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RULES OF ORIGIN

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Dr. Anil K. Kanungo

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From the Director's Desk

Rules of Origin (RoO) are a set of criteria required to determine the national origin of a product. When a product is wholly produced in one country, it doesn't invite any controversy or disagreement over its origin. However, in current era of globalization, where more and more products are produced through amalgamation of inputs from different sources and countries, determining origin of the product has become a difficult task.

In today's active pursuit of globalization of production, conduct of international trade in goods doesn't necessarily remain free and fair, rather confronts many complex challenges in terms of various stages of preparations such as sourcing of materials, tariffs negotiations, labelling requirement, value creation, involvement of technology, etc. These dimensions play a crucial role in producing the "finished" products creating uncertainty regarding its origin.

Trade distortions that emanate out of this transaction have invited wraths of many exporters and countries, who have repeatedly expressed in various fora at the WTO to establish a "Rules of Origin Agreement" to determine the origin of the product among members. This would ensure transparency without restricting, distorting or disrupting international trade and that they are administered in a consistent, uniform, impartial and reasonable manner. They should be based on a positive standard which essentially would mean that they should state what confers origin rather than what does not.

RoO that are currently active are of two types: non-preferential and preferential. Non-preferential RoO define the origin of goods mainly for statistical purposes and for the application of trade measures such as tariffs, quotas, anti-dumping, countervailing duties, etc. Preferential RoO, which is often more stringent, is defined by members of a preferential trade area to ensure that only goods which originate from one of the member countries benefit from a preferential access at importation.

It's often non-preferential which is critical and needs to be harmonized. Though Technical Committee on RoO set up by the WTO has already made some progress, collective will and efforts of developed and developing countries are needed to make them workable, understandable and predictable. RoO should not be used as a trade policy instrument having restrictive, distorting or disruptive effects on international trade, instead should be seen as a device to promote trade. The expected benefit lies in providing certainty to the origin of product to realize full potential of world trade.

(Dr. Surajit Mitra)

Rules of Origin in PTAs:
Issues, Concerns and Implications

Sejuti Jha*

Rules of Origin (RoO) have become the gatekeepers of global commerce. The WTO has been trying for many years to harmonize the widely different RoO regimes applied by governments across the globe. The Harmonization Work Programme, however, leaves out RoO in Preferential Trading Arrangements (PTAs). Governments negotiate different rules in different PTAs thereby creating a "spaghetti-bowl" of rules. This study tries to delineate the different issues surrounding RoO in PTAs, underlines the concerns that emanate from their application and discusses implications for policy-makers.

1. Introduction

RULES of Origin (RoO henceforth) are the set of conditions required to determine country of origin for a traded product. Their importance arises from the fact that most manufactured commodities now a days are not made in a single country. Thus we need rules to determine where a particular product is made. This is necessary for various reasons, e.g. to determine a country of origin label ("Made in country X"), to help in compiling trade statistics, for applying various commercial policies (like tariffs, anti-dumping duties, etc.) and also for government procurement. Each of these trade regulations need differentiating between domestic and foreign goods, or demarcating foreign goods according to their origin. Thus we see RoO perform multi-dimensional roles in international commerce. We focus on one such function – the role of RoO in preferential trading arrangements (PTAs). A PTA is a trade agreement between two or more countries whereby they agree to liberalize trade among themselves by granting tariff preferences on select products. Such goods are eligible for zero or reduced tariffs in an importing member of a PTA only if they "originate" in the exporting member of the PTA. RoO in a PTA determine exactly this and thereby are used to decide whether for an imported product the importer will pay the most favoured nation (MFN) tariff or preferential tariffs. RoO, thus, become gatekeepers to a PTA. If a product satisfies the rules it gains entry into the PTA market at zero or reduced tariffs; if it does not, it can still enter the market, but now has to pay MFN tariffs.

To give an example, if a cookie (sweet biscuit) is made in Indonesia using domestic eggs, imported flour from Turkey, refined sugar from Thailand, butter from New Zealand and Belgian chocolate and then exported to China, how will the Chinese Customs determine the exact country of origin for the cookie[1]? If the cookie satisfies the RoO of the ASEAN-China Free Trade Agreement, the Chinese Customs will allow it to enter China duty free; however, if it is determined to be made outside Indonesia on account of the imported ingredients then the normal MFN tariff needs to be paid, which is 15 per cent for cookies in China.

Apart from determining what tariff will be applied on a product, RoO serve another important function in PTAs, especially in Free Trade Agreements (FTAs), where they are instrumental in checking *trade deflection*. In an FTA, members maintain their own external tariffs. Hence, tariffs for a particular product may differ between member

* Research Associate, Confederation of Indian Industry (CII), New Delhi.

countries. In this setting, in the absence of RoO, a commodity can enter the country with the lowest duty on it and get re-exported to other countries in the FTA to take benefit of the tariff differential. This is known as *trade deflection*. RoO prevent such simple transhipment of goods by requiring products to "originate" in exporting member countries. Thus we find that RoO are necessary for a PTA to function effectively. However, by their design these necessary rules can turn evil and either restrict trade, which the PTA in the first place was trying to liberalize, or in some cases may even distort trade through *trade diversion*. Let us look at the rules, how their design and application restricts and/or distorts trade and what policy implications we can draw from it.

2. The Rules

Let us now ponder on the question how the "origin" of the cookie will be determined? Resolving the issue of "origin" for primary goods is uncomplicated. If such goods are "wholly obtained" in the territory of the exporting country (including its territorial waters), it is clear that they "originate" in that country. By extension goods that are made entirely from primary inputs originating in a country can themselves be considered as "originating goods". However, as a result of the globalization of production processes, many manufactured commodities today, like the cookie in our example, incorporate inputs produced in a wide variety of countries. In such cases "originating" status is accorded to that country where the product underwent "substantial transformation". "Substantial transformation" is something that imparts to the product its essential characteristic. The Kyoto Convention of 1973 laid down the general principles for "substantial transformation". Following the Convention, "substantial transformation" is ensured by fulfilling one of the following criteria:

Value added rule (VA): This rule is also known as Regional Value Content (RVC) criterion, Domestic Value Added (DVA) rule or simply the percentage test. The rule requires that a minimum percentage of value should be added to the product in the exporting country for the claim of origin from there (*domestic content*). It can also be calculated as an allowed maximum percentage of value added by materials of foreign origin (*import content*). Each PTA specifies which method of calculation will be applied. The *domestic content* method is used as a test by US for all its PTAs whereas the *import content* method is used by the EC. Under the ASEAN-China Free Trade Agreement, the RoO is simply a domestic content of 40 per cent. Thus if value of eggs (domestic input) in Indonesia makes up 40 per cent of the value of cookies made from it the cookies will get a "Made in Indonesia" certificate which will allow the Indonesian exporter to send his products duty-free into the Chinese market.

Change in tariff classification rule (CTC): If because of the processing done in the exporting country, a final product gets classified under a different head of the customs tariff classification system than the imported intermediate inputs used in its making, then the product may be claimed to be "originating" in that country. Most countries (more than 200) use the Harmonized Commodity Description and Coding System (HS in short) as their tariff classification system. The HS classifies products into Chapters (assigned a 2-digit number), Headings (assigned a 4-digit number), and Items (assigned a 6-digit number). All countries using HS have same product classification till this 6-digit. After this, countries can add 2 or 4 more digits to identify a product more specifically. An example is tomato juice, which is assigned HS Code 20095000 in India's tariff schedule, which follows an 8-digit HS classification. In this string of 8 digits the first two digits imply Chapter, in this case Chapter 20 (preparations of vegetables, fruits and nuts); the first 4 digits imply Heading – 2009 (fruits juices). For all countries using HS classification system, tomato juice will be assigned the same first 6 digits – 200950. So, for example, if RoO requires a change in heading (simply known as CTH rule), i.e. a change in the 4-digit level, then imported preserved tomatoes (HS Heading 2002) can be used to prepare tomato juice (HS Heading 2009). If, however, RoO requires a change in the chapter level i.e. a change in the 2-digit level, then imported tomatoes that are preserved cannot be used as both imported input and final product have same HS chapters (Chapter 20). Thus in a RoO where change in chapter is required, tomato juice will be originating in the exporting country only if domestic tomatoes are used.

Technical requirement rule (TECH): It sets out certain production activities that may (positive test) or may not (negative test) confer "originating" status to a product. For example, for semiconductors the process of diffusion, or wafer fabrication, has to be performed in the EC for integrated circuits to be considered of local origin.

Some PTAs use different combinations of the above three rules to make a general RoO regime for all products. For example, ASEAN Free Trade Area (AFTA) applies only the VA rule across all products; most of India's earlier PTAs used the twin criteria of a specific VA rule and a CTH rule for all products. However, most PTAs include general rules along with some Product Specific Rules of Origin (PSRO). For example, India's recent comprehensive economic cooperation agreement (CEPA) with Japan has an annex covering 36 pages which details product-by-product RoO. To understand this better, let us look at the product specific RoO for cookies. The preferential RoO for all bread, biscuit and pastry products (falling under HS Heading 1905) in the EU states, "Any imported inputs allowed except those under Chapter 11". HS Chapter 11 includes flour. Thus if a country, which has a PTA with EU, exports cookies to EU using all domestic ingredients except flour, which it imports, then its cookies will have to pay tariffs while entering EU. Under the India-Japan CEPA the RoO for HS Heading 1905 is, "Manufacture in which all the materials used are wholly obtained". It is thus even more restrictive than the EU rules. In the US-Australia Free Trade Agreement, to get tariff preferences, cookies need to just satisfy the CTC rule at the heading level. As most other inputs used in preparing cookie, like flour, sugar, butter, eggs, chocolates are in other headings even if these inputs are imported the final cookie will get tariff preferences under the FTA. Thus this PSRO is the least restrictive to trade.

Presence of other supplementary rules (like cumulation, absorption, *deminimis*) besides the three main rules, tries to relax the stringency of a particular RoO regime. These are described below:

- *Cumulation* encourages producers of one PTA to use imported materials from other PTAs. It thus relaxes stringency of the VA rule. For example, in India-Sri Lanka FTA the VA rule is 35 per cent of *domestic content*. If, however, the partners source intermediate inputs from each other the required value to be added domestically is reduced to 25 per cent.
- *Territoriality* or *outward processing* provisions go beyond the *cumulation* provisions in allowing the use of materials from non-member countries. Outward processing allows for a good to be taken out of the territory of a PTA member to a non-member for some processing, and then brought back for final manufacture and export to other member(s) of the PTA. The concept accumulates only the value addition which takes place in the territory of the exporting member at different stages, while it disregards the value addition which takes place in the territory of the non-member.
- *Tolerance* or *de minimis* rule states that a good may still be originating if the value of the non-originating materials, which do not satisfy the CTC rule, does not exceed a specified percentage of the final value of the good. For example, under the India-Korea CEPA for those goods that do not satisfy change in tariff sub-heading (CTSH) rule, if the imported inputs value is 10 per cent or less then they are considered to be originating. This *de minimis* threshold is applied as 7 per cent of weight for textile and apparel products.
- *Roll-up* or *absorption* principle allows intermediate products that have acquired originating status by meeting specific processing requirements to be considered to be 100 per cent originating when used as inputs in manufacturing another good. Thus the import content in these intermediate inputs is not taken into account in subsequent VA calculations of the final product. The importance of this rule can be found from the infamous Honda dispute between US and Canada under the US-Canada FTA (for details refer to Palmeter 1987; Cantin and Lowenfeld 1993; UNCTAD 1998).
- *Duty drawback* rule allows tariffs on imported materials used in the production of export items to be waived or refunded. In origin rules, access to drawback provisions can be restricted or denied entirely, raising the cost of exporting to member economies and encouraging firms to purchase inputs from potentially higher-cost local sources. Origin rules that disallow or derogate drawback arrangements for exporters are treated as more restrictive than rules that do not.

3. Effects by Design

Careful drafting of the rules can help in protecting industries from the liberalizing effects of PTAs. With the CTC rule there is the issue of the level of the classification at which change is required. The higher the level, the more trade restrictive effect it will have and thereby protect domestic industries. Many PTAs specify that the change should take place at the heading level of the HS (4-digit level). However, in North American Free Trade Agreement (NAFTA), RoO for some products require a change at the chapter level (HS 2-digit level), which is considered to be more restrictive. Palmeter (1993) points out that as all dairy products are classified in the same chapter (HS Chapter 4), even a "substantial transformation" of imported milk into cheese, does not ensure tariff preferences to cheese as there is no possibility of satisfying CTC at the 2-digit level in NAFTA. Thus cheese is deemed to be originating only if the milk from which it is prepared is also originating in the exporting country. The HS has 1,241 categories at the 4-digit level as against over 5,000 at the 6-digit level. This implies that requirement of a CTC even at the lesser restrictive 4-digit level will not be possible to attain for many products (Hoekman 1993).

The VA rule has the issue of valuation of materials. Depending on the method of valuation (ex-*factory*, *fob* or *cif*), the values of non-originating materials differ. *Ex-factory*, *fob*, *cif* are all sales contract terms used in international trade. They divide transaction costs and responsibilities between seller and buyer. *Ex-factory* in a sales contract implies the seller (exporter) makes the goods available at his/her premises (factory). The buyer (importer) is responsible for all costs and risks thereafter. *Fob* (free on board) implies the seller of the cargo has responsibility till he puts the goods on board of the ship. Risks are transferred to buyer from there on. *Cif* (cost, insurance and freight) is *fob* plus cost of ocean freight and marine insurance, which implies that the seller is also responsible for the transport of goods till the port of destination. Thus an *ex-factory* cost basis, used in PSRO of some EU agreements, is considered to be the narrowest valuation basis, and origin rules incorporating this provision are treated as the most restrictive on this account. Less restrictive valuation bases, in order of restrictiveness, include *fob* and *cif*. This can be shown from the following example. RoO VA requirements can be expressed either as maximum import content or minimum domestic value content in percentage terms. Say for a PTA a minimum 50 per cent value addition is required. This can be written as

$$\frac{\text{value of final product}^2 - \text{Imported input value}}{\text{value of final product}} * 100 \geq 50\%$$

Now say that the value of imported input used in making a product is US$50. And say *ex-factory* cost is US$80 (this is cost at factory premises), *fob* (which includes transport cost from factory to port) is US$100 and *cif* value of the final product is US$120 (as it now includes cost of ocean freight and insurance too). If the valuation base chosen for this particular PTA is *ex-factory* cost then VA in exporting country is

$$\frac{80-50}{80} * 100 = 37\% \text{ ;}$$

$\frac{100-50}{100} * 100 = 50\%$ was the chosen valuation base then

VA = ;

for *cif* the VA becomes

.

Thus with respect to restrictiveness agreements using *ex-factory* basis is deemed to be more restrictive and *cif* least restrictive.

