials are moved to another area in a matter of a few years. This policy does not seem to provide motivation to design and raise the stakes on RoO issues during FTA negotiations, since career promotion may be more linked to the conclusion of the free-trade agreement rather than having concluded a good protocol on rules of origin in a free-trade agreement. Recent studies conducted by the private sector in some member states contain a number of proposals that may need to be carefully assessed and addressed.[141] Some of the reforms that may be needed in some PSRO in EU free-trade agreements are discussed in Chapter 4.

3.4.2.2 A Comparison of the Major Features of the EU Free-Trade Agreements with Canada, Japan, South Korea, and Vietnam

Table 3.17 shows the different kinds of cumulation applied under EU free-trade agreements with Canada, Japan, South Korea, and Vietnam.

[139] See Decision 1/2018 of the EU–Jordan Associations Council, December 4, 2018, http://trade.ec.europa.eu/doclib/docs/2018/december/tradoc_157588.pdf.

[140] Most of the developing countries have graduated out of the GSP because of the new graduation policy clause discussed in section 3.2.5.2 of this chapter.

[141] In the EU, one of the most recent surveys has been undertaken by BDI, "Aiming for better utilization of EU free trade agreements policy: Recommendations for German and European politicians," March 2020. See also another important recent study done by Nora Plaisier, Corine Besseling, Stephanie Bouman and Henri de Groot (Ecorys), "Study on the use of trade agreements," 2018, www.ecorys.nl/sites/default/files/study-on-the-use-of-trade-agreements%20%283%29.pdf.

TABLE 3.17 *Cumulation rules in selected EU free-trade agreements*

EU–Canada	EU–Japan	EU–South Korea	EU–Vietnam
8. Subject to paragraph 9, if, as permitted by the WTO Agreement, each Party has a free trade agreement with the same third country, a material of that third country may be taken into consideration by the exporter when determining whether a product is originating under this Agreement. 9. Each Party shall apply paragraph 8 only if equivalent provisions are in force between each Party and the third country and upon agreement by the Parties on the applicable conditions. 10. Notwithstanding paragraph 9, if each Party has a free trade agreement with the United States, and upon agreement by both Parties on the applicable conditions, each	1. A product that qualifies as originating in a Party shall be considered as originating in the other Party if used as a material in the production of another product in the other Party. 2. Production carried out in a Party on a non-originating material may be taken into account for the purpose of determining whether a product is originating in the other Party. 3. Paragraphs 1 and 2 do not apply if the production carried out in the other Party does not go beyond one or more of the operations referred to in subparagraphs 1(a) to (q) of Article 3.4. 4. In order for an exporter to complete the statement on origin referred to in subparagraph 2 (a) of Article 3.16 for a product referred to in paragraph 2, the	Notwithstanding Article 2, products shall be considered as originating in a Party if such products are obtained there, incorporating materials originating in the other Party, provided that the working or processing carried out goes beyond the operations referred to in Article 6. It shall not be necessary that such materials have undergone sufficient working or processing.	2. Materials listed in Annex III to this Protocol (Materials Referred to in Paragraph 2 of Article 3) originating in an ASEAN country which applies with the Union a preferential trade agreement in accordance with Article XXIV of GATT 1994, shall be considered as materials originating in Viet Nam when further processed or incorporated into one of the products listed in Annex IV to this Protocol (Products Referred to in Paragraph 2 of Article 3). 3. For the purpose of paragraph 2, the origin of the materials shall be determined according to the rules of origin applicable in the framework of the Union's preferential trade agreements with those ASEAN countries. 4. For the purpose of paragraph 2, the

(*continued*)

TABLE 3.17 (*continued*)

EU–Canada	EU–Japan	EU–South Korea	EU–Vietnam
Party shall apply paragraph 8 when determining whether a product of Chapter 2 or 11, heading 16.01 through 16.03, Chapter 19, heading 20.02 or 20.03, or subheading 3505.10 is originating under this Agreement.[i]	exporter shall obtain from its supplier information as provided for in Annex 3-C.[ii]		originating status of materials exported from an ASEAN country to Viet Nam to be used in further working or processing shall be established by a proof of origin as if those materials were exported directly to the Union.

[i] See: Article 3, Cumulation of Origin of EU–Canada FTA agreement for the documentary requirements; paras. 8 and 9 under Article 3 for rules regarding FTAs with third countries; para. 10 under Article 3 for rules regarding FTA agreement with the United States.

[ii] See Article 3.5 of the EU–Japan FTA agreement.

The most encompassing form of cumulation is contained in the EU–Canada FTA agreement, providing a kind of open door for cumulation with materials originating in a partner that has entered a free-trade agreement with both parties. Such possibility is however tempered by the mention in paragraph 8 of "equivalent provisions" and "applicable conditions." These caveats are a reflection of the different understanding of the scope and the quality aspects of cumulation. Chapter 6 of this book discusses more in depth the difference between the concept of diagonal cumulation used by the EU and the Canadian concept of cross-cumulation. Most importantly the EU–Canada text also mentions the possibility of cumulation with the United States.

The EU–Japan and the EU–South Korea FTA agreements are much more cautious on cumulation since they do not provide for any kind of cumulation with third parties. The EU–Japan FTA agreement is somewhat more liberal than the EU–South Korea FTA agreement since it provides not only for diagonal cumulation or cumulation of materials but also mentions under paragraph 2 the possibility to cumulate "production," meaning that full cumulation applies under the EU–Japan FTA agreement.

Finally, the EU–Vietnam FTA agreement contains regional cumulation that is the most traditional form of cumulation provided for under EU free-trade agreements. In fact, ASEAN cumulation features also in paragraph 2 of Article 3 of Protocol 1 of the EU–Singapore FTA agreement:

> Materials originating in an ASEAN country which is applying with the Union a preferential agreement in accordance with Article XXIV of the GATT 1994, shall be considered as materials originating in a Party when incorporated in a product obtained in that Party provided that they have undergone working or processing in that Party which goes beyond the operations referred to in Article 6 (Insufficient Working or Processing).

It is important to note however that Vietnam opted in the course of the negotiation of the EU–Vietnam FTA agreement for an ASEAN cumulation limited to specific fishery products[142] while pushing for extended cumulation with South Korea for a number of fabrics as contained in paragraph 7 of the same article for providing cumulation for ASEAN:

> 7. Fabrics originating in the Republic of Korea shall be considered as originating in Viet Nam when further processed or incorporated into one of the products listed in Annex V (Products Referred to in Paragraph 7 of Article 3) to this Protocol obtained in Viet Nam, provided that they have undergone working or processing in Viet Nam which goes beyond the operations referred to in Article 6 (Insufficient Working and Processing).[143]

The denominator and numerator of the calculations of the percentage criterion that is commonly used for a variety of products under the EU free-trade agreements are important elements determining the clarity and predictability of the outcome of the calculation. Table 3.18 below provides for the definition of the denominator that

TABLE 3.18 *Definition of ex-works price in selected EU free-trade agreements*

EU–Canada[i]	EU–Japan[ii]	EU–South Korea[iii]	EU–Vietnam[iv]
Transaction value or ex-works price of the product means the price paid or payable to the producer of the product at the place where the last production was carried out and must include the value of all materials. If there is no price paid or	Ex-works price of the product paid or payable to the manufacturer in whose undertaking the last working or processing is carried out, provided that the price includes the value of all the materials used and all other costs	Ex-works price means the price paid or payable for the product ex-works to the manufacturer in a Party in whose undertaking the last working or processing is carried out, provided the price includes the value of all the	Ex-works price means the price paid for the product ex-works to the manufacturer in whose undertaking the last working or processing is carried out, provided that the price includes the value of all the materials used and

(*continued*)

[142] As contained in Annex II of the EU–Vietnam FTA agreement, these products are fresh squids and octopus.

[143] See para. 7 of Article 3 of the EU–Vietnam FTA agreement.

TABLE 3.18 (*continued*)

EU–Canada[i]	EU–Japan[ii]	EU–South Korea[iii]	EU–Vietnam[iv]
payable or if it does not include the value of all materials, the transaction value or ex-works price of the product: (a) must include the value of all materials and the cost of production employed in producing the product, calculated in accordance with generally accepted accounting principles; and (b) may include amounts for general expenses and profit to the producer that can be reasonably allocated to the product.	incurred in the production of a product minus any internal taxes which are, or may be, repaid when the product obtained is exported.[v] FOB price of the product paid or payable to the seller regardless of the mode of shipment, provided that the price includes the value of all the materials used, and all other costs incurred in the production of a product and its transportation to the exportation port in the Party, minus any internal taxes which are, or may be, repaid when the product obtained is exported.	materials used, minus any internal taxes which are, or should be, repaid when the product obtained is exported.	all other costs related to its production, excluding any internal taxes which are, or may be, repaid when the product obtained is exported.

[i] See definition of transaction value in Article 1 of EU–Canada FTA agreement for further details.
[ii] See the definition of ex-works and FOB in Annex 3-A of EU–Japan FTA agreement for further details.
[iii] See the definition ex-works price in Article 1 of EU–South Korea FTA agreement for further details.
[iv] See the definition ex-works price in Article 1 of EU–Vietnam FTA agreement for further details.
[v] See Annex 3-A of EU–Japan FTA agreement for the ex-works definition in the case where the price is not clearly ascertainable.

in most cases is the ex-works price formulation used in most of the EU free-trade agreements with the notable exception of Japan using as an alternative the FOB price.

The EU–Canada FTA agreement provides an equivalent meaning for transaction value used in NAFTA and USMCA with the ex-works price. The same EU–Canada FTA agreement provides also for a definition of net cost as follows:

> Net Cost means total cost minus sales promotion, marketing and after-sales service costs, royalty, shipping and packing costs, and non-allowable interest cost that are included in the total cost.

Such net cost formulation is not further specified or used in the PSRO of the EU–Canada FTA agreement.

Table 3.19 provides an excerpt from the introductory notes to the lists of PSRO of the EU–Canada and EU–Japan FTA agreements. Such introductory or explanatory notes are an essential part of the PSRO. In most of the EU free-trade agreements there are no significant variations from the explanatory notes used in the Euro-Mediterranean model discussed in section 3.4.1.3.6.

TABLE 3.19 *Introductory notes to the PSRO in CETA and EU–Japan FTA agreement*

EU–Canada	EU–Japan
If a PSRO requires: (a) a change from any other CHSH,[i] or a change to product x[ii] from any other CHSH, only non-originating material classified in a CHSH other than that of the product may be used in the production of the product; (b) a change from within a heading or subheading, or from within any one of these headings or subheadings, non-originating material classified within the heading or subheading may be used in the production of the product, as well as non-originating material classified in a CHSH other than that of the product; (c) a change from any heading or subheading outside a group, only non-originating material classified outside the group of headings or subheadings may be used in the production of the product; (d) that a product is wholly obtained, the product must be wholly obtained within the meaning of Article 4. If a shipment consists of a number of identical products classified under tariff provision x, each product shall be considered separately; (e) production in which all the material of tariff provision x used is wholly obtained, all of the material of tariff provision x used in production of the product must be wholly obtained within the meaning of Article 4. (f) a change from tariff provision x, whether there is also a change from any other chapter, heading or subheading, the value of any non-originating material that satisfies the change in tariff classification specified in the phrase commencing with the words	For the purposes of product specific rules of origin, the following abbreviations apply: "CC" means production from non-originating materials of any Chapter, except that of the product, or a change to the Chapter, heading or subheading from any other Chapter; this means that all non-originating materials used in the production of the product must undergo a change in tariff classification at the 2-digit level (i.e. a change in Chapter) of the Harmonized System. "CTH" means production from non-originating materials of any heading, except that of the product, or a change to the Chapter, heading or subheading from any other heading; this means that all non-originating materials used in the production of the product must undergo a change in tariff classification at the 4-digit level (i.e. a change in heading) of the Harmonized System. "CTSH" means production from non-originating materials of any subheading,

(*continued*)

TABLE 3.19 (*continued*)

EU–Canada	EU–Japan
"whether or not" is not considered when calculating the VNOM. If two or more PSRO are applicable to a heading, subheading, or group of headings or subheadings, the change in tariff classification specified in this phrase reflects the change specified in the first rule of origin; (g) that the VNOM of tariff provision x does not exceed x per cent of the transaction value or ex-works price of the product, only the value of the non-originating material specified in this rule of origin is considered when calculating the VNOM. The percentage for the maximum VNOM as set out in this rule of origin may not be exceeded through the use of Article 6; (h) that the VNOM classified in the same tariff provision as the final product does not exceed x per cent of the transaction value or ex-works price of the product, non-originating material classified in a tariff provision other than that of the product may be used in the production of the product. Only the value of the non-originating materials classified in the same tariff provision as the final product is considered when calculating the VNOM. The percentage for the maximum VNOM as set out in this rule of origin may not be exceeded using Article 6; (i) that the value of all non-originating materials does not exceed x per cent of the transaction value or ex-works price of the product, the value of all non-originating materials is considered when calculating the VNOM. The percentage for the maximum VNOM as set out in this rule of origin may not be exceeded through the use of Article 6; and (j) that the net weight of non-originating material of tariff provision x used in production does not exceed x per cent of the net weight of the product, the specified non-originating materials may be used in the production of the product, provided that it does not exceed the specified percentage of the net weight of the product in accordance with the definition of "net weight of the product" in Article 1. The percentage for the maximum weight of non-originating material as set out in this rule of origin may not be exceeded using Article 6.	except that of the product, or a change to the Chapter, heading or subheading from any other subheading; this means that all non-originating materials used in the production of the product must undergo a change in tariff classification at the 6-digit level (i.e. a change in subheading) of the Harmonized System.

[i] Chapter, heading or subheading.

[ii] In these notes, product x or tariff provision x denotes a specific product or tariff provision, and x per cent denotes a specific percentage.

By contrast, the EU–Canada and the EU–Japan FTA agreements introduce significant variations and drafting techniques compared to the usual drafting style of the EU.

In fact, and differently from all other free-trade agreements entered by the EU so far, the EU–Canada and EU–Japan FTA agreements are the first EU free-trade agreements to contain drafting techniques such as change of chapter (CC) or change of tariff subheading (CTSH) as contained in the self-explanatory Table 3.19. The EU–Vietnam and EU–South Korea FTA agreements explanatory notes did not contain any significant deviation from the EU common practice.

Strict rules of origin in fishery products in the EU free-trade agreements are a constant feature due to the EU fishery policies. As shown in Table 3.20, the PSRO in all the free-trade agreements reproduce the standard "wholly obtained" requirement, with the exception of the EU–Japan FTA due to the aquaculture industry in Japan. The specific provision under the EU–Japan FTA agreement echoes the drafting from the previous work carried out under the HWP of nonpreferential rules of origin as discussed in Chapter 2 of this book.

The most common drafting of the product-specific EU rules of origin for HS Chapter 4 is reflected in the EU–Vietnam FTA agreement where the requirement of wholly obtained is also associated with a limitation of non-originating sugar (see Table 3.21). This requirement is lifted from EU–South Korea, whereas EU–Japan uses different drafting techniques based on CTC to reach the same

TABLE 3.20 *PSRO (Chapter 3, Fish and crustaceans, molluscs and other aquatic invertebrates) across EU free-trade agreements*

EU–Canada	EU–Japan	EU–South Korea	EU–Vietnam
Production in which all the material of Chapter 3 used is wholly obtained.	All Atlantic Bluefin tuna (*Thunnus thynnus*) is wholly obtained; or production in which Atlantic Bluefin tuna (*Thunnus thynnus*) is subject to caging in farms with subsequent feeding and fattening/farming for a minimum period of 3 months in a Party. The duration of the fattening or farming shall be established according to the date of the caging operation and the date of harvesting recorded in the electronic Bluefin tuna Catch Document (eBCD) of the International Commission for the Conservation of Atlantic Tunas (ICCAT). All other fish and crustaceans, molluscs and other aquatic invertebrates are wholly obtained.	Manufacture in which all the materials of Chapter 3 used are wholly obtained.	All fish and crustaceans, molluscs and other aquatic invertebrates are wholly obtained.

TABLE 3.21 *PSRO (Chapter 4, Dairy produce; birds' eggs; natural honey; edible products of animal origin, not elsewhere specified or included) across EU free-trade agreements*

EU–Canada	EU–Japan	EU–South Korea	EU–Vietnam
For 04.01, a change from any other chapter, except from dairy preparations of subheading 1901.90 containing more than 10% by dry weight of milk solids, provided that all the material of Chapter 4 used is wholly obtained.	For 04.01–04.10, production in which all the materials of Chapter 4 used are wholly obtained.	Manufacture in which all the materials of Chapter 4 used are wholly obtained.	Manufacture in which: – all the materials of Chapter 4 used are wholly obtained; and – the weight of sugar used does not exceed 20% of the weight of the final product.

TABLE 3.22 *PSRO (Chapter 9, Coffee, tea, maté and spices) across EU free-trade agreements*

EU–Canada	EU–Japan	EU–South Korea	EU–Vietnam
For 0901.11–0901.90, a change from any other subheading. While for 0902.10–0910.99, a change from within any one of these subheadings or any other subheading.	For 09.01, CTSH; or Blending.	Manufacture in which all the materials of Chapter 9 used are wholly obtained.	Manufacture from materials of any heading.

conclusion. The EU–Canada FTA agreement is the most complex, both in terms of requirements and drafting.

Chapter 9 of the HS classifies coffee, tea, and other spices where there are remarkable differences across the various free-trade agreements, both in terms of substance than of wording, as shown in Table 3.22. The Japan–EU FTA agreement may combine leniency and readability since a CTSH for coffee of HS 09.01 means that the processes of roasting or decaffeination are origin conferring together with blending of different spices classified in HS Chapter 9. The EU–Canada FTA agreement uses CTC drafting techniques to obtain similar origin outcomes as under the EU–Japan FTA agreement.

Conversely the wholly obtained requirements under the EU–South Korea agreement are exactly the reverse since processes like roasting, decaffeination, and blending are not origin conferring.

The rules of origin for processed foodstuff of Chapter 16 are usually stringent under EU free-trade agreements. Table 3.23 shows variation of such stringency from the substantially tightened version of the EU–Japan FTA agreement, where all products of Chapters 2, 3, 16, and rice of HS 10.06 have to be wholly obtained, to the milder version of the EU–Vietnam FTA agreement. The more liberal rules appear to be the EU–South Korea FTA agreement, since it allows the use of non-originating meat of HS Chapter 2 while the EU–Canada FTA is a reproduction of the EU–Vietnam FTA agreement rule using the CTC as a drafting technique.

Table 3.24 shows different drafting techniques in the selected EU free-trade agreements for HS Chapter 28 (inorganic chemicals). The EU–Vietnam and the

TABLE 3.23 *PSRO (Chapter 16, Preparations of meat, of fish or of crustaceans, molluscs or other aquatic invertebrates) across EU free-trade agreements*

EU–Canada	EU–Japan	EU–South Korea	EU–Vietnam
For 16.01–16.02, a change from any other chapter, except from Chapter 2. For 1603, a change from any other chapter, except from Chapter 3. For 1604–1605, a change from any other chapter, except from Chapter 3.	For 16.01–16.02, production in which all the materials of Chapters 2, 3, and 16 and heading 10.06 used are wholly obtained.	– from animals of Chapter 1, and/or in which all the materials of Chapter 3 used are wholly obtained.	Manufacture in which all the materials of Chapters 2, 3, and 16 used are wholly obtained.

TABLE 3.24 *PSRO (Chapter 28, Inorganic chemicals; organic or inorganic compounds of precious metals, of rare-earth metals, of radioactive elements or of isotopes) across EU free-trade agreements*

EU–Canada	EU–Japan	EU–South Korea	EU–Vietnam
Note 1: A product of this Chapter is an originating product if it is the result of any one of the following: (a) an applicable change in tariff classification specified in the rules of origin of this Chapter; (b) a chemical reaction as described in Note 2 below; or	For 28.01–28.53, CTSH; A chemical reaction, purification, production of standard materials, or isomer	Manufacture from materials of any heading, except that of the product. However, materials of the same heading as the product may	Manufacture from materials of any heading, except that of the product. However, materials of the same heading as the product may

(*continued*)

TABLE 3.24 (*continued*)

EU–Canada	EU–Japan	EU–South Korea	EU–Vietnam
(c) purification as described in Note 3 below. Note 2: Chemical reaction and change of Chemical Abstract Service number A product of this Chapter shall be treated as an originating product if it is the result of a chemical reaction and that chemical reaction results in a change of Chemical Abstract Service (CAS) number. For the purposes of this Chapter, a "chemical reaction" is a process (including a biochemical process) that results in a molecule with a new structure by breaking intramolecular bonds and by forming new intramolecular bonds or by altering the spatial arrangement of atoms in a molecule. The following are not considered to be chemical reactions for the purposes of determining whether a product is originating: (a) dissolution in water or in another solvent; (b) the elimination of solvents, including solvent water; or (c) the addition or elimination of water of crystallization. Note 3: Purification A product of this Chapter that is subject to purification shall be treated as an originating product provided that the purification occurs in the territory of one or both of the Parties and results in the elimination of not less than	separation is undergone; MaxNOM 50% (EXW); or RVC 55% (FOB).	be used, provided that their total value does not exceed 20% of the ex-works price of the product or manufacture in which the value of all the materials used does not exceed 50% of the ex-works price of the product.	be used, provided that their total value does not exceed 20% of the ex-works price of the product; or manufacture in which the value of all the materials used does not exceed 50% of the ex-works price of the product.

TABLE 3.24 (*continued*)

EU–Canada	EU–Japan	EU–South Korea	EU–Vietnam
80% of the impurities. Note 4: Separation prohibition A product that meets the applicable change in tariff classification in the territory of one or both of the Parties as a result of the separation of one or more materials from a man-made mixture shall not be treated as an originating product unless the isolated material underwent a chemical reaction in the territory of one or both of the Parties.			

TABLE 3.25 *PSRO (HS 382640, Biodiesel and mixtures thereof, not containing or containing less than 70 percent by weight of petroleum oils or oils obtained from bituminous mineral) across EU free-trade agreements*

EU–Canada	EU–Japan	EU–South Korea	EU–Vietnam
For 38.26, a change from any other heading, provided that the biodiesel is transesterified in the territory of a Party.	For 38.26, production in which biodiesel is obtained through transesterification, esterification or hydro-treatment.	Not applicable	Not Applicable

EU–South Korea FTA agreements reflect the standard formulation of the EU rules for this specific sector while the EU–Japan and the EU–Canada rules in Tables 3.24 and 3.25 show the evolution of the product-specific rules in the chemical chapters. It is evident the latter rules of origin represent an innovative and modern technique progressively adopted in many free-trade agreements including USMCA, as further discussed in section 3.4.4.11.

Tables 3.26 and 3.27 show the different formulations of PSRO for garments. The wording of the different PSRO under the free-trade agreements changes but the essence remains basically the same across the free-trade agreements:

TABLE 3.26 *PSRO (Chapter 61, Articles of apparel and clothing accessories, knitted or crocheted) across EU free-trade agreements*

EU–Canada	EU–Japan	EU–South Korea	EU–Vietnam
For 61.01-61.17, Knitting or crocheting and making up (including cutting). For all other knit to shape products, spinning of natural or man-made staple fibers or extrusion of man-made filament yarn, in each case accompanied by knitting or crocheting; or Dyeing of yarn of natural fibers accompanied by knitting or crocheting.	Knitting or crocheting combined with making up including cutting of fabric.	Spinning of natural and/or man-made staple fibers, or extrusion of man-made filament yarn, accompanied by knitting (knitted to shape products); or Knitting and making up including cutting (assembling, two or more pieces of knitted or crocheted fabric which have been either cut to form or obtained directly to form).	Knitting and making up (including cutting).

TABLE 3.27 *PSRO (heading 62.01, Men's or boys' overcoats, car-coats, capes, cloaks, anoraks (including ski-jackets), wind-cheaters, wind-jackets and similar articles, knitted or crocheted, other than those of heading 61.03) across EU free-trade agreements*

EU–Canada	EU–Japan	EU–South Korea	EU–Vietnam
Weaving accompanied by making up (including cutting); or Making up preceded by printing, accompanied by at least two preparatory or finishing operations (such as scouring, bleaching, mercerising, heat setting, raising, calendering, shrink resistance processing, permanent finishing,	Weaving combined with making up including cutting of fabric; or Making up including cutting of fabric preceded by printing (as standalone operation).	Weaving accompanied by making up (including cutting);[i] or Making up preceded by printing accompanied by at least two preparatory or finishing operations (such as scouring, bleaching, mercerising, heat setting, raising,	Weaving accompanied by making up (including cutting); or Making up preceded by printing accompanied by at least two preparatory or finishing operations (such as scouring, bleaching, mercerising, heat setting, raising, calendering, shrink resistance processing,

TABLE 3.27 (*continued*)

EU–Canada	EU–Japan	EU–South Korea	EU–Vietnam
decatising, impregnating, mending and burling), provided that the value of the unprinted fabric used does not exceed 47.5% of the transaction value or ex-works price of the product.		calendering, shrink).	permanent finishing, decatising, impregnating, mending and burling), provided that the value of the unprinted fabric used does not exceed 47.5% of the ex-works price of the product.

[i] Or embroidering accompanied by making up (including cutting), provided that the value of the unembroidered fabric used does not exceed 40% of the ex-works price of the product or coating accompanied by making up (including cutting), provided that the value of the uncoated fabric used does not exceed 40% of the ex-works price of the product.

For Chapter 61 – double transformation for finished knitted garments meaning
(1) knitting and
(2) making up including cutting.
For other products in Chapter 61
(1) spinning and
(2) making up.
For Chapter 62 – double transformation for finished woven garments meaning
(1) weaving and
(2) making up including cutting or a series of alternative combination of rules as contained in the tables.

As shown in Table 3.28, the PSRO for shoes contained in the EU–Canada and EU–Vietnam FTA agreements represent the usual liberal formulation of rules of origin contained in EU free-trade agreements. The EU–Japan and EU–Korea FTA agreements introduce an additional RVC making the rules of origin requirements much stricter.

Table 3.29 shows the different rules for pipes and fittings of iron and steel where there is a clear difference in drafting techniques. The EU–South Korea and EU–Vietnam FTA agreements allow the use of blanks with the requirement to carry out a series of specific working or processing requirements and a VNOM of 35 percent. The EU–Canada and EU–Japan FTA agreements mostly use a CTC and an RVC according to their drafting techniques, allowing, under one of the alternatives, the use of forged blanks with a higher percentage.

Table 3.30 provides a comparison of different products specific rules of origin for selected heading of machineries of Chapter 84. Albeit there are still differences in the number of PSRO for different specific headings, the drafting of the chapter rules for the EU–Vietnam and the EU–South Korea FTA agreements is similar with a significant

TABLE 3.28 *PSRO (Chapter 64, Footwear, gaiters and the like; parts of such articles) across EU free-trade agreements*

EU–Canada	EU–Japan	EU–South Korea	EU–Vietnam
For 64.01–64.05, a change from any other heading, except from assemblies of uppers affixed to inner soles or to other sole components of heading 64.06.	For 64.01–64.06, CC; CTH except from headings 64.01–64.05 and from assemblies of uppers affixed to inner soles of subheading 6406.90 and MaxNOM 50% (EXW); or CTH except from headings 64.01–64.05 and from assemblies of uppers affixed to inner soles of subheading 6406.90 and RVC 55% (FOB).	Manufacture from materials of any heading, except from assemblies of uppers affixed to inner soles or to other sole components of heading 6406 or manufacture in which the value of all the materials used does not exceed 50% of the ex-works price of the product.	Manufacture from materials of any heading, except from assemblies of uppers affixed to inner soles or to other sole components of heading 6406.

TABLE 3.29 *PSRO (subheadings 730721, Flanges of iron and steel–730729, Other) across EU free-trade agreements*

EU–Canada	EU–Japan	EU–South Korea	EU–Vietnam
A change from any other heading, except from forged blanks of heading 72.07; or A change from forged blanks of heading 72.07, whether or not there is also a change from any other heading, provided that the value of the non-originating forged blanks of heading 72.07 does not exceed 50% of the transaction value or ex-works price of the product.	For 73.07, CTH except from forged blanks of heading 72.07; however, non-originating forged blanks of heading 72.07 may be used provided that their value does not exceed 50% of the EXW or 45% of the FOB of the product.	Turning, drilling, reaming, threading, deburring and sandblasting of forged blanks, provided that the total value of the forged blanks used does not exceed 35% of the ex-works price of the product.	For 73.07, Turning, drilling, reaming, threading, deburring and sandblasting of forged blanks, provided that the total value of the forged blanks used does not exceed 35% of the ex-works price of the product.

variation of VNOM, which in the case of the EU–Vietnam FTA agreement is more lenient. The EU–Canada and the EU–Japan rules of origin are substantially similar albeit with different drafting techniques. Table 3.30 provides a comparison of different products specific rules of origin for selected heading of machineries of Chapter 84.

Table 3.31 provides a comparison of different PSRO for selected headings of machinery of Chapter 85. Once again, and as shown in Table 3.30, albeit with

some differences, there the applicable PRSO for specific sectors are similar albeit with differences in the level of percentages required that may be significant, as in the case of Vietnam in Table 3.30.

TABLE 3.30 *PSRO (heading 84.01–84.12, Machinery[144]) across EU free-trade agreements*

EU–Canada	EU–Japan	EU–South Korea	EU–Vietnam
For 84.01–8412, a change from any other heading; or a change from within any one of these headings, whether or not there is also a change from any other heading, provided that the value of non-originating materials classified in the same heading as the final product does not exceed 50% of the transaction value or ex-works price of the product.	For 84.01–84.06, CTH; MaxNOM 50% (EXW); or RVC 55% (FOB).	Manufacture from materials of any heading, except that of the product or Manufacture in which the value of all the materials used does not exceed 45% of the ex-works price of the product.	Manufacture from materials of any heading, except that of the product or Manufacture in which the value of all the materials used does not exceed 70% of the ex-works price of the product.

TABLE 3.31 *PSRO (headings 85.01–85.12, Electronics[145]) across EU free-trade agreements*

EU–Canada	EU–Japan	EU–South Korea	EU–Vietnam
A change from any other heading, except from heading 85.03; or A change from within any one of these headings or heading 85.03, whether or not there is also a change from any other heading, provided that the value of non-originating materials classified in the same heading as the final product or heading 85.03 does not exceed 50% of the transaction value or ex-works price of the product.	For 85.01–85.02, CTH except from heading 85.03; MaxNOM 50% (EXW); or RVC 55% (FOB).		Manufacture from materials of any heading, except that of the product and of heading 8503; or Manufacture in which the value of all the materials used does not exceed 50% of the ex-works price of the product.

[144] For an accurate description of the products falling under headings 8401–8412, see the HS at www.wcoomd.org/en/topics/nomenclature/instrument-and-tools/hs-nomenclature-2017-edition/hs-nomenclature-2017-edition.aspx. The range of headings shown at the top of the table are purely indicative of possible applicable PSROs. For an accurate analysis it is necessary to refer to the specific heading level and to the text of the individual FTA.

[145] For an accurate description of the products falling under headings 8501–8512, see the HS at www.wcoomd.org/en/topics/nomenclature/instrument-and-tools/hs-nomenclature-2017-edi

TABLE 3.32 *PSRO (headings 87.01–87.02, Cars and vehicles) across EU free-trade agreements*

EU–Canada	EU–Japan	EU–South Korea	EU–Vietnam
8701–8705 Production in which the value of all non-originating materials used does not exceed 45% of the transaction value or ex-works price of the product.	For 87.01–87.07, MaxNOM 45% (EXW); or RVC 60% (FOB).	For 8701–8707 and 8712, Manufacture in which the value of all the materials used does not exceed 45% of the ex-works price of the product.	For Chapter 87, manufacture in which the value of all the materials used does not exceed 45% of the ex-works price of the product.

Table 3.32 shows the PSRO for cars showing a conspicuous simplicity compared to similar provision of NAFTA and USMCA. The basic rule is a 45 percent maximum VNOM across all the free trade agreements.

3.4.3 *The Rules of Origin of EPA in the EU–EAC, EU–ECOWAS, and EU–SADC*

3.4.3.1 Originating Products

The EU negotiations of the EPAs with the different African countries have been underway for more than a decade and at the time of writing such negotiations have been concluded with the major African regional groupings. The rules of origin contained in the EPAs are significantly more homogenous and similar than those examined in section 3.4.2. Yet, and as pointed out in this section, there are significant differences in some cases, especially among the PSRO in the SADC EPAs and EU–EAC EPAs contained in the respective protocols.

Special attention is given to the provisions about cumulation since:

(1) They attracted much debate during the negotiations that was, as discussed in Chapter 5 of this book, out of proportion, taking into account the scarce use made of cumulation in the sub-Saharan African context and the overall value of cumulation in a continent where local intermediate products are scarce.
(2) They are inherently complex to understand.
(3) As a corollary of (2), the implementation of these provisions has generated a number of implementation difficulties.

tion/hs-nomenclature-2017-edition.aspx. The range of headings shown at the top of the table are purely indicative of possible applicable PSROs. For an accurate analysis it is necessary to refer to the specific heading level and to the text of the individual FTA.

Table 3.33 shows the standard main provision for originating products under the different EPAs. Basically, all EPA architecture is based on a list of PSRO according to the EU standard and former Cotonou Agreement.[146]

3.4.3.2 Cumulation

3.4.3.2.1 COMPARISON OF CUMULATION PROVISIONS. Table 3.34 above provides a comparison among the cumulation provisions usually contained in the EU EPAs with Africa regional groupings; namely, the ECOWAS, SADC, EAC, and Eastern and Southern Africa (ESA).

With the exception of ESA,[147] the EPA architecture of cumulation is basically structured in a similar manner. The following kind of cumulation is provided:

TABLE 3.33 *Originating products*

SADC[i]	ECOWAS[ii]	EAC[iii]	ESA[iv]
1. For the purpose of this Agreement, the following products shall be considered as originating in the EU: (a) products wholly obtained in the EU within the meaning of Article 7 of this Protocol; (b) products obtained in the EU incorporating materials which have not been wholly obtained there, provided that such materials have undergone sufficient working or processing in the EU within the meaning of Article 8 of this Protocol. 2. For the purpose of this Agreement, the following products shall be considered as originating in a SADC EPA State: (a) products wholly obtained in a SADC EPA State within the meaning of Article 7 of this Protocol; (b) products obtained in a SADC EPA State incorporating materials which have not been wholly obtained there, provided that such materials have undergone sufficient working or processing in that SADC EPA State within the meaning of Article 8 of this Protocol.	The same as SADC.	The same as SADC and ECOWAS.	The same as SADC, ECOWAS and EAC.

[i] See Article 2 of Protocol 1 of SADC EPA.
[ii] See Article 2 of Protocol No. 1 of ECOWAS EPA.
[iii] See Article 2 of Protocol 1 of EAC EPA.
[iv] See Article 2 of Protocol 1 of ESA EPA.

[146] See www.europarl.europa.eu/intcoop/acp/03_01/pdf/mn3012634_en.pdf.
[147] The original ESA text did not provide a number of cumulation options with respect to other EPAs as shown in the table.

TABLE 3.34 *Cumulation of origin*

SADC[i]	ECOWAS[ii]	EAC[iii]	ESA[iv]
1. Bilateral cumulation (SADC–EU): ▪ EU originating materials to SADC originating materials – when incorporated into a product obtained in that SADC EPA State, provided that working or processing carried out there goes beyond the operations referred to in Article 9(1). ▪ SADC originating materials to EU originating materials – the same as above, provided that the product is exported to the same SADC EPA State. ▪ Working and processing – the same conditions as the two previous bullet points. 2. Diagonal cumulation: Materials	1. Materials originating in one of the Parties, in other ACP States which have at least provisionally applied an EPA, in the Republic of South Africa or the OCTs shall be considered as originating in the other Party when incorporated into a product obtained there, when the working or processing carried out in that Party goes beyond the operations referred to in Article 5(1). Where the working or processing carried out in the Party concerned does not go beyond the operations referred to in Article 5(1), the product obtained shall be considered as originating in that Party only where the value added there is greater than the value of the materials used originating in any of the other countries or territories. If this is not so, the product	1. Products shall be considered as originating in an EAC Partner State/EU if they are produced there, incorporating materials originating in the EU, materials originating in another ACP State which are entitled to DFQF treatment upon importation in the EU, materials originating in the OCTs or in the other EAC Partner States, provided the working or processing carried out in that EAC Partner State goes beyond the operations referred to in Article 9(1). It shall not be necessary for such materials to have undergone sufficient working or processing. Where the working or processing carried out in the EAC Partner States/EU does not go beyond the operations referred to in Article 9(1), the product obtained shall be considered as originating in that EAC Partner States/EU only where the value added there is	1. Products shall be considered as originating in the Community/ESA State if they are obtained there, incorporating materials originating in an ESA State/the Community, in the other ACP States or in the OCT or in the other ESA States, provided the working or processing carried out in the Community/that ESA State goes beyond the operations referred to in Article 8. It shall not be necessary for such materials to have undergone sufficient working or processing. Where the working or processing carried out in the Community/ESA State does not go beyond the operations referred to in Article 8, the product obtained shall be considered as originating in the Community/that ESA State only where the value added there is greater than the value of the materials

TABLE 3.34 (*continued*)

SADC[i]	ECOWAS[ii]	EAC[iii]	ESA[iv]
originating in a SADC EPA State, the EU, other ACP EPA States or in OCTs, shall be considered as materials originating in the SADC EPA State/EU where the materials are incorporated into a product obtained there, provided that the working or processing carried out in there goes beyond the operations referred to in Article 9(1). When working and processing does not go beyond the operations – the product obtained shall be considered as originating in that Party only where the value added there is greater than the value of the materials used originating in any of the other countries or territories.	obtained shall be considered as originating in the country or territory which accounts for the highest value of originating materials used in the manufacture of the final product. Working or processing carried out in one of the Parties, in other ACP States which have at least provisionally applied an EPA or in the OCTs shall be considered as having been carried out in the other Party, when the materials undergo subsequent working or processing going beyond that referred to in Article 5(1). Where the working or processing carried out in one of the Parties does not go beyond the operations referred to in Article 5(1), the product obtained shall be	greater than the value of the materials used originating in any of the other countries or territories. If this is not so, the product obtained shall be considered as originating in the country or territory which accounts for the highest value of originating materials used in the manufacture of the final product. Working and processing carried out in the EU, in the other EAC Partner States, in the other ACP States(/with which the EU applies an EPA) or in the OCTs shall be considered as having been carried out in an EAC Partner State/EU when the products produced undergo subsequent working or processing in this EAC Partner State/ the EU. Where the working or processing carried out in an EAC State/ EU does not go beyond the	used originating in any one of the other countries or territories referred to in paragraph 1. If this is not so, the product obtained shall be considered as originating in the country or territory which accounts for the highest value of originating materials used in the manufacture in the Community/That ESA State. Working and processing carried out in an ESA State/the Community, in the other ACP States or in the OCTs shall be considered as having been carried out in the Community/an ESA State when the products obtained undergo subsequent working or processing in the Community/ this ESA State. Where pursuant to this provision the originating products are obtained in two or more of the countries or territories concerned, they shall be considered as originating in the

(*continued*)

TABLE 3.34 (*continued*)

SADC[i]	ECOWAS[ii]	EAC[iii]	ESA[iv]
Working and processing carried out in a SADC EPA State/the EU, other ACP EPA States or in OCTS shall be considered as having been carried out in the SADC EPA State/the EU shall be considered as having been carried out in the SADC EPA State/the EU, when the materials go subsequent working or processing going beyond he operations referred to in Article 9(1). 3. Materials originating in other countries: a) benefiting from the "Special arrangement for least developed countries" of the	considered as originating in that Party only where the value added there is greater than the value of the materials used in any one of these countries or territories. If this is not so, the product obtained shall be considered as originating in the country or territory which accounts for the highest value of materials used in the manufacture of the final product. 2. Materials originating in countries and territories: a) benefiting from the "Special arrangement for least developed countries" of the Scheme of Generalised Tariff Preferences of the EU; or b) benefiting from duty-	operations referred to in Article 9(1), the product obtained shall be considered as originating in that EAC State/the EU only where the value added there is greater than the value of the materials used in any one of the other countries or territories. If this is not so, the product obtained shall be considered as originating in the country or territory which accounts for the highest value of materials used in the manufacture. 2. Materials originating in countries and teritorries: a) benefiting from the "Special arrangement for least developed countries" of the generalised system of preferences; b) benefiting from duty-free quota-free access to the EU market under the general	Community/this ESA State only if the working or processing goes beyond the operations referred to in Article 8. Where the working or processing carried out in the Community/ ESA State does not go beyond the operations referred to in Article 8, the product obtained shall be considered as originating in the Community/that ESA State only where the value added there is greater than the value of the materials used in any one of the other countries or territories referred to in paragraph 4. If this is not so, the product obtained shall be considered as originating in the country or territory which accounts for the highest value of materials used in the manufacture. 2. At the request of the ESA States and following the provisions of Article 41, materials originating in a neighbouring

TABLE 3.34 (*continued*)

SADC[i]	ECOWAS[ii]	EAC[iii]	ESA[iv]
generalised system of preferences; b) benefiting from duty-free quota-free access to the market of the EU under the general provisions of the generalised system of preferences, shall be considered as materials originating in SADC EPA State when incorporated into a product obtained there, provided they have undergone working or processing going beyond that referred to in Article 9 (1). At the request of a SADC EPA State, materials originating in	free quota-free access to the market of the European Union under the general provisions of the Scheme of Generalised Tariff Preferences; shall be considered as materials originating in a West African State when incorporated into a product obtained there. It shall not be necessary for these materials to have undergone sufficient working or processing, provided they have undergone working or processing going beyond that referred to in Article	provisions of the generalised system of preferences; shall be considered as materials originating in an EAC Partner State when incorporated into a product obtained there. It shall not be necessary that such materials have undergone sufficient working or processing, provided they have undergone working or processing going beyond that referred to in Article 9(1). A product, in which these materials are incorporated, in case it also includes non-originating materials, will have to undergo sufficient working or processing in accordance with	developing country, other than an ACP State, belonging to a coherent geographical entity, a listing of which is at Annex VIII, can be considered as materials originating in an ESA State when incorporated into a product obtained there. It shall not be necessary that such materials have undergone sufficient working or processing, provided that: (a) the working or processing carried out in the ESA State exceeds the operations listed in Article 8; (b) the ESA States, the Community and the neighbouring developing countries concerned have concluded an agreement on adequate administrative cooperation

(*continued*)

TABLE 3.34 (*continued*)

SADC[i]	ECOWAS[ii]	EAC[iii]	ESA[iv]
countries or territories which benefit from agreements or arrangements that provide for DFQF access to the market of the EU can be considered as materials originating in a SADC EPA State. The request shall be submitted by the SADC EPA State to the EU through the European Commission, which shall take a decision on the request in accordance with its internal procedures. It shall not be necessary that such materials have undergone sufficient working or processing, provided they	5(1). If the product into which these materials have been incorporated also includes non-originating materials, it will have to undergo sufficient working or processing in accordance with Article 4 to be considered as originating in West Africa. On the basis of a notification from a West African State, materials originating in countries or territories which are covered by agreements or arrangements that provide for DFQF access to the market of the EU shall be	Article 8 to be considered as originating in an EAC Partner State. At the request of an EAC Partner State, materials originating in countries and territories which benefit from agreements or arrangements that provide for DFQF access to the market of the EU shall be considered as materials originating in an EAC Partner State. The request shall be submitted by the EAC Partner State to the EU which shall grant the request in accordance with its internal procedures. The cumulation will remain in place as long as the aforementioned conditions are fulfilled.	procedures which will ensure correct implementation of this paragraph.

TABLE 3.34 (*continued*)

SADC[i]	ECOWAS[ii]	EAC[iii]	ESA[iv]
have undergone working or processing going beyond that referred to in Article 9 (1). 4. Non-originating materials which are subject to MFN duty free treatment in the EU shall be considered as materials originating in a SADC EPA State when incorporated into a product obtained there. It shall not be necessary that such materials have undergone sufficient working or processing, provided they have undergone working or processing	considered to be materials originating in a West African State. Such notification shall be sent by the West African State to the EU through the European Commission. Cumulation shall remain applicable as long as the conditions for granting such cumulation are met. It shall not be necessary for such materials to have undergone sufficient working or processing, provided they have undergone working or processing going beyond that		

(*continued*)

TABLE 3.34 (*continued*)

SADC[i]	ECOWAS[ii]	EAC[iii]	ESA[iv]
beyond that referred to in Article 9(1).	referred to in Article 5(1).		

[i] See Articles 3–6 of Protocol 1 of SADC EPA.
[ii] The Economic Community of West African States (ECOWAS). See Articles 7 and 8 of Protocol 1 of ECOWAS EPA.
[iii] See Articles 4–6 of Protocol 1 of EAC EPA.
[iv] See Articles 3–5 of ESA EPA.

(a) bilateral cumulation with EU (cumulation of materials and working and processing)
(b) regional diagonal cumulation (cumulation of materials and working and processing) with
  (i) countries of the same regional grouping
  (ii) other ACP countries
  (iii) overseas countries and territories (OCTs)
(c) cumulation with products that are MNF duty free at importation into the EU
(d) cumulation with products originating in preferential DFQF countries as follows:
  (i) LDCs and developing country beneficiaries of the EBA or GSP of the EU and
  (ii) countries having entered free-trade agreements with the EU
(e) limitation on cumulation (cumulation is not allowed for certain categories of products).

The EU jargon on cumulation may be quite confusing as it provides for the wording of "diagonal cumulation" that may be interpreted differently depending on the context where it is used. Under the EU provisions and the EU–SADC Protocol on Rules of Origin diagonal cumulation is the possibility to cumulate with other SADC members states, ACP states, and OCTs; that is, a geographical dimension of cumulation.

At the same time, diagonal cumulation is also referred to, including in the EU, as a qualitative aspect of cumulation (i.e. cumulation of originating materials) as opposed to "full" cumulation (i.e. a cumulation of working and processing operations).

The Guide to the Protocol on Rules of Origin of EU–SADC (EPA)[148] contains an illuminating example to illustrate the content of Article 4 of the EU–SADC EPA:

[148] See "Guide to the Protocol on Rules of Origin of the Economic Partnership Agreement (EPA) between the European Union and its Member States, of the one part, and the SADC EPA States, of the other part," Taxud.b.4(2017)3253415.

ARTICLE 4 – DIAGONAL CUMULATION

There are in fact three types of cumulation provided in this article:

(a) cumulation between materials originating in two or more SADC EPA States representing a form of "regional cumulation" between the SADC EPA States themselves for the purpose of exporting their goods to the EU;
(b) cumulation of materials originating in other ACP EPA states, OCTs or the EU, representing what is usually named "diagonal cumulation";
(c) cumulation of working or processing, usually referred to as "full cumulation" with materials from other SADC EPA States, ACP EPA states, OCTs or the EU.

Any combination of the three types of cumulation described above may be used in the manufacture of a product.

Cumulation is not automatic. In order for cumulation to effectively enter into force, a number of procedures have to be followed and complied with as further outlined in the next section.

3.4.3.2.2 CUMULATION UNDER THE EU–SADC EPA. In this section the relevant texts of the EU–SADC EPAs are reviewed and commented on to better understand the cumulation provision inserted in Table 3.34. It has to be borne in mind that, as explained in the preceding section, as the text of the EPAs is similar or identical across African EPAs, the same comments in this section about the SADC text are also valid, mutatis mutandis, for the text of other EPAs.

Bilateral Cumulation This form of cumulation is contained in Article 3 of the EU–SADC EPA Protocol on Rules of Origin:

2. Without prejudice to the provisions of Article 2(2) of this Protocol, materials originating in the EU within the meaning of this Protocol shall be considered as materials originating in a SADC EPA State when incorporated into a product obtained in that SADC EPA State, provided that the working or processing carried out there goes beyond the operations referred to in Article 9(1) of this Protocol.

It is important to note that bilateral cumulation extends not only to materials originating in the EU but also to working and processing carried out in the EU, as stated in paragraph 4 of Article 3 of the EU–SADC EPA Protocol on Rules of Origin:

4. Without prejudice to the provisions of Article 2(2) of this Protocol, working and processing carried out in the EU shall be considered as having been carried out in a SADC EPA State, when the materials undergo in the latter subsequent working or processing going beyond the operations referred to in Article 9(1) of this Protocol.

Regional Diagonal Cumulation Regional diagonal cumulation is contained in paragraph 2 of Article 4 of the EU–SADC EPA Protocol on Rules of Origin, which provides as follows:

> Without prejudice to the provisions of the Article 2(2) of the Protocol, materials originating in a SADC EPA State, the EU, other ACP EPA States or in OCTs shall be considered as materials originating in the SADC EPA State where the materials are incorporated into a product obtained there, provided that the working or processing carried out there goes beyond the operations referred to in Article 9(1) of the Protocol.

Paragraph 5 of Article 4 of the EU–SADC EPA Protocol on Rules of Origin provides a criterion for allocating origin among the different countries that have been involved in the production of a good:

> when the working or processing carried out in a SADC EPA State or in the EU does not go beyond the operations referred to in Article 9(1) of the Protocol, the product obtained shall be considered as originating in a SADC EPA State or in the EU only when the value added there is greater than the value of the materials used originating in any one of the other countries or territories.

The EU–SADC EPA provides as well for full cumulation, as contained in paragraph 2 of Article 4 of the EU–SADC EPA Protocol on Rules of Origin, which provides as follows:

> Without prejudice to the provisions of the Article 2(2) of the Protocol, working or processing carried out in a SADC EPA State, the EU, other ACP EPA States or in the OCTs shall be considered as having been carried out in the SADC EPA State when the materials undergo subsequent working or processing beyond the operations referred to in Article 9(1) of the Protocol.

Cumulation with EU MFN Duty Free Article 5(1) of the EU–SADC EPA provides for this kind of cumulation, which is a trade-facilitating compliance mechanism only existing in the EPAs with African countries. Such cumulation allows the consideration of non-originating components as originating if they could be imported MFN duty free into the EU as follows:

> 1. Without prejudice to the provisions of the Article 2(2) of the Protocol, non-originating materials which at importation into the EU are free of customs duties by means of application of conventional rates of the most-favoured nation tariff in accordance with its Common Customs Tariff shall be considered as materials originating in a SADC EPA State when incorporated into a product obtained there. It shall not be necessary that such materials have undergone sufficient working or processing, provided they have undergone working or processing going beyond that referred to in Article 9(1) of the Protocol.
>
> 2. Movement certificates EUR.1 (in Box 7) or origin declarations issued by application of paragraph 1 shall bear the following entry: "Application of Article 5(1) of Protocol 1 of the EU–SADC EPA".

3. The EU shall notify yearly to the Special Committee on Customs and Trade Facilitation referred to in Article 50 of the Agreement ("The Committee") the list of materials to which the provisions of this Article shall apply.

Preferential DFQF Access Cumulation This possibility of cumulation is twofold as it provides cumulation with GSP and EBA beneficiaries below in Article 6 and at the same time provides, upon request, for the possibility of cumulating with FTA partners of the EU such as South Korea and Japan that could be eminently important for African countries that have an extremely limited capacity of intermediate materials.

(i) Paragraph 1 of Article 6 of the EU–SADC EPA – Cumulation with GSP and EBA

Without prejudice to the provisions of the Article 2(2) of the Protocol, materials originating in countries and territories:

(a) benefiting from the "Special arrangement for least developed countries" of the generalized system of preferences;
(b) benefiting from duty-free quota-free access to the market of the EU under the general provisions of the generalized system of preferences;

shall be considered as materials originating in a SADC EPA State when incorporated into a product obtained there, provided they have undergone working or processing going beyond that referred to in Article 9(1) of the Protocol.

The origin of the materials of the countries or territories concerned shall be determined according to the rules of origin applicable in the framework of the EU's preferential arrangements with those countries and territories and in accordance with Article 30 of the Protocol.

(ii) Paragraph 2 of Article 6 – DFQF Agreements or Arrangements (EU Free-Trade Agreements)

At the request of a SADC EPA State, materials originating in countries or territories which benefit from agreements or arrangements that provide for duty-free quota-free access to the market of the EU can be considered as materials originating on a SADC EPA State. The request shall be submitted by the SADC EPA State to the EU through the European Commission, which shall take a decision on the request in accordance with its internal procedures.

It shall not be necessary that such materials have undergone sufficient working or processing, provided they have undergone working or processing going beyond that referred to in Article 9(1) of the Protocol.

The origin of the materials of the countries or territories concerned shall be determined according to the rules of origin applicable in the framework of the

EU's preferential agreements or arrangements with those countries and territories and in accordance with Article 30 of the Protocol.

Limitations on Use of Material for Cumulation Purposes

(i) Limitations on Diagonal Cumulation

15. The cumulation provided in paragraph 2 shall not apply to materials:
   (a) of Harmonised System Headings 1604 and 1605 originating in the EPA Pacific States according to Article 6(6) of Protocol II of the Interim Partnership Agreement between the European Community, on the one part, and the Pacific States, on the other part.
   (b) of Harmonised System Headings 1604 and 1605 originating in the Pacific States according to any future provision of a comprehensive Economic Partnership Agreement between the EU and Pacific ACP States.
   (c) originating in South Africa and which cannot be imported directly into the EU duty-free quota-free.

In respect of paragraph 15(c) of Article 4 above, the EU, the South African Customs Union (SACU), and Mozambique, respectively, shall establish the list of materials concerned and shall ensure the lists are revised as necessary to ensure compliance with this paragraph.

SACU and Mozambique shall notify their respective lists and any subsequent versions thereof in track changes to the European Commission. The EU shall notify its respective list and any subsequent versions thereof in track changes to the SACU Secretariat and the Ministry of Industry and Trade of Mozambique. After notification, as provided for in this paragraph, each party shall make public each of these lists according to their own internal procedures. The Parties shall publish the lists and any subsequent amendments thereof within one (1) month of receipt of the notification. In cases where lists, or their subsequent versions, are notified after the date of entry into force of cumulation, exclusion from cumulation with the materials will become effective six (6) months after the receipt of the notification.

By way of derogation from paragraph 15(c), the EU, SACU, and Mozambique may remove any material from their respective lists.

Cumulation with the materials that were removed from the respective list will become effective upon notification and publication of the revised lists. The Parties shall publish the lists and any subsequent amendments thereof within one (1) month of receipt of the notification.

(ii) Limitation on MFN Duty-Free Cumulation According to paragraph 4 of Article 5 of the EU–SADC Protocol on Rules of Origin cumulation:

shall not apply to materials:

(a) which at importation into the EU are subject to anti-dumping or countervailing duties when originating from the country which is subject to these anti-dumping or countervailing duties;
(b) classified in subheadings of the Harmonised System which include, in the EU Common Customs Tariff, 8-digit tariff lines which are not free of customs duties by means of application of conventional rates of the EU's most-favoured nation tariff.

(iii) Limitation of Cumulation with Preferential DFQF Agreements and Arrangements Paragraph 1 of Article 6 – GSP – cumulation shall not apply to:

(a) materials which at importation to the EU are subject to anti-dumping or countervailing duties when originating in a country which is subject to these anti-dumping or countervailing duties;
(b) materials classified in subheadings of the Harmonised System which include, in the EU Common Customs Tariff, 8-digit tariff lines which are not free of customs duties by means of application of the GSP arrangements;
(c) tuna products classified under Harmonised System Chapters 3 and 16, which are covered by Article 7 and 12 of Regulation (EU) No 978/2012 of the European Parliament and of the Council of 25 October 2012 applying a scheme of generalised tariff preferences, and subsequent amending and corresponding legal acts;
(d) materials which are covered by Articles 8, 22 and 29 of Regulation (EU) No 978/2012 of the European Parliament and of the Council of 25 October 2012 applying a scheme of generalised tariff preferences, and subsequent amending and corresponding legal acts.

Paragraph 2 of Article 6 – DFQF access agreements or arrangements – cumulation shall not apply to products:

(a) falling within Harmonised System Chapters 1 to 24 and the products listed in the Annex 1 – paragraph 1.(ii) of the Agreement on Agriculture belonging to the GATT 1994 unless these materials benefit from duty-free, quota-free access to the market of the EU under an agreement, other than an EPA, between an ACP State and the EU;[149]

[149] An exception is provided in para. 3 of Article 6:

3. Notwithstanding paragraph 2(a), the Parties, in support of African integration, will consider the possibility whether a material, referred to in paragraph 2(a)) and originating in a non-ACP party of the African continent, can be used for the purpose of cumulation provided for in paragraph 2.

4. Paragraph 3 can only be effected upon agreement by the Parties, including on the applicable conditions. It shall apply to materials benefitting from duty-free quota-free access to the market of the EU and provided each Party applies a free trade agreement in line with the GATT 1994 with that non-ACP party.

(b) which at importation to the EU are subject to anti-dumping or countervailing duties when originating from the country which is subject to these anti-dumping or countervailing duties;
(c) classified in subheadings of the Harmonised System which include, in the EU Common Customs Tariff, 8-digit tariff lines which are not free of customs duties by means of application of DFQF agreements or arrangements.

Procedures for the Entry into Force of Cumulation Provisions Each EPA concluded with African regional economic communities (RECs) provides for similar provisions of procedures to be complied with before the entry into force of cumulation. In the large majority of cases this has proved to be a difficult and tedious exercise for the African RECs and ACP states since they had problems in understanding the complexities of the protocols on rules of origin attached to the EPAs and most of all the provisions on cumulation. Cumulation has been a permanent feature of ACP/EU relations since it was provided for in the rules of origin of the former Lomé and Cotonou partnership agreement. However, under these former arrangements, cumulation, albeit seldom used by ACP countries, was automatic as part of a single EU–ACP undertaking contained in the Lomé/Cotonou arrangements.

With the EPAs' configuration such a single undertaking was no longer present. Hence it has been necessary to insert a number of procedures and conditionalities on cumulation in each EU EPA with African regional groupings to make sure that all EPA members were ready to ensure an efficient system of administrative cooperation for the proper functioning of cumulation in case of verification and related processes.

Paragraph 9 of Article 4 of the EU–SADC EPA Protocol on Rules of Origin provides that cumulation may only be applied when:

(a) the SADC EPA States, other ACP EPA States and OCTs have entered into an arrangement or agreement on administrative cooperation with each other, which ensures compliance with and a correct implementation of diagonal and full cumulation article and includes a reference to the use of appropriate proofs of origin;
(b) the SACU Secretariat and the Ministry of Industry and Trade of Mozambique have provided the European Commission with the details of the arrangements or agreements on administrative cooperation entered into with the other countries or territories referred to in the diagonal and full cumulation article.

5. The EU shall notify yearly to the SACU Secretariat and the Ministry of Industry and Trade of Mozambique the list of materials and countries to which paragraph 1 shall apply. The SADC EPA States shall notify the European Commission, on a yearly basis, the countries to which cumulation under paragraph 1 has been applied.

There has been, and there still is, a lot of confusion and fear among ACP states on the content of the arrangement or agreement on administrative cooperation required to fulfill such requirement. In reality an ACP document negotiated among ACP states exists since June 2015. On September 2018 thirteen ACP states signed the arrangement that simply provides for exchange of information among customs on the operational modalities listed in the annex to the document such as:

1. exchange addresses/contact details of the customs authorities responsible for issuing and verifying movement certificates EUR.1, supplier's declarations, invoice declarations, origin declarations, Form A, or statements on origin
2. exchange specimen impressions of stamps used in their customs offices for the issue of these proofs of origin
3. endorse proofs of origin going to other ACP EPA signatory countries and OCTs for cumulation purposes
4. accept proofs of origin coming from other ACP countries and OCTs for cumulation purposes
5. assist one another to verify the authenticity of the proofs of origin
6. settle any dispute that may arise in relation to the verification procedures provided for in this undertaking.

Moreover paragraphs 11 and 12 of Article 4 provide for a time horizon for such implementation:

> 11. Once requirements of paragraph 9 have been fulfilled and the date for the simultaneous entry into force of cumulation provided for under the diagonal and full cumulation article has been agreed upon between the EU and the SADC EPA States, each Party shall fulfill its own publication and information provided for in paragraph 14.

Paragraph 12 of Article 4 provides in fact an important caveat since in the absence of a common date of implementation as provided under paragraph 11 and after five years of having signed an agreement or arrangement of administrative cooperation each party may unilaterally apply cumulation:

> 12. Notwithstanding paragraph 11, the date of the implementation of cumulation provided for under this Article with materials from a particular country or territory shall not be beyond a period of five (5) years starting from the date of the signature by a SADC EPA State or the EU of an agreement/arrangement on

administrative cooperation with that particular country or territory provided for in paragraphs 9 and 10.

After the five-year period provided above, the EU and the SADC EPA states may start applying diagonal and full cumulation provided that the requirements of paragraph 9 (arrangement of administrative cooperation) have been fulfilled.

In the specific case of the EU–SADC EPA, on November 11, 2018, the EU issued a communication[150] stating that the EU may cumulate with:

- selected Caribbean countries
- Central Africa Region: Republic of Cameroon
- ESA region: Madagascar; Mauritius; Seychelles; Zimbabwe
- Pacific Region: Papua New Guinea and Fiji
- West Africa Region: Ivory Coast
- OCTs.

However, cumulation is still not applicable for SADC members of the EU–SADC EPAs since SACU countries have concluded the joint undertaking for administrative cooperation,[151] but the SACU Secretariat has not notified the EU according to Article 4(9)(b):

The SACU Secretariat and the Ministry of Industry and Trade of Mozambique have provided the European Commission with the details of the arrangements or agreements on administrative cooperation entered into with the other countries or territories referred to in this Article.

As a result, the EU can cumulate with the abovementioned countries while SACU cannot cumulate with anyone. As SACU was advised by the author,[152] there is an obvious case for SACU counties to redress the current situation by undertaking the following actions:

[150] See "Notice from the Commission pursuant to paragraph 14 of Article 4 of the Protocol 1 to the Economic Partnership Agreement between the European Union and the SADC EPA States, concerning the definition of the concept of 'originating products' and methods of administrative cooperation – Cumulation between the European Union and ACP EPA States and the overseas countries and territories of the EU as provided for under paragraphs 3 and 7 of Article 4 of the Protocol 1 to the EU-SADC EPA," OJ C 407/8 (November 12, 2018).

[151] This is a joint undertaking document under the aegis of the ACP Secretariat, open for signature to ACP states to facilitate compliance with the requirement of having an administrative arrangement in place as a condition to implement cumulation. See ACP/61/035/15 rev.2, January 26, 2015.

[152] February 2019.

(a) Notification as indicated in Article 4(9)(b) is to be given by the SACU Secretariat on behalf of SACU states and the Mozambique Ministry of Commerce to the EU Commission stating that:
  (1) SACU intends to apply cumulation as provided for in paragraphs 2 and 6 of Article 4 of the Protocol.
  (2) Such cumulation will be applicable among the countries that have signed the ACP joint undertaking, stating the name of the countries.
  (3) The content of the abovementioned joint ACP undertaking will be attached to the notification.
(b) After the notification, ALL parties (all SADC EPA states and the EU) shall agree on the date of entry into force (Article 4(11)). SADC EPA states cannot make recourse to Articles 4(12) and 4(13) as the EU has done, because the ACP Joint Undertaking has not been signed by any country more than five years ago. The EU is expected not to pose any problem on agreeing on the date.
(c) The last step is that each SADC EPA state and the EU shall publish according to their internal procedures (Articles 4(11) and 4(14)) the date of entry into force of cumulation.
(d) The EU shall publish it in the C Series of the EU Official Journal.

3.4.3.2.3 PSRO ACROSS AFRICAN EPAS – EXAMPLES. The PSRO contained in the EPAs are substantially similar and, in some cases, identical with the notable exception of the EAC rules of origin. In fact the EAC PSRO are the result of the request from the EAC side to have asymmetrical PSRO; that is, certain PSRO are more stringent for the EU than for the EAC as contained in Tables 3.39 and 3.40.

In addition, for a number of PSRO the EAC managed to negotiate a 70 percent requirement of non-originating materials similar to the EBA percentage while the remaining EPAs percentage-based PSRO still require a demanding limit of 40 percent of non-originating materials.

As shown in Table 3.35, there are also exceptions to the general tenet that EAC PSRO are more lenient. In this case the EAC PSRO contain an additional limitation on the use of non-originating sugar.

As shown in Table 3.36 for the products of Chapter 9, the PSRO contained in EPAs with African countries are – wholly obtained – substantially more restrictive that those contained in the EU free-trade agreements as shown in Table 3.21. Such stringent PSRO may depend, on the one hand, on the insistence of African countries who believe they possess all possible grades of coffee and spices and are therefore able to produce wholly obtained products of Chapter 9 for export to the EU and, on the other hand, on there being an intention to impose stringent rules of origin on the EU counterpart that does not grow such raw material. In reality this policy is rather self-defeating since mixing of different quality spices and teas of different origin is relatively common in industry even in countries having abundant raw materials.

TABLE 3.35 *PSRO (ex-Chapter 4, Dairy produce; birds' eggs; natural honey; edible products of animal origin, not elsewhere specified or included) across African EPAs*

SADC[i]	ECOWAS[ii]	EAC[iii]	ESA[iv]
Manufacture in which all the materials of Chapter 4 used are wholly obtained.	The same as SADC.	Manufacture in which: – all the materials of Chapter 4 are wholly obtained; and – the weight of sugar used does not exceed 40% of the weight of the final product.	The same as SADC and ECOWAS.

[i] See Annex II(A).
[ii] See Annex II to Protocol No. 1.
[iii] See Annex II.
[iv] See Annex II to Protocol No. 1.

TABLE 3.36 *PSRO (ex-Chapter 9, Coffee, tea, maté and spices) across African EPAs*

SADC	ECOWAS	EAC	ESA
Manufacture in which all the materials of Chapter 9 used are wholly obtained.	Manufacture in which all the materials of Chapter 9 used are wholly obtained.	Manufacture in which all the materials of Chapter 9 used must be wholly obtained.	Manufacture in which all the materials of Chapter 9 used must be wholly obtained.

As discussed above, the PSRO shown in Table 3.37 are a common feature in each EU free-trade agreements for HS Chapter 16. The different drafting of the EAC PSRO arises from the fact that the stringent rules for fishery products of Chapter 16, usually singled out in other free-trade agreements under heading 16.04 (prepared or preserved fish; caviar and caviar substitutes prepared from fish egg) and heading 16.05 (prepared or preserved fish; caviar and caviar substitutes prepared from fish egg) as is the case for the SADC, ECOWAS, and ESA text are applicable to all headings of HS Chapter 3. The EAC text in this case has different drafting and for fishery products does not provide for the 15 per cent tolerance that is present in other EPAs.

Table 3.38 refers to inorganic chemicals and once again the only difference across the EPAs is marked by the EAC showing a more lenient threshold of 50 percent of non-originating materials.

Table 3.39 reproduces the efforts of the EAC negotiators to obtain more lenient rules with a higher percentage of non-originating material of 50 percent instead of 40 percent. For the remaining part of the text the PSRO are identical.

The rules of origin contained in the EPAs for Chapter 61 (knitted and crocheted garments) all provide for a single transformation: from fabric to finished garments.

TABLE 3.37 *PSRO (Chapter 16, Animal or vegetable fats and oils and their cleavage products; prepared edible fats; animal or vegetable waxes) across African EPAs*

SADC	ECOWAS	EAC	ESA
For ex-Chapter 16: Manufacture from animals of Chapter 1. 1604 and 1605 Prepared or preserved fish; caviar and caviar substitutes prepared from fish eggs; Crustaceans, molluscs and other aquatic invertebrates, prepared or preserved Manufacture in which the value of any materials of Chapter 3 used does not exceed 15% of the ex-works price of the product	For ex-Chapter 16: Manufacture from animals of Chapter 1. 1604 and 1605 Prepared or preserved fish; caviar and caviar substitutes prepared from fish eggs; Crustaceans, molluscs and other aquatic invertebrates, prepared or preserved Manufacture in which the value of any materials of Chapter 3 used does not exceed 15% of the ex-works price of the product	For exports of EU to EAC and vice versa: – from materials of any heading, except meat and edible meat offal of Chapter 2 and materials of Chapter 16 obtained from meat and edible meat offal of Chapter 2, and – in which all the materials of Chapter 3 and materials of Chapter 16 obtained from fish and crustaceans, mollusks, and other aquatic invertebrates of Chapter 3 used are wholly obtained.	For ex-Chapter 16: Manufacture from animals of Chapter 1. 1604 and 1605 Prepared or preserved fish; caviar and caviar substitutes prepared from fish eggs; Crustaceans, molluscs and other aquatic invertebrates, prepared or preserved Manufacture in which the value of any materials of Chapter 3 used does not exceed 15% of the ex-works price of the product

In the case of Table 3.40 the wording of the EAC product-specific rules under the second alternative PSRO is similar to the wording used in the case of EBA. There are no substantial differences in terms of the restrictiveness since all products classified under "other," essentially parts of garments, fall under the double transformation requirements: spinning and knitting or spinning and dyeing.

The general chapter rules of origin contained in the EPAs for Chapter 62 (woven garments) all provide for a single transformation: from fabric to finished garments.

Table 3.41 provides for a comparison for certain heading 6213 and 6214 "embroidered products" that are an exception to the general chapter rules providing for a single transformation. As pointed out above, the EAC PSRO for these two heading are different than those of other EPAs.

There are no differences in PSRO for shoes under EPAs that are identical to those provided under EBA (see Table 3.42). These PSRO are extremely lenient as they allow the assembly of parts of shoes into finished shoes.

TABLE 3.38 *PSRO (ex-Chapter 28, Inorganic chemicals; organic or inorganic compounds of precious metals, of rare-earth metals, of radioactive elements or of isotopes) across African EPAs*

SADC	ECOWAS	EAC	ESA
Manufacture in which all the materials used are classified within a heading other than that of the product. However, materials classified within the same heading may be used provided their value does not exceed 20% of the ex-works price of the product.	Manufacture in which all the materials used are classified within a heading other than that of the product. However, materials classified within the same heading may be used provided their value does not exceed 20% of the ex-works price of the product.	For EU exports to EAC and vice versa: Manufacture from materials of any heading, except that of the product. However, materials of the same heading as the product may be used, provided that their total value does not exceed 20% of the ex-works price of the product.	Manufacture in which all the materials used are classified within a heading other than that of the product. However, materials classified within the same heading may be used provided their value does not exceed 20% of the ex-works price of the product.
or	or	or	or
Manufacture in which the value of all the materials used does not exceed 40% of the ex-works price of the product.	Manufacture in which the value of all the materials used does not exceed 40% of the ex-works price of the product.	Manufacture in which the value of all the materials used does not exceed 50% of the ex-works price of the product.	Manufacture in which the value of all the materials used does not exceed 40% of the ex-works price of the product.

TABLE 3.39 *PSRO (heading 3826, Biodiesel and mixtures thereof, not containing or containing less than 70% by weight of petroleum oils or oils obtained from bituminous minerals) across African EPAs*

SADC	ECOWAS	EAC	ESA
Manufacture in which the value of all the materials used does not exceed 50% of the ex-works price of the product.	Manufacture in which the value of all the materials used does not exceed 50% of the ex-works price of the product.	Manufacture in which the value of all the materials used does not exceed 70% of the ex-works price of the product.	Manufacture in which the value of all the materials used does not exceed 50% of the ex-works price of the product.

TABLE 3.40 *PSRO (Chapter 61, Articles of apparel and clothing accessories, knitted or crocheted) across African EPAs*

SADC	ECOWAS	EAC	ESA
– Obtained by sewing together or otherwise assembling, two or more pieces of knitted or crocheted fabric which have been either cut to form or obtained directly to form: Manufacture from fabric – Other: Manufacture from yarn.[i]	– Obtained by sewing together or otherwise assembling, two or more pieces of knitted or crocheted fabric which have been either cut to form or obtained directly to form: – Other: Manufacture from fabric or yarn.[ii]	– Obtained by sewing together or otherwise assembling, two or more pieces of knitted or crocheted fabric which have been either cut to form or obtained directly to form: Manufacture from fabric – Other: Spinning of natural and/or man-made staple fibers or extrusion of man-made filament yarn, in each case accompanied by knitting (knitted to shape products) or dyeing of yarn of natural fibers accompanied by knitting (knitted to shape products) (1).[iii]	– Obtained by sewing together or otherwise assembling, two or more pieces of knitted or crocheted fabric which have been either cut to form or obtained directly to form: Manufacture from fabric – Other: Manufacture from yarn.[iv]

[i] For special conditions relating to products made of a mixture of textile materials, see Introductory Note 5 of EU–SADC EPA Agreement.
[ii] For special conditions relating to products made of a mixture of textile materials, see Introductory Note 5 of EU–ECOWAS EPA Agreement.
[iii] For special conditions relating to products made of a mixture of textile materials, see Introductory Note 6 of EU–EAC EPA Agreement.
[iv] For special conditions relating to products made of a mixture of textile materials, see Introductory Note 5 of EU–ESA EPA Agreement.

TABLE 3.41 *PSRO (headings 6213, Handkerchiefs, and 6214, Shawls, scarves, mufflers, mantillas, veils and the like) across African EPAs*

SADC	ECOWAS	EAC	ESA
For embroidered products: Manufacture from yarn or Manufacture from unembroidered	For embroidered products: Manufacture from yarn or Manufacture from unembroidered	For embroidered products: Manufacture from yarn from EU to EAC: Weaving accompanied by making up (including cutting)	For embroidered products: Manufacture from yarn or Manufacture from unembroidered

(*continued*)

TABLE 3.41 (*continued*)

SADC	ECOWAS	EAC	ESA
fabric provided the value of the unembroidered fabric used does not exceed 40% of the ex-works price of the product.[i]	fabric provided the value of the unembroidered fabric used does not exceed 40% of the ex-works price of the product.[ii]	or Manufacture from unembroidered fabric, provided that the value of the unembroidered fabric used does not exceed 40% of the ex-works price of the product (1) or Making up preceded by printing accompanied by at least two preparatory or finishing operations (such as scouring, bleaching, mercerising, heat setting, raising, calendering, shrink resistance processing, permanent finishing, decatising, impregnating, mending, and burling), provided that the value of the unprinted fabric used does not exceed 50% of the ex-works price of the product.[iii] For Embroidered products from EAC to EU: Weaving accompanied by making up (including cutting); or Making up preceded by printing accompanied by at least two preparatory or finishing operations (such as scouring, bleaching, mercerising, heat setting, raising, calendering, shrink resistance processing, permanent finishing, decatising, impregnating, mending, and burling), provided that the value of the	fabric provided the value of the unembroidered fabric used does not exceed 40% of the ex-works price of the product.[iv]

TABLE 3.41 (*continued*)

SADC	ECOWAS	EAC	ESA
		unprinted fabric used does not exceed 50% of the ex-works price of the product. Or Manufacture from unembroidered fabric provided the value of the unembroidered fabric used does not exceed 40% of the ex-work price of the product.	

[i] See Introductory Notes 5 and 6 of EU–SADC EPA Agreement for further details.
[ii] For special conditions relating to products made of a mixture of textile materials, see Introductory Notes 5 and 6 of EU–ECOWAS EPA Agreement.
[iii] See Introductory Notes 5 and 6 for further details.
[iv] See Introductory Notes 5 and 6 for further details.

TABLE 3.42 *PSRO (Chapter 64, Footwear, gaiters and the like; parts of such articles) across African EPAs*

SADC	ECOWAS	EAC	ESA
For ex-Chapter 64: Manufacture from materials of any heading except for assemblies of uppers affixed to inner soles or to other sole components of heading No 6406.	For ex-Chapter 64: Manufacture from materials of any heading except for assemblies of uppers affixed to inner soles or to other sole components of heading No 6406.	For ex-Chapter 64 exports from EU to EAC and vice versa: Manufacture from materials of any heading except for assemblies of uppers affixed to inner soles or to other sole components of heading No 6406.	For ex-Chapter 64: Manufacture from materials of any heading except for assemblies of uppers affixed to inner soles or to other sole components of heading No 6406.

Table 3.43 compares the PSRO for tubes and pipes showing that in this case identical PSROs are contained in EPAs.

Tables 3.44 and 3.45 report remarkable differences in Chapters 84 and 85 in terms of percentages applicable and the provision of alternative rules of origin among the

TABLE 3.43 *PSRO (heading 7307, Tube or pipe fittings (for example, couplings, elbows, sleeves), of iron or steel) across African EPAs*

SADC	ECOWAS	EAC	ESA
Turning, drilling, reaming, threading, deburring, and sandblasting of forged blanks the value of which does not exceed 35% of the ex-works price of the product.	Turning, drilling, reaming, threading, deburring, and sandblasting of forged blanks the value of which does not exceed 35% of the ex-works price of the product.	For ex-7307 exports from EU to EAC and vice versa: Turning, drilling, reaming, threading, deburring, and sandblasting of forged blanks the value of which does not exceed 35% of the ex-works price of the product.	Turning, drilling, reaming, threading, deburring, and sandblasting of forged blanks the value of which does not exceed 35% of the ex-works price of the product.

TABLE 3.44 *PSRO (ex-Chapter 84, Nuclear reactors, boilers, machinery and mechanical appliances; parts thereof) across African EPAs*

SADC	ECOWAS	EAC	ESA
Manufacture in which: (1) all the materials used are classified within a heading other than that of the product (2) the value of all the materials used does not exceed 40% of the ex-works price of the product. Or Manufacture in which the value of all the materials used does not exceed 30% of the ex-works price of the product.	Manufacture in which: (1) all the materials used are classified within a heading other than that of the product (2) the value of all the materials used does not exceed 40% of the ex-works price of the product. Or Manufacture in which the value of all the materials used does not exceed 30% of the ex-works price of the product.	For ex-Chapter 84 from EU to EAC and vice versa: Manufacture from materials of any heading, except that of the product. Or Manufacture in which the value of all the materials used does not exceed 70% of the ex-works price of the product.	Manufacture in which: (1) all the materials used are classified within a heading other than that of the product (2) the value of all the materials used does not exceed 40% of the ex-works price of the product. Or Manufacture in which the value of all the materials used does not exceed 30% of the ex-works price of the product.

TABLE 3.45 *PSRO (ex-Chapter 85, Electrical machinery and equipment and parts thereof; sound recorders and reproducers, television image and sound recorders and reproducers, and parts and accessories of such articles) across African EPAs*

SADC	ECOWAS	EAC	ESA
Manufacture in which: (1) all the materials used are classified within a heading other than that of the product (2) the value of all the materials used does not exceed 40% of the ex-works price of the product. Or Manufacture in which the value of all the materials used does not exceed 30% of the ex-works price of the product.	Manufacture in which: (1) all the materials used are classified within a heading other than that of the product (2) the value of all the materials used does not exceed 40% of the ex-works price of the product. Or Manufacture in which the value of all the materials used does not exceed 30% of the ex-works price of the product.	For ex-Chapter 85 from EU to EAC and vice versa: Manufacture from materials of any heading, except that of the product. Or Manufacture in which the value of all the materials used does not exceed 70% of the ex-works price of the product.	Manufacture in which: (1) all the materials used are classified within a heading other than that of the product (2) the value of all the materials used does not exceed 40% of the ex-works price of the product. Or Manufacture in which the value of all the materials used does not exceed 30% of the ex-works price of the product.

EAC: 70 percent of non-originating material or CTH as in EBA, against a cumulative requirement of CTH and a 40 percent limit of non-originating material or a lower threshold of 30 percent of non-originating material with no cumulative requirement of a CTH.

Table 3.46 reports asymmetrical percentages for cars of Chapter 87 among the EU and EAC and a much more lenient percentage requirement of 70 percent of non-originating materials with respect to the 40 percent under the other EPAs.

TABLE 3.46 *PSRO (ex-Chapter 87, Vehicles other than railway or tramway rolling-stock, and parts and accessories thereof) across African EPAs*

SADC	ECOWAS	EAC	ESA
Manufacture in which the value of all the materials used does not exceed 40% of the ex-works price of the product.	Manufacture in which the value of all the materials used does not exceed 40% of the ex-works price of the product.	For ex-Chapter 87 from EU to EAC: Manufacture in which the value all the materials used does not exceed 50% of the ex-works price of the product. For ex-Chapter 87 from EAC to EU: Manufacture in which the value of all the materials used does not exceed 70% of the ex-work price of the product.	Manufacture in which the value of all the materials used does not exceed 40% of the ex-works price of the product.

3.4.4 *Rules of Origin in North America: From NAFTA to USMCA*

USMCA was signed in September 2018 and entered into force on July 1, 2020. The USMCA text has been the basis for this section, together with accompanying legislation – namely, the "Uniform Regulations,"[153] an essential piece of law to understand how vital aspects of USMCA will be managed on a day-to-day basis.

The US approach and experience with preferential rules of origin differs widely from the EU mainly due to the different trade policies and relations with third countries.

Until the beginning of the 1990s, the United States had few bilateral agreements and preferential tariff relations were centered around the GSP, the Caribbean Basin Initiative, the Andean Trade Preferences, and the US–Israel FTA. At that time, the US preferential rules of origin were based on the US GSP rules of origin requiring an across-the-board percentage criterion of 35 percent.[154]

[153] The examples provided in this section are excerpted from the US Federal Register, at www.govinfo.gov/content/pkg/FR-2020-07-01/pdf/2020-13865.pdf; and USMCA Implementing Instructions, June 30, 2020, CBP Publication Number 1118-0620, at www.cbp.gov/sites/default/files/assets/documents/2020-Jun/USMCA%20Implementing%20Instructions%20-%202020%20Jun%2030%20%28Finalv1%29.pdf. The previous Uniform Regulations under NAFTA are available at www.govinfo.gov/content/pkg/CFR-2018-title19-vol2/xml/CFR-2018-title19-vol2-part181.xml.

[154] For a discussion on the US GSP and Caribbean rules of origin, see D. Palmeter, "Rules of origin or rules of restriction? A commentary on a new form of protectionism," *Fordham*

A first rather drastic change in this simple approach to preferential rules of origin occurred when the Canada–US FTA agreement (CUSFTA) was negotiated. At that time, the trade volume involved and the subsequent emergence of powerful lobbies during the negotiations demanded a higher degree of discipline and specificity in setting up the rules of origin. The US–Canada FTA featured PSRO, that, during the NAFTA negotiations, rapidly evolved into one of the most sophisticated and detailed origin regimes yet devised at that time.

As one commenter described,[155] the CUSFTA contained 1,498 separate rules of origin spread among the twenty pages of the relevant annex to the free-trade agreement.[156] There is no public count of the number of separate rules of origin in the NAFTA, but the number of pages in the relevant annex (Annex 401) listing the specific rules is 148 (pp. 2–150) and it is a notorious fact that the NAFTA rules were more restrictive and specific than the ones under CUSTFA.[157]

Much of the complexity of NAFTA derived partly from the technical choices made during the negotiations to adopt a tariff-shift approach and partly from the intensity of lobbying and involvement of the specific industrial sectors. These two factors are closely intertwined. In drafting rules of origin there are a series of technical options, which may be pursued in determining when "substantial transformation" occurs, as discussed in Chapter 6 of this book.[158] By adopting the "tariff shift" as the main criterion for determining origin, the negotiators implicitly opted for PSRO given the inherent structures of the HS. This rendered rules of origin susceptible to capture by industries interested in minimizing their exposure to competition.[159]

The United States was not the first country to utilize the HS as providing the main criteria to determine origin. In fact, for more than two decades the main general criteria of the EU were the CTH criteria until the introduction of the Pan-European Rules of Origin. However, the general criteria based on a CTH requirement were coupled with a list of product-specific rules that was around seventy pages long. For the products falling in this list the respective product-specific rules applied instead of the general criteria based on CTH.

International Law Journal, vol. 1, no. 1 (1987); and "GSP Handbook on the Scheme of the United States of America," 2016 (UNCTAD/ITCD/TSB/Misc.58/Rev.3). In a rather anachronistic manner, the same GSP rules of origin of 1974 based on the 35% valued added remain in force at present.

[155] D. Palmeter, "Rules of origin in regional trade agreements," in P. Demaret, J.-F. Bellis, and G. García Jiménez (eds.), *Regionalism and Multilateralism after the Uruguay Round, Convergence, Divergence and Interaction*, European Interuniversity Press, 1997.

[156] See D. Palmeter, "The FTA rules of origin: Boon or boondoggle," in R. Dearden, M. Hart, and D. Steger (eds.), *Living with Free Trade: Canada, the Free Trade Agreement and the GATT*, Institute for Research on Public Policy and Centre for Trade Policy and Law, 1989, 41, 47.

[157] See A. Estedeavordal and D. Miller, "Rules of origin and the pattern of trade between US and Canada," Integration, Trade and Hemispheric Issues Division, Inter-American Development Bank, 2002.

[158] For a detailed discussion on the drafting of rules of origin, see Chapter 6 of this book.

[159] Palmeter, see fnn. 154 and 155 above.

The main difference in the utilization of the harmonized system for RoO purposes between the United States and the EU resides in the level of detail or disaggregation of the HS that occurred in NAFTA and later in all US-inspired rules of origin. Such differences in the design of rules utilizing the full codes at six-digit level and at tariff-lines level in the case of NAFTA and lately USMCA is one of the major differences between the US and EU models remaining valid today.

As pointed out in Chapter 2 of this book, the experience that the United States has gained with NAFTA and change of tariff classifications techniques has largely influenced the HWP and the approach to the negotiations of the harmonized set of nonpreferential rules of origin. Such North American model of drafting PSRO later migrated to South America since it was not only adopted in bilateral free-trade agreements with the United States but also by South American countries when they negotiated free-trade agreements among themselves. Ultimately the NAFTA model evolved and migrated across continents in a domino effect with the US free-trade agreements with Australia and New Zealand since the latter countries promoted the use of the NAFTA model when negotiating with ASEAN. Japan and South Korea also used to a large extent PSRO based on CTC criteria inspired by NAFTA, albeit much simpler.

As has been pointed out earlier, the EU utilizes a number of different techniques when drafting rules of origin ranging from specific working or processing to maximum import content and the change of tariff classification based on the HS. However, the design and drafting of the rules of origin utilizing the HS in the EU has been always done at heading level (four digits) and almost never at subheading (six digits) or national line level (see the tariff items in NAFTA and USMCA) as was the case for NAFTA and lately USMCA.

NAFTA and USMCA PSRO utilize the full disaggregation at six-digit level of the HS and even resorted in certain products to using national lines at eight-digit level. This entailed that concordances were to be made among the different national tariff lines (tariff items in NAFTA jargon) that also feature in USMCA.[160] Since national tariff lines change on a yearly basis, a complex exercise of concordances had to be carried out by customs officers.

In spite of their unprecedented complexity, the US administration and some users of the NAFTA model perceived NAFTA rules of origin as rather user friendly. They argued that the extensive use of the HS made rules of origin predictable and transparent even to the private sector.[161]

What is sure is that the NAFTA and the successor USMCA rules of origin, meaning the general rules of origin and the PSRO, are, on the one hand, complex

[160] See page 4-B-168 of USMCA, at https://ustr.gov/trade-agreements/free-trade-agreements/united-states-mexico-canada-agreement/agreement-between.

[161] Besides the United States, Australia and New Zealand actively pursued this view when negotiating with ASEAN.

to an unprecedented degree but, on the other hand, such complexity also means predictability. NAFTA and its successor USMCA tend to cover exhaustively many technical details that in other similar legislation, like the EU rules of origin, are not regulated as exhaustively as in NAFTA and USMCA. For instance, in the case of the EU there is nothing similar to the Uniform Regulations except manuals as discussed earlier. However, such manuals have no legal value and are not as detailed as the Uniform Regulations. Yet, on the other hand, it is also true that, in the case of the United States, there are no Uniform Regulations concerning other US free-trade agreements.

Undoubtedly, both in legal and economic literature on rules of origin, NAFTA rules of origin created a watershed in terms of complexity and implication derived from their use and application. It is, therefore, not surprising that NAFTA implementation by Canadian and US administrators was in many respects a learning ground and that the post-NAFTA period gradually generated changes in the North American attitude toward preferential rules of origin.

One of the main reasons generating the complexity and the level of detailed discipline of the NAFTA rules was the much-publicized fear of loss of North American jobs during NAFTA negotiations. These fears were partly based on the belief that North American industries would relocate to low-cost Mexico to obtain preferential access and compete with domestic industries in North America. In general, when forming an FTA with a developing country, developed countries that already have a strong industrial basis fear the trade deflecting or delocalization effects of liberal rules of origin more than they value – as exporters – their potential trade-creating effect. This fear prompted US domestic producers to press for finely tuned rules of origin in, for instance, automobiles,[162] textile and toy-manufacturing industries, and color picture tubes. For example, the yarn-forwarding rule adopted in the garment area results in the exclusion of low-cost intermediate materials from China and East Asia for the manufacturing of NAFTA-originating textiles unless natural fibers were imported. This exclusion may have ultimately provided an incentive for the development of a capital-intensive industry in Mexico, reducing NAFTA trade creation. US textile companies potentially wishing to relocate to Mexico had to invest a greater amount of capital in order to comply with NAFTA origin requirements.

These companies, in order to take advantage of labor costs and NAFTA preferential rates, had the following choices: (1) to import US cotton yarn with loss of comparative advantage; (2) to start the manufacturing process from imported natural

[162] See J. Cooper, "NAFTA rules of origin and its effect on the North American automotive industry in the North-West," *Northwestern Journal of International Law and Business*, vol. 14, no. 2 (1994), 442–470. See also J. A. La Nasa III, "Rules of origin under the North American Free Trade Agreement: A substantial transformation into objectively transparent protectionism," *Harvard International Law Journal*, vol. 34, no. 2 (1993), 381.

fibers or from imports of fabrics from North America[163] (i.e. increasing the trade diversion); or (3) require Mexican and Canadian textile producers to buy yarn from US textile mills before being allowed to sell the clothing to US consumers duty free. The combination of the yarn-forwarding rules and the high tariffs facing textile imports implies that the North American producers have an incentive to use US-made fabrics rather than competing fabrics from Asia.

As discussed in section 3.4.4.10, NAFTA rules have also evolved as demonstrated by the recent revision to the NAFTA rules and the negotiation of free-trade agreements with Central America, Colombia, and Peru.

In comparison with the EU, the United States has maintained within the overall architecture of NAFTA-style rules a distinct degree of flexibility to better customize the origin rules of the free-trade agreements to the trade patterns and volumes of the partners. This tendency is also reflected in the relative importance given to cumulation in the US free-trade agreements. In the EU context, cumulation is perceived as a major factor in liberalizing rules of origin and stimulate intraregional trade. In the free-trade agreements that the United States has recently entered into with Latin American countries there are no plans to establish cumulation other than bilateral. It follows that there is no insistence by the United States, as is the case in the EU when negotiating with partners, to use identical rules of origin in different trade agreements. The absence of a plan at this stage to set up a common system of cumulation under US free-trade agreements further provides room for flexibility in determining product specific rules of origin tailored to each FTA.

3.4.4.1 The Main Criteria for Determining Origin in NAFTA and USMCA

This section compares the main provision of NAFTA with those of USMCA and provides a series of examples that are drawn from USMCA materials.[164]

According to the original NAFTA text there are four ways that goods generally meet the NAFTA rule of origin, and therefore qualify for NAFTA tariff preference, while under USMCA the main provisions are as reported in the second column of Table 3.47.[165] A review of each case is reported in Table 3.47.

[163] See Richard H. Stringerg, "Antidote to regionalism: Responses to trade diversion effects of NAFTA," *Stanford Journal of International Law*, vol. 29, no. 2 (1993).

[164] The examples and other materials in this chapter have been excerpted from US Federal Regulations implementing USMCA, at www.govinfo.gov/content/pkg/FR-2020-07-01/pdf/2020-13865.pdf; the Trilateral Guide Uniform Regulations regarding the interpretation, application, and administration of Chapter 4 (rules of origin) and related provisions in Chapter 6 (textiles and Apparel goods) of the agreement between the United States, the United Mexican States, and Canada, at www.international.gc.ca/trade-commerce/assets/pdfs/agreements-accords/cusma-aceum/ftc-cle-regulations-reglementation-chap-4-6-en.pdf; and from Memorandum D-11-5-1 NAFTA, as revised in 2003, of the Canadian Uniform Regulations.

[165] If the good is an agricultural good, as defined by NAFTA, then exporters must ensure that their goods qualify under the special criterion for agricultural goods. Exporters should review the NAFTA definition of an "agricultural" good. Processed foods, often not considered an agricultural product, fall within the NAFTA definition of agriculture, as do raw natural fibers (silk, cotton, etc.) and fur skins.

TABLE 3.47 *Comparison of NAFTA and USMCA provisions*

NAFTA (summarized text)	USMCA (Legal text)
(a) Goods "wholly produced or obtained" in the NAFTA region, i.e. they contain no non-NAFTA material (b) Goods containing non-originating inputs, but meeting the product-specific origin rules (c) Goods produced in the NAFTA region wholly from originating materials, i.e. produced from materials that may contain non-NAFTA materials, but these materials have met the NAFTA rule of origin (d) Unassembled goods and goods classified in same HS category as their parts, that do not meet product-specific origin rules, but contain sufficient North American RVC. (Goods qualify in this category only in very limited circumstances.)	Except as otherwise provided in this Chapter, each Party shall provide that a good is originating if it is: (a) wholly obtained or produced entirely in the territory of one or more of the Parties, as defined in Article 4.3; (b) produced entirely in the territory of one or more of the Parties using non-originating materials provided the good satisfies all applicable requirements of Annex 4-B (Product-Specific Rules of Origin); (c) produced entirely in the territory of one or more of the Parties exclusively from originating materials; or (d) except for a good provided for in Chapters 61–63 of the Harmonized System: (i) produced entirely in the territory of one or more of the Parties; and (ii) one or more of the non-originating materials provided for as parts under the Harmonized System used in the production of the good cannot satisfy the requirements set out in Annex 4-B (Product-Specific Rules of Origin) because both the good and its materials are classified in the same subheading, or heading that is not further subdivided into subheadings or, the good was imported into the territory of a Party in an unassembled or a disassembled form but was classified as an assembled good pursuant to General Rule of Interpretation 2(a) of the Harmonized System; and (iii) the RVC of the good, determined in accordance with Article 4.11 (*Accumulation*), is not less than 60% if the transaction value method is used, or not less than 50% if the net cost method is used; and the good satisfies all other applicable requirements of this Chapter.

3.4.4.1.1 WHOLLY OBTAINED. Goods falling under (a) below respond, although with significant variations, to the usual list and concept of wholly obtained products used in the Kyoto Convention and in the EU rules of origin:

(a) a mineral good or other naturally occurring substance extracted or taken from there
(b) a plant, plant good, vegetable or fungus, grown, cultivated, harvested, picked, or gathered there
(c) a live animal born and raised there
(d) a good obtained from a live animal there
(e) an animal obtained by hunting, trapping, fishing, gathering, or capturing there
(f) a good obtained from aquaculture there
(g) fish, shellfish, and other marine life taken from the sea, seabed, or subsoil outside the territories of the parties and, under international law, outside the territorial sea of non-parties, by vessels that are registered, listed, or recorded with a party and entitled to fly the flag of that party
(h) a good produced from goods referred to in subparagraph (g) on board a factory ship that is registered, listed, or recorded with a party and entitled to fly the flag of that party
(i) a good other than fish, shellfish, and other marine life taken by a party or a person of a party from the seabed or subsoil outside the territories of the parties, provided that party has the right to exploit that seabed or subsoil
(j) waste and scrap derived from:
  i production there or
  ii used goods collected there, provided the goods are fit only for the recovery of raw materials and
(k) a good produced there, exclusively from goods referred to in subparagraphs (a) through (j), or from their derivatives, at any stage of production.

3.4.4.1.2 GOODS PRODUCED ENTIRELY IN THE TERRITORY OF ONE OR MORE OF THE PARTIES USING NON-ORIGINATING MATERIALS. The large majority of products fall under (b) in USMCA (Table 3.47) where PSRO have to be met. Thus, USMCA, like NAFTA, provides basically for a product-specific list where certain requirements have to be met such as:

(a) CTC
(b) a CTC and an RVC
(c) an RVC.

Products: Breads, pastries, cakes, biscuits (HS 1905.90) Non-North American input: Flour (classified in HS Chapter 11), imported from Europe.

Rule of Origin: "A change to heading 1905 from any other chapter."[166]
Explanation: For all products classified in HS headings 1905, all non-North American inputs must be classified in an HS chapter other than HS Chapter 19 in order for the product to obtain USMCA tariff preference. These baked goods would qualify for USMCA tariff preference because the non-originating items are classified outside of HS Chapter 19. (The flour is in Chapter 11.) However, if these products were produced with non-originating mixes, then these products would not qualify because mixes are classified in HS Chapter 19, the same chapter as baked goods.[167]

3.4.4.1.3 GOODS PRODUCED ENTIRELY IN THE TERRITORY OF ONE OR MORE OF THE PARTIES EXCLUSIVELY FROM ORIGINATING MATERIALS. Goods falling under (c) in Table 3.47 are considered originating if they are produced entirely in one or more USMCA country using only originating materials. This provision encompasses goods made of parts and materials that meet USMCA rules of origin, even though containing some non-North American inputs.

Example: An agricultural machine such as a wine press made in California of all originating parts could qualify, even if the parts contained non-North American metals. The difference in this case is that foreign materials have been transformed in North America to such an extent that new, originating parts have been created. These originating components are then used to produce the originating wine press.

3.4.4.1.4 RVC REQUIREMENT. If a product fails to qualify under product-specific tariff-shift rule of origin – under two limited circumstances – it may qualify under an RVC requirement, even if the PSRO in Annex 401 does not contain RVC provisions (case (d) of Table 3.47). These provisions never apply to products classified in HS Chapters 61–63 (apparel and other made-up textiles items such as blankets, linens, and bags). These two circumstances are applicable when the good is produced entirely in the territory of one or more of the USMCA countries, but one or more of the non-originating materials provided for as parts under the HS that are used in the production of the good does not undergo a CTC because:

(1) The good was imported into North America in an unassembled or disassembled form, but was classified as an assembled good under the HS system.

Parts and final products are classified in the same heading or subheading (as long as the description of the HS heading for the good provides for and specifically describes both the good itself and its parts and is not further subdivided into subheadings, or the subheading for the good provides for and specifically describes both the good itself and its parts).

[166] This PSRO is similar under NAFTA and USMCA.
[167] This example has been modified from the original to fit USMCA rules.

Example: Bicycle kits from Germany are assembled in Canada and sold in the USMCA territory. The bicycles would qualify as originating goods if the regional value content requirement is met.

(2) The goods are produced using materials imported into a NAFTA country that are provided for as parts according to the HS, and those parts are classified in the same subheading or undivided heading as the finished goods.

Example: A barber's chair and parts thereof classified in the Harmonized Tariff Schedule under subheading 9402.10.

3.4.4.2 Remanufactured Goods

According to an US International Trade Commission (USITC) report,[168] the United States is the world's largest producer, consumer, and exporter of remanufactured goods. Remanufacturing is an industrial process that restores end-of-life goods to original working ("like new") condition. According to the same report, almost 40 percent of US exports of remanufactured goods went to FTA partners for an amount of around 4.4 billion USD. Hence it is not surprising to see provisions related to remanufactured goods in USMCA. Article 4.4 of USMCA provides for the treatment of recovered materials used in the production of a remanufactured good. This article did not appear in the NAFTA text:

1. Each Party shall provide that a recovered material derived in the territory of one or more of the Parties is treated as originating when it is used in the production of, and incorporated into, a remanufactured good.
2. For greater certainty:
   (a) a remanufactured good is originating only if it satisfies the applicable requirements of Article 4.2 (Originating Goods); and
   (b) a recovered material that is not used or incorporated in the production of a remanufactured good is originating only if it satisfies the applicable requirements of Article 4.2 (Originating Goods).

In addition, the USMCA Uniform Regulations contain a series of examples that are worth quoting as they represent the first opportunity to clarify the scope of this new provision:

[168] Remanufactured Goods: An Overview of the U.S. and Global Industries, Markets, and Trade Investigation, No. 332-525, 2012.

Example 1 (Section 4)

In July 2023, Producer A located in a USMCA country manufactures water pumps of subheading 8413.30 for use in automotive engines. In addition to selling new water pumps, Producer A also sells water pumps that incorporate used parts.

To obtain the used parts, Producer A disassembles used water pumps in a USMCA country and cleans, inspects, and tests the individual parts. Accordingly, these parts qualify as recovered materials.

The water pumps that Producer A manufactures incorporate the recovered materials, have the same life expectancy and performance as new water pumps, and are sold with a warranty that is similar to the warranty for new water pumps. The water pumps therefore qualify as remanufactured goods, and the recovered materials are treated as originating materials when determining whether the good qualifies as an originating good.

In this case, because the water pumps are for use in an automotive good, the provisions of Part VI apply. Because the water pump is a part listed in Table B, the RVC required is 70% under the net cost method or 80% under the transaction value method.

The producer chooses to calculate the RVC using net cost as follows:

Water pump net cost = $1,000
Value of recovered materials = $600
Value of other originating materials = $20
Value of non-originating materials = $280
RVC = (NC¥VNM)/NC · 100
RVC = (1,000¥280)/1,000 · 100 = 72%

The remanufactured water pumps are originating goods because their regional value content exceeds the 70% requirement by net cost method.

Example 2 (Section 4)

Producer A located in a USMCA country, uses recovered materials derived in the territory of a USMCA country in the production of self-propelled "bulldozers" classified in subheading 8429.11.

In the production of the bulldozers, Producer A uses recovered engines, classified in heading 84.07. The engines are recovered materials because they are disassembled from used bulldozers in a USMCA country and then subject to cleaning, inspecting and technical tests to verify their sound working condition.

In addition to the recovered materials, other non-originating materials, classified in subheading 8413.91, are also used in the production of the bulldozers.

Producer A's bulldozers are considered a "remanufactured good" because they are classified in a tariff provision set out in the definition of a remanufactured good, are partially composed of recovered materials, have a similar life expectancy and perform the same as or similar to new self-propelled bulldozers, and have a factory warranty similar to new self-propelled bulldozers.

Once the recovered engines are used in the production of, and incorporated into, the remanufactured bulldozers, the recovered engines would be considered as originating materials for the purpose of determining if the remanufactured bulldozers are originating.

The rule of origin set out in Schedule I for subheading 8429.11 specifies a change in tariff classification from any other subheading.

In this case, because the recovered engines are treated as originating materials, and the non-originating materials, classified in subheading 8413.91, satisfy the requirements set out in Schedule I, the remanufactured bulldozers are originating goods.

3.4.4.3 *De Minimis*

3.4.4.3.1 GENERAL PROVISION. As in the case of the Pan-European Rules of Origin both NAFTA and USMCA rules of origin are providing for *de minimis* rules. In fact, as in the case of NAFTA, the reliance of the USMCA rules of origin on a CTC provides scope for introduction of such rules. A CTC requires that all non-originating materials undergo the required change. It follows that even a very low percentage of the materials may disqualify goods from originating status. USMCA contains a *de minimis* provision that allows goods to qualify as originating provided such materials are not more than 10 percent of the transaction value of the goods adjusted to an FOB basis or of the total cost of the goods.

In addition, where failure of materials to undergo a required CTC triggers a requirement for a minimum RVC, the calculation of that content is waived if the value of all non-originating materials used in the production of the goods is not more than the specified *de minimis* amount.

However, if after application of the *de minimis* allowance the goods must still meet a RVC requirement in order to qualify as originating (that is, if the value of all non-originating materials exceeds the applicable *de minimis* allowance), the value of all non-originating materials must be taken into account in calculating the RVC.

Example

Producer A, located in a USMCA country, uses originating materials and non-originating materials in the production of copper anodes of heading 74.02. The product-specific rule of origin set out in Schedule I for heading 74.02 specifies both a change in tariff classification from any other heading, except from heading 74.04, under which certain copper materials are classified, and a regional value content requirement. With respect to that part of the rule that specifies a change in tariff classification, in order for the copper anode to qualify as an originating good, any copper materials that are classified under heading 74.02 or 74.04 and that are used in the production of the copper anode must be originating materials.

In this case, all of the non-originating materials used in the production of the copper anode satisfy the specified change in tariff classification, with the exception of a small amount of copper materials classified under heading 74.04. Subsection 5(1) provides that the copper anode can be considered an originating good if the value of the non-originating copper materials that do not satisfy the specified change in tariff classification does not exceed ten per cent of the transaction value of the copper anode or the total cost of the copper anode, whichever is applicable. In this case, the value of those non-originating

materials that do not satisfy the specified change in tariff classification does not exceed the ten per cent limit.

However, the rule set out in Schedule I for heading 74.02 specifies both a change in tariff classification and a regional value content requirement. Under paragraph 5(1)(b), in order to be considered an originating good, the copper anode must also, except as otherwise provided in subsection 5(4), satisfy the regional value content requirement specified in that rule. As provided in paragraph 5(1)(b), the value of the non-originating materials that do not satisfy the specified change in tariff classification, together with the value of all other non-originating materials used in the production of the copper anode, will be taken into account in calculating the regional value content of the copper anode.

There is, however, a rather long list of excluded products and certain categories of products such as textiles and garments which are subject to specific *de minimis* provisions contained in Article 6.1.2 and 6.1.3 of USMCA. Annex 4-A of USMCA provides for a rather long list of products where the *de minimis* rule does not apply to the following materials:

Each Party shall provide that Article 4.12 (De Minimis) shall not apply to:

(a) a non-originating material of heading 04.01 through 04.06, or a non-originating dairy preparation containing over 10 per cent by dry weight of milk solids of subheading 1901.90 or 2106.90, used in the production of a good of heading 04.01 through 04.06;

(b) a non-originating material of heading 04.01 through 04.06, or non-originating dairy preparations containing over 10 per cent by dry weight of milk solids of subheading 1901.90 or 2106.90, used in the production of the following goods:
  (i) infant preparations containing over 10 per cent by dry weight of milk solids of subheading 1901.10;
  (ii) mixes and doughs, containing over 25 per cent by dry weight of butterfat, not put up for retail sale of subheading 1901.20;
  (iii) dairy preparations containing over 10 per cent by dry weight of milk solids of subheading 1901.90 or 2106.90;
  (iv) goods of heading 21.05;
  (v) beverages containing milk of subheading 2202.90; or
  (vi) animal feeds containing over 10 per cent by dry weight of milk solids of subheading 2309.90;

(c) a non-originating material of heading 08.05 or subheading 2009.11 through 2009.39 used in the production of a good of subheading 2009.11 through 2009.39, or a fruit or vegetable juice of any single fruit or vegetable, fortified with minerals or vitamins, concentrated or unconcentrated, of subheading 2106.90 or 2202.90;

(d) a non-originating material of Chapter 9 of the Harmonized System used in the production of unflavored instant coffee of subheading 2101.10 (instant coffee, not flavored);

(e) a non-originating material of Chapter 15 of the Harmonized System, used in the production of a good of headings 15.01 through 15.08, 15.12, 15.14, or 15.15;

(f) a non-originating material of heading 17.01 used in the production of a good provided for in heading 17.01 through 17.03;
(g) a non-originating material of Chapter 17 of the Harmonized System or heading 18.05 that is used in the production of a good of subheading 1806.10;
(h) non-originating peaches, pears or apricots of Chapter 8 or 20 of the Harmonized System, used in the production of a good of heading 20.08;
(i) a non-originating single juice ingredient provided for in heading 20.09 that is used in the production of a good provided for in subheading 2009.90, or tariff item 2106.90.cc (concentrated mixtures of fruit or vegetable juice, fortified with minerals or vitamins) or 2202.90.bb (mixtures of fruit or vegetable juices, fortified with minerals or vitamins);
(j) a non-originating material provided for in headings 22.03 through 22.08 that is used in the production of a good provided for in headings 22.07 or 22.08;
(k) a non-originating material used in the production of a good of Chapters 1 through 27 of the Harmonized System, unless the non-originating materials are provided for in a different subheading than the good for which origin is being determined under this Article.

The following example[169] demonstrates how the USMCA *de minimis* rules apply:

Example

Producer A, located in a USMCA country, uses originating materials and non-originating materials in the production of fans of subheading 8414.59. There are two alternative rules set out in Schedule I for subheading 8414.59, one of which specifies a change in tariff classification from any other heading. The other rule specifies both a change in tariff classification from the subheading under which parts of the fans are classified and a regional value content requirement. In order for the fan to qualify as an originating good under the first of the alternative rules, all of the materials that are classified under the subheading for parts of fans and used in the production of the completed fan must be originating materials.

In this case, all of the non-originating materials used in the production of the fan satisfy the change in tariff classification set out in the rule that specifies a change in tariff classification from any other heading, with the exception of one non-originating material that is classified under the subheading for parts of fans. Under subsection 5(1), if the value of the non-originating material that does not satisfy the change in tariff classification specified in the first rule does not exceed ten per cent of the transaction value of the fan or the total cost of the fan, whichever is applicable, the fan would be considered an originating good. Therefore, under subsection 5(2), the fan would not be required to satisfy the alternative rule that specifies both a change in tariff classification and a regional value content requirement.

Similarly to NAFTA, the USMCA *de minimis* rule does not apply to agricultural goods provided for in Chapters 1–27 of the HS unless the non-originating materials

[169] Example excerpted from the Uniform Regulations.

are classified in subheadings different from the subheadings in which the finished goods are classified. There follows an example:[170]

Example

Ground coffee, sold in retail packages, is produced in Mexico (HTS 0901.21). Most of the beans are grown and roasted in Mexico but to give the coffee a unique flavor the producer adds some roasted beans from Kenya (HTS 0901.21). The value of the beans from Kenya is 5 percent of the transaction value, adjusted to an FOB basis, of each retail package. The Annex 401 origin criterion for HTS 09.01 is:

A change to heading 09.01 through 09.10 from any other chapter.

The coffee cannot be considered originating because the Kenyan beans do not undergo the required tariff change. The *de minimis* rule does not apply because the Kenyan beans are classified in the same subheading as the final good.

Note: If green (unroasted) coffee were imported from Kenya and roasted in Mexico, the de minimis rule would apply because green coffee beans are classified in HTS 0901.11, a different subheading. Thus, the ground coffee in retail packages would qualify as originating.

3.4.4.3.2 USMCA: TEXTILE AND GARMENTS *DE MINIMIS*. As in the case of the Pan-European Rules of Origin, both NAFTA and USMCA special rules apply to textile and garments. In this case the *de minimis* rule is applied by weight (instead of value) to the component of the good that determines its tariff classification, as determined in accordance with the General Rules of Interpretation of the Harmonized System. In USMCA there is an entire section 6[171] dedicated to textile and garments including specific provisions for verifications of rules of origin.

> 6.1.2. A textile or apparel good classified in Chapters 50 through 60 or heading 96.19 of the Harmonized System that contains non-originating materials that do not satisfy the applicable change in tariff classification requirement specified in Annex 4-B (Product-Specific Rules of Origin), shall nonetheless be considered to be an originating good if the total weight of all those materials is not more than 10 percent of the total weight of the good, of which the total weight of elastomeric content may not exceed 7 percent of the total weight of the good, and the good meets all the other applicable requirements of this Chapter and Chapter 4 (Rules of Origin).
> 6.1.3. A textile or apparel good classified in Chapters 61 through 63 of the Harmonized System that contains non-originating fibers or yarns in the component

[170] This example is drawn from NAFTA materials and not reproduced in USMCA Uniform Regulations; see www.cbp.gov/trade/nafta/guide-customs-procedures/other-instances-confer-origin/deminimis.

[171] See USMCA Chapter 6, at https://ustr.gov/sites/default/files/files/agreements/FTA/USMCA/Text/06_Textiles_and_Apparel.pdf.

of the good that determines the tariff classification of the good that do not satisfy the applicable change in tariff classification set out in Annex 4-B (Product-Specific Rules of Origin), shall nonetheless be considered to be an originating good if the total weight of all those fibers or yarns is not more than 10 percent of the total weight of that component, of which the total weight of elastomeric content may not exceed 7 percent of the total weight of the good, and the good meets all the other applicable requirements of this Chapter and Chapter 4 (Rules of Origin).

***Example** 6 (**Subsection** 5(6))*[172]

Producer A, located in a USMCA country, manufactures an infant diaper, classified in heading 96.19, consisting of an outer shell of 94 percent nylon and 6 percent elastomeric fabric, by weight, and a terry knit cotton absorbent crotch. All materials used are produced in a USMCA country, except for the elastomeric fabric, which is from a non-USMCA country. The elastomeric fabric is only 6 percent of the total weight of the diaper. The product otherwise satisfies all other applicable requirements of these Regulations. Therefore, the product is considered originating from a USMCA country as per subsection (6).

***Example** 7 (**Subsection** 5(6))*

Producer A, located in a USMCA country, produces cotton fabric of subheading 5209.11 from cotton yarn of subheading 5205.11. This cotton yarn is also produced by Producer A.

The product-specific rule of origin set out in Schedule I for subheading 5209.11, under which the fabric is classified, specifies a change in tariff classification from any other heading outside 52.08 through 52.12, except from certain headings under which certain yarns are classified, including cotton yarn of subheading 5205.11.

Therefore, with respect to that part of the rule that specifies a change in tariff classification, in order for the fabric to qualify as an originating good, the cotton yarn that is used by Producer A in the production of the fabric must be an originating material.

At one point Producer A uses a small quantity of non-originating cotton yarn in the production of the cotton fabric. Under subsection 5(6), if the total weight of the non-originating cotton yarn does not exceed ten per cent of the total weight of the cotton fabric, it would be considered an originating good.

***Example** 8 (**Subsections** 5(7) **and** (8))*

Producer A, located in a USMCA country, produces women's dresses of subheading 6204.41 from fine wool fabric of heading 51.12. This fine wool fabric, also produced by Producer A, is the component of the dress that determines its tariff classification under subheading 6204.41.

The product-specific rule of origin set out in Schedule I for subheading 6204.41, under which the dress is classified, specifies both a change in tariff classification from any other chapter, except from those headings and chapters under which certain yarns and fabrics, including combed wool yarn and wool fabric, are classified, and a requirement that the good

[172] These examples are exerpted from USMCA Uniform Regulations. USMCA Uniform Regulations contain new and more numerous examples than the NAFTA Uniform Regulations on this specific issue.

be cut and sewn or otherwise assembled in the territory of one or more of the USMCA countries. In addition, narrow elastics classified in subheading 5806.20 or heading 60.02 and sewing thread classified in heading 52.04, 54.01 or 55.08 or yarn classified in heading 54.02 that is used as sewing thread, must be formed and finished in the territory of one or more of the USMCA countries for the dress to be originating. Furthermore, if the dress has a pocket, the pocket bag fabric must be formed and finished in the territory of one or more of the USMCA countries for the dress to be originating.

Therefore, with respect to that part of the rule that specifies a change in tariff classification, in order for the dress to qualify as an originating good, the combed wool yarn and the fine wool fabric made therefrom that are used by Producer A in the production of the dress must be originating materials. In addition, the sewing thread, narrow elastics and pocket bags that are used by Producer A in the production of the dress must also be formed and finished in the territory of one or more of the USMCA countries.

At one point Producer A uses a small quantity of non-originating combed wool yarn in the production of the fine wool fabric. Under subsection 5(7), if the total weight of the non-originating combed wool yarn does not exceed ten per cent of the total weight of all the yarn used in the production of the component of the dress that determines its tariff classification, that is, the wool fabric, the dress would be considered an originating good.

3.4.4.4 RVC in USMCA

As in the case of NAFTA, USMCA adopts in addition to the change of tariff a specified amount of RVC[173] in order for a good to obtain USMCA tariff preference. It has to be noted that the RVC is always applied in conjunction with a CTC or as an alternative and is not used in USMCA as the sole PSRO, as in the case of the EU rules of origin.[174]

RVC rules are used extensively for industrial automotive goods and chemicals, but are quite limited in other product areas.[175]

Similarly to NAFTA, in USMCA RVC may be calculated using two methods: transaction value or net cost. The difference lies in definition of the numerator and denominator used to make the calculation of percentage:

- Transaction value generally means the price actually paid or payable for a good, adjusted to exclude any cost incurred in the international shipment of the good.

[173] See Rules of Origin, Regional Value Content, NAFTA Facts Document 5011.

[174] This RVC calculation still applicable in spite of the suspicion and dislike for ad valorem percentage rules of origin demonstrated by US negotiators during the negotiations on non-preferential rules of origin. In spite of this the 35% value-added rule is still applicable under the US GSP and AGOA and attempts to change such rules by US customs have failed.

[175] It is important to note that the RVC test is not a generally available option for exporters, but may be used when specified in Annex 4-B of USMCA.

- The net cost method removes sales promotion, marketing, and after-sales service costs, royalties, shipping and packing costs, and some interest costs from the equation.

Because the transaction value is a broader basis for calculating content, the RVC required is higher than for net cost. In most cases, the required level of RVC is 60 percent for transaction value and 50 percent for net cost.

While this difference in the level of percentage requirements is aimed at making use of these alternatives percentages as trade facilitating, such difference, depending on the product and manufacturers, could produce different origin outcomes as contained in the following example drawn from NAFTA materials.

Example

Product: Wooden Furniture. Non-North American inputs: Parts of furniture classified in 9403.90

"A change to subheading 9403.10 through 9403.89 from any other chapter; or a change to subheading 9403.10 through 9403.89 from subheading 9403.90, provided there is a regional value-content of not less than:

- *60 percent where the transaction value is used, or*
- *50 percent where the net-cost method is used."*

Explanation: Wooden furniture can qualify for NAFTA tariff preference under two scenarios – a tariff shift, or a combination of a tariff shift and regional value content requirement.

The first option – the tariff-shift rule – requires that all non-originating inputs be classified outside of HS Chapter 94 (furniture and bedding). Since the non-originating inputs (furniture parts) are classified in Chapter 94 (subheading 9403.90), then the product cannot qualify based on tariff shift. However, it may still qualify based on the second part of the rule. The second option has two components – a tariff shift requirement, and a regional value content requirement. The tariff shift requirement is satisfied since the non-originating input (furniture parts) is classified in subheading 9403.90 as specified by the rule. The product must meet its regional value content requirement using the transaction value or the net cost methodology. Given the following values, furniture qualifies for USMCA tariff preference using the net cost methodology.

TABLE 3.48 *Example of calculations*

Transaction value method	Net cost method
(200 – 90) x 100 = 55	(182 – 90) x 100 = 50.5
Good does not qualify under transaction value method, because it does not have at least 60% regional value content.	Good qualifies under net cost regional value requirement because it has at least a 50% regional value content.

The calculation is found in Table 3.48, based on the following example:

- producer's net cost $182.00 each (not including shipping, packing royalties, etc.)
- transaction value $200.00 each piece
- value of non-originating parts $90.00.

Generally, exporters and producers may choose which methodology they prefer, but there are exceptions. In NAFTA only the net cost method was to be used for automotive goods, footwear, and word processing machines. In USMCA similar provisions are adopted with the exception that the transaction value may be used for certain parts of automotive goods albeit with higher level of RVC than the net cost method.[176] NAFTA[177] explicitly provided that the net cost method was the only RVC method to be used for (a) goods for which there is no acceptable transaction value, (b) goods designated as "intermediate materials," and (c) goods for which "accumulation" of RVC is used.

USMCA does not have similar provisions to exclusively use the net cost method in (a)–(c) above. USMCA just provides in paragraph 6 of Article 4.5 that the net cost method should be used whenever the product-specific annex on rules of origin does not provide for the alternative transaction value as follows:

> Each Party shall provide that an exporter or producer shall calculate the regional value content of a good solely on the basis of the net cost method set out in paragraph 3 if the rule under the PSR Annex does not provide a rule based on the transaction value method.

[176] See para. 2 of Article 4-B.3: Regional Value Content for Passenger Vehicles, Light Trucks, and Parts Thereof, providing as follows:

Notwithstanding Article 4-B.2 and the Product-Specific Rules of Origin in Annex 4-B, each Party shall provide that the regional value-content requirement for a part listed in Table A.1 of this Appendix that is for use in a passenger vehicle or light truck is:

(a) 66 percent under the net cost method or 76 percent under the transaction value method, if the corresponding rule includes a transaction value method, beginning on January 1 2020, or the date of entry into force of the Agreement, whichever is later;
(b) 69 percent under the net cost method or 79 percent under the transaction value method, if the corresponding rule includes a transaction value method, beginning on January 1 2021, or one year after the date of entry into force of the Agreement, whichever is later;
(c) 72 percent under the net cost method or 82 percent under the transaction value method, if the corresponding rule includes a transaction value method, beginning on January 1 2022, or two years after the date of entry into force of the Agreement, whichever is later; or
(d) 75 percent under the net cost method or 85 percent under the transaction value method, if the corresponding rule includes a transaction value method, beginning on January 1 2023, or three years after the date of entry into force of the Agreement, whichever is later, and thereafter.

[177] See para. 5 of Article 402 of NAFTA.

Under NAFTA there were a number of situations where the transaction value method could not be used and the net cost method was the only alternative. The net cost method was to be used when there was no transaction value, in some related party transactions, for certain motor vehicles and parts, when a producer is accumulating RVC, as well as to determine the RVC for designated intermediate materials. The producer may also have reverted to the net cost method if the result using the transaction value method was unfavorable.

USMCA, in comparison to NAFTA, has introduced some flexibilities on the use of the transaction value method that is generally simpler to use than the net cost method.

There are similarities between USMCA and NAFTA on the definitions of two RVC methods – namely, transaction value and net cost – but also some differences.

Similarly to NAFTA, the USMCA transaction value method calculates the RVC by subtracting the value of the non-originating materials to the transaction value as a percentage of the transaction value. Thus, a key determinant is the definition of transaction value that, as in the case of NAFTA, is linked to the WTO customs valuation transaction value of the good.[178] The essence of this method is a value-of-materials calculation methodology, as discussed in Chapter 6 of this book, where the value of non-originating materials can be calculated as a percentage of the invoice price which is usually the price actually paid for the finished product. The USMCA Uniform Regulations introduce an example on the calculations of materials to further clarify how this provision should be applied:

Example: Subsection 8(4), Transaction Value not Determined in a Manner Consistent with Schedule VI

Producer A, located in USMCA country A, imports a bicycle chainring into USMCA country A. Producer A purchased the chainring from a middleman located in country B. The middleman purchased the chainring from a manufacturer located in country B. Under the laws in USMCA country A that implement the Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade, the customs value of the chainring was based on the price actually paid or payable by the middleman to the manufacturer. Producer A uses the chainring to produce a bicycle, and exports the bicycle to USMCA country C. The bicycle is subject to a regional value content requirement.

Under subsection 3(1) of Schedule VI (Value of Materials), the price actually paid or payable is the total payment made or to be made by the producer to or for the benefit of the seller of the material. Section 1 of that Schedule defines producer and seller for the purposes of the Schedule. A producer is the person who uses the material in the production of a good that is subject to a regional value content requirement. A seller is the person who sells the material being valued to the producer.

[178] See USMCA definition: "transaction value means the customs value as determined in accordance with the *Customs Valuation Agreement*, that is, the price actually paid or payable for a good or material with respect to a transaction of, except for the application of Article 10.3 and 10.4(a) in Appendix 1 to Annex 4-B, the producer of the good, adjusted in accordance with the principles of Articles 8(1), 8(3), and 8(4) of the *Customs Valuation Agreement*, regardless of whether the good or material is sold for export."

The transaction value of the chainring was not determined in a manner consistent with Schedule VI because it was based on the price actually paid or payable by the middleman to the manufacturer, rather than on the price actually paid or payable by Producer A to the middleman. Thus, subsection 8(4) applies and the chainring is valued in accordance with Schedule IV.

Because the transaction value method permits the producer to count all of its costs and profit, the required percentage of RVC under this method is higher than under the net cost method where complex accounting is needed to define the allowable and nonallowable cost of producing the finished good. As discussed in more detail in Chapter 6 of this book, the transaction value method is somewhat similar to the pan-European method of calculating percentages since it is based on a value-of-materials methodology rather than on the net cost method that could be considered a value-addition calculation methodology.

These different methodologies may have determinant implications for the administration of rules of origin that are further illustrated in Chapter 6.

The USMCA formula for calculating the RVC using the transaction value method is:

$$RVC = \frac{TV - VNM}{TV} \times 100$$

where:

- *RVC* is the regional value content, expressed as a percentage.
- *TV* is the transaction value of the good, adjusted to exclude any costs incurred in the international shipment of the good.
- *VNM* is the value of non-originating materials including materials of undetermined origin used by the producer in the production of the good.[179]

The USMCA net cost method calculates the RVC as a percentage of the net cost to produce the good. Net cost represents all of the costs incurred by the producer minus expenses for sales promotion (including marketing and after-sales service), royalties, shipping and packing costs, and nonallowable interest costs calculated as provided for in paragraph 8 of Article 4.5 of USMCA. The percentage content required for the net cost method is lower that the percentage content required under the transaction value method because of the exclusion of certain costs from the net cost calculation.

The USMCA formula for calculating the RVC using the net cost method is:

$$RVC = \frac{NC - VNM}{NC} \times 100$$

where:

- *RVC* is the regional value content, expressed as a percentage.
- *NC* is the net cost of the good.

[179] Note that VNM is used in the context of USMCA; elsewhere it is known as VNOM.

- *VNM* is the value of non-originating materials including materials of undetermined origin used by the producer in the production of the good.

A significant change in USMCA with respect to NAFTA is the inclusion of Article 4.7 titled "Further adjustment to the value of materials." The inclusion of such article to better define the value of non-originating materials is drawn from the experience gained in other free-trade agreements entered by the United States subsequent to NAFTA, as further discussed below in this chapter. Article 4.7 provides as follows:

> ARTICLE 4.7: FURTHER ADJUSTMENTS TO THE VALUE OF MATERIALS
>
> 1. Each Party shall provide that for a non-originating material or material of undetermined origin, the following expenses may be deducted from the value of the material:
>
> (a) the costs of freight, insurance, packing, and all other costs incurred in transporting the material to the location of the producer of the good;
>
> (b) duties, taxes, and customs brokerage fees on the material paid in the territory of one or more of the Parties, other than duties and taxes that are waived, refunded, refundable, or otherwise recoverable, which include credit against duty or tax paid or payable; and
>
> (c) the cost of waste and spoilage resulting from the use of the material in the production of the good, less the value of reusable scrap or by-product.

As further discussed in Chapter 6 of this book, such article permits a fair calculation between the numerator, this being the transaction value as "The price actually paid or payable for the imported merchandise is the total payment, excluding international freight, insurance, and other C.I.F. charges, that the buyer makes to the seller,"[180] and the denominator as value of non-originating materials (VNM) that should be assessed in similar fashion to reach a fair calculation. In fact if the inclusion of international freight, insurance, and other cost would be included in the VNM while excluded in the calculation of the transaction value (TV) the comparison would be flawed as it would include an exogenous factor in the numerator that is disregarded in the denominator.

USMCA Uniform Regulations introduce some examples related to practical application of this rule:

Example 1 (Example of Point of Direct Shipment (with Respect to Adjusted to Exclude any Costs Incurred in the International Shipment of the Good))

A producer has only one factory, at which the producer manufactures finished office chairs. Because the factory is located close to transportation facilities, all units of the finished good are

[180] Excerpted from "What Every Member of the Trade Community Should Know About: Customs Value," US Customs and Border Protection, 2006, at www.cbp.gov/sites/default/files/assets/documents/2016-Apr/icp001r2_3.pdf.

stored in a factory warehouse 200 meters from the end of the production line. Goods are shipped worldwide from this warehouse. The point of direct shipment is the warehouse.

Example 2 (Examples of Point of Direct Shipment (with Respect to Adjusted to Exclude any Costs Incurred in the International Shipment of the Good))

A producer has six factories, all located within the territory of one of the USMCA countries, at which the producer produces garden tools of various types. These tools are shipped worldwide, and orders usually consist of bulk orders of various types of tools. Because different tools are manufactured at different factories, the producer decided to consolidate storage and shipping facilities and ships all finished products to a large warehouse located near the seaport, from which all orders are shipped. The distance from the factories to the warehouse varies from 3 km to 130 km. The point of direct shipment for each of the goods is the warehouse.

Example 3 (Examples of Point of Direct Shipment (with Respect to Adjusted to Exclude any Costs Incurred in the International Shipment of the Good))

A producer has only one factory, located near the center of one of the USMCA countries, at which the producer manufactures finished office chairs. The office chairs are shipped from that factory to three warehouses leased by the producer, one on the west coast, one near the factory and one on the east coast. The office chairs are shipped to buyers from these warehouses, the shipping location depending on the shipping distance from the buyer. Buyers closest to the west coast warehouse are normally supplied by the west coast warehouse, buyers closest to the east coast are normally supplied by the warehouse located on the east coast and buyers closest to the warehouse near the factory are normally supplied by that warehouse. In this case, the point of direct shipment is the location of the warehouse from which the office chairs are normally shipped to customers in the location in which the buyer is located.

3.4.4.5 Some Methodologies and Examples of Calculations under the Net Cost Method under NAFTA and USMCA

In the course of implementation of NAFTA and similar agreements based on the NAFTA model, the net cost method attracted a number of criticisms due to the complexities of the calculations. This explains the trend of reducing the use of the next cost methods in subsequent free-trade agreements that the United States entered with a number of partners as discussed in section 3.4.4.10. Moreover, the net cost method utilized under NAFTA attracted a lot attention since it is the only methodology based on a value added by addition to calculate a percentage criterion applied to large trade flows such as in the case of the trade under NAFTA.

As pointed out earlier, a valued added by addition methodology is also applied by the United States under a series of unilateral arrangements such as the GSP, AGOA, and trade preferences granted to Caribbean and Andean countries. Such methodology has also been used in the free-trade agreements of Morocco and Jordan, albeit a long series of product-specific rules have been added as exceptions to the general value-added rule.

The use of the value-added requirements by the United States appear to be guided by the trade flows under these latter arrangements. Textiles and garments are excluded from GSP and therefore there is no need for product-specific rules. However, when textiles and garments are covered by the arrangements such as under the AGOA, Jordan and Morocco FTA agreement product-specific rules are included and the general valued-added requirement is no longer applicable.

Chapter 6 on drafting rules of origin discusses the experience gained and lessons learned under NAFTA and NAFTA model rules of origin with the methodology to calculate net costs or value added by addition that are particularly interesting for those countries or regions who are currently involved in negotiating rules of origin. The examples and comments that follow are excerpted from USMCA material and should be taken into account when discussing options and methodologies for drafting rules of origin contained in Chapter 6 of this book.

The use of the net cost calculation gained a new lease of life under the Trump administration when negotiating USMCA.

NAFTA and USMCA provide exactly the same provisions on the different options that could be used to calculate the next cost of a good as contained in paragraph 8 of Article 405 of USMCA:

> For purposes of calculating the net cost of a good under paragraph 3, the producer of the good may:
>
> (a) calculate the total cost incurred with respect to all goods produced by that producer, subtract any sales promotion, marketing, and after-sales service costs, royalties, shipping and packing costs, and non-allowable interest costs that are included in the total cost of all those goods, and then reasonably allocate the resulting net cost of those goods to the good,
>
> (b) calculate the total cost incurred with respect to all goods produced by that producer, reasonably allocate the total cost to the good, and then subtract any sales promotion, marketing, and after-sales service costs, royalties, shipping and packing costs and non-allowable interest costs that are included in the
>
> (c) portion of the total cost allocated to the good, or
> reasonably allocate each cost that forms part of the total cost incurred with respect to the good so that the aggregate of these costs does not include any sales promotion, marketing, and after-sales service costs, royalties, shipping and packing costs, and non-allowable interest costs, provided that the allocation of all those costs is consistent with the provisions regarding the reasonable allocation of costs set out in the Uniform Regulations.

Basically the following examples illustrate how USMCA rules, similarly to NAFTA, have been designed to address the main disadvantages of a methodology based on a calculation of value added by addition; namely, (1) definition of

allowable costs to be computed, (2) sales to a related party, (3) allocation of costs when more than one product is produced in a factory, and (4) foreign exchange fluctuations.[181]

One of the major difficulties in calculating the value added is to define what costs could be allocated to the costs for the production of the good and what costs have to be disregarded as illustrated in the following example:

Example

A producer located in USMCA country A sells Good A that is subject to a regional value-content requirement to a buyer located in USMCA country B. The producer of Good A chooses that the regional value content of that good be calculated using the net cost method. The applicable regional value-content requirement is 50 percent. In order to calculate the regional value-content of Good A, the producer first calculates the net cost of Good A. Under section 6(11)(a) of USMCA the net cost is the total cost of Good A (the aggregate of the product costs, period costs, and other costs) per unit, minus the excluded costs (the aggregate of the sales promotion, marketing and after-sales service costs, royalties, shipping and packing costs, and non-allowable interest costs) per unit. The producer uses the following figures to calculate the net cost:

Product costs:	
Value of originating materials	$30.00
Value of non-originating materials	$40.00
Other product costs	$20.00
Period costs	$10.00
Other costs	$0.00
Total cost of Good A, per unit	$100.00

Excluded costs:	
Sales promotion, marketing, and after-sales service cost	$5.00
Royalties	$2.50
Shipping and packing costs	$3.00
Non-allowable interest costs	$1.50
Total excluded costs	$12.00

[181] These, however, are not by any means exhaustive of the NAFTA detailed rules to regulate apportionment of costs for inventory management methods.

The net cost is the total cost of Good A, per unit, minus the excluded costs.

Total cost of Good A, per unit:	**$100.00**
Excluded costs	-$12.00
Net cost of Good A, per unit	$88.00

The value for net cost ($88) and the value of non-originating materials ($40) are needed in order to calculate the regional value content. The producer calculates the regional value content of Good A under the net cost method in the following manner:

$$RVF = \frac{NC - VNM}{NC} \times 100$$

$$RVC = \frac{88 - 40}{88} \times 100$$

Therefore, under the net cost method, Good A qualifies as an originating good, with a regional value-content of 54.5 percent.

The examples in the following section relate to one of the difficulties intrinsic to the calculation of percentages: the itemization of costs to the single good when the producer is manufacturing different goods. There should be criteria for reasonably apportioning costs to each good to allow the calculation.

USMCA adopts the same criteria as NAFTA allowing for different options, listed below, and as illustrated in the subsequent examples excerpted from USMCA Uniform Regulations:

The net cost of a good may be calculated, at the choice of the producer of the good, by

a calculating the total cost incurred with respect to all goods produced by that producer, subtracting any excluded costs that are included in that total cost, and reasonably allocating, in accordance with Schedule VII, the remainder to the good;

b calculating the total cost incurred with respect to all goods produced by that producer, reasonably allocating, in accordance with Schedule VII, that total cost to the good, and subtracting any excluded costs that are included in the amount allocated to that good; or

c reasonably allocating, in accordance with Schedule VII, each cost that forms part of the total cost incurred with respect to the good so that the aggregate of those costs does not include any excluded costs.

Example under (a)

A producer in a USMCA country produces Good A and Good B during the producer's fiscal year. The producer uses the following figures, which are recorded on the producer's books and represent all of the costs incurred with respect to both Good A and Good B, to calculate the net cost of those goods:

Product costs:	
Value of originating materials	$2,000.00
Value of non-originating materials	$1,000.00
Other product costs	$2,400.00
Period costs: (including $1,200 in excluded costs)	$3,200.00
Other costs	$400.00
Total cost of Good A and Good B	$9,000.00

The net cost is the total cost of Good A and Good B, minus the excluded costs incurred with respect to those goods.

Total cost of Good A and Good B	**$9,000.00**
Excluded costs	– $1,200.00
Net cost of Good A and Good B	$7,800.00

The net cost must then be reasonably allocated, in accordance with the guidelines contained in the following example to Good A and Good B.

Example under (b)

A producer located in a USMCA country produces Good A and Good B during the producer's fiscal year. In order to calculate the regional value content of Good A and Good B, the producer uses the following figures that are recorded on the producer's books and incurred with respect to those goods:

Product costs:	
Value of originating materials	$2,000.00
Value of non-originating materials	$1,000.00
Other product costs	$2,400.00
Period costs: (including $1,200 in excluded costs)	$3,200.00
Other costs	$400.00
Total cost of Good A and Good B	$9,000.00

Under section 6(11)(b), the total cost of Good A and Good B is then reasonably allocated, in accordance with Schedule VII, to those goods. The costs are allocated in the following manner:

	Allocated to Good A	*Allocated to Good B*
Total cost ($9,000 for both Good A and Good B)	$5,220	$3,780

The excluded costs ($1,200) that are included in total cost allocated to Good A and Good B, in accordance with Schedule VII, are subtracted from that amount.

		Excluded cost allocated to Good A	*Excluded cost allocated to Good B*
Total excluded costs:			
Sales promotion, marketing and after-sale service costs	$500	$290	$210
Royalties	$200	$116	$84
Shipping and packing costs	$500	$290	$210
Net cost (total cost minus excluded costs)		$4,524	$3,276

The net cost of Good A is thus $4,524, and the net cost of Good B is $3,276.

Example under (c)

A producer located in a USMCA country produces Good C and Good D. The following costs are recorded on the producer's books for the months of January, February, and March, and each cost that forms part of the total cost is reasonably allocated, in accordance with Schedule VII, to Good C and Good D.

	Total cost: Good C and Good D (in thousands of dollars)	*Allocated to Good C (in thousands of dollars)*	*Allocated to Good D (in thousands of dollars)*
Product costs:			
Value of originating materials	$100	$0	$100
Value of non-originating materials	$900	$800	$100
Other product costs	$500	$300	$200
Period costs (including $420 in excluded costs)	$5,679	$3,036	$2,643

(*continued*)

	Total cost: Good C and Good D (in thousands of dollars)	*Allocated to Good C (in thousands of dollars)*	*Allocated to Good D (in thousands of dollars)*
Minus excluded costs	$420	$300	$120
Other costs	$0	$0	$0
	$6,759	$3,836	$2,923

Schedule V on "Reasonable Allocation of costs of USMCA, related methodologies, and examples" is similar to previous NAFTA regulations.

These USMCA Uniform Regulations are reproduced below to illustrate the complexities and the level of detail that the utilization of a net cost or value-added method imply on reasonable allocated costs of production.

DEFINITIONS AND INTERPRETATION

1 The following definitions apply in this Schedule,

costs means any costs that are included in total cost and that can or need to be allocated in a reasonable manner under to subsections 5(11), 7(11) and 8(8) of these Regulations, subsection 4(8) of Schedule III and subsections 4(8) and 9(3) of Schedule VI;

discontinued operation, in the case of a producer located in a USMCA country, has the meaning set out in that USMCA country's Generally Accepted Accounting Principles;

indirect overhead means period costs and other costs;

internal management purpose means any purpose relating to tax reporting, financial reporting, financial planning, decision-making, pricing, cost recovery, cost control management or performance measurement;

overhead means costs, other than direct material costs and direct labor costs.

2(1) In this Schedule, reference to "producer", for purposes of subsection 4(8) of Schedule III, is to be read as a reference to "buyer".

(2) In this Schedule, a reference to "good",

(a) for purposes of subsection 7(15) of these Regulations, is to be read as a reference to "identical goods or similar goods, or any combination thereof";

(b) for purposes of subsection 8(8) of these Regulations, is to be read as a reference to "intermediate material";
(c) for purposes of section 16 of these Regulations, is to be read as a reference to "category of vehicles that is chosen pursuant to subsection 16(1) of these Regulations";
(d) for purposes of subsection 4(8) of Schedule III, be read as a reference to "packaging materials and containers or the elements"; and
(e) for purposes of subsection 4(8) of Schedule VI, be read as a reference to "elements".

Methods to Reasonably Allocate Costs

3(1) If a producer of a good is using, for an internal management purpose, a cost allocation method to allocate to the good direct material costs, or part thereof, and that method reasonably reflects the direct material used in the production of the good based on the criterion of benefit, cause or ability to bear, that method must be used to reasonably allocate the costs to the good.

(2) If a producer of a good is using, for an internal management purpose, a cost allocation method to allocate to the good direct labor costs, or part thereof, and that method reasonably reflects the direct labor used in the production of the good based on the criterion of benefit, cause or ability to bear, that method must be used to reasonably allocate the costs to the good.

(3) If a producer of a good is using, for an internal management purpose, a cost allocation method to allocate to the good overhead, or part thereof, and that method is based on the criterion of benefit, cause or ability to bear, that method must be used to reasonably allocate the costs to the good.

4 If costs are not reasonably allocated to a good under section 3, those costs are reasonably allocated to the good if they are allocated:

(a) With respect to direct material costs, on the basis of any method that reasonably reflects the direct material used in the production of the good based on the criterion of benefit, cause or ability to bear;
(b) with respect to direct labor costs, on the basis of any method that reasonably reflects the direct labor used in the production of the good based on the criterion of benefit, cause or ability to bear; and
(c) with respect to overhead, on the basis of any of the following methods:
    (i) The method set out in Appendix A, B or C,
    (ii) a method based on a combination of the methods set out in Appendices A and B or Appendices A and C, and
    (iii) a cost allocation method based on the criterion of benefit, cause or ability to bear.

5 Notwithstanding sections 3 and 8, if a producer allocates, for an internal management purpose, costs to a good that is not produced in the period in

which the costs are expensed on the books of the producer (such as costs with respect to research and development, and obsolete materials), those costs must be considered reasonably allocated if:

(a) For purposes of subsection 7(11) of these Regulations, they are allocated to a good that is produced in the period in which the costs are expensed, and
the good produced in that period is within a group or range of goods, including
(b) identical goods or similar goods, that is produced by the same industry or industry sector as the goods to which the costs are expensed.

6 Any cost allocation method referred to in section 3, 4 or 5 that is used by a producer for the purposes of these Regulations must be used throughout the producer's fiscal year.

Costs Not Reasonably Allocated

7 The allocation to a good of any of the following is considered not to be reasonably allocated to the good:

(a) Costs of a service provided by a producer of a good to another person where the service is not related to the good;
(b) gains or losses resulting from the disposition of a discontinued operation,
(c) except gains or losses related to the production of the good;
cumulative effects of accounting changes reported in accordance with a specific requirement of the applicable Generally Accepted Accounting Principles; and
(d) gains or losses resulting from the sale of a capital asset of the producer.

8 Any costs allocated under section 3 on the basis of a cost allocation method that is used for an internal management purpose that is solely for the purpose of qualifying a good as an originating good are considered not to be reasonably allocated.

APPENDIX A COST RATIO METHOD

Calculation of Cost Ratio

For the overhead to be allocated, the producer may choose one or more allocation bases that reflect a relationship between the overhead and the good based on the criterion of benefit, cause or ability to bear.

With respect to each allocation base that is chosen by the producer for allocating overhead, a cost ratio is calculated for each good produced by the producer in accordance with the following formula:

CR is the cost ratio with respect to the good;
AB is the allocation base for the good; and
TAB is the total allocation base for all the goods produced by the producer.

Allocation to a Good of Costs Included in Overhead

The costs with respect to which an allocation base is chosen are allocated to a good in accordance with the following formula:

$$CAG = CA \times CR$$

where CAG is the costs allocated to the good;

CA is the costs to be allocated; and
CR is the cost ratio with respect to the good.

Excluded Costs

Under section 6(11)(b) of this appendix, where excluded costs are included in costs to be allocated to a good, the cost ratio used to allocate that cost to the good is used to determine the amount of excluded costs to be subtracted from the costs allocated to the good.

Allocation Bases for Costs

The following is a non-exhaustive list of allocation bases that may be used by the producer to calculate cost ratios:

Direct Labor Hours
Direct Labor Costs
Units Produced
Machine-hours
Sales Dollars or Pesos
Floor Space

Examples
The following examples illustrate the application of the cost ratio method to costs included in overhead.

Example 1: Direct Labor Hours
A producer who produces Good A and Good B may allocate overhead on the basis of direct labor hours spent to produce Good A and Good B. A total of 8,000 direct labor hours have been spent to produce Good A and Good B: 5,000 hours with respect to Good A and 3,000 hours with respect to Good B. The amount of overhead to be allocated is $6,000,000.

Good B: 3,000 hours/8,000 hours =.375

Allocation of Overhead to Good A and Good B:

Good A: $6,000,000 x.625 = $3,750,000
Good B: $6,000,000 x.375 = $2,250,000

Calculation of the Ratios:

Good A: 5,000 hours/8,000 hours =.625

Example 2: Direct Labor Costs

A producer who produces Good A and Good B may allocate overhead on the basis of direct labor costs incurred in the production of Good A and Good B. The total direct labor costs incurred in the production of Good A and Good B is $60,000: $50,000 with respect to Good A and $10,000 with respect to Good B. The amount of overhead to be allocated is $6,000,000.

Calculation of the Ratios:

Good A: $50,000/$60,000 =.833
Good B: $10,000/$60,000 =.167

Allocation of Overhead to Good A and Good B:

Good A: $6,000,000 x.833 = $4,998,000
Good B: $6,000,000 x.167 = $1,002,000

Example 3: Units Produced

A producer of Good A and Good B may allocate overhead on the basis of units produced. The total units of Good A and Good B produced is 150,000: 100,000 units of Good A and 50,000 units of Good B. The amount of overhead to be allocated is $6,000,000.

Calculation of the Ratios:

Good A: 100,000 units/150,000 units =.667
Good B: 50,000 units/150,000 units =.333

Allocation of Overhead to Good A and Good B:

Good A: $6,000,000 x.667 = $4,002,000
Good B: $6,000,000 x.333 = $1,998,000

Example 4: Machine-hours

A producer who produces Good A and Good B may allocate machine-related overhead on the basis of machine-hours utilized in the production of Good A and Good B. The total machine-hours utilized for the production of Good A and Good B is 3,000 hours: 1,200 hours with respect to Good A and 1,800 hours with respect to Good B. The amount of machine-related overhead to be allocated is $6,000,000.

Calculation of the Ratios:

Good A: 1,200 machine-hours/3,000 machine-hours =.40
Good B: 1,800 machine-hours/3,000 machine-hours =.60

Allocation of Machine-Related Overhead to Good A and Good B:

Good A: $6,000,000 x.40 = $2,400,000
Good B: $6,000,000 x.60 = $3,600,000

Example 5: Sales Dollars or Pesos

A producer who produces Good A and Good B may allocate overhead on the basis of sales dollars. The producer sold 2,000 units of Good A at $4,000 and 200 units of Good B at $3,000. The amount of overhead to be allocated is $6,000,000.

Total Sales Dollars for Good A and Good B:

Good A: $4,000 \times 2,000 = \$8,000,000$
Good B: $3,000 \times 200 = \$600,000$
Total Sales Dollars: $8,000,000 + $600,000 = $8,600,000

Calculation of the Ratios:

Good A: $8,000,000/$8,600,000 =.93
Good B: $600,000/$8,600,000 =.07

Allocation of Overhead to Good A and Good B:

Good A: $6,000,000 x.93 = $5,580,000
Good B: $6,000,000 x.07 = $420,000

Example 6: Floor Space

A producer who produces Good A and Good B may allocate overhead relating to utilities (heat, water and electricity) on the basis of floor space used in the production and storage of Good A and Good B.

The total floor space used in the production and storage of Good A and Good B is 100,000 square feet: 40,000 square feet with respect to Good A and 60,000 square feet with respect to Good B. The amount of overhead to be allocated is $6,000,000.

Calculation of the Ratios:

Good A: 40,000 square feet/100,000 square feet =.40
Good B: 60,000 square feet/100,000 square feet =.60

Allocation of Overhead (Utilities) to Good A and Good B:

Good A: $6,000,000 x.40 = $2,400,000
Good B: $6,000,000 x.60 = $3,600,000

APPENDIX B DIRECT LABOR AND DIRECT MATERIAL RATIO METHOD

Calculation of Direct Labor and Direct Material Ratio

For each good produced by the producer, a direct labor and direct material ratio is calculated in accordance with the following formula:

$$DLDMR = \frac{DLC + DMC}{TDLC + TDMC}$$

DLDMR is the direct labor and direct material ratio for the good;
DLC is the direct labor costs of the good;
DMC is the direct material costs of the good;
TDLC is the total direct labor costs of all goods produced by the producer; and
TDMC is the total direct material costs of all goods produced by the producer.

Allocation of Overhead to a Good

Overhead is allocated to a good in accordance with the following formula:

$$OAG = O \times DLDMR$$

Where OAG is the overhead allocated to the good;

O is the overhead to be allocated; and
DLDMR is the direct labor and direct material ratio for the good.

Excluded Costs

Under section 6(11)(b) of this appendix, where excluded costs are included in overhead to be allocated to a good, the direct labor and direct material ratio used to allocate overhead to the good is used to determine the amount of excluded costs to be subtracted from the overhead allocated to the good.

Examples
Example 1:

The following example illustrates the application of the direct labor and direct material ratio method used by a producer of a good to allocate overhead where the producer chooses to calculate the net cost of the good in accordance with section 6(11)(a) of this appendix. A producer produces Good A and Good B. Overhead (O) minus excluded costs (EC) is $30 and the other relevant costs are set out in the following table:

	Good A	*Good B*	*Total*
Direct labor costs (DLC)	$5	$5	$10
Direct Material costs (DMC)	$10	$5	$15
Totals	$15	$10	$25

Overhead Allocated to Good A

OAG (Good A) = O ($30) × DLDMR ($15/$25)
OAG (Good A) = $18.00

Overhead Allocated to Good B

OAG (Good B) = O ($30) × DLDMR ($10/$25)
OAG (Good B) = $12.00

Example 2:

The following example illustrates the application of the direct labor and direct material ratio method used by a producer of a good to allocate overhead where the producer chooses to calculate the net cost of the good in accordance with section 6(11)(b) of this appendix and where excluded costs are included in overhead.

A producer produces Good A and Good B. Overhead (O) is $50 (including excluded costs (EC) of $20). The other relevant costs are set out in the table of Example 1.

Overhead Allocated to Good A

OAG (Good A) = [O ($50) x DLDMR ($15/$25)] – [EC ($20) x DLDMR ($15/$25)]
OAG (Good A) = $18.00

Overhead Allocated to Good B

OAG (Good B) = [O ($50) x DLDMR ($10/$25)] – [EC ($20) x DLDMR ($10/$25)]
OAG (Good B) = $12.00

ADDENDUM C DIRECT COST RATIO METHOD

Direct Overhead

Direct overhead is allocated to a good on the basis of a method based on the criterion of benefit, cause or ability to bear.

Indirect Overhead

Indirect overhead is allocated on the basis of a direct cost ratio.

Calculation of Direct Cost Ratio

For each good produced by the producer, a direct cost ratio is calculated in accordance with the following formula:

$$DCR = \frac{DLC + DMC + DO}{TDLC + TDMC + TDO}$$

where

DCR is the direct cost ratio for the good;
DLC is the direct labor costs of the good;
DMC is the direct material costs of the good;
DO is the direct overhead of the good;
TDLC is the total direct labor costs of all goods produced by the producer;
TDMC is the total direct material costs of all goods produced by the producer; and
TDO is the total direct overhead of all goods produced by the producer;

Allocation of Indirect Overhead to a Good

Indirect overhead is allocated to a good in accordance with the following formula:

$$IOAG = IO \times DCR$$

where

IOAG is the indirect overhead allocated to the good;
IO is the indirect overhead of all goods produced by the producer; and
DCR is the direct cost ratio of the good.

Excluded Costs

Under section 6(11)(b) of this appendix, where excluded costs are included in

(a) direct overhead to be allocated to a good, those excluded costs are subtracted from the direct overhead allocated to the good; and
(b) indirect overhead to be allocated to a good, the direct cost ratio used to allocate indirect overhead to the good is used to determine the amount of excluded costs to be subtracted from the indirect overhead allocated to the good.

Examples
Example 1:

The following example illustrates the application of the direct cost ratio method used by a producer of a good to allocate indirect overhead where the producer chooses to calculate the net cost of the good in accordance with section 6(11)(a) of this appendix. A producer produces Good A and Good B. Indirect overhead (IO) minus excluded costs (EC) is $30. *The other relevant costs are set out in the following table:*

	Good A	*Good B*	*Total*
Direct labor costs (DLC)	$5	$5	$10
Direct Material costs (DMC)	$10	$5	$15
Direct overhead (DO)	$8	$2	$10
Totals	$23	$12	$35

Indirect Overhead Allocated to Good A

IOAG (Good A) = IO ($30) x DCR ($23/$35)
IOAG (Good A) = $19.71

Indirect Overhead Allocated to Good B

IOAG (Good B) = IO ($30) x DCR ($12/$35)
IOAG (Good B) = $10.29

Example 2:

The following example illustrates the application of the direct cost ratio method used by a producer of a good to allocate indirect overhead where the producer has chosen to calculate the net cost of the good in accordance with section 6(11)(b) of this appendix and where excluded costs are included in indirect overhead.

A producer produces Good A and Good B. The indirect overhead (IO) is $50 (including excluded costs (EC) of $20). The other relevant costs are set out in the table to Example 1.

Indirect Overhead Allocated to Good A

IOAG (Good A) = [IO ($50) x DCR ($23/$35)] – [EC ($20) x DCR ($23/$35)]
IOAG (Good A) = $19.72

Indirect Overhead Allocated to Good B

IOAG (Good B) = [IO ($50) x DCR ($12/$35)] – [EC ($20) x DCR ($12/$35)]
IOAG (Good B) = $10.28

3.4.4.6 Accumulation (Cumulation) in NAFTA and USMCA

As in the case of NAFTA, USMCA provides for what is defined in USMCA accumulation. The provisions are quite different from the sort of cumulation discussed above in the case of the unilateral trade preferences or the diagonal cumulation of the Pan-European Rules of Origin.

In the case of NAFTA, Annex 401 is drafted in a manner that incorporates the concept of the cumulation, as follows:

Accumulation

(1) Determination of originating good
For purposes of determining whether a good is an originating good, the production of the good in the territory of one or more of the NAFTA countries by one or more producers shall, at the choice of the exporter or producer of the good, be considered to have been performed in the territory of any of the NAFTA countries by that exporter or producer, if –

(A) all nonoriginating materials used in the production of the good undergo an applicable tariff classification change set out in Annex 401 of the Agreement;
(B) the good satisfies any applicable regional value-content requirement; and
(C) the good satisfies all other applicable requirements of this section.

The requirements of subparagraphs (A) and (B) must be satisfied entirely in the territory of one or more of the NAFTA countries.

The concept of cumulation in NAFTA and USMCA is rather similar to the diagonal cumulation under the Pan-European Rules of Origin but with some differences as discussed further here below and in Chapter 6.

The NAFTA cumulation provision allows the producer or exporter of goods to choose to include as part of the goods' RVC any regional value added by suppliers of non-originating materials used to produce the final goods. Thus, accumulation allows the producer to reduce the value of the non-originating materials used in the production of the good, by taking into account the NAFTA inputs incorporated into those non-originating materials. In this way, the NAFTA cumulation is quite similar to a full cumulation because a producer may add up working or processing in another NAFTA country to comply with origin requirements. An example of this kind of cumulation is given below in example 1, situation (b).

USMCA cumulation makes more explicit how cumulation works; also made more explicit is the kind of cumulation that is provided, as follows:

> **ARTICLE 4.11: ACCUMULATION**
>
> 1. Each Party shall provide that a good is originating if the good is produced in the territory of one or more of the Parties by one or more producers, provided that the good satisfies the requirements of Article 4.2 (Originating Goods) and all other applicable requirements in this Chapter.
> 2. Each Party shall provide that an originating good or material of one or more of the Parties is considered as originating in the territory of another Party when used as a material in the production of a good in the territory of another Party.
> 3. Each Party shall provide that production undertaken on a non-originating material in the territory of one or more of the Parties may contribute toward the originating status of a good, regardless of whether that production was sufficient to confer originating status to the material itself.

Paragraph 2 of Article 4.11 of USMCA makes clear that an "originating material" in any of the parties can be cumulated when used in the production of a finished good. This covers cumulation of "originating materials" or, to use the European jargon, diagonal cumulation.

Paragraph 3 of Article 4.11 of USMCA adds another dimension of cumulation. It mentions that "production" may contribute toward originating status of a good. This is equivalent to full cumulation or cumulation of working or processing. In addition to such provision it is important to recall another important new provision that has been added in paragraph 5 of USMCA Article 4.5:

> 5. Each Party shall provide that if a non-originating material is used in the production of a good, the following may be counted as originating content for the purpose of determining whether the good meets a regional value content requirement:

(a) the value of processing of the non-originating materials undertaken in the territory of one or more of the Parties; and
(b) the value of any originating material used in the production of the non-originating material undertaken in the territory of one or more of the Parties.

Such dimension of cumulation was not spelt out and provided for in such a clear language in NAFTA even if it was allowed, as further clarified below. USMCA Uniform Regulations provide extensive examples on how cumulation actually works, in part drawn from former NAFTA Uniform Regulations.

Under NAFTA cumulation, in the case where a producer is unable to satisfy an RVC requirement based on (1) his own processing costs and (2) the value of originating materials he uses to produce a good, cumulation allows him to include (3) any regional value added in the NAFTA territory by other persons who produced non-originating materials that were subsequently incorporated into the final good.

There were rather detailed conditions in NAFTA for using and administering cumulation:

- Producers/exporters who choose to use accumulation must use the net cost method to calculate any RVC.
- Producers/exporters of goods must obtain information on net cost and the RVC of non-originating materials used to make their goods from the producers (suppliers) of those materials.[182]

[182] Para. 2 of Part IV of the NAFTA Uniform Regulations provides as follows:

(2) Where a good is subject to a regional value-content requirement and an exporter or producer of the good has a statement signed by a producer of a material that is used in the production of the good that

(a) states the net cost incurred and the value of nonoriginating materials used by the producer of the material in the production of that material,
  (i) the net cost incurred by the producer of the good with respect to the material shall be the net cost incurred by the producer of the material plus, where not included in the net cost incurred by the producer of the material, the costs referred to in sections 7(1)(c) through (e), and
  (ii) the value of non-originating materials used by the producer of the good with respect to the material shall be the value of non-originating materials used by the producer of the material; or
(b) states any amount, other than an amount that includes any of the value of non-originating materials, that is part of the net cost incurred by the producer of the material in the production of that material,
  (i) the net cost incurred by the producer of the good with respect to the material shall be the value of the material, determined in accordance with section 7(1), and
  (ii) the value of non-originating materials used by the producer of the good with respect to the material shall be the value of the material, determined in accordance with section 7(1), minus the amount stated in the statement.

- All non-originating materials used in the production of the goods must undergo the tariff classification change set out in Annex 401 of the Agreement, and the goods must satisfy any applicable regional value-content requirement, entirely in the territory of one or more of the NAFTA countries.
- The goods must satisfy all other applicable requirements of the rules of origin.

USMCA Uniform Regulations provide for similar statements from suppliers as follows:

(7) *Particulars.* For the purposes of this section,

(a) in order to accumulate the production of a material,
  (i) if the good is subject to a regional value content requirement, the producer of the good must have a statement described in subsection (2) through (5) that is signed by the producer of the material, and
  (ii) if an applicable change in tariff classification is applied to determine whether the good is an originating good, the producer of the good must have a statement signed by the producer of the material that states the tariff classification of all non- originating materials used by that producer in the production of that material and that the production of the material took place entirely in the territory of one or more of the USMCA countries;

(b) a producer of a good who chooses to accumulate is not required to accumulate the production of all materials that are incorporated into the good; and

(c) any information set out in a statement referred to in subsection (2) through (5) that concerns the value of materials or costs is to be in the same currency as the currency of the country in which the person who provided the statement is located.

The following examples have been excerpted from the USMCA Uniform Regulations[183] and may assist in clarifying some concepts and method of application of USMCA cumulation:

Example 1

Producer A, located in USMCA country A, imports unfinished bearing rings provided for in subheading 8482.99 into USMCA country A from a non-USMCA territory. Producer A further processes the unfinished bearing rings into finished bearing rings, which are of the same subheading. The finished bearing rings of Producer A do not satisfy an applicable change in tariff classification and therefore do not qualify as originating goods.

[183] https://ustr.gov/sites/default/files/files/agreements/FTA/USMCA/Text/UniformRegulations RulesofOrigin.pdf.

The net cost of the finished bearing rings (per unit) is calculated as follows:

Product costs:	
Value of originating materials	$0.15
Value of non-originating materials	$0.75
Other product costs	$0.35
Period costs: (including $0.05 in excluded costs)	$0.15
Other costs	$0.05
Total cost of the finished bearing rings, per unit	$1.45
Excluded costs: (included in period costs)	$0.05
Net cost of the finished bearing rings, per unit	$1.40

Producer A sells the finished bearing rings to Producer B who is located in USMCA country A for $1.50 each. Producer B further processes them into bearings, and intends to export the bearings to USMCA country B.

Although the bearings satisfy the applicable change in tariff classification, the bearings are subject to a regional value content requirement.

Situation A

Producer B does not choose to accumulate costs incurred by Producer A with respect to the bearing rings used in the production of the bearings. The net cost of the bearings (per unit) is calculated as follows:

Product costs:	
Value of originating materials	$0.45
Value of non-originating materials (value, per unit, of the bearing rings purchased from Producer A)	$1.50
Other product costs	$0.75
Period costs: (including $0.05 in excluded costs)	$0.15
Other costs	$0.05
Total cost of the finished bearing rings, per unit	$2.90
Excluded costs: (included in period costs)	$0.05
Net cost of the finished bearing rings, per unit	$2.85

Under the net cost method, the regional value content of the bearings is

$$RVC = \frac{NC - VNM}{NC} \times 100$$

$$RVC = \frac{\$2.85 - \$2.50}{\$2.85} \times 100$$

$$RVC = 47.4\%$$

Therefore, the bearings are non-originating goods.

Situation B

Producer B chooses to accumulate costs incurred by Producer A with respect to the bearing rings used in the production of the bearings. Producer A provides a statement described in paragraph 9(2)(a) to Producer B. The net cost of the bearings (per unit) is calculated as follows:

Product costs:	
Value of originating materials ($0.45 + $0.15)	$0.60
Value of non-originating materials (value, per unit, of the unfinished bearing rings imported by Producer A)	$0.75
Other product costs ($0.75 + $0.35)	$1.10
Period costs: (($0.15 + $0.15), including $0.05 in excluded costs)	$0.30
Other costs ($0.05 + $0.05)	$0.10
Total cost of the bearings, per unit	$2.85
Excluded costs: (included in period costs)	$0.10
Net cost of the bearings, per unit	$2.75

Under the net cost method, the regional value content of the bearings is

$$RVC = \frac{NC - VNM}{NC} \times 100$$

$$RVC = \frac{\$2.75 - \$0.75}{\$2.75} \times 100$$

$$RVC = 72.7\%$$

Therefore, the bearings are originating goods.

Situation C

Producer B chooses to accumulate costs incurred by Producer A with respect to the bearing rings used in the production of the bearings. Producer A provides to Producer B a statement described in paragraph 9(2)(b) that specifies an amount equal to the net cost minus the value of non-originating materials used to produce the finished bearing rings ($1.40¥0.75 = $0.65). The net cost of the bearings (per unit) is calculated as follows:

Product costs:	
Value of originating materials ($0.45 + $0.65)	$1.10
Value of non-originating materials ($1.50 – $0.65)	$0.85
Other product costs	$0.75
Period costs: (including $0.05 in excluded costs)	$0.15
Other costs	$0.05
Total cost of the bearings, per unit	$2.90
Excluded costs: (included in period costs)	$0.05
Net cost of the bearings, per unit	$2.85

Under the net cost method, the regional value content of the bearings is

$$RVC = \frac{NC - VNM}{NC} \times 100$$

$$RVC = \frac{\$2.85 - \$0.85}{\$2.85} \times 100$$

$$RVC = 70.2\%$$

Therefore, the bearings are originating goods.

Situation D

Producer B chooses to accumulate costs incurred by Producer A with respect to the bearing rings used in the production of the bearings. Producer A provides to Producer B a statement described in paragraph 9(2)(b) that specifies an amount equal to the value of other product costs used in the production of the finished bearing rings ($0.35). The net cost of the bearings (per unit) is calculated as follows:

Product costs:	
Value of originating materials	$0.45
Value of non-originating materials ($1.50 – $0.35)	$1.15
Other product costs ($0.75 + $0.35)	$1.10
Period costs: (including $0.05 in excluded costs)	$0.15
Other costs	$0.05
Total cost of the bearings, per unit	$2.90
Excluded costs: (included in period costs)	$0.05
Net cost of the bearings, per unit	$2.85

Under the net cost method, the regional value content of the bearings is

$$RVC = \frac{NC - VNM}{NC} \times 100$$

$$RVC = \frac{\$2.85 - \$1.15}{\$2.85} \times 100$$

$$RVC = 59.7\%$$

Therefore, the bearings are originating goods.

Example 2

Producer A, located in USMCA country A, imports non-originating cotton, carded or combed, provided for in heading 52.03 for use in the production of cotton yarn provided for in heading 52.05. Because the change from cotton, carded or combed, to cotton yarn is a change within the same chapter, the cotton does not satisfy the applicable change in tariff classification for heading 52.05, which is a change from any other chapter, with certain exceptions. Therefore, the cotton yarn that Producer A produces from non-originating cotton is a non-originating good.

Producer A then sells the non-originating cotton yarn to Producer B, also located in USMCA country A, who uses the cotton yarn in the production of woven fabric of cotton provided for in heading 52.08. The change from non-originating cotton yarn to woven fabric of cotton is insufficient to satisfy the applicable change in tariff classification for heading 52.08, which is a change from any heading outside headings 52.08 through 52.12, except from certain headings, under which various yarns, including cotton yarn provided for in heading 52.05, are classified.

Therefore, the woven fabric of cotton that Producer B produces from non-originating cotton yarn produced by Producer A is a non-originating good.

However, Producer B can choose to accumulate the production of Producer A. The rule for heading 52.08, under which the cotton fabric is classified, does not exclude a change from heading 52.03, under which carded or combed cotton is classified. Therefore, under section 15 (1), the change from carded or combed cotton provided for in heading 52.03 to the woven fabric of cotton provided for in heading 52.08 would satisfy the applicable change of tariff classification for heading 52.08. The woven fabric of cotton would be considered as an originating good.

Producer B, in order to choose to accumulate Producer A's production, must have a statement described in subsection 9(7).

Situation E

Producer B chooses to accumulate costs incurred by Producer A with respect to the bearing rings used in the production of the bearings. Producer A provides to Producer B a signed statement described in subsection 9(3) that specifies the value of non-originating materials used in the production of the finished bearing rings ($0.75). Producer B chooses to calculate the regional value content of the bearings under the transaction value method. The regional value content of the bearings (per unit) is calculated as follows:

Transaction value of the bearing	$3.15
Costs incurred, per unit, in the international shipment of the good (included in transaction value of the bearings)	$0.15
Transaction value, per unit, adjusted to exclude any costs incurred in the international shipment of the good	$3.00
Value of non-originating materials (value, per unit, of the unfinished bearing rings imported by Producer A)	$0.75

Under the transaction value method, the regional value content of the bearings is

$$RVC = (TV¥VNM)/TV \cdot 100 = (\$3.00¥\$0.75)/\$3.00 \cdot 100 = 75\%$$

Therefore, because the bearings have a regional value content of at least 60 percent under the transaction value method, the bearings are originating goods.

3.4.4.7 Other USMCA and NAFTA Provisions

3.4.4.7.1 SELF-PRODUCED MATERIALS AND INTERMEDIATE MATERIALS. This concept is rather similar to the absorption principle earlier discussed in the case of

the pan-European rules. While the concept is similar, the modus operandi and the administration of these rules under NAFTA and USMCA are starkly different. The amount of details and conditions attached to the USMCA and previously NAFTA rules on intermediate material found no comparison with those under the Pan-European Rules of Origin.

3.4.4.7.2 ARTICLE 4.8: INTERMEDIATE MATERIALS. Article 4.8 provides that, except as provided in Article 10.3 of Appendix 1 to Annex 4-B:

> Each Party shall provide that any self-produced material, other than a component identified in Table G of that Appendix, that is used in the production of a good may be designated by the producer of the good as an intermediate material for the purpose of calculating the regional value content of the good under paragraph 2 or 3 of Article 4.5, provided that if the intermediate material is subject to a regional value-content requirement, no other self-produced material subject to a regional value-content requirement used in the production of that intermediate material may itself be designated by the producer as an intermediate material.

According to the USMCA rules for intermediate materials, a producer may designate as an intermediate material any self-produced, originating material used in the production of the final goods. As long as the intermediate material qualifies as an originating material, its entire value may be treated as originating in determining the RVC of the finished goods.

This provision covers all goods and materials except:

- automotive goods defined in Article 10.3 of Appendix 1 to Annex 4-B
- components included in Table G of Appendix 1 to Annex 4-B.

An intermediate material may be composed of originating and non-originating submaterials. After determining that an intermediate material satisfies the applicable rule of origin under Article 401, the total cost to produce that intermediate material is treated as an originating cost. In other words, the producer would not include the value of the non-originating materials used to produce the intermediate material as part of the value of non-originating materials when calculating the RVC of the final goods. The benefit of designating an intermediate material is that the producer may treat self-produced materials similarly to the way in which he would treat an originating material purchased at arm's length for purposes of determining the value of the non-originating materials of the final goods.

In USMCA, as in NAFTA, there are a series of limitations to the designation of intermediate materials. Under NAFTA the first limitation provided that if the intermediate material must satisfy a minimum RVC to qualify as originating, the net cost method must be used to calculate that RVC. Under USMCA such limitation is not present.

A second and more important limitation is that material subject to an RVC requirement may be designated as an intermediate material if it contains

submaterials also subject to an RVC requirement that were also designated as intermediate materials. In other words, this rule is designed to impede the successive designation of intermediate materials as shown in the following example drawn from NAFTA. There are no similar examples in the USMCA Uniform Regulations.

Example[184]

Company Z manufactures forklift trucks in Canada and makes some of the materials used in their production. As illustrated in the graphic above, each geometric symbol represents a material used in the production of the forklift truck.

The circles (i.e., outer races, balls, steel, gaskets, impellers, bearings, engine blocks, crank shafts) are materials acquired from sellers in non-NAFTA (USMCA) countries. The squares (i.e., rod-end bearings, casings, impeller assemblies, engines) are self-produced materials. They are considered horizontal materials in relation to each other. The impeller assemblies cannot be designated as intermediate materials because they do not meet the Annex 401 rule of origin ("a change to subheading 8413.91 from any other heading"). However, the rod-end bearings, casings, and engines could all be designated intermediate materials, as long as they satisfy the applicable NAFTA (USMCA) product-specific rules of origin. (The casings undoubtedly meet the rule of origin, which provides for "a change to subheading 8412.90 from any other heading." The engines and rod-end bearings meet the required tariff change prescribed in the Annex 401 rules of origin, but would also have to meet a regional value content requirement to qualify as originating.) We assume that the regional value content is met throughout this example.

The rod-end bearings and casings are used in the production of the cylinders. Likewise, the impeller assemblies and engines are used in the production of the pumps that drive the hydraulic mechanisms of the forklifts. The cylinders and pumps (represented by triangles) are intermediate materials that are horizontal in relation to each other, and vertical in relation to the materials from which they were made. As long as there is no regional value content requirement for more than one intermediate material in the vertical stream, each new material can be designated as an intermediate material. The cylinder qualifies as originating under article 401(c) because it is made in Canada exclusively from originating materials. Here, however, both the engine and the pump are subject to regional value content requirements.

*Thus, Company Z can choose to designate the engine or the pump as an intermediate material, **but not both**. Therefore, Company Z must choose which is most advantageous: to designate the engines as an intermediate material, or to designate the pump. The forklift truck will then qualify as an originating good.*

Under NAFTA Uniform Regulations, it was made clear that where a single producer designates intermediate materials that qualify as originating solely based on a tariff change – that is, without having to satisfy an RVC requirement – subsequent designations can be made with previously designated intermediate materials.

[184] This example has been excerpted from the Trilateral Customs Guide to NAFTA, at www.cra-arc.gc.ca/tax/business/smallbusiness/c124-e.html#Intermediate_materials. Such example is not contained in the USMCA trilateral Uniform Regulations.

Thus, in the example above, if the engine were not subject to an RVC requirement, both it and the pump could be designated as intermediate materials. Given the fact that USMCA provision on intermediate products is *verbatim* the same as NAFTA, it may be reasonably expected that the following example is also applicable to USMCA.

The following example further aims at clarifying the differences between when a successive designation of intermediate material is allowed or not, depending whether the RVC rules were previously applied.

Example of Single Producer and Successive Designations of Materials Subject to an RVC Requirement as Intermediate Materials

Producer A, located in NAFTA (USMCA) country, produces Material X and uses Material X in the production of Good B. Material X qualifies as an originating material because it satisfies the applicable RVC requirement. Producer A designates Material A as an intermediate material.

Producer A uses Material X in the production of Material Y, which is also used in the production of Good B. Material Y is also subject to an RVC requirement. Under the proviso set out above, Producer A cannot designate Material Y as an intermediate material, even if Material Y satisfies the applicable RVC requirement, because Material X was already designated by Producer A as an intermediate material.

Example of Single Producer and Multiple Designations of Materials as Intermediate Materials

Producer X, who is located in NAFTA (USMCA) country X, uses non-originating materials in the production of self-produced materials A, B, and C. None of the self-produced materials are used in the production of any of the other self-produced materials. Producer X uses the self-produced materials in the production of Good O, which is exported to NAFTA country Y. Materials A, B and C qualify as originating materials because they satisfy the applicable RVC requirements. Because none of the self-produced materials are used in the production of any of the other self-produced materials, then even though each self-produced material is subject to an RVC requirement, Producer X may, under section 7 (4), designate all of the self-produced materials as intermediate materials. The proviso set out in section 7(4) only applies where self-produced materials are used in the production of other self-produced materials and both are subject to an RVC requirement.

In NAFTA there was a second set of detailed rules that concerned the method for determining the value of the intermediate material. These provisions have been maintained under USMCA for determining the value of an intermediate material:

(8) *Value of an intermediate material.* The value of an intermediate material will be, at the choice of the producer of the good,

(a) the total cost incurred with respect to all goods produced by the producer that can be reasonably allocated to that intermediate material in accordance with Schedule V; or

(b) the aggregate of each cost that forms part of the total cost incurred with respect to that intermediate material that can be reasonably allocated to that intermediate material in accordance with Schedule V.

(9) *Calculation of total cost.* Total cost under subsection (8) consists of the costs referred to in subsection 1(6), and is calculated in accordance with that subsection and subsection 1(7).

The two methods allow producers to select the one that best fits their production and accounting practices. The value of the intermediate material should be approximately the same using either method. However, under NAFTA, the net cost method must be used for intermediate materials subject to an RVC requirement.[185]

Differently from NAFTA, the USMCA Uniform Regulations do not provide for examples of the calculation of value of intermediate materials. The examples reproduced below are excerpted from NAFTA to provide an idea of the level of complexity of such calculation. The USMCA Uniform Regulations in section 9 above provide that the total cost of the intermediate material is to be calculated according to section 1(6) and 1(7) of the Uniform Regulations.

THE HONDA CASE[186]

The much-debated and publicized Honda case may be regarded as the classic illustration of the technical complexities of rules of origin, globalization and relocation of industries and the policy and industry decisions underlying them. Ultimately, the Honda case, that arose in the context of the US–Canada FTA agreement, became the test case for the importance attached to rules of origin in the subsequent NAFTA negotiations.

From a technical point of view and in the opinion of those familiar with rules of origin, the issue at stake had to do with some of the traditional problems linked to origin determination: inadequacy of the CTH rule in specific cases, definition of

[185] Article 402(8) of NAFTA listed those costs which may not be included when calculating the RVC of the intermediate material using the net cost method:

- sales promotion, including marketing and after-sales service costs
- royalties
- shipping and packing costs
- now-allowable interest costs.

Although these costs are excluded in the net cost calculation, they do form part of the total cost of the materials. Accordingly, costs such as royalties are excluded when calculating the net cost for purposes of determining whether the material satisfies an RVC requirement (and thus originates and can be designated an intermediate material), but are included in the total value of the material once its origin has been determined. As noted above, the total value of an intermediate material may be counted as an originating cost.

[186] See F. P. Cantin and A. F. Lowenfeld, "Rules of origin: The Canada–United States FTA and the Honda case," *American Journal of International Law*, vol. 87, no. 3 (1993), 375–390.

allowable costs under the percentage criterion, and origin determination of intermediate input or components, the latter aspect being particularly related to the increasing globalization of production and the increasing practice by companies, especially in the automobile sector of subcontracting the manufacturing of subassemblies according to just-in-time agreements with suppliers. Under the US–Canada FTA agreement, the origin of automobiles and their components was subject to a CTH test plus a requirement for a minimum of 50 percent local content. Parts or components of an automobile (intermediate products) were also subject to the same rules. Thus, if a subcomponent of an automobile – for example, the engine as in the Honda case – meets the CTH requirement plus the 50 percent local content requirement in the United States, it can be considered to be of American origin. Then, when it is used to complete the automobile manufactured in Canada the value of the engine as a whole (100%) will be counted as North American content (and not only the 50% of US original local content), and its whole value will be added to the local content acquired in Canada to fulfill the 50% local content requirement for the complete automobile. This rule is called the "roll-up rule." Controversially, when the subcomponent did not acquire originating status, the whole value of the component would be counted as foreign (roll-down rule).

In the Honda case, Honda of Canada and the Canadian customs for a certain period treated the engines manufactured in the United States as originating and imported them duty-free into Canada. When the engines were subsequently assembled into the Honda Civic their full value was counted as being of North American content in order to reach the minimum 50 percent local content requirement to be re-exported to the United States duty-free. This trend continued until 1992 when a US customs investigation determined that the Honda Civic manufactured in Canada and exported to the United States did not meet the 50 percent requirement because it contained too many Japanese parts. Honda was then asked to pay a retroactive bill of 17 million USD for the 2.5 percent ad valorem tariff evaded on the Honda Civics re-exported to the United States. More specifically, the US customs ruled that engines manufactured in the Ohio plant did not qualify as North American. Then, according to the roll-down rule, their whole value could not be counted as local content when calculating the required 50 percent local content for the Honda Civic. As a consequence, the complete Honda Civic manufacture in Canada was not considered North American since the automobiles no longer met the 50 percent domestic content requirement, and had to pay duties as if they were exported direct from Japan.

In particular, the engine was considered not to have US origin following the US customs interpretation that did not allow certain "processing costs and indirect cost" incurred in the United States to be counted as local content. The determination of allowable costs and the accounting method to impute such costs to local content have been a traditional and classic pitfall of the percentage criterion.

These technical details gave rise to various political considerations. First, at that time, the US authorities were arguing with the European Economic Community (EEC) that Honda Accords made in Ohio were of American origin and that they should therefore not be counted as Japanese cars against the quota that the French authorities maintained on Japanese car imports. Second, Honda's

reputation and naturalized American image were affected following the finding by the US customs investigation, that accused Honda Japan of price-setting concerning its Honda Canada related suppliers (some of them were 100 percent Japanese owned) and transfer-price manipulation. Third, the issue became the subject of a political debate in which US policymakers started to weigh and review all aspects of the value of transplant operations in the United States and how they helped or competed with US automobiles.

Some Canadian policymakers, on the other hand, regarded the US customs ruling as a means of diverting Japanese investment from Canada to the United States. The core of the problem, which was heatedly debated at the technical level, lay, as admitted by a senior US official, in a flaw or (as others argue) a loophole in the drafting of the free-trade agreement rules of origin; namely, in the roll-up rule. Taking this rule to its extreme, a senior US official admitted that it was possible, through breaking up the car into as many subassemblies as possible, to obtain a 100 percent American car on paper with less than 50 percent local content in reality.[187] Most likely, the original drafters of the NAFTA rules could not imagine, or perhaps underestimated, the practices of multinational corporations and the possibilities offered by the globalization of production that have finally overtaken the traditional concept of origin and the classic method of origin determination. A number of the technical problems in origin determination connected with the Honda case were only a few years ago regarded as existing solely in the imagination of some customs officials. The realities of technological progress and economic interdependence made them real, however. As one executive said, "we have arrived in the era not only of multinational enterprises but of multinational goods." It goes without saying that the roll-up and roll-down rules did not acquire a new lease of life in the NAFTA rules. The domestic content requirement for cars was fixed, after lengthy negotiations, at 62.5 percent, to be implemented progressively.

Example: Value of Intermediate Materials[188]

A producer located in a NAFTA country produces Good B, which is subject to a regional value-content requirement under section 4(2)(b). The producer also produces Material A, which is used in the production of Good B. Both originating materials and non-originating materials are used in the production of Material A. Material A is subject to a change in tariff classification requirement under section 4(2)(a). The costs to produce Material A are the following:

[187] See "Honda: Is it an American car?," *Business Week*, November 18, 1991, 39.

[188] See NAFTA Uniform Regulations, at https://laws-lois.justice.gc.ca/eng/regulations/sor-94-14/fulltext.html.

Product costs:	
Value of originating materials	$1.00
Value of non-originating materials	$7.50
Other product costs	$1.50
Period costs: (including $0.30 in royalties)	$0.50
Other costs	$0.10
Total cost of Material A:	$10.60

The producer designates Material A as an intermediate material and determines that, because all of the non-originating materials that are used in the production of Material A undergo an applicable change in tariff classification set out in Schedule I, Material A would, under paragraph 4(2)(a), qualify as an originating material. The cost of the non-originating materials used in the production of Material A is therefore not included in the value of non-originating materials that are used in the production of Good B for the purpose of determining the regional value content of Good B. Because Material A has been designated as an intermediate material, the total cost of Material A, which is $10.60, is treated as the cost of originating materials for the purpose of calculating the regional value content of Good B. The total cost of Good B is determined in accordance with the following figures:

Product costs:	
Value of originating materials	
–intermediate materials	$10.00
–other materials	$3.00
Value of non-originating materials	$5.50
Other product costs	$6.50
Period costs	$2.50
Other costs	$0.10
Total cost of Good B	$28.20

Example: Originating Materials Acquired from a Producer Who Produced Them Using Intermediate Materials

Producer A, located in NAFTA country A, produces switches. In order for the switches to qualify as originating goods, Producer A designates subassemblies of the switches as intermediate materials. The subassemblies are subject to a regional value-content requirement. They satisfy that requirement, and qualify as originating materials. The switches are also subject to a regional value-content requirement, and, with the subassemblies designated as intermediate materials, are determined to have a regional value content of 65 percent.

Producer A sells the switches to Producer B, located in NAFTA country B, who uses them to produce switch assemblies that are used in the production of Good B. The switch assemblies are subject to a regional value-content requirement. Producers A and B are not accumulating their production within the meaning of section 14.

Producer B is therefore able, under section 7(4), to designate the switch assemblies as intermediate materials.

If Producers A and B were accumulating their production within the meaning of section 14, Producer B would be unable to designate the switch assemblies as intermediate materials, because the production of both producers would be considered to be the production of one producer.

3.4.4.8 USMCA and NAFTA Rules of Origin for Textile and Clothing

NAFTA rules of origin on textiles and clothing have been a notorious example of restrictive rules of origin driven by protectionist interests. As in the case of the automotive industry, the USMCA PSRO in this sector have caused considerable debate in the US textiles and clothing industry[189] as they provide for the introduction of some additional limitations in addition to the NAFTA restrictive rules of origin in this sector. In fact, "USMCA's rule-of-origin chapter notes for 61 and 62 go beyond NAFTA's provisions by requiring that sewing thread, pocketing fabric, narrow elastic bands, and coated fabric, when incorporated in apparel and other finished products, be made in the USMCA region for those finished products to qualify for trade benefits."[190]

Table 3.49[191] summarizes the new limitations in the textile and clothing sectors.

As discussed earlier, goods produced by the textile and textile products industries go through many processing steps. However, the USMCA rules as NAFTA rules are based on specific rules of origin reflecting four types of processing:

- production of fiber
- extrusion or spinning of yarn
- fabric formation through weaving, knitting, or other methods and
- cutting (or knitting to shape) and sewing or otherwise assembling apparel or made-up textile articles.

Generally, the non-originating inputs have to comply with two of the four processing steps to qualify as originating. This basic concept is rather similar to the Pan-European Rules of Origin but more stringent. In the case of apparel, non-originating materials have to comply with three of the processing steps. There are also specific instances where the inputs only have to comply with one processing step.

[189] See inside US trade, statement of Julia Hughes, president of the US Fashion Industry Association on November 29, 2018.

[190] See Dr. Sheng Lu, "Apparel rules of origin in new NAFTA 2.0 – The devil is in the detail," at https://shenglufashion.files.wordpress.com/2018/10/usmca-rules-of-origin-for-textile-and-apparel1.pdf.

[191] Adapted from Sheng Lu, ibid.

TABLE 3.49 *New transitional USMCA limitation on use of non-originating textiles material*

Applicable HS chapters	Product required to be made by USMCA members	Transition period
61, 62	Narrow elastic bands: Fabrics of subheading 5806.20 or heading 60.02	Effective **18 months** from the date of entry into force of the agreement
61, 62	Sewing thread of heading 52.04, 54.01, or 55.08, or yarn of heading 54.02 used as sewing thread	Effective **12 months** from the date of entry into force of the agreement
61	Pocket or pockets, the pocket bag fabric	Effective **18 months** from the date of entry into force of the agreement
62	Pocket or pockets, the pocket bag fabric for apparel that made of blue denim fabric of subheadings 5209.42, 5211.42, 5212.24, and 5514.30	Effective **30 months** from the date of entry into force of the agreement
62	Pocket or pockets, the pocket bag fabric for apparel that made of fabrics OTHER THAN blue denim fabric of subheadings 5209.42, 5211.42, 5212.24, and 5514.30	Effective **18 months** from the date of entry into force of the agreement

Fiber forward, yarn forward, fabric forward, and cut and sewn are concepts which are widely used under NAFTA and USMCA as well and they apply to various textile sectors with many exceptions.

According to the USMCA implementing instructions, the following are the basic concepts underlying the USMCA rules of origin in the textile and apparel sector:

> In general, the USMCA textile and apparel rules of origin are based on the yarn-forward concept. The yarn-forward concept requires that the formation of yarn, weaving or knitting of fabric, and cutting and sewing of a garment or other made-up article must occur in one or more of the USMCA countries to the Agreement.
>
> There are, however, exceptions to these requirements, depending on the product being imported. For more specific information, refer to GN 11 and Annex I of the Modification to the HTS to implement USMCA. Below is a general summary of the types of processes required to occur within the USMCA countries for a textile or apparel product to be considered eligible for preferential tariff treatment under USMCA.
>
> a) Yarn – generally follows the fiber-forward rule of origin, which means that the fiber must originate in the United States, Mexico or Canada and the yarn must be spun or extruded and finished in one or more of the USMCA countries to qualify for preferential tariff treatment.
> b) Woven Fabric – generally follows the yarn-forward rule of origin, which means that the yarn must be spun or extruded and finished and the fabric

woven in one or more of the USMCA countries to qualify for preferential tariff treatment. The fibers may be of any origin.

c) Knit Fabric – follows the fiber-forward rule of origin, which means that the fiber must originate in the United States, Mexico or Canada, the yarn must be spun or extruded and finished, and the fabric knit in one or more of the USMCA countries to qualify for preferential tariff treatment.

d) Apparel and made-up articles – generally follow the yarn-forward rule. The yarn must be spun or extruded and finished, the fabric woven or knit, or the components knit-to-shape, and the apparel or made-up article sewn and/or assembled in one or more of the USMCA countries to qualify for preferential tariff treatment.[192]

These concepts may be used in describing the production process as follows:

Yarn Forward – Basic Concept – Triple Transformation

(1) Production of yarn non-originating bales of cotton (52.01) produces cotton yarn (52.05)
(2) Production of fabric cotton yarn (52.05) produces knitted fabric (60.02)
(3) Production of apparel or other textile articles knitted fabric (60.02) produces men's shirt (6105.10) = originating shirt

Examples: [193] *cotton yarns to woven cotton fabrics; man-made filament yarns to pantyhose; wool yarns to woven wool fabrics to wool apparel.*

Specific rule for 6105.10 allows for transformation using input classified as 52.01:

A change to heading 61.05 through 61.06 from any other chapter, except from headings Nos. 51.06 through 51.13, 52.04 through 52.12 provided that the good is both cut (or knit to shape) and sewn or otherwise assembled in the territory of one or more of the NAFTA parties.

Fiber Forward – More Restrictive – Quadruple Transformation

(1) Production of fiber non-originating polymer chips (39.07) produces polyester staple fibers (55.03).
(2) Production of yarn polyester staple fibers (55.03) produces yarn of synthetic staple fibers (55.09).
(3) Production of fabric synthetic staple fibers (55.09) produces knitted or crocheted fabric (60.02).
(4) Production of apparel or other textile article knitted or crocheted fabric (60.02) produces table linens (6302.40) = originating table linen.

Examples: man-made staple fiber or cotton fiber to man-made staple fiber or cotton (spun) yarn; man-made filaments to nonwovens; man-made staple fiber or cotton fibers to man-made staple fiber or cotton (spun) yarns to man-made or cotton knitted fabrics.

[192] See USMCA Implementing Instructions, CBP Publication Number 1118-0620, June 30, 2020.
[193] These examples are drawn from NAFTA materials.

Specific rule for 6302.40 allows for the transformation using input classified as 39.07.

A change to heading 63.02 from any other chapter, except from headings Nos. 51.06 through 51.13, 52.04 through 52.12, 53.07 through 53.08 or 53.10 through 53.11, Chapters 54 through 55, or heading Nos. 58.01 through 58.02 or 60.01 through 60.02 provided that the good is both cut (or knit to shape) and sewn or otherwise assembled in the territory of one or more of the NAFTA parties.

Fabric Forward – Less Restrictive – Double Transformation

(1) Processing of fabric non-originating silk yarn (50.04) produces woven silk fabric (50.07).
(2) Production of apparel or made-up article woven silk fabric (50.07) produces women's blouse (6206.10) = originating garment.

Examples: woven man-made filament fabrics to coated fabrics of 5903; woven silk fabrics.
Specific rule for 6206.10 allows for transformation using input classified as 50.04.

A change to heading 62.06 through 62.10 from any other chapter, except from headings Nos. 51.06 through 51.13 . . . provided that the good is both cut and sewn or otherwise assembled in the territory of one or more of the NAFTA countries.

Cut and Sewn – Less Restrictive – Single Transformation

(1) Production of made up textile or apparel article non-originating woven silk fabric (50.07) produces men's shirt (6205.90) = originating shirt.

Examples: bras; garments made of woven silk fabric; garments made of woven linen fabrics (53.09).
Specific rule for 6205.90 allows for the transformation using input classified as 50.07.

A change to heading 6205.90 from any other chapter, except from heading Nos. 51.06 through 51.13, 52.04 through 52.12 provided that the good is both cut and sewn or otherwise assembled in the territory of one or more of the NAFTA parties.

As illustrated in the USMCA implementing instructions, there are a number of exceptions to the usual yarn-forward rules of origin and also transitional measures. The exceptions include certain apparel goods produced using a cut-and-sew (single transformation) rule, modifications to specific rules of origin for commercial availability determinations, tariff preference levels (TPLs), and the United States/Mexico Assembly provision.

A brief comparison[194] of the NAFTA–USMCA textile and garments PSRO is reproduced below.

[194] This comparison is drawn from Just-Style, October 12, 2018, www.just-style.com/analysis/new-nafta-20-the-devil-is-in-the-detail_id134687.aspx.

Specifically, if an apparel item is made of the following yarns and fabrics, these yarns and fabrics need to be sourced from the USMCA region so that the apparel item can be eligible for the import duty-free treatment under USMCA.

HS code	Product description
51.06 through 51.13	Wool yarns and fabrics
52.04 through 52.12	Cotton yarns and fabrics
53.10 through 53.11	Woven fabrics of jute and other vegetable textile fibers
Chapter 54	Man-made filament yarns and fabrics
55.08 through 55.16	Man-made filament, staple, fiber yarns, and fabrics
60.01 through 60.06	Knitted or crocheted fabrics

Notably, compared with NAFTA:

- USMCA *no longer requires* some jute or vegetarian yarns to be sourced from the United States, Mexico, or Canada, including products under HS code 53.07–53.08.
- USMCA *newly requires* some additional knitted or crocheted fabrics to be sourced from the United States, Mexico or Canada, including products under HS 60.03–60.06.

There are also special rules that have been widely used, especially in the post-NAFTA free-trade agreements, to introduce elements of leniency but also of stringency in the textile and clothing sector:

SPECIAL RULES FOR CHAPTER 61, 62, AND 63 PRODUCTS

Component that Determines Tariff Classification

For purposes of goods of these Chapters, the rule applicable to that good shall only apply to the component that determines the tariff classification of the goods and such component must satisfy the tariff change requirements set out in the rule for that good.

Visible Linings

Under USMCA, fabric used for visible linings in certain apparel, such as suits, coats and skirts (apparel classified in Chapters 61 and 62 (knit and woven apparel)) may be sourced from outside of the United States, Mexico and Canada.

Narrow Elastic Fabric

Upon entry into force of the Agreement, narrow elastic fabric of subheading 5806.20 or heading 6002 (used in apparel products of Chapter 61 and 62) may be sourced from anywhere. However, effective 18 months after the date of entry into force of the Agreement, apparel containing narrow elastic fabrics of subheading 5806.20 or heading 6002 will be considered originating only if such fabrics are both formed

from yarn and finished in the territory of one or more of the USMCA countries. The apparel article must also satisfy the tariff shift requirement(s) that apply to the good.

A fabric of subheading 5806.20 or heading 6002 is considered formed from yarn and finished in the territory of one or more USMCA countries if all production processes and finishing operations, starting with the weaving, knitting, needling, tufting, or other process, and ending with the fabric ready for cutting or assembly without further processing, took place in the territories of one or more of the USMCA countries, even if non-originating yarn is used in the production of the fabric of subheading 5806.20 or heading 6002.

Sewing Thread

Upon entry into force of the Agreement, sewing thread of headings 5204, 5401 or 5508, or yarn of heading 5402 used as sewing thread, used in apparel products of Chapter 61 and 62, may be sourced from anywhere. However, effective 12 months after the date of entry into force of the Agreement, apparel containing sewing thread of headings 5204, 5401 or 5508, or yarn of heading 5402 used as sewing thread shall be considered originating only if such sewing thread is both formed and finished in the territory of one or more of the USMCA countries. The apparel article must also satisfy the tariff shift requirements(s) that apply to the good.

Sewing thread is considered formed and finished in the territory of one or more USMCA countries if all production processes and finishing operations, starting with the extrusion of filaments, strips, film or sheet, and including slitting a film or sheet into strip, or the spinning of all fibers into yarn, or both, and ending with the finished single or plied thread ready for use for sewing without further processing, took place in the territories of one or more of the USMCA countries even if non-originating fiber is used in the production of sewing thread of headings 5204, 5401 or 5508, or yarn of heading 5402 used as sewing thread.

Pocket Bag Fabric

Upon entry into force of the Agreement, the pocket bag fabric used in apparel products of Chapter 61 and 62 may be sourced from anywhere. However, effective 18 months after the date of entry into force of the Agreement, for apparel containing a pocket or pockets, the pocket bag fabric must be both formed and finished in one or more of the USMCA countries from yarn that was wholly formed in one or more of the USMCA countries. The component must also satisfy the tariff shift requirement(s) that apply to the good.

For apparel of Chapter 62 made of blue denim fabric of subheadings 5209.42, 5211.42, 5212.24, and 5514.30, the pocket bag fabric rule is effective 30 months from the date of entry into force of the Agreement.

Pocket bag fabric is considered formed and finished in the territory of one or more of the USMCA countries if all production processes and finishing operations, starting with the weaving, knitting, needling, tufting, felting, entangling, or other process, and ending with the fabric ready for cutting or assembly without further processing, took place in the territories of one or more of the USMCA countries, even if non-originating fiber is used in the production of the yarn used to produce the pocket bag fabric.

Yarn is considered wholly formed in the territory of one or more USMCA countries if all the production processes and finishing operations, starting with the extrusion of filaments, strips, film, or sheet, and including slitting a film or sheet into strip, or the spinning of all fibers into yarn, or both, and ending with a finished single or plied yarn, took place in the territory of one or more of the USMCA countries, even if non-originating fiber is used in the production of the yarn used to produce the pocket bag fabric.

Pocket bag fabric is considered a pocket or pockets if the pockets in which fabric is shaped to form a bag is not visible as the pocket is in the interior of the garment (i.e. pockets consisting of "bags" in the interior of the garment). Visible pockets such as patch pockets, cargo pockets, or typical shirt pockets are not subject to the chapter rule.

Coated Fabrics

Upon entry into force of the Agreement, coated or laminated fabrics used in the assembly of a textile article of Chapter 63 may be sourced from anywhere. However, effective 18 months after the date of entry into force of the agreement, a good of Chapter 63 made of fabric classified in 5903, is considered to be originating only if all the fabrics used in the production of the fabrics of heading 5903 are formed and finished in Canada, Mexico or the United States. Fabrics of heading 5903 are coated, laminated or impregnated with plastics.

However, this does not apply to the following goods:

- 6305 – Bags
- 6306.12 – Tarpaulins, awnings, and sun blinds of synthetic fibers,
- 6306.22 – Tents of synthetic fibers, and
- Miscellaneous made-up articles of subheading 6307.90 that are not surgical drapes or national flags.

A fabric of heading 5903 is considered formed and finished in the territory of one or more USMCA countries if all production processes and finishing operations, starting with the weaving, knitting, needling, tufting, felting, entangling, or other process, including coating, covering, laminating, or impregnating, and ending with the fabric ready for cutting or assembly without further processing, took place in the territories of one or more of the USMCA countries, even if non-originating fiber or yarn is used in the production of the fabric of heading 5903.

Rayon Fiber and Rayon Filament

Rayon filament, other than lyocell or acetate, of headings 5403 or 5405, and rayon fibers, other than lyocell or acetate, of headings 5502, 5504, or 5507, may be of any origin when used in a good classified in Chapter 50 through 63 or heading 9619, provided that the good otherwise meets the applicable product specific rule.

3.4.4.9 Automotive Products in NAFTA and USMCA

NAFTA rules of origin on automotive products were the most regulated and detailed rules of origin existing in this sector, probably only to be overtaken by the new USMCA rules of origin for the automotive sector. The US automotive industry[195] produced an interesting publication detailing the impact of the new USMCA rules of origin in the automotive sector. The publication outlines a series of negative implications. In this section certain aspects of the rules are discussed as they may be used further as examples in other chapters.

NAFTA rules on automotive products introduced the concept of tracing. In a word, tracing is exactly the opposite of the rule on intermediate materials. Tracing allows counting value content by tracking the value of major automotive components and subassemblies imported into the NAFTA region. The non-originating value of these components and subassemblies is then reflected in the RVC calculation of the motor vehicle or in auto parts destined for original equipment use. For those components subject to tracing, any non-originating (non-NAFTA) value will remain non-originating through all stages of assembly to the time of calculation of the RVC of the motor vehicle (or auto part destined for original equipment use). The value of traceable automotive components is determined at the time the non-originating components are received by the first person in Canada, Mexico, or the United States who takes title to them, after importation from outside the NAFTA region. The value of the components will be determined in accordance with standard valuation norms and will generally be the transaction value. Certain costs must be added to the transaction value if not included in it (e.g. packing, selling commissions).

One can only imagine the complexities of the calculation of the net cost for car manufacturers in North America that are producing millions of cars, models using thousands of parts. Another important concept that NAFTA rules have elaborated are the sophisticated rules on averaging methodologies.

Producers of automotive goods may elect to average their costs when calculating the RVC. A motor vehicle producer may average the calculation over its fiscal year either by all motor vehicles or only those motor vehicles in a category that are exported to another NAFTA party. The four categories are:

- the same model line of motor vehicles in the same class of vehicles produced in the same plant
- the same class of motor vehicles produced in the same plant
- the same model line of motor vehicles produced
- special averaging rules for CAMI Automotive, Inc.

[195] K. Dziczek, M. Schultz, Y. Chen, and B. Swiecki, *NAFTA Briefing: Review of Current NAFTA Proposals and Potential Impacts on the North American Automotive Industry*, Center for Automotive Research, 2018.

Producers of components that must be traced may also average their costs. A producer may average its calculation:

- over the fiscal year of the motor vehicle producer to whom the good is sold
- over any quarter or month, or
- over its fiscal year, if the good is sold as an aftermarket part.

Producers may elect to calculate the average separately for any or all goods sold to one or more motor vehicle producers or calculate separately those goods that are exported to Canada, Mexico, and/or the United States.

USMCA Article 4-B.5 provides for similar averaging techniques albeit with some differences:

> 1. Each Party shall provide that, for the purposes of calculating the regional value content of a passenger vehicle, light truck, or heavy truck, the calculation may be averaged over the producer's fiscal year, using any one of the following categories, on the basis of either all motor vehicles in the category or only those motor vehicles in the category that are exported to the territory of one or more of the other Parties:
>   (a) the same model line of motor vehicles in the same class of vehicles produced in the same plant in the territory of a Party;
>   (b) the same class of motor vehicles produced in the same plant in the territory of a Party;
>   (c) the same model line of motor vehicles produced in the territory of a Party; or
>   (d) any other category as the Parties may decide.

Other Provisions: The provisions on accumulation, fungible goods, and intermediate materials may be used to integrate and rationalize production processes throughout Canada, Mexico, and the United States. Components that are subject to tracing for autos and light vehicles may be designated as intermediate materials. Producers may not, however, designate as an intermediate material any traceable component for motor vehicles other than autos and light vehicles.

USMCA rules of origin on automotive (passenger vehicles and light trucks) introduced a number of additional requirements that are summarized[196] in the subsections below.

[196] See Heather Innes, "The USMCA rules of origin: Changes auto manufacturers and auto parts makers should know," at www.mondaq.com/canada/x/744948/international+trade+investment/The+USMCA+Rules+Of+Origin+Changes+Auto+Manufacturers+And+Auto+Parts+Makers+Should+Know.

3.4.4.9.1 PROGRESSING RAISING OF THE OVERALL RVC. Under USMCA, the RVC is progressively increasing: starting from 2020 the RVC raises from 62.5 to 66 percent, progressively rising to 75 percent in 2023. In addition, the "tracing back" is substantially strengthened as USMCA directly provides that a number of parts must be "originating": such parts are listed under specific USMCA annexes and tables as follows:

- **Tables A.1 and A2:** These cover core parts of passenger vehicles and light trucks (engines, chassis, bodies and gear boxes, steering wheels).[197]
- For these parts (engines, engine parts, vehicle bodies, gear boxes, drive axles, shock absorbers, lithium batteries, and steering wheels) USMCA content requirement for passenger vehicles will progressively rise from 66% under the net cost method or 76% under the transaction value method in 2020 to 75% under the net cost method or 85% under the transaction value method by 2023.
- **Table B**: This covers principal parts of passenger vehicles and light trucks.
- For these parts (tires, rear-view mirrors, hydraulic fluid pumps, compressors, air conditions, electronic brake systems, clutches and shaft couplings, and airbags) the USMCA RVC will rise from 62.5% under the net cost method or 72.5% under the transaction value method by 2020 to reach 70% under the net cost method or 80% under the transaction value method.
- **Table C:** This covers complementary parts of passenger vehicles and light trucks.
- For these parts (pipes, locks, catalytic converters, valves, electric motors, batteries, distributors, windshield wipers, defrosters, and demisters) the USMCA regional value content will rise from 62% under the net cost method or 72% under the transaction value method, beginning on January 1, 2020, to 65% under the net cost method or 75% under the transaction value method by 2023.

In addition, other tables (D and E) cover specific parts of heavy trucks that are raising progressively the RVC in a similar fashion.

The progressive raising of the RVC requirement to 75 percent is contained in Article 4-B.3 below:

[197] Table A.1 is accompanied by Table A.2 specifying the components of such parts and paras. 7–9 of Article 4 B 3 and covers parts and components of core parts and additional components such as advanced batteries and shock absorbers.

ARTICLE 4-B.3: REGIONAL VALUE CONTENT FOR PASSENGER VEHICLES, LIGHT TRUCKS, AND PARTS THEREOF

1. Notwithstanding Article 4-B.2, each Party shall provide that the regional value-content requirement for a passenger vehicle or a light truck is:

(a) 66 percent under the net cost method, beginning on January 1, 2020, or the date of entry into force of the Agreement, whichever is later;
(b) 69 percent under the net cost method, beginning on January 1, 2021, or one year after the date of entry into force of the Agreement, whichever is later;
(c) 72 percent under the net cost method, beginning on January 1, 2022, or two years after the date of entry into force of the Agreement, whichever is later; and
(d) 75 percent under the net cost method, beginning on January 1, 2023, or three years after the date of entry into force of the Agreement, whichever is later, and thereafter.

This progressive increase of RVC concerning automotive parts, as provided for in Article 4-b2, is reproduced below. An interesting feature is that the USMCA article on automotive parts provides the alternative, in addition to the net cost method, of the transaction method albeit with a higher level of percentage.

Notwithstanding Article 4-B.2 and the Product-Specific Rules of Origin in Annex 4-B, each Party shall provide that the regional value-content requirement for a part listed in Table A.1 of this Appendix that is for use in a passenger vehicle or light truck is:

(a) 66 percent under the net cost method or 76 percent under the transaction value method, if the corresponding rule includes a transaction value method, beginning on January 1 2020, or the date of entry into force of the Agreement, whichever is later;
(b) 69 percent under the net cost method or 79 percent under the transaction value method, if the corresponding rule includes a transaction value method, beginning on January 1 2021, or one year after the date of entry into force of the Agreement, whichever is later;
(c) 72 percent under the net cost method or 82 percent under the transaction value method, if the corresponding rule includes a transaction value method, beginning on January 1 2022, or two years after the date of entry into force of the Agreement, whichever is later; or
(d) 75 percent under the net cost method or 85 percent under the transaction value method, if the corresponding rule includes a transaction value method, beginning on January 1 2023, or three years after the date of entry into force of the Agreement, whichever is later, and thereafter.

3.4.4.9.2 THE 70 PERCENT NORTH AMERICAN STEEL AND ALUMINUM CONTENT REQUIREMENTS. In addition to abovementioned rise of the RVC, USMCA introduces new requirements relating to the steel and aluminum purchases made by the vehicle producer. A passenger vehicle, light truck, or heavy truck will qualify as "originating" only if at least 70 percent of the vehicle producer purchases of steel and aluminum is "originating" as outlined below:

ARTICLE 4-B.6: STEEL AND ALUMINUM

1. In addition to the Product-Specific Rules of Origin in Annex 4-B or other requirements in this Appendix, each Party shall provide that a passenger vehicle, light truck, or heavy truck is originating only if, during the previous year, at least 70 percent of:

(a) the vehicle producer's purchases of steel in North America; and
(b) the vehicle producer's purchases of aluminum in North America, are originating.

2. Each Party shall provide that when a vehicle producer certifies that its purchases of steel and aluminum meet the requirement under paragraph 1 of this Article on an annual basis and that relevant records are kept as part of the Record Keeping Requirements under Article 5.9, a certification during one year applies to vehicles produced or exported in the following year; that is, the requirement in paragraph 1 will be considered to be met for all vehicles produced by that producer in the territory of a Party or exported by that producer from the territory of a Party in the following year.

3. The Parties shall endeavor to develop any additional description or other modification of steel and aluminum subject to paragraph 1, if needed, to facilitate implementation of this requirement. Upon request of one of the Parties, the Parties shall discuss and agree on any appropriate modifications to the description of steel and aluminum.

4. The Parties shall include any certification or verification provisions for this requirement in Uniform Regulations provided for in Article 5.17.

3.4.4.9.3 LABOR VALUE CONTENT REQUIREMENTS. On top of the requirements above, USMCA provides that the vehicle manufacturer certifies that 40–45 percent (depending on the type of vehicle) of its production activities such as costs of manufacturing, assembly, R&D, and information technology, are carried out by workers who earn at least 16 USD/hour as detailed below:

ARTICLE 4-B.7: LABOR VALUE CONTENT

1. In addition to the Product-Specific Rules of Origin in Annex 4-B or other requirements in this Appendix, each Party shall provide that a passenger vehicle is originating only if the vehicle producer certifies, on an annual basis, that its production meets a Labor Value Content (LVC) of:

(a) 30 percent, consisting of at least 15 percentage points of high-wage material and manufacturing expenditures, no more than 10 percentage points of high-wage technology expenditures, and no more than 5 percentage points of high-wage assembly expenditures, beginning on January 1 2020, or the date of entry into force of the Agreement, whichever is later;
(b) 33 percent, consisting of at least 18 percentage points of high wage material and manufacturing expenditures, no more than 10 percentage points of technology expenditures, and no more than 5 percentage points of assembly expenditures, beginning on January 1, 2021, or one year after the date of entry into force of the Agreement, whichever is later;
(c) 36 percent, consisting of at least 21 percentage points of high wage material and manufacturing expenditures, no more than 10 percentage points of technology expenditures, and no more than 5 percentage points of assembly expenditures, beginning on January 1, 2022, or two years after the date of entry into force of the Agreement, whichever is later;
(d) 40 percent, consisting of at least 25 percentage points of high wage material and manufacturing expenditures, no more than 10 percentage points of technology expenditures, and no more than 5 percentage points of assembly expenditures, beginning on January 1, 2023, or three years after the date of entry into force of the Agreement, whichever is later, and thereafter.

Paragraph 3 of USMCA Article 4-B.7: Labor Value Content provides detailed guidelines for calculating the labor value content containing the contested benchmark of 16 USD/hour:

3. Each Party shall provide that high-wage material or manufacturing expenditures, high-wage technology expenditures, and high-wage assembly expenditures described under paragraphs 1 and 2 are calculated as follows:

(a) For high wage material and manufacturing expenditures, the Annual Purchase Value (APV) of purchased parts or materials produced in a plant or facility, and any labor costs in the vehicle assembly plant or facility, that is located in North America with a production wage rate that is at least US$16/hour as a percentage of the net cost of the vehicle, or the total vehicle plant assembly APV, including any labor costs in the vehicle assembly plant or facility;

(b) For high wage technology expenditures, the annual vehicle producer expenditures in North America on wages for research and development (R&D) or information technology (IT) as a percentage of total annual vehicle producer expenditures on production wages in North America; and
(c) For high wage assembly expenditures, a credit of no more than 5 percentage points if the vehicle producer demonstrates that it has an engine assembly, transmission assembly, or an advanced battery assembly plant, or has long term contracts with such a plant, located in North America with an average production wage of at least US$16 per hour.

USMCA adopted tracing methods that can be shown using examples drawn from the NAFTA Uniform regulations:

Example: An electric motor provided for in subheading 8501.10 is imported from outside the territories of the NAFTA countries and is used in the territory of a NAFTA country in the production of a seat frame provided for in subheading 9401.90. The seat frame, with the electric motor attached, is sold to a producer of seats provided for in subheading 9401.20. The seat producer sells the seat to a producer of light-duty vehicles. The seat is to be used as original equipment in the production of that light-duty vehicle. The electric motor is a traced material; the seat is not a traced material because it was not imported from outside the territories of the NAFTA countries. For purposes of calculating the regional value content of the seat, the value of traced materials incorporated into it is included in the value of non-originating materials used in the production of the seat. The value of the electric motor is included in that value. (However, the value of the motor would not be included separately in the net cost of the seat because the value of the motor is included as part of the cost of the seat frame.) For purposes of calculating, under section 9.1, the regional value content of the light-duty vehicle, the value of the electric motor is included in the value of non-originating materials used in the production of the light-duty vehicle, even if the seat is an originating material.

The USMCA Uniform Regulations do not provide as NAFTA for a series of examples in the automotive sector. In any case, the following examples drawn from NAFTA may be contrasted with the examples made under the absorption rules described under the Pan-European Rules of Origin for the manufacturing of an engine. There is a stark difference in terms of restrictiveness of the rules because the European rules of origin are much more liberal and simple than the NAFTA rules on the automotive sector.

For instance, under the European rules of origin the whole value of the engine in Example 1 below would be calculated as originating under the absorption rules without deducting the value of the cast block, cast heads, and connecting rod

assemblies. The same holds true for Example 2 where the pistons would not have been calculated as non-originating material:

Example 1

Cast blocks, cast heads and connecting rod assemblies provided for in heading 8409 are imported from outside the territories of the NAFTA countries by an engine producer, who has title to them at the time of importation, and are used by the producer in the territory of NAFTA country A in the production of an engine provided for in heading 8407. After the regional value content of the engine is calculated, the engine is an originating good. It is not a traced material because it was not imported from outside the territories of the NAFTA countries. The engine is exported to NAFTA country B, to be used as original equipment by a producer of light-duty vehicles.

For purposes of calculating, the regional value content of the light-duty vehicle that incorporates the engine, because heading 8409 is listed in Schedule IV and because the cast blocks, cast heads and connecting rod assemblies were imported into the territory of a NAFTA country and are incorporated into the light-duty vehicle, the value of those materials, which are traced materials, is included in the value of non-originating materials used in the production of the light-duty vehicle, even though the engine is an originating material. The producer of the light-duty vehicle did not import the traced materials. However, because that producer has a statement stating the value of non-originating materials of the traced materials, the producer of the light-duty vehicle may, in accordance with section 9(8), use that value as the value of non-originating materials of the light-duty vehicle with respect to that engine.

Example 2

Aluminum ingots provided for in subheading 7601.10 and piston assemblies provided for in heading 8409 are imported from outside the territories of the NAFTA countries by an engine producer and are used by that producer in the territory of NAFTA country A in the production of an engine provided for in heading 8407. The aluminum ingots are used by the producer to produce an engine block; the piston assembly is then incorporated into the engine block and the producer designates a short block provided for in heading 8409 as an intermediate material. The intermediate material qualifies as an originating material. The engine that incorporates the short block is exported to NAFTA country B and used as original equipment in the production of a light-duty vehicle. The piston assemblies provided for in heading 8409 are traced materials; neither the engine nor the short block are traced materials because they were not imported from outside the territories of the NAFTA countries. For purposes of calculating, the regional value content of the engine, the value of the piston assemblies is included in the value of non-originating materials, even if the intermediate material is an originating material. However, the value of the aluminum ingots is not included in the value of non-originating materials because subheading 7601.10 is not listed in Schedule IV. The value of the aluminum ingots does not need to be included separately in the net cost of the engine because that value is

included in the value of the intermediate material, and the total cost of the intermediate material is included in the net cost of the engine. For purposes of calculating the regional value content of the light-duty vehicle that incorporates the engine (and the piston assemblies), the value of the piston assemblies incorporated into that light-duty vehicle is included in the value of non-originating materials of the light-duty vehicle.

3.4.4.10 The Evolution of the NAFTA Model of Rules of Origin: From NAFTA to CAFTA through US–Chile and US–Singapore and Other FTA Agreements

NAFTA certainly meant a watershed in the US rules of origin and the NAFTA model has often been branded as one of the most complicated and stringent sets of rules of origin. However, this does not mean that there has been no evolution in the NAFTA model. The NAFTA rules of origin themselves have undergone extensive revising at the initiative of the contracting parties. In subsequent RTAs, which the United States has entered with other partners like Australia, Singapore, Chile, and most recently, CAFTA, there is a marked evolution in some of the elements of the rules of origin.

In addition, and as shown in Chapter 6 when discussing the drafting of PSRO, there has been a marked tendency toward simplification and leniency of the PSRO in some sectors.[198] Such tendency is also reflected in USMCA, further discussed in section 3.4.4.11.

