



**United Nations Conference on
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Division for Africa, Least Developed Countries
and Special Programmes (ALDC)



**5th Meeting of the Continental Free Trade Area
Technical Working Group on Rules of Origin**

**New trends and techniques in Drafting RoO:
Using 1) utilization rates and 2) an input-output
matrix**

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Drafting RoO in FTAs: Do we have a golden model ?

- Absence of Multilateral rules
- Very few analytical studies on drafting RoO.
Forthcoming study by UNCTAD [2018]
- Existence of models : NAFTA inspired rules and evolution, Pan-Euro RoO and evolution, EU reform
- Absence of models in South-South FTAs
- Different practices in administering origin
- Will new FTAs or Mega-regionals (TPP 11) provide such a model ?

The issues we wish to address

- There is not a model of RoO for FTAs.
- In spite of a number of studies there is no evidence on the best method for origin determination, the best level of percentage and the best practices for certification.
- There are a number of lessons learned...

Drafting RoO in FTAs: We just have some lessons learned

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

Drafting RoO in FTAs: the starting point

- In pursuing a consensus on Drafting RoO s it is necessary to distinguish between the **policy-objectives** that underpin a given set of RoO (**the “substance”**) from the specific criteria used and how they are administered, i.e., **the “form” of a RoO.**
- The substantive dimension of a RoO is the degree of restrictiveness related to the value chain it impacts on.
- It is the substance that matters.
- If countries have common objectives as to what RoO are supposed to do, it is much more straightforward to achieve consensus, since the form a RoO takes is mostly a matter of drafting methodology

Concepts for designing an FTA Model RoO

A) **The principles of the form of RoO:**

- RoO should be technically sound, producing the same outcome, transparent, easy to administer and to comply with

B) **The principles of substance of RoO:**

- RoO should reflect actual manufacturing capacity in the partner countries ensuring sourcing from most efficient suppliers

A) Addressing the “Form” of RoO: Trends and techniques

- The form of a RoO refers to the technical drafting of the RoO independently from the content of the RoO i.e. the stringency.
- It is essential to fully understand this concept to clearly identify your negotiating interests across the huge variety of drafting techniques
- This is exactly what most of negotiators are missing

The Technical methods to draft RoO

- Kyoto conventions divide products in two categories
 - Wholly obtained products defined in a « standard» list
 - Products with non-originating inputs: Substantial transformation
- Defining the indefinable: How to determine substantial transformation?

Defining substantial Transformation The menu 1.0

1) Ad valorem percentage based on:

- a) value added
- b) Max amount of non originating materials
- c) value of materials either originating or non-originating based on ex-works, FOB price

2) Change of tariff classification:

- a) CTH, CTH with exceptions, CTSH
- b) Tariff shift at CTSH with exceptions and regional value content

3) Specific working or processing:

- a) Manufacture from ...

1. Ad valorem percentage methodologies

A) Value Added Calculation

- By addition: $\text{Originating Materials} + \text{Direct Cost of Processing}$

B) Value of Materials Calculations

- Value added by subtraction of non-originating materials:

$$\frac{\text{Ex Works price} - \text{VNM}}{\text{Ex Works price}}$$

- Maximum value of non-originating materials:

$$\frac{70\%}{\text{Ex Works price}}$$

- Minimum Value of Originating materials:

$$\frac{30\%}{\text{Ex Works price}}$$



Drafting RoO based on ad valorem percentages: value added (net cost) vs. value of materials methodology

- The disadvantages of value added calculation:
 - Itemization of cost to the single unit of production. It requires accounting, and discretion may be used in assessing unit costs.
 - Currency fluctuations may affect the value of the calculation.
 - Low labor costs in developing countries may result in low value added and instead of being a factor of competitiveness may penalize low labour cost producers

Value of non originating material method and Adjustments to Value of materials criteria

- The value of non originating material is straightforward and already used by the majority of African countries under Lomé, Cotonou and EPAs
- The calculation should allow high percentage of non originating materials= 75%
- The calculation should permit adjustments made to the value of non originating materials permitting :
 - The deduction of the Cost of insurance and freight to bring the non originating materials to the factory of the producer
 - This deduction establishes a level playing field among landlocked and coastal African countries



2. Change of Tariff classification (CTC)

- **CTH → Japan GSP, Acrosss-the-Board Rule of Origin:**

"As a general rule, working or processing operations will be considered sufficient when the resulting goods are classified under an HS tariff heading (4 digits) other than that covering each of the non-originating materials or parts used in the production".