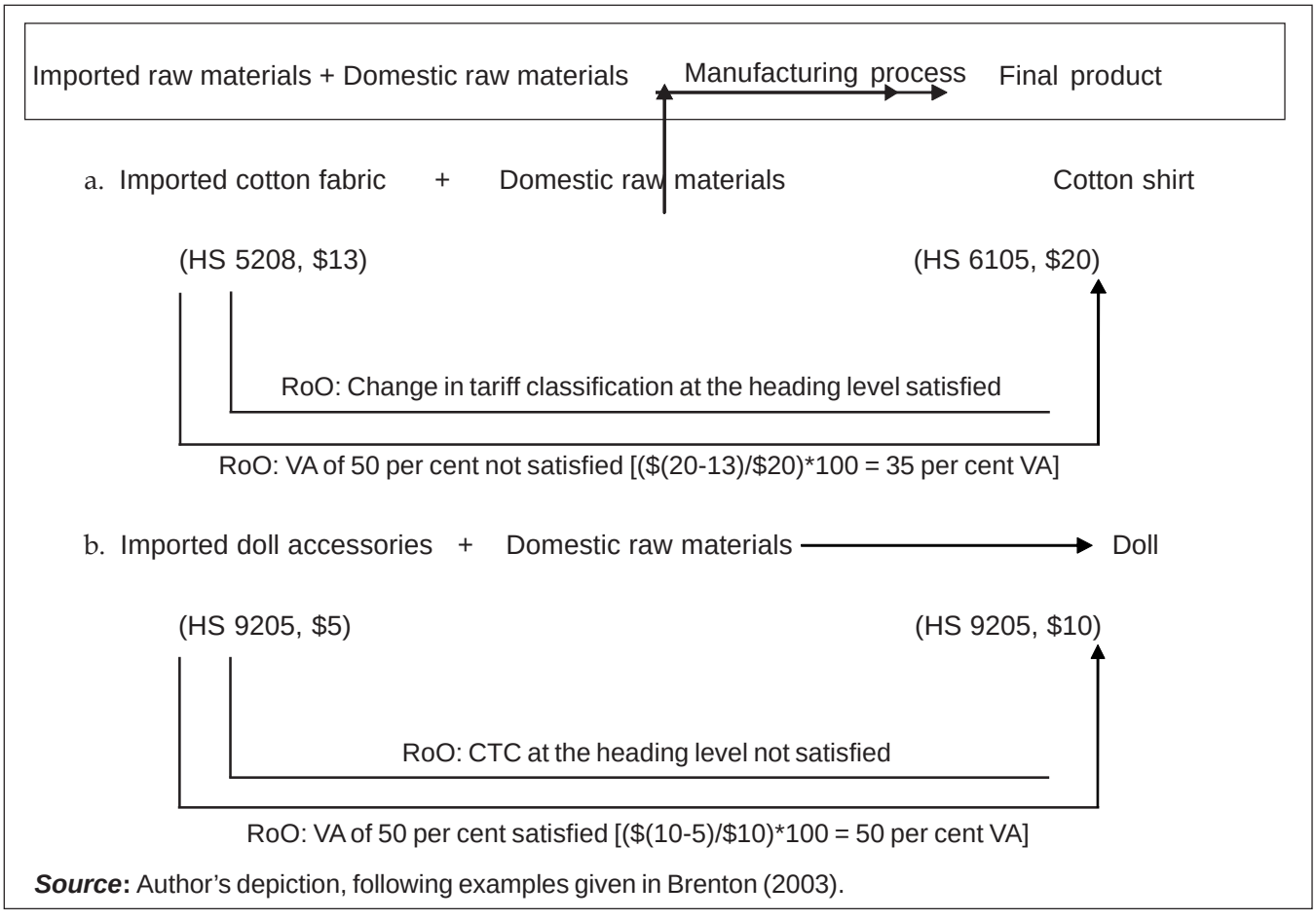
The TECH criterion states for each product certain manufacturing or processing operations that define origin (positive test), or that do not confer origin (negative test). One example is that of EU RoO for clothing products that stipulate "manufacture from yarn". The setting of technical requirements requires the participation of local industries in providing the technical knowhow that is required to arrive at a suitable RoO. This can let industries directly influence the drafting of RoO so as to protect their own interests. For example, the EU RoO for clothing products actually protects its domestic producers.

PSRO can be quite complicated and have high trade-restrictive effects as was shown in Brenton and Imagawa (2005, p. 192) where the authors discussing the RoO under NAFTA give the following example – RoO for men's or boys' overcoats made of wool (HS 620111) is - "A change to subheading 620111 from any other chapter, except from heading 5106 through 5113, 5204 through 5212, 5307 through 5308 or 5310 through 5311, Chapter 54 or heading 5508 through 5516, 5801 through 5802 or 6001 through 6006, provided that the good is both cut and sewn or otherwise assembled in the territory of one or more of the Parties." This RoO basically stipulates a CTC at chapter level and specifies a list of headings and chapters from which inputs cannot be used. By drafting such a rule the importing country (obviously the US as it is a large importer of men's or boys' overcoats) ensures an overcoat must be manufactured from the stage of wool fibres forward, because neither imported woollen yarn (HS 5106–5110) nor imported woollen fabric (HS 5111–5113) can be used. The rule also forbids use of imported cotton thread (HS 5204) or imported thread of man-made fibres (HS 54) in sewing the coat together. Thus this is certainly a very restrictive RoO.

How these rules affect a product's ability to get preferences is given in Figure 1. The schematic diagram follows the examples in Brenton (2003), where he shows that RoO of 40 per cent VA rule may not be satisfied by a garment manufacturer in a developing country if he/she uses imported fabric in the manufacture of apparel, even though it satisfies the CTC rule at the 4-digit heading level. This is because fabric makes up the major value of any apparel. Again, if a doll is made in a country and is clothed in imported doll clothes, it does not

FIGURE 1

RoO CRITERIA – SOME EXAMPLES



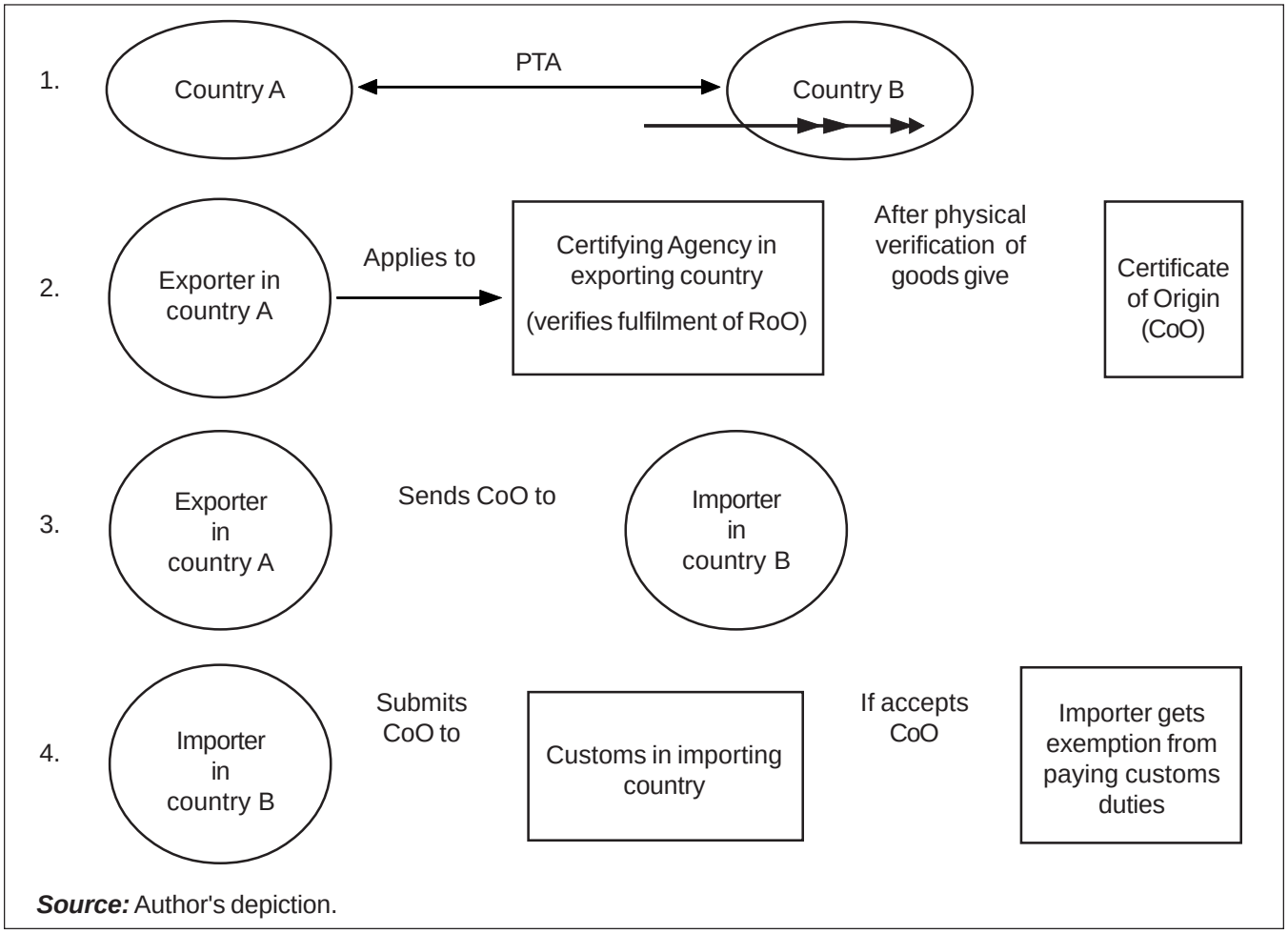
***Source*:** Author's depiction, following examples given in Brenton (2003).

satisfy the CTC rule as both the doll and the garments and accessories for the doll are under the same HS heading, even though it easily satisfies the VA rule.

From all the examples we can be certain that countries sometimes draft RoO in such a fashion so as to they can restrict trade and continue to protect domestic industries despite a PTA. As it is succinctly put by Estevadeordal and Suominen (2008, p. 3), "…negotiated at up to 8- or 10-digit level of disaggregation, RoO, like the tariff, make a superbly targetable instrument". RoO, apart from protecting domestic industries, can also distort trade. A producer may be forced to use local inputs (to satisfy high levels of value added) or partner inputs (to take help of *cumulation*) so that the final product will get tariff preferences. Thus there will be *trade diversion* in intermediates as was pointed out by Krueger (1993). Barcelo (2006) points to the role of *cumulation* rule in this *trade diversion* of intermediates. If more expensive local inputs are substituting cheaper non-member intermediate imports it can be termed as trade suppression (following de la Torre and Kelly, 1992) and if more expensive partner inputs are substituting cheaper non-member intermediate imports it is termed *trade diversion*. In case of *trade diversion* businesses will incur additional costs in production (if before FTA they were using non-member inputs perhaps it was because their price was cheaper or quality better) to satisfy RoO. They will be willing to do so till perceived tariff preference benefits of satisfying origin outweigh costs to do the same.

FIGURE 2

MODUS OPERANDI FOR GETTING PREFERENCES UNDER A PTA



Source: Author's depiction.

4. Effects of Enforcement

The *modus operandi* for getting tariff preferences under a PTA will let us shift our focus on to the implementation of the rules and their effects. This is described through a schematic diagram in Figure 2. The figure shows that to get tariff preferences, an exporter in country A, which has signed a PTA with country B, will first need to apply to the designated certifying agency in coutry A. The certifying agency will verify the claim of the exporter that his/her product fulfils RoO conditions laid down in the PTA and thus it is originating in the country. The agency checks the documents the exporter submits to it and then carries out physical inspection of the export products of the first consignment to be shipped to the importing country. If satisfied from both documents and physical verification, the certifying agency then issues a Certificate of Origin (CoO) to the exporter. The exporter then needs to send this document to the importer who can show it to the Customs in country B and get tariff preferences on his/her import.

The modus operandi makes it clear to us that satisfying a rule is the first step to get tariff preferences; proving it is the more important second test; there still exists the final hurdle – satisfying the foreign Customs to the veracity of the CoO and the authenticity of the goods. Physical verification requirement under the system is bound to cause time delays for exporters. Also it is plausible that there will be other transaction costs in getting the certificates from the certifying agency.

A study by Koskinen (1983) put the administrative costs associated with RoO in the EC related agreements to be around 1.4 to 5.7 per cent of the value of export transactions. Cadot *et al.* (2002) found that RoO related administrative costs under NAFTA translated to roughly around 2 per cent of Mexican exports to the US market. If costs to meet RoO requirements are high then businesses may forgo tariff preferences and trade via the MFN route. Thus utilization of tariff preferences of a PTA with restrictive RoO could be low because of high costs associated with fulfilling them, for example, under NAFTA export sectors in Mexico had, on an average, utilization rate of only 64 per cent (Cadot *et al.* 2002). In India the most utilized PTA scheme, till 2009, was found to be the India-Sri Lanka FTA; however, only 11 per cent of total export transactions were issued CoO under the FTA in 2008-09 (Jha 2011). This is not surprising as utilizations of most PTAs involving developing countries are found to be negligible (Takahashi and Urata, 2010; Kawai and Wignaraja, 2011). Most studies indicate that RoO, their design along with the costs a firm needs to incur to satisfy them and get CoO, play a definite role in such low utilizations. According to Inama (2009) the relation between RoO and low utilization of preferential schemes is an "acknowledged reality" (pp. 362).

RoO add cost and complexity for customs officials too. McNamara and Vermulst (1994) give many instances of mis-declaration of origin by exporters in the context of EC trade. Pursuing the veracity of CoO is a lengthy process and routine verifications exceeded staff resources of the LDCs like Uganda as reported by World Bank (2004). Resulting revenue loss from fraud was significant. In the context of India-Sri Lanka FTA there have been some reports of gross violations of RoO, mainly the circumvention of the VA rule by accounting manipulations (under-invoicing of imported inputs' values) (Jha 2010). Adequate attention is required to put on implementation of these rules so that on the one hand they do not hinder trade and on the other their misuse is checked.

5. Policy Implications

From the preceding sections we find that RoO are necessary evils[3] in the context of PTAs. They are necessary to enforce tariff preference schemes under a PTA, making sure that only "originating" products get tariff preferences. Their problem lies in restrictive designs, costly implementation and verification all of which lead to lower utilization of the preferential schemes. Policy-makers face a whole array of dilemmas when choosing RoO during PTA negotiations. Table 1 on the next page gives the relative merits and de-merits of the three main rules and associated policy dilemmas with each of them.

Most studies in the area of RoO of PTAs talk about the "spaghetti-bowl"[4] effect of such arrangements and RoO therein and how it complicates trade operations. Apart from complications that arise from design of the rules and their implementation, sometimes it is found that a good that satisfies origin for one PTA, may not do so in another as the RoO differ. There are some steps taken towards harmonization of non-preferential

RoO under the WTO (the Harmonization Work Programme is still going on). However, this harmonization programme leaves RoO out of the PTAs. In the absence of any multilateral effort in harmonizing these rules, different authors suggest different way out of the quagmire of the web of rules. Some authors put forward a suggestion to put more effort on multilateral initiatives to reduce MFN tariffs overall, as RoO become important only when MFN tariffs are higher than preferential tariffs (Palmeter 1993, Hoekman 1993). Lloyd (1993) prescribes replacing the RoO requirements by adopting a value-added tariff system that he designs for the purpose. He argues that with the progress of globalization and the increase in fragmentation of most production processes, trying to assign a single country-of-origin to a traded product will not be right. Depending on how much value is added to a product within a PTA, an appropriate tariff should be designed, thereby doing away with RoO requirements. In a later paper (Lloyd, 2002) the author further states that adopting such a system will help in avoiding problems of *trade regression* (investment diversion[5]) that RoO bring in. In the short run they affect only trade flows. Hirsch (1998), on the other hand, talks of developing a "progressive" system of RoO: different RoO for different countries depending on their factor endowments. According to him, a country with a large pool of resources is not going to be constrained by the rules in the way smaller trading partners will. He also argues for a compensatory mechanism to deal with the trade distortions that RoO result in.

In 2003, the European Commission opened a wide-ranging debate by releasing a Green Paper[6] on the RoO applied in PTAs, as it felt, "The present origin rules do not fit current economic reality... (also) the current origin rules are seen as too complex, restrictive and they lack transparency... (and) there is a clear call for rationalization and

TABLE 1

MERITS AND DEMERITS OF DIFFERENT RULES OF ORIGIN

Rule	Merits	Demerits	Policy dilemmas
Change of Tariff Classification (CTC)	• Simple, clear and transparent. • Easy to implement. • Entails less administrative cost.	• It fails to confer origin in several cases as the HS was not designed for granting originating status. • On occasions, CTC does not ensure substantial transformation. • Sometimes substantial transformation can occur without CTC.	• Level of classification at which change required? – Higher the level the more restrictive is the rule. • How to combine other rules when CTC fails?· • Ambiguity in several processes that cannot be captured by this rule.
Percentage Test (VA)	• If defined in terms of maximum import content, it can also be implemented easily. • Good complement for cases where CTC fails.	• Complex in application – requires firms to have sophisticated accounting systems. • Difficult to monitor at customs entry points. • Sensitive to changes in exchange rates, labour costs, input prices, etc. • High administrative costs of implementation. • Prone to accounting manipulations.	• The level of value added required for determining origin? • The valuation method for imported materials? – Methods which assign a higher value (eg CIF) than ex-factory price will be more restrictive on the use of imported inputs. • Calculation of value addition subject to malpractices.
Specific Process Test (TECH)	• Straightforward. • Provides for certainty if rules can be complied with.	• Implementation problems due to documentary requirements. • Difficult to comply with. • Leads to product specific rules. • Depends on technology, which differs from sector to sector.	• Difficulty in pinning down formulation of the specific processes: the more procedures required the more restrictive. • Should test be negative (processes or inputs which cannot be used) or a positive test (what can be used)? –Negative test more restrictive.

