

Concepts and techniques of Rules of origin

Stefano Inama

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Rules of origin in GATT 1947

- During the second session of the GATT Preparatory Committee in 1947, a Sub-Committee considered:
“it is to be clear that it is within the province of each importing member to determine, in accordance with the provisions of its law, for the purpose of applying the most-favoured-nation (MFN) provision whether goods do in fact originate in a particular country”.
- Only later – in 1951 and 1952 – were the first attempts made (without success) to address the question of harmonization of RoO.

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Kyoto Convention 1974 and 2000

The Convention identified two kind of products:

- **Wholly obtained products**-Products that does not contain non-originating materials
- Products where more than one country was involved in the manufacturing: **substantial transformation criterion**;

"Means the criterion according to which origin is determined by regarding as the country of origin the country in which the last substantial manufacturing or processing, deemed sufficient to give the commodity its essential character, has been carried out."

Kyoto convention 1974

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

Kyoto convention 2000

- **Recommended Practice**

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

- **Recommended Practice**

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

- **Recommended Practice**

- Where the **substantial transformation criterion is expressed in terms of the ad valorem percentage rule**, the values to be taken into consideration should be:
 - for the materials imported, the dutiable value at importation
 - for the goods produced, either the ex-works price or the price at exportation,
according to the provisions of national legislation

WTO Agreement on RoO

- Members undertake to apply non preferential rules of origin **equally for all purposes** art 9.1(a) of ARO.
- **Harmonization work program (HWP)** based on change of tariff classification and supplementary criteria (percentage criterion and specific working or processing).
- Technical Committee on Rules of origin (**TCRO**) in WCO and Committee on Rules of Origin in WTO (**CRO**).
- Work should have been concluded in 1998.
- Preferential rules of origin subject to a Common Declaration with no binding rules.

RoO rotates around few basic concepts and determinants

- Wholly obtained products
- Substantial transformation
- Cumulation
- Intermediate materials or absorption rule
- Certificate of origin



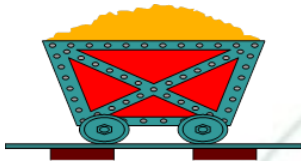
During this initial session we briefly examine:

- Wholly obtained products
- Substantial transformation

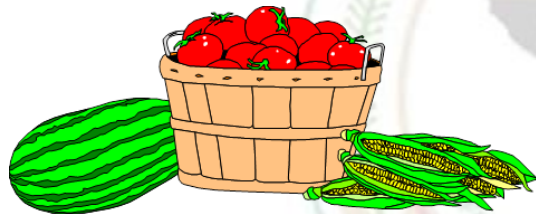


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Wholly obtained products: Do not contain non- originating inputs



**MINERAL PRODUCTS EXTRACTED
FROM THEIR SOIL OR FROM THEIR
SEABED**



**VEGETABLE PRODUCTS
HARVESTED ON THEIR SOIL**



**ANIMALS BORN AND RAISED
THEIRIN**

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Definition of wholly obtained products from fisheries (Excerpted from EU GSP Rules of Origin)

Article 75 (Commission Regulation (EU) No 1063/2010)

Paragraph 1:

- (h) products of sea fishing and other products taken from the sea outside any territorial sea **by its vessels**;
- (i) products made on board its **factory ships** exclusively from the products referred to in point (h);

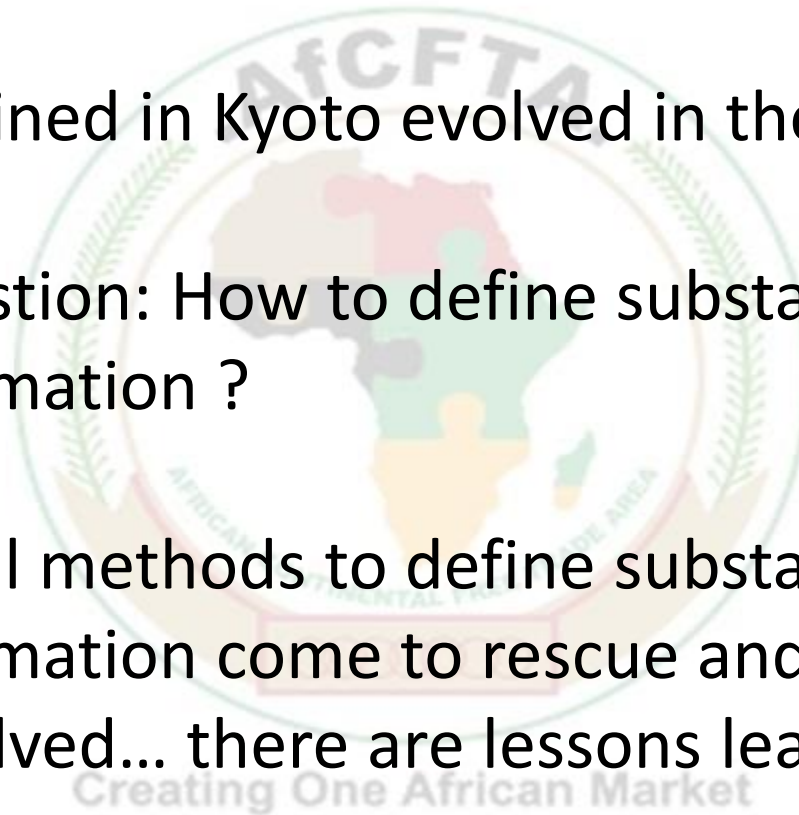
Paragraph 2:

