Do Rules of Origin Constitute an Impermissible Barrier to Trade?

Rules of Origin in EU Preferential Trade Agreements

Author: Faraz Davani
Supervisor: Professor Carl Fredrik Bergström
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## Abbreviations

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<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>ECJ</td>
<td>European Court of Justice</td>
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<td>EU</td>
<td>European Union</td>
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<td>GATT</td>
<td>General Agreement on Tariffs and Trade</td>
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<td>GSP</td>
<td>Generalised Scheme of Preferences</td>
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<td>NAFTA</td>
<td>North American Free Trade Agreement</td>
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<td>PTA</td>
<td>Preferential Trade Agreement¹</td>
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<td>ROO</td>
<td>Rules of Origin</td>
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<tr>
<td>TEU</td>
<td>Treaty on European Union</td>
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<td>TFEU</td>
<td>Treaty on the Functioning of the European Union</td>
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<td>UNCTAD</td>
<td>United Nations Conference on Trade and Development</td>
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<tr>
<td>WTO</td>
<td>World Trade Organisation</td>
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¹ Other, often referred to abbreviations in trade circumstances, with the same or similar meaning are FTA (Free Trade Agreement) and RTA (Regional Trade Agreement).
1 Introduction

1.1 Background

Determining the origin or economic nationality of goods is an essential procedure in international trade. The rules of origin (ROO) are necessary for two reasons. Firstly, they relate to the requirements that must be fulfilled in order to satisfy the conditions for being considered as originating in a given country. Secondly, the rules also relate to the formalities and certifications that must be presented to verify compliance with the above-mentioned requirements.²

Historically, ROO have been considered a technical necessity for preventing trade deflection.³ That is, the prevention of trans-shipment of goods through low tariff countries. Chinese products may face higher tariffs than Turkish products when entering the European Union (EU). This naturally creates an incentive for Chinese producers to ship their goods through Turkey. Origin requirements will prevent the trans-shipment, making sure only Turkish products benefit from a possible EU-Turkey trade agreement. The ROO are thus a fundamental component of international trade, and essential for the existence of trade agreements. The importance of ROO is also highlighted when trade restrictions or defences are in place against a certain country, such as sanctions, anti-dumping measures and quotas.⁴

With the development of global trade leading to more segmented production, creating so called global value chains, determining origin has become significantly more

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⁴ Ibid, p 2.
complicated.\textsuperscript{5} Origin can only be conferred to a single country.\textsuperscript{6} Therefore the definition of origin for a product, where the production process spans across several countries, will undoubtedly be difficult. The World Trade Organisation (WTO) aspires to remove all barriers to trade. Restrictive ROO could potentially constitute such a barrier to trade, pushing the limit of the international trade regulations of the WTO.

1.2 Aim

While preferential ROO are meant to prevent trade deflection, they may also be used as a trade restricting and protectionist tool. This may be in conflict with WTO agreements, which stipulate that restrictions of commerce between member states shall be eliminated. Are the ROO in preferential trade agreements (PTAs)\textsuperscript{7} increasingly used for illegitimate trade objectives, and do they constitute a protectionist barrier to trade?

1.3 Terminology

Preferential ROO are used within free trade agreements (FTA), regional trade agreements (RTA) and customs unions.\textsuperscript{8} FTAs and RTAs will from hereon be referred to as preferential trade agreements (PTAs). The terms products and goods will be used interchangeably in this thesis, as is common in trade law doctrine.\textsuperscript{9} While there may be a difference in certain circumstances, with goods often referring to raw material and products to something manufactured, there is little need to separate the two for the purpose of this text.

\textsuperscript{7} See section 1.3.
\textsuperscript{8} Estevadeordal and Suominen 2003, p 2.
\textsuperscript{9} Moëll 2008, p 27.
1.4 Limitations

Origin can be divided into two categories: preferential and non-preferential. Non-preferential ROO are often not considered to be more than a necessary trade instrument, why they will only be briefly explained.\textsuperscript{10} The preferential ROO, i.e. those used in PTAs, are more controversial and hence of primary interest for this text.

While most origin-related rules in trade agreements across the world share similarities, this thesis is written from a EU perspective. Focus will be on the EU’s external trade in goods, as opposed to trade in the internal market. Therefore the relationship between the EU and its member states will not be described more than what is necessary for the purpose of this text. Trade in intellectual property and services have distinctively different definitions of origin, in comparison to trade in goods. While both interesting and of great importance, ROO dealing with immaterial trade are best dealt with in a separate paper. The ROO can also be important for customers who demand knowledge of product origin for environmental, ethical or political reasons. Such consequences of origin fall outside the scope of this text, which will treat origin strictly from a customs and trade law perspective.

Furthermore, trade affects growth, job creation and the business climate, and therefore constitutes a vital component of the EU economy. This thesis deals with the relationship between trade and the economy to a limited extent, avoiding a detailed macroeconomic assessment. Finally, the legal information provided is not meant to be a handbook for how origin is conferred in practice. The thesis will focus on mapping the key principles of ROO and the intention is not to offer in-depth instructions on customs procedures.

1.5 Methodology and Materials

Information acquired from official documents and trade law doctrine will be used to present possible trade restrictive consequences of preferential ROO. The same sources

\textsuperscript{10} Estevadeordal and Suominen 2003, p 2.
are then used to assess this in the light of WTO law. Preferential ROO are negotiated between individual countries, covering thousands of products. There is a wide array of rules to consider. Not only do the rules differ from agreement to agreement, but sometimes also between the different products. This results in great difficulties when evaluating ROO as a political instrument. Referring to specific rules in specific agreements would be both time consuming and an ineffective method for the aim of this thesis. The necessary information is therefore derived from official WTO and EU press releases, guides and other publications, which present the rules in a more accessible and generalised format suitable for the aim of this thesis.

Additionally, there is a lack of transparency in diplomatic negotiations leading to PTAs. The motives of the legislators are therefore not always clear or available to the public. Oftentimes, official statements from the PTA parties are not comprehensive or objective enough. This requires the use of doctrine written by trade specialists and various NGOs to fully understand the reasons for, and the consequences of, preferential ROO. This includes sources from a vast area of academic fields, putting trade law in the context of politics, economics and development studies. Said doctrine will be applied using a traditional legal dogmatic method. The mapping of preferential ROO is thus mostly made de lege lata, and to a certain extent de lege ferenda, offering a perspective not often found in official documents.

1.6 Disposition

The thesis will initially present a short background of the legal framework for global trade in the second chapter, followed by the EU’s common trade policy and the laws that allow the EU to act in trade matters. The third chapter introduces the reader to the ROO, explaining the practicalities of ROO in EU PTAs. The various methods of conferring origin and potentially problematic outcomes are demonstrated, including the possible economical consequences of ROO. This is important in order to determine whether ROO can constitute a trade barrier, which is relevant for the following chapter. The fourth chapter challenges the legality of the rules in the light of the WTO
agreements, particularly with Article XXIV of the General Agreement on Tariffs and Trade (GATT) and the Agreement on Rules of Origin (ARO). The fifth and final chapter concludes the thesis.
2 The Legal Framework of the EU’s External Trade

2.1 Introduction

2.1.1 History of the GATT and the WTO

The General Agreement on Tariffs and Trade (GATT) was agreed to in 1947 as a result of the Bretton Woods Agreement, which also gave way to the creation of the World Bank and the International Monetary Fund.\(^{11}\) The purpose was to avoid a return to the protectionist trade policies of the first half of the 20\(^{th}\) century.\(^{12}\) The main focus of negotiations in the first years of GATT was the reduction of tariffs. By the 1980s, GATT had grown into a large array of treaties, which at times were not entirely consistent with each other. The Uruguay Round of Trade negotiations from 1986 to 1994 widened the scope and also dealt with issues such as non-tariff barriers and anti-dumping measures.\(^{13}\) The result of the negotiation rounds was the creation of the WTO in 1995.\(^{14}\) In contrast to GATT, the WTO has a clear legal structure and is binding upon its members through the WTO Agreement. Multilateral trade negotiations now take place within the WTO framework and are more transparent than before. Trade disputes are settled by the Appellate Body. The Appellate Body reports are binding upon all members after the Dispute Settlement Body has adopted the outcome.\(^{15}\) The central WTO agreement for trade in goods in the world is still GATT, with other agreements covering a wide array of trade, such as services, intellectual property and agriculture.

\(^{11}\) Understanding the WTO 2011, fifth edition, WTO publication, p 15.
\(^{12}\) Olsen, Steinicke and Sorensen 2012, p 2.
\(^{13}\) The World Trade Organisation in brief 2009, WTO publication.
\(^{14}\) Ibid.
\(^{15}\) Olsen, Steinicke and Sorensen 2012, p 11.
With Russia’s accession in 2012, after 16 years of negotiations, all major nations and more than 156 states in total are now members of the WTO.\footnote{WTO membership rises to 157 with the entry of Russia and Vanuatu, WTO Press/671, Press release August 22nd 2012.}

2.1.2 The Doha Round

The Doha Round, or the Doha Development Agenda, was initiated in 2001. The primary objective is, as the name suggests, the improvement of the trading prospects of developing countries and the further expansion of the WTO legal framework. Among the suggestions on the negotiating table is the simplification of ROO for developing countries, specifically intended to facilitate their exports.\footnote{WTO Director-General Roberto Azevedo speech in Bali, November 26th 2013.} The negotiations have so far stalled due to lack of consensus on certain key issues, particularly between the free trade friendliest states, such as the EU and USA, and somewhat more protectionist countries, such as Brazil, India and China.\footnote{The Economist, Dead man talking, April 28th 2011.} Some progress seems to have been made in December 2013, however, leading to the conclusion of the Bali Package. The package only contains a small part of the initial Doha Development Agenda, but might prove to be important for the future of the WTO.\footnote{Bali Ministerial Declaration, WT/MIN(13)/DEC/W/1, December 7th 2013.}

2.1.3 The Spaghetti Bowl of Preferential Trade Agreements

A PTA establishes trade conditions between two or more countries, which are more beneficial than those applied towards third countries. The preferences agreed are often the removal or decrease of tariffs and other barriers to trade. The augment of PTAs could be detrimental to WTO negotiations, as PTAs are concluded directly between the concerned countries.\footnote{Olsen, Steinicke, Sorensen 2012, p 82.} The progress of the WTO, or the lack of such, may therefore have significant consequences for global trade. The absence of advancement in the multilateral trade negotiations has led to a surge in PTAs the past decade, in order to
avoid tariffs and other trade barriers. The WTO has, since its creation in 1994, been notified of 381 preferential trade agreements to date. This has led to more than 70 per cent of the world trade today being conducted on a preferential basis, i.e. between PTA parties. 90 per cent of the WTO members are party to a PTA.