Source: Compiled from Das (2010).

simplification of the origin rules" (European Commission 2004, pp. 4). The Green Paper is set out to find a new approach to RoO in all preferential trade arrangements involving the Community. However, it envisages that the first concrete application should be to the GSP and a "revised proposal"[7] has been accepted on the same. It calls for sector specific RoO as opposed to the initial proposal of a simple value-added rule. It introduces many supplementary rules to relax the stringency of the three main methods of origin determination. The direct transport rule (direct consignment) is found to be burdensome to prove due to documentary requirements and so, a new *non-manipulation clause*[8], is inserted in its place. In this respect we may note that most PTAs in South and South East Asia have the direct consignment rule. Cumulation rules are relaxed in the revised proposal. Also the current system of certification of origin by the authorities of the beneficiary countries are proposed to be replaced by statements on origin to be given directly by "registered exporters"[9]. Transaction costs in getting CoO from a certifying agency can be bypassed through this system.

We need to learn both from the policy prescriptions offered by various authors and also from the initiatives that government agencies are undertaking to simplify RoO. The Harmonization Work Programme needs to include harmonization of RoO in PTAs as more than 50 per cent of world trade today occur under the aegis of various PTAs. Vermulst *et al.* (1994) call for harmonization of RoO and also prescribe use of identical RoO for preferential and non-preferential purposes. Barcelo (2006) puts forward the specific Articles of the WTO that can be employed to justify preferential RoO harmonization. There is also a need for more studies on how these rules are impeding tariff liberalization in PTAs and also how these rules are being circumvented and causing loss to the national exchequer. More understanding on these rules will help in drafting better rules, with better enforcement mechanisms that will in their turn ensure smooth functioning of bilateral trade between members of a PTA.

NOTES

[1] Indonesia is in fact the second most important import source of cookies for China; it is also a big importer of flour from Turkey, refined sugar from Thailand, butter from New Zealand, and chocolates from Belgium.

[2] Satapathy (1998) termed RoO as "a necessary evil" in context of the harmonization of the non-preferential RoO under the WTO.

[3] Bhagwati (1995) compares the overlapping PTAs with a "spaghetti bowl". The complex RoO of such overlapping arrangements is compared in Bhagwati (2008) as the "mess created for the tie and shirt of the person eating the spaghetti".

[4] An oft discussed case is that of the US Company Intel, which complained that changes introduced by the EC in 1989 to the definition of RoO for integrated circuits "forced" the company to invest in Ireland (Ghoneim 1993). Krishna (2005) states that such investment diversion effects are the long-run effects of RoO.

[5] A green paper released by the European Commission is a discussion document intended to stimulate debate and launch a process of consultation, at the European level, on a particular topic. A green paper usually presents a range of ideas and is meant to invite interested individuals or organizations to contribute views and information. It may be followed by a white paper, an official set of proposals that is used as a vehicle for their development into law.

[6] http://ec.europa.eu/taxation_customs/resources/documents/customs/customs_duties/rules_origin/preferential/gsp_rev_proposal_en.pdf viewed 31 August 2013.

[7] The direct transport rule for EU's GSP is replaced by a more flexible non-manipulation principle from 1 January 2011. The difference with the direct transportation requirement is that for non-manipulation clause no documentary evidence needs to be provided. Under the direct transport rule if the goods are transported via another country, the importer has to present documentary evidence that the goods did not undergo any operations there (in the country of transit), other than unloading, reloading or any operation designed to keep them in good condition. The non-manipulation clause is considered to be satisfied *a priori* unless the customs authorities have reasons to believe otherwise.

[8] An approved exporter system is already in place in EU. It is defined as an exporter who meets certain conditions imposed by the customs authorities. The customs authorities can withdraw this status if the exporter misuses the authorization.

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NEWS
(NATIONAL/INTERNATIONAL)

New EU Preferential Rules of Origin

THE EU has recently announced the revised rules of origin for the Generalized System of Preferences (GSP) or the preferential treatment of the products exported from developing countries to the EU markets. This came as a surprise to Nepalese stakeholders—precisely, the government and the garment exporters—who were striving for continuation of relaxation from the previously tough origin rules for Nepalese apparels to get the same preference. The facility of derogation from the preferential rules of origin for certain Nepalese textile items, which the EU has been granting for over a decade, was supposed to cease on 31 December 2010. Is there any reason for Nepalese stakeholders to panic with the end of derogation facility and the effect of new rules of origin? Not necessarily!

On the whole, the new rules of origin are simpler, and as claimed it's "more development-friendly." The rules for apparels, which used to be relatively more stringent in the past, have become more flexible. As a special privilege, the apparels made in LDCs are now eligible for tariff preferences even if they are made out of imported fabric. That means Nepalese exporters can manufacture apparels from the fabric originating in any country and export them to the EU market under the duty-free treatment.

Previously, most of the LDCs, including Nepal, faced more restrictive rules, requiring double-stage processing and minimum local value content. It was virtually impossible for LDCs without textile base to enjoy the GSP facility unless they manufactured own fabric and make apparels, to qualify for the preferential treatment. The complicated and stringent origin rule of the past had actually constrained LDCs to benefit the most from the Everything but Arms (EBA) scheme—the EU's pet programme aimed at stable and predictable preferential treatment to the world's poorest countries, like Nepal.

Considering Nepal's weak textile base, the EU had granted the facility of derogation from the double-stage transformation in favour of Nepal. That allowed Nepalese apparel exporters to go for only one processing operation and the use of fabrics originating in SAARC, ASEAN and ACP countries, besides the "regional cumulation", which generally permits the use of fabrics originated only from the member countries belonging to its own regional grouping. The situation could have been worse, had there been no privilege of derogation. The growing EU share in Nepal's overall apparel exports suffice to reveal that: it doubled from 20 to 40 per cent, between 2004 and 2008. In absolute value, export to EU was no less commendable: it surpassed the one and a half billion rupee mark in the annual three billion rupee worth exports in recent years, from miniscule values before the derogation facility was available.

The basic objective of rules of origin is to ensure that preferences are granted only to exporters from eligible beneficiary countries, and also to curb trade deflection from non-beneficiaries through beneficiaries to preference-giving countries. The rules of origin have always been a contentious issue in the preferential trading system, particularly in trade related to textiles and apparel products. Poor countries have often indicated the rule as too complex and non-user friendly, inhibiting them from exploiting the maximum benefits from the GSP scheme. As a result, they were bound to use inputs of less efficient sources and sometimes the cost of compliance exceeded the benefit from the preferential schemes. In that sense, a manufacturer's

decision whether to export under the preferential treatment or pay the applied tariff in importing countries depends on the margin of preference (the absolute difference between the rates under the MFN—most favoured nations—and the preferential tariff system) and the costs of compliance to the origin rules. Therefore, there is no reason for a beneficiary country to export under the preferential regime unless the cost of compliance is less than the benefits.

In practice, many LDC exporters, including in Nepal, forego the preferential market access, either due to their ignorance or due to higher cost of compliance of the origin rules. As a result, the rate of preference utilization of many LDCs remained insignificant, revealing the preferential treatment meaningless to many of them. An UNCTAD study revealed that out of the total EU GSP benefits in 2001, Nepal shared only 4 per cent as against 8 per cent for Cambodia and 82 per cent for Bangladesh. The reason for low utilization for Nepal was owing to the lack of exporters' awareness about the facility and the procedural complications to get it, mainly in the case of apparel exports. Hence, the challenge for Nepalese exporters, under the new and simplified EU preferential rules of origin, would be to diversify exports and raise the preference utilization rate, ultimately expanding the country's overall exports to one of the world's largest and affluent regional economic communities.

(*The Himalayan Times*, 27 December 2013)

Rules of Origin Can Make or Break the Trans-Pacific Partnership

A trade agreement's rules of origin indicate how to treat goods and services from sources that are not party to the agreement. Modern global commerce is characterized by sophisticated chains of manufacture and assembly across multiple countries. Rules of origin have thus become more important, contentious, and complex. For the Trans-Pacific Partnership (TPP), billed by its supporters as a "21st-century trade agreement" and a template for other major trade talks, rules of origin may be vital.

As with many aspects of the TPP, there is little public information on the negotiated rules of origin. Trade agreements can be undermined by complex rules, which confuse companies and cause them to forgo the new opportunities created by the accord due to fear of penalties. In addition, rules of origin serve as an important signal of the principal goal of the agreement: to liberalize or to exclude. As the global trade leader, the US should strive for simple and open rules of origin in the TPP.

The Basics

Rules of origin can be the most important part of a trade agreement. Without rules of origin, any trade agreement is essentially global – the new opportunities are available to any country, not just those party to the agreement. At the other end, the complete exclusion from liberalized market access of any goods or services produced by non-signatories completely warps a free trade agreement, turning it into a bloc.

Rules of origin therefore say a great deal about ultimate objectives. In the US, the TPP has been promoted as being open to all countries in the Asia-Pacific Economic Community willing to meet its new requirements. A restrictive set of rules of origin would indicate that the primary method of adding members is coercion: maximizing the difference between being party to the agreement and not being party.

While such an approach may be sensible in some instances, it has a considerable drawback: It punishes member countries that have important partners outside the accord. Essentially, parts of the economies of these countries – the parts integrated with non-member economies – are excluded from the agreement. If the outside parties do not later join, member countries gain from enhanced trade with each other but lose because the supply chains with non-members are broken. On a net basis, the agreement brings less prosperity.

Another important feature is complexity. Beyond the harm to member states from less integration with non-member states is a variant of the "noodle bowl" problem. The US and other TPP members have multiple trade agreements with multiple outside parties, often featuring complex rules themselves – "noodles" that are hard to separate. If the TPP's rules of origin are also complex, it will be difficult for firms and individuals to determine how to take advantage of the TPP

liberalization without risking penalty. Many economic actors could proceed without regard to the TPP, neutralizing its impact.

It is highly unlikely that the TPP will be rendered meaningless by poorly considered rules of origin, but its value could be considerably reduced. Ideally, rules of origin will be as simple as possible. A key element of this simplicity is having one set of rules that apply to all parties and all relationships, with no haphazard exemptions and departures for certain goods or countries. The TPP parties wisely agreed to this single set of rules in 2011. The common set of rules itself should also be as simple as possible.

A Specific Example: Textiles

The best-known industry illustration of the importance of rules of origin is consumer electronics. Components of computers, for example, are produced and assembled in multiple countries. The TPP's rules of origin will exert a powerful influence on this supply chain.

While the US has typically favoured liberal rules of origin in electronics, it has done the opposite in textiles. The textile supply chain is extensive, starting with cotton and ending with multi-component pieces of clothing. The standing American position on textile rules of origin is known as "yarn forward," meaning that all constitutive products in a garment, starting with the yarn and going forward, must be made by a party to the agreement (pre-yarn materials are allowed to come from outside parties).

Yarn forward is a clear example of a rule of origin intended primarily to exclude rather than liberalize. It is a relic of a time when textile trade was still governed by the quotas agreed to in the 1974-2004 Multi-Fibre Arrangement and protectionism dominated textile trade. To maximize gains from textile trade, TPP members must have the freedom to source materials and component products from the best suppliers – to create the best supply chain. Yarn forward sacrifices this freedom for the sake of maintaining restrictions on outside parties, diverting trade rather than creating it.

Yarn forward puts a spotlight on Vietnam. The principal benefit for Vietnam in joining the TPP is unimpeded textile market access in the US. In return, Vietnam will engage in powerful and difficult pro-market reforms across its economy, creating a vibrant economic partner for the US and an ally in promoting open trade. The TPP provides strong incentives and an excellent opportunity for loosening the yarn-forward rule. On the other hand, if the US once again prioritizes its very small textile industry, it sets a terrible precedent for other countries to make analogous demands regarding rules of origin.

Liberalization should be the goal

The WTO's Doha Round is comatose. Any trans-Atlantic partnership is years away and fraught with difficulty. The TPP is not just an important agreement in itself; it is the launching point for the next generation of global trade deals. Will future agreements liberalize wholeheartedly or half-heartedly or perhaps even close as many doors as they open?

The US wants its partners to push themselves with regard to liberalization, to expand market access in services and investment, not just goods. Restrictive rules of origin will greatly harm that effort directly, and also indirectly, by making it appear that America seeks to open only those sectors in which it has a comparative advantage. Therefore, the US Trade Representative should:

- Oppose any and all departures from the previous agreement by TPP countries on a common set of rules of origin so that the noodle bowl phenomenon is limited;
- Make this common set of rules of origin as open as possible to avoid creation of a trade bloc; and
- In particular, make clear that the US is not seeking more restrictive rules as a means of protecting its own uncompetitive sectors, most prominently by liberalizing the yarn-forward standard in textiles.

The TPP has been behind closed doors for a long time. The wait will be more than worth it if a sound agreement is struck, setting the tone for the rest of the decade and beyond. Confusing or protectionist rules of origin should not be allowed to stand in the way.

(http://www.heritage.org, 27 August 2013)

NAFTA Rules of Origin

What are the NAFTA Rules of Origin?

EACH NAFTA country retains its external tariffs *vis-a-vis* non-members' goods and levies a lower tariff on the goods "originating" from the other NAFTA members. Rules of origin provide the basis for customs officials to make determinations about which goods are entitled preferential tariff treatment under the NAFTA. Negotiators of the agreement sought to make the NAFTA's rules of origin very clear so as to provide certainty and predictability to producers, exporters and importers. They also sought to ensure that the NAFTA's benefits are not extended to goods exported from non-NAFTA countries which have undergone only minimal processing in North America. The NAFTA rules of origin are included in Chapter Four of the Agreement. The product-specific rules of origin for NAFTA are contained in Annex 401.

Amendments

The product-specific rules of origin of the NAFTA are periodically amended to reflect changes in industry production practices and sourcing patterns as well as to ensure their consistency following periodic amendments to the World Customs Organizations' Harmonized Commodity Description and Coding System (HS).

- ***Amendments to Annex 401***

On 1 September 2009, Canada implemented measures to amend some of the product-specific NAFTA rules of origin. Mexico implemented these same amendments on 14 October 2009, and the United States on 2 October 2009. The amendments liberalize the rules of origin applicable to agricultural, consumer, industrial, mineral fuel and oil products, representing over US$140 billion in annual trilateral trade.

- ***Amendments to Appendix 6, Annex 300-B (1 July 2009)***

On 1 July 2009, Canada and the United States implemented measures to liberalize the NAFTA rules of origin applicable to certain textile goods which are made from acrylic staple fibres, that are not available from domestic producers in commercial quantities – the so-called "short-supply" goods.

- ***List of Amendments to Annex 401 (1 July 2006)***

On 1 July 2006, Canada and the US implemented measures to liberalize some of the product-specific NAFTA rules of origin. On 5 July 2006, Mexico implemented these same measures. The amendments liberalize the rules of origin applicable to cocoa preparations, cranberry juice, ores, slag and ash, leather, cork, certain textile products, feathers, glass and glassware, copper and other metals, televisions and automatic regulating or controlling instruments.

