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**THE RELATIONSHIP BETWEEN REGIONAL TRADE AGREEMENTS AND MULTILATERAL
TRADING SYSTEM**

RULES OF ORIGIN

This paper forms part of a broader study on the relationship between Regional Trade Agreements and the Multilateral Trading System. Together with other chapters and an overall assessment it will be incorporated into a consolidated document to be submitted to the Trade Committee on 28-30 October, 2002.

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RULES OF ORIGIN

I. Key points emerging

1. In order to better understand RTA approaches with respect to tariffs and assess their effect on trade liberalisation it is necessary to also consider rules of origin in RTAs. Yet, it is difficult to draw firm comparisons between current WTO provisions on rules of origin (the provisions contained in the WTO Agreement on Rules of Origin) and corresponding provisions in RTAs, because of the very different nature of the two types of provisions. RTAs contain detailed rules of origin, while WTO provisions mainly introduce general principles “*to govern the application of rules of origin*” and not detailed rules of origin as such. The comparison may be easier once the WTO work on harmonisation has been completed and detailed rules of origin, harmonised at the WTO level, have been created. However, even after the completion of that work, the resulting **non-preferential** WTO rules will not be readily comparable to the RTA rules of origin, which are mainly **preferential**¹.

2. One of the criticisms often made of RTAs is that they necessarily lead to the proliferation of preferential rules of origin and so add complexity to the trading system and potentially make harmonisation more difficult. The RTAs described here do not seem unambiguously to support this observation. Looked at first from the point of view of RTA members:

- On the one hand it is not uncommon for a single country to have to apply several different sets of rules, depending on the RTAs the country belongs to. For instance, certain types of goods produced in Mexico, both a NAFTA member and a partner in the EU-Mexico agreement, may be subject to two rather different origin determination mechanisms depending on whether they are shipped to North America or Europe, although the Mexican Authorities have made sure that similar principles are applied in the context of both RTAs (see also the next point). For RTA members a question arising is whether expected benefits from preferential access in other partners’ markets will outweigh the inconvenience. Related production and sourcing decisions by companies already established or considering investing in participating countries may vary accordingly. Viewed from the perspective of RTA participants the proliferation and overlap of differing systems of rules of origin is perhaps less a problem of systemic incompatibility than of increased transaction costs for involved traders.

¹ It should be kept in mind that the European Union, as a customs union, sets non-preferential rules at the regional and not at the national level.

- On the other hand it appears that the same basic mechanisms or criteria are used by all RTAs, although in varying combinations. As RTAs proliferate, a small number of models, initially formulated by major trading partners such as the US or the EU, are replicated in the new agreements concluded between them and third countries. Cumulation initiatives further expand the coverage of these models and promote harmonisation among participants. Most of Europe now benefits from the effects of the European cumulation area and similar benefits with respect to preferential access should probably be expected in the Americas once the FTAA process is concluded.

3. From the perspective of non-participating countries the stakes are obviously different than for participating countries. Although the increased transaction costs arising from the proliferation of rules of origin affect third country traders too, for them there is the added question of the more or less restrictive character of the rules in discouraging external sourcing. Most RTA members make sure that RTA provisions, including rules of origin, are appropriately published and publicly disseminated. If, however, such rules are not sufficiently transparent or predictable, they can represent a trade barrier in their own right. This may also be the case if their discretionary character is subject to protectionist capture. Moreover, where the rules of origin allow minimal or no third country inputs (as is the often the case with respect to sensitive sectors), producers in RTA members have a strong incentive to avoid such inputs so as to preserve the preferential status of their own products. In this case third country supplies are not simply denied the preferential access provided for by the RTA, in practice they often lose access altogether. In addition to the resulting diversion of trade flows, this situation may provide a considerable incentive for potential investors to establish within the RTA region, rather than at its periphery.

4. Third country inputs may be widely allowed in several sectors among those covered by RTAs. For instance, in the context of NAFTA, printed circuits assemblies for magnetic tape recorders and other sound recording apparatus have to be produced in the NAFTA region but third country inputs can be used without limitation for their production. It is mainly with respect to sensitive sectors, like textiles and clothing, agricultural or automotive products where the comparison of RTA schemes with the situation that would have prevailed without them leads to concerns about protectionist capture. Often these sectors have been left out of the agreements altogether. In other cases, although detailed product-specific rules have been introduced in order to bring transparency and predictability and reduce the capture potential of more discretionary methods of determination, protectionist interests may have found their way into the texts at the drafting stage and thus been consolidated and “institutionalised” through this incorporation. The stringency of special sectoral rules ensures that third country inputs have very restricted access to the market, especially inputs of a higher value or level of processing. Sometimes the complexity of these rules is such that it may be difficult even for products from the beneficiary countries to qualify.

