10-1-1995

Learning from Computers: The Future of the Free Trade Area of the Americas

David A. Pawlak

LEARNING FROM COMPUTERS: THE FUTURE OF THE FREE TRADE AREA OF THE AMERICAS

DAVID A. PAWLAK*

---

* Joint-degree candidate at the University of Pittsburgh School of Law and Graduate School of Public & International Affairs. The author is also pursuing the Graduate Certificate Program offered through the University of Pittsburgh's Center for Latin American Studies and will graduate in May 1996. This article received the 1995 Raquel Kersten Professional Research Award for "Best Paper" at the North Central Council of Latin Americanists' November 1995 annual conference and also received the 1995 Outstanding Graduate Student Paper Award from the University of Pittsburgh's Center for Latin American Studies. The author warmly acknowledges the support of the Ivan Santa Cruz Memorial Award which facilitated completion of this project. The author also expresses his gratitude to Professor Ronald Brand of the University of Pittsburgh School of Law for his support and inspiration for this and other projects.

> Surely unity is what we need to complete our work of regeneration . . . It is *union*, obviously; but such union will come about through sensible planning and well-directed actions rather than by divine magic.[1]
>
> *Simón Bolívar*, September 6, 1815

I. INTRODUCTION

Simón Bolívar's declaration nearly two-centuries ago remains prophetic. Unity, this time in the form of the Free Trade Area of the Americas[2] (FTAA), will come about only through the sensible planning and well-directed actions of the leaders who attended the Summit of the Americas in Miami, Florida on December 9-10, 1994.[3] Central among the obstacles faced in attempting to integrate the national economies in the region and establish the FTAA is a workable origin rule.[4] Origin rules are used to determine which goods traded among members of a free trade area are granted preferential tariff treatment.

A review of the problems associated with country of origin determinations might suggest to those who are skeptical of the

---

1. Simón Bolívar, Carta de Jamaica (Sept. 6, 1815), *reprinted in* SIMÓN BOLÍVAR: THE HOPE OF THE UNIVERSE 115 (Arturo Uslar Pietri ed., 1983).

2. Although a number of names have been used for the latest integration effort, U.S. Trade Representative Mickey Kantor eliminated alternatives such as the Western Hemisphere Free Trade Area and America's Free Trade Area during the December 1994 Summit of the Americas. "We have a number of acronyms that fly around. What everyone agreed to unanimously is Free Trade Area of the Americas, which I think is quite appropriate." *Summit of the Americas: Press Conference with U.S. Trade Representative Mickey Kantor,* Federal News Service, Dec. 10, 1994, *available in* LEXIS, Legis Library, Curnws File. For a further discussion of the Summit of the Americas, see *infra* notes 59-60 and accompanying text.

3. The Declaration of Principles that was issued following the Summit stated that the leaders who attended the meeting will work toward the implementation of the Free Trade Area of the Americas, which will create a hemispheric free trade area. *See* U.S. GOV'T, SUMMIT OF THE AMERICAS, DECLARATION OF PRINCIPLES AND PLAN OF ACTION (Dec. 11, 1994), *reprinted in* Daily Report for Executives, Dec. 13, 1994 *available in* LEXIS, News Library, Curnws File. For further discussion of the Summit of the Americas, see *infra* notes 59-60 and accompanying text.

4. *See, e.g., Chile & G3: The Group of Three (Mexico, Colombia, and Venezuela) might soon become the Group of Four,* Latin American Regional Reports: Mexico & NAFTA Report, April 21, 1994, *available in* LEXIS, News Library, Lan File RM-94-04 (identifying lack of agreement between Colombia, Venezuela, and Mexico on the rules of origin as the obstacle to implementation of the G3 accord).

likelihood of an FTAA that "divine magic" is the only possibility to achieve integration in the Americas. This article is premised on an alternative view. It provides a "sensible plan" and suggests some "well-directed actions" for Bolívar's successors in *their* quest for economic integration in the Americas.

II. A SAMPLING OF THE ORIGIN RULE PROBLEM: THE HONDA CASE

The Honda case was essentially a set of rulings by the U.S. Customs Service issued during an audit of Honda's North American operations.[5] The controversy arose out of the tariff treatment of Honda Civics and their component parts under the Canada-United States Free Trade Agreement[6] (FTA). Following the audit of Honda's operations, U.S. Customs issued a retroactive multimillion-dollar invoice to Honda Motor Company for tariffs that the agency said should have been paid on Civics shipped from Canada to the United States. This action by U.S. Customs generated substantial controversy. For some, the Honda case even promoted doubts about the FTA as a whole.[7] A review of the facts of the case helps to explain those reactions and exemplifies the difficulties created by the rules which governed country of origin determinations under the Canada-U.S. FTA.

Honda was the first of the Japanese automobile companies to establish "transplants" in the United States; the automaker began manufacturing automobile engines in Marysville, Ohio in 1982.[8] The Ohio-built engines, the eventual focal point of the controversy, were produced using U.S. and Japanese inputs. Honda of America then shipped the finished engines from Ohio to a Honda plant in Ontario, Canada where they were incorporated into the finished product, Honda Civics. Honda of Canada shipped the overwhelming majority of the Civics to the United

---

5. U.S. Customs Internal Advice Rulings HQ 000112 (Nov. 14, 1991); HQ 000116 (Nov. 14, 1991); HQ 544833 (Dec. 3, 1991); HQ 544834 (Dec. 3, 1991); HQ 000131 (Dec. 12, 1991); HQ 000155 (Feb. 10, 1992); HQ 000160 (Feb. 27, 1992); HQ 000161 (Feb. 27, 1992). For the details of Honda's operations which are not clear from the rulings, see, e.g., Frederic P. Cantin & Andreas F. Lowenfeld, *Rules of Origin, The Canada-U.S. FTA, and the Honda Case,* 87 A.J.I.L. 375, 379-83 (1993).

6. Free Trade Agreement, Dec. 22-23, 1987 and Jan. 2, 1988, Can.-U.S., 27 I.L.M. 281 (entered into force in Jan. 1, 1989) [hereinafter Canada-U.S. FTA].

7. Cantin & Lowenfeld, *supra* note 5, at 385.

8. *Id.* at 379.

States for sale.[9]

Under the FTA rules of origin, Honda of Canada treated the engines imported from Ohio to the Canadian plant for incorporation in the Honda Civics as goods which qualified for preferential tariff treatment. Similarly, Honda of America claimed duty-free treatment for the Civics that were assembled in Canada that it imported for sale in the United States. Both of Honda's claims were based on the automaker's interpretation of the FTA origin rules. Honda treated the engines as products of U.S. origin even though the Ohio-built engines included Japanese components. According to Honda, the sum of U.S. origin components of each engine and the direct costs of processing in the U.S. amounted to more than fifty percent of the total engine value,[10] and therefore, the engines satisfied the fifty percent North American value content requirement imposed by the FTA.[11] U.S. Customs agreed that the engines qualified as goods originating in North America under the FTA origin rules.

The disagreement was over the North American value content calculation of the finished automobiles — the Civics assembled in Canada using the Ohio-built engines. U.S. Customs disagreed with Honda's inclusion of 100% of the value of the engines in the total North American value content calculation for the Civics that were shipped to the United States. In calculating the value content of the automobiles assembled in Canada, Honda had employed the roll-up[12] rule and included 100% of the value of the engines. Doing so enabled Honda to assert that the total North American value content of the Civics exported from Canada to the U.S. was greater than the fifty percent minimum required for duty-free treatment.[13]

When the FTA was implemented, the U.S. and Canada did not establish a means to ensure uniformity in the interpretation of the rules of origin. As a result, the Canadian and U.S. govern-

---

9. *Id.* at 380.

10. David Palmeter, *Rules of Origin in the United States*, *in* RULES OF ORIGIN IN INTERNATIONAL TRADE: A COMPARATIVE STUDY 27, 69 (Edwin Vermulst et al. eds., 1994).

11. Canada-U.S. FTA, *supra* note 6, art. 401(2), (4), implemented by United States-Canada Free Trade Agreement Implementation Act of 1988, 19 U.S.C. § 2112 (1988) [hereinafter U.S.-Canada FTA Implementation Act].

12. For a discussion of roll-up, see *infra* part VIII.A.2.a.

13. Canada-U.S. FTA, *supra* note 6, art 401(2), (4).

ments became embroiled in a dispute over the Honda case. U.S. Customs and its Canadian counterpart, Revenue Canada, reached opposite conclusions regarding the interpretation of the FTA origin rules and the corresponding tariff treatment of the Civics. Revenue Canada, like Honda Motor Company, treated virtually all of the engines manufactured in Ohio and incorporated into the Civics in Ontario as qualifying for duty-free entry into Canada under the FTA.[14] While the U.S. Customs Service agreed, it held that Honda could *not* count 100% of the value of the Ohio-built engines imported into Canada for inclusion in the Civics in the calculation of the North American value content of the Civics. Rather, using the roll-down[15] rule, U.S. Customs treated the engines as having *zero* North American content.[16] Thus, when U.S. Customs excluded the value of the engines from the value content calculation, the Civics shipped to the U.S. from Canada did not meet the fifty percent value content requirement.[17] Consequently, the U.S. Customs Service charged Honda $17 million for the 2.5% *ad valorem* back tariffs on Civics exported from Canada to the United States.[18] Canada supported Honda in its bid for tariff-free treatment for the Civics assembled in Canada, and the U.S. challenged Honda's claims. Eventually, the controversy grew political with the Canadian Government and Honda pitted against the U.S. Customs Service. Canada invoked the FTA dispute resolution procedure, but this did not result in the creation of a panel nor go beyond the consultation stage.[19] Because North American Free Trade Agreement[20] (NAFTA) negotiations were nearly complete, the

---

14. *See* Cantin & Lowenfeld, *supra* note 5, at 381.

15. For a discussion of roll down, see *infra* part VIII.A.2.b.

16. U.S. Customs Internal Advice Ruling HQ 000131 (Dec. 12, 1991). David Palmeter criticized the U.S. Customs' exclusion of the Ohio-built engines from the value content calculation of the Civics, calling the legal analysis "less than convincing" and "absurd." Palmeter, *supra* note 10, at 70-71. Others described the analysis as incomprehensible and suggested that the decision might have been politicized because it involved Honda, the Japanese automaker with the largest transplant presence in the United States. *See* Cantin & Lowenfeld, *supra* note 5, at 380. Had Customs given credit for even the clearly North American content of the engines that were used in the assembly of the Civics, the cars would have satisfied the fifty percent regional value content requirement of the FTA. *Id.* at 382.

17. Canada-U.S. FTA, *supra* note 6, art. 401(2), (4).

18. Cantin & Lowenfeld, *supra* note 5, at 381.

19. *Id.* at 385.

20. North American Free Trade Agreement, Dec. 17, 1992 Can.-U.S.-Mexico, 32 I.L.M. 296 and 32 I.L.M. 605 [hereinafter NAFTA].

U.S. and Canada consented to allow the negotiations to clarify the rules of origin and resolve the Honda dispute.[21]

The Honda case provides but one example of the types of problems created by rules of origin for the signatories to a trade accord like the Canada-U.S. FTA. Lengthy and costly audits are ordinarily required when trade accords incorporate origin rules based on value added requirements. In addition, regional value content requirements make country of origin determinations unpredictable due to fluctuations in input prices and exchange rates. As the Honda case demonstrates, the lack of uniformity in interpretation of origin rules creates further uncertainty. In sum, the FTA rules failed to achieve the predictability that those involved in international business transactions generally hold dear, created unnecessary costs and administrative burdens, and hampered the FTA objectives to liberalize trade and draw the U.S. and Canada into a closer economic relationship.

The experience of the U.S. and Canada in interpreting and applying the FTA origin rules demonstrates the substantial technical obstacles to the implementation of an FTAA. Origin rule problems not only threaten existing trade accords between close trading partners like Canada and the United States, but also have stalled recent initiatives undertaken by South American countries to negotiate and implement economic integration.[22] Notably, the differences in values, legal traditions, and levels of economic development between the U.S. and the countries of Latin America are greater than the differences be-

---

21. Cantin & Lowenfeld, *supra* note 5, at 385. According to Gary Hufbauer and Jeffrey Schott, the Honda dispute was settled to Canada's satisfaction. The new NAFTA origin rules will apply to all Honda imports that have not undergone a final determination by U.S. Customs as to duties owed. GARY C. HUFBAUER & JEFFREY J. SCHOTT, NORTH AMERICAN FREE TRADE: AN ASSESSMENT 41 (1993). As of February 1993, the dispute over those Honda Civics that had not undergone Customs' final determination remained to be resolved by a binational panel. Former trade representative Carla Hills, however, recommended that the NAFTA's implementing legislation make clear that the NAFTA origin rules apply to on-going disputes like the Honda case. *Id.* at 41 n.11.