(http://www.international.gc.ca, 23 August 2013)

Restrictive Rules Tilt Trade Agreements Against India

INDIA'S bilateral trade pacts including the relatively recent ones with ASEAN, Singapore, Malaysia, Japan and South Korea have arguably gone more to the partner's advantage if one takes into account the widening trade deficit or increased imports. That could be a case of lack of circumspection on the part of India's policymakers when deciding the schedules/items for tariff cuts/elimination, apart from the inability of the domestic industry to compete with counterparts in the partner country.

But according to some trade analysts, the relative under-performance of these agreements for the country has also a lot to do with the restrictive rules of origin (RoOs) clauses built into them. Because of the difficulty in complying with the RoOs and the low tariff differential between the free trade agreement (FTA) and non-FTA routes, sections of Indian exporters do a cost-benefit analysis and choose not to claim FTA benefits. Although the figure could vary for various trade pacts and across industries, experts estimate on the basis of anecdotal evidence that on average, roughly a fifth of India's trade with countries with which it clinched trade pacts in recent years take place outside the ambit of these agreements.

RoOs are meant to reduce chances of third-country exporters becoming unintended

beneficiaries of various bilateral trade pacts by stipulating that a certain level of value is added in the trade-originating (exporter) country bound by the trade pact to claim the duty benefit. A defined percentage of domestic value addition (up to 40% in case of the India-Singapore CECA or comprehensive economic cooperation agreement, for instance) and/or change of tariff heading (product description) and the newer "two-step process" (as in the case of India-Japan CEPA or comprehensive economic partnership agreement and India-Thailand early harvest scheme) are employed under the RoOs.

"There is a general complaint from exporters that sometimes RoOs are very difficult to comply with. But since the official trade statistics doesn't distinguish between FTA and non-FTA trade, there is no hard evidence to suggest RoOs hampering trade through the bilateral pact route," an official told. In the case of the India-Japan CEPA, exporters from some sectors where the value chain is not too long (like chemicals and pharmaceuticals) raise the issue of RoOs more frequently.

This is partly because India-Japan trade is facilitated by the generalized system of preferences (GSP) which in many cases makes the CEPA benefit almost redundant.

"Sometimes there is a lack of clarity in preferential and non-preferential rules of origin and this increases the cost of compliance to exporters. They therefore prefer to send their goods via the normal (most favoured nation) route," said Manab Majumdar, Assistant Secretary General, FICCI.

"With preferential tariffs (benefit of trade pacts), the RoO imposes conditions (including elaborate documentation requirements) to prove that the product has originated from the (partner) country. This could make it difficult for some categories of exporters to use the trade-pact route," noted Biswajit Dhar, Director General, Research and Information System for Developing Countries. The customs procedures are not always well equipped to cope with a multiple tariff regimes and in India's case, ports too have to develop additional capacities.

However, in the case of the textile industry, the RoOs are not a problem because the import contents in exports are limited. "As far as the textile and clothing exporters are concerned, the RoOs practically have the function of only to protect our markets (from imports)," said DK Nair, Secretary-General, Confederation of Indian Textile Industry.

FTAs have indeed added to the pace of trade growth in some cases. Since 2011, bilateral trade with ASEAN has increased by 43 per cent to reach $79.8 billion, making India the sixth largest trading partner of the bloc, but imports from the 10-country group have also increased at the same pace in that period. But in some other cases, the converse is true. For example, in case of the India-South Korea, CEPA, which was signed in 2009, both India's imports from and exports to Korea sharply declined in 2011-12 *vis-a-vis* 2010-11. India's imports from Korea rose 3 per cent in 2012-13, not higher than the trend growth in the immediate pre-CEPA years. The India-Japan CEPA pact has led to imports from Japan increasing at a faster rate than exports from India to that country.

But trade pacts not only have economic implications but political ones too. "These bilateral agreements have a geopolitical significance which delays the economic gains expected from them. The general economic conditions have also slowed down trade with our partner countries," said Bipul Chatterjee, deputy executive director of the Jaipur-based CUTS International. He added that India has been unable to penetrate into the ASEAN markets as much as it desired due to the presence of other established players.

Of course, a steeper growth in imports from FTA/CEPA partner countries than in exports to them cannot always be to the detriment of the Indian economy. If higher import growth is about capital goods and raw materials, it could make domestic output more competitive.

The priority areas for India while signing the FTAs are seeking market access through negotiations in goods, services and investments. India has set a bilateral trade target of $40 billion with South Korea by 2015 and $15 billion with Malaysia by then, while India and Japan have set a bilateral trade target of $25 billion by 2014.

(*Financial Express*, 8 July 2013)

Six Asian Countries Attend Seminar on Trade Rules on the Origin of Goods

UNCTAD and Japanese customs authorities have held a regional seminar for developing countries on rules of origin as they apply to preferential trade arrangements.

The seminar, which took place from 10 to 14 June 2013 in Tokyo, brought together 13 officials from six Asian developing countries - India, the Lao People's Democratic Republic, Malaysia, Myanmar, Thailand and Viet Nam. Those attending were senior officials who, in national capitals or regional offices, regularly deal with the certification, administration, and verification of origin of their respective countries' exports under various preferential trade arrangements, particularly those of Japan, such as economic partnership agreements (EPAs) and the Generalized System of Preferences (GSP).

The objective of the seminar was to help the officials to better understand substantive and administrative aspects of rules of origin, so that their countries' exports can make effective use of the preferential trade opportunities available under such schemes.

The seminar was organized jointly by UNCTAD and by Japan Customs (Ministry of Finance). It was hosted at the Tokyo customs offices. The training was held as part of the UNCTAD technical cooperation project entitled "Assistance to countries of the Asian region on most favoured nation (MFN) and preferential tariff negotiations and GSP utilization". The project is financed by Government of Japan.

Exports from developing countries, including the six Asian countries, are eligible, in principle, for preferential market access to Japan and other developed-country markets under GSP, as well as under various reciprocal free trade agreements that are increasingly being formed between developing and developed countries. However, in order to benefit from these preferential trade arrangements, exported goods must meet the relevant rules of origin. Failure to comply with these rules has often resulted in commercial losses for importers and exporters alike.

Against this backdrop, origin-certifying authorities in exporting countries (for example ministries of trade and industry that are responsible for issuing "certificates of origin") face the challenge of ensuring the proper application of relevant rules of origin in order to pre-empt such problems. The seminar was intended to help them better perform this important function, and to provide them with the opportunity to foster a common understanding between the authorities issuing certificates of origin in exporting countries, and customs authorities in the importing developed countries. (Customs authorities in importing countries examine and clear certificates of origin.)

The sessions of the seminar addressed such topics as substantive aspects of rules of origin under the various GSP schemes and the Japanese EPAs; administrative aspects of certification and verification of origin; and emerging trends in rules of origin, such as self-certification systems by approved exporters or importers. Presentations were delivered by UNCTAD experts and by officials of Tokyo Customs, the Ministry of Finance, the Ministry of Economy, Trade and Industry (METI), and the Japan Chamber of Commerce and Industry.

The seminar's programme also included field visits to various customs facilities, including clearance and inspection areas and a container inspection centre. This provided an opportunity for participants to observe state-of-the-art facilities and operations. In addition, the seminar promoted exchanges of experiences and a review of the lessons learned by the participants.

As a follow-up to the seminar, national advisory missions will be undertaken by UNCTAD in cooperation with Japan Customs (Ministry of Finance) to selected countries to better disseminate relevant information on rules of origin.

(www.unctad.org, 2 July 2013)

Preferential Rules of Origin Affect Trade within Regional Trade Agreements

ACCORDING to a WTO Secretariat Staff Working Paper published in March 2013, rules of origin "are increasingly becoming an economic, political and trade instrument," and their effect

goes well beyond the economic "*raison d'être* of… the avoidance of trade deflection". In parallel with stringent rules of origin, there has emerged a tendency to establish specific flexibilities for particular groups of states (e.g. LDCs) or particular goods on either a temporary or permanent basis. One consequence is that "preferences are sometimes actually provided by the rules of origin themselves, instead of the preferential tariff treatment." This, the paper considers, is because the "standard" rules of origin are so rigid as to restrict trade, making the countries benefiting from the flexibilities an attractive base for investors seeking to take advantage of the regional trade agreement (RTA).

The study embraces "192 RTAs covering trade in goods notified to the GATT/WTO up to 1 November 2010". Although this wide coverage means that many of the examples cited refer to non-ACP agreements, reference is made to Cameroon, CARICOM, the CARIFORUM–EU Economic Partnership Agreement (EPA), CEMAC, COMESA, Côte d'Ivoire, the SACU–EFTA Free-Trade Agreement and the South Africa–EU Trade, Development and Cooperation Agreement (TDCA). Moreover, the non-ACP focus for much of the detailed description of rules of origin means that the report is particularly useful for ACP trade policy-makers in identifying the range of provisions to be found in the preferential agreements not only of the EU and the US, but also of China and Latin America.

The paper describes the rules of origin provisions in such agreements, noting many widely recognized key features (such as the method of establishing whether imported inputs have been sufficiently transformed, and provisions for cumulation) as well as more technical details (such as whether duty-drawback is allowed with bilateral or cumulated trade).

The study also brings together some of the research on the extent to which preferences have been used in practice, the role of onerous rules of origin in explaining any under-utilization, and the margins of preference afforded to beneficiaries. However, the section on margins of preference excludes most of the trade regimes available to ACP states from the analysis.

One feature that is flagged is "the burdensome nature and trade-impediment aspects of multiple rules of origin". This is of particular contemporary relevance, in view of the continued proliferation of RTAs, a process to which the EU is contributing, as noted in the EC memorandum of 25 March 2013 summarizing the state of the EU's free trade agreement negotiations. It is also particularly important, given that one of the candidates for the post of the WTO Director-General, during a recent visit to Nigeria, expressed the view that the spread of RTAs is making multilateral rules obsolete.

A second feature flagged in the paper is that while the well-established, large producers navigate rules of origin reasonably well, small businesses face problems in utilizing RTA preferences because of rules of origin complexities. The WTO working paper highlights the need for simplicity. It cites approvingly the pledge of the Economic Commission for Africa that the African Continental Free Trade Area should include not only tariff reduction or elimination commitments, but also the "creation of simple and transparent rules of origin", through the "simplification and harmonization of rules of origin in all the RECs [Regional Economic Communities] and among them".

(http://agritrade.cta.int/en, 12 May 2013)

Tariff Treatment: Understanding Canada's Rules of Origin

Customs 101: An Importer's Quick-Start Guide to Customs Compliance

THIS is Part 3 of an on-going series of articles designed to help importers achieve the highest level of Customs compliance.

In our first two articles we presented a general outline of the rules used to determine the value for duty and tariff classification of imported goods. In this installment we will look at how the country of origin and routing of the cargo affect the rate of duty.

Every effort has been made to introduce the concept of *Tariff Treatment* as clearly and concisely as possible. As such, generalizations are both necessary and unavoidable, and we therefore ask you not to act on this information without consulting with us first.

Part 3—Tariff Treatment: Understanding Canada's Rules of Origin

Although it can be said that Canada treats all of its international trading partners *fairly*, it cannot be said that it treats them all *equally*.

Every imported product can be classified under a particular tariff item. Each of these tariff items bears one or more rates of duty prescribed under a series of different duty rate schedules referred to as *tariff treatments*.

The Canadian Customs Tariff includes both preferential and non-preferential tariff treatments. The default non-preferential tariff treatment is Most Favoured Nation. MFN applies to goods from the WTO member states and other countries with whom Canada has normalized trade relations. Preferential tariff treatments fall into two broad categories: bilateral and multilateral Free Trade Agreements; and unilateral tariff concessions extended to developing and least developed countries. There are currently seven Free Trade Agreements in force, including the North American Free Trade Agreement and there are several more in various stages of progress. Each includes a set of general and specific rules of origin, strictly enforced certification rules and a general requirement that the goods must be exported from the FTA country or territory where they originate to Canada.

The most frequently used unilateral tariff treatments are the General Preferential and Least Developed Country tariffs. GPT reduces or eliminates the duties on qualifying goods produced in virtually all developing countries including China and India. At least 60 per cent of the ex-factory price of the good must originate in one or more GPT countries or Canada and the good must be certified and exported on a through bill of lading with or without transhipment directly from the country of origin to Canada. Most textile, apparel and footwear products are specifically excluded from the benefits of GPT.

Under LDC, the local content requirement for general merchandise is reduced to 40 per cent, half of which may originate in a GPT country. Additionally, most wearing apparel products are eligible for LDC, subject to different, highly restrictive rules of origin and certification requirements. Goods entered under LDC are not subject to duty. Direct shipment rules like those under GPT apply.

It is a serious offence to intentionally use a preferential tariff treatment contrary to the applicable regulations. Tariff treatment errors must be voluntarily corrected within 90 days after the importer has reason to believe an error was made. Notwithstanding the fact that an importer usually relies in good faith on the certificate of origin provide by his supplier, it is the importer who must pay the additional duties if an audit discloses that the goods do not meet the rule of origin. An importer who does not correct within 90 days, or fails to furnish proof of origin upon request of Customs is subject to a monetary penalty.

(http://www.milgram.com/milgram/en, 28 November 2011)

The Future of Rules of Origin

THE European Commission on 18 November 2010 adopted a regulation revising rules of origin for products imported under the generalized system of preferences (GSP). This regulation relaxes and simplifies rules and procedures for developing countries wishing to access the EU's preferential trade arrangements, while ensuring the necessary controls are in place to prevent fraud. The new rules of origin will apply from 1 January 2011.

The Regulation adopted by the Commission will considerably simplify the rules of origin so that they are easier for developing countries to understand and to comply with. The new rules take into account the specificities of different sectors of production and particular processing requirements, amongst other things. In addition, special provisions are included for Least Developed Countries (LDCs) which would allow them to claim origin for many more goods which are processed in their territories, even if the primary materials do not originate there. For instance, an operator in Zambia that produces and exports plastics to the EU will benefit from the new rules of origin, because even with up to 70 per cent of foreign input the exported plastics can still be considered as originating from Zambia. These new rules should greatly benefit the industries and economies of the world's poorest countries.

The proposal also puts forward a new procedure for making out proofs of origin, which

places more responsibility on the operators. From 2017, the current system of certification of origin carried out by the third country authorities will be replaced by statements of origin made out directly by exporters registered via an electronic system. This will allow the authorities of the exporting country to re-focus their resources on better controls against fraud and abuse, while reducing red tape for businesses.

The underlying principles for the new regulation, namely simplification and development-friendliness, were laid down in a communication on the future of rules of origin in preferential trade arrangements adopted by the European Commission on 16 March 2005 following a wide-ranging debate initiated by a Green Paper of 18 December 2003. The Communication set out a new approach to rules of origin and envisaged that the first concrete application should be to the GSP.

The Communication also favoured a number of measures to ensure compliance by public authorities with their obligations, including a periodic monitoring system. In fact, monitoring actions, which are in the interest of beneficiary countries as well as the Union, have already begun, as a legal change was not required for this purpose.

(http://ec.europa.eu, 18 November 2010)

India Presses for Decision on Rules of Origin

INDIA, China and Pakistan have upped the ante on one of the most complex issues — rules of origin — in the global trading system, where the WTO members failed to agree on the rules since 1998.

During a General Council meeting, the highest body to take day-to-day decisions, the three Asian countries called for setting up of an urgent "deliberative" process to finish the work on the harmonization of non-preferential rules of origin that has become a major protectionist barrier for several members in the global trading system.

Several industrialized and developing countries, including the EU and Norway, lent support to the proposal from India, China, and Pakistan, highlighting the need to resolve the rules of origin on fast track. But, Australia, New Zealand, and Canada saw no need for such an urgent process under the General Council chair to be carried out.

The US, which has the most complex rules of origin that cause problems for exporters in several countries, indicated it was still reviewing the Indian proposal. The US said the work on rules of origin is highly technical, suggesting that it doesn't make sense for the General Council to take up the issue right away, expressed various trade diplomats present at the meeting.

In its proposal "Harmonization Work Programme (HWP) under the Agreement on Rules of Origin – the Way Forward", the three countries deplored the endemic stalemate to accelerate work on binding rules of origin because of persistent opposition from some members.

