



ECONOMIC
DEVELOPMENT IN

AFRICA

REPORT 2019



Made in Africa

Rules of origin for enhanced
intra-African trade



Economic Development in Africa Report 2019

Made in Africa – Rules of Origin for Enhanced
Intra-African Trade



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A stylized, light-colored map of the African continent is overlaid on a dark teal background. The map is composed of simple lines and shapes, representing the outlines of the continents.

Chapter 2

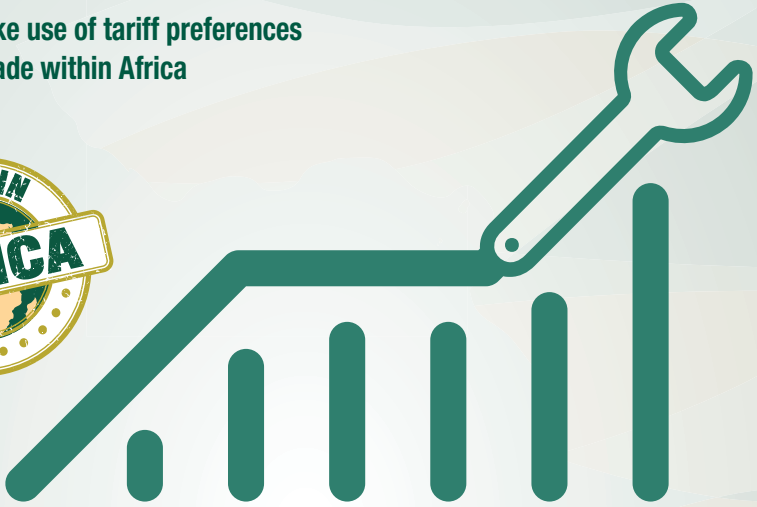
The role of preferential rules of origin in African trade

2.1 Introduction

The focus of this report is on preferential rules of origin, as they can have a significant impact on trade creation and trade diversion. The main objectives of and economic justification for preferential rules of origin are to prevent trade deflection and transshipment. Yet rules of origin have also been used to attain other objectives, namely, as a development tool. Cadot and De Melo (2008) state that in the context of preferential trade agreements between developed and developing countries, rules of origin have been justified as promoting manufacturing activities in developing economy members. Since trade preferences granted to eligible goods increase the price competitiveness of domestic products and of products from the preferential trade agreement region, the use of rules of origin can help retain and promote production capacities in the region. This can stimulate regional value chains and promote economic development.

PREFERENTIAL RULES OF ORIGIN:

A tool to make use of tariff preferences and boost trade within Africa



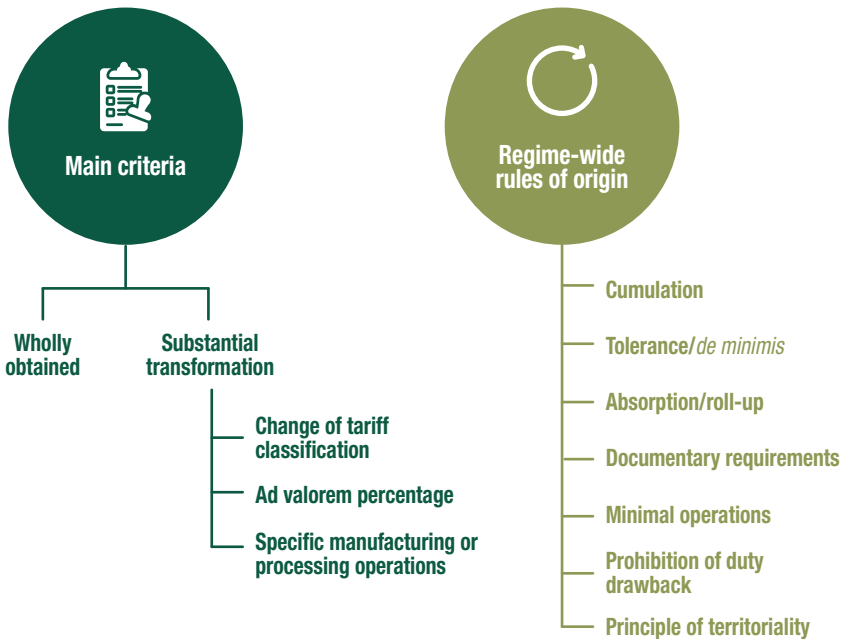
RULES OF ORIGIN SHOULD BE:



Rules of origin have become more complex over time in line with the proliferation of trade agreements, increasingly fragmented production processes and associated political economy interests. This chapter sets out the main issues related to the economic dimension of rules of origin in Africa. Section 2.2 discusses rules of origin and the respective approaches in free trade agreements in Africa and preferential trade agreements relevant to the African context. Section 2.3 discusses how such experiences contribute to the current negotiations with regard to rules of origin in the African Continental Free Trade Area and the aim of fostering trade in sophisticated products. Section 2.4 addresses the empirical relationship between rules of origin and African trade in terms of the restrictiveness of rules of origin regimes, preference margins and respective trade flows and utilization rates of trade preferences. Section 2.5 provides lessons learned on how rules of origin have impacted trade within Africa and with the rest of the world.

2.2 What are preferential rules of origin?

Governments have applied different sets of criteria, rules and approaches to determine the economic origin or national source of a product. Broadly, there is a distinction between main origin criteria (also referred to as product-specific rules) and regime-wide rules.



2.2.1 Main origin criteria

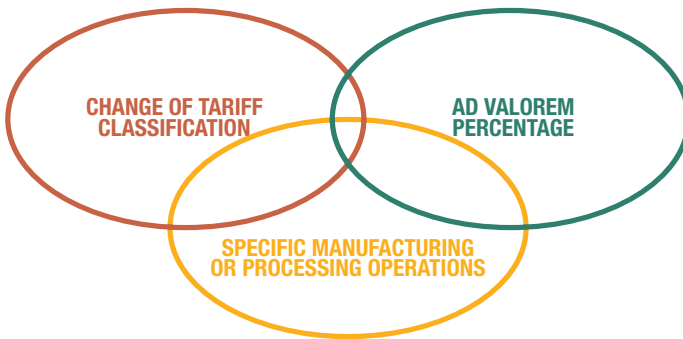
Main origin criteria are established for individual products. This implies that originating status is conferred on a product-by-product basis or, in some cases, for a specific sector. There are two basic criteria for determining the origin of products, namely, wholly obtained and substantial transformation.

The wholly obtained criterion applies to products that have been entirely grown, harvested or extracted from the soil in the territory of a member country or have been manufactured exclusively from such products, in line with annex K1 of the revised Kyoto Convention. This usually applies to commodities and related products. The convention provides that for products “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”.

The substantial transformation or sufficient working or processing criterion is typically determined according to three subcriteria that can be applied separately or in combination, as shown in figure 9 and detailed in this section.

Figure 9

Rules of origin: Subcriteria for determining substantial transformation



Change of tariff classification

According to this criterion, an imported input must be processed to a degree that the resulting exported product is classified under a different tariff classification than all of its imported inputs. This implies that the final good must be of a different tariff classification than the imported goods used in its production. The rule is usually specified in reference

to a level in the Harmonized System nomenclature, that is, either at the chapter, heading, subheading or tariff line level. Rules at a more disaggregated level take precedence over rules at a higher aggregation level. The more that a change is required at an aggregate level (chapter versus heading, heading versus subheading or subheading versus tariff line), the more restrictive the criterion typically is. A change is often requested at the chapter or heading level, yet appendices to rules of origin specify many exceptions to the rules.

A concern over this subcriterion is that the Harmonized System was designed as customs nomenclature and not to confer originating status to goods. As a result, transformation requirements or changes to tariff classifications at a certain level are not equally stringent across products and sectors. For example, a change required at the subheading level in the processing of coffee beans is relatively easily achieved, given that raw coffee beans (HS code 090111) transformed into roasted coffee beans (HS code 090121) are listed under different subheadings. With regard to diamonds, however, raw and cut diamonds are both classified under the same subheading (HS code 710210). This shows that a uniform change of tariff classification criterion does not necessarily reflect how easy or sophisticated a transformation process might be.

The Harmonized System undergoes periodic revisions and the classification of a specific product or sector may therefore change. For example, a recent revision includes a clearer distinction of environmental goods. The economic impact of a change of tariff classification requirement thus depends on the current classification of a product or sector.

The change of tariff classification rule is clear and unambiguous, yet it can lead to a proliferation of product-specific rules, which can also be influenced by domestic industries (Brenton, 2011).

Ad valorem percentage

This criterion refers to the percentage of value addition that must occur in an exporting country or within a specified region. It can be expressed as either the minimum share of value addition that must occur or material content that must originate in an exporting country or region; or as the maximum share of non-originating value addition. Non-originating value refers to the value of imported inputs in relation to the value of the product.

Various forms of calculation methods and percentage criteria are used (box 2). An important consideration in the calculation is how the value of the product is determined,

that is, whether the ex-works price, free on board price or cost, insurance and freight price is used. The calculation also requires the capacity to determine domestic costs, which are inherently complex. With regard to the percentage, some rules of origin set a uniform percentage across all products and others specify different percentages for different product categories.

A concern over this subcriterion is that, based on the method used, compliance with rules of origin requirements may be more or less demanding for exporters. Exporters need to devise and operate accounting systems tailored to the requirements of the free trade and/or preferential trade agreement under which they operate. The systems may not only differ from internal legal requirements in terms of definitions of concepts, applications of accounts, detail, scope and control, but also differ between free trade or preferential trade agreements (UNCTAD, 1998). For many exporters, especially in LDCs, this exceeds existing accounting capabilities. Further, movements in prices (e.g. commodity prices and wages) and exchange rates for finished products that use imported raw materials have an impact on the percentage criterion. Another concern is that the local value addition requirement may turn the competitive advantage of relatively inexpensive labour in developing countries into a penalty, if labour is too inexpensive to reach the required level of local value addition (WTO, 2014). The stringency or leniency of a rule also depends on the cumulation provision, that is, from which countries materials may be considered as originating.

Specific manufacturing or processing operations

This criterion relates to the specific manufacturing or processing operations required to confer originating status. The criterion is relatively clear and unambiguous once defined.

Box 2

Calculation methodologies for the ad valorem percentage criterion in selected regional economic communities in Africa and under the Tripartite Free Trade Agreement

The rules of origin regimes of regional economic communities and under the Tripartite Free Trade Agreement contain ad valorem percentage criteria. Notably, the methodologies used to calculate the criteria, and the stipulated minimum or maximum percentages, differ. Some communities, such as ECOWAS, use a uniform ad valorem percentage criterion across all products, and others, such as COMESA, apply different thresholds for different products or product groups or combine the criterion with other criteria. Some communities, such as COMESA, ECCAS and SADC, and the Tripartite Free Trade Agreement, also offer alternative criteria.

The methodologies applied in the communities are summarized in the table.