22. According to Juan Echavarria, the number two ranking member of the Colombian foreign trade ministry, "[t]he G3 was a regional axis which had visions of creating a hemispheric free-trade zone." *Chile & G3: The Group of Three (Mexico, Colombia, and Venezuela) might soon become the Group of Four, supra* note 4. However, "the G3 has yet to achieve free trade between its three members even though this was supposed to be done by the beginning of January [1994]. The three could not reach a final agreement on rules of origin." *Id.*

tween the U.S. and Canada in those areas. It will be difficult for the national governments of the countries of North and South America to agree upon a workable set of rules to govern country of origin determinations. The leaders in the region must learn from the mistakes that were made and the precedents that were set in formulating the origin rules embodied in the trade agreements like the FTA and the NAFTA, which are essentially precursors to the FTAA.[23] By doing so, Simón Bolívar's successors will not need to look too far for a means to eliminate a major obstacle to the creation of the FTAA. An innovative solution to the origin rule problem can be found in the NAFTA itself.

III. INTRODUCING THE SOLUTION: THE NAFTA COMPUTER RULE

The NAFTA negotiators established two favorable precedents regarding rules of origin. First, they sought to overcome the problems presented by the Canada-U.S. FTA origin rules when they formulated the NAFTA origin rules.[24] In doing so, the negotiators established a constructive *methodological* precedent. Despite the fact that the rules that were agreed upon have been termed "tools of discrimination" and identified as the "main area where the NAFTA is open to criticism,"[25] it is a positive step that the NAFTA negotiators at least attempted to learn from the problems that arose out of the operation of the FTA origin rules. The FTAA negotiators must build on this methodological precedent.

More important than the methodological precedent, the adoption of the NAFTA origin rules created a constructive substantive precedent. In one of the NAFTA's most unique provi-

---

23. *See infra* notes 28, 33, 62 and accompanying text (discussing the NAFTA as the forerunner to a hemisphere-wide free trade area).

24. According to John P. Simpson, the NAFTA rules were a product of a learning process. "We are learning some of these lessons from our audits of companies doing business under the FTA. We are benefitting from this experience and we are applying the lessons we are learning both to seek modifications to our free trade agreement with Canada and to devise improved rules for the NAFTA." *Enforcing Rules of Origin Requirements under the United States-Canada Free Trade Agreement, 1991: Hearing before the Comm. on Finance of the U.S. Senate*, 102d Cong., 1st Sess. 37 (1991) (prepared statement of John P. Simpson, Deputy Assistant Secretary for Regulatory, Tariff, and Trade Enforcement, U.S. Dep't of the Treasury) [hereinafter Simpson Statement]. *See also* 139 Cong. Rec. S16096 (Nov. 18, 1993) (committee statements on the NAFTA).

25. HUFBAUER & SCHOTT, *supra* note 21, at 5.

sions, Canada, Mexico, and the U.S. will harmonize their external tariffs on computers and related goods.[26] Duties will be payable only upon entry into the NAFTA territory once the NAFTA signatories harmonize their respective tariff rates for such goods downward to the lowest most-favored-nation rate assessed by any NAFTA signatory. Within the NAFTA territory, traders may ship computers and related goods between Canada, Mexico, and the United States without payment of duties. In effect, computers receive "common market treatment" under the NAFTA provisions.[27]

Government trade representatives throughout the Americas can eliminate the complications associated with origin determinations by relying on the innovative computer rule example. Upon each NAFTA accession on the way to the establishment of the FTAA,[28] negotiators can make it more like a customs union than a free trade area. Thus, the FTAA may become a reality in which many goods, if not all, receive common market treatment when traded within the Americas. In short, the 1992 NAFTA is for the Americas "akin to" the European Community's 1957 Treaty of Rome.[29]

---

26. *See* NAFTA, *supra* note 20, vol. 1, pt. 2, ch. 3, art. 308 & Annex 308.1, Most-Favored-Nation Rates of Duty on Certain Automatic Data Processing Goods and Their Parts. *See infra* note 176 for the text of art. 308 and Annex 308.1.

27. *See, e.g.*, General Agreement on Tariffs and Trade, *opened for signature* Oct. 30, 1947, art. XXIV, paras. 4 & 8, 61 Stat. pts. 5 & 6, T.I.A.S. No. 1700, 55 U.N.T.S. 187, *reprinted in* IV GATT, BASIC INSTRUMENTS AND SELECTED DOCUMENTS 1-78 (1969) [hereinafter GATT] (art. XXIV discusses circumstances under which a regional trading bloc, in the form of a customs union or a free trade area, is permissible even though contrary to the most-favored-nation principle of art. I).

28. According to Ann Hughes, U.S. Deputy Secretary of Commerce for the Western Hemisphere, "[w]hile recent indications are that the United States will endorse a 'building block' approach at the summit, including NAFTA accession for Chile . . . the matter was still under discussion and . . . the countries had not come to a final decision. The building block approach envisions that some countries, such as Chile, may be ready to assume NAFTA obligations, while other less developed countries may be ready for other types of arrangements." *NAFTA Commerce Official Hopes for Agreement at Summit Endorsing NAFTA Accession*, INT'L TRADE DAILY (BNA), November 22, 1994, *available in* LEXIS, Intlaw Library, Bnaitd File [hereinafter *NAFTA Accession*]. The fact that Chile began formal negotiations to accede to the NAFTA in June, 1995 suggests that the U.S. will pursue the building block approach towards free trade in the Americas. However, the Summit of the America's Declaration of Principles does not mention enlargement of the NAFTA. *See* U.S. GOV'T, SUMMIT OF THE AMERICAS, DECLARATION OF PRINCIPLES AND PLAN OF ACTION, *supra* note 3.

29. According to Hufbauer and Schott, "the NAFTA for North America is akin to the Treaty of Rome," signed in 1957 to establish the European Economic Commu-

IV. THE PURPOSES AND STRUCTURE OF THIS ARTICLE

While many discussions regarding free trade in the Americas are politically or ideologically oriented,[30] this Article focuses on a technical issue of free trade implementation, or the mechanics of integration; the purpose is to examine an issue that threatens current economic integration initiatives. Specifically, this Article reviews the problems presented by rules of origin and identifies a rule for use in the FTAA. Following a presentation in Part V of a brief history of integration efforts in the Americas, Part VI elaborates on the purpose of rules of origin and the growing challenges that they present for negotiators who must formulate the FTAA rules. Part VII describes several failed initiatives undertaken nationally and internationally to create a standard rule of origin. In order to provide a context-specific understanding of rules of origin, Part VIII describes the operation of the rules of origin in both the Canada-U.S. FTA and the NAFTA, two preferential trading arrangements that are essentially forerunners of the FTAA. Part VIII.B.4 describes the NAFTA rule of origin for computers in detail and elaborates on the benefits of its use in the formation of an FTAA for members and non-members alike.

In conclusion, the Article recommends an extension of the measures embodied in NAFTA's Article 308 and Annex 308.1, which provide for the eventual imposition of a common external tariff (CET) for computers and related goods.[31] Each NAFTA enlargement[32] provides an opportunity for national leaders in the region to demonstrate that they have learned from the NAFTA computer rule example. The piece-meal imposition of a CET is a sensible plan and a well-directed action that will en-

---

nity. HUFBAUER & SCHOTT, *supra* note 21, at 9 n.7. Although Hufbauer and Schott identify a parallel between the NAFTA and the Treaty of Rome, they distinguish the two. The goal of the NAFTA is a free trade area with minimal supranational infrastructure, while the objective of the Treaty of Rome was the creation of a common market with an extensive institutional infrastructure. *Id.*

30. *See generally* Howard Wiarda, *The Domestic Politics of the North American Free Trade Agreement*, *in* 3:12 CSIS POLICY PAPERS ON THE AMERICAS (1992) (identifying various stakeholders in the NAFTA and their arguments for or against the Agreement).

31. NAFTA, *supra* note 20, art. 308 & Annex 308.1.

32. For a discussion of Chile's pending accession to the NAFTA, see *infra* notes 61-64, 190-91 and accompanying text.

able benefits to accrue to the people of the Americas on the order of those benefits sought by Simón Bolívar in his quest to unify the region nearly two centuries ago.

V. A BRIEF HISTORY OF INTEGRATION EFFORTS IN THE AMERICAS

A. *Early Integration Efforts*

The efforts of Simón Bolívar in the early 1800s were among the first attempts to integrate the Americas.[33] However, "as Latin America's 'Liberator' lay dying . . . he mourned his dream for 'the Americas,' a land whose future he feared would be dim and precarious unless he could forge a single republic from its stubborn mosaic."[34] More than 150 years later, Bolívar is regarded as one of Latin America's great heroes, but the six countries that consider him their founding father have developed distinct identities. Bolívar's inability to unify the Americas has been followed by other unsuccessful attempts to achieve similar goals.

B. *Latin American Free Trade Association (LAFTA, 1960)*

In 1960, seven Latin American countries signed the Montevideo Treaty establishing the Latin American Free Trade Association (LAFTA).[35] The LAFTA members planned to reduce tar-

---

33. At the NAFTA signing ceremony, held at the Washington, D.C. headquarters of the Organization of American States on December 17, 1992, President Bush acknowledged the efforts of Simón Bolívar: "Simón Bolívar, the Liberator whose statue stands outside this hall, spoke about an America united in heart, subject to one law and guided by the torch of liberty. My friends, here in this hemisphere we are on the way to realizing Simón Bolívar's dream. And, today, with the signing of the North American Free Trade Agreement, we take another step toward making the dream a reality." Signing of the North American Free Trade Agreement, DEP'T ST. DISPATCH, Jan. 4, 1993. *See generally* GABRIEL GARCIA MARQUEZ, THE GENERAL IN HIS LABYRINTH (Edith Grossman trans., 1990) (a novel based on Bolívar's quest and his ultimate failure to unify South America).

34. Marie Arana-Ward, *A Turn in the South*, WASH. POST, Feb. 7, 1993, (Book World), at X5 (reviewing PETER WINN, THE CHANGING FACE OF LATIN AMERICA AND THE CARIBBEAN (1993)).

35. Montevideo Treaty, Instrument Establishing the Latin American Free Trade Association, Feb. 18, 1960. Originally, Argentina, Brazil, Chile, Mexico, Paraguay, Peru, and Uruguay formed the LAFTA. Later, they were joined by Colombia and

iffs on the goods of contracting states annually until 1972, at which time tariffs on goods traded among member states were to be eliminated.[36] The LAFTA was intended to lead to a Latin American Common Market, but it failed to achieve even its less ambitious goals of gradual trade liberalization and a regional economic integration program. LAFTA's lack of success prompted a reassessment which resulted in a new initiative in 1980.

C. Latin American Integration Association (LAIA, 1980)

In 1980, a new Montevideo Treaty replaced the LAFTA with the Latin American Integration Association (LAIA).[37] The LAIA differs from the LAFTA in that the earlier treaty established a goal to achieve economic integration within twelve years. Although the LAIA maintains the ultimate goal of the formation of a Latin American Common Market, the agreement does not include a deadline for this achievement.[38] The 1980 Treaty established a framework for negotiating bilateral trade accords that could be progressively multilateralized.[39] Thus, the LAIA

Ecuador.

36. *Id.*

37. Montevideo Treaty, Instrument Establishing the Latin American Integration Association, Aug. 12, 1980. The eleven Latin American member states are Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Mexico, Paraguay, Peru, Uruguay, and Venezuela. There are four observer organizations: the Inter-American Development Bank (IDB), Economic Commission for Latin America and the Caribbean (ECLAC), the Organization of American States (OAS), and the European Community (EC).

38. *Id.* arts. I & III(b).

39. Each of the several accords negotiated under the Latin American Integration Association (LAIA) framework adheres to a single origin regime, which is embodied in Resolution 78, adopted by the LAIA Committee of Representatives in 1987. Establecimiento del Régimen General de Origen, Asociación Latinoamericana de Integración ALADI/CR/Res. 78, Nov. 24, 1987. The Chile-Mexico Free Trade Agreement provides a sample of the language used in the individual agreements negotiated under the LAIA framework:

> The signatory countries shall apply to the imports sold under the protection of the Liberalization Program of the present Agreement, the General Origin Regime of the ALADI, established by Resolution 78 of the Committee of Representatives of the Association, unimpaired by the specific requirements fixed by the Administrative Commission referred to in Article 34 of the present Agreement.

Economic Complementation Agreement between Chile and Mexico, *done* Sept. 21, 1991, art. 10 (trans. by author). Each of the other agreements formed under the LAIA share similar language establishing Resolution 78 as their basic origin regime. *See, e.g.,* Acuerdo de Complementación para el Establecimiento de un Espacio Económico Ampliado entre Chile y Ecuador, *done in* Quito, Ecuador, December 20,

embraced more realistic expectations than those embodied in the LAFTA. Although the LAFTA was unsuccessful and the LAIA has yet to achieve its goal of a common market, national leaders continue to strive for integration. Recent efforts, including some initiated by the United States, hold greater promise than those of the past.

D. The Enterprise for the Americas Initiative (EAI, 1990)

On June 27, 1990, President George Bush announced the Enterprise for the Americas Initiative.[40] The Bush Administration's ultimate objective for the Initiative was the execution of a framework agreement that would lead to hemispheric free trade.[41] As a first step, the Bush program sought to increase capital flow to those Latin American countries that were willing to liberalize their trade and investment regimes. Debt reduction was another element.[42] The Initiative delineated a list of preconditions which were labeled "indicators of readiness" for a formal free trade agreement with the United States: (1) the economic and institutional capacity to fulfill long-term, serious commitments; (2) a stable macroeconomic environment and market-oriented policies; (3) progress in achieving open trade regimes; and (4) membership in the General Agreement on Tariffs and Trade.[43] These preconditions laid the foundation for yet another regional integration endeavor.