5. Although it appears that RTA preferential systems contain more restrictive rules than non-preferential systems adopted domestically by the Parties to an RTA, it is not clear that domestic preferential schemes, such as the GSP schemes, are less restrictive than comparable RTA schemes. Indeed, it has been argued that the potential advantage of such domestic preferential schemes is seriously curtailed by the complication of applicable rules of origin and the difficulty in qualifying under those rules. There seems therefore to be an increase in complexity when moving from non-preferential to preferential schemes, be they regional or domestic.

6. The harmonisation to be undertaken in the WTO may lessen the risks inherent in rules of origin by serving as a model for RTAs negotiated in the future. But at the same time, WTO activity will inevitably be influenced itself by the approach to rules of origin contained in existing RTAs, particularly by the models promoted by the major trading partners. A question arising is whether any move to simplify or lessen the restrictive effects of preferential rules of origin is more likely to result from the establishment of a world-wide harmonised system of rules of origin *per se*, or rather from further liberalisation of trade at the multilateral level.

II. Provisions in the WTO: The Agreement on Rules of Origin

Scope and coverage

7. WTO provisions on “rules of origin” mainly set **general principles** on the elaboration and use of rules of origin applied by WTO Members in the context of goods trade. They do not introduce detailed harmonised rules of origin to be used by WTO Members. However, recognising the importance of such rules for enhancing transparency and predictability in world trade, the Agreement on Rules of Origin provided for **harmonisation** to be undertaken by the WTO Committee on Rules of Origin (CRO) and the WCO Technical Committee on Rules of Origin (TCRO). Work on harmonisation, initially due to be completed by July 1998 but extended since, has mainly focused on the concepts of “*wholly obtained*”, for goods produced in a single country, and of “*last substantial transformation*”, if more than one country is involved in the production of the good. The principal criterion to be used for defining substantial transformation is the change of tariff heading (CTH), based on the harmonised system (HS) nomenclature; however, supplementary criteria such as the degree of value-added (VA) or the use of a specific process (SP) may also be used. In the context of WTO work on trade facilitation, several WTO Members have stressed that the achievement of harmonised rules of origin may prove to be the single most important measure of trade facilitation adopted at the multilateral level.

8. The WTO Agreement on Rules of Origin applies to **non-preferential** rules of origin used in commercial policy instruments such as the application of MFN treatment under GATT Articles I, II, III, XI and XIII; anti-dumping and countervailing duties; safeguard measures; origin marking requirements; discriminatory quantitative restrictions or tariff quotas; or in the context of government procurement. **Preferential** rules of origin are not covered by those provisions, although in a Common Declaration annexed to the Agreement WTO Members agree to observe the same principles when they use rules of origin to determine whether goods qualify for preferential treatment (with the obvious exception of principles that are incompatible with the concept of a preferential trade regime, such as the principle of non-discrimination).

9. WTO provisions on rules of origin do not cover rules on services or investment. However, GATS Article XXVII acknowledges the right of Members to deny the benefits of the agreement to “non-originating” services or service providers. By virtue of this provision, such services or service providers include services supplied from or in the territory of a non-Member; maritime transport services by vessels registered under the laws of non-Members; or juridical persons that are not service suppliers of another Member.

Main principles

10. *Neutrality*: By virtue of Article 2(b) and (c) of the Agreement on Rules of Origin, rules of origin should be tools for implementing the policy instruments mentioned above, and should not themselves be used as instruments to pursue trade policy, create restrictive, distorting, or disruptive trade effects, or be based on conditions unrelated to manufacturing, such as environmental or other conditions. However, the principle of neutrality is not included in the Common Declaration on preferential rules.

11. *Non-discrimination*: Article 2(d) expects rules of origin to observe national treatment and the MFN principle. The principle of non-discrimination is not reiterated in the Common Declaration on preferential rules.