As shown in Table 3.50, because of NAFTA there has been a strong tendency to move away from using the net cost method in calculating the RVC.

TABLE 3.50 *Evolution of the NAFTA RVC percentage-calculation-based rules of origin*[i]

RVC	NAFTA	CHL–USA	CAFTA	USA–SIN	USA–AUS	USA–KOR	TPP	USMCA
No. of PSRO	1,125	1,043	1,017	2,974	965	758	1,245	1,015
Net cost	323	0	6	0	0	6	22	324
Transaction	248	0	0	0	0	0	0	424
Build-up	0	164	146	239	148	147	398	0
Build-down	0	157	147	213	144	152	457	0

[i] This table has been elaborated and updated by the author on the basis of a former elaboration made by Inter-American Development Bank.
Source: Author's calculations.

[198] See Chapter 6 of this book.

The use of the net cost method has been significantly reduced from 323 in NAFTA to 6 in CAFTA and the US–Korean FTA and it has been eliminated in the US–Chile and US–Singapore agreements.

In particular the rules of origin contained in the agreements after NAFTA made good use of the lessons learned from the difficulties of calculation of the net cost. In all other agreements following NAFTA the build-down and build-up method as contained in Table 3.50 and as described in the following example have replaced the old calculation methodology. The build-up and build-down calculation methodology uses the value of materials in both calculations. Using such numerator based uniquely on costs of materials limits considerably the inherent difficulties of making the allocation of costs to the single unit of production and complex averaging calculations. The following is an excerpt from the US–Chile FTA agreement which is an example of the new formulation of the RVC:

Example

(i) *Where a rule set forth in subdivision (n) of this note specifies a regional value content for a good, the regional value content of such good shall be calculated, at the choice of the person claiming the tariff treatment authorized by this note for such good, on the basis of the build-down method or the build-up method described in the following section, unless otherwise specified in this note:*

(A) *For the build-down method, the regional value content may be calculated on the basis of the formula RVC = ((AV – VNM)/AV) x 100, where RVC is the regional value content, expressed as a percentage; AV is the adjusted value; and VNM is the value of nonoriginating materials used by the producer in the production of the good; or*

(B) *For the build-up method, the regional value content may be calculated on the basis of the formula RVC = (VOM /AV) x 100, where RVC is the regional value content, expressed as a percentage; AV is the adjusted value; and VOM is the value of originating materials used by the producer in the production of the good.*

Another excerpt shows what is intended as "adjusted value":

The term "adjusted value" means the value determined under articles 1 through 8, article 15 and the corresponding interpretive notes of the Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade (the Customs Valuation Agreement), except that such value may be adjusted to exclude any costs, charges or expenses incurred for transportation, insurance and related services incident to the international shipment of the merchandise from the country of exportation to the place of importation.

It is clear that the reliance on a multilateral instrument such as the agreement on customs valuation adds predictability to the application and administration of the methodology of calculating RVCs.

This way of calculating RVC is used to define many specific rules of origin in the CAFTA–Dominican Republic (CAFTA–DR) rather than the complex net cost method so often used in NAFTA, that is now only used for automotive industry products, on an optional basis. For instance, under CAFTA, for most goods, the Agreement provides for two methods for calculating RVC: (1) the build-up method, based on the value of originating materials; and (2) the build-down method, based on the value of non-originating materials. However, the RVC for certain automotive goods may be calculated using the net cost method. This is limited to the following automotive goods:

HTS	General description
8407.31 through 8407.34	Engines
8408.20	Diesel Engines for Vehicles
8409	Parts of Engines

Another additional feature in the recent free-trade agreements entered into by the United States is the issue of remanufactured products. For instance, under CAFTA–DR, remanufactured products are accorded the same tariff treatment as new products, but have some exclusive flexibility in terms of origin.

It has been found that the range of products that can be remanufactured is considerably larger than that agreed upon by the United States in its previous negotiations with Chile and Singapore. For the Central American countries,[199] accepting this larger range (870 subheadings, 2,000 percent more than in the agreements with Chile and Singapore) did not pose a difficulty for two fundamental reasons. First, remanufactured goods in Central America are largely subject to zero tariffs due to the absence of regional production. Second, Central American regulations allow used goods to be imported.

Some other innovations contained in the most recent agreement concerns the textiles and apparel products.

Under the US–Chile agreement these changes were limited because the basic elements were similar to NAFTA processes:

(a) Yarn – generally, fiber must originate in Chile or the United States in order to qualify for preferential tariff treatment.
(b) Fabric – generally, yarn must originate in Chile or the United States to qualify for preferential tariff treatment. Cotton and man-made knit fabric are under fiber-forward rules.

[199] See J. Granados and R. Corneyo, "Convergence in the Americas: Some lessons from the DR-CAFTA process," *World Economy* [2006], 857–891.

(c) Apparel – generally, yarn must originate in Chile or the United States in order to qualify for preferential tariff treatment.

The CAFTA–DR employs the value-of-materials methodology to determine whether a good qualifies for preferential tariff treatment that is found in previous agreements such as the US–Chile and US–Australia free trade agreements. Another notable similarity is that the responsibility for providing information to substantiate the claim is on the importer.

Generally, under the CAFTA–DR, a nontextile good is originating where:

(a) The good is wholly obtained or produced entirely in the territory of one or more of the parties (Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, Dominican Republic, or the United States).
(b) The good is produced entirely in the territory of one or more of the parties and
    (i) each of the non-originating materials used in the production of the good undergoes an applicable change in tariff classification as specified in the product specific list or
    (ii) the good otherwise satisfies any applicable RVC specified in GN29(n); and the good satisfies all other applicable requirements.
(c) The good is produced entirely in the territory of one or more of the parties exclusively from originating materials.

As in other free trade agreements, the CAFTA–DR contains a *de minimis* provision of 10 percent that applies to most goods, except some products. This provision is also inapplicable to textile articles, which have their own *de minimis* rule based on a weight percentage. Under the *de minimis* rule, a good that contains materials that do not undergo a required CTC (tariff shift), as specified in GN29(n), may still qualify as originating if the value of all non-originating materials used in the production of the good that do not undergo the required change in classification does not exceed 10 percent of the adjusted value of the good. The *de minimis* provision applies provided that the value of such non-originating materials will be included in the total value of non-originating materials for any applicable RVC requirement.

A textile or wearing apparel good that is not an originating good, because certain fibers or yarns used in the production of the component of the good that determines the tariff classification of the good do not undergo an applicable CTC, shall nonetheless be considered to be an originating good if the total weight of all such fibers or yarns in that component is not more than 10 percent of the total weight of that component.

The summary of the type of processes required for some of the more basic textile and apparel products in order for them to be considered eligible for CAFTA–DR contains some innovations.

(a) Yarn – generally, fiber must originate in a CAFTA–DR beneficiary country or the United States to qualify for preferential tariff treatment.

(b) Fabric – generally, yarn must originate in a CAFTA–DR beneficiary country or the United States to qualify for preferential tariff treatment. Cotton and man-made knit fabric are under fiber forward rules, meaning the fiber must originate in a CAFTA–DR beneficiary country or the United States to qualify for preferential treatment.
(c) Apparel – generally, yarn must originate in a CAFTA–DR beneficiary country or the United States to qualify for preferential tariff treatment.

In addition to this summary, a number of single transformation rules for luggage, cotton, and man-made fiber woven dresses other than corduroy, boxer shorts, brassieres, and boys' and girls' woven pajamas, and nightwear have been added.

Another important flexibility introduced in recent free trade agreements is the possibility to expand, upon request, the list of textile and garments in short supply. Inclusion on this list allows the use of these imported materials.

3.4.4.11 A Brief Comparison between Some PSRO in NAFTA and USMCA

Apart from the automotive and the textiles and garments sectors, where undoubtedly USMCA has added a number of supplementary requirements, USMCA appears to have introduced a series of simplifications and more lenient PSRO in a number of sectors as shown below. Certainly, these simplifications are not just the merit of USMCA as they are also the result of the evolution and simplification of the NAFTA model as outlined in the previous section.

In some cases, the simplifications covered a series of Chapter 28–38 chemical and allied industries where USMCA introduces a series of working or processing rules that are actually derived from the experience of the nonpreferential rules of origin. In fact, section VI of USMCA provides as follows:

> **Note 1:**
> A good of any chapter or heading in Section VI that satisfies one or more of Rules 1 through 8 of this Section shall be treated as an originating good, except as otherwise specified in those rules.

> **Note 2:**
> Notwithstanding Note 1, a good is an originating good if it meets the applicable change in tariff classification or satisfies the applicable value content requirement specified in the rules of origin in this Section.

The eight rules specified in Note 1 are (1) the Chemical Reaction Rule, (2) the Purification Rule, (3) the Mixtures and Blends Rule, (4) the Change in Particle Size Rule, (5) the Standards Materials Rule, (6) the Isomer Separation Rule, (7) the Separation Prohibition Rule, and (8) the Biotechnological Processes Rule. As stated

in Note 2, the goods classified in Chapters 28–38 retain the option to qualify as originating through a tariff change and/or RVC requirement as contained in USMCA.

Tables 3.51–3.53 provide a brief comparative analysis of the selected PSRO of NAFTA in the original version of 1992[200] compared with the NAFTA 2019 version of the same PSRO and contrasted with examples drawn from the original NAFTA Uniform Regulations.

Example from original NAFTA Uniform Regulations (see PSRO in Table 3.51):

> *Example: Under NAFTA a Producer A, uses originating materials and non-originating materials in the production of plastic bags provided for in subheading 3923.29. The rule set out in Schedule I for subheading 3923.29 specifies both a change in tariff classification from any other heading, except from subheadings 3920.20 or 3920.71, under which certain plastic materials are classified, and a regional value-content requirement. Therefore, with respect to that part of the rule that specifies a change in tariff classification, in order for the plastic bag to qualify as an originating good, any plastic materials that are classified under subheading 3920.20 or 3920.71 and that are used in the production of the plastic bag must be originating materials. In this case, all of the non-originating materials used in the production of the plastic bag satisfy the specified change in tariff classification, with the exception of a small amount of plastic materials classified under subheading 3920.71. The NAFTA product-specific rules of origin provides that the plastic bag can be considered an originating good if the value of the non-originating plastic materials that do not satisfy the specified change in tariff classification does not exceed seven percent of the transaction value of the plastic bag or the total cost of the plastic bag, whichever is applicable. In this case, the value of those non-originating materials that do not satisfy the specified change in tariff classification does not exceed the seven percent*

TABLE 3.51 *Comparison of selected PSRO between NAFTA and USMCA*

HS description	NAFTA	USMCA
NAFTA: 39.23.29 USMCA: 39.16–39.26	A change to subheading 3923.29 from any other heading, except from subheading 3920.20 or 3920.71. In addition, the regional value content percentage must be not less than: (a) 60% where the transaction value method is used, or (b) 50% where the net cost method is used.	A change to heading 39.15 through 39.26 from any other heading

[200] As published in the booklet, North America Free Trade Agreement, Parliamentary Committee working version, 1992.

limit. However, the NAFTA product-specific rules set for subheading 3923.29 specifies both a change in tariff classification and a regional value-content requirement. Therefore, under the NAFTA rules, in order to be considered an originating good, the plastic bag must also satisfy the regional value-content requirement specified in that rule. As provided in de minimis rules, the value of the non-originating materials that do not satisfy the specified change in tariff classification, together with the value of all other nonoriginating materials used in the production of the plastic bag, will be taken into account in calculating the regional value content of the plastic bag.[201]

Table 3.51 shows that USMCA new PSRO provides for a single rule for a number of headings (39.16–39.26), while NAFTA was setting rules at subheading level. This alone is a significant simplification since rather than having a plethora of product-specific rules at subheading level USMCA provides for a single rule for a number of headings. Second, USMCA does not provide for subheading exceptions, nor does it require in addition an RVC. It follows that in the example above producer A in USMCA can freely use the materials classified under subheadings 3920.71 without having to worry about the *de minimis* rule or meeting the RVC requirement.

Example from NAFTA original Uniform Regulations (see PSRO in Table 3.52):

Example: Producer A, located in a NAFTA country, uses originating materials and non-originating materials in the production of copper anodes provided for in heading 7402. The NAFTA product-specific rule of origin for heading 7402 specifies a change in tariff classification from any other chapter. There is no applicable regional value-content requirement for this heading. Therefore, in order for the copper anode to qualify as an originating good under the rule set out in Schedule I, Producer A may not use in the production of the copper anode any non-originating material provided for in Chapter 74. All of the materials used in the production of the copper anode are originating materials, with the exception of a small amount of copper scrap provided for in heading 7404, that is in the same chapter as the copper anode. Under the de minimis rules, if the value of the non-originating copper scrap does not exceed 10 percent of the transaction value of the copper anode or the total cost of the copper anode, whichever is applicable, the copper anode would be considered an originating good.[202]

In the case of NAFTA 2019 and USMCA, producer A may use in the production of the copper anode any non-originating material provided for in Chapter 74 with the only limitation that if he/she uses materials of heading 7404 he/she has to comply with the RVC rules. In this PSRO, USMCA codifies previous practice inherited from the experiences in managing PSRO under NAFTA and substantially liberalizes the requirement under this PSRO.

Example from NAFTA original Uniform Regulations (see PSRO in Table 3.53):

[201] See examples excerpted from NAFTA Uniform Regulations, at https://laws-lois.justice.gc.ca/eng/regulations/SOR-94-14/page-11.html.

[202] https://laws-lois.justice.gc.ca/eng/regulations/SOR-94-14/page-11.html.

TABLE 3.52 *Comparison of selected PSRO between NAFTA and USMCA*

HS description	NAFTA	USMCA
NAFTA: 7402 USMCA: 7402–7205	**NAFTA 1992** A change to heading 7401 through 7402 from any other chapter. **NAFTA 2019** (A) A change to headings 7401 through 7403 from any other heading, including another heading within that group, except from heading 7404; or (B) A change to headings 7401 through 7403 from heading 7404 whether or not there is also a change from any other heading, including another heading within that group, provided there is a regional value content of not less than: (1) 60% where the transaction value method is used, or (2) 50% where the net cost method is used.	A change to headings 74.01 through 74.03 from any other heading, including another heading within that group, except from heading 74.04; or A change to headings 74.01 through 74.03 from heading 74.04, whether or not there is also a change from any other heading, including another heading within that group, provided there is a regional value content of not less than: (a) 60% where the transaction value method is used, or (b) 50% where the net cost method is used.

TABLE 3.53 *Comparison of selected PSRO between NAFTA and USMCA*

HS description	NAFTA	USMCA
NAFTA: 8414.40–8414.80 USMCA: 84.14.51	**NAFTA Original rules 1992:** A change to subheading 8414.40 through 8414.80 from any other heading; or A change to subheading 8414.40 through 8414.80 from subheading 8414.90, whether or not there is also a change from any other heading, provided there is a regional value content of not less than (a) 60% where the transaction value method is used, or (b) 50% where the net cost method is used. **NAFTA 2019:** A change to subheading 8414.51 from any other subheading.	8414.51 A change to subheading 8414.51 from any other subheading.

Example: Producer A, located in a NAFTA country, uses originating materials and non-originating materials in the production of ceiling fans provided for in subheading 8414.51. There are two alternative product-specific rules of origin for subheading 8414.51, one of which specifies a change in tariff classification from any other heading. The other rule specifies both a change in tariff classification from the

subheading under which parts of the ceiling fans are classified and a regional value-content requirement. Therefore, in order for the ceiling fan to qualify as an originating good under the first of the alternative rules, all of the materials that are classified under the subheading for parts of ceiling fans and used in the production of the completed ceiling fan must be originating materials. In this case, all of the non-originating materials used in the production of the ceiling fan satisfy the change in tariff classification set out in the rule that specifies a change in tariff classification from any other heading, with the exception of one non-originating material that is classified under the subheading for parts of ceiling fans. Under the de minimis rules, if the value of the non-originating material that does not satisfy the change in tariff classification specified in the first rule does not exceed seven percent of the transaction value of the ceiling fan or the total cost of the ceiling fan, whichever is applicable, the ceiling fan would be considered an originating good. Therefore, under de minimis rules the ceiling fan would not be required to satisfy the alternative rule that specifies both a change in tariff classification and a regional value-content requirement.[203]

Once again, the PSRO under USMCA and NAFTA 2019 substantially liberalize the requirements with respect to NAFTA 1992. Under the new USMCA rules a producer may use parts of subheading 8414.90 to manufacture a ceiling fan of 8414.51. Under the old NAFTA rules this was only possible if an RVC could be met.

3.4.4.12 A Brief Comparison of the NAFTA–USMCA Model and the Pan-European Rules of Origin Approaches: Techniques and Substantive Requirements

It is undeniable that on one hand, NAFTA and its successor USMCA, and on the other hand, the EU approaches in dealing with preferential rules of origin are largely dominating and influencing the scene when preferential rules of origin are drafted in the context of any free trade agreement. Thus, it is opportune to draw some comparisons of a technical and substantive nature to illustrate the main differences between the two approaches.[204] There are a series of differences from the EU practice in setting the product-specific rules. In the EU, product-specific rules are set at chapter and heading level, sometimes referring to specific products classified within the heading by utilizing an "ex,"[205] while in the case of NAFTA and

[203] https://laws-lois.justice.gc.ca/eng/regulations/SOR-94-14/page-11.html.

[204] For an analysis of EU and NAFTA analysis see also A. Estevadeordal and K. Souminem, "Rules of origin in FTAs in Europe and in the Americas: Issues and implication for the EU–Mercosur Interregional Association agreement," INTEL-ITD, Working Paper, January 15, 2004; and for an overall general comparison see WTO, "Rules of origin regimes in regional trade agreements," Committee on Regional Trade Agreements, April 5, 2002.

[205] The meaning of the "ex" in the EU PSRO list is contained in the explanatory notes to the protocols attached to the EU free trade agreements. See, for instance, Explanatory Note 2.1 of the EU–Vietnam FTA agreement: "The first two columns in the list describe the product obtained. The first column gives the heading number or chapter number used in the Harmonized System and the second column gives the description of goods used in that system

USMCA product-specific rules are set at heading, subheading, and, in some cases, at tariff items level (a further subdivision of the HS at eight-digit level). Apart the different drafting techniques that are further explained in Chapter 6, the PSRO of the European model are at times more restrictive for agricultural and fishery goods and in certain cases more detailed at product-specific level. Conversely, the NAFTA and USMCA rules of origin are more restrictive on textiles, clothing, and motor vehicles. For the large majority of the textiles, metals, and automotive HS chapters, the breakdown at subheading or tariff item level of USMCA far exceeds those under the European rules. It is important to note, as set out in Chapters 2 and 6 of this book, that there are also signs of reciprocal influence among the two models. For instance, the note of Chapter 20 to USMCA provides that: "Fruit preparations of heading 20.08 that contain peaches, pears, or apricots, either alone or mixed with other fruits shall be treated as originating only if the peaches, pears, or apricots were wholly obtained or produced entirely in the territory of one or more of the Parties."

There are no such similar rules in NAFTA, which, in its original version, provided for a change of chapter, meaning that non-originating peaches, pears, or apricots could be used to obtain fruit preparations. Moreover, what is most interesting to observe is that USMCA uses the concept of wholly obtained as a criterion for defining PSRO. This is definitively a sign of convergence in the two models since the United States and Canada strongly opposed the use of the concept of wholly obtained products in defining PSRO when negotiating the harmonized nonpreferential rules of origin.[206]

Another remarkable difference in drafting product-specific requirements is that the NAFTA and USMCA rules do not utilize working or processing operations to confer origin except than in very limited cases.

One of the most visible differences in the drafting of the rules is the almost exclusive reliance by NAFTA and USMCA on CTC or, in the US jargon, a tariff-shift approach. For instance, for goods of Chapter 16 classifying prepared foodstuffs, the NAFTA and USMCA rules require "a change to heading 16.01 through 16.05 from any other chapter."

In plain words this means that a process that changes a material into a good of Chapter 16 from any other chapters of the harmonized system is origin-conferring. On the other hand, the requirement "from any other chapter" expressly impedes the possibility that a process changing the tariff classification inside Chapter 16 is origin conferring.

Assume frozen pork meat (HS 02.03) is imported into the United States from Hungary, and is combined with spices imported from the Caribbean (HTS

for that heading or chapter. For each entry in the first two columns, a rule is specified in column 3. Where, in some cases, the entry in the first column is preceded by an 'ex', this signifies that the rules in column 3 apply only to the part of that heading as described in column 2."

[206] See Chapter 2 of this book on "Ottawa language."

09.07–09.10) and cereals grown and produced in the United States to make fresh pork sausage (HTS 16.01). Since the imported frozen meat is classified in HS Chapter 2 and the spices are classified in Chapter 9, these non-originating materials meet the required tariff change. One does not consider whether the cereal meets the applicable tariff change, because it is originating – only non-originating materials have to undergo the tariff change.

Looking at the EU rules in Table 3.54 it is possible to note the most descriptive character of the rules and the concept of wholly obtained products that does not feature in NAFTA or any other NAFTA-model oriented rules of origin. As mentioned, the concept of wholly obtained products has been the object of fierce discussions in the drafting of the harmonized nonpreferential rules of origin.[207]

Basically, the EU architecture of rules of origin provides for the definition of wholly obtained products,[208] as do most other sets of rules of origin. According to this concept, wholly obtained products qualify as originating by virtue of the total absence of imported inputs. NAFTA used the concept of wholly obtained[209] as well but it did not use such wholly obtained criteria as PSRO. Even in the case of

TABLE 3.54 *Comparison of PSRO for Chapter 16 between EU, NAFTA, and USMCA*

HS code number	Description of goods	NAFTA rules[i]	EU rules[ii]	USMCA rules[iii]
Chapter 16	Preparations of meat, of fish or of crustaceans, mollusks, or other aquatic invertebrates.	A change to heading 16.01 through 16.05 from any other chapter.	Manufacture: – from animals of Chapter 1, and/or – in which all the materials of Chapter 3 used are wholly obtained.	A change to heading 16.01 through 16.05 from any other chapter.

[i] North American Free-Trade Agreement between the Government of Canada, the Government of Mexico, and the Government of the United States of America – NAFTA – Annex 401: Specific Rules of Origin.

[ii] See, for instance, EU–South Korea FTA agreements in Council Decision of September 16, 2010, on the signing, on behalf of the EU, and provisional application of the free trade agreement between the EU and its Member States, of the one part, and the Republic of Korea, of the other part, OJ L127 (May 14, 2011).

[iii] For further details, see https://ustr.gov/sites/default/files/files/agreements/FTA/USMCA/04%20Rules%20of%20Origin.pdf.

[207] See Chapter 2 of this book.

[208] See section 3.4.1.3.1 for the list of wholly obtained products in the Pan-European Rules of Origin.

[209] See Article 415 of NAFTA.

products classified in HS Chapter 1 (live animals), both NAFTA and USMCA provide that a CC is required. USMCA however introduced the concept and definition of wholly obtained in HS Chapter 20 (preparations of fruits, nuts, or other parts of plant), as mentioned earlier.

If we compare the substance of the rules, meaning how many processes we have to perform on the imported inputs to obtain origin, it can be observed that the EU rules for products of Chapter 16 are more stringent than NAFTA and USMCA. In the case of the EU rules, to manufacture originating products classified in Chapter 16 the manufacturer has to use materials of Chapter 1 (live animals), or from Chapter 3 (fish and crustaceans, molluscs, and other aquatic invertebrates) provided that the materials used are wholly obtained. This means that it is not possible to use non-originating meat classified in Chapter 2 of the HS and use it to manufacture meat preparations of HS Chapter 16; nor it is possible to manufacture canned tuna using tuna that is not wholly obtained (i.e. the tuna has to be caught by a vessel that is registered in one of the parties of the EU free-trade agreement).[210] Conversely in NAFTA and USMCA, rules of origin for HS Chapter 16 are more lenient since they provide for a change of HS chapter. This means that non-originating meat of HS Chapter 2 or non-originating fish of Chapter 3 may be freely used to manufacture products classified in HS Chapter 16.

Table 3.55 compares the EU with NAFTA and USMCA rules of origin for Chapter 60, which classify knitted and crocheted fabrics.

The EU rule of origin requires a specific working or processing requirement by specifying the non-originating materials that may be used in the production of knitted and crocheted fabrics, such as natural cotton fibers that have to be spun into yarn and woven into fabrics.

The difference in the wording of the two rules of origin corresponds to both a difference in drafting rules of origin and a different degree of stringency.

EU rules of origin for Chapter 60 for cotton fabrics requires the so-called double transformation, consisting of at least two working or processing operations. In effect, manufacturing natural fibers[211] into knitted or crocheted fabrics entails the processing of spinning and either knitting or crocheting. The NAFTA/USMCA rules of origin provide for a change from any other chapter excluding, for instance, the whole Chapter 52 that corresponds to cotton fibers, yarns, and fabrics. This means that a manufacturer of cotton fabrics has no other choice than to use

[210] See section 3.4.1.3.1 on EU rules of origin.

[211] See the introductory notes to the list of product-specific rules in the European Community Agreement: "Note 4: (1) the term 'natural fibers' is used in the list to refer to fibers other than artificial or synthetic fibers. It is restricted to the stages before spinning takes place, including waste, and, unless otherwise specified, includes fibers that have been carded combed or otherwise processed but not spun; (2) the term 'natural fibers' includes … the cotton fibers of heading 5201 to 5203" – i.e. cotton, not carded or combed; cotton waste; cotton, carded or combed.

TABLE 3.55 *Comparison of PSRO for Chapter 60 between EU, NAFTA, and USMCA*

HS code number	Description of goods	NAFTA rules	EU rules	USMCA rules
Chapter 60	Knitted or crocheted fabrics	A change to heading 60.01 through 60.02 from any other chapter, except from heading 51.06 through 51.13,[i] Chapter 52,[ii] heading 53.07 through 53.08[iii] or 53.10 through 53.11[iv] or Chapter 54[v] through 55.[vi]	Manufacture from:[vii] – Coir yarn; – Natural fibers; – Man-made staple fibers not carded or combed or otherwise processed for spinning; or – Chemical materials or textile pulp.	A change to heading 60.01 through 60.06 from any other chapter, except from heading 51.06 through 51.13, Chapter 52, heading 53.10 through 53.11, or Chapter 54 through 55.

[i] That is the manufacture of the following materials into goods of Chapter 60 is not origin conferring; the materials are: yarn of wool or fine animal hair, carded or combed wool, not put up for retail sale; yarn of wool or fine animal hair for retail sale; Yarn of coarse animal hair or of horsehair, whether or not put up for retail sale; woven fabric of wool or fine animal hair, carded or combed, or woven fabric of coarse animal hair or of horsehair.

[ii] This chapter corresponds to Cotton products.

[iii] That is the manufacture of the following materials into goods of Chapter 60 is not origin conferring; the materials are: yarn of jute or of other textile-based fibers; yarn of other vegetable textile fibers; paper yarn.

[iv] That is the manufacture of the following materials into goods of Chapter 60 is not origin conferring; the materials are: woven fabric of jute or of other textile-based fibers; woven fabric of other vegetable textile fibers; woven fabric of paper yarn.

[v] This chapter corresponds to man-made filaments.

[vi] This chapter corresponds to man-made staple fibers.

[vii] For special conditions relating to products made of a mixture of textile materials, see Introductory Note 5 of the agreement.

NAFTA/USMCA cotton products; that is, use of non-originating cotton fibers is not allowed. Conversely, under the EU rules of origin a manufacturer can still use non-originating fibers to manufacture the fabrics of Chapter 60. In other words and according to NAFTA and USMCA PSRO for Chapter 60, it appears that there is no alternative approach to fulfill the rules of origin (RoO) requirements other than using wholly obtained cotton yarn and fibers of cotton in NAFTA/USMCA countries to obtain originating cotton fabric of Chapter 60.

Chapter 61 classifies articles of apparel and clothing accessories, knitted or crocheted. For certain articles of apparel of this chapter the EU rules of origin usually requires two manufacturing process; namely, weaving the non-originating yarn into fabrics and cut, make, and trim the fabric into a complete article of the

chapter. Thus, the usual rules of origin for this chapter in a free-trade agreement with EU provides for the possibility to use non-originating yarn.

Under NAFTA and USMCA as contained in Table 3.56 a *fiber-forward*[212] rule is applied. This means a triple manufacturing process that is:

(1) spinning the non-originating natural fibers into yarn
(2) weaving the yarn into fabric and
(3) cutting, making, and trimming the fabric into a finished garment.

TABLE 3.56 *Comparison of PSRO for Chapter 61 between EU, NAFTA, and USMCA*

HS code number	Description of goods	NAFTA rules	EU rules	USMCA rules
Chapter 61	Articles of apparel and clothing accessories, knitted or crocheted	A change at subheading level through all Chapter 61 from any other chapter except from heading 51.06 through 51.13, 52.04 through 52.12,[i] 53.07 through 53.08 or 53.10 through 53.11, Chapter 54 or heading 55.08 through 55.16[ii] or 60.01 through 60.02,[iii] provided that: (a) the good is both cut (or knit to shape) and sewn or otherwise assembled in the territory of one or more of the Parties, and (b) the visible lining fabric listed in	Manufacture from yarn[v] Manufacture from: – Natural fibers; – Man-made staple fibers not carded or combed or otherwise processed for spinning; or – Chemical materials or textile pulp.	A change at subheading level through all Chapter 61 from any other chapter except from heading 51.06 through 51.13, 52.04 through 52.12, 53.10 through 53.11, Chapter 54 or Chapter 55[vi] or 60.01 through 60.06, or other made-up textile articles of heading 96.19,[vii] provided that the good is both cut (or knit to shape) and sewn or otherwise assembled in the territory of one or more of the Parties.[viii]

(*continued*)

[212] See Trilateral Customs Guide to NAFTA, at www.ccra-adcr.gc.ca.

TABLE 3.56 (*continued*)

HS code number	Description of goods	NAFTA rules	EU rules	USMCA rules
		Note 1 to Chapter 61 satisfies the tariff change requirements provided therein.[iv]		

[i] That is, the manufacture of the following materials into goods of Chapter 61 is not origin conferring; the materials are: cotton sewing thread for put up for sale or not; cotton yarn (other than sewing thread) combed or not for retail sale or not containing 85% of cotton; woven cotton containing at least 85% of cotton whether bleached or not, dyed or printed; woven cotton containing at least 85% of cotton, with man-made fiber, whether bleached or not, dyed or printed.

[ii] That is, the manufacture of the following materials into goods of Chapter 61 is not origin conferring; the materials are: sewing thread of synthetic or artificial staple fibers; yarn (other than sewing thread), 85% nylon, other polyamide, polyester, acrylic or modacrylic, other synthetic, or artificial staple fiber (man-made) not for retail sale; yarn of man-made staple fibers mixed with artificial staple fiber, or wool or fine animal hair, or cotton, not put up for sale; yarn of man-made staple fibers, not for retail sale; woven fabric, 85% of man-made staple fiber, unbleached or bleached or other than unbleached or bleached; fabric containing less than 85% man-made staple fiber, with cotton; woven fabric of man-made staple fiber, with or without viscose rayon staple fiber, man-made filaments, wool or fine animal hair; woven fabric, 85% man-made staple fiber, unbleached or bleached, dyed, yarn dyed, printed; woven fabric of artificial staple fiber, unbleached or bleached, dyed, yarn dyed, printed.

[iii] That is, the manufacture of the following materials into goods of Chapter 61 is not origin conferring; the materials are: long-pile knitted or crocheted textile fabric; looped-pile knitted or crocheted fabric, of cotton, man-made fibers or other textile materials; pile knitted or crocheted fabric, of cotton, man-made fiber or other textile materials; warp knitted fabric, of wool or fine animal hair, cotton, man-made fibers, or other materials; knitted or crocheted fabric, of wool or of fine animal hair, cotton, man-made fibers, or other materials.

[iv] See also Annex 300-B (Textile and Apparel Goods), Appendix 6(A) of NAFTA.
See NAFTA Rule 1 to Chapter 61. "A change to any of the following headings or subheadings for visible lining fabrics: 51.11 through 51.12, 5208.31 through 5208.59, 5209.31 through 5209.59, 5210.31 through 5210.59, 5211.31 through 5211.59, 5212.13 through 5212.15, 5212.23 through 5212.25, 5407.42 through 5407.44, 5407.52 through 5407.54, 5407.61, 5407.72 through 5407.74, 5407.82 through 5407.84, 5407.92 through 5407.94, 5408.22 through 5408.24 (excluding tariff item 5408.22.aa, 5408.23.aa or 5408.24.aa), 5408.32 through 5408.34, 5512.19, 5512.29, 5512.99, 5513.21 through 5513.49, 5514.21 through 5515.99, 5516.12 through 5516.14, 5516.22 through 5516.24, 5516.32 through 5516.34, 5516.42 through 5516.44, 5516.92 through 5516.94, 6001.10, 6001.92, 6002.43 or 6002.91 through 6002.93, from any heading outside that group."
See NAFTA Rule 2 to Chapter 61. "For purposes of determining the origin of a good of this chapter, the rule applicable to that good shall only apply to the component that determines the tariff classification of the good and such component must satisfy the tariff change requirements set out in the rule for that good. If the rule requires that the good must also satisfy the tariff change requirements for visible lining fabrics listed in Note 1 to this chapter, such requirement shall only apply to the visible lining fabric in the main body of the garment, excluding sleeves, which covers the largest surface area, and shall not apply to removable linings."

[v] Obtained by sewing together, or otherwise assembling, two or more piece of knitted or crocheted fabrics that have been either cut to form or obtained directly to form.

[vi] Some of the subheadings do not require a change from Chapter 55 but only a subset of it, for example 55.08 through 55.16

[vii] See subheadings 6107.11–6107.19, 6110.90, 61.11 for further details.

[viii] Subheadings 6107.21, 6108.21, 6108.31 have a special requirement to determine the origin of the goods. See USMCA Rule Chapter 61. "For the purposes of determining the origin of a good of this chapter, the rule applicable to that good shall only apply to the component that determines the tariff classification of the good and such component must satisfy the tariff change requirements set out in the rule for that good."
Special specification is provided for trading between Mexico and the United States for the following subheadings: 6103.23, 6104.23, 6110.30.
To determine the origin for subheadings 6107.21, 6108.21, 6108.31, the following rule could also be used: "a change of subheading from circular knit fabric, wholly of cotton yarns exceeding 100 metric number per single yarn, of subheading 6006.21, circular knit fabric, wholly of cotton yarns exceeding 100 metric number per single yarn, of subheading 6006.22, circular knit fabric, wholly of cotton yarns exceeding 100 metric number per single yarn, of subheading 6006.23 or circular knit fabric, wholly of cotton yarns exceeding 100 metric number per single yarn, of subheading 6006.24, provided that the good, exclusive of collar, cuffs, waistband or elastic, is wholly of such fabric and the good is both cut and sewn or otherwise assembled in the territory of one or more of the Parties, and such goods will not be subject to Notes 2 through 4 of this Chapter."

This is a strict rule of origin that exists for certain textile and apparel articles made of fibers that are produced in abundance in Canada, Mexico, and the United States. There are not significant variations among NAFTA and USMCA rules of origin for this chapter, as shown in Table 3.56. However, it is important to note that the requirement of visible lining that was present in NAFTA is not reproduced in USMCA, Moreover, USMCA introduces further restrictions on certain fabrics, the pockets, and the sewing thread used to make garments of Chapter 61 as follows:

> Effective 18 months from the date of entry into force of the agreement, and notwithstanding Chapter Note 1, a good of this chapter containing fabrics of subheading 5806.20 or heading 60.02 is originating only if such fabrics are both formed from yarn and finished in the territory of one or more of the Parties.
>
> Effective 12 months from the date of entry into force of the agreement, and notwithstanding Chapter Note 1, a good of this chapter containing sewing thread of heading 52.04, 54.01 or 55.08, or yarn of heading 54.02 used as sewing thread shall be considered originating only if such sewing thread is both formed and finished in the territory of one or more of the Parties.
>
> Effective 18 months from the date of entry into force of the agreement, and notwithstanding Chapter Note 1, if a good of this chapter contains a pocket or pockets, the pocket bag fabric must be formed and finished in the territory of one or more of the Parties from yarn wholly formed in one or more of the Parties.[213]

As explained by the Customs Guide to NAFTA Implementation,[214] less strict rules of origin governed certain knitted underwear, brassieres, and shirts made from fabric

[213] See USMCA notes to Chapter 61.
[214] See www.aaatrading.com/nafta/guide, but also www.customs.gov/nafta/docs/us/guidproc.html.

not commonly produced in North America. For example, silk[215] and linen[216] apparel articles follow a single-transformation rule. Therefore, silk blouses, HS 61.06.90, are considered originating even if they are made from non-originating fabric, as long as the fabric is cut and sewn in one or more NAFTA countries. These exceptions give producers flexibility to import materials not widely produced in North America. Actually, the basic origin rule for textile and apparel articles is *yarn-forward*. This means that yarn used to form the fabric, which may later be used to produce wearing apparel or other textile articles, must originate in a NAFTA country. Thus, a wool shirt made in Canada from fabric woven in Canada of wool[217] yarn produced in Argentina is not considered originating, since the yarn does not originate within a NAFTA country. If, however, Argentine wool fiber was imported into Canada and spun into wool yarn, and was then used to produce the wool fabric, the shirt is considered originating.

At present there is not yet a similar trilateral customs guide for USMCA, but no significant variations are expected.

Under NAFTA, certain apparel must satisfy the Note 1 to Chapter 61. The note provides a tariff shift for visible lining fabric from the headings listed in the note itself (see Table 3.56).

The NAFTA and USMCA rules of origin for Chapter 62 (articles of apparel and clothing accessories, not knitted or crocheted) are not substantially different from the one for Chapter 61 because a fiber-forward rule is required (see Table 3.57).

In the majority of the EU free-trade agreements, the applicable rules of origin for Chapter 62 is manufacturing from yarn.

In some cases, specific headings have different requirements. For example the PSRO for heading 62.10 requires the manufacture from uncoated fabric provided the value of the uncoated fabric used does not exceed 40 percent of the ex-works price of the product. Supposing that the custom value of the uncoated fabric used is 900 EUR and the ex-work price of the finished fire-resistant equipment is 2,300 EUR, the following is the calculation to be carried out:

100: 2300 = X: 900
X= 39 percent

Since 39 percent is less than the maximum amount of 40 percent, the product is originating.

A specific rule is stated for headings 62.13 and 62.14. The general rule for handkerchiefs, shawls, scarves mufflers, mantillas, and veils is the manufacturing from unbleached single yarn. For the percentage criterion, a different non-originating content is required, as well as a list of specific operations, which is essential to comply with the rule.

As stated in the introductory note – Note 3.5 – normally contained in the EU FTA Agreement, where a rule in the list specifies that a product must be manufactured

[215] Silk is classified in Chapter 50.
[216] Flax is classified in Chapter 53.
[217] Wool is classified in Chapter 51.

from a particular material, the condition obviously does not prevent the use of other materials, which because of their inherent nature cannot satisfy the rule. However, this does not apply to products that, although they cannot be manufactured from the particular materials specified in the list, can be produced from a material of the same nature at an earlier stage of manufacture. For example, in the case of an article of apparel of ex-Chapter 62 made from non-woven materials, if the use of only non-originating yarn is allowed for this class of article, it is not possible to start from non-woven cloth – even if non-woven cloths cannot normally be made from yarn. In such cases, the starting material would normally be at the stage before yarn – that is, the fiber stage (see Tables 3.57 and 3.58).

TABLE 3.57 *Comparison of PSRO for Chapter 62 between EU, NAFTA, and USMCA*

HS code number	Description of goods	NAFTA rules	EU rules	USMCA rule
(EU description) Ex[i] Chapter 62	Articles of apparel and clothing accessories, not knitted or crocheted except for:	A change to subheading 6201.19 from any other chapter, except from heading 51.06 through 51.13, 52.04 through 52.12, 53.07 through 53.08 or 53.10 through 53.11, Chapter 54, or heading 55.08 through 55.16, 58.01 through 58.02 or 60.01 through 60.02, provided that the good is both cut and sewn or otherwise assembled in the territory of one or more of the Parties.	Manufacture from yarn[ii]	A change to Chapter 62[iii] from any other chapter, except from heading 51.06 through 51.13 52.04 through 52.12, 53.10 through 53.11, Chapter 54, heading 55.08 through 55.16, 58.08 through 58.16, 58.01 through 58.02 or 60.01 through 60.06, provided that the good is both cut (or knit to shape) and sewn or otherwise assembled in the territory of one or more of the Parties.[iv]
Ex-62.02	Women's, girls' and babies'	A change to subheading	Manufacture from yarn	A change to headings 62.01

(*continued*)

TABLE 3.57 (*continued*)

HS code number	Description of goods	NAFTA rules	EU rules	USMCA rule
	clothing and clothing accessories for babies, embroidered	6202.91 through 6202.93 from any other chapter, except from heading 51.06 through 51.13, 52.04 through 52.12, 53.07 through 53.08 or 53.10 through 53.11, Chapter 54, or heading 55.08 through 55.16, 58.01 through 58.02 or 60.01 through 60.02, provided that: (a) the good is both cut and sewn or otherwise assembled in the territory of one or more of the Parties, and (b) the visible lining fabric listed in Note 1 to Chapter 62 satisfies the tariff change requirements provided therein.	Or Manufacture from unembroidered fabric provided the value of the unembroidered fabric used does not exceed 40% of the ex-works price of the product.	through 62.04[v] from any other chapter, except from heading 51.06 through 51.13 52.04 through 52.12, 53.10 through 53.11, Chapter 54, heading 55.08 through 55.16, 58.01 through 58.02 or 60.01 through 60.06, provided that the good is both cut (or knit to shape) and sewn or otherwise assembled in the territory of one or more of the Parties.

[i] See introductory notes to the list, Note 2: "2.1. The first two columns in the list describe the product obtained. The first column gives the heading number or chapter number used in the Harmonized System and the second column gives the description of goods used in that system for that heading or chapter. For each entry in the first two columns, a rule is specified in columns 3 or 4. Where, in some cases, an 'ex' precedes the entry in the first column, this signifies that the rules in columns 3 or 4 apply only to the part of that heading as described in column 2."

[ii] For special conditions relating to products made of a mixture of textile materials, see Introductory Notes 5 and 6.

[iii] See USMCA Rules, Chapter 62. "Apparel goods of this chapter shall be considered to originate if they are both cut and sewn or otherwise assembled in the territory of one or more of the Parties and if the

fabric of the outer shell, exclusive of collars or cuffs, is wholly of one or more of the following: (a) Velveteen fabrics of subheading 5801.23, containing 85 per cent or more by weight of cotton; (b) Corduroy fabrics of subheading 5801.22, containing 85 per cent or more by weight of cotton and containing more than 7.5 wales per centimeter; (c) Fabrics of subheading 5111.11 or 5111.19, if handwoven, with a loom width of less than 76 cm, woven in the United Kingdom in accordance with the rules and regulations of the Harris Tweed Authority, Ltd., and so certified by the Authority; (d) Fabrics of subheading 5112.30, weighing not more than 340 grams per square meter, containing wool, not less than 20 per cent by weight of fine animal hair and not less than 15 per cent by weight of man-made staple fibers; or (e) Batiste fabrics of subheading 5513.11 or 5513.21, of square construction, of single yarns exceeding 76 metric count, containing between 60 and 70 warp ends and filling picks per square centimeter, of a weight not exceeding 110 grams per square meter. Such apparel goods shall not be subject to Notes 3 through 5 of this Chapter."

[iv] Subheadings 6205.20–6205.30, 6207.11 provide extensive rules. See USMCA Chapter 62 for further details.

[v] See USMCA for further details. There is no heading level specifically for 62.02 but USMCA rules of origin directly include 62.01–62.04.

TABLE 3.58 *Comparison of PSRO for heading 8407 between EU, NAFTA, and USMCA*

HS code number	Description	NAFTA rule	EU	USMCA[i]
8407	Spark-ignition reciprocating or rotary internal combustion piston engines	A change to heading 84.07 through 84.08 from any other heading, including another heading within that group, provided there is a regional value content of not less than: (a) 60% where the transaction value method is used; or (b) 50% where the net cost method is used.	Manufacture in which: – The value of all the materials used does not exceed 40% of the ex-works price of the product.	A change to subheading 8407.10 through 8407.34 from any other heading, provided there is a regional value content of not less than: (a) 60% where the transaction value method is used; or (b) 50% where the net cost method is used.[ii]

[i] This is an excerpt from USMCA as the products specific rules of origin for heading 84.07 are set at subheading level.

[ii] See USMCA rules of origin for further details. For 8407.90, there should be a change to subheading 8407.90 from any other subheading to determine origin of the goods.

As shown in Table 3.58, the EU rules of origin for engines of heading 84.07 are rather straightforward, requiring they do not exceed 40 percent of non-originating materials. USMCA and NAFTA require a double requirement of CTC plus a percentage criterion rule. It may be observed that albeit the calculation methodologies differ substantially between the EU and USMCA, the level of percentage required is rather similar being at 60 percent (bearing in mind that the 40 percent of non-originating material in the EU may be, as a rule of thumb, equivalent to 60 percent of RVC). However, the different calculation methodologies together with the tracing-back rules examined above account for the difference in stringency under USMCA and NAFTA. In addition, the percentage requirements are going to rise under USMCA, as explained in section 3.4.4.9.1.

4

The Economics of Rules of Origin

4.1 THE BASIC TENETS OF RULES OF ORIGIN AND ECONOMICS

Until the beginning of the 1990s, trade economists paid little attention to rules of origin. Such scant interest changed drastically with the signing of the North American Free-Trade Agreement (NAFTA) as examined later. Before such period, the literature on the economic effects of rules of origin (RoO) was comparatively limited. In such literature, the main issues that were addressed are the following:

- the effects that rules of origin have on the allocation of resources within one country, and hence on efficiency and welfare
- whether rules of origin guarantee the achievement of the objectives that underlie the trade instrument under which they are adopted
- the effects of rules of origin in schemes of economic integration (free-trade agreements, customs unions) particularly as regards the incentive they might represent for "rent seeking"/lobbying activities.

Most of the economic models that were developed did not directly refer to rules of origin but, more generally, to schemes of "local content protection." According to these schemes, local producers are allowed to import inputs and raw materials free of duty so long as the final products contain a minimum percentage of local value added. These models can be adapted to RoO issues because in both cases, the failure to reach a minimum of local value-added results in the obligation to pay a tariff. The difference is, of course, that in the case of RoO requirements, the tariff will have to be paid on the exports of the final product when imported in the partner country whereas, in the case of local content schemes, the tariffs will be paid on the imports of the intermediate inputs. It should also be noted that local content models can be adapted not only to RoO requirements contained in preferential trade agreements but also to those that relate to anti-dumping (AD) actions or quotas, although the implications for noncompliance is quite different in these three cases, as indicated in Table 4.1.

TABLE 4.1 *Example of possible implications for noncompliance and application of trade instruments*

Rationale for RoO requirement	Implications for noncompliance of RoO requirement
Preferential rules of origin	Exports will not be entitled to benefit from the lower, preferential tariff rate
Anti-dumping	Exports may be subject to anti-dumping duties
Selective quantitative restrictions	Exports will not be allowed to enter the market

However, some qualifications are in order since the circumventing behavior of the firms that are subject to local content/rules of origin requirements can be very diverse. In fact, in the case of AD and selective quotas, circumvention will imply the establishment of production facilities in the territory of the *importing* country for the assembly of inputs that originate from countries that are subject to the restrictive measures. In contrast, preferential rules of origin imply the establishment of production facilities in the territory of the *exporting* countries for the assembly of inputs that originate from countries that are excluded from the preferential market access arrangements.

Thus, the adaptation of local content models to the reality of RoO regulations requires some caution. Additionally, caution is needed due to the standard assumptions on which these models are based (perfect competition on the markets of both the final product and the intermediate inputs, etc.).

It has also been noted that, since rules of origin regulations tend to increase the demand for locally produced intermediates, these regulations may be utilized for the so-called "directly unproductive profit seeking activities"; that is, lobbying activities pursued by big industrial groups and business associations. This has been and will continue to be the case especially during negotiations of free-trade agreements, especially NAFTA and more recently the US, Mexico, Canada Free-Trade Area agreement (USMCA).

However, these findings on the effect of rules of origin have some clear limitations which need to be taken into account:

(1) If the rule is not binding its effect will be nil; in other words, if the efficient combination of the imported and the locally produced input requires a percentage of the former that producers have already met, then they will not need to modify their production mix in favor of local producers of intermediates.
(2) If the rule is too stringent, its effect may also be nil. If the efficient combination of the imported and the locally produced input requires a percentage of the imported inputs that is much lower than the one actually used by producers, then the costs of compliance with the rules may be higher than the anticipated savings in tariffs. In other words, producers of the final goods will not find it economically advantageous to comply with the requirement.

In addition, the final effect of rules of origin regulations on the demand of locally produced inputs also depends on:

(a) the elasticity of substitution[1] between the imported and the locally produced inputs (the higher the elasticity, the easier it is to substitute the locally produced for the imported, and thus the larger the effect on demand of locally produced inputs)
(b) the difference in price between the local and the imported intermediate (the more costly the local brands, the more difficult the substitution will be, hence the smaller the effect on the demand of locally produced inputs)
(c) the magnitude of the preferential tariff margin or of the AD duty
(d) the elasticity of supply of local production (in fact, if the price of the local intermediate good increases substantially as demand increase, substitution in favor of the locally produced brand will be limited and thus the effect on the demand will be smaller)
(e) the costs connected to the documentary evidence and administrative paperwork to demonstrate the proof of origin (the higher the costs, the lower the profitability of meeting the requirements and, hence, the lower the effect on the demand of the intermediate inputs)

The ultimate consequence of the utilization of local content model in rules of origin is that the increase in demand for nationally produced intermediates has a cost in terms of efficiency and welfare. In fact, such rules are an incentive for producers to deviate from the efficient mix of imported and locally produced inputs.

4.1.1 *Developments in the Analysis of the Economic Effects of Rules of Origin*

At the beginning of the 1990s the formation of free-trade areas (FTAs) in North America generated new interest in the issue of rules of origin and the analysis of their economic impact.

Contractual rules of origin are clearly at the very core of FTAs because they ensure that preferential market access will be granted only to goods that have actually been "substantially transformed" within the area, and not to goods that are produced elsewhere and simply transshipped through one for the member countries. In the absence of rules of origin, it would not be possible to discriminate against imports from third countries, so that the significance of regional integration would be drastically diminished.

Traditionally, the main reason for the existence of rules of origin in FTAs is the preoccupation with trade deflection. In a free-trade agreement, each country maintains its own external tariff and commercial policy in relation to outside trading partners. To the extent that the tariffs and commercial policy are different with

[1] Elasticity of substitution is defined as the percentage change in the demand for one good resulting from a percentage change in the relative price of the substitute good.

regard to third countries, the incentive exists to import a good through the country with the most liberal import regime and tariffs. In that case, importers and producers will eventually operate minimal transformation and finally they will re-export the goods toward the countries with the higher tariffs. To sum up, it would be equivalent to a tariff circumvention operation.[2]

The NAFTA experience and most recently USMCA showed to the rest of the world how rules of origin in FTAs have been used as a trade policy instrument to make the tariff preference dependent on the utilization of regional inputs. The case of the yarn-forward rules where garments made in Mexico may benefit from the tariff preference only if US textile material is utilized and the case of higher regional value content (RVC) in automotive products championed by the Trump administration in USMCA negotiations are classic examples.

Thus, stringent rules of origin in FTAs are the result of complicated trade and industry considerations and negotiations. However, the more stringent they are, the more prevalent trade diversion may become, since producers from the integrated area will favor intermediate inputs originating there in spite of their higher cost in comparison with inputs from countries outside the FTA. Thus, trade diversion will be greater, the higher the preferential margin associated with origin compliance and the less costly the compliance with rules of origin and related administration costs.

In the case of unilateral rules of origin, the conventional wisdom of preference-giving countries is that trade preferences are granted to goods genuinely manufactured in the beneficiary countries and not to goods simply transshipped or made the object of minimal working or processing in the beneficiary countries just to take advantage of the trade preferences.

Ultimately, rules of origin are a secondary trade policy instrument necessary to attain the developmental policy objectives underlying the granting of trade preferences; that is, export increases, industrialization, and ultimate economic growth.

On the other hand, beneficiary countries have maintained since the inception of the first set of unilateral rules of origin under the Generalized System of Preferences (GSP) schemes that rules of origin are one of the main obstacles to the utilization of trade preferences.[3] The recent negotiations on preferential rules of origin for least-developed countries (LDCs) focused on this aspect and, as discussed in Chapter 1 and this chapter, have led to the notifications of the utilization rates by preference-giving countries as contained in the Nairobi Decision on preferential rules of origin for LDCs.

[2] Trade deflection does not have per se a negative economic effect; in fact, it may, from an economic point of view, be considered equivalent to a reduction in the tariffs of a high tariff country and thus indeed positive for its economic efficiency. It is, however, regarded as a negative phenomenon since it does not correspond to the objectives of FTAs' contracting parties. Taken to its extreme, trade deflection could go beyond the original intention of the contracting parties by transforming the original free-trade agreement into a customs union where the external tariffs will be determined by the country applying the lower tariffs.

[3] See various reports of the UNCTAD Working Group on Rules of Origin established in the 1970s.

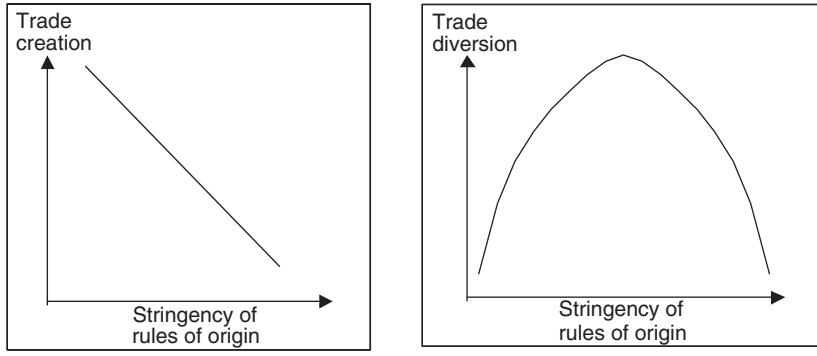


FIGURE 4.1 Effects of stringency of rules of origin on trade creation and trade diversion

Figure 4.1 depicts in simple terms the effects of the stringency of rules of origin on trade creation and trade diversion, conveying the reason why preferential rules of origin are such an important dimension of the trade effects of trade preferences.

It should be intuitive that as rules of origin become stricter, and thus more difficult to fulfill, trade creation falls.[4] In fact, either manufacturers will find progressively that the cost of compliance with rules of origin exceeds the value of the margin of preference or the required inputs are simply not available in the domestic market. Noncompliance with rules of origin implies that the most-favored nation (MFN) rate of duty will be charged at the time of customs clearance. Thus, trade effects expected from trade preferences will be nil.

Although trade effects of trade diversion are more evident in the case of contractual rules of origin, they may also have, or deter, significant trade effects when unilateral trade preferences are granted upon cumulation requirements.[5]

Suppose that, under a particular free-trade agreement, product-specific rules of origin (PSRO) for garments requiring the transformation of fabrics into ready-made garments are origin conferring. Producers of garments will then be encouraged to continue to source fabrics from within or outside the region from the most competitive supplier, transform them into ready-made clothing and then export them to partner countries.

If, alternatively, the PSRO require a double transformation – that is, weaving of the yarn into fabric and cut, make, and trim (CMT) – producers of garments will be encouraged to start sourcing fabrics from within the region unless they want to invest in further manufacturing by carrying out the weaving operations from imported yarn. However, sourcing fabrics within the region may imply a trade diverting effect

[4] Trade creation is defined as the reduction in the domestic production of foods that are substituted by imports from partner countries.

[5] Trade diversion is defined as the reduction in imports from countries that are not members of the regional agreements and that are substituted by imports from partner countries. Liberal rules of origin could reduce the incentive to source from within the region unless these regional inputs are really competitive.

or investment in textile manufacturing. This example has been a longstanding reality in the case of some LDCs such as Bangladesh and Cambodia where, before the European Union (EU) reform of rules of origin, some have advocated that rules of origin could play a role in building backward linkages.[6]

However, when rules of origin under a trade diversion scenario become very stringent, a second, similar effect starts to kick in – the cost of compliance becomes so high that it exceeds the margin of preference or simply there are no regional inputs available to comply with rules of origin. Not only will this reduce the incentive to source from a partner country products that were previously sourced from outside the region but, taken to its extreme, will again result in noncompliance with RoO requirements with a consequential denial of preferential rate of duty resulting in no trade effects. This, as further examined in Chapter 5, has been the destiny of many FTA agreements with rules of origin that are excessively stringent in relation to the manufacturing capacity and availability of regional inputs.

Thus, the expected trade and development effects of trade preferences in FTAs may, on the one hand be limited or frustrated by an excessive stringency of the RoO requirements attached to the granting of the preferential tariff treatment. On the other hand, the greater the preferential margin and more liberal and not burdensome for the manufacturing industries of the free-trade agreement parties the rules of origin are, the greater the effects that may be expected from the trade preferences contained in a free-trade agreement.

The lesson to be learned is that when rules of origin are excessively stringent, not matching the current industrial capacity of the parties to a free-trade agreement, or totally offset a commercially meaningful preferential margin, trade effects of free-trade agreement preferences are equal to zero since MFN rate of duty will be applied.

A pioneer study conducted by Herin[7] measured the impact of rules of origin in the free-trade agreement between European Free-Trade Association (EFTA) and the European Economic Community (EEC). In that study, it was found that many EFTA exporters preferred to pay MFN duties rather than comply with the rules of origin in cases where the preferential margin was not significant. As further detailed below such initial finding marked the beginning of a series of studies on the impact of rules of origin and underutilization of trade preferences where it was argued that their low utilization rates are largely due to low preferential margins. As contained in Table 4.2 and discussed later, other studies have tried to measure what are the costs of complying with rules of origin arguing that below a certain level exporters opt for paying MFN duties. The literature arguing that exporters would rather pay MFN duties rather than comply with RoO requirements when preferential margins are low should face the counterfactual that the MFN rate of duty for imported cars in the United States is 2.5 percent. Such level of duty may be estimated as low;

[6] See M. Rahman, "Trade benefits for least developed countries: The Bangladesh Case Market Access Initiatives, limitations and policy recommendations," CDP Background Paper 18, ST/ESA/2014/CDP/18 July 2014.

[7] See J. Herin, "Rules of origin and differences between tariff levels in EFTA and in the EC," EFTA Occasional Paper 13, 1986.

however, it has been one of the determinant factors in renegotiating the NAFTA automotive rules of origin into USMCA. Thus, it would be more important to link any discussion about the significance of a duty to the volume of trade, profit margins, and industrial sectors rather than discuss generic figures that often do not correspond to commercial realities.[8] Yet the majority of studies in Table 4.2 do not take into account such considerations. A recent study by the Swedish Board of Trade based on firm-level data has shown a much more complete and accurate picture contrary to the enduring myths on cost of compliance and behavior of firms.[9]

The study identified the following findings:

- It is generally assumed that companies in general fail to use free trade agreements due to complicated rules and administrative burdens. This analysis, however, indicates that companies tend to utilize the tariff preferences when large import transaction values are involved and the potential duty savings are high.
- It is generally assumed that free trade agreements are underutilized by small companies. This analysis, however, indicates that small companies might be even more efficient users of free trade agreements than large companies.
- It is generally assumed that the level of tariff reductions is the main driver of companies' use of free trade agreements. This analysis, however, indicates that the size of the tariff reduction is less significant than the import transaction value.
- Finally, it is generally assumed that exporters should be the focus of incentives to increase the use of free trade agreements. This report, however, argues that importers are the ones to request the use of tariff preferences and, therefore, the main beneficiaries of the potential duty savings. The efforts to increase the utilization of tariff preferences should, accordingly, focus on importers.

Tables 4.2–4.6 below attempt to summarize some of the major analysis in the different RoO topics.[10]

Krueger[11] examined the impact of rules of origin on intermediate products in NAFTA. One of the most convincing arguments concerning the potential "hidden" protectionism of rules of origin has been elaborated by Krishna and Krueger (see Table 4.3) who argued that rules of origin can induce a switch in the sourcing of low-cost nonregional to high-cost regional inputs in order for producers to take advantage of the preferential rates. Since the tariff applies to the transaction value of final goods whenever preferences are deep and rules of origin are restrictive, there is an incentive for regional producers to buy intermediate goods from regional sources. So, by displacing low-cost intermediate goods from the rest of the world, restrictive

[8] On the different margins that are guiding firms in compliance with rules of origin, see S. Inama and P. P. Ghetti, "The real cost of rules of origin: A business perspective to discipline rules of origin in a post COVID-19 scenario," *Global Trade and Customs Journal*, forthcoming.

[9] See Swedish Board of Trade, "Who uses the EU's Free Trade Agreements? A transaction-level analysis of the EU–South Korea free trade agreement," 2019.

[10] The summary analysis of the literature in these tables is by no means exhaustive and the author apologizes for any omissions.

[11] See A. Krueger, "Free trade agreements as protectionist devices: Rules of origin," NBER Working Paper 4352, 1993.

TABLE 4.2 *Determinants of utilization of preferential tariffs*[i]

Author(s)	Preference scheme	Utilization rates (UR)	Methodology	Determinants of utilization	Data source
Manchin & Pelkmans-Balaoing (2007)[ii]	AFTA	5% under ASEAN FTA agreement[iii]	Descriptive analysis on rules of origin; gravity model for analysing the effect of preferences on trade flows (at HS 6 level)	Preference margin Restrictiveness of RoO Compliance cost of RoO	World Integrated Trade Solutions (WITS) trade data Data for geographical variables are from CEPII
Kawai & Wignaraja (2009)[iv]	Asian countries	N/Av[v]	Descriptive analysis of surveys	FTAs Preference margin Compliance cost of RoO	Firm level surveys of 609 Asian firms
Katsuhide & Shujiro (2008)[vi]	Japan's FTAs	12.2% under the Japan–Mexico FTA agreement to 32.9% Japan–Malaysia FTA agreement	Probit model	Trade volume with FTA partners Compliance costs of RoO Information on FTAs Preference margin	Firm level survey
Athukorala & Kohpaiboon (2011)[vii]	Thailand–Australia Free-Trade Agreement (TAFTA)	60% to 70% from 2005 to 2010 under TAFTA	Pre- and post-TAFTA comparison of trade flows	Preference margin Restrictiveness of RoO Compliance costs of RoO	UN Comtrade
Hayakawa, Kim, & Lee (2014)[viii]	Korea–ASEAN Free-Trade Agreement (KAFTA)	Overall UR of 35% to 78% across ASEAN countries[ix]	OLS, Poisson, Tobit, Fractional model	Average export value Preference margin Restrictiveness of RoO	Korea Customs and Trade Development Institute
Brenton & Manchin (2003)[x]	Preference regime of the EU	Quoting UNCTAD figures of utilization rates of 31%	Descriptive analysis	Restrictiveness of RoO Compliance costs of RoO	European Commission

TABLE 4.2 (*continued*)

Author(s)	Preference scheme	Utilization rates (UR)	Methodology	Determinants of utilization	Data source
Francois, Hoekman, & Manchin (2006)[xi]	Preference regime of OECD countries	N/Av[xii]	Threshold estimation technique	Compliance costs of RoO	GTAP UNCTAD WTO CEPII
Bureau, Chakir, & Gallezot (2007)[xiii]	Preference regime of the EU and the US	89% under Everything But Arms (EBA) and US GSP	Binomial/ Multinomial Probit estimation	Compliance costs of RoO Predictability of the regime	USITC (US International Trade Commission) EU "Single Administrative Declaration"
Keck and Lendle (2012)[xiv]	Australia, Canada, EU, and US	61% for the overall UR for Australia to 92% of the other three countries	OLS/GLM/ Logit model	Preference margin Volume of exports Fixed costs (including compliance cost of RoO)	EuroStat USITC WTO Secretariat obtained
Abreu (2013)[xv]	192 RTAs	19% for the UR of Singapore to 99% UR of Jordan and Bahrain	Descriptive analysis of imports and utilization rates data	Compliance costs of RoO Lack of information Low margin of preference	WTO Database EuroStat USITC
Hakobyan (2015)[xvi]	US GSP	60% under US GSP	Linear Probability Model, Tobit and Fractional Logit Model	Production structure of the beneficiary country	USTIC Tariff Database OECD Input-Output UN Industrial Development Organization (UNIDO) industrial production database World Development Indicators CEPII

(*continued*)

TABLE 4.2 (*continued*)

Author(s)	Preference scheme	Utilization rates (UR)	Methodology	Determinants of utilization	Data source
Kuo-I & Hayakawa (2012)[xvii]	Economic Cooperation China-Taiwan Framework Agreement (ECFA)	0.2 to 1411[xviii]	Heckman Model and Mills Ratio	Systematic selection of products to be included in the Harvest list of ECFA Preference Margin	China Customs Law Firm China FTA Network ECFA Tariff Data WITS

Note: N/Av = No available information; CEPII = Centre d'Etudes Prospectives et d'Informations Internationales; GTAP = Global Trade Analysis Project; GLM = General Linear Model; OLS = Ordinary Least Squares

[i] The summary of major studies of rules of origin provided from Tables 4.2–4.6 are refined and updated from J. Yi, "Rules of origin and the use of free trade agreements," *World Customs Journal*, vol. 9, no. 1 (2015), 43–58 with the assistance of Egbert Amocio, Researcher, Goethe University.

[ii] See M. Manchin and A. Pelkmans-Balaoing, "Rules of origin and the web of East Asian free trade agreements," Policy Research Working Paper Series No. 4273, 2007.

[iii] See http://documents.worldbank.org/curated/en/873791468026936989/pdf/wps4273.pdf for further details.

[iv] See M. Kawai and G. Wignaraja, "The Asian 'Noodle Bowl': Is it Serious for Business," ADBI Working Paper Series, 2009.

[v] No explicit level of UR was provided by the authors.

[vi] See T. Katsuhide and U. Shujiro, "On the Use of FTAs by Japanese Firms," RIETI Discussion Paper Series 08-E-002, 2008.

[vii] See P. Athukorala and A. Kohpaiboon, "Australia–Thailand trade: Has the FTA made a difference?," Working Paper 2011/12, 2011.

[viii] See K. Hayakawa, H. Kim, and H. Lee, "Determinants on utilization of the Korea–ASEAN," *World Trade Review*, vol. 13, no. 3 (2014), 499–515.

[ix] Value of the UR is based on the calculation of the author for 2011.

[x] See P. Brenton and M. Manchin, "Making EU trade agreements work: The role of rules of origin," *The World Economy*, vol. 26, no. 5 (2003), 755–769.

[xi] See J. Francois, B. Hoekman, and M. Manchin, "Preference erosion and multilateral trade liberalization," *World Bank Economic Review*, vol. 20, no. 2 (2006), 197–216.

[xii] No explicit level of UR was provided by the authors.

[xiii] See J. Bureau, R. Chakir, and J. Gallezot, "The utilisation of trade preferences for developing countries in the agri-food sector," *Journal of Agricultural Economics*, vol. 58, no. 2 (2007), 175–198.

[xiv] See A. Keck and A. Lendle, "New evidence on preference utilization," WTO Staff Working Paper ERSD-2012-12, 2012.

[xv] See M. Donner Abreu, "Preferential rules of origin in regional trade agreements," WTO Staff Working Paper ERSD-2013-05, 2013.

[xvi] See S. Hakobyan, "Accounting for underutilization of trade preference programs: The US generalized system of preferences," *Canadian Journal of Economics*, vol. 48, no. 2 (2015), 408–436.

[xvii] See C. Kuo-I and K. Hayakawa, "Selection and utilization of the early harvest list: Evidence from the free trade agreement between China and Taiwan," IDE Discussion Paper 365, 2012.

[xviii] The authors define the UR as the number of issued certificates of origin (CO) divided by exports.

TABLE 4.3 *Implications of rules of origin on international trade flows and instruments*

Author(s)	Preference scheme	Implications of RoO
Vermulst (1992)[i]	Preferential/ Nonpreferential	Different methodological discrimination of RoO restricts the scope of eligible preferences under FTAs.
LaNasa III (1993)[ii]	NAFTA	RoO are often formulated to protect domestic industry and to promote relocation of manufacturing processes to within the trade area.
Krueger (1993)[iii]	Preferential	RoO restrict efficient sourcing for inputs of production. This extends protection for exporters to protection for producers from the competition with producers who use cheaper third countries' inputs.
Lloyd (1993)[iv]	Preferential	All-or-nothing approach in determining the origin under FTAs can cause protective and trade diverting influences in the highly globalized production.
Krishna & Krueger (1995)[v]	Preferential	Differences in percentage rules of RoO can exert a significant influence on welfare and FDI.
LaNasa III (1996)[vi]	Preferential/ Nonpreferential	Overly restrictive RoO can engender uncertainty on firms' purchasing, investment, and manufacturing strategies.
Falvey & Reed (1998)[vii]	Preferential	RoO take the form of domestic content rules and influence on production.
Bhagwati et al. (1998)[viii]	Preferential	Arbitrary specification of content rules, and the complexity in computing the origin, causes a myriad of problems in globalized production.
Estevadeordal & Suominen (2005)[ix]	Preferential	Restrictive RoO in final goods encourage trade in intermediate goods.
Augier et al. (2005)[x]	Preferential	The negative effect of cumulation of restrictive rules of origin is greater on intermediate than manufacturing trade.

(*continued*)

TABLE 4.3 (*continued*)

Author(s)	Preference scheme	Implications of RoO
National Board of Trade Sweden (2012)	Preferential	Rules of origin act as a barrier to trade by having negative effects on both utilization of preferences and trade flows.

[i] See E. Vermulst, "Rules of origin as commercial policy instruments – revisited," *Journal of World Trade*, vol. 26, no. 6 (1992), 61, 62.
[ii] See J. LaNasa III, "Rules of origin under the North American Free-Trade Agreement: A substantial transformation into objectively transparent protectionism," *Harvard International Law Journal*, vol. 34 (1993), 381.
[iii] See A. O. Krueger, "Free trade agreements as protectionist devices: Rules of origin," NBER Working Papers, No. 4352, 1993.
[iv] See P. Lloyd, "A tariff substitute for rules of origin in free trade areas," *The World Economy*, vol. 16, no. 6 (1993), 699–712.
[v] See K. Krishna and A. O. Krueger, "Implementing free trade areas: Rules of origin and hidden protection," NBER Working Paper, No. 4983, 1995.
[vi] See J. LaNasa III, "Rules of origin and the Uruguay round's effectiveness in harmonizing and regulating them," *American Journal of International Law*, vol. 90 (1996), 625.
[vii] See R. Falvey and G. Reed, "Economic effects of rules of origin," *Review of World Economics*, vol. 134 (1998), 209–229.
[viii] See J. Bhagwati, D. Greenaway, and A. Panagariya, "Trading preferentially: Theory and policy," *The Economic Journal*, vol. 108, no. 449 (1998), 1128–1148.
[ix] See A. Estevadeordal and K. Suominen, "Rules of origin in preferential trading arrangements: Is all well with the spaghetti bowl in the Americas?," *Economía Journal*, vol. 5, no. 2 (2005), 63–103.
[x] See P. Augier, M. Gasiorek, and C. Lai Tong, "The impact of rules of origin on trade flows," *Economic Policy*, vol. 20, no. 43 (2005), 567–624.

TABLE 4.4 *Restrictiveness of RoO implications in free-trade agreements*

Author(s)	Measures applied	Restrictiveness index (RI)	Method used	Findings
Ju & Krishna (1998)[i]	Impact of restrictive RoO on the production costs and trade flows	RoO is considered as an absolute deterrent of transshipment of intermediate good and assumes a value of α.[ii]	Theoretical model approach of capturing the effect of restrictive RoO.	Restrictive RoO undermine trade of both the finished goods and the inputs.
Estevadeordal (2000)[iii]	Differences in the restrictiveness of	Steps: (1) codify each rule or set of rules according to different criteria (2) construct the	It constructs a categorical variable ranging from 1 (least restrictive) to 7	The greater the preferential margin, the stricter the requirements

TABLE 4.4 (*continued*)

Author(s)	Measures applied	Restrictiveness index (RI)	Method used	Findings
	RoO under NAFTA	categorical variable RoO (y^*) assigning to each six-digit HS product category an ordered numerical value according to the following observation rule: $y = 1$ if $y^* \leq$ CTH (Item) $y = 2$ if CTH (Item) $< y^* \leq$ CTH (Subheading) $y = 3$ if CTH (Subheading) $< y^* \leq$ CTH (Subheading) & RVC $y = 4$ if CTH (Subheading) & RVC $< y^* \leq$ CTH (Heading) $y = 5$ if CTH (Heading) $< y^* \leq$ CTH (Heading) & RVC $y = 6$ if CTH (Heading) & RVC $< y^* \leq$ CTH (Section) $y = 7$ if CTH (Section) $< y^* \leq$ CTH (Section) & TECH	(most restrictive) on the basis of NAFTA RoO. The index can be conceptualized as an indicator of how demanding a giving RoO is for an exporter.	imposed by RoO.
Estevadeordal & Suominen (2005)[iv]	The restrictiveness of RoO in FTAs in Europe, the Americas, and Asia Pacific	Three modifications to the observation rule in the case of RoO for which no CTC is specified in order to allow for coding of such RoO in the Pan-Euro, SADC, and other regimes in which not all RoO feature a CTC component. (1) the level of restrictiveness of RoO	It discusses both Estevadeordal (2000) and Harris (2007), and reports results using the two measures.	The restrictiveness of PANEURO RoO is less than the NAFTA rules, and FTAs in Asia Pacific have the most generous RoO.

(*continued*)

TABLE 4.4 (*continued*)

Author(s)	Measures applied	Restrictiveness index (RI)	Method used	Findings
		based on the import content rule is equated to that imposed by a change in heading requirement (value 4) if the content requirement allows non-originating inputs up to a value of 50% of the ex-works price of the product. Value 5 is assigned when the share of permitted non-originating inputs is below 50%, as well as when the import content criterion is combined with a technical requirement. (2) RoO featuring an exception alone are assigned a value of 1 if the exception concerns a heading or a number of headings and a value of 2 if the exception concerns a chapter or a number of chapters. (3) RoO based on the wholly obtained criterion are assigned a value of 7.		
Estevadeordal et al. (2007)[v]	The restrictiveness of RoO in FTAs in Europe, the Americas, and Asia Pacific	Combined the RI employed by Estevadeordal (2000) Harris (2007).	Combines the two RI measures and calculated the restrictiveness of RoO at six-digit level in selected RTAs.	The restrictiveness within regimes and divergence across regimes increase transaction costs and uncertainty in international trade.

TABLE 4.4 (*continued*)

Author(s)	Measures applied	Restrictiveness index (RI)	Method used	Findings
Harris (2007)[vi]	Determinants of PSRO in five Western Hemisphere FTAs (NAFTA, CHLUSA, MEXBOL, MEXCRI, CANCRI).	Change of classification points: ΔI +2 ΔS +4 ΔH +6 ΔC +8 where ΔI represents a required change at the HS item level; ΔS represents a required change at the HS subheading level; ΔH represents a required change at the HS heading level; ΔC represents a required change at the HS chapter level. Exception points: exI +4 > exI and ≤ exS +5 > exS and ≤ exH +6 > exH and ≤ exC +7 > exC +8 where exI represents an exception at the HS item level; exS represents an exception at the HS subheading level; exH represents an exception at the HS heading level; exC represents an exception at the HS chapter level.	Addition points: addI −5 > addI and ≤ addS −6 > addS and ≤ addH −7 > addH and < addC −8 add without CC +8 where addI represents an addition at the HS item level; addS represents an addition at the HS subheading level; addH represents an addition at the HS heading level; addC represents an addition at the HS chapter level; add without CC represents an addition without a requirement for a change in classification Value test points: > 0% and ≤ 40% +5 > 40% and ≤ 50% +6 > 50% and ≤ 60% +7 > 60% +8 Net cost +1 where the percentages	This measure would capture the underlying technological constraints and would not be distorted by considerations of a classification system not designed for administration of rules of origin (the HS).

(*continued*)

TABLE 4.4 (*continued*)

Author(s)	Measures applied	Restrictiveness index (RI)	Method used	Findings
			represent the value content requirement imposed by the rule Technical requirement points: +4 Alternative rule points: −3 Wholly obtained points: +16	
Cadot et al. (2008)[vii]	Impact of European rules of origin on the prospects for integration of West Africa in world trade	Authors used a modified version of Estevadeordal (2000) RI with an extension to accommodate EU single list.[viii]	Additional modifications on Estevadeordal (2000): the authors codify "additional requirements": exceptions and allowances to the basic CTC criteria.[ix]	EU RoO are complex, restrictive, and discriminatory, hampering this integration of African producers in world trade.
Kelleher (2013)[x]	Impact of restrictive RoO on intra-PTA trade across 90 country-pairs	Weights the Harris (2007) index by three regime wide provisions: the economic size of the Cumulation Zone (the share of the zone's combined GDPs in world GDP), the *de minimis* allowance, and certification type.	Authors used a Regime Weighted Harris Index (RWHI) in an OLS and IV regression estimation to determine the impact of RoO on intra-PTA trade flows.	Negative trade effect of RoO measured by a RWHI.
Cadot & Ing (2017)[xi]	ASEAN's PSRO on regional trade	Dummy variables for different RoO categories	This study uses a gravity models where RoO dummies were added to capture the	ASEAN's RoOs have a relatively simple and transparent structure; the

TABLE 4.4 (*continued*)

Author(s)	Measures applied	Restrictiveness index (RI)	Method used	Findings
			trade effects of ASEAN RoO.	average tariff equivalent of RoO is 3.4% (2.09% using trade-weighting).
Conconi & Garcia-Santana (2018)	Impact of NAFTA RoO in sourcing decisions of intermediate inputs	The authors construct different treatment variables to capture the effect of RoO by considering final goods with RoO restrictions in the sourcing of inputs, excluding rules associated with final goods with zero preference margin and excluding flexible rules.	The authors map the input–output linkages embedded in NAFTA RoO and employ a triple-difference regression at the product- and country-level between 1991–2003	NAFTA RoO reduce the growth of Mexican imports of intermediates from third countries relative to NAFTA partners.

[i] See J. Ju and K. Krishna, "Firm behavior and market access in a free trade area with rules of origin," NBER Working Papers 6857, 1998.

[ii] RoO is assumed to be one of the parameters of the theoretical model. Hence, it is used as a tool to see the effects of the parameter to the behavior of the countries. Therefore, RI does not directly apply to the set-up.

[iii] See A. Estevadeordal, "Negotiating preferential market access: The case of NAFTA," *Journal of Free Trade*, vol. 34, no. 1 (2000), 141–166.

[iv] See A. Estevadeordal and K. Suominen, "Rules of origin: A world map and trade effects," Paper prepared for the Seventh Annual Conference on Global Economic Analysis: Trade, Poverty, and the Environment, 2004.

[v] See A. Estevadeordal, J. Harris, and K. Suominen, "Multilateralizing preferential rules of origin around the world," INT Working Paper 08, 2007.

[vi] See J. T. Harris, "Measurement and determination of rules of origin in preferential trade agreements (PTA's)," Dissertation submitted to the Faculty of the Graduate School of the University of Maryland, College Park, in partial fulfillment of the requirements for the degree of Doctor of Philosophy, 2007.

[vii] See O. Cadot, C. Carrere, J. de Melo, and B. Tumurchudur, "Product-specific rules of origin in EU and US preferential trading arrangements: An assessment," HAL Id: halshs-00564704, 2006.

[viii] Authors measure restrictiveness as follows: The wholly obtained criterion is given a low restrictiveness. The lowest restrictiveness value is assigned when exporters have a choice among alternative requirements to meet origin.

[ix] This modified index would be similar to the concept of effective protection, may then be used as a substitute for a vector of dummy variables in an equation seeking to analyze the correlates of utilization of preferences.

[x] See S. Kelleher, "Playing by the rules? The development of an amended index to measure the impact of rules of origin on intra-PTA trade flows," UCD Centre for Economic Research Working Paper Series; WP12/22, 2013.

[xi] See L. Ing, S. F. de Cordoba, and O. Cadot, "How restrictive are ASEAN's rules of origins?," Working Papers PB-2017-04, Economic Research Institute for ASEAN and East Asia (ERIA), 2014.

TABLE 4.5 *Studies on administrative aspects of rules of origin*

Author(s)	Key administrative procedures	Issues	Methodology	Findings
Izam (2003)[i]	Certificate of origin Origin verification	Changes on the list of authorized signatures are not updated in a timely manner Unclear procedures for dispute settlement, effectiveness of verification visits, and administrative costs	Descriptive account of administrative challenges both in private and public sectors	In order for a simple and clear RoO to work well, a sophisticated and efficient negotiating and administrative system will be needed.
Anson et al. (2003)[ii]	General administrative procedure	Administrative and bookkeeping costs	Compliance costs estimated based on the utilization ratio, the preference margin, and the RI of Estevadeordal (2000)	Compliance costs of 6% of trade amount, which is higher than average preferential margin of 4%.
Brenton & Imagawa (2005)[iii]	Certificate of origin Origin verification	Compliance costs Administration costs in terms of labor requirements	N/A	Administrative costs vary across agreements and falls heavily on MSMEs.
Estevadeordal et al. (2007)[iv]	Certificate of Origin	Administration and compliance costs	Restrictiveness of RoO	RoO are restrictive and divergent across regimes and can be improved through proper policies.
Manchin & Pelkmans-Balaoing (2007)	Origin verification	Compliance costs and stringency of verification procedures	Restrictiveness of RoO	Preferences having a preference margin of at least 25% show positive effects on intraregional imports.
Harris & Staples (2009)[v]	Certificate of origin and	Uncertainty in the administration of RoO as there is an	Descriptive examples of the cost of complying	A variety of requirements on international trade

TABLE 4.5 (*continued*)

Author(s)	Key administrative procedures	Issues	Methodology	Findings
	origin verification	unclear division of rights and obligations among producers and the importers on compliance with RoO	with administrative aspects of RoO	with RoO rely fundamentally on management of information regarding materials and suppliers used in the production of internationally traded goods.

Note: N/A = Not Applicable

[i] See M. Izam, "Rules of origin and trade facilitation in preferential trade agreements in Latin America," Serie comercio internacional No. 31, CEPAL, 2003.

[ii] See J. Anson, O. Cadot, A. Estevadeordal, J. Melo, A. Suwa Eisenmann, and B. Tumurchudur, "Assessing the costs of rules of origin in North–South PTAs with an application to NAFTA," Centre for Economic Policy Research Discussion Paper 2476, 2003.

[iii] See P. Brenton and H. Imagawa, "Rules of origin, trade, and customs," in L. de Wulf and J. B. Sokol (eds.), *Customs Modernization Handbook*, World Bank, 2005, 183–214.

[iv] See A. Estevadeordal, J. Harris, and K. Suominen, "Multilateralizing preferential rules of origin around the world," INT Working Paper 08, 2007.

[v] See J. Harris and B. R. Staples, "Origin and beyond: Trade facilitation disaster or trade facility opportunity?," IDB Working Paper Series #IDB-WP-147, 2009.

TABLE 4.6 *Compliance costs of rules of origin affecting the use of free-trade agreements*

Author	Measures applied	Findings
Carrère & De Melo (2004)[i]	Compliance costs estimated by nonparametric model	A preference margin of approximately 10% is required to compensate the compliance costs of the Mexican exporters.
Cadot et al. (2005)[ii]	The impact of compliance costs of RoO on the border price of textile and apparel products	The border price of Mexican products has risen 12% to compensate the compliance costs of RoO under NAFTA.
Cadot (2006)	Compliance costs	The approximate compliance costs of PANEURO's RoO are 8.0% and that of NAFTA is 6.8% of trade amount.

[i] See C. Carrère and J. de Melo, "Are different rules of origin equally costly? Estimates from NAFTA Commission of the European Communities," CEPR Discussion Papers 4437, 2004.

[ii] See O. Cadot, C. Carrère, J. de Melo, and A. Portugal-Perez, "Market access and welfare under free trade agreements: Textiles under NAFTA," *The World Bank Economic Review*, vol. 19, no. 3, (2005), 379–405.

rules of origin provide additional protection to regional producers of intermediate goods to the apparent detriment of downstream or final goods producers. This apparent conflict could be explained because of the specific production relations that exist between component producers and users. If the linkages between the different parts of the production chain are very tight, it may be difficult for a foreign final good producer to locate components within the region and remain competitive. In this way, rules of origin "export protection" both for the intermediate and final goods producers. Moreover, outside producers of intermediate goods hurt by restrictive rules of origin may have an incentive to move production facilities into the lower-cost country within the region, even though it is not the most cost-effective producer worldwide. This situation could potentially distort efficient investment decisions and hinder the liberalizing effects of a free-trade agreement.

In particular, Krueger was able to pinpoint in economic terms what was at that time the rule of the game when negotiators and lawyers were involved in NAFTA. She provided an economic reading and logic by transposing a partial equilibrium model theory to the ongoing logic of the negotiations.

At that time, the US negotiators argued, especially in case of import-sensitive sectors like textile and clothing and automotive, for restrictive rules of origin. Krueger pointed out that restrictive rules of origin in free-trade agreements can constitute a source of bias toward economic inefficiency. Twenty-five years later the same considerations are still valid, taking into account the logic of the negotiations of USMCA under the Trump administration on automotive products.[12]

A country like Mexico, with a MFN zero tariff for intermediates, could find its producers, post-free-trade agreement, diverting their imports from low-cost third-country sources to the United States in order to be eligible for NAFTA preferential treatment even if, as pointed out earlier, there are no Mexican tariffs on the imports of their intermediate products.

Krueger further reasoned that another effect could be generated by restrictive rules of origin: a shift by Mexican producers from low-cost world suppliers to a high-cost US supplier in order to qualify under rules of origin and gain preferential access to the US market. This argument was most recently reiterated by Conconi.[13]

Another important point was the significant role that rules of origin may play in the political economy game in order to win support for a free-trade agreement. A later finding on the effects of NAFTA rules of origin was pointed out by Krishna.[14]

[12] See Center of Automotive Research, "Review of current NAFTA proposals and potential impacts on the North American automotive industry," 2018.

[13] See P. Conconi, L. Puccio, M. Garcia-Santana, and R. Venturini, "From final goods to inputs: The protectionist effect of rules of origin," *American Economic Review*, vol. 108, no. 8 (2018), 2335–2365.

[14] See K. Krishna, "Understanding rules of origin," NBER Working Paper 11150, 2005 (paper prepared for the workshop on Rules of Origin in Regional Trade Agreements: Conceptual and Empirical Approaches, 2004).

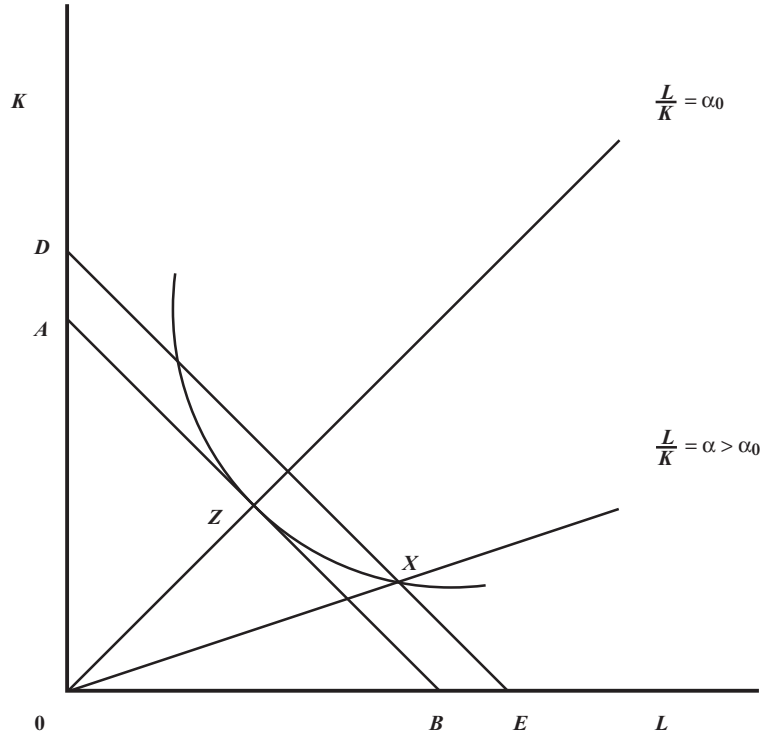


FIGURE 4.2 Physical content of rules of origin and costs

Rules of origin can have the effect of insulating an industry from the possible trade liberalization of a free-trade agreement. It follows that rules of origin may be modeled according to the prevailing political economy to make a free-trade agreement more or less acceptable to a certain domestic constituency. The effects of rules of origin on costs of production have been depicted by Krishna in Figure 4.2.

In Figure 4.2,[15] L and K are respectively free-trade agreement inputs (L) and imported inputs (K). To manufacture a finished product, a mixture of L and K has to be used. In the absence of a binding rule of origin, a producer may freely utilize inputs in L and K according to the best available sourcing to manufacture the finished product. This is represented by the point label representing the best available mix in the absence of binding rules of origin. The height of the line AB represents the lowest unit cost attainable. Binding rules of origin will oblige the producer to change the optimum mix of L and K inputs and would remove Z from the feasible set

Suppose the rules of origin require the use of more inputs originating in the free-trade agreement as represented in the ray $\alpha > \alpha 0$. In this case, the input mix at X represents the minimal unit costs and the line DE represents unit costs if rules of

[15] Excerpted from Krishna, ibid.

origin are met. It is easy to note that as line DE is higher than line AB, unit costs are increased and will continue to be so as more L inputs are demanded by the binding rules of origin in the product mix.

4.1.2 *Most Recent Studies on Economics and Rules of Origin: The Elaboration of an Index of Restrictiveness*

After Krueger and Krishna, Estevadeordal (1999[16] and 2000[17]) advanced a series of elaborated studies centered on the NAFTA model of rules of origin, and their possible impact and evolution in the framework of the FTAs of the Americas.[18] In particular, his studies elaborated a methodology for the measuring the restrictiveness of rules of origin in relation to a tariff phase-out schedule negotiated under NAFTA.[19] Similar assessments were later conducted in the framework of the pan-European rules to prepare Mercosur countries to eventual negotiations of an interregional FTA agreement with the EU.[20]

Ultimately, the index of restrictiveness elaborated by Estevadeordal has been often used, almost as a standard, in a series of econometric papers using regression analysis. This index of restrictiveness was used in conjunction with the degree or speed of preferential tariff liberalization. This degree was measured by the number of years to achieve zero intra-agreement tariffs. This latter variable was provided by the phase-out schedule of the NAFTA agreement. According to the structure of the liberalization program, each eight-digit Harmonized System (HS) product line (or in some cases at ten digits) is associated with a specific phase-out program. This first measurement was designed to identify those tariff lines that were back-loaded to match them with the respective rules of origin.

The index of the level of restrictiveness of the NAFTA rules of origin was modeled on the characteristics of NAFTA rules. According to Estevadeordal, rules of origin in the NAFTA agreement were negotiated at the product level (mostly at the six-digit tariff line level) and were defined using three methods: (1) a tariff shift, (2) an RVC, or (3) a Technical Requirement (TECH). The first criterion can be specified requiring a change at chapter level (two-digit HS), heading level (four-digit HS), subheading level (six-digit HS), or item level (higher than six-digit HS), with the possibility of including specific exceptions. The four methods could also be combined under the same rules of origin; for example, a change of subheading plus a specific RVC. Moreover, there are

[16] See A. Estevadeordal, "Negotiating preferential market access: The case of NAFTA," INTAL Working Paper 3, 1999.

[17] See A. Estevadeordal, "Negotiating preferential market access: The case of NAFTA," *Journal of Free Trade*, vol. 34, no. 1 (2000), 141–166.

[18] A summary analysis of the literature is provided in Tables 4.4–4.6. Such summary is by no means exhaustive and the author apologizes for any omission.

[19] See "Negotiating preferential market access: The case of NAFTA" (fn. 16 above).

[20] K. Suominen and A. Estevadeordal, "Rules of origin in FTAs in Europe and the Americas: Issues and implications for EU-Mercosur Interregional Association agreement," INTAL-ITD Working Paper 15, January 2004.

many cases where NAFTA defines alternative rules of origin for the same product. To obtain the restrictiveness index, Estevadeordal codified each rule or set of rules according to different criteria.

Then, a qualitatively ordered index was constructed under the following assumptions elaborated by Estevadeordal: First, a change of tariff classification (CTC) at chapter level tends to be more stringent than at the heading level, a change at the heading level more than at the subheading level, and so on. Second, a regional content requirement adds more restrictiveness to a given rule, as does the technical requirement. For each pair (or sometimes trio) of alternative rules being applied to the same product, we selected the one with the higher restrictiveness index.

Categorical variable rules of origin have been devised accordingly. The index is structured on the basis of a numerical order where number 1 is the more lenient rule and number 7 the more restrictive. Level 1 occurs when the rule of origin requires a change of tariff item or less. Level 2 is when the rule of origin requires more than a change of tariff item but equal or less than a change of tariff subheading (CTSH). Level 3 is when the rule of origin requires more than a change of subheading but equal or less than CTSH and RVC. Level 4 occurs when the rule of origin requires more than a CTSH and RVC but equal to or less than change of tariff heading (CTH). Level 5 occurs when the rule of origin requires more than a change of tariff level but equal or less than CTH and RVC. Level 6 occurs when the rule of origin requires more than a change of tariff level and an RVC but equal to or less than a change of chapter (CC). Finally, level 7 occurs when the rule of origin requires more than a CC but less than or equal to a CC or technical requirement.

The main limitation of this index is that the starting assumption is based on premises that do not match the reality of the structure of the HS as it is used in the context of drafting RoO requirements. The second limitation is that the restrictiveness of rules of origin has to be measured not just against the form used in drafting of rules but against the industrial processes required to comply with rules of origin and the corresponding capacity of the countries that are parties to the trade agreement.[21]

As is widely known, the HS has been conceived for tariff classification and not for drafting rules of origin. It follows that to assume that a change of tariff item (in this case at eight-digit level) is more lenient than a CTSH is rather arbitrary. As witnessed in the negotiations of nonpreferential rules of origin, there are entire chapters of the

[21] See Chapters 5 and 6 of this book for an extensive discussion on lessons learned on drafting rules of origin in free-trade agreements in Africa, Asia, and Latin America. The free-trade agreements in these regions tended to mirror the RoO models of EU and United States without realizing the different industrial context where the rules of origin are set to operate. The availability of upstream intermediate material and components in the region where they are designed to operate should be at the core of the rationale for drafting commercially viable rules of origin. However, most of the time rules of origin in developing regions are negotiated and drafted by government officials responding to rhetoric and/or political economy considerations rather than being based on solid evidence provided by the private sector and research.

HS where a CTSH is extremely restrictive. Such is the case of the chemical products where a change of subheading may not reflect an important chemical reaction.

It is quite difficult, if not impossible, to classify the level of restrictiveness of rules of origin using the classification made by Estevadeordal considered earlier. The following examples illustrate these difficulties. Let us assume classification of the level of restrictiveness of the rules in the following section excerpted from NAFTA using Estevadeordal index:

Rule 1 "A change to heading 6205.90 from any other chapter, except from heading Nos. 51.06 through 51.13, 52.04 through 52.12 . . . provided that the good is both cut and sewn or otherwise assembled in the territory of one or more of the NAFTA parties."

Rule 2 "A change to heading 62.06 through 62.10 from any other chapter, except from headings Nos. 51.06 through 51.13. . . provided that the good is both cut and sewn or otherwise assembled in the territory of one or more of the NAFTA countries."

Rule 3 "A change to heading 61.05 through 61.06 from any other chapter, except from headings Nos. 51.06 through 51.13, 52.04 through 52.12 . . . provided that the good is both cut (or knit to shape) and sewn or otherwise assembled in the territory of one or more of the NAFTA parties."

Rule 4 "A change to heading 63.02 from any other chapter, except from headings Nos. 51.06 through 51.13, 52.04 through 52.12, 53.07 through 53.08 or 53.10 through 53.11, Chapters 54 through 55, or heading Nos. 58.01 through 58.02 or 60.01 through 60.02 provided that the good is both cut (or knit to shape) and sewn or otherwise assembled in the territory of one or more of the NAFTA parties."

Since none of these rules includes an RVC, the choice in the level of restrictiveness according to the Estevadeordal index is between levels 1 or 2. Since the rules are requiring more than a change of tariff item one may classify all the rules under level 2 or, if one considers that the requirements of the cutting and sewing are technical requirements, under level 7. However, a closer look at rules 1–4 above indicates that they are very different in terms of restrictiveness.

Rule 1 in fact depicts a single transformation requirement from woven silk to a silk shirt; Rule 2 requires a double transformation: (1) the processing of the fabric and (2) the production of the apparel.

Rules 3 requires a triple transformation or yarn forward: from the manufacturing of the yarn to men's shorts. Rules 4 provides for an extremely stringent rule requiring a quadruple transformation.

This example shows that, even if the drafting style of rules of origin or their form – in this case "A change to heading [XX] from any other chapter, except from headings [XX]" – might be extremely similar, falling under a certain level of restrictiveness according to Estevadeordal's description, the substantive requirements and the corresponding level of restrictiveness may vary considerably.

Estevadeordal and Suominen[22] introduced a number of modifications to the initial observation rules outlined above. These changes were made in context of a worldwide analysis and comparison of different origin systems including the Pan-European Rules of Origin and rules of origin negotiated under South–South agreements.

The modifications were as follows:

- A value content (VC) rule (up to 50 percent) is equated to a CTH rule, both being assigned an index value of four.
- When a VC requirement allows more than 50 percent non-originating content, or when it is combined with a TECH, the resulting criterion (or combination of criteria) is assigned a value of five.
- An exception (EXC) requirement alone is assigned a value of one if the exception concerns a heading or number of headings, and a value of two if the exception concerns a chapter or number of chapters.
- A wholly obtained requirement is assigned a value of seven.

As mentioned above, it is difficult to assess the criteria and benchmark for the assumptions made by Estevadeordal in assigning a certain level of restrictiveness and equivalence between different methodologies of drafting rules of origin. As showed in the examples above, apparently similar drafting techniques may result in wide differences of the level of restrictiveness among rules of origin.

Nonetheless, the Estevadeordal and Suominen index was, according to scholars and economists, instrumental in making the empirical analysis of rules of origin possible. Such an index has been used extensively in carrying out extensive analysis on NAFTA rules of origin[23] using regressions.

After these modifications to the restrictiveness index, other analysts further elaborated it.

Cadot and de Melo – in an analysis[24] carried out in the context of the negotiations of Economic Partnership Agreements (EPAs) between African, Caribbean, and Pacific (ACP) countries and the EU – introduced further modifications. It was observed that the index did not take allowances into consideration, although these can substantially alter the restrictiveness of rules of origin.

Second, it treated "wholly obtained" criteria as the strictest form of rules of origin. In this respect it was considered that the classification may be misleading as wholly obtained criteria essentially apply to agricultural products where they are considered rarely problematic to comply with.

[22] See A. Estevadeordal and K. Suominen, "Rules of origin: A world map and trade effects," paper prepared for the Seventh Annual Conference on Global Economic Analysis: Trade, Poverty, and the Environment, 2004.

[23] See for instance O. Cadot, *Assessing the Effect of NAFTA Rules of Origin*, Mimeo, 2002.

[24] O. Cadot, J. De Melo, and B. Tumurchudur, *The Rules of Origin Facing ESA Trade: Analysis and Proposals for EPA Negotiations*, Mimeo, 2005.

The merit of the modifications of Cadot and de Melo to the original index is that they tried to codify what they define as "additional requirements": exceptions and allowances to the basic change of tariff classification criteria.

The Cadot and de Melo index is not substantially different from the index developed by Estevadeordal to capture the effects of the PSRO under NAFTA. However, the authors introduced significant variations since many of the EU rules of origin are defined at the HS four-digit level while the NAFTA rules of origin for industrial products are generally defined at six-digit level. In order to take into account these differences, an index at the HS six-digit level that corresponds to the 5,485 lines was worked out. In spite of the author's remarks, it is not clear how the correspondence between the EU rules of origin and the HS six-digit index has been carried out. In fact, there are significant variations in the architecture of the NAFTA and EU rules that may affect the accuracy of such transposition from a six-digit-based PSRO like NAFTA to a chapter or heading system of PSRO used by the EU.

This correspondence could have important implications for the results of the analysis, given the structure of the EU rules of origin as contained in the list of PSRO. Examples of such implications are given in the following paragraphs.

As shown in Table 4.7, in the majority of cases the EU rules provide for a chapter rule containing the PSRO for the majority of products classified in a HS chapter. This rule is commonly referred as the "chapter rule." In Chapter 62, the chapter rule of origin is manufacture from yarn. In some specific instances the EU rules singled out some headings out of a chapter rule by marking them by "ex" and some specific description. In the EU explanatory notes such "ex" means that the PSRO in column

TABLE 4.7 *Garments PSRO mainly involving products classified in ex-heading and basket-rule headings*

HS heading no.	Description of product	Working or processing carried out on non-originating materials that confers originating status	
(1)	(2)	(3) or	(4)
Ex-Chapter 62	Articles of apparel and clothing accessories, not knitted or crocheted except for:	Manufacture from yarn	
Ex-6202, ex-6204, ex-6206, ex-6209 and ex-6211	Women's, girls' and babies' clothing and clothing accessories for babies, embroidered	Manufacture from yarn	Manufacture from unembroidered fabric provided that the value of the unembroidered fabric used does not exceed 40% of the ex-works price of the product

3 or 4, distinct from the chapter rule, only apply to part of that heading as described in column 2.[25]

Since the degrees of stringency vary considerably from chapter-wide rules of origin to ex-rules of origin (as in the example above) the EU describes the rules as mainly HS two-digit chapter level, four-digit heading level, or "ex" four-digit level (heading level)

In spite of these characteristics of the EU rules of origin, according to Cadot and de Melo, the most commonly used requirement for satisfying the "substantial transformation" in the case of EU is the CTC rule whereby non-originating inputs must be classified in a different chapter (Change of Chapter – ΔC), a change of heading (Change of Heading – ΔH), subheading (Change of Subheading – ΔSH), and item (Change of Item – ΔI), followed by the product.

In line with Estevadeordal, they assumed that the change of chapter requirement is more restrictive than the requirement of a change of heading (ΔH) which in turn is more restrictive than the change of subheading (ΔSH). Therefore, as far as the CTC is concerned, they assume the following descending order of restrictiveness:

$$\Delta C > \Delta H > \Delta SH > \Delta I$$

The merit in the Cadot and de Melo elaboration of the index is that they realized that the CTC is seldom used in its simple form and that several complications, such as exceptions to the simple CTC, may occur, as pointed out in the previous comments made regarding the Estevadeordal original index. While the recognition that the CTC is seldom used in its simple form could have further refined the index, some confusion has arisen between the concepts of negative determination of origin and of exceptions to the simple CTC.

According to Cadot and de Melo, "a positive test states the tariff classification of imported inputs that can be used in the production of the exported good (for example those in a different subheading). By contrast a negative test states the case when a change of tariff classification does not confer origin. A negative test is presumably more restrictive than a positive test."[26] This distinction, they argued, is not captured in their index.

In order to explain this assumption, Cadot and de Melo quoted two examples of negative tests:

[25] The marking as an "ex" is a common feature of the EU rules of origin that is often not understood, albeit it is clearly specified in the explanatory notes of the PSRO contained in free-trade agreements.

[26] This leaves aside the legal aspects of this assumption since, according to para. (3)(b) of Annex II of the Agreement on Rules of Origin (containing the Common Declaration on Preferential Rules of Origin), "their preferential rules of origin are based on a positive standard. Preferential rules of origin that state what does not confer preferential origin (negative standard) are permissible as part of a clarification of a positive standard or in individual cases where a positive determination of preferential origin is not necessary."

> In the case of NAFTA, to protect Mexican producers of tomato paste from Chilean producers (see Palmeter (1997)), ketchup (HS 210320) produced from imported tomatoes or from any chapter will confer origin except when produced from imported tomato paste (HS 200290). In the case of PANEURO, bread, biscuits, and pastry products (HS 1905) can be made from any imported products except those of chapter 11 (i.e. flour).

However, in the same paper they provide examples of what they consider exceptions:

> Exceptions (EXC). Another important aspect of ROO is the presence of exceptions to the CTC. For example, any non-originating inputs can be used for the production of soups and broths of heading 2104 except from heading 2002 to 2005 (prepared of preserved vegetables). Therefore exceptions reduce the universe of permitted non-originating materials, thereby making a given ROO requirement more restrictive.

It follows that the distinction between *negative test* and *exception* is at the least contradictory in the light of the wording of the NAFTA rules for tomato ketchup used above as an example of negative test: "2103.20. A change to tariff item No. 2103.20.10 from any other chapter, except from subheading no. 2002.90."

The wording *except from*, described as the *negative test* in the first observation and example, is classified as *an exception* in the second observation. The bottom line is that one may paraphrase the rule for tomato ketchup to make it sound like a negative test while in reality it is nothing other than a CTC with exception. Obviously, this kind of confusion may cast serious doubts as to the final results and the accuracy of the index.

Cadot and de Melo also included in their elaboration of the index the concept of *allowances* and *alternative composite rules* coupled with a series of assumptions on assigning values of restrictiveness to such additional concepts.

According to their definitions, allowances are as important as exceptions in evaluating the restrictiveness of a given RoO system: "For example, the ROO for builders' joinery and carpentry of wood under heading 4418 says that all non originating materials must not have a same heading; however cellular wood panels, shingles and shakes of same heading may be used. Thus, this allowance increases the amount of eligible inputs from non-member countries and makes a given ROO requirement less restrictive."

The case of *alternative composite rule* derives from the fact that in some instances the EU allows for a choice between alternative composite rules to determine the origin of a product.

Table 4.8 is the form of the Cadot and de Melo restrictiveness index.

As pointed out by the authors, there is little difference between the most recent form of their index and previous ones elaborated on the basis of the original Estevadeordal index. It follows that the previous comments over the accuracy of

TABLE 4.8 *Cadot and de Melo restrictiveness index*

	Criteria (y^*)			
Index value	1st	2nd	3rd	4th
	NC			
	EXC	Allow		
	ΔSH	Allow		
1	ΔWH	Allow		
	ΔSH			
	EXC	WH		
2	TECH			
		WH		
	ΔSH	TECH		
	TECH	Exc		
3	ΔH	Allow		
	ΔH	Exc	Allow	
		vc2		
	VC > 40 percent	Nonor		
4	WH	Exc	TECH	
		vc2		
	VC <= 40 percent	Nonor		
		WH		
		TECH		
		Exc		
		Exc	TECH	
		VC > 40 percent		
		VC > 40 percent	Nonor	
	ΔH	VC > 40 percent	Allow	
		TECH		
		WH		
		ΔSH		
5	VC > 40 percent	WH	Nonor	
		TECH		
		WH		
		ΔSH		
	VC <= 40 percent	WH	Nonor	
		VC <= 40 percent		
		VC <= 40 percent	WH	Allow
		VC <= 40 percent	Nonor	
		VC <= 40 percent	Allow	

(*continued*)

TABLE 4.8 (*continued*)

Index value	Criteria (y^*)			
	1st	2nd	3rd	4th
		VC > 40 percent	TECH	
		VC > 40 percent	TECH	Exc
	ΔH	WH	TECH	Exc
		TECH		
6	ΔC	Exc		
		VC <= 40 percent	TECH	
		VC <= 40 percent	TECH	Exc
	ΔH	Exc	TECH	VC
		Exc	TECH	
		Exc	TECH	WH
7	ΔC	Exc	TECH	VC

the Estevadeordal index are still valid. The main fine-tuning concerns the refinement of the value assignment to the wholly obtained product. In the latest index formulation, the wholly obtained category was assigned a level of stringency of 1 for products classified in sections 1–3 of the HS, while for products in sections 4–21 a value of 4 was assigned. A value of 6 or 7 is assigned if the wholly obtained category is associated in conjunction with value content or a CTC. Once again one may raise several doubts about the assumptions made in assigning such values.

At the same time, it is worth reporting the comparison made by Cadot and de Melo of the final results on the degree of stringency of the Pan-European Rules of Origin using the two different indexes.

As can be observed from the first line of Table 4.9, the main difference between the Cadot and de Melo index and the Estevadeordal index is the treatment of the wholly obtained criterion, which shows up in the new index's low value for the first three sections of Table 4.9.

The latest attempt at developing an index of restrictiveness has been carried out by Harris (see Table 4.10).[27]

The analysis of Harris has the undoubted merit of having been carried out reading the legal texts of rules of origin and a higher level of technical knowledge than his predecessors.

[27] J. T. Harris, "Measurement and determination of rules of origin in preferential trade agreements (PTA's)," Dissertation submitted to the Faculty of the Graduate School of the University of Maryland, College Park, in partial fulfillment of the requirements for the degree of Doctor of Philosophy, 2007.

TABLE 4.9 *Alternative indices of PSRO restrictiveness*

Section	New RoO index	ES's RoO index for PANEURO
1. Live animals	1.04	7.00
2. Vegetable products	2.23	6.60
3. Fats and Oils	3.44	4.70
4. Food, Bev. & Tobacco	3.95	5.00
5. Mineral products	3.26	3.50
6. Chemicals	3.29	3.90
7. Plastics	4.48	4.90
8. Leather goods	3.12	3.30
9. Wood products	2.74	2.90
10. Pulp & paper	4.67	4.40
11. Textile & apparel	5.75	6.10
12. Footwear	2.79	2.80
13. Stone & glass	4.03	3.70
14. Jewelry	4.13	3.70
15. Base metals	4.61	4.20
16. Machinery & elect. eq.	4.99	4.80
17. Transport equip.	4.86	4.70
18. Optics	4.98	5.00
19. Arms & ammunition	5.00	4.00
20. Miscellaneous	4.13	4.10
Total	**4.21**	**4.50**

Moreover, Harris acknowledges the intrinsic limitation of designing an index of restrictiveness based on a series of assumptions deriving first and foremost from the fact that the form of PSRO should not be used as (1) the unique or primary criterion to assess the restrictiveness or leniency of PSRO and that (2) the HS has not been designed to draft rules of origin. It follows that design of an index of restrictiveness based on an imprecise instrument such as the HS cumulates the assumptions made. As Harris himself admitted:

> The main problem in this method, and indeed in the project of ranking the restrictiveness of PSRO in general, is the unobservable production structure that exists parallel to the HS. If there is only one other subheading in which inputs could be classified, the exclusion of the rest of the tariff universe does not change the restrictiveness of the rule of origin. Conversely, if only one subheading is excluded, and it is that one relevant subheading, then a rule that was completely lax becomes completely restrictive.

TABLE 4.10 *Harris's restrictiveness points*

Change of classification points	
ΔI	+2
ΔS	+4
ΔH	+6
ΔC	+8
ΔS/ΔH w/AI	+2
Exception Points:	
exI	+4
> exI and ≤ exS	+5
> exS and ≤ exH	+6
> exH and ≤ exC	+7
> exC	+8
Addition Points:	
addI	−5
> addI and ≤ addS	−6
> addS and ≤ addH	−7
> addH and < addC	−8
add without CC	+8
Value Test Points:	+5
> 0% and ≤ 40%	
>40% and ≤ 50%	+6
> 50% and ≤ 60%	+7
> 60%	+8
Net Cost	+1
Technical Requirement Points	+4
Alternative Rule Points	−3

Thus, abstractly assigning a numerical value to a CC or a CSH based on the HS structure may at best identify an indication but it should also be weighted as discussed further in this chapter and in Chapter 6 of this book. In particular, measuring the restrictiveness of rules of origin using the HS should take into account the following parameters: (1) the nature of the products since, for instance, a CC has a different impact when we discuss different HS chapters (a change of CC required for meat products or Chapter 61 not knitted and crocheted garments[28] is

[28] A change of chapter requirement for meat of HS Chapter 2 means that the non-originating inputs have to come from HS Chapter 1, Live animals, i.e. slaughtering of not originating animals is an origin-conferring operation. In the case of a change of chapter for HS Chapter 61, this means that non-originating fabrics may be used to make garments by cutting and making-up the fabric. It is rather obvious that in terms of industrial process and restrictiveness of the requirement it is difficult to compare slaughtering of animals with cut-making and trim (CMT) operation to manufacture a shirt.

not comparable in terms of industrial processing) and (2) the industrial capacity and the availability of intermediate products available in the free-trade agreement where the rules of origin are expected to operate.

Harris also makes the assumption that: "This problem is overcome to the degree that the negotiators of the PSRO are meticulous in crafting rules that reveal their intent. This is generally the case, but there is still noise in the signal that is visible in the comparison of alternative rules."

While it may be argued that negotiators of NAFTA and later USMCA or sophisticated FTAs have paid the necessary attention to the drafting of the rules this may rather certainly not be the case for the rest of world as widely discussed with facts and examples in this book and especially in Chapter 6.

Suffice here to recall the example of alternative rules of origin in the Association of Southeast Asian Nations (ASEAN) Trade in Goods Agreement (ATIGA) where, as discussed in Chapter 6, the many PSRO are based on alternatives between a CTC and a default addition of an RVC of 40 percent. As a result, we have a PSRO for headphones classified in subheading 851830 as follows: "A regional value content of not less than 40 percent; or A change to subheading 8518.30 from any other subheading."

Given that the structure of the HS parts of headphones are classified in 851890 and the complete headphones in 851830, then the second part of the rules is much more liberal than the first part, since the assembly of parts of headphones into completed headphones generates the change the subheading required without having to resort to the 40 RVC alternative that is much more demanding to comply with. Thus, this example first shows that it cannot and should not be assumed that negotiators are meticulous; on the contrary, experience has shown that negotiators tend to bring back a signed agreement first and let those who have to implement it deal with the difficulties. Second, alternative rules of origin in PSRO may not be co-equal. And third, in the specific case of the index of Harris, the number to be assigned to the abovementioned rule should not be a + 4 for the change of tariff subheading +5 for the requirement of 40 percent minus 3 for the alternative rules, since + 5 points of the RVC requirement is purely hypothetical.

The work of Conconi[29] echoes and elaborates upon the initial reflections of Krishna and Krueger that elaborated the theoretical underpinnings of the trade diversion created by restrictive rules of origin. Conconi's main objective is to empirically and numerically demonstrate the well-known fact that restrictive rules of origin have an impact on the use of intermediate material using NAFTA and Mexico as an example. Conconi concludes, along with Krishna and Krueger, that restrictive rules of origin raise protection for third countries not members of FTAs.

[29] Conconi, Puccio, Garcia-Santana, and Venturini, "From final goods to inputs: The protectionist effect of rules of origin" (fn. 13 above).

A series of assumptions have been made in the work of Conconi, such as "the rules contained in NAFTA were largely inherited from those contained in the Canada–US Free Trade Agreement." As explained in Chapter 3 of this book, there is no comparison between the complexities of NAFTA rules with those of Canada–US FTA agreement (CUSFTA).

Additionally, the list of variables (below) used in Conconi raise some comments. The classification of NAFTA rules of origin as "flexible" when the producers may use an alternative value-added rule against "stringent" NAFTA rules of origin when such possibility is not available is a rather simplistic way of measuring the concept of flexible and stringent rules of origin when compared to the efforts made by the earlier literature mentioned above.

1) RoO Placebo$_i$: this variable is constructed as the difference between RoO^1_j and RoO^2_j and thus captures rules RoO_{ij} that are irrelevant (producers have no incentives to comply with them, because the preference margin on good i is zero).
2) RoO Flexible$_i$: this variable is constructed as the difference between RoO^2_j and RoO^3_j and thus captures rules RoO_{ij} that are relevant (the preference margin on good i is positive) but flexible (producers can obtain origin by complying with an alternative VA rule).
3) RoO Strict$_i$: this variable is equal to RoO^3_j and thus captures rules RoO_{ij} that are both relevant (the preference margin on good i is positive) and strict (there is no alternative VA rule).

As illustrated in Chapter 5 of the 2009 edition of this book and further developed as methodology in Chapter 6 of this edition, the restrictiveness and trade effects of rules of origin have to be read and understood using an input–output matrix. The main addition in the work of Conconi is to have introduced an input–output coefficient in her empirical research. However, as reckoned in her work, the use of such an approach is limited by the fact that the BEA[30] input–output used are: (1) designed for different purposes and (2) highly aggregated while the NAFTA rules of origin are exactly the opposite, highly disaggregated.

Overall, the important factor to consider is that the index elaborated by Estevadeordal and subsequently by Cadot and de Melo, and Harris has been used widely in a variety of econometric studies utilizing regressions. As indicated in the preceding paragraphs, several doubts could be raised on the results of these regressions that are based on an index of restrictiveness that does not reflect the technical meaning of the rules of origin.

Moreover, such index of restrictiveness is calculated on the form (that is, the drafting form) of such rules of origin, not on the substantive requirements (that is, the manufacturing operations) or, where applicable, the differences of the level of

[30] See K. J. Horowitz and M. A. Planting, *Concepts and Methods of the Input–Output Accounts*, Bureau of Economic Analysis, 2006.

percentages required to comply and is not matched with the industrial and manufacturing capacity of the countries in which the rules of origin are designed to operate.

In other words, calculating an index of restrictiveness based uniquely on the "form" of a given rules of origin – this being a CTC at HS heading, subheading, ad valorem, and or specific working or processing (or technical requirement) level – does not take into account that, as explained in Chapter 6, the form is delinked from the substance of the rule – that is, the substantive requirement that a producer need to comply with to obtain.

In addition, the index and the majority of the studies based on such index largely ignores the fact that rules of origin are not an independent variable since their restrictiveness is dependent on the availability of inputs among the parties to a free-trade agreement and their industrial capacity. Rather, it should be intuitive that a rule of origin requiring, independently from the form in which is drafted,[31] a three-stage process or yarn-forward rule using NAFTA jargon – (1) spinning cotton into yarn, (2) weaving yarn into fabric, and (3) cut, make, and trim the fabric into a complete garment for the woven clothing sector – could be considered a somewhat demanding requirement. However, such a rule could be, in the majority of cases, easily complied with in countries like China where there are abundant originating intermediate materials, such as yarn and fabrics and weaving mills. As discussed in Chapters 4 and 6, the same or even more lenient version rules of origin requiring a double-processing requirement could be extremely difficult, if not simply impossible, to comply with in the case of Cambodia and Bangladesh and the totality of sub-Saharan Africa, with the notable exclusion of Mauritius for some clothing products.

The wholly obtained requirement has also been rated as a stringent requirement. However, for countries that have an export structure concentrated in a handful of agricultural products such requirements may be rather easy to comply with. Recent research shows that the wholly obtained requirement may be stringent not as substantive requirements but because of direct consignment requirements attached to it.[32]

Change of HS chapter with exceptions is considered a rather demanding requirement. Assuming a rule of origin requiring for pasta products a change of chapter except from flours of Chapter 11 would have very different implications for countries that have milling capacities and those that do not have them. The former countries would find it very easy to comply because they can import the flour, mill it, and make the pasta out of it or use domestic cereals if they are growing them. For the latter, compliance with the rules can only be achieved by either importing cereals

[31] See Chapter 6 for examples and further explanation of the concept of *form* of rules of origin as distinct from substance of rules of origin.

[32] See S. Inama, paper presented at the WTO LDC Retreat on October 5, 2019, Lausanne, Switzerland, subsequently submitted as WTO documents by the LDC WTO group, see WTO documents G/RO/W/191 direct consignment rules and low utilization of trade preferences.

and establishing their own milling capacity or milling into flour domestic cereals if they grow them.

At a technical level the index of restrictiveness so far used assigns a numerical order to a given "form" of rules of origin that in many cases is related to the NAFTA model but it is not adjusted to the EU model that is used by a conspicuous number of countries.

To partially cover these aspects, some adjustments have been later introduced in the index.[33] A "composition" effect has been carried out by Cadot and de Melo for a subgroup of ACP countries. Such composition however simply matched the index of restrictiveness with the export structure of concerned countries. Such exercise may provide preliminary indications on the countries and products that may be most affected by stringent rules of origin but may also provide misleading results because it combines an abstract index with an export structure of a country but it does not match it with its natural endowments and manufacturing capacity.

Some of these considerations were examined in a study carried out by the Overseas Development Institute (ODI).[34] The aim of the study was to draw up some possible policy recommendations for reform of EU rules of origin. This study set two alternative goals for the origin rules. The first goal is to avoid trade deflection and is described as the "essential goal." The second goal is described as "additional function" and seeks to encourage firms in developing countries to undertake more processing or to use more domestic or regional intermediate materials by making this a condition to obtain the tariff preferences.

The study identified the benchmarks to fulfill the "essential goal" of the rules of origin in terms of value added by carrying out two types of analysis. The first analysis was somewhat similar to the composite effect described above in the case of Cadot and de Melo. By analyzing trade flows of developing countries to the EU it identifies those products for which rules of origin are likely to be most relevant.

These results in terms of HS heading were then matched not with an index of restrictiveness but with UNIDO statistics on valued added and then compared with the Cotonou requirement on value added.

Not surprisingly, the results show that there are wide variations among countries and products and wide average differences with the value-added level required by Cotonou.

The second analysis was based on a modeling exercise using a partial equilibrium model. In both cases the starting point was the UNIDO statistics on value added in manufacturing. Such statistics are based on a calculation of the value added as a percentage of labor and operating surplus on the overall value of the output. Such

[33] O. Cadot, C. Carrère, J. de Melo, and B. Tumurchudur, "Product specific rules of origin in EU and US preferential trading arrangements: An assessment," *World Trade Review*, vol. 5, no. 2 (2006), 199–225 (also CEPR DP#4998).

[34] See ODI, "Creating Development Friendly rules of origin in the EU," August, 2006.

percentages are based on value added calculated according to the UNIDO user manual of the UNIDO statistics database:

> the measure of value-added normally reported is the census concept, which is defined as the value of census output less the value of census input, which covers:
>
> a) value of materials and supplies for production (including cost of all fuel and purchased electricity); and
> b) cost of industrial services received (mainly payments for contract and commission work and repair and maintenance work).

There are a series of observations to make on how such definition of value added tallies with the various calculations of valued added according to EU or NAFTA formulations and how UNIDO statistics could be used to assess rules of origin. The most obvious is that, as seen in the preceding chapter, there is a multitude of forms of numerator and denominator to calculate value added, resulting in different outcomes. None of the methods of calculation seem to be close to the above method used by UNIDO. It is also important to note that cost of fuel and purchased electricity under most of the rules of origin, including the EU rules of origin, are defined as "neutral elements" (i.e. are not included in the calculation of valued added).[35] Finally, as acknowledged in the study, there are also aggregation and concordance problems since the value-added data are classified according to the International Standard Industrial Classification four-digit level of aggregation that has to be matched with the HS even if concordance tables exist.

Apart from these initial points the modeling exercise carried out in the study also demands some comments. The positive side of the modeling is that it takes into consideration as the real constraining factor of rules of origin the issue of the use of intermediate materials as shown in Figure 4.3.

Such a positive feature is counteracted by a number of assumptions and averages that are made in the model. The first assumption is to divide the value of the finished good between intermediate and value added using the UNIDO statistics. The second observation is that there is no definition of intermediate products. Normally intermediate products in the context of rules of origin are upstream products that are used in the production of the finished product. These intermediate products may be, as correctly indicated in Figure 4.3, imported or produced domestically. The important factor, however, is that they are highly product specific. For example, in the case of woven textiles of HS 5209 the most immediate intermediate product is the yarn that can be sourced domestically or can be imported. This is precisely where the rules of origin are constraining, since they mostly

[35] Neutral elements: In order to determine whether a product is an originating product, it shall not be necessary to determine the origin of the following which might be used in its manufacture: energy and fuel; plant and equipment; machines and tools goods which neither enter into the final composition of the product nor are intended to do so.

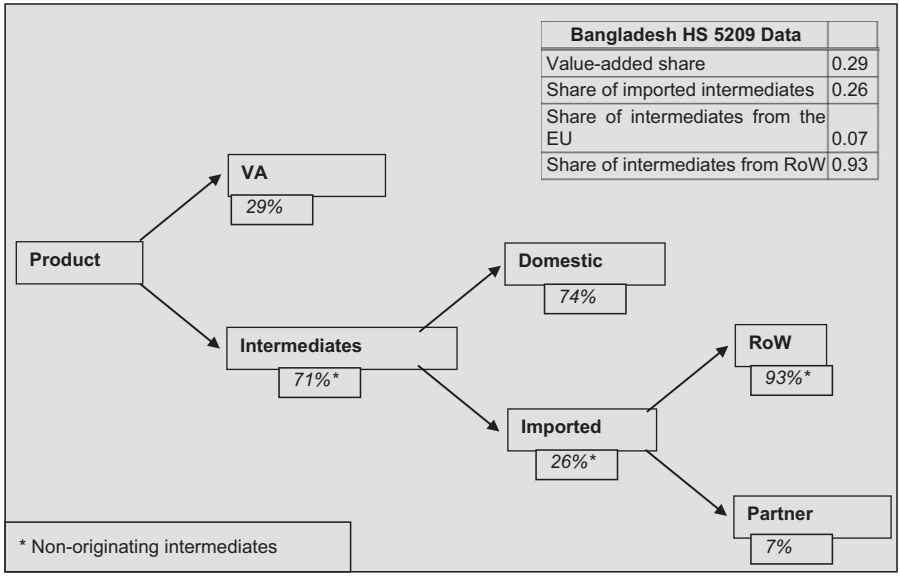


FIGURE 4.3 Calculation of valued added and rules of origin restrictiveness

regulate the use of intermediate products. However, unless the definition of intermediate product is product specific the measurement of the degree of constraint of certain rules is based on rather abstract assumptions.

A study done for the Common Market for Eastern and Southern Africa (COMESA)[36] also uses UNIDO statistics with "manufactured value added" percentages matching them with the COMESA ad valorem 35 percent.

The study finds that most of the COMESA countries and sectors fall below the 35 percent value-added criterion. As observed by the study, the data collected by UNIDO are based on surveys and thus might have a similar "error margin" and there are several issues related to missing data and years. Yet such statistics may provide a reality touch that many empirical studies are simply lacking. The WTO–Organisation for Economic Co-operation and Development (OECD) Trade in Value Added (TiVA) approach may also be used. However, there are some intrinsic limitations that are further discussed in Chapter 6 of this book on drafting rules of origin.

Kelleher[37] points out that "the indices of RoO restrictiveness currently used in empirical analysis are flawed as they focus solely on product specific RoO and do not incorporate information on regime wide provisions, that is, those rules that apply

[36] Review of the COMESA Rules of Origin, April 2018, not publicly available.

[37] S. Kelleher, "Playing by the rules? The development of an amended index to measure the impact of rules of origin on intra-PTA trade flows," Working Paper 201222, School of Economics, University College Dublin, 2012.

across all goods in a particular agreement." In fact another limitation of the index of restrictiveness is that it does not take into account the regime-wide rules that Kelleher included in what he defines as a regime-weighted Harris index, recognizing and incorporating in the index three "regime wide" rules – the size of the cumulation zone, the *de minimis* provision, and the certification type.

Yet, even this qualification does not escape the limits of categorizing rules of origin to place them in a straightjacket that may not match their complexities, with the objective of running econometrics.

Economic literature also examined the issues of "regime wide" rules of origin features focusing on cumulation. In particular, Gasiorek's has been the study most often quoted on the effects of cumulation of diagonal cumulation focusing on the effect within the pan-European system.[38] This study builds on the previous work of Augier and focuses on the changes caused by the introduction of the Pan-Euro-Mediterranean cumulation in 1996. The objectives of the study were first, to directly identify and differentiate between the restrictiveness of rules of origin across a range of sectors; second, to analyze the determinants of the restrictiveness of rules of origin; and, third, to assess the validity of the formal empirical results with reference to the case study of Egypt.

Kazunobu[39] examines the effects of diagonal cumulation comparing the trade flows under two overlapping free-trade agreements; namely, (1) the Japan–Thailand Economic Partnership Agreement (JTEPA), a bilateral free-trade agreement between Thailand and Japan that entered into force in November 2007, which allows only for bilateral cumulation, and (2) the ASEAN–Japan Comprehensive Economic Partnership (AJCEP), a plurilateral free-trade agreement between Japan and ASEAN countries, providing for cumulation among all parties. As a result of an empirical analysis, Kazunobu's estimates show around a 4 percent trade creation effect of diagonal cumulation, which is much smaller than the estimates in the previous studies (around 15 percent).

A study on cross-cumulation[40] examines the trade effects for cross-cumulation for Switzerland. Cross-cumulation is a form of cumulation that has been previously championed in the Asia-Pacific Economic Cooperation (APEC) forum by Canada.[41] Cross-cumulation is aired as an innovative solution to the problem of overlapping FTAs that do not have cumulation among them. In fact, one of the conditions for applying cumulation among free-trade agreements is that rules of origin should be identical. In the case of cross-cumulation, the proponents are

[38] M. Gasiorek, P. Augier, and C. Lai-Tong, "The impact of the diagonal cumulation of rules of origin in the context of Euro-Med integration," Research no. FEM31-11, Femise Research Programme 2006–2007, 2008.

[39] H. Kazunobu, "Impact of diagonal cumulation rule on FTA utilization: Evidence from bilateral and multilateral FTAs between Japan and Thailand," IDE Discussion Paper 372, 2012.

[40] SECO, *Cross-Cumulation in Free Trade Agreements: Opportunities, Potential and Challenge*, Study on behalf of the State Secretariat for Economic Affairs, SECO, 2013.

[41] See "Canada's approach to cross-cumulation," submitted by Canada at the 2009 APEC Meeting held in Singapore, 2009/CTI2/CTI-MAG/TPD/004.

suggesting that its key advantage is that it provides a form of mutual recognition of different rules of origin in bilateral free-trade agreements in order that trade can move freely without the challenges of negotiating common rules of origin or a common free-trade agreement.

To date, while the wide use of cumulation is often invoked as one possible solution to the stringency and complexities of rules of origin, there has been little concrete application of such principle, in practice, except for the Canadian GSP scheme examined in Chapter 3 of this book and a provision inserted in the Canada–Colombia and Canada–Peru FTA agreements that is yet to be made applicable.

4.1.3 *Status of the Economic Analysis on Rules of Origin and How It Contributed to Better Rules of Origin in International Trade*

As pointed out by the author and Hoekman:[42]

> Economic research on RoO has largely focused on estimating their trade-distorting effects, often using methodologies that are centred on estimating the ad valorem tariff equivalents of RoO or classifying RoO into types and constructing indexes in order to assess the relative restrictiveness of RoO across countries and trade agreements. While such efforts are important in determining how RoO can (and do) act as nontariff barriers to trade, this type of research is not particularly useful in informing efforts by governments seeking to cooperate on RoO to facilitate trade. Such efforts require detailed analysis of the specific RoO adopted by different countries or trade blocs, their evolution over time, and an understanding of where governments have adopted rules that are similar or equivalent.

The latter is the kind of multidisciplinary research that the author, often advising governments at regional and multilateral level, has been embarking on as discussed in Chapter 1 of this book and further detailed in this chapter when discussing the use of utilization rates and the input–output methodology for drafting of PSRO contained in Chapter 6.

As noted in the 2009 edition of this book, the striking factor in most of the economic literature examined in the preceding sections is the almost total lack of a multidisciplinary approach in the analysis carried out so far. Rules of origin are a complex issue involving different skills and background ranging from legal to customs aspects. Unless these technicalities are reflected in the construction of indexes to be used in regressions, or other empirical exercises, the final results of the exercise may be misleading and/or flawed. While most economists

[42] S. Inama and B. Hoekman, "Harmonization of rules of origin: An agenda for plurilateral cooperation?," *East Asian Economic Review*, vol. 22, no. 1 (March 2018), 3–28.

acknowledge[43] in their research that rules of origin are legal rules that are difficult to understand, there is little effort to embrace a multidisciplinary approach.

In the case where such a purely economic approach is to be used in theoretical exercises and academic discussions, the consequences may be limited. However ample research studies have been funded and mostly commissioned by international organizations[44] to advise developed and developing countries in their negotiations on rules of origin or in making reforms. In particular, such studies have been commissioned to provide workable trade solutions on how to best draft rules of origin in a free-trade agreement or a set of nonpreferential rules of origin. Considered under this perspective the issue at stake is to determine how this research has helped to shed light on what are the best rules of origin that could be adopted, what are the lessons learned for governments and from the private sector, and what are the best practices.

When such perspective is adopted, the main conclusion arising from the review of the economic literature so far is that their trade policy conclusions are not actionable by governments and policymakers at multilateral and regional level. Most of the literature is rather self-fulfilling and most importantly does not provide a clear-cut solution or a usable negotiating position, nor has such literature exerted any pressures on government or the private sector to advocate one set of rules of origin over another. As discussed in Chapter 5, the rules of origin in preferential trade agreements (PTAs) around the world continue to be complex and confused and there are no significant signs of an improvement.

African, but also ASEAN and Latin American, member states are still tangled in multiple and endless negotiations on PSRO with no end in sight. Obviously, this state of affairs cannot be imputed solely to the literature. Not even a literature with more action-oriented proposals that could be acted upon by governments could have addressed the current plethora of existing and overlapping rules of origin. However, it also has to be recognized that some trade policy conclusions of these studies would have gained from a multidisciplinary approach and a reality touch with the basic questions that, some of them, were called to address.

[43] See Conconi, Puccio, Garcia-Santana, and Venturini, "From final goods to inputs: The protectionist effect of rules of origin" (fn. 13 above): "The empirical literature on RoO is limited, due to the legal complexity of the rules, which makes measurement difficult"; and Augier: "Rules of origin are usually ignored for two good reasons: they are dauntingly complex and at first sight appear mind-numbingly dull."

[44] Mostly, but not only, by the World Bank. This may explain the bias toward an economic approach that continued with the involvement of studies carried out by researchers mostly affiliated to universities. The EU funded a number of studies during the reform period of the EU rules of origin and when adopting the Pan-European Rules of Origin and the cumulation built into this scheme.

As an example, the Cadot and de Melo study[45] indicated multiple rules of origin (resembling the one adopted by COMESA, and proposed by Brenton et al.[46]) as a viable proposal for the negotiations of the EPA with the EU as follows:

- a single change of tariff heading, or
- a minimum of 30 percent regional value added, or
- non-originating materials not to exceed 50 percent of the value of total inputs.

A spontaneous question is how different these suggested rules of origin are from the previous rules of origin existing in COMESA and the Southern African Development Community (SADC) bearing in mind that both SADC and COMESA rules of origin have not been recorded as best practices.[47] In fact both COMESA and SADC later adopted new PSRO as the rest of world is doing.

Furthermore, the Cadot and de Melo study was commissioned with the background of former EU–ACP rules of origin not working properly but within a negotiating scenario where it was crystal clear that the EU would not have relinquished a PSRO approach that it has adopted in free-trade agreements for decades. Even if, at first sight, a proposal to have multiple regime-wide origin rules appears business-friendly, in reality such approach may be a recipe for lack of transparency and unpredictability. Chapter 6 of this book discusses such multiple-rule approach, pointing out that, in order to work properly, there has to be coherency among the different alternatives in terms of level of restrictiveness. In the specific case of the abovementioned proposal, such coherency was not present because a "single" CTH often may be much easier to comply with than a 50 percent limit of non-originating materials. Besides, neither formulations of value-added rules mentioned above have clear and transparent definitions of numerator and denominator. Hence its technical soundness is highly debatable as it may lead to a different origin outcome for the same product depending on the rules of origin used.

Other conclusions and proposals of the same nature were contained in an extensive policy report on preferential rules of origin for the Asian region.[48] In this report it has been suggested that, in addition to the value-added rule criterion, a CTC be introduced as an additional choice to (and not instead of) the value-added rule, implemented as a common rule across products (e.g. change at the heading or

[45] See O. Cadot, J. de Melo, and B. Tumurchudur, "The rules of origin facing ESA trade: Analysis and proposals for EPA negotiations," World Bank, 2005.

[46] See P. Brenton, F. Flatters, and P. Kalenga, "Rules of origin and SADC: The case for change in the mid term review of the trade protocol," Africa Region Working Paper Series No. 83, The World Bank, 2005.

[47] Both COMESA and SADC rules of origin are examined in Chapters 5 and 6 of this book.

[48] See "Trade issues in East Asia: Preferential rules of origin," Policy Research Report 40216, World Bank, June 2007.

four-digit level) and if additional, product-specific exemptions are introduced to the common rule, they are kept to a minimum.

This suggestion again ignores the fact that the HS design is used as a customs nomenclature and not for RoO purposes. The introduction of a common CTH rule across products entails a series of undesirable implications, as explained in Chapter 6, that have to be redressed by PSRO. The latest consolidated version of the harmonization work program (HWP) on nonpreferential rules of origin discussed in Chapter 2 provides valuable examples of the merits and limits of a CTH rule.

More recently one of the main conclusions of the work of Conconi is that preferential rules of origin in free-trade agreements can violate Article XXIV, by substantially increasing the level of protection faced by non-members. In particular, rules of origin decreased the growth rate of imports of affected goods from third countries for "around 45% of the actual change in imports of treated goods."

In addition, Conconi affirms that:

> RoO might have affected imports of intermediate goods from non-NAFTA countries through two channels: (i) they may have led final good producers to switch from non-NAFTA to NAFTA suppliers (substitution effect); and (ii) they may have depressed demand for restricted inputs, by raising the cost of producing the output (level effect).

This point is well taken and noted. However, it does not answer the compelling question on how a negotiator or a policymaker can draft rules of origin to avoid or mitigate such occurrences.

Augier's[49] trade policy recommendations on the way forward on rules of origin could be summarized as follows:

> The widespread application of the value content rule, as opposed to the change of tariff classification rule or the product process rule. Any rule is to a large degree arbitrary. However, the value content rule is much more transparent, more flexible, and consequently more negotiable.
>
> The use of a value-added tariff rule in determining tariffs, if any, to be levied. This is a proposal first made by Lloyd (1993).

The suggestion, made above, to adopt widespread value-content rules is simply unrealistic in light of the lessons learned and practice in drafting rules of origin. It is a fact that every free-trade agreement currently being negotiated uses the CTC classification and it is a lesson learned that a value-added content rule is not a panacea. The adoption of a tariff instead of rules of origin could be an economically sensible debate in universities, but is simply not realistic.

[49] See P. Augier, M. Gasiorek, and C. Lai Tong, "The impact of rules of origin on trade flows," *Economic Policy*, vol. 20, no. 43 (2005), 567–624.

One may wonder about the impact of a multidisciplinary approach to research on rules of origin where funds are allocated in a more sensical way to ensure that the results are viable for concrete policy changes.

A pervasive finding all through this book is that rules of origin are in "no man's land" in multilateral trade affairs. Decades of negotiations from the early 1970s in different quarters, fora, and contexts have been conspicuously unable to put forward a sensible solution. Lately, convergence seems to be emerging in drafting rules of origin and there are some lessons to be learned. It is the hope of this author that future multidisciplinary research will be undertaken on the issues related to rules of origin convergence and the emerging trends discussed in this book. The following sections of this chapter on utilization of trade preferences and Chapter 6 suggest innovative multidisciplinary research on rules of origin leading to actionable proposals for governments wishing to engage in sensible solutions in the area of rules of origin in FTAs and at multilateral level.

4.2 THE WAY FORWARD IN ASSESSING THE ECONOMIC IMPACT OF RULES OF ORIGIN: EVIDENCE FROM THE UTILIZATION OF TRADE PREFERENCES

At the time of the first edition of this book in 2009, the concept of utilization of trade preferences was relatively little known and used in economic literature to assess the trade implications of rules of origin. In order to show the importance of the utilization rates as a tool to measure the restrictiveness of rules of origin, a section of the 2009 edition was entirely dedicated to an *ex ante* analysis and a partial equilibrium model simulation using utilization rates to:

(1) identify stringent rules of origin
(2) quantify missed trading opportunities due to stringent rules of origin.

The analysis was carried out using utilization rates of exports of Bangladesh and Cambodia of garments of HS 61, garments, knitted, and crocheted, and 62, garments, not knitted, and crocheted, to the EU using utilization rates to identify the implications of the stringent rules of origin adopted at that time.

The 2009 edition of this book linked the low utilization of EU trade preferences of Bangladesh and Cambodia on garments with stringency of rules of origin using an input–output[50] matrix on trade flows of intermediate inputs, in this case fabrics and yarns. The research identified the trade flows at HS level indicating that both these countries were importing the fabrics from China to manufacture garments for exports to the EU. However, making garments from non-originating fabric did not meet the EU origin requirement at that time since EU rules of origin required

[50] See Chapter 6 of this book for a more detailed analysis and discussion of the input–output methodology to draft rules of origin.

TABLE 4.11 *Comparative table of PSRO for sectors in the EBA rules of origin*[i]

HS	Product description	PSRO before the reform	PSRO after the form for LDCs
Ex-Chapter 61	Garments, knitted of crocheted	Manufacture from yarn	Manufacture from fabric
Ex-Chapter 62	Garments, not knitted or crocheted	Manufacture from yarn	Manufacture from fabric
8712	Bicycles	Manufacture in which the value of all the materials used does not exceed 40% of the ex-works price of the product	Manufacture in which the value of all the materials used does not exceed 70% of the ex-works price of the product

[i] In reality, the rules are more product specific. For presentation purposes, the rules have been simplified and summarized in the table.

a double transformation – weaving of the fabric and cut-make, and trim. Hence the EU utilization rates for garments of HS 62 were as low as 10 percent for Bangladesh and close to zero for Cambodia. The same section in 2009 edition calculated that liberalization of rules of origin would have resulted in the trade increase of more than 1 billion USD of garments from the same countries, underestimating somewhat the trade effects that took place as shown in section 4.2.2 of this chapter.

Years later, this *ex ante* analysis has been tested since the EU substantially liberalized the rules of origin under the reform of 2011 for garments and other products as shown for selected sectors in Table 4.11.

As eloquently put forward by the LDC submission to the WTO Committee on Rules of Origin[51] in 2014, elaborated with the assistance of the author, such early analysis proved right in facts and figures since a change of rules of origin allowing the use of non-originating fabric generated higher utilization rates and an increase in exports as argued in the 2009 edition of this book.

This section in fact investigates the *ex ante* analysis carried out in 2009, adding *ex post* research that intervened when the EU reform of rules of origin of 2011 was finally implemented, generating the higher utilization rates and increase of exports. Such research has benefited from updated data and interviews with private sector actors.

Overall, the following sections aim at showing that low utilization is mainly due to stringent rules of origin and that utilization rates are a useful tool in identifying candidates for reform of rules of origin.

[51] LDC submission to the CRO, "Challenges faced by LDCs in complying with preferential rules of origin under unilateral preference schemes," G/RO/W/148, October 28, 2014.

4.2.1 *The Concept of Utilization Rates*

The concept of utilization rates of trade preferences may appear relatively recent when related to free-trade agreements even if it was contained in the Transparency Mechanism for Preferential Trade Agreements (WTO PTAs transparency mechanism[52]).

Research on utilization rates of free-trade agreements might be considered a side-effect of the recent flourishing of free-trade agreements when governments started to wonder if the agreements that they negotiated were effectively utilized by business and business started to complain about the plethora of rules of origin that they had to comply with.[53]

In reality the utilization of trade preferences has a long-established history dating from 1975 when the major GSP schemes came into operation. At that time, member states of the United Nations Conference on Trade and Development (UNCTAD) mandated it to monitor the utilization of the GSP schemes and, on a yearly basis, notified the UNCTAD Secretariat of the trade data on utilization according to a set of indicators commonly agreed, including the utilization rate. Throughout the three initial decades of the existence of the GSP, the shortcomings of the origin system and consequent obstacles to GSP utilization identified by preference-receiving countries were discussed in the context of the UNCTAD Working Group on Rules of Origin and in the Special Committee on Preferences until 1995.

Thus, there is a wealth of lessons learned and experience that may be useful to draw on for an examination of the effect of rules of origin on the utilization of trade preferences.

UNCTAD's traditional methodology of assessing the performance of the GSP used a series of indicators as reported in the intergovernmental documents prepared for the Special Committee on Preferences since the early 1970s. These indicators are as follows:

- **Product coverage:** defined as the ratio between imports that are covered by a PTA and total dutiable imports from the beneficiary countries. The higher the percentage, the more generous the preferences may appear, depending on the structure of dutiable imports of the beneficiary countries. Coverage does not automatically mean that preferences are granted at the time of customs clearance.
- **Utilization rate:** defined as the ratio between imports actually receiving preference and dutiable covered imports. This rate is based on the customs declaration made by the importer at the time of importation. As further

[52] See WTO document WT/L/806, December 16, 2010, especially para. (e) of Annex 1: "Import data for the most recent three years preceding the notification from each of the beneficiary partners, in value for total imports, imports entered under MFN and imports entered under PTA benefits."

[53] See M. D. Abreu, "Preferential rules of origin in regional trade agreements," 2013, at https://ssrn.com/abstract=2244772.

examined in this chapter, higher or lower utilization rates are mainly the result of the stringency and/or complexity of rules of origin and ancillary requirements. The utilization rate is calculated on dutiable imports (i.e. MFN free trade is not taken into account as this would count empty preferences).

- **Utility rate:** defined as the ratio of imports actually receiving preference and all dutiable imports (covered or not). It refers to the percentage of total dutiable imports that receive preferences. A low level of this ratio means that a large part of dutiable imports (either covered or not) pay the MFN rate.

From the RoO perspective, the most important indicator to measure the effect of rules of origin on trade preferences is the utilization rate.

The trade flows on the utilization rates have been notified by the preference-giving countries since the early years of the GSP to permit UNCTAD to discharge its mandate to monitor the performance of the GSP. Utilization rates are computed on the basis of the customs declarations made by the importer at the time of importation.

UNCTAD and, most recently, WTO[54] further carry out the necessary checks. Trade data on utilization rates at highly disaggregate level, mostly tariff line level, notified by preference-giving countries have been largely considered and accepted as a reliable source to conduct analysis on utilization of trade preferences.

As pointed out earlier,[55] traditional methodology outside UNCTAD often assumed that preferences were fully utilized. Market access for developing countries has been analyzed on the assumption that MFN rates were not considered a real market access obstacle because of existing trade preferences.

Contrary to this conventional wisdom, the mere granting of tariff preferences or duty-free market access to exports originating in beneficiary/FTA partner countries does not automatically ensure that the trade preferences are effectively utilized. Preferences are conditional upon the fulfillment of an array of requirements related to rules of origin, with which, in many instances, parties to FTAs/or beneficiaries of unilateral preferences may not be able to comply.[56]

[54] WTO TAO database available at https://tao.wto.org/welcome.aspx?ReturnUrl=%2f.

[55] See S. Inama, "Market access for LDCs, issues to be addressed," *Journal of World Trade*, vol. 36, no. 1 (2002), 85–116; and UNCTAD, "Improving market access for least developed countries," UNCTAD/DITC/TNCD/4, May 2, 2001.

[56] As a matter of fact, this has constituted day-to-day business until recently. For instance, since the inception of the GSP, the UNCTAD Secretariat has been maintaining a register of customs stamps and signatures of issuing authorities of GSP Form A (the GSP Form A is a specific certificate of origin form). Routinely, the UNCTAD members notify UNCTAD of changes in signatures and stamps and the Secretariat circulates such notification to all UNCTAD member states. Quite often, urgent calls were made to the UNCTAD Secretariat from importers and clearing agents about shipments blocked at the time of customs clearance in a preference-giving country for the simple reason that the stamps and signatures were not the same as those registered. Failure to comply with the rules entails application of the MFN rate. In recent times with the increased adoption of self-declaration such occurrences are decreasing but this does

Recent literature[57] driven by the flourishing of unilateral and contractual preferential trading has been increasingly indicating rules of origin as prime suspects of underutilization of trade preferences and distortion in FTAs.

In spite of the evidence contained in various UNCTAD reports and related studies since the last decade, discussions are still ongoing about the real and empirical foundation of the relation between rules of origin and low utilization rates as a new finding rather than an acknowledged reality. Nevertheless, the fact that utilization rate is strictly linked to origin requirements is very clear to beneficiary/FTA partner countries and has been clearly demonstrated as further discussed in this chapter.

The sourcing implications and related costs of restrictive rules of origin have been correctly identified by the first wave of papers looking at the economic implications of rules of origin. Krueger and Krishna, as well as Palmeter (examined in section 4.1.2), provided valuable examples of the difficulties and related costs that Mexican producers of textiles and garments had to comply with under NAFTA rules of origin to access the North American market.

The subsequent wave of authors, starting with Estevadeordal and more recently with Cadot and De Melo (also examined in section 4.1.2), do not discuss in depth the use of the utilization rates in examining the economic impact of rules origin.

Moreover, little or no analysis was carried out at a product-specific level to exactly identify the reasons for such low utilization. Although it is intuitive that low utilization is mainly a function of how rules of origin are constraining the use of intermediate materials, little or no empirical analysis was carried out until recently[58] to further examine the implications of stringent rules of origin on preference utilization.

The author recently advocated the use of utilization rates as an useful tool to measure the effectiveness of the trade preferences granted to LDCs during the negotiations of the Bali Decision and more intensively during the preparation for the Nairobi Decision on preferential rules of origin for LDCs.

not necessarily means that no obstacles have been encountered at the time of customs clearance.

[57] See, for instance, UNCTAD and Swedish Board of Trade, "The Use of the EU's Free Trade Agreements – Exporter and Importer Utilization of Preferential Tariffs," 2018; Swedish Board of Trade, "Who uses the EU's Free Trade Agreements? A transaction-level analysis of the EUSouth Korea free trade agreement," 2019; Pramila Crivelli (Goethe University Frankfurt) Stefano Inama (United Nations Conference on Trade and Development) Jonas Kasteng (National Board of Trade Sweden), "Linking utilization of EU FTAs to rules of origin - A methodology to identify Rules of Origin reforms with high potential trade impact," EUI Working Papers, 2021.

[58] P. Crivelli and S. Inama, "The Impact of the European Reform of Rules of Origin under the Everything But Arms Initiative: An Empirical Analysis" (forthcoming), as discussed in section 4.2.4.3.

In fact, it took considerable time for the author to:

1. explain to the WTO LDC group, that the insertion of the utilization rate issue in the dynamics of the negotiations, including an obligation of the notification of trade data at tariff-line level, was an effective tool to monitor the effectiveness of trade preferences
2. explain that the obligation contained in the transparency mechanism has to be brought in the context of the Nairobi Decision on rules of origin for LDCs and the Committee on Rules of Origin (CRO)
3. convince the preference-giving countries and other stakeholders that utilization rates had a link with rules of origin

On the one hand, the LDCs had to realize the usefulness of utilization rates in monitoring the effectiveness of the trade preferences granted under the Duty-Free Quota-Free (DFQF) initiatives and, on the other hand, the WTO preference-giving countries had to accept the burden and the consequent scrutiny of the effectiveness of their DFQF schemes using the utilization rates.

A milestone in this journey was the presentation at the WTO committee of October 2014 of the LDC paper[59] on challenges faced by LDCs in complying with preferential rules of origin under unilateral preference schemes, drafted by the author using the existing UNCTAD database. The main argument of the LDC paper was based on the contrast between the results of the Canadian and EU reform of rules of origin and the absence of such reform under the US and Japanese preferential arrangements for LDCs. The paper showed that the Canada and EU reform of rules of origin resulted in higher utilization rates and increased exports from LDCs, while in the absence of such reform US and Japanese trade preferences for LDCs showed erratic or stagnant utilization rates with no significant increases of exports from LDCs.

These findings of the LDC paper were drawn from an analytical review of the utilization rates using the UNCTAD database on utilization rates. This revisiting of the concept of utilization rates and performance of trade preferences linked to RoO requirements laid down the foundation for the request made by the LDCs to preference-giving countries during the negotiations for the Nairobi Decision to systematically notify preference utilization to the WTO Secretariat. An updated and improved version of part of the analysis made in the LDC paper is set out below.

As a result of these efforts and intense negotiations in the trade negotiating group in preparations for the Nairobi WTO Ministerial Decision the notification of utilization rates was finally inserted in paragraph 4.3 of the Nairobi Decision as follows:

[59] "Challenges faced by LDCs in complying with preferential rules of origin under unilateral preference schemes," paper presented by Uganda on behalf of the LDC group, WTO document G/RO/W/148, October 24, 2014.

> 4.3. Preferential rules of origin shall be notified as per the established procedures. In this regard, Members reaffirm their commitment to annually provide import data to the Secretariat as referred to Annex 1 of the PTA Transparency Mechanism, on the basis of which the Secretariat can calculate utilization rates, in accordance with modalities to be agreed upon by the CRO.

According to the CRO report of March 2017:

> After consultations, Members had adopted the methodology proposed by the Secretariat (paragraph 3.2(a) of G/RO/W/161). This modality compared the value of imports, which benefitted from preferences with the value of total imports, which would have been eligible for preferences. Hence, only tariff lines where there was a tariff preference were taken into account (that is, tariff lines that were either excluded from the preferential scheme or for which the MFN rate was zero were excluded from the calculations).[60]

Paragraph 3.2(a) of the abovementioned document provides for the following formula to calculate utilization rates; that is, the formula traditionally used by UNCTAD in calculating utilization of GSP preferences:

$$pur_{i,p}^{value} = \frac{\sum_{i,p} PTA_{required}}{\sum_{i,p} PTA_{eligible}}$$

pur^{value}:	preference utilization rate (%) based on import value		
where:	i	=	import value
	p	=	products
	$PTA_{reported}$	=	imports reported to have taken place under the PTA preferential duty scheme
	$PTA_{eligible}$	=	imports under any eligible tariff line, i.e. preferential duty < MFN duty rate

The acceptance of a uniform formula to calculate the utilization rates, and the progressive acceptance by WTO members of the concept of utilization rates, took more than one year in the CRO as attention was primarily devoted toward the adoption of a template of notification in the rather fallacious hope that preference-giving countries would introduce changes in their rules of origin to comply with the Nairobi Decision.[61] In addition, it took time for certain "developing" preference-giving countries to fully understand the calculation methodology of the utilization rate.

[60] WTO G/RO/M/68.
[61] See Chapters 1 and 5 of this book.

As a result of the combined advocacy of the author and the LDC group, the CRO as well as the WTO Secretariat gradually realized the relevance and importance of the issue and agreed to insert the issue of utilization rate into the agenda of the CRO and progressively made use of the mandate of the Nairobi Decision to establish the so-called Tariff Analysis Online (TAO) database.[62]

4.2.2 *Linking Utilization Rates to Stringent Rules of Origin: Evidence from* Ex Ante *and* Ex Post *Analysis of the Bangladesh and Cambodia Utilization Rates of Garments (2009–2005)*

The analysis conducted in the 2009 edition stemmed from the consideration that, since 1973 until the reform of the EBA rules of origin in 2011, textile and clothing rules of origin have undergone only limited changes and modifications.

Figure 4.4[63] of the 2009 edition depicted the average utilization rates of Cambodia, Laos, and Bangladesh for Chapters 61 and 62 from 1994 to 2005. As can be seen, in more than a decade the utilization rate was steadily low for Chapter 62 for these three LDC Asian countries, only reaching almost 50 percent in 2005. As far as Chapter 61 is concerned, a rather progressive improvement has been recorded since 1998, mainly due to an improvement of rules of origin allowing for the use of imported yarn for certain knitted garments. Among the Asian LDC countries, the highest utilization rate was by Nepal and the lowest by Bangladesh and Cambodia.[64]

For Chapter 62, the utilization rates of these latter two countries have been as low as 0.8 percent in the case of Cambodia during the period 1997–1999 and 11 percent or lower for Bangladesh in the period 1994–1998 as shown in Figures 4.5 and 4.6.

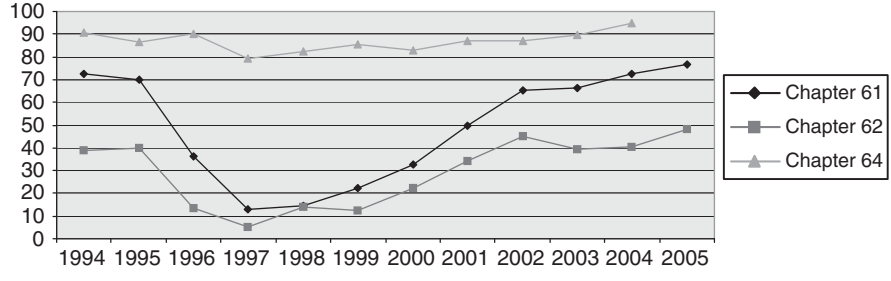


FIGURE 4.4 Average utilization of Bangladesh, Cambodia, and Laos – HS Chapters 61, 62, and 64 (1995–2005)

[62] https://tao.wto.org/welcome.aspx?ReturnUrl=%2f.

[63] Actually, a change to single transformation took place for Chapter 61 in the EU rules of origin, explaining the higher utilization recorded in this chapter when compared to Chapter 62.

[64] For Asian LDCs the selected countries were Nepal, Laos, Cambodia, and Bangladesh.

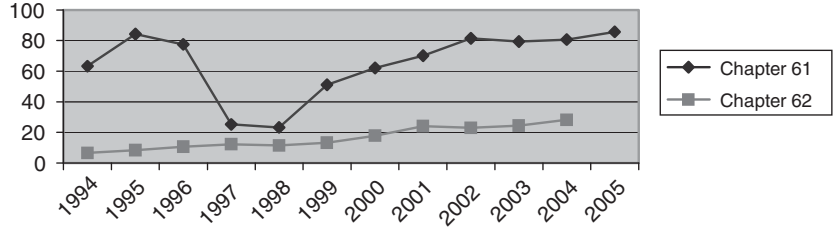


FIGURE 4.5 Bangladesh: EU GSP utilization rates for HS Chapters 61 and 62 (garments) (1994–2005)

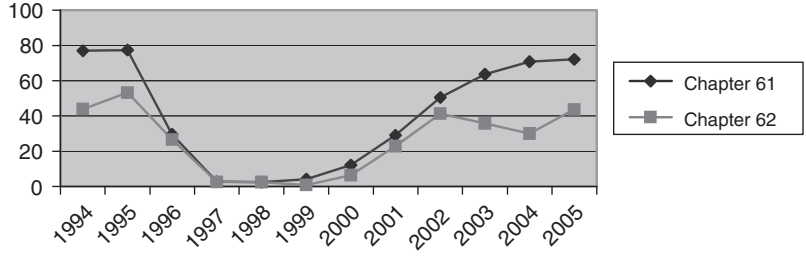


FIGURE 4.6 Cambodia: EU GSP utilization rates for HS Chapters 61 and 62 (garments) (1994–2005)

As shown in Figures 4.5 and 4.6, in the case of Cambodia low utilization was particularly striking in the last years of the decade because they had been granted a derogation on RoO requirements for certain textiles and clothing. However, such derogation was subject to quotas and rather complex administrative requirements and did not include the current major suppliers of fabrics, which largely affected the utilization rate of such derogation.[65] In the next section a more detailed analysis has been carried out on the period 1995–2000 using trade data and a combination of a field visit.

[65] Commission Regulation (EC) No. 292/2002 amending Regulation (EC) No. 1614/2000 derogating from Regulation (EEC) No. 2454/93 in respect of the definition of the concept of originating products used for the purposes of the scheme of generalized preferences to take account of the special situation of Cambodia regarding certain exports of textiles to the Community (OJ L46 (2002), 14). Commission Regulation (EC) No. 291/2002 amending Regulation (EC) No. 1613/2000 derogating from Regulation (EEC) No. 2454/93 in respect of the definition of the concept of originating products used for the purposes of the scheme of generalized preferences to take account of the special situation of Laos regarding certain exports of textiles to the Community (OJ L46 (2002), 12).

4.2.3 *Linking Low Utilization of Preferences and Rules of Origin: An* Ex Ante *Simulation Methodology Based on an Input–Output Analysis*

4.2.3.1 Introduction to the Input–Output Analysis

The trade diversion effects of rules of origin and the impact on intermediate materials originating in third countries outside the FTA partners have been correctly identified by the first wave of papers on the economics of rules origin examined in the proceeding section. Krueger and Krishna, as well as Palmeter, provided valuable examples of the difficulties and related costs that Mexican producers experienced in complying with NAFTA rules of origin and the sourcing limitations that the yarn-forward rules of origin imposed on them. Conconi further elaborated on this using a regression. However, such mainly empirical literature did not establish a link between implications of restrictive rules of origin on utilization rates of trade preferences, nor did it provide a compelling real-case scenario.

Section 4.2 of the 2009 edition of this book provided an extensive analysis and compelling evidence of the link existing between restrictive rules of origin and utilization rates using an input–output table. In particular such analysis was conducted using a product-specific input–output table elaborated by the author and further discussed in Chapter 6 of this book.

This section reports the results of early analysis of the utilization rate in Cambodia and Bangladesh, using the available trade data for the period 1994–2001 and, as far as utilization rate is concerned, 1994–2005. The preliminary results were subsequently verified during country visits.

More particularly, on the basis of the trends of utilization rates recorded in the preceding section, further analysis was conducted to detect and identify the reasons for such low or minimal utilization. Trade preferences of Cambodia and Bangladesh under the EU GSP schemes were sampled because they have been granted extensive trade preferences over the neighboring countries that were either graduated from the EU GSP as far as textiles and clothing were concerned or were not dependent on trade preferences to develop their export markets given their large supply capacity and competitiveness.

Second, Bangladesh and Cambodia have had a minimum base of relatively stable industrial capacity over the years, generating commercially meaningful trade flows of textile and clothing products.

Third, and perhaps most importantly, these countries are geographically positioned next to the most competitive suppliers of intermediary textile inputs (yarns and fabrics) like China and India. Thus, it is relatively easier to trace an established pattern of trade flows linked to constant and stable industrial relations and investment trends.

The analysis has been conducted by constructing an input–output table to reflect the various stages of production and identify the inputs and the outputs at HS four- and six-digit level on the basis of different textile materials (cotton, wool, man-made, synthetic) at different production stages.

The methodology's starting point is to identify the inputs and components of a specific finished product and match them with the corresponding HS headings. As an example, the identification of some HS headings for some textiles and clothing items corresponding to the "production chains" of finished garments is outlined below. Starting from the raw material, the sequencing of production stages in order to get to the finished product has been determined. A similar methodology is suggested in Chapter 6 to draft PRSO.

For instance, the production chain for articles of apparel and clothing accessories of cotton, not knitted or crocheted (of HS Chapter 62), can be set out as follows:

RAW COTTON (HS 5201)
↓
CARDING OR COMBING
↓
CARDED OR COMBED COTTON (HS 5203)
↓
SPINNING
↓
COTTON YARN (HS 5205–5207)
↓
WEAVING
↓
WOVEN FABRICS OF COTTON (HS 5208–5212)
↓
MAKING UP
↓
ARTICLES OF COTTON (ex-CHAPTER 62)

In the case of knitted or crocheted articles of cotton (Chapter 61) the last two stages, *weaving* and *making up*, should be replaced by *knitting or crocheting* (knitted or crocheted fabrics of cotton – Chapter 60) and *making up* (knitted or crocheted articles of cotton – Chapter 61).

The same break-down and identification of the corresponding HS headings has been carried out for other textile materials like wool, man-made and synthetics. A subsequent step has been undertaken to match these headings with import statistics of the sample countries on a time series basis of 1994–2001. These import statistics provided a map of imported inputs according to the level of manufacturing over the years and represented the first layer of the input matrix.

The other layer of the matrix represented the output; that is, the exported products of chapters 60 (fabrics), 61 (garments, knitted or crocheted), and 62 (garments, not knitted or crocheted).

As a subsequent step, both input and output trade flows have been broken down respectively by country of origin for imports and country of destination of exports. The next step is to analyze and contrast the trade flows of imported inputs and their level of manufacturing in the production chain with the EU rules of origin requirements and draw possible conclusions.

The following graphs (Figures 4.7–4.10) examine the import trends of textile inputs of Cambodia and Bangladesh according to different textile materials: cotton and man-made. In reading the following graphs, the following requirements under the EU rules of origin applicable at that time have to be borne in mind:[66]

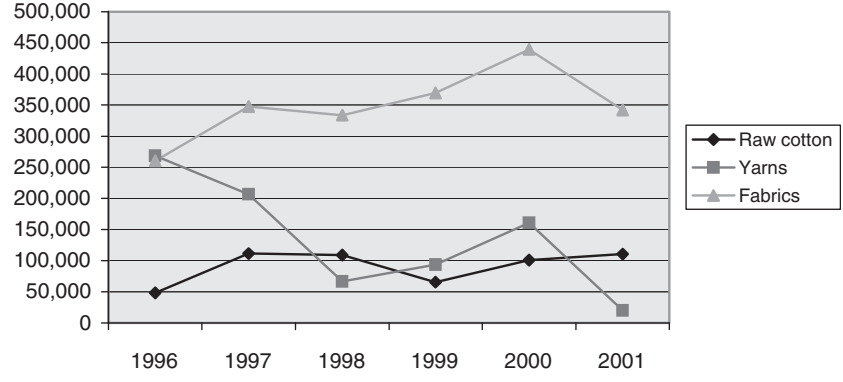


FIGURE 4.7 Bangladesh: Imports cotton (1996–2001)

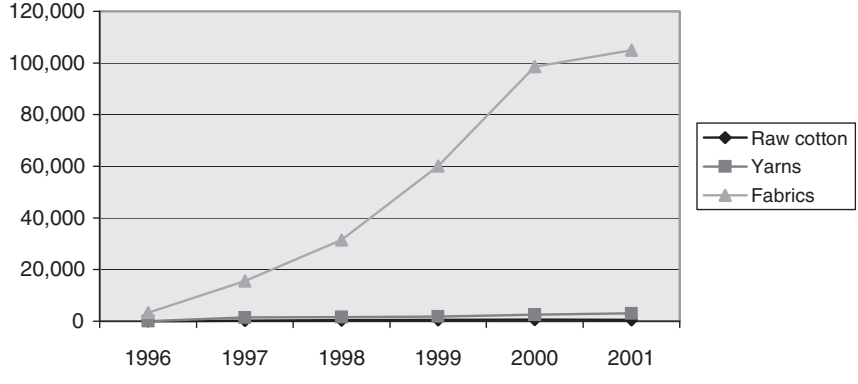


FIGURE 4.8 Cambodia: Imports cotton (1996–2001)

[66] For a detailed description of the rules and the specific working and processing requirements, see Handbook on the GSP scheme of the EU.

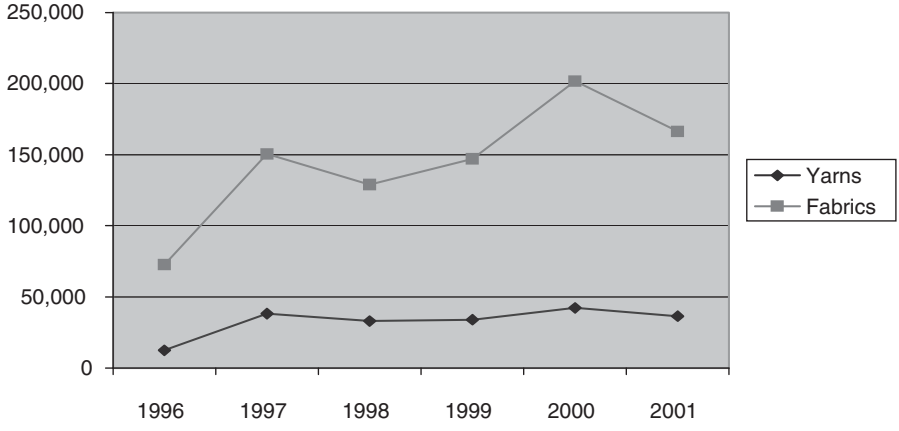


FIGURE 4.9 Bangladesh: Imports man-made and synthetic (1996–2001)

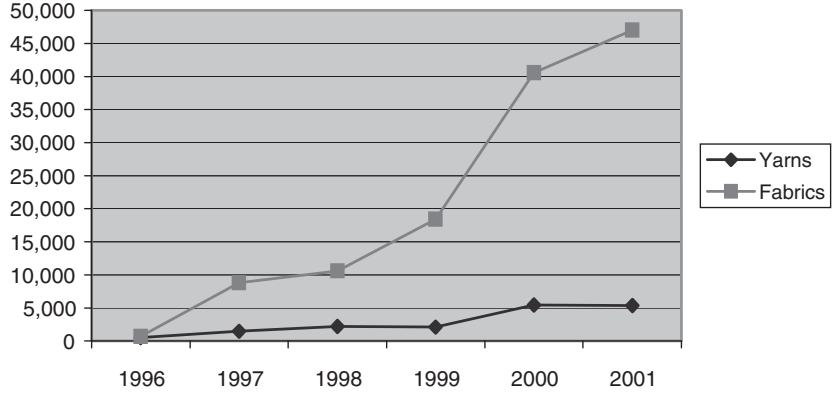


FIGURE 4.10 Cambodia: Imports man-made and synthetic (1996–2001)

- For products classified in Chapter 62 (garments not knitted or crocheted), the EU rules of origin require that the manufacturing process from non-originating member-states starts from yarn – that is, utilization of imported fabrics – is not permitted.
- For products classified in Chapter 61 (garments knitted and crocheted), the rules of origin require that the manufacturing process from originating materials starts from yarn in case of assembled products sewed together or natural fibers.

Considering these requirements, a peak in imports of fabrics and a parallel low utilization rate indicated that the manufacturers in Bangladesh and Cambodia

had to forego tariff preferences because they could comply with rules of origin requirements.

As shown in the graphs (from Figures 4.7–4.10) the analysis of the import flows of yarns and fabrics of cotton and man-made materials in Bangladesh and Cambodia clearly showed a consistent and steady increase of the imports of fabrics in both countries in comparison to minimal or decreasing import value of yarns.

In the case of Cambodia, it was noted that imports of yarn were in the majority of the figures of minimal value in absolute terms and could not be reasonably attributed to existing manufacturing capacity to transform these yarns into fabrics through a weaving process. Conversely, relative substantive import volumes of raw cotton and yarns in Bangladesh may lead to a presumption of existing industrial capacity able to transform these inputs into higher levels of manufacturing.

Imports of fabrics represented the preponderant mass in comparison to imports of yarns and other downstream inputs like raw cotton or filament tow. These trends indicate that manufacturing industries in Bangladesh and Cambodia were heavily relying on imports of fabrics from third countries.

The figures of trade flows of imports of cotton and man-made synthetic inputs were also contrasted with the corresponding output of exports of finished garments of Chapters 61 and 62. According to the general trends identified in the graphs below (Figures 4.11–4.14) these figures showed that the more Bangladesh and Cambodia were importing cotton and man-made fabrics, the more exports of finished garments grew. These trends further indicated that the manufacturing industries in Bangladesh and Cambodia were, and to a large extent are still, dependent on the sourcing of fabrics from external suppliers.

Dependence on imports of fabrics appeared very pronounced in the case of Cambodia and to a lesser extent in the case of Bangladesh. In particular, it was

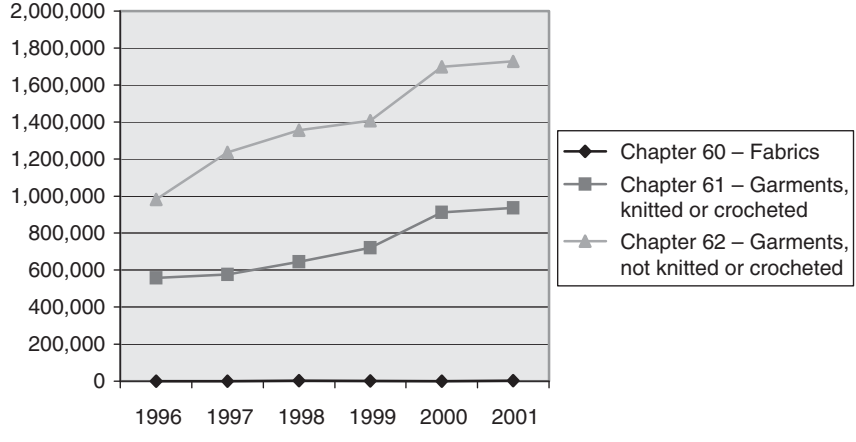


FIGURE 4.11 Bangladesh: Exports cotton (1996–2001)

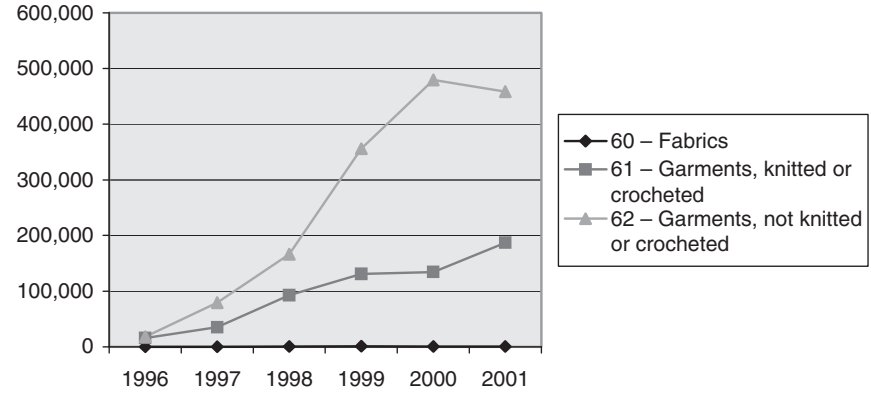


FIGURE 4.12 Cambodia: Exports cotton (1996–2001)

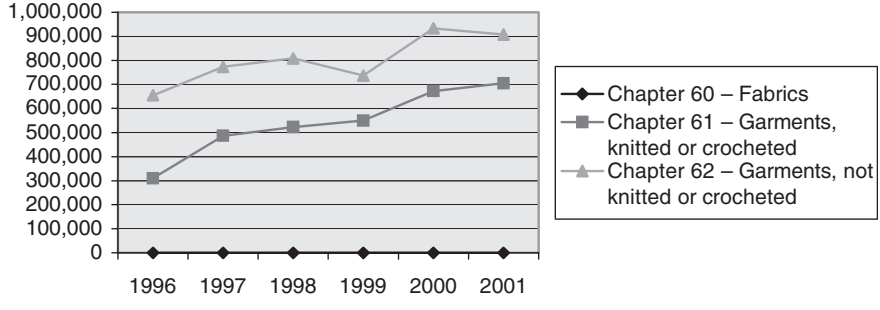


FIGURE 4.13 Bangladesh: Exports man-made and synthetic (1996–2001)

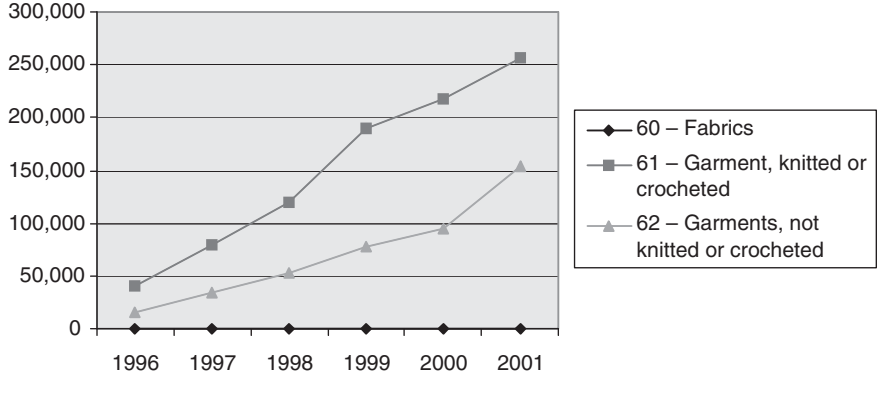


FIGURE 4.14 Cambodia: Exports man-made and synthetic (1996–2001)

observed that imports of raw cotton in Bangladesh were matched by an above average utilization rate in Chapter 61 and a high concentration of exports in the EU in relation to other markets (76 percent). This was confirmed by field missions and latest findings in other reports examined further in section 4.2.4. All these data suggested that for some products of Chapter 61, garment industries were increasingly able to comply with origin requirements.

As a final exercise, a comparison has been made between the ratio of imports of fabrics and exports of finished garments of Chapters 61 and 62 and the utilization rate of Bangladesh and Cambodia (see Figures 4.15 and 4.16). In the case of Bangladesh, a number of observations may be made (see Figure 4.15).

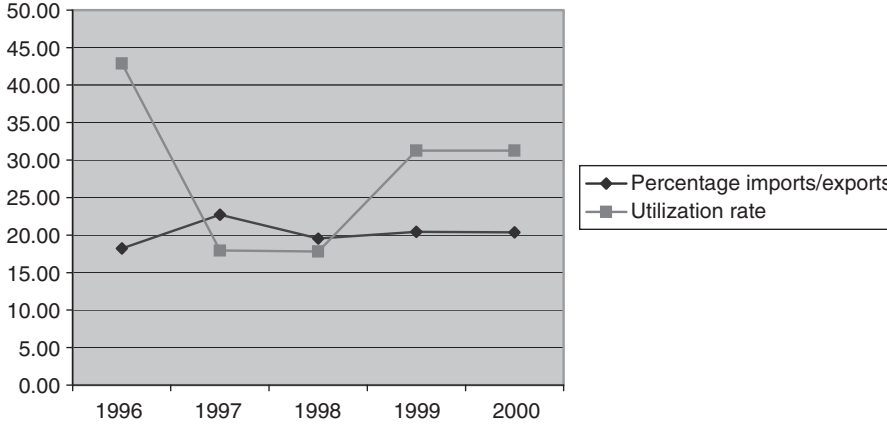


FIGURE 4.15 Bangladesh: Comparison of imports of fabrics/exports, Chapters 61 and 62 (garments), with EU GSP utilization rate (1996–2000)

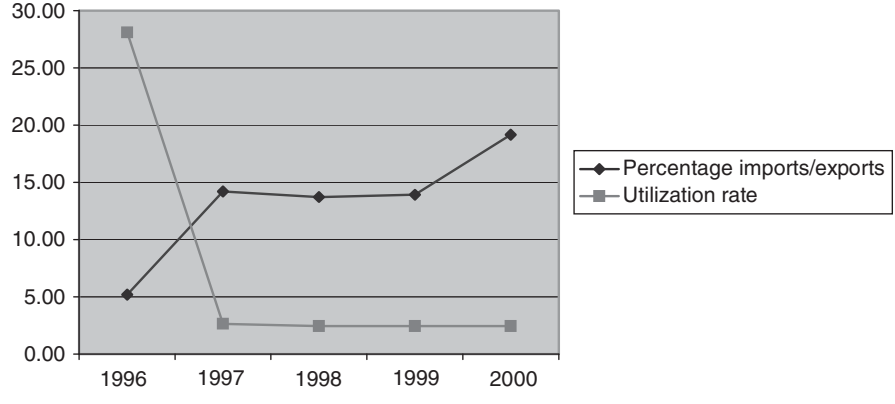


FIGURE 4.16 Cambodia: Comparison of imports of fabrics/exports, Chapters 61 and 62 (garments), with EU GSP utilization rate (1996–2000)

As noted earlier, the low utilization rate recorded in 1997 and 1998 is due to a more strict enforcement and surveillance of the issuance of certificates of origin following an investigation carried out by the EU. In March 1995 Customs of several EU members states, intrigued by the increase of t-shirt imports from Bangladesh decided to return systemically the certificates of origin Form A to the issuing authority in Bangladesh, the Department of Trade and Industry (DTI). As no reply was received during the ten months prescribed to receive a response, the EU launched a post-clearance investigation leading to the discovery of around 4,000 Form A issued wrongly (i.e. not complying with rules of origin) and 1,000 were simply false. Subsequently the EU launched a post-clearance recovery and the investigation had severe repercussions on the way DTI issued Form A. The DTI policy of stricter enforcement of rules of origin probably led to the fall in the utilization rate in 1997–1998.

In the period 1996–1997, the trend was set in a divergent manner: the more fabrics were imported in relation to exports, the more the utilization rate fell. In the years after 1998, the utilization rate increased with an almost unaltered import/export trade flow. The reason for this relative increase in utilization is explained by the change on rules of origin for garments of Chapter 61 and the restructuring of the Bangladesh textile and garments industry after the shock of 1997/1998 to comply with origin requirements. This finding appears to be further corroborated by the fact that in the years 1999 and 2000 the utilization rate and import/exports ratio are parallel.

This may be explained by the fact that once the adjustment in 1998 had taken place, given a certain mixture of input/output ratios between imports of fabrics and exports of finished garments, around 30 percent, a corresponding utilization rate may not exceed an average of 30 percent.

A quick glance at the chart of Cambodia is sufficient to note a clear and steady trend. The more the ratio of imports of fabrics to exports of finished garments grows, the more the utilization decreases or is maintained at a minimal level (see Figure 4.16).

As a further step, the analysis investigated the sourcing of the fabrics. In the case of Cambodia and Bangladesh, the pie charts depicted in Figures 4.17–4.21 provide an indication for 2001 of the sourcing of these inputs. A closer examination of the time series of trade flows from 1998–2001 and 2002–2004 shows that, in general, they have been relatively steady in terms of percentage shares among the various suppliers. Thus, 2001 could be considered a valid representative year.

The examination of the sourcing of fabrics clearly shows the limit of regional cumulation when the partners of the region are unable to supply the required inputs, in this case fabrics. Normally, rules of origin in the context of autonomous or unilateral contractual preferences are to be complied with within the customs territory of a single beneficiary country. However, some preference-giving countries considered that this requirement per se was not adequate to the existing realities in developing countries, especially in view of the regional trade initiatives taking place

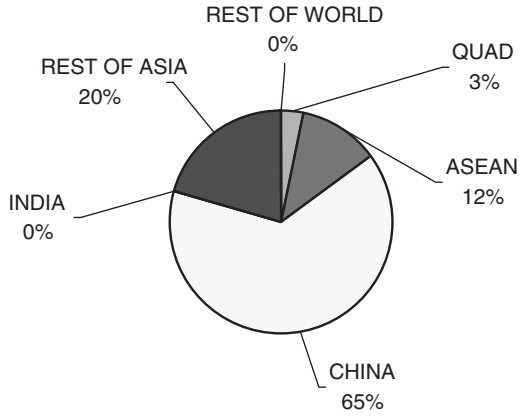


FIGURE 4.17 Bangladesh: Imports of cotton fabrics (2001)

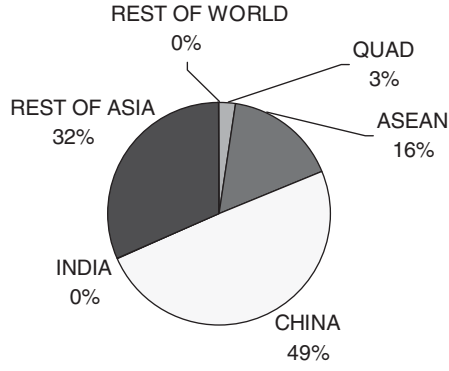


FIGURE 4.18 Cambodia: Imports of cotton fabrics (2001)

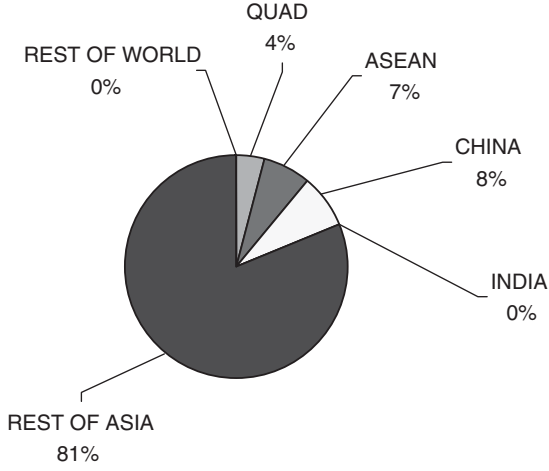


FIGURE 4.19 Bangladesh: Imports of man-made fabrics (2001)

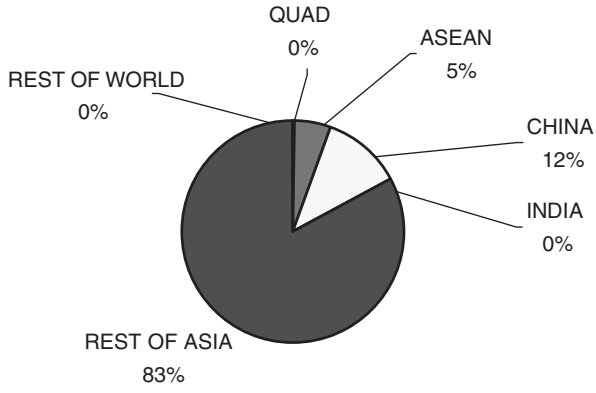


FIGURE 4.20 Cambodia: Imports of man-made fabrics (2001)

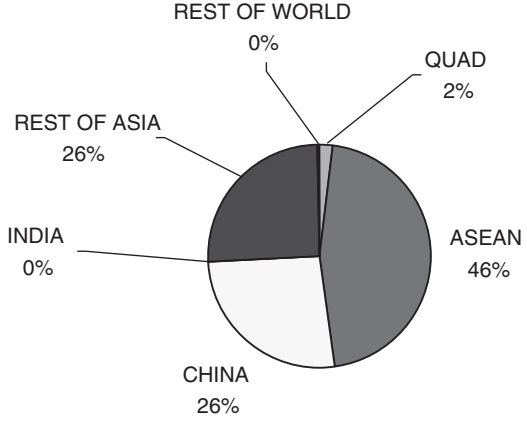


FIGURE 4.21 Cambodia: Imports of man-made synthetic fabrics (2001)

among them. First, isolated and stringent requirements to comply with rules of origin may demand excessive "verticalization" of production, which does not exist in developing countries. Second, an excessive requirement for carrying out multistage operations or value-added operations would frustrate trade creation effects.

As discussed in Chapter 3 under the schemes of some preference-giving countries, this rule has been liberalized to permit imported inputs from other beneficiary countries to be regarded as local content, thus easing compliance with the rules of origin requirements.

Under the EU GSP scheme, cumulation is permitted (subject to certain conditions) on a regional basis. Under the EU rules for regional cumulation, materials or parts imported by a member country of one of these four groupings from another member-country of the same grouping for further manufacture are considered as

originating products of the country of manufacture and not as third-country inputs, provided that the materials or parts are already "originating products" of the exporting member country of the grouping. Originating products are those that have acquired origin by fulfilling the individual origin requirements under the basic EU rules of origin for GSP purposes.

However, in the case of Bangladesh and Cambodia, Figures 4.17–4.21 indicated that the countries supplying fabrics were not members of ASEAN or SAARC. Almost half of imports of cotton fabrics in Cambodia are sourced in China with only 16 percent from ASEAN. In the case of Bangladesh, the percentage from China is even rising to 65 percent. In the case of man-made and synthetic fabrics, Bangladesh and Cambodia show that very few inputs are sourced from their partners in SAARC and ASEAN with the exception of only man-made synthetic fabrics for Cambodia where ASEAN accounts for 46 percent (Figure 4.21). Taking into account Figures 4.19 and 4.20, 81 percent and 83 percent of man-made fabrics are sourced by Bangladesh and Cambodia respectively from the rest of Asia, mainly Taipei and South Korea. This trend leaves minimal scope for regional cumulation as a means to improve utilization of trade preferences.

This finding is further corroborated by the consideration that even if the fabric is sourced from regional partners in SAARC and ASEAN the origin allocation rules in force at that time would confer origin back to the country that manufactured the fabric. Chapter 3 of this book contains a detailed description of the allocation of origin among country members of the same regional group under the EU GSP rules of origin.

This input–output analysis and consequent findings were tested during field missions and contrasted with available literature. It was found that analysis has already demonstrated that local output of the different segments of textile inputs in Bangladesh and Cambodia was extremely limited.

As far as Bangladesh was concerned, detailed figures were reported in an UNCTAD study.[67] It was outlined that the textile sector of Bangladesh consists of a fragile spinning subsector, a weak weaving subsector, an even weaker dyeing and finishing subsector, and an emerging knitting subsector.

In particular, it was found that about 80 percent of the demand for yarn was met by imports. The total yarn demand of the country was expected to double by 2005, when 263 million kg was required for domestic consumption and 554 million kg by the export oriented ready-made garment (RMG) sector. Yarn production capacity accounted for just 13 percent of the demand in 2005.

Most of the local fabrics were reported as unsuitable for the export-oriented RMG sector, which currently meets 86 percent of its demand from imports. It was estimated that the fabric production capacity of Bangladesh at that time met less

[67] See D. Bhattacharya, "The post-MFA challenges to the Bangladesh textile and clothing sector in trade, sustainable development and gender" (UNCTAD/EDM/Misc.78, 1999).

than 15 percent of the projected requirements of 6.1 billion meters for 2005. In the dyeing and finishing subsector, in 1997, the number of units stood at 250 with an annual production capacity of only 653 million kg, which was also far from meeting the demand of the RMG industry.

These early predictions and findings were further confirmed in a comprehensive report on the status of the RMG sector in Bangladesh.[68] According to this report, despite all the incentives and large protective barriers, the woven fabric section of the textile sector has not been able to reduce the demand–supply gap. It can meet only about one-fifth of the total requirement of the woven RMG sector, and this situation has not changed much for the last five years. The excess demand for woven fabric (over and above domestic supply) has, therefore, increased over the years. The unavailability of domestic woven fabric not only increases lead time, but also explains the low utilization of trade preference in Chapter 62 and ultimately poses a serious constraint to export competitiveness.

In the case of Cambodia, studies carried out by the World Bank[69] and the Garment Manufacturers Association in Cambodia[70] found that Cambodia has practically no production of fabrics[71] or accessories and it has been fully dependent on imported inputs for garment exports.

In conclusion the results of the input–output analysis crossed with the utilization rates carried out in the 2009 edition showed beyond any reasonable doubt that low utilization rates over the years 1994–2005 were due to restrictive rules of origin applicable at that time.

In the case of Bangladesh, it was observed that the minimal utilization of trade preferences has been a constant feature in the exports of finished garments of HS Chapter 62. The relative positive peaks observed in Bangladesh for garments of Chapter 61 were counterbalanced by the drastic lower rates recorded in the years 1997 and 1998. These latter variations are explained by the discovery of almost 10,000 wrongly issued certificates of origin by the EU authorities leading to a disruption of transitional trade flows (see Chapter 6).

The real boost to the utilization rate in knit garment manufacturing since 1998–1999 was given by the change in the applicable rules of origin for availing European GSP from three to two stages in HS Chapter 61 (garments, knitted and crocheted). The relaxation of the stringency of the rules of origin opened up a huge opportunity for the knit garment manufacturers. Many of them invested in integrated knit plants as the cost of investment was relatively modest. As a result of this change of rules of origin and the

[68] "End of MFA quotas: Key issues and strategic options for Bangladesh readymade garment industry," World Bank, 2005.

[69] See Y. Konishi, "Towards a private sector-led growth strategy for Cambodia," vol. I: "Value chain analysis," paper prepared for the World Bank, June 2003.

[70] See V. David, "Case study on trade in textiles & clothing," paper prepared for the UNDP Asia Trade Initiative, Cambodia, October 2003.

[71] An illustration of the embryonic state of development of cotton plantations is illustrated by a US-owned enterprise, Manhattan Textiles. In Cambodia it produced 120 MT of cotton fiber p.a. compared to its regular imports of 1,500 MT for its own factories' needs.

investments made, garments knitted or crocheted of Chapter 61 started to qualify for GSP duty-free and quota-free treatment as most of the knit fabric used by the RMG industry was manufactured locally. This gave knit exports from Bangladesh a considerable price advantage over non-LDC competitors because the MFN duty rates on garments in the EU were relatively high (up to 12.8 percent).[72]

A similar development did not happen in the upstream industries of the woven section of the garment industry. The principal reason for this is mainly the large cost of investment required to create upstream linkage industries such as spinning and weaving. While the relatively modest cost of investment for integrated knit plants enabled the knit garment manufacturers to move to knit fabric manufacturing, the same was not possible for most woven garment manufacturers. According to the estimates, the investment cost of manufacturing capacity of certain volume of processed knitted fabric is less than one-third of the cost of creating the same capacity for processed woven fabric. Hence, unlike the knit industry, woven fabric manufacturing and woven garment manufacturing remain separate (non-integrated) activities. The large investment requirements of primary textile manufacturing and low international prices due to worldwide excess capacity limited the growth of woven fabric manufacturing.

In the case of Cambodia, the utilization rate for Chapters 61 and 62 follows a similar pattern of an initial relatively high utilization rate in the year 1995 and a drastic fall to single-digit numbers from 1997 onwards.

4.2.3.2 Quantifying the Trade Effects of Rules of Origin: A WITS Simulation

As earlier examined, low utilization of available trade preferences means that, in practical terms, at the time of customs clearance the MFN rate is levied on the goods rather than the preferential rate. As a final part of the input–output analysis, a simulation was carried out to calculate estimates of trade effects of rules of origin. The cost of rules of origin was estimated by taking the amount of "missed trade preferences" – that is, the volume of trade that was covered and potentially eligible for preferences but failed to qualify for a preference – and simulate[73] the trade effects by counting that amount as if the preferential rate was granted.[74]

The simulation was carried out for the EU trade preferences and limited to LDC countries. It has to be noted that LDC beneficiaries were divided into two categories: those benefiting from ACP preferences under the present Cotonou and former Lomé Conventions and those not benefiting from ACP preferences – practically speaking, the Asian LDCs.

[72] In this sense see also "End of MFA quotas: Key issues and strategic options for Bangladesh readymade garment industry," Bangladesh Development Series, Paper 2, World Bank, 2005.

[73] World Integrated Trade Solutions (WITS) developed by the World Bank and UNCTAD is the model that has been utilized to carry out the simulation.

[74] As discussed, this was the method used by the EU Commission in its impact assessment used for the reform of EU rules of origin.

Until the entry into force of the EBA, ACP LDCs were benefiting from more generous trade preferences than non-ACP LDCs especially as far as trade coverage of agricultural products and cumulative rules of origin. As a result, ACP LDCs utilized rather the trade preferences under the Lomé/Cotonou Agreements than those available under the EU GSP scheme for LDCs. With the entry into force of the EBA that is providing an equal market access to all LDCs, such difference is no longer applicable.

However, for the scope of the simulation that was based on an average of the last three available years, it has been considered that such division between the ACP LDCs and non-ACP LDCs was necessary in order to utilize a consistent database.

The evaluation of the possible effects due to full liberalization (i.e. to full product coverage and/or full utilization) was made utilizing WITS. WITS is a simple tool for quantification of the effects on trade flows induced by changes in market access conditions constructed by the UNCTAD Secretariat in cooperation with the World Bank. The model used in WITS is partial equilibrium and is particularly useful for analyzing the first round or impact effects of trade liberalization on specific products. Some caution is advised in looking at the totals across products as these may also be subject to intersectoral effects (general equilibrium considerations), which normally lead to even larger effects. However, given the small value of LDC trade this may be less serious an issue than a much wider liberalization scenario – for example, WTO negotiations.

This simulation was carried out on the above assumptions and did not cover other nontariff barriers that could be liberalized. In particular, the simulation did not take into account the trade effects that may have arisen from the expected end of textile and clothing restrictions under the Agreement on Textiles and Clothing (ATC) at that time. This may have had a significant impact on the results of the simulations because, as will be discussed in the following paragraph, the majority of trade effects of the simulation activity take place in the textile and clothing area. Other models and studies have assessed the impact of trade liberalization on textiles and clothing.[75] The present exercise was aimed at simply quantifying the "missed trade preferences," either because there is no coverage or because utilization rates are low. Thus, the results of the simulation have to be read within this context.

Simulations have been run at the single tariff line. At this level of disaggregation it might well happen that for some products either trade is zero, because the beneficiary country does not export that particular good, or that the good is not covered by a preferential regime. In these cases, when the utilization rate was not available, the utilization rate of the corresponding HS 6 (six-digit subheading) or HS 4 (four-heading) section level was used in order to calculate the effects on trade flows from full utilization. If neither of these was available, the average utilization rate of all other non-LDCs at the same HS 4 section level has been used. Besides, because the utilization rate may vary a lot from year to year due to extemporary reasons, in the simulations we take the average of the last three years. The utilization rate in Table 4.12 was nevertheless obtained from 2000 trade data.

[75] See, for instance, D. Spinanger, *Beyond eternity: What will happen when textile and clothing quotas are eliminated as of 31/12/2003*, forthcoming UNCTAD publication.

TABLE 4.12 *Expected trade effects from full utilization of preferential schemes: EU–non-ACP LDCs*

	Description of the HS section	Imports from non-ACP LDCs*	Duty free	Imports covered*	Utilization rate (%)	TC*	TD*	TE*	TE (%)
01	Textile & textile articles	3,294,446	74,125	3,220,321	31.68	902,460	420,546	1,323,006	96.90
02	Footwear, headgear, umbrellas, etc.	109,970	31	109,939	78.54	11,377	5,261	16,637	1.29
03	Live animals & products	189,847	307	189,540	75.91	5,365	7,755	13,120	0.96
04	Prepared foodstuffs, beverages, etc.	24,694	6	24,650	56.81	1,774	3,140	4,914	0.36
05	Hides and skins, leather, etc.	109,414	17,721	91,693	86.10	1,930	797	2,727	0.32
06	Machinery & electrical equipment	23,766	11,302	12,464	11.56	813	651	1,464	0.11
07	Plastics & rubber	7,366	1,987	5,359	55.61	735	287	1,022	0.07
08	Wood & articles of wood	50,140	33,798	16,342	68.71	96	464	560	0.04
09	Miscellaneous manufact. articles	14,296	8,441	5,855	63.93	364	150	514	0.04
10	Transport equipment	12,759	170	12,589	93.18	254	125	379	0.03
11	Base metals & products	4,823	2,144	2,679	46.96	139	138	278	0.02
12	Articles of stone, cement, etc.	12,641	49	12,592	96.11	138	66	204	0.01
13	Vegetable products	24,967	15,091	9,876	90.34	37	98	135	0.01
14	Optical & precision instruments	3,245	2,158	1,087	7.36	81	51	132	0.01
15	Precious stones, etc.	7,316	5,564	1,752	52.51	85	45	131	0.01
16	Pulp of wood, paper, books, etc.	3,554	820	2,734	79.96	23	33	56	0.00

Note: Simulations are done using 2000 trade data and 2001 tariffs. Products 2709 (petroleum oils and oils obtained from bituminous minerals, crude), 2710 (petroleum oils and oils obtained from bituminous minerals, other than crude; preparations not elsewhere specified or included, containing by weight 70% or more of petroleum oils or of oils obtained from bituminous minerals, these oils being the basic constituents of the preparations), and 88 (aircraft, spacecraft, and parts thereof) are excluded.

Source: Author's calculations.

* In thousands current USD

As far as non-ACP LDC countries are concerned, the trade effects in textile and textile articles stand out from all the others, with an increase of more than 1 billion USD. This was mainly due to Chapters 61 and 62 (articles of apparel and clothing accessories). Missing trade in these two chapters was considerable, the utilization rate being 41 percent and 15 percent respectively. Even if to a much lesser extent, the sections "life animals and products" and "footwear, headgear, umbrellas, etc." also showed a relevant increase in exports in spite of a utilization rate already relatively high.

The trade effect in selected chapters for each country involved in the simulation is reported in Table 4.13. The country that would benefit more in absolute value if all covered goods in Chapters 61–63 actually received the special treatment they are entitled to is Bangladesh, followed by Cambodia. For a vast majority of countries imports covered would double. Figures in other sectors are maybe less impressive. Nevertheless, the Maldives, for example, would see an increase in its covered exports of prepared fish and crustaceans by almost 20%; Myanmar that of sugar by almost 60%, and that of fish and crustaceans by 4%.

As shown in Table 4.14, in the case of ACP LDCs, the biggest trade effect is in section 11 (textile and textile articles), even if this is much smaller than in the case of Asian LDCs. This is mainly due to the fact that EU imports of textiles and textile articles from ACP countries are smaller and also to the fact that a more considerable part of them is already duty free. In this case (details are not reported), Madagascar would be the major contributor to the total trade effect with an increase in export of "art of apparel & clothing access" of more than 87 million USD.

The increase in exports from full utilization was relevant also for "live animals and products" and "prepared foodstuffs, beverages, etc." (40 million and 46 million USD, respectively) and, to a lesser extent, for "transport equipment." Covered imports of fish and crustaceans from Madagascar and Mozambique would increase by 10 percent. Covered imports of sugar from Malawi would increase by almost 60 percent (equal to 23 million USD). (See Tables 4.13 and 4.14.)

TABLE 4.13 *Expected trade effects from full utilization of preferential schemes: EU–non-ACP LDCs – selected countries and markets*

HS chapter	Chapter description	Country	Imports covered	Utilization rate (%)	TE*	As a % of imports covered
61	Articles of apparel & clothing accessories knitted or crocheted	Afghanistan	571	2.98	348	
61	ditto	Bangladesh	1,186,006	49.55	360 514	30.40

TABLE 4.13 (*continued*)

HS chapter	Chapter description	Country	Imports covered	Utilization rate (%)	TE*	As a % of imports covered
61	ditto	Cambodia	193,799	6.97	113 284	58.45
61	ditto	Lao PDR	45,854	18.49	23 356	50.94
61	ditto	Maldives	8,035	0.02	4 958	61.70
61	ditto	Myanmar	151,160	31.58	64 078	42.39
61	ditto	Nepal	7,624	76.59	1 081	14.18
61	ditto	Yemen	1	0	0	0
62	Articles of apparel & clothing accessories, not knitted/ crocheted	Afghanistan	1,160	0.09	537	46.29
62	ditto	Bangladesh	1,101,511	13.01	582 636	52.89
62	ditto	Bhutan	2	50	1	50
62	ditto	Cambodia	61,593	3.84	37 710	61.22
62	ditto	Lao PDR	54,963	37.81	20 854	37.94
62	ditto	Maldives	8,024	1.16	5 082	63.33
62	ditto	Myanmar	112,059	20.76	54 733	48.84
62	ditto	Nepal	35,186	71.60	5 272	14.98
62	ditto	Yemen	4	50	1	25
63	Other made up textile articles; sets; worn clothing, etc.	Afghanistan	90	13.33	28	31.11
63	ditto	Bangladesh	44,582	75.21	2 280	5.11
63	ditto	Bhutan	1	100	0	0
63	ditto	Cambodia	0	3	27.27	
63	ditto	Lao PDR	5	80	0	0
63	ditto	Myanmar	3	66.67	0	0
63	ditto	Nepal	686	86.88	28	4.08

Note: Simulations are done using 2000 trade data and 2001 tariffs. Products 2709 (petroleum oils and oils obtained from bituminous minerals, crude), 2710 (petroleum oils and oils obtained from bituminous minerals, other than crude; preparations not elsewhere specified or included, containing by weight 70% or more of petroleum oils or of oils obtained from bituminous minerals, these oils being the basic constituents of the preparations), and 88 (aircraft, spacecraft, and parts thereof) are excluded.
Source: Author calculations.
* In thousands current USD

TABLE 4.14 *Expected trade effects from full utilization of preferential schemes: EU–ACP LDCs*

Description of the HS section		Imports from ACP LDCs*	Duty free	Imports covered*	Utilization rate (%)	TC*	TD*	TE*	TE (%)
01	Textile & textile articles	526,028	224,076	301,952	34.87	66,181	34,111	100,293	40.91
02	Prepared foodstuffs, beverages, etc.	340,972	58,632	281,976	46.92	15,462	31,086	46,548	18.99
03	Live animals & products	637,834	8,807	629,027	77.49	17,434	23,041	40,475	16.51
04	Transport equipment	264,390	190,697	73,693	0.43	15,636	9,860	25,496	10.40
05	Vegetable products	844,719	700,881	141,667	37.48	5,692	9,567	15,260	6.22
06	Hides and skins, leather, etc.	103,239	34,427	68,812	49.15	2,813	937	3,751	1.53
07	Fats and oils	83,797	2,152	81,645	64.65	2,097	1,574	3,671	1.50
08	Machinery & electrical equipment	78,704	42,081	36,623	17.88	1,570	1,253	2,823	1.15
09	Base metals & products	117,234	90,277	26,957	46.67	808	1,430	2,238	0.91
10	Optical & precision instruments	21,738	5,586	16,152	18.75	1,229	662	1,891	0.77
11	Footwear, headgear, umbrellas, etc.	14,422	92	14,330	60.63	646	288	934	0.38
12	Miscellaneous manufact. articles	8,989	2,670	6,319	70.63	278	130	408	0.17
13	Chemical products	133,998	129,079	4,651	50.27	166	201	366	0.15
14	Plastics & rubber	11,772	10,046	1,695	44.07	250	101	350	0.14
15	Wood & articles of wood	177,355	164,269	13,086	81.79	95	158	253	0.10
16	Articles of stone, cement, etc.	3,717	191	3,526	75.38	51	89	140	0.06
17	Precious stones, etc.	2,049,189	2,047,946	1,243	38.21	79	42	121	0.05

Note: Simulations are done using 2000 trade data and 2001 tariffs. Products 2709 (petroleum oils and oils obtained from bituminous minerals, crude), 2710 (petroleum oils and oils obtained from bituminous minerals, other than crude; preparations not elsewhere specified or included, containing by weight 70% or more of petroleum oils or of oils obtained from bituminous minerals, these oils being the basic constituents of the preparations), and 88 (aircraft, spacecraft, and parts thereof) are excluded.

Source: Author calculations.

* In thousands current USD

4.2.4 *Linking Utilization Rates to Stringent Rules of Origin: Evidence from* Ex Post *Analysis in GSP Schemes for LDCs*

4.2.4.1 Impact of Broad Reform: Evidence from the Utilization Rates of EU and Canada

As discussed in section 4.2.1 the LDC paper presented at the CRO in October 2014 represented a milestone in the advocacy of better rules of origin for LDCs and the use of utilization rates. The paper argued that the world's economy has changed since the 1970s. Yet, among the quadrilateral countries (QUAD: the EU, United States, Japan, and Canada), only Canada and the EU substantially reformed rules of origin for LDCs. Other preference-giving countries are still adopting rules conceived decades ago. This section draws from and expands on the original paper by updating data and adding new evidence.[76]

So far, the EU and Canada have been the only preference-giving countries that have conducted a *unilateral* reform of their rules of origin for LDCs that has triggered dramatic increases in the utilization rates of existing preferences and, most importantly, generated an overall increase of trade flows thanks to new investment and manufacturing operation located in LDCs. Other preference-giving countries have yet to do so, or have conducted limited reforms while a number of developing countries have introduced DFQF schemes containing rules of origin that need to be assessed in the light of the utilization rates that have recently started to notify to the WTO Secretariat following the Nairobi Decision.[77]

The results achieved by these two preference-giving countries show that a change in rules of origin reflecting global value chains generates a market response in terms of foreign direct investment and trade flows. Obviously, rules of origin do not operate in a vacuum and a number of other factors are concurring in the determination of such trade effects. Yet the response has been unequivocal and concrete evidence has been obtained from companies that decided to shift production to an LDC because of a change in rules of origin. At the CRO meeting of October 2014, the LDC paper prepared by UNCTAD was presented by Uganda on behalf of the LDCs.[78]

In this paper, prepared for the WTO LDC group, the author relaunched the idea of using the utilization rates as a tool to measure the stringency of rules of origin, as was previously the case in UNCTAD working groups described in Chapter 1 of this

[76] This section draws from and updates the contribution made by the author to the LDCs paper of October 2014 submitted by Uganda to the CRO WTO document G/RO/W/148, October 28, 2014.

[77] While a series of country-specific assessments have been carried out as contained and discussed in Chapter 1 of this book, a comprehensive analysis of all preference-giving countries is still to be carried out.

[78] See fn. 76 above.

book. In fact, due to the interruption of the UNCTAD working groups, the use of utilization rates to measure trade preferences was somewhat lost and little effort or resources were dedicated to this important topic by the international community. The author considered that it was time to have a fresh look at the issue of utilization by inserting it in the dynamic of WTO CRO as the only possible fora where the issue could get traction and interest from the international community.

The utilization rate (UR) is a clear indicator of the effectiveness of trade preferences used by UNCTAD since the inception of the GSP preferences in the late 1970s and subsequently adopted in the WTO following the Nairobi Decision as discussed in Chapter 1.

Such an indicator is the ratio of the amount of imports that actually received trade preferences at the time of customs clearance in preference-giving countries with respect to the amount of dutiable import eligible for preferences:

$$UR\,(\%) = \frac{Value\ of\ the\ dutiable\ imports\ covered\ by\ the\ preferential\ arrangement}{Value\ of\ dutiable\ imports\ being\ granted\ preferential\ duty\ rates} \times 100$$

Higher or lower utilization rates are mainly the result of the stringency and/or complexity of rules of origin and ancillary requirements as further developed in this section.

Figures 4.22 and 4.23 show how changes in rules of origin for textiles and clothing in the EU EBA introduced in 2011 and the Canadian GSP in 2003 positively affected the utilization rate and LDCs export flows.

For Canada, Figure 4.22 shows that the introduction of special rules for textile and clothing made the utilization rate immediately reach 100 percent in 2003 for

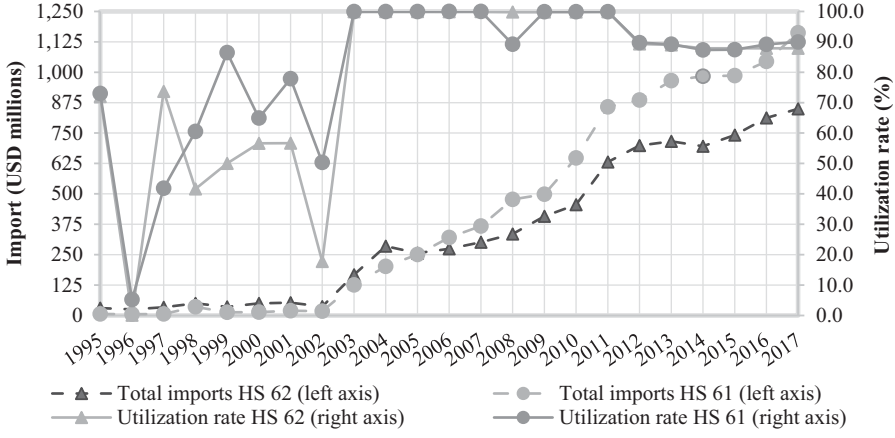


FIGURE 4.22 Canadian imports from effective LDCs and GSP utilization rates (1995–2015): Articles of apparel & clothing accessories, HS 61 (knitted/crocheted) and HS 62 (not knitted/crocheted)

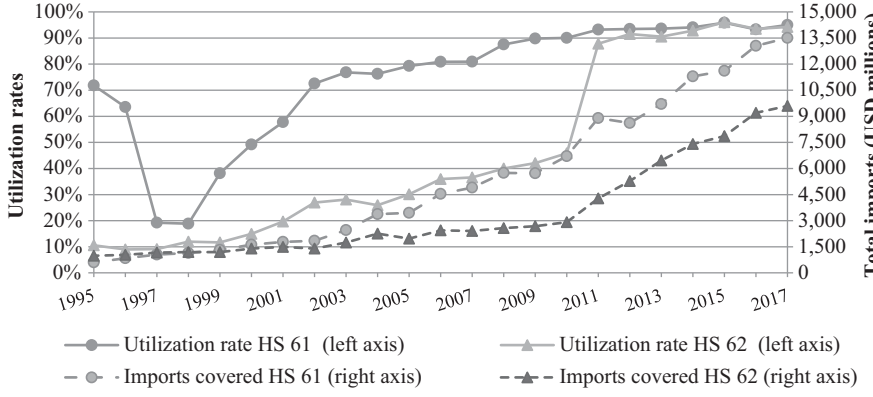


FIGURE 4.23 EU imports from effective LDCs and GSP utilization rates: Articles of apparel & clothing accessories, HS 61 (knitted/crocheted) and HS 62 (not knitted/crocheted)

products under HS 61 and HS 62. In addition, import values increased significantly. The total import values of woven garments of HS 62 multiplied by 4.6 from 36 to 167 million USD. The increase was even more significant for knitted and crocheted garments of HS 61, since import values multiplied almost sevenfold, from 18 to 125 million USD and continued to grow steadily after the reform from 2003 to 2017.

A similar development occurred after the reform of rules of origin in the textile sector under EBA. As Figure 4.23 shows, once again, both utilization rates and import values for garments (HS Chapters 61 and 62), have been positively affected.

The impact is particularly striking in HS Chapter 62 (not knitted and crocheted garments), where the utilization rate by LDCs exporters rose from 49 percent to 92 percent between the end of 2010 and the end of 2011, the first year of entry into force of the EU reform. Simultaneously, LDCs exports to the EU market for same HS chapter rose from 2.8 to 4 billion USD (+47 percent) to reach 5.9 billion USD in 2013.

The rise in utilization rates of knitted or crocheted garments (HS Chapter 61), has been moderated as the latter started from a much higher value than in the case of HS Chapter 62.

The EU reform of 2010 substantially liberalized the EBA rules of origin for almost the totality of sectors, allowing in certain cases up to 70 percent of non-originating materials and introducing a number of positive changes concerning cumulation and ancillary criteria.

The EU reform has demonstrated a capacity to trigger exports of non-traditional products as shown in Figure 4.24 by utilization rates of Cambodian bicycles. Exports of bicycles between 2010 and 2015, increased from 33 percent to 87 percent and their

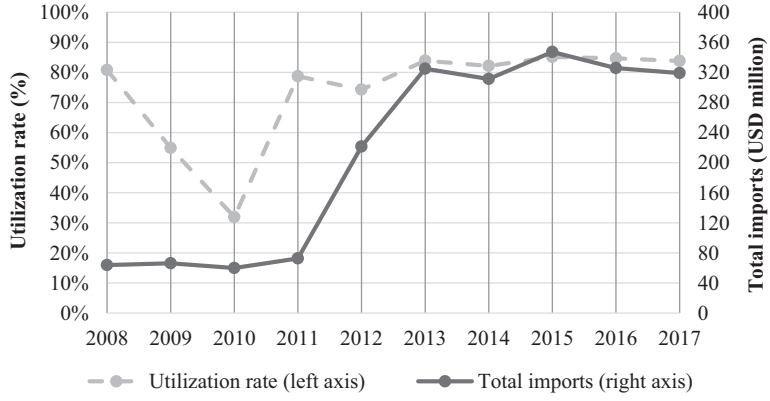


FIGURE 4.24 EU imports from Cambodia and GSP utilization rates: Bicycles

export values were multiplied by a factor of 5.8 rising from 60 to 347 million USD.[79] As recorded by interviews with bicycle manufacturers during UNCTAD field missions, Taiwanese and Chinese investors moved their manufacturing location to Cambodia from other neighboring countries like Vietnam, attracted by the combination of the preferential margin and the lenient rules of origin applicable after the EU reform.[80]

This is a concrete demonstration of how changes in rules of origin have real effects on trade and business in LDCs.

[79] In the case of bicycles, it has to be mentioned that following changes introduced in the EU GSP schemes of 2014, Singapore and Malaysia inputs (mainly gears) could at first not be used by Cambodia for ASEAN cumulation purposes. Similar changes in Canadian GSP rules of origin raised concerns and caused significant difficulties for the majority of bicycle industries based in Cambodia.