It is argued that international fragmentation of production leads to a spread of wealth, favouring developing countries in particular. The possibility of increasing efficiency through outsourcing production from highly industrialised countries to other areas of the world ideally creates a win-win scenario. However, there are fears that the difficulties encountered in WTO negotiations will lead to a change of focus, from global and multilateral negotiations to increased PTA-dependency. This could worsen the already existing spaghetti bowl of agreements, creating several problems. Negotiations for a PTA often lack transparency and are made in the best interest of only a few countries, in comparison to WTO discussions. The fragmentation of trade into a variety of PTAs, all with different rules, also results in technical and administrative difficulties for companies – such as overlapping and non-discrepent ROO. For further on this issue, see chapter 3.

2.2 The EU Trade Policy

2.2.1 The Purpose of Trade

According to the European Commission, the purpose of the EU trade policy is to increase economic growth, in order to create more jobs and sustain the European...
welfare state.\textsuperscript{27} Around 30 million EU jobs depend on EU exports, with every additional €1 billion of export supporting an additional 15,000 jobs in the EU. It is not only the exports that are vital. Two thirds of all imports consist of raw materials, necessary for production in European industries.\textsuperscript{28} The more an economy imports and integrates into global supply chains, the more does its exports grow.\textsuperscript{29} Trade is therefore an integral part of the European economies, especially during times of austerity.

In order to maximise the benefits of trade and boost the EU’s trade capacity, the EU is a proponent of the liberalisation of global trade. This is done both with the WTO as a forum, as mentioned above, and through the creation of an extensive network of PTAs.\textsuperscript{30} The EU has PTAs with nearly 50 countries, spread across all continents.\textsuperscript{31} It has recently concluded free trade agreements with Canada and Singapore, and is now in negotiations with Japan and the USA. Had all current EU PTAs negotiations been concluded today, two thirds of the EU’s external trade would have been made on a preferential basis.\textsuperscript{32} In the light of the above-mentioned trade dependence, it is in the interest of the EU to have a fully functioning PTA network with as few trade barriers as possible.

2.2.2 The EU Trade Competence

The Lisbon treaty clarified and strengthened the external capabilities of the EU.\textsuperscript{33} The Union shall have legal personality, according to Article 47 TEU (Treaty on European Union). This is further explained in Article 335 TFEU (Treaty on the Functioning of the European Union): \textit{the Union shall enjoy the most extensive legal capacity accorded to legal persons}. The European Commission shall represent the Union to this end,

\textsuperscript{27} \textit{Trade, Growth and Jobs} February 2013, European Commission contribution to the European Council, p 1.
\textsuperscript{28} Ibid, p 3.
\textsuperscript{29} \textit{Factors shaping the future of world trade} 2013, WTO World Trade Report, p 6.
\textsuperscript{30} Trade, Growth and Jobs 2013, p 2.
\textsuperscript{31} \textit{The EU’s bilateral trade and investment agreements – where are we?} October 18th 2013, European Commission Memo, p 6.
\textsuperscript{32} Trade, Growth and Jobs 2013, p 4.
assuming it has a legal basis for its action in the Treaties. Under international law, EU member states need to be contracting parties alongside the EU, in order to be bound by international treaties.\textsuperscript{34} However, Article 216 (2) TFEU stipulates that legally concluded agreements by the EU institutions are binding for the member states as well. This means that the WTO agreements are legally binding, both for the EU institutions and for the member states.\textsuperscript{35} Articles 3 and 207 TFEU are of central importance for the EU’s exclusive competence to enter trade agreements. Article 207 TFEU governs the EU’s common commercial policy, which shall be based on uniform principles with regard to tariffs, trade in goods and other trade measures. According to Article 3 (1) TFEU, the common commercial policy falls under EU exclusive competence. The Commission initiates proceedings for entering trade agreements, proposing the implementation of the common commercial policy (Article 207 TFEU). After authorisation by the Council, the Commission initiates negotiations. Finally, the Council must unanimously approve the agreement and the consent of the Parliament has to be obtained (Article 218 TFEU).\textsuperscript{36}

The EU shall uphold and promote free and fair trade, according to Article 3 (5) TEU. Article 205 TFEU, which acts as a \textit{chapeau} to Part V of the TFEU dealing with external relations, further declares that \textit{The Union's action on the international scene […/ shall be guided by the principles, pursue the objectives and be conducted in accordance with Chapter 1 of Title V of the TEU.}\textsuperscript{37} Article 21 (2) (e) of the aforementioned chapter stipulates that the Union shall work for cooperation in \textit{encouraging the integration of all countries into the world economy /…/ through the progressive abolition of restrictions on international trade}. Since most EU PTAs were conducted pre-Lisbon treaty, it remains to be seen how future trade policy is affected with regard to ROO.

\textsuperscript{34} Craig and De Búrca 2011, p 307.
\textsuperscript{35} Olsen, Steinicke and Sorensen 2012, p 95.
\textsuperscript{36} Ibid, p 90.
\textsuperscript{37} Ibid, p 304.
2.2.3 Generalised Scheme of Preferences

The Generalised Scheme of Preferences (GSP) is a PTA offered by the EU to developing countries. The GSP can be divided into three groups: the standard GSP offers reduced tariffs on imports into the EU for developing countries; the Everything-But-Arms Agreement further offers the Least Developed Countries (LDC) duty-and-quota-free access to the EU market for all goods except arms; and the GSP Plus scheme is offered to developing countries which have implemented 27 international conventions in areas such as labour, environmental and human rights.\(^{38}\)

First granted by the EU to old colonies in Africa, the Caribbean and the Pacific, the GSP offers lower tariffs on almost everything apart from agricultural products and textile\(^ {39}\). A result of an UNCTAD\(^ {40}\) agreement, several developed countries granted developing countries non-reciprocal duty-and-quota-free access to their internal markets.\(^ {41}\) According to the EU, the export revenue generated by the GSP duty preferences fosters growth and supports job creation in the developing countries.\(^ {42}\) The GSP will as of 2014 reduce the amount of beneficiaries from 177 to 90 countries. Many of the countries are now party to a PTA with the EU or are no longer considered to need unilateral preferential access to the EU market.\(^ {43}\)

2.3 Conclusion

The EU trade policy of creating a worldwide trading network through PTAs has been boosted by the failures of the Doha Round. Together with the expanded external competence of the EU in trade matters post-Lisbon treaty, this will likely lead to an


\(^{39}\) Olsen, Steinicke and Sorensen 2012, p 428.

\(^{40}\) United Nations Conference on Trade and Development.


\(^{42}\) *The EU’s new Generalised Scheme of Preferences* July 2013, European Commission fact sheet, p 2.

\(^{43}\) Ibid, p 4.
increase in PTAs in the near future. Not only do the PTAs and the GSP have major implications for the economic growth of the EU, they also have significant consequences for the EU’s trading partners – developing countries in particular.
3 The Rules of Origin in Practice – Substance and Application

3.1 Introduction

First internationally defined in the International Convention on the Simplification and Harmonisation of Customs Procedures from 1974, also known as the Kyoto Convention, the ROO serve the purpose of ascertaining the origin of a product for customs authorities across the world. ROO are part of all PTAs and are considered a critical aspect in their negotiations. The importance of the rules seems to have evolved in recent years with the augment of PTAs, leading to stricter ROO being imposed. This chapter will present what the ROO are, what the meaning of a strict ROO is, and what implications they may have for trade.

3.2 Who Do the Rules of Origin Serve?

The parties affected by the negotiation and application of ROO need to be identified before problematizing ROO. Moëll lists the following key actors as the stakeholders with an interest in the shape of ROO in PTAs. Above all, countries have an interest in trade and development for various reasons. This includes exporting countries and importing countries, but also third countries, i.e. those not taking part in PTA negotiations but who may still be affected by the result. Thereafter come the economic operators and domestic industries. These groups make the actual importing and

46 Estevadeordal and Suominen 2003, p 2.
exporting, and they are therefore the direct benefiteers or losers of a PTA depending on its content. Finally, the ROO may affect consumers and taxpayers. The price and quality of products, and the ability to distinguish their origin for various reasons is an essential consumer concern. While stimulating imports through the removal of tariffs may increase competition in favour of customers, it also creates a burden for EU taxpayers. Around ten per cent of the EU budget revenue originates in customs duties – revenue which would need to be collected elsewhere if duties were to beabolished.49

3.3 The EU Definition of Origin

3.3.1 Introduction

The EU internal ROO were first defined in 1968 and were eventually replaced by the Community Customs Code in 1992. The ROO can be divided into non-preferential and preferential, the meaning of which will be explained below. The European Court of Justice (ECJ) described the process of harmonising internal ROO with the following words:

A common definition of the origin of goods constitutes an indispensable means of ensuring the uniform application of the common customs tariff, of quantitative restrictions and all other measures adopted, in relation to the importation or exportation of goods, by the Community or by the Member States.51

The Community Customs Code is further explained in the Implementing Regulation, which also contains the preferential GSP ROO. The GSP ROO are consistent in many aspects with preferential origin in EU PTAs and have changed little since their original introduction in 1971.53 The EU ROO and those of the Kyoto Convention resemble each other in many aspects, and the EU is a signatory to the Kyoto Convention since 1975.

