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MULTILATERAL DISCIPLINES ON PREFERENTIAL RULES OF ORIGIN:

How far are we from squaring the circle?

Abstract

A significant quantity of global merchandise trade takes place under one of two sets of preferential rules of origin (ROO), either those of the European Union, the so-called Pan-European Cumulation System (PECS) or those generally preferred by the United States, as manifested in free trade agreements (FTAs) such as NAFTA and the many subsequent FTAs the US has concluded with various trading partners since then.

Many years of work conducted by the World Customs Organization and the World Trade Organization have finally culminated in a draft text on non-preferential ROO, with the only thing standing in the way of its adoption being a relatively limited subset of narrowly defined political economy interests in some of the largest trading nations.

Some observers have argued that the so-called spaghetti bowl of preferential trade agreements can be "multilateralized", and that one way to achieve this would be to harmonize preferential ROO at the multilateral level, i.e. at the WTO.

This paper looks at how easy or difficult it would be to achieve such harmonization, both in purely technical terms as well as a political economy matter. It concludes that that the current system of ROO is quickly being overtaken by the realities of increasingly unbundled and globally dispersed production processes and that these rules are even more likely to need a complete rethink as global manufacturing in so many industries undergoes what is probably the most profound economic shakeup in over a hundred years.

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Table of Abbreviations

AB	WTO Appellate Body
AGOA	African Growth and Opportunity Act
ARO	WTO Agreement on Rules of Origin
ATC	Agreement on Textiles and Clothing (of the WTO)
CBI	Caribbean Basin Initiative
CCC	Customs Cooperation Council (now the WCO)
CEEC	Central and European Countries
CRO	Committee on Rules of Origin (of the WTO)
CTH	Change of tariff heading
EBA	Everything But Arms (initiative on duty free and quota free access to the EU market for certain goods originating in LDCs)
EC	European Communities
EFTA	European Free Trade Area
EPCT	"E/PC/T" of the United Nations documents of 1946-1947 (used here primarily in connection with the drafting work which culminated in the GATT 1947)
FTA	Free trade agreement
GATT	General Agreement on Tariffs and Trade
GATS	General Agreement on Trade in Services (of the WTO)
GSP	Generalized System of Preferences
HS	Harmonized Commodity Description and Coding System (of the WCO)
HWP	Harmonization Work Program instituted under Part IV of the WTO Agreement on Rules of Origin.
ICC	International Chamber of Commerce
ISI	Integrated Sourcing Initiative
ISO	International Organization for Standardization
ITA	Information Technology Agreement (WTO)
LDC	Least developed country
MFN	Most-Favored-Nation
NAFTA	North American Free Trade Agreement
PECS	Pan-European Cumulation System
PTA	Preferential trading arrangement
OFAC	Office of Foreign Asset Control (United States Department of the Treasury)
ROO	Rules of origin
RVC	Regional value content
TCRO	Technical Committee on Rules of Origin (of the WCO and the WTO)
TEC	Transatlantic Economic Council
UN	United Nations Organization
UNCTAD	United Nations Conference on Trade and Development
VER	Vertical Export Restraint (a bilaterally agreed export and import quota)
WCO	Word Customs Organization (formerly Customs Cooperation Council)
WTO	World Trade Organization

I. INTRODUCTION

Rules of origin (ROO) play an important role in the administration of preferential and non-preferential trading arrangements, be they treaties like the North American Free Trade Agreement (NAFTA) or the Results of the Uruguay Round of Multilateral Trade Negotiations (the WTO Agreement). Origin is one of the defining characteristics of a good that must be determined when it crosses a border, so as to determine what kind of treatment it will be afforded, i.e. Most-Favored Nation treatment, as required by GATT Art. 1, lower-duty or duty-free access under some kind of preferential trading arrangement (PTA), or neither. Other such determinations include classification under the Harmonized System (HS), as well as valuation (where an *ad valorem* tariff is applicable upon importation). For the classification and valuation determinations, harmonized and agreed international treaty texts apply in very precise detail, and the rules contained therein prescribe and constrain the actions of customs officials, while at the same time affording economic operators a large degree of certainty. But when it comes to origin, no such harmonized rules have been adopted, and so there is both a large degree of national legal fragmentation, opacity and uncertainty for economic operators. Moreover, the lack of internationally enforceable texts for ROO has also made these rules easily prone to capture by well organized and powerful domestic political economy interests, allowing them to be co-opted into an already impressive arsenal of protectionist trade policies and instruments. This sort of capture would arguably have been harder if internationally agreed and adopted harmonization had excluded this possibility.

This paper examines how ROO of origin typically work and how they are close to becoming harmonized at the multilateral level for non-preferential trade (i.e. MFN trade). It also looks at how preferential ROO function in a number of large users of these rules and at how some initial efforts to harmonize them have fared. It discusses why greater harmonization of preferential ROO might be desirable and a few ways it might be achieved. Finally it attempts to address in brief what kind of political economy forces might be aligned against harmonizing ROO and why (as well as some very tentative thoughts on how they might be overcome). The paper concludes that the current system of ROO is quickly being overtaken by the realities of increasingly unbundled and globally dispersed production processes and is even more likely to need a complete rethink as global manufacturing in so many industries undergoes what is probably the most profound economic shakeup since Henry Ford perfected moving assembly line manufacturing a hundred years ago. The final conclusion is that harmonized ROO for both preferential and non-preferential trade are likely to be a reality at some time in the short to medium-term future, but they might be too late to be of much use in a rapidly changing global manufacturing and trading environment.

II. A PRIMER ON RULES OF ORIGIN

This chapter seeks to impart to the reader a basic understanding of the issue of the origin of goods and the various mechanisms for determining it. It also discusses in brief the distinction between preferential and non-preferential ROO before discussing the history of efforts to harmonize the latter set of rules.

1. The Uses of Origin

Origin is one of the three determinations that generally have to be made for goods[1] entering the customs territory of a country, the other two being classification under the Harmonized System[2] and valuation.[3] For the determinations that customs officials are required to make on classification and value, comprehensive international treaty frameworks have been adopted in various *fora*, including the World Trade Organization (WTO)[4] and the World Customs Organization (WCO).[5] When it comes, however, to determining origin, customs officials apply rules that have largely evolved and been adopted under domestic legislative processes.[6]

The origin of a good must be identified for a number of reasons, including determining whether or not it is covered by any kind of trade embargo or economic sanctions that may be in place.[7] Otherwise, the most common reason for identifying the origin of a good as it enters the customs territory of a country is to determine whether it is subject to an MFN tariff rate or preferential tariff treatment. In addition, there are other reasons for making this determination, such as enforcing trade defense instruments (e.g. imposing anti-dumping or countervailing duties), collecting import data for statistical purposes, ensuring compliance with origin requirements under government procurement rules, overseeing implementation of quantitative restrictions and various others.[8]

Origin in this sense is perhaps best understood as a corollary for nationality in the case of natural or juridical persons. Visa restrictions apply to natural persons and their nationality is typically determined on the basis of what passport they carry when crossing or about to cross an international border.[9] For juridical persons wishing to invest in a foreign country, nationality can also be an issue and is usually

[1] Some research has started to be done on the origin of services (see in particular Hoekman [1993]), but for the purposes of the present research paper, the focus is entirely and exclusively on the role played by rules of origin as they pertain to trade in goods.
[2] See for example United States Customs and Border Protection (2004 - classification).
[3] The latter generally only where an *ad valorem* tariff applies and thus can be dispensed with when goods benefit from duty free access or are subject to a specific tariff (although an imports value might also need to be ascertained for statistical purposes). See for example United States Customs and Border Protection (2006).
[4] See the WTO Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994 (otherwise known as the Customs Valuation Agreement). For a discussion on the history of adopting multilateral disciplines on customs valuation see Streatfeild (2003).
[5] See http://wcoomdpublications.org/harmonized-commodity-description-and-coding-system-1.html (April 1, 2012).
[6] See Inama (1998) p. 5.
[7] More generally, see Kern (2009). For information on countries against which the United States currently has economic sanctions in place see Sanctions Programs and Country Information of the Department of Treasury's Office of Foreign Asset Control (OFAC): http://www.treasury.gov/resource-center/sanctions/Programs/Pages/Programs.aspx (April 1, 2012).
[8] See Art. 1 (2) of the WTO Agreement on Rules of Origin for an indicative list of the kinds of measures that non-preferential ROO apply to.
[9] See more generally Aleinikoff *et al.* (2011).

determined on the basis of various criteria, such as the country of incorporation, the country in which a corporate entity's registered office is located, and/or the nationality of its parent company or beneficial owner.[10]