- **CTH with one or multiple exception → EU GSP, Product Specific Rules of Origin:**

Manufacture from materials of any heading, except those of headings 7106, 7108 and 7110

- **CTC, product specific with multiple exceptions → TPP ,Textiles Product Specific Rule:**

HS 611021: "A change to a good of subheading 6110.20 from any other chapter, except from heading 51.06 through 51.13, 52.04 through 52.12, or 54.01 through 54.02, subheading 5403.33 through 5403.39 or 5403.42 through 5407.94, or heading 54.08, 55.08 through 55.16, or 60.01 through 60.06, provided the good is cut or knit to shape, or both, and sewn or otherwise assembled in the territory of one or more of the Parties".



3. Specific Working or Processing

Chapter 61, PSRO EU GSP

HS	Product description	(a) LDCs	(b) Other beneficiary countries
Chapter 61	Articles of apparel and clothing accessories, knitted or crocheted: - Obtained by sewing together or otherwise assembling, two or more pieces of knitted or crocheted fabric which have been either cut to form or obtained directly to form	Manufacture from fabric	Knitting and making-up (including cutting)



Conclusion :What criteria is the best one among the ad valorem, CTC and specific working and processing ?

- There is not such a thing as a golden standard yet
- There is a tendency to adopt CTC but ad- valorem RoO is widely used in machinery and electronics and product specific for many FTAS used a variety of CTC and ad valorem percentage at times with alternative RoO for the same product

Suggested standard for CFTA PSROs:

- 1) Max value of non originating material with deduction of cost of transport and insurance
- 2) simple CTH at chapter or heading level where possible
- 3) specific working and processing for textiles and clothing with one single transformation stage

How many PRSOs do I need in a FTA ?

- Across the board criteria,
- Across the board with selected product specific,
- Product specific only
- The worldwide tendency is to have product specific rules of origin for all products
- First candidates for PRSOs may be products where there is trade among CFTA countries



Using CTC to draft RoO: HS is not designed for origin purposes

- Change of tariff classification implies a tariff line approach as
In some cases simple CTH or CTSH is extremely liberal, in others cases, extremely stringent
- Fresh vegetables 0701 Dried vegetable 0712
- Diamonds Worked or unworked same heading 71.02
- In machinery and electronic sector at times parts are classified in the same heading ,other times, in separate headings.
 - HS 8407: Spark-ignition reciprocating or rotary internal combustion piston engines / HS 8409 : Parts suitable for use solely or principally with the engines of heading 8407 or 8408
 - HS 8411: Turbojets, turbopropellers and other gas turbines, and parts thereof
 - Solution: **CTH or 75%**



Issue of alternative rules of origin for the same product: they should be really useful...

- Example from ATIGA alternatives RoO
- Heading 851830-headphones
- Heading 851890 –parts of headphones
- ASEAN PSRO for headphones subheading 851830: A regional value content of not less than 40 percent; or A change to subheading 8518.30 from any other subheading
- Assembly of parts of headphones 851890 into complete headphones is origin conferring as there is change of subheading
- The 40 % rule is redundant



Summary of standards and techniques to address the “Form” of RoO

- **Standard 1** : Move to Product Specific RoO(PSROs) V. across the board. **All products, Use trade data for the sequencing of negotiations of PSRO**
- **Standard 2**:Use 75% on non originating material with deduction of cost of insurance and freight for non originating materials
- **Standard 3** : **Use CTH at heading level or where possible at chapter level**
- **Standard 4**: **Insert Provision for tolerance allowance**



B) Addressing the “substance” of RoO: Trends and techniques

- **The substance of a RoO** refers to the content of a RoO : what a manufacturer needs to carry on non originating inputs to acquire origin independently from the form of a RoO **i.e. the form**
- The determinants in defining “the substance:
- To ensure that benefits are confined to products genuinely manufactured in the parties and avoid trade deflection.
- RoO should be matching the existing manufacturing capacity. Excessive stringency=low utilization and distortions on supply chains