E. The North American Free Trade Agreement (NAFTA, 1994)

Upon completion of the NAFTA negotiations on August 12, 1992, the Bush Administration claimed to have created the "largest market in the world, with 360 million consumers and $6 trillion in annual output."[44] Indeed, the NAFTA "is the most

---

1994, art. 7.

40. United States: Remarks on the Enterprise for the Americas Initiative, June 27, 1990 and September 14, 1990, 29 I.L.M. 1566 (1990).

41. *Id.* at 1567.

42. *Id.*

43. Gary C. Hufbauer & Jeffrey J. Schott, *Free Trade Areas, the Enterprise for the Americas Initiative, and the Multilateral Trading System, in* STRATEGIC OPTIONS FOR LATIN AMERICA IN THE TWENTIETH CENTURY 250-60 (Colin Bradford ed., 1990).

44. U.S. Dep't Comm., *The North American Free Trade Agreement: America's*

comprehensive free trade pact (short of a common market) ever negotiated between regional trading partners . . . ."[45] The accord is unprecedented not only in terms of its size and comprehensiveness, but also in that it establishes free trade between two developed countries, Canada and the U.S., and a developing country, Mexico.[46] The trilateral accord requires Mexico to implement a level of trade and investment liberalization equal to that already agreed to by Canada and the United States in their bilateral accord of 1988.[47] Thus, the NAFTA includes many of the provisions of the Canada-U.S. FTA.

NAFTA implementation began on January 1, 1994 and within ten years will eliminate tariff and most non-tariff barriers to regional trade.[48] Implementation is not free of complications. The rules of origin created problems due to their complexity. In fact, trade slowed as a result of the obstacles presented by the rules of origin.[49] Thus, while in some areas the NAFTA represents a new, improved and expanded version of the Canada-U.S. FTA,[50] the Agreement's problems must be resolved if its expansion is to become an effective vehicle for the establishment of the FTAA.[51]

Competitive Future, BUS. AM., Oct. 19, 1992, at 2.

45. HUFBAUER & SCHOTT, *supra* note 21, at 1. For a brief comparison of the NAFTA and the European Economic Community, see *supra* note 29.

46. GARY C. HUFBAUER & JEFFREY J. SCHOTT, NORTH AMERICAN FREE TRADE: ISSUES AND RECOMMENDATIONS 10 (1992). NAFTA is also one of only three post-war period *trilateral* regional free trade agreements. The first agreement was between the BENELUX countries (Belgium, the Netherlands, and Luxembourg), which was consumed by the formation of the European Economic Community. Kenya, Uganda, and Tanzania established the other trilateral FTA in 1967; the East African Community (EAC) failed by 1977. *Id.* at 23 n.1.

47. *See* HUFBAUER & SCHOTT, *supra* note 21, at 2 (discussing the similarity of the bilateral Canada-U.S. FTA of 1988 and the trilateral NAFTA of 1992).

48. *See* NAFTA, *supra* note 20.

49. *See NAFTA Accession*, *supra* note 28. *See also* Ken Cottrill, *Short-term Pain for Long Term Gain; Rules of Origin Regulations*; NAFTA/GATT, Global Trade & Transportation, June 1994, *available in* LEXIS, News Library, Curnws File, ISSN: 1069-2843.

50. HUFBAUER & SCHOTT, *supra* note 21, at 2.

51. For a brief discussion of using the NAFTA as a building block in the creation of the FTAA, see *supra* note 28.

F. The Summit of the Americas and Chile's Accession to the NAFTA

In December 1993, Vice President Al Gore affirmed the Clinton Administration's commitment to U.S. plans for hemispheric integration that President Bush originally initiated with the EAI. During a trip to Mexico, Vice President Gore proposed a meeting of all the leaders of the Western Hemisphere.[52] A few months later, the Clinton Administration confirmed its plan to establish a Western Hemisphere Free Trade Zone in ten to fifteen years. The Administration also announced that it would initiate the new integration process by negotiating Chile's accession[53] to the NAFTA.[54] Subsequently, on December 9-10, 1994, the leaders of the region's thirty-four democracies gathered at the historic Summit of the Americas in Miami, Florida.[55] The leaders committed themselves to unite the various trade accords within the region.[56] Currently, there are at least six regional trade arrangements operative in the Americas.[57] There are at

---

52. Tim Golden, *Clinton Planning Hemisphere Talks*, N.Y. TIMES, Dec. 2, 1993, at A9.

53. In the words of U.S. Trade Representative Mickey Kantor, "[t]he reason that we have worked closely with Chile is [that] the president elect of the United States in December 1992 committed himself that if and when the NAFTA was approved by the Congress of the United States . . . Chile would be the first country considered for accession . . . That has been a product of the very impressive economic and political record in Chile over the last number of years. Let me just say, in 1993 alone Chile had 10 percent growth and 4 percent unemployment and a budget and trade surplus." *Summit of the Americas: Press Conference with U.S. Trade Representative Mickey Kantor*, *supra* note 2.

54. Steven Greenhouse, *U.S. Plans Expanded Trade Zone*, N.Y. TIMES, Feb. 4, 1994, at D4.

55. *NAFTA Invitation to Chile Caps Americas Summit in Miami*, Latin American Regional Reports: Southern Cone, Dec. 29, 1994, *available in* LEXIS, News Library, Lan File [hereinafter *NAFTA Invitation*].

56. U.S. GOV'T, SUMMIT OF THE AMERICAS, DECLARATION OF PRINCIPLES AND PLAN OF ACTION, *supra* note 3.

57. The Andean Pact consists of Bolivia, Colombia, Ecuador, Peru, and Venezuela. Chile was initially a party to the Andean Pact but left the accord in 1976. The Central American Common Market (CACM) consists of Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua. The Caribbean Community (CARICOM) has thirteen members including Jamaica, Trinidad and Tobago, Barbados, Guyana, St. Lucia, Dominica, St. Vincent and the Grenadines, Grenada, Antigua, the Bahamas, Belize, Montserrat, and St. Kitts. The Group of Three includes Mexico, Venezuela, and Colombia. Mercosur or *El Mercado Común del Sur* includes Argentina, Brazil, Paraguay, and Uruguay. The North American Free Trade Agreement (NAFTA) includes Canada, the United States and Mexico. *See* GARY C. HUFBAUER & JEFFREY J.

least twenty-five bilateral trade agreements.[58]

The ultimate goal articulated by national leaders attending the Summit is the establishment of an FTAA by the year 2005. Under the Summit's Declaration of Principles, the countries committed to "begin immediately" the construction of the free trade area. It calls for building on existing bilateral and sub-regional arrangements "in order to broaden and deepen hemispheric economic integration."[59] The trade component of the Plan of Action accompanying the Declaration of Principles is entitled Promoting Prosperity through Economic Integration and Free Trade. It calls for analysis to "determine areas of commonality and divergence in the particular agreements under review and the consideration of the means of bringing them together."[60]

The NAFTA members wasted no time in pursuing the objectives established by the Declaration of Principles. Immediately following the Summit, the leaders from the NAFTA countries formally announced that preliminary discussions on Chile's accession to the NAFTA would begin in January 1995; formal negotiations would begin in June 1995.[61] Since the signing of the NAFTA, Chile's status in relation to the NAFTA indicates the willingness of the U.S. to actively pursue an expansion of its formal trading relationships.[62] Chile's successful accession to the NAFTA is important as it is the initial step toward hemispheric integration since the Summit.[63] As part of the accession

---

SCHOTT, WESTERN HEMISPHERE ECONOMIC INTEGRATION 219-49, app. C (1994).

According to Peter Smith, under "conventional usage, 'regional' agreements involve three or more countries; bilateral accords do not qualify." Peter Smith, *The Politics of Integration: Concepts and Themes*, *in* THE CHALLENGE OF INTEGRATION: EUROPE AND THE AMERICAS 13 n.4 (Peter Smith ed., 1993).

58. *After Free Trade Euphoria, Now Comes The Hard Part*, 12 Int'l Trade Rep. (BNA) No. 3 (Jan. 18, 1995), at 129, *available in* LEXIS, News Library, Curnws File.

59. U.S. GOV'T, SUMMIT OF THE AMERICAS, DECLARATION OF PRINCIPLES AND PLAN OF ACTION, *supra* note 3.

60. *Id.*

61. *NAFTA Invitation*, *supra* note 55.

62. President George Bush's remarks upon signing the NAFTA reflect an intended course of action. The enlargement of the NAFTA is a step toward further integration. "I hope and trust that the North American free trade area can be extended to Chile, other worthy partners in South America, and Central America and the Caribbean. Free trade throughout the Americas is an idea whose time has come." Signing of the North American Free Trade Agreement, *supra* note 33.

63. According to Kent Foster and Dean Alexander, "since Chile is a relatively

process, negotiators must formulate a workable set of origin rules. These rules are critical to Chile's successful accession as well as the creation of the FTAA.[64]

As noted above, the NAFTA negotiators used the enlargement of the existing Canada-U.S. FTA as an opportunity to modify the rules of origin.[65] Similarly, Chile's NAFTA accession negotiations create a window of opportunity to discard, or build upon, the current NAFTA rules of origin. Upon Chile's accession, NAFTA negotiators should adopt a common external tariff for a broad range of goods, in keeping with the precedent set by the NAFTA rules of origin for computers.[66] If the region's leaders who attended the Summit of the Americas capitalize on this opportunity to extend the computer rule to cover other goods, then subsequent NAFTA accessions will be made easier and hemispheric integration (this time in the form of the FTAA) is likely to succeed.

VI. INTEGRATION: THE CHALLENGE POSED BY ORIGIN DETERMINATIONS

There is much work to be done following the signing ceremonies, declarations of intent, and euphoria associated with the announcement of integration initiatives. The record of integration in the Americas cautions against high expectations. Past implementation efforts have been disrupted by a political tug-of-

---

small market for U.S. products and services, the overall economic impact . . . on the U.S. will probably be minimal. Yet, the political ramifications would be rather substantial: namely, the U.S. would take another step towards creating a unified economic bastion in the Western Hemisphere." KENT S. FOSTER & DEAN C. ALEXANDER, PROSPECTS OF A U.S.-CHILE FREE TRADE AGREEMENT 101 (1994).

64. *See* MICHAEL HART, A NORTH AMERICAN FREE TRADE AGREEMENT: THE STRATEGIC IMPLICATIONS FOR CANADA 104 (1990) (identifying the rules of origin as "the most difficult and the most important chapter that will have to be tackled in negotiating Mexican accession" to the NAFTA). *See also Designadas 4 Comisiones para Tratar Entrada de Chile al NAFTA*, EL MERCURIO (Santiago), July 4, 1995, at A1, A12 (identifying one of four Chilean negotiating teams as responsible for the rules of origin issue).

65. For a discussion of policy-maker's perceptions that the NAFTA presented an opportunity to improve the FTA rules of origin, see *supra* note 24 and accompanying text.

66. NAFTA, *supra* note 20, vol. 1, pt. 2, ch. 3, art. 308 & Annex 308.1, Most-Favored-Nation Rates of Duty on Certain Automatic Data Processing Goods and Their Parts.

war. Technical difficulties, like rules of origin, pose additional obstacles that disfavor successful integration.

Although the implementation of a trade agreement is not an easy task, national governments in the region now have the opportunity to capitalize on a complex set of factors which favor integration. Governments throughout Latin America have restored democracy and turned to liberal, market-oriented economic models.[67] Thus, the presence of ideological disharmony and competing economic models no longer present the obstacles that they have in the past.[68] These new circumstances allow for the establishment of liberalizing trade arrangements such as the NAFTA.[69] These achievements are the result of a complex process. One indication of the complexity involved in the implementation of free trade is the level of detail in the text of the trade agreements and their implementing legislation. For example, the NAFTA is comprised of more than 2,000 pages of dense legal text.[70] The annex to the chapter on the rules of origin spans 169 pages.[71]

A. Rules of Origin

Although rules of origin are only one of the difficulties confronting the implementation of free trade accords, they pose one of the primary obstacles.[72] If the rules of origin are overly com-

---

67. *See generally* Riordan Roett, *Why Integration Now? U.S. Interests and Purposes*, *in* THE CHALLENGE OF INTEGRATION: EUROPE AND THE AMERICAS 93, 97-99 (Peter H. Smith ed., 1993).

68. Craig Van Grasstek & Gustavo Vega, *The North American Free Trade Agreement: A Regional Model?*, *in* THE PREMISE AND THE PROMISE: FREE TRADE IN THE AMERICAS 157, 159 (Sylvia Saborio ed., 1992).

69. Once Mexico's market-oriented economic transformation was well underway, former Mexican President Salinas proposed to George Bush an FTA between the U.S. and Mexico. *See, e.g.*, Robert A. Pastor, *The North American Free Trade Agreement: Hemispheric and Geopolitical Implications*, *in* TRADE LIBERALIZATION IN THE WESTERN HEMISPHERE 53 (IADB, Economic Commission for Latin America and the Caribbean, 1995).