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49 Ibid, p 47.
50 European Commission Regulation no 2319/92.
51 C-49/76 – Gesellschaft für Überseehandel MBH, p 52.
52 European Commission Regulation no 2454/93.
53 Naumann 2011, p 1.
Both confer origin to products according to the principles mentioned below. The EU rules are either product specific or regime-wide. Product specific ROO refer to rules determining the origin of certain products, whereas regime-wide ROO apply generally. The former rules are more often in place for sensitive or highly specialised products, such as fish or textiles.

3.3.2 Non- Preferential Rules of Origin

Non-preferential ROO are generally used to determine origin for the purpose of country-specific trade rules being properly applied. The need to identify the origin of products is essential when trade embargos, tariffs, retaliation and other trade actions are in place. They also help distinguish goods with non-preferential access and goods with preferential access, allowing trade agreements to properly function.

The general framework for the EU non-preferential origin is found in Council Regulation No. 2913/92, Articles 22-26 and Articles 35-65 and Annexes 9 to 11 of Commission Regulation No. 2454/93. Article 23 of the former regulation states that goods shall be considered to originate in the country where they are produced or wholly obtained. For products originating in several countries, Article 24 states that the country where the last, substantial transformation took place will be considered origin. The meaning of this is explained below. Additionally, the EU is a signatory to the WTO Agreement on Rules of Origin, which aims to harmonise and clarify the non-preferential ROO.

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54 See section 3.4.
55 Moëll 2008, p 60.
56 Estevadeordal and Suominen 2003, p 2.
57 Also referred to as last substantial processing.
3.3.3 Preferential Rules of Origin

The preferential ROO exist to prevent trade deflection, which refers to the redirection of third country products through a EU trade partner before coming to the EU, in order to avoid tariffs.\textsuperscript{58} Non-preferential ROO are also meant to prevent trade deflection, but in order to avoid trade defence mechanisms, such as anti-dumping measures and embargos.\textsuperscript{59} Without ROO, the incitement to sign PTAs would naturally decrease due to the risk of abuse. Preferential ROO are defined in paragraph 2 of Annex II of ARO as determining \textit{whether goods qualify for preferential treatment /.../ leading to the granting of tariff preferences going beyond} the Most Favoured Nation principle (MFN). The principle is central to the WTO and requires all member states to apply tariffs without discriminating. If the EU offers a certain country tariff-free entry on a specific type of green apple, the Granny Smith, this must be offered to all countries on like products. Not only does this mean that the EU has to offer Granny Smith apples from all countries tariff-free entry, but the rate will also apply to all like products, such as the Gravensteiner apple. Preferential PTAs and their ROO allow an exception to the MFN principle. For further on this, see section 4.1.2.

Preferential ROO are negotiated between two or more parties, contrary to the non-preferential rules. The EU defines preferential ROO as an \textit{instrument of commercial policy}, with the purpose of opening up the EU market to other countries, reciprocally or otherwise, in a manner that would adequately protect EU interests.\textsuperscript{60} While the preferential ROO differ between the various EU PTAs, they all follow the same principles and structure, and are highly uniform in substance.\textsuperscript{61} The method of determining preferential origin is based upon the aforementioned principles of non-preferential origin. How origin is conferred is explained below.

\begin{itemize}
\end{itemize}

\textsuperscript{58} EU Export Helpdesk, exporthelp.europa.eu, accessed December 7th 2013.
\textsuperscript{59} Olsen, Steinicke and Sorensen 2012, p 130.
\textsuperscript{61} Estevadeordal and Suominen, p 11.
3.4 How Origin is Conferred

3.4.1 Produced and Wholly Obtained

When a product is completely produced or wholly obtained in a country, determining origin is rather unproblematic. Wheat grown in Sweden is likely to be considered Swedish. So will the bread that is produced in Sweden from that wheat. This is the least problematic and most straightforward method of determining origin. To the contrary, when the same bakery imports its wheat from Russia and the yeast stems from Turkey, the origin of the resulting loaf of bread is less clear. Besides the importance for consumers to know the origin of their bread, this has implications for trade. Certain countries may grant EU-exports preferential tariffs, whereas Russian or Turkish products receive non-preferential tariffs. The origin of the bread will hence be determined by the ROO applied by the importing country's customs.

The following goods are considered wholly obtained by the Kyoto Convention:

a. Mineral products extracted from its soil, from its territorial waters or from its sea-bed;
b. Vegetable products harvested or gathered in that country;
c. Live animals born and raised in that country;
d. Products obtained from live animals in that country;
e. Products obtained from hunting or fishing conducted in that country;
f. Products obtained by maritime fishing and other products taken form the sea by a vessel of that country;
g. Products obtained aboard a factory ship of that country solely from products of the kind covered by paragraph (f) above;
h. Products extracted from marine soil or subsoil outside that country’s territorial waters, provided that the country has sole rights to work that soil or subsoil;

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63 Kyoto Convention Specific Annex K, Chapter 1, Article 2.
i. Scrap and waste from manufacturing and processing operations and used articles, collected in that country and fit only for the recovery of raw materials;

j. Goods produced in that country solely form the products referred to in paragraphs (a) to (i) above.

Certain of the above mentioned wholly obtained-criteria have proven to be controversial in the EU’s application, such as what constitutes a vessel of a particular country. However, the list is still used by the EU as the basis for determining what is wholly obtained, and it is generally considered to be unproblematic. The origin of the above-mentioned loaf of bread cannot be determined by the Kyoto Convention list, as opposed to the wheat. Therefore, most issues with conferring ROO occur not when a product is wholly obtained in one country, but when the production chain is more complex.

### 3.4.2 Last Substantial Transformation

If the wholly obtained criteria cannot be met, possibly by production being spread to more than one country, the country where the last substantial transformation was made is considered to be origin. A substantial transformation can be made in three ways: by a change of tariff classification, by adding value and through a specific manufacturing process. Determining origin in this manner is well established in international trade law. The requirements may exclude actions such as packaging, painting or transporting a product from being sufficient to confer origin. The three methods of conferring a substantial transformation are explained below.

### 3.4.3 Change in Tariff Classification

The primary method of determining last substantial transformation is through a change in tariff classification. The Harmonised System, designed by the World Customs

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65 Brenton 2011, p 164.

66 Moël 2008, p 60.
Organisation, already classifies 90 per cent of the goods in world trade. More than 190 countries in the world have adopted the Harmonised System as the method of determining tariff heading. A product arriving with the heading “malt” and the accompanied four-digit code may be exported substantially transformed as “beer made from malt”. The origin would thus be granted to where the transformation into “beer made from malt” took place. Determining origin in this manner is considered clear, easy to use and predictable. The system is designed to classify products for tariff-purposes and not explicitly designed for determining origin, which is why there are several product-specific exceptions to the rule. This may lead to origin not being conferred even when it should, such as when two products remain in the same sub-heading despite going through significant processing. The method also requires an importing or exporting company to demonstrate the origin of all input products, which can be difficult. This difficulty often leads to the rules of origin being ignored, requiring tariffs to be paid even when they can be avoided. This is problematic considering the trade liberalising intentions of PTAs. See section 3.6.

3.4.4 Value Content Requirement

An alternative method of determining origin is by the value added rules, or the value content requirement. In order to qualify, a certain amount of value must be added in a country on top of imported inputs.

The total amount of domestic value added in the final product has to reach a certain percentage, also known as the value added test. The domestic value content requirements in EU trade agreements tend to be between 30 and 50 per cent, with the GSP requirements on the lower side of the scale. The calculation of value is complex and constitutes of production costs and other relevant expenditures that can be tied to a

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68 Brenton 2011, p 164.
69 Moëll 2008, p 72.
70 Brenton 2011, p 163.
72 Brenton 2011, p 165.
product, requiring detailed accounting of the whole production process. The three most common versions of the value added test require a minimum or maximum of: 1) domestic or regional content value; 2) import content value; and 3) value of parts. The EU applies a domestic content method (1) as a test for non-preferential origin, and an import content test (2) for preferential origin. In the second method, the obtained result of the local value added test has to be deducted from the value of the final good.

The issue of last substantial transformation and the value added criterion have been tried by the ECJ. In order for the last process or operation to be substantial, the product in question needs to have properties and a composition of its own, which it did not possess before that process or operation. Activities affecting the presentation of a product but which do not bring about significant qualitative change in its properties, do not determine the origin of the product. The cleaning and grinding of a raw material for marketing reasons or for the purpose of changing consistency or presentation, does not bring about such significant qualitative change in said material, and neither does the manner of packaging. The ECJ also ruled that the processing of for instance meat, by boning it, cutting it into pieces and vacuum packaging it was not a sufficient enough transformation of the product, nor was subsequent marketing of the product.

