Rules of Origin - Handbook

Rules of origin are now more topical than ever. They have become a very prominent feature of today's trading system and various regional trade agreements are being negotiated across the globe.

While negotiations are going on to harmonize the non-preferential rules of origin, the proliferation of preferential trade agreements represents an important concern in terms of customs revenues.

The rules of origin enable the preferential agreements to be correctly implemented, which promotes the development of trade and encourages investment.

The aim of this handbook is to enhance the understanding and correct application of rules of origin.

Background

Political situation in the WTO Committee on Rules of Origin (CRO)
In 1995 the World Trade Organization (WTO) was established via the so-called Marrakech Agreement. One of the annexes to the Marrakech Agreement is the WTO Agreement on Rules of Origin (part of the Annex 1A: Multilateral Agreements on Trade in Goods).

The Agreement on Rules of Origin aims at harmonizing the non-preferential rules of origin, outlines general principles for the making of rules of origin and established two committees, the Committee on Rules of Origin (CRO) and the Technical Committee on Rules of Origin (TCRO). The WTO Members have agreed on the overall agreement and on the exclusion of preferential origin from the harmonization.

The process of the Harmonization Work Programme concerning non-preferential rules of origin has been ongoing since 1995 with an initial deadline for the work to be finalized in 1998. The TCRO deals with certain technical aspects of the rules but does not have the power to conduct real negotiations. The TCRO completed the technical examination in May 1999 and 486 open issues were sent to the CRO for a more political discussion. In July 2002, 348 out of these 486 issues (72 %) were approved by the CRO and 138 issues were still to be resolved.

Among the remaining 138 issues, 93 core policy issues were identified for discussion and decision at the level of the General Council. These significant trade policy issues were thought to be too difficult to be dealt with at the Committee level. The CRO recommended that the General Council focus on the following 12 crucial issues:

- Implication issue: the implication of the implementation is thought to be a major problem. This concerns the scope of implementation of the agreement on rules of origin. The problem is whether the rules of origin shall be applied for all purposes prescribed in Article 1 of the agreement or optionally applied. The implication issue is relevant for anti-dumping measures, origin marking, safeguards etc. Up to now, this issue is deemed to be major barrier to finishing the negotiations.
- Fishing in the Exclusive Economic Zone (EEZ)
- Value added rules
- Slaughtering
- Blending of wine or alcohol
- Milk powder (does the origin depend on the milk itself or is transformation into powder enough?)
- Coffee roasting (is roasting enough or does the origin go with the green beans?)
- Production of wine and fruit juices
- Ottawa language
- Dyeing or printing for yarn and fabrics (main focus of dyeing and printing of textile products issue is whether origin will be given to the country which operated dyeing or printing or given to the country which produced yarns or fabrics)
- Refining of oil
- Assembly of machines, vehicles and watches (machinery is one of the main issues)

The outstanding issues are mainly in the categories of agricultural products, chemicals, textiles and machinery. Footwear has not been well proceeded either. Informally, though, the CRO has approached an agreement on many issues.

An additional problem is the high rates for agricultural products and textile products – these products are very important for developing countries. Negotiations and opinions depend on where a given country is in the process.

In informal consultations the Chairperson of the CRO is currently trying to get consensus of the remaining technical issues.

The General Council has asked the CRO to resolve as much as possible within the technical issues and decided to study the question of implications of the WTO Agreement on Rules of Origin on the other WTO Agreements.

In October 2011 the CRO decided to mandate the WTO Secretariat to initiate the transposition of the results of the Harmonization Work Programme to more recent versions of the HS nomenclature (a so-called technical rectification) and to complete the transposition exercise as soon as possible. The work needs to be gradual; that is, move step by step from one version of the HS to the other (1996, 2002, 2007 and 2012). The initiation of the transposition exercise should not disrupt the continuation of the CRO's technical discussions regarding the harmonization of the non-preferential rules of origin.

Trends for the future

WTO perspectives

In his keynote speech at the WCO Council in June 2011, Mr. Pascal Lamy, Director-General of the WTO, highlighted preferential rules of origin as an area of critical importance. He noted that as long as the origin of a good has a great impact on the duties to be collected, the door is open to fraud. He added that the solution could be to "kill the rules of origin", but that there is a need for these rules in other aspects of trade. Therefore, simplification is the way forward, especially for developing countries.

Mr. Pascal Lamy focused on the WTO initiative "Made in the World" and stated that at present, international trade flows are computed by attributing the full commercial value of a product to the last country of origin. This needs to change as business increasingly locates the different stages of its activities in a way that optimizes its value-addition chain. Therefore, trade flows should be measured in value added instead of gross numbers as it is the case today.

While the WCO recognizes that the new global production chains might give birth to a need for new trade analysis, it is also clear that the WTO initiative is an academic and statistical exercise which serves a different purpose than that of customs administrations.

Measuring trade in value added can be used by countries in their international trade negotiations and might give a more nuanced and balanced calculation of trade balances, but this does not change the origin criteria for imported or exported goods.

Countries might wish to renegotiate the rules of origin in their Free Trade Agreements (FTAs) in order to take account of the changes in the production lines, but rules of origin will still be needed for the customs clearance at the same level as the classification and the valuation of the good.

Moreover, the negotiations on the harmonization of non preferential rules of origin among WTO members clearly show the difficulties for the parties to agree on origin criteria adapted to the actual global production.

Proliferation of Free Trade Agreements
Rules of origin are now more topical than ever. They have become a very prominent feature of today's trading system and various regional trade agreements are being negotiated across the globe. The rules of origin enable the preferential agreements to be implemented, which promotes the development of trade and encourages investment.