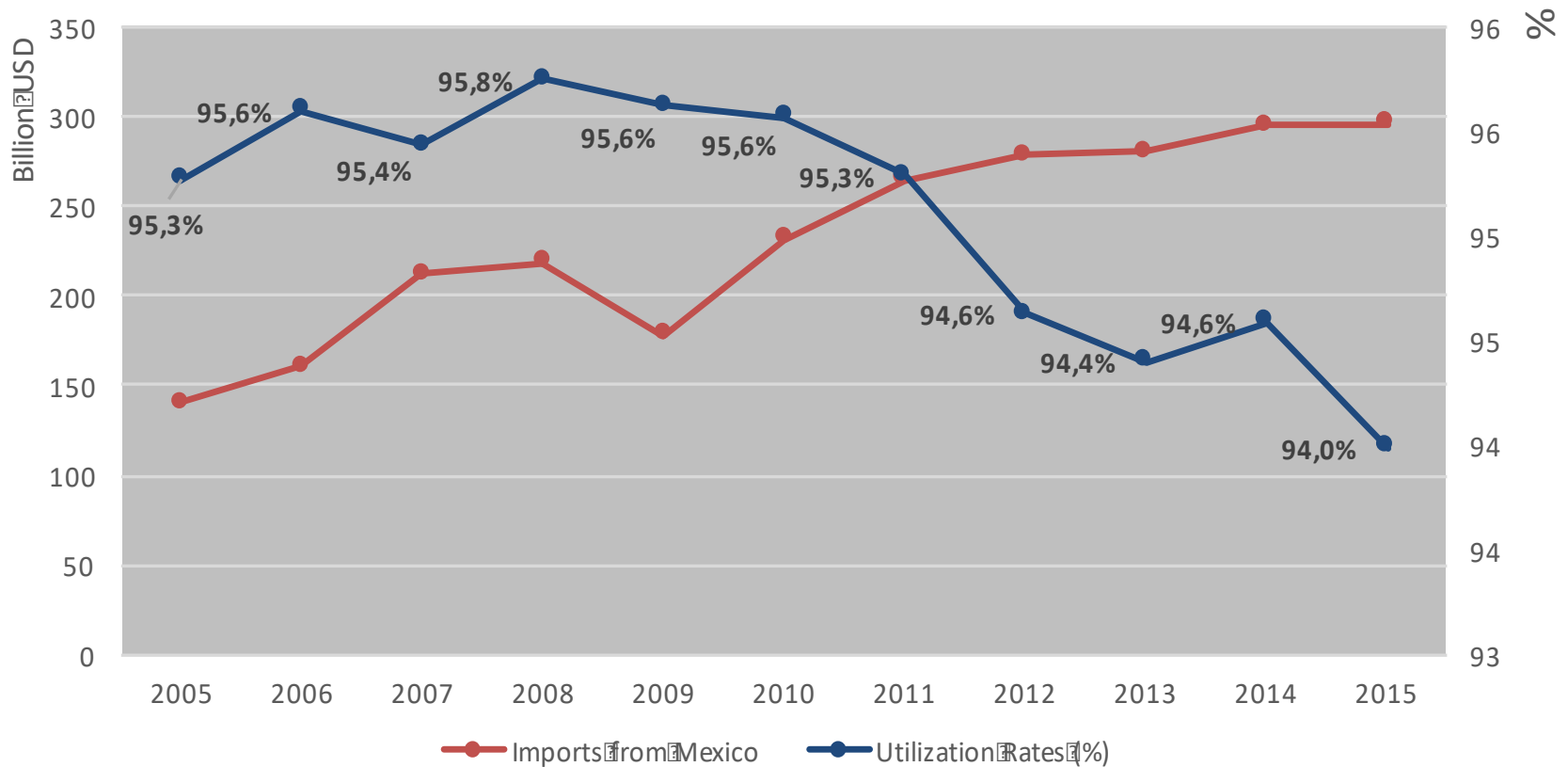
1) The substance:

Lessons learned from Utilization rates

- Customs based : the ratio among goods eligible for FTA treatment with those that have effectively received it
- WTO Nairobi decision : Use of utilization rates to monitor the effectiveness of RoO under DFQF initiatives for LDCs

