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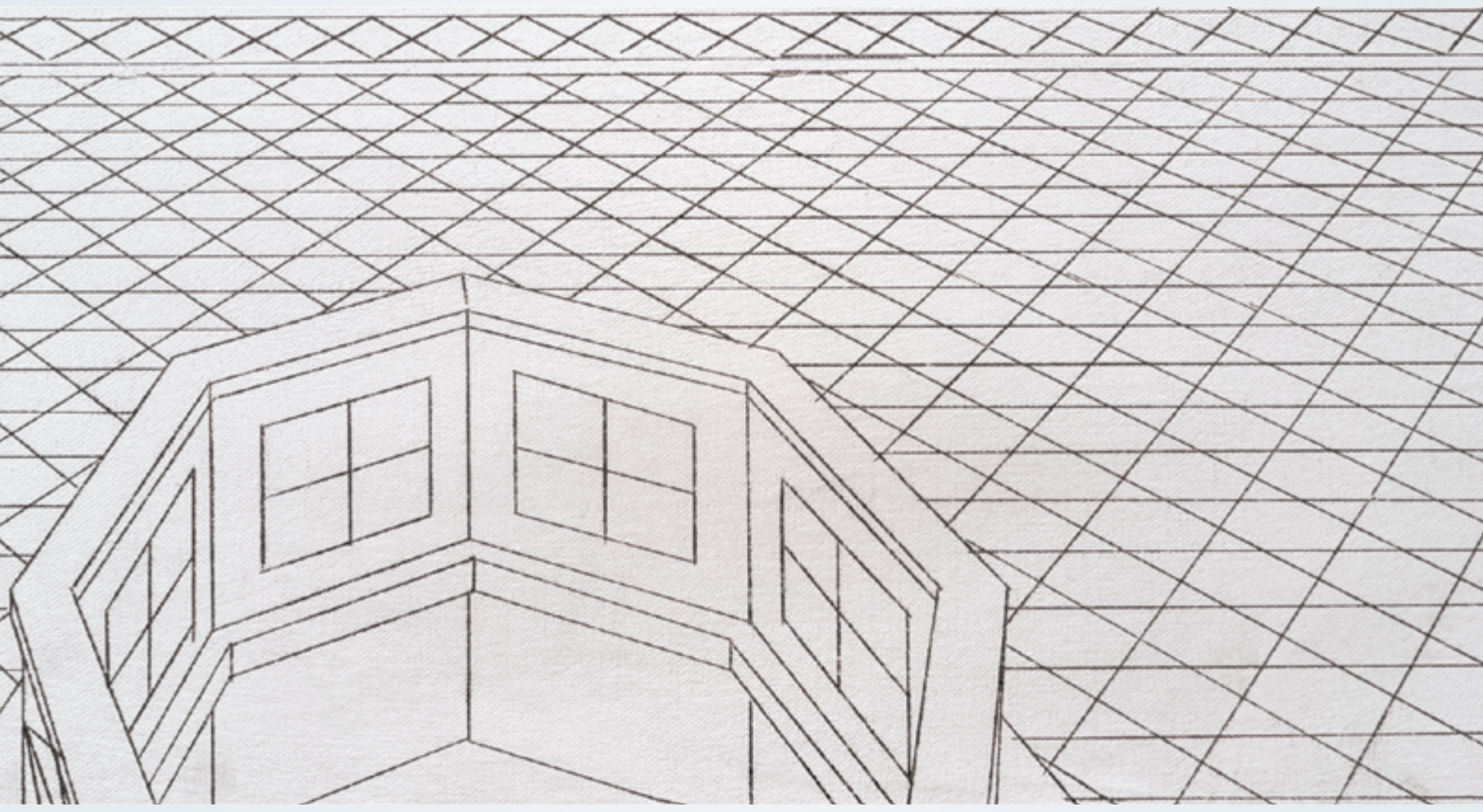
GETTING TO BETTER RULES OF ORIGIN FOR LDCS USING UTILIZATION RATES



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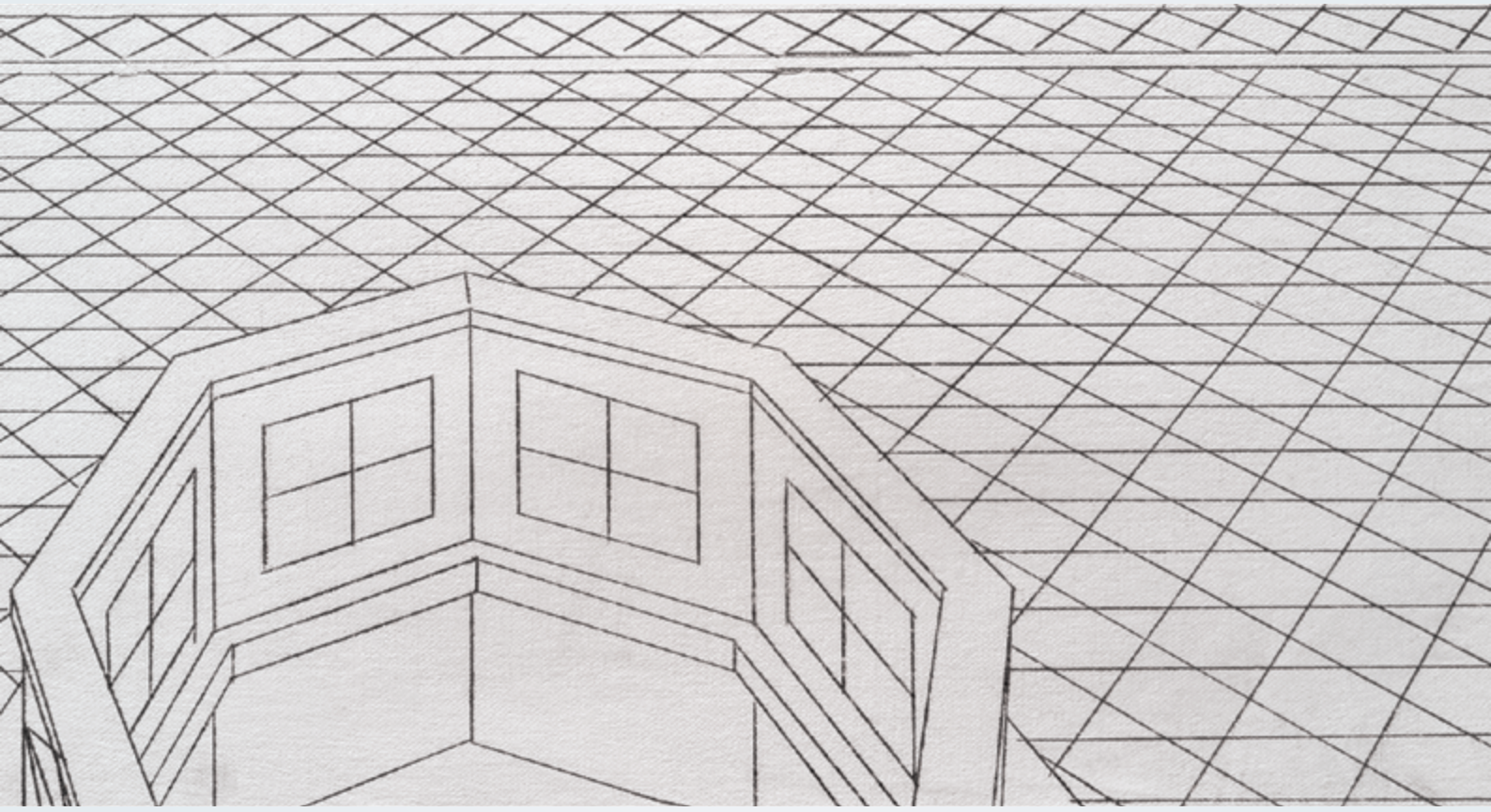

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Abbreviations

AGOA	African Growth and Opportunity Act
ASEAN	Association of Southeast Asian Nations
CBERA	Caribbean Basin Economic Recovery Act
CBTPA	Caribbean Basin Trade Partnership Act
CRO	Committee on Rules of Origin
CTH	Change of tariff heading
CTC	Change of tariff classification
DFQF	duty-free, quota-free
EBA	Everything but Arms
EPA	Economic partnership agreement
FOB	Free on board
FTA	Free trade agreement
GATT	General Agreement on Tariffs and Trade
GPT	General preferential tariff
GSP	Generalized System of Preferences
HELP	Haiti Economic Lift Programme
HOPE	Haitian Hemispheric Opportunity through Partnership Encouragement Act
LDC	Least developed country
MFN	Most-favoured nation
NAMA	Non-agricultural market access
RoO	Rules of origin
TBL	Through bill of lading
TDB	Trade and Development Board
TNC	Trade negotiating Committe
UNCTAD	United Nations Conference on Trade and Development
WTO	World Trade Organization

I. ADVANCING THE RULES OF ORIGIN AGENDA FOR THE LEAST DEVELOPED COUNTRIES: CHALLENGES AND OPPORTUNITIES 1996–2017

The challenges for the least developed countries (LDCs) in complying with rules of origin (RoO) under different duty-free, quota-free (DFQF) schemes have been at the core of the evolving proposals for a simplification of RoO regimes starting with the WTO Hong Kong (China) Ministerial Declaration in 2005. Ultimately, this culminated in multilaterally agreed decisions on preferential RoO in Bali, Indonesia and Nairobi in 2003 and 2005.[1] Yet after three ministerial decisions, of which two focused specifically on the matter of RoO for LDCs, the process of obtaining better RoO for LDCs is still ongoing.[2] According to proposals on RoO that have been circulated by LDCs among WTO members, an internal evaluation report by the European Union offers one of the best definitions of the challenges LDCs face:[3]

"RoO are old and have not followed evolutions in world trade. The present rules were initially drawn up in the 1970s and they have not materially changed much since, whereas the commercial world has. They were also based on the need to protect Community industry and on the premise that beneficiary countries should be encouraged to build up their own industries in order to comply. In most cases, this has not happened. Instead, there has been a trend towards the globalization of production, but RoO have not been adapted to this. At the same time, compliance costs are high and the paper-based procedures are outdated."

Lower preferential margins combined with high compliance costs make preferences unattractive. As a result of successive rounds of trade agreements, preferential margins are much smaller than they used to be. The dilemma of LDCs is well illustrated by the information received from countries requesting derogations from RoO. Such countries have little or no domestic fabric production, which means they have to import it (thereby failing to comply with the rule on two stages of processing) and add only between 27 per cent and maximum 40 per cent in value.[4]"

Since the launch of the DFQF initiative at the WTO ministerial meeting in 1996, RoO for LDCs have become an important topic of trade policy debates.[5] The LDC ministerial declarations at Dhaka (2003) and Livingstone, Zambia (2005) made reference to origin requirements, but did not address the RoO design needed by LDCs.[6]

According to the decision reached at the WTO Ministerial Conference in 2005, members agreed to ensure that "preferential RoO applicable to imports from LDCs are transparent and simple, and contribute to facilitating market access".[7] However, WTO members neither defined the legal meaning of transparent and simple, nor did they establish a working group for this purpose. In the immediate discussions that followed the post-Hong Kong (China) ministerial framework, preference-granting countries reiterated that RoO under the DFQF framework could not be discussed or negotiated due to their unilateral character. This closely echoed the position of preference-granting countries in the early 1970s, when they expressed similar reluctance to agree on a common set of RoO for GSP regimes in the UNCTAD working groups on RoO.[8] Although this

1 See WTO documents TN/CTD/W/29, TN/MA/W/74 and TN/AG/GEN/18 to the NAMA and Agriculture Committees and the Committee on Trade and Development, TN/CTD/W/30/Rev.2, TN/MA/W/74/Rev.2 and TN/AG/GEN/20/Rev.2 and the last version before TNC/C/63. Note: In this publication, trade data refers to effective beneficiaries under the respective preferential arrangements. It follows that if a beneficiary is excluded from preferential treatment, the trade volume of the beneficiary is not included in the period of the exclusion.

2 Part of this study draws upon S Inama, 2015, Ex ore tuo te iudico: The value of the WTO Ministerial Decision on Preferential RoO for LDCs, Journal of World Trade, 49(4):591–618, and the submission made by LDCs to CRO in 2014 (G/RO/W/148) and former LDC submissions. See also,S Inama, "Rules of origin in international trade" 2009 and 2021,forthcoming.

3 See TNC/C/63.

4 Impact assessment on RoO for the Generalized System of Preferences (GSP), European Commission, Brussels, 25 October 2007, Taxud/GSP-RO/IA/1/07 (p. 16).

5 Available at http://www.wto.org/english/thewto_e/minist_e/min96_e/wtodec_e.html.

6 For example, paragraph 12 of the Livingstone Declaration provides as follows: "Incorporation of provisions in the modalities on realistic, flexible and simplified RoO, certification and inspection requirements and technical and safety standards."

7 See annex F of the Hong Kong (China) Ministerial Declaration.

8 At the OECD Ad Hoc Group of the Trade Committee on Preferences, held in Paris in 1970, preference-giving countries expressed the view that, as preferences were being granted unilaterally and non-contractually, the general principle had to be that donor countries were free to decide on RoO which they thought were appropriate after hearing the views of the beneficiary countries.

stance is justifiable from a legal perspective, it prevents substantive discussions on an improved design of RoO regimes in favour of LDCs.[9]

LDCs state that it is anachronistic to maintain unaltered the same RoO as if the world trading system had remained unchanged since the 1970s. After 50 years, successive rounds of negotiations have substantially lowered the preferential margins, and dramatic change in technologies and transport, information technology and communications have occurred.[10] The fragmentation of production and the global value chains approach have defeated any argument for a vertical integration of industrial sectors underpinning the need for strict RoO.

The Agreement on Trade Facilitation demands a series of reforms in the way customs procedures operate, including RoO to facilitate trade. Yet, with some notable exceptions further discussed in this study, the RoO of some preference-granting countries and the related administrative requirements are the same as those of the 1970s and the arguments heard to maintain the status quo are almost exactly those of that period.

As illustrated in this study, there is no evidence that some set of RoO are transparent and simple, nor that they have created trade and investment in LDCs. In order to initiate implementation of the commitment on RoO contained in the Hong Kong (China) Ministerial declaration in 2005, the LDC group started as early as 2006 to work on a draft that could serve as a concrete proposal to make progress on the issue of RoO for DFQF. This initiative was aimed at setting the stage for a constructive debate on RoO between LDCs and preference-giving countries based on a legal text, rather than on declarations of principles and statements. Zambia, in its capacity as WTO LDC coordinator, submitted the first full-fledged proposal to operationalize the wording of the Hong Kong (China) Ministerial Declaration.[11]

The proposal by Zambia contained a narrative advocating the need for a change in the design of RoO for LDCs that were still based on assumptions going back to the 1970. Most importantly, to make the proposal as concrete as possible, the proposal contained a draft model of legal text that could be used by preference-giving countries in designing RoO for LDCs under DFQF arrangements. The model legal text advocated for a value of material calculation with deduction of the cost of insurance of freight, provisions of cumulation and related ancillary criteria. In short, the Zambia proposal was the first structured proposal to attempt a discipline in preferential RoO ever made at WTO.

The responses from preference-giving countries to such a proposal were not satisfactory, nor the level of comprehension of the LDC proposal. A series of meetings were held in 2007 with delegations of preference-giving countries, including Japan, the United States of America and the European Union. However, these meetings were not particularly productive, since the focus was on defending the status quo rather than being aimed at discussing possible ways to multilaterally achieve the objectives of RoO for LDCs that are "transparent and simple, and contribute to facilitating market access".

There were also misguided perceptions that either LDCs did not know what they actually wanted, nor how to proceed.[12] This was despite the fact that the LDC group presented the detailed proposal on RoO mentioned above to the NAMA Committee in 2006. There was also an assumption that the main objective of the LDC submission was to achieve harmonization of preferential RoO.[13] Although desirable, the LDC group never advocated the harmonization of RoO. Such misunderstandings of the Zambia proposal were probably due to the fact that for the first time the international community and WTO circles were presented with a structured technical proposal after several years of policy statements made on the need for clear and simple RoO. It should be noted, however, that the rather sceptical attitude adopted by some preference-giving countries towards the LDC proposals for improving RoO has been a constant feature during the whole process.

The statement of the NAMA chair of 2007 on the adoption of best practices was in line with the position of preference-giving countries, which all were of the view that their particular preferential RoO constituted a best practice, rather than discussing or even

9 This does not mean that LDCs aspire to a common set of RoO, as discussed below.

10 Preferential margin is commonly referred to as the difference between the MFN rate and the preferential rate granted under GSP or other preferences.

11 See WTO/TN/CTD/W/29, WTO/TN/MA/W/74 and WTO/TN/AG/GEN/18 to the NAMA and Agriculture Committees and to the Committee on Trade and Development.

12 In his introduction to the draft NAMA modalities (JOB (07/126) on 17 July 2007, the NAMA chair, in paragraph 38, stated that "on the issue of improving RoO for duty-free, quota-free market access, neither the proponents nor the members more broadly have a precise idea on how to proceed".

13 "I would note that harmonizing preferential RoO may not be the optimal solution and that there are best practices among members that could be readily adopted to enhance the effectiveness of these programmes" (ibid).

acknowledging the existence of an articulated proposal on RoO elaborated by LDCs and circulating as a WTO document among WTO members.

It was only after protracted negotiations that the summary of the NAMA chair contained the following statement, which finally reflected the LDC proposal: "Ensure that preferential RoO applicable to imports from LDCs, will be transparent, simple and contribute to facilitating market access, in respect of non-agricultural products. In this connection, we urge members to use the model provided in document TN/MA/W/74, as appropriate, in the design of the RoO for their autonomous preference programmes."[14]

From 2008 until the WTO Bali decision in December 2013, the LDC proposal on RoO was mainly discussed in the context of an LDC package. Such a package took the final form of a WTO document presented by Nepal as coordinator of the WTO LDC group.[15] Between 2008 and 2013, the LDC proposal on RoO underwent another two revisions, the first one with Bangladesh as the coordinator of the WTO LDC group, and the second with Nepal, which coordinated the LDC group until the Ministerial Conference in Bali.[16]

These proposals further refined the technical elements contained in the Zambia proposal. The Bangladesh and Nepal proposals further determined the parameters for the value of material calculation and the level of threshold, introduced the concept of product-specific RoO (PSRO) and clarified the stance of LDCs towards cumulation, stating that "the LDC group proposal contains provisions for allowing regional cumulation. These provisions have been elaborated in taking into account that, although laudable and highly desirable, cumulation is not a substitute for liberal RoO. With liberal RoO, the LDC producers may source their inputs worldwide from the most competitive producer at the best prices".

A major boost of confidence to the value of the LDC proposal and recognition of the significant need to reform the LDC regime for RoO (which had been almost unchanged for the last 40 years) came from the changes to RoO in Canada in 2003 and the European Union reform on RoO that entered into force in 2011.[17] In particular, the European Union reform introduced drastic changes to the European Union RoO in favour of both LDCs and developing countries, as follows:

(a) Introduced differentiation in favour of LDCs that benefit from more lenient RoO than developing countries in certain sectors;

(b) Allowed a single transformation process in textiles and clothing[18] – a request that LDCs had been advocating for more than a decade;

(c) Raised the threshold of the use of non-originating material, in many sectors from 40 to 70 per cent for LDCs;

(d) Eased cumulation rules.[19]

I.1. Path towards the Bali Decision in 2013

In 2013, a series of informal meetings were held between Nepal as LDC coordinator and the various preference-giving countries. On 31 May 2013, the RoO proposal was inserted into the LDC package circulated among WTO members.[20] During the summer of 2013 it became clear that preference-giving countries were not prepared to discuss the technical legal text on RoO contained in the LDC proposal. According to their view, there was not sufficient time and/or will to engage in such negotiations. Therefore, Nepal as LDC coordinator was requested to prepare a draft decision condensing the major RoO principles contained in the legal text of the LDC proposal into a decision. In little more than one month since they had presented the LDC package with a full legal text on RoO, LDCs were requested to formulate their request in the form of a two-to-three page decision that was first put on the table in mid-July 2013. In July, a text was initially tabled by Nepal in the form of a decision containing a series of binding guidelines on percentage criterion, level of percentages and use of the change of tariff classification (CTC) method, together with other detailed provisions excerpted from the legal text

14 See TN/MA/W/103/Rev.3, 6 December 2008.

15 See TNC/C/63, 31 May 2013.

16 See TN/CTD/W/30/Rev.2, TN/MA/W/74/Rev.2 and TN/AG/GEN/20/Rev.2.

17 See Commission regulation No. 1063/2010 of 18 November 2010 amending regulation No. 2454/93 laying down provisions for the implementation of Council regulation (EEC) No. 2913/92 establishing the Community Customs Code. For a commentary of the European Union reform, see Inama, Per aspera ad astra: The reform of the European Union GSP RoO, Journal of World Trade, 2011.

18 13 The European Union reform was preceded by the Canada reform of DFQF in favour of LDCs and RoO in 2003, expanding product coverage to textiles and clothing and cumulation among all beneficiaries of the Canada GSP scheme.

19 The value of this provision was later severely diminished by the graduation of many GSP beneficiaries from cumulation in the case of the new European Union GSP that entered into force in 2014.

20 See WTO/ TN/C/W/63.

of the LDC proposal. However, the migration from the legal text contained in the LDC package to the draft decision was not smooth. It is not clear how the migration from the LDC proposal to the draft ministerial decision took place at that critical juncture among delegations involved in the negotiations, since an initial suggested text containing clear drafting was not used in the crucial phase of the negotiations. In fact, the second draft text of the July decision contained wording that was either confusing or contradictory from a technical point of view and/or not sufficiently specific as to what the LDCs wished for.

In September, a new version of the draft decision was presented at a WTO meeting chaired by the Director General of WTO. This version of the decision, as the previous one of July, contained some imprecise language that weakened its technical value. This version attracted concerns voiced by delegations during the meeting over some specific areas – percentage threshold, cumulation, use of "must" and "shall", and the like. However, most delegations said that they could work on the basis of the proposed draft text and hoped to find a deliverable for Bali. The next step was undertaken in technical discussions led by Denmark as facilitator of the LDC package on the road to Bali. These sessions led by the facilitator were conducted in early October 2013. Preference-giving countries continued to oppose any binding language or specific benchmarks contained in the draft decision, with the final draft agreed by 23 October well ahead of the Ministerial Conference in Bali.

I.2. An assessment of the Bali Decision

The value of the Bali Decision should be considered in the context of the vacuum of multilateral deliberations on preferential RoO. The Decision represents a first attempt to resume such discussions since the UNCTAD working groups on GSP RoO in 1993 and the International Convention on the Simplification and Harmonization of Customs Procedures, Kyoto, Japan, 2000 (Kyoto Convention).

A critical consideration of the value of the Decision shows that its paragraphs (namely 1.3 and 1.4, ad valorem percentage; 1.5, change of tariff classification; and 1.6, specific working or manufacturing operations) list the three traditional methodologies on drafting RoO and add to each one of those elements, in comparison with the Kyoto Conventions[21] and the common declaration on preferential RoO contained in the WTO Agreement on rules of origin. Yet the Decision does not venture to recommend or suggest clarity on issues with regard to which the international community may stand to gain, such as a clarification on the different methodologies that may be used to calculate the ad valorem percentage.

Ad valorem percentages may be calculated by: (a) adding local cost of originating materials, cost of labour and other incidentals incurred during the production of a finished good as a percentage of the ex-works price; (b) calculating the ad valorem percentage by subtracting the value of non-originating material (VNM) from the ex-works price(or FOB price) of the finished product; or (c) determining a threshold on the use of originating or non-originating material as a percentage of the ex-works price (or FOB) of a finished product. The ex-works price as a denominator of the ad valorem percentage may also be replaced by the free-on-board (FOB) price. There are a number of lessons learned in using these different calculation methods that could be shared since they have been used for decades by different administrations.

A conspicuous and not yet fully understood novelty in the Decision is represented by the mention of costs of freight and insurance in relation to the ad valorem percentage calculation. This is an interesting concept that UNCTAD has promoted in a variety of contexts[22] with regard to which further reflection should be carried out, keeping in mind the above-mentioned differences in the calculation of the ad valorem percentage and the practices of WTO members under the customs valuation agreement.

Another interesting point in the Bali Decision is the following: "In the case of rules based on the change of tariff classification criterion, a substantial or sufficient transformation should generally allow the use of non-originating inputs as long as an article of a different heading or subheading was created from those inputs in an LDC."[23]

However, the Harmonized System is not designed for RoO purposes and an across-the-board change of tariff classification criterion may not reflect genuine substantial transformation in LDCs in all cases. It may be beneficial to further discuss and, if possible, identify the product sectors where

[21] To the respective annexes on rules of origin contained in Kyoto convention of 1974 and 2000.

[22] See The methodologies of drafting the ad valorem percentage criterion: Existing practices in African RECs and way forward in CFTA, available at https://unctad.org/meetings/en/SessionalDocuments/aldc2018_AfCFTA_TWGRoO7_tn_advalorem_en.pdf.

[23] See WT/MIN (13)/42, WT/L/917, p. 2.

other methodologies may be more appropriate to draft clear and simple RoO reflecting substantial or sufficient transformation.

Paragraph 1.6 contains a number of useful statements in which it refers to the "limited production capacity of LDCs". This statement could be related to the need of RoO for LDCs to facilitate their insertion into global value chains rather than induce them into import substitution of inputs to build their limited manufacturing capacities. In addition, the recognition that the use of RoO based on a working or processing operation "for chemical products has made such rules more transparent and easy to comply with" provides an example of what could be achieved by the international community if meaningful debates are conducted in the Committee on rules of origin (CRO) at the WTO as further discussed in section V.1.2.

Paragraph 1.7 on cumulation recognizes the different practices on cumulation and discusses the different options that may be envisaged. In this area it may be useful to discuss the effective use made by LDCs of cumulation under different arrangements to identify where cumulation may be best effective and where it has not generated the expected benefits.

Paragraph 1.8, section (b) contains two important statements related to documentary requirements. Too often the issue of documentary evidence required to benefit from tariff preferences is overlooked when dealing with RoO. This is an area where multilateral guidelines and lessons learned are almost non-existent.

Two ground-breaking statements are contained in this part of the Decision:

(a) "Non-manipulation or any other prescribed form for a certification of origin for products shipped from LDCs across other members may be avoided": this apparent minor statement contains a significant trade facilitation proposal taking into account that such non-manipulation form is until recently a requirement under many non-reciprocal preferential arrangements for LDCs. Yet such form or any other documentary evidence to that effect has been found to be extremely difficult to obtain as further discussed below in this study (see I 6.2) . The importance of such statement is extremely relevant when considering that a large number of LDCs are either landlocked or island countries and trans-shipment through other WTO members is either a geographical or a commercial reality.

(b) "With regard to certification of RoO, whenever possible, self-certification may be recognized": costs related to the certification requirements, mainly deriving from issuance of a certificate of origin by the certifying authorities in LDCs may be significant for the private sector. This is an area where there are significant gains to be had from sharing experiences and establishing links and synergies with the related provision in the Agreement on Trade Facilitation.

Finally, part C, paragraph 1.10 of the Decision contains a serious limitation to the mandate of the CRO since it provides the CRO to "annually review the developments in preferential RoO applicable to imports from LDCs, in accordance with these guidelines, and report to the General Council".

In fact, one of the fundamental weakness of the Bali Decision, as well as of its successor the Nairobi Decision, is the lack of a strong mandate to the Committee of RoO (CRO) to establish a process to further elaborate on the guidelines contained in the Bali and Nairobi Decisions. In the Bali Decision specifically, the annual review concerned only new developments and failed to provide a mandate to CRO to further discuss a meaningful way forward on how to build on the Decision.

I.3. From the Bali Decision to the Nairobi Decision in 2015

At the CRO meeting on 10 April 2014, the chair recalled that the last WTO Ministerial Conference had adopted a decision on preferential RoO for LDCs.[24] Paragraph 1.10 of the Bali Decision mandated the Committee to "annually review the developments in preferential RoO applicable to imports from LDCs... and report to the General Council".

As stated earlier, the fundamental weakness of the Bali Decision was the lack of a mechanism or a process to implement the statements contained in the Decision. Without such a mechanism, the hortatory language of the Decision was not actionable and could not lead to renewed discussion at WTO bodies aimed at implementing the commitments or refining them.

The CRO chair was, at that time, at a crossroad, since there were proposals to stop the proceedings of CRO given more than a decade of stalemate on the harmonization work programme of non-preferential RoO.[25] The timing was then mature and convenient to

[24] WT/L/917.

[25] For a detailed analysis of the harmonization work programme, see Inama, Rules of Origin in International Trade, 2009 and 2021,forthcoming, Cambridge University Press.

open a new line of work for the CRO focusing on LDC RoO. The chair made clear that the Committee's new mandate only applied to changes or developments to RoO applicable to LDCs. This provided limited scope for opening debate at the CRO on how to build on the Bali Decision. However, the chair proposed in addition, and as a separate initiative, "to intensify efforts in CRO to exchange information regarding existing preferential RoO for LDCs".

That proposal marked the start of a new process whereby LDC RoO were to be discussed at the CRO as an agenda item. Uganda, on behalf of LDCs, welcomed the chair's proposal and advised "CRO that the LDC group would prepare a paper outlining the challenges faced by LDCs in complying with existing RoO to facilitate discussions and foster exchange of information" at CRO.

The Committee agreed to engage in a transparency and outreach exercise "where the secretariat would prepare a background note describing the current state of notifications to be examined during a dedicated agenda item by CRO. An additional contribution to this dedicated agenda item would be the paper to be submitted by LDCs about their specific challenges. While the results of the first proposal would be part of the CRO report to the General Council and the LDC subcommittee, the results of the second would not".[26]

At the CRO meeting on 30 October 2014, the LDC paper prepared with the assistance of UNCTAD was presented by Uganda on behalf of LDCs under the above-mentioned agenda item. Uganda stated that the LDC group was in the process of identifying further evidence and concrete cases that would serve as additional elements for further contributions to be discussed at subsequent CRO meetings.[27]

The key message that LDCs flagged in the paper was that RoO for LDCs should reflect global value chains and be drafted in such a way that they were commercially meaningful and viable for FDI and local businesses to boost manufacturing in LDCs.[28] This main argument of the LDC paper was based on the utilization rates, drawing on the UNCTAD database,[29] contrasting the results of the reforms of RoO in Canada and European Union with the absence of such reform under the Japan and United States preferential arrangements for LDCs. The paper showed that the Canada and European Union reforms of RoO resulted in higher utilization rates and increased exports from LDCs, while in the absence of such reform, Japan and United States trade preferences for LDCs showed erratic or stagnant utilization rates, with no significant increases of exports from LDCs.

These findings of the LDC paper were drawn from an analytical review of the utilization rates, using the UNCTAD database on utilization rates. This revisiting of the concept of utilization rates linked to RoO requirements, a concept and method used by UNCTAD since 1975, laid down the foundation for the request made by LDCs to preference-giving countries during the negotiations for the Nairobi Decision (see I.5 further below) to systematically notify preference utilizations to the WTO secretariat. An updated and improved version of part of the analysis made in the LDC paper mentioned above is contained in section II of this study.

This initiative marked a watershed in the work of the CRO providing 1) the LDCs with an opportunity to make submissions about the utilization rates of preferences granting countries (see further below I.6.2 for some examples of such submissions) and 2)the WTO secretariat with a new mandate to produce periodic notes on utilization rates.

