Trade Policy

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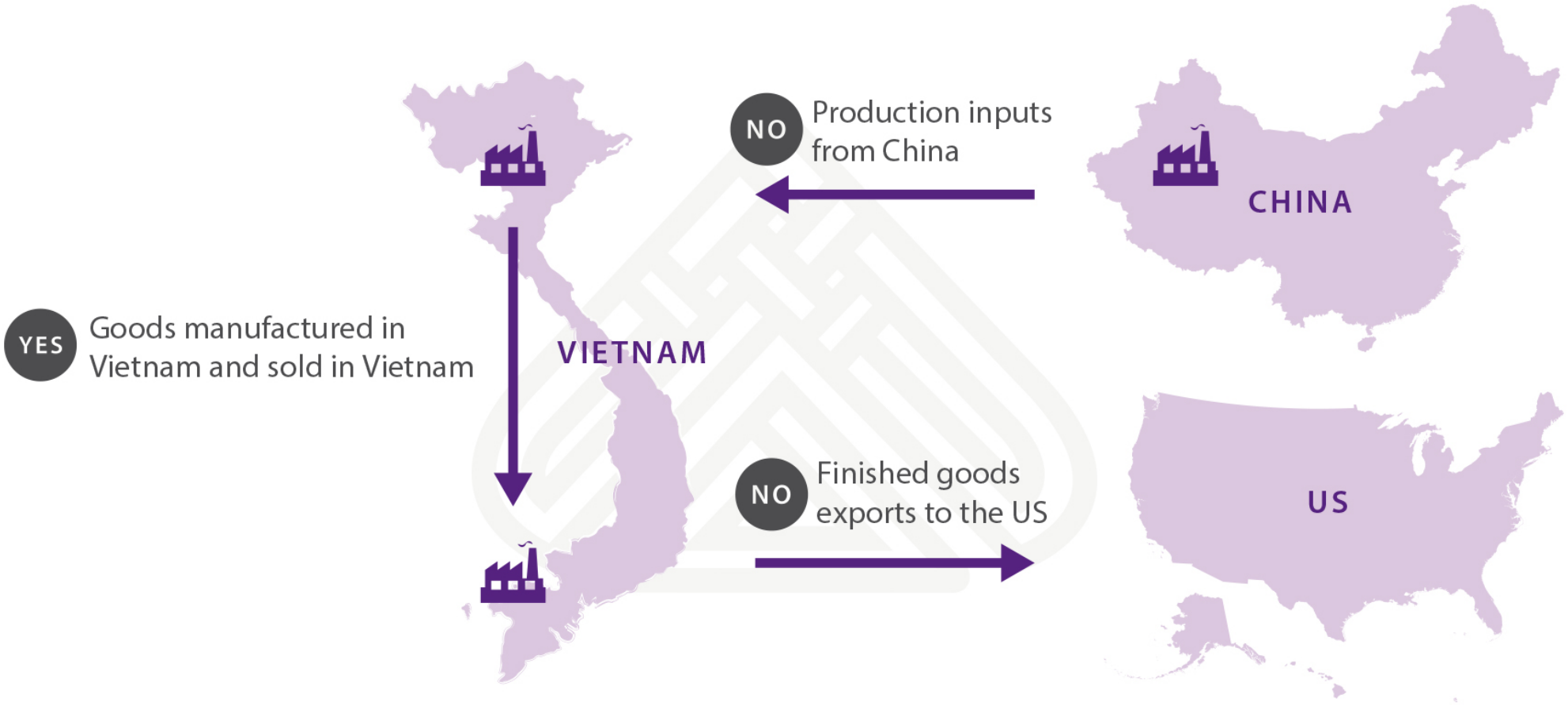
Made in Vietnam: Application of Draft Regulations



CPTPP Rules of Origin & Textile and Apparel Goods

Summing up Rules of Origin

- Article 3.2: Originating Goods Except as otherwise provided in this Chapter, each Party shall provide that a good is originating if it is:
  - (a) wholly obtained or produced entirely in the territory of one or more of the Parties as established in Article 3.3 (Wholly Obtained or Produced Goods);
  - (b) produced entirely in the territory of one or more of the Parties, exclusively from originating materials; or
  - (c) produced entirely in the territory of one or more of the Parties using non-originating materials provided the good satisfies all