The terms “**its vessels**” and “**its factory ships**” in paragraph 1(h) and (i) shall apply only to vessels and factory ships which **meet each of the following requirements**:

- a) they are registered in the beneficiary country or in a Member State,
- b) they sail under the flag of the beneficiary country or of a Member State,
- c) they meet one of the following conditions:
 - i. they are at least 50 % owned by nationals of the beneficiary country or of Member States, or
 - ii. they are owned by companies
 - which have their head office and their main place of business in the beneficiary country or in Member States, and
 - which are at least 50 % owned by the beneficiary country or Member States or public entities or nationals of the beneficiary country or Member States

Substantial transformation: the key concept

- Is the core concept of the rules of origin.
- First defined in Kyoto evolved in the ARO.
- Key question: How to define substantial transformation ?
- Technical methods to define substantial transformation come to rescue and they have also evolved... there are lessons learned.



Defining substantial Transformation The menu 1.0

1) Percentage criteria based on:

- a) Value added by addition(VA)
- b) Maximum value of non-originating materials (MVNOM)
- c) value of materials declined as Regional Value content – build down, build up,

2) Change of tariff classification:

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

3) Specific working or processing:

- a) Manufacture from ...

1. Ad valorem Percentage criterion

A) Value Added Calculation as in US GSP.AGOA or Net Cost method

- By addition:
$$\frac{\textit{Originating Materials} + \textit{Direct Cost of Processing}}{\textit{Ex - Works Price}}$$

B) Value of Materials Calculation

- Value added by subtraction of non-originating material(Build- down):
$$\frac{\textit{Ex Works Price} - \textit{VNM}}{\textit{Ex - Works Price}}$$
- Maximum value of non-originating materials EU/Japan,Canada(GPT) :
$$\frac{70\%}{\textit{Ex Works Price}}$$
- Minimum Value of Originating materials(build –up):
$$\frac{30\%}{\textit{Ex Works Price}}$$

2. Change of Tariff Classification (CTC)

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

” 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 exception → EU GSP, Product Specific Rules of Origin:**

Aluminium foil: Manufacture from materials of any heading, except that of the product and heading 7606

- **CTC with multiple exception → 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	<p>Articles of apparel and clothing accessories, knitted or crocheted:</p> <ul style="list-style-type: none"> – 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)

Drafting RoO in FTAs: We have some lessons learned

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

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Parameters for designing an FTA Model RoO

- A) **The form of RoO**-this is the drafting technique used:
- RoO should be technically sound, producing the same outcome, transparent, easy to administer and to comply with
- B) **The substance of RoO**-This is the requirement of working or processing to achieve substantial transformation:
- RoO should reflect actual manufacturing capacity in the partner countries ensuring sourcing from most efficient suppliers

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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 the point that most of negotiators is missing...

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Example of distinction between “form” and “substance”

- The substantive requirement is :manufacturing shirts from fabric.
- It is possible to draft this requirement through:
 - An ad valorem percentage criterion : 50 % of non originating material
 - Change of tariff classification Change of HS chapter: woven shirts are classified in HS chapter 61 and cotton fabrics in chapter 52
 - Manufacturing requirement: Cutting. Making-up and Trim (CMT)
- The key issue is to focus on the substance of the industrial process, not the form of the rules of origin
- What is important is the meaning of what you say ,not the language
- Of course there also important things about the language

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
- Many FTAs used a variety of CTC and ad valorem percentage at times with alternative RoO for the same product
- The current status of the AfCFTA is at variance with such techniques

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How many product specific RoO(PSRO) do I need in a AfCFTA ?