2. Basic Tenets of Determining Origin

As a starting point, the first question a customs official will seek to answer in relation to origin is whether the good in question was wholly obtained or produced in a single country or whether two or more countries have contributed in various ways to the finished import.[11] Where a good is the product of inputs from two or more countries, as a general rule the good in question will be attributed the origin of the country in which the last substantial transformation took place, with three standard methods for determining which country this was.[12] These methods are the percentage criterion test, the change in tariff heading (or CTH) test, and the third is a technical or process-requirement test.[13]

The percentage criterion test relies on one of three mechanisms to determine origin. Under the first of these, the import content method, a cap is placed on the maximum allowable value that imported materials may have contributed to the finished import. Under the second of these, the domestic context test, domestically sourced inputs must make up a minimum threshold percentage of the finished import in order for it to qualify as originating in the country in question. Finally, under the value-of-parts methodology, an examination is made of the total value of all the parts of the finished import to determine whether originating parts meet a minimum percentage value of the overall value.[14]

Unlike the percentage criterion test, the change in tariff heading method does not focus on the value percentages of different inputs but instead focuses on the country in which the import in question assumed the characteristics that allow it to be classified under the HS tariff heading under which it is being imported. This method enjoys broad adoption by many countries and "is the primary test for the EC's preferential origin rules and for NAFTA", as well as being that used by Japan for most of its non-preferential origin determinations.[15]

Under the technical test, certain production processes or sourcing requirements are stipulated that may or may not confer origin, depending upon whether a positive or negative test is applied. Both the US and the EU avail themselves of various configurations of this methodology in their preferential and non-preferential ROO, but some commentators also note that the technical test is also the method

[10] See The Working Group (2011).
[11] Of course, the import may itself just be a component and thus part of a larger manufacturing process. See Hiroshi and Vermulst (2006) p. 604.
[12] These methods and various deviations that different domestic ROO have adopted are discussed in more detail in the next section.
[13] Hiroshi and Vermulst (2006), p. 605.
[14] *Ibid*.
[15] *Ibid*.

that is the most likely to succumb to capture by well organized domestic interests seeking protection from the full force of trade liberalization initiatives.[16]

3. Preferential and Non-Preferential Rules of Origin

For all practical intents and purposes, ROO have come to be categorized into two broad forms, namely preferential and non-preferential ROO. As their name suggests, preferential ROO are those that apply in the context of a preferential trading arrangement, typically either a unilaterally given preference under a scheme such as the Generalized System of Preferences, the EU's Everything but Arms (EBA) initiative[17], or the US's African Growth and Opportunity Act (AGOA)[18], or a contractually negotiated tariff preference granted under some kind of reciprocal arrangement such as a free trade agreement (FTA). The purpose of making the determination under preferential schemes is to clarify whether the goods in question meet the established criteria in order to qualify for the preferential treatment on offer. This might involve paying customs duties at a lower rate[19], being exempt from other duties and charges[20] or benefitting from facilitated customs procedures.[21]

Non-preferential ROO are those that apply to measures imposed and determinations rendered in regard to goods trade which takes place on an MFN basis. These are typically made in the context of trade policy instruments regulated by the General Agreement on Tariffs and Trade (GATT) and include customs duties and charges levied in accordance with GATT Art. I, anti-dumping or countervailing duties imposed in application of GATT Art. VI and the respective WTO agreements[22], regulations on marks of origin under GATT Art. IX, the administration of quantitative restrictions pursuant to GATT Art. XIII, as well as emergency safeguard actions imposed in application of GATT Art. XIX and the WTO Agreement on Safeguards.

Whereas a basic framework agreement was achieved on non-preferential ROO during the Uruguay Round (discussed below), achieving multilateral consensus on harmonized rules for preferential ROO is barely even being considered by policymakers at present. This is arguably because preferential ROO have to a great extent been captured by well-organized import competing interests in the countries applying them, and have been press-ganged from being a purely technical and subsidiary trade policy tool into serving somewhat ignominiously on the front lines of protection from imports, together with

[16] *Ibid*, p. 608.
[17] See http://ec.europa.eu/trade/wider-agenda/development/generalised-system-of-preferences/everything-but-arms/ (April 26, 2012).
[18] See http://www.agoa.gov/ (April 26, 2012).
[19] By way of example, under the Harmonized Tariff Schedule of the United States, a good entering the customs territory of the United States and meeting the classification criteria for HS no. 8204.20.00 (socket wrenches, with or without handles, drives and extensions, and parts thereof) will be assessed at a duty rate of 9% *ad valorem* if entering under MFN, but can enter duty free if it is determined to originate from one of the US's PTA partners, such as Australia, Bahrain, Canada, Chile, Israel, Jordan, Korea, Mexico, Oman, Panama, Peru, Singapore *et al*. See http://www.usitc.gov/publications/docs/tata/hts/bychapter/1201C82.pdf at p. 4 (April 1, 2012).
[20] One concession the United States typically extends to its PTA partners is to waive its merchandise processing or customs-user fee; see Koh and Chang (2003) at p. 65.
[21] This is for example the case among signatory countries of the Greater Arab Free Trade Area; see Dennis (2006).
[22] For anti-dumping measures this would be the Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade; for countervailing duties this would be the Agreement on Subsidies and Countervailing Measures.

a number of other instruments that were not really designed for this purpose (one need only think of technical regulations and standards, sanitary and phytosanitary measures, or even anti-dumping and countervailing measures).

4. A Brief History of Rules of Origin in the GATT and WTO

From the very outset of the original drafting work which culminated in the GATT 1947, it was the intention of those involved that the contracting parties should have the discretion to determine origin for the purposes of granting MFN treatment, in accordance with their own domestic laws.[23] Efforts in the early 1950s by the International Chamber of Commerce (ICC) to encourage GATT contracting parties to adopt harmonized rules on the "nationality of manufactured goods" failed to attract much enthusiasm.[24] After initially considering the matter and assigning some information-gathering and analytics work to a GATT working party[25], the GATT contracting parties were unable to reach consensus on the matter and ultimately decided to retain the status quo.[26]

There were some attempts to harmonize preferential ROO under the auspices of UNCTAD in the context of the Generalized System of Preferences (GSP), starting in the late 1960s.[27] There was also some progress achieved in harmonizing ROO at the multilateral level in the context of the 1974 adoption of the International Convention on the Simplification and Harmonization of Customs Procedures (the Kyoto Convention) and its Annex D.1 under the auspices of the then Customs Co-operation Council in 1974.[28]

However the importance of origin and the use of ROO as a trade policy issue really only began to attract any attention from a broad range of major trading nations following the conclusion of the Tokyo Round, and thus in the early 1980s.[29] For example, one finds only indirect references to origin in the extensive documentation that emerged from the process of categorizing and drawing up a comprehensive inventory of non-tariff measures that the GATT undertook in the early years of the Tokyo Round.[30] However, after the Uruguay Round was launched in 1986, and as the negotiating

[23] Jackson (1969) at p. 468: "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-favored nation provision, whether goods do in fact originate in a particular country" (citing UN Doc. EPCT/174 at 3 [1947]).
[24] See Jackson (1969) at pp. 466-468. See also GATT Doc. G/22 of August 29, 1952 in which the Executive Secretary details the ICC's concerns regarding the "nationality of manufactured goods".
[25] See GATT Doc. G/28 (also documented in Jackson [1969] at p. 466 *et seq*.) where a working party was established to examine the issue of harmonized ROO and individual GATT contracting parties were invited to submit information on their domestic laws and procedures for determining origin.
[26] See GATT Doc. G/61 dated October 22, 1953. The discussions which took place in the working party seemed to pit the governments of France, Germany and Italy (who were in favor of harmonized ROO) against the United Kingdom and New Zealand (who seemed to be opposed).
[27] See Inama [1998], p. 2, with further references.
[28] See Asakura (1995) at p. 7.
[29] See for example the 1981 Note by the Secretariat on Rules of Origin (CG.18/W/48, dated April 6, 1981). It should, nevertheless, be noted that as early as 1973, the US had raised concerns about the preferential rules of origin that would apply between the EU and the EFTA countries; concerns that were largely brushed aside, thus forcing the US to seek consultations under the GATT's dispute settlement procedures in 1974; see GATT document L3/399 dated 31 January 1974.
[30] For some background on this process, see Winham (1986) pp. 84-90. Otherwise, see the Inventory of Non-Tariff Measures contained in GATT documents MTN/3B/1-5 and Addenda.

agenda started to become more concrete, work began in earnest on ROO[31], culminating in the WTO Agreement on Rules of Origin (ARO) as part of the WTO's Single Undertaking (discussed in more detail in the next chapter).

