Drafting preferential rules of origin: a methodology and the utilization rate database

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Drafting preferential RoO : *Do we have a best practice golden model ?*

- Absence of Multilateral rules
- Very few analytical studies. Forthcoming study by UNCTAD [2014]
- Existence of models : NAFTA inspired rules ,Pan-Euro RoO
- Absence of models in South-South FTAs
- Different practices in administering origin

There are clear lessons in drafting and administering preferential RoO

- Distinguish the issue of '*form*' from '*substance*' when drafting PSROs
- Moving away from use of value when using percentage criterion
- Use value of materials calculations
- Move from across the board to Product-Specific RoO [PSROs].This does not necessarily mean to have PSROs for all products
- Cumulation is not a substitute for liberal RoO

Objectives of the research

- To devise a multipurpose input-output table based on the Harmonized System for trade policy analysis
- Main immediate purposes of the table:
- A contribution to calculate value added in trade as compared to import content
- A tool to depict the interface of origin and trade policy instruments i.e. Effects of a set RoO of trade marks, trade statistics, trade defence mechanisms,
- RoO in FTAs and WTO

The proposed methodology: use of the Harmonized System to identify intermediates for outputs

- *The HS has been conceived for customs classification*
- *However, it has been used for RoO and its logic follows value chains and industrial processes*
- *It allows targeting of intermediates to produce the output*

The structure of HS: from unmanufactured to manufactured products by processing

- *Example 1: Cocoa and cocoa preparations*
- *18.01 Cocoa beans*
- *18.02 Cocoa shells*
- *18.03 Cocoa paste*
- *18.04 Cocoa butter*
- *18.05 Cocoa powder*
- *18.06 Chocolate, etc.*

Another example

- HS sub-heading 841430 classifying compressors was the fifth most exported products to ASEAN by China.

- Matching this finding with China's imports from the World, it was observed that HS 8414 90 -parts of compressor- ranked as the 36th most imported products from USA and Japan
- Thus, a rule of origin such as:

"*A change to subheading 841430 from any other subheading, except from subheading 8414.90"* may entail that the compressors exported to ASEAN utilizing parts imported from Japan and USA will not comply with rules of origin requirements

The methodology used

- *Step 1: De-structure the HS to obtain an excel file identifying what HS headings are used as intermediate products to produce finished goods. This exercise resulted in an excel file of 1480 observations at HS 4 digits and some hundreds at CTH 6 digits*
- *Step 2: Matching the results of the excel file with the identified HS of intermediates to import trade flows and those of finished products to exports*
- *Step 3: Apply a deflating factor to the value of exports when imported inputs are used in the manufacturing of exported products from China to US*

Some initial results

- Lamps of HS heading 8539 are manufactured from glass HS 70 , Tungsten filament 8101 switches of HS headings 8535,
- Total exports of HS 8539 from China to World $6 billions
- Total import of HS 94.05, 8535, 8536 from World $ 6 billion
- Normalized imports $4.6 billion from World
- Total exports to the US of 8539 is equal to $959 millions and imports of inputs chapter 70, 8535, 8101 from World $1.1 billion when normalized and $243 millions from US
- Thus the deflated exports to the US is $959 million *minus* $243 millions equal to $716 millions

Challenges and opportunities

- *Mere trade flows do not take into account national production and choice of firms in sourcing*
- *HS structure is not conceived for input/ouput matrixes*
- *Normalizing trade flows requires arbitrary assumptions*
- *Interpreting the data at such detailed level is not an easy task*
- *However*
- *HS is used to draft RoO and as such is a recognized tool to detect value chains*
- *The matrix can be used as a valid tool for firm surveys*
- *Possibility of refining the techniques are open for future research in a multidisciplinary fashion*