They urged the General Council chair to oversee the "deliberative process" to discuss all outstanding issues in the HWP "with the objective of preparing the ground for a formal decision in the next ministerial conference as provided for in Article 9.4 of the agreement on rules of origin."

India said, "globalization of production" has reinforced the need for an early agreement on rules of origin as "much of the global production of goods takes place in stages, using materials and components produced in different countries".

India argued there was no common understanding among members on what constituted "the last substantial transformation" at the core of the country of origin status as different members are using their own criteria to determine the source of goods of multi-country origin — where more than one country is involved in the production process.

Indian textile exporters, for example, are forced to adopt one set of rules for supplying to the United States and another set for exports to Canada or other countries because of absence of a harmonization of non-preferential rules of origin.

"The multiplicity of rules has given rise to a situation where the same product could be required to meet the value added criterion in one country, manufacturing or processing operations criterion in another and tariff change criterion in a third country," the three countries said in their proposal.

The manner in which countries applied the rules of origin convey the impression that these rules are increasingly being viewed as trade policy instruments *per se* instead of as a device to support trade policy instruments. Though India managed to include the harmonization work programme for rules of origin in Doha, there was little progress in the committee on rules of origin because of the continued opposition from some key members, trade diplomats said.

(*Business Standard*, 5 May 2010)

Rules of Origin Discord Delays Pact with ASEAN

DISAGREEMENT over the issue of rules of origin has derailed plans to implement an early harvest scheme between India and ASEAN (Association of South East Asian Nations) from 1 April 2005. The two sides are now working on initiating the Comprehensive Economic Cooperation Agreement (CECA) without an early harvest scheme.

Senior officials of the Ministry of Commerce and Industry said the two sides could not come to an agreement over the rules of origin, even though the draft rules of origin proposed for ASEAN is among the most liberal with only a 40 per cent value-addition norm without any change in the tariff heading. India was keen on stricter norms for select products, which was not agreeable to ASEAN. Commerce Minister Shri Kamal Nath is expected to resolve the issue after the announcement of the annual supplement to the foreign trade policy on March 31.

The CECA with Singapore has also not been inked following India's decision not to concede Singapore's demand in the telecom and financial services sector. "From our side there is no problem. However, the Reserve Bank of India has raised some concerns. Singapore is now discussing the issues in the financial sector and telecom with North Block," a senior official said.

The two sides have concluded 12 rounds of discussions and had earlier set a deadline of November 2004 for completing the deal. Around 106 items were slated to get concessional duty benefits under the early harvest scheme. While most of the items would have had a 40 per cent value addition with no change in tariff heading, there were around 40 items - including chemicals - for which India was seeking a change in tariff heading along with the value addition norm, officials said. India was also willing to offer unilateral tariff concessions to Cambodia, Laos, Myanmar and Vietnam (CLMV) on around 100 tariff lines. The framework Agreement on Comprehensive Economic Cooperation between the ASEAN and India was signed on 8 October 2003 in Bali, Indonesia. As per the agreement, the tariff reductions will start from 1 January 2006 and the most favoured nations (MFN) tariff rates will be gradually eliminated. India will eliminate tariffs by 2011 for Brunei Darussalam, Cambodia, Lao PDR, Indonesia, Malaysia, Myanmar, Singapore, Thailand and Vietnam. Brunei Darussalam, Indonesia, Malaysia, Singapore and Thailand will eliminate the tariffs for India by 2011 and new ASEAN member states, that is CLMV, will eliminate tariffs for India in 2016. India and Philippines will eliminate tariffs for each other on a reciprocal basis by 2016. Key elements of the Framework Agreement on Comprehensive Economic Cooperation between the ASEAN and India cover FTA in goods, services and investment, as well as "areas of economic cooperation". ASEAN has a membership of 10 countries, namely Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam.

(Business *Standard*, 24 March 2005)

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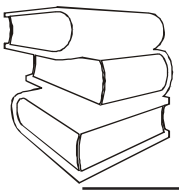

BOOKS/ARTICLES NOTES

BOOKS

Regional Trade Agreements and the WTO Legal System by Lorand Bartels and Federico Ortino, 2006.

THIS book is concerned with the legal aspects of regional trade agreements – free trade agreements and customs unions. There are currently around 300 regional trade agreements, and these continue to proliferate. As a result, this is becoming an increasingly important part of WTO law. This book investigates these agreements, and examines their regulation under WTO rules. It also looks at the relationship of these agreements to the WTO from the perspective of public international law.

Rules of Origin currently plays also a significant role in international trade. Since there has been a tariff cut and non-tariff barriers have come to a minimal level, the RoOs within PTA or RTA is not significantly distorting trade so much as it is done in the case of non-preferential RoOs.

The Origin of Goods: Rules of Origin in Regional Trade Agreements (Centre for Economic Policy Research) by Olivier Cadot, Antoni Estavadeoral, Akiko Suwa Eisenmann, Thierry Verdier, May 2006.

THIS book looks at RoOs in preferential trading agreements and their growing importance in trade negotiations. The book's message is that rules of origin can act as powerful barriers to trade and have been deliberately used as such.

One cannot understand today's multilateral trading system without understanding its web of Preferential Trade Agreements. And one cannot understand these agreements without understanding their RoOs. This collection of original theoretical and empirical papers sheds considerable light on what may well be the most important instrument of trade policy of our times.

Rules of origin are among the least understood and most important elements of free trade agreements. This well organized study presents both a technical and political analysis of their uses and impacts and is a "must read" for anyone responsible for developing, negotiating, or implementing these rules."

This book by some of the world's leading experts in the field is a state-of-the-art analysis of a complex and oft-neglected aspect of trade policy. With the growth of regionalism, RoOs become more significant by the day, yet remain poorly understood. The present work goes a long way in remedying this deficiency. It comprises an enticing blend of economic theory and empirical study, together with political economy and development analysis.

Rules of Origin in the WTO and in Other Free Trade Agreements - An Overiew by Jord Hollenberg, Seminar Paper, Suffolk University Law School, 2003, pp. 25.

THIS work wants to give an overview about non-preferential Rules of Origin, especially the dispute concerning the New American Rules of Origin for Textile Products among the European Communities and the United States.

A. Introduction "The Core Issue of Rules of Origin"

Rules of Origin are methods to extract the origin of a product (and sometimes of services), and help to determine the nationality of an imported good or product. The importance of rules of origin has to be seen in the light of economic values or any kind of trade restriction. Once the origin of a product is known, preferences or restrictions to the product can be much simpler applied by the importing

country. Such preferences and restrictions on the imported good are for instance duty-free entry into a Free Trade Area (FTA), quantitative restrictions on goods originating in a country subject to a quota, or anti-dumping duties on goods from the targeted company that originate in the targeted country. Furthermore, rules of origin are also used to compile trade statistics, and for "Made in …" labels that are attached to products. As long as all parts of a product were manufactured and assembled primarily in one country RoOs remained an noncontroversial and neutral device. But trade and economy are not under fixed or immovable conditions; then the rise of multinational corporations and the production of goods in multiple stages, using parts that are produced around the world, enabled RoOs to be used as effective means of protection and trade barriers. Bearing in mind that goods are produced from different parts around the world and under different free trade agreements, rules of origin do not have one correct definition and vary much in application and function.

One of the main objectives of rules of origin should be uniformity and simplicity in their administration. Although this is not always true, developing and developed countries have undertaken the task towards simplification, harmonization and liberalization of rules of origin. This harmonization work has been carried out under the auspices of the Committee on Rules of Origin (CRO) of the World Trade Organization (WTO) and the Technical Committee on Rules of Origin (TCRO) of the Brussels-based World Customs Cooperation Council, which has been responsible for the technical part of the work, including discussions on the rules of origin options for each product.

After all, an Agreement on Rules of Origin (ARO) was established in the WTO. This 'first-ever' agreement is designed to harmonize and to clarify non-preferential rules of origin for goods in trade on the basis of the substantial transformation test. The WTO wants to ensure that their rules are transparent and do not distort or disrupt on international trade, that they are administered in a consistent, uniform, impartial and reasonable manner, and that they are based on a positive standard. That means the ARO in WTO wants to state what does confer origin rather than what does not.

Regional Trade Agreements in the GATT/WTO: Article XXIV and the Internal Trade by James H. Mathis, January 2002, pp. 350.

THIS book addresses legal aspects of GATT Article XXIV and its "internal" trade requirements as they define the WTO gateway for regional trade agreements. The case for a narrow avenue is made by exploring historical foundations in the Havana ITO negotiations and later difficulties of applying provisions to developed-developing country free trade areas. The external economic effects for the trade of non-members will remain of concern, but rules of origin and regional safeguard regimes can affect intra-regional trade between large and small members as well. The GATT-47 practice is contrasted with the WTO developments as dispute settlement reports have established the conditional legal nature of the regional exception. A treaty law argument is made that the GATT/WTO rules retain continuing validity for regional members. Implications for the WTO review process are considered.

ARTICLES

Preferential Rules of Origin in Regional Trade Agreements by Maria Donner Abreu, Staff Working Paper, WTO, March 2013.

THIS study surveys preferential rules of origin applied by 192 regional trade agreements (RTAs) covering trade in goods notified to the GATT/WTO up to 1 November 2010. It takes into account the preferential rules of origin that were notified to the WTO; whenever known and available, modifications to the original rules of origin have been updated.

This study contains two basic features: a description of some key elements of preferential rules of origin in RTAs, followed by an attempt to provide a reality-check of how these rules affect actual trade. That is done by an ex-post examination of data on the use of RTAs' preferences and, in their absence, of their margins of preference (MOPs). While the *raison d'être* of preferential rules of origin is the avoidance of trade deflection, the practice in RTAs has diluted this objective and it would seem that preferential rules of origin are

increasingly becoming an economic, political and trade instrument. In its descriptive part, the study identifies what seems to be a tendency to design stricter rules of origin, while detecting concomitantly the inclusion in modern preferential rules of origin of flexibilities that provide, through the rules of origin themselves, a preference beyond the lower tariff rate resulting from the preferential treatment and mechanisms that allow the integration of third-parties into preferential rules of origin regimes.The reality-check part of the study points to the fact that much beyond the coverage of RTAs, it is their effective implementation that poses a challenge to economic operators. Though data on the use of preferences is either not disclosed or inexistent, they are nevertheless available for some economies. On the basis of existing data of preference utilization, the analysis of the effects of rules of origin on preferential trade flows appears to give rise to a dual reality — namely a relatively high use of preferences in certain instances coexisting with preferences failing to attain their potential in other cases. As regards RTAs for which utilization rate is not available, the paper analysis preferential rules of origin from a MOPs perspective, assuming that MOPs of at least 5 percentage points would offset compliance costs and thus provide a stimulus to comply with rules of origin in order to benefit from preferences. The analysis, made for 68 out of 192 RTAs, do not allow any conclusion regarding that generally presented hypothesis.

Finally, the paper briefly outlines some suggestions for further action, including the launching in the WTO of exploratory work on preferential rules of origin within an "open regionalism" scenario.

Do Rules of Origin in Free Trade Agreements Comply with Article XXIV GATT? by José Antonio Rivas, *Regioal Trade Agreements and the WTO Legal System*, Lorand Bartels and Federico Ortino (eds.), Oxford Scholarship online, March 2012.

THIS chapter examines whether rules of origin in free trade agreements (FTAs) are in compliance with Article XXIV of the General Agreement on Tariffs and Trade (GATT). It argues that FTA rules of origin qualify as "other regulations of commerce" (ORC) and should therefore satisfy the conditions for ORC set forth in Article XXIV. It discusses the distinction between rules of origin that are overly restrictive and neutral rules of origin which do not add an extra and unlawful layer of protection to the already permitted tariff differentials between the Most Favoured Nation (MFN) tariffs and the FTA tariffs.

International Trade: Rules of Origin by Vivian C. Jones and Michael F. Martin, CSR Report for Congress, January 2012.

DETERMINING the country of origin of a product is important for properly assessing tariffs, enforcing trade remedies (such as antidumping and countervailing duties) or quantitative restrictions (tariff quotas), and statistical purposes. Other commercial trade policies are also linked with origin determinations, such as country of origin labeling and government procurement regulations.

Rules of origin (RoO) can be very simple, non-controversial tools of international trade as long as all of the parts of a product are manufactured and assembled primarily in one country. However, when a finished product's component parts originate in many countries—as is often the case in today's global trading environment—determining origin can be a very complex, sometimes subjective, and time-consuming process.

US Customs and Border Protection (CBP) is the agency responsible for determining country of origin using various RoO schemes. Non-preferential rules of origin are used to determine the origin of goods imported from countries with which the United States has most-favored-nation (MFN) status. Preferential rules are used to determine the eligibility of imported goods from certain US free trade agreement (FTA) partners and certain developing country beneficiaries to receive duty-free or reduced tariff benefits under bilateral or regional FTAs and trade preference programs. Preferential rules of origin are generally specific to each FTA, or preference, meaning that they vary from agreement to agreement and preference to preference.

CBP has periodically proposed implementing a more uniform system of RoO as an alternative to the "substantial transformation" rule that is currently in place. CBP's last proposal was on 25

July 2008, when it suggested that a system known as the North American Free Trade Agreement (NAFTA) rules system "has proven to be more objective and transparent and provide greater predictability in determining the country of origin of imported merchandise than the system of case-by-case adjudication they would replace." The NAFTA scheme that would be applied has already been used for several years to determine the origin of imports under the NAFTA, and for most textile and apparel imports (about 40% of US imports). The CBP proposed to apply the NAFTA rules to all country of origin determinations made by CBP, unless otherwise specified (e.g., unless the import enters under a preferential RoO scheme already in place). The proposed rule changes received so many responses from the public that the deadline for public comment was extended twice, until 1 December 2008. Such changes in rules of origin requirements are often opposed by some importers due to costs involved in transitioning to new rules, or because they believe that certain products they import might be at a disadvantage under a new RoO methodology. According to CBP officials, CBP decided not to implement the proposed rule.

This report deals with RoO in three parts. First, we describe in more detail the reasons that country of origin rules are important and briefly describe US laws and methods that provide direction in making these determinations. Second, we discuss briefly some of the more controversial issues involving rules of origin, including the apparently subjective nature of some CBP origin determinations, and the effects of the global manufacturing process on RoO. Third, we conclude with some alternatives and options that Congress could consider that might assist in simplifying the process.

The Politics of Rules of Origin by Moshe Hirsch, *The Politics of International Economic Law*, Tomer Broude *et al.*(eds.), May 2011, pp. 317-336.

RULES of origin (RoOs) aim to determine whether a particular trade concession will be applied to a given product in international trade. Certain features of RoOs make them particularly susceptible for employment as an instrument of foreign and domestic policies. Though some of those political objectives are desirable, the unrestrained political employment of RoOs embraces some significant hazards, particularly the undermining of the predictability and stability of trade relations. The increasing political employment of RoOs was one of the principal factors leading to the inclusion of this topic in the Uruguay Round agenda and the formulation of the 1994 WTO Agreement on Rules of Origin. The 1994 initial agreement is not effectively coping with the widening political employment of ROOs. Consequently, it is suggested to further restrain the involvement of political considerations in the formulation and implementation of RoOs.

Rules of Origin under US Trade Agreements with Arab Countries: Are they Helping and Hindering Free Trade? by Bashar H. Malkawi, *Journal of International Trade Law & Policy*, Vol. 10, No. 1, 2011, pp. 29-48.

Introduction

RULES of origin mechanism used to determine the origin of a product. Rules of origin serve many purposes such as collecting data on trade flows, implementing preferential tariff treatment, and applying anti-dumping duties. Rules of origin can be divided into preferential and non-preferential rules. Preferential rules of origin are used to determine whether a product originates in a preference-receiving country or trading area and hence qualifies to enter the importing country on better terms than products from the rest of the world. Non-preferential rules of origin are used for all other purposes, including enforcement of product- and country-specific trade restrictions that increase the cost of, or restrict or prevent, market entry. Preferential rules of origin differ from non-preferential ones because they are designed to minimize trade deflection.