5. Why are Rules of Origin more Important Now?

As a historical matter, it is not difficult to discern what may have led to the growing importance of ROO and why it now occupies a central place in discussions on how to reconcile the world trading system - based on the broadest possible application of MFN since 1947 - with the rapidly proliferating "spaghetti bowl"[32] of bilateral and plurilateral preferential trading agreements. For one, some blame must be laid at the feet of globalization itself and the emergence of global supply and manufacturing chains which see products manufactured using inputs and processes from multiple countries.[33] A second culprit is surely the steady increase in the number of preferential trading arrangement being entered into by countries and which has seen a significant portion of global goods trade now taking place under preferential arrangements rather than on an MFN basis.[34] This trend inevitably means that an increasing share of world trade is subject to a dizzying array of different ROO and this only exacerbates the complexity of international customs procedures (for those that must administer them as well as those that must do business subject to an exact understanding of them). There is also undoubtedly a great deal of truth in the argument that the growing use of discriminatory quotas in the decades prior to the Uruguay Round also played a role in moving the formerly obscure area of ROO to a more central place on countries' trade policy agendas, particularly those countries subject to import quotas for textiles and apparel, or vertical export restraints (VERs) on various steel products.[35] Yet another reason behind the growing centrality of ROO on countries' trade policy agendas is their abuse for protectionist purposes, the unfairness of which leads trading partners to cry foul and advocate for a more harmonized approach. At this point, it is probably fair to say that harmonizing ROO is quickly becoming one of the most urgent issues for many countries' foreign economic policy agendas and this urgency will likely grow until either harmonized rules are adopted, or the tariff-rate differentials between preferential arrangements and the MFN regime have become so small that importers simply opt to solely enter goods under the MFN tariff, thereby saving themselves the costs of complying with preferential ROO regimes.

I now turn to a slightly more technical analysis of the different systems used to ascertain the origin of a good and what, at a technical level, might be needed in order to achieve a satisfactory degree of harmonization in terms of both preferential and non-preferential ROO.

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[31] Palmeter (1990) at p. 25 states that ROO were not a priority at the start of the Uruguay Round but that they became a more pressing concern as the Round entered its final stages. See also, GATT Secretariat Background Note on Rules of Origin (MTN.GNG/NG2/W/12, dated June 21, 1988).

[32] A term originally attributed to Jagdish Bhagwati, see Bhagwati (1995) at p. 4.

[33] See Plehn *et al.* (2010).

[34] See WTO (2011) at p. 300, which indicates that as of 2010, there were more than 300 PTAs in effect. In 2004, a report entitled "The Future of the WTO" noted that the EU applied tariffs on an MFN basis to only 9 countries. Since then, this number has been further reduced to eight: see The Consultative Board (2004) at p. 21 and fn. 11.

[35] See Palmeter (1997) at p. 351-352.

III. HARMONIZATION OF NON-PREFERENTIAL RULES OF ORIGIN

This chapter begins with a discussion of the ARO and the approach it takes or points to in establishing non-preferential ROO. It then discusses the progress that has been made in achieving harmonization on these rules within the WTO, both under the work program instituted as part of the results of the Uruguay Round as well as during the subsequent Doha Round of multilateral trade negotiations. The discussion then turns to the various non-preferential ROO in use, particularly by major trading nations or frequent users of PTAs, without delving too deeply into the technical minutiae. Finally this chapter discusses what progress has been made to date in achieving harmonization of non-preferential ROO at the WTO.

1. The WTO Agreement on Rules of Origin

The Agreement on ROO that emerged from the Uruguay Round is a relatively short treaty text comprising nine articles and arguably represents more of a declaration of intent and a roadmap for future negotiations than many of the other normative frameworks embodying actionable rights and obligations[36] that typically characterize the Annex 1A agreements which form the Results of the Uruguay Round of Multilateral Trade Negotiations as they pertain to trade in goods.[37]

Although the Uruguay Round lasted from September 1986 until December 1993 and only really gathered momentum with the signing of the first Blaire House accord between the EU and the US on agriculture in 1991, drafting work on ROO had largely been completed by December 1990 - a full three years before the remaining and more contentious issues of the Round would be settled.[38] However, early on during their work, negotiators recognized that due to the technical complexity of the undertaking, it would likely not be completed within the Uruguay Round itself and not without the involvement of the then Customs Cooperation Council.[39]

Article 1 of the Agreement defines ROO as "… those laws, regulations and administrative determinations of general application […] to determine the country of origin of goods …" but also excludes from its scope preferential ROO.[40] Also excluded from its scope are any determinations of

[36] This is not to say that the Origin Agreement hasn't seen its own fair share of invocations in the context of WTO dispute settlement, having been specifically cited in a number of disputes including *United States - Measures Affecting Textiles and Apparel Products I and II* (complaint by the EC), *United States - Tariff Rate Quota for Imports of Groundnuts* (complaint by Argentina), *United States - Rules of Origin for Textiles and Apparel Products* (compliant by India), *China - Measures Affecting Imports of Automobile Parts* (complaint by Canada), and *United States - Certain Country of Origin Labeling (COOL) Requirements* (complaints by Canada and Mexico).

[37] The reader will recall that the Results of the UR MTN are set out in the Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, comprising the Marrakesh Agreement Establishing the World Trade Organization, to which there are four Annexes - Annex 1A the Multilateral Agreements on Trade in Goods; Annex 1B the General Agreement on Trade in Services, Annex 1C the Agreement on Trade Related Aspects of Intellectual Property Rights; Annex 2 the Understanding on the Rules and Procedures Governing the Settlement of Disputes; Annex 3 the Trade Policy Review Mechanism; and finally Annex 4, the Plurilateral Trade Agreement (on Trade in Civil Aircraft, Government Procurement, Dairy, and Bovine Meat).

[38] Croome (1985) pp. 193 and 280.

[39] *Ibid*, pp. 192-193; Navarro Varona (1994) also gives a detailed historical account of the treatment of ROO at the multilateral level both prior to and during the Uruguay Round.

[40] Annex II to the Origin Agreement contains some declaratory text on preferential ROO that is discussed in more detail below.

origin that are made in the context of defining "domestic industry" or "like products of domestic industry" - essentially a carve-out out for this term in the administration of trade remedy investigations. The core "achievement" of the ARO is arguably its call for the launch of a work program to harmonize non-preferential ROO (discussed immediately below) with several of the Agreement's other provisions being aimed at supporting this process, either through the adoption of disciplines to apply during the transition period (Art. 2), after the transition period (Art. 3) or through the establishment of the requisite procedural and institutional arrangements (Art. 4, 5, 6, and 9). Articles 7 and 8 subject the Agreement's provisions to the same rules on consultations and dispute settlements as the rest of the Annex 1A agreements (namely GATT Art. XXII and XXIII respectively).

As mentioned above, Article 2 of the ARO sets out a series of disciplines on non-preferential ROO that WTO Members are required to abide by while work goes on in the harmonization work program (HWP). In particular, Art. 2 calls on Members to clearly define and specify the requirements set out in the administrative determinations of general application issued in the context of origin.[41] It also exhorts WTO Members not to use ROO to pursue trade objectives directly or indirectly.[42] It also requires that ROO not "create restrictive, distorting or disruptive effects on international trade".[43] Article 2 also requires WTO Members not to apply ROO on imports and exports that are more stringent that those used to determine whether a good is of domestic origin (an application of the national treatment obligation), nor to discriminate between other Members when applying ROO (an application of the MFN obligation).[44] Article 2 also requires that ROO be administered in a "consistent, uniform, impartial and reasonable manner"[45], and that Members' ROO be based on a positive standard (defining what qualities affirmatively confer origin) and that negative standards (stating what does not confer origin) may only be used in order to clarify an existing positive standard.[46] Members are also required to apply the same transparency obligations to ROO that are applicable under GATT Art. X[47]. Article 2 also requires Members to provide for the possibility of obtaining advance rulings on origin determinations, something described as "[o]ne of the more interesting innovations of the Agreement".[48] The final provisions of Art. 2 govern issues such as non-retroactive effect of changes to ROO, judicial review of administrative decisions and confidential information.[49]

Article 3 of the ARO sets out the disciplines that WTO Members are to apply following the transition period. As such, it represents an aspirational statement of where the WTO Membership should ideally be headed in terms of ROO. As could be expected, its confines are narrower than those granted WTO Members during the transition period, since what should ideally result from the harmonization work program is a tighter set of disciplines. Thus paragraph (a) of Art. 3 provides that Members will provide

[41] Art. 2 (a).
[42] Art. 2 (b).
[43] Art. 2 (c).
[44] Art. 2 (d).
[45] Art. 2 (e).
[46] Art. 2 (f).
[47] Art. 2 (g).
[48] Art. 2 (h); see Imagawa and Vermulst (2005), p. 611.
[49] Paragraphs (i), (j) and (k) of Art. 2 respectively.

