RULES OF ORIGIN UNDER THE CARIBBEAN BASIN INITIATIVE AND THE ACP-EEC LOMÉ IV CONVENTION AND THEIR COMPATIBILITY WITH THE GATT URUGUAY ROUND AGREEMENT ON RULES OF ORIGIN

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1. INTRODUCTION

"Rules of origin" can be defined as those laws and regulations that determine the country of origin of internationally traded goods.[1] In the past, rules of origin have primarily been used for purposes of duty assessment and, in the United States, for fulfilling the marking requirements under the Tariff Act of 1930.[2] Over the last several years, however, both the United States and the European Union have entered into various bilateral and multilateral agreements with both developing and industrialized countries to provide for duty-free treatment of goods produced in those countries.[3] They have also unilaterally

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[1] N. David Palmeter, *Rules of Origin or Rules of Restriction? A Commentary on a New Form of Protectionism*, 11 FORDHAM INT'L L.J. 1, 2 (1987) [hereinafter Palmeter, *Commentary*].

[2] 19 U.S.C. § 1304(a) (1988).

[3] For agreements involving the United States, see Free Trade Area Agreement, Apr. 22, 1985, U.S.-Isr., *reprinted in* 24 I.L.M. 653. The agreement was implemented by Congress in the United States-Israel Free Trade Area Implementation Act of 1985, Pub. L. No. 99-47, 99 Stat. 82 (codified in scattered sections of 19 U.S.C.). *See also* North American Free Trade Agreement ("NAFTA"), Oct. 7, 1992, U.S.-Can.-Mex., *reprinted in* 32 I.L.M. 296 (text of free trade agreement signed by the United States, Canada, and Mexico); Thomas J. Schoenbaum, *The North American Free Trade Agreement (NAFTA): Good for Jobs, for the Environment, and for America*, 23 GA. J. INT'L & COMP. L. 461, 468-75 (1993) (summarizing NAFTA's elimination of trade barriers for certain economic sectors such as agriculture and automotive products).

For agreements involving the European Union, see Council Regulation 1274/75 Concluding the Agreement Between the European

granted duty-free treatment to the products of certain developing countries.[4] Thus, rules of origin have become the most important element in determining whether a certain good is eligible for duty-free treatment under one of these preferential agreements. Due to the increasing number and importance of such preferential agreements, the GATT as well as the European Union have made several attempts at harmonizing the widely differing rules of origin.[5] Because, until recently, these attempts had

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Economic Community and the State of Israel, 1975 O.J. (L 136) 1; Council Regulation 2210/78 Concerning the Conclusion of the Cooperation Agreement Between the European Economic Community and the People's Democratic Republic of Algeria, 1978 O.J. (L 263) 1; Council Regulation 2213/78 Concerning the Conclusion of the Cooperation Agreement Between the European Economic Community and the Arab Republic of Egypt, 1978 O.J. (L 266) 1; Council Regulation 2215/78 Concerning the Conclusion of the Cooperation Agreement Between the European Economic Community and the Hashemite Kingdom of Jordan, 1978 O.J. (L 268) 1; Council Regulation 2214/78 Concerning the Conclusion of the Cooperation Agreement Between the European Economic Community and the Lebanese Republic, 1978 O.J. (L 267) 1; Council Regulation 2216/78 Concerning the Conclusion of the Cooperation Agreement Between the European Economic Community and the Syrian Arab Republic, 1978 O.J. (L 269) 1; Council Regulation 2212/78 Concerning the Conclusion of the Cooperation Agreement Between the European Economic Community and the Republic of Tunisia, 1978 O.J. (L 265) 1; Decision of the Council and Commission 91/400 on the Conclusion of the Fourth ACP-EEC Convention, 1991 O.J. (L 229) 1 (includes text of the agreement).

[4] The Generalized System of Preferences ("GSP"), established by the Trade Act of 1974, authorizes duty-free entry of eligible products of designated beneficiary countries. *See* Trade Act of 1974, Pub. L. No. 93-618, 88 Stat. 2066-71 (codified as amended at 19 U.S.C. §§ 2461-66 (1988 & Supp. IV 1992)); *see also* the Caribbean Basin Initiative implemented by the Caribbean Basin Economic Recovery Act, Pub. L. No. 98-67, 97 Stat. 384-95 (codified as amended at 19 U.S.C. §§ 2701-2706 (1988 & Supp. IV 1992)). The European Union has also established some generalized tariff preferences. *See, e.g.*, Council Regulation 3281/94 Concerning Generalized Tariff Preferences for 1995-1998 for Certain Industrial Products Originating in Developing Countries, 1994 O.J. (L 348) 1. *See generally* Ernst-Udo Bachmann, *Die Präferenzregelungen der Europäischen Gemeinschaft*, ZEITSCHRIFT FÜR ZOLLE + VERBRAUCHSTEUERN 2, 41-43 (1989) (discussing the European Union's general customs preferences for developing countries in terms of the legal bases, goals, characteristics, and actual practice thereof, and providing a comparison of the different rules of preference for different products).

[5] *See, e.g.*, Working Party on Nationality of Imported Goods, GATT, BASIC INSTRUMENTS AND SELECTED DOCUMENTS 53 (2d Supp. 1954);

either met with relatively little success[6] or had failed completely,[7] the harmonization of the rules of origin was an important issue on the agenda of the Uruguay Round of the

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Working Party on Definition of Origin, GATT, BASIC INSTRUMENTS AND SELECTED DOCUMENTS 94 (3d Supp. 1955).

In October 1953, the International Chamber of Commerce submitted a resolution to the GATT Contracting Parties suggesting uniform rules of origin for the determination of the nationality of internationally traded goods. A drafting group was established that proposed the following general rule of origin:

> A. The nationality of goods resulting exclusively from materials and labor of a single country shall be that of the country where the goods were harvested, extracted from the soil, manufactured or otherwise brought into being.
> B. The nationality of goods resulting from materials and labor of two or more countries shall be that of the country in which such goods have last undergone a substantial transformation.
> C. A substantial transformation shall, *inter alia*, be considered to have occurred when the processing results in a new individuality being conferred on the goods.
> Explanatory note: Each Contracting Party, on the basis of the above definition, may establish a list of processes which are regarded as conferring on the goods a new individuality, or as otherwise substantially transforming them.

Hironori Asakura, *The Harmonized System and Rules of Origin*, J. WORLD TRADE, Aug. 1993, at 5, 6-7.

[6] *See, e.g.*, the Kyoto Convention, Council Decision 77/415 Concerning Rules of Origin, Annex 1, 1977 O.J. (L 166) 3. The Kyoto Convention used two different criteria for determining the nationality of goods: (1) the criterion of "wholly produced" goods in cases where only one country was involved in producing the goods, and (2) the criterion of "substantial transformation" in cases where two or more countries have taken part in the manufacturing of the article. *See* Asakura, *supra* note 5, at 7. In order to determine whether a substantial transformation has taken place, the contracting parties may use three different methods: (1) the change of tariff criterion; (2) a list of manufacturing processes that are considered to substantially transform the article; or (3) the ad valorem percentage rule. *Id.*

Although the Kyoto Convention aimed at a relatively low level of harmonization of the different national rules of origin, it was signed by only a few parties. The United States did not ratify the Kyoto Convention. For a discussion of the Kyoto Convention, see EDMOND MCGOVERN, INTERNATIONAL TRADE REGULATION § 4.411 (2d ed. 1986); EBERHARD GRABITZ ET AL., EUROPÄISCHES AUSSENWIRTSCHAFTSRECHT 117 (1994) (discussing the criteria proposed under the Kyoto Convention for determining countries of origin).

[7] GATT's efforts in the 1950s provide an example. *See* MCGOVERN, *supra* note 6, § 4.4.

GATT.[8] At the end of often painstaking negotiations, a low level consensus was reached concerning the rules of origin to be used in preferential agreements. Most recently, in the "Common Declaration with Regard to Preferential Rules of Origin" contained in Annex II to the "Agreement on Rules of Origin,"[9] the GATT members agreed to ensure that, with respect to preferential rules of origin, "the requirements to be fulfilled are clearly defined."[10]

Therefore, it is worthwhile to examine how the preferential rules of origin work under two comparable sets of rules, the Caribbean Basin Initiative ("CBI")[11] and the ACP-EEC Lomé IV Convention.[12] Each of these rules grants duty-free treatment for specified products of particular developing countries, decides whether these preferential rules of origin meet the "clearly defined" requirement of the new Rules of Origin Agreement, and structures how they work. Both sets of rules are similar in that they involve one or more industrialized countries (the United States and the European Union) and a group of developing countries (the Caribbean Basin and "ACP states"[13]). Each set of rules provides for duty-free entry of some products originating in the respective developing countries in order to encourage

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[8] *See* GRABITZ, *supra* note 6, at 116; N. David Palmeter, *The U.S. Rules of Origin Proposal to GATT: Monotheism or Polytheism?*, J. WORLD TRADE, Apr. 1990, at 25, 25 [hereinafter Palmeter, *Monotheism*].

[9] OFFICE OF THE U.S. TRADE REPRESENTATIVE, EXECUTIVE OFFICE OF THE PRESIDENT, Agreement on Rules of Origin, *in* FINAL ACT EMBODYING THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS (VERSION OF 15 DECEMBER 1993), 1 (MTN/FA II-A1A-11), 11-13 [hereinafter Rules of Origin Agreement].

[10] *Id.* at 11.

[11] The Caribbean Basin Initiative is not a trade agreement between the United States and the states of the Caribbean Basin, but is instead a unilateral U.S. initiative that was implemented by the Caribbean Basin Economic Recovery Act, 19 U.S.C. §§ 2701-2706 (1988). For a general discussion of the passage of CBERA, see Francis W. Foote, *The Caribbean Basin Initiative: Development, Implementation and Application of the Rules of Origin and Related Aspects of Duty-Free Treatment*, 19 GEO. WASH. J. INT'L L. & ECON. 245, 264-66 (1985).

[12] Fourth ACP-EEC Convention, Dec. 15, 1989, 1991 O.J. (L 229) 3 [hereinafter Lomé IV Convention].

[13] The term "ACP states" includes countries in Africa ("A"), the Caribbean ("C"), and the Pacific ("P"). For a list of the developing countries that are parties to the ACP-EEC Lomé IV Convention, see Lomé IV Convention, *id.* at 7-18.

industrialization and economic development in these countries.

