

# WORLD TRADE ORGANIZATION

RESTRICTED

**G/RO/W/20**

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**Committee on Rules of Origin**

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## REVISED PROPOSAL BY THE UNITED STATES PURSUANT TO ARTICLE 9.3(a) OF THE AGREEMENT ON RULES OF ORIGIN

The Committee on Rules of Origin, at its meeting on 6 February 1997, agreed that the following communication from the Permanent Mission of the United States should be circulated to Members. The initial proposal by the United States on this matter is contained in document G/RO/W/15.

At the upcoming meetings of the WTO Committee on Rules of Origin (Committee) there will be consideration of a US proposal for a "Starting Point" for approaching the analysis required by the Harmonization Work Programme under the Agreement on Rules of Origin (Agreement), particularly at the WCO's Technical Committee on Rules of Origin (Technical Committee). The US proposal is intended to enhance the ongoing work by adding efficiency to the discussions, without changing any of the procedures already underway. The proposal is also intended to help ensure that the harmonization work is consistent with the intent of the Agreement. The US proposal also reflects ongoing concern over the need to avoid the use of rules of origin that involve requiring a value content percentage (value test).

Under the mandate of the Agreement, the Technical Committee is currently providing the Committee with its interpretations and opinions. Likewise, the Committee is giving its ongoing consideration to those interpretations and opinions of the Technical Committee. Pursuant to Article 9 of the Agreement, the Committee may request the Technical Committee "to refine or elaborate its work and/or to develop new approaches".

### US proposal for a Starting Point for origin harmonization discussions

- The development of product-specific rules is currently being conducted under the terms of the Agreement's second phase of the Harmonization Work Programme. In accordance with the Agreement, this task includes considering and elaborating upon, on the basis of the criterion of substantial transformation, "the use of change in tariff subheading or heading when developing rules of origin for particular products or a product sector and, if appropriate, the minimum change within the nomenclature that meets this criterion" (i.e. the criterion of substantial transformation).

- While it is true that the Harmonized System (HS) was not originally developed with an intent as a basis for origin rules, it is already used throughout the world for preferential and non-preferential rules of origin. This has developed by virtue of the fact that the HS establishes a unique nomenclature and coding system for all goods that are traded, with long-standing and well-established rules for interpretation.

- The Agreement specifically reflects an intent for the paramount use of change in tariff classification in developing multilateral non-preferential rules of origin. More importantly, the Agreement mandates consideration of the minimum change within the HS nomenclature that represents a substantial

transformation. This makes clear that a rigorous value test as rule of origin runs counter to the intent of the Agreement.

#### A Starting Point to provide focus for discussions

- The proposed Starting Point involves the following: the discussion would simply start with the proposition that substantial transformation is deemed to have taken place when assembly or other processing operation results in a change from the HS nomenclature category providing for "parts" to a tariff category providing for the "goods". This would be consistent with the Agreement-mandated consideration of "the minimum change within the nomenclature" which meets the criterion of substantial transformation.
- For certain products, any Member may have a view differing from the Starting Point proposition that origin is confirmed when an operation brings about a transformation of "parts" into a "product". The Member could present a specific reason for this view to the Committees in the course of the discussion on the specific rule of origin involved.
- Such a Starting Point would provide a common analytical framework for all Members and for both the Committee and the Technical Committee. It would also set a direction for discussion and consideration by the Members. The pace and efficiency of the Work Programme would be increased, consistent with the analytical methodology mandated under the Agreement.

