InBrief
No. 6I - April 2006

Comparing EU free trade agreements

Rules of Origin

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The aim of this *InBrief* series is to provide a synthesis of various chapters of the ten free trade agreements (FTAs) recently concluded by the European Union with developing countries, as well as other relevant trade agreements when appropriate. Each *InBrief* offers a detailed and schematic overview of a specific set of trade and trade-related provisions in these agreements.

Rules of Origin (RoOs) are an integral and increasingly important part of trade agreements, and are one of the main trade policy instruments that still remain, in the wake of the World Trade Organization's (WTO) quest to phase out tariff (and to some extent non-tariff) barriers.

As trade policy often requires the differentiated treatment of foreign goods entering a given domestic market, RoOs are used as a means of establishing the 'economic nationality' of goods and their eligibility under trade preference programmes. RoOs therefore provide guidelines for establishing the origin of goods, i.e. not just the source from where they have been shipped, but also the place where they are *deemed* to have been produced. This ensures that concessionary access to a given market benefits the intended recipient countries or regions rather than third-party countries. Major trade distortions would occur if RoOs depended solely on the geographic location from which goods are shipped, as producers would merely channel their exports to a given market via countries that enjoy the most favourable access to that market (in a process known as 'trade deflection'). From a development point of view, preventing trade deflection is the only legitimate - apart from being the original - rationale behind RoOs. However, current RoO regimes have increasingly gone beyond this key requirement and are seen by many stakeholders - especially in developing countries - as a form of protectionism that has led to an underusage of preferences and restricted market access.

Rules of Origin as a potential barrier to trade

By their very nature, RoOs are often elaborate sets of rules that apply in a non-homogenous manner across product categories. Owing to the vast array of often highly differentiated products featuring in international trade, RoOs attempt to capture all eventualities and product configurations. This means that the rules are often extremely complex and technical. RoOs therefore present the dual challenge of being frequently difficult to interpret, while at the same time prescribing origin configurations that may be geared more towards the industrial interests of host countries rather than those of the intended beneficiaries or trading partners. An example of the latter would be RoOs prescribing that a specific input material of a finished good *must* be sourced locally in order to provide that good with 'originating' status. Absence of the relevant local production capacity for such inputs would effectively render certain locally-produced finished goods (despite being covered by the trade agreement) ineligible for preferential market access.

The rapid integration of the world's economies accompanied by growing trade flows has led to increasingly fragmented production. Goods often undergo different stages of production in a number of countries, depending on their comparative advantages and particular industrial strengths. Added to that, new industrial configurations, in both producer-driven and buyer-driven value chains, have globalised production in many product categories. Raw materials may be grown or produced in one country, converted into finished goods in another, and offered for sale in a third. However, many RoOs do not fully recognise these (constantly changing) industrial configurations and can easily retard the effective utilisation of trade preferences. In fact, most preferential RoOs have not changed at all since their origins in the 1970s, while production structures and supply chain configurations have. As a result, many RoOs impede rather than facilitate preferential market access.

In practice, therefore, preferential access to a given market under a trade agreement is more limited than the product coverage may at first suggest. Adherence to specific RoOs often places a substantial burden on producers in exporting countries, who not

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only must be familiar with the specific rules pertaining to their export goods as well as the related administrative requirements, but may also be required to reconfigure the sourcing of inputs so as to become eligible for preferential market access. This would necessarily entail a diversion away from current sourcing configurations, which have most probably been put in place as being the most efficient and cost-effective options. Studies have shown that difficulties in the use of tariff-free market access can often be explained by the presence of restrictive RoOs. For instance, a recent UNCTAD study has shown that, in 1999, only a third of imports into the European Union (EU) that were eligible under the Generalised System of Preferences (GSP) actually entered the EU market with reduced duties.[1]

The European Commission recently published a Green Paper on the future of rules of origin in preferential trade arrangements with a view to encouraging a wide-ranging debate on the RoOs in its trade arrangements.[2]

Main elements of rules of origin

Origin criteria

RoOs contain various criteria for determining origin and hence preferential market access. There are numerous commonalities across the various RoO regimes that are applied worldwide, especially among the trade preference programmes that the EU is a party to. The RoOs of the EU's non-reciprocal preference programmes also contain shared principles. These programmes include the GSP for developing countries and the Cotonou Agreement for the African, Caribbean and Pacific (ACP) group of countries.

The overarching principle underlying the EU's RoOs in their various configurations is that goods are deemed to originate in the beneficiary country if they are 'wholly obtained' or if 'substantial transformation' has taken place. 'Substantial transformation' is deemed to have taken place if one of the following three criteria have been fulfilled:

1) *the minimum value added (VA) rule:* whether a prescribed minimum value has been added locally (in terms of a given percentage usually based on the ex-works price of the good);[3]
2) *the change of tariff-heading (CTH) rule:* whether the good has been substantially transformed to result in a different tariff heading to that of the input materials used; and
3) *the specific process (SP) rule:* whether prescribed processes have been undertaken in the production of the good in the preference-eligible exporting country. Associated with this latter point is the frequent listing of *insufficient processing activities* which on their own are unable to confer local origin on the good.

Cumulation

Cumulation is an important concept in RoOs and can determine the level at which countries are able to use the trade preferences available to them within a free trade agreement (FTA) or a unilateral preference programme. Cumulation refers to the extent to which production may be aggregated with other countries without losing originating status for the purposes of the applicable RoOs. In effect, cumulation is a derogation from one of the core concepts of origin, i.e. that of a product having to be 'wholly obtained' in the exporting country. The availability (or unavailability) of cumulation by extension can lead to trade enhancement, diversion or suppression.