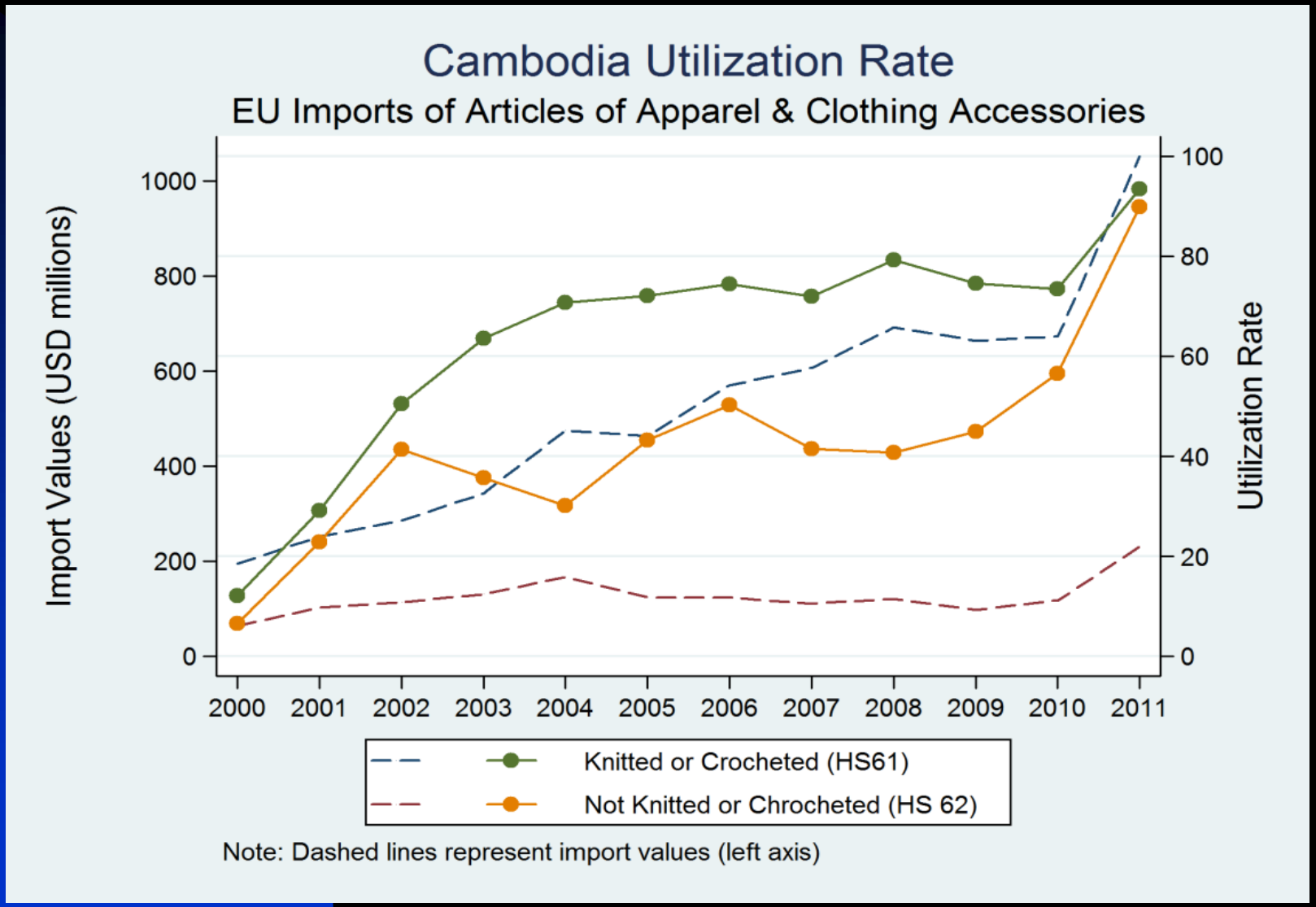
Drafting RoO in FTAs: *We just have some lessons learned*

- The lessons may be drawn from :
- Low utilization of a FTA or other preferential PTAs
- Changes in the way RoO are drafted since administrations found that some RoO are easier to administer than others.
- Need to adapt RoO to fragmentation of production Vs vertical industrial vision
- *There are those that are learning more and those who are learning less …*