- Across the board criteria,
- Across the board with selected product specific,
- Product specific only
- The world wide tendency is to have product specific but how specific do you need for intra- African trade ?
 - HS chapter with limited exceptions at HS heading ?
 - HS headings with exceptions at HS subheading ?
 - HS subheading (this is current degree of PSRO even if they are replicated by default)

Some lessons learned in drafting percentage criterion...



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

- Example of Value added calculation:

Originating Materials + Direct Cost of Processing

Ex – Works Price

- 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.
 - Confidentiality of the data
 - Wide discretion used in determining what are cost of production that could be considered as value added
 - 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 material calculation

- Method Based on Value of Non-Originating Materials (EU style)

$$\frac{VNM}{Ex - Works Price} \times 100 \geq \dots \%$$

- Method Based on Value of Non-Originating Materials (North America style)

$$RVC = \frac{Value\ of\ the\ Good - VNM}{Value\ of\ the\ Goods} \times 100$$

- Method Based on Value of Originating Materials

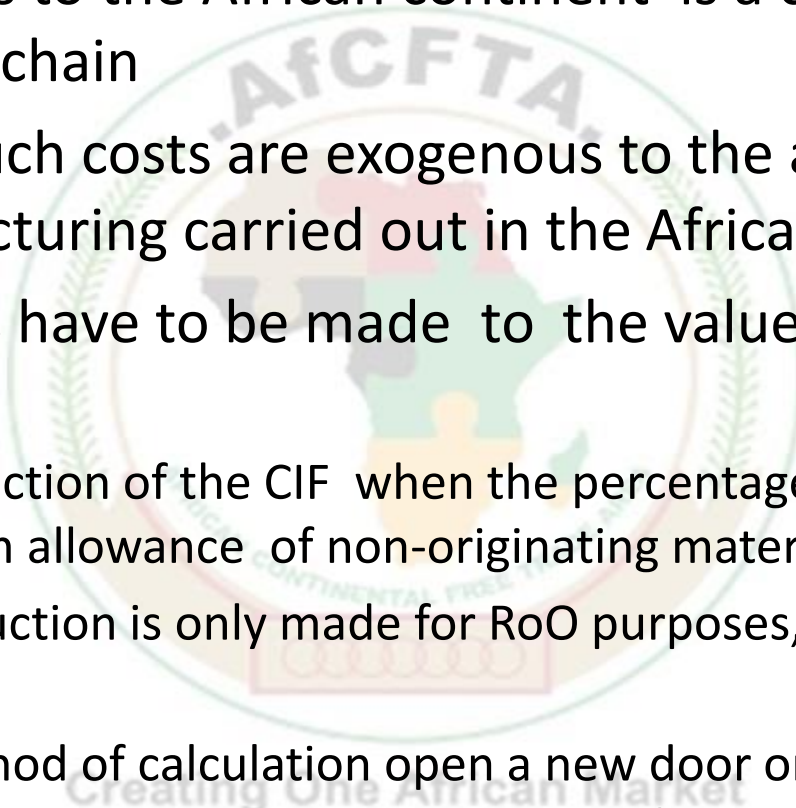
$$\frac{VOM}{Ex - Works Price} \times 100 \leq \dots \%$$

Where:

- EW is the Ex Works price;
- VNM is the value of non-originating materials that are acquired and used by the producer in the production of the good;
- VOM is the value of originating materials acquired or self-produced, and used by the producer in the production of the good.

Adjustments to the Value of non originating materials in the ad valorem percentage calculation

- The cost of shipping and insurance of intermediate inputs and products to the African continent is a crippling factor in global value chain
- Moreover such costs are exogenous to the amount of working and manufacturing carried out in the African region
- Adjustments have to be made to the value of materials permitting:
 - The deduction of the CIF when the percentage is based on a maximum allowance of non-originating materials
 - This deduction is only made for RoO purposes, Not for customs valuation
 - This method of calculation open a new door on RoO in the percentage calculation: the incidence of shipping costs



Summary of lessons learned in drafting percentage criterion...

- Adopt a value of materials calculation.
- allow deduction of cost of insurance and freight from values of non originating material
- All African countries are familiar with value of material calculation since it has been used in Lomé convention, Cotonou partnership Agreement and EPAs