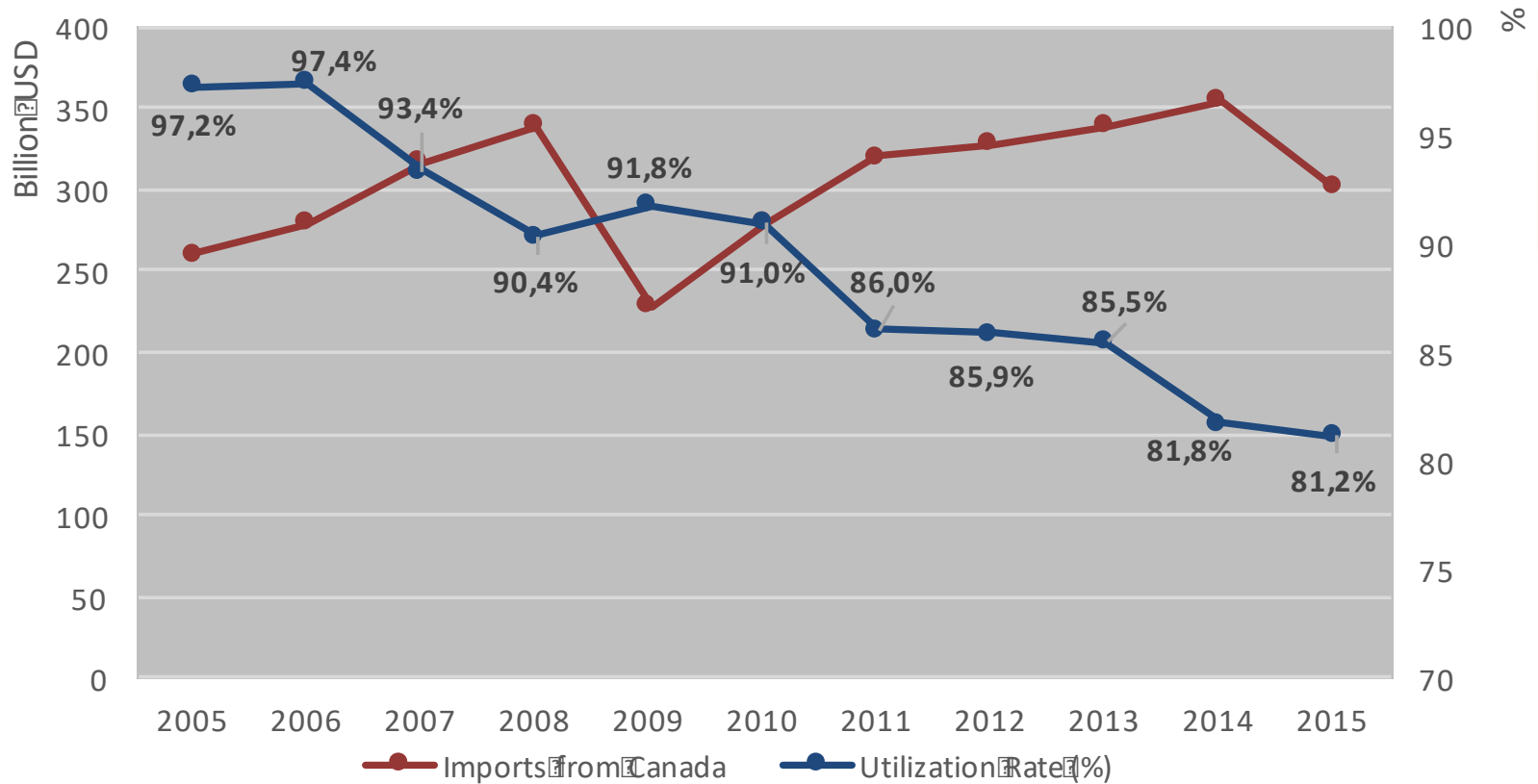
First: RoO may be stringent, however utilization high, RoO predictable, what trade effects with RoO less strict ?

US Imports from Mexico and NAFTA Utilization Rates



Second: Is compliance with RoO worth the effort ?