The Royal Government of Cambodia had requested a derogation from the EU Commission to continue to consider the ASEAN inputs from Malaysia and Singapore to be eligible for cumulation for a transitional period. Such request has been granted finally, with a quota on the amount of bicycles that can use cumulation. See Commission Implementing Regulation (EU) No. 822/2014, July 28, 2014 on a derogation from Regulation (EEC) No. 2454/93 as regards the rules of origin under the scheme of generalised tariff preferences in respect of bicycles produced in Cambodia regarding the use under cumulation of bicycle parts originating in Malaysia.

[80] The factories moved to Cambodia because of a combination of a factors: (1) duty-free treatment if the bicycles were originating in Cambodia in comparison to a high MFN in the EU of 14%; (2) a preferential rate of duty of 10.5% if the bicycles were originating in Vietnam; (3) a more lenient PSRO allowing use of non-originating materials up to 70%, and lenient provisions on the allocation of origin when cumulation was used; see further in Chapters 3 and 7 of this book.

4.2.4.2 Comparison: Utilization and Trade Effects in the Cases of the United States and Japan

This section examines the utilization rates and trade effects of the remaining two QUAD countries that have not undertaken a major reform of the rules of origin for LDCs.[81]

The GSP rules of origin under the US GSP have been practically unchanged since 1974.[82] The African Growth and Opportunity Act (AGOA) rules of origin are practically similar to those of the US GSP, with the notable exception of product-specific rules in the case of apparel where PSRO apply for such products.[83]

The United States is granting trade preferences for LDCs under different arrangements, as follows:

(a) the GSP for LDCs
(b) AGOA for African LDCs and
(c) the HOPE initiatives for Haiti.

Accordingly, the analysis of the utilization rates data has divided the LDCs into three groups:

(a) LDCs excluding AGOA beneficiaries that are granted GSP preferences
(b) AGOA LDCs beneficiaries that are granted AGOA preferences[84]
(c) HOPE initiative granted to Haiti.

In addition to these multiple preferential trade arrangements, other factors have to be taken into account when assessing the trade flows and the utilization rates under US GSP, such as:

(a) exclusion/graduation of beneficiaries
(b) the exclusion from coverage of the US GSP of textiles and garments that is the majority of export volume of the effective LDC beneficiaries under the US GSP scheme.

[81] This statement should not be construed as if there have not been any changes at all. For instance, Japan recently relaxed rules of origin for Chapter 61 (knitted and crocheted garments). However, neither the United States nor Japan have introduced a massive reform of their rules of origin for LDCs, drastically liberalizing such rules as has been the case for Canada and the EU.

[82] See, for further details on rules of origin, UNCTAD Handbook on Duty-Free and Quota-Free Market Access and Rules of Origin for Least Developed Countries, UNCTAD/ALDC/2018/5 (Part I).

[83] See Chapter 3 of this book. For a detailed analysis and reporting see the 2018 Biennial Report on the implementation of the African growth and opportunity act, at https://ustr.gov/sites/default/files/2018_AGOA_Implementation.pdf.

[84] See fn. 82 above. In May 2000, the United States promulgated the AGOA. Under AGOA, designated sub-Saharan African countries benefit from an expanded coverage compared to US GSP, including textiles and clothing.

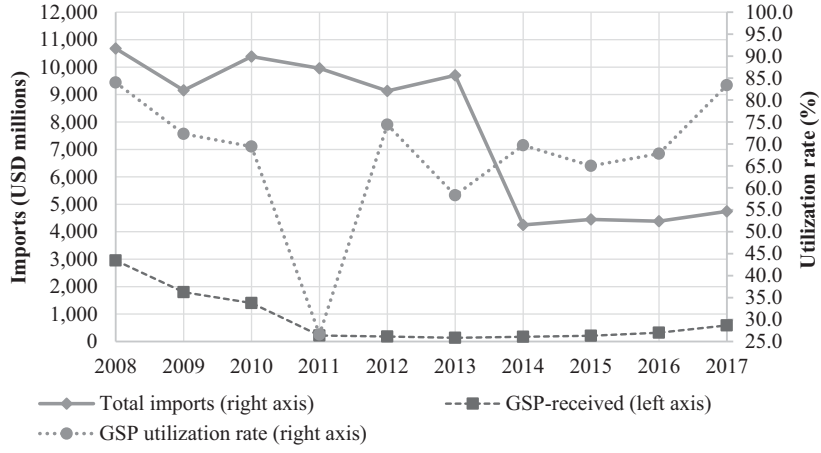


FIGURE 4.25 US total imports from effective LDCs excluding AGOA beneficiaries

Figure 4.25 shows the evolution of imports from LDCs excluding AGOA beneficiaries between 2008 and 2017. Over this period the total imports from effective beneficiaries have decreased from 10.7 to 4.7 billion USD. While the overall trend fluctuates, the biggest drop of total imports occurred from 2013 (9.7 billion USD) to 2014, when only 4.2 billion USD in imports from LDCs excluding AGOA were recorded. This substantial decrease in total imports is mainly due to the graduation of Equatorial Guinea in 2011 from the US GSP and most recently the exclusion of Bangladesh in 2013 from the US GSP scheme for not respecting worker rights according to US GSP provisions.

Over the same period, imports receiving the GSP treatment have also significantly declined, from 3 billion to 587 million USD.

The GSP utilization rate decreased from 84 percent in 2008 to 65 percent in 2015 and rose again to 84 percent in 2017. Various events may account for such fluctuation. There had been a significant decline from 2010 to 2011 when the utilization rate dropped by 42 percent from 69 to 27 percent, mainly caused by the graduation of Equatorial Guinea from the scheme and the expiry of the scheme on December 31, 2010. The US GSP scheme was only retroactively renewed on November 5, 2011. Similarly, from 2012 to 2013, the utilization rate dropped from 74 to 58 percent, reflecting the exclusion of Bangladesh in 2013 from the scheme for not respecting worker rights according to US provisions. In 2013, similarly, the scheme expired in July and was retroactively extended only in July 2015.[85]

Exclusion of a given beneficiary like Equatorial Guinea and Bangladesh may not by itself have a direct influence on utilization rates. However, the fact that the trade

[85] For the legislative developments of the GSP scheme see V. Jones, *Generalized System of Preferences (GSP): Overview and Issues for Congress*, Congressional Research Service, 2017, available from https://fas.org/sgp/crs/misc/RL33663.pdf.

values of GSP received as shown in Figure 4.25 are so minimal makes them dependent on exclusion of beneficiaries like Equatorial Guinea that was mainly exporting petroleum oils to the United States, a wholly obtained product that does not usually carry compliance problems with rules of origin.

Recent research addressing the impact of GSP expiration on exports and utilization rates found that the US GSP scheme's expiration has a significant impact on developing countries, with an average decline of 3 percent in exports for 2011. Even though collected duties are refunded upon retroactive renewal of the GSP scheme, uncertainty prevails and the interim payable duties remain an obstacle for exporters of developing countries.[86] This trend was also confirmed over the period of 1989 to 2012, when activity of the US Congress on renewal periods and expiration of GSP were associated with fluctuations of imports under the scheme.[87]

The most striking point emerging from Figure 4.25 is that the value of imports receiving GSP under the US GSP scheme are particularly low compared to the total MFN dutiable imports. This reflects the poor coverage of the GSP scheme and arguably that the existing rules of origin are not trade creating. In the period from 2011 to 2017, imports that received US GSP treatment amounted only to 261 million USD on yearly average, which corresponds to a utility rate of about 4.2 percent, whereas the overall utilization rate was on average 64 percent in the same period. Thus, not only is the coverage low but also the utilization rates are pointing to rules of origin as a deterrent to new trade dynamics.

In Figure 4.26, excluding agricultural products and fuel from the analysis, the pattern is somewhat equivalent. Total imports from non-AGOA beneficiary LDCs first increased over time, from 7.2 billion in 2008 to 9.3 billion USD in 2013. In the following years the total imports dropped to 4 billion USD in 2014 and slightly recovered in 2015 to 4.2 billion USD, reflecting the exclusion of Bangladesh.

In the period 2008–2015 the total amount of received GSP trade is about 1,064 billion USD, which equals a yearly average of 152 million USD.

Over the period a slight reduction in GSP received occurred, from 204.7 million USD in 2008 to 200 million USD in 2015 (-2.3 percent).

Specifically, in the period from 2008 to 2013, a significant reduction in GSP received occurred, from 204.7 million to 122 million USD (-40.4 percent). This trend recovered reaching 200 million USD again in 2015.

US imports from non-AGOA LDCs are notoriously highly concentrated in the textile and clothing sector. In this specific sector, the situation is not very different. The utilization rate even in the very few tariff lines covered by the scheme declined from 73 percent to 31 percent from 2008 to 2013. As for the utility rate, it is extremely low. With

[86] See S. Hakobyan, "GSP expiration and declining exports from developing countries," Working Paper, 2013.

[87] See The Trade Partnership, "The US Generalized System of Preferences Program," Annual Report prepared for The Coalition for GSP, 2013, 6.

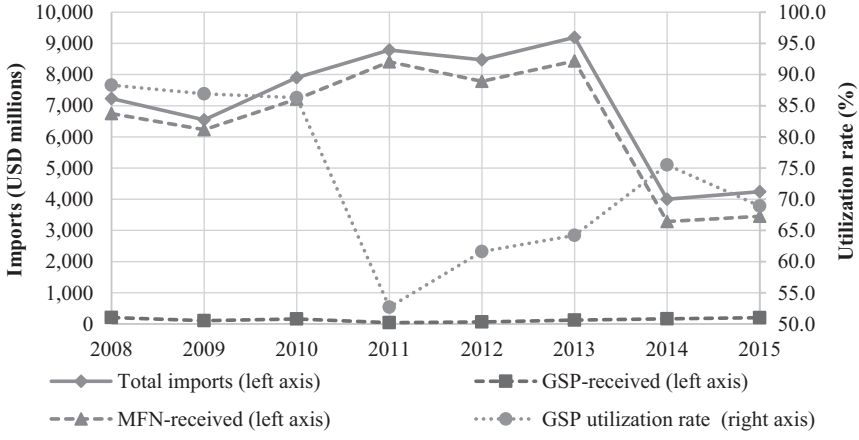


FIGURE 4.26 US total imports from effective LDCs excluding AGOA beneficiaries: Nonagricultural products excl. fuel

total imports of 7.9 billion USD, including 7.8 billion USD of dutiable imports, and only 21.7 million (6.8 + 14.9) covered by the GSP scheme in 2013, the utility rate amounted to 0.28 percent. In 2013, imports in the textile and clothing sectors, representing 90 percent of the total imports, was covered at a rate of 0.27 percent.

The most important issues to highlight in the context of dealing with the adequacy of rules of origin are that:

(1) The US RoO seems to have been so far unable to trigger a diversification of exports and the value of trade covered by the US GSP is abysmally low.
(2) It seems that, in the industries other than textile and clothing that are mostly covered by the US GSP scheme, preferences are not fully utilized with relatively high values of imports receiving MFN treatment.

Figures 4.27 and 4.28 show examples of the volatility and difficulties in complying with US GSP rules of origin even in the covered industrial sectors. It has to be noted that one of the difficulties of this exercise is that the volume of trade flows is extremely low and may show volatile fluctuations in utilization rates. Such low volume and volatility may also be read as a sign of inadequacy of the existing rules of origin.

Figure 4.27 shows the utilization of articles of jewelry. Among the effective LDCs (excluding AGOA), one the main exporters to the United States is Nepal. An initially high utilization rate on an average of 80% declined to 50% in 2013 to rise again to over 90% from 2014 to 2016, while total US imports of the products rose in 2013 and declined in 2014 and 2015 after the peak of 2013. Interestingly, the GSP expiry of 2010 did not affect the utilization rate, while the drop to 50 percent in 2013 coincides with the expiry of the scheme. Perhaps some models of the jewelry did not meet rules of origin requirements in 2013, showing extreme volatility of performances.

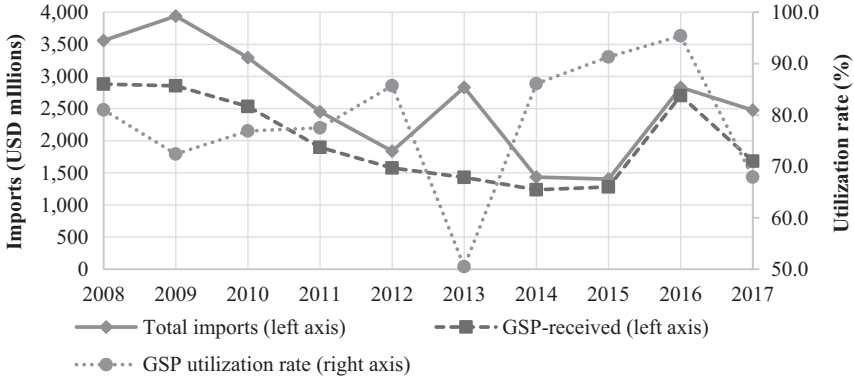


FIGURE 4.27 US imports from effective LDCs excluding AGOA beneficiaries: Jewelry products (HS 7113)

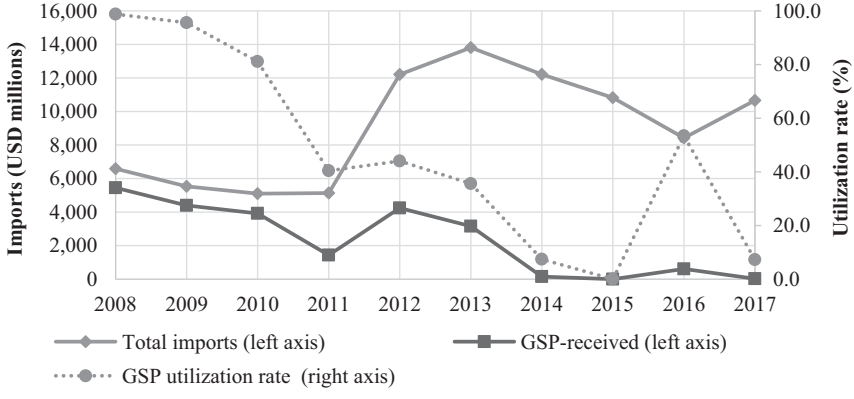


FIGURE 4.28 US imports from effective LDCs excluding AGOA beneficiaries: Articles & equipment for sports (HS 9506)

HS heading 9506 in Figure 4.28 shows the pattern of US imports of golf equipment. The utilization rate fell after an initially high performance of close to 100% in 2008 to 36% in 2013 reaching the latest account of 0% utilization in 2015. The main drops in utilization rate occurred from 2010 (81%) to 2011 (40%), as well as 2013 (36%) to 2014 (7%). The drop from 2010 to 2011 coincides with GSP expiry and overall falling rates of GSP utilization.[88] Most of those goods furthermore originated from Bangladesh, explaining the drop in 2013, when Bangladesh was suspended from US GSP.[89]

[88] See ibid.

[89] The rise in utilization rates in 2016 is due to Cambodian exports of sport equipment (TL 95066960) amounting to 612 million USD and fully using the preferential treatment. Cambodian exports to the United States on that specific tariff line have been recorded only for the year 2016.

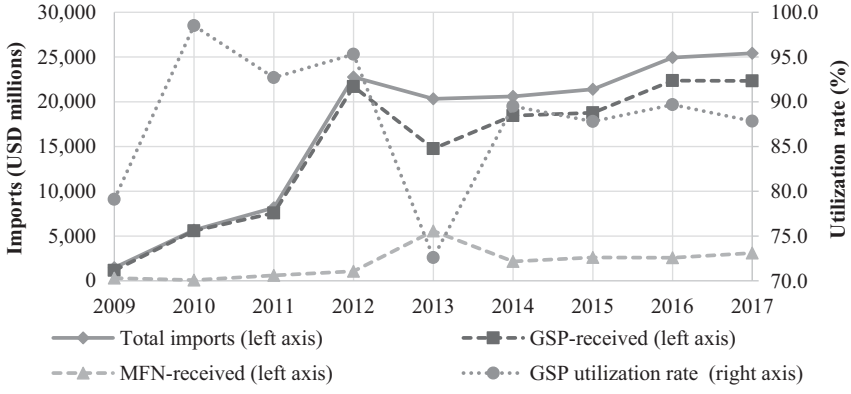


FIGURE 4.29 US imports from effective LDCs excluding AGOA beneficiaries: Bicycles & other cycles (non-motorized) (HS 8712)

As shown in Figure 4.29, US imports of bicycles originating mainly from Cambodia show a rather high percentage utilization rate and a similar fluctuating pattern as observed in Figures 4.27 and 4.28: as total imports are growing, the utilization rate of GSP is decreasing from about 99% in 2010 to 73% in 2013 and increasing again to roughly 88% in 2017, while imports are not showing significant gains. While it has to be noted that the preferential margin is considerably different in the US market with respect to the EU (in the EU, the MFN rate for bicycle is 14 percent while the EBA grants duty free; MFN rates of duty for most bicycles in the United States is 5.5 percent), it is clear that the current US rules of origin do not create additional trade opportunities.

The cases of HS 8712 and HS 9506, analyzed in Figures 4.28 and 4.29, support recent findings accounting for underutilization of the US GSP scheme. It was revealed that higher shares of local content in output are associated with higher utilization, as well as utilization rates generally increasing with preference margin, export size, and regional cumulation.[90] The case of Bangladeshi imports gives a good example of the linking of export size with GSP utilization. The exclusion of the main exporter under HS heading 9506, Bangladesh, from the scheme resulted in a decrease of about 60 percent of GSP utilization.

A similar case can be made for the high utilization regarding Cambodia's bicycle exports, that not only show a high concentration but also high local content measured as share of value added and domestic intermediate inputs. Being the only LDC accumulating the specialist welding, painting, and finishing skills necessary to produce technically advanced mid- to high-end bikes, Cambodia records relatively high local content for these exports.

Turning to the US imports covered by AGOA, Figure 4.30 shows the overall performance of AGOA from a utilization rate of 51 percent in 2009 to 90 percent in

[90] See S. Hakobyan, "Accounting for underutilization of trade preference programs: The US generalized system of preferences," *Canadian Journal of Economics*, vol. 48, no. 2 (2015), 408–436.

2017. In contrast to the GSP scheme, that recorded 65 percent in 2015 and 83 percent in 2017 (see Figure 4.25), the utilization rate of AGOA is 7 percentage points (pp.) higher showing however a similar level of volatility. The volatile pattern of the AGOA-received graph is probably due to the fluctuations of fuels imports from major LDCs suppliers, while for the US GSP expiration as well as exclusion of certain beneficiaries was among the causes for varying utilization rates.

As shown in Figure 4.31, once fuels and agricultural products are excluded, the utilization rate of AGOA shows an impressive pattern of 96 percent utilization in 2015 and does not reflect the volatile pattern of Figure 4.30. Between 2008 and 2015 the range of variation is set between 93 and 99 percent.

Such an impressive record is due to the extremely high concentration of exports in the clothing sector, where special rules of origin apply that allow the use of third-

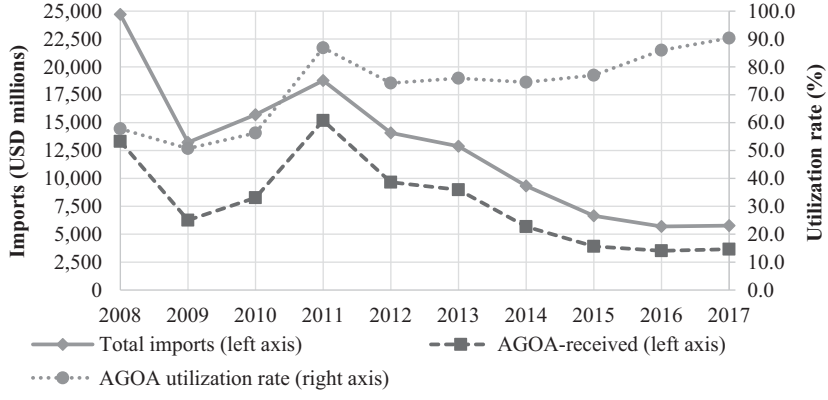


FIGURE 4.30 US total imports from effective LDCs AGOA beneficiaries

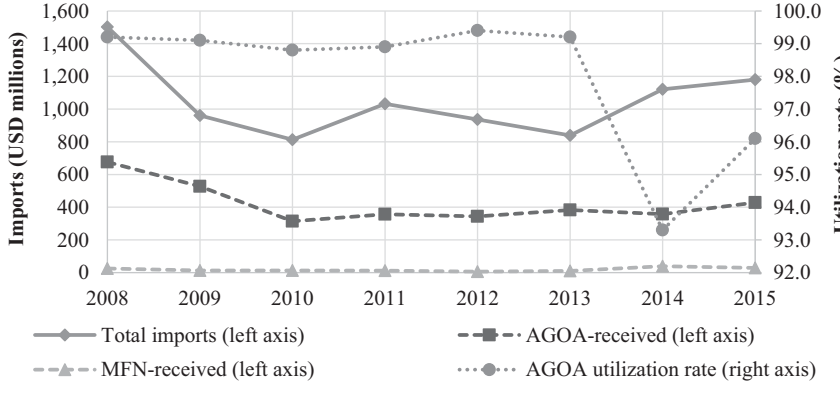


FIGURE 4.31 US total imports from effective LDCs AGOA beneficiaries: Nonagricultural products excl. fuel

country fabric. In simple words, under AGOA the United States has adopted rules of origin that are similar to the ones introduced by the EU reform allowing a single transformation as origin conferring. Once again, this figure is a telling example that lenient rules of origin with a sizable preferential margin are trade creating.

Besides clothing however, there are few other successes for AGOA. Figure 4.32 shows US imports of leather footwear under the agreement. The main exporter of these goods in this context is Ethiopia. Indeed, the utilization rate has constantly progressed from 34 percent in 2008 to almost full utilization (98.8 percent in 2017). However, it has to be noted that Ethiopia, itself being a leather producer, may not be facing particular difficulties in meeting the 35 percent value-added origin requirement.

A different case is shown in Figure 4.33 for US imports under AGOA of basketwork of HS 4602, mainly supplied by Rwanda. The utilization pattern here shows

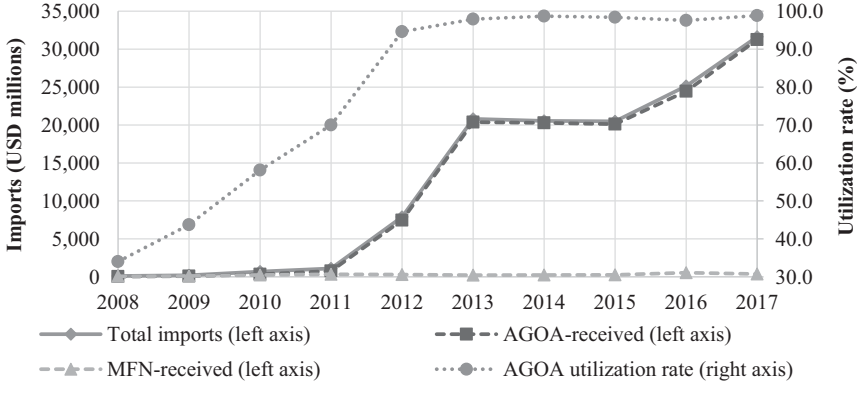


FIGURE 4.32 US total imports from effective LDCs AGOA beneficiaries: Leather footwear (HS 64)

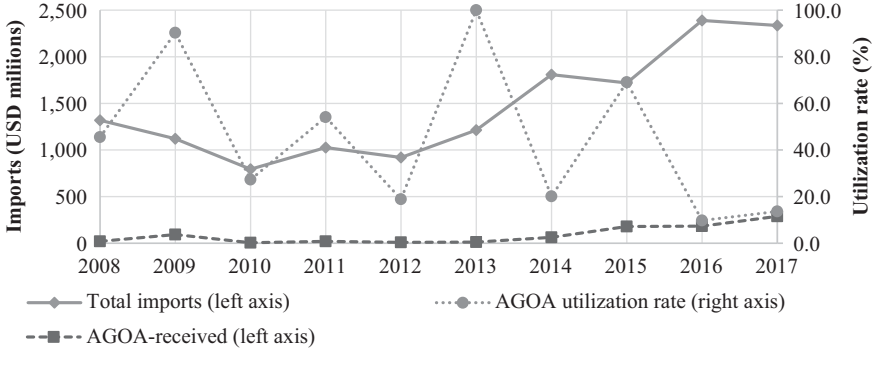


FIGURE 4.33 US Imports from effective LDCs AGOA Beneficiaries: Basketwork, wickerwork of plaits etc., loofa articles (HS 4602)

extreme volatility, as it jumps from 19 percent in 2012 to 100 percent in 2013, falls back to 20 percent in 2014, rises to 69 in 2015, and drops again around 10 percent in 2016 and 2017. Total imports, in contrast, remain relatively stable.

As the cases of leather shoes and basketwork exemplify, the main success story under AGOA remains the clothing sector. Little volatility and extremely high utilization rates are enabled by lenient rules of origin, allowing the use of third-country fabric and single transformation.

Similarly to the United States, Japan introduced limited (until recently) changes to its GSP's rules of origin since their inception in the 1970s.

Two major changes were made to PSRO of the Japanese GSP scheme. The first change was carried out in 2011 and mainly concerned the drafting form of PSRO and, most importantly, an initial liberalization of the PSRO for Chapter 62. A second change concerned Chapter 61, in 2015, when Japan introduced single transformation from fabric to garment for the whole of Chapter 61.

As shown in Figure 4.34, Japan shows a more stable, cyclical pattern with a decrease of overall imports following the financial crisis of 2009. Overall utilization rates are relatively high showing however, a rather stagnant linear approach with an average figure between 84 and 85 percent until 2013. Despite the slight increase in 2016, in recent years, by way of contrast, the rate shows a negative trend, declining to 77 percent in 2014 and 73.5 percent in 2017.

There are no significant differences in the pattern of utilization of the Japanese GSP scheme when fuels and nonagricultural products are excluded as shown in Figure 4.35. Utilization rates range from 88 to 86 percent in 2013 and afterwards show a similar trend compared to Figure 4.34. These figures show that, even after the improvements in terms of coverage to the Japanese GSP scheme, there has not been a significant modification in the overall trade patterns and utilization of the Japanese GSP.

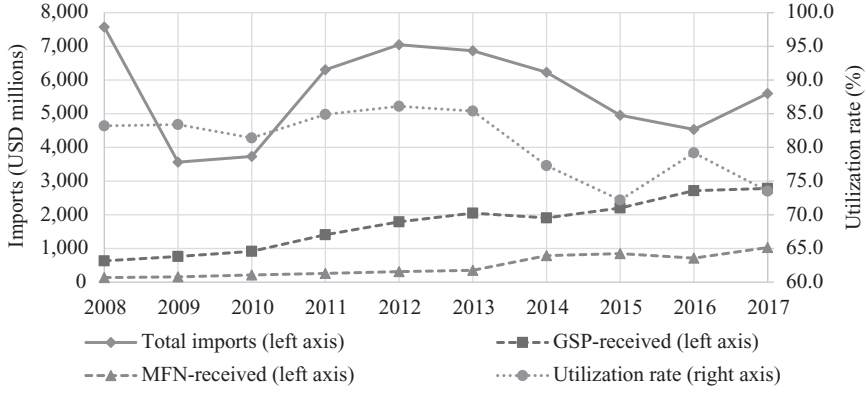


FIGURE 4.34 Japanese total imports from effective LDCs and utilization rates

TABLE 4.15 *Japanese reform of rules of origin in HS Chapter 61*

	Until April 2011	April 2011–April 2015	From 2015 onwards
Chapter 61 knitted and crocheted garments	Manufactured from chemical products, from products of heading nos. 47.01–47.06, or from natural textile fibres, man-made staple fibres or textile fibre waste	Manufactured from textile yarn	Manufacture from fabric

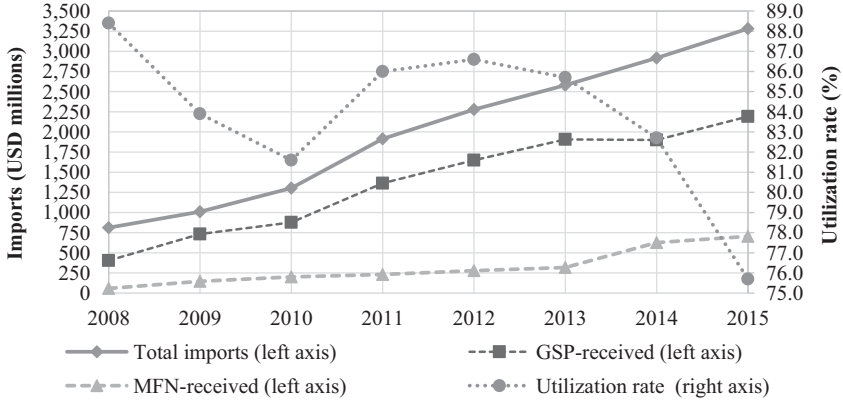


FIGURE 4.35 Japanese imports from effective LDCs and utilization rates: Nonagricultural products excl. fuel

HS Chapter 61 (knitted and crocheted garments) has been the one sector where the utilization rate of the Japanese GSP scheme was significantly lower with respect to the average utilization rate.

This underutilization could be easily explained by the overtly stringent rules of origin that have been applicable under the Japanese GSP scheme until 2011, requiring a triple transformation:

(i) spinning
(ii) weaving
(iii) making-up the finished garment.

In April 2011 the Japanese administration relaxed the RoO requirement, allowing a double processing requirement (see Table 4.15):

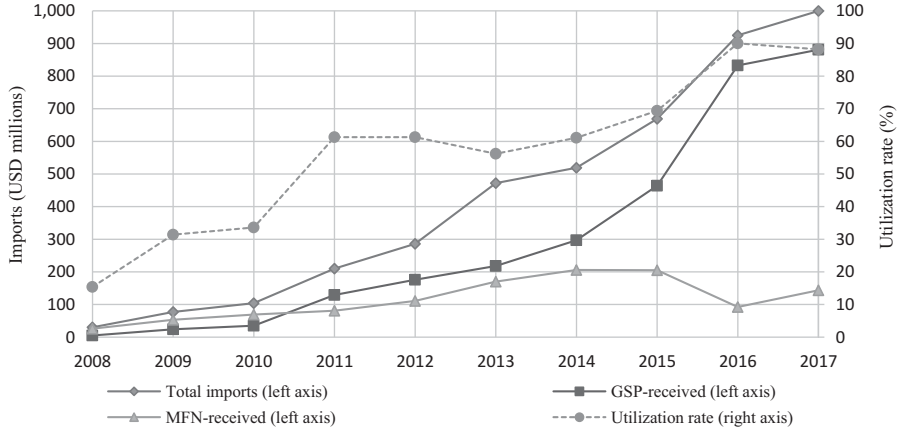


FIGURE 4.36 Japanese imports from effective LDCs and utilization rates: Articles of apparel & clothing accessories, knitted or crocheted (HS 61)

(i) weaving
(ii) making-up the finished garment.

As shown in Figure 4.36, the change from a triple to a double transformation requirement triggered a significant increase of the utilization rates in 2011, when the utilization rose from 34 percent in 2010 to 61 percent and the value of exports to Japan doubled in one single year.

Most recently, in 2015, Japan has further liberalized the PSRO in Chapter 61 from the previous two-stage process to a single stage process: manufacture from fabric (see Table 4.15). This policy change triggered a significant increase in utilization rates from 69 percent in 2015 to 90 percent in 2016. In addition, the reform has been highly trade creating with a rise in imports receiving GSP treatment from 464 million USD in 2015 to 833 and 881 million USD in 2016 and 2017 respectively.

4.2.4.3 The Impact the EBA Reform of Rules of Origin – An Empirical Analysis

As explained earlier, in spite of decades of multilateral attempts, there is no multilateral discipline on rules of origin.[91] One of the major problems affecting progress at

[91] This section reports the research presented by Prof. Pramila Crivelli at the Roundtable on the Future of Rules of Origin and Utilization Rates, June 26–28, 2019 at the European University Institute. Empirical specifications and results are further developed in a forthcoming EUI Working Paper, P. Crivelli and S. Inama, "The impact of the European reform of rules of origin under the Everything But Arms initiative: An empirical analysis" (forthcoming).

multilateral/subregional level toward reform and consensus on rules of origin is the lack of evidence that a given set of rules of origin would be better or more trade creating and less costly than another one. LDCs have argued in international negotiations that a reform of rules of origin from a more stringent set to a more liberal one is generating an increase of utilization of trade preferences and trade volumes (see section 4.2.4). However, despite an obvious correlation, their argument is often diminished due to the difficulty in establishing a causal effect. In other words, during WTO negotiations at the CRO, LDCs faced opposition from preference-granting countries, in particular the United States, arguing that the rise in utilization rates after the reforms may be explained by exogenous factors, independent from rules of origin.

While economic research on rules of origin determines the ad valorem tariff equivalents of such rules using an *ex ante* general coding, this type of research is not particularly useful in trade negotiations in creating consensus on the reduction of the trade distorting effects of PRSO.

In contrast, the research outlined in the following pages is the first attempt to establish a causal link between the liberalization of rules of origin in terms of manufacturing requirements with the increase of utilization rates and trade volume.[92] More specifically, it provides, on the basis of a coding of the PSRO, the first detailed, product-specific analysis of the trade effects of a reform of rules of origin taking the EU RoO reforms undertaken in 2010 as example. The following are research questions:

- Is low utilization due to excessive stringency of rules of origin in terms of manufacturing requirements?
- Does a liberal reform of such requirements increase utilization rates and trade volumes?
- Can we measure such trade effects?

4.2.4.3.1 PSRO CODING – TIME-VARYING MEASURE OF ROO STRINGENCY. The main challenge in establishing a causal effect between utilization rates and the stringency of rules of origin is twofold:

(1) The measure of the stringency of rules of origin has to reflect the industrial capacities and realities of the countries. The rule cannot be based exclusively on the form of rules of origin (CTH, CTC, ad valorem percentage criteria, etc.) since the form of a given rule of origin is just the way in which it is drafted.

[92] For a similar empirical exercise and research, see K. Tanaka, "The EU's reform in rules of origin and international trade: Evidence from Cambodia," IDE Discussion Paper, July 2019.

(2) Even when such measure is computed, it is usually not time varying, preventing the use of sophisticated econometric techniques such as panel data and fixed effects models to isolate exogenous factors that could impact utilization rates.

The major contribution of this research is to address these challenges through a codification of rules of origin based on the change in stringency between two time periods, before and after 2010 when the EBA reform was implemented. Most importantly, the change in stringency has been measured not by coding the form of a given PSROs in abstract but by comparing one by one the PSRO before and after the reform in terms of manufacturing requirements.

As discussed in section 6.1 of Chapter 6, a rule of origin might be much more stringent in some sectors than in others, independently from the form in which it is written. Codifying the stringency of rules of origin therefore requires a careful look at the meaning of such rules in terms of manufacturing processes: what manufacturing is required to obtain origin and what are the changes introduced by the reform? The most suitable way to answer this is to adopt a codifying methodology focusing on the change in stringency in terms of manufacturing requirement instead of the establishment of a stringency measure before and then after the reform that would require a comparison between all different PSRO across all sectors. For example, while a wholly obtained rule might be very stringent for industrial goods, the same rule might be far more lenient in the case of live animals. Assigning the same code to this rule in the different sectors would therefore not reflect the economic reality.

Codifying PSRO at sectoral level according to the list of PSRO before and after the reform in terms of manufacturing requirements constitutes the first major contribution of our present research. Table 4.16 is an example of the way rules of origin have been codified.

In the case of garments of HS Chapter 62, the rule became less stringent, moving from a double to a single transformation requirement. Similarly, for bicycles of HS heading 8712 it is clear that the rise in the percentage of the use of non-originating materials from 40 to 70 percent makes the rule easier to comply with and therefore classified as less stringent. In contrast, in the case of olive oil of HS headings 1509 and 1510, the requirement that all vegetable materials (including olives) must be wholly obtained is much more stringent than the initial CTH requirement. In addition, we notice a change in the drafting of the rule, which is also recorded in the codification for future research purposes.

The third case in Table 4.16 demonstrates a different scenario. Since the fruits, nuts or vegetables used to produce prepared or preserved tomatoes, mushrooms, and truffles of HS 2002 and 2003 are all included in HS Chapters 7 or 8, the old and new rules are similar in terms of stringency.[93]

[93] Some cases are not so clear-cut. These cases have been classified as undefined but their relative importance is marginal.

TABLE 4.16 *Coding restrictiveness of PSRO according to manufacturing requirements*

HS and product description	Old PSRO	New PRSO	Stringency change
Chapter 62 – Garment, not KoC	Manufaturing from yarn	Manufacuring from fabric	Less stringent
HS 8712 Bicycles	Manufacture where the value on non-originating material does not exceed 40% of the ex-works price of the finished products	Manufacture where the value on non-originating material does not exceed 70% of the ex-works price of the finished products	Less stringent
1509 and 1510 Olive oil and its fractions	Manufacture from materials of any heading, except that of the product	Manufacture in which all the vegetable materials used are wholly obtained	More stringent + Different form
2002 and 2003 Tomatoes, mushrooms and truffles prepared or preserved otherwise than by vinegar of acetic acid	Manufacture in which all the fruit, nuts or vegetables used are wholly obtained	Manufacture in which all the materials of Chapters 7 and 8 used are wholly obtained	Similar

Such analysis has been conducted for all old and new PSRO to be further matched with trade data and utilization rates in an empirical analysis.

4.2.4.3.2 EMPIRICAL MODEL AND DATA. Based on the PSRO classification described in the previous subsection, a regression analysis is carried out on a panel of beneficiary countries and HS heading chapters to provide evidence that higher or lower utilization rates are mainly the result of the stringency and/or complexity of rules of origin and ancillary requirements.

The following equation has been estimated with ordinary least squares and logit model:

$$Y_{ijpt} = \alpha + \beta_1 LS_p \times post_{ir} + \beta_2 MS_p \times post_{ir} + \gamma_{ijp} + \gamma_t + controls + \epsilon_{ijpt}$$

where:

- Y_{ijpt}: UR /imports receiving GSP treatment of reporter i, partner j, product p *(HS-4)* at year t.
- LS, MS: RoO stringency change dummy variable equal to 1 if at least one PSRO became less (LS) or more (MS) stringent within a given HS heading.

- $post_{ir}$: dummy variable equal to 1 from 2011 to 2015 in the EU (*r: time variable before/after reform*).
- γ_{ijp} and γ_t: country-pair-product and year fixed effects.
- Controls: preference margin (PM) before and after the reform, total imports, time trend and additional fixed effects $\left[\gamma_{ir}, \gamma_{jr}, \gamma_{hs2r}\right]$.

The model has been estimated using the UNCTAD database on utilization rates over ten years, from 2006 to 2015, dividing therefore the sample into two time periods of equal length, before and after the 2011 EBA reform of rules of origin. In addition to the EU, as counterfactual, the analysis includes two other preference-granting (importing) countries where no reform was implemented during the time period considered; namely, the United States and Canada. All trade values at the tariff line level have been converted to HS-2002 nomenclature and aggregated at the four-digit level. Preference margins (PM) are calculated based on preferential (LDC) and MFN tariffs reported in the Trade Analysis Information System (TRAINS) database. Finally, given the specificities of petroleum oil products (see the discussion in section 4.2.4.2), products of HS Chapter 27 have been excluded from the analysis.

4.2.4.3.3 PRELIMINARY RESULTS AND CONCLUSIONS. Table 4.17 reports the results when estimating the impact of the reform on utilization rates (dependent variable) for various levels of preference margin and different sets of fixed effects.

Results clearly show that utilization rates of products for which the PSRO have been liberalized have increased in the EU after the reform ($LS_p \times postEU_{ir}$).

Columns (1), (3), and (5) of Table 4.17 all account for product (HS-4), reporter, partner, and time fixed effects.

Therefore, the rise in utilization rates cannot be explained by any external factor fixed over time for a given product, reporter, or partner. This includes all country and product-specific characteristics. Since it may be argued that reforms implemented by partner countries at the same time as the EU could explain the rise in utilization rates, columns (2), (4), and (6) all include partner-post 2010 interacted fixed effects. Not only all coefficients on the $LS_p \times postEU_{ir}$ variable remain statistically significant but the magnitude of the reform impact on rules of origin increases, ranging between 9.5 and 12.9 pp. depending on the level of preference margin.

Interestingly, the preference margin only became a significant determinant of the utilization rate after 2010 in the EU while the coefficients were insignificant. When the full sample is considered (see column (2)), an increase in the preference margin by 1 pp. translates into a 0.371 (= 0.588 – 0.217) pp. rise in utilization rates, statistically significant at 1 percent.[94]

[94] Results of the test not reported.

TABLE 4.17 *Baseline results – utilization rates*

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
	PM > 0	PM > 0	PM > 3	PM > 3	PM > 5	PM > 5	PM > 5
$LS_p \times postEU_{ir}$	5.348***	9.551***	8.583***	10.587***	9.711***	12.862***	4.098*
	(0.90)	(1.31)	(1.22)	(1.58)	(1.49)	(1.93)	(2.23)
$MS_p \times postEU_{ir}$	0.736	-1.782	4.128	-0.198	4.705	1.760	-5.324
	(5.07)	(5.47)	(4.99)	(5.35)	(5.01)	(5.74)	(5.69)
$PM_{ijpt} \times postEU_{ir}$	0.786***	0.588***	0.626***	0.537***	-0.263	0.395***	-0.001
	(0.09)	(0.10)	(0.10)	(0.10)	(0.22)	(0.11)	(0.12)
PM_{ijpt}	-0.310*	-0.217	-0.226	-0.153	0.533***	-0.176	-0.144
	(0.19)	(0.18)	(0.18)	(0.18)	(0.10)	(0.21)	(0.21)
$Ln(Tot.Imp)_{ijpt}$	1.982***	1.763***	2.650***	2.296***	2.808***	2.278***	2.338***
	(0.23)	(0.22)	(0.33)	(0.32)	(0.40)	(0.38)	(0.38)
Fixed effects							
Rep x Part x HS 4; Year	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Part x $Post_t$	No	Yes	No	Yes	No	Yes	Yes
HS 2 x $Post_t$	No	Yes	No	Yes	No	Yes	Yes
Rep x $Post_t$	No	No	No	No	No	No	Yes
Observations	23,081	23,081	15,804	15,804	23,081	12,208	12,208
R^2	0.067	0.105	0.089	0.131	0.105	0.152	0.158

Note: Robust standard errors in parenthesis.
* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$

The last column reports an estimation including all fixed effects interacted with the post-2010 variable. While most coefficients became statistically insignificant, despite a reduction in magnitude, the effects of the $LS_p \times postEU_{ir}$ variable appear to be robust to the inclusion of the fixed effects, leaving no doubt that the EBA PSRO reform had a positive impact on utilization rates.

All coefficients are statistically significant even when including a partner post-reform fixed effect to account for exogenous factors in the partner country before or after 2010, and whose effect covers the period after 2010.

Table 4.18 reports the results of estimating the impact of the reform on the probability of starting to use the preference. The dependent variable is therefore a dummy variable equal to one if the value of imports receiving preferential treatment is positive and zero if otherwise. The model is estimated using a logistic regression model in panel data over various levels of preference margin.

Including partner post-2010 interacted fixed effects in columns (2), (4), and (6) shows that the probability of starting to use the preference increases after the reform, but only when the preference margin is above 3 pp. This model is not robust to the

TABLE 4.18 *Extensive margin – probability to start using preferences (xtlogit): Imp. received > 0*

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
	PM > 0	PM > 0	PM > 3	PM > 3	PM > 5	PM > 5	PM > 5
$LS_p \times postEU_{ir}$	0.249**	0.149	0.385***	0.379**	0.360***	0.478**	0.273
	(0.10)	(0.15)	(0.12)	(0.18)	(0.13)	(0.23)	(0.31)
$MS_p \times postEU_{ir}$	-0.167	-0.617	-0.064	-0.484	-0.142	-0.444	-0.524
	(0.37)	(0.57)	(0.37)	(0.59)	(0.38)	(0.61)	(0.62)
$PM_{ijpt} \times postEU_{ir}$	0.028***	0.018*	0.026***	0.007	0.024***	-0.001	-0.009
	(0.01)	(0.01)	(0.01)	(0.01)	(0.01)	(0.01)	(0.01)
PM_{ijpt}	-0.020*	-0.013	-0.016	-0.010	-0.025**	-0.020	-0.019
	(0.01)	(0.01)	(0.01)	(0.01)	(0.01)	(0.01)	(0.01)
Fixed effects							
Rep x Part x HS 4; Year	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Part x $Post_r$	No	Yes	No	Yes	No	Yes	Yes
HS 2 x $Post_r$	No	Yes	No	Yes	No	Yes	Yes
Rep x $Post_r$	No	No	No	No	No	No	Yes
Observations	8,971	8,971	7,919	7,919	6,377	6,377	6,377.

Note: Robust standard errors in parenthesis.
* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$

inclusion of the full set of fixed effects reported under column (5). However, this can also be explained by the high level of aggregation at the HS-4 level.[95]

As a conclusion, while it is clear from the previous sections that heterogeneity across sectors is observed, the wide range of fixed effects included in this research strongly suggest a causal average effect of the EBA RoO reform on the utilization of trade preferences, excluding most possible external factors that could explain the surge in imports and utilization. The study also controls for the preference margin, ruling out the idea that the latter is the driving factor behind the utilization rate evolution.

By empirically demonstrating that utilization rate is a crucial indicator of the restrictiveness of rules of origin, results and conclusions could be used to advocate for reforms in regional and multilateral negotiations. Indeed, it is clear that the use of utilization rates could help in addressing one of the major problems affecting reforms and consensus at the WTO on best practices in drafting rules of origin and in free-trade agreements.

[95] New results at the HS six-digit level of disaggregation will be reported in Crivelli and Inama "The impact of the European reform of rules of origin under the Everything But Arms initiative" (forthcoming).

4.2.5 *Evidence from EU FTA Utilization Rates*

4.2.5.1 The Asymmetric Use of EU FTAs: A Preliminary Analysis

Most recently the proliferation of FTAs has induced governments to monitor the use of the FTA agreements that they have entered into with partners.[96] In the case of the US utilization rates of FTAs, while not easy to find, they could be downloaded with certain limitations from the US International Trade Commission website.

The EU started to use utilization rates recently to find out that utilization rates have to be monitored not only on the importing side, in this case the EU, but also on the partner side, since that data will provide information on how EU exporters have been able to use effectively the trade preferences in accessing the market of the FTA partner. However, there was no express provision in EU free-trade agreements for data exchange till recently.

The utilization rates provide figures for the value of trade that has not received preferences at the time of customs clearance while it was eligible for preferential rates of duty. However, the utilization rates do not provide a clear and definitive reason why the preferential rate has not been granted at the time of customs clearance. From the point of view of customs law, the denial of the preferential duty rate may take place for the following reasons: (a) failure to provide a certificate of origin (CO)/exporter declaration (ED); (b) failure to comply with direct shipment conditions; (c) any other reason arising from the documentary evidence produced at the time of customs clearance (i.e. mismatch of the CO/ED with the shipping/packing list)

The failure to provide a CO/ED may derive from mainly two reasons: (a) failure to comply with substantive RoO requirements and hence to supply the required CO/ED at the time of customs clearance or related documentary evidence (i.e. direct consignment); or (b) failure to provide CO/ED at the time of customs clearance as a deliberate choice of the exporter not to comply with rules of origin since the preferential margin is not commercially meaningful.

There is hardly any computed evidence tracking or identifying what is the most common reason for the failure to provide a CO and/or exporter declaration. There are a number of empirical studies based on econometrics. Evidence from business in beneficiary countries and from business surveys, literature, and field activities shows that, in the majority of cases, failure to provide a CO/ED is mainly due to excessive stringency of PSRO and/or related administrative procedures. The administrative procedures related to rules of origin are discussed in Chapter 7 of this book.

[96] Section 4.2.5 draws from a collaboration with the Swedish Board of Trade leading to a first publication "The Use of the EU's Free Trade Agreements – Exporter and Importer Utilization of Preferential Tariffs," 2018. This section contains further elaborations of the study that are part of a future publication with the European University Institute.

In this context, and taking into consideration the existing research and analysis and evidence contained in this book, it is extremely important to point out that utilization rates are a symptom or a sign of a *disease* in the functioning of a free-trade agreement probably due to rules of origin and related administrative procedures. It is the duty of the researchers and other stakeholders to use the findings of the utilization rates to further dig out and identify the concrete and ultimate reasons for such low utilization. The following examples excerpted from the EU–Korea, EU–Switzerland, and EU–Mexico free-trade agreements are a valid example of such a kind of research.

The analysis made in this section relies on a set of data that was collected by the EU Commission requesting data on utilization rates from a series of FTA partners that have been the object of a UNCTAD-Swedish of Board Trade study.[97] The quality of such data obviously varies but in any case this has been the first systemic effort to collect such data for a number FTA partners over a reasonable amount of time. This section expands and further elaborates the findings of the abovementioned study by deepening the analysis and linking the utilization rates to rules of origin using a methodology and a series of filtering of the trade data to identify what has been defined by the author as "repeated offenders."

Repeated offenders are PSRO that have been found to generate low utilization of trade preferences across FTAs in different directions of trade flows as further elaborated below. A progressive filtering of the data shows low utilization for the sectors defined at HS four-digit level in a number of FTAs in both directions of trade and across different FTAs. There is a strong indication that the PSRO associated with the HS four-digit sector are the culprits of such repeated offences to higher utilization rates.[98] This repeated-offender analysis aims at conveying the policy message that, similarly to the GSP case, reforms of rules of origin in EU FTAs

[97] See fn. 96 above.

[98] As in the case of the UNCTAD-Swedish Board of Trade, there are some limitations on the data that need to be explained. The repeated-offender analysis is based on data from seventeen EU free-trade agreements (including a customs union in the case of Turkey), i.e. bilateral trade relations, between the years 2009 and 2013, where data on preference utilization are available for both parties, in order to make a comparative analysis. Not all free-trade agreements covered in this analysis have been in force for five years and the data on the EU's preference utilization, i.e. EU exports and/or partner country imports, are not always complete for all years in the period. The development of the preference utilization before and after the years 2009 and 2013 is not considered in the analysis. The EU's free-trade agreements (and customs unions) within different continents as of 2013, i.e. thirty-three free trade agreements, or rather bilateral free trade relations, as well as the free trade agreements covered by this analysis (in cursive), are as follows: Europe (Iceland, Norway, Liechtenstein, Switzerland, Andorra, San Marino, Turkey, Faroe Islands, Macedonia, Albania, Lebanon, Bosnia and Hercegovina, Montenegro, and Serbia); Africa (Tunisia, Morocco, South Africa, Egypt, and Algeria); Asia (Israel, Palestine, Jordan, South Korea); North America (Mexico, Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, and Panama); and South America (Chile, Colombia, and Peru). The data on preference utilization in this report is based on import data that are collected and processed by the different parties concerned. Unfortunately, more updated data have not been yet released by the EU Commission.

could generate strong market responses for the EU exporters and importers as well as FTA partners. To do so, specific methodologies based on utilization rates and input–output matrix, as discussed in Chapter 6, can be applied in order to identify (1) the PRSO where a reform would be the most beneficial and (2) which type of PSRO should be adopted to replace PSRO that are found to generate low utilization rates.

The UNCTAD-Swedish Board of Trade study found that, contrary to conventional wisdom, the EU's free-trade agreements, in general, are used to a high degree and that border-related aspects of implementation of the free-trade agreements in some cases might be more cumbersome than the provisions of the free-trade agreements themselves. Most interestingly the study found that: "The average total 'preference utilization rate' (2009–2013) of the EU's free trade agreements is 90 percent for partner country exporters and 67 percent for EU exporters." However, the same study noted that: "The EU partner country exporters, however, use the EU's free trade agreements to a higher degree at a relative level – by 23 percentage points."

This finding is echoed in Figure 4.37. Both simple and weighted average utilization rates[99] of EU imports from the selected partners[100] are relatively high, ranging from 87 percent to almost 91 percent over the 2009 and 2013 period.[101] These high figures match a preliminary analysis made by the author, finding that the utilization rates of NAFTA and other US trade FTAs have been high, in some case above the 90 percent figure.[102]

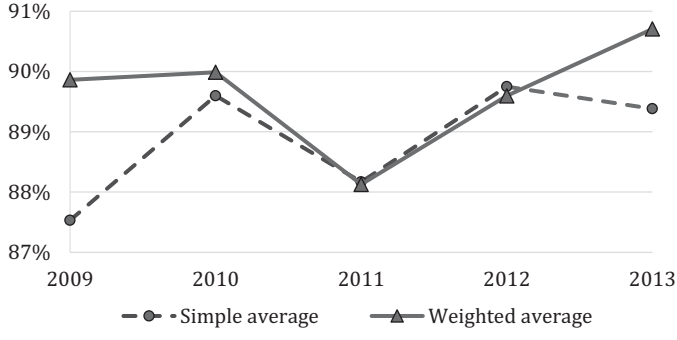


FIGURE 4.37 Utilization rates of EU imports from selected FTA partners: Simple and weighted average

[99] The simple average is the arithmetic mean of utilization rates calculated at the HS four-digit product level. The weighted average is calculated as the sum of imports receiving preferential treatment divided by the sum of imports eligible for the preferential treatment over all HS four-digit level products and FTA partners.

[100] Selected partners are those contained in fn. 101 below.

[101] Albania, Bosnia and Herzegovina, Switzerland, Chile, Algeria, Egypt, Iceland, Republic of Korea, Lebanon, Morocco, Mexico, Macedonia, Montenegro, Nicaragua, Norway, Panama, Peru, Serbia, Tunisia, and Turkey.

[102] See presentation made at WCO workshop in 2013.

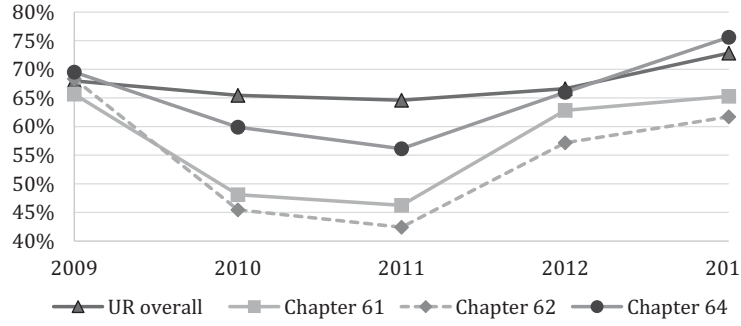


FIGURE 4.38 Utilization rates of EU imports overall and disaggregated by selected chapters

As further analyzed in the following paragraphs, this general high utilization rate of EU free-trade agreements in reality captures only a fraction of the overall picture. When the analysis is carried out at a more disaggregated level, by direction of trade, partner, and products, the utilization rates vary substantially, indicating areas where PSRO are problematic.

Figure 4.38 depicts the same utilization rate data in the direction of trade from the EU to the same EU partners over the same period. The figure shows that utilization rate is significantly lower ranging around 70 percent, with lower utilization rates in selected HS chapters such as garments of HS Chapters 61, 62, and 64 (shoes).

The asymmetrical use of trade preferences of EU free-trade agreements has been recorded both in the abovementioned UNCTAD-Swedish Board of Trade study and in the present analysis especially for certain free-trade agreements that are of relevance, given the magnitude of trade at stake and the economic relevance of the partner. A case in point is the EU–South Korea FTA agreement where the earlier analysis of the study has found an asymmetric use of trade preferences that have been later corroborated by field evidence and analysis conducted by the EU Commission.

As shown in Figure 4.39, between 2011 and 2013, EU covered imports[103] from South Korea increased dramatically from 2011 and utilization rate scored 59 to 82.4 percent.

Figure 4.40 shows the results of the filtering of the trade data to identify what are the major sectors at HS four-digit level. The data in the figure, as in other corresponding figures of this chapter, are filtered to record only sectors at HS four-digit level showing a preference utilization rate of minus 70 percent with an average preferential margin of 2 percent.

However over the same period, and as shown in Figure 4.41, the utilization rates of Korean imports from the EU range from 62 to 68 percent and the amount of

[103] Covered imports are those imports that are dutiable and eligible for trade preferences under the free-trade agreement.

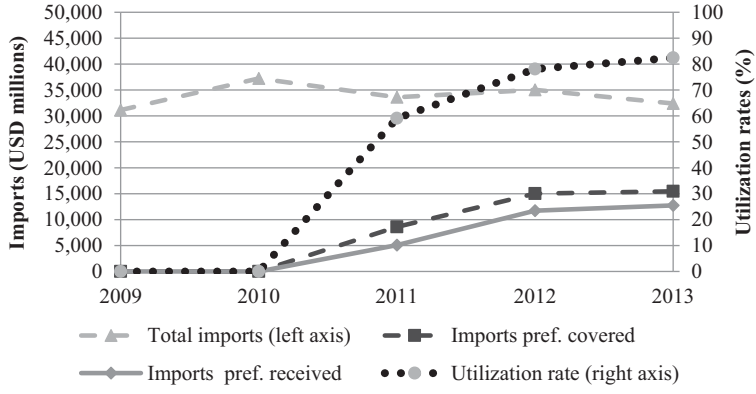
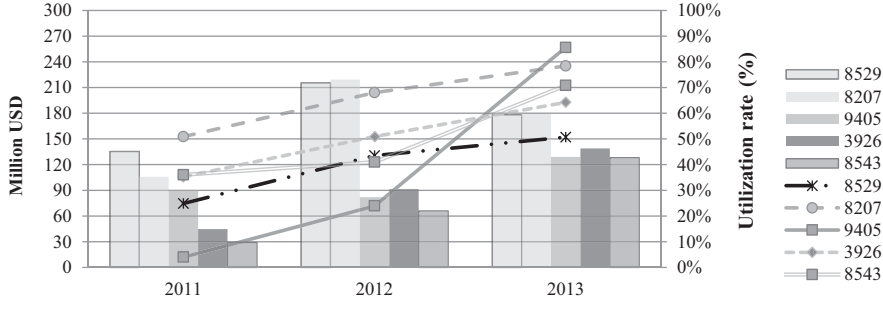


FIGURE 4.39 EU imports from South Korea and utilization rates



Utilization rates (lines, right axis) and value of covered imports (bars, left axis) for the five top products (HS code on the right) in descending order of average covered imports with average preference margin > 2 and average UR < 70%

8529	Accessory parts for the apparatus in heading 85.25 to 85.28
8207	Interchangeable hand tools, whether or not power operated, rock drilling etc.
9405	Lamps, lighting fittings, not elsewhere specified including parts
3926	Other articles of plastics, nes
8543	Electrical machines, apparatus with one functions not specified elsewhere

FIGURE 4.40 EU imports from Korea or: Utilization rates and covered imports (in descending order of covered imports over 2011–2013)

covered trade does not shown any drastic increase. How is this possible? In a free-trade agreement rules of origin are the same.[104]

[104] Some of this data was used during a presentation made by the LDC at the WTO CRO in October 2018 to show the effectiveness of utilization rates in identifying PSRO of related administrative procedures as an obstacle to full utilization. See also the data and findings of an extensive study carried out for the EU Commission, "Evaluation of the Implementation of the Free Trade Agreement between the EU and its Member States and the Republic of Korea – Interim Technical Report," Interim Technical Report Part 1: Synthesis Report, 2017: "Since

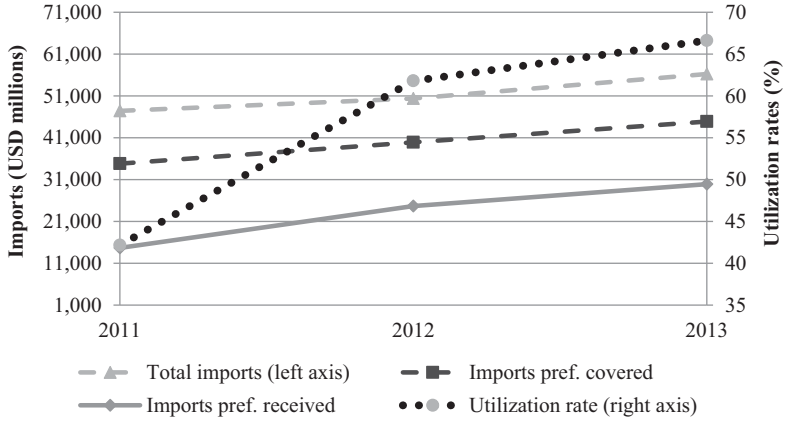


FIGURE 4.41 Korean imports from the EU and utilization rates

These asymmetrical figures of low preferences were later explained in an extensive study conducted by the EU Commission assessing the impact of the EU–South Korea FTA agreement. This EU study[105] initially found that, as in many free-trade agreements, there were many different reasons explaining different and asymmetric utilization rates that could be generally imputed to rules of origin such as:

- Low MFN tariffs: Low MFN tariffs can be a reason for not utilising FTAs, as there is a lower opportunity cost of not utilising preferential tariffs in sectors where MFN tariffs are low to begin with;
- Government promotion and support for businesses: Governments have a role to play in disseminating information and assisting companies;
- The Korean government devotes substantial resources to educating companies and assisting them in using the EU–Korea FTA agreement, contributing to the comparatively higher PURs;
- Costs vs. benefits of utilising preferences: Complex RoO (which are not harmonised across EU FTAs) may lead companies to not taking advantage of tariff preferences, due to the need to purchase third-party software for performing origin calculations;

utilisation of tariff preferences requires meeting certain requirements (see case study on the use of tariff preferences in section 10.7 below), it cannot be expected that all firms use those preferences immediately at the start of the agreement. Rather, the share of exports making use of the preferences (the preference utilisation rate, PUR) should gradually increase over time. Figure 5 shows that this is what has happened since 2011. The EU PUR increased from 50 percent in 2012 to 66 percent in 2013; subsequently, it remained at this level from 2013 on. In contrast, the Korean PUR increased steadily from 68 percent in 2012 to 84 in 2015. A further analysis of reasons for the differing use of tariff preferences under the agreement in the EU and Korea is provided in the aforementioned case study in section 10.7."

[105] See Evaluation of the Implementation of the Free Trade Agreement between the EU and its Member States and the Republic of Korea – Interim Technical Report, 2017.

- Lack of fulfilment of origin criteria: Exporters whose products do not fulfil the origin criteria of the EU–Korea FTA agreement are not eligible to use preferences, which can be a problem e.g. in the machinery and appliances sector, or other sectors (e.g. diamonds exported from the EU to Korea are not mined in the EU);
- Requirements for approved exporter status: Applying for approved exporter status may be resource- and time-intensive and therefore a barrier to companies (especially SMEs) using the tariff preferences of the EU–Korea FTA agreement. Information and documentation that exporters are required to submit when applying for approved exporter status, as well as the processing time for applications, varies widely across EU Member States.[106]

However, more specifically the study found that the EU–Korea Protocol on Rules of Origin states that products must be transported directly to and from the EU and Korea in order to benefit from the tariff preferences of the free-trade agreement.[107]

Exporters must provide customs authorities in the destination country with evidence verifying that the direct transport provision has been satisfied; for instance, in the form of a certificate issued by the customs authorities in the country of transit that provides an exact description of the products, the dates of unloading/reloading and where applicable, the names of the ships or the other means of transport use, and the conditions under which the products remained in the country of transit.

The interviews held during the abovementioned study confirmed the widely held view that the current wording of direct shipment in the EU–Korea FTA agreement is problematic and that the provision particularly affected EU exporters who make use of logistical hubs (mostly Singapore) for storage and operations such as repackaging and labeling prior to distributing their products to various Asian markets.

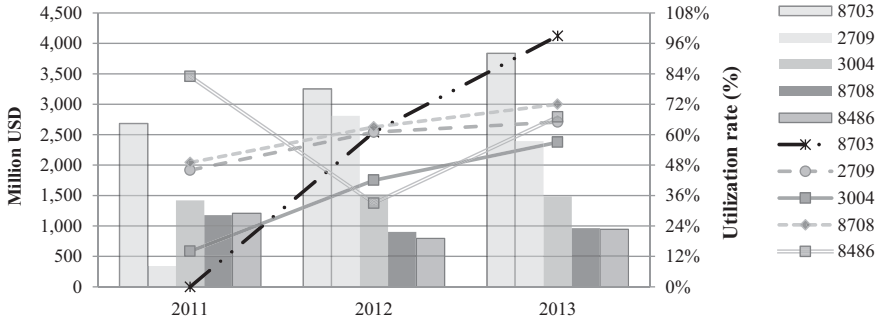
The study reported that in order to benefit from the preferential tariffs of the free-trade agreement, some companies have chosen to ship goods directly from the EU to Korea. However, in these cases, companies cannot react swiftly to demand fluctuations, as shipping from the EU to Korea can take well over a month.

Thus, the combined analysis of utilization rates, field visits, and interviews clearly established that besides the general reasons that could be raised for lower utilization the issue related to documentary evidence of direct shipment stands out for a specific reason of low utilization and a candidate for reform. In fact, and as widely discussed in Chapter 6 of this book, such rules on direct shipment have been replaced by the nonalteration rules contained in the EU–Japan free-trade agreements.

As discussed later, where the repeated offender will be further analyzed, it is noteworthy that among the sectors in Figure 4.42 listed as those with low utilization are the automotive headings of HS 8703 (cars) and HS 8708 (parts of cars).

[106] Excerpted from the EU study: "Evaluation of the implementation of the free trade agreement between the EU and its member states and the Republic of Korea: Interim technical report," Civic Consulting and the Ifo Institute, June 2017, 150.

[107] See extensive discussion in Chapter 7 of this book on direct shipment and related documentary evidence.



Utilization rates (lines, right axis) and value of covered imports (bars, left axis) for the five top products (HS code on the right) in descending order of average covered imports with average preference margin > 2 and average UR < 70%

8703	Motor cars and other motor vehicles principally designed passengers
2709	Petroleum oils and oils obtained from bituminous minerals, crude
3004	Medicaments of mixed or unmixed products, for retail sale
8708	Parts and accessories of the motor vehicles of headings 87.01 to 87.05
8486	Machines and apparatus of a kind used solely or principally for the manufacture of semiconductors or wafers

FIGURE 4.42 Korean imports from the EU: Utilization rates and covered imports (in descending order of average covered imports over 2011–2013)

Figures 4.43 and 4.45 depict a similar asymmetrical pattern in the EU free-trade agreement with Switzerland, raising a number of questions since such free-trade agreement has been in existence since the 1970s and, by any standards, should be a well-tested and widely known free-trade agreement for traders and the business community. Still, while the utilization rate is as high as 93 percent for goods imported in the EU, the corresponding utilization rates of Swiss imports from the EU ranges from 73 percent in 2011 with a lowering trend to 66 percent in 2013.

As there has not been a similar study on the implementation of the EU–Switzerland FTA agreement it is not possible to identify the reasons for such asymmetrical low utilization. However, the discussion in Chapter 1 of this book about the utilization of trade preferences for LDCs in the case of Switzerland demonstrated a similar pattern of low utilization. Initial bilateral meetings between Switzerland and the LDCs to identify the reasons for such low utilization indicate a similar provision on direct shipment in the EU free-trade agreement[108] and present in the Swiss GSP a possible culprit for such low utilization, taking into account that Switzerland is a landlocked country where most goods transit third countries before reaching their final destination.

[108] In reality the rules of origin contained in the Regional Convention on Pan-Euro-Mediterranean Preferential Rules of Origin (PEM) Convention are applicable and the Convention applies direct shipment rules and documentary evidence similar to the EU–South Korea FTA agreement.

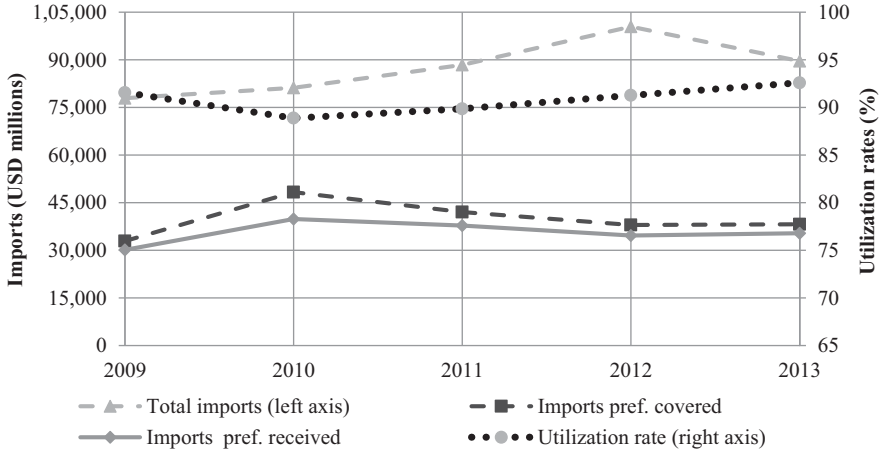
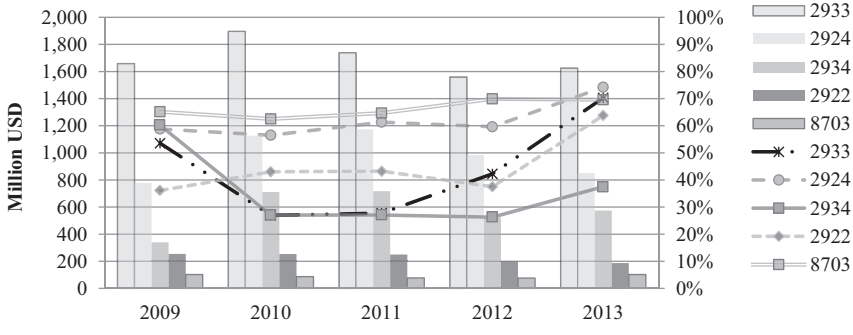


FIGURE 4.43 European imports from Switzerland and utilization rates



Utilization rates (lines, right axis) and value of covered imports (bars, left axis) for the five top products (HS code on the right) in descending order of average covered imports with average preference margin > 2 and average UR < 70%

2933	Heterocyclic compounds with nitrogen hetero-atom(s) only; nucleic acids
2924	Carboxyamide-function; amide-function compounds of carbonic acid
2934	Other heterocyclic compounds
2922	Oxygen-function amino-compounds
8703	Motor cars and other motor vehicles principally designed for passengers

FIGURE 4.44 EU imports from Switzerland: Utilizatio forn rates and covered imports (in descending order of average covered imports over 2009–2013)

Figure 4.44 shows that, in spite of a WTO agreement on chemical products for MFN free treatment[109] and the existence of a free-trade agreement, some chemical products still pay duties when imported into the EU.

[109] See GATT document L/7430, March 25, 1994.

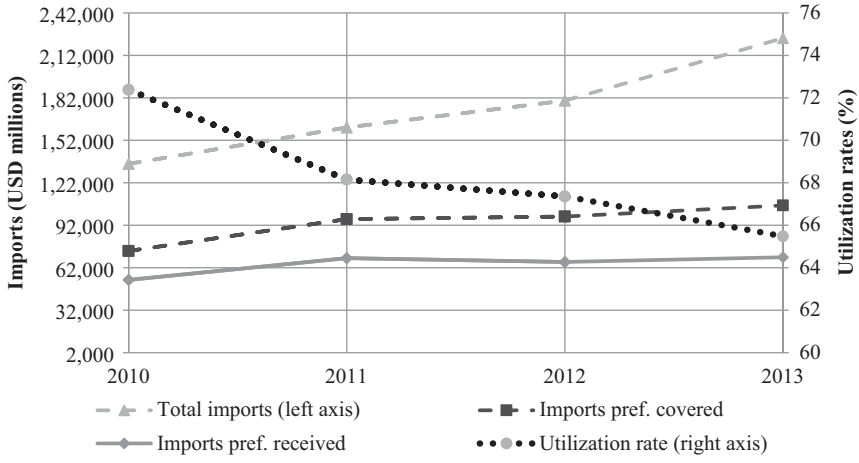


FIGURE 4.45 Swiss imports from the EU and utilization rates

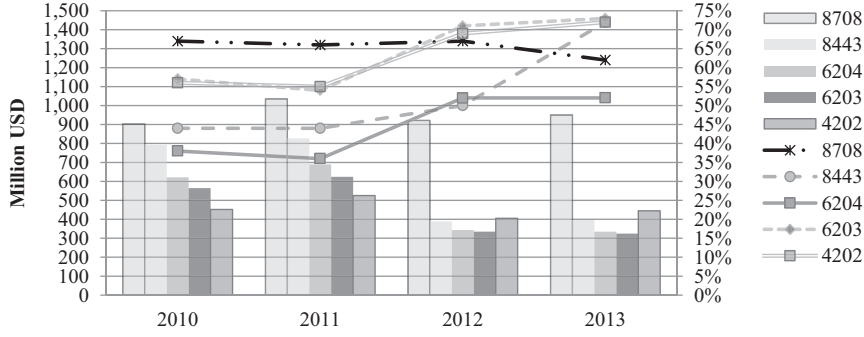
Figure 4.46 demonstrates the composition of the major products imported into Switzerland from the EU, showing a significant amount of trade and low utilization trade. Apart the usual parts of cars (HS 8708), it is rather striking to see that a significant number of garments are recorded as not utilizing the free-trade agreement when imported into Switzerland.

Finally, and as an example of how useful the analysis of utilization could be, the case of the EU–Mexico FTA agreement may provide further evidence and is shown in Figures 4.47–4.50. Even in this case, the utilization rate is relatively low and asymmetrical, as shown in Figures 4.47 and 4.49: from 68 to 70 percent in the case of imports from Mexico into the EU and 48 to 36 percent in the case of EU imports into Mexico.

According to one of the latest releases[110] from the EU Commission, the PSRO for cars and other vehicles (HS headings 8701–8707) have been recently reviewed to address such low utilization rates allowing up to 45 percent MaxNOM (non-originating material). Therefore, for the entire automotive sector, the permanent PSRO are the same as in the EU–Japan and EU–Korea FTA agreements.

The application of the methodology to identify the PSRO that are responsible for pockets of low utilization identified those in the automotive sector as the major culprits for low utilization. In fact, the original EU–Mexico FTA agreement of 2000 provided for stringent rules of origin in the automotive sector. Both

[110] See http://trade.ec.europa.eu/doclib/docs/2018/april/tradoc_156791.pdf.



Utilization rates (lines, right axis) and value of covered imports (bars, left axis) for the five top products (HS code on the right) in descending order of average covered imports with average preference margin > 2 and average UR < 70%

8708	Parts and accessories of the motor vehicles of headings 87.01 to 87.05
8443	Printing machinery, including ink-jet printing machines, other than those of heading No. 84.71; machines for uses ancillary to printing
6204	Women's or girls' suits, ensembles, jackets, dresses, skirts, etc
6203	Men's or boys' suits, ensembles, jackets, blazers, trousers, etc
4202	Trunks, suit-cases...; handbags... and similar items of leather, etc

FIGURE 4.46 Swiss imports: Utilization rates and covered imports (in descending order of average covered imports over 2010–2013)

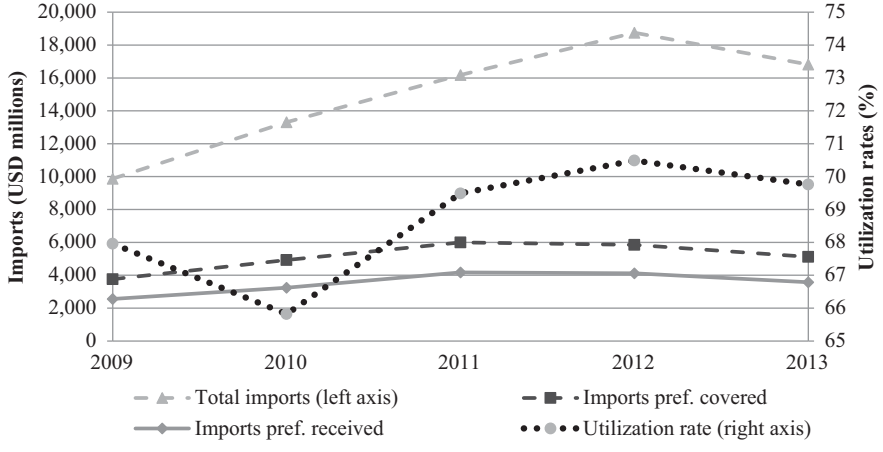
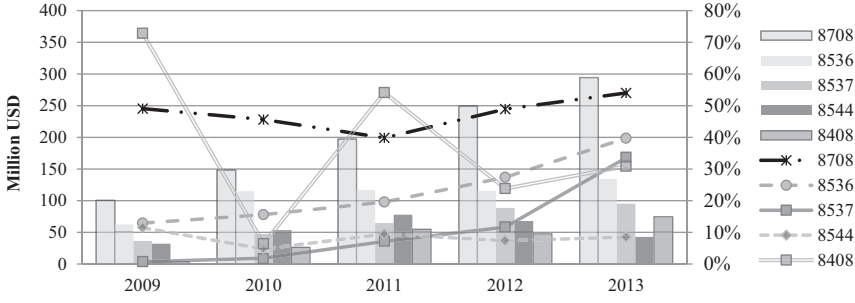


FIGURE 4.47 European imports from Mexico and utilization rates

Figures 4.48 and 4.50 show parts of cars or components of cars as showing low utilization rates and high volume of trade.



Utilization rates (lines, right axis) and value of covered imports (bars, left axis) for the five top products (HS code on the right) in descending order of average covered imports with average preference margin > 2 and average UR < 70%

8708	Parts and accessories of the motor vehicles of headings 87.01 to 87.05
8536	Electrical apparatus for making connections, voltage not >1,000 volts
8537	Boards, panels, consoles, desks etc.. other than switching apparatus
8544	Insulated wire, cable, other insulated electric conductors; optical cables…
8408	Compression-ignition, combustion piston engines (diesel/semi-diesel engines)

FIGURE 4.48 EU imports from Mexico: Utilization rates and covered imports (in descending order of average covered imports over 2009–2013)

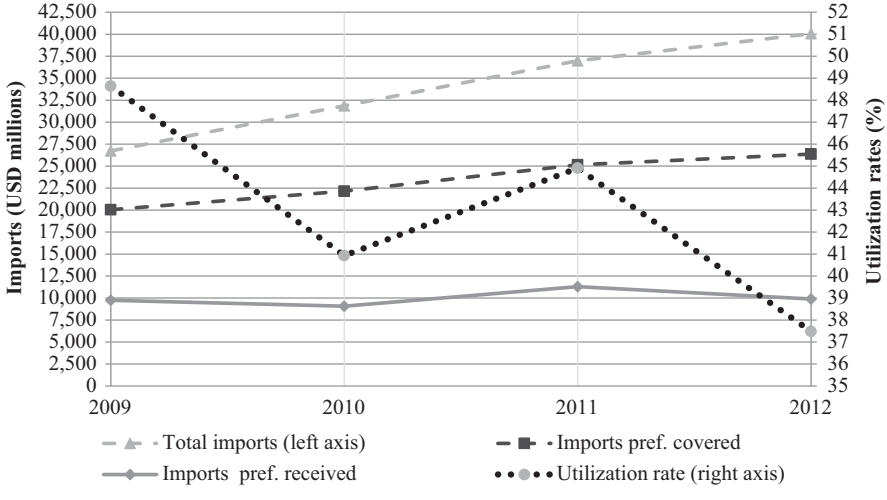
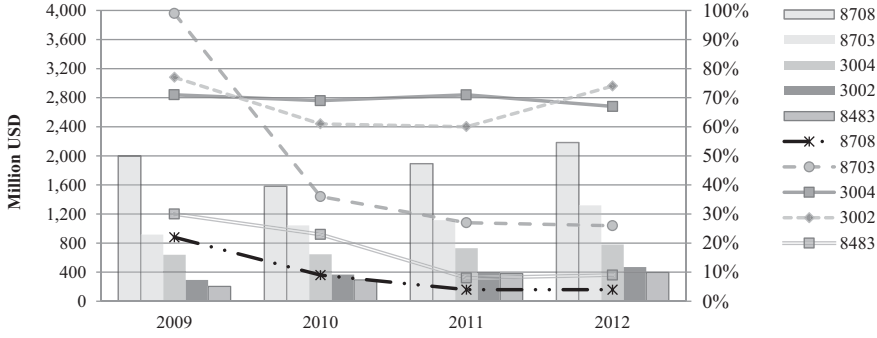


FIGURE 4.49 Mexico imports from EU and utilization rates

4.2.5.2 Identifying PSRO Causing Low Utilization in EU FTAs – "Repeated Offenders" Methodology

4.2.5.2.1 DESCRIPTION OF THE METHODOLOGY. The repeated-offender methodology is a tool aimed at identifying those PSRO or administrative procedures that are



Utilization rates (lines, right axis) and value of covered imports (bars, left axis) for the five top products (HS code on the right) in descending order of average covered imports with average preference margin > 2 and average UR < 70%

8708	Parts and accessories of the motor vehicles of headings 87.01 to 87.05
8703	Motor cars and other motor vehicles principally designed for passengers
3004	Medicaments of mixed or unmixed products, for retail sale
3002	Human blood; animal blood; antisera, etc; vaccines, toxins, etc
8483	Transmission shafts, cranks, clutches, sahft couplings (universal joints)

FIGURE 4.50 Mexico imports from the EU: Utilization rates and covered imports (in descending order of average covered imports over 2009–2012)

responsible for pockets of low utilization in free-trade agreements, and therefore where reform of PRSO may have significant trade effects.[111]

While the preceding sections have documented and discussed the magnitude of the trade flows affected by low utilization, the *repeated offenders methodology* applied in this section to the existing trade data and utilization rates of EU free-trade agreements allows the systematic identification of the sectors at HS four-digit level[112] in which PRSO may be causing low utilization of trade preferences. The methodology comprises five steps divided into two parts, as set out below.

Part A Identifying Low Utilization at Product-Specific Level (HS four digits)

(1) **Filtering the data to identify *critical products***

(a) Data has been filtered to keep only observations showing a low utilization rate (UR), relatively high preference margin (PM), and significant trade values at the HS four-digit level, on average. The thresholds applied are UR < 70% and PM > 2 pp.

(b) After the filtering described in (a) above, observations are ranked in descending order of covered imports to analyze in priority the critical products with relatively high trade values (most imported

[111] See Pramila Crivelli, Stefano Inama and Jonas Kasteng, 'Using Utilization Rates to Identify Rules of Origin Reforms: The Case of EU Free Trade Area Agreements', EUI Working Paper RSC 2021/21.

[112] Such level of disaggregation is explained by the fact that most PRSO of the EU free-trade agreements are set at HS four-digit level.

products) for each specific agreement and both directions of trade. Only the products with *a rank below a certain threshold* are then considered (i.e. the most exported/imported products). The thresholds will be defined in the next steps.

(c) The products remaining after the filtering of (a) and selection of (b) are referred to as "critical products."

The reasoning behind this filtering of 70 percent of utilization rate and a preferential margin of 2 pp. is twofold:

(i) to capture a significant size of non-optimal utilization with trade values that are not too low to be of a sporadic nature

(ii) a margin of 2 pp. could be considered significant taking into account that a preferential margin of 2.5 pp. on motor vehicles in the US market has generated around 100 pages of RoO text in NAFTA and even more in USMCA, still commanding headlines in the press to this very day.[113]

(2) **Identification of *Repeated Offenders***

Broadly speaking, repeated offenders are products that have been identified as reporting consistently low utilization rates across various FTAs or within a free-trade agreement in both directions of trade and with significant trade values (covered imports). Following the terminology defined in step (1), two kinds of repeated offenders have been singled out:

(a) **bilateral repeated offenders**: critical products in both direction of trade within a given agreement

(b) **repeated offenders across agreements**: critical products in one direction of trade (EU imports or exports), across a certain number of FTA partners.

The advantage of this methodology is to avoid considering isolated cases, for which the low utilization rate might result from various exogenous factors. Instead, with bilateral repeated offenders, the products are critical (among the top fifty critical products[114]) not only for the exports of an FTA partner to the EU or for the EU exports to that partner, but for both parties at the same time; with repeated offenders across agreements, the products are critical (among the top ten critical products[115]) for either several exporters to the EU or for the EU to several destination markets.

[113] See e.g. W. A. Reinsch, J. Caporal, M. Waddoups, and N. Tekarli, "The impact of rules of origin on supply chains: USMCA's auto rules as a case study," Report of the CSIS Scholl Chair in International Business, April 2019.

[114] In this section of the chapter, the critical products for bilateral repeated offenders are products among the top fifty products in terms of covered imports (Rank <= 50) after filtering according to step (1)(a) (low utilization rates and significant preference margin) and sorting following step (1)(b).

[115] Critical products for repeated offenders across agreements are products with a rank below ten after filtering according to step (1)(a) and filtering according to step (1)(b), for at least two FTA partners, either for EU imports or for EU exports.

Part B Identify PRSO for Reform: Linking Critical Products and Repeated Offenders to PSRO of FTAs The second part of the methodology matches the critical products and repeated offenders that have been identified to their respective PSRO.

(3) **Matching critical products with PSRO**
From step (1) above, critical products can be matched with PSRO. This step only constitutes a preliminary analysis as a transition to the application of the repeated offenders' stricter criteria.

(4) **Matching bilateral repeated offenders with PSRO**
Within a given free-trade agreement, PSRO are identical in both directions of trade. Therefore, a product that is critical for EU exports to the partner country AND for the partner's exports to the EU may be the sign of inadequate PSRO within the agreement. Therefore, it is crucial to match the bilateral repeated offenders with their respective PSRO. This allows us to examine these rules and understand what are the underlying reasons for low utilization in order to make recommendations for reform.

(5) **Matching bilateral and cross-agreement repeated offenders with PSRO as priority candidates for reform**
This step consists in identifying the critical products that are included in both bilateral and cross-agreement repeated offenders (for EU imports, EU exports, and for both), and then to match them to the PSRO of each concerned free-trade agreement.

Although PSRO are not identical across agreements, some similarities can be observed. Therefore, critical products that are bilateral repeated offenders in several agreements might be good candidates for reform, requiring the matching and analysis of the PSRO of these two-dimensional (bilateral and cross-agreement) repeated offenders.

4.2.5.2.2 OVERVIEW OF RESULTS. **Identification of Critical Products** Table 4.19 provides a rather focused snapshot of the EU products imported into FTA partners most affected by relatively low utilization rates and high volume of trade in descending order. Columns (1) and (2) provide the product HS four-digit code and its corresponding description. Columns (3) to (6) refers to the partner's imports from the EU, with the partner ISO code in column (3), the utilization rate in (4), preference margin in (5), and the value of covered imports in column (6). Columns (7) and (8) report the similar values for the European imports from the partner reported in (3). Results are reported in descending order of the partner's covered imports (9).[116]

[116] This chapter reports only values above 450 million of partner's imports and 35 million of EU imports, for reasons of readability.

TABLE 4.19 *EU most exported products to FTA partners with UR < 70%, PM > 2 pp., sorted in descending order of FTA partner covered imports (> 450 million USD)*

Product		FTA partners				EU		
HS 4	Description	ISO3	UR (%)	PM (pp.)	Covered imports (000 USD)	UR (%)	PM (pp.)	Covered imports (000 USD)
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
2710	Petroleum oils, etc., (excl. crude); prep. thereof, nes*	TUR	62.0	3.4	4,234,142	90.0	2.5	158,962
8703	Motor cars and other motor vehicles principally designed for passengers	KOR	59.2	5.8	3,257,273	86.0	4.2	1,595,926
8708	Parts and accessories of the motor vehicles of headings 87.01–87.05	MEX	9.7	2.6	1,913,190	48.1	3.8	198,000
2709	Petroleum oils and oils obtained from bituminous minerals, crude	KOR	61.8	3.0	1,848,504		0.0	0
2710	Petroleum oils, etc., (excl. crude); prep. thereof, nes	EGY	6.5	3.8	1,721,150	83.5	2.5	106,154
3004	Medicaments of mixed/ unmixed products	KOR	38.1	7.4	1,476,336		0.0	0
8703	Motor cars and other motor vehicles principally designed for passengers	MEX	43.9	34.3	1,098,697	93.7	9.8	1,972,232
8708	Parts and accessories of the motor vehicles of headings 87.01–87.05	KOR	60.4	8.0	1,014,729	83.2	3.1	692,849
8486	Machines and apparatus for the manufacture of semiconductor	KOR	64.4	3.5	982,070	29.0	0.3	318
8708	Parts and accessories of the motor vehicles of headings 87.01–87.05	CHE	65.5	4.7	952,469	94.8	3.8	493,679
8479	Machines, mechanical appliances having individual functions etc.	KOR	50.4	6.8	912,086	51.1	1.1	41,696
4202	Trunks, suit-cases; handbags of leather	KOR	23.7	7.3	863,917	19.6	2.9	30,391

(*continued*)

TABLE 4.19 (*continued*)

Product		FTA partners				EU		
HS 4	Description	ISO3	UR (%)	PM (pp.)	Covered imports (000 USD)	UR (%)	PM (pp.)	Covered imports (000 USD)
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
8481	Tapes, valves, for pipes pressure reducing, thermostatically controlled valve	KOR	43.6	4.8	813,883	47.6	1.8	44,898
3004	Medicaments of mixed/ unmixed products	MEX	69.4	5.9	698,982		0.0	0
8414	Air or vacuum pumps, exhausting and compression fans with/without filters	KOR	55.4	6.9	695,948	74.7	1.0	67,928
8413	Pumps for liquids, with or without measuring device; liquid elevators	KOR	61.4	6.9	682,808	57.6	0.8	25,043
8483	Transmission shafts, cranks, clutches, shaft couplings (universal joints)	KOR	46.9	5.7	664,207	69.2	1.6	45,659
2711	Petroleum gases and other gaseous hydrocarbons	MAR	38.2	2.8	663,254	100	0.7	17
8443	Printing machinery, including ink-jet printing machines	CHE	49.6	4.3	601,489	96.9	1.5	195,775
8544	Insulated wire, cable, other insulated electric conductors; optical cables . . .	MAR	11.2	23.4	543,430	99.3	2.9	796,360
1001	Wheat and meslin	MAR	35.4	29.5	513,203		0.2	0
6204	Women's or girls' suits, ensembles, jackets, dresses, skirts, etc.	CHE	42.1	16.2	497,260	78.9	12.0	72,398
0203	Meat of swine, fresh, chilled or frozen	KOR	64.1	9.9	488,868	0.0	0.0	375
6203	Men's or boys' suits, ensembles, jackets, blazers, trousers, etc.	CHE	61.3	12.7	462,048	94.9	12.0	146,466
4202	Trunks, suit-cases; handbags of leather	CHE	62.5	5.8	456,789	98.7	4.5	393,429
3824	Prepared binders; chemical products, nes; residual products, nes	CHE	35.8	3.5	453,979	89.9	5.3	136,637

* nes = not elsewhere specified.

It has to be noted that most of the products are petroleum oils, cars and parts thereof, and machinery of Chapter 84. The FTA partners importing from the EU are also few, mostly Mexico, Korea, Egypt, Switzerland, and Morocco. A preponderant volume of trade not fully utilizing trade preferences consists of petroleum oils and derivatives. These products normally attract an MFN duty of 2.5 percent in the EU.

The second most important products are cars and parts of cars that are attracting a high average of MFN rates in Mexico.

Table 4.20 provides a similar snapshot of the reverse side of trade; that is, EU imports from partner countries with data sorted in descending order of covered imports (6). The results mirror to a certain extent the findings of the previous table in the sense that there is a relatively high concentration of products and FTA partners that are recording low utilization. Chemicals and Switzerland appears to be country–product pairs showing substantial volumes of trade and suffering from low utilization. Cars and parts of motor vehicles also feature low utilization in this direction of trade from the same partners, mostly Mexico and Switzerland. Besides these specific products, it has to be noted that there are a great variety of products and partners recording a low utilization rate.

TABLE 4.20 *EU most imported products with UR < 70%, PM > 2pp., sorted in descending order of covered imports (> 35 million USD)*

Product		EU			FTA partners			
HS 4	Description	UR (%)	PM (pp.)	Covered imports (000 USD)	ISO3	UR (%)	PM (pp.)	Covered imports (000 USD)
(1)	(2)	(4)	(5)	(6)	(3)	(7)	(8)	(9)
2933	Heterocyclic compounds with nitrogen hetero-atom (s) only; nucleic acids	43.4	4.7	1,695,587	CHE	44.3	0.5	1,875,429
2924	Carboxyamide-function; amide-function compounds of carbonic acid	61.7	4.8	982,769	CHE	72.3	0.7	39,479
2934	Other heterocyclic compounds	32.9	4.9	573,394	CHE	37.8	0.0	81,579
802	Other nuts, fresh or dried, nes	60.6	2.6	518,687	TUR		0.0	0
2710	Petroleum oils, etc., (excl. crude); preparations, nes	58.9	2.5	502,340	DZA	62.0	0.9	302,424

(*continued*)

TABLE 4.20 (*continued*)

Product		EU			FTA partners			
HS 4	Description	UR (%)	PM (pp.)	Covered imports (000 USD)	ISO3	UR (%)	PM (pp.)	Covered imports (000 USD)
(1)	(2)	(4)	(5)	(6)	(3)	(7)	(8)	(9)
2922	Oxygen-function amino-compounds	44.0	5.2	228,360	CHE	57.8	0.5	110,137
0808	Apples, pears and quinces, fresh	46.8	2.9	217,903	CHL			
8708	Parts and accessories of the motor vehicles of headings 87.01–87.05	48.1	3.8	198,000	MEX	9.7	2.6	1,913,190
8536	Electrical apparatus for making connections,	24.6	2.1	108,875	MEX	17.2	1.9	525,130
8529	Accessory parts for apparatus in heading 85.25–85.28	41.2	2.6	105,832	KOR	26.3	6.6	69,883
1605	Crustaceans, molluscs and other aquatic invertebrates, prepared or preserved.	67.1	18.0	104,776	MAR	40.2	5.0	754
8207	Interchangeable hand tools, whether not power operated, rock drilling etc.	68.1	2.2	100,837	KOR	82.1	7.6	61,087
8703	Motor cars and other motor vehicles principally designed passengers	66.4	9.8	88,820	CHE	92.4	0.9	8,726,786
3907	Polyethers and epoxide resins; polyesters	48.9	5.5	84,049	TUR	80.0	5.6	527,532
8537	Boards, panels, consoles, desks etc., other than switching apparatus	14.4	2.1	66,457	MEX	37.4	4.9	179,037
8701	Tractors (other than of heading 87.09)	56.7	3.8	61,123	TUR	99.7	3.7	222,358
9405	Lamps, lighting fittings, nes including parts	44.3	2.4	60,289	KOR	41.4	8.0	64,916

TABLE 4.20 (*continued*)

Product		EU			FTA partners			
HS 4	Description	UR (%)	PM (pp.)	Covered imports (000 USD)	ISO3	UR (%)	PM (pp.)	Covered imports (000 USD)
(1)	(2)	(4)	(5)	(6)	(3)	(7)	(8)	(9)
2921	Amine-function compounds	67.2	5.3	60,251	CHE	87.9	0.5	156,135
3926	Other articles of plastics, nes	55.1	4.2	55,042	KOR	49.7	6.2	80,988
8544	Insulated wire, cable, other insulated electric conductors; optical cables …	8.1	2.9	54,858	MEX	26.5	5.5	225,626
8506	Primary cells and primary batteries	64.8	4.5	46,305	CHE	70.0	3.4	53,379
8543	Electrical machines, apparatus with one function not specified elsewhere	57.5	2.6	44,608	KOR	56.1	5.7	104,514
8527	Reception apparatus for radio-telephony, reproducing apparatus or a clock	68.5	8.2	42,990	KOR	2.8	8.0	22,003
7326	Other articles of iron or steel	66.4	2.1	41,964	KOR	19.2	8.0	343,266
8408	Compression-ignition, combustion piston engines (diesel/semi-diesel engines)	33.1	2.3	41,356	MEX	3.8	3.6	313,512
8528	Television receivers	34.0	3.1	40,193	KOR	15.8	7.0	17,050
8544	Insulated wire, cable, other insulated electric conductors; optical cables…	48.4	2.3	39,445	KOR	42.1	5.7	96,417
8482	Ball or roller bearings	51.7	3.2	38,917	KOR	55.0	5.1	266,974
9001	Optical fibres, bundles, other than of 85.44	55.3	2.2	37,516	KOR	56.2	7.7	100,221
8537	Boards, panels, consoles, desks etc., other than switching apparatus	67.8	2.1	37,269	TUN			

Bilateral Repeated Offenders Table 4.21 reports the bilateral repeated offenders for each free-trade agreement, namely the critical products with UR < 70 percent, PM > 2 pp. lying among the top fifty products in terms of covered imports cumulatively for both EU imports and partner imports from EU. Observations for each free-trade agreement are sorted in descending order of total covered trade (EU imports and partner imports from EU) reported in column (4). The latter corresponds to the sum of column (8) and (11).

The table further strengthens the previous findings, pointing to a number of products and free-trade agreements that have appeared in both Tables 4.19 and 4.20, with therefore high trade values, such as Switzerland for selected garments; South Korea for a variety of HS headings; and Mexico, Turkey, etc.

TABLE 4.21 *Bilateral repeated offenders sorted in descending order of total covered trade (EU and partner imports, thousands USD)*

			Total trade		EU imports			Partner imports		
Part.	HS code	Product description	Cov. (000 USD)	Rec. (000 USD)	UR (%)	PM (pp.)	Cov. (000 USD)	UR (%)	PM (pp.)	Cov. (000 USD)
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
ALB	8528	Television receivers	21,466	823	0.0	8.9	16,182	15.6	4.3	5,284
ALB	6217	Other made up clothing accessories	10,363	1,647	4.1	8.2	4,780	26.0	9.0	5,583
ALB	3926	Other articles of plastics, nes	7,392	4,723	35.4	5.2	871	67.7	5.7	6,521
ALB	8716	Trailers; other vehicles, not mechanically propelled; parts	4,590	1,446	10.2	2.4	75	31.9	2.4	4,515
ALB	7117	Imitations jewellery	1,600	389	45.5	4.0	505	14.5	11.4	1,094
ALB	8452	Sewing machines, table, bases	1,556	809	1.2	4.3	68	54.3	4.5	1,488
ALB	6005	Fabrics; warp knit	1,126	429	69.2	8.0	43	36.9	10.0	1,083
CHE	8711	Motorcycles, motor fitted cycles	202,331	121,725	65.1	6.9	3,361	60.1	2.1	198,970
CHE	8712	Bicycles, not motorised	98,040	11,592	63.8	14.7	1,128	11.2	10.0	96,912
CHE	6212	Brassieres, girdles, corsets, braces	72,049	25,027	50.2	6.5	2,469	34.2	7.0	69,581
CHE	6112	Track-suits, ski-suits and swimwear, knitted or crocheted	49,332	15,564	53.7	10.7	1,297	31.0	11.8	48,035

TABLE 4.21 (*continued*)

			Total trade		EU imports			Partner imports		
Part.	HS code	Product description	Cov. (000 USD)	Rec. (000 USD)	UR (%)	PM (pp.)	Cov. (000 USD)	UR (%)	PM (pp.)	Cov. (000 USD)
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
CHE	6106	Women's or girls' blouses, etc., knitted or crocheted	41,115	18,717	55.7	12.0	1,296	45.2	14.8	39,819
DZA	8708	Parts and accessories of motor vehicles of headings 87.01–87.05	46,837	27,544	0.8	3.8	155	59.0	3.1	46,682
DZA	8483	Transmission shafts, cranks, clutches, shaft couplings	14,785	5,165	0.4	2.1	29	35.0	3.3	14,756
DZA	9405	Lamps, lighting fittings, nes, parts	5,839	3,537	9.6	3.0	49	61.0	2.3	5,790
DZA	8702	Public-transport type passenger motor vehicles	4,240	164	0.0	12.7	134	4.0	2.8	4,106
EGY	8703	Motor cars/vehicles principally designed for passengers	337,202	140,482	37.7	9.8	2,003	41.7	10.7	335,199
EGY	8701	Tractors (other than of 87.09)	232,483	74,245	0.0	3.7	103	31.9	3.2	232,380
EGY	7307	Tubes or pipe fittings, iron or steel	105,420	19,638	64.8	3.5	566	18.4	5.8	104,854
EGY	8537	Boards, panels, consoles, desks etc.	75,512	35,621	10.1	2.1	292	47.3	3.1	75,220
EGY	8705	Special purpose motor vehicles; not for persons or goods	59,725	21,757	0.0	3.7	307	36.6	12.2	59,418
EGY	8483	Transmission shafts, cranks, clutches, shaft couplings	56,124	21,979	16.7	2.1	253	39.3	3.0	55,870
EGY	3811	Anti-knock preparations, oxidation inhibitors, to use as mineral oils	49,611	32,705	0.3	5.7	214	66.2	4.0	49,397
EGY	3808	Insecticides, rodenticides and similar products, for retail sale	48,996	24,538	62.5	6.0	483	50.0	4.4	48,513

(*continued*)

TABLE 4.21 (*continued*)

			Total trade		EU imports			Partner imports		
Part.	HS code	Product description	Cov. (000 USD)	Rec. (000 USD)	UR (%)	PM (pp.)	Cov. (000 USD)	UR (%)	PM (pp.)	Cov. (000 USD)
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
EGY	2106	Food preparations nes or included	43,637	20,945	31.4	13.3	1,789	48.7	3.8	41,848
EGY	8408	Compression-ignition, combustion piston engines	38,881	6,308	0.0	2.3	70	16.3	3.0	38,810
EGY	8716	Trailers; other vehicles, not mechanically propelled	34,977	7,637	10.1	2.4	108	21.9	5.4	34,869
ISL	8528	Television receivers	5,443	3,709	32.5	8.9	30	68.3	4.9	5,413
ISL	7113	Jewellery & parts of precious metal	1,825	1,066	4.1	3.0	240	66.6	10.0	1,585
ISL	4202	Trunks, suitcases; handbags, of leather	1,690	1,141	34.4	4.5	30	68.1	10.0	1,660
ISL	6103	Men's or boys' suits, ensembles, etc., knitted or crocheted	1,549	906	40.6	12.0	37	58.9	15.0	1,512
ISL	8529	Accessory parts for the apparatus in heading 85.25–85.28	655	361	22.0	3.2	61	58.6	3.8	593
ISL	6309	Worn clothing and worn articles	639	2	0.5	5.3	376	0.0	10.0	263
ISL	9507	Fishing rods & nets	296	129	50.3	3.3	106	40.0	6.8	190
KOR	4202	Trunks, suit-cases; handbags of leather, etc.	894,308	210,866	19.6	2.9	30,391	23.7	7.3	863,917
KOR	7326	Other articles of iron or steel	385,230	93,930	66.4	2.1	41,964	19.2	8.0	343,266
KOR	8482	Ball or roller bearings	305,892	166,891	51.7	3.2	38,917	55.0	5.1	266,974
KOR	2933	Heterocyclic compounds with nitrogen hetero-atom(s) only	202,494	92,967	50.5	4.4	11,410	45.6	5.6	191,084
KOR	6403	Footwear, with rubber, plastics, leather... soles, leather uppers	165,623	79,063	67.9	6.0	5,114	47.1	13.0	160,510
KOR	7307	Tubes or pipe fittings, iron or steel	135,674	40,332	56.7	2.8	15,499	26.3	6.5	120,175

TABLE 4.21 (*continued*)

			Total trade		EU imports			Partner imports		
Part.	HS code	Product description	Cov. (000 USD)	Rec. (000 USD)	UR (%)	PM (pp.)	Cov. (000 USD)	UR (%)	PM (pp.)	Cov. (000 USD)
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
MAR	6006	Knitted or crocheted fabrics, other than of headings 60.01–60.04	195,930	6,066	60.3	8.0	3,639	2.0	13.4	192,290
MAR	5208	Woven fabrics of cotton, with >= 85% cotton, but < 200g/m²	142,670	20,952	45.1	8.0	1,014	14.5	9.5	141,656
MAR	8408	Compression-ignition, combustion piston engines	116,889	27,307	11.4	2.3	585	23.4	8.2	116,304
MAR	3923	Articles for conveyance or packaging of goods, of plastics; stoppers, etc., of plastics	95,006	35,455	65.8	6.4	6,480	35.2	17.3	88,526
MAR	5516	Woven fabrics of artificial staple fibres	75,874	3,407	63.5	8.0	870	3.8	12.2	75,004
MAR	8547	Insulating fittings for electrical machines, base metal insulators	74,695	6,038	54.7	4.2	341	7.9	3.3	74,354
MAR	3907	Polyethers and epoxide resins; polyesters, in primary forms	71,283	48,514	54.7	5.5	171	68.1	9.9	71,112
MAR	5512	Woven fabrics of >= 85% synthetic staple fibres	70,302	3,429	45.5	8.0	1,052	4.3	13.5	69,249
MEX	8708	Parts and accessories of the motor vehicles of headings 87.01–87.05	2,111,191	281,431	48.1	3.8	198,000	9.7	2.6	1,913,190
MEX	8408	Compression-ignition, combustion piston engines	354,868	25,654	33.1	2.3	41,356	3.8	3.6	313,512
MEX	8481	Tapes, valves, for pipes pressure reducing	343,987	131,656	17.3	2.2	32,539	40.5	2.6	311,448
MEX	3926	Other articles of plastics, nes	286,569	47,865	31.8	5.2	33,371	14.7	8.8	253,198
MEX	8544	Insulated wire, cable, other insulated electric conductors; ...	280,483	64,329	8.1	2.9	54,858	26.5	5.5	225,626

(*continued*)

TABLE 4.21 (*continued*)

			Total trade		EU imports			Partner imports		
Part.	HS code	Product description	Cov. (000 USD)	Rec. (000 USD)	UR (%)	PM (pp.)	Cov. (000 USD)	UR (%)	PM (pp.)	Cov. (000 USD)
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
MEX	8537	Boards, panels, consoles, desks etc., other than switching apparatus	245,495	76,546	14.4	2.1	66,457	37.4	4.9	179,037
MEX	8501	Electric motors and generators	200,661	69,372	47.1	2.1	28,768	32.5	4.5	171,894
MEX	8504	Electrical transformers, static converters and inductors	125,707	45,732	15.5	2.1	15,714	39.4	2.8	109,994
MEX	3923	Articles for the of goods, of plastics; stoppers, etc., of plastics	104,920	38,717	17.8	6.4	13,825	39.8	9.3	91,095
MEX	8526	Radar, radio navigational aid apparatus, remote control apparatus	81,281	9,821	33.9	2.2	17,700	6.0	4.6	63,581
MEX	8212	Razors and razor blades	79,674	38,228	0.0	2.7	5,511	51.5	11.3	74,163
MEX	8515	Electrical brazing, welding machines, (hot spraying of metals)	73,841	15,324	3.2	2.7	5,472	22.2	6.6	68,369
MKD	5208	Woven fabrics of cotton, with >= 85% cotton, but < 200g/m²	44,267	18,690	64.2	8.0	133	42.2	9.5	44,134
MKD	4107	Leather of other animals, without hair on	25,686	14,221	27.9	6.4	272	55.7	12.5	25,414
MKD	5209	Woven fabrics of cotton, with >= 85% cotton, >= 200g/m²	21,908	8,859	44.9	8.0	124	40.4	10.1	21,784
MKD	5903	Textile fabrics impregnated, coated, covered/laminated	17,789	10,487	53.1	8.0	29	59.0	5.0	17,761
MKD	5515	Other woven fabrics, < 85% synthetic staple fibres	10,907	2,743	24.6	8.0	30	25.1	9.5	10,877
MKD	5512	Woven fabrics of >= 85% synthetic staple fibres	10,238	4,789	58.9	8.0	60	46.7	9.5	10,178

TABLE 4.21 (*continued*)

			Total trade		EU imports			Partner imports		
Part.	HS code	Product description	Cov. (000 USD)	Rec. (000 USD)	UR (%)	PM (pp.)	Cov. (000 USD)	UR (%)	PM (pp.)	Cov. (000 USD)
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
MKD	5111	Woven fabrics of carded wool or of carded fine animal hair	8,396	3,133	53.6	7.9	30	37.3	8.5	8,366
MKD	5210	Woven cotton fabrics with man-made fibres, < 85% cotton, =< 200g/m²	8,015	3,149	69.2	8.0	65	39.0	9.5	7,950
MKD	5513	Woven fabrics, < 85% synthetic staple fibres, with cotton, =< 170g/m²	6,325	2,675	6.2	8.0	35	42.5	9.5	6,290
MKD	6004	Knitted or crocheted fabrics of a width exceeding 30 cm	6,209	3,094	67.2	7.6	32	49.7	9.5	6,177
MKD	4113	Leather further prepared after tanning or crusting	5,674	1,738	58.5	2.4	61	30.3	13.0	5,613
MNE	8528	Television receivers	4,626	49	0.0	8.9	10	1.1	2.7	4,616
MNE	8483	Transmission shafts, cranks, clutches, shaft couplings	4,174	1,870	43.5	2.1	3,335	49.9	5.4	839
MNE	6204	Women's or girls' suits, ensembles, jackets, dresses, skirts, etc.	3,678	1,562	0.3	12.0	20	42.7	10.0	3,659
MNE	3926	Other articles of plastics, nes	2,231	1,369	1.0	5.2	17	61.8	8.7	2,214
MNE	7610	Aluminium structures, for structural use	1,694	1,097	13.1	6.3	19	65.4	8.7	1,675
MNE	6203	Men's or boys' suits, ensembles, jackets, blazers, trousers, etc.	1,651	609	0.0	12.0	13	37.2	10.0	1,638
MNE	6109	T-shirts, singlets and other vests, knitted or crocheted	1,342	753	63.0	12.0	67	55.8	10.0	1,275
MNE	2101	Extracts, essences and concentrates, of coffee, tea or maté	1,136	560	0.0	9.7	31	50.7	15.3	1,105

(*continued*)

TABLE 4.21 (*continued*)

			Total trade		EU imports			Partner imports		
Part.	HS code	Product description	Cov. (000 USD)	Rec. (000 USD)	UR (%)	PM (pp.)	Cov. (000 USD)	UR (%)	PM (pp.)	Cov. (000 USD)
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
MNE	6110	Jerseys, pullovers, cardigans, knitted or crocheted	977	401	0.0	11.9	9	41.4	10.0	968
MNE	8427	Fork-lift trucks, other trucks fitters with lifting or handling equipment	895	476	0.0	4.3	27	54.8	5.0	868
NIC	6204	Women's or girls' suits, ensembles, jackets, dresses, skirts, etc.	295	7	2.8	2.4	248	0.0	3.6	46
NIC	6206	Women's or girls' blouses, shirts and shirt-blouses	69	0	0.3	2.4	24	0.0	4.2	45
NIC	4203	Articles of apparel and clothing accessories of leather	69	0	1.6	3.6	3	0.0	2.5	66
NIC	4202	Trunks, suit-cases. . .; handbags. . . and similar items of leather, etc.	65	4	43.3	3.8	10	0.0	2.8	55
NIC	6405	Other footwear, nes	53	7	12.9	3.9	1	13.0	2.3	52
SER	3808	Insecticides, rodenticides . . . and similar products, for retail sale	50,533	29,357	8.6	6.0	1,307	59.4	2.6	49,226
SER	8528	Television receivers	38,551	476	0.0	8.9	16,103	2.1	3.9	22,448
SER	6212	Brassieres, girdles, corsets, braces, suspenders, garters, etc.	16,705	8,306	47.6	6.5	9,103	52.2	11.9	7,602
SER	8537	Boards, panels, consoles, desks etc., other than switching apparatus	15,185	8,622	18.4	2.1	715	58.7	4.0	14,470
SER	2101	Extracts, essences and concentrates, of coffee, tea or maté	13,042	7,743	39.8	9.6	417	60.0	13.6	12,625
SER	8465	Machine-tools, otherwise for working wood, etc.	7,004	4,377	8.4	2.7	412	65.9	3.3	6,592

TABLE 4.21 (*continued*)

			Total trade		EU imports			Partner imports		
Part.	HS code	Product description	Cov. (000 USD)	Rec. (000 USD)	UR (%)	PM (pp.)	Cov. (000 USD)	UR (%)	PM (pp.)	Cov. (000 USD)
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
SER	8512	Electrical lighting/ signalling equipment	6,738	3,361	24.7	2.6	2,430	64.1	2.6	4,308
SER	8543	Electrical machines, apparatus with one functions nes	6,301	3,388	3.8	3.3	688	59.9	2.1	5,613
SER	5601	Wadding of textile materials; textile fibres, =< 5mm	5,935	4,004	26.9	3.7	181	68.7	3.8	5,755
SER	8525	Transmission apparatus for radio, TV	5,655	2,773	0.0	4.5	270	51.5	3.7	5,385
SER	8459	Machine-tools for drilling, boring other than lathes of heading 84.58	2,535	1,324	53.1	2.4	385	52.1	4.0	2,150
SER	8457	Machining centres, construction machines for working metal	2,257	457	13.3	2.7	553	22.5	4.0	1,704
TUR	3808	Insecticides, rodenticides ... and similar products, for retail sale	187,713	105,093	62.9	6.0	5,068	55.8	6.0	182,645
TUR	2814	Ammonia, anhydrous or in aqueous solution	17,554	12,094	69.3	5.5	13,464	67.6	5.5	4,090

Looking only at products with covered imports above 80 million, which represent twenty-six products reported in Table 4.19, there is a rather concentrated pattern of free-trade agreements that are routinely encountering problems with different products like Mexico (ten products out of twenty-six) or South Korea (six products out of twenty-six). With trade above 200,000 million, seven products remain in the list of bilateral repeated offenders for Mexico free-trade agreements, four for South Korea, two for Egypt, and one for Switzerland (see Table 4.21).

Across Agreements Repeated Offenders Tables 4.22 and 4.23 report the subsequent step of the methodology; that is, the identification of those products at HS four-digit level that are found to report low utilization rates across a number of free-

TABLE 4.22 *Repeated offenders: EU imports of products with at least two FTA partners of product rank <= 10, when UR < 70%, PM > 2 pp. (products are sorted in descending order of EU covered imports (4))*

Product			EU			
HS 4	Description	Partner and rank in descending order of EU filtered covered imports	Covered imports (000 USD)	PM (pp.)	UR (%)	WUR (%)
(1)	(2)	(3)	(4)	(5)	(6)	(7)
2710	Petroleum oils, etc., (excl. crude); preparations thereof, nes	DZA1; PER2; LBN10; NOR12; ALB13; MKD19; PAN25	506,651	2.5	25.6	58.5
8708	Parts and accessories of motor vehicles	MEX1; LBN2; PAN3; ISL3; CHL4; DZA11; PER14; NIC14	202,955	3.8	22.1	47.7
8537	Boards, panels, consoles, desks etc., other than switching apparatus	MKD1; TUN1; MAR2; MEX3; BIH4; DZA5; ISL11; LBN15; MNE16; EGY17; SER17; NOR18; ALB20; CHL21	154,346	2.1	22.0	27.2
8529	Accessory parts for the apparatus in heading 85.25–85.28	KOR1; DZA4; MEX17; PAN23; EGY28; ISL28	124,354	3.0	10.9	35.3
8528	Television receivers (video monitors, projectors), reproducing apparatus	NOR1; ALB1; SER2; MKD4; KOR8; CHE12; BIH13; MAR18; MEX27	111,626	8.2	18.6	17.1
8536	Electrical apparatus for making connections, voltage not > 1,000 volts	MEX2; MKD6; DZA15; ISL15; CHL17; PER18; NOR26; ALB28; MNE29	110,314	2.1	22.2	24.6
8703	Motor cars and other motor vehicles principally designed passengers	MNE1; PAN2; EGY3; ALB4; NOR4; CHE5; BIH6; DZA8; CHL9; LBN11; PER13; NIC13; TUN14	108,003	8.4	25.0	62.5

TABLE 4.22 (*continued*)

Product			EU			
HS 4	Description	Partner and rank in descending order of EU filtered covered imports	Covered imports (000 USD)	PM (pp.)	UR (%)	WUR (%)
(1)	(2)	(3)	(4)	(5)	(6)	(7)
8207	Interchangeable hand tools, whether not power operated, rock drilling etc.	KOR2; ISL5; CHL7; PER8; DZA10; TUN10; EGY13; NOR19; ALB21; MNE23; MAR26	104,839	2.7	29.4	67.1
8544	Insulated wire, cable, other insulated electric conductors; optical cables…	MEX4; PER5; KOR9; NIC16; ISL19; NOR22; ALB24; DZA25; PAN27	95,089	2.8	24.0	25.1
3926	Other articles of plastics, nes	KOR4; NOR5; ALB5; MEX6; ISL13; CHL16; PER25	90,677	5.1	44.8	46.2
7326	Other articles of iron or steel	SER1; KOR7; LBN13; PAN19; MEX20; CHL22; ISL26	78,077	2.5	39.8	60.5
8543	Electrical machines, apparatus with one functions nes.	TUN3; KOR5; SER19; CHL24; MEX26; BIH29; EGY30	68,009	3.2	29.6	50.8
2921	Amine-function compounds	CHE6; TUR9	63,099	5.3	56.6	66.2
8701	Tractors (other than tractors of heading 87.09)	TUR3; MKD5; BIH9; SER22	62,958	3.8	21.0	55.3
9405	Lamps, lighting fittings, nes incl. parts	KOR3; LBN5; MNE24; ISL30; DZA30	61,193	2.9	29.2	44.6
8408	Compression-ignition, combustion piston engines	MEX5; LBN9; MAR19; CHL23	42,648	2.3	11.6	32.2
8481	Tapes, valves, for pipes pressure	MNE6; DZA6; MEX7; CHL8; ISL8;	34,242	2.2	10.8	17.5

(*continued*)

TABLE 4.22 (*continued*)

Product			EU			
HS 4	Description	Partner and rank in descending order of EU filtered covered imports	Covered imports (000 USD)	PM (pp.)	UR (%)	WUR (%)
(1)	(2)	(3)	(4)	(5)	(6)	(7)
	reducing, thermostatically controlled valve	PER19; PAN22; NOR25; ALB27				
2938	Glycosides and their salts, ethers, esters and derivatives	MAR6; CHE8; BIH30	32,680	5.5	16.3	40.4
4202	Trunks, suit-cases; handbags and similar items of leather, etc.	LBN4; PAN8; MKD9; PER12; KOR13; NIC26; CHL26	32,132	4.0	25.4	20.0
6006	Knitted or crocheted fabrics, other than of 60.01–60.04	TUN7; MAR7; KOR15; NOR28; ALB30	30,961	7.7	38.9	67.3
8512	Electrical lighting/signaling equipment (excl. in 85.39).	MKD3; SER7; MEX12	28,062	2.6	12.2	11.4
6309	Worn clothing and other worn articles	ISL6; CHE9; MAR13; TUN16	27,874	5.3	28.1	60.4
4011	New pneumatic tyres, of rubber	PAN1; LBN3; PER4; MNE5; DZA9; CHL20; MEX28	21,186	3.9	10.0	23.8
0306	Crustaceans, fresh, chilled or frozen	ISL1; ALB8; NOR8	18,720	8.1	55.2	57.3
8504	Electrical transformers, static converters and inductors	DZA3; EGY6; NOR15; ALB17; MEX21; PER22; CHL27	17,766	2.1	22.9	16.4
8802	Other aircraft, spacecraft, and spacecrafts launch vehicles	EGY2; CHE10	13,512	2.6	23.9	34.6

TABLE 4.22 (*continued*)

Product			EU			
HS 4	Description	Partner and rank in descending order of EU filtered covered imports	Covered imports (000 USD)	PM (pp.)	UR (%)	WUR (%)
(1)	(2)	(3)	(4)	(5)	(6)	(7)
6217	Other made up clothing accessories; parts of garments	ALB2; NOR2; MAR12; LBN24	10,733	8.2	21.8	10.3
4415	Packing cases of wood; cable-drums of wood; pallets, etc., of wood	MNE4; BIH5; SER5; NOR6; ALB6; MKD12; ISL18; PER30	8,713	3.5	37.1	58.6
3808	Insecticides, rodenticides... and similar products, for retail sale	TUR8; SER9; EGY9; MKD24	6,938	6.0	47.6	52.5
7113	Jewelles and parts of precious metal, metal clad with precious metal	LBN1; PAN5; ISL9	6,505	3.0	23.9	61.0
9015	Surveying equipments, appliances, excluding compasses; rangefinders	ISL2; PAN7; PER9; EGY12; TUN13; TUR15; DZA17; MNE18; MAR25	5,484	3.1	7.0	16.6
307	Molluscs and aquatic invertebrates, nes	NOR3; ALB3	4,551	7.1	69.2	69.2
8705	Special purpose motor vehicles; not for persons or goods	DZA7; MNE7; NOR13; SER13; ALB15; EGY16; MAR22; TUN24	3,125	3.7	3.9	1.8
2106	Food preparations nes or included	EGY4; BIH7; DZA13	2,925	12.6	33.7	40.0

(*continued*)

TABLE 4.22 (*continued*)

Product			EU			
HS 4	Description	Partner and rank in descending order of EU filtered covered imports	Covered imports (000 USD)	PM (pp.)	UR (%)	WUR (%)
(1)	(2)	(3)	(4)	(5)	(6)	(7)
8212	Razors and razor blades (incl. razor blades blanks in strips)	MNE8; PAN10; CHE17; TUR22	2,861	2.7	23.4	35.5
6101	Men's or boys' overcoats, knitted or crocheted	EGY5; NIC6; NOR11; ALB12	2,117	9.6	50.4	53.5
4107	Leather of other animals, without hair on	NOR7; ALB7; MKD10; CHL29	1,892	6.4	43.4	52.1
6102	Woman's or girls' overcoats, knitted or crocheted	NOR9; ALB10; NIC11	1,129	8.8	45.1	54.4
6203	Men's or boys' suits, ensembles, jackets, blazers, trousers, etc	LBN6; NIC10; CHL11; PAN21	1,121	7.2	42.5	51.3
6403	Footwear, with rubber, plastics, leather soles, leather uppers	LBN7; MNE10; PAN17	711	6.3	46.5	58.1
6104	Women's or girls' suits, ensembles, etc., knitted or crocheted	LBN8; NIC9	680	7.2	33.2	49.8
6211	Track suits, ski suits and swimwear; other than garments	PER6; PAN9; NIC18; LBN26	621	5.3	23.0	30.3
7019	Glass fibres (including glass wool) and articles thereof	MNE3; CHL10	556	6.7	0.0	0.0

TABLE 4.23 *Repeated offenders: Partner imports from EU with at least two FTA partners with product rank <= 10, when UR < 70%, PM > 2pp., and products are sorted in descending order of selected partners' imports from EU*

Product			Partners' Imports from EU			
HS 4	Description	Partner and Rank in descending order of covered imports from EUN	Cov. imports (000 USD)	PM (pp.)	UR (%)	WUR (%)
(1)	(2)	(3)	(4)	(5)	(6)	(7)
2710	Petroleum oils, etc., (excl. crude); preparations thereof, nes	EGY1; TUR1	5,955,292	3.6	46.0	2710
8703	Motor cars and other motor vehicles (designed for passengers)	KOR1; MEX2; EGY3	4,691,169	17.0	54.3	8703
8708	Parts and accessories of the motor vehicles of 87.01–87.05	CHE1; HRV1; MEX1; MAR4; KOR4; EGY7; DZA9	4,654,589	6.7	34.8	8708
3004	Medicaments of mixed or unmixed products, for retail sale	KOR3; MEX3; MAR9	2,448,144	6.4	49.5	3004
8479	Machines, mechanical appliances with individual functions	KOR6; EGY8; MEX8; MAR13	1,557,990	5.1	50.6	8479
4202	Trunks, suit-cases; handbags and similar items of leather, etc.	ISL4; CHE5; KOR7; MNE13; HRV22	1,333,282	9.5	37.0	4202
8481	Tapes, valves, for pipes pressure reducing	EGY6; MEX7; KOR8	1,305,766	3.2	43.0	8481
8414	Air or vacuum pumps, exhausting and compression fans	MNE9; KOR9; MEX11; EGY16	1,063,789	5.7	50.5	8414

(*continued*)

TABLE 4.23 (*continued*)

Product			Partners' Imports from EU			
HS 4	Description	Partner and Rank in descending order of covered imports from EUN	Cov. imports (000 USD)	PM (pp.)	UR (%)	WUR (%)
(1)	(2)	(3)	(4)	(5)	(6)	(7)
8413	Pumps for liquids, with or without measuring device	MNE6; KOR10; EGY11; MEX15	1,046,221	5.8	52.9	8413
3824	Prepared binders; chemical products; residual products, nes	CHE6; EGY10; DZA11; MKD24; KOR27	886,277	5.1	45.7	3824
2711	Petroleum gases and other gaseous hydrocarbons	MAR1; EGY5; MNE8	870,628	3.8	30.2	2711
6204	Women's or girls' suits, ensembles, jackets, dresses, skirts	CHE3; MNE3; HRV7; ALB15	524,122	12.3	41.5	6204
6203	Men's or boys' suits, ensembles, jackets, blazers, trousers, etc.	ALB3; CHE4; HRV13; MNE15; SER26	490,640	12.4	59.7	6203
6110	Jerseys, pullovers, cardigans, knitted or crocheted	HRV5; CHE8; ALB18; MNE27	463,307	10.0	41.2	6110
8408	Compression-ignition, combustion piston engines	HRV6; MEX6; MAR21; SER22	454,704	4.8	12.2	8408
2204	Wine of fresh grapes, (incl. fortified); other grape must	CHE7; NIC10	447,711	7.5	1.0	2204
3926	Other articles of plastics, nes	ALB8; MNE10; MEX12; MKD19; MAR20	386,289	7.8	18.6	3926
3808	Insecticides, rodenticides and similar products, for retail sale	HRV2; SER3; TUR4; MAR26	384,757	4.7	48.3	3808

TABLE 4.23 (*continued*)

Product			Partners' Imports from EU			
HS 4	Description	Partner and Rank in descending order of covered imports from EUN	Cov. imports (000 USD)	PM (pp.)	UR (%)	WUR (%)
(1)	(2)	(3)	(4)	(5)	(6)	(7)
3304	Beauty, make-up, skin-care, manicure preparations	NIC1; MNE4; KOR16	373,932	5.7	55.6	3304
8474	Machinery for sorting, screening, forming foundry moulds	SER5; MAR10	268,944	6.1	26.0	8474
7113	Jewellery and parts of precious metal	TUR2; ISL5	223,321	6.5	69.4	7113
6109	T-shirts, singlets and other vests, knitted or crocheted	ALB2; HRV10; CHE14; MNE19	195,521	11.4	45.7	6109
5209	Woven fabrics of cotton, with >= 85% cotton, >= 200g/m²	MKD6; ALB7; MAR17	162,564	9.0	17.1	5209
2402	Cigars, cigarillos, cigarettes, etc., of tobacco or substitutes	ALB1; HRV4; MNE5; SER20	135,260	12.5	2.7	2402
7318	Screws, bolts, nuts, screw-hooks, rivets, of iron or steel	DZA6; HRV8; ALB20	73,086	11.7	39.3	7318
8523	Prepared unrecorded media for sound, other than pdt of 37	SER7; DZA10	61,640	3.4	22.8	8523
5407	Woven fabrics of synthetic filament yarn	MKD4; HRV9	41,765	8.5	41.3	5407

(*continued*)

TABLE 4.23 (*continued*)

Product			Partners' Imports from EU			
HS 4	Description	Partner and Rank in descending order of covered imports from EUN	Cov. imports (000 USD)	PM (pp.)	UR (%)	WUR (%)
(1)	(2)	(3)	(4)	(5)	(6)	(7)
8528	Television receivers, reproducing apparatus	ISL1; MNE1; SER6; ALB12	37,761	4.0	13.4	8528
8415	Air conditioning machines	MNE7; ALB9; NIC18	8,909	5.4	55.5	8415

trade agreements for EU exports or imports. It is obvious that the more a product is found to report a low utilization rate in more than one free-trade agreement for a significant amount of trade, the more it is likely that the PSRO associated with that product is causing such low utilization. Despite the fact that PSRO can vary across agreements, the repeated offenders highlight that some PSRO are consistently inadequate across various agreements and need to be given serious consideration for potential reform.

Table 4.22 reports partners' imports from the EU with UR < 70 percent and PM > 2 pp. for at least two different free-trade agreements. The reading of the table is similar as for EU imports with the product HS code and description in columns (1) and (2) and the partner's name and rank in column (3). Column (4) shows the covered imports from the EU aggregated for all FTA partners listed under (3) and is therefore an indication of the overall exports of the EU to the various FTAs where the utilization rate is below 70 percent and the preference margin above 2 pp.

The most striking finding is the magnitude of trade flows that are significantly higher than on the EU import side. This is a potentially important trade policy indication since it clearly shows that EU exporters are facing difficulties in fully utilizing trade preferences and/or partner countries are facing difficulties in administering rules of origin in the free-trade agreement.

The repeated offenders are petroleum products, cars and parts thereof, machinery of Chapter 84, and chemicals. As in the previous figure, a number of FTA partners seem to appear regularly. For trade values above 100,000 million, South Korea leads

the pack with eight products with a rank below or equal to ten, followed by Switzerland and Egypt reporting seven products, and six for Mexico.

Table 4.23 reports the top products exported to the EU with UR < 70 percent and PM > 2 pp. for at least two different free-trade agreements. Column (3) reports the free-trade agreements for which the product is critical as well as the corresponding rank. For example, HS 8703 is the first critical product in terms of covered imports for Montenegro (MNE1), the second for Panama (PAN2); the fourth for Egypt (EGY4), Albania (ALB4), and Norway (NOR4); the fifth for Switzerland (CHE5), etc. All the countries reported in column (3) therefore face difficulties in using the preference when exporting to the EU. The table reports the rank of the first thirty. However, the selection criterion is that at least two free-trade agreements report a rank below or equal to ten. In the previous example for HS 8708, not two but ten free-trade agreements satisfy the condition.

Column (4) reports the EU covered imports from the respective partners listed in column (3). These therefore represent the total value of "critical" imports. Column (5) shows the preference margin while columns (6) and (7) are the simple and weighted average utilization rates of EU imports from the countries listed in (3). A simple average is calculated as the arithmetic average of the utilization rates of each country for the specific product while the weighted utilization rates is the sum of imports from the group of partners receiving the preference divided by the covered imports from the same partners.

Overall, the table finds, again, some of the products that appear regularly during this analysis as recording low utilization: petroleum oils, cars and parts of thereof, and chemical products. In addition, and differently from previous figures, there is a rather conspicuous amount of electrical machinery of Chapter 85.

Some partners appear more regularly than others. For trade values above 50,000 million, South Korea has eight critical products with a rank below or equal to ten. It is followed by Algeria and Mexico both with five critical products with ranks below ten; Macedonia has four; Norway, Switzerland, and Panama have two.

Matching Critical Products with PSRO Using the most exported and imported critical products reported in Tables 4.19 and 4.20, a preliminary analysis of the rules of origin can be carried out. Tables 4.24 and 4.25 report the various products previously identified as being critical and their corresponding PSRO (column (5)). For each product, a tentative reformed rule has been formulated in column (6) according to the comparative analysis of PSRO discussed in Chapter 1 of this book.

TABLE 4.24 *Matching EU most exported critical products with rules of origin: Partner imports from EU with WUR < 70% and PM > 2 pp., in descending order of covered imports, million USD (4)*

HS	Description	Part.	Cov. imp	Rules of origin	Proposed reformed rules of origin using EU method and related administrative procedures or alternative methodologies[i]
(1)	(2)	(3)	(4)	(5)	(6)
2710	Petroleum oils, etc.,	TUR EGY	4,234; 1,721	Operations of refining and/or one or more specific process(es) (1) or Other operations in which all the materials used are classified within a heading other than that of the product. However, materials of the same heading as the product may be used, provided that their total value does not exceed 50% of the ex-works price of the product	For purposes of heading 2710, the following processes confer origin: (a) Atmospheric distillation: A separation process in which petroleum oils are converted, in a distillation tower, into fractions according to boiling point and the vapor then condensed into different liquefied fractions. (b) Vacuum distillation: Distillation at a pressure below atmospheric but not so low that it would be classed as molecular distillation. (c) A change to any good of heading 2710 from any other good of heading 2710, provided that the good resulting from such change is the product of a chemical reaction, atmospheric distillation or vacuum distillation; or (d) A change to heading 2710 from any other heading, except from heading 2207.[ii] This PSRO requires further study and field interviews to identify a viable alternative.[iii]
8703	Motor cars & other motor vehicles	KOR	3,257	Manufacture in which the value of all the materials used does not exceed 45% of the ex-works price of the product	This rule reflects the maximum percentage of VNOM recently agreed with Korea and Japan. Further evidence should be identified to suggest a different PSRO.

		MEX	1,099	Manufacture in which the value of all the materials used does not exceed 40% of the ex-works price of the product	Increasing the percentage to 45% as in other free-trade agreements as recently agreed could be a solution.
8708	Parts and accessories of motor vehicles[iv]	MEX	1,913	Manufacture in which all the materials used are classified within a heading other than that of the product, except for materials of headings: 5806 and 6307 and Chapter 73; 6813; 8482; Chapter 73 and catalytic exhaust gas purifier of heading 8421; 4011; or Manufacture in which the value of all the materials used does not exceed 50% of the ex-works price of the product	CTH or MaxNOM 50% (EXW) or in case of reciprocity from partner CTSH may be envisaged.
		KOR	1,015	Manufacture from materials of any heading, except that of the product	
		CHE	952	Manufacture in which the value of all the materials used does not exceed 40% of the ex-works price of the product	
2709	Crude Petrol. Oils	KOR	1,849	Manufacture from materials of any heading	CTSH
3004	Medicaments, retail sale	KOR	1,476	Manufacture from materials of any heading, except that of the product. However, materials of the same heading as the product may be used, provided that their total value does not exceed 50% of the ex-works price of the product	CTSH A chemical reaction, purification, mixing and blending, production of standard materials, a change in particle size, isomer separation, or biotechnological processing is undergone. MaxNOM 50% (EXW)
8486	Machines and apparatus for semiconductor	KOR	982	Manufacture from materials of any heading, except that of the product or Manufacture in which the value of all the materials used does	This PSRO is the latest elaboration of the EU rule in the most liberal form. A possible formulation borrowing other experiences

(*continued*)

TABLE 4.24 (*continued*)

HS	Description	Part.	Cov. imp	Rules of origin	Proposed reformed rules of origin using EU method and related administrative procedures or alternative methodologies[i]
				not exceed 50% of the ex-works price of the product	could be: (A) a change to subheadings 8486.10 through 8486.40 from any other subheading or (B) no change in tariff classification to such subheadings is required, provided that there is an RVC of not less than: (i) 35% under the build-up method, or (ii) 45% under the build-down method.
8479	Machines, mechanical appliances	KOR	912	Manufacture from materials of any heading, except that of the product or Manufacture in which the value of all the materials used does not exceed 50% of the ex-works price of the product	CTSH

[i] The proposals for alternative PSRO in this table are tentative examples and further analyses and tests should be carried out to validate the technical and commercial feasibility of such alternatives in the specific context.

[ii] Excerpted from US–Korea FTA agreement.

[iii] The origin of petroleum products has not been the object of sufficient studies even if some complex origin questions may arise. See "The petroleum industry and free trade agreements: How oil companies can benefit," at www.slideshare.net/PeterMachielse/the-petroleum-industry-and-free-trade-agreements; and the NAFTA origin problem that Canada producers have: see https://business.financialpost.com/commodities/energy/canadas-oilpatch-pays-america-60-million-a-year-to-export-crude-and-usmca-may-not-help.

[iv] In reality the original PSRO under the EU–Mexico FTA agreement of 2000 listed a number of subdivisions for the heading 8708 that are not reported in this table for the sake of brevity.

TABLE 4.25 *Matching EU most imported critical products with rules of origin: EU imports from partners with WUR < 70% and PM > 2 pp., in descending order of covered imports, million USD (4)*

HS	Description	Part.	Cov. imp	Rule of origin	Proposed reformed rules of origin using EU method and related administrative procedures or alternative methodologies[i]
(1)	(2)	(3)	(4)	(5)	(6)
2933	Hetero-cyclic compounds	CHE	1,696	Manufacture from materials of any heading. However, the value of all the materials of headings 2932 and 2933 used shall not exceed 20% of the ex-works price of the product or Manufacture in which the value of all the materials used does not exceed 40% of the ex-works price of the product	CTSH A chemical reaction, purification, a change in particle size, production of standard materials, isomer separation, or biotechnological processing is undergone. MaxNOM 50% (EXW)
2924	Carboxy-amide-function	CHE	983	Manufacture from materials of any heading, except that of the product. However, materials of the same heading as the product may be used, provided that their total value does not exceed 20% of the ex-works price of the product or Manufacture in which the value of all the materials used does not exceed 40% of the ex-works price of the product	CTSH A chemical reaction, purification, a change in particle size, production of standard materials, isomer separation, or biotechnological processing is undergone. MaxNOM 50% (EXW)
2934	Other hetero-cyclic compounds	CHE	573	Manufacture from materials of any heading. However, the value of all the materials of headings 2932, 2933 and 2934 used shall not exceed 20% of the ex-works price of the product or Manufacture in which the value of all the materials used does not exceed 40% of the ex-works price of the product	CTSH A chemical reaction, purification, a change in particle size, production of standard materials, isomer separation, or biotechnological processing is undergone. MaxNOM 50% (EXW)
0802	Other nuts	TUR	519	Manufacture in which: all the fruit and nuts used are wholly obtained, and the value of all the materials of Chapter 17 used does not exceed 30% of the value of the ex-works price of the product	All products of chapter are wholly obtained.

(*continued*)

TABLE 4.25 (*continued*)

HS	Description	Part.	Cov. imp	Rule of origin	Proposed reformed rules of origin using EU method and related administrative procedures or alternative methodologies[i]
(1)	(2)	(3)	(4)	(5)	(6)
2710	Petroleum oils	DZA	502	Operations of refining and/or one or more specific process(es) (2) or other operations in which all the materials used are classified within a heading other than that of the product. However, materials of the same heading as the product may be used, provided that their total value does not exceed 50% of the ex-works price of the product	CTH except from biodiesel of subheadings 3824.99 and 3826.00. Or distillation or a chemical reaction is undergone, provided that biodiesel (including hydrotreated vegetable oil) of heading 27.10 and subheadings 3824.99 and 3826.00 used is obtained by esterification, transesterification, or hydrotreatment.
2922	Oxygen-function amino-comp.	CHE	228	Manufacture from materials of any heading, except that of the product. However, materials of the same heading as the product may be used, provided that their total value does not exceed 20% of the ex-works price of the product or Manufacture in which the value of all the materials used does not exceed 40% of the ex-works price of the product	CTSH A chemical reaction, purification, a change in particle size, production of standard materials, isomer separation, or biotechnological processing is undergone. MaxNOM 50% (EXW)
0808	Apples, pears, quinces	CHL	218	Manufacture in which: all the fruit and nuts used are wholly obtained, and the value of all the materials of Chapter 17 used does not exceed 30% of the ex-works price of the product	Eliminate or lessen the requirements for use of sugar of Chapter 17.

[i] The proposals for alternative PSRO in this table are tentative examples and further analysis and tests should be carried out to validate the technical and commercial feasibility of such alternative PSRO options in the specific context.

Matching Bilateral Repeated Offenders with PSRO – Selected Examples In Table 4.26 a few examples are provided of bilateral repeated offenders that have been matched with their corresponding rules of origin. Similarly to the previous section, for each case, a reformed rule of origin in the last column has been proposed.

TABLE 4.26 *Matching bilateral repeated offenders with PSRO: Selected examples (covered/received trade, columns (3) and (4) in thousands USD)*

HS	Part.	Trade cov.	Trade rec.	Rule of origin	Proposed reformed rules of origin and administrative procedures using the EU model of alternative methodologies[i]
(1)	(2)	(3)	(4)	(5)	(6)
8711	CHE	202,331	121,725	Manufacture in which: – the value of all the materials used does not exceed 40% of the ex-works price of the product, and – the value of all the non-originating materials used does not exceed the value of all the originating materials used or Manufacture in which the value of all the materials used does not exceed 20% of the ex-works price of the product	MaxNOM 45% (EXW)
8712	CHE	98,040	98,040	Manufacture in which the value of all the materials used does not exceed 30% of the ex-works price of the product	MaxNOM 45% (EXW)
6212	CHE	72,049	72,049	Manufacture from yarn	Manufacture from fabrics

(*continued*)

TABLE 4.26 (*continued*)

HS	Part.	Trade cov.	Trade rec.	Rule of origin	Proposed reformed rules of origin and administrative procedures using the EU model of alternative methodologies[i]
(1)	(2)	(3)	(4)	(5)	(6)
6112	CHE	48,332	48,332	Manufacture from yarn	Manufacture from fabrics
6106	CHE	41,115	41,115	Manufacture from yarn	Manufacture from fabrics
4202	KOR	901,665	894,308	Manufacture from materials of any heading, except that of the product	CTSH
7326	KOR	433,286	385,230	Manufacture from materials of any heading, except that of the product	CTSH
8482	KOR	346,706	305,892	Manufacture from materials of any heading, except that of the product or Manufacture in which the value of all the materials used does not exceed 50% of the ex-works price of the product	CTH MaxNOM 50% (EXW)
2933	KOR	223,991	202,494	Manufacture from materials of any heading, except that of the product. However, materials of the same heading as the product may be used, provided that their total value does not exceed 20% of the ex-works price of the product or Manufacture in which the value of all the materials used does not exceed 50% of the ex-works price of the product	CTSH A chemical reaction, purification, a change in particle size, production of standard materials, isomer separation, or biotechnological processing is undergone. MaxNOM 50% (EXW)

TABLE 4.26 (*continued*)

HS	Part.	Trade cov.	Trade rec.	Rule of origin	Proposed reformed rules of origin and administrative procedures using the EU model of alternative methodologies[i]
(1)	(2)	(3)	(4)	(5)	(6)
6403	KOR	170,088	165,623	Manufacture from materials of any heading, except from assemblies of uppers affixed to inner soles or to other sole components of heading 6406 or Manufacture in which the value of all the materials used does not exceed 50% of the ex-works price of the product	CTSH
7307	KOR	148,625	135,674	Turning, drilling, reaming, threading, deburring and sandblasting of forged blanks, provided that the total value of the forged blanks used does not exceed 35% of the ex-works price of the product	CTH except from forged blanks of heading 72.07; however, non-originating forged blanks of heading 72.07 may be used provided that their value does not exceed 50% of the EXW or 45% of the FOB of the product. Others: CTH
8708	MEX	2,111,191	281,431	Manufacture in which all the materials used are classified within a heading other than that of the product, except for materials of headings 5806 and 6307 and Chapter 73 or Manufacture in which the value of all the materials used does not exceed 50% of the ex-works price of the product	CTH or MaxNOM 50% (EXW) or in case of reciprocity from partner CTSH may be envisaged.

(*continued*)

TABLE 4.26 (*continued*)

HS	Part.	Trade cov.	Trade rec.	Rule of origin	Proposed reformed rules of origin and administrative procedures using the EU model of alternative methodologies[i]
(1)	(2)	(3)	(4)	(5)	(6)
8408	MEX	354,868	25,654	Manufacture in which the value of all the materials used does not exceed 60% of the ex-works price of the product	CTH or MaxNOM 50% (EXW) or in case of reciprocity from partner CTSH may be envisaged.
8481	MEX	343,987	131,656	Manufacture in which all the materials used are classified within a heading other than that of the product	CTH MaxNOM 50% (EXW)
3926	MEX	286,569	47,865	Manufacture in which the value of all the materials used does not exceed 50% of the ex-works price of the product	CTH MaxNOM 50% (EXW)
8544	MEX	280,483	64,329	Manufacture in which the value of all the materials used does not exceed 50% of the ex-works price of the product	CTH except from headings 74.08, 74.13, 76.05, and 76.14 MaxNOM 50% (EXW)
8537	MEX	245,495	76,546	Manufacture in which all the materials used are classified within a heading other than that of the product, except for materials of heading 8503 or Manufacture in which the value of all the materials used does not exceed 50% of the ex-works price of the product	CTH

[i] The proposals for alternative PSRO in this table are tentative examples and further analyses and tests should be carried out to validate the technical and commercial feasibility of such alternatives in the specific context.

Matching Bilateral and Cross-Agreements Repeated Offenders with PSRO as Priority Candidates for Reform The last step of this analysis is to combine the two types of repeated offenders and to keep only the products that are included in both, the bilateral and cross-agreement repeated offenders.

There are four options – combine the bilateral repeated offenders with the cross agreement repeated offenders for

(a) EU exports: twenty-seven products identified
(b) EU imports: forty-one products identified
(c) EU exports and imports as alternative conditions ((a) or (b)): forty-six products identified
(d) both together as a cumulative and therefore stricter condition ((a) and (b)): twenty-two products identified.

Table 4.27 reports the results for the twenty-two products identified in case (d).

Finally, Table 4.28 reports selected rules of origin for some of the products identified in Table 4.27 and proposes some options of reform.

Given that the results reported in Table 4.27 are based on option (d) above, it is important to keep in mind that they constitute only a restricted subsample of critical products and repeated offenders that could benefit from PSRO reform. The proposals for alternative PSRO in Tables 4.25–4.28 are tentative examples and further analysis should be carried out to validate the technical and commercial feasibility of such alternatives in consultation with the private sector and sectorial industries.

Further analysis will be conducted of all products of option (c) in a forthcoming publication by the author with other researchers. Additional research will also be conducted on matching *across agreement repeated offenders* in both directions of trade (i.e. products of Tables 4.20 and 4.21) without conditioning the products to be critical bilaterally *within the same agreement*.[117]

4.3 CONCLUSIONS

These sections on utilization rates have established the link between rules of origin and utilization. Governments are still reluctant publicly to use utilization rates for measuring the effectiveness of trade agreements, since such figures may tell stories that politicians may not like. Yet, if we wish to discuss transparency in trade policy, the use and availability of utilization rates of trade preferences is a primary tool.

It took time in the CRO for WTO members to accept the concept of utilization rates and notify such data to the WTO Secretariat to allow the research and analysis that is now being undertaken, as discussed in Chapter 1 of this book for the LDC

[117] Pramila Crivelli, Stefano Inama and Jonas Kasteng, 'Using Utilization Rates to Identify Rules of Origin Reforms: The Case of EU Free Trade Area Agreements', EUI Working Paper RSC 2021/21.

TABLE 4.27 *Bilateral and cross-agreements repeated offenders: Cumulative conditions (methodology case (d))*

	Bilateral rules of origin and trade					Partner and rank	EU imports (000 USD)			Partner and rank	Part. imports (000 USD)		
HS 4	ISO3	Covered	PM	UR	WUR	(EU imports)	Cov.	WUR	UR	(EU exports)	Cov.	WUR	UR
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)
8528	ALB	21,466	6.6	7.8	3.8	NOR1; ALB1; SER2; MKD4; KOR8; CHE12; BIH13; MAR18; MEX27	111,626	17.1	18.6	ISL1; MNE1; SER6; ALB12	37,761	13.4	21.8
3926	ALB	7,392	5.4	51.6	63.9	KOR4; NOR5; ALB5; MEX6; ISL13; CHL16; PER25	90,677	46.2	44.8	ALB8; MNE10; MEX12; MKD19; MAR20	386,289	18.6	43.2
8708	DZA	46,837	3.4	29.9	58.8	MEX1; LBN2; PAN3; ISL3; CHL4; DZA11; PER14; NIC14	202,955	47.7	22.1	CHE1; HRV1; MEX1; MAR4; KOR4; EGY7; DZA9	4,654,589	34.8	41.2
8703	EGY	337,202	10.2	39.7	41.7	MNE1; PAN2; EGY3; ALB4; NOR4; CHE5; BIH6; DZA8; CHL9; LBN11; PER13; NIC13; TUN14	108,003	62.5	25.0	KOR1; MEX2; EGY3	4,691,169	54.3	48.2

3808	EGY	48,996	5.2	56.2	50.1	TUR8; SER9; EGY9; MKD24	6,938	52.5	47.6	HRV2; SER3; TUR4; MAR26	384,757	48.3	50.1
8408	EGY	38,881	2.6	8.1	16.2	MEX5; LBN9; MAR19; CHL23	42,648	32.2	11.6	HRV6; MEX6; MAR21; SER22	454,704	12.2	39.2
8528	ISL	5,443	6.9	50.4	68.2	NOR1; ALB1; SER2; MKD4; KOR8; CHE12; BIH13; MAR18; MEX27	111,626	17.1	18.6	ISL1; MNE1; SER6; ALB12	37,761	13.4	21.8
7113	ISL	1,825	6.5	35.4	58.4	LBN1; PAN5; ISL9	6,505	61.0	23.9	TUR2; ISL5	223,321	69.4	68.0
4202	ISL	1,690	7.2	51.2	67.5	LBN4; PAN8; MKD9; PER12; KOR13; NIC26; CHL26	32,132	20.0	25.4	ISL4; CHE5; KOR7; MNE13; HRV22	1,333,282	37.0	43.6
4202	KOR	894,308	5.1	21.7	23.6	LBN4; PAN8; MKD9; PER12; KOR13; NIC26; CHL26	32,132	20.0	25.4	ISL4; CHE5; KOR7; MNE13; HRV22	1,333,282	37.0	43.6
8408	MAR	116,889	5.2	17.4	23.4	MEX5; LBN9; MAR19; CHL23	42,648	32.2	11.6	HRV6; MEX6; MAR21; SER22	454,704	12.2	39.2
8708	MEX	2,111,191	3.2	28.9	13.3	MEX1; LBN2; PAN3; ISL3; CHL4; DZA11; PER14; NIC14	202,955	47.7	22.1	CHE1; HRV1; MEX1; MAR4; KOR4; EGY7; DZA9	4,654,589	34.8	41.2

(*continued*)

TABLE 4.27 (*continued*)

	Bilateral rules of origin and trade					Partner and rank (EU imports)	EU imports (000 USD)			Partner and rank (EU exports)	Part. imports (000 USD)		
HS 4	ISO3	Covered	PM	UR	WUR		Cov.	WUR	UR		Cov.	WUR	UR
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)
8408	MEX	354,868	2.9	18.4	7.2	MEX5; LBN9; MAR19; CHL23	42,648	32.2	11.6	HRV6; MEX6; MAR21; SER22	454,704	12.2	39.2
8481	MEX	343,987	2.4	28.9	38.3	MNE6; DZA6; MEX7; CHL8; ISL8; PER19; PAN22; NOR25; ALB27	34,242	17.5	10.8	EGY6; MEX7; KOR8	1,305,766	43.0	42.9
3926	MEX	286,569	7.0	23.3	16.7	KOR4; NOR5; ALB5; MEX6; ISL13; CHL16; PER25	90,677	46.2	44.8	ALB8; MNE10; MEX12; MKD19; MAR20	386,289	18.6	43.2
8528	MNE	4,626	5.8	0.6	1.1	NOR1; ALB1; SER2; MKD4; KOR8; CHE12; BIH13; MAR18; MEX27	111,626	17.1	18.6	ISL1; MNE1; SER6; ALB12	37,761	13.4	21.8
3926	MNE	2,231	7.0	31.4	61.4	KOR4; NOR5; ALB5; MEX6; ISL13; CHL16; PER25	90,677	46.2	44.8	ALB8; MNE10; MEX12; MKD19; MAR20	386,289	18.6	43.2
6203	MNE	1,651	11.0	18.6	36.9	LBN6; NIC10; CHL11; PAN21	1,121	51.3	42.5		490,640	59.7	43.9

										ALB3; CHE4; HRV13; MNE15; SER26			
4202	NIC	65	3.3	21.6	6.6	LBN4; PAN8; MKD9; PER12; KOR13; NIC26; CHL26	32,132	20.0	25.4	ISL4; CHE5; KOR7; MNE13; HRV22	1,333,282	37.0	43.6
3808	SER	50,533	4.3	34.0	58.1	TUR8; SER9; EGY9; MKD24	6,938	52.5	47.6	HRV2; SER3; TUR4; MAR26	384,757	48.3	50.1
8528	SER	38,551	6.4	1.1	1.2	NOR1; ALB1; SER2; MKD4; KOR8; CHE12; BIH13; MAR18; MEX27	111,626	17.1	18.6	ISL1; MNE1; SER6; ALB12	37,761	13.4	21.8
3808	TUR	187,713	6.0	59.3	56.0	TUR8; SER9; EGY9; MKD24	6,938	52.5	47.6	HRV2; SER3; TUR4; MAR26	384,757	48.3	50.1

TABLE 4.28 *Bilateral and cross-agreements repeated offenders: Selected proposal for rules of origin*

HS	Trade cov.	Part.	Rule of origin	Proposed reformed rules of origin
(1)	(3)	(2)	(5)	(6)
3808	Insecticides, rodenticides	EGY	Manufacture in which the value of all the materials used does not exceed 50% of the ex-works price of the products	CTSH A chemical reaction, purification, production of standard materials, isomer separation, or biotechnological processing is undergone. MaxNOM 50% (EXW)
3926	Oth. articles of plastics, nes	MEX	Manufacture in which the value of all the materials used does not exceed 50% of the ex-works price of the product	CTH MaxNOM 50% (EXW)
4202	Trunks, suit-cases. . .; handbags . . . of leather	KOR	Manufacture from materials of any heading, except that of the product	CTSH may be envisaged.
8408	Compression-ignition, combustion piston engines	EGY MAR MEX	Manufacture in which the value of all the materials used does not exceed 40% of the ex-works price of the product Manufacture in which the value of all the materials used does not exceed 60% of the ex-works price of the product	MaxNOM 50% (EXW)
8481	Tapes, valves, for pipes pressure reducing	MEX	Manufacture in which all the materials used are classified within a heading other than that of the product	CTH MaxNOM 50% (EXW)
8708	Parts and accessories of motor vehicles of 87.01-87.05 Parts and accessories of motor vehicles of 87.01–87.05	MEX DZA	Manufacture in which all the materials used are classified within a heading other than that of the product, except for materials of headings 5806 and 6307 and Chapter 73 or Manufacture in which the value of all the materials used does not exceed 50% of the ex-works price of the product Manufacture in which the value of all the materials used does not exceed 40% of the ex-works price of the product	CTH MaxNOM 50% (EXW)
8703	Motor cars and oth. motor vehicles (passengers)	EGY	Manufacture in which the value of all the materials used does not exceed 40% of the ex-works price of the product	CTH MaxNOM 50% (EXW)

trade preferences. Much remains to be done for free-trade agreements, since there is no comparable ongoing exercise and fora.

There is also a mood of denial from governments and, to a certain extent, economists about linking low utilization to rules of origin. Governments objected, at times, to this link, alleging that low utilization may be caused by other factors even if there is now factual evidence and econometrics demonstrating such a link. Economists are doubtful since they allege the old theory that the cost of compliance with rules of origin is one of the main reasons for low utilization especially when MFN tariffs are low. Such argument could be easily defeated by pointing out that the MFN rates of duty in the United States for passenger cars is 2.5 percent and the empirical research outlined in section 4.2.5. Yet rules of origin for the automotive industry have mobilized US presidents, legions of lawyers, workers, and CEOs within the industry to discuss the best rules of origin in NAFTA and USMCA.

Besides such factual evidence and other testimony from the private sector,[118] Section 4.2.4.3 of this chapter contains an empirical analysis linking the increase of utilization rates and trade volume of LDCs to the EU under EBA trade preferences following the EU reform of rules of origin. Similar recent analysis has found parallel results.[119]

As mentioned earlier, utilization rates are not a panacea and the correlation to rules of origin at times may not be automatic. Low utilization rates are a sign of a *disease* in a trade agreement, most of the time caused by rules of origin or related administrative procedures. Yet it has to be realized that rules of origin may not be the reason for low utilization due to overlapping trade preferences, or, in some cases, especially for small and medium-size enterprises (SMEs) and micro, small, and medium-size enterprises (MSMEs), firms may not possess the technical expertise to comply with rules of origin or the cost of complying is simply too costly in relation to the trade volume and the MFN rate. These are all valid reasons that could also explain low utilization, but they have to be concretely identified at field level rather than being used as anecdotical evidence to dismiss figures of low utilization and efforts to genuinely identify reasons on factual grounds.

With respect to the 2009 edition of this book, there has been progress in this area, especially since the insertion of the obligation to notify utilization rates in the Nairobi Decision that has stirred debates and notes on utilization rates in the

[118] See the presentation by Jon Edward at a side-event organized by UNCTAD in July 2013 at https://unctad.org/meetings/en/Presentation/aldc2014_06_edwards_en.pdf, and the presentation by Bianchi, one of the leading bycicle manufactures in the EU, at https://unctad.org/meetings/en/Presentation/aldc2015_Florence_p11_Bianchi.pdf. Both presentations outlined the decisive impact of EU reform of rules of origin.

[119] K. Tanaka, "The EU's reform in rules of origin and international trade: Evidence from Cambodia," IDE Discussion Paper, July 2019.

[120] On specific suggestions for liberalizing PSRO see Chapter 5 and 6 of this book for further examples.

CRO. The case for reform of rules of origin that are causing low utilization rates is better established for LDCs. Yet the path is still dramatically long.

Apart from the LDC case, there are enormous gaps related to how to negotiate and administer efficient rules of origin in free-trade agreements, as will be further illustrated in Chapters 5 and 6.[120]

How many free-trade agreements around the world are still being negotiated with rules of origin leading to low utilization rates, especially in free-trade agreements among developing countries in Africa, Asia, and Latin America? Far too many in the opinion of the author and corroborated by some data that have progressively filtered from Governments and RECs.[121] It is therefore necessary to spread the use of utilization rates as a litmus test of the effectiveness of the hundreds of free-trade agreements in existence. This would help in clearing the trade policy agenda of policymakers and civil society that still believe the next free-trade area agreement is the one that will deliver the promise of economic prosperity and free trade. Also required is the courage to introduce changes and innovation in rules of origin that in some cases have not been modified since the 1970s, as admitted in the paper of the EU Commission introducing the EU GSP reform of rules of origin.[122]

Utilization rates are one of the tools, together with the other instruments contained in this book – namely, the comparative analysis of convergence of PSRO discussed in Chapter 1, the input–output methodology to draft PSRO in Chapter 6, and the mapping of certification and administrative procedures of Chapter 7 – at the disposal of the international community in order to come to a multilateral or plurilateral agreement and an intergovernmental committee with the appropriate mandate and fora to impart disciplines on rules of origin and record best practices and lessons learned.

[120] On specific suggestions for liberalizing PSRO see Chapter 5 and 6 of this book for further examples.

[121] The case of the data on utilization rates of ASEAN trade preferences, discussed in Chapter 5 of this book, is a rather blatant example. The author is currently engaged with other RECs to carry out more research in this area where transparency appears to be a long-term objective.

[122] See Commission of the European Communities, Green Paper on the future of rules of origin in preferential trade agreements, Brussels, COM(2003) 787 final.

5

Experiences in Drafting Preferential Rules of Origin in GSP Schemes in Africa, Asia, and Latin America

This chapter examines the various modalities for drafting rules origin in different regions. It aims at providing guidance to policymakers, customs, and the private sector on the issues to be considered and analyzed when drafting rules of origin.

The chapter is divided into five sections. Section 5.1 reports on the lessons learned from drafting the Generalized System of Preferences (GSP) rules of origin and the experience and feedback gained during the United Nations Conference on Trade and Development (UNCTAD) Working Group on Rules of Origin. Section 5.2 contains the specific experiences and lessons learned from drafting and implementing GSP rules of origin.

Sections 5.3 and 5.4, provide an analysis of the experiences concerning rules of origin in some major regional trading agreements (RTAs) among developing countries in Asia, Africa, and Latin America. Section 5.5 deals with megaregionals: the Comprehensive and Progressive Trans-Pacific Partnership Agreement (CP-TPP) and the Regional Comprehensive Economic Partnership Agreement (RCEP).

A general pervasive finding applicable to many RTAs examined in this chapter is, albeit to a different degree, the scarcity or, in extreme cases, the unavailability of the updated legal texts of rules of origin applicable and in force.

5.1 LEARNING DRAFTING RULES OF ORIGIN FROM THE PAST: EXPERIENCE GAINED WITH THE RULES OF ORIGIN UNDER THE GSP

5.1.1 *General Observations and Lessons Learned*

As is widely known, the first Secretary-General of UNCTAD, Raoul Prebisch, laid down the concept and intellectual foundations of the GSP. The principles and objectives of the GSP were finally agreed at the second UNCTAD conference, as contained in UNCTAD Resolution 21(II), but the elements and structure of the

GSP were still to be defined. In order to define and agree on these elements among UNCTAD member states, intergovernmental machinery was created within UNCTAD.

Thus, at the outset of the GSP, drafting a uniform set of rules of origin to be applied to the different GSP schemes adopted by preference-giving countries was one of the principal aims of the UNCTAD Special Committee on Preferences. Hence, the Committee decided to set up a working group on rules of origin, tasked with initiating consultations on the technical aspects of the rules of origin with the objective of preparing draft origin rules to be applied uniformly in all the GSP schemes. This working group was one of the first multilateral initiatives to regulate the issue of rules of origin at intergovernmental level.

However, in the Organisation for Economic Co-operation and Development (OECD) ad hoc Group of the Trade Committee on Preferences, held in Paris in 1970, the preference-giving countries expressed the view that, as preferences were being granted unilaterally and noncontractually, the general principle had to be that donor countries were free to decide on the rules of origin that they thought were appropriate after hearing the view of the beneficiary countries.[1] Within this general principle, the preference-giving countries felt that the process of harmonization had to be limited to some related practical aspects such as certification, control, verification, sanctions, and mutual cooperation. Even there, progress has been extremely limited.

A first implication of the decision taken at the OECD meeting was that different sets of rules of origin applied according to each national GSP scheme. It followed that since national schemes had different product coverage, different customs regulations, and different previous rules of origin for administering trade preferences, each preference-giving country modeled its own system of rules of origin according to these different parameters.

Preference-giving countries' rules of origin were then divided into two broad categories: those using the process criterion and those using the percentage criterion, but within these criteria there were large differences.

Although changes and modifications have been introduced in the GSP rules of origin, further described in the following section, since the 1970s, the basic requirements, shortcomings, and rationale for these rules have remained virtually the same for almost fifty years since that meeting.

It follows that the experience, analysis, and lessons learned, discussed, and identified in the context of the UNCTAD Working Group on Rules of Origin and in the Special Committee on Preferences are still relevant today.

Given the minor changes that occurred in the substantive requirements under the different GSP schemes, with the notable exception of the EU and Canada as

[1] See OECD, "Ad Hoc Working Group of the Trade Committee on Preferences, Rules of Origin, Second Report," TC/Pref./70.25, Paris, September 25, 1970, 9.

examined in Chapter 3 and 4 of this book, the large majority of the difficulties and problems discussed at the abovementioned meetings somewhat match and replicate the actual debates on the need for reform on rules of origin.

In the following sections, the main experience, lessons learned, and analysis of the UNCTAD Working Group on Rules of Origin are reported because they still represent an invaluable source of reflection and examples that countries may wish to draw from when drafting rules of origin.

5.2 SPECIFIC EXPERIENCES AND LESSONS LEARNED FROM DRAFTING AND IMPLEMENTING GSP RULES OF ORIGIN

5.2.1 *The Definition of Two Categories of Products: Wholly Produced and Products that Have Undergone Substantial Transformation*

As mentioned earlier,[2] even before the implementation of the national GSP schemes, many industrialized countries had adopted individual preferential arrangements of autonomous and independent character in favor of certain developing countries or former colonies. Each of these arrangements contained origin rules that were tailored to the particular exigencies of each preference-giving country. Thus, to better organize the work that had to be carried out, the second session of the Special Committee felt it necessary to make a comprehensive analysis of the different origin systems, in order to:

(i) evaluate the various features of the origin rules applied in the existing preferential arrangements
(ii) list the problems encountered by preference-giving and preference-receiving countries in the practical application of such rules.[3]

The analysis showed that the definition of the origin of goods was generally based on two different criteria:

(i) the wholly produced products criterion
(ii) the substantial transformation criterion.

It was found that the first criterion was used when the product had been wholly produced in a preference-receiving country from raw materials that originated in the same country, while the second criterion was used for the definition of origin when more than one country was involved in the manufacture of the final product.

[2] See Chapter 3 of this book. This section draws from materials and analysis of UNCTAD Working Group on Rules of Origin. See "Compendium of the work and analysis conducted by UNCTAD working groups and sessional committees on GSP rules of origin," Part I (UNCTAD/ITD/GSP/34, February 21, 1996).

[3] See UNCTAD document TD/B/AC.5/3, iii.

5.2.2 *Negotiations and Experiences on the Definition of the Wholly Produced Criterion*

The evaluation of the rules of origin applied in individual preferential schemes by some preference-giving countries before the entry into force of the GSP system,[4] undertaken at the second session of the Special Committee in 1968, permitted the Working Group, at its first session in March 1970 to identify the main features of this criterion. In fact, the wholly produced criterion was intended to cover two types of goods, namely:

(i) goods which were natural products of a particular country, such as unmanufactured raw materials, goods grown, extracted or harvested in that country, and certain marine products
(ii) goods which were manufactured in a single country without the use of materials or components imported from other countries.[5]

The criterion was used, inter alia, to a certain extent for the determination of origin of used articles and waste and scraps. It did not apply, however, in cases where the goods whose origin was to be determined had undergone a manufacturing process in more than one country.

At the first session of the Working Group, some doubts were raised as to the possibility to adopt the wholly produced criterion in cases mentioned under (ii) above. According to this rule, it was considered that goods could be regarded as wholly produced if they were produced within a single country or a group of countries exclusively from materials containing no material imported from a third country or of undetermined origin.[6] In such cases, the producer had to be able to prove the domestic origin of all parts and components of the export goods. However, empirical experience had shown that this could prove difficult in many cases and lead to the result that the goods concerned could not be regarded as "wholly produced." In fact, due to the difficulties for customs authorities in controlling the origin of all the parts of the product exported, origin documents showing that the wholly produced criterion was satisfied had been considered as false documents even if the goods satisfied another origin criterion (the process criterion or the percentage criterion).[7]

At the same time, it was considered that since the various existing origin systems examined did not differ very much with regard to the wholly produced criterion, the definition of the wholly produced criterion for GSP purposes might not present insurmountable difficulties. However, in the first meeting of the Working Group, intensive discussions were held, taking into account information derived from the

[4] The Special Committee evaluated the preferential rules of origin of the following countries and economic groups: Australia, EEC, EFTA, United Kingdom, and the United States. See ibid. paras. 10–74.
[5] See UNCTAD document TD/B/AC.5/3/Add.4, March 19, 1970, para. 70.
[6] Ibid. para. 71.
[7] Ibid. para. 71.

analysis of the different origin rules applied individually by some preference-giving countries. More specifically, there was consensus that the following products were among those to be considered as wholly produced: unmanufactured raw materials (e.g. mineral products extracted from the soil in the country of origin); petroleum and other minerals extracted from the continental shelf or from other parts of the seabed within the territorial waters of a country; and other products extracted from the seabed outside territorial waters in the narrow sense (provided that the country claiming origin exercised exclusive rights to exploit the seabed in question).[8]

Certain agricultural products were also generally considered wholly produced goods; that is, vegetable products harvested in a country, products obtained by hunting and fishing conducted there, live animals born and raised there, and products obtained from live animals. As regards the latter products, the Working Group raised the problem as to whether obtaining such products from any live animals within the country concerned was to be considered sufficient, or whether this criterion had to be supplemented by the requirement that the live animals in question be born and/or raised in that country. For example, were eggs obtained in country X from a hen to be treated as originating in that country if the hen itself was an animal imported from country Y, or did the hen have to be an animal born or at least raised in country X itself?[9] With regard to marine products, it was considered that products taken from the sea by a vessel of a particular country were usually considered as goods originating in that country. However, it was found that in some preferential origin systems before 1968, the expression "vessel of a particular country" was defined more precisely. In particular, the European Economic Community (EEC) rules for imports from the Associated African States[10] required in addition that the vessel be at least half-owned by nationals of the country or by a company the head office of which was situated in the country and which had nationals of the country as its managing director or directors, and as the chair of its board of directors or governors. Moreover, the majority of the members of such board should also be nationals. If it was a partnership or limited liability company, at least half the capital should belong to the country or to public corporations or nationals of the country. In addition, all the vessel's officers had to be nationals of the country and at least 75 percent of its crew. According to European Free-Trade Association (EFTA) rules, a vessel was regarded as that of a member state if it was registered in the state and flew its flag.[11] In this connection, special attention was devoted to the question of goods produced on board factory ships from products of sea fishing and other products taken from the sea, since a number of developing countries had established joint ventures for the exploitation of the resources of the sea.

[8] Ibid. para. 73.
[9] Ibid. para. 74.
[10] See UNCTAD document TD/B/AC.5/3, paras. 18–23.
[11] Ibid. para. 75.

Some existing rules examined by the Working Group contained special regulations for the treatment of used articles, waste, and scraps. EFTA rules treated used articles that were fit only for the recovery of materials and had been collected from users within EFTA,[12] and scrap and waste resulting from manufacturing operations within EFTA, as wholly produced articles. All EU rules at that time accepted scraps and waste from manufacturing operations and disused articles as wholly produced articles, provided they had been collected within the country concerned and could be used only for the recovery of raw materials.[13]

The Working Group considered it necessary to have a definition of the extent and nature of the use which had to be made of goods in a specific country in order to be able to treat it as the country of origin, in particular in the case of used machinery which had previously been imported. It was suggested that the article exported should show certain traces of usage. If necessary, a certain period of time during which the use had to be exercised should also be required. It was stated that such a requirement could help to avoid abuse of the scheme of preferences by way of delivery of virtually new articles from a developed country via a beneficiary country. Moreover, it was considered to be in the interest of the industrialization of exporting developing countries to be rather restrictive when formulating such a special clause.[14] The analysis of existing preferential schemes revealed that EFTA countries used a complementary provision, called the Basic Material List, which treated particular raw materials and some manufactures as goods from EFTA, whatever their origin.[15] The reason for the rule was an insufficient supply of these materials within the area itself. Consequently, the duties levied by EFTA states were either very low or zero. However, the Basic Material List was only used within EFTA and never for GSP purposes. The United States applied a similar provision on imports from insular possessions under preferential terms. Under this rule, no materials which could be imported into the United States free of duty were considered of foreign origin.[16] At the fourth session in 1973, some developing countries expressed appreciation for the provisions in the New Zealand scheme which stipulated that goods wholly manufactured from unmanufactured raw materials were wholly produced goods, whatever the origin of the raw materials. Developing countries urged other preference-giving countries to incorporate similar provisions in their schemes. Some developed countries proposed to establish a Basic Material List of products of interest to developing beneficiary countries, which, whatever their actual sources, would be regarded as originating in the preference-receiving countries.[17]

[12] Area means the territory of EFTA countries.
[13] Ibid. para. 76.
[14] Ibid. paras. 77–79.
[15] See UNCTAD document TD/B/AC.5/3, paras. 47 and 102–107.
[16] See UNCTAD document TD/B/C.5/WG(IV)/2, para. 100.
[17] See UNCTAD document TD/B/C.5/WG(IV)/L.1, November 8, 1973, para. 30.

In spite of the recognition by preference-receiving countries of the importance and usefulness of the Basic Material List, the Working Group, at its first session, did not attempt to formulate a specific view or recommendations regarding the establishment of such a list. The question of the Basic Material List was subsequently discussed at the fifth session of the Working Group in 1973. The preference-giving countries suggested that the problem of enabling beneficiaries to make full use of basic materials could best be solved through appropriate adaptations of Lists A and B rather than by providing a Basic Material List. The first Working Group was able to make some suggestions with regard to wholly produced goods, namely:

(a) mineral products extracted from its/their soil or from the seabed within its/their territorial waters;
(b) vegetable products harvested there;
(c) live animals born and raised there;
(d) products obtained there from live animals [born and raised there];
(e) products obtained by hunting or fishing conducted there;
(f) products of sea fishing and other marine products taken from the sea by vessels registered in the country/countries and flying its/their flag;
(g) products extracted from the sea bed outside the territorial waters of the country/countries, provided that the country/countries exercise(s) the exclusive rights to exploit the sea-bed in question;
(h) products made on board factory ships from products referred to in paragraph (f) above originating there, provided that such factory ships are registered in the country/countries and fly its/their flag;
(i) used articles fit only for the recovery of raw materials, provided that they have been collected there;
(j) waste and scraps resulting from manufacturing operations conducted there;
(k) goods produced there exclusively from the products referred to in paragraphs (a) to (j) above, or from derivatives thereof, or from materials containing no elements imports [from a non-beneficiary country] [from another country] or of undetermined origin;
(l) goods listed in the basic materials list.

The second session of the Working Group in July 1970 was dedicated, inter alia, to discussions of the text suggested by the Working Group at its first session. During these discussions it was pointed out that no agreed definition existed with regard to territorial waters.[18] In particular, some developing countries objected, with reference to paragraphs (a) and (g) of the above text. They proposed the use of the concept of "continental shelf of the developing beneficiary country or countries" for defining the scope of what constituted "wholly produced goods."[19] The representative of the EU expressed some concern with regard to the formulation of items (f) and (h).

[18] See UNCTAD document TD/B/AC.5/31, para. 26.
[19] Ibid, para. 27.

He pointed out that national laws relating to the registration of ships and to the right to fly the flag differed considerably. In some cases, the flying of a flag was therefore not a sufficient criterion for determining the origin of products taken from the sea by fishing vessels or factory ships. Requirements would need to be specified as to the crew and ownership of the vessel.

At its third session in December 1970, the Working Group was able to reach consensus on an agreed text regarding products to be considered as wholly produced:

> The following products shall be regarded as wholly produced in a preference-receiving country:
>
> (a) Mineral products extracted from its oil or from its sea bed;
> (b) Vegetable products harvested there;
> (c) Live animals born and raised there;
> (d) Products obtained there from live animals;
> (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;[20]
> (g) products made on board its factory ships exclusively from products referred to in paragraph (f) above;
> (h) used articles fit only for the recovery of raw materials, provided that they have been collected there;
> (i) waste and scrap resulting from manufacturing operations conducted there;
> (j) goods produced there exclusively from the products referred to in paragraphs (a) to (i) above.

The fifth session[21] of the Working Group was dedicated to the review of the main provisions of the rules of origin applied under the GSP. With regard to the wholly produced criterion, it was found that the rules applied by the preference-giving countries[22] generally corresponded to the above agreed text, with the exception of the rules for the following three categories of products:

(a) marine products and products made on board ships
(b) products obtained from live animals
(c) used articles.

According to the agreed text, marine products had to be regarded as "wholly produced in a given preference-receiving country if they were products of sea fishing

[20] The developing countries requested the inclusion of products of chartered vessels and chartered factory ships. The preference-giving countries agreed that, if additional wholly produced products are clearly identified during the periodic review, they will be added to the list at that time.

[21] UNCTAD document TD/B/C.5/2, paras. 14–112.

[22] The rules of origin of the following were revised: Austria, Czechoslovakia, Denmark, EEC, Finland, Ireland, Japan, New Zealand, Norway, Sweden, Switzerland, and the United Kingdom.

and other marine products taken from the sea by its vessels or products made on board its factory ships exclusively from such products." As no further definition of the terms "its vessels" and "its factory ships" had been provided, preference-giving countries gave different interpretations to these terms. Some of them contained rather stringent requirements.[23] A number of preference-giving countries had applied different definitions to the terms "its vessels" and "its factory ships." At that time, there was no common agreement among the European states: under the rules of the United Kingdom, vessels had to be registered in the exporting developing country, while under the rules of Finland, Sweden, and Switzerland the vessels had to be registered in the exporting country and had to sail under its flag. Denmark, the EEC, Japan, and Norway required, in addition, that the vessel or factory ship fulfilled certain conditions regarding ownership by the beneficiary country.[24] Moreover, the captain and officers and at least 75 percent of the crew had to be nationals of that country. Austria had not defined under what conditions a vessel or factory ship was considered as belonging to a particular country.

In addition, "the preference-receiving countries had requested from the outset the inclusion of products of chartered vessels and chartered factory ships in any definition of wholly produced goods." At the third session of the Working Group, the preference-giving countries agreed that, if additional wholly produced products were clearly identified during the periodic review, they would be added to the list.[25] No specific promise however was made as regards marine products and chartered vessels. In fact, it never materialized until some vague commitments in the Lomé IV Protocol on Rules of Origin – that is, after twenty years from the promise.

An UNCTAD study[26] as early as 1973 pointed out that, "establishing a fishing fleet is a rather capital-intensive undertaking." Many, if not most, developing countries did not, therefore, have fishing fleets of their own. The application of stringent requirements concerning registration, ownership, and crew of vessels would have deprived most developing countries of the possibility of exploiting their marine wealth and selling the products of their territorial waters on preferential terms. The same would have applied in the case of products of lakes within the territories of developing countries, since the commercial exploitation of lakes also requires major investment.

The study further considered that:

> The economic needs of many preference-receiving countries could be met by allowing the chartering of vessels and factory ships. At the very least, it should be sufficient that the vessels and the factory ships were registered in the preference-receiving country concerned and fly its flag. According to the rules of EFTA, a vessel was regarded as that

[23] See UNCTAD document TD/B/C.5/WG(IV)/2, para. 139.
[24] See UNCTAD document TD/B/C.5/2, para. 16.
[25] See UNCTAD document TD/B/AC.5/38, Appendix I, 2.
[26] See UNCTAD document TD/B/C.5/WG(IV)/2, September 26, 1973, para. 141.

of a member State if registered in the State and flying its flag in spite of the fact that all EFTA members had a considerable stake in shipping.[27]

The words "flying its flag" created some difficulties since in a certain number of cases joint ventures for the exploitation of the resources of the sea had been established among developing countries. To take account of these cases, the study proposed that the definition should refer to the registration in the preference-receiving country concerned, thus dropping any reference to the flag flown by the ship.

Other concerns and different interpretations were raised with regard to used articles. Sweden accepted used articles collected in a developing country as being wholly produced there, provided they were fit only for the recovery of materials. By contrast, the rules applied by Austria, Denmark, the EEC at that time, Finland, Norway, Switzerland, and the United Kingdom required, in line with the agreed text, that such products be fit only for the recovery of raw materials in order to qualify as wholly produced. Under the EFTA rules, on which the Swedish rules were based, used articles fit only for the recovery of materials collected from users within the free-trade agreement were regarded as being wholly produced within EFTA. For example, used batteries, whether or not of EFTA origin, collected from Swiss users and sent to Finland would receive EFTA tariff treatment if they were fit only for the recovery of their lead or other scrap materials. If, however, the batteries sent to Finland were fit for reconditioning, this provision did not apply.[28]

In the agreed conclusions of the Working Group at its sixth session in 1976, the UNCTAD Secretariat was requested to "continue the study of the difficulties encountered in the preference-receiving countries in the area of rules of origin."[29] As pointed out in Chapter 1 of this book, the UNCTAD Secretariat, in order to obtain information on difficulties encountered by preference-giving countries in the area of rules of origin, addressed a questionnaire to the governments of all preference-giving countries.[30] At the seventh session of the Working Group, the information collected was analyzed and commented on. With regard to the concept of wholly produced products, only a few problems emerged from the analysis of the replies to the questionnaire. The major difficulties encountered by some preference-giving countries concerned imports for which the wholly produced criterion, though certified, did not apply.[31] In the view of the Working Group,[32] this was because some exporters and authorities in certain preference-receiving countries did not understand the full significance of the wholly produced criterion, especially as it applied to manufactured goods. No concerns had been raised with regard to the definition of wholly obtained products. The fact that a common definition of wholly

[27] Ibid. para. 142.
[28] See EFTA, "Rules of Origin," 4th ed., rev., Geneva, January 1971, 28.
[29] See UNCTAD documents TD/B/C.5/55, para. 64, and TD/B/C.5/WG(VI)/5, para. 67.
[30] See Note Verbale, November 16, 1977, reference TD/423(Q).
[31] See UNCTAD document TD/B/C.5/WG(VII)5, para. 7.
[32] Ibid. 3.

produced goods had been accepted by preference-giving countries was considered by the Working Group as one of its most important achievements.[33]

Under the rules of origin applied by Austria, Denmark, EEC, Finland, Japan, Norway, Sweden, and Switzerland, and in line with the agreed text, products obtained in a preference-receiving country from live animals were regarded as wholly produced there. This rule covered, inter alia, products obtained from live animals which had been imported into the preference-receiving country concerned.[34]

From discussions held at the fifth session of the Working Group,[35] it appeared that this additional requirement was unnecessarily rigid. It assumed that animals might be imported into a preference-receiving country exclusively in order to confer the status of originating product or products on these animals. In fact, such abuses of the rule were unlikely to occur in practice. With few exceptions, developing countries were remote from countries not recognized as beneficiaries under the GSP, so that such operations would be unprofitable.[36] It appeared, therefore, that there was little justification for this additional requirement.

5.2.3 *Negotiations and Experiences in Drafting Origin Criteria for the Definition of Substantial Transformation*

During the second session of the Special Committee on Preferences, it was noted that all existing rules of origin adopted by preference-giving countries in their trade preferences granted to developing countries before the entry into force of the GSP schemes were based on the criterion of "substantial transformation." At the same time, it was evident that this basic criterion was not "in itself sufficiently precise" and that it admitted "many different interpretations."[37] The analysis of the various rules of origin commonly applied by these donor countries showed that the substantial transformation criterion had been specified in different ways, so that there were several criteria in use for determining the origin of such goods. These criteria were classified within three broad categories:

(a) extent and nature of manufacturing process undergone
(b) criterion of final transformation process
(c) percentage of value added.

[33] See UNCTAD document TD/B/C.5/76, para. 7.
[34] See "Rules of origin in the generalised scheme of preferences in favour of the developing countries – Report by the UNCTAD Secretariat," UNCTAD document TD/B/AC.5/3/Add.4, paras. 74–77.
[35] See UNCTAD document TD/B/C.5/2, paras. 87–112.
[36] See the relevant discussions at the fifth meeting regarding this particular sector contained in UNCTAD document TD/B/C.5/2, 8.
[37] See "Rules of origin in the generalised system of preferences in favour of the developing countries," UNCTAD document TD/B/AC.5/3, November 29, 1968, 18, para. 76.

The first criterion identified the rules which conferred the origin in the case of a completion of a specific process deemed sufficient to give the product in question its essential character. In order to assess whether or not a specific process could be regarded as being sufficient two main methods were in use: list of qualifying processes and use of the Brussels Tariff Nomenclature (BTN). The combination of the two methods was also to be found.

In the first case, it was necessary to compile relatively long lists indicating the qualifying processes in sufficient detail for each of the products falling within the scope of preferences. In the second case, the rules of origin were based on the change of tariff heading (CTH) of the Brussels Nomenclature.[38] This method permitted "a short and accurate definition of the materials" that could be used. At that time, it was found that the most important shortcoming of this method was that the BTN was not designed for origin purposes. In some cases, the CTH was not sufficient to complete a substantial transformation; in other cases, the substantial transformation could take place without a change in the tariff heading. This required a list of supplementary regulations for those products for which special rules were deemed necessary. As has been pointed out a number of times in this book, the same limitations are still totally valid for the Harmonized System (HS). It follows that all the experiences recorded in the following section with the change of tariff classification (CTC) are, *mutatis mutandis*, applicable to the CTC or tariff shift applicable under the modern rules.

The second definition – the criterion of final transformation process – was based on the criteria identified in the nonpreferential rules of origin of the EEC, as contained in Regulation 802/68:[39]

> product in the production of which two or more countries were concerned shall be regarded as originating in the country in which the last substantial process or operation that is economically justified was performed, having been carried out in an undertaking equipped for the purpose, and resulting in the manufacture of a new product or representing an important stage of manufacture.

The third definition is still used today to identify the rule that confers the origin if a certain percentage of value has been added in the beneficiary country or area in the process of manufacturing.

The main problem encountered by the Working Group with regard to the drafting of a uniform set of origin rules to be applied in all the GSP schemes of preference-giving countries was the opposition of the donor countries. These countries rejected the possibility of introducing uniform rules for determining the origin of goods in a scheme of preference of a non-contractual nature. This opposition was justified by the fact that the custom officials of preference-giving

[38] The actual HS has been conceived on the basis of the Brussels nomenclature.

[39] OJ L1481/65, 1968. This text has been now replaced by EU customs code legislation available at https://ec.europa.eu/taxation_customs/business/union-customs-code/ucc-introduction_en.

countries had been using specific criteria and administrative procedures since the inception of the preferential arrangements. Whatever change in these rules, it would have meant an increase in the cost for administering the rules of origin. It has to be noted that at that time neither the United States nor Canada had adopted the BTN as tariff nomenclature. As a result, the preference-giving countries announced in the second meeting of the Working Group on Rules of Origin that they would adopt, in their GSP rules of origin, the same criteria used before in the national individual schemes (1970).[40] However, in the third meeting of the Working Group,[41] held again in 1970, the preference-giving countries "appreciated the problems that would arise if the concept of substantial transformation were defined in many different ways." Following the concern expressed by the preference-receiving countries over the different criteria for determining the origin and the differences existing between them in the application of each criterion, the preference-giving countries were able to reduce the variant to two broad categories: the process criterion and the percentage criterion.[42] Moreover, while the preference-giving countries utilizing the process criterion said that they would eliminate differences between the process criterion rules "to the greatest extent possible,"[43] those adopting the percentage criterion said that they would "endeavour to harmonize their national rules."[44]

During this third meeting,[45] the preference-receiving countries agreed to the introduction of these two systems in the expectation that there would be one single system regulating the process criterion and one system regulating the percentage rule. They "trusted that goods qualifying under one set of rules would be accepted for GSP under the other set, in order to ensure equivalence of market access and to avoid distortion of trade."[46] The first objective of the Working Group on Rules of Origin was consequently to analyze the main divergences existing inside the two categories of criteria used for defining the origin of goods as applied by preference-giving countries.

It has to be pointed out that at that time the term "process criterion" was referring to the countries using the CTH at four-digit level of the BTN coupled with a list of extensive exceptions contained in Lists A and B as specified in the following section.

Lists A and B were later merged into a "single list"[47] in the late 1980s.

[40] See UNCTAD document TD/B/AC.5/31, July 8, 1970.
[41] See UNCTAD document TD/B/AC.5/38, December 21, 1970.
[42] See ibid. chapter II.
[43] Ibid. para. 12.
[44] Ibid.
[45] Ibid.
[46] Ibid. para. 16.
[47] The "single list" was the nomenclature adopted at that time. In practice it was a merger of Lists A and B.

5.2.3.1 An Analysis of the Experiences and Lessons Learned under the Process Criterion

As mentioned, in carrying out the tasks assigned to the Working Group, the first criterion analyzed was the process criterion and, in particular, the lists of qualifying and nonqualifying processes (Lists A and B) applied by individual preference-giving countries. However, since the BTN was not designed for determining origin, certain qualifying and nonqualifying processes had to be added to the rules in most schemes in the form of two lists. In particular, List A specified processes which, although resulting in a CTH heading from the starting materials to the finished article, did not confer origin status on the finished article, or did so only under certain conditions. List B comprised processes which did confer origin status on the products obtained, in spite of the fact that there was no CTH. In addition, for a number of tariff headings, these lists stipulated that goods had to be considered as originating in the beneficiary country only if the value of the non-originating material worked or processed did not exceed a given percentage of the value of the goods obtained. The analysis of the national rules indicated that, although Lists A and B generally followed the EEC pattern, certain differences, of both a substantive and a drafting nature, existed. In an early report to the Working Group made in 1982 and titled "The GSP: A comparative study of the rules of origin,"[48] the Secretariat pointed out a number of such technical differences and classified them into five categories:

(1) differences resulting from variation in the product coverage
(2) drafting differences
(3) differences resulting from different methods of describing the same requirements
(4) differences with respect to percentage requirements
(5) differences of substance.

5.2.3.1.1 DIFFERENCES RESULTING FROM VARIATIONS IN PRODUCT COVERAGE. Rules of origin under any preferential tariff arrangement utilizing the process criterion specified such requirements only for goods covered by the arrangement. Consequently, the lists (A and B) of nonqualifying and qualifying processes of preference-giving countries under the GSP specified origin requirements only for products covered by their individual scheme of preferences. Since differences in product coverage existed (and still exist) between individual schemes of preferences and were most prevalent in BTN chapters 1–24 and for textiles, it was found that, as long as these differences persisted, there would be corresponding differences in the lists of nonqualifying and qualifying processes.

[48] See "The GSP: A comparative study of the rules of origin in force," UNCTAD document TD/B/C.5/2, part two, November 30, 1972, paras. 97–111.

5.2.3.1.2 DRAFTING DIFFERENCES. According to the report, it appeared that preference-giving countries had not been able to agree on a common phraseology to describe origin requirements. First, in a number of cases, Lists A and B provided that goods obtained in a beneficiary country had to be considered as originating therein only if the value of the products worked or processed did not exceeded a given percentage of the value of the goods obtained. As can be seen from Tables 5.1 and 5.2 from List A, preference-giving countries had used different wordings to express the value of component requirement. Second, with respect to process requirements, the following examples from List A illustrate to what extent preference-giving countries had used different wordings to describe the same requirements as those listed in Tables 5.1 and 5.2.

5.2.3.1.3 DIFFERENCES RESULTING FROM DIFFERENT METHODS OF DESCRIBING THE SAME ORIGIN REQUIREMENTS. For products of a number of BTN headings, some preference-giving countries specified working or processing operations which did not confer the status of "originating" products, while other preference-giving countries specified working or processing operations for the same products which did confer such status when certain conditions were met. The origin requirements were virtually the same, the difference being that they had been determined by some preference-giving countries in a negative way and by others in a positive way. Differences, that may be relevant in the activity of drafting a set of uniform rules of origin, are illustrated by the example shown in Table 5.3.

TABLE 5.1 *Examples of drafting differences in PSRO*

Products obtained		Working or processing that confers the status of "originating" products when the following conditions are met	Preference-giving countries concerned
BTN heading	Description		
38.15	Prepared rubber accelerators	Manufacture in that the value of the products used does not exceed 50% of the value of the finished *product*	EEC, Norway, Finland, Sweden
		Manufacture in that the value of the products used does not exceed 50% of the value of the finished *goods*	Denmark, Switzerland
		Manufacture using "*nonoriginating products*" whose value does not exceed 50% of the value of the finished *product*	Japan
		The 50% *imported materials rule*	United Kingdom

Note: The data in the table refer to GSP schemes of 1972. At the time, Austria, Denmark, Finland, Sweden, and the United Kingdom were not members of the EEC and they had adopted their GSP schemes independently.

TABLE 5.2 *Examples of drafting differences in PSRO*

Products obtained		Working or processing that does not confer the status of "originating" products	Preference-giving countries concerned
BTN heading	Description		
11.04	Flours of the fruits falling within any heading in Chapter 8	Manufacture from fruits of Chapter 8	EEC
		Manufacture from fruits *falling within* Chapter 8	Norway
		Manufacture from *the* fruit	United Kingdom
19.05	Prepared foods obtained by the swelling or roasting of cereals products (puffed rice, corn flakes, and similar products)	Manufacture from *various products*	EEC, Switzerland
		Manufacture from *any products*	United Kingdom
32.06	Color lakes	*any* manufacture from *materials of headings* nos. 32.04 and 32.05	EEC, Finland, Norway, Sweden
		Manufacture from *products* of nos. 32.04 or 32.05	Austria
		Any manufacture from *products of headings* nos. 32.04 or 32.05	Denmark
		Manufacture from *materials of headings* nos. 32.04 or 32.05	United Kingdom
		Manufacture from *products falling within headings* nos. 32.04 or 32.05	Japan
		Manufacture from *products of headings* nos. 32.04 or 32.05	Switzerland
20.02	Vegetables prepared or preserved otherwise than by vinegar or acetic acid	Manufactures from "*originating*" *products falling within* Chapter 7	Japan
		Manufacture from "*originating*" *products* of Chapter 7	United Kingdom
45.03	Articles of natural cork	Manufacture from *products of heading* no. 45.01	EEC, Denmark, Finland, Norway, Sweden, Switzerland

TABLE 5.2 (*continued*)

Products obtained		Working or processing that does not confer the status of "originating" products	Preference-giving countries concerned
BTN heading	Description		
		Manufacture from *products of* no. 45.01	Austria
		Manufacture from *products falling within heading* no. 45.01	Japan
		Manufacture from *materials of heading* no. 45.01	United Kingdom

Note: The data in the table refer to GSP schemes of 1972. At that time Austria, Denmark, Finland, Sweden, and the United Kingdom were not EEC members and they had adopted their GSP schemes independently.

TABLE 5.3 *Examples of drafting differences in PSRO*

BTN heading	Description	
19.01	Malt extract	Japan regarded the manufacture of malt extract from cereals as conferring the status of "originating" products. The United Kingdom regarded the manufacture of malt extract from malt as not conferring the status of "originating" products.

Note: The data in the table refer to GSP schemes of 1972. At that time the United Kingdom was not an EEC member and it had adopted its GSP scheme independently.

In this example, if the malt extract is to qualify for preferential tariff treatment in the United Kingdom, the manufacturer, as in the case of Japan, has to start from cereals for the manufacture of malt and subsequently malt extracts.

5.2.3.1.4 DIFFERENCES WITH REFERENCE TO PERCENTAGE REQUIREMENTS. For a number of BTN headings, Lists A and B drawn up by preference-giving countries provided that the goods referred to and obtained in a beneficiary country had to be considered as originating in that country only if the value of the non-originating products worked or processed did not exceed a given percentage of the value of the goods obtained. Preference-giving countries had specified in their rules of origin[49] that the value to be taken into consideration in determining such percentage was:

[49] For relevant extracts, see Annex III of UNCTAD document TD/B/C.5/2.

(i) *as regards products whose importation could be proven*: their customs value at the time of importation into the developing country
(ii) *as regards products of undetermined origin*: the earliest ascertainable price paid for them in the developing country of manufacture
(iii) *as regards the goods obtained*: in the case of Japan the Free On Board (FOB) price of the goods, excluding any internal taxes refunded or refundable on exportation; in the cases of Austria, Denmark, EEC, Finland, Norway, Sweden, Switzerland, and the United Kingdom the "ex works" (ex-factory) price of the goods, excluding any internal taxes refunded or refundable on exportation.

It was clear to the Working Group that the differences in the definition of the value of the goods obtained might have created unequal conditions of access to markets of preference-giving countries concerned. This situation might have arisen because, while the ex-works price includes the costs of production and the producer's profit, the FOB price includes, in addition, all other costs in the producing country, in particular the costs of transport from the factory to the frontier or port and any cost and profit of trading intermediaries in the country. Where additional costs, such as transportation costs and/or trading costs, occurred after the goods obtained had left the factory, and if the FOB price was used for determining the value of the goods obtained, these costs would add to the base figure for calculating the percentage limit for non-originating products. Thus, these costs would increase proportionately the maximum value of non-originating products to be used in the manufacturing process in the total FOB value of the finished product and enable the exported product in borderline cases to qualify for preferential tariff treatment. If, however, the ex-factory price was used for determining the value of the goods obtained, such costs would not be counted toward the percentage limit and the share of non-originating products used in the manufacturing process might exceed the maximum percentage prescribed, thus making the finished products ineligible for preferential tariff treatment.

As explained above and as experienced in the application of GSP rules of origin, it was also considered that an advantage of the FOB price basis was that it allowed for a liberal operation of percentage value requirements. In fact, a greater proportion of non-originating products could be used in the manufacturing process than when the percentage limit was calculated based on the ex-factory price of the products obtained. Moreover, it was noted that the FOB price was probably the price most generally quoted in export transactions.[50] This price is normally readily available and does not need to be specially calculated as a basis for the calculation of the percentage. This is not necessarily true to the same extent of the ex-factory price. On the other hand, it was argued that the FOB price entailed the disadvantage that manufactures of a given product in a given beneficiary country might not be treated

[50] See UNCTAD document TD/B/AC.5/3/Add.4, para. 11.

on an equal footing. Where the value of the non-originating products used must not exceed 50 percent of the value of the goods obtained, the actual proportion of non-originating products allowed to be used in the manufacturing process would depend on whether or not internal transportation costs and/or trading costs had arisen. Consequently, in a hypothetical borderline case, a manufacturer established near the port of export or exporting directly would have failed to meet the percentage requirement because non-originating products amounted to slightly over 50 percent of the value of the manufactured product. By contrast, a manufacturer, established elsewhere and operating in identical production conditions, might qualify for preference because his FOB price includes internal transportation costs or because an intermediary trader is involved in his trade transactions. The question arose, however, whether in such a case the manufacturer, who had to bear additional internal transportation cost and/or trading costs, would have to reduce his profit margin accordingly in order to compete with the manufacturer near the port. If he did, the question of unequal treatment assumed above might, in fact, not have arisen. However, it was further argued that the ex-factory price was closer to the true concept of value added because it constituted a true measure of the manufacturing process leaving aside any postproduction costs, such as internal transportation cost or trading cost.

5.2.3.1.5 DIFFERENCES IN SUBSTANCE. According to the same report, it was thought useful to present some examples that showed the differences in substance of the definition of certain origin requirements which arose with the use of the process criterion. Some of these differences are shown in Table 5.4.

5.2.3.1.6 AN ANALYSIS OF THE SPECIFIC REQUIREMENTS RELATED TO SELECTED PRODUCTS UNDER THE PROCESS CRITERION

Drafting Techniques Another problem of great relevance identified by the UNCTAD studies on the process criterion was linked to the definition of the processes that confer the origin to the goods. In fact, as the problem of definitions connected with the use of the process criterion was easily solved by using a well-known and accepted nomenclature classification of products, there was also the necessity to provide some kind of definition of the processes that products must have undergone to fulfill the origin requirement. From a theoretical point of view, the best solution that was envisaged was to define the exact process for each single product. However, this system raised the question that in many instances this would have resulted in a splitting up of the headings for the final products into an extremely large number of subheadings, as happened some twenty years later during the negotiations on nonpreferential rules of origin.

In UNCTAD, it had been experienced that, as the BTN was taken as a basis for discussion, there nevertheless existed some BTN headings that comprised goods differing so considerably from each other that there would be no practical possibility of defining only one process of production for all of them. In fact, it was considered that

TABLE 5.4 *Differences in substantive requirements*

BTN heading	Description	
41.06	Chamois-dressed leather	Japan regarded manufacture from imported raw hides and skins (BTN 41.01) as not conferring the status of "originating" products (List A).
		Under the rules of origin of many countries the chamois-dressed leather was regarded as an originating product (no exception in List A); the general rule of change of BTN heading applied.
ex 31.04	Mineral or chemical fertilizers, potassic	Switzerland regarded manufacture from imported potassium chloride or from crude natural potassium salts as conferring the status of originating product (List B).
		Under the rules of origin of many countries the fertilizers did not qualify (no exception in List B; the general rule of change of BTN applied).
41.08	Patent leather and imitation patent leather; metallized leather	Austria, EEC, and Nordic countries regarded the varnishing or metallizing of imported leather as conferring the status of "originating" products if the value of the skin leather used did not exceed 50% of the value of the finished product (List A).
		Under the rules of Japan, the leather would qualify if manufactured from imported raw hides or skins (BTN heading 41.01) (List A).
		Ireland regarded the varnishing or metallizing of imported leather as conferring the status of originating products without any further conditions (no exception in List A: the general rule of CTH of BTN applied).

Note: The data in the table refer to GSP schemes of 1972. At that time Austria, Denmark, Finland, Ireland, Sweden, and the United Kingdom were not EEC members and they had adopted their GSP schemes independently.

in certain cases a single heading covered not only goods that could best be described as raw materials, but also goods that were highly manufactured. This consideration may still apply for the harmonized system. HS heading 30.03 comprises medicaments of all kinds from simple mixtures of plants to the most sophisticated mixtures of equally sophisticated chemical products. However, the HS provides a splitting-up of the heading that, in some cases, permits the description of processes of manufacture which are both economically reasonable and intelligible. On the other hand, providing different process criteria for each subheading of the HS may cause an exceptional proliferation of different and very complex rules of origin. It was felt that direct reference to a process, such as printing or rolling, was a simple solution for many products, as it was possible to apply such

references even to some whole headings. As an example, the printing process might be mentioned for goods falling under headings 49.01 or 49.02 (books, newspapers, etc.); a similar system was applied by the EEC in the GSP rules of origin in the 1970s.[51]

However, it was felt that even such definitions of the process requirement needed some refinement. For example, the expression "rolling" seemed to be unambiguous as a description for the manufacture of metal sheets. However, cold-rolled steel sheets have undergone many stages of rolling. First, the steel ingots are rolled down into slabs or sheet bars. The next stage is the production of hot-rolled steel plates, a procedure that means rolling in many steps down to a desired thickness. The cold rolling is a new stage that may again be performed in many steps depending on the desired final thickness. A rolling process has no doubt been fulfilled by a manufacturer who has performed only the last rolling of an already cold-rolled steel sheet. If the intention is that all cold rolling must be performed according to the origin criterion this must be clearly stated; such as by a direct requirement that all cold rolling has to be so performed or that the starting material must be hot-rolled steel sheets. If, on the other hand, the intention is that all rolling (hot and cold) must be performed according to the origin criterion, one solution would be to state that ingots must be used as starting material.

Similar considerations could be applied also to other procedures such as printing (e.g. the printing of only a few pages of a book), painting, and so on. However, the precautionary measure mentioned above – namely, to state the starting materials – might be enough even without a reference to the rolling procedure, since the only practicable way to make steel sheets from ingots is the rolling procedure.

5.2.3.1.7 EARLY EXPERIENCE AND DIFFICULTIES WITH THE ISSUE OF MULTISTAGE OPERATIONS, DOUBLE JUMPS, AND DOUBLE TRANSFORMATIONS. An UNCTAD study conducted in 1973[52] and entitled "The GSP: Proposals for improvement and harmonization of the rules of origin" analyzed rules of origin contained in Lists A and B of the GSP scheme from a different perspective. The study first considered that, normally, it is expected that each economically justified process adds a certain value to the processed goods. However, the study noted that many of the processes required in List A were multistage operations which did not provide that origin status was conferred by one single process of production (e.g. making garments from yarn, whereas use of textile fabrics as starting material would not confer origin status on the finished garment – processes required for garments falling into BTN headings 61.01–61.04),[53] or else they implied de facto that the finished articles must be wholly produced in the preference-receiving countries concerned. These rules, also called multistage rules, were criticized by the preference-receiving

[51] See Schedule B mentioned in Article 3(b) in UNCTAD document TD/B/AC.5/3/Add.1, 7.

[52] See "The GSP: Proposals for improvement and harmonization of the rules of origin," UNCTAD document TD/B/C.5/WG(IV)/2, September 26, 1973.

[53] Also, at present the EU adopt the same rule for articles of Chapter 62 for GSP purposes; see Regulation 2454/93, OJ L 253/93, 286.

countries as going "far beyond the conceivable limits of substantial transformation."[54] Since most of them are still in place today, the following paragraphs may be of extreme relevance for those wishing to avoid such experiences.

The implications of such provisions in the GSP rules of origin in force at that time had been demonstrated in the study by some technical examples, which are reported in the following paragraphs.[55]

The study considered that, in principle, processes requiring multistage operations may be justified by the fact that in quite a number of cases a manufacturing process can cause a change in tariff heading without resulting in sufficient transformation of the starting material. Since the BTN (and the HS) was not devised for purposes of determining origin, it sometimes classified goods that had undergone only a very simple manufacturing process in another tariff heading than that corresponding to their starting materials.

For example, cotton yarn, not put up for retail sale, fell within BTN heading 55.05, while the same yarn, put up for retail sale, fell within BTN heading 55.06.[56] It was quite understandable that the process involved in this CTH could not be deemed sufficient for conferring origin status on the cotton yarn put up for sale.

Multistage processing, however, usually involved much more than the simple exclusion of a simple manufacturing or finishing operation. In the examples contained in the study, it was shown that the multistage processing specified in List A generally required in the course of production an unusually high percentage of value added that made it extremely difficult for preference-receiving countries to derive benefits from the GSP.[57]

In examining the percentage requirement laid down in List A, it was noted that, in many cases, the processes in List A conferred origin status only if the value of the non-originating material did not exceed a certain percentage of the finished article. The concept of value added in this case was therefore used as a complementary provision.[58] It was found at that time that such provision had been prescribed for two tariff lines in BTN Chapters 1–24 and for 237 tariff lines in BTN Chapters 25–99 (account being taken of the processes covering whole chapters), making 239 tariff lines in all. Of the 409 processes specified in List A for BTN Chapters 25–99, 58.4 percent thus involved a percentage requirement. Of these 239 processes involving a percentage

[54] See UNCTAD document TD/B/C.5/18, 15.

[55] Paras. 68–90 with the exception of para. 84 are excerpted from the study: "GSP: Proposal for improvement and harmonization of the rules of origin."

[56] The same problem has found a solution with the adoption of the HS; in fact, both cotton yarn put up for sale and the cotton yarn not put up for sale fall within the same heading (52.04); the first is classified in a different subheading (5204.11) from the second (5204.20).

[57] See UNCTAD document TD/B/C.5/10, Annex 10, para. 67a, and UNCTAD document TD/B/C.5/11, 24.

[58] In the case of copper powder and flakes, for example (BTN heading 74.06), a manufacturing process conferred origin status only if the value of the non-originating products used did not exceed 50 percent of the value of the finished product; in other words, another 100 percent had to be added, in the course of production, to the value of the non-originating products.

requirement, 99 (or 41.4 percent) laid down a non-originating percentage limit of 40 percent of the value of the finished products (i.e. required that 150 percent of the value of the imported material be added in the course of manufacture in the preference-receiving country), and 80 processes (or 33.5 percent) laid dawn a non-originating percentage of 50 percent (i.e. required 100 percent of value added in the country of origin). One process laid down a non-originating percentage of 70 percent for imported raw materials, requiring therefore only 42.9 percent of value added. Thirteen processes (or 5.4 percent) used a combined formula laying down either 40 or 50 percent of non-originating elements for various parts of the finished article.[59]

The calculations made in the following examples concerning textile, plastics, metals, and other products were contained in the UNCTAD study of 1973 and were based upon averages pertaining to advanced industrial processing. In doing so, the reader was first warned of the empirical methodology assumed in the study. It was acknowledged that production costs and production techniques vary from one country to another depending on relative factor endowments and the level of industrialization. Consequently, it was considered that working out examples based on the actual cost situation in a developing country was impossible and, in any event, time consuming. To simplify matters, the situation obtaining in an advanced industry had been taken and the results obtained had therefore to be interpreted with caution. Another necessary premise was that, in the method of calculation used, the input of raw material, generally of a non-originating character, was assumed equivalent to 100. This hypothetical amount was added to the value attributable to a specific process of production (the processing factor) to obtain the value of the intermediate product. Next, the processing factor attributable to the further process of production was added, the result being the value of the finished article. By comparing this value with the value of the input of raw material, that was always 100, the total percentage of value added required by the hypothetical origin rules was obtained.[60]

5.2.3.1.8 SOME EXAMPLES OF PRODUCT-SPECIFIC EXPERIENCES UNDER THE PROCESS CRITERION

Textiles and Garments According to the requirement laid down in the GSP rules, numerous multistage operations are required in the production of textiles. For example, GSP rules of origin in the early 1970s required that cotton yarn (BTN

[59] In all these calculations, account was taken of processes covering more than one tariff heading.

[60] See UNCTAD document TD/B/C.5/WG(IV)/2, 9. The following is an example of the calculation: input of raw material of non-originating character (e.g. raw cotton): 100

+	first processing factor (e.g. spinning)	75%
=	value of the intermediate product (e.g. yarn)	175
+	second processing factor (e.g. weaving):	140%
=	value of the finished article (e.g. fabric):	420

Therefore, in this case value added required is 320 percent.

55.05), in order to obtain originating status, had to be manufactured from cotton, not carded or combed or from cotton linters or from cotton waste not carded or combed (the required process was "manufacture from materials of heading n. 55.01 or 55.03"). According to the average value attributable to the specific processing factor, the spinning factor raised the value of the starting material usually by 75 percent. For 100 units of raw cotton the yarn had a face value of 175, and the percentage of value added required by this process thus amounted on average to 75.[61]

For "other woven fabrics of cotton" (BTN 55.09) the process prescribed in the rules was "Manufacture from materials of headings Nos. 55.01, 55.03 and 55.04." Because the use of non-originating yarn was not permitted as raw material, the starting material for production of fabrics must again be raw cotton. Because it was assumed that the average value attributable to the weaving process was equivalent to 140 percent, this process raised the value of the yarn to a value of 420 units. The percentage of value added required by the rules for cotton fabrics is, therefore, not less than 328. For ready-made garments, such as men's and boy's outer garments (BTN 61.01), the process prescribed by the rules was that the working or processing conferring originating status was "manufacture from yarn."[62] The study considered that the rule of thumb in the textile industry was that one-third of the ex-factory price of the finished garment was accounted for by the material used, one-third by the outfitting process, and one-third by other items, such as overheads, royalties, taxes, and profits. The expression "material used," however, referred to the textile fabric, and on this assumption, the value of the woven fabric would represent about 33 percent of the value of the finished garment and the value added would be about 230 (the value of woven fabric is assumed = 100). The origin rules requiring yarn as starting material lead to the following result:

- value of the yarn 100%
- processing factor for weaving about 140%
- value of the woven fabric 240%

[61] The same process is still required for the EU GSP rules of origin using the HS system. The rule, in fact, is as follows:

Ex-Chapters 50–55	Yarn, monofilament and thread	
	– silk yarn	Manufacture from silkworm cocoons or silk waste, not carded or combed or otherwise processed for spinning
	– other	Manufacture from: natural fibres not carded or combed or otherwise processed for spinning chemical materials or textile pulp, or paper making materials

Excerpted from Commission Regulation 2454/93, 282 (see fn. 53 above).

[62] In the EU GSP rules of origin, the materials described in the text, classified in Chapter 62 of the HS, obtain originating status if they are manufactured from yarn.

Since the fabric represents one-third of the value of the finished garment, the value of the latter will be 720. Moreover, the value of the yarn represents about 14 percent of the value of the finished garment. The origin rule for finished garments, permitting only non-originating yarn as starting material, would involve, on this method of calculation based upon averages, more than 600 percent of value added to the starting material.[63]

These two examples showed clearly the implications of operations involving a two-stage process. In the first case, where "originating" fabric had to be made from raw cotton, a percentage of value of 320 must be added, instead of 140 percent represented by the processing factor for the weaving process. In the case of garments, the starting material of that had to be yarn, the industrially justified percentage of about 200–230 percent resulting from the manufacture of woven fabrics was increased to more than 600.

For yarn of man-made fiber (continuous) (BTN 51.01) the process prescribed was "Manufacture from chemical products or textile pulp."[64] As far as synthetics were concerned, about 40 percent of the ex-factory price of the yarn can be attributed to the chemical raw material. Thus, the processing factor accounts for about 150 percent.

For woven fabrics of man-made fibers (continuous) (BTN 51.04), the rules prescribed again "Manufacture from chemical products or textile pulp." The portion of the value of woven fabrics that can be attributed to the yarn varies from 30 percent to 40 percent of value added. The process requested is two-stage and leads to the following calculation:

– unit value of the raw material (chemical product)	100
– value of the yarn	250
– value added	150%
– value of the woven fabric	625–800
– value added	150–220%

The value of the chemical raw material represented between 12.5 percent and 16 percent of the woven fabric. The origin rule for woven synthetic fabrics thus

[63] It has to be noted that Japan has removed the "double jump" requirement for most clothing and accessories in Chapter 62; the amendment of the rules of origin relaxed in such a way that the articles falling in HS Chapter 62 are eligible for GSP even if they are manufactured directly from imported fabrics. However, there are some exceptions to the new rule: "handkerchiefs" of HS heading 6213 and "shawls, etc." of heading 6214 have to be manufactured from material of fiber (chemical products, etc.); and "ties, etc." of heading 6215, "gloves, etc." of heading 6216 and "other made-up clothing accessories, etc." of heading 62.17 have to be manufactured from textile yarn.

[64] See, for example, the nonpreferential rules of origin of the European Community contained in annex 10 of the Reg. 2454/93, in O.J. L 253, 11 October 1993, and the EC GSP rules of origin contained in the same regulations; the man-made filaments are now classified in Chapter 54 of the Harmonized system. The rules of origin for these products are still "manufacture from chemical materials or textile pulp."

requires, by this method of calculation based upon averages, between 500 percent and 700 percent of value added to the starting material.

In the case of textile items made of wool, the processes performed were found to be equivalent to lower percentages of value added. It was assumed that raw wool accounted for about 55 percent of the value of the woolen yarn, representing a processing factor of 80 percent value added. In addition, it was considered that the portion of the value of the woolen fabrics that can be attributed to the woolen yarn amounted to about 45 percent, with the processing factor amounting to about 120 percent of value added. The manufacturing processes prescribed by the rules required for woolen yarn (BTN 53.06) "Manufacture from products of headings Nos. 53.01 and 53.03," and for woven woolen fabrics (BTN53.11) "Manufacture from materials of headings nos. 53.01 to 53.05 inclusive." In both cases, the starting material had to be raw wool. However, for the manufacture of woolen fabrics, waste of wool, even pulled or garneted (BTN 53.04), and wool, carded or combed (53.05), were also admitted. A similar rule is still in force in the current rules of origin under the EU GSP scheme; in fact, for woolen fabrics (51.06) it is prescribed that the manufacture should start from natural fibers not carded or combed or otherwise prepared for spinning.[65] Assuming that raw wool was used as the starting material, the two-stage process in the rules described above leads to the following calculation:

- raw wool (starting material) 100
- value of the woolen yarn 180
- value added 55%
- value of the woolen fabric 400
- value added 180%

The value of the raw wool thus calculated represents 25 percent of the value of the woolen fabric. Therefore, the origin rule for woolen fabrics required, according to this calculation based on averages, 400 percent of value added to the starting material.

Woven fabrics of true hemp fell within BTN 57.09 and woven fabrics of jute within BTN 57.10. For woven fabrics of true hemp, materials of BTN heading 57.01 ("true hemp, raw or processed but not spun, tow and waste of true hemp (including pulled or garneted rags or ropes)") were required as starting material. For woven fabrics of jute, only raw jute was recognized as starting material. The Working Group considered the possible extension of the process prescribed for BTN 57.10 with a view to allowing the use of materials of heading 57.03. This would have enabled producers in preference-receiving countries to use not only raw jute, but also jute, processed, but not spun, and tow and waste of jute (including pulled or garneted rags or ropes) as starting materials. The manufacture of jute fabrics from these materials would constitute a substantial transformation, and the value thus added would have far exceeded 50 percent of the value of the finished article.

[65] See UNCTAD document TD/B/C.5/WG(IV)/2.

For various textile fabrics of BTN headings 59.07, 59.08, 59.09, 59.11, and 59.12, manufacture from yarn was recognized as conferring origin status. However, for "elastic fabrics and trimmings (other than knitted or crocheted goods) consisting of textile materials combined with rubber threads" (BTN 59.13) and "wicks, of woven, plaited or knitted textile materials, for lamps, stoves, lighters, candles and the like; tubular knitted gas-mantle fabric and incandescent gas mantles" (BTN 59.14) manufacture from single yarn was required. These rules had been reviewed, as the process of doubling and twisting yarn was a relatively wage-intensive one.