Section 2 of this Article analyzes the requirements that products imported from the Caribbean Basin states into the United States must satisfy in order to benefit from duty-free treatment under the Caribbean Basin Economic Recovery Act ("CBERA").[14] The basic rule of origin under CBERA, the "substantial transformation" test, is examined first. This Article seeks to demonstrate that courts have not reached a consensus regarding the issue of whether this test is policy-neutral and that the case law dealing with substantial transformation criteria is wholly inconsistent. After discussing the 35% local content and direct importation requirements, this Article then examines whether the substantial transformation test meets the "clearly defined" requirements of the Rules of Origin Agreement. Section 3, similarly analyzes the rules of origin under the ACP-EEC Lomé IV Convention,[15] which provides for duty-free entry into the European Union of products originating in ACP states. Finally, this Article concludes that the U.S. rule of origin, the substantial transformation test as currently applied by U.S. courts, is not "clearly defined." This conclusion is based upon the courts' inability to agree on coherent criteria for a substantial transformation determination. Moreover, this Article concludes that the European rules of origin are sufficiently clear to meet the Uruguay Agreement requirement.

2. RULES OF ORIGIN UNDER THE CARIBBEAN BASIN ECONOMIC RECOVERY ACT

CBERA,[16] which implements the Caribbean Basin Initiative,[17] empowers the President of the United States

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[14] 19 U.S.C. §§ 2701-2706 (1988 & Supp. IV 1992).

[15] The rules of origin are not contained in the Lomé IV Convention itself, but are included in the attached protocol. *See* Protocol No. 1 Concerning the Definition of the Concept of 'Originating Products' and Methods of Administrative Cooperation, *infra* note 140.

[16] 19 U.S.C. §§ 2701-2706 (1988 & Supp. IV 1992).

[17] The Caribbean Basin Initiative (CBI) was an essential part of the Reagan administration's Central America policy. The CBI's principal aim is to foster private economic development in Caribbean countries by opening the U.S. market to products from these countries. This

to designate twenty-seven Central American and Caribbean countries as nations that are eligible to receive duty-free treatment for some of their exports to the United States.[18] In order to profit from the duty-free treatment, an article must satisfy certain rule of origin requirements: (1) the article must be "the growth, product, or manufacture of a beneficiary country;" (2) if the article is processed in the beneficiary country, the process must add at least 35% to the value of the article; and (3) the article must be imported directly into the customs territory of the United States.[19]

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policy should provide an incentive for Central American governments to base their economic development on a free market economy with a minimum of government intervention, rather than on a planned economy modelled on the Cuban example. *See* Keiron E. Hylton, Recent Developments, *International Trade: Elimination of Tariffs on Caribbean Products*, 25 HARV. INT'L L.J. 245 (1984).

[18] The twenty-seven countries that are eligible for designation as beneficiary countries under CBERA are listed in 19 U.S.C. § 2702(b). Before designating an eligible country as a beneficiary country, the President must consider the eleven factors enumerated in 19 U.S.C. § 2702(c): (1) the desire of the country concerned to be designated a beneficiary country; (2) the economic conditions and the living standard in the country concerned; (3) the extent to which the market of the country concerned is open to U.S. exports; (4) the degree to which the country concerned follows the principles of the GATT; (5) the degree to which the country concerned distorts international trade by granting export subsidies or imposing export performance requirements or local content requirements; (6) the degree to which the trade policies of the country concerned contribute to the economic development of the Caribbean region; (7) the degree to which the country concerned is taking self-help measures to improve its own economic situation; (8) the working conditions and the protection of labor in the country concerned; (9-10) the extent to which the country concerned protects foreign intellectual property rights; and (11) the willingness of the government of the country concerned to cooperate with the U.S. government in the administration of the tax and trade provisions of CBERA. *See* 19 U.S.C. § 2702(c) (1988 & Supp. IV 1992).

Pursuant to 19 U.S.C. § 2703(b), duty-free treatment does not apply to all exports from the beneficiary country. For instance, textile and apparel articles, certain footwear articles, certain tuna products, petroleum and petroleum derivatives, as well as watches and watch parts, are excluded from duty-free treatment. *See* 19 U.S.C. § 2703(b) (1988 & Supp. IV 1992).

[19] 19 U.S.C. § 2703(a)(1) (1988 & Supp. IV 1992).

2.1. *Growth, Product, or Manufacture of a Beneficiary Country*

The question whether a certain article is "the growth, product, or manufacture of a beneficiary country" poses no problems if the article is wholly the product of a CBI country and if no parts from nonbeneficiary countries are used in its production.[20]

If, however, an article which has been imported into the beneficiary country from a non-beneficiary country is processed in a CBI country, the article qualifies for duty-free treatment under CBERA only if, after having been processed, it is "a new or different article of commerce which has been grown, produced, or manufactured in a beneficiary country . . . ."[21] In other words, the imported article must be transformed into a "product of" the CBI country in order to profit from preferential treatment under CBERA.[22] The most commonly used test for this purpose is the so-called "substantial transformation" test,[23] which, despite its enormous importance in the CBI and other contexts, is not defined expressly either in statutes or in regulations.[24] Nevertheless, CBERA, without mentioning the term "substantial transformation," provides two examples of processing operations which by themselves can never result in a "new or different article of commerce:" simple combining or packaging operations,[25] and mere dilution with water or with another substance that does not materially alter the characteristics of the article.[26] Thus, these processes do not produce substantial transformations. Other than this meager statutory guidance, case law is the only source of law in this area. Current U.S. law on the subject can be traced back to *Anheuser-Busch Brewing Ass'n*

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[20] Palmeter, *Commentary, supra* note 1, at 12.
[21] 19 C.F.R. § 10.195(a)(1) (1994).
[22] *See, e.g.*, Thomas P. Cutler, *United States Generalized System of Preferences: The Problem of Substantial Transformation,* 5 N.C. J. INT'L L. & COM. REG. 393, 399 (1980).
[23] C. Edward Galfand, Comment, *Heeding the Call for a Predictable Rule of Origin,* 11 U. PA. J. INT'L BUS. L. 469, 470 (1989).
[24] *Id.* at 480.
[25] 19 U.S.C. § 2703(a)(2)(A) (1988 & Supp. IV 1992).
[26] 19 U.S.C. § 2703(a)(2)(B) (1988 & Supp. IV 1992).

v. United States, where the Supreme Court held that:

> [m]anufacture implies a change, but every change is not manufacture, and yet every change in an article is the result of treatment, labor[,] and manipulation. But something more is necessary . . . . There must be *transformation*; a new and different article must emerge, "having a distinctive name, character, or use."[27]

Although nearly all courts dealing with the concept of substantial transformation refer to this Supreme Court decision, various and often differing criteria have been used to determine whether a material has undergone a substantial transformation.

2.1.1. Disagreement Regarding the Existence of a Policy-Neutral Substantial Transformation Test

One basic problem is that courts differ over whether the substantial transformation test should be applied uniformly in all country of origin decisions, or whether an article can be considered the product of country A for one purpose (e.g., for Generalized System of Preferences ("GSP")[28] or CBI

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[27] 207 U.S. 556, 562 (1908) (emphasis added) (quoting Hartranft v. Weigmann, 121 U.S. 609, 615 (1887)).

[28] The GSP was established by the Trade Act of 1974 (19 U.S.C. §§ 2461-66 (1988 & Supp. IV 1992)) and authorizes duty-free treatment for certain eligible products from designated beneficiary countries. Section 502(a)(1) of the Trade Act of 1974 (19 U.S.C. § 2462(a)(1) (1988)) vests in the President the authority to designate to a certain country a beneficiary country under the GSP. The President may also determine which products are eligible for duty-free treatment. 19 U.S.C. § 2463(a) (1988). To qualify for duty-free treatment, a product must be imported directly into the United States from a beneficiary country. 19 U.S.C. § 2463(b)(1)(A) (Supp. IV 1992). Moreover, the sum of the cost or the value of the materials produced in the beneficiary country plus the direct costs of the processing operations performed in the beneficiary country must be not less than 35% of the appraised value of the product at the time of its entry into the United States. 19 U.S.C. § 2463(b)(1)(B) (Supp. IV 1992). *See generally* Thomas R. Graham, *The U.S. Generalized System of Preferences for Developing Countries: International Innovation and the Art of the Possible*, 72 AM. J. INT'L L. 513 (1978) (tracing the early evolution and operation of the

purposes) and the product of country B for another purpose (e.g., for country of origin marking[29]).[30]

A recent case in which the latter position was adopted is *Tropicana Products, Inc. v. United States,* where the Court of International Trade held that "substantial transformation criteria cannot be applied indiscriminately in the identical manner across the entire spectrum of statutes for which it is necessary to determine whether merchandise has been 'manufactured.'"[31] The *Tropicana* court referred to its earlier decision in *National Juice Products Ass'n v. United States,*[32] where it had stated that "although the language of the tests applied under the three statutes [the GSP rules, the country of origin marking statute, and the

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U.S. GSP program); D. Robert Webster & Christopher P. Bussert, *The Revised Generalized System of Preferences: "Instant Replay" or a Real Change?*, 6 NW. J. INT'L L. & BUS. 1035 (1984-85) (discussing in detail the GSP in the United States).

[29] Under § 304(a) of the Tariff Act of 1930 (19 U.S.C. § 1304(a) (1988)), every imported article must be marked in a manner that allows the "ultimate purchaser" (generally the last person in the United States who receives the article in the form in which it was imported (19 C.F.R. § 134.1(d) (1994)) to identify the country of origin of the imported product. *See generally* National Juice Prods. Ass'n v. United States, 10 Ct. Int'l Trade 48, 58 (1986) (applying § 304 of the Tariff Act of 1930 and 19 C.F.R. § 134.1(d) (1994)). The primary purpose of section 304(a) of the Tariff Act of 1930 is to provide for the marking of imported goods "'so that at the time of purchase the ultimate purchaser may, by knowing where the goods were produced, be able to buy or refuse to buy them, if such marking should influence his will.' (Congress, of course, had in mind a consumer preference for American made goods.)." 10 Ct. Int'l Trade at 58-59 n.14 (quoting United States v. Friedlaender & Co., 27 C.C.P.A. 297, 302 (1940)). *See generally* David Silverstein, *Country-of-Origin Marking Requirements Under Section 304 of the Tariff Act: An Importer's Map Through the Maze*, 25 AM. BUS. L.J. 285 (1987) (analyzing the country of origin marking requirements in the United States).

[30] This dispute is not limited to the courts. There is also a lack of consensus among scholars whether the same standards should govern all rules of origin decisions. Compare Galfand, *supra* note 23, at 488-92 (pleading the case for a uniform rule of origin) with Michael P. Maxwell, *Formulating Rules of Origin for Imported Merchandise: Transforming the Substantial Transformation Test*, 23 GEO. WASH. J. INT'L L. & ECON. 669, 676-77 (1990) (urging a variegated rules application that ensures the economic development of developing nations).