70. *See generally* NAFTA, *supra* note 20; *U.S., Mexico, Canada Agree to Form Huge Common Market*, L.A. TIMES, August 13, 1994, at A1, A7.

71. *See* NAFTA, *supra* note 20, at vol. 1, pt. 2, ch. 4, Annex 401.

72. According to Ann Hughes, U.S. Deputy Secretary of Commerce for the Western Hemisphere, the NAFTA rules are complex. When she was asked about problems encountered with NAFTA implementation, Hughes reported that problems of interpretation of the rules of origin created backlogs on both sides of the border. *NAFTA Accession*, *supra* note 28, at 2. *See also supra* notes 4, 23, and 64 for other

plex, then businesses engaged in international trade will not deem the benefits of preferential tariff treatment worth the cost of compliance. The result is the negation of the carefully negotiated effects originally intended by the signatories of the agreement. For example, under the Canada-U.S. FTA, many firms discovered that the advantage of duty-free tariff treatment was not worth the cost of compliance with the FTA origin rules.[73]

Fortunately, NAFTA negotiators and drafters recognized the difficulties that the rules of origin pose. As such, when the nineteen NAFTA negotiating groups were formed, included among them was a negotiating group that would focus its full attention on the rules of origin.[74] At the Summit of the Americas, the leaders from each of the NAFTA signatories and Chile agreed to establish five special committees to look into Chile's preparedness for accession. Among the issues to be examined are the rules of origin.[75] The actual negotiation of Chile's accession to the NAFTA will involve an origin rule focus group like the one relied upon during the NAFTA negotiations.[76] Any successful enlargement of the NAFTA is, at least in part, dependent on the rules of origin issue.

1. Various Types of Origin Rules Defined

Rules of origin are those laws, regulations, and administrative practices that are applied to ascribe a country of origin to goods in international trade.[77] Many trade regulations, like

---

references identifying rules of origin as a primary obstacle to free trade implementation.

73. *See* U.S. GEN. ACCOUNTING OFFICE, IMPLEMENTATION OF THE U.S.-CANADA FREE TRADE AGREEMENT 28-31 (GAO/GGD-93-21, 1992). *See also* Joseph A. LaNasa, *Rules of Origin under the North American Free Trade Agreement: A Substantial Transformation into Objectively Transparent Protectionism*, 34 HARV. INT'L L.J. 381, 391 (1993).

74. HUFBAUER & SCHOTT, *supra* note 46, at 25, tbl. 2.1 (1993) (listing the nineteen negotiating areas under six broad categories). Negotiators and drafters included provisions for limited review of some of the rules of origin after the NAFTA was implemented. For example, the Agreement calls for a review of the rules of origin for textiles and apparel before Jan. 1, 1988. HUFBAUER & SCHOTT, *supra* note 21, at 44 n.17 (1993). The NAFTA, however, does not provide for a regular review and revision of the general rules of origin. *Id.* at 135.

75. *See NAFTA Invitation*, *supra* note 55, at 1.

76. *See generally* FOSTER & ALEXANDER, *supra* note 63, at 43-46.

77. U.S. INT'L TRADE COMM'N, STANDARDIZATION OF RULES OF ORIGIN, 1987:

preferential tariff treatment, are applicable on a country-by-country basis. Therefore, it is necessary to identify one and only one country of origin for each import, even if more than one country was involved in the production of the imported good. Rules of origin enable the trading community to distinguish those goods to which a particular regulation applies and those to which the regulation does not apply. They are the free trade implementation mechanism, but they serve other purposes as well.

a. Non-preferential Rules of Origin

Non-preferential rules are one type of origin rule. They have several purposes. For example, under U.S. law, every import must be marked with the name of its country of origin.[78] Non-preferential rules include those that determine origin for marking and statistical purposes. Non-preferential rules also determine most-favored-nation (MFN) tariff treatment under the General Agreement on Tariffs and Trade (GATT).[79] Under the MFN clause of the GATT, non-preferential origin rules are primarily rules to determine preferential eligibility for reduced tariffs.[80] However, because MFN treatment is available to most nations, the rules that determine which goods receive MFN tariff rates are considered non-preferential rules. In theory, if every country were to apply MFN treatment to imports, the origin of products would not be particularly important because there would be no need for any country to differentiate among its imports.[81] This, however, is not the case. Consequently, pref-

---

REPORT TO THE COMM. ON WAYS AND MEANS OF THE U.S. HOUSE OF REPRESENTATIVES (U.S. Int'l Trade Comm'n Pub. 1976), May 1987, at 1.

78. Under the Tariff Act of 1930, every import must be "marked in . . . such a manner as to indicate to an ultimate purchaser in the United States the English name of the country of origin of the article." 19 U.S.C.A. § 1304.

79. GATT, *supra* note 27, art. I.

80. Under the terms of the Harmonized Tariff Schedule of the United States, different MFN rates of duty are applied based on the country of origin of each imported product. 19 U.S.C. § 1202.

81. *See* Jacques Bourgeois, *Rules of Origin: An Introduction, in* RULES OF ORIGIN IN INTERNATIONAL TRADE: A COMPARATIVE STUDY 1 (Edwin Vermulst et al. eds., 1994). Note that the theory stated here becomes a reality, on a regional level, upon the imposition of a common external tariff (CET). No differentiation is necessary among the goods traded between countries that are party to a trade accord with a CET. Correspondingly, origin determinations and the cumbersome rules that govern

erential rules of origin play a major role in the international trading system.

b. Preferential Rules of Origin

Preferential rules govern the origin determinations of goods traded among members of an FTA, or preferential trading regime. Most importantly, they allow the advantages of a free trade area to accrue principally to the contracting parties.[82] Two examples of preferential rules of origin are those rules embodied in the U.S. General System of Preferences (GSP)[83] and those incorporated in the NAFTA. The origin rules of the GSP limit preferential treatment to the products of designated beneficiary developing countries (BDCs) by minimizing the possibility for developed countries to operate pass-through operations in the BDCs in a surreptitious attempt to gain preferential tariff treatment.[84] Under the NAFTA, tariffs are eliminated only on goods that "originate" in the NAFTA territory, as defined by Article 401 of the Agreement.[85] The rules embodied in Article 401 allow the trading community to establish which goods originate in the NAFTA territory and preclude traders from non-NAFTA countries from gaining preferential tariff treatment by merely shipping their goods through Mexico on their way to the U.S. or Canada, or vice versa.[86]

---

them become largely unnecessary for those goods shipped from one member state to another.

82. According to Secretary of Labor Lynn Martin, rules of origin are needed to "ensure that the free-trade benefits of a NAFTA accrue to North American products and their workers." *Testimony of Secretary of Labor Lynn Martin, 1992: Hearing before the Comm. on Finance of the U.S. Senate*, Sept. 10, 1992 at 5, *available in* LEXIS, Legis Library, Fedreg file.

83. Since 1974, the General System of Preferences has operated to facilitate the development of investment in lesser developed countries and the export of manufactures from those countries. *See* Trade Act of 1974, Pub. L. No. 93-618, tit. V, 88 Stat. 1978, 2066-71 (codified as amended at 19 U.S.C.A. §§ 2461-2466).

84. A product is eligible for beneficiary developing country (BDC) duty-free treatment if it is wholly made in a BDC. Or a product may qualify if it meets other statutorily controlled guidelines. Namely, the product is "originating" if the total of (1) the cost or value of materials produced in a BDC, and (2) the direct costs of processing operations performed therein is not less than thirty-five percent of the article's appraised value upon entry to the United States. *Id.* at §§ 2461-2466.

85. NAFTA, *supra* note 20, art. 401. For a discussion of the NAFTA rules of origin, see *infra* notes 158-187 and accompanying text.

86. *Id.* The U.S. concern over transshipment, or the creation of a "beachhead" or "export platform" significantly impacted the formulation of the origin rules. *See*

B. Obstacles to the Implementation of Free Trade

There are at least twenty-three preferential regional trading arrangements world-wide.[87] These arrangements include 119 countries and account for eighty-two percent of the world's international trade in goods.[88] Each of the six major regional accords in the Americas[89] has its own origin code. The complexity of the rules of origin in each of these arrangements presents obstacles to free trade. Moreover, the trading community faces serious challenges in understanding and complying with such a wide variety of rules. The fact that there are six *separate* trade arrangements, all of which share the common goal of trade liberalization, has complicated trade. Convergence of the various regional accords will be required to form the FTAA, and the establishment of a common origin rule will be a critical component of that process.

1. The Lack of Uniformity

At present, there is no uniform legal principle that governs origin determinations internationally. This results in increased costs and delays for those involved in international trade, as well as higher prices for consumers.[90] The NAFTA holds promise for the hope of uniformity. Under Article 511 of the Agreement, each of the parties must formulate uniform regulations for use in, *inter alia*, making country of origin determinations.[91] Thus, expansion of the NAFTA is an appealing vehicle for the creation of the FTAA. As countries accede to the NAFTA, Article

---

infra notes 102-107 and accompanying text.

87. Norman S. Fieleke, *One Trading World, or Many: The Issue of Regional Trading Blocs*, NEW ENG. ECON. REV., May-June 1992, at 3.

88. *Id.*

89. Although the Western Hemisphere has over twenty diverse trade arrangements, its major accords are the NAFTA, the Southern Cone Common Market (MERCOSUR), the Andean Pact, the Central American Common Market (CACM), the Caribbean Community (CARICOM), and the Group of Three. *See, e.g., Special Report: Trade Outlook for 1995*, *supra* note 57, at 129. For a list of the members to each of the six major trade accords in the Americas, see *supra* note 58.

90. U.S. INT'L TRADE COMM'N, STANDARDIZATION OF RULES OF ORIGIN, *supra* note 77, at 1.

91. NAFTA, *supra* note 20, art. 511. *See* 58 Fed. Reg. 69,497 for the uniform regulations.

511 would compel harmonization of the origin regimes that are used in the Western Hemisphere. The recognition of a uniform origin rule would not only facilitate trade in the Americas, but also would make the negotiation of an FTAA easier because each of the thirty-four potential signatories would have settled expectations regarding the origin rules for the FTAA.[92]

2. The Growing Problem of Determining Country of Origin

The question of where a good originates was once a relatively minor concern because the volume of international trade was comparatively low and preferential trade arrangements were not as common. Today, the question poses a significant problem. Origin determinations are becoming increasingly important for at least three reasons: (1) increasing levels of international trade and the proliferation of preferential trading arrangements; (2) the growing use of multiple country manufacturing processes by many enterprises; and (3) the need for signatories to an FTA to prevent free-riders from exploiting the reductions in trade barriers bargained for by the contracting states.[93] Correspondingly, the rules that govern origin determinations are becoming increasingly complex.

a. Increased Trade and the Proliferation of Preferential Trade Arrangements

Rules of origin have become increasingly important as the volume of global trade expands. Trade has grown quickly between the U.S. and its regional trading partners. From 1989 to 1992, for example, U.S. exports to Mexico increased by sixty-two percent and U.S. imports from Mexico increased by twenty-nine percent.[94] Theoretically, each good that crosses the U.S. border must undergo a country of origin determination and traders must prepare the necessary documentation for that purpose. Even more burdensome is the fact that, under the NAFTA, re-

92. *See* U.S. INT'L TRADE COMM'N, STANDARDIZATION OF RULES OF ORIGIN, *supra* note 77, at 24.

93. *Id.* at 3.

94. LENORE SEK, NORTH AMERICAN FREE TRADE AGREEMENT, CONG. RESEARCH SERVICE ISSUE BRIEF (The Library of Congress, Washington, D.C.) Jan. 5, 1994, at 2.

cords related to origin claims must be kept for five years.[95] Computers and related goods traded among NAFTA members, however, are exceptions to this otherwise universal rule.[96]

In addition to the effects of growing trade volume, preferential origin rules become increasingly important with the proliferation of preferential trading arrangements.[97] Trade liberalization results in increasingly competitive markets and makes preferential tariff treatment critical for firms engaged in international trade. As a result of increased competition, businesses must concern themselves with origin requirements if they are to gain the advantage of preferential tariff treatment. Also, customs officials must rely more heavily on origin determinations for regulatory purposes as trade expands and governments continue to form trade accords.

b. Multiple Country Manufacturing

Other factors make origin determinations increasingly important. Thirty-years ago, goods traded internationally were often produced in only one country.[98] Consequently, origin determinations were not a significant trade-related problem. The creation of a workable origin code governing goods wholly ob-

---

95. NAFTA, *supra* note 20, art. 505.

96. "Common market" treatment for computers will be significant for the industry and consumers alike, particularly given the size of the computer market in North America. Mexico and Canada constitute a U.S. $6.2 billion market for U.S. computer hardware manufacturers. U.S. DEP'T COMM., NORTH AMERICAN FREE TRADE AGREEMENT: OPPORTUNITIES FOR U.S. INDUSTRIES, COMPUTER AND SOFTWARE INDUSTRIES 1 (1993). During 1992, Mexico purchased U.S. $970 million worth of U.S. hardware. U.S. firms enjoyed twenty percent annual growth in the Mexican hardware market. The computer hardware industry in the U.S. is also a major employer with 290,000 employees in 1988, declining to 227,000 in 1991. *Id.* The gains in efficiency upon implementation of the computer rule common market treatment will result in substantial cost savings for producers and similar savings for consumers in North America; Mexico must reduce its tariffs on computers (currently 20%) to the level of those imposed by the U.S. (3.9%). As such, the reduction in tariffs is likely to result in a corresponding decrease in the price of any U.S. computers sold in Mexico. *See* Lawrence M. Friedman, *Putting NAFTA to Use: Duty Reductions for Computer Hardware and Software*, 2 COMPUTER LAW. 1, 4 (1994).