12. *Transparency*: Article 2(a) calls for a clear definition of the requirements conferring origin and in particular specifying which tariff headings or subheadings are covered by a specific CTH rule or its exceptions; explaining the method for calculating ad valorem percentages within a VA system; or identifying relevant manufacturing or processing operations within a SP system. Article 2(f) requires Members to use rules specifying what confers origin (positive standard) and avoid rules stating what does not. Article 2(g) requires Members to publish promptly all relevant laws, regulations, judicial decisions and administrative rulings of general application, while Article 5 requests them to provide advance notice of new rules or proposed modifications of existing rules. Article 2(h) requires Members to provide for pre-assessments of the origin of goods upon request from interested businesses.

13. *Predictability and due process*: Article 2(e) calls for a consistent, uniform, impartial and reasonable application of rules of origin, while Article 2(j) requires Members to provide for the possibility of judicial, arbitral or administrative review of determinations of origin.

III. Rules of origin in Regional Trade Agreements*Scope and coverage**Preferential rules of origin*

14. Rules of origin are contained in all regional trade agreements providing for preferential treatment among members, namely free trade areas and customs unions. Such **preferential** rules of origin are aimed at distinguishing products that are entitled to preferential tariff treatment from products that are not. They are an essential component of free trade areas, such as NAFTA, COMESA or ANZCERTA, or customs unions that have not yet completed the transition toward a common external tariff, such as Mercosur². These RTAs use rules of origin to avoid free riding of their regional preferences (trade deflection), by stopping third parties from shipping to the FTA entry with the lowest external tariff for a given product. They are less important for accomplished customs unions, which have a common external tariff, but nevertheless keep their relevance for the administration of external trade preferences, such as GSP schemes, or preferential agreements concluded with third countries. For instance, the existence of a common EU external tariff and a common EU external policy makes the choice between different EU entry points irrelevant. EU preferential rules are thus used to distinguish between goods from various non-EU origins and not between EU and third country origins.

² The validity of transitional rules of origin in Mercosur has been extended until at least 2006.

15. With respect to preferential rules of origin, RTAs cover an area that is not currently part of a work programme aiming at elaborating harmonised WTO rules in the future. However, this does not mean, in itself, liberalisation going beyond WTO commitments; indeed, commentators have often viewed negatively the very existence of preferential rules, since they imply by definition some kind of discrimination in the treatment of different trading partners. Yet, rules of origin are only tools for implementing the tariff policies contained in a given RTA; they should not be protectionist in themselves, although lack of transparency or excess of discretion may offer potential for protectionist capture. The present note focuses exclusively on the restrictiveness or flexibility of rules of origin *as such*, but it should be kept in mind that the more or less liberal character of the RTA will have to be judged mainly on the basis of the **tariff policies** which rules of origin are designed to help implement.

Non-preferential rules of origin

16. Most RTAs leave non-preferential rules outside their coverage: each RTA member country maintains its domestic system of rules of origin for administering anti-dumping and countervailing duties, marking requirements, or quantitative restrictions and quotas. The WTO Agreement on Rules of Origin thus goes beyond most RTAs in this area.

17. The only RTA that has common non-preferential rules of origin, in addition to its preferential rules, is the European Union, which, as a customs union, has a common external trade policy. Although the case is unique, it is worth mentioning as the only *regional* rules-of-origin system directly comparable to the systems already operating at the national level in WTO Members and to the WTO harmonised provisions, once they are finally adopted. At present comparisons between prospective WTO rules of origin and corresponding EU provisions are obviously premature. EU non-preferential rules have substituted domestic rules of Member countries and are used for administering MFN treatment, anti-dumping and countervailing duties, marking requirements, etc. This is an important step towards harmonisation, obviating the need for third countries to comply with differing rules from Member countries (see Box).

Box 1. EU Non-preferential Rules of Origin

EU non-preferential rules are relatively simple, considering product transformation to be substantial if it is “economically justified” and results in a new product or represents an important stage of manufacture, but the criterion is not further defined. Interpretation of the criterion as applied in each case or policy area belongs to the relevant EU institution and leaves certain room for discretion depending on the policy measure for which origin needs to be determined. The criterion is supplemented by an anti-circumvention provision, which denies origin to products transformed solely in order to circumvent anti-dumping or other trade policy measures against specific countries.

However, this transfer of decision-making authority from the Members to EU authorities deprives individual companies of the possibility of seeking redress against questionable origin determinations: unlike, for example, anti-dumping decisions, determinations of origin are not considered to produce direct legal effects vis-à-vis natural or legal persons, so that such persons do not have a standing to initiate proceedings against them. Natural or legal persons affected by determinations of origin will thus either have to ask their national authorities to seek redress on their behalf, or challenge each anti-dumping, countervailing or other decision based on the determination that prejudices them directly.