[31] 16 Ct. Int'l Trade 155, 160 (1992).

[32] 10 Ct. Int'l Trade at 48.

drawback statute[33]] is similar, the results may differ where differences in statutory language and purpose are pertinent."[34] *National Juice* was also cited in *Superior Wire v. United States*[35] as standing for the abandonment of a policy-neutral substantial transformation test and for taking into account the purposes of a voluntary restraint agreement in deciding whether a substantial transformation occurred.[36]

In *Ferrostaal Metals Corp. v. United States*,[37] the Court of International Trade stated that "none of the cases cited [including *National Juice*] even remotely suggest that the Court depart from policy-neutral rules governing substantial transformation in order to achieve wider import restrictions in particular cases," and concluded that "[a]s a practical matter, multiple standards . . . would confuse importers and provide grounds for distinguishing useful precedents."[38]

Other courts have also implicitly adhered to this policy-neutral standard as evidenced by the fact that their decisions rely upon precedents dealing with the substantial

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[33] 19 U.S.C. § 1313(a) (1988). "Drawback" is a refund of duties levied by U.S. Customs on imported articles if these articles are not sold in the United States but are instead used as components in the manufacture of other goods which, in turn, are exported to third countries. *See* 19 C.F.R. § 191.2 (1994); N. David Palmeter, *Pacific Regional Trade Liberalization and Rules of Origin*, J. WORLD TRADE, Oct. 1993, at 49, 58.

[34] 10 Ct. Int'l Trade at 58-59 n. 14. *Accord* Belcrest Linens v. United States, 741 F.2d 1368, 1372 (Fed. Cir. 1984) (stating that there is no one definition of the term "substantial transformation" for all purposes because the implementing regulations under the various tariff provisions define the term differently). Apparently ignoring its own statement, however, the *Belcrest* court, when ruling upon a tariff problem, drew heavily from Uniroyal, Inc. v. United States, 3 Ct. Int'l Trade 220 (1982), which dealt with country of origin marking requirements in answering a substantial transformation question. The *Belcrest* decision is consistent with another ruling of the Court of International Trade in Yuri Fashions Co. v. United States, 10 Ct. Int'l Trade 189, 195 (1986) (holding that "the country of origin of the merchandise [had been] Korea for textile restraint purposes, and may have been the "CNMI" (Commonwealth of Northern Mariana Islands) for duty and marking purposes" (footnote omitted)).

[35] 11 Ct. Int'l Trade 608 (1987).

[36] *See id.* at 613.

[37] 11 Ct. Int'l Trade 470 (1987).

[38] *Id.* at 474.

transformation test under a wide range of statutes. For example, the court in *Midwood Industries v. United States*[39] based its decision on *United States v. International Paint Co.*,[40] which dealt with a drawback question arising under section 313(a) of the Tariff Act of 1930,[41] as opposed to the country of origin marking requirements under section 304(a) of the Tariff Act of 1930[42] as did the *Midwood Industries* decision.[43] In relying on *International Paint*, the *Midwood Industries* court implicitly acknowledged that the criteria for a substantial transformation are the same under both statutes. Another example of an implicit recognition of a policy-neutral standard is *M.B.I. Merchandise Industries v. United States*,[44] an antidumping case. In its ruling, the court referred to the criteria developed in *Uniroyal, Inc. v. United States*,[45] even though *Uniroyal* ruled on a country of origin marking question under section 304(a) of the Tariff Act of 1930.[46] The opinion that the substantial transformation test is a policy-neutral test is shared by the Treasury Department, which argues that the standards for substantial transformation are the same in *all* country of origin decisions.[47]

2.1.2. Substantial Transformation Criteria

Despite this confusion, several criteria have emerged from the case law that serve as indicia of a substantial transformation.[48] Though there is no consensus as to whether the substantial transformation test is policy

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[39] 64 Cust. Ct. 499 (1970).
[40] 35 C.C.P.A. 87 (1948), *cited in* 64 Cust. Ct. at 507.
[41] 19 U.S.C. § 1313(a) (1988).
[42] 19 U.S.C. § 1304(a) (1988).
[43] 64 Cust. Ct. at 500.
[44] 16 Ct. Int'l Trade 495 (1992).
[45] 3 Ct. Int'l Trade 220 (1982), *cited in*, 16 Ct. Int'l Trade at 503.
[46] 19 U.S.C. § 1304(a) (1988).
[47] *See* T.D. 85-38, 19 Cust. B. & Dec. 58, 68 (1985) ("[I]t is Customs' view that the origin rules in section 12.130 [currently, 19 C.F.R. § 1.12.130 (1993)] are derived from Customs' interpretation of various court cases, most particularly *Uniroyal, Inc. v. United States*. Therefore, the principles of origin contained in section 12.130 are applicable to merchandise for *all* purposes, including duty and marking.") (emphasis added) (citation omitted)).
[48] *See* Galfand, *supra* note 23, at 480-84.

neutral,[49] courts formulating their country of origin decisions normally apply several substantial transformation criteria and draw from prior court rulings, even if those rulings deal with a country of origin decision under a different statute.[50]

2.1.2.1. Loss of Identity

The first case in which "loss of identity" was considered to be the decisive factor in determining whether a substantial transformation had taken place was *United States v. Gibson-Thomsen Co.*[51] In *Gibson-Thomsen*, the court held that Japanese handles, when later combined with American bristles in the United States, were substantially transformed into American toothbrushes because the handles thereby became "an integral part of the new article" and "los[t] their identity."[52] More recently, the court in *Uniroyal Inc. v. United States*[53] considered a situation in which leather shoe uppers were imported from Indonesia and sold to a U.S. firm that attached outsoles to the uppers. In deciding whether the uppers underwent a substantial transformation when attached to the outsole, the court held that the test to be applied was whether "the manufacturing or combining process is merely a minor one which leaves the *identity* of the imported article intact,"[54] or whether the imported product loses its identity and thereby experienced a substantial transformation. After careful examination of the facts, the *Uniroyal* court ruled that "the imported upper ha[d] not lost its *identity* and [was] scarcely a mere material in the manufacture of a finished shoe" because "the imported upper [was] the very essence of the finished shoe."[55] The same "loss of identity" test was used in *Belcrest Linens v. United States,*[56] *Azteca Milling Co. v.*

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[49] *See supra* section 2.1.1.
[50] *See supra* notes 39-46 and accompanying text.
[51] 27 C.C.P.A. 267, 273 (1940).
[52] *Id.*
[53] 3 Ct. Int'l Trade 220 (1982).
[54] *Id.* at 224 (emphasis added).
[55] *Id.* at 225 (emphasis added).
[56] 741 F.2d 1368, 1374 (Fed. Cir. 1984) (concluding that a substantial transformation had taken place because "the *identity* of the merchandise changed" (emphasis added)).

United States,[57] *M.B.I. Merchandise Industries v. United States,*[58] and *F.F. Zuniga v. United States.*[59]

2.1.2.2. Producer Good - Consumer Good Distinction

In *Midwood Industries v. United States,* the court applied another test in deciding whether the processing of imported articles alters the nature of these articles from producers' goods to consumers' goods.[60] The court held that, because the imported articles (forgings) were producers' goods, but the processed articles (flanges and fittings) were consumers' goods, the forgings were substantially transformed.[61] This distinction between producers' goods and consumers' goods was also made in *Torrington Co. v. United States,*[62] where the court drew heavily from *Midwood Industries* in deciding that the production of needles from swages constituted a "substantial transformation," and again in *Ferrostaal Metals Corp. v. United States,*[63] where the Court of International Trade ruled that Japanese hard cold-rolled steel sheets which had been annealed and galvanized in New Zealand were substantially transformed. The Japanese steel sheets were thus rendered into a product of New Zealand since "the annealing and galvanizing processes result[ed] in a change in character."[64]

In some cases, however, the distinction between pro-

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[57] 12 Ct. Int'l Trade 1153, 1159 (1988) (recognizing that whether a product has "'lost the identifying characteristics of its constituent material'" is a factor in determining whether a substantial transformation has occurred (quoting *Torrington Co. v. United States,* 764 F.2d 1563, 1569 (Fed. Cir. 1985))).

[58] 16 Ct. Int'l Trade 495, 502-03 (1992).

[59] 996 F.2d 1203, 1206 (Fed. Cir. 1993) ("[T]he substantial transformation of the original materials may be found where there is a definite and distinct point at which the *identifying characteristics* of the starting materials is [sic] lost and an *identifiable* new and different product can be ascertained." (emphasis added)).

[60] 64 Cust. Ct. 499, 507 (1970).

[61] *Id.*

[62] 764 F.2d 1563, 1571 (Fed. Cir. 1985), *aff'g,* 8 Ct. Int'l Trade 150 (1984).

[63] 11 Ct. Int'l Trade 470 (1987).

[64] *Id.* at 477.

ducers' goods and consumers' goods was not considered decisive, as in *Uniroyal,* where the imported article was a leather shoe upper to which an outsole was attached in the United States.[65] Although the upper itself was not a consumers' good since it could not be worn as a shoe, and although a producers' good was ultimately transformed into a consumers' good, the Court of International Trade held that there was no "substantial transformation."[66] A similar decision was reached in *National Juice Products.* The Court of International Trade held that "[u]nder recent precedents [such as *Uniroyal*], the transition from producers' to consumers' goods is not determinative."[67] The *National Juice Products* court also referred to *United States v. Murray,*[68] which clarified that "Chinese glue blended with other glues in Holland [was] not substantially transformed . . . although it was transformed from a processors' good to an end-users' good . . . ."[69]

2.1.2.3. Value-Added

Another test for gauging substantial transformation is the value-added standard. In *United States v. Murray*, the court held that:

> the sub-term "substantial transformation" mean[t] a fundamental change in the form, appearance, nature, or character of an article which adds to the value of the article an amount or percentage which is significant in comparison with the value which the article had when exported from the country in which it was first manufactured, produced, or grown.[70]

The value-added criterion was also used in *National Juice Products* (in which the Court of International Trade

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[65] 3 Ct. Int'l Trade 220 (1982).
[66] *Id.* at 224.
[67] 10 Ct. Int'l Trade 48, 60 (1986).
[68] 621 F.2d 1163 (1st Cir. 1980).
[69] 10 Ct. Int'l Trade at 60 (summarizing the holding of *United States v. Murray*).
[70] 621 F.2d at 1169.

stated that a "substantial transformation" requires that "the processing done in the United States substantially increase[] the value of the product),"[71] *Ferrostaal Metals,*[72] *Superior Wire,*[73] and *M.B.I. Merchandise.*[74] The *Superior Wire* court stressed that the essential advantage of the value-added test is that it enables both customs authorities and courts to reach more predictable results in their decisions.[75]

The only decision expressly rejecting the value-added test is *National Hand Tool Corp. v. United States,* in which the Court of International Trade held that, in a country of origin marking context, the value added "could lead to inconsistent marking requirements for importers who perform exactly the same processes on imported merchandise but sell at different prices."[76] This ruling, however, ignores the fact that, when using the value-added test, the determinative factor is the real value added in the course of the manufacturing process, rather than the difference between import *price* and sales *price* (which can both be arbitrary).

