Università Luigi Bocconi di Milano

RULES OF ORIGIN IN THE GATT – WTO SYSTEM

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PHD in International Law and Economics

XIX° Cicle

RULES OF ORIGIN IN THE GATT – WTO SYSTEM

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1.The functions of rules of origin

Rules of origin are the legal and administrative criteria applied to determine the nationality of imported goods. They exist because of discriminatory restrictions on international trade. In a completely open world economy, there would be little need for rules of origin because for most purposes it would be irrelevant to assess where goods originate. Even in a less than open world economy, the importance of rules of origin would be limited as long as trade-restrictive measures were applied on a non-discriminatory basis. Countries nevertheless do use origin rules, called non-preferential, to distinguish foreign products from domestic ones, for a variety of purposes, when they do not want to grant national treatment to foreign products. Non-preferential rules of origin are applied to impose discriminatory commercial policy instruments like trade defence instruments (TDIs - such as antidumping duties, countervailing duties and safeguard measures) origin marking requirements, tariff quotas, government procurement and trade statistics[1].

Following to the conclusion of free trade agreements (FTAs), many countries depart from the application of the most favoured nation (MFN) treatment of imported products. Whenever an importing country wants to differentiate between countries from which it imports products, it needs to define the nature of the link between each of these countries and the product that it wants to subject to a different, preferential

[1] See art. 1.2 of the WTO Agreement on rules of origin, World Trade Organization, *The Results of the Uruguay Round of Multilateral Trade Negotiations*, p. 241-254

treatment; such importing country must then define not only the foreign origin of the product but also the conditions under which it will consider that a product originates in the country to which it grants preferential treatment. The rules it adopts to do so are called preferential rules of origin. They establish the criteria to grant preferential treatment to the imported goods originating from the members to a FTA. Their main purpose is to prevent the trade deflection, which may arise when goods originating from third countries confront different tariffs in FTA member countries, creating an incentive to bring merchandise into the FTA through the member country with the lowest tariffs and then ship it as a duty free item to countries in the FTA with higher tariffs.

Whether non-preferential or preferential rules of origin should be applied is a major source of confusion at both institutional and firm level: the underlying common reasoning is that, since preferential rules of origin are more stringent than non-preferential ones, the compliance with the stricter criteria of preferential origin rules automatically satisfies the conditions set out by the non-preferential origin rules. Not to occur in this mistake, the definition of the origin of an imported product is to be done according to the purpose for which such an assessment needs to be made. The second step is to find out the appropriate legal source: while preferential rules of origin are based upon an international legal source, being normally provided for in an annex attached to the FTA, non preferential origin rules are national criteria established for the general purpose of determining the origin of imported goods. While in the context of an FTA preferential origin rules are an indispensable device to support the effectiveness of discriminatory trade regimes, they allow a positive discrimination to the products originating in developing countries imported under the Generalised Systems of Preferences (GSP). GSP origin rules are to be found as well in the national trade and customs legislation of the granting developed countries. The effectiveness performed by GSP rules of origin in regulating trade preference granted by developed countries and the desirability of harmonizing GSP origin rules, as provided for by the Doha Development agenda, is a raising issue which is gaining more and more attention[2]**.** Although there are cases in which the specific conditions provided for by both the preferential and non-preferential origin rule for a specific product are exactly the same, the case-by-case approach based upon the two-step analysis of both the

[2] See, *infra*, Charter III

purpose and the relevant legal source should never be disregarded not to occur in the fallacious identification of the origin.

Rules of origin have become more and more relevant as a consequence of the spiralling globalization of the international economy, featured by both the opening of international markets and the growing interdependence between national economies and international context. The development of logistic infrastructures and the consequent reduction of transportation's costs have been creating incentives to outsource the production in search of the country offering the lowest manufacturing cost for each stage of the productive process. This development, partially due to the progressive reduction of customs tariffs and dismantling of the quantitative measures, has exposed countries to a growing foreign competitive pressure, thus giving way to the frequent application of discriminatory non tariff barriers to trade. In this context, and in order to be better featured for the purpose of being used to apply discriminatory trade measures, rules of origin have been shifting from simple technical regulations, mainly used for statistical purposes, towards instruments of trade policy themselves. This evolution of the role of rules of origin in international trade has been mainly considered as a consequence of the increased use of trade defence instruments (TDIs), such as antidumping and anti-subsidy measures[3]. In more recent terms, the fact that many countries are either updating or adopting national origin marking regulations based upon the concept of origin is a further element accounting for the protectionist nature of rules of origin[4].

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[3] Vermulst and Waer have pointed out how *"during the 1990s, rules of origin sometimes took on a life on their own and developed in trade-restrictive measures in themselves where such restrictions did not necessarily, let alone automatically, follow from the application of other trade law instruments. Thus, for example, jurisdictions such as the United States and the EC used rules of origin as the legal justification for imposing anti-dumping duties on third country exports produced with components from the country with respect to which anti-dumping duties had been imposed following findings that the third country products had not acquired third country origin. Since no investigation had been conducted to determine whether the third country exports had been dumped and thereby caused injury, rules of origin were effectively used as a shortcut for imposing anti-dumping duties on exports from a third country, although the international legal basis for doing so was ambiguous, to say the least."* See VERMULST E., WAER P., "Anti – Diversion Rules in Anti-dumping Proceedings: interface or Short-Circuit for the Management of Interdependence?", in *Customs and Trade Laws as Tools of Protection: selected essays*, Cameron May, 2005, pp. 429-516

[4] Major attention, and at a global level, to origin marking as non tariff trade barrier and as a tool to sustain national products' competitiveness trade has been dedicated to the issue of marking the origin of goods more recently. China and Japan have recently adopted an origin marking legislation; Canada has recently revised its rules concerning origin marking in order to render them more suitable to effectively check the appropriateness of origin marking on imported goods; at EC level the proposal for a common origin marking system for imported products is currently under negotiation. See, *infra*, Chapter… More historical is the US legal experience and practice about origin marking. In fact, it has been pointed out how modern rules of origin law in the United States began more than half a century ago in cases involving the marking of imported goods with the name of their country of origin. See, PALMETER D., "Rules of origin in the United

Another reason for the growing importance of rules of origin has been found in the reduction of overall tariffs during the successive multilateral rounds of negotiations: in this respect it has been held that the technical complexity of rules of origin may have created the incentive for some countries to adopt stringent rules of origin in order to counteract the elimination of tariff measures. According to this view, the more trade is liberalized at the multilateral level, the more rules of origin, which are used to administer differentiated trade regimes, gain in importance[5].

Other authors have underlined the discretionary margin enjoyed by countries in the formulation and application of rules of origin.[6] In the absence of a multilateral regulation, individual countries retain the right to formulate and adopt their own rules of origin and apply them in any way they think appropriate. The customs authorities may use them as a rent-seeking instrument, while import-competing domestic industries may lobby for their restrictive construction and rigid application. Moreover, customs authorities have substantial discretion to ascertain whether imports have satisfied the rules. The protectionist dimension of rules of rules of origin became a cause of concern attracting efforts to envisage a multilateral discipline and set out the WTO harmonization programme.

The increasing number of preferential trade regimes is another reason why rules of origin play a key role in international trade.

2.The substantial transformation principle

States", in VERMULST E., WAER P., BOURGEOIS J., *Rules of Origin in International Trade, A Comparative Study*, The University of Michigan Press, 1994, p. 27.

[5] See Vermulst E. A., "The Importance of Rules of Origin in International Trade", Keynote Speech for the ADB Intensive Course on Rules of Origin, Bangkok, Thailand, 6 September 2004. The author refers to the fact that, as a result of the Uruguay Round, developed countries have agreed to a 40% cut in their tariffs on industrial products, from an average of 6,3% to 3,8%; moreover, the value of imported industrial products that receive duty-free treatment has jumped from 20% to 44%.

[6] La Nasa notes how, *"the formulation and application of rules of origin, far from being a transparent process, may leave the most developed countries free to use such rules to protect the domestic industries… The belief that the formulation and application of rules of origin is the result of a technical and objective process is a popular misconception."* According to this author in fact, the most developed countries take advantage of both this misconception and the absence of an effective GATT regulation to use the rules of origin as a tool of protection of the national economies. See LA NASA J., "Rules of Origin and the Uruguay Round's Effectiveness in Harmonizing and Regulating Them", in 90 *A.J.I.L* 625, The American Society of International Law,1996

According to Himagawa and Vermulst, "rules of origin not only have the potential of developing into trade policy instrument, but will in fact by definition impact on international trade flows. This seems seldom accepted by importing country administrators who tend to claim that the formulation of rules of origin and the application of such rules to concrete cases are technical exercises in which policy considerations play no role. This makes the administrators an easy target for domestic special interest". IMAGAWA H., VERMULST E., "The Agreement on Rules of Origin", in The World Trade Organization: legal, economic and political analysis, Oxford University Press, 2005, p. 604.

As already pointed out, over the last decades, determinations of the origin of goods in international trade have gained importance. During earlier years when the norm was to produce goods in one country and export from there, the use of origin rules to define a product's place of manufacture was simple. The advances of the technology in manufacturing processes have resulted in greater specialisation requiring ever-increasing capital investment. This has led to a growth in component suppliers, mostly independent from the manufacturer whose name appears on the final product. In many product areas the manufacturer, after the initial design and development stage, is little more than the "screwdriver" factory operator. The subcontract manufacturers who supply many components need not even be located in the same customs territory as the manufacturer or ultimate exporter but often in a country where the required resources, such as labour, are more economically available. Whether this situation brings into question, from an economic perspective, the weighting in relative importance of the factors of production, it puts into evidence, from a legal point of view, the need for simple origin definition. As a result of a great variety of manufacturing procedures, and thus of diverging economic interests, it is increasingly difficult to arrive at simple criteria on which the rules should be based.

Taking this background into consideration it follows that rules of origin vary considerably from country to country. There are also different kinds of rules within the regulatory scheme of a country, depending on both the government agency enforcing the rules and the policy objectives of that agency for their enforcement. Despite the lack of uniformity, two basic rules are virtually shared worldwide for determining the country of origin of imported goods. The first rule is the principle of complete production in one country. Generally speaking, whenever a good is obtained with operations that are wholly carried out in one country, determining its origin is normally not a difficult issue[7]; but the same cannot be said for the merchandise either containing components from third countries or partially manufactured abroad. In the latter case the legislation of each importing country defines conditions, types and amounts of foreign components that imported goods can contain. The general approach taken in most jurisdictions is that the origin of a product is determined by the location where the substantial transformation took place, that is, in the country in which significant

[7] **The origin of fishery products fished and transformed outside the limit of territorial waters is normally to be determined taking into consideration several factors such as: cite EC decision of 1984**

manufacturing or processing has been carried out. Rules of origin applied upon importation of foreign goods determine when a substantial transformation has taken place in order to confer to the imported product its essential character. Although countries differ in the manner in which they apply the principle, the majority of trading countries use three methods for determining whether a substantial transformation has occurred: change in tariff classification (CTC), value added method (VA), technical method (TM).

2.1 The change in tariff classification method

According to the CTC, the origin is being conferred if, as a result of the manufacture, the final product can be classified under a code of the Harmonized Commodity Description and Coding System that differs at a specific level, usually the four digit level, from the code under which the non-originating materials fall.

The Harmonized System (HS) is administered by the Customs Cooperation Council (CCC) which starting from October 3, 1994, adopted the working name of World Customs Organization. The HS is structured in twenty-one sections subdivided in ninety-nine chapters[8], categorized by productive sector, with goods grouped either according to the material of which are made or to the use, or function, they are destined to. It's a six-digit system and its signatories are obliged to use the same six digits in implementing their classification legislation, but are free to add more digits to classify the traded goods. Over the 90% of international trade is based upon this system, meaning that its application virtually meet the goal of being the internationally recognized language for trade. Tariff classification of the major trading partners is based upon the HS either at national or at regional level: it is for example the case of the US, Canadian, Japanese and Australian national tariff schedules. The EC Combined Nomenclature[9], the Nomenclature applied at Andean Community and MERCOSUR level are examples of regional implementation and development of the HS.

[8] Chapter 97 is reserved for possible future use, while chapters 98 and 99 are reserved for special uses by contracting parties

[9] The HS was implemented by the EC through Council Regulation 2658/87 on the tariff and statistical nomenclature and on the Common Customs Tariff. As the name of the Regulation indicates, this so-called Combined Nomenclature (CN) is used for both tariff and statistical purposes. Article 12 of Regulation 2658/87 provides that the Commission shall adopt each year, no later than 31 October, by means of a regulation, a complete version of the CN together with the corresponding autonomous conventional duty rates. The most important element of the yearly update consists of the amendments to Annex I to Regulation 2658/87 because the yearly revised Annex I contains the complete CN. The CN consists of twenty-one

The first two digits identify the HS chapter, the first four digits the HS heading and the first six digits the HS subheading. Classifying a good practically consists in finding the appropriate description and its correspondent HS code[10]. The tariff nomenclature of each State basically provides for the codification and description of merchandise, on one hand, and for the duties applied according to country of origin of each imported product, on the other hand. Each importing operation must be carried out based on the determination of tariff classification, origin, and whenever duty rates are levied *ad valorem*, on the customs value of the imported good.

The advantages of the CTC method are its conceptual simplicity, its ease of application and its lack of discretion. Furthermore, the adoption by almost all countries of the HS[11] means that a similarly applied CTC method will normally lead to uniform determinations of origin in such countries. It is therefore convenient that it was decided, early on in the Uruguay Round negotiations, and at US insistence, that any harmonization of non-preferential rules of origin delegated to the then CCC will be principally based on the CTC method. The relevant HS level whose change is more often considered to be origin conferring is the four digit one, and this explain why this method is often called "change in tariff heading". Nevertheless, following to a deeper comparative analysis of the different systems of rules of origin, it seems more appropriate to call this method according to how it generally works: in fact, whether it's true that the EC system of preferential and non-preferential origin rules and the WTO Harmonization Working Programme (HWP) of non-preferential origin rules are both mainly based on a change of the four digit code, and thus the expression "change in tariff heading" is correct, there still exist many examples of preferential and non-preferential origin systems in which the relevant HS change must occur either at chapter or at subheading level.

However the HS is primarily designed as a dual-purpose commodity classification and statistic system and may therefore not always be an appropriate basis for conferring the originating status. This has been realized by importing country authorities early on and has led to two lists of exceptions: i) a list of products with respect to which a change in

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sections, divided into 99 chapters. The first six digits are identical to the HS. The seventh and eight digit form the CN subheadings and can be used to make subdivisions not foreseen by the HS.

[10] It has been effectively noted how "tariff classification might be regarded as an operation putting millions of different kinds of goods into a limited number of pigeon holes", see HASAKURA H., "The Harmonized System and Rules of Origin", in *Journal of World Trade*, 27 (4), 1993, p. 13

[11] As of July 2007, the HS convention had 116 signatories and at last 73 other countries use it on a *de facto* basis

tariff heading is not sufficient to confer origin, thus additionally requiring a domestic content or an import content requirement and/or a requirement that specific manufacturing operations are carried out in the country in which the last production process takes place and ii) a list of exceptions with processing operations sufficient to confer origin even if they do not lead to a change in tariff heading[12].

The major disadvantage of the CTC method is that it requires in-depth knowledge on the part of producers and exporters of the HS and its application, through the classification legislation of the different countries, with respect to both the finished products and the semi-manufactured materials. The fact that in the everyday practice the customs classification of goods is carried out hurriedly without perception of the importance of this task is one reason for the substantial scarcity of customs experts skilled with both legal and technical tools.

2.2 The value-added method

The VA method occurs in three forms. In its first form, as the import content method, it imposes a ceiling in the use of imported parts and materials through a maximum allowable percentage of such parts and materials. In its second form, as the domestic content method, it requires a minimum percentage of local value-added in the last county in which the product was processed. The third form, the value of parts method, examines whether the originating parts reach a certain percentage of the total value of parts. This last method has been criticized as rather unfair, since it focuses on parts' value only and does not take into account assembly and overhead costs in the local production operations. The value-of-parts method is used as a subsidiary test to complement many EC origin rules[13] where the 45 percent value-added is not met. The percentage criterion method directly, under the pure domestic content test, or indirectly, under the import content test, specifies that a certain percentage of value-added in the last production process is necessary to confer originating status; if such a percentage cannot be reached, the last production process will not give origin and

[12] Such lists can be found, for example, in the EC GSP origin system
[13] See EC origin rule concerning radio and television receivers tape recorders

origin will be given to another country in the case of non-preferential rules or to no country at all where preferential agreements are concerned[14].

The percentage criterion, in particular the domestic content variant, requires an analysis of production costs. Production costs can be broken down in cost of manufacture and overhead costs. The cost of manufacture, in turn, can be divided into costs of materials, direct labour costs and manufacturing overhead.

) Costs of materials

This is the purchase price of parts, components, and the like. As explained above, the percentage criterion calculates either the maximum allowable import content or the minimum required domestic content. In either case, the question arises at what level imported, non originating parts ought to be valued, i.e. in ascending order: ex-works, FOB, CIF or into-factory (delivered). The answer to this question is important because each subsequent level leads to a higher price and thereby makes satisfaction of the import/domestic content test more difficult. It may be noted that Recommended Practice 5 of the Kyoto Convention's Annex D.1 endorses use of an ex-works price[15]. Countries generally value non-originating materials at their FOB (for example the United States) or CIF (like EC, Australia and Canada) value. A CIF valuation base means that all costs incurred in sending the parts from the factory to the importing country border would be treated as non-originating costs and that all post-border costs, such as inland freight in the importing country, customs duties indirect taxes, etc. would be treated as originating costs. A FOB valuation base would also treat the cost of ocean freight and insurance as originating cost items. Originating materials are normally on an into-factory basis.

) Direct Labour Costs

These comprise al the costs of the direct labour which can be identified or associated with production of the merchandise, such as basic pay, overtime pay, incentive pay,

[14] If, for example, the last production process is performed in a GSP beneficiary country, but not enough value is added, preferential treatment will be denied without a positive determination about the "real" origin of the merchandise.

[15] Recommended Practice 5 provides that for calculation of domestic content percentage, imported materials shall be valued at the dutiable value at importation (normally the CIF price) and produced goods shall be valued at the ex-works price or the price at exportation. Although Annex D.1 does not express a preference for the ex-works price over the price at exportation, there would appear to be a certain consensus that the ex-works price is more appropriate, see, e. g., Customs Cooperation Council, Permanent Technical Committee, *Rules of Origin of Goods*, Secretariat Note, 29.215E T7-3231, at 20 (2 November 1982). See, infra, Chapter II

bonuses, shift differentials, employee benefits, such as housing, holyday pay, retirement, social security programs, and any other employee-related expenses.

) Manufacture Overhead

This includes all indirect expenses incident to and necessary for the production of the product, such as indirect labour, supervision, depreciation, production royalties, rent, power, maintenance and repairs, and product-related R&D[16]. Manufacturing overheads would normally also include financing costs related to the production process (as opposed to financing costs related to the sales process)[17] which typically covers the financing costs of such items as raw materials, work in progress, the factory and the production line.

) General Overhead Expenses

These are often called selling, general and administrative (SGA) expenses. Such expenses cover all other expenses incurred (typically those related to the management and sales functions) for example, salaries of executives and salesmen, telecommunication expenses, outward freight and insurance, and legal and accounting fees. SGA also cover non-operating expenses (income) such as financing costs related to the sales process and exchange loss (gain).

Addition of all these cost items gives the fully allocated cost. The fully allocated cost plus the profit gives the sales price. The import content can easily be calculated by totalling the FOB or CIF cost of all non-originating materials. The domestic content can be calculated either by deducting the cost of non-originating materials from the sales price[18] or by adding up all items of local value added[19]. These two calculation methods would in theory lead to the same result. In practice, however, this is not always the case. The sales price as such is seldom used as the denominator in percentage criterion tests. Most jurisdictions rather rely on other denominators, such as an ex-works price or an FOB price which require certain adjustments to be made to the sales price. As a consequence, there are many variations between jurisdictions with respect to both the constituent elements, numerator and denominator, of the percentage criterion. Also, the allowable import/required domestic percentages are often different, even within the same jurisdiction where they appear to depend on the objective of the

[16] Non-product related R&D will generally be included in SGA as general expenses
[17] Financing costs related to the sales process would normally be reported as an SGA expense
[18] This is done, for example, under the EC and Canadian GSP rules and also under other EC preferential arrangements
[19] This is done, for example, under the U.S. and Australian GSP rules

law that they are designated to support[20]. Apart from this lack of uniformity in applying the percentage criterion among the different jurisdictions, a disadvantage of the percentage criterion is that it penalizes low cost or efficient production operations where labour and assembly costs will be lower than in high cost, inefficient facilities. Moreover, domestic content and import content calculations may change as a result of fluctuations in world market prices for raw materials and in exchange rates, creating uncertainty as to whether particular products meet the rule. Finally, domestic content calculations provide a certain amount of discretion to administrators, and technically would require detailed on-the-spot visits to check the accuracy of data provided. In general, the import content test seems preferable over the domestic content test because it is easier to apply and leaves the importing country administrators less discretion. This is because it is simply based on the prices paid by the producer, which can easily be checked through invoices, thereby obviating the need for complete cost of production calculations and allocations.

2.3 The Technical method

The TM prescribes certain production or sourcing operation that may (positive test) or may not (negative test) confer originating status. The advantage of this method is that of the three methods, it is best equipped to deal with the peculiarities of the situation at hand. However, on the other hand, it is also most easily abused by domestic interests[21]. An additional drawback of the negative test is that it only delineates those production or sourcing processes that do not confer origin, leaving therefore unclear whether other production or processes do[22]. The WTO Agreement on Rules of Origin in principle prohibits the use of negative technical tests, but provides two exceptions which still allow negative technical test during the transition period, either as a part of a clarification of a positive test or in individual cases where a positive determination of origin is not necessary. The wording of the second exception seems to leave importing

[20] The various preferential and non-preferential rules of origin
[21] Examples
[22] The EC product specific origin regulation with respect to photocopiers (the Ricoh rule) is a good example of a negative SPO rule. Although couched in general terms, the rule was really a producer-specific origin rule as it held that certain production processes performed by the Japanese producer Ricoh in an American plant were not sufficient to confer origin, thereby leaving it open which production processes would be considered sufficient

country authorities substantial discretion to resort to negative technical test during the transitional period.

2.4 The substantial transformation in the United States

The basic non-preferential rule of origin in the United States is substantial transformation. This is a judge-made rule, nowhere defined by statutory law. Its basic most authoritative formulation is that of the Supreme Court in *Anheuser-Busch*[23] whose statements have become the starting point of any discussion of US law concerning origin. According to the Supreme Court: "manufacture implies a change, but every change is not manufacture, and yet every change in an article is the result of treatment, labour and manipulation. But something more is necessary, as set forth and illustrated in *Hartranft v. Wiegmann*, 121 U.S. 609[24]. There must be a transformation, a new and different article must emerge, having a distinctive name, character or use". Just what it is new and different and what is a distinctive name, character or use are, of course, difficult questions. The questions are made more difficult because courts have formulated the rule differently from case to case, because the Customs Service itself does not use consistent terminology in its own regulations, and further because Congress has been content to remain silent on the issue. The Court of International Trade (CIT), in *Uniroyal Inc. v. United States* said "a substantial transformation…results in an article having a name, character or use differing from that of the imported article[25]". The CIT simply dropped the Supreme Court's requirement that "a new and different article must emerge" and required only the production of an article having a different "name, character or use". By this formulation, the process need change only the name, the character or the use, not all of them, and the article need not be new and different. A mere name change would meet the test articulated in *Uniroyal*, and this exactly what the CIT said in *Koru North America v. United States*:

[23] *Anheuser Busch Brewing Association v. United States*, 207 U.S. 556 (1907)
[24] *Hartranft v. Wiegmann*, cited and partially quoted in *Anheuser – Busch*, involved tariff classification. The question there concerned whether imported shells that had been cleaned and polished were, or were not, manufactured shells. The answer to this question determined whether the duty would be 35 percent *ad valorem* or zero. In holding that shells were not manufactured, the Supreme Court in 1886 coined the language later adopted by the *Anheuser-Busch* decision that echoes in rules of origin decisions a century later: "they were still shells. They had not been manufactured into a new and different article, having a distinctive name, character or use from that of a shell. The application of labour to an article, either by hand or by mechanism, does not make the article necessary a manufactured article, within the meaning of that term as used in the tariff laws". 121 U.S. at 615
[25] *Uniroyal Inc. v. United States*, 542 F. Supp. 1026, 1029 (Ct. Int'l Trade 1982)

"the article need not experience a change in name[26], character *and* use to be substantially transformed. Only one of these three prongs needs to be satisfied for a product to achieve substantial transformation"[27].

These statements however may be deemed *dicta* since they clearly were unnecessary to the decision rendered. In *Uniroyal* the Court found that no substantial transformation had occurred and in *Koru North America* the Court found a transformation of both name and character[28]. But the Court of Appeal for the Federal Circuit (CAFC) also has used the incomplete CIT's *Uniroyal* terminology. In *Torrington Co. v. United States*, the Appellate Court said "a substantial transformation occurs when an article emerges from a manufacturing process with a name, character or use, which differs from those of the original material subjected to the process"[29]. Despite the inexplicable exclusion of the "new and different" article requirement of *Anheuser-Busch*, the CAFC cites that case as authority for its formulation.

Four years later, however, a different three-judge panel of the CAFC, in an opinion that cited both *Anheuser-Busch* and *Torrington*, rejected that approach "with respect to the third *Anheuser-Busch* factors…the two products have different names….this is the least persuasive factor and is insufficient by itself to support a holding that there is a substantial transformation"[30].

The verbal confusion is compounded by the Customs Service whose regulations would not always be considered by everyone an example of the draftsman's art. For instance, for its regulation implementing the marking statute, Customs refers to a "process which results in a substantial transformation of the article, *even though the process may not result in a new or different article*"[31].

Unlike the CIT and the CAFC which, in *Torrington*, simply dropped the Supreme Court's "new and different article" requirement, Customs reformulates it, from new *and* different to new *or* different, and then explicitly rejects it. But elsewhere in its regulations dealing with articles assembled abroad with US components, consistent with *Anheuser-Busch*, Customs states "substantial transformation occurs when as a result of manufacturing processes, *a new and different article emerges, having a distinctive name, character, or use,* which is different from that originally possessed by

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[27] *Koru North American v. United States*, 701 F. Supp. 229, 234 (Ct. Int'l Trade 1988)
[28] Ibid., at 235
[29] *Torrington Co. v. United States*, 764 F.2d 1563, 1568 (Fed. Cir. 1985)
[30] *Superior Wire v. United States*, 867 F.2d 1409, 1414 (Fed. Cir. 1989)
[31] 19 C.F.R. § 134.1(d)(1) (emphasis added)

the article or material before being subject to the manufacturing process"[32]. For purpose of one Customs regulation, therefore, a substantial transformation occurs when "a new and different article emerges," and for the purpose of another, a substantial transformation may occur "even though the process may not result in a new or different article". There is no apparent policy reason for this inconsistency, the most likely explanation is simple carelessness in drafting[33].

2.4.1 The issue of a different standard of origin for different purposes

The different formulation of the substantial transformation test in the administrative regulations and in judicial opinions raises the question whether different statutory purposes require different degrees of substantial transformation. Is the test different if the issue is, for example, duty drawback rather than country of origin or MFN tariff rates? Both the courts and the Customs Service have been on both sides of this question, and it remains unresolved[34]. In 1984, the CAFC suggested that different standards might apply depending on statutory purpose, by stating in *Belcrest Linens v. United States* that: "although we decline to advance a definition of this term for all purposes, particularly because the implementing regulations under various tariff provisions define the term differently, it is clear that a substantial transformation occurs when, as a result of a process, an article emerges having distinctive name, character or use…."[35].

Two years later in *National Juice Product Assn. v. United States*, Judge Restani of the CIT noted the different policy purposes underlying tariff preferences duty drawback, and country of origin marking, and observed: "although the language of the test applied under the three statutes is similar, the result may differ where differences in statutory language and purpose are pertinent"[36]. In *Coastal States Marketing Inc. v. United States*, the following year, Judge Carmen of the CIT elaborated on the point in a case on MFN rates: "tests applied by the courts in determining whether a product has been 'substantially transformed' in the course of its progression through intermediate

[32] 19 C.F.R § 10.14(b) (emphasis added)
[33] See PALMETER, *supra*, footnote 4, p. 37
[34] **US Advanced Ruling procedure**
[35] *Belcrest Linen v. United States*, 741 F.2d 1368, 1372. In a footnote the court refers to the marking regulations, 19 C.F.R. § 134(d)(1) §
[36] *National Juices Products Assn. v. United States*, 628 F. Supp 978, 988-989 (Ct. Int'l Trade 1986)

countries such that the country of origin for customs purposes is affected are not necessarily identical within the various contexts"[37].

Less than a year later, *Ferrostaal Metals Corp. V. United States*, Judge Di Carlo of the CIT took a very different approach[38]. He termed "misplaced" the government's argument that the stringency of the substantial transformation test applied should depend on the context in which the issue arises[39]. None of the cases cited by the government in support of the argument, Judge Di Carlo held, including *National Juice Product*, "even remotely suggests that the Court depart from policy-neutral rules governing substantial transformation in order to achieve wider impor restrictions in particular cases"[40].

Ferrostaal dismisses the authority on the point of *National Juice Products* as simply a comment in a footnote; it does not mention *Coastal States Marketing*, and it concludes the topic with a very clear, straight-forward statement: "as a practical matter, multiple standards in these cases would confuse importers and provide grounds for distinguishing useful precedents. Thus, the Court applies the substantial transformation test using the name, character *and* use criteria in accordance with longstanding precedents and rules[41]".

Two months later, in *Superior Wire, A Div. Of Superior Products Co. v. United States*, Judge Restani returned to the issue and seemed to edge somewhat away from her view in *National Juice Product* and toward the view of Judge Di Carlo in *Ferrostaal*[42]. *Superior Wire* like *Ferrostaal*, presented the question whether a steel product, subjected to Voluntary Export Restraint (VRA) had been substantially transformed in a second country. Judge Restani raised the issue directly "there is a preliminary dispute as to whether the court may consider the purpose of the VRA in marking its decision as to whether a substantial transformation occurred"[43]. Always according to Judge Restani "in *National Juice Product*, the Court indicated that differing statutory language or purposes might vary the results.[44] The issue there was marking, and the court found

[37] *Coastal States Marketing Inc. v. United States*, 646 F. Supp 255, 257 (Ct. Int'l Trade 1986)
[38] *Ferrostaal Metals Corp. v. United States*, 664 F. Supp. 535 (Ct. Int'l Trade 1987). Ferrostaal was decided June 26, 1987; *Coastal States*, September 18, 1986; and *National Juice Products*, January 30, 1986
[39] *Ferrostaal*, 664 F. Supp. At 538
[40] Ibid.
[41] Ibid. at 539 (emphasis added)
[42] *Superior Wire, A Div. of Superior Products Co. v. United States*, 669F. Supp 472 (Cit. Int'l Trade 1987) (decided 21 August 1987)
[43] Ibid. at 477
[44] Ibid.

cases discussing substantial transformation in the context of marking most directly applicable, although the court relied on cases applying similar standards in other cases[45]. No statutory language or legislative purpose was available to directly guide the court in the contest of a VRA[46]. Thus, to the extent it is possible, the court must seek a neutral standard, unaffected by specialized statutory purpose, to determine the country of origin of the merchandise at issue"[47].

Judges of the CIT are coequal, and while they may be persuaded by each other, they are not bound by the opinions of their colleagues. However Judge Restani might have been persuaded by Judge Di Carlo. *Superior Wire*, accordingly, both because of its results and because of Judge Restani's language, would seem to strengthen the authority of *Ferrostaal*. But the issue is complicated by the fact that *Coastal States* was appealed and affirmed "on the basis the decision below", a month before *Ferrostaal* was decided.[48] Neither the CIT nor the CAFC opinions in *Coastal States* is mentioned in either *Ferrostaal* or in *Superior Wire*. Moreover, *Superior Wire* itself was appealed and affirmed, less than two years after the affirmance in *Coastal States*, without mention of the issue[49]. The issue is complicated even further by a still later decision by yet another CIT judge. In *Koru North America*, decided more than a year after *Ferrostaal*, Judge Tsoucalas stated: "in ascertaining what constitutes the country of origin under the marking statute, a court must look at the sense in which the term is used in the statute, giving reference to the purpose of the particular statute involved.[50]"

However, this statement was made not in the section of the opinion dealing with substantial transformation but in the previous section entitled "The Law of the Flag", dealing with the country of origin of fish caught by a vessel on the on high seas.[51] In the portion of his opinion dealing with substantial transformation, Judge Tsoucalas cites *National Juice*, *Coastal State*, and *Ferrostaal*[52] for a number of points, but not on

[45] Ibid.
[46] Ibid.
[47] Ibid. This statement was followed immediately by, *Ferrostaal*, 664 F. Supp. At 539: "multiple standards in these cases would confuse importers and provide grounds for distinguishing useful precedents". Subsequently, in *Timex Corp. v. United States*, 691 F. Supp. 1445 (Ct. Int'l Trade 1988), Judge Restani observed again in a foot note, that Customs Regulations define "product of the United States" for purposes of American goods returned generally in terms of substantial transformation. The same standards applies for drawback purposes." (Citing National Juice Products. See 691 F. Supp. 1445, 1448 n. 6.)
[48] *Coastal States*, 818 F.2d 860 (Fed. Cir. 1987) (decided 26 May 1987)
[49] *Superior Wire*, *supra* note 22 (decide 15 February 1989)
[50] *Koru North America*, *supra* note 19, at 233 (decided 23 November 1988)
[51] Ibid. at 231
[52] Ibid. at 234

the question of statutory purpose. In fact, other than in the statement quoted, the opinion in *Koru North America* does not address the issue.

If judicial authority is uncertain, the administrative position, at least, should be clear. It was the Customs Service itself, after all, that contended in *Ferrostaal* that changes sufficient to constitute a substantial transformation for one purpose would not be sufficient for another. But principled consistency does not always appear to prevail over short-term expediency at the Customs Service. On the day immediately after the trial was concluded in *Ferrostaal*, Customs, through the Treasury Department, published a Treasury Decision justifying a change in the country of origin of wool sweaters because there is but one law of substantial transformation "to applied in all country of origin decisions"[53]. Indeed, in an earlier ruling, Customs had been even more explicit: "Customs believes that Congress, by using similar language in statutes dealing with the origin of merchandise, clearly intended that there should be only one rule for determining the country of origin of merchandise without regard to the particular statute requiring that determination"[54].

Customs made this statement when issuing new rules of origin for textiles and textile products, rules that largely applied a specified-process test to determine substantial transformation for these articles. While the textile rules were issued under the authority of Section 204 of the Agricultural Act, and not under the Tariff Act, Customs expressed its view that "Congress did not intend for Customs to apply one rule of origin for duty and marking purposes and a different rule of origin for the purposes of Section 204[55]". According to Customs, "the principles of origin contained in the textile rules are applicable to merchandise for all purposes, including duty and marking[56]."

Yet the following year, in *Yuri Fashions*, Customs unblushingly argued precisely the opposite[57]. The case involved sweaters from an insular possession of the United States, the Commonwealth of the Northern Marian Islands (CNMI). Customs denied entry to the sweaters, maintaining that, under the textile origin rules, they were a product of Korea and therefore were subject to the quota applicable to sweaters from Korea (even though the sweaters meet the criteria necessary for both duty-free treatment and country of origin marking as a product of CNMI). Soon after *Koru North America* was

[53] T.D. 87-29, 21 Cust. B. & Dec. 37, 45, 52 Fed. Reg. 7825 (13 March 1987). Trial was concluded in *Ferrostaal* on March 12, 1987. 664 F. Supp at 536

[54] T. D. 85-38, 19 Cust. B. & Dec. at 64-65, 50 Fed. Reg. at 8713 (1 March 1985)

[55] Ibid. Section 204 of the Agricultural Act is codified at 7 U.S.C.A § 1854

[56] T. D. 85-38, *supra* note 46, at 68

[57] 632 F. Supp. 41 (Ct. Int'l Trade 1986)

decided, Customs began quoting from it for the proposition that "a court must look at the sense in which the term is used in the statute, giving reference to the purpose of the particular language involved[58]". Customs does not explain whatever happened to its publicly declared policy that "there should be only one rule for determining the country of origin of merchandise without regard to the particular statute requiring that determination[59]".

Presumably it is still good law, for while Customs was citing *Koru North America* for the proposition that the purpose of the statute controls, it published a further rule concerning origin for textiles that explicitly confronted the issue and explicitly reached the opposite conclusion. In a section of its ruling entitled "Uniform Application of Standard", Customs responded to commentators on the rule who "noted that recent court decisions have appeared to hold" that origin "depends on the particular statute under which that determination must be made and the intent of Congress in enacting that statut."[60]. Customs disagreed, with a statement that merits extended quotation: "Although such an inference may be drawn from language contained in some recent judicial decisions, Customs does not agree that the intended purpose of any of the statutes concerned requires standards to be applied which are different from the standards which Customs now seeks to uniformly apply. Customs also believes that application of the various statutes may not result in an article having more than one country of origin (*e. g.*, for marking, duty or textile restraints purposes) unless that result is explicitly directed by statute. Unless the courts hold that Customs should not apply the uniform standard in interpreting a particular statute, and that an article is to be considered a product of more than one country, Customs intends to continue its application of a unitary origin standard. Such a result is not only administratively expedient, but is legally required"[61].

2.5 The substantial transformation in the EC

The first act of the European Economic Community (EEC) authorities in the area of origin was Council Regulation (EEC) No 802/68 on the common definition of the

[58] *See, e. g.*, C. S. D. 90-52, 24 Cust. B & Dec. adv. Sheet no. 18, at 32; C. S. D. 90-61, 24 Cust. B. & Dec. adv. Sheet no. 21, at 31; C. S. D. 90-64, 24 Cust. B. & Dec. adv. Sheet no. 21, at 40; C. S. D. 90-68, 24 Cust. B. & Dec. adv. Sheet no. 23, at 18; C. S. D. 90-1, 25 Cust. B. & Dec. adv. Sheet no. 18, at 1
[59] T. D. 85-38, *supra* note 46, at 64-65
[60] T. D. 90-17, 24 Cust. B. & Dec. adv. Sheet no. 11, at 3-5 (14 March 1990)
[61] Ibid

concept of the origin of goods. At the end of the transitory period and following to the adoption of the common trade policy, with this framework regulation the EEC authorities set a first step towards the harmonization of the non-preferential origin rules, which thus far had been subject to diverging legislation in the different Member States[62].

The Court of Justice has rendered five judgements on the interpretation of the principle of the last substantial transformation: *Überseehandel*[63], *Yoshida*[64], *Cousin*[65], *Zentrag* [66]and *Brother*[67]. In these five judgements the Court to some extent clarified the general interpretation of the vague criteria of the then art. 5 without hesitating to scrutinize the application of these criteria by the Commission in the cases at hand, rather than allowing the Commission extensive discretionary powers.