Different forms of cumulation are provided for under the EU's preference programmes:

- Bilateral cumulation with the EU is the simplest form of cumulation, and merely provides for the use of EU-made inputs in the production of EU-destined goods made in the beneficiary country. Such cumulation therefore deems EU-inputs to originate in the exporting country for the purpose of qualifying under a trade preference programme.
- Diagonal cumulation is also provided for in the EU's trade preference programmes, and allows a limited use of intermediary inputs from third countries who are not party to a particular FTA to be counted as being of domestic origin. However, such diagonal cumulation is usually only possible following the conclusion of FTAs or administrative cooperation agreements between the cumulating countries. Diagonal cumulation certainly has the potential to significantly widen free trade areas by incorporating countries with established trade links. See also the comment on regional cumulation.
- Full cumulation refers to provisions that allow the unlimited use by the home country of inputs originating in certain other countries.[4]
- The EU's GSP contains a provision on regional cumulation (which is in effect diagonal cumulation with regions). This allows production to be cumulated among three predefined groups of developing countries (i.e. the SAARC, ASEAN and Andean Community countries).

All forms of cumulation (apart from bilateral cumulation) require compliance with certain administrative requirements between countries, as well as consistency with their RoO regimes.

Tolerance rules

All RoOs in EU FTAs and preferential trading arrangements contain tolerance rules, also known as *de minimis* rules. These allow manufacturers in countries that are party to an agreement to use non-originating materials up to a certain preset percentage value (usually based on the ex-works value of the final good) in the production of goods with originating status. Should the specific working or processing rule, as outlined earlier, already provide for the use of non-originating materials, the general tolerance rule cannot be used to exceed the percentage specified in the list rule.

Box 1 Rules of Origin and the WTO

In its role as the supervisor of the multilateral trading system, the WTO has devised a set of guiding principles relating to RoOs. These are found in the 1994 Agreement on Rules of Origin and in the work of related bodies and institutions (for instance, the Committee on Rules of Origin). The 1994 Agreement sets out basic principles on RoOs rather than detailed harmonised rules to be used by all WTO member countries. Furthermore, the Agreement relates only to RoOs used in non-preferential trade and not to those contained in regional and bilateral preferential trading arrangements. The Agreement also paves the way for a harmonisation programme to make RoOs more predictable, objective and understandable. Importantly, RoOs are supposed to be positive in their nature, i.e. they should state what does confer origin rather than what does not. This would remove some of the arbitrary interpretation often associated with RoOs. Work on RoOs at the WTO is ongoing, although several deadlines have already been missed. The eventual outcome may lead to a single set of RoOs, to be applied uniformly to all non-preferential trade by all WTO member countries.

For RoOs in the WTO, see www.wto.org/english/tratop_e/roi_e/roi_e.htm

Tolerance percentages in EU FTAs and non-reciprocal arrangements are generally set at either 10% (in the case of the GSP and all FTAs except that with South Africa) or 15% (in the case of the agreement with South Africa and the Cotonou Agreement).

Drawback provisions

Drawback refers to instances in which non-originating materials used in the manufacture of final goods having originating status (and subsequently exported) receive an exemption from or remission of import duties. The concept of drawback is an important one, as most RoOs contained in FTAs consider inputs from third countries to be ineligible for any special drawbacks of import tariff rebates if such inputs are used directly in the production of exports to the market of the preferential trading partner. These drawback provisions can thus act as a disincentive against the use of non-originating inputs from third countries, and in practice to some extent mitigate against the potentially more broad-based benefits that *cumulation* can provide. However, some EU FTAs (for instance, those with Morocco, Tunisia and Algeria), as well as the Cotonou Agreement and the EU GSP, contain no drawback prohibitions.

Documentary evidence

Common to all EU FTAs, as well as EU preferential regimes for other countries, is the need to adhere to the requirements relating to trade-related documentation. The agreements require the use of *EUR.1 movement certificates*, as well as associated declarations for shipments to the EU, to provide evidence of the originating status of the products shipped. EUR.1 forms are issued by the customs authorities of the exporting country, who verify the accuracy of the information contained in them.

Documentary evidence regarding the source of input materials used, and their originating status, is generally required to be kept for three years.