With rapid increase of bilateral and regional trade agreements, the role of rules of origin has become more evident. In the context of bilateral and regional trade agreements, rules of origin prevent free-riders from enjoying the benefits negotiated between the countries concerned. In other words, once the origin of a product is known, a country can extend the benefit of its free trade agreement to its trading partners thus excluding non-partners.

In principle, rules of origin are supposed to be straightforward and easy-to-follow methods used to determine origin especially when a product is manufactured in one country, which rarely happens in reality. However, more than often, rules of origin are complex and protectionist in nature and are used mostly as a barrier to trade. As another case study, the purpose of this article is to examine rules of origin in the US-Arab countries free trade agreements (FTAs) to provide critical inputs to the rules of origin debate.

The article begins with a brief discussion of the concept of free trade, its evolution through the GATT and then the WTO, and the recently concluded FTAs between the US and Arab countries. Then, in section three, the article analyzes in details rules of origin in the US-Arab countries FTAs. The analysis includes, among other things, substantial transformation and value-added tests, product specific processes, and other relevant rules of origin. Sections four and five address the documentations and procedures required to prove origin and the costs involved in this process. Finally, the article provides a set of conclusions.

Protecting Free Trade: The Political Economy of Rules of Origin by Kerry A. Chase, 2008. http://people.brandeis.edu/~chase/research/io08.pdf

THE design of rules of origin in free trade agreements (FTAs) arouses spirited lobbying campaigns that mostly escape public attention. This article argues that the domestic groups generally most favourable to FTAs differ in their preferences over rules of origin: industries with large returns to scale favour strict rules of origin to gain scale economies in an FTA, while industries with multinational supply chains prefer lenient rules of origin to accommodate offshore procurement. An econometric analysis of rules of origin in the North American Free Trade Agreement finds tougher rules of origin the higher the external trade protection and the larger the returns to scale, and more permissive rules of origin the greater the involvement in foreign sourcing. The results suggest that rules of origin may be critical to building domestic coalitions for FTAs. Industry preferences toward rules of origin therefore have important implications for the politics of FTA ratification.

Harmonizing Preferential Rules of Origin in the WTO System by John J. Barceló III, Research Paper, Cornell Law School, October 2006.

Introduction

PREFERENTIAL arrangements (bilateral and multilateral free trade areas and GSP systems (preferences for developing countries) are emerging everywhere in the world trading system and are causing concern because they discriminate against non-members and add complexity, distortions and inconsistency to the global system. Rules of origin (RoOs) linked to these arrangements are a significant part of the problem. More and more they have become the source in their own right of distortions in trade patterns, complexity, non-transparency and inconsistency. This essay argues that the WTO members should authorize negotiations seeking to harmonize preferential RoOs (rules of origin linked to preferential arrangements) around core principles consistent with WTO rules.

The harmonized preferential RoOs should be aligned as much as possible with the harmonized regime for non-preferential RoOs (rules of origin linked to non preferential arrangements) likely to emerge from the current hold-over WTO negotiations authorized by the Uruguay Round RoOs Agreement. They should be non-restrictive, based essentially on the principle that substantial transformation confers origin, and - except where developing countries benefit - should not allow cumulation (treating product components from within the preferential region as locally produced). This introduction first discusses some fundamentals about RoOs and then explains the structure of the essay.

Importing countries use RoOs to determine the national origin of imports. Normally substantial processing must occur in the shipment country before a good would be considered to originate there. Sometimes even more than "substantial processing" is mandated. RoOs are the provisions that determine for each product what exactly is required.

RoOs

RoOs are divided into two fundamental types: preferential and non-preferential, depending on the

nature of the policy instrument to which they are linked. Preferential RoOs (PRoOs) are linked to trade policy instruments, such Free Trade Area (FTA) agreements or Generalized System of Preference (GSP) systems, that accord preferential market access (reduced or zero tariff rates) to imports from select countries (FTA members or developing country beneficiaries of a GSP system). Preferential RoOs determine whether a good has the national origin of a preference country, in which case it gets preferential market access.

Non-preferential RoOs (NPRoOs) are linked to policy instruments of a more general nature that do not involve preferential access for goods—for example, a customs regime requiring all imports to bear a mark of origin. These policy instruments involve both neutral and also more politically sensitive purposes, though none involves offering preferential market access. Falling at the neutral—or non-political—end of the spectrum, for example, are programmes for collecting trade statistics (bilateral trade balances) and, as stated, for imposing marks of origin on imports.

At the politically sensitive end, there are policy instruments for restricting trade from select countries. This category includes such provisions as basic tariff laws (applicability of MFN or non-MFN tariffs), selective quotas, selective safeguard measures, antidumping duties, countervailling duties, and government procurement restrictions. Except for statistical and consumer information programmes, NPRoOs generally decide whether a good will face restricted entry (as opposed to preferential entry) because it comes from a country against which restrictions apply.

In today's world most traded goods contain components from, or are subject to processes in, more than one country. Some goods, however, plainly originate wholly in one country. Examples include animals raised in a single country, non-processed agricultural goods grown and harvested in a single country, and minerals extracted in a single country. For such products RoOs are uniform and non-controversial; they accord origin to that single country. In discussing RoOs this essay excludes such straightforward RoOs applicable to single-country goods and will always refer only to those RoOs applying to goods produced with the use of multiple inputs from, or processes in, two or more countries. Support for harmonizing RoOs stems from the desire for transparency, simplicity, and reduction of transaction costs in global trade. This essay focuses primarily on harmonizing PRoOs. Nevertheless, some understanding of efforts to harmonize NPRoOs is essential for a discussion of PRoOs, in part because the world trading system is much further along in efforts to harmonize NPRoOs and has not yet even seriously considered an undertaking to harmonize PRoOs.

Strictly speaking, it is the underlying policy instrument, and not the rules of origin themselves, that accords a preference or that is non-preferential in nature. For convenience, however, the rules of origin associated with these preferential or non-preferential policy instruments have come to be called preferential or non-preferential RoOs, respectively.

This essay contains four major parts. The first part discusses the current state of efforts to harmonize NPRoOs. The second part turns to PRoOs and discusses the trade distorting effects of preferential regimes, with a particular emphasis on trade distortions attributable to the PRoOs themselves and not just to the underlying policy instruments to which they are linked. This discussion is important for understanding the issues that arise when one asks (as Part three does) whether certain provisions of exisiting PRoOs should be avoided in harmonized rules because those provisions transgress basic WTO principles and rules. Part three, then, turns to a discussion of the relevant WTO rules that may apply to constrain or discipline PRoOs. Part four discusses the current EU effort to harmonize RoOs in preferential arrangements to which the EU is a party. This is the best-known example of a serious effort to harmonize PRoOs—albeit at only the regional level. The conclusion urges a harmonization effort for PRoOs at the WTO level and restates the core principles around which such an effort should be structured. The goal should be clear, relatively easy to apply rules, of a non-restrictive nature, based as much as possible on the emerging harmonized NPRoOs and on the fundamental notion that substantial transformation confers origin. The cumulation rule should also be eliminated, unless it benefits a developing country.

The Origin of Goods: Rules of Origin in Regional Trade Agreements by Olivier Cadot, Antoni Estevadeordal, Akiko Suwa-Eisenmann, and Thierry Verdier, Oxford Scholarship online, May 2006.

LITTLE analytical attention has so far been devoted to the issue of rules of origin in a services and investment context. This chapter wades into this largely uncharted territory by advancing a few thoughts on a range of economic and legal considerations arising from the way in which various agreements seek to determine and condition who gets to benefit from services trade and investment liberalization. It focuses on the practice of preferential and non-preferential services trade liberalization as found in various bilateral and regional trade and investment agreements as well as the WTO's General Agreement on Trade in Services (GATS). It addresses a range of conceptual issues relating to services trade that impinge upon the design and implementation of rules of origin for services. The discussion draws attention to a number of salient characteristics of trade in services that limit the usefulness of concepts and approaches to origin developed in the context of trade in goods. Attention is also drawn to a number of economic considerations that should inform the design of rules of origin for services trade to minimize the potentially adverse effects of trade and investment diversion, and maximize the economy-wide gains in allocative efficiency that well-designed services liberalization can entail.

Rules of Origin - Evolving Best Practices for RTAs/FTAs by Dorothea C. Lazaro and Erlinda M. Medalla, 2006.

THE paper aims to add to the understanding of the issues and suggests a framework to move towards the use of best practice in RoOs. Rules of Origin (RoO), originally designed as uncontroversial and neutral devise for authentication and statistical purposes, have evolved over time to accommodate different purposes which come about with new technologies and other developments, across different trade regimes. RoO is becoming a tool in implementing discriminatory trade policies and trade policy instrument *per se*. RoO has become a critical and to some extent, a dragging point in the negotiation process of recent trade agreements. The growing relevance of RoO in trade negotiations cannot be overemphasized.

The paper begins with the definition that has been adopted and traces the developments in the use of RoOs. It looks at RoOs within the context of multilateral rules of origin and the preferential RoO in Regional or Bilateral FTAs. Different types of RoO with some illustration from existing RTA are also presented. The paper also focuses on some recurring RoO issues, and presents some suggestions for a framework for RoO best practices which is characterized by transparency, predictability, neutrality, and non-discrimination, and with the added dimension of being development-friendly.

Rules of Origin and Rules of Preference and the World Trade Organization: The Challenge to Global Trade Liberalization by William E. James, The World Trade Organization: *Legal, Economic and Political Analysis*, 2005, pp. 1858-1887.

RULES OF ORIGIN (RoOs) are the criteria used to determine the source country or territory of an imported product. The determination of origin is important where tariffs or other trade barriers differ depending on the source of imports. This is the case in the implementation of various trade restrictions and preferences. Rules of origin, for example, are a necessary accompaniment of commercial policy instruments such as country-specific import quotas as under the multi-fibre Arrangement, anti-dumping measures, safeguards, government procurement and quarantine restrictions implemented for reasons of health, safety or environmental protection. Rules of origin are also used in compilation of trade statistics and in the application of labeling and marking requirements. Rules of origin are used in determining whether or not a good is eligible for preferential treatment under the generalized system of preferences and other preferential trade arrangements. In particular, rules of origin have become critically important in the implementation of discriminatory regional and cross-regional trading arrangements such as free trade agreements, customs unions and common markets.

International Government-Procurement Obligations of the United States: An Overview by Todd B. Tatelman, CRS Report for Congress, May 2005.

THIS report contains an overview of the major procurement agreements to which the United States is a party, including the World Trade Organization (WTO) Agreement on Government Procurement, the procurement chapter of the North American Free Trade Agreement (NAFTA) and provisions from other free trade agreements. In addition, this report highlights major federal laws that relate to the government-procurement obligations of the United States.

Rules of Origin (Article IV)

Rules of Origin are defined in Annex 1A of the WTO as laws, regulations and administrative determinations of general application applied by any Member to determine the country of origin of goods provided such rules of origin are not related to contractual or autonomous trade regimes leading to the granting of tariff preferences going beyond the application of paragraph 1 of Article I of GATT 1994. While the AGP itself does not contain separate rules of origin, it does provide that a Party may not implement rules of origin regarding the importation or supply of government procured products or services "which are different from the rules of origin applied in the normal course of trade and at the time of the transactions in question to imports of supplies of the same products or services from the Parties." Article IV, paragraph 2, however, allows this requirement to be amended in light of the results of WTO negotiations on rules of origin for products and services.

The Impact of Rules of Origin on Trade Flows by Patricia Augier, Michael Gasiorek and Charles Lai Tong, *Economic Policy*, Vol. 20, No. 43, July 2005, pp. 567-624.

A great deal of post-War trade liberalization resulted from regional, preferential trade agreements. Preferential trade agreements cut tariffs on goods originating only in those nations that have signed the agreement. Therefore, they need "rules of origin" to determine which goods benefit from the tariff cut. Rules of origin have long been ignored for two good reasons: they are dauntingly complex and at first sight appear mind-numbingly dull. The third standard reason for ignoring them - the assertion that they do not matter much - turns out to be wrong. We show that rules of origin are important barriers to trade. Moreover, such rules are emerging as an important trade issue for three additional reasons. *First*, preferential trade deals are proliferating worldwide. *Second*, the global fragmentation of production implies complex international supply chains which are particularly constrained and distorted by rules of origin. *Third*, the extent to which regionalism challenges the WTO-based trading system depends in part on incompatibilities and rigidities built into rules of origin.

The WTO Agreement on Rules of Origin: Implications for South Asia, by K.N. Harilal and P.L. Beena, Working Paper, Centre for Development Studies, 2003.

FROM neutral trade policy devices employed to identify country of origin of commodities, the rules of origin are emerging as protectionist tools. Nation-states, as they are increasingly denied of conventional trade policy tools, are reasserting themselves by evolving new and less visible weapons of intervention. The misuse of rules of origin as protectionist tools is widely reported from PTAs among developed countries, such as EEC and NAFTA. More recently, non-preferential rules of origin are also being used for protectionist purpose. It is such protectionist adaptation of the rules of origin that prompted the WTO to launch the HWP (Harmonized Work Programme) to evolve common rules of origin for all countries. The present study is a critique of the harmonization work programme. The central objective of the ARO (Agreement on Rules of Origin) and also the HWP is to ensure that the rules of origin are employed without/or with least trade distorting effects. But, as our study shows, it would be too optimistic to expect such an outcome from the HWP. On the contrary, even if it is successfully completed, the HWP is likely to leave considerable scope for misuse of rules of origin for protectionist purpose. Further, the new multilateral regime, even if it succeeds in establishing semblance of an order in the arena of rules of origin, is likely to have unequal effects on members. The moot question is as to whether the adopted harmonized rules match the trading interests of the developing

nations. The picture emerging from our analysis of outstanding disputes is not very encouraging for the developing countries. They belong mainly to the traditional areas of western protectionism against developing countries. The fear that the developed countries are trying to manipulate rules of origin to compensate for the loss of tariff and other conventional barriers, therefore, cannot be ruled out.

NAFTA Trade with East Asia by William E. James and Masaru Umemoto, *Journal of Southeast Asian Economies*, Vol. 17, No. 3, December 2000.

Introduction

RULES OF ORIGIN are among the most controversial aspects of the North American Free Trade Agreement (NAFTA). Early assessments of NAFTA indicated that its rules of origin, contained in a nearly two hundred page compendium, were one of the agreement's most disappointing features (Hufbauer and Schott 1993). Preferential trading arrangements must employ such rules in order to determine whether or not a good entering the customs territory is entitled to preferential treatment. In negotiations leading to the NAFTA, industry interests were well represented and were particularly involved in the design of detailed and product-specific rules of origin (Krishna and Krueger 1995). The possible use of rules of origin as a protectionist device in an FTA was first pointed out in the seminal paper on this topic (Shibata 1967). It has now been shown that rules of origin may be used as tools of commercial policy in a customs union as well (Vermulst and Waer 1990; James 1997) in the context of the European Union (EU). Awareness of the possible protectionist uses of such rules in the context of free trade areas (FTAs) has created new interest among economists in examining the welfare implications of FTAs. Some economists have regarded free trade agreements favourably, on the grounds that they, on balance, lead to lower trade barriers among members without raising barriers to non-members as is required by Article XXIV of the General Agreement on Tariffs and Trade. Bhagwati (1991) has taken up the cudgel in opposing discriminatory regional and other preferential trading arrangements on the grounds that they undermine multilateralism and the principles of GATT/WTO. Others have taken a middle ground, arguing that agreements such as NAFTA have desirable and undesirable features that need to be carefully weighed. The arguments for and against FTAs have been largely based on non-empirical theoretical analysis and on ex ante judgements regarding the likely magnitude of trade and investment creation versus diversion.