Calculation methodologies for the ad valorem percentage criterion

	COMESA OPTION 1	COMESA OPTION 2	EAC	ECCAS OPTION 1	ECCAS OPTION 2	ECOWAS	SADC	TRIPARTITE FREE TRADE AGREEMENT
Numerator	Value of non-originating materials	Ex-factory cost of finished product minus cost, insurance and freight value of non-originating materials	Value of non-originating materials	Value added (no clear definition provided)	Raw materials and materials originating from within Community	Ex-factory price of finished product before tax minus cost, insurance and freight value of non-originating materials	Cost, insurance and freight price of non-originating materials	Value of non-originating materials
Denominator	Value of materials used in production of goods	Ex-factory price	Ex-works price	Post-production cost before tax	Total cost of raw materials and consumables used	Ex-factory price	Ex-works price	Ex-works price
Method of calculation	Maximum value of non-originating materials	Value added by subtraction	Maximum value of non-originating materials	Value added by addition	Minimum value of originating materials	Value added by subtraction	Maximum value of non-originating materials	Maximum value of non-originating materials
Is ad valorem percentage criterion applied in combination with other product-specific rules?	No	No	Yes	No	No	No	Yes	Yes
Percentage	Maximum 60 per cent	Minimum 35 per cent	30 per cent for chapters 1–24 (except 70 per cent for chapter 18); 20–70 per cent for chapters 25–97	Minimum 35 per cent	Minimum 40 per cent	Minimum 30 per cent	30–60 per cent for chapters 1–24; 40–60 per cent for chapters 25–97 (except maximum 15 per cent for chapter 63)	Maximum 70 per cent
Are freight and insurance included?	Yes	Yes	Yes	Yes	Yes	No clear provision in legal text	Yes	Yes

Source: UNCTAD calculations, based on legal texts of origin provisions in respective regional economic communities as available in November 2018. Notes: The analysis does not include the rules of origin in AMU, as the text of the most recent rules was not available at the time of preparation of this report. See <https://unctad.org/en/pages/MeetingDetails.aspx?meetingid=1910> for a note on the methodologies of drafting an ad valorem percentage criterion.

As with the change of tariff classification criterion, domestic industries can influence the specification of manufacturing or processing operations, and they can quickly become obsolete due to technological progress (Brenton, 2011).

The requirement of substantial transformation is universally recognized, yet the use of the three subcriteria varies widely between free trade and preferential trade agreements. Each of the three subcriteria – change in tariff classification, ad valorem percentage and special manufacturing or processing operations – has particular advantages and disadvantages and consensus has not yet been reached as to which of the three is superior or facilitates trade the most (European Commission, 2005; Kommerskollegium, 2012; Naumann, 2011). The advantages and disadvantages of each are detailed in table 1. Most regimes use a combination of all three. For example, Estevadeordal and Suominen (2004), assessing 87 preferential trade agreement regimes worldwide, find that 83 use change of tariff classification requirements, 74 use specific technical requirements, 68 apply a value added rule based on import content and seven use a value added rule based on local value added.

2.2.2 Regime-wide rules of origin

Regime-wide rules of origin are those rules that apply to all products and/or sectors. Some of the rules allow for leniency with regard to the main criteria/product-specific rules (such as cumulation and tolerance rules) and others set out documentary requirements and additional criteria (such as minimal operations and prohibition of duty drawback rules).

Cumulation

Cumulation relates to non-originating materials imported from a fellow member of a preferential trade agreement or from a specific third country. In other words, cumulation allows for non-originating inputs to qualify as originating if they are imported from other members of a free trade or preferential trade agreement or third countries specifically mentioned in the agreement. A distinction is made between bilateral, diagonal and full cumulation, as represented in figure 10 and described in the following paragraphs.

Table 1

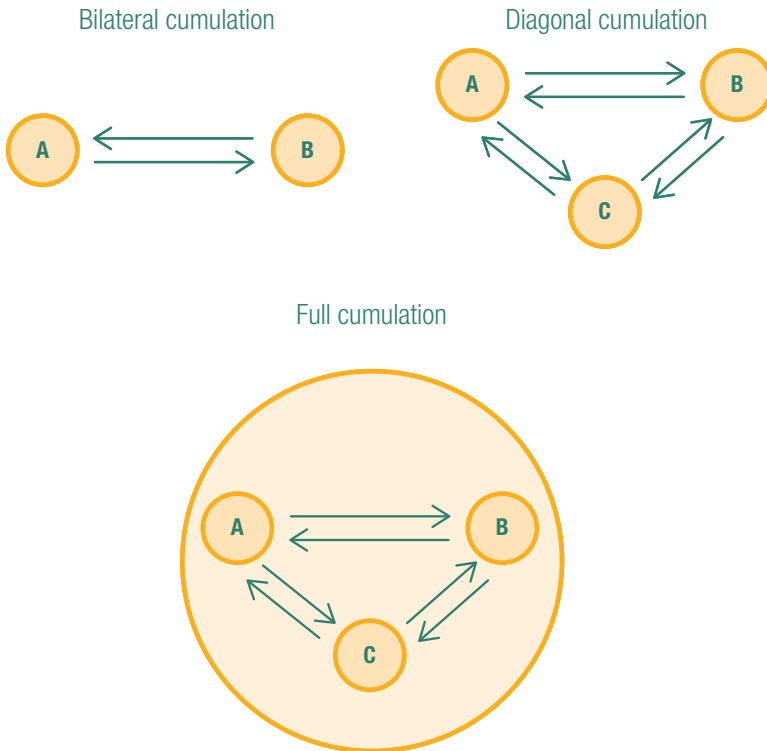
Main origin subcriteria: Advantages and disadvantages

	ADVANTAGES	DISADVANTAGES
Change of tariff classification	<p>Permits specific and objective formulation of conditions determining originating status.</p> <p>If required to produce evidence, manufacturers normally have no difficulty in furnishing data establishing that goods meet the conditions.</p>	<p>Preparation of lists of exceptions often difficult and require updating to keep abreast of technical developments and economic conditions.</p> <p>Any descriptions of manufacturing or qualifying processes must not be unduly complicated, to not lead manufacturers to commit errors in good faith.</p> <p>A prerequisite for use of the structure of a systematic goods nomenclature for determining originating status is that both country of export and country of import must have adopted same nomenclature as basis for respective tariffs, and must apply it uniformly.</p> <p>Difficulties likely to arise in borderline cases in which a slight difference above or below prescribed percentage causes a product to meet or fail to meet originating status requirements.</p>
Ad valorem percentage	<p>Precision: Value of constituent materials imported or of undetermined origin can be established from available commercial records or documents.</p> <p>If value of exported goods is based on ex-works price or price at export, as a rule, both prices can be readily ascertained and supported by commercial invoices and commercial records of traders concerned.</p>	<p>Origin attributed depends largely on fluctuating world market prices for raw materials and on currency fluctuations that may at times be significant enough that application of rules of origin formulated on this basis is appreciably distorted.</p> <p>Elements taken as basis for calculating value added, such as cost of manufacture or total cost of products used, often difficult to establish and may have a different make-up and interpretation in country of export and country of import.</p> <p>Disputes may arise as to whether certain factors, in particular overhead, are to be allocated to cost of manufacture or, for example, to cost of selling, distribution, etc.</p>
Specific manufacturing or processing operations	<p>Permits specific and objective formulation of conditions determining originating status.</p> <p>If required to produce evidence, manufacturers normally have no difficulty in furnishing data establishing that goods meet the conditions.</p>	<p>Preparation of lists of exceptions often difficult and require updating to keep abreast of technical developments and economic conditions.</p> <p>Any descriptions of manufacturing or qualifying processes must not be unduly complicated, to not lead manufacturers to commit errors in good faith.</p> <p>A prerequisite for use of the structure of a systematic goods nomenclature for determining originating status is that both country of export and country of import must have adopted same nomenclature as basis for respective tariffs, and must apply it uniformly.</p>

Source: UNCTAD.

Figure 10

Bilateral, diagonal and full cumulation



Source: UNCTAD.

Bilateral cumulation allows materials imported from a fellow member of a free trade or preferential trade agreement to be treated as originating. Originating input from country A is considered originating input in country B, and vice versa. This is the most common type of cumulation.

Diagonal cumulation is similar, but extends to more than two countries that have concluded preferential trade agreements. This type of cumulation may also be called regional cumulation. Only originating products or materials can benefit from diagonal cumulation. Fully originating inputs from each country are considered originating inputs in the other countries. Countries under a free trade or preferential trade agreement can therefore use materials that originate in any member country as if the materials had originated in the country in which processing was undertaken.

The most liberal or lenient form of cumulation is full cumulation, which allows for a country under a free trade or preferential trade agreement to consider working and processing carried out in any member country as having occurred in its territory. This allows for a greater use of materials from members of an agreement and more fragmented production processes within a region, and works to facilitate regional value chains. Full cumulation is therefore the most extensive and generous form of conferring originating status on a product. However, the documentary requirements under full cumulation can be more complex than those required under diagonal cumulation (Augier et al., 2005).

In LDCs, cumulation is of particular relevance, as they depend to a greater extent on imported inputs. Therefore, more liberal and generous cumulation provisions have an important impact on the capacity of LDCs to meet rules of origin requirements.

Tolerance/de minimis

This rule alleviates the manufacturing and/or production requirements for originating goods. It is called the tolerance rule in Europe and the *de minimis* rule in the context of the Association of Southeast Asian Nations, the North American Free Trade Agreement and the Trans-Pacific Partnership. The rule stipulates a maximum percentage of non-originating materials that can be used in production without affecting the defined origin of a final product. For example, in SADC, the change of tariff classification rule for certain products is combined with a maximum 15 per cent share of the ex-works price; this share can be non-originating without a product losing its originating status.

Absorption/roll-up

This rule allows for non-originating materials that have acquired originating status by meeting specific processing requirements to maintain this status when used as inputs in a subsequent transformation. This implies that a part of all non-originating inputs contained in an intermediate product is disregarded when assessing the origin of a final good.

Documentary requirements: Certification and direct transport

There are different models of certification that provide proof of originating status, including self-certification by exporters, certification by an industry umbrella group or certification by authorities of exporting countries, or a combination of the three (Kommerskollegium, 2012). The rule on direct transport relates to the direct transport of preferential goods, to ensure that goods arriving in an importing country are strictly the same as those that were exported. Related provisions usually allow for goods to pass through or stop over in a third country if they remain under customs supervision.

Minimal operations/list of insufficient working or processing

This rule sets out the operations that are insufficient to confer originating status, such as cleaning, preservation during transport and storage or packing.

Prohibition of duty drawback

This rule prohibits the refund of tariffs on imported inputs that are later included in a final product exported to a fellow member of a preferential trade agreement. Such a refund would allow an exporter to benefit from a double preference and thereby create unfair competition. However, duty drawback can stimulate trade in intermediate goods.

Principle of territoriality

This rule stipulates that working or processing must take place in a certain territory, and sets out derogations under certain conditions that allow for outward processing.

In sum, countries have defined different sets of rules and criteria to confer originating status on products. According to WTO (2018), the main criteria and requirements that must be met simultaneously are as follows: compliance with origin criteria, that is, a good must be wholly obtained in a beneficiary country or comply with minimum substantial transformation requirements to change its origin; compliance with such requirements demonstrated through a certificate; and direct consignment of a good from a beneficiary country to a preference-granting country, i.e. direct transportation requirements or exceptions to it. Non-compliance with one requirement may disqualify a product from preferences even if the other two requirements are met.

The difficulty of meeting rules of origin requirements has increased over time in line with ever more fragmented production processes and global sourcing networks. Moreover, the proliferation of trade agreements and trade regulations have further added to the complexity of determining the economic origin of a product. There are at least 291 preferential trade agreements, each with its own set of rules, and there is a lack of

compatibility between the rules in the agreements. Demonstrating compliance is costly in terms of the time required by customs agents to verify and certify compliance. In addition, there is evidence of complaints that some countries do not accept certificates of origin (see www.tradebarriers.org/). Further, the possibilities for direct consignment are constrained in Africa due to limited transportation networks. Such factors have made it more difficult for businesses to comply with requirements and take advantage of rules of origin and, as a result, rules of origin have become more controversial (Draper et al., 2016).