97. *See* David Palmeter, *Rules of Origin in a Western Hemisphere Free Trade Agreement, in* TRADE LIBERALIZATION IN THE WESTERN HEMISPHERE 191, 202 (IADB, Economic Commission for Latin America and the Caribbean, 1995).

98. *See* U.S. INT'L TRADE COMM'N, STANDARDIZATION OF RULES OF ORIGIN, *supra* note 77, at 2.

tained or produced in the territory of the contracting parties did not present severe difficulties. However, the practice of multiple country manufacturing has grown substantially.[99] Today, the manufacture of automobiles and like products incorporates many components and sub-components that frequently are produced or assembled in several countries.[100] The Honda case demonstrates that the problem of origin determinations is particularly onerous in those instances where a product consists of component parts from several different countries.[101] Various approaches have been employed to govern origin determinations of such products, but none have been identified as a workable universal solution.

c. Free-riders and Transshipment

Critics of the NAFTA argued that it would create a "beachhead" in Mexico for manufacturing firms from Asia and other countries. The outcome of the negotiations reflected this concern.[102] At the urging of the U.S., the NAFTA signatories instituted strict rules of origin. They were designed to prevent the development of an "export platform" that would allow Japan, Brazil, or other countries to gain tariff-free entry into the North American market.[103] Without these strict rules, the U.S. argued, non-contracting states might avoid U.S. trade barriers and enjoy the preferential rates bargained for by Canada and Mexico. Thus, the rules limit the possibility for traders from non-contracting states from using transshipment or superficial processing techniques to cloak non-originating goods as goods of NAFTA origin. Regardless, this practice remains a concern.[104] Non-contracting states seek to pass their goods through the territory of the contracting state with the lowest external trade barriers prior to shipping them to their final destination in order to ob-

99. *Id.* at 26.

100. Cantin & Lowenfeld, *supra* note 5, at 376.

101. The description of the Honda case provides an example of multiple country manufacturing by Honda Motor Company. The Civic engines were built in Ohio using Japanese and U.S. parts. The engines then were used in the assembly of the Civics before the finished automobiles were shipped to the U.S. for final sale. *See supra* Part II.

102. *See* HUFBAUER & SCHOTT, *supra* note 21, at 37.

103. *See* HART, *supra* note 64, at 37-38.

104. *See Testimony of Secretary of Labor Lynn Martin*, *supra* note 82.

tain preferential access to other markets in the NAFTA territory.[105]

A "screwdriver" plant is the term used to describe a facility where a company from a non-contracting state employs insignificant manufacturing processes in an attempt to impart bogus originating status to their goods before them shipping to the final destination within the FTA. Origin rules enable contracting states to prevent companies from non-contracting states from using such activities as a means of obtaining the preferential treatment bargained for by FTA members.[106] One specific example is Article 412 of the NAFTA which provides that goods diluted with water or another substance shall not be considered originating.[107] In other words, dilution does not confer origin, even if dilution produces a change in tariff heading. Although Article 412 and other provisions like it limit transshipment and free riders, they add complexity to the rules of origin and make further documentation necessary to demonstrate compliance.

VII. THE CALL FOR STANDARDIZATION

The global trading community has not established an accepted international standard for origin determinations for goods manufactured in more than one country, despite the fact that intra-agreement trade between members of preferential trade accords accounts for more than four-fifths of the total volume of world trade.[108] The benefits of standardization are substantial. They include facilitating business planning, reducing the opportunity for trade deflection, allowing for the compilation of country specific trade data, and avoiding the proliferation of multiple standards.[109] A universal standard would also minimize bur-

---

105. The imposition of a CET eliminates the advantages of transshipment because the tariff rate encountered upon entry into the territory covered by the trade agreement is the same regardless of the country of entry. For example, computers eventually will confront a 3.9% tariff when imported into the NAFTA territory regardless of whether the point of entry is located in Canada, Mexico, or the United States. *See infra* part VIII.B.4 for further discussion of the tariff treatment of computers under the NAFTA.

106. *See generally* NAFTA, *supra* note 20, art. 401 (outlining the rules of origin).

107. *Id.* art. 412.

108. *See* Fieleke, *supra* note 87 and accompanying text.

109. U.S. INT'L TRADE COMM'N, STANDARDIZATION OF RULES OF ORIGIN, *supra* note 77, at 2.

densome administrative costs and simplify compliance with origin rule requirements.[110] Although there have been several attempts to achieve standardization, the various origin rules remain complex and confusing.

The Honda case created tension between Canada and the United States because there was no mechanism for achieving uniformity in the interpretation of the rules of origin under the FTA. It provides one example of the need for a universal set of rules governing country of origin determinations and a uniform interpretation of those rules. The FTAA can only function effectively once a workable standard is in place. Yet, standardization has not been achieved despite the attempts highlighted below. An altogether new approach to origin determinations is necessary.

A. The Kyoto Convention (July, 1974)

On December 15, 1950, the signing of the Brussels Convention created the Customs Cooperation Council (CCC). The CCC is a technical organization that assists its members with customs issues.[111] It has attempted to standardize the national customs provisions of its 111 members. As part of the CCC's work, it has organized several conventions, including the International Convention on the Simplification and Harmonization of Customs Procedures, better known as the Kyoto Convention.[112] Annex D.1 to the Kyoto Convention concerns all rules of origin, both preferential and non-preferential.[113] It provides that when a good is produced in more than one country, it is an originating good of the country where its "substantial

---

110. For one testimonial highlighting the problem created by lack of harmonization, see *infra* note 192 and accompanying text.

111. Edurne Navarro Varona, *Rules of Origin in the GATT*, *in* RULES OF ORIGIN IN INTERNATIONAL TRADE: A COMPARATIVE STUDY 355, 359 (Edwin Vermulst et al. eds., 1994).

112. International Convention on the Simplification and Harmonization of Customs Procedures, May 18, 1973 (entered into force Sept. 25, 1974) [hereinafter The Kyoto Convention].

113. International Convention on the Simplification and Harmonization of Customs Procedures, Message from the President of the United States transmitting the International Convention on the Simplification and Harmonization of Customs Procedures (entered into force Sept. 25, 1994), with Annexes and Reservations to those Annexes, S. Treaty Doc. No. 97-23, 97th Cong., 2d Sess. 226 (1982) [hereinafter Annex D.1 to The Kyoto Convention].

transformation" occurs.[114] The Annex defines substantial transformation as the process that gives the product its "essential character."[115] The European Community and most industrial countries accepted the Convention's framework.[116] However, the Convention lacks product specific rules and provides only general, non-compulsory principles to guide origin determination.[117] Furthermore, the U.S. only partially ratified the Kyoto Convention.[118] Thus, although the U.S. does rely on the concept of substantial transformation for its general rule of origin,[119] it does not subscribe to the specifics of Annex D.1.

B. The United States International Trade Commission Report (May, 1987)

In September of 1986, the Chairman of the Committee on Ways and Means of the U.S. House of Representatives requested that the U.S. International Trade Commission investigate the possibility of developing a standard U.S. and international rule of origin.[120] The report generated in response summarized and evaluated three principal rules in use: (1) the last substantial transformation test; (2) the change of tariff heading test; and (3) the value added test.[121] The report identified the flaws inherent in each of the three rules and established four criteria to evaluate any new rules of origin: (1) uniformity; (2) simplicity; (3) predictability; and (4) administrability.[122] In conclusion, the report recommended the adoption of a new standard based on processing requirements.[123]

The recommended process-based approach would confer origin on the last country where one of a list of enumerated processes occurred. It would require that a product undergo a sufficiently significant process before origin would be conferred.

---

114. *Id. See also* HUFBAUER & SCHOTT, *supra* note 46, at 156.
115. Annex D.1 to The Kyoto Convention, *supra* note 113.
116. HUFBAUER & SCHOTT, *supra* note 46, at 157.
117. *See* Palmeter, *supra* note 10, at 201.
118. Navarro Varona, *supra* note 111, at 360.
119. Anheuser-Busch Brewing Assoc. v. United States, 207 U.S. 556 (1907).
120. U.S. INT'L TRADE COMM'N, STANDARDIZATION OF RULES OF ORIGIN, *supra* note 77, at (i).
121. *Id.* at 3.
122. *Id.* at 30-32.
123. *Id.* at 46-47.

This approach has not been pursued in subsequent efforts to standardize the rules of origin because it is contingent upon an unlikely event. Namely, the approach would require the creation of a coding system for manufacturing processes similar to the Harmonized Tariff System[124] (HTS). The HTS classifies products based on their similarities. The creation of lists of enumerated manufacturing processes on the order of the HTS is unlikely to occur. As such, the process-based approach will not lead to harmonization.

C. GATT Agreement on the Rules of Origin (April, 1994)

Until 1994, the Kyoto Convention's substantial transformation test was the closest approximation to an international standard. The problem was that it left many significant decisions to the discretion of national authorities.[125] As a result, the origin rule problem was included in the Uruguay Round of the GATT negotiations, in the framework of the Negotiating Group on Non-Tariff Measures.[126] The primary purpose of doing so was to harmonize existing national rules of origin and establish an international standard.[127] However, Article I:1 of the GATT Agreement on Rules of Origin establishes that the agreement does not apply to "contractual or autonomous trade regimes leading to the granting of tariff preferences going beyond the application of Article I:1 of the GATT 1994."[128] In other words, the Agreement does not apply to preferential rules of origin. While the U.S. proposed to extend harmonization to all rules of origin, many other countries sought to restrict the discussions to non-preferential rules of origin.[129] As the language of Article

---

124. International Convention on the Harmonized Commodity Description and Coding System, *done* June 14, 1983 (entered into force Jan. 1, 1988) [hereinafter HTS]. *See* 19 U.S.C. §§ 3001-3012 (1988) (adopted as tit. I, §§ 1201-1212, Omnibus Trade & Competitiveness Act of 1988, Pub. L. No. 100-418, 102 Stat. 1147). For the U.S. schedule, see U.S. Int'l Trade Comm'n Pub. No. 2449, Harmonized Tariff Schedule of the United States.

125. HUFBAUER & SCHOTT, *supra* note 46, at 165.

126. Navarro Varona, *supra* note 111, at 363.

127. General Agreement on Tariffs and Trade, *Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations*, § II-11, art. 1 [hereinafter GATT Origin Agreement].

128. *Id.* art. I:1.

129. *See generally* Navarro Varona, *supra* note 111, at 364 (discussing various proposals regarding the scope of harmonization efforts under the GATT).

I:1 indicates, the U.S. proposal was not accepted and the GATT Agreement excludes all origin rules embodied in FTAs like the NAFTA.

D. The Common Declaration with Regard to Preferential Rules of Origin (April, 1994)

Although the U.S. position on standardization was not adopted, Annex II to the GATT Agreement on Rules of Origin indicates the international recognition of the need for advancement in the area of preferential rules of origin. The Common Declaration with Regard to Preferential Rules of Origin, embodied in Annex II, results in a compromise. It does not harmonize all preferential rules of origin, but it does extend some of the guidelines for non-preferential rules to preferential rules. For example, both the Agreement and the Annex call for clarity and specificity in the design and application of rules of origin.[130] Member states also ensure that any administrative origin determinations are reviewable by judicial, arbitral, or administrative tribunals or procedures.[131]

The GATT harmonization program, like the Kyoto Convention, uses the substantial transformation test as its basic rule. Under the GATT Agreement, when a good is the product of multiple country manufacturing processes, the country of origin is the country "where the last substantial transformation has been carried out."[132] Both the U.S.[133] and the European Community[134] incorporate this test into their approach to origin determinations in some form. The widespread use of the "substantial transformation" formula gives the appearance that it is an

---

130. GATT Origin Agreement, *supra* note 127, Annex II, art. 3(a). (Annex II to the Agreement on Rules of Origin embodies the "Common Declaration with Regard to Preferential Rules of Origin").

131. *Id.* Annex II, art. 3(f).

132. *Id.* pt. IV, art. 9(1)(b).

133. According to David Palmeter, the substantial transformation test is a judge-made rule, nowhere defined by statutory law. Palmeter, *supra* note 10, at 35. A good has undergone substantial transformation when a new and different article with a distinctive name, character, or use emerges from the manufacturing process. Anheuser-Busch Brewing Assoc. v. United States, 207 U.S. 556 (1907) (extending the substantial transformation standard to U.S. rules of origin law).