Summary

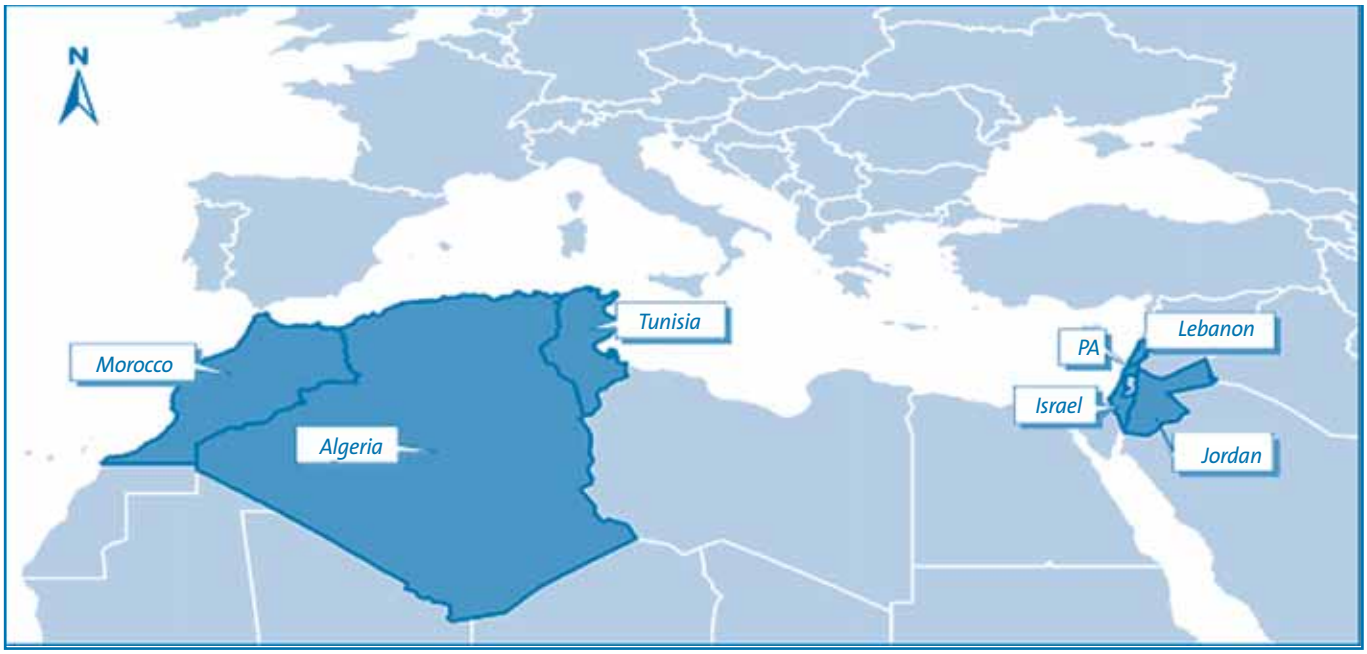
Rules of Origin are an integral and increasingly important part of trade agreements, and are one of the main trade policy instruments that still remain, in the wake of the WTO's quest to phase out tariff (and to some extent non-tariff) barriers. While the primary aim of RoOs is to ensure that preferences accrue only to the signatories of a preferential trade agreement, they are often complex and can act as a barrier to trade. RoOs contained in EU FTAs rely on the basic premise that goods must be 'wholly obtained' or 'sufficiently processed' in the party country in order to be granted originating status and thus become eligible for trade preferences. The main criteria used for deciding whether a good has been subject to sufficient local processing are the change in tariff heading rule (CTH), value-added criteria (VA) and specific processing (SP) rules. Further key features of RoOs are the degree of flexibility they provide for cumulating production with other countries, drawback rules that disallow the refund of import duties on non-originating materials, tolerance rules which provide flexibility with regard to local content, and administrative requirements associated with ensuring compliance with the RoOs.

Rules of Origin in EU FTAs, GSP and the Cotonou Agreement

The EU's trade preference programmes and FTAs are highly consistent with each other in terms of RoOs. The three types of preference programme covered by this *In*Brief are the bilateral and reciprocal EU FTAs, the non-reciprocal EU GSP covering developing countries and the non-reciprocal Cotonou Agreement applicable to select ACP countries.

The RoOs in the EU preference programmes and FTAs outline a mixture of SP, VA, and CTH criteria for different products, and at times a combination of these rules. Product-by-product rules are largely alike across the various FTAs and preferential programmes. Cumulation is also a central feature, with the GSP and the Cotonou Agreement currently providing the most extensive, and the FTAs with Chile and Mexico the most restrictive, opportunities for cumulation. All the agreements carry onerous administrative requirements and require inter-country RoOs to be met before allowing cumulation.

There are few drawback provisions, except in the FTAs with Chile and Mexico (delayed implementation) and in some of the Euro-Mediterranean (MED) Association



Agreements (e.g. with the Palestinian Authority). Tolerance levels with respect to non-originating content are highest in the Trade, Development and Cooperation Agreement (TDCA) with South Africa and in the Cotonou Agreement (15%). Table 1 lists the main features of the EU trade agreements and RoO regimes.

A brief review of some of the EU's trade agreements follows below, outlining some of the important features of their respective RoOs. The MED Association Agreements are grouped as one for this purpose, followed by the FTAs with South Africa (TDCA), Mexico, Chile, and the GSP and the Cotonou Agreement.

The Euro-Mediterranean Association Agreements

The EU and 12 Mediterranean countries have negotiated a number of Association Agreements since the first Euro-Mediterranean Conference held in November 1995. The overall objective is to form, by 2010, a single Euro-Mediterranean Free Trade Area out of the separate agreements that are currently in force. To date, bilateral Association Agreements (MED Agreements) have been concluded with seven countries: Tunisia (1995), Israel (1995), Morocco (1996), Jordan (1997), the Palestinian Authority (1997), Algeria (2001) and Lebanon (2002).

In terms of the trade aspects relating to RoOs, the agreements are largely consistent with each other and follow a similar pattern. Some of the core features of the respective RoOs discussed here are thus applicable to each agreement.

Origin criteria

Common to all MED Agreements is the notion of 'originating products', as the agreements provide for preferential market access to be granted only to goods that originate in the respective territories. Originating status is extended to wholly obtained products (i.e. manufactured entirely from locally-produced or grown inputs) and to products whose non-originating component has undergone 'sufficient working or processing'.