It is too early to judge whether or not NAFTA as a whole is beneficial in terms of world economic welfare or to comment on the overall distribution of gains and losses. However, it is now possible to begin an empirical assessment of the performance of trade components of NAFTA. Based on UN Commodity Trade Statistics, this paper examines trade in textiles and apparel among NAFTA members (Canada, Mexico and the United States). Textiles and apparel have the strictest rules of origin and, therefore, have the greatest potential with regard to trade diversion and protectionism (Hufbauer and Schott 1992 and 1993, Krueger 1997, and Krishna and Krueger 1995, Stephenson 1998). East Asian countries that have rapidly expanded market share in global markets for textiles and apparel, including members of the Association of Southeast Asian Nations (ASEAN) are most likely to be harmed by any trade diversion resulting from NAFTA's rules of origin.

"Triple-Transformation" — NAFTA Rules of Origin for Textiles and Apparel

Special rules of origin governing trade in fibers, yarns, fabrics, made-up textiles and clothing are set out in NAFTA Vol. II, annex 401 (HS chapters 50-63), and pp. 401-30 and 401-51. In essence these rules establish that most items of textiles and apparel must be produced from yam-forward to be conferred origin within the FTA. Some items must even have the fibers used to produce yarn originate within NAFTA (a fiber-forward rule). Some apparel items that require fabrics not generally available in NAFTA (such as silk, certain types of linen and shirt-making fabric) are allowed to qualify for preferential treatment, provided that otherwise they meet NAFTA labelling and origin requirements. These items, however, constitute a very small share of NAFTA trade in apparel.

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DOCUMENTS

INDIA-MALAYSIA COMPREHENSIVE ECONOMIC COOPERATION AGREEMENT (IMCECA) – EFFECTIVE 1 JULY 2011

CHAPTER 3

RULES OF ORIGIN

ARTICLE 3.1

DEFINITIONS

For the purposes of this Chapter:

(a) **carrier** means any vehicle for transportation by air, sea and land;

(b) **CIF value** means the price actually paid or payable to the exporter for a good including the cost of the good, insurance, and freight necessary to deliver the good to the named port of destination. The valuation shall be made in accordance with the WTO Agreement on Implementation of Article VII of GATT 1994;

(c) **FOB value** means the price actually paid or payable to the exporter for a good when the good is loaded onto the carrier at the named port of exportation, including the cost of the good and all costs necessary to bring the good onto the carrier. The valuation shall be made in accordance with the WTO Agreement on Implementation of Article VII of GATT 1994;

(d) **identical and interchangeable materials** means materials being of the same kind and commercial quality, possessing the same technical and physical characteristics, and which, once they are incorporated into the finished good cannot be distinguished from one another for origin purposes by virtue of any markings, *et cetera*;

(e) **materials** means ingredients, raw materials, parts, components, sub-assemblies or goods that are used in the production of another good or are physically incorporated into another good;

(f) **originating goods** means goods that qualify as originating in accordance with the provisions of Article 3.2 (Origin Criteria);

(g) **Product Specific Rules** are rules which specify that the materials have undergone a change in tariff classification or a specific manufacturing or processing operation, or satisfy qualifying value content criterion, or a combination of any of these criteria, as provided in Annex 3-1 (Product Specific Rules); and

(h) **production** means methods of obtaining goods including growing, planting, mining, harvesting, raising, breeding, extracting, gathering, collecting, capturing, fishing, trapping, hunting, manufacturing, producing, processing, assembling or disassembling a good.

ARTICLE 3.2

ORIGIN CRITERIA

For the purposes of this Chapter, goods imported by a Party which are consigned directly within the meaning of Article 3.8 (Direct Consignment), shall be deemed to be originating and eligible for preferential tariff treatment if they conform to the origin requirements under any one of the following:

(a) goods which are wholly obtained or produced in the territory of the exporting Party as set out and defined in Article 3.3 (Wholly Obtained or Produced Goods); or

(b) goods not wholly obtained or produced in the territory of the exporting Party provided the said goods are eligible under Articles 3.4 (Not Wholly Obtained or Produced Goods) or 3.5 (Cumulative Rule of Origin).

ARTICLE 3.3

WHOLLY OBTAINED OR PRODUCED GOODS

Within the meaning of paragraph (a) of Article 3.2 (Origin Criteria), the following good shall be deemed as being wholly obtained or produced in the territory of a Party:

(a) plant[1] and plant products grown, planted and harvested there;

(b) live animals[2] orn and raised there;

(c) products[3] obtained from live animals referred to in paragraph (b);

(d) goods obtained from hunting, trapping, fishing, aquaculture, gathering or capturing conducted there;

(e) minerals and other naturally occurring substances, not included in paragraphs (a) to (d), extracted or taken from its soil, waters, seabed or beneath their seabed;

(f) goods taken from the waters, seabed or beneath the seabed outside the territorial waters of that Party, provided that, the Party has the rights to exploit such waters, seabed and beneath the seabed in accordance with the United Nations Convention on the Law of the Sea, 1982;

(g) goods of sea-fishing and other marine goods taken from the high seas by vessels registered with a Party and entitled to fly the flag of that Party;

(h) goods processed or made on board factory ships registered with a Party and entitled to fly the flag of that Party, exclusively from goods referred to in paragraph (g) above;

(i) articles collected there which can no longer perform their original purpose nor are capable of being restored or repaired and are fit only for disposal or recovery of parts of raw materials, or for recycling purposes[4] ; and

(j) goods obtained or produced in the territory of a Party solely from goods referred to in paragraphs (a) to (i).

ARTICLE 3.4

NOT WHOLLY OBTAINED OR PRODUCED GOODS

1. For the purposes of paragraph (b) of Article 3.2 (Origin Criteria), a good shall be deemed to be originating:

(a) when such goods satisfy the criteria under the Product Specific Rules provided in Annex 3-1; or

(b) when:

(i) all non-originating materials used in the production of the goods have undergone a change in tariff classification in a sub-heading at the six digit level of the HS; and

(ii) qualifying value content of the goods is not less than thirty five per cent of the FOB value,

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[1] "Plant" refers to all plant life, including forestry goods, fruit, flowers, vegetables, trees, seaweed, fungi and live plants.

[2] "Animals" referred to in paragraphs (b) and (c) of this Article covers all animal life, including mammals, birds, fish, crustaceans, molluscs, reptiles, and living organisms.

[3] "Products" refer to those obtained from live animals without further processing, including milk, eggs, natural honey, hair, wool, semen and dung.

[4] This would cover all scrap and waste including scrap and waste resulting from manufacturing or processing operations or consumption in the same country, scrap machinery, discarded packaging and all products that can no longer perform the purpose for which they were produced and are fit only for disposal for the recovery of raw materials. Such manufacturing or processing operations shall include all types of processing, not only industrial or chemical but also mining, agriculture, construction, refining, incineration and sewage treatment operations.

provided that the final process of manufacturing is performed within the territory of the exporting Party.

2. For the purposes of this Article, the formulae for calculating the qualifying value content are as follows[5]:

(a) Direct Method:

$$\frac{\text{Originating Material Cost} + \text{Direct Labour Cost} + \text{Direct Overhead Cost} + \text{Other Cost} + \text{Profit}}{\text{FOB Price}} \times 100\% \geq 35\%$$

(b) Indirect Method:

$$\frac{\text{Value of Imported non-originating materials} + \text{Value of materials of undetermined origin}}{\text{FOB Price}} \times 100\% \leq 65\%$$

3. The value of the non-originating materials shall be:

(a) the CIF value at the time of importation of the materials, parts or produce; or

(b) the earliest ascertained price paid for the materials, parts or produce of undetermined origin in the territory of the Party where the working or processing takes place.

4. The method of calculating the FOB value is as set out in Annex 3-2 (Method of Calculation of FOB Value).

Article 3.5

CUMULATIVE RULE OF ORIGIN

Unless otherwise provided for, goods which comply with the origin requirements provided for in Article 3.2 (Origin Criteria) and which are used in the territory of a Party as materials for a finished good eligible for preferential tariff treatment under this Agreement shall be considered to be originating in the territory of the latter Party where working or processing of the finished goods has taken place.

Article 3.6

DE MINIMIS

1. A good that does not undergo a change in tariff classification pursuant to Article 3.4 (Not Wholly Obtained or Produced Goods) and Annex 3-1 (Product Specific Rules) in the final process of production shall be deemed as originating if:

(a) for goods except for those falling within Chapters 1 through 14 and Chapters 50 through 63 of the HS, the value of all non-originating materials used in its production, which do not undergo the required change in tariff classification, does not exceed ten percent of the FOB value of the good;

(b) for goods falling within Chapters 50 through 63 of the HS, the total weight of non-originating basic textile materials used in its production, which do not undergo the required change in tariff classification, does not exceed eight percent of the total weight of all the basic textile materials used; and

(c) the good meets all other applicable criteria set forth in this Chapter for qualifying as an originating good.

2. The value of such non-originating materials shall be included in the value of non-originating materials for any applicable qualifying value content requirement for the good.

Article 3.7

MINIMAL OPERATIONS AND PROCESSES

1. Notwithstanding any provisions in this Chapter, a good shall not be considered originating in the territory of a Party if the following operations are undertaken exclusively by itself or in combination in the territory of that Party:

(a) operations to ensure the preservation of goods in good condition during transport and storage including, but not limited to, drying, freezing, keeping in brine, ventilation, spreading out,

[5] The Parties shall be given the flexibility to adopt the method of calculating the qualifying value content, whether it is the direct or indirect method. In order to promote transparency, consistency and certainty, each Party shall adhere to one method. Any change in the method of calculation shall be notified to all the other Parties at least six months prior to the adoption of the new method. It is understood that any verification of the content by the importing Party shall be done on the basis of the method used by the exporting Party.

chilling, placing in salt, sulphur dioxide or other aqueous solutions, removal of damaged parts, and like operations;

(b) simple[6] operations consisting of removal of dust, sifting or screening, sorting, classifying, matching including the making-up of sets of articles, washing, painting, cutting;

(c) changes of packing and breaking up and assembly of consignments;

(d) simple[7] cutting, slicing and repacking or placing in bottles, flasks, bags, boxes, fixing on cards or boards, and all other simple packing operations;

(e) affixing of marks, labels or other like distinguishing signs on goods or their packaging;

(f) simple[8] mixing of goods whether or not of different kinds, where one or more components of the mixture do not meet the conditions laid down in this Chapter to enable them to be considered as originating goods;

(g) simple[9] assembly of parts of goods to constitute a complete good;

(h) disassembly;

(i) slaughter which means the mere killing of animals; and

(j) mere dilution with water or another substance that does not materially alter the characteristics of the goods.

2. For textiles and textile goods, an article or material shall not be considered to be originating in the territory of a Party by virtue of merely having undergone any of the following:

(a) simple[10] combining operations, labelling, pressing, cleaning or dry cleaning or packaging operations, or any combination thereof;

(b) cutting to length or width and hemming, stitching or overlocking fabrics which are readily identifiable as being intended for a particular commercial use;

(c) trimming and/or joining together by sewing, looping, linking, attaching of accessory articles such as straps, bands, beads, cords, rings and eyelets;

(d) one or more finishing operations on yarns, fabrics or other textile articles, such as bleaching, waterproofing, decanting, shrinking, mercerizing, or similar operations; or

(e) dyeing or printing of fabrics or yarns.

ARTICLE 3.8

DIRECT CONSIGNMENT

An originating good shall be deemed as directly consigned from the territory of the exporting Party to the territory of the importing Party:

(a) if the goods are transported without passing through the territory of any non-Party; or

(b) if the goods are transported through the territory of any non-Party provided that:

(i) the transit entry is justified for geographical reasons or transport requirements;

(ii) the goods have not entered into trade or consumption in the territory of such non-Party;

(iii) the goods have not undergone any operation in the territory of such non-Party other than unloading and reloading or any operation required to keep the goods in good condition; and

(iv) the goods have remained under the control of the customs authority of such non-Party.

ARTICLE 3.9

TREATMENT OF PACKING MATERIALS AND CONTAINERS

1. If a good is subject to the change in tariff classification criterion as provided in paragraph 1(b)(i) of Article 3.4 (Not Wholly Obtained or Produced Goods), packing materials and containers classified together with the packaged good, shall not be taken into account in determining origin.

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[6] "Simple" generally describes activities which need neither special skills nor machines, apparatus or equipment especially produced or installed for carrying out the activity.

[7] Refer to footnote 6 of this Chapter.

[8] Refer to footnote 6 of this Chapter.

[9] Refer to footnote 6 of this Chapter.

[10] Refer to footnote 6 of this Chapter.

2. If a good is subject to qualifying value content requirement as provided in paragraph 1(b)(ii) of Article 3.4 (Not Wholly Obtained or Produced Goods), the value of the packing materials and containers, shall be taken into account in determining the origin of that good, provided that the packing materials and containers are considered as forming a whole with the good and the good is packaged in such packaging materials and containers for the purposes of retail sale. Packing materials and containers in which a good is packed for the purposes of shipment and used exclusively for the transportation of a good shall not be taken into account in determining the origin of such good.

Article 3.10

ACCESSORIES, SPARE PARTS, TOOLS AND INSTRUCTIONAL OR OTHER INFORMATION MATERIAL

1. Any accessories, spare parts, tools, instructional or other information material delivered with a good that form part of the standard accessories, spare parts, tools or instructional or other information material of the good, shall be treated as originating goods if the good is an originating good, and shall not be taken into account in determining whether all the non-originating materials used in the production of the good undergo the applicable change in tariff classification, provided that:

(a) the accessories, spare parts, tools or the instructional and other information material are not invoiced separately from the good; and

(b) the quantities and value of the accessories, spare parts, tools or the instructional and other information material are standard trade practice for the good in the domestic market of the exporting Party.

2. If the good is subject to a qualifying value content requirement, the value of the accessories, spare parts, tools or the instructional and other information material shall be taken into account as originating or non-originating materials, as the case may be, in calculating the qualifying value content of the good.

Article 3.11

INDIRECT MATERIALS

In order to determine whether a good originates in the territory of a Party, any indirect material, including power, fuel, plant and equipment, machines, tools or consumables used to obtain such good shall be treated as originating irrespective of the origin of the material and its value shall be the cost registered in the accounting records of the producer of such good.

Article 3.12

IDENTICAL AND INTERCHANGEABLE MATERIALS

For the purposes of establishing if a good is originating when it is manufactured utilizing both originating and non-originating materials, mixed or physically combined, the origin of such materials can be determined on the basis of generally accepted accounting principles of stock control applicable or in accordance with the methods of inventory management practized in the exporting Party.

Explanation: For the purposes of this Article, "generally accepted accounting principles" means recognized consensus or substantial authoritative support given in the territory of a Party with respect to the recording of revenues, expenses, costs, assets, and liabilities, the disclosure of information, and the preparation of financial statements and may encom-pass broad guidelines for general application, as well as detailed standards, practices, and procedures.

Article 3.13

CERTIFICATE OF ORIGIN

A claim that an imported good shall be accepted as eligible for preferential tariff treatment shall be supported by a Certificate of Origin issued by an authority or authorities designated by the Government of the exporting Party and notified to the other Party in accordance with Annex 3-3 (Operational Certification Procedures).

Article 3.14

IMPLEMENTATION

The Sub-Committee on Trade in Goods established under Article 15.2 (Sub-Committees) shall consider matters relating to the implementation of this Chapter.

(www.commerce.nic.in/trade/imceca/chapter%2003%20roo.pdf)

Committee on Rules of Origin

Transposition of Draft Consolidated Text on Non-preferential Rules of Origin under the WTO Agreement on Rules of Origin

[Item V (a) on the Agenda]

The following submission, dated 22 March 2013, is being circulated at the request of the World Customs Organization.

BY letter dated 13 June 2012 the CRO has requested the advice of the WCO Technical Committee on Rules of Origin (TCRO) concerning the transposition of the draft text of non-preferential rules of origin, contained in document G/RO/W/111/Rev.6, to a newer version of the HS nomenclatures, taking into account the technicality of the undertaking and the TCRO's high capability to assist such work.

The WCO Secretariat and the TCRO have welcomed the opportunity for a review of the transposed text by the experts of the TCRO as this technical review of the transposed rules will ensure that the final agreement is simplified and, hence, facilitate its implementation by Customs administrations and the business community.