The analysis of the utilization rates in the context of the CRO, suggested in the course of the technical assistance provided by UNCTAD, assured a new lease of life to the work of the CRO as witnessed from the subsequent CRO meetings from 2015 onwards. As discussed further below such proposal was met by initial resistance during the negotiations of the Nairobi decision and was inserted during the final phase of the negotiations.

In fact the proposal about notification of utilization rates was made late when it became clear that the WTO LDC group was steering towards an ambitious and definitive outcome at the WTO Ministerial that was unlikely to succeed as suggested by UNCTAD during the research and capacity building activities organized during the preparatory stages to the WTO ministerial. At that time it was considered necessary to insert provisions that would ensure continuity in the CRO process after Nairobi, not to repeat the same impasse of the aftermath of the Bali decision discussed in I.2 above when resumption of the discussion after the Bali Decision was difficult due to lack of adequate mandate to the CRO in the Decision.

[26] See G/RO/W/148.

[27] See WTO/ G/RO/W/148.

[28] See UNCTAD/ALDC/2017/5.

[29] UNCTAD established a database on the utilization of trade preferences at the request of the Trade and Development Board in 1975. The database has been periodically updated.

Despite the submitted paper and the issues presented at the CRO meeting in October 2014, the demands of LDCs were still unclear in the view of preference-giving countries[30]. Accordingly, LDCs prepared a series of questions with the assistance of UNCTAD based on each of the items addressed by the Bali Decision, which were submitted as an agenda item for the CRO meeting on 30 April 2015.[31] The questions addressed at the formal session of CRO had the merit of making clear to preference-giving countries the intention of LDCs to make progress on the implementation of the Decision. Yet the replies provided to the questions of LDCs were evasive or merely restated that the existing rules of preference-giving countries were the best RoO.

On the one hand, it was voiced again that the demands of LDCs were not fully understood by preference-giving countries. On the other hand, some preference-giving countries did not show willingness to engage effectively in a discussion about existing RoO. After the CRO session in April, the LDC group insisted on the need to make progress, requesting a dedicated session of CRO within a few months, with the prospect of the tenth WTO Ministerial Conference on the horizon. At the same time UNCTAD, besides the assistance previously provided, started a systemic programme of research and capacity-building in partnership with the European University Institute to support LDC delegates during their negotiations, through ad hoc executive training and tailored research, to produce the necessary analysis and documents to support and develop LDC negotiating positions.[32] This systemic programme was instrumental in preparing the presentation materials and notes further outlined in the subsequent sections.

The WTO members accepted this request and a dedicated session of CRO took place on 23 and 24 July 2015. The agenda presented by LDCs for the dedicated session touched upon the seven fundamental items addressed by the Bali Decision, namely:

(a) Substantial transformation: Value added, percentage thresholds (paragraph 1.3);

(b) Substantial transformation: Methods of calculation of value added (paragraph 1.4);

(c) Substantial transformation: Change of tariff classification rules (paragraph 1.5);

(d) Substantial transformation: Specific manufacturing or processing operation rules (paragraph 1.6);

(e) Cumulation (paragraph 1.7);

(f) Documentary requirements and certification (paragraph 1.8);

(g) Review of legislation currently notified to the WTO secretariat (paragraph 1.9).

At the conclusion of the dedicated session, a preference-giving country pointed out the need to prioritize the issues raised by LDCs. This provided a summary of the challenge faced by LDCs during the negotiations, since the majority of preference-giving countries preferred to change tactics rather than engage in substantive discussions to confront the technical arguments raised by LDC delegates in the context of the seven structured presentations on each of the agenda items. Moreover, such a remark showed once again the degree of misunderstanding and the gap between LDCs and preference-giving countries, shifting again the burden of making proposals for improving RoO to LDCs, while LDCs at the same meeting had clearly indicated the elements to improve such RoO under each of the agenda items.

In a nutshell, it was not possible to prioritize issues for LDCs since each preference-giving country had different RoO with their particular shortcomings that had to be addressed on their own, unless LDCs wished to argue for a harmonization that was not possible to envisage. Once again, each preference-giving country argued that their individual RoO were the best rather than engage meaningfully in the discussion on how to build on existing RoO.

As the preparations for the tenth WTO Ministerial Conference were ongoing and the LDC group aimed for an enhancement of the Bali Decision, a first proposal for a second decision entitled “Preferential RoO under unilateral preference schemes for least developed countries” was submitted to the Trade Negotiating Committee (TNC) on 21 September 2015 by Bangladesh as coordinator of the LDC group at WTO.[33] The proposal, which was built on the Bali

[30] The term preference giving country is used thorought this paper instead of preference granting country according to UNCTAD Trade Development Board language used at the foundation of the Generalized System of Preferences.

[31] See the elements for a discussion in G/RO/W/154.

[32] The programme was launched with an initial funding contribution from the Netherlands. For details of the research and capacity, see https://unctad.org/fr/pages/MeetingDetails.aspx?meetingid=811 and https://globalgovernanceprogramme.eui.eu/research-project/trade-facilitation-and-rules-of-origin/.

[33] See JOB/TNC/53.

guidelines, was "intended to assist both preference-granting countries and LDCs to operationalize these guidelines with a view to attaining effective market access for LDCs on a lasting basis". The technical content of the proposal was the result of the intense capacity building and research exercise carried out with the assistance of UNCTAD to support the LDC WTO group.

The LDC proposal actively pursued by Bangladesh as LDC coordinator contained an ambitious approach on the belief that preference-giving countries could be obliged to introduce reforms in their unilateral preference schemes by virtue of a WTO decision. As anticipated at that time, such ambitious approach was resisted by preference giving countries since preferences are unilateral and reform of rules of origin can hardly be induced by a WTO decision by UNCTAD.

The LDC ambitious proposal stated that "given that no substantive efforts have been made by preference-granting members to streamline their preferential RoO in line with the Bali guidelines, they have remained largely non-operationalized" and called upon preference-granting countries to take into consideration the level of development and capacities of LDCs when putting in place their preferential RoO. The proposal was based on the same elements set forth in the Bali Decision on preferential RoO. However, it contained binding language, aimed at transforming the guidelines of the Bali Decision into mandatory criteria. As stated in the submission, "members shall adhere to the following in framing their legislation on preferential RoO".[34]

Moreover, a number of more precise provisions and parameters were included. The proposal provided specific criteria for determining substantial transformation, such as the requirement to use a method based on non-originating material in the case of use of the ad valorem percentage criterion, whereas the Bali Decision did not specify a concrete method of calculation but suggested the use of a simple method. Concerning the threshold, the LDC group reiterated the adoption of a level of at least 75 per cent or more as the maximum value of non-originating material. Accordingly, the requirement of change of tariff classification as stated in the Bali Decision was complemented by wording that "in such cases, provision for limiting use of inputs from certain headings and subheadings shall be avoided and at the same time, use of inputs from the same heading or subheading of final products must be allowed within permissible tolerance limits".

The proposal also called for the adoption of single transformation when a specific manufacturing or processing criterion is used, implying a step forward compared with the Bali Decision, which had merely suggested that "such rules should, as far as possible, take into account the productive capacity in LDCs". The proposal listed a number of specific examples of when single transformation could be adopted, such as "(a) for clothing of chapter 61 and 62 of the Harmonized System nomenclature when fabrics are assembled into finished garments; (b) for chemical products: a chemical reaction rule; (c) for agroprocessing products when raw agricultural products are transformed into agroprocessed products; and (d) in machinery and electronics when the assembly of parts results in finished products".

The draft proposal for the Ministerial decision included, in addition to the introduction of a new element, the requirement of avoiding a combination of two or more criteria for one product. The latter was aimed at Japan in particular, which until then had applied a combination of criteria for a number of products. It further detailed a series of provisions related to cumulation. Additionally, the new proposal, while maintaining the mandate established in Bali of notifying new developments of preferential RoO, also included for the first time under the CRO umbrella the notification of utilization rates of preferential schemes, reiterating the provision contained in the transparency mechanism of preferential trade agreements (PTAs).[35] The request for the notification of utilization proved to be one of the most remarkable advances made in the context of the Nairobi Decision, as further discussed in section II, and was the result of the advocacy process started by the paper submitted by Uganda as LDC coordinator in October 2014 with the assistance of UNCTAD, as discussed in this subsection.

At the next CRO meeting in October 2015, the LDC group informed members about the submission of the draft decision on preferential RoO. In addition, during the meeting, three preference-granting members, China, Japan and Thailand, presented notifications with regard to new preferential RoO applied to LDCs in accordance with the Bali mandate which stated that "preferential RoO for LDCs shall be notified as per the established procedures".

[34] Ibid.

[35] See WTO document WT/L/806, especially annex 1, paragraph 2 (e), which states that the member notifying of a PTA shall submit the following data, at the tariff-line level: import data for the most recent three years preceding the notification from each of the beneficiary partners, in value for total imports; imports entered under MFN; and imports entered under PTA benefits.

Moreover, Japan presented a simplification of its preferential RoO for knitted apparel under chapter 61 of the Harmonized System, moving from the requirement of double transformation (yarn to fabrics and fabrics to knitted or crocheted garments) to single transformation (fabrics to finished knitted or crocheted garments).[36]

During an open-ended meeting on 20 October 2015, the LDC proposal was presented and examined. A number of preference-granting members suggested that the level of ambition of the proposal was unrealistic since it strove to cover an overly broad spectrum of objectives, given the limited time constraints until the WTO Ministerial Conference in Nairobi. As a result, many preference-granting members encouraged the LDC group to focus on a few achievable objectives. Another major issue of unease amid preference-granting members was the binding language contained in the text An alternative proposal was also suggested by UNCTAD to learn from the lessons of the Bali Decision and provide a stronger mandate for the CRO to further develop the technical areas of rules of origin where convergence was possible with clear timeframes. However such proposal was not accepted by the LDC group.

Following several informal consultations and discussions with preference-granting members, the LDC proposal underwent two revisions. In November 2015, the LDC group drafted a first revision, taking into account comments and concerns raised by members. The new text also introduced a compromise on differentiation among developed and developing countries, allowing a longer implementation time frame for developing countries that were introducing new DFQF schemes, as follows: "The developing country members, which have recently introduced or will introduce the DFQF scheme, are encouraged to follow the decision. If these members face difficulties in complying with these obligations while introducing the DFQF scheme, they shall review their RoO not later than five years from the date of introduction of the DFQF scheme in order to be in compliance with the obligations set above and report to the Committee of RoO."

The issue of differentiation among developed and developing countries in providing simple and transparent RoO for LDCs remained a major concern for developing countries throughout the negotiations of the Nairobi Decision. The repeated and protracted insistence on such differentiation by developing countries drew the debate to such issues rather than devoting maximum attention to improve the text for the benefit of LDCs. Developing countries recalled the language in annex F of the Hong Kong (China) Ministerial Declaration, which states that "developed country members shall, and developing country members declaring themselves in a position to do so should". Yet it was debatable whether such language referred solely to the differentiation concerning DFQF market access provisions or also to preferential RoO.

On 2 December 2015, Denmark, as chair of the TNC, submitted a new draft decision. The draft text reflected the concerns voiced by members during the previous meetings. The discussions concluded on 8 December 2015. By that time, a final text was agreed on most items of the decision. Nevertheless, some items where left open, to be agreed upon following further consultations during the ministerial meeting in Nairobi, due to divergences expressed by a number of members, including wording of the draft decision related to the calculation methodology.

I.4. An assessment of the Nairobi Decision

The period between the Bali Decision and the Nairobi Decision was marked by intense activity in the LDC group to ensure that the commitment to build on the outcome of the Bali Decision was made operational. To this end, LDCs raised a number of technical issues on preferential rules that should have been used to engage in substantive discussions on how to improve existing preferential RoO. However, given the views of most preference-giving countries that each of their individual RoO was the best, including developing countries, it was difficult to progress on discussing the technical issues that LDCs brought to the table at CRO meetings and to related informal consultations. Faced by such stance of preference giving countries, LDCs redoubled their requests for binding language on the way to the Nairobi Decision.

Traces of this negotiating strategy and dialogue remain in the language of the Nairobi Decision, whereby a number of "shall" remain, immediately followed by wording or qualifications depriving the "shall" of any real meaning and ensuring the maintenance of the status quo of RoO of preference-giving countries.

As suggested to LDCs, a more productive strategy in the medium-term would have been to ensure that the Nairobi Decision provided a clear mandate to CRO to continue to build on the Bali guidelines by providing precise technical language. The experience gained at CRO meetings to which LDCs brought facts and

[36] See WTO document G/RO/M/65 for the minutes of the meeting, as well as G/RO/N/131 for the reform of Japan.

numbers has demonstrated that few delegations of preference-giving countries, whether developed or developing countries, possess the technical skills or are willing to engage in a debate on the lessons learned in administering preferential RoO. If agreed at the Nairobi Ministerial Conference, a decision providing a fresh mandate to CRO would have enabled the participation of capital-based experts with a clear agenda for the work ahead. Moreover, it should be realized that reform in the area of RoO takes a great deal of time due the uncommon mixture of complex political economies' considerations cutting across ministries and lobbies in preference-giving countries.

The present Nairobi Decision provides further technical language showing the divide between LDC wishes and the hesitations of preference-giving countries but fails to provide an engaging framework towards a process leading to further reflections on existing RoO for LDCs. In certain cases, the Nairobi Decision provides language to maintain the status quo of certain preference-giving countries.

On the issue of ad valorem percentage, the Nairobi Decision provides that preference-granting members shall "adopt a method of calculation based on the value of non-originating materials. However, preference-granting members applying another method may continue to use it. It is recognized that LDCs seek consideration of use of value of non-originating materials by such preference-granting members when reviewing their preference programmes". Such wording seems to provide a comfort zone for preference-giving countries, such as the United States, which still uses the 35 per cent value added rule from the inception of the GSP scheme in 1974.

The second subparagraph of the Nairobi Decision on the issue of ad valorem reflects one of the LDC demands, with a footnote reflecting the view of a preference-giving country aimed at adding a further caveat to a provision that does not have any binding obligation: "(b) consider, as the preference-granting members develop or build on their individual RoO arrangements applicable to imports from LDCs, allowing the use of non-originating materials up to 75 per cent of the final value of the product, or an equivalent threshold in case another calculation method is used, to the extent it is appropriate and the benefits of preferential treatment are limited to LDCs". The footnote to this subparagraph states that "this provision shall not apply to preference-granting members who do not use the ad valorem percentage criterion as their main method for the determination of substantial transformation". This seems to exclude from the application of the provision calling for a 75 per cent threshold of non-originating material, preference-giving countries such as Japan, which use the change of tariff classification (CTC) as their main method for the determination of substantial transformation but still use for broad sectors and entire chapters of the Harmonized System an ad valorem percentage often limiting the value of non-originating material to 40 per cent.[37]

The third subparagraph of paragraph 1.1 of the Nairobi Decision provides hortatory language for one the most important demands of LDCs in the context of the ad valorem percentage criterion that was one of the major advances made in the Bali Decision: "Consider the deduction of any costs associated with the transportation and insurance of inputs from other countries to LDCs." Such vague wording is one of the fundamental cost components of any value chain, that is, the availability of cost-competitive intermediate products and inputs to carry out any manufacturing activity in landlocked and island LDCs.

On the issue of CTC, the Nairobi Decision echoes the text of the Bali Decision: "(a) as a general principle, allow for a simple change of tariff heading or change of tariff subheading; (b) eliminate all exclusions or restrictions to change of tariff classification rules, except where the preference-granting member deems that such exclusions or restrictions are needed, including to ensure that a substantial transformation occurs; and (c) introduce, where appropriate, a tolerance allowance so that inputs from the same heading or subheading may be used."

However, subparagraph (b) provides the fundamental caveat of "substantial transformation" to the general statement that a CTC at tariff heading or subheading is origin-conferring. Again, this caveat allows for the perpetuation of repeated exceptions to the CTC criterion made by certain preference-giving countries that turn an apparently liberal rule into a stringent requirement. On the issue of specific working and processing, "preference-granting members shall, to the extent provided for in their respective non-reciprocal preferential trade arrangements, allow as follows". The insertion of the wording "to the extent provided for in their respective non-reciprocal preferential trade arrangement" provides again a comfort zone to those preference-granting countries that do not use the specific working or processing criterion to determine substantial transformation to maintain the current status quo, that is, not introducing any changes to their current RoO.

[37] This issue was later raised by the LDCs in WTO document on Change of tariff classification,see WTO document .

Despite long and protracted negotiations over cumulation at the Trade Negotiation Committee(TNC), the language of the Nairobi Decision mostly replicates the status quo existing under the different schemes: "Preference-granting members are encouraged to expand cumulation to facilitate compliance with origin requirements by LDC producers using the following possibilities: (a) cumulation with the respective preference-granting member; (b) cumulation with other LDCs; (c) cumulation with GSP beneficiaries of the respective preference-granting member; and (d) cumulation with developing countries forming part of a regional group to which the LDC is a party, as defined by the preference-granting member."

Apart from the best endeavour language adopted ("are encouraged"), the addition of subparagraph (b) ,"cumulation with other LDCs" represents more of a symbolic and potential case of cumulation rather than a significant improvement. Regional cumulation may be considered the most important form of cumulation[38] used by preference-giving countries, as well as the new forms of cumulation that could be defined as "extended cumulation"[39] under the European Union definition or cross-cumulation under the definition of Canada.[40] These latter forms of cumulation may represent in the near future the most important form of cumulation given the recent proliferation of FTAs entered into by preference-giving countries. Under this concept of extended or cross-cumulation, LDCs may be granted cumulation with other countries that have signed FTAs with preference-giving countries. However, the relevant paragraph of the Nairobi Decision does not make any reference to this new form of cumulation and subparagraph (d) appears to limit rather than expand the concept of regional cumulation.

The initial progress made in the Bali Decision over the issues of administration of RoO, evidence of non-manipulation requirements and the certification requirement, did not gain further advances in the language of paragraph 3 of the Nairobi Decision: "Preference-granting members shall: (a) as a general principle, refrain from requiring a certificate of non-manipulation for products originating in a least developed country but shipped across other countries unless there are concerns regarding trans-shipment, manipulation or fraudulent documentation; (b) consider other measures to further streamline customs procedures, such as minimizing documentation requirements for small consignments or allowing for self-certification."

Despite the protracted negotiations during TNC, it proved impossible to demonstrate to a number of developing and developed countries that documentary evidence of direct consignment was one of the most significant obstacles in utilizing trade preferences. Despite the fact that the Agreement on Trade Facilitation provides for a series of simplification requirements concerning documentation for customs procedures, LDC proposals in this area have been met with resistance by preference-giving countries to change or introduce trade facilitation measures to comply with RoO requirements. For example, the proposal advanced by LDCs on the adoption of best practices, such as the one introduced recently by the European Union of not systematically requesting documentary evidence to prove compliance with direct shipment requirements unless there are doubts, has not been accepted.[41]

In 2019, as discussed in section I.6.2 the issue of direct consignment was again at the forefront of the discussions at CRO, demonstrating the technical value of the submissions made by the LDC group. As a result, the majority of preference-giving countries still request, in addition to a certificate of origin or similar documentation proving origin of the goods, additional documentary evidence, in most cases a through bill of lading for goods that have been shipped from LDCs to preference-giving countries passing through the territory of other countries.[42] This additional conditionality may easily prove to be an insurmountable burden of proof for landlocked and island LDCs since the requirement to provide such a through bill of lading or any other relevant documentary evidence to prove that the goods in transit have not been manipulated during transit is extremely burdensome and does not respond to commercial realities. Similarly, requests by the LDC WTO group during the negotiations of the Nairobi Decision to minimize documentation for small shipments and to further consider or engage in

[38] With the caveat of the generous cumulation provisions provided under the Canada GSP scheme, which remains an isolated case of best practice in this area.

[39] For the concept of extended cumulation, see article 56 of Commission delegated regulation 2015/2446 of 28 July 2015 supplementing Regulation No. 952/2013 of the European Parliament and of the Council as regards detailed rules concerning certain provisions of the Union Customs Code.

[40] For the concept of cross-cumulation, see http://mddb.apec.org/Documents/2009/CTI/CTI-MAG-TPD/09_cti-mag_tpd_004.pdf.

[41] The issue of non-alteration introduced by the European Union is further discussed in section I 6.2.

[42] See the presentation by Nepal and Uganda on documentary requirements and certification at the WTO Committee on Rules of Origin (RD/RO/27).

a discussion on the most suitable form of certificate of origin requirement were technically valid as demonstrated by the progressive introduction of self declaration in major FTAs and megaregionals.[43] Yet at the time of the negotiations during TNC the discussions over simplification of certification requirements have been considered a challenge by most preference giving countries, especially developing rather than an opportunity to engage in a discussion that may prove fruitful even for the same preference-giving countries.

Finally, the Nairobi Decision provides in paragraph 4 for implementation, flexibilities, and transparency. Paragraph 4.1 contains a self-explanatory large carve-out for developing countries that provide preferences to LDCs in implementing the provision contained in the Nairobi Decision: "Developing country members declaring themselves in a position to do so should, with appropriate flexibility, undertake the commitments set out in the above provisions."

Paragraph 4.2 provides as follows: "No later than 31 December 2016, each developed preference-granting member, and each developing preference-granting member undertaking the commitments in accordance with paragraph 4.1 up to that date or thereafter, shall inform the Committee on RoO of the measures being taken to implement the above provisions."

Paragraph 4.3 provides as follows: "Furthermore, the Committee on RoO shall develop a template for the notification of preferential RoO, to enhance transparency and promote a better understanding of the RoO applicable to imports from LDCs."

Paragraph 4.2 read in conjunction with the above excerpt from paragraph 4.3 led to a sense of expectation among LDCs. There was a sentiment that the overall content of the Nairobi Decision, including the various provisions referring to substantial transformation, were to be faithfully implemented by preference-giving countries by 31 December 2016 or shortly thereafter. According to this expectation nurtured by the LDC WTO group in the aftermath of the Nairobi Decision, the template mentioned in paragraph 4.3 was expected to be the instrument for verifying and comparing which provisions of the Nairobi Decision had been implemented by preference-giving countries by the deadline of 31 December.

Such expectations, however, were not fulfilled as further discussed in section I.5 below since the preference giving countries, simply notified their RoO according to the template and declared themselves to be in compliance with the provisions contained in the Nairobi Decision.

The first sentence of paragraph 4.3 contains one of the most significant advances towards getting to better RoO for LDCs in spite of the initial hesitations, even from inside the WTO LDC group. Such advance is the commitment of WTO preference-giving countries to notify utilization rates of their trade preferences in favour of LDCs: "Preferential RoO shall be notified as per the established procedures. In this regard, members reaffirm their commitment to annually provide import data to the secretariat as referred to in annex 1 of the PTA transparency mechanism, on the basis of which the secretariat can calculate utilization rates, in accordance with modalities to be agreed upon by the CRO."

The utilization rates have been at the core of the LDC paper of 2014 discussed in part II of this study earlier that started the process leading to the Nairobi decision. The concept of utilization rates was first conceived in UNCTAD to monitor the effectiveness of the GSP. Utilization rates of the Generalized System of Trade Preferences (GSP) have been notified to UNCTAD since 1974 by UNCTAD member States, in accordance with the mandate given to UNCTAD to monitor the functioning and implementation of GSP. Annual reports of utilization rates were made by a standing committee of UNCTAD, the Special Committee on Preferences, until an UNCTAD reform in 1996 discontinued the committee. Since 1996, UNCTAD has continued to update the database on utilization rates to provide technical assistance to LDCs and UNCTAD member States and to publish a series of studies and support LDC delegations in elaborating their submissions in different forums.[44]

At present UNCTAD is building a web-based platform to share with private sector and Governments the utilization rates with the aim of increasing awareness and the rate of utilization rates.[45]

[43] The concept of self-certification has been recently introduced in the Regional Comprehensive Economic Partnership Agreement (RCEP) albeit with a series of limitations. See Crivelli, P. and Inama, S. (2021), «Making RCEP successful through business-friendly rules of origin», ADB Blog, 12 February 2021, available at: https://blogs.adb.org/blog/making-rcep-successful-through-business-friendly-rules-origin

[44] See UNCTAD/DITC/TNCD/4, UNCTAD/ITCD/TSB/2003/8, WTO/G/RO/W/148.

[45] https://unctad.org/topic/trade-agreements/trade-preferences-utilization

I.5. Beyond the Nairobi Decision, 2016–2017

In the early aftermath of the Nairobi Decision, LDCs focused their efforts on the implementation of the Decision that could be summarized as follows:

(a) No later than 31 December 2016, "preference-granting countries undertaking the commitments in accordance with paragraph 4.1 up to that date or thereafter, shall inform the Committee on RoO of the measures being taken to implement the above provisions";

(b) Notifications of utilization rates of preferences granted to LDCs;

(c) Developing a template for notification of RoO.

The development of a template required most of the focus of the LDC group in 2016, as it was hoped that preference-giving countries would notify according to such a template the eventual improvements to their RoO to comply with the deadline of 31 December 2016. However, it took until the CRO meeting in March 2017 to achieve consensus on the template, with LDCs insisting on new notifications to be made according to the new template to allow for a comprehensive review to be held at the October 2017 session of CRO.[46] Similarly, the methodology to calculate the utilization rates was agreed at the end of 2016, as reported by the chair at the CRO meeting in March 2017.

The CRO report in March 2017 stated: "After consultations, members had adopted the methodology proposed by the secretariat (paragraph 3.2 (a) of G/RO/W/161). This modality compared the value of imports, which benefited from preferences, with the value of total imports, which would have been eligible for preferences. Hence, only tariff lines where there was a tariff preference were taken into account (that is, tariff lines that were either excluded from the preferential scheme or for which the MFN rate was zero were excluded from the calculations)."[47]

Paragraph 3.2 (a) of the above-mentioned document provides for the following formula to calculate utilization rates that is the formula traditionally used by UNCTAD in calculating the utilization of GSP preferences:

$$pur_{i,p}^{value} = \frac{\sum_{i,p} PTA_{reported}}{\sum_{i,p} PTA_{eligible}}$$

$pur_{i,p}^{value}$: *Preference utilization rate (per cent) based on import value*

where: i *= import value*

p *= products,*

$PTA_{reported}$ *= imports reported to have taken place under the PTA preferential duty scheme*

$PTA_{eligible}$ *= imports under any eligible tariff line, i.e., preferential duty<MFN duty rate*

At the CRO meeting in October 2017, LDCs again made a series of substantive presentations on a series of agenda items outlining the divide between their requests to improve on the existing RoO of preference-giving countries and the statements made by several preference-giving countries that their current RoO are in full compliance with the Nairobi Decision. In particular, the existing data on utilization rates were used by Yemen to make a comprehensive presentation showing the impact on trade flows and utilization rates of the RoO reforms that had been undertaken by the European Union and Canada, respectively, and how the absence of such a reform in the RoO of other Quad countries, namely Japan and the United States, was not resulting in similar positive trade dynamics for LDCs.

As a summary of the efforts made to comply with the Nairobi Decision, the CRO report in 2017 to the WTO General Council reported that China had adopted new legislation introducing a series of simplifications to RoO and that Canada had announced changes to facilitate the requirements for some apparel items. Norway stated that it allowed for cumulation among LDCs and Australia stated that it was conducting a comprehensive review of its GSP. The remaining preference-giving countries expressed the view either formally or informally during various CRO meetings held in 2016 and 2017 that their existing preferential RoO for LDCs were already complying with the Nairobi Decision.[48]

The presentations made by LDCs in October 2017 took stock of all of the notifications made by preference-giving countries in 2016–2017 period and showing, once again, the significant gaps between the status quo and the requests made.[49]

Most importantly, and despite the efforts by LDCs at CRO since the Bali Decision, there is little sign at present of a genuine engagement to find the best possible

[46] See WTO G/RO/M/68 and WTO/RO/84.

[47] See WTO G/RO/M/68.

[48] See WTO G/RO/85.

[49] See WTO/RD/RO/38 to WTO/RD/RO/59.

RoO for LDCs. As shown in the following subsections, a reform of RoO for LDCs could contribute to triggering the productive capacities that are necessary to achieve the Sustainable Development Goals.

Finally, notifications of preference-giving countries on utilization rates are lagging behind, as shown in the 2020 report of CRO at the General Council; trade data (i.e., import statistics) were not or only partially available for the following WTO preference-granting members: Armenia; China; Iceland; India; Kazakhstan; Kyrgyzstan; Montenegro; New Zealand; the Russian Federation; and Turkey.

I.6. Back to work: The least developed countries thematic submission in 2018–2019 and beyond

I.6.1. Introduction

Once the notifications according to the template provided for in the Nairobi Decision had been completed, preference-giving countries progressively declared at CRO that they were in compliance with the Nairobi Decision, making full use of the loopholes and flexibilities contained in the Nairobi Decision. It was clear that new efforts needed to be deployed by LDCs to engage preference-giving countries in a series of thematic and focused discussions on the basis of further submissions at CRO elaborating on the Nairobi Decision. In the following section I.6.2 and I.6.3 two examples of such technical submissions by the LDC WTO group are reported both elaborated with the assistance of UNCTAD. Such technical notes spearheaded the discussion in the CRO on utilization opening the way to other subsequent submission elaborated by the WTO secretariat. In addition to the two examples below the LDC presented the following submissions[50] also elaborated with the technical assistance of UNCTAD.

I.6.2. Direct consignment rule

Direct consignment requirements are provisions present in almost all PTAs, of an either unilateral or reciprocal nature, to ensure that the originating goods exported from country A are the same as those imported in country B and that they have not been manipulated or further processed during transportation through third countries. At the same time almost all PTAs recognize that due to geographical or logistical reasons the originating goods from country A may have to transit through a third country in order to be delivered to country B. The practices under the majority of PTAs and especially the DFQF provisions of preference-giving countries differ widely on the documentary evidence to be provided at the time of importation into country B in case of passage through the territory of a third country.

The issue of direct consignment as an obstacle to the utilization of trade preferences was first raised by LDCs in a number of presentations in July 2015[51] and subsequently reiterated during the negotiations leading to the Nairobi Decision. The technical nature of the issue at stake, proved impossible to surmount during negotiations with WTO delegates,especially of developing countries, on the way to the Nairobi Decision. LDCs faced strong opposition from both developed countries, mainly Canada, and developing countries, mainly China and India, in coming to an understanding of the difficulties that direct consignment rules may imply for LDCs.

It took another four years to again table the subject at the CRO after a presentation by LDCs citing the findings of a major assessment of the FTA among European Union–Republic of Korea, in which direct consignment rules were quoted as a major obstacle to better utilization on the part of European Union exporters.[52] Meanwhile direct consignment rules were also found to be the likely cause for low utilization rates in Switzerland, as reported in a subsequent LDC submission and presentation at the CRO[53].

A subsequent document presented by the WTO secretariat at the CRO meeting in May 2019 titled “Utilization rates under preferential trade arrangements for LDCs under the LDC duty scheme” identified a series of issues related to paragraph 3.1 of the Nairobi Decision on documentary evidence.[54]

The main issues discussed in the WTO document related to the low utilization of trade preferences for agricultural products. Specifically, the document

[50] See for instance, WTO document G/RO/186/ of 6 May 2019 , »Further evidence from utilization rates « Discussing the utilization rates of the Swiss preferential treatment to LDCs ,see WTO document G/RO/W/184 of 7 May 2019 ,See,WTO document G/RO/W/199 of 26 October 2020 ,”Submission of LDcs to the committee on rules of origin ad-valorem criterion” For a more complete summary of the LDC submissions at WTO prepared with the assistance of UNCTAD see “Compendium of technical notes prepared for the LDC WTO group on preferential rules of origin, UNCTAD,2021”.