Summing up Rules of Origin

- Article 3.6: Materials Used in Production
- 1. Each Party shall provide that if a non-originating material undergoes further production such that it satisfies the requirements of this Chapter, the material is treated as originating when determining the originating status of the subsequently produced good, regardless of whether that material was produced by the producer of the good.
- 2. Each Party shall provide that if a non-originating material is used in the production of a good, the following may be counted as originating content for the purpose of determining whether the good meets a regional value content requirement:
  - (a) the value of processing of the non-originating materials undertaken in the territory of one or more of the Parties; and
  - (b) the value of any originating material used in the production of the non-originating material undertaken in the territory of one or more of the Parties.

Summing up Rules of Origin

- Article 3.11: De Minimis
- 1. Except as provided in Annex 3-C (Exceptions to Article 3.11 (De Minimis)), each Party shall provide that a good that contains non-originating materials that do not satisfy the applicable change in tariff classification requirement specified in Annex 3-D (Product-Specific Rules of Origin) for the good is nonetheless an originating good if the value of all those materials does not exceed 10 per cent of the value of the good, as defined under Article 3.1 (Definitions), and the good meets all the other applicable requirements of this Chapter.
- 2. Paragraph 1 applies only when using a non-originating material in the production of another good.
- 3. If a good described in paragraph 1 is also subject to a regional value content requirement, the value of those non-originating materials shall be included in the value of non-originating materials for the applicable regional value content requirement.

Summing up Rules of Origin on Textiles

- Application of Chapter 3
- 1. Except as provided in this Chapter, Chapter 3 (Rules of Origin and Origin Procedures) shall apply to textile and apparel goods. De Minimis
- 2. A textile or apparel good classified outside of Chapters 61 through 63 of the Harmonized System that contains non-originating materials that do not satisfy the applicable change in tariff classification requirement specified in Annex 4-A (Textiles and Apparel Product-Specific Rules of Origin), shall nonetheless be considered to be an originating good if the total weight of all those materials is not more than 10 per cent of the total weight of the good and the good meets all the other applicable requirements of this Chapter and Chapter 3 (Rules of Origin and Origin Procedures).
- 3. A textile or apparel good classified in Chapters 61 through 63 of the Harmonized System that contains non-originating fibres or yarns in the component of the good that determines the tariff classification of the good that do not satisfy the applicable change in tariff classification set out in Annex 4-A

Summing up Rules of Origin on Textiles

- Article 4.3: Emergency Actions
- 1. Subject to this Article if, as a result of the reduction or elimination of a customs duty under this Agreement, a textile or apparel good benefiting from preferential tariff treatment under this Agreement is being imported into the territory of a Party in such increased quantities, in absolute terms or relative to the domestic market for that good, and under such conditions as to cause serious damage, or actual threat thereof, to a domestic industry producing a like or directly competitive good, the importing Party may, to the extent and for such time as may be necessary to prevent or remedy such damage and to facilitate adjustment, take emergency action in accordance with paragraph 6, consisting of an increase in the rate of duty on the good of the exporting Party or Parties to a level not to exceed the lesser of:
  - (a) the most-favoured-nation applied rate of customs duty in effect at the time the action is taken; and
  - (b) the most-favoured nation applied rate of customs duty in effect on the day immediately preceding the date of entry into force of this Agreement for the importing Party.

Rules of Origin and Trade Preferences

Why do Rules of Origin Matter?

- The application of trade preferences, whether unilater (such as the Generalized System of Preferences or GSP) or granted as the result of free trade agreements (FTA's) requires guidelines that enable the origin of goods to be defined so as to ensure the preference benefit only those products originating in the beneficiary countries.
- Origin regimes can result in inefficient production and discrimination
- Stringent rules of origin can severely restrict the sourcing of inputs from outside and FTA

Why do Rules of Origin Matter?