134. Council Reg. (EEC) 802/68, art. 5, O.J. (1968) L 148/1 [Basic Origin Regulation].

accepted universal standard. However, the Kyoto Convention did not refer to the *last* substantial transformation, but merely substantial transformation.[135] Furthermore, the means by which the U.S. and the EC determine substantial transformations differ.[136] Because the substantial transformation approach to harmonization is vague and requires subjective interpretations of origin rules, it will not likely result in the desired harmonization.

The Common Declaration with Regard to Preferential Rules of Origin (Annex II to the GATT Agreement on Rules of Origin) refers only to some of the universal principles established for non-preferential rules, and their application is not compulsory with regard to preferential rules. In the case of preferential rules, additional requirements supplement the substantial transformation test of the Agreement on non-preferential rules. For example, specific value content rules must be satisfied in order to confer origin on goods manufactured in more than one country.[137] Thus, preferential rules of origin remain disjointed and complex, and the "substantial transformation" test is subject to various interpretations despite the Common Declaration.

E. The World Trade Organization & The World Customs Organization

In February 1995, the World Trade Organization (WTO) and the World Customs Organization (WCO) initiated a joint effort to standardize origin rules. According to the interim WTO Director General Peter Sutherland, the cooperation of the 150-member WCO is necessary in order to implement the new Uruguay Round GATT Agreement on Rules of Origin. James W. Shaver, Secretary General of the WCO, spoke of the advantages: "the new rules of origin will have an "enormous" impact on international trade, finance, investment, and employment.[138] The

---

135. Annex D.1 to The Kyoto Convention, *supra* note 113.

136. Although both the U.S. and the European Community rely on substantial transformation for their basic origin rule, the means by which substantial transformation is determined varies. *See* HUFBAUER & SCHOTT, *supra* note 46, at 163 (identifying the European Community's approach to origin determinations as involving more discretion than the U.S. approach).

137. GATT Origin Agreement, *supra* note 128, Annex II.

138. *WTO, Customs Group to Tackle Uniform Pact on Rules of Origin*, J. COM.,

three year work program, designed to formulate harmonized rules of origin, will build new rules "from the ground up."[139]

The comprehensiveness of the joint WTO-WCO initiative reflects the level of complexity confronted by the trading community in dealing with the current origin rules. Despite this comprehensive plan, the implementation of the Uruguay Round Origin Agreement will not facilitate the establishment of an FTAA for at least two reasons. First, the WCO has a three year time-line before it will even formulate the harmonized rules. As a result, implementation of the rules will not occur until after the NAFTA has confronted the challenges of enlargement. Second, the application of the GATT Agreement on Rules of Origin is not mandatory with regard to the origin rules of preferential trading agreements like the NAFTA.[140] Although welcomed, once implemented this new initiative will not simplify the realization of the FTAA by 2005.

In sum, only Annex II to the GATT Agreement on Rules of Origin has made any progress toward the harmonization of preferential rules, and these advances are only marginal given that compliance with the Common Declaration is voluntary. As a result, the NAFTA signatories and FTAA negotiators must concentrate on alternatives rather than additional efforts to achieve harmonization like those presented here, none of which hold much promise for simplifying the creation of the FTAA.

VIII. THE OPERATION OF PREFERENTIAL ORIGIN REGIMES IN NORTH AMERICA

The many unsuccessful efforts undertaken to harmonize origin rules demonstrate the difficulty of formulating a workable origin regime. Success with regard to preferential rules has been even more limited than in the case of origin rules generally. Particularly difficult is the formulation of rules for use in preferential trading arrangements to determine the origin of products which undergo multiple country manufacturing processes.[141] The Honda Civics discussed in Part II provide one example. The

---

Feb. 7, 1995, at A3.

139. *Id.*

140. GATT Origin Agreement, *supra* note 128, at Annex II.

141. *See, e.g.*, Simpson Statement, *supra* note 24.

analysis which follows focuses on the origin regimes of the Canada-U.S. FTA and the NAFTA. Particular attention is paid to the rules governing goods produced in multiple countries because they are the most problematic for the establishment of an FTAA. The analysis also demonstrates why the NAFTA rule for computers should be expanded upon and applied as a model in the creation of an FTAA.

A. Canada-United States Free Trade Agreement

The window of opportunity created by the Canada-U.S. FTA[142] negotiation process enabled the U.S. to establish origin rules distinct from those previously used.[143] The FTA embodied an approach that was unique to U.S. law in order to address the issue of origin determinations for goods produced in more than one country. Nonetheless, the Honda dispute demonstrates the inadequacy of this innovation as a measure to resolve the fundamental problem. The following discussion elaborates on the operation of the FTA rules and some of the difficulties they have engendered.

1. The Operation of the FTA Rules of Origin

Under the FTA, there were two principal ways for goods to satisfy the rules of origin requirements and become eligible for tariff-free trade between the U.S. and Canada. First, a good was admitted tariff free into Canada or the U.S. from the other country when it was "wholly obtained or produced in the territory of either Party or both Parties."[144] Second, the rules conferred origin if the good was "transformed in the territory of either Party or both Parties so as to be subject to a change in tariff classification."[145] To satisfy the second rule, each of the good's non-originating components had to be transformed in either the U.S. or Canada, and the transformation had to result in a change in tariff heading. As was the case with the Honda Civics, some

142. Canada-U.S. FTA, *supra* note 6.

143. *See* Palmeter, *supra* note 10, at 66.

144. U.S.-Canada Free-Trade Agreement Implementation Act of 1988, Pub. L. No. 100-449, § 202(a)(1)(A), 102 Stat. 1851 (1988) [hereinafter FTA Implementation Act].

145. *Id.* § 202(a)(1)(B)(i).

goods had to meet an additional minimum North American value content requirement to receive duty-free treatment.[146]

a. The "New" Harmonized System Transformation Test

Under the FTA, substantial transformation was determined according to the tariff classifications provided by the Harmonized Commodity Description and Coding System,[147] or HTS. The HTS classifies all goods into twenty-one sections and ninety-six chapters. Each chapter is divided into headings with four-digit codes, and further divided into subheadings with two additional digits.[148] In essence, the HTS provides a numerical code for every good. Goods are grouped together based on their similarities. The FTA chapter on origin rules was divided into sections corresponding to the HTS.

When a good containing non-originating components crossed U.S. or Canadian borders, the origin rules of the chapter and section applicable to that good were used to determine whether the good had undergone sufficient processing in the U.S. or Canada to qualify for a new tariff classification, different than the classification given to its third-country components. If the good qualified for the new classification, then it entered duty-free.

Because the HTS is organized so as to group similar goods under the same headings and chapters, significant change is said to have occurred when the processing of a good results in a change from one heading or chapter to another. This method, which relied on an HTS change of tariff heading to determine if the good had undergone a substantial transformation, was new to U.S. law.[149] The new system represented progress because reliance on the HTS-based definition of "substantial transformation" minimized the ambiguities of the conventional substantial transformation test.[150] In this sense, the FTA origin rules advanced U.S. trade law.

---

146. *Id.* §§ 202(a)(I)(B)(i)-(ii) & Annex 301.2.
147. HTS, *supra* note 124.
148. *Id.*
149. *See* Simpson Statement, *supra* note 24, at 36.
150. LaNasa, *supra* note 73, at 387.

b. Regional Value Content Requirements

Although a change in tariff heading from one chapter to another generally established that a good qualified for tariff-free entry, a change from one heading or subheading to another within a chapter did not always confer origin. In those instances, the good did not automatically receive FTA preferential entry. Rather, a second standard had to be met before many goods, such as automobiles and automobile parts, received duty-free entry. Specifically, goods subject to the value added requirement had to be at least fifty-percent North American.[151] However, some goods still received preferential treatment if they met the fifty percent value content requirement regardless of tariff headings.[152] Thus, the value content requirement was applied in combination with the change of tariff heading (CTH) test in some instances and independently in others.

2. Some Problems with the FTA Rules of Origin

The application of both the CTH test to determine substantial transformation sufficient to confer origin and the regional value content requirement posed problems. The CTH tests did not always function properly because the HTS was not designed with a view to institute an origin regime.[153] The HTS is organized according to the similarity of goods, not the significance of manufacturing processes. While most assembly operations do generate a CTH, the change is not always in fact significant. As a result, negotiators believed that value content requirements were necessary as a supplement to the CTH test. These regional value content requirements resulted in creative interpretations of what constituted regional value content when making origin determinations.

151. FTA Implementation Act, *supra* note 144, §§ 202(a)(I)(B)(i)-(ii) & Annex 301.2.

152. *Id.* § 202(c)(3)(A).

153. HUFBAUER & SCHOTT, *supra* note 46, at 159.

a. Roll-up

Two of the problems associated with value content requirements are roll-up and roll-down. As noted in Part II, both of these techniques came into play in the Honda dispute. Roll-up is the process whereby non-originating goods are subsumed during the manufacture of new and different goods (i.e., those which have a different commercial identity according to the HTS change of tariff heading test). When shipped across borders, the new product is said to originate where the conversion occurred. Thus, the costs of non-originating materials are rolled-up into the value of the finished good.

Under some interpretations of the FTA, if a component with non-originating inputs imported into the U.S. or Canada passed the CTH test plus the fifty-percent value added test, it was 100% originating for the purposes of the regional value content determination of the finished product. For example, Honda and Revenue Canada claimed 100% originating status for the engines incorporated into the Honda Civics. In fact, they contained substantial non-originating materials. Honda rolled-up the value of the non-originating (i.e., Japanese) sub-components of the engines into the Civics when the automobiles were exported from Canada for sale in the United States.

b. Roll-down

Alternatively, the FTA allowed for a component to be treated as non-originating merely because it included third country parts. When such a component was incorporated into a finished good, the component was sometimes treated as containing zero percent originating goods, even though it actually contained substantial American or Canadian parts. This process is known as roll-down and describes the reverse of the roll-up process. In order to deny preferential treatment to a finished good that incorporated components with non-originating parts, customs officials, at their discretion, could roll-down the actual value of the originating components incorporated into the finished good. Recall that U.S. Customs employed this technique in the case of the engines incorporated into the Civics in order to deny the

finished automobiles originating status.[154]

Both roll-up and roll-down are instances where divergent interpretations of the FTA origin rules resulted in the distortion of regional value content calculations. These techniques impacted North American trade of automobiles in particular because the practice of multiple country manufacturing and assembly is common to the automobile industry. The presentation of the Honda dispute above illustrates the problems with the value added element of the FTA rules.[155] Those problems were supposed to be resolved by the NAFTA.

B. The North American Free Trade Agreement

The implementation of the NAFTA began almost two years after the U.S. Customs Service and Revenue Canada issued conflicting rulings in the Honda case.[156] The FTA rules of origin and the disputes that arose out of their application shaped the NAFTA rules embodied in Article 401.[157] The non-controversial provisions of the FTA origin rules remain intact in the NAFTA, but NAFTA negotiators redrafted areas that presented problems, such as the value added requirements.

1. The Operation of the NAFTA Rules of Origin

NAFTA Article 401 defines originating goods in one of four ways: (1) goods wholly obtained or produced in the NAFTA territory;[158] (2) goods produced within the NAFTA region wholly from originating materials, i.e., produced from materials which may contain non-NAFTA materials which satisfy the specific rules of origin outlined in Annex 401 of the Agreement; (3) goods produced in the NAFTA territory exclusively from inputs that

---

154. For a discussion of the incongruous U.S. Customs determination that the engines were "originating" goods upon their initial shipment to Canada, see *supra* note 16 and accompanying text.

155. *See supra* part II.

156. Customs Regulations Amendments Relating to the United States-Canada Free-Trade Agreement, 57 Fed. Reg. 2447 (1992) (revising 19 C.F.R. §§ 10.84, 10.303, 10.305, 10.307, 10.310).

157. *See* Simpson Statement, *supra* note 24.

158. NAFTA, *supra* note 20, art. 415 (defining goods wholly produced in the NAFTA territory).

are considered to be originating under the Agreement; and (4) unassembled goods and goods classified with their parts which do not meet the Annex 401 rule of origin but contain a specified regional value content,[159] either fifty or sixty percent depending on the method of calculation.[160]

The second and third options are potentially controversial origin rule provisions. This is due to the complexity of establishing that a good satisfies the general rule of origin or meets the Annex 401 origin criteria. Article 401(b) indicates that goods may originate in a signatory country, even if they contain non-originating materials.[161] The Annex 401 rules, which govern origin determinations for goods with third-country inputs, must be satisfied in order for those goods to qualify for duty-free treatment. The specific Annex 401 rules are based on a change in tariff classification, a North American value-content requirement, or both.

2. Change of Tariff Classification

Like the origin rules in the FTA, the NAFTA organized its rules according to the HTS. The extent of the tariff classification change, or tariff shift, indicates whether sufficient North American processing has occurred to confer originating status. The rule requires that each of the non-originating inputs used in the manufacture of the beneficiary good shift its tariff classification as a result of processes occurring entirely within NAFTA territory.[162] In other words, non-originating goods must be classified under one tariff heading prior to processing and then classified under another upon completion of the processing. Therefore, exporters must know the HTS classifications of both the exported good and their non-North American components to apply the origin rules. The specific rules of origin of Annex 401 describe the exact tariff shift that must occur before Customs will treat goods as originating in North America and extend them preferential treatment.[163]

---

159. This provision is available only under two limited circumstances.

160. NAFTA, *supra* note 20, art. 401.

161. *Id.* art. 401(b).

