

**MULTILATERAL TRADE
NEGOTIATIONS
THE URUGUAY ROUND**

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Group of Negotiations on Goods (GATT)

Negotiating Group on Non-Tariff Measures

RULES OF ORIGIN

Background Note by the Secretariat

Introduction

1. At its meeting of 9 May 1988, the Negotiating Group requested the secretariat to prepare a background note on the administration of rules of origin, related GATT provisions and past discussion on the subject in the GATT (MTN.GNG/NG2/7, paragraph 8).

Background

2. Rules of origin are laws, regulations and administrative practices which are used to identify the country of origin of internationally traded goods. Rules of origin may be needed either because countries treat their imports differently depending on their origin, or in order to fulfil some specific objective of an administrative nature.

3. Some countries apply different rates of duty to imports, depending on whether or not these originate in countries to which they grant most-favoured-nation treatment. Furthermore, many countries participate in preferential trade arrangements such as free-trade areas, the Generalized System of Preferences, the Protocol of Trade Negotiations among Developing Countries, under which lower or zero rates of duty are applied to products originating in the country or countries benefiting from the preference. Many countries have therefore adopted rules of origin enabling them to identify the products which are entitled to preferential treatment. For instance, in the absence of rules of origin, trade deflection might be caused in free trade areas, where each member country applies its own tariff, by imports into the area through a member country having a lower tariff than the others. However, it may be noted that no such risk exists in the case of customs unions, since except in their transitional phases, they apply a common external tariff to imports originating from third countries. Rules of origin may also be necessary in countries which apply to imports of some products from some countries, quotas, other quantitative restrictions or measures such as anti-dumping or countervailing duties, in order to identify the products originating in the countries to which these measures apply.

4. Some national legislations may require that all imports be marked to indicate the country of origin of the imports, in which case the legislation will also define origin for that purpose.

5. Finally, rules of origin may also be needed for the purpose of keeping import statistics on a country-by-country basis.

Rules of origin and their administration

6. Detailed information on the rules of origin maintained by a number of countries can be found in the Customs Co-operation Council's "Compendium of Origin of Goods" and, for the GSP, the "Digest of Rules of Origin" prepared by UNCTAD and UNDP as part of a project on assistance to developing countries for the fuller utilization of the system.

7. Most rules of origin distinguish between imported products wholly mined, grown, fished or produced within the territory concerned and those which use material or components imported from a third country outside that territory. In the latter case, the importing country will want to know whether sufficient processing has occurred to create a new product in the country from which the product will be deemed to have originated. Rules of origin which serve that purpose generally use one or the other of the following criteria, or sometimes a combination thereof:

- (a) the value-added criterion which requires that a certain percentage of the value of the traded product be added in the country from which the product will be deemed to have originated;
- (b) the change in tariff heading criterion which requires that for origin to be conferred in a particular country, goods must have undergone sufficient transformation in that country for their tariff heading to be different from those applicable to them when they first entered the country.

8. However, neither of these criteria can be described as problem-free. A frequently mentioned weakness of the value-added criterion is that it lays down an arbitrary cut-off point. If for instance, the rule of origin requires that 50 per cent of the value of a product must have been added in a country for it to qualify as the country of origin, a product will be disqualified even if it fails to meet the cut-off point by very little. Another point often made is that the value-added criterion discriminates against developing countries whose labour costs are lower than those of industrialized countries, since it is therefore more difficult for their products to reach the required percentage of value added. The change-of-tariff-heading criterion's main weakness is that tariff nomenclatures on which it relies have not been developed for the purpose of identifying origin and may therefore lead to an unsatisfactory result. In particular, it is said that components imported from different sources can receive a different tariff-heading after very little processing

and a mechanical application of the rule may lead to origin being conferred to a country even though the traded product has not undergone much transformation in that country. For these reasons, some countries using this criterion have to either exclude some transformation operations not deemed sufficient to confer origin or list processes which are required to have been accomplished in a given country for it to be deemed country of origin.

9. Many rules of origin also require the direct consignment of goods, i.e. that a product be shipped directly from the place of final processing to its destination, in order to be eligible for differential treatment. Some rules of origin allow the cumulation of part of the production process in more than one country, provided that these are all eligible for the preferential treatment which will be accorded to the traded good or that the products include components originating in the country granting the preferential treatment.

10. Certificates of origin are often required to facilitate control of origin and thus expedite customs clearance operations.