2.3 Rules of origin in African trade

2.3.1 Rules of origin in regional economic communities and under the Tripartite Free Trade Agreement

In Africa, each regional economic community has negotiated or is in the process of negotiating its own set of rules of origin. The main characteristics of rules of origin approaches in COMESA, EAC, ECCAS, ECOWAS, SADC and under the Tripartite Free Trade Agreement are summarized in table 2, including information on the main origin criteria (change of tariff classification and ad valorem percentage) and the most common regime-wide rules, namely, cumulation, tolerance, absorption and documentary requirements. Each regional economic community applies an ad valorem percentage criterion but the underlying methodologies for calculating the relevant percentages and the percentages applied differ (box 2).

COMESA provides three options for the ad valorem percentage calculation, in combination with a change of tariff heading requirement. The change of tariff classification criterion consists mostly of specifications at the chapter and heading levels, yet there are many specifications and exceptions in the legal text. COMESA allows for diagonal cumulation and the absorption rule, but does not provide for the tolerance rule. With regard to documentary requirements, COMESA does not allow for self-certification and requires direct shipment, yet the documents required to prove direct shipment are not specified. There is a simplified procedure for small-scale traders, yet it remains subject to validation.

EAC does not have a general ad valorem percentage criterion applicable to all products, but has a list of product-specific rules of origin. The change of tariff classification criterion consists mostly of specifications at the chapter and heading levels, with 13 exceptions

Table 2
Main characteristics of rules of origin, selected regional economic communities in Africa and under the Tripartite Free Trade Agreement

	COMESA	EAC	ECCAS	ECOWAS	SADC	TRIPARTITE FREE TRADE AGREEMENT
MAIN ORIGIN CRITERIA						
Ad valorem percentage	General: Yes Three calculations and percentage across change of tariff heading (not an across-the-board criterion; limited to specific headings in appendix V of COMESA protocol on rules of origin)	General: No	General: Yes Uniform percentage across all products (minimum 30 per cent of regional value content; minimum value contingent on calculation criterion used)	General: Yes Uniform percentage across all products (minimum 30 per cent of regional value content; minimum value added by subtraction ^a)	General: No	General: No
Change of tariff classification	91	51	Not applicable	Not applicable	24	28
REGIME-WIDE 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						
Certificate of origin	COMESA certificate of origin	EAC certificate of origin	ECCAS certificate of origin	ECOWAS certificate of origin (agricultural products, livestock products and handmade articles exempt from this requirement)	SADC certificate of origin	Tripartite Free Trade Agreement certificate of origin
Certifying authorities	Yes; specimen impressions of stamps and specimen signatures of officials required	Yes; specimen impressions of stamps and specimen signatures of officials required	Yes; specimen impressions of stamps required	Yes; signature must be provided in name and function	Yes; specimen impressions of stamps and specimen signatures of officials required	Yes; specimen impressions of stamps and specimen signatures of officials required
Notification requirement to 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 consignments	No	Yes; maximum \$500 for personal effects; maximum \$1,200 as traveller luggage	No	No	No	Yes; maximum \$500 for personal effects; maximum \$1,200 as traveller luggage
Direct shipment requirement	Yes	Yes	No clear provision in legal text	No explicit terms in legal text; but definition of consignment is provided	Yes	Yes
Documentary evidence of direct shipment requirement	No clear provision in legal text	No clear provision in legal text	No clear provision in legal text	No explicit terms in legal text, but definition of consignment is provided	Single transport document or document certified by customs authorities of third country	Single transport document or document certified by customs authorities of third country (substantiating evidence may be accepted)
Obligation of pre-shipment and approval of manufacturer and/or exporter	No	No	Yes	Yes	No (recommended but not compulsory)	No

Source: UNCTAD calculations, based on legal texts of rules of origin provisions in respective regional economic communities as available in November 2018. Note: The number of product-specific rules of origin, based on the number of pages in the relevant appendices of the legal texts of regional economic communities, is used as a proxy for the complexity of the change of tariff classification criterion.

^a Change of tariff subheading also provided as a general rule, but must be accompanied by list of exemptions.

specifying a change at the subheading level. EAC allows for diagonal cumulation and the tolerance and absorption rules. The manual on the application of rules of origin provides for full cumulation, yet there is no such provision in the legal text. With regard to documentary requirements, EAC does not allow for self-certification, but has provisions for approved exporters and an exporter declaration for small consignments. EAC requires direct shipment, but provides for the possibility of trans-shipment.

ECCAS applies a uniform percentage across all products for the ad valorem percentage criterion, amounting to a minimum of 30 per cent of regional value content. ECCAS allows for diagonal cumulation and the absorption rule, but does not provide for the tolerance rule. ECCAS does not allow for self-certification and has no clear provision for direct shipment.

ECOWAS applies a uniform percentage across all products for the ad valorem percentage criterion, amounting to a minimum of 30 per cent of regional value content. ECOWAS does not have explicit terms for cumulation in the legal text. However, in practice, diagonal cumulation is applied to some extent, under article 2 of the ECOWAS trade liberalization scheme. ECOWAS does not allow for the tolerance and absorption rules. With regard to documentary requirements, ECOWAS does not allow for self-certification and has no explicit terms for direct shipment, but a definition of consignment is provided.

SADC does not apply a general ad valorem percentage criterion. The change of tariff classification criterion consists mostly of specifications at the chapter and heading levels, with four exceptions specifying a change at the subheading level. SADC allows for full cumulation (Draper et al., 2016) and the tolerance and absorption rules. SADC does not allow for self-certification and requires direct shipment.

In the process of negotiating the rules of origin regime for the Tripartite Free Trade Agreement, the three constituting regional economic communities, namely, COMESA, EAC and SADC, expressed diverging preferences due to the different approaches followed at the regional economic community level. Members agreed that the rules of origin under the Agreement should not restrict trade; should be simple, flexible and easy for customs administrations to administer and businesses to comply with at a reasonable cost; should not be more stringent than existing rules under the regional trading arrangements of regional economic communities and economic partnership agreements; should promote trade and enhance global competitiveness; and should enable diagonal cumulation (Draper et al., 2016). The negotiation process resulted in a regime that does not stipulate a general percentage across all products for the ad

valorem percentage criterion. The change of tariff classification criterion consists mostly of specifications at the chapter and heading levels, with four exceptions specifying a change at the subheading level. The Agreement allows for the tolerance and absorption rules. With regard to documentary requirements, the Agreement does not allow for self-certification, but has provisions for approved exporters and an exporter declaration for small consignments. It requires direct shipment.

This analysis suggests that the rules of origin under ECCAS and ECOWAS tend to be more transparent and easier to understand by exporters due to the uniform ad valorem percentage criterion. The rules of origin under ECOWAS are also less restrictive, as the change of tariff classification criterion requires, in general, a change at the subheading level, whereas the rules of origin under the other regional economic communities require, in general, a change at the chapter and heading levels. However, the interpretation of restrictiveness related to changes in level is only indicative, as noted in the example provided of coffee beans and diamonds.

Regional economic communities that have an ad valorem percentage criterion applicable to all products as a general rule do not contain provisions for the tolerance and absorption rules. This is in line with practices under other preferential trade agreements. Estevadeordal and Suominen (2008) note that “many regimes with across-the-board rules of origin neither provide for tolerance nor feature many regime-wide provisions of flexibility”, and that the regime-wide rule that occurs the most often in such preferential trade agreements is duty drawback.

Specific manufacturing or processing operations are not referred to in table 2. However, it should be noted that SADC applies specific rules that identify the manufacturing or processing operations that qualify to confer originating status, and this adds to the restrictiveness of the rules of origin in SADC.

Draper et al. (2016) state that challenges in EAC relate to “issues of verification or origin, administrative procedures, compliance difficulties for small-scale producers”. This is a particular concern as the private sector in Africa is largely comprised of small-scale producers and SMEs. By contrast, the rules of origin in COMESA have greater administrative simplicity and transparency (Brenton et al., 2005).

Self-certification is not allowed for in any regional economic community or under the Tripartite Free Trade Agreement, contrary to the provisions in some of the preferential trade agreements with major trading partners, such as the African Growth and Opportunity Act of the United States and the Everything but Arms initiative of the European Union, and as recommended by WTO. In most regional economic communities, a certificate

of origin is delivered upon request from an exporter or producer. Some communities require registration of the exporter or producer prior to the delivery of a certificate of origin. This procedure can be demanding in terms of the details required, such as in ECCAS and ECOWAS, where firms need to submit a series of details on their calculation methodology and its breakdown to be admitted to trade under the respective trade arrangement.

Due to the constraints related to transportation networks and customs capacity in Africa, compliance with the rules of origin provisions for direct shipment and certification requirements and procedures applicable in most regional economic communities is challenging. This highlights the need for customs modernization and trade facilitation reforms.

With regard to the enforcement of compliance, regional economic communities have limited capacity or procedures. In COMESA, while there have been isolated retaliatory actions, in general there is a diplomatic-style rather than a rules-based approach to dispute resolution (Draper et al., 2016).

2.3.2 Rules of origin in the African Continental Free Trade Area

At the time of preparation of this report, the Agreement Establishing the African Continental Free Trade Area had been signed by 49 countries, and the rules of origin remained under negotiation. Throughout this process, countries in Africa can build on and draw from their vast experience in trade and rules of origin negotiations with partners in Africa and external partners, such as with regard to the free trade agreements under regional economic communities, the Partnership Agreement between the Members of the African, Caribbean and Pacific Group of States and the European Community; the African Growth and Opportunity Act of the United States; the Generalized System of Preferences of the European Union; and economic partnership agreements.

In the Agreement, member States reaffirmed their existing rights and obligations under the other trade agreements of which they are members. Moreover, the Agreement considers the free trade agreements of the regional economic communities as building blocks, recognizes their best practices and guarantees the “acquis” obtained in them. Therefore, the Continental Free Trade Area will not replace existing regional agreements or those under negotiation such as the Tripartite Free Trade Agreement, and its rules of origin will be similar to those in the regional economic community protocols.

Accounting for these requirements has led to an extensive list of product-specific rules in the African Continental Free Trade Area. With regard to regime-wide rules, negotiators have agreed on the rules of cumulation, tolerance and absorption.

It is critical to formulate rules in language accessible by the main users, such as private operators, firms, brokers and customs authorities. If the language of the rules is overly complex, users will prefer to avoid risks and not use the arrangement, which would undermine the African Continental Free Trade Area. This emphasizes the need for rules of origin that are simple (in the sense of being clear and understandable), transparent, predictable and trade-facilitating for businesses and trade operators. Experiences in other regions, such as the Association of Southeast Asian Nations, shows that reliance on umbrella groups for certification could enhance transparency and help streamline procedures.

African Continental Free Trade Area negotiators need to account for regional and country-specific sensitivities. Only rules of origin that are well-balanced and have been fully consulted on can succeed in being accepted and applied. The protocol, including certification and verification methods, should be crafted with the future in mind, to avoid renegotiations and updates that may present challenges for Governments and private sector operators, and to account for future enhanced capacity in countries in Africa to participate in value chains.