The conditions that have to be met in order to obtain originating status consist of a mixture of CTH, VA and SP criteria, and are described in annexes to the agreements. The majority of rules apply SP criteria to non-originating products in order for the final product to be deemed to be originating. A smaller number of items are based on the CTH principle, and a few on the VA principle. Of all the MED Agreements, only the EU-Tunisia Agreement specifically contains the general option of using the CTH criterion (Protocol 4, Article 7.1), although it qualifies this (in Article 7.2) by stating that this option is not applicable to items listed in Annex II. Most goods are listed in this Annex.

Notwithstanding the criteria referred to above, some MED Agreements provide for up to 10% by value of the ex-works price of the final good to consist of non-originating inputs (under the tolerance or *de minimis* rule). This does not apply to harmonised system chapters HS50 to 63 covering textile and clothing goods, although this exception is not included in the agreements with Morocco, Tunisia and Algeria. However, where specific VA rules for a given product determine that a different percentage is applicable, such specific rules take precedence over the general 10% rule.

Cumulation

The MED Agreements provide only for *limited* cumulation, generally allowing only bilateral cumulation with the EU and vice versa (cumulation with third countries is possible if the non-originating inputs have undergone sufficient working and processing). The EU's bilateral agreements with Tunisia, Morocco and Algeria provide for additional cumulation. Each of these agreements provides scope for limited *diagonal* cumulation, under which Tunisia may cumulate with Morocco and Algeria, and vice versa. However, such goods must have undergone working or processing that goes beyond that referred to in Article 8(1) of the respective agreements. Article 8(1) of Protocol 4 lists operations that are deemed insufficient to confer the status of originating products, whether or not there is a change of tariff heading.

Recent developments in connection with cumulation include 'Pan-Euro-Mediterranean cumulation of origin', which extends pan-European cumulation (in its current limited scope) to all Mediterranean countries having preferential trade agreements or arrangements with the EU. This concept, which was endorsed by EU and Mediterranean trade ministers in mid-2003, will see the current protocols on RoOs replaced by a 'pan-Euro-Mediterranean' protocol. This would apply to both the bilateral agreements with the EU and the agreements between the partner countries (similar RoOs between beneficiary countries being a necessary condition for diagonal cumulation).

Summary

The agreements with Tunisia, Algeria and Morocco have marginally more flexible RoOs than those with the other MED countries, in that they provide for diagonal cumulation among each other, have no drawback rules and allow slightly greater flexibility with respect to tolerance rules. Current developments should see the adoption of pan-European RoOs leading to the replacement of current RoOs with new rules providing for greater diagonal cumulation.

The EU-South Africa TDCA

A Trade, Development and Cooperation Agreement (TDCA) was concluded with South Africa in 1999, and has been in force provisionally and partially since January 2000, and fully since May 2004.

Origin criteria

The TDCA origin rules also consist of a mix of CTH, VA and SP criteria, not unlike the MED Agreements. A few examples: *edible fruit* (Chapter HS08) must be wholly obtained locally (an SP requirement...), and where relevant the value of any non-originating materials used, as listed in Chapter HS17 (sugar products), must not exceed 30% of the ex-works price of the final product (...combined with a VA requirement). For *smoking tobacco* (HS 2403) to be granted originating status, at least 70% by weight of the un-manufactured tobacco used must already be originating (VA). Articles of clothing (woven, classified in HS62) are generally required to be manufactured from yarn (SP). *Tin articles* (HS80) must be manufactured from materials that are classified under a different heading to that applying to the product, while the value of non-originating materials used may not exceed 50% of the ex-works price of the product (a mixture of CTH and VA requirements).

Notwithstanding the various product-specific criteria, the TDCA provides for up to 15% by value of the ex-works price of the final good to consist of non-originating inputs (under the tolerance or *de minimis* rule). However, for products listed in Chapters HS03 to 24 (agricultural products) and selected products in HS01 (live animals and animal products) and HS02 (vegetable products), the permissible maximum for non-originating inputs is 10%. Any product-specific ceilings for non-originating inputs still take preference, however. This waiver does not apply to Chapters HS50-63, covering textile and clothing goods.

Cumulation

The TDCA allows bilateral cumulation between South Africa and the EU, diagonal cumulation with other ACP countries (Protocol 1, Article 3 (1-7)), as well as full cumulation with countries that are members of the Southern African Customs Union (SACU). For bilateral cumulation, it is not necessary for input materials sourced in either the EU or South Africa and used in the production of goods destined for each other's markets to have undergone any *specific* processing. Nonetheless, processing needs to go beyond *insufficient* working or processing operations as described in Article 6 (examples of insufficient processing include operations to ensure the preservation of goods during transport and storage, affixing of marks and labels, simple assembly of parts to constitute a complete product and the slaughter of animals.)

However, diagonal cumulation also requires that the value added in the EU or South Africa has to *exceed* the value added in any one of the ACP states, unless such goods are sufficiently further processed in the EU or South Africa and have thereby achieved originating status (this requirement does not apply in the *full* cumulation provision relating to SACU). Also, diagonal cumulation with ACP states is only possible if ACP materials have acquired originating status by the application of RoOs in the Fourth Lomé Convention, and if the formal notification requirements amongst the FTA partners have been satisfied. In practice, therefore, diagonal cumulation is somewhat more difficult to achieve than would at first appear to be the case.

Documentary evidence

In the TDCA, an invoice declaration (instead of an EUR.1 certificate) is sufficient for use by 'approved exporters' (Art. 20) or for shipments whose value does not exceed EUR 6,000 in value. 'Approved exporters' are exporters who are so approved by their customs authorities, normally as a result of their making frequent shipments under this trade agreement, who have been allotted a unique customs authorisation number, and have satisfied their customs authorities that they fulfil all relevant conditions with regard to the originating status of their exports.