US Imports from Canada and NAFTA Utilization Rates



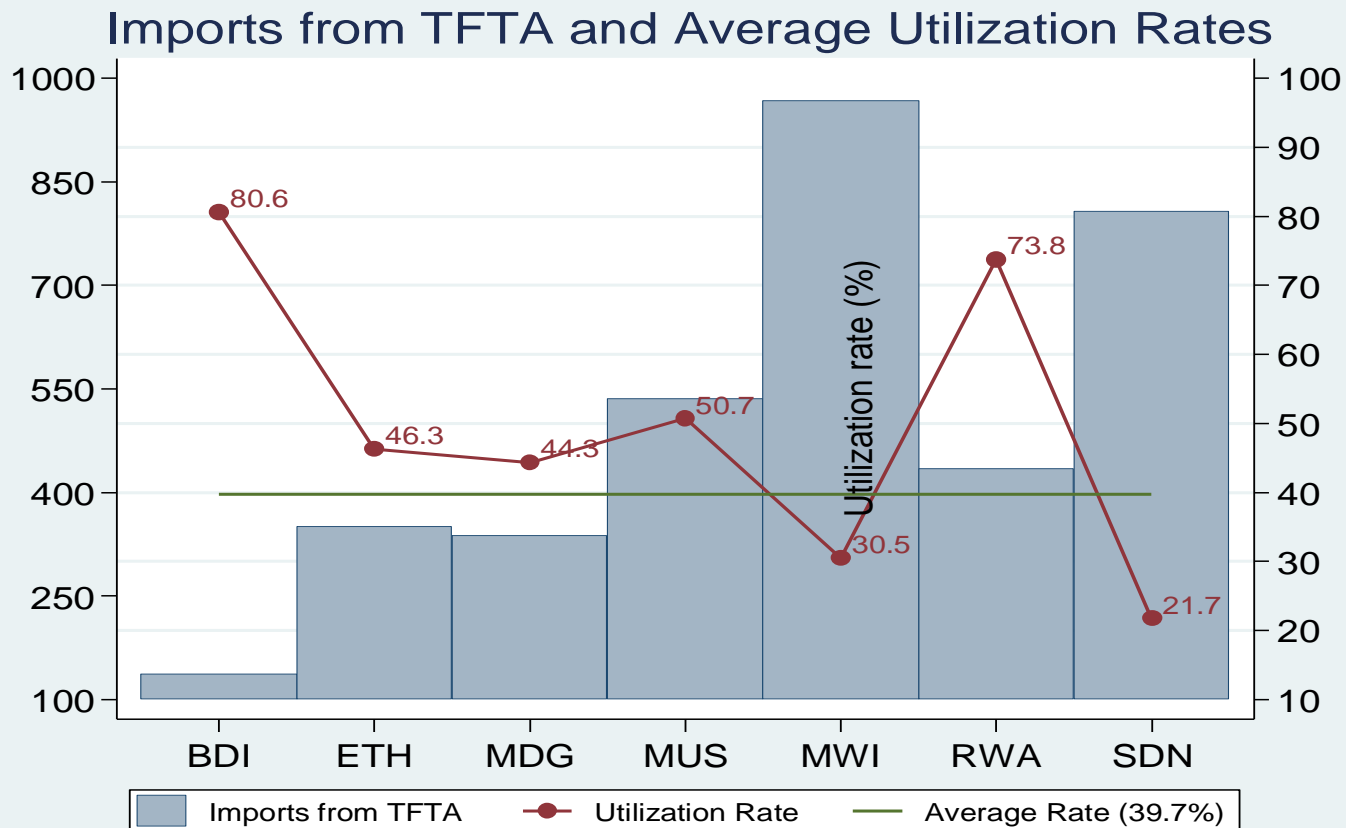
Third: Those who seems Learning less:

ASEAN Utilization rates [2010]