The coverage of EU non-preferential rules of origin is quite general. Sectoral exceptions include textiles and clothing, shoes, several electronic products, vehicle and equipment parts and certain foodstuffs (including meat and wine). For these sectors or sub-sectors specific non-preferential rules of origin apply, based on lists of specific requirements, such as a minimum percentage of value added (for example 60% for automobiles and electronic products), or of specified types of manufacturing processes. For some industrial product groups it is possible for the importer to choose between a combination of CTH and value-added criteria, or a single value-added criterion which is easier to prove but entails a higher level of local content.

The special case of APEC

18. RTAs that do not entail preferential tariff treatment among members, such as APEC, do not include common rules of origin of either a preferential or a non-preferential type. Rules of origin applicable in the APEC area are the domestic rules of each country member, as well as the preferential rules of RTAs established among APEC members, such as NAFTA, ANZCERTA or AFTA.

19. The principal activity within APEC related to rules of origin is entirely complementary to the process of negotiating and implementing multilateral rules in the WTO. In the 1995 Osaka Action Agenda, APEC economies have pledged to “align [their] respective rules of origin with internationally harmonised rules of origin to be adopted as a result of the WTO/WCO process.” They have thus engaged in information gathering on their respective rules of origin, so as to facilitate WTO/WCO harmonisation work and have already published a compendium of rules of origin in force in the region.

Main principles

Criteria for the determination of origin

20. As a general principle, the determination of the country of origin is based on the division of goods into two categories: “*goods wholly obtained or produced in one country*” and “*goods whose production involved more than one country*”. “*Goods wholly obtained*” in one country are considered as originating in that country, but, although the concept is still relevant for some agricultural and mining products, it has quite limited relevance for most other traded products given the increasing globalisation of production. Some RTAs simply indicate this covers “*the unmanufactured raw products of the territory*” and the goods “*wholly manufactured in the territory .. from .. unmanufactured raw products (or) materials wholly manufactured in the territory*”(ANZCERTA). Other RTAs determine wholly obtained goods on the basis of a list of products, identical or similar to the one contained in the Kyoto Convention (this is the case for AFTA, MERCOSUR, EFTA, CEFTA, the EU and all the agreements it has concluded with third countries). This list contains products mined, harvested or extracted in the country, animals raised, hunted or fished there, waste resulting from local operations and goods produced using exclusively one or more of the above. By extension, RTAs generally consider goods wholly obtained in the territory of one **or more** of their Parties (cumulation) as originating in the territory covered by the RTA and entitled to preferential tariff treatment (see below).

21. Goods whose production involved more than one country are considered as originating in the country where they underwent their **last substantial transformation**, as determined by a series of quite complex rules. The three main criteria used world-wide for defining substantial transformation and which have also influenced WTO work on rules of origin are whether the transformation has caused a specified **change of tariff heading** (CTH), based on the harmonised system (HS) nomenclature; what is the

percentage of **value added** (VA) by the transformation; and whether the transformation occurred using a **specified manufacturing process** (SP). Each criterion has its advantages and drawbacks and none is perfectly appropriate for all products and purposes, so that RTAs usually combine all of these criteria in varying degrees³. Special mention should be made of NAFTA and the EU, because these two agreements seem to have heavily influenced other RTAs concluded in their periphery, such as MERCOSUR, or the Canada-Chile FTA for NAFTA, and EFTA, CEFTA, or the agreements the EU has concluded with third countries for the EU. Other RTAs use different mixes of the above criteria (for instance, principally VA for the US-Jordan FTA; VA and SP for ANZCERTA; VA and CTH for COMESA). AFTA uses solely VA criteria, provided that the last manufacturing operation (not further specified) has taken place in the exporting Member State.

22. In NAFTA substantial transformation is judged mainly through a tariff-shift mechanism, supplemented by *value-added* criteria. The system is structured along detailed schedules of products or groups of products to which specified changes of tariff provision apply. Each non-originating material has to undergo a change in tariff classification, specified in the detailed schedule of HS tariff heading or subheading changes corresponding to each product or group of products. In some cases it is a change at the four-digit and in others at the six-digit subheading level of the tariff schedule. In certain circumstance where there is no change in the level of tariff classification specified in the first rule applicable to the good, origin can be conferred if a lesser tariff shift is satisfied and the regional value-added is not less than 60% of the transaction value or 50% of the net cost of the good. The extensive use of the tariff-shift mechanism brings considerable transparency and predictability to the system, although the choice of subheadings offers no less potential for protectionist capture than the other two main criteria for determining origin. In addition to the basically transparent nature of the system, NAFTA provides for an advance origin ruling at the request of importers, exporters or producers of the good, a provision that was taken up in the WTO Agreement on Rules of Origin.