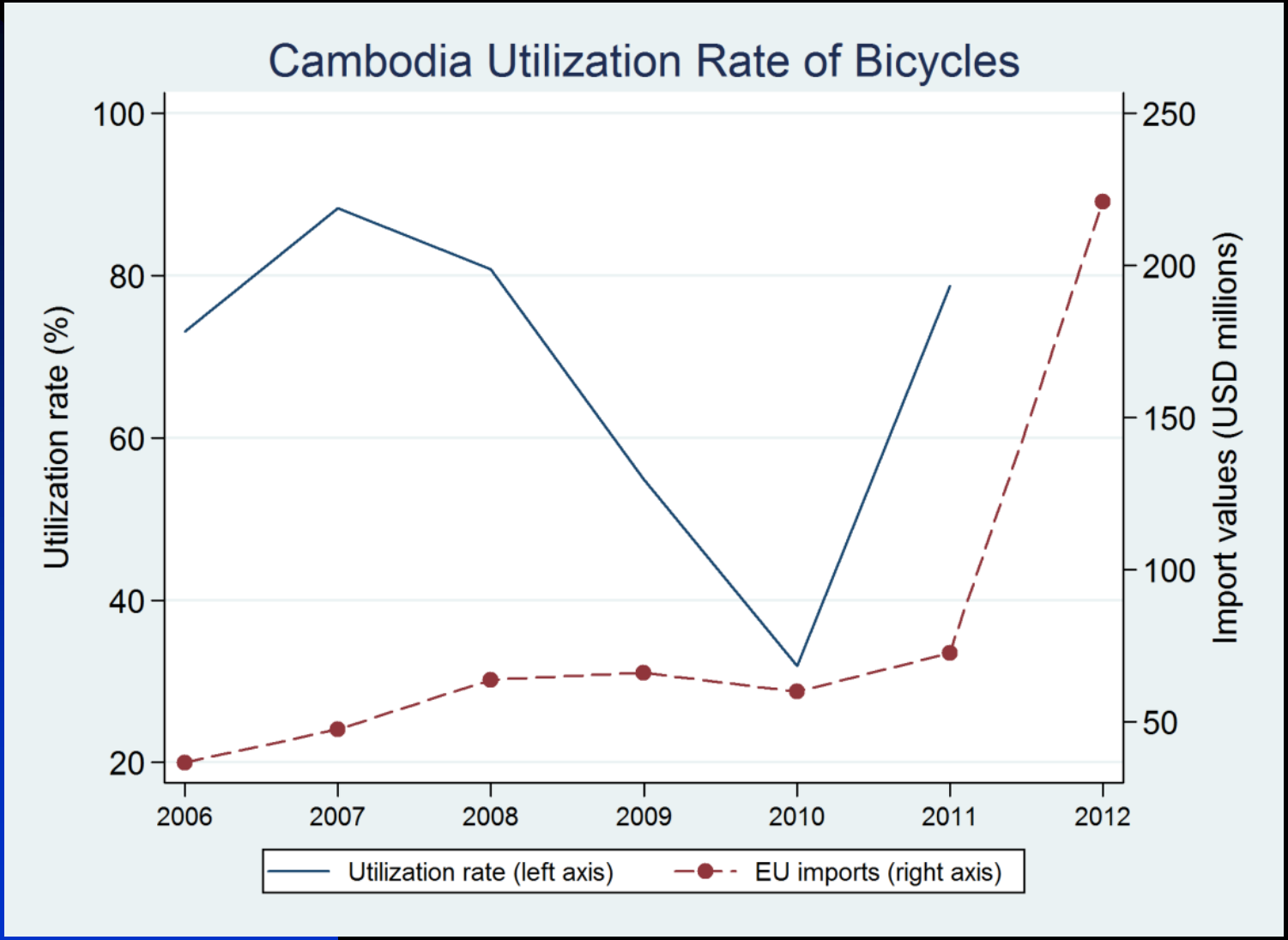
Recording lessons learned using utilization rates