At present more than 300 free trade agreements are in force around the world and around 100 more are in the stage of negotiation or ratification.

The increasing growth in the number of preferential trade agreements with their manifold rules of origin is a source of concern for WCO Members and private operators.

The application of rules of origin should not create new administrative burdens neither for international trade operators nor for Customs administrations. On the contrary, simplification measures should be investigated. In respect of the spirit of the Kyoto Convention a balance should be struck between the needs of Customs administrations and the measures to facilitate trade.

The proliferation of preferential trade agreements and the replacement of unilateral market access for developing countries with reciprocal market access within the framework of e.g. Economic Partnership Agreements represent an important concern in terms of customs revenues for developing countries. Therefore, the need for technical assistance in the administration and management of rules of origin – both in preferential and non-preferential areas – is increasing and the activities carried out by the WCO Secretariat are getting more and more significant.

As part of the WCO Origin Action Plan, the WCO has developed a database of free trade agreements and a comparative study on preferential rules of origin.

Certificates of origin
Preferential certificates of origin are delivered by the competent authorities of countries or entities having signed a preferential trade agreement. However, delivery of certificates of origin requires:

- legal ability to deliver certificates of origin
- good knowledge of the rules conferring origin to the goods
- powers to inflict sanctions on origin offences.

There is no standardization in the way to use and apply preferential origin evidence and significant differences exist for the issuance of preferential origin evidence which can be done by Customs, Ministries of Trade, Industry, Commerce or Agriculture etc., authorized exporters, other private bodies or authorities or in some countries by Chambers of Commerce.

Exporters may also be allowed to declare the origin of the goods for example for frequent consignments of a certain amount on the invoice itself.

The management of documentary evidence of origin remains an issue of the sovereign states which is outlined in the individual preferential trade agreements.

The harmonization of non-preferential rules of origin is not yet completed and there is, thus, no international instrument to handle documentary evidence in the domain of non-preferential origin. This means that the probative value of non-preferential origin evidence cannot be guaranteed and the certification of non-preferential origin by a country can merely serve as an indication for other countries, since each country maintains its own non-preferential rules.

The current economic situation has prompted countries and private companies to rethink the way to do business. They are concerned about increasing costs and are striving to limit these to the minimum possible. Studies have revealed that origin certificates cost about 5% of the goods' value. Certain preferential trade agreements are no longer used for preferential market access due to the high costs for issuance, and importers prefer to pay the most-favored-nations (MFN) duty instead of requesting preferential treatment with submission of a proof of origin.

Another relevant issue relating to certification of origin is the issuing of electronic certificates (e-certificates). This new trend is mostly used for non-preferential origin, but e-certificates are features in a growing number of new free trade agreements as well. Some FTAs operate with "no certificate" leaving it to the importer or exporter to issue an origin declaration instead.

Verification of origin
With the proliferation of preferential rules of origin there is an increasing risk of mismanagement of preferential trade agreements and rules of origin. This may lead to refusal of the requested exemption from customs duties or to the payment of penalties. In order to control the accuracy of the proof of origin there is a need for administrative cooperation between the exporting and importing country.

To ensure an efficient control and application of rules of origin, compliance operations are also carried out by Customs Administrations as part of their normal risk assessment programs which require that risky transactions be examined in depth by way of post audit verifications. In case of origin offences, accountability must be established and penalties paid.

The WCO Revenue Package Action Plan for an effective and efficient collection of revenues was adopted by the WCO Policy Commission in December 2010. The origin part of this Action Plan includes the development of Guidelines on Origin Verification, which have been adopted by the Permanent Technical Committee in March 2012 and will be presented to the WCO Council in June 2012 for final adoption.

1. Introduction

1.1. Definition of rules of origin

There may be several ways to define rules of origin. The International Convention on the Simplification and Harmonization of Customs Procedures (so-called Kyoto Convention which entered into force in 1974) defines rules of origin as follows:

"The specific provisions, developed from principles established by national legislation or international agreements applied by a country to determine the origin of goods." (Annex D, currently Annex K to the Revised Kyoto Convention).

The Agreement on Rules of Origin (Annex 1A to the Marrakech Agreement establishing the World Trade Organization in 1995) provides a useful definition for the Harmonized Non-Preferential Rules of Origin and for the Preferential Rules of Origin:

"Non-Preferential Rules of Origin shall be defined as those laws, regulations and administrative determinations of general application applied by any Member to determine the country of origin of goods" (Article 1.1).

"Preferential Rules of Origin shall be defined as those laws, regulations and administrative determinations of general application applied by any Member to determine whether goods qualify for preferential treatment under contractual or autonomous trade regimes leading to the granting of tariff preferences going beyond the application of paragraph a of Article 1 of GATT 1994" (Annex II, Paragraph 1).

1.2. Role of rules of origin

The basic role of rules of origin is the determination of the economic nationality as opposed to the geographical nationality of a given good. There are several mandatory legal or administrative requirements to observe when goods are traded on the international market. This is necessary for the implementation of various trade policy instruments such as imposing import duties, allocating quotas or for the collection of trade statistics.

The determination of the country of origin is the last step in the customs clearance procedures, the first steps being the classification of the goods and the determination of the value of the goods. The classification and valuation are important *per se* for the customs clearance, but these are also the basic tools for the determination of the country of origin of goods in the sense that the rules of origin are product specific rules linked to specific HS codes, and that in order to assess if value added rules are fulfilled, the composition of the customs value is needed.