ROO equally for all the purposes described in Art. 1. In addition, Art. 3.2 ARO provides that Members will confer origin on goods either from the country in which they were wholly obtained or in which the last substantial transformation was carried out. For the rest, Article 3 contains the same disciplines as Art. 2 (discussed above).

The ARO establishes both a Committee on Rules of Origin (CRO) and a Technical Committee on Rules of Origin (TCRO), the latter under the auspices of the then Customs Cooperation Council (CCC).[50] As stated above, arguably the most important element of the ARO is that laying out the harmonization work program, namely Art. 9. Here the disciplines to be achieved after the transition period as set forth in Art. 3 are essentially re-stated as a set of guiding principles. Otherwise, Art. 9 provides for a set of deadlines subject to which the work program should progress (none of which were subsequently complied with) as well as laying out a roadmap for harmonization to be achieved on such terms as "wholly obtained" and "minimal operations and process", "substantial transformation", "change in tariff classification" and other concepts that will inevitably be of central importance to the Committees' work.

Annex II to the ARO is in and of itself an interesting piece of treaty text, since, by means of a "Common Declaration with Regard to Preferential Rules of Origin" it imposes some disciplines on Members with regard to preferential ROO, namely largely those already set out in Art. 2 (disciplines during the transition program). Thus even after completion of the work under the harmonization program, it looks like Members will have one set of harmonized provisions on non-preferential ROO and another, less stringently circumscribed set of provisions on preferential ROO. As shall be discussed in more detail below, whereas some commentators have argued that the most effective way to square the circle and "multilateralize" regionalism would be to have a single set of ROO for both preferential and non-preferential free trade agreements[51], it also seems that this would by far and away exceed the ambitions of the ARO's drafters.

1. The Post Uruguay Round Harmonization Work Program

The HWP was from the outset a two-tiered process, with much of the technical work initially to be tackled under the auspices of the TCRO, (i.e. in conjunction with the WCO) and the results of this process subsequently to be forwarded to the CRO, which, under the direction of the WTO Goods Council, would take whatever non-technical (trade policy) decisions still needed. The TCRO proved relatively adept at advancing the technical work, although it was not completely immune to some trade-policy gridlock. Originally tasked with completing its work in three years, starting in 1995, the TCRO ultimately was only able to forward to the CRO a provisional draft text of the Harmonized Non-Preferential Rules of Origin in May 1999 in addition to a set of "referral documents" in which the remaining outstanding issues were set forth together with various proposals for resolving them.[52]

[50] Art. 4.1 on the Committee on Rules of Origin. Art. 4.2 establishes the Technical Committee on Rules of Origin and Annex I to the Origin Agreement has more concrete provisions governing the latter.
[51] See for example Barceló (2006).
[52] Hiroshi and Vermulst (2005) p. 616.

The CRO for its part had originally been mandated to complete its work and submit a finalized draft HRO for adoption by November 1999 (to coincide with the Seattle Ministerial Meeting) but this proved vastly over optimistic. A new deadline was set for the Doha Ministerial in November 2001, but this also proved too soon for the CRO. After the launch of the Doha Round, a newly invigorated CRO made relatively solid progress in dealing with many of the unresolved issues so that "[in] addition to the thirty issues that already been resolved from 1997 to 2000, it [the CRO] resolved 300 of the 486 issued that had been referred to it"[53] before progress slowed down considerably. In July 2002, the CRO forwarded 93 "core policy issues"[54] to the General Council for resolution, but it seems as if the General Council has only managed to achieve moderate progress since then. Indeed, since 2006 up until the last available summary of the CRO's work (in 2011), it seems that the difficult trade policy issues have largely been in the hands of the General Council were they have not progressed significantly.[55]

2. Draft Consolidated Texts of Non-Preferential Rules of Origin

Setting aside the difficulties experienced in resolving a certain number of core policy issues, a draft consolidated text of non-preferential ROO was circulated by the CRO in October 2007, comprising over 2000 pages of text and several thousand product-specific ROO[56]. A second heavily revised and edited version was circulated just over a year later in December 2008, comprising some 318 pages.[57] Without wishing to delve too deeply into the arcane minutiae of these provisions I will attempt to lay out and describe the workings of the draft rules. To begin with it is worth noting that the text is drafted in such a way that it can be appended to the existing ARO as Annex III. After laying out a number of definitions, it sets out six General Rules, followed by two appendices which make up the technical substance of the text. The first (relatively short) Appendix deals with wholly obtained goods whereas the second Appendix deals with product-specific ROO for goods, the origin of which cannot be determined under Appendix 1.

The six General Rules cover a range of issues, including the draft text's relationship with the Harmonized System (General Rule 1) and a statement of the principle (in General Rule 2) that the country of origin of a good is to be determined "in accordance with the provisions of Appendix 1 and Appendix 2, *applied in sequence*" (emphasis added), thereby setting out the methodology pursuant to which this determination is to be made. The General Rules also set out what constituent elements are not to be construed as conferring status, such as any energy inputs, plant and equipment, machines

[53] *Ibid*, p. 619.
[54] A term used by Hiroshi and Vermulst (2005) at *inter alia*, p. 615 (discussed in more detail below).
[55] See WTO Doc. "Twelfth Annual Review of the Implementation and Operation of the Agreement on Rules of Origin - Note by the Secretariat" (G/RO/W/106) September 29, 2006 and the corresponding document from the 17th annual review (G/RO/W/139) October 10, 2011, which have almost exactly the same wording with regard to progress on the HWP, namely that "the CRO felt that the difficulties they had encountered on the 'implications' issue and in the sector of machinery was such that guidance from the General Council was now warranted on how to take these issues forward. The recommendation of delegations in the CRO was that work on these issues be suspended until such guidance from the General Council would be forthcoming". The "implications issue" was originally raised by India in 1998 and were borne of a concern that changes to ROO in the textiles sector may have a negative impact on trade flows in this sector (Hiroshi and Vermulst [2005] pp. 657-658.
[56] See WTO Doc. G/RO/W/111, October 15, 2007.
[57] See WTO Doc G/RO/W/111/Rev.3, December 2, 2008.

and tools used in manufacturing a good (General Rule 3), packaging, packaging materials and containers (General Rule 4), and accessories, spare parts or tools (General Rule 5). Finally, the General Rules stipulate what minimal operations and processes are insufficient to confer status (General Rule 6 - preservation, those facilitating shipment or transport and those used for packaging or presenting goods for sale).

Appendix 1 comprises barely four pages and essentially consist of a set of definitions and accompanying notes on what goods are to be considered as being wholly obtained in one country. To give but one example definition 1 (d) lists "[p]lants and plant products harvested picked or gathered in that country" with the accompanying note specifying "[d]efinition 1 (d) covers all plant life, including fruit, flowers, vegetables, trees, seaweed, fungi and live plants grown in that country".

Appendix 2, which constitutes the remainder of the draft text, begins with introductory provisions comprising some basic rules of general application for the Appendix as a whole as well as a terminology guide, but then goes on to set out product-specific ROO on a chapter by chapter basis, in alignment with the chapters of the harmonized system. One commentator has noted that "[g]iven the current globalization of production in which goods are increasingly manufactures in more than one country, Appendix 2 contains the rules applicable to the majority of goods currently produced and traded…".[58] Its significance and its eventual impact for MFN trade will therefore clearly be considerable.

Rule 1 of Appendix 2 reiterates the sequence methodology referred to already above, in that it states that it shall apply when the origin of a good is not determined under Appendix 1 (first paragraph of Rule 1). Arguably of greater relevance is the second paragraph of Rule 1, which allows Members to choose between product specific rules using the change in tariff classification method or an *ad valorem* percentage for Chapters 84-90. Members will be required to notify the WTO Secretariat of their choice within 90 days of the draft Annex coming into force. This approach seems to represent the outcome of a compromise between the EU and the US, and as such, these chapters represent the only areas where negotiators were not able to finally agree on one of the standard methodologies for conferring origin (discussed in brief in Chapter I above).

