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Committee on Rules of Origin

SUBMISSIONS ON THE ASSEMBLY RULE

Addendum

The Secretariat circulates herewith an additional submission made by a Member on the assembly rule, which is to be discussed by the Committee on Rules of Origin (CRO) at the informal meeting on 28 November 2001.

SUBMISSION BY THE UNITED STATES

At the last meeting of the CRO, Members were invited to submit their views on appropriate criteria for determining the origin of goods of chapters 84 to 90 produced by assembly. The issue is Issue No. 1 to those chapters.

The issue

- In reviewing the positions taken thus far it appears that there is consensus that assembly can confer origin. Differences of view lie in respect of the conditions which should be satisfied for such assembly to be considered origin-conferring. There are two camps:

- One camp relies on the change of classification technique with an alternative value-added criteria when the required classification change is not satisfied (i.e. CTH or value-added rule).

In application, the value added criteria would be used in 3 instances;

- when a machine (or part) is completed from an unfinished machine (or part) or modified from a machine of the same heading,
- when a machine is assembled (wholly or in part) from goods classified as parts of such machine, and
- when a "part" is assembled from components classified in the same heading or subheading as the part (so-called parts to parts).

- The other camp relies largely on the change of classification technique, with the so-called 5-part rule to be applied in certain cases when the classification rule is not satisfied. Proponents of the 5-part rule seem to differ on the scope of its application and the way in which it would be applied.

- To clarify the United States position with respect to the 5-part rule:

For Chapters 84 through 90 the rule would apply only to goods classified under provisions for "parts" and only when the change of classification or other primary rule is not met. The rule would operate as follows:

- parts assembled from 5 or more components (as defined) would have origin in the country of assembly,

- parts assembled from fewer than 5 components parts where one is originating in the country of assembly would have origin in the country of assembly, or
- if fewer than 5 components are assembled and none has origin in the country of assembly, then the country of assembly cannot be the country of origin. In that case origin would be determined by the major portion rule based (usually on the cost of non-originating parts).

The differences between the two camps

(a) With respect to machines assembled from unfinished machines of the same heading or modified from machines of the same heading,

- the value-added (V/A) camp would recognize the assembly or modification as origin-conferring provided the value criteria are satisfied.
- the non-value-added (NV/A) camp would either not recognize the assembly or modification as origin-conferring (U.S.) or would apply the 5-part rule.

(b) With respect to machines assembled from their “parts”,

- the V/A camp would recognize the assembly as origin-conferring provided the value criteria are satisfied,
- the NV/A camp would recognize the assembly as origin-conferring without further conditions.

(c) With respect to “parts” assembled for components classified in the same heading or subheading as the part,

- the V/A camp would recognize the assembly as origin-conferring provided the value criteria are satisfied,
- the NV/A camp would recognize the assembly as origin-conferring provided the so-called 5 part criteria are satisfied.

Comments on the differences

(a) Machines assembled from unfinished machines of the same heading or modified from the same machine

Very little product-specific information in support of this rule has been forthcoming. Generally, in instances where it has been called to our attention that a significant manufacturing process has taken place which is considered to result in a substantial transformation, we have endeavoured to accept product-specific provisions in lieu of a value standard. Two examples are the case of encrypted machines and the modification of machine tools from non-numerically to numerically controlled tools. In both of those instances our statistical data have confirmed the extensive added value involved. Accordingly, and consistent with the Agreement, a value-added test was not necessary.

Unfortunately, specific examples of other cases have been lacking. In view of the burdens, limitations and inherent deficiencies of the value-added standard as an expression of substantial transformation, discussed below, we are not willing to recognize the conferring of origin merely based on unspecified processing operations. After the painstaking line-by-line review of the HS that the two committees have undertaken over the past 5 years, a blanket value rule to handle isolated cases is simply not acceptable. We can imagine that there may be many instances when a machine or apparatus classified in a particular heading undergoes minor assembly or production operations of a very limited nature. In that event the value-added approach would nevertheless require extensive

documentation to demonstrate that the origin of the machine has not been affected by those operations. The additional burdens placed on the trade would be, in our view, entirely unreasonable and unwarranted.

If there are specific processes of assembly that are applicable to the goods of these chapters which merit attention, we would be willing to examine them with a view to accepting such operations as origin-conferring.

(b) Machines assembled from their “parts”

As a matter of general principle we consider the assembly of a machine from its parts to be a substantial transformation whereby the identity of the individual parts and components have been subsumed into the identity of the whole. We can therefore accept the assembly as origin-conferring. If there are cases where it can be demonstrated that no substantial transformation has taken place we would appreciate being advised so that modifications can be made to the rules.

(c) “Parts” assembled from components classified in the same heading or subheading as the part.