Summary

Compared with other EU FTAs, the TDCA in some respect contains marginally more liberal RoOs, especially with regard to cumulation, tolerance rules and drawback. The Agreement provides for bilateral (with the EU), diagonal (with the ACP countries) and full (with the SACU) cumulation, and makes no mention of drawback rules that would disallow the claiming back of import duties paid on non-originating materials used for subsequent export. Tolerance levels for non-originating materials are set at 15% for most goods, which is the highest level in all EU FTAs.

The EU-Mexico Global Agreement

The Economic Partnership, Political Coordination and Cooperation Agreement, also known as the Global Agreement, between the EU and Mexico was signed on 8 December 1997 and came into force in October 2000.

Origin criteria

The EU-Mexico RoOs contain a mix of CTH, VA and SP criteria, as is the case with other EU FTAs. The SP requirements are largely consistent with the FTAs mentioned above. A notable difference relates to woven garments listed in HS62, in relation to which producers can choose to comply with either of two parallel origin criteria. The first relates to the usual two-stage transformation (for example, manufacture from yarn, or unembroidered fabric subject to VA limitations), while the second set of options relates to completing two *preparatory* or *finishing* operations (for example, scouring and bleaching) in addition to printing (provided that the value of the unprinted fabric does not exceed 47.5% of the ex-works price of the printed fabric - a VA component).

In practice, this suggests that manufacturers can qualify for originating status for their products by using plain garments produced elsewhere, and performing printing operations as well as, for example, scouring and bleaching, or shrink resistance processing and impregnating. This choice of criteria relating to woven garments is unique among the EU preference programmes covered by this report. However, this rule did not come into force until *after* 31 December 2002, and until that time garments had to be manufactured from yarn (with respect to natural yarns) or man-made staple *fibres*. This option does not apply to (knitwear) garments listed in chapter HS61.

The EU-Mexico Agreement also provides for up to 10% by value of the ex-works price of the final good to consist of non-originating inputs (under the tolerance or *de minimis* rule). As in the other agreements, this waiver does not apply to Chapters HS50-63, covering textile and clothing goods. Any non-originating materials used may not be subject to drawback (Article 14).

Cumulation

The agreement allows bilateral cumulation between Mexico and the EU (Annex III, Article 3 (1-2)). It is not necessary for input materials sourced in either the EU or Mexico and used in the production of goods destined for each other's markets to have undergone any *specific* processing. On the other hand, they must go beyond the *insufficient* working or processing operations described in Article 6(1).

Documentary evidence

As in the TDCA, an invoice declaration (instead of an EUR.1 certificate) is sufficient for use by 'approved exporters' (Article 20) or for shipments whose value does not exceed EUR 6,000.

Summary

Mexico's FTA with the EU contains RoOs that are largely similar to those contained in other EU FTAs. However, in a number of instances, the rules contain provisions that

are less flexible than those found elsewhere, especially with regard to cumulation and drawback. Cumulation is only allowed on a bilateral basis (i.e. between the EU and Mexico), while drawback is disallowed from 2003 onwards (two years after the inception of the agreement).

The EU-Chile Association Agreement

The most recent FTA concluded by the EU is that with Chile, signed in November 2002. Besides covering political dialogue and cooperation issues, the trade chapter in the EU-Chile Association Agreement stands out as being the most advanced in EU bilateral agreements. The provisions on RoOs, though, closely resemble those in the agreements concluded with South Africa and Mexico.

Origin criteria

The Chile-EU FTA origin criteria are consistent with those in other EU FTAs, containing a mixture of CTH, VA and SP rules. Specific processing requirements are also largely consistent with other EU FTAs. A small number of goods (mainly textile articles) qualify for apparently more liberal origin for a period of three years (for example, felt hats may contain up to 50% non-originating materials as opposed to the CTH criteria of having to be manufactured from yarn or textile fibres). These alternate conditions are contained in Annex II(a) to the agreement.

A *de minimis* rule allows up to 10% by value of the ex-works price of the final good to consist of non-originating inputs. This waiver does not apply to Chapters HS50-63, covering textile and clothing goods. A suspensive condition relates to drawback, which is effectively only prohibited four years after the agreement's entry into force in 2007.

Cumulation

The agreement allows bilateral cumulation between Chile and the EU (Annex III, Article 3 (1-2)). It is not necessary for input materials to have undergone sufficient working or processing. Nonetheless, they must go beyond insufficient working or processing operations as described in Article 6(1). This is consistent with the EU's other FTAs. No provision is made for diagonal cumulation with third countries.

Documentary evidence

The requirements relating to the preservation of proof of origin and supporting documents are contained in Article 27 of Annex III to the agreement, and are consistent with the other EU FTAs (e.g. those with Mexico and South Africa).

Summary

The RoOs contained in Chile 's Association Agreement with the EU are largely similar to those in the Global Agreement with Mexico. A differentiating aspect is the fact that drawback rules only come into play from 2007 onwards, and minor differences exist in the tolerance rules relating to textiles and apparel.

The EU Generalised System of Preferences (GSP)

The EU GSP is a system of tariff preferences granted by the EU to products originating in developing countries. These preferences reduce (often to 0%) the tariff rate applying to goods entering the EU market. As part of the GSP, least developed countries (LDCs) are granted, under the EU's 'Everything-But-Arms' initiative (EBA), duty-free and quota-free access for all goods except arms, and including bananas (for a transitional period to 2006), sugar and rice (to 2009). The origin criteria in the EU GSP are identical to the EBA criteria. The EU GSP broadly covers most industrial goods (HS 25-97), while coverage of agricultural goods (HS 1-25) is more restricted. The EU GSP runs in ten-year cycles, the current cycle having begun in 1995. The EU is currently compiling guidelines for the next ten-year period, which will run from 2006 to 2015.