In BTN Chapter 61, for garments falling within heading nos. 61.01 to 61.04 manufacture from yarn conferred origin status. For handkerchiefs (BTN 61.05), a special process allowed only the use of unbleached single yarn. Handkerchiefs, especially those of the scarf type, were of special export interest for some preference-receiving countries, and production was based to an extent on handicraft. The special process of manufacture led to an undue restriction of the export possibilities of interested countries.[66]

Plastics Another type of difficulty facing GSP beneficiaries in fulfilling origin requirements had been illustrated by the origin rule relating to BTN 39.07, "Articles of materials of the kind described in heading nos. 39.01 to 39.06"; namely, articles of plastic materials.[67] At that time, List A described "Working of artificial plastic materials, cellulose ethers and esters, and artificial resins" as a process that did not confer origin status. For a better understanding of this process it should be recalled that BTN Chapter 39 comprised "Artificial resins and plastic materials, cellulose esters and ethers; articles thereof." Artificial resins, plastic materials, and cellulose esters and ethers were covered by heading nos. 39.01–39.06 inclusive; the articles made thereof fell within heading no. 39.07. The process rule was obviously intended to exclude in principle manufactures of articles of plastic materials, falling within heading no. 39.07 made from plastic raw materials falling within earlier headings of BTN Chapter 39. The wording of this process rule, however, differed to an important extent from that of similar rules in this respect. It excluded only "working" of materials from headings nos. 39.01–39.06, whereas List A referred to "working or processing" that did not confer the status of "originating" products. The conclusion was that non-originating starting material from heading nos. 39.01–39.06 could be used for the manufacture of "originating" products as long as it was "processed" and not only "worked." The distinction between these two types of manufacture – "working" and "processing" – posed some problems with regard to some borderline cases, where neither "working" nor "processing" would be appropriate in defining the operation performed. In such cases, the first problem was one of interpretation.

[66] See UNCTAD document TD/B/C.5/WG(IV)/2, 14.
[67] See UNCTAD document TD/B/C.5/10, Annex A, para. 65.

Another problem of a technical nature reported in the study arose from the fact that "working" of artificial resins was virtually impossible. If artificial resins in their various forms – such as granules, blocks, emulsions, solutions, and dispersions – undergo a manufacturing process, they become a different kind of article with clearly distinct characteristics. Hence, the finished goods could not be considered "worked raw artificial resins." Thus, the exclusion of "working" of artificial resins was superfluous, because only the processing of artificial resins was economically feasible. On the other hand, foils of artificial plastic materials can be heated, coated (even with gold), and stamped to plastic spangle. This kind of manufacture could be held to be "working" rather than "processing" and would, therefore, not confer the status of "originating" products of the plastic spangle. However, the portion of the value of the finished goods (the plastic spangle) that could be attributed to the starting plastic foil could, in some cases, reach 10 percent at most, and hence the value added during manufacture might reach as much as 90 percent. Even such manufacture would not have conferred origin status on the plastic spangle by the application of the process rule as prescribed.

Further examples were given to show additional hardships created by the process rule for BTN 39.07. Producing plastic articles of polymer material, from monomers of BTN Chapter 29, would have normally led to a value added of about 230 percent, because the proportion of the value of the finished article which could be attributed to the starting monomer would have been, on average, not more than 30 percent. This average could, of course, vary considerably according to the kind of goods concerned. A cup made of polystyrene material with a value of 25 contained ray monomer material being not more than 3 percent. The processing factor from the monomer to the polymer would have been about 230 percent; from the polymer to the finished cup, it would have been about 150 percent.

In order to solve this specific problem, the study drew attention to the manner in which EFTA had dealt with the problem of formulating origin rules for goods falling within BTN 39.07. The qualifying process laid down in Schedule I to Annex B of the Stockholm Convention[68] (List of qualifying processes with alternative percentage criterion) allowed for either:

> Manufacture from materials not falling in chapter 39 and not being solutions of artificial resins (ex-32.09) and not being materials which contained materials of chapter 39, or Manufacture from materials falling in 39.01 to 39.03 which are in any form (other than blocks) mentioned in Notes 3(a) and 3(b) to chapter 39 or from materials falling in 39.04 to 39.06 or chapter 32 or from materials not being and not containing materials of chapter 39, provided that both (a) the process does not consist solely of agglomerating without change in

[68] The Convention establishing the European Free Trade Association was signed at Stockholm on 4 January 1960 and entered into force on 3 May 1960. See the EFTA Convention published in February 1967 by the European Free Trade Association.

the degree of polymerization, or sintering, or combination of these processes, and (b) 50 percent or more by weight of the artificial resins used is of Area origin.

The Stockholm Convention[69] also included special arrangements for the application of the 50 percent provision in the case of articles made from a certain number of artificial resins. In all other cases, a 50 percent rule was applicable.[70]

As Chapter 39 of the BTN roughly corresponds to Chapter 39 of the HS and the same happens for Chapter 29 of the BTN with regard to Chapter 29 of the HS, a rule of origin similar to that of the GSP scheme in 1973 would cause the identical problems reported in the text.

In the EU GSP rules of origin, the problem had been solved in a similar way as in the Stockholm Convention; the rule is as follows:

3901–3915	Plastics in primary forms, waste, parings and scrap, of plastic:	Manufacture in which:
	• Addition homopolymerization products	• the value of all the materials used does not exceed 50% of the ex-works price of the product, and • the value of any materials of Chapter 39 used does not exceed 20% of the ex-work price of the product
	• Other	Manufacture in which the value of any materials of Chapter 39 does not exceed 20% of the ex-work price of the product

In the same HS chapter some producers encountered difficulties[71] (1987) with regard to polypropylene film, with a rule of origin that required that the "value of any materials of chapter 39 used does not exceed 20 percent of the ex-work price of the product." The imported materials are, normally, homopolymer, copolymer, and polymer; the process of production is represented by the extrusion, cooling, longitudinal stretching, transversal stretching, corona treatment, and rolling. At the end of the manufacturing process, the average value of imported materials from Chapter 39 was 28 percent of the ex-work price of the product; so, the goods did not obtain originating status[72] even if a number of processes were carried out.

Metals Products In the field of metals, the rule requiring a minimum of domestic content was found to create problems for producers. For this kind of product, the

[69] Ibid.

[70] See original EFTA Stockholm Convention of 1967 mentioned in previous footnotes.

[71] See UNCTAD document TD/B/C.5/WG(XI)/2, September 8, 1987, 23.

[72] See "Priorities regarding improvements in rules of origin under the generalized system of preferences," UNCTAD document TD/B/C.5/WG(XI)/2, September 8, 1987.

study found that the indication of processing factors or average figures for the value added in the process of manufacture had been considered by the Working Group to be extremely difficult and open to too many misinterpretations. This finding derived not only from the large discrepancies in the value of possible material input and the varying influence of the capital and investment factors in production, but also from the large fluctuations in prices of nonferrous metals.

In this category of products, it appeared that the 50 percent rule could generally be met more easily in the case of sophisticated products, such as household articles, heating apparatus, builders' sanitaryware, and most "other" articles, than in the case of semimanufactured metalware. For the latter, the 50 percent rule prevented semimanufactured products made from imported raw material from qualifying for preferential tariff treatment. The effect of the 50 percent rule would be to require that these articles be wholly produced in the preference-receiving country concerned.

Other Products In the course of the proceedings of the Working Group and the Sessional Committee on Rules of Origin, many other problems related to specific rules of origin were reported. Some major problems are described in the following section, without pretending to be exhaustive.

Many producers faced difficulties in fulfilling a rule of origin relative to electronic security lamps, of Council Cooperation Customs Nomenclature (CCCN) heading 85.20, which required that imported materials must not exceed 40 percent of the ex-factory price or the FOB export price. The imported materials in that case are various lamps, bulbs, and transformers; the manufacturing process is the assembling and gluing of plastic and metal parts with the resistor; assembly and soldering of electrical and electronic components, winding of coils, final assembly, coloring of bulb, installation of glass fiber, and final testing. The problem is that imported materials account for 53 percent of the sales price, so the goods do not qualify for the origin.[73]

Another important problem is linked to the fact that, with regard to precious goods, the use of percentage criteria instead of CTH implies that the final origin of the good is the origin of the most precious part of the final products. For example, in the case of gold jewelry, according the European Community (EC) rules of origin, a gold ring manufactured in a country from imported gold metal would obtain originating status because for products of HS heading 71.14 it is enough to change the tariff heading, but the addition of an original precious stone would disqualify it because the rule for products under tariff heading 71.16 allowed the use of imported materials (in this case, gold) only up to a limit of 50 percent.[74]

With regard to toys (HS heading 95.43), some developing-country producers found it impossible to fulfill the rule of origin based on the CTH criterion; in fact

[73] See UNCTAD document TD/B/C.5/WG(XI)/2, September 8, 1987, 23.
[74] See UNCTAD document TD/B/C.5/126, July 12, 1989.

for some countries it is necessary to import some parts also under heading 95.43, so the finished toys cannot obtain originating status.

In general, the rules of origin that provoked most complaints were the CTH tests coupled with input restrictions. An example from the EC and EFTA GSP rules of origin is tariff heading 8525 ("transmission apparatus for radio-telephony, radio telegraphy, radio broadcasting or television, whether or not incorporating reception apparatus or sound recording or reproducing apparatus; television cameras"), which requires:

- manufacture in which the value of all the non-originating materials used does not exceed 40 percent of the ex-work price of the product (= percentage test)
- where, within the above (40 percent) limit, the materials classified within heading N. 85.29 are only used up to a value of 5 percent of the ex-work price of the product (= input restriction)
- where the value of all the non-originating materials used does not exceed the value of the originating materials used (value-of-part-test) and
- all the transistors of heading 8541 used are originating products (= obligatory input).

According to the UNCTAD report, manufacturers and exporters have complained about the stringency of this rule especially where it refers to the obligatory input (transistors). In particular, it was found that the CTH was generally replaced by a 40 percent limit on imported inputs for all machinery, electrical machinery, and appliances, most vehicles, and scientific and other instruments (Chapters 84, 85, 86, 87, and 90). In these chapters, additional restrictions on the use of imported materials were frequent for a number of important products. The transistor rule also applied to microphones, loudspeakers, record players, tape recorders, and video recorders. Moreover, restrictions were often imposed on the use of other inputs under different tariff headings. Specific restrictions of that type can for example be found for sewing machines (8452): in addition to a 40 percent maximum imported inputs allowance, imported materials may not exceed the value of originating materials used for assembling the head; and the thread tension, crochet, and zigzag mechanisms used must be originating products.

In the same document, it was reported that Japan used for machinery and electrical appliances the same general rules stipulating a 40 percent limit on imported inputs and limiting the use of parts and components from the same four-digit tariff heading to 5 percent. However, Japanese rules for such products usually do not stipulate additional requirements and were therefore less stringent than those under the EC and EFTA schemes. There are, however, some exceptions, for example, with respect to the use of imported razor blades for the production of motorized shavers and hair clippers (HS 85.10): the only manufacturing processes to qualify are those in which the value of the non-originating products of a tariff heading different from the one of the products obtained and non-originating razor blades of HS 85.10 does not exceed 40 percent of the value of the products obtained,

and in which the value of the non-originating products (excluding razor blades) of the same tariff heading as the product obtained does not exceed 5 percent of the value of this product.

5.2.3.1.9 DIFFICULTIES EXPERIENCED BY THE INTRODUCTION OF THE HARMONIZED SYSTEM AND THE SINGLE LIST. These particular difficulties may not be entirely replicated since the HS is currently implemented worldwide by the Customs administration of the preference-giving countries. However, even the HS is changing and evolving and at each time that a new version enters into force, amendments have to be made to the rules of origin that are using it.

Since the introduction of the HS in 1988, the preference-giving countries utilizing the process criterion have implemented these rules of origin (RoO) requirements based on the new customs nomenclature. However, even the HS system – like the previous BTN and CCCN – was not expressly designed for RoO purposes and the basic rule of CTH does not in all cases result in a "substantial transformation" to the satisfaction of preference-giving countries. Consequently, preference-giving countries elaborated a list of products accepted from the basic CTH rule and subjected to separate and specific rules. The list, commonly referred to as the "single list" contains various formulations of the requirements to be met and most of the time their content in terms of specific requirements was just the result of a combination of the previous Lists A and B.

Goods contained in the single list are those for which the CTH is not deemed sufficient to define a substantial transformation. It has been assessed that the number and range of products included in the lists of exceptions is extensive. Of the ninety-four chapters of the complete HS system, about eighty-four were found on the product lists. All HS chapters on textiles and clothing products, which were of particular interest to preference-giving countries, were represented on the lists. The various types of rules were found to replicate the previous requirements under Lists A and B, as follows:

- manufactures from specified materials, in some cases:
  - requiring several stages of manufacture
  - not requiring CTH
- manufacture with one percentage limitation
- manufacture from specified materials together with a percentage limitation
- manufacture resulting in a change of tariff heading together with a percentage limitation
- manufacture with two or three percentage limitations, in some cases with the added requirement that certain specified materials or parts must be of originating status.

As previously in Lists A and B and shown in Table 5.5, many of these requirements were expressed in terms of the HS, while others were expressed in plain language. Some employed a percentage criterion, occasionally in double or triple

TABLE 5.5 *Example of single list requirements*

HS heading	Description of goods	Working or processing carried out on such originating materials that confer originating status
ex 4302	Tanned or dressed fur skins, assembled, other than plates, crosses or similar forms	Manufacture from non-assembled tanned or dressed fur skins
4303	Articles of apparel, clothing accessories and other articles of fur skin	Manufacture from non-assembled tanned or dressed fur skins, of heading n. 4302
Chapter 61	Articles of apparel and clothing accessories, knitted or crocheted	Manufacture from: • natural fibers • man-made staple fibers not carded or combed or otherwise prepared from spinning or, • chemical materials or textile pulp
7116	Articles of natural or cultured pearls, precious or semi-precious stones (natural, synthetic or reconstructed)	Manufacture in which the value of all the materials used does not exceed 50% of the ex-work price of the product
7117	Imitation jewellery	Manufacture in which all the materials used are classified within a heading other than that of the product, or Manufacture from base metal parts, not plated or covered with precious metal, provided the value of all the materials used does not exceed 50% of the ex-work price of the product
8208	Knives and cutting blades, for machines or for mechanical appliances	Manufacture in which: • all the materials used are classified within a heading other than that of the product, and • the value of all the materials used does not exceed 40% of the ex-work price of the product
8415	Air-conditioning machines, comprising a motor-driven fan and elements for changing the temperature and humidity, including those machines in that the humidity cannot be separately regulated	Manufacture in that the value of all the materials used does not exceed 40% of the ex-work price of the product

(*continued*)

TABLE 5.5 (*continued*)

HS heading	Description of goods	Working or processing carried out on such originating materials that confer originating status
8418	Refrigerators, freezers and other refrigerating or freezing equipment, electric or other; heat pumps other than air-conditioning machines of heading n. 8415	Manufacture: • in which the value of all the materials used does not exceed 40% of the ex-works price of the product, and • where, within the above limit, the materials classified within the same heading as the product are only used up to a value of 5% of the ex-work price of the product, and • where the value of all the non-originating materials used does not exceed the value of the originating materials used

form. The percentage criterion was formulated with import content as the numerator and ex-factory price (FOB price in the case of Japan) as the denominator. Another type of rule specified the materials from which the finished product was required to be made.

The introduction of the HS entailed certain changes to the GSP rules of origin of the preference-giving country which used the process criterion. Although the basic characteristics remained unaltered, knowledge and correct application of the HS was deemed necessary in order to understand and apply the origin rules correctly. Where only the general rule applied (i.e. CTH),[75] the manufacturer had to ensure that none of the imported materials used fell within the same four-digit tariff heading as the finished product. This required certifying authorities in preference-receiving countries to have a certain expertise in HS classification over a wide range of goods. Cases may arise where correct HS classification remains in doubt even after reference to the relevant publications.

It was felt that in order to establish and maintain compliance with the basic rule of the process criterion, records would be required of the description, HS classification, and sources of materials used in manufacture. Once compliance with the criterion was determined, reassessment might be required in a limited range of circumstances, such as if a change were made in the descriptions of imported materials used, or if the HS classification were changed. However, in the case of goods that are

[75] At that time most of the preference-giving countries adopting the process criterion such as the EEC, Japan, Switzerland, and Norway applied an across-the-board CTH as a general rule.

listed as excepted from the percentage limit, records would be required of costs and quantities of imported materials used in manufacture and prices of finished products. Compliance with such rules would need to be recalculated as costs and prices fluctuate.

It was found that even in the HS a wide range of possibilities existed as regards the degree of restrictiveness imposed by the basic rule on imported materials used in manufacture. At one end of the spectrum, the rule had the appearance of being extremely liberal since it permitted a product to be manufactured entirely from imported materials provided that they were not classified in the HS heading of the product. At the other end of the spectrum the use of any "same heading" materials was totally excluded, no matter how minimal the quantity may be. Some practical examples showing how these possibilities may arise are given in Table 5.6.

TABLE 5.6 *Example of stringency of a change of a CTH criterion*

Finished product	Origin rule	Possible materials	HS classification	Comments
Soft toys (HS 9503)	CTH and value of imported materials must not exceed 50% of the ex-work price of the finished product	Stuffing material, thread, eyes, metal inserts for limbs, fabric	(a) stuffing materials and thread – not classified in 9503 (b) eyes – not classified in 9503 provided they are not mounted (c) fabrics – not classified in 9503 provided they are not cut to shape (d) metal inserts for limbs – classified in 9503 "solely or principally" for soft toys	The use of this example demonstrates the necessity for HS expertise. Even if all the materials used, except for mounted eyes, originated in a preference-receiving country the finished product would fail to qualify, even if the 50% rule was satisfied.
Leather handbags (HS 4202)	CTH	Finished leather in the piece, metal or leather handles, metal	(a) finished leather in the piece, thread, glue, rivets – not classified in 4202 (b) metal handbag	Compliance with the basic rule is satisfied, i.e. the handbags

(*continued*)

TABLE 5.6 (*continued*)

Finished product	Origin rule	Possible materials	HS classification	Comments
		handbag frames (incorporating clasp and lock), metal handbag corner pieces, handbag locks, thread, glue, rivets	handles – classified in 8302 (c) leather handbag handles – classified in 4205 (d) metal handbag frames – classified in 8301 (including clasp and lock) (e) metal handbag corner pieces – classified in 8302 (f) handbag locks – classified in 8301	described may be manufactured from the materials listed, all of which could be imported without altering GSP entitlement.

However, it was observed that implications of the adoption of the CTH as a general rule vary from case to case, depending upon the nature and the extent of the need to use imported materials, how they are classified in the HS system, what manufacturing process is required to produce the finished product, and what HS heading applies to it. The varying impact produced by such a general rule makes it difficult to provide a general assessment of its overall effects. If a sufficiently wide range of examples, with adequate manufacturing data, were available, an attempt at a general assessment might be feasible. Even then, the task of identifying an adequate range and sources of possible materials that are both suitable and available for use in manufacturing a given product would be formidable. This observation remains valid at present as further discussed in Chapter 6 of this book.

5.2.3.2 An Analysis of the Experiences and Lessons Learned under the Percentage Criterion

As in the case of the process criterion, each preference-giving country using the "percentage criterion" used its own formulation of percentage in terms of numerator, denominator, and level of percentage.

Under their respective GSP schemes, Canada, United States, Australia, New Zealand, and at that time the Central and Eastern European Countries (CEEC) used the percentage criterion exclusively[76] to determine the origin of products imported from beneficiary countries.

[76] See document UNCTAD/ITD/GSP/31, para. 10, Table 1.

The EU, Norway, Switzerland, and Japan adopt the "process criterion." As mentioned before, this criterion is usually expressed by the "change in tariff heading" rule combined with a so-called single list[77] of specific working or processing to be carried out on non-originating materials in order for the finished product to obtain originating status. However, many of the rules contained in the single list provide specific percentage limitations on the use of imported materials.[78]

As the experience with the "process criterion" (CTH) has been analyzed above, the present section is dedicated to the analysis of the "percentage criterion."

Notwithstanding the process of harmonization promoted by the Working Group on Rules of Origin and later by the Sessional Committee,[79] there were – and still are – wide differences between the preference-giving countries utilizing the "percentage criterion" as the main rule in assessing the substantial transformation.

A historical explanation of these differences derives from the fact that before the implementation of the national GSP schemes many industrialized countries used to adopt individual preferential arrangements of an autonomous and independent character in favor of certain developing countries or former colonies.[80] Each of these arrangements contained origin rules which were tailored to the particular exigencies of each preference-giving country.[81]

When elaborating GSP rules of origin, preference-giving countries were concerned about losing their sovereignty in controlling the benefits granted under their schemes. As preference-giving countries could implement their national schemes independently, they retained the general principle that they were free to decide on the rules of origin which they thought were appropriate after hearing the views of beneficiary countries.[82] Thus, the actual differences reflect those which existed before the implementation of the national GSP schemes.

The following sections will focus on the analysis of the differences in the formulation and in the application of the "percentage criterion" by the preference-giving countries in their GSP rules of origin, without taking into consideration whether the "percentage criterion" is used as an ancillary or principal criterion to determine the origin of the imported goods.

A first reading of the different origin rules reproduced in Table 5.7 makes possible the identification of the basic common elements of the "percentage criterion," namely:

[77] For the definition and the explanation of the characteristics of the single list see document UNCTAD/ITD/GSP/31, paras. 86 and 87.

[78] This mainly but not exclusively concerns machinery and consumer goods in the case of the EU rules of origin, in Chapters 80–99.

[79] For the description of the activity of harmonization promoted by the Working Group and the Sessional Committee see the quoted UNCTAD documents.

[80] See document UNCTAD/ITD/GSP/31, para. 9

[81] See UNCTAD document TD/B/AC.5/3/Add.4, 2ff.

[82] See OECD document TC/Pref/70.25, September 25, 1970, para. 37.

TABLE 5.7 *Overview of the percentage criterion rules used by some preference-giving countries*[i]

Country/ group of countries	Rules	Ancillary/ exclusive	Requirements	Numerators	Denominator	Percentage level
United States	to be eligible for duty-free treatment under GSP, an article must originate in, and be imported directly from, the beneficiary developing country, and the sum of the cost of materials produced in the beneficiary developing country plus the direct cost of processing there must be equal at least 35% of the appraised value of the article at the time of its entry into the United States[ii]	Exclusive	Minimum local content requirement	Cost of materials produced in the preference-receiving country plus the direct cost of processing carried out there	Ex-factory price or appraised value by US customs	Minimum 35%
Australia	goods must comply with two requirements: a) the final process of manufacture must have been carried out in the country claiming preference; and b) at least half of the total factory or works cost of the goods must consist of the value of labor	Exclusive	Minimum local content requirement	Labor and materials from the preference-receiving country, other preference-receiving countries and Australia	Ex-factory or ex-work cost	Minimum 50%

TABLE 5.7 (*continued*)

Country/ group of countries	Rules	Ancillary/ exclusive	Requirements	Numerators	Denominator	Percentage level
	and/or materials of one or more developing countries (for the purposes of this requirement any Australian content may be counted as if it were developing country content)[iii]					
New Zealand	. . . at least one half of the factory or work cost of the finished products is represented in each article by the value of: – material the product of any developing country, or – material the produce of New Zealand and/or – other items of factory or works cost incurred in any developing country in New Zealand[iv]	Exclusive	Minimum local content requirement	Expenditure on materials and components originating in the preference-receiving country and another preference-receiving country and New Zealand	Ex-factory or ex-work cost	Minimum 50%
Canada	. . . if the value of the import content amounts to not more than 40% or, in the case of LDCs, not more than 60% of the	Not Exclusive: coupled with product-specific origin for textile and	Maximum import content	Value of imported inputs is defined as their custom value at the time of importation	Ex-factory price of goods as packed for shipment to Canada	Not more than 40% or 60% for LDCs

(*continued*)

TABLE 5.7 (*continued*)

Country/ group of countries	Rules	Ancillary/ exclusive	Requirements	Numerators	Denominator	Percentage level
	ex-factory price of the goods as packed for shipment to Canada	clothing under special preferences for LDCs		into a preference-receiving country or, in the case of inputs of undetermined origin, the earliest ascertainable price paid for them in that country		
European Union, Japan	e.g. Ch. 82.07: . . . the value of all the materials used does not exceed 40% of the ex-work price of the product (in the case of Japan FOB price)	Ancillary	Maximum percentage of imported inputs	Custom value of imported inputs, or the earliest ascertainable price paid in the case of materials of unknown, undetermined origin.	Ex-factory price	Maximum 30, 40, or 50% as alternative percentages in the Machinery sector

[i] This table refers to the rules of origin in force at that time in the respective preference-giving countries when the UNCTAD Working Groups examined the different requirements under the percentage criterion. This table is reported here together with all related discussions since they are a valid testimony that some of the debates of decades ago are also relevant to some extent today, given the lack of progress on regulating rules of origin at multilateral level as discussed in Chapters 1 and 2 of this book.

[ii] See Trade Act of 1974, Pub. L. No. 93–618, tit. V, 88 Stat. 1978, 2066–71, 19 USCA Ch. 2463(b). See also the "Handbook on the Scheme of the United States of America," UNCTAD/TAP/163/Rev. 12, April 1989.

[iii] See "Handbook on the Scheme of Australia," UNCTAD/TAP/259/Rev.1, December 1989. See also for further details "Australian Customs Service Manual," vol. 8B, 2008.

[iv] See "Handbook on the Scheme of New Zealand," UNCTAD/TAP/258/Rev.2, 1988, p. 78; and Part IV of the New Zealand Customs and Excise Regulations, 1996.

(a) definitions of the basis used for calculation of the percentage (that is, the numerator and the denominator), as follows:
  (i) domestic content or import content (numerator), and
  (ii) cost assessment basis for origin purposes (denominator)
(b) the level of the required percentage
(c) the eventual additional requirements.

The following subsections analyze the characteristics, advantages, and disadvantages of the various percentage origin determination systems used by preference-giving countries as analyzed by the UNCTAD Working Group on Rules of Origin.

5.2.3.2.1 EXPERIENCES AND LESSONS LEARNED ON DIFFERENT WAYS OF DRAFTING THE NUMERATOR. In the case of the United States, New Zealand, and Australia the numerator used for calculating the percentage is expressed by reference to "domestic content," while in the case of Canada, the EU, Japan, and the other "process criterion" countries, reference is made to "import content." These different approaches to the "percentage criterion" imply that:

(a) in the case of "domestic content," a certain minimum percentage of the total value of materials, parts, or components originating in the exporting preference-receiving country and costs of processing must be reached or
(b) in the case of "import content," a maximum proportion of imported materials should not be exceeded; that is, non-originating materials, parts, or components (or materials of undetermined origin) are allowed to be used up to a maximum percentage of the value of the finished product.[83]

Different Drafting of the Numerator under the Domestic Content According to the domestic content determination of origin, as used by Australia, New Zealand, and the United States, both local materials and labor are included in calculating the minimum domestic content requirement. However, there were various definitions of how to compute and allocate these elements toward the minimum percentage requirement. Allowable costs are differently defined. The Australian rules refer to "labour and materials of the preference-receiving country." The New Zealand rules refer to expenditure on "materials and components originating in a preference-receiving country" and "expenditure on other items of ex-factory or ex-works cost."[84] The United States rules refer to the "cost or value of materials produced in the preference-receiving country" and to "direct costs of processing operations performed in the preference-receiving country."[85]

The definition of costs that may be computed toward the domestic content, may be different depending on the definition of allowable costs. The Australian rules allow costs directly attributed to the manufacture of the finished product, for

[83] See Trade Act of 1974, Pub. L. No. 93-618, tit. V, 88 Stat. 1978, 2066-71, 19 USCA Chpt. 2463 (b). See also the "Handbook on the Scheme of the United States of America," UNCTAD/TAP/163/Rev.12, April 1989. See "Handbook on the Scheme of Australia," UNCTAD/TAP/259/Rev.1, December 1989.

[84] See "Handbook on the Scheme of Australia," n. 83 above.

[85] See "Handbook on the Scheme of New Zealand," UNCTAD/TAP/258/Rev.2, 1989, 7.

example, factory operatives, foremen, and managers. On the other hand, costs attributed to the advertising or sale of the product are excluded. In particular, the expression "materials of a preference-receiving country" was interpreted as materials which already acquired the originating status in the preference-receiving country through fulfillment of the Australian GSP rules. In the case of materials of mixed origin, defined as "materials which include content from both the preference area and from elsewhere," new interpretative rules were issued in 1994. According to these rules, in calculating the expenditure on material of mixed origin incorporated for export to Australia, the cost of that material is taken as:

(a) partly of qualifying area content provided that the last process of manufacture occurred in the preference-receiving country; qualifying area content will be in direct proportion to the actual preference area content – namely, if a material has 30 percent area content, then 30 percent of the expenditure on that material will be included as qualifying content for the final good
(b) totally without area content, if it does not meet the "last process of manufacture" requirement for the preference-receiving country.[86]

On the other hand, the US reference to "cost or value of materials produced in the preference-receiving country" was defined in more detail. It referred to materials which were "wholly the growth, product or manufacture of the preference-receiving country."

In particular, it was found that the "cost or value of materials produced in the beneficiary country" included:

(a) actual cost of the materials to the manufacturer
(b) costs of freight, insurance, packing, and all other costs incurred in transporting the materials to the manufacturer's plant, when not already included in the actual cost of the materials to the manufacturer
(c) actual cost of waste or spoilage, less value of recoverable scrap
(d) taxes and/or duties imposed on materials, provided they are not remitted upon exportation.

Where materials are supplied to the manufacturer without charge or at less than fair market value, their cost or value shall be determined by computing the sum of:

(i) all expenses incurred in the growth, production, manufacture, or assembly of the materials, including general expenses
(ii) an amount for profit

[86] According to the interpretation provided in the old rules, the expression "materials of a preference-receiving country" had to be intended as materials that had already acquired the originating status in a preference-receiving country through fulfillment of the Australian GSP rules.

(iii) freight, insurance, packing, and all other costs incurred in transporting the materials to the manufacturer's plant.

In addition, according to the US rules, intermediate materials which were "substantially transformed ... into a new and different article of commerce" may be also added to the cost or value of materials produced in the beneficiary country.

However, the concept of "substantial transformation" was not clearly defined in the US rules.

In fact, in this case, the definition of "substantial transformation" referred to a judge-made rule according to the jurisprudence of the US Federal Circuit Courts. According to the definition of the US courts, a substantial transformation occurs when "a new and different article with a distinctive name, character, or use must emerge from the manufacturing process."[87] As pointed out by authoritative doctrine:

> what is new and different and what is a distinctive name, character or use are, of course, difficult questions. The questions are made more difficult because courts have formulated the rule differently from case to case, because the Custom Service itself does not use consistent terminology in its own regulations, and further because Congress has been content to remain silent on the issue.[88]

As the question does not involve directly the GSP rules of origin, the interpretation of the definition of "substantial transformation" according to the US courts is on a case-by-case basis.[89] An interpretation in each specific case has to be sought from the US authorities. The US Custom Service gave examples of materials that were substantially transformed.[90] Thus raw skins imported into a beneficiary country and tanned into leather could be a substantially transformed constituent material when used in the subsequent manufacture of a leather coat;[91] gold bars imported into a beneficiary country and cast into mountings qualify as substantially transformed materials when incorporated in rings exported to the United States; leather imported into the Philippines, cut into shaped pieces, and made into gloves is "substantially transformed" and its value may be included in order to meet the 35 percent requirement;[92] wax imported from Indonesia into Singapore, mixed with additives (dye, perfume, stearic acid) and made into candles is not regarded as having been substantially transformed and its value cannot be included in determining whether the 35 percent requirement is satisfied.[93] Again, cutting of plastic

[87] See US case *Anheuser Bush Brewing Association* v. *United States*, 207 US556 (1907).
[88] See N. D. Palmeter, "Rules of origin in the United States," in E. Vermulst, P. Waer, and J. Bourgeois (eds.), *Rules of Origin in International Trade: A Comparative Survey*, University of Michigan Press, 1994, 35.
[89] Ibid. 27–84.
[90] See UNCTAD document TD/B/373/add.5/Annex.
[91] See UNCTAD document TD/C.5/WG(VI)/3, para. 58.
[92] See UNCTAD/TAP/133/Rev.6, para. 20.
[93] Ibid.

sheets into goggle lenses; assembly of magnetic core memories from wires and cores; magnetic recording heads assembled from wire, cables, connectors, brackets, and recording tracks.[94] The full value of the intermediate products resulting from these operations was counted toward fulfillment of the origin criterion by the finished product.

This has caused delay and uncertainty about entitlement of the finished product to preferential treatment. The words "direct costs of processing operations" mean costs either directly incurred in, or that may reasonably be allocated to, the growth, production, manufacture, or assembly of the specific merchandise under consideration. Such costs include, but are not limited to:

(a) all actual labor costs involved in the growth, production, manufacture or assembly of the specific merchandise, including fringe benefits, on-the-job training, and the cost of engineering, supervisory, quality control, and similar personnel
(b) dies, molds, tooling, and depreciation on machinery and equipment allocable to the specific merchandise
(c) costs of inspecting and testing the specific merchandise.

Items not included within the meaning of "direct costs of processing operations" are those that are not directly attributable to the merchandise under consideration or that are not "costs" of manufacturing the product. These include, but are not limited to:

(a) profit
(b) general business expenses that are either not allocable to the specific merchandise or not related to the growth, production, manufacture, or assembly of the merchandise, such as administrative salaries, casualty and liability insurance, advertising, and salesmen's salaries, commissions, or expenses.

There are other costs related to the manufacture of the goods whose status under the US rules was not made clear; for example, costs of packaging, power and fuel, and machinery (other than "dies, moulds and tooling," whose costs are included only if they relate specifically to the particular finished product).[95]

From the account in the previous paragraphs, it was evident that the "domestic content" rules applied by the three preference-giving countries concerned differed in several respects. Only some of these differences can be highlighted because detailed rules of interpretation were not available.

[94] See UNCTAD document TD/B/C.5/WG(VI)/3.
[95] See Chapter 6 of this book on further elaboration concerning the use of the percentage criterion especially in the United States.

To summarize, differences of substance existed as regards:

(i) *Determination of the extent and conditions under which third-country materials, parts, components, etc., used in manufacture in a preference-receiving country were allowed to be counted towards the domestic content of the finished product.* The Australian rule related to "materials of" a preference-receiving country without defining what this expression meant or what proportion of the value of such materials was allowed to count as "domestic content." Similar obscurities existed about the New Zealand rule that referred to materials "originating in" a preference-receiving country.

(ii) *Treatment of labor costs.* For example, the Australian rules referred simply to "labour," without further clarification; the New Zealand definition makes reference to "other items of ex-factory or works cost" and the United States provided a complicated definition of the term "direct cost of processing operations."

Definition of the Numerator under the Import Content Among the preference-giving countries utilizing the "percentage criterion" for determining substantial transformation, only Canada calculated the numerator by reference to the value of the import content.

However, all the "process criterion" countries (the EU, the other West European preference-giving countries, and Japan) used the "import content" approach as subsidiary rule in the single list.

One of the characteristics of the "import content" approach is to utilize the customs value of the imported materials based on the rules on customs valuation concluded in the General Agreement on Tariffs and Trade (GATT) valuation code of 1979, later appearing in the 1994 World Trade Organization (WTO) Customs Valuation Agreement.

The use of such multilateral instrument provides for a common assessment of the determination of the customs value of imported materials, parts, and components. The application of the abovementioned rules by preference-receiving countries ensured a consistent approach to the valuation of imported materials, parts, and components into their territories and thus improved the operation of the concept of "import content."

5.2.3.2.2 PRELIMINARY CONCLUSIONS AND LESSONS LEARNED FROM THE DIFFERENT DRAFTING OF THE NUMERATOR UNDER THE PERCENTAGE CRITERION

Experience Gained in the Comparison between "Domestic Content" and "Import Content" In general, it may be observed that the "domestic content" concept consists of two elements: the definition of labor and materials that may be input toward the fulfillment of the percentage required and the cost of originating

materials used. On the other hand, the "import content" is based on only one element – namely, materials, either imported or of undetermined origin – used in the manufacturing process of a finished article. Thus, the "import content" approach possesses the advantage of immediate simplicity and transparency.

As outlined above, the preference-giving countries that adopt the "domestic content" approach defined the elements of labor and materials in different ways with sometimes significant and subtle variations.

Thus, a manufacturer who calculated the labor and materials costs that were admissible under the US rules was unlikely to find that the same calculations will be valid for New Zealand.[96]

As discussed above, it was not easy to determine the distinctions between allowable and nonallowable labor costs that may be input to domestic content. Furthermore, where lines were drawn, they appeared to be arbitrary.

Apart from the problems caused by lack of harmonization of the definition of domestic cost that could be allocated to the domestic content, the varied and incomplete definitions created not only substantial administrative burdens for traders in preference-receiving countries but also doubts as to whether their calculations were valid and accurate. In this connection, it should be borne in mind that the cost of both labor and materials may fluctuate according to currency exchange fluctuations, leading to different levels of "domestic content," with consequent acquisition or loss of preference, although the extent of transformation carried out in the preference-receiving country remained largely unchanged.

By comparison, it was found that "import content" could more easily be defined and its exact value determined, leaving less room for doubtful or incorrect interpretation. Although there is the possibility that the finished product may change its entitlement to preference as the value of imported materials fluctuates, this possibility is more limited than in the case of "domestic content," where variations in labor costs must also be taken into account. Additionally, the "domestic content" approach was found to have the following disadvantages:

(i) A product, although entirely produced in a preference-receiving country from originating materials, may not, under the rules of some preference-giving countries, achieve the necessary level of "domestic content" and thus be deprived of preference, a situation that could not arise under the "import content" concept. This might, for example, happen in the case of United States GSP rules of origin, where "domestic content" is defined having regard to the concept of "direct processing costs." In fact, it is theoretically possible that a wholly produced article will not meet the 35 percent origin requirement – when the indirect costs exceed 65 percent of the appraised value of the good

[96] See UNCTAD/TAP/133/Rev.6, para. 20.

imported in the United States.[97] Using the concept of "direct processing costs" in connection with the domestic content as the numerator might also reduce the scope for using imported materials and components.[98] For example, a product may be considered as having an appraised value of 100 USD, of which 50 USD are direct processing costs and locally produced materials and components and 50 USD are indirect processing costs. The 35 percent requirement requested by the US rules of origin means that only 15 USD worth of imported components (50 USD direct costs less 35 USD origin required) may be used. This example and others are illustrated in the following paragraphs.

	Case 1	Case 2	Case 3	Case 4
Appraised value	100	100	100	100
Indirect cost	66	50	40	25
Minimum value of originating materials and direct processing costs	35	35	35	35
Maximum import content	Cannot meet the 35% rule even if wholly produced	15	25	40

The examples in the table show that in three of the four cases only 15 percent, 25 percent, and 40 percent respectively of the appraised value can be accounted for by import content. Thus, the maximum import content is inversely related to the share of appraised value accounted for by indirect cost.

An UNCTAD study examined selected cost profiles of manufacturing establishments in developing countries. These cost profiles, presented in the following table, permitted a crude division of production costs between direct and indirect costs. The data indicated that the "effective value added" requirement was much higher than the one implied by the 35 percent domestic processing cost rule.[99] In fact, in the case of Portland cement produced in East Africa, the 35 percent requirement would have not been met even if the product had been wholly produced in a single developing country. Moreover, a number of additional production processes could not qualify under the 50 percent cumulative origin provision.

[97] Ibid.

[98] See TD/B/C.5/WG(VI)/3,* annex II.

[99] See GATT, Basic Instruments and Selected Documents, Twenty-sixth Supplement (Sales No. GATT/1980-3), 117.

The following example illustrates how the application of the import content rule permits a more liberal system for determining the origin than the domestic content requirement.

	Import content (max 50%)	Domestic content (direct cost of processing)
(a) Domestic materials	1.00	1.00
(b) Foreign materials (not substantially transformed)	4.00	4.00
(c) Direct cost of processing	2.00	2.00
(d) General expenses	1.50	1.50
(e) Profit	1.50	1.50
(f) Appraised value	10.00	10.00
(g) Import content/domestic content	40% (rule satisfied) (d/f) x 100	30% (rule not satisfied) [(a + c)/f] x 100

As the examples contained in the table show, a product in a regime of import content would qualify for preferential treatment because the cost of imported materials (4 USD) is not more than 50 percent of the appraised value (10 USD). The same product from a beneficiary of the scheme would not qualify for preferences because the cost of domestic materials (1 USD) plus the direct cost of processing (2 USD) is less than 35 percent of the appraised value (10 USD). In the case of the import content established at 50 percent, if all the materials were of foreign origin (5 USD) the article could still qualify for preferential treatment if the appraised value were simply increased to 10.01 USD. The cost of foreign material would then be just under 50 percent of that value.

(ii) An accounting analysis must be made and records of both labor and materials costs kept up to date. Such analysis and records would be more detailed and burdensome than those required under the "import content" concept where only imported materials, and those of undetermined origin need to be assessed. In the case of "import content," if the total material costs (that is, both imported and domestic materials) amount to less than the percentage level prescribed by the preference-giving country, although the total material costs would need to be assessed, there would be no need to distinguish between domestic and imported materials either in the records or in stock holding. The administrative burden would be correspondingly lighter.

The findings made above in the formulation of the numerator in terms of "import content" highlight the following advantages over "domestic content":

(i) greater simplicity and a smaller burden for preference-receiving countries in terms of administrative effort, including the maintenance of records for imported materials only, and a consequently reduced possibility of incorrect certificates of origin
(ii) less uncertainty in determining entitlement to preferential treatment
(iii) reduced tendency to result in disqualification of goods.

5.2.3.2.3 EXPERIENCES AND LESSONS LEARNED ON DIFFERENT WAYS OF DRAFTING THE DENOMINATOR

General The denominator used for GSP rules of origin is commonly intended to represent the value of the goods for that preference which is to be claimed. This value may be established at different points in the marketing chain (i.e. from the factory cost of the finished product to its FOB export value or even cost, insurance, and freight (CIF) import value in the preference-giving country of import). Overall, the higher the value of the denominator, the more liberal will be the rule when the numerator is in terms of "import content." By contrast, if the numerator is in terms of "domestic content," a high level for the denominator will make the percentage rule more restrictive.

Comparison of Different Definitions and Drafting of the Denominator Originally, there were four methods of determination of the denominator under the "percentage criterion" and "process criterion" used by preference-giving countries:

(i) ex-factory (or ex-works) cost (Australia and New Zealand)
(ii) ex-factory price (Canada, EEC, and other West European preference-giving countries)
(iii) "appraised value" (as determined by the US authorities) or ex-factory price (United States)
(iv) FOB price (Japan).

Leaving aside for the present the US formulation, that is perhaps unique, the other methods involved ex-factory cost, ex-factory price, and FOB value. The value corresponding to the ex-factory cost is the lowest of these three; the value is higher for ex-factory price and highest for the FOB price.

A consideration of the relative merits of these three methods must consider:

(i) the advantages or disadvantages of the administrative effort required in setting up accountancy methods according to denominator
(ii) the relevance to the concept of "substantial transformation"
(iii) possible inequities that might arise between producers because of, for example, differing levels of efficiency or of location of manufacturing plant.

"Ex-factory cost" was defined[100] in some detail in the New Zealand scheme. Some fine distinctions are drawn: for example, royalties were included if they related to processes or machines used in manufacture of the goods but were excluded if they related to the finished goods themselves. The cost of packing the goods into "outside packages" was also excluded, as well as the cost of the packaging material.

It was found that the "ex-factory cost" may reasonably be used as a denominator to reflect, in conjunction with the numerator, a certain degree of the transformation that has occurred. However, it may exclude some legitimate expenditure. Packing for exports, for instance, could be said to play a significant role in the transformation process, particularly for some types of finished products which are to be transported considerable distances and using several modes of transport.

"Ex-factory price," as noted above, exceeds ex-factory cost, because it includes additional elements, such as manufacturing profit, labor costs of packing, and packing materials, including packing for retail sale. The definition of ex-factory or ex-works price used by the OECD preference-giving countries, except the United States, is "the price paid to the manufacturer in whose undertaking the last working or processing is carried out, provided the price includes the value of all the products used in manufacturing." This definition was, at times, found to be inadequate. The terms on which the manufacturer sells or the purchaser buys may vary considerably, depending on the extent to which the buyer or seller is responsible for such items as handling, transport, and insurance. This definition does not cover these aspects.

Determination of the "ex-factory" cost may be a common accounting practice for many enterprises, although it is unlikely to be commercial practice to identify on a product-by-product basis the minor elements that, for example, the New Zealand rules demand (e.g. royalties, office expenses, and selling costs). These additional requirements would call for additional effort, the extent of which would vary from product to product. It should also be noted that import/export trade is not frequently conducted on an "ex-works" basis, because this requires the importer to be responsible for making transport and insurance arrangements and for paying all charges from the time the goods leave the factory. It is simpler for the manufacturer or an agent to undertake these tasks.

The "FOB price" concept is applied only in the Japanese scheme. In commercial terms, the exporter is responsible for all charges incurred in placing the goods on board of the exporting ship, aircraft, or other vehicle. Thus, the FOB price is the highest of the three concepts so far considered (although lower than CIF terms, when the exporter is responsible for all charges up to arrival at the port or place of ultimate destination).[101]

[100] See UNCTAD/TAP/133/Rev.6, para. 19.
[101] See UNCTAD document TD/B/C.5/WG(VI)/3, para. 47.

Although the additional elements contained in the FOB price, such as costs of transport, insurance, and handling, may not in themselves relate directly to the degree of transformation that the finished goods may have undergone in the preference-receiving country, they are nevertheless elements of value added contributed by the services and infrastructures of that country and could be said to possess a form of originating status that should be included in the calculation in such a way that it is counted toward the originating status of the product itself.

FOB terms are often preferred in international trade because the foreign customer:

(i) may have other goods being sent to him that can be exported at the same time, so as to save freight charges
(ii) may use ships and other services of his own country, thus saving foreign currency
(iii) may lack knowledge of the local conditions of transport, insurance, etc., in the preference-receiving country of export.

The difference in levels between "ex-works price" (ex-factory price) and "FOB price" may, of course, vary in each case, depending upon the nature of the goods, costs of transport services, location of factory, and so on. This difference in practice was illustrated in a typical case concerning the exportation of fabric from the United Kingdom to Milan by sea. In this particular case, the price of the goods, ex-factory and unpacked, amounted to 6,000 USD. The FOB price, which included packing costs, transport to the exporting ship, port dues, and loading charges, amounted to 6,810 USD. Thus, the FOB price, without any addition for insurance, was about 13 percent higher than the ex-factory price. If this transaction was between a preference-receiving and a preference-giving country and if originating status were based on "domestic content" setting at a minimum of 50 percent of the ex-works price, the effect of changing to the FOB price would be to require about 6.5 percent of additional domestic content. If the basis were 50 percent "import content," an additional 6.5 percent of imported materials could be used.

It was suggested[102] that the use of the FOB price could cause inequitable GSP treatment, depending upon the geographical location of manufacturing plants, because the nearer the plant to a point of export the lower the FOB price. Then, it could be easier to obtain the preferential treatment for products manufactured in plants that are relatively near to the point of export. A variation in the degree of liberality of the origin rule would ensue. However, inequities may also arise in connection with either factory cost or factory price. For example, the most efficient manufacturers will produce at a lower unit cost than the less efficient ones and may thus find the "percentage criterion" more restrictive as to the allowed proportion of

[102] See UNCTAD document TD/B/C.5/WG(VI), para. 51.

imported materials. It, thus, seems impossible to achieve complete equity in this respect based on the "percentage criterion," because of continuous variations in costs and prices.

The US system of "ex-factory price" and "appraised value" differs from that of other preference-giving countries. In completing Form A, exporters were required to declare the sum of the cost of materials and the direct cost of processing expressed as a percentage of the "ex-factory price" of the exported goods. Where, however, the US customs decides to appraise the value of the goods at a level higher than that of "ex-factory price," then entitlement to preference must be recalculated based on the higher appraised value. This may lead to loss of entitlement to GSP. In some cases, it also evidently causes a significant volume of work for exporters in preference-receiving countries, who are required to recalculate entitlement. In this connection, it has been observed that there were nine different possibilities for determination of "appraised value."[103]

Most significantly, exporters were not in a position to forecast whether "appraised value" terms would apply and, if so, whether this value would exceed ex-factory price and by what amount. Exporters were thus hindered, if not prevented, from ensuring that their products would qualify for preference until the US authorities had accepted the claim. It was clearly unsatisfactory for entitlement to the GSP to depend upon a figure that was not available within the country of export.

5.2.3.2.4 PRELIMINARY CONCLUSIONS AND LESSONS LEARNED FROM THE DIFFERENT DRAFTING OF THE DENOMINATOR UNDER THE PERCENTAGE CRITERION. To sum up, "FOB price" was found to have had a number of advantages over the other formulations:

(i) It is a price level most frequently quoted and used in international trade and is thus readily available for use in establishing origin states without additional effort or expense.
(ii) The administrative overheads for manufacturers are thus reduced to a minimum, comparing favorably with both factory cost and factory price, where detailed definitions have to be observed.
(iii) Some important elements are included in it that are excluded by other formulations and that may be regarded as "originating elements"; for example, local transport and insurance, packing, and handling costs.

Of the other formulations, that of the United States possesses a variety of disadvantages concerning the administrative burdens imposed on the traders in the preference-receiving country. A major disadvantage is the uncertainty caused

[103] See UNCTAD/TAP/133/Rev.6, para. 19.

where final valuation is made by the US authorities. It did not seem that this uncertainty would be dissipated on implementation of the rules on customs valuation.[104]

5.2.3.2.5 EARLY EXPERIENCE AND LESSONS LEARNED FROM UTILIZING THE PERCENTAGE CRITERION UNDER THE GSP SCHEMES. The rationale and restrictiveness in the percentage criterion have been examined during many meetings of the Working Group and of the Sessional Committee. In two different documents, the Working Group[105] and the Sessional Committee[106] evaluated the consequences of the differences abovementioned on the expression of percentage criterion in the individual GSP schemes of the countries that used it exclusively.

As pointed out by a preference-receiving country,[107] insuperable obstacles were caused by the need to devise and operate an accounting system that differed in the definition of concept, application of accounts, precision, scope, and control from its internal legal requirements. The system must provide the costing information to satisfy the rules of the countries of destination, to check the shares of domestic and imported inputs in the unit cost of the exported goods, and in some cases to identify the country of origin of the inputs and establishing direct and indirect processing costs. This often required (and still requires) data-processing techniques that are not in common use, especially in small- and medium-sized enterprises (SMEs). It was pointed out that the willingness of enterprises to change or adopt accounting systems different from normal systems depends on the volume of exports eligible for GSP, the share of such exports in total sales, and the cost involved.[108] In addition the expenditure incurred in operating a parallel accounting system may outweigh the benefit of GSP, such as where the preference margin is less than 5 percent.[109]

[104] See Chapter 6 of this book for updated discussions on the use of percentage criterion and the different calculation methodologies.

[105] See UNCTAD document TD/B/C.5/WG(IV)/2, paras. 78 ff.

[106] See UNCTAD document TD/B/C.5/WG(VI)/3, paras. 64–94.

[107] See the following documents:

TD/B/AC.5/3, July 10, 1970
TD/B/AC.5/3/Add.4, March 19, 1970
TD/B/AC.5/38, December 21, 1970
TD/B/C.5/WG(IV)/2, September 26, 1973
TD/B/C.5/WG(V)/L.2/Add. 1, December 6, 1974
TD/B/C.5/WG(VI)/4, March 14, 1977
TD/B/C.5/WG(VIlI)/2, July 18, 1980
TD/B/C. 5/141, February 28, 1992.

[108] See UNCTAD document TD/B/C.5/WG(IV)4, paras. 77 ff.

[109] See UNCTAD document TD/B/C.5/WG(VIII), para. 29.

Other inhibiting factors included uncertainty in supplies of inputs owing to inflation, international variation in prices, and difficulty in obtaining external finance. There was also continuous devaluation leading to the need to constantly update the costing system for origin rule purposes. More rigorous accounting methods were needed to determine unit costs when the range of exports is large, for which data-processing systems are again required. Where domestic inputs were used that themselves have been manufactured from imported materials it is difficult to obtain evidence of this; such inputs were thus treated as imported products. This occurred in textile handicrafts, leather, and other handicrafts using pigments or coloring matter and chemical and pharmaceutical products. All the abovementioned problems were amplified by the fact that, in particular cases, the accounting system adopted in order to fulfill the requirements of a certain preference-giving country's rules of origin is not useful in providing the required data necessary for the fulfillment of another preference-giving country's rules of origin.[110]

Another preference-receiving country gave a practical example that shows how differences between the various origin criteria and their application considerably diminished the full use of the GSP. Many preference-receiving countries pointed out that the use of imported materials, parts, and components was limited by not only the origin rules but also the variations between them, mainly in particular sensitive sectors such as textile and electronics.[111]

The hypothetical illustration in the following table shows that, assuming the same cost structure, only shipment to the United States will satisfy the percentage criterion (shipments of the same goods to Australia, Canada, will not[112]):[113]

I.	Imported materials, parts or components-non originating	750
II.A	Materials produced in the preference-receiving country "X"	200
II.B	Direct cost of processing operations performed in country "X"	
	1. Direct labor	100
	2. Overheads	135
III.	Overhead and general expenses and other costs of production involved	5
	EX-FACTORY COST (I + II + III)	1.190
IV.	Profit	50
	EX-FACTORY PRICE (EX-FACTORY COST + IV)	1.240
V.	Cost of transport from the factory to the frontier or port/brokerage/handling expenses	10
	FOB VALUE (EX-FACTORY PRICE + V)	1.250

[110] See UNCTAD document TD/B/C.5/WG(X)/2, 6.

[111] Ibid. 22.

[112] This example does not take into account cumulation possibilities.

[113] The example has been updated with the currently applicable Canada GSP rules of origin as contained in Memorandum D11–4-4 Ottawa, October 16, 2017, Rules of Origin Respecting the General Preferential Tariff and Least Developed Country Tariff.

Country	Method of calculation	Example	Percentage requirement	Satisfied/ not satisfied
Australia	$\frac{\textit{Cost of domestic labor and materials}}{\textit{EX FACTORY COST}}$	$\frac{100+200}{1190}=25\%$	50% minimum	not satisfied
Canada	$\frac{\textit{Value of imported materials and parts}}{\textit{EX FACTORY PRICE}}$	$\frac{750}{1240}=60\%$	40% maximum	not satisfied
New Zealand	$\frac{\textit{Expenditure on domestic materials}}{\textit{EX FACTORY PRICE}}$	$\frac{200}{1240}=16\%$	50% minimum	not satisfied
United States	$\frac{\textit{Cost of domestic materials and direct processes}}{\textit{EX FACTORY PRICE}}$	$\frac{200+100+135}{1240}=35\%$	35% minimum	satisfied

Another preference-receiving country underlined that the access to important markets on a preferential basis was prevented by the lack of harmonization of the rules based on the percentage criterion, particularly with regard to the schemes of the United States, Canada, Japan, and the EEC.[114] Therefore, it provided an example that showed the different treatment of the ball-bearings (classified in CCCN 84.62) depending on the preference-giving country of export:

- United States: they qualified for the GSP because the domestic material cost plus direct cost of processing was more than 35 percent requirement.
- EEC: they did not qualify because the imported materials used exceeded 40 percent of the value of the product obtained.
- Japan: they qualified for Japanese GSP by the use of the cumulation and donor country content.

Other preference-receiving countries reported the confusion of their exporters because of the lack of a uniform system in the method of calculation, and also regarding the costs that might be counted or excluded for determining either the import or the domestic content (e.g. Canada and New Zealand excluded the cost of labor from the processing cost while Australia and the United States included it).[115]

[114] UNCTAD document TD/B/C.5/WG(X)/2, 5. A preference-receiving country showed, as an example, that in the case of the United States, out of a total of 788.9 million USD of Mexican exports which could have benefited from GSP in 1983, and for which in principle there was no limitation apart from the presentation of origin certificates, 58.7% (462.2 million) comprised goods whose preference margin was less than 5%. For such goods the main reason for the nonuse of preference might have been this low margin compared with the more costly administrative requirement needed to establish compliance with the origin rules. The remaining 41.3% of exports, with a preference margin exceeding 5%, largely represented cases where the goods had failed to satisfy the origin rules.

[115] Ibid.

Some concerns had been raised also regarding different interpretations made by the custom authorities of different preference-giving countries concerning identical terms used in the percentage criterion. For example, it was pointed out that while Australia and New Zealand considered the appraised value (denominator) as the ex-factory cost, the United States, Canada, EFTA, and Japan applied the appraised value as the value of transaction or FOB value.[116]

5.2.3.2.6 DIFFICULTIES IN INTERPRETING THE TERMINOLOGY USED IN THE PERCENTAGE CRITERION. The problems encountered by preference-receiving country exporters in fulfilling the requirements of preference-giving countries rules of origin based on percentage criterion may be subsumed in two categories:

(a) problems related to the interpretation of the legal terms
(b) incapacity or difficulties in fulfilling the administrative requirements as interpreted by preference-giving countries' custom authorities.

In conclusion the main difficulties related to (b) above may be summarized as follows:

(a) substantial variations in the degree of transformation required and consequently in unequal conditions for preferential access to the markets of the preference-giving countries for the same products
(b) differing degrees of administrative efforts required of the exporters and authorities in the preference-receiving country in order to establish compliance with the rules under the various schemes
(c) confusion among exporter because of the complexity of the requirements
(d) disincentive to manufacture goods capable of satisfying the rules of more than one preference-giving country.

These disadvantages apply also to the use of the percentage criterion by the "process criterion" preference-giving countries. However, the effects are more limited than for the four "percentage criterion" preference-giving countries because the range of products affected is comparatively small. Nonetheless, they include some important industrial products.

Apart from these disadvantages of a general nature, some specific complaints had been voiced regarding the percentage criterion as applied by both groups of preference-giving countries.

Regarding the points made above, it has to be reported that preference-receiving countries, on many occasions, pressed for the harmonization and simplification of the various percentage rules (the definition of numerator and of denominator and the level of percentages).[117] The Working Group on Rules of Origin, at its eighth session, pointed out that measures of harmonization and simplification needed to have regard to changes

[116] Ibid. 10.
[117] Ibid. 17.

in the degree of liberalization or of restrictiveness that might result from their adoption.[118] It was pointed out that the selection of such measures had to consider that:

(a) one function of the origin rules is to avoid trade deflection, that is, the import under the GSP of goods that are essentially manufactured in countries not beneficiaries of the system. For this reason, the rules restrict the proportion of third-country materials parts and components;
(b) there is need to assist in the promotion of the industrialization of preference-giving countries.

In this connection, it was noted that each of the definitions of numerator and denominator, and the levels of percentage interacted to affect the degree of transformation (or, in other words, liberality or restrictiveness) that was obtained. It was found also that the definitions of numerator and denominator had important effects upon the level of administrative burdens and costs that were needed to operate the rules of origin.

Lack of harmonization is still one of the most important issues to be solved in GSP rules of origin. There follow some practical examples of the main problems encountered by preference-receiving countries in respecting the requirements of preference-giving countries' rules of origin.

5.2.4 *Comparisons of Formulations between Percentage and Process Criteria*

From the preceding paragraphs and the first part of the compendium, the most important difference between the two formulations consists of the extensive use of the HS system in the case of the process criterion and the comparative transparency – that is, the use of plain language – in the case of the percentage criterion. Comprehension of, and compliance with, the process criterion needs an accurate understanding and interpretation of the HS system. As regards the percentage criterion, the version that uses "import content" as numerator appears readily comprehensible and requires little specialist knowledge.[119] In this regard, it appears simpler than the process criterion. Where the percentage criterion uses "domestic content" as numerator, some versions might require expert advice to ensure compliance with the fine distinctions drawn between allowable and unallowable costs. How these versions compare with the formulation of the process criterion is difficult to assess.

The extent to which differences between the two formulations have a practical impact can only be surmised. It is reasonable to suggest that as far as newcomers to the GSP requirements are concerned, the formulation and presentation of the process criterion rules might initially be expected to produce a deterrent effect. This could be serious in the event that the newcomers had no experience of the HS or were familiar only with percentage criterion rules. If a reliable source of information and advice were, however, available concerning the HS system, difficulties

[118] Ibid. 16.
[119] Ibid. 7.

could readily be overcome and familiarity with the criterion established. The ability to provide such information and guidance in preference-receiving countries is thus important; it will of course vary from country to country.

As far as administrative effort is concerned (i.e. in relation to the establishment of compliance with the criteria and subsequent monitoring to ensure continuing compliance), there appears to be little in general to choose between the two. Possibly the percentage criterion might in practice be more burdensome since there would be an ongoing requirement to update calculations, especially during periods of inflation. This would apply especially where, as in some cases, a certificate of origin (CO) has to show the exact percentage content of the goods included in a consignment. By contrast, the process criterion seems to require less monitoring, except in those cases where goods are excepted from the basic CTH rule and percentage rules apply. Costs of administration are of course important, given the declining margins of GSP preference.

Assessment of comparative merits on a theoretical basis provides only an indication; the reality may well be different. Analysis of practical experience in application of the two criteria in both preference-giving and preference-receiving countries might help to provide a judgment of greater validity.

By the term "substance" is meant the operational elements of the origin rules, in particular the limitations, and their stringency, which the criterion places upon the use of imported materials, components, or parts in the manufacture of a product. These limitations are intended to serve the purposes of the origin rules as follows:

(i) to reduce or prevent "deflection of trade," (i.e. the undermining of the customs tariff of a preference-giving country); this would occur if duty-free admission were accorded to third-country goods that have merely transited through, or undergone only nominal processing in, a preference-receiving country
(ii) to confine the benefits of preferential admission to bona fide manufactures of a preference-receiving country to improve its export trade and promote industrialization and employment.

While the criteria are required to satisfy the purposes of (i) and (ii) they are not intended, in themselves, to create unnecessary obstacles to the use of GSP. In that connection preference-giving countries apply a variety of safeguard measures aimed at controlling GSP trade; for example, import restrictions such as ceilings and quotas as well as graduation.

The purpose of (i) is of particular importance to preference-giving countries in their wish to maintain the protective purposes of their tariff. They are naturally inclined to prefer stringency rather than liberality in the rules; that is, concerning the level of imported material permitted to be used. On the other hand, preference-receiving countries favor less stringency, in the belief that this would better serve the purpose of the origin rules described in (ii) above, in particular so as to increase

export trade. It follows from these separate and somewhat opposing interests that in forming a definition of "substantial transformation" a balance should be struck.

Examination of the substance of the two criteria is attempted in later paragraphs to describe the manner and extent to which each of them appears to fulfill the purposes of the origin rules and achieve an acceptable balance. This examination does not, however, consider several other factors that affect the impact of the two criteria. These factors, whose use varies between preference-giving countries, include the concept of "preference-giving country content," various forms of "cumulation" and, in the case of the EU, the availability of a system of derogation. These tend to moderate the impact of the substance of the criteria in the direction of less stringency.

5.2.4.1 Comparison of Substance as between the Percentage and Process Criteria

For the purposes of comparison with the percentage criterion, any one of the process criterion versions may be chosen (in respect of both the basic rule and the rules applied to excepted products), since the substance of all versions exhibits close comparability. However, the substance of the four versions of the percentage criterion is, on the other hand, clearly diverse. For the purposes of comparison, it is necessary to select one version; the Canadian version has been chosen because of its close similarity to the percentage rules applied to some products that are excepted from the process criterion basic rule.

As far as the basic process criterion rule is concerned, as already noted, there are differences as between the methods by which restrictions are applied by that rule and by the percentage criterion. The latter imposes quantitative limitations while the former imposes qualitative limitations (i.e. descriptions of materials). The percentage criterion applied by Canada allows the use of up to 40 percent of imported materials of any description in the manufacture of any product. The process criterion in its basic rule is capable, subject to HS classification of the finished product and the imported materials used, of permitting the use of up to 100 percent of imported materials, or of disqualifying a product where only an infinitesimal quantity of imported materials has been used.[120]

[120] At the third session of the Working Group on Rules of Origin, the group of 77 made some requests to the preference-giving countries regarding the percentage criterion, namely: "Preference-giving countries applying the percentage criterion should seek to achieve harmonization in this respect to the maximum extent possible. In particular, it would be desirable to aim at retaining the best features of the rules in application, as follows:

adoption of a common percentage of value added not exceeding 50 percent of the value of the exported product;
the share of imported materials in the exported product should preferably serve as a common basis for the determination of such percentage of value added;
adoption of a common method of valuation of such exported product based on the f.o.b. export price."

See UNCTAD document TD/B/C.5/WG(VI)/4, para. 3.

This perhaps extreme example illustrates the practical consequences of diverse origin criteria. A product can be manufactured to meet the Canadian criterion; the same product could fail to meet the process criterion.

The two methods are so different in approach that an examination of the texts is in itself incapable of producing an overall meaningful comparison. The effects depend upon the facts of each case. Where imported materials are required to be used by a particular manufacturer and none is classified with the finished product under the same HS heading, then the basic rule in that particular case is more liberal than the percentage criterion (i.e. the manufacturer can use as much of these materials as he wishes). At the other end of the scale, where a manufacturer wants to use an infinitesimal amount of imported materials classified in the same heading as the finished product, its use is prohibited and the product disqualified for GSP. This is a result that the percentage criterion is unlikely to produce. The basic rule in this case is substantially more restrictive than the percentage criterion.

As regards the rules for excepted products, however, some valid comparisons can be made between certain examples, such as those that contain a percentage requirement, and the Canadian version of the percentage criterion. The percentage rules for excepted products are expressed in terms of import content with a range of percentage levels and can be compared directly with the Canadian version of the percentage criterion, which is expressed on the same basis with a maximum of 40 percent for all products.

Comparisons on these lines have been made and are shown in illustrative lists in Annex V. In summary form, in about fifty four-digit HS headings (see list (i)) the process criterion percentage rule corresponds with the Canadian version of the percentage criterion. For ten four-digit headings (list (iv)), the process criterion percentage rules are more liberal than the Canadian; for five four-digit headings (list (iii)), they are more restrictive because of an additional requirement of CTH; and for fourteen (list (ii)), there may be parity of restrictiveness in practical terms between the process criterion rule (50 percent import content and CTH) and the Canadian rule. There are three other headings where multiple percentage requirements are specified. These, based on the texts, appear to be substantially more restrictive than the Canadian percentage criterion:

Goods	Process criterion rule	Limit of imported materials expressed in percentage terms
1. Cotton yarn	Manufacture from fiber	57
2. Cotton fabric, woven	Manufacture from fiber	23.8
3. Clothing of woven cotton fabric	Manufacture from fiber	13.6

Finished product	Origin rule requirement	Imported materials	Processed and value added	Ex-factory value of finished product	Percentage of import content
1. Cotton yarn	Manufacture from fiber	Cotton fiber value 100$ (a)	Spinning: value added 75$ (b)	175$ (c) (a) + (b) = (c)	(a + c) x 100 = 57%
2. Cotton fabric, woven	Manufacture from fiber	Cotton fiber value 100$ (a)	Spinning: value added 75$ (b) Weaving: value added 145$ (c)	320$ (d) (a) + (b) + (c) = (d)	(a + d) x 100 = 23.8%
3. Clothing of woven cotton fabric	Manufacture from fiber	Cotton fiber value 100$ (a)	Weaving and making up: value added 145$ (b) Value of fabric is 245$ (c)	735$ (d)	(a + d) x 100 = 13.6%

Another method of making direct comparisons can be applied in respect of process criterion rules (concerning those excepted products) that are expressed in plain language. These specify the materials from which manufacturing must commence, such as "Manufacture from (various) fibers" or "Manufacture from materials of heading . . ." In such cases, in order to illustrate comparative restrictiveness vis à vis the percentage criterion, it is in some cases possible to convert the rules expressed in this way into their equivalent in percentage terms. To use this method, a breakdown of manufacturing costs for a given finished product is required in order to establish costs of, for example, imported inputs and costs (or added value) attributable to the various processes of production. These data are then used to determine the percentage content of imported materials calculated based on processing costs as numerator and ex-factory price as denominator. The manufacturing data should preferably be obtained from sources in preference-receiving countries in order to arrive at results relevant to manufacturing activities in those countries.

Owing to its commercial confidentiality, there is little available information of this nature. However, some data have been published showing costs of manufacture of a few finished products in a preference-giving country.[121] The data concern finished products, that is (a) cotton yarns, (b) cotton woven fabric, and (c) garments made from such fabrics. For these products the process criterion rules specify for (a) and (b) that each should be manufactured from fiber. For (c), the rules require

[121] See UNCTAD document TD/B/C.5/WG(VIII)/2, para. 32.

manufacture from yarn. Data have been obtained that show the value added at each main stage of manufacture. On this basis, calculations show that the percentage limits for the use of imported material in manufacturing these particular products for cotton yarn are 57 percent; for cotton fabric, 23.8 percent; and for garments, 13.6 percent.[122] These results, subject to the qualification that they relate to manufacture in a preference-giving country (and also need to be updated), suggest that for two of the three products the process criterion rules are significantly more restrictive than a 40 percent percentage criterion rule based upon import content.

The results described above are of course based upon a comparison of the process criterion rules (largely harmonized) with only one of the current percentage criteria. Differing results would no doubt emerge if comparison were based upon other versions of the percentage criterion. It is difficult, however, to evaluate those versions where limitations on imported materials are exercised by reference to domestic content with differing and complex interpretations.

Only limited inferences can be drawn from the examination and results described in previous paragraphs in regard to the theoretical comparative restrictiveness as between the process criterion and (one version of) the percentage criterion. The inferences include:

(a) The basic rule of CTH has a widely variable impact that prevents an overall comparison between its restrictive qualities and those of the one version of the percentage criterion (a comparison with some other versions of the percentage criterion, that, per se, are also variable in impact, is likely to support the same inference).
(b) Where direct comparisons can be made between some products excepted from the basic rule of CTH and (one version of) the percentage criterion, the results vary: for some products the rules for excepted products are subject to the same restrictions, while in other cases the restrictions are greater or less.
(c) While further examination and research may make it possible to draw other and more precise comparisons, the inferences above support the view, important in connection with possible harmonization measures, that each of the two criteria produces individually variable impacts that prevent an assessment of the overall correspondence of the one criterion with the other.
(d) Illustrations of the significant disparities between the substance of the criteria underline the importance of harmonization in practical terms; that is, the more significant the current disparities the more evident it is that harmonization would reduce existing barriers to market access.

Table 5.8 summarizes the various findings on the comparative strength and weaknesses identified by the Working Groups and Sessional Committees on rules of origin.

[122] See UNCTAD document TD/B/C.5/141, para. 23.

TABLE 5.8 *Comparative strength and weaknesses of the percentage and process criteria*

	CTH	Ad valorem	Processing
Strength	• visible and ascertainable • determinations are more objective, transparent and trade neutral • eliminates subjective elements • manufacturers/ exporters know with certainty whether their goods qualify • usually unnecessary to know origin of input materials • diminishes record keeping and private sector enquiries • customs administrations can readily verify compliance • relatively straightforward • no costing involved when used on its own	• versatile, can be used with other systems • on the surface, rule is simple in concept • basic cost analysis formula • private sector can determine it independently • if high percentage of national inputs, simple to apply rule • does not require rule change even if technology changes	• allows for precise and objective formulation of conditions determining origin • straightforward and uncomplicated • no opportunity for manufacture/ exporter to manipulate • private sector can determine independently • relatively easy to verify by customs administrations
Weaknesses	• the HS is complicated and technical in its own right • the HS was not originally intended for origin purposes • requires complicated exceptions and additional rules • lack of private sector tariff expertise results in	• cost analysis may differ considerably from country to country depending on their economies • disputes as to what factors are included in cost of production • varying percentage threshold • major interpretative problems with borderline cases	• on its own is not particularly well suited for tariff application • requires compilation of extensive lists • most effective if used with other methods or with respect to specific product sectors • descriptions must not be unduly complicated, yet

(*continued*)

TABLE 5.8 (*continued*)

	CTH	Ad valorem	Processing
	mistakes and high administrative cost • rules need adjustment to keep up with technology • uses value added and processing lists as supplemental tools, therefore must know three systems • difficult system for developing countries to administer	• depend on fluctuating world market prices and exchange rates • discriminate against low cost countries • origin for input materials is relevant • manufacturer/ exporter can manipulate outcome • difficult for customs administrations to verify (i.e. only by detailed costing audits) • must rely on records and accounts in foreign countries	must be precise enough to be meaningful • practical application is limited

5.3 LEARNING DRAFTING RULES OF ORIGIN FROM REGIONAL EXPERIENCES

Rules of origin are one of the most tormented subjects in free-trade agreements. Origin is at their core, and increasingly so since origin issues made headlines in the international press about the stringency of the North Atlantic Free-Trade Agreement (NAFTA) rules or the Pan-European Rules of Origin and later USMCA. In this section the rules of origin of various free-trade agreements in different regions are examined providing an in-depth analysis with a comparative perspective including recent megaregionals such as CP-TPP, RCEP, and AfCFTA.

5.3.1 *Rules of Origin in ASEAN*

The Association of Southeast Asian Nations (ASEAN) rules of origin have been often described as an example of simplicity, including by ASEAN's own

leaders.[123] On closer inspection, a number of reports are unanimous that such apparent simplicity masks a different, complex reality. Different perceptions of mostly Japan multinational enterprise investment in ASEAN[124] have been registered and the existing literature[125] is pretty unanimous in providing a series of indications that ASEAN rules of origin are complex. Besides the implementation of ASEAN rules of origin, especially the administrative requirement related to CO Form D at ASEAN national level differs from country to country within ASEAN, making their day-to-day implementation scarcely predictable to businesses, leading to low utilization. Chapter 7 of this book, on administration of rules of origin, further discusses issues related to origin certification and recent developments such as the possibility of sending Form D in electronic format using the ASEAN Single Window (ASW).

The mixed results of ASEAN rules of origin are best summarized by the fact that they have been systematically revisited for more than two decades by the ASEAN negotiating machinery in a perpetual quest to improve them.

[123] This section draws from and updates S. Inama and E. W. Sim, *ASEAN Rules of Origin*, Cambridge University Press, 2015. See also *Handbook of ASEAN FTAs*, UNCTAD, 2021.

[124] See JETRO, "ASEAN FTAs and Rules of Origin," November 2004, at www.jetro.go.jp/ext_images/thailand/e_survey/pdf/fta_rulesoforigin.pdf. The report found, on the one hand, a number of examples about the ability to comply with the 40% requirements of ASEAN rules of origin, and, on the other hand, a number of statements by Japanese companies quoting that in some ASEAN countries, where supportive industries are not effective in providing inputs, there is a persistent difficulty in meeting the 40% requirement. This finding is extremely interesting especially when it is taken into account that Japanese firms are by far multinational enterprises with knowledge and ability to understate the complexities of rules of origin. The challenges remain for micro, small, and medium-size enterprises (MSMEs) that are unable to understand and comply with rules of origin requirements.

[125] See M. Manchin and A. O. Pelkmans-Balaoing, Rules of origin and the web of East Asian free trade agreements," Policy Research Working Paper, 2007, where the authors came to the conclusion that the rough utilization rate estimate of 5% (of total import value) based on firm interviews thus comes rather close to the regression estimates derived here. See E. M. Medalla and J. Balboa, "ASEAN rules of origin: Lessons and recommendations for best practice," Philippine Institute for Development Studies (PIDS), June 2009; and O. Cadot and L. Y. Ing, "How restrictive are ASEAN's RoO?," ERIA Discussion Paper Series, September 2014, where ASEAN rules of origin "Prima facie have a relatively simple and transparent structure, with a large chunk of trade flows subject to a 40 percent regional value content or a change of tariff classification. In many cases, the importers can choose which rule they claim, which makes the system less penalizing. However, the econometric analysis of trade flows uncovers evidence of moderately restrictive effects, with an average tariff equivalent, across all measures and products, of 3.40 percent (2.09 percent using trade-weighting). That is, ASEAN's RoOs 'deny preferences' by an amount roughly comparable to one fourth of the tariff preference margins. Although moderate, this may contribute to low take-up rates that have been observed on the basis of fragmentary evidence." However, the same report quoted that "the simplification and streamlining of RoOs should prioritize light industries like textile and apparel, footwear, and prepared foods (in particular fats) and this should be seen as part of ASEAN's internal development and poverty-reduction strategy. Future research should be carried out to assess the specific gains that ASEAN's poorer member states would reap from less stringent RoOs." The mention made in the report about the simplification of ASEAN rules of origin for textiles and apparel seems to ignore the fact that ASEAN rules of origin in that sector have been substantially liberalized in 1995, adopting single transformation as discussed in section 5.3.1.2.

The ASEAN Secretariat of 2004, summarizing the progressive establishment of AFTA, reported the following:

> In an effort to improve and strengthen the rules governing the implementation of the CEPT Scheme, to make the Scheme more attractive to regional businessmen and prospective investors, the CEPT Rules of Origin and its Operational Certification Procedures have been revised and implemented since 1 January 2004. Among the features of the revised CEPT Rules of Origin and Operational Certification Procedures include:
>
> (a) a standardized method of calculating local/ASEAN content;
> (b) a set of principles for determining the cost of ASEAN origin and the guidelines for costing methodologies;
> (c) treatment of locally-procured materials;[126] and
> (d) improved verification process, including on-site verification.
>
> In order to promote greater utilization of the CEPT AFTA Scheme, substantial transformation has also been adopted as an alternative rule in determining origin for CEPT products. The Task Force on the CEPT Rules of Origin is currently working out substantial transformation rules for certain product sectors, including wheat flour, iron and steel and the 11 priority integration sectors covered under the Bali Concord II.

Furthermore, the ASEAN Roadmap for an ASEAN Community 2009–2015[127] contained a reiterated call for simplification and improved rules of origin:

> Putting in place ROO which are responsive to the dynamic changes in global production processes so as to: facilitate trade and investment among ASEAN Member Countries; promote a regional production network; encourage development of SMEs and the narrowing of development gaps; and promote the increased usage of the AFTA CEPT Scheme.
>
> Actions:
>
> i. Continuously reform and enhance the CEPT ROO to respond to changes in regional production processes, including making necessary adjustments such as the introduction of advance rulings and improvements to the ROO;
> ii. Simplify the Operational Certification Procedures for the CEPT ROO and ensure its continuous enhancement, including the introduction of facilitative processes such as the electronic processing of certificates of origin, and harmonisation or alignment of national procedures to the extent possible; and

[126] The definition of what locally procured materials are is unclear. A reference is found in ATIGA but it does not provide a definition: "For locally-procured materials, self-declaration by the final manufacturer exporting under this Agreement shall be used as a basis when applying for the issuance of the Certificate of Origin."

[127] www.asean.org/storage/images/ASEAN_RTK_2014/2_Roadmap_for_ASEAN_Community_20092015.pdf.

iii. Review all the ROO implemented by ASEAN Member Countries, individually and collectively, and explore possible cumulation mechanisms, where possible

The call for improved ASEAN rules of origin is finally reiterated in the new ASEAN Economic Community Blueprint 2025:[128]

ii. Simplify and Strengthen the Implementation of the Rules of Origin (ROO). ROO implemented by ASEAN Member States should be simplified, business-friendly and trade-facilitative, to benefit the region's trade, in particular the participation of MSMEs to encourage them to expand, upgrade, and deepen their linkages within the region. Towards this end, priority sectors for Product Specific Rules (PSRs) can be negotiated, and processes for the determination of origin criteria streamlined.

Such persistent failure in addressing the shortcomings of ASEAN rules of origin is the result of, on one hand, a consistent allergy to drawing from the lessons learned in ASEAN and in other regions and, on the other hand, a lack of capacity to draft predictable and transparent legal texts on rules of origin.

Notwithstanding its domestic failures in addressing rules of origin, ASEAN has tried to export its model of rules of origin when negotiating bilateral or plurilateral free-trade agreements with the so-called ASEAN dialogue partners, again with meager results. As discussed below only the free-trade agreements with China and India reflect the shortcomings of the ASEAN rules of origin while the other free-trade agreements negotiated by ASEAN with Japan, Korea, and Australia/New Zealand reflect the rules of origin models of these respective ASEAN partners[129] or mix of both models. An early version, and the final version, of the RCEP[130] also shows that ASEAN has not changed strategy in most recent trade negotiations.

In this section the successive evolution of the ASEAN rules of origin from the inception to the later formulation in ATIGA will be analyzed, including the now almost thirty years of efforts to improve such rules of origin as well as the flourishing of different sets of rules of origin that ASEAN is confronting today in the free-trade agreements entered into with its trading partners.

For firms, the tariff liberalization emerging from free-trade agreements takes place at the time of customs clearance and it is subject to compliance with RoO requirements. These requirements are both of a *substantive* nature (namely, the imported product complies with the specific RoO requirements in the partner country) and of a *formal* nature (namely, documentary evidence such as a CO demonstrating that a product is originating). Unless these requirements are met the products will be

[128] www.asean.org/storage/2016/03/AECBP_2025r_FINAL.pdf.

[129] To the extent that, as one ASEAN member states official defined it to the author, ASEAN officials had been *brainwashed* during the negotiations of the FTA agreement with Australia and New Zealand on the use of CTC as a preferred method of drafting rules of origin.

[130] Made available to the author in June 2019.

charged the full most-favored nation (MFN) rate of custom duty instead of the duty free or reduced rate of customs duty.

As discussed in Chapter 4 of this book, stringent rules of origin and cumbersome administrative procedures have a decisive impact on utilization of trade preferences.[131] The recent reform of rules of origin in the EU has been driven by studies that identified a strict and direct correlation between stringency of rules of origin and underutilization of trade preferences.[132] As a result the EU has significantly liberalized its rules of origin under the EU GSP program[133] and adapted the rules of origin by progressively tailoring them further according to the different trading partners[134]

A stream of studies have also been carried out, specifically in East Asia, on the utilization of ASEAN free-trade agreements by Asian firms, in particular by Japanese firms.[135] The results of these studies shows that particularly in East Asia, the rate of free-trade agreement utilization remains at a fairly low level for a number of reasons.[136] A study pointed out that Japanese firms and their affiliates operating in ASEAN are not well aware of free-trade agreements.[137] Under this study the utilization of AFTA measured by the ratio of AFTA administrative records to total exports was low, at around 15 to 20 percent, during the period 2003–2006. The utilization rate on the import side was around 11 to 16 percent, lower than the corresponding rate for the export side.

Table 5.9, excerpted from a study and drawn from data collected from a questionnaire, corroborates the findings of these studies about low utilization of the trade preferences under free-trade agreements.[138] In the context of these results it has to be

[131] See for an analysis of the utilization rates in unilateral trade preferences and effects of restrictive rules of origin, UNCTAD, "Erosion of Trade preferences in the Post Hong Kong (China) Framework," in *From "Trade Is Better Than Aid" to "Aid for Trade"*, UN, 2007; "Trade Preferences for LDCs: An Early Assessment of Benefits and Possible Improvements," UNCTAD/ITCD/TSB/2003/8, 2003; "Market Access for Least Developed Countries," UNCTAD/DITC/TNCD/2019/1, 2020; "Challenges faced by LDCs in complying with preferential rules of origin under unilateral schemes," paper presented by Uganda on behalf of the LDCs Group, G/RO/W/148, October 2014; UNCTAD and Swedish Board of Trade, "The use of the EU's free trade agreements – exporter and importer utilization of preferential tariffs," 2018.

[132] See European Commission, "Impact assessment on rules of origin for the Generalized System of Preference (GSP)" (2007).

[133] See S. Inama, "The reform of the EC GSP rules of origin: *Per aspera ad astra*?," *Journal of World Trade*, vol. 45, no. 3 (2011), 577–603.

[134] See Chapter 3 of this book.

[135] K. Hayakawa, D. Hiratsuka, S. Shiino, and S. Sukegama, "Who uses free trade agreements?," *Asian Economic Journal*, vol. 27, no. 3 (2007), 219–321; E. M. Medalla and J. Balboa, "ASEAN rules of origin: Lessons and recommendations for best practice," ERIA Discussion Paper Series, 2009.

[136] See both titles cited in the previous footnote.

[137] D. Hiratsuka, I. Isono, H. Sato, and S. Umezaki, "Escaping from FTA trap and spaghetti bowl problem in East Asia: An insight from the enterprise survey in Japan," in H. Soesastro (ed.), *Deepening Economic Integration in East Asia: The ASEAN Economic Community and Beyond*, ERIA, 2007.

[138] See Hayakawa et al., "Who uses free trade agreements?" (fn. 135 above).

TABLE 5.9 *Utilization of free-trade agreements*

	Use by exporters	Intend to use	No intention to use	Use by importers	Intend to use	No intention to use
ASEAN	27%	27%	46%	23%	27%	50%
Indonesia	43%	22%	35%	33%	34%	33%
Malaysia	26%	19%	55%	20%	34%	59%
Philippines	14%	29%	57%	8%	21%	71%
Singapore	46%	17%	37%			
Thailand	26%	31%	43%	28%	29%	43%
Vietnam	12%	35%	53%	14%	28%	58%

Note: "Use" refers to the share of affiliates that are already using free-trade agreements; "Intend to use" refers to the share of affiliates that are now not using but are considering the use of free-trade agreements; and "No intention to use" refers to the share of affiliates that are now not using and are not going to use free-trade agreements. The figures in Singaporean imports are not available since the general tariff rates are already zero or quite low in Singapore.
Source: Survey of Japanese-affiliated firms in ASEAN, India, and Oceania.

noted that the higher utilization rates are achieved by exporters from Singapore, perhaps due to a better management of exports procedures and issuance of COs. The lowest utilization is recorded by the Philippines (14 percent by exporters) and Vietnam (12 percent for exporters) and for importers the same countries show a utilization rate as low as 8 percent for the Philippines and 14 percent for Vietnam.

The authors of the abovementioned study conclude that the reasons why free-trade agreement utilization in East Asia is low by international standards is mainly due to the following:

(1) The use of investment incentive schemes in ASEAN obviate the use of the free-trade agreement preferences. According to the authors, Japanese affiliates established in ASEAN countries do not need to use free-trade agreement schemes in order to import inputs at zero tariff rates since they benefit from investment schemes such as the ASEAN Industrial Cooperation (AICO) scheme, which allowed for application of fully liberalized tariff rates ahead of the region-wide application of such rates in 2010.
(2) The major trade in ASEAN for Japanese firms is in the electrical machinery industry, where MFN tariff rates are already low.
(3) The costs of complying with rules of origin requirements are prohibitive, for example the administrative costs resulting from the cumbersome procedures for obtaining a CO.

Concerning the main reason under (1) above, it has to be noted that while this could be the case for Japanese affiliates, investment schemes often do not apply to local firms

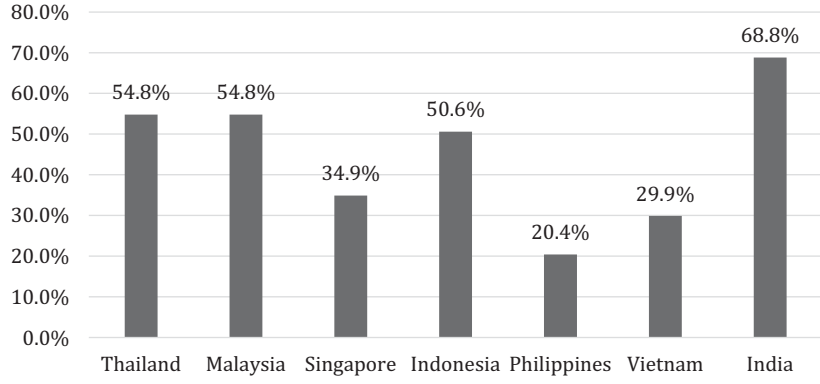


FIGURE 5.1 The ratio of Japanese companies meeting the 40% ASEAN content
Source: Japanese-Affiliated Manufacturers in Asia – Survey 2003, JETRO.

that may be penalized in this respect. At the same time such benefits are allowed for imported inputs and not on exports and are often tied up with a limited time frame. In any event, the AICO scheme lost its practical significance when the CEPT rates went into full effect in 2010 and the AICO scheme was terminated in 2011.

Concerning the second reason under (2) above, this may be true for electronics but not for sectors such as automotive for instance. A study of the ASEAN automotive industry showed that, based on ASEAN intra-trade, the maximum duty cost applying MFN rates to intra-ASEAN trade is about 1.9 billion USD while, applying the CEPT rate, the minimum duty cost would be reduced to about 165 million USD per annum.[139] This finding shows that MFN rates of duties in certain industrial sectors remain quite high and the scope of potential preferential tariff treatment and savings is therefore significant.

A study[140] based on surveys and questionnaires found that Japanese companies using CEPT preferences were able to meet the 40 percent ASEAN content requirement. However the same study identified a number of companies that had difficulties in meeting this requirement in ASEAN – especially in the Philippines and Malaysia with significantly lower abilities to meet it – as shown in Figure 5.1. These Japanese companies reported that it was difficult to locally procure materials to meet the 40 percent requirement given the scarce or nonavailability of originating inputs made by local supporting industries.

The fact that ASEAN preferences are consistently underutilized is further corroborated by ASEAN official reports. Although not stated in clear terms or highlighted

[139] See "ASEAN–EU Programme for Regional Integration Support Phase II, Pilot Sector Study on Rules of Origin to Facilitate the Integration of ASEAN Production Networks," unpublished report, 2010.

[140] ASEAN's FTAs and Rules of Origin, November 2004, Japan External Trade Organization Overseas Research Department.

as a major source of concern in the policy section of the Report, the most compelling evidence and official recognition of the underutilization of ASEAN preferences comes from the record of the Senior Economic Officials (SEOM) Chairman's Report to the AEM Twenty-fifth AFTA Council Meeting, held in August 2011. At that meeting, ASEAN member states submitted their data on Form D imports for the period of 2010, summarized in the report as follows (data are reported in Table 5.10):

> Based on the available data for the year 2010, it was found that the shares of Form D imports in intra-ASEAN are 3.34%, 47.1%, 18.98%, 3.44%, 11.089%, 0.49%, 41.15%, 22.6% and 13.44% for Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, Thailand and Viet Nam, respectively.

This extremely low utilization average of ASEAN – with major ASEAN trading member states like Indonesia, Malaysia, and Thailand recording utilization rates as low as 19, 11, and 23 percent after more eighteen years of existence of the CEPT – did not make a headline in the policy part of the SEOM report.

This utilization of ATIGA is extremely low by any international standards. By comparison, the NAFTA utilization rate by Mexican exports to the United States was around 60 percent in 2004–2005. Even utilization rates of least-developed countries (LDCs), the poorest countries of the world to the quadrilateral (QUAD: the EU, United States, Japan, and Canada) preference-giving countries, in the period 1994–2001 was found to exceed an average of 50 percent utilization, which is significantly higher than those of AFTA.[141] As contained in a recent study,[142] the utilization rate of EU free-trade agreements is around 90 percent.

Instead of seriously considering such low utilization rates, the SEOM in the same report discussed how to improve the notification procedures of the specimen signature of the customs officials in charge of signing the CO by hand. This has been an archaic and obsolete procedure that had been eliminated in the GSP Form A in the mid-1980s and that is not even requested anymore in unilateral preferences like the GSP. Only recently has ASEAN considered a pilot scheme for self-certification and the introduction of E-COs. This issue is further discussed in Chapter 7.

The ASEAN Secretariat should be tasked with gathering the utilization rates from ASEAN members with a view to establishing a database, together with yearly research and monitoring of the utilization rates of ATIGA and ASEAN free-trade agreements with dialogue partners. Such analysis should lead to reform of ASEAN rules of origin and a progressive rationalization of the administrative procedures of the ASEAN free-trade agreements with dialogue partners. However, discussions by the author with ASEAN Secretariat officials indicate that there is no consensus

[141] See UNCTAD, Trade Preferences for LDCs.

[142] UNCTAD and Swedish Board of Trade, "The use of the EU's free trade agreements – exporter and importer utilization of preferential tariffs," 2018.

TABLE 5.10 *Utilization rates of ASEAN free-trade agreements (2010)*

Ctry		Import from BRN	KHM	IDN	LAO	MYS	MMR	PHL	SGP	THA	VNM	Total
BRN	Form D			5,973		6,717		371	2,927	3,088	448	19,523
(Jan.–Jun.)	Intra-ASEAN		7	25,420		260,819	77	2,671	235,309	57,844	2,398	584,545
	Share (%)		0.00	23.50		2.58	0.00	13.90	1.24	5.34	18.67	3.34
KHM	Form D											792,323
(Jan.–Dec.)	Intra-ASEAN											1,682,043
	Share (%)											47.10
IDN	Form D		486		189	1,652,923	27,617	234,103	997,932	4,184,024	287,879	7,385,151
(Jan.–Dec.)	Intra-ASEAN	666,184	4,726		616	8,648,721	31,847	706,243	20,240,831	7,470,735	1,142,267	38,912,170
	Share (%)		10.27		30.67	19.11	86.72	33.15	4.93	56.01	25.20	18.98
LAO	Form D			65					8	13,816	25	13,913
(Jan.–Mar.)	Intra-ASEAN		10	4,792		282		108	4,900	364,649	29,429	404,170
	Share (%)		0.00	1.35		0.00		0.00	0.16	3.79	0.09	3.44
MYS	Form D											4,975,795
(Jan.–Dec.)	Intra-ASEAN											44,907,211
	Share (%)											11.08
MMR	Form D			981		1,445			534	6,704	152	9,815
(Jan-Dec)	Intra-ASEAN	27	132	203,332	15	135,153	489	14,041	1,126,095	475,806	38,081	1,993,171
	Share (%)	0.00	0.00	0.48	0.00	1.07	0.00	0.00	0.05	1.41	0.40	0.49
PHL	Form D	5,421		1,695,214		951,403	10,338		1,038,971	2,782,749	210,320	6,694,417

(Jan.–Dec.)	Intra-ASEAN	2,912	2,696	2,399,713	12	2,562,475	13,378		5,439,478	4,098,377	1,750,771	16,269,811
	Share (%)	186.17	0.00	70.64	0.00	37.13	77.27		19.10	67.90	12.01	41.15
THA	Form D		30,617	1,733,451	241,198	1,272,193	29,531	798,228	670,579		349,944	5,125,741
(Jan.–Sep.)	Intra-ASEAN	55,608	161,974	4,182,901	531,836	8,059,766	2,076,921	1,741,809	4,835,424		1,034,432	22,680,671
	Share (%)	0.00	18.90	41.44	45.35	15.78	1.42	45.83	13.87		33.83	22.60
VNM	Form D		25,385	168,447		199,751	2,286	35,533	85,372	502,639		1,019,413
(Jan.–Jun.)	Intra-ASEAN	601	134,148	794,350	121,891	1,573,008	52,354	328,249	2,046,370	2,535,664		7,586,635
	Share (%)	0.00	18.92	21.21	0.00	12.70	4.37	10.83	4.17	19.82		13.44

Note: Figures in thousands of US dollars
Source: SEOM Chairman's Report to the AEM Twenty-fifth AFTA Council Meeting, August 10, 2011, Manado, Indonesia.

among ASEAN member states in making public the figures on utilization and there is even less appetite to allow the ASEAN Secretariat to establish a database and conduct research. Moreover, there is a denial mode existing among ASEAN officials who refuse to acknowledge the low utilization of Asean trade preferences.[143]

Streamlining the existing overlapping sets of rules of origin and administrative procedures should be a priority for ASEAN. Efforts should be devised at ASEAN level to seek a cohesive strategy toward other partners and internally in ASEAN to introduce reforms in rules of origin aimed at facilitating compliance of production networks in the East Asian region. The absence of clear and unambiguous rules of origin has frustrated the intra-industry trade flows of the fastest trade-growing region of the world for more than three decades.[144]

A factor that makes negotiations of rules of origin difficult in ASEAN is that customs authorities do not play significant roles during the negotiations on the substantive aspects of rules of origin, with the trade or foreign affairs ministries assuming the major negotiation roles. As a result, the substantive requirements of the rules of origin are negotiated among trade officials with inputs, in some cases, from the private sector. This might be one of the reasons for the poor technical quality of the substantive rules of origin in ASEAN.

Practical experience and exchange of views indicated that many customs authorities' attention in Asia was on focusing upon the verification of certificates of origin and other rather mechanical aspects of the agreements. Little interest was paid to the substantive aspects of the rules and how to shape and draft product-specific rules of origin (PSRO).

Much remains to be done to increase transparency and predictability even in the aspects of certification and administrative requirement as contained in Chapter 7.

5.3.1.1 The Initial Set of ASEAN Rules of Origin: 1992–1995

5.3.1.1.1 THE AD VALOREM PERCENTAGE CALCULATION. The original AFTA rules of origin consisted of eight main rules (i.e. articles) and two annexes detailing with some calculation methods and twenty-three separate rules concerning operational certification procedures (OCPs) for the rules of origin of the CEPT scheme for the AFTA. The overall result was that the original AFTA rules focused more on the administrative aspects rather than on the substantive rules of origin requirements per se.

[143] As discussed in Chapter 4 of this book, the tendency to dismiss the value of utilization rates as a measure of the effectiveness of rules of origin is not unique to ASEAN officials.

[144] S. Inama, "The ASEAN–China free trade agreement: Negotiating beyond eternity with little trade liberalization?," *Journal of World Trade*, vol. 39, no. 3 (2005), 559–579.

RULES OF ORIGIN FOR THE CEPT SCHEME FOR AFTA

(endorsed by the 17th AFTA Council)

RULE 3 Not Wholly Produced or Obtained

(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-procured 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 I (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:

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

(c) The method of calculating local/ASEAN content is as set out in Annex A of this Rules. The principles to determine cost for ASEAN origin and the guidelines for costing methodologies in Annex B shall also be closely adhered to.

As can be seen from Rule 3 in this extract, the drafting of the original AFTA rules was rather ambiguous and contained a number of provisions and wording that left too much space for interpretation and little guidance to the various actors, be they customs or private sector, who have to implement this rule. Neither the various elements nor the definitions of the rules were laid down in a sequential manner.

For instance, the first paragraph (a)(i) stipulated that a product is originating "if at least 40% of its content originates from any Member States." This provision did not further specify what are the criteria for determining and calculating such 40 percent local content, nor there was an indication of the denominator to calculate this percentage. Moreover, the words "from any Member States" suggested a situation where the local content may originate in different member states and may be added up together to reach the required figure of 40 percent. Finally, there was no definition of what could be considered local content, which is a very vague concept unless properly defined.

The formula contained in paragraph (b)(ii) does not provide any clarification to the definition of local content since it is expressed indirectly. It requires that the amount of third-country material or undetermined origin should not exceed 60 percent of the FOB price.

Annexes A and B mentioned in paragraph (c) and attached to the AFTA rules shed some partial light on the definition of some of the elements and method of calculation of the ASEAN rules of origin. Only from the wording of Annex A, reproduced below, was the reader made aware of the existence of two ways of calculating the required local/ASEAN content: the *direct* and the *indirect* method. The direct method is an *addition* method, whereby qualifying content is added up to determine whether the 40 percent threshold is met. Singapore, Indonesia, Laos and Myanmar used this method.[145]

The indirect method is a deductive method, whereby non-qualifying content is deducted from the value of the finished good; the finished good qualified as ASEAN origin if the total of the non-qualifying content did not exceed 60 percent. Thailand, Malaysia, the Philippines, Brunei, and Vietnam used this method.

Annex A further stipulated that ASEAN member countries should adhere to only one method of calculation: either direct or indirect. However, the same Annex A did not contain the formula or additional elements that were needed for the calculations of the direct method.

In fact, Annex A did not expressly provide a method of calculation of local content and it was limited to defining the elements of the FOB price, ex-factory price, and production costs.

For instance, one may wonder whether, under this definition of local content, labor incurred in one or more ASEAN countries could be counted as a numerator to reach the 40 percent requirement or whether only material inputs obtained in different ASEAN countries could be cumulated.

[145] These different methods of calculations among different ASEAN member states was only known in ASEAN circles and was not made publicly available for years, nor did it appear in official legislation.

ANNEX A

METHOD OF CALCULATION OF LOCAL/ASEAN CONTENT

1. Member Countries shall adhere to only one method of calculating local/ASEAN content, i.e. whether it is the direct or indirect method, although Member Countries shall not be prevented from changing their method, if deemed necessary. Any change in the calculation method shall be notified to the AFTA Council Meeting.
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 + Labor Cost + Overhead Cost
      ii. Raw Materials shall consist of:
         • Cost of raw materials
         • Freight and insurance
      iii. Labor 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 buildings, repair and maintenance, taxes, interests on mortgage)
         • leasing of and interest payments for plant and equipment
         • factory security

Annex B, reproduced below, does not provide additional guidance on defining the numerator for the direct method but rather provides some principles and guidelines. In the absence of clear rules defining the numerators, it is only by interpretation that one may get to the conclusion that the applicable formula for the direct method could be as follows:

$$\frac{ASEAN\ RM + Labor + Overhead + Profit + Other\ Costs}{FOB} \times 100 > 40\%$$

ANNEX B

PRINCIPLES AND GUIDELINES ON THE CEPT-AFTA RULES OF ORIGIN

A. Principles to Determine Cost for ASEAN Origin
   i. Materiality – all cost material to the evaluation, assessment and determination of origin;
   ii. Consistency – costing allocation method should be consistent unless justified by commercial reality;
   iii. Reliability – costing information must be reliability and supported by appropriate information;
   iv. Relevance – costs must be allocated based on objective and quantifiable data;
   v. Accuracy – costing methodology should provide an accurate representation of the cost element in question;
   vi. Application of GAAP of the exporting country – costing information must be prepared based in accordance with the general accepted accounting principles and this includes the avoidance of double-counting of cost items;
   vii. Currency – updated costing information from existing accounting and costing records of companies should be used to calculate origin.

1. Guidelines for Costing Methodologies
   i. Actual Costs – basis for actual costs should be defined by the company. Actual costs should include all direct and indirect costs incurred in producing the product.
   ii. Projected and Budgeted Costs – projected costs may be used if it is justified. Companies should provide variance analysis and proof during the period origin is claimed to indicate accuracy of projections.
   iii. Standards Costs – the basis for standards costs should be indicated. Companies should provide evidence that the costs are used for accounting purposes.
   iv. Average/Moving Average Costs – average costs may be used if justified; the basis for calculating average costs, including time, etc. should be highlighted. Companies should provide variance analysis and proof during the period origin is claimed to indicate accuracy of average costs.
   v. Fixed Costs – fixed costs should be apportioned according to sound cost accounting principles. They should be a representative reflection of unit costs for the company in the particular period in question. The method for apportionment should be indicated.

At the same time there was no definition for the "locally-procured materials" mentioned under Rule 3(a)(ii). Should this provision be interpreted as meaning that any material locally sourced will be deemed to be originating? How can this provision be reconciled with the concept of origin?

Apparently, this provision was meant to be accompanied by a list of ASEAN companies nominated by the respective ASEAN member states producing inputs and intermediate materials deemed to be locally produced materials. However, such list was not public or at least not posted in the ASEAN website. Apparently, such list has been part of the 2004 package mentioned above to reform CEPT rules of origin. Yet recent searches have proved ineffective in finding a copy of such a list. Moreover, such unclear provision has also found its place in ATIGA without further specification to make it effective.

Cumulation Experience has shown that implementation of the calculation guidelines laid down in these two annexes has not been an easy task in ASEAN. The cumulation rules as contained in Rule 4 were not any easier to administer, given the uncertain drafting:

> RULE 4 CUMULATIVE RULES OF ORIGIN
>
> (a) Products which comply with origin requirements provided 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%.
> (b) If the material has less than 40% ASEAN content, the qualifying ASEAN national content shall be in direct proportion to the actual domestic content provided that it is equal to or more than the agreed threshold of 20%.

It is quite evident that it was difficult to define the methodology of the calculation for cumulation purposes. In fact, there was no definition of what could be counted toward the 40 percent aggregate ASEAN content.

Paragraph (b) of Rule 4 did not provide any further guidance because it was not clear what was the qualifying ASEAN national content in respect to the *actual domestic content*. An explanatory note was added to Rule 4 to better explain the functioning of cumulation in the ASEAN context:

> To be considered for partial cumulation, the local/ASEAN content of the materials, parts or produce originating from the country of last manufacture should not be less than 20 percent;
>
> . . .
>
> (b) the formula to be used in the calculation would be similar to the formula for calculating the 40 percent local/ASEAN content;
> (c) no CEPT preference shall be extended by the importing member country for that particular intermediate good;

Considering this drafting of the AFTA rules of origin, it was not surprising that there have been bitter disputes among ASEAN member states over the interpretation and implementation of AFTA rules. These disputes were never made public, in typical ASEAN fashion, but the Thailand/Singapore discussions over the application of the percentage criterion to flour and the issue of whisky from the Philippines were widely known to practitioners.

Absorption/Roll-up As discussed in Chapter 3 of this book, most free-trade agreements (e.g. all EU and US free-trade agreements) contain provisions to regulate the origin of intermediate products (US jargon), also known as "roll-up" or the "absorption principle" (EU jargon). This notion covers the principle that once an intermediate material has acquired originating status by fulfilling the applicable origin criteria, any non-originating materials used in its production will not be taken into account when the product is used as a material in the manufacture of another product.

AFTA did not explicitly incorporate roll-up, but it was an ASEAN practice to accept the principle although the concept was often confused with cumulation. Yet whether or not such a principle is applied has substantial consequences for the outcome of an origin determination process, as illustrated in the following example.

Assume that 40 percent ASEAN value is sufficient to confer ASEAN-origin for a final product, and assume that the final product consists of three components, A, B, and C.

Item	% ASEAN origin	Value
Component A	50%	100
Component B	40%	200
Component C	0%	200
Total		500

With a roll-up rule, A and B items would be considered of ASEAN origin, as they met the 40 percent value-added rule. This would mean that for purposes of determining the origin of the final product, components A and B would be considered of 100 percent ASEAN origin – the assumption would be that qualifying for ASEAN origin at the component level would have the effect of absorbing component C, conferring ASEAN origin on the overall finished product:

Item	% ASEAN origin	Value	After roll-up
Component A	50%	100 USD	100 USD ASEAN origin
Component B	40%	200 USD	200 USD ASEAN origin
Component C	0%	200 USD	0 USD ASEAN origin
Total		**500 USD**	**300 USD ASEAN origin, or 60% (300/500 USD)**

Hence the final product would be considered as ASEAN origin.

However, without a roll-up rule, the final product would be considered not of ASEAN origin according to the calculation below:

Item	% ASEAN origin	Value	No roll-up
Component A	50%	100 USD	50 USD ASEAN origin (**50% 100 USD**)
Component B	40%	200 USD	80 USD ASEAN origin (40% 200 USD)
Component C	0%	200 USD	0 USD ASEAN origin
Total		**500 USD**	**130 USD ASEAN origin, or 26% (130/500 USD)**

Hence the roll-up concept has a significant effect on the origin calculation. Note that the roll-up rule cannot be the same as cumulation since the roll-up rule does not require that the goods cross a border. Rather, the application of the roll-up rule depends on when a good becomes incorporated into the production of a further processed good, which can take place even within the same production facility.

Rule 4 of the AFTA rule of origin provided for cumulation when an ASEAN good crosses the border for incorporation into the finished product in another ASEAN member state. This concept of cumulation being conditional upon crossing national borders was brought forward into Article 30 of ATIGA:

ARTICLE 30 ACCUMULATION

1. Unless otherwise provided in this Agreement, goods originating in a Member State, which are used in another Member State as materials for finished goods eligible for preferential tariff treatment, shall be considered to be originating in the latter Member State where working or processing of the finished goods has taken place.

ASEAN customs officials have indicated that the roll-up concept (without requiring crossing a border) is incorporated into ATIGA by way of Article 54.2, which is a general article stating that:

> Customs procedures of Member States shall, where possible and to the extent permitted by their respective customs law, conform to standards and recommended practices of the World Customs Organisation and other international organisations as relevant to customs.

However, recommended practices of the World Customs Organization (WCO) do not explicitly provide for any guidelines on the roll-up text and practices of major trading nations such as the United States and EU differ in the way and substance of application of the roll-up rule.

In short, ATIGA does not contain any specific rules on the issue of roll-up, leaving a conspicuous loophole in the ATIGA rules of origin that ASEAN national customs officers can interpret at their will.

This tendency of ASEAN legal texts, to leave unsettled important issues, is revealing of the reluctance or inability to provide transparent and predictable rules of origin aimed at ensuring legal certainty and a better utilization of ATIGA.

5.3.1.2 Introduction of Alternative Rules of Origin: 1995–2000

As a conspicuous sign of the difficulties in determining origin according to the vaguely defined ASEAN percentage criterion in the previous section, ancillary product-specific rules were adopted in the area of textiles and textile products by the Seventh AFTA Council held in 1995:

> 1. Recognizing that the existing percentage criterion of the CEPT Rules of Origin may not be conducive towards the objective of increasing intra-ASEAN trade in textiles and textile products, the 7th AFTA Council at its meeting on 6th September 1995 decided that for the purpose of origin determination of textiles and textile products either the percentage or the substantial transformation criterion can be used by the exporting country. The 7th AFTA Council also decided that an ASEAN Single List identifying the processes for each of the textile and textile products shall be formulated to administer the substantial transformation criterion.
>
> 2. When an exporting country chooses to apply the substantial transformation criterion, the following rules of origin shall apply. The rules of origin should be read in conjunction with the attached ASEAN Single List.

It has to be observed that, according to the ASEAN single list and unlike the EU rules of origin model, the across-the-board general percentage rules continued to

apply together with the product-specific rules contained in the single list. In fact, the above text explicitly mentioned that the percentage or the substantial transformation criterion could be adopted. This implied that the exporting country had the option to choose to adopt the percentage or the *substantial transformation* criterion.

The introduction of the *substantial transformation criterion* provides an example of a terminology issue. In fact, ASEAN officials and official documents referred to the rules on textiles and clothing as adopting the substantial transformation criterion[146] as an alternative to the percentage transformation criterion.

As discussed in Chapter 1 of this book, and contained in the WTO agreement on rules of origin and Annex K of the revised Kyoto Convention, the term "substantial transformation" is a general criterion that has to be further technically defined and expressed by the adoption of different methodologies to determine origin, which could be:

(a) the CTC
(b) ad valorem percentages under the revised Annex K of the Kyoto Convention 2000 and
(c) specific manufacturing or processing operations as contained in Article 9(2)(c)(iii) of the WTO agreement.

Thus, it is multilaterally accepted that "substantial transformation criterion" is not an alternative to the ad valorem percentage but is a general definition that is based on the different methodologies that can be used to determine if substantial transformation has taken place.

This terminology problem was so deeply rooted in ASEAN that even the ASEAN Framework Agreement for the integration of priority sectors still refers in its Article 7(b) to "adopting substantial transformation as alternative criterion for conferring origin status."

In fairness, the introduction of the product-specific rules on textiles and clothing represented a trade liberalization effort, insofar as these rules provided for a single-stage transformation criterion on textiles and clothing, basically one stage – from yarn to fabric by weaving or knitting – and one stage – by cutting and making up from fabrics to finished garments. These rules were at that time far more liberal than the comparative rules in the EU demanding a double transformation – spinning and weaving for fabrics and weaving and making-up for finished products – and those under NAFTA demanding a triple transformation requirement. In addition, they

[146] The preamble to the textiles and clothing rules provides: "The 7th AFTA Council at its meeting on 6th September 1995 decided that for the purpose of origin determination of textiles and textile products either the percentage or the substantial transformation criterion can be used by the exporting country. The 7th AFTA Council also decided that an ASEAN single list identifying the processes for each of the textile and textile products shall be formulated to administer the substantial transformation criterion."

compared favorably with the 40 percent requirements of ASEAN rules since they were more predictable and easier to comply with.

5.3.1.3 The Introduction of Alternative PSRO: 2000–2009

As a result of industry complaints about the inaccessibility of AFTA benefits because of the rules of origin, ASEAN began studying alternative rules of origin in the early 2000s. This resulted in the decision by the AFTA Council in 2003 to adopt substantial transformation as an alternative rule of origin.

After several years of study and meetings, the ASEAN task force on rules of origin proposed that a dual RoO approach be used for certain products; such as both regional value content (RVC)[147] and substantial transformation through change of tariff classification expressed as change of chapter (CC), CTH, or change in tariff subheading (CTSH). The results of these efforts were consolidated in a large annex of product-specific rules of 166 pages and implemented in the second half of 2007 after adoption by the AFTA Council.

These were additional PSRO to those for textiles and clothing earlier adopted. The 2007 revision of ASEAN rules of origin subjected to PSRO products in nine priority sectors designated by the ASEAN Framework Agreement for the Integration of Priority Sectors, namely: (i) agro-based products; (ii) automotive; (iii) e-ASEAN; (iv) electronics; (v) fisheries; (vi) healthcare; (vii) rubber-based products; (viii) textiles and apparels; and (ix) wood-based products.

Product-specific rules were adopted for aluminum products of HS Chapter 76 (CTH with or without exceptions), steel products of HS Chapter 72 (CTH with exceptions, CC), wheat flour (CC), wood products of HS Chapter 44, and HS 94.01–94.03 and 94.06 (CTSH six-digits).

In the case of wheat flour and wood products, the product-specific rules were accompanied by a text explaining that these product-specific rules apply at the choice of the exporting country when *the substantial transformation criterion* is applied.

The techniques used in drafting these PSRO followed a rather predictable pattern. Almost all rules provided for an RVC and, as an alternative, a CTC that could take the form of change from another chapter:

> A regional value content of not less than 40 percent of the FOB value of the good; or Change to Subheading 1605.30 from any other Chapter.

Or a change from another heading:

> A regional value content of not less than 40 percent of the FOB value of the good; or Change to Subheading 2304.00 from any other Heading.

[147] According to some ASEAN officials, the main reason the RVC content of 40% was retained was that it used to be the main RoO of ASEAN.

Or a change from another subheading:

> A regional value content of not less than 40 percent of the FOB value of the good; or Change to Subheading 4409.10 from any other Subheading.

In the case of textiles and clothing from Chapter 50 to 63, a series of alternatives among the RVC, the CTC and a specific working or processing are provided as shown in the following example.

> A regional value content of not less than 40 percent of the FOB value of the good; or Change to Subheading 6105.10 from any other Chapter provided that the good is both cut and sewn in the territory of any Member State; or Process Rules for Textile and Textile Products as set out in Attachment 1.

Attachment 1 of the annex provided for specific one-stage working or processing operations such as the following:

> Working or Processing Carried Out on Non-Originating Materials that Confers Originating Status: Manufacture through the processes of cutting and assembly of parts into a complete article (for apparel and tents) and incorporating embroidery or embellishment or printing (for made-up articles) from:
> – raw or unbleached fabric
> – finished fabric

Attachment 2 of the annex contained definitions of RVC and substantial transformation.

In this attachment, the formula of RVC was defined as follows:

1. RVC of a good specified in Product Specific Rules shall be calculated in accordance with the following formula
   (a) Direct Method

$$\frac{\begin{matrix}\textit{ASEAN}\\ \textit{Material}\\ \textit{Cost}\end{matrix} + \begin{matrix}\textit{Direct}\\ \textit{Labour}\\ \textit{Cost}\end{matrix} + \begin{matrix}\textit{Direct}\\ \textit{Overhead}\\ \textit{Cost}\end{matrix} + \begin{matrix}\textit{Other}\\ \textit{Cost}\end{matrix} + \textit{Profit}}{\textit{FOB Price}} \times 100\%$$

   (b) Indirect Method

$$\frac{\textit{FOB Price} + \begin{matrix}\textit{Value of}\\ \textit{Non-originating materials,}\\ \textit{Parts or Produce}\end{matrix}}{\textit{FOB Price}} \times 100\%$$

For the purpose of calculating the regional value content provided in paragraph 1:

(a) The value of imported non-ASEAN 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.

(b) Labour cost shall include wages, remuneration and other employee benefits associated with the manufacturing process;

(c) The calculation of overhead cost shall include, but not limited to real property items associated with the production process (insurance, factory rent and leasing, depreciation on buildings, repair and maintenance, taxes, interests 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 good); 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 good or the right to manufacture the good); inspection and testing of materials and the goods; storage and handling in the factory; disposal of recyclable wastes; and cost elements in computing the value of raw materials, i.e. port and clearance charges and import duties paid for dutiable component; and

(d) FOB price means the free-on-board value of the good, inclusive of the cost of transport to the port or site of final shipment abroad. FOB price shall be determined by adding the value of materials, production cost, profit and other costs.

(e) Other costs 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.

The definition of substantial transformation contained in Attachment 2 was described as follows:

B. Substantial Transformation Criterion

1. A country of origin is that in which the last substantial transformation or process was performed resulting in a new product. Thus, materials which underwent a substantial transformation in a country shall be a product of that country.
2. A product in the production of which two or more countries are involved shall be regarded as originating in the country in which the last substantial transformation or process was performed, resulting in a new product.
3. A product will be considered to have undergone a substantial transformation or process if it has been transformed by means of substantial manufacturing or processing into a new and different article of commerce.

4. A new and different article of commerce will usually result from manufacturing or processing operations if there is a change in:
   i. Commercial designation or identity
   ii. Fundamental character, or
   iii. Commercial use
5. In determining whether a product has been subjected to substantial manufacturing or processing operations, the following will be considered:
   i. The physical change in the material or article as a result of the manufacturing or processing operations;
   ii. The time involved in the manufacturing or processing operations in the country in which they are performed;
   iii. The complexity of the manufacturing or processing operations in the country in which they are performed;
   iv. The level or degree of skill and/or technology required in the manufacturing or processing operations.

C. Specific Rules Applicable for Textile and Textile Products

1. Textile and Textile Products covered under this Rules are set out in Attachment 1.
2. Textile material or article shall be deemed to be originating in a Member State, when it has undergone, prior to the importation to another Member Sate, any of the following:
   i. Petrochemicals which have undergone the process of polymerization or polycondensation or any chemicals or physical processes to form a polymer;
   ii. Polymer which has undergone the process of melt spinning or extrusion to form a synthetic fiber;
   iii. Spinning fiber into yarn;
   iv. Weaving, knitting or otherwise forming fabric;
   v. Cutting fabric into parts and the assembly of those parts into a completed article;
   vi. Dyeing of fabric, if it is accompanied by any finishing operation which has the effect of rendering the dyed good directly;
   vii. Printing of fabric, if it is accompanied by any finishing operation which has the effect of rendering the printed good directly usable;
   viii. Impregnation or coating when such treatment leads to the manufacture of a new product falling within certain headings of customs tariffs;
   ix. Embroidery which represents at least five percent of the total area of the embroidered good.
3. Notwithstanding any provisions in the CEPT Rules of Origin, an article or material shall not be considered to be originating in the territory of a Member State by virtue of merely having undergone any of the following:

i. Simple combining operations, labelling, pressing, cleaning or dry cleaning or packaging operations, or any combination thereof;
ii. Cutting to length or width and hemming, stitching or over-locking fabrics which are readily identifiable as being intended for a particular commercial use;
iii. Trimming and/or joining together by sewing, looping, linking, attaching of accessory articles such as straps, bands, beads, cords, rings and eyelets;
iv. One or more finishing operations on yarns, fabrics or other textile articles, such as bleaching, waterproofing, decating, shrinking, mercerizing, or similar operations; or
v. Dyeing or printing of fabrics or yarns.

Overall, the period from 2000 to 2009[148] was marked by a series of texts on new versions of PSRO appearing in the ASEAN website with no clear indication of their legal status demonstrating the unpredictability of ASEAN rules of origin.

5.3.1.4 ATIGA and Beyond

ATIGA represents the culmination of the ASEAN revision of rules of origin that lasted almost a decade. While efforts have been undeniably deployed and improvements are present ATIGA still contains loopholes and drafting ambiguities.

The key RoO provisions of ATIGA are contained in Article 28. Paragraph I of Article 28 reproduced below contains across-the-board rules of origin with two alternatives: an RVC of 40 percent and a CTH.

A spontaneous comment arises on the significance of this rule since an RVC of 40 percent and CTH are not co-equal. Therefore depending on the product, the exporter will always choose the most lenient to the exclusion of the other; that is, an exporter of fish fillets of heading 03.04 carrying out filleting on imported fresh fish will not opt for the RVC of 40 percent since a CTH from headings 03.02 to 03.04 is sufficient to acquire origin. Thus, one alternative makes obsolete the other alternative since they are not co-equal in terms of stringency.

Paragraph (b) is a welcomed insertion in the main text since it clarifies that each ASEAN member state should leave the exporter free to choose the alternatives. However, it would have been advisable to complement this provision by adding that also the importer member states should accept the choice made by the exporter of other member states.

[148] The Trade Development Board of Singapore website still quoted until 2013 at least one of these earlier versions of rules of origin of 2008.

1. (a) For the purposes of Article 26(b), goods shall be deemed to be originating in the Member State where working or processing of the goods has taken place:
   (i) if the goods have a regional value content (hereinafter referred to as "ASEAN Value Content" or the "Regional Value Content (RVC)") of not less than forty percent (40%) calculated using the formula set out in Article 29; or
   (ii) if all non-originating materials used in the production of the goods have undergone a change in tariff classification (hereinafter referred to as "CTC") at four-digit level (i.e. a change in tariff heading) of the Harmonized System.
   (b) Each Member State shall permit the exporter of the good to decide whether to use paragraph 1(a)(i) or 1(a)(ii) of this Article when determining whether the goods qualify as originating goods of the Member State.

2. (a) Notwithstanding paragraph 1 of this Article, goods listed in Annex 3 shall qualify as originating goods if the goods satisfy the product specific rules set out therein.
   (b) Where a product specific rule provides a choice of rules from a RVC-based rule of origin, a CTC-based rule of origin, a specific manufacturing or processing operation, or a combination of any of these, each Member State shall permit the exporter of the goods to decide which rule to use in determining whether the goods qualify as originating goods of the Member State.
   (c) Where product specific rules specify a certain RVC, it is required that the RVC of a good is calculated using the formula set out in Article 29.
   (d) Where product specific rules requiring that the materials used have undergone CTC or a specific manufacturing or processing operation, the rules shall apply only to non-originating materials.

Paragraph 2 above introduces the PSRO exceptions to the general rule of paragraph 1. Once again, and as previously pointed out in the analysis of the ASEAN legal texts, it is not entirely clear from the text under (a) if the PSRO under Annex 3 are to be applied as an exception to the general rule and therefore as the only applicable criteria or if they are to be understood as additional criteria to the general rule.[149] This loophole is enough to seriously question the overall efforts of consolidation of ATIGA.

[149] In the absence of a clear direction from the legal text, different answers are provided depending on the ASEAN websites consulted. The Malaysian Ministry of Trade seems to suggests that the PSRO are additional to the general rules. The majority of the websites are of a generic nature and do not address or clarify the relation between the general rules and the product-specific rules.

The ATIGA list of PSRO covers all products at six digit from HS Chapter 1 (live animals) to Chapter 96 (miscellaneous), with exclusion of Chapter 97 (works of art), and is 283 pages long. Since the coverage of ATIGA PSRO extends to all products except works of art one may wonder what is the respective scope of application of the general rules contained in paragraph (1) of Article 28 and the PSRO contained in paragraph 2 of the same article.

> 3. Notwithstanding paragraphs 1 and 2 of this Article, a good which is covered by Attachment A or B of the Ministerial Declaration on Trade in Information Technology Products adopted in the Ministerial Conference of the WTO on 13 December 1996, set out as Annex 4, shall be deemed to be originating in a Member State if it is assembled from materials covered under the same Annex.

Adding to the proliferation of alternative rules for the same products, paragraph 3 of Article 28 provides that for products covered by the Information Technology Agreement (ITA) assembly operations carried out on materials covered by same ITA is origin conferring. The definition of what could be considered assembled is not further defined in ATIGA.

Article 29 of ATIGA provides for the calculation method of the RVC and is basically a replica of what was contained in previous text circulated in the period 2000–2009 and reproduced above under attachment 2 of the previous rules of origin. The drafting of ATIGA Article 29 provided an excellent opportunity to impart clarity to the percentage calculation of ASEAN rules of origin by eliminating the direct calculation method that has proved to be difficult to administer.

Article 30 of ATIGA deals with cumulation, adding more clarity in the text by incorporating the implementing guidelines.

> ARTICLE 30. ACCUMULATION
>
> 1. Unless otherwise provided in this Agreement, goods originating in a Member State, which are used in another Member State as materials for finished goods eligible for preferential tariff treatment, shall be considered to be originating in the latter Member State where working or processing of the finished goods has taken place.
> 2. If the RVC of the material is less than forty percent (40%), the qualifying ASEAN Value Content to be cumulated using the RVC criterion shall be in direct proportion to the actual domestic content provided that it is equal to or more than twenty percent (20%). The Implementing Guidelines are set out in Annex 6.

A thorough evaluation of ATIGA and its functioning has yet to be carried out. However, the comments raised above cast serious doubts over the ability of the

present ATIGA text to fill the previous gaps of CEPT-AFTA rules of origin and the subsequent developments.

As outlined in the following pages, questions have already arisen and implementation issues are still to be solved in ASEAN internal meetings, as further discussed in Chapter 7 of this book.

5.3.1.5 A Comparison of ATIGA and ASEAN Free-Trade Agreement Rules of Origin with Dialogue Partners

Table 5.11 compares the main origin criteria for not wholly obtained products under each ASEAN free-trade agreement.

Overall, all ASEAN free-trade agreements with dialogue partners provide for general rules, most of which require a combination of an RVC requirement with the alternative of a general CTC requirement, often at heading level: four digit of the HS, except the ASEAN–India Free-Trade Area (AIFTA) agreement where the RVC and the CTC at six-digit level are cumulative requirements. The general level of threshold is 40 percent with the exception of the AIFTA where the requirement is 35 percent. Another major difference among these free-trade agreements is that ATIGA, AIFTA, and the ASEAN–Australia–New Zealand Free-Trade Agreement (AANZFTA) maintain the direct method of calculation based on a value-added calculation, while the ASEAN–Japan (AJCEP)) and the ASEAN–Korea methodologies of RVC calculation are based on a value-of-materials calculation, a more practical methodology, as further discussed in Chapter 6 of this book.

All ASEAN free-trade agreements provide for diagonal or partial cumulation[150] of originating materials, as contained in Table 5.12. All ASEAN free-trade agreements, with the exception of ACFTA and AIFTA, provide for a "tolerance" or "*de minimis*" rule.

A tolerance or *de minimis* rule allows the use, up to a given percentage, of non-originating materials that normally should not be used.

For example, consider a doll (HS 9502) where the RoO requirement is CTC at HS heading four-digit level. Assume that the doll fully meets CTH except for the eyes, which were imported from a third country. Since dolls and dolls' eyes are classified under the same HS heading, the CTC rule is not satisfied. However, if the value of the doll eyes is less than the *de minimis* percentage threshold in the relevant free-trade agreement, the doll would still qualify for preferential treatment.

The *de minimis* provision is often set at about 10 percent of the value (see Table 5.12).

5.3.2 *PSRO in ASEAN Free-Trade Agreements*

Apart from some of the differences related to methodologies of calculation of the RVC, the major difference among the rules of origin contained in ATIGA and ASEAN free-trade agreements with dialogue partners are the PSRO contained in

[150] See Chapter 3 of this book for an explanation of diagonal cumulation and for the whole section Handbook on ASEAN FTAs, UNCTAD, 2021.

TABLE 5.11 *Substantial requirements: Criteria for not wholly obtained products to be considered as originating*

FTA	Main origin criteria	Numerator/ denominator	RVC percentage at horizontal level	Method of percentage calculation
ATIGA	RVC or CTC at four-digit level, i.e. CTH	*Direct method*: Value of originating materials (VOM) + cost of direct working or processing Denominator: FOB price *Indirect method*: A subtraction from the FOB price of the value of non-originating materials (VNM) Denominator: FOB price	Not less than 40%	*Direct method:* Value-added calculation *Indirect method:* Subtraction of VNM from the FOB price
AANZFTA	RVC or CTC at four-digit level, i.e. CTH	Direct and indirect method similar to ATIGA Denominator: FOB price	Not less than 40%	*Direct method:* Value-added calculation *Indirect method:* Subtraction of value of non-originating materials from the FOB price
AIFTA	RVC and CTC at six-digit level, i.e. change in tariff subheading (CTSH)	*Direct method:* VOM and direct processing costs Denominator: FOB price *Indirect method:* VNM Denominator: FOB price	*Direct method:* Not less than 35% *Indirect method:* Not to exceed 65% For both cases the non-originating materials have undergone at least CTSH	*Direct method:* Value-added calculation adding cost of processing and local materials. *Indirect method:* Based on the subtraction from FOB price of the CIF values of

TABLE 5.11 (*continued*)

FTA	Main origin criteria	Numerator/ denominator	RVC percentage at horizontal level	Method of percentage calculation
				non-originating inputs
ACFTA	RVC	*Direct method*: RVC Denominator: FOB price *Indirect method*: VNM + values of materials of undetermined origin Denominator: FOB price	Not less than 40% according to the direct formula and not to exceed 60% of non-originating inputs according to the indirect formula	*Direct method:* Based on a 40% of RVC requirement *Indirect method:* Based on a formula requiring not to exceed 60% of non-originating inputs
AJCEP	RVC or CTC at four-digit level, i.e. CTH	*Indirect method:* FOB price – VNM Denominator: FOB price	Not less than 40%	Subtraction of the VNM from the FOB price
AKFTA	RVC or CTC at four-digit level, i.e. CTH	*Build-up method:* VOM Denominator: FOB price *Build-down method:* FOB price – VNM Denominator: FOB price	Not less than 40%	Build-up method: Based on the VOM Build-down method: Based on the VNM

their annexes, as summarized in Table 5.13. In particular, the length and the levels of detail of the PSRO contained in these various free-trade agreements are different.

PRSO apply to a particular heading (four-digit code), subheading (six-digit code), or split subheading (ex. six-digit code). For example, PSRO usually apply to HS chapters such as textiles and clothing, steel products, electronics, and automotive products while requiring wholly obtained or produced products, RVC, CTSH with or without exceptions, and specific working or processing requirements. The following sections contain a brief comparison of the main origin criteria and Table 5.13 compares the PSRO of the different free-trade agreements, which are

TABLE 5.12 *Comparative tables on substantial requirements: Cumulation and tolerance/* de minimis *rules*

	Excerpt	Accumulation	Diagonal accumulation	*De minimis*/ tolerance rule
ATIGA	Article 30 Accumulation 1. Unless otherwise provided in this Agreement, goods originating in a Member State, which are used in another Member State as materials for finished goods eligible for preferential tariff treatment, shall be considered to be originating in the latter Member State where working or processing of the finished goods has taken place. 2. If the RVC of the material is less than forty percent (40%), the qualifying ASEAN Value Content to be cumulated using the RVC criterion shall be in direct proportion to the actual domestic content provided that it is equal to or more than twenty percent (20%). The Implementing Guidelines are set out in Annex 6.	Accumulation of originating materials + special provision for "partial cumulation" where a good not meeting the 40% RVC may nevertheless be eligible for accumulation	Yes	10% in case of CTC criteria
AANZFTA	Article 6 Cumulative Rules of Origin For the purposes of Article 2 (Originating Goods), a good which complies with the origin requirements provided therein and which is used in another	Accumulation of originating materials	Yes	10% with qualifications for some products

TABLE 5.12 (*continued*)

	Excerpt	Accumulation	Diagonal accumulation	*De minimis*/ tolerance rule
	Party as a material in the production of another good shall be considered to originate in the Party where working or processing of the finished good has taken place.			
AIFTA	Rule 5 Cumulative rule of Origin Unless otherwise provided for, products which comply with origin requirements provided for in Rule 2 and which are used in a Party as materials for a product which is eligible for preferential treatment under the Agreement shall be considered as products originating in that Party where working or processing of the product has taken place.	Accumulation of originating materials	Yes	Not applicable
ACFTA	Article 6 Accumulation Unless otherwise provided in this ANNEX, goods originating in a Party, which are used in another Party as materials for finished goods eligible for preferential tariff treatment, shall be treated as originating in the latter Party where working or processing of the finished goods has taken place	Accumulation of originating materials	Yes	Not applicable
AJCEP	Article 29 Accumulation Originating materials of a Party used in the production of a good in another Party shall be	Accumulation of originating materials	Yes	10% with qualifications for some products

(*continued*)

TABLE 5.12 (*continued*)

	Excerpt	Accumulation	Diagonal accumulation	*De minimis*/ tolerance rule
	considered as originating materials of that Party where the working or processing of the good has taken place.			
AKFTA	Rule 7 Accumulation Unless otherwise provided for in this Annex, a good originating in the territory of a Party, which is used in the territory of another Party as material for a finished good eligible for preferential tariff treatment, shall be considered to be originating in the territory of the latter Party where working or processing of the finished good has taken place.	Accumulation of originating materials	Yes	10% in case with qualifications for some products

TABLE 5.13 *PSRO under ASEAN free-trade agreements*

FTA	Contained in	HS level	Length	Comment	Main calculation applied	Range of RVC level
ATIGA[i]	Annex 3; Annex 3 attachment 1 (textiles)	six-digit level (subheading)	282 pages plus 34 pages for textiles	2,652 PSRO, plus 407 for textiles (separately listed)	CTSH RVC WO	Not less than 40%
AANZFTA[ii]	Annex 2	six-digit level (subheading)	635 pages[iii]	Applied to the majority of HS chapters	CTC/CTH/ CTSH RVC or CTC/ CTH/CTSH WO	Not less than 35 or 40%
AIFTA	(To be contained in Appendix B)	N/A	N/A	Currently under negotiation	N/A	N/A

TABLE 5.13 (*continued*)

FTA	Contained in	HS level	Length	Comment	Main calculation applied	Range of RVC level
ACFTA	Attachment B to Annex 1 of 2015 Amendment[iv]	six-digit level (subheading)	28 pages	472 PSRO, 393 of which apply to textiles and textile products (separately listed)	CTSH RVC WO	Not less than 40%
AJCEP[v]	Annex 2	HS chapters and subheading level	63 pages	Applied to the majority of HS chapters	CC/CTH/ CTSH RVC WO	Not less than 40%
AKFTA[vi]	Appendix 2	HS chapters and subheading level	52 pages	447 PSRO	CTH/CTSH RVC WO	Mostly not less than 40 or 45% of FOB; sometimes 35, 55, 60, or 70%

[i] See http://investasean.asean.org/files/upload/Annex%203.pdf; for textiles, see http://investasean.asean.org/files/upload/Annex%203%20-%20Attachment%201.pdf.
[ii] See https://aanzfta.asean.org/agreement/aanfzta-chapters-an-overview/rules-of-origin.
[iii] In contrast to other regulations published in A4 landscape orientation. Amended 2014; available from: http://aanzfta.asean.org/wp-content/uploads/2016/06/Annex_2_Product_Specific_Rules_1st_Protocol.pdf.
[iv] Under negotiation from 2004 to 2015; available from Protocol to Amend the Framework Agreement on Comprehensive Economic Co-operation and Certain Agreements thereunder between ASEAN and the People's Republic of China (2015), http://asean.org/?static_post=asean-china-free-trade-area-2.
[v] www.customs.go.jp/roo/english/text/asean2.pdf.
[vi] www.fta.go.kr/webmodule/_PSD_FTA/asean/1/eng/22.pdf.

usually set out in annexed or appended lists. ATIGA and AANZFTA have an extended list of PSRO, while AJCEP and AKFTA have relatively shorter PSRO lists.

5.4 COMPARISON OF SUBSTANTIAL ROO REQUIREMENTS UNDER THE ASEAN FREE-TRADE AGREEMENTS

5.4.1 *The ASEAN Free-Trade Agreement*

To qualify for preferential treatment under ATIGA, products exported by a member state must satisfy the applicable rules of origin.

5.4.1.1 Wholly Obtained or Produced Products

Pursuant to Article 27 of ATIGA, the following products will be considered as wholly obtained or produced in the exporting member state:

> (a) Plant and plant products, including fruit, flowers, vegetables, trees, seaweed, fungi and live plants, grown and harvested, picked or gathered in the exporting Member State;
> (b) Live animals, including mammals, birds, fish, crustaceans, molluscs, reptiles, bacteria and viruses, born and raised in the exporting Member State;
> (c) Goods obtained from live animals in the exporting Member State;
> (d) Goods obtained from hunting, trapping, fishing, farming, aquaculture, gathering or capturing conducted in the exporting Member State;
> (e) Minerals and other naturally occurring substances, not included in paragraphs (a) to (d) of [Article 27 of ATIGA], extracted or taken from its soil, waters, seabed or beneath its seabed;
> (f) Products of sea-fishing taken by vessels registered with a Member State and entitled to fly its flag and other products taken from the waters, seabed or beneath the seabed outside the territorial waters of that Member State, provided that that Member State has the rights to exploit such waters, seabed and beneath the seabed in accordance with international law;
> (g) Products of sea-fishing and other marine products taken from the high seas by vessels registered with a Member State and entitled to fly the flag of that Member State;
> (h) Products processed and/or made on board factory ships registered with a Member State and entitled to fly the flag of that Member State, exclusively from products referred to in paragraph (g) of [Article 27 of ATIGA];
> (i) Articles collected there which can no longer perform their original purpose nor are capable of being restored or repaired and are fit only for disposal or recovery of parts of raw materials, or for recycling purposes;
> (j) Waste and scrap derived from:
> (i) production in the exporting Member State; or
> (ii) used goods collected in the exporting Member State, provided that such goods are fit only for the recovery of raw materials; and
> (k) Goods obtained or produced in the exporting Member State from products referred to in paragraphs (a) to (j) of [Article 27 of ATIGA].[151]

[151] Footnotes omitted. In para. (f), "'other products' refers to minerals and other naturally occurring substances extracted from the waters, seabed or beneath the seabed outside the territorial waters. . . . For products of sea-fishing obtained from outside the territorial waters (e.g. Exclusive Economic Zone), originating status would be conferred to that member state with whom the vessels used to obtain such products are registered with and whose flag is flown in the said vessel, and provided that that member state has the rights to exploit it under international law."

5.4.1.2 Not Wholly Obtained or Produced Products

Goods which are not considered as wholly obtained or produced will nonetheless be deemed as originating in a member state if the following conditions are met. First, the goods must have been worked or processed in the member state. Second:

(a) the goods must have an RVC of forty percent or more or
(b) all non-originating materials used to produce the goods must have undergone a CTC at the HS four-digit level (that is, a change in tariff heading, CTH).[152]

The exporter can decide whether the RVC rule or the CTC rule applies. RVC is calculated as follows:[153]

Direct method:

$$RVC(\textit{per cent}) = \frac{\textit{ASEAN Material Cost} + \textit{Direct Labour Cost} + \textit{Direct Overhead Cost} + \textit{Other Cost} + \textit{Profit}}{\textit{FOB Price}} \times 100$$

Indirect method:

$$RVC(\textit{per cent}) = \frac{\textit{FOB Price} + \textit{Non} - \textit{originating materials, Parts or Goods}}{\textit{FOB Price}} \times 100$$

where:

- *ASEAN Material Cost* is the cost, insurance and freight (CIF) value of originating materials used in the production of the good.
- *Direct Labour Costs* encompass wages, remuneration, and additional benefits employees receive.
- *Direct Overhead Costs* are the real property items used in the production process, costs related to equipment, utilities, research and development, licenses, etc.
- *FOB Price* is the free-on-board value, with the addition of material and production costs, profit, and additional expenses.

5.4.1.2.1 TOLERANCE OR *DE MINIMIS*. A good which is made using non-originating materials that do not undergo a CTC will still be treated as originating in a member state as long as the value of non-originating materials (VNOM) does

[152] ATIGA, Article 28.
[153] ATIGA Article 29.

not exceed 10 percent of the FOB value.[154] The good must also satisfy all other applicable criteria for eligibility as an originating good.

The above rule only applies to non-originating materials which do not undergo a CTC. The VNM must be included when calculating any applicable RVC requirement for the good.

5.4.1.2.2 INSUFFICIENT WORKING OR PROCESSING. Article 31 provides that the following operations are not considered sufficient to confer originating status by themselves or in combination:

(a) ensuring the preservation of goods in good condition for the purposes of transport or storage
(b) facilitating shipment or transportation and
(c) packaging or presenting goods for sale.

5.4.1.3 Accumulation

ATIGA permits accumulation; that is, materials imported from one member state and worked or processed into finished goods in another member state will be considered as originating materials.[155] If the RVC of the non-originating material is less than 40 percent, the qualifying ASEAN value content to be cumulated using the RVC criterion shall be in direct proportion to the actual domestic content provided that it is equal to or more than 20 percent. The implementing guidelines are set out in Annex 6 of ATIGA.

5.4.1.4 PSRO

Article 28 of ATIGA provides PSRO as follows:

(a) Goods listed in Annex 3 qualify as originating goods if they satisfy the Annex 3 PSRO.[156] Where a choice of rules is provided, the exporter may decide which rule applies.[157]
(b) If Annex 3 specifies an RVC rule, RVC must be calculated according to the formulas for not wholly obtained or produced products (see Section (b) above).[158]
(c) PSRO requiring CTC or a specific manufacturing or processing operation apply only to non-originating materials.

[154] ATIGA, Article 33.
[155] ATIGA, Article 30(2).
[156] ATIGA, Article 30(2)(a).
[157] ATIGA, Article 30(2)(b).
[158] ATIGA, Article 30(2)(c).

(d) If a good is assembled from goods covered in attachment A or B of the WTO Ministerial Conference's Ministerial Declaration on Trade in Information Technology Products,[159] the good will be treated as originating.

ATIGA provides for PSRO for the majority of HS chapters including textiles and clothing, steel products, electronics, and automotive products.

Individual PSRO include requirements that a product be wholly obtained, meets a particular RVC threshold, satisfies a CTSH with or without exceptions, and/or satisfies specific working or processing requirements.

For example, a product listed under Chapter 16 is required either to have an RVC not less than 40 percent or change subheading from any other chapter to a Chapter 16 subheading.

HS code	Description	Origin criteria
1604.15	Mackerel	A regional value content of not less than 40%; or a change to subheading 1604.15 from any other chapter

Under Chapter 61, a product must either have an RVC of not less than 40 percent, or non-originating materials used in the product must undergo a change to a Chapter 61 subheading from any other chapter. The product must also be sewn and cut in the territory of ASEAN member states. Further, some goods in Chapter 61 must satisfy process rules for textile and textile products contained in attachment 1 to ATIGA.

HS code	Description	Origin criteria
6101.30	Of man-made fibres	A regional value content of not less than 40%; or a change to subheading 6101.30 from any other chapter and the good is both cut and sewn in the territory of any Member State; or process rules for textile and textile products as set out in attachment 1

The origin requirements for Chapter 87 products vary according to the particular product. For example, the origin criterion may be an RVC of not less of 40 percent, a CTSH, specific processing requirements, or a combination of these criteria.

[159] See ATIGA, Annex 4.

HS code	Description	Origin criteria
8708.10	Bumpers and parts thereof	A regional value content of not less than 40%
8708.21	Safety seat belts	A regional value content of not less than 40%; or a change to subheading 8708.21 from any other heading; or process rules for textile and textile products as set out in attachment 1

5.4.2 *The ASEAN–Australia–New Zealand Free-Trade Agreement (AANZFTA)*

AANZFTA[160] liberalizes and facilitates trade in goods, services and investment between Australia, New Zealand, and ASEAN member states (referred to in AANZTFA as "the Parties").

5.4.2.1 Wholly Obtained or Produced Product

Pursuant to Chapter 3, Article 3, the following products will be considered as wholly obtained or produced in the exporting party:

(a) plants and plant goods, including fruit, flowers, vegetables, trees, seaweed, fungi and live plants, grown, harvested, picked, or gathered in a Party;
(b) live animals born and raised in a Party;
(c) goods obtained from live animals in a Party;
(d) goods obtained from hunting, trapping, fishing, farming, aquaculture, gathering, or capturing in a Party;
(e) minerals and other naturally occurring substances extracted or taken from the soil, waters, seabed or beneath the seabed in a Party;
(f) goods of sea-fishing and other marine goods taken from the high seas, in accordance with international law, by any vessel registered or recorded with a Party and entitled to fly the flag of that Party;
(g) goods produced on board any factory ship registered or recorded with a Party and entitled to fly the flag of that Party from the goods referred to in Subparagraph (f);
(h) goods taken by a Party, or a person of a Party, from the seabed or beneath the seabed beyond the Exclusive Economic Zone and adjacent Continental Shelf of that Party and beyond areas over which third parties exercise jurisdiction under exploitation rights granted in accordance with international law;
(i) goods which are:

[160] Available from http://aanzfta.asean.org/agreement-establishing-the-aanzfta/.

(i) waste and scrap derived from production and consumption in a Party provided that such goods are fit only for the recovery of raw materials; or
(ii) used goods collected in a Party provided that such goods are fit only for the recovery of raw materials; and

(j) goods produced or obtained in a Party solely from products referred to in subparagraphs (a) to (i) or from their derivatives.[161]

5.4.2.2 Not Wholly Obtained or Produced Products

Chapter 3, Article 4 provides that goods not wholly obtained or produced will nonetheless be deemed as originating in a party if:

(a) all non-originating materials used in the production of the good undergo a CTC at the 4-digit level (CTH) in a party or
(b) the good has an RVC of not less than 40 percent of FOB, provided that the final process of production is performed within a party.

The producer or exporter of a good chooses whether the CTC or RVC rule applies.

The RVC can be calculated using a direct formula or an indirect formula. The direct formula is based on a value-added calculation, while the indirect formula is based on subtraction of the VNM from the FOB price (see Chapter 3, Article 5).

Direct formula:

$$RVC(percent) = \frac{AANZFTA\,material\,Cost + Labour\,Cost + Direct\,overhead\,Cost + Other\,Cost + Profit}{FOB\,price} \times 100$$

Indirect/build-down formula:

$$RVC(per\ cent) = \frac{FOB\ price - VNM}{FOB\ price} \times 100$$

where:

- *AANZFTA material cost* is the VOM, parts, or produce that are acquired or self-produced by the producer in the production of the good.
- *Labour cost* includes wages, remuneration, and other employee benefits.
- *Overhead cost* is the total overhead expense.
- *Other costs* are the costs incurred in placing the good in the ship or other means of transport for export, including but not limited to domestic transport costs, storage and warehousing, port handling, brokerage fees, and service charges.

[161] Footnotes omitted. "'In a Party' means the land, territorial sea, Exclusive Economic Zone, Continental Shelf over which a Party exercises sovereignty, sovereign rights or jurisdiction, as the case may be, in accordance with international law."

- *FOB* is the free-on-board value of the goods.[162]
- *VNM* is the CIF value at the time of importation or the earliest ascertained price paid for all non-originating materials, parts, or produce that are acquired by the producer in the production of the good. Non-originating materials include materials of undetermined origin but do not include a material that is self-produced.

5.4.2.2.1 TOLERANCE OR *DE MINIMIS*. A good which is made using non-originating materials which do not undergo a CTC pursuant to Article 4 will still be treated as originating in a party to AANZFTA as long as:

(i) For a good, other than that provided for in Chapters 50 to 63 of the HS Code, the value of all non-originating materials used in the production of the good that did not undergo the required change in tariff classification does not exceed 10 per cent of the FOB value of the good;
(ii) For a good provided for in Chapters 50 to 63 of the HS Code, the weight of all non-originating materials used in its production that did not undergo the required change in tariff classification does not exceed 10 per cent of the total weight of the good, or the value of all non-originating materials used in the production of the good that did not undergo the required change in tariff classification does not exceed 10 per cent of the FOB value of the good.[163]

However, the VNM must be included when calculating any applicable RVC requirement. The good must also meet all other applicable criteria in Chapter 3 of the agreement.[164]

5.4.2.2.2 INSUFFICIENT WORKING OR PROCESSING. Chapter 3, Article 7 provides that when a claim for origin is based solely on RVC, the following operations are considered to be minimal and will not be taken into account in determining whether or not a good is originating:

(a) ensuring preservation of goods in good condition for the purposes of transport or storage;
(b) facilitating shipment or transportation;
(c) packaging or presenting goods for transportation or sale;
(d) simple processes, consisting of sifting, classifying, washing, cutting, slitting, bending, coiling and uncoiling and other similar operations;
(e) affixing of marks, labels or other like distinguishing signs on products or their packaging; and

[162] FOB includes the cost of transport to the port or site of final shipment abroad. The valuation shall be made in accordance with Article VII of the GATT 1994 and the Agreement on Customs Valuation.
[163] AANZFTA, Chapter 3, Article 8.
[164] Ibid.

(f) mere dilution with water or another substance that does not materially alter the characteristics of the goods.[165]

5.4.2.3 Accumulation

Chapter 3, Article 6 provides that a good which:

(a) originates in one party according to the provisions of AANZFTA and
(b) is worked or processed into finished goods in another party

will be considered to originate in the party where working or processing of the finished good has taken place.

5.4.2.4 PSRO

Annex 2 provides for PSRO, which apply to the majority of HS chapters. A good that satisfies the applicable PSRO will be treated as an originating good. PSRO under AANZFTA include wholly obtained criteria, RVC, CTSH with or without exceptions, and specific working or processing requirements, as well as alternative rules. If the relevant PSRO includes a choice of rule, the producer or exporter of the good can decide which rule to use in determining if the good is originating.[166]

For example, a Chapter 16 product will be originating if:

(i) its RVC is not less than 40 percent or
(ii) the tariff classification is changed at the two-digit level; that is, to Chapter 16 from any other chapter.

HS code		Description	Origin criteria
Chapter 16		Preparations of meat of fish or of crustaceans, molluscs or other aquatic invertebrates	
1601	1601.00	Sausages and similar products of meat, food preparations based on these products	RVC (40) or CC

Chapter 61 products must satisfy either an RVC of not less than 40 percent or a change to Chapter 16 from any other chapter. However, some products must also satisfy specific working and processing requirements; namely, that the product is cut or knitted to shape and assembled in the territory of one or more Parties.

[165] Footnotes omitted. In para. (c), "'packaging' excludes encapsulation that is termed 'packaging' by the electronics industry."
[166] AANZFTA, Chapter 3, Article 4.

HS code		Description	Origin criteria
Chapter 61		Jerseys, pullovers, cardigans, waistcoats and similar Articles, knitted or crocheted	
6110	6110.11	Of wool or fine animal hair	RVC (40) provided that the good is cut or knit to shape and assembled in the territory of one or more of the parties or CC
6110	6110.20	Of cotton	RVC (40) or CC

Chapter 87 products may be required to:

(a) have an RVC not less than 40 percent or
(b) have an RVC not less than 40 percent and undergo a CTC to Chapter 87 from any other chapter or
(c) have an RVC of not less than 40 percent and undergo a CTC at the six-digit level (CTSH) (a change from one Chapter 87 tariff subheading to another).

HS code	Description	Origin criteria
Chapter 87	Vehicles other than railway or tramway rolling stock, and parts and accessories thereof	
8708.95	Other parts and accessories, safety airbags with inflator system, parts thereof	RVC (40%)
8708.99	Other parts and accessories	RVC (40%) + CTSH
8710.00	Tanks and other armoured fighting vehicles, motorized, whether or not fitted with weapons, and parts of such vehicles	RVC (40%) or CC

5.4.3 *The ASEAN–India Free-Trade Agreement (AIFTA)*

AIFTA's rules of origin and OCPs are contained in Annex 2 and the Appendices to AITGA. The main origin criteria under AIFTA are that products are wholly obtained or produced, have an RVC of not less than 35 percent, have undergone a change in tariff classification at the six-digit level (that is, CTSH), or satisfy product specific rules (Appendix B, currently under negotiation).

5.4.3.1 Wholly Obtained or Produced Products

Annex 2, Rule 3 of AIFTA provides that the following products will be considered as wholly obtained or produced in the exporting member state:

(a) plant and plant products grown and harvested in the Party;
(b) live animals born and raised in the Party;
(c) products obtained from live animals referred to in paragraph (b);
(d) products obtained from hunting, trapping, fishing, aquaculture, gathering or capturing conducted in the Party;
(e) minerals and other naturally occurring substances, not included in paragraphs (a) to (d), extracted or taken from the Party's soil, waters, seabed or beneath the seabed;
(f) products taken from the waters, seabed or beneath the seabed outside the territorial waters of the Party, provided that that Party has the rights to exploit such waters, seabed and beneath the seabed in accordance with the United Nations Convention on the Law of the Sea, 1982;
(g) products of sea-fishing and other marine products taken from the high seas by vessels registered with the Party and entitled to fly the flag of that Party;
(h) products processed and/or made on board factory ships registered with the Party and entitled to fly the flag of that Party, exclusively from products referred to in paragraph (g);
(i) articles collected in the Party which can no longer perform their original purpose nor are capable of being restored or repaired and are fit only for disposal or recovery of parts of raw materials, or for recycling purposes; and
(j) products obtained or produced in the Party solely from products referred to in paragraphs (a) to (i).[167]

5.4.3.2 Not Wholly Obtained or Produced Products

Rule 2, Annex 2 provides that goods not wholly obtained or produced will nonetheless be deemed as originating if:

(a) they have an RVC of not less than 35 percent
(b) all non-originating materials used in the production of the good undergo a CTSH and
(c) the final process of manufacture is performed within the territory of the exporting party.

The RVC can be calculated using either a direct method (a value-added calculation adding cost of processing and local materials) or an indirect method (based on a maximum allowance of non-originating inputs):[168]

Direct method: RVC $\geq$ *threshold*

[167] AIFTA TIG Agreement, Annex 2, Rule 3 (footnotes omitted). In para. (a), "plant here refers to all plant life, including forestry products, fruit, flowers, vegetables, trees, seaweed, fungi, and live plants … Animals referred to in paragraphs (b) and (c) covers all animal life, including mammals, birds, fish, crustaceans, molluscs, reptiles, and living organisms." In para. (d), "products refer to those obtained from live animals without further processing, including milk, eggs, natural honey, hair, wool, semen, and dung."

[168] AIFTA TIG Agreement, Annex 2, Appendix A, Rule 4.

$$RVC(\textit{per cent}) = \frac{\text{AIFTA Material Cost} + \text{Direct Labour Cost} + \text{Direct Overhead Cost} + \text{Other Cost} + \text{Profit}}{\text{FOB Price}} \times 100\%$$

Indirect method: RVC ≤ *threshold*

$$\text{RVC(per cent)} = \frac{\text{VNM Parts or Produce} + \text{Value of Undetermined Origin Materials, Parts or Produce}}{\text{FOB Price}} \times 100\%$$

where:

- *VNM* is
  (i) the CIF value at the time of importation of the materials, parts or produce or
  (ii) the earliest ascertained price paid for the materials, parts or produce of undetermined origin in the territory of the Party where the working or processing takes place.[169]
- FOB Price = Ex-Factory Price + Other Costs.
- *Other Costs* refers to the costs incurred in placing the products in the ship for export, including, but not limited to, domestic transport costs, storage and warehousing, port handling, brokerage fees, service charges, and the like.
- *Ex-Factory Price* = Production Cost + Profit.
- *Production Cost* = Cost of Raw Materials + Labour Cost + Overhead Cost.
- *Raw Materials* consists of the cost of raw materials, and freight and insurance.
- *Labour Costs* include wages, remuneration, and other employee benefits associated with the manufacturing process.
- *Overhead costs* include, but are not limited to:[170]
  - real property items associated with the production process (insurance, factory rent and leasing, depreciation on buildings, repair and maintenance, taxes, interests 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)

[169] AIFTA TIG Agreement, Annex 2, Rule 4(c).
[170] See AIFTA TIG Agreement, Appendix A.

- utilities (energy, electricity, water and other utilities directly attributable to the production of the good)
- research, development, design and engineering
- dyes, moulds, tooling and the depreciation, maintenance and repair of plant and equipment
- royalties or licences (in connection with patented machines or processes used in the manufacture of the good or the right to manufacture the good)
- 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

5.4.3.2.1 TOLERANCE OR *DE MINIMIS*. AIFTA does not include *de minimis* criteria.

5.4.3.2.2 INSUFFICIENT WORKING OR PROCESSING. Annex 2, Rule 7(a) provides that a product will not be considered originating in a party merely because any of the following operations are undertaken (either alone or together) in the territory of that party:

(i) operations to ensure the preservation of products in good condition during transport and storage (such as drying, freezing, keeping in brine, ventilation, spreading out, chilling, placing in salt, sulphur dioxide or other aqueous solutions, removal of damaged parts, and like operations);
(ii) simple operations consisting of removal of dust, sifting or screening, sorting, classifying, matching (including the making up of sets of articles), washing, painting, cutting;
(iii) changes of packing and breaking up and assembly of consignments;
(iv) simple cutting, slicing and repacking or placing in bottles, flasks, bags, boxes, fixing on cards or boards, and all other simple packing operations;
(v) affixing of marks, labels or other like distinguishing signs on products or their packaging;
(vi) simple mixing of products whether or not of different kinds, where one or more components of the mixture do not meet the conditions laid down in [Annex 2] to enable them to be considered as originating products;
(vii) simple assembly of parts of products to constitute a complete product;
(viii) disassembly;
(ix) slaughter which means the mere killing of animals; and
(x) mere dilution with water or another substance that does not materially alter the characteristics of the products.

For textiles and textile products listed in Appendix C, a good will not be considered as originating in a party by virtue of merely having undergone any of the following:

(i) simple combining operations, labelling, pressing, cleaning or dry cleaning or packaging operations, or any combination thereof;
(ii) cutting to length or width and hemming, stitching or overlocking fabrics which are readily identifiable as being intended for a particular commercial use;
(iii) trimming and/or joining together by sewing, looping, linking, attaching of accessory articles such as straps, bands, beads, cords, rings and eyelets;
(iv) one or more finishing operations on yarns, fabrics or other textile articles, such as bleaching, waterproofing, decanting, shrinking, mercerizing, or similar operations; or
(v) dyeing or printing of fabrics or yarns.[171]

5.4.3.3 Accumulation

A product which:

(a) originates in one party according to the provisions of AIFTA and
(b) is worked or processed in another party into a good which is eligible for preferential treatment under AIFTA

will be considered to originate in the party where the working or processing has taken place.[172]

5.4.3.4 PSRO

AIFTA PSRO are currently under negotiation. Annex 2, Rule 6 provides that products which satisfy the PSRO shall be considered as originating from that party where working or processing of the product has taken place. Upon finalization, the list of PSRO will be contained in Appendix B.

5.4.4 *The ASEAN–China Free-Trade Agreement (ACFTA)*

Annex 3 of the Agreement on Trade in Goods of the Framework Agreement on Comprehensive Economic Co-operation between ASEAN and China sets out the rules of origin and the OCPs applicable to the products it covers.[173] In 2015 the parties signed a Protocol by which Annex 3 of the Agreement on Trade in Goods was substituted by Annex 1 of the Protocol.[174]

A good shall be treated as an originating good, and therefore eligible for preferential tariff treatment, if it is:

(a) wholly produced or obtained in a Party as provided in Annex 1, Article 3 of the Protocol;

[171] See AIFTA TIG Agreement, Annex 2, Rule 7(b).
[172] AIFTA TIG Agreement, Annex 2, Rule 5.
[173] See ACFTA, Article 5.
[174] See Protocol to Amend the ACFTA.

(b) produced in a Party exclusively from originating materials from one or more of the Parties; or
(c) produced from non-originating materials in a Party, if it satisfies the requirements of Annex 1, Article 4 of the Protocol,

and it meets all other applicable requirements of Annex 1 of the Protocol.[175]

5.4.4.1 Wholly Obtained or Produced Product

Pursuant to Annex 1, Article 3 of the Protocol, the following products are considered wholly produced or obtained:

(a) plants and plant products (including fruits, flowers, vegetables, trees, seaweed, fungi and live plants) grown, harvested, picked, or gathered in a Party;
(b) live animals born and raised in a Party;
(c) goods obtained from live animals in a Party without further processing, including milk, eggs, natural honey, hair, wool, semen and dung;
(d) goods obtained from hunting, trapping, fishing, aquaculture, gathering, or capturing in a Party;
(e) minerals and other naturally occurring substances extracted or taken from the soil, waters, seabed or beneath the seabed in a Party;
(f) goods taken from the waters, seabed or beneath the seabed outside the territorial waters of that Party, provided that that Party has the rights to exploit such waters, seabed and beneath the seabed in accordance with international law;
(g) goods of sea fishing and other marine products taken from the high seas by vessels registered with a Party or entitled to fly the flag of that Party;
(h) goods processed and/or made on board factory ships registered with a Party or entitled to fly the flag of that Party, exclusively from products referred to in paragraph (g) above;
(i) waste and scrap derived from production process or from consumption in a Party provided that such goods are fit only for the recovery of raw materials; or
(j) used goods consumed and collected in a Party provided that such goods are fit only for the recovery of raw materials; and
(k) goods produced or obtained in a Party exclusively from products referred to in Subparagraphs (a) to (j) or from derivatives of the goods produced or obtained in the Party exclusively from products referred to in Subparagraphs (a) to (j).[176]

[175] ACFTA, Annex 3, Article 2.

[176] Footnotes omitted. "For the purposes of [Article 3], 'in a Party' means: (i) For ASEAN member states, the land, territorial air space, territorial sea, Exclusive Economic Zone, Continental Shelf, and areas beyond the territorial sea over which a member state exercises sovereign rights or jurisdiction, as the case may be, under respective domestic laws in accordance with international law, including the United Nations Convention on the Law of the Sea. (ii) For China, the entire customs territory of the People's Republic of China, including land territory,

5.4.4.2 Not Wholly Obtained or Produced Products

A good which is not wholly obtained or produced in a party, and which is classified in Chapters 25, 26, 28, 293, 314, 395, 42–49, 57–59, 61, 62, 64, 66–71, 73–83, 86, 88, 91–97 of the HS, will be treated as originating if all non-originating materials used in the production of the goods have undergone a CTC at the four-digit level (CTH). All other goods will be treated as originating if the good has an RVC of not less than 40 percent of FOB and the final process of production is performed within a party.

Annex 1, Article 5 of the Protocol provides that the formula for the RVC is calculated as follows:

$$RVC = \frac{FOB - VNM}{FOB} \times 100\%$$

where:

- *RVC* is the regional value content, expressed as a percentage.
- *VNM* is the value of the non-originating materials, determined as follows:
  - (i) in case of the imported non-originating materials, VNM shall be the CIF value of the materials at the time of importation
  - (ii) in case of the non-originating materials obtained in a party, VNM shall be the earliest ascertainable price paid or payable for the non-originating materials in that party. The value of such non-originating materials shall not include freight, insurance, packing costs, and any other costs incurred in transporting the material from the supplier's warehouse to the producer's location.
- If a product acquires originating status according to an RVC calculation, its non-originating component is not counted as non-originating material if the product is processed into another product in the same party.
- The valuation shall be determined in accordance with the Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994 in Annex 1A to the WTO Agreement (the Agreement on Customs Valuation).[177]

territorial airspace, internal waters, territorial sea, and areas beyond the territorial sea within which China exercises sovereign rights or jurisdiction under its domestic laws, in accordance with international law. (iii) The above definitions are purely for the purpose of the implementation of Article 3 of the Annex of the rules of origin."

[177] Protocol to Amend the ACFTA, Annex 1, Article 5 read with Article 1.

5.4.4.2.1 TOLERANCE OR *DE MINIMIS*. A good which is not wholly produced or obtained and which does not satisfy a CTC requirement, but meets all other applicable criteria in Annex 1, will still be an originating good if it satisfies the following conditions:

(1) For a good which is provided for in Chapters 50–63 of the HS, either:
   (i) the weight of all non-originating materials used in its production that did not undergo the required CTC does not exceed 10 per cent of the total weight of the good or
   (ii) the value of all non-originating materials used in the production of the good that did not undergo the required CTC does not exceed 10 per cent of the FOB value of the good.[178]
(2) For all other goods: the value of all non-originating materials used in the production of the good that did not undergo the required CTC does not exceed 10 per cent of the FOB value of the good.

5.4.4.2.2 INSUFFICIENT WORKING OR PROCESSING. The following list of operations or processes, by themselves or together, are considered to be minimal and are therefore not taken into account in determining whether a good has been wholly obtained in a country:

(a) ensuring preservation of goods in good condition for the purposes of transport or storage
(b) facilitating shipment or transportation
(c) packaging or presenting goods for sale.[179]

5.4.4.3 Accumulation

Unless otherwise provided in Annex 1 of the Protocol, a good which originates in a party and is used in another party as materials for a finished good eligible for preferential tariff treatment, shall be treated as originating in the latter party where working or processing of the finished good has taken place.[180]

5.4.4.4 PSRO

The 472 PSRO of ACFTA are contained in Attachment B to Annex 1 of the Protocol. The PSRO comprise 59 Exclusive Rules/Criteria (Part A) and 413 Alternative Rules (Part B). The Exclusive Rules/Criteria include an RVC of

[178] Protocol to Amend the ACFTA, Annex 1, Article 9.
[179] Protocol to Amend the ACFTA, Annex 1, Article 7. "Packaging" excludes encapsulation, which is termed "packaging" by the electronics industry.
[180] Protocol to Amend the ACFTA, Annex 1, Article 6.

not less than 40%, CTSH, and other specific requirements. When applying for a CO for products listed under the Alternative Rules, an exporter can use either the general rule set out in Annex Article 4 of the Protocol, or the Alternative Rules.

Unlike the PSRO of other ASEAN free-trade agreements, ACFTA Alternative Rules are sometimes clustered by the rule itself, not the HS code. The example of CTC is as follows:

Serial no.	HS chapter	Product description	Origin criteria
68	3006.10	Sterile surgical catgut, similar sterile suture materials (including sterile absorbable surgical or dental yarns) and sterile tissue adhesives for surgical wound closure; sterile laminaria and sterile laminaria tents; sterile absorbable surgical or dental haemostatics; sterile surgical or dental adhesion barriers, whether or not absorbable	Change to subheading 3006.10 from any other heading
69	4103.90	Other raw hides and skins (fresh, or salted, dried, limed, pickled or otherwise preserved, but not tanned, parchment-dressed or further prepared), whether or not dehaired or split, other than those excluded by Note 1(b) or 1(c) to this Chapter.	Change to subheading 4103.90 from any other heading
70	7218.10	Ingots and other primary forms	Change to subheading 7218.10 from any other heading

Process criteria for textile and textile products are separated into the following categories:

(a) "Fibres and Yarns"
(b) "Fabric/Carpets and Other Textile Floor Coverings; Special Yarns, twine cordage and ropes and cables and articles thereof" and
(c) "Article of Apparel and Clothing Accessories and Other Made Up Textile Articles."

Category (c) allows for alternative rules as follows:

a. Manufacture through the processes of cutting and assembly of parts into a complete article (for apparel and tents) and incorporating embroidery or embellishment or printing (for made-up articles) from:
– raw or unbleached fabric
– finished fabric;
OR

b. Undergo a change in tariff classification at four-digit level, which is a change in tariff heading, of the Harmonized System

5.4.5 *The ASEAN–Japan Comprehensive Economic Partnership (AJCEP)*

Rules of origin are provided for in Chapter 3 of AJCEP.[181]

5.4.5.1 Wholly Obtained or Produced Products

Article 25 provides that the following goods will be considered as wholly obtained or produced entirely in a party:

(a) plant and plant products grown and harvested, picked or gathered in the Party;
   i. Note: For the purposes of this paragraph, the term "plant" refers to all plant life, including fruit, flowers, vegetables, trees, seaweed, fungi and live plants.
(b) live animals born and raised in the Party;
   ii. Note: For the purposes of paragraphs (b) and (c), the term "animals" covers all animal life, including mammals, birds, fish, crustaceans, molluscs, reptiles, bacteria and viruses.
(c) goods obtained from live animals in the Party;
(d) goods obtained from hunting, trapping, fishing, gathering or capturing conducted in the Party;
(e) minerals and other naturally occurring substances, not included in paragraphs (a) through (d), extracted or taken from soil, waters, seabed or beneath the seabed of the Party;
(f) goods taken from the waters, seabed or beneath the seabed outside the territorial waters of the Party, provided that the Party has the rights to exploit such waters, seabed and beneath the seabed in accordance with its laws and regulations and international law;
   iii. Note: Nothing in [AJCEP] shall affect the rights and obligations of the parties under international law, including those under the United Nations Convention on the Law of the Sea.
(g) goods of sea-fishing and other marine products taken by vessels of the Party from outside the territorial sea of any Party;
(h) goods processed and/or made on board factory ships of the Party exclusively from products referred to in paragraph (g);
(i) articles collected in the Party which can no longer perform their original purpose or be restored or repaired, and are fit only for disposal, for the recovery of parts or raw materials, or for recycling purposes;
(j) scrap and waste derived from manufacturing or processing operations, including mining, agriculture, construction, refining, incineration and

[181] Available from http://ajcep.asean.org/agreements/legal-text/.

sewage treatment operations, or from consumption, in the Party, and fit only for disposal or for the recovery of raw materials; and

(k) goods obtained or produced in the Party exclusively from goods referred to in paragraphs (a) through (j).

5.4.5.2 Not Wholly Obtained or Produced Products

Article 26 provides that a good which is not wholly obtained or produced in a Party will still qualify as an originating good if:

(a) the good has an RVC of less than 40 per cent and the final process of production has been performed in the party or
(b) all non-originating materials used in the production of the good undergo a CTC at the 4-digit level (CTH) within the party.

An exporter can decide whether to apply the RVC or CTC rule. Article 27 provides that RVC is calculated as follows:

$$RVC(\textit{per cent}) = \frac{FOB - VNM}{FOB} \times 100$$

where:

- *FOB* is the free-on-board value of a good, inclusive of the cost of transport from the producer to the port or site of final shipment abroad.
  - o If the FOB value of a good is unknown and cannot be ascertained, FOB will be the value adjusted to the first ascertainable price paid for a good from the buyer to the producer of the good.
  - o If the good does not have a FOB value, the FOB will be determined in accordance with Articles 1–8 of the Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994 in Annex 1A to the WTO Agreement (the Agreement on Customs Valuation).
- *RVC* is the RVC of a good, expressed as a percentage.
- *VNM* is the value of non-originating materials used in the production of a good, determined in accordance with the Agreement on Customs Valuation.
  - o VNM includes freight, insurance, and where appropriate, packing and all other costs incurred in transporting the material to the importation port in the party where the producer of the good is located.
  - o If the value of non-originating materials is unknown and cannot be ascertained, the VNM is the first ascertainable price paid for the material in the party. This may exclude all the costs incurred in the party in transporting the material from the warehouse of the supplier of the material to the place where the producer is located such as freight, insurance and packing as well as any other known and ascertainable cost incurred in the party.
  - o VNM does not include the value of non-originating materials used in the production of originating materials of the party which are used in the production of the good.

5.4.5.2.1 TOLERANCE OR *DE MINIMIS*. A good which is not wholly obtained or produced, and which does not satisfy the requirements of the CTC rule, will nonetheless be considered originating if it meets all other requirements of Chapter 3 and:

i. in the case of a good classified under Chapters 16, 19, 20, 22, 23, 28 through 49, and 64 through 97 of the Harmonized System, the total value of non-originating materials used in the production of the good that have not undergone the required CTC does not exceed ten (10) per cent of the FOB;
ii. in the case of a particular good classified under Chapters 18 and 21 of the Harmonized System, the total value of non-originating materials used in the production of the good that have not undergone the required CTC does not exceed ten (10) per cent or seven (7) per cent of the FOB as specified in Annex 2; or
iii. in the case of a good classified under Chapters 50 through 63 of the Harmonized System, the weight of all non-originating materials used in the production of the good that have not undergone the required CTC does not exceed ten (10) per cent of the total weight of the good.[182]

However, the value of non-originating materials will be included in the VNM for the RVC rule.

5.4.5.3 Insufficient Working or Processing

Article 30 provides that a good does not satisfy the CTC requirement or specific manufacturing or processing operation merely by reason of:

(a) operations to ensure the preservation of products in good condition during transport and storage (such as drying, freezing, keeping in brine) and other similar operations;
(b) changes of packaging and breaking up and assembly of packages;
(c) disassembly;
(d) placing in bottles, cases, boxes and other simple packaging operations;
(e) collection of parts and components classified as a good pursuant to Rule 2(a) of the General Rules for the Interpretation of the Harmonized System;
(f) mere making up of sets of articles; or
(g) any combination of operations referred to in subparagraphs (a) through (f).

5.4.5.4 Accumulation

Originating materials of one party used in the production of a good in another party shall be considered as originating materials of the latter party where the working or processing of the good has taken place.[183]

[182] AJCEP, Article 28.
[183] AJCEP, Article 29.

5.4.5.5 PSRO

AJCEP PSRO are contained in Annex 2 and apply to the majority of HS chapters. Requirements include that a product be wholly obtained and produced, an RVC of not less than 40 percent, a CTC with or without exceptions, specific working or processing requirements, and alternative rules. Where a PSRO provides a choice between an RVC rule, a CTC rule, a specific manufacturing or processing operation, or a combination of these, the exporter of the good can decide which rule to use.[184]

For example, Chapter 16 products must undergo a change in chapter, except for Chapters 1 (live animals) and 2 (meat and edible meat offal).

HS chapter		Description	Origin criteria
Chapter 16		Preparations of meat, of fish or of crustaceans, molluscs or other aquatic invertebrates	
16.01	1610.00	Sausages and similar products, of meat, meat offal or blood; food preparations based on these products	CC except from Chapter 1 or 2
16.02		Other prepared or preserved meat, meat offal or blood	CC except from Chapter 1 or 2
	1602.20	Of liver of any animal	CC

Chapter 87 products must have an RVC of not less than 40 percent.

HS chapter	Description	Origin criteria
Chapter 87	Vehicles other than railway or tramway rolling-stock, and parts and accessories thereof	
8701.20	Road tractors for semi-trailers	RVC 40%

Chapter 61 products must have undergone a change in tariff chapter. If the product uses non-originating materials listed in Chapter 60 (knitted or crocheted fabrics) or in other specific tariff headings,[185] then such materials must meet a specific working or processing requirement; namely, they must be knitted or crocheted entirely in one or more of the AJCEP parties.

[184] AJCEP Article 26.

[185] For example, 50.07 (woven fabrics of silk or of silk waste); 51.11 (woven fabrics of carded wool or of carded fine animal hair); 54.07 (woven fabrics of synthetic filament yarn, and the like).

HS chapter	Description	Origin criteria
Chapter 61	Articles of apparel and clothing accessories, knitted or crocheted	CC, provided that, where non-originating materials of heading 50.07, 51.11 through 51.13, 52.08 through 52.12, 53.09 through 53.11, 54.07 through 54.08.55.12 through 55.16 or Chapter 60 are used, each of the non-originating materials is knitted or crocheted entirely in one or more of the parties

5.4.6 *The ASEAN–Republic of Korea Free-Trade Agreement (AKFTA)*

The relevant rules of origin and OCPs under AKFTA are set out in Annex 3 to the Agreement on Trade in Goods and its appendices.[186]

Rule 2 of Annex 3 provides that a good imported into the territory of a Party will be deemed to be originating and eligible for preferential tariff treatment if it:

(a) is wholly obtained or produced entirely in the territory of the exporting party under Rule 3 or
(b) otherwise eligible under Rule 4 (Not Wholly Obtained or Produced Goods), Rule 5 (Product Specific Rules), Rule 6 (Treatment for Certain Goods) or Rule 7 (Accumulation).

5.4.6.1 Wholly Obtained or Produced Products

Annex 3, Rule 3 provides that the following products will be considered to be wholly obtained or produced in the territory of a party:

(a) plants and plant products harvested, picked or gathered after being grown there;
(b) live animals born and raised there;
(c) goods obtained from live animals referred to in sub-paragraph (b);
(d) goods obtained from hunting, trapping, fishing, aquaculture, gathering or capturing conducted there;
(e) minerals and other naturally occurring substances, not included in subparagraphs (a) through (d), extracted or taken from its soil, waters, seabed or beneath its seabed;
(f) products of sea-fishing taken by vessels registered with the Party and entitled to fly its flag, and other products taken by the Party or a person of that Party, from the waters, seabed or beneath the seabed outside the territorial waters of the

[186] See AKFTA TIG Agreement, Article 5, at www.customs.go.kr/kcshome/main/content/ContentView.do?contentId=CONTENT_ID_00002361&layoutMenuNo=23269.

Party, provided that the Party has the rights to exploit the natural resources of such waters, seabed and beneath the seabed under international law;
(g) products of sea fishing and other marine products taken from the high seas by vessels registered with the Party and entitled to fly its flag;
(h) goods produced and/or made on board factory ships registered with a Party and entitled to fly its flag, exclusively from products referred to in sub-paragraph (g);
(i) goods taken from outer space provided that they are obtained by the Party or a person of that Party;
(j) articles collected from there which can no longer perform their original purpose nor are capable of being restored or repaired and are fit only for the disposal or recovery of parts of raw materials, or for recycling purposes;
(k) waste and scrap derived from:
  (i) production there; or
  (ii) used goods collected there, provided that such goods are fit only for the recovery of raw materials; and
(l) goods obtained or produced in the territory of the Party solely from goods referred to in sub-paragraphs (a) through (k).[187]

5.4.6.2 Not Wholly Obtained or Produced Products

Goods produced from non-originating materials are deemed to be originating if the RVC is not less than 40 percent of the FOB value or a good has undergone a CTC at the four-digit level (CTH).[188] Two methods for calculating RVC are allowed. The build-up method is based on the VOM and the build-down method is based on the VNM.

The build-up method is calculated as follows:

$$RVC(\textit{per cent}) = \frac{VOM}{FOB} \times 100$$

The build-down method is calculated as follows:

$$RVC(\textit{per cent}) = \frac{FOB - VNM}{FOB} \times 100$$

where:

- *VOM* includes the value of originating materials, direct labor cost, direct overhead cost, transportation cost, and profit.

[187] Footnotes omitted. Under para. (f), "The Parties understand that for the purposes of determining the origin of products of sea-fishing and other products, 'rights' in sub-paragraph (f) of Rule 3 include those rights of access to the fisheries resources of a coastal state, as accruing from agreements or other arrangements concluded between a Party and the coastal state at the level of governments or duly authorised private entities. . . . 'International law' in sub-paragraph (f) of Rule 3 refers to generally accepted international law such as the United Nations Convention on the Law of the Sea."

[188] AKFTA TIG Agreement, Annex 3, Rule 4.

- *VNM* is:
  - the CIF value at the time of importation of the materials, parts or goods or
  - the earliest ascertained price paid for the materials, parts or goods of undetermined origin in the territory of the party where the working or processing has taken place.
- *FOB* is the free-on-board value of the goods.

5.4.6.2.1 TOLERANCE OR *DE MINIMIS*. A good which is not wholly obtained or produced and which does not undergo the required CTC will still be considered as originating if:

> (a) for a good, other than that provided for in Chapters 50 through 63 of the Harmonized System, the value of all non-originating materials used in its production that do not undergo the required [CTC] does not exceed ten (10) per cent of the FOB value of the good;
> (b) for a good provided for in chapters 50 through 63 of the Harmonized System, the weight of all non-originating materials used in its production that do not undergo the required [CTC] does not exceed 10 per cent of the total weight of the good.[189]

and the good meets all other applicable criteria for qualifying as an originating good in Annex 3. However, the value of non-originating materials will be included in the VNM for any applicable RVC requirement for the good.

5.4.6.2.2 INSUFFICIENT WORKING OR PROCESSING. A good is not considered as originating in the territory of a Party if the following operations are undertaken exclusively by themselves or in combination in the territory of that party:

> (a) preserving operations to ensure that the good remains in good condition during transport and storage;
> (b) changes of packaging, breaking-up and assembly of packages;
> (c) simple[190] washing, cleaning, removal of dust, oxide, oil, paint or other coverings;
> (d) simple painting and polishing operations;
> (e) husking, partial or total bleaching, polishing and glazing of cereals and rice;
> (f) operations to colour sugar or form sugar lumps;
> (g) simple peeling, stoning, or un-shelling;
> (h) sharpening, simple grinding or simple cutting;

[189] Annex 3, Rule 10, *De Minimis*.

[190] "Simple" generally describes an activity which does not need special skills, machines, apparatus, or equipment especially produced or installed for carrying out the activity.

(i) sifting, screening, sorting, classifying, grading, matching;
(j) simple placing in bottles, cans, flasks, bags, cases, boxes, fixing on cards or boards and all other simple packaging operations;
(k) affixing or printing marks, labels, logos and other like distinguishing signs on products or their packaging;
(l) simple mixing[191] of products, whether or not of different kinds;
(m) simple assembly of parts of articles to constitute a complete article or disassembly of products into parts;
(n) simple testing or calibrations; or
(o) slaughtering of animals.[192]

5.4.6.3 Accumulation

If a good originating in a party is used in another party as material for a finished good eligible for preferential tariff treatment, the material must be considered as originating in the latter party where working or processing of the finished good has taken place.[193]

5.4.6.4 PSRO

Goods that satisfy the PSRO provided in Appendix 2 in fifty-two pages will be considered as originating. The PSRO include the good being wholly obtained, RVC requirements, CTSH with or without exceptions, specific working or processing requirements, and alternative rules.

For example, Chapter 16 products must satisfy varying requirements such as:

(a) an RVC of not less than 40 percent
(b) a CTSH from any other heading, provided that materials from Chapter 1 (live animals), Chapter 2 (meat and edible meat offal), and Chapter 5 (products of animal origin not elsewhere specified or included) used in its production are wholly obtained or produced in the territory of the exporting party, or
(c) an RVC of not less than 40 percent, provided that materials from Chapters 1, 2, and 5 used in its production are wholly obtained or produced in the territory of the exporting party.

[191] "Simple mixing" generally describes an activity which does not need special skills, machines, apparatus or equipment especially produced or installed for carrying out the activity. However, simple mixing does not include chemical reaction. Chemical reaction means a process (including a biochemical process) which results in a molecule with a new structure by breaking intramolecular bonds and by forming new intramolecular bonds, or by altering the spatial arrangement of atoms in a molecule.

[192] AKFTA TIG Agreement, Annex 3, Rule 8. "Slaughtering" means the mere killing of animals and not subsequent processes such as cutting, chilling, freezing, salting, drying, or smoking, for the purpose of preservation for storage and transport.

[193] AKFTA TIG Agreement, Annex 3, Rule 7.

HS chapter	Description	Origin criteria
Chapter 16	Preparations of meat, of fish or of crustaceans, molluscs or other aquatic invertebrates	
16.01	Sausages and similar products, of meat, meat offal or blood; food preparations based on these products	A regional value content of not less than 40% of the FOB value of the good
16.02	Other prepared or preserved meat, meat offal or blood	
1602.20	Of liver of any animal	Change to subheading 1602.20 from any other heading, provided that materials from chapters 1, 2 and 5 are wholly-obtained or produced in the territory of the exporting Party; or a regional value content of not less than 40% of the FOB value of the good provided that materials from chapters 1, 2 and 5 are wholly obtained or produced in the territory of the exporting Party

The PSRO for Chapter 62 goods are also variable. They include:

(a) an RVC of not less than 40 percent
(b) a CTH from any other chapter, provided that the product is both cut and sewn in the territory of the exporting party and
(c) a CTH from any other chapter, provided that materials under specific tariff headings used in the good's production originate in a party and the product is both cut and sewn in the territory of the exporting party.

HS chapter	Description	Origin criteria
Chapter 62	Articles of apparel and clothing, accessories, knitted or crocheted	
62.14	Shawls, scarves, mufflers, mantillas, veils and the like	Change to heading 62.14 from any other chapter, provided that the fabrics of 50.07, 51.11 through 51.13, 52.08 through 52.12, 53.09 through 53.11, 54.07 through 54.08, 55.12 through 55.16, 58.01 through 58.02, 60.01

(*continued*)

(*continued*)

HS chapter	Description	Origin criteria
		through 60.06 are originating and the good is both cut and sewn in the territory of the exporting Party; or a regional value content of not less than 40% of the FOB value of the good
62.15	Ties, bow ties, and cravats	Change to heading 62.15 from any other chapter, provided that the good is both cut and sewn in the territory of any Party; or a regional value content of not less than 40% of the FOB value of the good

Chapter 89 products must satisfy either an RVC of not less than 50 percent (compared to the usual 40 percent), or alternatively, a change to subheading 8907.10 from any other tariff heading.

HS chapter			Description	Origin criteria
Chapter 89			Ships, boats and floating structures	
	89.07		Other floating structures (for example, rafts, tanks, cofferdams, landing-stages, buoys and beacons).	
		8907.10	Inflatable rafts	Change to Subheading 8907.10 from any other Heading; or A regional value content of not less than 50% of the FOB value of the good

5.4.7 *Rules of Origin in Africa*

Rules of origin in the African continent in the last twenty years are best summarized in a statement of the Common Market for Eastern and Southern Africa (COMESA) Secretary-General at the opening session of the twelfth meeting of the Working Group on Rules of Origin of COMESA:[194]

> The Secretary General noted that a lot of progress had already been achieved by the Working Group in their past eleven meetings, a process that saw the workings and

[194] See Report of the Twelfth Meeting of the Working Group on Rules of Origin, held on April 5–6, 2011, in Lusaka, Zambia.

> processes that lead to a change in tariff heading of the agreed chapters go on for a considerable period of time and which involved commendable effort but also consumed large sums of capital resources amounting to US$1 million besides the economic costs associated with man-hours spent in these meetings. In this respect, he acknowledged and commended team of experts for the collective dedication and commitment which had thus far, delivered the achieved tangible results.

Only after another four years from this statement and other meetings was COMESA able to publish a new version of the COMESA rules of origin[195] that corrected a conspicuous lack of clarity in the original version as further discussed below.

Yet the experience of COMESA is not unique but rather the usual story in negotiating rules of origin in African free-trade agreements: lengthy and costly negotiations ending up in opaque texts of rules of origin and low utilization of free-trade agreements.

As discussed in the following paragraphs the negotiation of rules of origin in Southern African Development Community (SADC) was among the most contentious issues in the post-apartheid era and the final results have been meager, as recorded in the literature and in practice.[196] Years later, the three regional economic communities (RECs), COMESA, SADC, and the East African Community (EAC) embarked on a new and ambitious initiative to create a Tripartite Free-Trade Area (TFTA) that was designed to move beyond the lack of progress in the respective REC to establish effective free-trade agreements.

The First Summit of Head of States and Government of the COMESA-EAC-SADC Tripartite held in Kampala, Uganda on October 22, 2008 launched the TFTA. The issue of rules of origin quickly became the main negotiating issue of the TFTA and after more than ten years from the start the negotiations on rules of origin are yet to be concluded.

The newly launched African Continental Free-Trade Area (AfCFTA) has also been witnessing complex and protracted negotiations on rules of origin that by the time of the launching of the AfCFTA on May 30, 2019 were not yet concluded. Following an extraordinary AU summit held in December 2020, it has been decided to kick-start trading under a transitional set of agreed of rules of origin pending final consensus on a number of PSROs and related issues.

Apart from the lengthy and expensive negotiation outlined above, the absolute lack of transparency on the applicable legal texts in force cannot be overemphasized. The respective RECs' websites are often not updated or not accessible and the myriad of Internet websites report different versions of the applicable rules of origin. The

[195] See the COMESA Protocol on rules of origin. The document is undated but presumably from 2015. It is available on the website of the Kenyan State Department of Trade: www.trade.go.ke/content/comesa-protocol-rules-origin-2015.

[196] See F. Flatters, "SADC rules of origin: Undermining regional free trade," report prepared for the TIPS Forum, 2002.

attempts made to publish manuals are also not helping since the manuals at times contradict the legal texts or add interpretations or obligations that further complicate rather than facilitate the use of the free-trade agreement by the private sector.

This section examines the history and reasons why rules of origin in the continent have been – and still are – a formidable obstacle in African free-trade agreements rather than being a tool to access the tariff preferences derived from such free-trade agreements. The author has been involved in the negotiations of SADC, TFTA, and AfCFTA and has witnessed the various phases of the negotiations.

The recent technicalities of the negotiations in the TFTA and AfCFTA have introduced an unprecedented layer of complexities that are unjustified when compared with the amount of intraregional trade of the continent. In simple words, African member states are involved in strenuous, complex, and extremely detailed RoO negotiations at a highly disaggregated level – that is, heading or subheading – even when there is no or little intraregional trade or limited amount for the specific product falling in the specific heading or subheading.

It is not uncommon to witness entire days spent in negotiating rules of origin on products or issues that have no or limited relevance or applicable tariff. Nor is there any hope that the rules of origin emerging from such negotiations are trade creating since they are most of the time more stringent than those that the same African states have negotiated with the EU. In most of the cases the rules of origin contained in economic partnership agreements (EPAs) with the EU discussed in Chapter 3 of this book are more liberal than those negotiated under the African RECs.

Table 5.14 provides an overall summary of the rules of origin applicable under the various RECs.

As further discussed in the following paragraphs it emerges quite clearly that rules of origin in African RECs have progressively evolved from a series of general across-the-board alternative criteria modeled on the COMESA original format that provided for five alternative rules of origin criteria[197] to PSRO. SADC has been the first to embark on such a route at the time of the negotiations on SADC trade protocol back at the beginning of the 1990s. COMESA and EAC followed later with a mixture of alternative general criteria across the board and PSRO that remain applicable under the current COMESA rules of origin. EAC most recently[198] moved toward the adoption of PSRO adopting a similar structure and content to that of the EPA with the EU.

The current EAC rules of origin may be, as a consequence, the most liberal rules of origin applicable in sub-Saharan Africa. Some parts of the main text of the rules of origin negotiated under AfCFTA[199] also benefit from the experience gained in negotiating EPAs with the EU. Yet the negotiating process of AfCFTA seems a replica

[197] As discussed in section 5.4.7.1.
[198] See the East African Community Customs Union (Rules of Origin) Rules, 2015.
[199] See Draft Annex 2 of AfCFTA of August 2018.

TABLE 5.14 *Comparison of main origin criteria and related origin issues of main African RTAs*

	COMESA	EAC	ECCAS	ECOWAS	SADC	TFTA
Main origin criteria						
Ad valorem criterion	General: Yes Three ad valorem percentage calculations and CTH[i]	General: No	General: Yes Uniform percentage across all products[ii]	General: Uniform percentage across all products[iii]	General: No	General: No
CTC criterion (No. of PSRO[iv] pages as a proxy for complexity of CTC criterion)	91	51	N/A	N/A	24	28
Ancillary rules						
Cumulation	Yes	Yes	Yes	No explicit terms in legal text	Yes	Yes
Tolerance	No	Yes	No	No	Yes	Yes
Absorption	Yes	Yes	Yes	No	Yes	Yes
Documentary requirements (certification and direct transport)						
CO	CO	CO 2nd Origin Declaration 4th Schedule	CO	CO[v]	CO	CO

(*continued*)

TABLE 5.14 (*continued*)

	COMESA	EAC	ECCAS	ECOWAS	SADC	TFTA
Certifying authorities	Yes Specimen impressions of the stamps and specimen signatures of the officials are required	Yes Specimen impressions of the stamps and specimen signatures of the officials are required	Yes Specimen impressions of the stamps are required	Yes Signature must be provided with name and function	Yes Specimen impressions of the stamps and specimen signatures of the officials are required	Yes Specimen impressions of the stamps and specimen signatures of the officials are required
Notification requirement of certifying authorities	Yes	Yes	Yes	Yes	Yes	Yes
Exporter declaration (self-certification)	No	No	No	No	No	No
Approved exporter	No	Yes	No	No	No	Yes
Exporter declaration for small consignment	No	Yes Maximum 500 USD for shipment person to person; or maximum 1,200 USD as traveler luggage	No	No	No	Yes Maximum 500 USD for shipment person to person; or maximum 1,200 USD as traveler luggage
Direct shipment requirement	Yes	Yes	No clear provision provided in the text	Not explicitly provided however definition of consignment is provided	Yes	Yes

Documentary evidence of direct shipment requirement	No clear provision provided in the text	No clear provision provided in the text	No clear provision provided in the text	Not explicitly provided however definition of consignment is provided	Single transport document or a document certified by the Customs authorities of the third country	Single transport document or a document certified by the Customs authorities of the third country[vi]
Obligation of pre-registration and approval by manufacturer/ exporter	No	No	Yes	Yes	No[vii]	No

[i] CTH
[ii] Economic Community of Central African States (ECCAS) Annex 20 of 2004 refers to PSRO. Minimum value is contingent on the calculation criterion used.
[iii] Minimum 30% using value added by subtraction (VAVNOM). As a general rule, CTSH is also provided. However, such general rule must be accompanied by a list of exemptions.
[iv] Based on the number of pages in the provided appendix of each of the RECs.
[v] Agricultural products, livestock products, handmade articles are exempted from this requirement.
[vi] If these documents are not available, any substantiating evidence could be accepted. See Article 18 of TFTA rules of origin.
[vii] It is recommended but not compulsory.

of the TFTA in terms of length, complexities, and technicalities. AfCFTA negotiations on the PSRO contained in Appendix IV to Annex 2 of AfCFTA on rules of origin are carried out at highly disaggregated levels, sometimes at subheading level with little technical support, given the format and management of the negotiating process.

Table 5.15[200] summarizes the different methodologies used by African RECs that use the ad valorem percentage criterion as a general rule applicable to all products (i.e. the Economic Community of West African States – ECOWAS) or in combination with other criteria (i.e. COMESA) for all products or in all products and in PSRO – namely SADC.

It clearly emerges from the table that most African RECs – namely, EAC, SADC, COMESA 2, and ECOWAS – utilize a calculation methodology based on value of materials as outlined in Chapter 6 of this book.

In some cases, the wording of the rules of origin contained in COMESA, ECOWAS, ECCAS and SADC refers to "value added." However, a closer look to the legal texts in conjunction with the manuals on rules of origin[201] reveals that the actual calculation methodology is a value-added calculation by subtracting the value of non-originating materials.

This methodology of value of materials based on transactional value is the most commonly used and is the result of the evolution of the ad valorem percentage criterion. This is the same calculation made on the basis of value of materials as outlined in Chapter 6 of this book.

In addition, COMESA and ECCAS are using as one of the alternative criteria a rather unique calculation methodology using as denominator the total cost of materials used in the production of the good.

[200] Adapted table from the study elaborated by the author and presented as an UNCTAD contribution titled "The methodologies of drafting the ad valorem percentage criterion Existing practices in African RECs and way forward in AfCFTA Note drafted by the Division for Africa, Least Developed Countries and Special Programmes of the United Nations Conference on Trade and Development (UNCTAD) in preparation of the AfCFTA 7th Technical Working Group Meeting on Rules of Origin, July 2018."

[201] See, for instance, the COMESA Manual on Rules of Origin, p. 128, where the calculation of value added is made by subtracting the value of non-originating materials rather than by addition. Similarly, p. 15 of the SADC Manual on Rules of Origin provides for the same methodology of COMESA: "The value added is the difference between the ex-factory price of the finished product and the c.i.f. value of imported materials used in production. Article 1 of the ECOWAS protocol on rules of origin defines value added as follows: 'Value-added' means the difference, expressed as a percentage, between the ex-factory price of the finished product before tax, and the CIF value of raw materials consumables and packaging of non-ECOWAS origin, used in the manufacture of the final product in the form under which it is released into circulation." The drafting of these sections is based on the legal texts available in the websites or made available to the Author from official sources. Yet, one of the main challenge has been to make sure that the texts were the most updated possible.

TABLE 5.15 *Ad valorem percentage criterion calculation methodologies of African RECs*

	EAC	SADC	COMESA 1	COMESA 2	ECOWAS	ECCAS 1[i]	ECCAS 2[ii]	TFTA 1[iii]	TFTA 2
Numerator	Value of non-originating materials (VNOM)[iv]	Value of non-originating materials[v] (VNOM)[vi]	Value of originating materials[vii] (VOM)[viii]	Ex-factory cost of the finished product – CIF Value of non-originating materials[ix]	Ex-factory price of the finished product before tax – CIF value of non-originating materials[x]	Regional Value of originating materials (VOM)	Ex-works before tax – CIF value of non-originating materials	VNOM[xi]	VOM
Denominator	Ex-works price[xii]	Ex-works price[xiii]	Total Value of materials used in the production of the goods[xiv]	Ex-factory cost[xv]	Ex-factory price[xvi]	Total Value of materials used in the production of the goods	Ex-factory price (Cost price ex-works before tax as defined in ECCAS texts)	Ex-works price[xvii]	Ex-works price

(*continued*)

TABLE 5.15 (*continued*)

	EAC	SADC	COMESA 1	COMESA 2	ECOWAS	ECCAS 1[i]	ECCAS 2[ii]	TFTA 1[iii]	TFTA 2
Method of calculation	Max. VNOM	Max. VNOM	Max. VNOM	Value added by subtraction VAVNOM	Value added by subtraction VAVNOM	Min. VOM	Value added by subtraction VAVNOM	Max. VNOM	Min. VOM

[i] Extracted from Annex 1 of ECCAS Decision No. 03/CEEAC/CCEG/XI/04 Article (2)–(3).
[ii] Ibid.
[iii] Based on 2010 Protocol 4 on TFTA rules origin.
[iv] Extracted from EAC Customs Union rules of origin (2015), Rule 7, paras. 4 and 5.
[v] Extracted from Annex 1 of SADC Protocol on Trade, Rule 2, section 3.
[vi] Ibid. See also Appendix I of Annex I.
[vii] Ibid.
[viii] Extracted from COMESA Protocol on Rules of Origin, Rule 4.
[ix] Extracted from COMESA Protocol on Rules of Origin, Rule 2 b-ii.
[x] Extracted from Protocol A/P1/1/03 of ECOWAS, Article 4(2).
[xi] Extracted from the annex on rules of origin under Article 12 of the Agreement, Article (5)–(6).
[xii] Extracted from EAC Customs Union rules of origin (2015), Rule 7, paras. 4 and 5.
[xiii] Extracted from SADC Procedures Manual on the Implementation of Rules of Origin, Appendix 1 of SADC Protocol on Trade, Part 2, section 2.5.
[xiv] Together with ECCAS, this is a unique formulation as it refers as denominator to the total cost of material. Extracted from COMESA Protocol on Rules of Origin, Rule 2 b-i.
[xv] Extracted from COMESA Protocol on Rules of Origin, Rule 4.
[xvi] Extracted from Protocol A/P1/1/03of ECOWAS, Article 4(2). See section 5.4.7.2 for further discussions about numerator and denominator that are not entirely clear in ECOWAS official texts. The original French version made reference to ex-factory cost
[xvii] Extracted from the annex on rules of origin under Article 12 of the Agreement, Article (5)–(6).

As shown in Table 5.16, the method of calculation used by African Union (AU) member states with the EU under the different EPAs is based on a method of calculation of a maximum allowance of non-originating materials as discussed in Chapter 3.

The United States and the African Growth Opportunity Act (AGOA) still use a value-added calculation as outlined in Table 5.16. It has to be noted that the AGOA rules of origin also provide for the use of PSRO in the case of textiles and clothing and that the US administration has progressively abandoned the use of the ad valorem calculation methodology based on value added to adopt other kinds of calculation methodology as discussed below in Chapter 6 of this book.

A common crippling feature of the use of the ad valorem percentage requirement in African RECS is emerging from a reading of the legal texts and the manuals of the existing RECs. The legal texts and/or the manuals of the rules of the RECs detail the components of the ex-works price with painstaking details going over three or more pages to list what could be included/excluded.

As an example, the following is the definition of ex-factory cost in the COMESA manual[202] in the calculation of ex-factory cost.

The following costs, charges and expenses should be included:

(a) The cost of imported materials, as represented by their c.i.f. value accepted by the Customs authorities on clearance for home consumption, or on temporary admission at the time of last importation into the Member State where they were used in a process of production, less the amount of any transport costs incurred in transit through other member States.

Provided that the cost of imported materials not imported by the manufacturer will be the delivery cost at the factory but excluding customs duties and other charges of equivalent effect thereon;

(b) The cost of local materials, as represented by their delivery price at the factory;

(c) The cost of direct labour as represented by the wages paid to the operatives responsible for the manufacture of the goods;

(d) The Cost of direct factory expenses, as represented by:
   (i) the operating cost of the machine being used to manufacture the goods;
   (ii) the expenses incurred in the cleaning, drying, polishing, pressing or any other process, as may be necessary for the finishing of the goods;
   (iii) the cost of putting up the goods in their retail packages and the cost of such packages but excluding any extra cost of packing the goods for transport a on or export and the cost of any extra packages;
   (iv) the cost of special designs, drawings or layout; and the hire of tools, or equipment for the production of the goods.

(e) The cost of factory overheads as represented by:
   (i) rent, rates and insurance charges directly attributed to the factory;

[202] See pp. 125–127 of the COMESA Procedures for the Implementation of the Protocol on Rules of Origin contained in the COMESA.

TABLE 5.16 *Ad valorem percentage criterion calculation methodologies of EU EPA, EBA, EU/US/Japan GSP, and AGOA*

	EU EPA[i] (CARIFORUM,[ii] ESA,[iii] SADC,[iv] Pacific[v])	EU MAR[vi] (EAC[vii])	EU EPA[viii] (Cameroon[ix])	EU MAR (ECOWAS[x])	EBA[xi]	US GSP[xii]	AGOA[xiii]	Japan GSP[xiv]
Numerator	VNOM	VNOM	VNOM	VNOM	VNOM	Value of originating materials plus direct processing cost	Value of originating materials plus direct processing cost	VNOM
Denominator	Ex-works price	Ex-works price	Ex-works price	Ex-works price	Ex-works price	Appraised value of the article at the time of entry into the United States	Appraised value of the article at the time of entry into the United States	FOB price

Method of calculation	Maximum VNOM	Maximum VNOM	Maximum VNOM	Maximum VNOM	Maximum VNOM	Value added by addition	Value added by addition	Maximum VNOM

[i] All the EU EPA for SADC, Eastern and Southern Africa (ESA), Caribbean Forum (CARIFORUM), and Pacific follow the same format. For more details, see http://trade.ec.europa.eu/doclib/docs/2008/february/tradoc_137971.pdf.

[ii] CARIFORUM member countries are Antigua & Barbuda, Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Jamaica, Saint Lucia, Saint Vincent & Grenadines, Saint Kitts & Nevis, Surinam, Trinidad & Tobago, and Dominican Republic.

[iii] ESA member countries are Madagascar, Mauritius, Seychelles, and Zimbabwe.

[iv] SADC member countries are Botswana, Lesotho, Mozambique, Namibia, South Africa, and Swaziland. Angola has an option to join in the future.

[v] Members states include Papua New Guinea and Fiji.

[vi] For more details, see https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016R1076&qid=1486666013531. EU MAR (ECOWAS) is also covered in this document.

[vii] EAC members include Kenya.

[viii] For more details, see https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:057:0002:0360:EN:PDF.

[ix] Cameroon has an EU EPA but follows Market Access Regulation rules of origin. See https://trade.ec.europa.eu/tradehelp/proofs-and-rules-origin-mar#:~:text=MAR%20provides%20duty%20free%20quota,(EPAs)%20pending%20their%20ratification.

[x] West African countries under MAR are the following: Benin, Burkina Faso, Cape Verde, Gambia, Guinea, Guinea, Bissau, Liberia, Mauritania, Mali, Niger, Nigeria, Senegal, Sierra Leone and Togo. Ivory Coast and Ghana are under EU EPA.

[xi] For more details, see http://trade.ec.europa.eu/tradehelp/basic-rules.

[xii] For more details, see https://ustr.gov/sites/default/files/GSP%20Guidebook%20October%202015%20Final.pdf.

[xiii] For more details, see https://agoa.info/about-agoa/rules-of-origin.html.

[xiv] For more details, see www.mofa.go.jp/policy/economy/gsp/explain.html#section8.

(ii) indirect labour charges, including salaries paid to factory managers, wages paid to foremen, examiners and testers of the goods;
(iii) power, light, water and other service charges directly attributed to the cost of manufacture of the goods;
(iv) consumable stores, including minor tools, grease, oil and other incidental items and materials used in the manufacture of the goods;
(v) depreciation and maintenance of factory buildings, plant and machinery, tools and other items used in the manufacture of the goods

The following costs, charges and expenses should be excluded

(a) Administration expenses as represented by:
(i) office expenses, office rent and salaries paid to accountants, clerks, managers and other executive personnel;
(ii) directors' fees, other than salaries paid to directors who act in the capacity of factory managers;
(iii) statistical and costing expenses in respect of the manufactured goods;
(iv) investigation and experimental expenses.
(b) Selling expenses, as represented by:
(i) the cost of soliciting and securing orders, including such expenses as advertising charges and agents' or salesmen' commission or salaries;
(ii) expenses incurred in the making of designs, estimates and tenders.
(c) Distribution expenses, represented by all the expenditure incurred after goods have left the factory, including;
(i) the cost of any materials and payments of wages incurred in the packaging of the goods for export;
(ii) warehousing expenses incurred in the storage of the finished goods;
(iii) the cost of transporting the goods to their destination.
(d) Charges not directly attributed to the manufacture of the goods:
(i) any customs duty and other charges of equivalent effect paid on the imported raw materials;
(ii) any excise duty paid on raw materials produced in the country where the finished goods are manufactured;
(iii) any other indirect taxes paid on the manufactured products;
(iv) any royalties paid in respect of patents, special machinery or designs; and
(v) finance charges related to working capital.

In addition to the inherently complex calculation that such definition entails it has to be pointed out that both SADC and EAC use, with minor changes in the wording, the same abovementioned definitions as COMESA when defining the components of the ex-works price above adding profit but deducting all the administrative expenses included under (a) above.

One can only imagine the discretionary practices that importing/exporting certifying authorities and customs may have in assessing compliance with such complex determination of the ex-factory cost or ex-factory price. Such lengthy and complex definitions of the ex-works or ex-factory price do not find any comparable features in

the best practices adopted by the main trading partners such as the EU and United States. As further discussed in Chapter 6, all major administrations refer, for the definition of ex-works price or FOB, to the transaction value principles and alternative methodologies of the WTO customs valuation agreement.

5.4.7.1 SADC, COMESA, and EAC Experience

COMESA, SADC, and EAC are the three largest blocs in Eastern and Southern Africa, showing rather similar paths on rules of origin. The rules of origin that were first contained in the original SADC Protocol were inspired by those adopted by COMESA. EAC followed a similar path.

The COMESA rules of origin, being one of the first set of rules of origin on the African continent, exerted vast influence over the remaining free-trade agreements or RTA on the African continent.

The original COMESA rules origin, adopted a rather typical compromise to make every negotiator satisfied but the ultimate user confused, as follows:

1. Goods shall be accepted as originating in a member State if they are consigned directly from a member State to a consignee in another member State and:
   a. they have been wholly produced as provided for in Rule 3 of this Protocol; or
   b. they have been produced in the member-states wholly or partially from materials imported from outside the member-states or of undetermined origin by a process of production which effects a substantial transformation of those materials such that:
      i. The c.i.f. value of those materials does not exceed 60 percent of the total cost of the materials used in the production of the goods; or
      ii. The value added resulting from the process of production accounts for at least 35 percent of the ex-factory cost of the goods; or
      iii. The goods are classified or become classifiable under a tariff heading other than the tariff heading under which they were imported (the workings and processing conferring origin under this Rule are in Appendix V); or
   c. They are produced in the Member State and designated in a list by the Council upon the recommendation of the Committee through the IC to be goods of particular importance to the economic development of the member States, and containing not less than 25 per cent of value added notwithstanding the provisions of sub-paragraph (b) (ii) of paragraph 1 of this Rule. The list of goods so designated by Council is in Appendix VI.

According to this original drafting, the COMESA rules origin provided for five alternative criteria:

- wholly obtained

- a percentage criterion of not more than 60 percent of imported material out of the total cost of the material used in the production of the good
- a valued added of 35 percent out of the ex-factory cost
- a CTH rule
- a value added of 25 percent per cent value for goods of particular importance to the economic development of COMESA member states.

This COMESA architecture of rules of origin has been a source of inspiration for a variety of rules of origin used in South–South free-trade agreements. The original rules of origin texts of SADC, EAC, and Mercosur rules of origin were somewhat similar.

Such rules of origin, providing for multiple alternatives, give the impression of being of a liberal nature. However, there are a series of technical flaws in such rules.

As outlined later in more detail there is nothing wrong in providing alternative rules of origin for the same product. Both the pan-European model of rules origin, USMCA, and other most recent US inspired rules of origin contain provision for alternative rules of origin or different percentages. However, the alternatives provided must logically have the same or equivalent degree of restrictiveness (i.e. – to borrow a term from the nonpreferential rules of origin – they should be co-equal). Failing this, the exporter/producer will have a strong incentive to pick and choose the easiest rule to comply with and the other rules will be simply redundant. Ultimately the alternatives are only valid on paper since the most liberal rules of origin will be those used by the exporter/manufacturers.

As widely known, the CTH is quite easy to comply with for some products and a quite stringent rule for other kind of products. It follows that a producer will choose the CTH when it is easy to comply with and will switch to percentage requirements when they cannot satisfy the CTH. This may sound business friendly but, in reality, does not provide a workable basis for administering a set of rules of origin. It is unknown, or will require an extensive research, to find all the occurrences when the CTH is easy to comply with or when it is not. Ultimately adopting CTH as an across-the-board criteria is tantamount to leaving the origin to be determined by the hazard.

In addition, it was never clear if the CTH option mentioned in the original text was really effective. COMESA officials held, together with the author during the TFTA negotiation, that the CTH option was not an across-the-board option but was, in reality, meant to be a criteria to develop a series of PSRO expected to be negotiated at a later stage.

This argument was in line with a COMESA initiative that lasted years, aiming at turning the original simple across-the-board CTH origin criteria for all products into product-specific rules leaving, at same time, the option to use the percentage requirements listed above.

The latest available version of the COMESA[203] rules of origin contains a series of significant changes as follows:

RULE 2
Rules of Origin of the Common Market for Eastern and Southern Africa

1. Goods shall be accepted as originating from a Member State if they are consigned directly from a Member State to a consignee in another Member State and
   (a) They have been wholly produced as provided for in Rule 3 of this Protocol; or
   (b) They have been produced in the Member States wholly or partially from materials imported from outside the Member States or of undetermined origin by a process of production, which effects a substantial transformation of those materials such that:
      (i) The c.i.f. value of those materials does not exceed 60 percent of the total cost of the materials used in the production of the goods; or
      (ii) The value added resulting from the process of product on accounts for at least 35 percent of the ex-factory cost of the goods; or
      (iii) The goods are classified or become classifiable under a tariff heading other than the tariff heading under which they were imported (the workings and processing conferring origin under this Rule are in Appendix V); or
   (c) They are produced in the Member State and designated in a list by the Council upon the recommendation of the Committee through the IC to be goods of particular importance to the economic development of the member States, and containing not less than 25 per cent of value added notwithstanding the provisions of sub-paragraph (b) (ii) of paragraph 1 of this Rule. The list of goods so designated by Council is in Appendix VI.
2. The Council may:
   (a) Determine how long the goods contained in the list referred to in sub-paragraph (c) of paragraph (1) of this Rule shall remain on such list and may, from time to time, amend it as may be necessary; and
   (b) Amend any of the percentage values and value added specified in sub-paragraph (b)(i) and (ii) of paragraph 1 of the Rule, from time to time, as may be necessary.

The new version of the COMESA Protocol and the manual brings a series of welcomed clarifications that had been outstanding for more than a decade. First, paragraph 1(b)(iii) links the CTH to the list of specific working and processing to Appendix V and, second, paragraph 1(c) lists the "goods of particular importance to the Economic development" that are subject to 25 percent value-added requirement. Still a number of observations about the co-equality of the alternative rules of

[203] See the COMESA Protocol on rules of origin. The document is undated but presumably from 2015. It is available on the website of the Kenyan State Department of Trade: www.trade.go.ke/content/comesa-protocol-rules-origin-2015.

origin raised above are valid and a number of additional improvements could have been made as further discussed in Chapter 6.

The original SADC rules were largely inspired by the old version of the COMESA rules of origin. Goods would qualify for SADC tariff preferences if they (a) underwent a change of tariff heading or (b) contained a minimum of 35 percent regional value added, or (c) included non-SADC imported materials worth no more than 60 percent of the value of total inputs used.

The CTH rule contained in the original Protocol was accompanied by a provision in paragraph 2 for the elaboration of a list of working and processing to be carried out on non-originating materials in order for the manufactured product to obtain originating status. Paragraph 5 provided for cumulative treatment of goods processed in more than one member state. Finally, the requirements of Rule 2 may be subject to derogations, as provided by Rule 12.

Earlier in the negotiations on the implementation of the trade Protocol, the South African Customs Union (SACU) but mainly South Africa proposed to implement the abovementioned rule by developing product-specific rules especially in a very important manufacturing sector such as the textile and garment industry. South Africa was in fact extremely concerned that the trade Protocol, in its original formulation, provided for three general alternative rules of origin opening up the possibility of trade deflection.

Moreover, at the time when the SADC rules of origin started to be considered, South Africa had already entered into the Trade and Development Cooperation Agreement (TDCA) with the EU.

The TDCA was a free-trade agreement of a new generation encompassing areas besides trade in goods. In the case of rules of origin, the TDCA adopted the Pan-European Rules of Origin with minimal variations. During the SADC negotiations it became clear that the South Africa wished to adopt a similar model in the SADC context. South Africa's proposal initially met with opposition from other SADC member states. However, later in the negotiations, it was agreed to adopt a negotiating text that was partially based on the EU architecture of preferential rules of origin. This marked a radical shift from the across-the-board set of rules of origin contained in the SADC Trade Protocol to PSRO negotiations.

At a technical level, such a move might have been justified by the desire of providing a transparent and fair set of rules of origin for the SADC region. However, it soon emerged during the negotiations that other reasons were the real underpinnings of such an approach.

One of the first SACU proposals of product-specific rules demanded a wholly obtained requirement for many agricultural chapters including those classifying food-processing products. SACU required in a number of cases that the raw materials undergo a "double transformation," and not a CTH, in order for the manufactured product to acquire originating status. For example, in the case of "articles of apparel and clothing accessories, not knitted or crocheted," ex-HS Chapter 62, the

rule of origin required the manufacture to start from yarn. A garment maker who imports woven fabrics from outside the region would not be able to benefit from the preferential access to the SADC market because their finished products would not comply with the abovementioned origin rule. Thus, it would be necessary either to spin the yarn locally or to import the fabric from another SADC producer, so that the rule would be fulfilled through the cumulation mechanism. SACU held the view that rules of origin should help in the development of regional industry making sure that regional inputs should be favored over local inputs.

Other SADC member states argued that rules requiring a double transformation were basically mirroring the same EU rules that have been hampering the utilization of trade preferences under GSP or Lomé preferences for the last decades.

Ultimately the product-specific approach opened the Pandora's box of lobbies and powerful South African labor unions with the direct consequence that the area of contentions expanded to wheat, wheat flours and their products, coffee, tea and spices, and machinery and electrical products. At times, bizarre arguments such as environmental considerations accompanied the justification of restrictive rules of origin.