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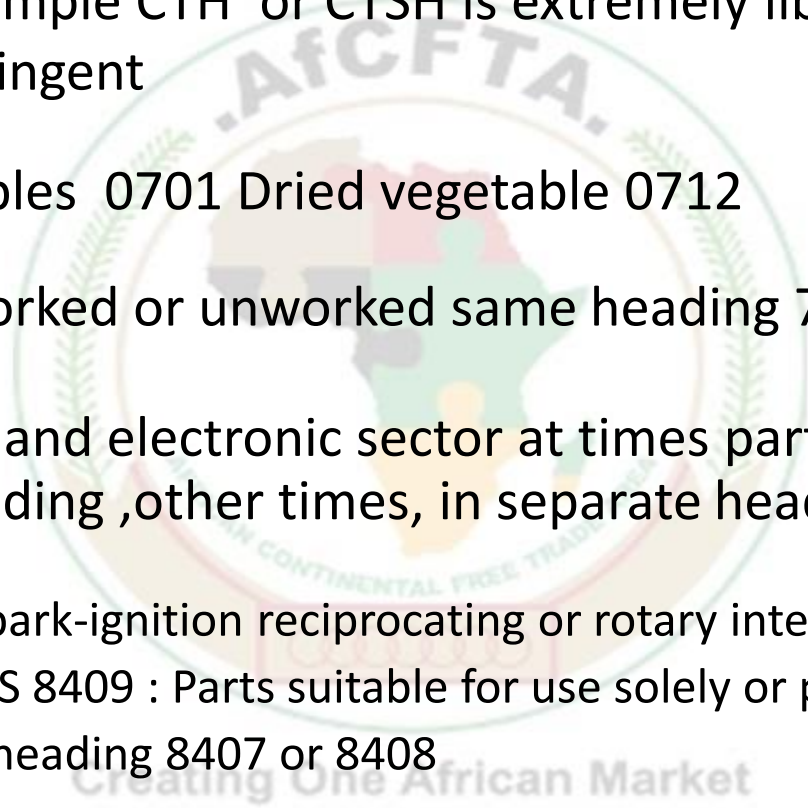
Some lessons learned in drafting RoO using change of tariff classification ...



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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 other 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



Examples of adjustments to the HS structure to suit origin purposes during HWP

HS Code number	Description of goods	Origin criteria
Chapter 25	Salt; sulphur; earths and stone; plastering materials, lime and cement	
25.07	Kaolin and other kaolinic clays, whether or not calcined	Options proposed by delegations: Chapter rule WO Proposals as indicated at the splits below
ex 25.07 (a)	Calcined	CTHS
Ex 25.07 (b)	Other	Options proposed by delegations: Chapter rule CC
25.18	Dolomite, whether or not calcined; dolomite roughly trimmed or merely cut, by sawing or otherwise, into blocks or slabs or a rectangular	Proposals as indicated for subheadings
2518.10	Dolomite not calcined	The country of origin of the goods shall be the country in which the dolomite of this subheading is obtained in its natural or unprocessed state
2518.20	Calcined dolomite	CTSH



Issue of alternative rules of origin for the same product: Are they really useful unless they are really an alternative ?

- 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

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Summary of lessons learned in using CTC

- CTC is a valid drafting technique
- However given the nature of the HS it may not be adopted as horizontal level for all products
- There is a need to make sure that alternative RoO are real, otherwise there is confusion and lack of predictability

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Some lessons learned from utilization rates



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The substance: Lessons learned from Utilization rates

- Customs based: the ratio among goods eligible for FTA treatment with those that have effectively received it
- LDCs Nairobi decision on Rules of origin for LDC WTO key initiatives on utilization rates that are now recognized as tool to measure the effectiveness of rules of origin
- Recent initiative on EU FTAs, including Euromed and EPAs