In another case, the assembly of electronic typewriters in Taiwan was not substantial enough to confer origin to Taiwan. Assembling products without specially qualified staff, sophisticated tools or specially equipped factories cannot lead to a change in origin. The assembly can only confer origin when it is technically the decisive production stage where products receive their characteristics. When the value added is appreciably less than the value added in other countries, the product cannot be considered as originating in the assembling country. The assembly added less than 10

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73 Naumann 2011, p 4.
74 Moëll 2008, p 75.
75 Ibid, p 75.
76 Ibid, p 78.
77 C-49/76 – Gesellschaft für Überseehandel MBH, paragraph 6.
78 Ibid, paragraph 6.
79 C-49/76 – Gesellschaft für Überseehandel MBH, paragraph 9.
80 C-93/83 – Zentralgenossenschaft des Fleischergewerbes eG (Zentrag), paragraph 15.
81 C-26/88 – Brother International GmbH, paragraph 17.
per cent of the value, which was deemed insufficient. The above rulings demonstrate the ECJ’s restrictive approach to a change in origin – particularly what constitutes the last substantial transformation process.

While the value content method is clear and non-discriminatory on paper, the result is that exchange rates, wages and temporary market fluctuations have a decisive effect on a product’s origin. Exporting products consisting of input goods from non-EU trade partners may result in paying EU-tariffs. This may hold true even when the same amount of work in the EU would have resulted in the value added threshold being reached, hence conferring originating status. Not only does this add a certain amount of unpredictability, but it also punishes companies in developing countries where wages and other costs tend to be low. Low cost production operations are penalised by value-added methods, even if the operations are more efficient than their high cost equivalents. Therefore, the value added method can act as a disincentive for local cost-efficiency improvements, considering high production costs simplify the reaching of the value-added threshold for tariff-free export.\textsuperscript{82} For further on this, see section 3.6.

3.4.5 Specific Manufacturing Process

The third method of defining origin is through a specific manufacturing process, which is the most commonly used method for determining last substantial transformation.\textsuperscript{83} Manufacturing procedures that do (positive test) and do not (negative test) confer origin are listed. While this method is customisable, clear and easy-to-use for producers, changes in production and advances in technology quickly make the system obsolete.\textsuperscript{84} Due to the ease of customisation, the method can also be tailor-made to suit the domestic industry, leading to difficulties when negotiating the rules.\textsuperscript{85}

\begin{thebibliography}{99}
\bibitem{82}Naumann 2011, p 4.
\bibitem{83}Ibid, p 3.
\bibitem{84}Brenton 2011, p 163.
\bibitem{85}Naumann 2011, p 4.
\end{thebibliography}
3.4.6 General Level of Tolerance

The general level of tolerance, or the *de minimis* rule, is the amount of material a product can contain from a non-PTA country without changing origin. The general level of tolerance in the EU free trade agreements tends to be between 7-15 per cent, usually with exceptions for certain products such as textiles. The difference in requirements from product to product is in itself a demonstration of built-in protectionism. Raising the tolerance rule to 15-20 per cent in EU PTAs would result in more products receiving originating status. This is demanded by the most free trade friendly EU nations, such as Sweden. The GSP general level of tolerance is 15 per cent.

The following is an EU example of how the tolerance rule works in practice:

*A doll (classified HS 9502) will qualify if it is manufactured from any imported materials, which are classified in different heading. This means a manufacturer in a beneficiary country is allowed to import raw materials such as plastics, fabrics etc. which are classified in other chapters of the HS. But the use of doll's parts (e.g. Doll's eyes) is not normally possible as these are classified in the same heading (HS 9502). However, the tolerance rule allows the use of these parts if they amount to not more than 15% of the doll's value.*

The calculation method of the general level of tolerance has received the same criticism as the value added test. Temporary fluctuations in the market can be decisive, leading to many European companies desiring an alternative method of calculation.

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86 Brenton 2011, p 168.
87 The duty value used is the ex-work price, according to Article VII of GATT.
88 Brenton 2011, p 169.
89 *The Impact of Rules of Origin on Trade* 2012, Swedish National Board of Trade, p 12.
91 GSP user guide 2010, p 20.
92 *The Impact of Rules of Origin on Trade* 2012, p 12.
3.5 Other Origin Related Rules

3.5.1 Cumulation in EU Preferential Trade Agreements

Considering the beneficiary nature of the GSP regime, the EU has included several exceptions that usually cannot be found in most trade agreements.\(^93\) One of these is the possibility of cumulation, also referred to as accumulation. Allowing cumulation is a way of minimising the negative effects of stringent ROO.\(^94\) There are two types of cumulation in the GSP, bilateral and regional.\(^95\) When utilising bilateral cumulation, material with EU origin that is sufficiently worked or processed in a beneficiary country will originate in the latter.\(^96\) This is the most common form of cumulation allowed and an element of all EU free trade agreements, not exclusive to the GSP arrangement.\(^97\) Regional cumulation is, in contrast, a rarity and only allowed as a result of the beneficiary nature of the GSP. Materials originating in one country, which would normally be considered insufficiently worked or processed, may accumulate the value added in the other countries of the group when acquiring origin.\(^98\) The cumulation possibilities are still rather narrow, as cumulation can only be made within specific groups. As of the fall of 2013, there were four cumulation groups in the EU GSP based on geographical proximity.\(^99\)

The origin requirements are thus applied to a group of beneficiary countries, instead of just one.\(^100\) This allows developing countries to utilise inputs from a larger array of countries, without sacrificing preferential access to the EU market. The bilateral and regional rules of cumulation may even be used in conjunction under some conditions, and there are possibilities of applying to the Commission for extended cumulation with

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\(^{93}\) Estevadeordal and Suominen 2003, p 21.
\(^{94}\) Ibid, p 6.
\(^{95}\) Sometimes referred to as full cumulation.
\(^{96}\) GSP user guide 2010, p 16.
\(^{97}\) The Impact of Rules of Origin on Trade 2012, p 11.
\(^{98}\) GSP user guide 2010, p 17. Note: textile products are an exception this rule.
other EU trade partners.\textsuperscript{101} Regional cumulation could, however, also have adverse effects to trade. The effect of being able to cumulate only with certain countries potentially has a trade distorting effect, further encouraging intra-PTA or intra-GSP cumulation group trade.\textsuperscript{102} The losers of this are, as always, the producers located outside the PTA-zone.

While regional cumulation is allowed to a certain extent in the GSP regime, it is limited to geographical groups. Bolivian products can be cumulated with those from Peru before entering the EU, but cumulation cannot be made with products from Bangladesh or the Ivory Coast. The effect of this is that products from the various groups must first be exported to the EU, where such value is added that the product receives EU origin, until further cumulation can be made with products from other cumulation groups. Therefore, the EU retains its status as the hub, encouraging the direction of trade through itself, which in turn may create local jobs and economic growth.\textsuperscript{103}

\subsection*{3.5.2 Absorption Principle and Direct Transport Requirement}

A majority of PTAs contain the absorption, or roll-up, principle. Goods that have acquired origin are considered to be entirely originating in any further processing.\textsuperscript{104} The result is that material that has conferred origin, despite a foreign input content of 20 per cent, will be considered 100 per cent domestic when it is subsequently used as input in a product (roll-up). Although this can be beneficial for importers and exporters, the result is the opposite if the initial material does not acquire originating status (roll-down). Origin is therefore something that is entirely acquired, or not at all.\textsuperscript{105} Brenton suggests that the domestic value added in material, which fails to satisfy origin requirements, should be counted when determining origin of the end product.\textsuperscript{106}

\begin{flushleft}
\textsuperscript{101} GSP user guide 2010, p 17.
\textsuperscript{103} See section 3.6.3 for further on the EU’s role as a hub.
\textsuperscript{104} Brenton 2011, p 168.
\textsuperscript{105} Estevadeordal and Suominen 2003, p 6.
\textsuperscript{106} Brenton 2011, p 168.
\end{flushleft}
Calculating domestic value added in such a manner would mitigate some of the adverse effects of stringent ROO. It can also be used in a protectionist manner, however, as is the case in NAFTA\(^ {107} \). The lack of roll-up possibilities prevents Mexican products from containing excessive amounts of non-NAFTA goods when entering the US.\(^ {108} \)

Traditionally, EU PTAs have also included a *direct transport* rule, requiring goods to be shipped directly from the country of origin, in order to maintain originating status. Many EU-based companies perceive the rules on direct transport in EU bilateral trade agreements to be problematic.\(^ {109} \) The European Commission has admitted that the including of such a rule in PTAs has been a mistake, and most EU member states agree that the rule should not be included in future agreements. Today, exceptions can only be made to secure the quality of a product.\(^ {110} \) The rule has been removed from the GSP regime and has been replaced by a *non-manipulation* requirement.\(^ {111} \)

3.6 The Effects of Restrictive Rules of Origin

3.6.1 Introduction

There is a clear connection between strict ROO and the use of a PTA.\(^ {112} \) Poorly designed ROO or intentionally restrictive ones can thus constitute a trade barrier.\(^ {113} \) This seems to dampen the trade-creating potential of the PTAs, in contrast to the EU objectives of improving economic growth and the development of global trade.\(^ {114} \) Restrictive ROO not only give incentives to companies to relocate to the country of interest, but also to purchase local products and services in order to reach the value

\(^ {107} \) North American Free Trade Agreement, ratified by Canada, Mexico and the US.


\(^ {109} \) The Impact of Rules of Origin on Trade 2012, p 34.

\(^ {110} \) Ibid, p 34.

\(^ {111} \) European Commission Regulation no 2454/93 Article 74.

\(^ {112} \) *The EU’s and the US’s Preferential Arrangements – a Comparison* 2012, Swedish National Board of Trade, p 7.

\(^ {113} \) Moëll 2008, p 2.