In the majority of cases, the crucial point debated during the negotiations was the implication of PSRO on the existing production chains of the SADC region. A double-processing requirement may match certain vertical-oriented production facilities that in reality scarcely exist, even in South Africa, the main industrialized country of southern Africa. The application of PSRO requiring double processing may be problematic because the producer will have either to change the source of its inputs, or invest in new machinery, or forego the tariff preferences. The ultimate result of such fierce and, at times acrimonious, negotiations[204] was a compromise rule for certain garments between SACU and the MMTZ (Malawi, Mozambique, Tanzania, and Zambia). Under this arrangement MMTZ were allowed to use imported fabrics to manufacture garments exported to SACU under a quota system. This compromise allowed the critical mass of consensus to make operational the SADC Trade Protocol. However, at the time of approval of the final negotiating package of the SADC Trade Protocol by SADC ministers in 2000, a number of PSRO were not agreed. Subsequent negotiations were unable to bridge a compromise and SADC rules of origin are commonly considered as a restrictive and business unfriendly set of rules of origin.

ASEAN, COMESA, and SADC have experienced problems with the origin criteria for flour. Some of their member states hold the view that grinding cereals of Chapter 10 into flour of Chapter 11 is not origin conferring. Others argued that grinding cereals into flour is an origin-conferring operation. Depending on the PSRO adopted, origin may be conferred by grinding because the calculation of the valued added may eventually satisfy

[204] The compromise was only reached after a series of inconclusive meetings and required the intervention of the Trade Minister of South Africa.

the 35 percent requirement. Conversely, if a PSRO requires the use of originating wheat to make flour, origin will not be conferred.

Thus, depending on the criteria used we may have two different origin outcomes. The following is another example for wooden tables:[205]

Materials	Cost (currency unit)
Timber:	
Local timber	200
From member State Z	100
Malaysian origin	900
Other costs	
Glue (imported from Brazil):	5
Varnish (imported from Germany):	8
Factory overheads:	
Rent and rates	100
Depreciation of machinery	80
Direct labor	300
Ex-factory cost	1,693

Calculations:

(a) (i) Import material content

$$= \frac{900 + 5 + 8}{200 + 100 + 900 + 5 + 8} = \frac{913}{1213} = 75\%$$

OR

(ii) Local material content

$$= \frac{200 + 100}{200 + 100 + 900 + 5 + 8} = \frac{300}{1213} = 25\%$$

(b) Value added $= \frac{1693-913}{1693} = 46\%$

The material content and value added should be calculated to the nearest whole number.

Example:

74.9 percent = 75 percent

74.5 percent = 75 percent

74.4 percent = 74 percent

[205] This example is used in the COMESA, SAC, and EAC manuals.

Explanation

It is clear from the above that the table largely satisfies the value-added criterion.[206] However, the same table would not satisfy the material-content criterion, because imported materials exceed 60 percent of the total cost of materials used in producing the table.

This example shows the consequences of a pick-and-choose approach. Some believe, however, that such an approach with different alternatives is business friendly because the producers/manufacturers have the flexibility to choose the rule that suits them best. However, when this reasoning is pushed to the extreme with the option of complying with a simple CTH criterion, it is obvious that such a loophole may work as an incentive to be exploited by unscrupulous traders.

A number of problems with rules of origin have been reported and discussed by COMESA member states within the internal negotiating machinery.[207] These difficulties have eventually generated the initiative of further defining the meaning of Rule 2(1)(b)(iii) of the Protocol by developing PSRO.

As mentioned at beginning of this section, it took several years to develop PSRO to replace the original across-the-board CTH approach. The alternative rules of origin based on the value added and the local material content will still be applicable. The simple CTH rules in the case of Chapter 61 have been replaced with a CTH with exception from heading 6217 to avoid a situation where the manufacture of products of Chapter 62 from parts and accessories classified in heading 62.17 confers originating status, as shown in the following table.

HS code	Description of goods	Working or processing carried out on non-originating materials that confers originating status
A	B	C
Ex. Chapter 62	Articles of apparel and clothing accessories, not knitted or crocheted	Manufacture from materials classified in a heading other than that of the product, except from materials from heading 62.17.
62.17	Other made up clothing accessories; parts of garments or of clothing accessories, other than those of heading No. 62.12	Manufacture from materials classified in a heading other than that of the product, except from materials of other headings of this Chapter.

As in the case of SADC, the elaboration of product-specific rules opened the Pandora's box of protectionist intents and related concerns. Ultimately this meant persistent disagreement on a number of tariff lines in particular headings 11.01, 11.02, 15.07,

[206] See Flatters, "SADC rules of origin: Undermining regional free trade" (fn. 196 above).

[207] Except for the following headings to which other rules are applicable: ex-6202, ex-6204, ex-6206, ex-6209 and ex-6211; ex-6210 and 6216; 6213 and 6214; and 6217.

15.08, 15.10, 84.22, 84.39–84.42, 84.76–84.79, 85.09, 85.10, 85.12, and 85.16 and Chapters 50, 51, 53–55, and those related headings.

Past experience would suggest that there is a need to rationalize the architecture of the COMESA rules of origin before entering into such complex and time-consuming discussion at product-specific level. COMESA member states should make the best possible efforts to refrain from adopting restrictive PSRO that do not reflect production reality in the region.

5.4.7.2 ECOWAS and ECCAS Experience

The ECOWAS rules of origin are scattered over four major legal texts that do not appear related to them in any logical or legal manner. An ECOWAS document of 2004 lumps together these different texts.[208] The main reference text of the ECOWAS rules of origin is contained in the "Protocol relating to the definition of the concept of originating from member states of Economic Community of West African States"[209] (hereinafter "the Protocol").

Three regulations[210] issued on the occasion of the Fifth Extraordinary Session of the Council of Ministers form ancillary legislation. However, none of the regulations makes an express reference to the Protocol, as they appear rather to relate to the harmonization efforts of the liberalization schemes of ECOWAS and the West African Economic and Monetary Union (WAEMU), as reflected in their respective preambles. At the time of writing a large technical assistance project funded by the EU is assisting ECOWAS in reviewing the existing rules of origin and related administrative procedures. It is hoped that such exercise will bring clarity and predictability.

In its Article 2, the Protocol provides for two kind of originating goods: wholly produced (further defined in Article 3) and goods that "have been produced in Member States but contain raw materials which were not wholly obtained from Member States." These goods, according to Article 2, have to undergo processing or transformation as defined in Article 4 of the Protocol.

Article 4 of the Protocol titled "operations and processes conferring origin"[211] provides as follows:

[208] The ECOWAS trade liberalization scheme, protocols, and regulations, published by the ECOWAS Executive Secretariat, 2004.

[209] The ECOWAS Protocol A/P1/1/03, January 31, 2003 defines the concept of originating products and origin criteria applicable for the free circulation of industrial goods.

[210] Regulation REG.5/4/02 relating to the assessment of the components making up the ex-factory price of a finished product before tax and the values added, April 2002; Regulation: REG./3/4/02 establishing procedures for the approval of originating products to benefit under the ECOWAS trade liberalization scheme (April 2002); and Regulation 4/4/02 adopting an ECOWAS certificate of origin.

[211] Note: "products" instead of "goods" where "goods" means materials and "products," according to the definitions in the Preamble of the Protocol, and "product" means a finished product, even if the product is to be used thereafter in the manufacture of another product.

> For the purpose of this protocol, the following operations and processes shall be considered as sufficient to support a claim of origin from a Member State:
>
> Where
>
> 1. goods are not wholly produced in Member States and where their production requires the exclusive use of materials which are to be classified under a different tariff sub-heading from that of the product;
>
> The above rule shall be accompanied by a list of exemptions mentioning the cases where the change in the sub-heading is not a determining factor, or imposing additional conditions. The list shall be established in by a Regulation of the Council of Ministers.
>
> Or
>
> 2. goods are not wholly produced in Member States and where their production requires the use of materials which have received a value-added of at least 30% of the ex-factory price of the finished goods

In addition, Article 5 of the Protocol provides as follows:

> Originating industrial goods shall be those referred to in articles 2 and 3 (j) of this Protocol, with the exception of hand-made articles or articles produced without the use of tools, instruments or implements directly operated by the manufacture.

This article appears to be rather redundant since Article 4, paragraph 2 already provides the main criterion for rules of origin being an ad valorem percentage criterion. Article 5 refers also to Article 3 where it mentions paragraph (j).

Paragraph (j) of Article 3 provides that *wholly produced goods* are, inter alia:

> goods produced from the materials listed in paragraphs (b) to (i) of this article, used alone or mixed with other materials, provided that they represent at least 60% of the total quantity of raw materials used.

This drafting is unclear since the category of wholly produced goods is, by its very nature and definition, wholly produced (100 percent). If the attempt of this article is to set criteria for goods that are produced using 60 percent of originating raw material, its place is surely not among the list of wholly produced goods.[212]

Conversations of the author with officials of the ECOWAS during AfCFTA negotiations confirmed that ECOWAS members states have not yet developed product-specific rules of origin (PSRO) provided under Article 4. It follows that the first

[212] The ECOWAS website on the ETLS seems to suggest such a reading of this rule. See www.etls.ecowas.int/.

criterion is inapplicable[213] since there is no trace of a list of "exemptions" mentioning the cases where "the change in the sub-heading is not a determining factor, or imposing additional conditions."

The second criterion is requiring a 30 percent of the value added out of the ex-factory price of the finished product. However, in the Protocol it is not clear or specified what constitutes *value added*.

The Regulation REG.5/4/02, relating to the assessment of the components making up the ex-factory price of a finished product before tax and the values added,[214] is designed to shed light on the definition of value added.[215]

Article 2 of the Regulation REG.5/4/02 provides as follows:

> Value-added is defined as the difference expressed as a percentage of the ex-factory price before tax of the finished product concerned and the CIF value of raw materials, consumables and packaging of foreign origin, utilised in obtaining the final product in the form under which it is released for consumption.

This definition could be summarized by the following calculation formula:

$$RVC = \frac{\text{Ex-factory price before tax} - \text{CIF value or raw material of foreign origin}}{\text{Ex-factory price before tax}} \times 100 \geq 30\%$$

However, there is no trace in Regulation REG.5/4/02 or in the Protocol of how the percentage should be calculated.[216] On the contrary, Regulation REG.5/4/02 contains an in-depth definition of ex-factory price that does not reflect the common understanding of ex-factory price as defined in INCOTERMS.[217] Conversations of the author with ECOWAS officials confirmed that there are differences in the English and French text where the French text makes reference to *prix de revient ex-usine* that should be translated into an English equivalent of "ex-factory cost." During AfCFTA, ECOWAS member states reiterated that ECOWAS is using as a denominator the ex-factory cost. Be that as it may, it is clear from the above that the ECOWAS RoO texts need consolidation and clarification. The ECOWAS website containing the legal texts is not easily accessible.

[213] The ECOWAS website on the ETLS (ibid.) seems to suggest that CTH is operational and not CTSH. Obviously, this is rather confusing.

[214] ECOWAS Council of Ministers, 23 April 2002.

[215] Its preamble also refers to the need to harmonize of the Trade Liberalization Schemes of ECOWAS and UEMOA.

[216] An example of calculation is provided on the ECOWAS website: www.etls.ecowas.int/.

[217] In its definition of ex-factory price, the Regulation set caps on the amount of wages and salaries that can be attributed to the costs of the products (20%) as well as financial charges (3%).

In a rather similar way to ECOWAS, ECCAS RoO texts are also rather scattered, containing some unclear and not implemented provisions.[218]

ECCAS 1[219] General Rule	ECCAS 2[220] general rule
Regional value of materials	Ex-works before tax – CIF value of non-originating materials
Total Value of materials used in the production of the goods	Ex-factory price (In ECCAS French version document of 2014: prix de revient ex-usine hors taxes)
Minimum value of regional originating materials	Value added by subtraction – Value Added minus Value of Non-originating Materials[221] (VAVNOM)

ECOWAS Regulation REG./3/4/02 and ECCAS regulations[222] introduced a unique ECOWAS and ECCAS feature: a prior-approval procedure that companies have to undergo to register their products as originating goods entitled to preferential treatment. It is worldwide practice that a product is considered to be originating in a given country once it has fulfilled the origin criteria laid down in the applicable legislation. As discussed in Chapter 7 of this book under various origin systems, lately the registered exporters (REX) system introduced in the EU, exporters and manufacturers are required to register themselves with certifying authorities before they are given the possibility of self-certification; that is, self-declare that their products are originating on a commercial invoice. The alternative traditional method is that the exporter/manufacturer submit a request for issuance of a CO accompanied by documentary evidence that the products meet origin requirements. The amount of documentary evidence required to be registered or issued a CO vary according to the administrative procedures contained in the free-trade agreement.

In the case of ECOWAS and ECCAS, there is a double requirement. First the companies (not the individual exporter) should submit all the necessary details to be registered with a painstakingly detailed breaking-down of the various costs and components of the good. Once the necessary documentation is submitted, the company has to be approved and only after that is the company entitled to request an ECOWAS CO.

[218] In the course of the AfCFTA negotiations the ECCAS officials provided the following texts that are not all readily available on the Internet: "Protocole relatif aux règles d'origine des produits qui seront echangés entre les Etats membres de la Communauté Economique des Etats de l'Afrique Centrale," undated and Annex XX of 27/01 2004 titled "Protocole relatif aux règles d'origine des produits qui seront echangés entre les Etats membres de la Communauté Economique des Etats de l'Afrique Centrale," and a series of Decisions. Some of these texts are available in French on the ECCAS website: http://ceeac-eccas.org/index.php/fr/. The text used in this section refers to ECCAS Annex A.1 of Decision Decision No. 03/CEEAC/CCEG/XI/04 of 27 January 2004 on the ECCAS Preferential Tariff / Standard approval document and document circulation schedule as appeared in ECCAS Council of Ministers of 2016.

[219] Excerpted from Annex 1 of ECCAS Decision No. 03/CEEAC/CCEG/XI/04 Article (2)–(3).

[220] Ibid.

[221] See Chapter 6 of this book for a discussion of the various calculation methodologies of the ad valorem percentage criterion.

[222] This procedure is detailed in "Guide to the Registration Procedure for the ECCAS Preferential Tariffs," 2016.

In the case of ECOWAS, companies, in order to benefit from the ECOWAS liberalization, need to be approved by the designated National Approval Committee (NAC). Thus, in addition to *compliance* with ECOWAS rules of origin, companies have to submit an application screened by the NACs. The first step of the process is for the companies to submit to the NAC an application form[223] (Article 4 of Regulation REG./3/4/02). The NAC reviews the application and approves companies and products that meet the originating-product criteria. In the third step, member states communicate these companies and products to the ECOWAS Commission. The fourth step requires the ECOWAS Commission to notify all member states of the approved companies and products. A list of these companies appears in the ECOWAS website[224] and, not surprisingly, only around a hundred companies in all ECOWAS are listed as registered for specific products identified at HS heading level.

In addition, Regulation REG.4/4/02 adopting the ECOWAS rules of origin provides for a format of CO.

Article 1 of Regulation REG.4/4/02 provides that origin of products manufactured within the ECOWAS community is attested by a CO. However, agricultural and livestock products, as well as hand-made articles or articles manufactured without the use of tools, instruments, or implements directly operated by the manufacturer, are exempted from this requirement.

Article 3 of REG.4/4/02 provides that the COs are to be issued and signed by authorities in members states, yet it does not provide for exchange of information among the member states nor procedures for *verification*. However, the CO form attached to REG.4/4/02 provides for a procedure for verification in box 12 and box 13.

Being scattered in various pieces of legislation lacking consistency and cross-reference, the legal texts governing the ECOWAS and ECCAS rules of origin are confusing and user-unfriendly.

In terms of economic impact, the ECOWAS and ECCAS rules of origin generate ambiguity and unpredictability for business and companies wishing to use the ETLS. Therefore, the legal drafting of applicable texts – namely, the protocols and the regulations – needs drastic improvement.

The complex procedure for preregistration and approval followed by the presentation of a CO under ECOWAS and ECCA is a unique requirement of a *restrictive* nature, resulting in the creation of additional/unnecessary barriers and red-tape for businesses. No other RTAs in the world adopt such a procedure.

In this scenario, it is not surprising that the WTO and World Bank reports[225] indicate that a large proportion of goods eligible for free movement within ECOWAS do not reportedly benefit from this status.

[223] However, the application form is not attached to REG.3/4/2002.

[224] www.etls.ecowas.int/.

[225] See WTO TPRM reports WT/TPR/S/236 of Burkina Faso, Mali, Benin, and World Bank Africa Trade Policy: "Removing Barriers to Trade between Ghana and Nigeria: Strengthening Regional Integration by Implementing ECOWAS Commitments," 2012.

The ECOWAS and ECCAS rules of origin acutely need reform by the adoption of a new, technically sound protocol text containing all rules of origin and their administration in one single piece of legislation. In so doing, ECOWAS may draw from the wealth of knowledge and experiences gained in negotiating EPAs' rules of origin. As a rule of thumb, ECOWAS intraregional rules of origin should, at least, be not more restrictive than those under the EPAs and the Everything But Arms (EBA) initiative. ECCAS should undergo a similar process taking the EU EBA rules of origin as a minimum benchmark and introduce further liberalizing.

Both ECOWAS and ECCAS should abolish the cumbersome preregistration and approval procedure and adopt a more trade-facilitating environment for companies using the trade preferences of the respective RTAs. In so doing they may adopt similar administrative procedures under their RTAs to the ones they are using with the EU under EPAs and start considering the REX system, which has been gradually installed in some of the ECOWAS and ECCAS countries.

Ultimately, the main beneficiaries of such reform of the RoO provisions will be the companies and business of ECCAS and ECOWAS, which will gain a *transparent* and *predictable* regime for intraregional free trade leading to economic growth and poverty reduction.

The recent experiences of the AfCFTA negotiations and the reform of the EU GSP Regulation on Rules of Origin both witness the fact that the reform and drafting process of new rules of origin is a comprehensive exercise, requiring the concerted effort of multidisciplinary expertise – namely economic and legal. Chapter 6 of this book extensively discusses the issues and challenges of drafting rules of origin.

5.4.7.3 Drafting Rules of Origin for the Tripartite Free-Trade Area

The First Summit of Head of States and Government of the COMESA-EAC-SADC Tripartite held in Kampala, Uganda on October 22, 2008 laid the groundwork for rationalizing existing REC programs as well as developing and implementing common programs aimed at deepening economic integration of the Southern and East African region.[226]

The Summit adopted a wide-ranging work program, a major component of which was the expeditious establishment of a free-trade agreement incorporating the twenty-six countries making up the memberships of COMESA, EAC, and SADC, which together account for half of the countries on the continent, and about 60 percent of its GDP and population.

The Second Meeting of the Tripartite Summit of Heads of State and Government, held on June 12, 2011, officially launched the TFTA negotiations. The Summit directed

[226] The initial part of this section draws from a draft paper of Stella Mushiri and Mark Pearson, formerly staff of Trade Mark Southern Africa (TMSA) prepared for the African Integration Through Law program as part of an overall effort to record the lessons learned during negotiation of the TFTA.

that the negotiations would be prioritized and undertaken in a phased manner, with Phase I (twenty-four to thirty-six months) covering negotiations on trade in goods (tariff liberalization, rules of origin, dispute resolution, customs procedures and simplification of customs documentation, transit procedures, nontariff barriers, trade remedies, technical barriers to trade, and sanitary and phyto-sanitary measures) and on movement of business persons, which was to be negotiated on a separate track. Phase II of the negotiations was to cover the built-in agenda covering trade in services, intellectual property rights, competition policy, and trade development and competitiveness.

The approved Tripartite Work Program relating to trade, customs, and economic integration (subsequently renamed the Market Integration Pillar) prioritized the establishment of the free-trade area (FTA) and directed the Tripartite Task Force (TTF – comprising the CEOs of COMESA, EAC, and SADC) to undertake and complete, within a period of twelve months, the necessary preparatory work that would form the basis for designing a comprehensive TFTA.

The Tripartite established its own institutional structure independent from the REC structures and this included the Tripartite Negotiating Forum, technical working groups, and oversight groups at ministerial level, all of whom reported to the Heads of State and Government eventually.

The TFTA negotiations were supported, administratively, technically, and financially, by the COMESA, EAC, and SADC Secretariats as well as through the Department for International Development-financed Regional Trade Facilitation Program (RTFP) (until October 2009) and the Trade Mark Southern Africa Program from November 2009 to March 2014. The Tripartite Task Force (TTF) established a task team of technical experts drawn from the three RECs' Secretariats, supported by RTFP/TMSA experts, and this task team spearheaded the work of designing the FTA. The author was part of this team of experts.

By November 2009 the TTF had completed the Draft Roadmap for Establishing the FTA, with the pre-negotiation preparatory phase scheduled for the first six months of 2010. The negotiating phase, which was scheduled to follow on immediately from the pre-negotiating preparatory phase, was to last for twelve months (July 2010 to June 2011). The reason for such a short negotiating phase was that the TFTA negotiations were designed to build on the acquis,[227] meaning that members of an existing free-trade agreement were not expected to negotiate with other members of the REC free-trade agreement of which they were a member.

[227] This is a French term borrowed from the EU's "*acquis Communautaire*." The meaning of *acquis* is "that which has been acquired or obtained," and, in the context of the COMESA-EAC-SADC Tripartite, it referred to the free trade agreements of COMESA, EAC, and SADC, and the associated rules, regulations, and provisions of the existing REC free trade agreements. In short, "building on the *acquis*" was taken to mean building on the free trade agreements already in existence in COMESA, EAC, and SADC, which implied that the TFTA would go beyond the existing free trade agreements and negotiations would start where the existing ones had left off.

Negotiations were to take place on the basis of working text prepared by the TTF. The initial draft Tripartite Agreement built upon what had already been achieved under the three RECs' own free-trade agreements, including an annex on rules of origin. Some provisions and constitutive instruments of the draft agreement were borrowed or derived from the REC's own free-trade agreements, while others were informed by, and drew from, best practices from other international FTA agreements. The output of this phase was to be an agreed comprehensive TFTA agreement.

In preparing the draft TFTA text, the task team of REC experts (TTF) took the following into account:

- In order to be in compliance with, and in the spirit of, Article XXIV of GATT, which all members of COMESA, EAC, and SADC had either agreed to or were aspiring to, the TFTA would need to be more beneficial (interpreted as being more liberal and so promote higher levels of regional trade) than the free-trade agreements it was to replace.
- A priori, no product or sector exceptions or exclusions should be provided, with the suggested approach to trade liberalization being based on a duty-free, quota-free, and exemption-free regime, supported where necessary by trade defense provisions such as safeguards against injury or potential injury arising from import surges; countervailing measures to guard against export subsidies; AD duties to remedy dumping; and infant industry safeguards.
- Rules of origin would be based on a general rule and should not restrict trade; should be simple, flexible, and easy for customs administrations to administer, as well as for businesses to comply with at a reasonable cost; should not be more stringent than existing rules under the RTAs of the RECs and EPAs with the EU; should promote trade and enhance global competitiveness; and should enable full cumulation.

These principles guided the reflections of the COMESA/EAC/SADC task force subcommittee meeting held in May 2009 in Benoni, Johannesburg, considering a new way forward on rules of origin for the Tripartite COMESA, EAC, and SADC states.

During the two-day event, the lessons learned from the evolution and utilization of current rules of origin of COMESA, EAC, and SADC were discussed in detail as well as the experience gained with the Cotonou rules of origin.

The two models of rules of origin – namely, North American and pan-European – were discussed, as well as the evolution that these models underwent during negotiations with other developing regions such as CAFTA (Central American Common Market) for the US and the Euro-Mediterranean partnership agreements, and the Trade and Cooperation Agreement with South Africa for the EU.

Rules of origin adopted in the context of South–South agreements were also illustrated, as their evolution in Mercosur, AEAN, and ASEAN–China FTA agreements follows a similar path to those in Eastern and Southern Africa.

The different drafting methodologies and the technical innovations introduced during the Harmonization Work Program (HWP) of nonpreferential rules of

origin carried out under the WTO Agreement on Rules of Origin were also discussed.

During the discussions among the tripartite experts, it was considered useful, given the technical nature of the topic, to progressively move from principles to a Draft Protocol incorporating some of the elements where the experts reached a convergence of views.

The Draft Protocol and an appendix containing PSRO was discussed during a two-day workshop in Nairobi from July 20 to 21, 2009 together with the lessons learned from the evolution and utilization of current rules of origin of COMESA, EAC, and SADC and other experiences.

A number of comments and suggestions were made during the two-day event that largely guided revisions and refinement in the Draft Protocol on Rules of Origin.

A Tripartite Subcommittee on Customs and Trade met in Mombasa from July 24 to 25, 2009 where it emerged that the principles of the TFTA rules of origin should be as follows:

(i) They should not restrict trade.
(ii) They should be simple, flexible, and easy for customs administration to administer as well as business to comply with a reasonable cost.
(iii) They should not be more stringent than existing rules under the RTAs of the RECs and EPAs.
(iv) They should promote trade and enhance global competitiveness.
(v) They should enable diagonal cumulation.

The following issues were further considered among the RECs' experts drafting the roadmap leading to the free-trade agreement:

- Experience and lessons learned in the region and outside suggested not to engage in a tariff line–PSRO exercise when determining the appropriate rules of origin for the COMESA/EAC/SADC free-trade agreements.
- Similar experience has shown that alternative rules of origin across the board for the same product may induce some inconsistencies and difficulties in their administration.
- Simplification and development-friendliness could be achieved by a single criterion applicable to all products for determining the origin of goods that are not wholly obtained in a beneficiary country, based on a value-of-materials calculations drawn from the existing RECs' rules and further refined drawing from most recent best practices.

Thus, a value-of-materials calculation was retained based on two methods as an across-the-board percentage criterion for determining origin as follows:

Method Based on Value of Non-originating Materials ("Build-down Method")

$$RVC = \frac{EW - VNM}{EW} \times 100$$

Method Based on Value of Originating Materials ("Build-up Method")

$$RVC = \frac{VOM}{EW} \times 100$$

where:

- *RVC* is the regional value content, expressed as a percentage.
- *EW* is the ex-works price.
- *VNM* is the value of non-originating materials that are acquired and used by the producer in the production of the good.
- *VOM* is the value of originating materials acquired or self-produced, and used by the producer in the production of the good.

The value-of-materials calculation was considered easier to administer than a valued-added calculation since it is less complex and demanding in terms of compliance cost for business. Moreover, the proposed value-of-materials calculation takes into account the special situations related to the transport costs of input materials to the COMESA/EACSADC countries as further discussed in Chapter 6 of this book. Basically the calculations method adopted was an overdue improvement of the existing percentages in the RECs with adjustments made to the value of materials permitting, on one hand, the deduction of the CIF costs when a "build-down" method is used and the addition of inter-member states costs of transport when the "build-up" method is used.

The level of percentages was provisionally fixed at 20 for the build-up method and 30 for the build-down method. Some more consultations were scheduled with selected producers /exporters to assess how realistic these thresholds were, taking into account the manufacturing capacity of COMESA/EAC/SADC countries.

The experts also recognized that in the light of previous experiences and objective technical considerations a single method for origin determination based on a percentage criterion may not be suitable for certain sectors. Moreover, according to feedback from stakeholders, there are a number of sectors for which a percentage criterion is either not well suited or should not be used as the sole criterion.

Consequently, it was considered that other criteria which may be easily understood by operators and easily controlled by administrations should be used in these limited sectors.

Nevertheless, it was emphasized that the number of product-specific rules should be as few as possible and that the negotiation process was not to degenerate into an endless PSRO negotiation. Therefore, the rules of origin should as far as possible be on a sector-by-sector rather than a product-by-product basis and may be identified as follows:

(1) sectors where there are technical requirements and lessons learned that a sector-specific rules may be more user friendly for business to understand and comply with and for Customs to administer

(2) sectors where the COMESA/EAC/SADC are currently trading and that are requiring attention to ensure that the traditional trade flows are preserved and/or new trading opportunities are created, or sectors where the COMESA/EAC/SADC states show potential trade flows for intraregional trade demonstrated by trade flows to third countries.

A list of PSRO were contained in Annex I of the Draft TFTA Protocol identified according to the abovementioned principles and drafted using the most appropriate drafting methodology taking into account the lessons learned in the sector and their user friendliness.

In the case of cumulation it was considered that both diagonal (or partial cumulation) and full cumulation should be possible in the COMESA/EAC/SADC FTA.

As for the certification and administration of RoO procedures, and taking into account the existing system in the regions that are largely similar, consideration was given to adopting the existing interim EPA/Cotonou procedures with minor amendments to simplify such procedures.

The most convincing factor was that the interim EPA procedures, when compared with some procedures for intraregional trade, are more business friendly and less burdensome while ensuring a reasonable degree of control and monitoring.

A set of draft TFTA agreement documents and a roadmap[228] were produced and circulated to all Tripartite member states at the end of 2010 and these texts were expected to be the basis upon which substantive text-based negotiations would start. However, the formal TFTA negotiating machinery only started in 2012 and the adoption of the original set of Tripartite draft FTA agreements and annexes as negotiating texts was met by resistance from some member states.

Later in the negotiations a harmonization option of the existing rules of origin of COMESA/EAC/SADC emerged and gradually gained ground. This option emerged from the consideration that all three RECS had a series of PSRO. Hence it was considered that the building block of the TFTA rules of origin were the commonalities already existing among the three RECS and building on such commonalities. However, and as pointed out by the author at that time, the commonalities among the PSRO were minimal and, most importantly, such course of action would turn the process into a PSRO negotiating exercise. In retrospect the decision to find the commonalities was one of the turning points toward a dead-end in TFTA RoO negotiations.

As a result, the Eighth TTNF Meeting held in October 2013 and the Technical Working Group (TWG) on Rules of Origin was still updating/validating a consolidated comparative matrix of the three RECs' trading arrangements' PSRO, categorizing them according to their commonalities, similarities, and divergences. The

[228] By this time, because national and REC consultations took a whole year, the roadmap time frames were extended by a year and the proposed date for entry into force of the FTA Agreement became January 2013.

TTNF agreed that it would not open up discussions in instances where there are commonalities among the REC trading arrangements' rules of origin.

At the Ninth TTNF Meeting, held in January 2014, the consolidated comparative matrix was unbundled into three matrices. The first category was a set of common rules comprising PSRO common in the three RECs' trading arrangements and, once agreed as such, there would be no need to negotiate. The second comprised products with similar rules of origin and the focus would be to narrow down differences in the rules. The third category consisted of products with divergent rules of origin for which more substantive negotiations were expected to take place. The meeting validated the common rules matrix except for the alternative rules and Chapters 3 and 17.

The Tenth TTNF Meeting (October 2014) noted that according to the revised negotiating schedule this should have been the last meeting of the TTNF to finalize negotiation of Phase I on trade in goods and should have taken place in April 2014.[229]

The TTNF considered recommendations of the Seventh TWG Meeting on Rules of Origin. The process of negotiating remained difficult and progress was slow with rules finalized for only 9 percent of intra-Tripartite trade. These consist of rules common to the three RECs' trading arrangements covering eleven of the ninety-seven HS chapters and twenty-five headings. With the launch of the TFTA Agreement then anticipated in December 2014, the proposal to develop a general rule of origin was rekindled and the matter was referred to the Tripartite Committee of Senior Officials (TCSO) for guidance. The general rule would be applied in the interim while negotiations for product-specific rules continued.

The Third Meeting of the Tripartite Sectoral Ministerial Committee on Trade, Finance, Customs, Economic Matters and Home/Internal Affairs held in October 2014 accepted the wholly produced/obtained rule and agreed in the interim to use a general value-addition rule with a threshold of 35 percent ex-works cost across all chapters where common rules have not yet been agreed to enable implementation of the Tripartite FTA, while negotiations on product-specific rules continued.

The first Extraordinary Meeting of the (Eleventh) TTNF held in February 2015 considered two options put forward by the Eighth and Ninth Meetings of the TWG on Rules of Origin:

- *Option 1*: to use agreed common rules and a value-addition rule of 35 percent ex-works costs as interim rules of origin of the TFTA. A positive list of products for which the value-added criteria of 35 percent ex-works cost would apply would be developed.
- *Option 2*: to use already agreed common rules for the launch of a partial TFTA.

[229] Unavailability of resources following the closure of TMSA (March 2014), which had funded the negotiations other than the costs of member states participation, was one of the main reasons given for the delay in continuing with the TFTA negotiations.

However, the TTNF failed to reach consensus and deferred the matter for further discussion at the Second Extraordinary Meeting of the TTNF.

The Sharm El Sheik summit of June 2015 launched a Tripartite FTA agreement that had serious flaws. Any free-trade agreement must have two key elements; namely, a tariff liberalization schedule and a set of rules to determine origin – rules of origin.

However, for the TFTA, participating countries could not finalize their tariff liberalization offers and could not agree Tripartite rules of origin. Annex I – Schedule of Tariff Liberalisation by Country – was missing as an annex to the Tripartite FTA agreement. Similarly, rules of origin, which were supposed to form Annex 4, were missing as negotiations on rules of origin had not been completed by the TFTA launch date. Interim rules of origin were available, but no country was keen to apply them.

The Tripartite initiative was widely expected to deliver the trade integration objectives and results that the individual RECs had failed to deliver for decades. Donors were eager and the international community widely expected the TFTA to be the building block and the driving force for the establishment of the AfCFTA.

5.4.7.4 Drafting Rules of Origin in AfCFTA

This section provides an overview of the process outlining the main trends and issues arising from the negotiations. Chapter 6 of this book provides an insight of the technical challenges of the AfCFTA negotiations. Similarly to the TFTA, the starting of the negotiations of the AfCFTA rules of origin was preceded by a study[230] aimed at providing an assessment of the rules of origin in the African continent.

The author was called by the African Union on February 2018 to provide advice during negotiations and capacity building when an initial draft Annex 2 on rules of origin was available.

At a first analysis, draft Annex 2 on rules of origin contained provisions and the administrative rules concerning the administrative aspect of rules of origin that were aligned with those of EPAs that the African RECS have entered into with the EU. This has been a positive sign, since for once:

(1) The African member states did not reject the idea that what has been negotiated with third partners like the EU could be used as a common platform to negotiate a new agreement.
(2) The draft text, being drawn from EPAs, was of a good technical quality. Undoubtedly the fact that the wide majority of African states had entered into EPAs with the EU, albeit at different levels of implementation, had a certain influence in the overall architecture of Annex 2.

[230] See "A situational analysis of rules of origin regimes in the CFTA Regional Economic Communities (REC) prepared for the African Union," 2017.

Yet the main contentious issues were far from being addressed. They concerned Article 6 of the main draft, which provides as follows:

> **Article 6 Sufficiently Worked or Processed Products**
>
> For purposes of Article 4(b) of this Annex, Products which are not wholly obtained are considered to be sufficiently worked or processed when they fulfil one of the following criteria:
>
> (a) Value Added;
> (b) non-originating Material content;
> (c) change in tariff Heading; or
> (d) specific processes.
>
> Notwithstanding paragraph 1 of this Article, Goods listed in Appendix IV shall qualify as originating Goods if they satisfy the specific rules set out therein.

As could be expected, old habits die hard: the African tendency of adopting multiple origin criteria is reflected in Article 6 where four different origin criteria are listed but not defined. On top of that, the third paragraph contains an additional alternative criterion based on a list of PRSO.

The objective of the Sixth TWG Meeting on rules of origin, which took place in Addis Ababa in April 2018, was to draft the AfCFTA appendix on PSRO. In this regard the meeting developed a template and agreed on the methodology for the drafting of Appendix IV to Annex 2 on rules of origin.

The draft appendix was to be the basis for national consultations in preparation for the next meeting. The TWG worked on drafting the template that was proposed by the AUC, elaborated from contributions from AU member states, as a base from which they could start proposing the AfCFTA PSRO. The TWG agreed to draft the template in a consultative format on the possible HS chapter rules and indicating exceptions to such chapter rules across all the ninety-seven chapters of the HS 2017 version. These chapter rules would take the form of general rules that would apply across each heading and subheading of the HS chapter, while additional product-specific rules would be assigned to exceptional headings or subheadings of each HS chapter. The matrix would then be used for national consultations after which firm decisions would be taken during the next TWG meeting.

General HS chapter rules were proposed for all the ninety-seven chapters of the HS and the whole meeting was basically devoted to singling out 738 HS headings and subheadings for possible product-specific rules in addition to HS chapter rules. The way of composing such an annex was peculiar since delegations were not required to justify why they needed PSRO at HS heading or subheading level. As a result, delegations routinely took the floor asking for PSRO supposedly based on their prospected tariff offer linking tariff concession to PSRO. On top of that, AU member states agreed that there was to be no mention of the delegation proposing the PSRO.

This is the main reason why, at the end of the meeting, there were 738 headings singled out in addition to the ninety-seven chapter rules of origin with no explanation or justification why there was a need to have them at HS heading level or

which African member states proposed them. Needless to say, this way of proceeding and managing the TWG meetings had an impact on the future TWGs.

The Seventh TWG Meeting held from July 30–August 11, 2018 was when the first real negotiations took place since member states were expected to have held the national consultations on Appendix IV on PSRO based on the template and methodology agreed at the Sixth Meeting. The meeting was preceded by a two-day technical capacity-building workshop, delivered by the author, based on a study further discussed in Chapter 6 of this book on the methodologies that could be adopted in drafting rules of origin based on ad valorem percentage criteria.

In fact, one of the major issues of contention discussed at the beginning of the negotiation session of the TWG was the relation among general rules contained in the first paragraph of Article 6 of Annex II and the product-specific rules contained in Appendix IV. Some African members states, mostly from West Africa, who proposed an ad valorem percentage criteria as a general rule in Article 6 of Annex II, were reluctant to examine the PSRO contained in Annex IV before coming to an agreement on what the ad valorem percentage rule was to be. In addition the delegation of South Sudan was extremely vocal in proposing an ad valorem percentage calculation using a denominator based on the ex-factory cost.[231] Another issue of contention was raised by the delegations of Tanzania and Burkina Faso, who circulated two notes arguing for the exclusion from preferential tariff treatment provided by AfCFTA of those products manufactured in special economic zones (SEZs). On that issue the AU Secretariat and member states requested UNCTAD to prepare a paper outlining the various options and indications.

Without settling the critical issue of the relation between the general origin criteria contained in the first paragraph of Article 6 of Annex 2[232] and the PSRO contained in Annex IV,[233] mentioned in paragraph 2 of Article 6, the TWG finally agreed to examine the PSRO contained in Annex IV.

In fact, the drafting of Article 6, reproduced below, is rather unclear on the relation between the general rules of paragraph 1 and the PSRO contained in paragraph 2:

> ARTICLE 6
>
> ***Sufficiently Worked or Processed Products***
>
> (1) For purposes of Article 4(b) of this Annex, Products which are not wholly obtained are considered to be sufficiently worked or processed when they fulfil one of the following criteria:
>
> (a) Value Added;

[231] Further discussed in Chapter 6 of this book.

[232] See Annex 2, Rules of origin to the Agreement establishing the African Continental Free-Trade Area.

[233] Annex IV of Article 6 contains the PSRO.

(b) non-originating Material content;
(c) change in tariff Heading; or
(d) specific processes.

(2) Notwithstanding paragraph 1 of this Article, Goods listed in Appendix IV shall qualify as originating Goods if they satisfy the specific rules set out therein.

Some African member states interpreted the general rules of paragraph 1 as an applicable criterion in addition to the PSRO listed in Annex IV. Accordingly, the PSRO listed in Annex IV are an additional possibility for complying with rules of origin. According to other African member states, the PSRO contained in Annex IV were an exception to the general rules of paragraph (1), and for those products listed in Annex IV the only possible option was to comply with the PSRO (hence the wording "Notwithstanding " at the beginning of paragraph 2 of Article 6 above).

Finally, for other African states the general rules contained in paragraph 1 were simply listing the possible rules of origin criteria that could be used in defining the PSRO contained in Annex IV.

The issue of general rules of origin versus PSRO was the subject of lengthy debates in the TWG, unfortunately with no reference to the legal text contained in Article 6. The general understanding was that an agreement was reached on a rather vague concept of "hybrid" rules of origin; that is, a mix of general criteria for rules of origin and PSRO with no clear definition of the sequencing and scope of application.

What is sure is that the end result of the work of the TWG has been to produce an exhaustive Annex IV covering all products. This fact may suggest that at the end of the negotiating process, still ongoing at the time of writing, either only PSROs will be applicable or general rules of origin and PSRO.

Once the issue of relation between general rules of origin and PSRO had been debated, the TWG deliberated on rules for Chapters 1–49 and 64–81. The TWG also deliberated on outstanding issues in Annex 2 of rules of origin that were related to the absorption principle and the *de minimis* rules. The content of the product-specific rules that were discussed or agreed were mostly of a restrictive nature, at times much more restrictive than the respective rules of origin contained in EPAs.

The pervasive general guiding principles adopted during the TWG meetings were the following:

(1) If the raw material was available in the African continent not only was such material to be wholly obtained but also all other downstream products using that material should be wholly obtained.
(2) If the raw material was not available a more lenient rule of origin was to be considered.

However, the products falling under (2) were mostly industrial products with inherent complex technicalities when negotiating at HS heading or subheading level. Consensus on a liberal set of rules of origin reflecting the limited industrial capacity of Africa and the need to use non-originating inputs from third countries was limited by the scarce and scattered nature of technical capability of the delegations and the dynamics of the negotiations where guidance provided by Chairpersons and the AU Secretariat was limited. In addition, technical experts could intervene during negotiations only upon invitation from the chair. The negotiations were carried out without the necessary back up in terms of trade data and statistics of agricultural and industrial production. Only later was a statistical brief prepared by UNCTAD, as well as two technical papers on Chapter 71 and 86 to be discussed at the next TWG meetings. In fact, the discussion of these papers would have provided the opportunity to explain to AU delegations some of the technical issues involved when negotiating HS chapters in industrial products. However, due to pressure of time exerted on the AU Secretariat to stick to the mandated agenda to complete all HS chapters before the expected Cairo Summit to launch AfCFTA, these papers were not discussed in the next TWG. As a result, the Ninth and Tenth TWG Meetings witnessed endless discussions on technical issues that could have been quickly addressed with proper neutral technical advice from an expert. These technical issues are further discussed in Chapter 6 of this book.

The Eighth TWG Meeting was expected to make progress in the drafting of the text of Appendix IV on the AfCFTA PSRO. The meeting considered Chapters 82–97 of Appendix IV. However, since the quorum of member states present during the session was not sufficient, all the positions arrived at in these chapters have been reviewed at the Ninth TWG Meeting.

The objective of the Tenth TWG Meeting, held in Cairo in December 2018, in addition to considering other outstanding work assigned to it, was to review the bracketed text of the draft Appendix IV on the AfCFTA rules of origin; namely, the bracketed text of the draft Appendix IV of HS Chapters 9, 11, 16, 17, 19, 20, 22–24, 28, 29, 32, 34, 36, 41, 42, 48–51, 53, 56, 59, 68, 69, 82, 84, 86, and 88.

Almost as a replica of the TFTA final negotiating phase, the AU member states realized that the progress of the negotiations did not allow for the launching of the AfCFTA as expected during the December Cairo EXPO event. The formal launching moved to June 2019, with a schedule of intense trade negotiations to conclude the outstanding issues, mostly – but not only – related to AfCFTA rules of origin.

As part of the negotiations for AfCFTA, AU member states also considered how to treat goods produced from Special Economic Arrangements/Zones (SEZs) under the rules of origin. Two proposals[234] were tabled that goods coming from SEZs

[234] See proposals from Burkina Faso of January 2018 and Tanzania of May 2018 at the TWG on Rules of Origin.

should not be considered as originating and, therefore, not benefit from preferential tariff treaties.

The proposals to exclude products made in economic zones or export processing zones (EPZs) are going against usual practice in FTAs as contained in a short study carried out by the author for UNCTAD.[235]

EPZs are treated differently in the various preferential trade agreements (PTAs) that African countries are signatories to as Tables 5.17 and 5.18 show.

From the tables it can be seen that most African RECs with the exception of ECOWAS do not apply restrictions on preferential treatment to products originating in EPZs. Nor do the EU EPAs with African RECs and AGOA[236] apply any restrictions on preferential tariff treatment for products originating under these arrangements.

The provisions contained in these PTAs provide that goods manufactured in SEZs should comply with the applicable origin criteria to be considered as originating and benefit from preferential tariff treatment. In addition, these rules include additional provisions to avoid goods being substituted, replaced, or further manufactured in case they pass through such SEZs.

Upon closer reading, the proposal of Burkina Faso was aimed at introducing a no-drawback[237] provision in AfCFTA. The proposal of Tanzania covered not only a prohibition of drawback but also the notion of how to treat firms located in economic zones that benefit from tax incentives other than refund or remission of customs duties under a drawback system.

In fact, the Tanzanian proposal referred to paragraph 2 of Article 22 of the draft AfCFTA Protocol on Trade, which provides as follows:

> 2. Products benefiting from special economic arrangements/zones shall be subject to any regulations that shall be developed by the Council of Ministers. Regulations under this paragraph shall be in support of the continental industrialisation programmes.

The reference to "Regulations" to be developed by the Council of Ministers escalated the debate from senior officials to a Council of Ministers' decision that would have to be prepared by senior officials and final endorsement by Ministers, opening a Pandora's box that will be difficult to come to terms with.

The technical paper elaborated by UNCTAD argued that besides the evidence resulting from the existing practices in PTAs, contained in Tables 5.17 and 5.18, it would be detrimental to AfCFTA objectives to exclude from AfCFTA preferential

[235] See "The treatment of goods originating in special economic arrangements/zone in the African Continental Free Trade Area," technical paper prepared by the Division for Africa, Least Developed Countries and Special Programmes (ALDC) of the United Nations Conference on Trade and Development (UNCTAD) upon the request of the African Union Commission, December 2018. See https://unctad.org/meetings/en/SessionalDocuments/aldc2019_AfCFTA_TWGR0O11_tn_SEZs.pdf.

[236] AGOA has no explicit provision governing products originating in EPZs.

[237] See Chapter 7 of this book for an analysis of the no-drawback rules inserted in some free-trade agreements and their relation with rules of origin.

TABLE 5.17 *Rules of origin for EPZ-produced products in African free-trade agreements*

	Provision	Treated as originating?	Treatment of goods produced in EPZs/SEZs or similar	Notes
ACP Cotonou	Protocol 1, Article 36	Yes	Granted preferential tariff treatment if rules of origin requirements of the Cotonou Agreement are met.	
ACFTA	Agreement on Establishment of the CFTA, Annex 2, Article 9	Yes	– Goods treated as originating if they satisfy the rules in Annex 2 and in accordance with the provisions of Article 23.2 of the Protocol on Trade in Goods. – Parties must take all necessary measures to ensure products remain under the control of the customs authority and not substituted by other goods	See also Annex 2, Article 42: States parties agree that issues pertaining to Special Economic Arrangements/Zones and drafting regulations for goods produced thereunder are outstanding issues.
COMESA	Protocol on the Rules of Origin (2015)	Yes	Granted preferential tariff treatment if requirements of the COMESA Rules of Origin are met	
EAC	Protocol on the Rules of Origin (2015)	No provision	No provision	
ECCAS	No provision	No provision	No provision	
ECOWAS	Protocol A/P1/1/03, Article 7	No	Not granted preferential tariff treatment	
SADC	No explicit provision	No explicit provision	– No explicit provision	
TFTA	TFTA, Annex 4, Article 40	Yes (conditional)	– Granted preferential tariff treatment if requirements of TFTA rules of origin are met.	

Source: Derived by the author from various sources.

TABLE 5.18 *Rules of origin for EPZ-produced products in agreements between African countries and Europe*

	Provision	Treated as originating?
ACP–EU EPA (Cotonou Agreement)	Protocol 1, Article 36	Yes
EAC–EU EPA	No provision.	N/A
ESA–EU Interim EPA	Protocol 1, Article 40	Yes
SADC–EU EPA	Protocol 1, Article 42	Yes
West Africa–EU EPA	EPA between the EU and West African States/ECOWAS/UEMOA, Annex 2 (Protocol 1), Article 40	Yes
SACU–EFTA FTA	Annex V, Article 33	Yes

treatment products manufactured in EPZs. As an example, the same product manufactured in an EPZ in AfCFTA can be exported to the EU and the United States with preferential tariff treatment while it will not be entitled to AfCFTA tariff treatment if the limitation were to be introduced in AfCFTA for products originating in EPZs. As a result, such a provision would work as a disincentive to invest in EPZs for exports to AfCFTA members, exactly the contrary of the AfCFTA objective. In addition, under EPAs entered into with the EU, SEZs established in the EU can freely trade with African states that have signed an EPA with the EU, while the African SEZ could not trade under AfCFTA with African states. In simple words, an investor would be better off, in terms of preferential tariffs, to locate factories in SEZs based in Europe rather than in those based in Africa.

The concern of some African countries led by Tanzania and Burkina Faso is how to address unfair competition that may emanate from goods produced in SEZs and trade under AfCFTA preferential treatment. The rationale is that, as goods produced in SEZs benefit from tax and other investment incentives, the cost of manufacture will be lowered so goods produced in SEZs will be able to be sold for less than goods not manufactured in SEZs. The challenge with this argument is:

- SEZs have evolved from firms in an enclave and many countries offer tax and investment incentives to companies/firms not in a specific enclave.
- Excluding goods produced in SEZs will reduce the effectiveness and efficiency of the AfCFTA.
- The tax incentives provided to firms in SEZs may not allow them to reduce costs of production.

The findings of the technical paper elaborated by the author suggested that using rules of origin as a means to avoid unfair competition, a use that rules of origin are not designed for, will be ineffective and counterproductive. In case of unfair

competition, AfCFTA state parties may make use of WTO rules on subsidies and countervailing measures as referred to in Article 2 of Annex 9 to the AfCFTA Protocol on Trade in Goods.

5.4.8 *Latin America Rules of Origin*

This section is providing an analytical overview of the rules of origin contained in the main South–South RTAs in Latin America; namely, Central American Common Market (CACM), Mercosur, and Pacific Alliance (see Table 5.19).

A number of major studies and technical assistance activities have been conducted in Latin America on rules of origin thanks to the Inter-American Development Bank, Organization of American States (OAS) and the Economic Commission for Latin America and the Caribbean (CEPAL).[238]

The Latin American countries have been impressively active in signing free-trade agreements among themselves and the rest of world. Many of them have also signed free-trade agreements with the United States adopting the North American model of rules of origin and with the EU, adopting the EU model. In a similar fashion to African countries Latin American countries have not elaborated their own model of rules of origin or adopted a common approach. A series of studies[239] have identified a series of models that have evolved in the region. One model has been inspired by the rules of origin contained in the Latin American Integration Association (LAIA) and is mostly used in free-trade agreements among South American countries. This model is based on a general rule applicable across the board for all tariff items (a change in tariff classification at the heading level or, alternatively, a regional value added of at least 50 percent of the FOB export value of the final good) in combination with a list of PSRO.

Apart from NAFTA itself, which involved Mexico, a series of free-trade agreements signed by Latin American countries with the United States has opened the way to the second model based on the evolution of NAFTA-inspired free-trade agreements such as US–Chile, US–CAFTA–DR, US–Colombia, US–Peru, and US–Panama. Mexico also played a preponderant role in expanding the use of the NAFTA-inspired agreements by adopting this model in a series of subregional free-trade agreements. All these free-trade agreements use an extensive list of PSRO based on a CTC expressed in change of chapter, heading, subheadings, and applicable CTC exceptions including combination of alternative rules with RVC

[238] See M. Izam, "Rules of origin in economic integration agreements signed by countries belonging to the Latin American Integration Association," Bulletin FAL No. 201, May 2003; A. Estedeavordal and K. Suominen, "Rules of rules of origin in FTAs in Europe and in the Americas: Issues and implications for the EU-Mercosur Inter-Regional Association Agreement," INTAL-ITD Working Paper 15, 2005; R. Cornejo and J. Harris, "Propuesta metodológica para la convergencia del Spaghetti Bowl de reglas de origen," INTAL-INT Working Paper 34, 2007.

[239] See A. Estevadeordal, J. Harris, and K. Suominen, "Multilateralising preferential rules of origin around the world," IDB Working Paper Series # IDB-WP-137, 2009.

TABLE 5.19 *Main rules of origin applicable in selected Latin American free-trade agreements*

	LAIA[i]	CARICOM[ii]	MERCOSUR I[iii]	MERCOSUR II	CAFTA– DR	Pacific Alliance Association of Latin American States I[iv]	Pacific Alliance Association of Latin American States II
Main origin criteria	Change of tariff heading,[v] or Percentage requirement, or PSRO (not negotiated)	CTH or VNOM	CTH or VNOM	CTH or VNOM	Build-up method: VOM Build-down method: Adjusted value (AV) – VNOM	Net cost – VNOM	FOB – VNOM
Denominator	FOB value of the final product	Export price	FOB value of the final product	FOB value of the final product	Build-up and Build-down method: AV	Net cost	FOB
Method of calculation	RVC	VNOM	Maximum VNOM	Maximum VNOM	RVC	RVC	RVC
PSRO				Yes	Yes	Yes	Yes
Consideration of freight and insurance	No	Unclear	No clear inclusion	No clear inclusion	Yes	Yes	Yes
Cumulation			Yes	Yes	Yes	Yes	Yes

[i] See ALADI/CR/Resolución 252, August 4, 1999.
[ii] For further details, see Rule 3 of Revised Treaty of Chaguaramas, at www.ttcsi.org/wp-content/uploads/2014/06/Revised%20Treaty%200f%20Chaguaramas.pdf.
[iii] For further details, see http://epp.com.uy/content/archivos/50a13efcbbea6.pdf.
[iv] For further details, see www.sice.oas.org/Trade/PAC_ALL/Pacific_Alliance_Text_s.asp#c4_sb.
[v] The LAIA text explicitly provides that mere assembly and other minor operations are not origin conferring even if there is change of tariff heading.

percentages. The long list of PSRO makes a detailed and satisfactory comparison between them extremely difficult and complex.

A study[240] comparing the US–DR–CAFTA with the US–Chile FTA agreement shows fairly similar structures as far as rules of origin are concerned. However, a closer look reveals a number of differences on RoO issues. The differences may relate to cumulation, to treatment of textiles and quotas, and to other ancillary provisions. The main differences apply to the Annex on Specific Rules that includes the requirements that each product must fulfill in order to be considered originating.

The complexity of the web of the Latin America free-trade agreements has been explored in a study[241] advocating a convergence of the different free-trade agreements to address the existing Pandora's box. This study noted that: "more than half of the FTAs concluded by Mexico, Chile and Peru (all signatories to FTAs with the U.S.), the same rules of origin apply for only slightly more than 40 percent of traded products. Regionally, FTAs include a complex web of rules of origin involving nearly 40 annexes of rules per product and 24 regulatory chapters."

The study argued that this complex web of rules of origin, as discussed in Chapter 3 of this book, creates obstacles to the expansion of cumulation among the different free-trade agreements in Latin America.

The original text of the Mercosur rules of origin is found in Annex II to the Treaty of Asunción. Although the wording is a bit elaborate, the rules of origin were based on an across-the-board approach:

Article 1

The following shall be classified as originating in the States Parties:

(a) Products manufactured wholly in the territory of any of the Parties, when only materials originating in the States Parties are used in their manufacture;

(b) Products included in the chapters or headings of the tariff nomenclature of the Latin American Integration Association referred to in Annex 1 of resolution 78 of the Committee of Representatives of that Association, simply by virtue of the fact that they are produced in their respective territories.

The following shall be classified as produced in the territory of a State Party:

(i) Mineral, plant and animal products, including hunting and fishing products, extracted, harvested or gathered, born and raised in its territory or in its territorial waters or exclusive economic zone;

[240] IDB, OAS, and ELAC, "A comparative guide to the Chile–United States free trade agreement and the Dominican Republic–Central America–United States free trade agreement: A study by the Tripartite Committee," 2005.

[241] See R. Cornejo and J. Harris, "Propuesta metodológica para la convergencia del Spaghetti Bowl de reglas de origen," INTAL-INT Working Paper 34, 2007.

(ii) Marine products extracted outside its territorial waters and exclusive economic zone by vessels flying its flag or leased by companies established in its territory; and

(iii) Products resulting from operations or processes carried out in its territory by which they acquire the final form in which they will be marketed, except when such processes or operations simply involve assembly, packaging, division into lots or volumes, selection and classification, marking, the putting together of assortments of goods or other equivalent operations or processes;

(c) Products in whose manufacture materials not originating in the States Parties are used, when such products are changed by a process carried out in the territory of one of the States Parties which results in their reclassification in the tariff nomenclature of the Latin American Integration Association under a heading different from that of such materials, except in cases where the States Parties determine that the requirement of Article 2 of this Annex must also be met.

However, products resulting from operations or processes carried out in the territory of a State Party, by which they acquire the final form in which they will be marketed, shall not be classified as originating in the States Parties when such operations or processes use only materials or inputs not originating in their respective countries and simply involve assembly, division into lots or volumes, selection, classification, marking, the putting together of assortments of goods or other similar operations or processes;

(d) Until 31 December 1994, products resulting from assembly operations carried out in the territory of a State Party using materials originating in the States Parties and third countries, when the value of those materials is not less than 40 per cent of the f.o.b. export value of the final product; and

(e) Products which, in addition to being produced in their territory, meet the specific requirements established in Annex 2 of Resolution 78 of the Committee of Representatives of the Latin American Integration Association.

Article 2

In cases where the requirement of Article 1(c) cannot be met because the process carried out does not involve a change in nomenclature heading, it shall suffice that the c.i.f. value of the third country materials at the port of destination or the maritime port does not exceed 50 per cent of the f.o.b. export value of the goods in question.

In considering materials originating in third countries for States Parties with no outlet to the sea, warehouses and free zones granted by the other States Parties when the materials arrive by sea shall be treated as the port of destination.

Article 3

The States Parties may establish, by mutual consent, specific requirements of origin which shall prevail over general classification criteria.

Article 4

In determining the specific requirements of origin referred to in Article 3 and in reviewing those already established, State Parties shall take the following elements, individually or jointly, as a basis:

I. Materials and other inputs used in production:
   (a) Raw materials:
      (i) Preponderant raw material or that which essentially characterizes the product; and
      (ii) Main raw materials.
   (b) Parts or components:
      (i) Part or component which essentially characterizes the product;
      (ii) Main parts or components; and
      (iii) Percentage of parts or components in relation to total weight.
   (c) Other inputs.
II. Type of processing used.
III. Maximum proportion of the value of materials imported from third countries in relation to the total value of the product arrived at using the valuation procedure agreed to in each case.

The basic rule of Mercosur was the CTH based on the Associación Latinoamericana de Integración (ALADI) nomenclature or, failing this, the percentage rule that the value of imported materials calculated on a CIF basis does not exceed 50 percent of the FOB price of the finished product. Articles 3 and 4 provided for the development of product-specific rules. In fact, a number of changes have occurred since the original rules were conceived.

The first consolidated version[242] of the Mercosur rules of origin grouped all the modifications and changes in 2006. The regime indicated a move from rules of origin based on an across-the-board to a product-specific approach.

With respect to the original version of the rules of origin reported above, the across-the-board CTH remain the basic criteria used in Mercosur but using the Mercosur nomenclature rather than that of ALADI. In addition, a long annex of product-specific rules was added.

According to paragraph (d) of the consolidated text,[243] products that do not meet the CTH requirement may qualify as originating products if the value of imported materials calculated on a CIF basis does not exceed 40 percent of the FOB price of

[242] Mercosur/XXXV CCM/DI no. 28/06 available in Spanish and Portuguese at www.mercosur.int/msweb/portal%20intermediario/es/index.htm.
[243] See Mercosur/XXXV CCM7DI no 28/06.

the finished product. The requirement of 40 percent seems to liberalize the former requirement of 50 percent.

In addition, paragraphs (d) and (e) further specify that products resulting from assembly operations utilizing inputs from third countries would have to comply with the same rule as above: the value of imported inputs calculated on a CIF basis must not exceed 40 percent of the FOB.

A new paragraph (f) of the consolidated text requires that capital products should comply with a 60 percent of RVC. However, there is no mention in the consolidated text of the method of calculation of the RVC.

A long annex of PSRO was added. The product-specific requirements contained in the annex concern the majority of tariff lines from Chapter 4 to Chapter 90. The product-specific requirements are most of the time a 60 percent RVC with or without the requirement of a CTH. In the case of electronic products, specific assembly operations are demanded as technical requirements.

In the consolidated text, the absence of a clear methodology to calculate the RVC is somewhat similar to the ASEAN peculiarity indicated earlier. It is only by interpretation that one may infer that the 40 percent method of calculation in paragraph (e) above is the method of calculation of the 60 percent RVC. Obviously, this interpretation may be contested and, as experienced in ASEAN, it may lead to a series of implementation problems.

Article 7 of the consolidated text on cumulation and related footnotes are rather confused. It clearly mentions full cumulation but it still refers in some parts of the text to materials and percentages rather than stating unequivocally that any working or processing operations carried out in Mercosur could be cumulated.

A more recent consolidated version of 2018 on the Mercosur Secretariat website[244] provides for some limited changes with respect to the previous consolidated version of 2006.

In fact, paragraph (c) below provides for a general CTC at four-digit heading:

> c) Products in whose preparation materials are used that do not originate in the States Parties, when they result from a transformation process that confers them a new individuality, characterized by the fact that they are classified in a tariff heading (first four digits of the Mercosur Common Nomenclature) different from the mentioned materials.[245]

Paragraph (d) below provides for an alternative criterion in the case where the CTC rule could not be satisfied as follows:

[244] See Mercosur XCV CT3/DT No. 03/18, Texto Ordenado del Regimen de Origen Mercosur (Versión Actualizada, August 2018).

[245] Unofficial translation.

> d) In cases where the requirement established in section c) cannot be fulfilled because the transformation process operated does not imply a change of tariff heading (first four digits of the Mercosur Common Nomenclature), it will be sufficient that the CIF value of the port of destination or CIF sea port of the inputs of third countries does not exceed 40% of the FOB value of the goods in question.

Paragraph (e) below seems to be a replica of paragraph (d) above with the addition that the products are resulting from assembly operations:

> e) Products resulting from assembly or assembly operations carried out in the territory of a Mercosur country, using materials originating in third countries, when the CIF value of destination port or CIF seaport of those materials does not exceed 40% of the FOB value.

Paragraph (f) below may appear vague since there is not a definition of capitals goods at HS product level:

> f) Capital goods must meet an origin requirement of 60% regional value added.

Finally, paragraph (g) below introduces a list of PSRO that apply as *lex specialis*; namely, as an exception to the general rules for not wholly obtained products. Such clarity, especially in respect to the ATIGA text examined in section 5.3.1.4 is welcomed.

> g) Products subject to specific requirements of origin, listed in Annex I. Said requirements shall prevail over the general criteria established in subparagraphs c) to f) of this Article, as long as they are not enforceable for products totally obtained from the literal a) and products made entirely in the territory of any of the States Parties of subparagraph b) of this Article.

5.4.9 *The Rules of Origin of the Pacific Alliance*

In comparison to other RTAs in Latin American region, the Pacific Alliance is a much more recent initiative that has attracted attention[246] in the press and literature

[246] See, for instance, M. Naim, "The most important alliance you've never heard of," *The Atlantic*, February 17, 2014 (as quoted in Baker and McKenzie, below): "Four nations are developing an initiative that could add new dynamism to Latin America, redraw the economic map of the region, and boost its connections with the rest of the world – especially Asia. It could also offer neighboring countries a pragmatic alternative to the more political groupings dominated by

since it was outside the traditional schemes of regional integration. The entry into force of the Additional Protocol to the Framework Agreement in May 2016 provides the testing ground for the ambitions matured under this initiative.

The main text of the Pacific Alliance rules of origin is contained in the Additional Protocol. However, the PSRO – the backbone of the rules of origin protocol – are not easily accessible.[247]

The main structure of the RoO text of the Pacific Alliance inherits some of the characteristics of the North American model. However, it seems that some of the latest developments and best practices discussed in Chapter 6 of this book about the methodologies in drafting an ad valorem percentage criterion and in certification have not found their way into the text of rules of origin of the Pacific Alliance, as further elaborated in the following paragraphs.

The RVC calculation contained in Article 4.4 contains two alternative calculations, one based on a formula of build-down or value added by subtraction and a second one based on a net cost formula.

The purpose of the second calculation is not entirely clear since: (1) As examined in Chapter 6, there is a clear tendency in US-inspired free-trade agreements to move away from calculations based on net cost; (2) Such net cost calculations demand extensive accounting and discretionary elements in the definitions of allowable and nonallowable costs. In fact, the text of the Pacific Alliance contains in Article 4.4 extensive provisions defining the meaning of net cost, totals cost, costs of sales promotion, marketing and after-sales services of goods, etc.

Another important factor to be noted in the calculation methodology is that it seems not to take into account the positive element introduced in North American-inspired free-trade agreements of the exclusion of the cost of insurance and freight from the value of non-originating materials. Paragraph 2 of Article 4.4, reproduced below, provides two options. The first one under subparagraph (i) clearly states that the value of not originating materials is the CIF price. The wording of the second option contained in subparagraph (ii) is rather unclear since it provides for "material acquired in the territory where the good is produced" and "regardless freight,

Brazil, Cuba and Venezuela. If the Alliance was a country, it would be the world's eighth largest economy and the seventh largest exporter." See also for initial studies and booklets on the Pacific Alliance initiative: G. Perry, "The Pacific Alliance: A way forward for Latin American integration?," Center of Global Development Essay, June 2014; and "The Pacific Alliance guide to the most important Latin American trade bloc you likely don't know," 2017, https://pacificallianceblog.com/wp-content/uploads/2018/01/2017-Baker-McKenzie-Handbook-Pacific-Alliance-Framework.pdf; J. R. Concha V, D. Heilbron, and M. A. Suarez, "Comparative analysis of rules of origin in member countries of Pacific Alliance and free trade agreements," *Journal of Business*, vol. 8, no. 1 (2016), 2–4.

[247] After a bit of searching on the Internet a Spanish version is available under SICE (Sistema de Information del Commercio exterior): www.sice.oas.org/Trade/PAC_ALL/Index_Pacific_Alliance_s.asp.

insurance, packing costs and all other costs incurred in transporting the material from the store of the supplier to the place where the producer is located."

The scope of application of this subparagraph (ii) is at best unclear, as it does not specify what is the "territory": can this be the territory of a third country? Can "regardless" be interpreted as "deducting" in the sentence above?

ARTICLE 4.4: REGIONAL VALUE CONTENT

1. The regional value content of a good shall be calculated on the basis of the FOB value or on the net cost, at the choice of the producer or exporter of the good, in the following way:

$$RVC = \frac{FOB - VNM}{FOB} \times 100$$

Where:

- RVC: is the regional value content of a good expressed as a percentage;
- FOB:[248] is the free on board value of the goods, and
- VNM: is the value of non-originating materials.

Or

$$RVC = \frac{NC - VNM}{NC} \times 100$$

Where:

- RVC is the regional value content, expressed as a percentage;
- NC is the net cost of the goods, and
- VNM is the value of non-originating materials used by the producer in the production of the good, determined in accordance with paragraph 2.

2. For purposes of calculating the RVC in paragraph 1:
   (a) The value of non-originating materials shall be:
      (i) The CIF value of the material at the time of importation, or
      (ii) In the case of a material acquired in the territory where the good is produced, the price paid or payable, regardless freight, insurance, packing costs and all other costs incurred in transporting the material from the store of the supplier to the place where the producer is located, and
   (b) The values referred to in sub-paragraph (a) shall be determined in accordance with the Agreement on Customs Valuation.

The Pacific Alliance has opted for a set of PSRO and the calculations of Article 4.4 are not general criteria. Annex 4.2 contains a long list of PSRO, running to 368

[248] In the original text downloaded from the Internet the FOB was not present in the formula. In the hope that it was a typo it has been added in the text by the author.

pages, where the product-specific rules are determined at six-digit level. The methodology used to draft the PSRO is a simplified CTC requiring a change of chapter, change of heading, or change of subheading. In the textiles and clothing sector the CTC provides for multiple exceptions and the RVC is mostly used in machinery, electronics, and cars. In many cases alternative rules are provided such as RVC or CTH.

The literature and press are lauding the Pacific Alliance for the introduction of an expanded version of cumulation. In reality, such expanded cumulation under the Pacific Alliance has to be read in a context where the free-trade agreements that the various Latin American countries have entered into with the United States do not provide for any other form of cumulation other than bilateral. In simple words, the US–Colombia and the US–Peru FTA agreements do not provide for diagonal cumulation between Peru and Colombia. This may appear rather counterintuitive but, when discussed by the author with Peruvian and Colombian officials, it emerged that both countries at that time were not keen to permit the other country "to perforate" the free-trade agreement with the United States by allowing cumulation. In this framework the provision for diagonal cumulation inserted in Article 4.8 of the Pacific Alliance is surely a step forward. Such cumulation is not full cumulation as it provides for the cumulation of "originating materials."

ARTICLE 4.8: ACCUMULATION

1. Originating materials from the territory of one or more Parties, incorporated in a good in the territory of other Party, shall be considered as originating in the territory of such other Party, provided they comply with the applicable provisions of this Chapter.
2. A good shall be considered originating, where it is produced in the territory of one or more Parties by one or more producers, provided they meet the applicable provisions of this Chapter.

Paragraphs 1 and 2 shall be applied only when the customs tariff of such good, that results from tariff elimination, is 0 percent in all parties.

As discussed in Chapter 7 of this book, there is worldwide tendency to move toward self-certification and the US-inspired free-trade agreements are leading somewhat in this direction. Yet the Pacific Alliance in Article 4.17 shows a rather traditional approach, relying on certifying authorities, exchanges of seals, and extremely detailed and complex entries and format of the certificate of origin.[249]

[249] See Annex 4.17 of the Additional Protocol. The CO has fourteen entries.

ARTICLE 4.17: CERTIFICATION OF ORIGIN

The importer may claim preferential tariff treatment based on a certificate of origin written or electronic[250] issued by the competent authority for issuing certificates of origin of the exporting party at the request of the exporter. The certificate of origin shall be issued not later than the date of shipment of the goods.

The same traditional approach seems to guide the provisions of documentary evidence of direct consignment where it is incumbent on the importer to demonstrate compliance with such requirement as can be seen in the second paragraph of Article 4.15: Transit and Transshipment:

The importer may demonstrate compliance with paragraph 1(b):

(a) In case of transit or transhipment, with transport documents, such as the air waybill, the bill of lading, the consignment note, or the multi-modal or combined transport document, as appropriate;
(b) In case of storage, with transport documents, such as the air waybill, the bill of lading, the consignment note, or the multi-modal or combined transport document, as appropriate, and the documents issued by the customs authority or other competent entity, in accordance with the laws of the country that is not Party, accrediting the storage or
(c) In the absence of the above, any other supporting documentation, issued by the customs authority or other competent authority, in accordance with the law of the country that is not Party.

The same regulatory approach is found in the provisions regulating third-country invoicing that is allowed subject to disclosure of the name of the third party in the CO. Such requirement appears to make the use of this provision not commercially viable.

ARTICLE 4.19: BILLING BY AN OPERATOR IN A COUNTRY NON-PARTY

1. Goods complying with the provisions of this Chapter retain their originating status, even when they are billed by commercial operators of a non-Party country.
2. The certificate of origin shall indicate in the "comments" field when a good is invoiced by an operator of a non-Party country. In addition, the full name and legal address of the operator of the non-Party country shall be indicated.

[250] If two or more parties are ready, they may issue and receive COs electronically at the time of entry into force of this Additional Protocol, by prior agreement between them.

In conclusion the rules of origin contained in the Pacific Alliance are a good step forward even if improvements may be needed in a number of areas toward simplification. As discussed in Chapter 4 of this book, utilization rates would be a litmus test for the Pacific Alliance rules of origin.

5.4.10 *Central American Common Market (CACM)*

CACM has entered into free-trade agreements with the United States and the EU and it is at the center of a complex web of bilateral agreements. The latest version of the rules of origin[251] provides for a complete text and an annex of PSRO.

Article 6 of the main text of CACM rules of origin provided for a rather unusually long list of originating goods. For a better understanding this article should be read in conjunction with the annex of PSRO providing for rules of origin based exclusively on a CTC. In this context the provision for a default RVC for goods that are not meeting the CTC as contained in paragraph (iii) below may represent a kind of trade facilitation insertion. In fact, paragraph (iii) provides for a default alternative of the CTC for an RVC of 30 percent. This provision is not applicable for textiles and clothing.

Original goods[252]

1. Unless otherwise provided in these Regulations, a good will be considered originating, when:
   a) is wholly obtained or produced entirely in the territory of one or more Parties, as defined in Article 4;
   b) is produced in the territory of one or more Parties from exclusively materials that qualify as originating in one or more Parties in accordance with this Regulation;
   c) is produced in the territory of one or more Parties using non-originating materials that meet a change in tariff classification, a regional value content, or a combination of both or other requirements, as specified in the Annex of specific rules of origin and the merchandise complies with the other applicable provisions of this Regulation; or,
   d) is produced in the territory of one or more Parties, even if one or more of the non-originating materials used in the production of the goods do not comply with a change in tariff classification established in the Annex of specific rules of origin because:
      (i) the merchandise has been imported into the territory of an unassembled or disassembled Party, and has been classified as a good assembled in accordance with Rule 2 a) of the General Rules for the Interpretation of the SAC;

[251] According to the Secretariat of Regional Economic Integration of Central America (SIECA), the latest changes date back to 2009.

[252] All the quotes in this section are unofficial translations from the original Spanish text.

(ii) the merchandise and its parts are classified under the same heading and specifically describe it, provided that it is not divided into subheadings; or,
(iii) the merchandise and its parts are classified under the same subheading and it specifically describes them; provided that the regional content value of the merchandise, determined in accordance with Article 10, is not less than thirty percent (30%), unless otherwise provided in the Annex of specific rules of origin and the merchandise complies with the others Applicable requirements of this Regulation. The provisions of this paragraph shall not apply to the goods included in Chapters 50 to 63 of the SAC

2. For the purposes of this Regulation, the production of a good from non-originating materials that comply with a change in tariff classification and other requirements, as specified in the Annex of specific rules of origin, must be done in full in a or more Parties, and any regional content value of a good must be satisfied in its entirety in one or more Parties.

The PSRO of the CACM are contained in an annex of forty-four pages and are mostly at heading level, which explains the fewer pages when compared with the Pacific Alliance. The drafting of the PSRO is based solely on a CTC. There are no PSRO with an RVC.

The CACM provision on accumulation, reproduced below, provides for diagonal cumulation among CACM materials and for cumulation of working and processing under paragraph 2. Such provision makes the CACM cumulation more generous than the one provided under the Pacific Alliance in the previous section.

Accumulation

1. Originating materials or merchandise originating in a Party, incorporated into a merchandise of another Party shall be considered originating in the latter.
2. For purposes of establishing whether a merchandise is originating, the producer of the merchandise may accumulate its production with the production of one or more producers, of one or more Parties, of materials that are incorporated in the merchandise, so that the production of those materials be considered as made 8 Article 10 by that producer, provided that the merchandise complies with the provisions of Article 6.

Article 10 of the CACM rules of origin provides for the calculation methodology for the RVC that is rather similar to the build-down formula adopted in US-inspired free-trade agreements. However, as in the case of the Pacific Alliance free-trade agreement, the CACM does not take on board the deduction of the cost of

insurance and freight that is included in the US free-trade agreements and most notable in those of the US–CAFTA–DR.

In fact, the value of non-originating materials is clearly stated as CIF as follows:

Regional Content Value

The Regional Content Value of the merchandise shall be calculated in accordance with the following formula:

$$RVC = \frac{\text{VM}-\text{VMNO}}{VM} \times 100$$

where:

- RVC is the regional content value expressed as a percentage;
- VM is the transaction value of the merchandise adjusted on a FOB basis.
- VMNO is the transaction value of non-originating materials adjusted on a CIF basis, except as provided in paragraph 3.

In the event that such value does not exist or cannot be determined in accordance with the provisions of Article 1 of the Customs Valuation Agreement, it shall be calculated in accordance with the provisions of Articles 2–7 of the Agreement.

As contained in Article 18 (see below) the CACM provides for a rather complicated administration of certification of origin since it distinguishes between exporter and producer. This is a rather unusual procedure that does not have much precedent.

ARTICLE 18: CERTIFICATION AND DECLARATION OF ORIGIN

1. To document that a good qualifies as originating in one of the Parties, the exporter will issue the Certification of Origin in the Customs Form that covers the respective definitive import. This certification must contain the name, title and signature of the exporter.
2. When the exporter is not the producer of the merchandise, the first of these must issue the Certification of Origin based on the Declaration of Origin, signed by the producer, in the respective Customs Form. In the event that the exporter is the producer of said merchandise, the Declaration of Origin will not be necessary.
3. When an exporter is not the producer of the merchandise, he will complete and sign the certification contained in the Customs Form based on:
   (i) knowledge as to whether the merchandise qualifies as originating;
   (ii) reasonable confidence in a written statement from the producer that the merchandise qualifies as originating; or,
   (iii) the Declaration of Origin referred to in paragraph 2.

5.5 THE MEGAREGIONAL DIMENSION: AN INITIAL ANALYSIS OF THE CP-TPP AND RCEP

5.5.1 *The CP-TPP Rules of Origin*

The CP-TPP is the first megaregional of a new generation that has entered into force. The overall text and PSRO of the CP-TPP adopts the North American model and is a direct descendant of the original TPP.

In comparison to the USMCA/NAFTA complexities, the CP-TPP adopts a format derived from former US-inspired free-trade agreements with PSRO mainly drafted using CTC, wide use of the HS even at HS six digits to define PSRO, and an RVC based on a value-of-materials calculation.

The key CP-TPP article setting the main origin criteria is contained in Article 3.2 of the CP-TPP.

> **Originating goods**
>
> Except as otherwise provided in this Chapter, each Party shall provide that a good is originating if it is:
>
> (a) wholly obtained or produced entirely in the territory of one or more of the Parties as established in Article 3.3 (Wholly Obtained or Produced Goods);
> (b) produced entirely in the territory of one or more of the Parties, exclusively from originating materials; or
> (c) produced entirely in the territory of one or more of the Parties using non-originating materials provided the good satisfies all applicable requirements of Annex 3-D (Product-Specific Rules of Origin),
>
> and the good satisfies all other applicable requirements of this Chapter.

It emerges clearly from this article that the CP-TPP opted for an encompassing PSRO list covering all goods.

Article 3.5, as shown in Table 5.20, provides for four different methodologies used to calculate the RVC percentage of a good.

The PSRO list makes extensive use of different CTC rules, which can be applied at three levels of the HS:

- *change in chapter (CC)* – change in any of the first two digits (or 'chapter') of the HS code of non-originating materials once part of the finished product (e.g. importing steel of HS Chapter 72 and making railway tracks of HS Chapter 73)
- *change in tariff heading (CTH)* – change in any of the first four digits of the HS code of non-originating materials once part of the finished product (e.g. manufacturing gold jewelry of HS heading 7113 from imported gold of HS heading 7108)
- *change in tariff subheading (CTSH)* – change in any of the six digits of the HS code of non-originating materials once part of the finished product (e.g.

importing fresh ginger of HS subheading 0910.11 and using it to produce crushed ginger of HS subheading 0910.12).[253]

Limiting at CTSH level (six-digit HS level), the definition of CTC criterion marks a significant departure from USMCA and NAFTA practice that, in the case of specific products, uses item subheadings at eight-digit national level that require concordance tables of extraordinary complexity.

The CP-TPP, in line with modern free-trade agreements, adopts an importer-based system for the certification of rules of origin.

5.5.2 *The RCEP Rules of Origin*

The initial analysis in this section is based on draft made available to the author in October 2018 and, to the extent possible, it has taken into account the final text that has been made available in November 2020.

The initial draft of the main text of rules of origin was 111 pages long, not including the PSRO that were contained in a different excel file of 6,247 lines.

From the documents available to the author, it took around twenty-one meetings of the Working Group on RCEP rules of origin to get to the initial draft comprised of forty-one articles of which only nine were agreed by October 2018 (21.9 percent of the text) according to the initial draft, not including the PSRO list. This data alone may provide an idea of the complexity of the negotiations and the time spent in getting to an agreement on a complete text of RCEP rules of origin.

The main proponents and actors of the initial draft were as indicated in the text: ASEAN, Australia, China, India,[254] Japan, New Zealand, and South Korea.

The initial draft contains text recalling the pragmatic approach of the CP-TPP, in adopting a complete annex of PSRO and no general rules of origin applicable across the board. However, a closer look at the initial draft reveals different approaches that can be summarized in the following bullet points:

- The initial draft contains provisions on general rules of origin, and the relation between general rules of origin and PSRO contained in the annex is not entirely clear. This seems to be a replica of ATIGA as pointed out in section 5.3.1. The final text has addressed this inconsistency.
- The RVC article contains a build-up methodology. However, the build-up methodology as defined in the initial draft is a carbon copy of the old ASEAN direct method, resembling a value added/net cost calculation. This is simply confusing and self-defeating.

[253] These examples are excerpted from "Guide to obtaining preferential tariff treatment when exporting and importing goods using CPTPP," published by the Australian Government in December 2018.

[254] India pulled out from RCEP in November 2019.

- The cumulation provision that actually suggests postponing the design of a cumulation scheme until five years after the implementation of RCEP is a conspicuous sign of the complexities related to that article.
- On the issue of direct shipment, the initial draft still requires documentary evidence of direct shipment in a variety of forms. That is a more liberal approach than the through bill of lading contained in many Asian free-trade agreements, but far from the principle of nonalteration further discussed in Chapter 7 of this book.
- The initial draft contains a fairly liberal provision on third-country invoicing and back-to-back CO arrangements, albeit the final text contained a number of qualifications making the drafting uncertain on the scope of application.
- A provision in the initial draft is dedicated to "material used in production" that refers to intermediate materials in the US model or the absorption principle in the EU model. This fills a conspicuous gap in previous free-trade agreements of the region.
- There are wide divergences among RCEP parties on the issue of administration of rules of origin. China favors the maintenance of competent authorities and COs while others (Australia and New Zealand) propose exporter/importer declarations. This divergence is still reflected in the final published version since some countries have preferred to defer by five years the self-certification provisions.

5.5.3 *A Brief Comparison of the CP-TPP and the RCEP and Recent Studies*

The available literature on RCEP and CP-TPP rules of origin is limited since the text of the RECP has been made public in November 2020.

At first sight the main advantage of RCEP rules of origin (RoO) derives from the fact that it will bring under one common set of rules of origin countries that until now have had diverse sets of rules. This is the same as in CP-TPP; however, the addition of China as an RCEP partner dramatically expands the scope for cumulation.

Each RCEP member currently uses different sets of RoO depending on the free trade agreements it has with each RCEP member country. In other words, not only ASEAN applies different RoO with each one of the ASEAN dialogue partners, but Australia, Japan, New Zealand, the PRC, and the Republic of Korea also rely on diverse sets of RoO to trade with the partners with whom they have an FTA. A brief[255] points out some of these shortcomings existing in the RCEP while the potential gains are evident.

A number of studies have touched upon the issue of rules of origin in the CP-TPP and RCEP as one of the factors influencing the expected economic outcome from such megaregionals.

[255] See https://blogs.adb.org/blog/making-rcep-successful-through-business-friendly-rules-origin

A study using Computable General Equilibrium modelling pointed out the following about the original TPP:[256]

- *Passenger vehicles and auto parts*: TPP rules of origin for passenger vehicles could have a negative impact on US production of certain auto parts, but also could facilitate US vehicle exports.
- *Textiles*: Initial growth in US imports from Vietnam under TPP preferences would likely be moderated by Vietnam's limited ability to meet the TPP's yarn-forward rules of origin.
- *Chemicals*: In addition to tariff elimination and market access, industry sources identified rules of origin as generally positive factors in helping to reduce their costs of doing business in the TPP region.
- Considering the impact of RCEP on ASEAN, some authors[257] questioned how can ASEAN's centrality be reconciled with the multilateralization of regionalism. Such authors recommend that in order to maintain the centrality of ASEAN while pursuing RCEP, the latter should be designed in such a way as not only to facilitate the free movement of trade, services, and investments, but also to contribute to ASEAN integration.

More specifically on rules of origin, a study[258] based on quantification exercises involving 271 free-trade agreements identified that the CP-TPP on average is better than most US free-trade agreements, but worse than nonreciprocal US arrangements such as the CBTPA, AGOA, and GSP.

Based on data assessments, the CP-TPP has both more lenient origin criteria than US free-trade agreements and more trade-facilitating provisions, with the exception only of USMCA.

A country-specific study related to Vietnam[259] found that the industrial production structure of Vietnam is not consistent with the provisions of the CP-TPP, particularly regarding the rules of origin. Due to the small scale of its domestic industries and the lack of strong supporting industries, Vietnam has to import most of its intermediate inputs. This makes it difficult for Vietnam to meet the requirements of domestic content under the CP-TPP.

Most importantly, future studies should focus on a comparative analysis of how the CP-TPP and RCEP have addressed the main issues affecting the drafting of rules of origin in the Asian region. As discussed in section 5.3.1

[256] See US International Trade Commission, "Trans-Pacific Partnership Agreement: Likely impact on the U.S. economy and on specific industry sectors," Publication Number: 4607 Investigation Number: TPA-105-001, May 2016.

[257] See Chien-Huei Wu, "ASEAN at the crossroads: Trap and track between CPTPP and RCEP," *Journal of International Economic Law*, vol. 23, no, 1 (2020), 97–117.

[258] See D. Kniahin, D. Dinh, M. Mimouni, and X. Pichot, "Global landscape of rules of origin: Insights from the new comprehensive database," presented at the 22nd Annual Conference on Global Economic Analysis, Warsaw, Poland (working version: June 21, 2019).

[259] See N. H. Hoang and T. Q. Hoan, "Vietnam and the CPTPP: Achievements and challenges," Working Paper, 2019, available at www.iseas.edu.sg/images/pdf/ISEAS_Perspective_2019_41.pdf.

there are significant improvements to be made. Both the CP-TPP and RCEP were the first opportunities of dialogue among major administrations such as Japan, Australia, and New Zealand with the ASEAN model of rules of origin. The CP-TPP appears to be strongly inspired by a North American model while, at first glance, the initial draft of the RCEP appears to have inherited some of the complexities and deficiencies of ASEAN rules of origin and their administration.

A quick comparison in Table 5.20 of some provisions may provide examples of such different approaches.

Concerning the main methodology for defining the origin criterion for goods not wholly produced or obtained, a comparison of Article 4 of the RCEP initial draft and

TABLE 5.20 *Comparison of the RCEP and CP-TPP rules of origin articles*

Draft RCEP text	CPTPP
Article 4 Goods not wholly produced or obtained	Article 3.2 of the CP-TPP
Goods shall be deemed originating if they meet the minimum Regional Value Content (RVC) or change in tariff classification (CTC) requirements. The exporter should be given a choice between these rules and if the PSRO provides a choice between RVC, CTC, a specific manufacturing or processing operation, or a combination of any of these, RCEP must let the exporter of the goods decide which rule to use in determining whether the goods qualify as originating goods.	Originating goods Except as otherwise provided in this Chapter, each Party shall provide that a good is originating if it is: (a) wholly obtained or produced entirely in the territory of one or more of the Parties as established in Article 3.3 (Wholly Obtained or Produced Goods); (b) produced entirely in the territory of one or more of the Parties, exclusively from originating materials; or (c) produced entirely in the territory of one or more of the Parties using non-originating materials provided the good satisfies all applicable requirements of Annex 3-D (Product-Specific Rules of Origin), and the good satisfies all other applicable requirements of this Chapter.
Article 5 Calculation of regional value content	Article 3.5 Regional value content
Methods in calculating RVC: Build-down formula: RVC = [(FOB – VNM) / FOB] *100% Build-up method: RVC = [(VOM + Direct labor cost + Direct overhead cost + Profit + Other cost)/FOB)] *100%	Methods of calculating RVC: Focused Value Method: RVC = [(Value of the good – FVNM)/Value of the good] *100% Build-down method: RVC = [(Value of the good – VNM)/Value of the good] *100% Build-up method: RVC = [VOM/Value of the good] *100% Net cost method (for automotive goods only): RVC = [(NC – VNM)/NC] *100%

TABLE 5.20 (*continued*)

Draft RCEP text	CPTPP
Article 6 Cumulation Goods and materials which comply with the origin requirements, and which are used in another Party as materials in the production of another good or material shall be considered to originate in the Party where working or processing of the finished good or material has taken place. The Parties will review Cumulation once all Parties or original signatories to the Agreement ratify and implement the Agreement or 5 years after the date of implementation of this Agreement, whichever comes earlier.	Article 3.10 Accumulation A good is originating if the good is produced in the territory of Party/s by producer/s, provided that it satisfies the origin requirements. Further, originating good or material that is used in the production of another good in the territory of another Party/s is also considered as originating in the territory of the other Party. Lastly, production undertaken on a non-originating material in the territory of Party/s by producer/s may contribute toward the originating content of a good for the purpose of determining its origin, regardless of whether that production was sufficient to confer originating status to the material itself.
Article 8 Direct consignment An originating good shall retain its originating status if the good has been transported directly from the exporting Party to the importing Party without passing through the territory of a non-Party. For goods transported through one or more Parties, other than the exporting Party and the importing Party, the good shall retain its originating status if good: Does not undergo any operation other than unloading, reloading, splitting up of the consignment, storing, repacking and/or labelling for the purpose of satisfying the requirements of the importing Party, or any other operation necessary to preserve it in good condition or to transport the good to the importing Party, and Remains under control of the customs authorities of the country or region of transit. Appropriate documentation may be requested by the Customs authorities of the Importing Party.	Article 3.18 Transit and transhipment Originating good retains its originating status if the good has been transported to the importing Party without passing through the territory of a non-Party. If an originating good is transported through the territory of one or more non-Parties, the good retains its originating status provided that the good: Does not undergo any operation outside the territories of the Parties other than: unloading; reloading; separation from a bulk shipment; storing; labelling or marking required by the importing Party; or any other operation necessary to preserve it in good condition or to transport the good to the territory of the importing Party; and Remains under the control of the customs administration in the territory of a non-Party.
Article 15 Materials used in production If a non-originating material is used in the production of a good, the following may be	Article 3.6 Materials used in production Non-originating material that undergoes further production will be treated as

(*continued*)

TABLE 5.20 (*continued*)

Draft RCEP text	CPTPP
considered as originating content if: The value of processing of the non-originating materials undertaken in the territory of one or more of the Parties; and The value of any originating material used in the production of the non-originating material undertaken in the territory of one or more of the Parties.	originating good and if a non-originating material is used in the production of a good, the following may be counted as originating content in calculating RVC: The value of processing of the non-originating materials undertaken in the territory of one or more of the Parties; and The value of any originating material used in the production of the non-originating material undertaken in the territory of one or more of the Parties.

Article 3.2 of the CP-TPP shows rather clearly that at the time of the negotiations there were divergent views among the RCEP countries. Some of them favored a mix of general rules and PSRO, other countries a list of PSRO, with others wishing to maintain a series of alternatives. The resulting Article 4 of the RCEP presented a statement of intentions rather than a set of rules of origin. Luckily the final RCEP text is almost identical to article 3.2 of CP-TPP in table 5.20 above marking a decisive improvement.

Article 5 of the RCEP initial draft defining the RVC calculation methodology is clearly inherited from the ATIGA text reflecting the cumbersome definition of build-up as a value-added or net cost calculation.

In comparison, Article 3.5 of the CP–TPP text is a direct descendant of the former TPP text listing four different methodologies of RVC of which three are based on a value-of-materials calculation and one based on a value-added/net cost calculation.

As in the majority of free-trade agreements of the North America model, the net cost calculation is mostly used in the CP-TPP for automotive products. The large majority of PSRO are based on an RVC based on an alternative between build-down or build-up methodologies.

The provisions on direct shipment in Article 8 of the RCEP initial draft make an express reference to evidence of documentary requirements: "Appropriate documentation may be requested by the Customs authorities of the Importing Party." The corresponding article in the CP-TPP does not make reference to such documentary evidence.

The comparative examination of the text on cumulation contained in Article 6 of the RCEP initial draft clearly indicates that the RCEP parties have yet to develop a clear idea on the scope and nature of the cumulation since they provide for five years to develop a suitable mechanism to regulate cumulation. Comparatively the CP-TPP text in Article 3.10 provides ample scope for cumulation since both kinds of cumulation of originating materials (diagonal cumulation) and full cumulation (cumulation of working and processing) are provided for.

The two texts are rather silent on a crucial issue related to cumulation and tariff phase out during the transitional period.

As the tariff phase-out is different in the CP-TPP and RCEP (i.e. New Zealand tariff phase-out may be different for China than the one for ASEAN), there should be a provision regulating this situation to determine the country of final origin when different countries have been involved in the production of a good. Such provision in the CP-TPP text to designate a final originating country when different parties have used cumulation is contained in section B of Chapter 2, national treatment and market access. Conversely, the RCEP text seems to indicate that the origin will be conferred to "the party where the working or processing of the finished goods or material has taken place," according to first paragraph of Article 6 of the RCEP initial draft in Table 5.20. The final RCEP version provides extensive regulations for tariff differentials for each RCEP member state.

Finally, Article 15 of the RCEP initial text and Article 3.6 provide discipline for the status of intermediate materials with the CP-TPP introducing a substantial limitation, making it applicable only when calculating RVC.

5.5.3.1 A Comparison of PSRO

The RCEP initial draft list of PSRO contained in an excel file shows a total of 5,205 PSROs for different HS subheadings. Among these PSROs, 3,326 HS subheadings PSRO were agreed while 1,879 HS subheadings were not yet agreed. In terms of the HS subheadings for the PSRO that were still under negotiation, on average, there were around three different PSRO proposals.

For the CP-TPP, the final text provides for significantly less PSRO: 1,204 for both HS headings and HS subheadings, of which 294 PSRO are at the HS headings level and 910 are at the HS subheading level.

Table 5.21 makes a short comparison of selected PSRO in the initial draft of RCEP and the CP-TPP.

TABLE 5.21 *Comparison of the RCEP and CP-TPP PSRO*

PSRO Overview		
General Description	RCEP	CP-TPP
Number of PSRO	5,205	1,204
Level of aggregation	HS6	HS4 (294) HS6 (910)
Proposed PSROs	Average: 3 Minimum: 2 Maximum: 4	N/A

(*continued*)

TABLE 5.21 (*continued*)

PSRO HS Subheading Comparison

HS subheading	Description	RCEP*	CP-TPP
040610	Fresh (unripened or uncured) cheese, including whey cheese, and curd	*RVC40* *CTH* *CTSH* *WO*	CC
160414	Fish, whole or in pieces, but not minced: tunas, skipjack and bonito (Sarda spp.)	*RVC40* *CC* *CC ex 01–03*	CC
190300	Tapioca and substitutes therefore prepared from starch, in the form of flakes, grains, pearls, siftings or in similar forms.	CC	CC
200410	Potatoes	*CC ex 07* *CC* *RVC40 or* *CC*	CC
280300	Carbon (carbon blacks and other forms of carbon not elsewhere specified or included).	RVC40 or CTH	CTH
290110	Acyclic hydrocarbons: Saturated	RVC40 or CTH	CTSH
390110	Polymers of ethylene, in primary forms: Polyethylene having a specific gravity of less than 0.94	RVC40 or CTH	RVC35 (build-up) or RVC45 (build-down) or CTH
610441	Dresses of wool or fine animal hair	CC	CC
620111	Overcoats, raincoats, car-coats, capes, cloaks and similar articles: of wool or fine animal hair	CC	CC
HS subheading	Description	RCEP*	CP-TPP
840120	Machinery and apparatus for isotopic separation, and parts thereof	RVC40 or CTSH	CTSH
850110	Motors of an output not exceeding 37.5	RVC40 or CTH	RVC35 (build-up) or RVC45 (build-down) or CTH
900110	Optical fibres, optical fibre bundles and cables	RVC40 or CTH	RVC35 (build-up) or RVC45 (build-down) or CC

*The PSRO under RCEP, in italics, for the subheadings 040610, 160414, and 200410 are still not yet agreed by the parties involved.

6

Drafting Rules of Origin

In the 2009 edition of this book the issue of drafting rules of origin was a section contained in Chapter 5 of this book. In this edition of the book I wish to share more openly the experience I gained in advising countries on the negotiation and drafting of rules of origin as well as the development of new research and literature. Thus, this edition is dedicating a whole chapter to this topic. Most of the driving force toward an increased interest in rules of origin derives from the simple fact that there is hardly a World Trade Organization (WTO) member that is not engaged in rules of origin (RoO) negotiations. Moreover, compliance with rules of origin is part of the daily routine for private sectors and firms.

As discussed in the preceding chapter, ASEAN is engaged with the Regional Comprehensive Economic Partnership (RCEP) – the ten ASEAN member states and its FTA partners (Australia, China, Japan, the Republic of Korea, and New Zealand).

Many ASEAN member countries have negotiated free-trade agreements with the EU, such as Singapore and Vietnam, while some others are still negotiating – like the Philippines, Indonesia, and Thailand. Other ASEAN countries are implementing the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CP-TPP).

The majority of African countries entered into full economic partnership agreements (EPAs) with the European Union (EU) entailing the implementation of rules of origin. At the same time, African countries and regional economic communities (RECs) have been negotiating the African Continental Free-Trade Area agreement (AfCFTA) and finalizing the rules of origin of the Tripartite Free-Trade Area agreement (TFTA) after years of negotiations.

In Latin America the latest negotiations concern the Pacific Alliance, discussed in Chapter 5, and the implementation phase of the US–Peru and US–Colombia FTAs that signaled a significant evolution of the North American Free-Trade Agreement (NAFTA), later confirmed in the US–Singapore and US–South Korea model of

rules of origin. This in turn has meant an increased capacity of the Latin American countries to negotiate complex rules of origin at product-specific level.

Many commentators and practitioners have been looking at the outcome of the Transatlantic Trade and Investment Partnership (TTIP) as the watershed on drafting in rules of origin. Yet in the absence of the TTIP, the Canada–EU and the Japan–EU FTA agreements have entered into force, while NAFTA has been redesigned into the US, Mexico, Canada Free-Trade Area agreement (USMCA).

The most notable advance made at multilateral level is the declaration on preferential rules of origin where the less-developed countries (LDCs) have engaged the multilateral community with the assistance of the author to implement the commitments contained in Hong Kong declaration on Duty-Free Quota-Free (DFQF) and those contained in the Bali and Nairobi Ministerial Decisions.

A recent initiative led by Switzerland[1] proposes adopting a template for the notification of nonpreferential rules of origin as discussed in Chapter 2 of this book.

In fact, the existing notifications were made in the mid-1990s and are by and large obsolete, incomplete, or nonexistent. The Swiss proposal draws on the positive experience of the adoption of a template for notifying the rules of origin under the DFQF initiative contained in the Nairobi Decision.

In the middle of these overlapping initiatives it is not surprising that the search for the best rules of origin and the simplest, transparent, and predictable criteria for determining origin is undergoing. A number of papers and studies have been carried out, recommending best practices or advocating one rule of origin over another one. Yet, as examined in Chapter 4, their impact on the current negotiations has been minimal judging from the complexity and stringency of rules of origin adopted in many South–South trade arrangements and the scarce results obtained by some developing countries' negotiators in seeking more lenient RoO requirements when negotiating free-trade agreements with the partners of the North.

In addition, and, as discussed in preceding chapters, there is a worldwide tendency to adopt product-specific rules of origin (PSRO). It is technically undeniable and also intuitive that PSRO make sense: it is not the same process to manufacture a portable phone or a fruit juice. Yet PSRO multiply by hundreds or thousands the challenges in drafting rules of origin.

The increasing technicalities and complexities of negotiating PSRO could be addressed by sophisticated negotiating teams and administrations capable of transforming such PSRO into a transparent and predictable set of rules of origin leading to high utilization rates. NAFTA has been quoted for decades as the pinnacle of technical rules of origin complexities, with hundreds of PSRO. Yet, as illustrated in Chapter 4, NAFTA utilization rates have been consistently high.

[1] See WTO documents JOB/RO/6, which had been circulated on October 13, 2016, and JOB/RO/7, on November 17, 2016. These documents have undergone a series of significant changes and updating in the last three years. At present the last version is not publicly available.

Conversely, and as discussed in Chapter 5, under the ASEAN and Africa experience, and in Chapter 4 dealing with the economic effects of rules of origin, PSRO have introduced a further element of complexity in an already difficult situation when less-equipped teams of negotiators and administrations come into play. Research has not helped in disentangling such complexity.

As an example, the negotiations on PSRO in AfCFTA have brought an unprecedented degree of technical complexity not justified by the trade intensity at stake in intraregional African trade. On the one hand, AfCFTA negotiators spend entire days in discussing the applicable rule of origin for curry where the amount of intraregional African trade is relatively minimal. On the other hand, the same AfCFTA negotiators did not focus their attention on which rules of origin could attract investment in developing productive capacities in the African region. Some of the AfCFTA PSRO, as discussed in this chapter, are more stringent than those negotiated with the EU under EPAs. The end result is that an investor wishing to export to African countries is better located in the EU than in Africa in terms of preferential market access.

Meanwhile, business is complaining about concurrent and overlapping sets of rules of origin, hundreds of pages long, requiring complicated software to be managed and trained personnel.

Yet, there is a persisting stalemate to establish multilateral discipline on rules origin in spite of the Agreement on Rules of Origin (ARO), even if, as argued in Chapter 1, there are increasing signs of convergence in the way rules of origin are drafted.

The literature and the analytical research have been unable to suggest the best rules of origin that may be used. This is not surprising given their multiform nature and complexity. The absence of clear multilateral disciplines on rules of origin leaves trade negotiators and customs officials negotiating free-trade agreements in a "no man's land."

While the work conducted by the Technical Committee on Rules of Origin (TCRO) at the World Customs Organization (WCO) and subsequently by the WTO CRO during the Harmonization Work Program (HWP) offers valuable technical solutions, it has not been used as guidance on drafting rules of origin in free-trade agreement negotiations. This is mainly due to the rigid separation established by technocrats and negotiators between nonpreferential and preferential rules of origin.[2] Decades of evolution in drafting rules of origin have amply demonstrated that while there is a difference between nonpreferential and preferential rules of origin in terms of stringency of requirements, the technicalities are the same and the world would be better off not creating artificial divisions and recognizing that there are similarities.

[2] As discussed in Chapter 2 of this book, the boundaries are not as thick as it was initially believed, and business does not really perceive such difference.

Nor was the Common Declaration with Regard to Preferential Rules of Origin at Annex II to the WTO ARO negotiated with the objective of providing guidance on drafting rules of origin as part of free-trade agreement negotiations. On the contrary, it was left deliberately vague to give WTO members sufficient latitude to draft preferential rules of origin as they see fit.

The debates about and literature on rules of origin are relatively new and largely stem from the increasing attention paid by economists to preferential trade flows granted under free-trade agreements or autonomous preferences, such as Generalized System of Preferences (GSP) schemes and, lately, NAFTA. However, such literature tends to assess the impact of rules of origin on trade, but falls short of providing guidance on how to draft them better, as discussed in Chapter 4. Therefore, what is still missing is a "positive agenda" on how to draft better rules of origin in free-trade agreements that goes beyond a broad call for their liberalization and policy statements. A proper workable course of action should be suggested, based on a solid technical background accompanied by an intergovernmental negotiating context and strong political will.[3]

The basic problem of adopting an exclusively economic approach when assessing the impact of rules of origin is the scant attention given to their multidisciplinary character. They are, by their very nature, rules involving complex legal, customs, and industrial considerations.

Moreover, these aspects are closely intertwined, making rules of origin an extremely problematic subject. Ignoring their multidisciplinary nature leads to flawed policy recommendations.

The truth of the matter is that over twenty years' experience with GSP rules of origin in the United Nations Conference on Trade and Development (UNCTAD) from the mid-1970s to the early 1990s, and over a decade of experience in the TCRO and CRO negotiations during the HWP, have amply demonstrated to the author that there is no such thing as a perfect and balanced set of rules of origin.

This chapter does not advocate the use of one set of rules of origin over another since such rules have to be tailored to the trade and development objectives of the trade instrument they are designed to serve, this being a free-trade agreement or the application of anti-dumping (AD) duties.

This chapter aims to clear the ground of misconceptions and stereotypes about drafting rules of origin offering: (1) a series of lessons learned and advice; and (2) a methodology to draft PSRO based on (a) an input–output table matched with trade flows and (b) a comparative table of PSRO identifying convergence and divergence on drafting PSROs. Such methodology has also to be contrasted with the lessons learned from utilization rates, as discussed in Chapter 4.

[3] Chapter 1 of this book discusses the amount of effort deployed by the LDCs to ensure an adequate follow-up to the Hong Kong Ministerial Decision of 2005. Similarly, the Gleneagles G8 communiqué made reference to a 10 percent value-added rule requirement to increase utilization of trade preferences for LDCs.

6.1 THE MAIN ACTORS IN NEGOTIATING AND DRAFTING RULES OF ORIGIN

As illustrated in the preceding chapters, rules of origin are a very complex issue, throughout their drafting, negotiating, and administration.

Rules of origin require an uncommon mixture of skills and experience very seldom found in one single person. In fact, rules of origin demand a multidisciplinary approach comprising knowledge of trade and customs laws, industrial processes, and related economics. This in turn requires that negotiating rules of origin is a task undertaken by a sophisticated, multidisciplinary team and consultation among various government departments, depending on the nature of the product, and consultation with the private sector.

It is rather obvious that rules of origin are one of the main customs laws together with customs valuation and customs classification. It follows that knowledge of the Harmonized System (HS), custom valuation, and practical experience in customs administration are needed when dealing with rules of origin. However, the time has long gone since rules of origin were considered a rather obscure and technical customs issue with little bearing on trade and economic policy. Customs officials may not possess the necessary trade and industrial policy vision and flexibility to elaborate constructive proposals or alternatives that are most needed during negotiations.

The "dream team" of RoO negotiators should be composed of a triad of trade officials, customs officials, and the private sector. All these actors should be able to overcome the stereotypes and silo mentality of their day-to-day work to embrace a negotiating setting. Such stereotypes vary; on the one hand, customs officials' concerns tend to be mainly related to the implementation phase of the rules of origin customs and they do not realize that their role is also to provide the technical ammunition to the trade negotiator during the negotiations rather than limiting themselves to the implementation phase. On the other hand, it is not rare to see negotiators keeping at arm's length senior customs officials who are often left waiting outside the negotiating room just to be consulted for a few minutes on some technical questions of the rules (those that the negotiator is unable to appreciate or understand).

The private sector should also abandon the skeptical attitude of not contributing its views in a constructive manner, dismissing the negotiating process only to intervene in the last stages of the negotiations with unrealistic requests and expectations.

The overall negotiating context where the rules of origin are discussed must not be underestimated since it may be a crucial factor determining success or failure. A knowledgeable chair with authority and confidence together with the possibility of seeking technical advice from neutral technical expertise are necessary preconditions. These preconditions should be common sense but often common sense does not prevail in the negotiating context.

In the context of the HWP discussed in Chapter 2 of this book, once the work of the Technical Committee on nonpreferential rules of origin was terminated at the WCO, it had to be continued and formally approved in the WTO CRO in Geneva and the negotiating process was resumed there. The WCO officials who were heavily involved in the three-year negotiating efforts and widely consulted by delegates in the TCRO at the WCO encountered serious procedural problems in attending and participating in informal meetings in the WTO CRO, where technical substantive issues were discussed. To put it simply, as the WCO has an observer status in the WTO, WCO officials could not attend and participate in informal CRO meetings where the real issues were debated, nor present the results of the work that they carried out for the last three years under a WTO mandate.

In retrospect, this could have been one of the reasons for the failure to come to an agreement on the results of the HWP, since the WCO technical experts at that time were customs experts delegated by customs administrations – namely the United States, Japan, the EU, Morocco, and Hungary – to the WCO and headed by a manager to assist the WCO Secretariat in negotiating the harmonized rules of origin. These technical experts, after three years of negotiations, were the only ones capable of explaining the 1,000 pages of PSRO and unresolved issues to the new delegates sitting in the WTO CRO. At the same time, these officials were the repository of the thousands of hours spent in negotiating PSRO in the TCRO and the technical solutions and compromises reached during the negotiations.

The CRO delegates were mainly diplomats or, at best, trade negotiators having little or no experience on the technicalities of the rules of origin. Yet because of procedural rules governing attendance and participation in WTO meetings, the WCO technical experts were unable to take the floor to explain to the CRO the results of the work of the TCRO, the technical options, and the unresolved issues. Precious time was lost, as well as the opportunity to seek consensus among major delegations at the CRO with the comfort of those WCO experts delegated from their capital to monitor the development of the harmonization work program.

In other contexts – like ASEAN, SADC, Tripartite FTA, and lately AfCFTA – rules of origin have been negotiated by a mixture of delegations with little continuity and scarcely any technical preparation. However, lately, it is undeniable that rules of origin are increasingly being dealt with by negotiators, economists, and trade policymakers. This is a positive development since the debate over rules of origin has to become increasingly transparent and open to intervention from many different actors. However, as pointed out earlier, the research and literature carried out on rules of origin has been unable to offer solutions that could gain traction from government and business toward approximation and convergence toward a simplification of rules of origin.[4] Chapter 1 of this book provides an overview of the steps that

[4] See Chapter 2, section 2.12.

would be undertaken in future research, as outlined by the author during the WTO Ministerial Conference in Buenos Aires.[5]

In a Platonian vision of the rules of origin, the ideal sequence for rule-making would be that, first of all, input is provided by the manufacturers/producers of the goods. In fact, they are in the best position to know and describe how the finished product has been obtained and what kind of manufacture or processing operations have been carried out. Thus, the producer/manufacturer should be placed at the very center of the drafting process of the rules of origin.

The customs legal expert should then be in a position to transform the raw inputs provided by the producer/manufacturer into a technically sound rule of origin reflecting the processing and manufacturing operations. Thus, if we take as an example a manufacturer producing flat-rolled products out of imported slabs, the rule of origin may be read according to one of the methodologies normally used to current draft PSRO for such products as follows:

Option 1	Option 2	Option 3
Manufacturing from slabs and other semi-finished products of heading 7207	Change of tariff heading	Manufacture in that the value of imported materials do not exceed X% of the ex-works price of the finished product

Option 1 provides a descriptive PSRO outlining the manufacturing process of obtaining flat-rolled products of iron and steel. Option 2 provides for a similar PSRO with no description of the manufacturing process just requiring a CTH. Option 3 uses a percentage criterion with an unspecified percentage level. The manufacturer should be ideally able to provide the necessary inputs to devise the best option for the applicable PSRO among the three options reflecting its manufacturing capacity, the availability of local or non-originating inputs (i.e. slabs in this case) and provide a figure for the level of percentage where PSRO based on a percentage requirement may be found preferable. There are also a series of substantive issues to be addressed since option 1 would implicitly disregard any other manufacturing process that is not the flat rolling of slabs into flat-rolled products. However other working or processing can be carried out on flat-rolled products, such as coating and galvanizing. In this case, a percentage-based PSRO may recognize such working or processing as origin conferring while option 1 and 2 may disregard such operation as non-origin conferring since they do not result in a CTH.

It is obvious that such a product-specific approach is open to the influence of lobbies during the drafting and negotiations of such PSRO. However, it is

[5] See Eleventh WTO Ministerial Conference, "New research shows convergence on rules of origin is happening," https://unctad.org/en/conferences/UNCTADatMC11/Pages/NewsDetails.aspx?OriginalVersionID=1637; and for ongoing research see https://globalgovernanceprogramme.eui.eu/research-project/trade-facilitation-and-rules-of-origin/.

undeniable that PSRO are nowadays the standard format of rules of origin in free-trade agreements. In every free-trade agreement, invariably, a protocol containing the general provisions on rules of origin and administration is accompanied by a long annex containing the PSRO. Back in the 1990s, NAFTA negotiations on PSRO undoubtedly set a precedent and the later negotiations on automotive products in USMCA were just a reminder. As pointed out by many commentators and former negotiators, NAFTA made clear how the lobbies and producers could use the intrinsic potential of rules of origin as rent-seeking devices.

Once designed by customs experts, the rules should be then examined in the overall context of the negotiating scenario by the trade policymakers/negotiators who will have to carefully balance their priorities in the different negotiating contexts and assess the economic and industrial implications of a specific rule of origin and the possible options.

Some examples in two different regional contexts may illustrate the difficult trade and economic policy choices with which trade negotiators are sometimes faced.

The economy of Bangladesh has been heavily reliant on its export of garments. Yet the backward linkages of ready-made garments (RMGs) are not fully developed, and the demand for imported fabric to manufacture RMGs is high. At the same time, some local businesspersons have taken up the challenge of producing local competitive yarn and fabrics to partially replace imported fabrics and yarns.

In the discussion with the EU over the granting of regional cumulation to South Asian Association for Regional Cooperation (SAARC) under the EU GSP rules of origin, the Bangladesh manufacturers of fabrics have been opposing the granting of regional cumulation because it would have permitted the utilization of Indian fabrics to manufacture RMGs.

The trade policymakers in this case had to balance obvious considerations of political economy between upstream products of fabrics and downstream exporters of RMGs, industrial strategy, and negotiating priorities.

A similar dilemma turned into one of the most contentious issues that emerged during the negotiations on rules of origin in the context of the Southern African Development Community (SADC) free-trade agreement. For many of the LDCs belonging to SADC, the most relevant benefit from such free-trade agreement was the prospect of improved market access in the garment sector to the South African Market. However, it soon became clear that the South African negotiators, under severe pressure from domestic trade unions in the garment sector (but also in the agricultural sector), argued for rules of origin on garments borrowed from their free-trade agreement earlier negotiated with EU.

Under the rules of origin proposed by South Africa, it was not possible to use imported fabric outside the SADC region to manufacture RMGs with duty-free access to the South African market. The LDCs argued that the regional production of yarn and fabrics is limited in quantity and quality in the region and that the adoption of similar rules of origin would have been tantamount to a zero-sum situation because tariff concessions were nullified by overly stringent rules of origin.

In an ideal situation, these negotiating dilemmas and contentions should be addressed by analytical studies based on industrial accounting and consultations with the private sector to identify which of the different rules of origin on the negotiating table ensures medium to long-term viability and sustainability of domestic industry. On the basis of such pragmatic analysis the negotiators could then take an informed decision. Customs and trade policy experts could contribute their own experience drawn from other regions and draft possible negotiating scenarios for the ways forward. Economists could resort to some modeling and scenarios on the merits of each proposal.

In practice, this seldom happens. Limitations on technical expertise and resources are most of the time the limiting factors especially during negotiations of free-trade agreements among developing countries. However, taking into account the growing technical assistance available, this should be less of a problem.

In reality, experience has shown that the lack of expertise and the failure of a well-functioning negotiating machinery at domestic level in FTA partners are the most formidable stumbling blocks to consensus building and sometimes it may lead to fatal mistakes when negotiating rules of origin. Timely technical assistance is often not available or not of the required technical level to address the issues at stake.

Besides the NAFTA case, where rules of origin became major victims of lobbies and industrial interests, there are a lot of other human and political factors turning negotiations on rules of origin into a nightmare.

In this context, one may be tempted to consider that a major issue for some of the developing countries involved in negotiating rules of origin is that the rules of origin in North–South free-trade agreements should be based on the "model" developed by their more industrialized partners. However, since the "models" are based on consultations and fine-tuning with domestic constituencies and stakeholders in the United States, Japan, and the EU, it follows that the rules of origin requirements and administrating techniques are tailored to the interests and industrial strategy of these industries. Hence, these rules of origin may not match the manufacturing capacity of the developing countries. For instance, the Pan-European Rules of Origin might have worked reasonably well in the context of the EU's Europe Agreements with countries of Eastern Europe with a relatively large industrial base in some sectors. However, the same rules may not be equally suitable in the context of a free-trade agreement or EPA that the EU is negotiating with certain regional groups composed of African, Caribbean, and Pacific countries. The same observations may be made in the case of the NAFTA rules when the United States has been negotiating free-trade agreements with Central American countries, or the free trade of the Americas.

However, experience and a closer look at the text of the free-trade agreement and the annexes of PSRO (see Chapters 3 and 5 of this book) across the regions and free-trade agreements and at intraregional level show a different story. In reality while it is true that the "models" build by the EU, United States, and Japan may be built up having in mind their own industrial structure and trade interests, it is an established fact that the rest of world, including developing countries, have either negotiated

rules of origin that are even stricter than those negotiated with their partners of the North, or, at best, they have been unable to develop their own rules of origin model and consequently have adopted, with minimum variations, the Northern models.

The difficulties in negotiating and drafting rules of origin have been and continue to be a dramatic stumbling block during the negotiations of free-trade agreements or RTAs, as illustrated in Chapter 5 of this book and further discussed in this chapter. One would expect that the lessons learned from the GSP utilization and the ongoing discussions at the WTO CRO on the implementation of the WTO Nairobi Decision on rules of origin for LDCs and the negotiations with the industrialized countries would have informed the negotiators in the various developing regions to draft balanced and workable rules of origin.

Unfortunately, this is not the case at all, as discussed in Chapter 5 and further analyzed in this chapter. Rules of origin in free-trade agreements among developing countries continue to be plagued by a combination of poor drafting and implementation, often the result of long, protracted, and expensive negotiations leading, in some cases, to inconclusive outcomes. Most importantly, such rules of origin in South–South free-trade agreements are overly restrictive when related to the industrial context where they are designed to operate, making the agreements unattractive for firms willing to invest in the region.

Basically, these are four scenarios where countries are confronted with having to negotiate or implement rules of origin. The first is related to participating in negotiations on nonpreferential rules of origin. As discussed in Chapter 2, the failure to agree the final result of the HWP means that this scenario at present is limited to the agenda under the WTO CRO and the updating of the revised Kyoto Convention. Yet, and as discussed in Chapters 1 and 2, a renewed effort to at least achieve transparency on nonpreferential rules of origin is a common public good where all countries including developing countries and LDCs stand to gain the most.

The second and the third scenarios are related to the negotiation and implementation of rules of origin in free-trade agreements. The second scenario is when developing countries negotiate rules of origin with a developed country and the third is when they are negotiating free-trade agreements among themselves.

The fourth scenario is related to preferential rules of origin used in the context of autonomous preferential tariff concessions like GSP, the African Growth and Opportunity Act (AGOA), and DFQF rules of origin. Under this latter scenario the unilateral nature of these preferences entails that there is no real negotiation but discussions mostly take place in the WTO CRO following the Nairobi Decision on preferential rules of origin for LDCs.

Given the increasing pace of regionalism, the major scenario where countries might experience challenges in negotiating and implementing rules of origin is free-trade agreements, and, most recently, megaregional free-trade agreements (of which the RCEP, CP-TPP, and AfCFTA are examples).

While the EU has been traditionally proliferous with free-trade agreements, most recently the United States and Japan and major developing countries like China, Brazil, and South Korea, as well as middle-income countries such as Chile and Vietnam, have been launching a series of free-trade agreements.

The United States and the EU, together with Japan, have been able to progressively develop their "model" of rules of origin that, with variations, are applied in many of these free-trade agreements. As discussed in Chapter 2 of this book, the shape and drafting of the preferential rules of origin is gradually converging and there are a number of lessons learned that could be used in the course of the negotiations.

On the one hand, the experience gained by the United States and the EU in developing their own models of rules of origin has not been exempt from mistakes. On the other hand, the lessons learned have allowed a progressive evolution of their respective models of rules of origin. In parallel with this evolution, the negotiating and administrative machinery of consultation with the various stakeholders involved with the negotiations and implementation of rules of origin has dramatically improved, to the extent that some of the consultations with the private sector are taking place by exchange of electronic messages.

The NAFTA-inspired approach in the case of the US and the Pan-European Rules of Origin evolved during the decades of operations as discussed in Chapter 3. In the case of NAFTA, trilateral consultations among the United States, Canada, and Mexico have revised and simplified the exasperating complexity of some product-specific NAFTA rules. It has also been noted in Chapter 3 that the latest free-trade agreements signed by the United States have already shown some degree of simplification and drastic changes in the calculation of the regional value content (RVC).

In the case of developing countries, even located in prosperous regions like Asia, there is still room to obtain more experience in negotiating and drafting rules of origin. In the following sections, some consideration and advice are given on how to approach and design rules of origin.

6.2 FORM AND SUBSTANCE OF RULES OF ORIGIN

Rules of origin are (i) industry-related and (ii) trade instrument-related. A rule that may work relatively well in the North American or European industrial context may be meaningless in the context of Central Africa, due to an absence of local or regional inputs.

In the case of preferential rules of origin, the issue at stake is simpler than in nonpreferential rules of origin since the former deliver an easily quantifiable premium: reduced tariff or duty-free entry. Yet the apparently straightforward nature of preferential rules of origin has not been sufficient to simplify the debate about the best rules to adopt in free-trade agreements.

In fact, the jury is out on the best set and form of rules of origin in free-trade areas. The reality is that there is no such thing as "best" rules of origin that can be adopted

in free-trade agreements, although a number of lessons have been learned on how to draft them and on potential mistakes to be avoided.

One should begin by considering the desired objective of a given set of rules of origin separately from the drafting methodology. A distinction has to be made between the "form" of a given set of rules of origin and its "substance." The "substance" is the degree of restrictiveness of rules of origin with respect to an existing value-chain context in which it is expected to operate. In short, the substance is the manufacturing operation that has to be carried out on non-originating inputs to obtain origin of the finished products.

For instance, GSP beneficiaries often complained of rules of origin requiring a double industrial processing stage – namely, (1) weaving the yarn into fabric and (2) cut, make, and trim the fabric into the finished garment in the clothing sector – that do not tally with existing value chains, as discussed in Chapter 4 of this book.

The "form" is the way in which the rules of origin are drafted using different methodologies; namely, a change of tariff classification (CTC) at heading level, at subheading level with or without exception, percentage criterion, or specific working or processing, and their different variants.

The "form" is neutral with respect to the "substance" of the rules. However, it may be argued that there are "forms" of rules of origin that are more prone to be the focus of protectionist interests and that, on technical grounds, may be easily drafted in a manner to exclude targeted inputs. Also, there are forms of PSRO that may be more accurate in terms of drafting techniques.

One of the common misconceptions during the negotiations, but also in research literature as discussed in Chapter 4, is mixing the "form" with the "substance."

In fact, the restrictiveness or leniency of a given rule of origin is a factor independent from the way in which the rule of origin is drafted. A requirement of a CTH or subheading (CTSH), whether or not coupled with exceptions, a requirement for a certain value added or RVC to be complied with, or the performance of a specific working or processing requirement are, ultimately, all technical instruments available in drafting a given rule of origin and which may produce a substantially similar effect in terms of measurement of restrictiveness. This is illustrated below, anticipating elements of drafting rules of origin.

Let us take the example of drafting rules of origin for processed fish, like canned tuna of heading 16.04, as shown in Table 6.1. Assume that the "substance" is that only originating fish may be used to obtain canned fish. We may have different drafting techniques as follows under the Canada–EU FTA agreement expressed as a CTC (in this specific case, a change of chapter with the exclusion of materials of Chapter 3, where live fish is classified; this excludes the possibility of using non-originating fish of Chapter 3), or we can have the same requirement in terms of substance expressed as a manufacturing requirement under the EU–Korea FTA agreement.

Conversely, assume that the substance of the rule of origin is that the process of obtaining canned fish from non-originating fish is an origin-conferring operation in

TABLE 6.1 *Comparison of different drafting of PSRO*

HS code	CETA	EU–KOREA	CP-TPP	US–KOR
16.04 Prepared or preserved fish	A change from any other chapter, except from Chapter 3	Manufacture: for animals of Chapter 1, and/or in which all the materials of Chapter 3 used are wholly obtained	A change to a good of subheading 1604.15 from any other chapter[i]	A change to heading 16.04 from any other chapter

[i] It has to be noted that, in the case of the CP-TPP, the PSRO are set at subheading level. This is another form of drafting that may also have an impact on substance since it allows a fine-tuning of the PSRO at higher, disaggregated levels.

terms of substance. This can be expressed in a CTC requirement, as in the case of the CP-TPP[6] or the US–Korea FTA agreement.

As another example, the requirement of double processing in the clothing sector may be expressed according to different drafting techniques:

(a) *Percentage criterion* as shown below:

HS heading	Description of the product	Origin requirement
Ex-62.10 Ex-62.16	Fire-resistant equipment of fabric covered with foil of aluminized polyester	Manufacture from uncoated fabric provided the value of the uncoated fabric used does not exceed 40% of the ex-works price of the product

In this case, the "form" is expressed by an ad valorem percentage requirement requiring that the value of the non-originating uncoated fabric does not exceed 40 percent of the ex-works price of the finished product. Such rule implies that, commercially speaking, it may be very difficult to use non-originating uncoated fabric since normally the value of the fabric may exceed 40 percent of the finished product. If this is the case, it turns out that the fabric has to be woven locally (first process) and then coated and cut to piece and assembled (second process). This would be a double processing requirement. In some cases under NAFTA and USMCA, the PSRO may even require a triple transformation requirement as in the next example.

(b) *Change of tariff classification* – NAFTA/USMCA model with exceptions:

[6] In the case of the CP-TPP, the PSRO are expressed at subheading level; that is another form of drafting rules of origin.

HS 61 description: Men's or boys' overcoats, car-coats, capes, cloaks, anoraks (including ski-jackets), wind-cheaters, wind-jackets and similar articles, knitted or crocheted, other than those of heading 61.03.[7] A change to heading 61.01 through 61.02 from any other chapter, except from heading 51.06 through 51.13, 52.04 through 52.12, 53.10 through 53.11, Chapter 54 or heading 55.08 through 55.16 or 60.01 through 60.06, provided that the good is both cut (or knit to shape) and sewn or otherwise assembled in the territory of one or more of the Parties.

In this case, while the beginning of rules of origin – "A change to heading 6101 through 61.02 from any other Chapter" – requiring a CTC from any other chapter may appear quite liberal, the remainder of the PSRO contains a number of headings that could not be used. Matching the number of the excerpted headings to the HS description of the materials classified in the excepted headings reveals that a manufacturer may only use non-originating raw cotton to make knitted or crocheted products of Chapter 61 (triple transformation or double transformation depending on the kind of garments).

We now turn to a different way of drafting product-specific rules requiring a double processing requirement as in the example below:

(c) *Specific working or processing* requirement according to the EU model:

HS chapter	Description of the product	Origin requirement
Ex-Chapter 62	Articles of apparel and clothing accessories not knitted or crocheted	Manufacture from yarn

In the EU model, the above rule is quite straightforward insofar as it expressly requires the working or processing requirements (i.e. manufacture from yarn) to confer originating status on finished apparel articles of Chapter 62 of the HS. This means that the use of non-originating fabric is not allowed.

In the above cases, the rules of origin are drafted according to different techniques; namely, a specific working or processing operation coupled with a percentage requirement in the first example; a CTC according to the NAFTA model in the second example; and specific working or processing in the third example.

In spite of these different drafting techniques it is important to bear in mind that the drafting "form" of a rule is just a neutral and more-or-less effective technical methodology to define PSRO. The substance of the PSRO relates to the manufacturing that is needed to obtain substantial transformation that may be independent from the drafting technique used.

[7] According to HS 2017, as in the WCO website.

Thus, the *form* in which the rules of origin are drafted should not be confused with the *substance* (measurement of restrictiveness of a given rule of origin).

Certainly, the *form* in which rules of origin are drafted also has a series of implications on rules of origin such the degree of predictability, ease of implementation, and degree of exposure to protectionist lobbies or liberalization efforts.

NAFTA and USMCA rules of origin appear much more detailed and, in certain cases, more predictable than the EU rules of origin at the price of complexity. The level of detail of PSRO in USMCA, often at subheading level, does not find a match with EU PSRO, where most of the time PSRO are set at heading or chapter level. Nor can you find in the EU anything similar to the NAFTA and USMCA Uniform Regulations discussed at length in Chapter 3 of this book. Most recently, the EU has started publishing briefs and guides on how to interpret and use PSROs in various preferential agreements, again as examined in Chapter 3.

In any case, these are choices made by different customs administrations that are, after all, drafting and legislative techniques where each administration has developed its own model over the years. As argued throughout this book, what is lacking is a forum to discuss such techniques aiming at sharing best practices toward simplification.

6.2.1 *Defining the Form of the Rules of Origin: Technical Tools and Lessons Learned*

There are different schools of thought about the best methodologies to draft the form of rules of origin.

In particular, a comparison of the abovementioned Kyoto Convention guidelines on rules of origin shows that there was no order of preference in defining substantial transformation[8] among the three criteria namely:

(1) CTC
(2) ad valorem percentage criterion
(3) specific working or processing criteria.[9]

However, the ARO containing a built-in agenda to negotiate the harmonized nonpreferential rules of origin clearly stipulated a preference for how "substantial transformation" should be defined.

The ARO mandated the TCRO established at the WCO to draft such harmonized nonpreferential rules of origin and elaborate the criterion of substantial transformation *primarily upon the use of a CTC* (i.e. CTH or CTSH).

[8] It has to be noted that the Kyoto Convention of 2000 does not mention specific working or processing as methodology for defining substantial transformation.

[9] See full text of the respective conventions relating to rules of origin at www.unece.org/fileadmin/DAM/cefact/recommendations/kyoto/ky-d1-e0.htm (Kyoto Convention 1974) and www.wcoomd.org/en/topics/facilitation/instrument-and-tools/conventions/pf_revised_kyoto_conv/kyoto_new/spank.aspx (Kyoto Convention 2000).

Article 9, paragraph 2(iii) of the ARO, provides for the TCRO to consider and draft rules of origin recurring to other criteria than the CTC as follows:

> When, upon completion of the work under subparagraph (ii) (i.e. the work based on the change of tariff heading criterion) for each product sector or individual product category where the exclusive use of the HS nomenclature does not allow for the expression of substantial transformation. The Technical Committee:
>
> – shall consider and elaborate upon, on the basis of the criterion of substantial transformation, the use, in a supplementary or exclusive manner, of other requirements, including ad valorem percentages and/or manufacturing or processing operations, when developing rules of origin for particular products or a product sector . . .

It follows that the harmonized nonpreferential rules of origin have been negotiated using the CTC criteria as a primary method to define substantial transformation. The ARO provided that only after it was not technically possible to determine substantial transformation using the CTC method, supplementary criteria such as ad valorem percentage criterion and or manufacturing or processing operations could be considered.

It is notorious that the United States and the North American model of rules of origin strongly argue that CTC is the best methodology for drafting the form of rules of origin. Yet, and as discussed below, it remains to be seen at what level of detail the CTC should be used, as many Northern American-inspired free-trade agreements use the CTC at six-digit level to determine PSRO. Other free-trade agreements do not use such level of details of the HS, especially those of the EU where normally PSRO are determined at HS heading level.

In other areas, such as the methodologies in drafting ad valorem percentages, there are clear lessons to be learned and best practices as discussed in sections 6.2.3.1–6.2.3.6 of this chapter.

Use of the specific working or processing requirement is mostly used for chemicals and by the EU in the case of textile and clothing products. One of the clear advantages of such "form" of drafting rules of origin is its simplicity and straightforwardness.

The following sections outline the different "forms" of drafting rules of origin and contain a section excerpted from a real-life negotiating scenario that could better explain the difference between "form" and "substance" and the different negotiating options and techniques when drafting rules of origin.

6.2.2 *Use of the HS in Drafting Rules of Origin*

Some negotiators and trade policymakers have referred to the preference of the HWP for the CTC over other drafting techniques, like percentages or specific working or processing, as a signal that the international trading community was unanimously moving toward that direction. As examined in Chapters 1 and 2 of this

book, both the revised Kyoto Convention of 2000 and the ARO provided for the preference for CTC over other drafting forms of rules of origin.

Yet neither the revised Kyoto Convention nor the ARO provided examples of how the CTC should be used in drafting rules of origin; that is, at heading level, heading level with exception, or subheading level with exceptions.

For instance, in the case of the EU, the use of CTC is mostly done at CTH level, coupled with exceptions, and, in the case of NAFTA/USMCA-inspired free-trade agreements, rules based on the HS are, at times, defined at six-digit level with exceptions. Yet in some other cases, like the recent EU–Japan scenario, other forms of use of the CTC have been used, as follows:[10]

> For the purposes of product specific rules of origin, the following abbreviations apply:
>
> "CC" means production from non-originating materials of any Chapter, except that of the product, or a change to the Chapter, heading or subheading from any other Chapter; this means that all non-originating materials used in the production of the product must undergo a change in tariff classification at the 2-digit level (i.e. a change in Chapter) of the Harmonized System.
>
> "CTH" means production from non-originating materials of any heading, except that of the product, or a change to the Chapter, heading or subheading from any other heading; this means that all non-originating materials used in the production of the product must undergo a change in tariff classification at the 4-digit level (i.e. a change in heading) of the Harmonized System.
>
> "CTSH" means production from non-originating materials of any subheading, except that of the product, or a change to the Chapter, heading or subheading from any other subheading; this means that all non-originating materials used in the production of the product must undergo a change in tariff classification at the 6-digit level (i.e. a change in sub-heading) of the Harmonized System.

Such "form" of using the CTC is reminiscent of the form used during the HWP of nonpreferential rules of origin discussed in Chapter 2, another conspicuous sign that such work still contains a number of technically valid solutions when using a CTC drafting form.

Bearing this in mind, the first concept that has to be understood in using the HS in drafting rules of origin is that the HS has been negotiated and drafted – and continues to be updated every five years – as customs nomenclature to classify goods, not for drafting rules of origin. Hence this intrinsic limitation on the use of the HS needs to be taken into account when using it to draft rules of origin.

Yet it is not uncommon to hear negotiators and delegates arguing during formal negotiations for general CTH or CTSH rules applicable across the board. It should be clear by now that the adoption of a CTH or even a CTSH at four-digit level

[10] See Annex 3, introductory notes to PSRO of the EU–Japan free-trade agreement.

implies that sometimes insufficient processing involves a change in HS heading while at times sufficient processing does not involve a change in HS heading or subheading.

The CTH or CTSH may be very useful and are widely used in drafting PSRO but they are far from perfect as an across-the-board origin criteria.[11]

The fact that the HS has been designed to provide customs classification nomenclature and not for drafting rules of origin is indicated by the inadequacy of CTC when applied to certain HS heading or subheading, as illustrated in the following examples.

Under CTH or CTSH criteria, any non-originating inputs are considered to have undergone sufficient working or processing if the finished products fall under a tariff heading of the HS at a four-digit (or, in the case of CTSH, six-digit) level different from that of any non-originating inputs used in the process. So, when non-originating materials or origin-unknown materials were used, there must be a change in HS heading or subheading.

The following examples provide evidence of the implications arising from the adoption of an across-the-board CTH or CTSH.

Example 1: Cocoa and Cocoa Preparations
HS 18.01 Cocoa beans

18.02 Cocoa shells
18.03 Cocoa paste
18.04 Cocoa butter
18.05 Cocoa powder
18.06 Chocolate, etc.

In this example, the HS reflects the manufacturing chain of a chocolate bar. It turns out that the CTH requirement is very liberal since, for instance, the breaking of the cocoa beans to obtain the cocoa shells is an origin-conferring operation. Making butter from cocoa paste, a manufacturing process including refining and purifying the cocoa paste, is also an origin-conferring operation. It may be argued that breaking the beans is a rather simple operation when compared with the process

[11] Some free-trade agreements have put forward that a list of minimal working or processing operations excluding operations such as simple assembly, packaging, and labeling from conferring origin would remedy the problems and inconsistencies mentioned above. Apart from the fact that it is virtually impossible to list all possible minimal operations that may generate a CTH, there are inherent problems in defining notions such as "simple assembly." In order to address the intrinsic limitations of the CTH some preference-giving countries provided adjustment provisions in the form of product-specific lists and enumeration of simple operations such as cutting, sorting, placing in bottles, change of packing, and affixing marks that do not confer the status of originating products. However, since it is impossible to enumerate a list of simple operations, this exercise turned into a long list of product-specific rules having stringent requirements.

of obtaining the butter from the cocoa paste. Such possible inequalities are the natural implication of the use of an across-the-board CTH.

Example 2: Iron and Steel

Iron ores	→	*Pig iron*	→	*Ingot*	→	*Bars*	*72.11* *72.13* *72.14* *etc.*
H.S. 25.01		*72.01*		*82.06*		*Sheets*	*72.08* *72.09* *72.10* *etc.*

This second example shows the manufacturing chain of steel products like bars and rods from iron ores. Even in this example the CTH requirement shows quite liberal implications, since each stage of the manufacturing process is origin conferring. On the one hand some may argue that substantial processes like cladding, plating, or coating of bar and sheets are not recognized as substantial transformations. On the other hand, it may be asked why the process of rolling to reduce the width of a flat-rolled product is a substantial transformation in certain cases – that is, when it is reflected in the HS – and not sufficient in others.

Heading 72.12 classifies flat-rolled products of iron or nonalloy steel, of a width of less than 600 mm, clad, plated, or coated. Heading 72.10 classifies flat-rolled products of iron or nonalloy steel, of a width of 600 mm or more, clad, plated, or coated.

If one product is rolled from a width of 500 mm to a width of 400 mm, the rolling is not origin conferring since the product will remain in heading 72.12. However, if the rolling reduces the width from 600 mm to 500 mm, the rolling is origin conferring since the product will move from 72.10 to 72.12.

Example 3: Assembly of watches

Watch movement *HS 91.04*	→	*Watch*
Clock case *HS 91.12*	→	*91.03*

Is the process of assembly of a clock case and a watch movement origin conferring? A simple CTH would imply substantial transformation even if the watch movement and the clock case are not originating. Such an apparently liberal rule is counteracted by the fact that CTH would not recognize operations as testing as origin conferring.

Example 4: Drying fruits and vegetables

Fresh vegetables	→	*Dried vegetables*
HS 07.01 09		*HS 07.12*

Is drying of vegetables a process that could be considered as substantial transformation?

In order to make cotton jackets, for example, basically these are the main processes:

Example 5: Making cotton jackets

- *To get a raw cotton (fiber)* *HS 52.01*
- *To make a cotton yarn* *HS 52.05*
- *To make cotton fabrics* *HS 52.08*
- *To make cotton jackets* *HS 62.03*

It should be noted that a mere adoption of the CTH criterion will eliminate the double or triple transformation requirement. On the other hand, essential processes such as dying, washing, and printing are excluded from origin conferring at CTH level.

Example 6: Special Case: Knitted wear

- *Raw wool* *HS 51.01*
- *Woolen yarn* *HS 51.09*
- *Knitted sweater* *HS 61.10*

In sharp contrast with such cases, there are some instances in which a process or manufacture does not involve a change in HS heading, but can well be regarded as a process or manufacture that results in a substantial transformation.

Example 7: Diamonds

- *Rough/unworked* *HS 71.02*
- *Cut/worked* *HS 71.02*

***Example** 8: With regard Toys (HS heading 95.43), some developing countries producers found it impossible to fulfill the rule of origin based on the CTH criterion; in fact for some countries it is necessary to import some parts also under heading 95.43, like the eyes of a teddy bear so the finished toys cannot obtain the origin.*

6.2.2.1 Problems with Adopting CTC in the Machinery and Electronic Sector

The HS identifies three broad categories of parts: (a) parts for general use, (b) parts suitable for use solely or principally for machines of a particular heading, and (c)

finished goods which will themselves be used as parts or components for other goods.

For some goods, therefore, assembly of parts to produce the finished good will result in a change of heading (for example, manufacture of motor vehicles of 87.01 to 87.05 from parts of 85.08), for others a change in subheading (for example, trailers and semi-trailers of 87.16 from parts of 8716.90).

However, in some cases parts are classified under the heading with the vehicles produced, without subheadings, and thus undergo no change of classification when used for production of the article, such as baby carriages of 87.15.

These examples show that the use of the CTH requirement as an across-the-board criterion implies a different origin outcome. Depending on the structure of the HS, at times a very complex assembly operation may be denied origin using a CTH requirement while a mere assembly operation of parts may be considered as origin conferring even if it is a screwdriver operation.

Apart from the fact that the HS has not been conceived for RoO purposes it has to be borne in mind that the HS nomenclature is updated every five years. It follows, as pointed out by the WCO Secretariat, that all preferential rules of origin in free-trade agreements linked to the HS nomenclature and tariff classification need to be updated.[12]

The HS amendments are made available at least two years before their implementation and the work can start at that time. However, it can be a challenging task for countries, due to the technical nature of the work.[13] In addition, different

[12] The WCO conducted a Workshop on the Updating of Preferential Rules of Origin following the Thirty-fifth Session of the TCRO in 2017, where the guide for the technical update of preferential rules of origin developed in 2015 and updated in January 2017 to assist members with the updating of their existing rules of origin in relation to changes in the HS was presented. The guide is an excellent tool demonstrating the complexity of updating PSRO based on the HS.

[13] In order to give an idea of the complexities and magnitude of the updating, the following is a notice that appeared in the US International Trade Commission website in July 2019 about the updating of PSRO in US free-trade agreements caused by the HS: "Two sets of changes to the Harmonized System have caused heading and subheading numbers and product coverage in some rules of origin for free trade agreements to be inconsistent with those in tariff schedule chapters. First, the rules of origin provisions for certain United States free trade agreements have NOT been updated since major changes to the HTS were proclaimed effective on February 3, 2007, and will therefore contain tariff numbers that do not exist in the chapters of the HTS; these outdated rules are included in terms of HS 2002. However, the rules for the North American Free Trade Agreement, the United States-Australia Free Trade Agreement, the United States-Singapore Free Trade Agreement, the United States-Chile Free Trade Agreement, the United States-Bahrain Free Trade Agreement, and the United States-Korea Free Trade Agreement have been updated, and the pertinent general notes do reflect proclaimed rectifications through 2007. See Presidential Proclamation 8097, which modified the HTS to reflect World Customs Organization changes to the Harmonized Commodity Description and Coding System and was effective as of Feb. 3, 2007; proclaimed modifications appear on the Web site of the United States International Trade Commission, www.usitc.gov. Second, the rules of origin for the United States-Chile Free Trade Agreement have been

practices are in place in the different free-trade agreement parties. This can create obstacles in updating preferential rules of origin. In some countries, the updating of the rules requires an approval by the parliament, even though it is a technical task.[14]

6.2.3 *Use of the Ad Valorem Percentage in Drafting Rules of Origin*

The methodologies for calculating the ad valorem percentage criterion is one area where there are lessons learned by various administrations and where best practices do exist.[15] This does not mean that there is an exact science, since the intrinsic limitations of the ad valorem percentage remain. Such built-in limitations are mainly related to the arbitrary nature of the level of the thresholds and the fact that the results of the calculation to comply with threshold level may fluctuate due to exogenous factors.

Bearing in mind these qualifications, there has been progress and techniques in the methodologies have reduced, albeit not eliminated, the shortcomings of using an ad valorem percentage for drafting rules of origin.

6.2.3.1 The Multilateral Disciplines Contained in Kyoto Convention of 1974 and 2000 on Drafting Rules of Origin Using an Ad Valorem Percentage Criterion

The advantages and disadvantages of using the ad valorem percentage rules and the different methodologies in calculating them could be summarized using the following examples contained in the Kyoto Conventions of 1974 and 2000:

> updated to reflect the modifications to the HTS made by Presidential Proclamation 8771 of December 29, 2011 and effective as of February 3, 2012, to reflect the WCO changes to the Harmonized System recommended to be effective in 2012. In addition, the rules of origin for the United States-Korea Free Trade Agreement were updated effective on and after January 1, 2014, pursuant to Presidential Proclamation 9072. Presidential Proclamation 9555 set forth modifications to the rules of origin for the United States-Oman Free Trade Agreement (scheduled to become effective February 1, 2017), the United States-Panama Trade Promotion Agreement (to become effective pursuant to a future Federal Register notice from USTR), and the Dominican Republic-Central America-United States Free Trade Agreement (also to become effective pursuant to a future Federal Register notice from USTR).Thus, where not updated for HS 2017, be aware that the rule you try to apply may contain HTS numbers as in effect in 2002, 2007 or 2012. Changes to FTA rules must be negotiated whenever Harmonized System changes arise and must go through appropriate national processes prior to implementation. You can find U.S. proclamations updating rules in the Federal Register. Contact officials of U.S. Customs and Border Protection in order to ascertain how to apply out-of-date rules and whether affected goods qualify for FTA treatment. A ruling on an individual shipment may be necessary."

[14] See the WCO website at https://mag.wcoomd.org/magazine/wco-news-79/new-wco-guide-for-updating-preferential-rules-of-origin/.

[15] This section draws from a paper drafted by the author at the request of the African Union during negotiations of the AfCFTA in March 2018 and from S. Inama and P. Crivelli, "Convergence on the calculation methodology for drafting rules of origin in FTAs using the ad valorem criterion," *Global Trade and Customs Journal*, vol. 14, no. 4 (2019), 146–153.

EXCERPT OF KYOTO CONVENTION 1974: AD VALOREM PERCENTAGE RULE

To determine origin by this method, one must consider the extent of the manufacturing or processing undergone in a country, by reference to the value thereby added to the goods. When this added value equals or exceeds a specified percentage, the goods acquire origin in the country where the manufacturing or processing was carried out.

The value added may also be calculated by reference to the materials or components of foreign or undetermined origin used in manufacturing or producing the goods. The goods retain origin in a specific country only if the materials or components do not exceed a specified percentage of the value of the finished product. In practice, therefore, this method involves comparison of the value of the materials imported or of undetermined origin with the value of the finished product.

The value of constituents imported or of undetermined origin is generally established from the import value or the purchase price. The value of the goods as exported is normally calculated using the cost of manufacture, the ex-works price, or the price at exportation.

This method may be applied either in combination with the two other methods, by means of the lists of exceptions referred to in Section A or the general lists referred to in Section B, or by a general rule prescribing a uniform percentage, without reference to a list of individual products.[16]

Advantages

1. The main advantages of this method are its precision and simplicity.
2. The value of constituent materials imported or of undetermined origin can be established from available commercial records or documents.
3. Where the value of the exported goods is based on the ex-works price or the price at exportation, as a rule, both prices are readily ascertained and can be supported by commercial invoices and the commercial records of the traders concerned.

Disadvantages

1. Difficulties are likely to arise especially in borderline cases in which a slight difference above or below the prescribed percentage causes a product to meet, or fail to meet, the origin requirements.
2. Similarly, the origin attributed depends largely on the fluctuating world market prices for raw materials and also on currency fluctuations. These fluctuations may at times be so marked that the application of rules of origin formulated on this basis is appreciably distorted.
3. Another major disadvantage is that such elements as cost of manufacture or total cost of products used, which may be taken as the basis for calculating value added, are often difficult to establish and may well have a different make-up and interpretation in the country of exportation and the country of importation.

[16] In the Kyoto Convention 1974, section A refers to *Change of Tariff Heading*, and Section B, to the *Lists of Manufacturing or Processing Operations*.

Disputes may arise as to whether certain factors, particularly overheads, are to be allocated to cost of manufacture or, for example, to selling, distribution, etc. costs.

EXCERPT FROM KYOTO CONVENTION 2000 AD VALOREM RULE: RECOMMENDED PRACTICE

Where the substantial transformation criterion is expressed in terms of the ad valorem percentage rule, the values to be taken into consideration should be:

- for the materials imported, the dutiable value at importation or, in the case of materials of undetermined origin, the first ascertainable price paid for them in the territory of the country in which manufacture took place; and
- for the goods produced, either the ex-works price or the price at exportation, according to the provisions of national legislation.

The above guidelines in the WCO Kyoto Conventions of 1974 and 2000 have been useful and for decades have provided the international community with reflections about the advantages and disadvantages of the various methodologies in drafting rules of origin.

With respect to the ad valorem percentage criterion, the important point to be noted is that the revised Kyoto Convention 2000 recommends a rather clear-cut methodology when compared to the previous 1974 text: "to use as basis for the numerator of the non originating material the dutiable value at importation and as denominator the ex-works price or the price at exportation."

This explicit guideline should contribute to ensuring simplicity (see advantage 2 and 3 above of the Kyoto Convention 1974) and diminishing possible disputes over the definition of the cost of manufacture or total cost of products (disadvantage 3 of Kyoto Convention 1974). The majority of countries involved in free-trade agreements have converged on such method of calculating the ad valorem percentage.

In spite of the clear preference of the drafting methodology contained in the ARO toward the adoption of the CTC mentioned in section 6.2.1, the ad valorem percentage criterion has remained one of most used methods for drafting rules of origin. This trend is explained by a variety of factor as follows:

(a) Some negotiators still believe (rather erroneously) that an across-the-board ad valorem percentage criterion is a valid shortcut to avoid negotiating PSRO.
(b) Other negotiators still believe that the use of ad valorem percentage as an alternative to CTC may facilitate trade for the private sector as ad valorem percentages are better understood than other drafting techniques.

(c) Part of the private sector still regards the ad valorem percentage as a user-friendly rule of origin.[17]

Ultimately the lessons learned from the Kyoto Conventions and the ARO could be summarized as follows:

(1) The ad valorem percentage criterion is not the ideal criterion for drafting rules of origin.
(2) When the ad valorem percentage criterion is used, the preferred method is for the non-originating materials to adopt the customs value (as numerator) and for the goods produced to adopt the ex-works price. This could be summarized according to this formula:

$$Max \ \frac{Value\ of\ non\text{-}originating\ materials}{Ex\text{-}works\ price} \times 100$$

As discussed in Chapter 3, this calculation methodology of the ad valorem criterion is used in the free-trade agreements of the EU while a similar, but not identical, calculation methodology is used by the North American-inspired free-trade agreements and the later USMCA. The majority of the world is aligning toward such methodology based on a value-of-materials calculation but a number of conspicuous exceptions and variations still exist as further discussed in section 6.2.3.2.1.

6.2.3.2 Different Calculation Methodologies of the Ad Valorem Percentage Criterion

The ad valorem percentage criterion has been used and can be drafted according to different methodologies. In practice the following factors are needed in order to have an arithmetical outcome according to basic mathematics:

(a) a numerator
(b) a denominator
(c) a level of percentage either as a minimum to be achieved or a maximum not to be exceeded.

The sections below outline the main two calculations methodologies of ad valorem percentage.

[17] See, for instance, the BDI Position Paper, "Rules of origin in TTIP," available at https://bdi.eu/media/themenfelder/aussenwirtschaftspolitik/TTIP/positionen/RoO_BDI-Positionspapier_Englisch_FINAL.pdf. In this position paper a "uniform cross-industry value added rule in TTIP, under which an economic operator can freely choose between the European and U.S. calculation methods with the exception of agricultural products of Chapters 1–24" was proposed. It has to be noted that the EU does not use a "value-added by addition" rule in any free-trade agreement. Such a proposal – which does not match any precedent, either under the EU or US model and is totally impracticable – tells a long story of the level of preparation of major sectors of EU industry at the time of the TTIP negotiations.

6.2.3.2.1 VALUE-ADDED CALCULATION BY ADDITION (VA) OR NET COST (NC) CALCULATION.

$$\frac{\text{VOM} + \text{direct cost of processing}}{\text{Ex-factory price}} \times 100$$

where:

- *VOM* is value of origin originating materials.
- *Direct cost of processing* is the sum of the cost of local labor and the direct processing costs.[18]
- *Ex-factory price* is the price of the product when leaving the factory including profit.

The most classic example of such calculation of value addition (35 per cent) is the US GSP and AGOA.[19]

The most recent example of net cost calculation is the one introduced by USMCA that is directly inherited from NAFTA.

$$RVC = \frac{\text{NC} - \text{VNOM}}{\text{NC}} \times 100$$

where:

- *RVC* is the regional value content, expressed as a percentage.
- *NC* is the net cost of the good.
- *VNOM* is the value of non-originating materials including materials of undetermined origin used by the producer in the production of the good.

6.2.3.2.2 VALUE-OF-MATERIALS CALCULATION. The value-added calculation can take a different form; namely, a value-added figure can be also calculated by subtracting the value of non-originating materials from the price of finished goods (calculated as adjusted value in many US free-trade agreements or as FOB value in Japan's free-trade agreements).

It is important to realize that the two calculations of value added – either by addition or by subtraction – while conceptually similar do not lead to the same origin outcome. The explanation for such a difference resides in the fact that in a value-added calculation by addition only clearly specified allowable costs may be considered as "direct cost of processing," while in the case of a value-added calculation by subtraction "all costs of producing the finished goods will be counted as value added." Section 6.2.3.3 lists example of allowable and nonallowable costs from AGOA and GSP. In the case of NAFTA and USMCA the Uniform Regulation discussed in Chapter 3 shows calculation examples that are tens of pages long. One

[18] See section 6.2.3.3 for the inherent difficulties to clearly define what are direct processing costs.
[19] See section 6.2.3.3.

of the distinct features of the net cost calculation is, in fact, the netting back of expenses that are not strictly related to the production and manufacturing process.

Hence the protective bias and effectiveness of the net cost method in securing the trade policy objective is greater: NAFTA and USMCA rules of origin in the automotive sector are designed to protect automotive manufacturing in the United States and the net cost method allows the dismissal of costs that are not strictly related to cost of manufacturing and wages of jobs that are also not directly linked to manufacturing.

The indirect way of calculating value added is defined as build-down and is used in a variety of US, Japanese, South Korean, and Australian free-trade agreements, or as transaction value in NAFTA and currently in USMCA.

Build-down/Transaction method:[20] Based on the value of non-originating materials (VAVNOM)

$$\frac{TV - VNOM}{TV} \times 100$$

where according to USMCA:

- *TV* is the transaction value of the good adjusted as to exclude any costs incurred in the international shipment of the good.
- *VNOM* is the value of non-originating materials including material of undetermined origin.

In the build-down method used in free-trade agreements entered by the United States with other countries the transaction value is replaced by other similar definitions,[21] invariably referring to the transaction value concept of the WTO Customs Valuation Agreement.

The build-down calculation is often used in conjunction with, and as an alternative to, the build-up calculation in a wide variety of free-trade agreements inspired by the US model:

Build-up Method: Based on the value of originating materials (VOM)

$$\frac{Value\ of\ Originating\ Materials\ (VOM)}{TV} \times 100$$

Focused Value Method:[22] Based on the value of specified non-originating materials (FVNM)

$$\frac{Value\ of\ the\ Good - FVNM}{Value\ of\ the\ Good} \times 100$$

where according to the TPP (Trans-Pacific Partnership):

[20] Method referred to as "transaction value" in NAFTA and USMCA.
[21] See for instance the definition provided in section 6.2.3.5.1 of adjusted value.
[22] See Article 3.5 of the TPP Agreement.

- *Value of the good* is defined as the transaction value of the good excluding any costs incurred in the international shipment of the good.[23]
- *The value of a material* is defined as, generally speaking, the transaction value of the material at the time of importation.[24]

The focused value method is considered to be a variant of the build-down method. The build-down method requires the RVC calculation to be based on the value of all the non-originating materials, while the focused value method is based on the value of only the non-originating materials specified in the applicable PSRO.

6.2.3.2.3 MAXIMUM ALLOWANCE OF NON-ORIGINATING MATERIALS. This method is among the most straightforward as it is based on a maximum amount of non-originating materials as a percentage of the ex-works price.[25] The EU has used this method of calculation for more than three decades and it is the current methodology used to draft percentage criterion rules under the free-trade agreements with Canada and Japan, and most recently EU–Mercosur. Japan in its GSP schemes also uses a similar criterion in its GSP scheme using the FOB price as a denominator.[26]

$$\frac{VNOM}{Ex\text{-}works\ Price} \times 100$$

where:

- *VNOM* is the customs value of the non-originating materials.
- *Ex-works price* is the price paid for the product ex-works to the manufacturer in the EU or (Partner) where the last working or processing is carried out, provided the price includes the value of all the materials used, minus any internal taxes paid which are, or may be, repaid when the product obtained is exported.

It has to be noted that this method of calculation corresponds to the recommended practice in drafting the ad valorem percentage criterion contained in Kyoto Convention 2000.

[23] See the definition of value of the good in the TPP Agreement.

[24] The TPP sets out precise rules on the definition of value of materials under different scenarios under Articles 3.6–3.8. See Chapter 5 of this book for further details.

[25] In reality, a third methodology of calculation exists in two African RTAs, namely the Common Market for Eastern and Southern Africa (COMESA) and the Economic Community of Central African States (ECCAS) where the denominator used is the total value of material used in the production of a good.

[26] It has to be noted that both the EU and Japan under the current GSP rules of origin do not use the percentage criterion as an across-the-board criterion. The percentage criterion is only used in the context of PSRO contained in an extensive list detailing the PSRO. With respect to the ex-works price, the FOB price includes inland transport to the port of embarkation.

6.2.3.3 Comparison and Lessons Learned in Drafting Ad Valorem Percentage Criteria

The nature of each methodology of the ad valorem percentage criterion affects the administrative effort required by customs and private parties to introduce and maintain compliance with the selected methodology. As discussed in the case of the net cost calculation, the choice of a methodology may also affect the substance; namely, the level of stringency of the criterion.

Although the various iterations of the arithmetical formulation may look different, as examined in section 6.2.3.2, there are two basic methodologies in determining the ad valorem percentage:

(1) a value addition calculation
(2) a value-of-materials calculation.

Both the calculations outlined under sections 6.2.3.2.2 and 6.2.3.2.3 – namely value-of-materials calculation and maximum allowance of non-originating materials – are methodologies based on value-of-materials calculation.

All these calculations are made taking as a reference the value of materials, whether originating or non-originating. These calculations, based on a value of materials, are easy, simple, and readily verifiable since the value of materials are most of the time based on invoices and can be assessed using a multilateral instrument like the WTO Customs Valuation Agreement.

Lesson learned in preferential rules of origin, and most recently in the net cost calculations in NAFTA, have amply demonstrated that the formulation of ad valorem percentage criterion calculation as value added by addition are complex. These calculations entail detailed rules to define what are allowable and nonallowable costs that can be counted as direct costs of processing.

As an example, the definition of allowable and nonallowable costs that may be counted as direct cost of processing in the US GSP and AGOA provides as follows:

> **10.178 Direct costs of processing operations performed in the beneficiary developing country.**[27]
>
> (a) Items included in the direct costs of processing operations. As used in § 10.176, the words "direct costs of processing operations" means those costs either directly incurred in, or which can be reasonably allocated to, the growth, production, manufacture, or assembly of the specific merchandise under consideration. Such costs include, but are not limited to:
>
> 1) All actual labor costs involved in the growth, production, manufacture, or assembly of the specific merchandise, including fringe benefits, on-the-job training, and the cost of engineering, supervisory, quality control, and similar personnel;

[27] See US Code of Federal Regulations: 19 CFR 10.178.

2) Dies, molds, tooling, and depreciation on machinery and equipment which are allocable to the specific merchandise;
3) Research, development, design, engineering, and blueprint costs insofar as they are allocable to the specific merchandise; and
4) Costs of inspecting and testing the specific merchandise.

(b) Items not included in the direct costs of processing operations. Those items which are not included within the meaning of the words "direct costs of processing operations" are those which are not directly attributable to the merchandise under consideration or are not "costs" of manufacturing the product. These include, but are not limited to:
1) Profit; and
2) General expenses of doing business which are either not allocable to the specific merchandise or are not related to the growth, production, manufacture, or assembly of the merchandise, such as administrative salaries, casualty and liability insurance, advertising, and salesmen's salaries, commissions, or expenses.

These elements may be familiar only to accountants. As prices, costs, and quantities change in the production of a given product, recalculation will be necessary to ensure compliance. While some of these tasks may form part of the normal accounting procedures required for commercial purposes, some may not. In such cases, therefore, additional professional expertise may be required. The calculation of the numerator in a value-added calculation is complex as it entails:

(i) a distinction of costs, which could be computed as local value added
(ii) itemization of such cost to the single unit of production; as a consequence, it often requires accounting, and discretion may be used in assessing unit costs (Additionally, currency fluctuations in beneficiary countries may affect the value of the calculation.)
(iii) Low labor costs in developing countries may result in low value added and, instead of being a factor of competitiveness, may turn out to be a factor penalizing producers based in developing countries.

The United States has progressively limited the use of value-added calculations by addition (VA) (defined as net cost calculation in US terminology) and has continued to use the VA for limited items in the automotive sector even in USMCA. The EU has not used a value-added calculation by addition in any of its free-trade agreements.

In most modern free-trade agreements the United States as well as the large majority of countries that have entered into free-trade agreements have replaced the "value addition" with the "build-down" calculation shown in section 6.2.3.2.2 (VAVNOM). This is a value-of-materials calculation and is presently included in USMCA even if defined as transaction value (TV) as discussed in section 6.2.3.2.2.

In order to simplify the comparison, it may be said that the calculation under sections 6.2.3.2.1 (VA) and 6.2.3.2.2 (VAVNOM) are the different sides of the same

coin: suppose a product with an ex-works price of 100 USD made of 40 USD of non-originating material, 10 USD of originating materials, and 50 USD being costs of processing and manufacturing (i.e. labor costs, overheads, machinery, etc.). It is possible to calculate the value added by adding the cost of processing and manufacturing to the value of originating material (50 + 10 = 60 USD), which corresponds to 60 percent of value added. Alternatively, it is simply possible to deduct from the ex-works price of the product the value of non-originating materials and obtain the value added as follows:

$$\text{Ex-works price} - \text{VNOM} = 100 - 40 = 60 \text{ USD} \rightarrow \text{Value added} = 60/100 = 60\%$$

The second calculation offers a number of advantages since it is not necessary to define the list of costs of direct processing and manufacturing. Moreover, the value of non-originating materials can be assessed based on invoices and a multilateral instrument like the WTO Customs Valuation Agreement. As discussed in sections 6.2.3.2.1 and 6.2.3.2.2, this apparently simple comparison hides an important caveat to an acute observer or to an NAFTA/USMCA reader: it does not consider that the 50 USD of cost of processing and manufacturing and the 100 USD of ex-works price in the above calculations include costs that are not related to the manufacturing of the product in question. Thus, according to this perspective, it is necessary to net back the costs to the bare manufacturing costs by subtracting "any sales promotion, marketing, and after-sales service costs, royalties, shipping and packing costs, and non-allowable interest costs that are included in the total cost of all those goods."[28] The complex and lengthy methodologies to net back the abovementioned costs are contained in the Uniform Regulations[29] – around 120 pages long – in NAFTA, regulating in extreme detail the complex modalities and technicalities for calculating allowable and nonallowable costs that could be counted as net costs, such as average inventory methods. The USMCA Uniform Regulations discussed in Chapter 3 and replacing the NAFTA Uniform Regulations are essentially similar in terms of complexity.

In fact, compared to value-of-materials calculation methods, the net cost calculation method and the related technicalities may be a more accurate methodology and conspicuously more exposed to "protectionist" intents as demonstrated under USMCA labor value content provisions.[30] Such methodology is inherently more complex and complicated to apply and administer as illustrated in disadvantage (3) of Kyoto Convention 1974 mentioned above.

[28] See para. 8 of Article 4.5 RVC of USMCA.

[29] See NAFTA Rules of Origin Regulations, at www.gpo.gov/fdsys/pkg/CFR-2012-title19-vol2/pdf/CFR-2012-title19-vol2-part181-app-id985.pdf.

[30] See Article 4-B.7: Labor Value Content of the Appendix to Annex 4-b: provisions related to the PSRO for automotive products.

6.2.3.4 The Issue of Cost of Freight and Insurance in Customs Value of Non-originating and Originating Materials

One of the important issues that needs to be considered in the calculation methodology of the ad valorem percentage criterion is the issue of inclusion/exclusion of the cost of insurance and freight in the definition of customs value.

Landlocked and islands countries, especially developing countries, may be facing disproportionate disadvantages in transports costs when they are using imported inputs in the manufacturing of finished products. Even the most generous percentages, like the 70 percent allowance of imported materials in the Everything But Arms (EBA) GSP rules of origin, may not be complied with if the cost of transport is not adequately addressed in the ad valorem percentage calculation. Most importantly, transport costs are an exogenous variable that is not related to the main purpose of rules of origin: to determine if substantial transformation has taken place. The inclusion/exclusion of such transport costs and insurance is related to the choice of the customs administrations on how to determine customs value to assess duty collection.[31] Obviously, the inclusion of transport costs and insurance on customs value raises such values ensuring higher revenues. However higher revenues from customs collection is not the purpose of rules of origin. It follows that the definition of customs value in the context of ad valorem calculation methodology may be distinct from the definition of customs value for duty collection since they serve different purposes:

(a) customs value to define value of materials for origin purposes
(b) customs value as basis to assess duty collection.

Thus, in the interest of the proper functioning of the free-trade agreements, the parties may adopt provisions drawing from the most recent best practices adopted in modern free-trade agreements, allowing the deduction of such costs from the ad valorem calculation methodology.

Consider the following example: A manufacturer based in Lilongwe, Malawi manufactures steel frames using imported steel tubes. The applicable rule of origin is a 70 percent allowance of non-originating inputs. The manufacturer purchases steel tubes from China for 10,000 USD to manufacture the steel frames. After manufacturing the steel tubes into steel frames by cutting, soldering, galvanizing, and coating, the manufacturer sells the frames to a South African importer at an ex-works price of 16,000 USD. It follows the ad valorem percentage calculation below:

[31] It has to be noted that the WTO Customs Valuation Agreement does not provide clear-cut rules for the inclusion/exclusion of cost of freight and insurance in the assessment of customs value, due to divergence of views and practices among different WTO members. For instance, as a general rule, the United States excludes from dutiable "transaction value" any charges relating to the international transportation of goods.

$$\frac{10,000}{16,000} = 0.625 = 62.5\% < 70\%$$

The frames are therefore originating.

However, if the value of non-originating material is based on a CIF basis, the cost of insurance and freight from China to Lilongwe – an average of 1,250 USD for ocean freight and 3,600 USD for inland[32] transport – has to be added to the cost of purchasing the container of steel tubes. Thus, the calculation will be as follows:

$$10.000 + 3.600 + 1.250 = 14.850 \text{ USD}$$

$$\frac{14,850}{16,000} = 0.928 = 92.8\% > 70\%$$

The frames in this case considerably exceed the threshold of 70 percent.

The legal texts of most free-trade agreements recently negotiated by the United States in the post-NAFTA period, as well as USMCA, contain provisions for the deduction of costs of insurance and freight for non-originating materials.[33] Some African free-trade agreements limit such deduction to the cost of transit among member states.[34] There is no parallel practice or clear provision in EU free-trade agreements, a conspicuous gap that should be addressed.

The author has proposed the deduction of the cost of freight and insurance from the calculation of the value of non-originating material in technical advice to a number of governments involved in negotiations of free-trade agreements.

Invariably such a proposal has met resistance first from those who do not understand the proposal; namely, that it is clearly aimed at deducting the cost of insurance and freight from the value of non-originating material in the context of calculation for the compliance with rules of origin, but not for the levying of customs duties.

In fact, many customs administrations maintain a CIF value for the purpose of customs valuation and in that case the move to a deduction of insurance and freight costs may cause a significant reduction of tariff revenues. The proposal aims at establishing a dual system where, for levying of the customs duties, the CIF method, when used, remains and introduces the possibility of deducting cost of insurance and freight for the calculation of compliance with rules of origin. It has to be remembered that local producers and exporters make all such RoO compliance calculations after the non-originating materials are imported and the related duties

[32] Author's estimates based on field visits and UNCTAD studies.

[33] Central American Free-Trade Area (CAFTA) contains provisions allowing the addition of such costs for intraregional transport when the build-up calculation is used.

[34] See para. (b) of Rule 4 of the COMESA Protocol on Rules of Origin; see also p. 16 of the EAC Manual on Rules of Origin.

have been paid. Once this point is taken into account, the proposal would greatly facilitate compliance with rules of origin for national producers.

The second line of resistance encountered during the AfCFTA negotiations derives from delegations that are not in favor of the use of non-originating materials coming from third parties outside the FTAs. In fact, it is clear that by deducting the cost of insurance and freight from the cost of non-originating materials, such materials become cheaper when imported from third parties such as Asian countries that are not parties to AfCFTA. Hence such deduction, in the eyes of these delegations, would act as a disincentive to use regional inputs rather than third-country inputs.

Obviously, such line of thinking tends to forget the scarce availability of originating inputs and intermediate products available in the African continent, as discussed in Chapter 5 of this book.

6.2.3.5 Worldwide Best Practices on Methodologies to Draft Ad Valorem Percentages

There is a worldwide convergence in the methodology of drafting the ad valorem percentage criteria. The EU and the United States, as well as their main counterparts, like Japan, South Korea, Australia, and New Zealand, have progressively abandoned a methodology based on the calculations of value added by addition to calculations based on a value of materials. The same trend is observed in free-trade agreements among developing countries in Asia[35] and Latin America.[36] Some innovations have also been introduced, such as the deduction of cost of freight and insurance under the majority of the most recent US free-trade agreements, including USMCA. There are, of course, differences in the arithmetical calculations and the definition of numerator and denominator. However, there is real convergence in the methodology of calculating the ad valorem percentage based on a value-of-materials calculation rather than a value-added or net cost approach, as used in NAFTA and presently in USMCA for automotive products. This tendency is confirmed by the progressive and widespread adoption of the build-up and build-down method in many free-trade agreements.

Such calculation replaced the transaction value of NAFTA as shown in Table 6.2 in many US free-trade agreements. In turn, USMCA reproduces the transaction value of NAFTA that is substantially equivalent to the build-down method. The recent negotiations of rules of origin for automotive products have reasserted the US view on the use of the net cost calculation with a protectionist intent. Yet the recent text of USMCA introduces, along with the use of the net cost, the use of the transaction

[35] See the ASEAN–Dialogue partners free-trade agreements that largely use a value-of-materials calculation as discussed in Chapter 5 of this book.

[36] The Pacific Alliance uses a value-of-materials calculation as discussed in Chapter 5 of this book.

TABLE 6.2 *Evolution of the US free-trade agreement percentage-based rules of origin*[i]

RVC	NAFTA	CHL–USA	CAFTA	USA–SIN	USA–AUS	USA–KOR	TPP	USMCA
No. of PSRO	1,125	1,043	1,017	2,974	965	758	1,245	1,015
Net cost	323	0	6	0	0	6	22	324
Transaction	248	0	0	0	0	0	0	424
Build-up	0	164	146	239	148	147	398	0
Build-down	0	157	147	213	144	152	457	0

[i] Calculations made by the author.

value albeit with a higher threshold.[37] Overall the USMCA outcome does not reverse the trend of limiting the use of net cost calculation to automotive products in US free-trade agreements that has been ongoing for decades, as shown in Table 6.2. The rest of world, including the United States in respect of products other than automotive goods, is now converging on a methodology based on a value-of-materials calculation expressed as:

(a) build-down
(b) build-up[38] or
(c) maximum value of non-originating materials.

Table 6.3 summarizes the different methodologies used by African RECs that are using the ad valorem percentage criterion as a general rule applicable to all products (i.e. the Economic Community of West African States – ECOWAS) or in combination with other criteria (i.e. Common Market for Eastern and Southern Africa – COMESA) for all products or in all products and in PSRO (i.e. SADC).

It clearly emerges from the table that most African RECs – namely EAC, SADC, COMESA 2, and ECOWAS – are utilizing a calculation methodology based on value of materials as outlined in sections 6.2.3.2.2 or 6.2.3.2.3.

In some cases, the wording of the rules of origin contained in COMESA, ECOWAS, and SADC refer to "value added." However, a closer look at the legal texts in conjunction with the manuals on rules of origin of these RECs reveals that

[37] See, for instance, para. 2 of Article 4-b-3 of appendix to Annex 4-B, Product Specific Rules of Origin, of USMCA.

[38] The build-up method based on the value of originating materials is often used in conjunction with the build-up method in many free-trade agreements. It is, however, not entirely clear how effectively it has been used by firms. In a conversation between the author and US customs officials it transpired that US customs have seen it used less than the build-down method.

TABLE 6.3 *Ad valorem percentage criterion calculation methodologies of African RECs*[i]

	EAC	SADC	COMESA 1	COMESA 2	ECOWAS	ECCAS 1[ii]	ECCAS 2[iii]	TFTA [iv]1	TFTA 2
Numerator	Value of non-originating materials (VNOM)[v]	Value of non-originating materials (VNOM)	VNOM[vii]	Ex-factory cost of the finished product – CIF VNOM[viii]	Ex-factory price of the finished product before tax – CIF VNOM[ix]	Cost price Ex-works before tax-CIF VNOM	Raw materials and materials originating from the Community	VNOM[x]	VOM
Denominator	Ex-works price[xi]	ex-works price	Value of materials used in the production of the goods[xiii]	Ex-factory cost[xiv]	Ex-factory price[xv]	Post-production cost before tax	Total cost of the raw materials and consumables used	Ex-works price[xvi]	Ex-works price
Method of calculation	Maximum VNOM	Maximum VNOM	Maximum VNOM	Value added by subtraction VAVNOM	Value added by subtraction VAVNOM	Value added by subtraction VAVNOM	Minimum Originating Value (VOM)	Maximum VNOM	Minimum VOM

[i] The rules of origin of the Arab Maghreb Union (UMA) have not been included in the present note as the text available on the Internet dates to 1991 while the AU Secretariat has been notified that a more recent text has been agreed but was not available at the time of this writing.
[ii] Extracted from Annex 1 of ECCAS Decision No. 03/CEEAC/CCEG/XI/04, Articles (2) and (3).
[iii] Ibid.
[iv] Based on 2010 Protocol 4 on TFTA rules of origin.
[v] Extracted from EAC Customs Union Rules of Origin (2015), Rule 7, paras. 4 and 5.
[vi] Extracted from SADC Procedures Manual on the Implementation of Rules of Origin, Appendix 1 of Annex 1 of SADC Protocol on Trade, Part 2, Section 2.5.
[vii] Extracted from COMESA Protocol on Rules of Origin, Rule 4.
[viii] Extracted from COMESA Protocol on Rules of Origin, Rule 2 b-ii.
[ix] Extracted from Protocol A/P1/1/03 of ECOWAS, Article 4(2).
[x] Extracted from Annex on Rules of Origin Under Article 12 of the Agreement, Articles (5) and (6).
[xi] Extracted from EAC Customs Union Rules of Origin (2015), Rule 7, paras. 4 and 5.
[xii] Extracted from SADC Procedures Manual on the Implementation of Rules of Origin, Appendix 1 of SADC Protocol on Trade, Part 2, Section 2.5.
[xiii] Together with ECCAS, this is a rather unique formulation as it refers to denominator as the total cost of material. Extracted from COMESA Protocol on Rules of Origin, Rule 2 b-i.
[xiv] Extracted from COMESA Protocol on Rules of Origin Rule 4.
[xv] Extracted from Protocol A/P1/1/03 of ECOWAS, Article 4(2).
[xvi] Extracted from Annex on Rules of Origin under Article 12 of the Agreement, Articles (5) and (6).

the actual calculation methodology is a value-added calculation methodology by subtracting the value of non-originating materials. This is the same calculation made on the basis of value of materials as outlined in section 6.2.3.2.

In addition, COMESA and ECCAS use, as one of the alternative criteria, a unique calculation methodology using as denominator the total cost of materials used in the production of the good as outlined in Table 6.3 under option COMESA 1.

As we have seen, there is a convergence toward a calculation methodology based on a value-of-materials calculation. This methodology is already largely used under the majority of free-trade agreements and it eliminates most of the shortcomings of a value-added calculation. The value-of-material methodology – either calculated as the maximum amount of non-originating materials in the case of the EU, as build-down (post-NAFTA-inspired free-trade agreements), or transaction value (USMCA) – is based on the WTO Customs Valuation Agreement anchoring this methodology to a multilateral instrument in use by WTO members. This method of calculation is used by the United States in USMCA; US FTA agreements with Australia, Singapore, Chile, Central America; as well as by the EU in its free-trade agreements and by Japan in free-trade agreements with Asian partners.

The simplest calculation that may be used is:

Method Based on Value of Non-originating Materials

$$FTA = \frac{VNOM}{EW} \times 100$$

where:

- *FTA* is the value content, expressed as a percentage.
- *EW* is the ex-works price as defined below.
- *VNOM* is the value of non-originating materials that are acquired and used by the producer in the production of the good; VNOM does not include the value of a material that is self-produced.[39]

6.2.3.5.1 FURTHER DEFINITION OF THE DENOMINATOR. In the case of the EU, the ex-works price as denominator is defined as follows:[40]

> "Ex-works price" means the price paid for the product ex-works to the manufacturer in the States Party in whose undertaking the last working or processing is carried out,

[39] The definition of "self-produced material" or "absorption principle" may need to be included in the definition of calculation methodology when drafting rules of origin.

[40] See, for instance, definition (f) of Article 1 of the PEM Convention.

provided the price includes the value of all the materials used minus any internal taxes paid which are, or may be, repaid when the product obtained is exported;

In the case of the United States,[41] the denominator is based on the concept of adjusted value based on the following definition as expected below from the US–Central America and Dominican Republic FTA agreement:

> ARTICLE 4.22: DEFINITIONS
>
> For purposes of this Chapter:
>
> Adjusted value means the value determined in accordance with Articles 1 through 8, Article 15, and the corresponding interpretative notes of the Customs Valuation Agreement, adjusted, if necessary, to exclude any costs, charges, or expenses incurred for transportation, insurance, and related services incident to the international shipment of the merchandise from the country of exportation to the place of importation;

These two definitions of denominator do not differ widely since they make reference, either by wording or by direct reference, to the transaction value as contained in the WTO Customs Valuation Agreement with the notable addition that the cost may be adjusted to exclude costs of international shipment of the merchandise. This provision seems to go hand in hand with the provision made in several US free-trade agreements to deduct the cost of shipment from the value of non-originating material as discussed in section 6.2.3.4. In plain words, US practice is to ensure a comparison on a FOB basis both on non-originating inputs used in manufacturing as numerator and on the definition of adjusted value in the denominator. In a similar fashion it may be argued that the EU practice is in line with the customs valuation method used in the EU; that is, CIF. Hence the CIF price of non-originating materials is the numerator but is also part of the ex-works price of the finished product once incorporated.

On the one hand, the US formulation makes explicit reference to the WTO Customs Valuation Agreement anchoring the determination of the denominator to a transparent and predictable text of law binding and applicable by all WTO members. On the other hand, the expression ex-works price has been widely used by the majority of free-trade agreements that are familiar with the ex-works price

[41] The excerpt below is drawn from USMCA and defines the transaction value as denominator in a similar manner: "*transaction value* means the customs value as determined in accordance with the Customs Valuation Agreement, that is, the price actually paid or payable for a good or material with respect to a transaction of, except for the application of Article 10.3 and 10.4(a) in Appendix 1 to Annex 4-B, the producer of the good, adjusted in accordance with the principles of Articles 8(1), 8(3), and 8(4) of the Customs Valuation Agreement, regardless of whether the good or material is sold for export."

definition. A solution could be to take the best of the two definitions. The ex-works price could be defined as follows:

> "ex-works price" means the price paid for the product ex-works to the manufacturer in FTA states in whose undertaking the last working or processing is carried out determined under Articles 1 through 8, Article 15 and the corresponding interpretive notes of the Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade (the Customs Valuation Agreement).

6.2.3.5.2 FURTHER DEFINITION OF NUMERATOR: VALUE OF NON-ORIGINATING MATERIAL. As mentioned, a good practice is to exclude the freight and insurance from the value of non-originating materials by including provisions as follows:

> (a) The following expenses are deducted from the value of the non-originating material:
> (i) the costs of freight, insurance, packing and all other costs incurred in transporting the material to the location of the producer;
> (ii) duties, taxes and customs brokerage fees on the material paid in the territory of one or more FTA member states or neighboring countries other than duties or taxes that are waived, refunded, refundable or otherwise recoverable, including credit against duty or tax paid or payable;
> (iii) the cost of waste and spoilage resulting from the use of the material in the production of the good, less the value of renewable scrap or by products;
> (iv) the cost of originating materials used in the production of the non-originating material;

The adjustments made to the value of materials by deducting the cost of insurance and freight permits a fair comparison between the denominator (i.e. the ex-works price not containing any cost of transport and insurance of non-originating materials) and the numerator (i.e. the value of non-originating good also not containing any cost of transport and insurance). This method of calculation of the value of materials used in manufacturing will greatly facilitate compliance with rules of origin by excluding an exogenous factor – cost of transport and insurance – that has nothing to do with compliance with substantial transformation. These deductions have to be made in parallel, both to the numerator and the denominator to allow a fair comparison as discussed in section 6.2.3.4.

Tables 6.4 to 6.6 summarize the calculation methodology used in major ASEAN, Latin American, and South Korean agreements, showing once again the overall convergence toward widespread use of a calculation methodology based on value of materials.

TABLE 6.4 *Ad valorem percentage criterion calculation methodologies of ASEAN free-trade agreements*

	ATIGA[i]	AANZFTA[ii]	AIFTA[iii]	ACFTA[iv]	AJCEP[v]	AKFTA[vi]
Numerator	***Direct method:*** VOM + cost of direct working or processing	***Direct method:*** VOM + cost of direct working or processing	***Direct method:*** VOM	***Indirect method:*** FOB – CIF VNOM[vii]	***Direct method:*** Not applicable	***Build-up method:*** VOM
	Indirect method: FOB price – VNOM	***Indirect method:*** FOB price – VNOM	***Indirect method:*** VNOM	***Direct method:*** VNOM + values of materials of undetermined origin	***Indirect method:*** FOB price − VNOM	***Build-down method:*** FOB price − VNOM
Denominator	FOB price	FOB price	FOB price	FOB price	FOB price	FOB price
Method of calculation	***Direct method:*** Value-added calculation	***Direct method:*** Value-added calculation	***Direct method:*** Value-added calculation adding cost of processing and local materials	***Direct method:*** Based on a 40% of RVC requirement	Subtraction of the VNOM from the FOB price	***Build-up method:*** Based on the VOM
	Indirect method: Subtraction of VNOM from the FOB price	***Indirect method:*** Subtraction of VNOM from the FOB price	***Indirect method:*** Based on a maximum allowance of non-originating inputs	***Indirect method:*** Based on a formula requiring not to exceed 60% of non-originating inputs		***Build-down method:*** Based on the VNOM

[i] The ASEAN Trade in Goods Agreement (ATIGA). For more details, see www.miti.gov.my/miti/resources/fileupload/Write-up%20on%20ASEAN%20Trade%20in%20Goods%20Agreement%20(ATIGA).pdf.

[ii] The ASEAN–Australia–New Zealand Free-Trade Agreement (AANZFTA).

[iii] The ASEAN–India Free-Trade Agreement (AIFTA).

[iv] The ASEAN–China Free-Trade Agreement (ACFTA).

[v] The ASEAN–Japan Comprehensive Economic Partnership (AJCEP).

[vi] The ASEAN–Republic of Korea Free-Trade Agreement (AKFTA).

[vii] The value of non-originating materials includes the value of non-ACFTA materials and the value of materials of undetermined origin. See www.asean.org/storage/2012/06/22204.pdf for further details.

TABLE 6.5 *Ad valorem percentage criterion calculation methodologies of Latin American free-trade agreements*

	LAIA[i]	CARICOM[ii]	Mercosur I[iii]	Mercosur II	Dominican Republic–Central American free trade agreement	Pacific Alliance Association of Latin American States I[iv]	Pacific Alliance Association of Latin American States II
Numerator	FOB Value of the final product – CIF VNOM	CIF VNOM	CIF VNOM	CIF VNOM	***Build-up method:*** VOM ***Build-down method:*** Adjusted value (AV) – VNOM	Net cost – VNOM	FOB – VNOM
Denominator	FOB value of the final product	Export price	FOB value of the final product	FOB value of the final product	Adjusted Value (AV)	Net cost	FOB
Method of calculation	RVC	VNOM	Maximum VNOM	RVC	RVC	RVC	RVC

[i] See ALADI Resolution 78 of 1980, available at www.sice.oas.org/trade/montev_tr/recr78s.asp.
[ii] See Rule 3 of Revised Treaty of Chaguaramas, available at www.ttcsi.org/wp-content/uploads/2014/06/Revised%20Treaty%200f%20Chaguaramas.pdf for further details.
[iii] See http://epp.com.uy/content/archivos/50a13efcbbea6.pdf for further details.
[iv] See www.sice.oas.org/Trade/PAC_ALL/Pacific_Alliance_Text_s.asp#c4_sb for further details.

TABLE 6.6 *Ad valorem percentage criterion calculation methodologies of Korea's free-trade agreements*[i]

	Korea–US	Korea–EU	Korea–ASEAN	Korea–Singapore	Korea–Australia	Korea–India CEPA	Korea–Chile	Korea–Peru
Numerator	***Build-up method:*** *VOM* ***Build-down method:*** Adjusted value[ii] (AV) of the good – VNOM	VNOM	Subtraction of the VNOM from FOB price	Customs Value (CV) – VNOM	***Build-up method:*** *VOM* ***Build-down method:*** Adjusted Value (AV) of the good – VNOM	Subtraction of VNOM from the FOB value	***Build-up method:*** *VOM* ***Build-down method:*** Adjusted value (AV) of the good – VNOM	Subtraction of VNOM from the FOB value
Denominator	***Build-up and Build-down method:*** AV	Ex-works price	FOB price	CV	***Build-up and Build-down method:*** AV	FOB value	***Build-up and Build-down method:*** AV	FOB value
Method of calculation	RVC[iii]	Maximum VNOM	RVC	RVC	RVC	RVC	RVC	RVC

[i] A list of comprehensive information on Korea's free-trade agreements can be found through this link: www.customs.go.kr/kcshome/main/content/.

[ii] Adjusted value is defined as the value of the product for customs purposes, usually the arms-length transaction value, adjusted, if necessary, to exclude any costs, charges, or expenses incurred for transportation, insurance, and related services incidental to the international shipment of the merchandise from the country of exportation to the place of importation.

[iii] RVC is calculated in the build-down method using VNOM. Alternatively, RVC could be calculated using a build-up method through the value of originating materials.

6.2.3.6 Setting the Level of Percentages in the Ad Valorem Percentage Methodology

One of the most glaring intrinsic limitations of the ad valorem percentage rule is the setting of the level of percentages. There are very few studies made on the level of the percentages[42] and there are even fewer convincing inputs, at least publicly available, from industries about the desired level.[43]

The most common question related to level of percentages is how to determine a level that is responding to trade policy objectives and the industrial reality: Can a given percentage be met by local industries? Will this percentage enable the local industries to source from the most competitive suppliers?

The major trading partners like the United States, the EU, Japan, and other developed countries that have signed a number of free-trade agreements have developed established consultative networks where they can consult major industries on several aspects of rules of origin, including the level of percentages. In particular the US administration relies on mass email notification to a network of industries to provide comments on the US negotiating position. It is not clear, nor has it been assessed in publicly available studies, how effective these consultations are as it may be that only major industries and lobbies are equipped to provide inputs during such consultative process. The major lobbies in Brussels, for instance, mainly represent the interests of big industries that could afford a permanent office in Brussels. It is therefore doubtful how this consultative process could be accessible to small and medium-sized enterprises (SMEs), bearing in mind that the levels of percentages are most likely to affect these businesses rather than large manufacturing firms.

Another important issue to be considered is that there are several factors determining the stringency or leniency of the level of the percentages:

(a) The first is the methodology used to calculate the level of percentage and inclusion/exclusion of cost of freight and insurance as discussed in section 6.2.3.2.
(b) The level of percentage varies according to the industrial sector at stake. The adoption of an across-the-board percentage criterion remains mainly relegated to the US GSP and AGOA while in the large majority of free-trade agreements the level of percentage varies depending on the industrial sector or on the processed agricultural sector.

[42] See O. Cadot, J. de Melo, and E. Pondard, "Evaluating the consequence of shift to value added method of determining origin in European Union preferential trade agreements," Revised Final Report, ADE, 2006; and M. Schleffer, "Study on the application of value criteria for textile products in preferential rules of origin," Final Report, Saxion University, Enschede, 2007.

[43] Apart from highly debatable submissions from German industry in the course of TTIP negotiations; see, for example, the call by the Federation of German Industries (BDI) for a uniform cross-industry value-added rule in TTIP. See Position Paper Document No. D-0697 of April 21, 2015.

(c) The level of percentages has to be measured taking into account the qualitative and quantitative aspects of cumulation that are available in a free-trade agreement. It is obvious that there is a substantial difference between a percentage expressed as an RVC, providing only for bilateral cumulation among the parties as in the case of the majority of US free-trade agreements, and an ad valorem percentage criterion expressed as maximum amount of non-originating materials, such as the Pan-Euro-Mediterranean (PEM) Convention where the materials originating in the countries that are part of the Convention are to be considered as originating.[44]
(d) The ancillary issues such as the provision of absorption rules or roll-up provisions, tolerance/*de minimis* rules also play a role in the stringency/leniency of a given percentage.

Above all, and as discussed in Chapter 4 of this book, the level of percentage and its stringency or leniency cannot be examined in isolation from the industrial context where it is expected to operate.

To provide an example, even what could be considered a minimum level of percentage, such as 5 percent, could represent an insurmountable obstacle. Suffice to consider a level of 5 percent of originating material to manufacture a portable phone in Zambia. Even if all the assembly processes and testing to produce the phone are conducted in Zambia it would be hardly possible to satisfy such a minimal level of percentage given the unavailability of Zambian originating materials.

In fact, the supporting industries in Zambia may be unable to produce even basic originating materials such as plastics that could be used as parts of the portable phone.

Tables 6.7–6.13 provide a comparative analysis of the level of percentages used in major free-trade agreements along with the main factors mentioned to better qualify the stringency/leniency of such level of percentages.

6.2.3.7 Difference in Level of Percentages in the Automotive Sector

As noted in the previous section, there are differences in the level of percentages in the various free-trade agreements that deserve a full study on their own.

One sector where the ad valorem percentage criterion is widely used across the free-trade agreements is the car and, in general, the automotive sector (see Table 6.14). The peculiarities of NAFTA and USMCA level of percentages and method of calculation have been discussed in Chapter 3 of this book.

The US–Korea FTA agreement requires a lower percentage of 35 percent when the net cost method is used.

In addition, the US–Singapore and US–Korea agreements provide for alternative calculations of a percentage requirement of 30 and 35 percent respectively,

[44] As discussed in Chapter 3 of this book, there are limitations to this kind of cumulation.

TABLE 6.7 *Level of percentages in the ad valorem calculation of US free-trade agreements*[i]

	US GSP	AGOA	NAFTA I	NAFTA II	CAFTA[ii]	US–Chile	US–Singapore	US–Australia	TPP I	TPP II[iii]
Numerator	VOM + direct processing cost	VOM + direct processing cost	Transaction value of the good adjusted to a FOB basis – VNOM	Net cost of the good – VNOM	***Build-up method:*** VOM ***Build-down method:*** AV – VNOM	***Build-up method:*** VOM ***Build-down method:*** AV – VNOM	***Build-up method:*** VOM ***Build-down method:*** AV – VNOM	***Build-up method:*** VOM ***Build-down method:*** AV – VNOM	***Build-up method:*** VOM ***Build-down method:*** Value of the good – VNOM	***Focused value method:*** Value of the good – FVNM[iv] ***Net cost method:*** Net cost – VNOM
Denominator	Appraised value of the article at the time of entry into the US	Appraised value of the article at the time of entry into the US	Transaction value of the good adjusted to a FOB basis	Net cost of the good	***Both methods:*** AV	***Both methods:*** AV	***Both methods:*** AV	***Both methods:*** AV	***Both methods:*** Value of the good	***Both methods:*** Value of the good
Method of calculation	Value added by addition	Value added by addition	Transaction method	Net cost method	RVC	RVC	RVC	RVC	RVC	RVC
PSRO	No	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes

(*continued*)

TABLE 6.7 (*continued*)

	US GSP	AGOA	NAFTA I	NAFTA II	CAFTA[ii]	US–Chile	US–Singapore	US–Australia	TPP I	TPP II[iii]
Level of percentage (minimum)	35%	35%	60–65%	50–55%[v]	***Build-up:*** 35–40%[vi] ***Build-down:*** 45–50%	***Build-up:*** 30–35% ***Build-down:*** 45–50%	***Build-up:*** 30–35% ***Build-down:*** 45%	***Build-up:*** 35%[vii] ***Build-down:*** 45%[viii]	***Build-up:*** 30–35%[ix] ***Build-down:*** 40–45%	***Focused value:*** 55–60% ***Net cost:*** 35–45%[x]
Deduction of freight and insurance	No clear inclusion	No clear inclusion	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Cumulation	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes

[i] A comprehensive document containing the information used in this table is accessible via https://hts.usitc.gov/current.

[ii] Information extracted from www.sice.oas.org/trade/cafta/caftadr_e/chapter1_5.asp#Article3.25.

[iii] Net cost method (as presented in NAFTA II) is used for automotive goods under TPP. See www.mfat.govt.nz/assets/Trans-Pacific-Partnership/Text/3.-Rules-of-Origin-and-Origin-Procedures-Chapter.pdf for further details.

[iv] FVNM is defined in TPP as the value of non-originating materials, including materials of undetermined origin, specified in the applicable product-specific rule (PSR) and used in the production of the good. For greater certainty, non-originating materials that are not specified in the applicable PSR in Annex 3-D are not taken into account for the purpose of determining FVNM. See www.mfat.govt.nz/assets/Trans-Pacific-Partnership/Text/3.-Rules-of-Origin-and-Origin-Procedures-Chapter.pdf for further details.

[v] HS 2009.90 follows a 60% minimum RVC using the net cost method. See www.international.gc.ca/trade-commerce/trade-agreements-accords-commerciaux/agr-acc/nafta-alena/fta-ale/ann-401-09.aspx?lang=eng for further details.

[vi] Note that HS 3920.10 – 3920.99 follows a minimum Regional Value Content of 25% when using the build-up method and 30% when using the build-down method. See www.sice.oas.org/trade/cafta/caftadr_e/specificrlesorigin.pdf for further details.

[vii] 154 of 158 cases where build-up method is used employs 35% as the minimum RVC threshold while HS 9017.10–9017.80 follows 30% minimum RVC.

[viii] US–Australia FTA agreement, as a rule, uses 45% minimum RVC. However, there are thirteen cases where 55% minimum RVC is followed and one case each where 35% and 50% are employed as the minimum threshold. See https://ustr.gov/sites/default/files/ANNEX%205A%20AustraliaFTA.pdf for further details.

[ix] There are twenty cases where the PSRO requires the minimum RV to be 40% and thirteen cases of 45% minimum threshold. See https://ustr.gov/sites/default/files/TPP-Final-Text-Annex-3-A-Product-Specific-Rules.pdf for further details.

[x] Note that there are variations on the level of percentages among the different PSRO as in the case of other free-trade agreements.

TABLE 6.8 *Level of percentages in the ad valorem calculation of EU trade agreements (EPAs, GSPs, free-trade agreements)*

	EU–EAC	EU–ECOWAS	EU–SADC	EU–Japan I	EU–Japan II	EBA	EU–Vietnam	EU–Mexico
Numerator	VNOM	VNOM	VNOM	VNOM	FOB – VNOM	VNOM	VNOM	VNOM
Denominator	Ex-works price	Ex-works price	Ex-works price	Ex-works price	FOB	Ex-works price	Ex-works price	Ex-works price
Method of calculation	Maximum VNOM	Maximum VNOM	Maximum VNOM	Maximum VNOM	RVC	Maximum VNOM	Maximum VNOM	Maximum VNOM
PSRO	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Level of percentage	Chs. 1–24:[i] 15% Chs. 25–97: 50%[ii] or 60–70%[iii]	Chs. 1–24: 30%[iv] Chs. 25–97: 40–50%[v]	Chs. 1–24: 30%[vi] Chs. 25–97: 40–50%[vii]	Chs. 1–24: 35%[viii] Chs. 25–97: 50%	Chs. 1–24: 70%[ix] Chs. 25–97: 55%	70%	Chs. 1–24: N/A Chs. 25–97:[x] 40–50%	N/As[xi]
Deduction of freight and insurance	No clear inclusion	No clear inclusion	No clear inclusion	No clear inclusion	No clear inclusion	No clear inclusion	No clear inclusion	No clear inclusion
Cumulation	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes

Note: N/A: Not applicable; N/As. Not ascertainable

[i] Except Chapter 16 (1604, 1605): Maximum 15%; Chapter 22 (2207, 2208): Maximum 5%.

[ii] For EU exports to EAC. Other maximum thresholds include 20%, 40%, and 60%.

[iii] For EAC exports to EU. Other maximum thresholds include 20%, 40%, and 50%.

[iv] 15% and 50% are also used as a maximum threshold for EU–ECOWAS. For example, HS Chapter 3 follows a 15% maximum while HS Chapter 4 and HS 1708 follows a maximum of 50%. The highest threshold is 60% for HS 2008.

[v] Note that there are cases when the maximum ex-works price is limited only to 20–30%.

[vi] Other cases include a maximum threshold of 15% and 50%. For example, HS 1301 uses a 50% maximum VNOM while HS 0304 uses a maximum of 15%.

[vii] There are cases where the maximum VNOM is designated at 20–25%.

[viii] Only HS Chapter 24 follows the maximum VNOM method of calculation.

[ix] Only HS Chapter 24 follows the RVC method of calculation.

[x] There are also other HS headings and subheadings that follow a maximum threshold of 20% or 70%.

[xi] The PSRO available online only refer to the amendment to Annex II, which only contains information on tariff items that EU and Mexico is eliminating. See www.sice.oas.org/Trade/mex_eu/english/Decisions_Council/2_2002_e.asp for further details.

TABLE 6.9 *Level of percentages in the ad valorem calculation of African RECs*[i]

	EAC	SADC	COMESA I	COMESA II	ECOWAS	ECCAS I	ECCAS II	TFTA I	TFTA II
Numerator	VNOM	VNOM	Value of materials used in the production of the goods	Ex-factory cost of the finished product – CIF VNOM	Ex-factory price of the finished product before tax – CIF VNOM	Raw materials and consumables wholly or partly of foreign origin	Raw materials and materials originating from the Community	VNOM	VOM
Denominator	Ex-works price	Ex-works price	Total value of materials used in the production of the good	Ex-factory cost	Ex-factory price	Post-production cost before tax	Total cost of the raw materials and consumables used	Ex-works price	Ex-works price
Method of calculation	Maximum VNOM	Maximum VNOM	Value of materials	Value added by subtraction	Value added by subtraction	Value added by subtraction	Minimum originating value	Maximum VNOM	Minimum VOM
PSRO	Yes	Yes	Yes	Yes	No	No	No	Yes	Yes
Level of percentage	Chs. 1–24:[ii] 30% Chs. 25–97: 20–70%	Chs. 1–24: 60% Chs. 25–97:[iii] 55–60%[iv]	Minimum 60%	Maximum 35%	Minimum 30%	Minimum 35%	Minimum 40%	Maximum 70%	Minimum 30%
Consideration of freight and insurance	No	No	Yes	Yes	No clear inclusion	Yes	Yes	Yes	Yes
Cumulation	Yes	Yes	Yes	Yes	No	No	No	Yes	Yes

[i] The rules of origin of the Arab Maghreb Union (UMA) have not been included in the present note as the text available on the Internet dates to 1991 while the AU Secretariat has been notified that a more recent text has been agreed but was not available at the time of this writing.

[ii] Except Chapter 18: Maximum 70%.

[iii] Except Chapter 63 (6308): Maximum 15%.

[iv] There are cases where the maximum VNOM is assigned at 40% and 50%.

TABLE 6.10 *Level of percentages in the ad valorem calculation of ASEAN free-trade agreements*

	ATIGA	AANZFTA	AIFTA	ACFTA	AJCEP	AKFTA
Numerator	***Direct method:*** VOM + cost of direct working or processing	***Direct method:*** VOM + cost of direct working or processing	***Direct method:*** VOM	***Indirect method*** FOB – (CIF VNOM + values of materials of undetermined origin)	FOB price – VNOM	***Build-up method:*** VOM
	Indirect method: FOB price – VNOM	***Indirect method:*** FOB price – VNOM	***Indirect method:*** VNOM	***Direct method:*** VNOM + values of materials of undetermined origin		***Build-down method:*** FOB price – VNOM
Denominator	FOB price	FOB price	FOB price	FOB price	FOB price	FOB price
Method of calculation	***Direct method:*** Value-added calculation	***Direct method:*** Value-added calculation	***Direct method:*** Value-added calculation adding cost of processing and local materials	***Direct method:*** RVC	Subtraction of the VNOM from the FOB price	***Build-up method:*** Based on the VOM
	Indirect method: Subtraction of VNOM from the FOB price	***Indirect method:*** Subtraction of VNOM from the FOB price	***Indirect method:*** Maximum VNOM	***Indirect method:*** Maximum VNOM		***Build-down method:*** Based on the VNOM
PSRO	Yes	Yes	Yes	Yes	Yes	Yes
Level of percentage	Minimum 40%	Minimum 35–40%	***Direct Method:*** Minimum 35%	***Direct Method:*** Minimum 40%	Minimum 40%	Minimum 40–45%[i]
			Indirect Method: Maximum 65%	***Indirect Method:*** Maximum 60%		
Consideration of freight and insurance	Yes	No clear inclusion	Yes	Yes	No clear inclusion	Yes
Cumulation	Yes	Yes	Yes	Yes	Yes	Yes

[i] There are some exceptions to this rule. For example, minimum VOM of 35% is used for HS 1605; 55% for HS 4011; 60% for HS 1602, 2003, 2005, and 9403; and 70% for HS 1302.

TABLE 6.11 *Level of percentages in the ad valorem calculation of Latin American free-trade agreements*

	LAIA	CARICOM	MERCOSUR I	MERCOSUR II	Dominican Republic–Central American free trade agreement	Pacific Alliance Association of Latin American States I
Numerator	CIF VNOM	CIF VNOM	CIF VNOM	CIF VNOM	***Build-up method:*** VOM	***Net cost method:*** Net cost – VNOM
					Build-down method: Adjusted value (AV) – VNOM	***FOB value method:*** FOB – VNOM
Denominator	CIF value of the final product	Export price	FOB value of the final product	FOB value of the final product	***Both methods:*** AV	***Net cost method:*** Net cost
						FOB value method: FOB
Method of calculation	RVC	Value-added calculation	Maximum VNOM	Maximum VNOM	Maximum VNOM	RVC
PSRO	N/As[i]	Yes	No	Yes	Yes	Yes[ii]
Level of percentage	Maximum 50% of non-originating materials, 60% for certain less developed countries	Maximum 60% for LDCs; Maximum 50% for other parties	Maximum 50%	Maximum 40 VNOM or RVC 60 for capital goods	N/As	Minimum 50%
Consideration of freight and insurance	No clear inclusion	Yes	No clear inclusion	No clear inclusion	Yes	Yes
Cumulation	Yes[iii]	No	No	No	Yes	Yes

Note: N/As: Not ascertainable.

[i] There were no PSRO in the original ALADI Resolution 78. For a more detailed discussion of rules of origin in Latin America, see "Rules of origin and trade facilitation in preferential trade agreements in Latin America," paper presented to the Second International Forum on Trade Facilitation, United Nations Office at Geneva, Switzerland, Hall XX, May 14–15, 2003.

[ii] See www.sice.oas.org/Trade/PAC_ALL/AnexoREOFINAL.pdf for further details.

[iii] Cumulation is only available to the Economic Complementation Agreement. See www.unece.org/fileadmin/DAM/forums/forum03/presentations/ventura_en_rev.doc for further details.

TABLE 6.12 *Ad valorem percentage criterion calculation methodologies of Korea's free-trade agreements*

	Korea–US	Korea–EU	Korea–ASEAN	Korea–Singapore	Korea–Australia	Korea–India CEPA	Korea–Chile	Korea–Peru	Korea–Turkey
Numerator	***Build-up method:*** VOM ***Build-down method:*** AV of the good – VNOM	VNOM	AV[i] of the good – VNOM	CV – VNOM	AV of the good – VNOM	FOB value – VNOM	AV of the good – VNOM	FOB value – VNOM	Ex-works price – VNOM
Denominator	AV	Ex-works price	FOB Price	CV	AV	FOB value	AV	FOB value	Ex-works price
Method of calculation	RVC	Maximum VNOM	RVC	RVC	RVC	RVC	RVC	RVC	Maximum VNOM
PSRO	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Level of percentage	***Build-up method:*** 35% ***Build-down method:*** 45–50%	Chs. 1–24: 30% or 50%[ii] Chs. 25–97: 40% or 50%[iii]	Minimum 40–45%	Minimum 45%	Minimum 40%	Minimum 35%	Minimum 45%	Minimum 40–50%	Chs. 1–24: 30% or 50%[iv] Chs. 25–97: 40–50%
Consideration of freight and insurance	Yes	N/S	Yes	Yes	Yes	Yes	Yes	Yes	N/S
Cumulation	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes

Note: N/S: Not specified.

[i] AV means adjusted value defined as the value of the product for customs purposes, usually the arms-length transaction value, adjusted, if necessary, to exclude any costs, charges, or expenses incurred for transportation, insurance, and related services incident to the international shipment of the merchandise from the country of exportation to the place of importation.

[ii] There are only two maximum VNOM thresholds for HS Chapter 1–24 under the Korea–EU FTA agreement.

[iii] Other cases included 20% and 60% as the maximum VNOM threshold.

[iv] Some special cases do not belong to these maximum thresholds. For example, HS Chapter 24 follows a 70% maximum VNOM.

TABLE 6.13 *Level of percentages in the ad valorem calculation of non-QUAD countries for LDCs under DFQF scheme*

	Australia	Eurasian Customs Union	New Zealand	Iceland, Norway, Switzerland	Chile	China	Chinese Taipei	India	Morocco	Rep. of Korea	Thailand
Numerator	Allowable factory cost	VNOM	Cost of materials + Expenditures in other items of factory or work cost in NZ or LDCs	VNOM	FOB value of final product – CIF VNOM	FOB price – VNOM	FOB price – VNOM	FOB price – VNOM	FOB price – VNOM	VNOM	FOB price – VNOM
Denominator	Total factory cost	Ex-works price	Ex-factory cost	Ex-works price	FOB value of final product	FOB price	FOB price	FOB price	Ex-works price	FOB price	FOB price
Method of calculation	Minimum amount of allowable factory cost	Maximum VNOM	Minimum local content requirement	Maximum VNOM	Calculation by subtraction of non-originating materials	Calculation by subtraction of non-originating materials	Calculation by subtraction of non-originating materials	Calculation by subtraction of non-originating materials	Calculation by subtraction of non-originating materials	Maximum VNOM	Calculation by subtraction of non-originating materials
PSRO	No	No	No	Yes	No	No	No	No	No	No	No
Level of percentage	Minimum 50%	Maximum 50%	Minimum 50%	Maximum 70%	Minimum 50%	Minimum 40%	Minimum 50%	Minimum 30%	Minimum 40%	Maximum 60%	Minimum 50%
Consideration of freight and insurance	No clear inclusion[i]	No clear inclusion	No clear inclusion[ii]	No clear inclusion	No clear inclusion	No clear inclusion	No clear inclusion	No clear inclusion	No clear inclusion	No clear inclusion	No clear inclusion
Cumulation	Yes	Yes	Yes	Yes	NO	Yes	Yes	Yes	NO	Yes	NO

[i] Only with US free-trade agreements.
[ii] Only applicable in some free-trade agreements.

TABLE 6.14 *Comparative table of PSRO for cars and parts of cars under different free-trade agreements*

	NAFTA[i]	USMCA[ii]	US–Korea	EU–Korea	EU–Japan	EU–Mercosur
Cars HS 8703	62.5% net cost method	66% by 2020 with progressive increase to 75% by 2023	(A) 35% under the build-up method; or (B) 55% under the build-down method; or (C) 35% under the net cost method.	MaxNOM 45% (EXW)	MaxNOM 45% (EXW); or RVC 60% (FOB)	MaxNOM 45% (EXW)
Parts of cars HS 8708	(A)[iii] A change to subheading 8708.10 from any other heading; or (B) A change to subheading 8708.10 from subheading 8708.99, whether or not there is also a change from any other heading, provided there is a regional value content of not less than 50% under the net cost method.[v]	Core parts: from 66% in 2020 to 75% using the net cost method and from 76% in 2020 to 85% in 2023 using the transaction value method	(A) 35% under the build-up method; or (B) 55% under the build-down method; or (C) 35% under the net cost method.	Manufacture from materials of any heading, except that of the product or manufacture in which the value of all the materials used does not exceed 50% of the ex-works price of the product	CTH; MaxNOM 50% (EXW); or RVC 55% (FOB).[iv]	MaxNOM 50% (EXW)

[i] For further details, see Chapter 3 of this book.
[ii] For further details, see ibid.
[iii] NAFTA provides for PSRO at subheading level for each of the subheadings of heading 8708. For the sake of brevity and comparison, only the PSRO for heading 8708.10 is reproduced in the table.
[iv] Special rules apply for heading 8708 as contained in Appendix 3-B-1 of the EU–Japan FTA agreement.
[v] The threshold of RVC was subsequently raised to 60%.

calculated according to the build-up method percentage of the adjusted value[45] of the car.

The percentage requirement of the build-up method is calculated according to the following formula:

$$RVC = \frac{VOM}{AV} \times 100 \text{ should be equal to or more than } 30\% \text{ [35\%]}$$

where:

- *RVC* is the regional value content.
- *AV* is the adjusted value.
- *VOM* is the value of originating materials.

Since the build-up method is based on the value of originating materials used in the manufacturing of the car, this rule implicitly requires that the remaining 70 percent [65 percent] is composed of non-originating materials, labor and factory overheads.

In addition, the US–Korea FTA agreement introduces a percentage requirement of 55 percent, calculated according to the following build-down formula:

$$RVC = \frac{AV-VNM}{AV} \times 100 \text{ should be equal or more than } 55\%$$

where:

- RVC is the regional value content.
- AV is the adjusted value.
- VNM is the value of non-originating materials.

Practically, this rule is similar to the PSRO under the EU–South Korea FTA agreement requiring a threshold of 45 percent non-originating materials out of the works price of the finished car should not be exceeded.

In reality the difference between the two rules is that the EU percentage is drafted on the basis of not exceeding a given amount of non-originating material while the US percentage uses the same numerator of non-originating materials that has to be subtracted from the overall amount of adjusted value of the finished car.

The main difference between these two calculation methods contained in the PSRO and, in general, in the calculation of the different percentages in the later US free-trade agreements (NAFTA excluded) and the EU percentage calculations resides in the method used to assess the cost of materials, both originating and non-originating. This issue is also discussed in sections 6.2.5.1 and 6.2.5.2.

[45] The term "adjusted value" means the value determined in accordance with Articles 1–8, Article 15, and the corresponding interpretive notes of the Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994 referred to in section 101(d)(8) of the Uruguay Round Agreements Act (19 USC 3511(d)(8)), adjusted, if necessary, to exclude any costs, charges, or expenses incurred for transportation, insurance, and related services incidental to the international shipment of the merchandise from the country of exportation to the place of importation.

Under the later stream of US free-trade agreements negotiated after NAFTA, the value of originating and non-originating materials may be adjusted as follows:[46]

> for originating materials, the following expenses, if not included in the value of an originating material calculated under subdivision (A) above, may be added to the value of the originating material:
>
> (I) the costs of freight, insurance, packing and all other costs incurred in transporting the material within or between the territory of Korea or of the United States, or both, to the location of the producer;
>
> (II) duties, taxes and customs brokerage fees on the material paid in the territory of Korea or of the United States, or both, other than duties and taxes that are waived, refunded, refundable or otherwise recoverable, including credit against duty or tax paid or payable; and
>
> (III) the cost of waste and spoilage resulting from the use of the material in the production of the good, less the value of renewable scrap or byproducts; and
>
> (2) for non-originating materials, if included the value of a non-originating material calculated under subdivision(A) above, the following expenses may be deducted from the value of the non-originating material:
>
> (I) the costs of freight, insurance, packing and all other costs incurred in transporting the material within or between the territory of Korea or of the United States, or both, to the location of the producer;
>
> (II) duties, taxes and customs brokerage fees on the material paid in the territory of Korea or of the United States, or both, other than duties and taxes that are waived, refunded, refundable or otherwise recoverable, including credit against duty or tax paid or payable;
>
> (III) the cost of waste and spoilage resulting from the use of the material in the production of the good, less the value of renewable scrap or by-products; or
>
> (IV) the cost of originating materials used in the production of the non-originating material in the territory of Korea or of the United States, or both.

In contrast, the EU practice in calculating the value of non-originating materials is the CIF (cost, insurance, and freight) and does not allow the deduction of the cost of insurance and freight:

> Value of the non-originating materials means the customs value at the time of importation of the non-originating materials used, or, if this is not known and cannot be ascertained, the first ascertainable price paid for the materials in the EU Party or in Korea.

6.2.4 *Use of Working or Processing in Drafting Rules of Origin*

The use of working or processing in drafting PSRO has been often labeled as a technical requirement and associated with overrestrictive rules of origin. In addition, such methodology in drafting rules was not considered as one of the preferred options since technology and scientific developments in manufacturing products may render PSRO based on specific working or processing rapidly obsolete.

[46] See US–Korea FTA agreement at www.cbp.gov/trade/free-trade-agreements/korea.

These statements are stereotypes that have little to do with reality. While in some cases specific working or processing requirements were crafted with protectionist intent, more recently such rules have been used to make PSRO more understandable to business and to the rest of the world and not only to customs officials.

Examples of these rules based on working or processing are illustrated in section 6.2, discussing the form and substance of drafting PSRO. The EU especially has been, and still is, the major user of such drafting techniques, especially in the textile and clothing area. In this area the simplicity and transparency of the working or processing requirement, in comparison to the convoluted CTC rules under the North American rules of origin for textiles and clothing, is evident. Most recently, even the North American model has begun to use the specific working or processing requirements in the case of chemical products and petroleum oils of Chapter 27.

The use of specific working or processing in the case of chemical products inherited from the HRO discussed in Chapter 2 of this book is evident as shown in Table 6.15.

As for the issue that PSRO based on working and processing requirements may be made obsolete by technological progress, suffice here to say that even rules based on

TABLE 6.15 *Summary for Chapter 27 and Chapters 28–38 chapter and section rules for selected free-trade agreements*

Chapter	Working of processing RoO	HRO (CH where the rules apply)	NAFTA	USMCA	CETA	EU–KOR	TPP	US–KOR	EU–JAP
27	Chemical reaction	Yes	No	Yes	No	No	Yes	Yes	Yes
27	Physical separation	Yes	No	Yes, with more specific processes than HRO	No	No	Yes	Yes	Yes
27	Mixing & blending	Yes	No	Yes	No	No	Yes	No	No
28–38	Chemical reaction	Yes (28–32, 34–35, 38)	No	Yes	Yes	No	Yes	Yes	Yes
28–38	Purification	Yes (28–33, 34–35, 38)	No	Yes	Yes	No	Yes	Yes	Yes
28–38	Mixture & blends	Yes (28–35, 37–38)	No	Yes	No	No	Yes	Yes	Yes
28–38	Change in particle size	Yes (28–30, 32, 34–35,[1] 38)	No	Yes	No	No	Yes	Yes	No
28–38	Standard materials	Yes (28–32, 35, 38)	No	Yes	No	No	Yes	Yes	Yes
28–38	Isomer separation	Yes (28–32, 35)	No	Yes	No	No	Yes	Yes	Yes

TABLE 6.15 (*continued*)

Chapter	Working of processing RoO	HRO (CH where the rules apply)	NAFTA	USMCA	CETA	EU–KOR	TPP	US–KOR	EU–JAP
28–38	Biotechnological processes	Yes (30)	No	Yes	No	No	No	No	No
28–38	Separation prohibition	No	No	Yes	Yes	No	No	Yes	No
28–38	Chapter residual	Yes (28–32)[ii]	No	No	No	No	No	No	No
28–38	"Weight"	Yes (30, 33–38)	No	No	No	No	No	No	No
29	Chapter special rule	29	No	No	Yes	No	No	No	No
32	Chapter special rule	32	No	Yes	No	No	No	No	No
30–35, 37–38	Non-origin-conferring processes	Yes (30–35, 37–38)	No	No	No	No	No	No	No
33	Change in use	Yes (33)	No	No	No	No	No	No	No

[i] Note for Change in particle size for Chapters 34–35, only reduction of particle size is applied.
[ii] Note that CH 30 have a different chapter residual rule.

the CTC need to be completely overhauled each time the HS is revised. The complexity of such exercise cannot be overemphasized, as discussed in section 6.2.2.