The Appendix determines origin under two sets of rules, primary rules and - where these are not sufficient to confer origin - residual rules (Rule 3 of Appendix 2). Primary rules are contained in column 3 of the rule schedules (column 1 is the HS code, and column 2 is the product description). The residual rules are typically contained at the start of each chapter. Rule 3 of Appendix 2 sets out the sequence to be followed. In essence, the residual rules apply in cases where the relevant substantial transformation criteria have not been met (in application of the primary rules), because a good has been transformed but not substantially. Thus a customs official making a determination will first classify the good under the HS, then check its description under Appendix 2, and before finally trying to determine if the primary rules is sufficient to confer origin (by answering in the affirmative the

[58] Inama (2009), p. 60.

question of whether a substantial transformation has occurred). Where this is not the case, because say, an originating product was processed in a second country but the process in question did not suffice to effect a change in tariff classification of the originated product, then recourse will need to be had to the residual rules in order to determine origin.[59]

3. Outstanding Issues to be Resolved with regard to certain Products

The public record of documents submitted to the WTO Committee on Rules of Origin documents that a number of issues remain to be resolved before Annex III to the ARO becomes a set of binding international treaty commitments.[60] These issues seem to be driven by a number of considerations, not all of which can be directly attributed to a narrow set of base, domestic political-economic interests clamoring for special treatment (i.e. protectionism), but in many ways simply reflect the realities imposed by other policy frameworks of varying degrees of legitimacy. For example, the position put forward by several delegations (in particular by Korea and Japan)[61], that filleting fish is not an origin-conferring process for those species of fish that are subject to chronic overfishing and which are the focus of conservation initiatives by multilateral fisheries management bodies, seems on its face to be a relatively noble (and legitimate) objective. Noble or not, recognizing filleting operations as origin conferring for some species of fish but not for others would seem to run afoul of several of the agreed principles set out in Art. 9 ARO, not least of which would have to include those requiring that ROO should be applied equally and that they should be coherent.

Another example is the European Union's reluctance to allow certain processes to be origin conferring in the context of condensed milk, milk power and other similar products. On the one side of this issue are Australia and New Zealand (big dairy exporters, particularly New Zealand), who wish to see the processes in question be designated as origin-conferring. The EU's intransigence on the issue seems to stem from purely internal constraints posed by the administration of its export subsidy regime for dairy products.[62] Although not motivated by base protectionism *per se*, even the most seasoned and cynical observer would have to admit that there cannot be very much legitimacy in holding up the adoption of uniform ROO over a policy instrument that the Member in question has tentatively agreed to remove in any event.[63] This is without even going into the well documented research on the massively trade-distorting effects of export subsidies[64], or the fact that Art. 9 (d) clearly and expressly exhorts Members not to use ROO as instruments to pursue trade objectives (like, say, export subsidy programs).

[59] This example from Inama (2009), p. 65.
[60] See WTO Documents in the "G/RO/W/*" series, particularly those submitted during the preparation and following circulation of the revised consolidated draft text of non-preferential rules of origin in December 2008.
[61] Cited by Inama (2009), see pp. 72-73.
[62] This is at least the assertion made by Inama (2009), at p. 75.
[63] The EU made a tentative commitment to eliminate all export subsidies by 2013 subject to the successful completion of the Doha Round prior to that date. Although an end to the Doha Round within this timeframe looks increasingly unlikely at this point, the fact that the EU made the offer can only mean that the writing is on the wall for its export subsidy programs as they currently exist.
[64] See Peters (2006).

One issue worth focusing on in more detail here is textiles and clothing, since from a political-economy perspective, it continues to play a determining role in the crafting of ROO at both the multilateral and bilateral/regional level (the latter discussed in more detail below). The work completed in the harmonization work program, sought, from the outset to distance itself from the double or triple processing requirements demanded in order to confer origin that characterize many preferential ROO schemes, so that, as a result, the draft text that emerged on these rules succeeded in introducing what one commentator has referred to as "a significant element of trade liberalization"[65] in this sector. Differences seem to remain on whether dying and printing of fabrics is origin conferring, as well as with regard to the coating of fabrics. The origin-conferring nature of embroidery is also reported as having been a contested issue.[66] Here, the rationale of those advocating for stricter ROO (i.e. advocating that origin should remain with the country that produced the fabric) is allegedly based upon concerns that contingency protection measures (of which there was a sudden and marked increase following the lifting of the quota system resulting from the expiration of the WTO Agreement on Textiles and Clothing [ATC] in 2004) may be more easily circumvented in the absence of tightly circumscribed and restrictive ROO. This line of argumentation - really a thinly veiled appeal to make the use of protectionist instruments easier - probably runs afoul of Art. 9 (d) of the ARO in that it seeks to use ROO as an instrument to achieve other trade policy objectives.

4. Squaring the Circle at the WTO - Waiting for an End to Doha?

The fate of the draft text at the time of writing is contingent on solutions being found between WTO Members with regard to a certain number of core policy issues. Barring any urgently felt need to show progress in the form of an "early harvest", or to have some kind of positive achievement to show the world at a future Ministerial Meeting otherwise devoid of much good news, it is hard to envisage the settlement of these issues not being tied to the outcome of the Doha Round as a whole and thus being part of a broader set of trade-offs needed to bring Doha to a successful conclusion (although many observers believe the Round is dead and can no longer be salvaged).[67] In this sense, waiting for Annex III of the WTO Agreement on Rules of Origin is most likely synonymous with waiting for the end of the Doha Round itself, something which by now already feels very much akin to the title of a very famous play by Samuel Becket.[68]

[65] Inama (2009), p. 84.
[66] *Ibid*, p. 85.
[67] See for example Beattie (2011).
[68] I am of course referring to "Waiting for Godot".

IV. HARMONIZING DIVERGING SYSTEMS OF NON-PREFERENTIAL RULES OF ORIGIN

Whereas non-preferential ROO are mainly used for the application of MFN treatment under the GATT and a range of other trade policy instruments governed by the same[69], the primary purpose of preferential rules of origin is to ensure that the preferential treatment being granted (normally in the form of tariff preferences) is only extended to goods originating in the beneficiary, or preference-receiving country.[70] This chapter looks at the two largest systems of ROO, namely those used by the United States with the majority of its FTA partners, as originally developed and applied under the North American Free Trade Agreement (NAFTA), and those ROO used by the European Union in its preferential trading arrangements.

1. Preferential Rules of Origin under NAFTA

The US's preferential ROO used to be a relatively simple and liberal system that operated for many years under such regimes as the GSP, the Caribbean Basin Initiative (CBI), the US FTA with Israel, as well as for imports of products originating in the Insular Possessions.[71] Matters began to become considerably more complex with the negotiation of the FTA with Canada starting in 1986.[72] Many commentators describe the ROO which the US negotiated for NAFTA as some of the most complex origin rules to have ever been devised.[73] These rules have formed the basis or underlying template for the US's subsequent FTA negotiations and they have evolved according.[74] Without delving too deeply into the technical details, what follows is a basic explanation of NAFTA's ROO.

The NAFTA ROO are essentially based on the concept of tariff shift (change in tariff heading or classification) as the primary ROO, and supplemented by a value-threshold approach and/or a technical test (particularly common in textiles and apparel, as well as electronics and machinery).[75] Chapter Four of the Agreement sets out the essential ROO on the basis of which an origin determination is to be made. In essence, Article 401 sets out four main ways in which goods may be deemed as "originating goods" under NAFTA. These are either (1) goods that are wholly obtained or produced entirely in the territory of one the NAFTA signatories [76]; or (2) where any non-originating materials used in the production of the good, such materials have undergone a change in tariff classification pursuant to Annex 401[77]; or (3) where a good is produced entirely in the territory of one of the NAFTA signatories, said good exclusively comprises originating materials[78]; or finally (4) where

[69] The reader will recall that Art. 1 (2) ARO specifies the scope of application of non-preferential ROO to encompass the application of MFN treatment under GATT Articles I,II, III, XI, and XIII, but also for anti-dumping and countervailing duties under GATT Art. VI, safeguard measures under GATT Art. XIX, origin marking requirements under GATT Art. IX, any discriminatory quantitative restrictions on tariff quotas, as well as for government procurement purposes and trade statistics.
[70] Inama (2009) at p. 234 refers to this as a "preoccupation with trade deflection".
[71] See Palmeter (1987), pp. 8-17.
[72] See *ibid*.
[73] See for example Ramírez (2004) at p. 621 who gives plenty of further references.
[74] See Inama (2009) pp. 320 *et seq*.
[75] See Palmeter (1997) p. 351.
[76] NAFTA Art. 401 (a).
[77] NAFTA Art. 401 (b).
[78] NAFTA Art. 401 (c).

unassembled goods, or goods classified in the same HS category as their parts do not meet product-specific origin criteria but are nevertheless deemed to contain sufficient regional value content.[79] For the latter set of goods, the NAFTA ROO also contain a regional value content (RVC) requirement which generally requires them to meet a minimum value threshold test of either 50 or 60 percent[80] depending on which one of two possible calculation methods is used (either the "net cost method" or the "transaction value method" respectively).[81] The use of RVC requirements in NAFTA was largely limited to the automotive and chemicals sectors (where their application was dictated by political economy considerations) but otherwise US negotiators have traditionally tended not to favor the use of value added content rules (as evidenced by their hostility to them in the negotiations on non-preferential ROO at the WTO).[82]