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



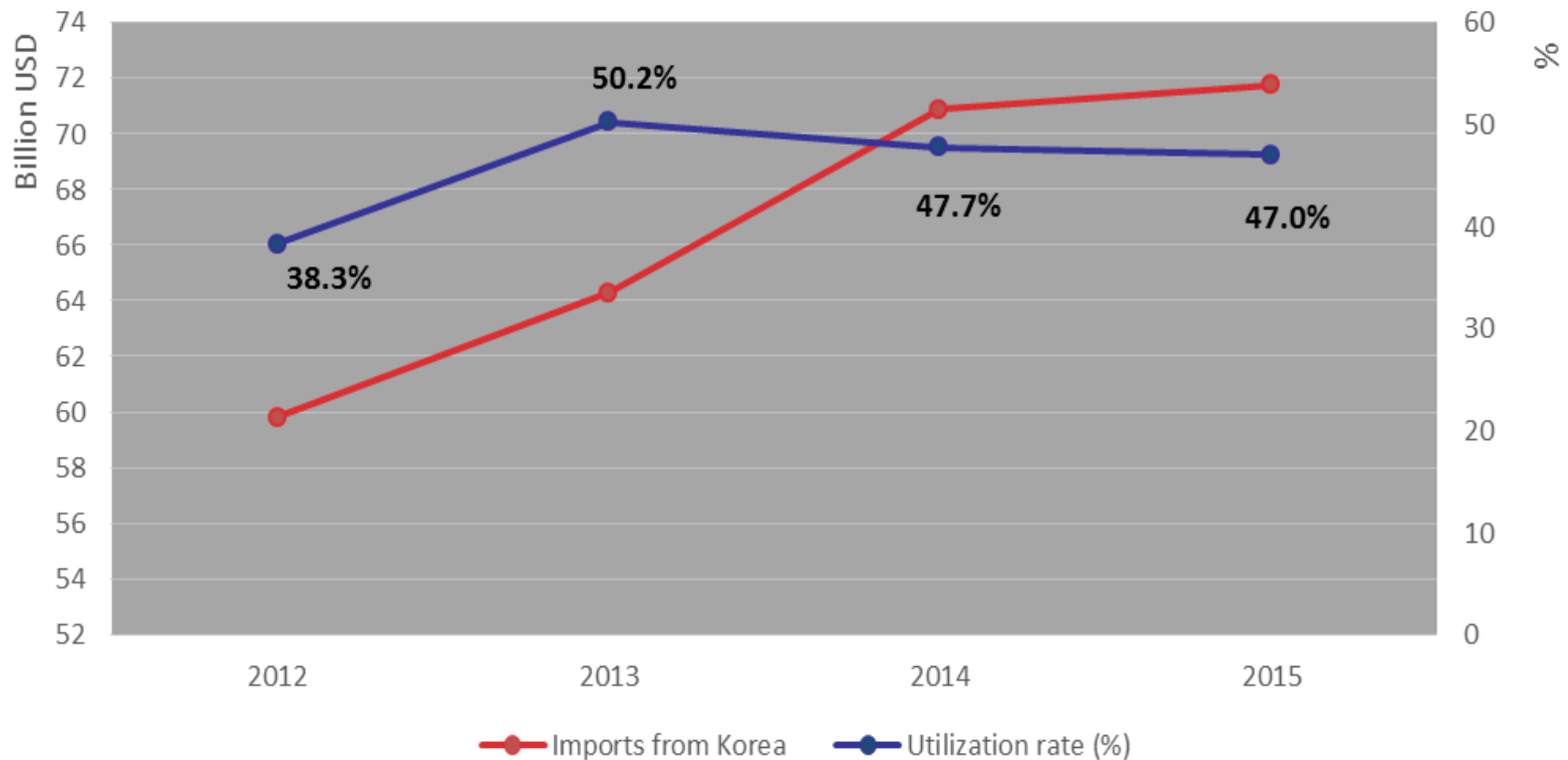
Fourth: Those who seems Learning less-Reported averages of Utilization Rates in COMESA and SADC [2010]



Fifth: Learning or NOT ?

Utilization Rate of US-Korea FTA

US imports from Korea and US-Korea FTA utilization rates



Addressing the “substance” of RoO: Trends and techniques

- **Trend 1** :It is possible to detect convergence in some areas.i.e. chemicals
- **Trend 2**: Difference in North-North FTAs from South-South FTAs: South South FTAs are by far most protectionist as stringent RoO are” expected to create industries and favour regional integration”
- **Trend 3** : Developing techniques to measures FTAs. As many countries are entering FTAs, there is need to monitor their utilization
- **Trend 4**:How to Draft substance of RoO ,any tool ?



What we can learn at this stage from Utilization rates

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

2) Using an input – output matrix to draft Product specific rules of origin (PSROs) In FTAs
“Excerpts from research studies and previous advise to Governments involved in FTAs negotiations”



The methodology (1)

- The methodology is based on a twofold approach:
 1. Text-based comparative analysis of the recent RoO regimes to identify previous RoO that may be used
 2. An input-output matrix approach to match trade flows of imported inputs used in a party to a FTA to manufacture a finished products for export to the other party

The methodology 1. B

Breaking the HS into output/input HS headings and subheading

- Trade statistics are based on HS and RoO increasingly based on HS as well (CTC)
- Output: Heading 16.04.14: Canned tuna
- Inputs:
 - A) HS 0302.31- Fresh tuna of albacore
 - B) HS 73.10.10-Tin
 - C) HS 15.09.10 -olive oil



Drafting China-ASEAN PSROs (2007)

- Subheading 847330 of the Harmonized System classifying parts and accessories of computers was one the most imported and most exported item among ASEAN countries and China.
- A) A change to heading 8473 from any other heading.
- This rule may mean that all assembly operations performed in China to manufacture sub-components from parts imported from ASEAN will not be considered as originating in China since the finished product is classified in the same heading
- Cumulation in this case may play a role