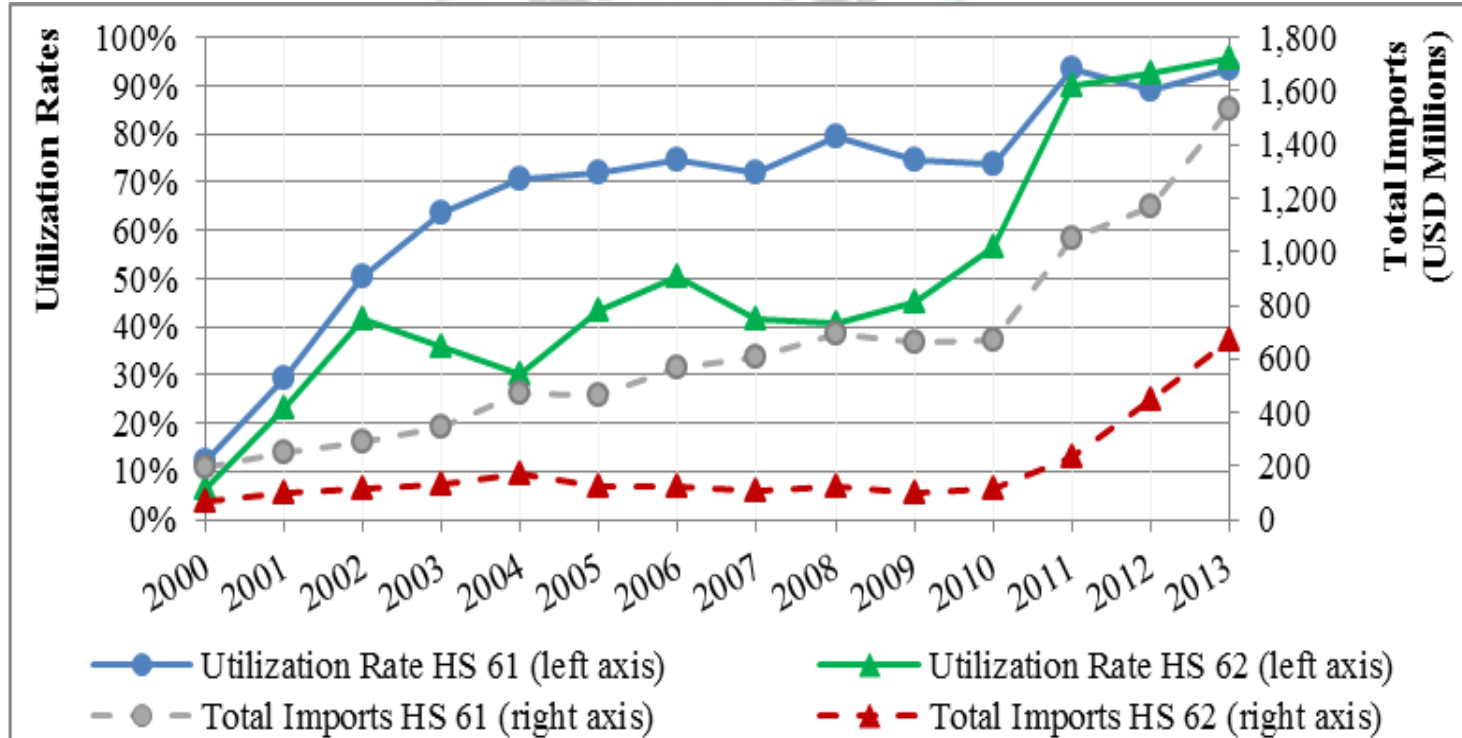
$$UR = \frac{\textit{Imports receiving preferential treatment}}{\textit{Imports covered by the preferential agreement}} * 100$$

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First lesson learned: RoO should Match Industrial capacity

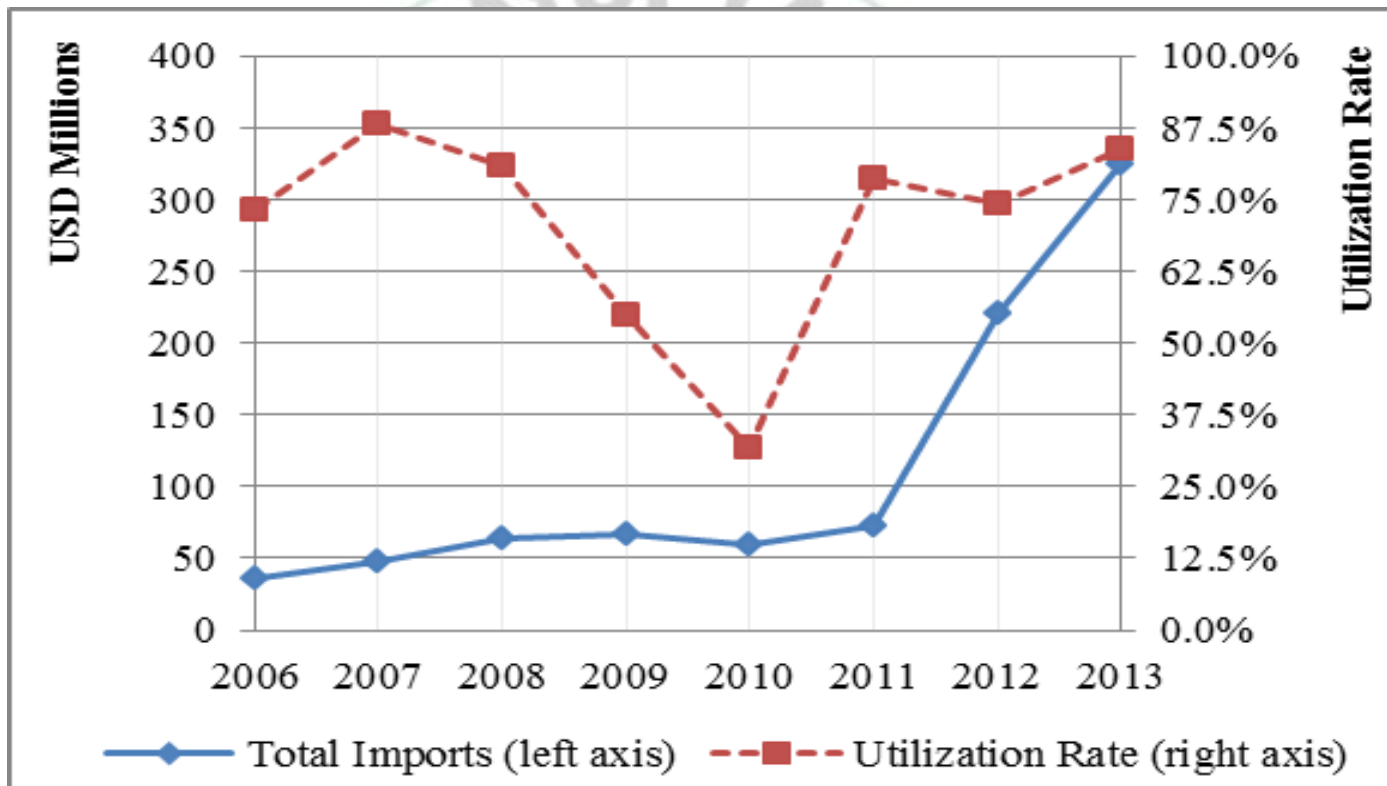
[EU reform of GSP RoO]