11. Problems apparently sometimes arise over the interpretation by customs authorities of rules of origin, especially when the combined use of different criteria increases their complexity. The great increase in multi-country processing of processed or manufactured products which has occurred in recent years, also makes the attribution of origin more difficult. When disputes arise over the decisions of the customs authorities, these can be referred to courts which in certain countries are playing an important rôle in building up jurisprudence in this field. A problem often mentioned which appears to be specific to GSP schemes is the difficulty faced in filling in the certificates of origin required for imports for which preferential treatment is claimed. It is sometimes said that the problems faced in complying with the rules of origin make traders give up the claim to preferential treatment. The question is also sometimes put of whether, at a time when average tariffs have come down substantially in most industrialized countries, the administrative costs involved in operating complex rules of origin are justified? Another source of concern is apparently the fact that rules of origin in a given country or group of countries vary unnecessarily both from product to product and from one preferential arrangement to another and it has sometimes been said that rules of origin may be used not as instruments to implement commercial policy but as instruments of commercial policy themselves, to encourage or discourage trade in particular goods or trade with particular sources.

Related GATT provisions

12. A Sub-Committee of the Preparatory Committee of the United Nations Conference on Trade and Employment which drafted the Havana Charter on which the GATT is based, examined the question of rules of origin in August 1947.

It considered "it to be clear that it is within the province of each importing country to determine, in accordance with the provisions of its law, for the purposes of applying the most-favoured-nation provision whether goods do in fact originate in a particular country" (E/PC/T/174, pages 3-4).

13. The General Agreement contains various provisions which foresee the necessity of rules of origin, though it allows individual contracting parties to apply their own systems and does not specify how rules of origin are to be applied. Among GATT provisions in question are Articles I:1, II:1(b) and (c), III:2 and 4, VI:3, 4, 5 and 6(a), XI:1 and XIII:1, and XXIV:8, all of which imply the identification of the origin of traded goods. Subject to exceptions contained in other provisions of the General Agreement, Articles I, II and III lay down the basic principles that in any country which has acceded to the GATT, products originating in the territories of contracting parties will be treated equally, that there will not be any discrimination against them and that if duties have been bound, no additional taxes will be levied on them. Under Article VI on anti-dumping and countervailing duties, such duties can be applied to dumped or subsidized imports originating in a given source, provided that they cause material injury to domestic industry. Articles XI:1 and XIII:1 deal with the elimination of quantitative restrictions on products originating in contracting parties and the non-discriminatory administration of those restrictions which are maintained. Finally, under Article XXIV:8, contracting parties which enter into customs unions or free-trade areas can introduce differential treatment in favour of the products of the other members of the union or area.

14. Article IX.1 states that "each contracting party shall accord to the products of the territories of other contracting parties treatment with regard to marking requirements no less favourable than the treatment accorded to like products of any other country". If marks of origin are to be used, some rule for identifying origin will be required.

15. Article VIII:1(c) states that "the contracting parties also recognize the need for minimizing the incidence and complexity of import and export formalities and for decreasing and simplifying import and export documentation requirements" without going into more detail on rules of origin themselves. Interpretative Note number 2 to this Article however, states that "it would be consistent with paragraph 1 if on the importation of products from the territory of a contracting party into the territory of another contracting party, the production of certificates of origin should only be required to the extent that is indispensable". Article VIII:4 states that "the provisions of this Article shall extend to fees, charges, formalities and requirements imposed by governmental authorities in connection with importation and exportation, including those relating to documents, documentation and certification".

Past discussion in the GATT

16. In an effort to deal with problems arising out of lack of standardization of rules of origin, the International Chamber of Commerce (ICC) recommended in 1952 that the CONTRACTING PARTIES adopt a common definition of the nationality of manufactured goods. Having examined this suggestion, the CONTRACTING PARTIES decided that they needed more detailed knowledge of the principles underlying national legislation before they could start drafting a uniform definition. They therefore recommended that contracting parties submit a statement of their principles and practices and any proposals that they might wish to make on international action regarding rules of origin (BISD, 1S/100).

17. In response to the above-mentioned request, some governments proposed that steps be taken with a view to establishing a standard definition of origin together with uniform rules for determining the nationality of imported goods. Others however, considered that any attempt to secure international agreement on a standard definition of origin would be fruitless as the question of origin was bound up with national economic policies, which were unavoidably different in different countries. The Working Party which had been entrusted with examining these suggestions had before it a proposal by a delegation, in which the basic element of the definition of nationality was the notion of "substantial transformation". Building on this proposal, the Working Party submitted the following text to the CONTRACTING PARTIES for study and comment:

- A. The nationality of goods 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.
- B. 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.
- C. A substantial transformation shall, inter alia, be considered to have occurred when the processing results in a new individuality being conferred on the goods.