162. U.S. CUSTOMS SERVICE, NORTH AMERICAN FREE TRADE AGREEMENT: A GUIDE TO CUSTOMS PROCEDURES (Customs Pub. No. 571), May, 1994, at 3.

163. NAFTA, *supra* note 20, art. 401 & Annex 401.

An example of the application of the CTH test taken from the NAFTA Guide to Customs Procedures illustrates the burdens that the rules of origin impose on traders.

> Frozen pork meat (HTS 02.03) is imported from Hungary and mixed with spices from the Caribbean (HTS 09.07-09.10) and cereals grown and produced in the U.S. to make pork sausage (HTS 16.01). The Annex 401 rule of origin states:
>
> A change in heading 16.01 through 16.05 from any other chapter.
>
> Since the imported frozen meat is classified in Chapter 2 and the spices are classified in Chapter 9, these non-originating inputs satisfy the required tariff shift. It is not necessary to consider whether the cereal satisfies the applicable tariff shift because it is originating in the U.S. and only *non-originating* inputs must undergo a tariff shift.[164]

When combined with cereals to produce pork sausage, the imported meat and spices undergo sufficient processing so as to allow the pork sausage "originating" status, despite the presence of inputs from outside NAFTA territory. The pork sausage will receive preferential tariff treatment when shipped to Mexico or Canada from the United States because, in the production of the sausage, the tariff heading of the non-originating inputs changes in the manner required by the specific rule of Annex 401.

3. Regional Value Content Requirements

In addition to CTH tests, further complexity arises because many Annex 401 specific rules require that a good must meet a minimum regional value-content before it is granted originating status.[165] This means that a designated percentage of the value of the good must be from the NAFTA territory. According to Article 402, producers may select one of two methods for calculating value content: (1) the transactional value method, or (2)

---

164. U.S. CUSTOMS SERVICE, NORTH AMERICAN FREE TRADE AGREEMENT: A GUIDE TO CUSTOMS PROCEDURES, *supra* note 162, at 4.

165. Under the NAFTA rules, regional value content requirements are applied to forty-two percent of the total number of tariff items. *IDB Report Downplayed at Ministerial Meeting*, INSIDE NAFTA, v. 2, no. 13 (June 28, 1995) at 9.

the net cost method.[166]

The transactional method is similar to the method employed in the European Community.[167] It is based on the sale price of the good upon export in accordance with the Customs Valuation Code of the GATT, which is designed to reflect actual value. Because the transactional method allows the producer to count all of its costs as territorial, it generally requires that sixty percent or more of the cost of the good eligible for preference be attributable to the value of North American inputs.[168] This method has the advantage of simplicity.

The NAFTA net cost method remains more or less the same as under the FTA. It generally requires only fifty percent regional value content because it excludes certain costs from the net cost calculation.[169] The changes made to the net cost method partly resolved the problem raised in the Honda case because they eliminated the subjectivity involved in determining which production costs, such as a proportion of plant overhead, could be included in the regional value content calculation.[170]

Other improvements to the FTA origin regime made the NAFTA origin rules function more effectively. For example, the NAFTA negotiators devised a provision which permits manufac-

---

166. NAFTA, *supra* note 20, art. 402.

167. *See* EC Council Regulation 802/68, Art. 5 (June 27, 1968), 1968 O.J. (L 148) 1, as amended by Council Regulation 1318/71 (June 21, 1971), 1971 O.J. (L 139) 6.

168. The formula for calculating the regional value content under the transactional method is:

RVC = TV-VNM/TV X 100

where,

RVC = regional value content, expressed as a percentage;
TV = the GATT transaction value of a good; and
VNM = the value of non-originating inputs incorporated into the production of the good.

U.S. CUSTOMS SERVICE, NORTH AMERICAN FREE TRADE AGREEMENT: A GUIDE TO CUSTOMS PROCEDURES, *supra* note 162, at 4.

169. The formula for calculating the regional value content under the net cost method is:

RVC = NC-VNM/NC X 100

where,

RVC = regional value content, expressed as a percentage;
TV = the net cost of the good; and
VNM = the value of non-originating inputs incorporated into the production of the good.

Id. at 5.

170. Cantin & Lowenfeld, *supra* note 5, at 388.

turers to trace all costs through to the final product in order to limit the roll-up/roll-down[171] phenomenon.[172] Tracing improves the accuracy of the value content determination by eliminating the possibility of counting the full value of the components incorporated into a finished good as originating or non-originating content, even though those components may consist of a combination of originating and non-originating inputs. The improvements require that any non-NAFTA value remains non-originating throughout the assembly process until the regional value content calculation is made. Unfortunately, the tracing provision applies only to automobiles.

Improvements to the general FTA origin regime evident in the NAFTA regime solve particular problems encountered in making origin determinations. Nevertheless, the changes do not address, but rather add to the fundamental problem of the origin rules — their trade-inhibiting complexity. This complexity leads to an insurmountable obstacle for the would-be trader, particularly the small business owner lacking the time and resources to identify how he or she can benefit from the NAFTA.[173] Additionally, administration and enforcement of the rules drains the resources of the customs services of each of the NAFTA signatories.[174] In short, the origin rules embodied in the Agreement inhibit trade and complicate regulatory efforts while, according to the objectives of the NAFTA, they should lead to the opposite result.[175]

---

171. For a discussion of roll-up and roll-down, see *supra* parts VIII.A.2.a-b.

172. U.S. CUSTOMS, NORTH AMERICAN FREE TRADE AGREEMENT: A GUIDE TO CUSTOMS PROCEDURES, *supra* note 162, at 59.

173. *See, cf., The Administration's Case for NAFTA: Testimony of Ambassador Michael Kantor, United States Trade Representative, Before the House Comm. on Ways and Means*, Federal Document Clearing House, Sept. 14, 1993, *available in* LEXIS, Legis Library, Cngtst File (testimony of Ambassador Michael Kantor describing small business owners as ill-equipped to wrestle with the tariff and licensing requirements).

174. *See Enforcing Rules of Origin Requirements under the United States-Canada Free Trade Agreement, 1991: Hearing before the Comm. on Finance of the U.S. Senate*, 102d Cong., 1st Sess. 37 (1991), at 6 (statement of Hon. Carol Hallett, Commissioner, U.S. Customs Service) (citing the demands of the Canada-U.S. FTA on the limited resources of the Customs Service).

175. NAFTA, *supra* note 20, art. 102(1)(a) (articulating a NAFTA objective to eliminate barriers to trade in, and to simplify the cross border movement of, goods and services between the territories of the Parties).

4. The Computer Rule

In addition to the general origin rules based on CTH and regional value content, the NAFTA includes several special provisions for conferring origin. Article 308 and Annex 308.1 embody one such provision.[176] Taken together, they govern the approach to origin determinations for computers and related goods. As noted in Part III above, the rule for computers departs from the origin rules found elsewhere in the accord. Canada, Mexico, and the U.S. agreed to harmonize external tariffs on computers and related goods in a series of staged reductions over ten years. The imposition of a common external tariff (CET) for computers is a constructive precedent. Substantial benefits will accrue to the hemisphere if the computer rule is employed as a model upon the enlargement of the NAFTA and the creation of the

---

176. NAFTA, *supra* note 20, art. 308 & Annex 308.1 provide:

Article 308: Most-Favored-Nation Rates of Duty on Certain Goods

1. Annex 308.1 applies to certain automatic data processing goods and their parts.

2. Annex 308.2 applies to certain color television tubes.

3. Each Party shall accord most-favored-nation duty-free treatment to any local area network apparatus imported into its territory, and shall consult in accordance with Annex 308.3.

Annex 308.1: Most-Favored-Nation Rates of Duty on Certain Automatic Data Processing Goods and Their Parts Section A — General Provisions

1. Each Party shall reduce its most-favored-nation rate of duty applicable to a good provided for under the tariff provisions set out in Tables 308.1.1 and 308.1.2 in Section B to the rate set out therein, to the lowest rate agreed by any Party in the Uruguay Round of Multilateral Trade Negotiations, or to such reduced rate as the Parties may agree, in accordance with the schedule set out in Section B, or with such accelerated schedule as the Parties may agree.

2. Notwithstanding Chapter Four (Rules of Origin), when the most-favored-nation rate of duty applicable to a good provided for under the tariff provisions set out in Table 308.1.1 in Section B conforms with the rate established under paragraph 1, each Party shall consider the good, when imported into its territory from the territory of another Party, to be an originating good.

3. A Party may reduce in advance of the schedule set out in Table 308.1.1 or Table 308.1.2 in Section B, or of such accelerated schedule as the Parties may agree, its most-favored-nation rate of duty applicable to any good provided for under the tariff provisions set out therein, to the lowest rate agreed by any Party in the Uruguay Round of Multilateral Trade Negotiations, or the rate set out in Table 308.1.1 or 308.1.2, or to such reduced rate as the Parties may agree.

4. For greater certainty, most-favored-nation rate of duty does not include any other concessionary rate of duty.

Id.

FTAA. The following examples demonstrate the win-win nature of the computer provision for NAFTA members and non-members alike.[177]

a. FTAA Member Benefits

The NAFTA members benefit from the computer rule. The rule provides originating status to any computer hardware item from non-Parties, if the MFN rate of duty was applied upon its shipment into the NAFTA region. In other words, non-originating computer goods receive NAFTA preferential treatment despite their actual origin when shipped to and from Canada, Mexico, and the United States. Thus, a company that imports a non-originating computer component for incorporation into a computer system pays duty on that component only upon initial importation into the NAFTA territory. Moreover, the duty is paid at the lowest MFN rate of any of the NAFTA signatories.[178] The company can ship the part throughout the NAFTA territory for processing unencumbered by tariffs. When the part is incorporated into the company's final computer product and shipped to markets in other signatory states, no tariffs apply. Thus, the rule encourages intra-FTA multiple country manufacturing. Due to the computer rule, the company involved in the computer trade dispenses with the need for burdensome value content determinations and tariff heading tracking. Computers are traded tariff free within North America, *without regard to rules of origin*. As a result, businesses involved in the North American computer trade enjoy substantial resource savings. The U.S. Customs Service and its counterpart organizations in Canada and Mexico will enjoy similar resource savings as monitoring the computer trade to ensure compliance with origin rule requirements will become unnecessary. In sum, the extension of the computer rule to other goods will diminish the number and the rate of tariffs within the NAFTA region as well as the need for the expensive and time-consuming monitoring required to ensure compliance.

---

177. The examples presented here were extracted from the author's discussion with Clay Woods, International Trade Specialist. Personal communication with Clay Woods, International Trade Administration, Trade Development, Office of Computers, (March 7, 1995).

178. NAFTA, *supra* note 20, Annex 308.1(A)(1).

b. Non-Member Benefits

The benefit of the computer rule to countries that are not members of the NAFTA derives from Annex 308.1(A)(1), which establishes that NAFTA members must harmonize their MFN duties on computers *downward* to the lowest rate of any member. A fictitious Asian computer manufacturer illustrates the advantages of the computer rule to NAFTA non-members. In the absence of the NAFTA provisions, if the Asian manufacturer imports a computer component into the NAFTA territory, it would be subject to the individual tariff rate established in the Harmonized Tariff Schedule (HTS) of the country into which the company imported the good. Currently, computers entering the United States under tariff heading 8471.20 are subject to a 3.9% MFN duty.[179] Computers entering Mexico under HTS heading 8471.20 are subject to a duty of twenty percent.[180] Assume the firm imports computer components into the U.S. for processing prior to export to Mexico for final sale. The company would be required to pay a 3.9% tariff on any component that it ships to the United States. Unless it satisfies the origin rules, when the component is shipped to Mexico the company would be assessed additional duties (most probably twenty percent depending on the form of the finished good). To eliminate the twenty percent Mexican duty and receive tariff-free entry into Mexico under the NAFTA origin rules generally applicable to products other than computers, the company would be required to show that the component (1) underwent a substantial transformation in NAFTA territory sufficient to prompt a tariff shift; (2) incorporated the requisite North American value content; or (3) both (1) and (2). Without the computer rule, if the company could not make this showing, Mexico would assess a duty on the product as a non-originating good.

Under Article 308 and Annex 308.1, downward harmonization will be complete within ten years of the signing of the NAFTA. At that time, the manufacturer will face the same rate of duty (3.9%) when shipping the component into any one of the

179. Int'l Trade Comm'n, Harmonized Tariff Schedule of the United States, Ch. 84 (1994 & Supp. 1 & 2) (adopted pursuant to 19 U.S.C. § 1202).

180. NAFTA, *supra* note 20, Annex 302.2 (Tariff Schedule of Mexico).

NAFTA signatories. Once a computer component enters NAFTA territory, the company can ship that component within NAFTA territory freely regardless of whether or not the imported component undergoes a manufacturing process sufficiently significant to prompt a "substantial transformation" or result in the creation of a good that is at least fifty percent North American. In other words, the company is not required to make any showing that it satisfied the NAFTA rules of origin.