- EU imports from Cambodia and GSP utilization rates: Art of the apparel & clothing access, HS 61 knitted/ creched and HS62 not knitted/crocheted

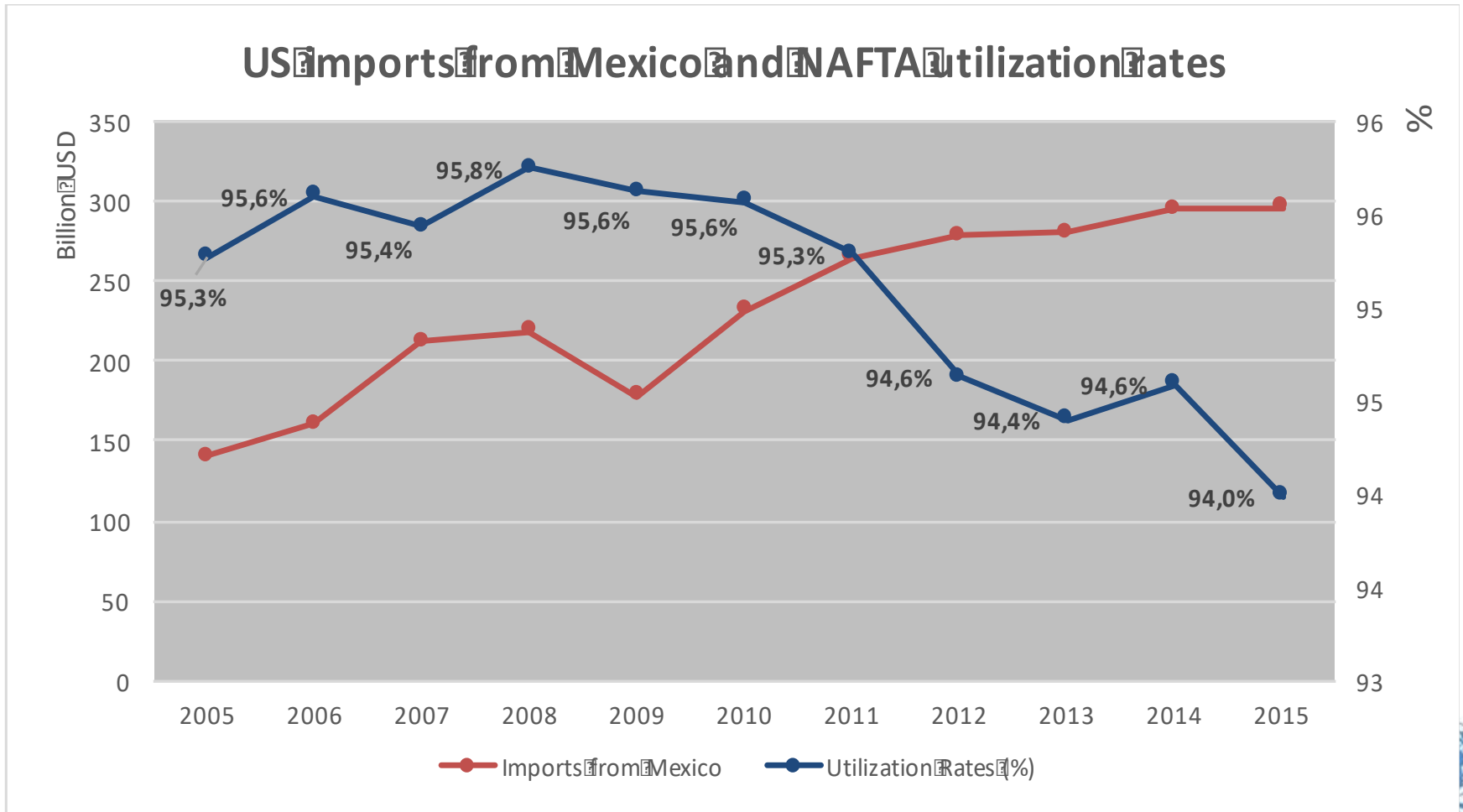


Second lesson learned :RoO should match value chains