- Two ways of collecting data on utilization rates
- Customs based : the ratio among goods eligible for FTA treatment with those that have effectively received it
- Companies questionnaires
- One difficulty: Utilization rates by customs are not publically available for the majority of countries

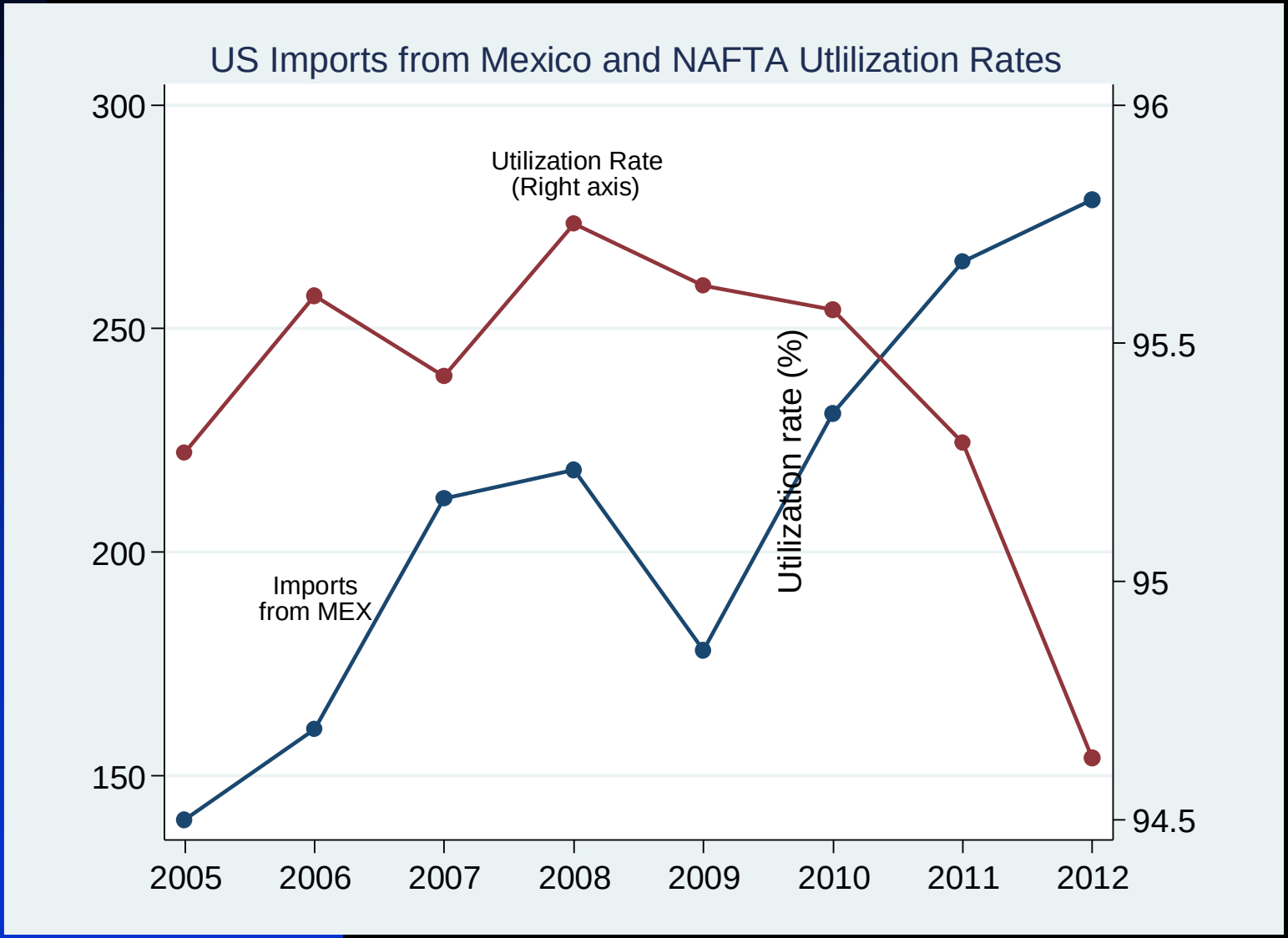
First lesson learned: RoO should Match Industrial capacity [EU reform of GSP RoO]



