CHAPTER 12

Rules of origin

Summary

Rules of origin are used by governments to determine the country in which imported goods should be treated as having been produced. The revolutionary changes that are taking place in communications and transport now enable manufacturing companies to obtain inputs for the production of final products in far-off countries where trained personnel are available and costs are lower. This trend towards sourcing inputs from different countries is further facilitated by steps being taken to remove tariffs and other barriers to trade.

Virtually all manufactured products available in markets today are produced in more than one country. This is so whether the products are consumer articles like textiles or cosmetics or the sophisticated machinery used in the manufacture of consumer goods. For instance, in the case of textile articles – say shirts or blouses – it is possible that the cotton or synthetic fibre used in their manufacture is produced in one country; the textile woven, dyed and printed in another country; and the cloth cut and stitched in yet another country.

Purposes for which rules are applied to determine country of origin

Why it is necessary for governments to determine the origin of imported goods? Such determination is necessary in three situations.

First, for imports under preferential arrangements, importing countries have to ensure that the lower or preferential rates are made available to products originating from preference-receiving countries. They therefore need evidence to show that the imported product has been, if not wholly produced, at least substantially transformed in a preference-receiving country.

Second, for imports under MFN tariff rates, the determination of origin is ordinarily not necessary as such duties are applied on a non-discriminatory basis to imports from all sources. However, where the measures applicable at the border take into account the country of origin, the determination of origin becomes necessary. These measures include the following:

- Collection of anti-dumping and countervailing duties;
- Administration of country-specific quota restrictions (e.g. those imposed under the provisions of the Agreement on Textiles and Clothing or under a country's safeguard measures);
- Administration of tariff quotas; and
- Application of marks of origin or labels to indicate the country of origin.

Third, the determination of origin is also necessary in the collection of trade statistics.

Main principles on which current national rules are based

The national systems currently in use to determine origin vary considerably. Moreover, within countries the rules may differ according to the purpose for which they are used (e.g. administering quantitative restrictions, collecting preferential duties, labelling to indicate origin). However, despite the wide variations in the systems adopted, broadly speaking they are based on two main principles.

The first is the principle of value added in manufacturing or further processing. Under systems based on this principle, a product would be considered to have been manufactured in the country where a specified percentage (e.g. 40%, 50%, 60%) of the product value has been added.

The second principle is the determination of origin on the basis of changes in tariff classification. WTO member countries are encouraged to use the Harmonized System Nomenclature (HS) developed by the World Customs Organization (WCO, the former Customs Co-operation Council) for both the collection of trade statistics and the imposition of customs duties. The System has 97 chapters, within each of which products are arranged according to the degree of processing, commencing with raw materials, through to semi-processed products and ending with finished products. By using this system of classification, a product is determined to have originated in the country where, as a result of processing, its tariff classification changes.

Problems posed by differences in the rules for determining origin

GATT does not contain specific rules for the determination of origin. This has given countries the flexibility to adopt their own rules and to apply them differently according to the purpose for which they are used (*see* above). Moreover, this flexibility has enabled countries to adopt rules of origin for protective purposes, for instance to deny access to quotas on the grounds that the import product cannot be considered to have originated in the country to which a quota is allotted.

To find solutions to these and the other problems that have arisen as a result of the absence of precise rules, the Agreement on Rules of Origin was negotiated in the Uruguay Round.

Agreement on Rules of Origin

Coverage and objectives

Agreement on Rules of Origin, Article 1:1

The provisions of the Agreement apply to "laws, regulations and administrative determinations of general application applied by any Member to determine the country of origin of goods" imported on an MFN basis. It specifically states that its substantive provisions do not apply to imports made under preferential arrangements.

The basic objective of the Agreement is to require countries to adopt a uniform set of harmonized rules for determining the origin of goods imported on an MFN basis. Since it was expected that technical work on developing such rules would take time, the Agreement provides two sets of provisions.

The first set lays down the disciplines which countries are expected to follow during the transition period, i.e. until the entry into force of the new harmonized rules. The technical work on the harmonization of these rules is currently being done by the WCO Technical Committee under the guidance of the WTO Committee on Rules of Origin, which has been established under the Agreement. The second set of provisions is applicable after the transition period. It also lays down principles and guidelines for the technical work on the harmonization of rules of origin.