- EU imports from Cambodia and GSP utilization rates: Bicycles



Third: Predictability of RoO leads to high utilization, what trade effects with RoO less strict ?

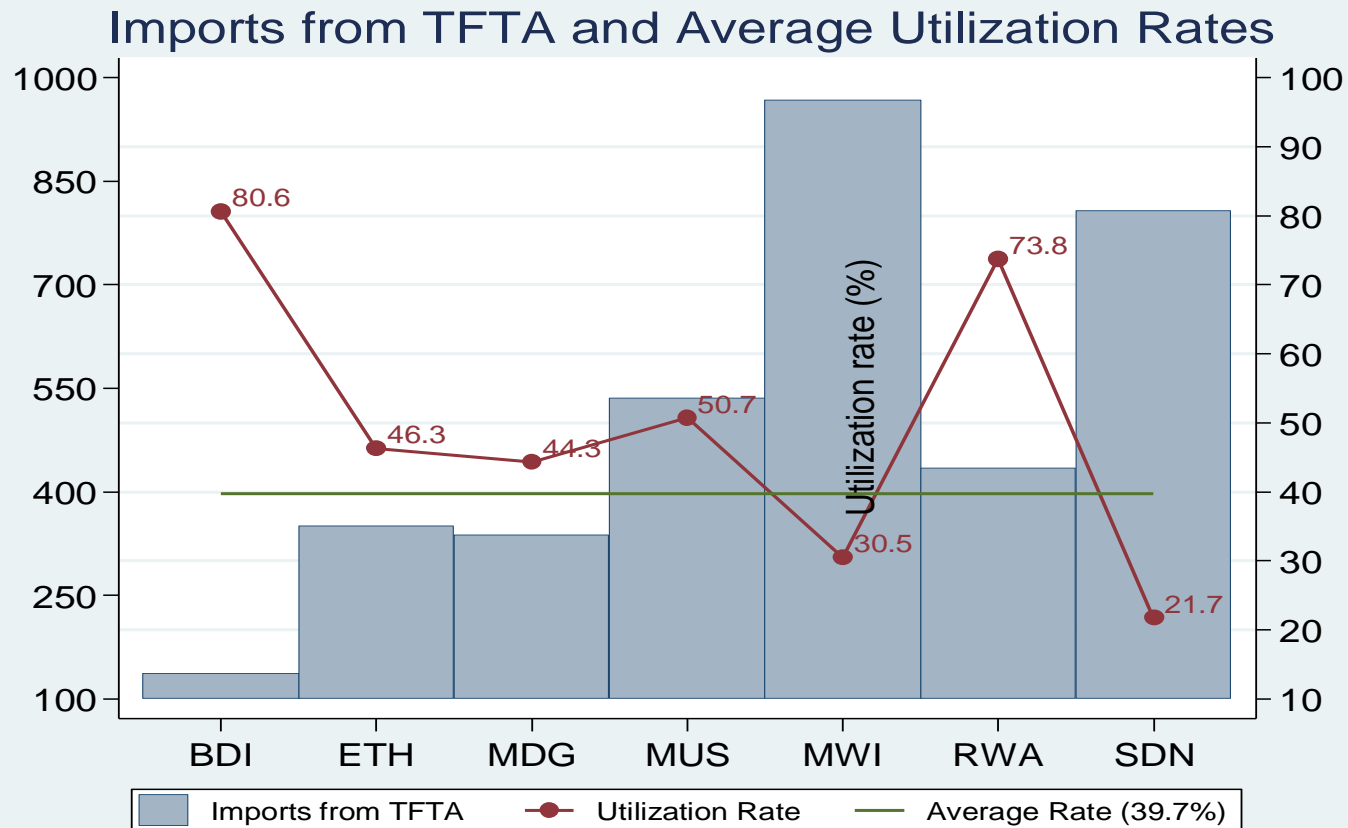


Fourth: Those who seems Learning less: ASEAN Utilization rates [2010]