6.3 DRAFTING THE FORM: A LIVING EXAMPLE EXCERPTED FROM NEGOTIATIONS

As mentioned in section 6.2, the "form" of a given PSRO is the way in which the rules of origin are drafted using different methodologies; namely, a CTC at heading level, at subheading level with or without exception, percentage criterion or specific working or processing, and their different variants.

Normally, the most important issue to determine is the "substance," which in simple terms is the industrial or manufacturing process that may or may not confer originating status to non-originating materials.

The dramatic importance of maintaining a distinction between these two concepts arose most recently during the negotiations of the AfCFTA when delegations of African countries started to examine the long Appendix IV[47] of PSRO at chapter, heading, and at times subheading level.

[47] Appendix IV to Annex 2 of AfCFTA.

The draft Appendix IV was assembled by the AU Secretariat on the basis of submissions by African member states, and amounted to 183 pages in the version that was circulated to African member states in June 2018.

One of the main problems built into the draft Appendix IV was the way in which the original submissions of PSRO were made by African member states in preceding negotiating sessions. The Sixth Meeting of the Technical Working Group (TWG) established during AfCFTA negotiations agreed in April 2018 to draft the template in a consultative format on the possible HS chapter rules and to indicate exceptions to such rules across all the ninety-seven chapters of the HS 2017 version. The chapter rules would take the form of general rules that would apply across each chapter, while product-specific rules would be assigned to exceptional headings or subheadings of each chapter. The matrix would then be used for national consultations, after which firm decisions would be taken during the next TWG meeting. General chapter rules were proposed for all the chapters of the HS and 738 HS headings and subheadings were identified for possible product-specific rules.[48]

During the Sixth TWG Meeting some delegations routinely asked to introduce PSRO at HS heading and HS subheading levels in addition to PSRO at HS chapter level. First, this immediately created a technical and substantive dilemma since the relation between PSRO at chapter level and PSRO at heading and subheading levels was not clear to the delegation, causing a series of impasses that delayed substantially the pace of the negotiations.

A second problem related to the fact the delegations were singling out headings and subheading levels for PSRO that were reflecting their import sensitivity in terms of tariffs rather than in terms of PSRO. Additionally, many PRSO were an exact replica of the PSRO that many delegations had in their EPAs with the EU.

Third, and perhaps most importantly, the draft Appendix IV that emerged from the Sixth TWG Meeting was anonymous, in the sense that the draft document did not report the member states who made the specific submission. At the first PSRO negotiating session at the Seventh TWG Meeting it turned out that many proposals at heading and subheading level had no support from individual delegations. In short, these exceptions were singled out randomly without any apparent negotiating logic or institutional memory. Still, these exceptions transformed Appendix IV into an unnecessarily complex technical document that opened a Pandora's box of questions and concerns for the delegations.

During the Seventh TWG Meeting, held in July–August 2018, as the discussions among delegations progressed toward sophisticated HS chapters it became progressively clear to African delegations that there was a need to better understand and assess the implications of a given CTC or a given PRSO expressed as ad valorem percentage, or specific working or processing requirement.

[48] See UNCTAD website at https://unctad.org/en/pages/MeetingDetails.aspx?meetingid=1910 for specific reporting of technical assistance provided during AfCFTA negotiations.

In particular there were questions related to the implications of general chapter rules based on a CTH, since there was concern that adoption of such CTH at HS chapter level would not take into account important manufacturing operations. Other questions related to the possibility of having CTH in the metals chapters as some delegations considered them raw materials. There were also questions related to the meaning of some PRSO that were found in the Appendix but were no longer sponsored by any delegation.

Faced by such a number of technical questions, which related to both the form and the substance of the PRSO that the African delegations were facing, the TWG requested the author, at that time representing UNCTAD, to draft a technical note for Chapter 71,[49] which at the time was one of the HS chapters that was found to register a significant number of concerns and questions from the delegations.

The following is the text that the author prepared to guide the delegations through the technicalities and the implications of a given PRSO. The note purposely aims at bringing to the attention of the delegations what were the "substantive issues" at stake: first, the manufacturing and industrial processes that may or may not be considered as conferring options; and, second, how the delegation wished to draft the "form" of a given PRSO to reflect the decision made about the "substance" of the rule. In some cases the note aimed at bringing to the attention of the delegations the implications of a given PSRO at chapter level to make them aware of possible unintended consequences.

The following sections comprise the information contained in the note drafted at the request of the AU.

6.3.1 *Introduction*

Chapter 71 of the Harmonized Commodity Description and Coding System (HS) contains a number of different items. Significantly, it is the first HS chapter dealing with metals. It is important that the PSRO for metals and metal products establish and maintain a logical and coherent sequencing. Chapter 71 gives rise to a number of issues that are replicated in other chapters dealing with metals and their products.

As rules of origin for the whole of Chapter 71, member states provisionally agreed on a CTH or manufacture in which the value of all the materials used does not exceed X percent of the ex-works price [cost] of the product, with Mauritius and Botswana requesting further consultation.

Chapter 71, subchapter I is subdivided into five headings:

(a) 71.01: Natural or cultured pearls and precious or semi-precious stones
(b) 71.02: Diamonds, whether or not worked, but not mounted or set
(c) 71.03: Precious stones (other than diamonds) and semi-precious stones, whether or not worked or graded but not strung, mounted or set; ungraded precious stones (other than diamonds) and semiprecious stones, temporarily strung for convenience of transport

[49] See the original text at https://unctad.org/en/pages/MeetingDetails.aspx?meetingid=2063.

(d) 71.04: Synthetic or reconstructed precious or semi-precious stones, whether or not worked or graded but not strung, mounted or set ungraded synthetic or reconstructed precious or semi-precious stones, temporarily strung for convenience of transport
(e) 71.05: Dust and powder of natural or synthetic precious or semi-precious stones.

The materials in each of headings 71.01 and 71.02 give rise to different considerations with respect to manufacturing operations as further detailed below.

6.3.2 *Issue 1: Heading 71.01*

6.3.2.1 Subheadings

Heading 71.01 is divided into three subheadings as follows:

7101.10	– Natural pearls
	– Cultured pearls:
7101.21	– Unworked
7101.22	– Worked

6.3.2.1.1 SUBHEADING 7101.10: NATURAL PEARLS. Goods classified as natural pearls under subheading 7101.10 can be obtained by extraction from an oyster classified under subheading 0307.10. During debate, member states appeared oriented toward the adoption of a requirement that goods classified under this subheading be wholly obtained or produced.

6.3.2.1.2 SUBHEADING 7101.21: UNWORKED CULTURED PEARLS. Cultured pearls of subheading 7101.21 may be obtained by a specific aquaculture process and extraction of the pearls from the oysters.

6.3.2.1.3 SUBHEADING 7101.22: WORKED CULTURED PEARLS. These are pearls from subheading 7101.21 that have been graded, grinded, sawn, or drilled and may be temporarily strung for transport. During debate, some Member States were of the view that grading, grinding, sawing, drilling, and temporarily stringing for transport were each a substantial transformation, and therefore conferred origin. However, according to the HS structure there is no CTH between worked (7101.21) and unworked cultured pearls (7102.22).

6.3.2.2 Technical Solutions

Member States which consider that grading, grinding, sawing, drilling, or temporarily stringing for transport confers origin may adopt one of the following options as a technical solution.

6.3.2.2.1 OPTION 1. Adopt a PSRO requiring a specific working or processing criterion as contained in the current Appendix IV of AfCFTA[50] (hereinafter "the Appendix"), drawing from the wording adopted in Economic Partnership Agreements (EPAs) with the EU as follows:

Subheading	Product description	Working or processing carried out on non-originating materials conferring originating status
7101.22	Unworked cultured pearls	Manufacture from unworked, precious or semi-precious stones[51]

6.3.2.2.2 OPTION 2. Adopt a change of tariff subheading (CTSH) criterion for subheading 7101.22:

Subheading	Product description	Working or processing carried out on non-originating materials conferring originating status
7101.22	Unworked cultured pearls	Change of tariff subheading

The above two options appear to be the simplest. However, for completeness, two other possible options are as follows.

6.3.2.2.3 OPTION 3. The drafting methodology outlined below used in several EU FTAs and EPAs that AU member states have entered into with the EU. See, for example, the PSRO for coffee (heading 09 .01) in table 3.22 above used in the context of EU FTAs:

Subheading	Product description	Working or processing carried out on non-originating materials conferring originating status
7101.22	Unworked cultured pearls	Manufacture from any heading

Under this formulation there is no need for a CTH since material from the same heading can be used. However, the working or processing operations carried out on the materials classified under the same heading must go beyond the working and processing listed in Annex 2, Article 7 of the African Continental Free Trade Agreement (AfCFTA).

[50] "Appendix" refers to the Appendix IV of the annex of AfCFTA.

[51] It appears clear from the context of this rule that "stones" should be "pearls."

This option would require an explanatory note in the Appendix as follows: "where a rule states that 'materials of any heading' may be used, materials of the same heading as the product may also be used, subject, however, to any specific limitations which may also be contained in the rule."[52]

6.3.2.2.4 OPTION 4. It is also possible to use a percentage criterion rule for subheading 7101.22:

Subheading	Product description	Working or processing carried out on non-originating materials conferring originating status
7101.22	Unworked cultured pearls	Manufacture in which the value of all the materials used does not exceed X% of the ex-works price of the product

If all member states by consensus consider that the above working or processing confers origin, a similar rule would need to be adopted for natural pearls because similar processes can be carried out on natural pearls. The EU EPAs are adopting PSRO which encompass natural and cultured pearls, as illustrated below:

Heading	Product description	Working or processing carried out on non-originating materials conferring originating status
Ex-7101	Natural or cultured pearls, graded and temporarily strung for convenience of transport	Manufacture in which the value of all the materials used does not exceed 50% of the ex-works price of the product

6.3.3 *Issue 2: Heading 71.02*

6.3.3.1 Heading 71.02

Member States have engaged in discussions about the working or processing requirements under the different subheadings of heading 71.02 (Diamonds), which are as follows:

7102.10 – Unsorted
– Industrial:
7102.21 – Unworked or simply sawn, cleaved or bruted
7102.29 – Other
– Non-industrial:
7102.31 – Unworked or simply sawn, cleaved or bruted
7102.39 – Other

[52] See Note 3.3 of the Introduction to list II of the SADC–EU EPA.

Subheading 7102.10 covers unsorted diamonds that are extracted through mining and sorted in lots. After they have been sorted by diamond experts as described in the HS explanatory notes, the diamonds can be classified as industrial under subheading 7102.21 or as non-industrial under subheading 7102.31. Some working or processing operations such as simple cutting, cleavage, and chemical polishing do not generate a CTH or even a CTSH. Similarly to Issue 1, member states which consider that these operations confer origin may adopt as a technical solution one of the options in section 6.3.3.2.

Subheadings 7102.29 and 7102.39 cover polished, drilled diamonds that have been the object of working or processing to make them suitable for industrial or non-industrial use. There is no change of tariff heading, but there is a change of tariff subheading (from subheadings 7102.21 and 7102.31 respectively). Member states that wish to recognize that the working and processing carried out in each of these subheadings confers origin may adopt as a technical solution one of the options in section 6.3.3.2.

6.3.3.2 Technical Solutions

One of the simplest technical solutions that can be borrowed from EPAs is as follows.

6.3.3.2.1 OPTION 1. Adopt a PSRO using a specific working or processing criterion as contained in the current Appendix drawing from the wording adopted in EPAs with the EU as follows:

Subheading	Product description	Working or processing carried out on non-originating materials conferring originating status
7102.21	Unworked or simply sawn, cleaved or bruted (Industrial)	Manufacture (or sorting) from unworked precious or semi-precious stones
7102.29	Other (Industrial)	Manufacture "or sorting" from unworked precious or semi-precious stones (or change of tariff subheading)
7102.31	Unworked or simply sawn, cleaved or bruted (Non-Industrial)	Manufacture from unworked precious or semi-precious stones
7102.39	Other (Non-Industrial)	Manufacture from unworked precious or semi-precious stones (or CTSH)

6.3.3.2.2 OPTION 1 VARIANT (SUBHEADINGS 7101.29 AND 7102.39). As a variant to Option 1, member states could insert a CTSH and add the process of sorting

diamonds from subheading 7102.10. This variant would only be available as an option for subheadings 7102.29 and 7102.39.

6.3.4 *Issue 3: Heading 71.03*

There have also been discussions among member states about the PSRO for heading 71.03 (precious stones (other than diamonds) and semi-precious stones, whether or not worked or graded but not strung, mounted or set; ungraded precious stones (other than diamonds) and semi-precious stones, temporarily strung for convenience of transport).

Heading 71.03 is divided into the following subheadings:

7103.10	– Unworked or simply sawn or roughly shaped
	– Otherwise worked:
7103.91	– Rubies, sapphires and emeralds
7103.99	– Other

A number of working or processing operations carried out under heading 71.03.10 such as working by sawing (e.g. into thin strips), cleaving (i.e. splitting along the natural plane of the layers), or bruting (i.e. stones which have only a provisional shape and clearly have to be further worked). The strips may also be cut into discs, rectangles, hexagons, or octagons, provided all the surfaces and ridges are rough, matt, and unpolished.[53] None of these operations generate a CTH or a CTSH. Member states considering that such working or processing confers origin may adopt the technical solutions set out at sections 6.3.2.2.1 and 6.3.3.2.1 – that is, PSRO at subheading level 7103.10 based on a specific working or processing requirement as currently contained in the Appendix: Manufacture from unworked, precious or semi-precious stones.

Subheadings 7103.91 and 7103.99 classify worked stones that have been polished or drilled stones, engraved stones (including cameos and intaglios), and stones prepared as doublets or triplets. As in the case of heading 7103.10, those delegations that are of the view that polishing and drilling stones are origin-conferring operations may wish to adopt one of the technical solutions envisaged in sections 6.3.2.2.1 and 6.3.3.2.1 above. In the specific case of these subheadings, a CTSH rule may be envisaged from heading 7103.10 to subheadings 7103.10 or 7303.99.

Upon request, UNCTAD could develop further technical options and/or clarify the issues at stake with respect to heading 71.03.

[53] See HS explanatory notes.

6.3.5 *Issue 4: Chapter 71, Subchapter II*

A series of rather complex issues and considerations raised by member states during discussion of this subchapter apply to the whole of subchapter II, which classifies precious metals and articles thereof, imitation jewelry, and coin. These issues are systemic and occur in many metals chapters. For the sake of brevity, only the major issues are discussed.

6.3.5.1 Subheadings

Heading 71.06 comprises silver (including silver plated with gold or platinum), unwrought or in semimanufactured forms, or in powder form. The heading is subdivided into three subheadings as follows:

7106.10 – Powder:
– Other:
7106.91 – Unwrought
7106.92 – Semi-manufactured

Heading 71.08 (gold) has a similar HS structure:

71.08 Gold (including gold plated with platinum) unwrought or in semi-manufactured forms, or in powder form

– Non-monetary:
7108.11 Powder
7108.12 Other unwrought forms
– 7108.13 Other semi-manufactured forms
– 7108.20 Monetary

Heading 71.10 (platinum) also follows a similar HS structure:

71.10 Platinum, unwrought or in semi-manufactured forms, or in powder form.

– Platinum:
7110.11 – Unwrought or in powder form
7110.19 – Other
– Palladium:
7110.21 – Unwrought or in powder form
7110.29 – Other
– Rhodium:
7110.31 – Unwrought or in powder form
7110.39 – Other
– Iridium, osmium and ruthenium:
7110.41 – Unwrought or in powder form
7110.49 – Other

In summary, under Chapter 71 precious metals may be (a) unwrought, (b) in powder, or (c) in semi manufactured forms.

A technical difficulty arises because a number of means of working or processing within the heading may be carried out without a change of tariff heading. During the discussions, a number of delegations considered that this matter needed to be more thoroughly considered.

6.3.5.2 Technical Solutions

A number of working or processing operations may be captured as mentioned in the analysis of previous issues by introducing a CTSH rule. For example, in the case of platinum, the adoption of a CTSH rule would allow the making of powders of silver of subheading 7106.10 from unwrought silver of subheading 71.06.91 and the making of semimanufactured items like foils, tubes, and pipes of silver of subheading 7106.91 from unwrought silver of heading 7106.92.

However, a CTSH rule may not cover all working or processing operations that may be undertaken within a subheading like subheading 7106.91 (unwrought precious silver). In fact, alloys of precious metals remain classified under the same subheading; and the electrolytic separation of precious metals as well. Both processes of making alloys and electrolytic separations are industrial processes in metallurgy.[54]

The manufacture of unwrought alloys requires at least the following operations:

(a) weighing the pure metals to respect the proportions specified depending on the uses for which the alloys are intended
(b) melting and mixing under extremely strict conditions (temperature control or working under vacuum) and
(c) analysis to check homogeneity or absence of impurities.

The processes for obtaining powders are crushing and atomization.

Delegations that are interested in conferring origin for these different processes may consider the technical solution outlined below that is excerpted from the EPAs text. Alternatively, UNCTAD could provide other technical solutions. The technical difficulties in heading 71.06 are also encountered, albeit with some differences, in headings 71.08, 71.10, and 71.11. A complete set of technical options may be proposed once delegations have reflected upon the various origin-conferring processes as listed above.

[54] See www.911metallurgist.com/blog/electrolytic_refining and www.uefap.com/reading/exercise/ess3/alex2.htm.

	Product description	Working or processing carried out on non-originating materials conferring originating status	Working or processing carried out on non-originating materials conferring originating status (Alternative PSRO)
7106, 7108, and 7110	Precious metals		
	– Unwrought	Manufacture from materials not classified within heading no. 7106, 7108 or 7110	Electrolytic, thermal or chemical separation of precious metals of heading no. 7106, 7108, or 7110 Or Alloying of precious metals of heading no. 7106, 7108, or 7110 with each other or with base metals
	– Semi-manufactured or in powder form	Manufacture from unwrought precious metals	

6.3.6 *Issue 5: Cladding of Base Metals*

Discussions have been ongoing among member states regarding:

(a) heading 71.07 (base metals clad with silver, not further worked than semi-manufactured)
(b) heading 71.09 (base metals or silver, clad with gold, not further worked than semi-manufactured)
(c) heading 71.11 (base metals, silver or gold, clad with platinum, not further worked than semi-manufactured).

6.3.6.1 Technical Solutions

The process of "cladding" consists of, among other things, soldering, brazing, and/or hot rolling base metals with precious metals. Those delegations that recognize the process of cladding may apply either a CTSH or a rule as follows: "Manufacture from metals clad with precious metals, unwrought." The latter drafting of the rules reflects the PSRO contained in the EPAs with the EU as reproduced below:

	Product description	Working or processing carried out on non-originating materials conferring originating status
Ex-7107, ex-7109, and ex-7111	Metals clad with precious metals, semi-manufactured	Manufacture from metals clad with precious metals, unwrought

6.3.7 *Issue 6: Heading 71.11*

Heading 71.11 covers "Waste and scrap of precious metal or of metal clad with precious metal; other waste and scrap containing precious metal or precious metal compounds, of a kind used principally for the recovery of precious metal."

Headings classifying waste and scrap have been the object of debates during the Seventh TWG Meeting negotiations. Many delegations expressed the view that the correct definition of wholly obtained as contained in paragraph 1, Annex 2, Article 5 of AfCFTA:

(j) used articles fit only for the recovery of Materials, provided that such articles have been collected therein;
(k) scrap and waste resulting from manufacturing operations therein;

Member states are yet to achieve a definitive consensus about the origin of waste and scrap of various headings.

6.3.7.1 Technical Solutions

A possible formulation for a technical solution could be as follows: "The origin of the goods shall be the country in which the waste and scrap of this heading are derived from manufacturing or processing operations of consumption."

6.4 DRAFTING THE SUBSTANCE OF PSRO: AN INPUT–OUTPUT METHODOLOGY

6.4.1 *Advantages and Disadvantages of Using an Input–Output Methodology for Drafting PSRO*

As discussed in Chapter 1 of this book and section 6.2.2, there is convergence in the use of CTC as the preferred form of drafting PSRO. Obviously, such tendency is not universal. In the majority of free-trade agreements, CTC is not used as a unique criterion as it is usually accompanied by the use of ad valorem percentage in

defining PSRO. In the majority of free-trade agreements we find that, while the CTC is widely adopted, many PSRO still use the percentage requirement as a unique criterion or as an alternative to the CTC method.

As discussed in Chapter 4, almost all of the studies and literature have focused on the impact and/or an assessment of the rules of origin in free-trade agreements. However, there is hardly a study that has focused on or indicated how to draft rules of origin and more specifically PSRO.

The aim of this section is to fill such a conspicuous gap in the literature by proposing a methodology to draft PSRO using an input–output methodology based on the structure of the HS.

It has to be clarified that such methodology is a tool to assist governments and industries involved in the negotiations of a free-trade agreement or assessing the PRSO contained in such an agreement. It is not a substitute for direct public–private consultations or other tools that may be used in conjunction with this methodology.

The use of the input–output analysis made in this section should not be confused with input–output tables used by the Organisation for Economic Co-operation and Development (OECD) in the Trade in Value Added (TiVA).

In fact, the major difficulty in using such input–output for RoO purposes is the level of aggregation, since even the most sophisticated tool produced by OECD at the moment only covers a limited number of industrial sectors. Moreover, the individual input–output matrices are derived from national accounts and are not able to reflect the fundamental question in drafting; namely, how the intermediate consumption of an industry in country A is used as an output in country B for manufacturing finished products for export.

As outlined in Figure 6.1 input–output tables are designed to measure the interrelationships between the producers of goods and services (including imports) within an economy and the users of these same goods and services (including exports). In so doing, these input–output tables use goods and services used in manufacturing without necessarily making a distinction if these goods and services are "originating." The OECD has further refined its input–output tables using bilateral trade statistics to cover such a gap. However, the industry-level of detail used is not sufficiently disaggregated for the purpose of drafting rules of origin.

International input–output tables have been used lately for the analysis of global supply chains when assessing the import content of exported goods. The OECD and the WTO joined forces to produce new estimates of international trade in value added; that is, measured in value-added instead of gross terms. This OECD–WTO initiative on TiVA aims at providing solid evidence to underpin the identification of policy issues and responses in an era of global value chains. However, the level of aggregation of these tables makes them unsuitable for an analysis of the impact of rules of origin that are set at a much-disaggregated level.[55]

[55] See www.oecd.org/sti/ind/input-outputtables.htm.

Symmetric *industry-by industry* I-O table	Intermediate demand			Final expenditure			Direct purchases abroad	Output (bp)
	Industry 1	…	Industry 36	Domestic demand	Cross-border exports	Direct purchase by non-residents		
Industry 1 (domestic, bp)								
…								
Industry 36 (domestic, bp)								
Product 1 (imports, bp)								
…	A			B	C	D	E	
Product 36 (imports, bp)								
Tax less subsidies in intermediate and final imported products								
Tax less subsidies in intermediate and final products paid in the domestic territory								
Total intermediate / final expenditure (pu)								
Value-added (bp)								
Output (bp)								

GDP (expenditure approach)
GDP (output approach)
pu: purchasers' prices
bp: basic prices

A: Imports of intermediate products
B: Imports of final products
C: Re-imports and re-exports
D: Imported products for non-residents expenditures
E: Direct purchases abroad of foreign products by residents

Imports are valued at basic prices of the country of origin; i.e. the domestic and international distribution included in goods imports in CIF purchasers' prices are reallocated to trade, transport, and insurance sectors of foreign and domestic industries.

FIGURE 6.1 Format of OECD harmonized national input–output tables

The present methodology is based on the construction of ad hoc input–output tables at product-specific level using the HS.

Figure 6.2 depicts the major challenges when drafting or assessing PSRO in a free-trade agreement; that is, the identification of non-originating inputs imported from third parties (rest of the world – RoW) that are incorporated in a final product to manufacture a finished product for exports to an FTA partner.

For certain products like canned meat, to design an input–output table is a relatively easy exercise since the inputs are the deboned meat, salt, colorants and preservatives, and the aluminum can.

These inputs are clearly defined and transparent. For other products like a computer or an airplane, which are made of thousands of parts and subcomponents, it is rather obvious that the task is much more complex, entailing the difficult

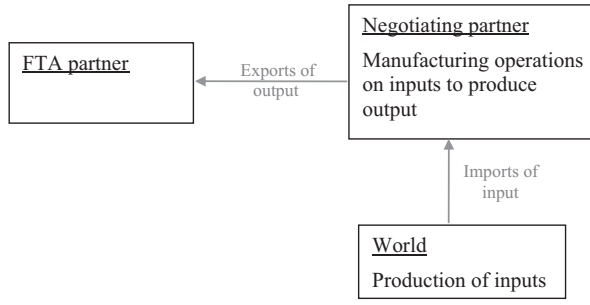


FIGURE 6.2 Depicting input–output matrix

exercise of detecting and identifying what are these hundreds and thousands of subcomponents used in the production process.

The input–output methodology developed by the author[56] is based on the structure of the HS, which is a multipurpose customs nomenclature used to classify the goods, levy customs duties, and to compile trade statistics.[57] As discussed earlier, while originally conceived as a customs nomenclature, the HS has been widely used to draft product-specific, highly sophisticated rules of origin starting from the NAFTA experience. It has also been adopted as the preferred method to draft PSRO in the context of the HWP carried out under the WTO's ARO. The underlying nature of the HS is based on industrial processes, starting from agricultural products classified in HS chapters (1–24) to industrial products (25–97) and ranging from the simplest manufacturing to the most sophisticated process.

The CTC of one product to another HS chapter, heading of the HS, or subheading is caused by an industrial process; namely, by moving from Chapter 1 "Live animals" to Chapter 2 "Meat," the process of slaughtering has taken place and from Chapter 2 to Chapter 16 the meat has been processed into canned beef.

The six-digit level of detail of the HS subheading permits focusing on specific products and their components. A further example is canned tuna of heading 16.04, which can be manufactured from fresh tuna of albacore classified in HS subheading 0302.31, and from the tin of HS subheading 731010 and the olive oil of HS subheading 150910.

[56] See S. Inama, "Made in China or made in Tlon? The quest for a new origin concept measuring international trade," GTAP, presented at the Sixteenth Annual Conference on Global Economic Analysis, Shanghai, China, 2013.

[57] This section draws from the study "Transatlantic value chains with Swiss participation and rules of origin: Is trade creation dominating trade diversion?," Study established on behalf of State Secretariat for Economic Affairs SECO, July 2014.

TABLE 6.16 *Description of input–output methodology based on HS classification*

(1) HS heading or subheading description (Output)	(2) Principal input	(3) CTC manufacturing processes	(4) Change within the heading (CWH)	(5) CWH manufacturing processes
0201 – Meat of bovine animals, fresh or chilled 0202 – Meat of bovine animals, frozen 0203 – Meat of swine, fresh, chilled, or frozen	Fresh or chilled meats and offal from live animals of Chapter 1 Frozen meats or offal from live animals of Chapter 1 or from fresh and chilled meats of this chapter	Slaughtering animals and/or freezing meats and offal	Yes	Freezing meats and offal
0209 – Pig fat, free of lean meat, and poultry fat, not rendered or otherwise extracted, fresh, chilled, frozen, salted, in brine, dried or smoked.	Pig meat of 02.03 or poultry meat of 02.07	Obtained by separating fat from the animal	Yes	Freezing, salting, smoking, preserving in brine
0210 – Meat and edible meat offal, salted, in brine, dried or smoked, edible flours and meals of meat or meat offal	Meat of this HS chapter	Preservation of meat of this chapter by salting, drying, and putting in brine	Yes	Reducing to meals of flours

Table 6.16 shows examples of how the input–output table has been developed for a relatively simple product such as pig meat and pig fat. For each output in column 1 principal input materials and the corresponding HS classification has been identified. Column 3 describe the manufacturing to be carried out on the materials of column 2 to obtain the output of column 1. Column 3 identifies if there is a possibility of a change within the heading due to manufacturing; that is, a CTSH

caused by manufacturing. Column 4 describes the manufacturing processes that can cause a change within the heading.

According to the example provided in Table 6.16, an excel table covering all sub-headings of the HS chapter has been developed, counting 5,386 observations. The process of elaborating an input–output table on the basis of the HS has entailed the following steps:

(1) examination of all HS headings to determine from what other HS headings or HS subheadings a CTC is possible as contained in column 2
(2) identification of the manufacturing process determining the change of tariff classification
(3) examination of the content of each heading to determine if a change within the heading due to a manufacturing process is possible
(4) identification of the manufacturing process that may cause a change within the heading.

The second important challenge is to match the input–output table so obtained containing the 5,386 observations with the trade flows of FTA partners at HS heading level of disaggregation.

As in any methodology there is a series of caveats and limitations that have to be taken into account. First, it has to be taken into account that the HS has been conceived as a customs classification nomenclature and not for drafting rules of origin or analytical purposes.

Thus, in a number of areas, the logic of industrial processes is not followed and the structure of the HS does not reflect coherently such processes. The most important area is machinery and electronics. In a number of cases the assembly of parts of machinery and electronic articles into finished products is reflected in the HS when parts are classified in a different heading or subheading of the finished products. However, at times, parts are classified in the same heading of the finished products. In these cases, adjustment have to be made to the HS, drawing from the lessons learned in drafting rules of origin in the harmonization work of nonpreferential rules of origin conducted in the WTO.

The input–output methodology creates an input–output table of triangular trade flows where an FTA partner country A is importing non-originating inputs from the RoW to manufacture finished products to be exported to FTA partner country B.

The input–output table so elaborated provides specific indications at disaggregated level of the triangular trade among inputs from the RoW and FTA partner A outputs as exports to FTA partner B. In so doing, the methodology provides a clear indication at detailed HS heading and subheading level of the inputs imported from the RoW that could be used or could be incorporated in finished products exported to partner B.

An important limitation of the methodology is that it provides a static overview; that is, it provides an analysis based on current and past trade flows. It does not

simulate and predict what could be the possible interindustry sourcing changes that may be generated by the free-trade agreement and/or its PSRO.

Another limitation is the fact that at the present stage of development the methodology does not identify the sourcing policy of a given enterprise based in partner country A that is manufacturing finished products using inputs from the RoW.

In fact, even if the trade flows may indicate that a certain input is imported from the RoW by FTA partner country A and a corresponding output is exported to FTA partner B, there is no assurance that such input is de facto used in the manufacturing of that output that is figuring in the trade flows from FTA partner country A to FTA partner country B. In order to do this, firm-level data would be needed or another methodological tool based on existing data should be further elaborated.

As an example, steering wheels are exported from the RoW to FTA partner country A, which exports finished cars to FTA partner country B. Even if one may suppose that these steering wheels imported from the RoW are incorporated in the cars exported to FTA partner country B, there is no definitive answer other than the sourcing policy of the individual firm to validate such finding. In fact different scenarios may be envisaged from the one mentioned above: a firm in FTA partner country A may be using the RoW-made steering wheels to simply re-export them to FTA partner country B; the RoW-made steering wheels are incorporated into car models sold in the FTA partner country A market or are incorporated in cars that are exported to other markets but not to FTA partner country B, etc. In reality the source policy of firms can only be detected through firm-level data or questionnaires and analytical review of the results.

One important aspect of the methodology is that it should be used as a tool to be further refined discussed and contrasted with a number of sample firms representative of the sectors to validate and corroborate the findings of the input–output analysis.

As further discussed in this section, the input–output spreadsheet that is the preliminary outcome of the analysis should be used during consultations with firms and/or associations of manufacturers.

In fact, it is only with such input–output analysis at hand that an in-depth firm survey could be conducted leading to meaningful results. This methodology has the merit of clearly delimiting what kind of sectors and industries may be most affected by a free-trade agreement and the specific products that could be used as inputs and are imported from the RoW. This is exactly the kind of information that is needed to carry out a meaningful field survey on a manageable sample of enterprises. Moreover, this exercise will be useful not only in the context of a single free-trade agreement but also for other negotiation scenarios. Once the sourcing policy of the most representative firms in a country is clearly depicted it is much easier to contrast it with other possible PSRO or RoO scenarios. This is exactly the experience of administrations such as the United States, the EU, and Japan, which have already gained expertise in negotiating an increasing number of free-trade agreements.

Another important aspect of the methodology is that it has to accompany a text-based review of the previous PSRO and other RoO provisions contained in the previous free-trade agreements that have been negotiated by the partner country. Such text-based analysis would provide a spectrum of the possible options that the partner may consider in drafting PSRO.

As discussed in the first edition of the book of 2009,[58] the input–output analysis according to an initial version of this methodology was first applied in the case of EU GSP for ASEAN LDCs in 1998, for the SADC Trade Protocol in 2001, and the ASEAN–China FTA agreement in 2005.

The first in-depth application of the input–output methodology using the complete detailed HS heading input–output table with 1,479 observations has been applied in a study (hereinafter "the study")[59] concerning the negotiations of the TTIP between the EU and United States. This study was carried out on a former version of the input-output at HS heading level and not using the more sophisticated and disaggregated input-output table with 5386 observation at HS subheading level. In this scenario there was concern that the free-trade agreement and the rules of origin contained therein could cause a significant trade diversion effect to the detriment of Swiss industry, especially, but not uniquely, for chemical and automotive sectors and optical and precision instruments of Chapter 90.

The study was carried out in 2014. The source of the data dates back to 2011,[60] the latest available year at six-digit level of the COMTRADE database when the analysis started. The tariff data was extracted from UNCTAD/ITC/WTO common database.

The analysis was conducted by a sequenced approach to better identify the findings and to progressively narrow down the results of the analysis according to the following sequencing:

(1) The first step is to show the results of a heading-level input–output analysis combined with trade flows.
(2) A closer analysis has been conducted at subheading level of input–output among the chapters.[61] Given the amount of tariff lines and the

[58] See Chapter 5, section 5.4.3 on rules of origin in international trade, in the 2009 edition.

[59] The following paragraphs are excerpted and adapted from the study "Transatlantic value chains with Swiss participation and rules of origin" (fn. 57 above).

[60] In terms of trade flows, 2011 has been taken as reference year. However the whole period of the analysis has taken into consideration the trade flows of the latest three-year period covering 2009–2011.This means that the recurrence of continuous trade flows over the three-year period of the tariff lines selected here has been carried out; i.e. has microtome been the most exported tariff line from Switzerland to the EU for the latest three years?

[61] Given that the chapters selected in this study are complex and the movement from a heading or subheading of a given chapter to another heading or subheading of the same chapter may involve significant manufacturing, this second step of the analysis attempts to identify such occurrences. In so doing, the analysis does take into consideration materials and components of the same chapters that may be used in the manufacture of a specific product of the same chapter. For example, heading 2923 classifies ammonium salts and hydroxides that may be

complex matching involved,[62] only selected subheadings have been extracted.

(3) The selected heading and/or subheadings were matched with the corresponding PSRO contained in NAFTA, other relevant US-negotiated free-trade agreements and the EU–South Korea and the EU–Singapore FTA agreements.

(4) The individual findings or assumptions identified were, to the extent possible, validated and contrasted with phone interviews with associations of the industry concerned.[63]

A series of preliminary findings indicated: (1) Many chemicals were most-favored nation (MFN) duty free in the US market due to the Uruguay Round Agreement on Chemical Products.[64] This narrowed down the analysis to those subheadings where a positive MFN rate was applied. (2) The comparative text-based analysis of the PSRO contained in different EU agreements found that the PSRO contained in the EU–Switzerland FTA agreement were obsolete and that it was a priority for the Swiss Government to engage in consultations with the EU to update such PSRO.

Table 6.17 reproduces the results of the input–output table for Chapter 29 (organic chemicals).

For each HS chapter examined in the study and reproduced in the following tables, the results of the input–output tables have been examined excerpting, as a general rule, the headings showing the highest trade flows of EU exports to the United States and the highest trade flows of EU imports from Switzerland. These are the headings where it is most likely that the inputs imported from Switzerland may be used in manufacturing products in the EU for exports to the United States.

This choice was made for presentational purposes; that is, to be able to present a summarized table showing at heading level the results of the input–output table.

derived from ammonia of heading 2814 and other ketones of heading 2914. This second part of the analysis aims at first to detect whether ammonium salts of heading 2923 are exported from the EU to the United States and then to identify whether ketones of heading 2914 classified in the same chapter are exported from Switzerland to the EU. In so doing, this part of the analysis does not capture the fact that heading 2814 could also be used, since this has been already dealt with in the first part of the analysis under (1).

[62] This caveat holds especially true for Chapter 29, given the complexity of the chapter and the amount of chemical reactions that may take place among the different chemical compounds.

[63] In particular the following were consulted: Prof. Dr. A. Schulz, ETH Zurich Chair of Technology and Innovation Management, Swiss Center for Automotive Research (Swiss CAR) and Dr. E. Jandrasits, Trade Affairs, Science Industries Chemie-Pharma-Biotech. As explained earlier, it is strongly recommended to carry out a firm-level survey on the basis of the findings of this study.

[64] Often referred to as the "Pharma Agreement"; see www.wto.org/english/tratop_e/pharma_ag_e/pharma_agreement_e.htm.

TABLE 6.17 *Results of the input–output table for Chapter 29 (organic chemicals) – TTIP study*

	Total exports of EU to USA			Principal EU members contributing in exports (with their respective ISO3 codes and shares in total exports of the product)						Main inputs				Principal EU members contributing in imports (with their respective ISO3 codes and shares in total imports of the product)					
				1st destin.		2nd destin.		3rd destin.						1st supplier		2nd supplier		3rd supplier	
HS definition	Value (000 USD)	Share in all exports of HS chapter (%)	No. of exp. contrib. members	ISO3 code	Exp. share (%)	ISO3 code	Exp. share (%)	ISO3 code	Exp. share (%)	HS definition	Total EU imports from Switzerland (000 USD)	Total imports normalized (000 USD)	No. of imp. contrib. members	ISO3 code	Imp. share (%)	ISO3 code	Imp. share (%)	ISO3 Code	Imp. share (%)
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20
2902	367,970	1.5	14	NLD	69.9	GBR	9.5	DEU	4.7	2709, 2710	466,582	66,654	27	DEU	22.3	BEL	19.4	NLD	17.4
2903	179,454	0.7	13	DEU	41.7	NLD	19.6	BEL	16.5	2901, 2902, 2801	23,247	1,755	21	DEU	55.6	FRA	40.5	NLD	1.0
2904	35,115	0.1	11	FRA	21.0	POL	19.8	DEU	19.1	2901, 2902, 2802	22,987	1,668	21	DEU	55.5	FRA	40.9	NLD	1.0
2905	156,421	0.6	20	DEU	47.0	BEL	18.1	NLD	11.1	2901	4,263	328	17	DEU	77.9	FRA	15.4	NLD	3.1
2906	65,888	0.3	12	DEU	54.6	NLD	20.9	ESP	9.3	2902	18,711	1,337	20	DEU	50.3	FRA	46.7	ITA	1.1
2907	49,032	0.2	12	DEU	44.0	ESP	31.1	GBR	10.6	2707.10, 2902	39,423	5,479	20	NLD	45.6	DEU	31.1	FRA	22.2
2908	8,787	0.0	10	DEU	48.0	GBR	42.5	HUN	7.5	2907	91,918	6,128	14	DEU	54.6	FRA	15.6	GBR	9.3
2909	112,700	0.5	15	DEU	31.1	NLD	26.4	BEL	12.6	2907	91,918	6,128	14	DEU	54.6	FRA	15.6	GBR	9.3
2910	51,789	0.2	10	NLD	71.4	ITA	19.9	DEU	4.7	2909	11,236	1,021	23	DEU	29.7	GBR	20.1	SWE	17.4
2911	3,139	0.0	6	ESP	40.8	DEU	31.6	BEL	15.0	2912	37,259	2,329	17	DEU	45.4	FRA	21.2	GBR	12.7
2912	82,756	0.3	12	DEU	53.9	GBR	27.6	ESP	9.8	2207, 2208, 2905	49,049	9,578	26	DEU	36.2	NLD	16.4	FRA	15.2
2913	1,690	0.0	3	DEU	69.0	GBR	19.5	BEL	11.4	2912	37,259	2,329	17	DEU	45.4	FRA	21.2	GBR	12.7

(*continued*)

TABLE 6.17 (*continued*)

	Total exports of EU to USA			Principal EU members contributing in exports (with their respective ISO3 codes and shares in total exports of the product)						Main inputs				Principal EU members contributing in imports (with their respective ISO3 codes and shares in total imports of the product)					
				1st destin.		2nd destin.		3rd destin.						1st supplier		2nd supplier		3rd supplier	
HS definition	Value (000 USD)	Share in all exports of HS chapter (%)	No. of exp. contrib. members	ISO3 code	Exp. share (%)	ISO3 code	Exp. share (%)	ISO3 code	Exp. share (%)	HS definition	Total EU imports from Switzerland (000 USD)	Total imports normalized (000 USD)	No. of imp. contrib. members	ISO3 code	Imp. share (%)	ISO3 code	Imp. share (%)	ISO3 Code	Imp. share (%)
2914	218,771	0.9	16	NLD	41.2	DEU	29.9	FRA	10.1	2905	33,404	1,953	23	DEU	41.0	FRA	15.7	GBR	11.0
2915	236,218	1.0	16	DEU	43.1	NLD	22.9	BEL	12.9	2912, 20720, 290224, 290532, 290511	38,368	2,382	20	DEU	45.6	FRA	21.5	GBR	12.4
2916	249,259	1.0	16	BEL	36.1	DEU	32.1	GBR	12.5	2912, 20720, 290224, 290532, 290511	38,368	2,382	20	DEU	45.6	FRA	21.5	GBR	12.4
2917	112,759	0.5	13	NLD	46.5	ESP	14.1	ITA	13.0	2912,20720, 290224, 290532, 290511	38,368	2,382	20	DEU	45.6	FRA	21.5	GBR	12.4
2918	209,041	0.8	20	DEU	25.7	GBR	19.3	ITA	16.7	2912, 20720, 290224, 290532, 290511	38,368	2,382	20	DEU	45.6	FRA	21.5	GBR	12.4

2919	29,182	0.1	13	DEU	68.6	GBR	21.3	NLD	5.8	2905, 2906, 2907, 2918, 2917	348,598	21,520	27	DEU	41.4	FRA	20.7	GBR	12.0
2920	92,806	0.4	14	GBR	40.0	FRA	30.5	DEU	13.8	2905, 2906, 2907, 2918,2917	348,598	21,520	27	DEU	41.4	FRA	20.7	GBR	12.0
2921	307,489	1.2	21	BEL	40.1	DEU	22.3	ITA	15.0	2814	2,076	415	7	DEU	48.6	FRA	46.4	ITA	4.1
2922	1,688,364	6.8	19	IRL	58.1	GBR	26.0	DEU	5.1	2905, 2906, 2907, 2918, 2917	348,598	21,520	27	DEU	41.4	FRA	20.7	GBR	12.0
2923	5,711	0.2	14	CZE	40.2	DEU	18.9	NLD	17.8	2814, 2914	76,949	7,222	22	DEU	38.0	FRA	26.3	GBR	13.1
2924	275,786	1.1	16	PRT	29.2	DEU	27.8	BEL	13.5	2918, 2836	190,510	11,520	27	DEU	34.2	FRA	22.7	GBR	14.4
2925	74,953	0.3	11	ESP	49.5	DEU	26.7	FRA	16.8	2915, 2916, 2917, 2918, 2919	325,997	21,460	27	DEU	36.7	FRA	17.1	GBR	12.9
2926	141,272	0.6	12	GBR	55.1	DEU	17.3	NLD	17.0	2814, 2905	35,480	2,368	23	DEU	41.4	FRA	17.5	GBR	10.4
2927	20,152	0.1	7	IRL	60.9	BEL	13.7	FRA	13.2	2921, 2086	114,946	9,579	23	GBR	36.5	DEU	20.4	ESP	11.4
2928	35,722	0.1	11	ITA	69.7	ESP	10.8	HUN	9.9	2921, 2922, 2229	–	–	–	–	–	–	–	–	–
2929	53,017	0.2	15	DEU	66.2	BEL	23.9	GBR	3.9	2921, 2922,2229	519,266	46,335	25	DEU	39.3	ITA	24.6	GBR	11.0
2930, 2931	425,643	1.7	20	DEU	45.6	GBR	13.7	FRA	11.5	2802, 2701, 2709, 2710, 2711	495,467	72,432	27	DEU	22.6	BEL	18.2	NLD	16.4

(*continued*)

TABLE 6.17 (*continued*)

	Total exports of EU to USA			Principal EU members contributing in exports (with their respective ISO3 codes and shares in total exports of the product)						Main inputs				Principal EU members contributing in imports (with their respective ISO3 codes and shares in total imports of the product)					
				1st destin.		2nd destin.		3rd destin.						1st supplier		2nd supplier		3rd supplier	
HS definition	Value (000 USD)	Share in all exports of HS chapter (%)	No. of exp. contrib. members	ISO3 code	Exp. share (%)	ISO3 code	Exp. share (%)	ISO3 code	Exp. share (%)	HS definition	Total EU imports from Switzerland (000 USD)	Total imports normalized (000 USD)	No. of imp. contrib. members	ISO3 code	Imp. share (%)	ISO3 code	Imp. share (%)	ISO3 Code	Imp. share (%)
2932, 2933	8,721,013	35.4	22	IRL	41.3	BEL	25.8	GBR	17.8	2915, 2916, 2917, 2918, 2919	325,997	21,460	27	DEU	36.7	FRA	17.1	GBR	12.9
2934	7,167,795	29.1	22	IRL	61.4	GBR	23.3	BEL	5.8	2809, 2932, 2933	4,117,970	377,687	27	ITA	29.8	ESP	28.7	DEU	16.6
2935	1,345,028	5.5	12	IRL	76.7	GBR	9.2	BEL	7.3	2930	58,053	5,278	18	GBR	28.3	FRA	25.2	DEU	22.2
2936	85,122	0.3	15	ITA	33.1	DEU	16.1	FRA	15.1	2905, 2906, 2915, 2916, 2917, 2918	378,168	24,737	27	DEU	36.9	FRA	18.4	GBR	12.5
2937	771,231	3.1	16	SWE	38.5	GBR	31.8	ITA	5.8	29	13,265,675	1,193,626	27	DEU	28.1	ITA	25.8	AUT	12.9
2939	365,508	1.5	13	DEU	82.1	GBR	5.5	ITA	3.7	29	13,265,675	1,193,626	27	DEU	28.1	ITA	25.8	AUT	12.9
2940	55,886	0.2	16	DEU	36.1	AUT	24.3	FRA	8.7	1702	3,045	381	22	DEU	40.6	NLD	21.1	FRA	15.8
2941	294,570	1.2	16	ITA	41.1	DNK	15.0	FRA	13.4	29	13,265,675	1,193,626	27	DEU	28.1	ITA	25.8	AUT	12.9

However, the detailed analysis, while starting from the results of the input–output tables at HS heading level, has been conducted at subheading or tariff lines level in order to:

(a) identify whether these subheadings are dutiable in the US market, and
(b) to better match the applicable PSRO.

Column 13 of the input–output table contains total imports *normalized*. The amounts shown in this column are the results of an assumption. Since imports of one heading of the HS may be used for manufacturing different products, the total amount of trade under that heading is split among the different headings of the whole HS where that heading is indicated as a possible heading to be used as input for a finished product. For example, HS heading 2907 can be used to manufacture products of subheadings of 2907, and headings of 2908 and 2909. Since it is not possible to apportion the amount of imports to one heading instead of another, the total imports for heading 2907 are split by default among those headings where heading 2907 can be used as an input.

Table 6.17 summarizes the most important headings showing considerable trade flows in terms of input from Switzerland and output from the EU to the United States.

2902: Cyclic hydrocarbons
2922: Oxygen-function amino-compounds
2924: Carboxyamide-function compounds; amide-function compounds of carbonic acid
2932 and 2933: Heterocyclic compounds
2934: Nucleic acids and their salts, whether or not chemically defined; other heterocyclic compounds
2937: Hormones, prostaglandins, natural or reproduced by synthesis; derivatives and structural analogues thereof, including chain modified polypeptides, used primarily as hormones.

This preliminary analysis demonstrated that all the subheadings of heading 2902 are MFN duty free in the US Tariff Schedule. Thus, these subheadings have not been a further object of observation in the study.

Conversely, various subheadings of heading 2922, like subheading 292250 (amino-alcohol/acid-phenols; amino-compounds with oxygen function, nes[65]) were found to be dutiable with an MFN rate of 6.5 percent.

Further analysis at subheading level among those classified in heading 2922 found that subheading 292250 turned out to be fourth most exported subheading from the EU to the United States at subheading level with a significant amount of possible trade inputs from Switzerland, as shown in Table 6.17.

[65] nes = not elsewhere specified.

At the same time, NAFTA sets a PSRO at subheading level 292250 as follows:

> (A) A change to subheading 2922.50 from any other heading, except from headings 2905 through 2921; or (B) A change to subheading 2922.50 from any other subheading within heading 2922 or headings 2905 through 2921, whether or not there is also a change from any other heading, provided there is a regional value content of not less than: (1) 60 percent where the transaction value method is used, or (2) 50 percent where the net cost method is used.

The result of this cross-analysis between the results of the input–output table, where a series of subheadings and headings was identified, was contrasted with the corresponding PSRO contained in various free-trade agreements signed by the United States and the EU as shown in Table 6.18 containing a comparison of relevant PSRO applicable.

TABLE 6.18 *Comparative PSRO applicable to selected headings and subheading of HS Chapter 29*

Headings and subheadings	NAFTA	US–Singapore[i]	US–Korea	EU–South Korea	EU–Switzerland
2922 2922.50 2922.19[ii] 2922.49[iii]	(A) A change to subheading 2922.50 from any other heading, except from headings 2905 through 2921; or (B) A change to subheading 2922.50 from any other subheading within heading 2922 or headings 2905 through 2921, whether or not there is also a change from any other heading,	A change to subheading 2922.11 through 2922.50 from any other subheading, including another subheading within that group.	A change to subheadings 2920.10 through 2926.90 from any other subheading.	Manufacture from materials of any heading, except that of the product. However, materials of the same heading as the product may be used, provided that their total value does not exceed 20% of the ex-works price of the Product or Manufacture in which the	Manufacture from materials of any heading, except that of the product. However, materials of the same heading as the product may be used, provided that their total value does not exceed 20% of the ex-works price of the Product or Manufacture in which the

TABLE 6.18 (*continued*)

Headings and subheadings	NAFTA	US–Singapore[i]	US–Korea	EU–South Korea	EU–Switzerland
	provided there is a regional value content of not less than: (1) 60% where the transaction value method is used, or (2) 50% where the net cost method is used.			value of all the materials used does not exceed 50% of the ex-works price of the product.	value of all the materials used does not exceed 40% of the ex-works price of the product.

[i] As in the case of the US–CAFTA FTA agreement, the following chapter rules of origin apply for Chapter 29: Chapter Rule 1: "Any good of Chapter 29 that is a product of a chemical reaction, as defined in subdivision (n)(v) of this note, shall be considered to be an originating good if the chemical reaction occurred in the territory of Singapore or of the United States." Subdivision (n)(v) provides as follows:

For purposes of applying this note to goods of chapters 27 through 40, inclusive, of the tariff schedule, a "chemical reaction" is a process (including a biochemical process) which results in a molecule with a new structure by breaking intramolecular bonds and by forming new intramolecular bonds, or by altering the spatial arrangement of atoms in a molecule. The following are not considered to be chemical reactions for purposes of this note:
(A) dissolving in water or other solvents;
(B) the eliminating of solvents including solvent water; or
(C) the addition or elimination of water of crystallization.
A chemical reaction as defined above is considered to result in an originating good for purposes of this note. Notwithstanding any of the change of tariff classification rules of subdivision (o) of this note, this "chemical reaction rule" may be applied to any good classified in chapters 28 through 40, inclusive.

[ii] The following is the NAFTA PSRO for 2922.19: "(A) A change to subheadings 2922.14 through 2922.19 from any other heading, except from headings 2905 through 2921; or (B) A change to subheadings 2922.14 through 2922.19 from any subheading outside that group within heading 2922 or headings 2905 through 2921, whether or not there is also a change from any other heading, provided there is a regional value content of not less than: (1) 60 percent where the transaction value method is used, or (2) 50 percent where the net cost method is used."

[iii] A change to subheading 2922.44 through 2922.49 from any other heading, except from heading 29.05 through 29.21; or A change to subheading 2922.44 through 2922.49 from any subheading outside that group within heading 29.22 or heading 29.05 through 29.21, whether or not there is also a change from any other heading, provided there is a regional value content of not less than: (a) 60 percent where the transaction value method is used, or (b) 50 percent where the net cost method is used.

The cross-analysis of the results of the input–output table with the comparative PSRO used in various free-trade agreements identified what kind of implications may arise for Swiss producers in the case where similar PSRO under these agreements are applied in the context of the TTIP.

The following paragraphs are the result of the analysis and comparisons made at HS heading and subheading level.

HS 2922 50 Oxygen-function amino-compounds

As reported in Table 6.18, the NAFTA PSRO are the most restrictive and may cause some trade diverting effects since NAFTA rules exclude different headings that the input–output table has shown as possible inputs for manufacturing products classified in heading 2902. The PSRO in the US–Singapore and US–Korea FTA agreements are substantially more liberal than NAFTA as they allow CTSH. The PSRO in the EU agreements provide for a CTH that is less liberal than the CTSH in these later US agreements. It has to be noted that the EU–South Korea percentage (50 percent) is more liberal than that of EU–Switzerland (40 percent).

In the study, other subheadings or headings were identified by the input–output tables and the comparison analysis of PSRO as having possible trade diverting effects if certain PSRO of restrictive nature, like in many cases those of NAFTA, were to be adopted.

Another interesting case identified by the study concerned the automotive sector. As shown in Table 6.19, the input–output analysis identified heading 8708 as one of the most trade-intensive in terms of potential input–output trade.

Heading 8708 classifies parts and accessories of the motor vehicles of headings 87.01–87.05. In particular, heading 8708 is subdivided into many subheadings classifying the large majority of parts of motor vehicles as follows:

Parts and accessories of the motor . . . :
- 8708.10 – Bumpers and parts thereof

Other parts and accessories of bodies (including cabs):
- 8708.21 – Safety seat belts
- 8708.29 – Other
- 8708.30 – Brakes and servo-brakes; parts thereof
- 8708.40 – Gear boxes and parts thereof
- 8708.50 – Drive-axles with differential, whether or not provided with other transmission components, and non-driving axles; parts thereof
- 8708.70 – Road wheels and parts and accessories thereof
- 8708.80 – Suspension systems and parts thereof (including shock-absorbers)

Other parts and accessories:
- 8708.91 – Radiators and parts thereof
- 8708.92 – Silencers (mufflers) and exhaust pipes; parts thereof
- 8708.93 – Clutches and parts thereof

TABLE 6.19 *Results of the input–output table for Chapter 87 – TTIP study*

	Total exports of EU to USA			Principal EU members contributing in exports (with their respective ISO3 codes and shares in total exports of the product)						Main inputs				Principal EU members contributing in imports (with their respective ISO3 codes and shares in total imports of the product)					
				1st destin.		2nd destin.		3rd destin.						1st supplier		2nd supplier		3rd supplier	
HS definition	**Value (000 USD)**	**Share in all exports of HS chapter (%)**	No. of exp. contrib. members	**ISO3 code**	**Exp. share (%)**	**ISO3 code**	**Exp. share (%)**	**ISO3 code**	**Exp. share (%)**	**HS definition**	Total EU imports from Switzerland (000 USD)	Total imports normalized (000 USD)	No. of imp. contrib. members	**ISO3 code**	**Imp. share (%)**	**ISO3 code**	**Imp. share (%)**	**ISO3 code**	**Imp. share (%)**
8701	955,605	2.5	12	DEU	42.1	GBR	24.3	FRA	18.3	8707, 8708, 8407, 8408	1,315,437	96,605	26	DEU	56.3	FRA	21.0	AUT	4.9
8702, 8703	27,994,516	72.1	25	DEU	70.6	GBR	14.1	BEL	4.0	8707, 8708, 8407, 8408	1,315,437	96,605	26	DEU	56.3	FRA	21.0	AUT	4.9
8704	520,200	1.3	19	GBR	61.1	DEU	32.9	FIN	3.7	8706, 8707, 8708, 8407, 8408	1,318,738	97,077	26	DEU	56.3	FRA	21.0	AUT	4.9
8705	337,916	0.9	15	DEU	89.4	NLD	5.1	AUT	1.1	8707, 8708, 8407, 8408	1,315,437	96,605	26	DEU	56.3	FRA	21.0	AUT	4.9
8706	6,248	0.0	7	DEU	83.5	GBR	8.1	CZE	5.9	8407, 8408	227,590	18,887	22	DEU	50.9	FRA	24.6	AUT	19.9

(*continued*)

TABLE 6.19 (*continued*)

	Total exports of EU to USA			Principal EU members contributing in exports (with their respective ISO3 codes and shares in total exports of the product)						Main inputs				Principal EU members contributing in imports (with their respective ISO3 codes and shares in total imports of the product)					
				1st destin.		2nd destin.		3rd destin.						1st supplier		2nd supplier		3rd supplier	
HS definition	**Value (000 USD)**	**Share in all exports of HS chapter (%)**	No. of exp. contrib. members	**ISO3 code**	**Exp. share (%)**	**ISO3 code**	**Exp. share (%)**	**ISO3 code**	**Exp. share (%)**	**HS definition**	Total EU imports from Switzerland (000 USD)	Total imports normalized (000 USD)	No. of imp. contrib. members	**ISO3 code**	**Imp. share (%)**	**ISO3 code**	**Imp. share (%)**	**ISO3 code**	**Imp. share (%)**
8707	308,656	0.8	17	DEU	85.9	ITA	6.2	AUT	2.2	73, 8707	2,731,149	87,748	27	DEU	47.0	FRA	11.2	AUT	8.4
8708	7,851,848	20.2	27	DEU	56.3	ITA	10.5	FRA	9.1	73, 8708	3,813,404	165,036	27	DEU	50.0	FRA	13.8	AUT	6.6
8709	26,773	0.1	13	DEU	31.3	FRA	20.7	SWE	17.8	8707, 8708, 8407, 8408, 8507, 8709	1,418,828	117,551	27	DEU	53.5	FRA	21.6	AUT	4.9
8710	8,908	0.0	3	DNK	99.1	SVK	0.6	POL	0.3	8707, 8708, 8407, 8408	1,315,437	96,605	26	DEU	56.3	FRA	21.0	AUT	4.9
8711	394,552	1.0	22	DEU	38.7	ITA	27.1	AUT	22.88	407, 8501, 8713, 8711	1,027,207	155,190	27	DEU	44.1	NLD	14.2	FRA	8.9
8713	8,149	0.0	12	SWE	60.0	DEU	22.7	ITA	6.7	8714, 8501	981,600	119,260	27	DEU	41.4	NLD	13.7	FRA	8.8

8708.94 – Steering wheels, steering columns and steering boxes; parts thereof
8708.95 – Safety airbags with inflater system; parts thereof
8708.99 – Other

The automotive sector manufacturing of components was one of the sectors where possible trade diverting effects were most possible, given the stringency of the NAFTA rules. A trade intensity analysis of heading 8708 using the input–output table at subheading further identified a number of subheadings where trade diverting effects were possible depending on the kind of PSRO that could be adopted in the TTIP.

HS 870899 Motor vehicle parts nes

The comparative analysis contained in Table 6.20 showed that the US–Korea PSRO for this subheading are far more liberal and less trade diverting than the other PSRO used in other free-trade agreements. By allowing a CTSH, it is possible to assemble parts classified in other subheadings of heading 8708 into parts classified in this subheading.

In simple words, under these PSRO, all Swiss parts of cars imported into the EU can be assembled into parts of this subheading and acquire originating status for exports to the United States under the TTIP. For example, Swiss parts classified in subheading 870829 (parts and accessories of bodies nes for motor vehicles) and subheading 870894 (steering wheels, steering columns, and steering boxes for motor vehicles) can be assembled in the EU and acquire originating status.

In comparison, both NAFTA and the US–Singapore FTA agreement do not allow such a CTSH and require in addition the compliance with an RVC of 50 percent with a net cost calculation and 30 percent with a build-up calculation. The EU PSRO require that 40 percent and 45 percent should not be exceeded out of the ex-works price, a rather restrictive approach for parts of cars. Apart from the PSRO under the US–Korea FTA agreement, all other PSRO for this subheading appear to have a potential trade diversion effect.

HS 870840 Transmissions for motor vehicles
HS 870850 Drive axles with differential for motor vehicles
HS 870829 Parts and accessories of bodies nes for motor vehicles

For all these abovementioned subheadings that are different parts of a car that could be incorporated into a car of HS heading 8703, the comments made for the HS subheading 870899 above were found valid. The US–Korea PSRO allowing a CTSH recognize as origin conferring an assembly operation of the parts classified into different subheadings into a different subheading. For instance, in the case of HS subheading 870895 classifying part of a steering wheel that can be assembled into a completed steering wheel of HS subheading 870894. The same, however, is not possible with HS subheading 870840, since parts of gearboxes and the finished gearbox are classified in the same HS subheading 870840. It may still however be

TABLE 6.20 *Comparative PSRO applicable to selected headings and subheading of HS Chapter 87*

Headings and subheadings	NAFTA	US–Singapore	US–Korea	EU–South Korea	EU–Switzerland
870899	(A) A change to subheading 8708.99 from any other heading; or (B) No required change in tariff classification to subheading 8708.99, provided there is a regional value content of not less than 50% under the net cost method.	(A) A change to subheading 8708.99 from any other heading; or (B) A regional value content of not less than 30% based on the build-up method, whether or not there is a change in tariff classification.	(A) A change to subheadings 8708.10 through 8708.99 from any other subheading; or (B) No change in tariff classification to a good of such subheadings is required, provided that there is a regional value content of not less than: (1) 35% under the build-up method; (2) 55% under the build-down method; or (3) 35% under the net cost method.	Manufacture from materials of any heading, except that of the product or Manufacture in which the value of all the materials used does not exceed 50% of the ex-works price of the product.	As above
870840	(A) A change to gear boxes of subheading 8708.40 from any other heading; (B) A change to gear boxes of subheading 8708.40 from any other good of subheading 8708.40 or	(A) A change to subheading 8708.40 from any other heading; or (B) A change to gear boxes of subheading 8708.40 from parts of subheading 8708.40 or	As above	As above	As above

	8708.99, whether or not there is also a change from any other heading, provided there is a regional value content of not less than 50% under the net cost method; (C) A change to any other good of subheading 8708.40 from any other heading; or (D) No required change in tariff classification to any other good of subheading 8708.40, provided there is a regional value content of not less than 50% under the net cost method.	from subheading 8708.99, whether or not there is also a change from any other heading, provided there is a regional value content of not less than 30% based on the build-up method.			
870850[i]	(A) A change to drive-axles with differential, whether or not provided with other transmission components, for vehicles of heading 8703, of subheading	(A) A change to subheading 8708.50 from any other heading, except from subheadings 8482.10 through 8482.80, or (B) A change to drive axles	As above	As above	As above

(*continued*)

TABLE 6.20 (*continued*)

Headings and subheadings	NAFTA	US–Singapore	US–Korea	EU–South Korea	EU–Switzerland
	8708.50 from any other heading, except from subheadings 8482.10 through 8482.80; (B) A change to drive-axles with differential, whether or not provided with other transmission components, for vehicles of heading 8703, of subheading 8708.50 from subheadings 8482.10 through 8482.80 or parts of drive-axles of subheading 8708.50, whether or not there is also a change from any other heading, provided there is a regional value content of not less than 50% under the net cost method; (C) A change to other drive-axles with differential, whether or not provided with other transmission components, of subheading 8708.50 from any other heading.	with differential, whether or not provided with other transmission components or to non-driving axles of subheading 8708.50 from parts of subheading 8708.50 or from subheadings 8708.99 or 8482.10 through 8482.80, whether or not there is also a change from any other heading, provided there is a regional value content of not less than 30% based on the build-up method.			

870829	(A) A change to subheading 8708.29 from any other heading; or (B) No required change in tariff classification to subheading 8708.29, provided there is a regional value content of not less than 50% under the net cost method.	(A) A change to subheading 8708.29 from any other heading; or (B) A regional value content of not less than 30% based on the build-up method, whether or not there is a change in tariff classification.	(A) A change to subheadings 8708.10 through 8708.99 from any other subheading; or (B) No change in tariff classification to a good of such subheadings is required, provided that there is a regional value content of not less than: (1) 35% under the build-up method; (2) 55% under the build-down method; or (3) 35% under the net cost method.	As above	As above

[i] (D) A change to other drive-axles with differential, whether or not provided with other transmission components, of subheading 8708.50 from subheading 8708.99, whether or not there is also a change from any other heading, provided there is a regional value content of not less than 50 percent under the net cost method;
(E) A change to non-driving axles and parts thereof, for vehicles of heading 8703, of subheading 8708.50 from any other heading, except from subheadings 8482.10 through 8482.80;
(F) A change to non-driving axles and parts thereof, for vehicles of heading 8703, of subheading 8708.50 from subheadings 8482.10 through 8482.80 or 8708.99, whether or not there is also a change from any other heading, provided there is a regional value content of not less than 50 percent under the net cost method;
(G) A change to other non-driving axles and parts thereof of subheading 8708.50 from any other heading;
(H) A change to other non-driving axles and parts thereof of subheading 8708.50 from subheading 8708.99, whether or not there is also a change from any other heading, provided there is a regional value content of not less than 50 percent under the net cost method;
(I) A change to any other good of subheading 8708.50 from any other heading; or
(J) No required change in tariff classification to any other good of subheading 8708.50, provided there is a regional value content of not less than 50 percent under the net cost method.

possible to use materials classified in other HS subheadings such as 870899. The same would not have been possible in the case of NAFTA or the US–Singapore FTA agreements unless the RVC content is complied with as specified in Table 6.20.

Finally, the results of the input–output table shown in Table 6.21 identified a number of subheadings in HS Chapter 90 (optical, photographic, cinematographic, measuring, checking, precision, medical or surgical instruments and apparatus; parts and accessories).

HS 902790 Microtomes; parts & access of instruments and apparatus for physical or chemical analysis, nes

Microtomes[66] were found to be the second most exported heading of Swiss products to the EU. As mentioned in the above description of this subheading, parts of microtomes and the finished machinery are classified within the same subheading. All the PSRO contained in Table 6.22 based on a CTC method of drafting PSRO require a CTH. It follows that under all US and EU free-trade agreement PSRO assembly of parts of microtomes into a finished microtome is not origin conferring. These PSRO may be quite trade diverting if Swiss parts of microtomes are assembled in the EU and exported to the United States. Only the US–South Korea FTA agreement relies on an exclusive CTC rule based on a CTH still not permitting such assembly of parts into the finished microtome. All other PSRO require either a CTH or a percentage requirement. Such percentage may be quite demanding and generate trade diversion effects. The EU percentage under the EU–South Korea has been raised up to 50 percent from the 40 percent requirement of the EU–Switzerland FTA agreement.

HS 903180 Measuring or checking instruments, appliances and machines, nes

This subheading comprises the most exported Swiss products to the EU and the second most exported dutiable product from the EU to the United states. Parts of this HS subheading classified in 903190 are also the fourth most exported product of Switzerland to the EU.

Parts of HS subheading 903180 are classified in subheading 903190. It follows that the US–Singapore FTA agreement with a CTSH PSRO provides for the most lenient rule recognizing assembly operations of parts into a complete article as an origin-conferring operation. All other PSRO demand a CTH or a CTSH combined however

[66] A microtome (from the Greek *mikros*, meaning "small," and *temnein*, meaning "to cut") is a tool used to cut extremely thin slices of material, known as sections. Important in science, microtomes are used in microscopy, allowing for the preparation of samples for observation under transmitted light or electron radiation. Microtomes use steel, glass, or diamond blades depending upon the specimen being sliced and the desired thickness of the sections being cut. Steel blades are used to prepare sections of animal or plant tissues for light microscopy histology. Glass knives are used to slice sections for light microscopy and to slice very thin sections for electron microscopy. Industrial-grade diamond knives are used to slice hard materials such as bone, teeth, and plant matter for both light microscopy and for electron microscopy. Gem-quality diamond knives are used for slicing thin sections for electron microscopy. Excerpted from Wikipedia.

TABLE 6.21 *Results of the input–output table for HS Chapter 90*

	Total exports of EU to USA		No. of exp. contrib. members	Principal EU members contributing in exports (with their respective ISO3 codes and shares in total exports of the product)						Main inputs				Principal EU members contributing in imports (with their respective ISO3 codes and shares in total imports of the product)					
				1st destin.		2nd destin.		3rd destin.						1st supplier		2nd supplier		3rd supplier	
HS definition	Value (000 USD)	Share in all exports of HS chapter (%)		ISO3 Code	Exp. share (%)	ISO3 code	Exp. share (%)	ISO3 code	Exp. share (%)	HS definition	Total EU imports from Switzerland (000 USD)	Total imports normalized (000 USD)	No. of imp. contrib. members	ISO3 code	Imp. share (%)	ISO3 code	Imp. share (%)	ISO3 code	Imp. share (%)
9001	710,564	2.7	26	GBR	45.9	IRL	21.5	DEU	21.2	39.70	5,062,157	724,892	27	DEU	47.6	FRA	10.5	ITA	10.4
9002	242,622	0.9	24	DEU	53.2	NLD	19.1	GBR	10.4	9001	202,769	12,673	26	DEU	67.8	FRA	12.0	AUT	6.0
9003	302,052	1.1	18	ITA	68.9	AUT	10.9	FRA	8.3	39,70	5,062,157	724,892	27	DEU	47.6	FRA	10.5	ITA	10.4
9004	550,258	2.1	23	ITA	92.3	FRA	4.6	DEU	1.6	9001, 9003	236,087	23,779	26	DEU	63.7	FRA	15.1	AUT	5.6
9005	55,650	0.2	23	DEU	52.9	AUT	33.4	ITA	5.0	9001, 9002	238,724	15,439	27	DEU	68.9	FRA	11.1	AUT	5.3
9006	98,623	0.4	26	ITA	36.6	DEU	13.6	SWE	12.4	9001, 9002	238,724	15,439	27	DEU	68.9	FRA	11.1	AUT	5.3
9007	42,597	0.2	19	GBR	53.0	DEU	26.2	ITA	4.8	9001, 9002, 8519,	247,562	17,206	27	DEU	68.0	FRA	11.3	AUT	5.2
9008	7,183	0.0	16	ITA	35.9	GBR	35.7	DEU	19.9	9001, 9002	238,724	15,439	27	DEU	68.9	FRA	11.1	AUT	5.3
9010	26,350	0.1	17	DEU	26.2	DNK	22.3	FRA	21.7	9001, 9002	238,724	15,439	27	DEU	68.9	FRA	11.1	AUT	5.3
9011	190,367	0.7	16	DEU	91.9	NLD	2.3	GBR	2.0	9001, 9002, 9006, 7326, 7626	698,453	35,770	27	DEU	56.5	FRA	11.3	AUT	8.4
9012	198,705	0.7	18	CZE	36.7	NLD	33.4	DEU	16.3	9001, 9002, 9006	271,222	23,563	27	DEU	64.3	FRA	11.0	AUT	5.3
9013	662,452	2.5	26	DEU	40.3	GBR	40.0	SWE	7.7	9001, 9002	238,724	15,439	27	DEU	68.9	FRA	11.1	AUT	5.3
9014	610,570	2.3	23	GBR	32,3	FRA	29.3	DEU	19.6	9001, 9002	238,724	15,439	27	DEU	68.9	FRA	11.1	AUT	5.3

(*continued*)

TABLE 6.21 (*continued*)

	Total exports of EU to USA		No. of exp. contrib. members	Principal EU members contributing in exports (with their respective ISO3 codes and shares in total exports of the product)						Main inputs				Principal EU members contributing in imports (with their respective ISO3 codes and shares in total imports of the product)					
				1st destin.		2nd destin.		3rd destin.						1st supplier		2nd supplier		3rd supplier	
HS definition	Value (000 USD)	Share in all exports of HS chapter (%)		ISO3 Code	Exp. share (%)	ISO3 code	Exp. share (%)	ISO3 code	Exp. share (%)	HS definition	Total EU imports from Switzerland (000 USD)	Total imports normalized (000 USD)	No. of imp. contrib. members	ISO3 code	Imp. share (%)	ISO3 code	Imp. share (%)	ISO3 code	Imp. share (%)
9015	645,668	2.4	25	GBR	40.1	DEU	23.7	FRA	21.3	9001, 9002, 9015	435,608	81,067	27	DEU	63.4	FRA	9.9	GBR	4.9
9016	15,993	0.1	12	DEU	75.6	ITA	11.9	GBR	7.5	7013, 7020, 7326, 7616, 9016	847,545	52,875	27	DEU	44.2	FRA	11.1	AUT	10.8
9017	38,208	0.1	25	DEU	34.9	GBR	25.2	NLD	24.7	4421, 3926, 3917, 73, 9017	3,885,018	243,784	27	DEU	50.1	FRA	9.7	ITA	8.5
9018	6,574,931	24.6	27	DEU	37.1	IRL	27.7	NLD	8.7	73, 9001, 9002, 3926, 9018	5,269,902	725,682	27	DEU	48.6	FRA	9.5	ITA	7.9
9019	209,788	0.8	24	DEU	40.3	IRL	38.6	GBR	6.5	73, 3926, 9019	3,426,017	175,190	27	DEU	48.4	FRA	10.5	ITA	7.9
9020	86,682	0.3	19	GBR	40.1	DEU	29.7	FRA	16.7	4014, 4016, 3926, 7326, 7626, 9020	1,190,697	145,338	27	DEU	54.0	FRA	8.6	AUT	8.0
9021	4,849,281	18.1	26	IRL	49.7	DEU	14.1	BEL	13.6	7326, 3926, 9021	4,827,793	1,334,163	27	DEU	34.9	NLD	23.5	BEL	10.2

9022	2,782,056	10.4	21	DEU	49.2	NLD	21.1	FRA	13.9	7326, 7626, 9022	593,961	67,783	27	DEU	46.5	FRA	11.7	AUT	8.2
9023	110,958	0.4	21	GBR	29.2	DEU	27.0	SWE	12.0	9023	27,414	9,138	27	DEU	29.2	FRA	27.2	GBR	10.2
9024-9031	6,320,870	23.6	27	DEU	45.3	GBR	21.4	FRA	5.7	84,85, 9024–9031	26,612,657	6,492,003	27	DEU	46.3	FRA	10.6	ITA	7.5
9032	1,292,318	4.8	25	DEU	59.0	GBR	10.1	AUT	7.3	90,84, 85, 9032	33,444,996	8,756,634	27	DEU	44.3	FRA	10.2	NLD	7.7
9033	121,085	0.5	25	GBR	38.3	DEU	28.1	FRA	5.5	84,85, 9033	24,140,834	5,668,062	27	DEU	45.5	FRA	10.4	ITA	7.6

TABLE 6.22 *Comparative PSRO applicable to selected headings and subheading of HS Chapter 90*

Headings and subheadings	NAFTA	US–Singapore	US–Korea	EU–Switzerland	EU–South Korea
902790	(A) A change to subheading 9027.90 from any other heading; or (B) No required change in tariff classification to subheading 9027.90, provided there is a regional value content of not less than: (1) 60% where the transaction value method is used, or (2) 50% where the net cost method is used.	(A) A change to subheading 9029.90 from any other heading, or (B) A regional value content of not less than 35% based on the build-up method or 45% based on the build-down method, whether or not there is a change in tariff classification.	A change to subheading 9027.90 from any other heading.	Manufacture in which the value of all the materials used does not exceed 40% of the ex-works price of the product.	Manufacture from materials of any heading, except that of the product or Manufacture in which the value of all the materials used does not exceed 50% of the ex-works price of the product.
903180	(A) A change to subheading 9031.80 from any other heading; or (B) A change to subheading 9031.80 from subheading 9031.90, whether or not there is	A change to subheading 9031.80 from any other subheading.	(A) A change to subheadings 9031.10 through 9031.80 from any other heading; (B) A change to coordinate	Manufacture in which the value of all the materials used does not exceed 40% of the ex-works price of the product.	Manufacture from materials of any heading, except that of the product or Manufacture in which the value of all the materials used does not

	also a change from any other heading, provided there is a regional value content of not less than: (1) 60% where the transaction value method is used, or (2) 50% where the net cost method is used.		measuring machines of subheading 9031.49 from any other good, except from bases and frames for the goods of the same subheading; or (C) A change to subheadings 9031.10 through 9031.80 from any other subheading, provided that there is a regional value content of not less than: (1) 35% under the build-up method, or (2) 45% under the build-down method.		exceed 50% of the ex-works price of the product.
902290	A change to tariff item 9022.90.05 from any other tariff item. (A) A change to subheading 9022.90	A change to subheadings 9022.19 through 9022.90 from any other subheading, including another	(A) A change to subheadings 9022.14 through 9022.90 from any other subheading; or	Manufacture: – from materials of any heading, except that of the product, and – in which the value of	As above

(*continued*)

TABLE 6.22 (*continued*)

Headings and subheadings	NAFTA	US–Singapore	US–Korea	EU–Switzerland	EU–South Korea
	from any other heading; or (B) No required change in tariff classification to subheading 9022.90, provided there is a regional value content of not less than: (1) 60% where the transaction value method is used, or (2) 50% where the net cost method is used.	subheading within that group.	(B) No change in tariff classification to a good of such subheadings is required, provided that there is a regional value content of not less than: (1) 35% under the build-up method, or (2) 45% under the build-down method.	all the materials used does not exceed 40% of the ex-works price of the product or Manufacture in which the value of all the materials used does not exceed 30% of the ex-works price of the product.	
903190	A change to subheading 9031.90 from any other heading.	(A) A change to subheading 9031.90 from any other heading, or	A change to subheading 9031.90 from any other heading.	Manufacture in which the value of all the materials used does not exceed 40% of the ex-	As above

		(B) A regional value content of not less than 35% based on the build-up method or 45% based on the build-down method, whether or not there is a change in tariff classification.		works price of the product.	
903289	A change to subheading 9031.90 from any other heading or (B) No required change in tariff classification to subheading 9032.90, provided there is a regional value content of not less than: (1) 60% where the transaction value method is used, or (2) 50% where the net cost method is used.	A change to subheadings 9032.10 through 9083.89 from any other subheading, including another subheading within that group.	(A) A change to subheadings 9032.10 through 9032.89 from any other heading; or (B) A change to subheadings 9032.10 through 9032.89 from any other subheading, provided that there is a regional value content of not less than: (1) 35% under the build-up method, or (2) 45% under the build-down method.	Manufacture in which the value of all the materials used does not exceed 40% of the ex-works price of the product.	As above

with an RVC requirement that may have a trade diverting effect in the case where the EU producers are not able to meet the RVC requirements when using Swiss parts.

HS 902290 Apparatus based on the use of X-rays or other radiations, nes; parts and accessories thereof

This subheading classifies parts and accessories of complete machinery of heading 9022. It is the first dutiable subheading exported from EU to the United States.

The US–Korea and US–Singapore FTA agreements allow CTSH, permitting the use of other subheadings of 9022. These PSRO appear to be quite lenient since they may allow assembly of parts from other subheadings of heading 9022. All other PSRO require a CTH or compliance with a percentage requirement that may lead to trade diverting effects.

HS 903190 Parts and accessories for measuring or checking instruments, appliances and machines nes

This subheading is the fourth most exported product from Switzerland to the EU and could be used as a component to manufacture machineries of HS subheading 903180.

The PSRO for this subheading all require a CTH or compliance with a percentage requirement. The CTH rules means that assembly of parts into parts classified in the same heading is not origin conferring. Thus, it may have trade diverting effects when Swiss parts classified in the same heading are used to manufacture parts that remain classified in the same heading.

HS 903289 Automatic regulating or controlling instruments and apparatus, nes

The US–Singapore PSRO are the most lenient rules allowing CTSH. In this case this means that assembly of articles of parts of subheading 903290 into complete article of 903289 is an origin-conferring operation. All other PSRO require a CTH that does not recognize assembly from parts as origin conferring or a percentage requirement. Besides the preliminary findings identified above the study found a number of critical headings and subheadings as discussed earlier where the adoption of NAFTA-inspired PSRO could have caused trade diversion effects for Swiss industry. Most importantly, the study identified the possible PSRO adopted by the EU and United States in other free-trade agreements after NAFTA that could have alleviated the possible trade diverting effects of NAFTA-inspired PSRO. It was up to the Swiss Government and Swiss industry to lobby the EU and US constituency for less trade diverting PSRO. In simple words, the study was able to provide a series of policy recommendation and technical arguments at product-specific level to respond to the concerns raised.

The methodology could also be used in conjunction with the results of the comparative study on convergence that has been discussed in Chapter 2 of this book since the comparative table on convergence or divergence on drafting PSRO provides valuable examples on how to draft PSRO, taking into account the findings of the input–output table. In fact, the combination of both methodologies could further strengthen the findings and results.

Years later, in 2016, a similar exercise was carried out for the Philippines Government, which was engaged in initial negotiations with the EU and RCEP partners in drafting PSRO. Table 6.23 presents a snapshot of the most exported products (column 1) by the Philippines to the EU and the principal inputs (column 3) according to the same layout of the abovementioned Swiss study. The complete tables were over 100 pages as they contained the input–output matrix for all products from HS Chapter 1 to Chapter 96. For the sake of brevity and to explain how the input–output tables work, only the most important products in terms of magnitude of trade flows are commented on.

Starting from the top of Table 6.23, one of the most exported dutiable products from Philippines to the EU was copra oil. The PSRO for copra oil mainly used by the EU were CTH and the raw materials were classified in heading 12.03 (copra), and copra oil is classified in heading 15.13 complying with the PSRO. Thus, one of the findings of the IO table was that even if non-originating copra was used from Papua New Guinea, as shown in Table 6.23, this was of no concern to the Philippines negotiators as the CTH rules usually inserted in the free-trade agreement were met.

Conversely the second product (preserved tuna), the third product (static converter), and the fourth product (parts of office machines) could be of concern for the Philippines negotiators since the IO tables showed that the Philippines was importing inputs from third countries as shown under the world imports column of Table 6.23 that could be used in the manufacture of such finished products and that compliance with EU PSRO could be problematic. The analysis of the results of the IO table with the convergence table on PSRO is conducted only on canned tuna while the analysis of other products is carried out in the context of the Korea–China FTA agreement.

Table 6.24 shows the PSRO for tuna products that the EU has been using in the previous free-trade agreements. None of the rules of origin shown in that table used in previous free-trade agreements was satisfactory to the Philippines since their canneries used fresh tuna imported from Papua New Guinea.

Hence as shown in Table 6.25 the Philippines negotiators had a series of negotiating options:

(1) seek a derogation subject to a quota to use non originating tuna, or
(2) negotiate different PSRO as depicted in Table 6.25 such as the PSRO used in US free-trade agreements that allow the use of non-originating tuna in manufacturing preserved tuna.

Given the extreme reluctance of the EU in relaxing the PSRO for fishery products,[67] probably option (1) could be the most practical. Yet Table 6.25 shows that other drafting possibilities exist, using the US drafting of PSRO for Chapter 16

[67] See L. Campling, "The global value chain in canned tuna, the international trade regime and implementation of Sustainable Development Goal 14," International Trade Working Paper 2016/22, Commonwealth Secretariat, London, 2016.

TABLE 6.23 *PHL exports to the EU (millions USD) and inputs suppliers (2015)*

Product HS and description		Dutiable exports to EU	Main inputs	World imports		Principal suppliers			
Column 1		2	3	Val.	Nor	ISO	%	ISO	%
Totals for all Dutiable Exports:		3,453.1	Totals for all Imports:	70,153.5			.		.
151311	Coconut (copra) oil, crude	451.1	1203	47.4	15.8	PNG	59.6	IDN	37.1
850440	Static converters	261.3	8504.90 – parts	117.6	11.8	CHN	39.3	UNS	17.2
160414	Tunas, skipjack & bonito (Sarda spp.), prepared/ preserved	123.6	0302.31; 0302.32; 0302.33; 0302.34; 0302.35; 0302.36; 0302.39; 0302.89; 0303.41; 0303.42; 0303.43; 0303.44; 0303.45; 0303.46; 0303.49; 0303.89; 0304.49; 0304.59; 0304.87; 0304.89; 0304.99; 0305.39; 0305.49; 0305.59; 0305.69	171.5	57.1	PNG	32.7	UNS	21.9
847340	Parts & accessories of the machines of 84.72	103.7	7207.11–7207.20 – semi-finished products (iron/steel); 7209.15 thr. 7209.90 – flat-rolled products, of (iron); 7215.10 and 7215.50 – bars and rods (iron/steel); 7218.91 and 7218.99 – semi-finished products (steel); 7219.31 thr. 7219.90 – flat-rolled products (steel); 7222.20 – bars and rods (steel); 7224.90 – semi-finished products (oth. alloy steel); 7225.11 thr. 7225.99 – flat-rolled products (oth. alloy steel); 7228.60 – bars and rods (oth. alloy steel); 7304.31 thr. 7304.39 – tubes and pipes (iron/steel); 8542.31 thr. 8542.39 – electronic integrated circuits	187.7	0.7	CHN	62.0	RUS	17.2

TABLE 6.24 *Rules of origin for canned tuna in EU free-trade agreements*[i]

HS 160414	EU–Vietnam	EU–Singapore	CETA	EU–Korea
Canned tuna	Manufacture in which all the materials of Chapter 2, 3 and 16 used are wholly obtained	Manufacture in which all the materials Chapters 2, 3 and 16 used are wholly obtained	A change from any other chapter, except from Chapter 3	Manufacture: – from animals of Chapter 1, and/or – in which all the materials of Chapter 3 used are wholly obtained

[i]See also Ch. 3 of this book for further details about possible PSRO variations in other EU FTAs.

drawing from the convergence/divergence tables mentioned in Chapter 1 of this book or singling out subheading 1604.14 concerning canned tuna rather than the whole heading 16.04 that covers an extreme variety of canned fish. Another option would be to follow the example set in this context by the African, Caribbean, and Pacific (ACP), which managed to negotiate global sourcing[68] or seek an extended

[68] See Article 6 of Protocol II Concerning the definition of the concept of "originating products" and methods of administrative cooperation of the Pacific EPA with the EU:

> The Parties recognise that since the Lomé Convention was signed in 1976, Pacific States have not been able to develop an adequate national fleet respecting the vessel conditions of Article 5.2 of the present Protocol II. The Parties also recognise the special circumstances of the Pacific States encompassing the insufficient wholly obtained fish to meet on-land demand, the very limited fishing capacity of the Pacific States' fishing fleet, the reduced processing capability due to physical and economic factors, the low risk of destabilising the EU market due to large inflows of fishery products from the Pacific States, the geographical isolation of the Pacific States as well as the distance to the EU market. The Parties also share the final goal of promoting further development in the Pacific States while promoting sustainable fisheries and good fisheries governance. (b) The Parties recognise the enormous importance of fisheries to the people of the Pacific States and that the fish, for example tuna in the Western and Central Pacific Ocean is the most important shared natural resource for long-term income and employment generation for the Pacific States. This shared fisheries resource in the waters of the Pacific States is subject to various management regimes at regional, sub-regional and national levels, including the Vessel Day Scheme aiming at regional sustainable tuna purse seine fisheries. These activities are subject to monitoring within the framework of the Western and Central Pacific Fisheries Commission, including the Vessel Monitoring System and Observer Programmes. In this context, the Parties agree that notwithstanding paragraph 1, when circumstances are such that wholly obtained products as defined in Article 5 paragraphs 1(f) and 1(g) cannot be sufficiently utilised to satisfy the on-land demand and following the prior notification to the European Commission by a Pacific State, processed fishery products of headings 1604 and 1605 manufactured in on-land premises in that State from non-originating materials of Chapter 03 that have been landed in a port of that State shall be considered as sufficiently worked or processed for the purposes of Article 2. The notification to the European Commission shall indicate the reasons why the application of this paragraph will stimulate the development of the fisheries sector in that State, and shall include the necessary

TABLE 6.25 *Drafting and assessing the PSRO – Tunas, prepared/preserved (HS 160414)*

Convergence/Divergence Options

	PSRO	Comments
Option 1	A change from any other chapter, except from chapter 3	EU rules model (CETA)
Option 2	A change of heading 1604 from any other chapter	US Model
Option 3	CC	HRO

Divergence Options

More restrictive

	PSRO	Comments
Option 1	Manufacture in which material of chapter 3 are wholly obtained	
Option 2	The other options in EU FTAs as contained in table 6.22 and related footnotes	

Less restrictive

	PSRO	Comments
Option 1	A change to heading 1604 from any other chapter	
Option 2	A change to heading 16 04 14 from any other chapter) In this way only canned tuna is covered by such PSRO and the remaining canned fish may be object of more lenient PSROs	The drafting of the PSRO could be fine tuned to cover only canned tuna

Optimal Rule

PSRO 1	PSRO 2
A change of heading 1604 from any other chapter	CC

cumulation provision inserted in the free-trade agreement to allow cumulation with tuna caught in Papua New Guinea.[69]

Such combination of methodologies, the new version of the IO table with 5836 observations, and the convergence has been used in the context of the China–Korea FTA agreement. It has been selected as a test since it is a free-trade agreement between two major trading countries that have not adopted a consistent model, either North American or European, in negotiating PSRO. In short, these two major trading countries were free to negotiate their own PSRO, taking into account their own experiences and lessons learned, as well as those of others. Moreover, the complexity and the trade intensity of these two major countries may be used as a good testing ground of the combined IO and convergence table methodology.

The Korea–China FTA agreement raised conspicuous expectations in the literature and in the press. The research carried out on the content of the FTA agreement has shown that it fell short of the expected trade liberalization ambitions.[70]

An initial assessment of its structure indicates that the list of PSRO, spanning 298 pages, covers all headings and subheadings of the HS. A closer look at the list reveals that it contains a kind of default approach in the setting of PSRO. For many chapter headings and subheadings, the list contains the same PSRO, being a wholly obtained criterion, a CTH (the large majority), CTH with exceptions (mainly in the metals chapters), and RVC either alone or in combination. A rather strong protective bias seems to dominate the setting of the PRSO for the agricultural sector where the wholly obtained rule applies for the first fifteen agricultural HS chapters. The clothing sector appear quite liberal with the adoption of a change of chapter rules (CC), while detailed PRSO for some headings in the textile sector appear more demanding. The protectionist mode in the automotive sector, detected in some analysis, is also present in the PSRO where the PSRO for cars are a combined requirement of CTH and RVC (60 percent).

Table 6.26 shows some of the most exported products from Korea to China, specifically subheading 854232 (integrated circuits) and LCDs (liquid crystal devices) of subheading 901380. The IO matrix contained in Table 6.26 shows that Korea was importing inputs classified in different subheadings to produce products of subheading 854232 from China as first supplier but also from Taiwan (UNS in the table) and Japan

information about the species concerned, the products to be manufactured as well as an indication of the respective quantities to be involved. (c) A report on the implementation of subparagraph (b) shall be drawn up no later than three years after the notification.

Besides, the PSRO for 16.04 introduced the possibility to use up to 15% of non-originating tuna: "Manufacture in which the value of any materials of Chapter 3 used does not exceed 15% of the ex-works price of the product."

[69] See Chapter 3 of this book for a discussion of extended cumulation under EU free-trade-agreements. In this specific case it may be extremely difficult to pursue such a route even if Papua New Guinea is a member of the EU-Pacific EPA.

[70] See J. J. Schott, E. Jung, and C. Cimino-Isaacs, "An assessment of the Korea–China free trade agreement," Policy Brief, PB15-24, Peterson Institute for Economics, 2015; and I. Cheong, "Analysis of the FTA negotiation between China and Korea," *Asian Economic Papers*, vol. 15, no. 3 (2016), 170–187.

TABLE 6.26 *Drafting PSRO for Korea*

HS product definition		MFN tariffs in partner country		Total exports to China		Main inputs	Total imports from world				Principal suppliers					
											1st supplier		2nd supplier		3rd supplier	
HS 6 code	HS 6 description	Total no. of tariff lines per HS code	MFN rate (simple avg.) (%)	Value (million USD)	Share in all exports of HS chapter (%)	HS definition	Value (million USD)	Normalized value (million USD)	Share in all imports of product group (%)	No. of suppl.	ISO3 code	Exp. share (%)	ISO3 code	Exp. share (%)	ISO3 code	Exp. share (%)
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17
854232	Electronic integrated circuits, memories	2	1.7	28,018	48.4	8532.21–8532.29 – electrical capacitors 8533.21 and 8533.29 – electrical resistors 8543.00 – printed circuit boards 8541.10 through 8541.50 – diodes, transistors and other semiconductor devices 8542.90 – parts	1,242	156	1.5	53	CHN	39.3	UNS	21.5	JPN	14.8
901380	Liquid crystal devices not constituting articles provided for more specifically in other headings; other optical appliances & instr.	6	7.3	8,993	62.0	9013.90 – parts	308	103	1.4	29	EUN	39.6	USA	32.7	JPN	20.6

making a total of 36.3 percent of shares of suppliers for the two combined suppliers. This could be a potential problem for Korean producers since inputs from China would qualify by virtue of cumulation, but the same would not be valid for inputs from Taiwan and Japan since these inputs to produce integrated circuits of HS 854232 for export to China may face difficulties complying in case of stringent PSRO.

The same may occur with LCD exports to China since Table 6.26 shows that there are inputs (basically parts of LCDs of subheading 9013.90) imported from the EU, the United States, and Japan that could be used in manufacturing LCDs for export to China.

Table 6.27 shows the different drafting techniques that could be used by Korea to draft PSRO for subheading 854332, taking into account that Table 6.26 shows that inputs of different subheadings are imported in South Korea and could be used to manufacture subheading 854332 for export to China.

The USMCA rules in option 1 of Table 6.27 do not require any CTC and are very liberal rules and should be listed as option 1 by South Korea. According to these PSRO, even if South Korea is using material of the same subheading to manufacture products of 854332, the finished products would comply according to such PSRO. Option 2 reflects the US–Korea FTA agreement and still remains quite liberal since it allows a CTSH or an RVC. This would obviously be a second-best option. The PSRO contained in the EU–South Korea FTA and CETA agreements are clearly more restrictive since they require a specific working or processing or ad valorem percentage criteria that are more stringent than USMCA PSRO for this specific subheading. Such kind of PSRO contained in EU free-trade agreements should be avoided from a South Korean perspective, as these PSRO are in fact more restrictive when compared with USMCA PSRO.

Table 6.28 shows the results of the IO table for two major exports of South Korea to China, namely parts of TVs of subheading 8529.90 and parts of electric machines of HS subheading 8548.90, where the IO analysis shows significant imports of inputs from Japan, China, and the EU for heading 852990 and the same countries, but in different order of suppliers, for 854890 (HS 8548.90 classifies parts of electrical machinery).

Table 6.29 shows the different drafting techniques that could be used by Korea to draft PSRO for subheading 854332 taking into account that the IO table shows that inputs of different subheadings are imported in South Korea that could be used to manufacture subheading 854332 for export to China.

The reasoning follows the same pattern as in preceding figures since in the subheadings the USMCA and US–South Korea FTA agreements PSRO are more lenient and less demanding than the EU rules.

In the case of subheading 852990 (see Table 6.29) the USMCA PSRO requires a CTSH while the US–Korea PSRO require a CTH or an RVC. Given the fact that the IO table shows that South Korea may be importing parts classified in different headings or different subheadings to make products of heading 852990, it is evident that the USMCA PSRO should be option 1 and US–Korea PSRO should be option 2. The EU PSRO are clearly more stringent requiring a VNOM of 50 percent and should therefore be listed as a more restrictive option.

TABLE 6.27 *Drafting PSRO for Korea – Electronic integrated circuits as memories (HS 854232)*

Convergence/Divergence Options

	PSRO	Comments
Option 1	No required CTC to any of subheadings 854110 through 854290	USMCA
Option 2	A change to any other good of subheading 8541.10 through 8542.90 from any other subheading; or No CTC is required, provided regional value not less than: (a) 30 % under the build-up method, or (b) 35% under the build-down method.	US & South Korea
Option 3	Manufacture from materials of any heading, except that of the product or The operation of diffusion, in which integrated circuits are formed on a semi-conductor substrate by the selective introduction of an appropriate dopant, whether or not assembled and/or tested in a non-party or Manufacture in which the value of all the materials used does not exceed 45% of the ex-works price of the product	EU and South Korea
Option 4	A change from any other heading or A change from within any one of these headings provided that the value of non- originating materials does not exceed 50 % of the transaction value or ex-works price of the product.	CETA

Divergence Options

More restrictive

	PSRO
Option 1	Manufacture from materials of any heading, except that of the product or The operation of diffusion, in which integrated circuits are formed on a semi-conductor substrate by the selective introduction of an appropriate dopant, whether or not assembled and/or tested in a non-party; or Manufacture in which the value of all the materials used does not exceed 45% of the ex-works price of the product
Option 2	A change from any other heading or A change from within any one of these headings, provided that the value of non- originating materials does not exceed 50 % of the transaction value or ex-works price of the product.

Less restrictive

	PSRO
Option 1	No Required CTC to any of subheadings 854110 No through 854290
Option 2	A change to any other good of subheading 8541.10 through 8542.90 from any other subheading; or No CTC is required, provided regional value not less than: (a) 30 % under the build-up method, or (b) 35% under the build-down method.

Optimal Rule

PSRO 1	PSRO 2
No required CTC to any of subheadings 854110 No through 854290	A change to any other good of subheading 8541.10 through 8542.90 from any other subheading; or No CTC is required, provided regional value not less than: (a) 30 % under the build-up method, or (b) 35% under the build-down method.

TABLE 6.28 *Drafting PSRO for Korea*

HS product definition		MFN tariffs in partner country		Total exports to China		Main inputs	Total imports from world				Principal suppliers					
											1st supplier		2nd supplier		3rd supplier	
HS 6 code	HS 6 description	Total no. of tariff lines per HS code	MFN rate (simple avg.) (%)	Value (million USD)	Share in all exports of HS chapter (%)	HS definition	Value (million USD)	Normalized value (million USD)	Share in all imports of product group (%)	No. of Suppl.	ISO3 code	Exp. share (%)	ISO3 code	Exp. share (%)	ISO3 code	Exp. share (%)
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17
852990	Other parts suitable for use solely/principally with the apparatus of headings 85.25–85.28, other than aerials & aerial reflectors	18	6.5	3,731	6.4	7229.90 wire, of other alloy steel 7304.31 – tubes, pipes and hollow profiles, seamless, of iron or steel 8543.70 – frequency amplifiers	2,339	39	2.8	56	JPN	35.8	CHN	25.9	EUN	9.7

(*continued*)

TABLE 6.28 (*continued*)

HS product definition		MFN tariffs in partner country		Total exports to China		Main inputs	Total imports from world				Principal suppliers					
											1st supplier		2nd supplier		3rd supplier	
HS 6 code	HS 6 description	Total no. of tariff lines per HS code	MFN rate (simple avg.) (%)	Value (million USD)	Share in all exports of HS chapter (%)	HS definition	Value (million USD)	Normalized value (million USD)	Share in all imports of product group (%)	No. of Suppl.	ISO3 code	Exp. share (%)	ISO3 code	Exp. share (%)	ISO3 code	Exp. share (%)
854890	Other electrical parts of machinery/ apparatus, not specified/ included. elsewhere in this chapter, other than waste & scrap of primary cells	6	11.7	3,351	5.8	Sub-components of HS 85	2,456	38	2.6	56	JPN	35.8	CHN	25.9	EUN	9.7

TABLE 6.29 *Drafting PSRO for Korea – Reception and transmission apparatus; for use with the apparatus of heading nos. 8525–8528, excluding aerials and aerial reflectors (HS 852990)*

Convergence/Divergence Options

	PSRO	Comments
Option 1	A change of subheading 852990 from any other good within the same subheading	USMCA
Option 2	A change to heading 85.29 from any other heading; or No change in tariff classification is required, provided that there is a regional value not less than: (a) 35 percent under the build-up method, or (b) 45 percent under the build-down method.	US & South Korea
Option 3	Manufacture in which the value of all the materials used does not exceed 50 % of the ex-works price of the product	EU and South Korea
Option 4	A change from any other heading; or A change from within this heading, provided that the value of non-originating materials of this heading does not exceed 50 per cent of the transaction value or ex-works price of the product.	CETA

More restrictive

	PSRO
Option 1	Manufacture in which the value of all the materials used does not exceed 50 % of the ex-works price of the product
Option 2	A change from any other heading; or A change from within this heading, provided that the value of non-originating materials of this heading does not exceed 50 per cent of the transaction value or ex-works price of the product.

Less restrictive

	PSRO
Option 1	A change of subheading 852990 from any other good within the same subheading
Option 2	A change to heading 85.29 from any other heading; or No change in tariff classification is required, provided that there is a regional value not less than: (a) 35 percent under the build-up method, or (b) 45 percent under the build-down method.

Divergence Options

Optimal Rule

PSRO 1	PSRO 2
A change of subheading 852990 from any other good within the same subheading	A change to heading 85.29 from any other heading; or No change in tariff classification is required, provided that there is a regional value not less than: (a) 35 percent under the build-up method, or (b) 45 percent under the build-down method

TABLE 6.30 *Drafting PSRO for Korea – Electrical parts of machinery or apparatus, not specified or included elsewhere in Chapter 85 (HS 854890)*

Convergence/Divergence Options

	PSRO	Comments
Option 1	No required change in tariff classification to electronic microassemblies of subheading 854890; or A change to any other good of subheading 854890 from electronic microassemblies of subheading 854890 or any other heading	USMCA
Option 2	A change to heading 85.48 from any other heading.	US & South Korea
Option 3	Manufacture in which the value of all the materials used does not exceed 45 % of the ex-works price of the product	EU and South Korea
Option 4	A change from any other heading; or A change from within any one of these headings, provided that the value of non- originating materials classified in the same heading as the final product does not exceed 50 % of the transaction value or ex-works price of the product.	CETA

Divergence Options

More restrictive

	PSRO	Comments
Option 1	A change to heading 85.48 from any other heading	
Option 2	Manufacture in which the value of all the materials used does not exceed 45 % of the ex-works price of the product	

Less restrictive

	PSRO	Comments
Option 1	No required change in tariff classification to electronic microassemblies of subheading 854890; or A change to any other good of subheading 854890 from electronic microassemblies of subheading 854890 or any other heading	
Option 2	A change to heading 85.48 from any other heading.	

Optimal Rule

PSRO 1	PSRO 2
No required change in tariff classification to electronic microassemblies of subheading 854890; or A change to any other good of subheading 854890 from electronic microassemblies of subheading 854890 or any other heading	A change to heading 85.48 from any other heading

Table 6.30 reproduces to some extent the situation of previous Tables 6.28 and 6.29. According to the IO table South Korea is importing inputs from third countries classified in Chapter 85 that could be used to manufacture parts of subheading 8528.90. In short it could be the case that South Korea is importing subcomponents of parts classified in Chapter 85 to manufacture parts of machinery. In short, it is a parts-to-parts operation as discussed in Chapter 2 of this book. As contained in Table 6.30, USMCA allows a CTSH or even does not require a CTC; and US–Korea PSRO allow a CTH that is somewhat more restrictive. The EU rules of origin are far more demanding, requesting an ad valorem percentage requirement or a CTH.

6.4.2 *Conclusion*

As shown in the preceding sections, the use of the IO methodology in conjunction with the comparative tables on convergence of PSRO discussed in Chapter 2 of this book[71] is undoubtedly a useful tool to draft PSRO and to assess the possible implications of a given PSRO.

It also allows a comparison of the different technical solutions that the other partner or major trading partners are using for a specific heading. In the examples given in the last section concerning South Korea and China it was clear that South Korea would be much better off adopting USMCA PSRO for the subheadings examined rather than those of the US–South Korea FTA agreement or the EU approach.

The IO methodology and the convergence tables on PSRO cover all HS chapters, at heading and subheading level. By ranking the excel tables by the most exported products it is possible to focus on those products and PSRO that are the most important and relevant during free-trade agreement negotiations.

The advantages and disadvantages of the combined use of the IO tables and the PSRO convergence tables could be summarized as follows:

Advantages

- It identifies, in detail, the HS headings and subheadings where PSRO are most important based on trade data.
- It is a valid basis for consultations with the private sector.
- It provides indications of the impact of given PSRO.
- It is useful in establishing on a solid basis a constructive dialogue with firms and private sectors.

[71] Both IO tables and the comparative tables on RoO are part of a series of research and capacity building activities organized with the Global Governance Program at the European University Institute (EUI).

- It provides a series of technical formulations of PSRO that could be adopted by the negotiating team.

Challenges

- The IO tables are based on trade flows and do not capture the firms' level sourcing policy (i.e. in spite of indications that a country is using inputs to manufacture a finished product the national firms may source locally the inputs required). Hence the need for consultations with the private sector.
- It depends on the HS and applicability of HS to PSRO and cannot be used to asses impacts in the case of RVC rules of origin.
- In some cases, the same inputs may be used to manufacture different products. Hence the need to programmatically adopt repartition criteria.

Further work and research are still underway using the IO tables that are currently being refined in terms of accuracy and level of details and are expected to be associated with other datasets to measure more effectively the availability of local inputs.

7

The Administration of Rules of Origin

An important element of the rules of origin is their administration. Rules of origin (RoO) are one of the three basic customs laws: the Harmonized System (HS) for customs classification, customs valuation, and rules of origin. These customs laws are designed to assist the customs officers in responding to basic questions such as: Where do I classify these goods? How much are they worth? Where are they coming from?

The third question relates to the proof of origin and is commonly understood as one of the most complicated areas for business according to recent surveys.[1]

In day-to-day business life, rules of origin are part of the border routine and they need to be administered in an efficient manner to facilitate customs clearance and not to cause hindrance to trade.

Discussions with business and various presentations made by private companies at the World Trade Organization (WTO) during educational exercises[2] clearly indicate that origin certification remains an unresolved issue and a net cost to business.

As mentioned in Chapter 1, there are no multilateral rules on administering rules of origin. On the one hand, the WTO Agreement on Rules of Origin (ARO) is conspicuously silent in this regard. On the other hand, Annex K of the revised Kyoto Convention provides only general guidelines that, at the time of writing, are finally under renegotiation and updating according to the ambitious work program established by the membership of the World Customs Organization (WCO) aiming at a revised Kyoto Convention.

Actually the revision of the Kyoto Convention carried out in 1999 would have provided a golden opportunity for the international community to update Annex

[1] In a survey conducted by the International Trade Center in thirty-eight developing countries, rules of origin were perceived by 84% of the interviewees as the most burdensome and 77% of the interviewees stated that the rules of origin are difficult to meet only because of procedural issues.

[2] See Chapter 1 of this book.

K of the Convention, or, at least Chapter 2 on documentary evidence of rules of origin and Chapter 3 on control of documentary evidence as they dated from the previous Kyoto Convention of 1974. However, the prevailing mindset in WCO member states at that time was to wait for the finalization of the Harmonization Work Program (HWP) of the nonpreferential rules of origin before engaging in an overall updating of Annex K. This mindset proved dramatically wrong and, in retrospect, unwise right from the start as the ARO did not provide any rule on administration of rules of origin or any mandate to either the WTO Committee on Rules of Origin (CRO) or the WCO Technical Committee on Rules of Origin (TCRO) to work on their administration.

In retrospect, it would have been good to start the revision of Annex K especially Chapters 2 and 3 during the HWP since the international community would have had at its disposal more updated versions of those chapters. Instead, the revision mainly concerned Chapter 1 on rules of origin ending up with a diminished text in terms of guidelines with respect to the original Kyoto Convention of 1974, as discussed in the first chapter of this book.

To sum up, if the substance of rules of origin dealt with in the preceding chapters of this book could be considered as "*terra cognita*," given the repeated multilateral efforts to regulate rules of origin, the administration of rules of origin is located in a territory that could be framed as "*hic sunt leones*," given, on the one hand, the paucity of multilateral efforts and, on the other hand, the complexity and overlapping rules and regulations on the administration of rules of origin functioning as a tangled jungle for business.

The issue of the administration of rules of origin has been neglected for decades at intergovernmental level given the lack of mandate under the ARO for the CRO and TCRO. Nor had the issue of certification been discussed in the WCO under the Kyoto Convention until recently when it was decided to update the whole Kyoto Convention in 2018. The International Chamber of Commerce (ICC) has made efforts to provide some guidance on the issuance of certificates of origin (COs) and the management of nonpreferential rules of origin, providing manuals on the procedural steps to obtain COs.[3]

As discussed in Chapter 1 of this book, once it became progressively clearer that the results of the HWP were not to be adopted, the CRO carried out a series of educational exercises that, at times, touched upon the issues of administration of rules of origin and certification. However, the strict boundaries imposed by WTO members, especially by the United States[4] on the content of the educational exercises was an obstacle to drawing any systemic lessons or encouraging substantive

[3] See International Chamber of Commerce, *International Certificate of Origin Guidelines: Facilitating Trade through Global Origin Fruition*, International Chamber of Commerce, 2019.

[4] It was well known in WTO circles that the agenda and the work program of the educational exercise were to be informally submitted in advance for approval by the WTO members before circulation by the WTO Secretariat.

debate that could lead to a series of conclusions or a summary of the debate leading to the identification of best practices on administration of rules of origin.

Upon reflection, even the obligation to provide for a procedure of preferential origin information assessment (a kind of binding origin information), which could be considered part of the RoO administration contained in Annex II of the Common Declaration on Preferential Rules of Origin, was never discussed in the CRO:

> (d) upon request of an exporter, importer or any person with a justifiable cause, assessments of the preferential origin they would accord to a good are issued as soon as possible but no later than 150 days[5] after a request for such an assessment provided that all necessary elements have been submitted. Requests for such assessments shall be accepted before trade in the good concerned begins and may be accepted at any later point in time. Such assessments shall remain valid for three years provided that the facts and conditions, including the preferential rules of origin, under which they have been made remain comparable. Provided that the parties concerned are informed in advance, such assessments will no longer be valid when a decision contrary to the assessment is made in a review as referred to in subparagraph (f). Such assessments shall be made publicly available subject to the provisions of subparagraph (g);

Overall, the ARO does not refer to COs and methods of administrative cooperation. Article 3(i) of the ARO indirectly lays the foundation for cooperation among Members:

> All information which is by nature confidential is treated as strictly confidential by the authorities concerned, which shall not disclose it without the specific permission of the person or government providing such information . . .

A WCO document[6] of the TCRO summarized the main requirements to implement the results of the HWP:

- to apply the nonpreferential rules of origin in those areas of application described in Article 1 paragraph 2 of the Agreement and as further specified by the latest draft of General Rule I on scope of application, as analyzed further below
- to apply the principle that the country to be determined as the origin of a particular good shall be either the country where the good has been wholly obtained, or when more than one country is concerned in the production of the good, the country where the last substantial transformation has been carried out

[5] In respect of requests made during the first year of entry into force of the WTO Agreement, members shall only be required to issue these assessments as soon as possible.

[6] See TCRO document oC0066E1 on practical guidance on the implementation of the WTO ARO presented at the Twentieth Session, December 3, 2001.

- to apply the rules in accordance with the results of the work program and not to apply rules for imports or exports that are more stringent than those applied to determine whether or not a good is of domestic origin
- not to discriminate between members, irrespective of the affiliation of the manufacturer(s) of the good concerned
- to administer the rules in a consistent, uniform, impartial, and reasonable manner
- to publish laws, regulations, judicial decisions, and administrative rulings of general application relating to rules of origin.

Yet even this document did not cover or address the issue of administration of rules of origin.

It took until June 2018 when the WCO Policy Commission and Council approved the setting-up of a Working Group on the Comprehensive Review of the International Convention on the Simplification and Harmonization of Customs Procedure (WGRKC) to start considering an overall update of the Kyoto Convention, including Annex K.

At the time of writing the WGRKC has started looking at the legal text of the revised Kyoto Convention (RKC) – body, general annex, and specific annexes, as well as the non-binding guidelines to the annexes of the RKC. The negotiating process is expected to take three years, ending in 2021. It is widely expected that such deadline will be missed.

Overall, the need to establish multilateral rules on certification of origin and related administrative procedures cannot be overemphasized. Business routinely complains about the complexities of different and overlapping RoO requirements and related costs. Large and medium-size companies nowadays invest in sophisticated software to comply with rules of origin.[7] The WTO Agreement on Trade Facilitation contains a great deal of best practices on trade facilitation that could be related to origin administration. Yet it falls short of providing the necessary details to address the current lack of guidance and best practices in the area of rules of origin besides reiterating commitments to transparency and advance ruling that are already present in the ARO.

As of January 4, 2019, 291 regional trade agreements (RTAs) were in force and the number is growing. It should be obvious that the acute need to regulate the administration of rules derives from the proliferation of RTAs.

The recent emergence of megaregionals such as the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CP-TPP) and the Regional Comprehensive Economic Partnership Agreement (RCEP) may facilitate the work toward convergence in the best practices in the administration of rules of origin. In

[7] See M. Anliker, "Non preferential rules of origin, high level assessment," and R. Soprano, "The challenge of designing 'new' rules of origin in international trade," papers prepared for the Global Governance Program at the European University Institute (EUI), 2016.

fact, members to these megaregionals, including major economies, are forced to agree on a text on administration of rules of origin at plurilateral level when at times they are reluctant to engage in a similar exercise at multilateral level. As examined in Chapter 5 and especially in section 5.5 when discussing the CP-TPP and the ongoing RCEP there are different schools of thought on administration of rules of origin and, even at that level, a compromise may be difficult to find. Further consideration should be given to the possibility of detecting areas of convergence of best practices in RoO administration as building blocks towards a plurilateral agreement, breaking the present impasse.[8] This chapter aims to analyze signs of such convergence of best practices in RoO administration that could help this process (as well as detect divergence).

One important issue to note is the progressive switch from unilateral to reciprocal trade preferences entailing that RoO administration and enforcement is becoming another important aspect of customs administration in developing countries. Added to this there is a proliferation of free-trade agreements with increasing membership of developing countries and least-developed countries (LDCs). At the time of writing many Central and Latin American, African, and, progressively, Association of Southeast Asian Nations (ASEAN) countries are parties to economic partnership agreements (EPAs) with the EU, United States, or Japan. Every major trading partner is entering into reciprocal free-trade agreements with developing countries.

This flourishing of North–South or South–South free-trade agreements means that customs administration in developing countries will also have to administer rules of origin at the time of importation. Free-trade areas (FTAs) and EPAs in fact mean, for instance, that imports from the EU into African and ASEAN countries, including in some cases LDCs, will be entitled to preferential rates of duty.

In many developing countries and LDCs, tariff revenue still accounts for a significant share of the budget. In addition, the fragile industrial structure of many developing countries may be highly sensitive to surges in trade flows of competing goods entering at preferential rates. These two factors suggest that developing countries should support the idea of multilateral rules on administration of rules of origin as standard, transparent rules are easier to apply and administer.

In the absence of multilateral rules in this area, this chapter first discusses the different models in administering rules of origin in FTAs including the experience of the Generalized System of Preferences (GSP) and duty-free quota-free (DFQF) rules of origin. This was an area that first registered efforts to harmonize some of the procedures related to administration of rules of origin.

This chapter then examines the different methodologies of administering rules of origin by main trading partners and regionals FTAs showing the different evolutions and best practices.

[8] See the forthcoming article, S. Inama, P. Crivelli, and B. Hoekman, "Now or never? The case for making progress to discipline rules of origin in international trade."

7.1 THE MAIN ELEMENTS OF THE ADMINISTRATION OF RULES OF ORIGIN

The administration of rules of origin is traditionally centered on three main elements:

(1) documentary evidence of origin: the issuance of the documentary evidence proving origin; that is, the CO or more recently the exporter or importer declaration of origin
(2) direct consignment conditions and related documentary evidence
(3) verification and post-clearance recovery procedures.

In addition, there is a fourth category related to administrative procedures that could be defined as:

(4) ancillary provisions

In fact, there is an impressive number of ancillary rules that are related to certification of origin as further discussed in detail in section 7.1.3. These ancillary rules may not be strictly related to administration of rules of origin (i.e. prohibition of drawback), but have a bearing on certification and for the sake of completeness of the administration of rules of origin they have been included in this chapter.

Table 7.1 shows the different kind of certification presently in use drawing from an earlier WCO study.[9] The use of certifying authorities (CAs) issuing COs and based on exchange of specimen stamps and signatures may be considered as the most traditional method of preferential origin certification. This can be partly explained by the fact that the GSP granted by some developed countries has long taken this approach. However, a series of changes have intervened as the EU, Switzerland, and Norway since 2017 have been progressively introducing the "registered exporter" system.[10] Accordingly, these countries will no longer use the GSP Form A. Still, as discussed further in section 7.2, many developing preference-giving countries still require stamps and signatures in the framework of the GSP to LDCs and many free-trade agreements among developing countries still use this rather archaic method of certification of origin.

The main reason for the tendency of using CAs rather than self-certification methodologies, especially in developing countries, is often justified by the concern of such administrations about the private sector lack of knowledge concerning rules of origin. It is felt that CAs need to strictly monitor the issuance of COs in order to avoid abuses and false declarations.

[9] Guidelines on Certification of Origin, last updated June 2018, at www.wcoomd.org/-/media/wco/public/global/pdf/topics/key-issues/revenue-package/guidelines-on-certification.pdf?db=web.
[10] See section 7.4.7.

TABLE 7.1 *Main methodologies for documentary evidence of origin*

Methodologies	Key features	Main users	Main comments/ Additional features
Certifying authorities (CAs), including E-certificate	The CO is issued by government authorities.[i]	This is the traditional methodology used by main trading partners like EU until 1990. Some African and Asian RTAs[ii] still use CAs.	The traditional form of use of CAs is joined with the requirement of exchange of signatures and stamps of the respective certifying officers of the free-trade agreement. This methodology is commonly regarded as the most burdensome on the administration and on business.
Approved exporters	Exporters may request CAs prior authorization to issue statement of origin on commercial documents	The EU and Japan use this approved exporter methodology in a variety of free-trade agreements.	According to this methodology the approved exporter should make a statement in manuscript form, or sign an agreed origin statement in a specified wording contained in the free-trade agreement. Reportedly, difficulties are arising from different wording of the statement required depending on the agreement. Additionally, CAs at national level may apply different parameters and criteria in delivering approved exporter status.
Registered exporters (REX)	Exporter registers with a CA and issue statement of origin.	The registered exporter system has been introduced by the EU in its GSP certification system.	The registered exporters system has been progressively adopted as a new system, replacing the Form A since 2017. It has been put into operation only recently and no overall assessment has been yet carried out.

(*continued*)

TABLE 7.1 (*continued*)

Methodologies	Key features	Main users	Main comments/ Additional features
Exporter declaration	Any exporter may issue a statement of origin in a certificate-of-origin format or form contained in the free-trade agreement or unilateral preferences.	According to the WCO survey,[iii] many Latin American countries are using this form of certification that is also increasingly adopted in the majority of free-trade agreements outside Latin America.	Under this methodology any exporter is free to issue an origin statement, often in prescribed format or certificate. The statement of origin can be made in (1) a specific format with a number of entries or (2) a separate statement, i.e. commercial invoice or a separate ad hoc statement according to provision of the agreement.
Importer declaration	The origin declaration is made by the importer at the time of customs clearance.	This is the method used mostly by the United States.	Under this methodology the importer makes the origin declaration at the time of customs clearance. However, it is rather obvious that in reality that an importer declaration is made on the basis of evidence provided to the importer by the exporter/ producer.
Full importer/ exporter declaration	The origin declaration is made on the basis of an exporter declaration or on the basis on the importer knowledge by the importer at the time of customs clearance.	This is the method recently introduced under the EU–Japan FTA agreement.	Under this methodology the claim for preferential duties may be made by the importer based on the exporter declaration or by the importer directly.

[i] As discussed in Chapter 1, Customs or Ministry of Commerce are normally used as CAs. The Chamber of Commerce issues certificates of origin mainly of a nonpreferential nature. According to the WCO study on certification of 2014, forty-six members (70%) indicated the Chamber of Commerce as the issuer of nonpreferential certificates of origin. Some countries like Japan accept under their GSP certificates of origin issued by nongovernmental bodies like the Chamber of Commerce.

[ii] See Chapter 5 for further details.

[iii] See WCO, "Comparative study on rules of origin," 2014.

A study carried out by the WCO[11] found that:

> 141 out of the 209 FTAs studied (67.5%) introduce a kind of self-certification, which are either approved exporter, fully exporter-based certification, or importer-based system. Furthermore, these FTAs provide several certification systems which allow traders to choose the most appropriate option in their applicable FTA. This kind of flexibility leads to increased userfriendliness and trade facilitation in the utilization of each FTA. Looking at the breakdown of the kinds of self-certification, 82 out of the FTAs studied (39.2%) require preferential certificates of origin to be issued by competent authorities, but provide for the option of origin declarations by approved exporters. In most FTAs of this type, Customs is the competent authority that issues the certificate of origin or is in charge of the authentication of approved exporters. 43 agreements (20.6%) have the fully exporter-based certification, while 16 agreements (7.7%) have an importer-based system. In total, in 59 agreements out of all FTAs studied (27.8%), authorities are never involved in the issuance of certificates of origin. In 68 out of the FTAs studied (32.5%), only the competent authorities are allowed to issue preferential certificates of origin. In this type, there seem to be no clear trend on the issuer of certificates of origin. The issuer could be Customs, trade ministries, or delegated private bodies. 151 out of the 209 FTAs studied (72.3%) introduce the certificate of origin issued by a competent authority, which represents a slightly higher proportion than FTAs using self-certification.

Against this background the WCO guidelines[12] are quite clear in the context of certification:

> Considering the increasing volume of preferential trade and recognizing the need for the facilitation of origin-related procedures, self-certification of origin by a producer, manufacturer, exporter and/or importer shall be utilized to the maximum extent possible while recognizing the specificities of domestic business environment.

Yet, and as reported in Table 7.1, there are significant variations in the self-certification methods adopted by different administrations.

E-certificates of origin are considered by the WCO to be a subcategory of the CO issued by the CA since, in fact, the producer or exporter may apply online to the CA for the issuance of COs; that is, upon approval, subsequently printed and signed by the CAs. In practice E-COs are mostly limited to online applications to the CAs, which at the end of the process issue printed and signed COs in the traditional way. The main advantage is represented by the fact that the request can be made online, with the remaining procedures still following the traditional processing path.

[11] See Comparative Study On Certification Of Origin, June 2020, at www.wcoomd.org/-/media/wco/public/global/pdf/topics/origin/instruments-and-tools/comparative-study/related-documents/comparative-study-on-certification-of-origin_2020.pdf?db=web.

[12] See fn. 9.

Recent developments in ASEAN[13] at the time of writing provide for E-COs that can be issued by CAs and subsequently electronically exchanged among ASEAN CAs using the ASEAN Single Window gateway. This system, once effectively operational, could potentially become a distinct certification system. At present it is limited to issuance of printed COs after application online to the CAs as described above. At the time of writing, pilot projects for the E-COs are underway in a number of regions, the Common Market for Eastern and Southern Africa (COMESA) being a recent addition. Yet it is unclear whether such pilots are fully operational.

Besides the traditional use of CAs, Table 7.1 reports the different systems of origin certification. The table is drawn from the point of view of trade facilitation; that is, the CAs methodology being the most demanding and least trade facilitating and the full importer/exporter declaration recently introduced in the EU–Japan FTA agreement as the most liberal.[14]

Without prejudice of the fact that the CAs may be considered the more restrictive system, there are significant differences among different self-certification systems depicted and commented upon in Table 7.1.

The variations in terms of restrictiveness or leniency among the various self-certification systems depend on additional details such as:

(1) the format, quality of the paper, or documents where the self-certification has to be made; that is, a specific CO format with a number of entries is more difficult to fill up than a simple declaration on an invoice[15]
(2) the wording of the statement of origin and who is entitled to make the statement of origin; that is, in some free-trade agreements there are specific provisions on the person entitled to issue statements of origin, powers of delegation to employees, the relation and difference between the exporter declaration and producer declaration
(3) the importer declaration has to be better qualified and explained since there are many factors driving the leniency and stringency of the importer declaration depending on the way in which it is administered and the ability of the importing country customs administration to monitor compliance with methodology. As can be seen from the following excerpt from the USMCA text, the "importer certification"

[13] See for instance the following website: www.customs.gov.sg/businesses/certificates-of-origin/asw.

[14] Even the EU private sector has been vocally complaining about this new system of administration. Much of the difficulty appears to have arisen due to the zealous attitude of the Japanese importers in asking EU exporters for an unusual number of documents before making their declaration. This, added to other misunderstandings, led to the adoption of the ten-page joint EU–Japan guidelines at https://ec.europa.eu/taxation_customs/sites/taxation/files/eu-japan-epa-guidance-statements-on-origin.pdf.

[15] See section 7.6 for the different requirements under the ASEAN FTA agreements.

regimes essentially demand some form of producer/exporter origin certification before making their own importer origin certification or declaration:

Article 5.2: Claims for Preferential Tariff Treatment

1. Each Party shall provide that an importer may make a claim for preferential tariff treatment, based on a certification of origin completed by the exporter, producer, or importer for the purpose of certifying that a good being exported from the territory of a Party into the territory of another Party qualifies as an originating good.

An important experience arising in the US–Latin America FTA agreements using the "importer certifications" is that such certification can amplify supply chain asymmetries (i.e. large US importers may find it easier to obtain origin information from smaller Latin American suppliers but smaller Latin American importers usually cannot get the same level of response from large US suppliers).

ARTICLE 3.16: Claim for Preferential Tariff Treatment under EU–Japan FTA

1. The importing Party shall, on importation, grant preferential tariff treatment to a product originating in the other Party on the basis of a claim by the importer for preferential tariff treatment. The importer shall be responsible for the correctness of the claim for preferential tariff treatment and compliance with the requirements provided for in this Chapter.
2. A claim for preferential tariff treatment shall be based on:
   a. statement on origin that the product is originating made out by the exporter; or
   b. the importer's knowledge that the product is originating.
3. A claim for preferential tariff treatment and its basis as referred to in subparagraph 2(a) or (b) shall be included in the customs import declaration in accordance with the laws and regulations of the importing Party. The customs authority of the importing Party may request, to the extent that the importer can provide such explanation, the importer to provide an explanation, as part of the customs import declaration or accompanying it, that the product satisfies the requirements of this Chapter.
4. The importer making a claim for preferential tariff treatment based on a statement on origin referred to in subparagraph 2(a) shall keep the statement on origin and, when required by the customs authority of the importing Party, provide a copy thereof to that authority.
5. Paragraphs 2 to 4 do not apply in the cases specified in Article 3.20.

The EU–Japan FTA agreement recognizes such ambivalent form of declaration either by the exporter or the importer as outlined in the excerpt below. Such formula represented a novelty for both sides. It is obvious from the wording of Article 3.16 above that while the importer retains the full responsibility for a claim of preferential origin, she or he does so on the basis of the information provided by a third party; that is, the

exporter or any other third party including the producer. As reported by the private sector during early implementation, such liberal attitude in origin declaration has taken time to take full effect since Japanese importers were constantly requesting a series of assurances from their European counterparts before making importer declarations.

7.1.1 *Direct Consignment*

Another fundamental requirement of the administration of rules of origin is the concept of direct consignment.[16] In fact, administrative systems of rules of origin require the direct consignment of goods, meaning that for a product to be eligible for preferential-origin treatment it has to be transported directly from the place of production to the FTA partner country or preference-giving country of destination.

The purpose of such a rule is primarily to ensure that the imported goods are identical to the goods that left the exporting country and that have not been manipulated or further processed during shipment through a third country. Direct consignment however does not mean direct shipment. Provisions are made in the different administrative systems of rules of origin that goods may be transported through the territory of a third country other than that of their origin or final destination.

However, in case of passage through the territory of a third country, the majority of administrations require documentary evidence of nonmanipulation during the transit in the territory of the third country and that the goods have not entered the customs territory of the third country.

The issue is that such documentary evidence is not easy to obtain and/or it may entail a cost. As contained in Table 7.2, the documentary evidence required in respect of direct consignment is often a through bill of lading covering the passage through the third country or a statement by the customs of the third country of transit that the goods have not been manipulated during transit besides unloading, loading, and preserving them in good condition. None of these documents are easy to obtain since a through bill of lading may be impossible to produce because (1) of geographical or commercial reasons (i.e. in the case of some landlocked or island countries there is simply no shipping agent capable of issuing a through bill of lading and/or it may be too expensive), or (2) the goods are sold to an intermediary or to a hub and are subsequently shipped to the country of final destination.

In these cases, it is impossible to comply with the documentary evidence of direct consignment requirements, unduly penalizing goods that are originating and a given country that may be disfavored due to its geographical location and/or for being far from commercial routes.

[16] See also Chapter 1 of this book for an analysis and discussion of provisions on direct shipment contained in DFQF schemes.

TABLE 7.2 *A comparison of direct shipment provision and related requirements*

Methodologies	Key features	Main users	Main variations/ Additional features
Direct consignment	Documentary evidence of direct shipment is requested: a through bill of lading or documentary evidence of nonmanipulation in the form of a certificate issued in the country of transit.	This is the traditional methodology used by all main trading partners alike albeit there might be variations in the requirements for documentary evidence. The standard clause under the EU provided that documentary evidence of direct shipment should be provided.[i]	The direct shipment requirement is accompanied by a request for documentary evidence that is notoriously difficult to produce. A through bill of lading may only be available when there is a direct relation of buyer and seller, which is no longer the case in the majority of cases since exporters/ producers sell to wholesaler who then resell the goods to the final buyer. In addition, issuance of a through bill of lading to final destination may be difficult for logistical reasons in a landlocked or island country, especially developing or LDC.
Nonalteration clause	There is no need for documentary evidence to prove direct shipment or nonmanipulation. In case of doubt, customs authorities may request and the importer may provide such evidence by any means.	The EU recently introduced this nonalteration article in the GSP and in various free-trade agreements. This article replaces the former articles requesting direct shipment and related documentary	According to this methodology it is no longer necessary to provide documentary evidence unless requested by the customs authorities at the time of customs clearance. In such case any means of proof is considered acceptable.[ii]

(*continued*)

TABLE 7.2 (*continued*)

Methodologies	Key features	Main users	Main variations/ Additional features
		evidence commentary.	
Split up consignments and back-to-back COs or replacement certificates	This facility allows splitting consignments and reissuing a new CO or exporter declaration based on the original CO or exporter declaration.	Such facility is rather common practice in EU and ASEAN free-trade agreements. However, many agreements do not provide explicitly for this possibility, even though it is indeed a trade facilitating feature.	According to this procedure, an original CO or exporter declaration is replaced by another CO issued by the customs authorities of the transit country or by a reconsignor for shipment to a third country. Such procedure is subject to a variety of conditions depending on the agreement.

[i] See further section 7.1.1.
[ii] See below excerpts from the EU–Japan FTA agreement.

The examples of the Canadian and Eurasian requirements for direct consignment under DFQF systems and the EU GSP corresponding provisions are at opposing poles. As previously discussed in Chapter 1 concerning the submission of the LDC WTO group to the CRO, the Canadian General Preferential Tariff provisions for documentary evidence of direct consignment contain unusually strict and detailed requirements as follows:[17]

Direct Shipment Requirements

The goods must be shipped directly on a through bill of lading (TBL) to a consignee in Canada from the LDC in which the goods were certified. Evidence in the form of a TBL (or a copy) showing that the goods have been shipped directly to a consignee in Canada must be presented to the CBSA upon request.

The TBL is a single document that is issued prior to the goods beginning their journey when the carrier assumes care, custody, and control of the goods, and it is used to guarantee the direct shipment of goods from the country of origin to a consignee in Canada. It generally contains the following information:

(a) Identity of the exporter in the country of origin;
(b) Identity of the consignee in Canada;

[17] www.cbsa-asfc.gc.ca/trade-commerce/tariff-tarif/ldct-tpmd-eng.html?wbdisable=true.

(c) Identity of the carrier or agent who assumes liability for the performance of the contract;
(d) Contracted routing of the goods identifying all points of transhipment;
(e) Full description of the goods and the marks and numbers of the package;
(f) Place and date of issue.

Note: A TBL that does not include all points of transhipment may be accepted, if these are set out in related shipping documents presented with the TBL.

On a case-by-case basis, an amended TBL may be accepted as proof of direct shipment where documentation errors have occurred, and the amended TBL corrects an error in the original document.

In such cases, the carrier must provide proof that the amended TBL reflects the actual movement of the goods as contracted when the goods began their journey. Documentation presented must clearly indicate the actual movement of the goods.

Air cargo is usually transhipped in the air carrier's home country even if no transhipment is shown on the house air waybill. Therefore, where goods are transported via airfreight, the house air waybill is acceptable as a TBL.

Under the LDCT treatment, goods may be transhipped through an intermediate country, provided that:

(a) They remain under customs transit control in the intermediate country;
(b) They do not undergo any operation in the intermediate country, other than unloading, reloading or
(c) Splitting up of loads or any other operation required to keep the goods in good condition;
(d) They do not enter into trade or consumption in the intermediate country;
(e) They do not remain in temporary storage in the intermediate country for a period exceeding six months.

A consignee in Canada must be identified in field No. 2 to ensure that the exporter in the beneficiary country certified the origin of the goods according to Canadian rules of origin. The consignee is the person or company, whether it is the importer, agent or other party in Canada, to which goods are shipped under a through bill of lading (TBL) and is so named in the bill. The only exception to this condition may be considered when 100 per cent of the value of the goods originates in the beneficiary country in question, in which case no consignee is required.

The combination of such requirements is simply overwhelming in today's business transactions and does not correspond to commercial reality. The requirement that a consignee in Canada should be identified in Box 2 of the CO practically nullifies any possibility for trade through intermediaries or third-country invoicing.

The standard formulation of the documentary evidence of direct consignment in the EU free-trade agreements has traditionally been as follows:

1. The preferential treatment provided for under the Agreement applies only to products, satisfying the requirements of this Protocol, which are transported directly between the Community and (FTA partner country) or through the

territories of the other countries referred to in Articles 3 and 4 with which cumulation is applicable. However, products constituting one single consignment may be transported through other territories with, should the occasion arise, trans-shipment or temporary warehousing in such territories, provided that they remain under the surveillance of the customs authorities in the country of transit or warehousing and do not undergo operations other than unloading, reloading or any operation designed to preserve them in good condition. Originating products may be transported by pipeline across territory other than that of the Community or (FTA Partner country).

2. Evidence that the conditions set out in paragraph 1 have been fulfilled shall be supplied to the customs authorities of the importing country by the production of:
   (a) a single transport document covering the passage from the exporting country through the country of transit; or
   (b) a certificate issued by the customs authorities of the country of transit:
      (i) giving an exact description of the products;
      (ii) stating the dates of unloading and reloading of the products and, where applicable, the names of the ships, or the other means of transport used; and
      (iii) certifying the conditions under which the products remained in the transit country; or
   (c) failing these, any substantiating documents.

According to an EU manual[18] the evidence of direct consignment mentioned in the article above can take any of the three forms outlined in Article 13(2). In the absence of a single transport document (e.g. a through bill of lading) the customs authorities of the countries through which the goods transit must provide documentary proof that the consignment was at all times under their surveillance when on their territory. Such proof must contain the details outlined in paragraph (2) above. In simple terms such documentary proof must detail the history of the journey of the consignment through their territory and the conditions under which the surveillance has been conducted. This documentary proof is known as a certificate of nonmanipulation.

In the absence of either of the foregoing proofs any other substantiating documents can be presented in support of a claim to preference. "However it is difficult to envisage any other documents (e.g. commercial documents) that would adequately demonstrate that all the conditions of paragraph 1 of the Article were satisfied."[19]

Most recently the EU introduced the concept of nonalteration with significant trade facilitating provisions. According to the nonalteration formulation introduced

[18] "A User's Handbook to the Rules of Preferential Origin used in trade between the European Community, other European Countries and the countries participating to the Euro-Mediterranean Partnership," at https://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/customs/customs_duties/rules_origin/preferential/handbook_en.pdf.

[19] Ibid.

in the EU GSP and progressively in many EU free-trade agreements, such as the EU–Japan FTA, only in case of doubt, the EU customs authorities request the declarant to provide evidence of compliance (paragraph 4 of Article 3.2 of the EU–Japan FTA – see below). Without reasonable doubts, it will be assumed that direct consignment requirements are met. Systematic evidence of direct consignment is no longer required.

It is important to emphasize that, even in the case where documentary evidence is requested, the proof of direct consignment may be given "by any means." The leniency of such provision contrasts with the usual provisions of many free-trade agreements, where the proof of direct consignment often may be given only by a through bill of lading or documentary evidence in the form of a certificate or statement of nonmanipulation provided by the customs authorities of the country of transit.

A guide from the EU further specifies the difference between the old system for evidence of direct shipment and the new principle of nonalteration:

> An important difference between the previous direct transportation requirement and non manipulation clause lies in documentary evidence to be provided. Until 31 December 2010, with direct transport in all cases where the goods were transported via another country, except where the country of transit was one of the countries of the same regional group, the EU importer was required to present documentary evidence that the goods did not undergo any operations there (in the country of transit), other than unloading, reloading or any operation designed to keep them in their condition. The types of the referred documentary evidence were strictly defined in the law. The new non-manipulation clause shall be considered as satisfied a priori unless the customs authorities have reasons to believe the contrary; in such cases, the customs authorities may request the declarant to provide evidence of compliance, which may be given by any means.[20]

As discussed in Chapter 4 of this book, the provisions of direct consignment and their application by customs authorities have been found to be one of the reasons for low utilization of trade preferences.

Non-Alteration Provision in the EU–Japan FTA Agreement

Article 3.10 Non-Alteration

1. An originating product declared for home use in the importing Party shall not have, after exportation and prior to being declared for home use, been altered, transformed in any way or subjected to operations other than to preserve them in good condition or than adding or affixing marks, labels, seals or any other

[20] "The European Union's Rules of Origin for the Generalised System of Preferences: A Guide for Users," May 2016, at https://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/customs/customs_duties/rules_origin/preferential/guide-contents_annex_1_en.pdf.

documentation to ensure compliance with specific domestic requirements of the importing Party.

2. Storage or exhibition of a product may take place in a third country provided that it remains under customs supervision in that third country.
3. Without prejudice to Section B, the splitting of consignments may take place in a third country if it is carried out by the exporter or under its responsibility and provided that they remain under customs supervision in that third country.
4. In case of doubt as to whether the requirements provided for in paragraphs 1 to 3 are complied with, the customs authority of the importing Party may request the importer to provide evidence of compliance, which may be given by any means, including contractual transport documents such as bills of lading or factual or concrete evidence based on marking or numbering of packages or any evidence related to the product itself.

7.1.2 *Back-to-Back or Replacement Certificate*

A back-to-back CO is a new CO issued by an intermediate exporting FTA partner country based on the original CO issued by the first exporting FTA partner country.[21] (See Figure 7.1.) The back-to-back CO enables a company to ship its goods to an intermediate FTA partner country for trading or logistical purposes before re-exporting the goods to other FTA partner countries, while still retaining the origin status of the first exporting FTA partner country and the corresponding preferential tariff treatment of the goods. Under the Pan-Euro-Mediterranean (PEM) Convention[22] when consignments arrive in a partner country they may be split up into smaller consignments for

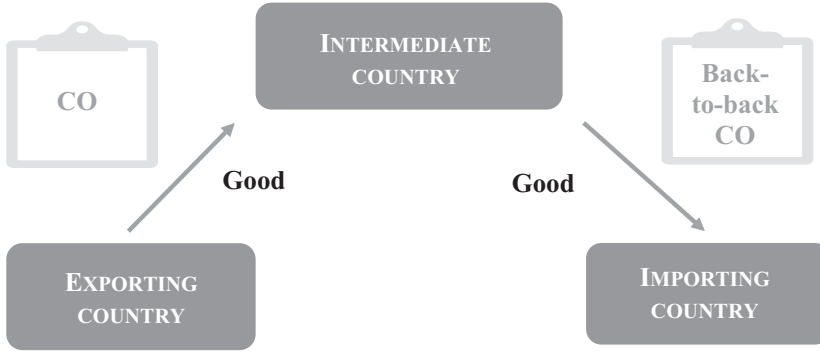


FIGURE 7.1 Back-to-back CO
Note: see also WCO Guidelines on Certification of Origin, last updated June 2018.

[21] In EU jargon the term is "replacement certificate" while in ASEAN jargon it is "back-to-back certificate."
[22] See Chapter 3 of this book.

clearance at different customs offices within that country. In such cases replacement movement certificates, issued on the basis of the EUR.1 that accompanied the original consignment, must accompany each of the smaller consignments. The provisions of the PEM Convention permit the issuing of such replacement EUR.1; however, the consignment must be under the control of the customs that issue the replacements. This article applies only when consignments are split and sent elsewhere in the EU or split and sent to other destinations within the territory of a PEM country.

Movement Certificates in the EU

ARTICLE 18
Issue of movement certificates EUR.1 on the basis of a proof of origin issued or made out previously

When originating products are placed under the control of a customs office in a Party, it shall be possible to replace the original proof of origin by one or more movement certificates EUR.1 for the purpose of sending all or some of these products elsewhere within the European Union or Central America. The replacement movement certificate(s) EUR.1 shall be issued by the customs office in the EU Party under whose control the products are placed or by the respective competent public authority of the Republics of the CA Party.

An application for a back-to-back CO is normally made by the exporter. If the applicable conditions under the relevant free-trade agreement are met, the issuing authority of the intermediate party will agree to issue a back-to-back CO while the product is passing through that party's territory.

As discussed earlier, the administration of rules of origin covers a number of ancillary methodologies related to the origin certification. This is one of the most significant areas where practices for administering vary differently among the different administrations.[23]

7.1.3 *Ancillary Methodologies for Documentary Evidence of Origin*

These ancillary provisions may not be central elements of the proof of origin or fulfillment of the direct consignment requirement. Nevertheless, they constitute a day-to-day challenge for firms and administration dealing with administration of rules of origin. Table 7.3 summarizes the main ancillary requirements while the following sections provide a more detailed explanation and characteristics of these ancillary requirements.

[23] See also "Application in the European Union of the provisions concerning replacement of rule of origin and A.TR. movement certificates: European Union guidelines," at https://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/customs/customs_duties/rules_origin/preferential/movement_certificates_en.pdf.

TABLE 7.3 *Main ancillary methodologies for documentary evidence of origin*

Ancillary	Key features	Main users	Main variations/Additional features
Supplier statements or certificate for cumulation	Supplier statement are used in the EU–Japan and other FTA agreements to prove the originating or non-originating nature of the goods that are to be used.	The EU makes wide use of these supplier statements as it is one of the main users of various cumulation systems.[i]	The supplier statement of origin in the EU, which under the Euro-Mediterranean Convention could also be long-term supply statement, is a unique feature. In other free-trade agreements of the United States, Japan, and in other FTAs there are no extensive provisions regulating supplier's forms. In any case documentary evidence in the form of invoices or other commercial documentation is still required under those free-trade agreements, especially in case of verification.
Third-country invoicing provision	Third country or third party invoice is a provision inserted in some FTAs regulating the case where the commercial invoice has been issued in a country that is not a party to the FTA where the CO or statement of origin has been issued.	ASEAN countries are widely using and regulating the use of third-party invoicing provisions.	Although it is common practice to have an intermediary during commercial transactions, many administrations,especially in developing countries, are concerned that this practice conceals fraud or irregularities and tend to deny preferential treatment in such cases. To obviate to this certain FTAs provide explicitly for third country or party invoicing with a number of conditionalities making the use of such provision difficult.
Accounting segregation	Accounting segregation is a provision inserted in many free-trade agreements when producers/ exporters are storing together originating and non-originating materials.	There are conspicuous differences among customs, such as EU and US administrations, on how accounting segregation is administered and monitored.	The US legislation and NAFTA Uniform Regulations are very detailed, providing examples of various accounting methods that may be used. Conversely, EU provisions are less detailed and provide explicitly that accounting segregation has to be previously authorized by the customs authorities.
	Record-keeping requirements are	Record-keeping requirements are	Record-keeping requirements play a fundamental role in the

TABLE 7.3 (*continued*)

Ancillary	Key features	Main users	Main variations/Additional features
Record-keeping requirements	a general obligation imposed on producers/ exporters to keep for a period (3–5 years normally) all documentary evidence related to proof of origin.	present in almost every free-trade agreement. There are differences in the extent of such obligations in terms of time and the detail of such documentation.	case of verification, since the exporters and producers are obliged to keep and show documentary evidence (i.e. invoices and bills of lading etc.) for the proof of origin that they have issued. This exercise could be tremendously demanding and labor intensive as it may involve hundreds of transactions going back several years.
No duty drawback (DD) clause	DD is a common customs procedure, allowing the repayment of customs duties of imported inputs that are used in the manufacturing of a finished product.	There are significant variations on the treatment of DD in various free-trade agreements. Generally speaking, the United States and the EU tend to prohibit DD.	The prohibition of DD in a free-trade agreement may have significant repercussions on the use of such agreements, especially where the FTA partners have different tariff structures. For this reason, both the EU and the United States allow, under certain conditions, partial DD.

[i] See Chapter 3 of this book on EU FTA agreements.

7.1.3.1 Documentary Evidence Related to Cumulation: The Case of the EU and NAFTA/USMCA

Under the EU model of rules of origin, cumulation has been – and still is – used widely in trade relations with partners. In fact, the EU has been using the quantitative and qualitative aspect of cumulation in modulating concessions with its trading partners and has associated cumulation with a number of administrative requirements; namely, the supplier's declarations. These supplier's declarations, mostly used in the PEM Convention, are a common feature in the EU rules of origin with many trading partners.[24]

[24] Supplier's declarations were part of the former Lomé and Cotonou Convention with ACP states and former Europe Agreement with Eastern European countries.

In particular, an EU regulation[25] and subsequent guidelines[26] provide a rather exhaustive discipline of the complex administrative procedures that are underlying the use of cumulation that is defined in the EU as supplier's declarations.

According to such guidelines a supplier's declaration is a declaration by which a supplier provides information to his customer concerning the originating status of goods with regard to the specific preferential rules of origin. There are also long-term supplier's declarations valid for consignments up to a maximum of two years.

The supplier's declarations are documentary evidence that is needed for:

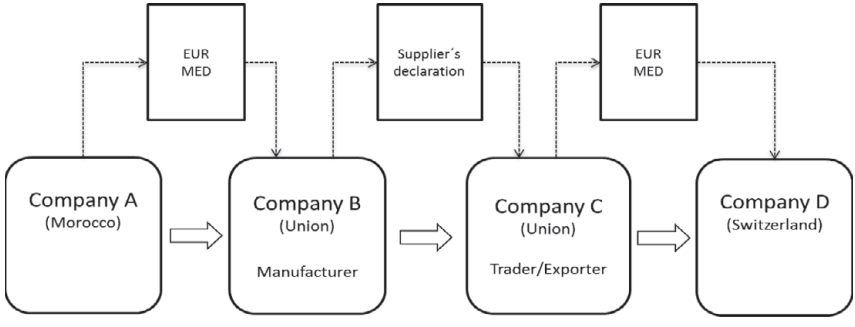
(1) applications for the issue of proof of origin by the customs office (movement certificates EUR.1 or EUR-MED)
(2) the making out of invoice/origin declaration, origin declaration EUR-MED and statement on origin.

Suppliers' declarations are mainly used for deliveries of goods within the EU.

Pan-Euro-Mediterranean Cumulation

In the framework of the Pan-Euro-Mediterranean Convention the wording of the supplier's declaration varies when the product acquires its preferential originating status pursuant to a diagonal cumulation of origin with Mediterranean countries participating in the Barcelona process. The details provided are intended to ensure the traceability of the countries with which Pan-Euro-Mediterranean cumulation is applicable.

Example 1



[25] Commission Implementing Regulation (EU) 2015/2447, November 24, 2015, setting out detailed rules for implementing certain provisions of Regulation (EU) No. 952/2013 of the European Parliament and of the Council laying down the Union Customs Code.

[26] See publication entitled "Application in the European Union of the provisions concerning the supplier's declaration: European Union guidelines," May 2018, at https://ec.europa.eu/taxation_customs/sites/taxation/files/suppliers-declaration-may-2018_en.pdf.

Source: European Commission, "Application in the European Union of the provisions concerning the supplier's declaration: European Union guidelines," May 2018.

Ballpoint pens (tariff heading 9608) are manufactured in the European Union and exported under preference to Switzerland.*

For this purpose:

- *pen refills (tariff heading 9608) originating in Morocco are exported to the European Union with proof of origin (EUR-MED).*
- *Company B manufactures ballpoint pens using the pen refills from Morocco and the remaining components processed are originating in the European Union.*
- *The ballpoint pens are sold by company B (the manufacturer) to the company C (trader) located in the European Union. Company C requires a supplier's declaration for the export of the goods under preference to company D in Switzerland.*
- *Company B makes out a supplier's declaration mentioning the following:*

  "Originate in the European Union" and "satisfy the rules of origin governing preferential trade with Switzerland" and "Cumulation applied with Morocco"

- *Company C sells the ballpoint pens to Company D in Switzerland with EU origin (proof of origin EUR-MED – cumulation applied with Morocco)*

* ***list rule for tariff heading*** *9608:*
Manufacture from materials of any heading, except that of the product. However, nibs or nib-points of the same heading as the product may be used.

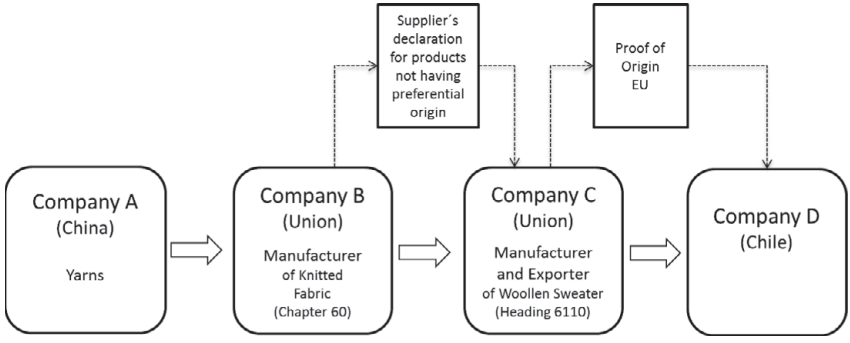
Supplier's Declarations for Products Not Having Preferential Origin Status in the European Union

Supplier's declarations for products not having preferential origin status should in principle only apply to deliveries within the EU. They are relevant if:

- the goods supplied were worked or processed in the EU, but did not acquire the preferential originating status and
- these goods are undergoing further working or processing by the consignee and
- the addition of the working or processing made by the various operators in the EU allows the products to obtain a preferential originating status.

Thus, a supplier's declaration for products not having preferential origin status doesn't certify an existing preferential origin of goods to the consignee. This type of supplier's declaration contains information about the non-originating materials used or the work or processing carried out.

Example 2



Source: European Commission, "Application in the European Union of the provisions concerning the supplier's declaration: European Union guidelines," May 2018.

A woollen sweater (chapter 61 in the customs nomenclature) is manufactured in the European Union and exported under preference to Chile.

For this purpose:

- *yarn originating in China is exported to the European Union.*
- *Company B in the European Union works on the Chinese yarn and obtains knitted fabric (chapter 60 in the HS).*
- *The knitted fabric is sold to Company C located in the European Union. Company C manufactures the woollen sweater from the knitted fabric. Company C requires a supplier's declaration from Company B for the export of the goods under preference to company D in Chile. Company B makes out a supplier's declaration "for products not having preferential origin". Indeed, the knitted fabric has not acquired EU origin according to the list rule applying to goods classified under chapter 60 (manufacture from natural fibres, man-made staple fibres, not carded, or combed or otherwise processed for spinning, or chemical materials or textile pulp) in the EU–Chile FTA. The supplier's declaration mentions that the knitted fabric was manufactured from non-originating yarn.*
- *As a consequence, the supplier's declaration proves that the final product, the woollen sweater, has been manufactured from yarn. The list rule applying to a woollen sweater classified in chapter 61 is respected.*
- *Company C sells the woollen sweater to Company D in Chile with EU origin (EUR.1 or invoice declaration).*

However, supplier's declarations in trade with some partner countries of the EU can be issued by EU exporters. These supplier's declarations are defined in the guidelines as "cross-border supplier's declarations" for products not having preferential origin status when applying full cumulation, as follows:[27]

[27] Ibid.

In this context, cross-border should be understood as meaning that the consignment of goods crosses the external borders of the European Union (import or export).

They are intended for the movement of goods:

- within the European Economic Area (EEA including the European Union, Iceland, Liechtenstein and Norway), in accordance with Article 27(2) of the origin protocol of the EEA Agreement, with the Maghreb countries (Algeria, Tunisia, Morocco) in accordance with Article 27a(2) of the origin protocols to the agreements with these countries, Article 27a of Decision No 2/2007 of the Association Council between the EU and Algeria,[28] Article 27a of Decision No 1/2006 of the Association Council between the EU and Tunisia or Article 27a of Decision No 2/2005 of the Association Council between the EU and Morocco
- with the countries that are part of the African, Caribbean and Pacific (ACP) Group of States under the Market Access Regulation (MAR), Article 26 (2) Annex II Council Regulation (EC) 2016/1076
- with Overseas Countries and Territories (OCTs) referred to in Article 32 (2) in Annex VI of Council Decision on the association of the overseas countries and territories with the European Union
- with CETA (Canada) referred to in Article 3(5) and Annex 3 of the Protocol on Rules of Origin and origin procedures
- with SADC referred to in Articles 3(4), 3(5), 4(6), 4(7) and 30 and Annex V B of the Protocol 1 on rules of origin and origin procedures
- with CARIFORUM referred to in Articles 2(3), 3(2), 4(2) and 27 and Annex V B of the Protocol 1 on rules of origin and origin procedures
- with ESA referred to in Articles 3(4), 4(4) and 28 and Annex V B of the Protocol 1 on rules of origin and origin procedures
- with Pacific referred to in Articles 3(4), 4(4) and 26 and Annex V B of the Protocol II on rules of origin and origin procedures.

In contrast, the United States, while using cumulation, albeit in a different form and to a different extent, is not using any comparable form of supplier's declaration. This difference may derive from the fact that the United States does not apply what is called diagonal cumulation among different US FTA partners like the EU. In simple words, the United States has entered into free-trade agreements with Colombia and Peru and each of these agreements provides for bilateral cumulation – that is, between the United States and Colombia and the United States and Peru – but not for diagonal cumulation – that is, Colombia or Peru may not use originating products in Peru or Colombia to be incorporated into a final product originating in Peru or Colombia for exports to the United States. The North American Free-Trade Agreement (NAFTA) and USMCA provide for cumulation among the three countries but neither NAFTA or USMCA contain provision for expanding cumulation to other countries.

[28] Full cumulation does not apply in the complete zone EU–Tunisia–Morocco–Algeria, due to the fact that Algeria has only signed a Pan-Euro-Mediterranean agreement with the EU, and not with Tunisia and Morocco.

This difference may explain why in practice there is no formal documentary evidence requirement in US legislation to show whether or not inputs from suppliers are originating. However, this does not mean that there are no provisions on cumulation in US legislation, nor that the use of cumulation is not checked or monitored. On the contrary, checking documentary evidence of originating status of cumulated inputs is also required in the case of US and North American-inspired free-trade agreements at the moment of verification of proof of origin, rather than using prescribed forms such as supplier's declarations. In a word, the US model and several US-inspired free-trade agreements that adopt an importer-based approach are basically shifting the burden of the proof of origin of cumulation to the eventual *ex post* verification process rather than using an *ex ante* form of supplier's declaration.

In any case, the NAFTA Uniform Regulations[29] especially provide that the producers making use of the cumulation have to have a statement proving the originating status of the goods. This requirement is specific in section 14(5) of Title IV Accumulation and it is articulated differently depending on whether or not the cumulated inputs are subject to a regional value content (RVC) requirement:

> (5) For purposes of this section,
>
> (a) in order to accumulate the production of a material
>
> (i) where the good is subject to a regional value-content requirement, the producer of the good must have a statement described in subsection (2) or (3) that is signed by the producer of the material, and
>
> (ii) where an applicable change in tariff classification is applied to determine whether the good is an originating good, the producer of the good must have a statement signed by the producer of the material that states the tariff classification of all non-originating materials used by that producer in the production of that material and that the production of the material took place entirely in the territory of one or more of the NAFTA countries . . .

In a similar fashion, the USMCA Uniform Regulations provide the following documentary evidence related to the use of cumulation:

> (7) *Particulars*. For the purposes of this section,
>
> (a) in order to accumulate the production of a material,
>
> (i) if the good is subject to a regional value content requirement, the producer of the good must have a statement described in subsection (2) through (5) that is signed by the producer of the material, and
>
> (ii) if an applicable change in tariff classification is applied to determine whether the good is an originating good, the producer of the good must have a statement signed by the producer of the material that states the tariff

[29] The NAFTA Uniform Regulations are available at www.cbsa-asfc.gc.ca/publications/dm-md/d11/d11-4-18-eng.html.

classification of all non-originating materials used by that producer in the production of that material and that the production of the material took place entirely in the territory of one or more of the USMCA countries;

(b) a producer of a good who chooses to accumulate is not required to accumulate the production of all materials that are incorporated into the good; and

(c) any information set out in a statement referred to in subsection (2) through (5) that concerns the value of materials or costs is to be in the same currency as the currency of the country in which the person who provided the statement is located.[30]

7.1.3.2 Third-Country Invoicing

The WCO guidelines on third-country invoicing mention that:

> it is a common practice in today's international trade to involve an intermediary between the importer and the exporter. This practice must be recognized and the related procedures must be in place. In trade involving an intermediary residing in a third country, the invoice issued in the third country (a third country invoice) would be submitted to the Customs of the importing country to support the import declaration.

Third-country invoicing is a reflection of current business practices of trading through agents or intermediaries. It is a procedure that allows originating goods exported to an FTA member country with a preferential CO to qualify for preferential tariff treatment even if the accompanying sales invoice is issued by:

(a) a company located in a non-FTA member country or

(b) an exporter in an FTA member country for the account of the company (see Figure 7.2).

This arrangement helps manufacturers who have limited market access and facilitates trade among FTA member countries.

In spite of the WCO recommendation that provisions have to be made in free-trade agreements for allowing third-country invoicing, in practice few agreements have explicit provisions on it. Additionally, and as discussed in section 7.6.4, when provisions for third-country invoicing exist, as in many ASEAN free-trade agreements,[31] there are a number of additional requirements to meet. There are no express provisions for third-country invoicing in the EU free-trade agreements. USMCA contains the following provision, recognizing that third-country invoicing is a common practice:

> 4. A Party shall not reject a claim for preferential tariff treatment for the sole reason that the invoice was issued in a non-Party. However, a certification of origin

[30] See USMCA Uniform Regulations, Part V, section 9, Accumulation, para. 7.

[31] See section 7.6.

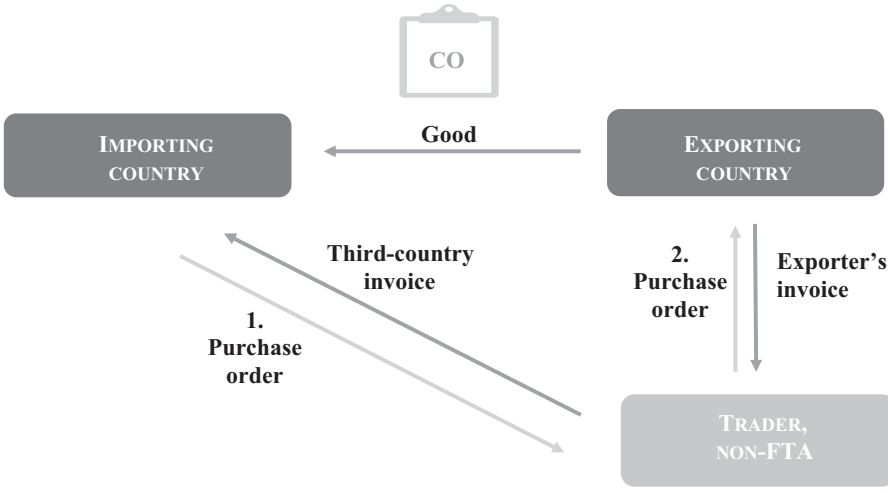


FIGURE 7.2 Third-country invoicing
Note: See also WCO Guidelines on Certification of Origin, last updated June 2018.

shall not be provided on an invoice or any other commercial document issued in a non-Party.[32]

USMCA, unlike ASEAN free-trade agreements, does not subject third-country invoicing to a special procedure but just ensures that the certification of origin is not to be provided by the third party.

7.1.3.3 Accounting Segregation

Accounting segregation is a procedure used to differentiate originating inputs from non-originating inputs when fungible goods are used to produce a finished product. Fungible goods are goods that are interchangeable for commercial purposes, and have essentially identical properties.

NAFTA and USMCA, like many other US free-trade agreements, provide for extensive regulations for accounting segregation. Accounting segregation is necessary when physical identification of originating goods is impossible and a producer mixes originating and non-originating fungible goods, most often in the production of finished product. Under such cases the producer may determine origin of those goods based on any of the standard inventory accounting methods (e.g. first in, first out (FIFO) or last in, last out (LIFO)) specified in NAFTA and USMCA and further detailed in the Uniform Regulations. These provisions apply equally to fungible materials that are used in the production of a good.

Company Y of Mexico supplies clips to airplane manufacturers throughout North America. Some of the clips Y supplies originate in Mexico and others are made in

[32] See USMCA, Chapter 5 on origin procedures.

China. All of the clips are of identical construction and are intermingled at Y's warehouse so that they are indistinguishable. On January 1, Company Y buys 3,000 clips of Mexican origin; on January 3 it buys 1,000 clips of Chinese origin. If Company Y elects FIFO inventory procedures, the first 3,000 clips it uses to fill an order are considered Mexican, regardless of their actual origin.[33]

Similar provisions, albeit not as detailed and specific as in the case of US free-trade agreements and NAFTA and USMCA Uniform Regulations, are also applied in the context of the EU. According to an EU manual[34] a trader who applies for authorization to use accounting segregation must first of all be able to prove that physical segregation of materials would be either impractical or would involve unreasonable financial costs to him.

According to this EU manual:

> It must also be impossible to distinguish the originating and non originating materials once they have been incorporated in the finished product. The accounting system must be able to maintain a clear distinction between the quantities of originating and non-originating materials acquired and show the dates they were put in stock.
>
> It may be necessary to also indicate the values of the materials, both originating and non-originating. It must also be possible to identify the quantities of finished products manufactured by using the originating and non-originating materials as well as the quantities of the products supplied to those traders requiring proof of originating status and to those who do not have such requirements.

The abovementioned EU practice differs from NAFTA practice, which establishes choices of different accounting segregation methodologies and accounting examples as follows:[35]

> "average method" means the method by which the origin of fungible materials withdrawn from materials inventory is based on the ratio, calculated under section 5, of originating materials and non-originating materials in materials inventory;
>
> "FIFO method" means the method by which the origin of fungible materials first received in materials inventory is considered to be the origin of fungible materials first withdrawn from materials inventory;
>
> "LIFO method" means the method by which the origin of fungible materials last received in materials inventory is considered to be the origin of fungible materials first withdrawn from materials inventory;

[33] Example drawn from www.cbp.gov/trade/nafta/guide-customs-procedures/other-instances-confer-origin/fungible-goods.

[34] "A User's Handbook to the Rules of Preferential Origin used in trade between the European Community, other European Countries and the countries participating to the Euro-Mediterranean Partnership" (fn. 18 above).

[35] See NAFTA Uniform Regulations, Part II, fungible goods.

"materials inventory" means,

(a) with respect to a producer of a good, an inventory of fungible materials that are used in the production of the good, and

(b) with respect to a person from whom the producer of the good acquired those fungible materials, an inventory from which fungible materials are sold or otherwise transferred to the producer of the good;

"opening inventory" means the materials inventory at the time an inventory management method is chosen;

"origin identifier" means any mark that identifies fungible materials as originating materials or non-originating materials.

In addition, the EU legislation requires that only traders who have been authorized by the customs can avail themselves of accounting segregation and the conditions for granting the authorization will be laid down by the national customs authorities. This practice requires a multinational firm established in multiple EU member states to secure approval from the different customs authorities of EU member states, since there is no EU approval valid for all EU member states.

A user manual[36] lists the numerous criteria and conditions to be addressed in order to be eligible for accounting segregation:

Conditions for the use of "accounting segregation" for the management of stocks of materials used in manufacture:

i) Authorisation to use accounting segregation for the management of stocks of materials used in manufacture shall be granted to any manufacturer who submits to the customs authorities a written request to this end and who satisfies all the conditions for the granting of the authorisation.

ii) The applicant must demonstrate a need to use accounting segregation on the grounds of unreasonable costs or impracticability of holding stocks of materials physically separate according to origin.

iii) The originating and non-originating materials must be fungible, meaning of the same kind and commercial quality and possess the same technical and physical characteristics. It must not be possible to distinguish materials one from another for origin purposes once they are incorporated into the finished product.

iv) The use of the system of accounting segregation shall not give rise to more products acquiring originating status than would have been the case had the materials used in the manufacture been physically segregated.

v) The accounting system must:

- maintain a clear distinction between the quantities of originating and non-originating materials acquired, showing the dates on which those materials were placed in stock and, where necessary, the values of those materials;

[36] "Guide to the Protocol on Rules of Origin of the Economic Partnership Agreement (EPA) between the European Union and its Member States, of the one part, and the SADC1 EPA States, of the other part," Taxud.b.4(2017)3253415.

- show the quantity of:
  (a) originating and non-originating materials used and, where necessary, the total value of those materials;
  (b) finished products manufactured;
  (c) finished products supplied to all customers, identifying separately:
    (i) supplies to customers requiring evidence of preferential origin (including sales to customers requiring evidence other than in the form of a proof of origin), and
    (ii) supplies to customers not requiring such evidence;
- be capable of demonstrating either at the time of manufacture or at the time of issue of any proof of origin (or other evidence of originating status), that stocks of originating materials were deemed available, according to the accounts, in sufficient quantity to support the declaration of originating status.

vi) a) The stock balance to which reference is made in paragraph 5 final indent shall reflect both originating and non-originating materials entered in the accounts. The stock balance shall be debited for all finished products whether or not those products are supplied with a declaration of preferential originating status.

b) Where products are supplied without a declaration of preferential origin, the stock balance of non-originating materials only may be debited for as long as a balance of such materials is available to support such action. Where this is not the case, the stock balance of originating materials shall be debited.

c) The time at which the determination of origin is made (i.e. time of manufacture or date of issue of proof of origin or other declaration of origin) shall be agreed between the manufacturer and the customs authorities and be recorded in the authorisation granted by the customs authorities.

vii) At the time of the application to commence using a system of accounting segregation, the customs authorities shall examine the manufacturer's records to determine opening balances of originating and non-originating materials that may be deemed to be held in stock.

viii) The manufacturer must:
- accept full responsibility for the way the authorization issued and for the consequences of incorrect origin statements or other misuses of the authorisation;
- make available to the custom authorities, when requested to do so, all documents, records and accounts for any relevant period.

ix) The customs authorities shall refuse authorisation to a manufacturer who does not offer all the guarantees that the customs authorities deem necessary for the proper functioning of the accounting segregation system.

x) The customs authorities may withdraw an authorisation at any time. They must do so whenever the manufacturer no longer satisfies the conditions or no longer offers the specified guarantees. In this case the authorities shall invalidate the proofs of origin or other documents justifying origin that have been incorrectly issued.

The same user's manual offered a number of "comments" on how to manage the accounting segregation and the "*ratio legis*" of such provision:

Often producers have to source their raw materials from both originating and non-originating sources. An economic operator who applies for an authorisation to use accounting segregation must be able to prove that physical segregation of materials would be either impractical or would involve unreasonable financial costs to him.

The primary condition attached to this method of accounting is that it must be evident that, at any time, the number or the quantity of originating products would be the same if the originating and non-originating materials or products had been physically separated. In other words, the amount of originating products resulting from the use of originating and non-originating materials or products must be the same, no matter the method of segregation used.

It must also be impossible to distinguish the originating and non-originating materials once they have been incorporated in the finished good. The accounting system must be able to maintain a clear distinction between the quantities of originating and non-originating materials acquired and show the dates they were put in stock. It may be necessary to also indicate the values of the materials, both originating and non-originating. It must also be possible to identify the quantities of finished goods manufactured by using the originating and non-originating materials as well as the quantities of the products supplied to those economic operators requiring proof of originating status and to those who do not have such requirements.

The purpose of this Article is to benefit those producers who are not in a position to physically separate originating and non-originating materials as well as to minimise the financial burden placed on manufacturers that physical segregation would incur. However, only economic operators who have been authorised by the customs authorities can make use of accounting segregation and the conditions for granting the authorisation will be laid down by the customs authorities.

However, the customs authorities also have the right to withdraw an authorisation should the manufacturer no longer satisfy the conditions of his authorisation or no longer offers the guarantees specified in it. The customs authorities will also invalidate any proofs of origin incorrectly issued as a result of the incorrect application of accounting segregation.

7.1.3.4 Record-Keeping Requirements

Record keeping requirements are a common feature of all free-trade agreements and consist of an obligation of the exporters and producers to keep documentary evidence of proof of rules of origin and related documentation in case of verification. As detailed further in this chapter there are significant variations among free-trade agreements about the length of the period for keeping the required documentary evidence, usually ranging from three to five years.

7.1.3.5 Duty Drawback (DD)

DD is a common customs procedure, allowing the refunding, remission, or non-payment – partial or complete – of customs duties or equivalent charges on non-

originating inputs (raw, semi-manufactured materials or components) that are used in the production of a final product that is exported to a third country. DD is commonly used in export processing zones (EPZs) or special economic zones (SEZs) to attract foreign investment for manufacturing destined for exports.

The common practice of the EU and United States is to prohibit DD in the context of free-trade agreements since it could create an imbalance among the parties to the agreements.

In short, the imbalance caused by DD is due to the fact that a producer of FTA partner country A can source on a duty-free basis from third countries for export to FTA partner country B, whilst their competitors in country B have to pay the applicable most-favored nation (MFN) duties when sourcing from third countries for products sold on their own domestic market.

Example: a company from an FTA partner exporting fabrics to the EU would benefit from duty drawback for the fibres it imports from a third country to produce the fabrics; in contrast, an EU fabric manufacturer selling in the EU would not benefit from the reimbursement of duties paid on the fibres it may import from third countries for the manufacturing of those fabrics. If the share of such imported fibres in the value of the fabric is, say, 25% for the EU manufacturer, the potential competitive advantage of that exporter in the EU (expressed as a percentage of the EU manufacturer's total price of the finished fabric) would be the result of multiplying by 25% the import duty rate in the EU of such fibres (4%), so some 1% of the value of the fabric.[37]

Generally speaking, DD can lead to unbalanced competition in the market of the importing country which can have negative effects on domestic industry with possible consequences on employment. Additionally, allowing DD would also enable third countries to have a free ride in the benefits of the free-trade agreement, as regards trade in intermediate products and materials.

The EU policy on DD as contained in a Commission paper[38] is geared toward a prohibition of DD in free-trade agreements. However, such prohibition is tempered[39] by a number of considerations and examples contained in the Commission paper.

The Commission paper rightly considered that the impact of a DD in a free-trade agreement depends on a number of factors depending mainly on the level of MFN duties applicable in the importing country as detailed below:

[37] Example drawn from "The future of 'Duty Drawback' in the rules of origin of EU free trade agreements," COM(2010) 77 final, March 9, 2010.

[38] See ibid.

[39] DD is prohibited, subject to transitional arrangements, in the free-trade agreements with developing countries like Mexico and Chile and all the Euro-Mediterranean free-trade agreements. However, it has been permitted in trade preferences linked to development purposes: under the GSP rules applicable to all developing countries and for ACP countries under Cotonou, in the EPAs, and in the Trade, Development and Co-operation Agreement (TDCA) with South Africa.

a) As regards the impact on the competitive position of exporters of finished products, the relevant factors are the MFN duties that the exporting country applies on intermediate materials combined with the degree of foreign sourcing in the same country: the higher the MFN duties and the greater the use made of foreign inputs (depending on RoO within the FTA) are, the greater the impact of DD could be on the final product exported. This is one of the main reasons why, for example, traditionally in most countries in Asia where MFN duties are relatively high, allowing DD plays a much more important role than in US or EU where MFN duties are comparatively relatively low.

Example: Ruritania applies a 14% tariff on the imports of fibres from third countries; if imported fibres account for 25% of the value of the fabrics exported by a Ruritanian company, the value of the duties paid on such imported fibres would be 3,5% (25% of 14%) of the value of the Ruritanian exporter's fabric. As seen above, for an EU exporter the value of the duties imposed on the import of such fibres would be 1% of his own fabric's price.

b) As regards the impact on competition in the finished products market in the importing country, the most relevant aspect is the MFN duty that the importing country applies on intermediate materials: the higher the MFN duties that a preferential country applies on the import of intermediate materials and the higher the use by domestic manufacturers of such imported materials from a third country, the bigger potentially the competitive disadvantage of domestic manufacturers of finished products as compared with exporters from an FTA partner country that benefits from DD.

To follow the same example above, the fabric manufacturer in the EU importing fibres from third countries would have to pay import duties on such fibres corresponding to 1% of its selling price, regardless of whether duty drawback is allowed or prohibited. Thus, in case duty drawback is allowed in an FTA, the competitive advantage of an exporter from an FTA partner country, say, Ruritania over a domestic EU producer would be 1% of the value of the fabrics.

If we look at the situation in Ruritania, a Ruritanian fabrics manufacturer importing the same amount of fibres from third countries would have to pay duties on imported fibres worth 3,5% of the value of the fabrics: this would constitute the advantage for an EU manufacturer exporting such fabrics to Ruritania in case duty drawback were allowed.

However, in case duty drawback were prohibited in an FTA between the EU and Ruritania, the Ruritanian exporter to the EU would be faced with a negative advantage of 2,5% of the value of the fabrics (3,5% in duties it would pay on the fibres imported from third countries minus 1% of the duties paid on the same fibres by its EU competitor); conversely, the EU exporter to Ruritania would have a competitive advantage in Ruritania of 2,5% (3,5% of duties paid by Ruritanian manufacturers minus 1% paid on such imports by EU exporters).

c) To switch from trade in finished products to trade in intermediate materials, the key factor that determines the impact on trade of intermediate materials and components between the EU and our FTA partners is the level of import

> duties applied by both sides on these materials and components that will be eliminated under a FTA: the higher such duties, the more trade between FTA partner countries in those materials will be encouraged, to the detriment of third country suppliers.

The Commission paper also outlines another factor interplaying with DD; namely, the degree of restrictiveness or leniency of the rules of origin under the free-trade agreement. In fact, the product-specific rules of origin (PSRO) determine the level of permissible non-originating materials and therefore the maximum amounts of duty that may have to be paid or that can be drawn back if the final product is exported.

The relevance and the trade effects of DD depend on the economy of the country, more specifically the structure of the tariff. Indeed, as regards trade in finished products, the impact on developed countries like QUAD[40] of allowing DD is relatively limited, as QUAD countries generally apply very low tariffs on the import of intermediate products/materials and, because of the varied QUAD industry base, there is less need for non-originating materials given their sophisticated industrial structure. However, the situation is much different for developing countries that are increasingly becoming free-trade agreement partners with QUAD countries or are negotiating such agreements among themselves. In particular, the Commission paper argued that such an impact may be greater in the EU trading partners, which often apply higher import duties and which, because of their size, have to rely more on non-originating materials.

In short the Commission paper found that even if the prohibition of DD was the preferred option in a free-trade agreement context, this policy can create problems in its application because it may act as a disincentive to enter into such agreements with the EU since, for some products, the producers of a partner country could even prefer to use MFN tariff duty, given that the cost of renouncing DD could be higher than the applicable MFN duty in the EU Market:

> To which degree these problems arise and their relative importance as compared with the impact of allowing DD depend, as indicated above, on different economic parameters like respective MFN tariffs of both countries, level of reduction/abolition of tariffs within the FTA, and the level of "leniency" of the "rules of origin" and thus maximum foreign content allowed and the economies of both partners.[41]

As a first example, the Commission paper found that developing countries are entitled to apply DD for all their exports to the EU under unilateral preferences (GSP); in fact, a large share of the exports of many developing countries to the EU are already duty free or subject to very low duty rates (sometimes called "nuisance duties") under the GSP whilst benefiting from DD. In those cases, the resulting situation under a free-trade agreement would be worse than currently for those products benefiting from zero duty under the GSP if DD is prohibited.

[40] Canada, the EU, Japan, and the United States.

[41] See "The future of 'Duty Drawback' in the rules of origin of EU free trade agreements" (fn. 37 above).

A calculation quoted in the Commission paper identified that shares of such exports subject to zero duty under the GSP in 2008 were: 24% for India, 10% for ASEAN countries, 20% for Central America, 13% for Colombia, and 23% for Peru. In these cases, free-trade agreement treatment would be worse in case of a prohibition of DD. To give an example, from the Commission paper:

> EU MFN duty for motor vehicle engines is 4,2%, but after the duty reduction under the GSP Regulation this duty is brought to zero for all developing countries. Thus, a developing country can export those engines under the GSP to the EU duty free and with duty drawback. If under an FTA with a developing country duty drawback were prohibited, the FTA treatment for the engines exporter from that developing country would be worse than the current one: assuming that the value of the engine is 2.000 €, and that the share of parts imported for the manufacture of the engine was 20%, if the average import duties on such parts is, say, 16%, the engines exported under the FTA from that developing country would be facing an additional cost of 64 € as compared with its exports under the current rules (20% of 2.000 € x 16% = 64 €, which would be equivalent to a duty of 3,2% on the engine). Should the share of imported parts used reach the maximum allowed under the EU standard rules of origin (40%), then the additional cost would be double, 128 €, which equals 6,4% of the value of the export and which is higher than the EU MFN import duty.

The Commission paper concluded that, as a matter of general policy, prohibition of DD in free-trade areas should be applied. However, some exceptions could be allowed to counteract the possible trade effects of the prohibition on partner countries as such prohibition could act as a disincentive to enter into free-trade agreements with the EU.

According to the Commission paper, such limited possibility for exceptions can be based on a comprehensive assessment of the following criteria:

a) The extent to which the RoO of the FTA are satisfactory for the EU including for its industry. Indeed, having the right product-specific RoO may be as significant or more in economic terms than prohibiting DD. On the one hand, the RoO in our FTAs should require an adequate level of transformation and/or value added, in order to promote that the benefits of the FTA accrue primarily to the FTA partners. On the other hand, it would be highly desirable that the FTAs have the same or similar RoO, as it is not practicable for EU industry to adjust foreign sourcing to rules different depending on the market of destination. Thus, the acceptance of rules of origin as close as possible to the EU standard rules of origin is an important and relevant factor to take into consideration. Once acceptable RoO are agreed that overall fulfils the needs of EU industry, it could thus be acceptable to show flexibility on DD, although preferably within certain limits, taking into account the other criteria below.
b) The likely impact of allowing – or as appropriate prohibiting – DD, both in terms of competitive conditions in the EU market as well as on EU exporters, should be assessed and taken into account in evaluating the overall balance of

the agreement. Such an analysis, including a quantitative assessment that should start early in the negotiating process and will in any case precede the decision on the conclusion of the FTA, will look into the impact on trade, production, investment and employment, on the use of the cumulation possibilities under the FTA, and on affected developing countries.

c) The ambition of the FTA in terms of market access and the extent to which it meets the interests of EU industry. Elements that may be considered, on a case by case basis, to assess such flexibility are the extent to which more advanced countries assume ambitious trade liberalisation commitments as a result of the FTA that constitute an overall satisfactory outcome for EU industry. Similarly, adequate market access conditions should be provided for EU exporters of intermediate products to whom it would not otherwise accrue some FTA benefits.

d) Development considerations, including the extent to which a FTA negotiating partner is already exporting duty free (or under so-called "nuisance duties") to the EU with DD, the impact of prohibiting DD on the benefits and on the incentives for them to enter into an FTA, and the effects of allowing DD on the use of domestically produced intermediate materials. The degree of development of the third country concerned should also be taken into consideration.

As to the possible concessions on DD, an example of limited flexibility could be to restrict DD to the difference between the average MFN rates applicable to intermediate inputs in the partner country and the EU respectively when the MFN duty rates of a future partner country are relatively high and relatively low in the EU. This could be attempted generally or for some sectors (or even products as necessary) where the impact of DD due to the differential MFN duties may be more significant. This would aim at maintaining a level playing field for the industries of both countries within the free trade zone. In other cases, time limitations or other limits could be considered. In the case of developing countries, a less demanding position would be justified in the light of a development-friendly policy (the degree of which may depend on whether it concerns an LDC or GSP+ country or not), and taking into account that they already benefit from DD for their exports to the EU under the GSP.

NAFTA prohibited DD but it allowed that some form of duty reduction payments of manufacturing drawbacks will be limited to an amount equal to the lesser of the United States external tariff or the NAFTA internal tariff:

Example: A U.S. company imports third-country parts and pays duty thereon. The company then uses the parts to manufacture articles. The articles are exported to Mexico. The U.S. company would be eligible to claim drawback in the amount of either the U.S. duty paid or the Mexican duty paid, whichever is less.[42]

[42] Example drawn from Neville Peterson LPP: "Duty drawback under NAFTA," at www.npllptradelaw.com/duty-drawback-under-nafta.

A study comparing the treatment of drawback in US–Chile FTA agreement and the DRC–CAFTA[43] found that the Chile–US FTA agreement prohibits DD:

> Except as otherwise provided in this Article, neither Party may refund the amount of customs duties paid, or waive or reduce the amount of customs duties owed, on a good imported into its territory, on condition that the good is: (a) subsequently exported to the territory of the other Party (b) used as a material in the production of another good that is subsequently exported to the territory of the other Party; or (c) substituted by an identical or similar good used as a material in the production of another good that is subsequently exported to the territory of the other Party.

Conversely the study found that there is no such general prohibition in DR–CAFTA free-trade agreements. Central American countries apply drawback and have some duty deferral programs such as export processing zones. In general, the provisions inserted in US free-trade agreements prohibit refunds, waivers, or reductions of customs duties for goods which are conditioned on the subsequent exportation of those goods to the other party or used in the production of other goods that are to be exported to the other party, or are substituted by identical or similar goods used as input for goods that are to be exported to the other party. However, in some cases and under specific circumstances DD is still allowed in US free-trade agreements.

7.1.4 *Verifications of Proof of Origin*

Verification of proof of origin is in itself a science that would deserve a full section in this book. The present analysis is limited to comparing the different texts in a sample of free-trade agreements. Verification of proof of origin is the policing of compliance with rules of origin and often involves an overall auditing of how a firm has organized its compliance policy and management with rules of origin. As such it is a significant and extremely burdensome procedure for firms, leading to potential fines and legal proceedings if they are found to be guilty of noncompliance. The verification of proof of origin is one of the aspects of rules of origin covered by Annex K of the revised Kyoto Convention, discussed in Chapter 1 of this book. Specific sections of this chapter deals with the issue of verification, such as section 7.2.2.2 on GSP, section 7.5.2 for NAFTA and USMCA, and section 7.4.6 on the Euro-Med Convention. The WCO has published extensive guidance and publications on this subject.[44]

[43] See a joint project of the Integration and Regional Programs Department of the Inter-American Development Bank (IDB), the Trade Unit of the General Secretariat of the Organization of American States (OAS), and the Washington Office of the United Nations Economic Commission for Latin America and the Caribbean (ECLAC), at www.sice.oas.org/TPCStudies/USCAFTAChl_e/Contents.htm#Contents.

[44] See www.wcoomd.org/-/media/wco/public/global/pdf/topics/research/research-paper-series/20_preforigin_worldtrends_tanaka_en.pdf?db=web.

A Brief Comparison of Verification Provisions in Selected Free-Trade Agreements

USMCA	US–Korea	EU–SADC	EU–Japan	Japan–Thailand	CP-TPP
STEP 1					
Article 5.9: Origin Verification	Article 6.18: Verification	Article 38 Verification of proof of origin	Article 3.21: Verification	Article 43 Request for Checking of Certificate of Origin	Article 3.27: Verification of Origin
1. For the purpose of determining whether a good imported into its territory is an originating good, the importing Party may, through its customs administration, conduct a verification of a claim for preferential tariff treatment by one or more of the following:	1. For purposes of determining whether a good imported into its territory from the territory of the other Party is an originating good, the importing Party may conduct a verification by means of:	1. Subsequent verifications of proof of origin shall be carried out based on risk analysis and at random or whenever the customs authorities of the importing country have reasonable doubts as to the authenticity of such documents, the originating status of the products concerned or the fulfilment of the other requirements of this Protocol.	1. For the purposes of verifying whether a product imported into a Party is originating in the other Party or whether the other requirements of this Chapter are satisfied, the customs authority of the importing Party may conduct a verification based on risk assessment methods, which may include random selection, by means of a request for	1. For the purposes of determining whether a good imported from the other Party under preferential tariff treatment qualifies as an originating good of the other Party, the customs authority of the importing Party may request information relating to the origin of the good from the competent governmental authority of the	1. For the purpose of determining whether a good imported into its territory is originating, the importing Party may conduct a verification of any claim for preferential tariff treatment by one or more of the following:5
(a) a written request or questionnaire seeking	(a) written requests for information from the importer, exporter, or producer;				(a) a written request for information from the importer of the good;
	(b) written questionnaires to the importer,				(b) a written request for information from

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USMCA	US–Korea	EU–SADC	EU–Japan	Japan–Thailand	CP-TPP
information, including documents, from the importer, exporter, or producer of the good; (b) a verification visit to the premises of the exporter or producer of the good in order to request information, including documents, and to observe the production process and the related facilities; (c) for a textile or apparel good, the procedures set out	exporter, or producer; (c) visits to the premises of an exporter or producer in the territory of the other Party, to review the records referred to in Article 6.17.1 or observe the facilities used in the production of the good; (d) for a textile or apparel good, the procedures set out in Article 4.3 (Customs Cooperation for Textile or Apparel Goods); or	2. For the purposes of implementing the provisions of paragraph 1, the customs authorities of the importing country shall return the movement certificate EUR.1 and the invoice, if it has been submitted, the origin declaration, or a copy of these documents, to the customs authorities of the exporting country giving, where appropriate, the reasons for the request for verification. Any documents and	information from the importer who made the claim referred to in Article 3.16. The customs authority of the importing Party may conduct a verification either at the time of the customs import declaration, before the release of products, or after the release of the products.	exporting Party on the basis of a certificate of origin. 2. For the purposes of paragraph 1 above, the competent governmental authority of the exporting Party shall, in accordance with its laws and regulations, provide the information requested within a period of 3 months from the date of receipt of the request.	the exporter or producer of the good; (c) a verification visit to the premises of the exporter or producer of the good; (d) for a textile or apparel good, the procedures set out in Article 4.6 (Verification); or (e) other procedures as may be decided by the importing Party and the Party where an exporter or producer of the good is located.

in Article 6.6 (Verification); or

(d) any other procedure as may be decided by the Parties.

2. The importing Party may choose to initiate a verification under this Article to the importer or the person who completed the certification of origin.

3. If an importing Party conducts a verification under this Article it shall accept information, including documents, directly from the importer,

(e) such other procedures to which the importing and exporting Parties may agree.

information obtained suggesting that the information given on the proof of origin is incorrect shall be forwarded in support of the request for verification.

3. The verification shall be carried out by the customs authorities of the exporting country. For this purpose, they shall have the right to call for any evidence and to carry out any inspection of the exporter's accounts or any other check considered appropriate.

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USMCA	US–Korea	EU–SADC	EU–Japan	Japan–Thailand	CP-TPP
exporter, or producer. 4. If a claim for preferential tariff treatment is based on a certification of origin completed by the exporter or producer, and in response to a request for information by an importing Party to determine whether a good is originating in verifying a claim of preferential treatment under paragraph 1(a), the importer does not					

provide sufficient information to demonstrate that the good is originating, the importing Party shall request information from the exporter or producer under paragraph 1 before it may deny the claim for preferential tariff treatment. The importing Party shall complete the verification, including any additional request to the exporter or producer under paragraph 1, within the time provided in paragraph 15.

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USMCA	US–Korea	EU–SADC	EU–Japan	Japan–Thailand	CP-TPP
5. A written request or questionnaire seeking information, including documents, or a request for a verification visit, under paragraphs 1 (a) or (b) shall: (a) include the identity of the customs administration issuing the request; (b) state the object and scope of the verification, including the specific issue the requesting Party seeks to resolve with the verification;					

(c) include sufficient information to identify the good that is being verified; and
(d) in the case of a verification visit, request the written consent of the exporter or producer whose premises are going to be visited and indicate:
(i) the legal authority for the visit,
(ii) the proposed date and location for the visit,
(iii) the specific purpose of the visit, and
(iv) the names and titles of the officials performing the visit.

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USMCA	US–Korea	EU–SADC	EU–Japan	Japan–Thailand	CP-TPP
6. If an importing Party has initiated a verification under paragraph 1(a) or 1 (b) other than to the importer, it shall inform the importer of the initiation of the verification.					
7. For a verification under paragraph 1 (a) or 1(b), the importing Party shall:					
(a) ensure that the written request for information, or documentation to be reviewed, is limited to information and documentation to determine whether the good is originating;					

(b) describe the information or documentation in detail to allow the importer, exporter, or producer to identify the information and documentation necessary to respond;
(c) allow the importer, exporter, or producer at least 30 days from the date of receipt of the written request or questionnaire under paragraph 1 (a) to respond; and
(d) allow the exporter or producer 30 days from the date of receipt of the written request for a visit under paragraph 1(b) to consent to or refuse the request.

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USMCA	US–Korea	EU–SADC	EU–Japan	Japan–Thailand	CP-TPP
STEP 2 Article 5.9 Origin Verification 8. On request of the importing Party, the Party where the exporter or producer is located may, as it deems appropriate and in accordance with its laws and regulations, assist with the verification. This assistance may include providing information it has that is relevant to the origin verification. The importing Party shall not deny a claim for preferential tariff	Where an importing Party conducts verification by the means referred to in subparagraph (a) or (b), the importing Party may request that the importer arrange for the exporter or producer to provide information directly to the importing Party. 2. The Parties shall agree on procedures for conducting visits provided for in paragraph 1(c).	5. The customs authorities requesting the verification shall be informed of the results of this verification as soon as possible. These results must indicate clearly whether the documents are authentic and whether the products concerned can be considered as products originating in a SADC EPA State, in the EU or in one of the other countries referred to in Articles 4 and 6 of this Protocol and fulfil the other requirements of	Article 3.22 Administrative cooperation 1. In order to ensure the proper application of this Chapter, the Parties shall cooperate, through the customs authority of each Party, in verifying whether a product is originating and in compliance with the other requirements provided for in this Chapter. 2. If the claim for preferential tariff treatment was based on a statement on origin referred to	Article 44 Verification visit 1. The customs authority of the importing Party may request the exporting Party to: (a) collect and provide information relating to the origin of the good and check, for that purpose, the facilities used in the production of the good, through a visit by its competent governmental authority along with the customs authority of the importing Party to the premises of the	Article 3.27 3. If a claim for preferential tariff treatment is based on a certification of origin completed by the exporter or producer and, in response to a request for information by an importing Party under paragraph 1(a), the importer does not provide information to the importing Party or the information provided is not sufficient to support a claim for preferential tariff treatment, the importing Party

treatment solely on the grounds that the Party where the exporter or producer is located did not provide requested assistance.

9. If an importing Party initiates a verification under paragraph 1(b), it shall, at the time of the request for the visit under paragraph 5, provide a copy of the request to:
(a) the customs administration of the Party in whose territory the visit is to occur; and
(b) if requested by the Party in whose territory the visit is to occur, the embassy of that

this Protocol.

6. If in cases of reasonable doubt there is no reply within ten (10) months of the date of the verification request or if the reply does not contain sufficient information to determine the authenticity of the document in question or the real origin of the products, the requesting customs authorities shall, except in exceptional circumstances, refuse entitlement to the preferences.
7. Where the verification procedure or any other available information appears to indicate

subparagraph 2(a) of Article 3.16, after having first requested information in accordance with paragraph 1 of Article 3.21, the customs authority of the importing Party conducting the verification may also request information from the customs authority of the exporting Party within a period of two years after the importation of the products if the customs authority of the importing Party conducting the verification considers that additional information is

exporter to whom a certificate of origin has been issued, or the producer of the good in the exporting Party referred to in subparagraph 7(b) of Article 40; and
(b) provide information relating to the origin of the good in the possession of the competent governmental authority or its designee during the visit pursuant to subparagraph (a) above.

2. When requesting the exporting Party to conduct a visit pursuant to paragraph 1 above, the importing Party shall deliver a

shall request information from the exporter or producer under paragraph 1(b) or 1(c) before it may deny the claim for preferential tariff treatment. The importing Party shall complete the verification, including any additional request to the exporter or producer under paragraph 1(b) or 1(c), within the time provided in paragraph 6(e).
7. If an importing Party makes a verification request under paragraph 1 (b), it shall, on request of the Party where the exporter or producer is

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USMCA	US–Korea	EU–SADC	EU–Japan	Japan–Thailand	CP-TPP
Party in the territory of the Party proposing to conduct the visit.		that the provisions of this Protocol are being contravened, the exporting country on its own initiative or at the request of the importing country shall carry out appropriate enquiries or arrange for such enquiries to be carried out with due urgency to identify and prevent such contraventions and for this purpose the exporting country concerned may invite the participation of the importing country in these verifications.	necessary in order to verify the originating status of the product. The request for information should include the following information: (a) the statement on origin; (b) the identity of the customs authority issuing the request; (c) the name of the exporter; (d) the subject and scope of the verification; and (e) if applicable, any relevant documentation. In addition to this information, the customs authority	written communication with such request to the exporting Party at least 40 days in advance of the proposed date of the visit, the receipt of which is to be confirmed by the latter Party. The competent governmental authority of the exporting Party shall request the written consent of the exporter, or the producer of the good in the exporting Party whose premises are to be visited.	located and in accordance with the importing Party's laws and regulations, inform that Party. The Parties concerned shall decide the manner and timing of informing the Party where the exporter or producer is located of the verification request. In addition, on request of the importing Party, the Party where the exporter or producer is located may, as it deems appropriate and in accordance with its laws and

of the importing Party may request the customs authority of the exporting Party for specific documentation and information, where appropriate.

3. The customs authority of the exporting Party may, in accordance with its laws and regulations, request documentation or examination by calling for any evidence or by visiting the premises of the exporter to review records and observe the regulations, assist with the verification. This assistance may include providing a contact point for the verification, collecting information from the exporter or producer on behalf of the importing Party, or other activities in order that the importing Party may make a determination as to whether the good is originating. The importing Party shall not deny a claim for preferential tariff treatment solely on the ground that the Party where the

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USMCA	US–Korea	EU–SADC	EU–Japan	Japan–Thailand	CP-TPP
			facilities used in the production of the product. 4. Without prejudice to paragraph 5, the customs authority of the exporting Party receiving the request referred to in paragraph 2 shall provide the customs authority of the importing Party with the following information: (a) the requested documentation, where available; (b) an opinion on the originating status of the product; (c) the description of the product subject to		exporter or producer is located did not provide requested assistance. 8. If an importing Party initiates a verification under paragraph 1(c), it shall, at the time of the request for the visit, inform the Party where the exporter or producer is located and provide the opportunity for the officials of the Party where the exporter or producer is located to accompany them during the visit. 9. Prior to issuing a written

examination and the tariff classification relevant to the application of this Chapter;

(d) a description and explanation of the production process sufficient to support the originating status of the product;

(e) information on the manner in which the examination was conducted; and

(f) supporting documentation, if appropriate.

5. The customs authority of the exporting Party shall not provide the information referred to in paragraph 4 to the determination, the importing Party shall inform the importer and any exporter or producer that provided information directly to the importing Party, of the results of the verification and, if the importing Party intends to deny preferential tariff treatment, provide those persons a period of at least 30 days for the submission of additional information relating to the origin of the good.

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USMCA	US–Korea	EU–SADC	EU–Japan	Japan–Thailand	CP-TPP
			customs authority of the importing Party if that information is deemed confidential by the exporter. 6. Each Party shall notify the other Party of the contact details, including postal and email addresses, and telephone and facsimile numbers of the customs authorities and shall notify the other Party of any modification regarding such information within 30 days after the date of the modification.		

STEP 3

Article 5.10: Determinations of Origin

1. Except as otherwise provided in paragraph 2 or Article 6.7 (Determinations), each Party shall grant a claim for preferential tariff treatment made under this Chapter on or after the date of entry into force of this Agreement.
2. The importing Party may deny a claim for preferential tariff treatment if:
3. A Party may deny preferential tariff treatment to a good where:

(a) the importer, exporter, or producer fails to provide information that the Party requested under paragraph 1(a) or 1 (b) demonstrating that the good is an originating good;
(b) after receiving a written notification for a visit pursuant to paragraph 1(c), the exporter or

Article 39 Verification of suppliers' declarations

1. Verification of suppliers' declarations shall be carried out based on risk analysis and at random or whenever the customs authorities of the country where such declarations have been taken into account to issue a movement certificate EUR.1 or to make out an origin declaration,

Article 3.24

Denial of preferential tariff treatment

1. Without prejudice to paragraph 3, the customs authority of the importing Party may deny preferential tariff treatment, if:

(a) within three months after the date of the request for information pursuant to paragraph 1 of Article 3.21:
(i) no reply is provided; or
(ii) if the claim for

3. The communication referred to in paragraph 2 above shall include:

(a) the identity of the customs authority issuing the communication;
(b) the name of the exporter, or the producer of the good in the exporting Party whose premises are requested to be visited;
(c) the proposed date and place of the visit;
(d) the object and scope of the

Article 3.28: Determinations on Claims for Preferential Tariff Treatment

1. Except as otherwise provided in paragraph 2 or Article 4.7 (Determinations), each Party shall grant a claim for preferential tariff treatment made in accordance with this Chapter for a good that arrives in its territory on or after the date of entry into force of this Agreement for

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USMCA	US–Korea	EU–SADC	EU–Japan	Japan–Thailand	CP-TPP
(a) it determines that the good does not qualify for preferential treatment; (b) pursuant to a verification under Article 5.9 (Origin Verification), it has not received sufficient information to determine that the good qualifies as originating; (c) the exporter, producer, or importer fails to respond to a written request or questionnaire for information, including documents, under Article 5.9 (Origin Verification);	producer declines to provide access to the records referred to in Article 6.17 or to its facilities; or (c) the Party finds a pattern of conduct indicating that an importer, exporter, or producer has provided false or unsupported declarations or certifications that a good imported into its territory is an originating good. 4. If, as a result of a verification, a Party finds that a good is not originating, the Party shall provide the importer with	have reasonable doubts as to the authenticity of the document or the correctness of the information given in this document. 2. The customs authorities to which a supplier's declaration is submitted may request the customs authorities of the State where the declaration was made to issue an information certificate, a specimen of which appears in Annex VI. Alternatively, the customs authorities to whom a supplier's declaration is	preferential tariff treatment was based on the importer's knowledge as referred to in subparagraph 2(b) of Article 3.16, the information provided is inadequate to confirm that the product is originating; (b) within three months after the date of the request for information pursuant to paragraph 5 of Article 3.21: (i) no reply is provided; or (ii) the information provided is inadequate to	proposed visit, including specific reference to the good subject of the verification referred to in the certificate of origin; and (e) the names and titles of the officials of the customs authority of the importing Party to be present during the visit.	that Party. In addition, if permitted by the importing Party, the importing Party shall grant a claim for preferential tariff treatment made in accordance with this Chapter for a good which is imported into its territory or released from customs control on or after the date of entry into force of this Agreement for that Party. 2. The importing Party may deny a claim for preferential tariff treatment if: (a) it determines that the good does not qualify for

(d) the exporter or producer fails to provide its written consent for a verification visit, in accordance with Article 5.9 (Origin Verification);
(e) the importer, exporter, or producer fails to comply with the requirements of this Chapter; or
(f) the exporter, producer, or importer of the good that is required to maintain records or documentation in accordance with this Chapter:
(i) fails to maintain records or documentation, or

a proposed determination to that effect and an opportunity to submit additional information demonstrating that the good is originating. Each Party shall provide that the importer may arrange for the exporter or producer to provide pertinent information directly to the Party.

submitted may request the exporter to produce an information certificate issued by the customs authorities of the State where the declaration was made. A copy of the information certificate shall be preserved by the office which has issued it for at least three (3) years.
3. The customs authorities requesting the verification shall be informed of the results thereof as soon as possible. The results must indicate clearly whether the

confirm that the product is originating;
(c) within 10 months after the date of the request for information pursuant to paragraph 2 of Article 3.22:
(i) no reply is provided; or
(ii) the information provided is inadequate to confirm that the product is originating; or
(d) following a prior request for assistance pursuant to Article 3.23 and within a mutually agreed period, in respect of products which have been

preferential treatment;
(b) pursuant to a verification under Article 3.27 (Verification of Origin), it has not received sufficient information to determine that the good qualifies as originating;
(c) the exporter, producer or importer fails to respond to a written request for information in accordance with Article 3.27 (Verification of Origin);
(d) after receipt of a written notification for a verification visit, the exporter or

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USMCA	US–Korea	EU–SADC	EU–Japan	Japan–Thailand	CP-TPP
(ii) denies access, if requested by a Party, to those records or documentation.		information given in the supplier's declaration is correct and make it possible for them to determine whether and to what extent this supplier's declaration could be taken into account for issuing a movement certificate EUR.1 or for making out an origin declaration. 4. The verification shall be carried out by the customs authorities of the country where the supplier's declaration was made out. For this purpose, they shall have the right to	the subject of a claim as referred to in paragraph 1 of Article 3.16: (i) the customs authority of the exporting Party fails to provide the assistance; or (ii) the result of that assistance is inadequate to confirm that the product is originating. 2. The customs authority of the importing Party may deny preferential tariff treatment to a product for which an importer claims preferential tariff		producer does not provide its written consent in accordance with Article 3.27 (Verification of Origin); or (e) the importer, exporter or producer fails to comply with the requirements of this Chapter.

call for any evidence or to carry out any inspection of the supplier's account or any other check which they consider appropriate in order to verify the correctness of any supplier's declaration.

5. Any movement certificate EUR.1 or origin declaration issued or made out on the basis of an incorrect supplier's declaration shall be considered null and void.

treatment where the importer fails to comply with requirements of this Chapter other than those relating to the originating status of the products.

7.2 THE ADMINISTRATION OF GSP RULES OF ORIGIN AND DFQF SCHEMES FOR LDCS' RULES OF ORIGIN

7.2.1 *Administration of the GSP and DFQF Rules of Origin*

The administration of GSP and DFQF rules of origin follows the pattern of the substantive GSP/DFQF rules; although efforts were made, harmonization results were limited.

Like in other sets of rules of origin, the main elements of administration of GSP/DFQF rules of origin are (1) issuance of certificates of origin, (2) direct consignment and related evidence, and (3) verifications.

For decades the documentary evidence used under GSP schemes by the majority of preference-giving countries has been the CO in Form A, which was designed in UNCTAD working groups in the 1970s to serve as a common CO.

However, there was considerable divergence because, at the outset, countries like the United States, Australia, and New Zealand opted for a declaration by the exporter and accepted GSP Form A as an alternative.

Lately, the United States switched to an importer-based declaration (as discussed in section 7.3) and, since 2017, the EU has used the registered exporter (REX) system or declaration by exporter or importer (as discussed under section 7.4).

7.2.2 *Arrangements for Administrative Cooperation*

The implementation of the GSP demands close cooperation and mutual assistance between the customs authorities in the preference-giving countries and the authorities concerned in the preference-receiving countries so as to ensure the observance of the provisions and requirements under the various schemes, including the effective control and verification of origin and consignment of products.[45]

As part of this mutual cooperation, preference-giving countries require certain information from the preference-receiving countries concerning the authorities/bodies competent to issue certificates of origin in Form A or, according to recent developments, the entity responsible for origin queries, as follows:

Information	Countries
Names and addresses of certifying authorities/bodies or counterparts for origin queries	The majority of preference-giving countries except United States, Australia, and New Zealand still require a notification of governmental authority responsible for certificate of origin[45] or official counterparts in the case of REX, for instance.
Specimen of stamps	As specified by each preference giving country
Specimen of signatures	No preference-giving country requires specimen of signatures in the case of GSP schemes.

[45] More details can be found in the UNCTAD Handbook on Duty-Free and Quota-Free Market Access and Rules of Origin for Least Developed Countries – Part II: Other Developed Countries and Developing Countries, UNCTAD/ALDC/2018/5, available at https://unctad.org/en/pages/PublicationWebflyer.aspx?publicationid=2258.

At present the majority of preference-giving countries are no longer using GSP Form A. A Certificate of origin may, however, be requested according to the form and entries of each preference giving country or a self declaration by the exporter/importer as requested.

As an example, the following is an excerpt from the US Code of Federal Regulations showing the required form.[46]

§10.172 Claim for exemption from duty under the Generalized System of Preferences

A claim for an exemption from duty on the ground that the Generalized System of Preferences applies shall be allowed by the Center director only if he is satisfied that the requirements set forth in this section and §§10.173 through 10.178 have been met. If duty-free treatment is claimed at the time of entry, a written claim shall be filed on the entry document by placing the symbol "A" as a prefix to the subheading of the Harmonized Tariff Schedule of the United States for each article for which such treatment is claimed.

§ 10.173 Evidence of country of origin

(a) Shipments covered by a formal entry – (1) Merchandise not wholly the growth, product, or manufacture of a beneficiary developing country – (i) Declaration. In a case involving merchandise covered by a formal entry which is not wholly the growth, product, or manufacture of a single beneficiary developing country, the exporter of the merchandise or other appropriate party having knowledge of the relevant facts shall be prepared to submit directly to the Center director, upon request, a declaration setting forth all pertinent detailed information concerning the production or manufacture of the merchandise. When requested by the Center director, the declaration shall be prepared in substantially the following form:

GSP DECLARATION

I,

(name), hereby declare that the articles described below were produced or manufactured in _____ (country) by means of processing operations performed in that country as set forth below and were also subjected to processing operations in the other country or countries which are members of the same association of countries as set forth below and incorporate materials produced in the country named above or in any other country or countries which are members of the same association of countries as set forth below:

Number and date of invoices	Description of articles and quantity	Processing operations performed on articles	Materials produced in a beneficiary developing country or members of the same association

[46] See Code of Federal Regulations, §§10.172 and 10.173 Claim for exemption from duty under the Generalized System of Preferences.

Description of processing operations and country of processing	Direct costs of processing operations	Description of material, production process, and country of production	Cost or value of material

Date
Address
Signature
Title

7.2.2.1 Direct Consignment

The rule that originating products must be transported direct from the exporting preference-receiving country to the preference-giving country of destination is an important common feature of all GSP origin rules except those of Australia.[47] Its purpose is to enable the customs administration of the preference-giving country of importation to be satisfied that the imported products are identical to the products that left the exporting preference-receiving country; that is, they were not manipulated, substituted, further processed, or entered into commerce in any intervening third country. Consignment conditions, as prescribed by individual preference-giving countries are listed in Table 7.4.

TABLE 7.4 *Provisions applied by particular preference-giving countries*

Countries	Direct consignment provisions
Canada, EU, Switzerland	Splitting up loads in intervening countries is allowed.
EU	Nonalteration principle: Article 43 Non-manipulation (Article 64 (3) of the Code) 1. The products declared for release for free circulation in the Union shall be the same products as exported from the beneficiary country in which they are considered to originate. They shall not have been altered, transformed in any way or subjected to operations other than operations to preserve them

[47] See Chapter 1 of this book for a more completed analysis and comparison of the different practices of direct consignment.

TABLE 7.4 (*continued*)

Countries	Direct consignment provisions
	in good condition or the adding or affixing of marks, labels, seals or any other documentation to ensure compliance with specific domestic requirements applicable in the Union, prior to being declared for release for free circulation. 2. The products imported into a beneficiary country for the purpose of cumulation under Articles 53, 54, 55 or 56 shall be the same products as exported from the country in which they are considered to originate. They shall not have been altered, transformed in any way or subjected to operations other than operations to preserve them in good condition, prior to being declared for the relevant customs procedure in the country of imports. 3. Storage of products may take place provided they remain under customs supervision in the country or countries of transit. 4. The splitting of consignments may take place where carried out by the exporter or under his responsibility, provided that the goods concerned remain under customs supervision in the country or countries of transit. 5. Paragraphs 1 to 4 shall be considered to be complied with unless the customs authorities have reason to believe the contrary; in such cases, the customs authorities may request the declarant to provide evidence of compliance, which may be given by any means, including contractual transport documents such as bills of lading or factual or concrete evidence based on marking or numbering of packages or any evidence related to the goods themselves
EU and preference-giving countries of EFTA (Norway and Switzerland)	Article 101 Replacement of statements on origin (Article 64(1) of the Code) 1. Where originating products not yet released for free circulation are placed under the control of a customs office of a Member State, the re-consignor may replace the initial statement on origin by one or more replacement statements on origin (replacement statements), for the purposes of sending all or some of the products elsewhere within the customs territory of the Union or to Norway or Switzerland. The replacement statement shall be drawn up in accordance with the requirements in Annex 22-20. L 343/608 Official Journal of the European Union 29.12.2015 EN Replacement statements on origin may only be made out if the initial statement on origin was made out in accordance with Articles 92, 93, 99 and 100 of this Regulation and Annex 22-07.

(*continued*)

TABLE 7.4 (*continued*)

Countries	Direct consignment provisions
	2. Re-consignors shall be registered for the purposes of making out replacement statements on origin as regards originating products to be sent elsewhere within the territory of the Union where the total value of the originating products of the initial consignment to be split exceeds EUR 6 000. However, re-consignors who are not registered may make out replacement statements on origin where the total value of the originating products of the initial consignment to be split exceeds EUR 6 000 if they attach a copy of the initial statement on origin made out in the beneficiary country. 3. Only re-consignors registered in the REX system may make out replacement statements on origin as regards products to be sent to Norway or Switzerland. 4. A replacement statement on origin shall be valid for 12 months from the date of making out the initial statement on origin. 5. Paragraphs 1 to 4 shall also apply to statements replacing replacement statements on origin. 6. Where products benefit from tariff preferences under a derogation granted in accordance with Article 64(6) of the Code, the replacement provided for in this Article may only be made if such products are intended for the Union.[i]
Japan	Transport through third countries must be justified for geographical reasons or exclusively on account of transport requirements. Japan accepts, in general, only unloading, reloading, trans-shipment, and temporary storage under the surveillance of the customs authorities in the transit country. Temporary storage is permissible if the goods remain under the surveillance of the customs authorities in the transit country, and are thereafter exported to Japan by the same exporter of the same preference-receiving country.
New Zealand	Products of one preference-receiving country are permitted to enter the commerce of another preference-receiving country without losing entitlement of GSP treatment.
USA	Products must be destined for the United States at the time that they depart from the country of production. Special rules[ii] apply for shipments through a free-trade zone in a preference-receiving country.
Australia	No consignment rule is applied

[i] The text above refers to the application of the REX systems. The former text is as follows:
Replacement of certificates of origin Form A and invoice declarations (Article 64(1) of the Code)
1. Where originating products not yet released for free circulation are placed under the control of a customs office of a Member State, that customs office shall, on written request from the re-consignor, replace the initial certificate of origin Form A or invoice declaration by one or more certificates of origin Form A (replacement certificate) for the purposes of sending all or some

of these products elsewhere within the Union or to Norway or Switzerland. The re-consignor shall indicate in his request whether a photocopy of the initial proof of origin is to be annexed to the replacement certificate.

2. The replacement certificate shall be drawn up in accordance with Annex 22-19. The customs office shall verify that the replacement certificate is in conformity with the initial proof of origin.
3. Where the request for a replacement certificate is made by a re-consignor acting in good faith, he shall not be responsible for the accuracy of the particulars entered on the initial proof of origin.
4. The customs office which is requested to issue the replacement certificate shall note on the initial proof of origin or on an attachment thereto the weights, numbers, nature of the products forwarded and their country of destination and indicate thereon the serial numbers of the corresponding replacement certificate or certificates. It shall keep the initial proof of origin for at least 3 years.
5. In the case of products which benefit from the tariff preferences under a derogation granted in accordance with Article 64(6) of the Code, the procedure laid down in this Article shall apply only when such products are intended for the Union.

[ii] The special rules are:

(a) The merchandise must not enter into the commerce of the country maintaining the free-trade zone;

(b) The eligible article must not undergo any operation other than:
- sorting, grading or testing;
- packing, unpacking, changes of packing, decanting, or repacking into other containers;
- affixing marks, labels, or other like distinguishing signs or articles or their packing, if incidental to operations allowed under these special provisions; or
- operations necessary to ensure the preservation of merchandise in its condition as introduced into the free-trade zone;

(c) Merchandise may be purchased and re-sold, other than at retail, for export within the free-trade zone. For the purposes of these special provisions, a free-trade zone is a pre-determined area or region declared or secured by or under government authority, where certain operations may be performed with respect to articles, without such articles having entered into the commerce of the country maintaining the free-trade zone.

Canada requires a through bill of lading addressed to a consignee in a specified port in Canada. The importer may be required to produce documentary evidence in cases of transit through intermediate countries.

As regards exports to the United States, the importer may be required to submit appropriate shipping papers, invoices, or other documents as evidence that the articles were imported directly. The district director of the US customs may waive the submission of evidence of direct shipment when he is otherwise satisfied that the merchandise clearly qualifies for GSP treatment. In the case of transit shipment, the invoices, bills of lading, and other documents connected with shipment must show the United States as the final destination.

7.2.2.2 Verification and Control

As discussed under section 7.1.4, requests for verification of certificates of origin (Form A) or exporter's declaration as applicable, are, as a rule, directed by the authorities of preference-giving importing countries to the relevant issuing authorities/bodies in the preference-receiving exporting country.[48] Selection of certificates for verification is made by the relevant customs authorities in the preference-giving importing country where they have doubts as to the authenticity of the document, or as to the accuracy of the information regarding the origin of the products in question, or on a random basis.