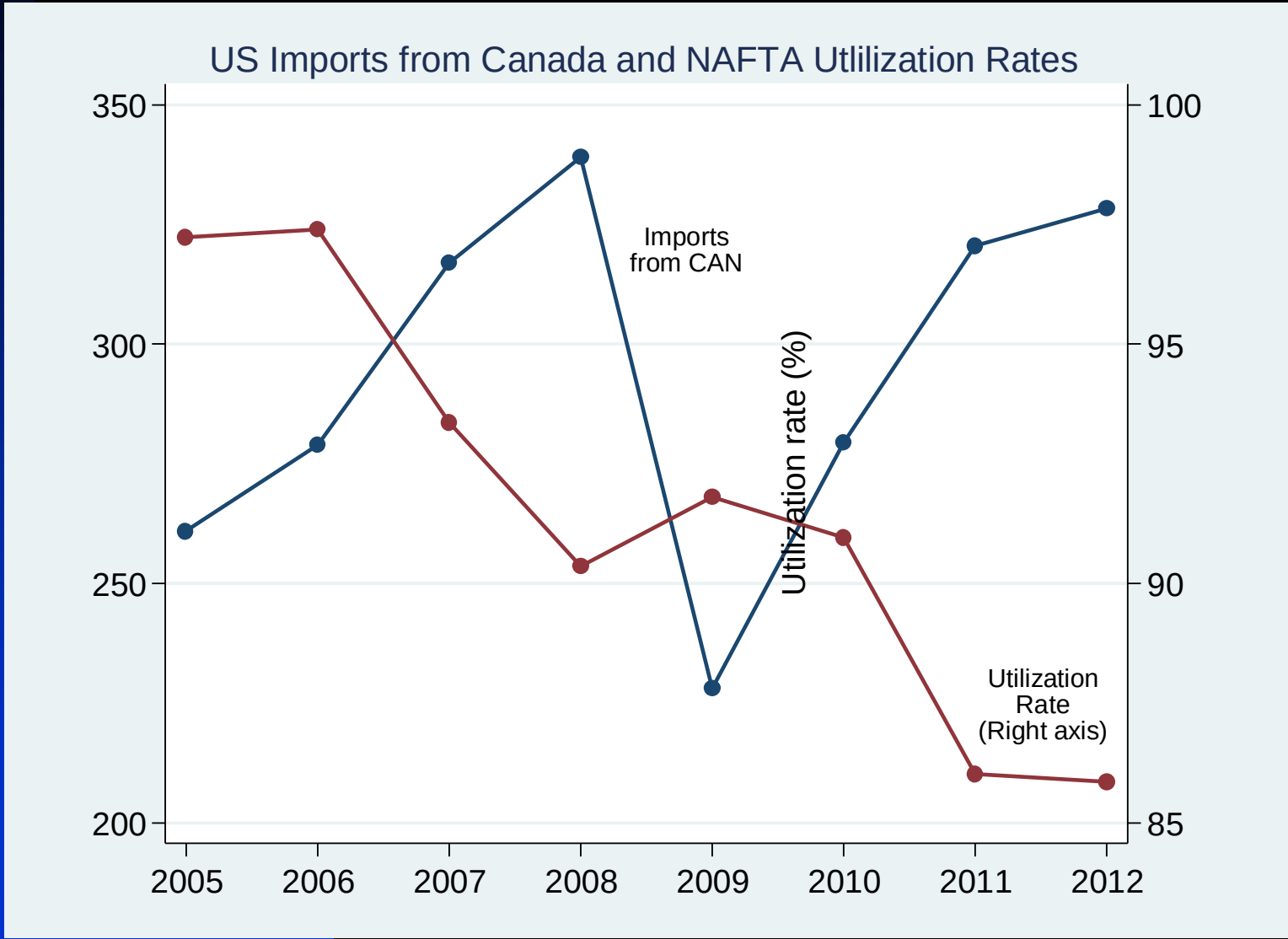
Second lesson learned :RoO should match value chains



Third: RoO may be stringent ,however utilization high, RoO well drafted,what would happen with RoO less strict ?