	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

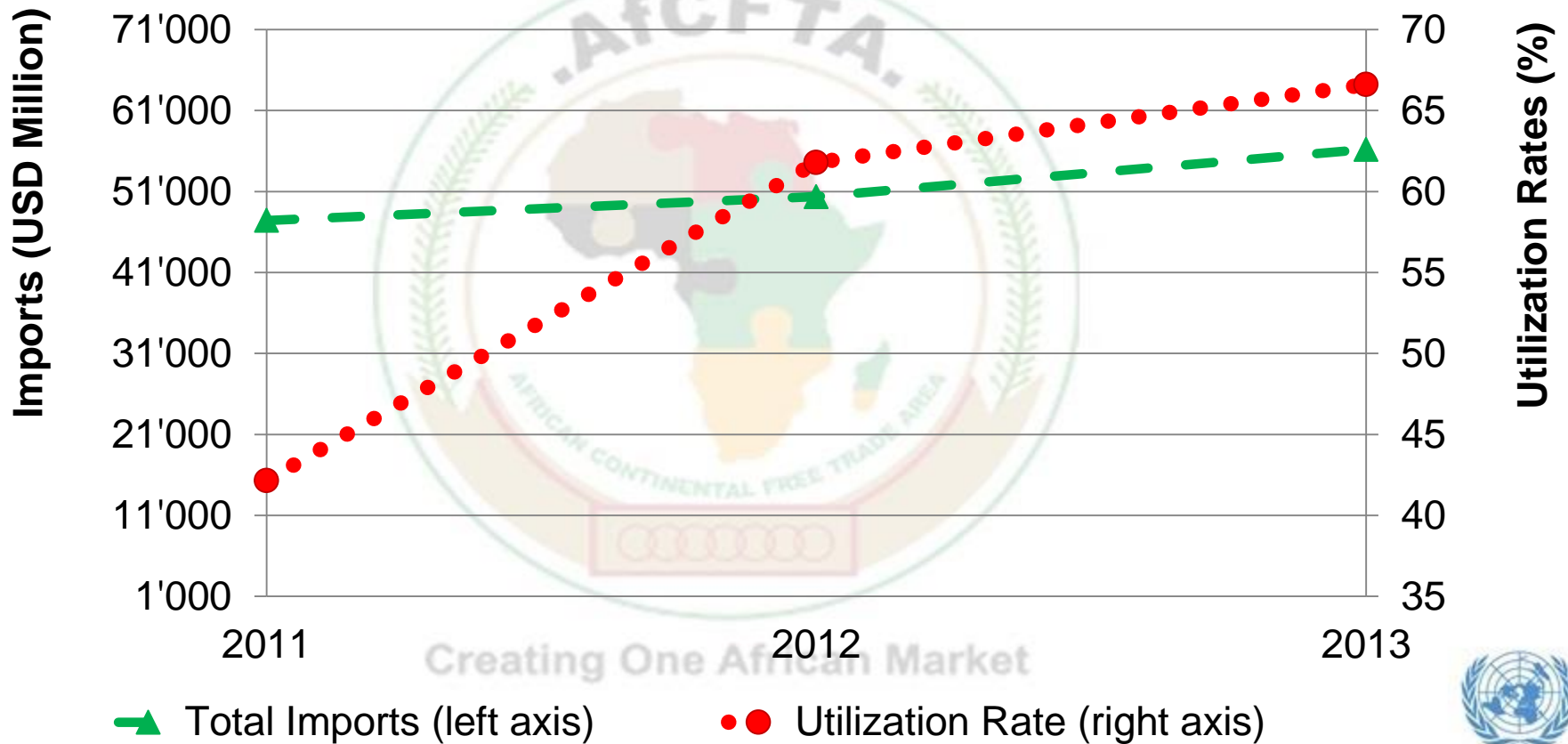
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Fifth: Those who seems Learning less-Reported averages of Utilization Rates in COMESA and SADC [2010]



Sixth : Effect of direct shipment rule ? Utilization Rate of EU-Korea FTA

Korean Imports from the European Union and Utilization Rate



▲ Total Imports (left axis)

● Utilization Rate (right axis)

Lessons learned 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]

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Thank You for your kind attention

Stefano Inama, Chief

Technical Cooperation and Enhanced Integrated Framework

Division for Africa, Least Developed Countries
and Special Programmes (ALDC)

United Nations Conference on Trade and Development

Stefano.inama@unctad.org



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