\(^ {114} \) Estevadeordal and Suominen 2003, p 8.
added criteria. It is argued that restrictive ROO may even benefit developing countries, since all phases of production will be integrated and concentrated to one country. However, this theory is widely contested and does not seem to be supported by the developing countries themselves.115

These effects of ROO are not isolated to developing countries. Their counterparts in developed countries encounter similar problems – importers and multinational companies in particular. Since the administrative costs for conferring origin can be higher than tariffs themselves, companies can often find it more expensive to acquire originating status than to pay tariffs.116 This can be illustrated by the problems faced by the Swedish automobile giant Scania when exporting out of Europe. In order to prove EU origin when exporting to certain EU PTA-parties, by conferring to a domestic value added criterion of 60 per cent, original documentation for almost 3000 truck parts has to be demonstrated.117

3.6.2 The GSP Rules Of Origin

The European Commission attempted to create flexible ROO in the current GSP regime. By simplification and adjustment of the origin criteria, the rules were meant to encourage development and facilitate trade through an easier acquisition of origin.118 The difficulties for developing countries in utilising the GSP preferences are, however, well documented. Far from all exports eligible for duty free entry to the EU enter at a preferential rate.119 The strictness of the ROO seem to be the reason, as the difficult requirements create administrative obstacles for exporters in developing countries, even when their products should receive duty free entry. Another reason seems to be the fear of using incorrect or inadequate information when applying for certificates of origin,

118 Moëll 2008, p 164.
119 Ibid, p 165.
potentially leading to expenses in the form of retroactive customs duties and penalties.\textsuperscript{120}

The EU ROO in the GSP are criticised for being too strict, especially in comparison to the US equivalent.\textsuperscript{121} A company in a developing country may therefore have preferential access to one market but not the other, resulting in unnecessary obstacles. This requires exporters in countries covered by both GSP regimes, which is often the case, to adapt production to the rules of both potential export markets, and to document the process after the requirements of both destinations.\textsuperscript{122} The EU GSP rules have been progressively simplified and relaxed, but critics claim that many of the problems remain. Efforts should thus be focused on making the current rules even more user-friendly, encouraging the growth and development of GSP beneficiaries.\textsuperscript{123}

\textbf{3.6.3 The Trade Diverting Effect of Rules of Origin}

Restrictive ROO may lead to trade diversion, an unnatural shift of purchasing from low-cost non-party providers to high-cost party providers.\textsuperscript{124} Trade diversion is not to be confused with trade deflection. Restrictive ROO create an incentive for foreign producers to change strategy, from creating subsidiaries in a party to a trade agreement, to moving production completely. An example of trade diversion is the following. The above-mentioned free trade friendly policy of the EU, which has lead to the creation of an extensive network of PTAs, has created a so-called hub and spoke effect. With EU as the hub and its trade partners as spokes, trade and investment is redirected through the EU in order to minimise expenses in form of tariffs. Instead of trading between themselves due to the lack of preferential trade agreements or strict cumulation rules, developing countries become more reliant on trade through the EU. This is partially solved by regional cumulation.

\begin{itemize}
\item \textsuperscript{120} Moëll 2008, p 166.
\item \textsuperscript{121} The EU’s and the US’s Preferential Arrangements – a Comparison 2012, p 7.
\item \textsuperscript{122} Brenton 2011, p 163.
\item \textsuperscript{123} The Impact of Rules of Origin on Trade 2012, p 6.
\end{itemize}
Regional trade agreements also help create trade and do not only divert it. Protectionism does not necessarily result in inefficiency.\textsuperscript{125} Assuming the trade created by a PTA is greater than the trade diverted, which it often seems to be, the economical effects of the trade liberalisation are more beneficial than detrimental for the global economy.\textsuperscript{126} Whether such economical growth should be made at the cost of the natural course of trade is open for discussion. While ROO may be guilty of diverting trade, tariffs and other regulations seem to have even further impact.\textsuperscript{127}

3.7 Why are the Rules of Origin Restrictive?

3.7.1 Who Benefits From Restrictive Rules of Origin?

While the EU ROO are intended to be a technical and non-political instrument, this does not seem to be the case.\textsuperscript{128} There are even claims that the rules are intentionally discriminatory against certain countries.\textsuperscript{129} The reasons for this can be traced back to the PTA negotiations and the involved actors. With all the aforementioned ROO-related issues in mind, why do the ROO remain restrictive?

In order to understand the design of the ROO, the beneficiaries of them must first be identified. All ROO are protectionist by their very nature, since they are meant to protect the domestic market from trans-shipped goods. While the rules are meant to be neutral, they are increasingly used as a means of attracting foreign investment, and to raise trade barriers towards non-parties.\textsuperscript{130} Local industries in particular seem to demand the strictest rules.\textsuperscript{131} Producers, who would face increased competition and possible

\textsuperscript{125} Moëll 2008, p 57.
\textsuperscript{126} Kim and Kim 2011, p 617.
\textsuperscript{127} Ghoneim 2003, p 617.
\textsuperscript{128} Moëll 2008, p 1.
\textsuperscript{129} Brenton 2011, p 169.
\textsuperscript{130} Moëll 2008, p 39 and Estevadeordal and Suominen 2003, p 50.
\textsuperscript{131} Moëll 2008, p 40 and Estevadeordal and Suominen 2003, p 3.
losses by the signing of a free trade agreement, will likely prefer restrictive ROO. Stringent ROO would limit the amount of imported products and limit competition.

Geographically and economically concentrated industries have much to lose and little to gain by trade liberalisation across borders. Due to the abolishment of tariffs, industries with production in the new free trade partner will naturally be the biggest winners. Restrictive rules will benefit both domestic winners and losers of a PTA, protecting both from production outside the new free trade area – protecting gains from the PTA or mitigating losses. Politicians therefore often have incentives to creating restrictive ROO.\textsuperscript{132} Companies with production in several countries, part of so called global value chains, will likely push for liberal ROO. Because of the difficulties in conferring origin, often since the administrative costs of origin certification can be higher than tariffs themselves, certain multinational companies find it more expensive to acquire originating status than to pay tariffs.\textsuperscript{133} Although economically neutral rules seemingly cannot be developed, the current ones can be improved in order to minimise the costs.\textsuperscript{134}

3.7.2 Lack of Transparency in the Decision-Making

There will always be winners and losers from the design of particular ROO, which inevitably results in intensive lobbying by the stakeholders.\textsuperscript{135} The results of this are most evident in certain product specific rules. For example, the ROO in NAFTA greatly protect the automobile industry through high value added requirements.\textsuperscript{136} The stringent EU ROO requirements for the textile industry, a highly sensitive sector, have proven to be detrimental for textile imports.\textsuperscript{137} In fact, the rules seem to be decided by the desired level of protectionism of a certain industry and not on neutral grounds. This is

\textsuperscript{133} Estevadeordal and Suominen 2003, p 48.
\textsuperscript{134} Moëll 2008, p 19.
\textsuperscript{135} Ibid, p 20.
\textsuperscript{136} Ghoneim 2003, p 614.
\textsuperscript{137} Estevadeordal and Suominen 2003, p 9.
particularly problematic since lack of transparency is considered one of the key issues with ROO, and with negotiations of PTAs in general.\footnote{Bouët and Laborde 2008, p 4.}

Since trade facilitation is the very purpose of trade agreements, industry influence during negotiations of a PTA is rather understandable. The treaties need to reflect the reality of trade – what better way than to include the actors of trade? The above-mentioned problems of Scania during export could be addressed with their involvement in shaping the rules. Most of the global trade is conducted by a concentration of large companies, who will naturally be influential in PTA negotiations. The top 5 to 10 per cent of the largest EU companies contribute to 80 to 90 per cent of all EU exports. 80 per cent of developing country exports are concentrated to the top five largest exporters in each country.\footnote{Factors shaping the future of world trade 2013, p 86.} This is not generally a concern for EU member states, which consider industry participation as informative and democratic.\footnote{Moëll 2008, p 49.} The lobbying is not necessarily problematic per se, but it raises legitimate doubts over the costs of the trade facilitation. While certain rules may benefit the industry and hence national growth, they may also be detrimental to the development of trade in poorer regions of the world. Rules with a protectionist design may also hit back at customers in the shape of decreased competition and availability of goods.

### 3.8 Future Methods of Determining Origin

The EU ROO are at a crossroads and need to be fundamentally reviewed, especially with regard to the future development of the multilateral trade negotiations and free trade agreements.\footnote{European Commission green paper 2003, p 4.} The objective, particularly regarding the GSP rules, should be to support sustainable development and the further integration of developing countries into world trade.\footnote{Ibid, p 7.} This was stated by the European Commission in 2003 and little has progressed since.\footnote{Moëll 2008, p 19.} The major issues with ROO are the difference in standards between
PTAs, the arbitrary definitions of origins and the thresholds for domestic value content. Regime-wide ROO that allow flexibility in their application seem to facilitate trade, as opposed to stringent product-specific rules, which are difficult to comply with.\textsuperscript{144} The difficulties of compliance may lead to unnecessary expenses in terms of tariffs, fines and penalties for importers. The multitude of PTAs, and the risk of overlap, makes it even more difficult. An alternative method of calculation could be to base tariffs on the value added outside a PTA, rather than on the final price of the product. This would result in lower tariffs whenever some value has been added within the PTA, mitigating the negative effects of the absorption principle.\textsuperscript{145} As mentioned in section 3.6, it may also lead to higher tariffs.