In *Überseehandel* the question before the Court was whether untreated casein, imported from Soviet Union and Poland, but cleaned, grinded, graded and packaged in Germany, had acquired EC origin[68]. From the facts of the case, it is clear that the Origin Committee had concluded that these processes were insufficient to confer origin[69]. The question before the Court concerned only the interpretation of the first and the fourth condition of Article 5 of Regulation 802/68 because the parties seemed

[62] As the third memorandum of the preamble of Reg. 802/68 reaffirms: "in the absence of any international definition of the concept of the origin of goods, Member States at present apply thier own rules for the determination, verification and certification of origin; whereas the differences between national rules are likely to lead to differences in applying the common customs tariff, quantitative restrictions and other provisions applicable to trade with third countries, and also in the preparation and the issue of certificates of origin for goods exported to third countries", in OJ L 148/1968, p. 1.
The EC Court of Justice had already highlighted the importance of a uniform legislation about origin by stating that "A common definition of the concept of the origin of goods constitutes an indispensable mean of ensuring the uniform application of the common customs tariff, quantitative restrictions and all other measures adopted, in relation to the importation and exportation of goods, by the Community or by Member States". *Gesellschaft für Überseehandel mbH v Handelskammer Hamburg*, Case 49/76 (1977) ECR 41, para. 5

[63] *Supra*, note 63

[64] *Yoshida Nederland B. V. v. Kamer von Koophandel en Fabrieken voor Friesland*, Case 34/78 (1979) ECR 115 [*Yoshida I*]; *Yoshida GmbH. V. Industrie- und Handelskammer Kassel*, Case 114/78, (1979), ECR 151 [*Yoshida II*]

[65] *Criminal proceedings against Cousin and others*, Case 162/82 (1983), ECR 1101

[66] *Zentralgenossenschaft des Fleischergewerbes e. G. v. Hauptzollamt Bochum*, Case 93/83 (1984), ECR 1095

[67] *Brother Industries Limited et al. v. Commission*, Case 229/86 (187), ECR 3758

[68] From the facts of the case as recorded in the judgement, it is not perfectly clear what exactly the material benefit for the plaintiff was in obtaining EC origin. In the Advocate General's opinion, it is simply noted that, "Many of the plaintiff's customers are in third countries... For its exports to them it is to the adventage of the plaintiff to have certificates showing the origin of its ground casein as being the Federal Republic of Germany". *Überseehandel*, *supra* note 63, at 58

[69] Ibid., at 48

to agree that the processes were "economically justified (second criterion) and "were performed in an undertaking equipped for that purpose" (third criterion)[70].

The main line of the plaintiff's argument was to link the first criterion to the second criterion by stating that the word "substantial" is semantically similar to the words "economically justified" because the question whether an operation is substantial can only be determined in economic terms. Since it was not contested that the processes were economically justified, these should also be considered as substantial. With regard to the fourth criterion, the plaintiff argued that untreated casein is not soluble in water and cannot be used. The grinding of the casein is essential if the product is to be used, which shows that the processes represent an "important stage of the manufacture" and meet the fourth criterion[71].

The Court held that the determination of the origin of goods must be based on a "real and objective distinction between raw material and processed product, depending fundamentally on the specific material qualities of each of those products"[72].

The last process or operation can only be considered substantial for purposes of article 5 (first condition) if "the product resulting therefrom has its own properties and composition of its own, which it did not possess before the operation or process[73]". The Court then in effect linked the first and the fourth condition by holding that "in providing that the said process or operation must, in order to confer a particular origin, result in the manufacture of a new product or represent an important stage of manufacture. Article 5 shows in fact that activities affecting the presentation of the product for the purposes of its use, but which do not bring about a significant quantitative change in its properties, are not of such a nature as to determine the origin of the said product"[74]. The Court ruled that the grinding of the casein only changed the "consistency of the product and its presentation for the purpose of its later use; it dose not bring about a significant qualitative change in the raw material"[75]. The Court further held that "the quality control by grading to which the ground product is subjected and the manner in which it is packaged relate only to the requirements for marketing the products and do not affect its substantial properties"[76]. The Court

[70] Ibid., at 52
[71] Ibid., at 45
[72] Ibid., at 53
[73] Ibid.
[74] Ibid.
[75] Ibid.
[76] Ibid.

decided that the grinding together with the grading and the packaging of casein could not be considered a substantial process or operation for the purpose of Article 5[77].

It should be noted that the Court, in this judgement, cut through the sophisticated semantic distinction drawn by the plaintiff and the Commission between the meaning of the "substantial" in the first criterion and the fourth criterion by effectively linking both criteria[78]. A manufacturing process would seem to be substantial for purposes of the first criterion if it satisfies the fourth criterion, namely, if the process results in the manufacture of a new product or represents an important stage in manufacture[79].

With regard to the fourth criterion, the Court also seemed to blur the distinction that he process or operation must result in the manufacture of a new product, or represent an important stage of manufacture[80]. By requiring that the process should bring about a significant qualitative change in the properties of the product – which would seem to mean essentially the manufacture of a (new) distinct product – the Court, within the limits of the facts of this case, would seem to deny a distinct alternative meaning to the criterion "important stage of manufacture". Ana alternative meaning of "important stage of manufacture" could consist of operations that do not bring about a significant qualitative change in the product but represent nevertheless a considerable value added[81]. This could have been the case if the value of untreated casein would have been very low, but the cleaning, grinding, grading and packaging operations, for example,

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[77] Ibid., at 54

[78] It is worth noting that in its argument in this case, the Commission tried to provide a theoretical distinction between the first criterion, "substantial process or operation", and the fourth criterion "manufacture of a new product or important stage of manufacture". According to the Commission, the criterion "substantial process or operation" expresses a "dynamic" point of view, because it necessitates an examination whether that activity as such plays an important part in the production as a whole. Regarding this, the question whether such an activity is indispensable to putting the product to its final economic use is not decisive. The Commission argued that, on the other hand, the criteria "manufacture of a new product" or "important stage of manufacture" express more a "static" point of view since they involve making some sort of comparison between the product as it was before the process and the one obtained after it, in particular to establish whether there is a significant qualitative change which would mean that the process represents an "important stage of manufacture". Ibid., at 49

In the opinion of Advocate General Warner this distinction was given short thrift. The Advocate General stated, "it seems to me that this is pushing semantic analysis too far. To my mind a process or operation is 'substantial' if it is the opposite of insubstantial, i.e., if it is not negligible or not trivial. Indeed I think that the phrase 'the last substantial process or operation' in Article 5 is to be interpreted as a single phrase, in which the emphasis is on 'last'. Ibid., at 59

[79] The Court on this point did not follow the Advocate General's opinion. In the Advocate General's opinion, the first condition was satisfied in this case, but the difficult question was only whether the fourth condition was satisfied. Ibid., at 59

[80] This distinction had been maintained by the Advocate General in its opinion. See ibid., at 59, *in fine*

[81] This would seem to some extent have been the reasoning of Advocate General Warner, who considered the value added and the comparative importance of the processes in determining the quality level of the finished casein to arrive at the conclusion that the processes in the case at hand were not an important stage in the manufacture. Ibid., at 61-62.

being the most machine and labour intensive, would be the most expensive production processes in the production of ready-to-use casein. In other words, this interpretation would confer origin in the country where expensive processing operations are performed on cheap raw materials but do not bring about a significant qualitative change in the product. It may be noted that, although not discussed by the Court, the value added by the processes in the case before the Court would appear to have been rather small[82]. Although the choice between an economic and technical approach of the origin determination would not seem to have been a material issue with regard to the facts of the case presented to the Court, the Court in *Überseehandel* would seem to have chosen a technical and qualitative approach. The Court also denied relevance to the use of the customs tariff classification of processed products as a criterion in the origin determination because the Common Customs Tariff has been "conceived to fulfil special purposes and not in relation to the determination of the origin of products"[83].

Finally the Court followed the invitation of the Commission[84] to give prominence to the pinions of the Origin Committee. The Court Stated: "Although opinions expressed by the Committee are not binding, except in so far as the Commission has adopted implementing provisions in application of Article 14(3)(a) of Regulation 802/68, nevertheless, until such time as the Commission adopts contrary provisions under subparagraph (b) and (c) of the said Article 14(3), they constitute an import criterion for interpreting Article 5 of the said regulation, the scope of which they define in respect of specific cases"[85].

In the *Yoshida* case, the Court had to judge the validity of the product-specific origin rule on slide fasteners that the Commission had adopted in 1977 and which provided in Article 1 that slide fasteners originated in the country of "assembly including placing of the scoops or other interlocking elements onto the tapes

[82] As is apparent from the Advocate General's Opinion, customers estimated the value added to range mainly between 5 and 20 percent. Ibid., at 62

[83] Ibid., at 52

[84] In its arguments the Commission had requested the Court to express its view on the status of the opinions of the Origin Committee, which the Commission argued should - similar to the case law of the Court on the opinions of the Committee on Common Customs Tariff Nomenclature – be considered to be an important factor for the interpretation of the Basic Origin Regulation. Ibid., at 47

[85] Ibid., at 54

accompanied by the manufacture of the slider and the forming of the scoops or other interlocking elements"[86].

This specific origin rule was the result of a long history going back to an antidumping proceeding that the Commission had initiated in 1973 against slide fasteners from Japan[87]. The proceeding had been terminated two years later "having regard to the development of the situation"[88]; in particular the assurances the Japanese company Yoshida Kogyo gave to the Commission to raise its export prices and not to exceed a certain ceiling of exports to Italy[89]. In 1975 the Commission introduced a Community surveillance system with regards to imports of slide fasteners[90] because it had found that Community imports of slide fasteners, particularly from Japan had increased considerably and thereby threatened to cause injury to the EC industry of slide fasteners. Yoshida Kogyo furthermore negotiated a voluntary export restraint with the Italian government. Nonetheless, Italian imports of Yoshida zippers kept increasing. When the Italian government discovered that the zippers produced by Yoshida Kogyo in its Dutch an d German factories included Japanese parts, it addressed the Origin Committee[91]. This action eventually led to the adoption of the specific origin rule, which had the effect that the zippers produced by Yoshida Kogyo in its Dutch and German factory could no longer obtain EC origin. It should also be noted that the product-specific origin rule, in the absence of a qualified majority in the Origin Committee and action being taken by the Council, was promulgated by the EC Commission in accordance with Article 14.3.c of Reg. 802/68[92] (spiega questo articolo cosa dice).

Both Yoshida's Dutch and German subsidiaries challenged the validity of this product-specific origin rule in two separate national proceedings, which both culminated in a requests for a preliminary ruling by the Court[93].

The Court held that the examination whether the operations required by the product-specific origin rule correspond to the requirements laid down in Article 5 of Reg. 802/68 was a "question of technical nature which must be examined having

[86] Regulations (EEC) No 2067/77 of the Commission of 20 September 1977 concerning the determination of the origin of slide fasteners, OJ (1977) L 242/5
[87] OJ (1973) C 51/2
[88] OJ (1975) C 63/1
[89] *Yoshida II*, *supra* note 65, at 163
[90] Commission Regulation (EEC) No 646/75, OJ (1975) L 67/21
[91] Opinion of the Advocate General Capotorti in *Yoshida I*, Case 34/78 (1979) ECR 146
[92] Ibid., at 138
[93] *Yoshida I*, *supra* note 65; *Yoshida II*, *supra* note…22

regard to the definition of a slide fastener and of the various operations resulting in its formation"[94]. On the basis of an analysis of the production processes of zippers, the Court determined – contrary to the opinion of Advocate General Capotorti[95] – that the combination of the processes of i) the attaching of the metal scoops or nylon spirals to the tapes and the subsequent joining of the tapes; the attaching of bottom stops and top stops; the insertion and where necessary the colouring of the sliders; and the drying and cleaning of the slide fasteners followed by the cutting of them to make individual slide fasteners; must be considered as constituting the "last substantial process or operation" conferring origin because they resulted in a "new and original product which, in contrast to each of the basic products , is a linking element which can be separated over and over again and is used to join objects, in particular pieces of fabric". The Court then declared the specific origin rule not valid because "the slider constitutes merely a particular part of the whole, the price of which cannot moreover have an appreciable influence on the final cost of a slide fastener and which, although it is a characteristic feature thereof, is however of no use unless it is combined in a harmoniously assembled whole". The Court here for the first time sets limits to the powers of the Commission under Reg. 802/68. In its reasoning the Court would seem to have emphasized that it should be the last substantial transformation that confers origin. The Court further rejected the use of rules of origin for the imposition of excessive local content conditions[96].

[94] *Yoshida I*, *supra* note 65, at 135

[95] In his opinion Advocate General Capotorti essentially stated that for the origin determination a technical criterion should be preferred over an economic criterion because there are serious objections against the use of a an economic criterion. The differences in production costs – among others dependent on salary levels, interest rates, and other factors differing from country to country – fluctuations in certain cost factors, the difficulties that arise from determining whether the cost of different processes have been accurately assessed, etc., make the use of an economic criterion problematic. Therefore, according to the Advocate General, the Commission was right in using a technical criterion with a high degree of objectivity. With regard to the origin determinations of the slide fasteners, the Advocate General stated that basically the alternative was, on one hand, to consider the assembly (the attachment of the scoops and the slider) as the last substantial transformation or, on the other hand, to go one step further back to the manufacture of both parts that are the typical components of a slide fastener, namely the scoops and the slider. According to the Advocate General, the Commission was right in considering the "assembly" process as such as not decisive. Otherwise every product assembled in the Community would achieve Community origin even if all parts are manufactured elsewhere. Since the production of either the scoop or the glider in itself cannot be considered as a "substantial transformation", the Commission correctly considered that the manufacture of both elements together with the assembly constituted the last substantial transformation. Ibid., at 141, 143, 144

[96] It may be noted that in the arguments of the plaintiffs in this case, it was put to the forefront that the product-specific origin rules should be neutral and cannot be used for commercial policy purposes. The plaintiffs exposed the trade restrictive character of the product-specific origin rule aimed at Yoshida, which had been using gliders of Japanese origin in its production of slide fasteners in the European Community. *Yoshida II*, *supra* note 22, at 155. See Opinion of the Advocate General Capotorti, who essentially argued

The *Cousin* case involved the interpretation of the specific origin regulation on certain textiles products[97]. Unbleached cotton yarn imported from Egypt and the United States was processed into ready-to-use yarn through the processes of gassing[98], mercerizing[99], dying, spooling and re-spooling in Germany. The products thus processed had been declared to French customs by the parties concerned as being of German origin. French customs challenged the origin declarations on the basis of the application of the criteria laid down in the product-specific origin regulation[100].

The product-specific origin regulation essentially relied on a combined change in tariff heading and technical description approach. The principal rule was that a change in tariff heading conferred origin with the exception of, on the one hand, certain processing operations that resulted in a change of tariff heading but did not confer origin or conferred origin only subject to certain conditions (list A) and, on the other hand, certain processing operations that that did not result in a change in tariff heading but that nevertheless did confer origin (list B)[101]. The processes carried out in Germany did not result in a change in tariff heading, and as the cotton yarn concerned did not appear in list B, the application of the product-specific origin regulation led to the conclusion that no German origin had been acquired[102].

In addressing the issue of the validity of the product-specific origin rule the Court first recalled the principle set forth in *Yoshida* judgements "that in adopting implementing provisions pursuant to Article 14 of the Council Regulation 802/86, the Commission is obliged not to exceed the powers which the Council has conferred upon it for the

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that no rule will ever be neutral since every rule will always be beneficial for some companies and work to the disadvantage of others and further challenged Yoshida's assertions on the facts. Ibid., at 145 ff.

[97] Commission Regulation (EEC) No 749/78, OJ (1978) L 101/7

[98] In this process fluff and small fibres are burnt off the thread with the aid of electric burners. The yarn is passed over the burners at a speed sufficient to ensure that the protruding material is burnt away without scorching or burning the yarn. The effect of the process is that the yarn is lighter in weight, smoother and softer to the touch. Its commercial value and usefulness is increased. Opinion of Advocate General Sir Gordon Slynn, *Cousin*, *supra* note 45, et 1, 124

[99] In this process the yarn is impregnated under tension with caustic soda. This increases its strength by between 30 and 40 percent and gives a silky sheen after drying. Ibid., at 1.125

[100] It is interesting to note that the material issue in the case only concerned the criminal sanctions for incorrect origin declarations under French law. Imports to France of cotton yarn not put up for retail sale, in free circulation in Germany but originating in the United States or Egypt, were free at the time and not subject to restrictions, since France had not introduced protective measures based on Article 115 of the EEC Treaty with regard to this product- Ibid., at 1, 113

[101] Commission Regulation (EEC) No 749/78 on the determination of origin of textile products falling within Chapters 51 and 53 to 62 of the Common Customs Tariff, OJ (1978) L 101/7

[102] The product at issue, cotton yarn not put up for retail sale, falling under heading 55.05 of the Common Customs Tariff, appeared only in list A with the additional requirement of "manufacture from products falling within heading No 55.01 to 55.03, "namely cotton waste, not carded or combed". Cousin, supra note 45, at 1.118

implementation of the rules which it had promulgated in that regulation and, more precisely, that it must define specific criteria of origin which comply with the objective criteria of Article 5 of Regulation (EEC) No 802/68 of the Council which is the legal basis of the implementing regulation and the source of the powers which the Commission exercises in adopting it"[103]. The Court also reiterated its *dictum* in *Überseehandel* that for the purposes of the application of Regulation 802/68 it was not sufficient to seek criteria for defining origin in the tariff classification of processed products, depending fundamentally on the specific material qualities of each of those products[104]. The Court then stated: " however those principles do not prevent the Commission, in exercising the power conferred upon it by the Council for the implementation 5 of Regulation 802/68, form having a margin of discretion which allows it to define the abstracts concepts of that provision with reference to specific working or processing operations"[105]. The Court held that the product-specific origin rule on textiles had not breached the principle set forth in *Überseehandel*, because it had only taken tariff classification as a basic rule and had adapted and supplemented that rule by lists A and B to take account of the particular features of specific working or processing operations[106]. The Court objected, however, to the fact that under the regulation the process of dying, accompanied where appropriate by mercerizing and gassing, are not to confer on unbleached cotton yarn the status of product originating in the country where those processes took place, while dying accompanied by finishing operations is sufficient to confer the status on knitted and crocheted fabrics[107]. The Court noted that the Commission had provided no explanation relating to the nature of the products and the processes in question that might justify such a difference in treatment between the process of dying and other finishing operations carried out on cloth and fabrics on the one hand and on cotton yarn on the other. The Court held that: "In these circumstances, it appears contradictory and discriminatory for Regulation No 749/78 to provide substantially more severe criteria for the determination of the origin of cotton yarn than for the determination of the origin of cloth and fabrics. Although the Commission possesses a discretionary power for the application of the general

[103] Ibid., at 1.119.
[104] Ibid., at 1.120
[105] Ibid.
[106] Ibid.
[107] In addition the Court noted "in fact, not only cotton yarn does not appear in List B, but it is mentioned in list A in such a way that, to enable it to be regarded as originating in a country, it must even haven been made there from cotton or cotton waste which has not been carded or combed". Ibid., at 1.121

criteria contained in Article 5 of Regulation 802/68 to specific working or processing operations it cannot, however, in the absence of objective justification, adopt entirely different solutions for similar working or processing operations"[108].

Notwithstanding the fact that the Court would seem to recognize a certain discretionary power to the Commission in the application of Reg. 802/68, it nevertheless invalidated the product-specific origin regulation basically on the ground of its contradictory and discriminatory character. Although the Court did not invoke this ground, it is clear from the opinion of Advocate General Sir Gordon Slynn, that the processes of dying, eventually accompanied by mercerizing and gassing, bring about a substantial qualitative change and a very substantial value added[109]. It's interesting to note that the Court in Cousin did not go as far as in Yoshida, by stating that the processes of dying, eventually accompanied by mercerizing and gassing, would be sufficient to confer origin[110].

In *Zentrag* the Court confirmed its judgement in *Überseehandel*. Zentrag imported meat from Austria. The meat originated from animals slaughtered and cut in beef quarters in Hungary. Zentrag's Austrian supplier had the meat boned, trimmed and sinews drawn, cut in pieces and vacuum packed in a processing plant in Austria. It was in Zentrag's interest to have the meat considered as originating in Austria because then it would be subjected to substantially lower import levies in the context of the Common Agricultural Policy.

The Court first had to interpret the applicability of the Meat and Offals Origin Regulation[111] to the facts at hand. The Court noted that this regulation provides that slaughter confers on the meat the origin of the country where it takes place if the slaughtered animals were previously fattened for a certain period in that country. The

[108] Ibid., at 1.121

[109] In his opinion Advocate General Sir Gordon Slynn stated that "the processes involved in this case, with the exception of spooling, do satisfy the text laid down in Article 5; gassing reduces the weight of the yarn and makes it smoother, with consequent effects on the fabric woven from the yarn; the increase in strength resulting from mercerizing, which is of the order of 30 to 40%, is in my view a significant qualitative change; dying was accepted by the Commission as an operation which would affect origin in both Regulation No 1039/71 and Regulation 749/78 in the case of woven fabrics (where accompanied by finishing operations such as mercerizing)". Ibid., at 1.128, 1.129, and further "these processes increase the commercial value by 159% even if certain processes such as gassing and mercerizing…are not performed…the increase in value attributable to dying alone is 99%". Ibid., at 1.125

[110] As was suggested by Advocate General Sir Gordon Slynn, ibid., at 1.129. This origin rule was finally amended nine years later by Commission Regulation (EEC) No 1349/91 of 24 May 1991 determining the origin of textiles and textile articles falling within Section XI of the combined nomenclature, OJ (1991) L 104/8

[111] Commission Regulation (EEC) No 964/71 on determining the origin of the meat and offals, fresh, chilled or frozen, of certain domestic animals, OJ (1971) L 104/12.

Court further noted that the statement of the reasons for this regulation showed that the Commission did not wish to adopt a position on the matter of what subsequent operations may be capable of conferring a new origin on the meat[112]. Hence this regulation was not conclusive for determining whether the subsequent processing operations performed by Zentrag's Austrian supplier did confer origin. With regard to this question, the Court referred to *Überseehandel* and reiterated that activities that alter the presentation of a product for the purpose of its use but that do not bring about a significant qualitative change in its properties do not determine the origin of the product[113]. The Court stated: "In the present case, it may be accepted that the operations in question facilitate the marketing of the meat by enabling it to be sold to the consumer through commercial undertakings which do not have their own butcher. However these operations do not produce any substantial change in the properties and the composition of the meat, and their main effect is to divide up the main parts of a carcase according to their qualities and pre-existing characteristic and to alter their presentation for the purpose of sale. A certain increase in the time for which the meat will keep and a slowing down in the maturing process do not constitute a sufficiently pronounce qualitative change in substance to satisfy the requirements mentioned above[114]. The Court also noted that: "Finally, while the market value of a whole beef quarter which undergoes the operations at issue is increased, according to the calculations supplied by Zentrag at the hearing, by 22%, that fact is not it itself of such a nature as to enable those operations to be regarded as constituting the manufacture of a new product or even an important stage of manufacture[115].

In this case, the Court thus for the first time explicitly addressed the value added criterion. It held that a 22 percent added value in itself would not constitute the manufacture of a new product or even an important stage of manufacture.

The *Brother* case followed a 1986 Commission decision to terminate the antidumping proceeding concerning typewriters from Taiwan, because "the cost of

[112] *Zentrag*, *supra* note 67, at 1.105
[113] Ibid., at 1.106
[114] Ibid., at 1.106. The Court seems to have followed the arguments of the Commission in this case. The Commission had argued that "Those operations can be carried out with expert knowledge alone and do not require the use of any special machines or implements….marketability is not the decisive criterion, The operations described do not bring about any change in the essential properties of the product or enhance its value appreciably…Admittedly, those processes also improve the quality of the product to a very slight extent, but they do not add to its properties unlike the case where a processed product such as corned beef or sausage is manufactured from beef". Ibid., at 1.101
[115] Ibid.

these (Taiwanese) operations was found to be less than that which would constitute the last major transformation required by Regulation 802/68 to confer Taiwanese origin on the goods in question"[116].

Brother Ltd., Brother Taiwan and Brother UK had first brought a direct action against this decision and a subsequent memorandum sent to all Member States signed on behalf of the Director-General for External Relations of the EC Commission. The Court had declared this direct appeal inadmissible because the Court held that the decision, even considered in conjunction with the memorandum, did not constitute an act that might adversely affect the legal position of Brother: the actual determination with regard to the origin of the typewriters produced by Brother in Taiwan was to be made by the Member States.

The customs authorities in Germany verified Brother in September 1986 and determined that the typewriters imported from Taiwan originated in Japan and the antidumping duty for typewriters originating in Japan[117] was retroactively applied to the typewriters exported from Taiwan. The consequence was that the German customs authorities ordered Brother to pay the antidumping duty. Brother appealed against this decision on the ground that the typewriters produced in Taiwan should be considered as originating in Taiwan on the basis of the application of Regulation 802/68: while most of the parts came from Japan, they were mounted and assembled in Taiwan in a fully equipped factory into ready-for-use typewriters. In the opinion of Brother, this was furthermore not a case of circumvention because the factory had existed for a long time and typewriters produced there had been exported to Germany since 1982[118].

In a question submitted by the competent German tribunal, the European Court of Justice was requested to apply the principles of article 5 and 6 of the Regulation 802/68 to the situation at hand.

With regard to the application of Article 5 to assembly operations, the Court first noted the basic arguments submitted by the parties involved. Brother's view was that the conditions in Article 5 were technical and that assembly constituted a classical operation of transformation within the meaning of this provision to the extent that it consists of the assembly of a great number of parts to form a new coherent whole[119].

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[116] *Electronic Typewriters* (Taiwan), OJ (1986) L 140/52
[117] *Typewriters* (Japan), OJ (1985) L 163/1 (definitive)
[118] Ibid., at 7
[119] Ibid., at 13

The Commission argued that the mere assembly of previously manufactured parts should not be regarded as a substantial process or operation within the meaning of Article 5 where, in the view of the work involved and the expenditure on materials on the one hand and the value added on the other, the operation is clearly less important than other processes or operations in another country or countries[120].

In this case, the Court recognized for the first time the relevance of the Kyoto Convention for the interpretation of the Regulations 802/68. In its reasoning the Court referred to the Sixth Standard of Annex D.1 of the Kyoto Convention to distinguish "simple" assembly operations from other types of assembly operations. It defined a simple assembly operation as an operation that does not require a specially qualified labour force, precision machinery or a specially equipped factory. Such an operation could not be considered to confer on a product its essential characteristics or properties[121]. Other types of assembly could confer origin. The Court stated that an assembly process could confer origin if it represents, from a technical point of view and having regard to the definition of the assembled product, the decisive stage of production during which the use to which the component parts are to be put becomes definite and the goods in question are given their final specific qualities[122]. However the Court noted that in view of the variety of assembly operations there might be situations in which an examination on the basis of technical criteria might not be decisive for determining the origin of a product. In those cases it is necessary to take account of the value added as an ancillary criterion[123]. The Court did not specify the value added required but limit itself to providing some guidelines, which in view of the practical importance of this matter deserve to be quoted in full: "as regards the application and in particular the question of the amount of value added which is necessary to determine the origin of he goods in question, the basis should be that the assembly operations as a whole must involve an appreciable increase of the commercial value of the finished product in the ex-factory stage. In that respect it is necessary to consider in each particular case whether the amount of the value added in that country of assembly in comparison with the value in other countries justifies conferring the origin of the country of assembly.

[120] Ibid., at 15
[121] Ibid., at paras. 16 to 19
[122] Ibid., at para. 19. The Court referred here to its judgement in *Yoshida I*, see *supra* note 63
[123] Ibid., at para. 20

Where only two countries are concerned in the production of goods and examination of technical criteria proves insufficient to determine the origin, the mere assembly of those goods in one country from previously manufactured parts originating in the other is not sufficient to confer on the resulting product the origin of the country of assembly if the value if the value added there is appreciably less than the value imparted in the other country. It should be stated that in such a situation value added of less than 10%, which corresponds to the estimate put forward by the Commission in its observations, cannot in any event be regarded as sufficient to confer on the finished product the origin of the country of assembly[124]".

It should be noted that the Court in these paragraphs suggests that the value added in the country of assembly should be important as compared to the value added in other countries but it is not necessarily the most important. On the contrary the Court suggests that it is sufficient that the value added should "not be appreciably less" than the value imparted in other countries[125]. On this important point the Court seems to have followed in its judgement the reasoning suggested in the Advocate General Van Gerven who stated: "that criterion is also consistent with Article 5 in so far as it mentions the "last" substantial process or operation; in many circumstances differing from those in the present case it is possible that three or four successive operations carried out in three or four different countries each make a not inconsiderable economic contribution. However, it is only the last, which from an economic point of view need not necessarily be the most important of the three or four operations, that confers origin[126]. The Court also added that is not necessary to examine whether the assembly includes a proper intellectual contribution, because this criterion is not provided for in Article 5[127]. Finally, with regard to the interpretation of Article 6, the Court stated that "the transfer of assembly from the country in which the parts were manufactured to another country in which use is made of existing factories does not

[124] Ibid., at paras. 22 and 23

[125] The importance of this point can be illustrated with an example in which the value added in Taiwan (country of assembly) was 47 percent and the value of imported parts with Japanese origin was 53 percent.

[126] Opinion of the Advocate General Van Gerven, *Brother II*, *supra* note 32, at para. 14. According to the report of the hearing, the Commission's position was that "Only assembly entailing considerable technical or time-consuming work can constitute a substantial process or operation within the meaning of Article 5 in which case two closely linked criteria must be applied, namely the input in labour and materials and the value added. Consequently, an assembly may determine origin when it is practically as costly as the production of the other components in a different country or when its significance is not appreciably less than that of other manufacturing processes. Any other interpretation of Article 5 would *remove the point of the link between measures of commercial policy and origin*. Ibid., Report for the Hearing, at 8 (emphasis added)

[127] Ibid., at para 24

itself justifies the presumption that the sole object of the transfer was to circumvent the applicable provisions unless the transfer of assembly coincides with the entry into force of the relevant regulations. In that case, the manufacturer concerned must prove that there were reasonable grounds, other than avoiding the consequences of the provisions in question, for carrying out the assembly operations in the country from which the goods were exported[128].

The General Agreement on Tariffs and Trade (GATT) does not treat origin rules per se, but its article IX deals with origin marking rules. Labelling and marking requirements for imports may have legitimate governmental purposes, such as consumer protection, but these requirements can also have significant protectionist effects. Whenever the mark required is costly and troublesome to affix, it causes the cost of importing to increase, thereby reducing the competitiveness of the imported goods[129]. Consequently, the GATT draftsmen felt that it was necessary to include an article in GATT that would govern the use of marking requirements, in order to protect the value of tariff concessions and prevent marking requirements from becoming significant protective non-tariff barriers.

Even though the GATT does not deal directly with determination of the origin of goods, a number of obligations touch the problem. The issue has two facets: substantive, i.e., how to define origin of goods; and procedural, i.e., what certificates or other formalities should be allowed or required to assist customs officials in verifying the origin of goods. The latter facet has most often been considered in GATT in connection with the Article VIII obligations respecting formalities. Moreover, both facets are related to the obligations of Article IX regarding marks of origin, although they pose different problems.

The substantive question of how to define or determine origin of goods directly relates to the legal obligations of at least seven GATT articles. Pursuant to Article I, MFN treatment must be accorded by a contracting party to the like product originating in the territories of

[128] Ibid., at para 29. It can be noted that according to the Report for the Hearing, "The Commission favours a narrow interpretation of article 6, namely that the circumvention of the applicable provisions must be the exclusive purpose of the process or operation in another country, not just one reason amongst many". Ibid., Report for the Hearing, at 8

[129] Some United States cases reflect problems of this type with respect to marking requirements of vsrious states. See, e.g., Tupman Thurlow Co. V. Todd, 230 F. Supp. 230 (D. Ala. 1964), which held invalid an Alabama meat inspection law which resulted in seizure of meat imports, and Territory of Hawaii v. Ho, 41 Hawaii 565 (1957), which struck down as unconstitutional and contrary to GATT a territorial law requiring sellers of imported eggs to advertise that fact. See INFRA ORIGIN MARKING CHAPTER AND CASE STUDY ABOUT EYEGLASSES REPLACEMENT PARTS

all other contracting parties. In other articles, obligations are imposed on the treatment of imports that are the "products of territories of other contracting parties"[130]. The crucial test then, for goods to be entitled to the treatment established by these GATT obligations, is the origin of the goods. The problem of origin determination in the case of a good being the product of materials originating in several countries have drawn the attention of international institutions from the very beginning of GATT history. In 1952 the International Chamber of Commerce recommended to GATT that the Contracting Parties adopt a common definition of nationality of manufactured goods[131]. The Contracting Parties did not think that they had sufficiently detailed knowledge of the principles underlying national legislation to formulate such a definition, but they decided to launch inter-sessional studies on the question with a view to further consideration. In order to assist their consideration of this problem, the Contracting Parties recommended that contracting parties should submit a statement of the present principles and practices, and that the GATT Secretariat should make a preliminary survey of this information. The recommendation contained the following outline as a guide for the study:

REPORT ON THE NATIONALITY OF IMPORTED GOODS

1. Purposes for which origin is required to be established in various countries, e.g.:
    a. Admission at differential rates of duty;
    b. Admission under quantitative restrictions;
    c. Trade statistics ;
    d. Merchandise marks ;
    e. Other reasons.
2. Definition of origin:
    a. Natural produce;
    b. Goods manufactured in one country from national raw materials;
    c. Goods manufactured in one country from imported raw materials;
    d. Goods manufactured in one or more than one country.
3. Treatment of goods which have passed through one or more countries on the way to the country of importation as regards:
    a. Admission at differential rates o duty;
    b. Admission under quantitative restrictions;

[130] The term "products of territories of other contracting parties" or a similar term occurs in GATT Articles II:1(b), (c); III:2, 4; VI:3, 4, 5, 6 (a); XI:1; XIII:1. The term "originating in" occurs also in GATT Article XXIV, paragraph 8.
[131] GATT, 1st Supp. BISD 100, 104 (1953)

c. Trade statistics ;
d. Merchandise marks.

4. Proofs of origin:
   - Form of certificates or other proof;
   - Issuance of certificates;
   - Verification of facts by customs authorities of the importing country

4. Conclusions as to international action called for in the light of the review of the subject.

The recommendation directed the Secretariat to keep in touch with the European Customs Union Study Group (predecessor to the CCC)[132] so as to be informed of any current studies by that organization.

In 1953, the GATT Working Party, appointed ti study the situation, reviewed the replies furnished by the GATT member countries[133] and examined the text of a proposed definition of nationality prepared by the French delegation, as follows:

E. The nationality of a good resulting exclusively from materials and labour of a single country shall be that of the country where the goods were harvested, extracted from the soil, manufactured or otherwise brought into being;

E. The nationality of goods resulting from materials and labour of two or more countries shall be that of the country in which such goods have last undergone a substantial transformation.

E. A substantial transformation shall – *inter alia* – be considered to have occurred when the processing results in a new individuality being conferred on the goods.

Explanatory Note: Each contracting party, on the basis of the above definition, may establish a list of processes which are regarded as conferring on the goods a new individuality, or as otherwise substantially transforming them[134].

However the working Party found that GATT members were still split on their views of the desirability of a definition of origin for customs purposes. Some members felt that the definition proposed "only gave the illusion of assuring uniformity between those countries which might adopt it and that in reality no uniformity would result, since countries would be free to put whatever interpretation they pleased upon the essentially subjective criterion

[132] See Customs Co-operation Council, The Activities of the Council, Bull. No. 13, at 1, 2, 17, 39 (1967)
[133] GATT Doc. L/71 and addenda (1953)
[134] GATT, 2d Supp. BISD 55-56, at paras. A, B, C (1954)

of substantial transformation". Accordingly they felt that the definition would "do more harm than good"[135] . Nevertheless, this proposed definition was submitted to governments for study and comment and, in 1955, the Contracting Parties, reviewed the replies received from governments responding to the proposal[136]. These replies indicated that the contracting parties were still widely split on the question of the desirability of a definition. This split over the ICC proposal in the 1950s foreshadowed a split that exists today between those country which view rules of origin as an instrument of commercial policy and those which view them as technical. Objective, neutral instruments[137]The CONTRACTING PARTIES also took note of a resolution by the International Chamber of Commerce that considered the GATT efforts and indicated "it has become clear, however, that the time is not yet ripe for attempting to obtain general acceptance by governments of a standard definition of origin"[138].

Consequently it appears that the statement of draftsmen in the preparatory work of GATT in 1947 still holds true, namely, in which it says that "it is within the province of each importing member country to determine, in accordance with the provisions of its law, for the purpose of applying the most-favoured-nation provision, whether goods do in fact originate in a particular country"[139].

As it has be authoritatively considered, this privilege of each member to determine origin on its own applies to the other GATT obligations that depend in any way on the origin of products[140].

Although unable to agree on a definition of origin, the GATT contracting parties had more success in agreeing on the narrower and more concrete question of certificates of origin. The problem of certificates of origin was mentioned in the 1952 International Chamber of Commerce recommendation[141] and was studies along with the definitional question by the GATT Working Party that reported in 1953[142]. Citing the related article of the 1923 Geneva Convention on the Simplification of Customs Formalities[143], this report listed four

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[135] *Id*. at 56
[136] GATT, 3d Supp. BISD 94 (1955)
[137] See JAMES W. E., Rules of Origin and Rules of Preference and the World Trade Organization: the Challenge to Global Trade Liberalization, in *The World Trade Organization: legal, economic and political analysis*, Oxford University Press, 2005, pp. 263-292
[138] GATT Doc. L/179 and addenda (1953)
[139] U.N. Doc. EPCT/174, at 3 (1947)
[140] See JACKSON J., *World Trade and the Law of the GATT*, Bobbs-Merryl Company, 1969, p. 468
[141] GATT, 1st Supp. BISD 100, 101, 105 (1953); ICC recommendation in GATT Doc. L/3172 (1969)
[142] GATT, 2d Supp. BISD 53 (1954)
[143] 30 L.N.T.S. 373, No. 775 (Nov. 3, 1923)

recommendations[144] for countries to follow. As to one of the recommendations, the International Chamber of Commerce suggested a change[145] and, in 1956, the GATT contracting parties amended their recommendation as follows:

a. certificates of origin should be required only in cases where they are indispensable.
b. In order to avoid delay to traders, governments should authorize a sufficient number of competent offices and bodies to issue certificates of origin and/or the visa certificates issued by traders.
c. Differences between the goods accompanied by a certificate of origin and the description in the certificate should not lead to a refusal to allow importation when the differences are due to minor clerical errors such as mistakes in the numbering of sacks, etc.
d. When, for any sufficient reason, an importer is unable to produce a certificate of origin at the time of importation, the customs authorities should grant the period of grace necessary to obtain this document, subject to such conditions as they may judge necessary to guarantee the charges which may eventually be payable. Upon the certificate being subsequently produced, the charges which may have been deposited, or the amount paid in excess, should be refunded at the earliest possible moment[146].

3.2 The Kyoto Convention

In the 1970s, Annex D of the Kyoto Convention[147] represented the multilateral attempt to move towards the harmonization of all rules of origin, both preferential and non-preferential, by adopting guidelines based on the principles of wholly obtained goods and substantial transformation that countries would use in drafting their rules of origin. Two annexes of particular significance are Annex D.1., concerning rules of origin and Annex D.2.[148], concerning the documentary evidence of origin. The revised Kyoto Convention, entered into force on 3rd February 2006, has placed its harmonizing standards in relation to origin in the three chapters of Specific Annex K to the Convention. One chapter concerns

[144] GATT, 2d Supp. BISD 57, at para. 10 (1954)
[145] GATT Doc. L/554 (1956)
[146] Recommendation of Nov. 17, 1956, GATT, 5th Supp. BISD 33 (1957); see also GATT, 5th Supp. BISD 102 (1957).
[147] The International Convention on the simlification and harmonization of customs procedures was signed in Kyoto on 18 May 1973 and entered into force on 6 December 1977
[148] The third Annex D. 3. concerns the control of documentary evidence of origin

the non-preferential rules of origin, one relates to documentary evidence of origin, and one deals with the control of that documentary evidence. The terms of these chapters are not, in many respects, different in substance from the provisions of Annexes D.1. and D.2.