While a large portion of the HS amendments has little or no impact on the rules of origin, the transposed rules may become overly complex in certain cases if the transposition was only carried out mechanically without any logical simplification. Therefore it is extremely important for Customs as well as the traders to ensure that the transposed rules are simple and clear, so that the rules are fully effective and implementable.

The WCO Secretariat had prepared a document to be examined by the TCRO focusing on the examination of those possible complex cases. The document has been examined by the TCRO at its 31st session in January 2013.

The TCRO expressed general appreciation for the work carried out by both Secretariats and stressed the need for harmonized, simple and transparent rules. The technical rectification should be merely a technical issue and should not lead to changes in the so far agreed rules. On the other hand, the transposition leads to complexity in some cases and these cases should be looked at.

After the discussion, the TCRO Chairperson concluded that the transposition process must ensure that agreed rules are not touched upon and that simplifications should not lead to changes in the rules. The TCRO took note of the document and of various comments made by delegations and agreed that the document be sent to the CRO as WCO Secretariat recommendations and technical advice.

According to the TCRO decision I am pleased to enclose the document trusting that it provides reasonable option to the CRO for consideration.

1. Since the beginning of the negotiations of the Harmonization Work Programme (HWP) the WCO Council has adopted several recommendations to amend the Harmonized System (HS). These HS amendments came into effect internationally on 1 January 2002, 2007 and 2012.

2. The Technical Committee on Rules of Origin (TCRO) has agreed in the past that synchronized application of the Harmonized System and the Harmonized Rules of Origin is essential. A technical rectification of the Agreement on Origin will therefore be needed.

3. At its meeting on 27 October 2011, the Committee on Rules of Origin (CRO) agreed to initiate the transposition of the draft consolidated text of Non-Preferential Rules of Origin into more

recent versions of the HS nomenclature. The WTO Secretariat has been mandated to conduct this work with a view to concluding it as soon as possible. The transposition exercise would be conducted on a step-by-step basis as to gradually conduct a technical rectification from HS 1996 to HS 2012.

4. At its meeting on 7 June 2012 the CRO agreed to invite comments from the TCRO on documents prepared by the WTO Secretariat concerning the transposition exercise. To that effect, the Chairperson of the CRO addressed a letter to the Chairperson of the TCRO on 13 June 2012.

5. On 29 June the Chairperson of the TCRO welcomed this opportunity for a review of the transposed text by the experts of the TCRO adding that a technical review of the transposed rules would ensure that the final agreement is simplified and, hence, facilitates its implementation by Customs administrations and the business community. The TCRO would provide the CRO with relevant advice to improve the quality of the transposition work.

6. On 24 September 2012 the Chairperson of the TCRO addressed a letter to the TCRO delegations stating that:

> "while a large portion of the HS amendments has little or no impact on the rules of origin, the transposed rules may become overly complex in certain cases if the transposition was only carried out mechanically without any logical simplification.

Therefore it is extremely important for Customs as well as the traders to ensure that the transposed rules are simple and clear, so that the rules are fully effective and implementable. The Technical Committee on Rules of Origin (TCRO) is now expected to contribute to this very important technical work. In this context, I am of the view that the TCRO should focus on the examination of those possible complex cases, and provide reasonable options to the CRO for consideration.

As the centrepiece of practical expertise in the implementation of rules of origin, I am confident that the TCRO can make valuable contributions as we have done through the early years of the development of the Harmonization Work Programme."

7. The Chairperson indicated that the WCO Secretariat would analyze the transposition documents received from the WTO Secretariat and draft a working document to facilitate the discussions at the TCRO.

8. The WCO Secretariat has analyzed the transposition documents received from the WTO. As indicated by the Chairperson, a large portion of the HS amendments has little or no impact on the rules of origin.

9. On the other hand, for those headings on which the HS amendments have great impact, the rules of origin will be very complex as a result of the mechanical transposition, thus the simplified presentation of the rules of origin must be considered for those headings.

10. The existence of complex rules of origin would have huge negative impacts on the implementation of rules of origin by Customs and economic operators. Thus it is extremely important from the Customs' standpoint to avoid such complex rules of origin to the maximum extent possible.

11. In this context, the Secretariat has selected the transposed rules of origin which include the following:

(1) Exceptions from other (sub) headings, or

(2) Creation of new split (sub) headings.

12. For these cases, it is appropriate for the TCRO to undertake technical discussions and make feasible and realistic recommendations of the transposed rules of origin based on the implementation feasibility by the Customs administrations and the economic operators.

13. The result of the decisions taken by the TCRO will be forwarded to the CRO by the Chairperson to be duly utilized for the CRO's consideration.

Conclusion

14. The Committee is invited to discuss the transposed rules of origin compiled in the Annexes* to the present document in order to provide the CRO with relevant advice to improve the quality of the transposition work undertaken by the WTO Secretariat.

(*For complete text* please refer to: www.org/G/RO/W/143, 9 April 2013)

Committee on Rules of Origin

DRAFT

Consolidated Text of Non-Preferential Rules of Origin*

Harmonization Work Programme

NOTE BY THE SECRETARIAT[1]

1. This document reflects the outcome of the work done under the Harmonization Work Programme pursuant to Article 9 of the Agreement on Rules of Origin, compiling product-specific rules of origin adopted by the Committee on Rules of Origin (the Committee) to date. Product-specific rules of origin in square brackets have not yet been adopted by the Committee, but reflect the proposals by the Chairperson of the Committee. General Rules, definition (2) of Appendix 1, and rules of Appendix 2 as well as product-specific rules of origin of Chs. 84-90 have not yet been endorsed by the Committee.

2. This document is circulated by the Secretariat in preparation for the technical work to be carried out by the Committee, as agreed by the General Council at its meeting on 27 July 2007.

ANNEX III

HARMONIZED NON-PREFERENTIAL RULES OF ORIGIN

Definitions

References to "manufacturing", "producing" or "processing" goods include any kind of working, assembly or processing operation. Methods of obtaining goods include manufacturing, producing, processing, raising, growing, breeding, mining, extracting, harvesting, fishing, trapping, gathering, collecting, hunting and capturing.

"Material" includes ingredients, parts, components, subassemblies and goods that were physically incorporated into another good or were subject to a process in the production of another good. "Originating material" means a material whose country of origin, as determined under these rules, is the same country as the country in which the material is used in production.

"Non-originating material" means a material whose country of origin, as determined under these rules, is not the same country as the country in which that material is used in production.

"Customs Valuation Agreement" means the Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994.

General Rules

General Rule 1: Harmonized System

References to headings and subheadings are references as they appear in the Harmonized Commodity Description and Coding System (hereinafter referred to as "Harmonized System" or "HS") as amended and in force on [— — ——]. Classification of goods within headings and subheadings of the Harmonized System is governed by the General Interpretative Rules and any relative Section, Chapter and Subheading Notes to that System. Classification of goods within any additional subdivisions created for purposes of the rules of origin shall also be governed by the General Interpretative Rules and any relative Section, Chapter and Subheading Notes to the Harmonized System, unless the rules of this Annex otherwise require.

General Rule 2: Determination of Origin

The country of origin of a good shall be determined in accordance with these General Rules and in accordance with the provisions of Appendix 1 and Appendix 2, applied in sequence.

General Rule 3: Neutral Elements

In order to determine whether a good originates in a country, the origin of the power and

* Excerpts from the main Draft.

[1] This document has been prepared under the Secretariat's own responsibility and is without prejudice to the positions of Members and to their rights and obligations under the WTO Agreement.

fuel, plant and equipment, including safety equipment, or machines and tools used to obtain a good or the materials used in its manufacture which do not remain in the good or form part of the good shall not be taken into account.

General Rule 4: Packing and Packaging Materials and Containers

Unless the provisions of Appendix 1 or Appendix 2 otherwise require, the origin of packing and packaging materials and containers presented with the goods therein shall be disregarded in determining the origin of the goods in accordance with the appropriate rules set forth in Appendix 1 and the tariff classification change rules or specific process rules provided in Appendix 2, provided such packing and packaging materials and containers are classified with the goods under the Harmonized System. The packing and packaging materials and containers which are not classified with their contents are separate goods, thus their origin shall be determined in accordance with the appropriate rules set forth in Appendix 1 and Appendix 2.

General Rule 5: Accessories and Spare Parts and Tools

Accessories, spare parts, tools and instructional or other informational material classified and presented with a good shall be disregarded in determining the origin of that good under General Rule 2, provided they are normally sold therewith and correspond, in kind and number, to the normal equipment thereof.

General Rules 6: Minimal Operations and Processes

Operations or processes undertaken, by themselves or in combination with each other for the purposes listed below, are considered to be minimal and shall not be taken into account in determining whether a good has been wholly obtained in one country:

(i) ensuring preservation of goods in good condition for the purposes of transport or storage;

(ii) facilitating shipment or transportation and packaging or presenting goods for sale.

APPENDIX 1
WHOLLY OBTAINED GOODS

1. Rule 1: Scope of Application

This Appendix sets forth the definitions of the goods that are to be considered as being wholly obtained in one country.

The following goods are to be considered as being wholly obtained in one country:

(a) Live animals born and raised in that country;

In definitions 1 (a), (b), and (c) the term "animals" covers all animal life, including mammals, birds, fish, crustaceans, molluscs, reptiles, bacteria and viruses.

(b) Animals obtained by hunting, trapping, fishing, gathering or capturing in that country;

Definition 1 (b) covers animals obtained in the wild, whether live or dead, whether or not born and raised in that country.

(c) Products obtained from live animals in that country;

Definition 1 (c) covers products obtained from live animals without further processing, including milk, eggs, natural honey, hair, wool, semen and dung.

(d) Plants and plant products harvested, picked or gathered in that country;

Definition 1 (d) covers all plant life, including fruit, flowers, vegetables, trees, seaweed, fungi and live plants grown in that country.

(e) Minerals and other naturally occurring substances, not included in definitions (a)-(d), extracted or taken in that country;

Definition 1 (e) covers crude minerals and other naturally occurring substances, including rock or solar salt, crude mineral sulphur occurring in free state, natural sands, clays, stones, metallic ores, crude oil, natural gas, bituminous minerals, natural earths, ordinary natural waters, natural mineral waters, natural snow and ice.

(f) Scrap and waste derived from manufacturing or processing operations or from consumption in that country and fit only for disposal or for the recovery of raw materials;

Definition 1(f) covers all scrap and waste, including scrap and waste resulting from manufacturing or processing operations or consumption in the same country, scrap machinery, discarded packaging and household rubbish and all products that can no longer perform the purpose for which they were produced, and are fit only for discarding or for the recovery of raw materials. Such manufacturing or processing operations include all types of processing, not only industrial or chemical but also mining, agricultural, construction, refining, incineration and sewage treatment operations.

(g) Articles collected in that country which can no longer perform their original purpose there nor are capable of being restored or repaired and which are fit only for disposal or for the recovery of parts or raw materials;

(h) Parts or raw materials recovered in that country from articles which can no longer perform their original purpose nor are capable of being restored or repaired;

(i) Goods obtained or produced in that country solely from products referred to in (a) through to (h) above;

(i) Products of sea-fishing and other products taken from the sea outside a country are considered to be wholly obtained in the country whose flag the vessel that carries out those operations is entitled to fly.

(ii) Goods obtained or produced on board a factory ship outside a country are considered to be wholly obtained in the country whose flag the ship that carries out those operations is entitled to fly, provided that these goods are manufactured from products referred to in subparagraph (i) originating in the same country.

(iii) Products taken from the sea bed or subsoil beneath the sea bed outside a country, are considered to be wholly obtained in the country that has the rights to exploit that sea bed or subsoil in accordance with the provisions of the UN Convention on the Law of the Sea.[2]

[2] It is understood that this Note is without prejudice to Members' rights and obligations who are not States Parties to the United Nations Convention on the Law of the Sea

APPENDIX 2

PRODUCT SPECIFIC RULES OF ORIGIN

Rule 1: Scope of Application

(a) This Appendix sets forth rules for determining the country of origin of a good when the origin of the good is not determined under Appendix 1.

(b) In framing its legislation each Member shall provide for the application of a set of primary rules of Chapters 84-90 and 92 referred to either in column C or in column D, for it. However, for the purpose each of headings 87.01 to 87.16 each Member shall chose one of the primary rules of origin referred to in either column C or D, for it. Each Member shall notify the Committee on Rules of Origin of its chosen rules of origin within 90 days after the date of entry into force of this Annex, for it.

Rule 2: Application of Rules

(a) The rules provided in this Appendix are to be applied to goods based upon their classification in the HS and any additional subdivisions created thereunder, as referred to in General Rule 2 of this Annex.

(b) All primary rules specified at the levels of specific chapter, heading, subheading or split (sub)heading in this Appendix are co-equal in determining the origin of the goods in accordance with Rule 3 of this appendix.

(c) Primary Rules based on the tariff classification change shall apply only to non-originating materials.

(d) Where the primary rules require a change in classification, the following changes in classification shall not be considered in determining the origin of the good:

(i) changes which result from disassembly;

(ii) changes which result from packaging or repackaging;

(iii) changes which result solely from application of General Rule of Interpretation 2 (a) of the HS with respect to collections of parts that are presented as unassembled or disassembled articles.

However, such changes shall not preclude conferring origin on a good if origin is conferred as a result of other operations.

(e) When a good is produced exclusively from originating materials in a country, the good shall be originating in that country.

(f) Where none of the primary rules are satisfied, origin shall be determined according to Rule 3 (c) through (f) of this Appendix.

Rule 3: Determination of Origin

The country of origin shall be determined in accordance with the following provisions, applied in sequence:
Primary Rules

(g) When a primary rule itself designates the country in which a good was obtained in its natural or unprocessed state as the country of origin of the good, or designates otherwise the country of origin of a good, the country of origin of the good shall be the single country designated as such;

(h) The country of origin of a good is the last country of production, provided that one of co-equal primary rule applicable to the good was satisfied in that country.

Residual Rules

(i) When a good is produced by further processing of an article which is classified in the same subdivision[3] as the good, the country of origin of the good shall be the single country in which that article originated;

(j) The country of origin of the good shall be determined as indicated in the applicable residual rule specified at the chapter level;

(k) When the good is produced from materials all of which originated in a single country, the country of origin of the good shall be the country in which those materials originated;

(l) When the good is produced from materials (whether or not originating) of more than one country, the country of origin of the good shall be the country in which the major portion of those materials originated, as determined on the basis specified in each chapter.

Rule 4: Intermediate Materials

Materials which have acquired originating status in a country are considered to be originating materials of that country for the purpose of determining the origin of a good incorporating such materials, or of a good made from such materials by further working or processing in that country.

Rule 5: Interchangeable Goods and Materials

Where it is not commercially practical to keep separate stocks of interchangeable materials or goods originating in different countries, the country of origin of each of the commingled materials or goods may be allocated on the basis of an inventory management method recognized in the country in which the materials or goods were commingled. The use of this system shall not give rise to more products originating in a specific country than would have been the case had the commingled materials or goods been physically segregated.

Rule 6: De Minimis

For the application of the primary rule, non-originating materials that do not satisfy the rule shall be disregarded, provided that the totality of such materials does not exceed 10 per cent in value, weight or volume, as specified in each chapter, of the good.

Residual Rules for agricultural products resulting from mixing (Chapters 2-24)

1. For the purpose of this residual rules, "mixing" means the deliberate and proportionally controlled operation consisting in bringing together two or more identical or different fungible materials.
2. The origin of a mixture of agricultural products shall be the country of origin of materials that account for more than 50 per cent by volume/ weight of all materials used. The volume/weight of materials of the same origin shall be taken together.
3. When none of the materials used meets the percentage required, the origin of the goods shall be the country in which mixing was carried out.
4. Units of Measure are as follows: HS Code; Description; Unit.

(www.wto.org G/RO/W/111 15 October 2007)

[3]The term "subdivision" relates to the lowest level of classification of the good, i.e. heading, subheading or split (sub) heading, at which a primary rule is specified in Appendix 2.

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(Anil K. Kanungo)
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