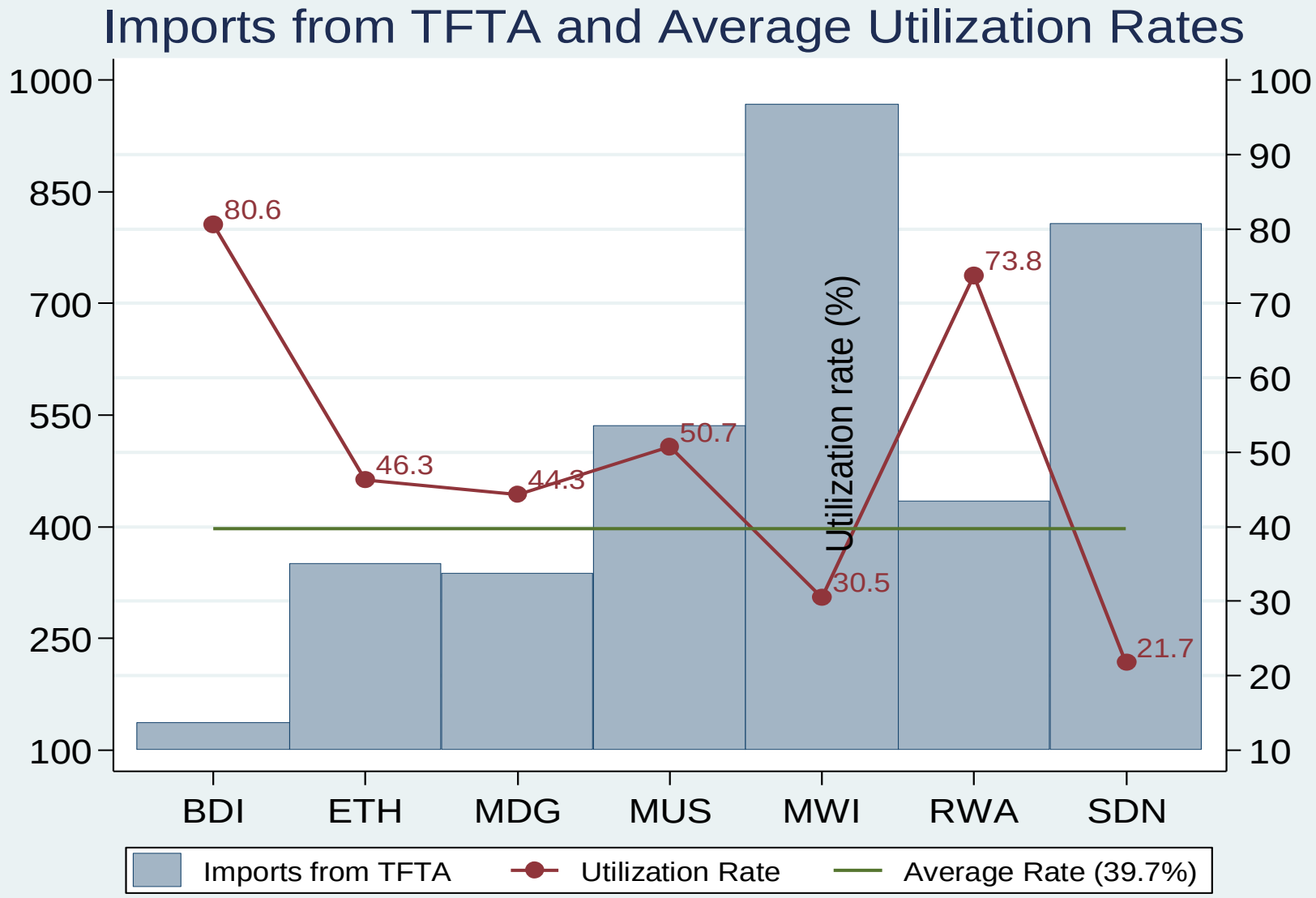
Fourth :Is compliance with RoO worth the effort ?



