

**World Trade Organization
Least Developed Countries Group**



**Substantial Transformation:
Methods of calculation of Value Added
(Paragraph 1.4 of the Decision)**

8 October ,Florence, Italy

Recalling Paragraph 1.4 of the Decision

- The methods for the calculation of value should be as simple as possible.
- It is recognized that different methodologies are used to calculate the ad valorem percentage of value addition.
- This percentage may be determined on the basis of the principles of simplicity and transparency.
- For example, in case of methods used for calculation of foreign inputs, Members may exclude costs related to freight and insurance as well as international transportation costs.
- In case of methods used for calculation of local/domestic content, Members may include national or regional inland transportation costs.

Questions

- Are WTO members using a calculation of value as simple as possible ?
- Is the percentage requirement determined on the basis of the principles of simplicity and transparency?
- Which WTO members are excluding costs related to freight and insurance as well as international transportation costs ?

Are WTO members using a calculation of value as simple as possible ?

a) Value added calculation by addition

$$\frac{\text{Direct cost of processing} + \text{value of originating material}}{\text{Appraised value (ex - factory price)}} = \dots\%$$

b) Value of material calculation

i. Value added by subtraction of non-originating materials:

$$\frac{EW - VNOM}{EW} = \dots\%$$

ii. Maximum value of non originating materials: $\frac{VNOM}{EW} = \dots\%$

iii. Minimum value of originating materials: $\frac{VOM}{EW} = \dots\%$

Where

EW: Ex-Works price;

VNOM: Value of non originating materials; VOM: Value of Originating Materials.

EW may be replaced by FOB in certain administrations

Is the percentage requirement determined on the basis of the principles of simplicity and transparency?

Percentage criteria calculation methodology

Value added calculation by addition

- The definition of direct processing costs is rather complicated:
 - A. Items included in the direct costs of processing operations: like labor, dies, mold, research, inspection*
 - B. Items not included in the direct costs of processing operations: like profit, general overhead expenses*
- There are around 375 to 800 records in US customs ruling website about the definition of direct costs of processing.
- Definition of value of materials-double transformation.
- There are around 490 records in the US customs ruling website

Percentage criterion: value added vs. value of materials

The disadvantages of a value added calculation by addition as in the US GSP/AGOA:

- Itemization of costs to the single unit of production. It requires accounting, and discretion may be used in assessing unit costs.
- Currency fluctuations may affect the results of the calculation.
- Low labor costs in LDCs may result in low value added and instead of being a factor of competitiveness may penalize LDC producers.

US : 35 percent value-content requirement

- The 35 percent value-content requirement may necessitate the submission of additional evidence of foreign manufacturing costs.
- Evidence may include product specifications, bills of materials, product cost sheets, payment records, overhead allocation schedules, raw material purchases, proof of factory labor, and support for manufacturing overhead.
- Production records must establish the value of the BDC materials used in the imported article on a lot-by-lot, batch-by-batch, shipment-by-shipment basis.
- Documentation and records supporting GSP must be verifiable by linkage to inventory and accounting records including summary records such as monthly production reports and accounts payable records.

Source: U.S. Customs and Border Protection Office of Strategic Trade Regulatory Audit Division - *A Guide for Supporting Generalized System of Preferences (GSP) Claims*, October 2003

What Methodology are WTO members using ?

| Country / group of countries | Methodology | Numerator | Denominator | Level of Percentage |
|---------------------------------|--|---|--|---------------------------|
| European Community (EBA) | Maximum Value of non-originating materials | Value of non-originating material | Ex-works price | Maximum 70% |
| Japan | Maximum Value of non-originating materials | Value of non-originating material | FOB price | Maximum 40% |
| Canada | Maximum Value of non-originating materials | Value of non-originating material | Ex-factory price | Maximum 60% for LDCs(80%) |
| United States | Value added by addition: direct costs of processing + value of originating materials | 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 | Minimum 35% |

What Methodology are WTO members using ?

| Country / group of countries | Methodology | Numerator | Denominator | Level of Percentage |
|------------------------------|--|---|----------------|---------------------|
| AGOA | Same as above with the exclusion of textiles and clothing | Same as above | Same as above | Minimum 35% |
| China | Value addition by subtraction of non-originating materials | FOB Price minus value of non-originating material | FOB price | Minimum 40% |
| India | Same as above | FOB Price minus value of non-originating material | FOB price | Minimum 30% |
| Eurasia CU | Maximum Value of non-originating materials | Value of non-originating material | Ex-works price | Maximum 50% |

Value of materials calculation

Method Based on Value of Non-Originating Materials

$$LVC = \frac{VNM}{EW} \times 100 \leq 75 \%$$

Where:

LVC: LDC Value Content, expressed as a percentage;

EW: Ex-Works price;

VNM: Value of Non-Originating Materials that are acquired and used by the producer in the production of the good

Adjustments to Value of materials criteria (1)

- The calculation method suggested by LDCs is based on adjustments made to the value of non originating materials permitting the **deduction of insurance and freight costs from the customs value of non-originating materials**
- The deduction of the cost of insurance and freights from the value of non originating materials ensures a fair comparison.
- This method of calculation of the value of materials used in manufacturing may greatly facilitate compliance with the rules of origin for LLDCs (16 LDCs) and SIDS (11 LDCs)

Adjustments to Value of materials criteria (2)

- Cost of insurance and freight of non originating materials are exogenous factors depending on geographical locations and have little to do with substantial transformation
- The cost of insurance and freight of inputs to a LLDCs or SIDS may be almost equivalent to a $\frac{1}{3}$ of the value of the shipment if not more

Recommendations

- It is clear from lessons learned and the practices of the large majority of preference giving countries that a value of materials calculation is to be preferred to a value added calculation by addition.
- All preference giving countries when using a percentage criterion should use a value of non-originating materials calculation allowing deduction of cost of insurance and freight from the value of non originating materials