The potential benefit of the CET to the Asian manufacturer is substantial.[181] Upon full implementation in 2005, if the Asian company ships directly to Mexico, it will encounter a tariff of only 3.9% versus the current rate of twenty percent.[182] Thus, the Asian firm has the opportunity to save $161 for every $1000 worth of computers shipped to Mexico.[183] In addition to these direct savings, the computer rule is easy to understand and apply. The Asian firm will eliminate the costly administrative burdens of origin determinations. Also, the Asian firm can choose its point of entry into the NAFTA territory based on efficiency considerations, rather than tariff treatment. In theory, both the direct and indirect savings will eventually reach consumers. The mandatory tariff reduction will improve the availability and price of computers, especially in the case of Mexico, which imposed comparatively high tariffs on computers prior to the start of the harmonization program.

The imposition of a CET creates greater trade liberalization than is available with an approach that requires compliance with the trade-inhibiting origin rule requirements. There are other advantages in addition to the practical ones outlined above. Because the rule harmonizes the common external tariff downward, even non-member countries can benefit from its extension. If extended, the rule will support the theoretical claim

---

181. Based on the calculations above, for every $1 million of computers shipped through the U.S. to Mexico for final sale, the firm will save $161,000. This figure represents the direct savings. They accrue to the company without any additional resource expenditure. In fact, the computer rule eliminates expenditures on rules of origin compliance measures. Thus, the total savings are significantly greater than the direct savings stated above.

182. NAFTA, *supra* note 20, Annex 308.1(A)(3).

183. The Mexican tariff = 20%; 20% x $1000 = $200. The lowest MFN rate = the U.S. tariff = 3.9%; 3.9% x $1000 = $39. $200 minus $39 = $161 savings in duties assessed. This calculation compares the pre-Agreement tariff rates with the rates that will be established upon full implementation of the computer rule.

that the NAFTA is a stepping stone to freer trade globally, rather than a protectionist bloc developed as a counterbalance to the European Economic Community. Reliance on the computer rule model will enable integrationists to rebut claims that the FTAA is a protectionist scheme designed to hinder European and Asian entry into American markets.

c. *Potential Problems, Incrementalism, and the Computer Rule*

An extension of the computer rule would be a sensible policy, but it is not without its problems. The extension of the computer rule will not resolve all origin determination issues definitively. Also, it will create additional issues that must be addressed if it is to be used effectively in the context of an FTAA or an enlarged NAFTA. Lastly, the imposition of the computer rule will have to overcome substantial obstacles to implementation, due to special interest involvement in the formulation of the rules of free trade and the novelty of the approach recommended here.

i. Remaining Origin Issues

The computer rule is not a panacea for all origin-related problems. The imposition of a CET would eliminate the need for origin rules only of the type applied in the Honda case. It would not eliminate the need for origin rules entirely. For example, some type of origin regime will remain necessary for statistical purposes and marking requirements.[184] Also, a mechanism to distinguish goods originating in GSP beneficiary developing countries from other imports will continue to be necessary. Nevertheless, the imposition of a CET would resolve the problems involved in making origin determinations for multiple country manufactures and thereby eliminate an obstacle to the implementation of an FTAA.

184. For a discussion of marking requirements for imports under 19 U.S.C.A. § 1304, see *supra* note 78 and accompanying text.

ii. New Issues

The elimination of rules of origin in favor of a CET creates a new set of issues that must be resolved. For example, the distribution of revenue generated from the common external tariff assessed as goods are imported into the NAFTA territory presents a substantial problem. As Mexico reduces its tariff rate on computers from twenty percent to 3.9%, the Mexican government will incur significant revenue losses. Mexico will lose even more revenue if companies from non-Parties ship the majority of computers through the U.S., and then to Mexico. Thus, the NAFTA signatories must establish some means of distributing the revenues garnered from the external tariff on computers imported into the NAFTA territory. There are several possibilities. One solution would be to deposit the CET revenues into an account for infrastructure development projects, which could be administered by the Inter-American Development Bank. A second option is to direct the revenues to a centralized inter-American environmental defense fund. This approach would facilitate environmental protection efforts and help to diminish the negative impact of the environmental lobby's opposition to free trade in the Americas.

iii. Overcoming Special Interests

The environmental lobby is not the only special interest group with active interests in the evolution of free trade arrangements. The formulation of specific NAFTA provisions like the rules of origin was a highly politicized process. A brief review of the Annex to the NAFTA Chapter on Rules of Origin reveals the level of special interest involvement in the drafting of the origin rules. For example, the automobile and textile industries were able to demand special rules of origin applicable to their industries.[185] These provisions complicate the origin regime. The extension of the computer provision will eliminate these complicating provisions but not without substantial political opposition. Industries protected by a tariff (even as low as

185. NAFTA, *supra* note 20, Annex 401 (describing what are commonly termed the specific rules of origin, which are based on CTH, regional value content, or both).

3.9%, as with computers and related goods) undoubtedly will fight the extension of the rule to their industries because it would result in a loss of tariff protection with respect to trade from other FTA members. Moreover, the rule will eliminate the protection provided by origin requirements against trade from FTA non-members. Thus, companies from non-member states will gain access to the NAFTA market more easily than before. In sum, the loss of this protection is bound to lead to political opposition, which will be a significant challenge for integrationists seeking an extension of the computer rule.

Another obstacle to the implementation of the suggestion made here is its novelty. The NAFTA computer rule is buried in an obscure annex. Only those involved in the computer industry or students of the trade accord are likely to know of its existence. This Article assumes an unorthodox position, primarily because the U.S. trade liberalization program for the Americas urges the creation of a free trade area, not a customs union.[186] The essential difference between the two is that the customs union has a common external tariff.[187] The leaders in the hemisphere who endorsed the creation of the FTAA ought to work to implement a CET, incrementally. Given the power of the textile and automobile lobbies, the result is likely to be a bifurcated trade accord or an FTA-customs union hybrid. Some goods will trade under a common external tariff. Others, like textiles and automobiles, will continue to trade under rules traditionally associated with an FTA. Those rules allow for member states of a free trade area to maintain their individual (external) tariff scheme and require that traded goods must satisfy origin requirements in order to receive the preferential tariff treatment bargained for during free trade negotiations. The imposition of a CET should be pursued as the *modus operandi* of

---

186. The Latin American Integration Association (LAIA), however, aims to create a common market. Treaty of Montevideo 1980, *supra* note 37. *See supra* Parts V.B. & V.C. discussing the LAFTA and the LAIA, which were established by the Treaties of Montevideo of 1960 and 1980, respectively. The texts of both of these South American-based integration initiatives demonstrate the existence of a long-standing trade liberalization program with the objective of the eventual imposition of a common external tariff. The extension of the NAFTA computer rule proposed here would achieve that end. It is ironic that the rule is lauded as one of the NAFTA's most innovative provisions. Its use in the creation of the FTAA is a viable option for resolving the origin problem, and a solution that will accomplish what Latin American integrationists have aspired to for more than thirty years.

187. *See* GATT, *supra* note 27, art. XXIII.

FTAA implementation, despite the political obstacles outlined above. It would eliminate the origin rule requirements for traders from FTAA member states, and thereby further liberalize trade in the Americas. Moreover, non-members would benefit as well.

IX. LEARNING FROM COMPUTERS: THE FTAA BUILDING BLOCK

The Summit of the Americas mandate to unify the many hemispheric trade agreements poses many problems for negotiators. One critical question they must resolve is which origin regime, of those that are operative in the Americas, should govern origin determinations in the FTAA. The computer rule presents a viable option. Working groups established at the Summit and within the NAFTA negotiating framework must adopt the origin rule as their FTAA building block.[188]

The combination of economic and political implications of Chile's accession to the NAFTA make it an opportune time to set important precedents. Chile is a comparatively small market for U.S. products and the economic impact of its accession to the NAFTA on the U.S. will probably be slight.[189] However, the political implications for all of the Americas are significant. Chile's accession is the first of the many North-South linkages that will be necessary for the establishment of the FTAA. Furthermore, it will send a signal to the countries of Latin America regarding the seriousness of the U.S. commitment to an FTAA. An additional benefit is that the particulars of Chile's accession will be scrutinized and evaluated by each potential NAFTA acceder.

Negotiators must demonstrate that they have learned from computers by declaring their intent to incrementally impose a CET. This would establish a workable norm at the outset of the FTAA implementation process. Subsequently, each country entering NAFTA accession negotiations will have settled expectations regarding the origin rules, which have been a primary sticking point in past initiatives intended to liberalize trade. Reliance on the computer rule model will allow negotiators to focus their attention on the time-frame for the downward harmoniza-

188. For a discussion of the origin rule working groups, see *supra* notes 74-76 and accompanying text.

189. *See* FOSTER & ALEXANDER, *supra* note 63, at 101.

tion of the external tariffs of each signatory country to the MFN level of the signatory with the lowest tariff for each good. In sum, the use of the NAFTA computer rule example can make the accession process a manageable one.

The long-term ramifications of Chile's smooth entry into the NAFTA are significant. The NAFTA accession clause, Article 2205, provides in general terms for the addition of new members.[190] Currently, the focus is Chile's successful accession. Article 2204, however, does not limit accessions to the countries of the Americas. In the future, the FTAA could include members from Asia and Europe. Doubts about the likelihood of such a proposal becoming a reality are understandable given the difficulties presented by integration in the Western Hemisphere. Nonetheless, there are positive signs. For example, in May of 1995, U.S. Trade Representative Mickey Kantor announced the need for exploratory discussions regarding a transatlantic free trade area between the U.S. and the EC.[191] The successful enlargement of the NAFTA will encourage such efforts. In this sense, the precedents set by the Chilean accession have the potential to influence the course of global liberalization programs beyond the year 2005 and the establishment of the FTAA.

X. CONCLUSION

This Article demonstrates the importance of identifying an innovative solution for the kinds of origin rule problems evidenced by the Honda controversy. The current rules are problematic and undermine many of the advances that the NAFTA and its expansion would otherwise bring to the region. Several efforts to resolve the issues related to origin determinations have failed. Nevertheless, negotiators have initiated a program to expand the NAFTA and establish an FTAA. Without a standardized rule or some other means of resolving the problems presented by origin rules, the obstacles they confront will be formidable.

The current origin regime inhibits the expansion of the NAFTA in at least three ways. First, the CTH test relies on the

190. NAFTA, *supra* note 20, art. 2205.

191. *IDB Report Downplayed at Ministerial Meeting*, INSIDE NAFTA, *supra* note 165, at 13.

Harmonized Tariff System, which was not designed for origin determinations. Thus, the HTS change of tariff heading approach requires complicated exceptions and special provisions that complicate matters for those engaged in or monitoring international trade. Second, regional value content tests require complicated and costly administration and bookkeeping, as well as subjective interpretations that are open to dispute. Also, they discriminate against countries like Chile and Mexico whose lower wage rates make it difficult to confer origin through processes that in the U.S. or Canada would confer origin based on value added. These discriminatory effects will grow in importance as the NAFTA membership becomes dominated by countries with wage rates more like those of Mexico than those of the United States. Third, the NAFTA origin regime creates unnecessary burdens on shippers and producers which prompt them to forego preferential treatment. When they do so, it negates any benefits of the carefully negotiated Agreement to liberalize trade. These burdens have resulted in calls for new standardization initiatives.[192] Yet, standardization efforts have been unsuccessful in the past. A new approach is needed.

The computer rule is the NAFTA negotiators' primary innovation. Despite its novelty, the leaders who participated in the Summit of the Americas must impose a CET on a broader scale. The CET will eliminate, within the NAFTA territory, complicated origin rules for multiple country manufactures. It will mark a fundamental departure from a past marked by failed integration initiatives. The arithmetic provided in the hypothetical case of an Asian computer firm presented above provides a supportive rationale for the adoption of the computer rule model for use in the FTAA. With each subsequent NAFTA accession, negotiators must grant common market treatment to those goods that will generate the least political opposition. Chile's NAFTA accession is the first opportunity. The trading community's growing awareness of the superior uniformity, simplicity, predictability, and administrability[193] of the computer rule approach will prompt

192. According to Tim Fairchild, corporate customs manager at Compaq Computer Corporation, "Harmonization is an absolute necessity. The fact that there is a degree of harmonization at all right now allows me to do my job without having a staff of 200 people to keep track of the different rules." Ken Cottrill, *supra* note 49, at 8.

193. For a discussion of the U.S. International Trade Commission report which

lobbyists to urge its adoption for the products of the industries they represent. Ultimately, goods from the automobile and textile industries will trade under a CET. Upon the creation of the FTAA, the governments in the Americas will have established a harmonized external tariff for all goods. The advantages that accrue from the adoption of the rule will transform it from an unorthodox recommendation to the preferred response to the origin rule problem and the *modus operandi* of the FTAA.

Curiously, it is computers that can provide us with advancements in international trade law on the order of those that they have brought in so many other sectors since the advent of the information age. This time, however, the advancements brought on by computers originate from their tariff treatment. Simón Bolívar's successors must not fail to recognize that the extension of the computer rule is just the sensible plan and well-directed action that Bolívar pronounced would be necessary to integrate the Americas.

---

established these four criteria to evaluate any new approach to origin determinations, see *supra* notes 120-124 and accompanying text.