

**World Trade Organization
Least Developed Countries Group**



Substantial Transformation: Value Added, percentage thresholds
(Paragraph 1.3 of the Decision)

7 October , Florence.Italy

Recalling Paragraph 1.3 of the Decision

- Given the limited productive capacity in the LDCs, it is desirable to keep the level of value addition threshold as low as possible, while ensuring that it is the LDCs that receive the benefit of the preferential trade arrangements.
- It is noted that the LDCs seek consideration of allowing foreign inputs to a maximum of 75% of value in order for a good to qualify for benefits under LDC preferential trade arrangements.
- *Note: The precise percentage may vary depending on the calculation methodology used in different schemes.*

Questions

- What levels of threshold are WTO members using that are as low as possible, while ensuring that it is the LDCs that receive the benefits of the preferential trade arrangements?
- Which WTO Members are closer to the 75% threshold proposed by the LDCs ?
- What is a desirable level of percentage taking into account the global value chains (GVCs) ?
- Is it realistic to set a level of percentage that is not arbitrary or is it preferable to adopt another methodology for certain sectors ?

Some Caveats

- The LDCs are not arguing that the percentage criterion is their preferred criterion to determine substantial transformation.
- The issue at stake is to determine a level of percentage that is commercially viable for businesses and investors taking into account GVCs
- Such level of percentage may vary depending on the sector at stake
- In some sectors and as recognized by the Decision the percentage criterion may not be the most appropriate method and other methods may be adopted.

What levels of threshold are WTO members using ?

Country	Percentage Level	Numerator	Denominator	Distance from The LDC proposed level
European Community (EBA)	Maximum amount of non-originating material 70%*	Value of non-originating material	Ex-works price	5% + issue of freight and insurance
Japan	Maximum amount of non-originating material 40%*	Value of non-originating material	FOB price	35% + issue of freight and insurance
Canada	Maximum amount of non originating materials 60% for LDCs(80%)	value of non originating materials	Ex-factory price	issue of freight and insurance
United States	Minimum 35%,	Cost of materials produced in preference-receiving country plus the direct cost of processing carried out there	Appraised value of the article at the time of entry into the United States	10% + issue of freight and insurance and methodology of calculation
AGOA	Same as above	Same as above	Same as above	
China	Minimum 40% value added by subtraction	Price of goods minus the price of materials originating from the beneficiary country	FOB price	15% + issue of freight and insurance
India	Minimum 30% value added by subtraction	FOB price minus the value of non-originating materials	FOB price	5% + issue of freight and insurance
Eurasian CU	Maximum 50% of non-originating material	Customs value ? **	Ex-works price ? **	25% + issue of freight and insurance

* Most used percentages ** English translation of the legal text not available

Level of percentage - Example 1: Sport Shoe

What is a desirable level of percentage taking into account the global value chains ?



Source: Trudo Dejonghe (Lessius)

Level of percentage - Example 1: Sport Shoe

What is a desirable level of percentage taking into account the global value chains ?

a) Raw material	8 €
b) Wages	0.4 €
c) Direct costs of processing	1.6 €
Allowable (assumed)	0.8 €
Not allowable (assumed)	0.8 €
d) <u>Profits producer</u>	<u>2 €</u>
Total cost (Ex-Works Price)	12 €