Origin can be conferred to one nation only, despite the fragmentation of global trade. The following quote by the WTO Deputy Director illustrates some of the problems with the measurement of trade and one-country origin:

\begin{quote}
First, gross trade statistics can be misleading and give the impression that a Nokia smartphone imported from China is made in China, suggesting that all the jobs necessary to produce this good are Chinese jobs. But this is hugely misleading, if we look at research carried out in Finland. Only 2 per cent of the final price refers to assembly costs, while 33 per cent of the cost relates to intermediate goods and 31 per cent are Nokia’s own value-added. Many other countries, in Europe, the United States, Japan and Korea will have added value and created jobs through design, component production, branding, marketing and a range of other services that go into the product.\textsuperscript{146}
\end{quote}

In the light of the above-mentioned example, the principle of one-country origin seems to be detached from the reality of trade. Proposals for alternative methods have been launched, which would allow a product multiple origins.\textsuperscript{147} While single-country origin may be out of date, we are a long distance from multi-country rules. The obvious cause of this are the administrative difficulties of conferring origin to several countries. With the stalled WTO negotiations in mind, such an essential change to the system of ROO

\textsuperscript{144} Estevadeordal and Suominen 2003, p 8.  
\textsuperscript{145} Moëll 2008, p 89.  
\textsuperscript{146} WTO Deputy Director-General Alejandro Jara speech 20th of April 2012.  
\textsuperscript{147} Moëll 2008, p 17.
seems unlikely for now. However, it does seem to be a viable alternative for the future.\footnote{Moëll 2008, p 90.}

3.9 Conclusion

One of the major obstacles to the above-mentioned trade objectives is that potential beneficiaries of preferential trade regimes often do not take advantage of the benefits. This is likely due to the complexity of complying with the ROO, the lack of production facilities and investment, or because of administrative deficiencies.\footnote{European Commission green paper 2003, p 8.} While the rules on cumulation and general tolerance level make the ROO more flexible, they do not seem to be a definite solution to the above-mentioned problems. Not only does this hinder trade development – it also benefits tariff planning and fraudulent certification of origin.\footnote{Ibid, p 8.} Just as there is a legal grey zone between lawful tax planning and illegal tax evasion, the avoidance of tariffs through origin “shopping” is also subject to controversy. This circumvention of ROO results in the inefficient location of global production and the undermining of global welfare, with geographic location motivated by trade regulations – akin to registering in a country for the sole purpose of its generous taxation laws.\footnote{Estevadeordal and Suominen 2003, p 10.}

Considering all the above-mentioned factors, it is clear that the current design of the EU ROO is not unproblematic. Potentially a barrier to trade, ROO could be considered to pursue illegitimate trade objectives that are prohibited by the WTO. The following chapter will thus assess the rules in the light of international trade law.
4 The WTO Legality of EU Rules of Origin

4.1 Introduction

The previous chapter was dedicated to explaining the substantive rules of the EU ROO and their potential effects on trade. In this chapter, the EU ROO will be looked at from a WTO perspective. As the main authority in international trade, the WTO regulations are legally binding for the EU. Although the EU partakes in direct PTA negotiations with other nations, the agreements must still conform to WTO law. After a brief introduction to the key principles of the WTO, an assessment of the legality of the EU ROO will be made. Are the negative trade effects of preferential ROO compatible with WTO law?

4.2 The key principles of GATT

4.2.1 Most Favoured Nation principle

GATT\textsuperscript{152} is based on the MFN\textsuperscript{153} principle, found in GATT Article I:

> With respect to customs duties and charges of any kind imposed on or in connection with importation or exportation /.../ and the method of levying such duties and charges, and with respect to all rules and formalities in connection with importation and exportation /.../ any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties.

\textsuperscript{152} General Agreement on Tariffs and Trade, see section 2.1.1.
\textsuperscript{153} Most Favoured Nation, see section 3.3.3.
The MFN thus stipulates that the lowest tariff granted by the EU to a particular country on a certain product, has to be granted to all other WTO members to the like product. GATT does not determine the quality or quantity of tariffs – only the non-discriminatory application of them.

4.2.2 Elimination of Quantitative Restrictions

GATT Article XI further prohibits restrictions other than tariffs, whether they are quotas, licenses or other measures. However, an exception in XI: 2 stipulates that prohibitions or restrictions necessary to the application of standards or regulations for classification and grading of commodities in international trade are permitted. ROO are necessary for classification of commodities in international trade, and therefore not considered a non-tariff trade restriction according to GATT Article XI.

4.3 Exceptions for Preferential Trade Agreements

An exception to the MFN principle can be found in GATT Article XXIV, which allows customs unions and free-trade areas to set internal rules. This highlights the necessity of ROO, in order to distinguish trade allowed under XXIV with other trade.\(^{154}\) A ROO-less PTA would significantly alter trade, encouraging transhipment of goods through the PTA and the undermining of the MFN principle.\(^{155}\) Within these unions or agreements, beneficial treatment is permitted without the necessity of extending the benefits to a third country. The reason for allowing PTAs can be found in Article XXIV paragraph 4, which explains that trade agreements can increase the freedom of trade through the development of closer integration between the countries. The paragraph further states that a PTA should be able to facilitate trade between parties and not raise trade barriers to non-parties.

\(^{154}\) Moëll 2008, p 34.

\(^{155}\) Estevadeordal and Suominen 2003, p 2.
4.4 The Criteria for GATT XXIV Compatibility

4.4.1 The Internal Criterion – Article XXIV: 8

The terms customs union and free-trade area are defined in GATT XXIV: 8 (a) and (b). A customs union is the substitution of a customs territory for two or more customs territories, so that duties and other trade restrictions are eliminated with respect to substantially all trade between the territories in question, or at least with respect to substantially all trade in products originating in such territories. GATT Article XXI: 8 (b) defines free-trade areas in the following words:

*A free-trade area shall be understood to mean a group of two or more customs territories in which the duties and other restrictive regulations of commerce /.../ are eliminated on substantially all the trade between the constituent territories in products originating in such territories.*

A free-trade area is therefore a group of two or more customs territories where the duties and other trade restrictions are eliminated on substantially all the trade between them, for products originating in such territories. The major difference with a customs union is that the latter has to apply substantially the same duties and other trade regulations to countries outside the union. This is not necessary for parties to a PTA. The above-mentioned exceptions to the MFN principle require the territories, or countries party to a PTA, to eliminate substantially all customs and trade barriers towards other parties to the union or free trade agreement, or at least to such trade which originates in said parties. The meaning of these requisites is explained below.

The internal criterion in Article XXIV requires duties and other restrictive regulations of commerce to be eliminated with respect to substantially all the trade between the parties. This liberalisation of market access in a PTA has to be reciprocal.156 The Article XXIV: 8 (b) requirement to eliminate tariffs and trade barriers on substantially all trade

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156 Olsen, Steinicke and Sorensen 2012, p 414.
is necessary to avoid undermining of the MFN principle. Without the requirement, countries could sign PTAs covering just a single product, effectively making GATT Article I toothless. The existence of PTA is politically difficult to prevent, not least considering the difficulties reaching consensus in WTO negotiations. A PTA with a high standard of liberalisation would therefore not harm global trade – as long as it is not used for trade protectionism. The GSP regulations are unilateral, and should therefore be prohibited by Article XXIV. These are allowed through an exception in the “Enabling Clause” from 1979, however, which can be found in the 26th supplement of the GATT. In order to determine the permissibility of preferential ROO in the internal requisite of Article XXIV, the requisites substantially all trade and other restrictive regulations of commerce first have to be defined.

4.4.2 The Meaning of Other Restrictive Regulations of Commerce

Article XXIV: 8 (b) requires that PTAs must eliminate other restrictive regulations of commerce (on substantially all products). These regulations can consist of, but are not exclusive to, quantitative restrictions such as quotas, subsidies, ROO and other technical trade barriers. Preferential ROO are more likely to be considered a restrictive regulation of commerce if they are unnecessarily complex. The level of complexity allowed was discussed during the Uruguay Round, and the WTO has recognised the possible restrictive effects of preferential ROO.

The textual interpretation of Article XXIV: 8 could prohibit preferential ROO that restrict trade between parties of a PTA, particularly when the purpose is protectionist. ROO that are so complex that importers or exporters would rather pay tariffs than confer origin, are according to Kim and Kim an example of what should constitute a prohibited ROO. There is no such precise definition of what constitutes an overly

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157 Kim and Kim 2011, p 616.
158 Ibid, p 616.
complex preferential ROO, however. According to the WTO Appellate Body, the dynamic nature of PTAs means that the paragraph’s area of application can evolve over time.\textsuperscript{162} In the light of the statement, one form of protectionism that is potentially prohibited is the application of arbitrarily different product-specific ROO – often in the value added requirements.\textsuperscript{163} As mentioned in chapter 3, most EU ROO are fairly uniform but with certain product-specific exceptions. While these exceptions could be considered other restrictive regulations of commerce, whether they are permitted or not also depends on the second requisite in Article XXIV: 8 (b). Even if arbitrary, product-specific ROO were considered a restrictive regulation of commerce, they would only have to be eliminated on substantially all trade.

4.4.3 The Meaning of Substantially All Trade

What constitutes substantially all trade is rather unclear. The WTO Appellate Body has defined the requisite as not the same as all the trade but considerably more than merely some of the trade.\textsuperscript{164} During the WTO Uruguay Round negotiations, it was suggested that the evaluation should be based upon an assessment of average tariff rates statistics.\textsuperscript{165} There is no international consensus on a specific percentage that constitutes substantially all trade. The requirement is both quantitative and qualitative. Quantitative liberation, as in 90 per cent of trade being liberated, shall not be considered substantially all trade if there are qualitative restrictions, i.e. sectors being entirely excluded from liberation.\textsuperscript{166} GATT and WTO members have historically suggested quantitative thresholds of 80-95 per cent of trade, but many PTAs have liberated considerably less trade.\textsuperscript{167}

\textsuperscript{162} WT/DS34/AB/R, Turkey – Restrictions in Imports of Textile and Clothing Products, paragraph 62.
\textsuperscript{163} Kim and Kim 2011, p 629.
\textsuperscript{164} WT/DS34/AB/R, Turkey – Restrictions in Imports of Textile and Clothing Products, paragraph 48.
\textsuperscript{166} Matsushita 2004, p 505.
\textsuperscript{167} Kim and Kim 2011, p 619.
However, even a PTA with 100 per cent trade liberation, with tariffs and other restrictions removed in every sector of trade, may be applying restrictive preferential ROO. For instance, the tariffs on a wholly obtained product from the PTA parties could be abolished. Nonetheless, if an imported product from outside the PTA is heavily processed within the PTA, restrictive ROO may lead to the final product not obtaining origin.