[51] See section I.3 above.

[52] See presentation by the United Republic of Tanzania at the CRO meeting in October 2018.

[53] Ididem footnote 50

[54] G/RO/W185.

identified a number of country and product pairs with regard to which a low utilization of trade preferences was recorded, and direct consignment requirements were indicated as possible reasons for such low utilization. In fact, the products identified, mainly fruits, vegetables, and mineral products, were subject to a wholly obtained origin criterion[55] that is usually easily complied with given the nature of the products. The document indicated that documentary evidence related to the direct consignment requirement could explain such low utilization. In particular, the document identified a number of cases showing that "direct transportation and certification requirements also have a direct impact on utilization."

Similarly, another WTO document titled "Impact of the direct consignment requirement on preference utilization by LDCs"[56] further corroborates the analysis made in the previous LDC submissions and oral presentations stating: "The calculation of utilization rates in this note offers a clear indication that direct consignment requirements have a significant influence on the ability of LDCs to utilize trade preferences, in particular those of landlocked LDCs."[57]

The fact that documentary evidence related to direct consignment requirements could be an insurmountable obstacle to the utilization of trade preferences by LDCs, especially landlocked and island LDCs, was initially identified by UNCTAD[58] and repeatedly raised by the LDC group on numerous occasions, starting with the dedicated session presentations in 2015.

Such concerns were first reflected in paragraph 1.8 of the Bali Decision: "The documentary requirements regarding compliance with the rules of origin should be simple and transparent. For instance, a requirement to provide proof of non-manipulation or any other prescribed form for a certification of origin for products shipped from LDCs across other members may be avoided. With regard to certification of rules of origin, whenever possible, self-certification may be recognized. Mutual customs cooperation and monitoring could complement compliance and risk-management measures."

Paragraph 3.1 of the Nairobi Decision reiterates such concerns, providing the following: "With a view to reducing the administrative burden related to documentary and procedural requirements related to origin, preference-granting members shall: (a) as a general principle, refrain from requiring a certificate of non-manipulation for products originating in a least developed country but shipped across other countries unless there are concerns regarding trans-shipment, manipulation or fraudulent documentation; (b) consider other measures to further streamline customs procedures, such as minimizing documentation requirements for small consignments or allowing for self-certification."

In this technically complex area, it is important to clarify the issues at stake and what action is required by a preference-giving country to simplify the requirements of documentary evidence related to direct consignment bringing hem into conformity with the Nairobi Decision.

The majority of administrations are requiring documentary evidence of non-manipulation during transit in the territory of a third country and that the goods have not entered the customs territory of the third country. Such documentation in the majority of preference-giving countries is: (a) a through bill of lading covering transit through a third country; or (b) a certificate of non-manipulation provided by the customs authority of the country of transit stating that the goods have remained under customs control.

The issue is that such documentary evidence is not easy to obtain and/or may entail a significant cost. As shown for the Quad group in table 1 and for other preference-giving countries in table 2, the documentary evidence related to direct consignment is often a through bill of lading covering the passage through a third country or a statement by customs in the third country of transit that the goods have not been manipulated during transit besides unloading, loading and/or other operations necessary to preserve them in good condition. None of these documents are easy to obtain. A through bill of lading may be impossible to produce because of the following reasons:

(a) Geographical or commercial reasons: In the case of some landlocked or island countries there may be no shipping agent capable of issuing a through bill of lading and/or it may be too expensive or not convenient;

(b) Goods may be sold by the LDC exporter or producer to an intermediary or hub and from that intermediary or hub, subsequently shipped to the country of final destination.

55 See paragraphs 6.5 and 6.6 of G/RO/W185.

56 See G/RO/W187.

57 See paragraph 6.1 of G/RO/W187.

58 See UNCTAD training materials prepared for the dedicated CRO session for LDCs in July 2015 and the UNCTAD *Handbook on Duty-Free and Quota-Free Market Access* and the *Handbook on Rules of Origin for Least Developed Countries*.

In such cases, it is not possible to comply with the kind of documentary evidence of direct consignment demanded by some preference-giving countries, such as a through bill of lading or certificate of non-manipulation. Such requirements unduly penalize goods originating in LDCs, especially SMEs that often sell to traders rather than directly to a client located in the preference-giving country. Landlocked and island countries may be particularly disfavoured due to geographical location or distance from commercial routes.

On the one hand, the requirements for direct consignment in Canada and for direct purchase in the Eurasian Customs Union and on the other hand, the corresponding provisions in the European Union GSP, are at opposing poles of existing practices in this area. The general preferential tariff provisions in Canada for documentary evidence of direct consignment contain strict and detailed requirements, as follows:[59]

"Direct shipment requirements: The goods must be shipped directly on a through bill of lading (TBL) to a consignee in Canada from the LDC in which the goods were certified. Evidence in the form of a TBL (or a copy) showing that the goods have been shipped directly to a consignee in Canada must be presented to the CBSA upon request. The TBL is a single document that is issued prior to the goods beginning their journey when the carrier assumes care, custody and control of the goods, and it is used to guarantee the direct shipment of goods from the country of origin to a consignee in Canada. It generally contains the following information:

(a) Identity of the exporter in the country of origin;

(b) Identity of the consignee in Canada;

(c) Identity of the carrier or agent who assumes liability for the performance of the contract;

(d) Contracted routing of the goods identifying all points of trans-shipment;

(e) Full description of the goods and the marks and numbers of the package;

(f) Place and date of issue.

Note: A TBL that does not include all points of trans-shipment may be accepted, if these are set out in related shipping documents presented with the TBL. On a case-by-case basis, an amended TBL may be accepted as proof of direct shipment where documentation errors have occurred, and the amended TBL corrects an error in the original document. In such cases, the carrier must provide proof that the amended TBL reflects the actual movement of the goods as contracted when the goods began their journey. Documentation presented must clearly indicate the actual movement of the goods. Air cargo is usually trans-shipped in the air carrier's home country even if no trans-shipment is shown on the house air waybill. Therefore, where goods are transported via airfreight, the house air waybill is acceptable as a TBL. Under the least developed country tariff treatment, goods may be trans-shipped through an intermediate country, provided that:

(a) They remain under customs transit control in the intermediate country;

(b) They do not undergo any operation in the intermediate country, other than unloading, reloading or splitting up of loads or any other operation required to keep the goods in good condition;

(c) They do not enter into trade or consumption in the intermediate country;

(d) They do not remain in temporary storage in the intermediate country for a period exceeding six months.

A consignee in Canada must be identified in field No. 2 to ensure that the exporter in the beneficiary country certified the origin of the goods according to RoO of Canada. The consignee is the person or company, whether it is the importer, agent or other party in Canada, to which goods are shipped under a TBL and is so named in the bill. The only exception to this condition may be considered when 100 per cent of the value of the goods originates in the beneficiary country in question, in which case no consignee is required."

The combination of such requirements may be overwhelming in current business transactions and does not correspond to commercial realities. The requirement that a consignee in Canada should be identified in the certificate of origin practically nullifies any possibility for trade through intermediaries or third country invoicing. Canada has granted special waivers from such stringent consignment requirements to China, Haiti and Mexico to take into account special situations, but not to LDCs, although requests were made during the negotiations leading up to the Nairobi Decision: "Some exceptions exist where goods may be entitled to alternative shipping requirements."[60]

[59] See https://www.cbsa-asfc.gc.ca/trade-commerce/tariff-tarif/ldct-tpmd-eng.html?wbdisable=true.

[60] Memorandum D11-4-4, Ottawa, 16 October 2017, paragraph 82. For more information, see Memorandum D11-4-9, Goods originating in Mexico, deemed to be directly shipped to Canada for the purposes of the general preferential tariff; Memorandum D11-4-10, Instructions

Under the United States GSP, the provisions in paragraph 10.175 are as follows:

"Imported directly defined. Eligible articles shall be imported directly from a beneficiary developing country to qualify for treatment under GSP. For purposes of 10.171 through 10.178 the words "imported directly" mean:

(a) Direct shipment from the beneficiary country to the United States without passing through the territory of any other country; or

(b) If the shipment is from a beneficiary developing country to the United States through the territory of any other country, the merchandise in the shipment does not enter into the commerce of any other country while en route to the United States and the invoice, bills of lading and other shipping documents show the United States as the final destination; or

(c) If shipped from the beneficiary developing country to the United States through a free trade zone in a beneficiary developing country, the merchandise shall not enter into the commerce of the country maintaining the free trade zone; and

1. The eligible articles must not undergo any operation other than:

(i) Sorting, grading or testing;

(ii) Packing, unpacking, changes of packing, decanting or repacking into other containers;

(iii) Affixing marks, labels or other like distinguishing signs on articles or their packing, if incidental to operations allowed under this section; or

(iv) Operations necessary to ensure the preservation of merchandise in its condition as introduced into the free trade zone;

2. Merchandise may be purchased and resold, other than at retail, for export within the free trade zone;

3. For the purposes of this section, a free trade zone is a predetermined area or region declared and secured by or under governmental authority, where certain operations may be performed with respect to articles, without such articles having entered into the commerce of the country maintaining the free trade zone; or

(d) If the shipment is from any beneficiary developing country to the United States through the territory of any other country and the invoices and other documents do not show the United States as the final destination, the articles in the shipment upon arrival in the United States are imported directly only if they:

1. Remained under the control of the customs authority of the intermediate country;

2. Did not enter into the commerce of the intermediate country except for the purpose of sale other than at retail, and the centre director is satisfied that the importation results from the original commercial transaction between the importer and the producer or the latter's sales agent;

3. Were not subjected to operations other than loading and unloading, and other activities necessary to preserve the articles in good condition."

In Norway, the legislation provides as follows:[61]

"Direct transport:

1. The products that are declared for importation to Norway shall be the same as those that are exported from the GSP country where they are regarded as originating from. They must not have been changed, converted in any way or undergone treatments other than treatments that have the purpose of keeping them in good condition before they are declared. Storage of products or consignments and splitting of consignments may occur if this takes place under the responsibility of the exporter or a subsequent holder of the goods and the products remain under the customs authorities' supervision in the transit country(ies).

2. Subsection (1) is deemed to be met, unless the customs authorities have reason to believe that the opposite is the case. In that respect, the customs authorities may request that the declarant or customs debtor proves compliance. Proof can be provided with the assistance of any means, including contractual transport documents such as, for example, bill of lading or factual or specific evidence based on labelling or numbering of packages or any form of evidence associated with the actual goods.

3. Subsections (1) and (2) apply correspondingly for cumulation pursuant to section 8-4-35."

Table 1 and Table 2 show the findings of an analysis carried out on the legal texts of preference-giving countries.

pertaining to the China direct shipment condition exemption order; and Memorandum D11-4-28, Haiti goods deemed to be directly shipped to Canada for the purposes of the general preferential tariff and the least developed country tariff.

61 Regulations to the Act on Customs Duties and Movement of Goods (customs regulations), January 2019, section 8-4-38.

Table 1
Quad requirements in terms of documentary evidence of direct consignment

Country or group	Administrative requirements	Other requirements	Compliance with Nairobi Decision, paragraph 3.1
European Union EBA[a]	Non-alteration principle: documentary evidence of direct consignment is not required unless European Union customs have doubts	In case of doubt, European Commission customs authorities may request evidence and importer may provide evidence of non-alteration by "any means"	Yes Most liberal since reform of EBA RoO in 2011
United States GSP[b]	(a) Remained under customs control in country of transit; (b) The United States port director is satisfied that the importation results from the original commercial transaction; (c) Were not subjected to operations other than loading and unloading (19 CFR 10.175)	Shipping and other documents must show United States as final destination[62]	No First there is a requirement that the United States is shown as the country of final destination and, for goods not showing the United States as the country of final destination, a number of requirements apply; "centre director is satisfied that the importation results from the original commercial transaction between the importer and the producer or the latter's sales agent"
United States AGOA[c]	Same as above	Same as above	No, evidence is required
Japan[d]	(a) A through bill of lading; (b) A certification by the customs authorities or other government authorities of the transit countries; or (c) Any other substantiating document deemed sufficient[e]		No, evidence is required
Canada[f]	The goods must be shipped directly on a TBL to a consignee in Canada from the beneficiary or LDC in which the goods were certified Evidence in the form of a TBL (or a copy) showing that the goods have been shipped directly to a consignee in Canada must be presented to the CBSA upon request	Special waiver exists for goods coming from Haiti, Mexico and Hong Kong (China) in which the documentary evidence is substantially relaxed	No, evidence is required

[a] *G/RO/LDC/N/EU/1*

[b] *G/RO/LDC/N/USA/1*

[c] *G/RO/LDC/N/USA/3*

[d] *G/RO/LDC/N/JPN/1*

[e] *The provision related to documentary requirement for proof of direct shipment is found in article 31 of the Cabinet Order for Enforcement of the Temporary Tariff Measures Law (unofficial translation), as follows: "Any person who intends to have paragraph 1 or 3 of article 8-2 of the temporary tariff measures law applied to those products enumerated in subparagraph (2) or (3) of paragraph 1 shall, at the time of import declaration of such products, submit one of the following documents, as a document proving that such products fall under either of such subparagraphs. However, this shall not apply to those products for which the total amount of customs value is not more than ¥200,000: (a) a copy of a through bill of lading for transportation of such products from a beneficiary of references as their origin, to the port of importation in Japan; (b) a certificate issued by customs or any other competent government authorities in a country of non-origin where the products were trans-shipped, temporarily stored or displayed at exhibitions, etc. as provided for in subparagraph (2) or (3) of paragraph 1; (c) any documents which are considered by the director general of customs to be appropriate, excluding those enumerated in the preceding two subparagraphs" (paragraph 3); "The following items shall be described in the certificate provided for in subparagraph (2) of paragraph 3: (a) marks, numbers, descriptions and quantities of the products under consideration; (b) dates on which such products were loaded on board and/or unloaded from, a vessel, aircraft or vehicle in the country of non-origin and names, registered marks or kinds of such vessels, aircraft or vehicles; (c) details of the handling of such products in the country of non-origin where the loading or unloading as provided for in the preceding subparagraph took place" (paragraph 5).*

[f] *G/RO/LDC/N/CAN1 and G/RO/LDC/N/CAN1*

Source: UNCTAD, based on notifications made to WTO and expanding on UNCTAD, 2015, available at https://unctad.org/meetings/en/Presentation/aldc2015_06-agenda6_wto_en.pdf.

62 See for better certainty ruling of customs director of Vermont of 1994 for a better clarifications available at www.customsmobile.com/rulings/docview?doc_id=557937&highlight=557937

Table 2
Other requirements in terms of documentary evidence of direct consignment

Economy or group	Administrative requirements	Compliance and comments
Norway[a]	The WTO notification appears not to be updated. The latest Customs legislation available online provides for the non-alteration rule	Yes, according to latest legislation
Switzerland[b]	According to the notification, Switzerland customs may require a certificate of non-manipulation [c]	No
New Zealand[d]	Not required at point of import. Any normal transaction, commercial documents on request	Yes
Australia[e]	No direct shipment requirements for LDC preferences	Yes
Eurasian Customs Union[f]	Goods must be directly purchased by the importer; goods must be delivered directly; not clear if documentary evidence of direct delivery is required	No, direct purchase is a unique requirement
China[g]	For imported goods transiting a third country (region), relevant documents that, according to the customs of China, are necessary to certify that the goods remain under customs control [h]	No, evidence is required
India[i]	Requirement of direct shipment. The following shall be produced to the customs authority of India at the time of importation: a through bill of lading issued in the exporting country; a certificate of origin issued by the issuing authority of the exporting beneficiary country; a copy of the original commercial invoice in respect of the product; and supporting documents in evidence that other requirements of rule 7 (direct shipment) have been complied with	No, evidence is required
Republic of Korea[j]	With regard to the goods that are not imported directly from the country or origin, but via a third country, if the relevant customs office, the institution authorized to issue certificates or the chamber of commerce and industry of the third country confirms the country of origin of the relevant goods or issues a certificate to that effect, the country of origin and a certificate to that effect shall be confirmed based on the certificate of origin issued by the country of origin for the relevant goods	No, evidence is required
Thailand[k]	An air waybill, a through air waybill, a bill of lading, a through bill of lading or a multimodal or combined transportation document, that certifies the transport from the exporting DFQF beneficiary country to Thailand, as the case may be. If there is no through air waybill or through bill of landing, supporting documents issued by the customs authority or other competent entity of other DFQF beneficiary country(s) or non-beneficiary country(s) that authorized this operation, according to its domestic legislation, are required; an original certificate of origin (form DFQF) issued by the issuing authorities of exporting DFQF beneficiary country; and a commercial invoice in respect of the goods	No, evidence is required
Taiwan Province of China[l]	Excerpt from notified text: "The exporters from LDCs could present the self-proof documentary of direct shipment to customs"	Unclear

[a] *G/RO/LDC/N/NOR1*

[b] *G/RO/LDC/N/CHE1*

[c] *Ordinance SR 946.39, article 19, paragraph 5 (unofficial translation): "1. If preferential taxation is claimed for an originating product, it must be the same product as that exported from the beneficiary country. Before being taxed at the preferential rate, it must not be modified or transformed in any way. Working or processing is permitted provided that it is necessary for the preservation of the product as it is; 2. The affixing of trademarks, labels or seals or the addition of documentation is permitted if this is necessary for the fulfilment of national regulations in Switzerland; 3. Paragraph 1 shall apply, mutatis mutandis, to originating products imported into a beneficiary country for the purpose of cumulation in accordance with articles 26 and 33; 4. The storage of products and the distribution of consignments in a country of transit are permitted provided the goods remain under customs control." To verify that the conditions in paragraphs 1-4 are met, Switzerland customs authorities may require the submission of freight documents, factual or concrete proof or a certificate from the customs authorities of the country of transit.*

[d] *G/RO/LDC/N/NZL1*

[e] *G/RO/LDC/N/AUS 1 and G/RO/LDC/N/AUS/rev1*

[f] *G/RO/LDC/N/RUS1 and Decision No. 60 of the Council of the Eurasian Economic Commission, 14 June 2018*

[g] *G/RO/LDC/N/CHN1*

[h] *Excerpt from notification made to WTO: "Transport documents covered the whole route from the beneficiary country to ports of entry in China; for goods transported into the territory of China through other countries or regions, importers shall submit certified documents issued by customs of that country or region or other documents accepted by China customs. Those certified documents mentioned above are not compulsory when customs has obtained electronic data information of certified documents via related electronic data system for trans-shipment. If the transport documents are determined by China customs to be sufficient to fulfil the requirement of the direct consignment, importers are not required to submit certified documents. Supporting documents required when the transport of consignment involves transit: customs announcement No. 57, promulgated in 2015; and customs announcement No. 52, promulgated in 2016."*

[i] *G/RO/LDC/N/IND1*

[j] *G/RO/LDC/N/KOR1*

[k] *G/RO/LDC/N/THAI1*

[l] *G/RO/LDC/N/TPKM1*

Source: UNCTAD, based on notifications made to WTO and expanding on UNCTAD, 2015, available at https://unctad.org/meetings/en/Presentation/aldc2015_06-agenda6_wto_en.pdf.

The LDC WTO group has observed the positive evolution of European Union requirements in terms of documentary evidence related to direct shipment. The standard formulation of the documentary evidence of direct consignment in European Union FTAs and previous GSP regulations has traditionally been as follows:

(a) "The preferential treatment provided for under the agreement applies only to products, satisfying the requirements of this protocol, which are transported directly between the Community and FTA partner country or through the territories of the other countries referred to in articles 3 and 4 with which cumulation is applicable. However, products constituting one single consignment may be transported through other territories with, should the occasion arise, trans-shipment or temporary warehousing in such territories, provided that they remain under the surveillance of the customs authorities in the country of transit or warehousing and do not undergo operations other than unloading, reloading or any operation designed to preserve them in good condition;

(b) Evidence that the conditions set out in paragraph 1 have been fulfilled shall be supplied to the customs authorities of the importing country by the production of:

(i) A single transport document covering the passage from the exporting country through the country of transit; or

(ii) A certificate issued by the customs authorities of the country of transit:

(a.) Giving an exact description of the products;

(b.) Stating the dates of unloading and reloading of the products and, where applicable, the names of the ships or the other means of transport used; and

(c.) Certifying the conditions under which the products remained in the transit country; or

(iii) Failing these, any substantiating documents."

As contained in a European Union manual, the proof required for documentary evidence under such standard formulation could take any of the three forms outlined above: 1) a single transport document, 2) a certificate of non manipulation or 3) any substantiating document: [63] "In the absence of a single transport document (e.g., a through bill of lading) the customs authorities of the countries through which the goods transit must provide documentary proof that the consignment was at all times under their surveillance when on their territory. Such proof must contain the details outlined in paragraph (b) above. In simple terms, such documentary proof must detail the history of the journey of the consignment through their territory and the conditions under which the surveillance has been conducted. This documentary proof is known as a certificate of non-manipulation. In the absence of either of the foregoing proofs any other substantiating documents can be presented in support of a claim to preference. However, it is difficult to envisage any other documents (e.g. commercial documents) that would adequately demonstrate that all the conditions of paragraph 1 of the article were satisfied."

Most recently, the European Union introduced the concept of non-alteration with significant trade-facilitating provisions. According to the non-alteration formulation introduced in the European Union GSP and progressively in many European Union FTAs such as the European Union–Japan FTA (box 1), only in case of doubt, the European Union customs authorities request the declarant to provide evidence of compliance (FTA, paragraph 4, article 3.2). Without reasonable doubt, it is assumed that direct consignment requirements are met. Systematic evidence of direct consignment is no longer required.

It is important to emphasize that, even where documentary evidence is requested, the proof of direct consignment may be given "by any means". The leniency of such a provision contrasts with the usual provisions of many preference-giving countries in tables 1 and 2 whereby, often, the proof of direct consignment may be given only by a through bill of lading or documentary evidence in the form of a certificate or statement of non-manipulation provided by the customs authorities of the country of transit.

A guide from the European Union further specifies the difference between the former legislation on documentary evidence and the new non-alteration principle: "An important difference between the previous direct transportation requirement and non-manipulation clause (non-alteration principle) lies in documentary evidence to be provided. Until 31 December 2010, with direct transport in all cases where the goods were transported via another country, except where the country of transit was one of the countries of the same regional group, the European Union importer was required to present documentary evidence that the goods did not undergo any operations there (in the country of transit), other

[63] S Inama, 2009 and 2021 forthcoming, RoO in international trade, Cambridge University Press; and A user's handbook to the rules of preferential origin used in trade between the European Community, other European countries and the countries participating in the Euro-Mediterranean Partnership.

than unloading, reloading, or any operation designed to keep them in their condition. The types of the referred documentary evidence were strictly defined in the law. The new non-manipulation (non-alteration principle) clause shall be considered as satisfied a priori unless the customs authorities have reason to believe the contrary; in such cases, the customs authorities may request the declarant to provide evidence of compliance, which may be given by any means."[64]

The LDC WTO group stated at the CRO meeting in October 2019 that the non-alteration principle provision introduced by the European Union or similar arrangements such those adopted by Australia and New Zealand may constitute a best practice that should be progressively adopted by other preference-giving countries. The WTO LDC group requested the other preference-giving countries to start considering the move to a similar approach abandoning requirements for a through bill of lading and certificate of non-manipulation that do not adhere to business realities and trade facilitation practices.

Box 1
Non-alteration provision in the European Union–Japan Free Trade Agreement, article 3.10

1. An originating product declared for home use in the importing party shall not have, after exportation and prior to being declared for home use, been altered, transformed in any way or subjected to operations other than to preserve them in good condition or than adding or affixing marks, labels, seals or any other documentation to ensure compliance with specific domestic requirements of the importing party.
2. Storage or exhibition of a product may take place in a third country provided that it remains under customs supervision in that third country.
3. Without prejudice to section B, the splitting of consignments may take place in a third country if it is carried out by the exporter or under its responsibility and provided that they remain under customs supervision in that third country.

In case of doubt as to whether the requirements provided for in paragraphs 1 to 3 are complied with, the customs authority of the importing party may request the importer to provide evidence of compliance, which may be given by any means, including contractual transport documents such as bills of lading or factual or concrete evidence based on marking or numbering of packages or any evidence related to the product itself.
Source:Japan/EU FTA[65]

I.6.3. Recent work on utilization rates[66]

Paragraph 4.3 of the Nairobi Decision provides as follows: "Preferential rules of origin shall be notified as per the established procedures. In this regard, members reaffirm their commitment to annually provide import data to the secretariat as referred to in annex 1 of the PTA transparency mechanism, on the basis of which the secretariat can calculate utilization rates, in accordance with modalities to be agreed upon by the CRO."

Four years later, most preference-granting members notified their utilization rates, which constituted a valuable tool to identify specific difficulties that LDCs may face in complying with RoO, such as highlighted in the presentation made by the LDC group at the last CRO meeting applying the UNCTAD methodology.[67] LDCs, assisted by UNCTAD, realized that utilization rates were critical in assessing the stringency of RoO, clearly showing that some preference-granting countries exhibit low utilization rates across all products; and high utilization rates may also hide large pockets of underutilization in specific sectors, implying a significant share of LDC imports subject to most-favoured nation (MFN) tariffs while eligible for preferential treatment. The advocacy by the LDC WTO group at CRO meetings led to the recognition that further steps to simplify RoO and improve utilization should be considered. WTO members agreed that more research work was to be conducted in order to better understand the causes behind the underutilization of tariff preferences and identify specific issues.

Two short studies on the utilization rates in China and Switzerland were elaborated to serve as the contribution of the WTO LDC group to the CRO meeting in October 2019 and are detailed in the following subsections.

I.6.3.1. Switzerland utilization rates

Table 3 shows the value of imports to Switzerland from LDC beneficiary countries, for tariff lines where the utilization rate, defined as the value of imports entering under the LDC GSP divided by the value of imports eligible for preferential treatment, is below 70 per cent. Observations are sorted in descending order of import value entering under MFN while eligible for preferential treatment. All import values in table 3 are dutiable.

64 The European Union RoO for the Generalized System of Preferences: A Guide for Users, May 2016.

65 Available at https://trade.ec.europa.eu/tradehelp/japan

66 This section draws on papers presented during the LDC thematic retreat held in Switzerland on October 2019 and later adopted by the LDC WTO group and submitted to the WTO secretariat. See G/RO/W/186, G/RO/W/192 and G/RO/W/191.

67 See forthcoming Europen University Institute(EUI) /UNCTAD study on drafting RoO.

Table 3
Switzerland imports from the least developed countries, 2017, by tariff line
(Utilization rate<70 per cent, by descending value of imports entering under MFN (>$5 million))

Least developed country beneficiary	Tariff line	Product description	Imports (thousands of dollars)				Utilization rate (percentage)	Specific most-favoured nation duty
			Dutiable	Eligible	Entering under			
					LDC GSP	MFN		
Bangladesh	62034200	Men's or boys' suits, ensembles, jackets, blazers, trousers... – of cotton	80 555	80 555	27 489	53 067	34	182 SwF/100kg brut
Bangladesh	61091000	T-shirts, singlets and other vests, KoC – of cotton	49 890	49 890	13 469	36 421	27	152 SwF/100kg brut
Bangladesh	61102000	Jerseys, pullovers, cardigans, waistcoats... KoC – of cotton	61 207	61 207	26 609	34 599	43	120 SwF/100kg brut
United Republic of Tanzania	71039100	Rubies, sapphires and emeralds	30 866	30 866	0	30 866	0	800 SwF/100kg brut
Myanmar	71039100	Rubies, sapphires and emeralds	26 864	26 864	0	26 864	0	800 SwF/100kg brut
Bangladesh	61103000	Jerseys, pullovers, cardigans, waistcoats... KoC – of MMF	42 075	42 075	16 311	25 764	39	300 SwF/100kg brut
Mozambique	71039100	Rubies, sapphires and emeralds	14 425	14 425	0	14 425	0	800 SwF/100kg brut
Bangladesh	62046290	Women's or girls' suits, ensembles, jackets, blazers, dresses... – of cotton	24 336	24 336	10 334	14 002	42	302 SwF/100kg brut
Madagascar	71039100	Rubies, sapphires and emeralds	10 229	10 229	0	10 229	0	800 SwF/100kg brut
Bangladesh	62052000	Men's or boys' shirts – of cotton	17 512	17 512	7 737	9 775	44	200 SwF/100kg brut
Bangladesh	61051000	Men's or boys' shirts, KoC – of cotton	11 775	11 775	3 080	8 695	26	130 SwF/100kg brut
Bangladesh	64039100	Footwear with outer soles of rubber, plastics, leather... – covering ankle	8 421	8 421	258	8 163	3	143 SwF/100kg brut
Zambia	71039100	Rubies, sapphires and emeralds	7 865	7 865	0	7 865	0	800 SwF/100kg brut
Bangladesh	62029300	Women's or girls' overcoats, carcoats, capes, cloaks... – of MMF	9 249	9 249	1 474	7 775	16	575 SwF/100kg brut
Bangladesh	61099000	T-shirts, singlets and other vests, KoC – of other textile materials	8 665	8 665	1 561	7 104	18	391 SwF/100kg brut
Cambodia	62034200	Men's or boys' suits, ensembles, jackets, blazers, trousers... – of cotton	8 993	8 993	1 951	7 041	22	182 SwF/100kg brut
Bangladesh	61046200	Women's or girls' suits, ensembles, jackets, blazers, dresses... – of cotton	15 415	15 415	8 590	6 825	56	165 SwF/100kg brut
Cambodia	61099000	T-shirts, singlets and other vests, KoC – of other textile materials	7 336	7 336	1 183	6 153	16	391 SwF/100kg brut
Cambodia	61046200	Women's or girls' suits, ensembles, jackets, blazers, dresses... – of cotton	8 020	8 020	1 914	6 105	24	165 SwF/100kg brut
Cambodia	64039992	Footwear with outer soles of rubber, plastics, leather... – other	7 740	7 740	1 666	6 074	22	145 SwF/100kg brut
Cambodia	61046300	Women's or girls' suits, ensembles, jackets, blazers, dresses, skirts, divided skirts, trousers, – of synthetic fibres	6 835	6 835	1 137	5 698	17	418 SwF/100kg brut
Bangladesh	62019300	Men's or boys' overcoats, carcoats, capes, cloaks... – of MMF	6 196	6 196	904	5 293	15	497 SwF/100kg brut
Haiti	33012930	Essential oils (terpeneless or not)... – other	5 230	5 230	0	5 230	0	3 SwF/100kg brut
Bangladesh	62034300	Men's or boys' suits, ensembles, jackets, blazers, trousers... – of cotton	6 691	6 691	1 653	5 038	25	500 SwF/100kg brut

Abbreviations: KoC, knitted or crocheted; MMF, human-made fibres

Notes: Dutiable means trade flows that are subject to positive MFN rates. Trade flows that are MFN free are not accounted for since it would be equivalent to calculating empty preferences. Eligible means products that are covered by the preferential schemes and that are potentially eligible for a preferential duty rate.

Source: TAO database, 1 May 2019.