23. In the EU substantial transformation is defined⁴ on the basis of a list of processing or manufacturing operations which have to be carried out on specific non-originating materials in order to confer origin to the resulting product. The system thus follows a *specific processing* criterion, which is quite restrictive upon firms' choice of production methods. Requirements are very detailed and specific, bearing a considerable degree of transparency and predictability, although it is often argued that they are so complex as to make it quite difficult for products to qualify. ECJ jurisprudence has consistently maintained that EC authorities should apply preferential rules (GSP rules) in a more restrictive manner than non-preferential ones so as to ensure that preferences benefit only industries in developing countries.

De minimis or tolerance rules

24. Most RTAs contain a *de minimis* rule, which allows for a specified maximum percentage of non-originating materials to be used without affecting origin (5% for EU, 7% for NAFTA, and 10% for EFTA). This rule concerns materials that would otherwise not be allowed under CTH or SP criteria but does not affect the operation of VA criteria: the non-originating materials will be counted in when calculating the maximum value of non-originating materials not to be exceeded. For instance, the Canada-Chile Agreement very clearly refers to "*the value of non-originating materials ... that do not undergo an applicable change in tariff classification*"⁵. In most RTAs energy, equipment and tools used in the

³ For a thorough discussion of the advantages and drawbacks of the three main methods for determining origin, see the survey by the WTO Secretariat "Rules of Origin Regimes in Regional Trade Agreements", Job No(01)/131 of 17 September 2001.

⁴ We refer here exclusively to EU **preferential** rules.

⁵ Similar language is to be found in NAFTA and all other RTAs negotiated by Canada since.

manufacture of products are not taken into account in this respect. The *de minimis* rule acts as a softening of CTH or SP criteria making it easier for products with non-originating inputs to qualify. It has thus to be taken into account when judging the more-or-less restrictive character of a system.

Insufficient operations

25. Independently from the criterion used primarily for defining substantial transformation, several RTAs contain a separate list indicating the operations that are in all circumstances considered insufficient to confer origin. The list may be quite short, such as in the US-Jordan Agreement (*simple combining and packaging operations, or mere dilution with water or with another substance that does not materially alter the characteristics of the article or material*)⁶, or in MERCOSUR (*assembly, division in lots or volumes, selection and classification, marking, putting together assortments of goods*). In these cases the list is often supplemented by an anti-circumvention provision, considering as non-qualifying any operation demonstrably aimed at circumventing rules of origin (such as in Canada-Chile). Other RTAs, such as EU, EFTA or CEFTA include a relatively detailed list of insufficient working or processing operations, covering preservation during transport and storage (f.i. ventilation, placing in salt or sulphur dioxide, removal of damaged parts), simple operations of cleaning, sorting, painting, packaging, marking and labelling, assembling, or animal slaughtering.

Intermediate materials

26. The input of non-originating intermediate materials may be dealt with in a more or less liberal manner. The **absorption**, or “roll-up” principle allows materials which have acquired origin by fulfilling specific processing requirements to maintain this origin when used as input in a subsequent transformation (i.e. non-originating materials are no longer taken into account in calculating value-added). Absorption is used quite extensively in the RTAs participating in the European cumulation area (EU, EFTA, CEFTA, see below) and contributes to simplifying the application of an otherwise complicated system. The EU-Mexico Agreement states that “*..if a product which has acquired originating status by fulfilling the conditions ... is used in the manufacture of another product, the conditions applicable to the product in which it is incorporated do not apply to it, and no account shall be taken of the non-originating materials which may have been used in its manufacture.*” Similarly, a good may acquire originating status if it is produced in a NAFTA country from materials considered as originating (whether such materials are wholly obtained or having satisfied a CTH or VA criterion) even if no tariff shift takes place between the intermediate material and the final product.

27. Other provisions (such as NAFTA with respect to textiles) require changes to some headings to occur sequentially through other specified tariff headings in order for the product to qualify: for instance, clothing must have gone through the tariff change from yarn to thread, from thread to cloth and from cloth to clothing. This approach, which brings the system close to a “specified-process” mechanism, means that clothing manufactured in a NAFTA country from cloth woven there, but using yarn not formed in a NAFTA country cannot qualify. This affords a level of protection from low-cost imports into NAFTA markets, which may be higher than that existing before NAFTA⁷. Furthermore, if a specified sequence of

⁶Similar language is to be found in NAFTA or Canada-Chile.