Country A and country B apply 15 per cent in tariffs for agricultural products towards all countries. A and B then sign a PTA, removing tariffs on agricultural products but with strict ROO requirements. B exports strawberry jam to A, made of imported strawberries from C. The strawberry jam is not considered to have been substantially transformed and therefore does not confer origin in B, leading to a 15 per cent tariff. To benefit from the PTA, jam producers in B need to purchase A or B strawberries, possibly to a higher price.\(^\text{168}\)

Despite this, duties and other trade restrictions are considered substantially eliminated in accordance with GATT XXIV – resulting in an apparently WTO-compatible PTA.\(^\text{169}\) The most typical example of restrictive ROO in EU PTAs, are those that deny trade preferences for products whose last substantial transformation took place in a PTA partner.\(^\text{170}\) This can be made through high requirements of domestic value added to specific products – excluding a large percentage of the product from preferential trade in practice. If the substantially all trade was to be counted not by liberated sector, but by the amount of internal trade that has been excluded from trade liberalisation, the above-mentioned percentages would probably be less deceptive.\(^\text{171}\) PTAs are hence increasingly challenging the requirements of Article XXIV, avoiding trade liberalisation while still meeting the \textit{substantially all trade} requirement.\(^\text{172}\) Specific products are excluded from the agreements, and overly restrictive ROO heavily reduce liberalisation of many products that are included in the agreements.\(^\text{173}\)

\(^{168}\) Author’s example. 
\(^{169}\) Kim and Kim 2011, p 625. 
\(^{171}\) Kim and Kim 2011, p 625. 
\(^{172}\) Ibid, p 614. 
\(^{173}\) Ibid, p 614.
4.4.4 The External Criterion – Article XXIV: 5

The external criterion is that PTAs shall not raise barriers to trade for WTO members not party to the agreement, according to GATT XXIV: 5 (b). Any new tariffs or other restrictive regulations of commerce shall not be higher or more restrictive than those in place before the agreement. In Turkey – Textiles, the WTO Appellate Body stated that the compatibility of a customs union with Article XXIV’s requirement, that trade with non-parties cannot be harmed, has to satisfy two conditions. The harm has to be a consequence of a necessary measure, and the trade as a whole cannot be affected. The WTO member states have been unable to decide whether strict ROO are to be considered an external trade barrier. While some are of the view that they only affect PTA-internal trade, others claim the opposite. As mentioned above in chapter three, restrictive ROO may have a trade diverting effect, creating incentives to move production from outside a PTA to within. It is argued that this raises a barrier towards third countries, particularly regarding intermediate goods, i.e. the goods destined to be part of production inside the PTA. Restrictive preferential ROO could thus theoretically qualify as an impermissible external trade barrier according to GATT Article XXIV: 5 (b). However, this does not seem to be the case in practice.

When NAFTA was introduced, it replaced the previous US-Canada agreement, imposing stricter ROO. The result was that products previously eligible for tariff-free entry could no longer confer origin. When this was under review, NAFTA representatives, backed by the EU, claimed that nothing in the NAFTA raised or introduced tariffs or other regulations of commerce towards third countries. While the NAFTA definition of the external criterion was strongly criticised by a number of countries, it never led to legal repercussions. Hudec and Southwick share the NAFTA point of view that, despite obvious mastery in engineering of certain ROO, the

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174 WT/DS34/AB/R, Turkey – Restrictions in Imports of Textile and Clothing Products, paragraph 58.
175 Olsen, Steinicke and Sorensen 2012, p 414.
176 Systematic issue related to "other regulations of commerce” October 1997, WT/Reg/W/17, paragraph 21.
177 Kim and Kim 2011, p 635.
178 Hudec and Southwick 1999, p 55.
179 Ibid, p 56.
agreement itself does not raise tariffs or other trade barriers. The ROO only determine who may benefit from the benefits negotiated in the agreement.\textsuperscript{180} GATT Article XXIV: 5 (b) is thus not breached.

On the other hand, Kim and Kim claim that the restrictive preferential constitute more than just a technical necessity.\textsuperscript{181} They are specifically designed to protect producers of intermediate goods in NAFTA parties, and should result in non-compliance with XXIV: 5 (b). However, this would have required the PTA to introduce new or more restrictive ROO than before. In practice, Kim and Kim conclude, the likelihood of a PTA being considered in breach of XXIV:5 (b) due to restrictive ROO is rather low.\textsuperscript{182} Hudec and Southwick acknowledge the risk of misuse of ROO, but claim it is not a restrictive regulation of commerce in the meaning of XXIV: 5 (b). One of the reasons is that it is overly difficult to compare restrictiveness of all ROO, product specific and regime-wide. If a comparison still were possible, Hudec and Southwick suggest that the rules are not to be more restrictive as a whole – the method stipulated in XXIV: 5 (a) regarding customs unions.\textsuperscript{183}

It is unlikely that a PTA introduces external non-tariff trade barriers, which as a whole are more restrictive than a prior agreement. Both sets of authors seem to agree that GATT Art XXIV, in its current shape, is toothless against the use of preferential ROO. This is further reiterated by the fact that the compatibility (or lack thereof) of PTAs with Article XXIV has lead to complaints, but never to the disqualification of an agreement by GATT/WTO.\textsuperscript{184} Whereas Kim and Kim believe that the field of application of XXIV: 5 (b) should be expanded, Hudec and Southwick propose that the issue should be dealt with separately in future WTO negotiations.\textsuperscript{185}

\textsuperscript{180} Hudec and Southwick 1999, p 56.  
\textsuperscript{181} Kim and Kim 2011, p 636.  
\textsuperscript{182} Ibid, p 637.  
\textsuperscript{183} Hudec and Southwick 1999, p 60.  
\textsuperscript{184} Ibid, p 52.  
\textsuperscript{185} Kim and Kim 2011, p 637 and Hudec and Southwick 1999, p 60.
4.5 The WTO Agreement on Rules of Origin

Neither preferential nor non-preferential ROO receive any mention in the GATT. Instead, the rules are treated by the WTO Agreement on Rules of Origin (ARO), which contains a number of rules on the application of non-preferential ROO. The ARO is as a result of the WTO Uruguay Round, and the harmonised preferential ROO are on the agenda for the stalled Doha Round.\textsuperscript{186} For the purpose of the ARO, ROO shall be defined as laws and regulations applied to determine country of origin of goods, provided such ROO are not related to trade regimes, which grant tariff preferences going beyond the MFN principle.\textsuperscript{187} This excludes preferential ROO from the scope of application. Instead, preferential ROO are only dealt with briefly in Annex II of the agreement.\textsuperscript{188}

According to the ARO, the ROO must not create disruptive effects on trade or pursue trade objectives. The ARO stipulates the same principles of origin, preferential and non-preferential, that can be found in the Kyoto Convention and in the EU trade agreements. Origin is the country where goods are wholly obtained or where the last substantial transformation has been made. The primary principle of the latter is the tariff classification method, with the value added method as an alternative.\textsuperscript{189} Nonetheless, the agreement leaves it to the member states to determine the specific origin requirements. This is intentional and seems to be the desire of the member states.\textsuperscript{190} There are plans for further harmonisation (Article 9) but until then, transitional rules are in place.

The ARO requires WTO members to clearly define their ROO and not discriminate against other WTO members. Member states must also avoid creating restrictions or trade distorting effects, according to ARO Article 2 (b). Non-preferential ROO are not to pursue trade objectives according to ARO Article 2 (b), particularly not

\textsuperscript{186} Moëll 2008, p 19.
\textsuperscript{187} Agreement on Rules of Origin Article 1, paragraph 1.
\textsuperscript{188} See section 3.3.3.
\textsuperscript{189} Olsen, Steinicke and Sorensen 2012, p 130.
\textsuperscript{190} Chase 2007, p 6.
“impermissible” trade objectives.191 If a ROO only has the objective to determine origin of products, it is consistent with Article 2 (b) of the ARO. In contrast, the indirect or direct pursuit of a trade objective violates the article. The meaning of trade objective was at stake in United States – Textiles Rules of Origin.192 One way of determining the objective is to look at the legislative process. What did local legislators declare when adopting the ROO? Another way is to ask whether there are any objectives revealed by the terms of the legislation. If the ROO are capable of creating restrictive effects to trade, de jure objectives, it is sufficient for the complainant to demonstrate that incentives and disincentives faced by traders as a result of the rules of origin at issue result in such restrictive effects. If the ROO have actual effects on trade, de facto objectives, the complainant would have to demonstrate that the defendant’s regulation actually produces such trade effects.193 The ARO rules must also be uniformly and reasonably administered and based on a positive standard.194 The latter also applies to preferential ROO, which are to be clearly defined in the PTAs and be based on a positive standard. The latter requisite has not hindered the use of ROO with negative standards by the EU or USA, among others, often in the shape of the specific manufacturing process.195

Therefore, while the ARO contains certain provisions on the application of preferential ROO, it is not a tool that can be used to prevent the most prominent problems. Were the preferential ROO to be treated as non-preferential ROO, leading to the ARO provisions being applicable, some of the adverse ROO effects could be solved. The harmonisation of ROO in PTAs would limit the use of discriminatory, product-specific ROO.196