Three main observations can be made from the information in Table 3:

(a) Several LDCs experienced difficulties in benefiting from preferential treatment in the garment and clothing sectors. Bangladesh and Cambodia are particularly affected, with considerable values taxed at the MFN specific duty. Considering the first three tariff lines under chapter 61 and chapter 62 of the Harmonized System together, the value of imports entering under MFN treatment while eligible for preferential treatment amounted to $124 million only for Bangladesh. For Cambodia, out of $9 million total imports under a single tariff line (62034200), only less than $2 million entered the Switzerland market duty free, leading to $7 million imposed by the MFN specific duty;

(b) Tariff line 71039100 is critical for all LDCs exporting rubies, sapphires and emeralds to Switzerland. All six countries concerned exhibit a utilization rate of zero, for a total import value of $99.7 million;[68]

(c) Haiti did not benefit from the preference granted for exports of essential oils (tariff line 33012930), leading to $5.3 million that could potentially enter the Switzerland market duty free but instead a specific MFN duty is imposed.

Table 4
Switzerland imports from the least developed countries, 2017, by Harmonized System chapter
(Utilization rate<70 per cent, by descending value of imports entering under MFN (>$3 million))

Country	Chapter	Product description	Imports (thousands of dollars)				Utilization rate (percentage)
			Dutiable	Eligible	Entering under		
					LDC GSP	MFN	
Bangladesh	61	Articles of apparel and clothing accessories, KoC	259 491	259 491	100 900	158 590	39
Bangladesh	62	Articles of apparel and clothing accessories, not KoC	207 387	207 387	74 000	133 388	36
Cambodia	61	Articles of apparel and clothing accessories, KoC	76 149	76 149	28 204	47 945	37
United Republic of Tanzania	71	Natural or cultured pearls, precious or semi-precious stones...	32 170	32 170	0	32 170	0
Cambodia	62	Articles of apparel and clothing accessories, not KoC	41 447	41 447	11 677	29 770	28
Myanmar	71	Natural or cultured pearls, precious or semi-precious stones...	27 512	27 512	0	27 512	0
Cambodia	64	Footwear, gaiters and the like...	28 083	28 083	5 519	22 564	20
Myanmar	62	Articles of apparel and clothing accessories, not KoC	23 669	23 669	6 924	16 745	29
Bangladesh	64	Footwear, gaiters and the like...	20 325	20 325	5 016	15 310	25
Mozambique	71	Natural or cultured pearls, precious or semi-precious stones...	14 746	14 746	0	14 746	0
Madagascar	71	Natural or cultured pearls, precious or semi-precious stones...	10 383	10 383	27	10 356	0
Madagascar	62	Articles of apparel and clothing accessories, not KoC	8 677	8 677	3	8 674	0
Zambia	71	Natural or cultured pearls, precious or semi-precious stones...	7 920	7 920	0	7 920	0
Bangladesh	63	Other made up textile articles...	8 184	8 184	2 723	5 461	33
Madagascar	61	Articles of apparel and clothing accessories, KoC	7 151	7 151	1 785	5 367	25
Haiti	33	Essential oils and resinoids; perfumery, cosmetics...	5 318	5 318	0	5 318	0
Myanmar	61	Articles of apparel and clothing accessories, KoC	9 618	9 618	4'723	4 896	49
Cambodia	87	Vehicles other than railway or tramway	5 624	5 624	808	4 816	14
Solomon Islands	71	Natural or cultured pearls, precious or semi-precious stones...	4 413	4 413	0	4 413	0
Lao People's Democratic Republic	61	Articles of apparel and clothing accessories, KoC	3 570	3 570	13	3 557	0
Bangladesh	42	Articles of leather...	3 390	3 390	187	3 203	6
Myanmar	64	Footwear, gaiters and the like...	3 650	3 650	552	3 099	15

Abbreviations: KoC, knitted or crocheted.

Notes: Dutiable means trade flows that are subject to positive MFN rates. Trade flows that are MFN free are not accounted for since it would be equivalent to calculating empty preferences. Eligible means products that are covered by the preferential schemes and that are potentially eligible for a preferential duty rate.

Source: TAO database, 1 May 2019.

[68] In order of import values: United Republic of Tanzania; Myanmar; Mozambique; Madagascar; Zambia; and Afghanistan ($1.679 million in imports of products under tariff line 71039100 from Afghanistan not shown in table 3).

Given the high number of tariff line and country pairs with utilization rates below 70 per cent (8,601 cases out of 11,923 observations), Table 4 shows similar information as Table 3 but aggregated at the Harmonized System chapter level, allowing for a better understanding of the magnitude of the trade concerned by low utilization rates. In particular, the following observations may be made:

(a) In the garment and clothing sector, $292 million of imports under chapter 61 and chapter 62 from Bangladesh receive MFN treatment while eligible for duty-free entry. This value amounts to almost $78 million for Cambodia, $21.6 million for Myanmar, $14 million for Madagascar and $6.3 million for the Lao People's Democratic Republic with preference margins ranging between 120SwF/100kg and 575SwF/100kg (see Table 3);

(b) Cambodia is facing difficulties in benefiting from preferential treatment in other sectors than garments and textiles, in particular footwear under chapter 64 of the Harmonized System ($22.5 million of imports receiving MFN treatment) and bicycles under chapter 87 of the Harmonized System ($4.8 million), with preference margins of, respectively, 145SwF/100kg and 23SwF/100kg;

(c) Under chapter 71 of the Harmonized System, tariff lines other than rubies, sapphires and emeralds (71039100) show zero utilization rates, for example, diamond imports (Harmonized System 71023900) from the Solomon Islands amounting to $4.4 million. Both tariff lines exhibit a preference margin of 800SwF/100kg.

Finally, it should be noted that Table 3 and Table 4 represent only a snapshot of the data and the list of tariff line and country pairs for which bilateral discussions could improve market access and therefore is not exhaustive. Other countries could potentially also face difficulties in some selected sectors that could be worth investigating further, as shown in Table 5.

Table 5
Switzerland imports from the least developed countries, 2017, by least developed country beneficiary

Country	Imports (thousands of dollars)				Utilization rate (percentage)	Country	Imports (thousands of dollars)				Utilization rate (percentage)
	Dutiable	Eligible	Entering under				Dutiable	Eligible	Entering under		
			LDC GSP	MFN					LDC GSP	MFN	
Afghanistan	2 234	2 234	7	2 227	0	Madagascar	31 666	31 666	4 939	26 727	16
Angola	13	13	0	13	0	Malawi	9	9	0	9	0
Bangladesh	504 850	504 850	185 833	319 017	37	Mali	537	526	31	495	6
Benin	380	380	214	166	56	Mauritania	329	329	0	329	0
Burkina Faso	1 016	1 016	11	1 005	1	Mozambique	34 933	34 933	19 580	15 353	56
Cambodia	158 521	158 521	51 155	107 366	32	Myanmar	67 103	67 103	14 000	53 104	21
Central African Republic	88	88	0	88	0	Nepal	8 075	8 075	3 428	4 647	42
Chad	10	10	0	10	0	Niger	216	113	14	98	13
Comoros	991	991	0	991	0	Rwanda	5	4	2	2	41
Democratic Republic of the Congo	377	377	243	134	64	Senegal	10 813	10 813	7 337	3 477	68
Djibouti	6	6	3	3	45	Sierra Leone	345	345	0	345	0
Eritrea	2	2	0	2	0	Solomon Islands	20 236	20 236	15 587	4 649	77
Ethiopia	3 945	3 551	1 057	2 495	30	Somalia	35	35	0	35	0
Gambia	14	14	0	14	0	Sudan	3 941	3 941	3 940	1	100
Guinea	156	156	19	137	12	United Republic of Tanzania	50 574	49 024	16 576	32 448	34
Haiti	5 510	5 510	1	5 508	0	Togo	375	372	279	92	75
Lao People's Democratic Republic	8 389	8 389	514	7 876	6	Uganda	4 640	4 611	4 128	483	90
Liberia	430	430	14	416	3	Zambia	8 073	7 978	18	7 960	0

Notes: Dutiable means trade flows that are subject to positive MFN rates. Trade flows that are MFN free are not accounted for since it would be equivalent to calculating empty preferences. Eligible means products that are covered by the preferential schemes and that are potentially eligible for a preferential duty rate.

Source: TAO database, 1 May 2019.

Preliminary findings linking Switzerland utilization rates to RoO:

(a) Switzerland utilization rates for garments and clothing imports under Harmonized System chapter 61 and chapter 62 ranging between 0 and 49 per cent (Table 4) are much lower than those observed in the European Union, which amount to 95 per cent on average.[69] Given that European Union and Switzerland RoO for garments under chapter 61 and chapter 62 are

[69] Utilization rates under chapter 61 and chapter 62 of the Harmonized System (2017): 97 per cent for Bangladesh; 96 per cent and 97 per cent for Cambodia; 91 per cent and 95 per cent for Myanmar.

identical, it is necessary to clarify the reasons for such lower utilization rates in the Swiss market;

(b) Pearls and precious stones under chapter 71 of the Harmonized System are primary products that should normally be considered as originating since they are mostly wholly obtained in LDCs;

(c) One possible explanation of such low utilization may be linked to the fact that Switzerland is a landlocked country near large distribution networks and hubs. Therefore, low utilization may be due to certification and direct shipment requirements and related documentary evidence rather than the substantive RoO requirements (substantial transformation). Another explanation could also be the relatively low MFN-specific duty.

I.6.3.2. China utilization rates[70]

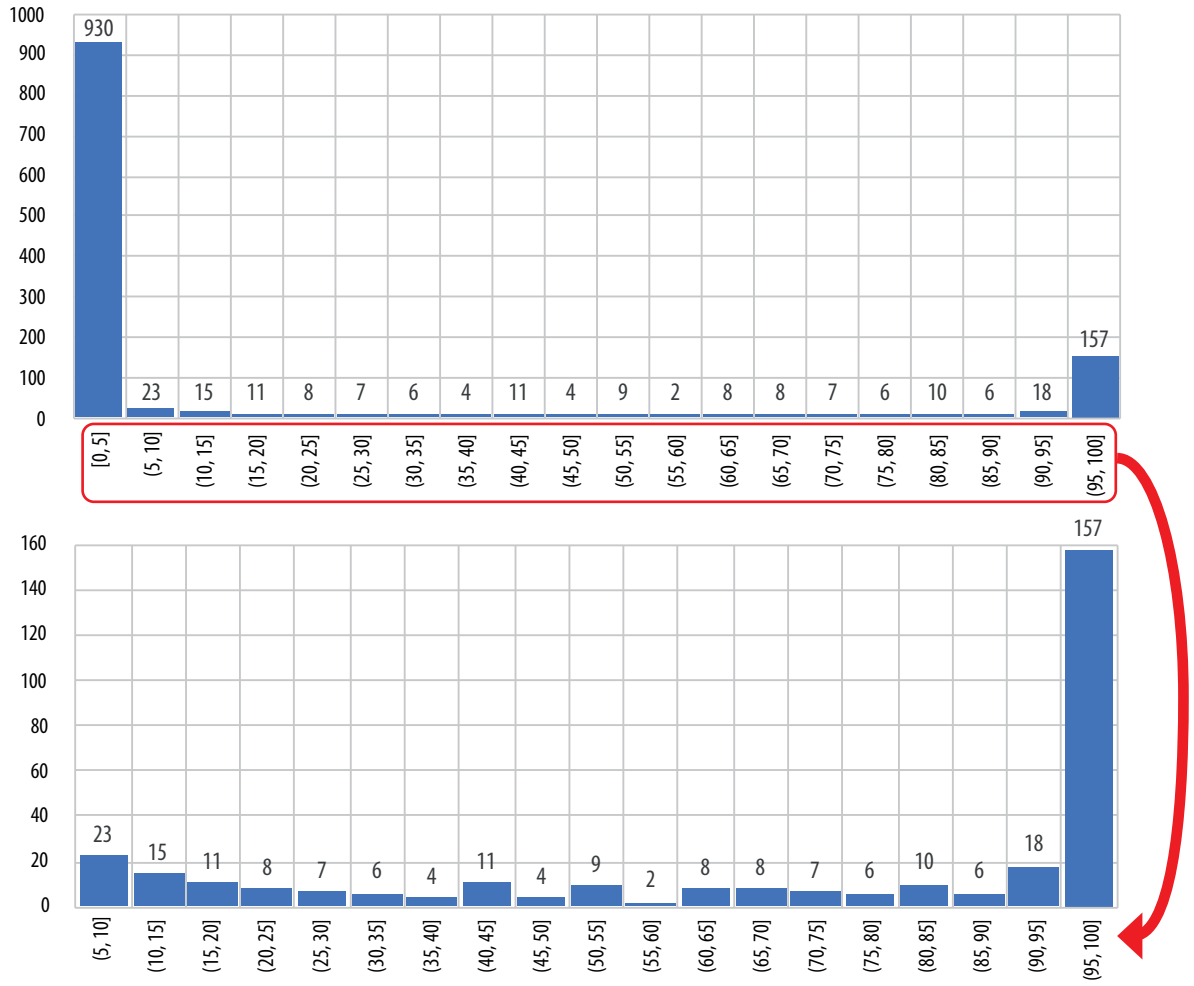
This subsection details the first attempt to analyse the recently released China utilization rates data for 2016.

Figure 1 shows the full distribution of tariff lines over the utilization rates with covered imports from LDCs above $10,000.[71] China utilization rates appear to be relatively polarized around 0 and, to a significantly lower extent, around 100 per cent. More specifically, in 2016, 70 per cent (880 out of 1250) of the tariff lines were reported to have a utilization rate of zero. This percentage remains unchanged (69 per cent) when considering preference margins above 5 per cent. This proportion increases to 74.4 per cent when considering utilization rates between 0 and 5 per cent (930 out of 1250). In contrast, 157 tariff lines (12.5 per

Figure 1

Distribution of tariff lines over utilization rate values

(Imports from the least developed countries> USD10,000)



Source: Authors' calculation based on data extracted from the WTO-Tariff Analysis Online Facility

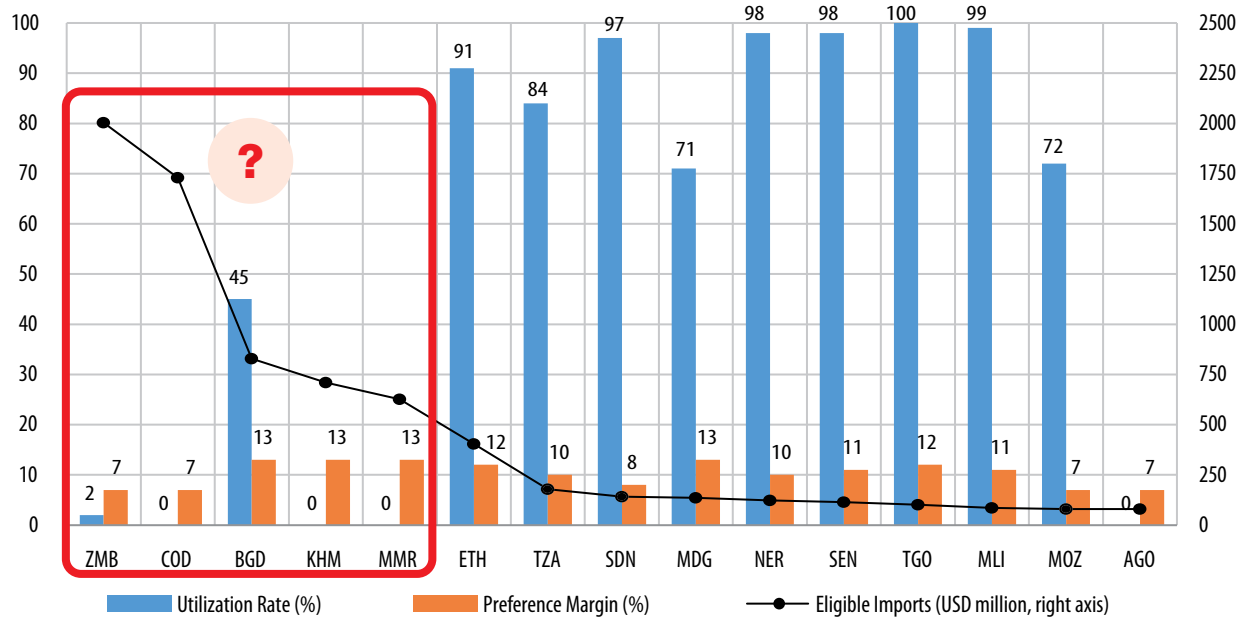
[70] See Crivelli and Inama, 2019, Selected issues on RoO for least developed countries: (1) Direct consignment rule (2) China utilization rates of trade preferences, paper presented at the WTO retreat in Switzerland, October 2019.

[71] Covered imports by the preferential scheme referred to as "eligible" in the TAO database.

cent of tariff lines) have a utilization rate of between 95 and 100 per cent. This frequency of high utilization rate is greater than those of intermediate values of utilization rates between 5 and 95 per cent, with a frequency ranging between 2 and 23 tariff lines (see lower part of Figure I.1). However, it is still far from the 74 per cent (930 tariff line) at the lower level of the utilization rate distribution, with utilization rates of between 0 and 5 per cent. Therefore, polarization exists and is heavily biased towards zero.

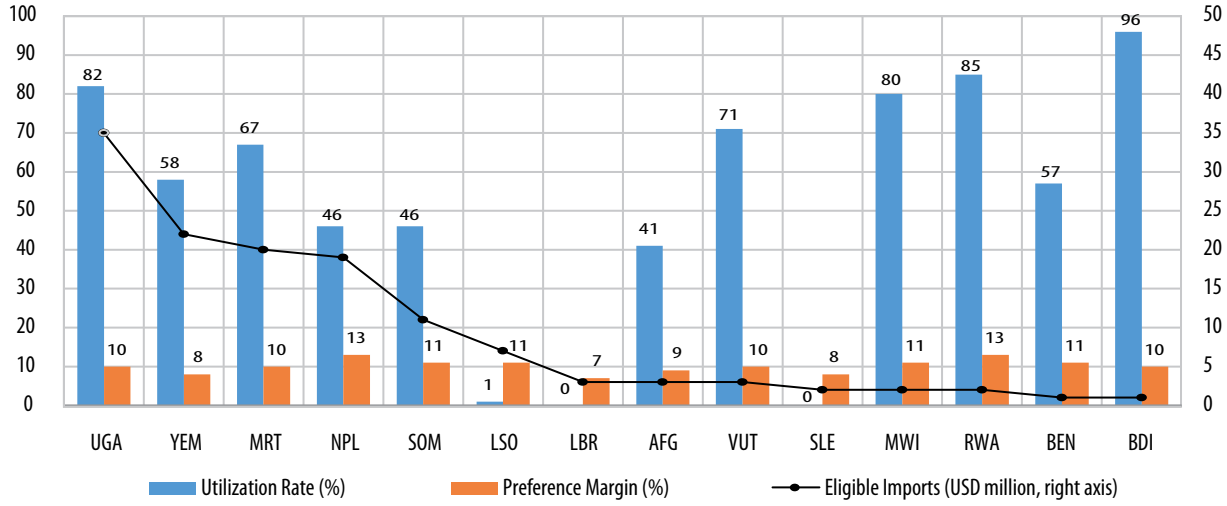
Strong variations of utilization rates are observed between LDCs. Figure 2 depicts utilization rates and imports from LDCs covered by preferential treatment with a value of above $50 million. While some LDCs exhibit high utilization rates (right part of the graph except Madagascar and Mozambique with mitigated results and Angola with a utilization rate of zero), it may be observed that the five greatest LDC exporters to China (with trade values of between $626 million and $2 billion) all face difficulties in benefiting from

Figure 2
China utilization rates, preference margins and eligible imports from the least developed countries (Covered imports> USD 50 million)



Source: Authors' calculation based on data extracted from the WTO-Tariff Analysis Online Facility

Figure 3
China utilization rates, preference margins and eligible imports from the least developed countries ($1 million<covered imports<= USD 50 million)



Source: Authors' calculation based on data extracted from the WTO-Tariff Analysis Online Facility. Country codes following International Organization for Standardization (ISO) 3166-1 alpha-3 standards.

DFQF preferential treatment. Indeed, three of these five LDCs, namely Democratic Republic of Congo, Cambodia, and Myanmar, all report a utilization rate of zero, while Zambia reports low utilization rate of 2 per cent.. Bangladesh, the third greatest exporter to China in terms of covered imports, only reaches 45 per cent. For the remaining LDCs with lower export values to China shown in Figure 3, the variation of utilization rates is even more important. A more disaggregated analysis is therefore needed to better understand the causes of such variations of utilization among LDCs and the reasons for the low utilization of the large exporters indicated in the table that in the case of some LDCs relates to minerals that are in general wholly obtained products.

Table 6 shows the value of imports to China from LDC beneficiary countries, for tariff lines where the utilization rate, defined as the value of imports entering under the LDC GSP divided by the value of imports covered by preferential treatment, is below 70 per cent. Observations are sorted in descending order of import value under MFN while covered by preferential treatment. All import values in Table 6 are dutiable.

Table 6
China imports from the least developed countries, 2016, by tariff line
(Utilization rate<70 per cent, sorted in descending value of imports entering under MFN (>$15 million), preference margin>2)

Country	Tariff line	Product description	Imports (thousands of dollars)				Utilization rate (percentage)	Preference margin (percentage)
			Dutiable	Covered	Entering under			
					LDC GSP	MFN		
Democratic Republic of the Congo	81052010	Cobalt mattes and other intermediate products of cobalt metallurgy; unwrought; powders	703 700	703 700	0	703 700	0.0	4
Cambodia	43021100	Tanned or dressed fur skins, unassembled – of mink	141 431	141 430	0	141 30	0.0	12
Cambodia	90139020	Liquid crystal devices; parts and accessories	108 990	108 990	0	108 990	0.0	8
Myanmar	71162000	Articles of precious or semi-precious stones (natural, synthetic or reconstructed)	73 111	73 111	0	73 111	0.0	35
Bangladesh	62034290	Men's or boys' suits, ensembles, jackets, blazers, trousers,	95 739	95 739	40 268	55 471	42.1	16
Democratic Republic of the Congo	81052090	Cobalt mattes and other intermediate products of cobalt metallurgy; unwrought; powders	51 343	51 343	0	51 343	0.0	4
Cambodia	35051000	Dextrins and other modified starches	50 770	50 770	0	50 770	0.0	12
Angola	27111200	Propane	50 671	50 671	0	50 671	0.0	5
Bangladesh	61091000	T-shirts, singlets and other vests, KoC – of cotton	78 065	78 065	31 917	46 147	40.9	14
Bangladesh	62046200	Women's or girls' suits, ensembles, jackets, blazers, dresses, skirts, divided skirts, trousers, – of cotton	43 999	43 999	6 122	37 878	13.9	16
Myanmar	12129300	Sugar cane	37 718	37 718	0	37 718	0.0	20
Cambodia	61091000	T-shirts, singlets and other vests, KoC – of cotton	25 519	25 519	0	25 519	0.0	14
Bangladesh	61102000	Jerseys, pullovers, cardigans, waistcoats and similar articles, KoC – of cotton	27 803	27 803	2 846	24 957	10.2	14
Myanmar	71031000	Precious stones (other than diamonds) and semi-precious stones unworked or simply sawn or roughly shaped	22 175	22 175	0	22 175	0.0	3
Cambodia	61112000	Babies' garments and clothing accessories, KoC – of cotton	21 856	21 856	0	21 856	0.0	14
Bangladesh	61103000	Jerseys, pullovers, cardigans, waistcoats and similar articles, KoC, MMF	26 110	26 110	5 403	20 707	20.7	16
Cambodia	61103000	Jerseys, pullovers, cardigans, waistcoats and similar articles, KoC, MMF	20 275	20 275	33	20 242	0.2	16
Cambodia	61102000	Jerseys, pullovers, cardigans, waistcoats and similar articles, KoC – of cotton	19 852	19 852	0	19 852	0.0	14
Bangladesh	62052000	Men's or boys' shirts – of cotton	35 019	35 019	15 251	19 768	43.6	16
Myanmar	71039910	Precious stones (other than diamonds) and semi-precious stones – other	19 767	19 767	0	19 767	0.0	8
Myanmar	90019090	Optical fibres and optical fibre bundles; optical fibre cables other than those under heading 85.44; other	18 163	18 163	0	18 163	0.0	8
Cambodia	85044014	Static converters	17 372	17 372	0	17 372	0.0	7
Cambodia	85011099	Motors of an output not exceeding 37.5W	16 859	16 859	0	16 859	0.0	9

Abbreviations: KoC, knitted or crocheted; MMF, human-made fibres.

Notes: Dutiable means trade flows that are subject to positive MFN rates. Trade flows that are MFN free are not accounted for since it would be equivalent to calculating empty preferences. Covered means products that are covered by the preferential schemes and that are potentially eligible for a preferential duty rate.

Source: TAO database, 1 October 2019.

Three main observations can be made from the information in Table 6:

(a) Given the low or zero utilization rates, a significant amount of imports from LDCs is entering China under a high MFN rate. As an illustration, with a preferential margin of 35 per cent, the $73 million in imports of precious and semi-precious stones from Myanmar (tariff line 71162000) could generate savings of $26 million through use of the preference;

(b) For the Democratic Republic of the Congo, despite the lower preferential margin (4 per cent), the use of the preferential treatment could also trigger substantial duty savings given the extensive amount of trade. Combining the two tariff lines for cobalt (81052010 and 81052090), the duty savings can be estimated as $30.2 million (4 per cent of $755 million);

(c) Low utilization rates in the case of China DFQF are not confined to a specific type of product but apply to a wide range of tariff lines, from raw materials, natural products, and agricultural products (see sugar cane) to garments and other industrial products (motors, static converters, etc).

Table 6 shows values of trade above $15 million from LDC beneficiary countries. However, other tariff line and country pairs are affected by low utilization rates, as shown in Table 7. The table provides an initial overview for each LDC by showing the tariff lines with the highest value of covered imports and a utilization rate of below 70 per cent. For example, Somalia exported $4.7 million of fish and crustaceans under chapter 3 of the Harmonized System to China but did not receive preferential treatment and therefore paid $560,000 in MFN duties. In Zambia, almost $2 billion of copper under chapter 74 of the Harmonized System were exported to China in 2016. While the tariff line did not appear in the previous table due to the filtering (preference margin>2 per cent), the duty savings that could be generated by a full use of preferential treatment amount to more than $35 million. It can therefore clearly be seen that a low preferential margin does not necessarily imply a low level of incentives to make use of preferential treatment.

Table 7

China imports from the least developed countries, 2016, by least developed country beneficiary

(First two Harmonized System sectors by country with utilization rate<70, in descending order of covered imports)

Country	Chapter	Description	Imports (thousands of dollars)				Utilization rate	Preference margin
			Dutiable	Covered	GSP LDC	MFN		
Afghanistan	51	Wool, fine/coarse animal hair; horsehair yarn and woven fabric	969	969	0	969	0.0	9.0
	12	Oil seeds and oleaginous fruits; miscellaneous grains, seeds and fruit; industrial or medicinal plants	251	251	0	251	0.0	6.0
Angola	27	Mineral fuels, mineral oils and products of their distillation; bituminous substances; mineral waxes	13 900 000	60 719	0	60 719	0.0	5.0
	25	Salt; sulfur; earths, stone; plastering materials, lime, cement	13 778	13 778	0	13 778	0.0	3.5
Bangladesh	62	Articles of apparel and clothing accessories, not KoC	266 713	265 782	71 980	193 802	27.1	15.9
	61	Articles of apparel and clothing accessories, KoC	203 225	202 692	49 578	153 114	24.5	15.7
Benin	14	Vegetable plaiting materials; vegetable products not elsewhere specified or included	1 230	1 230	821	409	66.7	4.0
	52	Cotton	14 653	186	0	186	0.0	10.0
Burundi	25	Salt; sulfur; earths, stone; plastering materials, lime, cement	2	2	0	2	0.0	3.0
Cambodia	61	Articles of apparel and clothing accessories, KoC	171 210	171 210	33	171 177	0.0	15.9
	43	Fur skins and artificial fur; manufactures thereof	145 648	145 648	0	145 648	0.0	14.0
Central African Republic	5	Products of animal origin, not elsewhere specified or included	114	114	0	114	0.0	10.0
	85	Electrical machinery and equipment and parts thereof; sound recorders and reproducers, television image and sound recorders and reproducers, parts and accessories of such articles	46	45	0	45	0.0	12.0
Chad	13	Lac; gums, resins and other vegetable saps and extracts	75	75	0	75	0.0	15.0
	25	Salt; sulfur; earths, stone; plastering materials, lime, cement	59	59	0	59	0.0	3.3
Comoros	33	Essential oils and resinoids; perfumery, cosmetic or toilet preparations	13	13	0	13	0.0	15.0
Democratic Republic of the Congo	74	Copper and articles thereof	971 358	971 358	0	971 358	0.0	2.0
	81	Other base metals; cermets; articles thereof	755 395	755 395	0	755 395	0.0	4.0
Djibouti	12	Oil seeds and oleaginous fruits; miscellaneous grains, seeds and fruit; industrial or medicinal plants; straw and fodder	18	18	0	18	0.0	10.0
	71	Natural or cultured pearls, precious or semi-precious stones, precious metals, metals clad with precious metal, and articles thereof; imitation jewellery; coin	12	12	0	12	0.0	3.0
Eritrea	25	Salt; sulfur; earths, stone; plastering materials, lime, cement	3	3	0	3	0.0	3.0
	62	Articles of apparel and clothing accessories, not KoC	1	1	0	1	0.0	16.0

Country	Chapter	Description	Imports (thousands of dollars)				Utilization rate	Preference margin
			Dutiable	Covered	GSP LDC	MFN		
Ethiopia	41	Raw hides and skins (other than fur skins) and leather	44 057	43 943	27 853	16 090	63.4	9.4
	9	Coffee, tea, mate and spices	7 356	7 356	4 759	2 598	64.7	12.7
Guinea	3	Fish and crustaceans, molluscs and other aquatic invertebrates	46	46	0	46	0.0	10.0
	92	Musical instruments; parts and accessories of such articles	22	22	0	22	0.0	17.0
Guinea-Bissau	61	Articles of apparel and clothing accessories, KoC	1	1	0	1	0.0	16.0
Lesotho	85	Electrical machinery and equipment and parts thereof; sound recorders and reproducers, television image and sound recorders and reproducers, parts and accessories of such articles	6 275	6 217	0	6 217	0.0	9.0
	52	Cotton	702	702	99	603	14.1	10.0
Liberia	74	Copper and articles thereof	2 911	2 911	0	2 911	0.0	1.0
	89	Ships, boats and floating structures	427	427	0	427	0.0	3.0
Madagascar	71	Natural or cultured pearls, precious or semi-precious stones, precious metals, metals clad with precious metal, and articles thereof; imitation jewellery; coin	8 154	8 154	52	8 102	0.6	15.0
	29	Organic chemicals	5 554	5 554	0	5 554	0.0	6.0
Malawi	9	Coffee, tea, mate and spices	718	718	296	422	41.2	11.5
	25	Salt; sulfur; earths, stone; plastering materials, lime, cement	9	9	0	9	0.0	3.0
Mali	8	Edible fruit and nuts; peel of citrus fruit or melons	73	73	0	73	0.0	20.0
	1	Live animals	40	30	0	30	0.0	10.0
Mauritania	3	Fish and crustaceans, molluscs and other aquatic invertebrates	8 938	8 938	4 539	4 399	50.8	11.8
	25	Salt; sulfur; earths, stone; plastering materials, lime, cement	20	20	0	20	0.0	3.0
Mozambique	72	Iron and steel	12 774	12 774	0	12 774	0.0	2.0
	74	Copper and articles thereof	4 597	4 597	0	4 597	0.0	2.0
Myanmar	74	Copper and articles thereof	130 227	130 227	0	130 227	0.0	4.5
	72	Iron and steel	127 610	127 610	0	127 610	0.0	2.0
Nepal	90	Optical, photographic, cinematographic, measuring, checking, precision, medical or surgical instruments	3 675	3 675	0	3 675	0.0	5.5
	83	Miscellaneous articles of base metal	5 686	5 686	2 983	2 702	52.5	12.0
Niger	71	Natural or cultured pearls, precious or semi-precious stones, precious metals, metals clad with precious metal, and articles thereof; imitation jewellery; coin	621	621	0	621	0.0	27.5
	40	Rubber and articles thereof	31	31	0	31	0.0	15.0
Rwanda	9	Coffee, tea, mate and spices	240	240	59	181	24.5	12.7
	12	Oil seeds and oleaginous fruits; miscellaneous grains, seeds and fruit; industrial or medicinal plants; straw and fodder	52	52	0	52	0.0	30.0
Senegal	41	Raw hides and skins (other than fur skins) and leather	86	86	0	86	0.0	14.0
	39	Plastics and articles thereof	47	47	0	47	0.0	8.0
Sierra Leone	71	Natural or cultured pearls, precious or semi-precious stones, precious metals, metals clad with precious metal, and articles thereof; imitation jewellery; coin	1 903	1 903	0	1 903	0.0	3.0
	85	Electrical machinery and equipment and parts thereof; sound recorders and reproducers, television image and sound recorders and reproducers, parts and accessories of such articles	190	117	0	117	0.0	8.6
Somalia	3	Fish and crustaceans, molluscs and other aquatic invertebrates	4 705	4 705	0	4 705	0.0	12.0
	41	Raw hides and skins (other than fur skins) and leather	994	994	64	930	6.5	14.0
Sudan	13	Lac; gums, resins and other vegetable saps and extracts	933	933	586	347	62.8	9.0
	74	Copper and articles thereof	142	142	0	142	0.0	1.0
United Republic of Tanzania	74	Copper and articles thereof	12 173	12 173	0	12 173	0.0	1.8
	53	Other vegetable textile fibres; paper yarn and woven fabrics of paper yarn	17 610	17 610	11 831	5 780	67.2	5.0
Timor-Leste	9	Coffee, tea, mate and spices	94	94	0	94	0.0	8.0
	14	Vegetable plaiting materials; vegetable products not elsewhere specified or included	20	20	0	20	0.0	15.0
Togo	25	Salt; sulfur; earths, stone; plastering materials, lime, cement	4	4	0	4	0.0	3.0
	83	Miscellaneous articles of base metal	3	3	0	3	0.0	8.0
Uganda	41	Raw hides and skins (other than fur skins) and leather	18 073	18 073	12 206	5 867	67.5	11.5
	5	Products of animal origin, not elsewhere specified or included	302	302	36	266	11.9	10.0
Vanuatu	12	Oil seeds and oleaginous fruits; miscellaneous grains, seeds and fruit; industrial or medicinal plant	172	172	0	172	0.0	8.0
	5	Products of animal origin, not elsewhere specified or included	99	99	0	99	0.0	12.0
Yemen	74	Copper and articles thereof	8 559	8 559	0	8 559	0.0	1.0
	3	Fish and crustaceans, molluscs and other aquatic invertebrates	426	426	0	426	0.0	10.0
Zambia	74	Copper and articles thereof	1 958 895	1 958 895	0	1 958 895	0.0	1.8
	25	Salt; sulfur; earths, stone; plastering materials, lime, cement	459	459	0	459	0.0	4.0

Abbreviations: KoC, knitted or crocheted; MMF, human-made fibres.