Finally, the negotiation process should ensure that exporters in Africa will be provided with the required incentives to trade within Africa and avoid situations wherein exporting to the United States or Europe is easier and less costly than exporting to other countries in Africa.

2.3.3 Rules of origin at the multilateral level and in preferential trade agreements with major trading partners

Rules of origin at the multilateral level

Trade preferences for developing countries have been a longstanding issue in international trade negotiations.¹³ In 1968, the United Nations Conference on Trade and

¹³ The multilateral trading community has deliberated on rules of origin for many decades without reaching a conclusion. In 1953, the International Chamber of Commerce made an initial attempt to harmonize rules of origin by facilitating a resolution of the contracting parties to the General Agreement on Tariffs and Trade that recommended the adoption of a uniform definition for determining the nationality of manufactured goods, yet a consensus was not reached. In the 1960s, during discussions on the establishment of the Generalized System of Preferences, a second attempt was made to harmonize rules of origin, but was not successful. As a result, preference-giving countries retained their own rules of origin systems. In the 1970s, the international community succeeded in including guidelines on rules of origin in the Kyoto Convention. However, diverging views on harmonization remained. In the 1990s, the Uruguay round of multilateral trade negotiations included rules of origin, but specified that only non-preferential rules of origin should be addressed. The Agreement on Rules of Origin emerged from this process, which sought to harmonize all non-preferential rules of origin used by WTO members in a single set of international rules. Negotiations on the harmonization of non-preferential rules of origin have not been finalized, and each country continues to apply its own non-preferential rules of origin (see <http://www.wcoomd.org/en/topics/origin/overview.aspx>).

Development, at its second session, adopted the concept of the Generalized System of Preferences and established a Special Committee on Preferences as a subsidiary body of the Trade and Development Board, agreeing, in resolution 21 (II), that “the objectives of the generalized non-reciprocal, non-discriminatory system of preferences in favour of the developing countries, including special measures in favour of the least advanced among the developing countries, should be: (a) to increase their export earnings; (b) to promote their industrialization; (c) to accelerate their rates of economic growth”.¹⁴

In 1970, the Special Committee on Preferences established the legal nature of commitments for preference-giving countries. Prospective preference-giving countries applied for a waiver from their obligations under article I of the General Agreement on Tariffs and Trade, which enshrined the most-favoured nation principle. Such waivers were initially granted on a temporary basis. However, in 1979, the contracting parties adopted a supplementary clause that enabled countries to permanently derogate from the most-favoured nation principle. The enabling clause also recognized the particular needs of LDCs, specifying that developed countries were allowed to grant special and preferential tariff treatment to LDCs in the context of any general or specific measures in favour of developing countries.

Resolution 21 (II) noted that a preference scheme should be based on generality, non-reciprocity and non-discrimination, yet its implementation has led to schemes that have differed substantially in terms of product coverage, the depth of tariff cuts, safeguards and rules of origin (UNCTAD, 2018g). A particular area of difference has been the treatment of the textiles and clothing sector; a sensitive sector for many developed and developing countries. Moreover, the rules of origin and ancillary requirements that emerged have been specific to each Generalized System of Preferences scheme. Unilateral preferences for LDCs have been an ongoing issue in this context. Rules of origin in LDCs began to be a subject of debate following the launch of the duty-free, quota-free initiative at the first Ministerial Conference of WTO in 1996.

The United States expanded its product coverage in its Generalized System of Preferences scheme in 1997, and amended the scheme in 2000 for countries in sub-Saharan Africa under the African Growth and Opportunity Act, enlarging the range of products and granting preferential treatment to selected apparel articles subject to special provisions, rules of origin and customs requirements. The European Union improved market access through its Everything but Arms initiative in 2001, which granted unrestricted duty-free access to all products from LDCs.

At the multilateral level, a decision on the duty-free, quota-free initiative and rules of

¹⁴ See <https://unctad.org/en/pages/MeetingsArchive.aspx?meetingid=22967>.

origin was made at the sixth Ministerial Conference of WTO in 2005. Members agreed that developed countries and developing countries in a position to do so should provide duty-free, quota-free market access on a lasting basis for all products originating from all LDCs or, for those members facing difficulties, for at least 97 per cent of products from LDCs. WTO members also agreed to “ensure that preferential rules of origin applicable to imports from LDCs are transparent and simple and contribute to facilitating market access” (WTO, 2014). However, preference-giving countries reiterated their position that rules of origin under the duty-free, quota-free initiative could not be discussed or negotiated, since preferences were unilateral (WTO, 2014). This argument had been made in the 1970s during discussions on the Generalized System of Preferences and rules of origin by the Special Committee on Preferences.

To initiate the commitment on rules of origin made at the sixth Ministerial Conference of WTO in 2006, the LDCs Group began work on a draft proposal for progress on the issue of rules of origin under the duty-free, quota-free initiative. The objective was to support a 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; and to counter the misperception that LDCs wished to emphasize the harmonization of preferential rules of origin. While theoretically desirable from the perspective of the LDC Group, it was understood that this was not a viable option (WTO, 2014).

Preference-giving countries recognized that their rules of origin were outdated and had not followed evolutions in world trade. For example, the European Commission noted that rules of origin had not been adapted to the trend of globalization in production and advances in technologies and transport, information technology and communications (European Commission, 2007). Moreover, lower preferential margins combined with high compliance costs made preferences unattractive. The European Union reformed its rules of origin; the revised legal texts became effective in 2011. Critically, the reform introduced a differentiation in favour of LDCs, allowing for a single transformation process in textiles and clothing and thereby accommodating a request that LDCs had made for over a decade. Further, it raised the threshold of the use of non-originating materials in many sectors, from 40 to 70 per cent for LDCs and to 50 per cent for other Generalized System of Preferences beneficiaries, and also eased the cumulation rule. As a result, the share of apparel exports from LDCs to the European Union increased significantly.

These developments supported the position of the LDCs Group at WTO that the rules of origin for LDCs needed to be reformed. Prior to the ninth Ministerial Conference of WTO in 2013, the Group prepared several proposals on rules of origin, which outlined

the challenges in LDCs of complying with existing rules of origin. The Conference adopted a decision on preferential rules of origin for LDCs that considered that duty-free, quota-free market access for LDCs could be effectively utilized if accompanied by simple and transparent rules of origin, and recognized that simple and transparent rules of origin may take into account the capacities and levels of development of LDCs.¹⁵ The decision also detailed certain elements for preference-granting members in the formulation of preferential rules of origin, including substantial transformation, cumulation, documentary requirements and notification. For example, with regard to substantial transformation, the guidelines recommended that, if the rules are based on the ad valorem percentage criterion, the level of value addition should be kept as low as possible, and noted that LDCs sought consideration of allowing non-originating materials to a maximum of 75 per cent of value. For rules based on the change of tariff classification criterion, a change of tariff heading or subheading should be sufficient for transformation, and rules based on specific manufacturing or processing operations should take into account the productive capacities of LDCs. Cumulation should be a feature of non-reciprocal preferential trade agreements, allowing for bilateral cumulation, cumulation with other LDCs, cumulation among Generalized System of Preferences beneficiaries of a preference-granting country and/or cumulation among developing country members forming part of a regional group. Finally, documentary requirements should be simple and transparent, avoid a requirement to provide proof of non-manipulation and, whenever possible, recognize self-certification.

The ninth Conference adopted the Agreement on Trade Facilitation, which requires a series of reforms in the operation of customs procedures, including with regard to rules of origin, to facilitate trade. Between the ninth and tenth Ministerial Conferences, at a meeting of the Committee on Rules of Origin, the LDCs Group stated: “No matter how rules of origin are designed or drafted, they should reflect global value chains. If not, trade will not be created and trade preferences will be underutilized. Rules of origin should not be used as a disguised form of industrial policy aiming at requiring substantial transformation in LDCs going beyond what is commercially meaningful and viable” (Third World Network, 2014). This implies, for example, that the degree of restrictiveness of rules of origin should be considered with regard to the existing value chain contexts in which they are expected to operate. The decision on preferential rules of origin of the ninth Ministerial Conference was expanded with more detailed guidelines in a decision adopted at the tenth Ministerial Conference in 2015, which aimed to reduce the administrative burden related to documentary evidence and ease the direct consignment rule through the avoidance of requiring non-manipulation certificates

¹⁵ See wto.org/english/thewto_e/minist_e/mc9_e/desci42_e.htm.

in transit countries. Other measures to streamline customs procedures should be considered, such as minimizing documentation requirements for small consignments or allowing for self-certification.

Following the tenth Ministerial Conference of WTO, the LDCs Group, at a meeting of the Committee on Rules of Origin, noted that even the 25 per cent value addition rule might be difficult or impossible to meet, given modern manufacturing methods and the globalization of value chains. Some commentators note that the decisions adopted at the ninth and tenth Conferences both contain best practices or benchmarks for drafting preferential rules of origin and the impact this can have (Inama, 2015).

In sum, the debate on rules of origin is ongoing. As long as the subject is not taken up in formal negotiations and an agreement reached, rules of origin largely fall outside WTO disciplines. As noted by Cadot and De Melo (2008), rules of origin are potentially a “choice candidate for creeping protectionism”.

Rules of origin in preferential trade agreements with major trading partners

The African Continental Free Trade Area is expected to boost regional integration in Africa and thereby facilitate and increase intra-African trade. However, external trading partners remain critical for growth in Africa and the participation of countries in Africa in global production networks. The European Union remains the major external partner for exports from Africa, followed by China and the United States. This section examines the rules of origin regimes that some major preference-giving partners apply to Africa. Table 3 summarizes the main features of two key non-reciprocal schemes, namely, the African Growth and Opportunity Act of the United States and the Everything but Arms initiative of the European Union. China has also established preferential rules of origin to facilitate market access for LDC products, which are important for many traders in Africa, but are not addressed in this report due to a lack of data.

The African Growth and Opportunity Act of the United States contains a uniform ad valorem percentage criterion that requires 35 per cent local and/or regional value addition. However, the uniform percentage is not applicable to the textiles and clothing sector, for which the change of tariff classification criterion is specified with regard to chapters 61 and 62, headings 6501, 6502 and 6504 and subheadings 6406.90.15 and 6505.00.02–6505.00.90 of the harmonized tariff schedule of the United States. The Act allows for full and diagonal cumulation. With regard to documentary requirements, a certificate of origin is, in general, not required, except for textiles and apparel goods. The Act provides for self-certification. Goods must be shipped directly to the United States. There is no obligation for pre-registration and approval of manufacturers and exporters.

Table 3

African Growth and Opportunity Act and Everything but Arms initiative: Main characteristics of rules of origin

	AFRICAN GROWTH AND OPPORTUNITY ACT	EVERYTHING BUT ARMS INITIATIVE
MAIN ORIGIN CRITERIA		
Ad valorem percentage	General: Yes Uniform percentage across all products (35 per cent value addition, excluding textiles and clothing)	General: No
Change of tariff classification	a	57
REGIME-WIDE RULES		
Cumulation	Yes	Yes
Tolerance		Yes
Absorption		Yes
Documentary requirements: Certification and direct transport		
Certificate of origin	Required for textile and apparel goods ^b	Yes (rules of origin form A or statement under registered exporter system)
Certifying authorities	No	No
Notification requirement to certifying authorities	No	No
Exporter declaration (self-certification)	Yes	Yes
Approved exporter	No	Yes
Exporter declaration for small consignments	Yes	Yes
Direct shipment requirement	Yes ^c	Yes; storage and splitting of consignments in a country of transit possible under certain conditions
Documentary evidence of direct shipment requirement	Yes	No
Obligation of pre-registration and approval of manufacturer and/or exporter	No	Yes

Note: The number of product-specific rules of origin, based on the number of pages in the relevant appendices of the legal texts of regional economic communities, is used as a proxy for the complexity of the change of tariff classification criterion.