2.1.2.4. Comparison of Processing Operations

As shown most recently in *M.B.I. Merchandise,* the concept of a value-added test is closely related to the fact that a process which substantially transforms an article is normally cost-intensive, labor-intensive, and raw material-intensive.[77] Therefore, some courts have stated that only

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[71] 10 Ct. Int'l Trade at 60.

[72] 11 Ct. Int'l Trade 470, 477 (1987).

[73] 11 Ct. Int'l Trade 608, 614 (1987).

[74] 16 Ct. Int'l Trade 495, 503 (1992).

[75] 11 Ct. Int'l Trade at 615 ("[A] value added test has appeal in many situations because it brings a common sense approach to a fundamental test [such as the substantial transformation test] that may not be easily applied to some products.").

[76] 16 Ct. Int'l Trade 308, 312 (1992).

[77] 16 Ct. Int'l Trade 495, 503 ("Taiwanese labor added approximately 45% to the value of the albums . . . . The process of making the album covers is very labor- and raw material-intensive."); *see also* Superior Wire v. United States, 11 Ct. Int'l Trade at 615 (expressly calling the amount of labor required to accomplish the change in a product a "related concept" vis-a-vis the value added test for determining whether the change is a "substantial transformation" or merely

major processing of an article can lead to a "substantial transformation." In *Uniroyal,* the Court of International Trade held that "a substantial transformation . . . ha[d] *not* occurred since the attachment of the outsole to the upper [was] a *minor* manufacturing or combining *process* . . . ."[78] The court in *Texas Instruments Inc. v. United States* applied the same standards and concluded that, "[g]iven our holding that the IC's [sic] and photodiodes were the result of *extensive* manufacturing *operations* . . . there was 'substantial transformation' . . . ."[79]

2.1.2.5. Change in Tariff Classification

Another criterion applied in some cases is "a change in the classification of the merchandise under the Tariff Schedules of the United States."[80] One court using this test has stressed that a change in tariff classification is not "the sole criterion for determining whether a substantial transformation occurred,"[81] and another noted that "it certainly should not be a controlling consideration."[82] Therefore, one court concluded, "different tariff classifications are . . . [only] additional evidence of substantial transformation."[83]

"minor processing"); Galfand, *supra* note 23, at 483 (explaining that the value-added test closely relates to a test that differentiates between minor and major processing); Foote, *supra* note 11, at 325-26 ("[I]n recent years the courts have placed special emphasis on the nature or degree of the processing under consideration in order to determine whether a 'substantial' transformation has taken place.").

[78] 3 Ct. Int'l Trade 220, 224 (1982) (second and third emphases added).

[79] 681 F.2d 778, 785 (C.C.P.A. 1982) (emphasis added).

[80] Ferrostaal Metals Corp. v. United States, 11 Ct. Int'l Trade 470, 478 (1987). At the time of its 1987 decision, all tariff classifications of imports were based on the Tariff Schedule of the United States (TSUS). The TSUS was replaced with the Harmonized Commodity Description and Coding System (the so-called "Harmonized System") by the Omnibus Trade and Competitiveness Act of 1988, Pub. L. No. 100-418, 102 Stat. 1107 (1988). See Title I, Subtitle B of this Act for implementation terms of the Harmonized System. For a discussion of the Harmonized System, see *infra* note 154.

[81] Belcrest Linens v. United States, 741 F.2d 1368, 1372 (Fed. Cir. 1984).

[82] Rolland Freres, Inc. v. United States, 23 C.C.P.A. 81, 89 (1935).

[83] Koru N. America v. United States, 12 Ct. Int'l Trade 1120, 1127 (1988).

A change of tariff classification, however, is not taken into account at all in some decisions. In *Torrington Co. v. United States*, for example, the court, without giving any reasoning behind its opinion, ruled that "[t]he proper tariff classification is not dispositive of whether the manufacturing process necessary to complete an article constitutes a substantial transformation from the original material to the final product."[84]

Thus, the case law concerning the substantial transformation criteria is inconsistent because it is not clear which criterion is conclusive regarding decisions concerning a particular country of origin.[85] This situation has led to great uncertainty among importers because the outcomes of country of origin decisions of both customs authorities and courts are no longer predictable.[86]

2.2. The 35% Value-Added Criterion

To be eligible for duty-free treatment under CBERA, a substantial transformation is not the only requirement. Pursuant to 19 U.S.C. § 2703(a)(1)(B), the sum of the cost of materials produced in *any* beneficiary country, plus the direct cost of processing there, must equal at least 35% of the appraised value of the article at the time of its entry into the United States.[87] The rationale behind the 35% minimum local content requirement is to "assure that, to the maximum extent possible, the preferences provide benefits to developing countries without stimulating the development of 'pass-through' operations[,] the major benefit of which accrues to enterprises in developed countries."[88]

2.2.1. The Dual Substantial Transformation Rule

The 35% local content requirement has led to the

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[84] 764 F.2d 1563, 1571 (Fed. Cir. 1985), *aff'g*, 8 Ct. Int'l Trade 150 (1984).

[85] *See* Galfand, *supra* note 23, at 484-88.

[86] *See* Maxwell, *supra* note 30, at 676-77.

[87] 19 U.S.C. § 2703(a)(1)(B) (1988).

[88] H.R. REP. NO. 571, 93d Cong., 1st Sess. 87 (1973).

development of the so-called "dual substantial transformation" test.[89] Even the first regulations implementing CBERA provided that materials of non-CBI origin had to be "substantially transformed in any beneficiary country . . . into a new or different article of commerce which is then used in any beneficiary country in the production . . . of a new or different article which is imported directly into the United States."[90] The result of this requirement is that the value of raw materials imported into a CBI country and used in the manufacture of the eligible article is counted toward the required 35% only if the imported raw materials are substantially transformed into an intermediate article that will, in turn, again be substantially transformed into the eligible article that can finally be imported into the United States at a preferential tariff rate.[91]

In *Torrington*,[92] a case involving imports into the United States under the "GSP"[93] which provides for an analogous 35% value-added requirement,[94] the dual substantial transformation requirement was applied by both the Court of International Trade[95] and the Federal Circuit Court.[96] In that case, steel wire produced in a non-beneficiary country was exported to Portugal (then a beneficiary country under the GSP). In Portugal, the wire was cut into swage needle blanks, and the blanks were then processed into sewing machine needles. Because the needles were produced from wire imported from a nonbeneficiary country, the value of the wire could not be counted toward the 35% requirement, which therefore precluded duty-free treatment. The court, however, found a dual substantial transformation: the first substantial transformation was the cutting of the imported wire into "needle blanks;" and

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[89] *See* Palmeter, *Commentary, supra* note 1, at 9.

[90] 19 C.F.R. § 10.196(a)(2) (1984). The original regulation that § 10.196 promulgated under CBERA is still in force. *See* 19 C.F.R. § 10.196(a)(2) (1994).

[91] *See* Palmeter, *Commentary, supra* note 1, at 9.

[92] 764 F.2d 1563, 1571 (Fed. Cir. 1985), *aff'g*, 8 Ct. Int'l Trade 150 (1984).

[93] *See* 19 U.S.C. §§ 2461-66 (1988 & Supp. IV 1992).

[94] *See* 19 U.S.C. §§ 2463(b)(1)(B) (Supp. IV 1992).

[95] *See* 8 Ct. Int'l Trade 150 (1984).

[96] 764 F.2d at 1567-68.

the second was the processing of the needle blanks into needles. Because the needle blanks were of Portuguese origin due to the first substantial transformation, they could be included in the 35% value-added calculation. The value added in Portugal was determined by adding the value of the Portuguese needle blanks to the costs of processing the needle blanks into needles.[97]

In *obiter dicta,* the Court of International Trade considered the hypothetical case where a single substantial transformation adds at least 35% to the value of the article. The court stated that:

> The question raised . . . is whether a two-stage substantial transformation is *required.* This Court finds that such a two-stage process is *required.* . . . It is not enough to transform substantially the non-BDC [beneficiary developing country] constituent materials into the final article . . . . There must first be a substantial transformation of the non-BDC material into a new and different article of commerce which becomes "materials produced," and these . . . must then be substantially transformed into a new and different article of commerce. . . . [A]bsent such a dual requirement, the GSP's goal of industrialization, diversification, and economic progression for underdeveloped nations could be frustrated. For example, a BDC could import eligible items, merely decorate or assemble these items and thereby satisfy the 35 percent value-added requirement since these direct costs of processing operations would be includable in the calculation.[98]

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[97] *See* 8 Ct. Int'l Trade at 156; *see also* Palmeter, *Commentary, supra* note 1, at 9.

[98] 8 Ct. Int'l Trade at 153 (emphasis added). Initially, mere decoration or assembly was sufficient to qualify a product for duty-free treatment under the GSP when the 35% local content requirement was met; a substantial transformation was not necessary. *See* 19 U.S.C. § 2463(b)(2) (1988). Thus, in Madison Galleries, Ltd. v. United States, 12 Ct. Int'l Trade 485 (1988), *aff'd,* 870 F.2d 627 (Fed. Cir. 1989), the courts held that vases produced in Taiwan and decorated in Hong Kong qualified for preferential treatment because the decoration cost was at

Therefore, a dual substantial transformation is required in every case if duty-free treatment is to be granted.[99] Hence, under the facts of *Torrington*, had the processing alone of the imported wire into needle blanks in Portugal added 35% to the value of the imported wire, both under regulation 10.196(a)(2)[100] and under the court's holding, the needle blanks themselves would still be ineligible for preferential tariff treatment.