- Origin regimes define a good as originating inside an FTA when it is produced entirely within the member nations. Possible criteria for enough change to still receive preferential treatment of the FTA include:
  - Change in tariff classification. This involves the requirement that the tariff classification of the finished good differs from that of the foreign components or materials
  - Minimum value added threshold
  - Use of specific technical process or certain components in manufacturing a product

NonPreferential Rules of Origin and the WTO Harmonization Program

Why do Rules of Origin Matter?

- WTO Agreement on Rules of Origin calls for Harmonization Work Program to create a common set of non-preferential rules of origin
- A principal objective of the Agreement on Rules of Origin is to harmonize non-preferential rules of origin and ensure that they are applied equally for all purposes
- A major issue for countries with respect to harmonization of origin rules is to decide whether to lose, retain, or obtain origin.

Why do Rules of Origin Matter?

- Business life evolves at a faster pace than multilateral trade negotiations yet customs and trade officials will always have to determine origin
- Rules of origin that are being negotiated are tailored to the industrial and technological processes used in industrial countries and do not necessarily mirror he needs, abilities, and resources of developing countries and their customs administration

Rules of Origin as Noodle Bowls


RULES OF ORIGIN
MAKE ACCESSING THE BENEFITS
OF TRADE AGREEMENTS ABOUT
AS EASY AS EATING A BOWL
OF NOODLES WITH ONLY
ONE CHOPSTICK
RULES OF ORIGIN
CHINA
JAPAN
USA
THAILAND
ASEAN
AUSTRALIA
NEW ZEALAND
CHILE
MALAYSIA
KOREA
TRADE AGREEMENTS