2. Rules of origin and trade policy

The rules of origin are used as an important trade measure. They do not constitute a trade instrument by themselves and are not to be used to pursue trade objectives directly or indirectly or as a policy measure. The rules of origin are used to address different commercial policy instruments and they can be used to attain specific purposes of national or international policies.

There might be consequent potential for abuse. It is therefore useful to identify the different types of discriminatory trade measures where an origin determination is required:

- Measures designed to correct "unfair trade" (e.g. imposition of anti-dumping or countervailing duties against imported products causing material injury to domestic industry)

- Measures designed to protect local industry (e.g. safeguard measures to protect against an unforeseen increase of imported products causing serious injury to a specific domestic industry)

- Measures designed to give preference to products from developing countries or from beneficiary countries in regional cooperation agreements (e.g. GSP schemes, Free Trade Agreements or Customs Unions)

In addition, rules of origin are used:

- To administer "buy national" policies (e.g. discriminatory government procurement procedures and practices for adjusting balance of payment with specific countries)

- To control access to the domestic market by foreign exporters (e.g. discriminatory quantitative restrictions which are imposed as a result of safeguard measures, or tariff quotas which are allocated to supplying countries of specific products such as textiles)

- To implement environmental or sanitary measures (e.g. preventing the import of contaminated foodstuff or plants from a specific country, preventing the import of nuclear and hazardous material and their waste)

- To ensure national security or political policy (e.g. control of trade in strategic weapons or specific products to which sanctions are applied)

3. Economic consequences of rules of origin

3.1. Effects to international trade

3.1.1. Allocation of resources

From an economic point of view, it is assumed that by minimizing restrictions, free trade (i.e. liberalism) will produce an economically efficient allocation of resources. According to the free trade assumption based on the comparative advantage[1], protective

[1] If there is one position on which virtually all economists agree, it is that free trade is almost always better that protection. The argument of free trade is based on the theory of comparative advantage, which is one of the oldest theories in economy, usually ascribed to David Ricardo (early 19th century). In essence, the theory of comparative advantage says that it pays countries to trade because they are different. It is impossible for at country to have no comparative advantage in anything. It may be the least efficient at everything, but it will still have a comparative advantage in the industry in which it is relatively least bad. And even if a country were the most efficient in every industry, giving it an absolute advantage in

impediments will produce a less efficient outcome in trade. This would be the case if rules of origin are used as an instrument to reinforce protectionist measures.

However, if one assumes that world trade is imperfectly competitive, trade restrictive measures may then be employed for strategic policy purposes. Rules of origin can be constructed in such a way as to ensure that "helpful" trade policy measures are actually effective (e.g. trade effect of Free Trade Agreement), without the rules of origin being a burden to trade.

3.1.2. Trial of correction against already distorted market

If "unfair trade" (e.g., dumped or subsidized goods) is distorting the market so that the result is not an efficient distribution of production and trade according to the comparative advantage, discriminatory counter-action may be justified. In this case strictly defined origin requirements can reinforce the measures designed to correct this market distortion.

However, in the way they are actually implemented, rules of origin even for justified protectionist measures might be doing more than just correcting a distortion through diverse interpretations of rules of origin and might in some cases be seen as Non Tariff Barriers (NTB) to trade.

3.2. Effects to investment

3.2.1. Artificial encouragement for inward investment

Restrictive origin and anti-circumvention regulations can affect investment flows since they might lead to excessive investments in the territories of major importers to satisfy local content requirements either deriving from an undertaking to the host government or to meet the origin criteria.

Inward investment assistance and other forms of artificial encouragement that lead to import substitution can have further economically inefficient consequences. The resultant lack of competition from more efficiently manufactured imported products and disappearance of the previous local competitors tend to price these products out of their markets.

3.2.2. Resulting in over-investment

By segmenting markets and establishing production capacity in each of them, global capacity can outstrip the total demand, and underutilization of individual plants can reduce or even negate the benefits that can be expected from economic advantages of scale.

Local content and origin requirements can therefore lead to investment that otherwise, on solely commercial grounds, might not have been economically justifiable.

---

everything, it could not have a comparative advantage in everything. In some industries its margins would be more impressive than in others.

3.3. Effects to industrial structure

3.3.1. Localization of the final stage of production

In industries that depend on exports and where origin is considered important for the product being manufactured, a bias toward the stage of production that is emphasized in relevant origin rules might occur.

If it is assumed that the current rules of origin are predominantly based on the criteria of substantial transformation (especially, change in tariff classification), rules of origin prefer the stage of final production to that of intermediate production which essentially represents component production.

Widespread use of the substantial transformation criteria to satisfy origin requirements might give greater importance to the last stage in the global production process rather than to the consideration of comparative advantage.

3.3.2. Less resources on Research and Development

If it is assumed that research and development are mainly related to the first stage of production and increasingly technology is built into components rather than being an element in the final manufacturing stage, research and development, technology and capital investment could be regarded as less important factors than the substantial transformation of the products concerned.

4. Origin criteria

There are two basic criteria to determine the country of origin of goods. These are:

- Wholly obtained criterion, and
- Substantial/sufficient transformation criterion.

4.1. Wholly obtained goods

Wholly obtained goods are: goods naturally occurring; or live animals born and raised in a given country; or plants harvested in a given country; or minerals extracted or taken in a single country. The definition of wholly obtained also covers goods produced from wholly obtained goods alone or scrap and waste derived from manufacturing or processing operations or from consumption.