^a Applies exclusively to chapters 61 and 62, headings 6501, 6502 and 6504 and subheadings 6406.90.15 and 6505.00.02–6505.00.90 of harmonized tariff schedule of the United States.

^b In general, certificate of origin not required, but when article not wholly grown in nor product or manufacture of a single beneficiary country, exporter of merchandise or other appropriate party with knowledge of relevant facts should be prepared to submit a declaration setting forth all pertinent detailed information concerning production or manufacture of merchandise.

^c In general, if shipment from beneficiary country to the United States passes through territory of any other country, merchandise in shipment cannot enter into commerce of any other country while en route to the United States, and in invoice, bills of lading and other shipping documents must show the United States as final destination; or if goods shipped from beneficiary developing country, merchandise cannot enter into commerce of the country maintaining free trade area.

The Everything but Arms initiative of the European Union provides for a set of product-specific rules based on the ad valorem percentage and/or change of tariff classification criteria and specific working processes in the textiles and garments sector. The change of tariff classification criterion is product specific. The initiative allows for regional diagonal cumulation and the tolerance and absorption rules. With regard to administrative requirements related to certification, the process differs from the free trade agreements in Africa. The initiative provides for self-certification and thereby transfers the responsibility for certification to exporters rather than public authorities. Goods must be shipped directly, with provisions for storage and the splitting of consignments in a transit country under certain conditions. There is no obligation for pre-registration and approval of manufacturers and exporters.

2.4 Empirical relationship between rules of origin and African trade

Rules of origin are an intrinsic part of international trade. However, the study of rules of origin has been limited by challenges in measuring the restrictiveness of rules of origin regimes; how rules of origin have affected trade patterns and flows; and the extent to which trade preferences have been utilized. These issues are elaborated on in this section.

2.4.1 Restrictiveness of rules of origin regimes

The study of rules of origin has been limited by the challenges in measuring the restrictiveness of rules of origin regimes and the extent to which trade preferences are actually used. The restrictiveness of a rules of origin regime is a measure of the degree to which it restricts the options of producers and/or exporters and affects economic decisions and/or the impact a regime has on trade diversion. For example, with regard to the restrictiveness of the rules of origin regimes applicable to apparel exports of some countries in Africa, the rules of origin were initially more restrictive under the Everything but Arms initiative, compared with under the African Growth and Opportunity Act. As a result, exports of apparel to the United States increased at a faster rate than did those to the European Union (De Melo and Portugal-Pérez, 2013; see chapter 3).

Various measures of restrictiveness have been developed (Brenton and Manchin, 2002; Estevadeordal, 2000; Estevadeordal and Suominen, 2004; Grettton and Gali, 2005; Harris, 2007). The indices of Estevadeordal (2000) and Harris (2007) are discussed

in more detail in this section, as they include free trade agreements in Africa in their analyses, and several other studies are variations of these indices. Both restrictiveness indices are based on the characteristics of or observations from the text of the rules rather than their effects (box 3). However, the observed or ex ante restrictiveness may be different from the real or effective restrictiveness. The level of restrictiveness may not be relevant if producers can source enough competitive inputs from within their free trade areas, whereby their production costs are not affected by the costlier inputs that would result from strict rules of origin. An ex ante restrictiveness index therefore does not account for the sectors and the economic context within which rules of origin are applied. For example, a rule in Kenya or Rwanda that requires all tea products to be derived from tea originating from within EAC would not be restrictive, whereas the same rule in an agreement between Benin and Liberia would be highly restrictive as neither is a tea producer. Preferential tariffs between Benin and Liberia would therefore be irrelevant and trade would need to be conducted on a most-favoured nation basis. Overall, free trade areas among large and developed markets might have a high level of observed restrictiveness of rules of origin, while the real or effective restrictiveness would be lower due to the possibility of sourcing inputs from within the free trade area.

Box 3

Restrictiveness indices

The ordinal index developed by Estevadeordal (2000) uses the rules of origin under the North American Free Trade Agreement as a reference to reflect how demanding given rules of origin are for exporters, assigning values between 1 (least restrictive) and 7 (most restrictive). The index assesses product-specific rules based on the following two assumptions: a change at the chapter level in the Harmonized System is more restrictive than a change at the heading level, and so on; and the technical requirements attached to a given change of tariff classification and a regional content requirement add to the restrictiveness of rules of origin. The studies carried out by Cadot, Estevadeordal et al. (2006), Portugal-Pérez (2006) and Suominen (2004) are variations of this approach.

The index developed by Harris (2007) has a similar logic. The index allocates points to various elements used in the definition of the rule, namely, change of classification, exception, addition, value test, technical requirement and alternative rule. Both the exception and addition points reflect explicit choices by negotiators to give special treatment to a particular product. The index therefore captures more details in variations between products and agreements in the definition of rules of origin and, as a result, the values of this index show more variation.

The Harris index, in particular, suggests that the United States agreements, and rules of origin regimes among more developed trading partners, tend to be more restrictive, while African agreements are more generous. Gretton and Gali (2005) find similar results of high restrictiveness in the North American Free Trade Agreement and European Union agreements. Their methodology is also based on characteristics of the rules of origin model, and therefore has an ex ante approach, yet it expands on the range of rules of origin factors examined and includes, for example, details of regional value content requirements and factors influencing market access. This may suggest that, with increasing globalization and evolving strong exports lobbies, Governments have come under pressure to find ways to compensate industries facing increasing pressure from imported goods. More restrictive rules of origin offer a means to compensate potential losers from liberalization. Moreover, strict rules of origin also discourage final goods producers from outsourcing production abroad. The results may also indicate that large and developed markets have a greater availability of inputs and are therefore in a dominant position, able to dictate more restrictive rules of origin. For example, evidence from the implementation of the North American Free Trade Agreement shows that restrictive rules of origin allowed the United States to charge higher prices on textiles for apparel producers in Mexico.

The index values of the three agreements included for Africa, namely, COMESA, ECOWAS and SADC, show that the rules of origin in the ECOWAS agreement are the most generous for both indices, reflecting the fact that rules of origin in ECOWAS are uniform across products. According to the Estevadeordal index, restrictiveness has a value of 5 in COMESA, 2 in ECOWAS and 4.5 in SADC. According to the Harris index, restrictiveness has a value of 4 in COMESA, 1 in ECOWAS and 7 in SADC. Similar values for the restrictiveness of the COMESA rules of origin are obtained in both indices. Rules of origin in SADC are much more restrictive according to the Harris index than the Estevadeordal index, reflecting the fact that the calculations in the former capture in more detail the complexity of rules of origin in SADC, which apply different criteria and thresholds for specific products or product groups, as well as specific processing rules.

Both studies were conducted prior to rules of origin reforms. The COMESA protocol on rules of origin was revised in 2015, the revised Generalized System of Preferences of the European Union became effective in 2011 and the North American Free Trade Agreement rules of origin have become less restrictive. The comparative results of the indices should therefore be interpreted with caution. The indices reflect the aggregate average value across sectors and, as such, are a useful measure of the complexity of a rules of origin regime overall. In practice, rules of origin are relevant at the product level, and it is therefore useful to consider more disaggregated indices.

Estevadeordal and Suominen (2008) calculate the restrictiveness of rules of origin in SADC by sector at the HS two-digit level. In line with other free trade or preferential trade agreements, in SADC, agricultural products have some of the highest restrictiveness values and those for the textiles sector, the lowest, contrary to observations of many preferential trade agreements. Given the low overall value of rules of origin restrictiveness in ECOWAS, the sectoral restrictiveness values are all low.

The calculation of a restrictiveness index is the subject of debate, given the underlying methodological choices. For example, the impact of a transformation requirement at a specific level can be significantly different across products, as noted with regard to coffee beans and diamonds. This implies that the restrictiveness of rules of origin can diverge sharply between products and sectors. Despite its limitations, a restrictiveness index is a valuable analytical tool as it provides an overall measure of how trade-inhibiting rules of origin for products might be. Such an index also allows for comparisons between schemes and enables empirical studies that can provide information on the impacts and usefulness of rules of origin.

Sources: Cadot and De Melo, 2008; Cadot, Estevadeordal et al., 2006; Estevadeordal, 2000; Estevadeordal and Suominen, 2008; Grettton and Gali, 2005; Harris, 2007; Portugal-Pérez, 2006; Suominen, 2003; Suominen, 2004.

It is important to note that more restrictive and selective rules of origin are more difficult and costlier to administer and, in practice, some countries have applied flexibility to reduce restrictiveness. Estevadeordal and Suominen (2008) note that some rules of origin regimes “have created innovative optional means of calculating value content to reduce the regimes’ restrictiveness. In SADC, a more-developed member may allow a less-developed member to count processes as originating that are usually left outside the calculation of value content under the SADC agreement”.

2.4.2 Preference margins of intra-African trade: Where rules of origin could matter most

Rules of origin are a trade policy tool that defines the scope of a preferential trade agreement and indirectly provides industries with incentives to source from within a free trade area or preferential trade agreement area. The magnitude of the incentives depends on various factors but primarily on the preference margin, that is, the difference between the applicable most-favoured nation tariff and the preferential tariff, and the costs of compliance with rules of origin of a specific free trade or preferential trade agreement.

In light of the integration of the market in Africa through the African Continental Free Trade Area, this section considers the 20 products traded within Africa with the highest preference margins.¹⁶ Trade in these products provides theoretically high incentives to comply with rules of origin, to make use of preferential tariffs. The analysis showed that, in 2014–2016, the products with the highest margins were beverages (margins exceeding 50 percentage points), tobacco products (around 30 percentage points), some meats (around 26 percentage points) and clothing (around 24 percentage points). The analysis further indicated that the intra-African trade values in terms of both imports and exports of these 20 products were relatively low, with the exception of tobacco products, beer and spirits, knit T-shirts, wine and women’s suits and pants. This may indicate that despite attractive preference margins, products cannot be easily sourced from within Africa. However, export capacity exists for several of these products, in particular clothing and wine, given their high export values to the rest of the world.

Where rules of origin could matter most



¹⁶ The following were used to calculate the margin: each product at the HS four-digit level; average most-favoured nation tariff; and average preferential tariff (average tariff of product by country and then average of all relevant countries). A simple average was used to ensure that all possible margins were represented. The analysis was conducted for Africa as a whole and for selected regional economic communities.