2.2.2. Cumulation of Value

Unlike the GSP, CBERA allows the cumulation of value among all CBI beneficiary countries to reach the required 35%,[101] thus making it easier for CBI countries to meet the local content requirement. In the *Torrington* case, for example, if the processing of wire into needle blanks took place in Panama, and if the final needles were processed in Costa Rica and exported from there to the United States, the value of the needle blanks, though not of Costa Rican origin, would be counted toward the 35% requirement. The rationale for permitting this cumulation is to encourage greater specialization, to enhance efficiency among the CBI countries, and to promote greater economic integration in the Caribbean region.[102]

Moreover, for purposes of determining the percentage of value added in a beneficiary country, Puerto Rico and the

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least 35% of the vases' appraised value. *See* 12 Ct. Int'l Trade at 487-88. The GSP did not require the imported article to be the product of the beneficiary country. 870 F.2d at 632. In 1990, however, Congress amended the GSP statute, thereby expressly rejecting the courts' decisions. *See* Customs and Trade Act of 1990, Pub. L. No. 101-382, § 226, 104 Stat. 629, 660 (1990). From that point forward, an imported article had to be the "growth, product, or manufacture of [the] beneficiary developing country" to benefit from duty-free entry. *Id.*; *see also* Maxwell, *supra* note 30, at 685-87. CBERA always contained the requirement that an imported article had to be "the growth, product, or manufacture of a beneficiary country." 19 U.S.C. § 2703(a)(1) (1988).

[99] *See* Foote, *supra* note 11, at 335-48, 369. *But see* Palmeter, *supra* note 1, at 10-11 (attacking the courts' decisions, but ignoring the clear wording of regulation 19 C.F.R. § 10.196(a)(2) (1987)).

[100] 19 C.F.R. § 10.196(a)(2) (1984).

[101] 19 U.S.C. § 2703(a)(1)(B) (1988).

[102] *See* Foote, *supra* note 11, at 378.

U.S. Virgin Islands are considered to be beneficiary countries.[103] Therefore, the cost or value of materials produced in Puerto Rico and the U.S. Virgin Islands, as well as the costs of processing operations there, is counted toward the 35% requirement.[104] Congress apparently intended to encourage the use of products from Puerto Rico and the U.S. Virgin Islands.[105]

2.2.3. Inclusion of U.S.-Produced Materials

Pursuant to 19 U.S.C. § 2703(a)(1), the cost or value of materials produced in U.S. customs territory,[106] other than Puerto Rico and the U.S. Virgin Islands, can be included in determining the value added in a CBI country.[107] This "component" of the 35% local content, however, may not exceed 15%.[108] Thus, the local content requirement is in effect reduced to 20% in cases where U.S. materials, adding at least 15% to the imported article's value, are used in manufacturing the eligible article.[109]

2.3. Direct Importation Requirement

The last requirement an eligible article must satisfy is the direct importation requirement; it must be imported directly from a beneficiary country.[110] Thus, an eligible article produced or processed in beneficiary country A can be imported from beneficiary country B without losing its preferential status, even though no value was added in beneficiary country B.[111] This is a remarkable deviation

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[103] 19 U.S.C. § 2703(a)(1) (1988).
[104] *See* Foote, *supra* note 11, at 378.
[105] *See id.*
[106] Because foreign trade zones located within the United States are treated as being outside the U.S. customs territory, 19 U.S.C. §§ 81a-81u (1988), the value of materials produced in such foreign trade zones cannot be counted toward the 35% local content. Nevertheless, the value of materials produced in a foreign trade zone located in Puerto Rico is included when determining the local content because Puerto Rico is defined as a beneficiary country without reference to the customs territory. *See* Foote, *supra* note 11, at 383-84 & n.736.
[107] 19 U.S.C. § 2703(a)(1) (1988).
[108] *Id.*
[109] *See* Foote, *supra* note 11, at 382.
[110] 19 U.S.C. § 2703(a)(1)(A) (1988).
[111] *See* Foote, *supra* note 11, at 387-88.

from GSP rules where the eligible article must be imported directly from the beneficiary country where the value-added requirement was satisfied.[112]

2.4. Compatibility of the Rules of Origin Under CBERA and the Rules of Origin Agreement

The Rules of Origin Agreement makes a distinction between *general* rules of origin and *preferential* rules of origin. "Rules of Origin" are defined as:

> those laws, regulations and administrative determinations of general application applied by any Member to determine the country of origin of goods provided such rules . . . are not related to contractual or autonomous trade régimes leading to the granting of tariff preferences going beyond the application of Article I:1 of the GATT 1994.[113]

"Preferential" rules of origin, however, are used to "determine whether goods qualify for preferential treatment under contractual or autonomous trade régimes leading to the granting of tariff preferences going beyond the application of Article I:1 of the GATT 1994."[114] The requirements concerning the "general" rules of origin are established in Parts I to IV of the Rules of Origin Agreement,[115] and the preferential rules of origin are dealt with in Annex II of the Agreement. Because the rules of origin applied in the context of CBERA are preferential rules of origin (they determine whether goods from Caribbean Basin countries are eligible for duty-free treatment under CBERA), they must meet the requirements of Annex II of the Rules of Origin Agreement. Thus, the rules of origin must be "clearly defined." For example:

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[112] *See id.* at 387; 19 U.S.C. § 2463(b) (1988).
[113] Rules of Origin Agreement, *supra* note 9, at art. 1(1).
[114] *Id.* at Annex II(2).
[115] *Id.* at arts. 1-9.

- in cases where the criterion of change of tariff classification is applied, such a preferential rule of origin, and any exceptions to the rule, must clearly specify the sub-headings or headings within the tariff nomenclature that are addressed by the rule;
- in cases where the *ad valorem* percentage criterion is applied, the method for calculating this percentage shall also be indicated in the preferential rules of origin;
- in cases where the criterion of manufacturing or processing operation is prescribed, the operation that confers preferential origin shall be precisely specified[.][116]

2.4.1. Clear Specification of the Headings Within the Tariff Nomenclature

The first requirement of any preferential rule under the Rules of Origin Agreement is that if a change of tariff classification criterion is used, the headings and sub-headings within the tariff nomenclature which are addressed by the preferential rule of origin must be clearly specified. With regard to the substantial transformation test (the rule of origin applicable under CBERA), it is unclear whether a tariff classification criterion is used because courts have applied the criterion in some cases,[117]

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[116] *Id.* at Annex II(3)(a). Moreover, under the new Rules of Origin Agreement: (1) preferential rules of origin must be based on a positive standard; (2) all laws, regulations, judicial and administrative rulings of general application concerning rules of origin must be published in accordance with Article X:1 of GATT; (3) new preferential rules of origin shall not be applied retroactively; and (4) any administrative action taken in the determination of preferential origin must be reviewable by an independent court or tribunal. *Id.* at Annex II(3)(b), (c), (e) & (f). Because these criteria are either not relevant or doubtlessly fulfilled in the context of both CBERA and the Lomé IV Convention, they will not be discussed in this Article.

[117] For cases where the criterion is used by the court, see Belcrest Linens v. United States, 741 F.2d 1368, 1372-73 (Fed. Cir. 1984);

but have completely disregarded it in others.[118] The aim of the first clearly-defined requirement is to remove uncertainties involved in the application of the change of tariff classification criterion. With regard to the substantial transformation test, however, the situation is far from clear. Not only are there uncertainties about the case-by-case application of this criterion,[119] but it is unclear whether the change of tariff classification criterion is a valid one that can be used when determining whether a product has been substantially transformed. Due to this fundamental uncertainty, the substantial transformation test does not fulfill the first clearly-defined requirement of the Rules of Origin Agreement.

2.4.2. Indication of the Method for the Calculation of the Ad Valorem Percentage Criterion

The only clearly-defined requirement of the Rules of Origin Agreement that does not pose any major problems is the second requirement, which prescribes a clear definition of the method for calculating the necessary local content of an imported article.[120] Every article that is not wholly the product of a CBI country must satisfy the 35% local content requirement of section 213(a)(1)(B) of CBERA to be eligible for duty-free treatment under CBERA.[121] Section 213(a) contains detailed provisions concerning the calculation of the value added to the article in the exporting

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Rolland Freres, Inc. v. United States, 23 C.C.P.A. 81 (1935); Koru N. Am. v. United States, 12 Ct. Int'l Trade 1120, 1127 (1988); and Ferrostaal Metals Corp. v. United States, 11 Ct. Int'l Trade 470, 478 (1987).

[118] For an example where the criterion was not employed by the court, see Torrington Co. v. United States, 8 Ct. Int'l Trade 150 (1984), *aff'd*, 764 F.2d 1563 (Fed. Cir. 1985); *see also supra* notes 80-84 and accompanying text.

[119] Even where the change of tariff classification criterion is applied, the courts disagree whether the criterion is decisive in the determination of the country of origin of an imported product or whether it serves as additional evidence for a substantial transformation. *See supra* notes 81-83 and accompanying text.

[120] *See* Rules of Origin Agreement, *supra* note 9, at Annex II(3)(a).

[121] 19 U.S.C. § 2703(a)(1)(B) (1988).

country:

> the sum of (i) the cost or value of the materials produced in a beneficiary country or two or more beneficiary countries, plus (ii) the direct costs of processing operations performed in a beneficiary country or countries is not less than 35 per centum of the appraised value of such article at the time it is entered.[122]

Essential terms such as "direct costs of processing operations" are either defined in section 213(a) of CBERA itself,[123] in the relevant customs regulations, or in both.[124] The cumulation rules are also set forth in CBERA in a very detailed manner[125] so that the method of calculating the necessary local content of an imported article is defined sufficiently to meet the requirements of the Rules of Origin Agreement.

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[122] *Id.*

[123] Section 213(a)(3) of CBERA, 19 U.S.C. § 2703(a)(3) (1988), explains:

> As used in this subsection, the phrase "direct costs of processing operations" includes, but is not limited to (A) all actual labor costs involved in the growth, production, manufacture, or assembly of the specific merchandise, including fringe benefits, on-the-job training and the cost of engineering, supervisory, quality control, and similar personnel; and (B) dies, molds, tooling, and depreciation on machinery and equipment which are allocable to the specific merchandise.

This phrase does not include costs which are not directly attributable to the merchandise concerned or are not costs of manufacturing the product, such as profit and general expenses of doing business which are either not allocable to the specific merchandise or are not related to the growth, production, manufacture, or assembly of the merchandise, such as administrative salaries, casualty and liability insurance, advertising, and salesmen's salaries, commissions, or expenses.

[124] *See, e.g.*, 19 C.F.R. § 10.178 (1994) (discussing direct costs of operations done in a Beneficiary Developing Country).

[125] *See supra* notes 101-05 and accompanying text.