The provisions of Annex D.1. by which the EC is bound are, first of all standard 1, which is a formal provision requiring compliance with the provisions of the Annex. Then follow the two fundamental standards, Standard 2 and 3. Standard 2 identifies what products are to be considered to be produced wholly in a given country. Standard 3 deals with the origin of products not wholly produced in one country. Recommended Practices 4 and 5 and Standard 6 address this criterion in more detail. Standard 9 provides that, for the purpose of determining origin, packing shall be deemed to have the same origin as the goods they contain unless the national legislation of the country of importation requires them to be declared separately for tariff purposes, in which case their origin shall be determined separately from that of goods. Standard 11 states that, for the purpose of determining the origin of goods, no account shall be taken of the origin of the energy, plant, machinery and tools used in the manufacturing or processing of the goods. Recommended Practice 12 states that where provisions requiring the direct transport of good from the country of origin are laid down, derogations from them should be allowed, in particular for geographical reasons (for example, in the case of landlocked countries) and in the case of goods which remain under customs control in third countries (for example, in the case of goods displayed at fairs and exhibitions or placed in customs warehouses). Standard 13 requires the competent authorities to ensure that rules of origin and any changes to them and interpretative information are readily available to any person interested in them, whilst Standard 14, the final provision of the annex, states that changes in the rules of origin, or in the procedures for their application, shall enter into force only after sufficient notice has been given to enable the interested persons, both in export markets and in supplying countries, to take account of the new provisions.

3.3 The WTO Agreement on Rules of Origin

The Agreement on Rules of Origin (ARO) consist of a preamble, four parts and two annexes[149]. As established by article 1.1 Parts I to IV of the ARO apply only to non-

[149] Part I provides definition and coverage; Part II provides the disciplines; Part III covers various procedural arrangements and Part IV is devoted to the harmonization process. Annex I concerned the Technical

preferential origin rules. Art. 1.2 clarifies that the ARO covers all rules of origin used in non preferential commercial policy instruments, such as MFN, antidumping and countervailing duties under Article VI of GATT 1994, safeguard measures under Article XIX of GATT 1994, origin marking requirements under Article IX of GATT 1994 and any discriminatory quantitative restriction or tariff quotas. Rules of origin used for governmental procurement and trade statistic are also covered by the ARO[150]. Part II of the ARO distinguishes between the disciplines applicable during the transition period pending completion of the harmonization process, and disciplines applicable afterwards, the latter being more stringent. The transitional period was supposed to last only for three years, until July 1998, but the harmonization process has not been completed yet. As a result, at the time of writing, July 2007, the transitional period still applies. The comparison between the rules to be applied during the transitional period and the ultimate ones to be applied by member states can be clarified as follows:

Committee on Rules of Origin set up under the auspices of the World Customs Organization, while Annex II contains a common declaration on preferential origin rules

[150] Footnote 1 to the ARO provides that Article 1.2 is without prejudice to those determinations made for purposes of defining "domestic industry" or "like products of domestic industry" or similar terms, typically used in the context of commercial defence legislation). As a matter of fact this opens an enormous loophole by declaring rules of origin not applicable to the definition of domestic industry in trade defence instruments. Thus, there is no requirement that the like product manufactured by domestic producers actually has domestic origin, allowing, at least in theory, that simple assemblers of a product to complain about dumping of foreign like products even though they themselves only assemble.

Transitional rules	Ultimate rules
a. requirements to comply with administrative determinations of general application must be clearly defined	a. rules of origin shall be applied equally for all purposes
b. rules should not be used to pursue trade objectives directly or indirectly	b. origin rules to be based on wholly obtained or last substantial transformation
c. rules shall not create restrictive distorting or disruptive effects on international trade	presumably taken care of a. and b. above
d. rules must observe national treatment and MFN requirement	c. rules must observe national treatment and MFN requirement
e. rules must be administered in consistent, uniform, impartial and reasonable manner	d. rules must be administered in consistent, uniform, impartial and reasonable manner
f. rules must be based on positive standard	Presumably moot because of b. above
g. laws, regulations, judicial decisions and administrative rulings of general application must be published	e. laws, regulations, judicial decisions and administrative rulings of general application must be published
h. establishment advanced ruling procedure	f. establishment advanced ruling procedure
i. prospective nature of changes or new rules	g. prospective nature of changes or new rules
j. independent review of administrative action	h. independent review of administrative action
k. confidentiality of information	i. confidentiality of information

One of the more interesting innovations of the ARO is the advanced ruling procedure, which is required for both non-preferential and preferential rules. The fairly detailed requirements of the ARO, including a 150 days time limit for the administering authorities and a publication requirement, have led to the establishment of a ruling procedure in more jurisdictions with respect to both non-preferential and preferential rules of origin.

Article 4.1 establishes the Committee on Rules of Origin (CRO) while Article 4.2 creates the technical Committee on Rules of Origin (TCRO) under the auspices the WCO. The TCRO is in charge of carrying out the technical work of the harmonization programme.

Annex I to the ARO sets forth Committee's responsibilities, as well as dealing with some procedural issues.

Article 5 requires WTO members to publish any new rules of origin , or modifications of existing ones, at least sixty days before their entry into force.

Article 6 contains rules on review of the ARO and the harmonization process.

Article 7 and 8 provide that disputes under the ARO are to be subjected to the consultations and dispute settlement procedures of GATT Articles XXII and XXIII and the WTO Dispute Settlement Understanding.

Article 9 deals with the harmonization process. Article 9.1 sets out the principles and objectives which are to guide the Harmonization Work Programme (HWP). Article 9.2 instructs the TCRO to draw up harmonized definitions of wholly obtained goods, on the one hand, and of minimal operations or processes that do not by themselves confer origin, on the other hand. As regards substantial transformation, Article 9.2 (c) (ii) establishes the key principle that the main criterion shall be a change in tariff classification; percentage or technical tests may be used as supplementary criteria only when the exclusive use of the HS nomenclature does not allow for the expression of substantial transformation.

The Declaration contained in Annex II to the ARO does extend many of the rules concerning non-preferential origin rules to preferential ones, as follows:

d. requirements for compliance with administrative determinations of general application must be clearly defined
d. rules of origin to be based on positive standard
d. laws, regulations, judicial decisions and administrative rulings of general application must be published
d. advanced ruling procedure
d. new rules or changes to existing rules not to be applied retroactively
d. independent review of administrative action
d. confidentiality of information.

These disciplines are similar to many of those pertaining to non-preferential rules during and after the transitional period. However, several of the key disciplines have been omitted, in particular the specification of the wholly obtained and substantial transformation rules, thereby clearly reflecting the desire of key negotiators to reserve significant discretion in the use of preferential origin rules. Other discipline imposed in non-preferential rules during the transitional period that not applicable to preferential rules

include that rules of origin are not to be used to pursue trade objectives, and that rules are not to create restrictive, distorting or disruptive effects on international trade. Similarly, the requirement that non-preferential rules must be administered in a consistent, uniform, impartial and reasonable manner during and after the transitional period is not imposed on preferential rules. Many authors have correctly underlined the limited legal significance of the Declaration contained in Annex II. As a matter of fact, the whole harmonization process covers non-preferential rules only, meaning that preferential ones, whether autonomous or negotiated, are clearly excluded.
Once the HWP will be completed, its results will constitute Annex III, called Harmonized Non-Preferential Rules of Origin, which will be an integral part of the ARO.

3.3.1 WTO disputes involving the Agreement on Rules of Origin

3.3.1.1 The EC-US dispute

Trade in textiles was regulated under various agreements through a rigorous quota regime. In the Uruguay Round, the Agreement on Textiles and Clothing (ATC) was negotiated which would result in a 10-year-phase-out by 2005 of the quota regime.
The rules of origin followed by the US up to 1 July 1996, for the determination of origin for textiles were[151]:

0. Dyeing of fabric and printing, when accompanied by two or more of the following operations: bleaching, shrinking, fulling, napping, decating, permanent stiffening, weighting, permanent embossing or moireing[152].
0. Spinning fibres into yarn.
0. Weaving, knitting or otherwise forming fabric.
0. Cutting of fabric into parts and the assembly of those parts into the completed article.
0. Substantial assembly by sewing and/or tailoring of all cut pieces pf apparel articles which have been cut from fabric in another country into a completed garment.

The alternative to the four-operations rule was substantial transformation, resulting in a change in tariff heading.

[151] US Customs notifications 19 CFR 12.130
[152] This is commonly known as the four-operations rule

Consequent upon the ATC becoming effective the US introduced changes in its rules of origin regarding textiles and clothing. The new rules de-recognized the four-operations rule. The origin now vests in the country where the fabric was woven or sewn. For a final product, the assembly became the determining factor.

According to the newly introduced US textile origin rules, contained in Section 334 of the Uruguay Round Agreement Act, a product was to be considered as originating in a country if:

- The product is wholly obtained or produced in that country;
- The product is a yarn, thread, twine, cordage, rope, cable or braiding and
  - ( ) the constituent staple fibres are spun in that country; or
  - ( ) the continuous filament is extruded in that country;
- The product is a fabric, including a fabric classified under Chapter 59 of the Harmonized System and the constituent fibres, filaments or yarns are woven, knitted, needled, tufted, felted, entangled or transformed by any other fabric-making process in that country…; or
- The product is any other textile or apparel product that is "wholly assembled in that country…from its component pieces".
- Multi-country rule – If the origin of a good cannot be determined under paragraph (1) or (2), then that good shall be considered to originate in, and be the growth, product, manufacture of:
  - ( ) the country in which the most important assembly or manufacturing process occurs, or
  - ( ) if the origin of the product cannot be determined under subparagraph (i), the last country in which important assembly or manufacturing occurs.

These new rules created problems for EC exporters of clothing. In fact, under the previous four-operations rule, EC exporters could claim origin by undertaking four recognized operations, even if the fabric was from a non-EC country. Under the new rules, the origin of the fabric determined the origin of the clothing. The immediate impact was that EC clothing exports became directly included under the ATC quota regime in cases where the fabrics were sourced from a country whose exports were subject to quota restraints. A second problem, especially suffered by the Italian exporters, was that as origin changed,

the right to label the product as "Made in Italy" (or any other EC member States) also disappeared, thus reducing the marketability of the final product[153].

The EC brought the issue to the conciliation process under the WTO dispute settlement system. The ATC provides in art. 4.2: "Members agree that the introduction of changes, such as changes in practices, rules, procedures and categorization of textiles and clothing products…should not upset the balance of rights and obligations between the Members concerned…adversely affect the access available to a Member, impede the full utilization of such access, or disrupt trade under this Agreement" and that "Members agree that the Member initiating such changes shall inform and, whenever possible, initiate consultations with the affected Member or Members prior to the implementation of such changes, with a view to reaching a mutually acceptable solution…".

There were two *process-verbal* agreements between the EU and the US. The US agreed to amend the relevant legislation to undo the damage caused by the 1996 rules to the EC exports to the USA. The final outcome was that Section 405 of the Trade and Development Act of 2000, entitled 'Clarification of Section 334 of the Uruguay Round Agreement Act', was adopted. Section 405, therefore, was adopted essentially to take care of the EC's objections.

To settle the dispute, the US agreed to amend Section 334, creating two exceptions to Section 334's fabric formation rules[154]. Consequent to the amendments (i) the four-operations rule was reintroduced, except for fabrics made of wool; (ii) for silk, cotton, man-made and vegetable fibre fabric, origin would be conferred by dyeing and printing and two or more finishing operations; and (iii) for certain textile products, excepted from the assembly rule, origin would be conferred on the identical bases, with exceptions[155].

Since the amendments made by Section 405 satisfied the EC, no dispute settlement panel was set up.

[153] NOTA INFRA CAPITOLO OM
[154] See United States – Rules of Origin for Textiles and Apparel Products, WTO, WT/DS 243, p. 8
[155] See WTO Doc WT/DS 243/R

Chapter II

The harmonization process of non-preferential rules of origin in the WTO

Summary: *1.Overview of the WTO Harmonization Work Programme; 1.2 Technical examination in the WCO Technical Committee on Rules of Origin (TCRO); 1.3 Negotiations in the WTO Committee on Rules of Origin (CRO); 2. General provisions and the Architecture of the Harmonized Non-preferential Rules of Origin (HRO); 2.1 Overview of the Architecture of the Harmonized Non-preferential Rules of Origin; 2.2 Primary rules and residual Rules; 2.3 Minimal operations or processes; 2.4 Other provisions of General Rules and Appendix 2 Rules; 3. Wholly-obtained goods – Appendix 1; 3.1 Preparatory discussions at the First Session; 3.2 TCRO's first text of Definitions of wholly-obtained goods; 3.3 The TCRO's further elaboration of Definitions of wholly-obtained goods; 3.4 The CRO's elaboration of Definitions of wholly-obtained goods; 3.5 Elaboration of Definition 2 – Goods obtained outside the country; 4. Product-specific rules of origin – Appendix 2; 4.1 Agricultural products; 4.2 Textiles and textile articles; 4.3 Machinery, transport equipment and photocopying apparatus; 5. Implications of the implementation of the HRO for other WTO agreements; 5.1 Initiation of a Study on the implications of the implementation of the HRO for other WTO agreements; 5.2 Restraints on the application of the HRO to certain trade policy instruments enumerated by Article 1.2 of the Agreement on Rules of Origin; 5.3 Applicability of the HRO to certain trade policy instruments enumerated by Article 1.2 of the Agreement on Rules of Origin; 5.4 Report by the Chairman of the CRO to the WTO General Council and the current state of play*

1.Overview of the WTO Harmonization Work Programme

1.2 Technical examination in the WCO Technical Committee on Rules of Origin (TCRO)

(g) The TCRO and the WCO Origin Project

Since the WCO had made a commitment to the GATT Secretariat to contribute to the harmonization of non-preferential rules of origin, the WCO started preparatory works on the HWP even before the Marrakesh Agreement establishing the WTO entered into force- The TCRO was still to be established. The WCO Council, the Organization's highest decision-making body, decided to assign top priority to the completion of the HWP.

Accordingly, a project team was set up within the WCO Secretariat in September 1994 to serve as the secretariat to the Technical Committee when it came into being.

Members to the WTO are automatically Members to the TCRO[156]. The HWP was itself officially initiated by a letter sent by the Chairman of the CRO to the Chairman of the TCRO on 20 July 1995, requesting the commencement of the three-year work programme. Within three years the TCRO was supposed to prepare and consider definitions of wholly-obtained goods; definitions of minimal operations or processes that do not by themselves confer origin on a good; criteria for substantial transformation based on a change in tariff heading; and, where the exclusive use of CTH does not allow for the expression of substantial transformation, supplementary criteria.

Despite its efforts, the TCRO was unable to finish its task within the initial three-year period. This was mainly due to the huge volume of work involved and the technical complexity and political sensitivity of the issues. In July 1998, the CRO agreed to extend the deadline for another year to November 1999[157]. In order to complete the HWP by the new deadline, in July 1998 the WTO General Council endorsed the CRO's plan and extended the deadline for completing the technical examination by the TCRO to May 1999 and the policy examination by the CRO to November 1999. In May 1999 the TCRO forwarded to the CRO the provisional text of the Harmonized Non-Preferential Rules of Origin as final result of the technical review, together with a series of referral documents setting out the unresolved issues and the possible options to resolve them[158].

(g) Working method

Based on Article 9.2 of the ARO, it was initially planned that Phase I of the HWP, concerning the definitions of wholly-obtained goods and minimal operations or processes, should be completed by October 1995; Phase II, concerning the substantial transformation and change in tariff classification, by October 1996; Phase III, concerning the supplementary criteria to get a substantial transformation, by October 1997. The TCRO also committed itself to undertaking any work requested by the CRO during the remaining nine months' life span of the HWP (the so called coherence exercise).

For the work of Phase I, the WCO Secretariat stuff in charge with the origin project prepared working documents on definitions of wholly-obtained goods and minimal

[156] See Annex I to the ARO
[157] WTO Doc. G/RO/M/18
[158] The WCO Secretariat has compiled the provisional text in three volumes entitled "Consolidated Text of the Technical Committee on Rules of Origin"

operations or processes. After extensive discussion, the TCRO was able to produce a single draft of definitions of wholly obtained goods by October 1995. However, the TCRO decided to defer the elaboration of definitions of minimal operations or processes until the end of Phase III with a view to carefully examining the relationship of these definitions to substantial transformation criteria.

For the Phase II work, the TCRO requested Members to submit written proposals to the Secretariat in accordance with an agreed tabular format, so that the Secretariat could produce a comparative table of proposals on an HS heading basis. The TCRO also decided to examine product sectors according to the following order of HS chapters: 25-27, 41-49, 64-71, 91-97, 72-81, 1-24, 28-40, 50-63 and 82-90. The aim was to complete the easier sectors before tackling the more contentious once, such as textiles and machinery. A unique management method was devised by the then Chairman of the TCRO, categorizing the decisions of the TCRO into the following three types[159]:

> Basket 1: The rule indicated was approved and should apply as specified. The Basket 1 rules were to be transmitted to the CRO for endorsement.
>
> Basket 2: The TCRO needed to conduct further research and analysis, and the rule would be examined later in Phase II. Basket 2 decisions could be converted to Basket 1 or Basket 3, as appropriate, as a result of subsequent examination.
>
> Basket 3: Examination of rules for particular products should be undertaken in Phase III.

This approach made it clear that the TCRO intended to send results to the CRO once a consensus was reached at the TCRO on the rule for a particular product. However, this working principle was not maintained for long. Divergent opinions were found to stem from countries' trade and industrial policies, and it was therefore extremely difficult to convince delegations that a particular proposal was the most technically suitable. The TCRO then came up against policy issues which were intrinsic to the technical questions. Consequently, in many product sectors, several technically possible options were sent to the CRO for its consideration, rather than a single (Basket 1) draft for the CRO's endorsement.

[159] See Annex C/1 to WCO Doc. 39.870 and *Consolidated Text*, *supra* note 136

As previously explained[160], the change in tariff classification method is mainly synonymous with the change of tariff heading rule. Article 9.2 (c)(ii) of the ARO permits the use of both change of tariff heading and change in tariff subheading (CTSH). Furthermore, the TCRO did not interpret the meaning of the use of change in tariff heading or subheading and of the exclusive use of the HS nomenclature, provided for by Article 9.2 (c)(ii) and (iii) of the ARO in a rigid manner. Instead the TCRO created, or the purposes of rules of origin, subdivisions of headings or subheadings entitled "split headings" or "split subheadings" to confer origin on a good with respect to which substantial transformation could occur within the scope of a particular heading or subheading in the 1996 version of the Harmonized System. These subdivisions of headings or subheadings (HS 1996) are expressed with the prefix "ex", together with a precise description of the goods, as the following example shows:

HS Code Number	Description of Goods	Origin Criteria
71.06	Silver (including silver plated with gold or platinum), unwrought or in semi-manufactured forms, or in powder form.	See subheadings
7106.10 Ex 7106.10(a) Ex 7106.10(b)	- Powder Flakes classified with powder[161] Powder	See split subheading CTSHS CTSH

The TCRO considered that, in this way, a change in tariff classification could be optimized. For instance, the expression "CTSHS", a change of split subheading rule, in the above example means that a substantial transformation takes place when flakes classified with powder of split subheading ex 7106.10(a) are produced form powder classified in the same subheading 7106.10, even though a change of subheading does not occur since both are 7106.10. on the other hand, power of split subheading ex 7106.10(b) must meet a

[160] See, *supra*, I.2.1, p. 4

[161] The HS classifies flakes with powder of subheading 7106.10 when 90 percent or more by weight passes through a sieve having a mesh of 0,5 mm (see HS subheading Note 1 to Charter 71). The example is drawn from the *Consolidated Text* of the TCRO, see supra note 136

CTSH for substantial transformation to occur. This means that production of powder from unwrought silver classifiable in subheading 7106.91 or any other goods classified outside subheading 7106.10 does constitute substantial transformation. However, producing powder from flakes classified with powder of split subheading ex 7106.10(a) is not considered to be substantial transformation.

(g) Second examination

The TCRO finished the first reading of proposals for substantial transformation, comprising Phase II and III together, at mid 1997. A second examination of Basket 2 issues then started and a new and standard reporting format to the CRO was introduced. This format was called "referral document" or "template document" which pinpointed the unresolved issues and suggested technically possible options for decision by the CRO.

The second examination was completed in May 1999 at the Seventeenth Session[162]. By that time, the TCRO's provisional text of the harmonized rules of origin consisted of General Rules, Appendix 1, concerning the definitions of wholly-obtained goods, and Appendix 2, concerning product-specific rules of origin[163]. The product-specific rules of origin for 511 HS headings, or 41 percent, out of 1,241 were agreed upon by consensus[164]. There were 66 referral documents covering 486 product-specific unresolved issues, involving 730 headings transmitted to the CRO for decision. Definitions of minimal operations or processes were presented as General Rule 5 and 2 of Appendix 1 of the TCRO's final text.

1.3 Negotiations in the WTO Committee on Rules of Origin (CRO)

Check last updates of the HWP

2.General provisions and the Architecture of the Harmonized Non-preferential Rules of Origin (HRO)

2.1Overview of the Architecture of the Harmonized Non-preferential Rules of Origin

(c) Background.

[162] Perchè i documenti prendono questa data come riferimento. Finisce qui il lavoro del TCRO
[163] See WTO Doc. G/M/25
[164] The majority of the agreed rules were the tariff-shift rues.

The ARO was silent with regard to several aspects of rules of origin. For example, the details of implementation were left completely untouched and the preparation of "general rules", including "residual rules", was not explicitly required by the agreement. However, it was obvious that the definitions of wholly-obtained goods and the criteria for substantial transformation needed to be guided by some general provisions which would govern the entire set of rules[165].

In order to apply the definitions of wholly-obtained goods and the substantial transformation criteria *per se*, delegations needed to have a clear idea based on their own experiences with existing preferential and non-preferential rules of origin. However, when the applicable substantial transformation criteria were not satisfied, it was not clear how to treat a good that has been transformed (but not substantially transformed or regarded as having undergone a minimal operation or process) from non originating materials. The idea of "residual rules", which had been proposed by the Secretariat as the "secondary rules" at the inaugural Session, was to remind the TCRO that, under the future HRO, there should not be a single good in the world for which the country of origin could not be determined[166]. This argument was compelling in the light of the broad coverage that the HRO were to have under Art. 1.2 of the ARO (even rules of origin used for trade statistics were to be covered). The TCRO therefore decided to draft "residual rules" as part of the general rules; the CRO endorsed this idea.

In the case of preferential rules of origin, the rules lead to either a "yes" (qualified) or "no" (not qualified) answer. Therefore, the concept of "residual rules" does not exist. Moreover, even in the context of current non-preferential trade, it appears that a clear distinction between the country of origin and the exporting country has not always been made, except in the case of some sensitive product sectors. In fact, 41 WTO Members did not have non-

[165] The ARO also did not deal with the day-to-day implementation of the HRO, in particular the certification and verification of origin. The TCRO requested the WCO Secretariat to undertake an exhaustive study on this issue in February 2000; based on 85 Members' replies to the questionnaire, a study paper entitled "Comparative Study on Systems of Certification and Verification as well as Documentation for Customs Clearance with Respect to Non-preferential Rules of Origin" was prepared by WCO Secretariat for the 20th Session, see WCO Doc. OC0067. At its 20th Session, the TCRO examined the same issue and felt that it was not necessary, in the context of the TCRO, to harmonize the procedural aspects of implementing the harmonized non-preferential rules of origin. After completion of the HWP, this issue would be reviewed by the WCO in the context of Annex K, devoted to origin, to the revised Kyoto Convention

[166] The "residual rules" should be applicable to a good when a change of heading ("CTH") rule as a "primary rule", for instance, is not satisfied in the country in question

preferential rules of origin as of October 2003[167]. Consequently the drafting of the "residual rules" was a lengthy process which involved a great deal of work.

(c) Elaboration of the architecture

While the TCRO adopted an item-by-item approach[168] to the general rules, the CRO suggested that the TCRO devise an overall structure for the HRO, i.e., look at how to place, format and present the general provisions and the product-specific rules. The CRO referred to the structural framework of the HRO as the "overall architecture" or "architecture", with its decision in November 1995 to request the TCRO to "forward …a general format establishing the overall architectural design within which the results of the different phases of the Harmonization Work Programme will be finalized as provided for in Article 9.4"[169].

Responding to the request of the CRO, the TCRO drafted the "provisional text of the Technical Committee on Rules of Origin at its Third Session"[170]. The basic structure consisting of General Rules, Appendix 1, concerning wholly-obtained goods, Appendix 2, concerning product-specific rules of origin, and Appendix 3, concerning minimal operations or processes was proposed and agreed. The sequential application principle between Appendices 1 and 2 was also agreed.

Two meetings in Canada provided a good opportunity to overcome an impasse in respect of the architecture. The first informal meeting in Ottawa, in September 1996, paved the way, *inter alia*, for the Appendix 2 rules for goods (e.g., coal) that had been wholly obtained (e.g., undergone a mining operation) in Country A, were subsequently were subsequently imported into Country B but did not undergo substantial transformation there (e.g., they were merely put into sacks), and were exported further to Country C. In this scenario there was a clear agreement that the country of origin should be determined by

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[167] WTO Doc. G/RO/57, Ninth Review of the Implementation and Operation of the Agreement on Rules of Origin

[168] Although a number of Members had general provisions in their preferential or non-preferential rules of origin, no specific existing rules of origin were used as a basis for the TCRO's consideration. At the time, there appeared to be a strong feeling among delegations that the TCRO should create a new set of non-preferential rules of origin, instead of harmonizing a number of existing non-preferential rules of origin. In other words, Members preferred not to be influenced by a couple pf major trading economies that had been using certain established phrases or terms enshrined in their legal system. Consequently, several draft texts for the "general rules" were proposed by the delegations, item-by-item.

[169] See WTO Doc. G/RO/M/3, para. 4.3(a). The content of the General Rules and the architecture were at first discussed separately. However, in the later stages of the technical examination, all questions other than the product-specific rules of origin were deemed to fall under the architecture issues, including the substance of the General Rules

[170] Annex G/2 to WCO Doc. 39.870

application of Appendix 1, concerning wholly-obtained goods, when goods were traded between Country A and Country B, and by Appendix 2, regarding product-specific rules of origin, when traded between Country B and Country C. This scenario also confirmed a general acceptance as to the sequence of when to invoke the Appendix 1 definitions and Appendix 2 rules to settle the country of origin.

(c) "Ottawa Language"

In seeking to draft the Appendix 2 rules to cover the above mentioned scenario, one delegation proposed to refer directly to "wholly-obtained", whereas others opposed that idea because wholly-obtained goods had to be dealt with under Appendix 1 only, based on the sequential application principle. Thus, to achieve consensus, the text should not include the term "wholly-obtained". Wording the rule, therefore, required technical skills.

The delegations attending the Ottawa informal session devoted some time to this issue and arrived to an agreed principle. Based on this agreement, at its subsequent session the TCRO endorsed three types of standard text, known as the "Ottawa text" or "Ottawa language":

(i) for scrap and waste, the rule was to be base upon the country were the crap or waste was derived;

(ii) for goods having antecedents[171], the rule was to be based on change of tariff classification with exclusions; and

(iii) for goods having no antecedents, the rule was to be based on the country where the good or material was obtained in its natural or unprocessed state[172].

In the later stages of the HWP, the "Ottawa language" has evolved to ensure greater clarity of the rule. One example is the rule for goods with antecedents. For example, yoghurt has milk as an antecedent. Consequently, for those who do not recognize a change from milk

[171] The rule "CTH except from heading 18.01 or 18.02" is proposed for heading 18.03, under which cocoa paste, whether or not defatted is classifiable, gives an example about goods having antecedents. This rule means that to obtain origin cocoa paste may not be produces either from non-originating cocoa beans, classified under heading 18.01, or from non-originating cocoa shells, husks, skins and other cocoa waste classifiable under heading 18.02. The only way to produce originating cocoa paste is to use originating materials, i.e., the cocoa paste would have to be produced as a wholly-obtained good in that country. Nevertheless, non-originating seasonings or any other materials which are excepted in the rule can be added. Therefore, this rule does not required the good to be wholly-obtained in the strict sense of the term. See further explanation for the term "solely" of Definition 1(i) of Appendix 1.
In the case of the cocoa paste, a straight CTH rule, without exception, has also been proposed: should this rule be finally agreed, a change from cocoa beans to cocoa paste will be considered to be a substantial transformation.

[172] See Annex C/2 to WCO Doc. 40.510

to yoghurt as a substantial transformation, a change of chapter (CC) or a CTH except from headings of milk should have been the ideal rule. However, this rule required a "residual rule" which determines the origin of yoghurt produced from non-originating milk. If a "primary rule" is able to determine the origin of goods in all cases, that would be an ideal situation. Thus, the expression "the country of origin of the goods of this subheading shall be the country in which the milk is obtained in its natural or unprocessed state" replaced the initial presentation of the "Ottawa language"[173].

The rule for live animals provides another good example. According to the rule proposed to the TCRO, the country of origin of live animals shall be the country in which the animal was born and raised. Instead of using the initial expression "the material, or the good, of this heading is obtained in its natural or unprocessed state, the proponents made it clear that the "material" in the "Ottawa text" should mean the animal. Consequently, the appropriate verb which is equivalent to the term used in definitions of wholly-obtained goods, is employed[174]. It was also pointed out that the initial "Ottawa text" could be interpreted in different ways. In the case of vegetable saps and extracts of split heading ex 13.02(a), the initial "Ottawa text" could be understood to mean that the country of origin of vegetable saps and extract is: "the country in which the vegetable saps (good) were extracted (obtained) from a plant (material wholly-obtained in a country, not further processed), regardless of the origin of the plant; or the country in which the plant (wholly-obtained material), from which the vegetable saps and extracts were extracted, grew (obtained in its natural state in that country)[175].

Since the evolved "Ottawa language" was able to designate certain processes or operations to be considered as substantial transformation, a number of supplementary criteria for Chapters 1 to 24 were proposed based on the evolved "Ottawa language". The criteria proposed were, for example, weight or fattening period, or even both, to indicate to indicate the growth of animals as follows: "the country of origin of the good of this heading shall be the country in which the animal was fattened for at least 6 months".

At this stage, a clear distinction can be made between the initial "Ottawa text" and its evolved version on the one hand, and the text designating a particular process or operation,

[173] Annex C/1 to WCO Doc. 41.755, para. 58. However, a number of rules based on the initial "Ottawa" text were sent to the CRO once they were agreed and the CRO endorsed them. It is therefore anticipated that the consistency of the text will need to be completely examined during the coherence review

[174] For example, the verbs used in the rules for goods of Chapters from 1 to 24 include: hatched, gathered, captured, raised, born, born and raised, farmed, extracted, grew, grown and harvested, or derived (*Id*., paras 59-60)

[175] *Id*., para 61. As of the time of writing, a CC rule has been widely supported for split heading 13.02(a)

on the other hand. The first category targeted a good that is wholly-obtained in another country or a good the material of which was wholly-obtained in another country. The latter category did not target a wholly-obtained good or material; an animal can be imported and origin-conferred in that country if the required condition is met. These supplementary criteria were often referred to as "Ottawa type rules"[176]. However, it should be noted that this technical jargon was not included in the legally binding text and has never been formally defined by the TCRO.

(d) Basic framework of the architecture

During the second informal meeting, held in Meech Lake in September 1998, the participating delegations reached broad agreement on the shape of the architecture of the HRO which was to be submitted to the CRO as the final result of the technical examination. The recommendations were that:

(i) definitions and the content of Appendix 3, entitled *Minimal Operations or Processes*[177], can be placed in the appropriate places in the architecture;

(ii) rules in Appendix 2, *Product-specific Rules of Origin*, are applicable to a good when a definition under Appendix 1, regarding wholly-obtained goods, does not confer origin on the good, thus confirming the logic of the sequential application between Appendices 1 and 2;

(iii) two types of origin rules, i.e., "primary rules" and "residual rules", may be set forth in Appendix 2[178];

(iv) in Appendix 2, "primary rules" can be placed at the beginning of the Chapter or in the matrix[179] when they are applicable to a particular heading, subheading, split heading or split subheading;

(v) the "primary rules" that confer origin, called "positive primary rules", are co-equal and there is no hierarchy;

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[176] In several reports of the Technical Committee, the expression "Ottawa type rules" has been used. However, there is no clear understanding whether the evolved "Ottawa text" is categorized in the "Ottawa type rule". Some delegations use the expression "Ottawa language" for all rules having a similar narrative presentation to the initial "Ottawa text" in the matrices in Appendix 2, whereas other delegations distinguish the original "Ottawa text" from the "Ottawa type rules"

[177] Appendix 3 was deleted accordingly

[178] The naming of the "primary rules" and "residual rules" was accepted as a preliminary term. In its 14th and 15th Sessions, the TCRO agreed such expressions to be formally used in the provisional text of the architecture

[179] A tabular format attached to Appendix 2 on a Charter basis has been informally called the "matrix". Thus, product-specific rules of origin set out in the matrix are often called "matrix rules"

(vi) the "primary rules" may preclude certain operations or processes from conferring origin: in this case they are called "negative primary rules";

(vii) the "residual rules" are applicable to a good only when the "primary rules" do not confer origin on the good;

(viii) the "residual rules" can be placed at the beginning of Appendix 2 or at the level of the Chapter, and

(ix) within the "primary rules" and within the "residual rules" the selection od the rule applied is governed by the time sequence, i.e., the rule that is last satisfied confers origin on a good[180].

Although item (ix) was contested, the TCRO endorsed the Meech Lake recommendations in most cases and reconstructed the architecture of the draft HRO. The provisional text of the TCRO, as revised at the 14th Session held in October 1998, had the following structure:

Preamble[181]

General Rules (*general provisions to govern the HRO*)

- General Rule[182] 1 to General Rule (6)

Appendix 1 (*definitions of wholly-obtained goods*)

- Scope of application
- Definitions and notes

Appendix 2 (*product-specific rules of origin*)

- Paragraph[183] 1 to paragraph 6 (*general provisions to govern Appendix 2*)
- "Matrix" rules (*HS Chapter 1 to 97*)
  - - Chapter rules, Chapter notes[184], definitions (*placed at the beginning of the Chapter similar to HS Notes to Section, Chapter or subheading*)
  - - Product-specific rules at a heading or subheading level (*such as CTH placed inside the "matrix", Chapter by Chapter*)

[180] See WCO Doc. 42.703

[181] At the 15th Session, the TCRO decided that the preamble was not necessary

[182] At the 14th Session, the TCRO decided to replace "Articles" with "General Rules" 1 to (6)

[183] Paragraphs were renamed as Rules (Rule 1 to Rule 6) at the 16th Session of the TCRO. See also the explanation in B.2(b), The criterion of the "essential character" for the general residual rules INFRA

[184] HS Notes to Sections, Chapters or subheading are not reproduced in the "matrices". The HS Notes were not included in order to save space. However, there is no doubt that such Notes are applicable when the goods are classified under the HS. Although this purely a matter of terminology, future users of the HRO should not confuse "Chapter Notes" for the purpose of rules of origin with the "HS Notes to Section, Chapter or subheading".

(e) Co-equal primary rules and elaboration of residual rules

At the early stage of the technical examination, several delegations proposed more than one rule to express substantial transformation for one (split) heading or (split) subheading, e.g., for the chemical products' sector, the rule proposed was meeting either a chemical reaction rule or CTSH. The TCRO decided that: (i) the chemical reaction rule should confer origin on chemicals even without change of classification, as long as the change meets the required definition of a chemical reaction[185]; and (ii) the chemical reaction rule and its definition should be placed at the beginning of the Chapter, instead of reproducing a cumbersome text for each subheading. This does not mean that the chemical reaction rule has priority over the CTSH rules; it is simply a means of saving space.

As pf the 14th Session, the TCRO confirmed that there should be general (or final) residual rules at the Appendix level to determine the origin of a good when none of the other residual rules determines the origin of the good, that the primary rules, such as the chemical reaction rule or the CTSH rule, are co-equal, and that more specific residual rules must be applied prior to the general residual rules. Therefore, the order of application of rules should be:

(iii) primary rules;

(iii) product-specific residual rules;

(iii) general residual rules.

This means that there is no sequential application among primary rules with the exception of the "Ottawa language". (METTI NOTA INFRA DOVE VERRA' SPIEGATO)

(e) The issue of "the country where the last substantial transformation has been carried out"

Article 9.1(b) of the ARO could be understood to mean that the country of origin determined by application of Appendix 2 rules, including residual rules, or at least the primary rules, should be "the country where the last substantial transformation has been carried out". Item (ix) of the Meech Lake recommendations, i.e., within the "primary rules" or within the "residual rules", the rule that is last satisfied confers origin on a good, was governed by this interpretation. At the same time this was the staring point pf the most contentious issue of the architecture, i.e., the adoption of the "tracing-back" approach.

[185] Thousands of chemicals can be transformed into other chemicals while remaining within the same HS subheading. It is obviously not appropriate to split a subheading into thousands of split subheadings in order to utilise a CTSHS (change of split subheading) rule

Two questions were raised[186]. Firstly, given that all primary rules express substantial transformation, and given that more than one primary rule may be applicable to a good, how will the architecture identify the rule which determines the country of "last substantial transformation"? Secondly, when should the search for a primary rule to determine origin should be exhausted, such that a residual rule is then applied? Although the agreed governing principle is the time sequence (the rule that is last satisfied determines origin), the TCRO had not decided how this principle was to be applied. At the 14th Session, the Chairman formulation was accepted as follows: (i) classifying within the Harmonized System the goods whose origin is to be determined; (ii) finding the primary rule or rules for that good; and (iii) applying those rules to determine whether any of them were satisfied in the country of exportation[187]. Therefore, if a primary rule is satisfied in the country of exportation, assuming also that no negative primary rule negates the determination, the country of origin has been established and the enquiry is at an end. However there was debate on how to deal with the scenario when no primary rule applicable to a good is satisfied in the country of exportation, i.e., the good does not undergo substantial transformation in that country. Two divergent opinions were expressed: (i) if the possibility of applying primary rules is exhausted, the origin of good should be determined by reference to an applicable residual rule; and (ii) if a good does not meet a primary rule by undergoing a substantial transformation in the country of exportation, the next level of analysis should whether a primary rule was satisfied in any preceding country which was involved in the production of the good (the "tracing-back" approach)[188].

The EC, Norway and Switzerland were against the "tracing-back" approach. A good which had undergone some processing in the country of exportation but had not undergone substantial transformation was not the same good as the good before processing. If the origin of the processed good was to be determined by applying the rule to the good before processing, the rules in their application would not be taking account of economically justified processing operations performed on the processed, but not substantially transformed, good in the country of exportation[189]. Furthermore, the "tracing-back"

[186] For details see Annex C/1 to WCO Doc. 42.711
[187] *Id*
[188] Id. Under the second option, the residual rule could be invoked only if there was no country in which a primary rule of origin was met.
[189] Annex C/1 to WCO Doc. 42.711 para. 31

approach would impose a considerable administrative burden on traders and administrators.