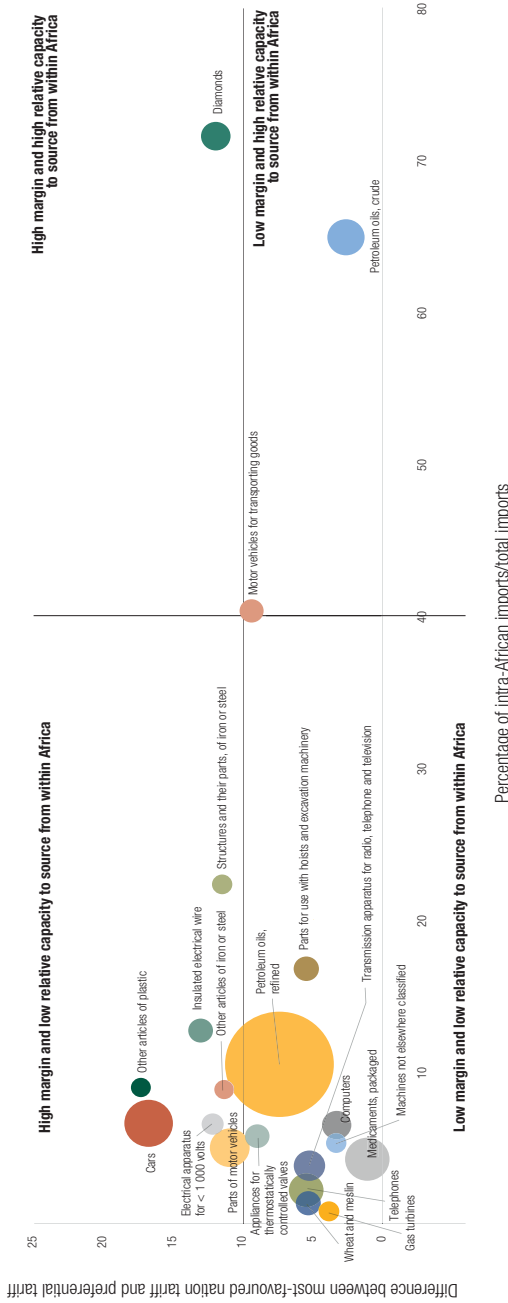
This underscores the argument that the restrictiveness of rules of origin critically depends on whether a trade area has the capacity to source the products in demand. In other words, if industries under a preferential trade agreement cannot import their products from within the agreement area because of a lack of availability and/or high compliance costs, the industries will source from outside and pay the most-favoured nation tariff. Therefore, the relevance of the preferential trade regime is a combination of the preference margin of the specific product, the demand for imports and the ability to import a product from within the preferential trade agreement area.

This relationship is shown in figure 11. For the 20 products with the highest import values in Africa, on average in 2014–2016, the figure shows their respective preference margins on the y-axis, and the current capacity to source these products from within the continent on the x-axis. The products with the highest demand for imports in Africa are refined petroleum (\$42 billion), cars (\$8.4 billion), packaged medicaments (\$7 billion), parts of motor vehicles (\$5.6 billion) and crude petroleum (\$4.9 billion). For crude petroleum and packaged medicaments, preference margins are low (2.7 and 1 percentage points, respectively). However, margins for cars and parts of motor vehicles are substantial (above 10 percentage points), along with several others of the top 20 products, and these products therefore provide incentives to source from within Africa. The ability to source from within the continent and use these incentives exists for only some products, primarily diamonds and motor vehicles for transporting goods. For most manufactures and products that require processing, countries in Africa depend predominantly on supplies from outside the continent.

Rather than examining the ability to source products from within Africa, i.e. focusing on imports, the focus is on exports, to analyse whether current trading relations provide incentives to intra-African exporters. Exporters assess whether using a preferential tariff provides sufficient incentives to cover the costs of compliance with rules of origin and thus forego the most-favoured nation tariff. François et al. (2006) find that exporters start to request preferences when preferential margins are around 4.0 and 4.5 per cent. Figure 12 shows that for the 20 products in Africa with the highest export values, preferential margins exceed 4.5 per cent for 11 products, including five of the six top export products, namely, petroleum gases; gold; petroleum oils, refined; diamonds; and cars. Similar to the main imports, for the main exports, firms in Africa mainly export to partners outside the continent. This may suggest that exporting to extracontinental partners is easier due to less stringent rules of origin, lower compliance costs and/or lower transport costs. A significant exception is motor vehicles for transporting goods, half of which are exported to other countries in Africa.

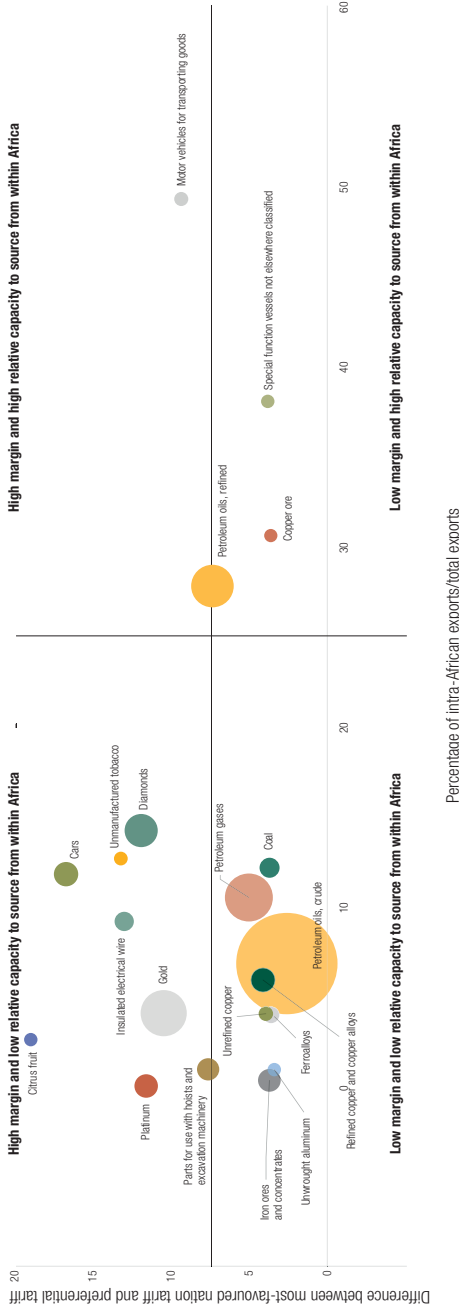
80 **Figure 11**

Africa: 20 products with highest import values, 2014–2016 average



Source: UNCTAD calculations, based on the UNCTAD Trade Analysis and Information System (TRAIS) database.
 Note: Commodities not specified according to kind, under the HS four-digit level, are not included, as the corresponding preference margin cannot be calculated.
 Size of bubble is size of total imports to Africa.

Figure 12
Africa: 20 products with highest export values, 2014–2016 average



Source: UNCTAD calculations, based on the UNCTAD TRAINS database.
 Note: Commodities not specified according to kind, under the HS four-digit level, are not included, as the corresponding preference margin cannot be calculated.
 Size of bubble is size of total exports from Africa.

Few studies have estimated the costs of compliance with rules of origin, in particular in Africa. Brenton (2011) finds that the trade-weighted average of compliance costs is 6.8 per cent for the North American Free Trade Agreement and 8 per cent under European Union rules of origin.¹⁷ Cadot and De Melo (2008) state that in preferential trade agreements, compliance costs range from 3 to 5 per cent of final product prices. Cadot and Ing (2016) estimate that costs of compliance with rules of origin in the Association of Southeast Asian Nations inhibit trade by around one fourth of its most-favoured nation tariffs, thereby nullifying about one quarter of the effect of tariff preference margins, but they emphasize that the effect differs largely by sector.

As rules of origin are negotiated with regard to the African Continental Free Trade Area, it may become easier and more attractive to producers to export to other countries in Africa and/or to source from within the continent. It may be insightful to consider how preference margins and trade volumes evolved in free trade agreements in Africa with established rules of origin regimes. In this regard, EAC, ECOWAS and SADC are considered in more detail. The rules of origin in SADC are based on an approach that is most similar to that preferred in current negotiations on rules of origin with regard to the African Continental Free Trade Area.

In SADC, the import basket of the 20 products with the highest import values is more balanced in terms of value and relatively similar in terms of content, compared with the import basket of Africa overall (figure 13). Yet it contains fewer primary commodities and more manufactures and/or processed products, highlighting the more advanced manufacturing capacities in SADC. It is a smaller market than the continental market, yet the SADC market is more diversified, and its capacity to source from within is relatively high. The regional sourcing capacity exceeds 40 per cent for several products. Rules of origin in SADC may thus support sourcing from within the regional economic community area. The preference margins of the top 20 products are, on average (unweighted), slightly lower and less dispersed than those of intra-African imports.

In ECOWAS, refined petroleum is largely the dominant import product (figure 14; the x-axis is scaled differently compared with the other charts to increase the visibility of the products). The ability to source from within ECOWAS is severely constrained for all main import products, with the exception of palm oil. Preference margins are spread similarly as in Africa overall. The combination of substantial preference margins, several processed products among the main imports and limited sourcing from within ECOWAS suggests that its rules of origin have not boosted processing activity within the regional

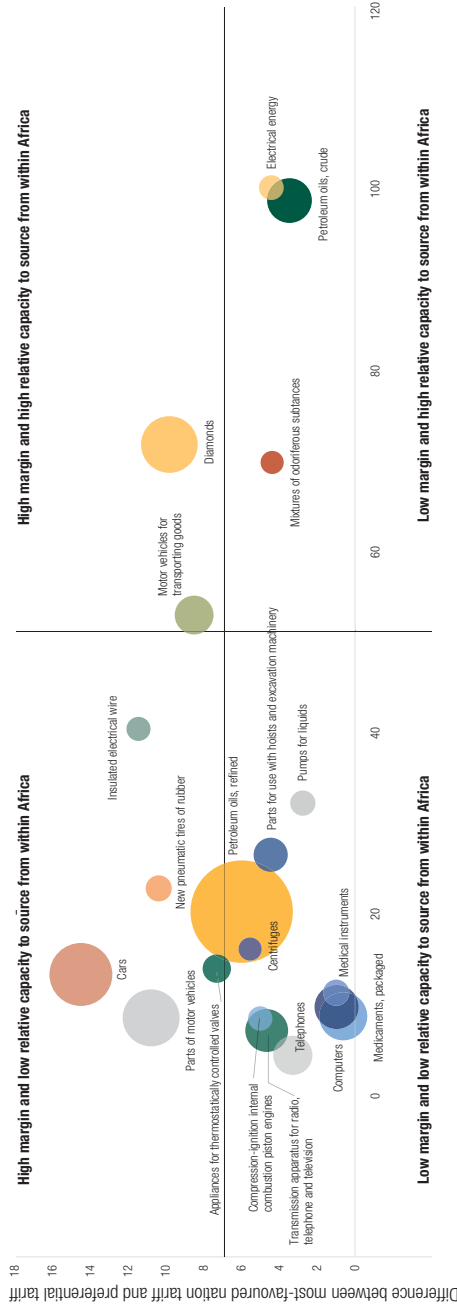
¹⁷ The studies are based on a non-parametric estimation of the upper and lower bounds of the costs of compliance with rules of origin by combining the restrictiveness index and information on the utilization of preferences.

economic community area and that rules of origin in ECOWAS may be difficult to comply with. The costly process of certification in ECOWAS is noted in section 2.3.

In EAC, the capacity to source major import products from within the regional economic community area is, in general, also severely limited (figure 15). There are, however, notable exceptions to trade capacity within EAC, namely, in tea, corn, monitors and projectors and cements, all of which have a high intra-regional economic community import share. This may suggest that these products could benefit from a larger market with favourable rules of origin, as trade capacity exists. In addition, the dispersion of preference margins of the main 20 products is significantly higher in EAC than in the other regional economic communities analysed, indicating that for some of these products, much can be gained through intraregional sourcing.