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

18. However, some delegations considered that the proposed definition 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 of "substantial transformation". Accordingly, they felt that the definition would do more harm than good (BISD 2S/53).

19. In 1955, the CONTRACTING PARTIES reviewed the replies which had been received from governments which had responded to the proposal. They noted that of the 28 contracting parties which had submitted observations, 11 favoured the proposed definition without reservation, nine considered that the proposed definition could not be accepted without modification and eight were opposed to it in principle. The CONTRACTING PARTIES noted that some of the reservations made were of such importance as to restrict severely the scope of the definition (BISD, 3S/94).

20. Rules of origin were also discussed in the context of the Protocol Relating to Trade Negotiations Among Developing Countries (BISD, 18S/11). Annex A of that instrument contains provisions governing the application of rules of origin and states that until common rules are adopted, the participating countries are permitted to use primarily (a) a value-added criterion or (b) a process criterion normally involving a change in tariff classification.

21. As part of the examination by the CONTRACTING PARTIES of some regional agreements concluded under Article XXIV concerns were expressed which related to the restrictiveness of the rules of origin contained in those agreements (BISD, 23S/46, 24S/80, 20S/145, 31S/170 etc.).

22. At the meeting of the Council of 19 October 1973, the delegation of the United States expressed concern with the rules of origin provided for under the agreements signed between the member countries of EFTA and the European Communities. These rules of origin were considered by that delegation to be much more stringent than the ones which had existed previously in the EFTA countries and it therefore requested the establishment of a Working Party to carry out a detailed examination and analysis of the problems of trade deflection and rules of origin in free-trade areas. A discussion was held on this proposal, which continued at the meetings of 7 November and 19 December 1973 but no decision was taken on the proposal (C/M/90-92). Subsequently, the delegation of the United States held consultations under Article XXII:1 with the European Communities and the member States of EFTA (L/3992).

23. At the meeting of the Consultative Group of 18 which was held on 22-23 October 1979, the delegation of the United States proposed that a Working Party be established to conduct a study on the nature of rules of origin and their implications for the world trading system (CG.18/W/33). At its meeting of 30-31 October 1980, the Group asked the secretariat to prepare a factual note on rules of origin currently applied in international trade, as a basis for further discussion on the need for future work on this subject (CG.18/13). At the meeting of the Group which was held on 25-27 March 1981, a discussion was held on this subject with the help of the secretariat note (CG.18/W/48) during which conflicting views were expressed, inter alia, on the possibility of harmonizing rules of origin (CG.18/14).

24. The Ministerial Declaration adopted on 29 November 1982 requested the Council to make arrangements for studies of dual-pricing policies and rules of origin and to consider what further action might be necessary with regard to these matters when the results of these studies were available (BISD, 29S/9). At the meeting of the Council of 26 January 1983, delegations were invited to send to the secretariat any comments or suggestions that they might have on these subjects and on the manner in which these studies should be carried out (C/M/165).

25. At the meetings of the Textiles Committee which were held on 4-5 September, 17 and 22 October 1984, serious concerns were expressed by a number of delegations about new rules of origin introduced in the United States for imports of textile products as they were held to be a protective measure contrary to the Multifibre Arrangement (MFA). The United States replied that they did not consider that these measures which were designed to deal with loopholes which facilitated evasion of the intent of bilateral agreements, were contrary to the MFA. However, they were willing to enter into bilateral consultations with any country on this matter (BISD, 31S/324 and 329). A discussion was held on the same subject at the meeting of the Council of 2 October 1984 (C/W/181).

The Customs Co-operation Council

26. Annex D.1 of the Kyoto Convention, adopted by the Customs Co-operation Council, aims at simplifying and harmonizing national rules of origin. It lays down the principle that when two or more countries have taken part in the production of goods, the origin of the goods will be determined according to the substantial transformation criterion, which can be expressed by a rule specifying change of tariff heading, a listing of manufacturing or processing operations which do or do not confer origin, or the ad valorem percentage rule. It also contains some recommendations designed to provide guidelines for the administration of rules of origin. However, only a limited number of countries have acceded to it.