Rules applicable in the transition period

Agreement on Rules of Origin, Article 2

In the transition period, it is open to a country to apply different standards according to the purpose or the objective for which the rules are applied. After the transition period, however, the harmonized standards elaborated on a product-by-product basis are to be applied uniformly, irrespective of the purpose for which they are used. In other words, it will not be open to a country to apply one set of standards for determining origin for the purpose of administering quantitative restrictions and another set for indicating origin through labelling.

The Agreement further lays down the principles (e.g. transparency, non-discrimination and provisions for review of administrative decision) which countries are expected to follow during the transition period. These are set out in box 30.

Rules applicable after the transition period

Agreement on Rules of Origin, Article 3(b)

After the transition period, the rules provide that the origin of goods shall always be "the country where the last substantial transformation has been carried out". For this purpose, the WCO Technical Committee is required to elaborate for particular products or product sectors the change in tariff subheading or heading that must occur, through manufacturing or processing, for a country to claim origin. However, for products for which the "exclusive use" of a change in tariff subheading "does not allow for the expression of substantial transformation", the Committee is advised to provide supplementary criteria. Such criteria could include additional requirements relating to "ad valorem percentages and/or manufacturing or process operations".

Agreement on Rules of Origin, Article 9:2(c)(iii)

Present state of play in the technical work on harmonization

The technical work on the harmonization of rules of origin was to have been completed by 1998. The highly complex nature of the work and the differences that have arisen among countries on specific criteria for determining origin in certain product groups have prevented the WCO Technical Committee from completing its work by the target date. The results of its work when completed will, after approval by the WTO Committee on Rules of Origin, be adopted by the WTO Ministerial Conference. They will then incorporated into the

Box 30

Disciplines during the transition period

(Agreement on Rules of Origin, Article 2)

During the transition period (i.e. until the entry into force of the new harmonized rules), Members are required to ensure that:

(a) Rules of origin, including specifications for the substantial transformation test, are clearly defined.

(b) Rules of origin are not used as a trade policy instrument.

(c) Rules of origin do not themselves create restrictive, distorting or disruptive effects on international trade and do not require the fulfilment of conditions not related to the manufacture or processing of the product in question.

(d) Rules of origin applied to imports and exports are not more stringent than those applied to determine whether a good is domestic, and do not discriminate between Members (the GATT MFN principle).

(e) Rules of origin are administered in a consistent, uniform, impartial and reasonable manner.

(f) Rules of origin are based on a positive standard. Negative standards are permissible either as part of a clarification of a positive standard or in individual cases where a positive determination or origin is not necessary.

(g) Rules of origin are published promptly.

(h) Upon request, assessments of origin are issued as soon as possible but no later than 150 days after such a request is submitted. Assessments are to be made publicly available; confidential information is not to be disclosed except if required in the context of judicial proceedings. Assessments of origin remain valid for three years provided the facts and conditions remain comparable, unless a decision contrary to an assessment is made in a review referred to in (j).

(i) New rules of origin or modifications thereof do not apply retroactively.

(j) Any administrative action in relation to the determination of origin is reviewable promptly by judicial, arbitral or administrative tribunals or procedures independent of the authority issuing the determination; such findings can modify or even reverse the determination.

(k) Confidential information is not disclosed without the specific permission of the person providing such information, except to the extent that this may be required in the context of judicial proceedings.

Agreement on Rules of Origin as an annex. All member countries will be required to apply the harmonized criteria specified in the annex on an MFN basis from the date agreed for its entry into force.

It should be noted that in addition to the obligation to apply the harmonized criteria, member countries will have to abide by the principles relating to transparency, non-discrimination, administrative assessment and judicial review listed in box 30 [(d) to (k)].

Preferential rules of origin

Though the harmonized rules of origin being developed by WCO will not apply to imports obtained under regional preferential arrangements or under Generalized Systems of Preferences, the Agreement provides that countries should take into account the general principles listed in box 30 in applying and administering such rules of origin.

Business implications

The adoption of harmonized criteria for determining origin is expected to resolve many of the problems faced by exporters today, particularly those related to textiles, in utilizing quotas allotted specifically to their countries. Harmonization will also eliminate current differences in national rules for determining origin. This will reduce the administrative burden on exporting enterprises which today have to ensure that they meet the varying requirements imposed by different countries on products subject to quantitative or other restrictive measures.