The NAFTA ROO also contain a *de minimus* provision[83] subject to which goods containing non-originating materials and which do not otherwise qualify as originating under any of the other provisions may nevertheless qualify as originating provided such non-originating materials do not exceed a certain threshold percentage of the transaction value of the good in question (as a rule 7 percent).[84] It should be noted that this *de minimus* provision does not apply to a whole range of politically sensitive products including many agricultural, and automotive goods and that it only applies by weight (not value) to textiles and apparel products.[85]

Together with the NAFTA ROO for automobiles, the rules relating to textiles and apparel are generally deemed by most commentators to be very restrictive. The ROO for textiles and clothing are built around four kinds of processing typical to the sector.[86] As a rule, any non-originating inputs (fabrics) have to meet at least two of the four processing requirements (three in the case of apparel) in order to qualify as originating. The NAFTA rules on automotive products rely on a concept known as "tracing" which permits automakers to track the value of the non-originating components and subassemblies used to manufacture an automobile. These values are then used in the RVC calculations when determining origin. For passenger vehicles and light trucks the RVC requirement is 62.5 percent and for other vehicles and car parts its 60 percent.[87]

The US's drafting of ROO with its FTA partners has evolved somewhat since concluding NAFTA. Generally, the US has tended to move away from the percentage criteria and in particular from the net cost method for calculating RVC.[88] Instead, in many of its FTAs, the US had pivoted towards either

[79] NAFTA Art. 401 (d).
[80] This is 62.5 percent for automobiles.
[81] NAFTA Art. 402; For some products, the method is prescribed, for others, it is up to the importer or the exporter to choose. See Cantin and Lowenfeld (1993) at pp. 386-388;Ramírez (2004) pp. 644-645, Einstein (1995) pp. 62-63.
[82] Inama (2009), p. 287.
[83] NAFTA Art. 405.
[84] See Inama (2009) at p. 282.
[85] *Ibid*, p. 284.
[86] (1) production of fibre; (2) extrusion of spinning yarn; (3) fabric formation through weaving, knitting or other methods; and (4) cutting (or knitting to shape) and sewing or otherwise assembling apparel or made-up textile articles; see Inama (2009) at p. 317.
[87] Cantin and Lowenfeld (1993) p. 385.
[88] Inama (2009), p. 323.

the build up or build down calculation methodologies for determining RVC.[89] One commentator, in a case study of the goods package resulting from the US FTA with Singapore, singles out a number of achievements made in these negotiations, which were tailored to the unique manufacturing realities of Singapore as a small, island city-state. One such example is outward processing, whereby the ROO on some product lines recognize outward processing, thereby allowing the accumulation of all Singaporean value added to a good. This is particularly important in the Singaporean context, because goods manufactured by Singaporean companies in local off-shore islands such as Bintan or Batam (part of the territory of Indonesia) are returned to Singapore only for final quality testing and outward processing before being shipped to export markets.[90] Another example is the Integrated Sourcing Initiative (ISI). Under a special Annex to the US-Singapore FTA some 266 products are deemed to be originating in Singapore, although they were not made there. These products are mostly goods that already enjoy duty-free access to the US market under the WTO Information Technology Agreement (ITA), but their value to Singaporean exporters availing themselves of the preferential treatment on offer under the FTA is that the Merchandise Processing Fee will be waived. Given the very thin margins in the IT goods sector, this is not an insubstantial gain for Singapore manufacturers of IT products. Interestingly, this concession is described as "one of the most controversial provisions of the Goods negotiation".[91]

2. The EC's Pan-European Rules of Origin

The European experience on ROO has in large part been the alter ego of its experience in preferential trade agreements and economic integration initiatives more generally. This experience was characterized by several different processes, being played out towards different partners, either at the same time or during largely overlapping periods. On the one hand - in the 1970s - one finds the EC in a process of seeking an accommodation with the (largely developed) EFTA States, while at the same time engaging in a first generation of cooperation agreements with a number of (developing) North African countries on the Mediterranean. A couple of decades later, following the fall of the Iron Curtain, the EC was actively engaged in a series of bilateral initiatives with the Central and Eastern Europe Countries (CEEC). Just like the EC's approach to these trade agreements was loosely based on the same general objectives and templates, its ROO were also loosely predicated on a number of general themes, but were also specifically crafted in each individual case so as to cater to the specifics of a given economic relationship. Despite the vast array of trade and economic cooperation agreements the EC was almost constantly engaged in, its approach tended to remain broadly consistent so that "overall, the characteristic common to all EC preferential rules of origin was the adoption of the CTH criterion that defines the concept of 'substantial transformation' coupled with a list of product-specific rules of origin, requiring CTH [change of tariff heading] with or without

[89] The build up method calculates the value of the originating materials, whereas the build down method calculates the value of the non-originating materials in order to come to a percentage of RVC.
[90] See Rossman (2004), p. 69.
[91] *Ibid*.

exceptions, specific working or processing, or maximum import content percentages".[92] Thus, in practice, protocols on ROO would usually contain an annex listing, on a product-by-product basis, the required transformation or processing considered sufficient in order to confer origin.

Despite the consistency of this general approach, it is also broadly apparent that "rules of origin have been one of the preferred policy instruments adopted by the EC to modulate and tailor, according to its priorities, the content of the concessions contained in the agreements with third countries".[93] Because of the technical opacity of ROO and the fact that they are generally determined on a product-by-product basis, at varying levels of tariff-line disaggregation, and because they involve the application of one or more of the three classic methods for determining substantial transformation (change in tariff heading, value content and process rule) there is very obvious scope for certain of these rules to be captured by well-organized, narrowly focused industry and sectoral interest, something that was on display in NAFTA in the automotive sector among others,[94] but which was also very much a factor in the European context.[95]

It was in 1994 that the European Commission published its first conceptual thinking on ROO, laying out its proposal for the "Pan-European Rules of Origin".[96] The Commission seemed to be motivated by the desire to achieve a number of advantages, including increasing trade flows and economic cooperation between the EC, EFTA and CEEC, improving the efficiency of resource allocation in sourcing decisions for materials and products, and enhancing the abilities of producers to achieve economies of scale by allowing them to organize their activities on a Europe-wide scale.[97] The Commission proposed to achieve this by a three-step process of gradually harmonizing ROO among agreements, and subsequently liberalizing rules on cumulation (discussed below), thereby incrementally extending the possibility for producers and exporters to cumulate both originating and non-originating inputs and processes from among all the EC's trade and cooperation agreement partners.[98]

The first phase of the three-step approach envisaged by the EC in 1994 involved streamlining and simplifying the ROO of the EC's agreement with the four States of Czech Republic, Hungary, Poland and Slovakia (the so-called "Visegrad" countries), incorporating Bulgaria and Romania and the possibility of extending full cumulation to Switzerland. The second stage envisaged diagonal cumulation between the EC/EFTA countries and the CEEC, together with the possibility of uniformly implementing the non-drawback rule, which up to then, was in effect with some partners but not with others. The third and final stage envisaged full cumulation.[99] The EC had essentially completed this program (covering its trade relations with EFTA and the CEEC) by 1997, extending it to Turkey in 1999.

[92] Inama (2009), p. 235.
[93] *Ibid*, p. 236.
[94] See Canton and Loewenfeld (1993).
[95] See Vermulst (1994).
[96] European Commission (1994).
[97] *Ibid*. p. 7.
[98] A process it called "Promoting Integration by Extending Cumulation Possibilities" *Ibid*, pp. 4 *et seq*.
[99] *Ibid*, p. 7.

In 2003 it committed to extending its Pan European Cumulation System (PECS) to its partners under the Euro-Med process, so that by 2006, some 40 percent of world trade was being conducted by PECS users.[100] The streamlined and simplified protocols on ROO that emerged from this process have, as a rule, henceforth been used as the template for almost all of the EU's subsequent FTAs.[101]

The powerful trade liberalizing effects of this process have been analyzed by a number of observers[102] and this approach has since been forcefully advocated by some as a way of "multilateralising regionalism".[103] This discussion is taken up below, before the following chapter discusses some of the political economy issues inevitably connected to tackling this task.

3. The Concept of Cumulation

Cumulation is an important concept in the context of FTAs and other economic integration initiatives. As a general rule, ROO in FTAs explicitly set forth provisions governing cumulation of origin, so that any products which originate in one or more signatory countries may be used in another signatory country in order to arrive at a finished product originating in said country (and thus being able to benefit from the preferential treatment on offer). Cumulation comes in three forms, bilateral, diagonal and full. The degree of cumulation granted under an FTA's ROO will to a large extent dictate the extent of its trade-liberalizing effects. Bilateral cumulation only operates between the two signatory countries to the FTA, so that only inputs originating from one of the countries may be cumulated if exported to the other signatory for processing. Diagonal cumulation covers those situations where several countries are party to the same agreement or different agreements among one another, and where the use of inputs originating in any of the signatory countries is deemed sufficient to confer origin. Finally, full cumulation - the most liberal - allows the cumulation of processing between different signatory countries so that any processing or transformative work performed on the good within the trade zone is taken into account.[104] As will be discussed in more detail below, full cumulation can have a very powerful trade-liberalizing effect and can effectively help to de-compartmentalize production and trade when a big trading entity (like say the EU) extends the possibility of full cumulation among all of its preferential trading partners.