The situation with respect to goods classified as “parts” is unique. Because of the non-specific nature and uncertain product scope of parts provisions it is not possible to provide product-specific rules to recognize substantial transformations resulting from assembly operations. That being the case we have proposed a surrogate test by means of the five part rule. Unlike value-added, the 5-part rule imposes specific production criteria, provides latitude in the case of originating material contributions and provides some comfort in recognizing simple assemblies from conferring origin unless there is significant production by the country of assembly.

The value-added approach and its limitations

In our view, to the extent possible value-added rules should be avoided for determining non-preferential origin by reason of their difficulty of administration, burdens upon traders, technical deficiencies, questionable neutrality, and lack of uniformity and predictability.

As a reflection of Substantial Transformation -

(a) Value-added rules are not neutral or consistent

The value-added approach brings about different results in countries with differing costs of production -- even though the same good is produced by the same process. This is particularly the case in sectors such as electronics, where multiple sources for inputs are utilised. Due to differing labour costs from country to country different origin determinations may result. To have the origin determination influenced by wage-rate differentials moves the issue very far away from the principle of substantial transformation and is not only contrary to the basic underpinning of the Agreement, it undermines the possibility of neutrality. What is called for is harmonization in the result not just in the approach.

In addition, prices are subject to many forces unrelated to the production process, such as fluctuations in currency values and material costs, as well as conditions of competition which may vary considerably for any given commodity from country to country and within the business cycle. Each of these elements frustrate the intent to harmonize the rules of origin on a predictable basis. Moreover, to the extent that the origin of the good is used for country of origin marking, this lack of consistent result can only result in confusion to both the producer and consumer.

(b) The value-added standard is unacceptable in non-preferential rules of origin

In preferential origin arrangements the purpose of a threshold standard (including one based on value added) is to determine eligibility for a benefit. Most typically this benefit is bargained-for or granted as a concession. There is in this regard an intention reflected that certain processing be performed in a particular country. The value-added standard is less objectionable in this context, because it may be presumed that the contracting parties take into account specific economic conditions and costs of production. Moreover, in preferential regimes substantial transformation is frequently not the specified legal standard.

Such is not the case in a non-preferential origin regime, which is not concerned in any direct way with the conferment of a benefit. It is beyond the technical capacity of this Committee to take account of local conditions and cost structures applicable to all production, and further, then to specify a value or cost threshold suitable for all. The setting of value or cost based thresholds for global non-preferential trade does not represent harmonization that facilitates trade and administration, but instead is the raising of unwarranted barriers to trade flows.

Equally unwarranted in a non-preferential regime are the burdensome documentary and record-keeping requirements that value-added rules inevitably bring with them. Given that no particular benefit is offered under non-preferential rules, the substantial costs of compliance, as discussed below, stand as an unrecoverable cost and obstacle to trade flows.

(c) Value-added rules use arbitrary thresholds not related to production

Under a value-added rule, fluctuations in price and cost factors – themselves unpredictable - can tip the origin outcome in one direction or another. Such variable factors should not be permitted to change origin outcomes in non-preferential rules based on substantial transformation. Among other things, it is this arbitrary, unpredictable aspect of value-added rules that renders the value-added test unacceptable as a multilateral non-preferential rule of origin, regardless of whether the threshold criteria is 60 per cent, 45 per cent, or 30 per cent. The United States does not find any principled basis for choosing one threshold over another in the context of this harmonization work. A 30 per cent threshold thought suitable for a country or for an operation at a given time does not have enduring or universal validity in the global sourcing environment.

Administrative Difficulties -(d) The needed data may either be unavailable or unreliable

For related party transactions the cost data are often not reliable; for non-related party transactions the data may not be available. Suppliers will normally be reluctant to provide data, and may not provide it at all. The reluctance of a seller to give cost data to his customer, or his customer's customer, is a commercial reality. In a preferential arrangement the unavailability or unreliability of the data may result in denial of preference. Given that for non-preferential origin every good must be assigned a country of origin, what does the importer do if he cannot obtain these data? What, for that matter, does the Administration do?

It has been stated in support of value-added that the value information is available currently as it is used for preferential regimes. For the United States, for the year 2000, of total imports of goods classified in chapters 84 through 90 (\$586.5 billion) \$459.5 billion (representing 78.4%) was not eligible for preferential treatment and value information were not required.

In addition, anecdotal information indicates that due to administrative burdens associated with preparing cost information there is substantial trade that forgoes claiming preferential treatment. For

Chapters 84 through 90 there is over \$5 billion of eligible imports from Canada and Mexico that do not claim the benefit of the NAFTA tariff preference.

(e) There is no end to tracking of costs and prices

Further administrative difficulties are presented by the fact that costs shift from shipment to shipment. A value added origin outcome could be changed by market fluctuations, seasonal requirements for sourcing, or when a producer shifts in minor ways between domestic and foreign materials used in production. It therefore follows that a trader exercising agility in adjusting to market conditions incurs an increased cost of tracking, calculating and verifying cost data each time the trader seeks, legitimately, a comparative advantage. He is in effect penalized for efficiency.