The EU GSP is modelled in accordance with principles agreed at the second United Nations Conference on Trade and Development (UNCTAD II, 1968). It is a facility for developed countries to grant preferential market access to exports from developing countries on a non-reciprocal basis. The European Community was the first to implement a GSP scheme over 30 years ago in 1971. Currently, there are five 'types' of GSP access, namely a general system for all beneficiary countries, the 'Everything But Arms' initiative for LDCs, and three special arrangements for combating drug trafficking, protecting labour rights and promoting environmental protection.

Origin criteria

Like the RoOs in other EU FTAs and preferential trade programmes, the RoOs in the EU GSP use CTH, VA and SP criteria for determining the origin of goods. Hence, products not wholly obtained in the beneficiary country have to be sufficiently worked or processed (as determined by the CTH/VA/SP criteria) to be deemed to originate in the beneficiary country and thus qualify for preferential treatment. It must be stressed that, as is the case with other RoOs, the GSP requires only the non-originating components to undergo sufficient working and processing. Certain types of working and processing are deemed insufficient to confer originating status on the good, such as simple painting and polishing operations, or breaking-up and assembly of packages.

Specific requirements in sample categories (for instance, edible fruit, tobacco, woven articles of clothing and articles made of tin) are consistent with the RoOs in the EU's FTAs and preference programmes.

LDCs (as listed in the EU GSP regulations) may apply for derogations from certain RoO requirements, if they face clear compliance difficulties and if this is justified by the growth needs of existing industries (or in order to establish new ones). However, this requires a formal and fairly elaborate application process, and only three countries (i.e. Laos, Cambodia and Nepal) have currently obtained derogations for certain textile

products. These allow them to use certain materials at a later stage of development while also lifting certain VA criteria.
A *de minimis* rule provides for up to 10% by value of the ex-works price of a good (non-clothing categories only) to consist of non-originating materials (provided that the value does not exceed any given percentages in the product-specific 'list' rules). This is consistent with the MED Agreements and the FTAs with Mexico and Chile (although the percentage is lower than those quoted in the TDCA and the Cotonou Agreement). An additional concession to GSP beneficiaries is the absence of a drawback rule (Title IV, Article 14 of the GSP).

Cumulation

The EU GSP allows both bilateral cumulation and limited diagonal cumulation among certain predefined regional groups of countries. This applies equally to the EBA initiative. The countries in question are:

- the 10 countries of the Association of Southeast Asian Nations (ASEAN);
- the 11 countries of the South Asian Association for Regional Cooperation (SAARC); and
- the 11 countries of the Andean Community.

Regional cumulation provides for countries within these groupings to freely use materials sourced from one another, although originating status is only conferred on goods shipped from the exporting country, provided that the value added by the latter exceeds the value added in any one of the other regional partner countries. If this criterion is not fulfilled, the good is deemed to originate in the country where the highest percentage of value is added, and will be subject to any GSP restrictions imposed on that country. A further requirement involving regional cumulation is the prior conclusion of administrative cooperation agreements between members of a group. Also, procedures must have been put in place to certify the origin each time goods are shipped between members of the group.

Documentary evidence

Two principal forms of documentary evidence are required under the GSP RoOs, namely a certificate of origin (Form A; Article 81 and Annex 17) and a certificate of movement (EUR.1; Article 90a and Annex 21). For shipments of low-value GSP exports (i.e. worth less than EUR 6,000) an invoice declaration is sufficient (Article 89 and Annex 18). Appendix IV of the EU GSP contains sample copies of the required documentation and forms.

Summary

EU GSP rules are generally valid for a period of ten years, after which they are overhauled. The current regime expires in 2005. Both bilateral and regional cumulation is possible among certain country groupings, i.e. the Andean Community, the SAARC and the ASEAN countries. RoOs under special dispensations applicable to least developed countries (under the EBA initiative, for example) contain no quantitative restrictions or tariffs, but are otherwise the same as the EU GSP. Tolerance levels are set at 10%, and there are no provisions prohibiting drawback. In contrast to EU FTAs, additional documentation ('Form A') is required for goods claiming GSP preferences.

The ACP-EU Partnership: the Cotonou Agreement

The Cotonou Agreement was signed in 2000 between the EU and 77 African, Caribbean and Pacific (ACP) countries, most of whom are former colonies of EU member states. It follows on from four previous non-reciprocal agreements known as Lomé Conventions (I-IV respectively). What distinguishes the Cotonou Agreement from the old Lomé Conventions is the fact that the current agreement seeks to change the basis of trade relations, by moving from non-reciprocity to reciprocity. It does so by introducing the concept of regional economic partnership agreements (EPAs) and by seeking to ensure that trade relations between ACP countries and the EU are WTO-compatible (Article 36(1) and (4)).

Negotiations on EPAs started in September 2002. These are due to enter into force by 2008 at the latest (Article 37.1 of the Cotonou Agreement). Until that time, the current trade preferences and RoOs will remain in force.

Origin criteria

The RoO criteria in the Cotonou Agreement (which are based on Lomé IV) are largely consistent with other EU FTAs and contain a mix of CTH, VA and SP criteria. They are set out in Annex V to the agreement. Specific processing requirements of sample product categories are broadly similar to those described in the other EU FTAs. A separate annex (Annex IX) contains a list specifically relating to textiles and clothing when working is carried out on textile materials originating in other ACP developing countries.