Notes: Dutiable means trade flows that are subject to positive MFN rates. Trade flows that are MFN free are not accounted for since it would be equivalent to calculating empty preferences. Covered means products that are covered by the preferential schemes and that are potentially eligible for a preferential duty rate.

Source: TAO database, 1 October 2019.

Finally, Table 8 shows for each country the number of tariff lines for different levels of utilization rates: zero; between 0 and 50 per cent; between 50 and 70 per cent; and above 70 per cent. It may be noted that observations to the right of the table are recorded for only 25 LDCs, as these are the countries that have exported selected products making use of the preference in at least half of the cases (tariff lines with utilization rates of above 50 per cent).

Table 8
Number of tariff lines and trade values over utilization rate categories

Country	Utilization rate=0			0<Utilization rate<50			50<Utilization rate<70			Utilization rate>70		
	Number of tariff lines	Covered	Preference margin	Number of tariff lines	Covered	Preference margin	Number of tariff lines	Covered	Preference margin	Number of tariff lines	Covered	Preference margin
Zambia	46	1 663 314	30	1	222	3	—	—	—	4	39 934	7
Democratic Republic of the Congo	32	703 700	20	—	—	—	—	—	—	—	—	—
Cambodia	480	141 430	45	1	20 275	16	—	—	—	—	—	—
Myanmar	352	130 227	35	5	5 875	15	—	—	—	—	—	—
Angola	20	50 671	35	—	—	—	—	—	—	—	—	—
Mozambique	37	12 774	14	—	—	—	—	—	—	11	37 700	16
Bangladesh	254	8 831	25	92	95 739	20	3	10 320	17	45	69 734	35
Lesotho	16	6 190	17	—	—	—	—	—	—	1	99	10
Madagascar	167	5 552	35	14	5 047	17	4	4 172	17	19	81 827	15
Yemen	20	5 234	35	1	342	3	—	—	—	3	12 200	6
United Republic of Tanzania	66	5 040	45	2	330	10	4	17 610	15	18	113 772	35
Somalia	14	4 705	35	1	962	14	—	—	—	1	4 931	10
Mauritania	9	4 166	17	—	—	—	—	—	—	13	10 529	15
Nepal	131	3 672	35	48	291	24	11	5 628	20	109	1 468	35
Liberia	11	2 911	20	—	—	—	—	—	—	—	—	—
Sierra Leone	66	1 903	16	—	—	—	—	—	—	—	—	—
Niger	26	615	35	—	—	—	—	—	—	1	121 619	10
Ethiopia	84	384	25	1	1 650	5	5	19 061	14	23	324 283	24
Afghanistan	43	365	20	—	—	—	—	—	—	1	1 739	6
Sudan	31	201	17	2	422	10	1	109	14	12	120 465	15
Benin	9	186	20	—	—	—	1	1 230	4	1	17	20
Rwanda	14	181	35	—	—	—	—	—	—	7	1 114	17
Vanuatu	4	172	15	1	1 000	12	—	—	—	1	2 109	10
Central African Republic	7	114	30	—	—	—	—	—	—	—	—	—
Timor-Leste	15	94	24	—	—	—	—	—	—	1	104	30
Senegal	38	86	30	1	1 401	17	—	—	—	19	97 104	15
Chad	14	75	30	—	—	—	—	—	—	—	—	—
Mali	26	73	30	—	—	—	—	—	—	4	84 364	15
Uganda	48	62	20	2	298	20	3	3 986	14	9	12 816	15
Guinea	22	46	24	—	—	—	—	—	—	—	—	—
Djibouti	12	18	16	—	—	—	—	—	—	1	89	14
Comoros	1	13	15	—	—	—	—	—	—	—	—	—
Malawi	9	9	20	1	717	15	—	—	—	3	1 068	15
Togo	6	4	24	—	—	—	—	—	—	4	92 417	20
Burundi	1	2	3	—	—	—	—	—	—	3	1 070	15
Eritrea	4	2	16	—	—	—	—	—	—	—	—	—
Guinea-Bissau	1	1	16	—	—	—	—	—	—	—	—	—

Source: TAO database, 1 October 2019.

This preliminary analysis of the utilization rate of China DFQF shows that there are significant figure of a low or zero utilization rate for significant exports from LDCs. In addition, high variations of utilization rates are observed and pockets of low utilization should be further studied. Both submissions of the LDC group on the utilization rates of China and Switzerland led to debate at CRO and exchanges and bilateral discussions with the delegations from China and Switzerland to identify the reasons for such low utilization. Constructive dialogue is possible, to make progress, even if it is too early to say whether such dialogue will be followed by constructive reforms of RoO of preference-giving countries.

Subsequent to the presentation made by the LDCs of the present document at the CRO meeting of October 2019 the Chinese delegation made statements and presented further evidence related the utilization rates presented in the tables presented by the LDCs to complement the information presented. As such information has yet to be published or made available it is not possible to further discuss it.

II. UTILIZATION RATES AS KEY INSTRUMENT TO MEASURE EFFECTIVENESS OF RULES OF ORIGIN AND DUTY-FREE, QUOTA-FREE SCHEMES FOR THE LEAST DEVELOPED COUNTRIES[72]

II.1. Impact of broad reform of rules of origin: Evidence from the utilization rates of Canada and the European Union

As discussed in subsection I.3, the LDC paper presented at CRO in October 2014 represented a milestone in the advocacy of better RoO for LDCs. The paper stated that the world economy had changed since the 1970s. Yet among the Quad group, only Canada and the European Union substantially reformed RoO for LDCs. Other preference-giving countries are still adopting RoO conceived decades ago.

Canada and the European Union have to date been the only preference-giving country and group that have conducted a unilateral reform of RoO for LDCs that has triggered dramatic increases in the utilization rates of existing preferences and, most importantly, generated an overall increase of trade flows due to new investment and manufacturing operations located in LDCs. Other preference-giving countries have yet to do so, while a number of developing countries have introduced DFQF schemes containing RoO that need to be assessed in the light of the utilization rates that have recently begun to be notified to the WTO secretariat following the Nairobi Decision.[73]

This section builds on the results achieved by Canada and the European Union to show that a change in RoO reflecting global value chains generates a market response in terms of FDI and trade flows. Obviously, RoO do not operate in a vacuum and a number of other factors concur in the determination of such trade effects. Yet the response has been unequivocal and concrete evidence has been obtained from companies that decided to shift production to LDCs because of a change in RoO. At the CRO meeting on 30 October 2014, the LDC paper was presented by Uganda on behalf of the LDC group.[74]

The utilization rate is a clear indicator of the effectiveness of trade preferences used by UNCTAD since the inception of the GSP in the late 1970s and subsequently adopted at WTO following the Nairobi Decision, as discussed in section I.4. Such an indicator is the ratio of the amount of imports that actually received trade preferences at the time of customs clearance in the preference-giving country with regard to the amount of dutiable imports eligible for preferences:

$$\text{Utilization rate (percentage)} = \frac{\text{(Value of dutiable imports covered by preferential arrangement)}}{\text{(Value of dutiable imports being granted preferential duty rates)} \times 100} \times 100$$

Higher or lower utilization rates are mainly the result of the stringency and/or complexity of RoO and ancillary requirements, as further developed below.

Figure 4 and Figure 5 show how changes in RoO for textiles and clothing under the European Union EBA introduced in 2011 and the GSP of Canada in 2003 positively affected the utilization rate and LDC export flows. For Canada, Figure 4 shows that the introduction of special rules for textiles and clothing made the utilization rate immediately reach 100 per cent in 2003 for products under chapter 61 and chapter 62 of the Harmonized System. In addition, import values increased significantly. The total import values of woven garments under chapter 62 of the Harmonized System multiplied by 4.6, from $36 million to $167 million. The increase was even more significant for knitted or crocheted garments under chapter 61 of the Harmonized System, since import values multiplied by almost seven, from $18 million to $125 million. Import values under both chapters continued to grow steadily since 2003.

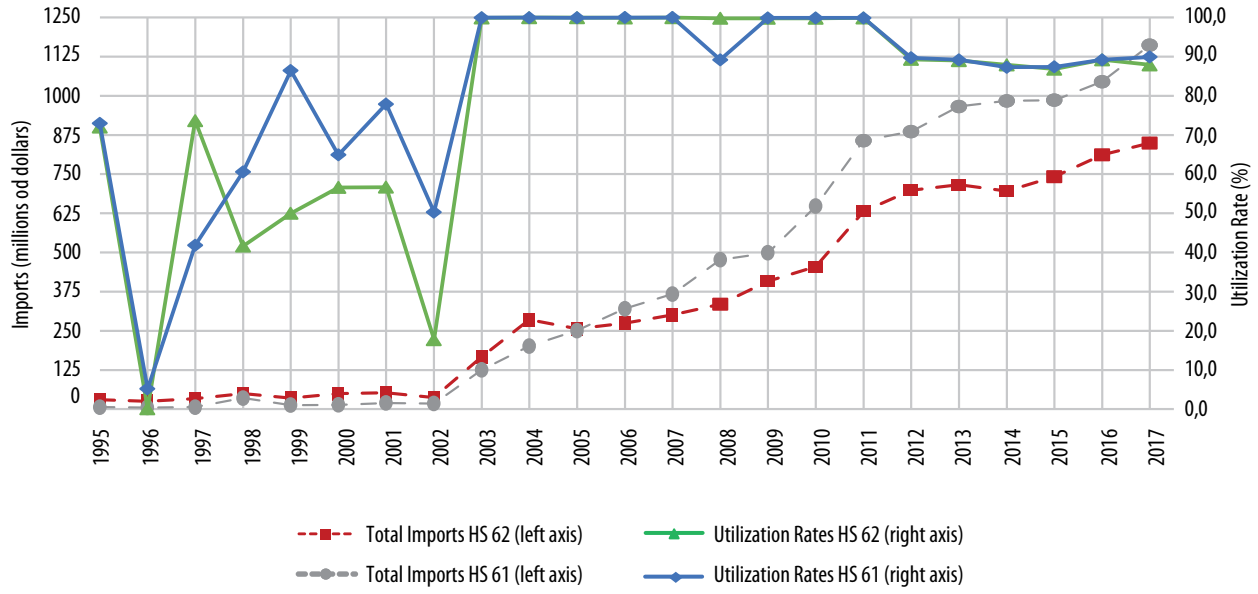
A similar development occurred after the reform of RoO in the garment sector under EBA. As shown in Figure 5, as in the case of Canada, both utilization rates and import values for garments (chapter 61 and chapter 62 of the Harmonized System) were positively affected. The impact is particularly striking under chapter 62 (not knitted or

[72] This subsection draws from and updates on the contribution made by UNCTAD to the LDC paper submitted by Uganda for G/RO/W/148 in October 2014.

[73] An analysis will be carried out by UNCTAD once a significant amount of data has been notified.

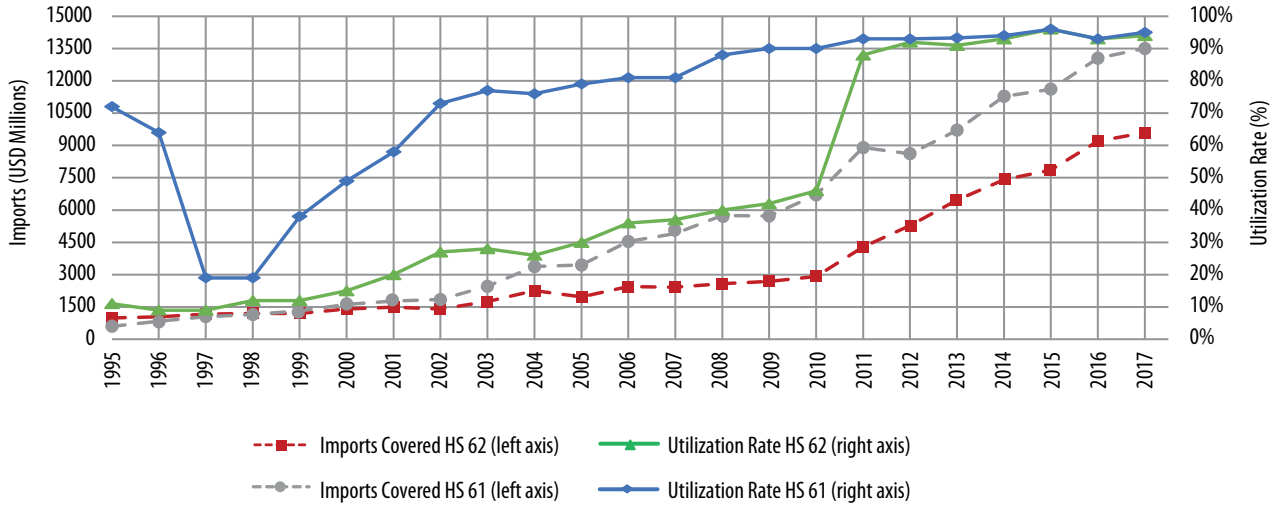
[74] G/RO/W187.

Figure 4
Canada imports from effective least developed countries and Generalized System of Preferences utilization rates



Source: Authors' calculation based on UNCTAD's GSP database.

Figure 5
European Union imports from effective least developed countries and Generalized System of Preferences utilization rates

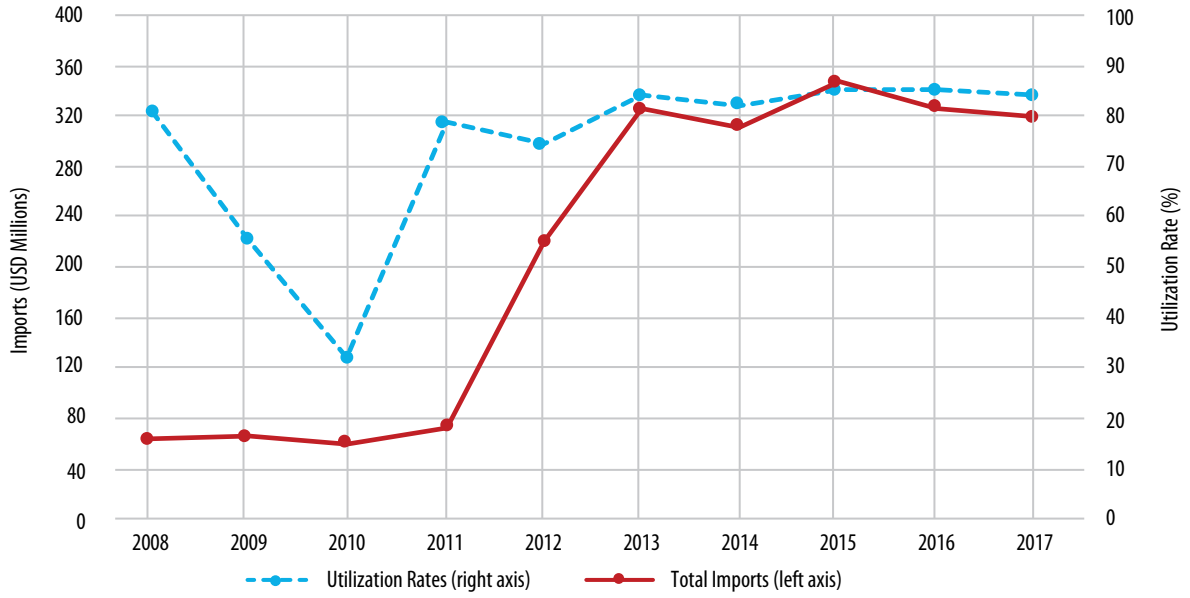


Source: Authors' calculation based on UNCTAD's GSP database.

crocheted garments), whereby the utilization rate by LDC exporters rose from 46 to 88 per cent between the end of 2010 and the end of 2011, the first year of entry into force of the European Union reform. Simultaneously, LDC exports to the European Union market under the same chapter rose from $2.9 billion to $4.3 billion (+47 per cent), and reached $6.5 billion in 2013 and continued to increase in the following years. The rise in utilization rates of knitted or crocheted garments (chapter 61) has been moderated, as the latter started from a much higher value than in the case of chapter 62.

The European Union reform in 2010 substantially liberalized RoO under EBA for almost the totality of sectors, allowing in certain cases up to 70 per cent of non-originating material and introducing a number of positive changes concerning cumulation and ancillary criteria. The European Union reform has demonstrated a capacity to trigger exports of non-traditional products, as shown in Figure 6 through the utilization rates of bicycles from Cambodia. Utilization rates of bicycles between 2010 and 2015 increased from 32 to 85 per cent and their export values multiplied by a factor

Figure 6
European Union imports from Cambodia and Generalized System of Preferences utilization rates: Bicycles

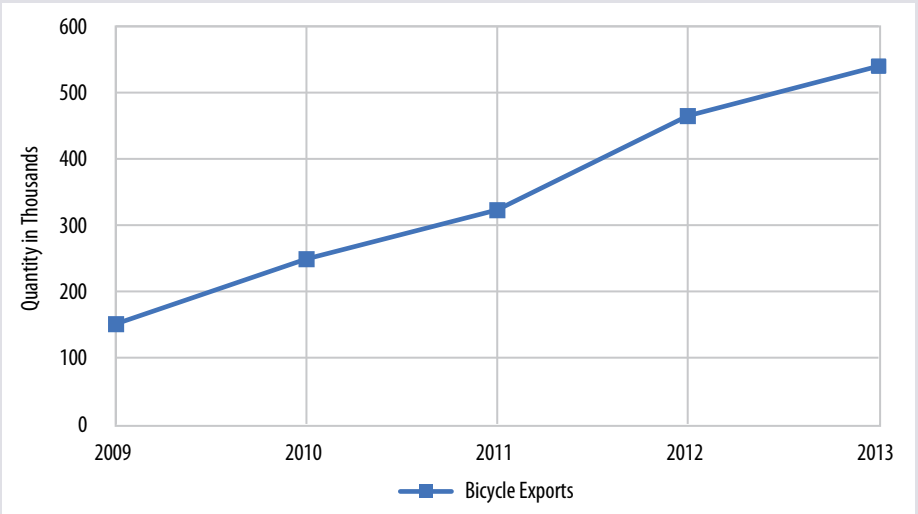


Source: Authors' calculation based on UNCTAD's GSP database.

Box 1
Cambodia: The A & J Company

A & J has been producing bicycles in Cambodia since 2006. The factory is located on 10 hectares of land and the investment is $16 USD million. The total workforce in Cambodia is around 2,000 people. Annual capacity is 720,000 bicycles and has been rising. Under the new European Union RoO, the sales of A and J have significantly increased, along with the unit value of each bicycle, and manufacturing operations in Cambodia. The reform of the European Union RoO has allowed the company to operate at a much higher market than in other LDCs. In turn, this has meant the need to develop special skills such as aluminium welding, including thin tube welding, lightweight wheel building and specialist painting, areas that customers would usually look for in Taiwan Province of China, which has been dominating this level of bicycle production. Cambodia is the only LDC producing mid-level to high-end bicycles and has the second highest average export price in Asia. The specialist welding, painting and finishing skills necessary to produce such technically advanced bicycles can currently only be found in Cambodia and Taiwan Province of China. At present, A and J is in the process of overcoming the difficulties arising from the graduation of Malaysia from the European Union GSP due to a derogation from the European Union allowing the transitional use of parts from Malaysia even if the country has graduated from the European Union GSP.

A and J Cambodia sales pattern



Source: AJ Company

of 5.8, rising from $60 million to $347 million.[75] As recorded in interviews with bicycle manufacturers during UNCTAD field missions, China and Taiwan Province of China moved manufacturing to Cambodia from other neighbouring countries such as Viet Nam, due to the combination of the preferential margin and the lenient RoO applicable after the reform.[76] This is a concrete demonstration of how changes in RoO have real effects on trade and business in LDCs (see box 1).

II.2. Comparison: Utilization rates and trade effects in Japan and the United States

This subsection examines the utilization rates and trade effects of the remaining two Quad countries that have not undertaken a major reform of RoO for LDCs.[77]

RoO under the United States GSP have been practically unchanged since 1974.[78] The AGOA RoO are practically similar to the GSP RoO with the notable exception of product-specific rules in the case of apparel where product-specific RoO apply for apparel.[79] The United States grants trade preferences for LDCs under different arrangements, as follows:

(a) GSP for LDCs;[80]

(b) AGOA for LDCs in Africa;

(c) HOPE initiative for Haiti.

Accordingly, the analysis of the utilization rate data is made following the main preference programme, with beneficiaries divided into two main groups, namely, LDCs, excluding AGOA beneficiaries that are granted GSP preferences; and AGOA LDC beneficiaries that are granted AGOA preferences.[81]

In addition to these multiple preferential trade arrangements, other factors must be taken into account when assessing the trade flows and utilization rates under the United States GSP, such as the exclusion or graduation of beneficiaries; and the exclusion from coverage under the United States GSP of textiles and garments that is the majority of export volume of the effective LDC beneficiaries under the United States GSP scheme. Figure 7 shows the evolution of imports from LDCs excluding AGOA beneficiaries between 2008 and 2017. In this period, the total imports from effective beneficiaries decreased from $10.7 billion to $4.7 billion. While the overall trend fluctuates, the greatest drop in total imports occurred from 2013 ($9.7 billion) to 2014, when only $4.2 billion in imports from LDCs excluding AGOA beneficiaries was recorded. This substantial decrease in total imports was mainly due to the graduation of Equatorial Guinea in 2011 from the United States GSP and, most recently, the exclusion of Bangladesh in 2013 from the United States GSP for not respecting worker rights according to United States GSP provisions. Over the same period, imports receiving GSP treatment also significantly declined, respectively, from $3 billion to $587 million.

The GSP utilization rate decreased from 84 per cent in 2008 to 65 per cent in 2015 and rose again to 83 per cent in 2017. Various events may account for such fluctuation. There was a significant decline from 2010 to 2011, when the utilization rate dropped by 42 percentage points, from 69 to 27 per cent, mainly due to the graduation of Equatorial Guinea from the

75 With regard to bicycles, it should be mentioned that following the changes introduced in the European Union GSP scheme in 2014, inputs from Malaysia and Singapore (mainly gears) could at first not be used by Cambodia for ASEAN cumulation purposes. Similar changes in the Canada GSP RoO raised concerns and caused significant difficulties for the majority of bicycle industries based in Cambodia. The Government of Cambodia requested a derogation to the European Commission to continue to consider the ASEAN inputs from Malaysia and Singapore to be eligible for cumulation for a transitional period. The request was finally granted with a quota on the amount of bicycles that can use cumulation (see Commission implementing regulation No. 822/2014 of 28 July 2014 on a derogation from Regulation (EEC) No. 2454/93 with regard to RoO under the scheme of generalized tariff preferences with regard to bicycles produced in Cambodia regarding the use under cumulation of bicycle parts originating in Malaysia and).

76 In Viet Nam, the European Union GSP provides for a tariff reduction of 3.5 per cent on an MFN tariff of 14 per cent, that is, bicycles originating in Viet Nam and exported to the European Union must pay 10.5 per cent duty while the same bicycles from Cambodia are granted duty free entry into the European Union under EBA. In addition, more favourable RoO apply for Cambodia, allowing more non-originating material content and eased cumulation.

77 This statement should not be construed as meaning there have not been any changes at all. For example, Japan recently relaxed RoO under chapter 61. However, neither Japan nor the United States has introduced a significant reform of RoO for LDCs drastically liberalizing such rules, as occurred in Canada and the European Union.

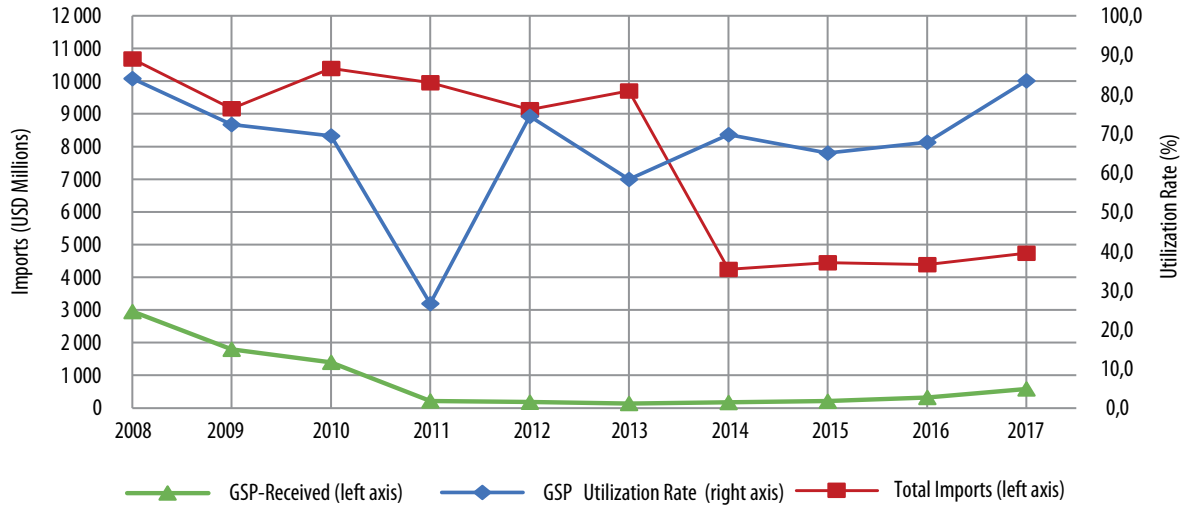
78 For further details, see the RoO Handbook on DFQF and RoO, part I, Quad countries, 2018.

79 With the caveat of the generous cumulation provisions provided under the Canada GSP scheme, which remains an isolated case of best practice in this area.

80 Special preferences were granted to Nepal following an earthquake (see https://www.federalregister.gov/documents/2016/12/20/2016-30738/to-implement-the-nepal-preference-program-and-for-other-purposes).

81 In May 2000, the United States promulgated the African Growth and Opportunity Act (AGOA), whereby the United States GSP scheme was amended in favour of designated sub-Saharan countries to expand the range of products, including textiles and clothing. Additional analysis should be carried out for Haiti in a forthcoming publication.

Figure 7
United States total imports from effective least developed countries excluding African Growth and Opportunity Act beneficiaries



Source: Authors' calculation based on UNCTAD's GSP database.

scheme and the expiry of the scheme on 31 December 2010. The United States GSP scheme was only retroactively renewed on 5 November 2011. Similarly, from 2012 to 2013, the utilization rate dropped from 74 to 58 per cent, reflecting the exclusion of Bangladesh in 2013 from the scheme for not respecting worker rights according to the United States GSP provisions. In 2013, similarly, the scheme expired in July, and was retroactively extended only in July 2015.[82]

Exclusion of a given beneficiary such as Bangladesh or Equatorial Guinea may not in itself have a direct influence on utilization rates. However, the fact that the trade values of GSP covered and received are minimal makes them dependent on the exclusion of beneficiaries such as Equatorial Guinea that mainly exported petroleum oils to the United States, a wholly obtained product that does not usually involve problems of compliance with RoO.

Recent research addressing the impact of GSP expiration on exports and utilization rates has found that the expiration of the United States GSP scheme had a significant impact on developing countries, with an average decline of 3 percent in exports for 2011. Although collected duties are refunded upon retroactive renewal of the GSP scheme, uncertainty prevails and the interim payable duties remain an obstacle for exporters in developing countries.[83] This trend was also confirmed over the period 1989–2012, when activity by the United States Congress on renewal periods and the expiration of GSP were associated with fluctuations of imports under the scheme.[84]

The most striking point emerging from Figure 7 above is that the value of imports receiving GSP under the GSP scheme are particularly low compared to total MFN dutiable imports. This reflects the poor coverage of the GSP scheme and, arguably, that existing RoO are not trade-creating. In the period 2011–2015, imports that received United States GSP treatment amounted to only $183.8 million based on yearly average, which corresponds to a utility rate of about 2.6 per cent, whereas the overall utilization rate was on average 59 per cent in the same period. Therefore, not only is the coverage low but also, the utilization rates point to RoO as a deterrent for new trade dynamics.