For the purposes of such requests for verification, the competent customs authorities in the preference-giving importing country are required to return the certificate Form A/exporter's declaration to the responsible authorities/body in the exporting preference-receiving country, giving, where appropriate, the reasons for making the request. The commercial invoice, if available, or a copy thereof, should be attached to the certificate Form A/Exporter Declaration and customs authorities will forward any information that has been obtained that suggests that the particulars given on certificate or form are inaccurate.

When a request for verification has been made, such verification has to be carried out and its result communicated within a maximum of six months from the date on which the request from the competent authority of the preference-giving importing country has been received by the competent authority/body in the exporting preference-receiving country. In cases of replacement certificates Form A issued by the customs authorities of the EU, Norway, or Switzerland, the time limit is extended to eight months. The result must be such as to establish whether the CO Form A/exporter's declaration in question is authentic, whether it applies to the products actually exported, and whether these products were in fact eligible to benefit from preferential tariff treatment, stating the reasons on which the rules of origin applicable in this case are met. If, in cases of reasonable doubt, there is no reply within the six months prescribed, or if the reply does not contain sufficient information to determine the authenticity of the form or of the true origin of the product, a second communication will be sent to the issuing authority/body. If thereafter the results are not provided as soon as possible (in any case within four months) to the requesting authorities, or if the results do not permit the determination of the authenticity of the document or the true origin of the products in question, the requesting authorities will refuse any GSP benefit except in the case of *force majeure* or in exceptional circumstances.

For the purpose of subsequent verification, copies of the certificates issued as well as any export document referring to them, if appropriate, must be kept for at least three years by the competent authority/body in the preference-receiving exporting

[48] See also further section 7.4.1.

country. Most preference-giving countries have rules setting out detailed provisions as described above. The current rules of replacement certificate in the EU, Norway, and Switzerland are undergoing a final transitional phase following the progressive adoption of the REX system.

7.3 THE US EXPERIENCE IN ADMINISTERING RULES OF ORIGIN

Before the free-trade area with Canada, later replaced by NAFTA, the experience of the United States with preferential origin administration was mainly related to the GSP, Caribbean Basin Initiative, and the trade agreement with Israel. NAFTA changed the US perspective with regard to rules of origin, given the trade volume involved and the different interests at stake. NAFTA, however, represented a peak and a number of lessons were learned during implementation.

The lessons drawn from the NAFTA experience may be best summarized in Table 7.5, comparing NAFTA with other recent FTAs.

TABLE 7.5 *Comparison of certification requirements and relative legislation among different free-trade agreements*

Provision	NAFTA	Singapore	Chile	GSP	Australia
General Agreement	NAFTA Implementation Act	US–Singapore FTA Implementation Act	US–Chile FTA Implementation Act	Generalized System of Preferences	US–Australia FTA Implementation Act
US Code	19 USC 3301–3473	19 USC 3805 note	19 USC 3805 note	19 USC 2461–2467	19 USC 3805 note
CFR	19 CFR 181 and rules of origin regs.	Regs. in early draft stage	70 FR 10868, March 7, 2005 (19 CFR 10 Subpart H)	19 CFR 10.171, 10.178	Regs. in early draft stage
HTSUS General Note	GN 12	GN 25	GN 26	GN 4	GN 28
Primary responsibility for compliance	Exporter	Importer	Importer	Importer	Importer
Special program indicator	CA or MX	SG or 9999.00.84 (ISI)	CL	A, A+, A*	AU
Expiration	No	No	No	2020 (likely to be renewed)	No

Source: US Customs and Border Protection (CBP).

The table clearly shows that NAFTA was the only agreement where the primary responsibility for compliance with rules of origin resides with the exporter. In all other free-trade agreements, the primary responsibility is shifted to the importer as can be inferred from Table 7.5 and the related legislation which:

- no longer requires a specified certificate of origin but only data elements
- offers multiple-choice certification: importer, exporter, or producer.

This change implied a switch from a system based on the existence of certifying authorities, customs cooperation, and CO to an importer declaration. This change had several implications for the partners to US FTA agreements. Among the various implications, it has been observed that in an importer-based system the burden of proving origin in case of doubt or verification of customs authorities obviously falls on the importer and his/her abilities to secure information about the origin of the goods from the exporter or manufacturer. Such ability however may be dependent on business realities related to the trade volumes and the number of transactions between the importer and the exporter. Providing and showing documentary evidence related to origin may be a rather tedious and time-consuming exercise, involving at times confidential aspects that a Chilean exporter may have to endure to maintain business relations with his US importer for its exports to the lucrative US market. The same may be less obvious in the case of a Chilean importer requesting origin information from a large exporter or manufacturer based in the US market where the Chilean importer may represent a small or rather insignificant share of its overall export sales turnover. The pros and cons of adopting an administration system based on certifying authorities, an importer-based system, or a combination of the two are open. Much of this debate is contained in section 7.5, illustrating the different options that administrations have adopted in administering rules of origin. In the following section, the more salient features of the African Growth and Opportunity Act (AGOA) as well as NAFTA administration will be discussed along with the version of the importer-based administration that has become the standard format of US administration of rules of origin.

7.3.1 *Customs Procedures and Enforcement under AGOA*

AGOA provides for transshipment penalties for exporters:[49]

> If the President determines, on the basis of sufficient evidence, that an exporter has engaged in unlawful trans-shipment, he shall deny for a period of five years all AGOA benefits to such exporter or any successor entity. The President delegated the authority to make these determinations to the Committee for the Implementation of Textile Agreements (CITA).

[49] Section 113(b)(4) of the Act states that "Trans-shipment has occurred when preferential treatment for a textile or apparel article under this Act has been claimed on the basis of material false information concerning the country of origin, manufacture, processing, or assembly of the article or any of its components."

7.3.1.1 Monitoring and Report to Congress

The President shall monitor, review, and report to Congress annually (not later than March 31 of each year). The latest biennial report[50] is available at www.ustr.gov.

As of 2020, Benin, Botswana, Burkina Faso, Cape Verde, Chad, Ethiopia, Ghana, Kenya, Lesotho, Liberia, Madagascar, Malawi, Mali, Mauritius, Mozambique, Namibia, Senegal, Sierra Leone, Tanzania, Uganda, and Zambia[51] were designated by the US Trade Representative (USTR) after demonstrating that they had an effective visa system in place to verify that apparel and textile goods are in fact produced in a beneficiary sub-Saharan African country in accordance with the required rules of origin. The US Government has provided countries with guidance on the elements of an effective visa system. The USTR will publish a *Federal Register* notice when it designates a country(ies) as eligible for AGOA apparel/textile benefits.[52]

In particular, in order to be declared eligible for textile/apparel provisions, sub-Saharan African countries are required to:[53]

(a) Adopt an effective visa system, domestic law and enforcement procedure in order to prevent illegal trans-shipment and the use of counterfeit documents relating to the importation of the eligible apparel products into the United States;
(b) Enact legislation or issue regulations in order to permit the United States Customs Service to investigate thoroughly allegations of trans-shipment;
(c) Agree to report on the total exports and imports of covered articles in the country;
(d) Cooperate with the United States in order to prevent circumvention;
(e) Agree to require all producers and exporters of covered articles in the country to maintain complete records of the production and the export of covered articles, including materials used in the production, for at least two years after the production or export;
(f) Agree to provide documentation to the United States customs establishing the country of origin of covered articles. This includes the production record, information relating to the place of production, the number and identification of the types of machinery used in production, the number of workers employed in production, and certification from both the manufacturer and the exporter. These records should be retained for five years.

[50] See 2018 Biennial Report of the Implementation of AGOA, prepared by the USTR, available at https://agoa.co.za/images/documents/15487/2018-agoa-implementation.pdf.
[51] For detailed eligibility tables, see https://agoa.info/about-agoa/country-eligibility.html.
[52] The information concerning country eligibility is available at www.ustr.gov.
[53] Section 113(a)(1) of the Act.

7.3.1.2 Visa Requirements under the AGOA

On January 18, 2001, the USTR directed the Commissioner of Customs to require that importers provide an appropriate export visa from a designated beneficiary sub-Saharan African country when the country claims preferential treatment of textile and apparel products under the Act.[54]

A shipment shall be visaed by stamping an original circular visa in blue ink only on the front of the original commercial invoice. The original visa shall not be stamped on duplicate copies of the invoice. The original of the invoice with the original visa stamp shall be required in order to obtain preferential tariff treatment. Duplicates of the invoice and/or visa may not be used for this purpose. Each visa stamp shall include: (a) the visa number, including the preferential groupings the apparels qualify for, a country code, and a numerical serial number identifying the shipment; (b) the date of visa issuance; (c) the authorized signature of an authorized official of the beneficiary countries; and (d) the quantity of goods being shipped.

A visa shall not be accepted and preferential tariff treatment shall not be permitted if the visa number, date of issuance, authorized signature, correct grouping, or the quantity or the unit of quantity is missing, incorrect, illegible, or has been crossed out or altered in any way.

If the visa is not acceptable, a new visa must be obtained from an authorized official of the eligible country, or a designate, before preferential tariff treatment can be claimed. Waivers are not permitted.

If the visa invoice is deemed invalid, the US Customs Service will not return the original document after entry, but will provide a certified copy of it for use in obtaining a new correct original visaed invoice.

7.3.2 *The Administration of NAFTA and USMCA Rules of Origin*

Any importer claiming preferential treatment of certain textiles and apparel shall comply with customs procedure and requirements similar to the relevant procedures and requirements under Chapter Five of NAFTA.[55]

The NAFTA system was based on three pillars: (1) a CO completed and signed by the exporter of the goods; (2) obligations of the importer when making an origin declaration; and (3) maintenance of records concerning origin and verifications.

[54] See "Visa Requirements under the AGOA," *Federal Register*, vol. 66, no. 17 (January 25, 2001), 7837.

[55] Chapter Five of NAFTA is available at www.mac.doc.gov/nafta/ch05.htm.

The role of the CO was central to the NAFTA rules of origin as pointed out in the US Customs and Border Protection (CBP) Directive No. 3810–014A of July 26, 2005:

2.1. The Certificate is the fundamental document required to support a claim for NAFTA benefits. The Certificate confers legal rights and obligations. Completion of a Certificate is an affirmation that the signatory has made a careful inquiry into the terms of the NAFTA, has determined that the goods covered by the Certificate originate as defined by the NAFTA, and maintains the relevant records.

2.2. The Certificate must be signed by the exporter, or by the exporter's authorized agent having knowledge of the relevant facts. Producers who are not exporters may choose to prepare a Certificate and provide it to the exporter, but there is no requirement that they do so and in no case will this relieve exporters of their obligation to prepare a Certificate.

2.3. A Certificate is required for each importation on which NAFTA preference is claimed and covers only those goods specified on the Certificate. The Certificate need not accompany each shipment, but must be presented to U.S. Customs and Border Protection (CBP) upon request.

2.4. The Certificate must be in the possession of the importer at the time preferential treatment is claimed. However, Port Directors may, in writing, waive this requirement in accordance with 19 Code of Federal Regulations 181.22(d)(i) if otherwise satisfied that the good qualifies for preferential treatment under the NAFTA.

The rules concerning the issuance of a CO were contained in Article 501, paragraph 3 of NAFTA:

Each Party Shall Provide that:

(a) an exporter in its territory shall complete and sign a Certificate of Origin for any exportation of a good for which an importer may claim preferential tariff treatment upon importation of the good into the territory of another Party; and

(b) where an exporter in its territory is not the producer of the good, such exporter may complete and sign a Certificate on the basis of

  (i) its knowledge of whether the good qualifies as an originating good

  (ii) reasonable reliance upon the producer's written representation that the good qualifies as an originating good, or

  (iii) completed and signed Certificate for the good voluntarily provided to the exporter by the producer.

Article 502 provides for obligations regarding import procedures related to origin:

> Except as otherwise provided in this Chapter, each Party, with respect to an importer in its territory that claims preferential tariff treatment for a good imported into its territory from the territory of another Party, shall provide that:
>
> (a) the importer shall make a written declaration, based on a valid Certificate of Origin, that the good qualifies as an originating good;

(b) the importer shall have the Certificate in its possession at the time such declaration is made;
(c) the importer shall provide, upon the request of that Party's customs administration, a copy of the Certificate;
(d) if the importer fails to comply with any requirement set out in this Chapter, that Party may deny preferential tariff treatment to the good;
(e) the importer, where the importer has reason to believe that a Certificate on which a declaration was based contains information that is not correct, shall promptly make a corrected declaration and pay any duties owing; and
(f) the importer, who voluntarily makes a corrected declaration pursuant to subparagraph (e), shall not be subject to penalties for the making of an incorrect declaration.

Such obligations on the part of the exporter and the importer are reinforced by the requirements of keeping the records for five years as specified in Article 505:

Records

1. Each Party shall provide that:
(a) an exporter or a producer in its territory that completes and signs a Certificate of Origin shall maintain in its territory, for a period of five years from the date the Certificate was signed or for such longer period as such Party may specify, all records relating to the origin of a good for which preferential tariff treatment was claimed in the territory of another Party, including records associated with
(i) the purchase of, cost of, value of, and payment for, the good that is exported from its territory, and
(ii) the purchase of, cost of, value of, and payment for, all materials, including indirect materials, used in the production of the good that is exported from its territory, and
(iii) the production of the good in the form in which the good is exported from its territory; and
(b) an importer claiming preferential tariff treatment for a good imported into the Party's territory shall maintain in that territory, for a period of five years from the date of importation of the good or for such longer period as the Party may specify, a copy of the Certificate and all other required documentation relating to the importation of the good.

Finally, Article 506 set up detailed procedures for origin verifications:

1. For purposes of determining whether a good imported into its territory from the territory of another Party qualifies as an originating good, a Party may, through its customs administration, conduct a verification solely by means of:
(a) written questionnaires to an exporter or a producer in the territory of another Party;
(b) visits to the premises of an exporter or a producer in the territory of another Party to review the records and observe the facilities used in the production of the good; or
(c) such other procedure as the Parties may agree. . .

The US implementing legislation reproduced below substantially reflects the NAFTA treaty provisions. Under NAFTA, it is clear the declaration made by the importer was based on the NAFTA CO.

§ 181.21 Filing of Claim for Preferential Tariff Treatment upon Importation

In connection with a claim for preferential tariff treatment for a good under the NAFTA, the U.S. importer shall make a written declaration that the good qualifies for such treatment. The written declaration may be made by including on the entry summary, or equivalent documentation, the symbol "CA" for a good of Canada, or the symbol "MX" for a good of Mexico, as a prefix to the subheading of the HTSUS under which each qualifying good is classified.

. . . the declaration shall be based on a complete and properly executed original Certificate of Origin, or copy thereof, which is in the possession of the importer and which covers the good being imported.

§ 181.22 Maintenance of Records and Submission of Certificate by Importer.

(a) Maintenance of records. Each importer claiming preferential tariff treatment for a good imported into the United States shall maintain in the United States, for five years after the date of entry of the good, all documentation relating to the importation of the good. Such documentation shall include a copy of the Certificate of Origin and any other relevant records as specified in § 163.1(a) of this chapter.

(b) Submission of Certificate. An importer who claims preferential tariff treatment on a good under § 181.21 of this part shall provide, at the request of the port director, a copy of each Certificate of Origin pertaining to the good which is in the possession of the importer. A Certificate of Origin submitted to Customs under this paragraph or under § 181.32(b)(3) of this part:

1. Shall be on Customs Form 434, including privately-printed copies thereof, or on such other form as approved by the Canadian or Mexican customs administration, or, as an alternative to Customs Form 434 or such other approved form, in an approved computerized format or such other medium or format as is approved by the Office of Field Operations, U.S. Customs Service, Washington, DC 20229. An alternative format must contain the same information and certification set forth on Customs Form 434; 194057T.

USMCA drastically changes the method of certification from the NAFTA certification of origin to a system of importer declaration in line with other US free-trade agreements.

Article 5.2 of USMCA: Claims for Preferential Tariff Treatment provides in paragraph 2 and subsequent paragraphs for an importer declaration that does not have to follow a prescribed format and that could be submitted by electronic means:

1. Each Party shall provide that an importer may make a claim for preferential tariff treatment, based on a certification of origin completed by the exporter, producer,

or importer for the purpose of certifying that a good being exported from the territory of a Party into the territory of another Party qualifies as an originating good.

1bis. An importing Party may:

(a) require that an importer who completes a certification of origin provide documents or other information to support the certification;
(b) establish in its law conditions that an importer shall meet to complete a certification of origin
(c) if an importer fails to meet or no longer meets the conditions established under subparagraph (b), prohibit that importer from providing its own certification as the basis of a claim for preferential tariff treatment; or
(d) if a claim for preferential tariff treatment is based on a certification of origin completed by an importer, prohibit that importer from:
  (i) issuing a certification, based on a certification of origin or a written representation completed by the exporter or producer, and
  (ii) making a subsequent claim for preferential tariff treatment for the same importation, based on a certification of origin completed by the exporter or producer.

2. Each Party shall provide that a certification of origin:

(a) need not follow a prescribed format;
(b) contains a set of minimum data elements as set out in Annex 5-A (Minimum Data Elements) that indicate that the good is both originating and meets the requirements of this Chapter;
(c) may be provided on an invoice or any other document;
(d) describes the originating good in sufficient detail to enable its identification; and
(e) meets the requirements as set out in the Uniform Regulations.

3. A Party shall not reject a claim for preferential tariff treatment for the sole reason that the invoice was issued in a non-Party. However, a certification of origin shall not be provided on an invoice or any other commercial document issued in a non-Party.
4. Each Party shall provide that the certification of origin for a good imported into its territory may be completed in English, French, or Spanish. If the certification of origin is not in a language of the importing Party, the importing Party may require an importer to submit, upon request, a translation into such a language.
5. Each Party shall allow a certification of origin to be completed and submitted electronically and shall accept the certification of origin with an electronic or digital signature.

7.3.3 *From NAFTA to the US–Chile FTA Agreement*

The preceding USMCA text should be compared with the US–Chile regulations reproduced below to measure the differences and the evolution of the administration of rules of origin from a system based on the CO and verification procedures carried out in the exporting partner to an importer-based system. As shown in Table 7.5, NAFTA was the only preferential trade regime providing for such a system. All subsequent free-trade agreements entered by the United States have consistently adopted, as far as the United States is concerned, an importer-based

approach and in-country verifications. The importer-based system does not completely eliminate the existence of a CO as contained in the following provision:

Article 4.12 of the US–Chile Agreement: Claims of Origin

1. Each Party shall require that an importer claiming preferential tariff treatment for a good:
   (a) make a written declaration in the importation document that the good qualifies as originating;
   (b) be prepared to submit, on the request of the importing Party's customs authority, a certificate of origin or information demonstrating that the good qualifies as originating;
   (c) promptly make a corrected declaration and pay any duties owing where the importer has reason to believe that the certificate or other information on which the declaration was based is incorrect.

In addition, Article 4.13 of the US–Chile FTA expressly provides for rules for issuance of certificates of origin by the importer or the exporter. However, the truth of the matter is contained in the provision reproduced next, making clear that the final responsibility for an origin declaration resides with the importer who cannot rely on a CO issued by the exporter. It follows that the value of the CO issued by the exporter is limited and is far from being the centerpiece of origin administration as in NAFTA.

Article 4.14: Obligations Relating to Importations

1. Each Party shall provide that the importer is responsible for submitting a certificate of origin or other information demonstrating that the good qualifies as originating, for the truthfulness of the information and data contained therein, for submitting any supporting documents requested by the Party's customs authority, and for the truthfulness of the information contained in those documents.
2. Each Party shall provide that the fact that the importer has issued a certificate of origin based on information provided by the exporter or the producer shall not relieve the importer of the responsibility referred to in paragraph 1.

Finally, an importer-based system does not eliminate the need for verifications. However, such verifications are conducted in-country. The US–Chile agreement does not provide in fact for visits of customs authorities of one party to the other party. Verifications are carried out in-country and on the declarations made by the importers.

The United States implementing legislation does not even mention the words "certificate of origin" and makes clear that a certification made by the exporter or producer will not relieve the importer from its own responsibilities.

US–CHILE

§ 10.412 Importer Obligations.

(a) General. An importer who makes a declaration under § 10.410(a) is responsible for the truthfulness of the declaration and of all the information and data contained in the certification, for submitting any supporting documents

requested by CBP, and for the truthfulness of the information contained in those documents.

(b) Compliance. In order to make a claim for preferential treatment under § 10.410 of this subpart, the importer:

1. Must have records that explain how the importer came to the conclusion that the good qualifies for preferential treatment. Those records must include documents that support a claim that the article in question qualifies for preferential treatment because it meets the applicable rules of origin set forth in General Note 26, HTSUS, and in this subpart. Those records may include a properly completed certification as set forth in § 10.411 of this subpart; and
2. May be required to demonstrate that the conditions set forth in § 10.463 of this subpart were met if the imported article was shipped through an intermediate country.

(c) Information provided by exporter or producer. The fact that the importer has issued a certification based on information provided by the exporter or producer will not relieve the importer of the responsibility referred to in paragraph (a) of this section. A U.S. importer who voluntarily makes a corrected declaration will not be subject to penalties for having made an incorrect declaration (see § 10.481 of this subpart).

(d) Internal controls. In accordance with Part 163 of this chapter, importers are expected to establish and implement internal controls which provide for the periodic review of the accuracy of the certifications or other records referred to in paragraph (b)(1) of this section.

§ 10.413 Validity of Certification.

A certification that is completed, signed and dated in accordance with the requirements listed in § 10.411 will be accepted by CBP as valid for four years from the date on which the certification was signed. If the port director determines that a certification is illegible or defective or has not been completed in accordance with § 10.411, the importer will be given a period of not less than five business days to submit a corrected certification.

The extent of the obligations of the importer in respect to NAFTA could also be measured by comparing the requirements under NAFTA section § 181.22 and the corresponding section concerning the US–Chile reproduced next. The latter provisions expressly require the keeping of a number of specific records and documents that are not requested in NAFTA.

§ 10.415 Maintenance of Records.

(a) General. An importer claiming preferential treatment for a good imported into the United States must maintain in the United States, for five years after the date of importation of the good, a certification (or a copy thereof) that the good qualifies as originating, and any records and documents that the importer has relating to the origin of the good, including records and documents associated with:

(1) The purchase of, cost of, value of, and payment for, the good;

(2) Where appropriate, the purchase of, cost of, value of, and payment for, all materials, including recovered goods and indirect materials, used in the production of the good; and,
(3) Where appropriate, the production of the good in the form in which the good was exported.

(b) Method of maintenance. The records referred to in paragraph (a) of this section must be maintained by importers as provided in § 163.5 of this chapter.

The CBP guidelines[56] made clear that the US–Chile FTA agreement places the burden of substantiating the validity of the claim for preferential tariff treatment on the importer. An importer may make a claim based on knowledge or information in his/her possession that the good qualifies as an originating good. CBP may verify the validity of the claim and will direct inquiries for verification via CBP Form 28, Request for Information, to the importer.

Furthermore, when requested by CBP, the importer shall provide additional documentation beyond the certification such as additional cost and manufacturing information. Such information may include information concerning the RVC calculation used in the claim for preference such as the build-up or build-down methods as outlined in General Note 26, HTS. This includes, but is not limited to, records concerning the purchase of, cost of, value of, and payment for the good and the purchase of, cost of, value of, and payment for all materials used in the production of the good, and the production of the good in its exported form.

§ 10.416 Effect of noncompliance; failure to provide documentation regarding transshipment.

(a) Effect of noncompliance. If the importer fails to comply with any requirement under this subpart, including submission of a certification of origin under § 10.411 (a) or submission of a corrected certification under § 10.413, the port director may deny preferential tariff treatment to the imported good.
(b) Failure to provide documentation regarding transshipment. Where the requirements for preferential tariff treatment set forth elsewhere in this subpart are met, the port director nevertheless may deny preferential tariff treatment to an originating good if the good is shipped through or transshipped in a country other than Chile or the United States, and the importer of the good does not provide, at the request of the port director, copies of documents demonstrating to the satisfaction of the port director that the requirements set forth in § 10.46 were met.

Most recently, the CPB guidelines made clear a number of provisions contained in the US–Chile FTA agreement:

[56] www.ecfr.gov/cgi-bin/retrieveECFR?gp=1&SID=43d56dada78b1717a29493ad67f63adf&ty=HTML&h=L&pitd=20191101&n=pt19.1.10&r=PART#sp19.1.10.h.

> ... an importer may satisfy a request under Article 4.12(1)(b) by providing a certificate of origin that sets forth a valid basis for a claim that a good is originating. Each Party shall provide that a certificate of origin need not be in a prescribed format, and that the certificate may be submitted electronically.

All references to a "certificate of origin" in this document, do not refer to an "official form" issued by CBP, such as the CF434 under the NAFTA. A CO may take many forms, such as a statement on company letterhead, a statement on a commercial invoice, or supporting documentation that demonstrates that the imported good qualifies for preferential treatment. Any format utilized must contain the data elements outlined in Attachment A.

At the request of CBP, the importer shall submit a CO or supporting documentation to demonstrate that the imported goods qualify for preferential tariff treatment. The certification is not required to be on file at the time the claim is made. However, the importer is responsible for retaining supporting documentation, which may be requested by CBP, as to the good's eligibility for preferential treatment at the time the claim was made. The CO shall be submitted in English or Spanish. If submitted in Spanish, CBP may request an English translation.

An importer may submit a CO completed or generated by an exporter or producer or may issue the CO based on information submitted by the exporter or producer that the good qualifies as originating; however, the importer must exercise reasonable care when certifying to the accuracy and truthfulness of the information submitted to CBP. The fact that the importer has issued a CO based on information provided by the exporter or producer, or submits a CO executed by the exporter or producer, shall not relieve the importer of the responsibility of exercising reasonable care.

7.4 THE EU EXPERIENCE IN ADMINISTERING RULES OF ORIGIN

The progressive adoption of the Pan-European Rules of Origin has meant a consistent effort to harmonize rules of origin and related procedures; however, a number of variations remain and have evolved over time especially with the entering into force of new generation free-trade agreements such as the EU–Japan FTA agreement. The differences concerning certification of origin and methods of administrative cooperation mainly relate to:

- the appropriate form to be used as proof of origin (CO Form A, for GSP purposes only; movement certificate EUR.1 and EUR-MED for other preferential agreements, most recently REX or importer-based declaration)
- the issuance of the CO for cumulation purposes (EUR.1 form, EUR-MED form, GSP form, invoice declarations, supplier's declarations, and recently the exporter statement under REX)
- the approved exporter system

- simplified procedure for the issuance of certificates of origin for low-value shipment.

While in general all reciprocal preferential agreements utilized the EUR.1 or EUR-MED form as the CO, the practice has recently evolved. The issuance of this certificate and the ancillary rules are almost identical for all agreements, with the exception of some differences explained below. In the context of the GSP, the form to be used was till recently the CO Form A, because its format was multilaterally agreed within UNCTAD at the time of the GSP's inception. This form is not going to be used anymore by the EU with the full entry into force of REX. In some cases, the procedure for the issuance of the CO Form A was similar to that for the issuance of Form EUR.1. The main differences concern:

- the issuing authority for Form EUR.1 or EUR-MED (always a customs office)
- the issuing authority for the CO Form A (the customs authorities or other governmental authorities designated by the beneficiary countries)
- number of boxes to be completed
- duration of the certificate's validity after its issuance
- a number of ancillary provisions related to simplified provisions, especially cumulation.

The CO Form A should be used only in the context of GSP preferences. However, the overlapping of trade preferences in the past induced some exporters in countries, which were beneficiaries of preferential trade arrangements, to use Form A instead of Form EUR.1.

This occurrence is mainly the result of these countries still being on the list of GSP beneficiaries, even though they are often granted better trade concessions under the free-trade agreements.[57]

[57] These cases occurred until 2014 when the new GSP regulation entered into force. It contained Article 5 of the EU GSP 978/2012, providing a graduation mechanism for GSP beneficiaries that have either met certain threshold or have signed a free-trade agreement with the EU:

1. A list of GSP beneficiary countries meeting the criteria laid down in Article 4 is established in Annex II.
2. By 1 January of each year following the entry into force of this Regulation the Commission shall review Annex II to provide a GSP beneficiary country and economic operators with time for orderly adaptation to the change in the country's status under the scheme:

(a) the decision to remove a beneficiary country from the list of GSP beneficiary countries, in accordance with paragraph 3 of this Article and on the basis of point (a) of Article 4(1), shall apply as from one year after the date of entry into force of that decision;
(b) the decision to remove a beneficiary country from the list of GSP beneficiary countries, in accordance with paragraph 3 of this Article and on the basis of point (b) of Article 4(1), shall apply as from two years after the date of application of a preferential market access arrangement.

The Pan-Euro-Mediterranean cumulation introduced in 2006 migrated, as discussed in Chapter 3 of this book, to the PEM Convention in 2013. The PEM Convention maintained the traditional EUR.I certificate, the EUR-MED certificate, and a rather complex system of administration that will be analyzed in the following sections.

As discussed in Chapter 3 in August 2020 the EU Commission adopted a new proposal in the context of the updating of the PEM Convention. Countries who choose to adhere to this proposal may adopt a different protocol on rules of origin while the PEM Convention will continue to apply. Such new protocol also introduces a number of modifications related to certification and management of EUR.1 and EURO MED, as summarized in Chapter 3. The following sections refer to the PEM Convention.

The reason for such a complex administration is the differences in the agreements between the EU, its European Economic Area (EEA) partners, and Switzerland on one hand and, on the other hand, the agreements between these countries and Mediterranean partners.

In fact, there are still differences in the cumulation that is full in the EEA and with Switzerland and Turkey and diagonal between these countries and the Mediterranean countries with the exception of the full cumulation between the EU and Tunisia, Morocco, and Algeria.

In addition, there are differences in the issues of drawback among the different agreements that further demand some differentiation, including those listed in the following section.

Prohibition of drawback is always applicable in trade, whether bilateral or diagonal, between the EU, Turkey, Switzerland, Norway, Iceland, and the Faeroe Islands and in the agreement between the EU and Israel.

However, drawback is still possible in purely bilateral trade between the EU and Morocco, Algeria, Tunisia, Egypt, West Bank and Gaza Strip, Jordan, Lebanon, and Syria.

The following example[58] may further clarify this difference:

Example of the Possibility of Drawback in Bilateral Trade:

Aluminum originating from the United Arab Emirates is imported into Egypt where aluminum screws (HS 7616) are manufactured. The final product originating in Egypt is exported to the Community.

Since Egyptian originating status is obtained on the basis of sufficient working and processing and not on the basis of cumulation with materials originating in one of the

3. For the purposes of paragraphs 1 and 2 of this Article the Commission shall be empowered to adopt delegated acts, in accordance with Article 36, to amend Annex II on the basis of the criteria laid down in Article 4.

[58] The example is excerpted from "Explanatory notes concerning the Pan-Euro-Mediterranean Protocols on Rules of Origin," OJ 2007/C 083/01, April 17, 2007, which is indicated as the official document in the website of TAXUD. The handbook has not been updated with the entry into force of the PEM Convention and the example and content have been used, *mutatis mutandis*, to explain the PEM Convention.

countries referred to in Articles 3 and 4, Egyptian customs authorities can grant drawback for non-originating materials used in the manufacture of the originating products when it is exported to the Community.

However, the screws cannot be used in the Community for the purpose of pan-Euro-Mediterranean cumulation. In this example the screws originating in Egypt can only be exported to the Community with a movement certificate EUR.1 or an invoice declaration.

Morocco, Algeria, Tunisia, Egypt, the West Bank and Gaza Strip, Jordan, Lebanon, and Syria can apply partial drawback. The application of partial drawback does not exclude goods from diagonal cumulation.

The EUR.1 and EUR-MED form are issued by the customs authorities of the exporting country following a written application. This application should be made on a form entitled "Application for the issuance of movement certificate Form EUR.1" or "EUR-MED."

The EUR.1 and EUR-MED form must be printed in one or more of the EU official languages. Each certificate must measure 210 × 297 mm. A tolerance of up to plus 8 mm or minus 5 mm in length may be allowed. The paper must be white, sized for writing, not containing mechanical pulp, and weighing not less than 60 g/m^2. It must have a printed green guilloche pattern background, making any falsification by mechanical or chemical means apparent to the eye. Non-EU countries may print their own certificates or have them printed by approved printers. In the latter case, each certificate must include a reference to such approval. Each certificate must bear the name and address of the printer or a mark by which the printer can be identified. It must also bear a serial number, printed or not, by which it can be identified.

7.4.1 *Procedure for the Issuance of Certificate of Origin EUR.1 and EUR-MED*

As analyzed in Chapter 3 of this book, the "pan-European" rules of origin started to be implemented in the Europe agreements with Eastern European countries that at that time were not members of the EU.[59]

The enlargement of the EU and the parallel evolution of the Barcelona process meant that, from 1998 to date, Euro-Mediterranean association agreements with Algeria, Tunisia, Morocco, Israel, Jordan, Lebanon, the Palestinian Authority, Syria, and Egypt have entered into force.

A system of cumulation of origin between all Mediterranean countries, the EU, the European Free-Trade Association (EFTA) countries (Iceland, Liechtenstein,

[59] The examples and some of the material in this section are drawn from "A User's Handbook to the Rules of Preferential Origin used in trade between the European Community, other European Countries and the countries participating to the Euro-Mediterranean Partnership" (fn. 18 above).

Norway, and Switzerland), the Faeroe Islands, Andorra, San Marino, and Turkey was created (Pan-Euro-Mediterranean cumulation).

The "Pan-Euro-Mediterranean" Protocol on Rules of Origin was developed in a working group with all partner countries concerned. This Protocol was endorsed by the Euro-Med Trade Ministerial Meeting in Palermo on July 7, 2003.

Pan-Euro-Mediterranean cumulation does not contain substantially different innovation or constitute change of directions from the traditional EU rules of origin policy or administration. It introduced, however, some new features or concepts that entailed some changes in the rules, especially related to the Pan-Euro-Mediterranean cumulation. In particular a new form EUR-MED was created and ancillary administrative rules were established to discipline what has been defined as variable geometry and differences in cumulation.

According to this concept, cumulation can be applied between three countries of the zone as soon as free-trade agreements containing identical rules of origin between the countries concerned are in place. The system can thus be applied to a limited group of countries, without the full network of free-trade agreements having been completed (so-called "variable geometry").

Article 16 of the PEM Convention sets out the procedure for the issuance of CO EUR.1 and EUR-MED.

To better understand the application of Article 16 it is necessary to bear in mind that the countries mentioned below as countries falling under paragraph 3(1) are the EU, Switzerland, Iceland, Norway, and Turkey.

The countries falling under paragraph 3.2 are the members of the Barcelona process (Algeria, Egypt, Israel, Jordan, Lebanon, Morocco, the Palestinian Authority, Syria, and Tunisia) and any other contracting party; namely, the participants in the EU Stabilisation and Association Process (SAP) (Albania, Bosnia and Herzegovina, the Republic of North Macedonia, Montenegro, Serbia, and Kosovo):

1. A movement certificate EUR.1 or EUR-MED shall be issued by the customs authorities of the exporting Contracting Party on application having been made in writing by the exporter or, under the exporter's responsibility, by his authorised representative.
2. For this purpose, the exporter or his authorised representative shall fill in both the movement certificate EUR.1 or EUR-MED and the application form, specimens of which appear in the Annexes III a and b. These forms shall be completed in one of the languages in which the relevant Agreement is drawn up and in accordance with the provisions of the national law of the exporting country. If the completion of the forms is done in handwriting, they shall be completed in ink in printed characters. The description of the products shall be given in the box reserved for this purpose without leaving any blank lines. Where the box is not completely filled, a horizontal line shall be drawn below the last line of the description, the empty space being crossed through.
3. The exporter applying for the issue of a movement certificate EUR.1 or EUR-MED shall be prepared to submit at any time, at the request of the customs

authorities of the exporting Contracting Party where the movement certificate EUR.1 or EUR-MED is issued, all appropriate documents proving the originating status of the products concerned as well as the fulfilment of the other requirements of this Convention.

4. Without prejudice to paragraph 5, a movement certificate EUR.1 shall be issued by the customs authorities of the exporting Contracting Party in the following cases:
   1. if the products are exported from one of the Contracting Parties referred to in Article 3(1) to one of the other Contracting Parties referred to in Article 3(1) and
      (i) the products concerned can be considered as products originating in the exporting Contracting Party, in the importing Contracting Party or in one of the other Contracting Parties referred to in Article 3(1) with which cumulation is applicable, without application of cumulation with materials originating in one of the Contracting Parties referred to in Article 3(2), and fulfil the other requirements of this Convention, or
      (ii) the products concerned can be considered as products originating in one of the Contracting Parties referred to in Article 3(2) with which cumulation is applicable, without application of cumulation with materials originating in one of the Contracting Parties referred to in Article 3, and fulfil the other requirements of this Convention, provided a certificate EUR-MED or an origin declaration EUR-MED has been issued in the country of origin;
   2. if the products are exported from one of the Contracting Parties referred to in Article 3(1) to one of the Contracting Parties referred to in Article 3(2) or from one of the Contracting Parties referred to in Article 3(2) to one of the Contracting Parties referred to in Article 3(1) and
      (i) the products concerned can be considered as products originating in the exporting Contracting Party or in the importing Contracting Party, without application of cumulation with materials originating in one of the other Contracting Parties, and fulfil the other requirements of this Convention, or
      (ii) the products concerned can be considered as products originating in one of the other Contracting Parties referred to in Article 3, with which cumulation is applicable, without application of cumulation with materials originating in one of the Contracting Parties referred to in Article 3, and fulfil the other requirements of this Convention, provided a certificate EUR-MED or an origin declaration EUR-MED has been issued in the country of origin;
   3. if the products are exported from one of the Contracting Parties referred to in Article 3(2) to one of the Contracting Parties referred to in Article 3(2) and
      (i) the products concerned can be considered as products originating in the exporting Contracting Party or in the importing Contracting Party, without application of cumulation with materials originating in one of the other Contracting Parties, and fulfil the other requirements of this Convention, or

(ii) the products concerned can be considered as products originating in one of the other Contracting Parties referred to in Article 3, with which cumulation is applicable, without application of cumulation with materials originating in one of the Contracting Parties referred to in Article 3, and fulfil the other requirements of this Convention, provided a certificate EUR-MED or an origin declaration EUR-MED has been issued in the country of origin.

5. A movement certificate EUR-MED shall be issued by the customs authorities of the exporting Contracting Party, if the products concerned can be considered as products originating in the exporting Contracting Party, in the importing Contracting Party or in one of the other Contracting Parties referred to in Article 3 with which cumulation is applicable and fulfil the requirements of this Convention, in the following cases:
   1. if the products are exported from one of the Contracting Parties referred to in Article 3(1) to one of the other Contracting Parties referred to in Article 3(1) and
      (i) cumulation was applied with materials originating in one or more of the Contracting Parties referred to in Article 3(2), provided a certificate EUR-MED or an origin declaration EUR-MED has been issued in the country of origin, or
      (ii) the products may be used in the importing Contracting Party as materials in the context of cumulation for the manufacture of products for export from the importing Contracting Party to one of the Contracting Parties referred to in Article 3(2), or
      (iii) the products may be re-exported from the importing Contracting Party to one of the Contracting Parties referred to in Article 3(2);
   2. if the products are exported from one of the Contracting Parties referred to in Article 3(1) to one of the Contracting Parties referred to in Article 3(2) or from one of the Contracting Parties referred to in Article 3(2) to one of the Contracting Parties referred to in Article 3(1) and
      (i) cumulation was applied with materials originating in one or more of the other Contracting Parties referred to in Article 3, provided a certificate EUR-MED or an origin declaration EUR-MED has been issued in the country of origin, or
      (ii) the products may be used in the importing Contracting Party as materials in the context of cumulation for the manufacture of products for export from the importing Contracting Party to one of the other Contracting Parties referred to in Article 3, or
      (iii) the products may be re-exported from the importing Contracting Party to one of the Contracting Parties referred to in Article 3;
   3. if the products are exported from one of the Contracting Parties referred to in Article 3(2) to one of the Contracting Parties referred to in Article 3(2) and
      (i) cumulation was applied with materials originating in one or more of the other Contracting Parties referred to in Article 3, provided a certificate

EUR-MED or an origin declaration EUR-MED has been issued in the country of origin, or

(ii) the products may be used in the importing Contracting Party as materials in the context of cumulation for the manufacture of products for export from the importing Contracting Party to one of the other Contracting Parties referred to in Article 3, or

(iii) the products may be re-exported from the importing Contracting Party to one of the Contracting Parties referred to in Article 3.

6. A movement certificate EUR-MED shall contain one of the following statements in English in box 7:

1. if origin has been obtained by application of cumulation with materials originating in one or more of the Contracting Parties: "CUMULATION APPLIED WITH … (name of the country/countries)"
2. if origin has been obtained without the application of cumulation with materials originating in one or more of the Contracting Parties: "NO CUMULATION APPLIED".

7.4.2 *The Use of Form EUR.1 and EUR-MED*

The complex drafting of Article 16 of the PEM Convention derives from the fact that:

(a) a variable geometry exists
(b) different cumulation systems apply and
(c) different drawback provisions apply within the PEM Convention.

Variable geometry has been defined as follows:

> Cumulation can be only applied if the countries of final manufacture and of final destination have concluded free trade agreements, containing identical rules of origin, with all the countries participating in the acquisition of originating status, i.e. with all the countries from which all the materials used originate. Materials originating in the country which has not concluded an agreement with the countries of final manufacture and of final destination shall be treated as non-originating.[60]

Since not all the countries have concluded free-trade agreements among themselves in order to benefit from cumulation, it has been necessary to maintain a differentiation between those countries who complied with this requirement and those who did not and maintain an updated matrix.[61]

[60] From "Explanatory notes concerning the Pan-Euro-Mediterranean Protocols on Rules of Origin" (fn. 58 above).

[61] www.consilium.europa.eu/en/documents-publications/treaties-agreements/agreement/?id=2010035.

A second definition, albeit incomplete but explaining the differences in cumulation applicable in the PEM, is contained in the explanatory notes to the PEM Convention:[62]

> **Cumulation of Working or Processing (Full Cumulation)**
>
> Full cumulation allows performing sufficient working or processing not in the customs territory of a single country but in the area formed by customs territories of a group of countries. For example, cumulation of working or processing outside the context of the Euro-Med cumulation is provided for in some of the origin protocols with Morocco, Algeria and Tunisia. Since the cumulation of working or processing falls outside the context of the pan-Euro-Mediterranean cumulation of origin, products obtaining origin on the basis of the full cumulation are excluded from the pan-Euro-Med trade.

A third definition concerns prohibition of drawback:

> **Article 15 – Prohibition of Drawback in Bilateral and in Diagonal Trade**
>
> In the agreements between the EU and the Mediterranean countries other than Israel, the prohibition of drawback is applicable as soon as the originating status of the product was obtained on the basis of cumulation with materials originating in the countries referred to in Articles 3 and 4 other than the country of destination or if a proof of origin EUR-MED is issued with a view of a subsequent application of the diagonal cumulation. In the agreements between the Turkey, Switzerland, Norway, Iceland and Faroe Islands and in the agreement between the EU and Israel, the prohibition of drawback is always applicable.[63]

It follows that different conditions have been established for the issuance of EUR.1 and EUR-MED certificates. Because the cumulation of working or processing falls outside the context of the Pan-Euro-Mediterranean cumulation of origin, products obtaining origin on the basis of the full cumulation are excluded from the Pan-Euro-Med trade.

"A User's Handbook to the Rules of Preferential Origin used in trade between the European Community, other European countries, and the countries participating to the Euro-Mediterranean Partnership" (the Handbook) recommends the following practices.

[62] See "Explanatory notes concerning the Pan-Euro-Mediterranean Protocols on Rules of Origin" (fn. 58 above).

[63] Updated as the original version contained in the explanatory notes that are now obsolete since they date back to 2007 and refer to the EC, instead of the EU, and Bulgaria and Romania as being outside of the EU.

The movement certificate EUR.1 can be issued when the conditions for the Pan-Euro-Med trade are met, namely:

- the product originates from any of the countries of the zone
- "no drawback" rule respected
- full cumulation not applied.

The movement certificate EUR.1 must be issued when the conditions for the diagonal, Pan-Euro-Med trade are not fulfilled, such as:

- the product originates from any of the countries of the zone, and
- full cumulation applied or
- drawback granted.

When the EUR.1 movement certificate has been issued, products concerned must stay on the market of the importing country and cannot be re-exported under preferences to other countries of the zone (bilateral EU–Mediterranean partner countries trade). This is a consequence of the fact that different kinds of cumulation exist within the PEM Convention.

1. *Example of the use of EUR.1 movement certificate when cumulation applied but no cumulation with the Mediterranean partner.*[64]

   Sugar (HS 1701) originating in the EU is imported into Switzerland where it is processed into sweets (HS 1704). The value of the EU originating sugar exceeds 30 percent of the ex-works price. The Swiss originating product is exported to Turkey.

   Since the originating status is obtained in Switzerland on the basis of cumulation without application of cumulation with a Mediterranean partner, and since the three countries are linked by free-trade agreements, the Swiss customs authorities may issue a EUR.1 certificate for the exportation to Turkey.

   However, in this example a movement certificate EUR-MED can be issued by the Swiss administration also if the sweets could be used in Turkey in the context of cumulation with any of the other countries who are members of the PEM Convention – for example, if the sweets are to be re-exported from Turkey to Tunisia. Therefore, if the Swiss exporter duly applied to his customs administration for a EUR-MED certificate, his application should be accepted and a movement certificate EUR-MED issued. The movement certificate EUR-MED shall contain in box 7 the statement "Cumulation applied with the EU."

[64] The examples and some of the material in this section are drawn and have been adapted from "A User's Handbook to the Rules of Preferential Origin used in trade between the European Community, other European Countries and the countries participating to the Euro-Mediterranean Partnership" (fn. 18 above).

2. *Example of the use of EUR.1 movement certificate when no cumulation applied.*

   Embroidered curtains (HS 6303) are manufactured in Lebanon from non-originating single yarn. The final product is exported to the EU.

   Since the originating status is obtained in Lebanon on the basis of sufficient working and processing and cumulation was not applied with any of the Pan-Euro-Mediterranean countries, the Lebanese customs authorities may issue a movement certificate EUR.1 for the exportation to the EU.

However, the use of a movement certificate EUR-MED in this example is also possible provided the prohibition of drawback in Lebanon is respected. This would allow the re-exportation of the curtains to any of the other countries of the PEM Convention. Therefore, as in the first example, if the Lebanese exporter duly applied to his customs administration for a EUR-MED certificate, his application should be accepted and a movement certificate EUR-MED issued. The movement certificate EUR-MED shall contain in box 7 the statement "No cumulation applied."

The mandatory use of movement certificate EUR.1 is required in a number of cases.

Movement certificate EUR.1 must be issued when conditions for diagonal, Pan-Euro-Mediterranean cumulation of origin are not satisfied. This happens when the prohibition against drawback is not respected in bilateral trade or when cumulation of working or processing with Morocco, Tunisia, or Algeria takes place.

In respect of cumulation and drawback, there are differences between the EU, EEA, Switzerland, and Turkey on the one hand and the Pan-Euro-Mediterranean cumulations on the other. It follows that a movement certificate EUR-MED can be issued when the conditions for the diagonal, Pan-Euro-Mediterranean cumulation are fulfilled, namely:

- the product originates from any of the countries of the zone
- "no drawback" rule respected
- full cumulation not applied.

However, the movement certificate EUR-MED must be issued when the above conditions for the diagonal, Pan-Euro-Mediterranean cumulation have been fulfilled and if cumulation with any of the Mediterranean countries has been applied. This is because the network of the free-trade agreements with the Mediterranean partners is incomplete so it is necessary to trace back the countries participating in the acquisition of the originating status on the basis of cumulation.

When the EUR-MED movement certificate has been issued, products concerned can be re-exported under preferences, from the importing country to any other Pan-Euro-Mediterranean country with whom cumulation is applicable (diagonal Pan-Euro-Med trade).

When the movement certificate EUR-MED is issued, box 7 has to be fulfilled.

In cases when the product obtained its originating status on the basis of cumulation, the names of the countries from which the materials originated have to be listed. In cases when the originating product is wholly obtained or when non-originating materials used in the manufacturing were sufficiently processed, the box "Cumulation not applied" has to be ticked.

Mandatory Use of the Movement Certificate EUR-MED

A movement certificate EUR-MED must be issued when the products concerned are originating either in the exporting country or in any of the other countries referred to in articles 3 and 4 and cumulation with Faroe Islands or any of the Mediterranean countries other than Turkey HAS BEEN APPLIED.

Examples:

1. Example of cumulation with materials originating in one of the Mediterranean countries.

   Fabrics originating in Egypt (HS 5112) are imported into Norway where man's trousers (HS 6103) are manufactured. The originating status is obtained in Norway based on cumulation applied with Egyptian materials and therefore when the final product is exported to the Community, Norwegian customs administration must issue a movement certificate EUR-MED containing the statement "Cumulation applied with Egypt".
2. Example of cumulation applied in one of the Mediterranean countries.

   Norwegian wooden boards cut to size (HS 4407) are imported into Morocco where the wooden boxes are manufactured (HS 4415). The Moroccan originating status is obtained on the basis of cumulation in a country that is a signatory country of Barcelona Declaration and therefore when the final product is exported to the Community, Moroccan customs administration must issue a movement certificate EURMED containing the statement "Cumulation applied with Norway".

7.4.3 *Simplified Procedures for the Issuance of Certificate of Origin: Approved Exporters*

The PEM Convention contains provision for a simplified procedure to prove origin (Article 21):

1. An origin declaration or an origin declaration EUR-MED as referred to in Article 15(1)(c) may be made out:
   (a) by an approved exporter within the meaning of Article 22, or
   (b) by any exporter for any consignment consisting of one or more packages containing originating products the total value of which does not exceed EUR 6 000.
2. Without prejudice to paragraph 3, an origin declaration may be made out in the following cases:

(a) if the products are exported from one of the Contracting Parties referred to in Article 3(1) to one of the other Contracting Parties referred to in Article 3(1) and
  (i) if the products concerned can be considered as products originating in the exporting Contracting Party, in the importing Contracting Party or in one of the other Contracting Parties referred to in Article 3(1) with which cumulation is applicable, without application of cumulation with materials originating in one of the Contracting Parties referred to in Articles 3(2), and fulfil the other requirements of this Convention, or
  (ii) the products concerned can be considered as products originating in one of the Contracting Parties referred to in Article 3(2) with which cumulation is applicable, without application of cumulation with materials originating in one of the Contracting Parties referred to in Article 3, and fulfil the other requirements of this Convention, provided a certificate EUR-MED or an origin declaration EUR-MED has been issued in the country of origin;
(b) if the products are exported from one of the Contracting Parties referred to in Article 3(1) to one of the Contracting Parties referred to in Article 3 (2) or from one of the Contracting Parties referred to in Article 3(2) to one of the Contracting Parties referred to in Article 3(1) and
  (i) the products concerned can be considered as products originating in the exporting Contracting Party or in the importing Contracting Party, without application of cumulation with materials originating in one of the other Contracting Parties, and fulfil the other requirements of this Convention, or
  (ii) the products concerned can be considered as products originating in one of the other Contracting Parties referred to in Article 3, with which cumulation is applicable, without application of cumulation with materials originating in one of the Contracting Parties referred to in Article 3, and fulfil the other requirements of this Convention, provided a certificate EUR-MED or an origin declaration EUR-MED has been issued in the country of origin;
(c) if the products are exported from one of the Contracting Parties referred to in Article 3(2) to one of the Contracting Parties referred to in Article 3(2) and
  (i) the products concerned can be considered as products originating in the exporting Contracting Party or in the importing Contracting Party, without application of cumulation with materials originating in one of the other Contracting Parties, and fulfil the other requirements of this Convention, or
  (ii) the products concerned can be considered as products originating in one of the other Contracting Parties referred to in Article 3, with which cumulation is applicable, without application of cumulation with materials originating in one of the Contracting Parties referred to in Article 3, and fulfil the other requirements of this Convention, provided a certificate EUR-MED or an origin declaration EUR-MED has been issued in the country of origin.

3. An origin declaration EUR-MED may be made out if the products concerned can be considered as products originating in the exporting Contracting Party, in the importing Contracting Party or in one of the other Contracting Parties referred to in Article 3 with which cumulation is applicable and fulfil the requirements of this Convention, in the following cases:
   (a) if the products are exported from one of the Contracting Parties referred to in Article 3(1) to one of the other Contracting Parties referred to in Article 3(1) and
      (i) cumulation was applied with materials originating in one or more of the Contracting Parties referred to in Article 3(2), provided a certificate EUR-MED or an origin declaration EUR-MED has been issued in the country of origin or
      (ii) the products may be used in the importing Contracting Party as materials in the context of cumulation for the manufacture of products for export from the importing Contracting Party to one of the Contracting Parties referred to in Article 3(2), or
      (iii) the products may be re-exported from the importing Contracting Party to one of the Contracting Parties referred to in Article 3(2);
   (b) if the products are exported from one of the Contracting Parties referred to in Article 3(1) to one of the Contracting Parties referred to in Article 3 (2) or from one of the Contracting Parties referred to in Article 3(2) to one of the Contracting Parties referred to in Article 3(1) and
      (i) cumulation was applied with materials originating in one or more of the other Contracting Parties referred to in Article 3, provided a certificate EUR-MED or an origin declaration EUR-MED has been issued in the country of origin, or
      (ii) the products may be used in the importing Contracting Party as materials in the context of cumulation for the manufacture of products for export from the importing Contracting Party to one of the other Contracting Parties referred to in Article 3, or
      (iii) the products may be re-exported from the importing Contracting Party to one of the Contracting Parties referred to in Article 3;
   (c) if the products are exported from one of the Contracting Parties referred to in Article 3(2) to one of the Contracting Parties referred to in Article 3 (2) and
      (i) cumulation was applied with materials originating in one or more of the other Contracting Parties referred to in Article 3, provided a certificate EUR-MED or an origin declaration EUR-MED has been issued in the country of origin, or
      (ii) the products may be used in the importing Contracting Party as materials in the context of cumulation for the manufacture of products for export from the importing Contracting Party to one of the other Contracting Parties referred to in Article 3, or
      (iii) the products may be re-exported from the importing Contracting Party to one of the Contracting Parties referred to in Article 3.

4. An origin declaration EUR-MED shall contain one of the following statements in English:
   (a) if origin has been obtained by application of cumulation with materials originating in one or more of the Contracting Parties: "CUMULATION APPLIED WITH . . . (name of the country/countries)"
   (b) if origin has been obtained without the application of cumulation with materials originating in one or more of the Contracting Parties: "NO CUMULATION APPLIED"
5. The exporter making out an origin declaration or an origin declaration EUR-MED shall be prepared to submit at any time, at the request of the customs authorities of the exporting Contracting Party, all appropriate documents proving the originating status of the products concerned as well as the fulfilment of the other requirements of this Convention.
6. An origin declaration or an origin declaration EUR-MED shall be made out by the exporter by typing, stamping or printing on the invoice, the delivery note or another commercial document, the declaration, the texts of which appear in Annexes IV a and b, using one of the linguistic versions set out in those Annexes and in accordance with the provisions of the national law of the exporting country. If the declaration is handwritten, it shall be written in ink in printed characters.
7. Origin declarations and origin declarations EUR-MED shall bear the original signature of the exporter in manuscript. However, an approved exporter within the meaning of Article 22 shall not be required to sign such declarations provided that he gives the customs authorities of the exporting Contracting Party a written undertaking that he accepts full responsibility for any origin declaration which identifies him as if it had been signed in manuscript by him.
8. An origin declaration or an origin declaration EUR-MED may be made out by the exporter when the products to which it relates are exported, or after exportation on condition that it is presented in the importing country at the latest two years after the importation of the products to which it relates.

The Handbook recommends the following procedures when completing an invoice declaration or an invoice declaration EUR-MED:

(a) The wording of the declaration must conform to the wording set out in the annexes to the Protocol;
(b) For consignments comprising goods originating in more than one country of the Pan-Euro-Mediterranean cumulation zone, the names or official abbreviations of the countries concerned, or a reference to a specific indication in the invoice must be entered in the wording of the invoice declaration or the invoice declarations EUR-MED;
(c) The name or official abbreviation for every country concerned should be entered on the invoice for each item listed;
(d) Declarations may be made on photocopies of invoices provided they bear the signature of the exporter, just as required on the original invoices. Approved exporters who are authorized not to sign original invoice

declarations or invoice declarations EUR-MED need not sign such declarations made on photocopied invoices;
(e) An invoice declaration or an invoice declaration EUR-MED may be made out on the reverse side of an invoice;
(f) An invoice declaration or an invoice declaration EUR-MED may be made on a separate sheet of the invoice provided that the sheet is obviously part of the invoice;
(g) If an importer makes out the invoice declaration or the invoice declaration EUR-MED on a label that is subsequently attached to the invoice there should be no doubt that the label has been affixed by the exporter and his stamp or signature should cover both the label and the invoice;
(h) An invoice declaration or an invoice declaration EUR-MED given on a delivery note or other commercial document must identify the exporter;
(i) In case of an invoice declaration EUR-MED the necessary statement: "Cumulation applied with … (name of the country/countries)" or "No cumulation applied" has to be made.

Article 22 of the PEM Convention provides for the following:

Approved Exporter

1. The customs authorities of the exporting Contracting Party may authorise any exporter (hereinafter referred to as "approved exporter"), who makes frequent shipments of products in accordance to the provisions of this Convention to make out origin declarations or origin declarations EUR-MED irrespective of the value of the products concerned. An exporter seeking such authorisation shall offer to the satisfaction of the customs authorities all guarantees necessary to verify the originating status of the products as well as the fulfilment of the other requirements of this Convention.
2. The customs authorities may grant the status of approved exporter subject to any conditions which they consider appropriate.
3. The customs authorities shall grant to the approved exporter a customs authorisation number which shall appear on the origin declaration or on the origin declaration EUR-MED.
4. The customs authorities shall monitor the use of the authorisation by the approved exporter.
5. The customs authorities may withdraw the authorisation at any time. They shall do so where the approved exporter no longer offers the guarantees referred to in paragraph 1, no longer fulfils the conditions referred to in paragraph 2 or otherwise makes an incorrect use of the authorisation.

Under this procedure, Form EUR.1 or EUR-MED is replaced by invoice declaration arrangements, issued by an "approved exporter."

7.4.4 *Supplier's Declarations*

As discussed in section 7.1.3.1 the main purpose of the supplier's declaration is to facilitate the issuance of a CO or for making out an invoice declaration.

The provisions about the supplier's declaration are not contained in the main text of the PEM Convention itself but in the various annexes to Appendix II; for example, in Annex III on Trade between the European Union and the Kingdom of Morocco:

Article 5 – Supplier's Declaration

1. When a movement certificate EUR.1 is issued, or an origin declaration is made out, in the European Union or Morocco for originating products, in the manufacture of which goods coming from Algeria, Morocco, Tunisia or the European Union which have undergone working or processing in these countries without having obtained preferential originating status, have been used, account shall be taken of the supplier's declaration given for those goods in accordance with this Article.
2. The supplier's declaration referred to in paragraph 1 shall serve as evidence of the working or processing undergone in Algeria, Morocco, Tunisia or the European Union by the goods concerned for the purpose of determining whether the products in the manufacture of which these goods are used, may be considered as products originating in the European Union or Morocco and fulfil the other requirements of Appendix I.
3. A separate supplier's declaration shall, except in the cases provided in paragraph 4, be made out by the supplier for each consignment of goods in the form prescribed in Annex A on a sheet of paper annexed to the invoice, the delivery note or any other commercial document describing the goods concerned in sufficient detail to enable them to be identified.
4. Where a supplier regularly supplies a particular customer with goods for which the working or processing undergone in Algeria, Morocco, Tunisia or the European Union is expected to remain constant for considerable periods of time, he may provide a single supplier's declaration to cover subsequent consignments of those goods (hereinafter referred to as a "long-term supplier's declaration").

   A long-term supplier's declaration may normally be valid for a period of up to one year from the date of making out the declaration. The customs authorities of the country where the declaration is made out lay down the conditions under which longer periods may be used.

   The long-term supplier's declaration shall be made out by the supplier in the form prescribed in Annex B and shall describe the goods concerned in sufficient detail to enable them to be identified. It shall be provided to the customer concerned before he is supplied with the first consignment of goods covered by that declaration or together with his first consignment.

   The supplier shall inform his customer immediately if the long-term supplier's declaration is no longer applicable to the goods supplied.
5. The supplier's declarations referred to in paragraphs 3 and 4 shall be typed or printed using one of the languages in which the Agreement is drawn up, in accordance with the provisions of the national law of the country where the declaration is made out, and shall bear the original signature of the supplier in manuscript. The declaration may also be handwritten; in such a case, it shall be written in ink in printed characters.

6. The supplier making out a declaration shall be prepared to submit at any time, at the request of the customs authorities of the country where the declaration is made out, all appropriate documents proving that the information given on that declaration is correct.

The supplier shall make a declaration according to the format contained in Annexes A, C, and E of the PEM Convention. This declaration will have to be made on the commercial invoice relating to a specific consignment or any other commercial document that describes the goods concerned in sufficient detail to enable them to be identified.

Under certain conditions, a long-term supplier's declaration may be made for a period not exceeding one year. Supplier's declarations should bear the signature of the supplier in manuscript. However, while the invoice is drawn up by a computer, the declaration need not be signed in manuscript if the supplier gave a written undertaking that he will accept responsibility for the supplier's declarations that identifies him as if it had been signed in manuscript by him.

7.4.5 *Documentary Evidence for the Issuance of Certificates of Origin*

Documentary evidence is required for the issuance of certificates of origin as pointed out in paragraph 3 of Article 16 of the PEM Convention, as mentioned above.

The meaning of the expression "appropriate documents" in that paragraph is clarified by Article 27 of the PEM Convention, which states that the appropriate documents to prove origin "may consist *inter alia* of the following":

> The documents referred to in Articles 16(3) and 21(5) used for the purpose of proving that products covered by a movement certificate EUR.1 or EUR-MED or an origin declaration or origin declaration EUR-MED may be considered as products originating in a Contracting Party and fulfil the other requirements of this Convention may consist inter alia of the following:
>
> 1. direct evidence of the processes carried out by the exporter or supplier to obtain the goods concerned, contained for example in his accounts or internal bookkeeping;
> 2. documents proving the originating status of materials used, issued or made out in the relevant Contracting Party where these documents are used in accordance with national law;
> 3. documents proving the working or processing of materials in the relevant Contracting Party, issued or made out in the relevant Contracting Party, where these documents are used in accordance with national law;
> 4. movement certificates EUR.1 or EUR-MED or origin declarations or origin declarations EUR-MED proving the originating status of materials used, issued or made out in the Contracting Parties in accordance with this Convention;
> 5. appropriate evidence concerning working or processing undergone outside the relevant Contracting Party by application of Article 11, proving that the requirements of that Article have been satisfied.

7.4.5.1 Validity of Form EUR.1 and EUR-MED and Preservation of Proof of Origin and Supporting Documents

Form EUR.1 or EUR-MED, must usually be submitted to the customs authorities of the importing country where the products are entered within four months of its date of issue by the customs authorities of the exporting country.

Article 28 of the PEM Convention provides for the following:

1. The exporter applying for the issue of a movement certificate EUR.1 or EUR-MED shall keep for at least three years the documents referred to in Article 16(3).
2. The exporter making out an origin declaration or origin declaration EUR-MED shall keep for at least three years a copy of this origin declaration as well as the documents referred to in Article 21(5).
3. The customs authorities of the exporting Contracting Party issuing a movement certificate EUR.1 or EUR-MED shall keep for at least three years the application form referred to in Article 16(2).
4. The customs authorities of the importing Contracting Party shall keep for at least three years the movement certificates EUR.1 and EUR-MED and the origin declarations and origin declarations EUR-MED submitted to them.

In the case of verification or for related reasons, the documentation is necessary to refer back to the supporting documents that have justified the issuance of a CO EUR.1 or EUR-MED or invoice declaration. Therefore, for a period of three years, both the exporter and the customs authorities are obliged to retain the documents relating to exports; that is, the applications for EUR.1 or EUR-MED certificates and the certificates themselves, invoice declarations, or invoice declarations EUR-MED. Even though for trade purposes EUR.1 or EUR-MED certificates have a validity period of four months, they must nevertheless be retained for three years in case of subsequent verification requests.

7.4.6 *Verification of Proofs of Origin*

Detailed provisions for this important part of the administration of rules of origin are contained in Article 32 of the PEM Convention:

1. Subsequent verifications of proofs of origin shall be carried out at random or whenever the customs authorities of the importing Contracting Party have reasonable doubts as to the authenticity of such documents, the originating status of the products concerned or the fulfilment of the other requirements of this Convention.
2. For the purposes of implementing the provisions of paragraph 1, the customs authorities of the importing Contracting Party shall return the movement certificate EUR.1 or EUR-MED and the invoice, if it has been submitted, the origin declaration or the origin declaration EUR-MED, or a copy of these documents, to the customs authorities of the exporting Contracting Party giving, where appropriate, the reasons for the request for verification. Any documents and

information obtained suggesting that the information given on the proof of origin is incorrect shall be forwarded in support of the request for verification.

3. The verification shall be carried out by the customs authorities of the exporting Contracting Party. For this purpose, they shall have the right to call for any evidence and to carry out any inspection of the exporter's accounts or any other check considered appropriate.
4. If the customs authorities of the importing Contracting Party decide to suspend the granting of preferential treatment to the products concerned while awaiting the results of the verification, release of the products shall be offered to the importer subject to any precautionary measures judged necessary.
5. The customs authorities requesting the verification shall be informed of the results thereof as soon as possible. These results shall indicate clearly whether the documents are authentic and whether the products concerned may be considered as products originating in one of the Contracting Parties and fulfil the other requirements of this Convention.
6. If in cases of reasonable doubt there is no reply within ten months of the date of the verification request or if the reply does not contain sufficient information to determine the authenticity of the document in question or the real origin of the products, the requesting customs authorities shall, except in exceptional circumstances, refuse entitlement to the preferences.

In all FTA agreements concluded by the EU with partner countries there is reciprocal obligation of the respective customs authorities to assist each other in managing the origin rules.[65] Article 32 lists the expectations from customs authorities and how they should conduct verifications.

The customs authorities of the importing country may request verification of the authenticity of the proofs of origin and of the originating status of the products concerned from the customs authorities of the exporting country. The reasons for such verification requests could stem from doubts about the true origin of the goods or, in the case of goods covered by an EUR.1 or EUR-MED, doubts about the stamp used to authenticate the document. Random verifications are also permitted under this article. The explanatory notes provide that no country shall be obliged to answer a request for subsequent verification received more than three years after the date of issue of a movement certificate EUR.1 or EUR-MED or the date of making out an invoice declaration or an invoice declaration EUR-MED. Pending the results of a

[65] In the case of the PEM Convention such cooperation is spelt out in Article 31:

1. *The customs authorities of the Contracting Parties shall provide each other, through the European Commission, with specimen impressions of stamps used in their customs offices for the issue of movement certificates EUR.1 and EUR-MED, and with the addresses of the customs authorities responsible for verifying those certificates, origin declarations and origin declarations EUR-MED.*
2. *In order to ensure the proper application of this Convention, the Contracting Parties shall assist each other, through the competent customs administrations, in checking the authenticity of the movement certificates EUR.1 and EUR-MED, the origin declarations and the origin declarations EUR-MED and the correctness of the information given in these documents.*

verification request, the customs of the importing country may decide to suspend granting preferential tariff treatment in respect of the goods under investigation and to any further consignments of similar goods from the same exporter. However, they will offer to release the goods subject to whatever precautionary measures they deem necessary, such as demanding payment from the importer of a deposit equal to the full duty payable on the goods or an undertaking guaranteed by a bank to pay the duty.

If, in cases of reasonable doubt, a reply to the verification request has not been received within ten months, or does not contain sufficient information to verify that the certificate is authentic or the declared origin is correct, the customs will refuse preference.

The explanatory notes concerning the Pan-Euro-Mediterranean Protocols on Rules of Origin[66] provide for the following parameters and guidance on the issue of verification:

Article 33 – Refusal of Preferential Treatment without Verification

This covers cases in that the proof of origin is considered inapplicable, inter alia for the following reasons:

- the goods to that the movement certificate EUR.1 or EUR-MED refers are not eligible for preferential treatment;
- the goods description box (Box 8 on EUR.1 or EUR-MED) is not filled in or refers to goods other than those presented;
- the proof of origin has been issued by a country which does not belong to the preferential system even if the goods originate in a country belonging to the system (e.g. EUR.1 or EUR-MED issued in Ukraine for products originating in Syria) or the proof of origin has been issued by a country with which cumulation is not applicable (e.g. EUR.1 or EURMED issued in Syria for goods exported to Norway when the free trade agreement between these two countries does not exist);
- one of the mandatory boxes on the movement certificate EUR.1 or EUR-MED bears traces of non authenticated erasures or alterations (e.g. the boxes describing the goods or stating the number of packages, the country of destination, or the country of origin).
- the time-limit on the movement certificate EUR.1 or EUR-MED has expired for reasons other than those covered by the regulations (e.g. exceptional circumstances), except where the goods were presented before expiry of the time-limit;
- the proof of origin is produced subsequently for goods that were initially imported fraudulently;
- Box 4 on the movement certificate EUR.1 or EUR-MED names a country not party to the agreement under which preferential treatment is being sought;

[66] See "Explanatory notes concerning the Pan-Euro-Mediterranean Protocols on Rules of Origin" (fn. 58 above).

- Box 4 on the movement certificate EUR.1 or EUR-MED names a country with which cumulation is not applicable (e.g. EUR.1 or EUR-MED issued in the EC [European Community] for products of Faroese origin imported to Morocco when the free trade agreement between Morocco and the Faeroe Islands does not exist).

In these cases, the explanatory notes provide that the action to be taken is as follows:

> The proof of origin should be marked "INAPPLICABLE" and retained by the customs authorities to that it was presented in order to prevent any further attempt to use it.
>
> Where it is appropriate to do so, the Customs authorities of the importing country shall inform the Customs authorities of the country of exportation about the refusal without delay.

Article 33 of the explanatory notes provides further clarifications on the term "Reasonable doubt." The following cases, by way of example, come into the category of reasonable doubt:

- the document has not been signed by the exporter (except for declarations on the basis of invoices or commercial documents drawn up by approved exporters where such a possibility is provided for);
- the movement certificate EUR.1 or EUR-MED has not been signed or dated by the issuing authority;
- the markings on the goods or packaging or the other accompanying documents refer to an origin other than that given on the movement certificate EUR.1 or EUR-MED;
- the particulars entered on the movement certificate EUR.1 or EUR-MED show that there has been insufficient working to confer origin;
- the stamp used to endorse the document does not match that which has been notified.

In these cases, the explanatory notes recommend the following actions:

- The document is sent to the issuing authorities for post-clearance verification, with a statement of the reasons for the request for verification. Pending the results of this verification, all appropriate steps judged necessary by the customs authorities shall be taken to secure payment of any applicable duties.
- The customs authorities may also refuse preferential origin without requesting verification of the proofs of origin presented. Amongst the reasons for such action are the following examples:
  (a) the goods to which the proof of origin relates are not eligible for preference;
  (b) the description box has not been completed;
  (c) the goods described in the proof of origin do not match those presented;
  (d) the proof of origin has been presented after the expiry of its period of validity and there are no grounds justifying its acceptance exceptionally;
  (e) the proof of origin has had words erased or has in some way been tampered with;
  (f) a country not party to the agreement or a country with that cumulation is not applicable has been cited in box 4 of the EUR.1 or EUR-MED certificate.

7.4.7 *Issuance of Certificate of Origin for Cumulation under the Pan-European Rules of Origin, GSP, and Regional Cumulation*

7.4.7.1 Procedure for the Issuance of Certificate of Origin or Statement on Origin under REX for Cumulation under EU GSP Rules of Origin

Among the preferential arrangements examined, there are differences concerning the issuance of the CO for cumulation purposes.[67] Under the original EU regional and bilateral cumulation rules, CO Form A for the finished product benefiting from cumulation is issued on the basis of the Form A certificate issued previously in the other member countries in respect of the originating materials and/or parts utilized in the manufacturing processes of the finished product.

Example: An exporter in country C wishes to export a finished product that contains imported inputs originating in countries A and B of the same regional grouping. The exporter will have to submit to the competent authority two form A certificates relating respectively to the inputs originating in country A and in country B and issued by the competent authorities in each of those countries. Based on these two certificates the competent authority in country C will then issue the final form A certificate relating to the finished product to be exported.[68]

This system of certification of origin, which is based on CO Form A officially stamped by the certifying authorities, is currently being replaced by REX as contained in section 7.4.9 where such Form A is replaced by statements on origin to be given directly by registered exporters. This entails a drastic change of business practices from the certifying authorities of beneficiary countries that will be responsible for maintaining and administering the database. Only exporters registered in the database will be able to issue statements of origin for receiving trade preferences. The current system will remain in place until 2017 with a provision for extending it until 2020 for beneficiaries asking for a longer transitional period.

With the entry into force of the REX, the Form A will no longer be used for cumulation purposes and the statement on origin issued by REX will be used according to Article 93 of EU Regulations.[69]

> **Article 93: Statement on Origin in the Case of Cumulation (Article 64(1) of the Code)**
>
> 1. For the purpose of establishing the origin of materials used under bilateral or regional cumulation, the exporter of a product manufactured using materials originating in a country with which cumulation is permitted shall rely on the statement on origin provided by the supplier of those materials. In these cases,

[67] See also section 3.2.5 in Chapter 3 of this book.

[68] Example taken from the EU Guide, at https://ec.europa.eu/taxation_customs/business/calculation-customs-duties/rules-origin/general-aspects-preferential-origin/a-guide-users-gsp-rules-origin_en#:~:text=The%20Commission%20has%20prepared%20a,(GSP)%20for%20developing.

[69] Commission Delegated Regulation (EU) 2015/2446, July 28, 2015 supplementing Regulation (EU) No. 952/2013 of the European Parliament and of the Council as regards detailed rules concerning certain provisions of the Union Customs Code.

the statement on origin made out by the exporter shall, as the case may be, contain the indication "EU cumulation", "regional cumulation", "Cumul UE", "Cumul regional" or "Acumulación UE", "Acumulación regional".

2. For the purpose of establishing the origin of materials used within the framework of cumulation under Article 54 of Delegated Regulation (EU) 2015/2446, the exporter of a product manufactured using materials originating in Norway, Switzerland or Turkey shall rely on the proof of origin provided by the supplier of those materials on condition that that proof has been issued in accordance with the provisions of the GSP rules of origin of Norway, Switzerland or Turkey, as the case may be. In this case, the statement on origin made out by the exporter shall contain the indication "Norway cumulation", "Switzerland cumulation", "Turkey cumulation", "Cumul Norvège", "Cumul Suisse", "Cumul Turquie" or "Acumulación Noruega", "Acumulación Suiza", "Acumulación Turquía". 29.12.2015 Official Journal of the European Union L 343/605 EN
3. For the purpose of establishing the origin of materials used within the framework of extended cumulation under Article 56 of Delegated Regulation (EU) 2015/2446, the exporter of a product manufactured using materials originating in a party with which extended cumulation is permitted shall rely on the proof of origin provided by the supplier of those materials on condition that that proof has been issued in accordance with the provisions of the relevant free-trade agreement between the Union and the party concerned. In this case, the statement on origin made out by the exporter shall contain the indication "extended cumulation with country x", "cumul étendu avec le pays x" or "Acumulación ampliada con el país x".

To date, four regional groups benefit from regional cumulation under EU GSP rules:[70]

1. Regional cumulation shall apply to the following four separate regional groups:
   (a) group I: Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar/Burma, Philippines, Thailand, Vietnam (ASEAN);
   (b) group II: Bolivia, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Nicaragua, Panama, Peru, Venezuela;
   (c) group III: Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, Sri Lanka (SAARC);
   (d) group IV: Argentina, Brazil, Paraguay and Uruguay (Mercosur).

Ancillary rules for the allocation of origin, transshipment, and administrative procedure are detailed enough to ensure the proper functioning of regional cumulation. The provisions for the allocation of origin among the members of the regional groups have been substantially liberalized by the EU reform of GSP rules of origin.[71]

[70] See Article 55 Regional Cumulation (Article 64(3) of the Code) of Commission Delegated Regulation (EU) 2015/2446, July 28, 2015 supplementing Regulation (EU) No. 952/2013 of the European Parliament and of the Council as regards detailed rules concerning certain provisions of the Union Customs Code, OJ L343 (December 29, 2015), 1.

[71] See S. Inama, "The reform of the EC GSP rules of origin: *Per aspera ad astra*?," *Journal of World Trade*, vol. 45, no. 3 (2011), 577–603.

Paragraph 4 of Article 55 lays down the rules according to which the country of origin of the final product shall be determined:

> Regional cumulation between beneficiary countries in the same regional group shall apply only under the condition that the working or processing carried out in the beneficiary country where the materials are further processed or incorporated goes beyond the operations described in Article 47(1) and, in the case of textile products, also beyond the operations set out in Annex 22-05.
>
> Where the condition laid down in the first subparagraph is not fulfilled and the materials are subject to one or more of the operations described in Article 47(1)(b) to (q), the country to be stated as country of origin on the proof of origin issued or made out for the purposes of exporting the products to the Union shall be the country of the regional group which accounts for the highest share of the value of the materials used originating in countries of the regional group.

Under the EU GSP Regulation 978/2012,[72] there has been a significant change in the treatment of inputs and materials originating in graduated countries. These changes have significant and concrete implications, especially for the countries that still benefit from GSP preferences. The previous EU GSP regulation (no. 732/2008) contained an express provision[73] that maintained the *acquis* of regional cumulation even in the case where one member of such a regional group has graduated out of the GSP. This key provision was somewhat hidden in the EU GSP regulation of 2008.

There is no equivalent provision in the EU GSP regulation of 2012. The absence of such a provision means that the inputs of the graduated countries can no longer be used for cumulation purposes under the regional cumulation provisions. This change of legislation has significantly limited the scope of cumulation since a number of countries have graduated out of the EU GSP either because of GNP per capita or because they are parties to a free-trade agreement with the EU.[74]

Such changes affected some LDC countries, like Cambodia, that have been successfully taking advantage of the EU reform of rules of origin. In the case of bicycles, following the changes introduced in the EU GSP Regulation 978/2012, Malaysian inputs (mainly gears produced by the Shimano factory in Malaysia) could no longer be used by Cambodia for ASEAN cumulation purposes. At that time,

[72] See Regulation (EU) No. 978/2012 of the European Parliament and of the Council, October 25, 2012 applying a scheme of generalised tariff preferences and repealing Council Regulation (EC) No. 732/2008.

[73] Para. 3, Article 5 of the EU GSP Regulation of 2008:
> Regional cumulation within the meaning and provisions of Regulation (EEC) No 2454/93 shall also apply where a product used in further manufacture in a country belonging to a regional group originates in another country of the group, which does not benefit from the arrangements applying to the final product, provided that both countries benefit from regional cumulation for that group.

[74] For an extensive analysis, see S. Inama, "The impact of changes in the GSP Regulation 978/2012 with a focus on the graduation of countries from the scheme, the role of preferences, and rules of origin," Research Paper, European Parliamentary Research Service, 2018.

similar changes in Canadian GSP rules of origin raised concerns and caused significant difficulties for the majority of bicycle industries based in Cambodia.[75] Such concerns were later addressed by the Canadian Government, as discussed during the adoption of new rules in the Canadian graduation policy allowing the use of inputs from graduated countries.[76]

Faced by this situation, the bicycle manufacturers contacted the Ministry of Commerce of Cambodia to request a derogation from the European Commission to continue using inputs originating in Malaysia as eligible under ASEAN cumulation, during a transitional period.[77] This request was granted with a quota on the amount of bicycles that can use cumulation[78] and with a time limitation of three years, from July 29, 2014 until December 31, 2016 and subsequently renewed after protracted exchanges.[79]

This derogation, however, did not address the production cycles, as best reported by bicycle manufacturers located in Cambodia:

> The derogation for Malaysia took much too long to put in place, we missed a whole model year with no Shimano as local content. Then when it was granted, it took a long time for the Malaysia government to start to issue form A. Frankly, we will only start to feel the benefit from this model year production, which starts in May, and we just have until the end of 2016 before [the EU GSP Regulation 978/2012] expires. Brands won't want to change specification half way through a model year in 2016. So for us it's almost all over from May 2016.[80]

7.4.8 *Developments in EU Administration of Origin: The Green Paper of 2004 and the Introduction of the REX System*

In January 2004, the Commission published a Green Paper on the future of rules of origin in preferential trade arrangements.[81] The objective of the Green Paper was to open a debate among EU institutions, civil society, and partner countries on the possible options for reform and changes in the area of rules of origin and their

[75] See S. Inama, "Ex ore tuo te iudico: The value of the WTO Ministerial Decision on Preferential RoO for LDCs," *Journal of World Trade*, vol. 49, no. 4 (2015), 591–617.

[76] See also the Canadian circular, at www.cbsa-asfc.gc.ca/publications/dm-md/d11/d11-4-4-eng.html.

[77] See Inama, "Ex ore tuo te iudico: The value of the WTO Ministerial Decision on Preferential RoO for LDCs" (fn. 75 above).

[78] Commission Implementing Regulation (EU) No. 822/2014, July 28, 2014 on a derogation from Regulation (EEC) No. 2454/93 as regards the rules of origin under the scheme of generalised tariff preferences in respect of bicycles produced in Cambodia regarding the use under cumulation of bicycle parts originating in Malaysia, OJ L223 (July 29, 2014), 19.

[79] Commission Implementing Regulation (EU) 2018/348, March 8, 2018 on a temporary derogation from the rules of preferential origin laid down in Delegated Regulation (EU) 2015/2446 in respect of bicycles and other cycles produced in Cambodia regarding the use under cumulation, of parts originating in Malaysia, OJ L67/24 (March 9, 2018), 1.

[80] Testimony from AJ Company, September 2018.

[81] See Green Paper on the future of rules of origin in preferential trade agreements, Brussels, COM(2003) 787 final, December 18, 2003.

administration. The Commission invited comments from all interested parties that had to be submitted through a questionnaire available on the Internet in March/April 2004.

The starting point of the Green Paper was the state of EU legislation and case law on preferential origin and customs debt, which was not perceived as satisfactory in the eyes of the Commission. In particular the Commission pointed out the following salient points as examples of a "status quo" in need of reform:

- Under EU law on remission, repayment, and nonrecovery of customs debt, an importer acting "in good faith" may be exempted from payment of the customs debt if the commercial risk involved is considered "abnormal"; an example is when an importer is confronted with an error made by the competent authorities in certifying or checking preferential origin or finds himself in a special situation involving no negligence on his part.
- The EU budget bears the corresponding financial loss.
- This situation constitutes a threat to the balance of preferences and to fair trade and competition.
- The result is a perverse system where one party suffers the economic and financial effects of negligence by the other party.

The Commission move was also motivated by the desire that arrangements are fairly and properly implemented, in the interests of both the EU and its trading partners. In practice, fraud and failure to meet the conditions for granting preferential treatment may not only mean a loss of revenue for the EU but will also damage its legitimate economic interests, and those of its partners, by distorting competition.

In order to enhance the protection of the EU interests, a number of actions were listed in the Green Paper to improve the administration of the rules of origin:

- Greater capacity is required for the EU to prevent and react to problems of fraud or incorrect application of preferential origin rules. To be effective, this protection may imply, at EU level, a clear breakdown of tasks and responsibilities between the Commission and the administrations of the member states in charge of controlling compliance with rules of origin by the economic operators as well as by the countries benefiting from preferences. It also implies enhanced cooperation and harmonization of controls among the different administrations involved in the beneficiary countries to administer the REX system, together with a rational allocation of the means and responsibility necessary to this end.
- A clause is required suspending preferences in the event of fraud or other irregularities and/or lack of administrative cooperation, which is progressively incorporated into the preferential agreements on a reciprocal basis. This instrument will be used where repeated problems adversely affect both the proper application of the arrangements and compliance with their objectives. It will have a preventive or deterrent effect on those inclined to abuse the arrangements or those who neglect to supervise them.

- A clause is required assigning financial liability to any contracting party that has failed to implement a preferential agreement correctly and consequently has caused injury to the other party. This clause should be considered not as an instrument of retaliation available to one of the parties but as an essential factor in ensuring that all parties implement the agreements fairly.

Apart from these policy guidelines, the Green Paper focused on various alternatives and options to introduce changes to the EU system traditionally based on certifying authorities. Thus, the key questions of the Green Paper focus on the issue of implementation of rules of origin and how to improve or change the current EU system. The options are contained around the following key issues:

- certification of preferential origin in the country of export
- declaration of preferential origin by the importer
- verification.

The Green Paper outlined the following options contained in the next subsections.

7.4.8.1 Certification of Preferential Origin on Export

This option is based on the system currently in operation. The following paragraphs present some additional options to introduce variations and/or make the current system more efficient.

Improve the Current System for Establishing Proof of Origin

- Develop training and information projects on the principles and practicalities of the rules of origin, issue of certificates, and the corresponding checks on the originating status of the products or the authorization and checks on the practices of approved exporters authorized to make invoice declarations.
- Step up monitoring as well as administrative cooperation and mutual assistance, including joint enquiries on the spot.
- Step up capacity to identify and react to fraud situations and poor application of the rules.
- Make the authorities of the beneficiary countries take responsibility by introducing preference suspension and, if necessary, financial liability clauses to be triggered in the event of failure to obey the rules or a lack of administrative cooperation.

Introduce Certification by the Exporter Only

- Give the exporter alone the task of certifying the originating status of the products, as a factor in his commercial relationship with the importer, without prejudice to any checks conducted by the competent authorities to ensure the origin rules are complied with.

- A standard form of certificate would incorporate all the details needed (with a view to subsequent checks) to identify the exporter, the goods, and the conditions of production on which their originating status is based; the exporter would fill in the form and send it (electronically, perhaps) to the importer.

Introduce an Intermediate System of "Approved" or "Registered" Exporters

- Abolish all certification by the authorities and entrust the task to exporters identified for this purpose by the country of export.
- Choose between two formulas: (i) "approval," entailing an audit (mainly of the firm's management structure, financial health, and length of time in business) and prior authorization plus monitoring of practice, and (ii) "registration," limited to listing exporters likely to certify preferential origin, with a view to facilitating subsequent checking.

7.4.8.2 Declaration of Preferential Origin on Import and the Responsibility of the Importer

The series of options outlined in the following section aims at strengthening the procedures by imposing additional responsibility on the importer.

Strengthening the Disciplines on Debt and Debt Recovery

- Without changing the current systems of certification and administrative cooperation, abolish all reference to equity and legitimate expectations by the debtor with regard to the recovery of debt incurred as a result of a refusal to grant preference.
- Alternatively, spell out the conditions to be met by the importer/debtor (particularly as regards his relations with the exporter) to qualify for a waiver of post-clearance recovery or remission/repayment.

Assuming the Authorities of the Country of Export Remain Responsible for Certifying Origin

- Impose additional commitments and obligations on the importer applying for preference (special declaration promising to comply with the rules of origin, an "origin clause" in the contract with the exporter, etc.).
- Amend/reinforce the Customs Code implementing provisions regarding customs declarations and/or the preferential origin rules (systematically requiring a specific declaration by the importer).

Assuming the Exporter Alone (Whether or Not He Is Registered or Approved) Bears Responsibility for Certifying Origin

- Ensure the importer's liability for the declaration of preferential origin based on a direct, exclusive commercial relationship with the exporter.

- Spell out the importer's commitment when declaring preferential origin, on his own responsibility, on the basis of the certificate and information received from the exporter. Make it obligatory to keep such information and to supply additional information on request in case of doubt about the origin of the products.
- Provide for a mechanism to reverse the burden of proof of preferential origin, offering the country of import the option of refusing preference if the origin of the product cannot be confirmed following checks or failing cooperation by the country of export.

7.4.8.3 Verification of Preferential Origin

This series of options contained in the Green Paper aims at strengthening the procedures for monitoring preferential origin of the goods.

Stepping up Checks on the Importer

- Develop mechanisms and criteria at EU level to target controls on declarations of preferential origin and direct enquiries relating to the importer and, if necessary, the exporter. Step up checks on imports using these mechanisms. Make sure that the importer's liability is invoked.
- Step up checks on the exporter assuming the authorities of the country of export remain responsible for certifying origin.
- Make current procedures for post-clearance checks and administrative cooperation work.

Assuming the exporter (whether or not he is registered or approved) bears sole responsibility for certifying origin:

Importing Country Carries Out Checks Directly

- Provide for the legal bases and procedures allowing direct checks on the exporter by the country of import, by means of a questionnaire or on the premises, as is done in NAFTA.

Country of Export Provides Country of Import with Assistance

- Mutual assistance and specific cooperation mechanisms to enable the country of import to have the country of export check the origin of the products exported and, if necessary, be involved in these operations.
- Checks carried out in this way should enable the authorities to establish that products declared to be of preferential origin really are. Failing positive and satisfactory confirmation, the country of import could refuse preference based on the information at its disposal.
- The assistance and control procedures to be introduced and the scope for traders to appeal should be subject to a more detailed description than exists at present.

As further examined in section 7.4.9, at the end of the reflection carried out in the Green Paper and the various options considered, the Commission opted to establish a platform for the registered exporter database.

7.4.9 *The Introduction of the REX System*

As of 2017 exporters in beneficiary countries have to self-register in the European Commission's newly established Registered Exporter (REX) system.[82] Governments of beneficiary countries are required to set up a database with registered exporters. Only exporters registered in the electronic database can issue these statements of origin for receiving trade preferences. REX was implemented on January 1, 2017 and replaced the transitional procedures based on the previous rules of origin until December 31, 2016. Beneficiary countries that were not ready to implement the system by January 1, 2017 were able to apply for a postponement of the registration of their exporters until January 1, 2018 or January 1, 2019.

Although the responsibility of administering exporters falls on the governments of beneficiary countries, the underlying IT system is provided by the European Commission. To claim preferences, exporting firms from beneficiary countries need to register with their competent authorities according to the process laid out in Regulation (EU) No. 2015/2447, Articles 80 and 86 and Annex 22-06. REX furthermore applies to:

- EU operators exporting to GSP beneficiary countries for the purpose of bilateral cumulation of origin
- EU operators exporting to third countries with which the EU has an FTA where the REX system is applied
- EU operators replacing proofs of origin initially made out in GSP beneficiary countries.[83]

After the initial registration, any changes to the database entries of registered exporters, including removal from the system in cases of companies ceasing to exist or committing fraud, are performed by the competent authorities in beneficiary countries, according to the procedures outlined in Regulation (EU) No. 2015/2447, Articles 80 and 89.

REX provides a publicly searchable interface that allows end users to verify the authenticity of registered exporters.[84] Exporters can opt out of the publication according to the process in Regulation (EU) No. 2015/2447, Annex 22-06, but in such cases an anonymous subset of the registration data will still be published for verification purposes.

[82] Note that the European Commission plans to progressively introduce the REX system for all of the EU's preferential trade arrangements, including reciprocal regional trade ag.reements.

[83] https://ec.europa.eu/taxation_customs/business/calculation-customs-duties/rules-origin/general-aspects-preferential-origin/arrangements-list/generalised-system-preferences/the_register_exporter_system_en.

[84] http://ec.europa.eu/taxation_customs/dds2/eos/rex_home.jsp?Lang=en.

For consignments below a value of 6,000 EUR, the EU continues to allow exporters outside of the REX system to claim preferences, if they provide a statement on origin that follows the rules laid out in Regulation (EU) No. 2015/2447, Articles 92, 93, and Annex 22-07.

In order to qualify for the REX system, governments of beneficiary countries have to:

(1) submit to the Commission an undertaking providing for administrative cooperation in the framework of the REX system (Article 70 of Regulation (EU) 2015/2447)
(2) communicate to the Commission the contact details of the competent authorities dealing with the registration of the exporters and administrative cooperation (Article 72 of Regulation (EU) 2015/2447).[85]

According to the European Commission:

> Until 31 December 2017, the competent authorities should continue to issue certificates of origin Form A at the request of exporters who have not yet been registered in the REX system. At the same time they should cease issuing certificates of origin Form A for exporters who have been registered in the system. Should this transition period prove insufficient for a beneficiary country, it may request an extension by maximum six months (grey arrow), i.e. until 30 June 2018. At the end of the transition period, consignments above 6 000 EUR will be entitled to GSP preferential tariff treatment in the EU only if accompanied by a statement on origin made out by a registered exporter.[86]

The provisions for the issuance process of Form A are laid out in Regulation (EU) 2015/2447, Articles 74–77 and Annexes 22-08–22-10.

In spite of the long transition period and the technical assistance provided by the Commission, the transition to the REX system has taken a long time and beneficiary countries have requested a number of exceptions or longer delays and some have yet to implement the REX system. The website of the EU Taxation and Customs Union Directorate-General (TAXUD), periodically updated, provides extensive information in this regard.[87]

7.4.9.1 Procedures Applicable from January 1, 2017

7.4.9.1.1 ESTABLISHMENT AND MANAGEMENT OF DATABASE (REGULATION (EU) NO. 2015/2447, ARTICLES 80–87). Exporters apply to the competent authorities of the beneficiary country, from which the goods are intended to be exported and

[85] https://ec.europa.eu/taxation_customs/business/calculation-customs-duties/rules-origin/general-aspects-preferential-origin/arrangements-list/generalised-system-preferences/the_register_exporter_system_en.
[86] Ibid.
[87] Ibid.

where the goods are considerate to originate, in order to get registered. For this application a form using the model set out in Annex 22-06 of Regulation (EU) No. 2015/2447 has to be submitted. The record must contain information on registered exporters, products intended to export, indications about the registration period of the exporter, as well as the reason for withdrawal. This application includes consent to store the information in the database of the European Commission and to publish nonconfidential data on the Internet.

In four cases exporters may be withdrawn from the record of registered exporters: first, if the registered exporter ceases to exist; second, if he no longer meets the conditions for exporting under the scheme; third, if he has informed the competent authority of the beneficiary country, or the customs authorities of a member state, that he does not have intention to continue exporting goods under the scheme; and finally if his statement on origin contains incorrect information which leads wrongly to the obtaining of preferential tariff treatment. The record of these registered exporters shall be immediately removed. A reintroduction into the record is only possible once they have proved to their competent authorities that they have remedied the situation that led to their withdrawal.

The competent authorities of the beneficiary countries shall notify the European Commission of the national numbering system used for designing registered exporters. The number shall begin with ISO alpha 2 country code (Regulation (EU) 2015/2447, Article 67(4)). Furthermore, they must carry out regular controls on exporters on their own initiative. If the information contained in the record of registered exporters changes, the European Commission must immediately be informed. Also, in case of a request made by the European Commission for control and verification, the competent authorities of beneficiary countries need to render all necessary support.

7.4.9.1.2 CONTROL AND VERIFICATION (REGULATION (EU) 2015/2447, ARTICLES 109–111). For the purpose of control of origin, exporters must hold appropriate commercial accounting records for production and supply of goods and keep all evidence and customs documentation relating to the material used in the manufacture. They need to preserve these documents for at least three years from the end of the year in which a statement was made out. These obligations also apply to the suppliers who provide exporters with supplier's declarations certifying the originating status of the goods they supply.

In order to ensure continued compliance with obligations, exporters are checked periodically, whereby the interval is determined by appropriate risk analysis criteria. Subsequent verification will also be done randomly. The customs authorities of EU member states can carry out subsequent verifications of statements on origin in case of doubt of authenticity, of the originating status of the products, or of the fulfilment of other requirements of the GSP rules of origin. The initial deadline to communicate the results of the verification is set at six months, starting from the date of the verification request. In case of no reply within this period or if the reply does not

contain sufficient information, a further deadline for a second communication is set at not more than six months.

7.4.9.1.3 STATEMENT ON ORIGIN (REGULATION (EU) NO. 2015/2447, ANNEX 22-07). A statement on origin is issued if the goods concerned can be considered to be originating. A registered exporter needs to make out a statement on origin for each consignment and provide it to the customer in the EU. It can be made in either English or French. The length of validity is twelve months from the date of its completion by the exporter. Exceptionally, a retrospective statement on origin – made out after the exportation – can be issued on the condition that it is presented in the EU member state of declaration for release for free circulation no longer than two years after the export.

The following items are exempt from the obligations to deliver a statement on origin: small packages of which the total value does not exceed 500 EUR, products of which the total value does not exceed 1,200 EUR, or those items that are part of travellers' personal luggage.

Discrepancies between a statement on origin and those in other documents shall not ipso facto render the certificate null and void. If it is duly established that the document corresponds to the products concerned, the discovery of slight discrepancies shall not have an impact.

The belated presentation of statements on origin may be accepted, provided that the failure to submit these documents to the customs authorities of the importing country by the final date is due to exceptional circumstances. Statements on origin submitted after the period of validity may be accepted if the products have been presented to customs before expiry of the time limit.

7.4.10 *Origin administration and customs cooperation in the EU*

Each EU national customs authority has established its own risk assessment software to monitor, inter alia, the risks arising from the managing of the preferential agreements and origin declaration.

While it is not the aim of this section to discuss such a system in detail, some general comments may assist in understanding the EU experience.

Import and export transactions in EU member states are carried out by electronic means. However, paperwork and documentary evidence are not totally eliminated because, as previously explained, CO Form EUR.1, invoice declarations, and so on still exist in parallel to the electronic means and risks assessment software.

A significant facilitation and time saving are nevertheless achieved by the introduction of electronic means because documentary evidence and physical inspection of the goods are carried out only in a minority of cases. The monitoring of import

declarations is based on a different level of control of import declarations, which can be summarized as follows:

- the goods are cleared and released to the importer with no *a posteriori* verification and no request to show documentary evidence
- the goods are released but documentary evidence is requested and examined by the customs authorities
- the goods are not released and are subject to physical inspection and documentary evidence is examined.

At present in the EU, there are no common parameters for risks assessment software. It follows that each member state has developed its own system according to risk assessments taking into account national parameters. Such a system invariably provides for feedback responses and its accuracy and effectiveness may depend on the quality and intensity of the interaction between the user and the system.

At EU-wide level, Council Regulation 515/97[88] ("the Regulation") is a fundamental piece of Community legislation laying down the modalities on mutual assistance between customs administrations of member states and the Commission and between the Community and third countries.[89]

The declared purpose of the Regulation is to establish clear rules and mechanisms among the EU member states administration authorities and with the Commission to guarantee the proper application of customs and agriculture laws and regulations, in particular by preventing and investigating breaches of those regulations.

At the same time, the Regulation set up a computerized customs information system at community level to secure the rapid and systemic exchange of information among EU member states and the Commission.

The Regulation is composed of five major titles, of which four contain the modalities for assistance, namely:

Title I: Assistance on request
Title II: Spontaneous assistance
Title III: Relations with the Commission
Title IV: Relations with third countries
Title V: Customs information system

Under the modality of assistance on request, the requested authority shall transmit under Article 4:

[88] Council Regulation (EC) No. 515/97 on mutual assistance between the administrative authorities of the member states and cooperation between the latter and the Commission to ensure the correct application of the law on customs and agricultural matters, OJ L82 (1997).

[89] As amended by Council Regulation 807/2003, OJ L122 (April 14, 2003); Regulation 766/2008 of the European Parliament and of the Council, OJ L218 (July 9, 2008); and Regulation 2015/1525 of the European Parliament and the Council (September 9, 2015).

1. . . . any information that may enable it to ensure compliance with the provisions of customs or agricultural legislation, and in particular those concerning:
   - the application of customs duties and charges having equivalent effect together with agricultural levies and other charges provided for under the common agricultural policy or the special arrangements applicable to certain goods resulting from the processing of agricultural products,
   - operations forming part of the system of financing by the European Agricultural Guidance and Guarantee Fund.
2. In order to obtain the information sought, the requested authority or the administrative authority to which it has recourse shall proceed as though acting on its own account or at the request of another authority in its own country.

Moreover, the applicant authority may ask the requested authority to arrange for a special watch on persons, places, movements of goods, and means of transport where there are reasonable grounds for believing that there is a breach of customs legislation.

The requested administrative authorities shall provide copies of any available information in its possession and shall carry out the appropriate administrative enquiries. Paragraph 2 of Article 9 set the modalities for joint administrative enquiries.

2. By agreement between the applicant authority and the requested authority, officials appointed by the applicant authority may be present at the administrative enquiries referred to in paragraph 1.

   Administrative enquiries shall at all times be carried out by staff of the requested authority. The applicant authority's staff may not, of their own initiative, assume powers of inspection conferred on officials of the requested authority. They shall, however, have access to the same premises and the same documents as the latter, through their intermediary and for the sole purpose of the administrative enquiry being carried out.

   In so far as national provisions on criminal proceedings reserve certain acts to officials specifically designated by national law, the applicant authority's staff shall not take part in such acts. In any event, they shall not participate in particular in searches of premises or the formal questioning of persons under criminal law. They shall, however, have access to the information thus obtained subject to the conditions laid down in Article 3.

Modalities for spontaneous assistance are laid down in Articles 13–16 of the Regulation where the competent authority shall provide and send to other authorities all related information concerning operations, which constitute or appear to them to constitute, breaches of customs legislation.

Title III regulates the relations between the competent authorities in the EU member-states and the Commission. In particular, Article 17 provides that:

1. The competent authorities of each Member State shall communicate to the Commission as soon as it is available to them:
   (a) any information they consider relevant concerning:
      - goods that have been or are suspected of having been the object of breaches of customs or agricultural legislation,

- methods or practices used or suspected of having been used to breach customs or agricultural legislation,
- requests for assistance, action taken and information exchanged in application of Articles 4 to 16 that are capable of revealing fraudulent tendencies in the field of customs and agriculture.

(b) any information on shortcomings or gaps in customs and agricultural legislation that become apparent or may be deduced from the application of that legislation.

2. The Commission shall communicate to the competent authorities in each Member State, as soon as it becomes available, any information that would help them to enforce customs or agricultural legislation.

In addition, the Commission itself may request assistance to the competent authorities of the member states according to the modalities mentioned above.

Paragraph 4 of Article 17 established a clear competence of the Commission to initiate investigations to which Commission officers may participate:

> where the Commission considers that irregularities have taken place in one or more Member States, it shall inform the Member State or States concerned thereof and that State or those Sates shall at the earliest opportunity carry out an enquiry, at which Commission officials may be present under the conditions laid down in Articles 9(2) and 11 of this Regulation.

Title IV of the Regulation deals with relations with third countries and modalities for administrative cooperation as contained in Article 19 of Title IV. Such administrative cooperation is subject to two basic conditions:

(1) the existence of a legal undertaking where the third country has committed to provide assistance to gather proof of the irregular nature of operations which appear to constitute breaches of customs legislation
(2) agreement of the competent authorities to provide information to the third countries.

In the case of third countries, the legal undertaking is normally represented by a protocol establishing mutual assistance between administrative authorities in customs matters, usually annexed to the agreement establishing a free-trade area, such as in the case of Mexico and Chile and other third countries which have entered into such trade relations with the EU. In other cases, the agreement on customs cooperation may be a stand-alone piece of legislation like the agreement entered with India on customs cooperation and mutual administrative assistance in customs matters.[90]

The establishment of a community Customs Information System (CIS) is dealt with in Title V of the Regulation. As stated in paragraph 2 of Article 23 of the Regulation:

> 2. The aim of the CIS, in accordance with the provisions of this Regulation, shall be to assist in preventing, investigating and prosecuting operations that are in breach

[90] Council Decision, March 30, 2004 concerning the conclusion of the Agreement between the European Community and the Republic of India on customs cooperation and mutual administrative assistance in customs matters, OJ L304 (2004).

of customs or agricultural legislation, by increasing, through more rapid dissemination of information, the effectiveness of the cooperation and control procedures of the competent authorities referred to in this Regulation.

The CIS consists of a central database facility and it is accessible via terminals in each member state and at the Commission. It comprises exclusively data necessary to fulfill its aim as stated in Article 23(2), including personal data, in the following categories:

(a) commodities
(b) means of transport
(c) businesses
(d) persons
(e) fraud trends
(f) availability of expertise.

Direct access to data included in the CIS is reserved exclusively for the national authorities designated by EU member states and the departments designated by the Commission. The CIS may be used for the purpose of identifying and reporting, discrete surveillance, or specific checks. A series of provisions in Title V aim to protect personal data and provide personal data protection and supervision.

The functioning of mutual assistance and the CIS is managed by a committee chaired by the EU Commission and made up of representatives of member states. This committee examines all matters related to mutual assistance and in particular:

— the general working of the mutual assistance arrangements provided for in this Regulation,
— the adoption of practical arrangements for forwarding the information referred to in Articles 15, 16 and 17,
— the information sent to the Commission pursuant to Articles 17 and 18 to ascertain if anything can be learnt from it, to decide on the measures required to put an end to practices found to be in breach of customs or agricultural legislation and, where appropriate, to suggest amendments to existing Community provisions or the drafting of additional ones,
— the organisation of joint customs operations, in particular special surveillance operations provided for in Article 7,
— the preparation of investigations carried out by the Member States and coordinated by the Commission and Community missions as provided for in Article 20,
— measures taken to safeguard the confidentiality of information, in particular personal data, exchanged under this Regulation, other than that provided for in Title V,
— the implementation and proper operation of the CIS and all the technical and operational measures required to ensure the security of the system,

— the need to store information in the CIS,
— the measures taken to safeguard the confidentiality of information entered in the CIS under this Regulation, particularly personal data, and to ensure compliance with the obligations of those responsible for processing.
— the measures adopted pursuant to Article 38(2).[91]

7.4.10.1 Experience of OLAF on Origin Investigation

The core activity of l'Office européen de lutte anti-fraude (OLAF), established in 1999, is the conduct and coordination of anti-fraud operations to protect the EU budget and the investigation of fraud and illegal activities within the European institutions. Thus, OLAF has not been created with the specific function of fighting customs fraud or conduct origin verification. In fact, the field of OLAF activities is substantially larger, including fraud related to agricultural subsidies, structural funds, aid projects, and other areas.

In the specific customs field, it has to be recalled that the Customs Union and the common commercial policy fall within the exclusive responsibility of the EU (Articles 23 and 131 of the EC Treaty). The Commission accordingly has the power to take action against operations that constitute or appear to constitute breaches of the customs legislation. Regulation (EC) No. 515/97[92] is the basic regulation containing provisions on mutual assistance between member states and between member states and the Commission. OLAF is responsible for the application of this regulation.

On the basis of implementing regulations[93] and international agreements, OLAF has the highest responsibility for organizing an effective cooperation at all levels in order to ensure a good application of customs regulations. To that end, it exchanges information, coordinates actions undertaken in the member states, takes part in checks and inspections in the member states and nonmember countries, and carries out spot checks.

All customs investigations concern exchange of goods between the EU and nonmember countries (import, export, transit, warehousing, processing) on the basis of information on established or suspected breaches of customs legislation.

7.5 MAPPING OUT CERTIFICATION IN FREE-TRADE AGREEMENTS

As contained in the original Green Paper[94] of the EU discussed in section 7.4.8 and reiterated in a recent EU submission in the course of the proceedings of the

[91] Council Regulation (EC) No. 515/97, Article 43 para. 4 (as amended).
[92] Council Regulation (EC) No. 515/97, March 13, 1997 on mutual assistance between the administrative authorities of the member states and cooperation between the latter and the Commission to ensure the correct application of the law on customs and agricultural matters, OJ L082 (March 22, 1997), 1, as amended.
[93] In particular Regulation 515/97 and Regulation 2185/96.
[94] See Chapter 3 of this book.

Working Group for the revision of Annex K of the Kyoto Convention, there are a series of different models and variations on the model for administering the certification of origin in free-trade agreements. Clearly it is hoped that there will be ongoing discussions on the revision of Annex K of the Kyoto Convention (and in particular Chapter 2 on certification of the annex).

As echoed in the recent EU proposal to overhaul Annex K, there are very different procedural approaches currently applied by and between preferential trade partners regarding certification requirements and related procedures. As illustrated in the tables which follow,[95] it is quite clear that the EU, the United States, Japan, and South Korea are moving toward a self-certification system by the importer, exporter, or a combination of the two. As recognized and encouraged by WCO and WTO documents and Ministerial decisions self-certification of origin is the way forward.[96] Yet there are a number of differences and nuances in how this general tendency is implemented by each of these major players in relation to each partner to a free-trade agreement; that is, in the case of the EU self-certification is applicable in a similar but different manner than in the case of CETA and the EU–Japan FTA agreement, and USMCA provisions are different from those of the US–Korea FTA agreement, and widely different are the provisions that are inserted in Japan's free-trade agreements with ASEAN countries that still provide for certifying authorities with stamps and signatures, as discussed in section 7.5.3.

Yet initiatives are flourishing toward mounting systems for E-certificates in developing countries of origin, sometimes funded by the same donors that are advocating and adopting different certifications systems.[97]

In such a vast area it may be hard to find common ground, yet it is still possible to identify major practices and lessons learned and put these at the disposal of the stakeholders. In order to reach such an ambitious objective, it is first necessary to map out the major trends and practices contained in a number of free-trade agreements, as outlined in the following sections. The sections below are part of a preliminary analysis of a new publication by the author[98] that is aimed at providing such useful platform.

[95] The drafting of these tables benefited from the assistance of Chenao Li.

[96] In line with WCO Guideline 4 on Certification of Origin (July 2014 – updated in June 2018) and point 3.1(b) of the WTO Nairobi Ministerial Decision, December 19, 2015 on Preferential rules of origin for LDCs, and recent international developments in preferential origin procedures.

[97] In Asia, the EU funded a World Bank project that invested resources in an E-certificate system in Cambodia when REX was about to be introduced. In Africa an EU project has funded a COMESA project on the establishment of E-certificates of origin recently when the ESA EPA is silent on the issue of using such certificates.

[98] Such publication is expected in the course of 2022.

For each of the major users, namely the EU (see Tables 7.6–7.18), the United States (see Tables 7.19–7.27), Japan (see Tables 7.28–7.35), South Korea (see Tables 7.36–7.43), and China (see Tables 7.44–7.57), the respective tables compare the major elements of administering rules of origin of free-trade agreements that they have entered into with partners in various regions. The selection of these countries has been made on the basis of their participation in free-trade agreements in different regions (EU, United States, and Japan) and their capacity to participate to in free-trade agreements where other partners are not members (China, South Korea).

Table 7.6 summarizes the main definitions and the major characteristics of each system, while the remaining tables make a text-based comparison of the major elements of the administration of rules of origin that these countries have in the free-trade agreements with different partners.

7.5.1 *European Union*

The main distinctive element in the EU administration of rules of origin that has emerged lately is the decisive move from an administration of certification of origin based on the existence of a certifying authority (CA) to an exporter-based system and most recently, in the case of the EU–Japan FTA agreement, also importer-based.

In fact until the Green Paper on the future of rules of origin examined in section 7.4.8, the EU administration on certification was centered on the certifying authorities, exchange of stamps, and, in the case of some free-trade agreements, the existence of the approved exporters. As discussed in section 7.4.8, the triggering mechanism for a progressive change to an exporter-based system was caused by a series of internal case law of the European Court of Justice[99] that made difficult the recovery of customs duties in cases where the importer could demonstrate his good faith by relying on a CO wrongly issue by a CA.

After the Green Paper, the EU started to launch the REX system for the certification of origin under the GSP discussed in section 7.4.9 a3nd, in the case of free-trade agreements, started to introduce the concept of exporter declarations as contained in, for instance, CETA[100] and the importer/exporter declaration, as discussed in section 7.1.

Another major feature of the EU administration that is different from the other countries examined in this section is the issue of administration of cumulation as discussed in section 7.1.3.1. The administration and detailed rules on cumulation, with supplier's declarations and related supplier's declaration administrations is present in all EU free-trade agreements, albeit with variations depending on the scope and geographical extension of cumulation possibilities.

[99] See Joined cases C-153 and 204/94, *The Queen* v. *Commissioner of Customs and Excise, ex parte Faroe Seafood Co. Ltd and Others* (1996) ECR I-2465.

[100] See Table 7.7.

TABLE 7.6 *Definitions in EU free-trade agreements*

Definition	Explanation
Certificate of origin issued by certifying authorities	Certificate of origin, normally EUR-1 or, in case of the Euro-Med Convention, EUR-Med certificate of origin issued and stamped by competent authorities.
Prior authorization (approved exporter)	The status of approved exporter may be granted by the competent authorities to exporters and the approved exporters may issue an exporter declaration of origin given by the exporter on an invoice, a delivery note, or any other commercial document that describes the products concerned in sufficient detail to enable them to be identified.
Prior registration (registered exporter)	The registered exporter system (the REX system) is the system of certification of origin of goods that has applied in the GSP of the European Union since January 1, 2017. It is based on a principle of self-certification by economic operators who will make out themselves so-called *statements on origin*. To be entitled to make out a statement on origin, an economic operator will have to be registered in a database by his competent authorities. The economic operator will become a "registered exporter."[i]
Exporter declaration (standard)	The exporter declaration is the text of the declaration made by the approved exporter specifically required and usually specified in an annex to the free-trade agreement in question.
Importer declaration's knowledge	The importer declaration is a new provision inserted in the EU–Japan FTA agreement, allowing the importer to claim preferential treatment based on: (a) a statement on origin that the product is originating made out by the exporter; or (b) the importer's knowledge that the product is originating.
Exporter declaration for small consignment	This declaration is made by any exporter on a commercial document for small consignments usually not exceeding 6,000 EUR. The declaration may be written on the invoice, the delivery notes, or any other commercial document relating to the consignment and describing the product.
Supplier's declaration	A supplier's declaration is a declaration by which a supplier provides information to his customer concerning the originating status of goods with regard to the specific preferential rules of origin.
Accounting segregation	Accounting segregation is a procedure used to differentiate originating inputs from non-originating

(*continued*)

TABLE 7.6 (*continued*)

Definition	Explanation
	inputs when fungible goods are used to produce a finished product. Fungible goods are goods that are interchangeable for commercial purposes, and have essentially identical properties.
Documentary evidence of direct consignment	This provision determines the documentary evidence that should be presented to the customs authorities at the time of customs clearance to accompany the origin declaration.
Nonalteration	Nonalteration is a new provision inserted in some EU free-trade agreements where documentary evidence about direct consignment is relaxed as explained in section 7.1.1.
Averaging (value of non-originating materials)	This is a provision inserted in the EU GSP allowing the averaging of the value of non-originating material.
Prohibition of drawback rule	The intention of this provision is to prevent "drawback" on any non-originating goods used in the working or processing of an originating product as further explained in section 7.1.3.5.
Exporter recordkeeping (# years)	This is a standard feature in any free-trade agreement where the exporter or importer, as applicable, have to retain the documents relating to exports, i.e. the applications for certificate of origin and the certificates themselves, invoice declarations, or invoice declarations, etc. Record keeping is of paramount importance in case of subsequent verification requests.
Binding origin information (BOI)	These are provisions aimed at providing legal certainty if, after consideration of the legal text, an application is lodged for a Binding Origin Information decision (BOI). Certain free-trade agreements provide for specific provisions governing BOI. BOIs may be issued for both the exporter and importer. They are binding on all customs administrations in the EU for a period of three years from their date of issue where the goods being imported or exported and the circumstances governing the acquisition of origin correspond in every respect with what is described in the BOI.

[i] For further details, see https://ec.europa.eu/taxation_customs/business/calculation-customs-duties/rules-origin/general-aspects-preferential-origin/arrangements-list/generalised-system-preferences/the_register_exporter_system_en.

TABLE 7.7 *Mapping certification in EU free-trade agreements*

	EU GSP[i]	EURO-MED Convention[ii]	EU–SADC[iii]	EU–Central American Common Market (CACM)[iv]	EU–Korea[v]	CETA[vi]	EU–Japan[vii]
Main provision for certification	REX	Products originating in one of the Contracting Parties shall, on importation into other Contracting Parties, benefit from the provisions of the relevant Agreements upon submission of one of the following proofs of origin: (a) a movement certificate EUR.1, a specimen of which appears in Annex III a;	Products originating in a SADC EPA State shall, on importation into the EU and products originating in the EU shall, on importation into a SADC EPA State, benefit from the provisions of this Agreement upon submission of either: (a) in the cases specified in Article 24(1) of this Protocol, a declaration, subsequently	Products originating in the European Union shall, on importation into Central America, and products originating in Central America shall, on importation into the European Union, benefit from this Agreement upon submission of either: (a) a movement certificate EUR.1, a specimen of which appears in	Products originating in the EU Party shall, on importation into Korea and products originating in Korea shall, on importation into the EU Party benefit from preferential tariff treatment of this Agreement on the basis of a declaration, subsequently referred to as the "origin declaration", given by the exporter on an invoice, a	Products originating in the European Union, on importation into Canada, and products originating in Canada, on importation into the European Union, benefit from preferential tariff treatment of this Agreement on the basis of a declaration ("origin declaration"). The origin declaration is provided on an invoice or any other commercial document that describes the originating product in sufficient detail to enable its identification.	A statement on origin may be made out by an exporter of a product on the basis of information demonstrating that the product is originating, including information on the originating status of materials used in the production of the product. The exporter is responsible for the correctness of the statement on origin and of the information provided.

(*continued*)

TABLE 7.7 (*continued*)

EU GSP[i]	EURO-MED Convention[ii]	EU–SADC[iii]	EU–Central American Common Market (CACM)[iv]	EU–Korea[v]	CETA[vi]	EU–Japan[vii]
	(b) a movement certificate EUR-MED, a specimen of which appears in Annex III b; (c) in the cases specified in Article 21(1), a declaration (hereinafter referred to as the "origin declaration" or "the origin declaration EUR-MED") given by the exporter on an invoice, a delivery note or any other commercial	referred to as the "origin declaration", given by the exporter on an invoice, a delivery note or any other commercial document which describes the products concerned in sufficient detail to enable them to be identified. The text of the origin declaration appears in Annex IV; or	Appendix 3; or (b) in the cases specified in Article 19, paragraph 1, a declaration, subsequently referred to as the "invoice declaration", given by the exporter on an invoice, a delivery note or any other commercial document which describes the products concerned in sufficient detail to enable them to be identified;	delivery note or any other commercial document which describes the products concerned in sufficient detail to enable them to be identified. The texts of the origin declarations appear in Annex III. 2. Notwithstanding paragraph 1, originating products within the meaning of this Protocol shall, in the cases specified in Article 21, benefit from preferential tariff		

		document which describes the products concerned in sufficient detail to enable them to be identified. The texts of the origin declarations appear in Annexes IV a and b.	(b) a movement certificate EUR 1, a specimen of which appears in Annex III.	the text of the invoice declaration appears in Appendix 4.	treatment of this Agreement without it being necessary to submit any of the documents referred to in paragraph 1.		
Prior authorization (approved exporter)	Yes	Yes	Yes	Yes	Yes	No	No
Prior registration (registered exporter)	Yes	Not applicable	Not applicable	Not applicable	Not applicable	Yes	Yes (limited to EU exporters)

(*continued*)

TABLE 7.7 (*continued*)

	EU GSP[i]	EURO-MED Convention[ii]	EU–SADC[iii]	EU–Central American Common Market (CACM)[iv]	EU–Korea[v]	CETA[vi]	EU–Japan[vii]
Exporter declaration (standard)	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Importer's declaration based on its knowledge	No	No	No	No	No	No	Yes
Exporter declaration for small consignment	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Long-term certificate for OM	Not applicable						
Long-term certificate for NOM	Yes	Yes	Yes	No	No	No	No
Accounting segregation	Yes	Yes	Yes	No	Yes	Yes	Yes
Documentary evidence of direct shipment requirement	Yes	Yes	No	Yes	Yes	Yes	No

Nonalteration	No	No	Yes	No	No	No	Yes
Averaging (value of non-originating materials)	Yes	No	No	No	No	Yes for automotive products: Article 14 of the EU–Canada FTA agreement. For the purpose of calculating the net cost of a product under paragraph 1, the producer may average its calculation over its fiscal year using any one of the following categories, on the basis of either all motor vehicles produced by that producer in the category or only those motor vehicles in the category that are produced by that producer and exported to the territory of the other Party: (a) the same model line of motor vehicles in the same class of	No

(*continued*)

TABLE 7.7 (*continued*)

	EU GSP[i]	EURO-MED Convention[ii]	EU–SADC[iii]	EU–Central American Common Market (CACM)[iv]	EU–Korea[v]	CETA[vi]	EU–Japan[vii]
						vehicles produced in the same plant in the territory of a Party; (b) the same model line of motor vehicles produced in the same plant in the territory of a Party; (c) the same model line of motor vehicles produced in the territory of a Party; (d) the same class of motor vehicles produced in the same plant in the territory of a Party; or (e) any other category as the Parties may decide.	
Prohibition of drawback rule	Yes	Yes	No	No	Yes	Yes	No

Exporter record keeping (# years)	3	3	5	5	5	3	3
Binding rules of origin	No	No	No	No	Yes	Yes	Yes
Cumulation of origin	Yes	Yes	Yes	Yes	Yes	Yes	Yes

[i] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32015R2446.
[ii] https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2004:304:0039:0208:EN:PDF.
[iii] http://trade.ec.europa.eu/doclib/docs/2015/october/tradoc_153915.pdf.
[iv] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:L:2012:346:FULL&from=en.
[v] https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=OJ:L:2011:127:TOC.
[vi] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:22017A0114(01).
[vii] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52018PC0192#document2.

TABLE 7.8 *EU free-trade agreements: Approved exporter*

EU GSP	EURO-MED	EU–South Africa	EU–Central America	EU–Korea	CETA	EU–Japan
Yes Only applicable for EU exporters for bilateral cumulation Article 67: Approved exporter authorisation (Article 64(1) of the Code) 1. Where the Union has a preferential arrangement with a third country which provides that a proof of origin is to take the form of an invoice declaration or an origin declaration made out by an approved exporter, exporters established in the customs territory of the Union may apply for an authorisation as an	Yes Article 22: Approved exporter 1. The customs authorities of the exporting Contracting Party may authorise any exporter (hereinafter referred to as "approved exporter"), who makes frequent shipments of products in accordance to the provisions of this Convention to make out origin declarations or origin declarations EUR-MED irrespective of the value of the products concerned. An exporter seeking such authorisation shall offer to the satisfaction of the	Yes Article 25: Approved exporter 1. The customs authorities of the exporting country may authorise any exporter who makes frequent shipments of products under the trade cooperation provisions of this Agreement to make out origin declarations irrespective of the value of the products concerned. An exporter seeking such authorisation must offer to the satisfaction of the customs authorities all guarantees necessary to	Article 20: Approved exporter 1. The competent public authorities of the exporting Party may authorise any exporter, hereinafter referred to as "approved exporter", who makes frequent shipments of products under this Agreement to make out invoice declarations irrespective of the value of the products concerned. An exporter seeking such authorisation must offer to the satisfaction of the competent public authorities all guarantees necessary to verify the originating status of the products as well as the fulfilment of the other requirements	Yes Article 17: Approved exporter 1. The customs authorities of the exporting Party may authorise any exporter, (hereinafter referred to as "approved exporter"), who exports products under this Agreement to make out origin declarations irrespective of the value of the products concerned in accordance with appropriate conditions in the respective laws and regulations of the exporting Party. An exporter seeking such authorisation must offer to the satisfaction of the customs authorities all	Article 19: Obligations regarding exportations 1. An origin declaration as referred to in Article 18.1 shall be completed: (a) in the European Union, by an exporter in accordance with the relevant European Union legislation; and (b) in Canada, by an exporter in accordance with Part V of the Customs Act, R.S.C., 1985, c. 1 (2nd Supp.). 2. The exporter completing an origin declaration shall at the request of the customs authority of the Party of export	Not applicable. See Table 7.6.

approved exporter for the purposes of making out and replacing those declarations.

2. Articles 11(1)(d), 16, 17 and 18 of Delegated Regulation (EU) 2015/2446 concerning the conditions for accepting applications and the suspension of decisions and Articles 10 and 15 of this Regulation concerning the use of electronic means for exchanging and storing information and the revocation of favourable decisions pertaining to applications and decisions shall not apply to decisions relating to approved exporter authorisations.

customs authorities all guarantees necessary to verify the originating status of the products as well as the fulfilment of the other requirements of this Convention.

2. The customs authorities may grant the status of approved exporter subject to any conditions which they consider appropriate.
3. The customs authorities shall grant to the approved exporter a customs authorisation number which shall appear on the origin declaration or on the origin declaration EUR-MED.
4. The customs authorities shall monitor the use of the authorisation by the

verify the originating status of the products as well as the fulfilment of the other requirements of this Protocol.

2. The customs authorities may grant the status of approved exporter subject to any conditions which they consider appropriate.
3. The customs authorities shall grant to the approved exporter a customs authorisation number which shall appear on the origin declaration.
4. The customs authorities shall monitor the use of the authorisation by the approved exporter.
5. The customs authorities may withdraw the authorisation at any

of this Annex.

2. The competent public authorities may grant the status of approved exporter subject to any conditions which they consider appropriate.
3. The competent public authorities shall grant to the approved exporter an authorisation number which shall appear on the invoice declaration.
4. The competent public authorities shall monitor the use of the authorisation by the approved exporter.
5. The competent public authorities may withdraw the authorisation at any time. They shall do so where the approved exporter no longer offers the guarantees

guarantees necessary to verify the originating status of the products as well as the fulfilment of the other requirements of this Protocol.

2. The customs authorities may grant the status of approved exporter subject to any conditions which they consider appropriate.
3. The customs authorities shall grant to the approved exporter a customs authorisation number which shall appear on the origin declaration.
   (1) The base year for the purpose of evaluating the statistical data under this Article will be the average of the latest three years immediately before

submit a copy of the origin declaration and all appropriate documents proving the originating status of the products concerned, including supporting documents or written statements from the producers or suppliers, and fulfil the other requirements of this Protocol.

3. An origin declaration shall be completed and signed by the exporter unless otherwise provided.
4. A Party may allow an origin declaration to be completed by the exporter when the products to which it

(*continued*)

TABLE 7.8 (*continued*)

EU GSP	EURO-MED	EU–South Africa	EU–Central America	EU–Korea	CETA	EU–Japan
3. Approved exporter authorisations shall be granted solely to persons who fulfil the conditions set out in the origin provisions either of agreements which the Union has concluded with certain countries or territories outside the customs territory of the Union or of measures adopted unilaterally by the Union in respect of such countries or territories. 4. The customs authorities shall grant to the approved exporter a customs authorisation number which shall appear on the proofs of preferential origin. The	approved exporter. 5. The customs authorities may withdraw the authorisation at any time. They shall do so where the approved exporter no longer offers the guarantees referred to in paragraph 1, no longer fulfils the conditions referred to in paragraph 2 or otherwise makes an incorrect use of the authorisation.	time. They shall do so where the approved exporter no longer offers the guarantees referred to in paragraph 1, does not fulfil the conditions referred to in paragraph 2 or otherwise makes an incorrect use of the authorisation.	referred to in paragraph 1, no longer fulfils the conditions referred to in paragraph 2 or otherwise makes an incorrect use of the authorisation.	the entry into force of this Agreement, each year being the fiscal year of January through December. The evidence could be based on an aggregate of all materials used as non-originating material for the product concerned or a subset of such materials. In the latter case, limitations on duty drawback and inward processing would only apply to the subset. (2) For greater clarity, no additional consultations other than those foreseen in paragraph 2, for which the deadlines	relates are exported, or after exportation if the origin declaration is presented in the importing Party within two years after the importation of the products to which it relates or within a longer period of time if specified in the laws of the importing Party. 5. The customs authority of the Party of import may allow the application of an origin declaration to multiple shipments of identical originating products that take place within a period of	

customs authorisation number shall be preceded by ISO 3166-1-alpha-2 country code of the Member State issuing the authorisation.

5. The Commission shall provide the third countries concerned with the addresses of the customs authorities responsible for the control of the proofs of preferential origin made out by approved exporters.
6. Where the applicable preferential arrangement does not specify the form that invoice declarations or origin declarations shall take, those declarations are the same as those of Article 14.3.4, are required before a Party may request the establishment of such Panel. The deadlines for the Panel to issue its ruling are indicated in Article 14.7.2.
4. The customs authorities shall monitor the use of the authorisation by the approved exporter.
5. The customs authorities may withdraw the authorisation at any time. They shall do so where the approved exporter no longer offers the guarantees referred time that does not exceed 12 months as set out by the exporter in that declaration.
6. An exporter that has completed an origin declaration and becomes aware or has reason to believe that the origin declaration contains incorrect information shall immediately notify the importer in writing of any change affecting the originating status of each product to which the origin declaration applies.
7. The Parties may allow the establishment of a system that permits

(*continued*)

TABLE 7.8 (*continued*)

EU GSP	EURO-MED	EU–South Africa	EU–Central America	EU–Korea	CETA	EU–Japan
shall be drawn up in accordance with the form set out in Annex 22-09. 7. Where the applicable preferential arrangement does not specify the value threshold up to which an exporter who is not an approved exporter may make out an invoice declaration or an origin declaration, the value threshold shall be EUR 6 000 for each consignment.				to in paragraph 1, no longer fulfils the conditions referred to in paragraph 2 or otherwise makes an incorrect use of the authorisation.	an origin declaration to be submitted electronically and directly from the exporter in the territory of a Party to an importer in the territory of the other Party, including the replacement of the exporter's signature on the origin declaration with an electronic signature or identification code.	

TABLE 7.9 *EU free-trade agreements: Conditions for exporter declaration*

EU GSP	EURO-MED	EU–South Africa	EU–Central America	EU–Korea	CETA	EU–Japan
Application to become a registered exporter (Article 64(1) of the Code) 1. To become a registered exporter, an exporter shall lodge an application with the competent authorities of the beneficiary country where he has his headquarters or where he is permanently established. The application shall be made using the form set out in Annex 22-06. 2. To become a registered exporter, an exporter or a re-consignor of goods established in the customs territory of the Union shall lodge an application with the customs authorities of that Member States.	Article 21: Conditions for making out an origin declaration or an origin declaration EUR-MED 1. An origin declaration or an origin declaration EUR-MED as referred to in Article 15(1)(c) may be made out: (a) by an approved exporter within the meaning of Article 22, or (b) by any exporter for any consignment consisting of one or more packages containing originating products the total value of which does not exceed EUR 6 000.	Article 24: Conditions for making out an origin declaration 1. An origin declaration as referred to in Article 19(1)(a) of this Protocol may be made out by: (a) an approved exporter within the meaning of Article 25 of this Protocol, or (b) any exporter for any consignment consisting of one or more packages containing originating products whose total value does not exceed EUR 6 000. 2. An origin declaration may be made out if the products concerned can be	Article 14: Products originating in the European Union shall, on importation into Central America, and products originating in Central America shall, on importation into the European Union, benefit from this Agreement upon submission of either: (a) a movement certificate EUR.1, a specimen of which appears in Appendix 3; or (b) in the cases specified in Article 19, paragraph 1, a declaration, subsequently referred to as the "invoice declaration", given by the exporter on an invoice, a delivery note or any	Article 16: Conditions for making out an origin declaration 1. An origin declaration as referred to in Article 15.1 of this Protocol may be made out: (a) by an approved exporter within the meaning of Article 17; or (b) by any exporter for any consignment consisting of one or more packages containing originating products whose total value does not exceed 6 000 euros. 2. Without prejudice to paragraph 3, an origin declaration may be made out	Article 19: Obligations regarding exportations 1. An origin declaration as referred to in Article 18.1 shall be completed: (a) in the European Union, by an exporter in accordance with the relevant European Union legislation; and (b) in Canada, by an exporter in accordance with Part V of the Customs Act, R.S.C., 1985, c. 1 (2nd Supp.). 2. The exporter completing an origin declaration shall at the request of the customs authority of the Party of export	Article 3.17: Statement on origin 1. A statement on origin may be made out by an exporter of a product on the basis of information demonstrating that the product is originating, including information on the originating status of materials used in the production of the product. The exporter is responsible for the correctness of the statement on origin and of the information provided. 2. A statement on origin shall be made out using one of the linguistic versions of

(*continued*)

TABLE 7.9 (*continued*)

EU GSP	EURO-MED	EU–South Africa	EU–Central America	EU–Korea	CETA	EU–Japan
The application shall be made using the form set out in Annex 22–06. 3. For the purposes of exports under the GSP and under the generalised schemes of preferences of Norway, Switzerland or Turkey exporters shall only be required to be registered once. A registered exporter number shall be assigned to the exporter by the competent authorities of the beneficiary country with a view to exporting under the GSP schemes of the Union, Norway and Switzerland as well as Turkey, to the extent that those countries have recognised the country where the registration has taken		considered as products originating in the SADC EPA States or in the EU or in one of the other countries or territories referred to in Article 4 of this Protocol and fulfil the other requirements of this Protocol. 3. The exporter making out an origin declaration shall be prepared to submit at any time, at the request of the customs authorities of the exporting country, all appropriate documents proving the originating status of the products concerned as well as the fulfilment of	other commercial document which describes the products concerned in sufficient detail to enable them to be identified; the text of the invoice declaration appears in Appendix 4. 2. Notwithstanding paragraph 1, originating products within the meaning of this Annex shall, in the cases specified in Article 24, benefit from the Agreement without it being necessary to submit any of the documents referred to above.	if the products concerned can be considered as products originating in the EU Party or in Korea and fulfil the other requirements of this Protocol. 3. The exporter making out an origin declaration shall be prepared to submit at any time, at the request of the customs authorities of the exporting Party, all appropriate documents proving the originating status of the products concerned including statements from the suppliers or	submit a copy of the origin declaration and all appropriate documents proving the originating status of the products concerned, including supporting documents or written statements from the producers or suppliers, and fulfil the other requirements of this Protocol.	the text set out in Annex 3-D on an invoice or on any other commercial document that describes the originating product in sufficient detail to enable its identification. The importing Party shall not require the importer to submit a translation of the statement on origin. 3. The customs authority of the importing Party shall not reject a claim for preferential tariff treatment due to minor errors or discrepancies in the statement on origin or for the sole reason that an invoice was issued in a third country.

place as a beneficiary country.

4. The registration shall be valid as of the date on which the competent authorities of a beneficiary country or the customs authorities of a Member State receive a complete application for registration, in accordance with paragraphs 1 and 2.

5. Where the exporter is represented for the purpose of carrying out export formalities and the representative of the exporter is also a registered exporter, this representative shall not use his own registered exporter number.

the other requirements of this Protocol.

4. An origin declaration shall be made out by the exporter by typing, stamping or printing on the invoice, the delivery note or another commercial document, the declaration, the text of which appears in Annex IV to this Protocol, using one of the linguistic versions set out in that Annex and in accordance with the provisions of the domestic law of the exporting country. If the declaration is

producers in accordance with domestic legislation as well as the fulfilment of the other requirements of this Protocol.

4. An origin declaration shall be made out by the exporter by typing, stamping or printing on the invoice, the delivery note or another commercial document, the text which appears in Annex III, using one of the linguistic versions set out in that Annex and in accordance with the legislation of

(*continued*)

TABLE 7.9 (*continued*)

EU GSP	EURO-MED	EU–South Africa	EU–Central America	EU–Korea	CETA	EU–Japan
		handwritten, it shall be written in ink in printed characters. 5. Origin declarations shall bear the original signature of the exporter in manuscript. However, an approved exporter within the meaning of Article 25 of this Protocol shall not be required to sign such declarations provided that he gives the customs authorities of the exporting country a written undertaking that he accepts full responsibility for any origin declaration which identifies him as if		the exporting Party. If the declaration is handwritten, it shall be written in ink in capital characters. 5. Origin declarations shall bear the original signature of the exporter in manuscript. However, an approved exporter within the meaning of Article 17 shall not be required to sign such declarations provided that he gives the customs authorities of the exporting Party a written undertaking that he accepts full		

it had been signed in manuscript by him.

6. An origin declaration may be made out by the exporter when the products to which it relates are exported, or after exportation on condition that it is presented in the importing country no longer than two (2) years after the importation of the products to which it relates.

responsibility for any origin declaration which identifies him as if it had been signed in manuscript by him.

6. An origin declaration may be made out by the exporter when the products to which it relates are exported, or after exportation on condition that it is presented in the importing Party no longer than two years or the period specified in the legislation of the importing Party after the importation of the products to which it relates.

TABLE 7.10 *EU free-trade agreements: Exemption from proof of origin for small consignments*

EU GSP	EURO-MED	EU–SADC	EU–Central America	EU–Korea	CETA	EU–Japan
Article 97: Exemptions from the obligation to provide a certificate of origin Form A or an invoice declaration (Article 64(1) of the Code) 1. Products sent as small packages from private persons to private persons or forming part of travellers' personal luggage shall be admitted as originating products benefiting from GSP tariff preferences without requiring the presentation of a certificate of origin Form A or an invoice declaration, provided that: (a) such products: (i) are not imported by	Article 26: Exemptions from proof of origin 1. Products sent as small packages from private persons to private persons or forming part of travellers' personal luggage shall be admitted as originating products without requiring the submission of a proof of origin, provided that such products are not imported by way of trade and have been declared as meeting the requirements of this Convention and where there is no doubt as to the veracity of such a declaration. In the case of products sent by post, that declaration may be	Article 29: Exemptions from proof of origin 1. Products sent as small packages from private persons to private persons or forming part of travelers' personal luggage shall be admitted as originating products without requiring the submission of a proof of origin, provided that such products are not imported by way of trade and have been declared as meeting the requirements of this Protocol and where there is no doubt as to the veracity of such a declaration. In the case of products sent by post, this declaration can be	Article 24: Exemptions from proof of origin 1. Products sent as small packages from private persons to private persons or forming part of travellers' personal luggage shall be admitted as originating products without requiring the submission of a proof of origin, provided that such products are not imported by way of trade and have been declared as meeting the requirements of this Annex and where there is no doubt as to the veracity of such a declaration. In the case of products sent by post, this declaration can be made on the	Article 21: Exemptions from proof of origin 1. Products sent as small packages from private persons to private persons or forming part of a traveler's personal luggage shall be admitted as originating products without requiring the submission of a proof of origin, provided that such products are not imported by way of trade and have been declared as meeting the requirements of this Protocol and where there is no doubt as to the veracity of such a declaration. In the case of products sent by post, this declaration may be	Article 24: Exemptions from origin declarations 1. A Party may, in conformity with its laws, waive the requirement to present an origin declaration as referred to in Article 21, for low value shipments of originating products from another Party and for originating products forming part of the personal luggage of a traveller coming from another Party. 2. A Party may exclude any importation from the provisions of paragraph 1 when the importation is part of a series of importations that may reasonably be considered to have	Article 3.20: Small consignments and waivers 1. Products sent as small packages from private persons to private persons or forming part of travellers' personal luggage shall be admitted as originating products provided that such products are not imported by way of trade 13, have been declared as satisfying the requirements of this Chapter and if there is no doubt as to the veracity of such a declaration. 2. Provided that the importation does not form part of importations that may reasonably be

way of trade; (ii) have been declared as meeting the conditions required for benefiting from the GSP scheme; (b) there is no doubt as to the veracity of the declaration referred to in point (a)(ii).

2. Imports shall not be considered as imports by way of trade if all the following conditions are met:
(a) the imports are occasional;
(b) the imports consist solely of products for the personal use of the recipients or travellers or their families;
(c) it is evident from

made on the customs declaration CN22/CN23 or on a sheet of paper annexed to that document.

2. Imports which are occasional and consist solely of products for the personal use of the recipients or travellers or their families shall not be considered as imports by way of trade if it is evident from the nature and quantity of the products that no commercial purpose is in view.

3. Furthermore, the total value of these products shall not exceed EUR 500 in the case of small packages or EUR 1 200

made on customs declaration CN22/CN23 or on a sheet of paper annexed to that document.

2. Imports which are occasional and consist solely of products for the personal use of the recipients or travellers or their families shall not be considered as imports by way of trade if it is evident from the nature and quantity of the products that no commercial purpose is in view.

3. Furthermore, the total value of these products shall not exceed EUR 500 in the case of small packages or EUR 1 200

customs declaration CN22/CN23 or on a sheet of paper annexed to that document.

2. Imports which are occasional and consist solely of products for the personal use of the recipients or travellers or their families shall not be considered as imports by way of trade if it is evident from the nature and quantity of the products that no commercial purpose is in view.

3. Furthermore, the total value of these products shall not exceed in the case of small packages or of products forming part of travellers'

made on a postal customs declaration or on a sheet of paper annexed to that document.

2. Imports which are occasional and consist solely of products for the personal use of the recipients or travellers or their families shall not be considered as imports by way of trade if it is evident from the nature and quantity of the products that no commercial purpose is intended.

3. Furthermore, the total value of these products shall not exceed:
(a) for importation into the EU Party,

been undertaken or arranged for the purpose of avoiding the requirements of this Protocol related to origin declarations.

3. The Parties may set value limits for products referred to in paragraph 1 and shall exchange information regarding those limits.

considered to have been made separately for the purpose of avoiding the requirement for a statement on origin, the total value of the products referred to in paragraph 1 shall not exceed:
(a) for the European Union, 500 euros in the case of small packages or 1,200 euros in the case of products forming part of travellers' personal luggage. The amounts to be used in other currency of a Member State of the European

(*continued*)

TABLE 7.10 (*continued*)

EU GSP	EURO-MED	EU–SADC	EU–Central America	EU–Korea	CETA	EU–Japan
the nature and quantity of the products that no commercial purpose is in view. 3. The total value of the products referred to in paragraph 2 shall not exceed EUR 500 in the case of small packages or EUR 1 200 in the case of products forming part of travellers' personal luggage. Article 103: Exemptions from the obligation to provide a statement on origin (Article 64(1) of the Code) 1. The following	in the case of products forming part of travellers' personal luggage.	in the case of products forming part of travellers' personal luggage.	personal luggage, the amounts in Euros established in Appendix 6 (Amounts referred to in Articles 19, paragraph 1(b) and 24, paragraph 3 of Annex II, concerning the Definition of the Concept of "Originating Products" and Methods of Administrative Cooperation).	500 euros in the case of small packages or 1 200 euros in the case of products forming part of a traveller's personal luggage; (b) for importation into Korea, 1 000 US dollars both in the case of small packages and in the case of the products forming part of a traveller's personal luggage. 4. For the purpose of paragraph 3, in cases where the products are invoiced in a currency other than euro or US dollars, amounts in the national currencies of the Parties equivalent to the amounts expressed in euro or		Union shall be the equivalent in that currency of the amounts expressed in euro as at the first working day of October of each year. The amounts shall be those published for that day by the European Central Bank, unless a different amount is communicated to the European Commission by 15 October of each year, and shall apply from 1 January of the following year. The European Commission shall

products shall be exempted from the obligation to make out and produce a statement on origin:

(a) products sent as small packages from private persons to private persons, the total value of which does not exceed EUR 500;

(b) products forming part of travellers' personal luggage, the total value of which does not exceed EUR 1 200.

2. The products referred to in paragraph 1 shall

US dollars shall be fixed in accordance with the current exchange rate applicable in the importing Party.

notify Japan of the relevant amounts.

(b) for Japan, 100,000 yen or such amount as Japan may establish.

3. Each Party may provide that the basis for the claim as referred to in paragraph 2 of Article 3.16 shall not be required for an importation of a product for which the importing Party has waived the requirements.

(*continued*)

TABLE 7.10 (*continued*)

EU GSP	EURO-MED	EU–SADC	EU–Central America	EU–Korea	CETA	EU–Japan
meet the following conditions: (a) they are not imported by way of trade; (b) they have been declared as meeting the conditions for benefiting from the GSP scheme; (c) there is no doubt as to the veracity of the declaration referred to in point (b). 3. For the purposes of point (a) of paragraph 2, imports shall not be considered as imports by way of trade if all the following conditions are met:						

(a) the imports are occasional;

(b) the imports consist solely of products for the personal use of the recipients or travellers or their families;

(c) it is evident from the nature and quantity of the products that no commercial purpose is in view.

TABLE 7.11 *EU free-trade agreements: Supplier's declarations*

EU GSP	EURO-MED	EU–SADC	EU–Central America	EU–Korea	CETA	EU–Japan
Article 62: Long-term supplier's declaration (Article 64(1) of the Code) 1. Where a supplier regularly supplies an exporter or trader with consignments of goods, and the originating status of the goods of all those consignments is expected to be the same, the supplier may provide a single declaration covering subsequent consignments of those goods (long-term supplier's declaration). A long-term supplier's	Article 5: Supplier's declarations 1. When a movement certificate EUR.1 is issued, or an origin declaration is made out, in the European Union or Algeria for originating products, in the manufacture of which goods coming from Algeria, Morocco, Tunisia or the European Union which have undergone working or processing in these countries without having obtained preferential originating status, have been used, account shall be taken of the supplier's declaration given for those goods in accordance with this Article. 2. The supplier's declaration referred to in paragraph 1 shall serve as evidence of the working	Article 30: Information procedure for cumulation purposes 1. When Articles 3(2), 3(3), 4(2), and 4(3) of this Protocol are applied, the evidence of originating status within the meaning of this Protocol of the materials coming from a SADC EPA State, from the EU, from another ACP EPA State or from an OCT shall be given by a movement certificate EUR.1, an origin declaration or the supplier's declaration, a specimen of which appears in Annex V A, given by the exporter in any of these countries or territories or in the EU from which the materials came. When Article 6(1) of this Protocol is applied, the	Article 25: Supporting documents The documents referred to in Articles 15, paragraph 3 and 19, paragraph 3 used for the purpose of proving that products covered by a movement certificate EUR.1 or an invoice declaration can be considered as products originating in the European Union or in Central America and fulfil the other requirements of this	Article 22: Supporting documents The documents referred to in Article 16.3 used for the purpose of proving that products covered by proofs of origin can be considered as products originating in the EU Party or in Korea and fulfil the other requirements of this Protocol may consist inter alia of the following: (a) direct evidence of the processes carried out by the	Article 25:[i] Supporting documents The documents referred to in Article 19.2 may include documents relating to the following: (a) the production processes carried out on the originating product or on materials used in the production of that product; (b) the purchase of, the cost of, the value of, and the payment for the product; (c) the origin of, the purchase of, the cost of, the value of, and	Accumulation 1. A product that qualifies as originating in a Party shall be considered as originating in the other Party if used as a material in the production of another product in the other Party. 2. Production carried out in a Party on a non-originating material may be taken into account for the purpose of determining whether a product is originating in the

declaration may be made out for a validity period of up to 2 years from the date on which it is made out.
2. A long-term supplier's declaration may be made out with retroactive effect for goods delivered before the making out of the declaration. Such a long-term supplier's declaration may be made out for a validity period of up to 1 year prior to the date on which the declaration was made out. The

or processing undergone in Algeria, Morocco, Tunisia or the European Union by the goods concerned for the purpose of determining whether the products in the manufacture of which those goods are used, may be considered as products originating in the European Union or Algeria and fulfil the other requirements of Appendix I.
3. A separate supplier's declaration shall, except in the cases provided in paragraph 4, be made out by the supplier for each consignment of goods in the form prescribed in Annex A on a sheet of paper annexed to the invoice, the delivery note or any other commercial document describing the goods

evidence of originating status shall be given by Form A or a statement on origin.
2. When Articles 3(4), 3(5), 4(6) and 4(7) of this Protocol are applied, the evidence of the working or processing carried out in a SADC EPA State, in the EU, in another ACP EPA State or in an OCT shall be given by the supplier's declaration a specimen of which appears in Annex V B, given by the exporter in any of these countries or territories or in the EU from which the materials came. A separate supplier's declaration shall be made up by the supplier for each consignment of goods on the commercial invoice related to that shipment or in an annex to that invoice, or on a delivery

Annex may consist inter alia of the following:
(a) direct evidence of the processes carried out by the exporter or supplier to obtain the goods concerned, contained for example in his accounting records or internal book-keeping;
(b) documents proving the originating status of materials used, issued or made out in a Party, where these documents are used in accordance with domestic

exporter, supplier or producer to obtain the goods concerned, contained for example in his accounts or internal book keeping;
(b) documents proving the originating status of materials used, issued or made out in a Party where these documents are used as provided for in its domestic law;
(c) documents proving the working or processing of materials in a Party, issued or made out in a Party where

the payment for all materials, including neutral elements, used in the production of the product; and
(d) the shipment of the product.

other Party.
3. Paragraphs 1 and 2 do not apply if the production carried out in the other Party does not go beyond one or more of the operations referred to in subparagraphs 1(a) to (q) of Article 3.4.
4. In order for an exporter to complete the statement on origin referred to in subparagraph 2(a) of Article 3.16 for a product referred to in paragraph 2, the exporter shall obtain from its supplier information as provided for in

(*continued*)

TABLE 7.11 (*continued*)

EU GSP	EURO-MED	EU–SADC	EU–Central America	EU–Korea	CETA	EU–Japan
validity period shall end on the date on which the long-term supplier's declaration was made out. 3. The supplier shall inform the exporter or trader concerned immediately where the long-term supplier's declaration is not valid in relation to some or all consignments of goods supplied and to be supplied.	concerned in sufficient detail to enable them to be identified. 4. Where a supplier regularly supplies a particular customer with goods for which the working or processing undergone in Algeria, Morocco, Tunisia or the European Union is expected to remain constant for considerable periods of time, he may provide a single supplier's declaration to cover subsequent consignments of those goods (hereinafter referred to as a "long-term supplier's declaration"). A long-term supplier's declaration may normally be valid for a period of up to one year from the date of making out the declaration. The	note or other commercial document related to that shipment which describes the materials concerned in sufficient detail to enable them to be identified. 3. When a supplier regularly supplies a particular customer with goods whose status in respect of the rules of preferential origin is expected to remain constant for considerable periods of time, he may provide a single declaration, hereinafter referred to as "a long–term supplier's declaration", provided that facts or circumstances on which it is granted remain unchanged, to cover subsequent shipments of those goods. A long-term supplier's declaration may be	legislation; (c) documents proving the working or processing of materials in the European Union or in Central America, issued or made out in a Party, where these documents are used in accordance with domestic legislation; (d) movement certificates EUR.1 or invoice declarations proving the originating status of materials used, issued or made out in a Party in	these documents are used as provided for in its domestic law; (d) proofs of origin proving the originating status of materials used issued or made out in a Party in accordance with this Protocol; and (e) appropriate evidence concerning working or processing undergone outside territories of the Parties by application of Article 12, proving that the requirements of that		Annex 3-C. Annex 3-C Information Referred to in Article 3.5 The information referred to in paragraph 4 of Article 3.5 shall be limited to the following elements: (a) description and HS tariff classification number of the product supplied and of the non-originating materials used in its production; (b) if value methods are applied in

customs authorities of the country where the declaration is made out lay down the conditions under which longer periods may be used.
The long-term supplier's declaration shall be made out by the supplier in the form prescribed in Annex B and shall describe the goods concerned in sufficient detail to enable them to be identified. It shall be provided to the customer concerned before he is supplied with the first consignment of goods covered by that declaration or together with his first consignment.
The supplier shall inform his customer immediately if the long-term supplier's declaration is no longer applicable to the goods supplied.

issued for a period of up to one year from the date of issue of the declaration.
4. A long–term supplier's declaration may be issued with retroactive effect. In such cases, its validity may not exceed a period of one year from the date on which it came into effect. However, it is recognised that the customs authority would have the right to revoke a long-term supplier's declaration, should the circumstances change, or when inaccurate or false information has been provided.
5. The supplier shall inform the client immediately when the long-term supplier's declaration is no longer valid in relation to the goods supplied. The supplier's declaration may be

accordance with this Annex.

Article have been satisfied.

accordance with Annex 3-B, the value per unit and the total value of the product supplied and of the non-originating materials used in its production;
(c) if specific production processes are required in accordance with Annex 3-B, a description of the production carried out on the non-originating materials used; and
(d) a statement by the supplier that the elements of

(*continued*)

TABLE 7.11 (*continued*)

EU GSP	EURO-MED	EU–SADC	EU–Central America	EU–Korea	CETA	EU–Japan
	5. The supplier's declarations referred to in paragraphs 3 and 4 shall be typed or printed using one of the languages in which the Agreement is drawn up, in accordance with the provisions of the national law of the country where the declaration is made out, and shall bear the original signature of the supplier in manuscript. The declaration may also be handwritten; in such a case, it shall be written in ink in printed characters. 6. The supplier making out a declaration shall be prepared to submit at any time, at the request of the customs authorities of the country where the declaration is made out, all appropriate documents proving	made out on a pre-printed form. The suppliers' declarations shall bear the original signature of the supplier in manuscript. However, where the origin and the supplier's declaration are established using electronic data-processing methods, the supplier's declaration need not be signed in manuscript provided the responsible official in the supplying company is identified to the satisfaction of the customs authorities in the State where the suppliers' declarations are established. The said customs authorities may lay down conditions for the implementation of this paragraph. 6. The supplier's declaration may be made out on a pre-printed form.				information referred to in paragraphs (a) to (c) are accurate and complete, the date on which the statement is provided, and printed name and address of the supplier.

that the information given on that declaration is correct.	7. The suppliers' declarations shall bear the original signature of the supplier in manuscript. However, where the origin and the supplier's declaration are established using electronic data-processing methods, the supplier's declaration need not be signed in manuscript provided the responsible official in the supplying company is identified to the satisfaction of the customs authorities in the State where the suppliers' declarations are established. The said customs authorities may lay down conditions for the implementation of this paragraph. 8. The supplier's declarations shall be submitted to the customs authorities in the exporting country requested to issue the movement certificate EUR.1.

(*continued*)

TABLE 7.11 (*continued*)

EU GSP	EURO-MED	EU–SADC	EU–Central America	EU–Korea	CETA	EU–Japan
		9. The supplier making out a declaration must be prepared to submit at any time, at the request of the customs authorities of the country where the declaration is made out, all appropriate documents proving that the information given on this declaration is correct. 10. Suppliers' declarations made, and information certificates issued before the date of entry into force of this Protocol in accordance with Article 26 of Annex II of Council Regulation (EC) No 1528/2007 shall remain valid for a transitional period of twelve (12) months.				

[i] See also Annex 3 of the Protocol on Rules of Origin of the EU–Canada FTA agreement containing the format of the supplier's declaration.

TABLE 7.12 *EU free-trade agreements: Accounting segregation*

EU GSP	EURO-MED	EU–South Africa	EU–Central America	EU–Korea	CETA	EU–Japan
Yes Article 58: Accounting segregation of Union exporters' stocks of materials (Article 64(3) of the Code) 1. If originating and non-originating fungible materials are used in the working or processing of a product, the customs authorities of the Member States may, at the written request of economic operators established in the customs territory of the Union, authorise the management of materials in the Union using the accounting segregation method for the purpose of	Yes Article 20: Accounting segregation 1. Where considerable cost or material difficulties arise in keeping separate stocks of originating and non-originating materials which are identical and interchangeable, the customs authorities may, at the written request of those concerned, authorise the so-called "accounting segregation" method (hereinafter referred	Yes Article 16: Accounting segregation 1. Where considerable cost or material difficulties arise in keeping separate stocks of originating and non–originating fungible materials, the customs authorities may, at the written request of those concerned, authorise the so–called "accounting segregation" method (hereinafter referred to as the "method") to be used for managing	There are no provisions for accounting segregation in the original text of the EU–CACM EPAs	Yes Article 11: Accounting segregation of materials 1. Where identical and interchangeable originating and non-originating materials are used in the manufacture of a product, those materials shall be physically segregated, according to their origin, during storage. 2. Where considerable costs or material difficulties arise in keeping separate stocks of identical and	Yes Article 10: Accounting segregation of fungible materials or products 1. (a) If originating and non-originating fungible materials are used in the production of a product, the determination of the origin of the fungible materials does not need to be made through physical separation and identification of any specific fungible material, but may be determined on the basis of an inventory management system; or (b) if originating and non-originating fungible	Yes Article 3.8: Accounting segregation 1. Originating and non-originating fungible materials shall be physically segregated during storage in order to maintain their originating status. 2. For the purpose of this Article, "fungible materials" means materials that are of the same kind and commercial quality, with the same technical and physical

(*continued*)

TABLE 7.12 (*continued*)

EU GSP	EURO-MED	EU–South Africa	EU–Central America	EU–Korea	CETA	EU–Japan
subsequent export to a beneficiary country within the framework of bilateral cumulation, without keeping the materials on separate stocks. 2. The customs authorities of the Member States may make the granting of authorisation referred to in paragraph 1 subject to any conditions they deem appropriate. The authorisation shall be granted only if by use of the method referred to in paragraph 1 it can be ensured that, at any time, the quantity of products obtained which could be considered as "originating	to as the "method") to be used for managing such stocks. 2. The method shall ensure that, for a specific reference period, the number of products obtained which could be considered as "originating" is the same as that which would have been obtained had there been physical segregation of the stocks. 3. The customs authorities may make the grant of authorisation referred	such stocks. 2. The method shall ensure that, at any time, the number of products obtained which could be considered as originating in a SADC EPA State or in the EU is the same as that which would have been obtained had there been physical segregation of the stocks. 3. The customs authorities may grant the authorisation referred to in paragraph 1 subject to any conditions		interchangeable originating and non-originating materials used in the manufacture of a product, the producer may use the so-called "accounting segregation" method for managing stocks. 3. This method is recorded and applied in accordance with the generally accepted accounting principles applicable in the Party where the product is manufactured. 4. This method must be able to ensure that, for a specific	products of Chapter 10, 15, 27, 28, 29, heading 32.01 through 32.07, or heading 39.01 through 39.14 of the HS are physically combined or mixed in inventory in a Party before exportation to the other Party, the determination of the origin of the fungible products does not need to be made through physical separation and identification of any specific fungible product, but may be determined on the basis of an inventory management system. 2. The inventory management system must: (a) ensure that, at any time,	characteristics, and which cannot be distinguished from one another once they are incorporated into the finished product. 3. Notwithstanding paragraph 1, originating and non-originating fungible materials may be used in the production of a product without being physically segregated during storage provided that an accounting segregation method is used. 4. The accounting segregation method

in the Union" is the same as the number that would have been obtained by using a method of physical segregation of the stocks. If authorised, the method shall be applied and the application thereof shall be recorded on the basis of the general accounting principles applicable in the Union.

3. The beneficiary of the method referred to in paragraph 1 shall make out or, until the application of the registered exporter system, apply for proofs of origin for the quantity of products which may be considered as originating. At the reference-period, no more products receive originating status than would be the case if the materials had been physically segregated.

5. A Party may require that the application of the method for managing stocks provided for in this Article is subject to a prior authorisation by customs authorities. Should this be the case, the customs authorities may grant such an authorisation subject to any conditions deemed appropriate.

4. The method shall be applied and the application thereof shall be recorded on the basis of the general accounting principles applicable in the country where the product was manufactured.

5. The beneficiary of the method may make out or apply for proofs of origin, as the case may be, for the quantity of products which may be considered as originating. At the reference-period, no more products receive originating status than would have been the case if the fungible materials or fungible products had been physically segregated;

(b) specify the quantity of originating and non-originating materials or products, including the dates on which those materials or products were placed in inventory and, if required by the applicable rule of origin, the value of those materials or products;

(c) specify the quantity of products produced using fungible materials, or the quantity of fungible referred to in paragraph 3 shall be applied in conformity with an inventory management method under accounting principles which are generally accepted in the Party.

5. A Party may require, under conditions set out in its laws and regulations, that the use of an accounting segregation method is subject to prior authorisation by the customs authority of that Party. The

(*continued*)

TABLE 7.12 (*continued*)

EU GSP	EURO-MED	EU–South Africa	EU–Central America	EU–Korea	CETA	EU–Japan
considered as originating in the Union. At the request of the customs authorities of the Member States, the beneficiary shall provide a statement of how the quantities have been managed. 4. The customs authorities of the Member States shall monitor the use made of the authorisation referred to in paragraph 1. They may withdraw the authorisation in the following cases: (a) the holder makes improper use of the authorisation in any manner whatsoever, or (b) the holder fails to fulfil any of the other conditions	which may be considered as originating. At the request of the customs authorities, the beneficiary shall provide a statement of how the quantities have been managed. 6. The customs authorities shall monitor the use made of the authorisation and may withdraw it whenever the beneficiary makes improper use of the authorisation in any manner whatsoever or fails to fulfil any of the other conditions laid	request of the customs authorities, the beneficiary shall provide a statement of how the quantities have been managed. 6. The customs authorities shall monitor the use made of the authorisation and may withdraw it whenever the beneficiary makes improper use of the authorisation in any manner whatsoever or fails to fulfil any of the other conditions laid down in this Protocol. 7. For the purposes of paragraph 1, fungible		conditions deemed appropriate and they shall monitor the use of the authorisation and may withdraw it at any time whenever the beneficiary makes improper use of it in any manner or fails to fulfil any of the other conditions laid down in this Protocol.	products, that are supplied to customers who require evidence of origin in a Party for the purpose of obtaining preferential treatment under this Agreement, as well as to customers who do not require such evidence; and (d) indicate whether an inventory of originating products was available in sufficient quantity to support the declaration of originating status. 3. A Party may require that an exporter or producer within its territory that is seeking to use an inventory management system pursuant to this Article	customs authority of the Party shall monitor the use of the authorisation and may withdraw the authorisation if the holder makes improper use of the accounting segregation method or fails to fulfil any of the other conditions laid down in this Chapter. 6. The accounting segregation method shall be any method that ensures that at any time no more materials receive originating status than would be the case if

laid down in this subsection, subsection 2 and all other provisions concerning the implementation of the rules of origin.	down in this Convention.	materials means materials that are of the same kind and commercial quality, with the same technical and physical characteristics, and which cannot be distinguished from one another for origin purposes.	obtain prior authorisation from that Party in order to use that system. The Party may withdraw authorisation to use an inventory management system if the exporter or producer makes improper use of it. 4. For the purpose of paragraph 1, "fungible materials" or "fungible products" means materials or products that are of the same kind and commercial quality, with the same technical and physical characteristics, and which cannot be distinguished from one another for origin purposes.	the materials had been physically segregated.

TABLE 7.13 *EU free-trade agreements: Documentary evidence of direct shipment requirement*

EU GSP	EURO-MED	EU–SADC	EU–Central America	EU–Korea	CETA	EU–Japan
Article 43: Non-manipulation (Article 64(3) of the Code) 1. The products declared for release for free circulation in the Union shall be the same products as exported from the beneficiary country in which they are considered to originate. They shall not have been altered, transformed in any way or subjected to operations other than operations to preserve them in good condition or the adding or affixing of marks, labels, seals or any other documentation to	Article 12: Direct transport 1. The preferential treatment provided for under the relevant Agreement shall apply only to products satisfying the requirements of this Convention which are transported directly between or through the territories of the Contracting Parties with which cumulation is applicable in accordance with Article 3. However, products constituting one single consignment may be transported through	Not applicable as nonalteration principle applies.	Article 12: Direct transport 1. The preferential tariff treatment provided for under this Agreement applies only to products, satisfying the requirements of this Annex, which are transported directly between the Parties. However, products may be transported through other territories with, should the occasion arise, trans-shipment or temporary warehousing in such territories, provided that they remain under the	Article 13: Direct transport 1. The preferential treatment provided for under this Agreement applies only to products, satisfying the requirements of this Protocol, which are transported directly between the Parties. However, products constituting one single consignment may be transported through other territories with, should the occasion arise, trans-shipment or temporary warehousing in such territories, provided	Article 14: Transport through a third country 1. A product that has undergone production that satisfies the requirements of Article 2 shall be considered originating only if, subsequent to that production, the product: (a) does not undergo further production or any other operation outside the territories of the Parties, other than unloading, reloading, or any other operation necessary to preserve it in good condition or to transport the product to the	Not applicable as nonalteration principle applies.

ensure compliance with specific domestic requirements applicable in the Union, prior to being declared for release for free circulation.
2. The products imported into a beneficiary country for the purpose of cumulation under Articles 53, 54, 55 or 56 shall be the same products as exported from the country in which they are considered to originate. They shall not have been altered, transformed in any way or subjected to operations other than operations to preserve

other territories with, should the occasion arise, trans-shipment or temporary warehousing in such territories, provided that they remain under the surveillance of the customs authorities in the country of transit or warehousing and do not undergo operations other than unloading, reloading or any operation designed to preserve them in good condition.
Originating products may be transported by pipeline across territory other than that of the Contracting Parties

surveillance of the customs authorities in the country of transit or warehousing and do not undergo operations other than unloading, reloading or any operation designed to preserve them in good condition.
Originating products may be transported by pipeline across territories other than those of the Parties.
2. Evidence that the conditions set out in paragraph 1 have been fulfilled shall be supplied to the customs authorities of the importing Party by the production of:
(a) a single transport

that they are not released for free circulation in the country of transit or warehousing and do not undergo operations other than unloading, reloading or any operation designed to preserve them in good condition.
2. Evidence that the conditions set out in paragraph 1 have been fulfilled shall be supplied to the customs authority, in accordance with the procedures applicable in the importing Party, by the production of:
(a) evidence of the circumstances

territory of a Party; and
(b) remains under customs control while outside the territories of the Parties.
2. The storage of products and shipments or the splitting of shipments may take place where carried out under the responsibility of the exporter or of a subsequent holder of the products and the products remain under customs control in the country or countries of transit.
Article 22: Proof related to transport through a third country
Each Party, through its customs authority, may require an importer to

(*continued*)

TABLE 7.13 (*continued*)

EU GSP	EURO-MED	EU–SADC	EU–Central America	EU–Korea	CETA	EU–Japan
them in good condition, prior to being declared for the relevant customs procedure in the country of imports. 3. Storage of products may take place provided they remain under customs supervision in the country or countries of transit. 4. The splitting of consignments may take place where carried out by the exporter or under his responsibility, provided that the goods concerned remain under customs supervision in the country or countries of transit. 5. Paragraphs 1 to 4 shall be considered to	acting as exporting and importing parties. 2. Evidence that the conditions set out in paragraph 1 have been fulfilled shall be supplied to the customs authorities of the importing Contracting Party by the production of: (a) a single transport document covering the passage from the exporting Contracting Party through the country of transit; or (b) a certificate issued by the customs authorities of the country of transit: (i) giving an exact description of the products; (ii) stating the dates of unloading and		document covering the passage from the exporting Party through the country of transit; or (b) certification issued by the customs authorities of the country of transit containing the following: (i) an exact description of the products, (ii) the dates of unloading and reloading of the products and, where applicable, the names of the ships, or the other means of transport used, and (iii) the conditions under which the products remained in the transit country; or (c) failing these, any	connected with transshipment or the storage of the originating products in third countries; (b) a single transport document covering the passage from the exporting Party through the country of transit; or (c) a certificate issued by the customs authorities of the country of transit: (i) giving an exact description of the products; (ii) stating the dates of unloading and reloading of the products and, where applicable, the names of the ships, or the other means of transport used; and (iii) certifying the	demonstrate that a product for which the importer claims preferential tariff treatment was shipped in accordance with Article 14 by providing: (a) carrier documents, including bills of lading or waybills, indicating the shipping route and all points of shipment and transhipment prior to the importation of the product; and (b) when the product is shipped through or transhipped outside the territories of the Parties, a copy of the customs control documents indicating to that customs authority that the product remained	

be complied with unless the customs authorities have reason to believe the contrary; in such cases, the customs authorities may request the declarant to provide evidence of compliance, which may be given by any means, including contractual transport documents such as bills of lading or factual or concrete evidence based on marking or numbering of packages or any evidence related to the goods themselves.	reloading of the products and, where applicable, the names of the ships, or the other means of transport used; and (iii) certifying the conditions under which the products remained in the transit country; or (c) failing these, any substantiating documents.		substantiating documents to the satisfaction of the customs authority of the importing Party.	conditions under which the products remained in the country of transit.	under customs control while outside the territories of the Parties.

TABLE 7.14 *EU free-trade agreements: Nonalteration*

EU GSP	EURO-MED	EU–SADC	EU–Central America	EU–Korea	CETA	EU–Japan
Article 43: Non-manipulation (Article 64(3) of the Code) 1. The products declared for release for free circulation in the Union shall be the same products as exported from the beneficiary country in which they are considered to originate. They shall not have been altered, transformed in any way or subjected to operations other than operations to preserve them in good condition or the adding or affixing of marks, labels, seals or any other documentation to ensure compliance with specific domestic requirements applicable in the Union, prior to being declared for release for free circulation.	Not applicable.	Article 15: Non-alteration 1. The products declared for home use in a Party shall be the same products as exported from the other Party in which they are considered to originate. They shall not have been altered, transformed in any way or subjected to operations other than to preserve them in good condition or than adding or affixing marks, labels, seals or any documentation to ensure compliance with specific domestic requirements of the importing Party, prior to being declared for home use. 2. Storage of products or consignments may take place provided they remain under customs supervision in the country(ies) of transit.	Not applicable.	Not applicable.	Not applicable.	Article 3.10: Non-alteration 1. An originating product declared for home use in the importing Party shall not have, after exportation and prior to being declared for home use, been altered, transformed in any way or subjected to operations other than to preserve them in good condition or than adding or affixing marks, labels, seals or any other documentation to ensure compliance with specific domestic requirements of the importing Party. 2. Storage or exhibition of a product may take place in a third country provided that it remains under customs supervision in that third country.

2. The products imported into a beneficiary country for the purpose of cumulation under Articles 53, 54, 55 or 56 shall be the same products as exported from the country in which they are considered to originate. They shall not have been altered, transformed in any way or subjected to operations other than operations to preserve them in good condition, prior to being declared for the relevant customs procedure in the country of imports.
3. Storage of products may take place provided they remain under customs supervision in the country or countries of transit.
4. The splitting of consignments may take place

3. Without prejudice to the provisions of Title V, the splitting of consignments may take place where carried out by the exporter or under his responsibility, provided they remain under customs supervision in the country(ies) of splitting.
4. Compliance with paragraphs 1 to 3 shall be considered as satisfied unless the customs authorities have reason to believe the contrary; in such cases, the customs authorities may request the declarant to provide evidence of compliance, which may be given by any means, including contractual transport documents such as bills of lading or factual or concrete

3. Without prejudice to Section B, the splitting of consignments may take place in a third country if it is carried out by the exporter or under its responsibility and provided that they remain under customs supervision in that third country.
4. In case of doubt as to whether the requirements provided for in paragraphs 1 to 3 are complied with, the customs authority of the importing Party may request the importer to provide evidence of compliance, which may be given by any means, including contractual transport documents such as bills of lading or factual or concrete evidence based on marking or

(*continued*)

TABLE 7.14 (*continued*)

EU GSP	EURO-MED	EU–SADC	EU–Central America	EU–Korea	CETA	EU–Japan
where carried out by the exporter or under his responsibility, provided that the goods concerned remain under customs supervision in the country or countries of transit. 5. Paragraphs 1 to 4 shall be considered to be complied with unless the customs authorities have reason to believe the contrary; in such cases, the customs authorities may request the declarant to provide evidence of compliance, which may be given by any means, including contractual transport documents such as bills of lading or factual or concrete evidence based on marking or numbering of packages or any evidence related to the goods themselves		evidence based on marking or numbering of packages or any evidence related to the goods themselves.				numbering of packages or any evidence related to the product itself.

TABLE 7.15 *EU free-trade agreements: Drawback rule*

EU GSP	EURO-MED	EU–SADC	EU–Central America	EU–Korea	CETA	EU–Japan
Yes Not applicable.	Yes Article 15: Prohibition of drawback of, or exemption from, customs duties 1. Non-originating materials used in the manufacture of products originating in the Community, in Egypt or in one of the other countries referred to in Article 4 for which a proof of origin is issued or made out in accordance with the provisions of Title V shall not be subject in the Community or Egypt to drawback of, or exemption from, customs duties of whatever kind. 2. The prohibition in paragraph 1 shall apply to any arrangement for refund,	No express provision in the original free-trade agreement.	No express provision in the original free-trade agreement.	Article 14: Drawback of, or exemption from, customs duties 1. After five years from the entry into force of this Agreement, upon the request of either Party, the Parties shall jointly review their duty drawback and inward processing schemes. One year after entry into force, and subsequently on a yearly basis, the Parties shall exchange available information on a reciprocal basis on the operation of their duty drawback and inward processing schemes, as well as detailed statistics as follows: 1.1 Import statistics at the 8/10 digit level by country starting	Article 2.5: Restriction on duty drawback, duty deferral and duty suspension programs 1. Subject to paragraphs 2 and 3, a Party shall not refund, defer or suspend a customs duty paid or payable on a non-originating good imported into its territory on the express condition that the good, or an identical, equivalent or similar substitute, is used as a material in the production of another good that is subsequently exported to the territory of the other Party under preferential tariff treatment pursuant to this Agreement.	No

(*continued*)

TABLE 7.15 (*continued*)

EU GSP	EURO-MED	EU–SADC	EU–Central America	EU–Korea	CETA	EU–Japan
	remission or non-payment, partial or complete, of customs duties or charges having an equivalent effect, applicable in the Community or Egypt to materials used in the manufacture, where such refund, remission or non-payment applies, expressly or in effect, when products obtained from the said materials are exported and not when they are retained for home use there. 3. The exporter of products covered by a proof of origin shall be prepared to submit at any time, upon request from the customs authorities, all appropriate documents proving that no drawback has been obtained in respect of the non-			from one year after the entry into force of this Agreement shall be provided for imports of materials classified under HS 2007 headings 8407, 8408, 8522, 8527, 8529, 8706, 8707 and 8708, as well as export statistics for 8703, 8519, 8521 and 8525 through 8528. Upon request, such statistics shall be provided on other materials or products. Regular information shall be exchanged on the measures taken to implement limitations on duty drawback and inward processing schemes introduced on the basis of paragraph 3 of this Article. 2. At any time after the initiation of the above review, a Party may request consultations with the other	2. Paragraph 1 does not apply to a Party's regime of tariff reduction, suspension or remission, either permanent or temporary, if the reduction, suspension or remission is not expressly conditioned on the exportation of a good. 3. Paragraph 1 does not apply until three years after the date of entry into force of this Agreement.	

originating materials used in the manufacture of the products concerned and that all customs duties or charges having equivalent effect applicable to such materials have actually been paid.
4. The provisions of paragraphs 1 to 3 shall also apply in respect of packaging within the meaning of Article 8(2), accessories, spare parts and tools within the meaning of Article 9 and products in a set within the meaning of Article 10 when such items are non-originating.
5. The provisions of paragraphs 1 to 4 shall apply only in respect of materials which are of the kind to which the Agreement applies. Furthermore, they

Party with a view to discussing possible limitations on duty drawback and inward processing schemes for a particular product in case there is evidence of a change in sourcing patterns since the entry into force of this Agreement which may have a negative effect on competition for domestic producers of like or directly competitive products in the requesting Party.
2.1 The abovementioned conditions would be established on the basis of evidence provided by the Party requesting consultations that:
(a) the rate of increase of dutiable imports into a Party of materials incorporated

(*continued*)

TABLE 7.15 (*continued*)

EU GSP	EURO-MED	EU–SADC	EU–Central America	EU–Korea	CETA	EU–Japan
	shall not preclude the application of an export refund system for agricultural products, applicable upon export in accordance with the provisions of the Agreement. 6. The provisions of this Article shall not apply for six years following the entry into force of the Agreement. 7. After the entry into force of the provisions of this Article and notwithstanding paragraph 1, Egypt may apply arrangements for drawback of, or exemption from, customs duties or charges having an equivalent effect, applicable to materials used in the manufacture of originating products, subject to the			into a particular product from countries with which no free trade agreement is in force is significantly greater than the rate of increase of exports to the other Party of the product incorporating such materials, unless the Party to which the consultation request is addressed establishes that, inter alia, such increase in imports of materials is: (i) essentially due to an increase in domestic consumption of the product incorporating such materials of the Party; (ii) essentially due to use of imported materials in a product other than that covered by paragraph 2; (iii) due to an increase in		

following provisions:
(a) a 5% rate of customs charge shall be retained in respect of products falling within Chapters 25 to 49 and 64 to 97 of the Harmonised System, or such lower rate as in force in Egypt;
(b) a 10% rate of customs charge shall be retained in respect of products falling within Chapters 50 to 63 of the Harmonised System, or such lower rate as in force in Egypt. Before the end of the transitional period referred to in Article 6 of the Agreement, the provisions of this paragraph will be reviewed.

exports to countries other than the other Party of the product incorporating such materials; or
(iv) limited to imports of high tech/value components, not lowering the price of the export product of the Party; and
(b) imports from the Party into the other Party of the product incorporating such materials have significantly increased in absolute terms or relative to domestic production. Consideration shall also be given to pertinent evidence as regards the effect on conditions of competition for producers of the like or directly competitive products of the other Party (1).

(*continued*)

TABLE 7.15 (*continued*)

EU GSP	EURO-MED	EU–SADC	EU–Central America	EU–Korea	CETA	EU–Japan
				3. In case of disagreement as to whether the conditions in paragraph 2 are fulfilled, the issue shall be determined through binding arbitration by a Panel established in accordance with Article 14.5 (Establishment of the Arbitration Panel) of Chapter Fourteen (Dispute Settlement) as a case of urgency (2). Should the Panel rule that the conditions of paragraph 2 are fulfilled, unless otherwise agreed, the Parties shall, normally within 90 days and in no case more than 150 days of the ruling, limit the maximum rate of customs duties on non-originating material for that product that can be refunded to five percent.		

TABLE 7.16 *EU free-trade agreements: Exporter record keeping (# years)*

EU GSP	EURO-MED	EU–SADC	EU–Central America	EU–Korea	CETA	EU–Japan
3 years Article 91: Obligations of exporters (Article 64 (1) of the Code) 1. Exporters and registered exporters shall comply with the following obligations: (a) they shall maintain appropriate commercial accounting records concerning the production and supply of goods qualifying for preferential treatment; (b) they shall keep available all evidence relating to the materials used	3 years Article 28: Preservation of proof of origin and supporting documents 1. The exporter applying for the issue of a movement certificate EUR.1 or EUR-MED shall keep for at least three years the documents referred to in Article 16(3). 2. The exporter making out an origin declaration or origin declaration EUR-MED shall keep for at least three years a copy of this origin declaration as well	3 years Article 32: Preservation of proof of origin and supporting documents 1. The exporter applying for the issue of a movement certificate EUR.1 shall keep for at least three (3) years the documents referred to in Article 20(3) of this Protocol. 2. The exporter making out an origin declaration shall keep for at least three (3) years a copy of this origin declaration as well as the documents	3 years Article 26: Preservation of proof of origin and supporting documents 1. The exporter applying for the issuance of a movement certificate EUR.1 shall keep for at least three years the documents referred to in Article 15, paragraph 3. 2. The exporter making out an invoice declaration shall keep for at least three years a copy of this invoice declaration as well as the documents referred to in	5 years Article 23: Preservation of proof of origin and supporting documents 1. The exporter making out an origin declaration shall keep for five years a copy of this origin declaration as well as the documents referred to in Article 16.3. 2. The importer shall keep all records related to the importation in accordance with laws and regulations of the importing Party. 3. The customs authorities of the	3 years Article 26: Preservation of records 1. An exporter that has completed an origin declaration shall keep a copy of the origin declaration, as well as the supporting documents referred to in Article 25, for three years after the completion of the origin declaration or for a longer period of time as the Party of export may specify. 2. If an exporter has based an origin declaration on a written statement from the producer,	3 years Article 3.19: Record keeping requirements 1. An importer making a claim for preferential tariff treatment for a product imported into the importing Party shall, for a minimum of three years after the date of importation of the product, keep: (a) if the claim was based on a statement on origin, the statement on origin made out by the exporter; or (b) if the claim was based on the importer's

(*continued*)

TABLE 7.16 (*continued*)

EU GSP	EURO-MED	EU–SADC	EU–Central America	EU–Korea	CETA	EU–Japan
in the manufacture; (c) they shall keep all customs documentation relating to the materials used in the manufacture; (d) they shall keep for at least 3 years from the end of the calendar year in which the statement on origin was made out, or longer if required by national law, records of: (i) the statements on origin they made out; (ii) their originating and non-originating materials, production and stock accounts. Those records and those statements on	as the documents referred to in Article 21(5). 3. The customs authorities of the exporting Contracting Party issuing a movement certificate EUR.1 or EUR-MED shall keep for at least three years the application form referred to in Article 16(2). 4. The customs authorities of the importing Contracting Party shall keep for at least three years the movement certificates EUR.1 and EUR-MED and the origin declarations and origin declarations	referred to in Article 24(3) of this Protocol. 3. The supplier making out a supplier's declaration shall keep for at least three (3) years copies of the declaration and of the invoice, delivery notes or other commercial document to which this declaration is annexed as well as the documents referred to in Article 30(9) of this Protocol. 4. The customs authorities of the exporting country issuing a movement certificate EUR.1 shall keep for at	Article 19, paragraph 3. 3. The competent public authority of the exporting Party issuing a movement certificate EUR.1 shall keep for at least three years the application form referred to in Article 15, paragraph 2. 4. The customs authorities of the importing Party shall keep for at least three years the movement certificates EUR.1 and the invoice declarations submitted to them, which may be kept in electronic format.	importing Party shall keep for five years the origin declarations submitted to them. 4. The records to be kept in accordance with paragraphs 1 through 3 may include electronic records.	the producer shall be required to maintain records in accordance with paragraph 1. 3. When provided for in laws of the Party of import, an importer that has been granted preferential tariff treatment shall keep documentation relating to the importation of the product, including a copy of the origin declaration, for three years after the date on which preferential treatment was granted, or for a longer period of time as that Party may specify.	knowledge, all records demonstrating that the product satisfies the requirements to obtain originating status. 2. An exporter who has made out a statement on origin shall, for a minimum of four years after the making out of that statement on origin, keep a copy of the statement on origin and all other records demonstrating that the product satisfies the requirements to obtain originating status. 3. The records to be kept in accordance with this Article

origin may be kept in an electronic format but shall allow the materials used in the manufacture of the exported products to be traced and their originating status to be confirmed. 2. The obligations provided for in paragraph 1 shall also apply to suppliers who provide exporters with suppliers' declarations certifying the originating status of the goods they supply.	EUR-MED submitted to them.	least three (3) years the application form referred to in Article 20(2) of this Protocol. 5. The customs authorities of the importing country shall keep for at least three (3) years the movement certificates EUR.1 and the origin declarations submitted to them.	4. Each Party shall permit, in accordance with that Party's laws, importers, exporters, and producers in its territory to maintain documentation or records in any medium, provided that the documentation or records can be retrieved and printed. 5. A Party may deny preferential tariff treatment to a product that is the subject of an origin verification when the importer,	may be held in electronic format. 4. Paragraphs 1 to 3 do not apply in the cases specified in Article 3.20.

(*continued*)

TABLE 7.16 (*continued*)

EU GSP	EURO-MED	EU–SADC	EU–Central America	EU–Korea	CETA	EU–Japan
3. The re-consignors of goods, whether registered or not, who make out replacement statements on origin shall keep the initial statements on origin they replaced for at least 3 years from the end of the calendar year in which the replacement statement on origin was made out, or longer if required by national law.					exporter, or producer of the product that is required to maintain records or documentation under this Article: (a) fails to maintain records or documentation relevant to determining the origin of the product in accordance with the requirements of this Protocol; or (b) denies access to those records or documentation.	

TABLE 7.17 *EU free-trade agreements: Advance rulings*

EU GSP	EURO-MED	EU–South Africa	EU–Central America	EU–Korea	CETA	EU–Japan
Not present.	Not present.	Not present.	Not present.	Yes Article 6.6: Advance rulings 1. Upon written request from traders, each Party shall issue written advance rulings, through its customs authorities, prior to the importation of a good into its territory in accordance with its laws and regulations, on tariff classification, origin or any other such matters as the Party may decide. 2. Subject to any confidentiality requirements in its laws and regulations, each Party shall publish, e.g. on the Internet, its advance rulings on tariff classification and any other such matters as the Party may decide. 3. To facilitate trade, the Parties shall include in their bilateral dialogue regular	Yes Article 33: Advance rulings relating to origin 1. Each Party shall, through its customs authority, provide for the expeditious issuance of written advance rulings in accordance with its law, prior to the importation of a product into its territory, concerning whether a product qualifies as an originating product under this Protocol. 2. Each Party shall adopt or maintain procedures for the issuance of advance rulings, including a detailed description of the information reasonably required to process an application for a ruling. 3. Each Party shall provide that its customs authority: (a) may, at any time during the course of an evaluation of an application for an advance ruling, request supplemental information from the person requesting the ruling; (b) issue the ruling within 120 days from the date on which it has obtained all necessary information from the person requesting the advance ruling; and	Yes Article 4.7: Advance rulings 1. Each Party shall issue, through its customs authority, an advance ruling that sets forth the treatment to be provided to the goods concerned. That ruling shall be issued in a reasonable, timebound manner to the applicant that has submitted a written request, including in electronic format, containing all necessary information in accordance with the laws and regulations of the issuing Party. 2. An advance ruling shall cover tariff classification of the goods, origin of goods including their qualification as originating goods under Chapter 3 or any other

(*continued*)

TABLE 7.17 (*continued*)

EU GSP	EURO-MED	EU–South Africa	EU–Central America	EU–Korea	CETA	EU–Japan
				updates on changes in their respective legislation on the matters referred to in paragraphs 1 and 2.	(c) provide, to the person requesting the advance ruling, a full explanation of the reasons for the ruling. 4. When an application for an advance ruling involves an issue that is the subject of: (a) a verification of origin; (b) a review by, or appeal to, a customs authority; or (c) a judicial or quasi-judicial review in the customs authority's territory; the customs authority, in accordance with its laws, may decline or postpone the issuance of the ruling. 5. Subject to paragraph 7, each Party shall apply an advance ruling to importations into its territory of the product for which the ruling was requested on the date of its issuance or at a later date if specified in the ruling. 6. Each Party shall provide, to any person requesting an advance ruling, the same treatment as it provided to any other person to whom it issued an advance ruling, provided that the facts and circumstances are identical in all material respects. 7. The Party issuing an advance ruling may modify or revoke an advance ruling:	matter as the Parties may agree, in particular regarding the appropriate method or criteria to be used for the customs valuation of the goods. 3. Subject to any confidentiality requirements in its laws and regulations, a Party may publish its advance rulings, including through the Internet.

(a) if the ruling is based on an error of fact;
(b) if there is a change in the material facts or circumstances on which the ruling is based;
(c) to conform with an amendment of Chapter Two (National Treatment and Market Access for Goods), or this Protocol; or
(d) to conform with a judicial decision or a change in its law.

8. Each Party shall provide that a modification or revocation of an advance ruling is effective on the date on which the modification or revocation is issued, or on a later date if specified in the ruling, and shall not be applied to importations of a product that have occurred prior to that date, unless the person to whom the advance ruling was issued has not acted in accordance with its terms and conditions.

9. Notwithstanding paragraph 8, the Party issuing the advance ruling may, in conformity with its law, postpone the effective date of a modification or revocation for no more than six months.

10. Subject to paragraph 7, each Party shall provide that an advance ruling remains in effect and is honored.

TABLE 7.18 *EU free-trade agreements: Cumulation of origin*

EU GSP	EURO-MED	EU–SADC	EU–Central America	EU–Korea	CETA	EU–Japan
Article 53: Bilateral cumulation (Article 64 3) of the Code) Bilateral cumulation shall allow products originating in the Union to be considered as materials originating in a beneficiary country when incorporated into a product manufactured in that country, provided that the working or processing carried out there goes beyond the operations described in Article 47(1). Articles 41 to 52, and provisions concerning subsequent verification of proofs of origin shall apply mutatis mutandis to exports from the Union to a	Article 3: Cumulation of origin 1. Without prejudice to the provisions of Article 2(1), products shall be considered as originating in the exporting Contracting Party when exported to another Contracting Party if they are obtained there, incorporating materials originating in Switzerland (including Liechtenstein) (1), Iceland, Norway, Turkey or in the European Union, provided that the working or processing carried out in the exporting Contracting Party goes beyond the operations referred to in Article 6. It shall not be necessary for such materials to have undergone sufficient working or processing. 2. Without prejudice to the provisions of Article 2(1), products shall be considered as originating in the exporting Contracting Party when exported to another Contracting Party if they are obtained there, incorporating materials originating in the Faroe	Article 3: Bilateral cumulation 1. This Article shall apply only in the case of cumulation between a SADC EPA State and the EU. 2. Without prejudice to the provisions of Article 2(2) of this Protocol, materials originating in the EU within the meaning of this Protocol shall be considered as materials originating in a SADC EPA State when incorporated into a product obtained in that SADC EPA State, provided that the working or processing carried out there goes beyond the operations referred to in Article 9(1) of this Protocol. 3. Without prejudice to the provisions of Article 2(1) of this Protocol, materials originating in a SADC EPA State within the meaning of this Protocol shall be considered as materials originating in the EU when incorporated into a product obtained in the EU, provided that the working or processing carried out there goes	Article 3: Cumulation of origin 1. Materials originating in the European Union shall be considered as materials originating in Central America when incorporated into a product obtained there. It shall not be necessary that such materials have undergone sufficient working or processing, provided they have undergone working or processing going beyond that referred to in Article 6. 2. Materials originating in Central America shall be considered as materials originating in the European Union when incorporated into a product obtained there. It shall not be necessary that such materials have undergone sufficient working or processing, provided they have undergone working or processing going beyond that referred to in Article 6. 3. Notwithstanding paragraphs 1 and 2, materials originating in Bolivia, Colombia, Ecuador, Peru or	Article 3: Cumulation of origin Notwithstanding Article 2, products shall be considered as originating in a Party if such products are obtained there, incorporating materials originating in the other Party, provided that the working or processing carried out goes beyond the operations referred to in Article 6. It shall not be necessary that such materials have undergone sufficient working or processing.	Article 3: Cumulation of origin 1. A product that originates in a Party is considered originating in the other Party when used as a material in the production of a product in that other Party. 2. An exporter may take into account production carried out on a non-originating material in the other Party for the purposes of determining the originating status of a product. 3. Paragraphs 1 and 2 do not apply if the production carried out on a product does not go beyond the operations referred to	Article 3.5: Accumulation 1. A product that qualifies as originating in a Party shall be considered as originating in the other Party if used as a material in the production of another product in the other Party. 2. Production carried out in a Party on a non-originating material may be taken into account for the purpose of determining whether a product is originating in the other Party. 3. Paragraphs 1 and 2 do not apply if the production carried out in the other Party does not go beyond one or

beneficiary country for the purposes of bilateral cumulation.

Islands, any participant in the Barcelona Process other than Turkey, or any Contracting Party other than those referred to in paragraph 1 of this Article, provided that the working or processing carried out in the exporting Contracting Party goes beyond the operations referred to in Article 6. It shall not be necessary for such materials to have undergone sufficient working or processing.

3. Where the working or processing carried out in the exporting Contracting Party does not go beyond the operations referred to in Article 6, the product obtained shall be considered as originating in the exporting Contracting Party only where the value added there is greater than the value of the materials used originating in any one of the other Contracting Parties referred to in paragraphs 1 and 2. If this is not so, the product obtained

beyond the operations referred to in Article 9(1) of this Protocol and the product is exported to the same SADC EPA State.

4. Without prejudice to the provisions of Article 2(2) of this Protocol, working and processing carried out in the EU shall be considered as having been carried out in a SADC EPA State, when the materials undergo in the latter subsequent working or processing going beyond the operations referred to in Article 9(1) of this Protocol.

5. Without prejudice to the provisions of Article 2(1) of this Protocol, working and processing carried out in a SADC EPA State shall be considered as having been carried out in the EU, when the materials undergo there subsequent working or processing going beyond the operations referred to in Article 9 (1) of this Protocol and the product is exported to the same SADC EPA

Venezuela shall be considered as materials originating in Central America when further processed or incorporated into a product obtained there (2).

4. In order for the products referred to in paragraph 3 to acquire originating status, it shall not be necessary that the materials have undergone sufficient working or processing, provided that:

(a) the working or processing of the materials carried out in Central America went beyond the operations referred to in Article 6;

(b) the materials were originating in one of the countries listed in paragraph 3, in application of rules of origin identical to those applicable if said materials were exported directly to the European Union; and

(c) the existing arrangements in force between Central America and the other countries referred to in paragraph 3 allow for adequate

in Article 7 and the object of this production, as demonstrated on the basis of a preponderance of evidence, is to circumvent financial or fiscal legislation of the Parties.

4. If an exporter has completed an origin declaration for a product referred to in paragraph 2, the exporter must possess a completed and signed supplier's statement from the supplier of the non-originating materials used in the production of the product.

5. A supplier's statement may be the

more of the operations referred to in subparagraphs 1(a) to (q) of Article 3.4.

4. In order for an exporter to complete the statement on origin referred to in subparagraph 2(a) of Article 3.16 for a product referred to in paragraph 2, the exporter shall obtain from its supplier information as provided for in Annex 3-C.

5. The information referred to in paragraph 4 shall apply to a single consignment or multiple consignments for the same material that is supplied within

(*continued*)

TABLE 7.18 (*continued*)

EU GSP	EURO-MED	EU–SADC	EU–Central America	EU–Korea	CETA	EU–Japan
	shall be considered as originating in the Contracting Party which accounts for the highest value of originating materials used in the manufacture in the exporting Contracting Party. 4. Products originating in the Contracting Parties referred to in paragraphs 1 and 2 which do not undergo any working or processing in the exporting Contracting Party shall retain their origin if exported into one of the other Contracting Parties. 5. The cumulation provided for in this Article may be applied only provided that: (a) a preferential trade agreement in accordance with Article XXIV of the General Agreement on Tariffs and Trade is applicable between the Contracting Parties involved in the acquisition of the originating status and the Contracting Party of destination; (b) materials and products have acquired originating status by the	State. Article 4: Diagonal cumulation 1. This Article shall not apply to cumulation laid down in Article 3 of this Protocol. 2. Without prejudice to the provisions of Article 2(2) of this Protocol, materials originating in a SADC EPA State, the EU, other ACP EPA States or in OCTs shall be considered as materials originating in the SADC EPA State where the materials are incorporated into a product obtained there, provided that the working or processing carried out there goes beyond the operations referred to in Article 9(1) of this Protocol. 3. Without prejudice to the provisions of Article 2(1) of this Protocol, materials originating in a SADC EPA State, other ACP EPA States or in OCTs shall be considered as materials originating in the EU when incorporated into a product obtained there, provided that the working or processing	administrative cooperation procedures ensuring full implementation of this paragraph, as well as of certification and of verification of the originating status of the products (3). 5. The originating status of materials exported from one of the countries referred to in paragraph 3 to Central America to be used in further working or processing shall be established by a proof of origin under which these materials could be exported directly to the European Union. 6. Proof of the originating status, acquired under the terms of paragraph 4, of goods exported to the European Union shall be established by a movement certificate EUR.1 issued or an invoice declaration made out in the exporting country in accordance with the provisions of Title IV (Proof of Origin) of this Annex. These documents shall bear the mention "cumulation with (name of country)".		statement set out in Annex 3 or an equivalent document that contains the same information describing the non-originating materials concerned in sufficient detail for their identification. 6. If a supplier's statement referred to in paragraph 4 is in electronic format, it does not need to be signed, provided that the supplier is identified to the satisfaction of the customs authorities in the Party where the supplier's statement was completed. 7. A supplier's statement applies to a single invoice or multiple invoices for the same material that	a period that does not exceed 12 months from the date on which the information was provided.

application of rules of origin identical to those given in this Convention; and
(c) notices indicating the fulfilment of the necessary requirements to apply cumulation have been published in the Official Journal of the European Union (C series) and in the Contracting Parties which are party to the relevant Agreements, according to their own procedures.
The cumulation provided for in this Article shall apply from the date indicated in the notice published in the Official Journal of the European Union (C series).
The Contracting Parties shall provide the other Contracting Parties which are party to the relevant Agreements, through the European Commission, with details of the Agreements, including their dates of entry into force, which are applied with the other Contracting Parties referred to in paragraphs 1 and 2.

carried out in the EU goes beyond the operations referred to in Article 9 (1) of this Protocol.
4. For the purposes of paragraphs 2 and 3, the origin of the materials originating in the EU or a SADC EPA State shall be determined according to the rules of origin of this Protocol and in accordance with Article 30 of this Protocol. The origin of materials originating in other ACP EPA States or in the OCTs shall be determined according to the rules of origin applicable in the framework of the EU's preferential arrangements with these countries and territories and in accordance with Article 30 of this Protocol.
5. For cumulation provided in paragraphs 2 and 3, when the working or processing carried out in a SADC EPA State or in the EU does not go beyond the operations referred to in Article 9(1) of this Protocol, the product obtained shall be considered as originating in a SADC EPA State or in the EU only

7. At the request of a Republic of the CA Party or the European Union, materials originating in Mexico, South American or Caribbean countries shall be considered as materials originating respectively in Central America or in the European Union when further processed or incorporated into a product obtained there.
8. The request shall be submitted to the Sub-Committee on Customs, Trade Facilitation and Rules of Origin established under Article 123 of Chapter 3 (Customs and Trade Facilitation) of Title II of Part IV of this Agreement.
9. In order for the products referred to in paragraph 7 to acquire originating status, it shall not be necessary that the materials have undergone sufficient working or processing, provided that:
(a) the working or processing of the materials carried out in Central America or in the European Union went beyond the operations referred to in Article 6;

is supplied within a period that does not exceed 12 months from the date set out in the supplier's statement.
8. Subject to paragraph 9, if, as permitted by the WTO Agreement, each Party has a free trade agreement with the same third country, a material of that third country may be taken into consideration by the exporter when determining whether a product is originating under this Agreement.
9. Each Party shall apply paragraph 8 only if equivalent provisions are in force between each Party and the third country and upon agreement by the Parties on the applicable conditions.
10. Notwithstanding

(*continued*)

TABLE 7.18 (*continued*)

EU GSP	EURO-MED	EU–SADC	EU–Central America	EU–Korea	CETA	EU–Japan
		when the value added there is greater than the value of the materials used originating in any one of the other countries or territories. 6. Without prejudice to the provisions of Article 2(2) of this Protocol, working and processing carried out in a SADC EPA State, the EU, other ACP EPA States or in OCTs shall be considered as having been carried out in the SADC EPA State where the materials undergo subsequent working or processing going beyond the operations referred to in Article 9(1) of this Protocol. 7. Without prejudice to the provisions of Article 2(1) of this Protocol, working and processing carried out in a SADC EPA State, other ACP EPA States or in OCTs shall be considered as having been carried out in the EU, when the materials undergo in the EU subsequent working or processing going beyond the operations referred to in Article 9(1) of this Protocol. 8. For cumulation provided in paragraphs 6 and 7, when the	(b) the materials were originating in Mexico, South American or Caribbean country, in application of rules of origin identical to those applicable if said materials were exported directly to the European Union; (c) the materials were originating in Mexico, South American or Caribbean country, in application of rules of origin identical to those applicable if said materials were exported directly to Central America; and (d) the Republics of the CA Party, the European Union and the other country or countries concerned have an arrangement on adequate administrative cooperation procedures which will ensure full implementation of this paragraph as well as of certification and of verification of the originating status of the products. 10. The Parties, on a common accord, shall notify to the Sub-Committee on Customs, Trade Facilitation and Rules of Origin the		paragraph 9, if each Party has a free trade agreement with the United States, and upon agreement by both Parties on the applicable conditions, each Party shall apply paragraph 8 when determining whether a product of Chapter 2 or 11, heading 16.01 through 16.03, Chapter 19, heading 20.02 or 20.03, or subheading 3505.10 is originating under this Agreement.	

working or processing carried out in a SADC EPA State or in the EU does not go beyond the operations referred to in Article 9(1) of this Protocol, the product obtained shall be considered as originating in a SADC EPA State or in the EU only when the value added there is greater than the value added in any one of the other countries or territories. The origin of the final product shall be determined according to the rules of origin of this Protocol and in accordance with Article 30 of this Protocol.

9. The cumulation provided for in paragraphs 2 and 6 may only be applied provided that:

(a) the SADC EPA States, other ACP EPA States and OCTs have entered into an arrangement or agreement on administrative cooperation with each other, which ensures compliance with and a correct implementation of this Article and includes a reference to the use of appropriate proofs of origin;

materials to which the provisions of paragraphs 7 to 12 shall apply.

11. The cumulation established in paragraphs 7, 8, 9, 10 and 12 of this Article may be applied provided that:

(a) preferential trade agreements in accordance with Article XXIV GATT 1994 between the non-party concerned and the Republics of the CA Party and the European Union respectively, are in force. This cumulation shall only be applied between the Parties for which those agreements are in force;

(b) cumulation provisions equivalent to the ones provided under paragraphs 7, 8, 9, 10 and 12 of this Article are contained in the Agreements referred to under (a), in order for the cumulation provisions to apply in a reciprocal manner between the Republics of the CA Party, the European Union and the non-Party concerned, respectively; and

(c) notices indicating the fulfilment of the necessary requirements to apply cumulation under paragraphs

(*continued*)

TABLE 7.18 (*continued*)

EU GSP	EURO-MED	EU–SADC	EU–Central America	EU–Korea	CETA	EU–Japan
		(b) the SACU Secretariat and the Ministry of Industry and Trade of Mozambique have provided the European Commission with the details of the arrangements or agreements on administrative cooperation entered into with the other countries or territories referred to in this Article. 10. The cumulation provided for in paragraph 3 and 7 may only be applied provided that: (a) the EU (1), the other ACP EPA States and OCTs have entered into an arrangement or agreement on administrative cooperation with each other, which ensures compliance with and a correct implementation of this Article and includes a reference to the use of appropriate proofs of origin; (b) the European Commission has provided the SADC EPA States, through the SACU Secretariat and the Ministry of Industry and Trade of Mozambique, with details of agreements on administrative cooperation with the other countries	7, 8, 9, 10 and 12 of this Article have been published in the Official Journal of the European Union (C series), in the official publications of the Republics of the CA Party and of the non-Party countries concerned according to their own procedures. 12. The Parties may establish additional conditions for the application of paragraphs 7 to 11.			

or territories referred to in this Article.

11. Once the requirements of paragraphs 9 and 10 have been fulfilled and the date for the simultaneous entry into force of cumulation provided for under this Article has been agreed upon between the EU and the SADC EPA States, each Party shall fulfil its own publication and information requirements provided for in paragraph 14.

12. Notwithstanding paragraph 11, the date of the implementation of cumulation provided for under this Article with materials from a particular country or territory shall not be beyond a period of five (5) years starting from the date of the signature by a SADC EPA State or the EU of an agreement/ arrangement on administrative cooperation with that particular country or territory provided for in paragraphs 9 and 10.

13. After the period specified in paragraph 12, the SADC EPA States

(*continued*)

TABLE 7.18 (*continued*)

EU GSP	EURO-MED	EU–SADC	EU–Central America	EU–Korea	CETA	EU–Japan
		may start applying the cumulation foreseen in paragraphs 2 and 6 provided that the requirements of paragraph 9 have been fulfilled, while the EU may start applying the cumulation foreseen in paragraphs 3 and 7 provided that the requirements of paragraph 10 have been fulfilled. 14. Each party shall make public the date of entry into force of cumulation with a particular country or territory according to its own internal procedures. 15. The cumulation provided in paragraph 2 shall not apply to materials: (a) of Harmonised System Headings 1604 and 1605 originating in the EPA Pacific States according to Article 6 (6) of Protocol II of the Interim Partnership Agreement between the European Community, on the one part, and the Pacific States, on the other part (1). (b) of Harmonised System Headings 1604 and 1605 originating in the Pacific States according to any future provision of a comprehensive				

Economic Partnership Agreement between the EU and Pacific ACP States.

(c) originating in South Africa and which cannot be imported directly into the EU duty-free quota-free.

16. The cumulation provided in paragraph 3 shall:

(a) Where the final product is exported to SACU, not apply to materials:

(i) originating in non-SACU SADC states, which do not enjoy duty-free quota-free access into SACU under the SADC Protocol on Trade; and

(ii) originating in OCTs or ACP EPA states, other than the non-SACU SADC states, which cannot be imported directly into SACU duty-free quota-free.

(b) Where the final product is exported to Mozambique, not apply to materials originating in OCTs or other ACP EPA states, which cannot be imported directly into Mozambique duty-free quota-free.

17. In respect of paragraphs 15(c), 16(a), 16(b), the EU, SACU and

(*continued*)

TABLE 7.18 (*continued*)

EU GSP	EURO-MED	EU–SADC	EU–Central America	EU–Korea	CETA	EU–Japan
		Mozambique, respectively, shall establish the list of materials concerned and shall ensure the lists are revised as necessary to ensure compliance with those paragraphs. SACU and Mozambique shall notify their respective lists and any subsequent versions thereof in track changes to the European Commission. The EU shall notify its respective list and any subsequent versions thereof in track changes to the SACU Secretariat and the Ministry of Industry and Trade of Mozambique. After notification, as provided for in this paragraph, each party shall make public each of these lists according to their own internal procedures. The Parties shall publish the lists and any subsequent amendments thereof within one (1) month of receipt of the notification. In cases where lists, or their subsequent versions, are notified after the date of entry into force of cumulation, exclusion from cumulation with the materials will				

become effective six (6) months after the receipt of the notification.

18. By way of derogation from paragraphs 15(c), 16(a), and 16(b), the EU, SACU and Mozambique may remove any material from their respective lists. Cumulation with the materials that were removed from the respective list will become effective upon notification and publication of the revised lists. The Parties shall publish the lists and any subsequent amendments thereof within one (1) month of receipt of the notification.

19. The cumulation provided for in this Article shall become applicable to the products listed in Annex IX only after 1 October 2015.

TABLE 7.19 *Definitions in US free-trade agreements*

Definition	Explanation
Certificate of origin issued by certifying authorities	The US free-trade agreements do not use any specific form of certificate of origin, except under NAFTA.
Prior authorization (approved exporter)	There are no approved exporters in US free-trade agreements.
Exporter declaration (standard)	An exporter declaration may be used as a basis for the importer declaration.
Importer's declaration	After NAFTA all US free-trade agreements are based on an importer declaration that may make use of exporter information provided to the importer.
Exemption from proof of origin for small consignment	The majority of US free-trade agreements provide for small consignment provisions.
Long-term certificate for OM	The United States does not use any specific form of supplier's declaration in its legislation.
Long-term certificate for NOM	The United States does not use any specific form of supplier's declaration in its legislation.
Accounting segregation	Detailed provisions on accounting segregation is constant feature in almost every US free-trade agreement.
Documentary evidence of direct shipment requirement	The US free-trade agreements systemically contains provisions requesting documentary evidence of direct shipment.
Drawback rule	There are extended and detailed provisions in NAFTA that have not been replicated in other US free-trade agreements.
Exporter record keeping (# years)	There are systemic provisions for record keeping in every US free-trade agreement.
Advance rulings	Detailed provisions on advance ruling is a feature of almost every US free-trade agreement.

7.5.2 *North America*

See Tables 7.19–7.27. The administration of the certification of the rules of origin in the United States differs widely from the EU since, with the exception of NAFTA where the United States and other partners initially agreed to rely on a CO, all other free-trade agreements are based on an importer-based declaration of origin. After NAFTA, the United States has invariably opted for an importer-based system of declaration of origin. Obviously, and as recognized in USMCA,[101] the importer declaration is based on information provided by the exporter.

[101] See Table 7.19.

TABLE 7.20 *Mapping certification in US free-trade agreements*

US GSP	NAFTA[i]	USMCA[ii]	CAFTA[iii]	US–KOREA[iv]	US–Colombia[v]	US–Australia[vi]	US–Singapore[vii]
Certificate of origin							
CO not required, Declaration if not WO	Each Party shall: (a) require an exporter in its territory to complete and sign a Certificate of Origin for any exportation of a good for which an importer may claim preferential tariff treatment on importation of the good into the territory of another Party; and (b) provide that where an exporter in its territory is not the producer of the good, the exporter may complete and sign a Certificate on the basis of (i) its knowledge of whether the good qualifies as an originating good, (ii) its reasonable reliance on the producer's written representation that the good qualifies as an originating good, or (iii) a completed and signed Certificate for the good voluntarily provided to the exporter by the producer.	Not required	Not required	Not required	Not required	Not required	Not required

(*continued*)

TABLE 7.20 (*continued*)

US GSP	NAFTA[i]	USMCA[ii]	CAFTA[iii]	US–KOREA[iv]	US–Colombia[v]	US–Australia[vi]	US–Singapore[vii]
Importer's declaration							
	No	Yes Each Party shall provide that an importer may make a claim for preferential tariff treatment, based on a certification of origin completed by the exporter, producer, or importer for the purpose of certifying that a good being exported from the territory of a Party into the territory of another Party qualifies as an originating good.	Yes	Each Party shall provide that an importer may make a claim for preferential tariff treatment based on either: (a) a written or electronic certification by the importer, exporter, or producer; or (b) the importer's knowledge that the good is an originating good, including reasonable reliance on information in the importer's possession that the good is an originating good.	Each Party shall provide that an importer may make a claim for preferential tariff treatment based on either: (a) a written or electronic certification by the importer, exporter, or producer; or (b) the importer's knowledge that the good is an originating good, including reasonable reliance on information in the importer's possession that the good is an originating good.	Yes Article 5.12: Claims for preferential treatment 1. Each Party shall provide that an importer may make a claim for preferential treatment under this Agreement based on the importer's knowledge or on information in the importer's possession that the good qualifies as an originating good. 2. Each Party may require that an importer be prepared to submit, on request, a statement setting forth the reasons that the good	Yes, Article 3.13: Claims for preferential treatment 1. Each Party shall provide that an importer may make a claim for preferential treatment under this Agreement based on the importer's knowledge or on information in the importer's possession that the good qualifies as an originating good. 2. Each Party may require that an importer be prepared to submit, upon request, a statement setting forth the reasons that the

						qualifies as an originating good, including pertinent cost and manufacturing information. The statement need not be in a prescribed format, and may be submitted electronically, where feasible.	good qualifies as an originating good, including pertinent cost and manufacturing information. The statement need not be in a prescribed format, and may be submitted electronically, where feasible.
Special for small consignment							
Yes	No	No	Yes	No	No	Yes	Yes
Accounting segregation							
Not present in original legislation	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Documentary evidence of direct shipment requirement							
Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Averaging (value of non-originating materials)							
Not applicable	See US NAFTA Uniform Regulations (15) For purposes of the net cost method, the regional value content of the good, other than a good with respect to which a	Article 5: Averaging 1. Each Party shall provide that, for the purposes of calculating the regional value content of a passenger vehicle, light	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable

(*continued*)

TABLE 7.20 (*continued*)

US GSP	NAFTA[i]	USMCA[ii]	CAFTA[iii]	US–KOREA[iv]	US–Colombia[v]	US–Australia[vi]	US–Singapore[vii]
	choice to average may be made under section 11(1), (3) or (6), 12(1) or 13(4), may be calculated, where the producer chooses to do so, by (a) calculating the sum of the net costs incurred and the sum of the values of non-originating materials used by the producer of the good with respect to the good and identical goods or similar goods, or any combination thereof, produced in a single plant by the producer over (i) a month, (ii) any consecutive three month or six month period that falls within and is evenly divisible into the number of months of the producer's fiscal year remaining at the beginning of that period, or (iii) the producer's fiscal year; and (b) using the sums referred to in paragraph (a) as the net cost and the value of non-originating materials, respectively. (16) The calculation made under subsection (15) shall apply with respect to all units of the good	truck, or heavy truck, the calculation may be averaged over the producer's fiscal year, using any one of the following categories, on the basis of either all motor vehicles in the category or only those motor vehicles in the category that are exported to the territory of one or more of the other Parties: (a) the same model line of motor vehicles in the same class of vehicles produced in the same plant in the territory of a Party; (b) the same class of motor vehicles produced in the same plant in the territory of a Party; (c) the same model line or same class of motor vehicles produced in the territory of a Party; or (d) any other category as the Parties may decide.					

produced during the period chosen by the producer under sub-section (15)(a).(17) A choice made under subsection (15) may not be rescinded or modified with respect to the goods or the period with respect to which the choice is made.

CHOICE OF AVERAGING PERIOD CANNOT BE CHANGED FOR REMAINDER OF FISCAL YEAR

(18) Where a producer chooses a one, three or six month period under subsection (15) with respect to goods, the producer shall be considered to have chosen under that subsection a period or periods of the same duration for the remainder of the producer's fiscal year with respect to those goods.

2. Each Party shall provide, that for the purposes of calculating the regional value content for an automotive good listed in Tables A.1, B, C, D, or E of this Appendix, produced in the same plant, or a super-core for a passenger vehicle or light truck, the calculation may be averaged:

(a) over the fiscal year of the motor vehicle producer to whom the good is sold;

(b) over any quarter or month;

(c) over the fiscal year of the producer of the automotive material; or

(d) over any of the categories in paragraph 1 (a) through (d), provided that the good was produced

(*continued*)

TABLE 7.20 (*continued*)

US GSP	NAFTA[i]	USMCA[ii]	CAFTA[iii]	US–KOREA[iv]	US–Colombia[v]	US–Australia[vi]	US–Singapore[vii]
		during the fiscal year, quarter, or month forming the basis for the calculation, in which: (i) the average in subparagraph (a) is calculated separately for those goods sold to one or more motor vehicle producers, or (ii) the average in subparagraph (a) or (b) is calculated separately for those goods that are exported to the territory of another Party.					
Drawback rule							
	See section 7.1.3.5	See section 7.1.3.5	See section 7.1.3.5	See section 7.1.3.5	See section 7.1.3.5	See section 7.1.3.5	See section 7.1.3.5
Exporter recordkeeping (# years)							
Yes	5 years	5 years	5 years	5 years	5 years	5 years	5 years
Advance rulings							
	Yes	Yes	Yes	Yes	Yes	Yes	Yes

Cumulation of origin							
Yes, for specific regional grouping.	yes	Yes	Yes	Yes	Yes	Yes	Yes

[i] www.nafta-sec-alena.org/Home/Texts-of-the-Agreement/North-American-Free-Trade-Agreement.
[ii] https://ustr.gov/trade-agreements/free-trade-agreements/united-states-mexico-canada-agreement/agreement-between; and https://ustr.gov/sites/default/files/files/agreements/FTA/USMCA/Text/05_Origin_Procedures.pdf.
[iii] https://ustr.gov/trade-agreements/free-trade-agreements/cafta-dr-dominican-republic-central-america-fta/final-text.
[iv] https://ustr.gov/trade-agreements/free-trade-agreements/korus-fta/final-text.
[v] https://ustr.gov/trade-agreements/free-trade-agreements/colombia-fta/final-text.
[vi] https://ustr.gov/trade-agreements/free-trade-agreements/australian-fta/final-text.
[vii] https://ustr.gov/trade-agreements/free-trade-agreements/singapore-fta/final-text.