4.2. Substantial/sufficient transformation

There are three major criteria to express a substantial/sufficient transformation:

a. A criterion of a change in tariff classification

   A good is considered substantially transformed when the good is classified in a heading or subheading (depending on the exact rule) different from all non-originating materials used.

Example:

2523.10	- Cement clinkers - Portland cement:	CTH

Merits: Simplicity and predictability. The Harmonized System (HS) is designed to be a multi-purpose nomenclature and has been established as *a common Customs language*. Traders and customs officers are familiar with the HS.

Demerits: In some HS chapters extensive knowledge is needed. Although being a multi-purpose nomenclature, the HS is not always suitable for origin determination purposes.

b. A criterion of value added (ad valorem percentages)

Regardless a change in its classification, a good is considered substantially transformed when the value added of a good increases up to a specified level expressed by ad valorem percentage. The value added criterion can be expressed in two ways, namely a maximum allowance for non-originating materials or a minimum requirement of domestic content.

Example:

85.29	Parts suitable for use solely or principally with the apparatus of headings Nos. 85.25 to 85.28.	45% value added rule

Merits: Suitable for addressing certain goods which have been further refined or value-added, despite the unchanged classification. The value provides a simpler threshold than manufacturing or processing operations.

Demerits: Lack of predictability and consistency due to currency fluctuation and possible exposure to transfer pricing. Difficulty to calculate the real value of the good.

c. A criterion of manufacturing or processing operations (technical requirement)

Regardless a change in its classification, a good is considered substantially transformed when the good has undergone specified manufacturing or processing operations.

Example:

ex 70.01(a)	- Cullet and other waste and scrap of glass	The origin shall be the country of cullet and other waste and scrap of glass where the goods are derived or collected from manufacturing or processing operations or from consumption

Merits: A more technical, objective criterion.

Demerits: Need for frequent modifications to catch up with technological developments. To be precise, longer and more detailed texts are needed.

4.3. Minimal operations

A reverse form of the specific manufacturing operations above can be found in the Agreement on Non-Preferential Rules of Origin as well as in many preferential trade agreements, whereby specifically identified manufacturing operations are insufficient to confer origin (e.g. labeling, packaging or assembly).

4.4. De minimis or tolerance rule

The *de minimis* or tolerance rule permits a specific share (often between 10% and 15%) of the value or volume of the final product to be non-originating without the final product loosing its originating status. In some agreements, the components to which the rule applies are specifically identified. Alternatively, there may be a negative list of components that may not be included in the allowance or a list of products (e.g. HS Chapters) to which the tolerance rule does not apply.

5. Non-preferential rules of origin

A need for countries to distinguish the non-preferential origin of a product exists in WTO terms if the countries wish to apply WTO rules on anti-dumping duties, countervailing measures, safeguard measures or origin labeling. Otherwise, non-preferential origin is only important for the collection of trade statistics.

Actually, only 83 countries currently (March 2012) have non-preferential rules of origin in their legislation, and in some cases these consists of only a line or two of text.

5.1. The WTO Agreement on Rules of Origin

The absence of a clear and binding multilateral discipline in the field of rules of origin has been one of reasons for opening the way to the utilization of rules of origin as trade policy instrument. The growing concern over the trade policy implications of the rules of origin ultimately generated the efforts which matured in the long-awaited multilateral discipline.

The WTO Members, desiring to ensure that rules of origin do not in themselves create unnecessary obstacles to trade, agreed to establish the Agreement on Rules of Origin as part of the Marrakech Agreement establishing the WTO in 1995. Until the finalization of the harmonization of the rules of origin all WTO Members can apply their own non-preferential rules of origin. The complexities of national rules lead to complications and increased costs both for customs administrations and for the business community.

Before the development of the WTO Agreement on Rules of Origin, Annex D of the Kyoto Convention (now Specific Annex K of the Revised Kyoto Convention) of the Customs Co-operation Council (now WCO) was the only existing international convention mentioning the rules of origin. Only about 20 countries had formally acceded

to the Kyoto Convention. It was finally resolved that there was an urgent need for harmonization of the rules of origin.

The agreement clarifies that the rules of origin are not to be used as instruments to pursue trade objectives directly or indirectly and they shall not themselves create restrictive, distorting or disruptive effects on international trade (Article 2 (b) and (c) and Article 9 (d) of the Agreement on Rules of Origin).

All Members of the WTO including any new Members will apply the harmonized rules of origin as part of the package of membership, when these rules enter into force. They will bring uniformity as to how the origin of a specific product is determined and how the rules are applied.

5.1.1. Objectives and principles of the Agreement on Rules of Origin

The objectives and principles of the Agreement on Rules of Origin are:

- To develop clear and predictable rules of origin
- To facilitate the flow of international trade
- Not to create unnecessary obstacles to trade
- Not to nullify nor impair the rights of Members under GATT 1994
- To provide transparency of laws, regulations, and practices regarding rules of origin
- To ensure that rules of origin are prepared and applied in an impartial, transparent, predictable, consistent and neutral manner
- To make available a consultation mechanism and procedures for the speedy, effective and equitable resolution of disputes arising under the Agreement
- To harmonize and clarify non-preferential rules of origin

5.1.2. Scope of Application of Rules of Origin

The non-preferential rules of origin are not related to contractual or autonomous trade regimes leading to the granting of tariff preferences. They are used in the application of:

- Most-favored-nation treatment (MFN)

  In the WTO, most-favored-nation means that each member country has to treat all its fellow-members equally – whether rich or poor, weak or strong. If one member country grants a special favor (such as a lower duty rate for an imported product) to another member, that favor also has to be granted to all other WTO members so that they are all equally “most-favored”. This kind of non-discrimination is one of the most important principles of the WTO trading system, and is covered in Article 1 of the GATT 1994.