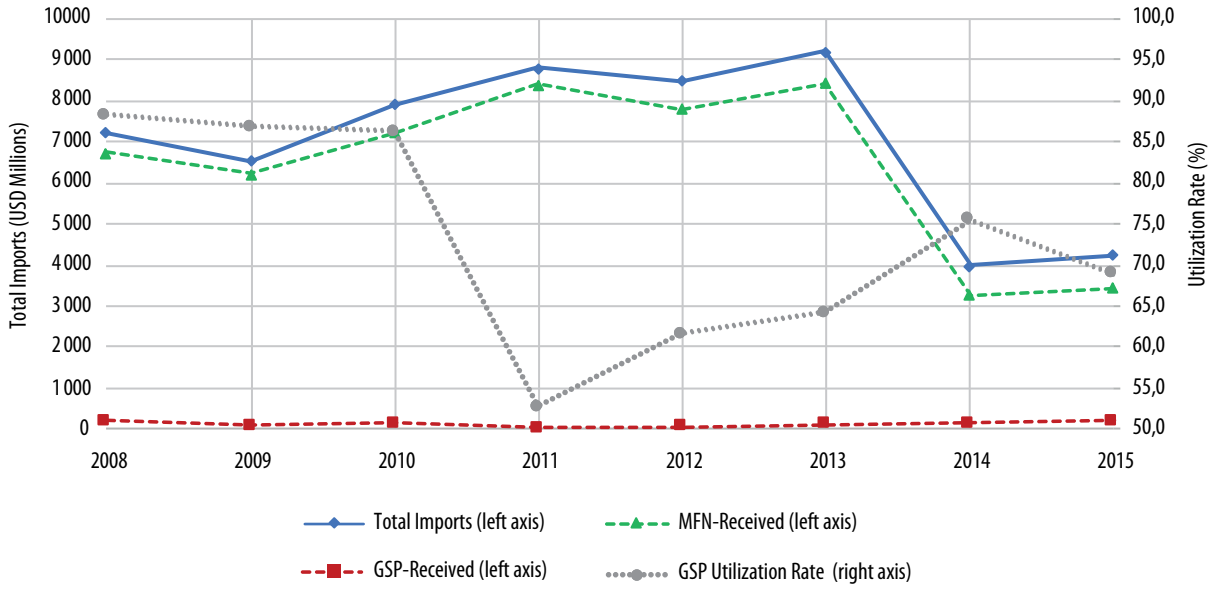
In Figure 8, excluding agricultural products and fuel from the analysis, the pattern is somewhat equivalent. Total imports from non-AGOA beneficiary LDCs first increased, from $7.2 billion in 2008 to $9.3 billion in 2013. In subsequent years, total imports dropped to $4 billion in 2014 and slightly recovered in 2015, to $4.2 billion, reflecting the exclusion of Bangladesh. In the period 2008–2015, the total amount of received GSP trade was about $1,064 billion, which equals a yearly average of $133 million. Over the period, a

82 For the legislative developments of the GSP scheme, see V Jones, GSP: Overview and issues for Congress, Congressional Research Service, 2017, available at https://fas.org/sgp/crs/misc/RL33663.pdf.

83 Hakobyan, Shushanik, 2013, GSP expiration and declining exports from developing countries, working paper.

84 The Trade Partnership, 2013, The United States GSP programme, annual report prepared for the Coalition for GSP. p. 6.

Figure 8
United States total imports from effective least developed countries excluding African Growth and Opportunity Act beneficiaries: Non-agricultural products, excluding fuel



Source: Authors' calculation based on UNCTAD's GSP database.

slight reduction in GSP received occurred (-2.3 per cent). Specifically, in the period 2008–2013, a significant reduction in GSP received occurred, from $204.7 million to $122 million (-40.4 per cent). This trend recovered, reaching $200 million again in 2015. United States imports from non-AGOA LDCs are highly concentrated in the textiles and clothing sector. In this sector, the situation is not very different. The utilization rate even in the few tariff lines covered by the scheme declined from 73 to 31 per cent from 2008 to 2013. The utility rate is significantly low. With total imports of $7.9 billion, including $7.8 billion of dutiable imports and only $21.7 million ($6.8 million+$14.9 million) covered by the GSP scheme in 2013, the utility rate amounted to 0.28 per cent. In 2013, imports in the textiles and clothing sectors, representing 90 per cent of total imports, were covered at a rate of 0.27 per cent.

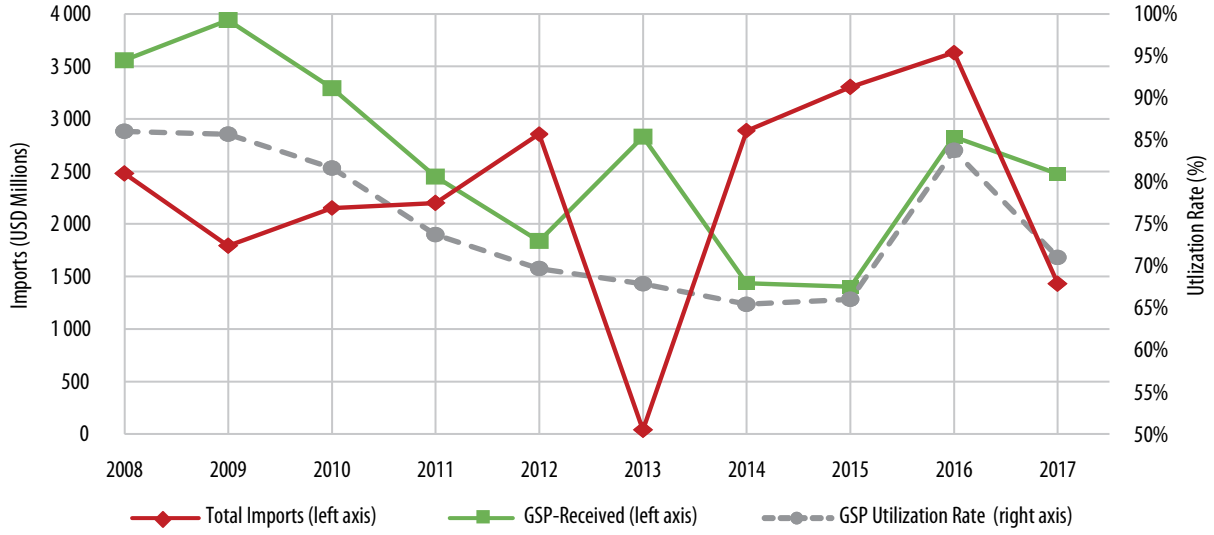
The most important issues to highlight in the context of dealing with the adequacy of RoO is that the United States RoO seems to have been, to date, unable to trigger a diversification of exports: The value of trade covered by the United States GSP is abysmally low; and it seems that in industries other than textiles and clothing that are mostly covered by the United States GSP scheme, preferences are not fully utilized, with relatively high values of imports receiving MFN treatment.

Figure 9 and Figure 10 show examples of volatility and difficulties in complying with the United States GSP RoO, even in the covered industrial sectors. It should be noted that one of the difficulties of this exercise is that the volume of trade flows is quite low and may show volatile fluctuations of utilization rates. Such low volumes and volatility may also be read as a sign of the inadequacy of existing RoO.

Figure 9 shows the utilization of articles of jewellery (heading 7113 of the Harmonized System). Among the effective LDCs (excluding AGOA beneficiaries), one of the main exporters to the United States is Nepal. An initial high utilization rate at an average of 81 per cent declined to 50 per cent in 2013 and reached about 90 per cent in 2014–2016, while total United States imports of the products rose in 2013 and declined in 2014 and 2015 after the peak in 2013. Interestingly, the GSP scheme expiration in 2010 did not affect the utilization rate, while the drop to 50 per cent in 2013 coincided with the expiration. Perhaps some models of jewellery did not meet RoO requirements in 2013, showing extreme volatility of performance.

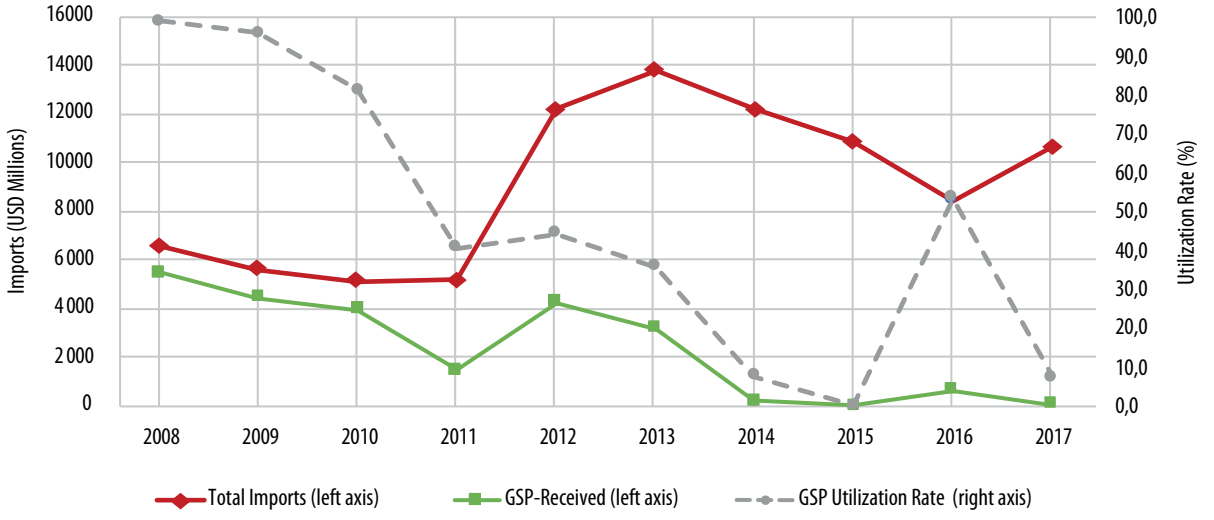
Figure 10 shows the pattern of United States imports of golf equipment (heading 9506 of the Harmonized System). The utilization rate fell, after an initial high performance of close to 100 per cent in 2008, to 36 per cent in 2013, reaching the lowest utilization rate of 0 per cent in 2015. The main drops in utilization

Figure 9
United States imports from effective least developed countries excluding African Growth and Opportunity Act beneficiaries: Jewellery products. HS Heading 7113



Source: Authors' calculation based on UNCTAD's GSP database.

Figure 10
United States imports from effective least developed countries excluding African Growth and Opportunity Act beneficiaries: Articles and equipment for sports. HS Heading 9509



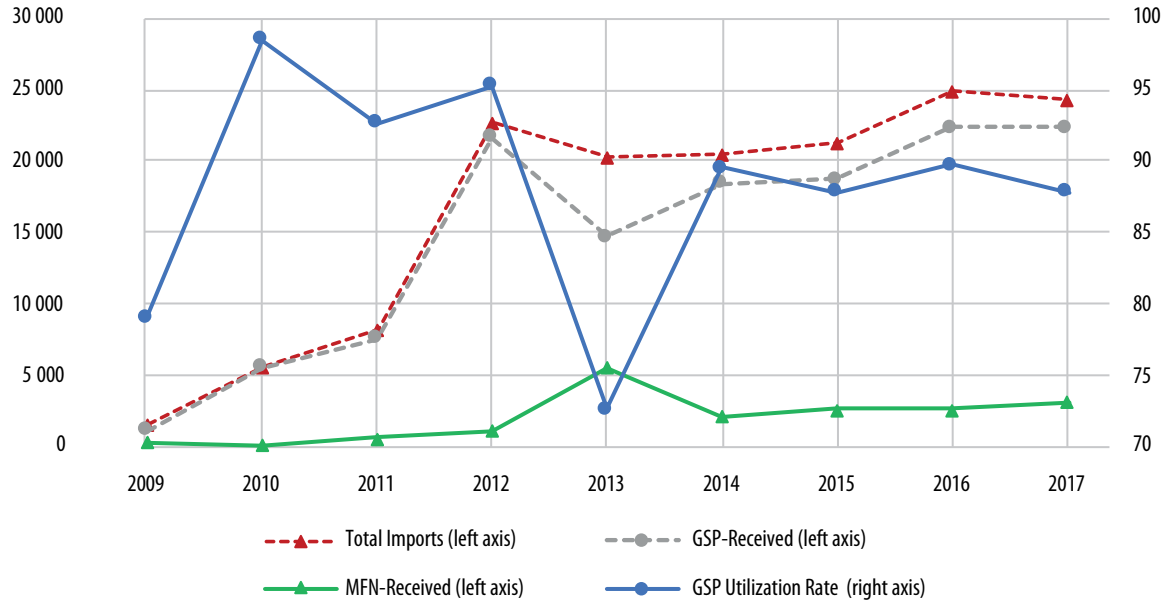
Source: Authors' calculation based on UNCTAD's GSP database.

rate occurred from 2010 (81 per cent) to 2011 (40 per cent), as well as from 2013 (36 per cent) to 2014 (7 per cent). The drop from 2010 to 2011 coincided with the GSP scheme expiration and overall falling rates of GSP utilization (see Figure 8).[85] Furthermore, most of these goods originated in Bangladesh, explaining the drop in 2013, when Bangladesh was suspended from the United States GSP.[86] When more recent trade data on these products becomes available, it will be interesting to see whether GSP utilization rates recover.

[85] Ibid.

[86] The rise in utilization rates in 2016 was due to exports of sports equipment from Cambodia (tariff line 95066960), amounting to $612 million and fully using the preferential treatment. Exports from Cambodia to the United States under this specific tariff line have been recorded only for 2016.

Figure 11
United States imports from effective least developed countries excluding African Growth and Opportunity Act beneficiaries: Bicycles and other cycles (non-motorized) HS Heading 8712



Source: Authors' calculation based on UNCTAD's GSP database.

Figure 11 shows United States imports of bicycles (heading 8712 of the Harmonized System) originating mainly from Cambodia, which show a rather high utilization rate and a similar fluctuating pattern: as total imports grew, the utilization rate of GSP decreased, from about 99 per cent in 2010 to 73 per cent in 2013, and increased again to roughly 88 per cent in 2017, while imports did not show significant gains. While it should be noted that the preferential margin is considerably different in the United States market with regard to the European Union (in the European Union, the MFN rate for bicycles is 14 per cent while EBA grants duty free and MFN rates of duty for most bicycles in the United States are 5.5 per cent), it is clear that the current United States RoO appear not to create additional trade opportunities.

The analysis of golf equipment of heading 9506 represented in Figure 10, and of bicycles of heading 8712 in Figure 11 supports recent findings accounting for the underutilization of the United States GSP scheme. Higher shares of local content in output are associated with higher utilization, and utilization rates generally increase with preference margins, export sizes and regional cumulation.[87] The case of imports from Bangladesh gives a good example for the finding on export size in association with GSP utilization. The exclusion from the scheme of the main exporter under heading 9506, Bangladesh, resulted in a decrease of about 60 per cent in GSP utilization.

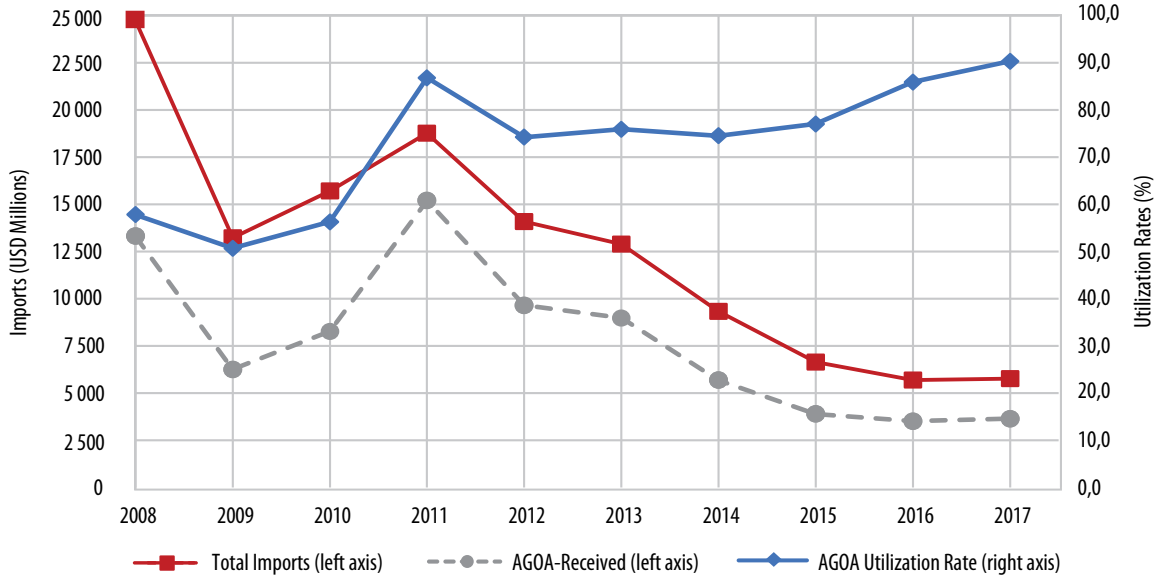
A similar case can be made for the high utilization regarding bicycle exports from Cambodia, that not only show a high concentration, but also high local content measured as a share of value added and domestic intermediate inputs. As the only LDC accumulating the specialist welding, painting and finishing skills necessary to produce technically advanced mid-level to high-end bicycles, Cambodia records high local content for such exports.

Turning to the United States imports covered by AGOA, Figure 12 shows the overall performance of AGOA, from a utilization rate of 51 per cent in 2009 to 77 per cent in 2015 and 90 per cent in 2017. In contrast to the GSP scheme, the recorded 65 per cent in 2015 (see Figure 7), the utilization rate of AGOA is 12 percentage points higher, showing, however, a similar level of volatility. The volatile pattern in the AGOA-received graph of Figure 12 is probably due to the fluctuations of fuel imports from major AGOA LDC suppliers, as well as the exclusion of certain beneficiaries. The United States AGOA expiration was also among the causes of varying utilization rates.

As shown in Figure 13, once fuels and agricultural products are excluded, the utilization rate of AGOA shows an impressive pattern of 96 per cent utilization in 2015 and does not reflect the volatile pattern in Figure 12. Between 2008 and 2015, the range of variation is between 93 and 99 per cent.

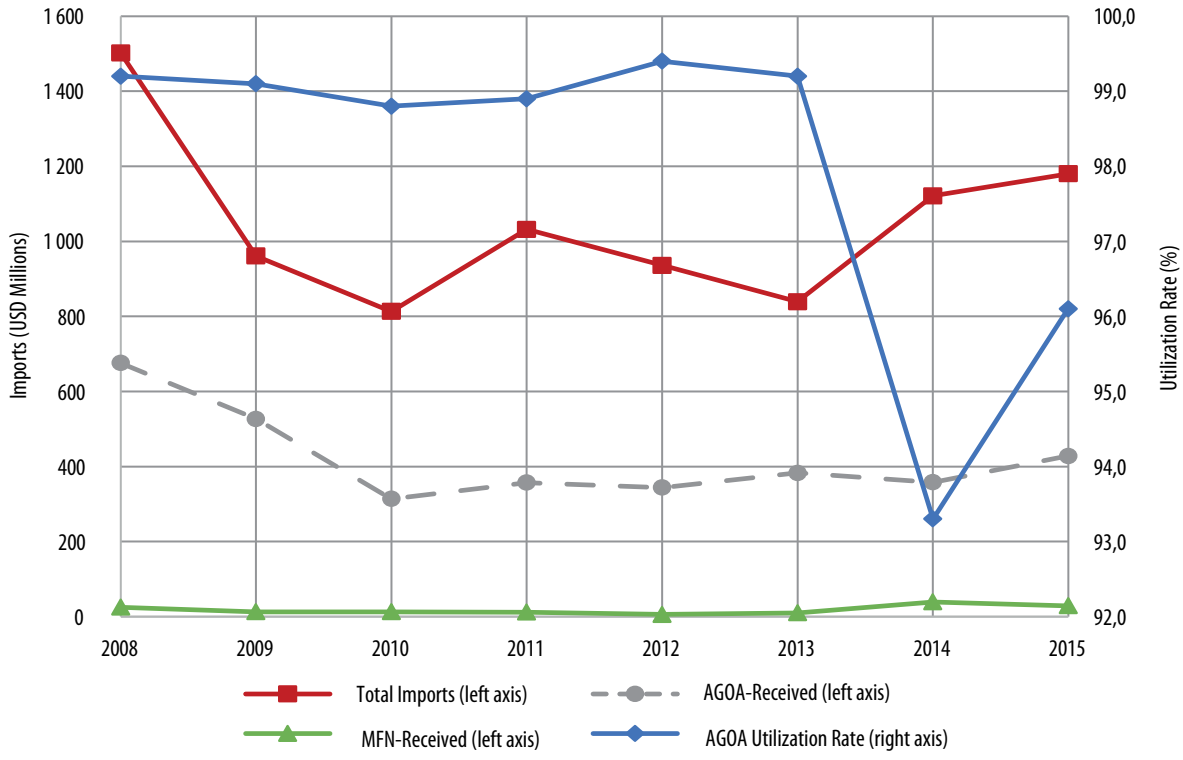
[87] See Hakobyan, Shushanik, 2015, Accounting for underutilization of trade preference programmes: The United States generalized system of preferences, *Canadian Journal of Economics*, 48(2).

Figure 12
United States total imports from effective least developed countries, African Growth and Opportunity Act beneficiaries



Source: Authors' calculation based on UNCTAD's GSP database.

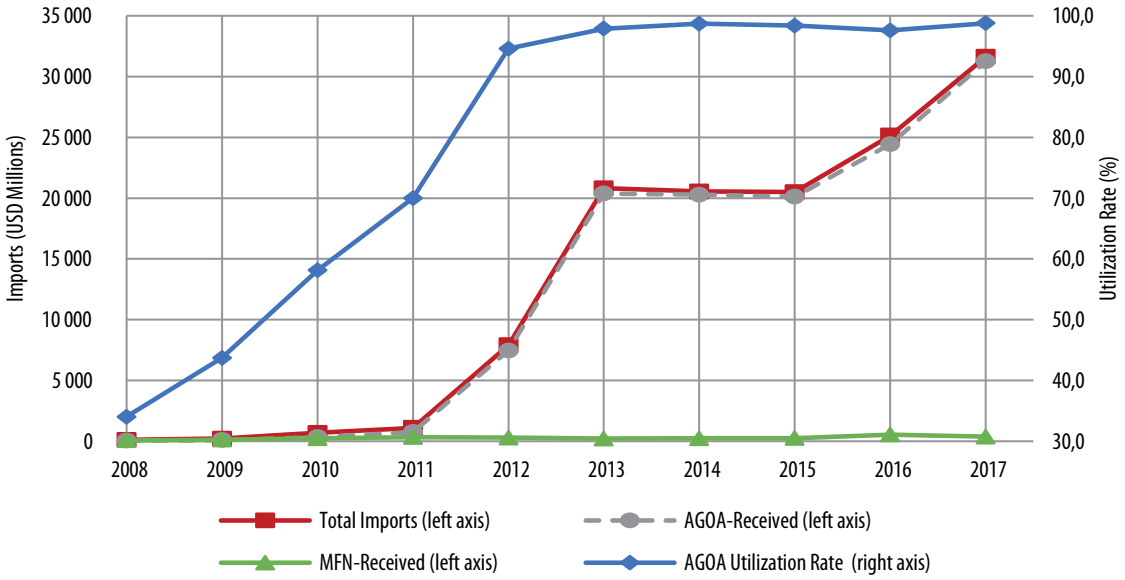
Figure 13
United States total imports from effective least developed countries, African Growth and Opportunity Act beneficiaries: Non-agricultural products excluding fuel



Source: Authors' calculation based on UNCTAD's GSP database.

Such a remarkable utilization rate is due to the high concentration of exports in the clothing sector, where special RoO apply that allow the use of third-country fabric. Simply, under AGOA, the United States has adopted RoO that are similar to those introduced by the European Union reform allowing single transformation as origin-conferring. Once again, this figure is a telling example that lenient RoO with a sizeable preferential margin are trade-creating. Besides clothing, however, there are few other successes under AGOA. Figure 14 shows United States imports of leather footwear (chapter 64 of the Harmonized System) under the agreement. The main exporter of such goods in this context is Ethiopia. The utilization rate has constantly progressed, from 34 per cent in 2008 to almost full utilization, at 98 per cent in 2017. However, it should be noted that Ethiopia, as a leather producer, may not be facing particular difficulties in meeting the 35 per cent value added origin requirement.

Figure 14
United States total imports from effective least developed countries, African Growth and Opportunity Act beneficiaries: Leather footwear



Source: Authors' calculation based on UNCTAD's GSP database.

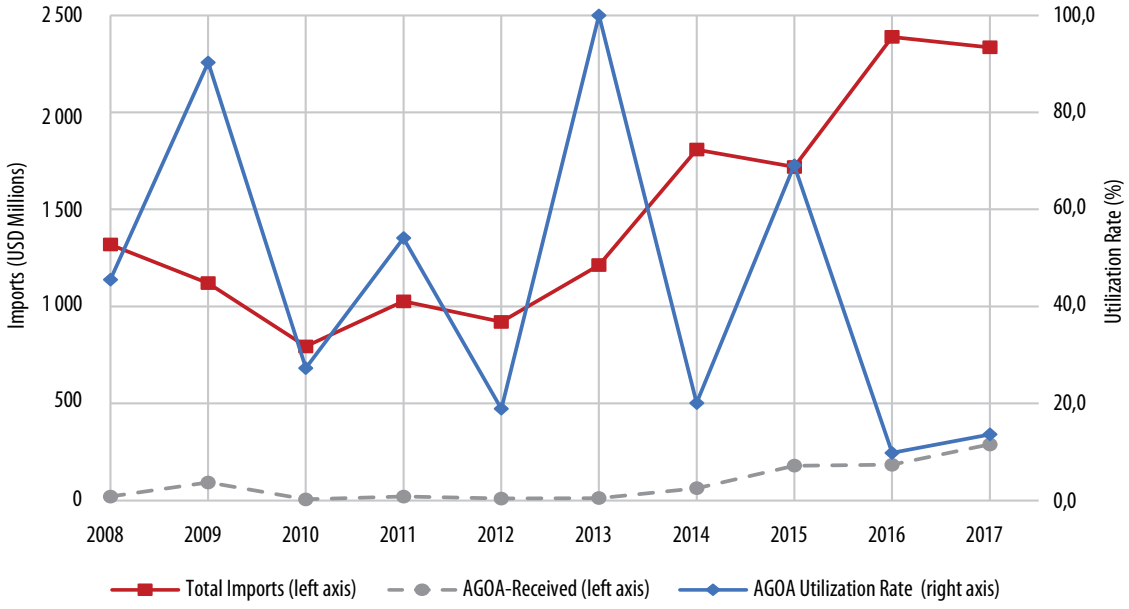
A different case is shown in Figure 15 on United States imports under AGOA of basketwork (heading 4602 of the Harmonized System), mainly supplied by Rwanda. The utilization pattern shows extreme volatility, as it jumps from 19 per cent in 2012 to 100 per cent in 2013, falls back to 20 per cent in 2014, rises to 69 per cent in 2015 and drops again to around 10 per cent in 2016 and 2017. Total imports, in contrast, remain relatively stable.

As the cases of leather footwear and basketwork exemplify, the main success story under AGOA remains the clothing sector. Little volatility and extremely high utilization rates are enabled by lenient RoO, allowing for the use of third-country fabrics and single transformation.

Similar to the United States, Japan had introduced, until recently, limited changes to GSP RoO since their inception in the 1970s. Two major changes were made to the product-specific RoO of the Japan GSP scheme. The first change was carried out in 2011 and mainly concerned the drafting form of product-specific RoO and, most importantly, an initial liberalization of the product-specific RoO under chapter 61 allowed the use of non -originating yarns. A second change in 2015 concerned chapter 61, whereby Japan introduced single transformation, from fabric to garment, for the whole of chapter 61. As shown in Figure 16, Japan shows a more stable, cyclical pattern, with a decrease in overall imports following the financial crisis in 2009.[88] Overall utilization rates are relatively high, showing, however, a rather stagnant linear approach with values ranging from 84 to 86 per cent until 2013. Despite the slight increase in 2016, in recent years, in contrast, the rate shows a negative trend, declining to 77 per cent in 2014 and 73.5 per cent in 2017.

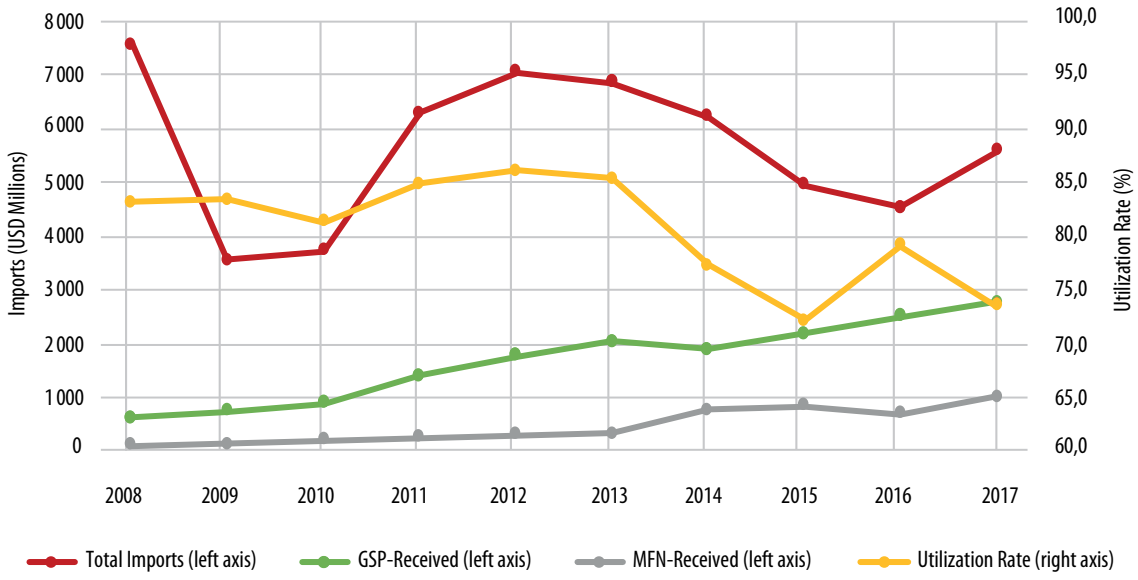
[88] See http://www.customs.go.jp/toukei/epa/epa_happyou2.htm.

Figure 15
United States imports from effective least developed countries, African Growth and Opportunity Act beneficiaries: Basketwork, wickerwork of plaits, etc.,



Source: Authors' calculation based on UNCTAD's GSP database.