⁷NAFTA rules on textiles use a “triple transformation” test, instead of the “double transformation” test (covering only the immediate inputs and not the whole production process) used in the Canada-US FTA. Canada, whose apparel production was quite dependent on third country inputs, has negotiated tolerance quotas, based on essential inputs shortages in their market.

tariff changes has to apply, there is an incentive for producers to avoid any non-originating inputs, and this may result in trade diversion to the detriment of non participating countries.

Excluded sectors and special sectoral rules

28. In addition to their origin rules of general application, several RTAs contain sector-specific rules for a number of sensitive sectors. Special sectoral rules of origin are commonly more stringent than rules of general application, allowing more limited, if any, non-originating inputs. The two sectors that are most commonly covered by RTA preferential tariff treatment but excluded from general RTA rules of origin are textiles and clothing and the automotive sector. On the other hand, sectoral rules of origin for agricultural products are far less common, mainly because agriculture does not usually benefit from the same liberal treatment RTAs may bestow on other sectors (in CEFTA for instance, a schedule of concessions covers agricultural products while industrial products benefit from a timetable for the progressive abolition of customs duties). In RTAs which contain rules of origin on agricultural products (most RTAs using SP criteria, such as EFTA or EU agreements with third countries), several of these products need to be wholly obtained in order to qualify: non-originating inputs are not allowed as no working or processing carried out on them can confer originating status.

29. In NAFTA rules on automobiles require the item to satisfy minimum content requirements. The mechanism of regional value content is quite similar to a value-added mechanism, minus the “roll-up” principle: a good other than a motor vehicle produced from non-originating materials will acquire origin because of a change in tariff classification, but if it is subsequently used, for example, in a motor vehicle engine assembly, the value of the non-originating materials will be deducted when it comes to calculating the value-added of the engine as a whole. In the automotive sector regional value content requirements have been progressively raised from 60 to 62.5%, depending on the vehicle type (from an initial 50%, corresponding to the rule applicable under the US-Canada FTA).

30. Textiles and clothing are often subject to a very stringent specified sequence of tariff changes or manufacturing operations that strongly discourage non-originating inputs too. In RTAs mainly relying on SP criteria (for instance EFTA or EU-Mexico), the precision and sequencing of qualifying operations tends to allow non-originating inputs only if completely unprocessed or at a very early stage of processing (for NAFTA coverage of the textiles sector see above). However, this is very restrictive stance is somehow mitigated by the tolerance of some percentage of non-originating input in accordance with *de minimis* rules. Contrary to the *de minimis* rules of general application, tolerance in the textile sector usually refers to a maximum weight of non-originating materials (see EU-Mexico).

Cumulation mechanisms

31. Cumulation is another important instrument for the admission of non-originating materials. Where cumulation applies it allows producers to use non-originating materials from specified origins without losing the preferential status of the final product. The most basic form of cumulation is generally applied to materials which do not originate in the preference-seeking country but in another of the countries parties to the RTA (*bilateral* cumulation between the members of a bilateral RTA, *full* cumulation within a plurilateral RTA considered as a single preferential territory). In the application of such cumulation RTAs generally consider goods obtained in the territory of one or more of their Parties as originating in the territory covered by the RTA and entitled to preferential tariff treatment. This includes production in more than one of the RTA Members or production in one Member from materials originating in another Member. EFTA rules of origin consider as “*originating*” the products that have been obtained using materials originating in another EFTA Party. EU products that undergo transformation in a country

granted preferential access are considered as originating in that country. Similar rules of full or bilateral cumulation between the parties of the RTA apply to NAFTA, ANZCERTA, Canada-Chile or EU-Mexico.

32. *Diagonal* cumulation allows for materials supplied by specific countries *not* parties to a given RTA to be counted as “domestic”. The most important examples of diagonal cumulation, established by separate agreements between members of the “cumulated” RTAs, are the European Economic Area (EEA) Agreement between EU and those EFTA countries that have not joined the EU; and the Europe Agreements between EU and the European economies in transition. Since 1997 a system of European cumulation, based on a network of “connecting” agreements and protocols between the concerned countries, has been established between the EU, the EFTA countries, the central and eastern European countries, the Baltic States, Slovenia and Turkey, harmonising preferential rules of origin. European cumulation now allows economic operators to use components originating from any of the 30 participating countries without losing the preferential status of the final product. Cumulation thus goes a long way in expanding the geographical and product coverage of the system and is a major factor of harmonisation. However, some WTO Members have raised concerns that cumulation between separate, free-standing RTAs, where a particular RTA scheme provides benefits to certain non-Parties to that RTA but not to others, may violate the MFN principle⁸.