191 Moëll 2008, p 44.
193 Ibid.
195 See section 3.4.5 and Brenton 2011, p 166.
4.6 Conclusion

There seems to be consensus on the problematic role of preferential ROO in the light of WTO law. GATT XXIV allows an exception to the MFN principle of Article I under certain conditions. This has created a legal grey zone that is utilised by the EU and other parties to PTAs. The PTAs liberalise trade, while simultaneously inserting external and internal restrictions, leading to the undermining of the MFN principle. Whereas some authors believe that this can be solved through the extensive application of GATT Article XXIV, others do not consider the current regulation to be applicable. The issue of preferential ROO is on the agenda for the stalled Doha Round. As long as WTO negotiations cannot proceed, the augment of PTAs with stringent ROO will continue.
5 Conclusion

5.1 Are Preferential Rules of Origin a Potential Trade Barrier?

The WTO has the aim of abolishing trade barriers and harmonising trade rules. However, the lack of progress of the Doha Round has led to an increased fragmentation of trade. The responsibility of regulating trade has therefore been overtaken by individual states, leading to a large variety of PTAs. The PTAs can liberate trade, which may lead to economic growth and increased competition. Preferential ROO hinder trade deflection, i.e. third country trans-shipment of goods through a PTA-party. This is used as an excuse to designing strict and protectionist ROO, usually through high domestic value content requirements. Such ROO decrease both the possible risk of competition from third countries, but also the growth-creating potential of a PTA. Preferential ROO can also distort natural trade patterns, diverting trade from cost-efficient locations in order to circumvent ROO. The stricter the ROO are the more evident are the adverse effects on trade.

Preferential ROO can therefore constitute more than merely a technical instrument for the prevention of trade deflection. In fact, they constitute one of the most integral components of PTAs, with the potential to significantly alter trade. Most ROO-related problems are encountered in the demands of last substantial transformation, the value added criterion in particular. The high requirements for value added hinders imports on goods that compete with European production, while allowing easy importation of input goods that are domestically necessary. The value added criterion benefits rich countries, where the higher production costs and wages make reaching origin conferring levels easier. Further production in Sweden on cheap input goods from China will likely reach origin-levels of value added easier than further production on Chinese products in Mexico will. Therefore, when said Swedish product is exported to Mexico, a PTA partner, the probability of tariff-free entry is higher than vice versa since PTA eligibility
is based on EU or Mexican origin. Nonetheless, PTAs do seem to create more intra-PTA trade than what is diverted from other countries. The losers are industries both within and outside a PTA without the administrative or productive capabilities of conferring ROO, often found in developing countries. Even large multinational companies that are reliant on so called global value chains, find the ROO to be a barrier. While the EU has an increased responsibility to prevent this as one of the richest key actors of trade, no country seems to be innocent. Complaining countries tend to be just as guilty of applying restrictive ROO and trade regulation in general as everyone else.\textsuperscript{197}

The EU has emphasised the necessity of flexible ROO that are easy to confer to, in order to make input material more easily accessible. Despite the lower value added in poorer countries, this would facilitate development. When the ROO can be bypassed or lead to manipulation, the stringency is usually increased. This is of particular importance in the GSP regimes, where the increases in trade benefits encourages fraud and trade deflection. Strict ROO are therefore, to a certain extent, justified. What can be disputed is the justification for some of the product-specific ROO, which are a subtle form of protectionism in PTAs. While the protection of the domestic industry is understandable to a certain extent, it is also a cause for concern. Likewise, the lack of transparency in diplomatic negotiations might be essential, but in conjunction with industry influence, legitimate doubts are raised over the motives of strict product-specific ROO. It is of no coincidence that smaller EU countries relying heavily on the import of input goods, such as Sweden, are in favour of regime wide and relaxed ROO with generous cumulation possibilities.\textsuperscript{198}

\section*{5.2 Do Preferential Rules of Origin Breach WTO Law?}

PTAs are allowed as an exception to the MFN principle of GATT Article I. The exception can be found in GATT Article XXIV, stipulating that preferential agreements are permitted under certain conditions. Substantially all tariffs and other restricting

\begin{flushleft}
\textsuperscript{197} Moëll 2008, p 19.
\textsuperscript{198} The Impact of Rules of Origin on Trade 2012, p 34.
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regulations of trade have to be abolished within the PTA, and no barriers can be raised towards third countries. This is bypassed by the liberation of a majority of trade sectors, while maintaining strict ROO criteria for PTA-eligibility. Not only do preferential ROO affect natural trade patterns, diverting trade and encouraging origin planning, but restrictively designed ROO may also undermine the key principles of the WTO. The current ROO in PTAs challenge WTO regulation, particularly GATT Article XXIV. The exceptions in GATT Article XXIV exist to allow PTAs, with the assumption that they benefit global trade and growth. There seems to be little consensus on the exact definition of the above-mentioned requirements of GATT Article XXIV. Even if current EU PTAs were impermissible in the light of the Article, the WTO has yet to disqualify a PTA on the grounds of its ROO. While some claim that the Article should prevent the application of preferential ROO when they hinder trade, this does not seem to be the case in practice. Other agreements, such as the ARO, stipulate stricter prohibitions on the use of ROO as a political tool. Nonetheless, the ARO only covers non-preferential ROO and is in its current form not a solution to the problems of non-preferential ROO.

The fragmentation of world trade into regional free trade areas is currently the only path to liberating trade, which ironically also creates obstacles in the form of ROO. As long as multilateral trade negotiations stall, preferential ROO will play an important part in the world trading system.\(^{199}\) One way of combatting the use of protectionist ROO is through stricter requirements on their uniformity and neutrality. This can be done through the application of the principles of non-preferential ROO found in the ARO, instead of individually negotiated preferential ROO. Obviously, such harmonisation would require stricter WTO rules, either through the expansion of current agreements, such as GATT XXIV or ARO, or through new agreements in upcoming Doha Round negotiations. The former could possibly be made by future jurisprudence of the WTO Appellate Body. The latter seems far from completion, with several key issues under contention. The current Bali negotiations of the winter of 2013 are often called the *last chance*, not only for the future of the Doha Round, but also for the future of the entire WTO. While the negotiations have been successful in several aspects, leading to

\(^{199}\) Estevadeordal and Suominen 2003, p 14.
promises on the simplification of ROO for the LDC, this is likely not sufficient to stop further fragmentation of trade into PTAs.

Finally, the relationship between trade restricting preferential ROO and WTO law is not entirely unproblematic. Whereas some believe GATT Article XXIV prohibits such ROO, others disagree. Appellate Body reports offer little guidance on the issue, creating the assumption that restrictive preferential ROO currently are permitted.

5.3 Political Implications

The above-mentioned effects of restrictive ROO are not exclusive to the EU. In fact, EU trade policy heavily affects other countries. This is illustrated in the following example. Current PTA negotiations between the EU and the USA may lead to the redirection of trade from Mexico, a EU and USA trade partner. Mexico is a hub of cross-Atlantic trade, and a natural location for production for EU companies who desire tariff-free export to the USA, and vice-versa. This is due to the lack of a PTA between the EU and the USA. For this reason, amongst others, some EU and US trade is diverted through Mexico. The strictness of the EU-Mexico agreement and NAFTA’s ROO create an incitement to move production to Mexico, in order to confer origin that will allow tariff-free entry to the EU or the USA. An agreement between the EU and the USA would mitigate this benefit of producing in Mexico, leading to the latter desiring flexible ROO and cumulation possibilities, in order to receive a slice of the trans-Atlantic trade cake.200

The principal risks of imposing stricter demands on the harmonisation of ROO are the potential effects on the incitement to negotiate PTAs. The possibility of mitigating the effects of liberalisation through strict ROO helps unite local industries, offering a compromise that sufficiently protects some local industries from foreign competition. Although the existence of a PTA often is better than no PTA for economic growth,

200 The Mexico example is derived from a report written by the author of this text in the summer of 2013, during an internship at the Swedish Embassy in Mexico City.
creating more trade than it is diverting, the losers are third country producers of intermediate goods. Furthermore, spoke countries are often more dependant on concluding PTAs with economically powerful nations and unions such as the EU and the USA, who are often hubs in global trade, than vice versa. GSP beneficiaries are often reliant on trade with the EU and therefore tend to have less negotiating power, leading to many ROO being set to suit local EU industries. Stricter WTO-demands on the neutral application of preferential ROO may be a solution, aiding the prevention of protectionism in PTAs.

5.4 The Future of Rules of Origin

There seems to be consensus among critics on the important role of ROO in global trade. Some try to tackle the issue by demanding increased transparency in PTA negotiations or through improved WTO cooperation. Others believe GATT Article XXIV should be expanded to include preferential ROO, leading to PTAs being illegitimate. Currently, the fine art of restricting the effects of the liberalisation of trade through ROO, i.e. giving with one hand and taking with the other, seems to have been mastered. The attempt to prevent trade deflection is used as a pretext for restricting preferential ROO.201

While multiple-country origin may be a possibility one day, they do not seem to be a realistic option for the near future. Kim and Kim suggest the harmonisation of preferential ROO through the ARO as an alternative. These rules could then be used as preferential ROO for all PTAs, preventing protectionist ROO.202 Such harmonisation is in line with both the EU’s trade objectives, and the uniform and flexible preferential ROO desired by the Swedish National Board of Trade. The consequence would be the significant simplification of trade for importers and exporters, without necessarily compromising on the ability to prevent trade deflection. Nonetheless, fears of jobs disappearing abroad and increased competition damaging the domestic industry, may

\[201\] Kim and Kim 2011, p 638.
\[202\] Ibid, p 637.
prevent such relaxation of ROO. Naturally, the abolishment of tariffs and trade barriers through the WTO would decrease the incitement of signing PTAs. The future negotiations of the Doha Round therefore hold the key to the future of ROO.
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