2.4.3. Adequate Description of the Manufacturing or Processing Operation Conferring Preferential Treatment

When examining whether the substantial transformation test, the rule of origin applied under CBERA, meets the requirements for preferential rules of origin in Annex II(3)(a) of the Rules of Origin Agreement, it is essential to remember that every substantial transformation necessarily implies that the imported article underwent a manufacturing or processing operation in the exporting country prior to importation. This is the scenario envisaged by Annex II(3)(a) of the Rules of Origin Agreement, which provides that "in cases where the criterion of manufacturing or processing operation is prescribed, the operation that confers preferential origin shall be precisely specified."[126] The basic problem with the substantial transformation test, however, is that courts do not agree on which processing or manufacturing operation renders the article to be imported into the United States a product of the exporting country. Because the courts have been unable to develop a single and uniform standard for country of origin decisions,[127] and since the case law dealing with the substantial transformation test is completely inconsistent, there is no single substantial transformation test. Rather, numerous differing tests exist which, if applied to the same product, can lead to contradictory results.

Furthermore, there are no standards for determining whether a court will apply a certain substantial transformation criterion to a given product since, as demonstrated above. In one case a criterion may be considered decisive for the country of origin decision, while in another comparable case the same criterion may not be taken into consideration at all.[128] In addition, it is unclear whether the

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[126] Rules of Origin Agreement, *supra* note 9, at Annex II(3)(a).

[127] *See supra* notes 28-47 and accompanying text.

[128] *Compare* Ferrostaal Metals Corp. v. United States, 11 Ct. Int'l Trade 470, 478 (1987) (using the change in tariff classification criterion) *with* Torrington Co. v. United States, 8 Ct. Int'l Trade 150 (1984) (using the dual substantial transformation requirement). *See also* Galfand, *supra* note 23, at 488; Palmeter, *Monotheism, supra* note 8, at 31.

substantial transformation test is the same for all purposes or whether each country of origin decision is subject to a particular substantial transformation test (e.g., country of origin decisions for CBI purposes would then be governed by a special CBI substantial transformation test).[129] Thus, no importer can predict which test will be applied to the product it wants to import from one of the CBI beneficiary countries into the United States.[130] Moreover, for this reason, it is not very difficult for the Customs Service to tighten or to loosen the prerequisites for duty-free treatment simply by reapportioning the weights of a certain substantial transformation criterion in a given case. If it is the policy of an administration to foster duty-free imports from beneficiary countries, it may use substantial transformation criteria which militate in favor of a substantial transformation, while ignoring other more disadvantageous criteria.[131]

If, however, the U.S. Customs Service wants to restrict duty-free entry of products from CBI countries, it can base its country of origin decisions on criteria that are not fulfilled in the particular case, while criteria leading to a substantial transformation are either not mentioned at all or are given little weight.[132] The Treasury Department itself acknowledged that the substantial transformation test is by no means clearly defined when it admitted that "[a]dministrative agencies, particularly the U.S. Customs Service, have suffered from the absence of a clear standard on which to base their case-by-case [country of origin] decisions."[133] The view criticizing the absence of a clear basis for determining a product's country of origin was expressed in a recent report by the U.S. International Trade Commission, which stated that "[i]n the case of substantial transformation . . . deficiencies include unpredictability of result

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[129] *See supra* notes 28-47 and accompanying text.

[130] *See* Maxwell, *supra* note 30, at 676-77.

[131] *See* Edward H. Davis, Jr., *National Juice Products Association v. United States: A Substantial Transformation of the Country-of-Origin Substantial Transformation Test?*, 19 U. MIAMI INTER-AM. L. REV. 493, 506 (1987-88).

[132] *Id., see also* Maxwell, *supra* note 30, at 676 (remarking that "the vagueness of the criteria may allow for result-orientated decisions").

[133] Maxwell, *supra* note 30, at 671 n.14.

and complexity of application, in large part because the language of the rule permits wide interpretation."[134] These issues elucidate how the rule of origin under CBERA, otherwise known as the substantial transformation test, does not meet the third "clearly defined" requirement identified in Annex II(3)(a) of the Rules of Origin Agreement.[135]

3. RULES OF ORIGIN UNDER THE LOMÉ IV CONVENTION

Article 168(1) of the Fourth ACP-EEC Convention signed at Lomé on December 15, 1989 (the Lomé IV Convention), allows products originating in the ACP states to be imported "into the Community free of customs duties and charges having equivalent effect."[136] With regard to certain agricultural articles, which are enumerated in Annex II to the Lomé IV Convention,[137] and which at the same time are covered by a "common organization of the market within the meaning of Article 40 of the Treaty" of Rome,[138] the Lomé IV Convention contains exceptions from the general duty-free treatment.[139]

Thus, apart from the products covered by this exception, the only requirement for duty-free treatment is that products imported into the European Union must originate in the ACP states. The phrase "products originating in the ACP states" is not defined in the main body of the Lomé IV

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[134] U.S. INT'L TRADE COMM'N, STANDARDIZATION OF RULES OF ORIGIN, H.R. REP. NO. 332-239, at 4-5 [hereinafter STANDARDIZATION REPORT].

[135] Rules of Origin Agreement, *supra* note 9, at Annex II(3)(a). *See also* Galfand, *supra* note 23, at 492 (arguing that the substantial transformation test lacks "uniformity, simplicity, predictability, and administrability"); *cf.* Palmeter, *supra* note 1, at 31 (stating that, with regard to the substantial transformation test, "[c]onsistency, it seems clear, does not prevail.").

[136] Lomé IV Convention, *supra* note 12, art. 168(1), 1991 O.J. (L 229) at 60.

[137] Lomé IV Convention, *supra* note 12, Annex II, List of Working or Processing Required to Be Carried Out on Non-Originating Materials in Order that the Product Manufactured Can Obtain Originating Status, 1991 O.J. (L 229) at 149-86 [hereinafter Annex II].

[138] TREATY ESTABLISHING THE EUROPEAN ECONOMIC COMMUNITY art. 40.

[139] Lomé IV Convention, *supra* note 12, art. 168(2)(a).

Convention itself, but rather in an appendix entitled "Protocol No. 1 Concerning the Definition of the Concept of 'Originating Products' and Methods of Administrative Cooperation,"[140] Article 1 of which stipulates:

> [f]or the purpose of implementing the trade cooperation provisions of the Convention, a product shall be considered to be originating in the ACP [s]tates if it has been either wholly obtained or sufficiently worked or processed in the ACP [s]tates.[141]

Thus, two kinds of products must be distinguished: wholly obtained products and sufficiently processed products.

3.1. Wholly Obtained Products

Article 2 of Protocol Number 1, instead of giving a general definition of "wholly obtained products," enumerates ten groups of primary products which are per se considered "wholly obtained."[142] This list includes raw materials extracted in the ACP states, the European Union, or in the "countries and territories" defined in Annex III to the Lomé IV Convention[143] (hereinafter "OCT"), as well as agricultural products of the aforementioned states and products made from these raw materials and agricultural products.[144]

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[140] Protocol No. 1 to the Lomé IV Convention, 1991 O.J. (L 229) at 134-206 [hereinafter Protocol No. 1].

[141] *Id.* at art. 1.

[142] *Id.*

[143] Lomé IV Convention, *supra* note 12, Annex III. The "countries and territories" encompass the overseas territories of former European colonial powers as well as Greenland.

[144] The following products are considered to be wholly obtained in either the ACP states, the Union, or the OCT: (1) mineral products extracted from their soil or from their seabed; (2) vegetable products harvested therein; (3) live animals born and raised therein; (4) products from live animals raised therein; (5) products obtained by hunting or fishing conducted therein; (6) products of sea fishing and other products taken from the sea by their vessels; (7) products made aboard their factory ships exclusively from products referred to in (6); (8) used articles collected there qualify only as the recovery of raw materials; (9) waste and scrap resulting from manufacturing operations conducted therein; and (10) goods produced there exclusively from the products

In order to qualify for duty-free treatment, however, all wholly obtained products must be transported directly from an ACP state to the customs territory of the European Union or an OCT.[145] Goods may be transported through the territory of that state if they are under permanent control of the customs authority of that third state and if they do not undergo operations other than unloading and reloading.[146] This exception is of enormous importance for ACP states that do not have direct lines of communications with the European Union.[147]

3.2. Sufficiently Processed Products

If nonoriginating materials are used in the manufacture of a product, they must undergo sufficient working or processing before the finished product can be said to originate in the beneficiary country.[148] In order to determine whether an article can be considered a "sufficiently processed product" within the meaning of Article 3 of Protocol Number 1, a distinction must be made between those products that are listed in Annex II[149] and those that are not.

3.2.1. Products not Listed in Annex II of Protocol Number 1

With regard to products not listed in Annex II, the same basic rule of origin that applies to all preferential agreements, namely the tariff classification test, must be used. Article 3 of Protocol Number 1 provides:

> non-originating materials are considered to be sufficiently worked or processed when the product obtained is classified in a heading which is different from those in which all the non□originating materi-

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specified in (1) to (9). Protocol No. 1, *supra* note 140, art. 2(1).

[145] *Id.* art. 10(1).

[146] *Id.*

[147] NICHOLAS A. ZAIMIS, EC RULES OF ORIGIN 158-60 (1992).

[148] *Id.* at 151-52.

[149] Annex II, *supra* note 137, at 149-86.

als used in its manufacture are classified.[150]

Thus, there is neither a value-added requirement nor a double substantial transformation requirement for this category of products. A change in tariff classification, however, does not confer "originating products" status if the working or processing carried out in the ACP states, the European Union, or the OCT is insufficient.[151] Article 3(3) of Protocol Number 1 contains an exhaustive list of "insufficient working or processing" operations, including: (1) preserving products in good condition while in transport and storage; (2) sifting, screening, sorting, or classifying the articles; (3) changing the products' packaging; (4) affixing marks, labels, etc.; (5) simple mixing of products; (6) simple assembling of parts of articles to constitute a complete article; (7) a combination of two or more of the above operations; and (8) slaughtering animals.[152]

3.2.2. Products Listed in Annex II

According to Article 3 of Protocol Number 1, if a product is listed in Annex II, the basic rule of origin for preferential agreements (the tariff classification rule) is superseded by the special transformation requirements provided in the list of exceptions in Annex II.[153] This list is divided into three columns, the first and the second of which describe the products that are subject to special transformation requirements. The first column specifies the applicable customs heading of the chapter number used in the Harmonized Commodity Description and Coding System (the "Harmonized System"),[154] and the second column includes a

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[150] Protocol No. 1, *supra* note 140, art. 3(1).
[151] *Id.* art. 3(3).
[152] *Id.*
[153] *Id.* art. 3(2).
[154] The Harmonized System is an international standard of numerical tariff classification codes which is intended to make tariff nomenclature uniform throughout the world. It was drafted by the Customs Cooperation Council ("CCC") in Brussels and consists of 20 sections and 96 chapters. The chapters are further subdivided into headings and subheadings. Headings are identified by four-digit numbers, and subheadings are identified by six-digit numbers. The first two digits designate the chapter, the next two the heading and the last two

specific description of the products. For each entry in the first two columns, a separate rule of origin is specified in the third column that indicates the working or processing that must be performed on the nonoriginating product to enable the product to obtain preferential origin treatment.[155] Table 1 provides an example from Annex II.