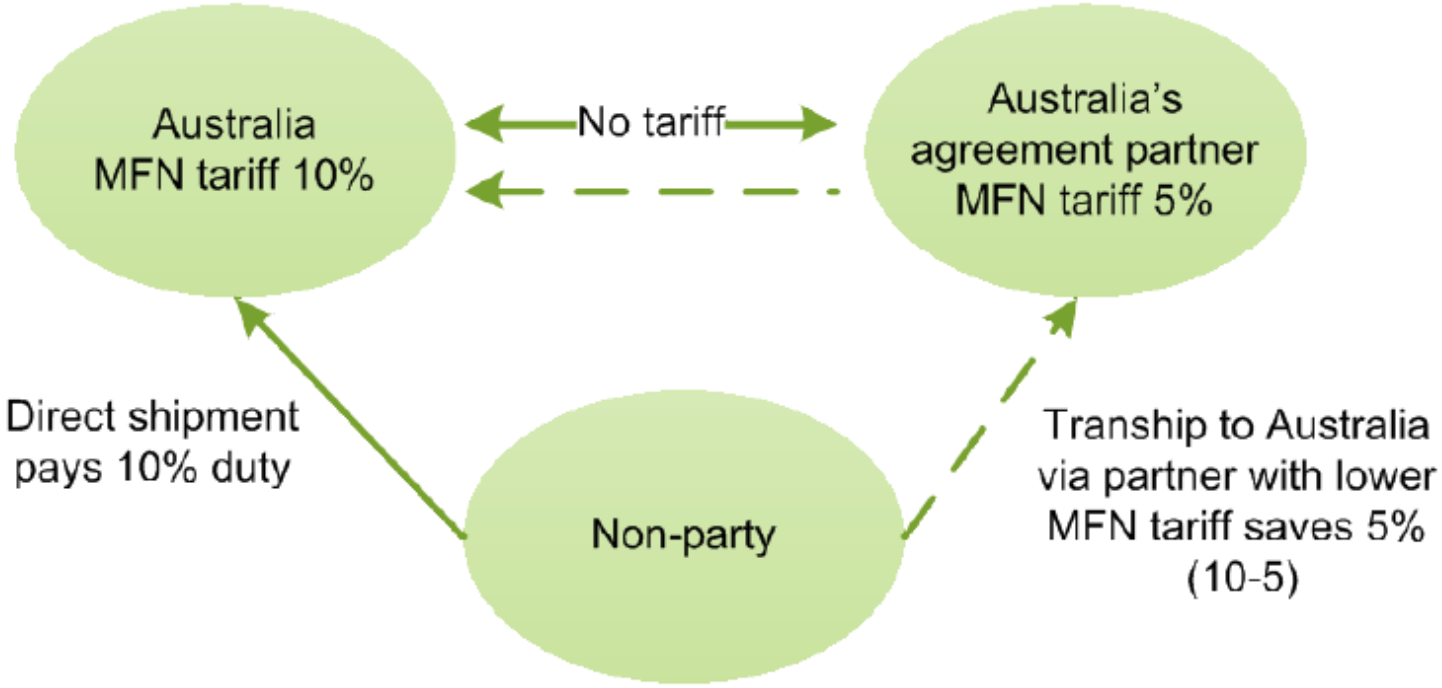
Summing up Rules of Origin

- Rules of Origin (RoO) have become a pernicious barrier to trade for Australian business. Their inherent protectionism is little known — well disguised in their daunting yet mind numbingly dull complexity.
- RoO are transformation tests (often requiring a local value added threshold be met) to earn tariff and quota preferences under preferential trade agreements (PTAs). They are a non-tariff barrier.
- RoO are insidious as they afford an impression of trade concessions, but instead their complexity and restrictiveness substantively erode the purported positive trade impacts of the PTA.
- The costs of RoO (which also include business uncertainty and trade concession erosion) will only worsen in a world of fragmented global value add chains and PTA proliferation.

What are Rules of Origin?

Rules of Origin (RoO) are intended to stop exporters in countries, other than partners to a preferential trade agreement (PTA), availing themselves of the preferences negotiated in the agreement. Goods partly manufactured in a partner country (using inputs from non-partner countries) are only eligible for preferential tariff treatment if the local manufacturing has sufficiently transformed the non-partner inputs.

Figure 1 **RoO aim to prevent non-agreement parties taking advantage of preferential tariffs**



What are Rules of Origin?

- How much are RoO being used for trade creation or protectionist purposes?
- Are RoO getting in the way of the expansion of PTAs working for overall trade liberalisation?
- Does the cost of compliance undermine the value of PTAs for importers and exporters?

How Protectionist are Rules of Origin?

- Discriminatory tariff preferences in each trade agreement have both trade creating and trade diverting tendencies. The RoO in each agreement affects just how much trade is restricted.
- In a PTA the transformation tests can be varied by product and it is generally agreed that no one test is best. The WTO concluded that there is no fully satisfactory methodology for origin determination, applicable to all products and serving all purposes (WTO 2002). This gives considerable scope for the RoO to be designed with protection for import competing industries (and regional input suppliers).

Details Matter

With RoO, the devil is in the details. More stringent RoO reduce the scope for transhipment, but they also can act as protection for import competing firms from competition from the exporters in the PTA partner country. That is, they can restrict the very trade that the PTA was aiming to boost.

Transformation Test

- The regional value content (RVC) test — the exported good must reach a threshold percentage value of locally or regionally produced inputs. For instance, a family car imported into Australia from the USA is eligible for tariff reduction under the AUSFTA if at least 50 per cent of the production cost was on USA and Australian inputs.
- The change in tariff classification (CTC) test — the exported good must have a different tariff classification from any imported inputs. The CTC method can be applied at 'broad' more restrictive (2 digit or chapter) or more 'fine' less restrictive (HS 4 digit or heading or HS 6 digit sub-heading) product groupings of the Harmonized Commodity Description and Coding System (HS). For instance, transforming non-originating cotton (within chapter 52) into clothing (within chapter 61) involves more significant transformation than the 4 digit change of turning uncarded cotton (52.01) into carded cotton (52.02).
- The specified process test — the exported good must have undergone specified manufacturing or processing operations which are deemed to confer origin of the country in which they were carried out. For example, dissolving solution in water or other solvents is not considered a chemical reaction and purification must result in the elimination of not less than 80 per cent of the impurities.