(f) Appropriate accounting will entail extraordinary costs

The accounting questions that must be answered simply to administer value added rules include: allocation of overhead costs; attribution of profit; treatment of related party costs; treatment of tariffs, taxes, rebates, returns, commissions and licensing fees. The United States acknowledges that the specific EC proposal does not necessarily raise all of these questions. Nevertheless, the issues of assigning value to self-produced materials, of accounting for related party transactions, and of accounting for the value of intermediate materials will be present, and will bring with them unavoidable administrative burdens. The United States reiterates that such costs are an unjustifiable non-tariff barrier.

(g) The risk of manipulation is high

Such a document-intensive regime creates large incentives to less-than-full compliance. Traders would naturally seek to minimize the number of origin assessments, even though, as discussed above, the elements of the rule are dynamic. A temptation to rely upon "stale" certifications would be likely. Obviously, also, a fictitious price, for example, could permit a trader to achieve his desired origin outcome.

These issues do not arise under a tariff shift regime. A material obtained from any country, and subjected to the same operation, yields the same origin outcome without reliance on documentation.

(h) The record-keeping burden is both unreasonable and unnecessary

Such difficulties amount to an unacceptable record-keeping burden for the private sector, along with an equally unacceptable intrusiveness when customs administrations conduct verifications.

Technical problems

(ij) Recall EC formula:

"manufacture where the increase in value acquired as a result of working and processing, and if applicable, the incorporation of parts originating in the country of manufacture represents at least 45% of the ex-works price of the product."

Formula allows intangibles to be improperly taken into account -(k) Not reflective of actual production

The “subtractive method”, i.e. a formula that starts with the ex-factory price of the good and then subtracts domestic materials and production costs, does not identify the major portion of the processing. It compares costs of inputs against the total market price or value. In this regard it departs from the substantial transformation principle by introducing “apples-to-oranges” comparisons that will be valid only for that single transaction; fluctuations in the ex-market price (which are to be expected) will affect, transaction-by-transaction, whether the added value criterion is met. When profits, which are always part of an ex-factory price, are compared with costs of materials, the comparison is not appropriate, because while materials costs may legitimately reflect production, profits do not. Moreover, the inclusion of profit in the value added calculation means that profit fluctuations will generate instability and inconsistency of origin outcomes by application of a value added rule. This fact works to frustrate the objective of uniformity in origin determinations.

(l) Value-added is not needed

In conclusion, no case has been made on a product-specific basis that such rules would either: 1) express substantial transformation where other criteria do not; or 2) serve to prevent “simple assembly” from being recognized as substantial transformation.

(m) The tariff shift approach is clear, simple, objective and transparent and a reliable reflection of substantial transformation

The point of departure for all origin rules is the identification and classification of the materials used to produce a good. It is only a single further step to determine whether materials have undergone a prescribed change in classification. This determination can be made by simple consultation of the change in classification requirements for the good in question. The objectivity of the determination is assured by the near-universality of the Harmonized System, and correspondingly, by the avoidance of supplementary indicia that are subject to interpretation and discretion. Any trader or Administration may make, observe or supervise the determination by reference to well-accepted signposts.

(n) There is neutrality of application and result

The United States considers that one of the most critical advantages of the tariff shift approach is its neutrality. Given that classification of a good or material is in the overwhelming majority of cases, the same in any country, specified changes in classification will produce the same outcomes everywhere. The tariff shift approach thus can assure, unlike value added rules, uniformity of results: the same processing of a good in any number of countries will have the same result under the rules of origin. This result can only be to the advantage of every user.

(o) Tariff shifts represents actual problem

The tariff shift method is faithful to the substantial transformation principle because substantial transformation is determined by reference to actual manufacturing operations and not presumed by reference to a price that the trader may have been able to obtain. The Committee has been careful to ensure that only tariff shifts that reflect production operations, and not shifts resulting from minimal operations events such as packaging, merely putting up in sets, and application of GIR 2(a) are used in the expression of substantial transformation. It is important not to lose sight of the fundamental idea that substantial transformation is the result of manufacturing operations.

- (p) The tariff shift approach, with several simple processing rules, affords simplicity and ease of use

It has always been the view of the United States that in every possible case the rule of origin for a good should be indicated at a product-specific level in the matrix. In overwhelming proportion this can be done, providing a rule and outcome at the primary rule level with a single application. Moreover, this approach permits consideration of the nature and industrial processing of the good and its relationship to substantial transformation.

- (q) The application and outcome of tariff shift rules is easily verifiable

The use of a single neutral, transparent and objective basis for the origin rules-- tariff classification – furnishes Administrations with a universally understood measurement. Verification of origin can be done without reference to cost studies, prices, or necessary adjustments to these for freight, packing and other expenses. The United States submits that the tariff shift approach is by far the least burdensome for Administrations verifying compliance. For traders, the approach clearly minimizes the burdens of record keeping.