Drafting ASEAN-China PSROs(2007)

- HS subheading 841430 classifying compressors were the fifth most exported products to ASEAN by China.
- Matching this finding with China's imports from the World, it was observed that HS 8414 90 -parts of compressor-ranked as the 36th most imported product from USA and Japan
- Thus, a rules of origin such as:

"A change to subheading 841430 from any other subheading, except from subheading 8414.90"

may entail that the compressors exported to ASEAN utilizing parts imported from Japan and USA will not comply with rules of origin requirements

PHL exports to the EU (millions USD) and Inputs Suppliers

Product HS and Description	Dutiable Exports to EUN		Main Inputs	World Imports		Principal Suppliers			
	Val	%		Val.	Nor	ISO	%	ISO	%
TOTALS FOR ALL DUTIABLE EXPORTS	3'453.1		TOTALS FOR ALL IMPORTS :	70'153.5					
151311 Coconut (copra) oil, crude	451.1	90.8	1203	47.4	15.8	PNG	59.6	IDN	37.1
850440 Static converters	261.3		408504.90 - parts	117.6	11.8	CHN	39.3	UNS	17.2
160414 Tunas, skipjack & bonito (Sarda spp.), prepared/preserved	123.6	99.1	0302.31; 0302.32; 0302.33; 0302.34; 0302.35; 0302.36; 0302.39; 0302.89; 0303.41; 0303.42; 0303.43; 0303.44; 0303.45; 0303.46; 0303.49; 0303.89; 0304.49; 0304.59; 0304.87; 0304.89; 0304.99; 0305.39; 0305.49; 0305.59; 0305.69	171.5	57.1	PNG	32.7	UNS	21.9
847340 Parts & accessories of the machines of 84.72	103.7	40.2	7207.11 thr. 7207.20 - semi-finished products (iron/steel); 7209.15 thr. 7209.90 - flat-rolled products, of (iron); 7215.10 and 7215.50 - bars and rods (iron/steel); 7218.91 and 7218.99 - semi-finished products (steel); 7219.31 thr. 7219.90 - flat-rolled products (steel); 7222.20 - bars and rods (steel); 7224.90 - semi-finished products (oth. alloy steel); 7225.11 thr. 7225.99 - flat-rolled products (oth. alloy steel); 7228.60 - bars and rods (oth. alloy steel); 7304.31 thr. 7304.39 - tubes and pipes (iron/steel); 8542.31 thr. 8542.39 - electronic integrated circuits	187.7	0.7	CHN	62.0	RUS	17.2

RCEP Imports and Exports (millions USD), Products Destinations and Inputs Suppliers

Basic Product (HS4)		Exports to RCEP		Destination				Main Inputs	World Imports		Principal Suppliers			
		Val	%	ISO	(%)	ISO	(%)		Val.	Nor	ISO	%	ISO	%
441890	Builders' joinery&carpentry of wood	2'426	85	JPN	99.9	CHN	0.1	4407.10 - coniferous; 4407.21 - Mahogany ; 4407.22 - Virola, Imbuia and Balsa ;4407.25 - Dark Red Meranti, Light Red Meranti and Meranti Bakau ; (etc, other wood) 4407.26; 4407.27; 4407.28; 4407.29; 4407.91; 4407.92; 4407.93; 4407.94; 4407.95; 4407.99; 4409.10 ; 4409.21 ;4409.29	82	2.1	CAN	60	MYS	16
847170	Storage units	1'269	29	CHN	74.2	JPN	13.8	8473.30 and 8473.50 - parts and accessories	2'013	335	JPN	30	SGP	16
854140	Semi-conductor devices	1'211	10	JPN	95	CHN	4.5	8541.90 – parts	31	5.2	CHN	25	UNS	22
847330	Parts & accessories of the machines 84.71	1'158	27	THA	36.6	CHN	35.7	<i>Iron products:</i> 7207.11 thr. 7207.20 - semi-finished; 7209.15 thr. 7209.90 - flat-rolled; <i>Steel products:</i> 7218.91 and 7218.99 - semi-finished ; 7219.31 thr. 7219.90 - flat-rolled; 7222.20 - bars and rods; 7224.90 - semi-finished products <i>Oth. alloy steel products:</i> 7225.11 thr. 7225.99 - flat-rolled ; 7228.60- bars and rods; <i>Iron/steel:</i> 7215.10 and 7215.50 - bars and rods ; 7304.31 thr. 7304.39 - tubes and pipes	188	0.7	CHN	62	RUS	17
854430	Ignition wiring sets vehicles/ aircraft/ ships	1'033	8	JPN	84.4	THA	8.3	8544.49 - insulated wire	160	1.8	CHN	36	JPN	24
847160	Input/output units (Computers)	1'028	24	CHN	53.1	JPN	15.8	8471.70 - storage unit ; 8473.30 and 8473.50 - parts and accessories	2'089	373	JPN	31	SGP	16