Argentina, Australia, Canada, Egypt, Hong Kong, Japan, New Zealand, Senegal, Singapore and the United States supported the "tracing-back" approach[190]. In their view it was implicit in an required by the ARO, because under Article 9.1(b), the HRO should provide for the country of origin of a good to be "the country where the last substantial transformation has been carried out". Stopping the enquiry at the country of exportation, and not trying to find a substantial transformation in preceding countries under the primary rules would amount to ignoring the primary rules and placing excessive reliance upon the residual rules. The extensive use of residual rules would have the effect of reducing the predictability of the rules of origin and thereby frustrating trade facilitation[191].

The TCRO devoted a considerable amount of time to this issue during both the 14th and 15th Sessions. The "tracing-back" approach was also discussed as part of the concept of "origin-retaining", which focused on the result of processing in the chain of manufacture of goods, i.e., once origin is conferred on a good or a material in a country, the origin is retained even in the subsequent countries as long as no substantial transformation takes place there. At the last stage of the technical examination, the term "tracing-back" was scarcely used by its proponents, primarily due to the implications of the "heavy administrative burden". A consensus was not reached and the issue was therefore referred to the CRO after the 15th Session. While lengthy formal debates continued at the CRO meetings, several bilateral consultations among the active key players brought about a solution before the concluding TCRO session in May 1999, which was not to adopt the "tracing-back" approach or to narrow the scope of the "origin-retaining" principle.

The "tracing-back" approach might have served better for the enforcement of antidumping measures or quantitative restrictions. However, since the HRO will be used for multiple purposes as provided in Art. 1.2 of the ARO, ease of administration seemed to be the determining policy consideration in this case. One of the key players conducted thorough research about the administrability of the "tracing" procedures and came to the conclusion that "tracing-back" would not be possible in most industrial sectors unless present

[190] Colombia and Thailand joined this group at the 15th Session
[191] See Annex C/1 to WCO Doc. 42.711 paras. 29-30

commercial practices were drastically changed. The Member did not publish details of the study, but its essence was widely shared with Members[192].

Since the time sequence was no longer a decisive principle for applying the primary rules, it was decided during the TCRO's sessions that if two or more primary rules were applicable to a good, there was no need to prove which primary rule was last satisfied in a country. If origin had been conferred in a country by application of a primary rule, it did not matter whether other primary rules are also satisfied in the same country.

(g) Multiple countries of origin

Based on Article 9.1(b) of ARO stating that "rules of origin should provide for the second country to be determined as the origin of a particular good", it appeared that there was a common understanding that one good can only have one country of origin. In most cases, this understanding was well reflected in the text of the draft HRO. While a good for which rules of origin are applied is to be identified under the Harmonized System as specified in columns A and B of the "matrix", that understanding could be taken to express a principle of "one good, one classification and one country of origin". However, there were some proposals which: (i) didi not recognized goods classified together in one (sub)heading under the HS as one good; or (ii) did recognize a good classified in one (sub)heading as one good, but where origin is conferred on the components instead of the good itself. Case (i) covers a collection of parts that are presented as unassembled or disassembled . Although classified in a (sub)heading by virtue of General Rule 2(a)[193] for the interpretation of the Harmonized System, the individual parts retain their origin prior to such collection (METTI NOTA INFRA, V. p. 628). Putting up in sets or kits, as provided for by General Rule 6 for the interpretation of the Harmonized System, is another example. There is a proposal suggesting that goods put up in sets, which are to be classified in a heading, should retain the origin of the individual articles in the set (for details,INFRA, v. p. 628). Case (ii) is that, as the last applicable residual rule proposed by India, "in the event of two or more countries equally contributing major portions of those materials, the good shall be assigned a multi-country origin".

[192] Consequently, by May 1999, the supporters of the "tracing-back" approach dwindled to five Members (Brazil, Hong Kong, China, India, Malaysia and the Philippines). These Members finally joined the other group at a later meeting of the CRO

[193] According to this Rule: "Any reference in a heading to an article shall be taken to include a reference to that article incomplete or unfinished, provided that, as presented, the incomplete or unfinished article has the essential character of the complete or finished article. It shall also be taken to include a reference to that article complete or finished (or falling to be classified as complete or finished by virtue of this Rule), presented unassembled or disassembled".

2.2 Primary rules and residual Rules

The "Ottawa language", explained above, is a prerequisite to understand the draft HRO. A rough but determinant shape of the final architecture was established at the Meech Lake informal session and its recommendations are still valid in many aspects. In the history of the harmonization of non-preferential rules of origin the Meech Lake recommendations and a series of elaborations by the TCRO provided the guiding principles for drafting the residual rules. The sequential application between Appendices 1 and 2, and of Appendix 2 Rules –concerning the determination of origin, were agreed by the TCRO. The order of provisions for the residual rules, to which this next subsection devotes its analysis, has become one of the most crucial issues tackled by the TCRO and the CRO.

(a) In-depth discussions on the residual rules.

Extensive discussions on the residual rules finally started at the 15th Session of the TCRO in December 1998. Reflecting the aforementioned positions on the issue of the "last" substantial transformation, each proponent suggested modifications to the architectural structure of the residual rules. The first group[194], supported by the EC and Norway, now proposed that a few residual rules should be presented at the level of Appendix 2[195]. A newly identified proposal by Switzerland[196] preferred to indicate the nature and the application of the principle of the residual rules in Appendix 2, while providing a cross-reference to the specific residual rule which would apply to each Chapter. The last group[197] proposed that generic ultimate residual rules be presented in Appendix 2, with other residual rules being specified at Chapter or even heading or subheading level; this was in contrast to the first group which did not require product-specific residual rules[198].

The first and the second group were heavily criticized by the third group on the point that relinquishing the application of the primary rules at an early stage could lead to a situation where origin was assigned *administratively* instead of pursuing the country where the last

[194] This position was referred to as "Option B" in the referral document (WCO Doc. 42.774)
[195] See Annex C/1 WCO Doc. 42.820, *Report to the Fifteenth Session*, para. 15
[196] Referred to as "Option C", see WCO Doc. 42.774
[197] Referred to as "Option A" supported by Argentina, Australia, Canada, Colombia, Egypt, Hong Kong, China, Japan, New Zealand, Senegal, Singapore, Thailand, Unites States, see WCO Doc. 42.774
[198] The EC did not completely abandon the idea of establishing product-specific residual rules, see WCO Doc. 42.771

substantial transformation was carried out. It appeared that the third group's argument was based on the assumption that the primary rules are the criteria to determine substantial transformation; thus, the country of origin determined by application of the residual rule does not reflect substantial transformation.

The EC refuted this argument[199]. When more than one country is involved in the production of goods, the origin is determined by the concept of "last substantial transformation". Therefore, the residual rules should indicate which operation is considered to be the last substantial transformation for the goods which do not meet the primary rules.

If the transformation which the goods last underwent cannot be considered as substantial, the origin should be determined on the basis of the penultimate transformation, which then considered to be the last substantial transformation. When two or more materials of different origin are used, the last substantial transformation should be the production of the materials that impart the essential character[200] to the final goods.

The second group's position was almost identical to that of the first. The main difference is in the use of a value-added criterion for the general residual rule. The third group maintained the hierarchical structure as agreed at the 14th Session, i.e., (i) the primary rules, (ii) the product-specific rules, and (iii) the general residual rules[201].

(b) The criterion of the "essential character" for the general residual rules

The expression "essential character" is used in the HS General Interpretative Rules (GIR). The question arose as to whether the meaning of essential character in terms of origin should be the same as in the HS. The HS Explanatory Note to GIR 3(b)[202] indicates that the factor which determines essential character will vary, and may, for example, be determined by the nature of the material or component, its bulk, quantity, weight or value, or by the role of a constituent material in relation to the use of the goods. For some Members, GIR 3(b) was itself a sufficient standard. Origin could be determined under a residual rule

[199] *EC Position Paper*, see WCO Doc. 42.771, para 3

[200] The EC proposed that the essential character could be determined, in general terms, by the non-originating material or materials that predominate by weight, volume or value. The applicable criterion would be chosen based on the function of the good and be listed at the appropriate place in the relevant Chapter; see WCO Doc. 42.771, para. 4

[201] This group did not put forward a single text for the general residual rules. Several alternative rules were proposed

[202] Mixtures, composite goods consisting of different materials or made up of different components, and goods put up in sets for retail sale, shall be classified as if they consisted of the material or component which gives them their essential character, insofar as this criterion is applicable."

which specifies that origin follows from the origin of the material or component giving the good its essential character which determines the classification of the good. Under this view, "essential character" would have the same meaning as under the Harmonized System. Other Members questioned the applicability of GIR3(b). They wondered whether a classification rule designed for mixtures, composite goods and sets should be applied in respect of the origin of any kind of good which has not undergone substantial transformation under a primary rule. In the TCRO, the factors of volume, weight and value of materials have been considered generally appropriate, although Members differ on particulars[203].

Elaboration of the general residual rules continued at the 16th Session of the TCRO. Faced with a deadline only a few months away, the Chairman instructed the Secretariat to draft a compromise text for the general residual rules. After lengthy discussions based on the Secretariat text, the TCRO was finally able to agree to a single draft text (with several square brackets) for the general residual rules. From this text onwards, paragraphs in Appendix 2 were replaced with "Rules"; these were often referred to as "Appendix 2 Rules"[204]. A broad notion of essential character seemed to be universally applied, but with differing criteria for identifying essential character. It was also unanimously accepted that the initial origin of goods was to be "carried forward" when the goods underwent minimal operations or processes.

In the compromise text, the following aspects regarding the formulation of residual rules still needed to be settled: (i) whether to take into account both originating and non-originating materials or non-originating materials only; (ii)whether to take into account the materials which do not satisfy the conditions set out in the primary rules or all of the materials; (iii) whether to include a provision to confer origin if at least fifty percent of the materials by value, volume or weight are originating; (iv) whether a criterion based on value is needed in the residual rules; and (v) whether to take account not only of materials but also of related processing and assembly[205].

(c) The TCRO final text of Appendix 2, Rule 2 (May 1999)

[203] See Annex C/1 to WCO Doc. 42.820, paras 21-23

[204] See Annex O/2 to WCO Doc. OC0010E3 for the agreed simgle text of Rule 2 developed from the Secretariat's compromise text

[205] See Annex O/1 to WCO Doc. OC0010E3, para 5

In the TCRO's final text of Rule 2[206] to Appendix 2, Product-specific Rules of Origin, agreed at the 17th Session, the expression "essential character" has disappeared. It was finally agreed that the last residual rule , Rule 2(g), to determine the country of origin of the goods is: "the country in which the major portion of those materials originated, as determined on the basis specified in each Chapter". Thus, such criteria as value, weight and volume proposed for the general residual rules at the 16th Session now appear at the Chapter level. It can be opined that this conclusion was intended to refrain from using the conceptual expression "essential character" but still utilize the practical part of GIR 3(b)[207].
Rule 2(c)(ii) has three alternative texts seeking to convey the same message. For instance, when a wooden kitchen table, classified in subheading 9403.40, is imported and painted with non-originating paints of Chapter 32, the painted wooden kitchen table is still classified in subheading 9403.40. In this case, the table does not change its classification[208], remaining in subheading 9403.40, but other materials, such as the paints, undergo a change of classification from Chapter 32 to subheading 9403.40. By application of Rule 2(c), the origin of the painted wooden kitchen table should be the country where the unpainted wooden kitchen table originated.
Rule 2(g) would lead to several different countries of origin depending on the following square-brackets texts: (i) "whether or not originating"; and (ii) "that did not undergo the change of classification or otherwise satisfy the primary rule applicable to the good".
The following hypothetical example highlights the difference:

Country A exports manioc pellets (heading 07.14; 100 kg) produced from originating fresh manioc (cassava) (heading 07.14; 200 kg $50), together with flour of manioc originating in Country B (heading 11.06; 50 kg, $150) and binder (molasses) originating in Country C (heading 17.03; 3 kg, $20). The product-specific (primary rule for heading 07.14 is CTH, except from heading 11.06. Assuming that the criterion for applying Rule 2(g) is by weight, which country, A, B or C is the origin of the manioc pellets?

In this example, the primary rule is not an "Ottawa-type rule" which has the fixed narrative text starting with "The country of origin of the goods of this (sub)heading is the country

[206] In September 2000 the CRO renumbered Rule 2 as Rule 3
[207] It should be noted, however, that when the specified criterion dose not determine the major portion of the materials, e.g., assuming that the materials originating in Country A and the ones in Country B have the same weight, in this case, under the text formulated in May 1999 there is no way to determine the country of origin of the good in question
[208] The rule for heading 94.03 has been agreed as "CTH; or change from subheading 9403.40"

where…"; Rule 2(a) is not applicable. The primary rule is not satisfied due to the use of non-originating manioc (heading 11.06); Rule 2(b) is not applicable. A non-origin-conferring operation (i.e., negative rules) is not set out for this heading; Rule 2(c)(i) is not applicable. The non-originating material or article that has the same classification as the resulting good (i.e., manioc of heading 07.14) is not used; Rule 2(c)(ii) is not applicable. Assuming that no Chapter residual rule is applied, Rule 2(d) is not applicable. The materials come from more than one country; thus, Rules 2(e) and 2(f) are not applicable. Finally, it falls to Rule 2(g) to determine the country of origin of the manioc pellets.

The qualifying text "(whether or not originating)" makes clear the coverage of Rule 2(g). The proponents of Rule 2(g) with this qualifying text considered that the last applicable residual rule should cover not only non-originating materials, but also the originating materials. Several delegations supported the inclusion of this text, because there was no rational reason why the originating materials should be discriminated against and excluded from the calculation formula[209].

Therefore, the answer to the hypothetical question is Country A where the originating fresh manioc, in the major portion of 200 kg, was supplied.

However, the proponents of Rule 2(g) without this qualifying text argued that Rule 2(g) should target non-originating materials only. The residual rules are intended to determine the country of origin from among those countries which supplied materials, rather than giving a "second chance" to the country in which the manufacturer failed to meet the primary rule[210]. In this context, another delegate was of the view that the primary rule and the residual rule should not contradict each other[211]; if the same origin results from both the primary and the residual rules, the primary rule would seem pointless, even replaceable with the residual rule[212]. Consequently the answer to the question should be Country B from which 50 kg of flour of manioc (the supplier of the major portion between Countries B and C).

The qualifying text "that did not undergo the change of classification or otherwise satisfy the primary rule applicable to the good" was proposed to maintain the close link between the primary rule and the residual rule. If the applicable primary rule is change of heading "except from a specific heading", then obviously the intent of the primary rule is that the specified change does not result in substantial transformation. It s thus logical and

[209] See Annex H/2 to WCO Doc. OC0030E/2
[210] See WCO Doc. 42.771, para 5
[211] Only a few delegations supported this view, already pointed out at the Meech Lake meeting
[212] See Annex H/2 to WCO Doc. OC0030E/2

appropriate to focus on the origin of the materials which do not undergo the required change[213]. The answer to the question then becomes Country B from which the precluded content, i.e., flour of manioc (heading 11.06), was imported. The opponents to the inclusion of that text pointed out, however, that in the residual rule, origin should be based upon the origin of all the materials used, without distinction[214].

(g) The CRO's latest text of Rules 2 and 3 (as of June 2002)

Elaboration of the architecture by the CRO progressed steadily, item by item. In September 2000, the plurilateral meeting agreed to "place the provision on rules of application between Rule 1, concerning the scope of application, and Rule 2, devoted to the determination of origin, as it was more logical to have rules of application preceding the determination of origin[215]. Consequently, Rule 2 in the TCRO's final text was renumbered as Rule 3[216]; Rule 3 in the TCRO's final text was renumbered as Rule 2[217] with the new title "Application of Rules". In September 2000, the plurilateral meeting also agreed that Rule 2 should contain: (i) a link between the classification of the good in the HS and the corresponding product description in the HRO; (ii) a provision stipulating that primary rules should apply only to non-originating materials; (iii) the concept that all primary rules are co-equal, and that in their application account should be taken of Chapter Notes; and (iv) reconfirmation of the sequence of application of Rules 3(c) through (f)[218].

Rule 3(a) was queried as to whether its coverage "should be expanded in order to deal with the situation in which origin was to be conferred on the basis of a designated stage of manufacture"[219]. At the February 2002 meeting of the CRO, a footnote to Rule 3(b) was added to clarify its coverage. Some delegations even questioned the appropriateness of Rule 3(a). As of June 2007, the latest text at the time of writing, one Member made new proposals for Rule 3(a). Another Member suggested revising the order of Rules 3(a) and 3(b).

In December 2000 the proponent of the first alternative to Rule 3(c) offered to drop its proposed text "on condition that this resulted in consensus on the first alternative of Rule 3(f), and with the clear understanding that Rule 3(c) applied to goods that were almost

[213] *Id*.
[214] *Id*.
[215] WTO Doc. G/RO/M/32, para 1.1
[216] Hereinafter referred to as Rule 3
[217] Hereinafter referred to as Rule 2
[218] *Id*.
[219] WTO Doc. G/RO/M/28, para 1.1

finished, i.e., maintaining the same Harmonized System description as the processed good[220]. In May 2001, the participants of the informal meeting deemed that any further technical discussion with regard to rules 3(c) and (f) would be fruitless. The group therefore was "increasingly interested in the package offered by the proponent of the first alternative or Rule 3(c)"[221]. As of June 2002, there was consensus on the text of Rules 3(b), (d) and (e). As the commentaries on Rule 3 indicated, there was also a general agreement among Members on the basic approach to Rule 3, namely, the application of primary rules in the last country of production as the first test, the application of the origin-retaining concept as the second test, and the application of major portion concept as final test. The proposal for Rules 3(f) and (g) still retain the crucial difference as to whether the major portion should be determined by considering: (i) both originating and non-originating materials expressed by "whether or not originating", proposed by India; (ii) both originating and non-originating materials, which do not satisfy a primary rule applicable to the goods, proposed by the United States[222]; or (iii) non-originating materials only, proposed by the EC. It was also noted that Rule 3(e) might not be necessary, since the application of Rule 3(f) and (g) would result in the same origin outcome.

As described above, the CRO has simplified and refined the text. Although 94 core policy issue have been forwarded to the WTO General Council, drafting issues relating to the architecture were retained in the CRO as part of the remaining technical issues. However, these issues will only be dealt with by the CRO when all the core policy issue will have been resolved. It is therefore premature to conclude how the provisions of Rule 3 affect the determination of the country of origin of goods. The CRO has not yet specified the criteria for Rule 3(f) or 3(g) to be applied to each HS Chapter. The criteria for the agricultural sector would differ from those for the textile sector or the machinery sector. The CRO may also further develop Chapter-specific residual rules for certain Chapters.

(g) Substantial transformation and the residual rules

To date, no conclusion has been reached as to whether the country of origin attained by application of the residual rules is the reflection of substantial transformation. The CRO appears to be reluctant to touch upon this grey area. It is clear from the view of the

[220] WTO Doc. G/RO/M/34, para 1.1
[221] WTO Doc. G/RO/M/35, para 1.1
[222] The U.S. subdivided its proposal into Rule 2(f) – the single country providing the materials which did not satisfy a primary rule – and Rule 2(g) – the country, among several countries, providing the major portion of the materials which did not satisfy a primary rule

proponents of the "tracing-back" approach that, for several Members, assigning origin by application of the residual rules is determined by administrative needs[223]. Although all proponents have already withdrawn their position concerning the "tracing-back" approach, that fundamental notion of how the residual rules should be defined is deemed to be valid. This was one of the reasons why the title of the Appendix 2 rules could not use the term "substantial transformation". Similar arguments took place when the TCRO discussed the provision of interchangeable goods and materials (Rule 5); the assignment of origin on a rather arbitrary basis to goods which have not undergone processing seemed contrary to the concept of last substantial transformation[224]. It was then clarified that a rule on interchangeable goods and materials was not intended itself as a rule of origin to determine whether or not goods are substantially transformed, but as a practical way of assigning origin regardless of whether goods are substantially transformed[225]. In this discussion a strong argument was put forward by the Republic of Korea[226]. First of all, the ARO does not provide a mandate o the CRO and TCRO to establish criteria other than those for expressing substantial transformation. Setting out residual rules may be acceptable, but this must be undertaken within the framework of the ARO, i.e., the residual rules must be prepared as a part of the criteria for substantial transformation. When a new category of rules, other than the criteria for substantial transformation, is created, the ARO should be amended accordingly.

3. Minimal operations or processes

( ) Initial discussions at the First and Second Sessions of the TCRO

Definitions of minimal operations or processes were briefly discussed at the 1st Session of the TCRO; fuller discussions were held at the 2nd Session. With regard to the definitions, Members agreed that: (i) minimal operations or processes should neither take away origin nor confer it; (ii) minimal operation or processes should be re-examined together with the general rules at a later stage; (iii) packaging sometimes went beyond a minimal operation as it could require the use of complex processes and could add more than negligible value

[223] The implication of adopting this position might be that, in its application, it is possible to differentiate the status of the origin conferred by the primary rule as truly substantially transformed and by the residual rule as administratively assigned. Consequently, only goods that have satisfied the primary rules could be treated as originating goods for the purposes of quota allocation, etc.
[224] See Annex C/1 to WCO Doc. 42.820, para. 80
[225] *Id*.
[226] The Korean position was consistent from the very early stages through to the end of the technical examination

to the goods[227]; and (iv) packaging for transport should be separated from the other types of packaging to be discussed later[228]. Reflecting such discussions, the text of Definitions 1 and 2 and the Explanatory Notes to the definitions were adopted at the 2nd Session, subject to further consideration throughout Phases II and III of the HWP[229].

Definition 2 stated that minimal operations or processes should not be taken into account in determining whether a good had been wholly-obtained in one country. Therefore, even if there is an operation to facilitate transportation of the wholly-obtained goods, that operation does not negate the status of wholly-obtained goods. The last paragraph of the Explanatory Notes provided that a minimal operation or process or a combination thereof shall not preclude conferring origin on a good if a substantial transformation occurred as a result of other operations or processes. Similar to Definition 2 above, when one of the origin criteria such as a CTH rule is met, an operation to facilitate transportation should not negate the originating status of the goods.

( ) Placement of minimal operations or processes

After the 3rd Session, these definitions and Explanatory Notes were placed in Appendix 3. However, in view of the "one-page-only" layout of the Appendix, it was agreed to merge its content into the General Rules at the 14th Session. Further details were discussed at the 15th Session. In this process, the principle of minimal operations or processes was presented in Appendices 1 and 2 in differing formulations. Appendix 1 specified that minimal operations or processes were not to be taken into account while Appendix 2 specified that such operations were not origin-conferring[230]. This modification was thought to offer a more precise description of how the principle of minimal operations or processes would be applied in the respective Appendices[231].

The text of the Explanatory Notes prepared at the 2nd Session was deleted with the exception of the last paragraph and an illustrative list of minimal operations or processes. At the request of several Members, the list which had been fully deleted at the 14th Session was reinstated at the 15th Session[232] as part of General Rule 5 as a non-binding, non-

[227] Several countries opposed this point
[228] See Annex C/1 to WCO Doc. 42.820, para 65
[229] For details, see Annex E/2 to WCO Doc.39.488
[230] See Annex C/1 to WCO Doc. 42.820, para 65
[231] *Id*.
[232] These Members considered that the list was a highly important aid to interpretation and application of the provision of minimal operations or processes. However, other Members did not favour inclusion of the list being cognizant of the fact that no list could be comprehensive; the items now listed might contradict certain

exhaustive list of example[233]. Thus, in the TCRO's final text of General Rule 5, there were no longer Explanatory Notes to the definitions of minimal operations or processes.

( ) Relationship with origin-conferring rules

There were two divergent opinions as to whether the scope of minimal operations or processes should, or should not, cover Appendix 2. India, the Philippines and Switzerland argued that: (i) there was no need to set forth a general provision in General Rules because a primary rule has already taken into account whether that rule may confer origin on a good by a minimal operation or process; (ii) otherwise origin conferred by such primary rule will be overruled by the general provision. Thus, in Appendix 2 the issue of minimal operations or processes should be addressed by a Chapter Note, devoted to negative standards, or an individual primary rule, where appropriate[234].

Canada, the EC, Morocco and the United States, in the other hand, stressed that minimal operations or processes should cover both Appendices 1 and 2; they argued that: (i) Article 9.2(c)(i) of the ARO requires the TCRO to develop the definitions in a horizontal manner; (ii) those definitions must apply to the entire HRO. The General Rules must have a safety valve to prevent minimal operations or processes from conferring origin on a good[235]. The EC further argued that General Rule 5 (TCRO's final text) should be applicable to the change of classification rule only because the process rules were articulated to confer origin on the particular good in any condition, if the specified process requirements are satisfied[236].

( ) Negotiations in the CRO after June 1999

In December 2000, consensus was reached to apply General Rule 5 (TCRO's final text) only to Appendix 1[237]. It was also decided to delete the list of examples, even though one

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primary rules; and not all the operations listed (e.g., testing and calibration) corresponded to the operations enumerated in the legal definition, see Annex C/1 to WCO Doc. 42.820, para 66

[233] Examples of minimal operations or processes include: ventilation; spreading out; drying; chilling; removal of damaged parts; application of grease, anti-rust paint or protective coating; removal of dust; cleaning; washing; sifting or screening; sorting; classifying or grading; testing or calibration; breaking bulk; packing, unpacking or repacking; grouping of packages; affixing of marks, labels or distinguishing signs on goods or their packages; dilution with water or any other aqueous solution; ionizing; salting, Husking; shelling and unshelling; stoning and crashing, see Annex C/2 to WCO Doc. 42.920

[234] See Annex H/2 to WCO Doc. OC0030/2

[235] *Id*.

[236] *Id*.

[237] See WTO Doc. G/RO/M/34, para 1.1

delegation pointed out that an indicative list might be useful[238]. Consequently, the provision was moved to its appropriate place under Appendix 1 as Rule 2[239]. The agreed text limits the scope of operations or processes to those following purposes: (i) ensuring preservation of goods in good condition for the purpose of transport or storage; (ii) facilitating shipment or transportation; and (iii) packaging or presenting goods for sale. This commentary on Appendix 1, Rule 2 of the latest CRO text indicated that consensus on Rule 2 was confirmed, and that the possibility of application of Rule 2 of Appendix 1 to Appendix 2 should be reconsidered at a later stage when the work was virtually completed. Under the current text, the origin of a good which has merely undergone minimal operations or processes in a country will be determined, in many cases, by application of Rule 3(c) from the standpoint of whether the good has changed its HS classification, although Rule 3(c) would also cover the "grey area".

4. Other provisions of General Rules and Appendix 2 Rules

In the TCRO's final text, several provisions were placed in square brackets. In addition, the order of the rules and the placement of the rules were of a preliminary nature. The CRO has refined the text and endeavoured to remove the square brackets. Among the General Rules and Appendix 2 Rules, the following may need further explanation.

(i) Determination of Origin – General Rule 3

This General Rule confirmed the agreed principles: (i) General Rules are the governing rules for the application of both Appendices 1 and 2; (ii) the sequential application between Appendix 1 and Appendix 2[240].

(i) Neutral elements – General Rule 4

"Neutral elements" are those factors of production as plant and equipment, fuel, machinery and other elements whose origin is not to be taken into account in determining the origin of a good. The TCRO discussed this matter at the 14th and 15th Sessions. An exhaustive list seemed impossible. While an indicative list might introduce ambiguity or uncertainty. One view was that such a provision would provide clarification and certainty. Another view

[238] *Id*.
[239] *Id*.
[240] The plurilateral meeting of the CRO agreed to delete General Rule 3 (definitions – TCRO's final text) at the June 2000 meeting; renumbered General Rule 3 (determination of origin) appeared in the WTO document as from December 2000 (WTO Doc. G/RO/M/34, para 1.1)

was that a provision was not needed because the exclusion of neutral elements from origin determination was too obvious to need mentioning. It was also argued whether there was a possible contradiction between the exclusion of neutral elements from origin determination and the use of value added criteria. The calculation of value of materials would necessarily include the cost or price of plant, machinery, etc.

On this basis, it was suggested that the provision on neutral elements should include the provision "unless otherwise provided…". Others saw no such contradiction and hence did not favour including any provisions. At its 15th Session, the TCRO reached broad agreement that the origin of neutral elements should not, in general terms, be a factor in the determination of origin. Materials were normally incorporated in a good and their origin was essential to origin determination under most origin criteria[241].

During the discussions in the TCRO, the only delegation having reservations regarding the text lifted them. Thus, the text has been unbracketed since April 2001, except for the phrase "unless otherwise provided in this Annex" which remained in brackets[242].

(i) Intermediate materials – Appendix 2, Rule 4

At its 14th and 15th Sessions, the TCRO had lengthy discussions on this issue and concluded that: (i) once origin is conferred on a good or material in a country, the good or material will not lose its originating status by subsequent processing undertaken in the same country; (ii) a good produced solely from originating materials has the same country of origin as the materials; and (iii) the concept was relevant to the primary origin-conferring rule of Appendix 2, and probably not to any other part of the Harmonized Rules of Origin[243].

Under several existing preferential and non-preferential rules of origin, this concept is known as the "roll-up" method or "absorption" concept for calculating the value of originating and non-originating materials. It might be anticipated that if and when the value-added rules proposed for some Chapters are finally accepted by the CRO, the "roll-up" approach might be needed for the calculation method. However, there was no substantive discussion during the sessions concerning how to deal with the intermediate

[241] See Annex C/1 to WCO Doc. 42.820

[242] WTO Doc. G/RO/M/35, para 1.1. The latest text of the CRO confirmed consensus on the unbracketed text of General Rule 4. However, one delegation requested that the bracketed text be included in the provision until a complete picture was obtained.

[243] See Annex C/1 to WCO Doc. 42.820

materials provision in connection with the value-added rules[244]. For a tariff-shift rule, which is the dominant rule in the draft HRO, the required changes must always be made from non-originating materials; therefore, once a component of a machine meets the origin rule for components, that component is no longer subjected to the tariff-shift rule for the machine, even though non-originating parts were used for the production of the component.

Specific issues were also discussed, for example whether non-originating steel spoons, classified in subheading 8215.99 and for which a CTH rule has been agreed) underwent substantial transformation when the spoons were melted and cast into ingots in one factory and reprocessed to new spoons in another factory. In this example, there was no change in classification between the source materials and the final products. The common understanding of the delegations was that the non-originating steel spoons underwent substantial transformation when the spoons changed into steel ingots classified in heading 7206, and for which a CTH rule has been agreed. The new spoons produced solely from originating steel ingots has to be regarded as originating in the same country. However, when intermediate materials are produced in the course of successive plant operations leading to the final goods yet the same intermediate materials *per se* do not appear on the market, there may be some difficulty in administering Rule 4. The TCRO discussed an hypothetical case where used steel rails of heading 7302 are recast into new steel rails, classified in the same heading, without being interrupted at any intermediate process. The used steel rails were first placed for melting at a steel mill, then further processed automatically by the plant, and finally changed to the shape of the new steel rails. In this hypothetical case, an intermediate material, such as ingots or bars, was not offered on the market and, consequently, there was no independent transaction for these materials. The state of an intermediate material might have existed for a moment, but it kept changing shape and moving towards the final product. Several delegations shared the view that the steel rails from used steel rails should be considered substantially transformed.

During the negotiations in the CRO, it was confirmed that all Members accepted the principle of this provision. However, it should be noted that there is no explicit text in the current architecture to confer origin on a good which is produced solely from intermediate

[244] The calculation method for the value-added rule should be further elaborated in the future in order to deal with cases where intermediate materials do not satisfy the product-specific rules of origin: either (a) such intermediate materials being considered to be 100 percent non-originating materials (the "roll-down" method): or (b) non-originating material used for the intermediate materials being counted as non-originating materials ("tracing" method). See Vermulst, Waer, Bourgeois, supra note xxx, p. xxx

materials, except for Rule 3(e) concerning the case of a single country providing all the materials to produce a good.

(d) *De minimis* – Appendix 2, Rule 7

Although the idea of a *de minimis* rule had been presented at its 3rd Session, the TCRO only started the examination of *de minimis* rules at the 14th Session. Proponents were of the opinion that *de minimis* rules were useful and trade-facilitating and would help reduce over-dependence on residual rules in determining the origin of goods[245]. On the other hand, several delegations felt that the concept of *de minimis* could serve no practical purpose because the existing primary rules coupled with residual rules would be insufficient to determine the origin of goods; thus, the *de minimis* would involve extra work and resources on documentation which would only add the burden of traders[246].

Discussions continued at the 15th Session. Several negative points were made, namely that: (i) it did not seem possible to apply a *de minimis* threshold to a process-based primary rule; (ii) it seemed difficult to set thresholds in a rational basis; and (iii) the administration of thresholds would be difficult and costly for developing countries. Those in favour of this rule gave broad support to the idea of making the application of de *minimis* rules mandatory. It was also generally understood that a *de minimis* rule should be applied positively to permit a primary rule to give a result, and never negatively to prevent a result under a primary rule. Only if primary rules did not give an outcome should de minis rules be applied to exclude from the calculus any non-originating materials which might have prevented a result under primary rules. If it is determined that no result is possible under primary rules, even with the benefit of *de minimis*, then residual rules are applied[247].

The TCRO could not reach consensus on this matter and proposed several alternative approaches at its 17th Session. India, Malaysia, New Zealand, Philippines and Senegal opposed the inclusion of *de minimis* rules in the HRO, Morocco proposed that the *de minimis* rules should cover both Appendices 1 and 2, with the fixed threshold of twenty percent of the ex-works price. The EC proposed that the *de minimis* rules cover Appendix 2 only, but the rules should be placed under the General Rules and their thresholds

[245] See Annex C/1 to WCO Doc. 42.711, para 19
[246] *Id*.
[247] See Annex C/1 to WCO Doc. 42.820

indicated at Appendix level. Canada and Switzerland proposed that the *de minimis* rules with a horizontally applicable threshold[248] be placed at Appendix 2 level only[249].
Colombia, Egypt, Japan and Korea proposed that the *de minimis* rules be set out on a Chapter or product-sector basis. Although participants were still divided on the actual need for a rule, the plurilateral meeting of June 2000 confirmed growing consensus on its application being limited to Appendix 2[250]; consequently the *de minimis* rule was moved from the General Rules[251] to Appendix 2. In December 2000, it was confirmed that there was growing consensus on the mandatory character of this provision[252]. Since that meeting the facilitator's proposed text with the square-bracketed ten percent threshold has been maintained as a single draft[253].

3.Wholly-obtained goods – Appendix 1

This section examines how rules at the Appendix level have been discussed and subsequently agreed or retained as issues. Firstly, an outline of the development of definitions of wholly-obtained goods by the TCRO is provided. The treatment of the expressions "country", "vessels" and "scrap and waste" is then explained. Finally, a newly introduced concept of "outside a country" and related definitions will be considered.

3.1 Preparatory discussions at the First Session

In the context of the first items mandated by Article 9.2(c)(i) of the ARO, the WCO Secretariat prepared a working document on definitions of wholly-obtained goods for discussion by the TCRO at its inaugural session. The Secretariat's proposals, based on the text of Annex D.1 to the Kyoto Convention, contained several new suggestions[254]. For example, a definition of the term "country" was provided and several new concepts were

[248] Switzerland proposed twenty percent of the ex-works price, while Canada proposed seven percent of the total weight for textiles, seven percent of the transactional value for non-agricultural goods
[249] See General Rule (5), (8) or (Rule 6) of the TCRO's final text in WCO Doc. OC0029
[250] See WTO Doc. G/RO/M/30, para 1.1
[251] ((5) proposed and (8) – TCRO's final text)
[252] See WTO Doc. G/RO/M/34, para 1.1
[253] See WTO Doc. G/RO/45. The commentary on Rule 7 – *de minimis* of the latest text of CRO states: "there was general support for this Rule. Some Members stated that the nature of this Rule should be optional for producers, although this Rule itself should be mandatory for all Members"
[254] See WCO Doc. 39.166

inserted such as "product of activities in territories not subject to the jurisdiction of a single country".

The treatment of the term "country" has been one of the contentious issues. The Secretariat draft referred to the first paragraph of the Explanatory Notes to the Marrakesh Agreement establishing the WTO[255] and provided a geo-physical definition of the term country[256]. Another issue raised concerned the treatment of customs unions; the working document supported the idea that: "for origin purposes the definition of "country" would also include customs unions[257].

Members welcomed the working document since it provided the TCRO with a good starting point for discussion. Although most of the conventional Kyoto-type definitions were supported by delegations, none of the new suggestions was accepted. Members did not agree to use certain politically sensitive terms, such as "sovereignty", or refer directly to the UN Convention on the Law of the Sea[258] to define "territorial sea". Several delegations explicitly expressed their opposition to including a customs union as a part of the definition "country"[259]. The treatment of the Exclusive Economic Zone was also controversial as to whether "country" should include the EEZ. It appears that these issues were too substantial for discussion at the one-week inaugural session, even though three months were allotted for the work of Phase I. Finally, the TCRO decided to refer to the CRO the issue of whether the definition of the term "country" was a matter clearly within the competence of the TCRO[260].

3.2 TCRO's first text of Definitions of wholly-obtained goods

[255] The first paragraph of the Explanatoru Notes states that: "The term 'country' or 'countries' as used in this Agreement and the Multilateral Trade Agreements are to be understood to include any separate customs territory Member of the WTO"

[256] "For the purposes of the Agreement on Rules of Origin the term 'country' shall be taken to mean the land, including the airspace above and the soil and subsoil beneath the land, and the territorial sea appurtenant to the land, including the airspace above and the seabed and subsoil beneath the territorial sea, over which a country exercises sovereignty. The term 'country' shall al so be taken to include free ports, free zones and in bond operations. The term 'territorial sea' shall be interpreted in accordance with international law as defined in the 1982 Convention on the Law of the Sea". See WCO Doc. 39.166, pp 2 and 6. These definitions were placed in the column entitled "explanatory Notes" tat were intended to be legally binding

[257] See WCO Doc. 39.166, para 3. See also Annex D.1. to the Kyoto Convention, Commentary (2) to Definitions

[258] The UN Convention on the Law of the Sea entered into force on November 16, 1994. When the WTO Agreement came into force in January 1995, most of the major trading partners were not yet contracting parties to the Law of the Sea Convention. As of July 2007, 145 countries have ratified, acceded or succeeded to the UN Convention on the Law of the Sea. In January 1995 Contracting parties were only 82. At a later stage of the negotiation, the CRO used the Law of the Sea Convention as a basis for discussion; see WTO Doc. G/RO/M/32, para 1.1

[259] See WCO Doc. 39.310, para 192

[260] See WCO Doc. 39.310, para 201

At its 2nd Session, the TCRO had agreed to the text and submit it to the CRO in time for the deadline of Phase I. Many of the proposed definitions were readily agreed by the TCRO with a slight modification or addition of terms. With regard to the definition of "scrap and waste", several delegations proposed to delete the expression "fit only for disposal or for the recovery of raw materials", while some Members opposed the idea on the ground that the expression was not an "end-use" provision but merely stated the current condition of the goods[261]. The distinction between "used goods" and "waste and scrap" was proposed by a delegation, taking into account the fact that the HS does not adequately define more types of scrap and waste[262]. On the other hand, several delegations were of the view that the "used articles" in question were implicitly covered by the term "scrap and waste". With regard to the addition of "articles collected" and "recovery of parts" to the text of the definition, one group emphasized the commercial reality of the international collecting and recycling trade, while another preferred to consider this issue during Phases II and III[263]. The TCRO decided to send the CRO two alternative texts, both in square brackets. The first text was the original Secretariat proposal from WCO Doc. 39.481, and the second one was a delegation's proposal, which consisted of two parts.