Drawback provisions

33. An important aspect of RTA rules of origin (which mitigates the above mentioned expansion effects of cumulation within the RTA) is that shipments among RTA partners are no longer considered to be “exports” for purposes of drawback laws. This means that tariffs collected on non-originating products can no longer be refunded when those products are incorporated into products exported to other RTA partners. This operates as a disincentive to the importation of some components from third-country sources, and may have the same trade-diverting effect as a restrictive rule of origin. Drawback prohibitions are to be found in most RTAs.

Rules of origin for investment and services

34. “Rules of origin”/denial of benefits clauses for investment and services are contained in few RTAs. A noteworthy example is NAFTA. Criteria used in determining the origin of investment or services are quite different from those applied to goods. In this area the Agreement has adopted a relatively liberal stance, compared to provisions previously applied by the US-Canada FTA. Origin is conferred to investments made by any resident or incorporated entity in a NAFTA country, regardless of country of ownership or control. The cross-border trade in services chapter goes even further, extending NAFTA privileges to any service-providing entity having substantial business activities in a NAFTA country. That is, a Party may deny the benefits of the cross-border trade in services chapter to a service provider incorporated in another Party only if it establishes that the entity is owned or controlled by persons of a third party *and* that the enterprise has no substantial business activities in the territory of *any* Party. NAFTA also contains preferential “rules of origin”/denial of benefits clauses for investment and for services trade. The focus in developing such rules was on ensuring that non-member entities did not circumvent the investment and services disciplines of the Agreement through recourse to shell companies.

⁸See "Rules of Origin in Regional Trade Agreements, WTO Job No. (01)/131, paragraph 34.

GLOSSARY

- ACP (African, Caribbean and Pacific States):** Burundi Cameroon Central African Republic Chad Congo (Brazzaville) Equatorial Guinea Gabon Rwanda Sao Tomé and Príncipe Congo, Democratic Republic Comoros Djibouti Eritrea Ethiopia Kenya Madagascar Mauritius Seychelles Somalia Sudan Tanzania Uganda Angola Botswana Lesotho Malawi Mozambique Namibia South Africa Swaziland Zambia Zimbabwe Benin Burkina Faso Cape Verde Côte d'Ivoire Gambia Ghana Guinea Guinea Bissau Liberia Mali Mauritania Liberia Mali Mauritania Niger Nigeria Senegal Sierra Leone Togo Antigua and Barbuda Bahamas Barbados Belize Dominica Dominican Republic Grenada Guyana Haiti Jamaica St Christopher and Nevis St Lucia St Vincent and the Grenadines Haiti Jamaica St Christopher and Nevis St Lucia Suriname Trinidad and Tobago Cook Islands Federated States of Micronesia Fiji Kiribati Marshall Islands Niue Papua New Guinea Republic of Nauru Republic of Palau Solomon Islands Republic of Nauru Republic of Palau Solomon Islands Tonga Tuvalu Vanuatu Samoa.
- AFTA (ASEAN Free Trade Area):** Brunei Darussalam, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam.
- ANDEAN COMMUNITY:** Bolivia, Colombia, Ecuador, Peru and Venezuela.
- ANZCERTA (Australia-New Zealand Closer Economic Relations Trade Agreement):** Australia and New Zealand
- APEC (Asia Pacific Economic Co-operation Forum):** Australia; Brunei Darussalam; Canada; Chile; China; Hong Kong, China; Indonesia; Japan; Korea; Malaysia; Mexico; New Zealand; Papua New Guinea; Peru; the Philippines; Russia; Singapore; Chinese Taipei; Thailand; United States; Vietnam.
- CARICOM (Caribbean Community):** Antigua and Barbuda, the Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Haiti, Jamaica, St Kitts and Nevis, St Lucia, St Vincent and the Grenadines, Republic of Suriname and Trinidad and Tobago. The Bahamas does not participate in the common market and Haiti is not yet a full member.
- CEFTA (Central European Free Trade Agreement):** Bulgaria, Czech Republic, Hungary, Poland, Romania, Slovakia, Slovenia.
- COMESA (Common Market for Eastern and Southern Africa):** Angola, Burundi, Comoros, Democratic Republic of Congo, Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Madagascar, Malawi, Mauritius, Namibia, Rwanda, Seychelles, Sudan, Swaziland, Zambia, Zimbabwe.
- EAA (Agreement on the European Economic Area):** Austria, Belgium, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Liechtenstein, Luxembourg, the Netherlands, Norway, Portugal, United Kingdom, Spain, Sweden.
- ECOWAS (Revised Treaty of the Economic Community of West African States):** Benin, Burkina Faso, Cape Verde, Côte d'Ivoire, Gambia, Ghana, Guinea, Guinea-Bissau, Liberia, Mali, Mauritania, Niger, Nigeria, Senegal, Sierra Leone and Togo
- EFTA (European Free Trade Association):** Iceland, Liechtenstein, Norway and Switzerland.