Testing Rules of Origin

- De minimis — exempts a certain minimal part of non-originating goods from having to satisfy a CTC test. For instance, AUSFTA allows up to 10 per cent of the free on board value of the final good for all non-originating materials. The ASEAN, EU and proposed TPP all use 10 per cent, and NAFTA 7 per cent, but are not all directly comparable as there are differences in the calculation basis (such as free on board, ex-works, total cost, and final price).
- Cumulation — extends the definition of originating inputs to include other countries. For example, under the ANZCERTA an Australian exporter to New Zealand can count inputs from New Zealand as 'originating'. RoO today routinely allow for this bilateral accumulation. A more liberal arrangement is diagonal cumulation. This allows an Australian exporter to New Zealand to count Chilean inputs because both Australian and New Zealand had agreements with Chile. Full cumulation occurs when a group of countries are all linked to each other by a network of agreements and the cumulation area is the whole area covered by the countries in two or more separate PTAs

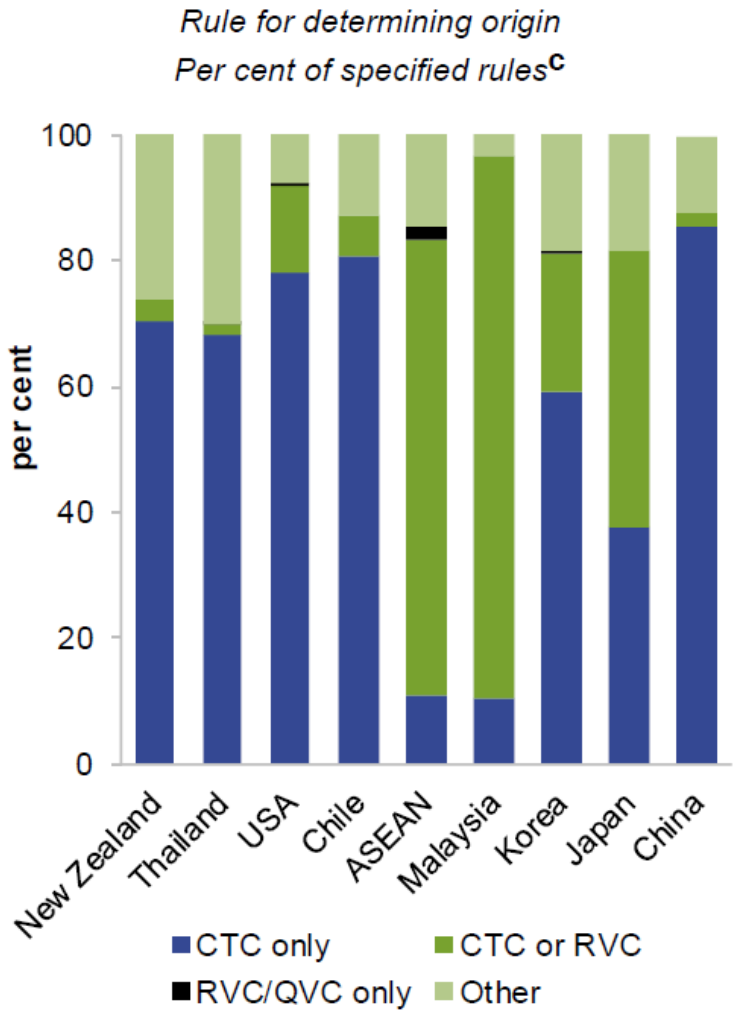
Why Do Rules of Origin Inhibit Liberalization?