A number of delegations supported the view that the term "solely", contained in the Definition 1(i), should be applied in a literal sense, whereas several other Members preferred a flexible interpretation to be achieved by a General Rule, such as a *de minimis* rule or by means of an explanatory note[264]. The TCRO agreed to interpret the term "solely" in its strict sense.

Part 2 of the definitions dealt with goods obtained outside a "country". Consequently, the scope of this part could be clarified only once the term "country" was defined. In response to the TCRO's request, the CRO agreed to set up a drafting group to elaborate a definition of the term "country" for the sole purpose of the ARO[265]. The TCRO decided that it would

[261] See WCO Doc. D/1 to WCO Doc. 39.488, paras 16 and 18

[262] According to this delegation, "used articles" should be qualified with words to the effect that they can no longer perform their original purpose and cannot be repaired or restored. The WCO Director of Nomenclature and Classification commented that used articles that could not be re-used would normally be classified as scrape and waste. The HS Nomenclature contained headings for scrap and waste that could be classified according to the main materials used. There was a problem, however, as how to classify scrap and waste consisting of different materials

[263] See Annex D/1 to WCO Doc. 39.488, pp. 4-12

[264] *Id*.

[265] See WTO Doc. G/RO/M/2, paras 12-13

review this matter when the CRO had finished its work on the definition of the term "country".

Several delegations opposed the proposed definition for the term "vessel" which linked only the country of origin of registration of a vessel. A number of countries suggested that chartering and leasing also be included. The TCRO decided to refer to the CRO the issue of whether Definitions 2(i) and (ii) should include the possibility that goods obtained on or by means of a chartered vessel or factory ship or on leased structure or installation or spacecraft should be considered as being wholly-obtained[266].

3.3 The TCRO's further elaboration Of definitions of wholly-obtained goods

The CRO supported most of the TCRO's first text with regard to definitions of wholly-obtained goods, but requested the TCRO to: (i) refine Definition 1(c), regarding products obtained from live animals; (ii) refine Definition 1(d), regarding plants and plant products harvested, with respect to the interpretation of "plant products" and "products obtained from a plant"; (iii)refine Definition 1(g), regarding goods obtained solely from other wholly-obtained goods, in terms of consistency between the interpretation of the term "solely" and Definition 2[267] in minimal operations or processes; (iv) address the issue of the origin of recovered parts with respect to renumbered Definitions 1(g) as 1(h) and 1(f)(i) as 1(g); revisit the Explanatory Notes on the basis that they are to be legally binding[268].

The CRO formulated an alternative text for Definition 2 and agreed that this issue required further deliberation and consultations. Several countries reserved their position on this issue. The CRO concluded that a general and abstract definition of the term "country" was not required at this time, and requested the TCRO to proceed with the Harmonization Work Programme in the absence of abstractly constructed definition of the term "country"; and that the CRO should delay its consideration of this issue until the TCRO had forwarded all the unresolved issues.

At the request of the CRO, the TCRO re-examined, during its 3rd Session its first text of the definitions of wholly-obtained goods. The TCRO explained that Definition 1(c) was intended to cover, for example, "wool" as illustrated in the Explanatory Note, whereas

[266] See Annex D/1 to WCO Doc. 39.488, para 69

[267] According to this definition: "The minimal operations or processes defined above shall not be taken into account in determining whether a good has been wholly-obtained in one country". See TCRO's text at its 2nd Session

[268] See WTO Docs. G/RO/M/3, paras 4.11-4.20 and 4.24-4.25; G/RO/M/5, paras 2.4-2.7, 2.9 and 2.12-2.14

renumbered 1(h) covers products made from wool. The TCRO decided to retain the text of the definition, but to insert the expression "without further processing" into the legally binding Note to Definition 1(c)[269]. Concerning Definition 1(d), the expression "plant products" was taken to cover, for instance, fruits that were not in themselves the whole plant and had not been obtained by processing the plant, but which were obtained from the plant, in a similar sense to milk obtained from cow under Definition 1(c)[270].

With regard to interpretation of the term "solely" in renumbered Definition 1(h)[271] and the relationship between this definition and Definition 2 of minimal operations or processes, the CRO's question was related to its work on the overall architecture of the HRO[272]. To help clarifying the interpretation of the term "solely", a draft legally binding note required that: the goods must have been obtained or produced from the wholly-obtained products of that country mentioned in Definitions 1(a) to (h); and the products of Definitions 1(a) to (h) must not have undergone processing in another country[273]. The TCRO decided that it would defer a decision on this draft note, and that a final decision on a legal note for renumbered Definition 1(i) should await a decision on the renumbered Definitions 1(g), regarding articles collected, and 1(h), concerning parts and raw materials recovered[274].

The TCRO agreed that parts recovered in the same country from articles collected in the country were to be considered as wholly obtained in that country. However, it did not reach a consensus concerning the origin of parts recovered in a country from articles collected in another country. The following five possibilities for conferring origin were analysed: (i) country of origin of the parts; (ii) country of origin of the articles collected; (iii)country of consumption of the articles collected; (iv) country where the articles were collected; and (v) country where the parts were recovered[275]. A number of delegations were of the opinion that the wholly-obtained status should be conferred on the basis of where the parts were recovered and they proposed the text for a new Definition 1(h)[276]

One delegation made an alternative proposal and expressed a different technical opinion , namely that articles collected in a country deserved origin of that country under the

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[269] See Annex F/1 to WCO Doc. 39.870, paras 4-8
[270] *Id*.
[271] Renumbered again as 1(i) – a new Definition 1(h)was inserted to cover parts or raw materials recovered
[272] *Id.*, para 11
[273] *Id*., para 12
[274] *Id.*, para 13
[275] *Id*., paras 16-18. The TCRO commented that due to the administrative burden and othet technical problems (including lack of adequate proof of origin) in connection with the first three possibilities, the Technical Committee focused its work on the lasr two.
[276] "Parts or raw materials recovered in that country from articles which can no longer perform their original purpose nor are capable of being restored or repaired". See Annex F/2 of WCO Doc. 39.870

assumption that these articles were consumed in the country of collection. Consequently, the original origin was lost. For the same reason, the parts recovered from those articles deserved the origin of the articles collected, reflecting thereby the country where the parts had been consumed[277]. However, this proposal was criticized on the grounds that: (i) recovery of parts was no less demanding than collecting; (ii) finding out "true" origin of recovered parts was not possible; (iii) parts might be recovered from articles collected in several countries; and (iv) consumption and collection normally could not always take place in the same country[278].

3.4 The CRO's elaboration of Definitions of wholly-obtained goods

The Informal Working Group, established by the CRO at its meeting on November 16, 1995, considered parts issue and proposed a text[279] to be added to alternative 1 to draft Definition 1(h), which could resolve some policy concerns that were raised[280]. The CRO agreed to place the footnote, in square brackets, to alternative 1 to draft Definition 1(f)[281].With regard to Definitions 1(c), (d) and (i), the CRO approved the new text of the Notes to Definitions 1(c) and (d), and took note of the report by the TCRO concerning Definition 1(i)[282]. Except for minor modifications, Definitions 1(a) to(g), 1(i) and the Notes to Definitions 1(a) to (f) are retained in the latest text of the CRO. At a later stage of the negotiations, the CRO agreed to adopt the text of alternative 1 for Definition 1(h) without the footnote, and to delete the Note to Definition 1(i)[283].

3.5 Elaboration of Definition 2 – Goods Obtained Outside the Country

Since the TCRO sent its draft to the CRO as the First Report, Definition 2 has never been referred back to the WCO. At its meeting in February 1996, the CRO formulated the single

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[277] Annex F/1 to WCO Doc. 39.870, paras 21-22. "parts or raw materials obtained in that country from articles collected in that country which are not fit for their original purpose nor are capable of being restored or repaired and are fit only for disposal or for the recovery of raw materials". See Annex F/2 to WCO Doc. 39.870

[278] See Annex F/1 to WCO Doc, 39.870, paras 23-27

[279] "In the recovery of parts or raw materials, environmental considerations may arise, particularly for radioactive, hazardous and toxic waste that may result from th erecovery of parts or raw materials from articles. In this connection, this rule is without prejudice to Members' rights to take WTO-consistent measures to protect the environment", see WTO Doc. G/RO/M/6, para 2.4

[280] *Id*.

[281] *Id*., paras 2.12-2.13

[282] *Id.*, paras 3.2-3.8

[283] See WTO Docs. G/RO/M/32, para 1.1; G/RO/M/34, para 1.1

alternative draft text[284]. The CRO was of the opinion that the alternative text presented a possible basis for an agreed definition[285]. At the meeting in May 1996, when the Informal Working Group considered this issue with the intention of presenting a proposal for a solution to the CRO for formal adoption, it was concluded that "regrettably, discussions in the Informal Working Group in the past few days had resulted in branching out that single alternative draft text into four options"[286].

At the October 1996 meeting, the WTO secretariat circulated a succinct comparative analysis of the four options[287]; the CRO agreed to adopt the bracketed one-option draft for Definition 2 recommended by the Informal Working Group[288]. The Group further reviewed the text and reached consensus on the main body of the text of Definitions 2(i), 2(ii) and 2(iii). There was also agreement on the text of the note. At its meeting in February 1997, the CRO agreed with the single text[289].

Argentina proposed an alternative text regarding the scope of the term "country"[290].

In response to the Argentine proposal, most delegation strongly expressed the view that the definition of the term "country" should continue to focus on practical issues having a bearing on the assignment of origin on products produced or obtained either within a country outside a country. In this regard, it was agreed that the Argentine proposal required

[284] See WTO Doc. G/RO/M/5, para 2.12

[285] *Id*.

[286] See WTO Doc. G/RO/M/6, para 2.14

[287] As key legal issues, the four options are identical, except for (a) the geographical extent of a country's territory, and (b)the nationality of vessels. Concerning geographical extent of a country's territory: (i) Option I does not specify the geographical extent of a country's territory; (ii) Option II uses the term "maritimezones under national jurisdiction"; (iii) Option III uses the term "customs territory of a Member"; and (iv) Option IV uses the term "territorial sea". With regard to nationality of vessels: (i) Options I, II and III rely on registration of a vessel to determine its nationality; and (ii) Option IV requires a genuine link between th evessel and the user's country

[288] See WTO Doc. G/RO/M/8, para 3.3. However, Japan and Korea reserved thier position. Japan's comment was that the use of th eterm "country" without definition would cause legal problems as well as general confusion, and that the relationship between subparagraphs 2(i) and 2(iii) needed further clarification. See para 3.4

[289] Definition 2: (i) products of sea-fishing and other products takn from the sea outside a country are considered to be wholly-obtained in the country of registration of the vessel that carries out those operations. (ii) Goods obtained or produced on board factory ships are considered to be wholly-obtained in the country of registration of the factory ships, provided that those goods are manufactured from the products referred to in subparagraph (i) originating in the same country. (iii) Products taken from seabed or subsoil beneath the seabed outside a country are considered to be wholly-obtained in the country that has the rights to exploit that seabed or subsoil. See WTO Doc. G/RO/M/9, para 3.2

[290] For Definition 2(i), the scope extends to the sea outside the territorial sear and maritime zones over which the coastal State has jurisdiction; while in Definition (iii), the scope extends to the area of the seabed and ocean floor and subsoil thereof outside national jurisdiction, as defined in the UN Convention on the Law of the Sea (*Id*.)

further consultations[291]. New Zealand also commented on the Note[292]. Japan, supported by Venezuela recalled its proposal made during the informal consultations[293].

The CRO deferred the issue until the June 2000 meeting. At that meeting, in the light of the new proposals made by two delegations, it was decided that any future discussion should focus on the following substantive issues: (i) the concepts of "territorial sea" and "exclusive economic zone"; and (ii) "nationality" of the vessel: flag as a single criterion to determine the origin of fishery products outside the territorial sea[294]. In December 2000, one delegation submitted a new alternative text[295]. At the time of writing, six alternative texts are being tabled.

The following table illustrates the positions of delegations and the related issues as at the time of writing:

Summary of positions with regard to definition 2[296]

1.Products of the sea-fishing and other products taken from the sea, and	
2.Goods obtained on board a factory ship	
(1) Within the territorial sea [including the Contiguous Zone (Argentina)]	Definitions 1(a), (b), (c), (d), (i)
(2) Within the EEZ	Option A. Flag of the vessel or factory ship Option B. Registration of the vessel or factory ship Option C. The coastal State
(3) On the high seas	Option A. Flag of the vessel or factory ship Option B. Registration of the vessel or factory ship
3.Products taken from the seabed or subsoil beneath the seabed	
(1) Within the territorial sea [including the Contiguous Zone (Argentina)]	Definition 1(e)
(2) Within the continental shelf (EEZ)	Option A. The country that has the rights to exploit

[291] *Id*.
[292] The goods are considered to be wholly-obtained in a country that granted registration to chartered vessel or factory ships, provided that this registration was in accordance with the requirements of that country (*Id*.)
[293] A footnote to Definition 2(i) to read: "Further consideration should be given to the scope of the term "country" if necessary, in the course of the harmonization work programme"
[294] See WTO Doc. G/RO/M/30, para 1.1. The proponent of the "alternative" text for Definition 2 withdrew its proposal
[295] See WTO Doc. G/RO/M/34, para 1.1
[296] Source: WCO training material

	Option B. The coastal State
(3) Beyond the limit of national jurisdiction ("the Area")	The country that has the right to exploit

Definitions 1(a) to 1(i) have already been agreed by the CRO. However, the CRO may require more time to resolve Definition 2 issues. The definition of a "country" might not be provided for by the CRO; the treatment of the EEZ would implicitly provide an answer to this question. The treatment of a customs union was discussed by the TCRO at an early stage in the negotiations; that question has not been examined. Furthermore, several early draft texts referred to products obtained in a spacecraft. It appears that these kinds of provision will be discussed again when the actual need arises.

As explained in Sub-section B, definitions of wholly-obtained goods are placed in Appendix 1. Two governing Rules are provided before the texts of the definition. Rule 1 provides for scope of application, and Rule 2 covers minimal operations or processes. As already mentioned, "definitions of minimal operations or processes that do not by themselves confer origin to a good", dealt with by Article 9.2(c)(i), began as an independent Appendix and now finds its place as an Appendix 1 Rule.

4. Product-Specific Rules of Origin – Appendix 2

As the history of Phases II and III , the TCRO spent a considerable time elaborating product-specific rules of origin. A total 486 product-specific issues were sent to the CRO for decision[297]. The TCRO referral documents some 650 pages of narrative explanation and amounted to over 2.000 pages, including "matrices"[298]. On the other hand, it is also a fact that 511 out of 1.241 headings or 41 percent of all the headings have been agreed by the TCRO.

As has been described above, the product-specific rules of origin are designed to determine the origin of goods the production of which involves more than two countries, as stated by Article 9.1(b). Given that the sequential approach was agreed, product-specific rules of Appendix 2 are applicable only when a definition of Appendix 1, regarding wholly-obtained goods, does not determine the country of origin of a good. Two types of origin-

[297] Some issues were treated as "horizontal" and were dealt with under the architecture
[298] By July 2007 the CRO had resolved 349 issues out of 486, i.e., 71.8 percent

conferring rules, i.e., the primary rules and the residual rules, must also be subjected to that principle. When two or more primary rules are provided, these primary rules must be co-equal. However, this principle does not preclude the possibility of providing a set of primary and residual rules which have a hierarchical structure, i.e., the "cascading" approach proposed by the United States for Chapter Rules and Chapter Notes for Chapters 84 to 90. Under this approach a tariff-shift rule is applied first and a subsidiary rule, proposed for specific products only, is in the second raw of the "matrix". When origin is not determined by the application of the primary rules in the "matrix", Chapters Rules and Chapter Notes are applied also to primary rules. If, despite the latter, the origin of the good cannot be determine, the product-specific residual rules set out as Chapter Rules and Chapter Notes are then applied in the order stipulated. By way of illustration, a summary of the discussions for three critical product sectors, agriculture, textiles and machinery, is set out in the following paragraphs.

4.1 Agricultural products

The origin of agricultural products is determined, in many cases, by application of a definition of wholly-obtained goods, In fact, Definitions 1(a) to (d) in Appendix 1 are applicable, in most cases, to the agricultural sector only. However, a major issue discussed, and still being argued in the CRO, relates the origin of processed agricultural goods, for which two fundamental positions have been presented.

One argument is that the origin of agricultural products should always be carried forward from the original product having been wholly-obtained in that country and cannot be changed by subsequent processing. Under this scenario there exists no substantial transformation for agricultural goods. To articulate this position, the initial or the evolved "Ottawa language" has been used. For those countries and semi-governmental organizations having made a considerable investment in promoting the image of a particular commodity linked with the country of origin as a "brand name", retaining the origin of the source material was the only sustainable option. Although these proponents recognize the economic reality of blending or mixing source materials originating in more than one country, their products must carry the name of the place were they were originally produced. It was very late stage of negotiations that several delegations proposed to separate the issue of labelling for retail sale from the origin of goods for customs purposes,

in order to achieve a possible compromise. This proposal has been considered by delegations with interest.

Another argument is that the processing of agricultural raw materials is basically a substantial transformation, and origin should be conferred on the processed goods in the country where these processes are carried out. This would imply the use the Ottawa-type rules or tariff-shift rules with extensive use of split (sub)headings. This position was championed by countries which import source materials and then process them. However, it was not easy to draw a line between "simple" processes and substantial ones. For instance, chilling, freezing or shelling a fish could be agreed as a non-origin-conferring process because such operations are intended to keep the fish in good condition; on the other hand, drying, smoking and salting of fish has been subject to discussion as these processes change the original condition of the fish.

With regard to mixtures and blending, three divergent views were presented: (i) mixing or blending is origin conferring, meaning that the origin is of the country were the goods are mixed or blended; (ii) mixing or blending is origin conferring either *per se* or upon satisfaction of a specific criterion, according to which origin is conferred either by the country supplying more than a specified level by weight or volume of the source material[299]; or (iii) mixing or blending is not origin conferring, and thus origin should be determined by application of the residual rule: in this case the product originates from the country that provided the major portion of the source material[300]. Option (i) was proposed for the primary rule. Option (ii) is a combination of the primary and the Chapter residual rules[301], and this seems to be securing growing support.

4.2 Textiles and textile articles

The textile sector was one of the most difficult areas of negotiation, since major importing countries have maintained their own well-established rules of origin under the Multi-fibre Arrangement (MFA) or bilateral arrangements. From the outset, it was clear that an east compromise was unlikely in view of the strong opposition by various textile lobbies in

[299] The proposed criteria for the primary rules are: 50 percent in general; 85 percent and 75 percent in volume for wine; 85 percent in volume for spirits; 85 percent in weight for coffee; 75 percent in weight for olive oil

[300] The term "mixing" is defined as the the deliberate and proportionlly controlled operations involving two or more identical or different interchangeable materials

[301] When the primary rules for the mixture are not met, the Chapter residual rules determine the origin of the mixed goods to be the country where the mixing was carried out. Thus, the general residual rules, i.e., the country contributing the major portion, are not being used

different Members. The negotiations naturally started with proposals identical to importing countries' current rules. Consequently, printing or dyeing of yarn and fabrics remains one of the most contentious issues in this sector. On the other hand, developing have tried to confer originating status on the goods they are actually producing. Lenient rules were thus favoured by those countries.

Under the circumstances, an important agreement was reached by the TCRO and the CRO. The production of: (i) yarn from fibre, (ii) fabric from yarn, and (iii) apparel, parts or accessories of garments knitted or crocheted to shape are, by themselves, origin conferring. The principle of a "two stage-double jump", i.e., fabrics from fibres or garments from yarn, found in many preferential rules of origin, was not adopted. Furthermore, a number of processes have been recognized as substantial transformation by a majority of Members. Such processes include the production of garments by assembly from parts that are cut to shape from fabric and accessories, like ties and gloves, by assembly from parts that are cut to shape.

4.3 Machinery, transport equipment and photocopying apparatus

Regardless of the size or value of goods, e.g., from semiconductors or portable radios to gas turbines, oil tankers or spacecraft, the predominant production process for goods of Chapters 94 to 90 is an assembly operation. Thus, the single major issue concerning the suitability of assembly operations to be origin conferring has been clearly identified and argued from the beginning of the negotiations. For this generic issue two divergent views were first presented. One position, solely or mainly suitable for a particular kind of machine, was to recognize a change from parts to articles expressed by a change of classification rule to be origin conferring. The proponents of this view were confident that the inherent HS structure was suitable for purposes of origin determination; thus, a tariff-shift rule alone would be used. As the HS forms the basic foundation, the term "parts" is subject to the definition under the harmonized System. Another position put forward, and exactly contrary to the previous one, was not to recognize a change from parts, suitable with a particular kind of machine only, to articles as origin conferring. This view begins with the premise that the HS is not created for purposes of origin determination; consequently, even the so-called "screwdriver" assembly meets a change of tariff classification criterion. Paradoxically, when the quality of a good is improved significantly, the classification remains unchanged. The proponents argued that such assembly

operations could be considered as substantial transformation when a specified *ad valorem* percentage of added value prescribed for a particular good was achieved.

Assembly operations are, of course, not limited to the transformation from parts to articles. The origin of parts became a new focus known as "parts-to-parts" issue. Members realized that as more parts become progressively incorporated into other parts like subassemblies or components in the production processes, the less likely they are to have been manufactured directly from raw materials. Under the current e-commerce practice or the "just-in-time" system of assembly, enterprises do not always produce those parts themselves despite their capability to do so; they prefer to remain competitive in the market and procure parts from somewhere else at a lower cost and under more acceptable conditions.

The initial proposal for parts by the tariff-shift rule approach was, in most cases, CTH requiring a change from outside the category of "parts suitable for use solely or principally for a particular machine". If this were the rule, certain production processes of parts, such as "a subassembly incorporating individual parts" or "a component consisting of numerous subassemblies", do not result in a change of classification. This situation led the proponents of the tariff-shift rules splitting into two groups. One group, made, among others, by Canada and Japan, tried to resolve these issues by splitting the "parts" headings or subheadings. The intention was to confer origin on particular "parts" assembled from other parts of the same heading or subheading by meeting a simple CTHS or CTSHS rules. These proponents, however, argue that exhaustive splitting is not necessary and that the general residual rules which are themselves sufficient represent an alternative. Another group, participated by India, Singapore, Morocco and the United States, proposed the establishment of definitions or requirements for assembly to be considered substantial, as well as to use the tariff-shift rules. These proponents wanted to avoid a situation where thousands of parts are aggregated, based on the country of origin of the source parts, in order to apply the general residual rules. AS already mentioned, under current commercial practice, parts are not always supplied from the same country. It appears that, in this case, the administrative cost of determination of origin may diminish the benefit of the harmonization of non-preferential origin rules. The United States suggested the "cascading" approach mentioned earlier. The U.S. approach has been criticized for its complexity but is recognized as a well-elaborated method to deal with issues of assembly of parts into other parts, emphasizing that the approach can determine the country of origin of any single good without using a value-added rule as well as the general residua rules.

The proponents[302] of the value added rules did not alter their position. They believed that value-added rules were undoubtedly able to address this "parts to parts" issue better, and could be administered much more easily than the complex "cascading" approach or the use of conceptual definitions. At the same time, they were of the view that further splitting of the "parts" headings or subheadings was definitely not the solution to the problem, primarily because a simple CTHS or CTSHS rule should not confer origin on the parts in questions, given that their position did not recognize assembly of articles from components, or components from parts, as origin conferring.

5. Implications of the implementation of the HRO for other WTO agreements

Although Articles 3(a) and 9.1(a) state explicitly that the HRO should be applied equally for all purposes as set out in Art. 1, two questions have been raised as to whether: (i) the HRO should not be applied to other WTO instruments listed in Art. 1.2 of the ARO, which might be governed by another set of rules; and (ii) the HRO should automatically be applied to all the WTO instruments, including those enumerate in Art 1.2 of the ARO, where the country of origin needs to be determined in the course of trade in goods.

5.1 Initiation of a Study on the implications of the implementation of the HRO for other WTO agreements

The issue of the implications of the implementation of the HRO for other WTO agreements was first taken up as an agenda item by the CRO in July 1998. It had never been discussed by the TCRO. India initiated this issue and suggested that the WTO Secretariat analyse the implications of how different proposals for the textiles sector would impact on the flow of trade and/or the rights and obligations under various WTO agreements and instruments referred to in the ARO[303]. In response to this request, the WTO Secretariat prepared a working document which compiled the provisions relating to the rules of origin in various agreements[304]. In addition, several countries submitted proposals on this matter[305].

[302] EC for all Chapters 84 to 90; Brazil, Egypt and Turkey for certain Chapters and headings
[303] See WTO Docs. G/RO/W/28/Rev.1 and 30
[304] See WTO Doc. G/RO/W/31. See also a general study paper prepared by UNCTAD, *Globalization and the International Trading System – Issues Relating to Rules of Origin*, UNCTAD/ITCD/TSB/2 1998
[305] Dominican Republic and Honduras – WTO Doc. G/RO/W/33; El Salvador – G/RO/W/34; Korea – G/RO/W/38; United States – G/RO/W/32

At the beginning of the discussion, India's concern was the implication of the proposed restrictive rules of origin to be applied to the existing textile trade. It felt that suppliers of raw textile materials should not be affected by the quantitative restrictions on the textile articles by means of application of the substantial transformation criteria proposed by several countries[306].Consequently, origin rules should be devised to have each processing stage of the textile production chain regarded as origin conferring. Otherwise, rules of origin are likely to have adverse implications for the implementation of a number of provisions of the Agreement on Textiles and Clothing[307]. The United States replied that the last substantial transformation was not always carried out in the country of export; the proposals themselves did not give rise to adverse effects. However, when the HWP was completed, every Member would use the same rules of origin, which would ameliorate the problem described by India[308]. The European Community was of the opinion that the establishment of the HRO should not be influenced by other WTO agreements or by the desired outcome of various non-preferential commercial policies. Therefore, EC did not agree with India's view that the last country of production should always be recognized as the country of origin. If one proposal did not recognize the cutting of fabric as a substantial transformation, for example, that did not mean that the proponent of the proposal intended to distort trade[309].

5.2 Restraints on the application of the HRO to certain trade policy instruments enumerated by Article 1.2 of the Agreement on Rules of Origin

The United States considered that there was no common understanding on the implications of the HRO for other WTO agreements, and that more communication with other WTO bodies was needed[310]. The United States argued, from the very early stages of the negotiations, that the use or application of rules of origin for a particular administrative purpose may be a separate matter from the development and implementation of particular trade measures or commercial policy instruments, such as the application of anti-dumping measures, that fall under the jurisdiction of other agreements. Consequently, the issue is most certainly not a sector or product-specific matter, but broadly extends to all sectors of

[306] See WTO Doc. G/RO/M/19, para. 2.3
[307] See WTO Doc. G/RO/W/42
[308] See WTO Doc. G/RO/M/26, para 4.2
[309] *Id*., para 4.5
[310] See WTO Doc. G/RO/M/19, para 2.6

industry, from agriculture to a wide range of consumer products[311]. Considering the fact that many of the then 38 (currently 41) Members that have notified that they do not have non-preferential rules of origin were known to utilize anti-dumping measures, rules of origin were not being used for such measures. Consequently, the United States raised a question as to whether the existence of the HRO would require changes in those practices by those Members[312].

A number of Members, however, have questioned the U.S. interpretation of the implications issue. The European Community made it clear that the HRO should be applied equally for all purposes as set out in Article 1 (3(a)) of the ARO and suggested a common understanding: "If other WTO agreements require that origin be determined for specific purposes of those agreements, HRO would then have to be used[313]. Sharing the above view, Brazil understood that it was far beyond the mandate of the CRO to specify each and every circumstance as the United States proposed, and also doubted the ability of other Committees definitely to foresee every possibility under the respective agreements in which a determination of origin might be warranted. Subsequently, Brazil criticized the U.S. argument that "was required by these delegations would be an explicit decision to overturn the applicability of the HRO to specific agreements mentioned in Article 3 of the agreement itself", and that it was "as if these delegations were seeking to withdraw their signature from portions of the agreement[314].

As far as the applicability of the ARO to other WTO agreements was concerned, Canada opined that it was the other WTO agreements that had to determine whether or not rules of origin would be applied to them and that, if Members had to use rules of origin, they then had to apply the HRO[315]. On the contrary, Argentina understood that since the provisions of the ARO were more specific than those of other WTO agreements, the ARO had precedence over other[316] WTO agreements.

Korea was of the view that the Agreement on Anti-Dumping had no direct relationship with rules of origin, because investigations were based on the market conditions prevailing in the exporting country, and not on the origin of a good. Where there were no the sales of like products in the ordinary course of trade in the domestic market of the exporting

[311] See WTO Doc. G/RO/W/32
[312] See WTO Docs. G/RO/M/40, para 4.12 and G/RO/W/45
[313] *Id*., para 4.18
[314] *Id*., para 4.4
[315] *Id*., para 4.22
[316] Stated as a preliminary comment, WTO Doc. G/RO/M/41, para 5.10

country, or where the intermediate country was involved[317] the HRO should be applied to determine the country of origin and, by implication, the country subject to the investigation. As concerns circumvention of anti-dumping measures, although there was yet to be an agreement n this issue, the HRO could be useful[318]. Hong Kong and China considered that, in the case of anti-dumping, rules of origin were clearly relevant irrespective of whether anti-dumping was based on the concept of "exporting country" or "country of origin". The HRO should also be relevant since conscious decisions were needed in such cases to determine whether the products in question had originated in that exporting economy or originated from somewhere else for the purpose of determining the normal value for individual companies concerned[319]. India was of the opinion that, if for purposes of anti-dumping the term "like products" referred to the domestic industry[320], may be defined differently than for the HRO, then it would be contrary to the principle of applying the HRO to all trade policy instruments[321].

5.3 Applicability of the HRO to certain trade policy instruments enumerated by Article 1.2 of the Agreement on Rules of Origin

A proposal was tabled by Japan stating that the HRO should not be applied automatically to domestic labelling requirements on foods, and that sanitary and phytosanitary (SPS) measures should be placed outside the scope of the HRO[322]. Although the United States did not favour this idea, describing it as "a multilateral pick-and-choose approach"[323], the proposal appeared to gain support from Members at the April 2002 meeting of the CRO. Brazil echoed Japan's view that there would be no apparent inconsistency between measures taken under SPS or labelling requirements and rules of origin for customs purposes[324]: by labelling requirements both labelling of all ingredients of a food and origin marking were meant. New Zealand and Australia also supported that approach on the ground that the objective of the SPS Agreement was to protect human, animal or plant life and health, and concerned the nature of the goods in and of themselves, irrespective of their origin, while the main objective of the ARO, as applied by the customs authorities at

[317] Articles 2.2 and 2.5 of the Anti-Dumping Agreement
[318] See WTO Doc. G/RO/M/19, para 2.2
[319] *Id*., para 2.4
[320] See Footnote 1 to Article 1.2 of the ARO
[321] See WTO Doc. G/RO/W/42, para 5
[322] See WTO Doc. G/RO/M/40, para 4.2
[323] *Id*., para 4.12
[324] *Id*., para 4.3

the border, was to attribute a single origin for each product imported in a country[325]. The purpose of domestic labelling was to meet other trade objectives, such as consumer demand for product information or the prevention of deceptive practices; thus, Members should retain the right to determine their domestic labelling requirements for products sold in their domestic markets[326]. India added that the origin determination at the border was not an alternative to, but supplemental to, the requirements for SPS and labelling purposes, and that there was no hierarchy implicit or explicit in these two purposes and provisions of various WTO agreements, since there was no conflict among them[327]. It was thus expected that a common understanding on the need for flexible treatment of domestic labelling and SPS requirements, if so agreed, would provide the HWP negotiations with a practical clue, particularly to assist with impasse encountered in the agricultural sector.

5.4 Report by the Chairman of the CRO to the WTO General Council and the current state of play

The main stumbling block to progress in the CRO's work that had been identified by many delegations was the implication issue which was first raised in 1998, This was seen being closely related to the problem of circumvention of anti-dumping procedures and the application of SPS measures and quota regulations[328]. Informal consultations held with Members and robust discussion on the implication issue during the CRO meetings held in 2001 – 2002 could neither lead to agreement on it nor on concrete actions affecting product-specific issues. Thus, the Chairman of the CRO decided to submit this implication issue to the WTO General Council demanding such issue and other eleven crucial issues among the 94 product-specific core policy issues brought before the Council be given priority attention[329].

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[325] *Id*., paras 4.7 and 4.9
[326] *Id*., para 4.9
[327] *Id*., para 4.10
[328] See WTO Doc. WT/6C/M/75, para 168
[329] See WTO Doc. G/RO/52. The Chairman's proposal constitutes paragraph 4.2 of the Report by the chairman of the CRO to the General Council and reads as follows:
Pursuant to Article 3(a) of the Agreement on Rules of Origin ("the Agreement"), Members should ensure, upon the implementation of the results of the HWP, that they apply the harmonized rules of origin (HRO) equally for all non-preferential commercial instruments as set out in Article 1 of the Agreement, in which rules of origin are used; and
Each Member, in accordance with its rights and obligations under the provisions of the WTO Agreements (other than this Agreement), is to decide whether rules of origin are used in its non-preferential commercial policy instruments.

In the Report, Australia and New Zealand raised the issue of "overall impact of the HWP" with a view to ensuring that the product-specific rules developed under the HWP, and the HWP as a whole, be consistent with the trade-facilitating objectives and principles of the Agreement, They stated that the General Council should consider all elements of the HWP as a package, which required the General Council to satisfy itself that the HRO made sense in terms of economic benefit, transparency and certainty, and e reduction in compliance and transaction costs[330].

In July 2003, the Chairman of the CRO reported to the General Council on the progress of the consultations on the 94 core policy issues, which he and the Vice-Chair had held with delegations in 2003. In order to bridge the existing gaps among members, extensive, one-to-one small groups and open-ended consultations were held. The Chair circulated a proposal intended as a "balanced package", which was contained in an informal document[331]. Unfortunately, it was not possible to reach consensus on this. The Chair summarized the state of play as follows: "There had been a discussion about the understanding among Members on three notions: (1) that the harmonized rules of origin should be applied only for goods, not for services or intellectual property; (2) that the harmonized rules of origin should be applied equally for non-preferential commercial policy instruments, whenever a Member was required – or in absence of such requirement, voluntarily decided – to determine the country of origin; and (3) that were some non-preferential commercial policy instruments where an origin determination was not necessary[332]".

There was almost agreement on the first two notions despite that some Members had raised a question as to whether any WTO agreement required a Member to apply rules of origin. The third notion yielded differing views. Some Members argued that the text proposed by the Chair should designate explicitly the specific commercial policy instruments for which an origin determination was irrelevant, such as marking and labelling requirements or SPS measures. Other disagreed to any carve-out of specific commercial policy instruments and rejected this view arguing that Article 3(a) of the ARO did not create any new rights or obligations under the WTO Agreement. Thus, the disparity among Members remains wide and the implication issue "remains unresolved but resolvable[333].

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[330] *Id*., para 4.3
[331] JOB(03)/132
[332] See WTO Doc. WT/GC/M/81, para 171
[333] See WTO Doc. G/RO/M/43, para 4.4

Completing the state of play with regard to the other 93 product-specific rules, the CRO Chairman admitted that there were several genuinely political issues, the resolution of which appeared impossible at the present stage, such as the issue of fish taken from the EEZ. There were also other issues closely linked with other trade policy issues, such as circumvention of anti-dumping duties, export subsidies policies in agriculture, and textile quotas, the resolution of which appeared to be difficult unless the related issues were resolved in other bodies or sub-bodies of the WTO. While some Members cited the lack of political will rather than technical difficulties for the lack of progress, others indicated flexibility on several issues and constructive and pragmatic attitude mindful that a satisfying solution for each and every issue might not be possible. Nevertheless, many Members had considered the CRO Chair's proposal as a good basis for further work. There was a discussion on the need for a possible new working methodology in order to facilitate the negotiations[334]

[334] See WTO Docs. WT/GC/M/75 and 81

Chapter III

New WTO perspectives concerning rules of origin for Least-Developed Countries (LDCs)

Summary: *1. Introduction; 2.The "LDCs package" at the Hong Kong Ministerial Conference; 3. The LDCs proposal on rules of origin; 4.Framing the issue of market access for LDC products beyond the drafting of appropriate origin rules; 4.1 The origins of GSPs; 4.2 Reasons for under-utilization of unilateral preferences; 4.3 The GSP of Canada; 4.4 The GSP of the European Union; 4.5 The GSP of Japan; 4.6 The GSP of the United States; 5. Drafting rules of origin for development: some suggestions*

1. Introduction

Since its inception, the Generalized Systems of Preferences (GSPs) have been object of debate at both multilateral and academic level. The erosion of tariff preferences, as a consequence of the MFN multilateral tariff negotiations, and the under-utilization of such preferences are still considered to be the major responsible factors in impeding developing countries to benefit from the preferential schemes. Among the developing countries, the least-developed ones are more seriously affected by these circumstances. According to the existing literature, rules of origin is the main reason why tariff preferences are under-utilized, especially by Least-Developed Countries (LDCs)[335].

The "LDCs package" contained in the Hong Kong Ministerial Declaration, while reaffirming the Duty-Free Quota-Free (DFQF) initiative for market access for LDC products, addresses two major issues related to the utilization of unilateral preferences: i) product coverage and ii) the need for drafting transparent and simple rules of origin[336].

After analyzing the LDCs' proposal on rules of origin, this chapter aims at giving some suggestions about how LDCs origin rules should be drafted in order to enhance the benefits deriving from the preferential schemes to the advantage of LDC exporters.

2. The "LDCs package" at the Hong Kong Ministerial Conference

[335] See, for instance, Inama S.

[336] See para 47 and Annex F of the Hong Kong Ministerial Declaration, WTO Doc.WT/MIN(05)/DEC

Trade preferences provide access for goods originating in beneficiary countries at a lower level of duty or duty-free. The difference between the MFN rate of duty is called the preferential margin. Thus, if a MFN duty is at 10 percent and is reduced to zero under GSP or other preferential arrangements, there will be a 10 percent preferential margin. However, when MFN liberalization occurs, it may result in the MFN duty of 10 percent being reduced to 6 percent, thus generating a preference erosion equivalent to 4 percent.

The issue of preference erosion is linked to the basic question of how the GSP, like any other preferences works. If suppliers from different countries compete in the same product market, importers will have an incentive to divert orders from a non-beneficiary country, which must pay the full MFN rate of duty, to a preference-receiving country. Such an incentive to divert sourcing may be reduced by the erosion of the preference margin, which ultimately may not be sufficiently attractive or commercially meaningful for such a switch.

Several practical questions arise concerning how preferences work in practice and who is capturing the rents – the exporter, the importer, or is it shared? Field experience suggests that in the majority of cases, it is the importer who pockets the tariff revenue forgone, which arises as a result of the GSP or other trade preferences. It is precisely this incentive that causes the importer to divert the order in favour of developing countries. Some developing countries' exporters have negotiated, after establishing a good working relationship with the importer, a share of tariff revenue foregone.

The different types of benefits that developing countries can draw from preference schemes can flow from i) larger quantities of export goods sold; ii) higher prices charged for export goods; and iii) a higher total value of sales of exported goods.