Fifth: Those who seems Learning less: ASEAN Utilization rates [2010]

	BRN (Jan-Jun)	KHM (Jan-Dec)	IDN (Jan-Dec)	LAO (Jan-Mar)	MYS (Jan-Dec)	MMR (Jan-Dec)	PHL (Jan-Dec)	THA (Jan-Sep)	VNM (Jan-Jun)
Form D (USD millions)	20	792	7'385	14	4'976	10	6'694	5'126	1'019
Intra-ASEAN (USD millions)	585	1'682	38'912	404	44'907	1'993	16'270	22'681	7'587
Utilization (%)	3.34	47.1	18.98	3.44	11.08	0.49	41.15	22.6	13.44

Sixth: *Those who seems Learning less-Reported averages of* Utilization Rates in COMESA and SADC [2010]



What we can learn

- RoO matching industrial capacity are trade creating and generate value chains [Cambodia]
- RoO may be stringent and predictable leading to high utilization rates in NAFTA. Counterfactual : what if RoO were less stringent ?
- The less trade creating: RoO are not predicable and/or do not reflect industrial capacity [ASEAN ,COMESA and SADC]

Lessons learned in Administering RoO

- The classical model of the certifying authorities and the certificate of origin
- Stamps only (GSP)
- Variations: approved exporters and registered exporters(EU reform)
- Importer declaration (US)
- Stamps and signatures : RTAs in Africa and Asia
- There is clear evidence from utilization rates that the latter is the less trade facilitating

Example 1 of input/output matrix - Cambodia

Product Group, CAMBODIA, year 2012									
Main Output		**Most Exported**	Principal Export Destinations		Main Input		**Most Imported**	Principal Suppliers	
HS4 Code	HS4 Description	Value (US$ 000)	1st Destin. ISO3 Code	1st Destin. Exp. Share (%)	HS4 Code	HS4 Description	Value (US$ 000)	1st Supplier ISO3 Code	1st Supplier Exp. Share (%)
1	2	3	4	5	6	7	8	9	10
6104	Women's or girls'suits, ensembles	1'064'841	USA	48.6	5515	Other woven fabrics	1'663'857	CHN	66.5
6108	Women's or girls' pyjamas	250'068	USA	64.3	6004	Knitted or crocheted fabrics	592'990	CHN	65.6
6109	T-shirts knitted or crocheted	586'798	USA	48.6	5209	Woven fabrics of cotton	156'351	CHN	83.6
6110	Jerseys, pullovers, knitted or crocheted	754'198	EUN	47.8	5211	Woven fabrics of cotton	326'816	CHN	34.7

Example 2 of input/output matrix - Lesotho

Product Group, LESOTHO, year 2012									
Main Output		**Most Exported**	Principal Export Destinations		Main Input		**Most Imported**	Principal Suppliers	
			1st Destin.					1st Supplier	
HS4 Code	HS4 Description	Value (US$ 000)	ISO3 Code	Exp. Share (%)	HS4 Code	HS4 Description	Value (US$ 000)	ISO3 Code	Exp. Share (%)
1	2	3	4	5	6	7	8	9	10
6203	Men's or boys' suits	88'588	USA	92	6004	Knitted or crocheted fabrics	43'645	VNM	35.7
6104	Women's or girls' suits	69'258	USA	99.3	5209	Woven fabrics	31'234	PAK	45.3
6110	Jerseys, pullovers, knitted or crocheted	45'215	USA	96.1	6006	Other knitted or crocheted fabrics	28'372	UNS	57.1
6204	Women's or girls' suits	33'050	USA	93.9	6001	Pile fabrics, knitted or crocheted	16'529	UNS	86.4