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

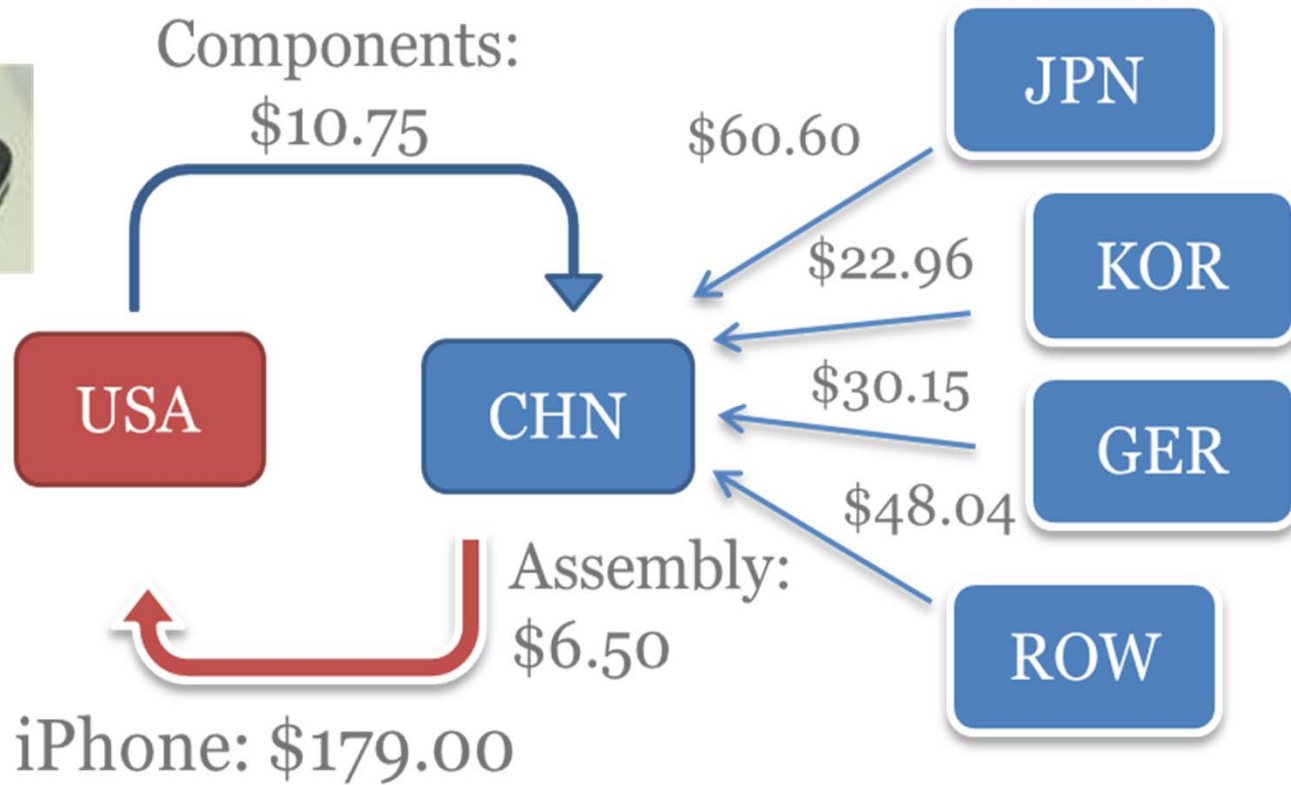
This example assumes that all raw material originates in countries where no cumulation is applicable.

Level of percentage - Example: i-Phone

What is a desirable level of percentage taking into account the global value chains ?



Retail price:
\$500.00
(Profit margin:
64%)



Level of percentage - Example: i-Phone

What is a desirable level of percentage taking into account the global value chains ?

a) <i>Material and components</i>	172.5 €
b) <i>Direct costs of processing</i>	6.5 €
c) <u><i>Profits producer (assumed ~8%)</i></u>	<u>14 €</u>
<i>Total cost (Ex-Works Price)</i>	193 €

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

What is a desirable level of percentage taking into account the global value chains ?

- **One lesson learned:** The EU carried out an impact assessment study and set the level at 70% of non originating materials: the new rule generated trade effects
- The experience and the examples show that the level of percentage vary depending on the industrial sectors
- Modern rules of origin contained in FTAs show that the percentage criterion is mostly used in combination with a CTC and is seldom used as a stand alone criterion
- The large majority if not the totality of FTAs does not use anymore a percentage criterion as a stand alone criterion

Recommendations

- LDCs would recommend the following best practices:
 - 1) Whenever it is used, the level of percentage should be calculated according to the LDCs proposal of not more than 75% of non originating materials out of the ex-works price with deduction of cost of insurance and freight
 - 2) Notwithstanding this, in some sectors, other methodologies such as CTC and Specific working or processing may be used to better reflect the processing stages of the GVCs
 - 3) The presentations on item (3), CTC, and Item (4), specific working or processing, will provide useful examples on alternative methodologies to define substantial transformations for those sectors