  Some exceptions are allowed, though. For example, countries within a region can set up a free trade agreement that does not apply to goods from outside the group. Or a country can raise barriers against products from specific countries if these goods are considered to be traded in an unfair manor.

- Anti-dumping and countervailing duties

  Article VI of the GATT provides for the right of contracting parties to apply anti-dumping measures, i.e. measures against imports of a product at an export price below its normal value (usually below the price of the product in the domestic market of the exporting country) if such dumped imports cause injury to a domestic industry on the territory of the importing contracting party.

  In order to offset or prevent dumping, a contracting party may levy on any dumped product an anti-dumping duty not greater in amount than the actual margin of dumping.

  The term “countervailing duty” is a special duty levied for the purpose of offsetting any bounty or subsidy bestowed, directly or indirectly, upon the manufacture, production or export of any merchandise.

- Safeguard measures

  Article XIX of the GATT 1994 allows a Member to take a safeguard action to protect a specific domestic industry from an unforeseen increase in imports of any product which is causing, or which is likely to cause, serious injury to the industry. The safeguard measure should be applied only to the extent necessary to prevent or remedy serious injury and to facilitate adjustment. Contrary to dumping, these imports are not defined as “unfair trade”, but they are nevertheless causing injury to local industry.

- Origin marking requirements

  Article IX of GATT 1994 stipulates that contracting parties shall co-operate with each other with a view to preventing the use of trade names in such manner as to misrepresent the true origin of a product, to the detriment of such distinctive regional or geographical names of products of the territory of a contracting party as are protected by its legislation. Whenever it is administratively practicable to do so, contracting parties should permit required marks of origin to be affixed onto the goods at the time of importation.

- Discriminatory quantitative restrictions or tariff quotas

  Quantitative restrictions imposed as a result of safeguard measures should normally not reduce the quantities of imports below the annual average for the last three representative years for which statistics are available.

  In principle, safeguard measures have to be applied irrespectively of the source. In cases in which a quota is allocated among supplying countries, the Member applying restrictions may seek agreement with other Members having a substantial interest in supplying the product concerned.

- Government procurement

  Procurement of products and services by government agencies for their own purposes represents an important share of the total government expenditure and,

thus, has a significant role in domestic economies. It is estimated that government procurement typically represents 10-15% of the gross domestic product (GDP) (it will be much more if local governments and all institutions controlled by the government are included). Any discriminatory government procurement procedures and practices can lead to distortions in international trade.

The Agreement on Government Procurement (1994) establishes an agreed framework of rights and obligations among its parties with respect to their national laws, regulations, procedures and practices in the area of government procurement. The cornerstone of the rules in the agreement is national treatment: foreign suppliers and foreign goods and services must be given no less favorable treatment in government procurement than national suppliers and goods and services. In other words, foreign suppliers must be given the same commercial opportunity to bid for a government contract as domestic suppliers.

- Trade statistics

  In the field of international trade, there are close links between customs and statistical aspects. It is for this reason that in most countries the primary data used for the preparation of international trade statistics are taken from customs import or export documents, which means that the data are based on the national tariff classification system or the Harmonized System. The harmonized rules of origin which are devised on the premises of the Harmonized System provide further detailed information in complying trade statistics.

5.1.3. Role of WTO and WCO in the Harmonization Work Programme

The international institutions carrying out the Harmonization Work Programme are the WTO Committee on Rules of Origin (CRO) which reports to the WTO Council for Trade in Goods, and the Technical Committee on Rules of Origin (TCRO) which was established under the auspices of the WCO to undertake the technical work related to the harmonization.

Membership of both Committees is limited to Members of the WTO. However, the TCRO admits as observers those WCO Members that are not WTO Members, as well as some international organizations including WTO, OECD, UNCTAD, the UN Statistical Division, the UN Law of the Sea Convention Secretariat and the International Chamber of Commerce.

5.1.4. Harmonization Work Programme (HWP)

The initiation of the HWP

During the Uruguay Round, participating countries recognized the necessity to provide transparency of regulations and practices regarding rules of origin, in order to prevent unnecessary obstacles to the international trade flow.

The WTO Agreement on Rules of Origin lays down the work programme to harmonize non-preferential rules of origin within three years from the initiation, i.e. by 20 July 1998.

Due to the complexity of many issues raised during the work, the intended time schedule in the agreement was extended several times. The negotiations are still on-going but without a formal deadline or time schedule.

The Principles of the Harmonized Rules of Origin (HRO)
Article 9 of the agreement provides for the principles of the HRO as follows:

- the Harmonized Rules of Origin shall be applied equally for all purposes as set out in Article 1 of the agreement;
- the country of origin of a particular good is determined to be:
  (a) either the country where the good has been wholly obtained or
  (b) when more than one country is involved in the production of the goods, the country where the last substantial transformation has been carried out;
- the HRO shall be objective, understandable and predictable;
- the HRO shall not be used as instruments to pursue trade objectives directly or indirectly;
- the HRO shall not create restrictive, distorting or disruptive effects on international trade by themselves;
- the HRO shall be administrable in a consistent, uniform, impartial and reasonable manner;
- the HRO shall be coherent and based on a positive standard.