As expected, the issue of market access proved highly divisive at the Hong Kong Ministerial Conference[337]. A number of major exporters of agricultural products in developing countries strongly objected to the proposal that implementation periods for market access commitments be delayed in order to take into account long-standing preferences. Some developing countries (e.g. Pakistan and Sri Lanka) were concerned that extended market access LDCs would adversely affect their exports. This led to language reflecting their concerns regarding the market access commitments in respect of LDCs. Nevertheless, and against this background, the main commitments resulting from the

[337] This intense debate over market access and preferences is reflected in the Chair's Reports of the Agricultural and National Agri-Marketing Association (NAMA) Negotiating Committee contained in annexes A and B of the Ministerial Declaration

"LDCs package" regards the widening of product coverage, on one hand, and the need for more simple and transparent rules of origin.

Some argued that the LDCs package, consisting of duty and quota-free market access on a lasting basis for all products originating from all LDCs by 2008 or no later than the start of the implementation period, combined with the Aid for Trade initiative (o qui nota esplicativa AFT?), was one of the most tangible commitments in the Hong Kong Declaration.

According to paragraph 47 of the Hong Kong Ministerial Declaration, developed countries and developing countries declaring themselves in a position to do so, agreed to implement duty-free and quota-free (DFQF) market access for products originating from LDCs. In order to succeed in such initiative, they also committed themselves to take additional measures to provide effective market access, including simplified and transparent rules of origin so as to facilitate exports from the LDCs. More specifically, with Annex F to the Hong Kong Ministerial Declaration it was agreed that developed and developing countries declaring themselves in a position to do so should provide DFQF market access on a lasting basis, for all products originating from all LDCs by 2008 or no later than the start of the implementation period in a manner that ensures stability, security and predictability; and that Members facing difficulties in providing market access shall provide DFQF market access for at least 97 percent of products originating from LDCs, defined at the tariff level, by 2008 or no later than the start of the implementation period. Developing country Members are permitted to phase in their commitments and enjoy appropriate flexibility in coverage. As regards rules of origin, Annex F reaffirms that Members should ensure that preferential rules of origin applicable to imports from LDCs be transparent and simple, and contribute to facilitating market access.

Few people before the Hong Kong Ministerial Conference believed that major WTO members would accept such an improvement in the currently available unilateral trade preferences. However, it remains to be seen how such commitments will be meaningfully implemented[338]. A mechanism to review the implementation has been incorporated in the Decision; in fact, members should notify the implementation of the schemes adopted to implement DFQF market access to LDCs to the WTO Committee on Trade and Development, which is in charge to annually review the steps taken to provide LDCs with DFQF market access and report to the General Council for appropriate action.

[338] See infra

The importance of providing additional financial and technical support aimed at the diversification of LDC economies is also recognized. Such additional financial and technical assistance is intended to help LDCs in implementing their obligations and managing their adjustment processes. In this respect the WTO has been coordinating with donors and other agencies such as the World Bank, the IMF and other regional development banks to find appropriate mechanisms to secure additional financial resources. Aid for Trade (para 57 HK MD) and IF programmes are the operational results of these multilateral action (metti nota esplicativa AFT).

3. The LDCs proposal on rules of origin

Following to the Hong Kong Ministerial Meeting, the LDC Group submitted a communication regarding the implementation of the DFQF system[339] containing proposals on how making the decision taken on DFQF market access operational. More specifically, Members should implement the decision as follows:

i) in order to meet the minimum 97 percent benchmark, with a view to achieving 100 percent coverage, developed country Members should provide DFQF market access in tariff lines in which positive duties are still applied to LDC existing exports;

ii) those developing countries considering themselves in a position to provide LDCs with DFQF market access should make their positions known by the end of 2006. They should provide, as a first step, DFQF market access to products of export interest, and which are commercially meaningful to LDCs, with a commitment to gradually achieving 100 percent;

iii) DFQF market access that is provided to LDCs will be defined as the percentage of the total number of tariff lines which are zero rated for all LDCs;

iv) in order to ensure that improved market access provided under the DFQF market access provisions are not nullified by non-tariff barriers to trade, SPS provisions and other technical barriers to trade, WTO Members will work with LDCs to ensure that they receive the necessary trade-related technical assistance and capacity building and aid for trade to allow them to conform to non-tariff regulations which govern imports into WTO Members markets; and

[339] See WTO Doc.TN/CTD/W/31 para. 2

v) in providing market access to LDC exports as set out above, the origin of goods will be conferred to LDCs if they conform to the LDC rules of origin as set out in the proposal submitted by Zambia on behalf of the LDC Group[340]. Ad regards notification, developed and developing countries declaring themselves in a position to provide DFQF market access to LDCs shall provide a provisional list of the products they intend to initially exclude from DFQF market access, the steps they intend to take to progressively achieve compliance with the obligation to provide DFQF market access to all products from all LDCs, and a time frame within which they intend to complete those steps.

As regards rules of origin, LDCs have, for a long time argued that, despite being accorded preferential market access through the various agreements, they have not been able to take advantage of these opportunities because of the associated, often stringent, rules of origin. It is against this background that LDCs have been advancing the position that rules of origin need to be simplified.

LDCs' perception about rules of origin as being one major instrument allowing them to benefit from the preferential schemes is clearly reflected in their proposal. Firstly, LDCs affirm that rules of origin are required in any preferential trading agreement, with the minimum requirement being to minimize trade deflection[341] by ensuring that the product to be exported into the customs territory granting the preference is produced in the customs territory the preference is granted to. Secondly, LDCs recognize that rules of origin are important in that they can affect the sourcing and investment decisions of companies and can, at the same time, distort the relative prospects of similar firms within a country. Moreover they acknowledge that, the adoption of restrictive rules of origin are more likely to constrain than to stimulate regional economic development and can act to undermine preferential trade agreements[342].

The rules that LDCs propose in order to determine the originating character of the products they export towards the preference-giving countries are based upon the distinction between wholly obtained and substantially transformed products. "Wholly obtained" refers to mineral products, vegetable and agricultural products that are collected and grown in the

[340] See WTO Doc. TN/CTD/W/30
[341] See supra note...
[342] See WTO Doc. TN/CTD/W/30, paras 5 e 6.

exporting country, live animals and products obtained from live animals[343]. Products obtained in the LDCs incorporating materials which have not been wholly obtained there, are considered to have LDC origin, provided that such materials have undergone sufficient substantial transformation.

Goods not being wholly obtained are considered to be sufficiently worked or processed in an LDC when the LDC value content is calculated either on the basis of the domestic content criterion (build-down method) or the import content criterion (build-up method)[344].

According to the domestic content method, the LDC value content of a good may be calculated on the basis of the formula:

$$LVC = \frac{P - VNM}{P} \times 100$$

Where:

LVC is the LDC value content of the good, expressed as a percentage.

P is the ex-works price of the good.

VNM is the value of non originating materials that are acquired and used by the producer in the production of the good, but does not include the value of a material that is self-produced.

Whilst, according to the import content method, the LDC value content of a good may be calculated on the basis of the formula:

$$LVC = \frac{VOM}{P} \times 100$$

Where:

LVC is the regional value content of the good, expressed as a percentage.

P is the ex-works price of the good.

VOM is the value of originating materials that are acquired or self-produced, and used by the producer in the production of the good.

[343] Art. 3 of the LDCs proposal

[344] See, *supra*, I.2.2

In both cases the LDC content will have to be expressed as as a percentage to be defined. In the case where adjustments are to be made to calculate the value of non-originating materials used in the production of a good when the domestic content is used, calculation of the value of the material is to be done as follows:

1. in the case of a material that is imported by the producer of the good, the value of the material;
2. in the case of a material acquired or self-produced in such a way that it can be considered substantially transformed in the territory in which the good is produced, the value, determined in accordance with the Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994:

The following expenses, if not included in the value of an originating material calculated under 1. and 2. above, may be added to the value of the originating material:

(i) the cost of freight, insurance, packing and all other costs incurred in transporting the material within or between of one or more of the LDCs or neighbouring developing countries[345] to the location of the producer;

(ii) duties, taxes and customs brokerage fees on the material paid in the territory of one or more of the neighbouring developing countries, other than duties or taxes that are waived, refunded, refundable or otherwise recoverable, including credit against duty or tax paid or payable;

(iii) the cost of waste and spoilage resulting from the use of the material in the production of the good, less the value of renewable scrap or by-products.

The following expenses, if included in the value of a non-originating material calculated under 1. and 2. above, are deducted from the value of the non-originating material:

( ) the costs of freight, insurance, packing and all other costs incurred in transporting the material to the location of the producer;

( ) duties, taxes and customs brokerage fees on the material paid in the territory of one or more of the neighbouring developing countries, other than duties or taxes that are waived, refunded, refundable or otherwise recoverable, including credit against duty or tax paid or payable;

( ) the cost of waist and spoilage resulting from the use of the material in the production of the good, less the value of renewable scrap or by-products;

[345] According to art. 7 of the LDCs' proposal, the principle of diagonal cumulation applies to both LDCs and neighbouring developing countries. See, infra, ...

( ) the cost of originating materials used in the production of the non-originating material;

( ) in the case where the deductions made under (i) to (iv) are not made and the value of a non-originating material is calculated on a c.i.f. basis the required percentage under the domestic content criterion will be increased by a percentage to be defined.

Diagonal cumulation is provided for in order to facilitate LDC producers in reaching the percentage, according to the case, of domestic or import content. According to the provision regarding cumulation, products exported from LDCs containing materials originating in all LDCs, neighbouring developing countries and preference-giving countries are considered to have LDC origin. In this respect, it is not necessary that such materials have undergone sufficient working or processing, provided they have undergone in the exporting country territory working or processing going beyond the insufficient working or processing operations listed by art. 5 of the proposal[346].

Finally, and in order to avoid transhipment to take place, the proposal provides for the territoriality requirement. According to such requirement, the acquisition of the originating status shall not be affected by working or processing done outside the LDCs on materials exported from the LDCs and subsequently re-imported there, provided that:

( ) the said materials are wholly obtained in the LDCs or have undergone working or processing beyond the insufficient operations prior to being exported; and

( ) it can be demonstrated to the satisfaction of the customs authorities of the preference-giving countries that:

[346] The following operations shall be considered as insufficient:

(a) operations to ensure the preservation of products in good condition during transport and storage (ventilation, spreading out, drying, chilling, placing in salt, sulphur dioxide or other aqueous solutions, removal of damaged parts, and like operations);

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

(c) changes of packaging and breaking up and assembly of packages or simple placing in bottles, flasks, bags, cases, boxes, fixing on cards or boards, etc., and all other simple packaging operations;

(d) affixing marks, labels and other like distinguishing signs on products or their packaging;

(e) simple mixing of products, whether or not of different kinds, where one or more components of the mixtures do not meet the conditions laid down in this Agreement to enable them to be considered as originating in a LDC;

(f) simple assembly of parts to constitute a complete product;

(g) a combination of two or more operations specified in sub-paragraphs (a) to (f); and

(h) slaughter of animals.

- the re-imported goods have been obtained by working or processing the exported materials; and
- the total added-value acquired outside LDCs by applying the territoriality provisions does not exceed a percentage, that is to be established, of the ex-works price of the end product for which originating status is claimed.

4.Framing the issue of market access for LDC products beyond the drafting of appropriate origin rules

The acquisition of the originating status required in order to have the unilateral preferences applied is certainly a pre-condition to be satisfied by the products exported from LDCs. Nevertheless, solving this issue alone does not guarantee LDC exports the application of the preferential schemes. That's why a description, in historical terms, of the birth and major multilateral developments of the GSPs helps considering the LDC origin issue in its wider context. The following step is pointing out what have been considered as the main shortcomings of the GSPs by the existing literature. After that, and in order to draw some conclusions about how GSP rules of origin could be changed, an overview the main characteristics of the GSPs and an outline of the origin rules of the QUADS[347], e.g. Canada, European Community, Japan and United States, are provided.

4.1 The origins of GSPs

The underpinnings of the GSPs were largely based on Prebisch and Singer's work on the secular decline in the terms of trade for agricultural commodities and the perception that only manufacturing could provide stability and jobs in developing countries.[348] Even today, many of the least-developed countries and others, whose trade remains concentrated in basic commodities, have suffered a declining share of world trade, whereas developing countries which have been able to diversify into manufactures have been able to expand

[347] According to the AITIC Glossary, "QUAD" is "the casual term given to a group formed by the trade ministers of the four largest trading entities: Canada, the European Community, represented by its Comission, Japan and the United States. The QUAD was a crucial and ultimately decisive grouping in the Uruguay Round". See AITIC SECRETARIAT, Glossary Division, *AITIC Glossary of Commonly Used International Trade Terminology with Particular Reference to the WTO*, Geneva 2003

[348] For an early history, see "The History of UNCTAD 1964-84", United Nations, New York, 1985 (Document UNCTAD/OSG/286, UN Publication Sales No. E.85.II.D.6).

their share.[349] The Prebisch-Singer hypothesis led to two important policy prescriptions: sectoral intervention favouring import-competing manufacturing industry (import-substitution industrialisation), and the idea of creating non-reciprocal tariff preferences to foster manufactured exports from the developing countries. This is one of the reasons for the relatively low coverage of agricultural products in GSP schemes.

The various drafts of a charter for an International Trade Organization (ITO) included an article on tariff negotiations. However, after the failure of the ITO, Article XXVIII *bis*, dealing with tariff negotiations, was only adopted as a consequence of the 1954-55 Review Session of the GATT Contracting Parties. Article XXVIII *bis* contains one of the first indications of differential and non-reciprocal treatment; Paragraph 3 states that negotiations shall be conducted on a basis which affords adequate opportunity to take into account, *inter alia*, "the needs of less-developed countries for a more flexible use of tariff protection to assist their economic development and the special needs of these countries to maintain tariffs for revenue purposes; and all other relevant circumstances, including the fiscal, developmental, strategic and other needs of the contracting parties concerned."

The idea of non-reciprocity became an issue in the preparation of the Kennedy Round of Multilateral Trade Negotiations with the increase in the number of developing countries which were becoming GATT contracting parties. The issue was discussed at the GATT Ministerial Meeting of 1963, which established a working party to look at the issue. This led in 1965 to the addition of Part IV on Trade and Development, recognising the need for a "rapid and sustained expansion of the export earnings" of the developing countries and exhorting "positive efforts designed to ensure that [developing countries] secure a share in the growth of international trade commensurate with the needs of their economic development" by developed countries. Part IV also recognised the needs to "provide in the largest possible measure more favourable and acceptable conditions of access to world markets" for their limited range of primary exports, including "measures to attain stable, equitable and remunerative prices". It also stated that the "rapid expansion of the economies of the [developing countries] will be facilitated by a diversification of the structure of their economies… and the avoidance of an excessive dependence on the export of primary products".

However, Part IV did not fully exempt developing countries from reciprocity. Article XXXVI:8 states that "The developed contracting parties do not expect reciprocity

[349] WTO, "Participation of developing countries in world trade: Recent developments, and the trade of the least-developed countries", Note by the Secretariat (WT/COMTD/W/65 of 15 February 2000), Geneva.

for commitments made by them in trade negotiations to reduce or remove tariffs and other barriers to the trade of less-developed contracting parties." However, the Note to Article XXXVI:8 makes it clear "that the phrase "do not expect reciprocity" means, in accordance with the objectives set forth in this Article, that the less-developed contracting parties should not be expected, in the course of trade negotiations, to make contributions which are inconsistent with their individual development, financial and trade needs, taking into consideration past trade developments".

The Generalised System of Preferences was proposed by Dr Prebisch, then Secretary-General of UNCTAD, as a non-reciprocal system of tariff preferences in favour of the developing countries, at UNCTAD I in 1964. The arguments were essentially: MFN treatment did not provide equality with domestic producers or regional trade partners unless set at zero; MFN treatment did not take account of inequality in economic structure and levels of development; and because negotiations were conducted on the basis of reciprocity and the MFN principle, developing countries' exports continued to face high tariffs. Preferences were seen as helping to overcome these disadvantages. After overcoming divergences of view and considerable work on the practical details, Prebisch's proposals were subsequently adopted as a principle at UNCTAD II in New Delhi in 1968. The compromise was that the Conference "agrees that the objectives of the generalized, non-reciprocal, non-discriminatory system of preferences in favour of developing countries should be: (a) to increase their export earnings; (b) to promote their industrialization; and (c) to accelerate their rates of economic growth."[350]

In the earliest discussions, some flexibilities were discussed and these have become *de facto* part of operational schemes. For example, it was noted that "…the industrial countries could establish a quota for admitting manufactured goods from developing countries *free of duty*, but they could *exclude from these preferences* a schedule of items constituting a reasonable percentage of the total goods they import."[351] And "*all the developing countries*, irrespective of their level of development, would be eligible to avail themselves of the *preferential system* up to the amount of the relevant quota. But there would have to be a periodic review of the flow of exports; and if the exports from one or more countries increased so much that they did not leave sufficient room for those from others, equitable solutions should be sought." "Special preferences should be granted to the less advanced developing countries." It was also accepted that, after preferences had

[350] Conference resolution 21 (II).
[351] UNCTAD, "Towards a New Trade Policy for Development", E/CONF.46/3 (1964). Italics in original.

helped the developing countries "to prevent or rectify the structural imbalance in their trade", they "will gradually have to disappear". That was the concept of "graduation": that developing countries becoming advanced would not longer benefit from the GSP. Finally, it was recognised that, while developing countries would not offer "conventional reciprocity", as a result of preferences they would be able to import more than if the preferences had not been granted. Thus, irrespective of the subsequent legal texts, the early discussion already envisaged quota limits, graduation, special preferences for LDCs and the eventual phasing out of preferences.

In order to allow the GSP system to become legally operational, on 25 June 1971, the CONTRACTING PARTIES decided to waive the provisions of Article I of the GATT for a period of 10 years to the extent necessary to permit contracting parties to accord preferential tariff treatment to products originating in developing countries and territories.[352] (This was anticipated by Australia which became the first country to introduce a GSP scheme in 1966). This Decision refers to "generalized, non-reciprocal, non discriminatory preferences beneficial to the developing countries". Finally, on 28 November 1979, following the conclusion of the Tokyo Round in one of the "framework agreements", the CONTRACTING PARTIES adopted the Decision on Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries (the "Enabling Clause") which provided a legal basis (other than a waiver) for the granting of trade preferences, tariffs and non-tariff measures, by developed contracting parties in favour of developing countries, and special treatment of the LDCs in the context of any general or specific measures in favour of developing countries.[353] The Enabling Clause, as a decision of the GATT Contracting Parties, became part of the WTO system under provisions of paragraph 1 of the GATT 1994.[354]

The Enabling Clause therefore constitutes the legal basis by which individual WTO Members may unilaterally grant GSP preferences to developing countries.[355] Based on the permissive rather than mandatory language of the Decision, preference givers usually consider that they may also unilaterally modify, extend or withdraw such preferences, including the coverage of beneficiaries. Developing countries often argue that this creates a degree of uncertainty about the scope and duration of preferences, mitigating the benefits.

[352] BISD 18S/24.
[353] L/4903 (BISD 26S/203)
[354] The Enabling Clause also allows for regional or global preferences among developing countries with less rigour than under Article XXIV of the GATT.
[355] The granting of non-reciprocal preferences by developing countries in favour of LDCs is the subject of the Decision of 15 June 1999 (WT/L/304).

Some such countries have therefore suggested the binding of preferential rates or margins to increase the security of GSP benefits.[356]

Similarly, the Enabling Clause does not provide legal cover for non-reciprocal, country-selective preference schemes such as those by the EC in favour of ACP countries, by the US and Canada in favour of Caribbean countries, and so on. These are covered by waivers from Article I of the GATT which are limited in time and require WTO approval for renewal.

The Enabling Clause requires WTO Members to notify the introduction, modification or withdrawal of GSP benefits and furnish all the information they may deem appropriate relating to such action. An attempt to list the notifications made by the Quad with respect to their GSP schemes can be found in Annex I. The lists are probably not comprehensive but still illustrate the fact that it is difficult to get a clear picture of the current application of the GSP schemes by considering the numerous notifications to the WTO.

It may be useful to recall that developing countries are not defined in the WTO, but such status is largely self-determined. This does not mean that all countries which consider themselves to be developing are necessarily accepted as such by GSP preference givers, and the list of developing countries receiving GSP benefits varies between preference givers. This ambiguity, linked with the unilateral nature of the schemes, appears to open the possibility for selection or graduation of GSP beneficiaries, despite the principle that the schemes are to be non-discriminatory. Moreover, even countries which are designated beneficiaries under the various GSP schemes do not necessarily obtain GSP treatment for all their exports: for example, some products may be excluded or eliminated from GSP treatment because they are considered by the preference giver to be "competitive", because the preference giver has concerns about the effects on domestic industry or for other reasons, thus reducing the generality of the schemes. On the other hand, LDCs which are eligible for special preferences under paragraph D of the Enabling Clause, are defined by the United Nations system, and this definition is accepted by the WTO.

4.2 Reasons for under-utilization of unilateral preferences

The analysis of the market access conditions for LDCs has been traditionally conducted on the basis of market access provided under trade preferences[357]. Since currently available

[356] See for example WT/GC/W/331.

trade preferences are granting substantially better market access than MFN rates to LDCs, the current MFN rates of duty were not deemed to constitute a market access barrier to exports of LDCs. However, a closer look to the functioning of trade preferences may still reveal a less optimistic reality. The assumption that MFN tariffs do not represent a substantial trade barrier for exports from LDCs covered by preferential schemes and are seldom applied to their exports, is not tenable once the utilization rate of the available trade preferences is taken into account. In fact, the analysis of trade flows under the GSP appears to demonstrate that such analytical framework largely ignores substantial underpinnings and mechanisms regulating the effective functioning of trade preferences.

The mere granting of tariff preferences or duty-free market access to exports originating in LDCs does not automatically ensure that the trade preferences are effectively utilized by beneficiary countries. Preferences are conditional upon the fulfilment of an array of requirements which, in many instances, LDCs may not be able to comply with. Similarly, the design and structure of the legal framework through which these preferences are made available to LDCs might not properly reflect LDCs' interest of stability and security necessary to attract the needed export oriented investments to generate supply capacity.

As a result, even when a wide product coverage[358] suggests potential benefits in terms of preferential market access to LDCs, the actual utilization of such preferences could be limited. A clear indicator of the effectiveness of trade preferences is the utilization rate[359]. Such an indicator is the ratio of the amount of imports, which actually received trade preferences at the time of customs clearance in the preference-giving country, to the amount of dutiable imports eligible for preferences, This is the most realistic measurement of the effectiveness of trade preferences.

Usually, the value of trade preferences has been measured by referring to a ratio between the product coverage of the preferential scheme and the current exports of the beneficiary countries. The larger the ratio in relation to the exports from beneficiaries, the bigger the

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[357] See, for instance, UNCTAD document "The Post-Uruguay Round Tariff Environment for Developing Countries' Exports: Tariff Peaks and Tariff Escalation", TD/B/COM.1/14/Rev.1

[358] Product coverage is defined as the ratio between imports that are covered by a preferential trade arrangement and total dutiable imports from the beneficiary countries. See UNCTAD, *Improving Market Access for Least-Developed Countries*, UNCTAD/DITC/TNCD/4, Geneva 2001, p. 7

[359] Utilization rate, defined as the ratio between imports actually receiving preference and covered imports, can refer to all beneficiaries, to a sub-group or to single countries. Higher or lower utilization rates, on the other hand have to do with the complexity of the conditions required to grant a product preferential treatment together with the capacity of exporters to comply with these requirements, while, on the other hand, they depend on the degree of the preferential margins offered. In the latter case low preferential margin might discourage exporters to utilize the scheme, because the cost of compliance to qualify products under the GSP might result higher than the MFN duty. See, *supra*

value of the trade preferences granted to the beneficiary countries. Such an approach, however, may not be an accurate measurement. First it does not take adequate consideration that MFN zero rates should first be deducted from the coverage of preferential schemes. Thus, unless trade coverage is calculated over exports which are "dutiable" there might be the risk of calculating "empty preferences". Second, there is need to assess the value of the preferential margin in relation to the requirement of compliance with rules of origin, e.g. low preferential margin associated with restrictive rules of origin reduce the value of trade preferences. Third,, and most importantly, the matching of dutiable exports with the coverage of the preferential schemes provides an indication of the potential effects of the trade preferences granted. In order to obtain more realistic and balanced results in assessing the value of trade preferences, a fourth step should be undertaken by calculating the amount of trade that actually received trade preferences as a percentage of potential coverage, e.g. the utilization rate.

In the context above described, there is ground for considering the main reasons why unilateral preferences continue to be under-utilized. The four main points are being analyzed in the following paragraphs:

-) lack of security of access to the unilateral preferences due to the autonomous character of the preferential schemes;
-) insufficient product coverage;
-) excessively stringent rules of origin
-) lack of technical knowledge needed to apply origin rules and the certification procedures.

( ) Lack of security of access

The lack of security of access is due to the autonomous and unilateral character of the GSP. Indeed, over the years of its operation, several changes in the level of preferences have been introduced to the GSP schemes by including/excluding products/countries for graduation reasons, or simply by revision of the schemes. Under certain schemes, quantitative limits on preferential treatment were applied limiting the predictability of obtaining preferential market access. While graduation mechanisms and quota limitations on preferential treatment have seldom been applied to LDCs, the possibility of introducing these limitations or exclusions and the uncertainty about the triggering mechanisms of these limitations have brought an element of unpredictability deriving from the built-in

autonomous character of the GSP concessions. This factor may have affected the generation of the trade dynamics and the expected foreign direct investment flows in LDCs deriving from the more generous market access opportunities made available to them when compared to other beneficiaries of trade preferences.

( ) Excessively stringent rules of origin with respect to the industrial capacity of LDCs

GSP rules of origin requirements often exceed the manufacturing capacity and industrial development of many beneficiary countries and represent one of the main factors determining the current low utilization of available preferences. Under most of preferential arrangements and GSP schemes, certain modalities of documentary evidence require a series of administrative steps and procedures involving issuance of certificates of origin, through bill of lading, etc. These requirements may exacerbate the cost and difficulties of meeting rules of origin and undermine the effective utilization of trade preferences. Rules of origin requirements, when associated with low preferential margins, might discourage exporters to utilize the scheme because the cost of compliance to qualify products for preference exceed the value of the preferential margin, e.g. the preferential margins are not commercially meaningful[360].

( ) Lack of understanding or awareness of the preferences available and the conditions attached therein leading to application of MFN rates rather than preferential ones

One of the consistent findings of technical assistance activities in favour of LDCs has been clear indication that low utilization rates are due to a combination of factors. On the one hand, the main reason for low utilization is due to the lack of knowledge of the preferential advantages available under the preferential arrangements on the part of the exporters. On the other hand, there is need for the establishment of efficient institutions to administer and promote exports under existing preferential arrangements. Often, LDCs exporters and trade officials are unaware of the pitfalls involved in submitting incomplete or inaccurately

[360] See HERIN J., "Rules of Origin and Differences between Tariff Levels in EFTA and in the EC", occasional paper No. 13, EFTA Secretariat, 1986

completed documentation such as customs declaration. They are also impeded from exporting due to associated difficulties in understanding tariff classifications and changes in such classifications and modifications and amendments made to the preferential schemes. The costs of this lack of technical knowledge, in the unnecessary payment of customs duties, rejected imports, origin verifications, unnecessary testing, legal fees and foregone opportunity in general, can discourage even important exporters in preference-receiving countries, as well as those just entering the market.

In addition, to these trade-related factors, the effectiveness of preferential regimes is also affected by the lack of export capacity or supply, that can hardly be addressed by trade-related instruments. It has often been quoted in various analyses on the value and trade effects of trade preferences granted to LDCs, that one of the main reasons for the limited export performance and utilization of these preferences is represented by the supply constraints of the LDC beneficiaries. Obviously, supply constraints are one of the main obstacles for the full utilization of trade preferences. However, the conventional wisdom that market access is not a major issue for LDCs should be revisited in the light of the utilization rates. In fact, if one considers that a major part of current LDC exports still face MFN duties in spite of the available preferences, action should be taken to eliminate the remaining obstacles to full access by expanding product coverage and increasing utilization rates of available trade preferences.

4.3 The GSP of Canada

Canadian legislation implementing a system of tariff preferences in favour of developing countries was brought into effect on 1 July 1974. In 2000 Canada renewed the General Preferential Tariff rates program by adding some 570 tariff lines to the list of duty-free items for the benefit of the LDCs. That new coverage included a wide range of agricultural and fish products as well as a number of other industrial goods such as iron and steel, chemical products, toys and games. Limited improvements in Canadian market access appeared to accrue to wine, and to a lessr extent fish (lobsters) and mushrooms. However, these improvements, although welcomed, were too small to produce significant changes to the current structure of the GSP for LDC exports.

As from 1 January 2003, the Government of Canada announced steps to liberalize the treatment to be granted to LDC products, to help reduce poverty in the world's poorest countries. The Least-Developed Countries Tariffs (LDCT) program was then introduced.

Specifically, Canada committed to eliminating tariffs and quotas on 99 percent of Canada's tariff lines. An important change was the inclusion of formerly excluded textile and apparel products in the ambit of the LDCT. As a result of this initiative, Canada added over 900 tariff lines to the list of duty-free tariff items including a wide range of agricultural, textile, apparel and footwear products. The LDCT provides duty-free and quota-free access for all product from LDCs provided they meet the rules of origin with the exception of over quota access for supply-managed products in the dairy, poultry and eggs sectors[361]. The initiative also changed the rules of origin, introducing an innovative cumulation system allowing inputs from all beneficiary countries. In 2004 Canada renewed its LCDT program for a ten year period to 2014[362]. This means that the LDCT is currently applied to all Canadian imports of the products of LDCs, giving them duty-free and quota-free access to the Canadian market except for the excluded supply-managed agricultural goods. LDC governments whose exporters or producers wish to benefit from textile and apparel sectors of the LDCT need only sign a Memorandum of Understanding (MOU) with the Government of Canada on the certification and verification of the rules of origin of these textile and apparel products. Once a MOU has been signed with Canada these textile and apparel products benefit from the LDCT. Twenty-one foreign governments have signed MOUs with Canada, giving their products access to the approximately 99 percent of tariff lines that are duty-free and quota-free under this initiative[363].

As a result, since the 2003 enlargement, merchandise imports into Canada from LDCs have more than tripled[364]. In terms of product coverage, almost half the imports from LDCs are comprised of mineral fuels and oils, with the next largest category being apparel, followed by precious stones and minerals. Growth in finished apparel products has been particularly notable. These results are quite important despite the fact that Canada's import volumes from African LDCs are not large compared to LDC's exports to the United States and Europe.

This modification of the Canadian regime in favour of LDC products has been welcomed during the sixty-fourth session of the WTO Committee on Trade and Development. It has also been recognized that Bangladesh's exports to Canada had increased significantly since the introduction of the improved Canadian scheme, in particular in textile and apparel products. Nevertheless the LDC Group called on Canada to further improve its scheme in

[361] See notification contained in WTO Doc. WT/COMTD/N/15/Add.1, dated 13 February 2003
[362] See notification contained in WTO Doc. WT/COMTD/N/15/Add.2, dated 11 May 2004
[363] See the Communication from Canada in WTO Doc. WT/COMTD/W/159, para 4, dated 25 May 2007
[364] From US $ 403 million in 2002 to US $ 1.6 billion in 2006, WTO Doc. WT/COMTD/W/159, para 6

terms of coverage and in terms of flexibility and simplicity of rules of origin. In this last respect, accordance with the concrete proposal on rules of origin presented by Zambia on behalf of the LDCs in 2006 was recalled. Finally, a request was made to the Government of Canada to accord DFQF market access without a time limit[365].

4.4 The GSP of the European Union

The preferential market access conditions of the European Community for LDCs exports are regulated by two main trade arrangements:

( ) THE EC GSP scheme, which from the date of the entry into force of the "Everything but Arms" (EBA) amendment, provides for an unlimited period of time, duty-free quota-free treatment for all products originating in LDCs beneficiaries, except for arms and ammunition, and with special provisions applicable to three sensitive products, namely rice, fresh bananas and sugar, where customs duties will be phased out over specific transitional periods, and;

( ) The new ACP-EC Cotonou Partnership Agreement[366], which basically provides for an eight-year roll-over of the previous preferences granted under Lomè IV with minor improvements, until 2008[367].

It has to be noted that, before the implementation of the EBA initiative, ACP LDCs had traditionally enjoyed more generous market access conditions and legal certainty under the Lomè/CPA regime. As a matter of fact, the only effective LDC users of the EC pre-EBA GSP scheme were those LDCs that are not members of the ACP Group. One of the main differences between the tariff preferences provided to LDCs by the EC under its pre-EBA

[365] See WTO Doc. WT/COMTD/M/64

[366] The Partnership Agreement between EU and 78 African, Caribbean and Pacific States was signed at Cotonou, Benin, on 23 June 2000. Pending the ratification progress, the Agreement was put into provisional application on 2 August 2000, according to the modalities laid down in Decision No 1/2000 of the ACP-EC Council of Ministers of 27 July 2000 (2000/483/EC, Official Journal L 195 of 1.8.2000, p. 46

[367] Under the Cotonou Partnership Agreement, the EU had anticipated the EBA initiative by entering into a commitment whereby it would "*start a process which, by the end of multilateral trade negotiations and at latest 2005, will allow duty-free access for essentially all products from all LDCs, building on the level of the existing trade provisions of the Fourth ACP-EC Convention and which will simplify and review the rules of origin, including cumulation provisions, that apply to their exports*", art. 37, paragraph 9, of the Cotonou Partnership Agreement

GSP scheme and the Lomè/CPA trade regime lay in the in the different legal nature of the two preferential arrangements. While the GSP was conceived as a unilateral, non-reciprocal, unbound grant by industrialized countries aimed at contributing to the economic development of developing States, the Lomè/CPA preferences are an integral part of a broader international treaty which is legally binding upon the two parties (the EC, on the one hand, and the ACP States, on the other hand) and by which the EC has committed itself on a contractual basis to ensuring until 2008 non-reciprocal preferential market access conditions for ACP products. With a view to giving greater stability to the EBA-GSP preferences for LDCs, the EC has undertaken to maintain the special preferential treatment in favour of LDC products for an unlimited period of time, exempting such treatment for the periodical reviews of the basic GSP scheme or the negotiations for the Post-Cotonou Agreement.

Before the introduction of the EBA amendment, which improved the market access conditions of LDCs, the extremely high trade-weighted coverage, amounting to 99.9 percent, granted under the former Lomè Convention and the current CPA, appeared to provide little scope of improving market access to LDC products. However, a closer analysis of the preferential treatment provided under Cotonou and former GSP trade revealed that the product coverage and preferential rates granted to LDCs were not necessarily equivalent to duty-free access[368]. The structure of the duties applicable to imports into the European Union is extremely complex. Many agricultural products face a combination of *ad valorem* and specific duties depending on the specific agricultural product and on its components, e. g. the duty varies according to the presence or not, in different percentages, of certain ingredients or inputs. For example, many tariffs applicable to products of the food industry, such as sugar confectionery, cereals preparation, chocolate, etc, vary according to the content of sugar and milk fat contained therein. In addition, entry prices, and relative tariffs, are applicable to imports of vegetable and fruit products. Thus, exports may face different duty rates in relation to the time period in which they are exported to the European Union. Similarly, for some products such as meat and dairy products, cheese, tomatoes, mandarins and some cereals, preferences under the Cotonou Agreement were limited by ceiling or tariff quotas.

A closer analysis provides evidence that the wide product coverage provided by the European Union under the Cotonou Agreement and the pre-EBA GSP for LDCs was not

[368] See Inama S., Market Access for LDCs, p. 99

equivalent to full product coverage and duty-free access[369]. More specifically, there was considerable scope in eliminating all specific duties in the agricultural sector, by abolishing or reducing the entry-price system and removing the remaining tariff quotas applicable under the Cotonou Agreement.

The EBA amendment to the European Union GSP scheme considerably improves the preferential market access granted to LDCs beyond the preferences provided by the Cotonou Agreement and the European Union GSP for LDCs. Under EBA, all products are admitted duty and quota free for an unlimited period of time, excluding sugar and rice[370] where customs duties are to be phased out over a transitional period. All dutiable products that were previously granted only a margin of preference or were subject to quantitative limitations are now given duty and quota free treatment. Most importantly, the EBA initiative abolishes the specific duties and entry prices that were previously applicable for certain categories of agricultural and processed foodstuff under both the Cotonou Agreement and the GSP. This additional market access provided by EBA may have not been fully appreciated given its technical character. On the other hand, it has to be mentioned that few of the actual LDC exports may be benefiting from this improved market access given the limited or non-existent supply capacity in the areas where the margin of preferences provided by the EBA is greater than the one provided under the former Lomè Convention and CPA[371].

Another important feature of the EBA is the stability imparted to these preferences. In fact, even if the EBA is an integral part of the European Union GSP scheme, its duration is not subject to the periodic GSP reviews, nor to time-limits. By the same token, the initiative is subject to all the disciplines and various limitations of the GSP scheme, such as the unilateral and unbound character of the GSP, the provisions of temporary withdrawal of the preferences[372], strengthened safeguard provisions and rules of origin.

In particular, a significant limitation of the current initiative may be found in the absence of improvement in the field of rules of origin since previous GSP rules are still

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[369] See BRENTON P., IZEKUKI T., *The Value of Trade Preferences for Africa*,

[370] Full liberalization for bananas was completed in 2006. In the 61st Session of the WTO CTD, the representative of the European Communities delegation said the progressive implementation of market liberalization for rice and sugar was continuing as foreseen in the EC's GSP Regulation, and that further progressive steps had been taken to achieve the same target for rice and sugar in 2009. He also informed the CTD that the EC was reviewing its preferential rules of origin requirements with a view to making them more simple, transparent and easy to use. See WTO Doc. WT/COMTD/M/61, para 82

[371] UNCTAD, *Trade Preferences for LDCs: an Early Assessment of Benefits and Possible Improvements*, UNCTAD/ITCD/TSB/2003/8, p. 40

[372] See art. 22 of Regulation 2320/98, specially reinforced by the EBA amendment itself

applicable. Comparing the Cotonou Agreement and the GSP origin rules, one of the major differences is given from the cumulation system. Cumulation allows inputs from specified countries to be treated as originating materials. Under the GSP, diagonal cumulation can take place within four regional groupings: ASEAN, CACM, the Andean Community and the SAARC. Diagonal cumulation allows originating materials, i.e. those who satisfy the EU rules of origin for that product, from regional partners to be further processed in another country and treated as if the materials were originating in the country where the process is undertaken. However, this flexibility in sourcing is constrained by the requirement that the value-added in the final stage of production exceeds the highest customs value of any of the inputs used from countries in the regional grouping.

Cumulation under the EBA is not available to the ACP countries. Such cumulation is a possibility for Cambodia and Laos within ASEAN and for Bangladesh, Bhutan, Maldives and Nepal within SAARC. Thus, for example, the standard rule of origin for clothing states that products must be made from yarn. In other words, the fabric from which the clothes are cut and made-up must be woven in the beneficiary country or the European Union. With diagonal cumulation clothing producers in Cambodia can use fabrics from Indonesia (provided they are originating, that is produced from the stage of fibres) and still receive duty-free access to the European Union. Similarly, producers in Nepal can import originating fabric from India. This provides for slightly more freedom in sourcing decisions than is available under the basic rule of origin[373]. However, it has been shown how the value-added requirement can render regional cumulation of little value[374]. For example, value-added in the making-up of clothing in Bangladesh ranges from between 25 and 35 percent of the value of exports. However, value-added in the production of fabrics in India is around 65 to 75 percent. Regional cumulation allows clothing produced in Bangladesh from Indian fabrics preferential access to the European Union but not at zero rate, for which Bangladesh is eligible, but at the rate for which India is eligible, which is only a 20 percent reduction from the MFN rate, that is a tariff of 9.6 percent.