Advise Philippines in EU and RCEP: Canned tuna 2017

HS 160414	EU-Vietnam	EU -Singapore	CETA	EU Korea
Canned tuna	Manufacture in which all the materials of Chapters 2, 3 and 16 used are wholly obtained	Manufacture in which all the materials of Chapters 2, 3 and 16 used are wholly obtained	A change from any other chapter, except from Chapter 3	Manufacture: -from animals of Chapter 1, and/or - in which all the materials of Chapter 3 used are wholly obtained



Advising Philippines in EU and RCEP

HS 840440	EU-Vietnam	EU -Singapore	CETA	EU Korea
Static converters	<p>Manufacture from materials of any heading, except that of the product or</p> <p>Manufacture in which the value of all the materials used does not exceed 70% of the ex- works price of the product</p>	<p>Manufacture from materials of any heading, except that of the product or</p> <p>Manufacture in which the value of all the materials used does not exceed 60% of the ex- works price of the product¹</p>	<p>A change from any other heading; or</p> <p>A change from within any one of these headings, whether or not there is also a change from any other heading, provided that the value of non-originating materials classified in the same heading as the final product does not exceed 50 percent of the transaction value or ex-works price of the product.</p>	<p>Manufacture in which the value of all the materials used does not exceed 45% of the ex-works price of the product</p>

¹ ASEAN cumulation

Advise Philippines in EU and RCEP: Parts of office machines

HS 847340	EU-Vietnam	EU -Singapore	CETA	EU Korea
Parts and accessories of the machines of heading 84.72 (office machine)	<p>Manufacture from materials of any heading, except that of the product or</p> <p>Manufacture in which the value of all the materials used does not exceed 70% of the ex- works price of the product</p>	<p>Manufacture from materials of any heading, except that of the product or</p> <p>Manufacture in which the value of all the materials used does not exceed 60% of the ex- works price of the product¹</p>	<p>A change from any other heading; or</p> <p>A change from within any one of these headings, whether or not there is also a change from any other heading, provided that the value of non-originating materials classified in the same heading as the final product does not exceed 50 percent of the transaction value or ex-works price of the product.</p>	<p>Manufacture in which the value of all the materials used does not exceed 50% of the ex-works price of the product</p>

¹ ASEAN cumulation



Advantages and challenges of the methodology work in progress

Advantages:

- Identifies in a detailed –trade data based the heading and subheadings where PSROs are most important
- A valid basis for consultations with private sector
- Provides indications of impact of a given PSROs
- Useful to establish a dialogue with firms

Challenges

- It does not depicts sourcing policy of the company ;it may source locally the inputs required
- It depends on the HS and applicability of HS to PSROs
- Difficult to asses impacts in case of RVC RoO

The way forward for the CFTA



UNITED NATIONS
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A RoO Protocol: main features

- A protocol on rules of origin consists of two documents:
 - The main text.
 - The annex of product specific rules of origin.
 - The PSRO contained in the annex will be the only rules of origin applicable
 - How to negotiate the Annex ?

The Template

- Sequencing the priorities on PSRO
- The CFTA parties either may not show significant trade in some of the HS headings or the tariff rate is MFN duty free in others.
- Attention may be therefore focused on the product specific - rule of origin where a significant trade flows and high preferential margins has been showed in the template.
- To this end the national template may contain information on
 - a) the preferential margin
 - b) the amount of trade flows recorded for that specific heading or chapter from the different parties
 - c) Alternative proposals for PSROs

Drafting PSRO for CFTA

- Article 7 will make a reference to an annex containing PSRO.
- The PSRO will be the only rules of origin applicable to the products contained in the annex.
- Criteria for determining substantial transformation in the PSRO contained in the annex :
 - wholly obtained
 - 75% of non-originating materials
 - CTH
 - Specific working or processing