TABLE 7.21 *US free-trade agreements: Importer's knowledge*

NAFTA	USMCA	CAFTA	US–KOREA	US–Colombia	US–Australia	US–Singapore
Not applicable	Yes Each Party shall provide that an importer may make a claim for preferential tariff treatment, based on a certification of origin completed by the exporter, producer, or importer1 for the purpose of certifying that a good being exported from the territory of a Party into the territory of another Party qualifies as an originating good.	Yes Article 4.16: Claims of Origin 1. Each Party shall provide that an importer may make a claim for preferential tariff treatment based on either: (a) a written or electronic certification by the importer, exporter, or producer; or (b) the importer's knowledge that the good is an originating good, including reasonable reliance on information in the importer's possession that the good is an originating good.	Yes Article 6.15: Claims for preferential tariff treatment 1. Each Party shall provide that an importer may make a claim for preferential tariff treatment based on either: (a) a written or electronic certification by the importer, exporter, or producer; or (b) the importer's knowledge that the good is an originating good, including reasonable reliance on information in the importer's possession that the	Yes Article 4.15: Claims for preferential treatment 1. Each Party shall provide that an importer may make a claim for preferential tariff treatment based on either: (a) a written or electronic certification by the importer, exporter, or producer; or (b) the importer's knowledge that the good is an originating good, including reasonable reliance on information in the importer's possession that the	Yes Article 5.12: Claims for preferential treatment 1. Each Party shall provide that an importer may make a claim for preferential treatment under this Agreement based on the importer's knowledge or on information in the importer's possession that the good qualifies as an originating good. 2. Each Party may require that an importer be prepared to submit, on request, a statement setting forth the reasons	Yes Article 3.13: Claims for Preferential Treatment 1. Each Party shall provide that an importer may make a claim for preferential treatment under this Agreement based on the importer's knowledge or on information in the importer's possession that the good qualifies as an originating good. 2. Each Party may require that an importer be prepared to submit, upon request, a statement setting forth the reasons

			good is an originating good.	good is an originating good.	that the good qualifies as an originating good, including pertinent cost and manufacturing information. The statement need not be in a prescribed format, and may be submitted electronically, where feasible.	that the good qualifies as an originating good, including pertinent cost and manufacturing information. The statement need not be in a prescribed format, and may be submitted electronically, where feasible.

TABLE 7.22 *US free-trade agreements: Exporter declaration for small consignment*

US GSP	NAFTA	USMCA	CAFTA	US–KOREA	US–Colombia	US–Australia	US–Singapore
Not applicable	Yes Article 503: Exceptions Each Party shall provide that a Certificate of Origin shall not be required for: (a) a commercial importation of a good whose value does not exceed US$1,000 or its equivalent amount in the Party's currency, or such higher amount as it may establish, except that it may require that the invoice accompanying the importation include a statement	Yes Article 5.5: Exceptions to Certification of Origin Each Party shall provide that a certification of origin shall not be required if: (a) the value of the importation does not exceed US$1,000 or the equivalent amount in the importing Party's currency or any higher amount as the importing Party may establish. A Party may require a written representation certifying that the	Yes Article 4.17: Exceptions No Party may require a certification or information demonstrating that the good is originating where: (a) the customs value of the importation does not exceed 1,500 U.S. dollars or the equivalent amount in the currency of the importing Party, or such higher amount as may be established by the importing Party, unless the importing Party	Yes Article 6.16: Waiver of certification or other information Each Party shall provide that a certification or information demonstrating that a good is originating shall not be required where: (a) the customs value of the importation does not exceed 1,000 U.S. dollars or the equivalent amount in the currency of the importing Party, or such higher amount as may	Yes Article 4.16: Exceptions No Party may require a certification or information demonstrating that a good is originating where: (a) the customs value of the importation does not exceed US$1,500 or the equivalent amount in the currency of the importing Party, or such higher amount as may be established by the importing Party, unless the importing Party	Yes Could not find rules about small consignment.	Yes Could not find rules about small consignment.

certifying that the good qualifies as an originating good,
(b) a non-commercial importation of a good whose value does not exceed US$1,000 or its equivalent amount in the Party's currency, or such higher amount as it may establish, or
(c) an importation of a good for which the Party into whose territory the good is imported has

good qualifies as an originating good; or
(b) it is an importation of a good for which the Party into whose territory the good is imported has waived the requirement for a certification of origin, provided that the importation does not form part of a series of importations that may reasonably be considered to have been undertaken or

considers the importation to be part of a series of importations carried out or planned for the purpose of evading compliance with the certification requirements; or
(b) it is a good for which the importing Party does not require the importer to present a certification or information demonstrating origin.

be established by the importing Party, unless the importing Party considers the importation to be part of a series of importations carried out or planned for the purpose of evading compliance with the Party's laws governing claims for preferential tariff treatment under this Agreement; or
(b) it is a good for which the importing Party does not require

considers the importation to be part of a series of importations carried out or planned for the purpose of evading compliance with the Party's laws governing claims for preferential treatment under this Agreement; or
(b) it is a good for which the importing Party does not require the importer to present a certification or information

(*continued*)

TABLE 7.22 (*continued*)

US GSP	NAFTA	USMCA	CAFTA	US–KOREA	US–Colombia	US–Australia	US–Singapore
	waived the requirement for a Certificate of Origin, provided that the importation does not form part of a series of importations that may reasonably be considered to have been undertaken or arranged for the purpose of avoiding the certification requirements of Articles 501 and 502.	arranged for the purpose of evading compliance with the importing Party's laws, regulations, or procedures governing claims for preferential tariff treatment.		the importer to present a certification or information demonstrating origin.	demonstrating origin.		

TABLE 7.23 *US free-trade agreements: Accounting segregation*

US GSP	NAFTA	USMCA	CAFTA	US–KOREA	US–Colombia	US–Australia	US–Singapore
Article 58: Accounting segregation of Union exporters' stocks of materials (Article 64(3) of the Code) 1. If originating and non-originating fungible materials are used in the working or processing of a product, the customs authorities of the Member States may, at the written request of economic operators established in the customs territory of the Union, authorise the management of	Article 406: Fungible Goods and Materials For purposes of determining whether a good is an originating good: (a) where originating and non-originating fungible materials are used in the production of a good, the determination of whether the materials are originating need not be made through the identification of any specific fungible material, but may be determined on the basis of any of the inventory management	Article 4.13: Fungible Goods and Materials 1. Each Party shall provide that a fungible material or good is originating if: (a) when originating and non-originating fungible materials are used in the production of a good, the determination of whether the materials are originating is made on the basis of an inventory management method recognized in the Generally Accepted Accounting	Article 4.7: Fungible Goods and Materials 1. Each Party shall provide that an importer may claim that a fungible good or material is originating where the importer, exporter, or producer has: (a) physically segregated each fungible good or material; or (b) used any inventory management method, such as averaging, LIFO or FIFO, recognized in the Generally Accepted Accounting Principles of the	Article 6.7: Fungible Goods and Materials 1. Each Party shall provide that an importer claiming preferential tariff treatment for a good may claim that a fungible good or material is originating where the importer, exporter, or producer has: (a) physically segregated each fungible good or material; or (b) used any inventory management method, such as averaging, LIFO or FIFO, recognized in the Generally Accepted	Article 4.7: Fungible Goods and Materials 1. Each Party shall provide that an importer may claim that a fungible good or material is originating where the importer, exporter, or producer has: (a) physically segregated each fungible good or material; or (b) used any inventory management method, such as averaging, LIFO or FIFO, recognized in the Generally Accepted Accounting Principles of the	Article 5.7: Fungible Goods and Materials 1. Each Party shall provide that the determination of whether fungible goods or materials are originating goods shall be made either by physical segregation of each good or material or through the use of any inventory management method, such as averaging, last-in first-out, or first-in first-out, recognized in the generally accepted accounting principles of the Party in which the production is	Article 3.8: Fungible Goods and Materials 1. Each Party shall provide that the determination of whether fungible goods or materials are originating goods shall be made either by physical segregation of each good or material or through the use of any inventory management method, such as averaging, last-in, first-out, or first-in, first out, recognized in the generally accepted accounting principles of the Party in which the production is

(*continued*)

TABLE 7.23 (*continued*)

US GSP	NAFTA	USMCA	CAFTA	US–KOREA	US–Colombia	US–Australia	US–Singapore
materials in the Union using the accounting segregation method for the purpose of subsequent export to a beneficiary country within the framework of bilateral cumulation, without keeping the materials on separate stocks. 2. The customs authorities of the Member States may make the granting of authorisation referred to in paragraph 1 subject to any conditions they deem appropriate. The authorisation	methods set out in the Uniform Regulations; and (b) where originating and non-originating fungible goods are commingled and exported in the same form, the determination may be made on the basis of any of the inventory management methods set out in the Uniform Regulations. Article 511: Uniform Regulations 1. The Parties shall establish, and implement through their respective laws or regulations by January 1, 1994,	Principles of, or otherwise accepted by, the Party in which the production is performed; or (b) when originating and non-originating fungible goods are commingled and exported in the same form, the determination of whether the goods are originating is made on the basis of an inventory management method recognized in the Generally Accepted Accounting Principles of, or otherwise accepted by, the Party from which the good is exported.	Party in which the production is performed or otherwise accepted by the Party in which the production is performed. 2. Each Party shall provide that the inventory management method selected under paragraph 1 for a particular fungible good or material shall continue to be used for that good or material throughout the fiscal year of the person that selected the inventory management method.	Accounting Principles of the Party in which the production is performed or otherwise accepted by the Party in which the production is performed. 2. Each Party shall provide that the inventory management method selected under paragraph 1 for a particular fungible good or material shall continue to be used for that good or material throughout the fiscal year of the person that selected the inventory	Party in which the production is performed or otherwise accepted by the Party in which the production is performed. 2. Each Party shall provide that the inventory management method selected under paragraph 1 for a particular fungible good or material shall continue to be used for that good or material throughout the fiscal year of the person that selected the inventory management method.	performed or otherwise accepted by the Party in which the production is performed. 2. Each Party shall provide that that an inventory management method selected under paragraph 1 for particular fungible goods or materials shall continue to be used for those fungible goods or materials throughout the fiscal year of the person that selected the inventory management method.	performed or otherwise accepted by the Party in which the production is performed. 2. Each Party shall provide that that an inventory management method selected under paragraph 1 for particular fungible goods or materials shall continue to be used for those fungible goods or materials throughout the fiscal year of the person that selected the inventory management method.

shall be granted only if by use of the method referred to in paragraph 1 it can be ensured that, at any time, the quantity of products obtained which could be considered as "originating in the Union" is the same as the number that would have been obtained by using a method of physical segregation of the stocks.
If authorised, the method shall be

Uniform Regulations regarding the interpretation, application and administration of Chapter Four, this Chapter and other matters as may be agreed by the Parties.
2. Each Party shall implement any modification of or addition to the Uniform Regulations no later than 180 days after the Parties agree on such modification or addition, or such other period as the Parties may agree.

2. The inventory management method selected under paragraph 1 must be used throughout the fiscal year of the producer or the person that selected the inventory management method.
3. For greater certainty, an importer may claim that a fungible material or good is originating if the importer, producer, or exporter has physically segregated each fungible material or good as to allow their

management method.

(*continued*)

TABLE 7.23 (*continued*)

US GSP	NAFTA	USMCA	CAFTA	US–KOREA	US–Colombia	US–Australia	US–Singapore
applied and the application thereof shall be recorded on the basis of the general accounting principles applicable in the Union. 3. The beneficiary of the method referred to in paragraph 1 shall make out or, until the application of the registered exporter system, apply for proofs of origin for the quantity of products which may be considered as originating in		specific identification.					

the Union. At the request of the customs authorities of the Member States, the beneficiary shall provide a statement of how the quantities have been managed.
4. The customs authorities of the Member States shall monitor the use made of the authorisation referred to in paragraph 1. They may withdraw the authorisation in the following cases:
(a) the holder makes improper

(*continued*)

TABLE 7.23 (*continued*)

US GSP	NAFTA	USMCA	CAFTA	US–KOREA	US–Colombia	US–Australia	US–Singapore
use of the authorisation in any manner whatsoever, or (b) the holder fails to fulfil any of the other conditions laid down in this subsection, Subsection 2 and all other provisions concerning the implementation of the rules of origin.							

TABLE 7.24 *US free-trade agreements: Direct shipment requirement*

NAFTA	USMCA	CAFTA	US–KOREA	US–Colombia	US–Australia	US–Singapore
Article 411: Transshipment A good shall not be considered to be an originating good by reason of having undergone production that satisfies the requirements of Article 401 if, subsequent to that production, the good undergoes further production or any other operation outside the territories of the Parties, other than unloading, reloading or any other operation necessary to	Article 4.18: Transit and Transshipment 1. Each Party shall provide that an originating good retains its originating status if the good has been transported to the importing Party without passing through the territory of a non-Party. 2. Each Party shall provide that if an originating good is transported outside the territories of the Parties, the good retains its originating status if	Article 4.12: Transit and Transshipment Each Party shall provide that a good shall not be considered to be an originating good if the good: (a) undergoes subsequent production or any other operation outside the territories of the Parties, other than unloading, reloading, or any other operation necessary to preserve the good in good condition or to transport the	Article 6.13: Transit and Transshipment Each Party shall provide that a good shall not be considered to be an originating good if the good: (a) undergoes subsequent production or any other operation outside the territories of the Parties, other than unloading, reloading, or any other operation necessary to preserve the good in good condition or to transport the	Article 4.13: Transit and Transshipment Each Party shall provide that a good shall not be considered to be an originating good if the good: (a) undergoes subsequent production or any other operation outside the territories of the Parties, other than unloading, reloading, or any other operation necessary to preserve the good in good condition or to transport the	Article 5.11: Third Country Transportation A good shall not be considered to be an originating good if the good undergoes subsequent production or any other operation outside the territories of the Parties, other than unloading, reloading, or any other operation necessary to preserve it in good condition or to transport the good to the territory of a Party.	Article 3.12: Third Country Transportation A good shall not be considered to be an originating good if the good undergoes subsequent production or any other operation outside the territories of the Parties, other than unloading, reloading, or any other operation necessary to preserve it in good condition or to transport the good to the territory of a Party.

(*continued*)

TABLE 7.24 (*continued*)

NAFTA	USMCA	CAFTA	US–KOREA	US–Colombia	US–Australia	US–Singapore
preserve it in good condition or to transport the good to the territory of a Party.	the good: (a) remains under customs control in the territory of a non-Party; and (b) does not undergo an operation outside the territories of the Parties other than: unloading; reloading; separation from a bulk shipment; storing; labeling or marking required by the importing Party; or any other operation necessary to preserve it in good condition or to transport the good to the territory of the importing Party.	good to the territory of a Party; or (b) does not remain under the control of customs authorities in the territory of a non-Party.	good to the territory of a Party; or (b) does not remain under the control of customs authorities in the territory of a non-Party.	good to the territory of a Party; or (b) does not remain under the control of customs authorities in the territory of a non-Party.		

TABLE 7.25 *US free-trade agreements: Drawback rule*

NAFTA	USMCA	CAFTA	US–KOREA	US–Colombia	US–Australia	US–Singapore
Article 303: Restriction on Drawback and Duty Deferral Programs 1. Except as otherwise provided in this Article, no Party may refund the amount of customs duties paid, or waive or reduce the amount of customs duties owed, on a good imported into its territory, on condition that the good is: (a) subsequently exported to the territory of another Party, (b) used as a material in the production of another good that is subsequently exported to the territory of another Party, or (c) substituted by an identical or similar good used as a material in the production of another good that is subsequently exported to the territory of another Party, in an amount that exceeds the lesser of the total amount of customs duties paid or owed on the good on importation into its territory and the total amount of customs duties paid to another Party on the good that has been	Article 7.6: Advice or Information Regarding Duty Drawback or Duty Deferral Programs Upon request from an importer in its territory, or an exporter or producer in the territory of another Party, a Party shall, within a reasonable timeframe, provide advice or information relevant to the facts contained in the request on the application of duty drawback or duty deferral programs that reduce, refund, or waive customs duties.	There are no clear provisions on restriction of duty drawback.	Special provisions exist in Annex 22-B Committee on Outward Processing Zones on the Korean Peninsula.	There are no clear provisions on restriction of duty drawback.	Article 7.6: Advice or Information Regarding Duty Drawback or Duty Deferral Programs Upon request from an importer in its territory, or an exporter or producer in the territory of another Party, a Party shall, within a reasonable timeframe, provide advice or information relevant to the facts contained in the request on the application of duty drawback or duty deferral programs that reduce, refund, or waive customs duties.	Not present

(*continued*)

TABLE 7.25 (*continued*)

NAFTA	USMCA	CAFTA	US–KOREA	US–Colombia	US–Australia	US–Singapore
subsequently exported to the territory of that other Party. 2. No Party may, on condition of export, refund, waive or reduce: (a) an antidumping or countervailing duty that is applied pursuant to a Party's domestic law and that is not applied inconsistently with Chapter Nineteen (Review and Dispute Settlement in Antidumping and Countervailing Duty Matters); (b) a premium offered or collected on an imported good arising out of any tendering system in respect of the administration of quantitative import restrictions, tariff rate quotas or tariff preference levels; (c) a fee applied pursuant to section 22 of the U.S. Agricultural Adjustment Act, subject to Chapter Seven (Agriculture and Sanitary and Phytosanitary Measures); or (d) customs duties paid or owed on a good imported into its territory and substituted by an identical or similar good that is subsequently exported to the territory of another Party.						

3. Where a good is imported into the territory of a Party pursuant to a duty deferral program and is subsequently exported to the territory of another Party, or is used as a material in the production of another good that is subsequently exported to the territory of another Party, or is substituted by an identical or similar good used as a material in the production of another good that is subsequently exported to the territory of another Party, the Party from whose territory the good is exported:
(a) shall assess the customs duties as if the exported good had been withdrawn for domestic consumption; and
(b) may waive or reduce such customs duties to the extent permitted under paragraph 1.
4. In determining the amount of customs duties that may be refunded, waived or reduced pursuant to paragraph 1 on a good imported into its territory, each Party shall require presentation of satisfactory evidence

(*continued*)

TABLE 7.25 (*continued*)

NAFTA	USMCA	CAFTA	US–KOREA	US–Colombia	US–Australia	US–Singapore
of the amount of customs duties paid to another Party on the good that has been subsequently exported to the territory of that other Party. 5. Where satisfactory evidence of the customs duties paid to the Party to which a good is subsequently exported under a duty deferral program described in paragraph 3 is not presented within 60 days after the date of exportation, the Party from whose territory the good was exported: (a) shall collect customs duties as if the exported good had been withdrawn for domestic consumption; and (b) may refund such customs duties to the extent permitted under paragraph 1 on the timely presentation of such evidence under its laws and regulations. 6. This Article does not apply to: (a) a good entered under bond for transportation and exportation to the territory of another Party;						

(b) a good exported to the territory of another Party in the same condition as when imported into the territory of the Party from which the good was exported (processes such as testing, cleaning, repacking or inspecting the good, or preserving it in its same condition, shall not be considered to change a good's condition). Except as provided in Annex 703.2, Section A, paragraph 12, where such a good has been commingled with fungible goods and exported in the same condition, its origin for purposes of this subparagraph, may be determined on the basis of the inventory methods provided for in the Uniform Regulations established under Article 511 (Uniform Regulations);
(c) a good imported into the territory of a Party that is deemed to be exported from its territory, or used as a material in the production of another good that is deemed to be exported to the territory of another Party, or is substituted by an identical or similar good used as a material in the production of

(*continued*)

TABLE 7.25 (*continued*)

NAFTA	USMCA	CAFTA	US–KOREA	US–Colombia	US–Australia	US–Singapore
another good that is deemed to be exported to the territory of another Party, by reason of (i) delivery to a duty-free shop, (ii) delivery for ship's stores or supplies for ships or aircraft, or (iii) delivery for use in joint undertakings of two or more of the Parties and that will subsequently become the property of the Party into whose territory the good was deemed to be imported; (d) a refund of customs duties by a Party on a particular good imported into its territory and subsequently exported to the territory of another Party, where that refund is granted by reason of the failure of such good to conform to sample or specification, or by reason of the shipment of such good without the consent of the consignee; (e) an originating good that is imported into the territory of a Party and is subsequently exported to the territory of another Party, or used as a material in the production of another good that is subsequently exported to						

the territory of another Party, or is substituted by an identical or similar good used as a material in the production of another good that is subsequently exported to the territory of another Party; or

(f) a good set out in Annex 303.6.

7. Except for paragraph 2(d), this Article shall apply as of the date set out in each Party's Section of Annex 303.7.

8. Notwithstanding any other provision of this Article and except as specifically provided in Annex 303.8, no Party may refund the amount of customs duties paid, or waive or reduce the amount of customs duties owed, on a non-originating good provided for in item 8540.11.aa (color cathode-ray television picture tubes, including video monitor tubes, with a diagonal exceeding 14 inches) or 8540.11.cc (color cathode ray television picture tubes for high definition television, with a diagonal exceeding 14 inches) that is imported into the Party's territory and subsequently exported to the territory of another Party, or is used as a

(*continued*)

TABLE 7.25 (*continued*)

NAFTA	USMCA	CAFTA	US–KOREA	US–Colombia	US–Australia	US–Singapore
material in the production of another good that is subsequently exported to the territory of another Party, or is substituted by an identical or similar good used as a material in the production of another good that is subsequently exported to the territory of another Party. 9. For purposes of this Article: customs duties are the customs duties that would be applicable to a good entered for consumption in the customs territory of a Party if the good were not exported to the territory of another party; identical or similar goods means "identical or similar goods" as defined in Article 415 (Rules of Origin Definitions); material means "material" as defined in Article 415; used means "used" as defined in Article 415. 10. For purposes of the Article: Where a good referred to by a tariff item number in this Article is described in parentheses following the tariff item number, the description is provided for purposes of reference only.						

TABLE 7.26 *US free-trade agreements: Exporter record keeping (# years)*

US GSP	NAFTA	USMCA	CAFTA	US–KOREA	US–Colombia	US–Australia	US–Singapore
Yes	5 years Article 505: Records Each Party shall provide that: (a) an exporter or a producer in its territory that completes and signs a Certificate of Origin shall maintain in its territory, for five years after the date on which the Certificate was signed or for such longer period as the Party may specify, all records relating to the origin of a good for which preferential tariff treatment was claimed in the territory of another	5 years Article 5.8: Record Keeping Requirements 1. Each Party shall provide that an importer claiming preferential tariff treatment for a good imported into its territory shall maintain, for a period of no less than five years from the date of importation of the good: (a) the documentation related to the importation, including the certification of origin	5 years Article 4.19: Record Keeping Requirements 1. Each Party shall provide that an exporter or a producer in its territory that provides a certification in accordance with Article 4.16 shall maintain, for a minimum of five years from the date the certification was issued, all records and documents necessary to demonstrate that a good for which the producer or exporter	5 years Article 6.17: Record Keeping Requirements 1. Each Party shall provide that an exporter or a producer in its territory that provides a certification in accordance with Article 6.15 shall maintain, for a minimum of five years from the date the certification was issued, all records necessary to demonstrate that a good for which the producer or exporter provided a	5 years Article 4.17: Record Keeping Requirements 1. Each Party shall provide that an exporter or a producer in its territory that provides a certification in accordance with Article 4.15 shall maintain, for a minimum of five years from the date the certification was issued, all records necessary to demonstrate that a good for which the producer or exporter provided a	5 years Article 5.14: Record Keeping Requirement Each Party may require that importers maintain, for up to five years after the date of importation, records relating to the importation of the good, and may require, as set out in Article 5.12.2, that an importer provide, on request, records necessary to demonstrate that a good qualifies as an originating good, including records concerning:	5 years Article 3.15: Record Keeping Requirement Each Party may require that importers maintain for up to five years after the date of importation records relating to the importation of the good, and may require that an importer provide, upon request, records which are necessary to demonstrate that a good qualifies as an originating good, as stipulated in Article 3.13.2, including records concerning:

(*continued*)

TABLE 7.26 (*continued*)

US GSP	NAFTA	USMCA	CAFTA	US–KOREA	US–Colombia	US–Australia	US–Singapore
	Party, including records associated with (i) the purchase of, cost of, value of, and payment for, the good that is exported from its territory, (ii) the purchase of, cost of, value of, and payment for, all materials, including indirect materials, used in the production of the good that is exported from its territory, and (iii) the production of the good in the form in which the good is exported from its territory; and (b) an importer	that served as the basis for the claim; (b) all records necessary to demonstrate that the good is originating, if the claim was based on a certification of origin completed by the importer; and (c) the information, including documents, necessary to demonstrate compliance with Article 5.4.1(e) (Obligations Regarding Importations), if applicable. 2. Each Party shall provide that an exporter or a	provided a certification was an originating good, including records and documents concerning: (a) the purchase of, cost of, value of, and payment for, the exported good; (b) the purchase of, cost of, value of, and payment for, all materials, including indirect materials, used in the production of the exported good; and (c) the production of the good in the form in which it was exported. 2. Each Party shall	certification was an originating good, including records concerning: (a) the purchase of, cost of, value of, and payment for, the exported good; (b) the purchase of, cost of, value of, and payment for all materials, including indirect materials, used in the production of the exported good; (c) the production of the good in the form in which it was exported; and (d) such other documentation as the Parties may agree to	certification was an originating good, including records concerning: (a) the purchase of, cost of, value of, and payment for, the exported good; (b) the purchase of, cost of, value of, and payment for all materials, including indirect materials, used in the production of the exported good; and (c) the production of the good in the form in which it was exported. 2. Each Party shall provide that an importer claiming	(a) the purchase, cost and value of, and payment for, the good; (b) the purchase, cost, and value of, and payment for, all materials, including indirect materials, used in the production of the good; and (c) the production of the good in the form in which the good was exported.	(a) the purchase of, cost of, value of, and payment for, the good; (b) the purchase of, cost of, value of, and payment for, all materials, including indirect materials, used in the production of the good; and (c) the production of the good in the form in which the good is exported.

claiming preferential tariff treatment for a good imported into the Party's territory shall maintain in that territory, for five years after the date of importation of the good or for such longer period as the Party may specify, such documentation, including a copy of the Certificate, as the Party may require relating to the importation of the good.	producer in its territory that completes a certification of origin or a producer that provides a written representation shall maintain in its territory for five years after the date on which the certification of origin was completed, or for such longer period as the Party may specify, all records necessary to demonstrate that a good for which the exporter or producer provided a certification of origin or other written representation is	provide that an importer claiming preferential tariff treatment for a good imported into the Party's territory shall maintain, for a minimum of five years from the date of importation of the good, all records and documents necessary to demonstrate the good qualified for the preferential tariff treatment.	require. 2. Each Party shall provide that an importer claiming preferential tariff treatment for a good imported into the territory of that Party based on the importer's certification or its knowledge that the good is an originating good shall maintain, for a minimum of five years from the date of importation of the good, all records necessary to demonstrate the good qualified for the preferential tariff treatment.	preferential tariff treatment for a good imported into the Party's territory shall maintain, for a minimum of five years from the date of importation of the good, all records necessary to demonstrate the good qualified for the preferential tariff treatment.

(*continued*)

TABLE 7.26 (*continued*)

US GSP	NAFTA	USMCA	CAFTA	US–KOREA	US–Colombia	US–Australia	US–Singapore
		originating, including records associated with: (a) the purchase of, cost of, value of, shipping of, and payment for, the good or material; (b) the purchase of, cost of, value of, shipping of, and payment for all materials, including indirect materials, used in the production of the good or material; and (c) the production of the good in the form in which the good is exported or the production of the material in the form		3. Each Party shall provide that an importer claiming preferential tariff treatment for a good imported into the territory of that Party based on a certification issued by the exporter or producer shall maintain, for a minimum of five years from the date of importation of the good, a copy of the certification that served as the basis for the claim. If the importer possesses records demonstrating that the good satisfies the			

in which it was sold.
3. Each Party shall provide in accordance with that Party's law that an importer, exporter, or producer in its territory may choose to maintain the records or documentation specified in paragraphs 1 and 2 in any medium, including electronic, provided that the records or documentation can be promptly retrieved and printed.
4. For greater certainty, the record keeping requirements to remain originating under Article 6.13, the importer shall maintain such records for a minimum of five years from the date of importation of the good.
4. Each Party shall provide that an importer, exporter, or producer may choose to maintain the records specified in paragraph 1, 2, or 3 in any medium that allows for prompt retrieval, including, but not limited to, digital, electronic,

(*continued*)

TABLE 7.26 (*continued*)

US GSP	NAFTA	USMCA	CAFTA	US–KOREA	US–Colombia	US–Australia	US–Singapore
		requirements on an importer, exporter, or producer that a Party provides for pursuant to this Article apply even if the importing Party does not require a certification of origin or if a requirement for a certification of origin has been waived.		optical, magnetic, or written form.			

TABLE 7.27 *US free-trade agreements: Advance rulings*

US GSP	NAFTA	USMCA[i]	CAFTA	US–KOREA	US–Colombia	US–Australia	US–Singapore
General advance ruling applicable	Yes Article 509: Advance Rulings 1. Each Party shall, through its customs administration, provide for the expeditious issuance of written advance rulings, prior to the importation of a good into its territory, to an importer in its territory or an exporter or a producer in the territory of another Party, on the basis of the facts and circumstances presented by such importer, exporter or producer of the good, concerning: (a) whether materials imported from a non-Party used in the production of a good undergo an applicable change in tariff classification set out in Annex 401 as a result of production occurring entirely in the territory of one or more of the Parties; (b) whether a good satisfies a regional value-content requirement under either the transaction value method or the net cost method set out in Chapter Four; (c) for the purpose of determining whether a good satisfies a regional	Yes Article 5.14: Advance Rulings 1. In accordance with Article 7.5 (Advance Rulings), each Party, through its customs administration, shall, on request, provide for the issuance of a written advance ruling on origin under this Agreement. 2. Each Party shall adopt or maintain uniform procedures throughout its territory for the issuance of advance rulings on origin under this Agreement, including the common standards set out in the Uniform Regulations regarding the information required to process an application for a ruling. Article 7.5: 1. Each Party shall, through its customs administration, issue a written advance ruling, prior to the importation of a good into its territory, that sets forth the treatment that the Party shall provide to the good at the time of importation. 2. Each Party shall allow an exporter, importer, producer, or any other person with a justifiable cause, or a	Yes Article 5.10: Advance Rulings 1. Each Party, through its customs authority or other competent authority shall issue, before a good is imported into its territory, a written advance ruling at the written request of an importer in its territory, or an exporter or producer in the territory of another Party with regard to: (a) tariff classification; (b) the application of customs valuation criteria for a particular case, in accordance with the application of the provisions set out in the Customs Valuation Agreement; (c) the application of duty drawback, deferral, or other relief from customs duties; (d) whether a good is originating in accordance with Chapter Four (Rules of Origin and Origin Procedures); (e) whether a good re-entered into the territory of a Party after being exported to the territory of another Party for repair or alteration is eligible for duty free treatment in accordance with	Yes Article 7.10: Advance Rulings 1. Each Party shall issue, through its customs authority, before a good is imported into its territory, a written advance ruling at the written request of an importer in its territory, or an exporter or producer in the territory of the other Party with regard to: (a) tariff classification; (b) the application of customs valuation criteria for a particular case, in accordance with the Customs Valuation Agreement; (c) the application of duty drawback, deferral, or other relief from customs duties;	Yes Article 5.10: Advance Rulings 1. Each Party shall issue, before a good is imported into its territory, a written advance ruling at the written request of an importer in its territory, or an exporter or producer in the territory of another Party with regard to: (a) tariff classification; (b) the application of customs valuation criteria for a particular case, in accordance with the application of the provisions set forth in the Customs Valuation Agreement; (c) the application of duty drawback, deferral, or other relief from customs duties;	Yes Article 6.3: Advance Rulings 1. Each Party shall provide for written advance rulings to be issued to a person described in paragraph 2(a) concerning tariff classification, questions arising from the application of the Customs Valuation Agreement, country of origin, and the qualification of a good as an originating good under this Agreement. 2. Each Party shall adopt or maintain procedures for issuing written advance rulings that: (a) provide that a potential importer in its territory or an exporter or producer in	Yes Article 4.3: Advance Rulings 1. Each Party shall provide for the issuance of written advance rulings to a person described in subparagraph 2(a) concerning tariff classification, questions arising from the application of the Customs Valuation Agreement, country of origin, and the qualification of a good as an originating good under this Agreement. 2. Each Party shall adopt or maintain procedures for the issuance of advance rulings that: (a) provide that an importer in its territory or an exporter or

(*continued*)

TABLE 7.27 (*continued*)

US GSP	NAFTA	USMCA[i]	CAFTA	US–KOREA	US–Colombia	US–Australia	US–Singapore
	value-content requirement under Chapter Four, the appropriate basis or method for value to be applied by an exporter or a producer in the territory of another Party, in accordance with the principles of the Customs Valuation Code, for calculating the transaction value of the good or of the materials used in the production of the good; (d) for the purpose of determining whether a good satisfies a regional value-content requirement under Chapter Four, the appropriate basis or method for reasonably allocating costs, in accordance with the allocation methods set out in the Uniform Regulations, for calculating the net cost of the good or the value of an intermediate material; (e) whether a good qualifies as an originating good under Chapter Four; (f) whether a good that re-enters its territory after the good has been exported from its territory to the territory of another Party for repair or alteration qualifies for duty free	representative thereof, to request a written advance ruling. 3. No Party shall as a condition for requesting an advance ruling, require an exporter or producer of another Party to establish or maintain a contractual or other relation with a person located in the territory of the importing Party. 4. Each Party shall issue advance rulings with regard to: (a) tariff classification; (b) the application of customs valuation criteria for a particular case in accordance with the Customs Valuation Agreement; (c) the origin of the good, including whether the good qualifies as an originating good under the terms of this Agreement; (d) whether a good is subject to a quota or a tariff-rate quota; and (e) other matters as the Parties may agree. 5. Each Party shall adopt or maintain uniform procedures throughout its territory for the issuance of advance	Article 3.6 (Goods Re-entered after Repair or Alteration); (f) country of origin marking; (g) the application of quotas; and (h) such other matters as the Parties may agree. 2. Each Party shall provide that its customs authority or other competent authority shall issue an advance ruling within 150 days after a request, provided that the requester has submitted all information that the Party requires, including, if the authority requests, a sample of the good for which the requester is seeking an advance ruling. In issuing an advance ruling, the authority shall take into account facts and circumstances the requester has provided. 3. Each Party shall provide that advance rulings shall be in force from their date of issuance, or another date specified in the ruling, provided that the facts or circumstances on which the ruling is based remain unchanged. 4. The issuing Party may modify or revoke an advance ruling after the	(d) whether a good is originating; (e) whether a good re-entered into the territory of a Party after being exported to the territory of the other Party for repair or alteration is eligible for duty free treatment in accordance with Article 2.6 (Goods Re-entered after Repair or Alteration); (f) country of origin marking; (g) whether a good is subject to a quota or tariff-rate quota; and (h) such other matters as the Parties may agree. 2.Each Party shall issue an advance ruling within 90 days after its customs authority receives a request,	(d) whether a good is originating in accordance with Chapter Four (Rules of Origin and Origin Procedures); (e) whether a good re-entered into the territory of a Party after being exported to the territory of the other Party for repair or alteration is eligible for duty free treatment in accordance with Article 2.6 (Goods Re-entered after Repair or Alteration); (f) country of origin marking; (g) the application of quotas; and (h) such other matters as the Parties may agree. 2. Each Party shall issue an advance	the territory of the other Party may request a ruling prior to the importation that is the subject of the advance ruling request; (b) include a detailed description of the information required to process a request for an advance ruling; and (c) provide that an advance ruling will be based on the facts and circumstances presented by the person requesting the ruling. 3. Each Party shall provide that its customs authorities: (a) may request, at any time during the course of evaluating a request for an advance ruling, additional information	producer in the territory of the other Party may request such a ruling prior to the importation in question; (b) include a detailed description of the information required to process a request for an advance ruling; and (c) provide that the advance ruling be based on the facts and circumstances presented by the person requesting the ruling. 3. Each Party shall provide that its customs authorities: (a) may request, at any time during the course of evaluating a request for an advance ruling, additional information necessary to evaluate

treatment in accordance with Article 307 (Goods Re-Entered after Repair or Alteration);
(g) whether the proposed or actual marking of a good satisfies country of origin marking requirements under Article 311 (Country of Origin Marking);
(h) whether an originating good qualifies as a good of a Party under Annex 300B (Textile and Apparel Goods), Annex 302.2 (Tariff Elimination) or Chapter Seven (Agriculture and Sanitary and Phytosanitary Measures);
(i) whether a good is a qualifying good under Chapter Seven; or
(j) such other matters as the Parties may agree.
2. Each Party shall adopt or maintain procedures for the issuance of advance rulings, including a detailed description of the information reasonably required to process an application for a ruling.
3. Each Party shall provide that its rulings, including a detailed description of the information required to process an application for a ruling.
6. Each Party shall provide that its customs administration:
(a) may, at any time during the course of an evaluation of a request for an advance ruling, request supplemental information from the person requesting the ruling or a sample of the good for which the advance ruling was requested;
(b) in issuing an advance ruling, take into account the facts and circumstances provided by the person requesting that ruling;
(c) issue the ruling as expeditiously as possible and in no case later than 120 days after it has obtained all necessary information from the person requesting an advance ruling; and
(d) provide to that person a full explanation of the reasons for the ruling.
7. Each Party shall provide that its advance rulings take effect on the date Party notifies the requester. The issuing Party may modify or revoke a ruling retroactively only if the ruling was based on inaccurate or false information.
5. Subject to any confidentiality requirements in its law, each Party shall make its advance rulings publicly available.
6. If a requester provides false information or omits relevant facts or circumstances relating to the advance ruling, or does not act in accordance with the ruling's terms and conditions, the importing Party may apply appropriate measures, including civil, criminal, and administrative actions, monetary penalties, or other sanctions.

provided that the requester has submitted all information that the Party requires, including, if the Party requests, a sample of the good for which the requester is seeking an advance ruling. In issuing an advance ruling, the Party shall take into account facts and circumstances the requester has provided. For greater certainty, a Party may decline to issue an advance ruling if the facts and circumstances forming the basis of the advance ruling are the subject of administrative or judicial review. A Party that, pursuant to this

ruling within 150 days after a request, provided that the requester has submitted all information that the Party requires, including, if the Party requests, a sample of the good for which the requester is seeking an advance ruling. In issuing an advance ruling, the Party shall take into account facts and circumstances the requester has provided.
3. Each Party shall provide that advance rulings shall be in force from their date of issuance, or another date specified in the ruling, provided that the facts or circumstances on

necessary to evaluate the request;
(b) shall issue the advance ruling expeditiously, and no later than 120 days after obtaining all necessary information; and
(c) shall provide a written explanation of the reasons for the ruling.
4. Subject to paragraph 5, each Party shall apply an advance ruling to importations into its territory beginning on the date it issues the ruling or on any other date specified in the ruling. The Party shall apply the treatment provided by the advance ruling to all importations regardless of the

the request;
(b) shall issue the advance ruling expeditiously, and within 120 days after obtaining all necessary information; and
(c) shall provide, upon request of the person who requested the advance ruling, a full explanation of the reasons for the ruling.
4. Subject to paragraph 5, each Party shall apply an advance ruling to importations into its territory beginning on the date of issuance of the ruling or such date as may be specified in the ruling. The treatment provided by the advance ruling shall be applied to importations

(*continued*)

TABLE 7.27 (*continued*)

US GSP	NAFTA	USMCA[1]	CAFTA	US–KOREA	US–Colombia	US–Australia	US–Singapore
	customs administration: (a) may, at any time during the course of an evaluation of an application for an advance ruling, request supplemental information from the person requesting the ruling; (b) shall, after it has obtained all necessary information from the person requesting an advance ruling, issue the ruling within the periods specified in the Uniform Regulations; and (c) shall, where the advance ruling is unfavorable to the person requesting it, provide to that person a full explanation of the reasons for the ruling. 4. Subject to paragraph 6, each Party shall apply an advance ruling to importations into its territory of the good for which the ruling was requested, beginning on the date of its issuance or such later date as may be specified in the ruling. 5. Each Party shall provide to any person requesting an advance ruling the same treatment, including the same interpretation and application of	that they are issued or on a later date specified in the ruling, and remain in effect unless the advance ruling is modified or revoked. 8. Each Party shall provide to a person requesting an advance ruling the same treatment, including the same interpretation and application of provisions of Chapter 4 (Rules of Origin) regarding a determination of origin, as it provided to any other person to whom it issued an advance ruling, provided that the facts and circumstances are identical in all material respects. 9. An advance ruling issued by a Party shall apply throughout its territory to the person to whom the ruling is issued. 10. After issuing an advance ruling, the issuing Party may modify or revoke the advance ruling if there is a change in the law, facts, or circumstances on which the ruling was based, or if the ruling was based on inaccurate or false information, or on an error. 11. A Party may decline to issue an		paragraph, declines to issue an advance ruling shall promptly notify the requester in writing, setting forth the relevant facts and the basis for its decision to decline to issue the advance ruling. 3. Each Party shall provide that advance rulings shall take effect on the date they are issued, or on another date specified in the ruling, provided that the facts or circumstances on which the ruling is based remain unchanged. 4. The issuing Party may modify or revoke an advance ruling after the Party notifies the requester. The issuing	which the ruling is based remain unchanged. 4. The issuing Party may modify or revoke an advance ruling after the Party notifies the requester. The issuing Party may modify or revoke a ruling retroactively only if the ruling was based on inaccurate or false information. 5. Subject to any confidentiality requirements in its laws, each Party shall make its advance rulings publicly available. 6. If a requester provides false information or omits relevant facts or circumstances relating to the advance ruling,	importer, exporter, or producer involved, provided that the facts and circumstances are identical in all material respects. 5. A Party may modify or revoke an advance ruling on a determination that the ruling was based on an error of fact or law, or where there is a change in law consistent with this Agreement, a change in a material fact, or a change in the circumstances on which the ruling is based. The issuing Party shall postpone the effective date of any such modification or revocation for at least 60 days where the person to whom the	without regard to the identity of the importer, exporter, or producer, provided that the facts and circumstances are identical in all material respects. 5. A Party may modify or revoke an advance ruling upon a determination that the ruling was based on an error of fact or law, or if there is a change in law consistent with this Agreement, a material fact, or circumstances on which the ruling is based. The issuing Party shall postpone the effective date of such modification or revocation for a period of not less than 60 days where the person to whom the ruling was

provisions of Chapter Four regarding a determination of origin, as it provided to any other person to whom it issued an advance ruling, provided that the facts and circumstances are identical in all material respects.

6. The issuing Party may modify or revoke an advance ruling:

(a) if the ruling is based on an error

(i) of fact,

(ii) in the tariff classification of a good or a material that is the subject of the ruling,

(iii) in the application of a regional value content requirement under Chapter Four,

(iv) in the application of the rules for determining whether a good qualifies as a good of a Party under Annex 300B, 302.2 or Chapter Seven,

(v) in the application of the rules for determining whether a good is a qualifying good under Chapter Seven, or

(vi) in the application of the rules for determining whether a good that re-enters its territory after the good has

advance ruling if the facts and circumstances forming the basis of the advance ruling are the subject of a post-clearance audit or an administrative, judicial, or quasi-judicial review or appeal. A Party that declines to issue an advance ruling shall promptly notify, in writing, the person requesting the ruling, setting out the relevant facts and circumstances and the basis for its decision.

12. No Party shall apply retroactively a revocation or modification to the detriment of the requester unless the person to whom the advance ruling was issued has not acted in accordance with its terms and conditions or the ruling was based on inaccurate or false information provided by the requester.

13. Each Party shall provide that, unless it retroactively applies a modification or revocation as described in paragraph 12, any modification or revocation of an advance ruling shall be effective on the date on which the modification or revocation is issued, or on such later

Party may modify or revoke a ruling retroactively only if the ruling was based on inaccurate or false information.

5. Each Party shall ensure that requesters have access to administrative review of advance rulings.

6. Subject to any confidentiality requirements in its laws, each Party shall publish its advance rulings, including on the Internet.

7. If a requester provides false information or omits relevant facts or circumstances relating to the advance ruling, or does not act in accordance with the ruling's terms and

or does not act in accordance with the ruling's terms and conditions, the importing Party may apply appropriate measures, including civil, criminal, and administrative actions, monetary penalties, or other sanctions.

ruling was issued has relied in good faith on that ruling.

issued has relied in good faith on that ruling.

(*continued*)

TABLE 7.27 (*continued*)

US GSP	NAFTA	USMCA[1]	CAFTA	US–KOREA	US–Colombia	US–Australia	US–Singapore
	been exported from its territory to the territory of another Party for repair or alteration qualifies for duty free treatment under Article 307; (b) if the ruling is not in accordance with an interpretation agreed by the Parties regarding Chapter Three (National Treatment and Market Access for Goods) or Chapter Four; (c) if there is a change in the material facts or circumstances on which the ruling is based; (d) to conform with a modification of Chapter Three, Chapter Four, this Chapter, Chapter Seven, the Marking Rules or the Uniform Regulations; or (e) to conform with a judicial decision or a change in its domestic law. 7. Each Party shall provide that any modification or revocation of an advance ruling shall be effective on the date on which the modification or revocation is issued, or on such later date as may be specified therein, and shall not be applied to importations of a good that have occurred prior to that	date as may be specified therein. 14. The issuing Party shall postpone the effective date of such modification or revocation for a period not exceeding 90 days if the person to whom the advance ruling was issued demonstrates that it has relied in good faith to its detriment on that ruling. 15. Each Party shall, in accordance with its laws, regulations, and procedures, make its advance rulings, complete or redacted, available on a free, publicly accessible website.		conditions, the importing Party may apply appropriate measures, including civil, criminal, and administrative actions, monetary penalties, or other sanctions.			

date, unless the person to whom the advance ruling was issued has not acted in accordance with its terms and conditions.

8. Notwithstanding paragraph 7, the issuing Party shall postpone the effective date of such modification or revocation for a period not exceeding 90 days where the person to whom the advance ruling was issued demonstrates that it has relied in good faith to its detriment on that ruling.

9. Each Party shall provide that where its customs administration examines the regional value content of a good for which it has issued an advance ruling pursuant to subparagraph 1(c), (d) or f), it shall evaluate whether:

(a) the exporter or producer has complied with the terms and conditions of the advance ruling;

(b) the exporter's or producer's operations are consistent with the material facts and circumstances on

(*continued*)

TABLE 7.27 (*continued*)

US GSP	NAFTA	USMCA[i]	CAFTA	US–KOREA	US–Colombia	US–Australia	US–Singapore
	which the advance ruling is based; and (c) the supporting data and computations used in applying the basis or method for calculating value or allocating cost were correct in all material respects. 10. Each Party shall provide that where its customs administration determines that any requirement in paragraph 9 has not been satisfied, it may modify or revoke the advance ruling as the circumstances may warrant. 11. Each Party shall provide that, where the person to whom an advance ruling was issued demonstrates that it used reasonable care and acted in good faith in presenting the facts and circumstances on which the ruling was based, and where the customs administration of a Party determines that the ruling was based on incorrect information, the person to whom the ruling was issued shall not be subject to penalties.						

12. Each Party shall provide that where it issues an advance ruling to a person that has misrepresented or omitted material facts or circumstances on which the ruling is based or has failed to act in accordance with the terms and conditions of the ruling, the Party may apply such measures as the circumstances may warrant.

[i] USMCA provisions on advance ruling are contained in Articles 5.14 and 7.5. Both articles have been quoted.

One of the major differences between the EU and the United States is that the latter does not make extensive use of cumulation as the EU (e.g. the PEM Convention on rules of origin). As a consequence, it not perhaps surprising that the United States has not put in place the system of supplier statements and their verifications as EU has done in the case of the PEM Convention and which is also present in other free-trade agreements. The verification and administration of such documentation, however, is laid down in more detail than usual in the USMCA Uniform Regulations discussed in Chapter 3 of this book and in section 7.1.3.1. The treatment of suppliers' declarations between the two systems should be the subject of further research to determine the pros and cons and best practices.

Subpart G – Origin Verifications and Determinations[102]

§181.72 Verification Scope and Method.

(c) Inquiries to importer not precluded. Nothing in paragraph (a) of this section shall preclude Customs from directing inquiries or requests to a U.S. importer for documents or other information regarding the imported good. If such an inquiry or request involves requesting the importer to obtain and provide written information from the exporter or producer of the good or from the producer of a material that is used in the production of the good, such information shall be requested by the importer and provided to the importer by the exporter or producer only on a voluntary basis, and a failure or refusal on the part of the importer to obtain and provide such information shall not be considered a failure of the exporter or producer to provide the information and shall not constitute a ground for denying preferential tariff treatment on the good.

In addition, there are significant differences between the EU and United States on the provisions concerning accounting segregation and, especially, drawback that deserve further study.

As shown in the NAFTA Uniform Regulations reproduced below with respect to documentary evidence of direct consignment, the United States seems to be much more restrictive than the nonalteration rules that are now included in many EU FTAs.

As discussed in section 3.4.4:

US Uniform Regulations

§181.23 Effect of Noncompliance; Failure to Provide Documentation Regarding Transshipment.

(a) Effect of noncompliance. If the importer fails to comply with any requirement under this part, including submission of a Certificate of Origin under §181.22(b) or submission of a corrected Certificate under §181.22(c), the port director may deny preferential tariff treatment to the imported good.
(b) Failure to provide documentation regarding transshipment. Where the requirements for preferential tariff treatment set forth elsewhere in this part are met, the

[102] See Code of US Federal Regulations.

port director nevertheless may deny preferential tariff treatment to an originating good if the good is shipped through or transshipped in a country other than the United States, Canada or Mexico and the importer of the good does not provide, at the request of the port director, copies of the customs control documents that indicate to the satisfaction of the port director that the good remained under customs control while in such other country

The USMCA Uniform Regulations provide the following as far as direct shipment is concerned:

10(1) Transport requirements to retain originating status.

If an originating good is transported outside the territories of the USMCA countries, the good retains its originating status if

(a) the good remains under customs control outside the territories of the USMCA countries; and
(b) the good does not undergo further production or any other operation outside the territories of the USMCA countries, other than unloading; reloading; separation from a bulk shipment; storing; labeling or other marking required by the importing USMCA country; or any other operation necessary to transport the good to the territory of the importing USMCA country or to preserve the good in good condition, including:
  (i) Inspection;
  (ii) removal of dust that accumulates during shipment;
  (iii) ventilation;
  (iv) spreading out or drying;
  (v) chilling;
  (vi) replacing salt, sulphur dioxide or other aqueous solutions; or
  (vii) replacing damaged packing materials and containers and removal of units of the good that are spoiled or damaged and present a danger to the remaining units of the good.

USMCA Uniform Regulations do not provide any specific documentary evidence related to the abovementioned requirements. A recent analysis[103] suggests that in spite of a number of trade facilitation procedures related to the abolition of COs in NAFTA, the provisions on evidence of direct shipment under NAFTA, illustrated above in respect of the effect of noncompliance, are still applicable.

7.5.3 *Japan*

Japan's administering of certification of origin is somewhat at a middle way. On the one hand the administration provisions in certain free-trade agreements are fairly advanced and liberal, as in the EU–Japan FTA agreement and the CP-TPP where

[103] See www.lexology.com/library/detail.aspx?g=dde35d32-3ca2-41ae-bd1c-a15695e0a7a4.

TABLE 7.28 *Definitions in Japan's free-trade agreements*

Definition	Explanation
Certificate of origin issued by certifying authorities (CAs)	Japan uses CAs under GSP and free-trade agreements with ASEAN, Malaysia, Vietnam, Indonesia, Philippines, and India.
Prior authorization (approved exporter)	Self-certification system by approved exporters in the CP-TPP.
Exporter declaration (with origin criteria)	Exporters can issue a statement of origin so that a good to be exported qualifies as an originating good of the exporting country. Not applicable in the case of Japan except for the Japan–EU and CP-TPP.
Importer declaration	Importers can make a declaration of origin of a good to be imported. Applicable under the Japan–EU EPA and CP-TPP.
Exporter declaration for small consignment	Waiver for certificate of origin if customs value does not exceed a certain value. Applicable in all the free-trade agreements examined except for Japan–India.
Long-term certificate for OM	Japan does not use a specific format for supplier's declaration.
Long-term certificate for NOM	Japan does not use a specific format for supplier's declaration.
Accounting segregation	Accounting segregation for fungible/interchangeable products. Required in Japan's free-trade agreements.
Documentary evidence of direct shipment requirement	Evidence to prove that the transportation was in conformity with the conditions specified. Applicable for all of Japan's free-trade agreements. The nonalteration principle is applied for the Japan–EU EPA.
Non-alteration	Nonalteration principle is used in Japan–EU EPA only.
Averaging (value of non-originating materials)	Averaging is not used in Japan's free-trade agreements.
No drawback rule	Prohibition of refunding duties paid on imported goods. No specific provisions on drawback in Japan's free-trade agreements.
Exporter record keeping (# years)	3 years: Japan–ASEAN, Japan–Switzerland, Japan–Vietnam; 5 years: Japan–Chile, Japan–India, Japan–Malaysia, Japan–Mexico, Japan–Philippines, Japan–Thailand, and Japan–Indonesia.
Advance rulings	Only specifically mentioned in free-trade agreements with Malaysia, Thailand, India, and EU. However, Japan has an Advance Classification Ruling System which allows inquirers to get precise information on classification, origin, and valuation; can be submitted in writing, orally, or by email; response valid for 3 years; objections can be filed within two months; issued rulings available on the Japan Customs website and at the Customs offices.

TABLE 7.29 *Mapping certification in Japan's free-trade agreements*

	Japan GSP	Japan ASEAN[i]	Japan–Malaysia[ii]	Japan–Vietnam[iii]	Japan–Indonesia[iv]	Japan–Thailand[v]	Japan–Philippines[vi]	Japan–CP-TPP[vii]	Japan–EU[viii]	Japan–India[ix]
Certificate of origin issued by CA	Form A	Certificate of origin issued by designated authority of a party is required. Notification of names and addresses, and a list of specimen signatures and specimen of official seals or impressions of stamps of the designated authorities must be provided.	The importing country shall require a certificate of origin for an originating good of the exporting country from importers who claim the preferential tariff treatment for the good.	Certificate of origin issued by designated authority of a party is required. Notification of names and addresses, and a list of specimen signatures and specimen of official seals or impressions of stamps of the designated authorities must be provided.	Certificate of origin issued by a designated authority of a party is required.	Certificate of origin issued by a designated authority of a party is required.	Certificate of origin issued by a designated authority of a party is required.	An exporting party may require that a certification of origin for a good exported from its territory be either: (a) issued by a competent authority; or (b) completed by an approved exporter.	Self-certification system; exporters self-certify that the product is originating by making a statement on origin in line with Chapter 3, Section A including its Annex 3-D ("Text of the statement on origin"). In the EU, exporters need to be registered in the REX system (registered exporter system).	A certificate of origin referred to in paragraph 1 of Section 2 shall be issued by the competent governmental authority of the exporting Party on request having been made in writing by the exporter or its authorized agent.

(*continued*)

TABLE 7.29 (*continued*)

	Japan GSP	Japan ASEAN[i]	Japan–Malaysia[ii]	Japan–Vietnam[iii]	Japan–Indonesia[iv]	Japan–Thailand[v]	Japan–Philippines[vi]	Japan–CP-TPP[vii]	Japan–EU[viii]	Japan–India[ix]
Prior authorization (approved exporter)	No	No	No	No	No	No	No	Yes	Yes	No
Prior registration (registered exporter)	No	No	No	No	No	No	No	No	Yes	No
Exporter declaration (with origin criteria)	No	No	No	No	No	No	No	Yes	Yes	No
Importer's knowledge	No	No	No	No	No	No	No	Yes	Yes	No
Exporter declaration for small consignment	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No
Accounting segregation	No	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Documentary evidence of direct shipment requirement	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No, only in case of doubts	Yes

Nonalteration	No	No	No	No	No	No	No	No	Yes	No
No drawback rule	No	No	No	No	No	No	No	No	No	No
Exporter record keeping (# years)	No	3 years	5 years	3 years	5 years	5 years	5 years	5 years	3 years (importer) 4 years (exporter)	5 years
Advance rulings	No	No	Yes	No	No	Yes[x]	No	No	Yes	Yes

[i] www.mofa.go.jp/policy/economy/fta/asean/agreement.html.
[ii] www.mofa.go.jp/region/asia-paci/malaysia/epa/index.html.
[iii] www.mofa.go.jp/region/asia-paci/vietnam/epa0812/index.html.
[iv] www.mofa.go.jp/region/asia-paci/indonesia/epa0708/index.html.
[v] www.mofa.go.jp/region/asia-paci/thailand/epa0704/index.html.
[vi] www.mofa.go.jp/region/asia-paci/philippine/epa0609/index.html.
[vii] www.cas.go.jp/jp/tpp/naiyou/tpp_text_en.html#TPP11
[viii] www.mofa.go.jp/ecm/ie/page4e_000875.html.
[ix] www.mofa.go.jp/region/asia-paci/india/epa201102/index.html.
[x] www.mofa.go.jp/region/asia-paci/thailand/epa0704/agreement.pdf.

TABLE 7.30 *Japan's free-trade agreements: Exporter declaration for small consignment*

Japan GSP	Japan ASEAN	Japan–Malaysia	Japan–Vietnam	Japan–Indonesia	Japan–Thailand	Japan–Philippines	Japan–CP-TPP	Japan–EU	Japan–India
Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No
Importers are not required to submit a certificate of origin in relation to an importation of a consignment of a good whose aggregate customs value does not exceed 200,000 yen.	Annex 4, Rule 3: Presentation of Certificate of Origin 2. A CO shall not be required for an importation of a consignment of originating goods of the exporting Party whose aggregate customs value does not exceed two hundred United States dollars (USD200) or its equivalent amount in the Party's currency, or such higher	Article 39: Claim for Preferential Tariff Treatment Notwithstanding paragraph 1 of this Article, the importing Country shall not require a certificate of origin from importers for: (a) an importation of a consignment of originating goods of the exporting Country whose aggregate customs value does not exceed	Annex 3, Rule 3: Presentation of Certificate of Origin 2. A CO shall not be required for an importation of a consignment of originating goods of the exporting Party whose aggregate customs value does not exceed two hundred United States dollars (USD200) or its equivalent amount in the Party's currency, or such higher	Article 40: Claim for Preferential Tariff Treatment 2. Notwith-standing paragraph 1, the importing Party shall not require a certificate of origin from importers for an importation of a consignment of originating goods of the exporting Party whose aggregate customs value does not exceed 200 United States dollars or its	Article 39: Claim for Preferential Tariff Treatment 2. Notwith-standing paragraph 1 above, the importing Party shall not require a certificate of origin from importers for: (a) an importation of a consignment of originating goods of the exporting Party whose aggregate customs value does not exceed	Article 40: Claim for Preferential Tariff Treatment 2. Notwith-standing paragraph 1 above, the importing Party shall not require a certificate of origin from importers for: (a) an importation of a consignment of originating goods of the exporting Party whose aggregate customs value does not exceed	Article 3.23: Waiver of Certification of Origin No Party shall require a certification of origin if: (a) the customs value of the importation does not exceed US $1,000 or the equivalent amount in the importing Party's currency or any higher amount as the importing Party may	Article 3.20: Small consignments and waivers 1. Products sent as small packages from private persons to private persons or forming part of travelers' personal luggage shall be admitted as originating products provided that such products are not imported by way of trade 1, have been declared as	No provisions about waiver in regard to small consignments.

amount as the importing Party may establish.	1000 United States dollars or its equivalent amount in the Country's currency, or such higher amount as it may establish.	amount as the importing Party may establish.	equivalent amount in the Party's currency, or such higher amount as it may establish.	200 United States dollars or its equivalent amount in the Party's currency, or such higher amount as it may establish.	two hundred (200) United States dollars or its equivalent amount in the Party's currency, or such higher amount as it may establish.	establish.	satisfying the requirements of this Chapter and if there is no doubt as to the veracity of such a declaration. 2. Provided that the importation does not form part of importations that may reasonably be considered to have been made separately for the purpose of avoiding the requirement for a statement on origin, the total value of the products referred to in paragraph

(*continued*)

TABLE 7.30 (*continued*)

Japan GSP	Japan ASEAN	Japan–Malaysia	Japan–Vietnam	Japan–Indonesia	Japan–Thailand	Japan–Philippines	Japan–CP-TPP	Japan–EU	Japan–India
								1 shall not exceed: (a) for the European Union, 500 euros in the case of small packages or 1,200 euros in the case of products forming part of travelers' personal luggage. The amounts to be used in other currency of a Member State of the European Union shall be the equivalent in that currency of the amounts expressed in euro as at the first working day of October of each	

year. The amounts shall be those published for that day by the European Central Bank, unless a different amount is communicated to the European Commission by 15 October of each year and shall apply from 1 January of the following year. The European Commission shall notify Japan of the relevant amounts;

(b) for Japan, 100,000 yen or such amount as Japan may establish.

TABLE 7.31 *Japan's free-trade agreements: Accounting segregation*

GSP	ASEAN	Malaysia	Vietnam	Indonesia	Thailand	Philippines	CP-TPP	EU	India
Not applicable.	Yes Article 35: Identical and Interchangeable Materials The determination of whether identical and interchangeable materials are originating materials shall be made by the use of generally accepted accounting principles of stock control applicable, or those of inventory management practiced, in the exporting Party.	Yes Article 34: Fungible Goods and Materials 1. For the purposes of determining whether a good qualifies as an originating good of a Country, where fungible originating materials of the Country and fungible non-originating materials that are commingled in an inventory are used in the production of the good, the origin of the materials may be	Yes Article 35: Identical and Interchangeable Materials The determination of whether identical and interchangeable materials are originating materials shall be made by the use of generally accepted accounting principles of stock control applicable, or those of inventory management practiced, in the exporting Party.	Yes Article 35: Fungible Goods and Materials 1. For the purposes of determining whether a good qualifies as an originating good of a Party, where fungible originating materials of the Party and fungible nonoriginating materials that are commingled in an inventory are used in the production of the good, the origin of the materials may be	Yes Article 34: Fungible Goods and Materials 1. For the purposes of determining whether a good qualifies as an originating good of a Party, where fungible materials consisting of originating materials of a Party and non-originating materials that are commingled in an inventory are used in the production of the good, the origin of the materials may be	Yes Article 35: Fungible Goods and Materials 1. For the purposes of determining whether a good qualifies as an originating good of a Party, where fungible originating materials of the Party and fungible nonoriginating materials that are commingled in an inventory are used in the production of the good, the origin of the materials may be	Yes Article 3.12: Fungible Goods or Materials Each Party shall provide that a fungible good or material is treated as originating based on the: (a) physical segregation of each fungible good or material; or (b) use of any inventory management method recognized in the Generally Accepted Accounting Principles if the fungible good or	Yes Article 3.8: Accounting segregation 1. Originating and non-originating fungible materials shall be physically segregated during storage in order to maintain their originating status. 2. For the purpose of this Article, "fungible materials" means materials that are of the same kind and commercial quality, with the same technical and physical characteristics, and which cannot be distinguished	Yes Article 36: Fungible Goods and Materials 1. For the purposes of determining whether a good qualifies as an originating good of a Party, where fungible originating materials of the Party and fungible nonoriginating materials that are mixed in an inventory are used in the production of the good, the origin of the materials may be

determined pursuant to an inventory management method under the Generally Accepted Accounting Principles in the territory of the Country. 2. Where fungible originating goods of a Country and fungible non-originating goods are commingled in an inventory and, prior to exportation do not undergo any production process or any operation in the territory of the Country where they were	determined pursuant to an inventory management method under the Generally Accepted Accounting Principles in the Party. 2. Where fungible originating goods of a Party and fungible non-originating goods are commingled in an inventory and, prior to exportation do not undergo any production process or any operation in the Party where they were commingled other than unloading,	determined pursuant to an inventory management method recognized in the Generally Accepted Accounting Principles in the Party. 2. Where fungible goods consisting of originating goods of a Party and non-originating goods are commingled in an inventory and, prior to exportation do not undergo any production process or any operation in the Party where they were commingled	determined pursuant to an inventory management method set out in the Operational Procedures on Trade in Goods and Rules of Origin referred to in Article 25. 2. Where fungible originating goods of a Party and fungible non-originating goods are commingled in an inventory and, prior to exportation do not undergo any production process or any operation in the Party where they were commingled other than	material is commingled, provided that the inventory management method selected is used throughout the fiscal year.	from one another once they are incorporated into the finished product. 3. Notwithstanding paragraph 1, originating and non-originating fungible materials may be used in the production of a product without being physically segregated during storage provided that an accounting segregation method is used. 4. The accounting segregation method referred to in paragraph 3 shall be applied in conformity with	determined pursuant to an inventory management method under the Generally Accepted Accounting Principles in the Party. 2. Where fungible originating goods of a Party and fungible non-originating goods are mixed in an inventory and, prior to exportation do not undergo any production process or any operation in the Party where they were mixed other than unloading, reloading or any

(*continued*)

TABLE 7.31 (*continued*)

GSP	ASEAN	Malaysia	Vietnam	Indonesia	Thailand	Philippines	CP-TPP	EU	India
		commingled other than unloading, reloading or any other operation to preserve them in good condition, the origin of the good may be determined pursuant to an inventory management method under the Generally Accepted Accounting Principles in the territory of the Country.		reloading and any other operation to preserve them in good condition, the origin of the good may be determined pursuant to an inventory management method under the Generally Accepted Accounting Principles in the Party.	other than unloading, reloading or any other operation to preserve them in good condition, the origin of the good may be determined pursuant to an inventory management method recognized in the Generally Accepted Accounting Principles in the Party.	unloading, reloading or any other operation necessary to preserve them in good condition, the origin of the good may be determined pursuant to an inventory management method set out in the Operational Procedures on Trade in Goods and Rules of Origin referred to in Article 25. 3. Once an inventory management method set out in paragraphs 1 and 2 above has been chosen, it shall be		an inventory management method under accounting principles which are generally accepted in the Party. 5. A Party may require, under conditions set out in its laws and regulations, that the use of an accounting segregation method is subject to prior authorization by the customs authority of that Party. The customs authority of the Party shall monitor the use of the authorization	other operation to preserve them in good condition, the origin of the good may be determined pursuant to an inventory management method under the Generally Accepted Accounting Principles in the Party.

used through all the fiscal year or period.

Rule I: Fungible goods and materials

The inventory management method referred to in paragraphs 1 and 2 of Article 35 should be subject to the Generally Accepted Accounting Principles in the exporting Party.

and may withdraw the authorization if the holder makes improper use of the accounting segregation method or fails to fulfil any of the other conditions laid down in this Chapter.

6. The accounting segregation method shall be any method that ensures that at any time no more materials receive originating status than would be the case if the materials had been physically segregated.

TABLE 7.32 *Japan's free-trade agreements: Documentary evidence of direct shipment requirement*

Japan GSP	Japan–ASEAN	Japan–Malaysia	Japan–Vietnam	Japan–Indonesia	Japan–Thailand	Japan–Philippines	Japan–CP-TPP	Japan–EU	Japan–India
Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Evidence relating to transport In the case of transportation coming under (a) and (b) of the rules for transportation mentioned above, the following evidence to prove that the transportation was in conformity with the conditions specified respectively thereunder must be produced:	Annex 4, Rule 3: Presentation of Certificate of Origin 3. Where an originating good of the exporting Party is imported through one or more of the Parties other than the exporting Party and the importing Party, or non-Parties, the importing Party may require importers who claim preferential	Article 32: Consignment Criteria 1. An originating good of the other Country shall be deemed to meet the consignment criteria when it is: (a) transported directly from the territory of the other Country; or (b) transported through third States for the purpose of transit or temporary storage in	Article 31: Direct Consignment 1. Preferential tariff treatment shall be accorded to an originating good satisfying the requirements of this Chapter and which is consigned directly from the exporting Party to the importing Party. 2. The following shall be considered as consigned directly from the exporting	Article 31: Direct Consignment 1. Preferential tariff treatment shall be accorded to an originating good satisfying the requirements of this Chapter and which is consigned directly from the exporting Party to the importing Party. 2. The following shall be considered as consigned directly from the exporting	Article 32: Consignment Criteria 1. An originating good of the other Party shall be deemed to meet the consignment criteria when it is: (a) transported directly from the other Party; or (b) transported through one or more non-Parties for the purpose of transit or temporary storage in	Article 33: Consignment Criteria 1. An originating good of the other Party shall be deemed to meet the consignment criteria when it is: (a) transported directly from the other Party; or (b) transported through one or more non-Parties for the purpose of transit or temporary storage in	Article 3.18: Transit and Transshipment 1. Each Party shall provide that an originating good retains its originating status if the good has been transported to the importing Party without passing through the territory of a non-Party. 2. Each Party shall provide that if an originating good is transported through the	Article 3.10: Non-alteration 1. An originating product declared for home use in the importing Party shall not have, after exportation and prior to being declared for home use, been altered, transformed in any way or subjected to operations other than to preserve them in good condition or than adding or affixing marks, labels, seals or	Article 34: Consignment Criteria 1. An originating good of the other Party shall be deemed to meet the consignment criteria when it is: (a) transported directly from the other Party; or (b) transported through one or more non-Parties for the purpose of transit or temporary storage in warehouses in such non-Parties,

(a) A through bill of lading;
(b) Certification by the customs authorities or other government authorities of the transit countries;
(c) Any other substantiating document deemed sufficient.
However, with regard to consignment of customs value not exceeding 200,000 yen, this evidence will not be required.

tariff treatment for the good to submit:
(a) a copy of through bill of lading; or
(b) a certificate or any other information given by the customs authorities of such one or more Parties or non-Parties, or other relevant entities, which proves that the good has not undergone operations other than unloading, reloading and any other operation to preserve it in good condition

warehouses in such third States, provided that it does not undergo operations other than unloading, reloading or any other operation to preserve it in good condition.
2. If the originating good of the other Country does not meet the consignment criteria referred to in paragraph 1 of this Article, that good shall not be considered as the originating good of the other Country.
Article 39:

Party to the importing Party:
(a) a good transported directly from the exporting Party to the importing Party; or
(b) a good transported through one or more non-Parties, provided that the good does not undergo operations other than transit or temporary storage in warehouses, unloading, reloading, and any other operation to preserve it in

Party to the importing Party:
(a) a good transported directly from the exporting Party to the importing Party; or
(b) a good transported through one or more non-Parties, provided that the good does not undergo operations other than transit or temporary storage in warehouses, unloading, reloading, and any other operation to preserve it in

warehouses in such non-Parties, provided that it does not undergo operations other than unloading, reloading or any other operation to preserve it in good condition.
2. If the originating good of the other Party does not meet the consignment criteria referred to in paragraph 1 above, that good shall not be considered as the originating good of the other Party.
Article 39:

warehouses in such non-Parties, provided that it does not undergo operations other than unloading, reloading or any other operation necessary to preserve it in good condition.
2. If the originating good of the other Party does not meet the consignment criteria referred to in paragraph 1 above, that good shall not be considered as the originating good of the other Party.

territory of one or more non-Parties, the good retains its originating status provided that the good:
(a) does not undergo any operation outside the territories of the Parties other than:
unloading;
reloading;
separation from a bulk shipment;
storing;
labelling or marking required by the importing Party; or any other operation necessary to

any other documentation to ensure compliance with specific domestic requirements of the importing Party.
2. Storage or exhibition of a product may take place in a third country provided that it remains under customs supervision in that third country.
3. Without prejudice to Section B, the splitting of consignments may take place in a third

provided that it does not undergo operations other than unloading, reloading and any other operation to preserve it in good condition.
2. If an originating good of the other Party does not meet the consignment criteria referred to in paragraph 1, the good shall not be considered as an originating good of the other Party.
Section 2: Claim for Preferential Tariff Treatment
3. Where an originating good

(*continued*)

TABLE 7.32 (*continued*)

Japan GSP	Japan–ASEAN	Japan–Malaysia	Japan–Vietnam	Japan–Indonesia	Japan–Thailand	Japan–Philippines	Japan–CP-TPP	Japan–EU	Japan–India
	in those Parties or non-Parties.	Claim for Preferential Tariff Treatment 3. Where an originating good of the exporting Party is imported through one or more non-Parties, the importing Party may require importers, who claim the preferential tariff treatment for the good, to submit: (a) a copy of through bill of lading; or (b) a certificate or any other	good condition. Article 39: Claim for Preferential Tariff Treatment 3. Where an originating good of the exporting Party is imported through one or more non-Parties, the importing Party may require importers, who claim the preferential tariff treatment for the good, to submit: (a) a copy of through bill of lading; or	good condition. Article 39: Claim for Preferential Tariff Treatment 3. Where an originating good of the exporting Party is imported through one or more non-Parties, the importing Party may require importers, who claim the preferential tariff treatment for the good, to submit: (a) a copy of through bill of lading; or	Claim for Preferential Tariff Treatment 3. Where an originating good of the exporting Party is imported through one or more non-Parties, the importing Party may require importers, who claim the preferential tariff treatment for the good, to submit: (a) a copy of through bill of lading; or (b) a certificate or any other	Article 40: Claim for Preferential Tariff Treatment 3. Where an originating good of the exporting Party is imported through one or more non-Parties, the importing Party may require importers, who claim the preferential tariff treatment for the good, to submit: (a) a copy of through bill of lading; or (b) a certificate	preserve it in good condition or to transport the good to the territory of the importing Party; and (b) remains under the control of the customs administration in the territory of a non-Party.	country if it is carried out by the exporter or under its responsibility and provided that they remain under customs supervision in that third country. 4. In case of doubt as to whether the requirements provided for in paragraphs 1 to 3 are complied with, the customs authority of the importing Party may request the importer to provide	of the exporting Party is imported through one or more non-Parties as provided for in Article 34, the customs authority of the importing Party may require the importer, who claims the preferential tariff treatment for the good, to submit: (a) a copy of through bill of lading indicating the port of exportation and importation; or (b) a certificate or any other information given by the

information given by the customs authorities of such non-Parties or other relevant entities, which evidences that it has not undergone operations other than unloading, reloading or any other operation to preserve it in good condition in those non-Parties.	(b) a certificate or any other information given by the customs authorities of such non-Parties or other relevant entities, which evidences that it has not undergone operations other than unloading, reloading or any other operation to preserve it in good condition in those non-Parties.	(b) a certificate or any other information given by the customs authorities of such non-Parties or other relevant entities, which evidences that it has not undergone operations other than unloading, reloading or any other operation to preserve it in good condition in those non-Parties.	information given by the customs authorities of such non-Parties or other relevant entities, which evidences that it has not undergone operations other than unloading, reloading or any other operation to preserve it in good condition in those non-Parties.	or any other information given by the customs authorities of such non-Parties or other relevant entities, which evidences that it has not undergone operations other than unloading, reloading or any other operation necessary to preserve it in good condition in those non-Parties.	evidence of compliance, which may be given by any means, including contractual transport documents such as bills of lading or factual or concrete evidence based on marking or numbering of packages or any evidence related to the product itself.	customs authorities of such non-Parties or other relevant entities, which evidences that the good has not undergone operations other than unloading, reloading and any other operation to preserve it in good condition in those non-Parties. 4. Notwithstanding paragraph 3, the customs authority of the importing Party may require the importer to

(*continued*)

TABLE 7.32 (*continued*)

Japan GSP	Japan–ASEAN	Japan–Malaysia	Japan–Vietnam	Japan–Indonesia	Japan–Thailand	Japan–Philippines	Japan–CP-TPP	Japan–EU	Japan–India
									submit documents provided for in subparagraph 3 (b) in addition to a copy of through bill of lading provided for in subparagraph 3 (a) in accordance with the relevant provisions of Implementing Procedures referred to in Section 11.

TABLE 7.33 *Japan's free-trade agreements: Exporter record keeping (# years)*

GSP	ASEAN	Malaysia	Vietnam	Indonesia	Thailand	Philippines	CP-TPP	EU	India
No	5 years Annex 4, Rule 5: Record Keeping 1. Each Party shall, in accordance with its laws and regulations, ensure that the exporter to whom a CO has been issued or the producer of a good in the exporting Party referred to in subparagraph 4(b) of Rule 2 keeps records relating to the origin of the good. For the purposes of this Agreement, the exporter or producer shall keep these records for three (3) years after	5 years Article 40: Certificate of Origin Each Country shall ensure that the competent governmental authority or its designees shall keep a record of the certificates of origin issued for a period of five years after the date on which the certificate was issued. Such record will include all antecedents, which were presented to prove the qualification as an originating good of	3 years Annex 3, Rule 5: Record Keeping 1. Each Party shall, in accordance with its laws and regulations, ensure that the exporter to whom a CO has been issued or the producer of a good in the exporting Party referred to in subparagraph 4(b) of Rule 2 keeps records relating to the origin of the good. For the purposes of this Agreement, the exporter or producer shall keep these records for three years after the	5 years Article 41: Certificate of Origin 10. Each Party shall ensure that the competent governmental authority or its designees shall keep a record of issued certificate of origin for a period of five years after the date on which the certificate was issued. Such record will include all antecedents, which were presented to prove the qualification as an originating good of the exporting Party.	5 years Article 40: Certificate of Origin 10. Each Party shall ensure that the competent governmental authority or its designees shall keep a record of the certificates of origin issued for a period of 5 years after the date on which the certificate was issued. Such record will include all antecedents, which were presented to prove the qualification as an originating good of the exporting Party.	5 years Article 41: Certificate of Origin 10. Each Party shall ensure that the competent governmental authority or its designees shall keep a record of the certificates of origin issued for a period of five (5) years after the date on which the certificate was issued. Such record will include all antecedents, which were presented to prove the qualification as an originating good of the exporting Party.	5 years Article 3.26: Record Keeping Requirements 1. Each Party shall provide that an importer claiming preferential tariff treatment for a good imported into the territory of that Party shall maintain, for a period of no less than five years from the date of importation of the good: (a) the documentation related to the importation, including the certification of	3 years (importer) 4 years (exporter) Article 3.19: Record keeping requirements 1. An importer making a claim for preferential tariff treatment for a product imported into the importing Party shall, for a minimum of three years after the date of importation of the product, keep: (a) if the claim was based on a statement on origin, the statement on origin made out by the exporter; or (b) if the claim was based on the	5 years Section 5: Record Keeping 1. Each Party shall ensure that the competent governmental authority of the Party or its designees shall keep a record of the issued certificate of origin for a period of five years after the date on which the certificate was issued. Such record will include

(*continued*)

TABLE 7.33 (*continued*)

GSP	ASEAN	Malaysia	Vietnam	Indonesia	Thailand	Philippines	CP-TPP	EU	India
	the date on which the CO was issued. 2. Each Party shall ensure that its competent governmental authority or its designees shall keep a record of the issued CO for a period of three (3) years after the date on which the CO was issued. Such record includes all supporting documents presented to prove the qualification as an originating good of the exporting Party.	the exporting Country.	date on which the CO was issued. 2. Each Party shall ensure that its competent governmental authority or its designees shall keep a record of the issued CO for a period of three years after the date on which the CO was issued. Such record includes all supporting documents presented to prove the qualification as an originating good of the exporting Party.				origin that served as the basis for the claim; and (b) all records necessary to demonstrate that the good is originating and qualified for preferential tariff treatment, if the claim was based on a certification of origin completed by the importer. 2. Each Party shall provide that a producer or exporter in its territory that provides a certification of origin shall maintain, for a period of no less than five years from	importer's knowledge, all records demonstrating that the product satisfies the requirements to obtain originating status. 2. An exporter who has made out a statement on origin shall, for a minimum of four years after the making out of that statement on origin, keep a copy of the statement on origin and all other records demonstrating that the product satisfies the requirements to obtain originating status.	all antecedents, which were presented to prove the qualification as an originating good of the exporting Party. 2. Each Party shall, in accordance with its laws and regulations, ensure that the exporter to whom a certificate of origin has been issued, or the producer of a good in the

the date the certification of origin was issued, all records necessary to demonstrate that a good for which the exporter or producer provided a certification of origin is originating. Each Party shall endeavor to make available information on types of records that may be used to demonstrate that a good is originating. 3. Each Party shall provide that an importer, exporter or producer in its territory may choose to maintain	3. The records to be kept in accordance with this Article may be held in electronic format. 4. Paragraphs 1 to 3 do not apply in the cases specified in Article 3.20.	exporting Party referred to in subparagraph 6(b) of Section 3 shall keep the records relating to the origin of the good for five years after the date on which the certificate of origin was issued. 3. The records to be kept in accordance with this Section may include electronic records.

(*continued*)

TABLE 7.33 (*continued*)

GSP	ASEAN	Malaysia	Vietnam	Indonesia	Thailand	Philippines	CP-TPP	EU	India
							the records specified in paragraphs 1 and 2 in any medium that allows for prompt retrieval, including electronic, optical, magnetic or written form in accordance with that Party's law.		

TABLE 7.34 *Japan's free-trade agreements: Advance rulings*

Japan GSP	Japan–ASEAN	Japan–Malaysia	Japan–Vietnam	Japan–Indonesia	Japan–Thailand	Japan–Philippines	Japan–CP-TPP	Japan–EU	Japan–India
Not present in original legislation.	No	Yes Article 41: Advance Rulings The importing Country shall endeavor to, prior to the importation of a good, issue a written advance ruling as to whether the good to be imported qualifies as an originating good of the exporting Country to importers of the good of the exporting Country or their authorized agents	No	No	Yes Article 41: Response to Inquiries The customs authority of the importing Party shall endeavor to, prior to the importation of a good, provide a response to inquiries in accordance with its laws and regulations as to whether the good to be imported qualifies as an originating good of the exporting Party to importers	No	Yes Article 5.3: Advance Rulings 1. Each Party shall issue, prior to the importation of a good of a Party into its territory, a written advance ruling at the written request of an importer in its territory, or an exporter or producer in the territory of another Party, with regard to: (a) tariff classification; (b) the application of customs valuation criteria for a particular case in accordance with the Customs Valuation Agreement; (c) whether a good is originating in accordance	Yes Article 4.7: Advance Rulings 1. Each Party shall issue, through its customs authority, an advance ruling that sets forth the treatment to be provided to the goods concerned. That ruling shall be issued in a reasonable, time-bound manner to the applicant that has submitted a written request, including in electronic format,	Yes Article 47: Advance Rulings Where a written application is made in accordance with relevant laws or procedures adopted or maintained by the importing Party and the importing Party has no reasonable grounds to deny the issuance, the importing Party shall endeavor to, prior to the importation of the good, issue a

(*continued*)

TABLE 7.34 (*continued*)

Japan GSP	Japan–ASEAN	Japan–Malaysia	Japan–Vietnam	Japan–Indonesia	Japan–Thailand	Japan–Philippines	Japan–CP-TPP	Japan–EU	Japan–India
		and exporters, and producers of the good in the territory of the exporting Country or their authorized agents, where a written application is made with all the necessary information.			of the good of the exporting Party or their authorized agents, where a written application is made with all the necessary information.		with Chapter 3 (Rules of Origin and Origin Procedures); and (d) such other matters as the Parties may decide. 2. Each Party shall issue an advance ruling as expeditiously as possible and in no case later than 150 days after it receives a request, provided that the requester has submitted all the information that the receiving Party requires to make the advance ruling. This includes a sample of the good for which the requester is seeking an advance ruling if requested by the receiving Party. In issuing an advance ruling, the Party shall take into account the facts and	containing all necessary information in accordance with the laws and regulations of the issuing Party. 2. An advance ruling shall cover tariff classification of the goods, origin of goods including their qualification as originating goods under Chapter 3 or any other matter as the Parties may agree, in particular regarding the appropriate	written advance ruling concerning the tariff classification, the customs valuation and the origin of the good, as well as the qualification of the good as an originating good of the exporting Party under the provisions of Chapter 3.

circumstances that the requester has provided. For greater certainty, a Party may decline to issue an advance ruling if the facts and circumstances forming the basis of the advance ruling are the subject of administrative or judicial review. A Party that declines to issue an advance ruling shall promptly notify the requester in writing, setting out the relevant facts and circumstances and the basis for its decision to decline to issue the advance ruling.

3. Each Party shall provide that its advance rulings shall take effect on the date that they are issued or on another date specified in the ruling, and remain in

method or criteria to be used for the customs valuation of the goods.

3. Subject to any confidentiality requirements in its laws and regulations, a Party may publish its advance rulings, including through the Internet.

(*continued*)

TABLE 7.34 (*continued*)

Japan GSP	Japan–ASEAN	Japan–Malaysia	Japan–Vietnam	Japan–Indonesia	Japan–Thailand	Japan–Philippines	Japan–CP-TPP	Japan–EU	Japan–India
							effect for at least three years, provided that the law, facts and circumstances on which the ruling is based remain unchanged. If a Party's law provides that an advance ruling becomes ineffective after a fixed period of time, that Party shall endeavour to provide procedures that allow the requester to renew the ruling expeditiously before it becomes ineffective, in situations in which the law, facts and circumstances on which the ruling was based remain unchanged. 4. After issuing an advance ruling, the Party may modify or revoke the advance ruling if there is a change in the law, facts or		

circumstances on which the ruling was based, if the ruling was based on inaccurate or false information, or if the ruling was in error.

5. A Party may apply a modification or revocation in accordance with paragraph 4 after it provides notice of the modification or revocation and the reasons for it.

6. No Party shall apply a revocation or modification retroactively to the detriment of the requester unless the ruling was based on inaccurate or false information provided by the requester.

7. Each Party shall ensure that requesters have access

(*continued*)

TABLE 7.34 (*continued*)

Japan GSP	Japan–ASEAN	Japan–Malaysia	Japan–Vietnam	Japan–Indonesia	Japan–Thailand	Japan–Philippines	Japan–CP-TPP	Japan–EU	Japan–India
							to administrative review of advance rulings. 8. Subject to any confidentiality requirements in its law, each Party shall endeavor to make its advance rulings publicly available, including online.		

TABLE 7.35 *Certification of origin: Format and distribution of copies, Japan*

	Japan–ASEAN	Japan–Indonesia	Japan–Thailand	Japan–Philippines	Japan–Vietnam
Name of the form	Form AJ	Form IJEPA	Form JTEPA	Form JP	Form JV
Specimen	Attachment to Annex 4 (OCP) of the Agreement, Minimum data requirements attachment to Annex 4	Appendix 1-A of attachment to the Agreement, Minimum data requirements attachment to Annex 3	Appendix 1-A of Attachment to the Agreement, Minimum data requirements in Annex 3	Appendix 1-A of attachment to the Agreement, Minimum data requirements in Annex 3	Attachment 1 and Attachment 2 to the Agreement/Minimum data requirements in attachment to Annex 3
Format	A4 size paper, in English	ISO A4 size paper, in English	ISO A4 size paper, in English	ISO A4 size paper, in English	A4 size paper, in English
Copies	1 original 2 copies (ASEAN Member States)	1 original 2 copies (Indonesia)	1 original 2 copies (Thailand)	1 original Additional copies may be issued (Philippines)	1 original 2 copies (Vietnam)
Distribution of copies	Original forwarded by the exporter to the importer for submission to the customs authority of the importing party. A copy is to be retained by both the exporter and the competent governmental authority of the exporting party or its designees, respectively.	Original forwarded by the exporter to the importer for submission to the customs authority of the importing party.	Original forwarded by the exporter to the importer for submission to the customs authority of the importing party.	Original forwarded by the exporter to the importer for submission to the customs authority of the importing party.	Original forwarded by the exporter to the importer for submission to the customs authority of the importing party. A copy is to be retained by both the exporter and the competent governmental authority of the exporting party or its designees, respectively.

exporter/importer-based declaration of origin is adopted; on the other hand, a number of Japan's free-trade agreements adopt a rather archaic system based on a CO, exchanges of stamps, and at times signatures. Table 7.35 provides a snapshot of the major CO requirements under the different Japanese free-trade agreements. Such ambivalent, or pragmatic, attitude by Japan is motivated by the fact that Japan tends to adopt a conservative approach on administering rules of origin when there are concerns over the other partner's ability to efficiently manage a liberal origin administration based on exporter/importers declaration. Added to this, a number of Japan's trade partners, like India or ASEAN, remain attached to a traditional way of RoO administration based on the existence of CAs. In such latter cases it is obvious that the ASEAN and India free-trade agreements provide for an administration of rules origin based on CAs with COs stamped and exchange of stamps.

Besides this tendency, the other characteristic feature of Japan's administration of rules of origin is that, similarly to the case of the United States, there are no extensive written procedures for supplier's declarations.[104] Apart from the non-alteration article in the EU–Japan FTA agreement, the documentary evidence requirements for direct consignment are quite standard requiring documentary evidence. In many Japanese free-trade agreements there are no particular provisions for drawback, and averaging. Advance rulings are unevenly regulated as detailed further in Table 7.34.

7.5.4 *South Korea*

Korea has been an active player in entering a number of free-trade agreements with different countries in the world in different geographic regions. Thus, it is important to identify the pattern of South Korea when it comes to administration of rules of origin given the extreme diversity of experiences and lessons learned. Table 7.36 provides an outline of the main definitions used in South Korea's free-trade agreements. Table 7.43 provides valuable insights of the different forms of COs in a number of South Korea's free-trade agreements.

Similarly to Japan, South Korea appears to have adopted a pragmatic approach modulating the method of administration of rules of origin according to the level of experience and method used by the free-trade agreement partners. In fact, South Korea uses the traditional CAs with exchange of stamps in some free-trade agreements with ASEAN, the approved exporter system in the context of the EU–South Korea FTA agreement, and the importer knowledge in the CP-TPP.

South Korea requires documentary evidence of direct shipment in all free-trade agreements except in those with Chile and Australia, does not use supplier's declarations, and allows for exemption of proof of origin in all FTAs examined.

[104] Japan's GSP provides for regional cumulation and donor country content. In both cases specific forms are required.

TABLE 7.36 *Definitions in Korea's free-trade agreements*

Definition	Explanation
Certificate of origin issued by certifying authorities (CAs)	Korea uses CAs under free-trade agreements with ASEAN, India, CEPA, and Peru.
Prior authorization (approved exporter)	Self-certification system by approved exporters in Korea–EU and Korea–EFTA.
Exporter declaration (with origin criteria)	Self-certification system. Exporters issue a statement of origin so that a good to be exported qualifies as an originating good of the exporting country. Applicable in Korea's free-trade agreements with the EU, United States, Canada, EFTA, Australia, and Chile.
Importer's knowledge	Importers can make a declaration of origin of a good to be imported. Applicable under CP-TPP.
Exporter declaration for small consignment	Waiver for certificate of origin if customs value does not exceed certain value. Applicable in all of Korea's free-trade agreements.
Long-term certificate for OM	Korea does not use a specific format for supplier's declaration.
Long-term certificate for NOM	Korea does not use a specific format for supplier's declaration.
Accounting segregation	Accounting segregation for fungible/interchangeable products is required in Korea's free-trade agreements.
Documentary evidence of direct shipment requirement	Evidence to prove that the transportation was in conformity with the conditions specified. Applicable for all of Korea's free-trade agreements, except for Korea–US, Korea–Australia, and Korea–Chile.
Nonalteration	Nonalteration principle is not specifically mentioned in Korea's free-trade agreements.
Drawback rule	Prohibition of refunding duties paid on imported goods. Allowed in Korea–EU and Korea–Turkey. No specific provisions on drawback in the others.
Averaging (value of non-originating materials)	Averaging is not used in Korea's free-trade agreements.
Exporter record keeping (# years)	Varies from 3 (Korea–ASEAN) to 5 years (rest).
Advance rulings	Free-trade agreements with the United States, EU, Canada, Singapore, Australia, Chile, Peru, and Turkey contain specific provisions on advance rulings, which allow inquirers to get precise information on origin in a certain amount of time.

TABLE 7.37 *Mapping certification in Korea's free-trade agreements*

	Korea–US	Korea–EU	Korea–ASEAN	Korea–Canada	Korea–EFTA	Korea–Singapore	Korea–Australia	Korea–India CEPA	Korea–Chile	Korea–Peru	Korea–Turkey
Certificate of origin	Certificate of origin is self-issued by the exporter, producer, importer.	Certificate of origin is self-issued by the exporter (for goods under the value of 6,000 EUR), Approved exporter (goods of value above 6,000 EUR).	Certificate of origin issued by a competent authority designated by the exporting party and notified to all the other parties in accordance with the Operational Certification Procedures, as set out in Appendix 1. Each party shall provide the names, addresses, specimen signatures and	A certificate of origin duly completed and signed by an exporter or a producer in the territory of the other party is required.	Certificate of origin is self-issued by the exporter.	Certificate of origin is issued by competent authority designated.	Australian and Korean exporters and producers of goods can self-certify through completing a certificate of origin. Australian exporters and producers also have the option to be granted a certificate of origin from an authorized body.	Certificate of origin is issued by the competent authority designated. Each party shall inform the other party of the names and addresses of the authorized officials of its respective Issuing Authorities and also provide the original sets of their specimen signatures and	Certificate of origin is self-issued by the exporter.	Certificate of origin is issued by the competent authority designated. Each party shall notify the other party the names and seals of its authorized bodies.	Origin declaration by the exporter is required.

			specimen of official seals of its authorities to all the other parties, through the ASEAN Secretariat.					specimen of official seals.			
Prior authorization (approved exporter)	No	Yes Art. 17 Protocol for > 6,000 EUR	No	No	Yes, Art. 16 Annex 1	No	No	No	No	No	No
Prior registration (registered exporter)	No	No	No	No	No	No	No	No	No	No	No
Exporter declaration (with origin criteria)	Yes	Yes	No	Yes	Yes	No	Yes	No	Yes	No	Yes
Importer's knowledge	Yes (Art. 6.15 1 b)	No	No	No	No	No	No	No	No	No	No
Exporter declaration for small consignment	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes

(*continued*)

TABLE 7.37 (*continued*)

	Korea–US	Korea–EU	Korea–ASEAN	Korea–Canada	Korea–EFTA	Korea–Singapore	Korea–Australia	Korea–India CEPA	Korea–Chile	Korea–Peru	Korea–Turkey
Accounting segregation	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Documentary evidence of direct shipment requirement	No	Yes	Yes	Yes	Yes	Yes	No	Yes	No	Yes	Yes
Nonalteration	No	No	No	No	No	No	No	No	No	No	No
No drawback rule	No	No, specifically mentioned, drawback allowed.	No	No	No	No		No		No	No, specifically mentioned, drawback allowed.
Exporter record keeping (# years)	5 years	5 years	3 years	5 years	5 years	5 years	5 years	5 years	5 years	5 years	5 years
Advance rulings	Yes	Yes	No	Yes	No	Yes	Yes	No	Yes	Yes	Yes

TABLE 7.38 *Korea's free-trade agreements: Exporter declaration for small consignment*

Korea–US	Korea–EU	Korea–ASEAN	Korea–Canada	Korea–EFTA	Korea–Singapore	Korea–Australia	Korea–India Cepa	Korea–Chile	Korea–Peru	Korea–Turkey
Yes Article 6.16: Waiver of Certification or other information Each Party shall provide that a certification or information demonstrating that a good is originating shall not be required where: (a) the customs value of the importation does not exceed 1,000 U.S. dollars or the equivalent amount in the currency of the	Yes Article 21: Exemptions from Proof of Origin, Protocol Originating Products 1. Products sent as small packages from private persons to private persons or forming part of a traveller's personal luggage shall be admitted as originating products without requiring the submission of a proof of origin, provided that	Yes Rule 11, Appendix 1: Operational Certification Procedures for the Rules of Origin A Certificate of Origin shall not be required for: (a) a good originating in the territory of a Party which does not exceed US$ 200.00 FOB; or (b) a good sent by post from the territory of a Party which does not exceed US$ 200.00 FOB,	Yes Article 4.3: Waiver of Certificate of Origin Each Party shall provide that a Certificate of Origin is not required for: (a) an importation of a good whose value does not exceed US$1,000 or its equivalent amount in the Party's currency, or such higher amount as it may establish.	Yes Article 19: Waiver of Origin Declaration 1. Products sent as small packages from private persons to private persons or forming part of travelers' personal luggage shall be admitted as originating products without requiring the submission of an origin declaration, provided that such products are not imported	Yes Article 5.6: Waiver of Certificate of Origin 1. Notwithstanding paragraph 1(b) of Article 5.3, a certificate of origin shall not be required for: (a) an importation of a good whose aggregate customs value does not exceed USD 1,000 or its equivalent amount in the Party's currency, or such higher	Yes Article 3.19: Waiver of Certificate Origin Each Party shall provide that a Certificate of Origin shall not be required for: (a) an importation of a good whose customs value does not exceed 1,000 Australian dollars for Australia or 1,000 US dollars or its equivalent amount for Korea, or such higher amount	Yes Article 4.9: Waiver of Certificate of Origin Goods sent as small packages from private persons to private persons or forming part of travellers' personal luggage may be admitted as originating goods without requiring the submission of a Certificate of Origin, in accordance with each Party's laws and regulations.	Yes Article 5.5: Exceptions Each Party shall provide that a Certificate of Origin shall not be required for: (a) a commercial importation of a good whose value does not exceed US$1,000 or its equivalent amount in the Party's currency, or such higher amount as it may establish, except that it may require that the invoice	Yes Article 4.2: Waiver of Certificate of Origin A Certificate of Origin shall not be required where: (a) the customs value of the importation does not exceed 1,000 US dollars or the equivalent amount in the currency of the importing Party, or such higher amount as may be established by the importing Party, unless the	Yes Article 20: Exemptions from Origin Declaration 1. Products sent as small packages from private persons to private persons or forming part of travellers' personal luggage shall be admitted as originating products without requiring the submission of an origin declaration, provided that such products

(*continued*)

TABLE 7.38 (*continued*)

Korea–US	Korea–EU	Korea–ASEAN	Korea–Canada	Korea–EFTA	Korea–Singapore	Korea–Australia	Korea–India Cepa	Korea–Chile	Korea–Peru	Korea–Turkey
importing Party, or such higher amount as may be established by the importing Party, unless the importing Party considers the importation to be part of a series of importations carried out or planned for the purpose of evading compliance with the Party's laws governing claims for preferential tariff treatment under this Agreement.	such products are not imported by way of trade and have been declared as meeting the requirements of this Protocol and where there is no doubt as to the veracity of such a declaration. In the case of products sent by post, this declaration may be made on a postal customs declaration or on a sheet of paper annexed to that document. 2. Imports which are occasional and consist solely of	provided that the importation does not form part of one or more importations that may reasonably be considered to have been undertaken or arranged for the purpose of avoiding the submission of a Certificate of Origin.		by way of trade and have been declared as meeting the requirements of this Annex and where there is no doubt as to the veracity of such a declaration. In the case of products sent by post, this declaration can be made on a postal customs declaration or on a sheet of paper annexed to that document. 2. Imports which are occasional and consist solely of products for the personal use of	amount as it may establish.	as each Party may establish.		accompanying the importation include a statement certifying that the good qualifies as an originating good, (b) a non-commercial importation of a good whose value does not exceed US$1,000 or its equivalent amount in the Party's currency, or such higher amount as it may establish.	importing Party considers the importation to be carried out or planned for purposes of evading compliance with the Party's laws governing claims for preferential tariff treatment under this Agreement.	are not imported by way of trade and have been declared as meeting the requirements of this Protocol and where there is no doubt as to the veracity of such a declaration. In the case of products sent by post, this declaration may be made on a postal customs declaration or on a sheet of paper annexed to that document. 2. Imports which are occasional and consist solely of products for the

products for the personal use of the recipients or travelers or their families shall not be considered as imports by way of trade if it is evident from the nature and quantity of the products that no commercial purpose is intended.
3. Furthermore, the total value of these products shall not exceed:
(a) for importation into the EU Party, 500 euros in the case of small packages or 1,200 euros in the case of products

the recipients or travelers or their families shall not be considered as imports by way of trade if it is evident from the nature and quantity of the products that no commercial purpose is intended.
3. For the purposes of paragraph 1, in case of small packages sent from private persons to private persons the total value of these products shall not exceed the following amounts:
(a) 500 euro for

personal use of the recipients or travellers or their families shall not be considered as imports by way of trade if it is evident from the nature and quantity of the products that no commercial purpose is intended.
3. Furthermore, the total value of these products shall not exceed:
(a) for importation into Turkey, 500 euros in the case of small packages or 1,200 euros in the case of products forming part of

(*continued*)

TABLE 7.38 (*continued*)

Korea–US	Korea–EU	Korea–ASEAN	Korea–Canada	Korea–EFTA	Korea–Singapore	Korea–Australia	Korea–India Cepa	Korea–Chile	Korea–Peru	Korea–Turkey
	forming part of a traveller's personal luggage; (b) for importation into Korea, 1,000 US dollars both in the case of small packages and in the case of the products forming part of a traveller's personal luggage. 4. For the purpose of paragraph 3, in cases where the products are invoiced in a currency other than euro or US			importation in an EFTA State; or (b) 1000 US dollar (USD) for importation in Korea. 4. For the purposes of paragraph 1, in case of products forming part of travellers' personal luggage the total value of these products shall not exceed the following amounts: (a) 1200 euro for importation in an EFTA State; or (b) 1000 US						traveller's personal luggage; (b) for importation into Korea, 1,000 US dollars both in the case of small packages and in the case of the products forming part of traveller's personal luggage. 4. For the purpose of paragraph 3, in cases where the products are invoiced in a currency other than euro or US dollars, amounts

dollars, amounts in the national currencies of the Parties equivalent to the amounts expressed in euro or US dollars shall be fixed in accordance with the current exchange rate applicable in the importing Party.	dollar (USD) for importation in Korea. 5. Where the value of the products is invoiced or declared in a currency other than those mentioned in paragraphs 3 and 4 the amount equivalent to the amount expressed in the national currency of the importing Party shall be applied.	in the national currencies of the Parties equivalent to the amounts expressed in euro or US dollars shall be fixed in accordance with the current exchange rate applicable in the importing Party.

TABLE 7.39 *Korea's free-trade agreements: Accounting segregation*

Korea–US	Korea–EU	Korea–ASEAN	Korea–Canada	Korea–EFTA	Korea–Singapore	Korea–Australia	Korea–India Cepa	Korea–Chile	Korea–Peru	Korea–Turkey
Article 6.7: Fungible Goods and Materials 1. Each Party shall provide that an importer claiming preferential tariff treatment for a good may claim that a fungible good or material is originating where the importer, exporter, or producer has: (a) physically segregated each fungible good or material; or (b) used any inventory management method, such as averaging, LIFO or FIFO, recognized in the Generally	Article 11: Accounting Segregation of Materials, Protocol Originating Products 1. Where identical and interchangeable originating and non-originating materials are used in the manufacture of a product, those materials shall be physically segregated, according to their origin, during storage. 2. Where considerable costs or material difficulties arise	Rule 14, Annex 3: Identical and Interchangeable Materials 1. For the purposes of establishing the origin of a good, when the good is manufactured utilising originating and non-originating materials, mixed or physically combined, the origin of such materials can be determined by generally accepted accounting principles of inventory management practiced in the territory of the exporting Party. 2. Once a	Article 3.9: Fungible Materials and Goods 1. For the purposes of determining whether a material or good is an originating material or good, any fungible material or good shall be distinguished by: (a) physically separating each fungible material or good; or (b) using any inventory management method recognised in the Generally Accepted	Article 11, Annex 1: Segregation of Materials 1. Where identical and interchangeable originating and non-originating materials are used in the manufacture of a product, those materials shall be physically segregated, according to their origin, during storage. "Identical and interchangeable materials" means materials being of the same kind and commercial quality, possessing the	Article 4.11: Fungible Goods and Materials 1. The determination of whether fungible goods or materials are originating goods shall be made either by physical segregation of each good or material or through the use of any of the inventory management method, such as averaging, last-in, first-out, or first in, first-out, recognised in the Generally Accepted	Article 3.7: Fungible Goods and Materials 1. An importer claiming preferential tariff treatment for a good may claim that a fungible good or material is originating where the importer, exporter, or producer has: (a) physically segregated each fungible good or material; or (b) used any inventory management method, such as averaging, LIFO or FIFO, recognised in	Article 3.12: Fungible Materials 1. Where identical and interchangeable originating and non-originating materials are used in the manufacture of a product, those materials shall be physically segregated, according to their origin, during storage. 2. A producer facing considerable costs or material difficulties in keeping separate stocks of identical and	Article 4.7 Fungible Goods and Materials 1. For purposes of determining whether a good is an originating good: (a) where originating and non-originating fungible materials are used in the production of a good, the determination of whether the materials are originating need not be made through the identification of any specific fungible material, but	Article 3.8: Fungible Goods and Materials 1. In determining whether a good or material is originating for purposes of granting preferential tariff treatment, any fungible goods or materials shall be distinguished by: (a) physically separating each fungible good or material; or (b) using any inventory management method, such as averaging, LIFO or FIFO,	Article 11: Protocol on Origin and Origin Procedures Accounting Segregation of Materials 1. Where identical and interchangeable originating and non-originating materials are used in the manufacture of a product, those materials shall be physically segregated, according to their origin, during storage. 2. Where considerable costs or material difficulties arise in keeping separate stocks of

Accepted Accounting Principles of the Party in which the production is performed or otherwise accepted by the Party in which the production is performed.
2. Each Party shall provide that the inventory management method selected under paragraph 1 for a particular fungible good or material shall continue to be used for that good or material throughout the fiscal year of the person that selected the inventory management method.

in keeping separate stocks of identical and interchangeable originating and non-originating materials used in the manufacture of a product, the producer may use the so-called "accounting segregation" method for managing stocks.
3. This method is recorded and applied in accordance with the generally accepted accounting principles applicable in the Party where the product is manufactured.
4. This method must be able to

decision has been taken on the inventory management method, that method shall be used throughout the fiscal year.

Accounting Principles of the Party in which the production is performed or otherwise accepted by that Party in which the production is performed.
2. Once a particular inventory management method is selected under paragraph 1, that method shall continue to be used for those fungible materials or goods throughout the fiscal year of the person that selected the inventory

same technical and physical characteristics, and which once they are incorporated into the finished product cannot be distinguished from one another for origin purposes.
2. A producer facing considerable costs or material difficulties in keeping separate stocks of identical and interchangeable originating and non-originating materials used in the manufacture of a product, may use the so-called "accounting

Accounting Principles of a Party in which the production is performed or otherwise accepted by the Party in which the production is performed.
2. Once a particular inventory management method is selected under paragraph 1, that method shall continue to be used for those fungible goods or materials throughout the fiscal year of the person that selected the inventory management method.

the Generally Accepted Accounting Principles of the Party in which the production is performed or otherwise accepted by the Party in which the production is performed.
2. The inventory management method selected in accordance with paragraph 1 for a particular fungible good or material shall continue to be used for that good or material throughout the fiscal year of the person that selected the inventory

interchangeable originating and non-originating materials used in the manufacture of a product, may use the so-called "accounting segregation" method for managing stocks.
3. The accounting method shall be recorded, applied and maintained in accordance with Generally Accepted Accounting Principles applicable in the Party in which the product is manufactured. The method chosen shall:

shall be determined on the basis of any of the inventory management methods set out in the Uniform Regulations; and (b) where originating and non-originating fungible goods are commingled and exported in the same form, the determination shall be made on the basis of any of the inventory management methods set out in the Uniform Regulations.
2. Once a decision has been taken on the inventory management

recognized in the generally accepted accounting principles of a Party in which the production is performed or otherwise accepted by the Party in which the production is performed.
2. The inventory management method selected under paragraph 1 for a particular fungible good or material shall continue to be used for that good or material throughout the fiscal year of the person that selected the inventory

identical and interchangeable originating and non-originating materials used in the manufacture of a product, the producer may use the so-called "accounting segregation" method for managing stocks.
3. This method is recorded and applied in accordance with the generally accepted accounting principles applicable in the Party where the product is manufactured.
4. This method must be able to ensure that, for a specific reference-period, no more products receive

(*continued*)

TABLE 7.39 (*continued*)

Korea–US	Korea–EU	Korea–ASEAN	Korea–Canada	Korea–EFTA	Korea–Singapore	Korea–Australia	Korea–India Cepa	Korea–Chile	Korea–Peru	Korea–Turkey
	ensure that, for a specific reference-period, no more products receive originating status than would be the case if the materials had been physically segregated. 5. A Party may require that the application of the method for managing stocks provided for in this Article is subject to a prior authorisation by customs authorities. Should this be the case, the customs authorities may		management method.	segregation" method for managing stocks. 3. The accounting method shall be recorded, applied and maintained in accordance with generally accepted accounting principles applicable in the Party in which the product is manufactured. The method chosen must: (a) permit a clear distinction to be made between originating and nonoriginating materials		management method.	(a) permit a clear distinction to be made between originating and nonoriginating materials acquired and/or kept in stock; and (b) guarantee that no more products receive originating status than would be the case if the materials had been physically segregated.	method, this method shall be used throughout the fiscal year.	management method.	originating status than would be the case if the materials had been physically segregated. 5. A Party may require that the application of the method for managing stocks provided for in this Article is subject to a prior authorisation by customs authorities. Should this be the case, the customs authorities may grant such an authorisation subject to any conditions deemed appropriate and they shall

grant such an authorisation subject to any conditions deemed appropriate and they shall monitor the use of the authorisation and may withdraw it at any time whenever the beneficiary makes improper use of it in any manner or fails to fulfil any of the other conditions laid down in this Protocol.

acquired and/or kept in stock; and

(b) guarantee that no more products receive originating status than would be the case if the materials had been physically segregated.

4. The producer using this facilitation shall assume full responsibility that origin declarations are completed for the quantity of products considered as originating and for keeping all documentary evidence of origin of the materials. At the

monitor the use of the authorisation and may withdraw it at any time whenever the beneficiary makes improper use of it in any manner or fails to fulfil any of the other conditions laid down in this Protocol.

(*continued*)

TABLE 7.39 (*continued*)

Korea–US	Korea–EU	Korea–ASEAN	Korea–Canada	Korea–EFTA	Korea–Singapore	Korea–Australia	Korea–India Cepa	Korea–Chile	Korea–Peru	Korea–Turkey
				request of the customs authorities, the producer shall provide satisfactory information on how the stocks have been managed. 5. A Party may require that the application of the method for managing stocks as provided for in this Article is subject to prior authorization by customs authorities.						

TABLE 7.40 *Korea's free-trade agreements: Documentary evidence of direct shipment requirement*

Korea–US	Korea–EU	Korea–ASEAN	Korea–Canada	Korea–EFTA	Korea–Singapore	Korea–Australia	Korea–India Cepa	Korea–Chile	Korea–Peru	Korea–Turkey
No specific provisions.	Article 13: Direct Transport, Protocol Originating Products 1. The preferential treatment provided for under this Agreement applies only to products, satisfying the requirements of this Protocol, which are transported directly between the Parties. However, products constituting one single	Rule 9, Appendix 1 For the purposes of claiming preferential tariff treatment, the importer shall submit to the customs authority of the importing Party at the time of import, a declaration, a Certificate of Origin including supporting documents (i.e. invoices and, when required, the through Bill of Lading issued in the territory of the exporting Party) and other	Memorandum of Understanding Between Canada and The Republic of Korea Concerning Uniform Regulations for the Interpretation, Application and Administration of Chapter Four of the Free Trade Agreement Between Canada and The Republic of Korea 7. Pursuant to Article 4.2.1(d) of the Agreement, the importer, at the request of the customs	Article 14, Annex 1 2. The importer shall upon request supply the appropriate evidence that the conditions set out in paragraph 1 have been fulfilled, to the customs authority in accordance with the laws and regulations of the importing Party.	Yes, upon request Article 5.9 (c) if, where the good is shipped through or transshipped in the territory of a country that is not a Party under this Agreement, the importer of the good does not provide, on the request of that Party's customs administration: (i) a copy of the customs control documents that indicate, to the satisfaction of the importing Party's customs administration, that the goods remained under	No specific provisions.	Article 4.8 3. For the purposes of paragraph 1(d), the customs authority of the importing Party may require an importer to demonstrate that the good was shipped in accordance with Article 3.15 (Direct Consignment) by providing with: (a) bills of lading or waybills indicating the shipping route and all points of shipment and transhipment prior to the importation of	No specific provisions.	Article 3.14: Direct Transport 3. Compliance with paragraphs 1 and 2 shall be demonstrated by presenting the following documentation to the customs authority of the importing Party: (a) in the case of transit or transshipment, the transportation documents, such as the airway bill, the bill of lading, or the multimodal or combined transportation document, that certify the transport from the	Article 13.2: Protocol on Origin and Origin Procedures 2. Evidence that the conditions set out in paragraph 1 have been fulfilled shall be supplied to the customs authority, in accordance with the procedures applicable in the importing Party, by the production of one of the following: (a) evidence of the circumstances connected with transhipment or the storage of the

(*continued*)

TABLE 7.40 (*continued*)

Korea–US	Korea–EU	Korea–ASEAN	Korea–Canada	Korea–EFTA	Korea–Singapore	Korea–Australia	Korea–India Cepa	Korea–Chile	Korea–Peru	Korea–Turkey
	consignment may be transported through other territories with, should the occasion arise, transshipment or temporary warehousing in such territories, provided that they are not released for free circulation in the country of transit or warehousing and do not undergo operations other than unloading, reloading or any operation designed to preserve them in good condition. 2. Evidence that	documents as required in accordance with the domestic laws and regulations of the importing Party.	administration of the Participant of import, will demonstrate that the good was shipped in accordance with Article 3.16 (Transit and Transhipment) of the Agreement by providing that Participant's customs administration with: (a) bill(s) of lading or waybill(s) indicating the shipping route and all points of shipment and transhipment prior to the importation of the good; and		customs control while in the territory of such non-Parties; (ii) any other information given by the customs administration of such non-Parties or other relevant entities, which evidences that they have not undergone, in such non-Parties, operation other than unloading, reloading, crating, packing, repacking or any other operation necessary to keep them in good condition; or (iii) any other information or commercial documents given by the importer		the good; and (b) where the good is shipped through or transhipped in a non-Party, a copy of the customs control documents indicating that the good remained under customs control while in that non-Party.		country of origin to the importing country, as the case may be; and (b) in the case of storage, the transportation documents, such as the airway bill, the bill of lading, or the multimodal or combined transportation document, that certify the transport from the country of origin to the importing country, as the case may be, as well as the documents issued by the customs authority or other competent authority that authorized this operation in	originating products in non-parties; (b) a single transport document covering the passage from the exporting Party through the country of transit; or (c) a certificate issued by the customs authorities of the country of transit: (i) giving an exact description of the products; (ii) stating the dates of unloading and reloading of the products and, where applicable, the names of the ships, or the other means of

the conditions set out in paragraph 1 have been fulfilled shall be supplied to the customs authority, in accordance with the procedures applicable in the importing Party, by the production of: (a) evidence of the circumstances connected with transshipment or the storage of the originating products in third countries; (b) a single transport document covering the passage from the exporting Party through the country of transit;	(b) if the good is transported through the territory of a non-participant, a copy of the customs control documents indicating to that customs administration that the good remained under customs control while in that non-participant territory.	which evidence that they have not undergone, in such non-Parties, operation other than unloading, reloading, crating, packing, repacking or any other operation necessary to keep them in good condition.	accordance with the domestic legislation of the non-Party.	transport used; and (iii) certifying the conditions under which the products remained in the country of transit.

(*continued*)

TABLE 7.40 (*continued*)

Korea–US	Korea–EU	Korea–ASEAN	Korea–Canada	Korea–EFTA	Korea–Singapore	Korea–Australia	Korea–India Cepa	Korea–Chile	Korea–Peru	Korea–Turkey
	or (c) a certificate issued by the customs authorities of the country of transit: (i) giving an exact description of the products; (ii) stating the dates of unloading and reloading of the products and, where applicable, the names of the ships, or the other means of transport used; and (iii) certifying the conditions under which the products remained in the country of transit.									

TABLE 7.41 *Korea's free-trade agreements: Exporter record keeping*

Korea–US	Korea–EU	Korea–ASEAN	Korea–Canada	Korea–EFTA	Korea–Singapore	Korea–Australia	Korea–India Cepa	Korea–Chile	Korea–Peru	Korea–Turkey
5 years Article 6.17: Record-Keeping Requirements 1. Each Party shall provide that an exporter or a producer in its territory that provides a certification in accordance with Article 6.15 shall maintain, for a minimum of five years from the date the certification was issued, all records necessary to demonstrate that a good for which the producer or exporter provided a certification was an originating good, including records concerning: (a) the purchase of, cost of, value of, and payment	5 years Article 23, Protocol Originating Products: Preservation of Proof of Origin and Supporting Documents 1. The exporter making out an origin declaration shall keep for five years a copy of this origin declaration as well as the documents referred to in Article 16.3. 2. The importer shall keep all records related to the importation in accordance with laws and regulations of the importing Party. 3. The customs authorities of the importing Party shall keep for five years the origin	3 years Rule 13, Appendix 1 1. For the purposes of the verification process pursuant to Rules 14 and 15, the producer and/or exporter applying for the issuance of a Certificate of Origin shall, subject to the domestic laws and regulations of the exporting Party, keep its supporting records for application for not less than three (3) years from the date of issuance of the Certificate of Origin. 2. The importer shall keep records relevant to the importation in accordance with the	5 years Article 4.5: Record-Keeping Requirements Each Party shall provide that: (a) an exporter or a producer in its territory that completes and signs a Certificate of Origin must maintain, in its territory, for five years after the date on which the Certificate of Origin was signed or for a longer period as specified by the Party, records relating to the origin of a good for which preferential tariff treatment was claimed in the territory of the other Party, including records associated with: (i) the purchase of, cost of, value	5 years Article 21, Annex 1: Record-Keeping Requirements 1. The exporter or the producer making out an origin declaration shall keep for a maximum of five years a copy of the origin declaration in question as well as the documents referred to in paragraph 7 of Article 15. 2. The importer shall keep all records related to the importation in accordance with national laws and regulation. 3. The records to be kept in accordance with paragraph 1 and 2 shall include	5 years Article 5.5: Record-Keeping Requirements 1. Each Party shall provide that an exporter and a producer in its territory that has obtained a certificate of origin shall maintain in its territory, for five (5) years after the date on which the certificate of origin was issued or for such longer period as the Party may specify, all records relating to the origin of a good for which preferential tariff treatment was claimed in the territory of the other Party, including records associated with: (a) the purchase of, cost of, value	5 years Article 3.22: Record Keeping Requirements 1. Each Party shall provide that: (a) an exporter or a producer that completes and signs, or applies for a Certificate of Origin shall maintain, for five years after the date on which the Certificate of Origin was signed, all records necessary to demonstrate that the good for which the producer or exporter provided the Certificate of Origin was an originating good; and (b) an importer claiming preferential tariff treatment shall	5 years Article 4.10: Record Keeping Requirement 1. The application for a Certificate of Origin and all documents related to origin shall be retained by the Issuing Authorities, exporter and producer for not less than five years from the date of issuance of the Certificate of Origin. 2. A copy of the Certificate of Origin and all relevant import documents shall be retained by an importer for not less than five years from the date of importation. 3. An importer, exporter or	5 years Article 5.3: Obligations Regarding Importations 4. Each Party shall provide that an importer claiming preferential tariff treatment for a good imported into its territory maintain in that territory, for five years after the date of importation of the good or for such longer period as the Party may specify, such documentation, including a copy of the Certificate of Origin, as the Party may require relating to the importation of the good.	5 years Article 4.6: Record Keeping Requirement 1. The records that may be used to prove that a good covered by a Certificate of Origin is originating and has fulfilled other requirements under this Chapter and Chapter Three (Rules of Origin) include, but are not limited to: (a) documents related to the purchase of, cost of, value of, and payment for, the exported good; (b) documents related to the purchase of, cost of, value of, and payment for, all materials,	5 years Article 22: Protocol on Origin and Origin Procedures: Preservation of Origin Declaration and Supporting Documents 1. The exporter making out an origin declaration shall keep for five years a copy of this origin declaration as well as the documents referred to in Article 17.2. 2. The importer shall keep all records related to the importation in accordance with laws and regulations of the importing Party. 3. An importer or exporter may choose to maintain the

(*continued*)

TABLE 7.41 (*continued*)

Korea–US	Korea–EU	Korea–ASEAN	Korea–Canada	Korea–EFTA	Korea–Singapore	Korea–Australia	Korea–India Cepa	Korea–Chile	Korea–Peru	Korea–Turkey
for, the exported good; (b) the purchase of, cost of, value of, and payment for all materials, including indirect materials, used in the production of the exported good; (c) the production of the good in the form in which it was exported; and (d) such other documentation as the Parties may agree to require.	declarations submitted to them. 4. The records to be kept in accordance with paragraphs 1 through 3 may include electronic records.	domestic laws and regulations of the importing Party. 3. The application for Certificates of Origin and all documents related to such application shall be retained by the issuing authority for not less than three (3) years from the date of issuance. 4. Information relating to the validity of a Certificate of Origin shall be furnished upon request of the importing Party by an official authorised to sign a Certificate of Origin and certified by the appropriate government authorities. 5. Any	of, and payment for, the good that is exported from that Party's territory; (ii) the purchase of, cost of, value of, and payment for, all materials, including indirect materials, used in the production of the good that is exported from that Party's territory; (iii) the production of the good in the form in which the good is exported from that Party's territory; and (iv) other documentation as mutually agreed by both parties; and (b) an importer claiming preferential tariff treatment for a good	electronic records.	of, shipping of, and payment for, the good that is exported from its territory; (b) the sourcing of, the purchase of, cost of, value of, and payment for, all materials, including neutral elements, used in the production of the good that is exported from its territory; and (c) the production of the good in the form in which the good is exported from its territory. 2. Each Party shall provide that an importer claiming preferential tariff treatment for a good imported into the Party's territory shall maintain in that territory, for five (5) years after the date of	maintain, for five years after the date of importation of the good, such documentation, including a copy of the Certificate of Origin, as the Party may require relating to the importation of the good. 2. Each Party shall provide that an importer, exporter or producer may choose to maintain the records specified in paragraph 1 in any medium that allows for prompt retrieval, including, but not limited to, digital, electronic, optical, magnetic or written form.	producer may choose to maintain records specified in paragraphs 1 and 2 in any medium that allows for prompt retrieval, including, but not limited to, digital, electronic, optical, magnetic or hard copy. 4. Importers, exporters and producers that are required to maintain documents related to origin pursuant to paragraphs 1 and 2 will make those documents available for inspection by an officer of the customs authority or Issuing Authorities of a Party		including indirect materials, used in the production of the exported good; (c) documents related to the production of the good in the form in which it was exported; and (d) such other documents as the Parties may agree. 2. An exporter or producer in the territory of the exporting Party that completes and signs a Certificate of Origin shall keep, at least for five years from the date of issuance of the Certificate of Origin, the records referred to in paragraph 1. 3. An importer claiming	records specified in paragraphs 1 and 2 in any medium that allows for prompt retrieval, including, but not limited to, digital, electronic, optical, magnetic, or written form.

information communicated between the Parties concerned shall be treated as confidential and shall be used for the validation of Certificates of Origin purpose only.	imported into the Party's territory must maintain, in that Party's territory, for five years after the date of importation of the good or for a longer period as specified by that Party, records relating to the importation of the good required by that Party, including a copy of the Certificate of Origin.	importation of the good or for such longer period as the Party may specify, such documentation, including a copy of the certificate of origin, as the Party may require relating to the importation of the good. 3. The records to be maintained in accordance with paragraphs 1 and 2 shall include electronic records and shall be maintained in accordance with the domestic laws and practices of each Party.	conducting a verification visit and provide facilities for inspection thereof.	preferential tariff treatment for a good imported into the territory of a Party shall keep, at least for five years from the date of importation of the good, the records related to the importation, including a copy of the Certificate of Origin. 4. An importer, exporter, or producer may choose to keep the records referred to in paragraph 1 in any medium that allows for prompt retrieval, including, but not limited to, digital, electronic, optical, magnetic, or written form.

TABLE 7.42 *Korea's free-trade agreements: Advance rulings*

Korea–US	Korea–EU	Korea–ASEAN	Korea–Canada	Korea–EFTA	Korea–Singapore	Korea–Australia	Korea–India CEPA	Korea–Chile	Korea–Peru	Korea–Turkey
Article 7.10: Advance Rulings 1. Each Party shall issue, through its customs authority, before a good is imported into its territory, a written advance ruling at the written request of an importer in its territory, or an exporter or producer in the territory of the other Party4 with regard to: (a) tariff classification; (b) the application of customs valuation criteria for a particular case, in accordance with the Customs Valuation Agreement; (c) the application of duty drawback, deferral, or other relief from customs duties; (d) whether a good is originating;	Article 6.6: Advance Rulings 1. Upon written request from traders, each Party shall issue written advance rulings, through its customs authorities, prior to the importation of a good into its territory in accordance with its laws and regulations, on tariff classification, origin or any other such matters as the Party may decide. 2. Subject to any confidentiality requirements in its laws and regulations, each Party shall publish, e.g. on the Internet, its advance rulings on tariff classification and any other such matters as the Party may decide. 3. To facilitate trade, the Parties shall	No specific provisions.	Article 4.10: Advance Rulings 1. Each Party shall, through its customs administration, provide for the expeditious issuance of written advance rulings, prior to the importation of a good into its territory, to an importer in its territory or an exporter or a producer in the territory of the other Party on the basis of the facts and circumstances presented by that importer, exporter, or producer of the good, concerning: (a) whether materials imported from a non-party used in the production of a good undergo an applicable change in tariff classification set out in Annex 3-A	No specific provisions.	Article 5.8: Advance Rulings 1. Prior to the importation of a good into its territory, each Party, through its customs administration, shall provide for the issuance of written advance rulings to an importer of the good in its territory or to an exporter or producer of the good in the other Party's territory concerning tariff classification, questions arising from the application of the Customs Valuation Agreement and country of origin so as to determine whether the good qualifies as an originating good. 2. Each Party shall adopt or maintain procedures for the issuance of advance	Article 4.7: Advance Rulings 1. Each Party shall issue, through its customs administration, prior to the importation of a good into its territory, a written advance ruling at the written request of an importer in its territory, or an exporter or producer in the territory of the other Party with regard to: (a) tariff classification; (b) the application of customs valuation criteria for a particular case, in accordance with the provisions of the Customs Valuation Agreement;	No specific provisions.	Article 5.9: Advance Rulings on Determinations of Origin 1. Each Party shall, through its competent authorities, provide for the expeditious issuance of written advanced rulings, prior to the importation of a good into its territory, to an importer in its territory or an exporter or a producer in the territory of the other Party, on the basis of the facts and circumstances presented by such an importer, an exporter or a producer of the good, concerning: (a) whether a good qualifies as an originating good under Chapter 4; (b) whether materials imported from a non-Party used in the production of a good undergo an applicable	Article 5.7: Advance Rulings 1. The Parties shall adopt or maintain procedures for the issuance of advance rulings on the following matters: (a) tariff classification; (b) execution of the rules of origin; and (c) such other matters as the Parties may agree. 2. Procedures for the issuance of these advance rulings shall include at least: (a) a maximum term of 120 days for issuance or such shorter period as may be established by a Party, starting from the date on which all the requirements by the competent authority are met; (b) conditions for their validation, revocation, and publication; and (c) sanctions 3. Upon written request of importers, exporters, or producers, each Party shall issue, through its customs administration or	Article 3.8: Advance Rulings 1. Upon written request from traders, each Party shall issue written advance rulings, through its customs authorities, prior to the importation of a good into its territory in accordance with its laws and regulations, on tariff classification, origin or any other such matters as the Party may decide. 2. Subject to any confidentiality requirements in its laws and regulations, each Party shall publish, e.g. on the Internet, its advance rulings on tariff classification and any other such matters as the Party may decide. 3. To facilitate trade, the Parties shall

(e) whether a good re-entered into the territory of a Party after being exported to the territory of the other Party for repair or alteration is eligible for duty free treatment in accordance with Article 2.6 (Goods Re-entered after Repair or Alteration); (f) country of origin marking; (g) whether a good is subject to a quota or tariff-rate quota; and (h) such other matters as the Parties may agree. 2. Each Party shall issue an advance ruling within 90 days after its customs authority receives a request, provided that the requester has submitted all information that the Party requires, including, if the Party requests, a sample of the good for which the requester is seeking	include in their bilateral dialogue regular updates on changes in their respective legislation on the matters referred to in paragraphs 1 and 2.	(Product Specific Rules) as a result of production occurring entirely in the territory of one or both of the Parties; (b) whether a good satisfies a value test, based on either the transaction value or ex-works price or the net cost of the good, as set out in Chapter Three (Rules of Origin); (c) for the purpose of determining whether a good satisfies a value test under Chapter Three (Rules of Origin), the appropriate basis for value to be applied by an exporter or a producer in the territory of the other Party, in accordance with the principles of the Customs Valuation Agreement, for calculating the transaction value or ex-works price of the good or of the	rulings, including: (a) the provision that an importer or its agent in its territory or an exporter or producer or their agent in the territory of the other Party may request such a ruling prior to the importation in question; (b) a detailed description of the information required to process a request for an advance ruling; and (c) the provision that the advance ruling be based on the facts and circumstances presented by the person requesting the ruling. 3. Each Party shall provide that its customs administrations: (a) may request, at any time during the course of evaluating an application for an advance ruling, additional information	(c) whether a good is originating in accordance with Chapter 3 (Rules of Origin and Origin Procedures); and (d) such other matters as the Parties may agree. 2. Each Party shall adopt or maintain procedures for issuing written advance rulings which: (a) include a detailed description of the information required to process a request for an advance ruling; (b) allow its customs administration, at any time during the course of an evaluation of an application for an advance ruling, to request that the applicant provide additional information,	change in tariff classification set out in Annex 4 as a result of production occurring entirely in the territory of one or both of the Parties; (c) whether a good satisfies a regional value-content requirement under either the build-down method or the build-up method set out in Chapter 4; (d) for the purpose of determining whether a good satisfies a regional value-content requirement under Chapter 4, the appropriate basis or method for value to be applied by an exporter or a producer in the territory of the other Party, in accordance with the principles of the Customs Valuation Agreement, for calculating the adjusted value of the good or of the materials used in the production of the good;	competent authority, written advance rulings on customs matters, in particular on tariff classification and rules of origin, in accordance with the legislation of each Party. 4. Detailed procedures, and in particular deadlines, for the issuance, use, and revocation of advance rulings shall be set out in the legislation of each Party. 5. Peru shall fully implement the obligations under paragraph 1 from January 1, 2012	include in their bilateral dialogue regular updates on changes in their respective legislation on the matters referred to in paragraphs 1 and 2.

(*continued*)

TABLE 7.42 (*continued*)

Korea–US	Korea–EU	Korea–ASEAN	Korea–Canada	Korea–EFTA	Korea–Singapore	Korea–Australia	Korea–India CEPA	Korea–Chile	Korea–Peru	Korea–Turkey
an advance ruling. In issuing an advance ruling, the Party shall take into account facts and circumstances the requester has provided. For greater certainty, a Party may decline to issue an advance ruling if the facts and circumstances forming the basis of the advance ruling are the subject of administrative or judicial review. A Party that, pursuant to this paragraph, declines to issue an advance ruling shall promptly notify the requester in writing, setting forth the relevant facts and the basis for its decision to decline to issue the advance ruling. 3. Each Party shall provide that advance rulings shall take effect on the date			materials used in the production of the good; (d) whether a good qualifies as an originating good under Chapter Three (Rules of Origin); (e) whether a good that re-enters its territory after the good has been exported from its territory to the territory of the other Party for repair or alteration qualifies for duty-free treatment in accordance with Article 2.6 (Goods Re-Entered after Repair or Alteration); (f) tariff classification, applicable rate of customs duty, or any tax applicable on importation; or (g) other matters as agreed by the Parties. 2. Each Party shall adopt or maintain		necessary to evaluate the application; (b) shall issue the advance ruling expeditiously, and in any case within ninety (90) days of obtaining all necessary information; and (c) shall provide, upon request of the person who requested the advance ruling, a full explanation of the reasons for the ruling. 4. The importing Party may modify or revoke the issued ruling: (a) if the ruling was based on an error of fact; (b) if there is a change in the material facts or circumstances on which the ruling was based; (c) to conform with an amendment to	which may include a sample of the goods, necessary to evaluate the request; (c) ensure that an advance ruling be based on the facts and circumstances presented by the applicant and any other relevant information in the possession of the decision-maker; (d) provide that an advance ruling be issued to the applicant expeditiously, and within a period specified in its laws, regulations or administrative procedures, after the receipt of all necessary information; and (e) provide that its customs		(e) for the purpose of determining whether a good satisfies a regional value-content requirement under Chapter 4, the appropriate basis or method for reasonably allocating costs, in accordance with the allocation methods set out in the Uniform Regulations, for calculating the value of an intermediate material; (f) whether a good that re-enters its territory after the good has been exported from its territory to the territory of the other Party for repair or alteration qualifies for duty free treatment in accordance with Article 3.7; or (g) such other matters as the Parties may agree. 2. Each Party shall adopt or maintain		

they are issued, or on another date specified in the ruling, provided that the facts or circumstances on which the ruling is based remain unchanged.
4. The issuing Party may modify or revoke an advance ruling after the Party notifies the requester. The issuing Party may modify or revoke a ruling retroactively only if the ruling was based on inaccurate or false information.
5. Each Party shall ensure that requesters have access to administrative review of advance rulings.

6. Subject to any confidentiality requirements in its laws, each Party shall publish its advance rulings, including on the Internet.

procedures for the issuance of advance rulings, including a detailed description of the information reasonably required to process an application for a ruling.
3. Each Party shall provide that its customs administration:
(a) during the course of an evaluation of an application for an advance ruling, may request supplemental information from the person requesting the ruling;
(b) after it has obtained all necessary information from the person requesting an advance ruling, shall issue the ruling within the amount of time specified in the Uniform Regulations; and
(c) if the advance ruling is unfavourable to the

this Agreement; or
(d) to conform with a judicial or administration decision or a change in its domestic laws and regulations.
5. Each Party shall provide that any modification or revocation of an advance ruling is effective on the date on which the modification or revocation is issued, or on such a later date as may be specified therein, and shall not be applied to importations of a good that have occurred prior to that date, unless the person to whom the advance ruling was issued has not acted in accordance with its terms and conditions.
6. Notwithstanding paragraph 5, the issuing Party shall postpone the effective date of such

administration provides a written explanation of the reasons for the advance ruling.
3. A Party may decline to issue an advance ruling if the facts and circumstances forming the basis of the advance ruling are the subject of administrative or judicial review. A Party that, in accordance with this paragraph, declines to issue an advance ruling, shall promptly notify the requestor in writing, setting forth the relevant facts and the basis for its decision to decline to issue the advance ruling.
4. Each Party shall provide that advance rulings shall be in force from the date they

procedures for the issuance of advanced rulings, including a detailed description of the information reasonably required to process an application for a ruling.
3. Each Party shall provide that its competent authorities:
(a) may, at any time during the course of an evaluation of an application for an advanced ruling, request supplemental information from the person requesting the ruling;
(b) shall, after it has obtained all necessary information from the person requesting an advanced ruling, issue the ruling within the periods specified in the Uniform Regulations; and
(c) shall, where the advanced ruling is unfavourable to the person requesting it, provide to that person with a full explanation of the reasons for the

(*continued*)

TABLE 7.42 (*continued*)

Korea–US	Korea–EU	Korea–ASEAN	Korea–Canada	Korea–EFTA	Korea–Singapore	Korea–Australia	Korea–India CEPA	Korea–Chile	Korea–Peru	Korea–Turkey
7. If a requester provides false information or omits relevant facts or circumstances relating to the advance ruling, or does not act in accordance with the ruling's terms and conditions, the importing Party may apply appropriate measures, including civil, criminal, and administrative actions, monetary penalties, or other sanctions.			person requesting it, shall provide that person with a full explanation of the reasons for the ruling. 4. Each Party may provide that the customs administration may decline or postpone the issuance of the advance ruling, if an application for an advance ruling involves an issue that is the subject of: (a) a verification of origin; (b) a review by, or appeal to, the customs administration; or (c) in accordance with its domestic law, a judicial or quasi-judicial review in its territory. 5. Subject to paragraph 7, each Party shall apply an advance ruling to importations into its territory of the good		modification or revocation for a period not exceeding sixty (60) days where the person to whom the advance ruling was issued demonstrates that it has relied in good faith to its detriment on that ruling. 7. Each Party shall provide that where it issues an advance ruling to a person that has misrepresented or omitted material facts or circumstances or failed to act in accordance with the terms and conditions of the ruling, the Party may impose penalties or deny the preferential tariff treatment as the circumstances may warrant. 8. A good that is subject to an origin verification process or any instance of	are issued, or another date specified in the ruling, provided that the facts or circumstances on which the ruling is based remain unchanged. Subject to paragraphs 1 and 5, an advance ruling shall remain in force for no less than five years, or such other period as specified in the laws, regulations or administrative rulings of the issuing Party. 5. The issuing Party may modify or revoke an advance ruling after the Party notifies the requestor, and where, consistent with this Agreement: (a) there is a change in its laws		ruling. 4. Subject to paragraph 6, each Party shall apply an advanced ruling to importations into its territory of the good for which the ruling was requested, beginning on the date of its issuance or such a later date as may be specified in the ruling. 5. Each Party shall provide to any person requesting an advanced ruling the same treatment, including the same interpretation and application of the provisions of Chapter 4 regarding a determination of origin, as it provided to any other person to whom it issued an advanced ruling, provided that the facts and circumstances are identical in all material respects. 6. The issuing Party may modify or revoke an advanced ruling:		

for which the ruling was requested, beginning on the date of its issuance or a later date as may be specified in the ruling.
6. Each Party shall provide consistent treatment with respect to the application for advance rulings provided that the facts and circumstances are identical in all material respects.
7. The issuing Party may modify or revoke an advance ruling:
(a) if the ruling is based on an error:
(i) of fact;
(ii) in the tariff classification of a good or a material that is the subject of the ruling;
(iii) in the application of a value test under Chapter Three (Rules of Origin); or
(iv) in the application of the

review or appeal in the territory of one of the Parties may not be the subject of an advance ruling.
9. Subject to paragraph 10, each Party shall apply an advance ruling to importations into its territory of the relevant good from the date of its issuance or from such later date as may be specified in the ruling.
10. The importing Party shall apply the advance ruling for three (3) years from the date of issuance of the ruling.

and regulations;
(b) incorrect information was provided or relevant information was withheld;
(c) there is a change in a material fact; or
(d) there is a change in the circumstances on which the ruling was based.
6. The issuing Party may modify or revoke an advance ruling retroactively if the requestor, intentionally or negligently, provided incorrect information or withheld relevant information.
7. Each Party shall endeavour to publish its advance rulings, subject to its laws, regulations and administrative procedures.

(a) if the ruling is based on an error:
(i) of fact;
(ii) in the tariff classification of a good or a material that is the subject of the ruling;
(iii) in the application of a regional value-content requirement under Chapter 4; or
(iv) in the application of the rules for determining whether a good that re-enters its territory after the good has been exported from its territory to the territory of the other Party for repair or alteration qualifies for duty-free treatment under Article 3.7;
(b) if the ruling is not in accordance with an interpretation agreed by the Parties regarding Chapter 3 or Chapter 4;
(c) if there is a change in the material facts or circumstances on which the ruling is based;
(d) to conform with a modification of Chapter 3, Chapter 4,

(*continued*)

TABLE 7.42 (*continued*)

Korea–US	Korea–EU	Korea–ASEAN	Korea–Canada	Korea–EFTA	Korea–Singapore	Korea–Australia	Korea–India CEPA	Korea–Chile	Korea–Peru	Korea–Turkey
			rules for determining whether a good that re-enters its territory after the good has been exported from its territory to the territory of the other Party for repair or alteration qualifies for duty-free treatment under Article 2.6 (Goods Re-Entered after Repair or Alteration); (b) if the ruling is not in accordance with an interpretation agreed by the Parties regarding Chapter Two (National Treatment and Market Access for Goods) or Chapter Three (Rules of Origin); (c) if there is a change in the material facts or circumstances on which the ruling is based; (d) to conform with a modification of Chapter Two					this Chapter or the Uniform Regulations; or (e) to conform with a judicial or administrative decision or a change in its domestic law. 7. Each Party shall provide that any modification or revocation of an advanced ruling is effective on the date on which the modification or revocation is issued, or on such a later date as may be specified therein, and shall not be applied to importations of a good that have occurred prior to that date, unless the person to whom the advanced ruling was issued has not acted in accordance with its terms and conditions. 8. Notwithstanding paragraph 7, the issuing Party shall postpone the effective		

(National Treatment and Market Access for Goods), Chapter Three (Rules of Origin), this Chapter or the Uniform Regulations; or
(e) to conform with a judicial decision or a change in its domestic law.
8. Each Party shall provide that a modification or revocation of an advance ruling shall be effective on the date on which the modification or revocation is issued, or on a later date as may be specified in the ruling, and shall not be applied to importations of a good that have occurred prior to that date, unless the person to which the advance ruling was issued has not acted in accordance with its terms and conditions.
9. Notwithstanding paragraph 8, the date of such modification or revocation for a period not exceeding 90 days where the person to whom the advanced ruling was issued demonstrates that it has relied in good faith to its detriment on that ruling.
9. Each Party shall provide that where its competent authorities examine the regional value content of a good for which it has issued an advanced ruling pursuant to subparagraphs 1(d), (e) and (f), it shall evaluate whether:
(a) the exporter or producer has complied with the terms and conditions of the advanced ruling;
(b) the exporter's or producer's operations are consistent with the material facts and circumstances on which the advanced ruling is based; and
(c) the supporting data and computations

(*continued*)

TABLE 7.42 (*continued*)

Korea–US	Korea–EU	Korea–ASEAN	Korea–Canada	Korea–EFTA	Korea–Singapore	Korea–Australia	Korea–India CEPA	Korea–Chile	Korea–Peru	Korea–Turkey
			issuing Party shall postpone the effective date of the modification or revocation for a period not exceeding 90 days if the person to which the advance ruling was issued demonstrates that it has relied in good faith on that ruling to its detriment. 10. Each Party shall provide that, if its customs administration examines the value test of a good for which it has issued an advance ruling, the customs administration shall evaluate whether: (a) the exporter or producer has complied with the terms and conditions of the advance ruling; (b) the exporter's or producer's operations are						used in applying the basis or method for calculating value or allocating cost were correct in all material respects. 10. Each Party shall provide that where its competent authority determines that any requirement in paragraph 9 has not been satisfied, it may modify or revoke the advanced ruling as the circumstances may warrant. 11. Each Party shall provide that, where the person to whom an advanced ruling was issued demonstrates that it used reasonable care and acted in good faith in presenting the facts and circumstances on which the ruling was based, and where the competent authority of a Party determines that the ruling was based on incorrect information, the		

consistent with the material facts and circumstances on which the advance ruling is based; and (c) the supporting data and computations used in applying the basis or method for calculating value or allocating cost were correct in all material respects.

Each Party shall provide that, if its customs administration determines that a requirement in paragraph 10 has not been satisfied, the Party may modify or revoke the advance ruling if the circumstances warrant.

12. Each Party shall provide that:

(a) if the person to which an advance ruling was issued demonstrates that it used reasonable care and acted in good faith in presenting the facts and

person to whom the ruling was issued shall not be subject to penalties.

12. Each Party shall provide that where it issues an advanced ruling to a person that has misrepresented or omitted material facts or circumstances on which such a ruling is based or has failed to act in accordance with the terms and conditions of the ruling, the Party may apply such measures as the circumstances may warrant.

13. The Parties shall provide that the person to whom the advanced ruling was issued may use it only while the material facts or circumstances that were the basis of its issuance are still present. In this case, the person to whom the advanced ruling was issued may present the necessary information for the issuing authority to proceed pursuant to

(*continued*)

TABLE 7.42 (*continued*)

Korea–US	Korea–EU	Korea–ASEAN	Korea–Canada	Korea–EFTA	Korea–Singapore	Korea–Australia	Korea–India CEPA	Korea–Chile	Korea–Peru	Korea–Turkey
			circumstances on which the ruling was based; and (b) the customs administration of a Party determines that the ruling was based on incorrect information, the person to which the ruling was issued shall not be subject to penalties. 13. Each Party shall provide that if it issues an advance ruling to a person that has misrepresented or omitted material facts or circumstances on which the ruling is based, or has failed to act in accordance with the terms and conditions of the ruling, that Party may apply measures that are warranted by the circumstances, in accordance with its domestic law.					paragraph 6. 14. A good that is subject to an origin verification process or any instance of review or appeal in the territory of one of the Parties may not undergo an advanced ruling.		

	14. Each Party shall provide that an advance ruling remains in effect and will be honoured if there is no change in the material facts or circumstances on which it is based, in accordance with its domestic law.

TABLE 7.43 *Certification of Origin: Format and distribution of copies, Korea*

Korea–US	Korea–EU	Korea–ASEAN	Korea–Canada	Korea–EFTA	Korea–Singapore	Korea–Australia	Korea–India CEPA	Korea–Chile	Korea–Peru	Korea–Turkey
					Name of the form					
No official form is required, recommended form available	Invoice declaration	Form AK	Form for Korea–Canada free-trade agreement	Invoice declaration	Format of the certificate of origin issued by Korea/Format of the certificate of origin issued by Singapore	Format for Korea–Australia Free Trade Agreement (KAFTA)	Form KIN	Different for each country	Form for Korea–Peru free-trade agreement	Invoice declaration
					Specimen					
Data requirements in Paragraph 2 of Article 6.15 of the agreement	Must include declaration, name, date, and approved exporter number if applicable	Attachment of the agreement	Annex A	Appendix 3	Annex 5B (issued by Korea) and Annex 5C (issued by Singapore)	Annex 3-D, Data requirements on Annex 3-C	Annex 4-B	Annex 5B and Annex 5C	Appendix 4A-1 and Annex 4B	Annex III
					Format					
No prescribed format. Printed or electronic	No recommended form. Invoice,	A4 size paper. In English language. Shall	Printed or electronic format. In	No recommended form. Invoice,	In English language.	Printed or electronic format. In	Printed or electronic format. In	In English language.	Printed or electronic format. In	Invoice, delivery note, and/or other

form. In English or Korean language.	delivery note, and/or other commercial documents. In Korean or EU states language. (Article 15 Protocol)	bear a reference number separately given by each place or office of issuance.	language required under domestic law (English or Korean for Korea, English or French for Canada).	delivery note, and/or other commercial documents. In Korean or EU states language.		English language.	English language.		English language.	commercial document.
				Copies						
1 original 2 copies	Not specified	1 original 3 copies	Not specified	Not specified	Not specified	Not specified	1 original 3 copies	Not specified	1 original 3 copies	Not specified
				Distribution of copies						
Exporters should retain a copy for their records.	Not specified	Original shall be forwarded by the producer and/or exporter to the importer for submission to the customs authority of the importing party. The triplicate	CO must be completed legibly and in full by the exporter or producer and be in the possession of the importer at the time the	Not specified	Not specified	Not specified	The issuing authorities retain the duplicate. The original document should be forwarded, together with the triplicate by	Importers customs administration can request copy of CO. Importer should possess original CO at time of declaration.	Importers, exporters and competent authorities should keep a copy of CO for five years.	The exporter should retain copy of the original declaration for five years. The importer shall keep all records related in accordance with

(*continued*)

TABLE 7.43 (*continued*)

Korea–US	Korea–EU	Korea–ASEAN	Korea–Canada	Korea–EFTA	Korea–Singapore	Korea–Australia	Korea–India CEPA	Korea–Chile	Korea–Peru	Korea–Turkey
		shall be retained by the producer and/or exporter.	declaration is made.				the importer to the exporter for submission to the customs authority at the port or place of importation. The triplicate should be retained by the importer. The quadruplicate should be retained by importer.			laws and regulations of the importing party.

TABLE 7.44 *Definitions in China's free-trade agreements*

Definition	Explanation
Certificate of origin	China uses certificates of origin in all current free-trade agreements
Prior authorization (approved exporter)	No approved exporters
Prior registration (registered exporter)	Not applicable
Exporter declaration (standard)	Not applicable
Exporter declaration (with origin criteria)	No exporter declarations
Exporter declaration for small consignment	Applicable in China–Singapore, China–South Korea, and China–ASEAN
Long-term certificate for OM	Not applicable
Long-term certificate for NOM	Non applicable
Accounting segregation	China uses accounting segregation provisions
Documentary evidence of direct shipment requirement	Required in all free-trade agreements
Drawback rule	Not applicable
Exporter record keeping (# years)	Yes
Advance rulings	Yes

7.5.5 *China*

China is a relative newcomer to free-trade agreements, given that they have yet to develop a network comparable to other major traders. China's standard way of administering rules of origin is based in certifying authorities with exchanges of stamps and, in some free-trade agreements, specimen signatures. Of the free-trade agreements examined, the China–South Korea and the China–Singapore FTA agreements are those where more modern provisions are inserted, such as accounting segregation, advance ruling, and third-party invoice.[105]

[105] These tables were produced with the assistance of Chenao Li.

TABLE 7.45 *Mapping certification in China's free-trade agreements*

	China–Singapore[i]	China–Hong Kong[ii]	China–Korea[iii]	China–ASEAN[iv]
Certificate of origin	1. For the purpose of obtaining preferential tariff treatment in the other Party, a Certificate of Origin shall be issued by the authorised body of the exporting Party. 2. Each Party shall inform the customs administration of the other Party of the names and addresses of the authorised bodies issuing the Certificate of Origin and shall provide specimen impressions of official seals used by such authorised bodies. Any change in names, addresses or official seals shall be promptly notified to the other Party.	Procedure for the Issue and Check of the Certificate of Origin 5. A Certificate of Origin shall be issued by the authorized bodies, on the application by the exporter.	A Certificate of Origin as set out in Annex 3-C shall be issued by the authorized bodies of the exporting Party, on application by the exporter, producer, or under the exporter's responsibility, by his authorized representative, in accordance with the domestic legislation, subject to the condition that the goods concerned fulfill the requirements of this Chapter. Article 3.16: Authorized Body 1. Each Party shall inform the customs authority of the other Party of the name of each authorized body, as well as relevant contact details, and shall provide details of any specimen of stamps for relevant forms and	A claim that products shall be accepted as eligible for preferential concession shall be supported by a Certificate of Origin issued by a government authority designated by the exporting Party and notified to the other Parties to the Agreement in accordance with the Operational Certification Procedures, as set out in Attachment A.

			documents used by each authorized body, prior to the issuance of any certificates by that body. 2. Any change in the information provided above shall be promptly notified to the customs authority of the other Party and enter into force seven working days after the date of notification or on a later date indicated in such notification.	
Importer's knowledge	No	No	No	No
Exporter declaration for small consignment	Yes	No	No	Yes
Long-term certificate for OM	No	No	No	No
Long-term certificate for NOM	No	No	No	No

(*continued*)

TABLE 7.45 (*continued*)

	China–Singapore[i]	China–Hong Kong[ii]	China–Korea[iii]	China–ASEAN[iv]
Accounting segregation	Yes	No	Yes	No
Documentary evidence of direct shipment requirement	Yes	Yes	Yes	Yes
Averaging (value of non-originating materials)	No	No	No	No
Drawback rule	No	No	No	No
Exporter record keeping (# years)	3 years	No	3 years	No
Advance rulings	Yes	No	Yes	No
Pre-exportation examination	No	No	No	Yes
Non-party invoice	Yes	No	Yes	No
Cumulative rule of origin	Yes	No	No	Yes

[i] http://fta.mofcom.gov.cn/singapore/doc/cs_xieyi_en.zip.
[ii] http://fta.mofcom.gov.cn/topic/enhongkong.shtml.
[iii] http://fta.mofcom.gov.cn/korea/annex/xdzw_en.pdf.
[iv] http://fta.mofcom.gov.cn/dongmeng/annex/xieyi2004en.pdf.

TABLE 7.46 *China's free-trade agreements: Exporter declaration for small consignment*

	China–Singapore	China–Hong Kong	China–Korea	China–ASEAN
Exporter declaration for small consignment	Article 30: Waiver of Certificate of Origin Each Party shall provide that a Certificate of Origin shall not be required for: (a) a commercial importation of a good whose value does not exceed US$600 or its equivalent amount in the Party's currency, or such higher amount as it may establish, except that it may require that the invoice accompanying the importation include a statement certifying that the good qualifies as an originating good; or (b) a non-commercial importation of a good whose value does not exceed US$600 or its equivalent amount in the Party's currency, or such higher amount as it may establish, provided that the importation does not form part of a series of importations that may reasonably be considered to have been undertaken or arranged for the purpose of avoiding the certification requirements.	No	Article 3.19: Exemption of Obligation of Submitting Certificate of Origin 1. For the purpose of granting preferential tariff treatment under this Chapter, a Party shall waive the requirements for the presentation of a Certificate of Origin for consignment of originating products of a customs value not exceeding 700 US dollars or its equivalent amount in the Party's currency; or 2. Waivers provided for in paragraph 1 shall not be applicable when it is established by the customs authorities of the importing Party that the importation forms part of a series of importations that may reasonably be considered to have been undertaken or arranged for the purpose of avoiding the submission of a Certificate of Origin.	Rule 14 In the case of consignments of products originating in the exporting Party and not exceeding US$200.00 FOB, the production of a Certificate of Origin shall be waived and the use of simplified declaration by the exporter that the products in question have originated in the exporting Party will be accepted. Products sent through the post not exceeding US$200.00 FOB shall also be similarly treated.

TABLE 7.47 *China's free-trade agreements: Accounting segregation*

China–Singapore	China–Hong Kong	China–Korea	China–ASEAN
Article 21: Fungible Products and Materials In determining whether a good is an originating good, any interchangeable materials shall be distinguished by: (a) physical separation of the goods; or (b) an inventory management method recognised in the generally accepted accounting principles of the exporting Party.	No	Article 3.9: Fungible Materials 1. In determining whether a material used in the production is originating, any fungible materials shall be distinguished by: (a) physically separating each fungible material; or (b) using any inventory management method recognized in the Generally Accepted Accounting Principles of a Party in which the production is performed. 2. The inventory management method selected under paragraph 1 for a particular fungible material shall continue to be used for that material throughout the fiscal year.	No

TABLE 7.48 *China's free-trade agreements: Documentary evidence of direct shipment requirement*

China–Singapore	China–Hong Kong	China–Korea	China–ASEAN (ACFTA)
Article 18: Direct Consignment 1. Preferential tariff treatment provided for in this Agreement shall be applied to goods which satisfy	The Rules of Origin for Trade in Goods 10. The originating goods of the Parties claiming for preferential tariff treatment shall be	Article 3.14: Direct Transport 1. The originating goods of the Parties claiming for preferential tariff treatment shall be	Rule 8: Direct Consignment The following shall be considered as consigned directly from the exporting Party to the importing

TABLE 7.48 (*continued*)

China–Singapore	China–Hong Kong	China–Korea	China–ASEAN (ACFTA)
the requirements of this Chapter and are directly consigned between the Parties. 2. For the purposes of paragraph 1, the following shall be considered as consigned directly from the exporting Party to the importing Party: (a) goods that are transported without passing through the territory of a non-Party; (b) goods whose transport involves transit through one or more non-Parties with or without transshipment or temporary storage of up to three (3) months in such non-Parties provided that: (i) the goods do not enter into trade or commerce there; (ii) the goods do not undergo any operation there other than unloading and reloading, or any operation required to keep them in good condition; and (iii) the transit entry is justified for	directly transported between the Parties.	directly transported between the Parties. 2. Goods whose transport involves transit through one or more Non-Parties, with or without transshipment or temporary storage in such Non-Parties, shall be considered directly transported between the Parties, provided that: (a) the transit entry of goods is justified for geographical reason or by consideration related exclusively to transport requirements; (b) the goods do not enter into trade or consumption in the non-Party; and (c) the goods do not undergo any other operation in the non-Party other than unloading, splitting up of loads for transport reasons, and reloading, or any operation necessary to preserve it in good condition. In the case where the goods are temporarily stored in a Non-Party as provided in this	Party: (a) If the products are transported passing through the territory of any other ACFTA member states; (b) If the products are transported without passing through the territory of any non-ACFTA member states; (c) The products whose transport involves transit through one or more intermediate non-ACFTA member states 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

(*continued*)

TABLE 7.48 (*continued*)

China–Singapore	China–Hong Kong	China–Korea	China–ASEAN (ACFTA)
geographical reasons or by considerations related exclusively to transport requirements. 3. Compliance with the provisions set out in paragraph 2(b) shall be authenticated by the importer presenting to the customs authorities of the importing Party either with customs documents of the non-Parties or with any other documents provided to the customs authorities of the importing Party.		paragraph, the goods shall remain under control of the customs authorities in that Non-Party during its stay. The stay of the goods in that Non-Party shall not exceed three months from the date of their entry. In the case of force majeure, the stay of the goods in that Non-Party may exceed three months but shall not exceed six months from the date of their entry. 3. For the purpose of paragraph 2 of this Article, the following documents shall be submitted to the customs authority of the importing Party upon import declaration of the goods: (a) in the case of transit or transshipment, transport documents such as the airway bill, the bill of lading, or the multimodal or combined transport documents covering the whole transporting route from the exporting	operation required to keep them in good condition. Rule 19 For the purpose of implementing Rule 8 (c) of the China–ASEAN Rules of Origin, where transportation is effected through the territory of one or more non-ACFTA member states, the following shall be produced to the Government authorities of the importing Member State: (a) A through Bill of Lading issued in the exporting Member State; (b) A Certificate of Origin issued by the relevant Government authorities of the exporting Member State; (c) A copy of the original commercial invoice in respect of the product; and (d) Supporting documents in evidence that the requirements of Rule 8(c) subparagraphs

TABLE 7.48 (*continued*)

China–Singapore	China–Hong Kong	China–Korea	China–ASEAN (ACFTA)
		Party to the importing Party; and (b) in the case of storage or devanning of the containers, transport documents such as the airway bill, the bill of lading, or the multimodal or combined transport documents covering the whole transporting route from the exporting Party to the importing Party, and supporting documents provided by the customs authority of a Non-Party. The importing customs authority may designate other competent agencies in such Non-Party to issue such supporting documents and inform the exporting customs authority of such designation.	(i), (ii) and (iii) of the China–ASEAN Rules of Origin are being complied with.

TABLE 7.49 *China's free-trade agreements: Exporter record keeping (# years)*

China–Singapore	China–Hong Kong	China–Korea	China–ASEAN
Article 31: Record Keeping Requirement 1. Each Party shall require its producers, exporters and importers to retain origin documents for three (3) years. 2. Each Party shall ensure that its authorised bodies retain copies of Certificates of Origin and other documentary evidence of origin for three (3) years. 3. The records to be maintained may include electronic records and shall be maintained in accordance with the domestic laws and practices of each Party.	No	Article 3.20: Record Keeping Requirements 1. Each Party shall require its producers or exporters to retain origin documents for three years from the date the Certificate of Origin was issued for the producers or exporters. These documents include records of, but not limited to the following: (a) the purchase of, cost of, value of, and payment for, the good; (b) the purchase of, cost of, value of, and payment for all materials, including neutral elements, used in the production of the good; (c) the production of the good in the form in which it was exported; and (d) such other documentation as is required by the laws and regulations of each Party. 2. Each Party shall require its importer to retain all records related to the importation in accordance with its laws and regulations. 3. Each Party shall require that its authorized bodies retain copies of Certificates of Origin and any other documentary evidence sufficient to substantiate the origin of the goods for three years. 4. An exporter, producer, importer or authorized bodies may choose to maintain the records specified in paragraphs 1 through 3 in any medium that allows for prompt retrieval, including, but not limited to, digital, electronic, optical, magnetic, or written form in accordance with its domestic legislation.	Rule 17 (a) The application for Certificates of Origin and all documents related to such application shall be retained by the issuing authorities for not less than two (2) years from the date of issuance. (b) Information relating to the validity of the Certificate of Origin shall be furnished upon request of the importing Party. (c) Any information communicated between the Parties concerned shall be treated as confidential and shall be used for the validation of Certificates of Origin purposes only.

TABLE 7.50 *China's free-trade agreements: Advance rulings*

China–Singapore	China–Hong Kong	China–Korea	China–ASEAN
Article 32: Advance Rulings 1. Each Party shall issue an advance ruling, on an application of the exporter, importer or any person, that is submitted at least three (3) months before the date of importation of the goods that are the subject of the application. The importing Party shall issue its determination regarding the origin of the good within sixty (60) days of the date of an application for advance ruling, provided that all the origin requirements have been complied with. An applicant for an advance ruling from China Customs shall be registered with China Customs. 2. The importing Party shall apply an advance ruling issued by it under paragraph 1. The customs administration of each Party shall establish a validity period for an advance ruling of not less than two (2) years from the date of its issue or in accordance with its respective domestic laws. 3. The importing Party may modify or revoke an advance ruling: (a) if the ruling was based on an error of fact; (b) if there is a change in the material facts or circumstances on which the ruling was based; (c) to conform with a modification of this Chapter; or (d) to conform with a judicial decision or a change in its domestic laws. 4. Each Party shall provide that any modification or revocation of an	No	Article 4.10: Advance Rulings 1. The customs authority of each Party shall issue written advance rulings prior to the importation of a good into its territory on the written request of an importer, an exporter, or any other applicant in the territory of that Party, on the basis of the facts and circumstances provided by the requester, including a detailed description of the information required to process a request for an advance ruling. The advance ruling may be issued on the following matters: (a) tariff classification; (b) origin of a good in accordance with this Agreement; and (c) such other matters as the Parties may agree. 2. The customs authority shall issue an advance ruling within 90 days after a request, provided that the requester has submitted all information required under the domestic laws, regulations and rules. The advance ruling shall be in force from its date of issuance, provided that the facts or circumstances on which the ruling is based remain unchanged. 3. The advance rulings that are into force may be annulled, amended or revoked: (a) where the facts or circumstances prove that the information on which the advance ruling is based is false or inaccurate. In these cases, the customs authority may apply appropriate measures to the requester, including civil, criminal	No

(*continued*)

TABLE 7.50 (*continued*)

China–Singapore	China–Hong Kong	China–Korea	China–ASEAN
advance ruling shall be effective on the date on which the modification or revocation is issued, or on such later date as may be specified therein, and shall not be applied to importations of a good that have occurred prior to that date, unless the person to whom the advance ruling was issued has not acted in accordance with its terms and conditions.		and administrative actions, penalties or other sanctions in accordance with its domestic laws; (b) where the customs authorities deem appropriate to apply different criteria due to the obvious error made by customs authorities on the same facts and circumstances of the original advance rulings. In this case, the amendment or revocation shall be applied from the date of the change; or (c) when the administrative decisions are affected due to changes in the laws, regulations and rules that served as basis. In these cases, the advance rulings shall automatically cease to be in force from the date of publication of those changes. In the cases mentioned in subparagraph (c), the customs authority shall make available to interested persons the information reviewed, with sufficient time prior to the date on which the amendments enter into force, so they can take them into account, with the exception of the cases where it is impossible to publish in advance. 4. Each Party shall publish its advance rulings subject to any confidentiality requirements in its laws, regulations and rules. 5. A Party may decline to issue an advance ruling if the facts or circumstances forming the basis of the advance ruling are the subject of administrative or judicial review.	

TABLE 7.51 *China's free-trade agreements: Pre-exportation examination*

	China–Singapore	China–Hong Kong	China–Korea	China–ASEAN
Pre-exportation examination	No	No	No	Rule 6 The Government authorities designated to issue the Certificate of Origin shall, to the best of their competence and ability, 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 authorised signatory; (b) The origin of the product is in conformity with the China-ASEAN 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.

TABLE 7.52 *China's free-trade agreements: Non-party invoice*

China–Singapore	China–Hong Kong	China–Korea	China–ASEAN
Article 36: Third Party Invoicing The importing Party shall accept Certificates of Origin in cases where the sales invoice is issued either by a company located in a non-Party or by an exporter in the exporting Party for the account of the said company, provided that the product meets the requirements of Chapter 4 (Rules of Origin).	No provisions	Article 3.22: Non-Party Invoice The importing Party shall not reject a Certificate of Origin only for the reason that the invoice was issued in a non-Party, provided that the requirements under this Chapter are complied with.	No provisions

TABLE 7.53 *China's free-trade agreements: Cumulative rule of origin*

China–Singapore	China–Hong Kong	China–Korea	China–ASEAN
Article 14: Cumulative Rule of Origin	No	No	Rule 5: Cumulative Rule of Origin
Where originating goods or materials of a Party are incorporated into a good in the other Party's territory, the goods or materials so incorporated shall be regarded to be originating in the latter's territory.			Unless otherwise provided for, products which comply with origin requirements provided for in Rule 2 and which are used in the territory of a Party as materials for a finished product eligible for preferential treatment under the Agreement shall be considered as products originating in the territory of the Party where working or processing of the finished product has taken place provided that the aggregate ACFTA content (i.e. full cumulation, applicable among all Parties) on the final product is not less than 40%.

7.6 KEY ELEMENTS IN THE ASEAN FREE-TRADE AGREEMENTS

In this section the main elements related to administration of ASEAN free-trade agreements are examined. The main reason for such a deep analysis is to analyze to what extent ASEAN provisions differ even within a common framework and how complex and demanding it could be for business to comply with such a variety of requirements.

ASEAN administrative requirements detail the actions and documentation necessary to support a claim of eligibility for preferential treatment. This may include the CO, the operational certification procedures (OCPs), third-country invoicing, and the back-to-back CO.[106] Table 7.54 further below discusses these aspects.

[106] The drafting of these tables benefited from the assistance of Janine Waltz and Michaela Summerrer. See also Handbook on ASEAN FTAs UNCTAD, 2021.

TABLE 7.54 *Definitions*

Administrative requirements	Indicate what specific actions and documentation are required to support a claim of being eligible for preferential treatment
CO	Document attesting that a product satisfies rules of origin of a certain free-trade agreement
OCPs	Sets of procedures for the issuing and use of a CO as well as for verifying that origin requirements have been met
Third-country invoicing	Instrument allowing originating goods, which are exported to an FTA member country, to qualify for preferential tariff treatment, even if the accompanying sales invoice is issued by a company located in a non-FTA member country or by an exporter in an FTA member country for the account of the company
Back-to-back CO	Document issued by an intermediate exporting FTA partner country based on the original CO issued by the first exporting FTA partner country

7.6.1 *Certificates of Origin*

A CO serves to attest that a good in a particular export shipment is wholly obtained, produced, manufactured, or processed in a particular country. In other words, it is evidence that a product satisfies the rules of origin of a certain free-trade agreement.[107] Every free-trade agreement specifies the entity which may issue the CO and whether notification to other parties is required.

Table 7.55 compares administrative requirements under the ASEAN free-trade agreements, including the issuing entities for a CO and whether notification to other member states is required.

OCPs prescribe how a CO must be issued and used, and how to verify that a product meets the applicable origin criteria. Table 7.56 compares the different forms used in each ASEAN FTA and Table 7.57 specifies the location and content of the OCPs. The OCPs of the ASEAN FTAs with respect to filling out a CO, verification visits, action against fraudulent acts, and record keeping are compared in Tables 7.58–7.65.

7.6.2 *Operational Certification Procedures*

OCPs are sets of procedures for the issuing and use of a CO and for verifying that origin requirements have been met.

[107] Specimens of COs are available as follows: ATIGA, Annex 7: http://investasean.asean.org/files/upload/Annex%207.pdf; AANZFTA: www.homeaffairs.gov.au/Freetradeagreements/Documents/aanzftacoform.pdf; AIFTA, Annex to Chapter 3 (OCP): www.asean.org/wp-content/uploads/images/2012/Economic/AEM/document/Doc-ASEAN-India-OCP.pdf; ACFTA, Attachment C: www.asean-cn.org/index.php?m=content&c=index&a=show&catid=274&id=97; AJCEP: www.mofa.go.jp/ecm/ep/page22e_000383.html; and AKFTA: http://akfta.asean.org/uploads/docs/akfta-certificate-of-origin-form.pdf. See also UNCTAD, Handbook ASEAN FTAs, 2021.

TABLE 7.55 *Issuance of COs and notification*

Agreement	CO issued by	Details to be provided
ATIGA	Issuing authority means the Government authority of the exporting Member State designated to issue a Certificate of Origin (Form D) and notified to all the other Member States in accordance with this Annex[i]	Each Member State shall provide a list of the names, addresses, specimen signatures and specimen of official seals of its issuing authorities, in hard copy and soft copy format, through the ASEAN Secretariat for dissemination to other Member States in soft copy format. Any change in the said list shall be promptly provided in the same manner. The specimen signatures and official seals of the issuing authorities, compiled by the ASEAN Secretariat, shall be updated annually. Any Certificate of Origin (Form D) issued by an official not included in the list referred to in paragraph 1 shall not be honoured by the receiving Member State.[ii]
ACFTA	The Certificate of Origin (Form E) shall be issued by the Issuing Authorities of the exporting Party.[iii]	A Party shall inform all the other Parties of the names and addresses of its respective Issuing Authorities and shall provide specimen signatures and specimen of official seals, and correction stamps, if any, used by its Issuing Authorities. The above information and specimens shall be provided to all the other Parties to the Agreement and a copy furnished to the ASEAN Secretariat. A Party shall promptly inform all the other Parties of any changes in names, addresses, or official seals in the same manner.[iv]
AANZFTA	The Certificate of Origin shall be issued by an Issuing Authority/Body of the exporting Party. Details of the Issuing Authorities/Bodies shall be notified by each Party, through the ASEAN Secretariat, prior to the entry into force of this Agreement. Any subsequent changes shall be promptly notified by each Party, through the ASEAN Secretariat.[iv]	The Issuing Authorities/Bodies shall provide the names, addresses, specimen signatures and specimens of the impressions of official seals of their respective Issuing Authorities/Bodies to the other Parties, through the ASEAN Secretariat. The Issuing Authorities/ Bodies shall submit electronically to the ASEAN Secretariat the above information and specimens for dissemination to the other Parties. Any subsequent changes shall be promptly notified through the ASEAN Secretariat. Any Certificate of Origin issued by a

TABLE 7.55 (*continued*)

Agreement	CO issued by	Details to be provided
		person not included in the list may not be honoured by the Customs Authority of the importing Party.[v]
AIFTA	The AIFTA Certificate of Origin shall be issued by the Government authorities (Issuing Authority) of the exporting Party.[vi]	Each Party shall provide 11 original sets of, or through electronic means, specimen signatures and specimen of official seals used by their Issuing Authorities, including their names and addresses, through the ASEAN Secretariat for dissemination to the other Parties. Any change in names, addresses, specimen signatures or official seals shall be promptly informed in the same manner or electronically.[vii]
AJCEP	The competent governmental authority of the exporting Party shall, upon request made in writing by the exporter or its authorised agent, issue a CO or, under the authorisation given in accordance with the applicable laws and regulations of the exporting Party, may designate other entities or bodies (hereinafter referred to as "designees") to issue a CO.[viii]	Each Party shall provide the other Parties with a list of names and addresses, and a list of specimen signatures and specimen of official seals or impressions of stamps for the issuance of a CO, of its competent governmental authority and, if any, its designees. Any CO bearing a signature not included in the list referred to in paragraph 2 shall not be valid.[ix]
AKFTA	Issuing authority means the competent authority designated by the government of the exporting Party to issue a Certificate of Origin and notified to all the other Parties in accordance with this Appendix.[x]	Each Party shall provide the names, addresses, specimen signatures and specimen of official seals of its issuing authorities to all the other Parties, through the ASEAN Secretariat. Any change in the said list shall be promptly provided in the same manner.[xi]

[i] ASEAN Trade in Goods Agreement (ATIGA) Annex 8 Rule 1. In addition, pilot programs for self-certification have been implemented, see: www.asean.org/storage/images/2015/October/outreach-document/Edited%20ROO%20Self%20Certification.pdf.
[ii] ATIGA, Annex 8, Rule 2.
[iii] ASEAN–China Free-Trade Area (ACFTA), Appendix A, Attachment A, Rule 2.
[iv] ACFTA, Appendix A, Attachment A, Rule 3.
[v] ASEAN–Australia–New Zealand Free-Trade Agreement (AANZFTA), Appendix 2, Section B, Rule 1.
[vi] AANZFTA, Appendix 2, Section B, Rule 2.
[vii] ASEAN–India Free-Trade Agreement (AIFTA), Appendix D, Rule 1.
[viii] AIFTA, Appendix D, Rule 2.
[ix] ASEAN–Japan Comprehensive Economic Partnership (AJCEP), Annex 2, Rule 2.
[x] AJCEP, Annex 4, Rule 2.
[xi] ASEAN–Republic of Korea Free-Trade Agreement (AKFTA), Appendix 1, Rule 1.

TABLE 7.56 *Certificates of origin: Format and distribution of copies*

	ATIGA[i]	AANZFTA[ii]	AIFTA[iii]	ACFTA[iv]	AJCEP[v]	AKFTA[vi]
Name of the form	Form D	Form AANZ	Form AI	Form E	Form AJ	Form AK
Specimen	Annex 7 of ATIGA	Attachment of AANZFT Minimum data requirements in Appendix 2	Attachment D of AIFTA	Attachment Appendix 1 of 2015 Amendment to ACFTA	Attachment to Annex 4 of AJCEP, revised version published 2014	Attachment of AKFTA
Format	ISO A4 size white paper	Hardcopy; in English	ISO A4 size, white paper; in English	ISO A4 size paper; in English	In English	A4 paper; in English
Copies	1 original 2 carbon copies	1 original 2 copies	1 original 3 copies	1 original 2 copies	In the case of a Party which is an ASEAN Member State: 1 original, 2 copies. In the case of Japan: original only.	1 original 2 copies The colours of the original and the copies shall be mutually agreed upon by the parties.
Distribution of copies	Original forwarded by exporter to importer for the submission to customs authority. Duplicate retained by issuing authority.	Original be forwarded by exporter to importer for submission to the customs authority of the importing Party. Duplicate	Original forwarded, together with the triplicate, by exporter to importer. The original submitted by importer to the	Original forwarded, by exporter to importer for submission to the customs authority Duplicate retained by issuing	Original forwarded by the exporter to importer for submission to customs authority of importing Party. In the case of a Party which is an	Original forwarded by the producer and/or exporter to importer for submission to the customs authority of the importing Party. The

	Triplicate retained by exporter.	retained by the issuing authority. Triplicate retained by the exporter.	customs authority at the port or place of importation. The duplicate retained by the issuing authority in the exporting Party. The triplicate retained by importer. The quadruplicate retained by exporter.	authority. Triplicate retained by exporter.	ASEAN Member State, a copy of the CO is to be retained by both the exporter and the competent governmental authority of the exporting Party or its designees, respectively.	duplicate retained by issuing authority of the exporting Party. The triplicate retained by producer and/or exporter.

[i] Annex 8, http://investasean.asean.org/files/upload/Annex%208.pdf.
[ii] Appendix 2, http://aanzfta.asean.org/wp-content/uploads/2017/02/AANZFTA-First-Protocol-Appendix-2B2.pdf.
[iii] Annex 2, Appendix D, www.asean.org/wp-content/uploads/images/2012/Economic/AEM/document/Doc-ASEAN-India-AppendicesC&D.pdf.
[iv] www.asean.org/storage/images/archive/documents/acfta/Appendix1-101125.pdf.
[v] www.mofa.go.jp/policy/economy/fta/asean/implement.pdf.
[vi] Appendix, http://akfta.asean.org/uploads/docs/akfta-operational-certification-procedures.pdf.

TABLE 7.57 *Specific operational certification procedures*

ASEAN FTA	Provision	Content of OCPs	
ATIGA	Annex 8[i]	• Definitions • Specimen signatures and official seals of the issuing authorities • Supporting documents • Pre-exportation verification • Application for CO • Examination of application for a CO	• CO (form D) • Declaration of origin criterion • Treatment of erroneous declaration in the CO • Issuance of the CO • Verification visit
AANZFTA	Annex to Chapter 3 (Operational Certification Procedures)[ii]	• Authorities • Applications • Pre-exportation examination • Issuance of certification of origin • Presentation • Origin verification	• Verification visit • Suspension of preferential tariff treatment • Action against fraudulent acts • Goods in transport or storage • Settlement of disputes
AIFTA	Annex 2, Appendix D[iii]	• Authorities • Applications • Pre-exportation examination • Issue of AIFTA certification of origin	• Presentation • Verification • Special cases • Action against fraudulent acts
ACFTA	Amending Protocol, Attachment A[iv]	• Definitions • Issuing Authorities • Applications • Pre-exportation examination • Issue of certification of origin (Form E)	• Presentation • Record Keeping Requirement • Special cases • Action against fraudulent acts • Contact Points
AJCEP	Annex 4[v]	• Definitions • Issue of certification of origin • Presentation of CO • Validity of CO	• Determination of origin and preferential tariff treatment • Confidentiality

TABLE 7.57 (*continued*)

ASEAN FTA	Provision	Content of OCPs	
		• Record keeping • Verification • Verification visit	• Appropriate penalties or other measures against fraudulent acts • Implementing regulations
AKFTA	Annex 3[vi]	• Definitions • Issuing authorities • Issuance of certification of origin • Presentation • Record keeping requirement	• Verification (verification visit) • Denial of preferential tariff treatment • Special cases • Action against fraudulent acts • Custom contact point

[i] http://investasean.asean.org/files/upload/Annex%208.pdf.
[ii] http://aanzfta.asean.org/annex-on-operational-certification-procedures/.
[iii] www.iesingapore.gov.sg/~/media/IE%20Singapore/Files/FTA/Existing%20FTA/ASEAN%20India%20FTA/Legal%20Text/Appendix20C20Single20List200f20Textiles2020Textile20Products2020Appendix20D20Operational20Certification20Procedures.pdf.
[iv] http://asean.org/storage/2012/10/Protocol-to-Amend-the-Framework-Agreement-ACFTA-Complete.pdf.
[v] www.mofa.go.jp/policy/economy/fta/asean/annex4.pdf.
[vi] www.customs.go.kr/kcshome/main/content/ContentView.do?contentId=CONTENT_ID_000002361&layoutMenuNo=23269.

7.6.3 *Back-to-Back Certificates of Origin*

The back-to-back CO is a new CO, issued by an intermediate exporting FTA partner country based on the original CO issued by the first exporting FTA partner country. The back-to-back CO enables a company to ship its goods to an intermediate FTA partner country for trading or logistical purposes before re-exporting the goods to other FTA partner countries, while still retaining the origin status of the first exporting FTA partner country and the corresponding preferential tariff treatment of the goods. Note that ACFTA does not provide for the issuance of back-to-back COs.

An application for a back-to-back CO is made by the exporter. If the applicable conditions under the relevant free-trade agreement are met, the issuing authority of the intermediate party will agree to issue a back-to-back CO while the product is passing through that party's territory. Table 7.58 compares the conditions for the issuance of a back-to-back CO in the different FTAs.

TABLE 7.58 *Comparison of back-to-back CO conditions*

ASEAN FTA	Rule/Article	Back-to-back CO
ATIGA	Annex 8, Rule 10	Upon application by an exporter, the issuing authority of an intermediate Member State may issue a back-to-back CO if the following conditions are met. (a) A valid original CO (Form D) or certified true copy is presented. (b) The back-to-back CO issued contains some of the same information as the original CO. Every column in the back-to-back CO should be completed. (c) The FOB price of the intermediate Member State in Box 9 is reflected in the back-to-back CO. (d) For partial export shipments, the partial export value is shown instead of the full value of the original CO. The intermediate Member State will ensure that the total quantity re-exported under the partial shipment does not exceed the total quantity of the CO from the first Member State when approving the back-to-back CO to the exporters. (e) If information is not complete and/or circumvention is suspected, the final importing Member State(s) could request that the original CO is submitted to their respective customs authority. (f) Verification procedures (see Rules 18 and 19) are applied to the Member State issuing the back-to-back CO.
AANZFTA	Annex to Chapter 3 (Operational Certification Procedures), Rule 10(3)	An Issuing Authority/Body of an intermediate Party shall issue a back-to-back Certificate of Origin, if an application is made by the exporter while the good is passing through that intermediate Party, provided that: (i) A valid original CO or its certified true copy is presented. (ii) The period of validity of the back-to-back CO does not exceed the period of validity of the original CO. (iii) The consignment which is to be re-exported using the back-to-back CO does not undergo any further processing in the intermediate Party. Exceptions are repacking or logistics activities such as unloading, reloading, storing, or any other operations necessary to preserve them in good condition or to transport them to the importing Party.

TABLE 7.58 (*continued*)

ASEAN FTA	Rule/Article	Back-to-back CO
		(iv) The back-to-back CO contains relevant information from the original CO in accordance with the minimum data requirements in Appendix 2 to the Annex on OCPs. (v) The FOB value is the FOB value of the goods exported from the intermediate Party. (vi) The verification procedures in Rules 17 and 18 of the Annex on OCPs also apply to the back-to-back CO.
AIFTA	Annex 2, Appendix D, Article 11	Upon application by an exporter while a product is passing through an intermediate Party's territory, the issuing authority of the intermediate Party may issue a back-to-back CO if the following conditions are met. (a) A valid AIFTA CO from the original exporting Party is presented only to the Issuing Authority of the intermediate Party. (b) The importer of the intermediate Party and the exporter who applies for the back-to-back AIFTA CO in the intermediate Party are the same. (c) Validity of the back-to-back AIFTA CO has the same end date as the original AIFTA CO. (d) The originating products re-exported could either be full or part of the original consignment. (e) The consignment which is to be re-exported using the back-to-back AIFTA CO must not undergo any further processing in the intermediate Party, except for repacking and logistics activities consistent with Annex 2, Rule 8 of AIFTA (rules of origin). (f) The product shall remain in the intermediate Party's customs territory, including its free-trade zones and bonded areas approved by the customs. The product shall not enter into trade or consumption in the intermediate Party. (g) Information on the back-to-back AIFTA CO includes the name of the Party which issued the original AIFTA CO, date of issuance and reference number. (h) Verification procedures are applied. The original exporting Party, the intermediate Party and the importing Party shall cooperate in the process of verification. The AIFTA CO issued by the

(*continued*)

TABLE 7.58 (*continued*)

ASEAN FTA	Rule/Article	Back-to-back CO
		original exporting Party shall be given to the customs authority of the importing Party if the customs authority requests it during the process of verification.
ACFTA	N/A	ACFTA does not provide for back-to-back COs.
AJCEP	Annex 4, Rule 3(4)	An intermediate Party may issue a back-to-back CO upon request by the exporter in the importing Party or its authorised agent with presentation of the valid original CO. Where a valid back-to-back CO is issued, "an originating good of the exporting Party" shall be construed as an originating good of the Party whose competent governmental authority or its designees has issued the original CO.
AKFTA	Annex 3, Appendix 1, Rule 7	The issuing authority of the intermediate Party may issue a back-to-back Certificate of Origin, if an application is made by the exporter while the good is passing through its territory, if the following conditions are met. (a) A valid original CO is presented. (b) The importer of the intermediate Party and the exporter who applies for the back-to-back CO in the intermediate Party are the same. (c) Verification procedures as set out in Annex 3, Appendix 1, Rule 14, are applied.[i]

[i] Note that originating status of the goods can be retained for as long as 12 months with this specific arrangement; original form AK (six months) plus back-to-back form AK (six months). Available from: http://akfta.asean.org/uploads/docs/akfta-operational-certification-procedures.pdf; http://akfta.asean.org/uploads/docs/akfta-certificate-of-origin-form.pdf.

7.6.4 *Third-Country Invoicing*

Third-country invoicing is an adaptation to business practices of trading through agents. It is a procedure which allows originating goods exported to an FTA member country with a preferential CO to qualify for preferential tariff treatment even if the accompanying sales invoice is issued by:

(a) a company located in a non-FTA member country or
(b) an exporter in an FTA member country for the account of the company (see Figure 7.2).

This arrangement helps manufacturers who have limited market access and facilitates trade among FTA member countries.

A CO accompanied by a third-country invoice will only be approved if the exporter of the goods indicates "third-country invoicing" and information such as the name and country of the company issuing the invoice in the CO. Table 7.59 sets out the third-party invoicing provisions in each ASEAN free-trade agreement.

TABLE 7.59 *Third-country invoicing*

ASEAN FTA	Rule/Article	Third-country invoicing
ATIGA	Annex 8, Rule 23	1. Relevant Government authorities in the importing Member State shall accept Certificates of Origin (Form D) in cases where the sales invoice is issued either by a company located in a third country or by an ASEAN exporter for the account of the said company, provided that the goods meet the requirements of Chapter 3 of this Agreement. 2. The exporter shall indicate "third country invoicing" and such information as name and country of the company issuing the invoice in the Certificate of Origin (Form D).
AANZFTA	Annex on OCPs to Chapter 3 (rules of origin) as amended by the First Protocol, Rule 22	1. The Customs Authority of the importing Party may accept Certificates of Origin in cases where the sales invoice is issued either by a company located in a third country or by an exporter for the account of that company, provided that the goods meet the requirements of Chapter 3 (Rules of Origin). 2. The words "SUBJECT OF THIRD-PARTY INVOICE (name of company using the invoice)" shall appear on the Certificate of Origin.
AIFTA	Annex 2, Appendix D, Article 22	The Customs Authority in the importing Party shall accept an AIFTA Certificate of Origin where the sales invoice is issued either by a company located in a third country or an AIFTA exporter for the account of the said company, provided that the product meets the requirements of the AIFTA Rules of Origin.
ACFTA	Amending Protocol, Annex 1, Attachment A, Rule 23	The Customs Authority of the importing Party shall accept a Certificate of Origin (Form E)

(*continued*)

TABLE 7.59 (*continued*)

ASEAN FTA	Rule/Article	Third-country invoicing
		in cases where the sales invoice is issued either by a company located in a third country or by an ACFTA exporter for the account of the said company, provided that the product meets the requirements of the Rules of Origin for the ACFTA. The invoice-issuing third party can be an ACFTA Party or non-ACFTA Party. The original invoice number or the third-party invoice number shall be indicated in Box 10 of the Certificate of Origin (Form E), the exporter and consignee must be located in the Parties and the third-party invoice shall be attached to the Certificate of Origin (Form E) when presenting the said Certificate of Origin (Form E) to the Customs Authority of the importing Party.
AJCEP	Annex 4, Rule 3(1)	For the purposes of claiming preferential tariff treatment, the following shall be submitted to the customs authority of the importing Party by the importer: (a) a valid CO; and (b) other documents as required in accordance with the laws and regulations of the importing Party (e.g. invoices, including third country invoices, and a through bill of lading issued in the exporting Party).
AKFTA	Annex 3, Appendix 1, Rule 21	1. Customs authority in the importing Party may accept Certificates of Origin in cases where the sales invoice is issued either by a company located in a third country or by an exporter for the account of the said company, provided that the good meets the requirements of Annex 3. 2. The exporter of the goods shall indicate "third country invoicing" and such information as name and country of the company issuing the invoice in the Certificate of Origin.

TABLE 7.60 *Threshold for CO requirement*

	CoO requirement over US$200,00 FOB threshold
ATIGA	Annex 8, Rule 15
AANZFTA	Annex on OCPs to Chapter 3, Rule 14
AIFTA	–
ACFTA	Amending Protocol, Attachment A, Rule 16
AJCEP	Annex 4, Rule 3
AKFTA	Rule 11 of Appendix 1 to Annex 3

7.6.5 *Practical Advice on Documentary Requirements*

In general, there are three conditions that a good sent to a free-trade agreement party must fulfil to enjoy preferential tariffs under that agreement. First, the exported good must be eligible for concessions in the country of destination. Second, it must comply with consignment conditions (direct consignment is required).[108] Third, goods must comply with the origin criteria provided for in the relevant agreement. In addition, each item claiming preferential tariff treatment must qualify for preferential treatment in its own right, meaning that all the goods must qualify separately. This is of particular relevance when similar articles of different sizes or spare parts are exported. Most agreements require a CO only if the consignment from the exporting member state exceeds the value of 200 USD FOB. Table 7.60 indicates the relevant provision on documentary requirements for each ASEAN free-trade agreement.

Exporters must formally apply to the issuing authority for preferential treatment in the export process under the relevant free-trade agreement. The ASEAN Tariff Finder can provide useful information on the requirements for particular goods.[109] Exporters must provide supportive information on the good to be exported, such as information on the exporter, a full description of the good, shipment specifics, and a declaration by the exporter about the truthfulness of the statement.

7.6.5.1 Content of a CO

A CO contains thirteen boxes to be filled out by the importing country (Box 4), the exporter and the certifying country (Reference No., Box 12). Figure 7.3 shows, by way of example, the ATIGA CO (Form D). The issuing authority provides a reference number for each CO which indicates the place and office of issuance. In form AANZ it is referred to as the Certificate No.

[108] ATIGA: Article 32 of Chapter 3; AANZFTA: Article 14; AIFTA: Rule 8; ACFTA: Rule 8; AJECP: Article 31; AKFTA: Rule 9 of Annex 3.

[109] http://tariff-finder.asean.org/.

1. Goods consigned from (Exporter's business name, address, country)	Reference No. ASEAN TRADE IN GOODS AGREEMENT/ ASEAN INDUSTRIAL COOPERATION SCHEME CERTIFICATE OF ORIGIN (Combined Declaration and Certificate)
2. Goods consigned to (Consignee's name, address, country)	FORM D Issued in _____ (Country) See Overleaf Notes
3. Means of transport and route (as far as known) Departure date Vessel's name/Aircraft etc. Port of Discharge	4. For Official Use ☐ Preferential Treatment Given Under ASEAN Trade in Goods Agreement ☐ Preferential Treatment Given Under ASEAN Industrial Cooperation Scheme ☐ Preferential Treatment Not Given (Please state reason/s) ..... Signature of Authorised Signatory of the Importing Country

5. Item number	6. Marks and numbers on packages	7. Number and type of packages, description of goods (including quantity where appropriate and HS number of the importing country)	8. Origin criterion (see Overleaf Notes)	9. Gross weight or other quantity and value (FOB)	10. Number and date of invoices

11. Declaration by the exporter The undersigned hereby declares that the above details and statement are correct; that all the goods were produced in ..... (Country) and that they comply with the origin requirements specified for these goods in the ASEAN Trade in Goods Agreement for the goods exported to ..... (Importing Country) ..... Place and date, signature of authorised signatory	12. Certification It is hereby certified, on the basis of control carried out, that the declaration by the exporter is correct. ..... Place and date, signature and stamp of certifying authority
13 ☐ Third Country Invoicing ☐ Exhibition ☐ Accumulation ☐ De Minimis ☐ Back-to-Back CO ☐ Issued Retroactively ☐ Partial Cumulation	

FIGURE 7.3 Specimen CO for ATIGA
Source: ATIGA TIG Agreement, Annex 7.

Box 1 must contain the exporter details. The name, address, and country of the exporter must be identified to specify where goods are consigned from. To indicate where goods are sent to, Box 2 has to be filled with the consignee's name, address, and country. As far as is known, the shipment details, including the departure date, vessel name/aircraft, and the like, as well as port of discharge, must be given in Box 3.

Box 4 must contain the signature of the authorized signatory of the importing country. Whether preferential treatment is accorded under the specific agreement must be indicated in Box 4. The item number must be inserted in Box 5 and the marks and numbers on packages detailed in Box 6.

The number and type of packages, and a description of the goods, must be included in Box 7. The HS number (of the importing party) and quantity must be included where appropriate. The description of the products must be sufficiently detailed to enable them to be identified by the customs officers examining them. The name of the manufacturer and any trade mark must also be specified. The ASEAN–Australia–New Zealand Free-Trade Agreement (AANZFTA) and ASEAN–Japan Comprehensive Economic Partnership (AJCEP) require indication at a six-digit level.[110]

Box 8 concerns the relevant origin-conferring criteria. An exporter must indicate the origin criteria met, according to the requirements in the relevant free-trade agreement. Table 7.61 outlines how the indications in Box 8 must be made under each ASEAN free-trade agreement.

The gross weight or other quantity and value (FOB) must be indicated in Box 9. Box 10 is for the number as well as the date of the invoices. In Box 11 the exporter (including manufacturer or producer) must declare that the goods comply with the relevant origin requirements, and provide the place, date, and signature of the authorized signatory. If, after reviewing the supporting documentation, the issuing authority is satisfied that the goods qualify for preferential treatment, it certifies that the exporter's declaration is correct by providing its signature and stamp and indicating the place and date. Box 13 provides a number of options which may be ticked depending on their relevance to the particular CO. Table 7.62 outlines the options for Box 13 under each ASEAN free-trade agreement.

[110] AJCEP: With respect to subheading 2208.90 and 9404.90, in an exceptional case where the good is a specific product requiring a special description (for example, "sake compound and cooking sake (Mirin) of subheading 2208.90," "beverages with a basis of fruit, of an alcoholic strength by volume of less than 1 per cent of subheading 2208.90," "quilts and eiderdowns of 9404.90") such description of specific products should be indicated.

TABLE 7.61 *Origin criteria: Entries required in Box 8*

	ATIGA	AANZFTA	AIFTA	ACFTA	AJCEP	AKFTA
Goods wholly obtained or produced	WO	WO	WO	WO	WO	WO
Goods entirely produced	Not included	PE	Not included	Not included	PE	Not included
Regional value content	Percentage of regional value content, e.g. 40%	RVC	Not included	Percentage of single country content,[i] e.g. 40% Percentage of ACFTA cumulative content,[ii] e.g. 40%.	RVC	RVC 40%
Change in tariff classification	The actual CTC rule, e.g. CC, CTH, or CTSH	CTC, whether on chapter, heading or subheading level, no need to place actual tariff shift	Not included	Not included	CTC	CTH
Specific processes	SP	Not included	Not included	Not included	SP	Specific processes
Combination criteria	Actual combination criterion, e.g. CTSH + 35%	CTSH + RVC, actual PSE needs to be inserted	RVC [ ] per cent + CTSH	Not included	CTH or RVC	CTH or RVC 40%

Product-specific requirement	Not included	"Other" for product-specific requirement included in Annex 2	Appropriate qualifying criteria	Product-specific requirement	Not included	CTC WO-AK[iii] RVC, e.g. RVC 45% Combination rule that needs to be met for good to qualify as originating, e.g. CTH + RVC 40% Specific processes Rule 6[iv]
Partial cumulation (PC)	PC X%, where X would be the percentage of regional value content of less than 40%, e.g. PC 25%	Not included	Not included	Not included	Not included	Not included
***De minimis* accumulation**	Not included	Not included	Not included	Not included	*De min.* acc.	Not included

[i] For the purpose of implementing the provisions of Rule 2(b) of the ACFTA rules of origin, products worked on and processed as a result of which the total value of the materials, parts, or produce originating from non-ACFTA member states 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 party.

[ii] Products complying with origin requirements provided for in Rule 2 of the ACFTA rules of origin and used in a party as inputs for a finished product eligible for preferential treatment in another/other party/parties shall be considered as a product originating in the member state where working or processing of the finished product has taken place, provided that the aggregate ACFTA content of the final product is not less than 40%.

[iii] Wholly obtained or produced in the territory of any party.

[iv] Goods satisfying Rule 6.

TABLE 7.62 *Box 13: Options to tick under the different free-trade agreements*

	ATIGA	AANZFTA	AIFTA	ACFTA	AJCEP	AKFTA
Third-country invoicing	X	X	X	X	X	X
Exhibition[i]	X		X	X		X
Accumulation	X	X	X			
De minimis	X	X				
Back-to-back CO	X	X	X		X	X
Issued retroactively[ii]	X	X			X	
Partial cumulation	X					
Movement Certificate				X		

[i] In cases where goods are sent from the exporting member state for exhibition in another country and sold during or after the exhibition for importation into a member state, indicate the name and address of the exhibition in Box 2.

[ii] In exceptional cases, due to involuntary errors or omissions or other valid causes, the CO may be issued retroactively.

7.6.5.2 Special Indications under Each FTA when Applying the CO

(a) **ATIGA**

Multiple items: If multiple items are declared in the same form D and preferential treatment is not granted to any of the items, indicate this in Box 4 and circle or mark the item number appropriately in Box 5.

Partial cumulation: If the RVC of the material is less than 40 percent, the CO may be issued for accumulation purposes, in accordance with Article 30(2) of ATIGA. The "partial cumulation" box should be ticked.

Third-country invoicing: Information such as the name and country of the company issuing the invoice must be indicated in Box 7.

(b) **AANZFTA**

FOB value: An exporter from an ASEAN member state must provide the FOB value of the goods in Box 9. An exporter from Australia or New Zealand can complete either Box 9 or provide a separate "Exporter declaration" stating the FOB value of the goods.

The FOB value is not required for consignments where the origin criteria does not include an RVC requirement. In the case of goods exported from and imported by Cambodia and Myanmar, the FOB value must be included in the CO or the back-to-back CO for all goods, irrespective of the origin criteria used, for two years from the date of entry into force of the First Protocol or an earlier date as endorsed by the Committee on Trade in Goods.

Certified true copy: In case of a certified true copy, the words "CERTIFIED TRUE COPY" should be written or stamped on Box 12 of the CO form with the date of issuance of the copy in accordance with Rule 11 of the OCP.

Third-Party invoice: The number of invoices issued by the manufacturers or the exporters and the number of invoices issued by the trader (if known) for the importation of goods into the importing party should be indicated in Box 10. In Box 13, "Subject of Third-Party Invoice" should be ticked and the name of the issuing company should be provided in Box 7, or in case of insufficient space, on a continuation sheet.

(c) **AIFTA**

Third-country invoicing: Information such as the name and country of the company issuing the invoice must be indicated in Box 7.

Back-to-back CO: For a back-to-back CO, the name of the original exporting party has to be indicated in Box 11 and the date of the issuance of the CO and the reference number must be indicated in Box 7.

(d) **AJCEP**

FOB value: The FOB value in Box 9 must be reflected only when the RVC criterion is applied in determining the origin of goods. In the case of goods exported from and imported by Cambodia and Myanmar, the FOB value must be included on the CO, irrespective of the origin criteria used, for two years from the implementation of the new arrangement.

Invoices: Indicate the invoice number and date for each item. The invoice should be the invoice issued for the importation of the good into the importing party.

Third-country invoicing: The number of invoices issued for the importation of goods into the importing party should be indicated in Box 10, and the full legal name and address of the company or person that issued the invoices must be indicated in Box 7. In an exceptional case where the invoice issued in a third country is not available at the time of issuance of the CO, the invoice number and the date of the invoice issued by the exporter to whom the CO is issued should be indicated in Box 10. "Third-country invoicing" in Box 13 should be ticked, and Box 7 should indicate that the goods will be subject to another invoice to be issued in a third country for the importation into the importing party. The full legal name and address of the company or person that will issue another invoice in the third country should be identified in Box 7. In such a case, the customs authority of the importing party may require the importer to provide the invoices and any other relevant documents which confirm the transaction from the exporting party to the importing party.

(e) **AKFTA**

Third-country invoicing: Information such as the name and country of the company issuing the invoice must be indicated in Box 7.

7.6.6 *Verification and Penalties*

7.6.6.1 Record Keeping

After a CO is issued, the documents must be retained for a certain period of time in order to allow for potential checks and verification. The record-keeping requirements under each ASEAN free-trade agreement are indicated in Table 7.63. In general, every document has to be kept for three years from the date of issuance.

TABLE 7.63 *Comparative table on record keeping*

ASEAN FTA	Rule/Article	Record keeping
ATIGA	Annex 8, Rule 17	The producer and/or exporter applying for the issuance of a CO must keep its supporting records for application for not less than **three years from the date of issuance of the CO**. The issuing authorities must retain an application for CO and all related documents for not less than three years from the date of issuance.
AANZFTA	Annex to Chapter 3 (Operational Certification Procedures), Rule 16	Each Party shall require that the issuing authority/body, manufacturer, producer, exporter, importer, and their authorized representatives maintain for a period of not less than **three years after the date of exportation or importation**, as the case may be, all records relating to that exportation or importation which are necessary to demonstrate that the good for which a claim for preferential tariff treatment was made qualifies for preferential tariff treatment. Such records may be in electronic form. Information relating to the validity of the CO shall be furnished upon request of the importing Party by an official authorised to sign the CO and certified by the appropriate issuing authority/body.
AIFTA	Annex 2, Appendix D, Article 18	The application for AIFTA Certificates of Origin and all documents related to such application shall be retained by the Issuing Authorities for not

TABLE 7.63 (*continued*)

ASEAN FTA	Rule/Article	Record keeping
		less than **two years from the date of issuance**. Information relating to the validity of the AIFTA Certificate of Origin shall be furnished upon request of the importing Party.
ACFTA	Amending Protocol, Attachment A, Rule 19	The application for the CO and all documents related to such application shall be retained by the issuing authorities for not less than **three years from the date of issuance**. Information relating to the validity of the CO shall be furnished upon request by the importing Party. For the purposes of the verification process/ retroactive check, the producer and/or exporter applying for the issuance of a CO shall, subject to the domestic laws, regulations and administrative rules of the exporting Party, keep its supporting records for application for not less **than three years from the date of issuance** of the CO.
AJCEP	Annex 4, Rule 5	The exporter to whom a CO has been issued or the producer of a good in the exporting Party must keep records relating to the origin of the good **for three years after the date on which the CO was issued**. The competent governmental authority or its designees shall keep a record of the issued CO for a period of **three years after the date on which the CO was issued**. Such record includes all supporting documents presented to prove the qualification as an originating good of the exporting Party.
AKFTA	Annex 3, Appendix 1, Rule 13	The producer and/or exporter must keep its supporting records for application for not less than **three years from the date of issuance of the CO**. **The importer shall keep records relevant to the importation in accordance with the domestic laws and regulations of the importing Party.** The application for CO and all documents related to such application shall be retained by the issuing authority for not less than **three years from the date of issuance**.

7.6.6.2 Verification-Visits

When there is reasonable doubt as to the authenticity of the CO or the accuracy of the information regarding the true origin of the goods, an importing member state can request the issuing authority of the exporting member state to conduct a retroactive check at random. If the importing member state is not satisfied with the outcome of the retroactive check, in exceptional circumstances it may request verification visits to the exporting member state. In general, in order to conduct a verification visit, the customs authority of the importing country must deliver a written and comprehensive request/notification. In answer, the exporter or producer must give a written consent. The issuing authority receiving the notification may postpone the proposed verification visit, but only for a defined period. The written determination of whether or not the subject goods qualify as originating is delivered by the member state conducting the verification visit. The exporter or producer can provide written comments on the determination, or additional information regarding the eligibility of the goods, for a limited period of time. Table 7.64 sets out the provisions for verification visits under each ASEAN free-trade agreement.

Each party must maintain the confidentiality of the information and documents provided by other parties in the course of the verification process. Such information and documents shall not be used for other purposes, including being used as evidence in administrative and judicial proceedings, without the explicit written permission of the party providing such information.

TABLE 7.64 *Provisions for verification visits in the ASEAN free-trade agreements*

ASEAN FTA	Rule/Article	Verification visit
ATIGA	Annex 8, Rule 19	1. Customs authority of the importing Party delivers **a written notification** of its intention to conduct the verification visit to: (a) the exporter/producer whose premises are to be visited; (b) the issuing authority of the Member State in whose territory the verification visit is to occur; (c) the customs authorities of the Member State in whose territory the verification visit is to occur; and (d) the importer of the goods subject of the verification visit. The written notification must be as comprehensive as possible, including: (a) the name of the customs authorities issuing the notification;

TABLE 7.64 (*continued*)

ASEAN FTA	Rule/Article	Verification visit
		(b) the name of the exporter/producer whose premises are to be visited; (c) the proposed date for the verification visit; (d) the coverage of the proposed verification visit, including reference to the goods subject of the verification; and (e) the names and designation of the officials performing the verification visit. 2. Obtain the **written consent** of the exporter/producer whose premises are to be visited. When a written consent from the exporter/producer is not obtained within 30 days upon receipt of the notification, the notifying Member State may deny preferential treatment to the goods that would have been subject of the verification visit. 3. The issuing authority receiving the notification may **postpone** the proposed verification visit and notify the importing Member State of such intention. Notwithstanding any postponement, any verification visit shall be carried out within 60 days from the date of such receipt, or for a longer period as the concerned Member States may agree. 4. The Member State conducting the verification visit shall provide the exporter/producer whose goods are the subject of the verification and the relevant issuing authority with a **written determination** of whether or not the subject goods qualify as originating goods. Any suspended preferential treatment shall be reinstated upon the written determination that the goods qualify as originating goods. 5. The exporter/producer will be allowed 30 days, from receipt of the written determination, to provide in writing **comments or additional information regarding the eligibility** of the goods. If the goods are still found to be non-originating, the final written determination will be communicated to the issuing authority within 30 days from receipt of the comments/additional information from the exporter/producer. 6. The **verification visit process**, including the actual visit and determination of whether the subject goods are originating or not, shall be carried out and its results communicated to the issuing authority within a maximum of 180 days. While awaiting the results of the verification visit, suspension (according to Rule 18(c)) of preferential treatment shall be applied.

(*continued*)

TABLE 7.64 (*continued*)

ASEAN FTA	Rule/Article	Verification visit
AANZFTA	Annex to Chapter 3 (Operational Certification Procedures), Rule 18	1. The customs authority of the importing Party who wishes to undertake a verification visit must issue a **written request** to the issuing authority/body of the exporting Party at least 30 days in advance of the proposed verification visit. If the issuing authority/body of the exporting Party is not a government agency, the customs authority of the importing Party shall notify the customs authority of the exporting Party of the written request to undertake the verification visit. A written request must include at minimum: (a) the identity of the customs authority issuing the request; (b) the name of the exporter or the producer of the exporting Party whose good is subject to the verification visit; (c) the date the written request is made; (d) the proposed date and place of the visit; (e) the objective and scope of the proposed visit, including specific reference to the good subject to the verification; and (f) the names and titles of the officials of the customs authority or other relevant authorities of the importing Party who will participate in the visit. 2. The issuing authority/body of the exporting Party must **notify the exporter or producer of the intended verification** visit by the customs authority or other relevant authorities of the importing Party and **request the exporter or producer to** permit the customs authority or other relevant authorities of the importing Party to visit their premises or factory and to provide information relating to the origin of the good. Furthermore, the issuing authority/body must advise the exporter or producer that, should they fail to respond by a specified date, preferential tariff treatment may be denied. 3. The issuing authority/body of the exporting Party must **advise** the customs authority of the importing Party within 30 days of the date **of the written request** from the customs authority of the importing Party whether the exporter or producer has agreed to the request for a verification visit. 4. The customs authority of the importing Party must not visit the premises or factory of any exporter or producer in the territory of the exporting Party without **written prior consent** from the exporter or producer.

TABLE 7.64 (*continued*)

ASEAN FTA	Rule/Article	Verification visit
		The customs authority of the importing Party shall complete any action to verify eligibility for preferential tariff treatment and make a **decision within 150 days of the date of the request to the issuing authority/body**. The customs authority of the importing Party shall provide **written advice** as to whether goods are eligible for preferential tariff treatment to the relevant parties within ten days of the decision being made.
AIFTA	Annex 2, Appendix D, Article 17	1. The importing Party shall deliver a **written notification** of its intention to conduct the verification visit through a focal customs or any other appropriate authority simultaneously to: (a) the producer/exporter whose premises are to be visited; (b) the Issuing Authority of the Party in the territory of which the verification visit is to occur; (c) the focal customs or any other appropriate authority of the Party in the territory of which the verification visit is to occur; and (d) the importer of the good subject to the verification visit. Written notification includes must be as comprehensive as possible and include: (a) the name of the focal customs or any other appropriate authority issuing the notification; (b) the name of the producer/exporter whose premises are to be visited; (c) the proposed date of the verification visit; (d) the coverage scope/purpose of the proposed verification visit, including reference to the good subject to the verification; and (e) the names and designation of the officials performing the verification visit. 2. The importing Party shall obtain the **written consent** of the producer/exporter whose premises are to be visited. When a written consent from the producer/exporter is not obtained within 30 days from the date of receipt of the notification, the notifying Party may deny preferential tariff treatment to the good referred to in the AIFTA CO that would have been subject to the verification visit and the issuing authority receiving the notification may **postpone** the proposed verification visit and notify the

(*continued*)

TABLE 7.64 (*continued*)

ASEAN FTA	Rule/Article	Verification visit
		importing Party of such intention within 15 days from the date of receipt of the notification. Notwithstanding any postponement, any verification visit shall be carried out within 60 days from the date of such receipt, or for such longer period as the parties may agree. 3. The importing Party conducting the verification visit shall provide the producer/exporter whose good is subject to the verification and the relevant Issuing Authority with a **written determination** of whether that good qualifies as an originating good. Any suspended preferential tariff treatment shall be reinstated upon a determination that the good qualifies as an originating good. 4. If the good is determined to be non-originating, the producer/exporter shall be given 30 days from the date of receipt of the written determination to provide any **written comments or additional information** regarding the eligibility of the good for preferential tariff treatment. If the good is still found to be non-originating, the final written determination issued by the importing Party shall be communicated to the issuing authority within 30 days from the date of receipt of the comments/additional information from the producer/exporter. The verification visit process, including the actual visit and the determination whether or not the good subject to verification is originating, shall be carried out and its results communicated to the issuing authority within **a maximum period of six months** from the date when the verification visit was conducted.
ACFTA	Amending Protocol, Attachment A, Rule 18	1. The customs authority of the importing Party must **notify** the competent authority of the exporting Party with an aim to mutually agree on the conditions and means of the verification visit. 2. The **verification visit shall be conducted** not later than 60 days after receipt of the notification. 3. The verification process, **including the retroactive check and verification visit**, shall be carried out and its results communicated to the customs authority and/or the issuing authorities of the exporting Party within **a maximum of 180 days after the receipt of the request**. While awaiting the results of the verification visit, suspension of preferential treatment shall be applied. In case an extension request has been made, the period shall be extended to a maximum of two hundred and 270 days.

TABLE 7.64 (*continued*)

ASEAN FTA	Rule/Article	Verification visit
		Preferential treatment may be **denied** when the exporting Party fails to respond to the request to the satisfaction of the customs authority of the importing Party in the course of a retroactive check or verification process.
AJCEP	Annex 4, Rule 7	1. The customs authority or the relevant authority of the importing Party may **request** the exporting Party: (a) to collect and provide information relating to the origin of the good and check, for that purpose, the facilities used in the production of the good, through a visit by the competent governmental authority of the exporting Party along with the customs authority or the relevant authority of the importing Party to the premises of the exporter to whom the CO has been issued, or the producer of the good in the exporting Party; (b) during the visit, to provide information relating to the origin of the good in the possession of the competent governmental authority of the exporting Party or its designees. 2. When requesting the exporting Party to conduct a visit, the customs authority or the relevant authority of the importing Party shall deliver a **written communication** with such request to the exporting Party at least 60 days in advance of the proposed date of the visit, the receipt of which is to be confirmed by the exporting Party. The competent governmental authority of the exporting Party shall request the **written consent** of the exporter, or the producer of the good in the exporting Party whose premises are to be visited. The written communication must include: (a) the identity of the customs authority or the relevant authority issuing the communication; (b) the name of the exporter, or the producer of the good in the exporting Party whose premises are requested to be visited; (c) the proposed date and places of the visit; (d) the object and scope of the proposed visit, including specific reference to the good subject of the verification referred to in the CO; (e) the names and titles of the officials of the customs authority or the relevant authority of the importing Party to be present during the visit.

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TABLE 7.64 (*continued*)

ASEAN FTA	Rule/Article	Verification visit
		3. The **exporting Party shall respond in writing** to the importing Party, within 30 days from the receipt of the communication referred to in paragraph 2, whether it accepts or refuses to conduct the visit requested. The competent governmental authority of the exporting Party shall, in accordance with the laws and regulations of the Party, provide within 45 days or any other mutually agreed period from the last day of the visit, to the customs authority or the relevant authority of the importing Party **any additional information** obtained.
AKFTA	Annex 3, Appendix 1, Rule 15	1. The importing Party shall deliver a written notification of its intention to conduct the verification visit simultaneously to (a) the producer and/or exporter whose premises are to be visited; (b) the issuing authority of the Party in the territory of which the verification visit is to occur; (c) the customs authority of the Party in the territory of which the verification visit is to occur; and (d) the importer of the good subject to the verification visit. Written notification must be as comprehensive as possible and must include: (a) the name of the customs authority issuing the notification; (b) the name of the producer and/or exporter whose premises are to be visited; (c) the proposed date of the verification visit; (d) the coverage of the proposed verification visit, including reference to the good subject to the verification; (e) the names and designation of the officials performing the verification visit. 2. The importing Party must obtain the **written consent** of the producer/or exporter whose premises are to be visited. If a written consent from the producer and/or exporter is not obtained within 30 days from the date of receipt of the notification, the notifying Party may deny preferential tariff treatment to the good referred. 3. The issuing authority receiving the notification may **postpone** the proposed verification visit and notify the importing Party of such intention within 15 days from the date of receipt of the notification. Notwithstanding any postponement, any verification visit shall be carried out

TABLE 7.64 (*continued*)

ASEAN FTA	Rule/Article	Verification visit
		within 60 days from the date of such receipt, or a longer period as the parties may agree. 4. The Party conducting the verification visit shall provide the producer and/or exporter, whose good is subject to such verification, and the relevant issuing authority with a **written determination** of whether or not the good subject to such verification qualifies as an originating good. Any suspended preferential tariff treatment shall be reinstated upon the written determination. 5. The producer and/or exporter shall be allowed 30 days from the date of receipt of the written determination to provide in **writing comments or additional information** regarding the eligibility of the good for preferential tariff treatment. If the good is still found to be non-originating, the **final written determination** shall be communicated to the issuing authority within thirty 30 days from the date of receipt of the comments/additional information from the producer and/or exporter. The **verification visit process, including the actual visit and the determination** whether the good subject to such verification is originating or not, shall be carried out and its results communicated to the issuing authority within a **maximum period of six months** from the first day the initial verification visit was conducted.

7.6.6.3 Action against Fraudulent Acts

In cases where fraudulent acts in connection with the CO are suspected, the government authorities need to cooperate in taking action in the relevant member state against the parties involved. Table 7.65 outlines the provision against fraudulent acts in each ASEAN free-trade agreement.

TABLE 7.65 *Comparative table on action against fraudulent acts*

ASEAN FTA	Rule/Article	Protection against fraudulent acts
ATIGA	Annex 8, Rule 24	When it is suspected that fraudulent acts in connection with the CO have been committed, the government authorities concerned shall cooperate in the action to be taken in the respective Member State against the persons involved. Each Member State shall provide legal sanctions for fraudulent acts related to the CO.
AANZFTA	Annex to Chapter 3 (Operational Certification Procedures), Rule 23	When it is suspected that fraudulent acts in connection with the CO have been committed, the government authorities concerned shall co-operate in the action to be taken in the respective Party against the persons involved, in accordance with the Party's respective laws and regulations.
AIFTA	Annex 2, Appendix D, Article 23	When it is suspected that fraudulent acts in connection with the AIFTA CO have been committed, the relevant government authorities concerned shall cooperate in any action taken against the persons involved. Each Party shall be responsible for providing legal sanctions against fraudulent acts related to the AIFTA CO.
ACFTA	Amending Protocol, Attachment A, Rule 24	When it is suspected that fraudulent acts in connection with the CO have been committed, the government authorities concerned shall co-operate in the action to be taken in the territory of the respective Parties against the persons involved. Each Party shall be responsible for providing legal sanctions for fraudulent acts related to the CO in accordance with its domestic laws, regulations and administrative rules.
AJCEP	Annex 4, Rule 10	Each Party shall establish or maintain, in accordance with its laws and regulations, appropriate penalties or other measures against its exporters or producers who have committed fraudulent acts in connection with a CO, including submission of false declarations or documents to its competent governmental authority or its designees.

TABLE 7.65 (*continued*)

ASEAN FTA	Rule/Article	Protection against fraudulent acts
AKFTA	Annex 3, Appendix 1, Rule 22	When it is suspected that fraudulent acts in connection with a CO have been committed, the government authorities concerned shall cooperate in the action to be taken by a Party against the persons involved. Each Party shall provide legal sanctions for fraudulent acts related to a CO.

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