84 **Figure 13**

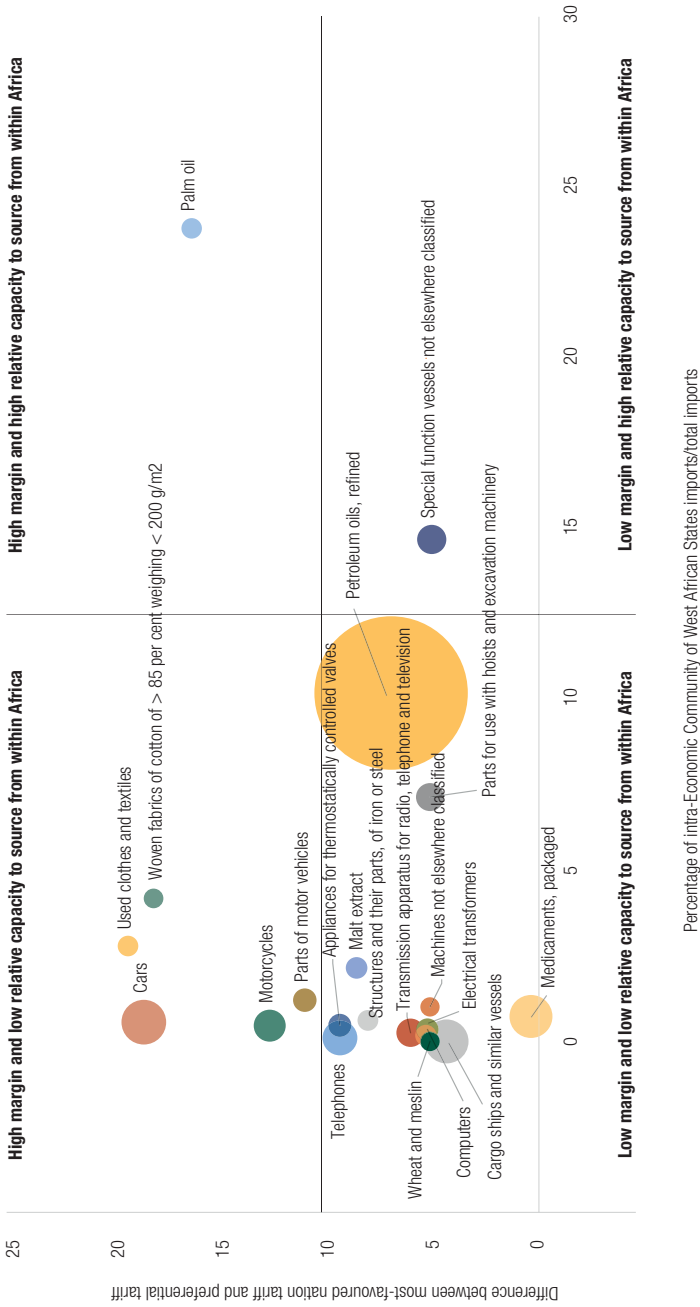
Southern African Development Community: 20 products with highest import values, 2014–2016 average



Percentage of intra-Southern African Development Community imports/total imports

Source: UNCTAD calculations, based on the UNCTAD TRAINS database.
 Note: Commodities not specified according to kind, under the HS four-digit level, are not included, as the corresponding preference margin cannot be calculated.
 Size of bubble is size of total imports to SADC.

Figure 14
Economic Community of West African States: 20 products with highest import values, 2014–2016 average



Source: UNCTAD calculations, based on the UNCTAD TRAINS database.
 Note: Commodities not specified according to kind, under the HS four-digit level, are not included, as the corresponding preference margin cannot be calculated. Size of bubble is size of total imports to ECOWAS.

86 Figure 15
Eastern African Community: 20 products with highest import values, 2014–2016 average



Percentage of intra-Eastern African Community imports/total imports

Source: UNCTAD calculations, based on the UNCTAD TRAINS database.

Note: Commodities not specified according to kind, under the HS four-digit level, are not included, as the corresponding preference margin cannot be calculated. Size of bubble is size of total imports to EAC.

2.4.3 Utilization rates of trade preferences

The utilization of trade preferences depends on whether exporters can and have incentives to comply with the rules of origin of a given free trade or preferential trade agreement. High rates indicate that exporters are able to comply with administrative prerequisites and that preference margins are sufficient. Cadot and Ing (2016) show that in the Association of Southeast Asian Nations, preference margins tend to be substantial in comparison with the costs of compliance with rules of origin; the sensible choice for exporters is therefore to incur these costs and use preferences. Keck and Lendl (2012) show that utilization and/or compliance costs include an important fixed cost element and should therefore be expressed as a fixed amount rather than a percentage share of the trade value. According to their analysis, these costs range between \$14 and \$1,500.

Low rates may indicate the opposite, that rules of origin requirements cannot be met and could be operating as a trade barrier (WTO, 2018). Low utilization rates can also result from the existence of competing preference schemes. For example, many exporters from Africa to the United States have been utilizing the African Growth and Opportunity Act preference scheme and have established operating processes and accounting systems to comply with the requirements of this scheme. As a result, the utilization rate of the Generalized System of Preferences of the United States is rather low.

Utilization rates of trade preferences compare the value of imports that are eligible and make use of preferential treatment to all imports that are eligible for preferential treatment.¹⁸ This implies that preferences must be real, that is, the most-favoured nation tariff cannot be zero. The calculation of utilization rates requires custom authorities to record the value of imports, the tariffs levied and the preference schemes used. For trade with Africa, such data are available for various non-reciprocal schemes of preference-giving countries, but are unavailable for reciprocal schemes within Africa. The European Union remains the main external trading partner for Africa. This section therefore presents an analysis of the extent to which trade from Africa to the European Union makes use of trade preferences and the lessons that could be learned. The analysis is based on all preference schemes granted by the European Union to Africa, including reciprocal and unilateral schemes, namely, the Generalized System of Preferences of the European Union, the Everything but Arms initiative and the economic partnership agreements.

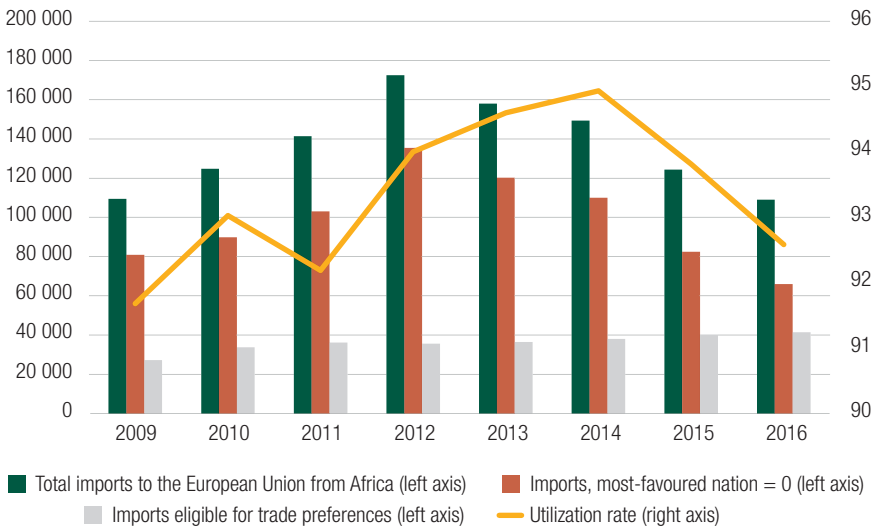
¹⁸ Trade takes place either under most-favoured nation terms, outside the scope of preference schemes, or within the scope of preference schemes. In the latter, a distinction can be made between trade that makes use of preferences and trade that does not, either because of an inability to meet preference requirements or because other preferential schemes have been used.

Figure 16 shows that preference utilization rates in 2009–2016 fluctuated but remained continuously above 90 per cent. Following the reform of the Generalized System of Preferences of the European Union, which simplified rules of origin, in particular for textiles and apparel, and became effective in 2011, preference utilization rates increased from 92.2 per cent in 2011 to 94.9 per cent in 2014. Thereafter, the rates decreased to 92.6 per cent in 2016. This is likely the result of new preference schemes that came into force in 2014 and the fact that exporters need time to adjust operations and procedures to comply with new requirements. Imports to the European Union from Africa eligible for preferential treatment increased in this period and reached 38 per cent of total imports in 2016, compared with 26 per cent in 2011. Therefore, it may be argued that the reform of the Generalized System of Preferences of the European Union stimulated preferential trade and that more lenient rules of origin with sizeable preference margins can be trade creating.

Figure 16

Imports to the European Union from Africa, by value and utilization rate, 2009–2016

(Millions of euros and percentage)



Source: UNCTAD calculations, based on the Eurostat database.

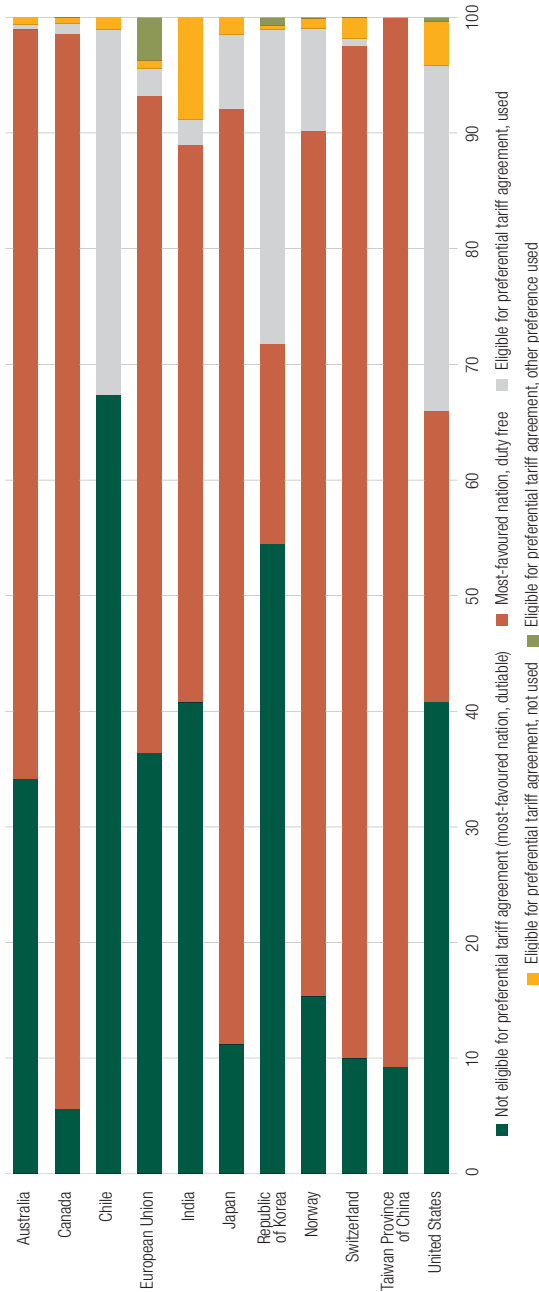
High utilization rates can also be obtained for continuously small amounts of trade, which shows that rules of origin are not a trade barrier, but might not foster trade and

investment. Such a situation could arise when rules of origin are relatively easy to comply with but are limited to sectors that are not appealing to investors. However, rules of origin could stimulate foreign investment in an exporting country, if they were favourable for products and sectors of interest to investors. Foreign direct investment outflows from the European Union to Africa increased substantially from 2011 to 2015, when preferential trade increased. However, prior to the effective date of the reform of the Generalized System of Preferences of the European Union, these outflows were higher and, in 2016, they became negative. It cannot be inferred, therefore, that there is a relationship between the preferential trade agreements of the European Union and European Union investment in Africa. The evolution may instead reflect that much of the foreign direct investment of the European Union in Africa is directed to the natural resources sector, in which applicable rules of origin tend to be easy to use and are typically not a barrier to trade.