5.1.5. Architecture of the Agreement on Rules of Origin
The architecture and the content of the Agreement on Rules of Origin are as follows:

Definitions
General Rule 1 - Harmonized System (is the basis for the product specific rules)
General Rule 2 - Determination of origin
General Rule 3 - Neutral elements
General Rule 4 - Packing and packaging materials and containers
General Rule 5 - Accessories and spare parts and tools
General Rule 6 - Minimal operations and processes

Appendix 1: Wholly Obtained Goods
- Rule 1: Scope of application
- Definitions 1(a) to (i) and 2

Appendix 2: Product Specific Rules of Origin (Rules for determining the country of origin when the origin of the good is not determined under Appendix 1)

- Rule 1: Determination of Origin (Provisions of this Rule applied in sequence, taking into account Rule 2 where applicable)

- Rule 1 (a): The country of origin is the country in which the good is produced exclusively from originating materials;

- Rules 1 (b) and (c): Primary Rules

- Rules 1 (d) to (g): Residual Rules

- Rules 2 (a) to (g): Application of the Rules

- Terminology Guide

- Origin Criteria for HS Chapters 1 – 97 in matrices

6. Preferential rules of origin

Preferential rules of origin are set out under the preferential trade arrangements, which facilitate trade from developing countries (within the frames of the General System of Preferences (GSP)) or between contracting parties (e.g. FTA, RTA) by offering a reduced or zero rate of duty to goods exported from beneficiary countries or contracting parties. To benefit from the preferential trade arrangements the goods exported must be originating in the beneficiary country or the contracting party.

Preferential trade arrangements include autonomous trade regimes (e.g. Generalized System of Preferences (GSP)) and contractual trade regimes (e.g., EPA, NAFTA, EFTA).

Preferential rules of origin are more restrictive than non-preferential ones. The theoretical reason for this is to prevent “trade deflection”. Trade deflection involves transshipment of a good via a preference-holding country in order for the good upon import to obtain the preferential treatment available under a preferential trade agreement. Preferential rules of origin may serve as well other purposes than prevention against trade deflection. Principally they may act as non-tariff instruments of protection with domestic production requirements that are difficult to meet.

6.1. Structure of the preferential Rules of Origin

Some of the basic elements of a preferential trade agreement are:

- Origin criteria
- Direct consignment rule
- Documentary evidence
- Prohibition of duty drawback

6.1.1. Origin criteria

The origin conferring criteria included in preferential trade agreements are:

- Wholly obtained goods definitions
- Substantial/sufficient transformation criteria (based on a change in tariff classification, value added (ad valorem percentages) or manufacturing or processing operations).

These criteria are further developed under point 4. The system is the same whether dealing with preferential or non-preferential rules, only the product specific rules themselves can be different, as the rules of origin are part of negotiations between

parties and, thus, depend on the negotiation process and the consent/agreement of the contracting parties.

Some exceptions to substantial transformation criteria exist as well in the area of preferential origin:

- Several operations or processes are identified as “minimal operations or processes” and do not by themselves confer origin (see point 4.3.).

- The *de minimis* or tolerance rule permits a specific share of the value or volume of the final product to be non-originating without the final product loosing its originating status (see point 4.4.).

- Under “cumulation” rules, contracting parties to a preferential trade agreement or beneficiary countries under the GSP regimes may source non-originating raw materials or components from specified countries and count them as originating. There are three types of cumulation:

    - Bilateral cumulation, where only raw material or components in the preference-granting country can be counted in this way,
    - Diagonal cumulation, where raw materials or components from the preference-granting country and a list of other designated countries to which the same rules of origin apply can be counted, and
    - Full cumulation, where raw materials from all countries to which the same rules of origin apply can be counted.

    Different types of cumulation can appear in one and the same preferential trade agreement, where each type would then apply to different countries.

6.1.2. Direct consignment rule

Most rules of origin require the direct consignment of goods, meaning that for a product to be eligible for origin treatment it must be transported directly from the place of production to its preferential destination.

The purpose of such a rule is primarily to ensure that the imported goods, in particular bulk cargo etc. whose identity is difficult to establish, are identical with the goods that left the exporting country and to reduce the risk of eligible goods being mixed with non-eligible goods.

Provision is, however, made in most rules of origin that goods may be transported through territory other than that of their origin or final destination if this is justified, e.g. for geographical reasons and if the goods in question have remained under customs surveillance and have not entered into the commerce of the transit country. A certificate of non-manipulation from the transit country can be required in the country of destination.

6.1.3. Documentary evidence

A documentary evidence of origin is required for a good to benefit from the preferential regimes. The evidence can be a certificate of origin issued by the competent authorities,

a certified declaration of origin certified by a competent authority or an origin declaration made on a commercial document (e.g. invoice) by the manufacturer, producer, supplier, exporter, importer or other competent person.

The definition of the competent authority or person is clearly stipulated in the free trade agreements, as well as the general requirements, the procedure for the issue, the validity of the proof of origin and possible exemptions from proof of origin.

A more detailed description of documentary evidence is found under item 7.1.

6.1.4. Prohibition of duty drawback

Another aspect of the rules of origin in preferential trade agreements is that they are always accompanied by more or less restrictive administrative conditions. A frequent condition is a prohibition on beneficiary countries to provide their exporters with remission or exemption of import duties (duty drawback) on non-originating raw materials or components, where these enter into products benefiting from a preferential treatment when the final product is exported.

7. General common aspects

7.1. Documentary evidence

Documentary evidence means a specific form/certificate or a declaration identifying a given product, in which the authority, manufacturer or other competent person certifies that the goods to which the certificate or declaration relates, originate in a specific country.

The Agreement on Rules of Origin does not mention documentary evidence.