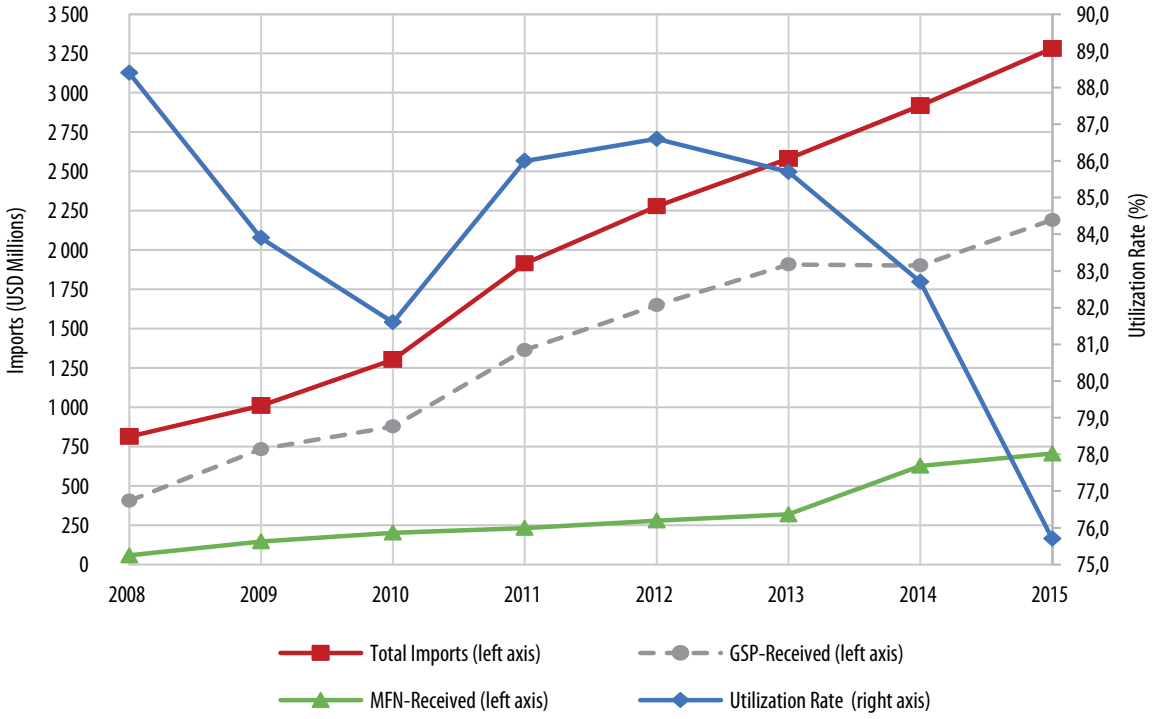
Figure 16
Japan total imports from effective least developed countries and utilization rates



Source: Authors' calculation based on UNCTAD's GSP database.

There are no significant differences in the pattern of utilization of the Japan GSP scheme when non-agricultural products and fuel are excluded, as shown in Figure 17. Utilization rates ranged from 88 to 86 per cent in 2013 and afterwards showed a similar trend, compared with Figure 16. These figures show that even after the improvements in terms of coverage under the Japan GSP scheme, there has not been a significant modification in the overall trade patterns and utilization of the Japan GSP.

Figure 17
Japan imports from effective least developed countries and utilization rates: Non-agricultural products excluding fuel



Source: Authors' calculation based on UNCTAD's GSP database.

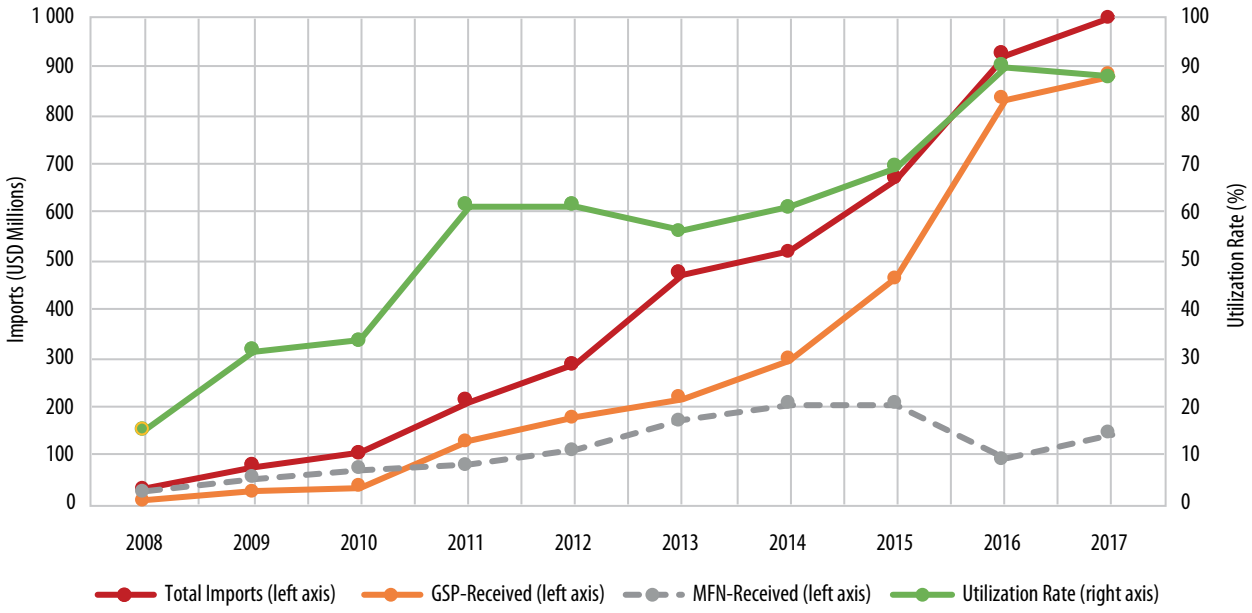
Chapter 61 of the Harmonized System (knit or crocheted garments) has been the one sector in which the utilization rate of the Japan GSP scheme has been significantly lower with regard to the average utilization rate. This underutilization could easily be explained by the overtly stringent RoO that were applicable under the Japan GSP scheme until 2011, requiring triple transformation: spinning; weaving; and making up finished garments. In April 2011, Japan relaxed the RoO requirement, allowing for double processing: weaving and making up finished garments, as shown below.

	Until April 2011	April 2011–April 2015	Since 2015
Chapter 61: Knitted or crocheted garments	Manufacturing from chemical products; products under headings 47.01 to 47.06; or natural textile fibres, human-made staple fibres or textile fibre waste	Manufacturing from textile yarn	Manufacturing from fabric

Most recently, in 2015, Japan further liberalized the product-specific RoO under chapter 61, from the previous two-stage process to a single-stage process: manufacturing from fabric. This policy change triggered a significant increase in utilization rates, from 69 per cent in 2015 to 90 per cent in 2016 , as shown in Figure 18. In addition, the reform was highly trade-creating, with a rise in imports receiving GSP treatment, from $464 million in 2015 to $833 million in 2016 and $881 million in 2017.

As shown in Figure 18, the change from a triple to a double transformation requirement triggered a significant increase in utilization rates in 2011, when the utilization rates rose to 61 per cent from 34 per cent in 2010 and the value of exports to Japan doubled in one year.

Figure 18
Japan imports from effective least developed countries and utilization rates: Articles of apparel and clothing accessories, knitted or crocheted



Source: Authors' calculation based on UNCTAD's GSP database.

III. STRINGENCY OF RULES OF ORIGIN AND UTILIZATION RATES: EVIDENCE FROM ECONOMETRIC MODELLING [89]

As explained earlier, despite decades of multilateral attempts, there is no multilateral discipline on RoO. One of the major problems affecting progress at the multilateral and subregional level towards reform and consensus on RoO is the lack of evidence that a given RoO would be better or more trade-creating and less costly than an other RoO. LDCs have stated during negotiations that a reform of RoO from a more stringent set to a more liberal one is generating an increase in the utilization of trade preferences and trade volumes. However,despite the obvious and factual correlations,this argument is challenged by those questioning a casual effect between reform of rules of origin and increase of utilization rates and volume of trade. In other words, at WTO negotiations at CRO, LDCs faced opposition from preference-granting countries, in particular the United States, stating that the rise in utilization rates after the reforms might be explained by exogenous factors independent from RoO.

Traditional economic research on RoO determines the ad valorem tariff equivalents of RoOusing an ex ante general coding of RoO, this type of research is not particularly useful in trade negotiations tocreate consensus on the reduction of the trade-distortingeffects of product-specific RoO (PRSO).[89] In contrast, this research is the first attempt to establish a causal link between the liberalization of RoO in terms of manufacturing requirements with the increase of utilization rates and trade volume. More specifically, it provides, on the basis of a coding of product-specific RoO, a first, detailed, product-specific analysis of the trade effects of a reform of RoO taking the European Union reform of RoO in 2010 as an example. The research questions are as follows:

(a) Is low utilization due to excessive stringency of RoO in terms of manufacturing requirements?

(b) Does a liberal reform of such requirements increase utilization rates and trade volumes?

(c) Can such trade effects be measured?

III.1. Product-specific rules of origin coding: Time varying measure of rules of origin stringency

The main challenge in establishing a causal effect between utilization rates and the stringency of RoO is twofold:

(a) The measure of the stringency of RoO needs to reflect the industrial capacities and realities of countries. The rule cannot be based exclusively on the form of RoO (CTH, CTC, ad valorem percentage criterion, etc.) since the forms of given RoO are simply the way they are drafted;

(b) Even when such a measure is computed, it is usually not time varying, preventing the use of sophisticated econometric techniques such as panel data fixed-effects models to isolate exogenous factors that could impact utilization rates.

The major contribution of this research is to address the challenges above through a codification of RoO based on the change in stringency between two time periods, before and after 2010 when the EBA reform was implemented.

RoO might be much more stringent in some sectors than in others independently from the form in which they are written. Codifying the stringency of RoO therefore requires a careful look at the meaning of such rules in terms of manufacturing processes: what manufacturing is required to obtain origin and what are the changes introduced by the reform? The most suitable way to answer these questions is to adopt a codifying methodology focusing on the change in stringency instead of the establishment of a stringency measure based on the form in which the PSRO are drafted before and after the reform. The latter would require the form of all PSRO to be comparable across sectors, which is in reality not the case. For example, while a wholly obtained rule might be stringent for industrial goods, the same rule might be more lenient in the case of live animals. Assigning the same code to this rule in different sectors would therefore not reflect the economic reality.

In contrast codifying the change of the PSRO on the basis of stringency(manufacturing requirements) rather than on its form(the way in which the PSRO is drafted) reflects economic realities and does not suffer from the above-mentioned limitations. This constitutes the first major contribution of the research. In the table below, an example of the way RoO have been codified is shown. In the case of garments

[89] This subsection details the research of Pramila Crivelli presented at the round table on the future of RoO and utilization rates at the European University Institute, 26–28 June 2019. Empirical specifications and results are further developed in Crivelli and Inama, 2021, The impact of the European reform of RoO under the Everything but Arms initiative: An empirical analysis, forthcoming EUI working paper.

under chapter 62 of the Harmonized System, the rule became less stringent, moving from a double to a single transformation requirement. Similarly, for bicycles under heading 8712 of the Harmonized System, it is clear that the rise in the percentage of the use of non-originating material, from 40 to 70 per cent, made the rule easier to comply with and therefore classified it as less stringent. In contrast, for olive oil under headings 1509 and 1510 of the Harmonized System, the requirement that all vegetable materials (including olives) must be wholly obtained is more stringent than the initial change of tariff heading requirement. In addition, there is a change in the drafting of the rule, which is also recorded in the codification for future research purposes. The third case shows a different scenario. The fruits, nuts or vegetables used to produce prepared or preserved tomatoes, mushrooms and truffles under headings 2002 and 2003 of the Harmonized System are all included in chapters 7 or 8, and the old and new rules are similar in terms of stringency.[90]

This analysis has been conducted for all former and new PSRO, to be further matched with trade data and utilization rates in an empirical analysis.

Harmonized System level	Product-specific rules of origin		Change in stringency
	Former	New	
Chapter 62: Garments, not knitted or crocheted	Manufacturing from yarn	Manufacturing from fabric	Less stringent
Heading 8712: Bicycles	Manufacturing in which the value of non-originating material does not exceed 40 per cent of the ex-works price of the finished products	Manufacturing in which the value of non-originating material does not exceed 70 per cent of the ex-works price of the finished products	Less stringent
Headings 1509 and 1510: Olive oil and its fractions	Manufacturing from materials of any heading, except that of the product	Manufacturing in which all of the vegetable materials used are wholly obtained	More stringent and in different form
Headings 2002 and 2003: Tomatoes, mushrooms and truffles prepared or preserved otherwise than by vinegar of acetic acid	Manufacturing in which all the fruits, nuts or vegetables used are wholly obtained	Manufacturing in which all the materials under chapters 7 and 8 used are wholly obtained	Similar

Source: Authors' elaboration

III.2. Empirical model and data

Based on the PSRO classification described above a regression analysis is carried out on a panel of beneficiary countries and Harmonized System headings to provide evidence that higher or lower utilization rates are mainly the result of the stringency and/or complexity of RoO and ancillary requirements. The following equation has been estimated with ordinary least squares and a logit model:

$$Y_{ijpt} = \alpha + \beta_1 LS_p \times post_{ir} + \beta_2 MS_p \times post_{ir} + \gamma_{ijp} + \gamma_t + controls + \epsilon_{ijpt}$$

Where:

Y_{ijpt} : Utilization rate/imports receiving GSP treatment of reporter i, partner j, product p (Harmonized System four-digit level) at year t

LS, MS: RoO stringency change dummy variable equal to 1 if at least one PSRO grew less (LS) or more (MS) stringent under a given Harmonized System heading

$post_{ir}$ dummy variable equal to 1 in the European Union in 2011–2015 (r: time variable before/after reform)

γ_{ijp} and γ_t : country pair product and year fixed effects

Controls: preference margin before and after reform, total imports, time trend and additional fixed effects $[\gamma_{ir}, \gamma_{jr}, \gamma_{hs2r}]$

The model has been estimated using the UNCTAD database on utilization rates over 10 years, from 2006 to 2015, dividing the sample into two time periods of equal length, before and after the EBA reform of RoO in 2011. In addition to the European Union, as a counterfactual the analysis includes two other preference-granting (importing) countries where a reform was not implemented during the time period considered, namely Canada and the United States. All trade values at the tariff line level have been converted to Harmonized System 2002 nomenclature and aggregated at the four-digit level. Preference margins are calculated based on preferential (LDC) and MFN tariffs in the TRAINS database. Finally, given the specificities of petroleum oil products, products under chapter 27 of the Harmonized System have been excluded from the analysis.

[90] Some cases are not as clear cut and have been classified as undefined; their relative importance is marginal.

III.3. Preliminary results and conclusions

Table 9 shows the results when estimating the impact of the reform on utilization rates (dependent variable) for various level of preference margins and different sets of fixed effects. The results show that the utilization rates of products for which PSRO have been liberalized increased in the European Union after the reform ($LS_p \times postEU_{ir}$). Columns (1), (3) and (5) all account for product (Harmonized System four-digit level), reporter, partner and time fixed effects. Therefore, the rise in utilization rate cannot be explained by any external factor fixed over time for a given product, reporter or partner. This includes all country and product-specific characteristics. Since it may be argued that reforms implemented by partner countries at the same time as the European Union could explain the rise in utilization rates, columns (2), (4) and (6) all include post-2010 partner-interacted fixed effects. Not only do all coefficients on the $LS_p \times postEU_{ir}$ variable remain statistically significant but the magnitude of the impact of reform on RoO increases, ranging between 9.5 and 12.9 percentage points depending on the level of preference margin.

Of note, the preference margin only became a significant determinant of the utilization rate after 2010 in the European Union, while the coefficients are insignificant. When the full sample is considered (see column (2)), an increase in the preference margin by 1 percentage point translates into a 0.371 (=0.588-0.217) percentage point rise in utilization rates, statistically significant at 1 per cent (results of the test are not reported). The last column shows the results of an estimation including all fixed effects interacted with the post-2010 variable. While most coefficients become statistically insignificant, despite a reduction in magnitude, the effect of the $LS_p \times postEU_{ir}$ variable appears to be robust to the inclusion of fixed effects, leaving no doubt that the EBA PSRO reform had a positive impact on utilization rates. All coefficients are statistically significant even when a partner post-reform fixed effect is included to account for exogenous factors in a partner country before or after 2010 and the effects of which cover the period after 2010.

Table 9
Baseline results: Utilization rates

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
	PM>0	PM>0	PM>3	PM>3	PM>5	PM>5	PM>5
$LS_p \times postEU_{ir}$	5.348***	9.551***	8.583***	10.587***	9.711***	12.862***	4.098*
	(0.90)	(1.31)	(1.22)	(1.58)	(1.49)	(1.93)	(2.23)
$MS_p \times postEU_{ir}$	0.736	-1.782	4.128	-0.198	4.705	1.760	-5.324
	(5.07)	(5.47)	(4.99)	(5.35)	(5.01)	(5.74)	(5.69)
$PM_{ijpt} \times postEU_{ir}$	0.786***	0.588***	0.626***	0.537***	-0.263	0.395***	-0.001
	(0.09)	(0.10)	(0.10)	(0.10)	(0.22)	(0.11)	(0.12)
PM_{ijpt}	-0.310*	-0.217	-0.226	-0.153	0.533***	-0.176	-0.144
	(0.19)	(0.18)	(0.18)	(0.18)	(0.10)	(0.21)	(0.21)
$Ln(Tot.Imp)_{ijpt}$	1.982***	1.763***	2.650***	2.296***	2.808***	2.278***	2.338***
	(0.23)	(0.22)	(0.33)	(0.32)	(0.40)	(0.38)	(0.38)
Fixed effects							
Rep x part x HS4; year	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Part x postr	No	Yes	No	Yes	No	Yes	Yes
HS2 x postr	No	Yes	No	Yes	No	Yes	Yes
Rep x postr	No	No	No	No	No	No	Yes
Observations	23 081	23 081	15 804	15 804	23 081	12 208	12 208
R2	0.067	0.105	0.089	0.131	0.105	0.152	0.158

Abbreviations: HS, Harmonized System; PM, preference margin
** p<0:10*
*** p<0:05*
**** p<0:01; robust standard errors in parentheses*
Source: Authors' calculation.

Table 10
Extensive margin: Probability of starting to use preferences (xtlogit) – Imp. received>0

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
	PM>0	PM>0	PM>3	PM>3	PM>5	PM>5	PM>5
$LS_p \times postEU_{ir}$	0.249**	0.149	0.385***	0.379**	0.360***	0.478**	0.273
	(0.10)	(0.15)	(0.12)	(0.18)	(0.13)	(0.23)	(0.31)
$MS_p \times postEU_{ir}$	-0.167	-0.617	-0.064	-0.484	-0.142	-0.444	-0.524
	(0.37)	(0.57)	(0.37)	(0.59)	(0.38)	(0.61)	(0.62)
$PM_{ijpt} \times postEU_{ir}$	0.028***	0.018*	0.026***	0.007	0.024***	-0.001	-0.009
	(0.01)	(0.01)	(0.01)	(0.01)	(0.01)	(0.01)	(0.01)
PM_{ijpt}	-0.020*	-0.013	-0.016	-0.010	-0.025**	-0.020	-0.019
	(0.01)	(0.01)	(0.01)	(0.01)	(0.01)	(0.01)	(0.01)
Fixed effects							
Rep x part x HS4; year	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Part x postr	No	Yes	No	Yes	No	Yes	Yes
HS2 x postr	No	Yes	No	Yes	No	Yes	Yes
Rep x postr	No	No	No	No	No	No	Yes
Observations	9 971	9 971	7 919	7 919	6 377	6 377	6 377

Abbreviations: HS, Harmonized System; PM, preference margin
** p<0:10*
*** p<0:05*
**** p<0:01; robust standard errors in parentheses*
Source: Authors' calculation.

Table 10 shows the results of estimating the impact of the reform on the probability of starting to use preferences. The dependent variable is therefore a dummy variable equal to 1 if the value of imports receiving preferential treatment is positive and 0 otherwise. The model is estimated using a logistic regression model for panel data over various levels of preference margins. Including partner post-2010 interacted fixed effects shows (in columns (2), (4) and (6)) that the probability of starting to use preferences increased after the reform, but only when the preference margin was above 3 percentage points. This model is not robust to the inclusion of the full set of fixed effects shown in column (5). However, this can also be explained by the high level of aggregation at the Harmonized System four-digit level.[91]

In conclusion, while it is clear from the previous subsections that heterogeneity across sectors is observed, the wide range of fixed effects included in this research strongly suggest a causal average effect of the EBA RoO reform on the utilization of trade preferences, excluding most of the possible external factors that could explain the surge in imports and utilization rates. The study also controls for the preference margin, ruling out the idea that the latter is the driving factor behind the utilization rate changes. By empirically demonstrating that the utilization rate is a crucial indicator of the restrictiveness of RoO, results and conclusions may be used to advocate for reforms in regional and multilateral negotiations. It is clear that the use of utilization rates could help address one of the major problems affecting reforms and consensus at WTO and in FTAs.

[91] Results at the Harmonized System six-digit level of disaggregation are detailed in Crivelli and Inama, 2021.

IV. MAKING FURTHER PROGRESS: ACCEPTING LESSONS LEARNED, BEST PRACTICES AND TAKING THE LEAD[92]

IV.1. Lessons learned

IV.1.1. Setting priorities and the debate on the form and substance of rules of origin

Recent experience gained during the negotiations and implementation of the Bali Decision and the Nairobi Decision has shown that one of the most formidable challenges faced by LDCs is the request made by preference-giving countries to prioritize LDC requests to change the current RoO applied under DFQF initiatives. Such a request, however, misleads the debate. The Bali Decision recalls that preference-giving countries "will build on their existing RoO regimes". Since each preference-giving country adopts its own RoO system, as stated since 1970, LDC requests are necessarily tailored to addressing the shortcomings of RoO adopted by each preference-giving country. Setting a priority or a preferred method of determining origin for LDCs among the different criteria used by preference-giving countries would be equivalent to seeking a harmonization of RoO that preference-giving countries have systemically rejected since the inception of the GSP schemes in 1970.

LDCs have long recognized that there are a variety of forms of RoO used by preference-giving countries to determine origin. No one of these forms may be better than another. Experience has shown that what matters the most besides the form of a given RoO is the substance of RoO. The substance is the degree of restrictiveness of RoO with regard to an existing value chain context in which RoO are expected to operate. The form is the way in which RoO are written using different methodologies, namely a change of tariff classification at the heading level, subheading level with or without exception, ad valorem percentage criterion or specific working or processing and the different variants.

The best set and form of preferential RoO have not yet been determined. The reality is that there is no "best" RoO that can be adopted in preferential RoO, although a number of lessons have been learned on how to draft RoO and there are many examples of how mistakes may be avoided. The first principle to adopt is to consider the desired objective of RoO, separately from the drafting methodology.

In the context of the negotiations and discussions with preference-giving countries, LDCs should make clear that they are not strictly advocating the use of an ad valorem percentage application of 75 per cent on non-originating material over the use of a specific working or processing requirement of a change of tariff clasification or vice versa. Any form of determining substantial transformation may be valid as long as the final result is RoO liberal enough to be commercially viable for LDCs, investors and local business. For example, it is clear that LDCs are advocating for single stage transformation for woven or knitted garments. This means that the manufacturing of non-originating fabrics to make finished garments is a substantial transformation. This is the substance of RoO. To express this substance in RoO terms, different forms of RoO may be used, as follows:

(a) An ad valorem percentage rule with a rate of 75 per cent or more that allows the use of non-originating fabrics to make garments;[93]

(b) A change of tariff classification that in this specific case could be a simple change of tariff heading since all of the headings classifying finished garments are in chapter 61 and chapter 62 and all of the fabrics are in other chapters of the Harmonized System;[94]

(c) A simple working or processing requirement currently used under the Japan and European Union GSP RoO: Manufacturing from fabric.

These are a series of lessons learned over the method of drafting the form of RoO, which should be taken into account, such as the use of a value of material calculation rather than value addition, as detailed in the subsequent subsections.

IV.1.2. Lessons learned: The issue of cumulation

Cumulation is a practice that allows for the consideration of products originating in other countries or working or processing carried out in other countries as

[92] See Inama, drafting RoO in FTAs, World Customs Organization, available at http://www.wcoomd.org/en/media/wco-news-magazine/previous/wco-news-n72.aspx.

[93] It would have to be first double checked with LDC producers if such level of percentage would be commercially viable for them.

[94] A limitation may be inserted for parts of garments of HS heading 61.17 or 62.17 respectively.

domestic products or domestic working or processing. Cumulation may be granted at a bilateral or regional level as adopted by the majority of GSP preference-giving countries[95] or among the beneficiaries.[96] In short, cumulation may be divided into two broad categories: quantitative aspects, i.e., with whom beneficiaries can cumulate; and qualitative aspects, i.e., the kind of cumulation.

Experience from the negotiations prior to the Nairobi Decision shows that cumulation may easily turn into one of the most contentious issues. Moreover, cumulation is an additional factor that may be confusing when dealing with the assessment of a given criteria to determine substantial transformation used by a preference giving country. In fact a given set of RoO should always be read in conjunction with the cumulation provision, e.g., the RoO percentages and requirements of Canada should be read in conjunction with the generous cumulation provisions of the scheme of Canada that provide for cumulation among all beneficiaries, making the overall set of RoO requirements quite liberal. Conversely, a preference-giving country that provides for limited cumulation facilities may make the RoO criteria used to determine substantial tranformation used by that preference giving country more stringent.

Cumulation is a useful instrument for facilitating compliance with RoO. However, it should not be pursued as a per se negotiating objective or as a panacea. The viewpoint of LDCs is best reflected in the earlier LDC proposal, that was clear on the issue of cumulation: "Although laudable and highly desirable, cumulation is not a substitute for liberal RoO. With liberal RoO, the LDC producers may source their inputs worldwide from the most competitive producer at the best prices." [97]

In short, cumulation is not a substitute for introducing RoO allowing for global sourcing from the most competitive supplier. In a manufacturing world dominated by the existence of transnational supply chains, LDC companies and investors should be allowed to source their inputs from the most competitive supplier rather than being provided incentives through cumulation to restrict sourcing and indulge in trade-diversion practices. The case of bicycle companies in Cambodia shows the merits and the limits of cumulation.[98]

It should also be noted that cumulation comes with additional administrative requirements in form of documentary evidence to show that the inputs or working or processing carried our in other countries can be used for cumulation. This is a cost to business.[99]

Cumulation is a viable tool for regional integration arrangements at a high or advanced industrial stage, such as in ASEAN, where there is tangible evidence that cumulation has been effectively utilized. In other regions such as sub-Saharan Africa or island LDCs with low industrial bases and high costs of freight, cumulation may offer limited possibilities and cannot replace liberal RoO. Moreover, cumulation possibilities are dependent on documentation related to certification and the capacity of customs administrations to trace inputs.

IV.2. Best practices and technical issues

IV.2.1. Best practices in drafting percentage criterion rules of origin

As discussed, the form of given RoO may be expressed or drafted according to different techniques such as change of tariff classification with or without exceptions, specific working or processing or a percentage criterion, and no one of these forms may necessarily be better than another. However, there are a number of lessons learned from LDC practices when using the percentage criterion. Focusing the analysis on the percentage criterion should not be read or understood as meaning that LDCs are of the view that the percentage criterion is the preferred form of RoO. Percentage criterion is a form of drafting RoO requiring meeting or not exceeding a given percentage calculated by using a numerator and a denominator. There are various forms of percentage criterion,[100] as follows:

(a) Value addition (35 per cent) calculated as a percentage of the cost of local originating material, labour and the direct cost of processing

95 For example, Japan, the United States and the European Union grant regional cumulation under their GSP schemes.

96 For example, Canada grants cumulation among all beneficiaries under its GSP scheme.

97 See WTO document TNC/C/63.

98 For a description of the challenges affecting bicycle producers in Cambodia and cumulation, see http://unctad.org/en/pages/newsdetails.aspx?OriginalVersionID=578.

99 See « The Real Cost of Rules of Origin: A Business Perspective to Discipline Rules of Origin in a Post COVID-19 "Scenario Stefano Inama and Pier Paolo Ghetti, Global Trade and Customs Journal, Volume 15, Issue 10 ,2020,

100 See the latest submission of the LDC WTO group See,WTO document G/RO/W/199 of 26 October 2020 ,"Submission of LDcs to the committee on rules of origin ad-valorem criterion, November 2020.

out of the ex-factory price of a finished product. This is the method used, for example, under the United States GSP and AGOA. This method is also used, albeit with other required percentages and different definitions of the numerators and denominators, by other preference-giving countries such as Australia and New Zealand and under the Eurasian Customs Union;[101]

(b) Value addition defined as the subtraction of the value of imported material out of the ex-works price of a finished good (or "adjusted value" in United States terminology). This, for example, is the build-down method used under the United States–Central America Free Trade Agreement;

(c) Allowance of a maximum amount of foreign inputs as a percentage of the ex-works price. This is the current practice of the European Union under EBA and under many FTAs and the practice of Japan using the FOB price as a denominator;[102]

Limitations in using the percentage criterion are well known and may be summarized as follows:

(a) Percentage calculations are easily affected by movements in exchange rates for finished products that have imported raw materials, so that when a local currency appreciates, the percentage value added tends to decline and vice versa;

(b) The level of percentage threshold may be arbitrarily set and it is difficult to set it up, even with consultations with the private sector, given the number of variables of costs and products to take into account;

(c) The cost of labour in developing countries is relatively affordable and in a value added calculation may turn an asset into a penalty;

(d) The calculations may be difficult, entailing some accountancy expertise and a certain amount of discretion in assessing costs that may lead to disputes. In addition, the required accountancy skills are generally not available in most small firms in LDCs.

There are important differences in the formulation of the numerator and the calculation of percentages. The major differences in the numerator reflect two approaches: one places a maximum limit on the use of imported material, such as in Japan and the European Union; and the other places a minimum limit of value added, such as under the United States GSP, represented by the cost of local materials and the the direct cost of processing. A third variation is a valued added calculation obtained by subtraction as in the build-down calculation under the United States–Central America Free Trade Agreement and other FTAs.

Lessons learned in preferential RoO and in the net cost calculations under NAFTA have amply demonstrated that the formulation of percentage criterion calculations as value added or domestic content are complex, entailing detailed rules to define allowable and non-allowable costs that can be counted as numerators in a value added calculation. Such elements may be familiar only to accountants. As prices, costs and quantities change, recalculation is necessary to ensure compliance. While some of these tasks may form part of the normal accounting procedures required for commercial purposes, some may not. In such cases, therefore, additional professional expertise may be required. The calculation of the numerator in a value added calculation is complex, as it entails the following:

(a) A distinction of costs, which could be computed as local value added;

(b) Itemization of such costs to the single unit of production. As a consequence, this often requires accounting and discretion may be used in assessing unit costs;

(c) Currency fluctuations in beneficiary countries may affect the value of the calculation.

The United States has progressively restricted the use of such value added calculations that, under NAFTA, were referred to as net cost calculations, to limited items in the automotive sector and the European Union that had planned to use such calculations in its reform of GSP RoO changed plans and adopted a method based on a value of non originating materials.

[101] The intrinsic limitations and limited trade facilitation effects deriving from the use by preference-giving countries of different calculation methods and different levels of percentages are evident, as noted by UNCTAD in 1998 (UNCTAD/ITCD/TSB/2, p. 19): "A preference-receiving country pointed out that insuperable obstacles were caused by the need to devise and operate an accounting system that differed in the definition of concept, application of accounts, precision, scope and control from its internal legal requirements. The system must provide the costing information to satisfy the rules of the countries of destination, to check the shares of domestic and imported inputs in the unit cost of the exported goods, in some cases identifying the country of origin of the inputs and establishing direct and indirect processing costs."