The Cotonou Agreement contains a *de minimis* rule (Protocol 5, Article 4.2) which allows the use of non-originating materials up to a maximum of 15% of the ex-works price of the product. This percentage (identical to that quoted in the TDCA) is higher than the 10% threshold laid down in the FTAs between the EU and Chile, Mexico and the MED Countries, whose tolerance threshold for non-originating materials is 10%.

Unlike other EU agreements (with the exception of the GSP), the Cotonou Agreement also applies the de *minimis rule* to textiles and clothing products (HS 50-63).

Cumulation

The agreement allows bilateral cumulation between ACP countries and the EU, and makes provision for diagonal cumulation with South Africa (Annex V, Article 6). Limited cumulation is also provided for with certain 'neighbouring developing countries belonging to a coherent geographic entity'. Full cumulation is permitted between ACP countries, since technically they are considered as being 'one territory' (Title II, Article 2).

The agreement attaches extensive conditions to cumulation with non-ACP countries (as well as South Africa), which may be summed up as follows:

- Materials originating in South Africa may be used without further processing, but the value added in the ACP country must exceed the value added in South Africa. This cumulation only applies after 3-6 years following the conclusion of the TDCA and does not apply to all products (as listed in Annex XIII). Also, this cumulation is only possible after the lifting of tariffs on these products agreed between the EU and South Africa, and following publication in the *Official Journal of the European Communities* of the date on which these conditions have been met. South African materials must also have obtained originating status by application of RoOs identical to those set out in the Cotonou Agreement.
- Cumulation with materials originating in 'neighbouring developing countries, other than an ACP state, belonging to a coherent geographical entity' is possible, but requires the prior conclusion of administrative agreements between the ACP countries, the EU and the affected neighbouring countries. For products listed in HS50-63 (textiles and clothing), CTH processing must also subsequently take place in the ACP country, while a further Annex prescribes the working or processing required on certain of the textile and clothing products listed in HS50-63.

Despite the flexibility with respect to cumulation with South Africa, the conditions and

administrative requirements mean that diagonal cumulation is difficult to achieve in practice.

Documentary evidence

The requirements relating to the preservation of proof of origin and supporting documents are set out in Article 28 of Protocol V of the agreement, and are consistent with the EU FTAs (i.e. the use of EUR.1 movement certificates and three-year preservation requirements for the documents).

Summary

Despite its non-reciprocal nature, the RoOs in the Cotonou Agreement are similar to those in the various EU FTAs, although some provisions are significantly more flexible. Cumula-tion is provided for on a bilateral and diagonal basis with South Africa (three years after the conclusion of the TDCA and subject to additional postponement clauses and conditions) and regionally with certain predefined 'neighbouring developing country groupings', subject to the observance of certain administrative procedures. Tolerance levels are set at 15% with no special mention of the textile and clothing sectors, making this the highest tolerance level (together with South Africa) of all EU trade preference programmes.

Synthesis of main features

The EU FTAs and trade preference programmes display a high degree of consistency and similarity. In most cases, there are few differences between non-reciprocal and (negotiated) reciprocal agreements, although non-reciprocal preference programmes are clearly aimed only at the developing and least developed countries (for instance under the GSP or Cotonou Agreement).

The basic premise underlying the RoOs in EU FTAs is the concept of determining the ***originating status*** of goods that are 'wholly obtained' or 'sufficiently processed' in one of the countries that are party to an agreement. While the originating status of 'wholly obtained' goods is usually clear cut, a combination of comprehensive rules, based on SP, VA and CTH criteria, have been devised to underscore what constitutes sufficient working or processing. While only one of the criteria is prescribed in most instances, a combination of, and sometimes a choice between, qualifying criteria is offered in other instances. A few sample product categories used for comparison purposes revealed a very high degree of correlation among the seven MED Agreements, the three FTAs with South Africa, Mexico and Chile, and the non-reciprocal trade regimes (the GSP and the Cotonou Agreement). Instead of stipulating a uniform local content criterion (for example), the various RoOs are relatively onerous and place a significant burden on producers and other economic agents in exporting countries.

Augmenting the RoO principles are tolerance levels which, as the name implies, allow a certain measure of deviation from the principle that all materials used must be originating. The tolerance rules in the EU-South Africa FTA and the Cotonou Agreement are the most liberal (at 15%), while those in the other EU FTAs and the GSP are set at 10%. The textile and clothing sector, which is particularly sensitive and is thus subject to additional protection in FTAs, is specifically excluded from these tolerance levels, except in the Cotonou Agreement and the GSP, which contain no reference to such a limitation.

The principle of *cumulation* amounts in effect to a derogation from the basic premise that goods have to be 'wholly obtained' in the home country. The availability (or unavailability) of cumulation can have a significant impact on the extent to which countries are able to take advantage of trade preferences.

A significant degree of variance was found among the various agreements. Both the TDCA and the Cotonou Agreement offer the greatest flexibility: both provide for bilateral (with the EU) and diagonal (with 78 ACP countries) cumulation. In addition, the TDCA offers full cumulation with members of the SACU, while the Cotonou Agreement provides for full cumulation among ACP countries, diagonal cumulation with South Africa (three years after the inception of the TDCA), and limited regional cumulation with certain 'neighbouring developing countries'. A number of clothing categories are, however, excluded from the general cumulation provisions. The GSP allows limited regional cumulation with certain developing country groupings, while the MED Association Agreements mostly offer bilateral cumulation (with the exception of Tunisia, Morocco and Algeria, which may cumulate with each other). The EU-Mexico and EU-Chile Agreements offer the least flexibility, and provide only for bilateral cumulation.