The Revised Kyoto Convention, Specific Annex K, Chapter 2, deals with documentary evidence of origin. The Revised Kyoto Convention does not distinguish between non-preferential and preferential origin and the definitions, principles and requirements stipulated in the Convention are, thus, relevant to both areas.

The documentary evidence is required for the application of:

- preferential customs duties,
- economic or trade measures, whether these are adopted unilaterally or under bilateral or multilateral agreements, or
- measures adopted for reasons of health or public order.

A certificate of origin is a specific form (a model of the form is annexed to Specific Chapter K of the Revised Kyoto Convention) in which the competent authority certifies expressly that the goods covered originate in a specific country. The competent authority may be the customs administration, a ministry (of trade, agriculture, commerce etc.), a chamber of commerce etc.
A certificate of origin can be electronic if this is provided for in the agreement and/or in legislation.

A declaration of origin is an appropriate statement as to the origin of the goods made by the manufacturer, producer, supplier, exporter, importer or other competent person on the commercial invoice or any other document relating to the goods. In most agreements there are restrictions as to this self-certification which in some cases will require an approval from the competent (customs) authorities, a so-called approved exporter requirement.

A certified declaration of origin is a declaration of origin certified by a competent authority.

7.2. Verification of proofs of origin and Administrative Assistance

The Chapter 3 of the Specific Annex K of the Revised Kyoto Convention deals with control of documentary evidence of origin. The contracting parties of a preferential trade agreement as well as the parties involved in trade relating to non-preferential rules of origin shall upon request provide administrative assistance for the control of the origin of goods. The principle of reciprocity governs the assistance, and the competent authority of the requested party shall only comply with the provisions if the competent authority of the requesting party would be able to furnish the assistance if the positions were reversed.

The competent authority in the importing country may request the competent authority in the exporting country (or the country in whose territory documentary evidence of origin has been established) to carry out a control of the proof of origin

- where there is reasonable doubts as to the authenticity of the document,
- where there is reasonable doubts as to the accuracy of the information in the document, or
- on a random basis (which shall be kept to a minimum necessary to ensure adequate control).

The Revised Kyoto Convention as well as the various preferential trade agreements set out the requirements for the verification requests.

The requested competent authority shall carry out the necessary controls and reply to the request by answering the questions put by the requesting competent authority as well as furnish any other information it may consider relevant.

The Revised Kyoto Convention as well as the various preferential trade agreements set out deadlines for requesting verification and deadlines for replying to a request for verification.

A request for control/verification by itself shall not prevent the release of the goods, provided that they are not subject to import prohibitions or restrictions and there is no suspicion of fraud.
According to the legislation of the importing and preference-granting country, goods can be released after payment of the preferential import duties or after payment of the MFN import duties. In the first case, the difference between the preferential rate and the MFN rate may be due in case of a negative reply to the verification request (this may be subject to an evaluation of the good faith of the importer). In the second case, the

difference between the two rates may be reimbursed in case of a positive answer to the verification request.

Sanctions relating to false documentary evidence depend on national legislation.

7.3. Origin Fraud

Origin fraud falls within the area of commercial fraud. There is a high risk of fraud within the origin area because of the level of duties and because of the complexity of the rules of origin.

The reasons for fraud in origin are multiple:

- Obtaining illicit access to preferential duty rates via a false indication of the country of origin of the imported goods
- Evading quantitative restrictions in the importing country
- Evading import prohibitions on import of goods
- Avoiding anti-dumping or countervailing duties in the importing country. The good will in fact penetrate the market of the importing country and gain a commercial advantage.
- Illegally satisfying the documentary requirements laid down in the importing country.

There can be several authors of fraud, including:

- Brokers – in order to keep or to attract customers with “good deals”
- Exporters on the demand of the importer – to falsely claim preferential duty rates
- Exporters – to abuse consumers in the importing country (if there is attraction for one determined origin)
- Exporters – to avoid anti-dumping or countervailing duties and be able to sell at a good price
- Exporters – to realize importation of goods normally subject to prohibitions or restrictions (quotas, sanitary or phyto-sanitary requirements etc.) in the country of destination.