4. Squaring the Circle on Preferential Rules of Origin

The political economy dynamics which led the EC to essentially reverse its previous position on ROO and to introduce PECS in the 1990s basically seem to have been driven by the unbundling of manufacturing processes across the region more broadly, so that those interests who had originally advocated more restrictive ROO ultimately became victims of these rules, forcing them to advocate for opening them up. In this way, the broader European and Euro-Med region, encompassing Turkey, became one large and integrated production platform. The same process seems to be taking place in

[100] Baldwin (2006) p. 22.
[101] Inama (2009), p. 236.
[102] Gasiorek *et al.* (2007).
[103] Baldwin (2006).
[104] See Gasiorek *et al.* (2009) at p. 8 *et seq*.

Asia as ASEAN, which is explicitly moving toward this goal[105], has spent the last ten years or so entering into and implementing FTAs with China, Korea and Japan. The Western Hemisphere, despite the failure to conclude the Free Trade Agreement of the Americas, has also been moving towards closer economic integration in more modest and incremental steps, with the signing of a slew of bilateral and regional preferential arrangements. This inevitably causes one to ask whether the Americas might try and adopt a kind of regional Pan American Cumulation System, mostly likely under US leadership, essentially mirroring the experience of Europe in the 1990s.

This would be one possible technical approach to square the circle on preferential rules of origin, although it would still result in most of the world's production being traded under essentially one of two separate systems of ROO, with the rest being traded under Asian or other residual systems (Australia-New Zealand for example). Indeed, the only comprehensive way to come up with multilateral disciplines on preferential ROO is at a multilateral institution, like the WTO, the WCO or even the International Organization for Standardization (ISO). At a technical level, the work done in the context of harmonizing non-preferential ROO at the WCO and the WTO could show the way to doing this for preferential ROO, in that the initial technical work would be fielded out to the WCO to complete in a relatively short period of time. The more politically sensitive trade policy issues could then be dealt with by the WTO. In fact, there's very little reason, from a technical perspective, why the rules on non-preferential ROO cannot be taken as a basis for harmonizing preferential ROO, with Members given the option of reserving a certain number of tariff lines where they will be granted the ability to impose additional value-content or production process requirements for a transition period of say between 3 to 6 years. This would in many ways mirror the delayed elimination of all textiles quotas that was agreed under the Agreement on Textiles and Clothing in the Uruguay Round and would give manufacturers the chance to adapt accordingly.[106]

In the next section I discuss some of the possible political economy considerations of harmonizing non-preferential ROO before turning, in the final chapter, to a discussion of some of the broader "big picture" issues for the global trading system as a whole.

5. The Political Economy of Harmonizing Preferential Rules of Origin

This section discusses in brief some of the prevailing political economy dynamics and how they might help or hinder efforts to harmonize non-preferential rules of origin. I discuss this on the basis of the textiles and apparel sector, since it has consistently proven to be one of the most adept at getting rules of origin inserted into trade agreements in a way that ultimately shields it from the full brunt of trade liberalization.[107]

The textiles and apparel sectors in both the US and the EU have long been in a process of steady decline, unable to withstand the onslaught from exports of countries where manual labor is

[105] See the ASEAN Economic Community Blueprint, one aspect of which is transforming the 10 ASEAN Member States into a Single Market and Production Base: www.aseansec.org/5187-10.pdf (April 26, 2012).
[106] See Nordås (2004).
[107] See USITC (2007).

considerably cheaper. In many ways, this has been a direct and largely inevitable result of the combined forces of globalization and comparative advantage, since manufacturing textiles in general and apparel in particular is a very labor-intensive process, it only makes sense that production of these goods would gravitate to countries that have corresponding factor endowments, particularly once the cost of moving these goods from factories in one country or region to markets in another has fallen drastically over the last four decades.[108]

Focusing in more detail on the situation that prevails in the United States, the ROO that govern this sector in most FTAs the US enters into, are some of the most restrictive and complex ever adopted.[109] Two of the most common processing requirements are the Fiber Forward and the Yarn Forward rule. Under the Fiber Forward rule, the fiber itself must be grown or extruded in either the US or the FTA signatory country. Under the Yarn Forward rule, the yarn must be grown or extruded in the US or an FTA signatory.[110] In addition, in the textiles and apparel sector under the ROO applicable to most FTAs, the so-called triple transformation rule applies, pursuant to which apparel must have undergone three processing stages in either the US or the FTA signatory country.[111] These rules impose heavy compliance costs on manufacturers and exporters, but they also put manufacturing processes and supply chains in the textiles and apparel sector into a tight straight jacket, preventing them from finding and exploiting more efficient sources of inputs and preventing them from innovating in their production processes for fear of stepping outside the tight confines of the ROO requirements.

These ROO essentially protect a narrow set of interests, namely US textile manufacturers and US cotton growers. Cotton growers in the United States have long been the beneficiaries of various government schemes intended to artificially afford them a degree of competitiveness that in reality they ceded long ago to other producers of cotton, in places like China, Turkey, Indonesia and Thailand.[112] It is probably safe to say that without the subsidy programs and the "imposed export competitiveness" that US cotton gets from ROO, there would be very little cotton produced in the United States. But the domestic political calculus of cotton, a commodity grown in 17 of the (demographically) fastest growing and/or politically most important US States,[113] makes any effort to change these rules or remove the subsidies, tantamount to political suicide. The only way to achieve progress on this front, by which I mean adopt ROO in textiles and apparel that are less restrictive, would probably be to gradually eliminate US cotton production by "buying out" US cotton growers and giving them assistance to transition to the production of other more competitive crops. Buying out cotton growers in just a few key states like Florida, California and Texas would probably be sufficient to be able to change the political-economy dynamics of this issue.

[108] See Behar and Venables (2011).
[109] Inama (2009), p. 316.
[110] *Ibid*.
[111] *Ibid*.
[112] See http://www.ers.usda.gov/Briefing/Cotton/trade.htm (April 26, 2012).
[113] Cotton is grown in Alabama, Arkansas, Arizona, California, Florida, Georgia, Kansas, Louisiana, Mississippi, Missouri, New Mexico, North Carolina, Oklahoma, South Carolina, Tennessee, Texas and Virginia; source: National Cotton Council website http://www.cotton.org/edu/faq/ (April 26, 2012).

The other industry in the US that benefits from these rules are cotton mills and textile producers. The US textile industry comprises firms that transform basic fibers such as cotton, wool, and polyesters, into a range of products including yarn, fabric, and thread, which are themselves manufactured into finished items such as apparel, sheets, bags or other items.[114] A 2007 Congressional Research Report sums up many of the woes that the industry has succumbed to in recent history:

> "The decline [in US production of textiles and apparel] has been especially notable over the last several years. For example, US output of textile product materials, non-apparel textile end-products, and apparel in August 2006 was 33%, 11%, and 37%, respectively, below the 1999 levels….More significant to many in the U.S. textile and apparel industries, employment in those industries combined fell by more than 60% between 1980 and August 2006. The industries together employed about 610,000 people that month, compared with 2.1 million in 1980."[115]

In the US political economy context, the interest of the textiles producers is directly opposed by those of importers and retailers. The size of the retail clothing store sector in terms of its contribution to GDP and jobs easily dwarfs that of the US textile industry,[116] but it has typically been less well-organized and less vocal in pushing for reform of ROO than have textile manufacturers in advocating restrictive ROO.[117] This is not so much a matter of electoral math (since the retail clothing sector could easily prevail over the textile producers' lobby) as it is getting the US retail clothing sector to organize themselves and unite behind the cause of more liberal ROO.

The most effective way, however, to minimize the incidence of differing ROO is also perhaps the most counter-intuitive, in that it entails an approach that doesn't focus on the ROO at all, nor on mitigating the political economy influence of those interests who advocate for making them as stringent as possible. Reducing MFN tariff rates to zero or close to zero is perhaps the best way to get around overly complex and stringent ROO, since once the margins of preference are sufficiently eroded, the cost of foregoing preferential treatment also approaches zero. Reducing tariffs is something the institutions overseeing the multilateral trading system have proven very efficient at historically, and this indeed seems to be the way things are going, provided the WTO can conclude the present Round[118], and continue with its primary mission of further reducing tariffs, either in the context of future trade Rounds or by means of sectoral arrangements, such as those already in place for, say, information technology products or chemicals.