Beyond trading relations between Africa and the European Union, insights into utilization rates of the tariff preferences granted by various partners can be drawn from the Tariff Analysis Online database of WTO. The database includes information on the types of tariffs applied to exports from Africa and the utilization rates of preferential schemes provided by Australia, Canada, Chile, India, Japan, Norway, the Republic of Korea, Switzerland, the United States, Taiwan Province of China and the European Union.¹⁹ Figure 17 shows that some of these external partners, namely, Canada, Switzerland and Taiwan Province of China, grant duty-free access for a large share of goods from Africa, and that the share of imports of goods from Africa that is eligible and makes use of preferential treatment varies greatly between trading partners, and is highest in Chile, the Republic of Korea and the United States.

¹⁹ The preferential trade agreements included in the analysis are the following: Australia, Generalized System of Preferences and LDCs, 2016; Canada, Generalized System of Preferences and LDCs, 2016; Chile, LDC-specific, 2015; India, LDC-specific, 2015; Japan, Generalized System of Preferences and LDCs, 2016; Norway, Generalized System of Preferences and LDCs, 2016; Republic of Korea, LDC-specific, 2016; Switzerland, Generalized System of Preferences and LDCs, 2016; United States, Generalized System of Preferences and LDCs, 2016, and African Growth and Opportunity Act, 2016; Taiwan Province of China, LDC-specific, 2016; and European Union, Generalized System of Preferences and LDCs, 2016.

Figure 17
Share of imports from Africa by preference eligibility status and external trading partner, 2016 (Percentage)



Source: UNCTAD calculations, based on the Tariff Analysis Online database of WTO.

For analytical purposes, it may be useful to focus on the underutilization of trade preferences, as it allows for an identification of sectors that may require further attention and/or research. Underutilization rates compare the imports that do not make use of eligible trade preferences with total eligible imports. With regard to the use of the schemes by countries in Africa, some countries are largely unable to make use of preferential treatment for their exports to external partners, namely, Benin (underutilization rate of 95.4 per cent), Burkina Faso (100 per cent), the Central African Republic (100 per cent), Djibouti (96.5 per cent), Equatorial Guinea (93.2 per cent), Guinea (100 per cent), Guinea-Bissau (100 per cent), Liberia (100 per cent), Libya (100 per cent), Mali (99.6 per cent), Seychelles (100 per cent), Sierra Leone (100 per cent), Somalia (98.9 per cent), Togo (100 per cent) and the United Republic of Tanzania (94 per cent). However, several of these countries export mainly products subject to a most-favoured nation tariff of zero, such as Guinea-Bissau and Libya. Conversely, underutilization rates are low for Botswana (1.1 per cent), Cabo Verde (3.6 per cent), Chad (0.1 per cent), Côte d'Ivoire (2 per cent), the Comoros (4.3 per cent), Ghana (2.3 per cent), Kenya (4.5 per cent), Lesotho (1.7 per cent), Madagascar (4.9 per cent) and Mauritania (3.1 per cent).

The foregone opportunities, in terms of volume of underutilization of trade preferences, are depicted in figure 18 (including Harmonized System sections with trade volumes of \$10 billion or more). In 2016, unused preferences were highest for mineral products, amounting to \$2.3 billion, followed by precious materials (\$1.4 billion) and vegetable products (\$0.6 billion). It is notable that some sections with relatively easy rules of origin requirements show the highest rates of underutilization in terms of value. In terms of shares of underutilization in 2016, precision instruments had the highest, followed by chemicals, wood and hides and skins.

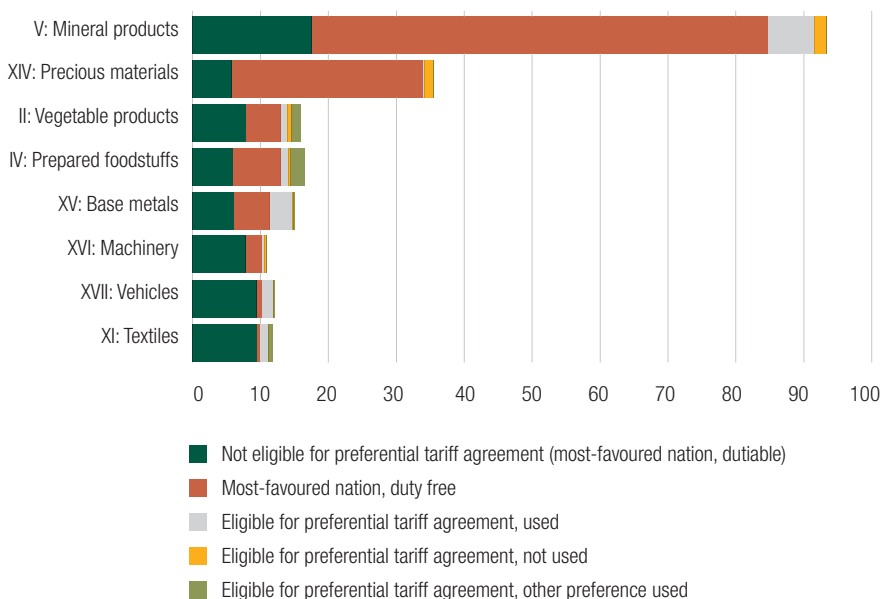
Table 4 shows, for some of the aforementioned external trading partners, the three Harmonized System sections with the highest values of unused preferences. The sections with unused preferences are highest for exports from Africa to India, the United States and the European Union, and include mineral products, precious materials, vegetable products, machinery, prepared foodstuffs and chemicals. India has the highest value of unused preferences at \$1.26 billion, namely, on imports of precious materials, as none of its imports of precious materials from Africa makes use of preferential treatment. The United States imports \$1.11 billion of mineral products from Africa without using preferences, amounting to 15 per cent of the total eligible trade in that category. Several of the products with high values of unused preferences are manufactures and may have rules of origin that are complex to fulfil, but the list also includes products based on

primary commodities for which rules of origin tend to be easier to comply with, since they are, or large shares of them are, wholly obtained. A direct link with rules of origin can only be established if the analysis is made at the most disaggregated level.

Figure 18

Types of tariffs applicable to imports from Africa, selected external partners, by sector, 2016

(Billions of dollars)



Source: UNCTAD calculations, based on the Eurostat database.

Table 4

Imports of African goods by extracontinental trading partners: Harmonized System sections with three highest values of unused preferences, 2016

IMPORTER	HARMONIZED SYSTEM SECTION	ELIGIBLE FOR PREFERENTIAL TRADE AGREEMENT BUT NOT USED (MILLIONS OF DOLLARS)	ELIGIBLE FOR PREFERENTIAL TRADE AGREEMENT BUT NOT USED (PERCENTAGE OF TOTAL ELIGIBLE TRADE)
Australia	XI: Textiles	3.1	50
	XVIII: Precision instruments	2.7	100
	XVI: Machinery	1.7	98
Canada	IV: Prepared foodstuffs	13.4	61
	XI: Textiles	7.8	21
	XII: Shoes, headgear, umbrellas	1.2	42
Chile	IV: Prepared foodstuffs	0.9	50
	III: Animal or vegetable fats	0.7	51
	II: Vegetable products	0.7	100
India	XIV: Precious materials	1 261.8	100
	V: Mineral products	596	91
	II: Vegetable products	421.1	69
Japan	I: Animal products	75.7	30
	II: Vegetable products	16.3	35
	XI: Textiles	7.1	66
Norway	II: Vegetable products	5.9	16
	XI: Textiles	1.8	62
	IV: Prepared foodstuffs	0.2	5
Republic of Korea	II: Vegetable products	8.8	15
	XV: Base metals	7.3	1
	IV: Prepared foodstuffs	5.2	8
Switzerland	XIV: Precious materials	102.5	100
	II: Vegetable products	22.8	96
	XI: Textiles	14.9	90
United States	V: Mineral products	1 113.3	15
	XVI: Machinery	73.3	31
	IV: Prepared foodstuffs	55.5	17
European Union	XVI: Machinery	254.4	100
	IV: Prepared foodstuffs	201.6	21
	VI: Chemicals	163.5	99

Source: UNCTAD calculations, based on the Tariff Analysis Online database of WTO.

Underutilization of trade preferences offered by Africa's main trading partners*

TOP 3 UNUSED PREFERENCES IN 2016



Mineral products

\$ 2.3 billion



Precious materials

\$ 1.4 billion



Vegetable products

\$ 0.6 billion

*Australia, Canada, Chile, India, Japan, Norway, the Republic of Korea, Switzerland, the United States, Taiwan Province of China and the European Union (as included in the WTO Tariff Analysis Online database). Figures are expressed in terms of value.

2.5 Conclusion

Rules of origin are an integral part of international trade agreements and define the conditions under which products are eligible for preferential treatment.

The main objective of rules of origin is to prevent trade deflection or the arbitrage of external tariff differences in free trade and preferential trade agreements. However, rules of origin are also widely used for more developmental objectives, including fostering more integrated manufacturing activities and regional trade. Whether they can deliver on these objectives depends largely on the capacity to source products from within the region. Cadot and De Melo (2008) state that rules of origin have gone vastly beyond the role of preventing trade deflection by mandating that sufficient processing take place in a preferential zone, and have become akin to technical barriers to trade.

The design of rules of origin matters for how trade creating or trade diverting they are and the degree to which trade preferences are used. With ever more fragmented

production structures, firms need to be able to source intermediates from abroad and rules of origin need to be designed to support this need. This differs substantially from the period of vertical integration of industrial sectors that benefited from strict rules of origin. The experiences in East Asia suggest that there are fewer incentives for restrictive rules of origin in areas with integrated regional value chains and global value chains (Cadot and Ing, 2016).

Rules of origin requirements tend to be particularly daunting for smaller firms, which is a concern as the private sector in Africa is mainly comprised of SMEs and informal enterprises. Similar challenges are faced by customs authorities, in particular in LDCs, in which administering rules of origin may divert scarce customs resources from other tasks, such as trade facilitation or tax collection (Brenton and Imagawa, 2004).

The preference utilization rates of European Union preferential trade agreements are high, and this suggests that their rules of origin requirements may be more easily met. The analysis of preference margins and capacity to source from within Africa and regional economic communities and export to other countries in Africa provides some evidence that trading with external partners may be easier with and supported by less restrictive rules of origin.

Current rules of origin regimes in Africa are at the regional economic community level and therefore regulate intra-regional economic community trade. This chapter argues that it would be desirable to achieve some regulatory convergence of rules of origin in regional economic communities and the African Continental Free Trade Area, to make better use of intra-African trade opportunities compared with intra-regional economic community trade. Intra-African trade would also benefit if rules of origin were not overly restrictive, as this would enable all countries to benefit from the Agreement. It is widely acknowledged that rules of origin are context-specific. At the same time, there is consensus that rules of origin should be simple, transparent, predictable, trade-facilitating and development friendly (Estevadeordal and Suominen, 2005; Kommerskollegium, 2012).