- EU (European Union):** Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, United Kingdom, Spain, Sweden.
- Europe Agreements:** The EU has concluded these with Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic, Slovenia.
- Euro-Med (Euro-Mediterranean Association Agreements) (First-generation):** The EU has concluded these with Cyprus, Malta, Turkey.
- Euro-Med (Euro-Mediterranean Association Agreements):** The EU has concluded these with Tunisia, Israel, Morocco and the Palestinian Authority.
- Euro-Med (Euro-Mediterranean Co-operation Agreements):** The EU has concluded these with Algeria, Egypt, Jordan, Lebanon and Syria.
- FTAA (Free Trade Area of the Americas):** Antigua and Barbuda, Argentina, Bahamas, Barbados, Belize, Bolivia, Brazil, Canada, Chile, Colombia, Costa Rica, Dominica, Dominican Republic, Ecuador, El Salvador, Grenada, Guatemala, Guyana, Haiti, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay, Peru, St Lucia, St Kitts and Nevis, St Vincent and Grenadines, Suriname, Trinidad and Tobago, Uruguay, United States, Venezuela.
- MERCOSUR (Mercado Común del Sur / Southern Common Market Agreement):** Argentina, Brazil, Paraguay and Uruguay.
- NAFTA (North American Free Trade Agreement):** Canada, Mexico, United States.
- OAU (Organization of African Unity):** Algeria, Angola, Benin, Botswana, Burkina Faso, Burundi, Cameroon, Cape Verde, Central African Republic, Chad, Comoros, Cote d'Ivoire, Democratic Republic of Congo, Djibouti, Egypt, Equatorial Guinea, Eritrea, Ethiopia, Gabon, Gambia, Ghana, Guinea, Guinea-Bissau, Kenya, Lesotho, Liberia, Libya, Madagascar, Malawi, Mali, Mauritania, Mauritius, Mozambique, Namibia, Niger, Nigeria, Rwanda, Saharawi, Arab Democratic Republic, Sao Tome and Principe, Seychelles, Senegal, Sierra Leone, Somalia, South Africa, Sudan, Swaziland, Tanzania, Togo, Tunisia, Uganda, Zambia, Zimbabwe.
- SAARC (South Asian Association for Regional Co-operation):** Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, Sri Lanka.
- SADC (Southern African Development Community):** Angola, Botswana, Democratic Republic of Congo, Lesotho, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, Tanzania, Zambia, Zimbabwe.
- Treaty Establishing the African Economic Community:** Algeria, Angola, Benin, Botswana, Burkina Faso, Burundi, Cameroon, Cape Verde, Central African Republic, Chad, Comoros, Cote D'Ivoire, Democratic Republic Of Congo, Djibouti, Egypt, Equatorial Guinea, Eritrea, Ethiopia, Gabon, Gambia, Ghana, Guinea, Guinea-Bissau, Kenya, Lesotho, Liberia, Libya, Madagascar, Malawi, Mali, Mauritania, Mauritius, Mozambique, Namibia, Niger, Nigeria, Rwanda, Saharawi Arab Democratic Republic, Sao Tome And Principe, Seychelles, Senegal, Sierra Leone, Somalia, South Africa, Sudan, Swaziland, Tanzania, Togo, Tunisia, Uganda, Zambia, Zimbabwe.
- Treaty Establishing the Economic and Monetary Union of West Africa:** Benin, Burkina Faso, Côte d'Ivoire, Mali, Niger, Senegal and Togo.