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[114] Source: www.bis.doc.gov/defenseindustrialbaseprograms/osies/defmarketresearchrpts/texreport_ch1.html (April 26, 2012).
[115] CRS (2007), p. 2.
[116] The U.S retail clothing store industry comprises roughly 100,000 stores nationwide and accounts for a total of $150 billion in revenues each year (http://www.fulcrum.com/clothing_appraisal.htm).
[117] As a rule, retailers in general, and clothing retailers in particular, are more interested in advocating offensive interests in the sense of achieving greater access into new markets and they make this felt in negotiations on opening up distribution services markets in large developing countries, either in the context of WTO accession negotiations or bilateral trade negotiations. These interests might also play an active role in trying to bring down tariffs in NAMA negotiations, but in general they have not taken a very active or organized approach in fighting overly restrictive ROO.
[118] Admittedly a big "if" at the time of writing.

V. IMPLICATIONS FOR THE MULTILATERAL TRADING SYSTEM

In this Chapter, I discuss in brief some of the broader "big picture" issues that merit further consideration in the context of moving towards a set of harmonized non-preferential ROO at the multilateral level.

1. Stepping Stones or Stumbling Blocks?

Much has been written by some very prominent authors about the proliferation of preferential trading arrangements and its potential systemic implications for the world trading system.[119] Many commentators and almost all trade economists seem to take the view that abandoning multilateralism in favor of regionalism or bilateralism cannot be defended on the basis of simple global-welfare arguments, and that, because the institutions overseeing the multilateral trading system have been so good at bringing trade barriers down over the last 60 years, anything that might diminish the WTO's importance or marginalize its role is probably not a good thing. Other commentators seem to take the long view that the wave of regionalism that the world has experienced recently is just the final phase towards the realization of global free trade.[120]

The purpose of this paper is not to discuss the pros and cons of regionalism versus multilateralism, but rather to discuss the desirability and attainability of multilateral disciplines on ROO. With regard to non-preferential rules of origin, the case was made several decades ago (at the latest by the middle of the Uruguay Round as discussed above), for harmonized rules on conferring origin in the context of granting MFN treatment and administering a broad array of trade policy instruments governed by multilateral treaty texts. I shall not revisit these arguments now accept to say that there is a certain compelling logic behind harmonizing rules on such matters as the classification of goods, customs valuation, and of course rules of origin.

In terms of harmonized ROO in the realm of PTAs, it is only recently that the case has started to be convincingly laid out as to why some effort should be expended on achieving this.[121] Perhaps the most obvious reason for trying to achieve harmonization of preferential ROO must be the supply-side inefficiencies they impose in terms of their inherent complexity to administer and organize production around, as well as the compliance costs them impose on producers. The downsides of the current status quo also include the trade-distorting effects of different and overly restrictive ROO at the global level, since they divert resources away from their more efficient uses. In short, opaque, complex and diverging preferential ROO give rise to inefficiencies in global supply chains that in economic terms act a lot like a tax, albeit one that imposes a larger deadweight loss on global economic welfare than a real tax would, since taxes often have broadly distributive effects that can, on the whole, be globally welfare enhancing.

[119] See for example Chapter 2 of the Report by the Consultative Board (2004) cited above at footnote 15.
[120] Baldwin (2006).
[121] The work began in the mid 2000s under the rubric of "multilateralizing regionalism" was arguably one of the first systematic attempts to do this, and also included some reflection on the role that ROO would play in this: see Gasiorek *et al.* (2009) and Estevadeordal *et al.* (2009) for more on this debate.

2. Harmonized Rules of Origin or Liberal Cumulation as Obvious Solutions?

This was effectively the dilemma faced by policy makers in Europe as they were confronted by an industry that, thanks to the unbundling in manufacturing that had taken place over a period of a decade and a half, had become the victim of the overly stringent ROO it had previously sought to impose. Policymakers in Europe addressed this with the PECS (discussed above) and generally speaking, this approach seems to have worked. Whether a similar scheme would be effective at a global level is questionable, but it certainly would seem to recommend itself as a first step in the context of Pan American or Asian regionalism.

A more comprehensive approach would be to negotiate binding disciplines on non-preferential ROO at either the WTO, the WCO or even at the ISO, or perhaps in some kind of combination of some or all of these institutions. Certainly the large degree of success achieved in negotiating harmonized rules on non-preferential ROO (now just awaiting a final push to cross the finish line and become Annex 3 of the WTO Agreement on Rules of Origin) should allow one to be at least vaguely optimistic about the chances of success in doing the same for preferential ROO. Grounds for optimism could be particularly pronounced if a detailed set of non-binding guidelines could initially be developed between, say UNCTAD, the OECD and perhaps an intra-regional best practices club like APEC.[122]

3. Single Undertaking or Variable Geometry?

This last point leads to the question of whether it would be desirable or even feasible to pursue such an agenda under the all-or-nothing formula that has typically characterized most of the rules agreed under the multilateral trading system since the Uruguay Round (under the rubric of the Single Undertaking[123]), or whether a more flexible approach would be likely to produce better results faster. The very tentative calls for a more flexible approach made by then European Trade Commissioner Pascal Lamy in the early days of the Doha Round under the rubric of Flexible Geometry[124] would indeed arguably be the only way forward for coming to a consensus in the near future on non-preferential ROO. The logic of this last statement lies in the fact that an accommodation (i.e. consensus) would only need to be found among 4 or 5 major preference-giving WTO Members, albeit subject to regular consultation with the broader WTO Membership, or in strict compliance with a set of best practices produced by either the WTO Membership as a whole or a coalition of international institutions like those mentioned above (UNCTAD, OECD, APEC).

The Variable Geometry dynamic would also need to be accompanied by an out-of-round approach, by which I mean negotiations on non-preferential ROO should not be tied to the progress of any future trade Round - since so much uncertainty still abounds as to whether we can even finish the present one. The out-of-round approach has yielded some success in the past, say in the case of the overtime negotiations following conclusion of the Uruguay Round, which culminated in a multilateral

[122] See http://www.apec.org/Groups/Committee-on-Trade-and-Investment/Rules-of-Origin.aspx (April 26, 2012).
[123] See Steger (2000) for a discussion of the notion of "Single Undertaking".
[124] Once it was clear that progress on the four Singapore Issues would be impossible under the constraints imposed by the Single Undertaking.

agreement on trade in telecommunications services and another one on trade in financial services.[125] There is no reason why a similar approach shouldn't be able to yield results for non-preferential ROO, particularly if only a smaller sub-set of WTO Members accounting for say, 60 percent of the world's preferential or non-MFN trade were at the negotiating table.[126]

4. Findings and Conclusions

It is probably a fairly safe conclusion that the work which has largely been completed by the WTO and the WCO on non-preferential ROO will culminate in a finished agreement at some point in the short to medium-term future, either as part of a final deal under the Doha process or separately. This is likely to only strengthen the case for a similar set of rules on non-preferential origin determinations, particularly as more and more of the world's trade takes place on a preferential basis and as more and more of the world's manufacturing becomes unbundled, with global supply chains becoming faster, more efficient and cheaper.

This last statement disregards to a certain extent the fact that manufacturing as an industry is itself in the grips of a far-reaching and potentially highly disruptive upheaval, something that some commentators have called the "third industrial revolution".[127] Thus manufacturing is moving away from industrial scale mass-production processes to an increasing level of individual customization and thus back to closer geographic proximity to end users. What this trend will mean for ROO really has yet to be contemplated, although the conceptual work done on origin in the context of trade in services (alluded to at the very beginning of this paper) will doubtless prove very useful).

Finally it's probably time for the quantitative economists to weigh in and produce some research that spells out in unambiguous terms the deadweight economic losses the world is being asked to bear for the perpetuation of a small number of highly restrictive and protectionist ROO that are inimical to the idea of global free trade.[128] And it's time for those economic interests that would benefit from opening up such rules, particularly retailers, to stop lobbying solely for better access for distribution services in large and largely untapped developing country markets, and to start caring more about lowering the costs caused by these rules for the benefit of their present customers.

[125] See Bronckers and Larouche (2005) and Parlin (2002) respectively for a discussion of the overtime negotiations that took place in these two sectors.
[126] This figure would arguably be reached if just the EU and the US did a deal themselves on harmonized preferential ROO, (something they could arguably do in the context of the Trans-Atlantic Economic Cooperation [TEC] initiative) and then impose the results on the rest of the world - similar to what was largely done in the agriculture negotiations during the Uruguay Round with the set of Blaire House agreements.
[127] See "The Economist" dated April 21st-27th, 2012.
[128] See for example Augier *et al.* (2002).

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