The no-drawback rule is an important provision in certain EU FTAs. As trade in goods between partners of an FTA is no longer interpreted as 'exports' for the purposes of drawback laws, (non-originating) imported materials obtained from third countries and used in the manufacture of exports to the

FTA partner may not receive any refunds of import tariffs originally paid on them. While drawback rules are a feature in many FTAs worldwide, the FTAs under discussion here are only partly exposed to drawback prohibitions. The MED Association Agreements (with the exception of those with Tunisia, Morocco and Algeria) disallow drawback, while the EU-Mexico FTA disallows it from 2003 onwards and the EU-Chile FTA disallows it from 2007 onwards. No mention of drawback is made in the TDCA, the GSP or the Cotonou Agreement.

Administrative requirements, encompassing documentary evidence, proof of origin and customs procedures are fairly onerous across all FTAs. While the original aim is to avoid transhipment and FTA benefits accruing to unintended third countries, they may also serve to protect the interests of the preference-giving country. Nonetheless, they place a significant burden of compliance on exporters, and are frequently seen as a reason for goods that are ostensibly eligible for preferences not receiving preferential market access. Countries such as the United States and Canada generally impose less stringent documentary requirements. Unlike the EU, which only accepts origin declarations issued by government authorities, the latter allow declarations by exporters and certain non-governmental bodies, thus essentially shifting the burden of proof to the importer.

On the whole, there is a high degree of consistency among all the EU's FTAs and preferential trade regimes. The actual requirements for being recognised as 'wholly obtained' or 'sufficiently transformed' and thus originating are largely the same on a product-by-product basis. The main differences among RoOs are with regard to cumulation, tolerance rules and drawback provisions, where, on the whole, the EU-South Africa TDCA displays the greatest degree of flexibility.

Table 1: Main features

	MED	TDCA	Mexico	Chile	GSP	Cotonou
Origin criteria						
Wholly obtained/ sufficiently processed	✓	✓	✓	✓	✓	✓
List rules	✓	✓	✓	✓	✓	✓
Combination of CTH, VA and SP	✓	✓	✓	✓	✓	✓
Cumulation						
Bilateral	✓	✓	✓	✓	✓	✓
Diagonal	Yes (Tunisia, Algeria and Morocco only) Pending: New rule covering diagonal cumulation among all EU-MED countries	Yes (with ACP countries), subject to certain conditions Full (with SACU countries only)	No	No	No	Yes, with South Africa, three years after TDCA (subject to certain conditions)
Regional					Yes (three predefined country groups only)	Yes, with neighbouring developing countries (limited and onerous conditions)
Drawback	Disallowed, except in agreements with Tunisia, Morocco and Algeria	No provision	Disallowed from 2003	Disallowed from 2007	No provision	No provision
Tolerance / *de minimis*	10% excluding textiles and clothing; does not apply to Tunisia, Morocco and Algeria	15% excluding textiles and clothing; 10% for certain agricultural categories	10% excluding textiles and clothing	10% excluding textiles and clothing and products listed in Appendices II and IIa	10%	10%
Documents	EUR.1 / Invoice Declaration	EUR.1 / Invoice Declaration	EUR.1 / Invoice Declaration	EUR.1 / Invoice Declaration	EUR.1 / Certificate of Origin Form A / Invoice Decl.	EUR.1 / Invoice Declaration

Notes

1 *See UNCTAD (2004).*
2 *European Commission (2003).*
3 *'Ex-works price' means the price paid for the product ex works (i.e. available from the seller's premises) to the manufacturer in a Contracting Party in whose undertaking the last working or processing is carried out, provided the price includes the value of all the materials used, minus any internal taxes which are, or may be, repaid when the product obtained is exported.*
4 *For instance, this is a feature of the Trade, Development and Cooperation Agreement (TDCA) with South Africa in relation to cumulation among countries that are members of the Southern African Customs Union (SACU). Alternatively, in the Cotonou Partnership Agreement, all ACP countries are seen as a single territory for cumulation purposes and may thus freely use each other's inputs.*

Acronyms

ACP	African, Caribbean and Pacific states
ASEAN	Association of Southeast Asian Nations
CTH	Change in Tariff Heading
EBA	Everything-But-Arms
EU	European Union
FTA	Free Trade Agreement
GSP	Generalised System of Preferences
HS	Harmonised System
MED	Mediterranean
RoO	Rules of Origin
SAARC	South Asian Association for Regional Cooperation
SACU	Southern African Customs Union
SP	Specific Processing
TDCA	Trade, Development and Cooperation Agreement
VA	Value-Added
WTO	World Trade Organization

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This *InBrief* series on trade is an initiative by the European Centre for Development Policy Management (ECDPM), under the editorial supervision of Sanoussi Bilal (sb@ecdpm.org).

This *InBrief* on Rules of Origin has been developed in cooperation with International Lawyers and Economists Against Poverty (iLEAP).

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The ECDPM acknowledges the support it receives for the *InBrief* from the Ministries of Foreign Affairs in Sweden, Finland, The Netherlands and Ireland, the Directorate-General for Development Cooperation in Belgium, the Swiss Agency for Development and Cooperation, the Instituto Português de Apoio ao Desenvolvimento in Portugal and the Department for International Development in the United Kingdom.

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ISSN 1571-7542