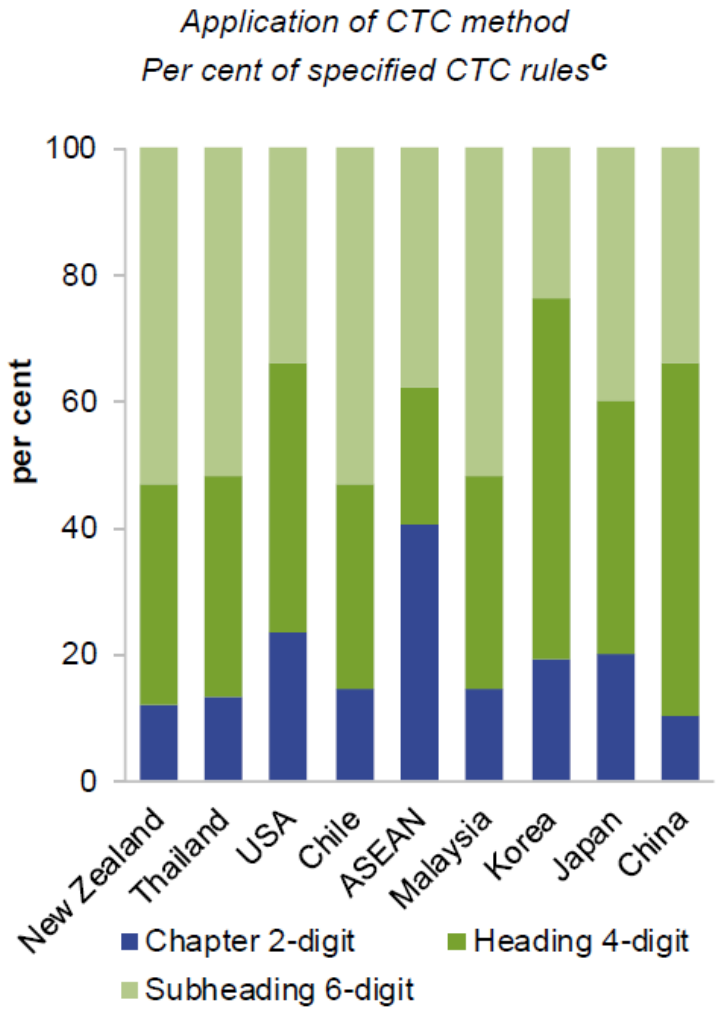
In a world where governments have largely stepped back from unilateral trade liberalisation and multilateral negotiations have stalled, it has been argued that bilateral and regional trade agreements can be a force for liberalisation. However, multiple agreements, each with its own RoO, and tariff reduction schedules, complicate the production and trade calculus. Baghwati (2008) has described this set of overlapping agreements as the ‘spaghetti bowl’, and more recently Davidson (2014) labelled Australia’s set of agreements as the ‘noodle-bowl’.

Why Do Rules of Origin Inhibit Liberalization?

Trade diversion happens because the tariff preference allows the PTA-partner exporter to ‘undercut’ existing (or potential) cheaper non-party suppliers. It is the RoO transformation test that protects this advantage by preventing third-party country transhipment. Thus, there is trade creation between the partners and trade diversion away from lower cost sources. If the agreement partner is the existing supplier of a product — a so called natural trading partner — the RoO is unlikely to be needed. But its existence may exclude relatively ‘lightly’ transformed product and thereby diminish trade creation.

Figure 5 **Methods used to determine origin of merchandise trade in Australia's preferential trade agreements[a,b,c,d]**





How Does RoO Work in Practice?

- All of Australia's trade agreements provide some products with a choice between a CTC or RVC test. Allowing choice should act to reduce the stringency and compliance costs compared to only the specified CTC or RVC.6 The choice formulation is highly prevalent for the MAFTA (almost 90 per cent of tariff lines), ANZCERTA (around 85 per cent) and JAEPA (about 50 per cent).
- In contrast to a choice formulation, some RoO require dual tests, for instance a CTC and RVC, which effectively sets the RoO at the more restrictive of the two. The ChAFTA requires motor vehicles (HS 8704) to satisfy both a CTC(4) and a RVC45 test. Curiously, the parts and accessories for these vehicles (HS 8708) are subject to a choice test (CTC(4) or RVC50).
- An example that combines both a choice and a dual test can be found in the AANZFTA. Cooking appliances and plate warmers: for gas fuel or for both gas and other fuels (HS 7321.11) offer a choice between a RVC(40) or CTC(4) test, or alternatively the choice of a dual test of (RVC(35) + CTC(6)).