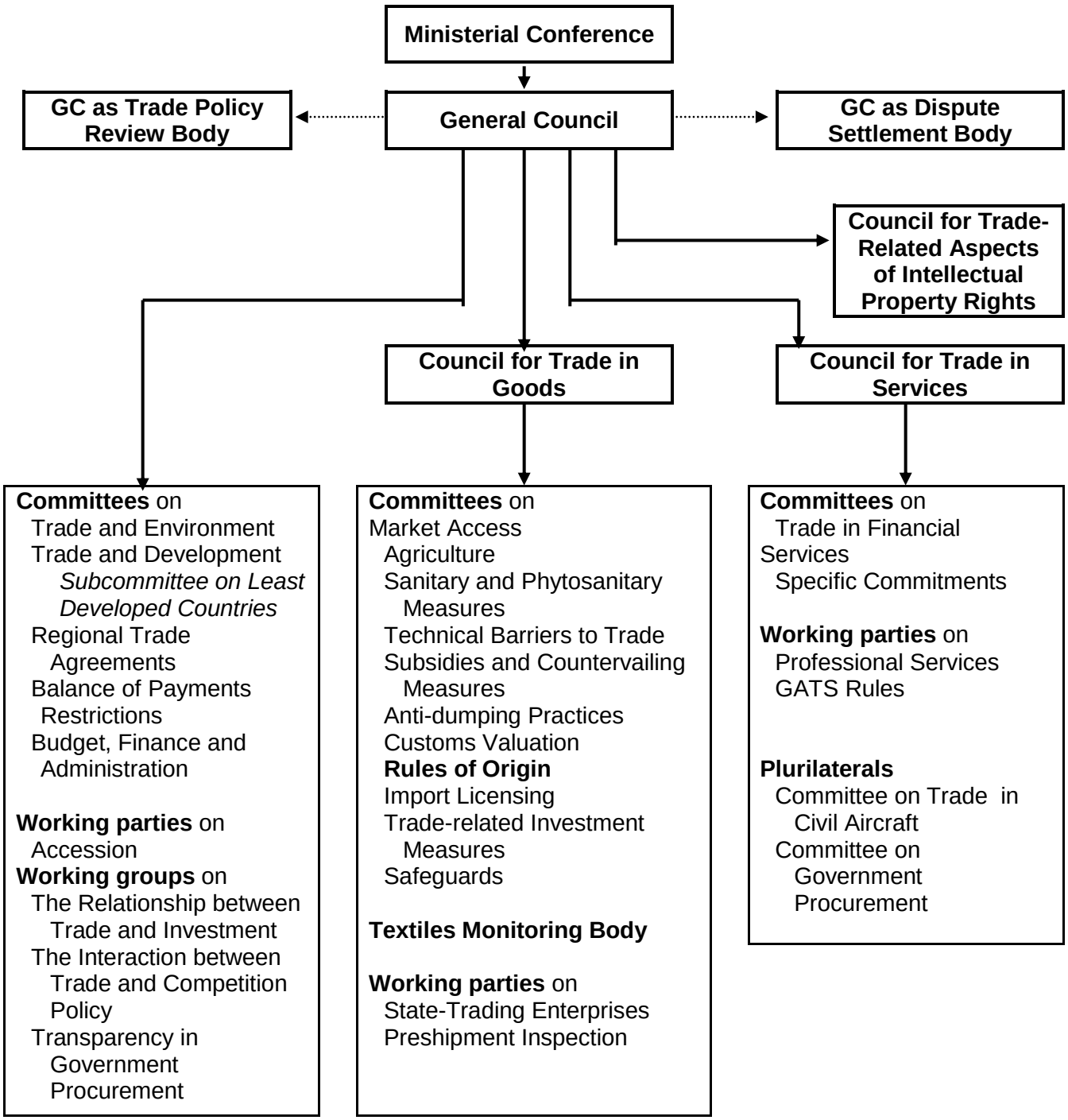
Fraud can be discovered via physical checks of documents and/or goods, exchange of information between countries, information from trade associations, studies on cargo vessels itineraries or other traffic studies through statistical tools, studies on the internet etc.

Sanctions relating to fraud in origin depend on the national legislation both in the exporting and the importing country.

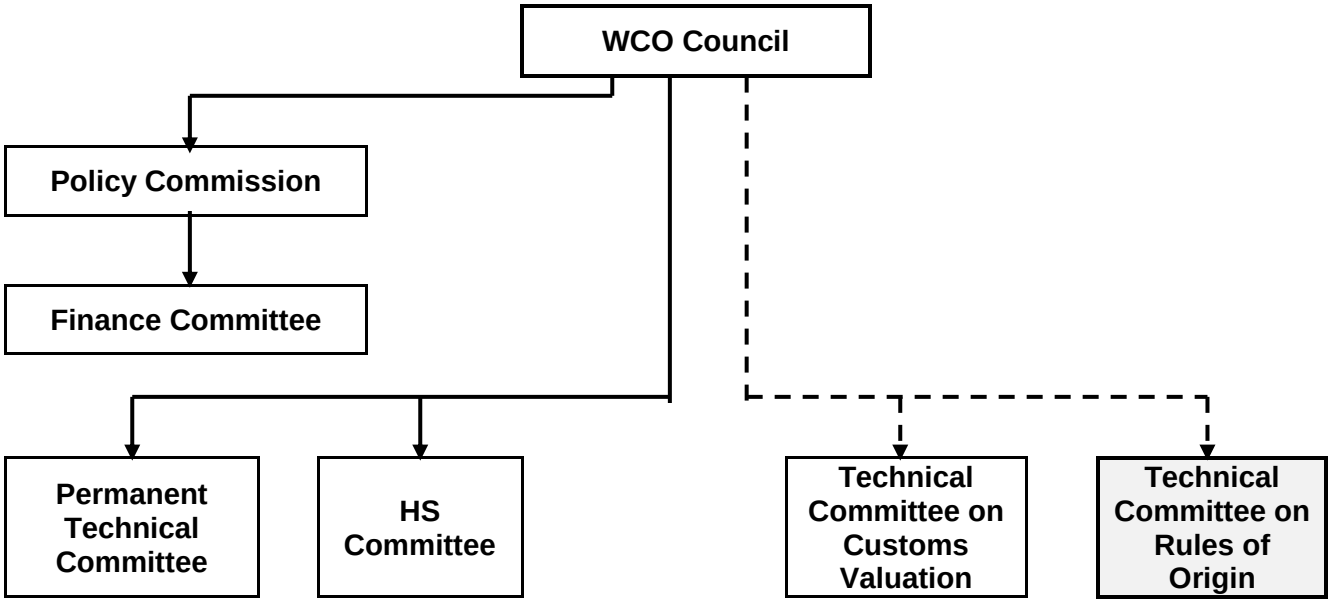
Annexes

Interaction between WTO and WCO

WTO:



WCO:



Main areas of interaction:

- Valuation
- Rules of Origin
- Harmonized System
- Trade Facilitation