#### The Starting Point would not disturb procedures

- The use of a Starting Point would not involve disturbing results already reached, and such a Starting Point would have no effect on Members' participation in discussions, nor in the substance or format of the results of the work being done by the Technical Committee.
- More importantly, it would ensure that the focus of the harmonization negotiations is on the products themselves, by considering - as mandated by the Agreement - the minimum change in tariff classification that articulates a substantial transformation.
- This Starting Point for the harmonization discussions is to be contrasted with an inappropriate focus - as has been suggested by some Members - on how "sophisticated" or "complex" or "substantial" a particular manufacturing process is. Such a focus which ignores the effect that takes place on the product itself (i.e. the substantial transformation of "parts" into a "product") will bring about rules of origin - such as a value test - that are disruptive to trade and contrary to the intent of the Agreement.
- The use of a Starting Point would advance the fundamental intent of the Agreement, which is to ensure that "rules of origin themselves do not create unnecessary obstacles to trade" and "are prepared in an impartial, transparent, predictable and consistent manner".

#### Difficulties with a value test as a non-preferential rule of origin

- In this regard, we are aware that some participants in the Harmonization Work Programme are seeking a value test as a multilateral rule of origin for certain products, such a 45 per cent domestic content test for products in the electronics sector. This is a matter of concern because of the uncertainty, complexity and cost burdens resulting from the use of such a value test as a rule of origin.

Cost burden on trading community

- Implementation of a value test can bring about a significant resource burden on customs administrations. More importantly, with regard to the compliance burden presented to the trading community there have been estimates that such a rule of origin - regardless of the percentage required by the value test rule of origin - is the equivalent of an additional two to five per cent tariff. This is because of the costly systems necessary to track inputs and other costs.
- The Harmonization Work Programme must be undertaken in an outward-looking fashion, with market access concerns in mind, rather than inward-looking with an intent to maintain outdated, inefficient and trade-distorting practices. The results of the harmonization should be rules that allow origin determinations to be made easily and transparently.

Complex, with inconsistent results

- It has been suggested that a value test as a rule of origin would be simple. In fact, our experience shows the theory is simple, the application is not. A value test as a rule of origin presents the need to track the cost of inputs and keep extensive accounting and financial records, adding an unwarranted costly burden to manufacturing.
- The results of a value test as a rule of origin are often inconsistent and unpredictable. Many manufacturers utilize global sourcing, particularly with fungible inputs. Changes in the cost of materials combined with exchange rate fluctuation can mean that a particular production operation may confer one country of origin one day, but a different country of origin the next day.
- The non-preferential rules of origin resulting from the ongoing Harmonization Work Programme will be used multilaterally. Inconsistent determinations of country of origin that may result from a multilateral value test rule of origin will be contrary to the intent of the Agreement and the Harmonization Work Programme.

Same product, same process, but with different origin results

- A value test as a rule of origin could be applied to the same product made by the same process, but could lead to different results in countries that have differing costs of production. In this way value test as a rule of origin may actually reward less efficient, more costly production. In particular, such a rule may work to the disadvantage of developing countries, where labour costs may be low and make it difficult to meet the value test if any significant amount of foreign inputs are used.
- Under a value test for determining country of origin, issues over allocation continually arise with regard to each cost involved in the production of a good, creating a need for complex rules of inclusion and exclusion. One example of this problem relates to determining the proportion of overhead costs attributable to production, or determining whether such costs, if fully allocated to past production, cannot be allocated to future production of exported goods.
- The value test may not reflect the level of production that occurs in a particular country, since the results may be more dependent on currency exchange rates and swings in the costs of raw materials. As such, the value test does not produce consistent results, and means that its use as a multilateral rule of origin would not bring certainty to the trading community.

Implementation resources

- Significant resources on the part of both the private sector and customs administrations are required to ensure compliance with value test rules of origin, including development of agreed-upon accounting controls and analysing and verifying cost information.
- Customs administrations are presented with difficulty when verifying or refuting origin claims by a non-domestic manufacturer under a value test rule of origin. Because of the complexities and uncertainties involved, a value test as a non-preferential rule of origin provides opportunities for manipulation in order to circumvent trade laws, and also provides ample potential for trade disputes over origin determinations.
- All of these difficulties mean that a value test as a multilateral non-preferential rule of origin could undermine the intended benefits of the results of the work under the Agreement.