Table 1

(1)	(2)	(3)
8546[156]	Electrical insulators of any material	Manufacture in which the value of all materials used does not exceed 40% of the ex works price of the product . . .

In the example given in Table 1, electrical insulators of any material (customs heading 8546) are considered to be "sufficiently processed," and therefore of ACP origin, only if the value of the nonoriginating materials used in the manufacture of these insulators does not exceed 40% of the "ex-works price." The ex-works price is defined as "the price paid for the product obtained to the manufacturer in whose undertaking the last working or processing is carried out, provided the price includes the value of all the materials used in manufacture . . . ."[157] Therefore, electrical insulators do not have to meet the change in tariff classification test. The only rule of origin applied to "electrical insulators of any material" is a 60% local content requirement.

The rules of origin contained in the third column differ from one product to the next. Such rules may require the use of certain materials, the implementation of specific processes, or the fulfillment of a value-added requirement.

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the subheading. *See generally* Galfand, *supra* note 23, at 489-90; Peggy Chaplin, *An Introduction to the Harmonized System*, 12 N.C. J. INT'L L. & COM. REG. 417, 426-27 (1987).

[155] *See* ZAIMIS, *supra* note 147, at 153.

[156] Annex II, *supra* note 137, at 179.

[157] Protocol No. 1, *supra* note 140, art. 3(2)(c).

There may also be restrictions on the use of certain materials or any combination of the above.[158] Table 2 contains some examples of different rules of origin:

Table 2

(1)	(2)	(3)
4909[159]	Printed or illustrated postcards; printed cards bearing personal greetings, messages or announcements, whether or not illustrated, with or without envelopes or trimmings	Manufacture from materials not classified within heading No 4909 or 4911
ex 5908[160]	Incandescent gas mantles, impregnated	Manufacture from tubular knitted gas mantle fabric
ex Chapter 75[161]	Nickel and articles thereof, except for heading Nos 7501 to 7503	Manufacture in which: -all the materials used are classified within a heading other than that of the product, and -the value of all the materials used does not exceed 50% of the ex-works price of the product

With respect to illustrated or printed postcards, the rule of origin contained in the third column not only restricts the use of certain materials, but it also specifies, though only

[158] ZAIMIS, *supra* note 147, at 153.
[159] Annex II, *supra* note 137, at 163.
[160] *Id.* at 167.
[161] *Id.* at 172.

implicitly, processing operations that are insufficient to confer preferential origin on the finished product. Consider, for example, an illustrated postcard from Taiwan that is imported into one of the ACP states where trimmings are affixed to the postcard. Under the rule of origin applicable to illustrated postcards, the finished postcards (illustrated postcard with trimmings) would not qualify for duty-free treatment because, in the manufacture of the finished postcard (customs heading 4909), an already illustrated postcard from Taiwan (also customs heading 4909) was used. Thus, the affixing of trimmings to an illustrated postcard is not a sufficient processing operation for the purposes of the Lomé IV Convention.

The rule of origin in the second row (manufacture from tubular gas mantle fabric) prescribes the use of certain materials, and the rule of origin in the third row combines a value-added requirement (50% local content) with a restriction on the use of certain materials.

3.2.2.1. The Problem of Absorption

For certain products, the special rule of origin specifies a value-added requirement. In such cases, the problem arises of whether to count the value of imported materials (processed in a beneficiary country, and then incorporated into an eligible article) in the required percentage of local content.

This "problem of absorption"[162] is expressly addressed in the introductory Note 3.4 of Annex I of the Lomé Convention, which stipulates:

> If a product made from non-originating materials which has acquired originating status during manufacture by virtue of the change of heading rule or its own list rule is used as a material in the process of manufacture of another product, then the rule applicable to the product in which it is incorporated does not apply to it.[163]

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[162] *See* ZAIMIS, *supra* note 147, at 154-55.
[163] Lomé Convention, *supra* note 12, Annex I.

Table 3 provides an example that illustrates the application of this rule:[164]

Table 3

(1)	(2)	(3)
ex 7224 7225 to 7227[165]	Semi-finished products, flat-rolled products, bars and rods, in irregularly wound coils, of other alloy steel	Manufacture from ingots or other primary forms of heading No 7224
8407[166]	Spark-ignition reciprocating or rotary internal combustion piston engines	Manufacture in which the value of all the materials used does not exceed 40% of the ex works price of the product

A spark-ignition reciprocating piston engine (customs heading 8407) is made from "other alloy steel" of customs heading ex 7224.[167] If this forging occurred in the beneficiary country from a nonoriginating ingot, then it has already acquired origin by virtue of the rule applicable to customs heading 7224 in the list. Therefore, the value of the forging can be counted toward the 60% local content requirement under the rule of origin of heading 8407.[168]

Thus, the rules of origin under the Lomé Convention "accept the principle of absorption of non[]originating value by originating products which are further used in the

[164] The example is taken from the introductory Note 3.4 of Annex I, *id.*

[165] Annex II, *supra* note 137, at 171.

[166] *Id.* at 174.

[167] *Id.* at 171.

[168] Annex I, *supra* note 163, at 145.

manufacture of other products."[169]

3.2.2.2. Insufficient Working or Processing

Even where the requirements of column three are met, products cannot be considered as originating from an ACP country if the working or processing carried out in such a country was equivalent to any one of the operations enumerated in Article 3(3) of Protocol Number 1,[170] which are considered insufficient to confer the status of originating products.[171]

3.2.2.3. Cumulation Rules

To satisfy the value-added requirement, Article 6(1) of Protocol Number 1 allows for the cumulation of value added by ACP states to a product.[172] Thus, sufficient working or processing need not take place in a single ACP country; several countries can be involved in the manufacture of a product. The essence of the rule is that the totality of the operations performed on the product in the ACP countries involved must *collectively* meet the rule of origin requirements defined in column three of the list of exceptions.[173]

Paragraphs (2) and (3) of Article 6 extend the scope of cumulation. Even if a product is wholly obtained in the European Union or in the OCT, it is regarded as originating in the ACP states if it undergoes working or processing in the ACP states.[174] The term "working and processing" as used in Article 6(2) is not the same as that used in Article 3 because the former applies to *any* working or processing carried out in the ACP states regardless of the magnitude of the operation, while the latter disallows various "simple"

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[169] ZAIMIS, *supra* note 147, at 154-55.

[170] Protocol No. 1, *supra* note 140, art. 3(3).

[171] *See supra* note 152 and accompanying text (providing a list of these insufficient operations).

[172] Specifically, this article states that "the ACP states shall be considered as being one territory [for cumulation of value purposes]." Protocol No. 1, *supra* note 140, art. 6(1).

[173] ZAIMIS, *supra* note 147, at 187.

[174] Protocol No. 1, *supra* note 140, art. 6(2).

operations.[175] These "simple" operations enumerated in Article 3(3), although too insignificant to confer originating products status under Article 3(1) and (2), still are sufficient for purposes of Article 6(2).[176]

Furthermore, Article 6(3) provides that "[w]orking and processing carried out in the [Union] or in the OCT shall be considered as having been carried out in the ACP states, when the materials undergo working or processing in the ACP states."[177] Once again, the term "working and processing," pursuant to Article 6(4),[178] includes a variety of operations, including those mentioned in Article 3(3).

These extremely generous rules of cumulation sometimes lead to unusual and anomalous results. For example, if a machine tool, designed and produced entirely in the European Union or the OCT, is shipped to an ACP state for labelling, it will obtain the origin status of the ACP state and can then be re-imported into the European Union without being subject to duties.[179]

3.2.3. Direct Importation Requirement

There is an additional requirement in the case of products to which the general preferential rule of origin (change in tariff classification) applies and also in the case of products that must satisfy the special rules of origin specified in the list of exceptions in Annex II. All of these products must be directly imported into the European Union.[180] Although goods from ACP states generally must be transported directly from an ACP state to the customs territory of the European Union, the Protocol allows the shipment to pass through the territory of a third state if the merchandise remains under close surveillance of the customs authorities of the third country.[181]

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[175] *Id.* art. 3(3).
[176] *Id.* art. 6(4).
[177] *Id.* art. 6(3).
[178] *Id.* art. 6(4).
[179] ZAIMIS, *supra* note 147, at 190.
[180] Protocol No. 1, *supra* note 140, art. 10(1).
[181] *Id.*

3.3. Compatibility of the Rules of Origin Under the Lomé Convention with the Rules of Origin Agreement

3.3.1. Clear Specification of the Headings Within the Tariff Nomenclature

The change of tariff classification test is the basic rule of origin of the Lomé IV Convention.[182] As such, under the first clearly-defined requirement of the Rules of Origin Agreement,[183] the sub-headings or headings that are addressed by the rule of origin must be clearly specified.[184] This requirement does not present a serious hurdle for the Lomé IV rule of origin. Article 3(1), which provides that materials not originating in the ACP states are sufficiently processed to profit from preferential treatment if "the product obtained is classified in a heading which is different from those in which all the nonoriginating materials used in its manufacture are classified."[185] Article 3(1) also contains a clear definition of the term "heading"[186] and expressly refers to the Harmonized Commodity Description and Coding System (the Harmonized System)[187] as a common basis for the classification of all products.[188] Thus, there is no ambiguity with respect to the headings within the Tariff nomenclature that are addressed by the rule of origin.