[102] It should be noted that both Japan and the European Union under the current GSP RoO do not use the percentage criterion as an across-the-board criterion. The percentage criterion is only used in the context of certain product-specific RoO contained in an extensive list detailing the product-specific RoO. With regard to the ex-works price, the FOB price includes inland transport to the port of embarkation.

Table 11
Evolution of the percentage-based rules of origin under different US FTAs

Regional value content	NAFTA	United States–Chile	Central America Free Trade Agreement	United States–Singapore	United States–Australia	United States–Republic of Korea	Trans-Pacific Partnership[103]
Number of PSRO	1 125	1 043	1 017	2 974	965	758	1 245
Net cost	323	0	6	0	0	6	22
Transaction	248	0	0	0	0	0	0
Build-up	0	164	146	239	148	147	398
Build-down	0	157	147	213	144	152	457

Source: UNCTAD calculations.

Recent research has shown that there is convergence on the use of a value of material calculation even beyond the United States and the European Union since such methodology is also increasingly used in other countries such as Australia, Japan, New Zealand and the Republic of Korea.[104] Progressively, all of these above-mentioned countries abandoned a methodology based on the calculation of value added by addition to adopt a value of material calculation. Some innovations have also been introduced, such as the deduction of the addition of cost of freight and insurance under the majority of the most recent United States FTAs, including the Trans-Pacific Partnership. There are, of course, differences in the arithmetical calculations and the definitions of numerator and denominator. However, there is convergence on the concept of calculating the ad valorem percentage based on a value of material calculation rather than a value added or net cost approach, as used under NAFTA for automotive products and subsequently USMCA. This tendency is confirmed by the evolution of the use of the net cost method under United States FTAs that has gradually been introduced in subsequent FTAs and the introduction of the build-up and build-down method that has replaced the transaction value under NAFTA, as shown in Table 11.

LDCs therefore propose that when preference-giving countries use a percentage calculation, they should use a methodology based on a value of material calculation. Such a methodology used to calculate the percentage criterion may be based on two formulas, defined as the value of non-originating material[105] using best practices from Canada, Japan, the United States and the European Union, as follows:

Method based on the value of non-originating material:

$$\text{VNOM} = \frac{\text{VNOM}}{\text{EW or FOB}} \times 100$$

Where:

VNOM is the value of non-originating material that are acquired and used by a producer in the production of a good. VNOM does not include the value of a material that is self-produced and should be eventually adjusted to deduct the cost of insurance and freight from the value of non-originating material

EW is the ex-works price eventually adjusted to deduct the cost of the insurance and freight of non-originating material incorporated into the final good, alternatively FOB (Free on Board) can be used.

Alternatively the formula can be expressed as follows where LVA is Local Value Added calculated as subtraction:

$$\text{LVA} = \frac{\text{EWor FOB} - \text{VNOM}}{\text{EW or FOB}} \times 100$$

IV.2.2. The issue of the level of percentages

Another intrinsic limitation of the percentage criterion is in setting the level of percentage. The first criticism is derived from the fact that, even if determined through consultations with the private sector, setting an adequate level of percentage tends to be arbitrary, as it may change from time to time due to variations in the cost of the inputs and currency fluctuations. Moreover, the level of the percentage may differ from product to product and the stringency or leniency of a given percentage depends on the calculation methodology.

[103] While US negotiated the RoO in TPP, it subsequently withdrew from such FTA.

[104] See Hoekman and Inama, Harmonization of Rules of Origin: An Agenda for Plurilateral Cooperation? East Asian Economic Review vol. 22, no. 1 (March 2018) 3-28

[105] The United States also uses a value of originating materials method based on the value of originating material that may be considered as an alternative, as follows:
Where VOM is the value of originating material acquired or self-produced and used by the producer in the production of a good; EW is the ex-works price eventually adjusted; and LDC is the LDC value content.

The recent experience of preference-giving countries has also been taken in account. In 2003, Canada introduced changes to RoO, setting a 60 per cent maximum import content allowance for LDCs (instead of the 40 per cent permitted for other developing country GSP beneficiaries). This means that to qualify for the LDC duty-free treatment, at least 40 per cent of the ex-factory price of goods packed for shipment to Canada must originate in one or more LDC beneficiary countries or in Canada. In addition, 20 per cent of the 40 per cent qualifying content may originate from other developing countries that are beneficiaries of the GSP scheme of Canada bringing the total amount of percentage of materials not originating in LDC to 80 per cent. Special rules for textiles and clothing were also introduced, allowing for the use of imported fabric from other beneficiaries of the GSP scheme of Canada, provided that they do not exceed 75 per cent of the ex-factory price of the final goods.[106]

In addition to findings from field research, the European Union impact assessment contained simulations of the trade creation deriving from the use of different percentages; 50 per cent local content and 30 per cent local content. The policy implication of the simulations was that trade creation resulting from the exercise was far greater under the 30 per cent level. Therefore, the final reform of the European Union rules introduced, for a number of goods, a threshold of 30 per cent of local value content, equivalent to a maximum allowance of foreign imports of 70 per cent. The introduction of a 70 per cent allowance of non-originating material as a default rule under many chapters of the Harmonized System as part of the European Union RoO represents a watershed as the most liberal percentage used by preference-giving countries to date.[107] The results and trade effects of such liberalization are illustrated in section II. Table 12 shows a comparison of the existing levels of percentages in the schemes of major preference-giving countries and the European Union.

As shown in Table 12, it is clear that the level of percentage required should not be considered in isolation since the extent of the cumulation and different numerators and denominators used also have an effect on the stringency or leniency of a given percentage. The example of Canada is revealing, as the requirement of 60 per cent rises to 80 per cent with the opportunity of cumulation with all GPT beneficiaries, including countries such as China, with a large manufacturing base that can supply inputs to neighbouring LDCs.[108] Such a graduation policy is not unique to Canada since the European Union in 2014 also introduced a new graduation policy that has affected around 54 countries.[109] The Cambodia bicycle industry was particularly affected by this graduation, as it could no longer use bicycle gears made in Malaysia. A derogation was later granted by the European Union to address such a situation. Besides the example of Canada, Table 12 also shows that, even taking into account the different level of numerators and denominators, the level of percentages is the most generous in the case of the European Union, followed by the United States, even if the method of calculation is different, with Japan the least generous of the Quad group. This should not be surprising, as the United States has not changed its RoO since it enacted the first GSP in 1974 and Japan has introduced limited changes to its GSP RoO since their inception in the 1970s.

Table 13 provides a comparison of the use of the different percentage criteria used by Japan and the European Union. It is evident that in the European Union, 40 chapters and 638 headings of the Harmonized System benefit from a 70 per cent rule and Japan does not allow such a percentage. Under 38 chapters and 580 headings, the European Union allows for the use of alternative RoO among CTH and a percentage criterion, a flexible approach, and Japan does not provide for such a possibility. Under 141 headings, Japan requires compliance with RoO and a percentage criterion, and such cases are limited to 54 headings in the case of the European Union. It is evident that the European Union has engaged in a meaningful reform that has generated a number of positive changes for LDCs. Such reforms and policy changes have yet to occur in the case of Japan and the United States. Such differences are reflected in the results achieved by these countries in boosting LDC trade and increasing utilization rates of GSP schemes, as discussed in section II.

106 See UNCTAD/ALDC/2017/3.

107 Such a liberal rule may be said to occur in the electronics and machinery sector, in which MFN rates of duty are low and the room for preferential margins is limited, as demonstrated by the example of bicycles, for which the MFN rate is as high as 14 per cent; this suggestion does not bear up under close scrutiny.

108 This possibility was potentially limited by the graduation policy of Canada that came into effect on 1 January 2015 and removed benefits from 72 higher income and trade-competitive countries, including China, and therefore no cumulation would have been possible with the countries that had graduated. Most recently, Canada has taken steps to ensure that the benefits of the least developed country tariff regime will not be reduced by changes to GPT country eligibility (see http://canadagazette.gc.ca/rp-pr/p2/2013/2013-10-09/html/sor-dors161-eng.html and the general preferential tariff withdrawal order (2013 GPT Review) P.C. 2013-967, 27 September 2013).

109 For these countries, see http://trade.ec.europa.eu/doclib/docs/2013/december/tradoc_152015.pdf.

Table 12
Comparative summary of the Quad rules of origin percentage criterion for the least developed countries

Country or group	Origin criteria	Requirements	Numerator	Denominator	Percentage level	Administrative requirements
Canada	One rule across the board for all products except textile and apparel articles for which product-specific rules apply	Maximum amount of non-originating inputs	Value of non-originating material	Ex-factory price	Maximum amount of non-originating material 60 per cent, for LDCs, 80 per cent with cumulation	Form A certificate of origin or exporter's statement of origin may be submitted as proof of origin; special certificate of origin for textiles and clothing
European Union EBA	Product-specific rules for all products	Change of Harmonized System heading with or without exemptions, specific working or processing requirements and/or maximum percentage of imported inputs or a combination of requirements	Value of non-originating material	Ex-works price	Maximum amount of non-originating material does not exceed 70 per cent; exception under chapter 63: 25 per cent, 40 per cent, 50 per cent when used in the single list	System of registered exporters that issues statements of origin, administered by beneficiary countries
Japan	CTH as a general rule and single list of product-specific rules	Change of Harmonized System heading with or without exemptions, specific working or processing requirements and/or maximum percentage of imported inputs or a combination of requirements	Value of non-originating material	FOB price	Maximum amount of non-originating material 40 per cent	Form A to be stamped by Chamber of Commerce; GSP; Form A exempted for consignments not exceeding ¥200,000 or goods whose origins are evident
United States GSP	One percentage (35 per cent) rule across the board for all products	Minimum local content requirement	Cost of materials produced in preference-receiving country plus direct cost of processing carried out there	Appraised value of article at time of entry into the United States	Minimum 35 per cent, exact percentage must be written in certificate of origin	No certificate of origin required, claim of GSP on entry form
United States AGOA	Same as above, with exclusion of textiles and clothing[a]	Same as above; product-specific origin for textiles and clothing[a]	Same as above	Same as above	Same as above	Special requirements apply for textiles and clothing
United States CBERA and CBTPA	Same as above, with exclusion of textiles and clothing[a]	Same as above; product-specific origin for textiles and clothing[a]	Same as above	Same as above	Same as above	No certification for CBERA required, but specific regulations for CBTPA[a]
United States CBERA, HOPE and HELP	Specific regulation[a]	Specific regulation[a]	Specific regulation[a]	Specific regulation[a]	Specific regulation[a]	Special requirements apply[a]
United States Nepal	Same as GSP, product-specific rules for textiles and clothing[a]	Same as GSP, product-specific rules for textiles and clothing[a], article belongs to designated 77 categories	Same as GSP	Same as GSP	Same as GSP	Same as GSP

[a] *For product-specific RoO, see below in the corresponding section in the UNCTAD handbooks and specific legislation of the preference-giving country.*

Notes: Japan and the European Union use the percentage criterion together with other criteria such as CTC and working or processing requirements; for a discussion of other DFQF schemes for LDCs, see UNCTAD/ALDC/2017/4.

Source: UNCTAD/ALDC/2017/3.

Table 13
Comparison of the use of the percentage criterion in Japan and the European Union

		Number and percentage of chapters and headings for which the percentage criterion is used						
		As exclusive* RoO criteria	As additional criteria**	Alternative*** RoO criteria with CTH	At 40 per cent or less	At 50 per cent	At 70 per cent	At 20 or 30 per cent
European Union	Number of headings	88	54	580	62	18	638	4
	Percentage of total	7.19	4.41	47.39	5.07	1.47	52.12	0.33
European Union	Number of chapters	6	4	38	7	1	40	
	Percentage of total	6.19	4.12	39.18	7.22	1.03	41.24	
Japan	Number of headings	0	141	0	112	29	0	
	Percentage of total	0.00	11.52	0.00	9.15	2.37	0.00	
Japan	Number of chapters	0	5	0	4	1	0	
	Percentage of total	0.00	5.15	0.00	4.12	1.03	0.00	
				Total number of headings Total number of chapters			1224 97	

* *only percentage criterion*

** *other RoO and percentage criterion*

*** *other RoO or percentage criterion*

Source: Authors' calculation

The LDC group has assessed various literature in the search for an appropriate level of percentage that may reflect supply chains and be adequate to their industrial level.[110] The group has made use of a survey conducted in Eastern and Southern Africa and other evidence from recent studies conducted by researchers employed by preference-giving countries. Another survey is currently being carried out in LDCs to gather additional evidence through a questionnaire. Such literature reviews have indicated that in the majority of cases, the required percentages of preference-giving countries are not realistic when confronted with industrial reality. A recent example of manufacturing of electronics in China shows that local content is around 10 per cent.

On the basis of the above-mentioned best practices and lessons learned, LDCs consider that a level of 15–25 per cent or even lower for certain categories of products calculated according to the formula contained in section IV.2.1 above would guarantee that substantial transformation takes place and that genuine manufacturing operations have been carried out in LDCs.

IV.2.3. Treatment of freight and insurance costs in the value of originating and non-originating inputs

The majority of LDCs have basic or, in most cases, a bare minimum industrial base. Such LDCs, especially landlocked and island LDCs, rely on inputs imported from third countries to manufacture their finished products. As shown in Table 12, preference-giving countries use different numerators and denominators in the calculation methodology of the percentage rule. The definition of the numerator and denominator matters in the calculation formula. There are a variety of experiences in the definition of the numerator and denominator. In principle, they should allow for a fair comparison, reflecting on one side the cost (and profit) of the finished product and on the other side the cost of the foreign materials used or the local content added. The addition or exclusion of certain costs such as the cost of insurance and freight may alter the results of the calculation. It is therefore suggested that the form of the percentage formula used should take into account the special situations related to the transport costs of the input of materials to LDCs, especially landlocked and islands LDCs or, if it is not possible for such formulas to take into account such factors, by adjusting accordingly the level of percentage. Such RoO that allow adjustments to the costs of material by deducting or adding the cost of freight and insurance already exist under United States FTAs such as the Central America Free Trade Agreement.This point has been raised in various submission of the LDC WTO group but has yet to be meaningfully discussed in the CRO.

[110] See, for example, European Commission, Impact assessment on RoO for GSP, 25 October 2007, Taxud/GSP-RO/IA/1/07; Evaluating the consequences of shift to a value-added method for determining origin in European Union PTAs, July 2006, letter of contract No. 2005/103984, framework contract AMS/451-LOT No. 11; Michiel Scheffer, Study on the application of value criteria for textile products in preferential RoO, October 2006, Tender 06-H13; Contract Cadre FISH/2006/20, Specific Convention No. 3, RoO in preferential trade arrangements: New rules for the fishery sector, trade preferences for LDCs: An early assessment of benefits and possible improvement in the context of WTO negotiations, UNCTAD/ITCD/TSB/2003/8. December 2003, An assessment of the impact of preferences erosion and RoO in Eastern and Southern Africa, a survey of ESA exporters, UNCTAD and COMESA, 2010.

V. FRAMING THE DEBATE FOR PROGRESS TOWARDS BETTER RULES OF ORIGIN FOR THE LEAST DEVELOPED COUNTRIES

V.1. Background and way forward

The relative progress made from 1996 to present in getting to better RoO for LDCs and the work ahead should be measured within a broader scenario. The multilateral trading system, including GATT 1947, has to date provided limited discipline to RoO, especially preferential RoO. This is in contrast with other similar basic customs laws such as customs valuation and customs classification, under which multilateral instruments have provided effective disciplines for decades, namely the WTO customs valuation agreement and the International Convention on Harmonized Commodity Description and Coding System for customs classification.

The WTO agreement on RoO was originally conceived to partially fill in the existing gap. However, its scope and coverage are limited to non-preferential RoO and even in such areas, it has not been possible to conclude the harmonization work programme on non-preferential RoO.

Before the Bali and Nairobi decisions on preferential RoO for LDCs, the existing multilateral instruments to discipline preferential RoO were limited to the two annexes of the Kyoto Conventions of 1974 and 2000 and the common declaration with regard to preferential RoO contained in the agreement on RoO. Despite being simple guidelines contained in the annexes to conventions, the content and recommendations contained in annexes to the Kyoto Conventions have been the unique source of inspiration for the myriad of trade officials and negotiators facing the task of drafting preferential RoO. This latter consideration applies in the context of unilateral or contractual RoO in FTAs.

In retrospect, more detailed non-binding guidelines would have assisted the multilateral trading system in drafting effective and predictable preferential RoO without necessarily limiting the policy space of Governments and negotiators. RoO are a technical subject where it is possible to make substantial progress in drafting techniques while leaving policy space intact for negotiators and policymakers to determine their content.

The common declaration on RoO contained in the WTO agreement on RoO, although having some potential, generated less practical and concrete effects compared with the Kyoto Conventions. This is probably due to the fact that it did not contain much technical novelty on drafting RoO with regard to the Kyoto Conventions and the existing preferential RoO of WTO members. The declaration provided for, and largely anticipated, some provisions of the Agreement on Trade Facilitation, namely subparagraphs (d) to (g) on binding advance ruling information, judicial review, publication and confidentiality, yet there is not much trace of follow-up debates in the records of CRO to make these subparagraphs operational.[111]

Bearing the above-mentioned precedents in mind, it may be reasonably argued that much of the value of the Bali Decision and Nairobi Decision depends not on their binding or non-binding nature but rather on their capacity to increase interest in discussing RoO at

[111] See subparagraph (d) and subsequent subparagraphs of the common declaration: "(d) upon request of an exporter, importer or any person with a justifiable cause, assessments of the preferential origin they would accord to a good are issued as soon as possible but no later than 150 days after a request for such an assessment provided that all necessary elements have been submitted. Requests for such assessments shall be accepted before trade in the good concerned begins and may be accepted at any later point in time. Such assessments shall remain valid for three years provided that the facts and conditions, including the preferential RoO, under which they have been made, remain comparable. Provided that the parties concerned are informed in advance, such assessments will no longer be valid when a decision contrary to the assessment is made in a review as referred to in subparagraph (f). Such assessments shall be made publicly available subject to the provisions of subparagraph (g); (e) when introducing changes to their preferential RoO or new preferential RoO, they shall not apply such changes retroactively as defined in, and without prejudice to, their laws or regulations; (f) any administrative action which they take in relation to the determination of preferential origin is reviewable promptly by judicial, arbitral or administrative tribunals or procedures, independent of the authority issuing the determination, which can effect the modification or reversal of the determination; (g) all information that is by nature confidential or that is provided on a confidential basis for the purpose of the application of preferential RoO is treated as strictly confidential by the authorities concerned, which shall not disclose it without the specific permission of the person or Government providing such information, except to the extent that it may be required to be disclosed in the context of judicial proceedings."

the multilateral level.[112] The deliberations of CRO have been progressively reduced since 2007 due to a lack of consensus on the harmonization work programme on non-preferential RoO. For almost a decade, discussions at CRO were limited to educational exercises, meaning presentations made by private sector representatives, associations or international organizations on the relevance of non-preferential RoO.

Given this state of affairs, discussions on preferential RoO for LDCs have provided a new lease of life for CRO debates. Notably, it may be argued that such debates had a positive spillover on the debate on non-preferential RoO, as seen in the initiative by Switzerland on resuming some form of dialogue on non-preferential RoO[113]: "In addition, he confirmed that his delegation was not proposing to restart negotiations for the harmonization of non-preferential RoO. His delegation had been inspired by the successful format of the Nairobi Decision on preferential RoO for LDCs and thought that members could agree on best practices towards which all members could progressively converge. He further stated that his delegation's intention was to work perfectly within the mandate and objectives of the agreement on RoO. Finally, he said that further discussions with members would be useful to clarify these elements."

When the value of the Bali Decision and Nairobi Decision is assessed against the low level of progress at the multilateral level on the issue of RoO, they have undoubtedly reintroduced the debate on rules of origin at multilateral level. In fact, there are a number of issues and novelties in the wording of the decisions through which the multilateral trading system may gain considerable clarity and transparency on drafting RoO, and not only for LDCs.[114] Only recently the resumed discussion at WCO for an updating of annex K on rules of origin of the Revised Kyoto Convention have created an additional multilateral fora to discuss rules of origin.

One of the lessons learned from the negotiations prior to the Nairobi Decision was that efforts should be made to enhance the level of engagement and understanding of RoO by WTO members attending CRO. Experience has shown that at times discussion or consensus at the Trade Negotiating Committee (TNC) over the draft Bali and Nairobi Decisions was stalled or substantially slowed down by a lack, or insufficient understanding, of the technical issues at stake. On the one hand, Geneva-based delegations might not possess technical expertise on RoO, while on the other hand, LDC delegations at CRO, mostly Geneva based, have made progress in debating RoO at CRO. However, the commitment and engagement shown by LDC delegations have yet to be adequately matched by other delegations at CRO, either by including experts from capitals or by showing commitment to learning and understanding better RoO. Efforts should be made to progressively establish a level playing field to make further progress on RoO beyond the Bali Decision and the Nairobi Decision.

V.1.2. Framing the debate for further progress at Committee of Rules of Origin

The main challenge in making further progress on LDC RoO is to appropriately frame the debate. On the one hand, it is clear that preferential RoO are unilateral and that preference-giving countries are not willing to be bound by multilateral disciplines on drafting their RoO. On the other hand, the objective of LDCs has been to obtain binding commitments. This was the core of the debate leading to the Nairobi Decision resulting in a number of seemingly binding paragraphs of the Decision starting with "shall", just to be invariably followed by a series of additional paragraphs introducing a series qualifications and flexibilities emptying the "binding" commitment of the preceding paragraph.

In framing the debate for a way forward after the Nairobi Decision and, more precisely after 5 years of implementation period that has seen few improvements, it is necessary to move beyond the quandary of binding and non-binding language. More in-depth technical discussions to explore how progress might be made on lessons learned and best practices should be explored with involvement of capital based delegates, and possibly the participation of the private sector. Given their technical nature, progress could be made on RoO while leaving almost intact the policy space of preference-giving countries in determining RoO for LDCs.

[112] For an analysis of the Bali Decision, see S Inama, 2015, Ex ore tuo te iudico: The value of the WTO Ministerial Decision on Preferential RoO for LDCs, Journal of World Trade, 49(4):591–618.

[113] See the statement by Switzerland made at the CRO meeting on 2 March 2017 in WTO document G/RO/M/68.

[114] This issue will be discussed in a series of publications under the UNCTAD and European University initiative (see https://globalgovernanceprogramme.eui.eu/research-project/trade-facilitation-and-rules-of-origin/).

What is required is genuine engagement and resources to carry out the necessary technical work. The recent debates at CRO over preferential RoO for LDCs and, most recently, some reflections on non-preferential RoO have shown that the CRO may have the necessary inspiration and ambition to move forward, on the condition that members redouble their efforts. Better and strengthened coordination with the Technical Committee on RoO at the World Customs Organization (WCO) should also be sought in the interest of the multilateral community. The work on revising and updating the Kyoto Convention, including annex K, at WCO may also be a source of further inspiration and cooperation among the international community.

A recent submission by LDC[115] on the occasion of fifth anniversary of the Nairobi Decision highlighted the fact that the LDCs have made around 18 submissions from 2015 to 2020 either in form of substantive presentation or analytical documents. To date there has not been a single written response or submission from Preference Giving countries in response to LDCs, with the notable exception of Switzerland that provided an oral explanation for the low utilization of trade preferences by LDC and pledged that a solution will be found.

The LDCs should not be left alone on the quest for better rules of origin. The work carried out by the LDCs in the CRO is a public good having potential positive spillover for the whole international community and WTO itself, given the current lack of multilateral discipline on rules of origin. Establishing best practices and lessons learned on rules of origin for LDCs could the source of inspiration and guidance for rest of the multilateral community and other preferential trading arrangements.

To this effect a proposal by the LDC[116] to strengthen the mandate of Committee of Rules of Origin and better frame and focus its deliberation with a clear timeline to report results at the next WTO Ministerial conference has been made at the CRO of November 2020. The proposal aimed to ensure that implementing the Nairobi decision is a shared responsibility of the WTO membership. Consultations on such proposal still undergoing at the time of this writing.

A set of topics to carry out such technical work may be used to frame the debate at CRO, as follows:

(a) Single transformation: Members may wish to discuss and carry out technical work on identifying how single transformation i.e., a single manufacturing stage[117] such as manufacturing garments from fabrics, carried out in LDCs may be considered confer origin to a finished product obtained in LDCs. Single transformation could be defined in a number of ways, including: ad valorem percentage criterion; change of tariff classification; and specific manufacturing or processing operations. It should be recognized that single transformation may be expressed according to different drafting techniques as outlined below and/or through a combination of different drafting techniques and the use of cumulation;

(b) Ad valorem percentage: In the light of the Bali Decision and the Nairobi Decision on preferential RoO for LDCs on this methodology, WTO members should carry out technical work to identify best practices in calculating the ad valorem percentage and the appropriate level of percentages required to ensure that single transformation is achieved in LDCs. For example, an area in which the international community may stand to gain is clarification of the different methodologies that may be used to calculate the ad valorem percentage and the appropriate level of percentages for different sectors;

(c) Change of tariff classification: In the light of the Bali Decision and the Nairobi Decision on preferential RoO for LDCs on this methodology, WTO members should carry out technical work to identify best practices at the sector or product-specific level on how the change of tariff classification criterion may be used to reflect single transformation achieved in LDCs. It is recognized that the Harmonized System is not designed for RoO purposes and that an across-the-board change of tariff classification criterion may not reflect genuine substantial transformation in LDCs in all cases. It may be beneficial to further discuss and, if possible, identify the

[115] G/RO/W/194 of 5 March 2020" 5 Anniversary of the Nairobi Ministerial Decision :review of implementation, identification of gaps and the way forward

[116] See WTO document G/RO/W/198, November 2020,Implementaion of the WTO Ministerial Decisions identification of gaps and the way forward

[117] Obviously the requirements for single transformation will have to be identified in details for different sectors and should be accompanied by a list of minimal working or processing operations that are not origin conferring as is presently the case in many preference giving countries rules of origin

products and sectors for which a simple CTC could be used with or without CTC exceptions to reflect single transformation;

(d) Specific manufacturing or processing operation criterion: In the light of the Bali Decision and the Nairobi Decision on preferential RoO for LDCs on this methodology, WTO members should identify best practices that may be used to identify specific working or processing operations that are a reflection of single transformation in LDCs. The experience gained by the international community on chemical products may be extended to other sectors.[118] RoO reflecting specific working or processing requirements carried out in value chains may facilitate the insertion of LDCs into global value chains;

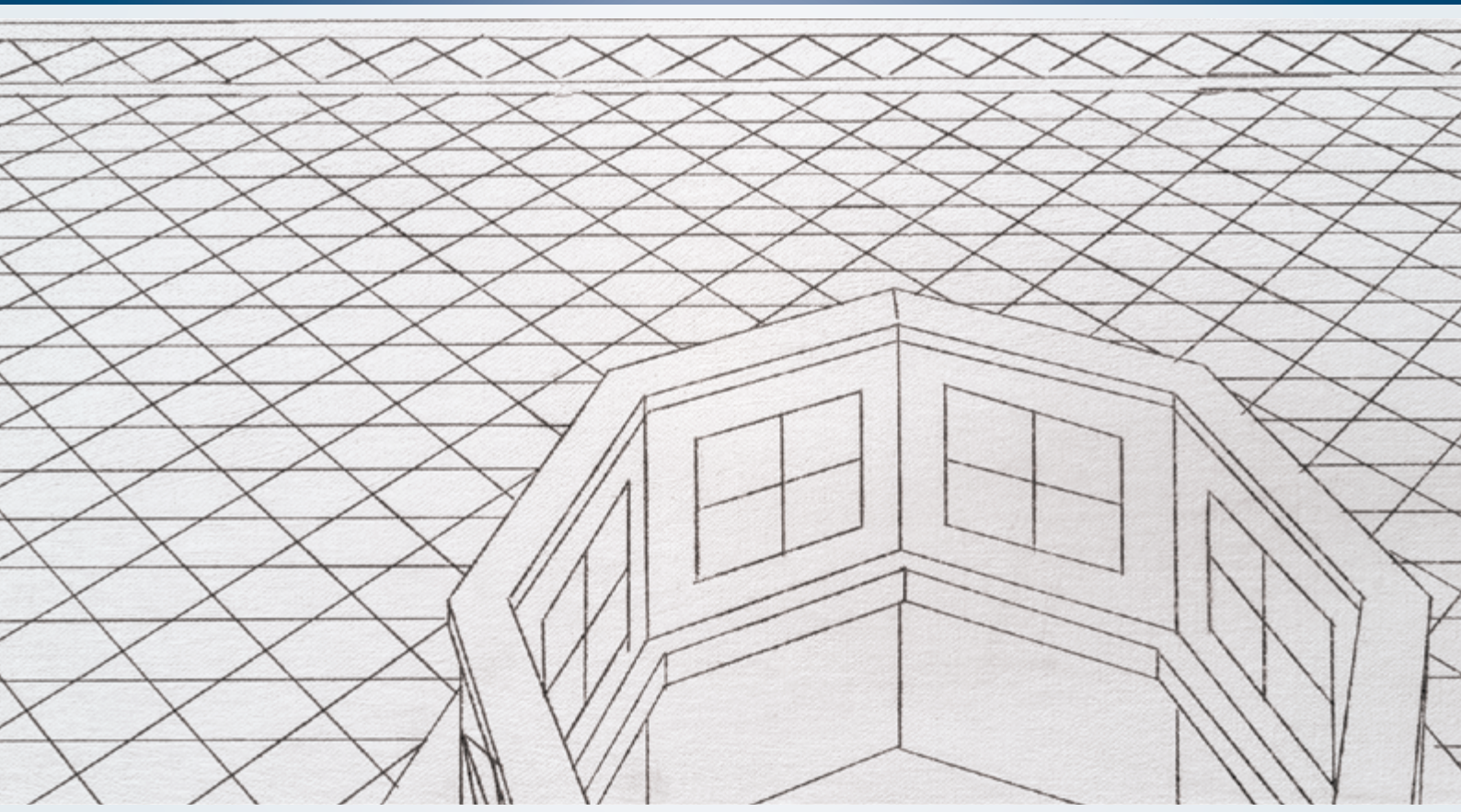
(e) Cumulation: WTO members should carry out technical work to identify best practices on cumulation, taking into account the fact that cumulation may provide LDCs with cumulation of working and processing operations and materials with: preference-granting countries; GSP beneficiaries of a given preference-granting country; countries that are members of the same regional grouping; and countries with which a preference-granting member has concluded a regional trade agreement (extended cumulation and/or cross cumulation);

(f) Documentary evidence and direct consignment: In the light of the Agreement on Trade Facilitation and the work conducted by WCO during the revision of annex K to the Kyoto Convention, WTO members should carry out technical work to identify best practices on certification on RoO, taking into account the fact that certification on RoO is evolving from certifying authorities towards self-certification such as exporter declarations, importer declarations. Use of IT technology and blockchain should be equally explored.

(g) Members should carry out technical work to identify best practices of trade facilitation on issues of direct shipment to avoid the requirements of forms of documentary evidence that are not commercially realistic or available and adequate trade facilitating provisions third country invoicing and small consignments.[119]

[118] In the course of the negotiations for the Transatlantic Trade and Investement Partnership (TTIP) among US and EU the respective associations of chemical industries reached an agreement on RoO before than formal negotiations were launched.

[119] For an explanation of third country invoicing see WCO guidelines on certification of origin,June 2018, available at http://www.wcoomd.org/-/media/wco/public/global/pdf/topics/key-issues/revenue-package/guidelines-on-certification.pdf?la=en



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