[373] For certain textile and clothing products, but subject to quantitative limits, Cambodia, Laos, and Nepal have requested and been granted a derogation from the rules for certain textile and clothing products such that originating inputs from any countries belonging to the SAARC, ASEAN, or the ACP can count as originating materials.

[374] See *Inama S.*, *supra*

Under the Cotonou Agreement, full cumulation[375] can occur with any of the ACP countries and there is no requirement concerning value-added in the final stage relative to the customs value of inputs used. There is also the possibility of cumulation with South Africa, provided that the value-added exceeds the value of materials from South Africa, and with neighbouring non-ACP developing countries, although highly constrained for textile and clothing products. Hence it is possible that ACP countries using materials from other ACP countries qualify for duty-free access to the EU market under the Cotonou Agreement but not under the EBA.

After the entry into force of the EBA, ACP countries were expected to react to the new incentives provided by increased market access. However, trade data seem to indicate that that the majority of ACP countries are continuing to export under ACP trade preferences. This may be hardly surprising when one considers that different formalities apply to the benefit of trade preferences under the CPA and EBA initiatives[376]. In fact, in order to benefit from CPA trade preferences, the certificate of origin "EUR 1" is required as under the previous Lomè Conventions. Conversely, as the EBA is an amendment to the EU GSP scheme, in order to benefit from the EBA, the GSP certificate of origin "Form A" has to be used. Since ACP countries have exported their products to the EU for the lasr 20 years utilizing the "EUR 1", it is likely that they will continue to use it even after the entry into force of the EBA.

The difference in certificates of origin between EBA and CPA could partly explain the low utilization of the EBA in 2002 and the continued reliance on the CPA trade preferences[377]. The major implication of this double system of certificates of origin varies depending on the product exported to the EU:

- if ACP countries are exporting under EBA, they are not granted the more liberal cumulation system available under the CPA;

[375] The most advanced form of cumulation, full cumulation, allows for any working or processing (even if it does not confer origin) undertaken in one country to be carried forward to another country and counted as if it were undertaken in the country of final processing. For example, a clothing products made in one country from fabric produced in a regional partner which in turn was made from non-originating yarn would be eligible for duty-free access to the EU under full cumulation but not under diagonal cumulation since the fabric would not be deemed to be originating (the rule of origin for the fabric requires manufacture from fibres

[376] See, *supra*, note 54, p. 48

[377] Since trade data on utilization of trade preferences are recorded according to the customs declaration made by the importer, this is probably th ereason for the low utilization of the EBA preferences by LDC – ACP countries. Obviously, when th eimporter presents an "EUR 1", the transaction will be recorder under ACP trade flows and not under EBA

- if ACP countries are exporting, under the CPA, agricultural products that have been granted additional liberalization under EBA by elimination of entry prices and agricultural components, they are depriving themselves of an additional margin of preferences.

Thus, for ACP-LDC countries, there might be pros and cons in utilizing EBA or the CPA preferences depending on the product.

4.5 The GSP of Japan

The Japanese of generalized preferences, granting advantageous treatment to imports from 164 developing and LDCs, was recently reviewed and extended until March 2014. The scheme covers a majority of industrialized products with few exceptions. And also includes selected agricultural and fishery products. Since its inception in 1971 it has been revised several times[378], extending DFQF treatment to a substantial number industrial and agricultural products. Traditionally Japan's GSP scheme has adopted a positive list for agricultural products and a negative list for industrial products, including textiles. Special treatment accorded to LDCs included i) duty-free entry; ii) exemption from ceiling restrictions; and, iii) an additional list for which preferences are granted only to LDC beneficiaries. The scheme incorporates an ongoing graduation policy removing GSP privilege for specific products deemed to 'have become competitive' in course of time.

In 2000, Japan launched the "99% initiative", which came into force in April 2001, allowing LDCs to enjoy the following special treatment for all products covered by the scheme:

- duty-free entry;
- exemption from ceiling restrictions; and
- an additional list of products for which preferences are granted only to LDC beneficiaries.

During the fiscal year 2001/2002, the special treatment granted to LDCs was improved by adding a number of tariff items for duty-quota-free treatment for their exclusive benefits.

Japan further improved its scheme in 2003. The number of LDCs' agricultural and fishery products under duty-free and quota-free treatment were increased to around 500 items from around 300 existing items: the additional 200 items included prawns and frozen fish fillets.

[378] The last revision is of 2003

As for LDCs' industrial products, almost all items had already been given duty-quota-free treatment. Moreover, this revision further liberalized the Japanese market vis-à-vis exports from LDCs of textiles, leather and footwear.

For goods from an LDC to be considered eligible for preferential tariff treatment they must be recognized as originating in the LDC concerned under the origin criteria of the Japanese GSP scheme and transported to Japan in accordance with the rules of transportation, which involve direct consignment. The basic rules of origin require the product exported from the LDC to be either wholly obtained in the exporting country or, whenever imported raw materials are being used, sufficiently processed in the exporting country. The sufficient processing means conversion from one HS 4-digit level item to another HS 4-digit level[379]. There are exceptions to these rules of origin, when the processing of imported intermediate goods or raw materials are not considered sufficiently processed: in fact, a "single list" has been developed describing all processing requirements, on a product-by-product basis, for obtaining the originating status. The "99% initiative" has introduced a positive list of agricultural and industrial products for the exclusive benefit of LDCs at duty-free quota-free rate. Moreover, some improvements have been made by reducing the number of items in the negative list.

Following to the 6th WTO Ministerial Conference in Hong Kong, and in order to expand DFQF market access for LDCs, Japan launched the "Development Initiative for Trade" in order to provide DFQF market access for essentially all products originating from all LDCs along with a package of extensive development assistance. In 2006, Japan amended the relevant regulations in order to implement DFQF treatment for all LDCs. The domestic process necessary to make the "Development Initiative for Trade" affective is ongoing and Japan periodically reports to the CTD the progressive legal implementation of the initiative[380].

4.6 The GSP of the United States

The US GSP programme provides for duty-free entry to all products covered by the scheme from designated beneficiaries. The scheme has been in operation since 1976, initially for 10-years periods, and then it has always been renewed every one or two years. Modifications to the product and country coverage of the US GSP are considered each year

[379] See supra
[380] See WTO Doc. WT/COMTD/W/150

by the GSP Sub-committee of the Trade Policy Staff Committee, an inter-agency committee of the US Government. Submissions requesting modifications may be made to that Sub-committee by any interested party, including beneficiaries or interested US firms. Such modifications are brought into force by means of a Proclamation of the President. Certain articles are prohibited from receiving GSP treatment, including most textiles and apparel, watches, footwear, handbags, luggage, flat goods, work gloves and other leather wearing apparel. Any other article deemed to be "sensitive" cannot be included. Steel, glass and electronics items are therefore excluded from the US GSP scheme.

Since GSP treatment in the United States is duty-free, special treatment for LDCs involves providing additional product coverage, rather than a higher margin of preference. In practice, imports from LDCs under the scheme are dominated by unprocessed commodities such as petroleum, tobacco and raw cane sugar, suggesting that the scheme has had limited success in encouraging industrialization among LDCs. A significant improvement in the US scheme was recorder in 1997, when 1,783 new products originating in LDCs were granted duty-free treatment. By then, the list of products eligible for duty-free treatment includes selected dutiable manufactures and semi-manufactures and also selected agricultural, fishery and primary industrial products not otherwise duty-free.

As in other schemes, not all countries that consider themselves to be developing countries I the WTO are eligible for GSP. For example, some are excluded from normal – permanent or conditional – trade relations or are subject to embargoes[381]. Some countries which are previously subject to such restrictions, e.g., certain socialist and OPEC countries are now eligible. Mexico lost GSP when NAFTA came into effect. Other countries have seen their benefits reduced, suspended or terminated as a result of disputes over workers' rights or other matters. Still other countries which previously enjoyed GSP status have been graduated because of theirs income levels, being defined as "high income" by the World Bank[382]. Graduation was introduced in the US scheme as early as 1985, but there remains a high concentration of imports from a few GSP beneficiaries.

Initially, the US GSP scheme had "no strings attached". The scheme was non-contractual and autonomous, with the preference giver having the right to withdraw or modify benefits at any time. However, the Trade and Tariff Act of 1984 expanded the number of criteria which beneficiaries had to meet, so that the USTR was able to use these provisions as a

[381] See UNCTAD, *GSP Handbook on the Scheme of the United States of America*, UNCTAD/ITCS/TSB/Misc.58

[382] Hong Kong, China, the Republic of Korea, Singapore and Chinese Taipei

"non-reciprocal toll". The main conditions relate to protection of intellectual property, the respect of labour rights, and the resolution of investment disputes.

Competitive needs limitations (CNLs) are the main restriction in the US scheme other than the non-eligibility of certain products. They are intended to prevent the extension of preferential treatment to countries that are considered competitive in the production of an item. Ceilings are set for each products and country, and with certain qualifications, a country automatically loses its eligibility for a given product the year following that in which the ceiling is passed. There are two forms of CNLs in the US scheme. The "upper" competitive limits, the most common, are exceeded if, during any calendar year, US imports of that product from that country: (a) account for 50 percent or more of the value of total US imports of that product; or (b) exceed a certain dollar value, which is annually adjusted in proportion to the change in the nominal GDP of the United States. In addition, products which are found to be "sufficiently competitive" when imported from a specific beneficiary country are subject to the "lower" competitive limit. In this case, eligibility is terminated if imports exceed 25 percent or a dollar value set as approximately 40 percent of the "upper" competitive need level.

For products that have exceeded the CNLs, the exporter may excluded permanently, or "graduated", from GSP benefits or, if imports fall below the CNL in the subsequent year, the exporter can have GSP benefits restored, that is, the country can b "re-designated". Permanent exclusion can result form: a petition submitted in the previous annual review; by precluding individually beneficiaries from newly designated products; or by denying re-designation[383].

There are two ways in which a country can maintain its GSP benefits for a product when it has exceeded the CNLs. It can obtain a *de minimis* waiver, a temporary one year exception available only for imports of relatively small amounts[384]. The other option is to obtain a permanent waiver, which is subject to a more detailed review process. In either case, the waiver must be on the grounds of "the national interest of the United States". Importantly, there are no CNLs for LDCs and for AGOA designated beneficiaries.

The main rule of origin is that the sum of the cost or value of the materials produced in the beneficiary country plus the direct costs of processing must equal at least 35 percent of the appraised f.o.b. value of the article at the time of its entry into the United States. Imported materials can be included only if they are "substantially transformed". Cumulation is

[383] See WTO Doc. WT/COMTD/W/93, para 57
[384] $14.5 million in 1999

allowed within GSP eligible regional associations up to the 35 percent appraised value. Such regional associations are: the Andean Community, ASEAN (excluding Singapore and Brunei Darussalam), CARICOM, the South Africa Development Community (SADC) and the West African Economic and Monetary Union (WAEMU).

In the GSP scheme of the United States, textile products of HS Chapters 61 and 62, i.e. articles of apparel and clothing both knitted and not knitted, and footwear are currently excluded[385]. Hides, skins and woods are partially excluded too. For textile and clothing products LDC exporters are subject, on average to a trade weighted tariff of 15.2 percent[386], while for certain footwear articles, which are considered very sensitive products, duties are around 35 percent. The beneficiary countries that are mostly affected by this exclusion are Bangladesh, since it supplies almost 90 percent of the 20 main products excluded by the US scheme[387], as well as Nepal. Other countries that are partially affected by the tariffs applicable to excluded products are Yemen, for article of stone, Madagascar, for some textile and wood products, and Nepal for products like hides and skins.

The African Growth Opportunity Act (AGOA)[388] is the most recent United States initiative authorizing a new trade and investment policy towards Africa. It represents a meaningful opportunity for eligible Sub-Saharan African countries. The Act originally covered the 8-year period from October 2000 to September 2008, but amendments signed into law in July 2004 further extend AGOA to 2015. Since the Act provides for a series of preconditions and requires positive actions on the part of the 48 potential beneficiary Sub-Saharan countries[389], the actual utilization of the trade benefits will depend on the capacity

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[385] Only the Caribbean Basin Initiative and the Andean trade preferences provide for preferences for textiles and clothing subject to rules of origin. See UNCTAD, *Trade Preferences for LDCs: an Early Assessment of Benefits and Possible Improvements*, UNCTAD/ITCD/TSB/2003/8

[386] Weighted average of *ad valorem* tariffs, not including the applicable specific rates (2002)

[387] These 20 products accounts for 70 percent of the uncovered LDC exports. See WTO Doc. WT/COMTD/LDC/W/38, concerning *Market Access Issues Related to Products of Export Interest Originating from Least-Developed Countries*, dated 22 February 2006

[388] AGOA, which is part of the Trade and Development Act of 2000, was signed into law by the President of the United States on 18 May 2000. The AGOA implementation regulation was published on 2 October 2000.

[389] First of all, any AGOA beneficiary country must be eligible under normal GSP programme. As additional eligibility requirements, under AGOA, as an eligible beneficiary the President is authorized to designate a sub-Saharan country if the country has made or is making progress in all of the following respects:

(a) the country must have established, or be in the process of establishing:
  (i) a market-based economy that protects private property rights, incorporates an open rules-based trading system, and minimizes government interference in the economy;
  (ii) the rule of law, political pluralism and the right to due process, a fair trial and equal protection under the law;
  (iii) the elimination of barriers to United States trade and investment, including by the provision of national treatment, the protection of intellectual property rights and the resolution of bilateral trade and investments disputes;

at institutional level to satisfy those preconditions and undertake the requested actions. The larger Sub-Saharan African countries may thus be better equipped to qualify as AGOA beneficiaries than other least developed countries in the region.

Product coverage does include apparel articles for 30 African LDCs. However, the rules of origin and quota limitations may diminish the value of this preferential agreement. Under the AGOA apparel provisions, duty-free treatment is granted to apparel products originating in designated sub-Saharan African countries only if made from US yarn of fabrics. Apparel made out of fabric originating from the African region can be exported duty-free to the US, subject to an annual quantitative limitation of 1.5 percent in the first year, which is increased annually over an eight-year period, by equal increments, rising ultimately in the last year, up to a maximum cap of 3.5 percent of total annual apparel shipments to the United States. Besides this general provision a special treatment is granted to LDC designated beneficiaries, allowing them to export apparel made from third-country fabric, i.e. non United States and non-African. However this privilege is also subject to the same cap described above. Moreover, the fact that this general cap is administered on a first-come-first-serve basis and that is cumulative, i.e. does not make a distinction between LDC and non-LDC suppliers, affects the ability of LDC exporters to take advantage of the cap since they will have to compete with other non LDCs-AGOA countries. In addition, in order to become eligible, countries are required to adopt an effective visa system and enforcement mechanism for protection in order to avoid trade deflection trough transhipment[390]. Although a substantial number of LDC sub-Saharan African countries have been declared eligible, the procedures for fulfilling the visa system may imply in certain cases that new legislation has to be adopted in beneficiary countries to specifically prevent illegal transhipment. The combination of these rather complex origin, visa and quota system requirements, applicable under AGOA, are likely to limit the trade impact of these concessions and their utilisation by beneficiary countries.

(iv) economic policies to reduce poverty, increase the availability of health care and educational opportunities;
(v) a system to combat corruption and bribery;
(vi) protection of internationally recognized worker rights

(b) the country must not engage in activities that undermine United States national security or foreign policy interest;
(c) the country must not engage in gross violations of internationally recognized human rights;
(d) the country must have implemented its commitments to eliminate the worst form of child labour (ILO Convention No. 182)

If an eligible country dose not continue to make progress in complying with the above requirements of AGOA country eligibility, the President shall terminate the designation of the country

[390] See *supra* note

Since the launching of the DFQF initiative, the LDC Group has expressed concern in the context of the WTO Committee on Trade and Development sessions for the delay in the implementation of such an initiative on the part of the United States[391]. In response, the US delegation, after reaffirming its full commitment in this respect, has explained that in order to implement a special program for LDC exports the consultation process provided by the US legislation must be carried out. Updates regarding the state of the consultation[392] with all the interested parties are contained in various communications of the United States[393] to the CTD. Nevertheless, at the time of writing, the US have not presented concrete proposals yet.

5. Drafting rules of origin for development: some suggestions

Such explicit acknowledgement in the context of a ministerial declaration of the key function of preferential rules of origin in the effectiveness of the market access of products originating in LDCs is, in principle, noteworthy.

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[391] See WTO Doc. WT/COMTD/M/61, para 77

[392] In order to grant the benefits outlined in the Hong Kong Ministerial Decision, the United States must develop a legislative framework. Development of this legislation requires careful evaluation of its impact on and relationship to current tariff preference programs, such as the AGOA and the Caribbean Basin Initiative. Internal deliberations are underway to analyze the aspects of these programs which would be affected by the DFQF initiative.

Under statutory mandates, the United States must also consult with interested parties, including through legally established mechanism. The consultative process in the United States is designed to inform decision makers of stakeholders views to the fullest extent possible, as well as to maximize the transparency of the decision-making process. In particular, interested WTO Members have the opportunity to participate in the consultative process, including through the formal process of soliciting public comment. The consultative process is iterative and is conducted through formal and informal mechanisms such as:

- requests for submission of public comments and notifications of public hearings through publication of notices in the Federal Register. The Federal Register is the official publication of the United States. It is published every business day and contains Federal agency regulations, proposed rules, notices, Executive Orders, proclamations, and other Presidential documents;
- Formal consultations with the Congress, including through the Congressional Oversight Group (COG) composed of Members from a broad range of Congressional committees, and with the formally-appointed official Congressional advisors on trade policy. The COG was created by the Trade Act of 2002 as a forum for consultations on trade negotiations between USTR and the US Congress;
- Informal consultations with Congress consisting of detailed briefings provided on a regular basis and extensive liaison activities;
- Consultations with the private sector through the trade policy advisory committee system which consists of 26 advisory committees with a total membership of approximately 700 advisors; and
- Intergovernmental consultations among 19 federal agencies through the Trade Policy Review Group and the Trade policy Staff Committee agencies.

Finally, the administration will seek the advice of the International Trade Commission regarding the economic effects associated with implementation. See WTO Doc. WT/COMTD/W/149

[393] See WTO Docs. WT/COMTD/W/149, WT/COMTD/W/149/Add. 1, WT/COMTD/W/149/Add. 2, WT/COMTD/W/149/Add. 3, WT/COMTD/W/149/Add. 4

However, legally speaking, one may argue that Ministerial Decisions once the deadline of 2008 has lapsed are justiciable. It follows, therefore, that the commitments in the Decisions may be an enforceable right of LDCs providing recourse to the Dispute Settlement Understanding (DSU) against those members that have not faithfully fulfilled their commitments. Others nay cast doubts on this possibility. Above all, the track record of LDCs participation to the DSU proceedings suggests that such dispute is unlikely[394].

With regard to other aspects of the package, the Aid for Trade proposal was endorsed, but its actual features.

Many questions remain unanswered about the implementation of the "LDC package". The value of the market access initiative is expected to derive from further concessions to be made especially by the United States. The EBA initiative of the EU more than fully satisfies the 97 percent requirement

After an introduction about the origins of the GSP and a brief overview of the main unilateral schemes, the following paragraphs consider the current state of the art of the implementation given to the Hong Decisions by the major trade partners of the LDCs. The analysis outlines as well the major reasons for the under-utilization of the trade preferences currently in force.

The lack of security of access has been limiting the trade effects and implementation of unilateral trade preferences for more than two decades. This situation should be corrected through a new arrangement imparting stability and predictability to the new initiatives in favour of LDCs by making the trade preferences contractual and by assuring the maximum of security for the duty free access so provided.

The Generalized System of Preferences (GSP) is an exemption from the most favoured nation principle (MFN) that obligates WTO member countries to treat the imports of all other WTO member countries no worse than they treat the imports of their "most favoured" trading partner. According to the Resolution 21, adopted in the UNCTAD conference in New Delhi in 1968, the objectives of generalized, non-reciprocal systems of preferences in favour of developing countries are i) to increase their export earnings; ii) to promote their industrialization; and iii) to accelerate their rates of economic growth[395]. Under GSP schemes of preference-giving countries, selected products originating in developing countries are granted reduced

[394] See MAVROIDIS P., INAMA S., "What Developing Countries should be asking in the Context of DSU Negotiations", mimeo, 2003

[395] For an historical and legal comprehensive overview, see for all, JACKSON J. H., DAVEY W. J., SYKES A. O., *Legal problems*, *supra* note..., p. 1168

or zero tariff rates over MFN rates. In 1971, the GATT contracting parties approved a waiver to the MFN principle for the years in order to authorize the GSP scheme. Later on, the Contracting Parties of the GATT decided to adopt the 1979 Enabling Clause, entitled "Differential and more favourable treatment, reciprocity and fuller participation of developing countries, creating a permanent waiver to the MFN clause to allow preference-giving countries to grant preferential tariff treatment under their respective GSP schemes[396]. The least developed countries (LDCs) receive special and differential treatment for a wider coverage of products and deeper tariff cuts[397].

Products exported from developing countries can effectively benefit from GSP treatment to the extent they are proved to be originating from those countries. The traditional literature has highlighted some shortcomings in the GSP accorded by preference-giving countries reducing the degree of utilization and benefit effectively enjoyed by developing countries. Excessively stringent rules of origin have been identified as being the main cause for the under utilization of GSP. Three sources of trouble in the utilization of the GSP schemes that directly involves rules of origin are being analyzed: 1) the type of rules origin too stringent and often obsolete; 2) the difficulty faced by developing countries in meeting different origin criteria according to the GSP they want to utilize; 3) the lack of technical knowledge needed to apply origin rules and the certification procedures.

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[396] According to the UNCTAD there are currently 11 national GSP schemes in force notified to the UNCTAD Secretariat: Australia, Belarus, Canada, the European Union, Japan, New Zealand, Norway, the Russian Federation, Switzerland, Turkey and the United States of America

[397] The United Nations identifies 50 LDCs. More specifically, in the last triennial review of the list of LCDs, the Economic and Social Council of the United Nations used the following three criteria for the identification of the LDCs, as proposed by the Committee for Development Policy (CDP):

1) a low income criterion, based on a three years average estimate of the gross national income per capita (under $900 for inclusion, above $1.035 for graduation);
2) a human resource weaknes criterion, involving a composite Human Assets Index (HAI) based on indicators of: (a) nutrition; (b) health; (c) education; and (d) adult literacy; and
3) an economic vulnerability criterion, involving composite Economic Vulnerability Index (EVI) based on indicators of: (a) the instability of agricultural production; (b) the instability of exports of goods and services; (c) the economic importance of non-traditional activities (share of manufacturing and modren services in GDP); (d) merchandise export concentration; and (e) the handicap of economic smaliness (as measured through the population in logarithm), and th epercentage of popultaion displaced in national disasters.

To be added to the list, a country must satisfy all three criteria. To qualify for graduation a country must meet the threshold for two of the three criteria in two consecutive triennial reviews by the CDP. In addition, since the fundamental meaning of the LDC category, i.e. the recognition of structural handicaps, excludes large economies, the population must not exceed 75 million.

In the 2000 review, Senegal was included in the list of LDCs. Timor-Leste was added to the list in 2003, bringing the total number of LDCs to 50.

With regard to the 2003 triennial review of the list, the CDP concluded that Cape Verde and Maldives qualified for graduation and recommended that they be graduated from the LDC category. The CDP also concluded that Samoa was eligible for graduation in 2006. Based on the CDP report, the ECOSOC makes a recommendation to the General Assembly, which is responsible for the final decision on the list of LDCs.

35 of the 50 LDCs recognized by the United Nations are WTO members.

The proposal from Zambia, made on behalf of the LDC Group, outlines various considerations about how the decisions taken with the Hong Kong Declaration on DFQF market access shall be made operational. Most importantly, LDCs want that, in providing DFQF market access to LDC exports, the origin of goods will be conferred to LDCs if they conform to the LDC rules of origin contained in their proposal[398]. This proposal sets a precedent in this area since it is not limited to statements and principles but contains a precise negotiating proposal articulated in eight articles. This initiative is to be welcomed since it sets the stage for a sensible debate on rules of origin among LDCs and preference-giving countries on the basis of a concrete legal text rather than on declarations of principles and statements. Moreover, this firm position, currently reaffirmed by LDCs in the context of the WTO CTD Sessions, is also quite new in that it contrasts with the usual logic followed by the GSP schemes, according to which, since GSPs confer preferences on a unilateral basis, it's up to the country conferring the benefits to define the applicable origin rules[399].

The challenge to be faced in drafting rules of origin for LDCs under autonomous trade challenge is to identify a substantive origin requirement that i) respects the limited industrial capacity of LDCs and facilitates utilization of preferences; and ii) safeguards the legitimate interests of preference-giving countries from transhipment and circumvention making sure that tariff preferences are limited to those products that are genuinely manufactured in preference-receiving countries.

Most recently some authors have proposed that the requirements for goods to be considered as originating to be adopted under a South-South free trade area like the Southern Africa Development Community (SADC) should be as follows:

- goods wholly produced in the region; or
- goods undergo a single change of tariff heading; or
- goods contain non-SADC imported materials worth no more than 65 percent of the net cost of the good (or a regional content of 35 percent of net cost) or no more than 60 percent of the ex-works price of the good (regional content of 40 percent)[400].

[398] See WTO Doc. TN/CTD/W/31

[399] As it has been noted noted: "*Hopefully, the multilateral community and the preference-giving countries will not entrench themselves into the fact that since preferences are unilateral, rules of origin under the DFQF cannot be discussed or negotiated*", see INAMA S., Drafting Rules of Origin for Development: Lessons learned beyond Conventional Wisdom and Misunderstanding, in *Global Trade & Customs Journal*, 1 (2), 2006, p. 73

[400] See BRENTON P., FLATTERS F., "Rules of Origin and SADC: the Case for Change in the Mid-Term Review of the Protocol", Working Paper Series No. 83, World Bank, 2005

Unfortunately this kinds of suggestion have been at times translated into reality. For instance, the original rules of origin text under MERCOSUR, COMESA, SADC and ASEAN rules contained such a kind of "pick and choose" approach. In principle there is nothing wrong in providing alternative rules of origin for the same product. Both the Pan-European model of rules of origin, NAFTA and other most recent rules of origin contain provision for alternative rules of origin or different figures of percentages. However, the alternatives provided must logically have the same or equivalent degree of restrictiveness, i.e to borrow a term for the non preferential rules of origin, should be co-equal. Failing this the exporter/producer will pick and choose for the easiest rule to comply with. Circumvention and trade deflection will then take place. The main shortcoming of this type of rules of origin is that they may provide different origin outcome for the same products depending on the criteria adopted. Moreover, experience and difficulties in administering the original rules of origin under the SADC, COMESA and ASEAN gradually forced these regional groupings to adopt product-specific rules of origin. This does not mean that product-specific rules of origin are not appropriate or technically wrong. However, experience has shown that the elaboration of product-specific rules of origin may opens a leeway to protectionist intents and lobbies

Moreover, the major problems normally associated with rules of origin are recalled as follows:

- there is a direct cost associated with the completion of rules of origin of about 3 to 5 percent which reduces exports under preferential schemes;
- rules of origin can make it more difficult to achieve the economies of scale since input requirements may vary according to destination markets of the final products;
- Rules of origin are an incentive to purchase intermediate goods in the country conceding the preference, and this can be a source of trade diversion if there is a more efficient producer of intermediate goods elsewhere;
- Rules of origin can be used as a means of protection for the importing country. In fact, the larger the difference between MFN and preferential tariffs, the more restrictive the associated rules of origin; and
- Rules of origin usually do not recognize constantly changing industrial configurations brought about through globalisation and can delay the effective

utilization of trade preferences and may impede rather than facilitate preferential market access[401].

Since the 1970s preference-giving countries have expressed the view that as preferences were being granted unilaterally and non-contractually, the general principle had to be that donor countries were free to decide on the rules of origin which they thought were appropriate after hearing the view of the beneficiary countries[402]. Within this general principle, the preference-giving countries felt that the process of harmonization had to be limited to some related practical aspects such as certification, control, verification, sanctions and mutual cooperation. Even there, progresso has been extremely limited.

Although changes and modifications have been introduced in the GSP rules of origin since the 1970s, the basic requirement, shortcomings and rationale for these rules have remained virtually the same for almost 30 years since the OECD meeting. The first implication is that different sets of rules of origin apply according to each national GSP scheme. It follows then that, since national schemes have different product coverage, different customs regulations and different previous rules of origin for administering trade preferences, each preference-giving country modelled its own system of rules of origin according to these different parameters. In addition, the fact that the ARO has not brought any significant discipline in the context of the preferential rules of origin, has given way to an uncontrolled proliferation of different sets of rules of origin in autonomous and contractual trade preferences. As a result of the lack of multilateral action about the issue of origin, the shortcomings of the initial scenario have remained almost unchanged. As pointed out by a preference-receiving country, insuperable obstacles are caused by the need to devise and operate an accounting system, which differs in the definition of concept, application, accounts, precision, scope and control from its internal legal requirements[403]. The system must provide the costing information to satisfy the rules of the countries of destination, and to check the shares of domestic and imported inputs in the unit cost of the exported goods, in some cases identifying the country of origin of the inputs and

[401] See WTO Doc. TN/CTD/W/30, para 16

[402] See OECD, Ad Hoc Working Group of the Trade Committee on Preferences, Rules of Origin, second report, TC/Pref./70.25, p. 9, Paris, 25 September 1970. At the out set of the GSP, drafting a uniform set of rules of origin to be applied to the different GSP schemes adopted by preference-giving countries was the principal aim of the UNCTAD Special Committee on Preferences. Hence the latter decided to set up a working group on rules of origin with the task of initiating consultations on the technical aspects of rules of origin with the objective of preparing draft rules of origin to be applied uniformly in all GSP schemes. This working group was one of the first multilateral initiatives to regulate the issue of rules of origin at the intergovernmental level.

[403] See UNCTAD document TD/B/C.5/WG(X)/2, p. 6

establishing direct and indirect processing costs. This often requires data-processing techniques, which are not in common use, especially in small and medium-sized enterprises.

Chapter IV

The relationship between rules of origin and origin marking

Summary: *1.Purposes of origin marking; 2. The multilateral legal framework; 2.1 Marks of origin: an intellectual property right?; 2.2 WTO provisions dealing with marks of origin; 3. US legislation about origin marking; 4. State of play of the EC origin marking legislation; 4.1 The EC proposal for a regulation on origin marking: suggestions from the Italian experience; 4.2 Legal issues related to an EC compulsory origin marking scheme*

1. Purposes of origin marking

Marks of origin are meant to indicate the origin of a product on the product itself or on its packaging, typically in the form of "Made in + the name of the country of origin". Many countries' regulations provide for origin marking requirements in order to achieve a better information for consumers. In countries in which origin marking is regulated on a voluntary basis, there is a legal framework of reference to comply with in case an origin marking claim is voluntarily applied by producers. An increasing number of countries are requiring the compulsory marking of origin of imported products. In this case the affixing of an origin mark is the condition that must be complied with in order to put a product on these markets. The reason of this trend, besides consumer's protection, is the promotion of national products. Moreover, origin marking regulations may cover either imported goods only or domestic products made by materials or semi-manufactured goods of foreign origin too.

On the basis of the principle of territoriality of legislation, each importing State is free to rule about the compulsoriness of an origin marking scheme and to set out the substantial rules to be followed by producers in assessing the country of origin for marking purposes. Some countries consider origin marking to be correct and accurate if determined according to non preferential rules of origin[404]. Countries are also free to set out modalities

[404] See Beretta L. C., Dordi C. (2000), "Le regole di origine: un fattore critico negli investimenti internazionali", *Economia & Management*, SDA Bocconi; Beretta L. C., Dordi C. (2001), *Le règle d'origine*, in Giordano P., Valladao A., Durand M. F., *Vers un accord entre l'Europe et le Mercosur*, Science PO Presse, Paris; Beretta L. C.,De Antoni F., Dordi C. (2003), *Le regole di origine nell'Unione europea*, Ipsoa; Dordi C. (1994), *Le regole di origine negli accordi regionali: modalità applicative nella Comunità Europea*, in Alessandrini A., Sacerdoti G., *Regionalismo economico e sistema globale degli scambi*, Giuffré; Bourgeois J., Vermulst E., Waer P. (1994), *Rules of Origin in International Trade*; Palmeter D. (1987), *Rules of Origin or Rules of Restrictions: a Commentary on a new Form of Protectionism*, in *Fordham International Law Journal*, Vol. II

of affixing for the different categories of goods. As regards lacking, misleading or inaccurate country of origin marking, seizure of the imported merchandise is the first consequence provided for in many countries[405]. This inconvenience is likely to cause delays in the delivery of goods. According to each importing country's legislation stricter penalties can be applied[406]. From the point of view of export-oriented firms this fragmented legal background implies a twofold consequence: burdens in terms of delay, additional costs and reliability that the non compliance with the importer's country rules could involve, on one hand; financial and organizational costs to arrange the production in order to market their products in accordance with the legislation of different countries, on the other hand.

The different state of play of US and EC origin marking rules is being analysed here. While the US origin marking system has very detailed rules and a consolidated customs practice, EC Members are negotiating a common discipline about marks of origin. As a matter of fact, at EC level there is no harmonized legislation on origin marking for imported products, so that, as a result of very diverse national legal requirements, the meaning of "made in" differs among member States. Moreover, administrative and customs authorities of the different EC members neither have the same practice in checking the truthfulness and accuracy of the origin marking borne by imported goods nor have the same concern in checking imported goods[407]. Among the main reasons why the

[405]According to art. IX.2-3 of the *General Agreement on Tariffs and Trade – GATT*, in order to reduce to a minimum the difficulties and inconveniencies the laws and regulations relating to marks of origin may cause, whenever it is administratively practicable to do so, importing States should permit required marks of origin to be affixed at the time of importation.
Examples: when articles or containers are found upon examination not to be legally marked, the US legislation provides the importer the possibility to arrange with the port director's office to properly mark the articles or containers, or to return all released articles to Customs custody for marking, exporting, or destruction. 19 C.F.R. Subpart F 134.51.
Similar rules are applied by the Japanese customs administration providing for the possibility to correct the improper origin marking in order to get the import permission.

[406]According to the US legislation, if a false certificate of marking is filed indicating that goods have been properly marked when in fact they have not been so marked, a seizure or a claim for monetary penalty, that can amount to a 10 percent of additional *ad valorem* duty, can be made. Cases involving wilful deceit may result in a criminal case report providing for a fine up to $10,000 and/or imprisonment up to five years for anyone who wilfully conceals a material fact or uses any document knowing the same to contain any false or fraudulent statement in connection with any matter within the jurisdiction of an agency of the United States. 19 C.F.R. Subpart F 134.52.
Israeli's Consumer Protection Law of 1981 provides for compulsory origin marking for some goods. Lacking origin marking results in a fine of three times the amount stated in art. 61 of the Penal Code. Such amount corresponds to $ 5.861. This sum tripled is the fine.

[407]Following to the contacts with some customs authorities it seems that controls of origin marking labels are quite frequent in the Italian customs practice. On the contrary, according to the opinions given by the Dutch chambers of commerce and customs authorities checking origin marking is nearly a non issue. Examples of the practice by the Italian customs in checking imported goods bearing the "Made in Italy" mark or other kind of words, i.e. "Italy", can be found in the internet in the Italian customs website www.agenziadogane.it

negotiation of an EC origin marking system is a controversial issue is given by the position of those EC firms that, having already outsourced an integral part of the production stages, hinder the institution of a compulsory scheme for origin marking for products imported into the EC[408].

In such a fragmented international legal framework, the definition to be given to marks of origin becomes an issue to be addressed.

The first purpose of origin marking is to inform the consumer about the origin of a product. Since when most industrial goods are the result of manufacturing processes carried out in two or more countries, regulating the origin indication aims at giving the consumer the opportunity to select his purchases according to the perceived quality that a given origin is meant to imply[409]. Many manufacturers do believe the origin of a product to have an impact on the buyer's decisions. This partially explains why so many Italian manufacturers still producing with a very limited outsourcing want to defend the national origin of goods. In this respect, whenever the domestic origin is perceived by consumers as a plus, origin marking is an instrument to promote the image of national products. Another reason driving the consumer's choices is the degree of protection of labour standards and human rights guaranteed by the legislation of the developed countries. Marks of origin are also meant to prevent unfair competitive practices following to false, misleading or inaccurate origin indications. Finally, the application of origin marking rules upon

[408]For an ascertainment of the different stakeholders' positions related to the different options discussed at EU level see European Commission Services, *Consideration of an EU origin marking scheme – Consultation Process, Analysis and Next Steps*, 2004 and Commission*, Staff Working Document annexed to the Proposal for a Council regulation on the indication of the country of origin of certain products imported from third countries*, COM (2005) 661 final

[409]The effect of a product's county of origin on purchasers is one of the most-widely studied consumer-behaviours. It has generated numerous marketing studies detailing the strong impact origin labelling has on consumers throughout the world. See Guerini C. (2004), *Made in Italy e mercati internazionali*, Egea; Corbellini E., Saviolo S. (2004), *La scommessa del Made in Italy e il futuro della moda italiana*, Etas; Liefeld J. P. (2004), *Consumer Knowledge and Use of Country of Origin Information at the Point of Purchase*, http://www.uoguelph.ca/consumerstudies/faculty/liefeld%20papers/LiefeldCountryofOrigin.pdf, visited in April 2006; Peterson R. A., Jolibert J. P. (1995), *A Meta Analysis of Country of Origin Effects*, Journal of International Business Studies, vol. 26, p. 883; Maheswaran D. (1994), *Country of Origin as a Stereotype: effects of consumer expertise and attribute strength on product evaluations*, Journal of Consumer Research: an Interdisciplinary Quarterly, vol. 21, p. 354; Wall M., Liefeld J. P. and Heslop L. A. (1991), *Impact of Country of Origin Cues on Consumer Judgements in Multi-cue Situations: A Covariance Analysis*, Journal of the Academy of Marketing Science, vol. 19, p. 105-113; Han C. Min, (1989) *Country Image – Halo or Summary Construct*, in Journal of Markeying Research, vol. 26; Han C. Min, Terpstra V. (1988), *Country of Origin Effects on Uni-National and Bi-National Products*, Journal of International Business Studies, vol. 19. These and other studies suggest that while origin markings on imported product may not be the sole or even primary determinative factor, they do have an influence on consumer purchasing.

importation could also have the effect of favouring domestic products over competing foreign goods[410].

2. The multilateral legal framework

In most countries origin marking is provided for by laws aimed at protecting the consumer's buying decisions. Some countries' legislation is based upon the correspondence of origin marking with customs non preferential origin. In such cases the country of origin of a good that has being processed in two or more countries is the country where the good has undergone its last substantial transformation according to the requirements of the non preferential rules of origin. From the analysis of the relevant multilateral agreements it follows that the definition of the origin of a product is considered either in terms of customs non trade barrier having an impact on trade liberalization or from the point of view of the protection of intellectual property rights.