3.3.2. Indication of the Method for the Calculation of the Ad Valorem Percentage Criterion

Under the Rules of Origin Agreement, the method for calculating the local content percentage must be indicated

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[182] *See supra* notes 150-52 and accompanying text.
[183] Rules of Origin Agreement, *supra* note 9, at Annex II(3)(a).
[184] *Id.*
[185] Protocol No. 1, *supra* note 140, art. 3(1).
[186] *Id.* "The expression[] . . . 'headings' used in this Protocol shall mean . . . the headings (four-digit codes) used in the nomenclature which makes up the Harmonized Commodity Description and Coding System . . . ." *Id.*
[187] For a discussion of the Harmonized System, see Chaplin, *supra* note 154.
[188] Protocol No. 1, *supra* note 140, art. 3(1).

in the preferential rule of origin.[189] Article 3(2) of Protocol Number 1 gives clear guidelines concerning the calculations of added value that are valid for all cases where Annex II provides for the application of a percentage rule.[190] The general rule is that "the value added by the working or processing shall correspond to the ex-works price of the product obtained, less the customs value of third-country materials imported into the Community, an ACP [s]tate[,] or the OCT."[191] Thus, the first step in the calculation of the value added is the valuation of the third-country materials (the materials originating neither in one of the ACP states, nor in the European Union, nor in one of the OCTs) which are used in the manufacture of the finished product. The basis for this first valuation is the customs value of the third-country materials at the time of the importation of these nonoriginating materials into the territory of the ACP state concerned.[192] The meaning of the term "customs value" is the same as that laid down in the Brussels "Convention Concerning the Valuation of Goods for Customs Purposes" of December 15, 1950.[193]

The next step in the calculation of the value added is the determination of the "ex-works price." Article 3(2)(c) of Protocol Number 1 defines this term as "the price paid for the product obtained to the manufacturer in whose undertaking the last working or processing is carried out, provided the price includes the value of all the materials used in manufacture, minus any internal taxes which are,

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[189] Rules of Origin Agreement, *supra* note 9, at Annex II(3)(a).

[190] Protocol No. 1, *supra* note 140, art. 3(2)(a).

[191] *Id.*

[192] *See id.; see also* Ian S. Forrester, *EEC Customs Law: Rules of Origin and Preferential Duty Treatment*, 5 EUR. L. REV. 167, 184 (1980).

[193] Protocol No. 1, *supra* note 140, art. 3(2)(d). For purposes other than the determination of the customs value under Protocol No. 1, the basis for the determination is no longer the 1950 Brussels Convention, Convention on the Valuation of Goods for Customs Purposes, *done* Dec. 15, 1950, 171 U.N.T.S. 305. Rather, the GATT Customs Valuation Code, Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade (Relating to Customs Valuation), Apr. 12, 1979, T.I.A.S. No. 10,402, which superseded the 1950 Brussels Convention, is used. *See generally* Saul L. Sherman, *Reflections on the New Customs Valuation Code*, 12 LAW & POL'Y INT'L BUS. 119 (1980).

or may be repaid when the product obtained is exported,"[194] such as any value-added taxes. Finally, the value added is obtained by the subtraction of the customs value of the third-country materials from the ex-works price.[195] Because of this methodology, the local content tends to be higher if the manufacturer can sell at a great profit or if high fixed costs are reflected in the sales price; i.e., the higher the manufacturer's profit or fixed costs, the higher the local content.[196] Thus, the method of calculating the value added is straightforward, particularly because all important terms are clearly defined in Article 3 of Protocol Number 1.[197] Consequently, the Lomé IV Convention's preferential rules of origin also fulfill the second clearly-defined requirement of the Rules of Origin Agreement, the indication of the method for calculating the *ad valorem* percentage.[198]

3.3.3. Adequate Description of the Manufacturing or Processing Operation Conferring Preferential Treatment

Finally, the Lomé IV Convention's preferential rules of origin must specify the manufacturing or processing operation which confers preferential origin if the criterion of manufacturing or processing operation is prescribed.[199] This requirement only concerns products that are contained in the list of exceptions in Annex II of Protocol Number 1 because, pursuant to Article 3(2) of Protocol Number 1, all other products are subject to the change of tariff classification criterion.[200] The third column of the list of exceptions contained in Annex II of Protocol No. 1 indicates the processing operation that must be performed in order to

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[194] Protocol No. 1, *supra* note 140, art. 3(2)(c).
[195] *Id.* art. 3(2)(a).
[196] *See, e.g.*, Forrester, *supra* note 192, at 184.
[197] Problems in the determination of the value added arise if the manufacturer sells at different prices to different customers because, in such a case, there is no uniform ex-works price. *See* Forrester, *supra* note 192, at 184-85.
[198] Rules of Origin Agreement, *supra* note 9, at Annex II(3)(a).
[199] *Id.*
[200] *See supra* section 3.2.1.

make the product eligible for preferential treatment.[201] Because every product is assigned a specific manufacturing operation, which is described in a detailed manner in the third column of the list of exceptions, there should be no doubt regarding which processing operations must be carried out to confer preferential origin upon the product.

Therefore, the Lomé IV rules of origin meet all the clearly-defined requirements and are thus in compliance with the Rules of Origin Agreement.

4. CONCLUSION

Although both CBERA and the Lomé IV Convention aim to increase the importation of products from certain developing beneficiary countries into the United States and the European Union respectively, their rules of origin differ considerably. Both regimes contain a direct importation requirement, and both the CBI and the Lomé IV Convention allow the cumulation of value added among all the CBI countries and the ACP countries. A striking difference, however, is that under CBERA the same rule of origin (substantial transformation plus 35% local content requirement) is applied to all imports without exception, while under the Lomé IV Convention the general rule of origin (change in tariff classification) is applied only if a product is not enumerated in the list of exceptions in Annex II. Thus, the European method is product specific, with virtually hundreds of different rules of origin, prompting one commentator to say that European Union "rules of origin are at best complicated and at worst almost unfathomable."[202]

This great number of rules of origin would seem to make the European system more complex for importers,[203] but in fact the contrary is true. Both the lucid general rule of origin (the change in tariff classification test) and the special rules of origin assigned to each product under the list of exceptions provide for highly predictable customs and

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[201] *See supra* note 155 and accompanying text.

[202] MCGOVERN, *supra* note 6, § 4.43.

[203] *Cf.* Forrester, *supra* note 192, at 185 (noting significant differences in the rules of origin used).

list of exceptions provide for highly predictable customs and court decisions. Thus, the rules of origin set forth in Protocol Number 1 to the Lomé IV Convention are "clearly defined" within the meaning of the Uruguay Agreement on Rules of Origin. What makes the application of European Union rules so complicated is not that they are incredibly difficult, but rather that a different set of rules exists for every purpose.[204] Therefore, the Lomé IV Convention contains rules of origin which differ from the rules of origin under the GSP[205] which, in turn, differ from the rules under the cooperation agreements with the Caribbean countries. Finally, each of these preferential rules of origin has little in common with the general rule of origin of Council Regulation 802/68.[206] This fact, however, does not alter the observation that the rules of origin under the Lomé IV Convention are clearly defined.

The same statement cannot be made regarding the U.S. rules of origin that apply to products imported from CBI states. Because the courts do not use the substantial transformation test in a uniform manner, and because they inconsistently apply the various criteria for a substantial transformation, the U.S. Customs Service has almost complete discretion in making substantial transformation decisions.[207] This arrangement has caused considerable confusion among importers.[208] As one commentator explained, "[t]he only consistency is a policy that results either in higher duties or in fewer imports."[209] It is therefore nearly impossible to forecast the decisions the U.S. Customs Service or the courts will make because the decisional criteria may be mixed, their respective weights may be reapportioned, and the decisions themselves may sometimes be disregarded entirely.[210] As one court sug-

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[204] See MCGOVERN, *supra* note 6, § 4.43, for a discussion of the complexities introduced by special rules.

[205] *Cf.* GRABITZ ET AL., *supra* note 6, at 124 (discussing differences between the two sets of rules, such as their differential treatment of minimal product alteration).

[206] Council Regulation 802/68, 1968 J.O. (L 148) 1.

[207] Davis, *supra* note 131, at 506.

[208] Maxwell, *supra* note 30, at 676.

[209] Palmeter, *Commentary, supra* note 1, at 4.

[210] *See* Galfand, *supra* note 23, at 488-89.

gested, this lack of predictability may be a result of the fact that "cases dealing with substantial transformations are very product specific and are often distinguishable on that basis, rather than by their statutory underpinnings."[211] This holds true even though some courts base their deviations from precedent on different interpretations of statutory purposes.[212]

The United States will have to change its rule of origin under CBERA (as well as under other preferential trade régimes) to comply with its obligations under the Rules of Origin Agreement. Nevertheless, the United States may freely choose which rule of origin will replace the substantial transformation test. Commentators,[213] as well as the Clinton Administration, already have made proposals for a new more predictable and clearer rule of origin that would remove most or all of the uncertainties in the application of the substantial transformation test. In its Standardization Report, the ITC suggests a uniform rule of origin based on economically justifiable or commonly employed processes for a product.[214] For CBI purposes, this means that CBI origin would be conferred on the product if, in one of the CBI countries, it underwent one of the enumerated or economically justified processing operations for the product in question.[215] It may be questioned, however, whether it is possible to draft a list of processes that is comprehensive enough to cover all products that are traded internationally at the present time or all products that will be traded internationally in the future.[216] Moreover, such a list rapidly can rapidly rendered obsolete by the development of new manufacturing processes.[217]

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[211] Superior Wire v. United States, 669 F. Supp. 472, 479 (Ct. Int'l Trade 1987).

[212] *See supra* section 2.1.1.

[213] *See, e.g.*, Palmeter, *Monotheism, supra* note 8, at 25.

[214] STANDARDIZATION REPORT, *supra* note 134, at 22-23.

[215] *Id.*

[216] Davis, *supra* note 131, at 506-07.

[217] *See* Palmeter, *Monotheism, supra* note 8, at 27. *But see* Asakura, *supra* note 5, at 11 ("As regards the updating of exception lists to keep them abreast of technical developments and economic conditions, this is a normal administrative effort to be applied to every law and regulation.").

A more practical solution may be a rule of origin based solely on the change of tariff classification test.[218] This choice could lead to shortcomings in the case of assembly-oriented products, however, because insignificant assembly operations may still cause a change in tariff classification.[219] Furthermore, the tariff nomenclatures such as the Harmonized System were not designed with origin determinations in mind,[220] and therefore the application of the change of tariff classification criterion alone could sometimes lead to arbitrary results.[221] The best system, therefore, appears to be a combination of the two rules of origin which are currently found in the Lomé IV Convention.

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[218] *See, e.g.*, Galfand, *supra* note 23, at 491-92.
[219] STANDARDIZATION REPORT, *supra* note 134, at 19.
[220] *See* Palmeter, *Monotheism, supra* note 8, at 26.
[221] *But see* Asakura, *supra* note 5, at 12 ("[T]he Harmonized System would be suitable for use for origin purposes.").