How Does RoO Work in Practice?

- A significant consequence of tailor-made RoO across agreements is that an exporter faces different RoO in different markets. For example, in the case of bed linen (HS 6302), six agreements require a CTC(2) transformation but differ in the supplementary tests and exceptions. Where an exporter faces different RoO the most restrictive can become binding for a firm. That is, if that market is important to the firm and the costs of altering the product for different markets are non-trivial, firms have to change their production process in order to comply.
- Overlapping trade agreements compound the problem. Australia has bilateral preferential arrangements with New Zealand (1983), Singapore (2003), Thailand (2005) and Malaysia (2012), which are also members of the AANZFTA (2010) agreement. The 2016 revision (yet to take effect) to the SAFTA (to a CTC based system to align with the AANZFTA) resolved one overlap as originally the Singapore agreement was a RVC-only test of either 30 or 50 per cent, but other overlaps remain.

Examples of RoO in Trade

- Australia–United States. Change to heading 6302 from any other chapter, except from heading 5106 through 5113, 5204 through 5212, 5307 through 5308 or 5310 through 5311, chapter 54, or heading 5508 through 5516, 5801 through 5802 or 6001 through 6006, provided that the good is both cut (or knit to shape) and sewn or otherwise assembled in the US or Australia.
- Thailand–Australia. Change to heading 6302 from any other chapter, provided that any non-originating material that is fabric is pre-bleached or unbleached, and that there is a regional value content of not less than 55 per cent.
- Australia–New Zealand. Change to heading 6302 from any other chapter, provided that where the starting material is fabric, the fabric is raw and fully finished in the territory of the Parties; or No change in tariff classification is required, provided that there is a regional value content of not less than 45 per cent based on the build down method.
- Australia–Chile. Change to heading 6302 from any other chapter provided that where the starting material is fabric, the fabric is raw and fully finished in the territory of the parties.
- Malaysia–Australia. Change to heading 6302 from any other chapter, provided that where the starting material is fabric, the fabric was greige fabric that: (a) is dyed or printed; and (b) finished in Australia or Malaysia to render it directly usable.
- Japan–Australia. Change to heading from any other chapter provided that, where non-originating materials of headings 50.07, 51.11 through 51.13, 52.08 through 52.12, 53.09 through 53.11, 54.07, 54.08, 55.12 through 55.16, or chapter 60 are used, each of the non-originating materials is woven, or knitted or crocheted entirely in the Area of one or both Parties.

Table 5 **Proof-of-origin systems: import country requirements**

System	*Key features*	*Percentage of trade agreements*[a]	*Typical adoptees*
1. Authority issued certification, including e-certificates	Government authorities or delegated bodies issue the certificate of origin in a prescribed format	32.9	Intra-African and intra-Asian
2. Approved Exporter system	Exporters with prior approval may make origin declaration on commercial documents	36.9	European
3. Fully exporter-based system	Any exporter can sign and issue a certificate of origin of a prescribed form	22.1	Americas
4. Importer-based certification	Importers certify the origin of goods	8.1	

[a] 149 trade agreements entered into force 1994 to 2013.

Source: Azzam 201.

Appendix Slides

Transformation Footnotes

[a] CTC refers to a change in tariff classification test. RVC refers to a regional or qualifying value content rule. 'Other' includes combined CTC and RVC rules, CTC rules with exceptions, and specified process tests requiring particular production methods needed to qualify for preferential entry. [b] The agreement with Singapore is not included as it applies a RVC-only test to all products, of either 30 or 50 per cent. In 2016 it was agreed that it would change to a CTC only system that aligns with the AANZFTA (yet to take effect). [c] Individual rules can be expressed at the 4 digit heading level, 6 digit subheading level or groupings of tariff line items. [d] When the ANZCERTA entered into force in 1983, an RVC rule with a simple technical test was the main rule applied. The figure reflects revised rules in force since 1 January 2007.

Source: Commission estimates.