2.1. The origin of products: an intellectual property right?

There are at least three concepts aimed at indicating the linkage between a good and its place of origin: indication of source, appellation of origin and geographical indication. The difference and the overlapping among this three concepts have been widely studied and commented by the most relevant literature about intellectual property rights[411]. Each concept takes into account the relationship between good and place considered in a twofold perspective: the required linkage between product's characteristics and place of origin, and the modalities allowed to express such linkage.

An indication of source is any geographical sign used to indicate that a product originates in a given country or place; it can either be a word, e.g. *Italy*, or a sign, e.g. a picture representing Mount Blanc. An appellation of origin is the geographical name used to indicate that the quality and the characteristics of a product originating in a given country or place are exclusively or essentially due to natural (e.g. climate and soil) and human

[410] *Infra* 3.2, p.8

[411] See Escudero S. (2001), *International Protection of Geographical Indications and Developing Countries*, in Trade-Related Agenda, Development and Equity (T.R.A.D.E.), Working Papers, n. 10, South Centre; O'Connor and Company European Lawyers (2003), *Geographical indications in National and International Law*, in Monographs in Trade Law, n. 6

factors (e.g. methods of production)[412]. In this case, the denomination must correspond to the geographical name which serves to designate a product and cannot be given by a symbol or other kinds of expression. This means that the product and the geographical name should be the same, e.g. *Bordeaux* or *Porto*. The Paris Convention for the Protection of Industrial Property of 1883[413] defines both indications of sources and appellations of origin as objects for protection of intellectual property[414]. This might suggest that both expressions should be considered as synonymous. As a matter of fact there is a great difference between them: an appellation of origin requires a quality linkage between the product and its geographical origin. Quite differently the use of an indication of source is merely subject to the condition that a given product originates in the place designated by the indication of source[415]. As regards the legal protection, the Paris Convention provides for the seizure of goods bearing a false indication of source either on importation or in the country of affixation[416]. The seizure of goods only applies to false indications of source and not to the deceptive ones, and it is not always mandatory.[417] In this respect the Madrid Agreement for the Repression of False or Deceptive Indications of Source on Goods of 1891[418] goes further than the Paris Convention by providing for the seizure on importation of goods bearing not only false but also deceptive indications of source. Nevertheless, it must be noted that, being the Madrid Agreement in force in 34 States only, its legal effectiveness in guaranteeing an appropriate origin marking practice at multilateral level is quite limited.

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[412]See art. 2 of the Lisbon Agreement for the Protection of Appellations of Origin and their International Registration of 1958. The Agreement has been revised in 1967 and revised in 1979. It currently has 25 contracting parties, status April 15, 2006, see http://www.wipo.int/treaties/en/documents/pdf/lisbon.pdf

[413]Hereinafter referred to as the Paris Convention. This Convention has been revised in 1925, 1934, 1958 and amended in 1979. Originally signed by 11 countries it now has 169 countries, status on April 15, 2006, see http://www.wipo.int/treaties/en/documents/pdf/paris.pdf

[414] Art. 1.2 of the Paris Convention

[415]See Escudero, *cit.*, p. 3

[416]Arts 9-10 of the Paris Convention

[417]In fact, art. 9.4 of the Paris Convention provides that "the authorities shall not be bound to the seizure of goods in transit"; according to art. 9.5 "If the legislation of a country does not permit seizure on importation, seizure shall be replaced by prohibition of importation or by seizure inside the country"; finally, art 9.6 states that: "If the legislation of a country permits neither seizure on importation nor prohibition of importation nor seizure inside the country, then, until such time as the legislation is modified accordingly, these measures shall be replaced by the actions and remedies available in such cases to nationals under the law of such country."

[418] Hereinafter referred to as the Madrid Agreement. The Agreement has been revised in 1911, 1925, 1934, 1958 and supplemented by the Additional Act of Stockholm in 1967. It currently has 34 countries, status on April 15, 2006, see http://www.wipo.int/treaties/en/documents/pdf/madrid_source.pdf

Art. 22.1 of the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights[419] provides for the more recent multilateral concept of geographical indications defined as *"...indications which identify a good as originating in the territory of a Member, or a region or locality in that territory, where a given quality, reputation or other characteristic of the good is essentially attributable to its geographical origin*."[420] Unlike an appellation of origin, a geographical indication could be any expression that could serve the purpose of identifying a given geographical place, and not necessarily the name of the place where the product originates. For example, the French flag could be used to identify wines of certain quality or reputation. This means that geographical indications could also be expressed by a symbol; moreover, they also refer to the reputation of the product which must be essentially, but not exclusively, attributable to a given geographical origin. The concept of geographical indication is more general than the one of appellation of origin[421].

To the extent to which marks of origin aim at informing consumers as regards the origin of products, they can *prima facie* be assimilated to indications of source. Generally speaking, for origin marking purposes, the reputation and the characteristics of the good do not have to be essentially attributable to their geographical origin; for this reason marks of origin are neither covered by the TRIPs provisions regarding geographical indications nor recognized as an intellectual property right by the European Court of Justice decisions[422].

2.2 WTO provisions dealing with marks of origin

As we have seen, the relevant WTO provisions are provided for by art. IX of the GATT and by the ARO.

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[419] Hereinafter referred to as TRIPs. The WTO system has 149 member States, see http://www.wto.org/english/thewto_e/whatis_e/tif_e/org6_e.htm status as December 2005

[420] A clear EC definition of geographical indications and designations of origin had been given less recently by the European Court of Justice as follows: *"Whatever the factors which may distinguish them, the registered designations of origin and indirect indications of origin [...] always describe at the least a product coming from a specific geographical area. To the extent to which these appellations are protected by law they must satisfy the objectives of such protection, in particular the need to ensure not only that the interests of the producers concerned are safeguarded against unfair competition, but also that consumers are protected against information which may mislead them. These appellations only fulfil their specific purpose if the product which they describe does in fact possess qualities and characteristics which are due to the fact that it originated in a specific geographical area. As regards indications of origin in particular, the geographical area of origin of a product must confer on it a specific quality and specific characteristics of such a nature as to distinguish it from all other products."* EC Commission vs. Germany ECR 1975, point 7

[421] Escudero, cit. p. 5

[422] Hereinafter referred to as ECJ. *Infra* 4, p.12. See Dordi C. (2005), *Le indicazioni geografiche nell'accordo TRIPs/WTO*, in G. Venturini, M. Vellano, G. Coscia, Le nuove sfide per l'Organizzazione Mondiale del Commercio a 10 anni dalla sua istituzione, Torino, p. 5

The applicability to origin marking of some GATT provisions concerning the regional integration is also an issue to be addressed. As regards the distinction between origin marking and other more comprehensive marking and labelling requirements, a recent study has excluded that the *WTO Agreement on Technical Barriers to Trade*[423] applies to marks of origin[424]. According to this study, the issue has just been echoed in the WTO panel practice with no definition regarding the relationship between art. IX of the GATT and the TBT Agreement. Moreover, even though art. 1.2 of the ARO refers to art. IX on marks of origin, it does not mention the TBT Agreement. This fact makes it hard to conclude that the TBT Agreement applies to marks of origin. Finally, it is pointed out that, whenever WTO Members or the WTO Secretariat have addressed the issue of marks of origin, art. IX of the GATT continues to be seen as the exclusive legal basis for origin marking[425]

Art. IX of the GATT, though recognizing the necessity of protecting consumers against fraudulent or misleading indications, aims at reducing to the minimum difficulties and inconveniences that may be caused by laws, regulations and administrative practices during the customs clearance of imported products[426]. Whenever it's possible, the authorities of the importing country should permit affixation of the required marks of origin at the time of importation[427]. In the same trade facilitating perspective, art. IX.5 requires that "*no special duty or penalty should be imposed […] for failure to comply with marking requirements prior to importation unless corrective marking it's unreasonably delayed or deceptive marks have been affixed or the required marking has been intentionally omitted*." The practical application of the requirements of art. IX seems to be quite complicated in terms of legal assessment and cost planning. As already pointed out, this general multilateral provision does not prevent firms, importers and exporters from the necessity of copying with a very fragmented legal and administrative scenario. To the extent to which every importing State is free to provide for a national legislation and administrative guidelines, the imported goods have to comply with the rules and the administrative practice of each importing country[428].

[423] Hereinafter referred to as TBT Agreement
[424] Working Party on Trade Questions, Non Paper of 22 March 2006, see http://www.mincomes.it/made_in/dgpolcom/Made%20in%20Non%20Paper%20Commissione.pdf
[425] See Working Party on Trade Questions, cit. p. 2
[426] Art. IX.2 of GATT
[427] Art. IX.3 of GATT
[428] *Supra* 1

Following to the legislation and the practice of the main EC trade partners and to the findings of the GATT/WTO panels, it's possible to draw some general conclusions. Firstly, the provision for compulsory origin marking rules is consistent with the GATT/WTO rules. In this respect, in *Japan – Film*, the Panel said that, while being sensitive to the possibility that a discriminatory origin indication requirement could result in impairment of competitive relationships, GATT art. IX specifically allows origin marking requirements[429]. Secondly, as noted by the Panel Report in *US – Restrictions on Imports of Tuna*[430], art. IX of the GATT refers to marking of origin of imported products. The Panel further noted that art. IX does not contain a national treatment but only a most favoured nation requirement[431], which indicates that this provision was intended to regulate marking of origin of imported products but not marking of products generally. This means that each WTO Member is free, in cases where marking of foreign imported goods is required, to decide about the compulsoriness of a domestic marking requirement. Thirdly, it must be noted that indications going beyond origin marking are not covered by art. IX. This is the conclusion of the Panel in *Korea – Various Measures on Beef*[432] recalling a Working Party Report on *Certificates of Origin, Marks of Origin and Consular Formalities,* which noted that "*the question of additional marking requirements, such as an obligation to add the name of the producer or place of origin, or the formula of the product, should not be brought within the scope of any recommendation dealing with the problem of marks of origin. […] Requirements going beyond the obligation to indicate origin would not be consistent with the provisions of art. III, if the same requirements did not apply to domestic producers of like products*"[433].

In light of the above, an EC regulation providing for a compulsory origin marking scheme for imported products would be consistent with the interpretation of art. IX of the GATT.

By stating that non-preferential rules of origin must be used for defining the country of origin to be indicated by the origin marking label, the ARO establishes for the first time a multilaterally agreed link between non preferential origin rules and marks of origin[434]. As

[429] Panel Report, *Japan – Measures affecting Consumer Photographic Film and Paper*, DS44
[430] Panel Report, *US – Restrictions on Imports of Tuna*, not adopted, DS21/R
[431] Hereinafter referred to as MFN. According to this principle, every advantage granted to products originating from one WTO Member has to be applied to similar products originating from all WTO States.
[432] Panel Report, *Korea – Measures affecting Imports of Fresh, Chilled and Frozen Beef*, DS169, DS 161
[433] *Certificates of Origin, Marks of Origin and Consular Formalities*, Report of the 1956 Working Party on Trade and Customs Formalities, L/595, adopted on 17 November 1956, 5S/102, 105-106, para. 13
[434] Art. 1.1 of ARO defines rules of origin as "*those laws, regulations and administrative determinations of general application applied by any Member to determine the country of origin of goods*" and specifies that

it the most relevant literature has pointed out, despite the principles set out by the ARO, national rules of origin can be used by States as instruments to reach trade policy objectives[435]. The US – EU dispute clearly shows how rules of origin can be used in order to achieve trade policy objectives and, as a consequence, how origin marking rules can play as non tariff barriers to trade.

4. State of play of the EC origin marking legislation

Current EC customs legislation requires the customs origin of imported products to be accompanied by a declaration of origin[436], but does not provide for any origin marking regulation, except for some specific cases concerning agricultural goods. Any compulsory origin marking scheme at national level would be a measure having equivalent effect to quantitative restrictions, inconsistent with art. 28 of the EC Treaty, and not justifiable on consumer protection grounds. This has constantly been affirmed by the ECJ's decisions[437]. Having said that, member States regulating the issue at national level set different criteria to determine the country of origin for marking purposes, thus giving rise to a heterogeneous legal framework. An ascertainment of the differences existing among selected member States follows:

Austria

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preferential rules of origin do not fall within the scope of ARO. For the difference between preferential and non preferential rules of origin see footnote 1. Art. 1.2 of ARO states that non preferential rules of origin falling into the scope of the ARO are those used in non-preferential commercial policy instruments, such as in the application of: most favoured treatment, antidumping and countervailing duties, safeguard measures, origin marking requirements and any discriminatory quantitative restrictions or tariff quotas.

[435] See Vermulst E. (1992), *Rules of Origin as commercial policy instruments – revisited*, Journal of World Trade, vol. 26, p. 62

[436] Customs duties and discriminatory trade policy measures are applied on the basis of the origin, customs classification and customs value of the product. The main provisions regarding declarations of origin are contained in art. 26 of the Customs Community Code (reg. 2913/92), in articles 81-92 and 109-120 of the Implementing Regulation (reg. 2454/93) and in the origin protocols annexed to the various free trade agreements concluded by the EC with third countries

[437] According to the Court , the purpose of indication of origin or origin marking is to enable consumers to distinguish between domestic and imported products. This would enable the consumers to assert their prejudices which they may have against products lawfully marketed or produced in another Member State. The Court rejected the argument that the measure was necessary for reasons of consumer protection, since a local survey carried out amongst local consumers that the consumers associated the quality of goods with the countries in which they are produced. The Court of Justice disagreed with this argument. According to the Court, indications of origin are intended to enable the consumer to distinguish between national products and products lawfully produced or marketed in another Member State, which may thus prompt him to give his preference to national products. Moreover the Court observed that if the national origin of goods brings certain qualities to the minds of consumers, it is manufacturers' interest to indicate it themselves on the goods or on their packaging, and it ias not necessary to compel them to do so. In that case the protection of consumers is sufficiently guaranteed by rules which enable them the use of false indications of origin to be prohibited. See *Commission vs. United Kingdom*, Case 207/83

Legislation: Zollkodes

Definition of origin for marking purposes is defined through EC customs code and based on non preferential rules of origin

Source: Commission Staff Working Document [COM (2005) 661 final]

Belgium

Legislation: Loi du 14 Juillet 1991 sur les Pratiques du Commerce en Matiére d'Information et de Protection du Consommateur. Art. 23 of this law aims at avoiding that the consumer could be mislead by inaccurate claims of origin

Loi du 29 Juillet 1994 tendant à favoriser la Transparence du Commerce des Marchandises Originaires d'un Pays non Membre de l'Union Européenne. Customs controls are based upon this law.

Practice: origin marking is voluntary. If a product bears an origin marking label the information must be accurate. Origin marking is controlled when importing, transiting and exporting non EC industrial goods in order to avoid claims leading to believe that these goods have been manufactured in Belgium or in other EC member State. In case of improper origin marking, the possibility of either correcting or removing the incorrect label is usually accorded excepts in case of recidivism.

Source: Belgian customs

Estonia

Legislation: Consumer Protection Act, 11 February 2004 (RT 1 I 2004, 13, 86)

Practice: Failure to provide or concealment of truthful information in Estonian concerning the characteristics, price or origin of goods or is punished by a fine.

Source: Commission Staff Working Document [COM (2005) 661 final]

France

Legislation: Toubon Law 1994. French Customs Code. Consumer Protection Law. Bulletin official des douanes n° 6567

Practice: France has no law requiring or forbidding the mention of a product's origin. Nevertheless, if a product bears an origin marking label the information must be accurate. A false or ambiguous indication of origin may be considered misleading advertising. The use of false or deceitful information of origin is an offence. According to art. 39 of the French Customs Code, origin marking is compulsory in those cases in which a product originating in third countries of bears words or signs that could suggest that such products has French origin. This provision only applies to goods imported into the French territory. French territory comprises Overseas Departments and Territories. In accordance with art.

28 of the EC Treaty goods put into free circulation in the territory of any other EC member State, and goods with an export destination are exempted from the application of art. 39. In the event that the country of origin is marked on the products, it's necessary to comply with the definition of non preferential origin provided for by art. 24 of the European Community Customs Code. In case of improper origin marking, the possibility of either correcting or removing the incorrect label is usually accorded.

Source: French customs

Germany

Legislation: Markengesetz

Practice: In cases of signs stating incorrectly the "Made in…" indication customs may seize the products and order to the owner of the goods to remove the improper signs.

Source: German customs

Greece

Origin marking for is compulsory for imported products and voluntary for goods of EC origin. Marking must be precise and not misleading.

Source: Commission Staff Working Document [COM (2005) 661 final]

Hungary

Legislation: Act CLV of 1997 on Consumer Prrotection

Practice: the label of goods shall include the place of origin of the goods, except for those originating in the European Economic Area

Source: Commission Staff Working Document [COM (2005) 661 final]

Italy

Legislation: Legge 126 del 10 aprile 1991; legge 350 del 24 dicembre 2003; Consumer Code; Circolare dell'Agenzia delle Dogane 20/D del 13 maggio 2005

According to art. 6.c of the recently updated Consumer Code the indication of origin of imported products is compulsory. The application of this part of the Consumer Code has been currently postponed to 1st January 2007

Practice: imported products bearing a false or misleading indication of origin are stopped during the customs clearance operations. Origin marking is considered to be false when the origin of good is different from the origin indicated by the label. Misleading origin marking occurs when any sign or expression may suggest the Italian origin. Origin marking is misleading even when despite the correct indication of origin there are signs or expressions that may suggest the Italian origin of the product. It's up to the court to decide whether the origin indication is false or misleading.

Origin marking is correct if in accordance to the non preferential rules of origin as provided for by the European Community Customs Code.

If the import clearance documentation contains an indication of an origin which do not correspond to that specified in the label, the customs authority starts an investigation in order to protect both the consumers and the Members of the Madrid Convention 1981.

Sources: Italian customs; Commission Staff Working Document [COM (2005) 661 final]

Lithuania

Legislation: Rules on Labelling and Indication of Prices of Items for Sale in the republic of Lithuania – Order of the Republic of Lithuania Ministry of Economy No. 170, 2002 (revision of April 2004). Under revision

Practice: If labelling of particular goods (commodity group) is not regulated by a specific legal act, the country of origin shall be presented, provided that the product is imported from third countries

Sources: Commission Staff Working Document [COM (2005) 661 final]

Netherlands

Legislation: No specific rules.

Practice: a company claiming the products are Made in the Netherlands must prove by a certificate of origin that the goods have Dutch origin

Source: Amsterdam Chamber of Commerce

Poland

Legislation: Regulation of Ministry of Agriculture and rural development of December 16, 2002 on labelling of foodstuff and permitted additives. Act of 12 December 2003 on general product safety. Regulation of Ministry of Health of 19 December 2002 on requirements concerning indication on packages of medical products. Regulation of Ministry of Health of 10 December 2002 on basic requirements for medical devices.

Practice: on the labelling of individually packaged foodstuff the indication of place of provenance must be indicated when the absence of such information might mislead consumers. For medical devices the legislation makes a reference to the address of manufacturer more than to the country of origin.

Sources: Commission Staff Working Document [COM (2005) 661 final]

Portugal

Legislation: Decreto Lei n° 238/86, art. 1. Consumers Defence Act – Lei n° 24 de 31/07/96

Practice: origin marking is voluntary. The only obligation concerning the marking of products provides that all information must be translated in Portuguese (e.g. "Fabricado em…"; "Feito em…")

Source: Association for the Defence of Consumers

Slovenia

Practice: origin marking is voluntary. Whenever origin marking is found to be false Slovenian customs authorities infirm the Slovenian Market Inspectorate

Source: Ministry of Finance

Spain

Legislation: RD 769-1984 on leather goods. RD 1999-2253 on rules on labelling, presentation and publicity of foodstuff. RD 1988-1468 on general rules on labelling, presentation and publicity.

Practice: for leather goods, an indication on the provenance (national or imported) of the product is compulsory. It will in Spanish. Importers of foreign goods must ensure that the product comply with this requirements. For foodstuff the place of origin or provenance is compulsory.

Sources: Commission Staff Working Document [COM (2005) 661 final]

Sweden

Legislation: Swedish Marketing Act of 1995

Practice: origin marking should not be misleading

Source: Swedish customs

United Kingdom

Legislation: Trade Description Act 1968. Enterprise Act 2002. Order 2003 (S. I. 2003/2580). Trade Descriptions (Country of Origin) (Cutlery) Order 1981, SI 1981/122

Practice: there is no requirement for goods to bear marks indicating their origin, nor is there anything to prevent voluntary origin marking where traders wish to do so. However it's a criminal offence for a person, in the course of business, to apply false or misleading trade descriptions to goods. The term "trade description" includes, amongst others, an indication, however given, of the "place of manufacture, production, processing or reconditioning" of the goods. Importation of goods bearing false indications of origin is also prohibited. Originating goods are goods manufactured or produced in the country in which they last underwent a treatment or process resulting in a substantial change. However no definition of "substantial change" is provided. It is for the trader and

ultimately for a court to decide whether a particular country or place specified is indeed where the last substantial change took place.

When the goods bearing false or misleading indications of origin, imported from third countries, are encountered by customs in the exercise of normal import procedures, the details of the importation are given to Trading Standards Department (TSD) at the earliest operational opportunity . This allows TDS the opportunity to take direct action under their powers at the point of entry into the UK.

Only the courts can decide whether an offence has been committed and if the indication is misleading. Possibilities of correcting and removing the wrong origin labelling are usually provided.

Sources: UK customs; Commission Staff Working Document [COM (2005) 661 final]

The possibility of considering origin marking as an intellectual property right is to be excluded in light of the ECJ decisions suggesting that marks of origin are to be simply considered as geographical indications of provenance[438]. For this reason, the EC legislation concerning the protection of intellectual property rights does not apply to marks of origin, therefore excluded from the application of both *Regulation 3295/94 laying down measures to prohibit the release for free circulation, export, re-export or entry for a suspensive procedure of counterfeit and pirated goods*[439] and *Regulation 1383/2003 concerning customs action against goods suspected of infringing certain intellectual property rights and the measures to be taken against goods found to have infringed such rights*[440]. The same is to be said for the *Directive 2004/48/EC of 29 April 2004 of the European Parliament and the Council on the enforcement of intellectual property rights*. It follows then that there is no clear obligation for Members' administrations enabling them to act against false, misleading or inaccurate origin marking[441]. On the contrary, the *Directive 2005/29/EC of the Council concerning unfair business-to-consumer practices in the internal market* mentions the commercial origin of products.[442] The purpose of this directive is to attain a high level of consumer protection[443]. Due to the different legislation

[438]See *Haus Kramer*, Case 312/98 and *Commission vs. Germany*, Case 325/00
[439] OJ 1994 L 341/8
[440] OJ 2003 L 196/7
[441] See the Commission Staff Working Document, *cit.*, p. 4
[442] OJ 2005 L 149/22
[443] Recital 1 of the directive

enforced at national level, the directive aims at approximating the laws currently in force in the Member States[444].

4.1 The EC proposal for a regulation on origin marking: suggestions from the Italian experience

The proposal of an harmonized origin marking system at EC level aims at first to improve certain EC industrial sectors' competitiveness by avoiding, or at least reducing, importation of goods that either bear no information about their geographical origin or carry false or misleading claims of origin. At the same time it would grant consumers informed buying decisions, allowing them to distinguish between products obtained according to the demanding EC standards and goods made in third countries whose legislation provides for less strict health, environmental and labour standards. Moreover, it would re-establish a level-playing field with the EC's major trading partners currently enacting mandatory origin marking requirements: as a matter of fact, EC exporters not complying with such requirements cannot export to these markets[445].

According to the proposed regulation, origin marking indication will be compulsory for certain goods imported from third countries[446]. The explanatory memorandum preceding the proposed regulations clarifies that the definition of the country of origin is to be based on the EC non-preferential rules of origin, as applied for other customs purposes. In order to limit the administrative burdens and unnecessary costs for the EC industry, origin marking will be mandatory only for those sectors for which origin indication constitutes a value added[447]. The annex to the proposed regulation lists all the products that are to be marked. Should origin marking be necessary and agreed for other categories of goods, the list contained in the annex can be further updated[448]. The proposed regulation will not be applied to fishery products and foodstuff covered by specific EC discipline. Goods of EC, Bulgarian, Romanian, EEA and Turkish origin and goods that cannot be marked for technical or commercial reasons are exempted from compulsory origin

[444] Recital 6 of the directive
[445] Recitals 2-4, 6 and 7 of the proposed regulation. European Commission Services, *cit.*; Commission Staff Working Document, *cit.*
[446] Proposal for a Council Regulation on the indication of the country of origin of certain products imported from third countries [SEC (2005) 1657]
[447] Mainly textile goods, footwear, ceramic products and furniture
[448] Art. 4 of the proposed regulation

indication[449]. The Commission can determine the case in which goods cannot or need not to be marked for such reasons[450]. Goods in travellers' personal luggage bought for personal use and not for commercial purposes are also excluded from marking[451].

As regards modalities of marking, the country of origin of goods shall be marked on imported goods; in case of packaged goods the marking is to be made separately on the package. For those goods that normally reach the consumer in their usual packaging, the Commission can determine cases in which marking on the packaging can avoid marking on the goods themselves[452]. As regards wording, the words "Made in…" followed by the name of the country of origin shall indicate the origin of goods[453]. Origin marking indication shall be in clearly legible and indelible characters and visible during normal handling.

The proposed regulation further clarifies that the origin indication shall be markedly distinct from other information and presented in a way which is neither misleading nor likely to create erroneous impression about the origin of the product[454]. This specification must be welcomed. In fact, according to the Italian experience, one major concern of both importing firms and customs authorities is the correct application of the requirements prescribed by the national legislation forbidding the use of misleading origin indications. The fact that a good of Chinese origin bearing the words “Made in Italy” is punished for bearing a false indication is right. It is also clear why a good bearing either words like “Italy”, or a sign, like the Italian flag, is considered to bear a misleading indication[455]. But in practice, in the absence of clear legal requirements or interpretative guidelines, it happens that the Italian customs authorities stop goods bearing the mere indication of the name and address of the producer. The fact that according to the current Italian practice, such indication is likely to be considered misleading to the extent to which it may suggest the Italian origin is troublesome. This practice should indeed be questioned. Unlike the French discipline, the Italian one does not allow Italian producers or importers to indicate, besides the name and address of the producer, the real substantial origin

[449] Art. 1.2 of the proposed regulation
[450] Art. 4 of the proposed regulation
[451] Recital 14 of the proposed regulation
[452] Art. 3.1 of the proposed regulation
[453] Art. 3.2 further provides that marking may be made in any official language of the European Community in order to be easily understood by the final customers in the member State in which the good is to be marketed.
[454]Art. 3.3 of the proposed regulation
[455] The difference of interpretation to be given to “false” and “misleading” origin marking indication has been clarified by a circular issued by the Italian customs administration, see table below, Circolare 20/D of May 13th, 2005.

determined by application of the non preferential origin rules[456]. As a result it may happen that goods bearing the name and the address of the producer and besides the words "Made in China" are at times considered to get the consumer confused. The lack of clear interpretation in this respect results in an incoherent, controversial and unpredictable implementation of the Italian legislation on origin marking.

In light of the discipline so far analyzed, it follows that imported goods not bearing origin marking or bearing a marking not correspondent to their non preferential origin are not in compliance. As a consequence the measures and penalties established at national level by each member State will apply following to infringements of the provisions of the EC regulation. The penalties applied at national level have to be notified to the EC Commission within 9 months after the entry into force of the regulation. Subsequent amendments made by a member State are to be notified without delay. This last provision is likely to leave room to a non homogeneous application of the regulation at level of customs controls upon importation, and to the possibility for the importers to import goods via the State providing for the most flexible legislation. Luckily the proposed regulation enables the Commission to determine the rules to be applied to goods that are found out of compliance.

The usefulness effectiveness of an EC discipline on origin marking strictly relies on the concrete application of the provisions. Should the EC member States not reach the necessary consensus to implement a compulsory origin marking scheme for imported products, an EC regulation providing at least for a uniform legal framework would be welcomed.

4.2 Legal issues related to an EC compulsory origin marking scheme

Following to the analysis of both the international legal framework related to marks of origin and the regulation proposed at EC, it is to be concluded the EC compulsory origin marking scheme provided for by the proposed regulation complies with art. IX of the GATT and the ARO[457].

One legal issue to be addressed is the consistency of an EC law providing for a compulsory origin marking regime for goods originating in countries that have a

[456]Law n° 350 of December 24th 2003 itself provides that indicating the real origin or provenance besides any sign or illustration that may suggest the Italian origin of the product could mislead the consumer!
[457]*Supra* 3

preferential trade agreement with the EU. As regards the enforcement of a national origin marking system on goods originating from other EC members the EC jurisprudence has always been unambiguous. As we've already seen, in several cases the ECJ has reaffirmed that a national origin marking obligation, though indistinctly applicable to domestic and imported goods, constitutes a measure having equivalent effect to a quantitative restriction being therefore inconsistent with the EC key principle of free circulation of goods contained in art. 28 of the EC Treaty.[458] It's important to determine if such interpretation of art. 28 can be extended to the trade relationships with countries having preferential trade agreements with the EC. Should the answer be affirmative, it would mean that an EC legislation providing for a compulsory origin marking on goods originating in these countries would violate the obligation on free circulation of goods contemplated by the free trade agreements.

The issue needs to be analyzed in light of the main findings of the *Turkish – Textiles* case[459], in which India challenged certain quotas that Turkey had imposed on textile imports from India. According to Turkey's defence, the imposition of such quotas had been necessary in sight of the Turkish accession into the customs union with EC. The key issue then is whether the Turkish measures could be justified under art. XXIV.

The Panel found the quantitative restrictions to be inconsistent with art. XI of GATT, regarding the elimination of quantitative restrictions and art. XIII concerning the non discriminatory administration of quantitative restrictions. The Turkish quotas were also inconsistent with art. 2.4 of the WTO *Agreement on Textiles and Clothing*[460]; according to this provision the restrictions applied at the time of entry into force of the ATC had to constitute the totality of the restrictions applied by Members and no new restrictions could be introduced in the trade textile products[461]. Turkey appealed this Panel's interpretation of art. XXIV. The Appellate Body partially rejected the perfunctory reasoning of the Panel and examined the issue in light of the meaning of the *chapeau* of paragraph 5 of art. XXIV

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[458] *Supra* 4

[459] Appellate Body Report, *Turkey – Restrictions on Imports of Textile and Clothing Products*, WT/DS34/AB/R. For an extensive analysis of this case see Dordi C. (2002), *La discriminazione nel commercio internazionale*, Milano, Giuffrè

[460] Hereinafter referred to as ATC

[461] *"With regard to the specific relationship between, in the case before us, Article XXIV and Articles XI and XIII (and Article 2.4 of the ATC), we consider that the wording of Article XXIV does not authorize a departure from the obligations contained in Articles XI and XIII of GATT and Article 2.4 of the ATC. Paragraphs 5 and 8 of Article XXIV do not … address any specific measures that may or may not be adopted on the formation of a customs union and importantly they do not authorize violations of Articles XI and XIII, and Article 2.4 of the ATC… We draw the conclusion that even on the occasion of the formation of a customs union, Members cannot impose otherwise incompatible quantitative restrictions*. Panel report, para. 9.86

which states that *"the provisions of this Agreement shall not prevent, as between the territories of the contracting parties, the formation of a customs union or a free trade are or the adoption of an interim agreement…*". The Appellate Body read the wording "shall not prevent" to mean that the provisions of GATT shall not make impossible the formation of a customs union, which means that under certain conditions the adoption of a measure inconsistent with other GATT provisions could be justified and invoked as possible defence to a finding of inconsistency[462]. The Appellate Body further noted that the text of the *chapeau* states that the provisions of GATT shall not prevent "the formation of a customs union" and that this wording indicates that art. XXIV can justify the adoption of a measure inconsistent with other GATT provisions only if the measure is introduced upon formation of a customs union and only to the extent that the formation of the customs union would be prevented if the introduction of the measure were not allowed[463]. In order to reinforce this point the Appellate Body recalled the interpretation to be given to the definition of customs union[464] and noted that art. XXIV.8 allows members of a customs union to maintain, where necessary, in their internal trade, certain restrictive regulations of commerce. In other terms, a certain flexibility is offered to the constituent members of a customs union when liberalizing their internal trade. The Appellate Body's analysis resulted in setting out a two-tiered test for assessing if art. XXIV may justify the application of the Turkish quotas. Turkey had to demonstrate, at first, that the quantitative restrictions had been introduced upon the formation of a customs union that fully meets the requirements of sub-paragraphs 8(a) and 5(a) of art. XXIV. Secondly, Turkey had to demonstrate that the imposition of quantitative restrictions had been necessary for the formation of the customs union. Regarding the first part of the test, the Appellate Body noted that the Panel had not addressed the question of whether the regional trade agreement between Turkey and the European Communities is, in fact, a customs union meeting the requirements provided for by art. XXIV. On the contrary, the Panel had assumed that such agreement is a customs union. Given that Turkey had not appealed this

[462] Appellate Body Report, para. 45
[463] Appellate Body Report, para. 46
[464] *"Sub-paragraph 8(a)(i) of Article XXIV establishes the standard for the internal trade between constituent members in order to satisfy the definition of a "customs union". It requires the constituent members of a customs union to eliminate "duties and other restrictive regulations of commerce" with respect to "substantially all the trade" between them. Neither the GATT CONTRACTING PARTIES nor the WTO Members have ever reached an agreement on the interpretation of the term "substantially" in this provision.[464] It is clear, though, that "substantially all the trade" is not the same as all the trade, and also that "substantially all the trade" is something considerably more than merely some of the trade."* Appellate Body Report, para. 48

point of the Panel, the Appellate Body did not rule on this issue[465]. Concerning the second condition to be met, Turkey asserted that had it not introduced the quantitative restrictions on some textile and clothing products from India, the EC would have excluded these products from free trade within the Turkey-EC customs union. Turkey underlined that its exports of textiles to the European Communities accounted for 40% of Turkey's total exports to the EC. For this reason, excluding textiles from the trade with the EC would have resulted in a disregard of the provision of art. XXIV, according to which duties and ORRCs are to be eliminated for substantially all the trade. The Appellate Body, though theoretically accepting this point of the Turkish defence, observed that there were other alternatives available to Turkey and the EC to meet the substantially-all-the-trade requirement[466]. Therefore, the Appellate Body concluded that Turkey had not fulfilled the second necessity condition and had not demonstrated that the formation of a customs union between EC and Turkey would have been prevented if it were not allowed to adopt the quantitative restrictions. Thus, in this case, the Turkish quotas had been found to be inconsistent with the provisions of art. XXIV[467]. Finally, the Appellate Body pointed out that it was making no finding on the issue of whether quantitative restrictions found to be inconsistent with article XI and XIII of GATT will ever be justified and that only the quantitative restrictions at issue in that specific appeal were not so justified.

As regards the scope of this analysis aimed at establishing if the Appellate Body's findings are to be applied to determine whether a compulsory origin marking system would be inconsistent with the provisions of art. XXIV of the GATT, the last conclusion of the Appellate Body is noteworthy. Nevertheless, this interpretation would be a forcing and is to be rejected for different reasons. First of all, quotas were the measures applied by Turkey, and found inconsistent with the provisions of art. XXIV by the Appellate Body. One of the main principles upon which the GATT/WTO system is based upon is the

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[465] Appellate Body Report, para. 60

[466] *"For example, Turkey could adopt rules of origin for textile and clothing products that would allow the European Communities to distinguish between those textile and clothing products originating in Turkey, which would enjoy free access to the European Communities under the terms of the customs union, and those textile and clothing products originating in third countries, including India. In fact, we note that Turkey and the European Communities themselves appear to have recognized that rules of origin could be applied to deal with any possible trade diversion. Article 12(3) of Decision 1/95 of the EC-Turkey Association Council, which sets out the rules for implementing the final phase of the customs union between Turkey and the European Communities, specifically provides for the possibility of applying a system of certificates of origin.[466] A system of certificates of origin would have been a reasonable alternative until the quantitative restrictions applied by the European Communities are required to be terminated under the provisions of the ATC. Yet no use was made of this possibility to avoid trade diversion. Turkey preferred instead to introduce the quantitative restrictions at issue."* Appellate Body Report, para. 62

[467] Appellate Body Report, para. 63

gradual phasing out of quantitative restrictions. On the contrary, marks of origin are explicitly allowed by art. IX of the GATT and by the WTO jurisprudence. Art. IX recognizes that origin marking systems aim at protecting consumer's interests and awareness. The main reason according to which extending the interpretation of art. 28 of the EC Treaty would be a forcing must be found in the uniqueness of the EC as a customs union in relation to the requirements of art. XXIV. Art. XXIV prescribes the elimination of duties and ORRCs for substantially all the trade. If it has been authoritatively asserted that this obligation regards also quotas[468], it cannot be disregarded that the concept of "measures having equivalent effect" has its major expression in the context of the EC, considered a unique example of customs union, to the extent to which it has achieved total internal free circulation of goods. The total internal free circulation of goods, realized within the EC internal market, is a concept going far beyond the substantially-all-the-trade requirement of art. XXIV. There is thus no reason to maintain that the enforcement of an origin marking system on products originating in countries partners of the EC in free trade areas is inconsistent with art. XXIV. An origin marking system would hardly constitute such a trade barriers as to be inconsistent with the provisions of art. XXIV that, as a matter of fact, by not providing for the elimination of duties and ORRCs on *all* trade, allows some flexibility. According to the same logic, the exclusion of origin marking on products originating in the countries that are acceding to the EC provided for by the proposed regulation is coherent. In fact, by acceding to the EC, the territories of Bulgaria, Romania and Turkey will constitute part of the EC customs territory and the concept of "measure having equivalent effect to quotas" will be extended to products originating in those countries. Thirdly, NAFTA constitutes a precedent[469] whose rightfulness has never been questioned. Finally, given the many countries to which the EC grants a preferential trade regime, excluding the products originating in those countries from the origin marking obligation provided for by the proposed regulation would empty the provision of an EC compulsory origin marking scheme of any meaning.

[468]See Sacerdoti G. (1994), *Nuovi regionalismi e regole del Gatt dopo l'Uruguay Round*, in Sacerdoti G:, Alessandrini S., *Regionalismo economico e sistema globale degli scambi*, Milano, Giuffrè, p. 13

[469]Art. 311.2 states that each party to NAFTA "may require that a good of another party, as determined in accordance with the marking rules, bear a country of origin marking, when imported into its territory, that indicates to the ultimate purchaser of that good the name of its country of origin", http://www.sice.oas.org/trade/nafta/naftatce.asp

ABBREVIATIONS

AGOA African Growth Opportunity Act
ARO Agreement on Rules of Origin
CAFC Court of Appeal for the Federal Circuit CAFC
CCC Customs Cooperation Council
CIT Court of International Trade CIT
CRO Committee on Rules of Origin
CTC change in tariff classification
DFQF duty-free quota-free
DDA Doha Development Agenda
DSU Dispute Settlement Understanding
EEZ Exclusive Economic Zone
FTA free trade area or free trade agreement
GATT General Agreement on Tariffs and Trade
GIR General Interpretative Rules
GSP Generalised System of Preferences
HWP Harmonization Work Programme
HRO Harmonized Non-Preferential Rules of Origin
MOU Memorandum of Understanding
MFA Multifibre arrangement
MFN Most favoured nation
SGA Selling, general and administrative
SPS Sanitary and Phytosanitary
TCRO Technical Committee on Rules of Origin
TDIs Trade Defence Instruments
TM technical method
VA value added method
VRA Voluntary Export Restraint

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